Introductory Guide to Matrimonial Issues in Bankruptcy

All too often, financial difficulties spur matrimonial difficulties. Matrimonial difficulties, in turn, tend to only exacerbate the original financial difficulties, particularly if the couple is unable to resolve their differences, ultimately leading to separation or divorce proceedings. In order to alleviate this financial hardship, bankruptcy is often an attractive option. However, when considering bankruptcy, particularly during pending separation or divorce proceedings, individuals must be aware of several potential issues.

Andrew M. Thaler

The Automatic Stay

Arguably, the greatest protection in bankruptcy is the automatic stay, which is found in Section 362 of the Bankruptcy Code.[1] At the moment an individual or business files a bankruptcy petition, the automatic stay goes into effect, halting nearly all collection and enforcement efforts against the debtor.[2]

There are, however, several important exceptions to the automatic stay's wide-ranging protection.[3] Specifically, in addition to not stopping criminal proceedings and government investigations, the automatic stay also does not stop pending family law matters, including proceedings involving domestic support obligations, paternity, divorce, and child custody.[4] The automatic stay will, however, prevent equitable distribution of property of the debtor's bankruptcy estate.[5]

David N. Saponara

This means that filing bankruptcy will not, in and of itself, provide an individual with total relief in contentious separation or divorce proceedings. Rather, filing bankruptcy will only serve to delay, at least for some period of time, equitable distribution of the individual's property, which property becomes property of the bankruptcy estate upon the bankruptcy filing.

The Bankruptcy Estate

The Bankruptcy Code also addresses equitable distribution in Section 541, which sorts out which property is and is not part of the bankruptcy estate.[6] Generally, all of the debtor's property at the time of the bankruptcy filing becomes property of the bankruptcy estate.[7] Property the debtor becomes entitled to receive after filing a bankruptcy petition, on the other hand, is generally not subject to administration in bankruptcy.[8]

The Bankruptcy Code specifically provides, however, that if the debtor acquires property "as a result of a property settlement agreement with the debtor's spouse" within 180 days after the bankruptcy filing, then such property becomes property of the bankruptcy estate if the property would have been part of the bankruptcy estate had the debtor owned it at the time of filing.[9]

In other words, an individual awaiting an equitable distribution determination that files a bankruptcy petition, runs the risk that if he or she receives or becomes legally entitled to receive equitable distribution property within six (6) months after filing, then the property is property of the bankruptcy estate available for distribution to creditors. To prevent this unanticipated and potentially devastating loss of property, proper pre-bankruptcy planning must include coordination between the individual's family law and bankruptcy attorneys, to anticipate and address these issues when considering if and when to file a bankruptcy petition.

Failing to engage in proper pre-bankruptcy planning may inadvertently cause an asset to become property of the bankruptcy estate, thwarting the entire purpose and expectations of the parties entering into a divorce or separation agreement. For example, it is not uncommon for a financially distressed spouse holding title to real property to transfer that property to the other spouse in consideration for a reduction in the amount of maintenance or child support obligations as part of a marital settlement agreement.

If either the transfer or the bankruptcy filing is premature – that is, the judgment of divorce has not yet been entered by an order of the matrimonial court prior to the bankruptcy filing – then the bankruptcy estate of the transferor spouse may be able to recover the transfer as a fraudulent conveyance, enabling the bankruptcy trustee to administer the value of that transfer for the benefit of the transferor's creditors. Alternatively the property transferred can still be treated as part of the bankruptcy estate of the transferring spouse.[10] This is an unfortunate, unintended result where the real goal was to preserve value for the transferee spouse and children of the marriage, if any.

On the other hand, a financially distressed spouse who owns real property and whose goal is to impede the matrimonial court's ability to award the non-debtor spouse equitable distribution of property may purposely file bankruptcy or threaten to file bankruptcy as a negotiation tactic, in an attempt to obtain a more desirable settlement. In that scenario, the attorney for the non-debtor spouse would benefit from the counsel of an experienced bankruptcy attorney to assess the legitimacy of the threat of bankruptcy and, if necessary, offer advice regarding the ways in which to protect the non-debtor spouse's interests over the competing interests of creditors of the debtor spouse.

