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## TITLE EXAMINATIONS AS AFFECTED BY THE FEDERAL GIFT AND ESTATE TAX LIENS

*L. Hart Wright\**

THE Treasury Department may look to either of two security devices to protect its rights with respect to federal gift and estate taxes. The most sweeping of these devices—the *general* federal tax lien,<sup>1</sup> a discussion of which appeared in the last issue of this *Review*, has been complemented in the case of each of these taxes by special liens, presumably designed to meet what apparently were considered peculiar needs. It is with the impact of these special liens on the work of title examiners that this article is concerned.

### FEDERAL GIFT TAX LIEN

#### A. *General Description*

The gift tax, computed for each calendar year upon all gifts made within that period,<sup>2</sup> is said by section 1009 of the Internal Revenue Code to be a lien for ten years upon all such gifts from the time of the transfer.<sup>3</sup>

Since the turn of the century, the federal government has followed the practice of supplementing provisions establishing tax liens with various measures designed to protect certain third persons who might innocently acquire an interest in property against which the government had previously obtained a lien. In the case, for example, of the *general* federal tax lien, Congress provided that the lien would be valid against such third persons only if the collector had previously filed a notice of the lien in certain offices of record.<sup>4</sup> In the case of the special liens, however, it chose a somewhat different technique. With respect to the gift tax lien, provision was made whereby the lien would be

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<sup>1</sup> I.R.C., §3670 et seq.

<sup>2</sup> I.R.C., §1000(a).

<sup>3</sup> I.R.C., §1009.

<sup>4</sup> I.R.C., §3672. In its original form this relief dates back to Act of March 4, 1913, 37 Stat. L. 1016, c. 166.

automatically divested if the property subject to the encumbrance was "sold by the donee to a bona fide purchaser for an adequate and full consideration in money or money's worth."<sup>5</sup> While this divestment provision is quite sweeping in the sense that it applies to *any* property so sold, the quoted language does, nevertheless, include certain words of limitation. And it is on these words that attention should be focused in considering the title examiner's problem.

### B. *Limitations in the Divestment Provision*

1. *The meaning of "purchaser."* The first of the possible limitations contained in the divestment provision involves the phrase, "sold . . . to a . . . purchaser." Query: will this be construed to include mortgages given to a mortgagee? This question has been involved in but one case, a controversy which arose in Michigan in the context of an estate tax lien problem.<sup>6</sup> That case, however, was actually resolved by the United States Supreme Court on a ground which made it unnecessary for the Court to consider the meaning to be attributed to this particular phrase. Accordingly, one is left with the language of the act and with that of other related statutes.<sup>7</sup>

In this latter connection, it might be contended on the one hand that Congress was actually more liberal in, or, on the other hand, simply took greater care in drafting, the provision which established the *general* federal tax lien, for there the protected class expressly includes a "mortgagee, pledgee, purchaser or judgment creditor."<sup>8</sup> With respect to these competing contentions, nothing more definitive can be said at this time than that the scales before a federal court might well be tipped by a policy argument, namely, that the merits of a mortgagee's case are the same as are those of the purchaser—a matter which has led state courts in some cases arising in the context of property law to treat mortgagees as "purchasers *pro tanto*."<sup>9</sup>

2. *The meaning of "bona fide": In general.* Equally controversial questions are likely to arise in connection with the congressional use of

<sup>5</sup> I.R.C., §1009.

<sup>6</sup> *Detroit Bank v. United States*, 317 U.S. 329, 63 S.Ct. 297 (1943).

<sup>7</sup> Pre-enactment materials are of no assistance. The House report concerning the revival of the gift tax in 1932 did devote three lines to the lien, but these contributed nothing by way of interpretation. H. Rep. 708, 72d Cong., 1st sess., p. 30 (1932). And while the Estate Tax Act embodies similar language, the pre-enactment materials covering all of that act run to less than a page. H. Rep. 922, 64th Cong., 1st sess. (1916) p. 5.

<sup>8</sup> I.R.C., §3672.

<sup>9</sup> *Bacon v. Van Schoonhoven*, 87 N.Y. 446 (1882).

the words "bona fide" in describing the character of purchasers to be protected. In this connection, perhaps the first question which should be asked is whether or not this characterization is to be considered superfluous. That is, does bona fide have any meaning whatever over and above that meaning already carried by the language which follows it, namely, "purchaser for an adequate and full consideration in money or money's worth?"

Ordinarily in the context of property law, the term bona fide has meant something more than a purchaser who has paid full and adequate consideration. A complex standard of good faith, some facets being pitched at a rather demanding level, is usually also said to be involved. However, it is not wholly clear that even the least exacting of these requirements, namely, an absence of actual notice of the adverse lien, was intended by Congress to be embodied in its statutory use of the term. And if, perchance, Congress did not intend to be so demanding, then from the title examiner's point of view the term does, of course, come close to being superfluous.

