

Dealing with an Insolvent Estate

When someone dies, the task of winding up their estate usually falls to their loved ones. This process is often talked about in terms of selling property, closing bank accounts and valuing belongings. However, dealing with someone's estate also includes addressing any outstanding debts and liabilities that were held by the estate.

Almost all estates will involve some kind of debt. Often, this is in the form of utility bills, unpaid credit card expenditure or outstanding mortgages. In most cases, the personal representatives will be able to cover these costs from the estate before they go on to distribute what is left to the beneficiaries.

Unfortunately, things are not always this straightforward. Sometimes estates have so many outstanding debts and liabilities that there is not enough money left to pay them all, even once property and other belongings have been sold. This is what is known as an insolvent estate.

When an estate is insolvent, any money or valuables must go towards covering debts. There will not be anything left over to pass to beneficiaries, even if specific monetary bequests have been made in the Will. Insolvent estates are often not able to pay all creditors in full, in cases like these, debts that are still unpaid once the estate has been wound up will usually be written off.

An estate should not be considered to be insolvent so long as there is enough money to pay all creditors, even if there isn't enough money left to pay any specific gifts for beneficiaries that were set out in the Will.

What is involved in administering an insolvent estate?

Administering an estate is always a big responsibility, but it may feel particularly difficult if you find yourself dealing with an insolvent estate. There are specific rules that you will need to follow and not following them correctly could result in you becoming personally liable for the estate's liabilities.

With this in mind, it's very important to make sure you document everything you do, including any valuations you arrange and any property or belongings you sell. It's also vital to ensure you do not pay any creditors before the full estate has been assessed and creditor priority has been established, even if creditors are putting pressure on you to do this.

Considering whether or not to take the grant

If you have been appointed as an executor in a Will, you do not have to agree to take on the role. This is also the case if there is not a valid Will and you are the person most eligible to be appointed as administrator. Deciding whether to act on behalf of an estate is known as 'taking the grant'.

If it's been established that an estate is insolvent, that estate will have to be administered to the benefit of the creditors, not to the benefit of the beneficiaries. In these cases, any significant creditors of the estate may request to be appointed as administrators themselves. For example, if an estate is liable for a large bank loan and does not have enough to pay it, it might be in the interest of the bank to involve themselves with the administering process.

Depending on the situation, you may wish to carefully consider a request like this as it could save you a great deal of time and stress, as well as shielding you from any potential personal liability.

However, it is not always clear that an estate is insolvent until after you have agreed to act as the personal representative.

There are certain procedures that must be followed if the person who has died was under a bankruptcy order at the time of their death. In these cases, their estate will likely be under a court order and will need to be dealt with accordingly.

How should an insolvent estate be managed?

There are three ways for an insolvent estate to be managed:

1. Out of court by the personal representative

This means that the personal representative chooses to administer the estate themselves, not under any formal bankruptcy or insolvency regime. This is likely to be the cheapest and quickest option. However, it also carries the most personal risk.

2. Under the direction of the court

If a personal representative believes the estate, they are dealing with is insolvent, they can apply to administer the estate under the direction of the court. This means the court will oversee the process.

3. Under an insolvency administration order (IAO)

An application for an insolvency administration order can be made by either a creditor or a personal representative. If an IAO is in place, the estate will be dealt with by a bankruptcy trustee in much the same way that the estate of an individual who has been proclaimed bankrupt would be managed. The trustee would have the power to do things such as reduce the liability of the estate or challenge the order in which creditors should be paid. In practice, it is rare for an insolvent estate to be administered under an IAO.

If you are in any doubt as to whether an estate is insolvent, you should act as if it is until proven otherwise.

Funeral, bankruptcy and administration costs

If the estate you are administering is insolvent, you may still be able to use any money in the estate to cover limited expenses for funeral costs, and bankruptcy, testamentary and administration fees.

However, these expenses will need to be considered and recorded very carefully, as it may be possible for creditors to challenge them later on. You should consider whether or not you will be able to justify any expenditure as absolutely necessary.

Making payments to creditors

Once the full extent of the estate's liabilities have been explored, creditor payments will have to be made.

If there is not enough money to pay the debts even after everything has been sold, you will need to follow a strict set of rules to determine which debts should be paid first. This order is set out in the Insolvency Act 1986.

Order of priority

1. Secured creditors (such as mortgage or loan providers).
2. Bankruptcy costs and reasonable funeral, testamentary and administration expenses.
3. Preferential debts (such as contributions to occupational pension schemes or renumeration employees).
4. Secondary preferential debts (such as money owed for PAYE income tax or employee National Insurance contributions).
5. Ordinary unsecured debts (such as credit card bills, payments for services).

6. Interest of preferential and ordinary debts.
7. Deferred debts (such as loans from a spouse/civil partner or loans to a partnership where the interest varies with the profits)

If there is anything left after the full payment of all these priorities, it can be distributed amongst beneficiaries.

How to protect yourself from personal liability

The danger with managing an insolvent estate is that the personal representatives could find themselves personally liable for any outstanding debt.

This could happen because you have:

- Paid debts in the wrong order of priority. If you have paid an inferior debt before a superior one and there is then not enough money to pay the superior debt.
- If you pay one creditor in full when there is not enough money to pay all creditors of that class in full.
- If you have otherwise given one creditor preferential treatment over others.
- Because any bankruptcy, administration, testamentary or funeral costs have been successfully challenged by a creditor.

We can help manage an insolvent estate

If you are responsible for administering an insolvent estate, you may wish to seek professional help from us. This can help to ensure you are protecting yourself against any personal liability for the debts incurred by the estate.

How Roche Legal can help

Dealing with legal issues can be confusing and stressful. We understand this, and we're always on hand to untangle jargon and offer support.

If you need advice on any of the issues raised in this help guide, please don't hesitate to [get in touch](#). Roche Legal is an award-winning legal practice, offering practical and caring advice.

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