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Liability of Fiduciary for Decedent's Unpaid Federal Taxes and That of Transferee for Federal Taxes

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Where all the rights in and to securities are actually and effectively transferred to another person, subsequent dividends or any other benefits from it are thereafter the income of the transferee, and he and the transferor will be taxable with respect to any future yield.[1] The transfer may be by way of a gift or into a trust. The fact that the gift was oral or by parol trust is in itself not determinative.[2] But the tax is not effectively shifted to the assignee where there is a transfer only of the right to receive either the accrued or future dividends or other yield on the securities, as distinguished from the securities themselves.[3] In a case where a corporation acquired all the assets of another, it was held "that a loss of the transferor in a prior taxable year is not available to the transferee for its income tax purposes, nor does a defense which was personal to the transferor survive to the transferee."[4] The statutory transferee provisions are not exclusive for enforcing a tax liability against a transferee of the taxpayer's assets. They provide a new summary remedy.[5]

The transferee's liability is several, and regardless of his *pro rata* share of the tax the transferee may be held liable for the full amount of the transferor's tax up to the value of the assets received by the particular transferee.[6] These rules apply to corporate transferees, individual transferees and distributees of a trust

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[1] Apt. v. Birmingham, 89 F. Supp. 361 (N.D. Iowa 1950); Northern Trust Co. of Chicago v. U.S., 100 F. Supp. 177 (N.D. Ill. 1950), *aff'd* 193 F. 2d 127 (7th Cir. 1951).

[2] I. T. 4007, 1950-1 CUM. BULL. 11; J. S. Rippell, 12 BTA 438 (1928); W. A. Graeper, 27 BTA 632 (1933); Grand Rapids Trust Co., Admrs., 34 BTA 170 (1936); Preston R. Bassett, 33 BTA 182 (1935).

[3] Helvering v. Horst, 311 U.S. 112 (1940); Hyman v. Nunan, 143 F. 2d 425 (2d Cir. 1944); *aff'd* 1 TC 911; Carlton B. Overton, 6 TC 304, *aff'g* 162 F. 2d 155 (2d Cir. 1947).

[4] Michael Carpenter Co., 47 BTA 626, *aff'd* 136 F. 2d 51 (7th Cir. 1943).

[5] U.S. v. Kensington Shipyard & Drydock Corp., 187 F. 2d 709 (3d Cir. 1951); U.S. v. Fisher, 57 F. Supp. 410 (E.D. Mich. 1944).

[6] Phillips v. Comm., 283 U.S. 589 (1931); Buzard v. Helvering, 79 F. 2d 391 (D.C. Cir. 1935).

or estate. *The transferee is also liable for interest and penalties of transferor.*[7]

The Internal Revenue Code section 1119 provides that "A transferee of a taxpayer's property is liable for taxes accrued against transferor before or at time of transfer. The liability is limited to the property received, and attaches to the transferee only if the transferor was insolvent at the time of transfer or was rendered insolvent by the transfer. The burden of proof that property was transferred to the transferee at or after liability for the tax accrued against the transferor, and that transferor was insolvent, rests on the Commissioner of Internal Revenue, but he need not show that transferor was liable for the tax."

The amounts claimed as taxes against a transferee must be assessed and collected the same way as a deficiency. The Code thus provides an additional remedy to the one of an ordinary creditor's suit at law.

According to the definition of the Code the term "transferee" includes heirs, legatees, devisees and distributees. The regulations give it a broader meaning and interpretation, including, in addition, shareholders of a dissolved corporation, assignees or donees of an insolvent individual, successors of a corporation, a party to a reorganization, and mortgagees.[8]

Section 3653 (b) of the Code prohibits a transferee from seeking injunctive relief to restrain the assessment or collection of taxes for which he is liable as transferee.[9] Transferee liability as a derivative obligation should be distinguished from personal liability imposed on fiduciaries in respect to the distribution of trust property.[10]

Where an insolvent corporation transfers property or assets, and where such transfer renders the corporation insolvent, the property transferred is considered as a trust fund for the benefit of its creditors, who may take it from the transferee to the extent of the debt or property received, whichever is the smaller amount. An equitable lien attaches to the property transferred in favor of creditors. The government can sue as a creditor or bring transferee

[7] Louisiana & Arkansas Ry. Corp. v. Helvering, 28 BTA 153, *aff'd* 70 F. 2d 286 (D.C. Cir. 1934); Brier Bill Steel Co. v. U.S., 45 F. Supp. 209 (Ct. Cls. 1942).