The argument to the effect that Congress, by its use of this term, did not intend to incorporate even the lowest of the property law standards rests on the cumulative effect of two considerations, the first of which is the fact that the donee of a gift, like the donor, is personally liable for the tax.<sup>10</sup> In other words, in the event of nonpayment, the donee as well as the donor becomes something of a culprit. Second, and of even more importance to the basic argument, is the further fact that a sale of the donated property by the donee to a bona fide purchaser *shifts* the lien from the donated property itself to the consideration received by the donee, as well as to all of his other property.<sup>11</sup> It must be understood that this shift occurs if, and only if, the purchaser is deemed bona fide. Could it not be argued from this that Congress contemplated one of the less demanding interpretations of bona fide? And that in the typical case it is enough to protect the purchaser that the donee did in fact receive "adequate and full consideration in money or money's worth" to which the lien could shift? This argument would attribute to Congress a not unreasonable preference for a lien on all of the property of a person—the donee, who was

<sup>10</sup> I.R.C., §1009. *Mississippi Valley Trust Co. v. Commissioner*, (8th Cir. 1945) 147 F. (2d) 186. In *Fidelity Union Trust Co. v. Trinda Heller Anthony*, 13 N.J. Super. 596, 81 A. (2d) 191 (1951), 51-1 U.S.T.C. ¶10817, a donee who had paid the tax was denied reimbursement from the donor.

<sup>11</sup> *Ibid.*

personally and primarily liable for the tax, over a lien on a single piece of property now belonging to a purchaser who was not personally liable for the tax. To make this position more attractive, some respectable function should be found for the term *bona fide*. In this connection, could it not be argued that Congress intended only to make explicit what otherwise likely would have been inferred, namely, that it did intend to reach the gift-property in the hands of any purchaser who had notice of the lien *and* of the donee's intention, if any, to "hinder, delay, or defraud" the government of its tax? That this standard would have been incorporated in any event rests, of course, on the law of fraudulent conveyance.<sup>12</sup>

Should a court adopt the interpretation just noted, title examiners would not, of course, have any reason whatever to fear the gift tax lien. But an examiner cannot be sure that a court will follow the line of reasoning just suggested, for there is an equally attractive competing alternative. Since the donee's property could be reached in any event through individual process because of his continued personal liability, it could be argued that Congress, in establishing the lien, intended to use "*bona fide*" in the sense in which it is normally used in property law, its thought being that there would be little injustice in increasing the range of the government's protection so as to include a right against a purchaser who fell short of the standards traditionally established by state law.

The absence of *actual* judicial construction suggests, of course, that at least some title examiners, the more cautious ones, will feel constrained to assume that the latter, the more strict, of the two possible interpretations will ultimately prevail. The discussion which follows proceeds upon that assumption.

3. *The meaning of "bona fide" in the context of property law.* As a matter of general property law a purchaser is usually denied *bona fide* status when he has notice of an existing lien. Such notice may be actual, constructive from the record, or may arise where the purchaser had knowledge of facts sufficient to put a reasonably prudent man upon inquiry which, if pursued with reasonable diligence, would have disclosed the adverse lien.<sup>13</sup>

The first two of these three types of notice are not of particular concern here. Questions of constructive notice from the record will not

<sup>12</sup> See §7, Uniform Fraudulent Conveyance Act.

<sup>13</sup> See 55 AM. JUR. §696 et seq. (1946).

arise, for this lien is not subject to filing or recording.<sup>14</sup> Nor do title examiners usually know, or concern themselves with the question of, whether a client, a prospective purchaser, has actual knowledge of unrecorded liens. Of such cases, nothing more need be said than that a title examiner who happens to be made aware of the actual existence of such knowledge should, of course, recommend that a certificate discharging the lien be obtained from the government.<sup>15</sup>

The third and last of the types of notice related above, herein referred to as "inquiry notice," requires more detailed examination. Of first concern are the types of facts, knowledge of which will be deemed sufficient to activate the inquiry of a reasonably prudent man.

To deny bona fideness to a prospective purchaser under this rule would seem to require:

- (1) That the purchaser know or be deemed as a matter of law to know that there is an encumbrance known as a gift tax lien, otherwise his suspicions would never be aroused;
- (2) That he have knowledge of facts sufficient to put a reasonably prudent man upon inquiry to determine if a gift was included in the chain of title; and
- (3) That he have knowledge of facts sufficient to put a reasonably prudent man upon inquiry to determine if a gift tax lien existed on the subject matter of the suspected gift.<sup>16</sup>

4. *The meaning of "bona fide": Knowledge of the law presumed.* The first requirement in denying bona fideness, that is, that the prospective purchaser must have knowledge that there is in the law such an encumbrance as a gift tax lien, requires little attention. Is it not likely that a federal court would adopt the same premise as that which attracted the Michigan Supreme Court in a different, but, nevertheless, related specific-tax-lien situation, namely, that "everyone is presumed to know the law?"<sup>17</sup> Certainly a title examiner can ill afford to assume that the federal courts would not here indulge in this traditional supposition.

<sup>14</sup> The government may resort to the provisions of I.R.C., §3670 et seq. which provide for filing of a notice. But this is a separate and distinct lien. See *Detroit Bank v. United States*, 317 U.S. 329, 63 S.Ct. 297 (1943).

<sup>15</sup> See I.R.C., §1009; U.S. Treas. Reg. 108, §86.36.

