

Memorandum 90-121

Subject: Study L-3018 - Litigation Involving Decedents (Tax Litigation Issue)

At the July meeting, the Commission approved the *Tentative Recommendation Relating to Litigation Involving Decedents* to print and for submission to the 1991 legislative session, subject to possible revision to deal with comments of Paul Gordon Hoffman concerning federal tax litigation. (A copy of Mr. Hoffman's letter directed to the tentative recommendation is attached as Exhibit 1.)

The staff discussed the matter with Mr. Hoffman by telephone on July 30. It appears that Mr. Hoffman's concern really focuses on the meaning of "decendent's cause of action" as used in proposed Code of Civil Procedure Sections 377.310 and 377.320 (set out on following pages of this memorandum). His experience with the IRS raises doubts that this language fits the situation where a taxpayer is petitioning to review a determination of a deficiency. He is concerned that there may be a distinction between a cause of action where the decedent was suing for payment of money and the situation here, in which the taxpayer is petitioning within 90 days of notice of deficiency to contest the determination.

The experience reflected in Mr. Hoffman's letter dates from over a year and a half ago. Later, in a 1989 case, the Tax Court ruled that, under California Code of Civil Procedure Section 385, a decedent petitioner's only child would be allowed to be substituted as a party in a case initiated by the decedent and pending at death. *Everett v. Commissioner, T.C.M. (P-H) ¶ 89-124 (Mar. 27, 1989)*. The court drew a distinction between a case where a successor seeks to initiate an action and where the successor seeks to be substituted as a party, phrasing the question in the case as whether California law would allow the substitution.

Everett is completely consistent with proposed Code of Civil Procedure Section 377.320. In fact, the language in existing Code of

Civil Procedure Section 385 concerning successors in interest is the source from which sprang the *Tentative Recommendation Relating to Litigation Involving Decedents*. The recommendation goes one step further and also applies to commencement of actions by successors. Consequently, this should have the effect of extending the *Everett*-type of ruling to permit the successor to petition in the Tax Court for a redetermination within the applicable 90-day period. Of course, the state cannot do this directly, but only through adopting general rules concerning proper parties following death, since the federal rules apply state law to determine proper parties. See Tax Court Rules 60, 63. This is precisely what we have been proposing to do in the tentative recommendation.

The last hurdle appears to be making the change in California law apparent to the IRS and the Tax Court. This brings up the question of whether "decedent's cause of action" is an adequate expression. The staff discussed several alternatives with Mr. Hoffman, including revising or defining this phrase. The staff is reluctant to depart from this traditional general language, and it has been our experience that some basic terms are best left undefined. Once we set out to define something like "cause of action" we are likely to cause problems elsewhere. Definition of a fundamental term like "cause of action" tends to impose unintended limitations or introduce new sources of confusion. In any event, "action" is already defined in Code of Civil Procedure Section 22 in sufficiently broad terms: "An action is an ordinary proceeding in a court of justice by which one party prosecutes another for the declaration, enforcement, or protection of a right, the redress or prevention of a wrong, or the punishment of a public offense." Section 23 fills any remaining gaps: "Every other remedy is a special proceeding."

"Cause of action" is used throughout the Code of Civil Procedure without further definition and, so far as we know, without causing any serious problems. Incidentally, a reading of *Everett* supports the notion that traditional language is fully workable in this procedural stance, and the staff is not convinced that this type of litigation presents any special problems requiring new language.

Nevertheless, the staff believes that proposed Section 377.310 can be made more informative by revising the wording and keeping the

concept of a "cause of action." (See below.) Other alternatives for resolving Mr. Hoffman's concern involve adding language to the comments to proposed Sections 377.310 and 377.320. The staff favors this approach, since it provides additional and more specific guidance as to the intent of the statute. The staff proposes to revise the proposed statute and their comments as follows:

§ 377.310. Commencement of decedent's cause of action

377.310. A ~~decedent's~~ cause of action that survives the death of the person entitled to commence an action or proceeding passes to the decedent's successor in interest, subject to Chapter 1 (commencing with Section 7000) of Part 1 of Division 7 of the Probate Code, and an action or proceeding may be commenced by the decedent's personal representative or, if none, by the decedent's successor in interest.

Comment. Section 377.310 restates the first portion of the first sentence of former Code of Civil Procedure Section 353 and part of former Probate Code Section 573(a) without substantive change, but adds the reference to the successor in interest drawn from former Code of Civil Procedure Section 385. Under this section, an action or proceeding may be commenced by the decedent's successor in interest only if there is no personal representative. The distributee of the cause of action in probate is the successor in interest or, if there is no distribution, the heir, devisee, trustee, or other successor has the right to proceed under this article. See Section 377.120 ("decedent's successor in interest" defined). See also Prob. Code § 58 ("personal representative" defined). The addition of the reference to the successor in interest makes the rules applicable to commencement of an action consistent with the rules applicable to continuation of a pending action. Thus, the distinction between commencing and continuing the decedent's action drawn in Everett v. Commissioner, T.C.M. (P-H) ¶ 89,124 (Mar. 27, 1989), is not applicable under Sections 377.310 and 377.320.

