Louisiana Law Review

Volume 72 | Number 1
The Future of Community Property: Is the Regime Still Viable in the 21st Century? A Symposium
Fall 2011

Community Property in Bankruptcy: Laws of Unintended Consequences

Margaret Dee McGarity

Community Property in Bankruptcy: Laws of Unintended Consequences

*Margaret Dee McGarity**

For most people, the law is seemingly irrelevant to their personal lives. They go about their business, doing whatever is necessary to fulfill the needs and wants of daily life, all without the intervention of lawyers or courts. If a large purchase requires both a husband and wife's signatures, they both sign. If a credit card application requires both signatures, perhaps because one spouse has insufficient income to qualify alone, both sign. Even if only one spouse signs the application, they pool their money to pay the bill. Signatures are required for other activities, such as opening a bank account or designating a death beneficiary. No problem; the documents get signed. No one contemplates the legal consequences of what they have done; they just do it.

When legal intervention is necessary, the role of the law is often predictable. If you beat up someone in a bar, the police will haul you away. If you do not make your car payments, a court will eventually be involved, and you are riding your bike or the bus. An individual might need a lawyer for a will, but he or she might use cheaper self-help forms. The person using those self-help forms probably feels the result is predictable because nothing has happened to tell him otherwise. Courts are necessary for divorces, but many people are forgoing legal advice even here. They will never know which remedies are lost, but the divorce is completed. Expectations are met.

When it comes to credit, most people expect to pay their debts and avoid any legal consequences, but it does not always work that way. Unemployment, divorce, and medical problems are leading causes of bankruptcy, and these are not always foreseeable when one incurs a debt. Similarly difficult to predict are auto accidents for which an individual is found liable, or business failures with substantial guaranteed debts or other personal liabilities. In community property states,[1] all or most non-exempt community property can be recovered to pay the debts of one spouse if those debts were incurred for a community purpose, and most spouses in those states probably realize that. Several community property

* U.S. Bankruptcy Judge, Eastern District of Wisconsin.

1. Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin are all community property states. Alaska is an opt-in community property state. Puerto Rico allows property to be owned as community property, as do several Indian jurisdictions.

states have modified collection rules to protect certain types of property, especially for pre-marriage debts of one spouse, torts incurred by one spouse, or for non-community purpose debts. Nevertheless, the scope of creditors' collection rights often surprises spouses. Many a heated dinner conversation has undoubtedly taken place when one spouse's wages are garnished for a debt incurred by the other.

In the 12-month period ending March 31, 2011, 1,571,183 bankruptcy cases were filed in the United States.[2] As long as there has been commercial activity, dealing with insolvency has been necessary, a purpose which bankruptcy serves. Vigorous commerce requires investment and credit, so the people with money can make more money by putting that money into enterprises run by people without money. Everyone wins when the enterprise is successful. But the crops might fail, or the ship might go down, and the leftovers have to be divided. Since there may be multiple interested parties vying for limited resources, the process might not be as easy as signing a joint credit application. Rules become more important as the opportunity for adversary interests increases. The writers of the Constitution provided that only Congress could pass laws on bankruptcy, thereby enhancing commerce by ensuring uniformity to a substantial extent when insolvency occurred.[3] Historically, when there has been a bankruptcy law, it has applied only to liquidation and only to businesses. The concept of discharge of debts by an individual debtor has relatively recent origins, but it has caught on dramatically.

The vast majority of recently filed cases are consumer cases, filed by individuals seeking either a discharge of most of their debts in chapter 7, or a relatively modest reorganization in chapter 13 that will enable the debtor to keep a house, car, or other secured asset. Of total filings, 1,516,971 were non-business cases.[4] Although the federal bankruptcy law, Title 11 of the United States Code, is intended to be uniform, the obligations incurred by individuals and the property rights related to debt collection are generally creatures of state law. The overlay of a federal statute on such disparate property systems as the common law title system and community property system can create surprisingly different

2. ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, BANKRUPTCY STATISTICS, 2010–2011 MARCH YEAR COMPARISON, http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2011/0311_f.pdf.
3. U.S. CONST. art. I, § 8, cl. 4.
4. ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, *supra* note 2.

outcomes when a married person or couple files a bankruptcy petition—the act that initiates a voluntary bankruptcy case. This article deals with how community property and the individuals who own it are affected by the bankruptcy filing of one or both spouses. The examination of the interplay of state and federal law in the bankruptcy context is also intended to address whether community property, as a default property and debt system, meets the needs and expectations of spouses in modern society.

