Marquette Law Review

Volume 51
Issue 4 *Spring 1968*

Article 5

Personal Liability Of Executors And Administrators For Decedent's Federal Tax Liability

Thomas G. Boyer

NOTE

PERSONAL LIABILITY OF EXECUTORS AND ADMINISTRATORS FOR DECEDENT'S FEDERAL TAX LIABILITY

The defendant in *Leroy K. New*[1] was a practicing attorney acting as substitute administrator for an estate of a decedent indebted to the United States for income taxes. Because he had distributed estate assets, leaving the estate insolvent, without first satisfying the debt due the United States, the Tax Court found him personally liable for those taxes under section 6901(a)(1)(B) of the Internal Revenue Code.

During the administration of the estate, the defendant attended several meetings with officers of the bank which had been the original administrator. At each of these meetings, the bank's trust officer, among others, informed the defendant that the decedent had failed to file income tax returns for the last five years of his life, and that the estate was believed to be indebted to the federal government thereby in the amount of $4,000 to $5,000. The fact that the defendant was so informed was corroborated at the trial by persons in attendance at the various meetings.

Acting upon this information, the defendant commenced an examination of bank records pertaining to the properties and investments of the decedent. The records revealed that the decedent had received taxable income from these sources, but they showed nothing about his other sources of income. In addition, the defendant questioned "some people" in the town where the decedent had owned rental property and examined records there to determine if there had been rental income. However, these examinations never divulged the full extent of the decedent's tax liability.

Without doing more, the defendant distributed all of the assets of the estate leaving the estate unable to pay the taxes due. Thereafter, he received his full and final discharge as administrator from the probate court. It was not until after the probate proceedings and after the defendant's discharge as administrator that the Commissioner made a formal claim for the taxes, seeking to hold the defendant personally liable. For his defense, the defendant relied heavily on his discharge as administrator and the entry of the final judgment. The Tax Court rejected his defense as being without merit, finding that the statutory and case law prerequisite for holding an administrator personally liable for unpaid debts owed the United States had been fulfilled.

This note is an attempt to identify and clarify those prerequisites, as defined in the past and as further clarified by the instant case.

[1] 48 T.C. 671 (1967).

The court relied on section 6910(a)(1)(B).[2] It, in effect, provides for the application of sections 3466 and 3467 of the Revised Statutes which contain three statutory prerequisites. Section 3466[3] establishes the prerequisites of *debt due to the United States* and *insolvency* and these must first be satisfied before section 3467[4] is applicable.

The debt prerequisite is fulfilled whenever there is money owing to the United States by a person or an estate. Income, gift, and estate taxes have been held to be debts to the United States.[5] For an executor or administrator charged with personal liability, the question of when a debt came into existence could be an important one where there was no formal claim for, nor assessment of, the debt made by the Government before the distribution of estate assets. If there is no debt until such action is taken, the debt prerequisite would fail. The courts have answered this question by holding that the Government is not bound to become a party to probate proceedings nor file its claim therein,[6] and that assessment is not necessary.[7] As far as taxes are concerned, a debt exists whenever a tax can legally be imposed, and the right to its collection is not contingent upon the Government's discovery of its existence nor upon other procedural steps.[8]

> The fact that the Commissioner had not determined the existence of the liability prior to the discharge of the administratrix does

[2] INT. REV. CODE of 1954, § 6901 Transferred Assets
(a) Method of Collection.—The amounts of the following liabilities shall, . . . be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:
(1) Income, Estate, and Gift Taxes.— . . . . .
(B) Fiduciaries.—The liability of a fiduciary under section 3467 of the revised Statutes (31 U.S.C. 191) in respect of the payment of any tax described in subparagraph (A) from the esatte of . . . , the decedent, . . .

[3] Revised Statutes, § 3466 (31 U.S.C. 191):
Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and affects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

[4] Revised Statutes, § 3467 (31 U.S.C. 192).

[5] Price v. United States, 269 U.S. 492 (1926), established the rule that taxes are debts to the United States. Since then a taxpayer's fiduciary was found liable for unpaid gift taxes in Want v. Commissioner, 280 F.2d 777 (2d Cir. 1960), and for deficient estate taxes in United States v. First Huntington Nat'l Bank, 34 F. Supp. 578 (S.D. W.Va. 1940).

[6] Viles v. Commissioner, 233 F.2d 376 (6th Cir. 1956).

[7] Lillia L. Morris, 36 B.T.A. 516 (1937).

