TAX COURT CASE UPDATE

Citation:

U.S. v. Elaine T. Marshall et al., No. 12-20804 (5th Circuit), November 10, 2014*.*

Overview:

The Court of Appeals for the Fifth Circuit has affirmed, with one exception, multiple district court orders involving gift tax that was never paid by the donor or his estate on an indirect gift consisting of a sale of stock at below market value.

The Facts:

In 1995, Mr. Marshall made what the IRS later determined was an indirect gift of Marshall Petroleum, Inc. ("MPI") stock to MPI's other shareholders: (1) Eleanor Pierce (Marshall) Stevens, Mr. Marshall's former wife, who was the beneficiary of a trust that was funded by MPI stock; (2) E. Pierce Marshall, Mr. Marshall's son; (3) Elaine T. Marshall, the son's wife; (4) the Preston Marshall Trust, which had been formed for the benefit of Mr. Marshall's grandson, Preston Marshall; and (5) the E. Pierce Marshall, Jr. Trust, which had been formed for the benefit of Mr. Marshall's grandson, E. Pierce Marshall, Jr. At the time that he made this indirect gift, Mr. Marshall did not pay gift taxes. He passed away shortly after making this gift.

After several years of negotiation over Mr. Marshall's tax liability for this indirect gift, the IRS and Mr. Marshall's estate entered into a stipulation that determined the value and recipients of the indirect gifts. Mr. Marshall's estate still did not pay the gift tax and pursuant to Code Section 6324(b), the IRS tried to collect the unpaid gift tax from the donees. The son's estate paid approximately $45 million toward the unpaid gift tax for the benefit of his family members (his wife and two sons). Mrs. Steven's estate did not pay any gift tax because it disputed that Mrs. Stevens was a beneficiary of the 1995 gift.

In 2010, the government brought suit against the donees, seeking to recover the unpaid gift taxes and to collect interest from the beneficiaries. It also sought to recover from two individuals, the grandson and Finley L. Hilliard, who as representatives of various estates and trusts, allegedly paid other debts before paying those owed to the government.

In a series of orders issued in 2012, the district court found:

(1) the donees' debt under Code Section 6324(b) was a liability independent from that of the donor's unpaid gift tax and the donees had incurred interest on that independent liability

(2) Mrs. Stevens was a donee of Mr. Marshall's indirect gift; and
(3) Mr. Hilliard and the grandson were individually liable for several of the debts they paid as executors and trustees before they paid the debt owed to the government.

On appeal, the appellants argued that the district court erred in each of the rulings. The Fifth Circuit mostly affirmed the district court.

Discussion:

All of the appellants argued that the district court erred in finding that the donees incurred an independent interest liability as a result of the donor's unpaid gift tax. Mrs. Stevens also argued that the district court was incorrect in finding that she was a donee by virtue of her income interest in the grantor retained interest trust. Finally, Mr. Hilliard and the grandson claimed that the district court erred when it held them responsible, as fiduciaries and individually, for distributions they made from the Living Trust and Mrs. Stevens' estate.

All of the appellants argued that the district court erred when it found both that Code Section 6324(b) creates an independent liability on the part of the donee to pay the unpaid gift tax and that the donee can be charged interest until the gift tax is paid. First, they argued that the district court's interpretation of Code Section 6324(b) directly contradicts the plain language of the statute. Second, they argued that the district court erred in applying Code Section 6901 because the IRS did not assess transferee liability under it, but instead chose to seek a personal judgment against the donee. But they claimed that even if Code Section 6901 applied, the district court's interpretation of Code Section 6324(b) was incorrect for several reasons. The Fifth Circuit carefully examined each of these arguments in considerable detail and disagreed with all of them. As a result, it held that interest accrued on the donee's liability for the unpaid gift taxes and that interest was not limited to the extent of the value of the gift.

Mrs. Stevens argued that the district court erred in finding that she was a donee of Mr. Marshall's 1995 indirect gift. First, she argued that the trust was not even the donee of Mr. Marshall's gift because it did not receive a present interest in property when Mr. Marshall sold his MPI stock back to MPI. Second, she argued that the trust was the donee and so the trustee was the proper party to be held liable under Code Section 6324(b). In the alternative, she claimed that the remainder beneficiary was the donee, or, at the very least, partly responsible for any donee liability. Finally, she argued that even if the trust, the trustee, and the remainder beneficiaries were not the donees, the government still had failed to prove that Mr. Marshall made a gift to her because Mr. Marshall's sale of MPI was an arm's-length transaction in the ordinary course of business and free from donative intent. The Fifth Circuit rejected all of her arguments. It also held that res judicata barred her from arguing that Mr. Marshall did not make a gift to her.

In the earlier proceeding, the IRS had moved for summary judgment against the grandson and Mr. Hilliard for violations of the Federal Priority Statute (31 USC 3713(b)), and against the grandson for breach of state law fiduciary duties. The court granted the motion and found that the grandson and Mr. Hilliard were (1) individually liable for money they had distributed from Mrs. Stevens' estate and the Living Trust, respectively, in violation of 31 USC 3713 and (2) jointly liable for money they set aside for charitable purposes in violation of the government's priority under 31 USC 3713.

The two men argued that the district court committed several errors in holding them liable for distributions from the Living Trust and Mrs. Stevens' estate in violation of the Federal Priority Statute. First, they argued that the government did not prove that they knew about Mrs. Stevens' potential liability for the unpaid gift tax, and therefore, they could not be found to have violated 31 USC 3713. Next, they argued that there was insufficient evidence for the district court to find them personally liable for: (1) the charitable set-aside; (2) the distribution of personal property and apartment rent from Mrs. Stevens' estate; or (3) the payment of legal and accounting fees from the Living Trust. Last, the grandson claimed that the district court erred in finding that he breached his fiduciary duty under Texas law.

Conclusion:

The Fifth Circuit rejected all of the above arguments except one. It concluded that the grandson did not breach his fiduciary duty under state law because he did not owe a fiduciary duty to Mrs. Stevens' estate's creditors. Thus, it held that the grandson did not breach his state law fiduciary duties and rendered judgment in his favor on this point.