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From: [REDACTED]

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To: [REDACTED]

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Subject: FW Probate case assignment

This responds to your office's request for advice on a case involving the failure of a probate court to pay a claim filed by the Internal Revenue Service. You have asked whether the Service is bound by the probate court's decision to not pay the claim, which should have been paid ahead of the claim of a competing secured creditor based on priority principles established under section 6323 of the Internal Revenue Code, and whether the Service might be able to recoup the amount erroneously paid out.

Initially, we note that it appears to be undisputed that the Service's claim was, under section 6323, superior to that of the competing creditor. Moreover, this is a case to which the federal insolvency statute, 31 U.S.C. § 3713, arguably applies. Per section 3713(a)(1)(B), claims of the United States shall be paid first when the deceased debtor's estate, in the custody of an executor, is not large enough to pay all of the debtor's debts. Thus, in a case like this one, where the estate was unable to pay all the debtor's debts, the executor should have paid the tax claim ahead of the other creditor's claim. See United States v. Bielaski, 360 Md. 67 (2000)(probate court's determination that IRS's claim should be paid pro rata, as opposed to being paid in full, was erroneous under the insolvency statute).

Section b of section 3713 provides that an estate's representative violating section 3713(a) will be personally liable to the extent of the incorrectly made payment. In addition to the liability imposed by section 3713, liability for breach of fiduciary duty may exist under relevant state law. However, despite the potential applicability of these authorities in this case, the Service appears to have waived its right to challenge the executor's incorrect action since the government did not object to or appeal the determination that the other creditor should be paid ahead of the Service. If the government were to file suit for breach of fiduciary duty, the executor would most likely have a viable defense -- that a fiduciary has no personal liability when the government becomes a party to the proceeding by filing a claim, receives notice of the distribution, and does not object, all of which occurred in this case. See United States v. Muntzing, 69 F. Supp. 503 (N.D. W. Va. 1946); United States v. Pate, 47 F. Supp. 965 (W.D. Ark.

1942). See also United States. v. Vibradamp Corp., 257 F.Supp. 931, 936 (S.D. Cal. 1966) (court, citing Muntzing, held that when the United States has a claim against a decedent's estate because of a preexisting debt of the decedent, the government may content itself with notifying the executor, look to him to preserve the priority accorded by statute, and otherwise ignore the probate proceedings, or it may file and prosecute its claim in probate court the same as any other creditor, and if it does so, the government is bound by the determination of the probate court.).

Here, because the government participated in the probate case, the government probably waived its right to now challenge the probate court's final determination regarding the Service's claim. Thus, as noted above, an action against the executor under either the insolvency statute or state law would probably not be successful. Moreover, alternative bases of recovery (quiet title, levy) are not applicable to this situation since the competing creditor is not in possession of tangible property of the taxpayer. We recommend as a "best practice" that the Service either refrain from any participation in a probate proceedings involving a taxpayer (thus preserving its right to potentially sue the executor for distributing assets in violation of section 6323 and/or the insolvency statute), or participate fully in the proceedings, objecting to proposed distributions and appealing adverse determinations as appropriate.

If you have questions or concerns regarding this advice, please feel free to contact Branch 3 or Branch 4 of P&A..