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12-1-1950

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Recommended Citation

Wirt Peters and Tom Maxey, *The Gift Tax Lien and the Examination of Abstracts*, 5 U. Miami L. Rev. 64 (1950)

Available at: <http://repository.law.miami.edu/umlr/vol5/iss1/6>

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THE GIFT TAX LIEN AND THE EXAMINATION OF ABSTRACTS

WIRT PETERS* and TOM MAXEY**

The title succinctly states a problem which has been much discussed by the faculty of taxation at the University of Miami, and which it has been agreed is of sufficient moment to be presented here pursuant to a policy of bringing to the attention of the members of the Bar the important tax possibilities and consequences involved in comparatively common practical situations.

The problem, however, might better be stated somewhat more descriptively to show the full scope of the warning to be here considered. Accordingly, it could be asked:

Should an attorney unconditionally pass upon the title to real property without first determining whether any owner, including any co-tenant, had acquired or transferred the property within the past ten years for less than an adequate and full consideration in money or money's worth?

Presented in this language, it is to be noted that the inquiry relates equally to property involved in a gift and to property acquired from a decedent. However, practical limitations demand a delineation of the subject, and we will direct our attention only to those situations in which no gift tax return was filed by either the donor or the donee. We can thus eliminate the additional complications relating to the varying periods of limitations within which an assessment of the tax would otherwise have to be made, i.e., no return, no limitation. And, while our discussion must revolve about the efficacy of the gift tax lien, our conclusions can not be developed adequately without comparing and contrasting the other liens provided by statute for unpaid federal taxes.

I

THE IMPOSITION OF THE LIEN

The similarity of the lien for unpaid gift taxes and the lien for unpaid estate taxes is particularly evident. Compare the following provisions of the Internal Revenue Code:

The Gift Tax Lien

The tax imposed by this chapter shall be a lien upon all gifts made during the calendar year, for ten years from the time the gifts are made.¹

The Estate Tax Lien

Unless the tax is sooner paid in full, it shall be a lien for ten years upon the gross estate of the decedent.²

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1. INT. REV. CODE § 1009.

2. INT. REV. CODE § 827 (a).

There are some peculiar attributes of these liens to which attention must be directed and which distinguish them from the general lien for federal taxes to be discussed later. Notice that the gift tax lien arises spontaneously whenever a taxable transfer is made and attaches immediately and automatically to the property at the time of the gift, although the computation of the amount of the tax may be impossible before the end of the calendar year and the tax is not even due until the following March 15. While the estate tax is not due until fifteen months after the death of the decedent, a lien for that tax attaches to the gross estate at the very time of death. There is, of course, no requirement relating to the filing of an assesment list, nor for the recording of any liability anywhere. Neither is there any requirement relating to the giving of notice in order for the liens to come into existence and attach to the property as, obviously, no demand for payment of the tax could be made until, at least, it was due. Rather, conversely, as will more fully appear, the subsequent purchaser has the burden of establishing that he had no indication of the lien or knowledge of facts intimating the possibility of it in order to have the property divested of the lien in his hands.

II

THE LIABILITY OF THE DONEE, TRANSFEREE, OR BENEFICIARY

Further similarity of these liens appears in the provisions relating to the personal liability for the payment of the tax by the individuals who receive the property:

The Gift Tax Liability

If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift.³

The Estate Tax Liability

If the tax herein imposed is not paid when due, then the recipient who receives, or has on the date of the decedent's death certain property⁴ shall be personally liable for such tax.⁵

A comparison of these provisions indicates that the personal liability for the unpaid gift tax on the part of the donee arises regardless of the kind of property interest received by the gift. But, a more detailed examination of the section establishing the personal liability for the estate tax will reveal that this personal liability arises only in certain instances. In brief, the property required to be included in the gross estate of the decedent is regarded as being of two kinds: type 1, the interest of the decedent in the property at the time of his death; and type 2, the interests of others, in property which must be included in his gross estate, which mature by reason of the death of the decedent. It is only in connection with type two that the per-

3. INT. REV. CODE § 1009.

4. The "certain property" is stated in the section to be: § 811 (b) Dower or Court-
esy Interests; (c) Transfers in Contemplation of or taking Effect at Death; (d) Revocable
Transfers; (e) Joint Interests; (f) Powers of Appointment; (g) Proceeds of Life Insurance.
This section thus omits § 811 (a) which refers to the property in which the decedent
still retained an interest at the time of death.