[8] Kieferdorf v. Com., 142 F. 2d 723 (1944); Davis v. Modern Industrial Bank, 279 N. Y. 405 (1927).

[9] Phillips et al. Executors v. Com., 283 U.S. 589 (1931).

[10] Com. v. Western Union Telegraph Co., 141 F. 2d 774 (1944).

proceedings in the Tax Court of the United States.[11] The Court will not in a transferee proceeding adjust the rights of the transferees to contribution amongst them.[12]

Assessments against transferees must be made within the following periods: (1) In the case of the first transferee, within one year after the expiration of the period which would have been applicable against the taxpayer; (2) in the case of a second transferee within one year after the expiration of the period of limitation for assessment against the preceding transferee (but not more than three years after the expiration of the period of limitation for assessment against the original taxpayer); (3) in the case of any transferee, if a court proceeding was begun in time against the taxpayer or last preceding transferee, within one year after the return of the execution in the proceeding; (4) in the case of a fiduciary, within one year after the liability arose or within the limited period for collecting the tax, whichever is later.

In applying the foregoing provisions the period of limitation against the taxpayer shall be the period that would be in effect had the death or termination of existence of the taxpayer not occurred.

Exactly what must one do to become liable for tax, as a transferee? Here are the main tests: (1) Transfer must be made after liability has accrued and of course the transferor must have been liable himself; (2) before the transferee proceeding is commenced efforts must be made to collect the tax from the original taxpaper; (3) there must be a transfer of valuable assets to the transferee from the transferor, which left the transferor insolvent.[13] A transferee, it has been said in this connection, is "one who takes the property of another without full, fair and adequate consideration therefor, to prejudice of the rights of creditors;"[14] the proceeding against transferee must be begun within the period specified in the statute of limitations applicable to the case.[15]

Obviously though, not every transfer makes the transferee liable. For example, the mere sale of stock by a stockholder does

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[11] U.S. v. Goldblatt Bros., Inc., 128 F. 2d 576 (1942).
[12] Rite Way Products, Inc., 12 TC 475 (1949).
[13] Botz v. Helvering, 134 F. 2d 538 (8th Cir. 1943).
[14] Agnes C. Jacob, 47 BTA 381 (1942), *decision reversed* in Jacob v. Comm. of Internal Revenue, 139 F. 2d 277 (1943); Letonia Furnace Co., 23 BTA 979 (1931); Myrtle M. Irvine, 36 BTA 653 (1937), *reversed* in Irvine v. Helvering, 99 F. 2d 265 (8th Cir. 1938).
[15] U.S. v. De Martini et al., 53 F. Supp. 162 (N.D. Calif. 1943).

not make the buyer a transferee.[16] The sale by a partnership[16a] or by a corporation of its assets to another corporation for stock of the latter, which stock is issued directly to the stockholders of the seller, leaving the seller without assets to satisfy its creditors, makes the purchaser liable as transferee to creditors of the seller, to the extent of the value of the property received.[17] The theory is that the transaction is a fraud upon creditors and the purchaser is a party to the fraud.[18]

This rule was applied in a case in which one corporation purchased all of the assets of another corporation for common stock, which was distributed directly to the shareholders of the selling company. Here both the purchasing corporation and the stockholders of the selling corporation, were held liable as transferees. It was held, however, that the tax in this case could only be collected once.[19]

