Highlights of U.S.A. v. Johnson

ACTEC Estate and Gift Tax Committee

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I. Brief Overview. The two published opinions issued by the Utah federal district court in U.S.A. v. Johnson (No. 2:11-CV-00087, 2013 BL 200401 (D. Utah July 29, 2013); No. 2:11-cv-00087, 2016 BL 399607 (D. Utah Dec. 1, 2016)), involve a number of important estate tax issues, including several of first impression. In addition to § 3713, which is not in the IRC, the legal arguments involve at least 30 different code provisions, the majority of which specifically relate to the federal estate tax (see §§ 645, 676, 1022, 2002, 2033, 2035, 2036, 2037, 2038, 2042, 2043, 2203, 2204, 2205, 2207A, 2207B, 2512, 6166, 6321, 6322, 6323, 6324, 6324A, 6325, 6501, 6502, 6503, 6504, 6901, and 7403).

II. Background. Anna Smith (the "Decedent") owned a majority of the stock in State Line Hotel and Casino, a closely-held business that used to operate in Wendover, Nevada (the "Hotel"). Prior to her death on September 2, 1991, the Decedent transferred her stock in the Hotel (the "Stock") into her fully revocable trust (the "Trust"). Following her death, the Decedent's estate (the "Estate") paid over $7 million in estate taxes plus more than $1.3 million in interest.[1] The Estate made a § 6166 election to pay the remaining tax over fifteen years (originally about $1.9 million, this balance declined as deductible interest payments were made each year).

In order to satisfy Nevada gaming laws, on December 31, 1992, the two children who served as trustees and personal representatives (the "Trustees" or "Personal Representatives") distributed the Stock, constituting most of the value of the Trust, to all four of the Decedent's children (the "Children"). All remaining assets of the Trust were distributed at that time as well. In connection with this distribution, the Children, the Personal Representatives, and the Trustees signed an agreement that the Children would be equally responsible for paying the remaining estate tax (the "Distribution Agreement").

In 1997, the IRS asked the Personal Representatives to provide a special lien under § 6324A to secure the unpaid tax because the ten-year estate tax lien under § 6324(a)(1) would be expiring. In exchange for the special lien, the IRS offered to discharge the fiduciaries from personal liability and provided directions on how to complete the process. Although the Children tendered the Stock as collateral and provided all of the documentation requested by the IRS, the Service refused to accept

[1] In this outline, "Estate" is used in a generic sense to collectively refer to the assets included in the gross estate and the fiduciaries and entities involved in paying the estate tax.

the Stock and the matter was dropped. Although the Estate continued to make the required payments, before the estate tax liability had been fully satisfied, the Hotel went into bankruptcy around 2002. This event occurred as a result of a number of factors, including the terrorist attack on September 11, 2001 that significantly impacted travel and tourism in the United States. Around 2006, the IRS made a limited attempt to recover assets from the Estate, but no assets remained.

In January 2011, after years of silence and without any separate assessment, the Government suddenly filed a lawsuit in Utah federal district court naming as defendants the Children, a daughter-in-law, and the two children as Trustees and Personal Representatives. In this lawsuit, the Government sought to recover approximately $1.6 million in unpaid estate taxes along with accrued interest for about eleven years plus future interest.

III. Government's Position. In its initial Complaint, the Government argued that the Defendants were liable under § 6324(a)(2), which creates personal liability for unpaid estate tax for several categories of persons, including "transferees," "trustees," and "beneficiaries," who have or receive property that is included in the gross estate under §§ 2034 to 2042. In particular, the Government asserted that the Defendants were personally liable based on the following theories: (1) the Children were equally liable as "transferees" and "beneficiaries" based on their status as beneficiaries of the Trust (about $400,000 each plus interest); (2) the Children were liable as "beneficiaries" based on their status as beneficiaries of a life insurance policy (about $90,000 each);[2] and (3) the Trustees were jointly and severally liable solely based on their status as "trustees" of the Trust.

In addition, the Government argued that the Personal Representatives were subject to joint and several personal liability pursuant to U.S.C. § 3713 (a non-tax code provision) for making distributions from the Estate prior to paying the full amount of the estate tax. Section 3713 imposes such liability against fiduciaries and others who are responsible to pay a federal tax outstanding, but who instead distribute assets in their possession, if that distribution causes or is made during insolvency.[3]

In an Amended Complaint filed in July 2013, the Government also argued that it was a third-party beneficiary of the Distribution Agreement and that it had a general tax lien under § 6321 enforceable against that Agreement.

IV. Defendants' Motion to Dismiss. In April 2011, the Defendants filed a motion to dismiss based on the following arguments:

[2] The Government did not actually include this claim in its initial Complaint but argued it nonetheless.

[3] The Defendants later argued that the claim under § 3713 had only been brought against the Personal Representatives, but was not brought against the Trustees who made the distributions allegedly causing the insolvency. Although the Court acknowledged that the Government had been put on notice of this potential deficiency, the Government never took any steps to resolve it.