I. THE STATUTES

The Bankruptcy Code has several provisions that are applicable only to spouses in community property states. Other bankruptcy statutes are, of course, also applicable to those cases, but this section will summarize those that apply exclusively to community property and community debts.

A. 11 U.S.C. § 541—Property of the Bankruptcy Estate

When a debtor files a bankruptcy case, it creates an estate, which includes almost all of the debtor's property interests. Generally, property interests and liabilities are created under state law,[5] but federal law determines how those interests are treated in the bankruptcy proceeding. When a married person in a community property state files a bankruptcy petition, the estate includes most types of interests the debtor has in property, including separate property, plus some interests that arise post-petition, and income earned on estate property. Some types of property are excluded from the estate, such as qualified pension plans and spendthrift trust interests, but exclusions must be specifically excepted by statute to be excluded from the estate.[6]

Subsections 541(a)(2)(A) and (B) of the Bankruptcy Code provide for community property that is included in the estate of a married person. First, all community property under the sole, equal, or joint management and control of the debtor comes into the estate. This is most community property. Second, the estate includes community property that is subject to recovery for a claim against the debtor or for a claim against the debtor and the debtor's spouse. This encompasses certain assets not under the sole, equal, or joint management and control of the debtor that is nonetheless available to satisfy certain claims.

5. Butner v. United States, 440 U.S. 48 (1979).
6. *See* 11 U.S.C. § 541(b)–(e) (2006).

B. 11 U.S.C. § 101(7)—Definition of "Community Claim"

Just as property rights in community property states differ from common law property rights, the rights of creditors to collect from the debtor's assets—and assets of the debtor's spouse—are also different. If a creditor has the right under state law to collect its debt from community property defined under 11 U.S.C. § 541(a)(2), it has a community claim, which carries rights to collect from the bankruptcy estate. The creditor meets this definition *even if there are no such assets actually in the estate.* Thus, the creditor's hypothetical collection rights with respect to classifications of community property under state law must be analyzed in order to determine whether a particular creditor meets the definition.

By way of example, a pre-marriage creditor of the non-filing spouse of a bankruptcy debtor might be a community claim holder. If, under state law, that creditor could recover from community property assets generated only by the non-debtor spouse, such as the community property wages of the spouse that incurred the debt who is not the bankruptcy debtor, that creditor would meet the definition of a community claim holder. This definition applies even if no such wages are being earned or accumulated.

Section 342(a) provides that the holder of a community claim is entitled to notice of the filing of a bankruptcy case. The practical effect of this requirement is that a married debtor in a community property estate who files a bankruptcy case without his or her spouse as a joint debtor must give notice to creditors whose community debts were incurred by the non-filing spouse as well as the debtor. If the non-filing spouse is not forthcoming with this information, community claimants might not receive notice of the bankruptcy, and the debtor's rights might be adversely affected.

C. 11 U.S.C. § 524(a)(3), (b)—Discharge Injunction Protecting After-Acquired Community Property

When one spouse completes all of the requirements of a bankruptcy case, he or she receives a "discharge" in the absence of a successful objection. This discharge is an injunction prohibiting community claimants holding dischargeable debts (not all debts are subject to discharge) from collecting those debts. Because an interest in community property is an undivided interest in the entire asset, this section protects the interests of both the debtor and his or her spouse in community property acquired after the bankruptcy, even if only one spouse filed. If there is an objection to the dischargeability of a debt incurred by the debtor's spouse, such as an objection alleging fraud, and that objection is made within the time limits set for such objections in the debtor's case, neither of the spouses' interests in after-acquired community property is protected. Similarly, under subsection (b), this protection does not apply if the debtor's spouse would be denied a discharge in a hypothetical case the spouse filed at the same time as the debtor's case.[7]

D. 11 U.S.C. § 726(c)—Distribution of Community Property in the Estate

This section establishes sub-estates for distribution of community property and separate property to creditors holding community claims and non-community claims. Depending on the existence of the various classifications of property, certain creditors might be able to collect from assets not available under state law.[8]

II. SCENARIOS

Many legal concepts appear to be based on wise and fair principles in the abstract, but when they are applied to real people in a variety of real world situations, problems arise. The same could be said of the law applying to assets and liabilities in community property states. Community property embraces the concept of partnership and sharing, and it supposedly provides protection and benefits to a spouse who earns little or nothing in the work force but is an equally valuable member of the marriage. Historically, when spouses rarely separated and never divorced, community property was one way to protect spouses who were without direct access to the economy. Until recently, sole management and control of community property by the husband was the rule. Nevertheless, if a husband died or absconded, the wife would be entitled to half the couple's assets, thereby affording her some economic protection. The concept also recognized the value of both spouses' contributions to work and to the family. The glory of this sharing concept drowned out the voices of dissent, which focused mainly on practical application when the Uniform

7. *See* FED. R. BANKR. P. 4004, 4007.

