Delving into the Mysteries of Chapter 13: Unsettled and Emerging Issues Involving §§ 1322 and 1325

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Student Loans and Chapter 13

"Student loans has now surpassed credit cards as the largest source of unsecured consumer debt." *Annual Report of The CFPB Student Loan Ombudsman*, p.4, Consumer Financial Protection Bureau, citing Consumer Financial Protection Bureau and Department of Education, Report to Congress on Private Student Loans (July 2012). "Outstanding student loan debt is now over $1 trillion, which private student loans accounting for more than $150 billion. There are at least $8 billion of private student loans in default, representing more than 850,000 individual loans." *Id.* at 2. "In its most recent report to Congress, the Treasury Department's Office of Financial Research acknowledged that conditions in the student loan market could 'significantly depress demand for mortgage credit and dampen construction.' With 40 percent of households headed by an individual having student loan debt, the economy may already be feeling some of the effects." *Annual Report*, p.18, *citing Survey of Consumer Finance* (2010), Pew Research Center.

Accounts changing hands, unexpected forbearance fees, inadequate assistance from servicing staff and an inability to refinance were all identified as factors which could lead a borrower to default and perhaps, bankruptcy. The Report stated, "By far, the most common concern communicated by borrowers is the difficulty they have negotiating a repayment plan with their servicer in periods of unemployment, underemployment or financial hardship." *Report* at 2.

"Most private student loans do not have the same borrower protections of federal loans, such as income-based repayment plans, discharges upon death or military deferments." *Report: Private Student Loan Borrowers Face Roadblocks to Repayment*, CFPB, p.1, October 16, 2012. "Federal loans made up of 92% of all student loan accounts and 86% of overall balances…From 2007 to 2012, federal student loan delinquencies rose 27%, which private loan delinquencies actually dropped 2% in that same timeframe…It's important to highlight that both federal and private student loan delinquency rates are higher than most other credit products such as mortgages, home equity lines of credit, credit cards and auto loans." TransUnion Study Finds More Than Half of Student Loans in Deferment; High Unemployment Rates Put Loans at Risk, newsroom.transunion.com/press-releases.

Student loans as long term debt and cured and maintained in the Plan

11 U.S.C. § 1322 - Contents of plan
(b) Subject to subsections (a) and (c) of this section, the plan may-
(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;…
(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due …

(10) Subject to subsections (a) and (c) of this section, the plan may ... provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are nondischargeable under section 1328(a), except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims.

Cases holding that a debtor may use 11 U.S.C.§1322(b)(5) to maintain payments on long term student loan debt as long as the test for unfair discrimination under §1322 are met:

- *In re Kubeczko*, 2012 WL 2685115, 2012 Bankr. LEXIS 3081 (Bankr. D. Colo. July 6, 2012).
  "A court must respect the legislative will and the threshold for finding that different sections of a statute conflict with one another is a high one. So long as a debtor can fully comply with both subsections—even if that compliance is burdensome—a court should rarely find a conflict." *Id*. at *4. "Section 1322(b)(10) makes it extremely difficult to provide a treatment for a nondischargeable unsecured claim that is any different from other unsecured claims. The Court cannot find it unreasonable or absurd for Congress to adopt a provision that, in the vast majority of cases, requires parity of treatment between nondischargeable unsecured debts and dischargeable unsecured debts." *Id.* at *7.

- *In re Edmonds*, 444 B.R. 898 (E.D.Wisc. 2010).
  "Unfair discrimination must be evaluated on a case-by-case basis. *See In re Crawford,* 324 F.3d 539 (7th Cir.2003). Courts often look to the following four factors in determining whether separate class treatment is fair:
  (1) whether the discrimination has a reasonable basis,
  (2) whether the debtor can carry out a plan without such discrimination,
  (3) whether such classification is proposed in good faith, and
  (4) whether the degree of discrimination is related to the basis or rationale for the discrimination." *Id*. at 901.
  "There is nothing in the case at bar which establishes that the debtors are unable to formulate a plan that provides for equal treatment of unsecured creditors. Student loan debts should not be paid at the expense of the other general unsecured creditors." Also, "Section 132(b)(10) is very clear in its wording. The debtors' proposed plan does not pay all creditors in full. Accordingly, post-petition interest may not be paid on the debtors' student loan debt." *Id*. at 902.

- *In re Zeigafuse*, 2012 WL 1155680 (Bankr. Wyo. 2012).
  The Court listed the various tests employed for analyzing unfair discrimination, taken from *In re Mason*, 300 B.R. 379 (Bankr.D.Kan. 2003).
  (1) the "four step test." [See above, *Edmonds*, above],
  (2) the "balancing test" which "involves balancing the relative benefits and detriments allocated to the debtor and creditors from the proposed discrimination….The comparisons of the benefits and detriments must be made in light of the legitimate interests and expectations of the parties-in-interest in the Chapter 13 proceeding,"
  (3) the "baseline test." *See In re Bentley,* 266 B.R 229 (1st Cir. BAP 2001). "In the "baseline test," the court reviews the four guiding principles of chapter 13 for what is the norm, or the

"baseline" from which departures can be evaluated for fairness, including: (i) equality of distribution; (ii) nonpriority of student loans; (iii) mandatory vs. optional contributions; and, (iv) the debtor's fresh start."
(4) the "Debtor's Interest test" which focuses on whether the discrimination furthered a legitimate interest of the debtor. *Id* at *4.
The Court "agree[d] with the Kansas Court's determination that the baseline test is objective, fairly easy to implement and prevents courts from legislating priorities….The Debtors have failed to meet their burden that the proposed payment to their unsecured student loan claim does not unfairly discriminate under the baseline test." *Id* at *6.

Cases holding that there is no unfair discrimination requirement for payments on long term debt:

"The courts holding the minority view find that § 1322(b)(5) is specific and clear in its language and that the statutory construction principle that dictates that the specific language trumps the general terms supports the contention that (b)(5) trumps the more general terms of (b)(1)." I*n re Zeigafuse*, 2012 WL 1155680, *3 (Bankr. Wyo. 2102).

- *In re Truss*, 404 B.R. 329 (Bankr. E.D.Wisc. 2009).
  "Congress has authorized separate treatment for creditors having claims when there is a co-debtor on a consumer debt under section 1322(b)(1). This special treatment is authorized in the same sentence in the subsection that otherwise prohibits unfair discrimination, so it is clear that no fairness analysis is needed...Congress determined that long term debt, both secured and unsecured, may be treated differently from other creditors that are of the same priority… If the plan provides for the cure of a default and maintenance of payments on a debt, the terms of which extend beyond the term of the plan, it is not for the court to determine whether this is fair to the other creditors or not." *Id.* at 334.