[8] In United States v. Vibradamp Corp., 257 F. Supp. 931 (S.D. Cal. 1966), the court held that the Government must assert a claim before distribution of estate assets in order to satisfy the debt prerequisite of § 3466. This is a minority ruling, however, and the court seemed to confuse the debt prerequisite and the notice prerequisite. The court concluded that a fiduciary must have actual notice of the debt in order to be liable and that the Government must assert its claim before distribution in order that such notice exist.

> not alter the fact that the liability of the estate to pay the tax existed prior to such discharge and that it was due to be satisfied from the assets of the estate.[9]

Procedurally the Government need only proceed within the time set by the statute of limitations of the Internal Revenue Code.

Insolvency occurs whenever the property of the estate is insufficient to pay the debts of the decedent.[10] Thus, if an executor finds, or, as a result of his distributions (as in the case here), causes the estate's liabilities to exceed its assets, the estate is deemed insolvent within the meaning of the section.

The importance of these two prerequisites is that once met they operate to give a priority to the debts due the United States. The priority of the United States, however, does not extend to all debts owed by the debtor or estate. Valid prior liens and the expenses incurred by the settlement of an estate are superior.[11] But with these exceptions, it can be safely said that if insolvency exists, priority attaches to the debts due the United States and the fiduciary proceeds at his peril under section 3467.[12] Section 3467 supplies the third prerequisite: the *payment of other debts before satisfaction of the debts due to the United States.*

Section 3467 names executors, administrators, assignees, and other persons as those to whom it applies, and the courts have liberally interpreted the clause "other person" to include trustees in bankruptcy,[13] stockholders in complete control of the assets of an insolvent corporation,[14] and court appointed receivers.[15]

Although section 3467 provides for liability only where the fiduciary satisfies other debts in disregard of the Government's priority, the cases have based liability on the making of any distribution whatsoever.[16]

---

[9] Elna S. Evans, 12 B.T.A. 334, 338-9 (1928).

[10] Kennedy, *The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien,* 63 Yale L. J. 905, 934 (1954).

[11] An executor was not liable for discharging a valid prior lien in disregard of a debt owing the United States by selling land used as collateral for a loan to repay that loan. Union Guardian Trust Co., 41 B.T.A. 1306 (1940). In United States v. Weisburn, 48 F. Supp. 393 (E.D. Pa. 1943), the court permitted payment of settlement costs in disregard of a United States claim. The costs included the widow's exemption, administrative expenses, the costs of a headstone, advertising, filing inventory, appraiser's and attorney's fees and the accountant's commission.

[12] Alexander, *Personal Liability of Executors and Trustees for Federal Income, Estate, and Gift Taxes,* 9 TAX L. REV. 1, 6-7 (1953). § 3467 provides:
Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

[13] United States v. Kaplan, 74 F.2d 664 (2d Cir. 1935).

[14] Lakeshore Apartments, Inc. v. United States, 351 F.2d 349 (9th Cir. 1965).

[15] United States v. Crocker, 313 F.2d 946 (9th Cir. 1963).

[16] Viles v. Commissioner, 233 F.2d 376 (6th Cir. 1956); United States v. First

"The cases have not carefully considered the language in section 3467 requiring a debt payment and . . . limiting liability to other debts paid, but the dogma that either payment of debts or the making of a distribution will render the executor liable for the estate taxes seems deeply ingrained."[17] This conclusion is not limited in application to estate taxes but applies to other debts as well.

The satisfaction of these prerequisites fulfills the statutory requirements. But to hold a fiduciary liable at this point would place an impossible burden upon him.[18] To avoid holding the fiduciary liable for disregarding debts to the United States which were unknown to him at the time of distribution, the courts developed the additional requirement that unless the fiduciary had *notice of the debt* due to the United States, he would not be liable under section 3467. Since *United States v. Clark*,[19] one of the first cases so holding, the courts have relieved fiduciaries where no notice existed.

In *Irving Trust Co.*[20] the court relieved a trustee in bankruptcy who was charged under section 3467. No notice was found, since the debt due the Government was not shown in any of the records of the bankrupt nor revealed in an oral examination of witnesses. Other courts have reached the same results under similar circumstances.[21] And when there is no notice, the cases lead to the conclusion that the fiduciary is under no duty to search for or make an inquiry about a possible debt to the United States.[22] One case holds in this regard that there is no duty to recall past contracts with the Government and inquire

---

Huntington Nat'l Bank, 34 F. Supp. 578 (S.D. W.Va. 1940); United States v. Monroe, 65 F. Supp. 213 (W.D. Pa. 1946).

[17] Alexander, *supra* note 12, at 15.

