

What happens when a deceased person's liabilities exceed their assets?

Introduction

In this day and age where loans, mortgages, and other forms of financial assistance are frequently sought by individuals, one may wonder as to what happens when one passes away and has yet to settle their liabilities. A more curious question which infrequently arises in the minds of most people is, what are the consequences if these liabilities exceed their assets when they pass away?

This article seeks to explore the question of what happens when a deceased's liabilities exceed their assets, and whether an executor would be liable for the same, from the perspective of Malaysian law.

What is the role of an executor?

In most circumstances, a deceased person's estate (i.e. all movable and immovable assets owned by the deceased) would be left to their beneficiaries under a will. An executor is typically appointed by the deceased under the will and would then be tasked to administer the estate and distribute the deceased's assets to the beneficiaries of the deceased in accordance with the provisions of the will, or applicable provisions of law, upon the passing of the deceased.

An executor is defined under Section 2 of the Malaysian Probate and Administration Act 1959 ("PAA") as *"a person to whom the execution of the last will of a deceased person is, by the testator's appointment, confided and includes a person deemed to be appointed executor as respects settled land"*.

The probate administration process generally requires the executor to apply for a Grant of Probate in order to perform his/her duties as an executor. To ensure that the wishes of the deceased are fulfilled in accordance with the will, an executor's duties include (but are not limited to) locating the will, engaging with a lawyer to apply for a Grant of Probate from the High Court, identifying the assets and liabilities of the estate, determining the beneficiaries of the estate, paying off the deceased's debts and liabilities out

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E: general@shinassociates.com.my | T: +603 2201 5584

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of the assets of the estate, distributing the remaining assets in accordance with the will, and retaining a complete inventory and accounts of the estate.

Executors are often concerned as to whether they would have to pay out of their own pockets to settle the liabilities of the estate, given that they have the responsibility to administer the estate, which is a perfectly valid question for anyone who has been appointed as an executor by a friend or loved one.

While there are certain measures of protection afforded to executors in performing their duties, there can be situations where overarching and existing liabilities of the deceased impact the executor's ability to distribute the deceased's assets to the beneficiaries of the estate, particularly where an insolvent estate is concerned.

What happens when a deceased's estate is insolvent?

A deceased's estate is considered 'insolvent' when its liabilities exceed its assets. When a person dies, their liabilities are not discharged automatically unless it is contractually provided for. While some liabilities of the deceased may potentially be covered by insurance policies, other liabilities of the deceased must be repaid from the estate.

The provisions under the Civil Law Act 1956 ("**CLA**") provide some clarity in terms of the approach to be taken for the administration of a deceased's insolvent estate.

Section 4 (1) of the CLA provides that in the administration by the Court for the assets of any deceased person whose estate proves to be insufficient for the payment in full of the deceased's debts and liabilities then the same rules shall prevail and be observed, as to the respective rights of secured and unsecured creditors, and as to debts and liabilities provable, and as to the valuation of annuities and future and contingent liabilities respectively, as are in force for the time being, under the law of bankruptcy, with respect to the estates of persons adjudged bankrupt, will apply.

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Section 4(2) of the CLA further states that all persons who would be entitled to prove for and receive dividends out of the estate of the deceased person may come in under the decree or order for the administration of the estate and make such claims against the deceased person as they may have been entitled to by virtue of the CLA.

Section 69(1) of the PAA also states that where the estate of a deceased person is insolvent his estate shall be administered in accordance with the rules set out in Part I of the First Schedule of the PAA.

Part 1 of the First Schedule of PAA also states that, in respect of an insolvent estate, *“the same rules shall prevail and be observed as to the respective rights of secured and unsecured creditors and as to debts and liabilities provable and as to the valuation of annuities and future and contingent liabilities respectively, and as to the priorities of debts and liabilities, as may be in force for the time being under the law of bankruptcy with respect to the assets of persons adjudged bankrupt.”*

In short, if an estate is insolvent, the assets of the estate are to be distributed to the creditors of the estate as if the deceased was bankrupt at the time of death, and the creditors of the deceased may claim against the estate for settlement of the deceased’s liabilities.

Is an executor personally liable for the debts of the insolvent estate?

Generally, once a grant of probate is extracted, the executor has an overarching duty to administer the estate correctly in accordance with the provisions of the deceased’s will and in accordance with applicable laws.

The executor may accumulate the assets of the deceased under his or her possession by virtue of Section 3 of the Trustee Act 1949, in order to settle the deceased’s outstanding debts and/or liabilities and to distribute the remainder of the assets to the beneficiaries of the estate.

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Where the estate is insolvent, the laws of bankruptcy would apply to the insolvent estate, which would require the executor to make payment out of the estate to various categories of creditors (e.g. secured, unsecured, etc.) in accordance with prescribed creditor ranking provisions under bankruptcy laws.

An executor's liability in respect of the payment of debts and liabilities of the estate is typically limited to the extent of the assets of the estate that the executor has taken possession of in the execution of the executor's duties.

Section 64(1) of the PAA provides a measure of protection for executors in carrying out their executorial duties, where it states that "Every person making or permitting to be made any payment or disposition in good faith under probate or letters of administration shall be indemnified and protected in so doing, notwithstanding any defect or circumstances whatsoever affecting the validity of the probate and letters of administration"

However, it should be noted that the above indicates that executors would not be personally liable for the liabilities of the estate, provided that they carry out their executorial duties in good faith.

The United Kingdom case of *Re Yorke (deceased): Stone and another v Chataway and another* [1997] 4 ALL ER 207, further elucidates this position, where in this case the Court stated that:

"Amongst the various possible forms of devastavit [liability for maladministration or any breach of trust] is that which occurs where an executor has paid obligations of an inferior degree ahead of a superior one; where, for example, he has paid legatees ahead and to the detriment of creditors. Where such a devastavit is provided, the executor concerned becomes personally liable in respect of the assets so misapplied. He may be liable for interest thereon. He is also very likely to become personally liable to the creditors in respect of costs".

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This implies that executors can potentially be held personally liable for a breach of their duties, particularly in circumstances where the assets are misapplied by the executors or where they distribute the assets to beneficiaries without first ensuring that all creditors of the estate are paid in full.

Conclusion

If an estate is insolvent, executors may find difficulty and complications in dealing with the same due to the technical legal requirements applicable thereto. While there are legal structures in place to assist executors in handling these situations, executors could still be exposed to personal liability vis-à-vis the liabilities of the estate if their duties are not carefully adhered to.

It is therefore imperative for executors to be fully cognisant of their duties and responsibilities towards the estate, the beneficiaries of the estate, and the relevant authorities before commencing the estate administration process, and to ensure that they have the necessary knowledge and information required to perform their duties as executors of an estate. It would be prudent and beneficial for executors to seek legal advice before commencing such processes to avoid the potential pitfalls which may arise during the administration process, leading to mismanagement of a deceased's estate and the executors facing potential exposure to personal liability as a result.

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