- *In re Hanson*, 310 B.R. 131 (Bankr. E.D.Wisc. 2004).
  Section "1322(b)(5) is specific and clear in its language. [Section (b)(1)] is more general in that it refers to all classes of unsecured claims, not to claims having specific characteristics. "[W]hen we are forced to choose between specific statutory provisions and a general ... [one], [a court will] err on the side of specific provisions in the belief that they reflect congressional intent more clearly."" *Id*. at 134, citing *Matter of Lifschultz Fast Freight Corp.,* 63 F.3d 621 (7th Cir. 1995). Although in this case, the plan was not confirmed because the plan proposed the debtors to make payments on the student loans less than the regular payments. Therefore, the plan did not propose to "maintain" the regular payments to the student loan creditor underß1322(b)(1). *Id*. at 135.

- *In re Cox*, 186 B.R. 744 (Bankr. N.D.Fla. 1995).
  While non-disability of the student loans is not a basis for discrimination in favor of student loans, the long term debt provisions are. "Section 1322(b)(5) would be rendered largely ineffective with respect to unsecured debt if student loans could not be treated thereunder solely because the creditor would receive better treatment than other nonpriority unsecured creditors." *Id*. at 746.

Student loans as special circumstance deductions:

Cases holding that the student loans are not allowed as a special circumstance:

- *In re Vaccariello*, 375 B.R. 809 (Bankr. N.D.Ohio 2007)
  "This Court is not persuaded that merely because a debt is not dischargeable it can or should constitute a special circumstance. If Congress had wanted to make any or all of the exceptions to discharge a special circumstance, it could have chosen to do so. It did not. This Court does not find any basis in the Bankruptcy Code or case law to support a *per se* rule that having no reasonable alternative to paying a nondischargeable debt constitutes special circumstances." *Id*. at 815.

- *In re Carrillo*, 421 B.R. 540 (Bankr. D.Ariz 2009)
  "In the specific context of student loans, some courts have concluded that it is not the obligation to repay a loan itself that qualifies as a "special circumstance." Instead, the circumstances that led to incurring the debt must be special to justify the inclusion of the additional expense in the means test. These courts focus on the reasons the debtor incurred the debt, noting that there is rarely anything special about the incurrence of student loans, which have become ubiquitous. *Id*. at 543-4, citing *Vaccariello* at 816.

Cases holding that student loans are allowed as a special circumstance:

- *In re Martin*, 371 B.R. 347 (Bankr. C.D.Ill. 2007)
  "The Debtors have acknowledged the non-dischargeability of their student loan debt and they have no reasonable alternative other than to pay the debt. Chapter 13 is not a reasonable alternative. A Chapter 13 filing would result in only partial payment of the student loan during the term of the Chapter 13 case and, most likely, a substantial balance would still be due upon completion of the case. Student loan debt is non-dischargeable and, as such, must be paid. The existence of this debt is a distinct, particular, additional, and extra factor which this Court should consider in determining whether abuse exists here. This Court finds that the Debtors' obligation to pay their student loan debt is a 'special circumstance.'" *Id*. at 356.

- *In re Delbecq*, 368 B.R. 754 (Bankr. S.D.Ind. 2007)
  "The Court concludes that because of her student loan, Debtor does not have a meaningful ability to repay her debts either outside of bankruptcy or under Chapter 13. and that she has rebutted section 707(b)(2 's presumption of abuse by demonstrating "special circumstances." While there are alternatives to making her student loan payment, the Court cannot conclude that such alternatives are *reasonable.* Furthermore, there is no evidence to suggest that Debtor's petition was filed in bad faith or that abuse is apparent from the totality of the circumstances." *Id.* at 761-762.

A middle ground case using a subjective test:

- *In re Pageau*, 383 B.R. 221 (Bankr. D.N.H. 2008)

"It is not the obligation to repay a loan itself that qualifies such an expense as a special circumstance under section 707(b)(2)(B)(i), but rather it is the circumstances that lead to incurring a loan that must be special and justify the inclusion of this additional expense item

in the means test, as long as the debtor has no reasonable alternative but to make monthly payments on such loan. *Eisen*, 370 B.R. at 773. For that reason, the Court shall focus on the reasons the Debtor borrowed money for her education and incurred the Student Loan debt." *Id*. at 228. "Educational loans incurred in pursuit of education and training that is necessitated by permanent injury, disability or an employer closing might constitute special circumstances because such events are outside the control of a debtor…Here, the Debtor provided no evidence as to any special circumstances that caused her to borrow money to fund her education. Rather, the record before the Court supports a finding that the Debtor incurred the Student Loan in the ordinary course of acquiring her education and without any special circumstances. *Id*.

A case looking at both the special circumstance deduction and maintaining long term debt:

- *In re Johnson*, 446 B.R. 921 (Bankr. E.D.Wisc. 2011)
  While the debtor could not deduct her student loan payments as a special circumstance, the debtor could separately classify her long term student loan debt without unfair discrimination based on section 1322(b)(5).

Social Security in Bankruptcy

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Prior to 2005, the role of Social Security income in bankruptcy appeared fairly uncontroversial. If a Debtor received Social Security income, the Bankruptcy Code treated it as such. A Debtor was required to disclose Social Security income; and Courts considered Social Security income in determining whether a Chapter 7 case was "substantially abusive" under Section 707, or in determining "projected disposable income" in Chapter 13.

In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, generally referred to as BAPCPA. Congress inserted, for the first time, a provision that attempts to remove an entire class of income from the bankruptcy process:

> The term "current monthly income" –
>
> (A) means the average monthly income from all sources that the Debtor receives … Without regard to whether such income is taxable income ….
>
> (B) includes any amount paid by any entity other than the Debtor … on a regular basis for the household expenses of the Debtor or the Debtor's dependents … but excludes benefits received under the Social Security Act.

11 USC §101(10A).

This exclusion of "benefits received under the Social Security Act" raises a number of questions. Exactly what is excluded as a "benefit" under the Social Security Act? Does this "exclusion" impact the determination of "presumptive abuse" under Section 707(b)(2)? The determination of "abuse" based on the totality of the circumstances under Section 707(b)(3)? The calculation of "projected disposable income" under Section 1325(b)?

Are Social Security Benefits Paid to the Debtor "Excluded"?