<sup>16</sup> Two authors in writing on this subject assumed that this third requirement was not involved. Peters and Maxey, "The Gift Tax Lien And the Examination of Abstracts," 5 *MIAMI L.Q.* 64 (1950). But it is not necessarily true that mere knowledge that the chain of title includes a gift will be held sufficient to lead a reasonably prudent man to determine if there is a lien. See discussion *infra*, p. 331.

<sup>17</sup> *Stevens v. The Lake George & Muskegon River R. Co.*, 82 Mich. 426 at 433, 46 N.W. 730 (1890).

5. *The meaning of "bona fide": The types of facts sufficient to put a reasonably prudent man upon inquiry to determine if a gift was included in the chain of title.* It will be recalled that the second of the three factors upon which the matter of bona fideness may turn concerned the question of when a prospective purchaser will be deemed to have knowledge of facts sufficient to put a reasonable man upon inquiry to determine if a gift was included within the chain of title. It is not possible here to exhaust anything like all of the possibilities. A few illustrative situations will serve, however, to indicate the general nature of the problem.

At one extreme is the case where the prospective purchaser actually has knowledge of something more than mere facts which would lead him to make inquiry. He has imputed notice, and when his lawyer reads the abstract—actual notice, that one of the transfers in the chain was in the nature of a gift. The author has reference to a deed in a chain which contains the now seldom used recited consideration of "love and affection." The same knowledge would exist in the case of previous transfers to trustees where a recorded trust instrument expressly reveals the gratuitous character of the conveyance.

The suspicions of a reasonably prudent man would not seem, however, to be aroused by, and inquiry should not be expected in connection with, what is perhaps the most typical type of deed with which lawyers are concerned. Assume in this connection that the last deed in the chain recited the usual "\$1 and other good and valuable consideration." It must be conceded at the outset that if such a consideration had actually been paid, it is still possible, under the Internal Revenue Code, that the transfer was a taxable gift.<sup>18</sup> Many "good and valuable considerations" at common law fall short of the standards established for consideration by the Gift Tax Act. The latter's standard, "adequate and full consideration *in money or money's worth*,"<sup>19</sup> would not be satisfied, for example, by a binding promise of marriage made in connection with a pre-nuptial arrangement.<sup>20</sup> But even so, it is the judgment of the author that the recitation of "\$1 and other good and valuable consideration" would not, standing alone, lead a court to find that suspicion of a gift would be aroused in the mind of the reasonably

<sup>18</sup> I.R.C., §1002.

<sup>19</sup> *Ibid.*

<sup>20</sup> *Commissioner v. Wemyss*, 324 U. S. 305, 65 S.Ct. 652 (1945).

prudent man, or for that matter, in the mind of the average prudent lawyer. The fact is that this stated consideration is so universally used in connection with "honest-to-goodness" commercial transactions that the average man, or lawyer, would, in view of the preponderance of such transactions over all others, seem justified in treating it as such.

Suppose, however, that the foregoing recited consideration is supplemented by the additional fact that a deed from X runs to a husband and wife as tenants by the entireties, and that farther back in the chain it is evident that this same husband, in order to accomplish a division of his property, had used the device of transferring the property to X who had in turn re-transferred it by the deed running to the husband and wife as tenants by the entireties. Query: is it not possible that these additional facts would be said, in view of the intimate relationship of the parties and of the fact that this conveyancing practice is probably used most frequently in connection with gifts, to call for a reasonable man to suspect that a gift was involved?<sup>21</sup>

These illustrations should at least serve to indicate that there are frequently-used conveyancing devices which, if present in a given case, might well be deemed sufficient to lead a reasonably prudent man to suspect that the chain of title included a gift.

6. *The meaning of "bona fide": The types of facts sufficient to put a reasonably prudent man upon inquiry to determine if a gift tax lien actually exists on the subject matter of a suspected gift.* The last of the three cumulative requirements, the presence of which in a given case would, as a matter of property law, deprive a person of bona fide status, concerned the question of when a prospective purchaser would be deemed to have notice of facts sufficient to put a reasonably prudent man upon inquiry to determine if a gift tax lien actually existed on the property which, it will now be assumed, is suspected of having been the subject matter of an earlier gift.

Whether or not in the typical case there is cause to suspect the *present* existence of a lien might well turn, first, on the relative timing of the proposed purchase, and second, on the value of the property.

With respect to the matter of relative timing, assume first that the preceding transfer, which is suspected of having been a gift, took place on January 15, 1951. Assume also that it involved property having a

<sup>21</sup> Cf., e.g., *Sanborn v. McLean*, 233 Mich. 227, 206 N.W. 496 (1925).



market value of \$7,000 and that the prospective purchaser proposed to take title sometime *within* that same calendar year, before the gift tax return for that year would even be due. If we impute knowledge of the law to such a purchaser, he will know (1) that a lien did attach, according to the statute, at the moment the suspected gift was made, and (2) that it had not yet been discharged and would not be discharged until sometime after the following December 31st, when discharge might be effected either by the donor's election in the return filed for that calendar year to exercise a part of whatever remained of his lifetime exemption of \$30,000, or by payment of the tax.<sup>22</sup> Here then the title examiner will not only suspect, but will know that a lien does exist as of the date of the proposed purchase—assuming, of course, as the title examiner must, that his suspicion, to the effect that the earlier transfer was a gift, was warranted. And because of the possibility that the statutory term, *bona fide*, may eventually be deemed to embody its common law meaning, this title examiner would be under some compulsion to note an exception in his title opinion. This would mean, of course, that the donee, the last transferee, should be required to procure a certificate releasing the lien,<sup>23</sup> or would at least be expected to give an affidavit to the effect that a gift was not involved.

