

# CREDITOR ISSUES & ESTATE ADMINISTRATION

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## I. INTRODUCTION

A rapidly declining real estate and securities market hurts every aspect of society. The administration of probate estates is no exception. This article discusses the payment of creditors in the ordinary solvent course, when the value of estate assets exceeds estate liabilities, and in the insolvent course, when estate liabilities exceed the value of estate assets. More and more often a fiduciary will discover that an estate that was solvent at inception has suddenly become insolvent. In such a case, the fiduciary must act swiftly to properly administer and settle the estate. However, determining what is "proper" under the circumstances is often not intuitive and, as a result, the fiduciary must seek out probate court instruction.

When an estate includes volatile investments which can be easily liquidated, such as marketable securities, the fiduciary must act quickly to liquidate those assets in order to preserve and conserve the estate value and to avoid being held liable for a solvent estate becoming insolvent.<sup>1</sup> Since estate assets currently receive a step-up in basis at death, for capital gain tax purposes, there is no capital gain tax reason not to liquidate.<sup>2</sup> While real estate and closely held businesses may also need to be sold to pay estate debts, it is not always easy to sell such assets, particularly in a down market.

### A. Solvent Estates

In the ordinary course of administering a solvent estate, the fiduciary (whether an executor, administrator or personal representative) focuses his attention on collecting estate assets and paying debts, without regard to priority of claims or the order of payment. No one complains because all estate creditors are paid and there are sufficient assets remaining for distribution to the estate beneficiaries. In a rapidly declining market, however, the fiduciary must be especially careful to collect assets and pay debts in accordance with state law. If he does not, the fiduciary could be held personally liable to the creditors and/or the heirs of the estate.

R.S.A. 554:19 sets forth the priority in which estate debts and expenses must be paid by the fiduciary:

- I. The just expenses of administration (including taxes, legal, appraisal, accounting and fiduciary fees);
- II. The necessary expenses of the funeral and burial of the deceased;
- III. The reasonable allowance to the surviving spouse, if any;
- IV. The just debts owed by the deceased, including the necessary

expenses for the decedent's last illness;

- V. The support of the deceased's minor children until age 18;
- VI. The total amount paid for old age assistance and disability assistance and, under certain circumstances, charges pursuant to R.S.A. 166:19.
- VII. The legacies given by the will of the deceased

The fiduciary has a duty to pay the "just debts owed by the deceased" under R.S.A. 554:19, IV. These are debts owed by the decedent at the time of the decedent's death and include any real estate taxes assessed as of April 1<sup>st</sup> of a decedent who dies later in that tax year.<sup>3</sup> If a fiduciary fails to pay such debts, the failure is a breach of a condition of his fiduciary bond and the unpaid creditor could recover on the bond.<sup>4</sup>

Coming after the support of minor children, but before the payment of legacies on the priority list, are amounts "paid for old age assistance or aid to the permanently and totally disabled and, under certain circumstances, charges pursuant to R.S.A. 166:19."<sup>5</sup>

R.S.A. 166:19 provides that "[a]ny county furnishing any assistance to any person within 6 years preceding his death, shall be entitled to recover from the estate of such person the sum or sums paid out for such assistance, the same to be a preferred claim against his estate, after the payment of his funeral charges, expense of last sickness and expenses of administration, provided he leaves no widow or minor children living at his decease." This topic (the ever changing methods by which the state and counties pursue estates of decedents who have received government assistance) could be the subject of an entire *Bar Journal* article. It is noteworthy, however, that fiduciaries must be mindful of this category of creditors and should be advised to actively investigate whether the decedent received such government assistance prior to his death.

Despite his duty to pay debts, the fiduciary also has a duty to compromise creditor claims if it is reasonable to do so and beneficial to the estate.<sup>6</sup> Accordingly, the fiduciary cannot blindly pay all creditor claims submitted to him. Rather, the fiduciary must carefully examine the accuracy and validity of such claims and, if appropriate under the circumstances, compromise and settle such claims. Prior court approval of a settlement may be requested but it is not always required.