The courts that have addressed issues regarding Social Security benefits have not reached consistent conclusions on many of the issues, as will be discussed below. However, all of the courts begin with the presumption that Social Security benefits received by a Debtor are *per se* excluded from the calculation of "current monthly income". *See, e.g., Anderson v. Cranmer,*

2012 WL 5235365 (10th Cir. 2012)(holding, without discussion, that Social Security benefits received by Debtor are excluded from calculation of "projected disposable income"). However, a close reading of Section 101(10A) does not support this holding. The first subsection of Section 101(10A) defines "current monthly income" as all income received by the Debtor from any source whatsoever, without regard to whether the income is taxable. The first subsection of Section 101(10A) arguably sweeps in any Social Security income received by the Debtor during the relevant six-month period. Section 101(10A)(A) does not contain any exclusion for Social Security benefits.

Where, then, do courts find the Social Security exclusion? That exclusion is found only in Section 101(10A)(B) which, based on the introductory clause of that subsection, includes only amounts paid by any entity other than the Debtor for the Debtor's household expenses. Given the definition of income in Section 101(10A)(A) includes any income received by the Debtor, and with a view toward the principle of statutory interpretation that statutes should be construed together in such a way as to neither conflict nor render one portion unnecessary, the provision in Section 101(10A)(B) must apply only to amounts received by the Debtor from third parties. If the reference in Section 101(10A)(B) to "any amount paid by any entity … on a regular basis for the household expenses of the Debtor" is interpreted to include money paid directly to the Debtor, then Section 101(10A)(A) becomes superfluous. Congress enacted two separate subsections of Section 101(10A). Presumably, Congress intended those two Sections to mean two different things – Section 101(10A)(A) addressing "income" received by the Debtor and Section 101(10A)(B) addressing income received by third parties and then regularly paid for Debtor's household expenses.

The conclusion that Section 101(10A) does not exclude Debtor's Social Security Income is further supported by the principal of statutory construction that where Congress included a provision in one section or subsection of the Code, but did not include that provision in a second section or subsection, the presumption is that Congress intended that provision apply only where included. After all, if Congress had intended to put a provision in a second Code section, it certainly could have done so and certainly knew how to do so. The omission of the provision from the second section is not considered an error, but is interpreted as Congress' intentional omission of that provision. Courts will not lightly "impute" the provision to the section from which that provision was omitted.

In enacting Section 101(10A), Congress chose to include Social Security income only in Section 101(10A)(B). Presumably, Congress intentionally chose not to include this reference in Section 101(10A)(A) which deals with the Debtor's income. Had Congress intended to exclude Social Security income when received directly by the Debtor, Congress knew how to do so, as evidenced by the reference in Section 101(10A)(B). BAPCPA in general, and Section 101(10A) in particular, were discussed, debated and analyzed extensively during the lengthy legislative process. Congress' exclusion of Social Security income only in Section 101(10)(B) could not be considered accidental or an "oversight".

Including Social Security received by the Debtor in calculating CMI is also more consistent with the plain language of Section 101(10A). Subsection 101(10A)(A) addresses money received by the Debtor. Subsection 101(10A)(B) addresses "any amount paid by an entity other than the Debtor … for the household expenses of the Debtor or the Debtor's dependents …." Subsection 101(10A)(B), by its terms, is *limited* to those circumstances where a third party pays expenses of the Debtor. Subsection 101(10A)(B) *does not* include money paid

by those third parties *to the Debtor* who in turn uses that money to pay the Debtor's expenses. Had Congress intended to include in Subsection 101(10A)(B) money paid *to* the Debtor, Congress would not have used the phrase "paid *by* any entity … for the household expenses of the Debtor". Congress would simply have said "any money paid to the Debtor". There can be no doubt that the rather strained construction of Section 101(10A)(B) incorporates only payments made by third parties for those expenses, not money paid to the Debtor directly.

Where, then, does Section 101(10A) account for money paid to the Debtor from sources such as child support, alimony, gifts, lottery winnings, and other "non-wage" sources? Section 101(10A)(A) addresses those sources and all other sources of money received by the Debtor, sweeping in not only money paid to the Debtor from employment, but *all* money received by the Debtor from *all* sources whatsoever. Social Security is one of those sources from which the Debtor receives money and so is swept into the calculation of CMI under Subsection 101(10A)(A). Unless Social Security starts paying a Debtor's household expenses directly, rather than sending monthly income to the Debtor to spend as the Debtor sees fit, those Social Security payments are free and clear of the exception for Social Security found solely in Subsection 101(10A)(B).

Courts that exclude Social Security income from calculation of Current Monthly Income have relied on a perception that Section 101(10A) included a blanket exemption for Social Security income from that calculation. A closer reading of Section 101(10A) indicates that Social Security income there is no basis to exclude Social Security income received by the Debtor from the calculation of CMI.

Assuming Social Security Income Received by the Debtor is Excluded, How Does That Exclusion Impact Bankruptcy Cases Under BAPCPA?

The inclusion or exclusion of Social Security income primarily impacts four subsections of the Bankruptcy Code –dismissal for "presumed abuse" under Section 707(b)(2); dismissal for "abuse" under Section 707(b)(3); calculation of "applicable commitment period" under Section 1325(b)(4); and the calculation of disposable income and projected disposable income under Sections 1325(b)(2) and (3).

a. "Presumed Abuse" – Section 707(b)(2)

Of all the issues involving Social Security income in the post-BAPCPA era, this is the least complex. The analysis of "presumed abuse" begins with the calculation of Current Monthly Income. If Social Security income is excluded in calculating Current Monthly Income, then whether the Debtor or anyone else receives Social Security will have no effect on whether the Debtor is presumptively abusive.

The cases are not so clear on whether Social Security income received by third parties and used on a regular basis to pay household expenses of the Debtor on a regular basis. Although as posited above, this would appear to be the one instance where Social Security income *should be* disregarded in calculating CMI, the Courts have split on the issue based and on entirely different grounds.

Cases holding that Social Security received by a third party is included in calculation of CMI include:

> *In re Olguin,* 429 BR 346 (Bankr. D. Colo. 2010) – Section 101(10A) excludes social security benefits received by Debtor from calculation of CMI, but does not exclude social security benefits received by non-Debtor and regularly contributed to household expenses. Debtor's grandparents resided with Debtor. Grandparents received social security and gave that to the Debtor to cover household expenses. Debtor must include the social security received by grandparents and contributed to household expenses in determining CMI.

