

## **The Perilous Road to Probate: Twenty Litigation Pitfalls in Estate Administration**

By: John L. Pritchard, Esq.

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The common perception is that estate litigation consists mostly of will contests. In fact, estate litigation matters usually center on allegations of improper conduct by the executor, administrator or trustee during the course of the administration.

Since most fiduciaries do not have experience in these matters, they may fall victim to hidden pitfalls. This article will itemize these pitfalls, and describe how the issues would play out in subsequent litigation in the Probate Part of the Chancery Division.

When there are family tensions among the beneficiaries of an estate, litigation is more likely. The fiduciary is more likely to act in an improper manner, and the beneficiaries are more likely to seek a resolution in Court.

The civil procedure for litigating fiduciary matters is unique. It generally starts with the fiduciary filing an accounting for his or her actions, and then the beneficiaries or even the creditors of the estate have the opportunity to challenge the accounting, and any of the fiduciary's actions. Instead of having the titles of plaintiff or defendant, the fiduciary is the "accountant", and the beneficiaries or creditors are the "exceptants". The fiduciary is "charged" with assets deemed to have been received, and "credited" for expenses or distributions properly paid out.

A formal accounting action can also be sought by the beneficiaries. This is common when the administration has been outstanding for a long period of time. The aggrieved party will seek an order requiring that an accounting be filed, and will then have the opportunity to challenge the accounting once it has been filed.

Prior to any litigation or formal proceeding, the fiduciary can prepare an accounting in some informal form, and submit it to the beneficiaries. The fiduciary will then request that the beneficiaries sign releases approving the acts of the fiduciary.

If the beneficiaries refuse to approve the acts of the fiduciary on an informal basis, then the matter will be unresolved until either the fiduciary or a beneficiary begins an accounting action in Probate Part.

The body of substantive law in accounting actions is also unique. Most of the points of law governing fiduciaries are obscure, and many of the leading authorities on point are old cases found only in the New Jersey Equity Reports. Some cases are found only in Atlantic First Reports, and not in New Jersey Equity or New Jersey Law Reports. Accounting actions may also require the

litigants to address highly technical questions of Federal income tax and estate tax law.

Hereafter follows 20 of the most serious traps into which a fiduciary can fall. This list can be used to advise executors, administrators and trustees, and can also be used as a list of issues for attorneys representing the beneficiaries in reviewing an accounting.

1. **Failure to Maintain Records.** Even well-intentioned fiduciaries fail to keep adequate records. Estate administrations commonly take a year or more, and since most fiduciaries have little experience they keep records that are at best informal. In an accounting proceeding the burden falls on the fiduciary to justify all expenditures. Incomplete records will damage the credibility of the fiduciary on all issues in any litigation. The executor, administrator or trustee should keep a separate checking account for the estate or trust, make all deposits into this account and make all payments from the account. The checkbook register should be maintained on a current and detailed basis.
2. **Failure to Timely Administer the Estate.** Some estates take years of continuous effort to settle. For others, delays are caused by fiduciaries who ignore their responsibilities, or even fail to make distributions out of hostility towards the beneficiaries. The Court will usually not require an executor or administrator to do an accounting until a year has elapsed, and dollar amount bequests will only accrue interest after one year.
3. **Failure to File Income Tax Returns.** Commonly no actual tax is due, but a Federal return must still be filed if the annual gross income was \$600.00 or more. Often, even the attorney for a fiduciary will "forget" that both a Federal Form 1041 and a NJ-1041 is required to be filed. If the matter goes to litigation, opposing counsel may obtain a order from the Probate Part instructing the fiduciary to promptly file the tax returns, and to be personally responsible for any penalties and interest. This will quickly put the fiduciary on the defensive. Even if no actual income tax liability is due, a contesting beneficiary will have the advantage of showing that the fiduciary has neglected the administration of the estate.
4. **Failure to File the Decedent's Income Tax Return.** Even if the final form 1040 return is filed, the fiduciary may fail to take unique deductions, such as for medical expenses incurred by the decedent during life, but paid after death. If the decedent passes away prior to April 15 of any year, it is likely that the executor or administrator will have to prepare and file returns for both the entire preceding calendar year, and for the calendar year in which the death occurred. If the fiduciary files these returns late and without an extension, he can commonly obtain a waiver of any penalties from the IRS.
5. **Construction Problems.** The preparer of a will or trust may not have foreseen certain occurrences, or may simply have made drafting errors. The fiduciary's counsel should identify all issues of interpretation, and

obtain appropriate releases from the beneficiaries. If necessary, the advise of the Court should be sought, upon notice to all parties affected.

