

Memorandum 2018-61

**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

This memorandum continues the examination of the "property return provisions" that are included in each of the probate avoidance procedures.

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,

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.

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 “successor” 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 “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

In specified circumstances, a successor who returns property to the estate is entitled to reimbursement¹⁰ of value that the successor added to the property before its return. Conversely, the estate may be entitled to reimbursement when the value of the property was diminished by the successor. Those issues were discussed in Memorandum 2018-37 and 2018-45, respectively.

REFORM OF REIMBURSEMENT RULES

After considering those memoranda, the Commission made a number of decisions.¹¹ This memorandum discusses the implementation of those decisions.

7. Sections 13109, 13204. The rules for liability of a surviving spouse are more complicated.

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.

10. Technically, these rules will sometimes result in a credit against an amount that must be paid to the estate, rather than a reimbursement. Nonetheless, the term “reimbursement” is used in this memorandum as a convenient shorthand.

11. Minutes (Aug. 2018), p. 14; Minutes (Oct. 2018), p. 11.

Most significantly, the Commission decided to explore a different approach to the reimbursement issues than is used in existing law.

The staff should develop and present a different statutory approach to the issue of reimbursement of a transferee and restitution to the estate, when property is returned to the estate. Rather than listing categorical reimbursement and restitution requirements, the statutes could state more general rules, grounded in the general principle underlying the existing requirements. It might also be appropriate to include the existing categorical requirements in a nonexclusive illustrative list of circumstances in which reimbursement or restitution could be required.¹²

That alternative approach would eliminate the need for the statutes to be exhaustive in anticipating situations in which reimbursement should be required. It would also introduce a degree of flexibility that would avoid some of the line-drawing problems that were discussed in the earlier memoranda.

In general concept, the staff believes that the language below would implement all of the Commission's decisions regarding the reimbursement rules:

(a) If the successor's actions increased the value of property returned to the estate or decreased the estate's obligations, the personal representative shall reduce the successor's restitution liability under [Section ___] by the same amount. Successor actions that may increase the value of returned property or decrease the estate's obligations include, but are not necessarily limited to, the following actions:

(1) A payment toward an unsecured debt of the decedent.

(2) A payment toward a debt secured against the returned property.

(3) A significant improvement of the returned property that increased the fair market value of the property.

(b) If the successor's actions or inaction decreased the value of property returned to the estate or increased the estate's obligations, the personal representative shall increase the successor's restitution liability under [Section ___] by the same amount. Successor actions that may decrease the value of the returned property or increase the estate's obligations include, but are not necessarily limited to, the following actions or inaction:

(1) An action or inaction that resulted in a lien or encumbrance being recorded against the property.

(2) The receipt of income from the property, if that income would have accrued to the estate had the property not been transferred to the successor.

(3) Waste.

12. Minutes (Oct. 2018), p. 11.

(c) The personal representative shall provide the successor a written statement of any increase or decrease in restitution liability under this section, along with a statement of the reasons for the increase or decrease.

(c) If the successor returns tangible property to the estate and is entitled to an overall reduction in restitution liability under this section, the estate shall pay the successor an amount equal to the reduction in liability. For the purposes of Section 11420, this payment shall be deemed an expense of administration.

(d) In the event that the successor and the personal representative cannot agree on how the successor's liability should be adjusted under this section, the successor may petition the court for an order determining the amount of the adjustment. In making a decision under this subdivision, the court should consider the surrounding circumstances, including whether the parties acted in good faith and whether a particular adjustment would impose an unfair burden on the successor or the estate.

There are a few points worth discussing about that proposed language. They are addressed below.

Liability for Waste

Proposed paragraph (b)(3) would address an issue that was not discussed in either of the prior memoranda, the liability of a successor for waste.

That provision would mirror proposed paragraph (a)(3), which provides for successor reimbursement for a "significant improvement of the returned property that increased the fair market value of the property." If a successor is to be reimbursed for adding value to returned property, it makes general sense that a successor should be liable to the estate for an affirmative act or negligence that causes the fair market value of the property to decline. For example, if a successor fails to weatherize property in the mountains and the plumbing is damaged as a result, and that property is later returned to the decedent's estate, it would seem fair to assess the cost of repairs against the successor who failed to safeguard the property.

