

#S-15

signed 8-18-04

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF KANSAS**

**In re:**

**CAROL S. ADKINS,**

**DEBTOR.**

**CASE NO. 02-14110-7  
CHAPTER 7**

**MEMORANDUM OF DECISION DETERMINING THAT  
PROPERTY OF THE BANKRUPTCY ESTATE INCLUDES  
PORTIONS OF THE EARNED INCOME CREDITS INCLUDED IN  
THE DEBTOR'S 2002 FEDERAL AND STATE INCOME TAX REFUNDS**

This matter is before the Court for a determination whether pro rata portions of the earned income tax credits included in the Debtor's 2002 federal and state income tax refunds belong to her Chapter 7 bankruptcy estate. The Debtor appears by counsel Calvin L. Wiebe. Chapter 7 Trustee J. Michael Morris appears by counsel Sarah L. Newell. The Court has reviewed the relevant materials and is now ready to rule.

The question the Court must answer is whether pro rata portions of the earned income tax credits for which the Debtor qualified in 2002 are property of her bankruptcy estate, even though she qualified for the credits only because she and her daughter lived apart from her husband for the last six months of the year, most of which occurred after she filed for bankruptcy. While the Court is not without sympathy for the Debtor's arguments, the Court believes it is bound to follow a Tenth Circuit decision that requires rejecting them. The Court must declare that the bankruptcy estate is entitled to pro rata shares of the earned income credits.

## **FACTS**

At least through 2002, the Debtor was married to Alonzo Adkins. They had one minor child, a daughter, and the three of them lived together during the first part of 2002. On June 1 that year, though, the Debtor leased an apartment that she and her daughter alone moved into a short time later. She and her daughter lived separate from her husband for the rest of 2002. On July 30, the Debtor filed a petition for separate maintenance, asking that she be given primary residential custody of the child. An order making her the primary residential parent was entered the same day. More than a year later, no further orders had been entered in the separate maintenance action.

On August 21, 2002, the Debtor filed a Chapter 7 bankruptcy petition. Sometime in 2003, she filed federal and state income tax returns for 2002. Because she lived separately from her husband for the last six months of that year and her daughter was a qualifying child, the Debtor qualified for both federal and state earned income tax credits. The Debtor's federal return showed she was entitled to a \$298 refund of over-withheld wages and a \$2,506 earned income credit. Her Kansas state return showed she was entitled to an \$86 refund of over-withheld wages and a \$376 earned income credit. The Trustee obtained all the refunds. He claimed that 233/365ths (the fraction of the year that passed before the Debtor filed for bankruptcy) of the refunds, or \$2,084.87, belonged to the bankruptcy estate, and distributed the balance to the Debtor. Of the

amount the Trustee retained, \$1,839.74 is attributable to the federal and state earned income credits.

The Debtor objects to the Trustee's assertion that the earned income credits belong to the bankruptcy estate, contending that because her eligibility for the federal credit depended on her living with her daughter and apart from her husband for the last six months of 2002, either no portion of the credits belongs to the bankruptcy estate, or at most 52/184ths (the fraction of the last six months of the year that passed before she filed for bankruptcy) of the credits, belongs to the estate. The Trustee responds that a variety of court decisions make clear that the portions of the refunds that he claims are property of the estate.

## **DISCUSSION**

Under § 541(a)(1) of the Bankruptcy Code, a Chapter 7 debtor's estate generally includes "all legal or equitable interests of the debtor in property as of the commencement of the case."<sup>1</sup> The Debtor contends that when she filed for bankruptcy in August 2002, she had no interest in the federal earned income tax credit because to qualify for it, (1) she had to live apart from her husband every day for the last six months of the year to be entitled to file her 2002 federal return as if she were not married, and (2) her daughter also had to live with her during those months. The Kansas

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<sup>1</sup>11 U.S.C.A. § 541(a)(1).

earned income credit is simply a percentage of the federal one,<sup>2</sup> so there would seem to be no reason to treat it any differently than the federal one. Presumably for this reason, the Debtor's arguments are based solely on the law governing the federal credit. The Court will likewise discuss only the federal law, but the discussion will govern the estate's claim to the state credit as well.

The Debtor correctly points out that to be able to file a separate return and qualify for the earned income credit despite being married, she had to: (1) live apart from her husband for the last six months of the year; (2) have her daughter living with her for more than one-half of the year; and (3) have furnished more than one-half the cost of maintaining the household where she and her daughter lived.<sup>3</sup> But she also had to meet a number of other criteria to qualify for the 2002 earned income credit, including: her investment income for the year could not exceed \$2,550; and her adjusted gross income and her earned income for the year both had to be less than \$29,201.<sup>4</sup> So if the Debtor had had enough investment or earned income during the first six months of the year, either standing alone or coupled with her income for the last six months of the year, she would not have been eligible for the earned income credit. In other words, events in the

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<sup>2</sup>K.S.A. 2003 Supp. 79-32,205(a).