Now suppose that negotiations by the prospective purchaser were opened *after* the due date of the gift tax return covering the calendar year in which the suspected gift was made. Would the prospective purchaser, knowing or being required as a reasonably prudent man to suspect the gratuitous character of the earlier transfer, now buy at his peril? In other words, must he assume as a matter of self protection that the lien which did attach at the time of the gift, before the return was actually due, was not discharged in due course?

On the one hand, more than one court in dealing with the meaning of *bona fide* in the context of property law has in effect taken the position that a purchaser is charged "with notice of everything that has happened because he jolly well knew it might have happened."<sup>24</sup> And in dealing with a local "specific" or excise, as contrasted with a property, tax, the Michigan Supreme Court was led to say with reference to a related but yet different problem:

<sup>22</sup> U.S. Treas. Reg. 108, §86.12. The exemption is not automatically applied to the current year. It may be saved for use in the future. Accordingly, until a binding election is made, it would not seem that the lien is discharged.

<sup>23</sup> See I.R.C., §1009, and U.S. Treas. Reg. 108, §86.36.

<sup>24</sup> DUFFEE, *CASES ON SECURITY* 409 (1951).

"There is no presumption of payment. Purchasers of property, upon which the state has a lien, have no right to act upon the presumption that the officers charged with the duty of collection have exhausted all the remedies provided for such collection, and have secured payment. There is no presumption that taxes have been paid any more than that other debts have been paid."<sup>25</sup>

A fairly convincing case can be made then for the proposition that the relative timing of the proposed purchase does not change the title examiner's problem, and that his client is in the same position whether he proposes to buy the property in the same year in which the gift was made or in a later year which comes within the life span of the lien, namely ten years. On the other hand, one distinction between the gift tax lien and the many diverse types which are products solely of property law might well argue for a contrary conclusion. In this latter connection, it is to be remembered that the donor of the suspected gift in our second situation above might have been in a position, prior to the offer from our title examiner's client, to have discharged the lien in question *without* cost, namely, by having elected to take advantage on the appropriate March 15th of whatever remained of his lifetime exemption of \$30,000. And this difference might persuade a court to put the question concerning the third aspect of bona fide in the following terms: can it be said in this day and age that mere notice that a person has made a gift of \$7,000 in an earlier year will lead a reasonably prudent man to suspect that the donor has made *other* gifts in yet earlier years which exceeded his yearly exclusions of \$3,000<sup>26</sup> plus his added lifetime exemption, and that the donor did not, therefore, on the occasion of the gratuitous transfer in question have any exemption with which to discharge the lien? In other words, the fact that many, and probably most, such liens will have been discharged by donors without cost might well lead a court, in trying to be reasonable in establishing the standard for reasonable men, to conclude that our prospective purchaser will be less than bona fide only if he also had cause to suspect that the donor of this gift had previously made *other* gifts which may have exhausted his lifetime exemption. This standard would normally have the practical effect of relieving the title examiner of whatever concern he otherwise might have had in such cases. But this freedom

<sup>25</sup> *Stevens v. The Lake George & Muskegon River R. Co.*, 82 Mich. 426 at 433, 46 N.W. 730 (1890).

<sup>26</sup> I.R.C., §1003(b)(3).

from concern would be justified only in the instance where the property covered by his opinion is valued at less than \$33,000, this being the sum of the yearly exclusion and lifetime exemption.

In this latter connection, where the earlier conveyance shows the donor to have been a married man, it is arguable that the title examiner should feel secure so long as the property is valued at less than \$66,000. This further conclusion would be predicated upon the right of husband and wife to elect at the time the return was filed for the earlier calendar year to divide for tax purposes those gifts which either of them made to third parties,<sup>27</sup> the exercise of such right having the practical effect of doubling the exclusion and allowable exemption. It is one thing, however, to argue that notice of a gift of \$7,000 will not be sufficient to cause a reasonably prudent man to suspect that a donor has made other gifts, and quite another to say that prospective purchasers are entitled to assume that a husband or wife will always make his or her exemption available to a spouse.<sup>28</sup>

### C. *Conclusion Re Title Examiner's Problem*

In summarizing the title examiner's problem with respect to the gift tax lien, due caution would seem to require the lawyer to assume that the "bona fide purchaser" for whom the divestment provision was designed refers only to those who satisfy the attributes prevailing generally in property law. On the one hand, this would clearly call for an objection in the title opinion in those cases where a prospective purchaser, having notice from the abstract of facts sufficient to put a reasonable man upon inquiry to determine if a gift was included in the chain, proposes to purchase the property in the same year in which it was suspected of having been transferred by gift. It is not so clear, however, that the same precaution is necessary in those cases where (1) the property is valued at less than \$33,000, and (2) the proposed purchase of such property is to be made following the due date of the tax return covering the year of the suspected transfer by gift.

