

# Protecting the Personal Representative from the Claims of the Estate's Creditors

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# What is a Claim?

- N.J.S.A. 3B:1-1 defines “Claims” as including liabilities whether arising in contract, or in tort or otherwise, and liabilities of the estate which arise at or after the death of the decedent, including funeral expenses and expenses of administration, but does not include estate or inheritance taxes, demands or disputes regarding title to specific assets alleged to be included in the estate.
- Definition important when talking about the manner in which claims must be presented.

# Who is a Creditor?

- “[T]he word ‘creditor’ is not used in the restricted sense of one to whom a debt is due, but includes a party entitled to prosecute a suit upon a tort of the deceased.” Hackensack Trust Co. v. Van Den Berg, 92 N.J.L. 412, 413-414 (E. & A. 1918).
- The term includes all claims enforceable by suit terminating in a money judgment.

# Common Creditors

- Funeral Bills
- Taxing Authorities
- Credit Card Companies
- Creditors secured by Judgment
- Business Partners and contract claimants
- Persons injured by Decedent's tortious conduct
- Mortgage Companies and other secured creditors

# Duty of the Personal Representative to the Estate

- An executor is required to settle and distribute an estate as expeditiously and efficiently as is consistent with the best interests of the estate. N.J.S.A. 3B:10-23. This includes payment of the decedent's lawful debts.
- Executors have the non-delegable duty to collect and preserve the estate assets, to supervise the administration of the estate and to exercise the care that an ordinary, prudent person would employ in like matters of his or her own. See In re Mild's Estate, 25 N.J. 467, 480 (1957); N.J.S.A. 3B:10-26.
- When and if an executor fails to act in the best interests of the estate, then he or she may be discharged. See N.J.S.A. 3B:14-21
- See Estate of Sauer, 2011 N.J. Super. Unpub. LEXIS 1431 (Docket No. BER-P-088-11) Decided May 19, 2011

# Duty of the Personal Representative to the Beneficiaries

- An executor has a fiduciary duty to act in the best interests of all the beneficiaries under the will. Branch v. White, 99 N.J. Super. 295, 306 (App. Div. 1968).
- The most fundamental duty owed by an executor to the beneficiaries is the duty of loyalty, see, e.g., Wolosoff v. C.S.I Liquidating Trust, 205 N.J. Super. 349 (App. Div. 1985), and the executor is obligated to deal impartially with all beneficiaries, In re Koretzky Estate, 8 N.J. 506, 530 (1951).
- The executor of the estate must, at all times, act with the best interests of the estate in mind, Taylor v. Errion, 137 N.J. Eq. 221 (Ch. Div. 1945), aff'd 140 N.J. Eq. 495 (1947), and must attempt to ensure that the estate is distributed according to the decedent's wishes. In re Duke, 305 N.J. Super. 408, 439 (Ch. Div. 1997).
- It is beyond peradventure that an executor cannot use his or her position to further his or her own personal interests. Estate of Sauer, 2011 N.J. Super. Unpub. LEXIS 1431 citing Taylor, *supra*, 137 N.J. Eq. at 225-227.

# Overview of Estate Administration

- Decedent Dies
- A Personal Representative (*i.e.* Executor) is appointed
- If testate, Decedent's Will is admitted to probate
- Assets are Inventoried
- Debts are Catalogued
- Beneficiaries and Intestate heirs are given notice of probate
- Lawful debts and taxes are paid
- Assets are distributed
- The Estate is Closed

# How Claims must be Presented – N.J.S.A. 3B:22-4

- Creditors of the decedent shall present their claims to the personal representative of the decedent's estate:
  - in writing, and
  - under oath,
  - specifying the amount claimed, and
  - the particulars of the claim.

# Timeframe; Statute of Limitations

- **Presentation of a Claim.** A claim must be presented within **nine (9) months** from the decedent's death.—N.J.S.A. 3B:22-4
- **Time to Dispute.** Within **three (3) months** after presentation to the personal representative, the personal representative shall allow it or dispute it, in whole or in part, and give notice in writing to the creditor.—N.J.S.A. 3B:22-7
- **Time to Commence an Action.** Within **three (3) months** after receiving notice that a claim or a part of it has been disputed, the creditor shall commence an action to recover on the claim.—N.J.S.A. 3B-22-8

# Failure to Present in Time

- If a creditor fails to present its claim within the nine (9) month period, the personal representative may distribute assets without being personally liable to the creditor
  - Not applicable for taxing authorities
- However, if distribution is made within the nine (9) months, the personal representative will be personally liable to any creditor who brings a valid claim
- After the nine (9) months, creditors may continue to make claims against the remaining assets held in the estate. N.J.S.A. 3B:22-10

# One-Year Rule for Real Property

- N.J.S.A. 3B:22-22
- The real property of the decedent shall be and remain liable for the payment of his debts for 1 year after his death;
- The personal representative may sell the real estate free from liability upon application to the court upon terms and conditions as the court may direct for the protection of creditors.