(1) Section 6324(a)(2) Liability of Trust Beneficiaries. Based on a careful reading of the statute, trust beneficiaries are not “beneficiaries” within the meaning of subsection (a)(2). Also, although they may be transferees in general, trust beneficiaries are not “transferees” subject to personal liability under subsection (a)(2) because they are transferees of the trustees who held the property at death and subsection (a)(2) only creates liability for transferees who receive or have property on the date of the decedent’s death. See Englert v. Commissioner, 32 T.C. 1008 (1959). However, the Defendants acknowledged that beneficiaries of life insurance proceeds are “beneficiaries” for purposes of subsection (a)(2).

(2) Section 6324(a)(2) Liability of Trustees. Aside from their statute of limitations defense (see below), the Defendants offered no direct defense against this liability in the motion to dismiss.

(3) Section 3713 Liability of Fiduciaries. The Defendants argued that there was no insolvency when the assets were distributed because the Distribution Agreement constituted an asset of the Trust equal to the amount of the unpaid estate tax liability.

(4) Section 6901 Defense. The Defendants argued that § 6901 requires that estate taxes be assessed against initial “transferees” (here defined as anyone personally liable under § 6324(a)(2)) within one year after the three-year assessment period under § 6501 (essentially four years from the date of the return). They also argued that § 3713 fiduciary liability must be assessed under § 6901, although they recognized that this liability can be assessed at any time under § 6901(c)(3) as long as the collection period against the original taxpayer is still open. Defendants argued that the Court should distinguish certain case law holding that § 6901 is an alternative measure for collection (notwithstanding the use of the word “shall”) and that the Government is free to sue transferees and fiduciaries without assessment as long as the time for collection against the transferor under § 6502 (normally ten years unless suspended under § 6503) has not run.

(5) Section 6503(d) Defense. Section 6503(d) suspends the running of the statute of limitations with respect to the collection of “any tax imposed by chapter 11” (i.e., the estate tax) while a § 6166 election is in effect. As a result, the statute of limitations against an estate making such an election can be almost 25 years. However, the Defendants argued that the personal liability of transferees (including beneficiaries and trustees) under § 6324(a)(2) and fiduciaries under § 3713 are separate taxes imposed by code sections outside of chapter 11, and therefore the running of the statute is not suspended in those cases. In other words, instead of the almost 25-year collection period potentially applying to estates with 6166 elections, transferees and fiduciaries should be subject to a maximum collection period of only ten years after assessment against the estate.

V. Court's May 2012 Original Opinion. In May 2012, the Court ruled on the motion to dismiss. The Court agreed with the Defendants' position that trust beneficiaries are neither "transferees" nor "beneficiaries" for purposes of § 6324(a)(2) and dismissed those claims, including the claim against the daughter-in-law. The Court did not dismiss the § 3713 claim, suggesting that an issue of fact was involved with respect to the insolvency question and the value of the Distribution Agreement. However, the Court went further, following certain case law suggesting that pursuant to § 2002, the estate tax is to "be paid by the executor," and that therefore the Distribution Agreement constituted an impermissible delegation by the Trustees of their responsibility to pay the tax. According to the Court, the question of insolvency was not to be "viewed from the perspective of straight accounting principles, but rather from the perspective of whether the estate has impermissibly attempted to delegate its tax obligations." The Court also stated that § 3713 "does not recognize such shifts in liability. In other words, personal representatives cannot divest themselves of statutory liability through a contract with others."

With respect to § 6901, the Court followed the case law concluding that assessment under the statute was not mandatory but was instead one of the alternatives that the Government could choose. Finally, the Court agreed with the Defendants that the personal liability of trustees and fiduciaries under § 6324(a)(2) and § 3713 were separate taxes from the estate tax, and appeared to agree that the plain language of § 6503(d) did not suspend the running of the statute of limitations in those cases. However, the Court felt constrained to follow an opinion from the Tenth Circuit (see U.S. v. Russell, 461 F.2d 605, 607 (10th Circuit. 1972), cert denied, 409 U.S. 1012 (1972); U.S. v. Russell, 532 F.2d 175 (10th Cir. 1976)), which held that if the statute of limitations was open against the estate, it was open against the transferees, notwithstanding the facts that (i) when Russell was decided, the statute of limitations under § 6502 was only six years; (ii) no § 6166 election was involved in that case; and (iii) the Tenth Circuit expressed concern about allowing even a six-year period of time for bringing a lawsuit with no assessment.

VI. Defendants' First Motion for Reconsideration. The Defendants filed a motion for reconsideration with respect to the Court's ruling on the § 3713 issue, arguing that the Court had inappropriately introduced the concept of impermissible delegation into the analysis and had misconstrued § 2002, which is a facility of payment provision that creates no personal liability for the executor. The Defendants also argued that "executor" as used in § 2002 is a defined term under § 2203 and does not have the same meaning as the term "executor" as used in § 3713, which has a very different purpose.

VII. Court's July 2013 Replacement Opinion. In July 2013, the Court issued a replacement opinion, leaving everything the same as in the original opinion except for the discussion of § 3713. The new opinion states: "Previously this court addressed this duty to pay estate taxes and stated that insolvency is viewed from the perspective of whether the estate impermissibly attempted to delegate tax obligations. It is unnecessary, however, for this court to determine whether the obligation of the Estate to pay taxes could

properly be delegated by the fiduciaries in this case." With this modification, the Court continued its previous ruling allowing the § 3713 claim to continue because of the issue of fact involving the insolvency question.

