What will happen to the bankrupt's home?

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Summary

In personal insolvency, the bankrupt is usually most concerned about what will happen to his/her home. The largest potential asset in a bankrupt’s estate is usually a beneficial interest in the family home. The treatment of the bankrupt’s home and, specifically, whether the appointed trustee in bankruptcy (the ‘trustee’) has the right to force its sale is determined by the Insolvency Act 1986 (as amended), the Insolvency (England and Wales) Rules 2016 and the Enterprise Act 2002. Insolvency law in this area is complex.

On bankruptcy, assets that form part of the bankrupt’s estate pass to the trustee and, subject to certain exceptions, the trustee may act in relation to them as he thinks necessary for the benefit of the creditors. This means that the trustee may need to sell the bankrupt’s home if this is the only way to raise money to repay creditors. This applies whether the home is freehold or leasehold or whether it is solely or jointly owned. However, it may be possible for the sale to be postponed until the end of the first year after the date of the bankruptcy order if a spouse or children live with the bankrupt. After that time, the court will only refuse an order for sale in exceptional circumstances.

Under section 283(A) of the Insolvency Act 1986, the trustee has 3 years in which to deal with the bankrupt’s home. There are several options available to the trustee, not just sale, for example he could apply for a charging order on the property. If the trustee does nothing (which is unlikely) his/her interest in the property will revert back to the bankrupt. The 3-year period in which the trustee must act begins to run from the date of the bankruptcy order.

The purpose of this note is to provide a general outline of what will happen to the bankrupt’s home under current insolvency legislation. It should be emphasised that anyone made bankrupt (or considering bankruptcy) should seek proper legal advice based on a full appraisal of the facts of their case.
**1. Bankruptcy in a nutshell**

Bankruptcy procedures and the sale of property is determined by provisions of the *Insolvency Act 1986* (as amended) (the IA 1986), the *Insolvency (England and Wales) Rules 2016* (as amended), and the *Enterprise Act 2002* (as amended) (EA 2002).

**Box 1: Who can petition for bankruptcy?**

A petition for bankruptcy may be made by either:

- the debtor himself (under section 272 of the IA 1986); or
- by creditors who are owed more than £5,000 resulting from the debtor’s failure to comply with a court order or statutory demand

In brief, bankruptcy is the administration of the affairs of an insolvent individual, in the interests of their creditors. On the making of a bankruptcy order, following a bankruptcy petition or a debtor’s application (see Box 1), the Official Receiver (OR) is appointed trustee.\(^1\) The OR continues as trustee unless or until removed by the court.\(^2\) If there are valuable assets, or if it is a particularly complex case, a private sector insolvency practitioner may be appointed trustee in place of the OR.

All assets that comprise the bankrupt’s estate will vest in the trustee subject to certain exceptions (e.g. tools necessary for the bankrupt’s business or domestic or personal items). The trustee’s statutory function is to get in, realise and distribute the bankrupt’s estate in accordance with the IA 1986. In a nutshell, this means realising the bankrupt’s assets and distributing the net sale proceeds to the creditors. The trustee’s professional costs are paid out of the bankrupt’s estate.

Automatic discharge from bankruptcy usually occurs after one year (see Box 2 below). Following discharge, the bankrupt is no longer liable for the balance of his/her debts. The rest of this note outlines in detail what will happen to the bankrupt’s home.

**Box 2: Effect of discharge from bankruptcy on bankrupt estate**

- After discharge from bankruptcy (usually after one year) the bankrupt is released from his/her bankruptcy debts and any property they acquire after discharge is theirs to keep; the trustee cannot lay claim to it.
- However, property comprised in his/her estate at the time of the bankruptcy order remains under the control of the trustee.
- Discharge does not return ownership or control of bankruptcy assets to the bankrupt or prevent the trustee from carrying out any of his remaining functions in relation to the bankrupt’s estate.\(^3\)

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1. Section 291A, Insolvency Act 1986
2. Section 298(4), Insolvency Act 1986
3. The bankrupt has a continuing obligation to attend on and provide information to the trustee if required
2. Which assets can the trustee claim?

Once a bankruptcy order has been made by the court, the trustee (either the official receiver or an insolvency practitioner) is legally entitled to seize all assets in the bankrupt’s possession at the time of the bankruptcy order (see Box 3). His primary aim is to raise money to pay the bankrupt’s creditors.

