

Memorandum 2018-37

**Disposition of Estate Without Administration:
Property Return Provisions**

In this study, the Commission¹ is considering a number of technical issues that relate to certain Probate Code provisions allowing the disposition of a decedent's estate without administration (hereafter "probate avoidance procedures"). The provisions discussed here address personal property of small value,² real property of small value,³ and property received by a surviving spouse.⁴

The issues to be addressed in this study were identified in a letter from the Executive Committee of the Trusts and Estates Section of the California Lawyers Association ("TEXCOM").⁵ While that letter was commenting on deficiencies in Probate Code Section 5676, which governs revocable transfer on death deeds, the Commission provisionally concluded that the issues had similar application to the nearly identical provisions in the probate avoidance procedures.⁶ Although this memorandum does not discuss Section 5676 further, the resolution of issues in this study may be helpful in addressing the same issues in that section.

This memorandum considers only a few of the issues raised by TEXCOM. Others will be considered in future memoranda. This study may also reveal other technical problems in the probate avoidance procedures, which were not pointed out by TEXCOM. Such issues will be presented for the Commission's consideration later in the study.

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. Prob. Code §§ 13100-13116.

3. Prob. Code §§ 13200-13210.

4. Prob. Code §§ 13500-13660.

5. See Memorandum 2017-35, Exhibit.

6. Prob. Code §§ 13111, 13206, 13562.

Unless otherwise indicated, all statutory references in this memorandum are to the Probate Code.

OVERVIEW

Ordinarily, property that would pass by will or intestacy would be administered in a probate proceeding. However, in certain circumstances, existing law permits such property to pass to a devisee of a will or an heir under intestate succession rules without probate administration. **For convenience of reference, the remainder of this memorandum will use the term “transferee” to mean a person who receives property from a decedent under one of the probate avoidance procedures.**

In probate, a decedent’s estate is used to pay the decedent’s debts (and certain expenses) before it is distributed to devisees or heirs. If property passes outside of probate, it passes outside of that creditor satisfaction procedure. To avoid unfairness to creditors, the probate avoidance procedures make the transferee personally liable for the decedent’s unsecured debts, up to the value of the property received.⁷

A transferee is also personally liable if another person establishes a superior claim to the property by will or intestate succession (i.e., the other person, and not the transferee, was actually the devisee or heir of the property).⁸

In addition to the rules establishing personal liability, the probate avoidance procedures also include what this memorandum will call “property return provisions.” Those are provisions that allow the decedent’s personal representative to require a transferee to return transferred property (or its value) to the probate estate for use in paying creditor claims or transferring the property to a person with a superior right.⁹

For ease of reference, the discussion that follows will only cite to Section 13206, the property return provision that governs real property of small value. Unless otherwise indicated, it should be assumed that a citation to Section 13206 includes a citation to similar language in the other property return provisions and that there is no material difference between the provisions worth noting.

7. Sections 13109, 13204. The rules for liability of a surviving spouse are more complicated. See Sections 13550-13551, which will be discussed at length in Memorandum 2018-38.

8. Sections 13110, 13205, 13561.

9. Sections 13111, 13206, 13562. Section 5676 serves the same purpose in the revocable transfer on death deed statute. For discussion of property return under that provision, see Memorandum 2018-33.

Section 13206 provides:

13206 (a) Subject to subdivisions (b), (c), (d), and (e), if proceedings for the administration of the decedent's estate are commenced, or if the decedent's personal representative has consented to use of the procedure provided by this chapter and the personal representative later requests that the property be restored to the estate, each person who is designated as a successor of the decedent in a certified copy of an affidavit issued under Section 13202 is liable for:

(1) The restitution to the decedent's estate of the property the person took under the certified copy of the affidavit if the person still has the property, together with (A) the net income the person received from the property and (B) if the person encumbered the property after the certified copy of the affidavit was issued, the amount necessary to satisfy the balance of the encumbrance as of the date the property is restored to the estate.

(2) The restitution to the decedent's estate of the fair market value of the property if the person no longer has the property, together with (A) the net income the person received from the property prior to disposing of it and (B) interest from the date of disposition at the rate payable on a money judgment on the fair market value of the property. For the purposes of this paragraph, the "fair market value of the property" is the fair market value, determined as of the time of the disposition of the property, of the property the person took under the certified copy of the affidavit, less the amount of any liens and encumbrances on the property at the time the certified copy of the affidavit was issued.

