

Married Debtors in Chapter 13 Cases

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**The Projected Disposable Income
of Married Debtors in Chapter 13 Cases**

Hon. Steven Rhodes
United States Bankruptcy Judge
Eastern District of Michigan

I. The Bankruptcy Code

A. Section 302(a) provides that spouses may file a joint case:

A joint case under a chapter of this title is commenced by the filing with the bankruptcy court of a single petition under such chapter by an individual that may be a debtor under such chapter and such individual's spouse.

B. Section 302(b) provides, "After the commencement of a joint case, the court shall determine the extent, if any, to which the debtors' estates shall be consolidated."

C. Section 707(b)(2)(A)(ii)(I) states, "Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor or the dependents of the debtor."

D. Under § 707(b)(2)(A)(ii)(I), the "debtor's" monthly expenses shall be the amounts specified in the listed IRS Standards "for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case if the spouse is not otherwise a dependent."

E. Section 1325(b)(2) defines "disposable income":

[I]ncome which is received by the debtor and which is not reasonably necessary to be expended—(A) for the maintenance or support of the debtor or a dependent of the debtor; and (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

F. Section 101(10A) defines "current monthly income":

(A) means the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such income is taxable income, derived during the 6-month period ending on—

(i) the last day of the calendar month immediately preceding the date of the commencement of the case if the debtor files the schedule of current income required by section 521(a)(1)(B)(ii); or

(ii) the date on which current income is determined by the court for purposes of this title if the debtor does not file the schedule of current income required by section 521(a)(1)(B)(ii); and

(B) includes any amount paid by any entity other than the debtor (or in a joint case the debtor and the debtor’s spouse), on a regular basis for the household expenses of the debtor or the debtor’s dependents (and in a joint case the debtor’s spouse if not otherwise a dependent)[.]

(Question: Who is the “debtor” and who is the “debtor’s spouse” for purposes of the CMI calculation in § 101(10A)?)

II. The Bankruptcy Rules

Rule 1015(b), Fed. R. Bankr. P., provides:

(b) If a joint petition or two or more petitions are pending in the same court by or against (1) a husband and wife . . . the court may order a joint administration of the estates. Prior to entering an order the court shall give consideration to protecting creditors of different estates against potential conflicts of interest.

III. The Case Law

A. When Married Individuals File a Joint Case

1. A joint petition filed by married debtors creates two separate estates. *Reider v. FDIC* (*In re Reider*), 31 F.3d 1102, 1109 (11th Cir. 1994); *In re Morrison*, 403 B.R. 895, 900 (Bankr. M.D. Fla. 2009); *In re Shjeflo*, 383 B.R. 192, 195 (Bankr. N.D. Okla. 2008); *In re Bippert*, 311 B.R. 456, 462 (Bankr. W.D. Tex. 2004); *In re Estrada*, 224 B.R. 132, 135 (Bankr. S.D. Cal. 1998); *In re Stampley*, 437 B.R. 825, 828 (Bankr. E.D. Mich. 2010); *In re Fernandes*, 346 B.R. 521 (Bankr. D. Nev. 2006) (“Section 302 does not automatically consolidate estates. Rather, it provides for the coordinated administration of two presumably related cases. . . . [A]n order of joint administration under Section 302 and Bankruptcy Rule 1015 does not mingle or mix the assets or claims of each estate with the other. As a result, the filing of a joint case does not, without more, affect whatever rights creditors . . . have as against either spouse individually.”). *But see In re Shjeflo*, 383 B.R.

192 (Bankr. N.D. Okla. 2008) (By local rule, joint filing of spouses resulted in substantive consolidation.).¹

2. Unless the joint debtors' estates are consolidated by the court pursuant to § 302(b) and Rule 1015(b), the two estates remain separate. *In re Toland*, 346 B.R. 444, 449 (Bankr. N.D. Ohio 2006); *In re Stampley*, 437 B.R. 825, 828 (Bankr. E.D. Mich. 2010).

3. "In assessing the propriety of substantive consolidation, a court must determine: (1) whether there is a substantial identity between the assets, liabilities, and handling of financial affairs between the debtor spouses; and (2) whether harm will result from permitting or denying consolidation. In assessing the extent of substantial identity, relevant factors will include the extent of jointly held property and the amount of joint-owed debts." *Reider v. FDIC (In re Reider)*, 31 F.3d 1102, 1108-09 (11th Cir. 1994).

4. "Cases should be consolidated where the affairs of the husband and wife are so intermingled that their respective assets and liabilities cannot be separated." *In re Chan*, 113 B.R. 427, 428 (N.D. Ill. 1990); *In re Birch*, 72 B.R. 103, 106 (Bankr. D.N.H. 1987); *In re Barnes*, 14 B.R. 788, 790 (Bankr.N.D.Tex.1981).

5. *In re Herrmann*, 2011 WL 576753, at *9 (Bankr. D.S.C. 2011) (citations omitted):

In this case, Debtors' joint living expenses should be allocated fairly between them and Mrs. Herrmann should not be allowed to absorb more than her fair share of the expenses at the expense of her creditors. If done in this case, Mrs. Herrmann

¹ See Lundin & Brown, CHAPTER 13 BANKRUPTCY (4th ed.) § 7.1[4], available at ch13online.com:

It is not routine in Chapter 13 practice for the debtor or trustee to move for substantive consolidation after the filing of a joint petition. Bankruptcy courts do not review every joint Chapter 13 petition filed by a husband and wife to determine whether the estates should be consolidated. Routinely, the joint petition is treated as a single case, and the assets and liabilities are administered as if substantively consolidated. In most Chapter 13 cases, the debts and assets of each spouse will be so similar that substantive consolidation has no adverse effect on creditors.

will have more income available to pay her creditors.

Courts have considered a similar issue in cases where a chapter 13 plan is challenged on good faith grounds because the debtor's non-filing spouse is making little or no contribution to the payment of their reasonable joint household expenses. In such a situation, courts may require a chapter 13 debtor to demonstrate that the bankruptcy estate has not assumed responsibility for a disproportionate share of the reasonable household expenses in order to establish that the plan is proposed in good faith. . . .

. . . Absent evidence to the contrary, it would appear that joint expenses should either be shared equally or in the proportion that each debtor's income bears to the total family income.