For example, in *Burtman v. Butman*,<sup>7</sup> the New Hampshire Supreme Court held that where a fiduciary entered into a verbal settlement agreement with the decedent's surviving spouse who had elected against the decedent's will, the agreement was binding and enforceable even though the fiduciary did not obtain prior court approval of the agreement.<sup>8</sup>

If a fiduciary is also a creditor of the estate, however, he cannot compromise or settle his own claim against the estate without prior

court approval.<sup>9</sup>

In some instances, as a result of a mistake or the failure of a creditor to pursue payment, some creditors may go unpaid. R.S.A. 556 governs the statutory time periods for suits by and against a fiduciary. The statute is intended to protect creditor rights while ensuring the efficient administration of probate estates.

R.S.A. 556:3 provides that a creditor's claim against an estate is barred unless the creditor files a notice of claim and demand with the fiduciary within six (6) months of the grant of administration.<sup>10</sup> R.S.A. 556:5 provides that a creditor's claim is barred unless the creditor files suit against the estate within one (1) year of the grant of administration.

Beginning in 2008, the proper venue in which to bring such a suit has been expanded to include the probate court, concurrently with the district court or the superior court which otherwise has jurisdiction. RSA 547:3-1 provides that probate courts have concurrent jurisdiction over ancillary matters including "claims for liquidated or non-liquidated damages or for the recovery of money or property brought on behalf of an estate, trust, conservatorship, or guardianship including claims against a third party or brought by a third party against an estate, trust, conservatorship, or guardianship including claims against a fiduciary bond and entry or possessory actions..." (Emphasis added).

There is no statutory procedure for presenting a claim to the fiduciary. However, R.S.A. 556:2 states that a written "notice sent to the fiduciary or his agent by registered mail, setting forth the nature and amount of the claim and a demand for payment, shall be deemed a sufficient exhibition and demand." Note that this is not the exclusive method of giving notice. A claim may be made against an estate verbally, in writing or a combination of both.<sup>11</sup>

A creditor who fails to meet either the six (6) month claim or one (1) year lawsuit deadline may petition the court having subject matter jurisdiction over the nature of the claim for an extension pursuant to R.S.A. 556:28. The Petition must set forth facts sufficient to show that justice and equity require the requested extension and that failure to file timely notice or suit was not the result of culpable neglect.<sup>12</sup>

The term "culpable neglect" has been defined as "less than gross carelessness, but more than the failure to use ordinary care, it is a culpable want of watchfulness and diligence, the unreasonable inattention and inactivity of creditors who slumber on their own rights. It exists if no good reason, according to the standards of ordinary conduct, for the dormancy of the claim is found."<sup>13</sup>

In *Tulsa Professional Collection Services v. Pope*,<sup>14</sup> the U.S. Supreme Court held that an executor must give actual notice to all "known or reasonably ascertainable" creditors of an estate of deadlines by which the creditors must file claims with or suit against the executor. In addition, an executor must make "reasonably diligent efforts" to uncover the identities of estate creditors.<sup>15</sup>

Many practitioners send "Tulsa" letters to all known creditors by certified mail, return receipt requested, to provide proof of mailing in the event that actual notice is later disputed by a creditor. This firm's typical "Tulsa" letter provides: (1) the name of the fiduciary; (2) the date the fiduciary was appointed by the court; (3) notice of the six (6)

month period for creditors to file claims with the fiduciary; and (4) notice of the one (1) year period for creditors to file suit against the estate.

Numerous cases have considered whether a creditor's extension request under R.S.A. 556:28 should be denied on the basis of culpable neglect. In *Stewart v. Farrell*,<sup>16</sup> the N.H. Supreme Court held that the superior court erred in ruling that a tort plaintiff was chargeable with culpable neglect since (1) a tort plaintiff was not required to notify the tortfeasor of an intent to bring suit within the time allowed by the statute of limitations, then six (6) years; and (2) the plaintiff may have been a known or reasonably ascertainable estate creditor who was entitled to actual notice of deadlines for filing claims.<sup>17</sup>

By contrast, in *Cass v. Ray*,<sup>18</sup> the N.H. Supreme Court held that the superior court erred in allowing an extension of time to file suit against an estate where, due to an oversight, the creditor's attorney failed to file suit within the statutory period. In that case, the N.H. Supreme Court held that the attorney's culpable neglect in filing suit would be attributed to the creditor.<sup>19</sup>

