

## Understanding After-Death Financial Debts

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### Abstract

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*Two and a half million of the seventy-four million living baby boomers turned age 73 in 2019. It is especially important for these baby boomers who do not have estate plans, such as a living trust and a last will and testament, to get up to speed on estate planning. An essential part of the estate plan is the management of financial debts that may outlive you because the debts do not simply disappear after death. Failure to deal with these debts can put unexpected financial burdens on your spouse and family. This paper discusses what happens to debts after death. Living trust, and last will and testament are also briefly discussed.*

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**Keywords:** Community Property Jurisdiction, Last Will & Testament, Living Trust, Probate, Secured Debt

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### 1. Introduction

Seventy-six million American children were born between mid-1946 and mid-1964 (History.com) and they are commonly referred to as baby boomers or boomers (Hogan, Perez, and Bell, 2008). Nearly 25 percent of the American population consists of these boomers (Colby and Ortman, 2014). In 2016, two and a half million living boomers turned 70 years old (Newcott, 2016) and in the following four years, approximately another fourteen million will turn 70 years old (Colby and Ortman, 2014). Unfortunately, financial debt does not disappear after one says goodbye to his/her loved ones. Failure to discuss and address these debts in a timely manner may cause unexpected financial burdens and other problems to the loved ones (spouse and family) after a person's death. Even if you understand every tax law and investment strategy, it's always helpful to get support from an expert. Financial planning can be complex. After-death debt is not an exception. In this article, the process of debt management after death and directly related topics are discussed.

## 2. Definition of Terms

Community Property	Community property is any property a husband and wife own jointly. Any property that a partner acquired before marriage, by gift or inheritance during marriage is separate property.
Community Property Jurisdiction	<p>In a community property jurisdiction, most property acquired during the marriage is community property and is divided upon divorce, annulment, or death. Moving from a community state to a noncommunity state won't change a community property to a separate property, i.e., not a community property.</p> <p>There are nine community property states in the United States: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Guam and Puerto Rico are also community property jurisdictions. Community property arrangement is optional in Alaska (IRS, 2019).</p>
Estate	An estate consists of all the assets a person owns and all the debts he/she owes.
Living Trust	A living trust is an estate planning tool that allows a person to arrange the lifetime and after-death management of his/her assets and debts. A last will and testament achieve a similar goal. A living trust does not need to go through the complicated, potentially expensive and tedious probate process. However, a living trust is not functional until the ownership of assets is transferred to it.
Last Will and Testament	A last will and testament is also an estate planning tool. It lets a person arrange the distribution of the person's estate at the time of his or her death, appoint a guardian for his/her minor children, and name an executor to carry out his/her last will.
Probate	Probate is the legal process of authenticating a last will and testament. In addition to validating a decedent's last will and testament, a probate court will locate and appraise the value of his/her assets, pay the final bills and taxes, and distribute the balance of the estate to the heirs.

## 3. Estate Settlement Process

Though the estate settlement process is state-specific, the main steps are uniform across the United States. The executor named in the will and the trustee named in the trust have the power and the legal duty to effectively complete the estate settlement process. If the deceased has not left a will, the state probate court will assign an administrator. The estate settlement process usually takes place as follows:

1. Identifying and notifying the decedent's creditors,
2. Locating and valuing the decedent's assets,
3. Paying the decedent's debts,
4. Preparing and filing the decedent's tax returns, and
5. Distributing the remaining assets.

This article focuses on the third step of the process, paying the decedent's debt.

## 4. How the Decedent's Debts Are Paid?

Not all after-death debts are treated the same. Some assets cannot be used to pay off debts. Typically, the decedent's life insurance, retirement accounts and brokerage accounts are excluded from the estate and are protected from the creditors. These assets go directly to the named beneficiaries. If the decedent's liquid assets are not sufficient to pay off his/her debts, the cosigner and joint account holder are liable for the debt. In a community property jurisdiction, the spouse of the decedent may be liable for the debt of the deceased.