B. When One Spouse Files an Individual Case

1. In a case where a married debtor files individually, “courts base their calculation of the debtor’s disposable income on the debtor’s family budget, including the income and expenses of the nondebtor spouse.” *In re Carter*, 205 B.R. 733, 735 (Bankr. E.D. Pa.1996). *See also In re Welch*, 347 B.R. 247, 252 (Bankr. W.D. Mich. 2006); *In re McNichols*, 249 B.R. 160, 169 (Bankr. N.D. Ill. 2000); *In re Bottorff*, 232 B.R. 171, 173 (Bankr. W.D. Mo. 1999); *In re Stampley*, 437 B.R. 825, 828 (Bankr. E.D. Mich. 2010).
2. “Failure to consider the impact of the nondebtor spouse’s income and proposed expenditures therefrom would leave the debtor’s unsecured creditors to subsidize the spouse’s expenses.” *McNichols*, 249 B.R. at 173. *See also In re Williamson*, 296 B.R. 760, 764 (Bankr. N.D. Ill. 2003); *In re Schnabel*, 153 B.R. 809, 818 (Bankr. N.D. Ill. 1993); *In re Kern*, 40 B.R. 26, 29 (Bankr. S.D. N.Y. 1984); *In re Stampley*, 437 B.R. 825, 828 (Bankr. E.D. Mich. 2010)

3. A majority of cases conclude that when calculating the filing spouse's net disposable income, the joint expenses of the debtor and the non-filing spouse should be allocated in proportion to their income.

- *McNichols*, 249 B.R. at 172 (rejecting a 50/50 split of expenses when the parties' incomes are disparate, and holding "a more equitable and logical approach would be to have the Debtor and her spouse proportionally bear reasonable and necessary family expenses to maintain the family in the same relative ratio as their respective net incomes[.]").
- In *In re Blair*, 226 B.R. 502, 506 (Bankr. D. Me. 1998), the court found that the debtor-husband's income was sufficient to pay a significant dividend to his creditors. Instead he used that income to pay his wife's debts. The court denied the debtors' motion for substantive consolidation and found substantial abuse, explaining:

Absent substantive consolidation, Rodney's creditors may look to Rodney's assets (and, in Chapter 13 or outside bankruptcy, Rodney's assets and earnings) for satisfaction of their claims. Darlene's creditors may look to Darlene. Since Rodney has almost \$2,000.00 per month of income in excess of his living expenses, and since Darlene has only \$100.00 per month in gross income, substantive consolidation would result in Rodney's dollars going to pay Darlene's (unliquidated but substantial) individual debts. As a consequence, Rodney's creditors' repayment potential would be diluted significantly.

- In *In re Stampley*, 437 B.R. 825, 828 (Bankr. E.D. Mich. 2010), the court stated:

The debtor earns approximately 66% of the household income. Accordingly, the debtor's fair share of the joint expenses should be 66% of \$4,946, or \$3,264. When her sole expenses of \$640 are added, her total expenses become \$3,904. As noted, her net monthly income is \$4,706. As a result, her net disposable income ought to be \$802. A chapter 13 plan at \$802 per month for 36 months totals \$28,872. Schedule F discloses unsecured debt of

\$25,403.98. Thus the debtor's chapter 13 plan could be a 100% plan, less trustee fees and attorney fees, assuming all of the creditors file claims.

However, the debtor's stated net disposable income is significantly lower because the debtor and her husband allocate a large portion of her monthly net disposable income for his sole expenses. This is unfair to the debtor and even more unfair to the debtor's sole creditors. For all practical purposes, the excess is a gift, and it is a gift from the spouse who is in bankruptcy and insolvent to the spouse who is not in bankruptcy and to that spouse's creditors.

- *In re Cox*, 2005 WL 681464 (Bankr. N.D. Iowa 2005) (To determine the available projected disposable income, the non-filing spouse's income must be considered and one way to do that is to allocate expenses to the non-filing spouse's income in the proportion that each spouse contributes to the family income. Because debtor's income is 85% of the family income, 15% of the family expenses will be allocated to the non-filing spouse.).
- *In re Waechter*, 439 B.R. 253, 256–57 (Bankr. D. Mass. 2010) (“[I]f the debtor received income towards household expenses from her non-filing spouse while at the same time enjoying the benefits of excessive luxury household expenses paid for exclusively by the spouse, courts have denied plan confirmation on the basis of bad faith. . . . On the other hand, if it is clear that the non-filing spouse is using his surplus income substantially to pay his own obligations, and is not otherwise subsidizing the debtor's luxury lifestyle while the debtor's creditors take it on the chin, then courts will find the debtor's plan to be filed in good faith.”).
- *In re Louviere*, 389 B.R. 502, 510 n. 20 (Bankr. E.D. Tex. 2008) (clarifying that a challenge to the allocation of household expenses between a debtor and a non-filing spouse may be made by questioning the good faith of the debtor in

proposing a plan in which she is absorbing more than her fair share of the household expenses) (“Thus, the duty of a Chapter 13 debtor to demonstrate, upon challenge, that the bankruptcy estate has not assumed responsibility for a disproportionate share of the reasonable household expenses remains essentially unchanged from pre-BAPCPA days.”).

4. A minority of cases hold otherwise:

- *In re Boatright*, 414 B.R. 526 (Bankr. W.D. Mo. 2009) (declining to allocate expenses in proportion to income).
- *In re Pattison*, 2006 WL 2086585, at *1 (Bankr. S.D. Ohio 2006) (Non-filing spouse’s income and expenses are considered for disposable income test purposes; apportioning based on ratio of incomes is not appropriate when there is substantial disparity between income of debtor and income of non-filing spouse. Debtor’s only income was \$467 per month of child support. Debtor’s non-filing spouse had monthly gross income of \$8,621. Proposed plan payment was \$75 per month, resulting in a 14% dividend. The court stated:

The majority of cases hold that the income of the non-debtor spouse must be included in computing the debtor’s disposable income. . . . These decisions are based on the rationale that a portion of the non-debtor spouse’s income is likely to be applied to the cost of the debtor’s needs, thereby potentially increasing the share of the debtor’s own income that is not reasonably necessary for support and, hence, available as disposable income. . . . [T]he cases further hold that the expenses of the non-debtor spouse must also be included in the computation. . . . A few courts have adopted a mechanical analysis, apportioning the payment of household expenses by the debtor and non-debtor spouse to match the apportionment of their respective incomes. . . . [W]hen there is a great disparity between the two incomes, a mechanical apportionment is not at all reflective of the payment of the family expenses. . . . The Debtor could not possibly support herself, much less her dependents, on \$467 a month. . . . [T]he non-debtor

spouse is paying virtually all of the Debtor's expenses, thus freeing up all of the Debtor's monthly income as disposable income. To hold otherwise would allow the Debtor to live relatively 'high on the hog' while her unsecured creditors receive virtually nothing.

**Married Debtors in Chapter 13:
Strategic Decisions**

Submitted by

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I.