VIII. Defendants' First Motion for Partial Summary Judgment. In February 2014, the Defendants filed a motion for partial summary judgment arguing that the Trustees were not personally liable under § 6324(a)(2) because the trust assets were included under § 2033 rather than any of §§ 2034 through 2042, as required by the statute. Section 2033, which is the shortest of the estate tax inclusion provisions, states: "The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death." According to IRS Regulations, § 2033 includes the value of all property "beneficially owned by the decedent at the time of his death." (Regs. § 20.2033-1(a)). In response, the Government filed its own motion for summary judgment and argued that the assets were included under § 2036 (dealing with the retention of possession and enjoyment for life) and § 2038 (dealing with revocable transfers).

In support of their position, the Defendants argued, among other things:

(1) Revenue Ruling 75-553. In Revenue Ruling 75-553 (1975-2 C.B. 477), the IRS stated that §§ 2036-2038 "do not become operative unless someone other than the decedent receives a beneficial interest in the transferred property." Addressing a revocable trust pouring over to the decedent's estate at death, the Ruling continues: "Accordingly, the trustee is not subject to transferee liability for estate tax pursuant to section 6324(a)(2) of the Code since the corpus of the trust was not includible in the decedent's estate under sections 2036, 2037, or 2038, but was includible under section 2033 exclusively."

(2) No Transfer for Purposes of §§ 2036 and 2038. Under long-standing Supreme Court authority, a transfer to a fully revocable trust is not really a transfer at all. According to the Supreme Court, "[t]axation is not so much concerned with the refinements of title as it is with the actual command over the property taxed" and "the essence of a transfer had come to be identified more nearly with a change of economic benefits than with technicalities of title." See Burnet v. Guggenheim, 28 U.S. 280, 283 (1933); Corless v. Bowers, 281 U.S. 376, 378 (1930). Because the Decedent had retained complete power to amend, revoke, and withdraw—i.e., "actual command" over the assets, the lifetime funding of the Trust created no more than a technicality of title for transfer tax purposes.

(3) Adequate and Full Consideration. Alternatively, if the lifetime funding of the Trust was a transfer for estate tax inclusion purposes, that transfer must have been for adequate and full consideration (a defense to the application of both §§ 2036 and 2038) because no gift was made at the time of funding.

(4) The Relevance of Section 2035(e). Section 2035(a) provides that if an interest in property which is transferred within three years of death "would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death," then that property is included in the gross estate under § 2035. However, § 2035(e) states: "For purposes of this section and section 2038, any transfer from any portion of a trust during any period that such portion was treated under section 676 as owned by the decedent by reason of a power in the grantor . . . shall be treated as a transfer made directly by the decedent." In other words, in the case of a transfer from a § 676 trust within three years of death, the true transferor is the decedent rather than the trust. If a transfer is treated as made directly by the decedent and not the trust, then the decedent must not have possessed § 2036 and § 2038 powers. The corollary principle is that with respect to the hypothetical retention under § 2035(a) of those same trust assets until death, the decedent and not the trust is the true owner. Accordingly, with respect to the trust, there is no lifetime transfer, there are no § 2036 and § 2038 powers, and the trust assets are not includible under either section. Although § 2035(e) was enacted about six years after the Decedent's death, the legislative history indicates that it codifies a line of cases beginning with Estate of Jalkut v. Commissioner, 96 T.C. 675 (1991), which were decided under prior law (Jalkut was partially overruled by new subsection (e)).

IX. Court's Unpublished October 2014 Ruling. In connection with a hearing held on October 1, 2014, the Court ruled from the bench in an unpublished opinion. In its ruling, the Court denied the Defendants' motion for partial summary judgment with respect to personal liability under § 6324(a)(2) and granted the Government's motion for summary judgment on the same issue. While acknowledging that the Trust was fully revocable until the Decedent's death, based on the "specific language of 2036," the Court ruled that it was "required to find" that the statute applied because there was a transfer by trust in which the Decedent had retained enjoyment of the property for life. The Court distinguished Revenue Ruling 75-553, stating that "upon the instant of death in this case the beneficiaries had a legally enforceable interest which would bring it back within the specific language of 2036."

X. Defendants' Second Motion for Reconsideration. Following the October 2014 ruling, the Defendants filed their second motion for reconsideration in March 2015. Among other things, the Defendants made the following arguments:

(1) The Time of Inclusion. In focusing upon the "instant of death" and legally enforceable interests that arise in the hands of beneficiaries, the Court applied the wrong test. In two Supreme Court cases, Justice Holmes noted that what is subject to tax is what the decedent held at death, not the interests of beneficiaries or "legatees" that arise at death. Instead, the estate tax "comes into existence before, and is independent of, the receipt of the property by the legatee." Edwards v. Slocum, 264 U.S. 61, 62 (1924) (superseded on unrelated grounds). Also, the estate tax taxes "not the interest to which some person succeeds on a death, but the interest which is ceased by reason of the

death," (id. citing YMCA v. Davis, 264 U.S. at 50), and is a tax "on the act of the testator, not on the receipt of the property by the legatees." Ithaca Trust Co. v. United States, 279 U.S. 151, 155 (1929). More recently, the Fifth Circuit in Bright Estate v. U.S., 658 F.2d 999 (5th Cir. 1981) (en banc), stated that in this regard, "valuation is not determined by the value of the interest in the hands of the legatee."