8. *See* 6 LAWRENCE P. KING, COLLIER ON BANKRUPTCY ¶ 726.05 (Matthew Bender 16th ed. 2009); *see also In re* Provenza, 316 B.R. 177 (Bankr. E.D. La. 2003), *rev'd on other grounds*, 82 Fed. App'x. 101 (5th Cir. 2003).

Marital Property Act was being debated before it eventually became law in Wisconsin.[9]

Hard economic times can arise for married couples anywhere, and couples in community property states are not immune. For many, bankruptcy is the only option to deal with unmanageable financial difficulties. The bankruptcy statutes summarized above reflect the unitary treatment of community assets and debts in community property states when one or both spouses file a bankruptcy case. Even if only one spouse files, community debts generally are recoverable from all community property, so all community property must be in the estate to be administered for community creditors. These rules make sense for an intact marriage where the parties are cooperating with each other and have been pooling their assets and debts all along. Most couples in this situation file a joint case anyway, and, unless there is a disparity either in their assets or creditors, the joint case will be administered as if it were a single case.[10]

But, even though people are still legally married, own community property assets, are incurring community debts, and are earning community property wages, their interests may diverge. This is likely to occur if they are separated and not yet divorced. Since marital disputes frequently have financial underpinnings, and many couples have one member who is less fiscally responsible than the other, these divergent interests may arise even before separation. When this occurs, and bankruptcy ensues for one or both, the unitary treatment of community assets and debts may bring surprising results for the spouses. Creditors may be in for a few surprises, too, when rules for community property apply to

---

9. The author was very active in this debate, having served on the Wisconsin State Bar Committee, a committee formed to analyze several proposals for the Act. Few women joined in her public criticism of the Act, which frequently focused on the application of marital property debt collection rules and the fact that women earned significantly less than men. The Wisconsin Legislature enacted the Marital Property Reform Act, 1983 Act 186, which became effective on January 1, 1986. *See* WIS. STAT. ANN. §§ 766.001–766.97 (West, Westlaw through 2011 Act 31). The Wisconsin legislation is based on the Uniform Marital Property Act, as approved by the National Conference of Commissioners on Uniform State Laws. *See* UNIF. MARITAL PROP. ACT §19, 9A U.L.A. 103 (1998).

10. 11 U.S.C. § 302 (2006); FED. R. BANKR. P.1015(b); *see In re* Ageton, 14 B.R. 833, 839 (B.A.P. 9th Cir. 1981) (community property in both estates must be administered as if consolidated); *In re* Hicks, 300 B.R. 372, 378 (Bankr. D. Idaho 2003) (estates of debtors who filed jointly had to be administered separately because wife had separate property; community property was in both estates).

spouses whom the creditors have treated as independent individuals.

In a perfect world, legislators or lawmakers would test fact situations to see if a proposed law, when applied to certain common and uncommon fact situations, achieves the desired result. After enactment, when a court is required to apply the law, it must apply it to the facts as they are found. Most of the time, the result is predictable and inevitable. When it is not, one can only wonder if the result is *really* what the lawmakers had in mind.

A. 11 U.S.C. § 541(a)(2)—Property of the Estate

Kapila v. Morgan (In re Morgan)[11] exemplified the perfect storm of issues that arises when community property and bankruptcy intersect. Teddy and Moritta Morgan were married in Wisconsin. During their marriage, they had three children and accumulated a small amount of property, including a modest house titled in both names. Pursuant to Wisconsin law, all property they accumulated while married in Wisconsin was presumed to be marital property (the Wisconsin term for community property), and no one argued otherwise.[12] Management and control had to be joint because the property was a homestead titled in the names of both spouses.[13]

The marriage did not last, but divorce was not immediate. Nevertheless, Teddy moved to Florida, leaving Moritta and the children in the family home. Unbeknownst to her, he filed a bankruptcy case in Florida.

Pursuant to 11 U.S.C. § 541(a)(2)(A), all of Teddy's community property, including the house Moritta and the children occupied, went into his estate to be administered by the trustee for the benefit of all community creditors. Most of Teddy's creditors probably were community creditors. He might have incurred some separate creditors in Florida, but the outcome of the administration is not pertinent here.

Wisconsin law provides that marital property is accumulated only "during marriage," which is defined as the period during which the spouses are domiciled in Wisconsin,[14] so property Teddy

11. 286 B.R. 678 (Bankr. E.D. Wis. 2002).

