Estate of L.E. McKnight, Deceased, L.E. McKnight, Jr., Administrator, Petitioner, v. Commissioner of Internal Revenue, Respondent. Docket No. 11318. 8 T.C. 871. Promulgated September 26, 1947.

An administrator of an estate who liquidates a corporation in which the estate holds stock is personally liable for the corporation's unpaid federal taxes if he distributes the corporate assets to the estate's beneficiaries before satisfying the tax debt, even if he lacks actual knowledge of the tax liability.

Summary

The administrator of an estate, McKnight Jr., liquidated a warehouse company in which the estate held stock. He distributed the assets to pay a personal judgment against the deceased, administration expenses, and a widow's allowance, before paying the warehouse company's outstanding federal taxes. The Tax Court held the administrator personally liable for the unpaid taxes under Sections 3466 and 3467 of the Revised Statutes, as he distributed the assets of the corporation, which he held in trust for creditors, before satisfying the debt to the United States. The court rejected his arguments that the widow's allowance had priority and that the government failed to prove his knowledge of the tax debt.

Facts

L.E. McKnight, Sr. died owning stock in Merchants Warehouse Co.
McKnight, Jr., as administrator of the estate, liquidated the Merchants Warehouse Co.
He distributed the assets to pay a personal judgment against McKnight, Sr., administration expenses, and a $5,000 widow's allowance granted by the Probate Court.
Merchants Warehouse Co. had outstanding federal tax liabilities of $1,762.87 and $1,049.24.
These taxes remained unpaid after the distributions.

Procedural History

The Commissioner of Internal Revenue determined that McKnight, Jr., as administrator, was personally liable for the unpaid taxes of the Merchants Warehouse Co.
McKnight, Jr. petitioned the Tax Court for a redetermination of this liability.
The Tax Court upheld the Commissioner's determination, finding McKnight, Jr. personally liable.

Issue(s)

1. Whether the administrator of an estate is personally liable for the unpaid federal taxes of a corporation in which the estate held stock when he liquidates the corporation and distributes its assets to beneficiaries before paying the taxes.

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2. Whether a widow’s allowance paid from the assets of a liquidated corporation takes priority over the corporation’s federal tax liabilities.
3. Whether the government must prove that the fiduciary had knowledge of the tax liability at the time of distribution to establish personal liability under Sections 3466 and 3467 of the Revised Statutes.

Holding

1. Yes, because the administrator held the corporate assets in trust for the corporation’s creditors, including the United States, and he breached that trust by distributing the assets before satisfying the tax debt.
2. No, because the widow’s allowance applies only to assets of the decedent’s estate, and the assets of the liquidated corporation were not part of the estate until the corporation’s debts were satisfied.
3. No, because knowledge of the tax liability is not a specific requirement under Sections 3466 and 3467 of the Revised Statutes; lack of knowledge is a matter of defense.

Court’s Reasoning

The court relied on Sections 3466 and 3467 of the Revised Statutes, which give priority to debts due to the United States when a debtor is insolvent or an estate is insufficient to pay all debts.
The court reasoned that the administrator, upon liquidating the Merchants Warehouse Co., held the assets in trust for the corporation’s creditors. By distributing the assets to the estate’s beneficiaries before satisfying the corporation’s tax liabilities, he violated this trust.
The court distinguished Jessie Smith, Executrix, 24 B. T. A. 807, noting that in that case, the assets used to pay the widow’s allowance were assets of the decedent’s estate, whereas here, they were assets of the corporation.
The court stated that knowledge of the tax liability is not a prerequisite for liability under Sections 3466 and 3467, placing the burden on the fiduciary to prove lack of knowledge as a defense. The court noted the administrator’s prior role as secretary and treasurer of Merchants Warehouse Co. when it filed the tax return, suggesting he likely had knowledge of the company’s tax liabilities.

Practical Implications

This case establishes that fiduciaries who liquidate corporations or administer estates with corporate holdings must prioritize the payment of the corporation’s federal tax liabilities before distributing assets to beneficiaries.
It clarifies that a widow’s allowance under state law does not take priority over a corporation’s federal tax debts when the allowance is paid from the corporation’s assets.
It reinforces the principle that fiduciaries can be held personally liable for unpaid taxes even if they lack actual knowledge of the liability, although lack of knowledge

can be asserted as a defense.

This case informs tax planning for estates and corporate liquidations, emphasizing the importance of due diligence in identifying and satisfying all tax obligations before distributing assets. Later cases may distinguish this ruling based on specific state laws regarding the priority of claims or the fiduciary’s level of knowledge of the tax debt.

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