(b) Subject to subdivision (d), if the person fraudulently executed or filed the affidavit under this chapter, the person is liable under this section for restitution to the decedent's estate of three times the fair market value of the property. For the purposes of this subdivision, the "fair market value of the property" is the fair market value, determined as of the time the certified copy of the affidavit was issued, of the property the person took under the certified copy of the affidavit, less the amount of any liens and encumbrances on the property at that time.

(c) Subject to subdivision (d), if proceedings for the administration of the decedent's estate are commenced and a person designated as a successor of the decedent in a certified copy of an affidavit issued under Section 13202 made a significant improvement to the property taken by the person under the certified copy of the affidavit in the good faith belief that the person was the successor of the decedent to that property, the person is liable for whichever of the following the decedent's estate elects:

(1) The restitution of the property, as improved, to the estate of the decedent upon the condition that the estate reimburse the person making restitution for (A) the amount by which the improvement increases the fair market value of the property

restored, determined as of the time of restitution, and (B) the amount paid by the person for principal and interest on any liens or encumbrances that were on the property at the time the certified copy of the affidavit was issued.

(2) The restoration to the decedent's estate of the fair market value of the property, determined as of the time of the issuance of the certified copy of the affidavit under Section 13202, less the amount of any liens and encumbrances on the property at that time, together with interest on the net amount at the rate payable on a money judgment running from the date of the issuance of the certified copy of the affidavit.

(d) The property and amount required to be restored to the estate under this section shall be reduced by any property or amount paid by the person to satisfy a liability under Section 13204 or 13205.

(e) An action to enforce the liability under this section may be brought only by the personal representative of the estate of the decedent. Whether or not the personal representative brings an action under this section, the personal representative may enforce the liability only to the extent necessary to protect the interests of the heirs, devisees, and creditors of the decedent.

(f) An action to enforce the liability under this section is forever barred three years after the certified copy of the affidavit is issued under Section 13202, or three years after the discovery of the fraud, whichever is later. The three-year period specified in this subdivision is not tolled for any reason.

DISCUSSION

If a transferee is required to return property to the probate estate, to what extent should the transferee be reimbursed for payments made by the transferee to satisfy decedent obligations or increase the value of the returned property?

In its letter, TEXCOM raises issues about the *kinds* of payments that should be reimbursed and the *priority* that the decedent's personal representative should give to reimbursement.

Before turning to those specific questions, it would be helpful to establish a general policy principle to guide the analysis of the property recovery provisions.

The staff believes that the following is a reasonable statement of the policy underlying the property recovery provisions:

The property recovery provisions should restore the status quo ante, as if the decedent's property had not been transferred by operation of a probate avoidance procedure. This will restore all of the decedent's property to the decedent's probate estate, for use in satisfying the

decedent's obligations and effecting the decedent's testamentary intentions.

The property recovery provisions should not operate to deprive the transferee of property that the transferee did not receive from the decedent's estate (i.e., the transferee's own property). Only the decedent's property is liable for the decedent's obligations and subject to the decedent's testamentary control.

To the extent that the property recovery provisions result in the transferee's own property being added to the estate or used to satisfy estate obligations, that property should be returned. The transferee's own property was not and never should never have been part of the decedent's estate. It is not liable for any of the decedent's obligations.

The analysis below is based on those principles.

Which Kinds of Expenditures Should be Reimbursed?

The staff sees two kinds of transferee expenditures that should be reimbursed:

- (1) Payments made to satisfy estate obligations.
- (2) Payments that increase the value of the returned property.

Those two kinds of payments are discussed separately below.

Transferee Payment of Estate Obligations

Existing Section 13206(d) already provides for reimbursement of payments that a transferee made to a decedent's creditor or to a person with a superior right to property that the transferor received, if the transferor is later required to return that property to the estate:

(d) The property and amount required to be restored to the estate under this section shall be reduced by any property or amount paid by the person to satisfy a liability under Section 13204 [personal liability to decedent's unsecured creditors] or 13205 [personal liability to person with superior claim by will or intestate succession].

That is consistent with the policy principles set out above. If a transferee is required to return property (or its value) to the estate, the returned property should be sufficient to restore the status quo ante. The return of that property should make the decedent's estate whole.

If, however, the transferee of the property had already used their own funds to pay decedent's unsecured debts or compensate a person with a superior claim to the property that the transferee received, the estate will have received a windfall. Not only will it have received the decedent's property that was returned, it will also have been enriched by the payments that the transferee made to satisfy the decedent's obligations. That would be unfair. The transferee should not be made worse off than if the decedent's gift to the transferee had never been made. Section 13206(d) prevents that result, in the situation where a transferee personally paid estate obligations before being made to return the property received from the estate.

