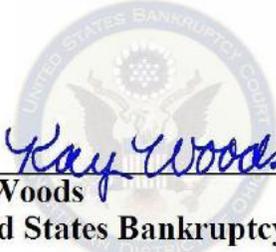


IT IS SO ORDERED.

Dated: September 6, 2011  
12:27:15 PM



*Kay Woods*  
 Kay Woods  
 United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF OHIO

IN RE:	*	
	*	
	*	CASE NUMBER 09-41001
	*	
THOMAS L. PARKER,	*	CHAPTER 13
	*	
Debtor.	*	HONORABLE KAY WOODS
	*	
*****	*	*****

IN RE:	*	
	*	
	*	CASE NUMBER 09-44380
	*	
SANDRA E. WILLIAMS,	*	CHAPTER 13
	*	
Debtor.	*	HONORABLE KAY WOODS
	*	
*****	*	*****

IN RE:	*	
	*	
	*	CASE NUMBER 10-43718
	*	
BELINDA J. HALEY,	*	CHAPTER 13
	*	
Debtor.	*	HONORABLE KAY WOODS
	*	
*****	*	*****

IN RE:

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CASE NUMBER 10-43850

KRISTIN M. WALLACE,

CHAPTER 13

Debtor.

HONORABLE KAY WOODS

\*\*\*\*\*  
MEMORANDUM OPINION REGARDING TRUSTEE'S MOTIONS TO DISMISS FOR  
FAILURE TO CONTRIBUTE EXCESS TAX REFUND  
\*\*\*\*\*

Before the Court are four motions ("Motions to Dismiss"), each filed by Michael A. Gallo, Standing Chapter 13 Trustee ("Trustee"), which seek to dismiss the four above-captioned cases based on each Debtor's failure to contribute such Debtor's Excess Tax Refund (as that term is defined in Article 1B of the Plan).<sup>1</sup> In each of the cases in question, the Debtor is married and filed a joint tax return with the Debtor's non-debtor spouse.

The issue before the Court in each of the Motions to Dismiss is whether and/or to what extent a non-debtor spouse's portion of a joint tax refund must be contributed to the chapter 13 plan. The Motions to Dismiss are substantively identical although the facts of each case are slightly different. As set forth below, the Court has determined the approach to be used to determine the amount of a debtor's Excess Tax Refund when a married debtor files a joint tax return with his or her non-debtor spouse.

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<sup>1</sup>The Motions to Dismiss are as follows: (i) in the *Parker* case, Doc. # 22, filed on June 9, 2011; (ii) in the *Williams* case, Doc. # 45, filed on June 9, 2011; (iii) in the *Haley* case, Doc. # 43, filed on June 8, 2011; and (iv) in the *Wallace* case, Doc. # 30, filed on June 9, 2011.

**I. TRUSTEE'S POSITION**

The Trustee moves to dismiss each of the above-captioned cases, pursuant to 11 U.S.C. § 1307(c)(6), based on "material default by the debtor with respect to a term of the confirmed plan[.]" 11 U.S.C. § 1307 (West 2010). The Trustee asserts that the Debtors have failed to comply with Article 1B of their respective plans,<sup>2</sup> which states:

1 B. Upon request of the Trustee, subject to objection by Debtor, the Debtor may be required to devote all annual federal, state and/or local income tax refunds (excluding earned income credits and child care credits) greater than \$1,500.00 (One Thousand Five Hundred Dollars) (the "Excess Tax Refund"), to the repayment of creditors under this Plan, which contribution shall be in addition to the payments in Article 1A above, and the dividend to general unsecured creditors shall increase commensurate with the additional contribution if the Debtor is above the median level of income. The contribution of the Excess Tax Refund shall decrease the term of the plan in Article 1A above if the Debtor is below the median income level, but will not reduce the term to less than 36 (Thirty Six) months.

Plan, Art. 1B (emphasis added).

The Trustee claims that each of the Debtors has an Excess Tax Refund, which he or she has refused to turn over to the Trustee. Each of the Motions to Dismiss sets forth a dollar amount that the Trustee asserts should be devoted to repayment of creditors, as set forth in Article 1B.

The Trustee argues that, in order to arrive at a debtor's projected disposable income to determine plan contributions, the

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<sup>2</sup>Because the Court requires the use of a standardized chapter 13 plan, each Debtor's confirmed plan contains the same Article 1B.

Bankruptcy Code requires consideration of both the debtor and the non-debtor spouse's income and expenses.<sup>3</sup> (Citing *In re Reeves*, 327 B.R. 436 (W.D. Mo. 2005)). The Trustee notes that Form 22C requires the non-debtor spouse's income to be included in calculating the applicable commitment period and the amount of disposable income. Form 22C also places an affirmative duty on the non-debtor spouse to disclose why such spouse's income is not used for household expenses. In contrast, non-spouse third parties who contribute to household expenses are only required to disclose their historical contributions to household expenses. The Trustee does, however, recognize that the definition of "current monthly income" in 11 U.S.C. § 101(10A)(B) seems to exclude any amount earned by a non-debtor spouse that is not regularly used for household expenses of the debtor and the debtor's dependents.