12. *See* WIS. STAT. ANN. §§ 766.001(2), 766.01(5), 766.31(2) (West, Westlaw through 2011 Act 31).

13. WIS. STAT. ANN. § 706.02 (West, Westlaw through 2011 Act 31) (requiring two signatures to convey a homestead).

14. WIS. STAT. ANN. § 766.01(8) (West, Westlaw through 2011 Act 31); *see also* CAL. FAM. CODE § 771 (West, Westlaw through Ch. 138 of 2011 Reg. Sess.

or Moritta acquired after he moved to Florida would not be marital property. This provision did nothing to change the classification of the house, however. That was in Teddy's bankruptcy estate. Of course, Teddy was required to give notice of his bankruptcy to creditors having community claims incurred by Moritta, but, because they were obviously not communicating about such matters, he probably did not.[15]

Sometimes, spouses are separated for long periods of time without obtaining a divorce. A divorce is an expensive and emotionally upsetting experience, and unless one of the spouses needs something from the other, like financial support or cooperation in raising children, it might be delayed or never undertaken. Moritta did not put off the divorce forever, and she filed for divorce from the missing Teddy in Wisconsin. She asked for the house as part of the property division, and it was granted to her by default. Unfortunately for her, Teddy had already filed his bankruptcy case, and the house she wanted was part of his bankruptcy estate. The state court had no jurisdiction to order transfer of title of an asset that neither she nor Teddy owned. She also did not request relief from the automatic stay to have the state court determine property division.[16] The full ownership of the house that was awarded to her by the divorce court was void.[17]

When someone other than the debtor has possession of property of the estate, the trustee may request that the property be turned over to the trustee to administer.[18] Without question, the bankruptcy court had to order turnover. Moritta was no longer a co-owner, and her only right was to purchase the house from the estate at the same price that would be obtained from a third party.[19] She would have to pay the full value of the asset, which she undoubtedly would have found unfair—not to mention a financial

---

and Ch. 8 of 2011–2012 1st Ex. Sess.) (California rules for property acquired after parties have separated).

15. 11 U.S.C. § 342(a) (2006); *see also* 11 U.S.C. § 523(a)(3) (2006).

16. *See* 11 U.S.C. § 362(a) (2006). The Bankruptcy Abuse and Consumer Protection Act of 2005 expanded exceptions to the automatic stay, but obtaining a division of property still requires relief from the stay. *See* 11 U.S.C. § 362(b)(2)(A)(iv) (2006).

17. *In re* Wardrobe, 559 F.3d 932, 934 (9th Cir. 2009); *In re* Myers, 491 F.3d 120, 127 (3d Cir. 2007); United States v. White, 466 F.3d 1241, 1244 (11th Cir. 2006).

18. 11 U.S.C. § 542(a) (2006); *see also In re* Petersen, 437 B.R. 858 (D. Ariz. 2010) (debtor's estranged non-filing husband had to turn over community property to the trustee, but he was allowed to offset amount the divorce court had ordered to be turned over to him pre-petition).

19. 11 U.S.C. § 363(i), (j) (2006).

hardship—when she previously owned at least half, and she thought she owned the entire house.

Wisconsin has a $75,000 (then $40,000) homestead exemption, and one might think Moritta could benefit from that. After all, the same creditors entitled to file community claims in Teddy's bankruptcy case would not be able to reach an exempt homestead in a collection action against either of them under state law, or if Moritta as sole owner of the same house had filed her own bankruptcy case. Again, application of the bankruptcy statutes worked to Moritta's detriment. Only "an individual debtor may exempt from property of the estate" certain assets.[20] Moritta was not the debtor; Teddy was. Teddy could not claim a homestead exemption in a Wisconsin homestead (we have no reason to believe he tried) because Florida has opted out of federal exemptions, and Florida homestead law does not allow claiming out-of-state real estate as a homestead.[21] Even if Moritta filed her own bankruptcy case, the house was not property of *her* estate, so there would be nothing for her to exempt.[22]

Does this mean Teddy meant to deprive Moritta and their children of a place to live? No evidence suggests that he did. Does it mean Congress intended that people who have de facto dissolved their marriages should lose their houses? Probably not. But, such is the result when community property rules in bankruptcy are applied to a very common fact situation in today's society.

