

CONSUMER BANKRUPTCY

Non-Filing Spouse Keeps Tax Refund

Pro-se litigant scores victory against Chapter 13 trustee

By Craig D. Robins

When it comes to post-petition tax refunds in Chapter 13 cases, the long-standing practice in this jurisdiction for debtors who propose to pay unsecured creditors less than 100% is to surrender to the trustee all tax refunds the debtor receives during the pendency of the bankruptcy case. Every experienced consumer bankruptcy practitioner who practices on Long Island is keenly aware of this "requirement."

However, what happens when only one spouse files for Chapter 13 relief? Does the non-filing spouse also have to surrender his or her tax refund to the trustee?

Recently, Chapter 13 trustee Michael Macco of Melville said yes to this question and threatened to dismiss a confirmed Chapter 13 plan filed only by the wife, unless the non-filing husband cooperated and turned over the entire joint tax refund. The trustee argued that inherent in the debtor's obligation to turn over all post-petition tax refunds, was an obligation by the non-debtor spouse to do the same, so that the debtor's creditors would then receive a distribution from these funds.

The husband refused to do so, went to a law library, and then brought a *pro se* motion seeking a determination that his share of the tax refund should be protected. He did this two months after writing a letter to the judge expressing frustration over what he perceived to be an extremely unreasonable request from the trustee.

In an affidavit in opposition that was barely longer than one page, the Chapter 13 trustee argued that: a) the debtor chose to file a joint tax return; b) there is no mention in the Chapter 13 plan that there can be an exclusion for the non-debtor spouse's tax refund if the debtor files a joint return; and c) the Bankruptcy

Code requires the debtor to pledge all household income to pay unsecured creditors.

The husband and trustee had oral argument before Central Islip Bankruptcy Judge Robert E. Grossman in August, who reserved decision. The judge delivered an oral decision at a subsequent hearing in September. Judge Grossman then issued a detailed written decision on November 4, 2010. It held that the trustee had no basis, either at law or under the terms of the plan, to compel the husband, as a non-filing spouse, to turn over his property to the trustee, or to hold the debtor in default for the husband's failure to do so. *In the Matter of Susan Malewicz*, no. 09-74807-reg, (Bankr. E.D. New York 2010).

Why do debtors have to turn over tax refunds?

Judge Grossman first addressed the concept of why Chapter 13 trustees require debtors to turn over their tax refunds. Apparently, Chapter 13 trustees claim that if a confirmed plan does not require a debtor to turn over tax refunds, debtors may manipulate deductions on their W-2 forms which would have the effect of reducing monthly income payable to creditors through the plan.

Mindful of the potential for abuse, bankruptcy courts have found that turnover of a debtor's post-confirmation tax refunds is appropriate under the following situations: when they are property of the estate; when they are included in "projected disposable income" which means they must be committed to the Chapter 13 plan; and/or when the terms of the plan provide for such turnover.

Spouse's tax refund not property of



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the estate

The judge determined that Bankruptcy Code Section 541(a)(2) and 1306(a) are the relevant statutes that determine what is property of the estate in a Chapter 13 case. He then found that there is no provision in the code that includes a non-debtor spouse's property as being included in the debtor's "property of the estate."

Projected disposable income does not include non-filing spouse's income

Judge Grossman noted that other courts have permitted Chapter 13 trustees to require turnover of post-confirmation tax refunds under the theory that the refunds must be included in the calculation of the debtor's "disposable income."

Bankruptcy Code Section 1325(b) requires debtors to pledge all of "the debtor's" projected disposable income in order for the plan to be confirmed. Here, the judge emphasized the wording which focused on "debtor" and ultimately found that a non-filing spouse's entire income is not included in this analysis. "Nothing in the Code obligates anyone other than the Debtor to fulfill the requirements of the confirmed Plan."

The Chapter 13 plan is binding

Although the plan had the typical language that "the debtor shall pay tax refunds to the trustee," the judge found that this wording could not be interpreted to include the non-debtor spouse's tax refunds. The judge also remarked that even though the husband signed an affidavit of contribution, indicating that he was contributing his income to the plan, it was not binding because it was not mentioned in the Chapter 13 plan.

I actually called the debtor's husband to get his take on what happened, as scoring a *pro se* victory over a Chapter 13 trustee is an impressive feat. He said that he felt very firmly that his position was correct and even went to a law library to do his homework.

As for bringing the motion, he said, "I was not afraid to go in and stand up for what was right. If I lose; I lose. I'm in no worse position than when I started." No one can argue with that reasoning. As I've indicated in some past articles, just because a trustee strongly and loudly enunciates a particular position does not mean the trustee is correct. Always consider presenting your issue to the court if you believe you have a solid basis for doing so. As the debtor's spouse said, you have nothing to lose. Congratulations to him!

I was greatly intrigued by one particular statement that Judge Grossman inserted in the decision: "The parties have not raised, and this Memorandum Decision does not address, whether it is appropriate for the Trustee to require the turnover of the Debtor's post-confirmation tax refunds. This leads me to ponder if the Judge questions whether Chapter 13 debtors should uniformly commit their tax refunds to the plan. Perhaps there are some exceptions to our local practice. This would certainly be a major issue, but that is a subject for another day."

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