

The Weekly Scenario: Estate Tax Liabilities

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Protecting a Personal Representative When There are Retirement Plan Accounts

In certain situations where a person has a large retirement plan account, such as an IRA, and a substantial estate tax liability, but insufficient probate assets to pay the estate tax, certain precautions may be in order.

The personal representative of the estate is responsible to pay the federal and state estate tax to the extent there are probate assets. However, if a personal representative has knowledge of unpaid estate tax but distributes money to creditors of an estate instead of paying the federal and state taxing authorities, the IRS and state taxing authority can hold the personal representative liable for any unpaid taxes. Moreover, if IRA assets pass directly to a beneficiary or beneficiaries, each recipient can be held personally liable for the unpaid estate tax, generally limited to the amount of IRA distributions received.

So how might a personal representative protect his or her own interests and the interests of the beneficiaries?

One solution is to name a trust as the IRA beneficiary. The trust could stipulate that the Trustee will pay the estate an amount equal to the estate tax attributable to the retirement assets. The trust could also provide that the Trustee is required to pay the income taxes attributable to the IRA funds.

This type of trust should be drafted to allow distributions to IRA beneficiaries, but after settling any taxes that are due. Any trust would likely be drafted as a short-term trust (2-4 years) with enough time to give the Trustee the ability to settle the tax liabilities.

As always, if you have any questions or would like to learn more, please contact Steve Shane at sshane@offitkurman.com or [301.575.0313](tel:301.575.0313).