[18] An executor would find himself in a dilemma whenever he desired to distribute assets. For instance, if the deceased taxpayer filed a deficient tax return, one in which the tax imposed exceeded the amount shown as the tax by the taxpayer on his return, even a prudent executor may be unable to discover the existence of the debt due. He would then be forced to delay distribution until the three year limitation for assessment had passed or risk liability. The same dilemma exists where the deceased taxpayer failed to file returns or failed to pay the tax due. The government has in the past charged fiduciaries with liabilities under such circumstances. Giovaninni Terranova, 12 P-H T.C.M. 1186 (1943); United States v. Purdome, 240 F. Supp. 221 (D. Mo. 1963).

[19] 25 F. Cas. 447 (No. 14,807) (C.C.D. N.Y. 1826).

[20] 36 B.T.A. 146 (1937).

[21] Where the defendant was trustee of an insolvent company and he distributed the assets before he was informed of the debt to the United States, the court found there was no notice. The only evidence of the debt was a carbon copy of a letter found in the Government files addressed to the defendant, informing him of the debt, but there was no showing of the posting or reception of the letter. The trustee was not liable. Livingston v. Becker, 40 F.2d 673 (D. Mo. 1929). Similar results were reached when the Commissioner determined a tax liability by an examination of the decedent's bank deposits after the executor had distributed the assets. The executor had no notice. Giovaninni Terranova, 12 P-H T.C.M. 1186 (1943).

[22] "But the petitioner was under no duty to seek out unknown creditors of the bankrupt." Irving Trust Co., 36 B.T.A. 146, 149 (1937).

whether money is still owing under them when no facts exist which would indicate there was such a debt.[23]

Notice, the fourth prerequisite, has been found to exist in two different forms, actual and circumstantial notice. Actual notice is actual knowledge or actual awareness of the debt. If the fiduciary has such knowledge of the debt, it matters not how that knowledge was obtained.[24] Actual notice exists when a revenue agent advises a fiduciary,[25] or the Internal Revenue Service sends written notice to a fiduciary.[26] It exists when the Internal Revenue files a claim for the debt against the estate,[27] and when a proceeding for the redetermination of a tax deficiency occurs during the administration of an estate.[28] Circumstantial notice is not of the debt itself, but actual knowledge of facts which would cause a prudent man to inquire about the existence of a debt. *Clark* held it was sufficient notice if the fiduciary was in "possession of such facts as that a faithful and fair discharge of his duty would put him on an inquiry."[29] The court there imposed on the fiduciary the duty to inquire "at the proper office, to see what the debt was. . . ."[30] *United States v. Barnes* stated the rule thusly: "Information which puts a party upon inquiry, and shows where the inquiry may be effectively made is notice of all facts to which the inquiry might have led."[31] The instant case is an example of how this rule is effectuated.

The court, relying on the *Clark* case with its comparable fact situation, found that Mr. New had circumstantial notice of the debt. In *Clark* the defendant, a trustee, was informed by the assignor of a surety of a bond to the United States that the bond was believed broken. The defendant made no inquiry. It was held that such information was sufficient to put the trustee on notice and he was held liable. The trust officer who informed Mr. New was aware of the decedent's financial situation. He had known the decedent when the latter was the beneficiary of a trust administered by the bank and he had also been personally in charge of the estate before the bank was removed as administrator. In the instant case, the court decided that the unofficial information was sufficient to put a prudent man on inquiry,[32] and that it showed where such inquiry could be effectively made. Indeed, the

---

[23] United States v. Vibradamp Corp., 257 F. Supp. 931 (S.D. Cal. 1966).
[24] United States v. Kaplan, 74 F.2d 664 (2d Cir. 1935).
[25] Viles v. Commissioner, 233 F.2d 376 (6th Cir. 1956).
[26] United States v. Luce, 78 F. Supp. 241 (D. Minn. 1948); United States v. Monroe, 65 F. Supp. 213 (W.D. Pa. 1496); United States v. First Huntington Nat'l Bank, 34 F. Supp. 578 (S.D. W.Va. 1940).
[27] John H. Beasley, 42 B.T.A. 275 (1940).
[28] Lillia L. Morris, 36 B.T.A. 516 (1937).
[29] United States v. Clark, 25 F. Cas. 447, 451 (No. 14,807) (C.C.D. N.Y. 1826).
[30] *Ibid.*
[31] 31 F. 705, 707 (C.C.D. N.Y. 1889).
[32] ". . . Leroy was in possession of more than enough facts and notice as that a faithful and fair discharge of his duty should have put him on inquiry." Leroy K. New, 48 T.C. 671, 678 (1967).

defendant did conduct an inquiry, but the court deemed it an ineffective one:

