



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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MEMORANDUM FOR DISTRICT COUNSEL HOUSTON

FROM: Alan C. Levine
Chief, Branch 1 (General Litigation)

SUBJECT:

LEGEND:

Taxpayer (Donor) X
Donee Y
Amount \$Z

This is in response to your memorandum of September 9, 1999, regarding the above subject. The questions you raised concern the application of I.R.C. § 6324(b).

ISSUES:

1. Whether donee liability under section 6324(b) may be imposed where the Internal Revenue Service (Service) has asserted a deficiency for additional gift tax against the donor with respect to unreported transfers of property to third parties while the case is pending in the Tax Court.
2. What is the Service's current policy with respect to the assertion of donee liability under section 6324(b).

CONCLUSION:

The Service may impose personal liability against a donee pursuant to section 6324(b) while a deficiency proceeding is pending in the Tax Court as a result of the Service's assertion of additional gift tax liability against the donor but it will have to await the court's decision to ascertain the amount of that liability. It is the current

policy of the Service to pursue donee liability only where it appears that collection from the donor is not possible.

FACTS:

X the donor, died on _____ On October 14, 1997, the Service issued a notice of deficiency to the executor and temporary administrator of the estate of X for federal gift tax relating to transfers made by X during the _____ taxable year. The Service had determined, among other things, that during _____, X had made taxable gifts of to Y. The Service also determined that during that same year, X made a taxable gift of real property valued at \$ _____ to, a _____, married Y subsequent to having made the taxable gifts to her in _____

The decedent filed his _____ gift tax return on or about _____. None of the above-mentioned gifts were reported on the _____ gift tax return. Neither Y or _____ were listed as donees of any gift reported on the _____ return. Although the amount of tax shown on the _____ gift tax return was fully paid with the filing of the return, the Service, however, increased the amount of the decedent's taxable gifts and asserted a deficiency in gift tax for the _____ year. The donor's estate filed a petition with the Tax Court _____ in response thereto.

Prior to the decedent's death, a great majority of his assets were transferred into the donor's Living Trust, leaving his estate nearly devoid of assets. The decedent's son, _____, is the primary beneficiary of the trust and the decedent's long-time _____ is the trustee. The Service has not yet taken any steps to assert transferee liability against the trust for the decedent's unpaid gift tax liabilities.

The estate contends that it has no funds and that the remaining assets of the living trust are insufficient to satisfy the outstanding gift tax liabilities. Consequently, the estate believes that the Service should assert donee liability under I.R.C. § 6324(b) against both Y and _____ for the unpaid _____ gift tax liabilities.

Y filed a petition in bankruptcy under Chapter 11 of the Bankruptcy Code on _____. The bankruptcy case is currently pending and the Service did not file a proof of claim for her gift tax liability since the Service was not asserting gift tax liability against Y at time her petition was filed. The period for filing a proof of claim has expired and the plan has been confirmed. Bankruptcy Code § 507(a)(8) governs the priorities of tax claims in bankruptcy. Unlike subsection (8)(A) which refers to income or gross receipts taxes, subsection (8)(E) provides for the priority of excise taxes under which category gift taxes fall. In re Grynberg, 986 F.2d 367 (10th Cir. 1993). Pursuant to subsection (8)(E)(i), priority is awarded to a gift tax where the transaction (gift) occurs within three years prior to the date the petition is filed. In the instant case, the gifts to Y were made between _____ and _____. Thus, except for any gifts that Y may have been given to Y between _____

, all the other gifts would fall within the three year period prior to the petition date and the gift taxes arising therefrom would constitute nondischargeable taxes. One caveat that must be considered is that B.C. § 507(a)(8) does not state that the priority afforded the government applies not only to the debtor (who is usually the taxpayer) but to transferees of the debtor as well. However, the legislative history of that section leads us to believe that the same result would apply in the case of a transferee. See, Statement of Senator DeConcini, 124 Cong. Rec. S17429 (daily ed., October 6, 1978). As just stated, it is too late for the Service to collect these taxes from the bankruptcy estate since no proof of claim was filed. In addition, the gift tax lien provided by section 6324(b) is an unrecorded lien, unlike a notice of federal tax lien, and can be avoided by the bankruptcy trustee. B.C. § 545(2). However, the tax liability will survive the bankruptcy and will be collectible from any after-acquired assets. In this regard, presently there is an adversary proceeding in which Y has filed suit against the decedent's son, , to contest the share of donor's estate to which she claims to be entitled. If she is successful in that litigation, there may exist ample funds to satisfy her gift tax liability after having satisfied all the bankruptcy claim creditors. Pursuant to B.C. § 1141(d)(1)(A), the confirmation of Y's Chapter 11 plan entitled her to a discharge from her prepetition debts. Accordingly, the automatic stay was no longer in effect following confirmation of her plan. B.C. § 362(c)(2)(C).

