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THE TAX LAWYER

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### When Estates Don't Pay Tax, IRS Chases Beneficiaries

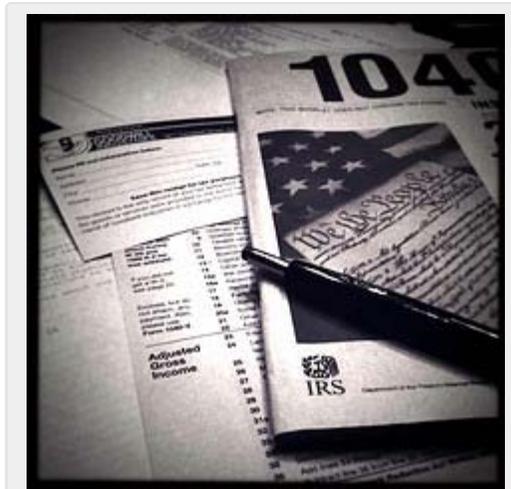
When you inherit money or property you shouldn't have to pay taxes. It's not subject to income tax. Plus, if there's an inheritance tax to pay, the estate or person giving it to you has already paid it or provided for its payment.

At least that's how it's *supposed* to work. But what if it turns out the estate tax was not paid, or there's an audit and the estate owes more?

That's what happened to Anna Smith's four children after she died in 1991. See [\*U.S. v. Mary Carol S. Johnson\*](#).

The executors filed a federal estate tax return showing her estate was worth \$15,958,765, with a federal estate tax liability of \$6,631,448. But the estate elected a ten-year installment payment of the tax due, a choice that's available when certain conditions are met.

The bulk of Anna Smith's estate was stock in Stateline Hotel worth \$11,508,400. When the estate distributed the stock, the beneficiaries had to sign an agreement acknowledging that some of what they received would later have to go for taxes. They would pay their share, they agreed.



(Photo credit: David Reber's Hammer Photography)

Three years later in 1995 the IRS sent a bill to the estate claiming the hotel stock was not worth \$11.5M but rather \$15M. The estate eventually settled with the IRS and agreed to pay additional estate tax of \$240,381. That brought the total estate tax to \$6,871,829. Still, the estate was liable for it and was going to pay in installments.

Unfortunately, in January 2002, the hotel went bankrupt and its stock became worthless. In 2003, after having paid \$5M of the total amount due, the estate defaulted on its tax debt. Did the IRS say OK? Nope, it came after the heirs for the rest.

Can you be personally liable as a beneficiary? Yes. Section 6234(a)(2) of the tax code lists six ways you can be on the hook. Several big ones: “transferee,” “trustee,” and “beneficiary.”

The IRS argued the heirs were transferees, but the transferee statute only covers transfers immediately after death, not later as occurred here under a trust agreement. Then the IRS said they were beneficiaries, which they clearly were. Under a technical reading, though, the court ruled they were not liable under this provision.

What’s more, the court ruled that the IRS was too late to collect from most of the heirs since the [statute of limitations](#) had run. The only ones the IRS could pursue were the two heirs who had acted as personal representatives. Under [31 USC 3713\(b\)](#), a representative of an estate that pays an estate’s debt before paying the IRS is liable if the government doesn’t get its due.

Thus, if an estate has insufficient assets to pay its debts, a personal representative must pay the IRS first. If he doesn’t, the personal representative has personal liability. Here, the two contended they didn’t know the assets were insufficient.

After all, everything looked rosy when they handed out the stock. The bankruptcy came later. But the court said that was tough.

For more, see:

[Whitney Houston’s Death and Taxes](#)

[‘Sick Lawyer’ Excuse Not Enough To Escape IRS Penalties](#)

[Home Mortgage Interest Deduction is Pure Poetry](#)

[How To Report Foreign Gifts And Bequests To IRS](#)

[How Mark Zuckerberg's Taxes Change Now That He's Married](#)

['Aggressive' Tax Returns Can Mean Fraud](#)

[Even The IRS Has Time Limits](#)

[IRS Mines Real Estate Deeds To Collect Gift Tax](#)

[Dying To Know About Estate Tax?](#)

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