A debt is either secured or unsecured. A secured debt is backed by collateral to guarantee the payment of the debt. If the borrower defaults on payment, the creditor repossesses the collateral, sells it and uses the proceeds to settle the loan. An unsecured debt is not collateralized. Here's how major private debts are handled:

### **Mortgage Loan**

Mortgage loan is a secured debt by the property or real estate. Federal law bars a lender from forcing the joint mortgage holder to pay off the mortgage loan immediately after the death of the co-mortgage holder. The mortgage loan usually passes to the joint mortgage holder. If there is no joint mortgage holder, the mortgage loan can be paid out of the estate or the heir can take over the mortgage payments, and move in or sell the building.

### **Home Equity Loan**

Home Equity Loan is a secured debt by the home. A lender can force the person who inherits the home to immediately repay a home equity loan after the death of the equity loan holder. However, the lender might work with the heir to let him/her take over the loan repayments.

### **Car Loan**

Car loan is another secured debt by the vehicle. The estate can take care of the car loan if the funds are available. If there are not sufficient funds, the heir may continue to make loan payments or sell the car to pay off the loan.

### **Student Loan**

Student loan is unsecured debt. Federal student loan is discharged upon death (Federal Student Aid, 2019). Federal Plus loan is also discharged upon the death of parent or student. Sallie Mae student loans can also be discharged if the student die or if the person who took out the loans for the student, like a parent, dies (Withaar, 2019). Estate funds can be used to pay off private student loan. If the liquid funds are not available, the lender has no recourse unless there is a co-signer for the private student loan. The spouse of the decedent in a community property jurisdiction may be liable for student loans incurred during the marriage.

### **Credit Card Debt**

Credit card debt is unsecured debt. Estate funds can be used to pay off credit card debt. If the liquid funds are not available, the lender cannot collect because the debt is not secured by an asset. However, the lender may be able to collect against a joint account holder. Additionally, the spouse of the decedent in a community property jurisdiction may be liable for the credit card debt because the debts were accrued during the marriage. Credit card authorized users are not liable for credit card debt.

It is important to plan for the possibility of incapacity and death, managing the debts, and ensuring the estate is distributed timely according to our wishes. Both living trust, and last will and testament are estate planning tools. In many respects, both accomplish similar objectives. However, there are differences between the two. A living trust is more costly and time consuming to create because the assets must be transferred to it for it to be functional. It, however, allows your heirs to skip the probate system, which can be a tedious process as the assets are administered under court supervision. When a person needs to deal with child guardianship, a last will and testament is the only choice for a living trust simply cannot do it. Estate planning also involves legal methods of minimizing estate taxes. In the absence of living trust, and last will and testament, the state determines how property will be distributed under the default rules. Such distribution may not be what the decedent would have wanted. Table 1 summarizes the differences between the two documents.

It is obvious living trust, and last will and testament are not mutually exclusive. Many people have both. To avoid unnecessary legal issues, both should be consistent. Writing a living trust, or last will and testament is generally not a do it yourself project. It is recommended that an attorney should be consulted in connection with the preparation of the two documents.

**Table 1**  
**Major Differences between Living Trust and Last Will & Testament**

	Living Trust	Last Will & Testament
Name guardians for children	No	Yes
Avoid probate	Yes	No
Specify final wishes	No	Yes
Sign document in front of witnesses	No	Yes
Require notarization	Yes	No

## 5. Summary

There are approximately seventy-four million living baby boomers. Two and a half million of the baby boomers turned age 70 in 2016. It is never too late for boomers to start the estate planning process and have a candid talk with the spouse or family members about their estates to avoid financial and other problems. As much as we may wish, debts do not simply disappear after death. If the borrower defaults on payment for secured debt, the creditor can seize the collateral, sell it, and use the proceeds to pay down the debt. For unsecured debt, if the estate has insufficient liquid assets, there is no co-signer or joint account holder, and community property does not apply, the lender may have no recourse. In addition to discussing the major private debts, this article briefly discusses the living trust, and the last will and testament. This article may help the readers know how each estate planning tool works and decide what is right for them.

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