Cases holding that Social Security received by a third party is not included where the recipient uses that income on a regular basis to pay household expenses of the Debtor include:

> *Anderson v. Cranmer,* 2012 WL 5235365 (10th Cir. 2012) – Social Security of Debtor and non-filing spouse are excluded from calculation of projected disposable income and do not need to be included in calculating plan payment. Exclusion of SSI from calculation of PDI was not lack of good faith that prevents confirmation of the plan.
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> *In re Miller,* 2011 WL 95335 (Bankr. D.S.C. 2011) – Section 101(10A) excludes all social security benefits, regardless of recipient and regardless of whether contributed to Debtor's household expenses. Debtor's non-filing husband received Social Security which he contributed in full each month for payment of household expenses. Debtor also received Social Security. Debtor not required to include either her social security or that of her non-filing spouse in calculating Current Monthly Income or disposable income in Chapter 13.
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> *In re Wilson,* 397 BR 299 (Bankr. M.D.N.C. 2008) – Social security benefits paid to non-filing spouse are not included in Debtor's calculation of CMI.

Notwithstanding this relatively limited split of authority on the issue of Social Security income received by a third party, there has been virtually no discussion, and no split of authority on whether a Debtor can be found to be "presumptively abusive" under Section 707(b) based on Social Security income.

b. "Abuse" – Section 707(b)(3)

Although Congress was "kind enough" to add the concept of "presumptive abuse" to the Code, Congress also carried forward the concept of "abuse" formerly found in Section 707(b)(2) (then known as "substantial abuse") in Section 707(b)(3).

> (3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in paragraph (2)(A)(i) does not arise or is rebutted, the court shall consider--
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> (A) whether the Debtor filed the petition in bad faith; or

> (B) the totality of the circumstances (including whether the Debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the Debtor) of the Debtor's financial situation demonstrates abuse.

To determine whether a Chapter 7 case is abusive under the "totality of the circumstances, courts consider entirety of Debtor's financial condition. Although an ability to repay debts is an important factor, it is not the only factor. In *In re Modiri,* 474 B.R. 511 (Bankr. E.D. Mi. 2012), the Court reviewed the totality of circumstances to determine if Debtor's financial situation indicates abuse. The Court first noted that it is an abuse of Chapter 7 for a Debtor to seek a discharge of debts that the Debtor can pay. However, ability to repay debts without more does not rise to the level of abuse. The Court must also consider the Debtor's overall financial situation including income, expenses, assets and liabilities. The Court determined that the Debtor's filing was abusive where Debtor had the ability to pay creditors and evidence indicated that Debtor had made no effort to reduce his lifestyle or cost of living, but instead wanted to maintain an substantial lifestyle at the expense of creditors. After incurring debts, Debtor moved to California and rented apartment on beach facing Pacific Ocean for $3,000 per month, which was a luxury at a cost far in excess of reasonable. Although the IRS standards did not control under Section 707(b)(3), the Court noted that IRS local standards for California county where Debtor resided had housing and utility expense of $1,999.00. Using that would create extra $1,000 in disposable income. Debtor's transportation expense of more than $1,000 per month was also unreasonable, and far exceeded the IRS guidelines for transportation expenses. Debtor chose the most expensive means of obtaining transportation – short term car rentals and purchasing insurance through the rental company. The Court concluded that reducing just these two unnecessary expenses would free up $1200 per month

which, over 60 month plan term, would produce significant dividend on $81,000 of scheduled unsecured debt.

The Court also found a Debtor's Chapter 7 case to be abusive where Debtor's Schedules I and J showed $540 per month available for creditors, coupled with the Debtor's retention of a boat on which Debtor was making payments; maintenance expenses for a surrendered condominium unit; and payments on back taxes that would end in approximately 18 months, creating additional cash flow that could be used to pay creditors. Although there was no indication of bad faith pre-petition conduct, the Debtor's ability to pay creditors coupled with Debtor's failure to make any real effort to reduce expenses or change his lifestyle indicated that the filing was "abusive" under Section 707(b)(3).

There have been very few cases to consider whether Section 707(b)(3) allows, or requires, the Court to consider Social Security income in determining whether a Chapter 7 petition is "abusive", and those that have addressed the issue have reached a determination without reaching the specific issue at hand. For example, in *In re Suttice,* 4878 BR 245 (Bankr. C.D. Ca. 2013), the United States Trustee sought dismissal under Section 707(b)(3) because the Debtors' combined Social Security income would have permitted the Debtors to repay creditors. The Court concluded that it did not need to reach the issue presented. Instead, looking at the totality of circumstances, the Court concluded that even if the Social Security income was considered, the totality of the circumstances did not support a finding of abuse where the Debtors were quite elderly and in poor and rapidly failing health and had fixed income, much of which was used and would continue to be used to pay for medical and related expenses. If Debtors were required to use Social Security income to pay creditors, Debtors would be relegated to a

"shut in" life for their remaining years. This, the Court concluded, did not rise to the level of abuse.

One Court has squarely addressed the issue of Social Security under Section 707(b)(3) in *In re Suttice,* 2013 WL 100199 (Bankr. C.D. Ca. 2013). In *Suttice,* the Court drew inspiration from the Courts that have concluded that a Chapter 13 Debtor cannot be forced to contribute Social Security income to the Chapter 13 plan to conclude that the Court should not take into account Social Security income in determining abuse under Section 707(b0(3). Based on Debtors' Schedules I and J, Debtors received combined Social Security income of $1,072.90, plus pension and retirement income, veteran benefits, and family contributions; and after deducting Schedule J expenses, Debtors has $900 per month in available income. The Court concluded that it was appropriate to deduct the Social Security income in determining whether Debtors had any ability to pay creditors. Once the Social Security income was deducted, the Debtors no longer had available income and, in fact, had a deficit in available income. Thus, even though the Debtors could pay well over $54,000 during a 60 month Chapter 13 plan, the Court denied the United States Trustee's Motion to Dismiss, holding that conversion of the case to Chapter 13 would be futile as the Debtors in Chapter 13 would not have any disposable income from which to make plan payments, once the Social Security income was excluded.

c. Applicable Commitment Period in Chapter 13

One of the more interesting "additions" in BAPCPA is the concept of "applicable commitment period". Under the pre-BAPCPA Code, Debtors were generally required to have a plan length of no less than 36 months; and could extend beyond 36 months for "cause" but in any event not longer than 60 months. Under BAPCPA, a Debtor and Debtor's spouse who have Current Monthly Income, multiplied by 12, that is less than the applicable median family income

has an Applicable Commitment Period of 36 months; while the Debtor and spouse with Current Monthly Income multiplied by 12 that exceeds the applicable median family income as an Applicable Commitment Period of 60 months. *See, e.g., Danielson v. Flores,* 2012 WL 3803936 (9th Cir. 2012) (Debtor with CMI in excess of applicable median income has an applicable commitment period of 5 years even where "projected disposable income" calculated under Section 1325(b)(3) produces a negative amount).