5. INT. REV. CODE § 827 (b).

sonal liability of the recipient for any of the estate tax arises, although the estate tax lien itself attaches to all the property of the estate. The necessity for making this distinction will soon become apparent.

III

A GENERAL LIEN FOR UNPAID FEDERAL TAXES

In addition to the gift tax and estate tax liens, there is still another lien provided in the Internal Revenue Code, and it must be considered before actually relating the liens to the examination of abstracts pursuant to the assigned title. In Subtitle D, Chapter 36, sub-chapter B, it is provided:

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.⁶

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.⁷

It is to be noted that this lien does not arise until a demand for payment of the tax has been made and the assessment list has been received by the collector. Further, this is a general lien upon all the property of the one who owes the tax, not merely upon specific property which may have been acquired in some particular manner, i.e., by gift or by reason of another's death. Further, in connection with this lien, the statute provides that:

Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector⁸ in the office in which the filing of such notice is authorized by the law of the State.⁹

This section is merely repetitive to direct attention to the requirement for the filing of this lien before it effectively attaches to the property so as to be valid in the hands of a subsequent purchaser, and to the requirement for making a demand for the payment of the tax and the filing of an assessment list before the lien even arises.

The necessity for considering this general lien in relation to our subject arises from the following sections which may seem to incorporate these enforcement provisions into the administration of the gift and estate taxes:

6. INT. REV. CODE § 3670.

7. INT. REV. CODE § 3671.

8. INT. REV. CODE § 3672 (a).

9. INT. REV. CODE § 3672 (a). (1). Florida has authorized the filing of this lien in the office of the clerk of the circuit court. FLA. STAT. § 28.20 (1941).

Gift Tax Administration

All administrative, special or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this chapter.¹⁰

Estate Tax Administration

For general provisions relating to assessment, collection, closing agreements, compromises, and refunds, see Chapters 35, 36, and 37 of sub-title D.¹¹

So, we have now reached the first obstacle in the development of our thesis. If we are not to give a negative answer here and now to the question whether one must look beyond the record of filed liens before purchasing property, it becomes imperative to show that the requirement for filing a lien relates only to the general lien and has no application to the special liens for the gift and estate taxes. This question was before the court in the case of the *Detroit Bank v. United States*.¹² There, certain property had been owned at the time of his death by the decedent and his wife as tenants by the entirety, but none of this property had been included in his gross estate for the computation of the estate tax. Prior to the assessment of any estate tax, the property was mortgaged by the widow, the surviving tenant, to the petitioner who had no actual knowledge of a lien, knowing only of the death of the co-tenant. Upon default in payment of the mortgage, a foreclosure action was brought in which the trial court found that the mortgagee had acted in good faith and had given value. The commissioner subsequently assessed an estate tax by reason of the failure to include in the gross estate the above interest of the decedent, and brought a proceeding to enforce the lien.

The lower court held that the estate tax lien, although unrecorded, became a lien at the date of death of the decedent property owner even without assessment, and was superior to a mortgage lien which accrued after the death. Upon appeal, the appellant contended that the government's claim of lien was untenable because of a failure to comply with § 3670, requiring demand and filing. But the court reviewed the legislative history of the two sections, relating to the estate tax lien (§ 827) and to the general lien (§ 3670), and concluded that it was intended that each section should operate separately and independently of the other. Therefore, the estate tax lien attached to the property at the date of death without assessment, demand, or filing, and was superior to all subsequent liens even though accrued in good faith and without actual notice. Property passing at death is normally dealt with by probate proceedings of public notoriety and there is less need to protect third parties by requiring notice of a lien. In any event the mortgagee could have protected himself by securing a certificate of release from the commissioner.