Added Value

The same policy principles support the reimbursement rule in Section 13206(c)(1), which governs real property that was improved by a transferee after it was received.

Paragraph (c)(1) provides (with emphasis added):

(c) Subject to subdivision (d), if proceedings for the administration of the decedent's estate are commenced and a person designated as a successor of the decedent in a certified copy of an affidavit issued under Section 13202 made a significant improvement to the property taken by the person under the certified copy of the affidavit in the good faith belief that the person was the successor of the decedent to that property, the person is liable for whichever of the following the decedent's estate elects:

(1) The restitution of the property, as improved, to the estate of the decedent *upon the condition that the estate reimburse the person making restitution for (A) the amount by which the improvement increases the fair market value of the property restored, determined as of the time of restitution, and (B) the amount paid by the person for principal and interest on any liens or encumbrances that were on the property at the time the certified copy of the affidavit was issued.*

Thus, if a transferee uses their own resources to improve property that is later required to be returned to the estate, the transferee must be reimbursed for the value that they added to the property.¹⁰ In addition, if the transferee paid down

10. The existing statutes measure this added value by reference to the fair market value of the property, rather than by the amount the transferee spent to make the improvement. The staff does not intend to reconsider that approach in this study. If the Commission or members of the public believe it should be reconsidered, that could be done in a later memorandum.

debts that were secured against the property when it was received, those payments will be reimbursed if the property is later returned to the estate.

Again, this makes policy sense, for the reasons discussed above. The estate is entitled to be made whole, but is not entitled to receive any of the transferee's own property. If the transferee improves real property or pays down a debt that burdened the property when it was received, the transferee is increasing the property's value (either by increasing its resale value or adding to its equity). If that property is returned to the estate, the estate is receiving a windfall. In addition to the property that the decedent owned at death, it is receiving the value that the transferee added to the property. Section 13206(c) avoids that unfairness by reimbursing the transferee for the added value.

TEXCOM points out that there is no equivalent reimbursement rule in Section 13206(a)(1), which governs *unimproved* property that is returned to the estate:

A beneficiary required to restore property to the transferor's estate is seemingly not entitled to credit for payments made by the beneficiary toward encumbrances that existed before the transferor's death, an important and inequitable omission in section 5676, subdivision (a)(1). This should be corrected¹¹

The staff agrees that this is a problem. There does not seem to be any good reason to reimburse the payment of preexisting secured debts when property has been improved, but deny such reimbursement when the property has not been improved. The fact of improvement does not seem to have any relevance to the issue of reimbursement of loan payments. In either case, the transferee of the property has paid funds that increased the equity in the property that will be returned to the estate, creating a windfall. Such payments should be reimbursed. **The staff recommends that the statutes be revised to provide such reimbursement.** If the Commission agrees, the staff will prepare implementing language for consideration in a future memorandum.

TEXCOM makes a similar argument with respect to "necessary payments" made by a transferee, such as the payment of property taxes or insurance, arguing that such payments should also be reimbursed.¹² The staff is not sure of the breadth of TEXCOM's notion of "necessary payments," but it might include maintenance that is required to avoid waste (e.g., the prompt repair of a leaking roof to prevent water damage to interior structures).

11. Memorandum 2017-35, Exhibit p. 8.

12. *Id.*

The staff believes that the issue of reimbursement of necessary payments is complicated. Depending on the circumstances, the benefit of such payments may accrue to the estate or to the transferee. Consider the following two examples:

- (1) Decedent devises a car to transferee, who takes title and possession under a probate avoidance procedure. Transferee owns and uses the car for a year. During that period, transferee pays for insurance, registration, and routine maintenance. At the end of the year, the personal representative requires that the car be returned to the estate.
- (2) Decedent devises a car to transferee, who takes title and possession under a probate avoidance procedure. Immediately on receipt, transferee pre-pays for a year's worth of insurance, registration, and preventative maintenance. The next day, the personal representative requires that the car be returned to the estate.

In the first example, the benefit of the payments accrue primarily to the transferor. They are the costs of operating the car during the year in which the transferor enjoyed its use. None of those payments increase the resale value of the car or increase its equity. In this scenario, there does not seem to be any good reason to require that the payments be reimbursed by the estate.

In the second example, the benefits of the payments made by the transferor are not enjoyed by the transferor. They accrue to the estate, which can forego making similar payments for the next year. In that scenario, the transferor's funds have increased the value of the estate, giving it a windfall. Those payments should probably be reimbursed.