Unfortunately, as explained above, Courts have incorrectly assumed that Social Security income is not included in calculating CMI. For example, in *Baud v. Carroll,* 2011 WL 338001 (6th Cir. 2011), the Court correctly noted that Section 1325(b) ties "applicable commitment period" to Current Monthly Income and not calculation of "disposable income". Debtor who has Annualized Current Monthly Income in excess of applicable median income has an Applicable Commitment Period of 60 months regardless of whether calculated "disposable income" is positive, zero or negative.

Although the issue of Social Security income was not directly before it (the Debtors had voluntarily included Social Security income in Schedule I and in the proposed Chapter 13 Plan payment), the Sixth Circuit stated without explanation that just because a Debtor included Social Security income on Schedule I did not require that same income to be included on Form B22C for purposes of calculating CMI.

The Sixth Circuit in *Baud* cited as support for the proposition that Social Security was not included in the calculation Current Monthly Income the First Circuit BAP's holding in *Kibbe v. Sumski,* 361 BR 302 (1st Cir. BAP 2007). The issue in *Kibbe* did not involve Social Security in any way. The issue in *Kibbe* was whether a Court could depart from the calculation of CMI in determining "projected disposable income" where the Debtor obtained higher paying

employment immediately prior to filing bankruptcy. The Debtor in *Kibbe* did not receive, and never received, Social Security income. The Court in *Kibbe* makes only two passing references to Social Security income, one in quoting Section 101(10A) and one in citing Section 101(10A)(B) as an example of items that may be excluded from CMI. The Court did not make any critical analysis of Section 101(10A), nor was it required to do so on the facts of that case. The Court's passing references to Section 101(10A) do not amount to any authority for the proposition for which it was cited in *Baud* - that Social Security income is entitled to some blanket exception for determining CMI.

d. Good Faith and Social Security Income in Chapter 13

The primary area of litigation regarding Social Security income in Chapter 13 has been the concept of "good faith" – that a Debtor has a duty to commit all of Debtor's disposable income for funding of the plan, to ensure that Debtors "pay what they can pay" and to produce the best possible dividend to creditors.

Some courts, and particularly the earlier bankruptcy court decisions, concluded that good faith requires that a Debtor disclose on Schedule I the amount of social security received and that a Debtor include that income in determining the plan payment as a matter of good faith:

> *Mains v. Foley,* 2011 WL 2160890 (Bankr. W.D. Mi. 2011) – Debtor who receives Social Security Income is required to include that income in determining projected disposable income under Section1325(b). Exclusion of Social Security from calculation of CMI does not remove that income from consideration of Debtor's good faith and must be considered with the rest of Debtor's circumstances to determine if Debtor sincerely intends to repay creditors.
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> *In re Westing,* 2010 WL 2774829 (Bankr. D. Idaho 2010) - Above-median-income Debtor's failure to account for Social Security income on Schedule I resulted in a lack of good faith. Current Monthly Income exclusion of Social Security in calculating "projected disposable income" under Section 1325(b), does not preclude the Court's consideration of that income when evaluating a plan for good faith. Debtor's plan proposed a monthly payment of only $165 and would produce dividend of 1.9% while Debtor had disposable income of more than $2,300 if the Social Security was included.

In re Thomas, 2010 WL 5630827 (Bankr. N.D. Ga. 2010) – Exclusion of Social Security income from Current Monthly Income does not provide a basis for a Debtor to fail to disclose that income on Schedule I or monthly disposable income on Schedule J. Debtor's proposed retention of Social Security income would allow Debtor to retain a substantial surplus at the expense of creditors, in violation of Section 1325(a)(3).

In re Herrmann, 2011 WL 576753 (Bankr. D.S.C. 2011) - Above-median-income Debtor's failure to list his ongoing receipt of Social Security income in Schedule I resulted in Debtor's plan lacking good faith. Debtor contended that social security income is not subject in any way to the bankruptcy case, does not have to be disclosed, and can be applied or used by the Debtor for any purpose, including savings or luxury items, without implication of the good faith or confirmation standards. Court stated that Section 521(a)(1)(B) requires a Debtor to file a schedule of current income without limitation or exclusion. Although Section 101(10A) excludes Social Security income for purposes of calculating "disposable income", no exclusion for social security income is provided in § 521(a)(1)(B). Means test does not override Section 521(a)(1)(B) requirement to report current income and current expenses. Debtor's failure to include Social Security income on Schedule I would result in the spouse assuming a disproportionate share of the household expenses, by allowing one spouse to effectively shield income from the payment of those expenses and forcing the other spouse to absorb those expenses. Section 521 and good faith require the disclosure of all income, including Social Security income, on Schedule I.

Other courts rejected this approach, holding that good faith does not require inclusion of Social Security income in determining the plan payment:

In re Vandenbosch, 459 BR 140 (M.D. Fl. 2011) – Debtor cannot be required to include social security income on Schedule I or to include that in determining whether plan payment constitutes all disposable income. BAPCPA excludes social security from calculation. Because social security benefits are not a component of projected disposable income, a plan cannot be rejected for failure to include such benefits as projected disposable income. A necessary corollary is that a finding of bad faith may not be based upon such a failure.

In re Welsh, 440 BR 836 (Bankr. D. Montana 2010) - Congress' express exclusion of Social Security income from the calculation of Current Monthly Income, buttressed by 42 USC Section 407 which prohibits subjecting Social Security income to the operation of any bankruptcy or insolvency law, acted as an absolute prohibition against compelling a Debtor to include Social Security income in either the calculation of CMI or in calculating income on Schedule I. Section 101(10A)(B) and 42 U.S.C. § 407 are two separate federal statutes, each more specific than § 1325(a)(3) with respect to SSI benefits. Section 1325(a)(3) does not include reference § 407 which § 407(b) requires in order to limit or otherwise modify § 407(a)'s prohibition against the operation of any

> bankruptcy law against SSI. Trustee's good faith objection on the basis of SSI cannot be sustained without running afoul of 42 U.S.C. § 407(a). Good faith under Section 1325(a)(3) does not compel a Debtor to include Social Security income on Schedule I.