Pre-Filing Analysis and Planning

DETERMINING CHAPTER CHOICE

Before determining whether a Chapter 7, 13 or 11 individual filing is appropriate for the debtor, practitioners need to explore the true underlying cause of the debtor's problem. Listen to your client's story to determine whether the debtor would benefit from a simple Chapter 7 or whether a Chapter 13 or 11 would not better address his issues. Some of the most common factors that arise leading to the decision to file a reorganization rather than Chapter 7 include:

(1) arrears on debt secured by liens on property the debtor wishes to retain,

EX. Debtor comes to you to stop a foreclosure on his primary residence. His budget supports the home's affordability now that he's back to work but he is unable to cure the arrears as quickly as the mortgage company is demanding.

(2) "cram down" potential on debts secured by liens

EX. Debtor has a vehicle that is worth significantly less than he owes and that he financed 911 days ago, or that he financed more recently but has a loan with extraordinarily high interest rate, etc.

(3) junior liens that can be stripped

EX. Debtor's \$60,000 home is encumbered by a first mortgage note with a balance of

\$60,000.01 and also has a second mortgage note in the amount of \$10,000.

(4) projected disposable income sufficient to fund a plan

EX. Debtor's net household income is \$2400 per month and his reasonably necessary expenses are \$1900. He has \$500 disposable income but he currently needs \$900 to service his unsecured debt.

(5) the existence of nondischargeable (priority or otherwise) debt

EX. Debtor has, in addition to his unsecured debt load, a significant amount of income tax debt that was incurred last year. Consider also situations where a Debtor has a divorce related property settlement due that would be nondischargeable in a Chapter 7 but may be dischargeable under Chapter 13.

(6) the debtor's current monthly income as indicated by the average income over the past six months is a

EX. Debtor has averaged \$7,200 per month and the median for his family size is \$6213

DETERMINING INDIVIDUAL vs JOINT FILING

All of these examinations must be made, not only with respect to the debtor, but also with respect to the debtor's non-filing spouse. You will want to analyze the impact any of your chapter choice decisions will have on your client, but also the non-filing spouse as an individual and the family as a whole.

For instance it would be wise to file both spouses if you were presented with a case where a Chapter 13 would enable junior lien stripping of liens upon which both spouses are obligated. The same thing would be true if both spouses were co-obligated on nondischargeable debt. Filing an individual case would certainly benefit your client. However, in the long run he may not be any better off if his non-filing spouse did not obtain relief, as his "family" would still owe the debts. As a practical matter, if the family shares a budget, he would still endure the hardship of the obligation as his non-filing spouse would still have to pay it out of the family budget

A non-filing spouse who is obligated on his own share of unsecured debt or has his own vehicle that can be crammed down may just need to discuss the matter with competent counsel to actual comprehend the situation and/or feel more at ease with filing. It is not at all unusual to meet a married couple where one partner is significantly more involved in the family budget. Often in fact the other partner has no idea how dire the situation has become. Sitting down with competent counsel who will review the family's budget, assets and liability may be the wake up

call that partner needs to see that there really is no money left to service the credit cards after supporting the family. It may not have been apparent because the family may have been eking by with “smoke and mirrors” – servicing the debt with wages thereby keeping creditors at bay but then having to put living expenses on credit. If the debts have been paid the creditors are not likely aggressive and a false sense of security could set in ... temporarily. Competent counsel can also help dispel the “myths” of bankruptcy (e.g. that you’ll lose everything, that you’ll never get credit again, that your name will be published somewhere, etc.)

It is not unusual for a client to say to me “my husband can’t file, attorney X told him he failed the means test”. When faced with this piece of news, counsel has the difficult task of taking what was probably true advise and gently correcting the assumptions this prospective client made based thereon! In the case of a married debtor who chooses to file individually, most courts base their disposable income calculations on the debtor’s *family* budget – including the non-filing spouse. *See: In re Carter*, 205 B.R. 733, 735 (Bankr. E.D. Pa. 1996); *In re Bottorff*, 232 B.R. 171, 173 (Bankr. W.D. Mo 1999); *In re Ehert*, 238 B.R. 85, 88 (Bankr. D.N.J. 1999); *In re Cardillo*, 170 B.R. 490, 491 (Bankr. D.N.H. 1994); *In re Schnabel*, 153 B.R. 809, 818 (Bankr. N.D. Ill 1993); *In re Belt*, 106 B.R. 553, 563 (Bankr. N.D. Ind. 1989); *In re Carbajal*, 73 B.R. 446, 447 (Bankr. S.D. Fla 1987).

However, compare those holdings with *In re Harmon*, 118 B.R. 68 (Bnkr. E.D. Mi 1990) where Judge Rhodes held under pre BAPCPA that because the Court had no jurisdiction over the non-filing spouse or her assets or income the Court could not compel her to contribute to plan

payments and that deducting family income from family expenses is only appropriate where both debtors are before the court. Also compare to In re Rysso, 321 B.R. 522 (Bankr. D. Mn 2005) wherein the court did consider the non-filing spouse's significant income but only as it contributed to a reduction in joint debt/expenses – not as an increase in income available to the debtor. The result was that debtor was eligible for a Chapter 7 even though the family in a joint filing would have been well over the “threshold”.

You will also need to consider the age of the marriage, whether the parties truly share income and expenses as well as assets and liabilities. You will need to prepare a “joint statement of financial affairs” even if you never end up filing a joint case. Doing so will assist in discovering if there have been any potential preferences or fraudulent transfers. For instance, did the debtor diminish his estate by “putting” his new wife on his home upon marriage? If so you could be faced with a fraudulent transfer action. Did the parties use the family's (joint) resources (income or property as collateral for debt consolidation loans) to pay off the non-filing spouse's debts in an attempt to “protect at least one credit report”? If so you could be faced again with a fraudulent transfer action. Did the debtor repay a loan to his spouse prior to filing that could lead to a preference action?

BOTH SPOUSES BUT SEPARATE FILINGS

Asking the questions of both spouses may lead to separate cases where each spouse files a different chapter.

EX. Assume H & W recently married. H has \$85,000 in unsecured debt and very few assets. W on the other hand has \$10,000 in debt and roughly \$75,000 in non-exempt assets. Together as a family they can not afford to service the combined \$95,000. Analyzing the joint liquidation analysis and W's Schedule C the case would have to be filed as a Chapter 13 if the parties wished to save assets from liquidation. The parties would end up paying roughly \$75,000 of the \$95,000 debt back in order to pay creditors at least what they would have gotten in a Chapter 7 liquidation. However, if it was W only she could file a Chapter 13 "best interest" case and pay 100% of her \$10,000 back to protect her assets. Husband, who has no assets to speak of could file a Chapter 7. The family as a whole paid back \$10,000 in debt over the life a plan instead of \$75,000.