LAW AND ANALYSIS:

ISSUE 1:

I.R.C. § 6324(b) provides another source of collection for the gift tax when that tax cannot be collected from a donor, i.e., it imposes personal liability upon the donee. Section 6324(b) reads as follows:

Except as otherwise provided in subsection (c), unless the gift tax imposed by chapter 12 is sooner paid in full or becomes unenforceable by reason of lapse of time, such tax shall be a lien upon all gifts made during the period for which the return was filed, for 10 years from the date the gifts are made. 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. Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a purchaser or holder of a security interest shall be divested of the lien imposed by this subsection and such lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a purchaser or holder of a security interest.

I.R.C. § 6151 provides for the time and place for paying the tax shown on a return. Subsection (a) thereof states the following:

General Rule – Except as otherwise provided in this subchapter, when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, pay such tax to the internal revenue officer with whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

See also, Treas. Reg. § 25.6151-1.

The liability of a donee arises as soon as the donor fails to pay the tax when due, and the liability is not contingent upon a determination of a deficiency against the donor. Mississippi Valley Trust et al. v. Commissioner, 147 F.2d 186 (8th Cir. 1945). In that case, the period of limitations for asserting a deficiency against the donor had expired. The argument by the donee there was that the donor's liability for the tax was primary and that of the donee secondary, and that no liability should, therefore, exist against a donee for any part of a tax which a solvent donor has not admitted in his return, until there has been a deficiency determination against the donor in the manner and time provided by the statute. ^{1/} However, as noted by the Eighth Circuit, the statute itself imposes the tax, fixes its amount, and prescribes the date when the payment thereof is legally due. "If the full amount of the tax thus imposed is not paid by the 15th day of March following the close of the calendar year, the tax has not been paid 'when due,' and the unpaid portion bears interest from that date. And, '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'." Id at 187. According to the court of appeals, "Nowhere in its language does the statute make the liability of the donee contingent or dependent upon a formal determination of deficiency against the donor or upon any other steps to collect from him. . . . Where there have been no proceedings against the donor, the donee is afforded a full opportunity to contest the validity and the amount of the tax, under the provision in the transferee section of the statute for assessing and collecting his liability in the same manner as in the case of a deficiency." Id at 188.

In the present case, the Service has alleged that the donor, _____, made gifts during _____ that were not reflected on the gift tax return filed by his estate. The tax shown on the _____ return was paid in full with the return. Pursuant to I.R.C. § 6151, the tax was "due" when the gift tax return was due to be filed, i.e., on _____ . (I.R.C. § 6075(b)(1)). Had the donor not paid the gift tax shown on the return, the donee here, Y, would have been liable only, to the extent of value of the gifts she received, for the amount shown on that return assuming the Service

^{1/} Although the tax in Mississippi Valley was governed by the provisions of Title III of the Revenue Act of 1932, 26 U. S. C. A. Int. Rev. Act. P. 580, et seq., the result would be the same under section 6324(b).

had not asserted a deficiency. However, since the Commissioner asserted a deficiency with respect to that return, we believe that the words of the statute, section 6324(b), “If the tax is not paid **when due** . . .” (emphasis ours) refer to the amount of the deficiency asserted. Although, the court in Mississippi Valley held that the donee’s liability is not contingent upon a “formal determination of a deficiency against the donor or any other step to collect from him,” it would be more prudent to await the Tax Court’s decision regarding the amount of that deficiency, if any, prior to taking steps to collect the amount of the deficiency asserted by the Service. The period of limitations pursuant to section 6901(c) for asserting transferee liability against an initial transferee such as Y is one year after the expiration of the period of limitations for assessment against the transferor. The total tax due at the time of filing of a gift tax return includes the amount shown on the return, plus the amount of the deficiency. As noted by the court in Mississippi Valley, citing section 1011 of the Internal Revenue Code of 1939, “the term deficiency means ‘the amount by which the tax imposed by this chapter exceeds the amount shown as the tax by the donor upon his return’.” Id at 187. Until the Tax Court redetermines the amount of gift tax liability in the present case, there has been no final determination of the additional gift tax due for 1993. The facts in Mississippi Valley do not reflect whether the donor actually paid the amount of gift tax shown on the return either prior to, or subsequent to the time the Service alleged that a deficiency existed. However, as stated above, in the present case, the tax shown on the donor’s gift tax return for _____ was paid prior to the issuance of the notice of deficiency. In any event, we do not view the fact of payment of the amount of gift tax shown to be due on the return as negating the donee’s personal liability under section 6324(b) or section 6901 where the Service could assert a deficiency.

Pursuant to section 6215(a), “If the taxpayer files a petition with the Tax Court, the entire amount redetermined as the deficiency by the Tax Court which has become final, shall be assessed and paid upon notice and demand from the Secretary. No part of the amount determined as a deficiency by the Service but disallowed as such by the decision of the Tax Court which has become final, shall be assessed or collected by levy or by a proceeding in court with or without assessment.” Section 6215(a) clearly is applicable to the donor’s liability, not that of the donee since it was the donor here who petitioned the Tax Court for review. Thus, although Y, as donee, is not the party who is contesting the notice of deficiency in the Tax Court, she is, nevertheless, pursuant to section 6324(b), personally liable for the gift tax but the amount of her liability generally should await the finality of the Tax Court’s decision.