It is important to distinguish between real and personal property, which are subject to administration in bankruptcy, and payments received on account of alimony or child support. Under both the Bankruptcy Code[11] and New York law,[12] a debtor's right to receive alimony and/or child support

See MATRIMONY, Page 14

Young Lawyer of the Month

Jennifer L. Koo

By Andrea M. Brodie

The Young Lawyers Committee (YLC) of the Nassau County Bar Association is pleased to highlight the achievements of Jennifer L. Koo, Esq.

As an attorney with Sales Tax Defense LLC, Ms. Koo represents taxpayers in hearings against the New York State Department of Taxation and other State Tax Departments.

In 2006, Ms. Koo graduated cum laude from Ithaca College with a Bachelor of Science degree. While at Ithaca, she was also a President's Scholar and presented at the James J. Whalen Academic Symposium.

Ms. Koo graduated from Hofstra University School of Law in 2009. While at Hofstra, Ms. Koo was a member of the American Association for Justice and was an advocate for the Unemployment Action Center, where she represented clients seeking unemployment insurance benefits in proceedings. Upon graduation, Ms. Koo received the Pro Bono Program Gold Level Certificate.

Ms. Koo is admitted to practice law in the States of New York and Connecticut, as well as the Eastern District of New York.

She is an active and contributing member of the Nassau County Bar Association, specifically, the Young Lawyers Committee and the Tax Law Committee. She is also active in the Tax Law Committee in the Suffolk County Bar Association, New York State Bar Association and the American Bar Association.

Ms. Koo spoke with members of her firm at the Long Island Tax Professionals Accounting Technology Forum regarding Sales and Use Tax Tools Related to Digital Property in July 2013 and the Nassau County Bar Association regarding New York State Sales and Use Tax – What Every Lawyer Needs to Know in November 2013.

Ms. Koo is also a published author. She authored "What to do when you Owe New York States Sales and Use Tax," The Nassau Lawyer, March 2010; "How to Dispute a Sales Tax Assessment" for the Nassau Chapter Newsletter of the New York State Society of Certified Public Accountants in January 2012; and "How to Dispute a Sales Tax Assessment" for an online publication of the New York Society of Certified Public Accountants in November 2013.

The YLC congratulates Ms. Koo on her accomplishments and contributions to the community and wishes her continued success in her endeavors.

Andrea M. Brodie, Esq. is an associate at Abrams, Fensterman, Fensterman, Eisman, Formato, Ferrara & Wolf, LLP in Lake Success and Chair of the Young Lawyers Committee.

MATRIMONY ...

Continued From Page 11

payments is exempt and is not subject to administration in bankruptcy. However, as noted above, a debtor's right to receive property in equitable distribution will become property of the estate and subject to administration for the benefit of creditors. The real distinction is nothing more than a policy choice on the part of Congress to protect the support rights of former spouses and their children, a policy also found in bankruptcy's priority distribution scheme.

Treatment of Domestic Support Obligations

The basic purpose and framework of bankruptcy is as follows: (1) to collect and liquidate the debtor's non-exempt assets; (2) to assess the claims filed by creditors to determine which claims will be paid and in what amount; and (3) to pay the allowed claims according to the Bankruptcy Code's priority scheme. Out of all the types of debts entitled to priority under Section 507 of the Bankruptcy Code, Congress gave first priority to domestic support obligations.[13] Accordingly, in a case where a debtor has significant alimony or child support arrears, much, if not all, of the property recovered and distributed in bankruptcy, may be used solely to pay these statutorily-preferred debts.

In addition to priority in distribution, "domestic support obligations" are among the types of debts that are not dischargeable in bankruptcy.[14] Thus, if a debtor has significant alimony or child support arrears before bankruptcy, then these obligations will survive the debtor's bankruptcy, unlike credit card debt or utilities arrears, which, absent fraud, are typically included in the debtor's discharge. Additionally, debts owed to a spouse arising out of a divorce or separation agreement, such as equitable distribution obligations, are not dischargeable in chapter 7,[15] but may be dischargeable in chapter 13.[16]

Interestingly, a debtor's obligation to pay his or her ex-spouse's attorneys' fees may also constitute a domestic support obligation, making it a non-dischargeable debt subject to priority in distribution.[17] The treatment of certain marital obligations in bankruptcy is yet another important consideration that an individual's bankruptcy and family law counsel must discuss when determining whether bankruptcy is an appropriate course of action for a client dealing with financial and matrimonial issues.