The Trustee argues that the true issue before the Court is whether a non-debtor spouse's portion of a tax refund is disposable income. According to the Trustee, this issue is resolved by looking to 11 U.S.C. § 1325(b)(2). The Trustee discounts the relevancy of *In re Rice*, 442 B.R. 140 (Bankr. M.D. Fla. 2010), because in the *Rice* case, the bankruptcy court focused on whether the non-debtor spouse's portion of the tax refund was property of the estate and held that it was not.

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<sup>3</sup>In the above-captioned cases, the Trustee filed responses to the Debtors' objections to the Motions to Dismiss, which contain the arguments set forth herein. The Trustee's responses, which were filed on July 20, 2011, are as follows: (i) in the *Parker* case, Doc. # 27; (ii) in the *Williams* case, Doc. # 56; (iii) in the *Haley* case, Doc. # 53; and (iv) in the *Wallace* case, Doc. # 35.

The Trustee further contends that *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010), suggests that projected disposable income is based on the income and expenses of both the filing and non-filing spouses. The Trustee contends the *Lanning* decision also establishes that current monthly income does not provide a final answer to the question of projected disposable income.

Finally, the Trustee concludes by stating that there is no dispute that tax refunds are part of projected disposable income. (Citing *Freeman v. Schulman (In re Freeman)*, 86 F.3d 478 (6th Cir. 1996)).

## II. DEBTORS' POSITIONS

### A. Responses of Parker, Williams and Wallace

Debtors Parker, Williams and Wallace are represented by the same counsel, which responded to the Motions to Dismiss with substantively identical objections<sup>4</sup> and memoranda in support thereof.<sup>5</sup> These Debtors assert that (i) they filed joint tax returns with their non-filing spouses; and (ii) at least some portion of the tax refunds is not property of the estate.

The Debtors argue that the Plan only requires them to turn over their tax refunds, not the tax refunds of their non-debtor spouses. The Debtors propose that the tax refunds be allocated to each spouse

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<sup>4</sup>The objections to the Motions to Dismiss are as follows: (i) in the *Parker* case, Doc. # 24, filed on June 9, 2011; (ii) in the *Williams* case, Doc. # 47, filed on June 30, 2011; and (iii) in the *Wallace* case, Doc. # 28, filed on June 9, 2011.

<sup>5</sup>The memoranda in support of the objections, which were filed on July 27, 2011, are as follows: (i) in the *Parker* case, Doc. # 28; (ii) in the *Williams* case, Doc. # 57; and (iii) in the *Wallace* case, Doc. # 36.

based on the contribution of each spouse, *i.e.*, the tax withholdings and credits attributable to each spouse. This approach to allocation is commonly known as the withholding approach. The Debtors further argue that the bankruptcy court has no jurisdiction over the non-debtor spouses and cannot compel the non-debtor spouses to devote their income, in the form of tax refunds, to the Plan.

The Debtors distinguish their cases from *In re Colian*, 09-43067, Doc. No. 63 (Bankr. N.D. Ohio May 18, 2011), in which this Court ordered the debtor to turn over his joint tax refund to the Trustee, because the entirety of the tax refund in *Colian* was based on the debtor's income (the non-debtor spouse earned no income).

The Debtors cite *In re Rice*, 442 B.R. 140 (Bankr. M.D. Fla. 2010), in support of their contention that a non-debtor spouse's portion of a tax refund is not property of the bankruptcy estate and, thus, does not need to be turned over to the trustee. The Debtors contend that each spouse's interest in a joint tax refund is limited to the amount attributable to the contribution of that spouse. In other words, Parker, Williams and Wallace each urge this Court to find that the withholding approach is appropriate to determine the Trustee's Motions to Dismiss.

By way of example, the withholding approach would be applicable to the *Wallace* case, as follows: Wallace states that (i) \$2,714.21 was withheld from her wages for tax purposes; (ii) \$4,363.92 was withheld from her spouse's wages for tax purposes; (iii) a claimed educational credit in the amount of \$2,500.00 was attributable to

Wallace; and (iv) claimed making work pay credits in the amount of \$400.00 were attributable to Wallace and her spouse, respectively, totaling \$800.00. Wallace argues that, of the total \$10,472.00<sup>6</sup> in withholdings and credits on the joint tax return, she contributed \$5,614.00<sup>7</sup> or 54%. As a consequence, Wallace argues that her share of the joint refund in the amount of \$4,871.00 is \$2,630.00,<sup>8</sup> i.e., 54%. After subtracting \$1,500.00 (as set forth in Article 1B of the Plan), Wallace argues that the amount to be turned over to the Trustee is \$1,130.00, rather than the \$2,435.00 demanded by the Trustee.

**B. Response of Haley**

The Trustee demanded that \$10,544.00 be turned over by Haley as the Excess Tax Refund. Haley argues<sup>9</sup> that her non-debtor spouse contributed 100% of the federal tax withholdings and all but \$94.37 of the state and local tax withholdings. Haley contends that only \$94.37 of the tax refund is attributable to her and, thus, constitutes her tax refund.