PRACTICE POINT

Often these cases are presented to you by only one party. We have all had the situation where one spouse comes in and says he or she needs to file a bankruptcy proceeding and doesn't want the other spouse to be a part of the proceeding. You need to address this issue immediately in an sympathetic and direct manner and let the debtor know that his or her success in the bankruptcy proceeding is contingent upon information and potential participation from the non-filing spouse. Sometimes these matters are simple, according to the debtor, and the non-filing spouse's income and expenses are "not up for discussion." How to obtain information from an uncooperative non-filing spouse will be discussed in more detail. However, most of the time the

information will be more forthcoming if you establish a rapport, a sense of comfort and familiarity with the debtor and advise the debtor the non-filing spouse's information is imperative not optional. It is appropriate to invite the non-filing spouse to the next meeting or encourage the debtor to do so, simply to talk about issues and options. The non-filing spouse may be making their decision in vacuum. If they have an opportunity to meet with competent debtor's counsel, they may too determine that a joint bankruptcy proceeding is their best option.

WHAT TYPE OF STRATEGIC PRE-PLANNING IS ALLOWED?

As we all know the Bankruptcy code requires a debtor to pay “projected disposable income” into his Chapter 13 plan for the applicable commitment period.

The meaning of projected disposable income was determined by the U. S. Supreme Court last year in Hamilton v Lanning (In re Lanning), 130 S. Ct. 2464 (U.S. 2010). In *Lanning*, during the six months prior to filing his Chapter 13 bankruptcy the debtor received a one-time severance payment. This resulted in a six month average income that greatly exceeded debtor's typical monthly income. In her plan, however, the debtor proposed a monthly payment that was based on her actual monthly income at the time that the case was filed rather than on the skewed six month average. The Chapter 13 Trustee objected to confirmation of this plan arguing that the monthly plan payment should be based on the debtor's average income in the six months prior to the date that the case was filed.

The debtor argued that her actual monthly income at the time of filing conformed with the

Bankruptcy Code’s requirement that she pay her “*projected disposable income*” since that is the income she expects to earn during the term of the plan. The Trustee on the other hand asserted that although the Code does not define “*projected disposable income*”, it defines the phrase “disposable income” as “current monthly income...less amounts reasonably necessary to be expended....” 11 U.S.C. § 1325(b)(2). “Currently monthly income” is defined as the average monthly income received by the debtor in the six months prior to the date that the case was filed. 11 U.S.C. § 101(10A). The Trustee, therefore, argued that “*projected disposable income*” means “disposable income”, as defined by § 1325(b)(2).

Justice Alito, writing for the eight-justice majority, held that the debtor’s position (the “forward looking” approach) was the stronger one. The Court found that “projected” takes into account anticipated events and is not simply the mechanical extension of past results.

The Lanning Court dismissed the Trustee’s “mechanical approach” as inconsistent with other provisions of the Bankruptcy Code. Furthermore, the Court found the “mechanical approach” to be in opposition to the goals of the Bankruptcy Code because it would preclude individuals, such as the debtor, from filing Chapter 13 cases by creating an artificially high payment.

The Sixth Circuit has also taken a forward looking approach, this time in a case that netted *higher* disposable income in the future and therefore a *higher* plan payment. Darrohn v. Hildebrand, 2010 WL 2852251 (6th Cir. 2010) . In Hildebrand the debtor obtained new employment at a lower salary during the six month look-back period prior to filing. Because of

gap in employment and lower wage, the debtor's CMI was significantly less than his actual income. Debtor's higher actual income was known or substantially certain as of the date of confirmation. Therefore, the Court could take this additional income into account in determining debtor's projected monthly income based plan payment. Further, debtor's intent to surrender property was also known or substantially certain at the time of confirmation. Therefore, the Court could disregard the mortgage and other payments and expenses attendant to that property in determining projected disposable income.

How do Lanning and Hildebrand affect whether you recommend debtor and non-filing spouse change how they handle family finances post petition?

At least one Court has held that, despite evidence of deliberate manipulation of income during the six months prior to filing, that the burden of proof under Section 727 had not been met. In re Ireland, 441 B.R. 572 (Bankr. W.D. Ky 2011). In Ireland, the Court found that the Debtor's draw from his company during the six months preceding the bankruptcy indicated that he manipulated his draw so his income would not violate the means test. The Debtor had been drawing an annual salary for the preceding years in excess of \$400,000.00 (over \$33,000.00 per month), but for the six months prior to filing he only drew \$5,000.00 per month.

A creditor filed an adversary proceeding under Sections 727 and 523. The Court acknowledged that the Debtor had either misrepresented his financials to the creditor, or had knowingly and fraudulently made a false oath or account in the case. Accordingly, the Court held that "[w]hile the evidence does not show with certainty which is the true state of affairs, this Court

will rely on the trustee’s inaction and a liberal construction of discharge to determine that based on the totality of the circumstances, [the Debtor] has not made a false oath and will not be denied his discharge pursuant to §727(a)(4)(A). That is, considering a totality of the particular facts and circumstances, the Plaintiff has failed to carry the required burden of proof.” *Id* at 581-82. The Court in Ireland was careful to limit its holding to the “particular facts and circumstance” in that case *Id.* at 582.

Discussion Point:

Is it acceptable for a debtor to change his or her financial arrangement with his non-filing spouse in anticipation of filing a bankruptcy so that a Chapter 7 or 36 month

II.

Changes During the Case: When Debtor Gets Married

As we know post-confirmation modifications can be proposed by Debtor, Trustee or an Allowed Unsecured Creditor. Therefore, any of these parties may elect to propose a modification. The Debtor, to modify, must be able to show a change in financial circumstances effecting ability to pay.

Recall that according to Lanning and Hildebrand the Courts allowed/required (respectively) that Debtors use a forward looking approach to determine the amount of projected disposable

income available for plan payments. In Lanning this did not include a one time severance received within six months of filing because that amount was not likely to be received again and therefore would not be readily available for plan payments. In Hildebrand a review of debtors situation from filing forward showed that debtor would have more disposable income available to fund a plan because debtor was fully employed at a higher rate and had eliminated expenses associated with secure claims.

Every bankruptcy attorney knows that a great deal can change during a Chapter 13. The nature of a Chapter 13 requires a Debtor to amend the plan and budget whenever circumstances change. Ideally, if the Debtor earns more household income he may be able to pay more to his creditors. Likewise, when expenses increase, plan payments may need to decrease. But what happens when a Chapter 13 Debtor gets married during an on-going proceeding? If Debtor's new spouse is wealthy, must his plan payments increase as well? Should his new spouse be required to contribute a portion of her income to the Debtor's plan just because they were married during the proceeding? Wouldn't this person have to do so if they were married at the time of filing? Does it make a difference if it is the last year of a 60 month plan?