In *Skrizowski v. Chandler*,<sup>20</sup> the N.H. Supreme Court held that the probate court erred in ruling that a creditor's claim was not time barred on grounds that the executor had actual knowledge of the debt. In that case, the estate paid monthly mortgage payments to the creditor for approximately six (6) months.<sup>21</sup> When payments stopped, the creditor filed a petition seeking payment.<sup>22</sup> The probate court ruled in favor of the creditor on the grounds that the statute was not intended to deprive creditors of their rights but to bring a claim to the executor's attention.<sup>23</sup> The probate court held that the executors had actual knowledge of the debt, having made partial payments, and that they could not claim surprise or the benefit of the statute.<sup>24</sup> The N.H. Supreme Court reversed stating that the creditor's action was time-barred because the statutory deadlines were missed.<sup>25</sup> However, the creditors could petition the superior court for an extension under R.S.A. 556:28.<sup>26</sup>

The N.H. Supreme Court also held, in the *Bennett* case, that the probate court erred in ruling that a creditor's claim was time barred on grounds of culpable neglect where a probate asset was discovered more than one (1) year after the initial grant of administration.<sup>27</sup> In the *Bennett* case, the fiduciary represented to the creditor that the estate was insolvent and the creditor discharged most of the decedent's mortgage.<sup>28</sup> More than a year later, when an annuity payable to the estate was discovered, the creditor objected to distribution to the estate heirs and demanded payment.<sup>29</sup> The probate court held that the creditor's failure to bring suit against the estate within one (1) year of the initial grant of administration constituted culpable neglect and the N.H. Supreme Court reversed its decision.<sup>30</sup> The case was remanded to the probate court to extend the time for filing and prosecuting the claim under R.S.A. 556:28.<sup>31</sup>

A two (2) year limitations period applies with respect to real estate when no estate administration has been initiated.<sup>32</sup> R.S.A. 556:29 provides "if no administration shall have been granted upon the estate of a deceased person within two years from the date of death, no creditor of the deceased shall thereafter be entitled to maintain any action or proceeding in any court to appropriate the real estate

or interests therein of which the deceased died seized, to the payment or satisfaction in whole or in part of his claim against the estate.”

Real estate of a decedent is subject to special rules and, as a result, careful attention is required by the fiduciary. Unlike personal property, which passes to the fiduciary upon the death of the decedent, real estate of a decedent passes directly to the decedent’s devisee or heir, subject to being divested for the payment of the decedent’s debts.<sup>33</sup>

The fiduciary of a solvent estate has no affirmative duty to take possession of a decedent’s real estate and is not required to account for such property in his fiduciary accounting, although he must list all real estate on the estate inventory. If the fiduciary does take possession, the fiduciary must use reasonable care with respect to such property or risk being held accountable for any failure.<sup>34</sup>

In *McInnes v. Goldthwaite*,<sup>35</sup> a fiduciary took possession of real estate owned by a decedent, paid real estate taxes and insurance premiums thereon and generally maintained the property. The N.H. Supreme Court found that the real estate, which was retained in the estate for nine (9) years after the decedent’s death, was not sold by the fiduciary on a timely basis.<sup>36</sup> The N.H. Supreme Court found that the real estate should have been sold five (5) years after the decedent’s death and disallowed certain estate expenditures, including fiduciary fees and bond premiums, that were incurred after that date.<sup>37</sup> The N.H. Supreme Court ruled that where a fiduciary takes possession and control of “real estate and seeks to have his expenditures of estate funds thereon allowed in his account, he cannot complain if the corresponding duty of using reasonable care and skill to make the property productive is imposed upon him.”<sup>38</sup>

In some instances, it will become necessary for the fiduciary to sell estate assets to pay the debts of an estate. If the personal property of an estate is insufficient for this purpose, the fiduciary must either obtain a license from the probate court to sell the real estate under R.S.A. 559:1 or obtain the written consent of the surviving spouse and heirs or devisees to sell the real estate under R.S.A. 559:18. The proceeds from the sale of the real estate may then be used to pay the debts of the estate. Note that if a sale is not appropriate, the fiduciary could obtain a license to mortgage the real estate for this purpose under R.S.A. 554:30, although it is questionable whether a mortgage could be obtained from a commercial lender, as a practical matter. As a result of significant market declines, many estates that are initially opened as solvent estates may become insolvent. The fiduciary in such case should either seek to have the estate administered as an insolvent estate under R.S.A. 557 or file a petition with the probate court seeking instructions regarding the payment of estate creditors.

