

Bankruptcy and Divorce: Survival Strategies

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Nothing in this presentation should be construed as legal advice.

Although I encourage you to call me to explore your options as to filing bankruptcy, I cannot give advice without speaking and/or meeting with you first.

The law firm of Karina Pia Lucid, Esq. LLC, is a debt relief agency. We help people file for bankruptcy.

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Introduction

- This presentation will discuss some of the commonly asked questions that arise during and after a divorce proceeding.
- When working with clients who are engaged in a Collaborative process, and who are experiencing financial distress, it is advantageous to consider various bankruptcy issues as part of the negotiations, such as:
 - Whether a bankruptcy proceeding should be filed by one or both spouses;
 - Should the filing(s) take place before or after the judgment for divorce is entered; and
 - Should the filing be joint or separate?

What does the Bankruptcy Code say?

- First let's look at how your divorce decree, property settlement agreement and support obligations will be treated in by the Bankruptcy Court.
- Under the Bankruptcy Code there are dischargeable and non-dischargeable debts. Since the 2005 Amendments to the Bankruptcy Code were passed, most debts that are incurred as a result of a divorce are non-dischargeable (with some important exceptions)
 - Section 523(a)(5) states that a a debtor cannot discharge a domestic support obligation under any circumstances.
 - Section 523(a)(15) provides that an obligation to a spouse, former spouse or child of a debtor that is incurred in the course of a divorce or separation or in connection with a separation agreement or divorce decree is not dischargeable.

What constitutes a “domestic support obligation”?

- Bankruptcy Code Section 101(14A) provides that a “domestic support obligation” is:
 - a debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is—
 - (A) owed to or recoverable by—
 - (i) a spouse, former spouse, or child of the debtor or such child’s parent, legal guardian, or responsible relative; or
 - (ii) a governmental unit;
 - (B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child’s parent, without regard to whether such debt is expressly so designated;
 - (C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of—
 - (i) a separation agreement, divorce decree, or property settlement agreement;
 - (ii) an order of a court of record; or
 - (iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and
 - (D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child’s parent, legal guardian, or responsible relative for the purpose of collecting the debt.

Distinction Between Chapter 7 & Chapter 13

- Domestic support obligations (“DSO”) are NOT dischargeable under chapter 7 or 13
 - Child support
 - Back child support (arrears)
 - Alimony
 - Maintenance and
 - “Support”
- However, all other obligations that arise under a separation agreement or divorce decree are dischargeable under chapter 13 – as long as the debtor spouse successfully completes his/her chapter 13 plan.
- Note – default or failure to pay a DSO claim during the life of a chapter 13 plan = denial of discharge. See 11 U.S.C. 1328(a)

Key to Non-Dischargeability = Maintenance or Support

- To insure that an obligation to a non-debtor spouse will be treated as a non-dischargeable DSO claim, the property settlement agreement (“PSA”) must clearly state that the obligation is intended for the “support” or “maintenance” of the non-debtor spouse.
 - Debtor obligated to pay mortgage? State in PSA that it is in lieu of other alimony or support.
 - Debtor may be obligated to pay non-debtor spouse's legal fees. Legal fees will only be non-dischargeable if the obligation is “in lieu of” or “in the nature of” support.
 - Tuition payment – PSA should state it is in lieu of child support
 - Etc.
- If the PSA is clear that the obligation is a DSO or “in lieu of” a DSO, then the Court will look no further and the debt will not be dischargeable.
- If the PSA is not clear the non-debtor spouse may have to file a proof of claim and a complaint and engage in proofs to show that the function of the obligation at the time of the divorce or PSA was truly “in the nature of support.”

Intentional Torts

- It should be noted that obligations to pay for intentional tort claims – including any form of “willful and malicious injury” to the non-debtor spouse, are not DSO claims. Non-debtor spouse *MUST* file a non-dischargeability complaint within 60 days of the filing of the Debtor’s petition, and have the claim adjudicated.
- “Domestic violence” awards are exempt assets in a case where the Debtor was the victim.