The opposite scenario also presents questions. In a case where a higher-earning debtor marries a lower income spouse during the case, must creditors receive less because Debtor chose to marry during the case? What if the new spouse has children, increasing the household size and expenses? Would this be relevant if they were married at the time of filing? One court was very clear in its decision in case where debtor married post petition and in doing so increased his

expenses but not his income which ultimately lowered his disposable income or ability to fund the plan. In the case of In re Walker, 114 BR 847 (1990) the Court supported its decision that debtor *could amend to lower* in such a situation by stating: “Apparently the trustee would have Chapter 13 debtors, who incur additional expenses due to their post-confirmation marriage, provide notice to unsecured creditors and an opportunity to object to the marriage. Such a scenario stretches beyond recognition of the already controversial limits of the bankruptcy court's subject matter jurisdiction.. *Id.* at 850. It went on to support its decision by pointing out that “marriage is one of the basic rights of man, fundamental to our very existence and survival.” Loving v. Commonwealth of Virginia, 388 U.S. 1, 12, 87 S.Ct. 1817, 1824, 18 L.Ed.2d 1010 (1967). Even prisoners have a constitutionally protected right to marry. Turner v. Safley, 482 U.S. 78, 107 S.Ct. 2254, 2265, 96 L.Ed.2d 64 (1987). The obligation of financial support as it flows from the decision, albeit perhaps untimely, to marry or procreate, is not intended to be superceded by the

Discussion Point:

How do the varying parties at this conference insure the Plan stays in compliance – or that said changes are accounted for? Decreases usually take care of themselves as Debtors diligently

creditor's rights under the Code. In re Walker, 114 BR 847, 850 (1990).

III.

As the World Turns: When Debtor Gets Divorced

Experienced Chapter 13 attorneys are acclimated to many of the unexpected twists and turns that can arise during such a lengthy engagement and are familiar with the available options. One particularly thorny issue that can arise during a chapter 13 is divorce. When married Debtors

are engaged in an ongoing chapter cases and contact you to tell you they are getting a divorce, a number of issues will immediately arise in the bankruptcy attorney's mind:

1. What ethical concerns arise with continuing representation?
2. Should they both complete the bankruptcy and who is going to pay for it?
3. Would the Debtors be better served by a conversion to Chapter 7?
4. Is one Debtor better served by converting while the other finishes the Chapter 13?
5. Should they file completely new separate Chapter 13 or Chapter 7 cases?
6. How do child support, alimony, and new debt issues impact this decision?

ETHICAL CONCERNS – INHERENT CONFLICT OF INTEREST

While all of these procedural issues must be addressed, the first issue that must be considered before proceeding is the inherent conflict that now exists. Can counsel continue representing both parties? Can counsel continue representing either party? If the debtors go elsewhere must they have separate attorneys?

The first step for any attorney in this situation is to examine the Michigan Rules of Professional Conduct.

MRPC 1.7 - Conflict of Interest: General rule

(a) A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless:

- (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and
- (2) each client consents after consultation.

(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

- (1) the lawyer reasonably believes the representation will not be adversely affected; and
- (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

An attorney's initial reaction might be that these rules do not provide a bright line indicator for what must be done in a chapter 13 context. Every chapter 13 is somewhat unique in terms of the Debtors' ability to continue when a divorce arises. What might be in the best interests of one Debtor might not be in the best interests of the other. For instance, one Debtor would be leaving the household and is not obligated on the mortgage or vehicle, or if the lions' share of the unsecured debt were one only tied to one spouse. Alternatively, it may be that a Chapter 13 proceeding is very near completion and both debtors would benefit by remaining in the proceeding. No two cases are identical and the application of the Model Rules must be applied uniquely in each setting.

Counsel may believe they have too much information about either party to allow continued representation of both Debtors. In other words, the attorney may believe their inherent knowledge of both sides of the matter put the attorney in a spot in which his or her advice benefits one debtor and harms the other. In this scenario, the attorney may have to get out of the case. If the Debtors are not agreeable and are not able to work together towards the conclusion of the bankruptcy, the attorney is not able to continue to represent both, or likely either, parties. At the very least, counsel should always obtain waivers from both parties in any scenario, even if the attorney believes it is a simple resolution that can be agreed to by both Debtors and quickly resolved.

Can counsel represent one debtor if he/she ceases representing the other?

The State Bar has issued an advisory opinion that states that a lawyer who has formerly represented a client in a joint representation, may represent the other client from that joint representation, in which that person's interests are materially adverse to the interests of the former client, provided that (a) the former client consents after consultation, or (b) the matter is not the same or substantially related to the former representation and protected information regarding the former client is not used or revealed.. Michigan State Bar, RI-248 (Dec. 20, 1995). The gist of this rule is that, even after a lawyer's representation of a client ceases, the lawyer may not, without the consent of the former client, represent another client in the same or a *substantially related* matter in which the new client's interests are *materially adverse* to those of the former client. Even if the matters are neither related nor adverse. When deciding if the clients' interests are "materially adverse" the Bar noted that lawyers represent clients, not property. The fact that

the former representation concerned the same property against which an equity interest may now be asserted, is not controlling. In situation being analyzed (like in a Chapter 13/Divorce situation), where an attorney-client relationship with the ex-spouse. There was also no doubt that in the prospective representation of the remaining ex-spouse will be materially adverse to those of the former.

The Ethics committee also described two common tests to determine if there is a "substantial relationship". These tests were first fashioned by courts, and then codified into ABA Model Rule 1.9(a), from which MRPC 1.9 was adopted. Some cases use a "transactional analysis", which holds that a conflict exists if the prior representation and the subsequent representation involved even interconnected (but not the same) events which could reveal a pattern of client conduct. This is done on the theory that relevant confidences could have been acquired by the lawyer in question. See for example: Analytica, Inc. v NDP Research, Inc., 708 F2d 1263 (CA7 1983). Other cases use a narrower "issues analysis", finding a substantial relationship only when the *issues* involved in the two cases are identical or virtually so. See for example: Lawyer Disciplinary Board v Printz, 452 SE2d 720 (W Va 1994).

Michigan has not taken a specific position as to which analysis should be used. However, it would seem highly probable that under *either* of the above described tests a Chapter joint Chapter 13/Divorce would bare "substantial relationship" nexus. My firm's practice is to get a *plain language* consent signed by both or get out of the case completely.

Can Counsel continue representing both parties?

A lawyer may assist both parties in a legal transaction if the conditions of MRPC 2.2 are met. MRPC 2.2 states:

1.