Many other cases make similar distinctions, especially with respect to valuation. Although the Government argued that these cases deal with valuation rather than inclusion and that these are separate steps in the process of determining the value of the gross estate, the Defendants argued that the determination of what is included and how that property is valued are essentially the same thing, and that the concept of "inclusion" is really just shorthand for "valuation." In fact, almost all of the estate tax inclusion provisions include the following clause: "The value of the gross estate shall include the value of all property . . ." These inclusion provisions make clear that what is included is value, not property. Furthermore, the IRS would clearly not allow valuation discounts based on the theory that a decedent with complete power over a fully revocable trust only held a life estate at death or that the resulting interests in the beneficiaries were separate and minority in nature. Based on the foregoing, the Defendants argued that whether beneficiaries have "legally enforceable interests" arising at the moment of death is immaterial.

(2) Ambiguity of Section 2036 and Harmonization of the Code. In its October 2014 ruling, the Court determined that the specific language of § 2036 was not ambiguous and that the Court could therefore not look beyond the statute. In response, the Defendants cited U.S. v. Marshall, 771 F.3d 854, 863 (5th Cir. 2014), in which the Fifth Circuit stated: "Because statutes dealing with the same subject should be read together and 'harmonized, if possible,' we should not resolve this question without looking beyond § 6324(b) and attempting to harmonize it with other provisions of the Internal Revenue Code." Also, in King v. Burwell, 576 U.S. __ (2015), dealing with the Affordable Care Act, the Supreme Court stated: "If the statutory language is plain, we must enforce it according to its terms. . . . But oftentimes the 'meaning—or ambiguity—of certain words or phrases may only become evident when placed in context.' . . . So when deciding whether the language is plain, we must read the words 'in their context and with a view to their place in the overall statutory scheme. . . . Our duty, after all, is 'to construe statutes, not isolated provisions.'" (Citations omitted.)

In order to place § 2036 in its full context and to demonstrate that the Court's interpretation was inconsistent with the broader context and design of the IRC, the Defendants argued that both the income and the estate tax provisions of the Code call for ignoring trusts over which the grantor has "the power to revest" title to the trust assets in herself within the meaning of § 676. In support of this position, the Defendants made the following arguments in addition to § 2035(e):

(a) Section 1022. In connection with estate tax repeal in 2010, § 1022 provided a limited step-up in basis for assets not only "acquired from the

decedent" (as in § 1014), but which were also "owned by the decedent at the time of death." There are three types of property considered to be owned by the decedent at the time of death under § 1022, only one of which involved trust assets. Section 1022(d)(1)(B)(ii) provides: "The decedent shall be treated as owning property transferred by the decedent during life to a qualified revocable trust (as defined in section 645(b)(1))." A qualified revocable trust under § 645 is defined as a trust owned by the decedent under § 676.

(b) Section 645. This statute provides that the trustee of a qualified revocable trust and the executor of the estate can elect to have the trust "treated and taxed as part of such estate (and not as a separate trust) . . ."

(c) Section 676. The § 645 election to combine the trust and estate after death is consistent with the treatment of a grantor trust under § 676 during the grantor's lifetime: "The grantor shall be treated as the owner of any portion of a trust . . . where at any time the power to revest in the grantor title to such portion is exercisable by the grantor…"

(d) Section 6166. Pursuant to § 6166, one way to qualify stock as an "interest in a closely held business" is for at least 20 percent of the value of the voting stock to be "included in determining the gross estate of the decedent." This determination "shall be made as of the time immediately before the decedent's death." (§ 6166(b)(2)) The value of the interest included in the gross estate must also exceed 35 percent of the "adjusted gross estate," which "means the value of the gross estate" subject to certain reductions, although no time for testing is given. Section 6166(b)(4) makes clear that "for purposes of this section, value shall be value determined for purposes of Chapter 11 (relating to estate tax)." It makes no sense to measure the value of what is included in the gross estate based on what the decedent owned immediately before death for purposes of the 20% test, but to determine the value of what is included in the gross estate for purposes of the 35% test (or for purposes of §§ 2036 and 2038) based upon what the beneficiaries received as a result of the decedent's death. Nor does it make sense to determine the property that is included on a different basis than the determination of the value of that property (speaking loosely in terms of inclusion). Thus, § 6166 provides statutory evidence that both value and inclusion should be determined "immediately before the decedent's death."

