

## Introduction

Marital breakdown is one of the most common causes of financial hardship, which often leads to a spouse filing for bankruptcy. The effect of family support obligations, the

division of family assets, and the loss of income can have a devastating effect on both parties going through a separation. As these situations are becoming more common, we thought it would be worthwhile to provide an overview of this topic.

This article will be divided into two sections: Matrimonial

Property and Family Support Obligations. For ease in reviewing the issues at hand, we shall refer to these two parties as "husband" and "wife" and assume that:

1. they are legally married (as opposed to being in a common-law relationship);
2. the husband will be making the equalization payment and family support payments to the wife;
3. we shall only be considering the law as it applies in Ontario; and
4. the husband will be filing for bankruptcy.

## Matrimonial Property

### Claims for Equalization

The division of any net property between the husband and wife (e.g., assets such as the home, pension funds, savings, RRSPs, the car, the cottage; less debts such as the mortgage, credit card bills, bank loans) is governed in Ontario by the Family Law Act ("FLA").

The basic principle in division of property is, with some exceptions, to equalize the property accumulated by the couple during their time of co-habitation. For each of the parties at the date of separation, a fairly complicated process is undertaken to:

- Assess the value of property;
- Determine what property (if any) is excluded (e.g., some inheritances or property purchased before the time of cohabitation);
- Assess the value of the debts;
- Subtract the value of the debts from the value of the non-excluded property; and
- Calculate what is called the "net family property".

The law requires the person with the higher net family property to pay his spouse an "equalization payment". This payment is half of the difference in value between the two spouses' net family properties.

The FLA does not grant proprietary rights to the spouse over her husband's assets when a permanent separation occurs. At most, the FLA creates a creditor-debtor relationship between the spouses.

Therefore, if the husband's obligation to make an equalization payment occurs before he becomes bankrupt, then the wife becomes a creditor in the bankruptcy. His assets are no longer accessible by the wife to enforce her claim for equalization, as his property vests in his trustee. Assuming the husband obtains a discharge from his bankruptcy, his equalization payment obligation shall also be discharged, along with his other debts.

The above assumes that his obligation to make an equalization payment occurs prior to his bankruptcy; if not, the equalization claim becomes a post-bankruptcy debt for which he is liable.

## The Matrimonial Home

In most marriages, the husband and the wife jointly own the family home (i.e., joint tenancy). The bankruptcy of the husband has the legal effect of severing joint tenancy and his interest in the home vests with his trustee. The trustee and the wife become tenants in common.

Under the Bankruptcy and Insolvency Act ("BIA"), it is the trustee's duty to realize as soon as possible, on all of the husband's assets, including his interest in the family home. On the other hand, under the FLA and many court-approved separation agreements, the wife will have exclusive possession of the home until certain events transpire, e.g., the children reach adulthood. Therefore, there is an inherent conflict between the trustee's mandate to realize on the husband's interest in the home and the wife's rights to possession of the home. This raises a practical problem of how the husband's interest will be dealt with by the trustee.

One avenue that can be taken by the trustee is to file an application with the court for an order of partition and sale of the family home. In determining whether such an order will be granted, the court must consider the hardship the wife and children might suffer if the order was made.<sup>1</sup> The wife must demonstrate (with evidence) that serious hardship would result in the event that an order was granted. The court may consider:

# The Double Whammy: Bankruptcy after a Marital Breakdown

1. the length of time that the wife and children have been living in the home;
2. the availability of other suitable accommodation in the area;
3. the effect on the children of moving to another neighbourhood and school;<sup>2</sup>
4. whether the wife has any disability and/or the employability of the wife; and
5. associated with factor 2, the ability of the wife to finance the purchase or rental of a similar home in the same area.

It is usually quite difficult for the trustee to obtain a partition and sale order once the court considers the above factors.

The more practical approach taken by trustees is to facilitate a sale of the husband's interest to the wife. Hopefully, the wife can obtain the necessary financing by borrowing the funds from friends/family members or by refinancing the home with the assistance of a mortgage broker. Failing that, the trustee may, with the consent of the estate creditors, attempt to obtain an Order of partition and sale from the court, although the likelihood of success is questionable for reasons discussed above.

### Family Support Obligations

Child support and spousal support obligations can be onerous on the payor and from the author's experience, is often the proverbial straw that breaks the camel's back. Family support payments usually result in the accumulation of debt by the payor: either the payments themselves go into arrears, or if the payments are made, the husband has insufficient funds left over to finance his living expenses and goes into unsustainable debt.

### Status of Obligations in Arrears

A wife's claim for spousal or child support under an order made prior to her husband's bankruptcy is a provable claim.<sup>3</sup> For amounts accrued in the year before the date of bankruptcy, the wife has a preferred claim (i.e., paid in priority to all other unsecured creditors).<sup>4</sup> For amounts accrued prior to that period, the wife has an ordinary unsecured claim. For example:

At the date of John's bankruptcy, Jane is owed \$10,000 in child support - \$8,000 that accrued in the last year. John has \$50,000 in total debts - \$10,000 owing to Jane and \$40,000 owing on credit cards. There is \$20,000 in the bankruptcy estate to distribute to John's creditors.

In this case scenario, the \$20,000 would be distributed as follows:

1. Amount to be distributed	\$20,000
Child support accrued in past year (preferred claim)	-8,000
Balance for ordinary unsecured creditors:	<u>\$12,000</u>
2. Credit card debt	\$40,000
Child support accrued outside last 12 months	2,000
Total ordinary unsecured creditors:	<u>\$42,000</u>
3. Payable to Jane for child support:	\$8,000
Preferred payment	571
Ordinary payment (2,000/42,000 X 12,000)	<u>\$8,571</u>
4. 5% levy payable to the Superintendent of Bankruptcy:	-429
5. Net payable to Jane::	<u>\$8,143</u>

Any balance owing on such a claim after deducting dividends received in the bankruptcy will not be released by an order of discharge of the bankrupt.<sup>5</sup> In the above case scenario, John would still owe Jane \$1,857 (i.e., \$10,000 less \$8,143 net dividend paid) after he is discharged from bankruptcy.<sup>6</sup>

### Stay of Proceedings

Generally, upon a debtor's bankruptcy, none of his creditors has any remedy against his property, or shall commence or continue any action or other proceedings. In essence, a debtor becomes creditor-proof upon his bankruptcy.

An exception to this are proceedings taken by the wife to collect child or spousal support in arrears. The stay of proceedings enjoyed by the bankrupt husband will not protect him from his ex-wife's collection efforts. Therefore, even if the husband is bankrupt, the wife can conceivably obtain a writ or lien to seize his exempt assets or wages to satisfy the obligations in arrears.

Notwithstanding this, she has no remedy against any of the husband's assets that have vested in his trustee nor against amounts payable to the bankruptcy estate under section 68 of the BIA (i.e. surplus income obligations).

### Conclusion

It was not long ago that separation/divorce and bankruptcy were considered social taboos. As our society has changed (some may argue for the worse) and the stigma associated with both divorce and bankruptcy waned, they occur together with increasing frequency.

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