

In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

MARVIN R. COURON and
GAYLE A. COURON

Debtor(s).

Bankruptcy No. X90-00442S

Chapter 7

MEMORANDUM AND ORDER RE: OBJECTION TO EXEMPTION

The matter before the court is the trustee's objection to the debtors' claim of exemption in an income tax refund. A hearing was held on June 29, 1990 in Sioux City, Iowa. The court now issues its findings of fact and conclusions of law as required by Bankr. R. 7052. This is a core proceeding under 28 U.S.C. § 157(b)(2)(B).

FINDINGS OF FACT

The debtors, Marvin and Gayle Couron, filed their joint voluntary chapter 7 petition on March 14, 1990. On schedule B-4 of the petition, the debtors claimed as exempt their 1989 federal and state tax refunds. Each debtor claimed a \$650.00 exemption under Iowa Code § 627.6(9)(c). On May 16, 1990, the debtors amended schedule B-4, increasing Gayle Couron's claimed exemption in the 1989 income tax refund to \$1,000.00.

Gayle Couron was employed in 1989 by Marian Health Center, where she earned \$9,143.48. Of this amount, \$591.55 was withheld for federal income taxes and \$219.33 was withheld for Iowa state income taxes.

Marvin Couron was not employed in 1989, but as a result of the previous termination of his job, he received \$2,870.72 from his former employer as a distribution from a company pension trust fund. The fund was apparently comprised of withheld wages matched with employer funds. No state or federal income tax was withheld from this distribution in 1989.

The debtors claimed a \$1,325.00 refund on their joint federal income tax return. Of this refund, \$592.00 was claimed from taxes withheld from Gayle Couron's wages. The remaining \$733.00 was claimed as an earned income credit.

The debtors' state tax liability for 1989 was \$180.00. Because \$219.33 had been withheld from Gayle Couron's wages, the debtors claimed a state tax refund of \$39.00.

DISCUSSION

The trustee, Donald H. Molstad, filed an objection to the debtors' claims of exemption on April 18, 1990. The trustee contends that because Marvin Couron was not employed in 1989, the debtors' entire 1989 tax refund is attributable to the wages of Gayle Couron, and that only she may claim it as exempt. Trustee also argues that because Gayle Couron is limited to a \$1,000.00 tax refund exemption under Iowa Code § 627.6(9)(c), the amount of the refund in excess of \$1,000.00 must be returned to the bankruptcy estate.

Debtors argue that Marvin Couron is entitled to claim a portion of the tax refund as exempt.

The trustee is correct in asserting that Marvin Couron may not claim as exempt any portion of the tax refund arising

solely from the refund of taxes withheld from Gayle Couron's income. This court has held in the past that a spouse is not entitled to claim a tax refund exemption if he or she did not contribute to tax withholdings. In re Gran, Bankr. No. X89-00291S, slip op. at 3 (Bankr. N.D. Iowa, July 14, 1989). "Where spouses claim a refund under a joint return, the refund is divided between the spouses, with each receiving a percentage of the refund equivalent to his or her proportion of the withheld tax payments." Gordon v. U.S., 757 F.2d 1157, 1160 (11th Cir. 1985) (citations omitted). Because Marvin Couron had no income tax withheld in 1989, he is not entitled to receive any portion of the refund of withheld taxes. In re Gran, Bankr. No. X89-00291S at 4.

Like withheld wages, earned income credits are distributed through the tax refund process. Unlike withheld wages, a recipient need not have owed or paid any taxes to be eligible for an earned income credit. Rucker v. Secretary of Treasury of U.S., 751 F.2d 351, 356 (10th Cir. 1984). "Although the earned income credit is given effect through the income tax return, the credit is not a tax refund because eligibility for the credit is not contingent upon payment of any federal income tax." *Id.* at 356. See also In re Searles, 445 F.Supp. 749, 752 (D. Conn. 1978) ("The earned income credit is given effect through a refund, but it is not a refund of taxes previously paid. Most of the people who receive the credit have little or no tax liability; part or all of what they receive exceeds the amounts withheld from their earnings.")