Haley cites *In re Malewicz*, 2010 Bankr. LEXIS 3940 (Bankr. E.D.N.Y. Nov. 4, 2010), in support of her contention that she should be required to turn over no more than \$94.37 of the tax refund,

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<sup>6</sup>The Court's calculations, based on the above-referenced amounts, show that the actual total of the withholdings and credits is \$10,378.13.

<sup>7</sup>The Court's calculations, based on the above-referenced amounts, show that the actual total of the Debtor's contributions is \$5,614.21.

<sup>8</sup>The Court's calculations show that 54% of \$4,871.00 is \$2,630.34.

<sup>9</sup>Haley filed an objection (Doc. # 50) to the Trustee's Motion to Dismiss on July 12, 2011, and a memorandum in support thereof (Doc. # 54) on July 29, 2011.

which is the portion of the tax refund relating to her withholding overpayments and/or tax credits. Haley advocates the separate filings approach, as applied in *Malewicz* and *In re Duarte*, 2011 Bankr. LEXIS 2711 (Bankr. E.D.N.Y. July 12, 2011).

### III. NON-DEBTOR SPOUSE'S INCOME AS PROJECTED DISPOSABLE INCOME

It is not disputed that tax refunds qualify as projected disposable income for purposes of determining monthly plan payments. See *Freeman v. Schulman (In re Freeman)*, 86 F.3d 478 (6th Cir. 1996). The dispute before this Court is whether a non-debtor spouse's tax refund must be contributed to the chapter 13 plan.

The Trustee argues that a non-debtor spouse's income (and, thus, the non-debtor spouse's interest in an income tax refund) comes within the definition of projected disposable income. As a result, the Trustee argues that he can compel turnover of the entirety of a joint tax refund.

This argument was addressed in *In re Malewicz*, 2010 Bankr. LEXIS 3940 (Bankr. E.D.N.Y. Nov. 4, 2010), in which the bankruptcy court concluded that it had "no basis either at law or under the terms of the Plan to compel the Non-Debtor Spouse to turnover his property to the Trustee, or find that the Debtor is in default of her Plan for his failure to do so." *Id.* at \*1. The court found that the non-debtor spouse's income tax refund was not property of the estate and, although the calculation of projected disposable income under the means test included a portion of the non-debtor spouse's monthly income, that calculation was used only to arrive

at the debtor's monthly plan payment. The court reached its conclusion despite the express terms of the confirmed plan that stated tax refunds were to be paid to the chapter 13 trustee upon receipt.

The *Malewicz* court found that, pursuant to the definition of current monthly income, "If [non-debtor] income is not (1) expended regularly (2) on household expenses, then it is not included in the debtor's current monthly income." *Id.* at \*15 (quoting *In re Quarterman*, 342 B.R. 647, 650-51 (Bankr. M.D. Fla. 2006)). The court further stated,

The Debtor is obligated under the Bankruptcy Code to make payments under the confirmed Plan or risk dismissal of the case. Nothing in the Code obligates anyone other than the Debtor to fulfill the requirements of the confirmed Plan.

The Court finds for the reasons stated above that while a non-debtor spouse's income is considered in determining projected disposable income this cannot in and of itself be the basis to require the non-debtor spouse to contribute such income for distribution to creditors under the Plan.

*Id.* at \*16 (emphasis added).

Finally, the *Malewicz* court found that the confirmed plan referenced only the debtor's tax refund, not the tax refunds of non-debtors, and that the plan was binding only upon the debtor and creditors of the debtor. The court stated that, at most, it could find that the failure of the non-debtor spouse to turn over property constituted a plan default.

This Court finds the reasoning of the *Malewicz* court to be persuasive. Although the Plans at issue here call for the Debtors,

upon the Trustee's request, to "devote all annual federal, state and/or local income tax refunds . . . to the repayment of creditors under this Plan[,]" this provision cannot encompass the interests of the non-debtor spouses in joint tax refunds. As a consequence, the Court rejects the Trustee's argument that, when one spouse files for chapter 13 protection and subsequently files a joint tax return with a non-debtor spouse (who also has income and tax withholding), which return results in a tax refund, the entire joint tax refund must be turned over to the Trustee.

Based upon this conclusion, the Court must determine how to allocate a joint tax refund between a debtor and his or her non-debtor spouse.

#### **IV. FOUR APPROACHES TO ALLOCATION**

In Ohio, which is not a community property state, spouses maintain separate interests in property. In addition, the mere fact that spouses jointly file a tax return does not change the ownership interest of each spouse in a resulting tax refund. Thus, a spouse has no inherent property interest in a joint tax refund beyond that spouse's own interest in the tax refund. *See, e.g., In re Gazvoda*, 2011 Bankr. LEXIS 2786 (Bankr. N.D. Ohio July 21, 2011).<sup>10</sup> In such instances, the amount of the tax refund attributable to the non-debtor spouse is not property of the bankruptcy estate because the

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<sup>10</sup>Although *Gazvoda* was a chapter 7 case in which the trustee objected to the debtor's claimed exemption in a joint tax refund, principles regarding allocation of joint tax refunds are equally applicable in chapter 7 and chapter 13 proceedings.

debtor has no interest in the non-debtor spouse's tax refund. See *id.*; *In re Duarte*, 2011 Bankr. LEXIS 2711 (Bankr. E.D.N.Y. July 12, 2011).