B. 11 U.S.C. § 101(7)—Community Claims

As the definition states, a creditor has a community claim if there is any type of community property that could be recovered under state law to satisfy the claim, *even if no such property is owned by the spouses or is in the estate*. Important rights go along with this classification, such as the right to receive money from the estate, to object to a plan, and to object to the discharge. The debtor will need to analyze each creditor's rights under state law with respect to types of community property recoverable for collection. All community and separate creditors of the debtor spouse must be listed, as well as all community creditors of the nondebtor spouse.

---

20. 11 U.S.C. § 522(b)(1) (2006).

21. FLA. CONST. art. 10 § 4; FLA. STAT. ANN. §§ 222.20, 222.01 (1998 and Supp. 2010); *see also In re* Sanders, 72 B.R. 124 (Bankr. M.D. Fla. 1987) (holding that the homestead exemption does not have extraterritorial effect).

22. The author, who was also the judge in this case, met the trustee at a conference. He informed me, to my sincere relief, that the case was settled and Moritta got to keep the house.

For most debts incurred during marriage, such as contract debts, this is easy. Most of these creditors can clearly recover from community property. Even debts carved out under state law as limited in the property available for satisfaction may have some type of community property available, so surprising categories of debts meet the definition.[23]

Once the status of the creditor has been established, the creditor is entitled to notice of the bankruptcy.[24] For debtors who cannot obtain this information from an estranged spouse, there is a risk that the debt will be excepted from discharge if the creditor has no actual notice in time to exercise certain rights with respect to the debtor or the debtor's non-filing spouse.[25]

Case law has revealed that some surprising creditors might have community claims. For example, in *In re Silver*,[26] the debtor's non-filing spouse committed a tort during marriage that made him subject to a $24 million judgment. The wife was not named in that suit, and the judgment did not determine whether it was a community debt or a separate debt. The wife filed a bankruptcy case after the parties were divorced. The husband's creditor filed an adversary proceeding to revoke her discharge, and the debtor challenged the creditor's standing as a community claimant. The court noted that, under New Mexico law, there is a presumption that debts arising during the marriage are presumed to be community debts, even tort debts, for which the community is liable. Notably, the wife did not present evidence that this was a separate debt. Therefore, the creditor had standing, and her discharge was revoked.

---

23. *But see In re* Trammell, 399 B.R. 177 (Bankr. N.D. Tex. 2007). A car titled in the non-debtor spouse's name was "sole management community property" under Texas law and was not in the debtor's estate under 11 U.S.C. § 541(a)(2)(B) because the asset could only be recovered by a creditor of the debtor's spouse. It could not be recovered by a creditor having a claim against the debtor or against both spouses. Although the issue in that case was relief from the automatic stay (which did not apply since the car was not property of the debtor's estate) and not the status of the creditor as a community claimant, it appears that the car creditor *would* qualify as having a community claim in the debtor's case. The car creditor could recover from the income of the non-debtor title holder. His income was community property; therefore, the car creditor could—hypothetically, at least—recover from the spouse that would not be liable under Texas law. *See also In re* Nahat, 278 B.R. 108 (Bankr. N.D. Tex. 2002) (holding the non-filing spouse's earned income was a "special" type of community property not available for recovery of claims against the debtor and not property of debtor's estate).

24. 11 U.S.C. § 342(a) (2006); *In re* Schweitzer, 111 B.R. 792, 798–99 (Bankr. W.D. Wis. 1990).

25. 11 U.S.C. § 523(a)(3) (2006).

26. 367 B.R. 795 (Bankr. D. N.M. 2007).

The court focused on the classification of a debt incurred during marriage, which could have been either a separate or community tort. The creditor also based its standing on the fact that there was property in Mrs. Silver's bankruptcy estate that had been transferred to her pursuant to the spouses' marital settlement agreement at the time of their pre-petition divorce. This transferred property was probably former community property, but once it was divided by the divorce before the bankruptcy filing, it should have been solely owned by the debtor and no longer community property. At the time of filing, former community property or a former spouse might have been liable under state law for a debt incurred by the debtor's former husband, but the assets she received in the divorce were not community property. Community property can be held only by spouses, and this debtor was no longer married. The bankruptcy court, which the Tenth Circuit Bankruptcy Appellate Panel affirmed,[27] seemed to be saying "once a community debt, always a community debt." Such an interpretation is questionable because it does not track the statutes but rather illustrates how complicated the analysis can be.

Suppose the Silvers' marriage remained intact. The distinction between a community tort and a separate tort might not have made a difference. A community tort would, of course, have been a community claim. Under New Mexico law, a separate tort may be satisfied first from the incurring spouse's separate property, and if that property is insufficient, it can be satisfied from the incurring spouse's interest in community property.[28] The non-debtor's interest in community property is still community property, so the separate liability would meet the definition of a community claim. It might be subject to disallowance if the non-debtor's separate property were adequate to satisfy it, but until then, it would be a community claim.