It makes no difference that there is a direct issue of stock of the purchasing corporation to the stockholders of the selling corporation. Where a corporation transfers its assets, either directly to a new corporation or to its own stockholders, who in turn transfer the assets to the new corporation, the stockholders may be held as transferees, on the tax liability of the old corporation.[20]

The foregoing rule as to purchasers of corporate assets is especially applicable where the purchaser is a new corporation organized to take over the assets of the seller for stock. The new corporation is regarded as a reincorporation and a reorganization of the old corporation, with the same business and assets.[21] That the old corporation is kept in technical legal existence is im-

[16] Lester L. Robinson, 22 BTA 395 (1931); Comm. v. Bryson, 79 F. 2d 397 (9th Cir. 1935).

[16a] *In re* Glover-McConnell Co., 9 F. 2d 683 (1925).

[17] Aviation Corp. v. U.S., 46 F. Supp. 491 (Ct. of Cl. 1942); Scruggs-Vandervoort-Barney, Inc., 1 TC Mem. Dec. 115 (1942).

[18] West Texas Refining & Development Co., 68 F. 2d 77 (10th Cir. 1933).

[19] Woodley Petroleum Co., 16 BTA 253 (1929); U.S. v. Armstrong, 26 F. 2d 227 (8th Cir. 1928); California Iron Yards Corp'n v. Comm., 82 F. 2d 776 (9th Cir. 1936); Warner Collieries Co. of Delaware, 36 BTA 54 (1937); C. W. Murchison, 35 BTA 1023 (1937).

[20] Homer S. Warren et al., adm., 31 BTA 1041 (1935); Continental Oil Co., 34 BTA 29 (1936), aff'd 100 F. 2d 101 (D. C. Cir. 1938).

[21] Waterproofed Products Co., 25 BTA 648 (1932); Delacroix Corp'n v. Comm., 84 F. 2d 442 (5th Cir. 1936); Newport Industries, Inc., 40 BTA 978 (1939); 121 F. 2d 655 (7th Cir. 1941); Knoxville-Gray Eagle Marble Co. v. U.S., P. H. par. 62, 939, appeal dismissed by counsel, 119 F. 2d 1021 (1941); California Iron Yards Corp'n v. Comm., 82 F. 2d 776 (9th Cir. 1936), cert. denied 299 U.S. 553 (1936).

material; a de facto dissolution is deemed to have taken place where a corporation has been stripped of all its assets.[22]

A sale of assets for an inadequate consideration may result in transferee liability.[23] A corporation has been held not a transferee merely because it purchased all of the assets of another corporation, paying for it in shares of its own stock, when shares were issued directly to the seller corporation, and the stock issued was at least equal in value to assets purchased. In such case the stock received by the seller corporation is an asset out of which taxes can be collected.[24]

It was held that a corporation does not become a transferee just because it purchases a business from an individual, paying for it in its own stock and notes, if there is a fair consideration. The fact that the individual later disposes of his stock without receiving full consideration does not affect the position of the purchasing corporation.[25]

It is important that it be noted that a transferee of the assets of a corporation cannot usually be held liable for the tax of the corporation where the commissioner has not previously exhausted his remedies against the corporation.[26]

But it is not necessary that there be an assessment against the original transferor, in order to enforce the transferee's liability.[27] Where it is evident that a proceeding against the transferor would bring no results the liability may be enforced at once against transferee.[28] Thus, the known insolvency of the original taxpayer or the fact that the original transferor has no existing assets constitutes an exception to the usual rule.[29]

The commissioner is required to make out a prima facie case

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[22] Hunn v. U.S., 60 F. 2d 430 (8th Cir. 1932); Waterproofed Products Co., 25 BTA 648 (1932).

[23] U.S. v. Goldblatt Bros., Inc., 128 F. 2d 576 (7th Cir. 1942).

