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Dying to Get Out of Taxes

Fiduciary held liable for distributing assets prematurely.

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In *United States v Kelley*, Case No. 3:17-cv-965-BRM-DEA (Oct. 22, 2020), the District Court of New Jersey addressed in an unpublished opinion the liability of a deceased executor for unpaid estate tax. Finding that the deceased executor distributed the estate assets to himself, as beneficiary, with knowledge of unpaid

estate taxes, the court granted the motion of the United States for summary judgment against the estate of the executor and the executrix of the executor's estate.

Unfinished Business

Lorraine M. Kelley died on Dec. 30, 2003. A Form 706, reporting a gross estate of over \$1.7 million and an estate tax liability of \$214,412, was timely filed by the co-executors of her estate, Richard Saloom (her brother and sole beneficiary) and Richard K. Leckey.

As a result of an examination of the Kelley estate beginning on Oct. 28, 2004, an additional tax liability of \$448,367 was imposed, for a total tax of \$662,780, based on a corrected gross estate of over \$2.6 million. On June 27, 2006, Saloom, as co-executor, consented to the additional tax.

In late 2007, Saloom, who had already received many of the estate assets, entered into an installment agreement with the Internal Revenue Service pursuant to which several "significant payments" were made. By the end of 2007, the co-executors had transferred the entirety of the Kelley estate assets (\$2.6 million in property) to Saloom, as the sole beneficiary of the estate.

Saloom died on March 21, 2008, leaving an estate valued at over \$1.1 million. His daughter, Rose, as the executrix, filed a New Jersey inheritance tax return listing a debt of \$456,406 for "federal tax." Rose distributed all of the Saloom estate property to herself, as sole beneficiary.

As of Sept. 2, 2019, the Saloom estate no longer held property, Rose no longer held any property of the Saloom estate and the total unpaid estate tax liability for the Kelley Estate was \$688,644.

On Feb. 10, 2017, the United States filed a complaint against Rose and the Saloom estate for, in relevant part, transferee liability against the Saloom estate, fiduciary liability against the Saloom estate and fiduciary liability against Rose. On March 5,

2020, the court considered plaintiff's motion for summary judgment on the transferee and fiduciary liability of the Saloom estate and the fiduciary liability of Rose, and on Oct. 22, 2020, granted summary judgment on all three counts.

Transferee Liability of Saloom Estate

When an estate fails to pay its federal taxes, Internal Revenue Code Section 6324(a) (2) imposes personal liability on the transferees of such property based on the value of the property received. Finding that an outstanding estate tax liability remained while \$2.6 million of Kelley estate assets were transferred to Saloom, the court granted plaintiff's motion for summary judgment for transferee liability against the Saloom estate.

Fiduciary Liability of Saloom Estate

The federal insolvency statute, IRC Section 3713, imposes personal liability on an executor who disburses estate funds to creditors before paying a claim of the United States, to the extent of such disbursements. Such personal liability requires the establishment of three elements: (1) the fiduciary distributed estate assets, (2) the distribution rendered the estate insolvent, and (3) the distribution occurred after the fiduciary had actual or constructive knowledge of the liability for unpaid taxes.

Section 3713 is construed liberally in favor of securing revenue for the United States. Therefore, a fiduciary who's distributed all of the assets of an estate to the heirs of the estate may be found liable for rendering an estate insolvent.

The court found that Saloom distributed \$2.6 million of Kelley estate property to himself, rendering the Kelley estate insolvent. In addition, the court found that Saloom had "at least constructive knowledge" of the estate tax liability, that a "reasonably prudent person" would inquire into the existence of tax liability on a \$2.6 million estate and that, by entering into an installment plan with the IRS, Saloom indicated that he had knowledge of the outstanding tax liability. Therefore,

the court granted the motion for summary judgment for fiduciary liability against the Saloom estate.

Interestingly, the court satisfied the knowledge requirement with two findings, neither of which seem supported by the fact pattern. Note that in establishing the elements of Section 3713, the government must demonstrate that the fiduciary had knowledge of the unpaid tax liability *before* making the contested distributions. Here, the court relied on the installment plan entered into in the end of 2007, after the majority of the assets had been transferred from the estate. Based on the sequence of events, the fact that Saloom explicitly consented to additional tax in 2006 seems to be a stronger support for Saloom's timely knowledge.

In addition, the court relies on the instinctive recognition of a "reasonably prudent person" that a \$2.6 million estate would have tax liability. However, Saloom, as co-executor, filed a timely estate tax return in 2004 reporting a taxable estate and an estate tax liability. A reasonably prudent executor filing an estate tax return would seemingly expect tax liability equal to the reported tax liability, rather than triple that amount. Seemingly, the court could have made a stronger argument by emphasizing the 2004 audit (of which the co-executors were surely aware) when most of the Kelley assets were presumably still held by the estate, which would reasonably be expected to result in an increased tax liability.

Fiduciary Liability of Rose

As previously described, Section 3713 imposes personal liability on an executor who disburses estate funds to creditors before paying a claim of the United States, to the extent of such disbursements. Finding that Rose distributed all of the \$1.1 million of property of the Saloom estate to herself, rendering the estate insolvent despite knowledge of her father's tax liabilities (evidenced by her periodic payments and New Jersey inheritance tax return), the court granted the motion for summary judgment for fiduciary liability against Rose.

Takeaways

Although only death and taxes are certain, taxes triumph even over death.

In advising a fiduciary-client, it's crucial to remind the executor/administrator/successor trustee of the decedent's revocable trust (repeatedly and in writing) of the importance of retaining assets until final tax returns are filed, an estate tax return (if relevant) is filed and any periods of limitation have run.

In addition, a conscientious fiduciary eager to do a superlative job in administration may be eager to pay outstanding debts. In a situation in which an estate may have insufficient assets to pay all creditors, including the United States, counsel should be sure to explain at the very outset of the administration process the potential for personal liability by the executor. An executor may (rightfully) be irate to discover that their reward for paying off the decedent's debts in a timely fashion is being personally responsible for the same amount, payable to Uncle Sam. Such executor's counsel will presumably bear the (unpleasant) brunt of such (easily avoidable) righteous wrath.

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