The Marital Residence

It should come as no surprise that a married couple's most significant asset, the marital home, is likely to be the focal point of any property settlement in separation or divorce proceedings. Likewise, the attention given to the marital home by the trustee in bankruptcy is no different, particularly if there is significant equity in the property. Depending on whether a debtor utilizes the federal or state exemption scheme, either $22,975[18] or $150,000[19] (for a Nassau County resident) of equity in the debtor's principal residence is exempt.

Generally, a debtor's principal residence is the location where he or she has primarily resided for a certain amount of time prior to the bankruptcy or where the debtor intends to stay for the time being.[20] However, in a situation where the debtor and his spouse are experiencing marital difficulties, the issue of what constitutes the debtor's principal residence may not be so clear.

Oftentimes, in an attempt to defuse a tense living arrangement, a spouse may leave the marital home and live elsewhere for a period of time while the couple attempts to work out their marital issues. Sometimes, unfortunately, this sort of living arrangement is necessary because of the potential for violence or other volatility between spouses, making it unsafe for both spouses and their children to reside together under the same roof.

In any event, case law from the United States Bankruptcy Court for the Eastern District of New York provides support for the proposition that an absentee spouse can live outside of the marital residence without forfeiting his or her right to claim a homestead exemption in property where his or her spouse and children remain in the marital residence.[21] In essence, the presence of the debtor's spouse and children in the marital residence establishes the absentee spouse's constructive possession of the property. This exception to the general rule, requiring occupancy of the property as the individual's primary residence, is beneficial to an individual dealing with marital and financial issues and contemplating bankruptcy. This would obviate the need to decide between taking action to preserve marital harmony and taking action to preserve an interest in real property.

The issues discussed in this article are just an introduction to the multitude of issues that arise when separation or divorce proceedings and bankruptcy proceedings intersect. To avoid, or, at the very least, mitigate, the potentially significant adverse impact of these issues, it is imperative that an individual's family law and bankruptcy law counsel coordinate, as the action taken in either proceeding can have dramatic consequences in the other.

Andrew M. Thaler is the founding member of Thaler Law Firm PLLC, located in Westbury, and concentrates his practice in bankruptcy, debtor and creditors' rights, mediation, and trustee representation. Mr. Thaler is also a Chapter 7 Panel Trustee for the United States Bankruptcy Court for the Eastern District of New York. David N. Saponara is an associate at Thaler Law Firm PLLC.

1. 11 USC § 362(a).
2. *See id.*
3. *See* 11 USC § 362(b).
4. *Id.*
5. 11 USC § 362(b)(2)(B).
6. *See* 11 USC § 541(a).
7. *See id.*
8. *See* 11 USC § 541(a)(6).
9. 11 USC § 541(a)(5)(B).
10. *See In re DiGeronimo*, 354 B.R. 625, 636–38 (Bankr. E.D.N.Y. 2006); *Musso v. Ostashko*, 468 F.3d 99 (2d. Cir. 2006).
11. 11 USC § 522(d)(10)(D).
12. N.Y. CPLR 5205(c)(4); N.Y. Debt. & Cred. Law § 282(2)(d).
13. *See* 11 USC § 507(a)(1).
14. *See* 11 USC § 523(a)(5).
15. *See* 11 USC § 523(a)(15).
16. *See* 11 USC § 1328(a); *In re Rogowski*, 462 B.R. 435, 440 n.9 (Bankr. E.D.N.Y. 2011).
17. *See In re Tarone*, 434 B.R. 41, 48–49 (Bankr. E.D.N.Y. 2010).
18. 11 USC § 522(d)(1).
19. N.Y. CPLR 5206.
20. *See* 11 USC § 522(d)(1); N.Y. CPLR 5206.
21. *See In re Moulterie*, 398 B.R. 501, 507 (Bankr. E.D.N.Y. 2008).