# Order of Priority of Claims – 3B:22-2

- If the assets of the estate are insufficient to pay all claims in full, the personal representative shall make payment in the following order:
  - a. Reasonable funeral expenses;
  - b. Costs and expenses of administration;
  - c. Debts incurred by the Office of the Public Guardian for Elderly Adults;
  - d. Debts and taxes with preference under federal or state law;
  - e. Reasonable medical and hospital expenses of the last illness of the decedent;
  - f. Judgments entered against the decedent according to the priority of their entry;
  - g. All other claims.

# Order of Priority of Claims – 3B:22-2

- No preference is given in the payment of any claim over any other claim of the same class.
- No preference is given between claims due and claims not yet due.
- An action against the personal representative for payment does not entitle that creditor to priority over others of the same class.

# Payment of Claims Not Legally Presented

- What happens if the personal representative pays a claim not presented in accordance with 3B:22-4?
- If the claim is paid in good faith, and if it is shown that the claim was owed by the decedent, the claim will be allowed.
- **However, if the estate is later found insolvent, the personal representative will be liable for the *pro rata* portion of the claim that should not have been paid.—N.J.S.A. 3B:22-6**

# Fact Pattern

- John is the court appointed administrator of his mother's estate. The estate is worth \$300,000 and John is also a one-third beneficiary. A week after the funeral, his siblings, the other beneficiaries, are demanding their share. What must John do to protect himself?
- Susan Sondheim, Esq. is the named executor under Decedent's Will. The estate has assets of \$1.3M but debts are believed to exceed \$1M, and may exceed the value of the estate. Beneficiaries are the Decedent's five (5) children. Should Susan qualify as executor? If so, what must she do to protect herself?

# Claims Against the Estate for Services Rendered During Life of the Decedent

- Fact Pattern: John does work for Decedent during Decedent's life. Decedent makes an oral promise to John to compensate him in Decedent's Will. Decedent dies and the Will makes no mention of John. Can John bring a claim against the Estate?
- N.J.S.A. 3B:1-4 provides that these types of contractual arrangements relating to death must be in writing.
- Estate of Cosman, 193 N.J. Super. 664 (App. Div. 1984)

# Claims for Palimony

- Estate of Roccamonte, 174 N.J. 381, 389 (2002) The NJ Supreme Court recognized that “unmarried adult partners, even those who may be married to others, have the right to choose to cohabit together in a marital-like relationship, and that if one of those partners is induced to do so by a promise of support given her by the other, that promise will be enforced by the court”.
- Following amendment to the Statute of Frauds in 2010, all such promises of support must be in writing.—N.J.S.A. 25:1-5(h).

# Claims for Palimony – Cont.

- What happens if the parties were cohabiting prior to 2010?
- Palimony Agreements are governed by contract law, in 2013 the Appellate Division held that unless the cause of action (*i.e.* the breakup) occurs prior to the new law, that a preexisting oral palimony agreement would be unenforceable.—Maeker v. Ross, 430 N.J. Super. 79 (App. Div. 2013)
- The N.J. Supreme Court recently **reversed** stating that the 2010 act did not intend to render pre-existing oral palimony agreements unenforceable. Maeker v. Ross, 2014 N.J. LEXIS 910 (September 25, 2014).

# Claims for Unpaid Real Estate Assessment

- Homestead at Mansfield Homeowners Assoc. v. Estate of Mount
  - 2014 N.J. *Super.* Unpub. LEXIS 1634 (Docket No. A-0836-13T1)
  - Decided July 8, 2014
- Issue Presented – Is the beneficiary of real property liable for claims against the Decedent that have attached to the property?
- N.J.S.A. 3B:1-3 states in part that upon the death of an individual, his real and personal property devolves to the person to whom it is devised by his will, subject to rights of creditors and to administration.

# Claim Adjudication

- The Probate Part does not adjudicate common creditor claims.
- A creditor whose claim is denied by a personal representative must initiate a Law Division action to reduce the claim to judgment.
- Once a creditor has reduced a claim to judgment, the creditor has standing to demand an accounting if the judgment is not satisfied.

# How Claims are Paid; Abatement

- The personal representative pays claims out of the assets of the estate in the following order (3B:22-3 & 3B:23-12):
  - a. Property passing by intestacy;
  - b. Residuary devises (*e.g.* “I give my children all the rest, residue and remainder of my estate, in equal shares”);
  - c. General devises (*e.g.* “I give my son \$100,000”);
  - d. Specific devises (*e.g.* “I give my son my house located in Edison”).

