

Chapter 8

Your Debts and Liabilities

Just as you have accumulated many different types of assets during your lifetime, it is also possible to accumulate many types of debt and bills. Having someone else take over the obligation of paying your bills and debt obligations on your behalf can be an onerous task, particularly if he or she has no clue what debts need to be paid and when.

Before the digital age, it was easy to find out what bills needed to be paid. The person you had designated to be responsible for the task would simply have your bills (and other mail) forwarded to his or her address, and within several months, they would have a good idea what your current obligations were. They could notify the utility, credit card, and other companies to change the address on the accounts to their address, and could therefore conveniently continue paying your bills on your own behalf.

But while the U.S. Postal Service still allows mail forwarding, there is a limit to how long you can continue having mailed forwarded. In certain circumstances, a fee may be assessed by them for forwarding the mail. And certain types of mail (e.g. certain government mailings) cannot be forwarded at all.

As in my discussion in the chapter about assets, many companies encourage you to “go green,” and rather than have them mail a monthly bill to you, they now send you a digital bill via email. That may be convenient for you, but if someone else needs to pay your bills for you, if they don’t know the bill is being transmitted to you in this manner, how will that person know the bill even exists, let alone that it needs to be paid?

An even greater convenience to you is the ability to have your bills paid automatically from your bank checking account. You may authorize your utility, credit card companies, and other service providers, to automatically debit your checking account for the amount due to them. The auto-pay service most banks provide is an excellent method to remain current in paying your obligations and avoiding those nasty late charges and interest on what might otherwise be past due bills.

Similarly, many subscriptions and services can be set to automatically renew and charged to your credit card or debited from your checking account.

But if you become incapacitated or die, who knows that you have authorized these automatic payments and renewals to take place? And more importantly, who knows how to turn them off? Your designated representative needs to know about all auto-pay and auto-renew services being used, and know how to stop the payments from coming out of your account. This means that your representative will need to know the account information, your log-in username, and your password, to be able to turn off the payments and renewals.

And your representative also needs to know which auto-pay services should **not** be terminated! For example, if you are incapacitated, you are not going to want to stop automatic payments of your life insurance and health insurance coverage, lest you lose your coverage. Similarly, you want your mortgage and utility bills to continue being paid.

Some types of bills and debts need rapid handling to avoid high interest, penalties, and potential foreclosure or repossession, so the sooner your representative knows about them, the better.

For example, upon your death, social security payments, pension payments, and other payments being made to you, need to be terminated immediately. Any payments to which you are not entitled after your death, if paid to you (or directly deposited into your bank account), need to be returned to the sender, or they become a debt of the estate.

Not remaining current with payment of your secured debt items may result in adverse actions. For example, your mortgage lender may foreclose on your property if you (or your representative) don't remain current on your payments. Your automobile, jewelry, and other large-ticket items may be repossessed if the monthly payments aren't kept current. If the automobile, for example, is then sold by the lender for less than the remaining balance owed, you or your estate may become liable for the deficiency still owed.

Speaking of large-ticket items such as furniture, jewelry, or major construction work done on your house, as an incentive to you to buy their product or service, the vendors often charge no interest if the bill is paid within a particular time period (e.g. six months, a year, etc.). But if the entire balance isn't paid by the end of that term, all the unpaid accumulated interest (often at a high interest rate) gets added back in, and the entire debt becomes due. Your representative needs to know about this type of purchase and the debt payment obligations.

Where are the documents?

Just as important as knowing where you store the documents proving your ownership of assets, such as deeds, certificates of title to your vehicles, etc., it is also important for your named representative to know where you store the documents regarding your debts and contractual obligations.

Examples include mortgages on any real estate you own, car loans, leases (both personal and business), contractual obligations, etc.

And don't forget about litigation paperwork if you are the defendant in a lawsuit. Your representative must know about pending litigation, so your representative knows he or she needs to notify your lawyer about your infirmity or death.

Secured debt

In order to reduce the risk of loss to lenders associated with a loan, the debt is secured by collateral, which the lender is allowed to claim to satisfy or reduce the amount of your obligation, should you fail to pay off the debt in full.

