By John J. Johnston

Family Law and the New Bankruptcy Code

Key amendments to the Bankruptcy Code have a special impact on family law. Here are some of the most important provisions, issues, and strategies.

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Mark Twain asserted over 100 years ago that the report of his death was an exaggeration.[1] The same can be said of bankruptcy practice after October 17, 2005.[2] It is changing drastically, but the Code is still alive.

The recent changes are, however, having a significant impact on the practice of family law. Although many of the amendments appear to favor those who are owed support obligations or property settlements, attorneys must carefully analyze the Code and determine case by case whether it is wise to use these tools on behalf of a given obligee client. It might actually be easier for the obligor to fulfill his responsibilities to your client if he can discharge his debts.

Therefore, you must review the possible consequences before deciding whether to contest the bankruptcy. The changes reviewed in this article only apply to cases filed after October 16, 2005. Many existing Chapter 13 cases will go on for years, and the old law will apply to them.

The new Code makes property settlements nondischargeable in Chapter 7. It is no longer necessary to file an adversary complaint to determine whether obligations assumed in a divorce are dischargeable. The ability-to-pay standard and the balancing test of section 523(a)(15) have been deleted from the statute. Under section 523(c), challenges to dischargeability of property settlements no longer must be brought in bankruptcy court.

Here's a look at specific features of the Code amendments from a family-law practitioner's perspective.

What is a "domestic support obligation"?

Attorneys differ over whether it is better to file bankruptcy before or after a judgment of dissolution has been entered. Since property divisions are no longer dischargeable, it's usually good practice to give the other spouse an opportunity to file bankruptcy jointly with your client. If the spouse refuses, file the bankruptcy and then argue to the family court judge that he had a chance to file. Therefore, your argument goes, the debts shouldn't be assigned to the party who filed bankruptcy.

However, if your client is required to hold the former spouse harmless for specific martial debts or pay him or her a sum pursuant to a property division, there is still an option. These obligations may be dischargeable in Chapter 13.[3] As a non-priority unsecured creditor, the former spouse may receive little if anything under a Chapter 13 plan. Although the new Code attempts to do away with the distinction between support obligations and property distributions by making them both nondischargeable in Chapter 7, this will continue to be an issue in a Chapter 13 bankruptcy.

The issue in a Chapter 13 case will be whether the debt is really a domestic support obligation because it was assigned in lieu of maintenance or support.[4] If both parties earn relatively equal amounts and have no children, any debt they are allocating is unlikely to be viewed as support, which means it will be dischargeable.

However, if the couple has children and the non-custodial parent is assigned mortgage or car payments, those would probably be considered a nondischargeable domestic support obligation. If the obligor files under Chapter 13 and attempts to discharge a property distribution, the former spouse may argue that the debt is actually a domestic support obligation. Domestic support obligations are not dischargeable under Chapter 7 or Chapter 13.

If that argument is successful, the debt would have to be paid as a priority debt under the Chapter 13 plan. It's unclear what the deadline is for filing an objection to the discharge of a property distribution. The safest practice until this issue is clarified will be to object before the plan is confirmed.

Past-due support under the new law

An amendment to Section 507(a) makes domestic support obligations a first priority in distribution in a Chapter 7 bankruptcy. Support obligations assigned to governmental units are also now priority debts. As a priority debt, the support obligation must be paid in full during the life of the Chapter 13 plan.

This can be a major problem for debtors who owe large support arrearages. They may not be able to propose a plan that can pay off the debt within five years, which is the maximum length of a plan. There is a distinction if the support obligation has been assigned to a governmental unit. Those claims owed to the state do not have to be paid in full if the debtor commits all of his disposable income to a five-year plan and still can't pay the arrearage in full.[5] The arrearage owed to the state would not be discharged, but for the five years the plan is in effect no collection action could be taken.

It might actually be easier for the would-be bankrupt obligor to fulfill his responsibilities to your obligee client if he can discharge his debts.

One of the most significant changes to the Code is the addition of the means test. Debtors who have income above the state's median must submit to the means test.[6] In some cases, however, the debtor

1. Mark Twain, "The report of my death was an exaggeration." *New York Journal*, June 2, 1897.
2. S. 256, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, made substantial changes to the Bankruptcy Code, 11 USC §§ 101 thru 1532. Most of the changes were effective October 17, 2005.
3. 11 USC § 1328(a)(2). See also, John Rao, *Consumer Bankruptcy Law and Practice, Special Guide to the 2005 Act* § 10.6 (National Consumer Law Center 7th ed 2004) (H. Sommer, ed.).
4. The definition of domestic support obligation is found in § 101(14A) and includes both pre-petition and post-petition support and maintenance obligations, including interest that accrues under state law. It also includes support owed to a spouse, former spouse, child, child's parent, guardian, responsible relative or governmental unit.
5. 11 USC § 1322(a)(4).
6. 11 USC § 707(b)(2). Under the means test, the debtor's current allowable expenses are deducted from his monthly income to determine whether there will be a monthly amount available to unsecured creditors. If the amount available is large enough, there is a presumption of abuse and the debtor will generally be required to file Chapter 13.

may be able to use large support arrearages to his advantage.

