



Tip of the Month October 2012

Divorce and Bankruptcy

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The financial situation of individuals and families changes dramatically in the wake of a divorce. Where there was one household, now there are two with two sets of food, housing and other expenses. Additionally, divorce can create an unexpected disruption to family income pushing individuals and families into debt or further into debt. Clients facing divorce may consider filing bankruptcy in order to deal with substantial marital debt so they can truly get a “fresh start” after the divorce. However, some practitioners might not immediately know the answers to questions about the effects bankruptcy and divorce have on each other, and the best timing for filing bankruptcy. Below is a brief outline of some of the major issues that affect chapter 7 bankruptcy and divorce.

CHILD SUPPORT AND SPOUSAL MAINTENANCE IN A CHAPTER 7 BANKRUPTCY

Certain debts are not dischargeable in bankruptcy. When a debt is characterized in the divorce decree as a domestic support obligation, such as child support or spousal maintenance, it is clear that debt is not dischargeable.¹ Additionally, while the automatic stay, a provision of bankruptcy law that stops all collection efforts harassment and foreclosure actions, will halt collection of past due support, it does not apply to current and ongoing support obligations.

When the debt is not clearly characterized as a domestic support obligation, whether the debt is dischargeable depends on how the parties have characterized it in the judgment and decree. Debts “in the nature of support” are not dischargeable.² Generally, if a debtor has assumed some other debt in lieu of a support obligation, that debt is characterized as domestic support.³ For example, if a debtor’s child support obligation is less because he agreed to pay certain credit card debt and medical expenses, the debt and medical expenses are not dischargeable in a chapter 7 bankruptcy.⁴ Family law practitioners should take extra care when drafting this language as this area is ripe for dispute.

THE EFFECT OF DEBT DIVISION IN A BANKRUPTCY

When a marital dissolution involves a division of marital debts, one party often assumes a debt held by both parties and holds the other party harmless from it. When the party who has assumed the debt successfully discharges a debt held in *both parties’* names, the creditor will seek to collect payment from the other party. The party who was held harmless on the debt can then seek to collect payment from his or her spouse. Like child support and spousal maintenance, property division debts are not dischargeable in bankruptcy.⁵ However, the parties often have to go back to family court to sort out these issues, which, depending on how much money is at issue, may not be economical.

¹ *Dougherty v. Dougherty*, 1991 WL 75256 at * 1 (Minn. Ct. App. 1991).

² 11 U.S.C.A. § 101(14A)(B).

³ *Id.*

⁴ *In re McLain*, 241 B.R. 415, 421 (B.A.P. 8th Cir. 1999).

⁵ *Fast v. Fast*, 766 N.W.2d 47, 48-49 (Minn. Ct. App. 2009).

It is important for divorce clients to understand that, should their former spouse file bankruptcy or quit paying debts, the divorce decree will not prevent creditors from attempting to collect on debts that were originally held in both parties' names. In dissolutions where bankruptcy is being considered by either party, it is best to advise the client of this possibility when determining how to divide marital assets and debts. Jointly filing bankruptcy before divorce may be the preferred option.

WHETHER TO FILE BANKRUPTCY BEFORE OR AFTER FILING FOR DIVORCE

Generally, as long as the parties are still married, they can file a joint bankruptcy. This may allow for greater exemptions and may save more of the parties' assets. When a couple jointly files for a chapter 7 bankruptcy, there is one filing fee, one lawyer and one legal bill. It can also be much easier to resolve issues surrounding assets, debt, and support in divorce proceedings and prevent return trips to family court if bankruptcy has discharged certain obligations. Another benefit for divorce clients is that a joint bankruptcy provides for full financial disclosure from both sides. This can make divorce settlement easier.

Alternatively, sometimes there are benefits to filing for bankruptcy after divorce. The individual debtor's assets and debt obligations are much clearer after divorce, which may make filing for bankruptcy easier. It is also worth considering whether either the individual debtor or the married debtors' income would be too high to qualify for a chapter 7 bankruptcy filing. Other considerations, such as whether the client or spouse has filed bankruptcy in recent years, whether the client is judgment proof and whether the client is willing to part with his or her belongings, may affect the choice to file bankruptcy.

MINNESOTA STATUTE 519.05(a) DEBT DIVISION AND COLLECTIONS BY THIRD PARTY

Generally, a spouse is not liable for a debt solely in the other spouse's name. However, spouses who live together are jointly and severally liable for necessary medical services provided to either spouse and necessary household articles and supplies furnished to and used by the family.⁶ Notwithstanding this statute, a court may still apportion medical debt between parties in a marital dissolution.⁷ Due to lack of case law it is unclear whether allocation of medical debt in a divorce decree will actually prevent a creditor from attempting to collect the debt from the spouse who did not receive services.

PLEASE NOTE:

The treatment of marital debt, property division and support in a bankruptcy is complex issue. VLN volunteers are strongly encouraged to speak with a mentor attorney or VLN resource attorney if these issues arise in their VLN case.

⁶ Minn. Stat. § 519.05(a).

⁷ *Id.*