6. **Improper Form of Accounting.** Court Rule 4:87-3 describes the format for this document. It is not a format which a certified public accountant would use if given the task without detailed instructions, and most attorneys do not wish to undertake the preparation. Most initial accounts do not follow the rules, and opposing counsel or the Surrogate will commonly demand revisions.
7. **Failure to Cut-Off Creditors.** The executor or administrator is charged with paying off the known debts prior to making distributions to the beneficiaries. The claims of unknown creditors may be cut-off by obtaining and publishing a notice to limit creditors, which will require the creditors to file their claims within a certain period of time. N.J.S.A. 3B:22-4.
8. **Failure to Maintain Insurance on Real Estate.** Fiduciaries are required to obtain hazard and liability insurance, even if the decedent did not insure the property. The fiduciary will be personally liable for any uninsured losses. In re Ramsey's Estate, 66 A. 410 (Prerog. 1907).
9. **Unapproved Attorney's Fees.** There is an entire body of law relating to when attorney's fees are allowed as an estate administration expense. If contested, the fees will only be allowed when the attorney has provided a proper affidavit of services under R. 4:88-4. Another pitfall is that attorney's fees and accountants fees will not be allowed for work which is the responsibility of the fiduciary, and which could be expected to be done by a lay person.
10. **Ethical Problems with the Role of the Attorney.** The "attorney for the estate" has the fiduciary for a client. Care must be taken so the beneficiaries do have cause to believe that this attorney is also representing them. This could lead to removal of the attorney if any dispute arises in the future. A fiduciary who is not an attorney of this state may not appear in court pro se. Kasharian v. Wilentz, 93 N.J.Super. 479 (App. Div. 1967).
11. **Incorrect Commissions.** Fiduciaries are entitled to be paid commissions for their services according to N.J.S.A. 3B:18-1 et seq., but the statute is confusing and is commonly misunderstood. Assets passing outside the probate estate are not "commissionable", and neither is real estate unless it is sold. Commissions are allowed not only on the principal of the estate, but also on income earned by the assets. Attorneys who serve as a fiduciary and render legal services are entitled to both commissions and legal fees. N.J.S.A. 3B:18-6.
12. **Improper Investment Decisions.** The fiduciary can be held liable for errors in investments. The law in this area has recently seen a dramatic change with the enactment of the Prudent Investor Act, N.J.S.A. 3B:20-

- 12 et seq. Traditionally, fiduciaries were required to make very conservative investment decisions, especially for long-term trusts. The result was that the trustees usually invested in bonds. This worked to the advantage of current income beneficiaries, but to the great detriment of remaindermen and other further interests due to inflation and the failure of the corpus to grow in value. Under the new Prudent Investor Act, fiduciaries are required to consider the effects of inflation. In addition, fiduciaries will not be personally responsible if they delegate investment decisions to professionals. The most immediate hazard for trustees is that if they continue to invest in bonds and other very conservative investments without diversification, they can be held liable to the remaindermen long after they have made the investment decisions. Since the statute only took effect on June 7, 1997, any damage so far is minor, if the investments are now reconsidered.
13. **Income and Corpus Errors.** During the course of administration, the fiduciary may need to determine which assets are principal and which assets are income. Stock splits, bond premiums or discounts, and closely-held businesses will all raise this issue. Different types of expenses are chargeable either to the income beneficiaries or to the principal. Some expenses are to be charged in equal parts to the income and to the principal. N.J.S.A. 3B:19A-28 et seq.
14. **Failure to Make Timely Tax Elections.** An executor or administrator is allowed to deduct as administration expenses either as an income tax deduction or an estate tax deduction. There are other elections which can be made, including the method of valuation of assets. All of these elections have time limits.
15. **Failure to File Estate and Inheritance Tax Returns.** An extension of the filing time for the Federal return can easily be obtained. If the return is filed late, penalties will be assessed, and an audit may be more likely. Beneficiaries will want to surcharge the Fiduciary for penalties, interest and interest on penalties.
16. **Failure to Recognize Environmental Hazards.** Strict liability for environmental damage is no longer applied to fiduciaries. However, an expert environmental audit should be obtained whenever there is a reason to suspect a problem. A failure to timely identify a hazard could even lead to an overpayment of estate taxes if proper deductions are not claimed.
17. **Failure to Serve Beneficiaries.** Once the will has been admitted to probate, the executor must serve notice of this upon each beneficiary under the will, and upon each person who would have inherited by intestacy. A copy of the will must be offered to each of them. The notice must be made within 60 days. R. 4:80-6. If such notice is not made, a person with a claim to challenge the will may not be bound by the ordinary limitation period of four months.

18. **Other Neglect of Assets.** High standards of care are imposed upon fiduciaries dealing with unusual assets. If long term notes or mortgages are held, the fiduciary must promptly act in the event of a default, or even a danger of a default. Adequate appraisals must be obtained before a sale or distribution in kind. A search for escheated assets may be advisable.
19. **Tangible Personal Property.** The executor or administrator is responsible for all of the estate assets, including the contents of the decedent's residence. An unfortunate but common occurrence is that the house becomes the scene of a free-for-all, with relatives claiming for themselves the tangible personal property. The fiduciary should at least inventory everything and establish some order.
20. **Failure to Obtain Release and Refunding Bonds.** Most commonly available forms combine these two items, but they are two separate matters. Under N.J.S.A. 3B:23-24, every time the fiduciary makes a distribution to the beneficiaries of an estate, the fiduciary is required to obtain a refunding bond, in which the beneficiary promises to return the money if further estate debts are discovered. The release portion of the form gives a full release to the fiduciary for all his actions in the administrator. The refunding bond is required by law, but the release is not required. Obtaining a release from the beneficiary should always be an ultimate goal of the fiduciary's counsel. The release should be obtained in a manner so the beneficiary can never claim he was misled, or that he believed that the fiduciary's attorney was also representing him.

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