§ 377.320. Continuation of decedent's pending action

377.320. On motion after the death of a person who commenced an action or proceeding, the court shall allow a ~~decedent's~~ pending action or proceeding that does not abate to be continued by the decedent's personal representative or, if none, by the decedent's successor in interest.

Comment. Section 377.320 restates part of former Section 385, but recognizes that the personal representative or successor in interest has an absolute right to be substituted for the decedent; substitution in this situation

is not discretionary with the court. See, e.g., Pepper v. Superior Court, 76 Cal. App. 3d 252, 260, 142 Cal. Rptr. 759 (1977). See also Section 377.120 ("decedent's successor in interest" defined). This section is consistent with the application of former Section 385 in a federal Tax Court. See Everett v. Commissioner, T.C.M. (P-H) ¶ 89-124 (Mar. 27, 1989) (daughter of decedent petitioner substituted as party under federal rules adopting local law as to proper parties).

If the Commission approves these revisions, we will include this material (subject to any other changes made) in the recommendation when it is prepared for printing.

Respectfully submitted,

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CA LAW REV. COMM'N
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May 30, 1990

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Re: Tentative Recommendation Relating to
Litigation Involving Decedents

Ladies and Gentlemen:

There is one particular item which I do not believe is adequately dealt with in the above mentioned Tentative Recommendation. This has to do with litigation involving the decedent's liability for income taxes.

I have been involved in several situations where the Internal Revenue Service asserted a proposed income tax deficiency against a decedent based upon the joint income tax return filed by the decedent and his surviving spouse. When the decedent died, there was no probate administration since all of the assets passed to the surviving spouse without the need for an administration, pursuant to California Probate Code § 13500 et seq.

Notwithstanding the fact that the surviving spouse is liable for all of the debts of the decedent pursuant to § 13550, and is potentially liable for the entire tax deficiency (on a joint and several basis) by virtue of there being a joint income tax return, the Internal Revenue Service has refused to accept the surviving spouse as the sole proper party to the suit. Rather, the Service has maintained that if the surviving spouse fails to open a probate and defend on behalf of the estate as well as on behalf of the surviving spouse individually, the Service would seek to obtain a default judgment against the decedent and attempt to enforce it directly against the surviving spouse. Having been unable to convince the Service of the error

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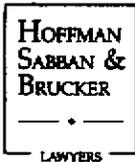
of its views, and since the cost of opening a probate is relatively small in comparison to the legal fees that might have to be incurred to assert my position in the Tax Court, I have always proceeded to open a no-asset probate.

The nature of Tax Court litigation does not fall neatly within the categories discussed in the Tentative Recommendation. It is not a suit brought on the decedent's cause of action since it is a suit to avoid payment of a liability. In the Tentative Recommendation, you indicate that in an action on the decedent's liability, where the plaintiff does not proceed directly against the decedent's successors in interest,

"the personal representative is the proper party. This rule ensures that all the decedent's beneficiaries are assessed their proper shares of the debt without the complications of interpleader and contribution. This also enables the creditor to marshal assets simply, without the need to join various recipients of the decedent's property and without complicating issues of the extent to which the property and its proceeds may be traced. And the rule provides a mechanism for ranking claims where there is more than one creditor."

Based on these statements, it seems clear to me that you are siding with the Service in its view of the law. However, this seems nonsensical to me. First, the liability of the surviving spouse in the normal case is unquestionable. The surviving spouse is liable for the decedent's debts pursuant to Section 13500 et seq. Second, there is joint and several liability on behalf of the spouses when they file a joint income tax return. Third, I see no reason to unnecessarily expend court time on handling a "dry probate".

I would urge you to specifically authorize a surviving spouse who takes assets pursuant to § 13500 et seq. to commence an action for a determination of taxes, where no administration of the estate is pending at the date the action is brought, and to make a determination of the Tax Court binding based on all the assets of the decedent. While it may be that, in obscure cases, a beneficiary of the decedent other than the surviving spouse may



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be named as the executor, and be adversely affected by his or her inability (upon subsequent appointment by the court as executor) to participate in the litigation, I have never seen such a situation which could have arisen, and in the vast majority of cases my proposal would streamline procedures and eliminate unnecessary court involvement.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Paul Gordon Hoffman".

Paul Gordon Hoffman

PGH34:cdb