If both the debtor and the non-debtor spouse have taxes withheld from income or claim credits or exemptions, each spouse will have some interest in the joint tax refund. Under such circumstances, the issue then becomes the proper method to allocate the tax refund and, in the bankruptcy context, the extent to which the refund is property of the estate. Four approaches for such allocation have emerged: (i) the withholding approach; (ii) the income approach; (iii) the 50/50 approach; and (iv) the separate filings approach. The Court will discuss each approach, below.

#### A. Withholding Approach

In *United States v. MacPhail*, 149 Fed. Appx. 449 (6th Cir. 2005) (unpublished decision), the IRS sought to recover an erroneous refund paid to the spouse of the income-earning spouse. In affirming that the spouse was not entitled to the refund, the Sixth Circuit Court of Appeals appeared to advance the withholding theory:

The district court held that [the income-earning spouse] was entitled to the refund because, under the tax code, overpayments by joint filers are apportioned in proportion to each filer's contribution to the overpayment, and [the income earning spouse]'s final payment of \$490,000 generated the entire overpayment. While we agree with the district judge's conclusion, we do not agree with his reasoning. . . .

As many courts have noted, 26 U.S.C. § 6402(a) permits the IRS to credit an overpayment to "the person who **made** the overpayment . . . ." (Emphasis added.) The person who made the payment does not have to be the person who incurred the liability. *United States v.*

*Elam*, 112 F.3d 1036, 1038 (9th Cir. 1997) ("Simply put, the person who overpaid is entitled to claim the overpayment credit."). In the case of joint filers, "a joint income tax return does not create new property interests for the husband or the wife in each other's income tax overpayment." [T]he wife having paid the entire amount of the tax is entitled to the entire amount of the overpayment. Accordingly, the Service may not credit the overpayment on the joint return against the separate tax liability of the husband for a prior year." Rev. Rul. 74-611, 1974-2 C.B. 399. Therefore, courts have consistently found that a refund should be disbursed in proportion to the amount each spouse paid to the taxes owed. *Ragan v. Commissioner*, 135 F.3d 329, 333 (5th Cir. 1998) ("the source of an overpayment of income tax determines the character of the refund . . . ." *In re Bathrick*, 1 B.R. 428, 430 (Bkrtcy. S.D. Tex. 1979)); *Elam*, 112 F.3d at 1038; *Conklin v. Commissioner*, 897 F.2d 1027, 1031 (10th Cir. 1990); *Gordon v. United States*, 757 F.2d 1157, 1160 (11th Cir. 1985).

While [the income-earning spouse] certainly benefitted from filing her 1996 taxes jointly because it enabled her to take additional deductions, arising in particular from a large loss on Columbus Alive!, which she would otherwise have had to split with [her spouse], the fact that [the spouse]'s portion of the deductions changed the total tax liability is irrelevant to the consideration of the proper ownership of the overpayment. The IRS looks to the source of the payment, not to the person who incurred the liability. Between 1991 and 1996, Stanbery, Ltd. paid all of the joint taxes of [the spouses], including the credit from 1995 that was used to make the first quarter estimated 1996 tax payment. Only [the income-earning spouse] had any interest in Stanbery, therefore the money is attributable only to her.

*Id.* at 452-53 (emphasis added). Although suggestive of the withholding approach, the *MacPhail* case was not selected by the Sixth Circuit Court of Appeals for publication and, thus, has limited, if any, precedential value. In addition, the proceeding before the Court of Appeals did not involve a bankruptcy issue.

In *In re Gazvoda*, 2011 Bankr. LEXIS 2786 (Bankr. N.D. Ohio July 21, 2011), the bankruptcy court followed the withholding

approach and sustained the chapter 7 trustee's objection to the non-wage earning spouse's claimed exemption in a joint tax refund. The bankruptcy court stated:

The Court finds that even if spouses jointly file tax a [sic] return in order to enhance the tax refund and also jointly file a bankruptcy petition, the tax refund remains the property of the wage earning spouse. Only the spouse whose overwithheld earnings resulted in the refund has the requisite property interest to claim exemptions in that refund under 11 U.S.C. § 522.

*Id.* at \*1-2 (emphasis added). The court found that cases which divide a tax refund equally among debtors "fail to reflect the current state of property law in Ohio that marriage alone does not confer upon a spouse an interest in the other spouse's separately titled property." *Id.* at \*11 (citations omitted).

