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Who Will Inherit Your House, 401K, DEBT When You're Gone?

BY GARY ALTMAN, ESQ.

Understandably, when most people hear the word "inheritance", they think of things like money, investments, real estate, jewelry and other things of value. As an estate planning attorney, another word comes to mind - debt. Nearly everyone will leave behind some amount of debt upon passing. How much, of course, depends on the individual, their financial decisions in life and the value of their total estate, which is not always truly known until after a relative dies and the individual's complete financial details are unearthed. In some cases, we could be looking at a simple $250 Macy's credit card bill, income taxes and a handful of utilities. In others, we could be talking about a couple of million dollars in unpaid back taxes.

"Every state has specific laws for dealing with unpaid bills, debts and creditors..."

So, just who becomes responsible for lingering debts after a person's passing? The answers vary depending on the type of debt and individual state laws.

The Type of Debt Matters

In most cases, heirs are not liable for a decedent's debts. If the person incurred the debt in his or her name alone, creditors generally receive payment through the probate process or they don't receive payment at all. Of course, there are exceptions...

Co-signed or Guaranteed Debts

When two individuals co-sign for a debt, the creditor has a legal right to go after one signer if the other can't pay. For example, if two people are co-applicants on a credit card or car loan, the living cardholder is liable for any unpaid amount — regardless of who ran up the charges or the "primary" account holder was. Guaranteed debts work much the same way. The guarantor promises the lender payment of the debt if the person who incurs it cannot. A guarantee can be limited or unlimited, making the guarantor liable for only a portion or all of the debt. This sometimes happens with medical bills, for example.

Mortgages

As it pertains to mortgages, a co-borrower will typically be financially liable for the mortgage moving forward. If that person plans to continue living in the home, they will need to show credit worthiness and an ability to keep current on payments.

In the case of a spouse passing, the surviving spouse may be able to use a life insurance payoff to keep up with or completely wipe out the mortgage balance.

Heirs who aren't on the mortgage may still be able to assume the loan, either because they were added to the deed after closing or the home was left to them in a will.

Retirement Accounts

ERISA Qualified

Whether or not a creditor can seize assets from a person's retirement accounts after death depends on whether the account was set up under the Employee Retirement Income Security Act (ERISA). ERISA accounts are generally protected from judgment creditors, as are employee welfare benefits.

Examples ERISA protected accounts include:

- 401K Plans
- Deferred Compensation Plans and
- Profit Sharing Plans
- "Covered" Employee Welfare Benefit Plans

ERISA Exceptions

As you might expect, protection of qualified-ERISA plans are not iron-clad. Examples of conditions in which ERISA benefits can be subject to creditors:

- Ex-spouses may have rights to an ERISA account under a Qualified Domestic Relations Order (QDRO) as a marital asset or child support.
- The IRS can seize funds for federal income tax debts.

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Who Will Inherit Your DEBT When You're Gone CONTINUED

- The federal government may seize funds for criminal fines and penalties.
- Courts may enforce civil or criminal judgments in cases where there was wrongdoing against the plan.

Beware of Distributions

Keep in mind, however, that while an ERISA plan is generally protected, any *distributions* made to you may not be. For example, ERISA benefits may no longer be protected once they leave the plan, are distributed to you and deposited into your checking account.

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Non-ERISA Qualified Accounts

Retirement assets that are not ERISA qualified or covered are at the highest risk of being tapped by creditors. Whether or not they are protected depends on state and federal exemption laws.

Examples of Non-ERISA Retirement Accounts include:

- Traditional Individual Retirement Accounts (IRAs)
- Roth IRAs
- Simplified Employee Pension (SEP) Plans
- SIMPLE IRAs
- Keogh Plans
- 403(b) Plans for Employees of a Public School or University
- Plans that do not benefit employees, or "employer-only" plans
- Government Plans and
- Church Plans

The Role of State Laws

Common Law vs. Community Property

Every state has specific laws for dealing with unpaid bills, debts and creditors, so it highly depends on where someone was living when he or she died. In most "common law" states, relatives whose names are not on the account cannot be held personally responsible for a deceased person's debt. However, in the U.S.'s nine "community property" states - Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin - spouses (and registered domestic partners in states where domestic partnerships are recognized) may be responsible for paying the debt, even if their name is not on the account. If you are a permanent resident of one of these states, it is important to talk with a lawyer about what your obligations are.

Statute of Limitations

Another factor that comes into play (and varies from state to state) is how long a creditor has to file a claim against an estate. In Maryland, for example, a creditor generally has to file a claim within 6 months of a person's death in order to receive payment otherwise the debt or bill may become null and void. In the District of Columbia, however, the countdown doesn't start until the date that the first Notice of Appointment is published in a local newspaper. So, hypothetically, if someone waits 6 months to publish the notice, the creditor will have had one year from the date of death to submit a claim. Virginia has its own unique set of probate regulations and procedures, including a very stringent "Order of Distributions" that spells out the specific order in which all distributions, including debts, must be made.

The Snowbird Factor

Dual-state residency at the time of death can further complicate estate and debt matters as well. If a person divides their time between Maryland and in Florida, for example, which state's laws would apply to their debts upon their passing? The answer lies in which state is considered the person's permanent residence or domicile. Only one state can be designated as such and the legal implications of that designation are far-reaching. To put it bluntly, it comes down to which state would be most advantageous to die a resident of. This decision begs for the counsel of an experienced estate planning attorney – ideally one whose firm is capable of practicing in both states.

When the Debt Outweighs the Value of the Estate

There are times when a decedent leaves behind more debts than assets. In these cases, the estate is insolvent. Executors are then obligated to sell and/or liquidate assets to pay

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off the deceased's debts. Depending on state law, there can be a pecking order with respect to which debts are paid off first. For example, unsecured creditors may be last on the list. If there is no money left in the estate, and no one can be found responsible for the debt, creditors have no options for collection and will be forced to write it off.

The Bottom Line

In a perfect world, everyone would die having done the kind of thorough estate planning required to best shield their assets (and their heirs) from any debt they may leave behind.

For those of us fortunate enough to still be living, the bottom line is *don't put off planning!* Engage the help of an experienced estate planning attorney who will work with you and your financial advisors to put that "perfect world" plan in place and bring you (and your heirs) peace of mind.

In the event that you become responsible for managing the estate of a friend or family member, it is similarly vital to seek out the help of an estate planning attorney to guide you. When it comes to probate, time is of the essence and mistakes are not only costly to the estate, a failure to comply with federal and state laws (whether knowingly or unknowingly) can subject you to personal liability.

Debt happens...but don't let yours become your legacy and don't let someone else's become your liability!

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