<sup>27</sup> I.R.C., §1000(f). This right did not exist, however, with regard to taxable years preceding 1948.

<sup>28</sup> The so-called split provision does not operate automatically. It is not binding or operative until the two spouses file a consent with the government. I.R.C., §1000(f)(1)(B). On the other hand, if the gift is of a non-terminable interest from one spouse to the other, the marital deduction would automatically apply. I.R.C., §1004(a)(3). And such circumstances might, therefore, call for a different result.

In weighing the risks involved in a situation which satisfies these last two requirements, a down-to-earth title examiner might remind himself that taxable gifts are usually made today only by well-to-do persons. The continued primary liability of what is then a normally well-to-do donor, and the like liability of the donee are not insignificant considerations. In this same connection it is interesting to note that no request for the release of a gift tax lien has, within the past fourteen years, appeared in the offices of the federal revenue agents stationed in Michigan.<sup>29</sup> Moreover, not one case is reported in the books where the United States has attempted to enforce a lien against any person other than the donor or donee. And yet the law has been on the books since 1924.

### THE FEDERAL ESTATE TAX LIEN

#### A. *The Scope of the Lien, and the Shape of Protection Provided Third Persons*

The estate tax lien was actually the forerunner of the gift tax lien. The Estate Tax Act, dating back to 1916, has always provided that "unless the tax is sooner paid in full, it shall be a lien for ten years upon the *gross estate* of the decedent."<sup>30</sup>

The "gross estate" to which reference has just been made is currently divided for purposes of the lien into three classifications. The first of these is concerned with interests in property held by the decedent at the time of his death, such being referred to herein as "section 811(a) property" because it is by virtue of that section of the Code that the interest is included in the gross estate. With one exception, no attempt has ever been made with reference to such property to protect third persons against the secret, unrecorded estate tax lien. The one exception, being the matter constituting our second classification, is to the effect that any part of the gross estate which is used to pay "charges against the estate and [judicially allowed] expenses of its administration" is said to be "divested of such lien."<sup>31</sup> Where a sale is first necessary to accomplish this end, it seems to be enough to evidence the

<sup>29</sup> According to the recollections of Arthur C. Smith, Revenue Agent in charge of the Estate and Gift Tax Section in the Detroit office.

<sup>30</sup> Revenue Act of 1916, §209, now I.R.C., §827, 39 Stat. L. 756 at 780.

<sup>31</sup> I.R.C., §827(a).

divestment of the lien that the order authorizing the sale shall have stated its purpose.<sup>32</sup>

The third and last classification into which the gross estate is divided for the purpose of this lien relates to transfers which in a property sense involve interests other than those owned by the decedent at the time of his death but which are, nevertheless, required to be included in his gross estate—and, by virtue of some provision of the code other than section 811(a).<sup>33</sup> More specifically, and yet considering the matter in fairly general terms, this classification, herein referred to as “non-section 811(a) property,” consists of five different property interests:

(1) The interest of a surviving spouse in the nature of dower or curtesy, or statutory substitutes therefor;

(2) Inter vivos gifts covered by section 811(c), for example, those which are deemed to have been made by the decedent in contemplation of death or are said by virtue of the form of the transfer to have been intended by him to take effect in possession or enjoyment at or after death;

(3) Inter vivos gifts by the decedent in trust or otherwise where the enjoyment thereof was subject at the date of his death to alteration, amendment, revocation or termination through his exercise of a reserved power;

(4) Property, for which the decedent had paid the purchase price, but, the title to which was held at the time of his death with another as joint tenants or as tenants by the entireties; and

(5) Property which was included in the gross estate by virtue of section 811(f) because of a power of appointment which the decedent held with respect thereto.<sup>34</sup>

The need for protection of possible third party purchasers in some of the foregoing five situations cannot be seriously questioned. The most compelling case of such need exists, of course, with respect to proposed purchases of property which had been the subject of an inter vivos gift made in contemplation of death. Gratuitous transfers of this character will not be reflected in probate proceedings. And of even more

<sup>32</sup> The divestment was deemed effective in *United States v. Security-First National Bank of Los Angeles*, (D.C. Cal. 1939) 30 F. Supp. 113, though apparently such an order had not been issued. The same case indicates that the lien is divested only to the extent the proceeds are used for the payment of the two types of expense in question.

<sup>33</sup> I.R.C., §827(b).