The problem with that approach is that, until the personal representative requires return of the property, the successor does not owe any duty to the estate to maintain the property. Owners of property are free to make their own decisions about whether and how to maintain their property, without incurring any liability to uninvolved third parties. It could be unfair to impose a duty to avoid waste retroactively, after the waste has already occurred.

That problem could perhaps be minimized by providing for an express warning to a successor that the estate can require return of the property, with the successor having liability for any loss in the property's value. But that would place the property into a kind of limbo state. While the successor would hold fee title to the property, the property would be burdened by an obligation to maintain the property for the benefit of the decedent's estate. That period of obligation could last up to three years.¹³

Another way to minimize the burden of imposing liability on a successor for waste would be to narrow the rule so that it only applies to *voluntary* waste¹⁴ and not to *permissive* waste.¹⁵ That would require a higher degree of intention on the part of the successor, who might be more reasonably held responsible for affirmatively destructive actions. That narrowed approach would avoid surprising a successor with liability for mere inattention.

The staff is unsure how to balance the competing considerations on this issue.

How would the Commission like to proceed?

Reimbursement Priority

At its August meeting, the Commission decided that any reimbursement owed to a successor should be paid with a higher priority than creditor claims or family protections. The value that the successor added to the property before its return to the estate never belonged to the decedent and was never liable for the decedent's obligations. Nor was it a gift from the successor to the decedent's estate.

Subdivision (c) would implement this decision. It would do so by classifying the reimbursement as a cost of administration, under Section 14200, which prioritizes the payment of the different kinds of estate obligations:

14200. (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

13. See, e.g., Section 13206(f).

14. "Voluntary waste. Also referred to as affirmative waste. In property law, refers to overt and willful acts of destruction that lead to the drop in value of a piece of property by harming the property or depleting natural resources available on the property." <https://www.law.cornell.edu/wex/voluntary_waste>.

15. "Permissive waste. In property law, this refers to harm to a piece of property, such as the land falling into disrepair, caused by a tenant's neglect of the property. Examples of permissive neglect include the tenant not doing maintenance on the property, performing ordinary repairs, or paying taxes owed on the land." <https://www.law.cornell.edu/wex/permissive_waste>.

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.

(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.

Under that approach, successor reimbursement would be paid at the highest priority, along with other administration expenses.

Judicial Dispute Resolution

The approach outlined above provides that the personal representative shall determine how the successor's restitution liability should be adjusted (if at all). The successor could provide input into that process, but the ultimate responsibility would fall on the personal representative.

Although that relatively informal approach should be sufficient to address straightforward cases, there would undoubtedly be instances where the personal representative and the successor do not agree on how to adjust the successor's liability. In such cases, it seems reasonable to allow for court resolution of the dispute. Proposed subdivision (d) would provide such a remedy.

The second sentence of subdivision (d) would emphasize that judges should take good faith and fairness into account when deciding such a dispute: "In making a decision under this subdivision, the court should consider the

surrounding circumstances, including whether the parties acted in good faith and whether a particular adjustment would impose an unfair burden on the successor or the estate.” For example, it might make sense to impose liability for waste if the successor acted maliciously in damaging the returned property. By contrast, if a successor acted in good faith and without fault, it might make sense to excuse actions that caused a reduction in the value of returned property (e.g., misguided “improvements” that actually caused a drop in fair market value).

Coordination with Other Provisions

If the Commission decides to tentatively recommend language along the lines discussed in this memorandum, the staff will need to make conforming changes in the property return provisions. For example, Section 13206 would need to be revised along these lines:

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~~ or increased as provided in [proposed new provision].

(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.

There may be other coordinating changes that also need to be made. The staff will wait to do a thorough analysis of the matter until after the Commission has decided on the reform that needs to be accommodated. If those coordinating changes turn out to be straightforward, the staff will present them as part of a

draft tentative recommendation. If instead the coordinating changes raise issues that need a Commission decision, the staff will bring them back for further discussion.

CONCLUSION

The Commission needs to decide how to address the issues discussed in this memorandum. How would the Commission like to proceed?

Respectfully submitted,

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