At least two courts concluded that while Social Security is not included in determining CMI, it did not reach the issue of good faith of a Debtor who chose not to include Social Security income in determining the plan payment:

> *Baud v. Carroll,* 2011 WL 338001 (6th Cir. 2011) - Social Security income does not have any role in calculating "disposable income" or "projected disposable income" in Chapter 13. However, Court did not determine whether Social Security income had some other role in Chapter 13, such as in calculating Schedule I or in determining "monthly disposable income" on Schedule J.
>
> *In re Tobias,* Case No. 11-40453 (Bankr. E.D. Mi. 2011) – Debtor's social security income is excluded in determining disposable income and projected disposable income pursuant to Section 101(10A). Debtor not required including Social Security Income on B22C. Debtor should list Social Security Income on Schedule I but is allowed to then deduct that income on Schedule J. Court did not address issue of whether deduction of Social Security Benefits constituted lack of good faith.

In the past year, the Circuit Courts have begun to weigh in on the issue of good faith when it comes to Social Security income, and the decisions have demonstrated a remarkable level of uniformity.[1]

In *Anderson v. Cranmer,* 2012 WL 5235365 (10th Cir. 2012), in what appears to be the first Circuit Court decision on the issue of good faith, the Court, *citing Baud*, stated that Social Security of Debtor and non-filing spouse are excluded from calculation of projected disposable income.[2] From this premise, the Court stated that if the Debtor calculates projected disposable income exactly as stated in Section 1325, the Debtor cannot, by definition, be held to act in bad faith. The Court would not use one section of the Code – good faith – to overrule another explicit

[1] All of the decisions begin with the presumption that Social Security received by the Debror is excluded from CMI, a proposition that the author again contends is not warranted by the language of Section 101(10A) but which is accepted uncritically by the appellate courts.

[2] *Baud* was an interesting choice for this reliance, as *Baud* did not involve the question of whether Social Security income had to be included in the plan payment, as the Debtors had already agreed to use their Social Security to fund the plan. The sole issue before the Court was whether a Debror with negative disposable income on the Form B22C nonetheless had an applicable commitment period, and attendant minimum plan length, of 60 months.

section of the Code. In short, a Debtor cannot be found to act in bad faith if the Debtor does nothing more than the Code allows or requires, even if doing so produces an artificially low plan payment and a potential windfall to the Debtor at the expense of creditors.

The decision in Anderson was followed within a matter of weeks by the Firth Circuit in *Beaulieu v. Ragos,* 2012 WL 5292949 (5th Cir. 2012). In *Beaulieu,* the Court first noted that the definition of CMI excludes Social Security income; and definition of "disposable income" uses CMI as its starting point. The Court concluded that the exclusion of Social Security in calculating CMI expressed Congressional intent to exclude Social Security from disposable income and by extension, the Chapter 13 Plan payment. The Court also stated that the Social Security Act, 42 USC Section 407(a), enacted in 1935, prohibited Social Security income from being subject to "any bankruptcy or insolvency law." The Court then rejected the Trustee's objection based on lack of good faith, stating, "[I]t is apparent that Debtors are not in bad faith merely for doing what the Code permits them to do." Debtors' choice to exclude Social Security, which amounted to 90% of their income is not "bad faith".

The Ninth Circuit reached the same conclusion in *Drummond v. Welsh,* 711 F.3d 1120 (9th Cir. 2013). Quoting *Beaulieu,* the Court stated that Section 1325 did not compel a Debtor to include Social Security income in determining the plan payment, and the failure to do so could not be in bad faith. "We thus join every court of appeals that has decided this issue in concluding that, '[w]hen a Chapter 13 Debtor calculates his repayment plan payments exactly as the Bankruptcy Code and the Social Security Act allow him to, and thereby excludes [Social Security income], that exclusion cannot constitute a lack of good faith." *711 F.3d 1132.*

CONCLUSION

In enacting the exclusion for Social Security income in Section 101(10A)(B), Congress

created a number of problems for practitioners and Judges alike. The initial analysis, which has been shortchanged in all of the cases considering any aspect of Social Security income after BAPCPA, is whether Section 101(10A) actually excludes Social Security in calculating Current Monthly Income. After that issue is addressed, there a numerous issues that must be addressed. We can anticipate that these issues will continue to be addressed at the Circuit Court level and, perhaps, even at the Supreme Court. Given the importance of the issues presented, one would hope that the Courts would take a close look at the issues presented to ensure that the purposes and provisions of the Bankruptcy Code are correctly interpreted and applied.

Tax Refunds and the Non-Filing Spouse

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Since the advent of BAPCPA, Courts have wrestled with how to deal with income and expenses where the debtor is married but files an individual Bankruptcy Petition. Some of those issues emanate from the definition of Current Monthly Income found in Section 101(10A)(B), which sweeps into Current Monthly Income the income of the non-filing spouse to the extent that income is used for the maintenance and support of the Debtor or the Debtor's dependents. Other issues arise from the requirement of Section 1325 that a Debtor commit 100% of the Debtor's disposable income and the related requirement that the Debtor propose a plan in "giid faith".

Few of these issues, however, have vexed the Courts more than tax refunds where the Debtor is married and files a joint tax return, but the Debtor's spouse is not a debtor in Bankruptcy. Courts have used at least five separate methods of analyzing tax refunds in cases where only one spouse files for bankruptcy protection and the debtor and the non-filing spouse file joint tax returns.

A. Allocation Based on Tax Withholdings

The first approach used by Courts is to allocate tax refund between the spouses based on the proportion to which each spouse had taxes withheld from their incomes – in essence, based on the proportion to which each spouse "contributed" to the refund. This approach was used by the Tenth Circuit Bankruptcy Appellate Panel (the "BAP") in *In re Kleinfeldt,* 287 BR 291 (10th Cir. BAP 2002). The BAP noted that a tax refund results from an overpayment to the government by the taxpayer. A joint tax return does not convert income from one spouse into income to the other spouse. Spouses who file a joint return have separate interests in the overpayment based on their relative contributions to the overpaid tax. In *Klienfeldt,* only the debtor was employed and only the debtor had income tax withholdings. The non-filing spouse

had no income and no tax withholdings. The Court rejected the "property right" approach, stating "that there was no metamorphosis effective [by the joint tax return] converting the nature of the fund into the property of the other party." 287 BR at 295. As the debtor was the sole wage earner and the sole contributor to the tax overpayment, the entire tax refund belonged to the debtor. *See also Callaway v. Comm'r of Internal Revenue,* 231 F.3d 106 (2d Cir. 2000) (a joint return does not convert income of one spouse into income of the other spouse); *United States v. Elam,* 112 F.3d 1036, 1038 (9th Cir. 1997) ("[a] joint return does not itself create any equal property interests for each party in a refund. Spouses who file a joint return have separate interests in any overpayment, the interest of each depending on his or her relative contribution to the overpaid tax.").