<sup>34</sup> The divestment provision also relates to insurance proceeds covered by I.R.C., §811(g). A title examiner is not, however, directly concerned with such.

importance, the instrument which effected the gratuitous conveyance would not ordinarily expressly tie the transfer to the death of the donor. Accordingly, a title examiner who passes on the donee's title will not be forewarned by the abstract that the original donor is dead—assuming such to be the case.<sup>35</sup> There would not, then, be any reason for the purchaser to suspect that such property was involved in estate tax matters. While the need for protection of third persons in some of the other of these five situations is not quite so compelling,<sup>36</sup> Congress has, nevertheless, provided in all five cases<sup>37</sup> that the lien would be divested to the extent at least that such property was “sold” by the beneficiary or trustee to a “bona fide purchaser for an adequate and full consideration in money or money's worth.”<sup>38</sup>

From the foregoing discussion, it appears that where the proper estate tax was not paid and where ten years have not elapsed since the death of a decedent, a third party who acquires an interest in a part of the gross estate will be subordinated to this secret, unrecorded lien on all but two occasions:

(1) With respect to so-called section 811(a) property, the third party acquirer will not be protected unless his acquisition results from a transfer made by the executor during probate in order that the latter may pay claims against, or administration expenses of, a decedent's estate; and

(2) With respect to all other interests included in the gross estate, that is, the so-called section 811(b), (c), (d), (e), and (f) properties, the third party acquirer is stripped of protection except where his acquisition satisfies the language, “sold . . . to a bona fide purchaser for a full and adequate consideration in money or money's worth.”

<sup>35</sup> It is equally possible that the title examiner will pass on the donee's title before the donor's death. But under this particular circumstance a divestment provision is not needed to protect third persons from the estate tax lien, for the lien comes into being only on the date of the donor's death. See *Detroit Bank v. United States*, 317 U.S. 329, 63 S.Ct. 297 (1943).

<sup>36</sup> For example, the title examiner would at least know of the donor's death if the title concerned property held by the decedent and another as joint tenants, the decedent's interest passing only by right of survivorship.

<sup>37</sup> Until 1942, the divestment provision applied only to property included in the gross estate by virtue of I.R.C., §811(c). *Detroit Bank v. United States*, 317 U.S. 329, 63 S.Ct. 297 (1943). The Revenue Act of 1942, §411(a), 56 Stat. L. 798, expanded its sweep so as to cover all non-§811(a) properties.

<sup>38</sup> I.R.C., §827(b).

B. *Title Examiner's Problem Re "Section 811(a) Property"*

The title examiner, with respect to the problem occasioned by liens which might exist upon the first of the foregoing properties, the so-called section 811(a) property, will be confronted with one of two types of abstracts. The abstract to be examined will either carry, or will not carry, a notation to the effect that the probate file covering the decedent's estate includes a receipt in a given amount for estate taxes actually paid. Separate discussions of these two possible situations follow.

1. *When probate file includes a receipt for estate taxes.* While somewhat comforting, the presence in the abstract of a notation to the effect that a *closed* probate file includes a receipt for federal estate taxes actually paid would not, standing alone, necessarily mean that the section 811(a) property has been divested of the tax lien. It is possible, for example, that an executor effected distribution, made a final accounting, and was released by the probate court from his fiduciary obligation before the estate tax return which he had previously filed was actually approved by the federal authorities. Fortunately, however, two practical considerations serve to militate against this possibility, or serve to minimize its potentially serious consequences.

The first involves the many cases where the executor was not a beneficiary, the choice of a trust company being illustrative. Such an executor, if properly advised, would not have made distribution and closed the probate proceedings unless (1) it were adequately protected, as it would be, for example, in the case where it had also been named trustee and had thereby retained assets which it, and which the government, could easily reach in the event a deficiency assessment was later made, or (2) it had been absolutely sure that no question whatever would be raised with respect to the estate tax return and the amount which it paid by way of tax, there having been no serious questions whatever relating either to inclusions, deductions, or valuations. This same cautious attitude would not be expected, of course, in the case of an executor, who, for practical purposes, was the sole beneficiary, or where he was the recipient of whatever residue remained after the payment of taxes.

The second factor which serves in many cases to militate against a premature distribution by the executor concerns a common procedural sequence. Probate judges in Michigan, for example, will not

usually permit an estate to be closed until the agents of the state Department of Revenue give a clearance with respect to the state inheritance tax,<sup>39</sup> and in many cases, though not all, the local agents will not, where a federal return is contemplated, give that clearance until the federal authorities have issued a final closing letter.<sup>40</sup> In short, the local state authorities will generally postpone judgment on controversial issues where the federal authorities are involved, until the matter has been resolved by the latter. Accordingly, the fact that the probate is closed in a state such as Michigan provides some additional assurance that the receipt reflected by the abstract was for the *proper* federal tax.

But none of the factors just mentioned provide complete assurance in all cases. For example, the Michigan inheritance tax does not reach some frequently recurring types of testamentary transfers, such as joint interests which go to the survivor,<sup>41</sup> and certain types of insurance.<sup>42</sup> These are reached, however, by the federal act.<sup>43</sup> Accordingly, the local Department of Revenue may have given a clearance<sup>44</sup> and an executor who was also the sole or residuary legatee may have effected distribution and procured a closing of the probate proceeding though there may have been a real possibility that the federal authorities would later question the manner in which the executor dealt, for example, with the joint interests. A lien for the partially unpaid federal tax may then still remain on all section 811(a) property even though that section 811(a) property was itself properly reflected in the return.<sup>45</sup>

<sup>39</sup> Cf. Mich. Comp. Laws (1948) §704.56, Mich. Stat. Ann. §27.3178 (307), and Mich. Comp. Laws (1948) §205.210, Mich. Stat. Ann. §7.571.