(e) Section 2207B. Section 2207B provides a decedent's estate with a right of recovery with respect to assets that are included under § 2036. Although it is generally left to state law and a decedent's estate planning documents to determine where liability for the estate tax ultimately falls, § 2207B is one of just four code sections that override state law and the estate planning documents to actually assign liability to certain recipients of property included in the gross estate. Therefore, the effect of the statute is to substantively change the economic interests of the different parties. In addition to the actual right of

recovery, other serious economic consequences may arise because of this provision. For example, the existence of a right of recovery in the probate estate will frequently mean that a personal representative has a corresponding duty under state law to marshal the assets by suing the recipient of the property, and may be liable to the beneficiaries of the estate for failure to do so. Alternatively, consistent with the Regulations under § 2207A (dealing with QTIPs), the voluntary decision of beneficiaries not to pursue a right of recovery may be a taxable gift. Under normal circumstances, a decedent is able to allocate estate tax liability with a standard tax apportionment clause. However, if the assets of a fully revocable trust are included under § 2036, the only way to override the § 2207B right of recovery is if the decedent "specifically indicates an intent to waive any right of recovery under this subchapter." This provision probably requires a specific reference to § 2207B. Whether or not they contain basic apportionment provisions, it seems unlikely that many traditional estate plans utilizing fully revocable trusts contain such specific waiver language. It also seems unlikely that Congress intended to create a right of recovery in such cases.

XI. Defendants' Second Motion for Partial Summary Judgment. Also in March 2015, the Defendants filed a second motion for partial summary judgment, arguing that the tendering of collateral and an agreement under § 6324A creates a special estate tax lien under that section, even if the IRS purports to reject the tendered collateral. As a result, the § 3713 personal liability of a fiduciary is automatically discharged under § 2204.

(1) Special Estate Tax Lien Under Section 6324A. The requirements for creating a special estate tax lien on "section 6166 lien property" are as follows: (1) a § 6166 election is in effect; (2) the executor makes an election under § 6324A; and (3) the executor files the specified agreement with the IRS. Section 6166 lien property is any property "that can be expected to survive the deferral period" and that has been designated in the agreement. Although there is a maximum value that the IRS can require for lien property which is based on the deferred amount, there is no stated minimum value.

In May 1997, the IRS sent a letter to the executors offering them "an alternative to your continued personal liability for the unpaid estate tax." The letter stated that "in order to insure protection of the government's interest and to terminate your personal liability, you, as personal representative of the estate, may elect . . . 2) to furnish a Special Lien for Estate Tax Deferred Under Section 6166, as described in 26 U.S.C. 6324A." In addition, the letter states: "We have attached information to assist you in completion of the application to elect the special lien." However, although the Defendants submitted the required documentation including the agreement and tendered the Stock as collateral, the IRS purported to reject the special lien on the theory that it could not accept closely held stock because of securities law problems and other reasons. Notwithstanding this rejection, in an internal memorandum of the IRS (obtained many years later through discovery), the reviewing agent concluded that the Stock would "adequately secure the liability" for the remainder of the deferral period.

In early 1998, counsel for the Estate responded to the IRS: "I would still like to restate our opinion that it appears that if an election is made under Section 6324A and the identified property can be expected to survive the period of deferral, the requirements of the statute have been met and the application of the special lien is mandatory. If there are securities law problems, it would appear that they belong to the IRS, not to the taxpayer." Following this correspondence, neither side pursued the matter further.

However, subsequent IRS authority is consistent with the position taken in the 1998 letter from Defendants' counsel. For example, the subject of Chief Counsel Advice (CCA) 200747019 is "Taking Stock as Collateral for the Special Estate Tax Lien Under Section 6324A." The CCA states:

> If the three requirements under 6324A are met, the Section 6324A special lien arises and the collateral must be accepted by the Service. The Service does not have the authority to reject collateral proffered by the estate on the grounds that it would be burdensome for the Service to make the economic or business calculations to determine the value nor does the Service have the authority to reject collateral proffered by the estate because the Service would prefer other collateral. Congress gave the Service a very limited role in the creation of the Section 6324A special lien: The Service determines whether the statutory requirements have been met.

(2) Section 2204 Discharge. Section 2204(a) provides that after paying any tax which is due at the time, the executor "shall be discharged from personal liability" upon (a) making a "written application" for (i) determination of the tax and (ii) "discharge from personal liability therefor," and (b) "furnishing any bond which may be required for any amount for which the time for payment is extended." Significantly, § 2204(c) provides that "an agreement which meets the requirements of section 6324A . . . shall be treated as the furnishing of a bond." Defendants argued in the alternative that either (i) their submission of the special lien materials as directed by the IRS constituted a written application within the meaning of § 2204(a), or (ii) a careful reading of the second sentence of subsection (a) demonstrates that a written application is not required for discharge if all tax then due has been paid and the special lien is furnished for the deferred portion. In support of their position that a written application had been made, Defendants also argued that the IRS does not have an official form for such an application and that they had substantially complied with the requirements of the statute in any event. See Baccei v. United States, 632 F.2d 1140, 1145-1146 (9th Cir. 2011); Germantown Trust Co. v. Commissioner, 309 U.S. 304 (1940).

XII. Government's Second Motion for Summary Judgment. Also in March 2015, the Government filed its second motion for summary judgment, arguing that: (1) the fiduciary children were liable under § 3713 for making distributions during or causing insolvency;

(2) under state law, the Government was a third-party beneficiary of the Distribution Agreement, giving it the right to collect the unpaid estate tax in equal amounts from the Children; (3) the general federal tax lien under § 6321 gave the Government the right to enforce the Distribution Agreement; and (4) the Children were liable under § 6324(a)(2) as beneficiaries of the life insurance proceeds.