**Box 3: Bankrupt’s estate**

The “bankrupt’s estate” essentially consists of all the property which belongs to or is vested in the bankrupt at the start of his bankruptcy (i.e. the date on which the bankruptcy order is made). The IA 1986 defines the bankrupt’s estate as follows:

283.-(a) all property belonging to or vested in the bankrupt at the commencement of the bankruptcy; or
(b) any property which is or is treated as being comprised in the estate by virtue of the provisions of the Act which relate to the insolvency of individuals

Under insolvency legislation, the term “property” is defined widely. It includes:

…money, goods, things in action, and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property.

In addition to assets that are readily available, the trustee may also lay claim to “after-acquired property”, that is property acquired after the date of the bankruptcy order but before the date of discharge. (For example, the court may order that part of the bankrupt’s income from employment should be paid to the trustee).

The trustee may also claim any “future and contingent interests” the bankrupt may hold (i.e. an interest which is uncertain, either as to the person who will enjoy it in possession or as to the event on which it will arise), provided they exist as “proprietary interests” at the date of the bankruptcy. (For example, an interest in a life policy.)

If the bankrupt has a “beneficial interest” in a property, whether freehold or leasehold (i.e. an interest in the proceeds of sale of the property) this interest will generally pass to the trustee for the benefit of the creditors.

If the bankrupt jointly owns the property (perhaps with a spouse or partner) the beneficial interest is usually an equal share of the value (unless specified otherwise in the original conveyance or transfer document). If the property has been mortgaged, the mortgage company has first claim on any proceeds of sale. Therefore, the bankrupt’s beneficial interest is calculated after deducting any loans secured against the property. In effect, the property passes to the trustee subject to the mortgagee’s interest and subject to the mortgagee’s right to take possession even after the bankruptcy and to exercise all the other rights of a mortgagee (including the right of sale).
Prior to 2004 (particularly in the 1990s), it was not unusual for a trustee to delay selling the bankrupt's interest in a property, sometimes for many years, because the property was in or near negative equity. As house prices increased, it was not uncommon for trustee to then make an application for possession and sale of the bankrupt's home. Sometimes such applications would be made a decade or more after the date of the bankruptcy order, long after discharge, and would come as a complete shock to the bankrupt.

3. Dealing with the bankrupt’s home

3.1 Legislation in outline

The bankrupt’s home is usually the most valuable asset in the bankrupt’s estate. It will automatically vest in the trustee immediately on his appointment without any conveyance, assignment or transfer.\(^4\) The trustee has a duty to deal with the property for the benefit of the bankruptcy creditors. In an ideal world, the trustee’s interest is sold to a joint owner or family member, but this is not always possible (see below).\(^5\)

When assessing whether to apply to the court for an order for sale, a trustee must consider the equity available in the bankrupt’s family home. The beneficial interest (equity) in a jointly owned property is not always split equally between the co-owners and the trustee must make enquiries as to the proportion of equity which vests on his/her appointment.

**Section 283A** of the IA 1986 limits the time in which the trustee can deal with the bankrupt’s home to a period of 3 years from the date of the insolvency order (see Box 4 below).

**Box 4: Application of section 283A of the Insolvency Act 1986**

Section 283A of the IA 1986 applies only where property comprised in the bankrupt’s estate consists of an interest in a dwelling-house which at the date of the bankruptcy was the sole or principal residence of:

(a) the bankrupt,
(b) the bankrupt’s spouse, or
(c) a former spouse of the bankrupt

Where a bankruptcy order was made after 1 April 2004, the trustee must take steps to deal with their interest in the bankrupt’s family home within 3 years of the bankruptcy order by:

(a) realising the interest (i.e. selling it to somebody else, often the joint owner or family member); or
(b) applying for an order for possession and sale; or
(c) applying for a charging order over the property for the value of the trustee’s interest; or
(d) entering into an agreement with the bankrupt regarding the interest.

If the trustee fails to take any steps to deal with their interest within 3 years, it falls out of the bankruptcy estate and reinvests in the bankrupt. (i.e. it will no longer form part of the bankruptcy estate). This is sometimes known as the “use it or lose it” rule (see *Re Byford* [2003] EMHC 1267).

Section 283(A) of the IA 1986 came into force on 1st April 2004. For all new bankruptcy cases commenced after 1st April 2004, the 3-year period in which the trustee must deal...
with the bankrupt's home will begin to run from the date of the bankruptcy order. If, however, the trustee is not aware of the bankrupt’s interest in a property, (i.e. it was not disclosed by the bankrupt) the trustee will have 3 years from the date on which he/she became aware of it to deal with the interest. The 3-year period can be extended by a court order but only in exceptional circumstances.