[24] Metropolitan Securities Corp., 19 BTA 299 (1930); B. F. Fairless, 19 BTA 304 (1930); Fairless v. Comm., 67 F. 2d 475 (1933); Kinnett-Odom Co., 19 BTA 1124 (1930); Dobrin v. Comm., 27 BTA 611 (1933); Warren et al., 31 BTA 1041 (1935).

[25] Exclusive Prescription Pharmacy, Inc., 21 BTA 33 (1930).

[26] Phil Gleichman, 17 BTA 147 (1929).

[27] Flynn v. Comm., 77 F. 2d 180 (1935); Woodley Petroleum Co., 16 BTA 253 (1929).

[28] B. F. Fairless, 19 BTA 304 (1930); Fairless v. Comm. 67 F. 2d 475 (1933); Flynn v. Comm., 77 F. 2d 180 (1935).

[29] W. W. Cleveland, 28 BTA 578 (1933); Cleveland v. Comm., 77 F. 2d 184 (1935); U.S. v. Garfunkel, 52 F. 2d 727 (1931); John Thompson, 20 BTA 1 (1930).

of transferee liability; the petitioner then must rebut it.[30] He must establish all facts necessary to show liability, at law or in equity, on the part of transferee.[30a]

The prima facie case of the commissioner may be made out by proving: (1) That the assets were transferred to petitioner which left taxpayer insolvent or was in fraud of creditors; (2) the value of the transferred assets; (3) that a proceeding against transferor or that effort to collect would be a futile gesture.[31] The stockholder of a dissolved corporation may be required to produce its books for examination as to possible transferee liability.[32]

The burden of proof on certain affirmative defenses is on the transferee; for example: (1) Absence of tax liability on the part of transferor taxpayer; (2) statute of limitations; (3) payment of tax by or on behalf of transferor; (4) creditor status; (5) discharge by paying transferor's creditors;[33] (6) nonbeneficial ownership of assets received.

As soon as the commissioner receives notice that a person is acting in a fiduciary capacity such fiduciary assumes the powers, rights, duties and privileges of the taxpayer with respect to income tax. So, the fiduciary of the transferee is required to act as if he himself were the taxpayer. The amount of the tax is ordinarily not collectible from the personal estate of the fiduciary, but is collectible from the estate of the taxpayer or from the estate of the transferee. The notice to the commissioner must be a written notice signed by the fiduciary and filed with the commissioner, including the information required by the regulations.

Furthermore, unless there is already on file with the commissioner satisfactory evidence of the authority of the fiduciary to act for such person in a fiduciary capacity, such evidence must be filed as part of the notice. If the fiduciary capacity has been created by court order, a certified copy of the order may be regarded as satisfactory evidence. When the fiduciary capacity has terminated, the fiduciary, in order to be relieved of any further liability, must file with the commissioner written notice of the termination. The

[30] C. A. Hutton, 21 BTA 101, *affirmed* 59 F. 2d 66 (9th Cir. 1932); Edward H. Garcin, 22 BT 1027, *remanded* 79 F. 2d 993 (4th Cir. 1935).
[30a] Alexander C. Buchanan Trust, BTA Memo. Op. Dkt. 103809 (1941).
[31] Chris D. Matrangos, 8 T. C. Mem. Dec. 639 (1949).
[32] *Ibid.*
[33] Northwestern Jobbers Credit Bureau, 1 T. C. 863 (1943); Estate of L. E. McKnight, 8 T. C. 871 (1947).

notice should also state the name and address of the substitute, if any.

If the notice of fiduciary capacity is not filed prior to the sending of notice of a deficiency by registered mail to the last known address of the taxpayer, or the last known address of transferee, no notice of deficiency will be sent to the fiduciary. In such case the sending of the notice to the last known address of the taxpayer or transferee, as the case may be, will be sufficient compliance with the requirements of the Internal Revenue Code, even though the taxpayer transferee is deceased, or is under legal disability, or in case of a corporation is dissolved. Under these circumstances, if no petition was filed with the Tax Court within ninety days after the mailing of the notice (or within 150 days after notice mailed after October 21, 1942, and addressed to a person outside the United States and District of Columbia) to the taxpayer or transferee, the tax or liability under section 311 will be assessed immediately upon the expiration of such ninety days or 150-day period, and demand for payment will be made by the collector. "Fiduciary" is defined in section 3797 (a) (6) to mean a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

Where the commissioner undertakes to assert transferee liability it may be advisable to check the facts, law, rules and regulations on the following defenses:

(1) Has the commissioner attempted to collect the tax from the transferor?