---

27. *In re* Silver, Nos. NM-07-054, 7-96-11878-SS, 2007 WL 2915042 (B.A.P. 10th Cir. Oct. 2, 2007).

28. N.M. STAT. ANN. § 40-3-10 (West, Westlaw current through the First Regular Session of the 50th Legislature (2011)); *see also In re* Oliphant, 221 B.R. 506 (Bankr. D. Ariz. 1998). Arizona law establishes *personal liability* for a community debt after divorce that can be recovered from the debtor's separate property (i.e., anything received in the property division or acquired thereafter) and from the debtor's interest in community property of a new community. Had the non-incurring, non-bankrupt spouse in this case remarried and thereafter filed a bankruptcy case (or the new spouse did so), the creditor would have a community claim in the bankruptcy of either the non-incurring spouse or the new spouse of the non-incurring spouse. This occurs because the personal liability that followed the non-incurring spouse could be recovered from the new community, a bizarre result in a case in which neither spouse incurred the debt.

Every party to a marriage comes with baggage, and a spouse that has been married before or has children of a prior relationship often has more baggage than usual. Such was the case in *In re Pfalzgraf*.[29] The spouses originally filed a joint case. However, the husband had a substantial child support obligation to a former spouse who filed a proof of claim. Under section 1322(a)(2), a chapter 13 plan shall provide for full payment of priority debts, and child support was a priority debt even before it was elevated to first priority by the Bankruptcy Abuse Prevention and Consumer Protection Act as a domestic support obligation. Given the couple's income, the claim was too large to be paid as a priority claim at 100%, so the husband dismissed his case. His former wife's claim was still a community claim in the present wife's case. Her claim qualified as a community claim because under Wisconsin law, a form of community property—property that would have been the husband's property but for the current marriage—would be subject to recovery for his pre-marriage child support obligation. However, the obligation was not a priority debt in the wife's chapter 13 case. The former spouse was not the spouse, former spouse, or child of the debtor, so the claim did not have to be paid in full. The wife was able to confirm a plan.

The federal government has even broader rules for collection from community property, thus enhancing the chance it will be a community claimant in a case. For federal income taxes, for example, it can recover the debtor's one-half interest in community property, regardless of limitations imposed by state law. Also, if state law provides for recovery by a creditor of more than the debtor's one-half interest in community property—perhaps for all of a liable spouse's community property earnings—the tax creditor has those remedies as well.[30]

C. 11 U.S.C. § 524(a)(3)—Community Property Discharge

If one spouse in a community property state receives a discharge, the after-acquired community property of both spouses is thereafter protected from recovery for community claims.[31] This

29. 236 B.R. 390 (Bankr. E.D. Wis. 1999).

30. *See, e.g.*, *In re* Field, 440 B.R. 191 (Bankr. D. Nev. 2009); *In re* Whitus, 240 B.R. 705, 708 (Bankr. W.D. Tex. 1999) (citing Medaris v. United States, 884 F.2d 832 (5th Cir. 1989)).

31. 11 U.S.C. § 524(a)(3) (2006). provides, in relevant part:

> (a) A discharge in a case under this title--
>
> . . . .
>
> (3) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover

is consistent with having all community property included in the estate and allowing recovery for all community claims. However, creditors who treat spouses as individuals might be in for a surprise. In *In re Strickland*,[32] the wife hired the attorney–creditors to represent her in custody proceedings concerning her children from a prior marriage. They failed to identify the debt she owed them as a separate debt. Her current husband filed a bankruptcy case, and the wife's debt to the attorneys was a community claim. Thus, upon his discharge, the community discharge provision of section 524(a)(3) applied, and they could not recover their fees from the couple's community property. The court did observe, however, that the wife remained liable and only certain property was protected. Therefore, if she possessed or acquired any separate property, that property would be subject to recovery.[33]

Even if a debtor receives a general discharge, certain debts are not subject to discharge.[34] Some debts, such as for support, maintenance, property division, driving while intoxicated, or restitution as part of a criminal sentence, are excepted from discharge without any further action by the creditor. Student loans require an adversarial proceeding brought by the debtor to be discharged. Also, some debts require a timely adversary proceeding brought by the creditor; otherwise, these are discharged.[35] This latter type includes certain intentional torts, such as fraud, theft, embezzlement, defalcation in a fiduciary capacity, and willful and malicious injury.

Section 524(a)(3) protects both spouses' interests in after-acquired community property, even if only one spouse files.[36] On

---

from, or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523, 1228(a)(1), or 1328(a)(1), or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.