*In re Rice*, 442 B.R. 140 (Bankr. M.D. Fla. 2010), involved two chapter 13 cases in which the debtors received joint tax refunds with their non-filing spouses. The bankruptcy court concluded that the chapter 13 trustee was not entitled to the full amount of the joint tax refunds because: (i) a debtor's interest in a joint refund is the amount attributable to his or her contribution; (ii) only the debtor's interest in a joint refund is property of the estate; and (iii) a confirmation order does not bind a non-debtor spouse to turn over his or her separate property to the chapter 13 trustee. The court instead concluded that "the interest of each Debtor in a joint refund is the amount attributable to his income." *Id.* at 143 (citations omitted). The court stated, "the respective interests should be allocated between the spouses based on their contributions

to the refund, and . . . only the Debtor's interest in the joint refund is property of the estate under §541 and §1306 of the Bankruptcy Code." *Id.* at 144. Finally, the court concluded that the plans were not binding on the non-debtor spouses and could not cover funds that were not property of the estates.

In evaluating the trustee's motion for turnover of a joint tax refund in *In re Edwards*, 363 B.R. 55 (Bankr. Conn. 2007), the bankruptcy court acknowledged that there are three approaches to apportioning a tax refund: (i) the withholding approach, which the court characterized as the majority approach; (ii) the income approach; and (iii) the 50/50 approach. Based on Connecticut state law, the court found the withholding approach to be the proper approach because the filing of a joint tax return does not alter the property rights between husband and wife. Thus, the court "'must look not to the check for the tax refund, but to the actual earnings and withholdings from the wages of husband and wife to determine what part of the refund should belong to each.'" *Id.* at 58 (quoting *In re Boudreau*, 350 F. Supp. 644 (D. Conn. 1972)). The court criticized the income approach because it "may bear little relationship to the contribution of each spouse toward the overpayment which results in a refund." *Id.* at 58. The court also noted that the 50/50 approach is rooted in domestic relations law, which is not applicable in bankruptcy proceedings.

#### **B. Income Approach**

*In re Colbert*, 5 B.R. 646 (Bankr. S.D. Ohio 1980), was a

chapter 7 case in which the debtor claimed an exemption, pursuant to O.R.C. § 2329.66(A)(17), in a joint tax refund. The bankruptcy court concluded that the debtor, who earned no income during the tax year, could not claim an exemption in the joint tax refund because she had no interest in the tax refund. The court advanced the income approach and stated,

That refund is the property of the taxpayer from whose earnings it was withheld. If both spouses receive income from which withholdings were withheld, each spouse has a property interest in the refund to the extent that their withholdings exceeded their portion of the joint tax liability, based on his or her income in proportion to the gross family income. Therefore, where two spouses incur an income tax liability, the portion of each individual's interest in the tax refund must be computed. First, divide the individual's income by the couple's joint income to obtain a percentage. Second, multiply that percentage by the couple's total tax liability to obtain the individual's proportionate tax liability. Third, subtract that individual's proportionate tax liability from that individual's withholdings to obtain the amount of his or her interest in the joint tax refund.

*Id.* at 648-49 (emphasis added).

Similarly, in consolidated proceedings regarding objections of the chapter 7 trustee to the debtors' claimed exemptions in joint income tax refunds, the Bankruptcy Court for the Northern District of Ohio stated:

The Court follows the result of the other bankruptcy courts considering the effect of Ohio law in its own determination that the non-income producing spouse has no property interest, and therefore no right to claim an exemption under Section 2329.66 Revised Code, in an income tax refund made jointly payable to husband and wife debtors. Further, the Court recognizes that, in cases where husband and wife have both earned wages and made contributions through income tax withholdings which exceed their eventual joint tax liability, that [sic]

each spouse has a potential property interest in the tax refund. In future cases, where both spouses have earned wages and made contributions exceeding their eventual tax liability, the Court will leave it to the Trustee to propose a formula for a fair allocation of the tax refund, which formula, absent proof to the contrary, should be presumed to be fair and equitable. In the event of a dispute in the manner of determination of a spouse's property interest in the income tax refund, the Court will make its own determination as to the proper formula to be applied.

*In re Taylor*, 22 B.R. 888, 891 (Bankr. N.D. Ohio 1982) (internal citations and parentheticals omitted; emphasis added).

In *In re Smith*, 310 B.R. 320 (Bankr. N.D. Ohio 2004), the bankruptcy court followed the reasoning in *Taylor, supra*, and held that no portion of the debtor's income tax refund was allocable to his non-debtor spouse because the entire overpayment was due to the debtor's earnings. The non-debtor spouse earned zero income during the tax year. The court stated, "Thus, this Court takes the position that, for purposes of § 541(a), a spouse has no interest in the proceeds due from any tax refund as the result of the other spouse making a tax overpayment. As for other courts, this, by far, is the prevailing view on the issue." *Id.* at 323. The court noted that joint liability on tax obligations is mitigated by the fact that the filing of a joint return is not mandatory. The court further noted, "this holding may also work against the bankruptcy estate in the reverse situation where a debtor's spouse, who is not in bankruptcy, is the only party contributing to the tax overpayment." *Id.* at 324 (emphasis added). Finally, the court concluded that "the filing of a joint tax return does not have the

effect of converting the income of one spouse into the income of the other, regardless of each spouse's potential liability." *Id.*; see also *In re McEachern*, 2005 Bankr. LEXIS 2140 (Bankr. N.D. Ohio Sep. 6, 2005) (holding that a debtor has no interest in the tax refund of his or her spouse).