"(a) A lawyer may act as intermediary between clients if:

"(1) the lawyer consults with each client concerning the implications of the common representation, including the advantages and risks involved and the effect on the client-lawyer privileges, and obtains each client's consent to the common representation;

"(2) the lawyer reasonably believes that the matter can be resolved on terms compatible with the client's best interests, that each client will be able to make adequately informed decisions in the matter, and that there is little risk of material prejudice to the interests of any of the clients if the contemplated resolution is unsuccessful; and

"(3) the lawyer reasonably believes that the common representation can be undertaken impartially and without improper effect on other responsibilities the lawyer has to any of the clients.

"(b) While acting as intermediary, the lawyer shall consult with each client concerning the decisions to be made and the considerations relevant in making them, so that each client can make adequately informed decisions.

"(c) A lawyer shall withdraw as intermediary if any of the clients so requests, or if any of the conditions stated in paragraph (a) is no longer satisfied. Upon withdrawal, the lawyer shall not continue to represent any of the clients in the matter that was the subject of the intermediation."

The State Bar issued an informal opinion addressing representation of *both* parties that can be found at Michigan State Bar, [RI-172](#), (Sept. 17, 1993). Though this case involved dual representation in the divorce itself, the reasoning may be something we should consider in relation to bankruptcy. The Committee advised that an attorney should not continue representation of *either* spouse after it has become known that each had *made disclosure to the attorney of assets and income information*. In such circumstances to continue representation of either would lead to the appearance of having obtained vital and relevant information by a direct out of court inquisitorial process. the organization wished to represent. To be quite frank, if the divorce is not terribly acrimonious and both parties consent my firm will continue representing

both parties until one or the other (or the attorney!) becomes uncomfortable. Without hesitation we will withdraw if one party requests per MRPC 2.2 subsection c and at all times we convey information candidly to both sides. If a situation arises where we can no longer candidly share information we withdraw.

OPTION 1: KEEP THEM BOTH IN THE EXISTING 13

Once ethical concerns are addressed and assuming counsel continues representing both parties the next issue is what do we do with these debtors now? One option is to keep them in the existing Chapter 13 “as is”. This is most likely to be the choice if the parties are very near completion. Staying in the current case minimizes transactional costs (fees to convert, amend, etc.) Often the family court will address the issue of which party will pay which portion of the bankruptcy payments. This can be done while the divorce is pending, prior to its finalization, via temporary support orders. Most of the time the party remaining in the home or keeping the vehicle or with the disposable income to maintain payments will be the one to pay the plan payments. This is also likely to be the best option if the parties will benefit from a Chapter 13 “super-discharge” in ways that they would not if they were to convert to a Chapter 7 (as would be the case for instance where a successful Chapter 13 discharge would strip a junior lien or address otherwise nondischargeable unsecured debt).

OPTION 2: BIFURCATE & KEEP ONE IN AND CONVERT THE OTHER

If the Chapter 13 is relatively young and there are no significant benefits of a Chapter 13

discharge over a Chapter 7 discharge it would likely make more sense to separate the cases. To put it as bluntly as possible: why would anyone want to be tied to their ex-spouse, financially, for 36 to 60 months unless there was a overwhelmingly good reason to be! In these cases Counsel should meet with both parties, together, and discuss how they intend to proceed in the divorce for property settlement purposes and budgets.

If the Chapter 13 is a “mortgage case” (i.e. curing a mortgage arrear to retain property that was facing foreclosure) generally the party staying in the home will stay in the plan and the other will convert to a Chapter 7. This is *generally* the case, but not always. Sometimes, in lieu of spousal support a family court judge will order the spouse who is not retaining the home to maintain plan payments to keep the property safe for the spouse whom is staying in the home. It is assumed that the standard “equalization” of budgets can flow seamlessly through to the bankruptcy.

It is also important to remind clients and sometimes their divorce counsel that any debt incurred during the course of a divorce by either party is likely nondischargeable as to the other party. These would also be post-petition debts to each other. For example, assume W converts to a 7 but H dismisses. Wife discharges her obligation to pay \$20,000 unsecured debt co-signed with Husband. Husband negotiates in the divorce that Wife is to pay these debts and hold him harmless. Wife thinks she’s all set because she discharged them in her converted case. Husband thinks he’s all set because he has his hold harmless. Creditors do not feel very “all set” at all and begin collecting against Husband. He then begins arguing 11 U.S.C. 523(a)(15) and ... Well, if this comes up counsel has been given a pretty clear sign that the divorce is acrimonious enough to

perhaps consider backing out. When the risks/benefits are compared – why would you stay involved?

A good practice point would be to update all information on each debtor individually when a divorce arises. Just as discussed in the Introduction herein, treat this consult as an initial intake consultation. Discover both clients' expectations and goals. Redetermine “chapter choice” on an individual level as opposed to joint and proceed accordingly.

OPTION 3: CONVERT THEM BOTH

Recently a family in a joint Chapter 13 filed in 2008 and ready to successfully close, called me and indicated they had changed their mind and wanted to surrender the family home. Assume this was the driving factor behind a 13 chapter choice. The plan had cured all arrears on the home and maintained monthly payments such that the family would be 100% current upon discharge next month. We had already filed closing certificates and the case was nearly completed. It turns out the debtors were now divorcing and neither wanted the home. The simplest solution would be to convert them both (assuming all other factors such as budgets were non-problematic). However, if you had other reasons for favoring a Chapter 13 discharge over a Chapter 7 discharge, as discussed throughout, as long as the last plan payment had not been made, debtors could file an amended plan surrendering the property. Also if as a family these debtors initially “failed” the Means Test, (i.e. they could afford repayment of some amount), they may not do so as two separate families. It is imperative to re-evaluate *each person's* new situation independently. When two sets of household expenses are suddenly involved, the

income that used to be spread thick may suddenly be much thinner.

THE IMPACT OF CHILD & SPOUSAL SUPPORT ON THE DECISION

As discussed, support obligations can be used to equalize the affordability via bankruptcy just as they would outside of bankruptcy. Compare for instance a situation where Adam and Eve were never involved in bankruptcy. A divorce was filed and the family court judge ordered Adam to pay Eve \$900 per month to cover the house payment for ten years as rehabilitative spousal support. If the parties were in a Chapter 13 and the plan was paying \$1100 which included the on-going payment of \$900 + \$200 additional to cover administrative fees, arrears, and a dividend to general unsecured creditors, it is conceivable that perhaps the family court judge would order Adam to continue plan payments in lieu of that support payment. The same goal is met: allow Mary time to rehabilitate into the work force and assist with payments until she can do so herself.

Neither debtor is eligible for a Chapter 13 discharge unless they can certify that they are current on an domestic support obligations. Therefore any support ordered during the pendency of the case would have to be maintained current for the plan to be a success. I have had clients say to me: “that doesn’t count because I didn’t owe it when I filed so go ahead and get me my discharge now please”. Rest assured: “it counts”.