Other Courts that have allocated tax refunds based on proportion of withholding include *In re Edwards,* 400 BR 345 (D. Conn. 2009) ("majority approach" allocates tax refunds based on withholdings contributed to better reflect economic reality); *In re Lyall,* 191 BR 78 (E.D. Va. 1996) (majority of courts have held tax refunds should be allocated proportionally in accordance with tax withholdings); *In re WDH Howell,* 294 BR 613 (D.N.J. 2003) (non-debtor spouse does not have interest in tax refund where parties filed joint tax return but non-debtor spouse had no income); *In re Levine,* 50 BR 587 (S.D. Fl. 1985); *In re Carlson,* 394 BR 491 (8th Cir. BAP 2008) (adopting "majority approach" allocating tax refunds in proportion to respective tax withholdings – where only one spouse earned income, entire refund is attributable to that spouse). *See also In re Traylor,* 22 BR 888 (Bankr. Ohio 1982) (spouse cannot claim exemption in tax refund where spouse did not work or earn income – refund entirely attributable to earnings of other spouse belongs solely to other spouse, filing of joint tax return did not convey to spouse any portion of refund attributable to earnings of other spouse).

Allocation of tax refunds based on withholdings most closely reflects economic reality and is most closely aligned with the policies and principals underlying Chapter 13. A Debtor's choice (whether conscious or by happenstance) to over-withhold produces an artificially low calculation by Debtor of his, and by extension the household's, net disposable income. This produced an artificially low plan payment. In *In re Zontini,* Case no. 07-58316, Debtor was the sole earner and the sole person contributing to any tax payments. Debtor's Schedule I indicated that Debtor had Average Monthly Gross income of $7,557.46, less tax withholdings of $1,732.21, for net monthly income of $5,746.26. Debtor's total tax refunds for the years in question were $24,513.46. Prorated over the 60 month term of Debtor's plan, this produces an average monthly "overwithholding" of $408.55. Had Debtor's Schedule I reflected Debtor's true tax liability, his monthly income would have been $408.55 higher than shown in Schedule I. This would have produced a monthly plan payment that was $408.55 per month higher than Debtor actually paid. *See 11 USC Section 1325(b).*

Allocating according to withholdings is also more consistent with both Section 1325 and Section 549. A Debtor who over-withholds taxes and then attempts to "split" the refund with the non-filing spouse essentially has created a "savings account". Debtor would effectively make a "gift" of a portion of that "savings account" to Debtor's non-filing spouse. If a Debtor indicates on Schedule J that Debtor intended to make a "gift" to his non-filing spouse on a monthly basis, Debtor's Plan would not be confirmable under Section 1325(b) as Debtor would no longer have been contributing 100% of the net disposable income. Debtor's Plan would also violate Section 1325(a)(1) as Debtor propose monthly post-petition transfers of property of the estate to Debtor's spouse, in violation of Section 549. *Santiago v. Rivera,* Case No. 11-075 (1st Cir. BAP 2012) (tax refunds received by debtor in Chapter 13 are property of estate - to extent refund is rooted in pre-

petition earnings, refund is property of estate pursuant to Section 541(a); and to extent refund is rooted in post-petition earnings, refund is property of estate pursuant to Section 1306).

This requirement that a Debtor remit tax refunds for funding of the plan does not arise out of a vacuum. The Sixth Circuit concluded long ago that a Debtor's tax refunds constitute "disposable income". In *In re Freeman,* 86 F.3d 478 (6th Cir. 1996), the Court held that tax refunds constitute "projected disposable income" that must be contributed to the Plan unless the Debtor can demonstrate that the refunds were "needed for 'maintenance and support' of the debtor or her dependents". *86 F.3d at 481.* Debtor must contribute 100% of disposable income, and cannot "shield" some portion of that income by over-withholding taxes producing artificially low "disposable income" and an attendant artificially low Plan payment, and then transfer some portion of the resulting tax refund to the non-filing spouse.

The "proportion of withholding" approach fulfills the requirements of Section 1325 and *In re Freeman* by ensuring that a debtor does not over-withhold (whether by design or inadvertence) and then effectively "convey" disposable income to the non-filing spouse by "conveying" to the spouse the tax refund attributable to the Debtor.

B. Allocation Based on Gross Income

A second approach used by Courts is to allocate tax refunds based on the respective gross incomes of the Debtor and the non-filing spouse. Judge Whipple in the Northern District of Ohio used this approach in *In re McCrory*, 2011 WL 4005455 (Bankr. N.D. Ohio 2011). In that case, Debtor earned 96.65% of the household Adjusted Gross Income but paid 100% of the withholdings that produced the refund. The Court noted that a joint tax return does not transfer property of the Debtor to the non-filing spouse:

> Thus, where an overpayment of a tax obligation results in a tax refund that derives solely from one debtor's income, courts

> applying Ohio law, including this court, have found that the debtor's spouse has no property interest in the refund. Courts have so found notwithstanding the fact that a joint return was filed and the refund check is made jointly payable to both the husband and wife.

2011 WL at *3 (citations omitted). Judge Whipple concluded that to the extent the refund was attributable to over-withholdings, that refund was entirely attributable to the Debtor as the spouse did not have any withholdings from her income. Therefore, 100% of that portion of the refund constituted Debtor's sole property for Bankruptcy purposes. To the extent that some portion of the refund was attributable to refundable tax credits for "Making Work Pay" based on total household income, that credit would be allocated in proportion to Debtor's and his spouse's incomes, with Debtor receiving 96.65% of that credit.

C. The "Hypothetical Tax Return" Approach

The "hypothetical tax return" approach appears to have originated in *In re Crowson,* 431 BR 484 (10th Cir. BAP 2010). Under this approach, the Court starts with the joint return and endeavors to determine the proportion of each spouse's contribution to the refund. Each spouse calculates what the tax liability for each would have been had each filed "married filing separately" on his or her separate income. That liability is then divided by the total liability shown on each of the two "married filing separately" returns to determine the pro-rata amount of liability attributable to each. That pro-ration is then multiplied by the total tax liability on the joint return. That results in an allocation of the joint tax liability to each spouse.