XIII. Defendants' Response to Government's Second Motion for Summary Judgment. The Defendants made the following arguments in response to the Government's Second Motion:

(1) No Insolvency Under Section 3713; the Distributions Were Permissible. There was no insolvency under § 3713 based on a "balance sheet" test because the Distribution Agreement was a viable and valuable asset of the Trust. Also, based on the predecessor of § 3713 (which was revised and codified by the new law "without substantive change"), insolvency should be interpreted in the context of "debts due," and deferred estate tax under § 6166 is not due until the times specified by statute. The Defendants also submitted an expert valuation report demonstrating the value of the Distribution Agreement (which was subject to a discount in the report for risk of nonpayment), as well as the present value (about $110,000) of a stream of inheritance tax refund payments from the State of Utah arising from the continually increasing interest deduction that reduced the overall value of the gross estate. Finally, the Defendants argued that § 3713 liability is not an all or nothing proposition, and that such liability only arises to the extent that insolvency is created.

In addition to their solvency defense, the Defendants' argued that although the estate tax is normally to be paid before distributions are made from the estate, making distributions before that time is not a per se violation of a federal policy, as the Government appeared to argue. In Riggs v. Del Drago, 317 U.S. 95, 101 (1942), the Supreme Court clearly recognize that it is permissible to make distributions before the estate tax is paid: "In short, Section 826 (b) . . . simply provides that, if the tax must be collected after distribution, the final impact of the tax shall be the same as though it had first been taken out of the estate before distribution, thus leaving to state law the determination of where that final impact shall be." Former § 826(b) is currently codified as § 2205, which continues to provide that persons receiving property from the estate who pay part of the estate tax are entitled to "reimbursement out of any part of the estate still undistributed or by a just and equitable contribution by the persons whose interest in the estate of the decedent would have been reduced if the tax had been paid before the distribution of the estate . . . it being the purpose and intent of this chapter that so far as is practicable and unless otherwise directed by the will of the decedent the tax shall be paid out of the estate before its distribution." In addition, the Distribution Agreement did not violate the principles underlying § 3713 because § 6166(g), which is the more specific statute applying to the situation, actually contemplates distributions to beneficiaries without acceleration of the deferred tax. This interpretation is consistent with Estate of Romani v. U.S., 523 U.S. 517 (1998), in which the Supreme Court

"harmonized" a possible conflict between § 3713 and the lien provisions of §§ 6321 and 6323(a).

(2) Statute of Limitations on Third Party Beneficiary Claim. Under Utah law, the statute of limitations for enforcing the Government's third party beneficiary claim with respect to the Distribution Agreement was six years. Because more than six years had lapsed from the time that the Distribution Agreement should have been enforced, the Defendants argued that the Government's claim filed in 2011 was time barred.

(3) Statute of Limitations on General Tax Lien. Defendants argued that pursuant to Aquilino v. U.S., 363 U.S. 509 (1960), in determining the property that a federal tax lien can attach to, "both federal and state courts must look to state law, for it has long been the rule that 'in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . .'" Along the same lines, in U.S. v. Rodgers, 461 U.S. 677 (1982), the Supreme Court stated: "We agree with the Court of Appeals that the Government's lien under § 6321 cannot extend beyond the property interests held by the delinquent taxpayer." Also, in Gardner v. U.S., 34 F.3d 985 (10th Cir. 1994), the Tenth Circuit Court stated in this regard that "'the Government's rights can rise no higher than those of the taxpayer to whom the property belongs. . . . Moreover, the tax collector not only steps into the taxpayer's shoes but must go barefoot if the shoes wear out.'" (Citing 4 B. Bittker, Federal Taxation of Income, Estates, and Gifts paragraph 111.5.4, at 111-102 (1981)). The Defendants distinguished certain fraudulent transfer type cases in which the Government is not bound by state statutes of limitations.

In addition to the statute of limitations defense against the application of the general tax lien, the Defendants reviewed the extremely complicated history of the IRS Notices of Federal Tax Lien in this case, including the filings, refilings, releases, revocations of releases, and related errors with respect to the NFTLs, as well as the complex provisions of §§ 6323 and 6325 which govern the circumstances under which the general tax lien remains in effect, ceases to exist, or can be reinstated. After the Defendants demonstrated that the general tax lien was no longer in effect, the Government attempted to reinstate its tax lien by filing a new lien on the same day it filed its Reply Brief. In response, Defendants filed a Sur-Reply arguing that although the § 6502 collections statute of limitations was still open against the Estate (because of the suspension under § 6503(d)) when the personal liability case against the transferees and fiduciaries was brought in 2011, it was no longer open in May 2015 when the Government refiled its lien.