Finally it is worth noting that any support ordered will be an expense of the payor and income to the payee for budget purposes. Again, this is why we stress the need to re-evaluate

each debtor's situation carefully upon news of a separation.

THE CASE OF AN INDIVIDUALLY FILED MARRIED DEBTOR GET'S DIVORCED

In the above examples we assumed that both debtors were married spouse and that both married spouses were debtors. In a case where a married person is in his own individual case and his non-filing spouse and he divorce a unique set of issues arises. The spouse in bankruptcy has a significant change in circumstance that may impact his ability to continue with her current plan payments. He may be making much less money than was “projected” based on his whole household’s income/expenses now that he resides alone. He may have more in that he may have decreased his expenses but kept his income the same. Can he amend to lower his payments if his income decrease (assuming his payments are budget based as opposed to claims based or asset-equity based, etc)? Can he decrease his committee period?

When addressing the case of a debtor in this situation, Judge Wedoff recently allowed plan modifications as it was in “good faith” even though it decreased the unsecured dividend from 100% to less and shortened the term from 60 to 36 months. In doing so he reviewed debtor’s *current* budget. He indicated that if she did increase that budget the trustee could attempt to have her payment increased accordingly. He further opined that this debtor was no a “below the median” debtor and was eligible for a shorter term. In re Davis, 439 B.R. 863 (N.D. Ill 2010). A proposed modification is likely to be required.

In proposing a modification remember that the disposable interest tests discussed herein are not applicable to plan modification according to the Middle District of Tennessee. Something to watch! A modification must satisfy the general requirements for confirmation

found in Section 1325 and 1329. The budget is based on debtors' current (as opposed to average six month) income and expenses. However those expenses must still be reasonable. In re Crim, 2011 WL 863452 (Bankr M.D. Tenn 2011).

Discussion Point:

In which situations would it be potentially beneficial to dismiss and re-file each debtor in their own case?

Tax Refunds in Chapter 13

Submitted by

Marilyn R. Somers

In a Chapter 13 all disposable income of a debtor is required to be turned over to pay unsecured creditors pursuant to 11 U.S.C. §1325(b)(1)(B). The code clearly states that “projected disposable income” is to be included in plan payments.

The question is whether income tax refunds received by debtor (refunds obtained due to the withholding of income) are to be included in the projected disposable income. Most courts have determined that tax refunds should be included in the §1325(b)(1) “projected disposable income” calculation. See In re: Kruse, 406 B.R. 833, 837 (Bankr. N.D. Iowa 2009); In re Cleaver, 426 B.R. 390, 394-395 (Bankr. D. N.M. 2010). Even tax “refunds” attributable to earned income tax credits have been held to be income for Chapter 13 purposes. See, In re Forbish, 414 B.R. 400, 403 (Bankr. N.D. Ill. 2009) tax refund attributable to earned income tax credit is income; In re Royal, 397 B.R. 88, 101-102 (Bankr. N.D. Ill. 2008) tax refund attributable to earned income tax credit is income; In re Barbutes, 436 B.R. 518 (Bankr. M.D.Tenn 2010) debtor’s future tax refunds are considered disposable income that must be contributed to Plan Funding.

Must debtors contribute income tax refunds when the debtor’s plan does not provide a 100% dividend to unsecured creditors? The court in In re Michuad, interprets the code sections of 11 U.S.C. §1325(b)(1), 1325(b)(2), and 11 USC §101(10A), as requiring “debtors to submit their projected disposable income to fund their chapter 13 plan if the debtor does not propose a plan that will pay his or her unsecured creditors a 100% dividend.” In re Michuad, 399 B.R. 365, 370 (Bankr. D.N.H. 2008). Another Bankruptcy Judge in that district has subsequently applied the same rule. See, In re: Watson, 417 B.R. 165 (Bankr. D.N.H. 2009).

Since the majority of the courts have held that debtor’s tax refunds must be committed to the Plan, HOW MUCH of the tax refund is be paid to the trustee when the return was filed jointly with the non-filing Spouse? The proration of a joint refund appears to be a rapidly changing area of law. The issue becomes even more difficult where one spouse is the main or sole income earner. Four approaches to this issue were summarized by the Court in Hundley v. Marsh 944 N.E. 2d 127 (Mass. March 2011). The 1st approach which is the majority approach, allocates a joint tax

refund between the spouses in proportion to their respective tax withholdings. Similarly, the 2nd approach would divide a refund according to the income generated by each spouse. The 3rd approach would split the refund equally between the spouses, regardless of the source of the income or tax withholding. The 4th approach, called the separate filings rule, allocates the refund based on each spouse's hypothetical individual tax liability had the spouses filed their tax returns as married parties filing separately. A common ground among the four approaches is that property rights are determined in accordance with state law.

1st Approach – The Withholding Rule

In *In re Kleinfeldt*, 287 B.R. 291 (10th Cir BAP Wyo. 2002), the non-debtor spouse had no income and no tax withholdings. The Court found that the filing of a joint tax return does not create equal property interests for each spouse in any resulting refund. Instead, each spouse has a separate interest in any overpayment based upon their contribution to the overpaid tax. Accordingly, even though a refund is payable to both the debtor and the non-debtor spouse, the refund was entirely the debtor's property and consequently was property of the estate.

Other courts utilizing a similar approach adopted by *Kleinfeldt* include:

In re Edwards, 400 B.R. 345 (D.Conn. 2008) finding the majority approach is appropriate and attributing to the debtor only the amount of the joint tax refund that reflects the withholdings she contributed.

In re Lyall, 191 B.R. 78 (E.D. Va. 1996) the majority of courts have held tax refunds should be allocated between spouses proportionally in accordance with tax withholdings.

In re WDH Howell, 294 B.R. 613 (D.N.J. 2003) non-debtor wife does not possess an interest in tax refund where parties filed joint return and wife earned no income.

In re Rice 442 B.R. 140 (M.D. Fla 2010) the individual debtor's interest in a joint refund is the amount attributable to his contribution.

In re Palmer, 449 B.R. 621 (D.Mont. 2011) the court must first determine respective contributions to total payments made by the debtor and spouse, and then determine to

what extent each spouse's contribution to payments should be applied against joint tax liability. A very complex formula is given in the ruling.

2nd Approach – The Income Rule

This approach was utilized in *In re Verill*, 17 B.R. 652 (Md 1982). The Court found there is a presumption, absent proof to the contrary, that a formula prorating the tax return as of the date of the filing is both fair and equitable, and a further presumption that prorating a tax refund between spouses' estates based upon each spouse's annual earnings is fair and equitable. The court adopted the Trustee's allocation, based upon the bankrupt spouse earning 79.4% of the spouses' joint income, and his voluntary petition being filed on the 326th day of the year. Thus, 79.4% of 326/365 of the total income tax refund of \$1,160.23 was allocated to the estate, equaling \$822.79.