> Such 'investigation and inquiry' in no way satisfies petitioner's duty. If a fiduciary is put on inquiry, the fact that he inquires wrongly or haphazardly is not enough and is no defense. To absolve petitioner because his inquiry turned out to be inadequate would be to reward the careless fiduciary and to put a premium on rapid cursory investigations. Once a fiduciary is put on notice sufficient to put a reasonable prudent person on inquiry, he thereafter pursues a *unilateral* inquiry at his peril. Any other conclusion would make the fiduciary the final arbiter of what the estate owed in tax, a result entirely nullifying all effect of 31 U.S.C. 192.[33] [Emphasis Added]

The examination of bank records and the questioning of witnesses by the defendant was termed a unilateral inquiry and was considered inadequate to discharge his duty to inquire. Presumably a bilateral inquiry would be adequate or effective, but a bilateral inquiry was not defined. In its opinion, the court did indicate that the defendant should have inquired at the local I.R.S. office and that any inquiry which did not include such a search would not satisfy the defendant's duty. The I.R.S. office was the "proper office," as required in *Clark* and the place "where the inquiry may be effectively made," according to *Barnes*. It is safe to conclude therefore that a bilateral inquiry is a search of both the debtor's records and the appropriate Government records.

Though the notice prerequisite is satisfied by a finding of either actual or circumstantial notice, the scarcity of cases which have based liability on circumstantial notice is support for the conclusion that there is a reluctance to charge a fiduciary with personal liability in the absence of actual notice.[34] At least one court has decided that to hold a fiduciary liable on the basis of circumstantial notice is to impose too harsh a rule. In *United States v. Vibradamp Corporation*,[35] the defendant, an executor of an estate of a decedent who many years before had incurred a debt to the Government through a contract, had known of the debt at the time of the contract but had forgotten about it. Nothing occurred before distribution of estate assets to refresh his memory. In denying the Government's claim, the court concluded that the fiduciary must have actual notice of the debt, by means of Government assertion of the claim before distribution, in order to hold him liable and to fulfill the debt requirement of section 3466. This conclusion appears to be in conflict with *Leroy K. New*, but the court in the latter case distinguished the two cases on the facts. It is evident

---

[33] *Id.* at 679.

[34] Alexander, *supra* note 12. One example of a finding of liability based on circumstantial notice is where the fiduciary is obliged to file the income tax return of the person for whom he acts. C. W. Posey, 20 P-H T.C.M. 368 (1951).

[35] 257 F. Supp. 931 (S.D. Cal. 1966).

that the court in *Vibradamp* was anxious to relieve the defendant because of the long period of time involved. In spite of *Vibradamp*, the rule of *New* (requiring a bilateral inquiry in event of circumstantial notice) represents the greater weight of authority.

It is important to note at this point that the Government need only prove the satisfaction of the three statutory prerequisites to establish liability. The burden of proof is upon the fiduciary to show an absence of notice.[36] This burden is satisfied by a showing of a lack of facts which would put the fiduciary on inquiry or by a showing that the inquiry he conducted included an examination of both personal records and the appropriate Government records.

The burden of making the inquiry at the proper office can be transferred to the Government by utilizing section 6501(d) of the Internal Revenue Code. It provides that a proper request for prompt assessment can be made by the fiduciary of a decedent, estate, or corporation. This has the effect of shortening the statute of limitations for assessment of tax liability from three years to eighteen months and no personal liability can be imposed for a distribution if no assessment has been made within 18 months. However, the statutory requirements for making a proper request must be followed exactly. Section 6501(d) has been very strictly construed,[37] and in only one contested case did the fiduciary successfully invoke its effect. If the debt is a deficient estate tax, the Code contains a similar section.[39] In fact one should be less hesitant to use this latter section than section 6501(d). Estate tax returns are normally audited in any event, but an unnecessary request under section 6501(d) may result in the auditing of income tax returns which would not have otherwise been audited.

THOMAS G. BOYER

---

[36] L. T. McCourt, 15 T.C. 734 (1950).

[37] The importance of making a proper request cannot be too heavily stressed. In the cases where the fiduciary was unsuccessful, the reason was lack of a proper request. The requirements of a request are set out in Treas. Reg. § 301.6501(d)-1 (1959). For an interesting discussion, compare Kohlhase v. Commissioner, 181 F.2d 331 (6th Cir. 1950) and Cage v. Commissioner, 15 T.C. 529 (1950).

[38] Kohlhase v. Commissioner, 181 F.2d 331 (6th Cir. 1950).

[39] INT. REV. CODE of 1954, § 2204 provides that if an executor requests a determination of the amount due and discharge from personal liability therefore, the executor will be notified of the amount due within one year of such request, and, upon payment of the tax, the executor will be discharged from personal liability for any deficiencies later found to be owing.