The most common examples are a mortgage note secured by your house. If you fail to make your payments in a timely fashion, the mortgage company can initiate a foreclosure action to seize the house, sell it, and use the proceeds to pay back the debt. If the sales price is not enough to pay off the balance in full (plus accrued interest, attorney's fees, and court costs), you or your estate may become subject for the deficiency on the unpaid balance.

Similarly, an automobile loan is secured by the vehicle. If you fail to make your payments in a timely fashion, the lender can repossess the vehicle, sell it, and use the proceeds to pay back the debt. Again, if the sales price is insufficient to pay off the balance in full, you or your estate may become subject for the deficiency balance.

On occasion, the lender may "forgive" a deficiency balance. But under current federal income tax laws, forgiveness of a debt may result in you or your estate becoming liable for payment of income taxes on the forgiven debt. Due to the financial crisis in 2007 resulting in many houses being sold for less than the debt owed on them, if the house was your primary residence from 2007 through 2014 (subject to certain limitations and regulations), forgiveness of a deficiency balance on a mortgage did not create a taxable situation.

At the time this chapter is being written, it is unclear whether this waiver of taxability of debt forgiveness on a personal residence will be continued beyond 2014. This waiver applied only to debt on a personal residence, as defined in the Mortgage Forgiveness Debt Relief Act of 2007 (H.R. 3648).

But whether or not the temporary waiver is extended beyond 2014, for any other forgiven debts, the taxability of the forgiven amount may still create a taxable obligation, adding an additional, seemingly cruel, consequence. You have already lost the house or other asset, and will still be required to pay income taxes on the forgiven amount of the loan.

Unsecured debt

This term applies to most other types of debt. There is no security interest or collateral reducing the risk to the lender. As a consequence, the interest rate you pay on the debt obligation is a higher rate than the secured debt.

Typical unsecured debts include:

- Credit cards
- Student loans
- Leases (apartment, store, automobile, etc.)
- Business debt
- Tax obligations
- Personal loans
- Child support and alimony
- Judgments entered against you
- Debts on which you are a co-signer or guarantor
- And much, much more

Dischargeable and non-dischargeable debts

While a discussion of the bankruptcy code is far outside the scope of this book, a brief discussion of which debts can, and which debts cannot, be discharged in a bankruptcy, is appropriate, as your representative will need to know the consequences of the types of bills he or she may need to pay on your behalf.

While most debts are dischargeable (and therefore non-collectable by the creditors), your secured debts are still subject to the lender's security interest. Therefore, while they will need the bankruptcy court's approval, your mortgage lender can still foreclose on your house, and your car lender can still repossess your car. You may be able to reaffirm the debt, and therefore keep your house and/or car, but it is also subject to the court's approval.

Certain types of obligations are not dischargeable in bankruptcy. These include:

- Certain tax obligations
- Certain types of student loans; and
- Alimony and child support obligations

A conversation with a bankruptcy attorney is recommended if you or your representative (on your behalf) are considering filing for bankruptcy relief.

Co-signers and Guarantors

In addition to your own debts and obligations, your representative needs to know about any debts or obligations of others for whom you have either guaranteed payment or have co-signed on the obligations.

If your daughter needed a car but didn't qualify for a loan without you signing as a guarantor, if she fails to make the payments, it becomes your obligation. Your representative needs to know about these types of obligations.

Similarly, if you own a business as a corporation or limited liability company, in order to help protect your personal assets from the claims of creditors if the business should fail, many vendors will require you to sign as a personal

guarantor of the obligation. These vendors are not limited to the corporate assets to satisfy their claims; they can pursue your personal assets.

And when you and your spouse buy a house or automobile together, and you then divorce, even if one of you is awarded the house and the car, the other is still obligated on the loans. You may no longer be the owner of the asset, but you are still obligated on the loan if your spouse fails to make payments. The only way to completely absolve yourself of potential liability is to require the spouse receiving the assets to refinance the house or car in his or her name only, and get your name off the obligation.

Filial Laws

Most people understand that parents are responsible for supporting their children. Beyond co-signing a debt obligation for a child, a parent can be held liable for the “necessaries” of a child (e.g. housing, food, health care expenses, etc.). So in some states, if your child is under 18 years of age and requires hospitalization, you may be responsible for the health care bill.