In particular, in what appears to be an issue of first impression, Defendants argued that the flush language of § 6502(a) does not provide an additional suspension of the running of the statute of limitations because the Government chose to sue transferees and fiduciaries for a separate tax rather than sue the Estate for the actual estate tax. See United States v. Updike, 281 U.S. 489 (1930); Hall v. United States, 403 F.2d 344, 346 (5th Cir. 1968); and United States v. Anderson, 2013 U.S. Dist. LEXIS 102086 (M.D. Fla. July 22, 2013) (in the first two cases, the flush language was not in

effect; for the third case, suspension applied because the suit was brought first against the estate and then against the personal representatives). In other words, under § 6502(a), suing an estate will suspend the statute of limitations with respect to both the estate and the transferees, but suing the transferees does not extend the statute with respect to the estate; therefore, the limitations period for filing a new general tax lien against the Estate was not suspended by the Government's action in 2011 and had already closed prior to May 2015.

(4) Insurance Proceeds. Subject to their appeal rights on the issue of suspension of the statute of limitations under § 6503(d), the Defendants did not object to summary judgment with respect to the status of the surviving Children as the beneficiaries of the life insurance proceeds.

XIV. Government's Supplemental Memorandum on Section 2204 Discharge and Defendants' Response. In March 2016, the Government filed a Supplemental Memorandum arguing, among other things, that § 2204 did not discharge personal liability arising under § 6324(a)(2) and that the Defendants had the burden of proof with respect to whether the collateral offered under § 6324A would survive the deferral period. Defendants objected on the basis that these issues were no longer timely, particularly because the § 6324(a)(2) discharge issue had been raised in their March 2015 second motion for partial summary judgment (and in their reply brief as well) and the Government had not responded.

In addition to presenting arguments for placing the burden of proof on the Government with respect to the survivability of the collateral, the Defendants made the following arguments with respect to the discharge of a trustee's § 6324(a)(2) liability: (1) § 2204 makes no distinction between liability arising under § 3713 and § 6324(a)(2); (2) it would be a strange interpretation of the IRC to say that a code provision (§ 2204) discharges a fiduciary from personal liability arising under a non-code provision relating to insolvency distributions (§ 3713) but does not discharge that same fiduciary from similar personal liability arising under another code provision (§ 6324(a)(2)); (3) it would turn the written offer from the IRS into a trap for the unwary—i.e., the IRS asks the personal representatives/trustees to provide a special lien in exchange for obtaining a discharge from § 3713 liability but continues to hold the trustees personally liable for the same amount under § 6324(a)(2); (4) the proximity and interrelatedness of §§ 6324 and 6324A suggest that both code sections are closely connected to § 2204, especially given the fact that both of them expressly refer to that statute and § 6324A is the source of the special lien specifically mentioned in § 2204(c); and (5) § 6324(a)(3) states: "The provisions of section 2204 (relating to discharge of fiduciary from personal liability) shall not operate as a release of any part of the gross estate from the [§ 6324(a)(1)] lien for any deficiency that may thereafter be determined to be due, unless such part of the gross estate . . . has been transferred to a [qualified person]." In other words, the Government's position is essentially that § 2204 releases a lien under § 6324(a)(1) if

certain conditions are met, but under no circumstances does it discharge a fiduciary from personal liability under § 6324(a)(2).

XV. Court's December 2016 Final Opinion. On December 1, 2016, the Court issued its final Memorandum Decision and Order. In that opinion, the Court made the following rulings:

(1) Ruling on Second Motion for Reconsideration and Inclusion Under Section 2033. In order "to prevent clear error," the Court reconsidered its October 1, 2014 unpublished ruling and determined that the trust assets were included in the Estate under § 2033. While focusing again on the meaning of the word "transfer," the Court stated that it had "erred by not also keeping in mind the overall estate tax statutory scheme," in which § 2033 provides for the primary inclusion of assets that have never really been given away while other code provisions (such as §§ 2036 and 2038) provide for the inclusion of assets that have been given away during life subject to the retention of certain "strings." The Court acknowledged that what truly matters is "actual command over the property taxed" as opposed to mere "refinements of title," stating that the transfer of title to the Decedent as trustee did not change the "beneficial ownership of the Trust assets during her lifetime," and that "the beneficiaries of the Trust merely had a 'hope and expectation' of inheriting a beneficial interest in the Trust assets, rather than any actual ownership interests during Decedent's lifetime."

In addition, the Court reached the following important conclusions:

> The court's original ruling erred in determining that the specific language of section 2036 was broad enough to make Decedent's creation of the Trust and transfer of legal title from the Decedent as grantor to the Decedent as trustee a "transfer" for estate tax purposes. . . The court also erred in determining that at the "instant of death" the beneficiaries had a legally enforceable interest such that Trust assets were properly includable in the estate pursuant to section 2036 . . . because it was persuaded by the government's argument that sections 2036 and 2038 are "transfer provisions" intended to capture "all incomplete transfers, which includes transfers taking effect at death via revocable trusts" . . . Upon reconsideration and for the reasons stated above, the court finds that Trust assets were never "given away" such that Decedent lost the beneficial ownership of them during her lifetime, and thus that there was no transfer—incomplete or not—for purposes of sections 2036 and 2038 prior to Decedent's death. As a result, the court concludes that Trust assets were included in the gross estate pursuant to section 2033, which precludes Smith and Johnson's liability as trustees for the estate tax under 26 U.S.C. § 6324.

