

INSOLVENCY UPDATE

Does a bankrupt always lose the house?

Other than writing about the current Russian incursion into Ukraine, current media attention tends to be focused upon terms such as “rising inflation”, “cost of living crisis”, “eat or heat”, “interest rate rises”, and “fuel poverty”. Indeed, it may not take many more months until we start reading about “bankruptcy” and “house repossession”.

After all, if personal debts become as unmanageable as the stress created by the inability to pay them, the bankruptcy option often provides a release from creditor pressure and an opportunity to reorganise one’s financial circumstances such that a more balanced position can be established.

Whilst bankruptcy will eliminate virtually all personal debts.....good news.....what about the ability to keep the house?

If the house is rented then, as long as rent continues to be paid at the agreed amount, the accommodation position will not change.

However, if the house is owned, the provisions of the Bankruptcy (Scotland) Act 2016 “the Act” mean that all assets, including a house, transfer to the trustee when bankruptcy occurs.

Whether or not the bankrupt remains in the house is subject to numerous factors, which will vary depending upon individual circumstances. For example, if the house has negative equity e.g. worth £300,000 but has a mortgage of £340,000, the trustee is unlikely to be interested in the house and indeed, may abandon his interest at an early stage. The State official dealing with sequestrations, the accountant in bankruptcy “aib”, permits abandonment when the view is taken that the negative equity position is unlikely to reverse in the next few years.

Another option is for the trustee to accept an agreed sum (£500 is the current aib figure) from the bankrupt in exchange for removing his interest in the house where it can be shown that minimal net equity exists.

Another matter to consider is the secured creditor’s attitude because, even if the trustee does not wish to pursue the house, the secured creditor may seek to

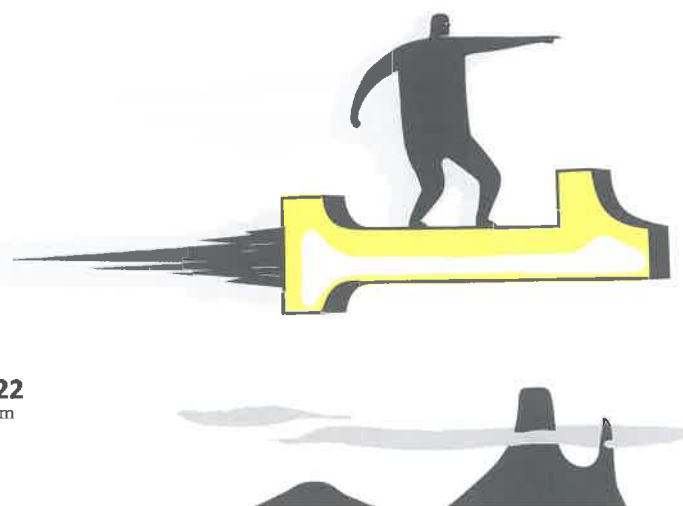
repossess if the mortgage is not serviced on a regular basis. In general terms, a secured creditor does not relish the thought of repossessing and selling a house and would prefer to leave the bankrupt in occupation if possible. A further complication can arise if there is a Restraint Order over the house as a result of the Proceeds of Crime Act 2002 but, thankfully that happens rarely.

As readers might expect, the family home is treated differently to the house that a bankrupt might own and rent to a third party. Thus, if a house is not deemed to be the family home, the trustee will view it as an asset and, subject to the likelihood of a reversion to the estate upon sale, take steps to sell it.

That is not the case with the family home where, as one might anticipate, the Act has comment to make. For example, section 113 provides that before a trustee can sell or dispose of the bankrupt’s family home, he must obtain formal consent from those who live in the house : typically the husband/wife who has not been made bankrupt. Where such consent is not provided voluntarily, the trustee must seek authority from the sheriff court. Such an order, if granted, means that the trustee can evict the bankrupt and his family, secure vacant possession and place the property on the open market for sale.

The position is not made any easier if, for example, title is in the sole name of the bankrupt. The Act provides an element of protection for all those living in the house and if the trustee is seeking court authority to evict, section 113 requires the sheriff to have due regard to :

1. The needs and financial resources of the bankrupt’s spouse, or former spouse.
2. The needs and financial resources of the bankrupt’s civil partner, or former civil partner.



3. The needs and financial resources of any child of the family.
4. The interests of the creditors generally.
5. The length of the period during which the house was used as a family home by any of the persons referred to above.

Even if the sheriff is minded to grant an Order in the trustee's favour, the Act gives the sheriff latitude to delay the issuing of such Order for a period of up to three years. For example, if a child is about to sit important school exams next year, the sheriff may decide that it is vital to have stability within the family home until the exam diet has been held.

It is fairly common practice for the trustee to negotiate with the bankrupt about establishing the net equity position and how best to deal with it. In reality, not many people wish to go to court and speculate upon the risk of the sheriff granting an Order for/against the bankrupt. There are many cases where the net equity position is agreed, and in this regard the guidelines from the accountant in bankruptcy suggest that such negotiations should take place at the commencement of a bankruptcy in order to try and introduce an early element of certainty for the bankrupt and his family.

Discussion will then ensue regarding how best to fund the bankrupt's share of the net equity interest. Sometimes a bankrupt is able to increase the mortgage in order to release the sum required. Frequently, the spouse will provide the cash required, and it is not unusual for either a friend or family member to provide the necessary sum of money : normally on the basis that the bankrupt will seek to repay the lender at some point in the future.

It is fair to say that every bankrupt who owns a house does not lose the house. The majority of trustees will try to reach a settlement position because, after all, the trustee's focus is merely to recover fair value from the house such that a dividend can be paid to creditors.

The best course of action when bankruptcy occurs is to seek advice from an experienced professional. Although the whole issue can become somewhat stressful and often takes a year or so to resolve, it is by no means certain that a bankrupt will always lose the house.

Director disqualifications

Figures released by The Insolvency Service in April show that there were 802 successful actions by the director disqualification unit in the year ended 31 March 2022, down slightly from 981 in the year ended 31 March 2021. One might be forgiven for observing that the unit tends to select cases where they are confident of the outcome because 83% (previous year 88%) of cases were concluded by an Undertaking i.e. the director considering that a court is likely to agree with The Insolvency Service and hence, agreeing to a ban from being a director for a set period of time rather than incurring the expense and speculation of legal action and perhaps being subject to an Order for the same period of time.....but with a large legal bill to pay.

Deluge of liquidations on the horizon?

Some commentators are talking of a huge surge in liquidations due to failure to repay bounce back loans. It would appear that such an increase may well happen in England where the government acts as liquidator of last resort i.e. if there are no assets to finance the appointment of a private practitioner. In Scotland, no such facility exists and thus, many companies will be left to rot in a zombie state because a liquidator will decline to take office and the bounce back loan provider (and perhaps HMRC) will object to the company being struck off because there is an unpaid debt. An unintended impasse that will leave many directors in Scotland with an unwelcome headache. If in doubt, seek advice.

GDPR

The names and addresses contained on the Meston Reid & Co Insolvency Update database are used only for this communication. If you wish to be removed from such database, please e-mail ryriel@mestonreid.com.

Conclusion

This Update is provided for general interest purposes and does not purport to offer definitive advice. Thank you for taking the time to read this Update and feel free to pass it to anyone who you think might be interested in reading it.

Meston Reid & Co