### **C. 50/50 Approach**

In an action by the chapter 7 trustee to recover a joint tax refund, the Bankruptcy Court for the Western District of Tennessee allocated one-half of the tax refund to the debtor's bankruptcy estate and one-half to the non-filing spouse. *Loevy v. Aldrich (In re Aldrich)*, 250 B.R. 907 (Bankr. W.D. Tenn. 2000). The court found that, because the non-debtor spouse's contributions to the household as a homemaker helped give rise to the tax refund, she had an equitable interest in one-half of the refund. The court also noted that the non-debtor spouse would have joint liability for any tax deficiency.

In *In re McKain*, 2011 Bankr. LEXIS 2831 (Bankr. E.D. Tenn. July 22, 2011), the bankruptcy court concluded, *inter alia*, that there is a rebuttable presumption that a tax refund is owned equally by spouses. However, this outcome can be overcome by "evidence suggesting 'whether by their present conduct or history of financial management, the taxpayers have demonstrated a basis for separate ownership.'" *Id.* at \*37 (quoting *In re Barrow*, 306 B.R. 28, 30-31 (Bankr. W.D.N.Y. 2004)).

The 50/50 approach was also followed in *In re Smith*, 2011

Bankr. LEXIS 390 (Bankr. S.D. Ind. Feb. 2, 2011), although the court recognized that such approach is a minority view. In what the bankruptcy court construed as a motion for turnover, the court addressed three approaches to allocating tax refunds between spouses: (i) the withholding approach, characterized as the majority approach; (ii) the income-based approach; and (iii) the 50/50 approach. In the *Smith* case, the tax withholdings were attributable to the debtor and the tax credits were attributable to the non-debtor spouse. The court adopted the 50/50 approach, which "provides a bright-line rule which is easy to understand and apply." *Id.* at \*3. The court stated, "This Court, therefore, adopts a presumption that spouses share equal ownership in a tax refund, which may be rebutted only by evidence of a domestic relations court order or an enforceable, written, prepetition contract between the spouses designating alternative ownership of the refund." *Id.* at \*4-5 (citations omitted).

#### **D. Separate Filings Approach**

*Crowson v. Zubrod (In re Crowson)*, 431 B.R. 484 (10th Cir. B.A.P. 2010) is representative of the separate filings approach. In *Crowson*, the Tenth Circuit Bankruptcy Appellate Panel overturned the bankruptcy court's decision, which required the debtor to turn over to the chapter 7 trustee the entirety of a joint tax refund received by the debtor and her non-debtor spouse. The debtor and her spouse both earned income and claimed credits, but only the debtor had income taxes withheld. The bankruptcy court found that

the entire tax refund was property of the estate because only the debtor had tax withholdings. In overturning the bankruptcy court decision, the B.A.P. concluded that the separate filings approach better represents the true allocation of spouses' contributions to a joint tax refund.

The B.A.P. stated that its prior holding utilizing the withholding approach is limited to the "situation where only one spouse has income, the joint refund is comprised of only one spouse's withheld wages, and no refundable tax credits or other types of overpayments had to be allocated between the spouses . . . ." *Id.* at 487 (citing *Kleinfeldt v. Russell (In re Kleinfeldt)*, 287 B.R. 291 (10th Cir. B.A.P. 2002)). The panel also noted that Wyoming is not a community property state and that equitable division principles do not apply until divorce. Based on IRS Revenue Ruling 74-611, which holds that each spouse has a separate interest in a joint refund, the panel concluded that the separate filings approach is proper when each spouse contributes withholdings or credits.

Another case adopting the separate filings approach is *Hundley v. Marsh*, 944 N.E.2d 127 (Mass. 2011). In that case, the bankruptcy court certified to the state court the question of what interest the non-debtor spouse had in a joint tax refund, when only the husband generated income in the tax year. The state court concluded that the non-debtor spouse "has a property interest in the joint tax refund if she would have been entitled to a refund had she and her

husband filed separate tax returns. The extent of her property interest, if any, is determined by two factors: (a) her contributions to the refund in the form of payments or credits; and (b) what her tax liability would have been had the spouses filed separately." *Id.* at 129. The court discussed the pros and cons of the various approaches to allocating tax refunds and stated:

We conclude that the separate filings rule provides the most appropriate method of allocating the spouses' interests in a joint tax refund. Unlike the withholding and income rules, the separate filings rule properly allocates a couple's tax credits by determining if each spouse is responsible for all, part, or none of a claimed credit. While this approach is more complex, "simplicity cannot come at the expense of the debtor's non-filing spouse."

*Id.* at 133 (quoting *Crowson*, 431 B.R. at 496).