Based on this ruling, the Court vacated its prior grant of partial summary judgment to the Government and granted Defendants' motion for partial summary judgment. Although the Court stated that it was persuaded by the Defendants' arguments that (i) the concepts of valuation and inclusion should be harmonized, and (ii) § 2035 has a bearing on whether the trust assets were included under either § 2036 or §

2038, it did not base its ruling on those arguments. However, the Court did make the following statement: "It is worth noting, however, that the IRS interpretations above are consistent with a statutory tax scheme that functions as set forth by defendants in their motion to reconsider, and that nothing in the government's response persuades the court otherwise." Finally, as a result of its ruling, the Court did not need to reach the issue whether § 6324(a)(2) personal liability is discharged under § 2204.

(2) Section 6324A Special Lien and Section 2204 Discharge. The Court initially found that the IRS did not have a particular form for a written application under § 2204 and that the parties were already fully aware of the amount of the tax owing. Furthermore, citing Baccei, the Court ruled that "a separate written application is [not] a substantive requirement of section 2204 because it appears that its essential purposes are fulfilled not by a written application but by the payment of the tax assessed or the furnishing of an appropriate bond." In the alternative, the Court concluded that the Defendants' written communications with the IRS actually constituted a written application.

The Court next found that if the statutory requirements for a special lien have been met, the IRS is obligated to accept the special lien and associated collateral. With respect to whether the Stock was expected to survive the deferral period, the Court concluded that by simply questioning the Defendants' expert report without attempting to independently value the Stock, the report from the Government's expert failed to create any issue of fact with respect to survivability (especially in light of the party admission in the IRS internal memorandum), and that the Government had therefore failed to meet its burden. Although the Court questioned whether value had truly been a factor in the rejection of the Stock, it found that question to be nonmaterial:

> The government's remedy for insufficient value to secure deferred tax obligations is to accept a bond in the amount of the shortfall, 26 U.S.C. § 6324A(b)(3), or to require the addition of property to the special lien agreement. 26 U.S.C. § 6324A(d)(5). It is undisputed that rather than making such specific requests, the government instead purported to reject the Hotel stock as collateral. But, because section 6324A is a taxpayer election, nothing in the statute authorizes the government to reject the election.

The Court also rejected the IRS position that it could not accept closely held stock, noting that even the title of § 6166--"Extension of time for payment of estate tax where estate consists largely of interest in closely held business"—contemplates the use of such collateral.

Based on this analysis, the Court concluded:

> For the foregoing reasons, the court finds that the three requirements for a valid special lien are met under 26 U.S.C. § 6324A. Therefore, the IRS had no discretion to reject the special lien, and that lien constitutes the bond required pursuant to the discharge statute. 26 U.S.C. § 2204.

Consequently, Johnson and Smith's fiduciary liability as personal representatives of the Estate for the unpaid estate tax was discharged as a matter of law and the government's claim for fiduciary liability under 31 U.S.C. § 3713(b) is moot.

(3) Statute of Limitations for Enforcing the Distribution Agreement. The Court first ruled that the six-year statute of limitations under Utah law had already run prior to the time that the Government brought its action against the Defendants. In response to the Government's reliance on U.S. v. Summerlin, 310 U.S. 414 (1940), and its claim that it is not bound by state statutes of limitation, the Court looked to U.S. v. California, 507 U.S. 746 (1993), in which "the Supreme Court indicated that a more robust analysis of the cause of action under which the government is proceeding is required before simply relying on the general assertion in Summerlin and related cases that the government is not bound by state statutes of limitations." According to the Court, that analysis "requires this court to first evaluate the nature of the government's claim to determine whether it was obtained through or created by a federal statute, and second, to determine whether it is pursuing the claim in its sovereign capacity. Only if it meets those requirements has it acquired a right not barred by the state statute of limitations." Because the Government's claim was obtained by virtue of a private contract which required the Government to step into the shoes of the trustees as a third party beneficiary rather than act in its sovereign capacity, the Court concluded that the state statute applied and the breach of contract claim was time barred.

(4) Enforcement of General Tax Lien. Although the parties made a number of different arguments with respect to the enforceability of the general tax lien under § 6321, the Court found it unnecessary to consider them because of two points that were "both simple and dispositive." First, the Court noted that a special lien agreement under § 6324A is treated as the furnishing of a bond under § 2204(c). The Court noted that "section 6325(a) provides that the IRS 'shall issue a certificate of release of any lien imposed' within 30 days of being timely furnished an acceptable bond for the assessed tax." Accordingly, the Court determined that the Government's tax liens had been released with the result that "there is no section 6321 general lien remaining upon which the government can foreclose." Second, the Court concluded that the Government's attempts to refile its lien in 2015 were too late because the statute had already run on the Distribution Agreement and there was therefore no property upon which the lien could attach.

(5) Insurance Proceeds. The Court directed the Government to file a motion requesting judgment in the appropriate amount with respect to the insurance proceeds received by the two surviving Children (the Government did not substitute the estates of the two deceased children as parties in the case). The total amount of that judgment is $92,500 for each of the two Children.