But in addition, in certain states, and under certain conditions, adult children can become legally responsible for supporting their **parents**. These are called filial laws, and at the time of writing this chapter, approximately half of the states have adopted them in one form or another. Usually, your parent must be indigent and receiving some sort of governmental assistance, or help to pay for a nursing home or hospital bill, before you can be held responsible for the debt.

If you or your parents are living in a state where filial laws exist, you will want to make sure your representative knows about this potential debt obligation.

Priority of Claims in Probate

We have discussed above what happens to your debts if you are unable to pay them while you are alive. Secured creditors can foreclose on your house, repossess your car, and/or sue you for any deficiency. Unsecured creditors can sue you, and try to collect the debt from you.

But what happens when you die? Do your heirs and surviving family members become responsible for your debts?

The laws are too varied among the states, so it is important to have this discussion with an attorney in the state in which you reside. Unless your heir(s) have co-signed or guaranteed your obligation, they have no obligation to pay your debts and obligations. Basically, your debts die with you, which is not to say they don't need to be paid. Your debts are paid out of the non-exempt assets in your estate.

The probate court will appoint a Personal Representative to administer your estate. If you have a Last Will and Testament, you may have specified whom you want to serve in that capacity, which will usually be honored by the court. If you don't have a Will, the Personal Representative will usually be a close family member.

The Personal Representative is charged with the duties of collecting the assets of your estate, paying your debts, and then distributing what is left to your heirs. But what happens if there aren't sufficient assets to pay off all the debts?

Different rules apply in different states, so be sure to confer with an estate-planning attorney in the state in which you reside. But basically, each state sets the order in which claims must be paid, with certain types of claims having a higher priority to payment than others.

For example, in Florida Statute 733.707, obligations are paid in the following order:

Class 1: Administrative costs and fees for the personal representative, estate attorney, and court costs get paid first

Class 2: Reasonable funeral, internment, and grave expenses up to \$6,000.00 are paid

Class 3: Debts and taxes with preference under federal law, which include reimbursement of Medicaid and public assistance payments

Class 4: Reasonable and necessary medical and hospital expenses of the last 60 days of the decedent's final illness

Class 5: Family allowance to support surviving spouse and dependents during estate administration, up to a maximum of \$18,000.00

Class 6: Court-ordered child support arrearage

Class 7: Debts acquired after death by continuing decedent's business

Class 8: All other claims, including any judgments against the decedent and any overage on Class 3 and Class 4 items

Why is the order of priority important? In Florida, if a Personal Representative pays creditors of a lower Class and then does not have sufficient assets to pay the creditors of a higher priority Class, then the Personal Representative will be **personally responsible** to satisfy in full the higher priority creditor! Therefore, a Personal Representative should not pay **any** creditors without first consulting the estate attorney handling the probate administration.

All the debts of the estate need to be satisfied (some can be compromised as to amount) before distribution can be made to the heirs. If there are insufficient liquid assets, other types of assets may need to be sold to satisfy the claims of creditors.

If you live in a community property state, the laws can be even trickier, and consulting with an attorney well versed in the estate planning and/or probate laws of that state is strongly advised.

Payment of Periodic and Occasional Bills

Most bills are paid **monthly**. The most common monthly bills include rent, mortgage, utility bills (electric, gas, water, sewer, scavenger, telephone, cable, internet, etc.), credit cards, student loans, child support and/or alimony payments.

Some bills are paid **quarterly**, such as income tax and business tax obligations.

Some bills are paid **semi-annually**, such as automobile insurance premiums.

And some bills are paid **annually**, such as life insurance premiums, real estate tax bills, and income taxes.

So, it is important to provide your representative with detailed information on your debts and customary obligations. This will help to avoid having late charges or interest assessed against you by credit card companies, your utilities being shut off, your car being repossessed, your insurance lapsing, or a home mortgage foreclosure action being filed by your bank.

Go through your check register or bank statements to start compiling the list of all the bills you pay. You'll be amazed by how many bills there are, and by the ones you may have forgotten to include in your list.