<sup>3</sup>See 26 U.S.C.A. §§ 32(d) ("married" individual must file joint return to qualify for earned income credit) & 7703(b) (individual who meets three criteria mentioned in text not considered as "married").

<sup>4</sup>IRS Publication No. 596, "Earned Income Credit (EIC), for use in preparing 2002 returns," at page 1, Table 1, pages 6-7, and pages 19-20 (obtained Aug. 6, 2004, from Internal Revenue Service Web site at "www.irs.gov"); see also 26 U.S.C.A. § 32 (statute establishing earned income credit and eligibility criteria).

first half of 2002 could have prevented the Debtor from qualifying for the earned income credit, just as events in the last half of the year could have. Still, but for binding precedent, the Court might be willing to agree with the Debtor that when post-bankruptcy-filing events are necessary prerequisites to a Chapter 7 debtor's eligibility for the earned income credit, none of the credit should be considered to be property of the bankruptcy estate.

In *In re Montgomery*, affirming the Bankruptcy Appellate Panel, the Tenth Circuit rejected a bankruptcy court's reasoning that because an earned income credit does not accrue until the end of a Chapter 7 debtor's tax year, it is contingent and does not become property of the debtor's estate if the debtor files for bankruptcy before the end of the year.<sup>5</sup> Instead, the Circuit said that Congress intended for such contingent interests to be included in the property of the estate.<sup>6</sup> The Circuit went on to say that it agreed with the B.A.P. "and the overwhelming weight of authority that a debtor's [earned income credit] for a tax year, as pro-rated to the date the bankruptcy petition was filed, is property of the estate regardless of whether the petition was filed prior to the end of the tax year."<sup>7</sup>

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<sup>5</sup>224 F.3d 1193, 1194-95 (10th Cir. 2000).

<sup>6</sup>224 F.3d at 1195.

<sup>7</sup>224 F.3d at 1195.

The central requirement for qualifying for the credit is to have earned income that does not exceed the eligibility limit. After filing for bankruptcy but before the end of the tax year, any debtor might experience an increase in earned income that would end his or her eligibility. But this fact was not enough to prevent the Tenth Circuit from concluding that for the tax year during which a debtor files a Chapter 7 bankruptcy, a pro rata share of the earned income credit becomes property of the bankruptcy estate. Although the Debtor in this case had to live apart from her husband for all of the last six months of 2002 to be considered as unmarried for purposes of the earned income credit, the Court is convinced the Tenth Circuit would similarly conclude that this fact does not prevent her bankruptcy estate from including a pro rata share of her earned income credit for that year.

The Debtor suggests that her interest in the earned income credit as of the day she filed for bankruptcy is similar to the property interests involved in *In re Roth*, which were held not to be property of the estate.<sup>8</sup> But *Roth* involved two questions about a debtor's interest in property held in trust. First, as of the day he filed a Chapter 7 bankruptcy, the debtor was a beneficiary of a spendthrift trust; the court held this property interest was expressly excluded from the bankruptcy estate by § 541(c)(2) of the Bankruptcy Code and Kansas law that makes spendthrift provisions enforceable.<sup>9</sup>

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<sup>8</sup>289 B.R. 161, 164-69 (Bankr.D.Kan. 2003).

<sup>9</sup>289 B.R. at 164-66.

Second, the settlor of the trust died less than 180 days after the debtor filed for bankruptcy, terminating the trust and making certain trust property distributable to the debtor; the court held the debtor did not become entitled to this property by “bequest, devise, or inheritance,” so the property was not brought into the bankruptcy estate by § 541(a)(5)(A). Unlike interests in spendthrift trusts, Code § 541 contains no provision that expressly excludes a contingent interest in an earned income tax credit from a Chapter 7 debtor’s bankruptcy estate. Furthermore, as indicated earlier, the Tenth Circuit held in *Montgomery* that the contingent nature of the earned income credit before the end of the tax year does not prevent a pro rata portion of the credit from becoming property of the estate when the debtor files for bankruptcy during the tax year. Section 541(a)(5) applies to new property interests that a debtor acquires after filing for bankruptcy, not contingent property interests that merely cease to be contingent after the filing. *Roth* does not support the Debtor’s position here.

## **CONCLUSION**

For these reasons, the Court concludes it must declare that 233/365ths of the earned income credits included in the Debtor’s 2002 federal and state tax refunds are property of her bankruptcy estate.

The foregoing constitutes Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules

of Civil Procedure. A judgment based on this ruling will be entered on a separate document as required by FRBP 9021 and FRCP 58.

Dated this \_\_\_\_ day of August, 2004.

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DALE L. SOMERS  
BANKRUPTCY JUDGE

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that true and correct copies of the above **MEMORANDUM OF DECISION DETERMINING THAT PROPERTY OF THE BANKRUPTCY ESTATE INCLUDES PORTIONS OF THE EARNED INCOME CREDITS INCLUDED IN THE DEBTOR'S 2002 FEDERAL AND STATE INCOME TAX REFUNDS** were mailed via regular U.S. mail, postage prepaid, on the \_\_\_\_ day of August, 2004, to the following:

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