32. 153 B.R. 909 (Bankr. D. N.M. 1993).

33. *Id.* at 911–12; *see also In re* Moore, 318 B.R. 679 (Bankr. W.D. Wis. 2004) (holding an automatic stay does not prevent discovery of assets that may be subject to recovery).

34. 11 U.S.C. §§ 523(a), 1328(a) (2006).

35. 11 U.S.C. § 523(c) (2006); FED. R. BANKR. P. 4007(c), (d).

36. 11 U.S.C. § 524(a)(3) (2006); *see also In re* Dyson, 277 B.R. 84 (Bankr. M.D. La. 2002) (holding a chapter 13 discharge of one spouse also protects both spouses' interests in after-acquired community property).

the other hand, if a debt is excepted from discharge on account of the conduct of one spouse, the protection of after-acquired community property does not apply to *either* spouse's interest in community property.[37] The community property discharge is denied even if the innocent spouse also files a bankruptcy case.[38] The denial of the general discharge for one spouse also denies protection of both spouses' interest in after-acquired community property.[39]

If one spouse has committed an act that requires a creditor to file an adversary proceeding that would result in a non-dischargeable debt, such as fraud, the determination of non-dischargeability has to be made when the first spouse files (or when a joint case is filed). If this were not the case, the spouses could enjoy the benefit of the innocent spouse's discharge, which would protect both halves of the community property assets. The wrongdoing spouse would never have to file a bankruptcy case.

If the wrongdoing spouse is the first to file, or if the spouses file a joint case, the creditor's course of action is clear. The creditor must file an adversary proceeding within the time limits set by Fed. R. Bankr. P. 4004(a). But, if the innocent spouse files, the Code provides that the creditor of the wrongdoing spouse must file an adversary proceeding objecting to the hypothetical discharge of the non-filing spouse.[40] This can be a trap for creditors who fail to object.

Such was the case in *In re Costanza*.[41] The debtor's innocent wife filed a chapter 7 case, about which the creditors knew, and she received her discharge. The community property discharge took effect. Then, the husband filed, and the creditors filed an adversary proceeding objecting to the dischargeability of their

---

37. 11 U.S.C. § 524(a)(3) (2006); *see, e.g.*, *In re* Kimmel, 367 B.R. 174, 180 (Bankr. N.D. Cal. 2007) (holding that a creditor must take action in an innocent spouse's bankruptcy case to collect a pre-petition community claim from after-acquired community property); *In re* Strickland, 153 B.R. 909, 912 (Bankr. D. N.M. 1993) (noting a creditor must proceed against non-filing spouse in hypothetical case); *In re* LeSueur, 53 B.R. 414, 416 (Bankr. D. Ariz. 1985) (finding "the economic sins of either spouse shall be visited upon the community").

38. *See In re* Grimm, 82 B.R. 989, 994 (Bankr. W.D. Wis. 1988) (holding that marital property in which an innocent debtor wife has an interest may be reached to satisfy the debt of wrongdoing debtor husband).

39. 11 U.S.C. § 524(b) (2006).

40. *See Kimmel*, 367 B.R. at 181 (time limits under Fed. R. Bankr. P. 4007(c) apply). The rule does not refer to the hypothetical discharge, but it may be inferred by the reference in section 524(a)(3) to the date of filing of the filing spouse.

41. 151 B.R. 588 (Bankr. D. N.M. 1993).

claim on account of his fraud. The court held they had failed to object to his hypothetical discharge in the wife's earlier case, so the community property discharge applied in spite of their timely objection in his case. However, the court noted "'[T]he Devil himself could effectively receive a discharge in bankruptcy if he were married to Snow White.' To this I would add: if he does not treat her better than his creditors, she will, by divorcing him, deny his discharge."[42]

D. 11 U.S.C. § 522—Exemptions

Unlike the other issues discussed in this article, there is no specific exemption provision for community property. This means that debtors, trustees, creditors, and courts must somehow harmonize a statute that pulls all community property of both spouses into one spouse's estate with an exemption statute that allows only the debtor's interest in an asset be claimed exempt.[43]

Section 522(b) provides that only "an individual debtor may exempt from property of the estate" certain property allowed under state or federal law, whichever is applicable. If the debtor has a non-filing spouse, the spouse who is not a bankruptcy debtor cannot claim an asset exempt. If all of the community property asset is in the debtor's estate, as was the case in *In re Homan*,[44] and if the debtor does not claim the asset as exempt, the non-filing spouse has no way to remove the asset from the estate. State homestead laws cannot supersede the federal law in this instance.[45] The result was particularly harsh in *Homan* because, like the *Morgan* case described above, the debtor's estranged spouse was the one who resided in the house, not the debtor. Also, since the debtor had filed a claim of exemptions, she was not allowed to supplement his claim.[46]

Not all debtors, of course, are adversaries with a joint debtor or non-filing spouse. The debtor in *In re DeHaan*,[47] tried to claim

42. *Id.* at 590 (citing Alan Pedlar, *Community Property and the Bankruptcy Act of 1978*, 11 ST. MARY'S L.J. 349, 382 (1979)).

