Insights: Publications

Death, Taxes, and the Sale of Business Interests

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Introduction: What is Estate Tax and Who Has to Pay?

Over 200 years have passed since Benjamin Franklin famously wrote, “in this world, nothing can be said to be certain, except for death and taxes.” This sentiment still rings true today – but did he mention anything about death triggering a tax?

Whether Benjamin Franklin thought of it or not, the United States imposes an estate tax on the transfer of property upon death if an individual's gross estate exceeds a certain threshold ($13,610,000 in 2024).[1] The value of an individual's gross estate is determined by taking the total fair market value of all includible assets as of the date of death, which may include cash, securities, real estate, life insurance, trust property, annuities, retirement assets, business interests, and more.[2] Once the value of the gross estate is calculated, this number is reduced by any applicable deductions (such as the value of assets passing to a surviving spouse and/or qualified charities, debts, estate administration expenses, etc.).[3] If the net value of the estate exceeds the individual's remaining exemption ($13,610,000 in 2024, less any gifts made during life), estate tax will be assessed on the portion of the estate above the exemption.[4]

The Silent Estate Tax Lien

How does the Internal Revenue Service (“IRS”) enforce payment of estate tax? In addition to estate tax audits, upon death, an estate tax lien immediately attaches to all property includible in an individual (“Decedent”)'s gross estate, which serves as security for any potential estate tax that may be due.[5] The estate tax lien is a “silent lien,” meaning it does not have to be recorded or filed to be enforced. Further, the estate tax lien attaches immediately upon death before any potential estate tax liability is determined and regardless of whether the Decedent even has a taxable estate.[6]

Deal or No Deal – What Effect does the Estate Tax Lien have on a Sale?

Suppose that the Decedent has a taxable gross estate, which includes an interest in a closely held business that was about to be sold. What effect does the estate tax lien have on the sale? Does the purchaser take the Decedent's shares subject to the lien? Does the purchaser have to request the IRS to discharge the lien? Can the purchaser be held liable for the estate tax? The answer, per usual, is that it depends.

When determining what happens to the estate tax lien upon a sale, the IRS makes a distinction between probate assets and non-probate assets. Non-probate assets commonly include property held in trust, jointly held property, life insurance, and assets that pass by way of beneficiary designation. Probate assets, by definition, require opening a probate estate to be administered. Probate requirements vary by state, but common examples include real estate and assets over a certain value (for example, the threshold in Illinois is $100,000).

The Internal Revenue Code provides that upon the sale of non-probate assets, such assets will be divested of the

estate tax lien and a like lien will attach to the property of the transferor (i.e., the lien will follow the sale proceeds).[7] So, suppose during the Decedent's lifetime, the Decedent established a Revocable Trust and assigned all of their interest in the business to their Revocable Trust. In this case, the Decedent's shares will be classified as a non-probate asset and the estate tax lien will automatically detach upon a sale without any further action.

But what about estate tax liability – what happens if the representative of the estate fails or refuses to pay the estate tax? Is the purchaser on the hook? For non-probate assets, the short answer is no. In *United States v. Paulson*, the Court held that the transfer of non-probate estate assets to a bona fide purchaser for good and adequate consideration divests the transferred property of the estate tax lien and the purchaser will not be liable for estate tax.[8]

Probate assets, however, are treated differently. If the representative of the estate sells a probate asset, the estate tax lien will not automatically detach by virtue of the sale to a bona fide purchaser. So, suppose the Decedent did not have an estate plan and their interest in the business is subject to probate. To transfer the shares free and clear of the estate tax lien, the purchaser could either: (a) wait for the probate estate to close (which could take anywhere from six months to several years), or (b) request the IRS to issue a certificate of discharge. There is also the possibility that the purchaser opts to back out of the sale completely.

Conclusion: A Failure to Plan is a Plan to Fail

Overall, the impact of the estate tax lien on the sale of a business largely depends on whether the Decedent had an estate plan. If the Decedent owns their shares of the business in trust, the estate tax lien will automatically divest upon a sale without delay or any additional action. Alternatively, if the Decedent did not have an estate plan and a probate estate is necessary, a purchaser will not automatically take the Decedent's shares free and clear of the estate tax lien, resulting in inevitable delays and potentially worse, phone calls to the IRS.

Kilpatrick's Private Client Group is here to help with all things planning. Please reach out to a member of our group if you have any questions – whether it be related to business planning and estate tax considerations, or if you would simply like to discuss how to pass wealth from one generation to the next in the most tax efficient manner, we would be happy to discuss.

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[1] See 26 U.S. Code § 2001(a).
[2] See 26 U.S. Code § 2031.
[3] See 26 U.S. Code § 2051.
[4] See 26 U.S. Code § 2001(b)-(c).
[5] See 26 U.S. Code § 6324(a)(1).
[6] Id.
[7] See 26 U.S. Code § 6324(a)(2).
[8] See *United States v. Paulson*, 68 F.4th 528, 543 (9th Cir. 2023).