The Court must then determine each spouse's "contribution" to "total payments" shown on the joint return. Withholding based payments are deemed contributions by the spouse whose income was withheld. For credits such as the Earned Income Credit which are income and family-size based (the "EIC") or the Additional Child Tax Credit ("ACTC"), the Court, using the

"Married Filing Separately" returns, determines how much each spouse would have received as the EIC/ACTC as a percentage of the total EIC/ACTC shown on both "Married Filing Separately" returns, and then multiplying those percentages times the actual EIC or ACTC shown on the joint return. The Court then determines the total contribution by each spouse, calculated as the total withholdings attributable to that spouse plus the allocated Tax Credits, as a percentage of the total contributions shown on the joint return.

Each spouse's proportionate tax liability (calculated above) less the allocated contribution for that spouse produces the total tax refund "allocated" to each spouse. The Court would then determine each spouse's pro-rata share by dividing the spouse's "allocated" tax refund by the total "allocated" refund for both spouses, and then multiplying that pro-ration by the actual tax refund shown on the joint return.

The byzantine formula adopted by the Court in *Crowson* and later adopted in cases such as *In re Palmer,* 2011 WL 890690 (Bankr. D. Montana 2011), is very difficult to apply in the practical administration of Chapter 13 estates. Rarely, if ever, will the Debtor and the non-filing spouse produce these hypothetical tax returns, and in most cases neither the Court nor the Chapter 13 Trustee will have the information necessary to implement this approach. The few cases that have used this approach do not provide sufficient information to determine whether the outcome of the analysis differs in any material respect from the outcome of the "allocation based on withholding" approach. There is no clear evidence that would appear to warrant the additional calculations necessary to use this approach, and given that most debtors likely would need to engage the services of a tax accountant to prepare the multiple "hypothetical" returns necessary, the additional costs to the estate would likely exceed any additional benefit to the estate.

D. Current Monthly Income Basis

Following the adoption of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), some Courts have referred to the concept of Current Monthly Income ("CMI") as defined in Section 101(10A). In *In re Scott,* Case no. 10-66147 (Bankr. E.D. Mi. 2011), this Court concluded that based on the definition of CMI, there was no longer any basis to allocate tax refunds between the Debtor and the non-filing spouse. Section 101(10A) defines a Debtor's CMI as:

> The term "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 ….

11 USC §101(10A). In *Scott,* the Debtor's Schedule I and Schedule J indicated that Debtor and the non-filing spouse routinely comingled their income for payment of household expenses. The full amount of all tax refunds (including in *Scott* that portion "attributable" to the non-filing spouse's income) constituted income that is "paid … on a regular basis" for the maintenance and support of Debtor or a dependent of the Debtor. This Court held that a portion of a tax refund could be excused only to the extent that the non-filing spouse could prove that the income was

received by the spouse and that the spouse used the money for some purpose unique to the non-filing spouse.

Applying the CMI test to the facts of virtually any Chapter 13 case results in the Debtor remitting 100% of the tax refunds for funding of the Plan. In most cases, Debtor's Schedule J or the Marital Adjustment on the Form B22C[1] will already account for any separate expenses of the non-filing spouse, with all of the remaining income for the household being used for household expenses. This approach does retain flexibility that eludes the other approaches, as it creates a presumption that all of the tax refunds must be contributed but does not eliminate the possibility that a non-filing spouse could rebut that presumption based on some individual expense of the non-filing spouse that had not previously been accounted for.

E. Allocation of Refunds on a 50-50 Basis

The fifth approach used by Courts to allocate tax refunds is a blanket 50-50 rule – when two people file a joint tax return, they are each entitled to 50% of the refund regardless of their contributions to the refund, the amount of any withholdings, or any other external factors.

Courts that use this approach overlook a basic tenet of tax law – the filing of a joint tax return does not operate to transfer any portion of the refund from one spouse to the other. Filing a joint tax return is a convenience afforded by the Tax Code, but each of the joint filing parties retains the full ownership of the overpayment attributable to that party. *See In re Taylor,* 22 B.R. 888 (Bankr. N.D. Ohio 1982) (where tax refund derives from overpayment from one spouse's income, the spouse has no property interest in the refund); *In re Smith,* 310 B.R. 320, 323 ("The fact that the checks name both Debtors as payees, and thus are not transferable without the working spouse's signature, does not alter the underlying property rights in any of the

[1] Depending on whether one is a jurisdiction that views Projected Disposable Income based on Schedules I and J or a jurisdiction that equates "Disposable Income" and "Projected Disposable Income".

proceeds."); *United States v. Macphail,* 149 Fed. Appx. 449 (6th Cir.2005) ("a joint income tax return does not create new property interests for the husband or the wife in each other's income tax overpayment"); *McClelland v. Massinga,* 786 F.2d 1205, 1210 (4th Cir.1986) (joint income tax return does not create new property interests for the husband or the wife in each other's income tax overpayment).

The cases which have adopted the 50-50 rule have done so in the context of a Chapter 7 case, where the Court is attempting to determine what portion of the *pre-petition* tax refund is property of the Estate. *See, e.g., In re Bowles,* case number 11-35340 (Bankr. E.D. Mi. 2012); *In re Trickett,* 391 BR 657 (Bankr. D. Mass. 2008). This case is overlaid by the additional requirements of Chapter 13, Debtor's own Plan, the requirements of Section 1325(b) that a debtor remit 100% of disposable income, and the expansive definition of "property of the estate" found in Section 1306 which includes not only property that would have been included in the estate in a Chapter 7 proceeding plus all income and earnings of the Debtor attributable to post-petition services. There is no dispute that a Chapter 7 estate does not include post-petition earnings of the Debtor or any tax refund attributable to post-petition withholdings.

Allowing Debtor's non-filing spouse to retain one-half of the tax refunds produces a windfall to the spouse (and, indirectly, the Debtor) at the expense of Debtor's creditors. But for Debtor's overwithholding, those funds would have been paid into Debtor's Chapter 13 Plan, not gifted to Debtor's spouse, used for savings, or spent on discretionary expenses. There is no legal justification to automatically allocate one half of the tax refund to the non-filing spouse regardless of which spouse earned the income; or which contributed to the payment of taxes (thereby creating the refund). While the 50-50 approach as the benefit of simplicity of

administration, that simplicity does not warrant circumventing the requirements of the Bankruptcy Code that a Debtor remit all disposable income.

CONCLUSION

Courts have used five separate methodologies when faced with joint tax returns where only one spouse has filed for Bankruptcy. Each of these methodologies has its benefits and drawbacks. Courts must use caution in choosing and implementing one or more of these methodologies, to ensure that the result does not result in funds that should be paid into the Chapter 13 estate instead being paid to the non-filing spouse, whether through the vehicle of artificially lower plan payments or by a post-petition transfer of the Debtor's tax overpayment, in violation of Section 549.