<sup>40</sup> It is the understanding of the author that the tentative closing letter of the Revenue Agent in charge of the Detroit office is relied upon in Wayne County whereas in the outstate counties, reliance is placed on the closing letter forthcoming from Washington.

<sup>41</sup> Unreported Op. Atty. Gen., May 29, 1940. *Contra*, Op. Atty. Gen. (Feb. 28, 1925) p. 77; Op. Atty. Gen. (May 21, 1924) p. 338.

<sup>42</sup> Op. Atty. Gen. (Oct. 11, 1938) p. 519.

<sup>43</sup> I.R.C., §811(e) and (g).

<sup>44</sup> The agents of the Michigan Department of Revenue generally indicate that a probate file has been cleared by a notation to that effect on a small sticker (R.D. 380) which is attached to each probate file. After the probate judge has made a final determination of tax based on the agent's findings, the Department of Revenue has until the allowance of the final account to secure a rehearing. Mich. Comp. Laws (1948) §205.213, Mich. Stat. Ann. §7.574.

<sup>45</sup> If the *proper* tax was not paid, the lien remains, e.g., on §811(a) property even though that particular part of the gross estate was properly reflected in the return. I.R.C., §827.



Since a notation in the abstract pertaining to a receipt for the federal tax is not perfect assurance that there is no lien—particularly in those cases where the executor is someone other than a trust company, a cautious title examiner, when dealing with section 811(a) property, may feel warranted in noting an exception in his opinion and in calling for additional assurance.

Such a lawyer might go on to indicate that his client should be satisfied with any one of the following:

(1) A certified copy of the closing letter which the executor may have received from the federal authorities if, in truth, the former's return had been approved. Unfortunately, such letters are seldom found in the probate files;<sup>46</sup>

(2) An affidavit from the executor to the effect that such a letter had been received but had been destroyed or misplaced;<sup>47</sup>  
or

(3) A certificate from the government releasing the lien.<sup>48</sup> While this requires action in Washington, such a release under these circumstances is usually forthcoming within one to two weeks from the date of the application.<sup>49</sup>

Assume now a slight change in facts, namely, that the property covered by the type of abstract in question is being purchased by the third party before the probate proceeding is closed. Even though a return has been filed and a receipt given to the executor, the title examiner should still call for one of the three types of assurance just noted, or, in the alternative, for an order from the probate court to the effect that the property is being sold in order to pay claims against the estate in an amount equal to the sale price—if such is the case.

(2) *When probate files do not include a receipt for a federal estate tax.* Going back to cases where the probate proceedings are closed, assume now that the abstract does not affirmatively indicate that the probate file includes a receipt for estate taxes. How should

<sup>46</sup> Would not attorneys be contributing to a solution of the problem created by estate tax liens if they would arrange to see that a certified copy of such letter is placed in the probate files—even if the probate proceeding itself is closed? It should be understood, however, that a closing letter from the government would not preclude a subsequent assessment on after-discovered assets.

<sup>47</sup> In such case, the title examiner is, of course, relying on the honesty of the executor.

<sup>48</sup> I.R.C., §827(a); U.S. Treas. Reg. 105, §81.86.

<sup>49</sup> This represents the average with respect to requests which go through Mr. Arthur C. Smith, Revenue Agent in charge of the Estate and Gift Tax Section of the Detroit office.

the title examiner deal with the problem where his client proposes to buy what, according to the abstract, would have been section 811(a) property if an estate tax had been due?

This situation illustrates why every attorney should acquaint himself with the *exact* practices followed by local abstract companies. Otherwise he will not know whether the absence of a notation relating to a receipt for this federal tax was due (1) to the negligence of the executor in not filing a receipt which he may have received, or to the fact that no tax was in fact paid or (2) to the fact that the particular abstract company does not as a matter of normal practice reflect such receipts even where such are included in the probate file.

The discussion which immediately follows assumes, first, that the abstract company, perhaps because of suggestions from members of the bar, follows the practice of reflecting the existence of such receipts when they are included in the files, and second, that the probate proceeding has been closed. Can the title examiner rightly assume, without further exploration, that no tax was owing? A negative answer is clearly indicated. One can be sure that at least some executors have not filed returns even though such should have been filed. A given executor, for example, may have resolved certain doubtful tax questions in favor of the estate, and by this means may have avoided making a return.

There is, however, certain collateral information to which the title examiner may look for added assurance that a tax is not owing. For example, in Michigan, while most abstract companies do not reflect an item by item account of the entire inventory undergoing probate, they sometimes do reflect its total value. Those valuations will be of some slight aid at least in determining whether or not a return should have been filed. Further assurance would be derived, because of the reliability of the Michigan inheritance tax procedure, if the abstract showed either that no inheritance tax had been paid, or that only a small inheritance tax had been paid. But again, none of this collateral information affords complete assurance that the federal lien, if such did exist, has been fully discharged. The valuation of the inventory, even if one should make the bold assumption that it is completely reliable for federal tax purposes, will not, as previously noted, cover a number of interests which may be properly included for federal purposes in a gross estate. Nor, as previously noted, does the local inheritance tax in Michigan reach all of the

testamentary transfers which are covered by the federal act, and it is possible, therefore, that a sizeable federal tax is due whereas only a small inheritance tax was assessed.

