

## **When a Bankruptcy Trustee Sells Real Property Owned by a Debtor and a Non-Debtor Co-Owner, What Happens to the Sale Proceeds?**

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Scenario: Two individuals, entering into a real estate investment, purchase a house together as tenants in common, each owning one-half of the property. When one of the individuals runs into financial trouble and can no longer afford to pay his or her half of the mortgage or any other expenses relating to the property, the co-owner bears the burden of continuing to make all of the payments. If the individual then files for bankruptcy, the bankruptcy trustee will likely sell the property and argue that the debtor owner's bankruptcy estate is entitled to one-half of the sale proceeds because the debtor owner had a one-half ownership interest in the property. However, the non-debtor owner, who continued to make all of the payments when the debtor owner no longer could, may argue that he or she is entitled to more than one-half of the sale proceeds because he or she contributed more to the property, by way of payments, than the debtor owner did. Thus, what is the result when the trustee sells the property?

According to the Bankruptcy Code, if a debtor had an interest in a property as a tenant in common prior to the commencement of his or her bankruptcy case, a trustee may sell the bankruptcy estate's interest in the property as well as the non-debtor owner's interest in the property if the following four conditions are met. First, partition of the property must be impracticable. For example, it is virtually impossible to partition a single family residence. *See, In re Griffin*, 123 B.R. 933, 935 (Bankr. S.D. Fla. 1991). Second, selling the bankruptcy estate's undivided interest in the property would result in less for the bankruptcy estate than selling the entire property. Third, the benefit to the bankruptcy estate of selling the entire property outweighs the detriment to the non-debtor owner. Lastly, the property cannot be used in the production or transmission of electric energy or gas for heat, light, or power. *See*, 11 U.S.C. § 363(h).

Section 363(j) of the Bankruptcy Code states that after the property is sold by the trustee, the proceeds of the sale should be distributed to the non-debtor owner and the debtor owner's bankruptcy estate, according to each of their interests. The purpose of the bankruptcy estate receiving these proceeds is to pay the creditors of the debtor owner. *See*, 11 U.S.C. § 363(j); *see also, Griffin*, 123 B.R. at 935.

A situation similar to our scenario arose in *In re Shelton*, 334 B.R. 174 (Bankr. D. Md. 2005). In *Shelton*, the debtor owner had a one-half ownership interest in a property and filed for bankruptcy. The trustee sold the property, asserting the bankruptcy estate's right to one-half of the sale proceeds, but the non-debtor owner, who owned one-half of the property, objected because he had contributed more to the property than the debtor owner had, in terms of the mortgage payments. For the three years prior to the debtor owner filing for bankruptcy, the non-debtor owner paid all of the mortgage payments. Thus, the non-debtor owner claimed entitlement to more than one-half of the property. The court, in *Shelton*, held that the non-debtor owner was entitled to contribution in the amount of half of the mortgage payments that he alone had paid on the property. *Shelton*,

334 B.R. at 178. This amount was then added to the non-debtor owner's one-half of the sale proceeds.

Therefore, pursuant to the case law, when property is jointly owned, a co-owner, who makes payments to preserve the property, is entitled to contribution from the other co-owners of the property. Shelton, 334 B.R. at 177. Thus, regarding our scenario, the entire amount advanced by the non-debtor owner may be deducted from the sale proceeds and paid to the non-debtor owner before distributing the balance of the proceeds between the non-debtor owner and the debtor owner's bankruptcy estate. Or, in the alternative, the proceeds of the sale may be distributed to the non-debtor owner and the debtor owner's bankruptcy estate according to their ownership interests in the property, and then half of the amount advanced by the non-debtor owner may be deducted from the bankruptcy estate's share and then the non-debtor owner's share may be increased by the amount of the bankruptcy estate's deduction. *See, Id.*

In conclusion, the non-debtor owner will most likely receive more than half of the sale proceeds when the trustee sells the real property because the non-debtor owner contributed more payments to the property than the debtor owner did.

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