43. *Compare* 11 U.S.C. § 541(a)(2) (2006), *with* 11 U.S.C. § 522(b) (2006).

44. 112 B.R. 356 (B.A.P. 9th Cir. 1989).

45. *Id.* at 359–60. *But see In re* Perez, 302 B.R. 661 (Bankr. D. Ariz. 2003) (holding a debtor could claim exemptions for himself and his non-filing spouse because Arizona law allows either spouse to act for the benefit of the community).

46. *See* 11 U.S.C. § 522(b)(l) (2006). If the debtor does not file a list of property claimed exempt, a dependent of the debtor may file a list. However, here the debtor filed his own list.

47. 275 B.R. 375 (Bankr. D. Idaho 2002).

exemptions on behalf of his non-filing spouse because her interest in community property was in his estate. However, this was disallowed because she was not the individual debtor. Similarly, the chapter 13 debtor in *In re Manso*[48] was not allowed to claim an exemption in his wife's community property car, even though it was in his estate, and her income was necessary to fund his plan. Filing a joint case does not always solve the problem. The wife in *In re Bryan*[49] was not allowed to claim a tools-of-the-trade exemption in community property tools because they were not tools of *her* trade—only her joint debtor husband's. Hypothetically, if only she had filed, and his tools were in her estate, *none* of the value of the tools could have been claimed.

A literal reading of 11 U.S.C. § 522(b) appears to limit a debtor to one half of the value of each potentially exempt community property asset.[50] This is the debtor's interest in exempt assets, and the non-filing spouse's interest would then go to pay claims in the debtor's case. In practice, this is more likely to be the case when an asset is easily divisible, such as a bank account, or the asset would be sold. However, when the asset cannot be divided, such as an exempt community property house or car, there is no way the debtor can remove half of the asset from the estate. As a community property interest is a non-divisible interest in an entire asset, the only way to make the claim of exemption meaningful is to allow the entire asset to be removed from the estate.[51]

III. THE BOTTOM LINE

Society has changed since the concept of community property was conceived. Men and women are more likely independent today. Indeed, many people find good reasons to marry that have nothing to do with money. Still, about half of all marriages end in

---

48. 348 B.R. 74 (Bankr. E.D. La. 2005).

49. 126 B.R. 108 (Bankr. D. N.M. 1991).

50. *In re* Victor, 341 B.R. 775, 781 (Bankr. D. N.M. 2006) (holding a debtor may exempt her one-half interest in community property, while the whole of the property is included in the bankruptcy estate); *see also In re* Page, 171 B.R. 349, 352 (Bankr. W.D. Wis. 1994) (claim of exemption was not timely objected to, but debtor was allowed only to avoid lien on what should have been his exempt interest, i.e., one-half of the community property funds in the estate).

51. *See In re* Griffith, 449 B.R. 909 (Bankr. W.D. Wis. 2011) (allowing claim of exemption in entire community property asset "at least in the context of assets which are not fungible or easily divisible"); *In re* Vanderhei, 449 B.R. 359 (Bankr. W.D. Wis. 2011) (same); *In re* Xiong, No. 05-43121-svk, 2006 WL 1277129 (Bankr. E.D. Wis. May 3, 2006) (denying trustee's motion for turnover because debtor's undivided one-half interest in the whole of the community property assets was not divisible).

divorce. Serial marriages are more common today than they were when the concept of community property was born. This means financial interests, such as interests in property and debts, are more often brought to the marriage. Parents may have an interest in benefitting children of a prior relationship. Both women and men have opportunities to accumulate wealth and debts so spouses' economic relationships may be more complex than a default system that provides for total sharing of assets and debts that accumulate during a marriage. The effects of community property rules can be altered by agreement, of course, but these agreements can be expensive and unsettling for the relationship. Also, spouses are often legally unsophisticated about the effects of community property until it is too late. This is the fate of many people who find themselves in financial trouble or in bankruptcy. Thus, for many marriages and individuals, the community property rules reflect a concept whose time has passed.