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Beware Liability For Other's Taxes

The IRS sometimes comes after one taxpayer to collect the tax liability of someone else. How is this possible? It's bad enough to have to pay your ***own*** taxes, let alone someone ***else's***.

The answer is "transferee liability," a concept embodied in the Internal Revenue Code (Section 6901) but having roots in legal history. In fact, it is a creditor protection device going back hundreds of years. Essentially, the IRS can pursue a "transferee"—someone who received assets or money for less than full and fair value from the taxpayer. Think of it as kind of a stolen property rule.

> **Example**: Uncle Johnny, a delinquent taxpayer, gives you his Mercedes. You may enjoy driving it and may have no idea Johnny owes the IRS. Even so, the IRS can repossess it. The IRS claim on the Mercedes trumps yours, even if you didn't know about the taxes. The result is the same if you paid Johnny $5,000 for it but the car is really worth $20,000.

As with everything else in the tax code, applying these rules isn't simple, and procedure and timing are important. The person ***owing*** taxes is the "transferor," and the ***person being pursued*** the "transferee."

There are two bases of transferee liability: at law and in equity. You are liable as a transferee ***at law*** when you are responsible for the transferor's tax liability by contract. The IRS must prove the tax liability was within the terms of the contract. In some cases, this arises by statute, such as in corporate mergers.

The vast bulk of transferee liability cases involve equity. You are liable as a ***transferee in equity*** when you receive the transferor's assets for less than full, fair and adequate consideration and leave the transferor insolvent and unable to pay the tax liability. Your liability is limited to the value of the assets you received.

The IRS must prove five elements:

1. The transferor ***became insolvent*** when the transfer occurred or because of a series of asset transfers.

2. The transfer was for ***less than adequate consideration***.

3. The transfer was made ***after the tax liability*** accrued. The tax liability need not have been assessed at the time of the transfer, as long as the tax debt had accrued.

4. The ***transferor was liable*** for the tax.

5. The IRS made ***reasonable attempts*** to collect from the transferor *or* ***it would be futile***. An example of the latter would be a dissolved corporation.

For more, see:

Internal Revenue Manual: Transferee Liability Cases

Transferee Liability

IRS Asserts Transferee Liability For Florida Condo

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