In *In re Palmer*, 449 B.R. 621 (Bankr. Mont. 2011), the debtor's income greatly exceeded that of his non-debtor wife. The chapter 7 trustee argued that the debtor's portion of any refund should be based on the debtor's income, while the debtor argued that a 50/50 allocation was appropriate because the debtor and his spouse held property as tenants-in-common and presumptively held equal interests in the tax refund. The bankruptcy court found that, based on Ninth Circuit precedent, tax refunds "should generally be allocated according to a debtor and non-debtor spouses' contribution to the overpayment." *Id.* at 625. The court stated that the separate filings approach adopted by the Tenth Circuit Bankruptcy Appellate Panel in *Crowson*, which is the formula used by the IRS when it divides joint tax refunds between spouses, is the proper allocation

method. The court described the process for computing a spouse's tax refund under the separate filings approach, but left ultimate resolution and calculation to the parties.

As set forth in *Crowson* and further explained in *Palmer*, the formula for calculating a spouse's portion of a joint income tax refund, pursuant to the separate filings approach, is as follows:

- (1) Calculate the amount of withholdings, credits, etc., to arrive at a contribution figure for each spouse. When the contributions of both spouses are added together, the sum should equal the amount in the "total payments" line on the joint tax return;
- (2) Calculate the tax liability each spouse would have incurred had he or she filed a separate tax return, which is referred to as the spouse's "married filing separately" tax liability;
- (3) Divide each spouse's married filing separately tax liability by the sum of both spouses' married filing separately tax liability to calculate the percentage of the joint tax liability that is to be allocated to each spouse (the sum of these percentages will equal 100%);
- (4) Multiply the percentage for each spouse from step 3 by the actual joint liability to arrive at each spouse's share of the joint tax liability; and
- (5) Subtract each spouse's share of the joint tax liability from his or her contribution (from step 1), which results

in the amount representing that spouse's share of the joint tax refund.

*Crowson*, 431 B.R. at 491-492; see also *Palmer*, 449 B.R. at 626-628.

Likewise in *In re Duarte*, 2011 Bankr. LEXIS 2711 (Bankr. E.D.N.Y. July 12, 2011), the chapter 13 trustee objected to confirmation of the debtor's plan because it did not include the debtor's joint tax refund as disposable income. The court adopted the separate filings approach as set forth in *Crowson*. The court first noted:

[A] non-debtor spouse's share of a joint tax refund received post-confirmation is not property of the debtor's estate or part of the "projected disposable income" and therefore unless the non-debtor spouse specifically consents to contribute the refund to the Plan, the non-debtor spouse's share of tax refunds received post-confirmation is not to be turned over to the Trustee. The Non-Debtor Spouse is not required to devote her share of tax refunds to payments under the Plan and property of the Debtor's estate does not include the property of the Non-Debtor Spouse. Therefore, the Non-Debtor Spouse's share of the tax refunds are [sic] not included in the calculation of Plan payments. Because the Debtor consents to turn over his share of the tax refunds, the sole issue for the Court to determine is how to calculate the Debtor's interest in the tax refunds.

*Id.* at \*7-8 (footnote omitted).

The court further stated:

The lone complaint courts lodge against the Separate Filings Rule is that it is complicated and unwieldy. The Court agrees that the test may be somewhat difficult to apply. However, this Court believes it is the best approach to allocate tax liability and credits between spouses, taking into account income earned, credits that each may be entitled to receive, and taxes withheld. The fact that it may be complicated is no reason to reject it for a "bright line" approach which has the attraction of simplicity but fails to protect each spouses's true legal

interest in and to the tax refund. This Court is not ruling that the Trustee, the debtor and the non-debtor spouse in each case must undertake this analysis in order to determine each parties' [sic] interest in a joint income tax refund, but this formula shall be employed where the parties do not agree on the proper allocation. Furthermore, in contested matters of this type the Court will rely upon the parties to calculate the debtor's interest using the formula set forth in *Crowson*, as modified by *Hundley v. Marsh*, 459 Mass. at 87, 944 N.E.2d at 134, n. 12.

*Id.* at \*25-26.

The *Marsh* modification to the *Crowson* analysis is simply that, "In cases in which a couple does not claim any credits, and their refund is due entirely to withholdings from income, the separate filings rule will produce the same result as the withholdings [sic] rule. In those cases, the withholding rule may be an appropriate allocation method." *Hundley v. Marsh*, 944 N.E.2d 127, 134 n.12; see also *In re Hraga*, 2011 Bankr. LEXIS 2517 (Bankr. N.D. Ga. June 3, 2011) (finding that the withholding approach is proper, but if exemptions or credits are claimed, the separate filings approach is more accurate).

#### **V. CONCLUSION**

Each of the approaches set forth above is subject to criticism. The withholding and income approaches do not necessarily reflect true contributions because the "reality of the Internal Revenue Code is that the total tax is not necessarily linked to income, while the overpayment is not necessarily linked exclusively to income or withholdings. For many taxpayers, a significant portion of the refund is attributable not to these factors, but to any of a number

of credits . . . ." *In re Palmer*, 449 B.R. 621, 625 (Bankr. Mont. 2011) (quoting *In re Barrow*, 306 B.R. 28, 30-31 (Bankr. W.D.N.Y. 2004)). In addition, the 50/50 approach is unrealistic in that a joint tax refund does not itself create equal property interests for each spouse in non-community property states. Finally, the separate filings approach is difficult to apply.