Once again, then, the really cautious title examiner would, as a theoretical matter, note an exception in his opinion, and might perhaps go on to suggest that particular steps be taken in order to obtain added assurance. His problem, with reference to the steps which he might suggest, differs somewhat from the previously discussed case where a return had been filed and some federal tax paid. It is the impression of the writer that the Bureau of Internal Revenue would not be as sympathetic to a request for a release of possible liens in cases where a return had not been filed, and none was contemplated, as it is in the instance where its auditing procedures will at some stage be brought to bear on a filed return. Accordingly, the title examiner might suggest either of the two following steps:

(1) That the estate be requested, first, to file a return, though none was actually required, and second, that the filing be accompanied by a request for a release of possible liens on the particular property in question; or

(2) That an affidavit be procured from the executor explaining the absence of a return and bearing specifically on the question of whether to his knowledge there were transfers which did not go through probate but which would be properly included in a gross estate for tax purposes. If such other interests, for example, joint interests, are identified in the affidavit, their values can be added in a state such as Michigan to the values reflected in the local Michigan inheritance tax work sheet,<sup>50</sup> a permanent insert in the probate file. This total figure would be of some aid in determining the probability that an estate tax might be owing. In this connection, it should be observed that a federal tax will generally be owing in the case of a single man only if the net estate exceeds \$60,000,<sup>51</sup> and, in the case of a married man whose wife takes non-terminable interests equal to one-half of the value of the estate, only if the net estate exceeds \$120,000.<sup>52</sup>

<sup>50</sup> R.D. 206, Michigan Department of Revenue.

<sup>51</sup> The additional estate tax provided for by I.R.C., §935 allows only a \$60,000 exemption.

<sup>52</sup> This includes the \$60,000 exemption allowed by I.R.C., §935(c), and the marital deduction allowed by I.R.C., §812(e).

The steps which have been outlined might also be used if the client proposes in the case under consideration to buy section 811(a) property *before* the probate proceedings are closed, unless, of course, an order is forthcoming from the court to the effect that the sale is being made in order to satisfy claims against the estate, or to pay the expenses of administration, which are equal to the sale price.

### C. *Title Examiner's Problem Re "Non-Section 811(a) Property"*

In discussing the impact of the estate tax lien on non-section 811(a) property, e.g., gifts made in contemplation of death, it was noted that third parties are protected only where their acquisition satisfies the language "sold . . . to a bona fide purchaser for an adequate and full consideration in money or money's worth."<sup>53</sup> Since the general implications of identical language were considered in the discussion of the *gift* tax lien above,<sup>54</sup> further reference to such will not be made here other than to note that the Gift and Estate Tax Acts are usually said to be in *pari materia*.<sup>55</sup>

### *Conclusion Re Estate Tax Lien*

In concluding this analysis of the estate tax lien, it is to be observed that the discussion indicated always that it was the *cautious* title examiner who might want to suggest that additional steps be taken under various circumstances in order to provide complete assurance that a lien did not actually exist against particular property which his client proposed to buy. The emphasis on the word cautious was due, first, to the realization that the individual title examiner must in the end be the final judge, and that title examiners will differ as to the amount of reliance they will place on the fact, e.g., that a trust company acted as executor in a given estate, just as they will differ in their reaction to the pressures which frequently exist to close a transaction. In arriving at a final judgment as to the precautions to be taken in a given case, the title examiner might also consider certain relevant statistics. For example, with respect to property located in Michigan, the federal government has not had occasion since 1943 to enforce any estate tax lien after the property to which

<sup>53</sup> I.R.C., §827.

<sup>54</sup> *Supra* p. 326 et seq.

<sup>55</sup> *Estate of Sanford v. Commissioner*, 308 U.S. 39, 60 S.Ct. 51 (1939).

such may have attached had been acquired by a third party.<sup>56</sup> Nor since that date, and after such an acquisition, has any instance involving enforcement of liens of this type been litigated before any court of this country the reports of which are published. There are perhaps several reasons for this. But the most important is that most executors do file a return where such is required, and should the audit justify a deficiency, the government can proceed against the fiduciary in his fiduciary capacity,<sup>57</sup> the fiduciary in his individual capacity,<sup>58</sup> and the original gratuitous transferees,<sup>59</sup> the lien on the property, if the latter is now in the hands of a third party, being the last, that is, a fourth resort.

<sup>56</sup> This was the recollection of Arthur C. Smith, Revenue Agent in charge of the Estate and Gift Tax Section of the Detroit office.

<sup>57</sup> I.R.C., §822(b).

<sup>58</sup> I.R.C., §827(b); U.S. Treas. Reg. 105, §81.99. This can be avoided by complying with I.R.C., §825(a).

<sup>59</sup> I.R.C., §827(b).