10. INT. REV. CODE § 1028.

11. INT. REV. CODE § 828.

12. 317 U.S. 329 (1943). In the lower courts this case was styled *Paul v. United States*, 127 F.2d 64 (1942); 41 F. Supp. 41 (1940).

Although not required for a decision, the court also considered the legislative history of the gift tax lien and concluded that it, too, was intended to operate as a separate lien in addition to that provided in § 3670. The Supreme Court, by dictum, thus confirms our contention that the gift tax lien attaches to the property without assessment, without demand, or without notice.

IV

THE DIVESTMENT OF THE LIENS

The statutes have saving clauses, for application in proper cases, relating to the divesting of the property from the liens:

The Gift Tax Lien

Any part of the property comprised in the gift sold by the donee to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien herein imposed.¹³

The Estate Tax Lien

Any part of such property sold by such spouse, transferee, trustee, . . . or beneficiary, to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien.¹⁴

Again, a comparison indicates that any of the property covered by the gift tax lien which is disposed of by the donee to a bona fide purchaser for an adequate and full consideration in money or money's worth is divested of the lien. As to the estate tax lien, only those specified property interests received by the beneficiaries which made them personally liable for the tax (type two above) are divested of the lien when sold to a bona fide purchaser for an adequate consideration. There is no provision relating to the divesting of the lien from the other property (type one above) included in the gross estate when it is sold to such a bona fide purchaser. This, naturally, compels the initial query: Who is a bona fide purchaser?

(a) *Who is a Bona Fide Purchaser*

It is almost too well established to require citation that the essential elements for being a bona fide purchaser of realty are:

(1) that one give valuable (not merely good) consideration (the tax statute requires the consideration to be full and adequate in money or money's worth);

(2) that one purchase in good faith and with an evidence of the absence of purpose to take any unfair advantage of any possible outstanding rights of others; and

(3) that one have no notice, actual or constructive, of any such outstanding rights, and be without notice of any circumstances which would put a prudent man on inquiry concerning them.¹⁵

13. INT. REV. CODE § 1009.

14. INT. REV. CODE § 827 (b).

15. 5 Words and Phrases 623 *et seq.*; *Glasco v. Akin*, 143 Okla. 38, 287 Pac. 390 (1930); *Miller v. Yanicek*, 106 Neb. 661, 184 N.W. 132 (1921); *Bergstrom v. Johnson*, 111 Minn. 247, 126 N.W. 899 (1910); *Wilkins v. McCorkle*, 112 Tenn. 688, 80 S.W. 834 (1904).

A cursory review of these characteristics immediately compels another query, which holds the key to the solution of our principal problem. Obviously, we must determine what constitutes a notice.

(b) *What Constitutes Notice*

Again, in the general fields of the law, it is too well established to permit of much argument that a purchaser who has brought to his attention information sufficient to put him upon inquiry which, if pursued with due diligence, would have led to a knowledge of a lien, has such notice as would preclude him from being a bona fide purchaser.¹⁶ He is presumed to have made the inquiry or to have been guilty of negligence equally fatal to his bona fide status.¹⁷

So, we reach a consideration of our specific problem, that of notice of a gift tax lien in the examination of an abstract of title. We have arrived at a point of alternatives:

(1) If it can be said that there *is* notice of a possible gift tax lien in the various entries in the abstract, or the public records themselves, then before passing upon the title we must ascertain the existence of the lien.

(2) If, on the other hand, we can satisfactorily conclude that the abstract can be said *not* to contain a notice of such a possible lien, then no further inquiry is necessary.

Perhaps the best approach to a possible agreement upon the final result is a consideration of specific instances. It is not the purpose here to develop the various circumstances in which the gift tax may apply, although it may be hoped that the examples will reemphasize the ever present gift tax possibilities in the more common practical situations. It is now to be assumed that no return was filed; the gift tax was not paid when due; a lien does exist; and that we are concerned only with the possibility of a notice such as would prevent the purchaser from acquiring the property divested of the lien.