(2) Has the transferee paid full consideration for the property transferred?

(3) Will the transfer leave the transferor bankrupt and unable to pay the tax involved and the debts to his creditors?

(4) Was the transfer made in fraud of creditors and the government, although made for an adequate consideration?

(5) Was assessment made within the statute of limitations?

(6) If the relationship springs out of a fiduciary capacity, has the fiduciary followed the statutory method to discharge himself?

We can propound it as a basic rule that the executor must have had knowledge of the tax before personal liability arises. The theory rests on the premise that personal liability is penal in nature and can only be availed of in clear cases. Obviously an executor will be held to stricter rules of personal liability where returns filed by himself are involved. An example is where the executor files returns for the decedent for a period immediately prior to the latter's death, covering the estate's returns during the period of the executor's administration.[34]

The question remains as to the liability for payment of estate tax by an executor, administrator, or assignor. One holding the trusts named, or other persons liable for payment of estate tax, who before paying all of the tax pay any debt or distribute any portion of the estate, are personally liable for the unpaid tax in an amount not exceeding the amount paid or distributed.[35]

Where the executor distributes the estate without paying the tax, the Government may seek to recover the tax from both the executor and the distributees of the assets of the estate.[36]

Where an erroneous tax refund was made to the executor who distributed it, and whose authority over the funds ceased with the distribution under the State laws, the executor was held not personally liable. The Government could only proceed against the distributees.[37]

The Tax Court has jurisdiction to determine a deficiency due from the executors in their representative capacity, but has no jurisdiction to determine whether or not the executors have been released from personal liability.[38] If the estate tax is not paid when due, any person who receives, or had on the date of the decedent's death, property included in the gross estate, is personally liable for the tax to the extent of its value at the time of the decedent's death.[39]

Among the transferees liable are the decedent's spouse, the donee of a gift in contemplation of death, the surviving joint

[34] Reg. 111, Section 29.162.

[35] R. S. sec. 3467, as amended by sec. 518 of the 1934 Act; United States v. First Huntington Nat. Bank, 34 F. Supp. 578 (1940); affirmed in 117 F. 2d 376 (1941).

[36] United States v. Cruikshank, 48 F. 2d 352 (S.D. N.Y. 1931); United States v. Wolff, 26 F. Supp. 940 (S.D. N.Y. 1938).

[37] Lindley v. United States, 59 F. 2d 336 (9th Cir. 1932), modifying Whelan v. First Nat. Bank of Mayfield, Ky., 56 F. 2d 1004 (6th Cir. 1932).

[38] Newton H. Neustadter, Walter W. Stettheimer, and Julian Hart, Executors, Estate of David Neustadter, Petitioner, v. Commissioner of Internal Revenue, Respondent, 15 BTA 839 (1929).

[39] Sec. 827 (b).

tenant, or the person who benefits from the exercise, release or non-exercise of a taxable power of appointment held by the decedent.

The executor may make written application for determination of the tax, and his discharge from personal liability for it. The commissioner must then notify the executor of the amount of the tax within one year after the filing of the application or the return, whichever is later. Upon payment of the amount the executor is discharged from any personal liability for any deficiency found to be due subsequently.

The discharge of the executor from personal liability does not bar the determination of a deficiency against the estate of a transferee.[40]

[40] Bessie M. Brainard, Petitioner, v. Commissioner of Internal Revenue, Respondent, 47 BTA 947 (1942).

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