## B. Insolvent Estates

An estate is insolvent if the sum of all estate debts is greater than the fair market value of the estate assets. R.S.A. 557 governs the administration of insolvent estates and provides little practical guidance to practitioners handling insolvent estates. Fortunately, as of the date of this writing, we have received word that the Administrative Judge of the New Hampshire Probate Court, David D. King, will be forming a committee to revise the insolvency statute and the procedures for administering insolvent estates in New Hampshire.

Currently, R.S.A. 557:1 provides that a fiduciary may, but is not required to, seek to have an estate administered as insolvent. This is sometimes referred to as an administration in the “insolvent course.” The court will appoint up to three (3) commissioners to examine all claims and to determine how claims should be paid.<sup>39</sup> Generally, only one (1) commissioner is appointed by the probate court and often the court will appoint an attorney suggested by the fiduciary to serve as the commissioner. Due to its pecuniary interest in the estate, a creditor cannot serve as a commissioner of an insolvent estate.<sup>40</sup>

If insolvency is not apparent when an estate is initially opened, the fiduciary may later petition the court to continue administration in the insolvent course under the insolvency statute. R.S.A. 557:2 provides that if a fiduciary applies for insolvent administration of an estate more than six (6) months after the initial grant of administration, the application will be granted only upon notice of the petition by publication and in the discretion of the judge.

Note that a fiduciary cannot pay claims of an insolvent estate until the probate court accepts the commissioner’s report and issues a decree for distribution.<sup>41</sup>

Interestingly, an estate that is solvent may be administered in accordance with the insolvency statute.<sup>42</sup> This could be useful in solvent estates where there are creditors with disputed claims.<sup>43</sup> The commissioner in such case could expedite the administration of the estate by examining all claims at once and making a recommendation regarding the payment of all estate creditors.

Once the court decrees that an estate is insolvent, estate creditors are barred from filing suit against the fiduciary unless the deceased was insured for the matter which is the subject of the action and recovery is limited to the coverage of the insurance policy.<sup>44</sup> In addition, all pending actions against a fiduciary cannot be further prosecuted without leave of the court and if a judgment is rendered by the court, such judgment will be added to the list of claims against the insolvent estate.<sup>45</sup>

Generally, in an insolvent estate, the court will set a time period of three (3) to six (6) months for creditors to present claims against the estate to the commissioner.<sup>46</sup> For sufficient cause, however, the court may extend the time for creditors to present their claims, up to one (1) year from the date of the original commission.<sup>47</sup>

If real estate is part of an insolvent estate, the fiduciary must collect all rents and profits attributable to the property and, unlike the case of a solvent estate, the fiduciary must take possession of the real estate and keep it in good repair.<sup>48</sup>

If a creditor’s debt is secured by collateral, the commissioner is required to estimate the value of the security and allow the creditor the difference between the value of the security and the amount of the creditor’s debt.<sup>49</sup> If the creditor is dissatisfied with the commissioner’s estimate of the value of the security, the creditor’s only recourse is to relinquish its interest in the security and surrender the security to the fiduciary.<sup>50</sup> The fiduciary must then sell or otherwise dispose of the security and pay the proceeds to the creditor.<sup>51</sup> The difference between the proceeds paid to the creditor from the sale of the security and the creditor’s claim shall be inserted on the list of claims, in place of the sum allowed by the commissioner.<sup>52</sup>

Once all claims have been presented and considered, the commissioner must file a report with the court of all claims presented and the amounts allowed on such claims, pursuant to R.S.A. 557:17. The probate court will rely on the commissioner's report as the basis for its final decree.