(c) *Husband and Wife as Co-Tenants*

The application of the gift tax upon purchases by a husband and wife as co-tenants, regardless of the type of tenancy, where one spouse furnishes the consideration, has been well and frequently brought to the attention of the profession¹⁸ although in practice situations continue to arise in which the attorney apparently was unaware of the tax consequences. This is a reminder, then, that when one spouse furnishes the consideration for a purchase of property on which title is taken in the names of both spouses as co-tenants, the other spouse takes her interest by gift. Thus, this is a tax-

16. *Univ. of Virginia v. Stone*, 148 Va. 686, 193 S.E. 257 (1937); *Shepard v. Van Doren*, 40 N. M. 380, 60 P.2d 635 (1936); *Mangum v. Stadel*, 76 Kan. 764, 92 Pac. 1093 (1907); *Prickett v. Muck*, 74 Wis. 199, 42 N.W. 256 (1889).

17. *Salmon v. Norris*, 82 App. Div. 362, 81 N.Y.S. 892 (1903).

18. Among articles on this matter see Bernstein, *Tax Dangers in Estates by the Entirety*, 1 *MIAMI L. Q.* 86 (1947).

able transaction. A gift tax may be due depending upon the available exemptions and a lien attaches to the property for the payment of the tax. In the event this property is then sold within a ten year period, what is the status of the lien, and what is the position of the purchaser?

Let us first assume a series of entries in the abstract of title you are examining which rather obviously indicate that the wife probably acquired her interest by gift. Suppose that John Doe purchased some property prior to his marriage, and that afterwards, having heard somewhere that married couples could advantageously hold their property in tenancy by the entirety, he conveys his title to himself and his wife using a third-party conduit. Do not the following entries indicate that the present owners acquired their interest in some such manner as that hypothesized?

Entry No. 36: John Doe
to
Richard Roe, a single man.

Entry No. 37: Richard Roe, a single man
to
John Doe and Mary Doe,
(in co-tenancy of any kind).

We might even further assume that on Entries 36 and 37 the documentary stamp tax was nominal (if any), indicating a lack of consideration; and, that the evident value of the property considerably exceeded the possible gift tax exemptions.

Now, even with no further information, have you not been given sufficient notice of facts which indicate that a transfer of a property interest may have been made without an adequate and full consideration in money or money's worth; that, therefore, a gift tax may have been due; and that a lien for the tax has automatically attached to the property? Remember there is no requirement that you have any notice that there was a tax due, or any notice of the lien, but merely notice of circumstances which would put a prudent man on inquiry. Having due regard for the nature of the gift tax lien, if it can be said that you have been given such a notice, then your client can not be such a bona fide purchaser as to divest the property of the lien.

If the above entries can be regarded as giving the necessary notice, how can they be distinguished on principle from any evidence of co-tenancy by owners who are man and wife? In our economic and social system, if property is held in co-tenancy by husband and wife, and if the property was acquired by purchase, the probabilities are that the consideration was furnished by only one of the spouses, and, accordingly, the interest of the other resulted from a gift. Therefore, does not the mere statement of the co-tenancy give notice of this probability, and would not a prudent man investigate the existence of a possible lien for gift tax? The practicing attorney

may find it difficult to agree because it is difficult to keep in mind the peculiar character of the gift tax lien inasmuch as it is so different from the kind of liens with which he is more familiar. But, it must be re-emphasized that notice of the lien itself does not have to be brought to the attention of the purchaser, or his attorney, in order to have the lien attach. The lien attaches automatically even before the tax is due and it is the purchaser, if he would hold his property free of the lien, who must prove that he had no information that would place a prudent man on inquiry regarding a possible lien.