For old bankruptcy cases, where the bankrupt has long-since been discharged but their home continues to vest in the trustee (described in the Act as 'pre-commencement bankruptcies'), the 3 years period ran from the date the provisions come into force (i.e. 1st April 2004) to 31 March 2007.

Finally, it should be noted that the 3-year rule does not apply to the sole or principal residence of a cohabitee or ex-cohabitee in which the bankrupt has an interest.

3.2 Are there any alternatives to an order for sale?

As an alternative to obtaining an order for sale, under section 283(A) of the IA 1986, an agreement may be reached whereby the bankrupt’s spouse, partner, a relative or a friend buys from the trustee the bankrupt’s beneficial interest in the property.

Another alternative would be for the trustee to agree to a charging order on the property; this would enable the bankrupt and his family to continue to live at the property (see Box 5).

Any decision regarding the sale of the property ultimately rests with the trustee (and any mortgagee of the property) and not with the bankrupt. It is not unusual for a trustee to opt for a charging order in circumstances where he is not able to dispose of the bankrupt’s interest in the family home by the time he has completed the remainder of the administration of the estate.

**Box 5: Charging Order on the family home**

- The maximum duration of a charging order is normally 12 years, but it can be renewed.
- The charging order would be subject to the provisions of the Charging Orders Act 1979. Under this Act the court has discretion to impose conditions as to when the charge is to become enforceable (and whether interest will accrue).
- When the property is eventually sold sometime in the future, the trustee would seize his share of the equity.

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6 The court may substitute for the period of 3 years a longer period in (a) prescribed circumstances, and (b) in such other circumstances as the court thinks appropriate. Alternatively, a shorter period may be specified instead of the normal 3 years period.
3.3 Rights of the bankrupt’s partner and children

In most bankruptcies the family home will be the main asset in the bankrupt’s estate available for realisation and distribution among creditors. Since selling the home is likely to make the bankrupt and his family homeless, a conflict of interest arises between the needs of the family and the needs of the creditors which has difficult legal and financial implications.

**Box 6: Spouse/civil partner has a proprietary interest in the family home**

- If the matrimonial home was originally conveyed into joint names of the bankrupt and his partner, only the bankrupt’s interest in the property will automatically vest in the trustee.

- The partner will retain his/her own beneficial interest in the property and will in law be known as “a trustee for sale”. If he/she refuses to sell the property, the trustee must apply to the court for an Order of Sale.

- If and until that order is made the partner has a legal right to occupy the property because they have a beneficial interest under a trust for sale which has not yet been determined by the court.

- If an order for possession and sale is made by the court and the property is eventually sold, the trustee can only take the bankrupt’s share of the proceeds of sale. The trustee could only claim the partner’s share if he/she can prove to the satisfaction of the court, that the original conveyance should be set aside (i.e. cancelled) as a transaction to defraud creditors under sections 339 and 423 of the IA 1986.

**Box 7: Spouse/civil partner has no proprietary interest in the family home**

Under section 30 of the Family Law Act 1996, a spouse who does not have any proprietary (i.e. legal) interest in the family home may be given rights of occupation, known as ‘matrimonial home rights’. These rights may be legally protected by registration.

In effect, a spouse’s matrimonial home rights are a legal charge on the estate which binds the trustee in bankruptcy.

Section 335(A) of the IA 1986 provides that a trustee in bankruptcy can apply to the court for an order for possession and sale of the bankrupt’s family home. In considering this application, the court must have regard to:

- the interest of the bankrupt’s creditors;
- the conduct of the spouse, civil partner, former spouse or former civil partner in contributing to the bankruptcy;
- the needs and financial resources of the spouse, civil partner, former spouse or former civil partner;
- the needs of any children, and
- all the circumstances of the case other than the needs of the bankrupt.
It is important to note that after **one year** (from the date of the bankruptcy order) the interests of the bankruptcy creditors will usually outweigh all other considerations, except in **exceptional** circumstances. In effect, after one year, the rights of bankruptcy creditors are considered paramount to any matrimonial home rights and the rights of occupation of the bankrupt **unless** the court considers the circumstances are truly “exceptional”. According to the Insolvency Service, the court has considered certain types of family suffering as “exceptional circumstances” but generally the trend is to favour creditors’ rights without regard to ordinary family suffering.

**Box 8: A final word of warning**

- Bankruptcy and property law are complex and detailed legal advice based on the full facts of a case should be sought.
- The information contained in this briefing paper is of a very general nature only and should not be taken as a substitute for proper legal advice.
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