Fraudulent Transfers

- A division of property pursuant to a PSA is a “transfer”
- When property is transferred in a manner that is designed to avoid obligations to “other” creditors rather than to actually serve the purposes of equitable distribution or support, then the “transfer” may be avoided by the bankruptcy trustee
- Consideration and Fairness are key here. Was there an arms length transaction? Was there a lopsided distribution in the PSA? Did the non-debtor get all the non-exempt assets while the debtor got all the exempt assets and the dischargeable debt?
- Consideration can be shown in the allocation of exempt assets, such as retirements accounts, or relief from non-dischargeable debts, such as child support.

The House

- Who gets to keep the house? Can that spouse afford it? Is there significant debt encumbering the house? Can that debt be discharged or reorganized?
- If the house is owned jointly and the debt IS NOT joint, then the house cannot be sold by a trustee in bankruptcy.
- If the house is owned jointly and the debt is also joint, then the trustee can sell the house subject to the 50% interest in equity owed to the non-debtor spouse and the debtor's exemption. Under Federal law, the debtor has the right to receive \$22,975 of the equity.
- The trustee must show that after the payment to the debtor, the non-debtor spouse, trustee commission, brokers fees and legal fees, etc., there is still some equity left over for distribution to other creditors. Otherwise the court will not allow the trustee to sell the house.
- If the debtor's obligation to pay the mortgage is stated as alimony or support in the PSA, then the obligation is not dischargeable.

Credit card and unsecured other debts

- If it's in lieu of support, then it may be dischargeable as to the third party creditor, but you can't leave the non-debtor spouse holding the debt.
- If the creditor seeks to collect the debt from the non-debtor spouse, the debtor will be obligated to either (1) repay non-debtor spouse or (2) pay the creditor.

The Automatic Stay

- The imposition of the automatic stay gives rise to important timing issues arises
- When planning for divorce and bankruptcy remember that certain actions will be subject to the automatic stay and initiation or continuation of those actions will require a motion or consent order to be filed
- Actions stayed include all actions with respect to property of the estate – so anything that seeks a determination of what will happen to the debtor's money or other assets
- Actions NOT STAYED include the divorce proceeding itself, child custody proceedings, paternity cases, domestic violence proceedings, and Domestic Support proceedings
- A state court has the jurisdiction to hear and decide upon a request for establishment or modification of a DSO during the chapter 7 or chapter 13 case.

Joint Petition or Solo?

- Can we file a Joint Petition?
 - Yes – before the divorce
 - No – after the divorce
- Should we?
 - Are most obligations joint?
 - If not joint obligations, are there other factors that make it necessary for both parties to file for bankruptcy relief?
 - Are assets held jointly?
 - Were tax returns filed jointly?
 - How much income does each spouse have?
 - Does one spouse have unsecured obligations that, if discharged, will make it more feasible to keep up with support payments?
 - If the debt is not joint, what benefit will there be to a joint filing?
 - These are fact sensitive considerations that must be discussed with counsel before making a determination of whether or file joint or solo.
- If you file 2 separate cases you will have to have 2 separate attorneys and 2 separate fees. Filing together when it will benefit both parties is often advisable to save on costs.
- However, bear in mind that this only works for chapter 7 cases. In a chapter 13 case, you will each have long term repayment obligations (36 to 60 months). You will have to retain separate counsel because your case will not be complete prior to your divorce.
- It does not matter if you are living together or not. If the couple is still married they can file jointly.

Some benefits to Filing of Bankruptcy Relief

- Debtor's discharge of non matrimonial debts can free up income an increase the debtor's ability to pay DSO
- Automatic stay will stop wage executions or garnishments of non-DSO creditors
- Automatic stay extends to non-debtor co-obligor during the pendency of a chapter 13 plan (referred to as the "co-debtor stay")
- Chapter 13 provides and opportunity to cure mortgage arrears and save the home from foreclosure
- In chapter 7 or chapter 13 cases, debtor's can request "loss mitigation" to modify existing mortgage debt
- Relief from debts simplifies and clarifies the issues to be addressed in the PSA or divorce decree
- A fresh start – Bankruptcy relieves the family from the dark cloud and burden of many debt obligations and often allows everyone to re-focus

We hope you enjoyed this presentation!

- We happily accept referrals for chapter 7 and chapter 13 cases as well as for consultations in the planning stages of Collaborative proceedings.
- Please contact us for information regarding fees or case specific questions.
- Thank you!

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