(d) *Other Tax Situations*

The holding of title by the husband and wife as co-tenants is only one of the more common and obvious indications of a possible gift tax lien to be found in the abstract. However, if notice of the lien can be found to exist in any one situation, the notice will be found in connection with the indication of any taxable transfer. For example, property conveyed to a trustee can usually be presumed to have been conveyed without an adequate consideration. Certain transfers of property in connection with divorce proceedings would raise a question in the mind of a tax counsel. Even in connection with property acquired by distributees from an intestate, if they agree to take other than equally, a gift tax may be due and a gift tax lien (as well as the estate tax lien) raised on the property coming through an estate. The examples could be multiplied. The ones mentioned are certainly oversimplified, but additional examples can not change the principle of notice of a gift tax lien in the examination of an abstract.

V

TRANSFERENCE OF THE LIEN TO OTHER PROPERTY

Let us suppose that the donee has disposed of the specific property acquired by gift to a bona fide purchaser in such a manner as to divest that property from the lien for the gift tax. We are still not free from difficulties inasmuch as the law provides that in these circumstances:

the lien, to the extent of the value of such gift, shall attach to all the property of the donee, (including after acquired property) except any part sold to a bona fide purchaser for an adequate and full consideration in money or money's worth.¹⁹

And, so, the circle starts again, and years later perhaps in some obscure and unrelated transaction, some piece of property may be found subject to a lien for unpaid, long forgotten, gift taxes. The donee is truly the modern Sinbad saddled with his own Old Man of the Sea.

VI

CERTIFICATE OF RELEASE

There are statutory provisions for the issuance of a certificate of re-

19. INT. REV. CODE § 1009. The related estate tax provision is in § 827 (b).

lease from the lien. The very method by which the property is to be certified as free of the lien may well have been provided by Congress as one of the more effective means by which the gift tax was to be enforced. By simply requesting the Commissioner for a release, he is notified of the possibility of a tax. The statutes provide:

- (a) *The Gift Tax Lien.* If the Commissioner is satisfied that the tax liability has been fully discharged or provided for, he may, under regulations prescribed by him with the approval of the Secretary, issue his certificate, releasing any or all of the property from the lien herein imposed.²⁰
- (b) *The General Lien.* Subject to such regulations as the Commissioner, with the approval of the Secretary, may prescribe, the collector charged with an assessment in respect of any tax, may issue a certificate of release of the lien.²¹

VII

THE LIABILITY OF THE ATTORNEY

For eighteen years the gift tax has been treated almost as a step-child of the revenue system; it has been much neglected. For several understandable reasons, there has been little effort toward enforcement. Accordingly, many attorneys, and most laymen, are not as familiar with the gift tax as with some of the other federal taxes, and therefore, the payment of the gift tax on transfers of property interests without adequate consideration has been widely evaded. This can possibly be attributed to culpable negligence rather than to deliberate intent to evade. Now, with additional revenues becoming increasingly more necessary, it is entirely possible that the Treasury Department may turn some attention upon this already assessed but neglected source. A concerted effort to collect the taxes which have become due during the past ten years, but which have remained unpaid, would produce enormous revenues for the government and just as enormous difficulties and problems for those liable for the tax, and their attorneys.

This memorandum to the Bar cannot be concluded without mentioning the responsibility of the attorney. A client, a prospective purchaser of property, seeks the attorney's assurance regarding possible incumbrances upon the title, and the attorney unqualifiedly states that no third parties have any enforceable interest in the property. Suppose that some years later the client finds his property distrained for payment of a lien for prior gift taxes. In the attorney-client relationship, the attorney could hardly be heard to defend against the damage he had caused on the grounds that he had relied upon the assertions of some title company which was not licensed to practice law, or that he did not know of the application of the gift tax.

The examination of abstracts is only one of the more common instances in the practice of law in which serious consequences may result from a lack

20. INT. REV. CODE § 1009. The related estate tax provisions is in § 827 (a).

21. INT. REV. CODE § 3673.

of awareness of tax possibilities. In fact, an attorney cannot practice law adequately without a continual consciousness of taxes. On the other hand, a general practitioner cannot possibly maintain an expertness in the field of taxation, and when he seeks assistance it should be from one who can measure the general legal effect as well as just the incidence of the tax.