Based upon the foregoing discussion, we are of the view that Y, the donee, is liable, to the extent of the value of the gifts she received during _____ for the amount of gift tax asserted as a deficiency for the gift tax return due for that year. Considering, as stated earlier, that the estate has challenged that deficiency in the pending Tax Court case, the extent of Y’s liability will be determined by the

outcome of the case, i.e., as prescribed by section 6324(b), she will be personally liable only to the extent of the value of the gifts she received assuming the Service's deficiency notice is upheld by the court.

ISSUE 2:

As a rule, the Service will not attempt to assert donee liability under section 6324(b) until all efforts to collect from the donor have been exhausted. IRM § 4582.21 states that "Except as provided . . . every effort should be made to assert the tax liability against the transferor within the period of limitation. However, if a deficiency in tax is determined in the case of the transferor and the period of limitation has expired, the deficiency should be asserted against the transferees (or fiduciary) within the statutory period of limitation applicable to them." Section 6324(b) renders the donee personally liable for the gift tax if it is not paid by the donor. Although there exist two separate methods for collecting gift tax liability against a donee, i.e., the foreclosure of the section 6324(b) lien or the assertion of transferee liability under section 6901, the collection procedures set forth in the statute are not exclusive and mandatory but are cumulative and alternative to other methods of tax collection recognized and used prior to enactment of that statute and its predecessors. United States v. Russell, 461 F.2d. 605 (10th Cir. 1972). (Note that although Russell involved estate tax liability, the result would be the same for gift tax liability since sections 6324(a) and 6324(b) are similar.

For example, in Ripley v. Commissioner, 102 T.C. 654 (1994), the Service attempted to collect the gift taxes owed from the donee pursuant to the liability established under section 6324(b). Simultaneously, the Service issued the donee a notice of transferee liability pursuant to section 6901 and the donee filed a petition with the Tax Court for redetermination of the liability. The donee filed a motion to restrain collection under section 6213(a). Section 6213(a) permits the Tax Court to restrain assessment and collection of a deficiency in cases where "a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition." According to the Ripley court, normally the Service's collection efforts will be enjoined where it is attempting prematurely to collect a deficiency that is the subject of a timely filed petition for redetermination. See Meyer v. Commissioner, 97 T.C. 555 (1991). However, citing Treas. Reg. § 301.6324-1(d) which provides that the general tax lien under section 6321 and the special gift tax lien under section 6324(b) are not exclusive of each other but are cumulative, the Tax Court in Ripley concluded that the Service could collect the gift tax from the transferee (donee) without having made a prior transferee assessment pursuant to section 6901.

In La Fortune v. Commissioner, 263 F.2d 186 (10th Cir. 1958), one of the issues concerned a question of transferee liability for gift taxes. It was agreed that the donors were solvent but that the statute of limitations barred collection against them. Although all of the gift tax cases had been consolidated, in four of the cases

presented, the assessments were made against donees of gifts out of which none of the claimed deficiencies arose.

According to the Tenth Circuit, the liability of the donee as transferee for unpaid gift tax of his donor is clearly established by statute but such liability is limited to the value of the gift received. Such liability has been repeatedly upheld by the courts. Solvency or insolvency of the donor is immaterial and assertion of a deficiency against the donor is not required. The statute, *i.e.*, present section 6324(b), clearly imposes the liability on any donee of a gift made during the year and the fact that a deficiency exists because of a gift to another makes no difference. In La Fortune, the donees claimed that the notice of transferee liability did not prorate the liability. However, in the Tenth Circuit's view, that is of no concern since the statute makes each donee liable to the extent of his gift. See also, Tilton v. Commissioner, 88 T.C. 590 (1987).

The present situation is similar to that before the United States Claims Court (now Court of Federal Claims) in Murray v. United States, 687 F.2d 386 (Ct. Cl. 1982). In that case, the plaintiffs, who represented the estate of the donor, believed that because the transferees (donees) represented an available source of payment, somehow the estate was absolved of any responsibility for the delinquent gift taxes. According to the court, "the plaintiffs' argument fails to recognize that even though the transferee liability provision causes a donee to be immediately and directly liable for the gift tax should the donor fail to pay the tax when due, section 6901(a)(1)(A)(iii), this does not prevent the IRS from seeking payment from the donor." As further stated by the court, "There is nothing in the Code requiring the IRS to obtain recovery from the donees in lieu of attempting to secure payment directly from the assets of the donor's estate. For this reason, we find that the IRS acted completely within its prerogative in assessing and collecting the unpaid gift taxes from Oliver's estate." *Id* at 393. Thus, based upon the foregoing discussion, we conclude that a donor has no right to insist that the Service pursue collection against a donee for the donor's unpaid gift taxes.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:





If you have any further questions, please do not hesitate to call us on 202-622-3610.