R.S.A. 557:22 governs the payment of preferred claims in an insolvent estate. Expenses of administration, burial expenses, the widow's allowance and taxes must be paid in the order named. R.S.A. 557:23 then provides that the expenses of last illness must be paid. Any remaining balance in the Estate must then be distributed among the other creditors in proportion to their respective claims.<sup>53</sup> Note that this order of preference is similar, but not identical, to preferred claims in a solvent estate, where expenses of last illness are in the same category as other debts of the decedent.

The probate court decree will contain the name of each creditor, the amount allowed to each creditor and the amount each creditor is entitled to receive from the fiduciary, usually by accepting the commissioner's report.<sup>54</sup>

R.S.A. 558 governs appeals from the commissioner's report. Once a commissioner's report is accepted by the probate court, the court must send a notice to each creditor whose claim has been wholly or partly disallowed stating that the creditor has a right to appeal the report within thirty (30) days of the notice.<sup>55</sup> Unless an appeal is taken in a timely manner, the claim will be barred under R.S.A. 558:22.

A dissatisfied creditor may file a petition for appeal with declaration "in the proper form" with the probate court within thirty (30) days of the notice regarding the commissioner's report under R.S.A. 558:2. A similar procedure is available for a dissatisfied fiduciary under R.S.A. 558:6 and an heir or other creditor under R.S.A. 558:8. Note that an heir or other creditor filing an appeal must file a bond with the probate court to indemnify the estate from cost or damage that may accrue in the prosecution of the appeal.<sup>56</sup>

A declaration is sufficient, under R.S.A. 558:10, if it states that the decedent, at the time of his death was, and his estate is, justly indebted to the creditor. The petition should set forth the substance and amount of the claim and whether it was disallowed in whole or in part.<sup>57</sup>

R.S.A. 558:22 provides that all demands against an estate which might have been presented to the commissioner and were not so presented are barred. This statute does not apply to debts that are wholly secured<sup>58</sup> and also does not apply to specific property belonging to a claimant and wrongfully withheld by the fiduciary.<sup>59</sup> In the latter case, the claim is brought against the fiduciary and not the estate.<sup>60</sup> The bar also will not apply to bar subsequently discovered claims that were fraudulently concealed by a decedent.<sup>61</sup>

If the payment of preferred claims consumes all of the assets of the estate, the fiduciary may file the final account with the probate court and, by decree, be discharged from all claims of creditors without the appointment of a commissioner or further proceedings.<sup>62</sup> If assets are subsequently discovered, however, creditors may assert claims against the fiduciary.<sup>63</sup>

Settlement of insolvent estates invariably involves debt forgiveness. One land mine of which fiduciaries of insolvent estates must be mindful is that artificial concept of taxable income from discharge

of indebtedness. Internal Revenue Code 61(a)(12) provides that discharge of indebtedness must be included in a taxpayer's gross income. Thankfully, there is an exception to the income recognition rule for insolvent taxpayers. Internal Revenue Code 108(a)(1)(B) provides that a taxpayer may exclude from income a discharge of indebtedness that occurs while the taxpayer is insolvent up to the amount by which the taxpayer is insolvent. For purposes of the exception, the term "insolvent" means the excess of liabilities over the fair market value of assets, determined immediately before the discharge.<sup>64</sup> The amount that may be excluded from income is no more than the amount by which the taxpayer is insolvent.<sup>65</sup> For example, if a taxpayer with liabilities of \$100,000 and assets with a fair market value of \$94,000 has a \$10,000 debt forgiven, the taxpayer may exclude \$6,000, leaving discharge of indebtedness income of \$4,000. In order to take advantage of the insolvency exception, the taxpayer must file Internal Revenue Service Form 982 with the taxpayer's income tax return for the taxable year in which the discharge occurred.

## II. CONCLUSION

The fiduciary who is charged with administering an estate in a declining economic environment must act swiftly and prudently to liquidate marketable securities, settle estate claims and distribute any remaining assets to the estate beneficiaries. When in doubt, the fiduciary should seek probate court guidance to ensure that the estate is administered properly and the fiduciary is shielded from personal liability.