Since support arrearages are a priority debt, the total amount owed would be divided by 60 months and included in the means test calculations required under the new law. This might allow someone with high income who would not otherwise qualify to file a Chapter 7 rather than Chapter 13. Alternatively, it may allow a debtor in a Chapter 13 to minimize or eliminate payments to non-priority unsecured creditors, such as credit card or payday loan companies.

There are now many ways counsel for a custodial parent can exert pressure on a debtor to pay support.

Current support obligations will now play a prominent role in bankruptcy. There are many ways counsel for a custodial parent can exert pressure on a debtor to pay support. In order for a Chapter 13 plan to be confirmed, post-judgment support must be current.[7] Failure to make post-petition payments is grounds for dismissal.[8] An affidavit must be filed at the conclusion of the case to certify that all support obligations are paid in full. The debtor may not receive discharge without this certification.[9]

If the debtor is attempting to discharge a property settlement through a Chapter 13, the support obligee might want to move for a dismissal order under 1307(c)(11) if the debtor falls behind in current support payments. There could also be a dispute if the debtor files an affidavit claiming to be current in his domestic support obligation and the former spouse claims he is not because certain debts he was to pay were actually in lieu of support.

Creditors who are owed support should carefully review Chapter 13 plans. In some districts, the plan controls and could be determinative of the amount of pre-petition domestic support arrearages. In such cases, the amount set forth in the plan would control and be res judicata on this issue, which could have been reviewed prior to plan confirmation.[10]

Miscellaneous Issues

Challenging a Chapter 7 plan. There will typically be no reason to challenge a Chapter 7 debtor, because none of the obligations imposed by the divorce decree will be discharged. It is better to allow the debtor to get out from under his debts so he is better able to assume his support responsibilities. The debtor will still discharge his obligation to the individual creditor. However, if that creditor pursues the former spouse, the debtor will be responsible under the hold-harmless provisions of the divorce decree.

Automatic stay. The new Code has clarified several issues with regard to application of the automatic stay in family law cases.[11] The stay does not apply to custody and visitation disputes, domestic violence cases, or divorces to the extent that division of estate property is not at issue. The stay also does not preclude child support withholding, driver's license suspensions, tax intercepts, and reporting debtors to credit reporting agencies to collect support. However, a confirmed Chapter 13 plan may bind the support creditor to the debtor's plan for payment of arrearages and preclude collection action outside the bankruptcy court.[12]

Notice to support creditors. Debtors are now required to notify trustees of the names and addresses of all holders of support claims. Trustees must now notify those persons of their rights to use support enforcement agencies and where to contact those agencies. Trustees must also advise support creditors of their rights as a creditor and notify the state's child support agency of the support holder's name, address, and phone number.[13] At the time a discharge is entered, the trustee must notify the holder of the support claim and the state support agency of the debtor's last known address and his employer.

Tax returns. Debtors also must now provide copies of tax returns to trustees in both Chapter 7 and Chapter 13 cases. Creditors have a right to receive a copy of those returns under section 521. This may be a useful discovery tool if a former spouse is a creditor, but doesn't have an action pending in family court.

Preferences. Under the amended Code, a trustee cannot avoid a bona fide pre-petition transfer as a preference if it was intended to satisfy a support obligation.[14] A debtor might transfer assets he would lose in bankruptcy to the support obligee before filing, since the support obligation would not be dischargeable. As a first priority creditor, the support obligee might be paid anyway if the assets were liquidated by the trustee. However, by transferring the assets before filing, the debtor retains control and avoids liquidation expenses of the trustee.

Still a useful tool

Despite all of the changes to the Bankruptcy Code, bankruptcy can still be a useful tool for both parties in family law cases. It is often helpful to file a joint case before a judgment of dissolution is entered to simplify the issues and allow both parties to survive financially.

Chapter 13 may be helpful for the support obligor who needs to take control and restructure the payment of his obligations. The new Code imposes new restrictions on serial filing of bankruptcy cases.[15]

However, even when the client isn't eligible for discharge because of a prior bankruptcy, a Chapter 13 may be helpful. Foreclosure can be stayed and mortgage arrearages can still be cured in a Chapter 13. Saving the family home, or the home in which your former spouse and family reside, is still possible under the Code.

It's important for family law attorneys to explore these alternatives when their clients are in financial distress. While the post-amendment Code might be more difficult to use, bankruptcy is still a viable alternative. ■

7. 11 USC § 1325(a)(8).
8. 11 USC § 1307(c)(11).
9. 11 USC § 1328(a).
10. *In re Harvey*, 213 F3d 318 (7th Cir 2000).
11. 11 USC § 362.
12. Rao, *Consumer Bankruptcy Law and Practice, Special Guide to the 2005 Act* § 9.4 (cited in note 3).
13. 11 USC § 704(c)(1) and 11 USC § 1302(d)(1).
14. 11 USC § 547(c)(7).
15. 11 USC § 727(a)(8) (A debtor can't obtain a discharge in a Chapter 7 filed within 8 years of the filing of a prior Chapter 7 in which a discharge was granted); 11 USC § 1328(f)(1) (A discharge can't be granted in a Chapter 13 if filed within 4 years of the filing of a prior Chapter 7 where there was a discharge).