See also the recent ruling in *In re McCrory*, 2011 WL 4005455 (N.D. Ohio 2011) where an overpayment of a tax obligation results in a tax refund that derives solely from one debtor's income, debtor's spouse has no property interest in the refund even if a joint return was filed and the refund check is made jointly payable to both the husband and wife. Debtor's non-filing spouse had minimal income and had no taxes withheld from her pay. That portion of the tax refund attributable to over-withholding from Debtor's income is property of the estate and must be turned over without reduction. However, First Time Home Buyer Tax Credit is refundable credit even if the taxpayer had no income at all. Had debtor and his wife filed separate returns, the wife would have received \$4,000 of the tax credit as a refund, even though she had no income. Therefore, \$4,000 of the refund is property of the non-filing spouse and is not property of the estate. Tax credits for Making Work Pay, Earned Income and Additional Child Tax credits would be allocated proportionate to gross income of debtor and wife. Where Debtor earned 96.65% of the household income, debtor's estate included 96.65% of the credits in calculating the amount of the tax refund obligation.

Although the Income Rule is frequently noted as one of three approaches to the tax refund issue, there are few reported cases utilizing this approach. However, there was an unreported ruling in the Eastern District of Michigan in the case *In re Hall*, 09-75095, which held that 100% of the joint tax refund must be remitted to the Trustee

where the refund was generated from 100% of the debtor's Income as the non-filing spouse had no income at all.

3rd Approach – The 50/50 Rule

This approach, and increasingly more common, is known as the 50/50 refund rule and is discussed by the Court in *In re Trickett*, 391 B.R. 657 (D.Mass. 2008). The Court first applied the pro rata by days method to determine what amount is potentially property of the estate, then went on to further adjust the estate's interest based on the allocation between the debtor and the non-filing spouse. The Court noted that the question of the extent of a debtor's interest in property is one of state law.

However, *Hundley v. Marsh*, 944 N.E.2nd 127 (Mass. 2011) overruled the *Trickett* case, and discussed in detail the 4 current approaches to allocating joint refunds in bankruptcy. This Court held that the proper method to allocate a joint tax refund in a bankruptcy is to use the 4th approach, called the "separate filings rule."

Courts seem to hold that the ownership analysis should be made on a case-by-case basis. In the matter of *In re Garbett*, 410 B.R. 80 (E.D. Tenn. 2009), a joint bankruptcy filing, the Court noted the primary difference between those courts which adopted the withholding approach and those adopting the 50/50 Refund Rule is the applicable underlying state law. Looking to Tennessee law with respect to marital property, the Court imposed the rebuttable presumption that each spouse had an equal interest in the tax refund, and allow each debtor to claim an exemption in 50% of the refund. In *Garbett*, the joint tax return included combined incomes, earned income credit, child tax credit, joint losses, joint capital gains, and taxes on a joint IRA distribution. Given this level of intermingling of the debtors' incomes and deductions, the trustee had not successfully rebutted the presumption of joint ownership.

In *In re Aldrich*, 250 B.R. 907 (W.D. Tenn. 2000), the court held that the non-filing spouse, a homemaker who did not produce income but made a substantial contribution to the family, may be entitled to have a property interest in a joint tax refund check, notwithstanding that all the taxable income was generated by the debtor. The court directed that one-half of the tax refund check would be allocated to the debtor-husband's bankruptcy estate for administration and distribution to creditors after his

allowed exemptions, and the other half would be allocated to the non-filing spouse, stating that the “totality of the particular facts and circumstances existing here create an equal ownership in the joint refund check.”

The underpinnings of the 50/50 refund rule were explained by the Court in *In re Innis*, 331 B.R. 784 (Bank. C.D. Ill. 2005) as well as the practical reasons supporting its adoption. The concept of marriage as a shared partnership should be included within the court’s “decisional framework”. Where right to an income tax refund accrues during the parties’ marriages, the refund is marital property without regard to whose income generated the refund. Furthermore, the court gave consideration to the fact that joint liability is imposed on the spouses for any tax deficiency that results from a jointly filed tax return, so it follows that there should be a presumption of equal ownership of a tax refund. “If a debtor’s spouse can suffer the burdens of filing a joint return, he or she should get the attendant benefits as well.” The *Innis* court adopted the 50/50 rule but disagreed with the rebuttable presumption established by the courts in *Barrow* and *Aldrich*, in which courts may look to the financial histories and the particular circumstances of the spouses. Instead, the *Innis* court opined that ownership of a tax refund by spouses is 50/50, and there need be no inquiry beyond the fact that the parties voluntarily elected to file a joint return. The only evidence which could be introduced to rebut the 50/50 presumption would be a pre-existing domestic relations court order, or an enforceable, written, prepetition contract between the spouses designating a particular degree of ownership.

In a New York case involving joint debtors, the Court concluded that 50/50 ownership was appropriate. In *In re Glenn*, 430 B.R. 56 (N.D.N.Y. 2010), the court adopted the reasoning of *Trickett*, *Garbett* and *Innis* as well as the rationale set forth by the court in *Innis* in limiting the rebuttal inquiry to domestic relations court orders or enforceable contracts.

4th Approach – The Separate Filings Rule

This approach allocates the refund based on each spouse’s hypothetical individual tax liability had the spouses filed their returns as married parties filing separately. See *Hundley v. Marsh*, 944 N.E. 2d. (Mass. 2011) which adopted this rule.

The Court stated that to determine the proper allocation first each spouse's contribution to total payments is determined. Second, each spouse's share of the joint tax liability is calculated based on the ratio of that spouse's hypothetical liability to the sum of both spouses' hypothetical liability. The court believed that this approach is both consistent with the principles of proportionality in state laws and with allocation methods already employed by the IRS. See also *In re Crowson*, 431 B.R. 484 (10th Cir BAP Wyo. 2010) where the Court gave deference to the "IRS rulings" to determine the allocation of overpayments between taxpayers who file joint returns. The formula developed by that Court was quite complicated.

Is there a Current Monthly Income rule emerging? Courts may soon look to the definition of current monthly income to determine how much of the joint tax return must be remitted to the trustee. Disposable Income under §1325(b) starts with a calculation of current monthly income. If the debtor's schedule I and J are the combined incomes and expenses of the debtor and non-filing spouse, and the non-filing spouse contributes all of his/her income to the debtor, then 100% of the joint tax refund must be contributed and used to calculate CMI. Therefore, the only way the refund could be excused from CMI is by the non-filing spouse demonstrating that some use of the tax refund is used for his/her own separate expenses.