## ENDNOTES

1. See Estate of Norman P. Bolduc, Jr., Rockingham County Probate Court Docket No. 2000-1299, an unreported probate court decision from 2000 in which the executor was surcharged because he should have acted sooner to liquidate the marketable securities in the estate. See also *In re Estate of McCool*, 131 N.H. 341 (1989).
2. IRC 1014(a)(1).
3. *In re Estate of Robbins*, 116 N.H. 248 (1976).
4. 10 DeGrandpre, *New Hampshire Practice: Probate and Administration of Estates, Trusts & Guardianships*, 36-6 (4th ed. 2008), citing *Hoyt's Probate Practice* 39-40 (1901).
5. R.S.A. 554:19, VI.
6. *Simes v. Ward*, 78 NH 533, 535 (1918). See also, R.S.A. 556:27.
7. 94 NH 412 (1947).
8. *Id.* at 416.
9. R.S.A. 554:14.
10. R.S.A. 556:1 and R.S.A. 556:3.
11. *Frost v. Frost*, 100 NH 326 (1956).
12. R.S.A. 556:28. *Cass v. Ray*, 131 NH 550, citing *Stewart v. Farrell*, 131 NH 458 (1989), *Emerson's Sons v. Cloutman*, 88 N.H. 59 (1936).
13. *Coffey v. Besnahan*, 127 NH 687, 693 (1986).
14. 485 US 478 (1988).
15. *Id.* at 491.
16. 131 NH 458 (1989).
17. *Id.* at 465, citing *Tulsa Professional Collection Services v. Pope*, 108 S. Ct. 1340 (1988).
18. 131 NH 550 (1989).
19. *Id.* at 554.
20. 133 NH 502 (1990).
21. *Id.* at 503.

22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.* at 504.
26. *Id.*
27. *In re Bennett*, 149 NH 496 (2003).
28. *Id.*
29. *Id.* at 497.
30. *Id.*
31. *Id.* at 499.
32. R.S.A. 556:29.
33. 10 DeGrandpre, *New Hampshire Practice: Probate and Administration of Estates, Trusts & Guardianships*, 35-5 (4th ed. 2008), citing *Lucy v. Lucy*, 55 N.H. 9 (1874) and *Gregg v. Currier*, 36 N.H. 200 (1858).
34. *McInnes v. Goldthwaite*, 96 N.H. 413, 416 (1951).
35. *Id.*
36. *Id.* at 415.
37. *Id.*
38. *Id.* at 416.
39. R.S.A. 557:1.
40. *Preston v. Cutter*, 64 N.H. 461 (1888).
41. *Judge of Probate v. Couch*, 59 N.H. 506 (1880).
42. 11 DeGrandpre, *New Hampshire Practice: Probate Law and Procedure*, 49-1 at p. 3 (3d ed. 2001), citing *Reynolds v. Chase*, 87 N.H. 227 (1935) and 9<sup>th</sup> Report Judicial Council, p. 13 (1962).
43. *Id.*
44. R.S.A. 556:8.
45. *Id.*
46. R.S.A. 557:7.
47. R.S.A. 557:8.
48. R.S.A. 554:15.
49. R.S.A. 557:15.
50. R.S.A. 557:16.
51. *Id.*
52. *Id.*
53. R.S.A. 557:24.
54. R.S.A. 557:25.
55. R.S.A. 558:1.
56. R.S.A. 558:8.
57. 11 DeGrandpre, *New Hampshire Practice: Probate Law and Procedure*, 50-2 at p. 20 (3d ed. 2001), citing *Cook v. Bennett*, 51 N.H. 85 (1871).
58. *Tuttle v. Robinson*, 33 N.H. 104 (1856).
59. *Rice v. Connally*, 71 N.H. 382 (1902).
60. *Id.*
61. 11 DeGrandpre, *New Hampshire Practice: Probate Law and Procedure*, 49-3(f) at p. 13 (3d ed. 2001), citing *Sugar River Bank v. Fairbank*, 49 N.H. 131 (1869).
62. R.S.A. 557:34.
63. *Clough v. Clark*, 63 N.H. 403 (1885).
64. IRC 108(d)(3).
65. *Id.*



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