Although the withholding approach has been the majority rule, it appears that the separate filings approach is gaining ground, in part, because it is the approach used by the IRS to allocate joint tax refunds. This Court finds that the separate filings approach most accurately reflects the true contribution of each spouse to a tax refund; the fact that such method may be difficult to apply should not preclude its application.

As a consequence, this Court finds that: (i) the Debtors' interests in the tax refunds do not extend to the refunds to the extent attributable to the non-debtor spouses and, thus, those portions of the joint tax refunds attributable to the non-debtor spouses are not property of the Debtors' estates; (ii) the Court cannot compel the non-debtor spouses to contribute their portions of the joint tax refunds to the Plans because such portions of the tax refunds are not property of the bankruptcy estates and the Plans are not binding on parties other than the Debtors and their creditors; and (iii) the best method to allocate the joint tax refunds is the separate filings approach.

Based upon this guidance, the Court directs the Trustee to

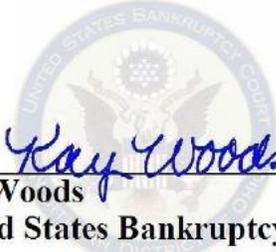
confer with each of the Debtors to see if they can agree on the amount of each Debtor's Excess Tax Refund to be contributed to each Plan. To the extent the Trustee seeks dismissal of any of the above-referenced cases based on the failure or refusal of the Debtors to turn over the entire joint tax refund (less credits and deductions set forth in Article 1B), the Motions to Dismiss will be denied. If the parties cannot agree on the amount of the Excess Tax Refund in any instance, the Debtor or the Trustee may move the Court for a determination of the exact amount of such Excess Tax Refund.

An appropriate order will follow.

# # #

IT IS SO ORDERED.

Dated: September 6, 2011  
12:27:15 PM



*Kay Woods*  
 Kay Woods  
 United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF OHIO

IN RE:	*	
	*	
	*	CASE NUMBER 09-41001
	*	
THOMAS L. PARKER,	*	CHAPTER 13
	*	
Debtor.	*	HONORABLE KAY WOODS
	*	
*****	*	*****

IN RE:	*	
	*	
	*	CASE NUMBER 09-44380
	*	
SANDRA E. WILLIAMS,	*	CHAPTER 13
	*	
Debtor.	*	HONORABLE KAY WOODS
	*	
*****	*	*****

IN RE:	*	
	*	
	*	CASE NUMBER 10-43718
	*	
BELINDA J. HALEY,	*	CHAPTER 13
	*	
Debtor.	*	HONORABLE KAY WOODS
	*	
*****	*	*****

IN RE:

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CASE NUMBER 10-43850

KRISTIN M. WALLACE,

CHAPTER 13

Debtor.

HONORABLE KAY WOODS

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ORDER DENYING TRUSTEE'S MOTIONS TO DISMISS FOR  
FAILURE TO CONTRIBUTE EXCESS TAX REFUND

\*\*\*\*\*

Before the Court are four motions ("Motions to Dismiss"), each filed by Michael A. Gallo, Standing Chapter 13 Trustee ("Trustee"), which seek to dismiss the four above-captioned cases based on each Debtor's failure to contribute such Debtor's Excess Tax Refund (as that term is defined in Article 1B of the Plan).<sup>1</sup> In each of the cases in question, the Debtor is married and filed a joint tax return with the Debtor's non-debtor spouse.

The issue before the Court in each of the Motions to Dismiss is whether and/or to what extent a non-debtor spouse's portion of a joint tax refund must be contributed to the chapter 13 plan. The Motions to Dismiss are substantively identical although the facts of each case are slightly different.

For the reasons set forth in this Court's Memorandum Opinion Regarding Trustee's Motions to Dismiss for Failure to Contribute Excess Tax Refund entered on this date, the Court hereby:

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<sup>1</sup>The Motions to Dismiss are as follows: (i) in the *Parker* case, Doc. # 22, filed on June 9, 2011; (ii) in the *Williams* case, Doc. # 45, filed on June 9, 2011; (iii) in the *Haley* case, Doc. # 43, filed on June 8, 2011; and (iv) in the *Wallace* case, Doc. # 30, filed on June 9, 2011.

- (1) Finds that the Debtors' interests in the joint tax refunds do not extend to the refunds to the extent attributable to the non-debtor spouses;
- (2) Finds that the portions of the joint tax refunds attributable to the non-debtor spouses are not property of the estates;
- (3) Finds that the Court has no authority to compel the non-debtor spouses to contribute their portions of the joint tax refunds to the chapter 13 plans;
- (4) Finds that the best method to allocate the joint tax refunds between the Debtors and their non-debtor spouses is the separate filings approach; and
- (5) Denies the Motions to Dismiss to the extent such motions are based on the refusal of the Debtors to turn over the non-debtor spouses' portions of the joint tax refunds.

**IT IS SO ORDERED.**

# # #