# Release & Refunding Bonds – 3B:22-15

- In an action by a creditor against a personal representative, for the payment of a ratable proportion of his debt, it shall be presumed that the assets of the estate due a devisee or heir have not been paid over to him, if no refunding bond from the devisee or heir is on file.
- However, the presumption may be rebutted by actual proof of payment.

# Claims for Unpaid Taxes

- Who is liable for the unpaid income taxes of a decedent?
- Who is liable for the estate and inheritance taxes?
- What actions can be taken to protect the personal representative?

# Claims for Federal Estate & Income Taxes

- 26 U.S.C. 2002 imposes the responsibility to pay the Estate's tax on the executor.
  - Treas. Reg. 20.2002-1 provides that the Federal estate tax is payable by the executor of the decedent's estate. This duty applies to the entire tax, regardless of the fact that the gross estate consists in part of property which does not come within the possession of the executor.
- 26 U.S.C. 2203 defines an "executor" as the appointed executor, or if none, then *any person* in actual or constructive possession of any property of the decedent.
- 31 U.S.C. 3713(b): a personal representative "paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government."

# Claims for Federal Estate & Income Taxes Cont.

- The word "debt" includes a beneficiary's distributive share of an estate.
- Thus, if the executor pays a debt due by the decedent's estate or distributes any portion of the estate before all the estate tax is paid, he is personally liable, to the extent of the payment or distribution, for so much of the estate tax as remains due and unpaid. –Treas. Reg. 20.2002-1

# David Allen, et al., TC Memo 1999-385, 11/24/1999

- Facts: In 1987, Decedent died intestate with a gross taxable estate of \$11M. Following Decedent's death, Decedent's son David took possession of Decedent's assets rendering the estate insolvent. David never qualified as the administrator of his father's estate, but transferred all of the assets to himself.
- Held:
  1. David is the "executor" of Decedent's estate within the purview of section 2203.
  2. David was the fiduciary (personal representative) of Decedent's estate within the purview of 31 U.S. section 3713(b). David is responsible for the payment of income and estate taxes, as well as additions to tax, owed by Decedent's estate.
  3. David is liable as a transferee of the assets of Decedent's estate for the income and estate taxes, as well as additions to tax, owed by the estate.

# New Jersey Estate & Inheritance Taxes

- 54:35-2. Executors, administrators, trustees, grantees, donees or vendees shall be personally liable for any and all such taxes until paid.
- 54:36-7. No executor or trustee shall turn over any property of an estate until all taxes have been paid. Any executor or trustee who shall turn over any such property prior to the payment of tax due thereon, together with interest, shall be personally liable for such tax and interest.
- 54:38-6. All administrators, executors, trustees, grantees, donees and vendees, shall be personally liable for taxes. Taxes imposed under this chapter shall remain a lien on all property of the decedent as of the date of the decedent's death until paid.

# Tax Liability on Non-Probate Assets

- Gould v. Director, Division of Taxation, 2 N.J. Tax 316 (Tax Ct. 1981)
- Decedent's estate comprised of non-probate insurance transfers to Decedent's niece and grandniece, both living out of state. Decedent named plaintiff sole residuary beneficiary and executor.
- Held. Executor is personally liable for unpaid taxes to the extent of the estate assets entering his possession regardless of whether those taxes are the result of non-probate transfers. His "liability as executor is measured by, and limited to, the value of assets which actually came into his hands, irrespective of whether he acquired dominion over the subject matter of a particular taxable transfer".

# Insufficiency of Probate Estate

- Estate of Jerry Turco, 2013 N.J. Super. Unpub. LEXIS 1923
  - Docket No. ESX-CP-0162-2005
  - Decided July 22, 2013
- Question Presented: Does the personal representative have a duty to pursue non-probate assets to satisfy the debts of the Decedent?
- Answer: No. There is no statutory authority permitting the personal representative to access non-probate assets. The PR has no duty under federal law to pursue the non-probate assets.

# Joint Accounts – N.J.S.A. 17:16I-7

- The Multiple-Party Deposit Account Act contains provisions for the payment of debts, taxes, and administrative expenses in situations where the estate assets are otherwise insufficient.
- Ordinarily, the joint owner would take sole possession of the account.
- N.J.S.A. 17:16I-7 allows the estate of a deceased account holder to recover from the survivor to pay debts, taxes and administration expenses if other estate assets are insufficient.
- The Act provides in part that no multiple-party account will be effective against the estate to transfer to a survivor sums needed to pay debts, taxes, and expenses of administration.

# Prompt Assessment of Federal Taxes

- The IRS generally has three (3) years to assess tax from the date the return is filed.
- This places an added burden on the Executor, because the true nature of unpaid income tax liabilities may not be known for several years.
- One option is for the executor to request a prompt assessment of the decedent's income tax liabilities by filing a form 4810.
- This gives the IRS just eighteen (18) months (instead of 36 months) to review the filed returns and assess the tax.