This suggests that it would not be appropriate to craft a categorical rule that all "necessary payments" be reimbursed by the estate. Instead, if the statute were to address the issue, it would need to employ a rule that looked closely at the facts to determine whether payments made by the transferor benefitted the estate. For example, the statute could provide something along these lines:

The estate shall reimburse the recipient of the property for any payment made by the recipient that benefits the estate.

The above language is offered only to illustrate the concept. The staff suspects that careful drafting would be required to make sure that the rule would be clear and comprehensive enough to warrant the reform. The staff is also not sure if the problem described above would be common and severe enough to warrant the costs that would be involved in implementing such a remedy.

Public comment on this issue would be helpful.

Reimbursement Priority

On the issue of reimbursement priority, TEXCOM writes:

Although section 5676, subdivision (b)(1) provides that (under certain circumstances) where a beneficiary restores the property to the estate of the transferor after having made a significant improvement to the property, the estate shall reimburse the beneficiary for the amount by which the improvement increases the fair market value of the property restored, the statutes do not provide any clear guidance regarding how a beneficiary is reimbursed for the value of property attributable to improvements made. Third parties should not unfairly benefit from a beneficiary's devotion of personal resources to improving the property. Thus, any reimbursement due to a beneficiary for improvements made to property that passed by RTODD should enjoy the highest priority, akin to that of a secured creditor.¹³

Before considering TEXCOM's proposal, it is worth briefly reviewing how payment priorities work in probate. If a probate estate is not sufficient to pay all of a decedent's debts, existing law provides a priority scheme for the payment of different classes of debts:

11420. (a) Debts shall be paid in the following order of priority among classes of debts, except that debts owed to the United States or to this state that have preference under the laws of the United States or of this state shall be given the preference required by such laws:

(1) Expenses of administration. With respect to obligations secured by mortgage, deed of trust, or other lien, including, but not limited to, a judgment lien, only those expenses of administration incurred that are reasonably related to the administration of that property by which obligations are secured shall be given priority over these obligations.

(2) Obligations secured by a mortgage, deed of trust, or other lien, including, but not limited to, a judgment lien, in the order of their priority, so far as they may be paid out of the proceeds of the property subject to the lien. If the proceeds are insufficient, the part of the obligation remaining unsatisfied shall be classed with general debts.

- (3) Funeral expenses.
- (4) Expenses of last illness.
- (5) Family allowance.
- (6) Wage claims.

13. Memorandum 2017-35, Exhibit p. 7.

(7) General debts, including judgments not secured by a lien and all other debts not included in a prior class.

(b) Except as otherwise provided by statute, the debts of each class are without preference or priority one over another. No debt of any class may be paid until all those of prior classes are paid in full. If property in the estate is insufficient to pay all debts of any class in full, each debt in that class shall be paid a proportionate share.¹⁴

That scheme reflects a series of policy choices about the relative importance of different classes of debts. TEXCOM suggests that reimbursement of a transferee for value added to an estate be given the highest priority.

In thinking about that proposal, one might feel inclined to weigh the importance of transferee reimbursement against the importance of each of the classes of debts in the statutory priority scheme. Is reimbursement more important than the payment of funeral expenses? A family allowance? Outstanding wage claims? But the staff believes that this would be incorrect way of understanding the issue.

The statutory priority scheme is designed to allocate the *decedent's* property to satisfy the *decedent's* obligations. It does not apply to property that is not liable for the decedent's obligations. For example, if decedent's neighbor had loaned decedent a fishing boat for use on a vacation and decedent died in possession of the boat, that boat would not be sold with the proceeds used to pay off the decedent's debts. Consequently, the statutory debt priority scheme would have no application to the boat. The boat would simply be returned to the rightful owner.

The staff believes that this is the proper way to understand property that is to be reimbursed to a transferee. That property is not owned by the decedent and is not liable for the decedent's debts. Consequently, the debt payment priority scheme should have no application to the reimbursement of the transferee's property. Like the neighbor's boat, that property should simply be given back. It should never be absorbed by the decedent's estate, even to pay high priority debts.

If the Commission agrees, the staff will prepare implementing language for consideration in a future memorandum. The staff invites public comment on this issue, regarding both the merits of the proposed approach and how best to implement it.

14. Section 11420.

CONCLUSION

If the Commission decides to pursue any of the possible reforms discussed in this memorandum, the staff will prepare implementing language for consideration at a future meeting.

Respectfully submitted,

Brian Hebert
Executive Director