Consequently, the earned income credit is not a traditional form of refund intended to compensate the recipient for the overpayment of taxes. Rather,

The earned-income credit was enacted to reduce the disincentive to work caused by the imposition of Social Security taxes on earned income (welfare payments are not similarly taxed), to stimulate the economy by funneling funds to persons likely to spend the money immediately, and to provide relief for low-income families hurt by rising food and energy prices.

Sorenson v. Secretary of Treasury, 475 U.S. 851, 864 (1986).

Iowa Code § 627.6(9)(c) permits the following exemption:

In the event of a bankruptcy proceeding, the debtor's interest in accrued wages and in state and federal tax refunds as of the date of filing of the petition in bankruptcy, not to exceed one thousand dollars in the aggregate.

Exemption statutes in Iowa are to be liberally construed. Matter of Honomichl, 82 B.R. 92, 93 (Bankr. S.D. Iowa 1987); Frudden Lumber Co. v. Clifton, 183 N.W.2d 201, 203 (Iowa 1971). However, the court must be careful not to depart from the express language of the exemption statute. Matter of Honomichl, 82 B.R. at 93; Matter of Hahn, 5 B.R. 242, 244 (Bankr. S.D. Iowa 1980).

Iowa Code § 627.6(9)(c) exempts the debtor's interest in state and federal tax refunds. Because a spouse has no inchoate right to the other spouse's personal property in Iowa, In re Honomichl, 82 B.R. at 94 (citing Gunsaulis v. Tingler, 218 N.W.2d 575, 578 (Iowa 1974)), a spouse has no interest in a tax refund when the tax withholdings and refunds derived solely from the other spouse's wages. In re Gran, Bankr. No. X89-00291S, Slip op. at 4; In re Honomichl, 82 B.R. at 94. This result is not altered by the fact that the debtors have filed a joint tax return. It is well settled that a joint filing does not change the ownership of property rights between taxpayers. In re Wetteroff, 453 F.2d 544, 547 (8th Cir. 1972), cert. denied 409 U.S. 934 (1972), reh'g. denied 409 U.S. 1050 (1972).

However, the earned income credit portion of a federal tax refund does not actually "refund" any money withheld from either spouse. As stated above, spouses may be entitled to an earned income credit without ever having paid any federal income tax. Consequently, the property interest analysis which is commonly applied to the refund of withheld wages breaks down when determining spousal interest in an earned income credit. Unlike withheld wages, neither spouse can trace any property interest in an earned income credit until the credit is actually paid to them.

To be eligible for an earned income credit, an individual must realize some earned income. 26 U.S.C. § 532(a). The Internal Revenue Code defines earned income as "wages, salaries, tips, and other employee compensation, plus . . . the amount of the taxpayer's net earnings from self-employment for the taxable year 26 U.S.C. § 32(c)(2)(A).

The court concludes that because an individual must realize some earned income in order to qualify for an earned income credit, a spouse must realize some earned income in order to have an interest in the earned income credit from a jointly filed return.

Marvin Couron received no 1989 earned income, as defined by 26 U.S.C. § 32(c)(2)(A). His only income in 1989 was from a company pension trust fund, a source of income specifically excluded from the Internal Revenue Code's definition of earned income. See 26 U.S.C. § 32(c)(2)(B)(ii). Therefore, Marvin Couron is not an eligible individual under 26 U.S.C. § 32(c) and would not have been entitled to a 1989 earned income credit absent his wife's eligibility.

The court notes that Marvin Couron's pension did affect the calculation of the debtors' earned income credit. This, however, does not alter the fact that Marvin Couron himself would not have been eligible for the credit. Consequently, the court finds that because Gayle Couron was eligible to receive an earned income credit in 1989 and Marvin Couron was not, Marvin Couron has no interest in the 1989 earned income credit.

Because Marvin Couron has no interest in the 1989 federal and state withholding tax refunds, and because he does not have an interest in the 1989 earned income credit, he cannot claim any portion of the 1989 refund as exempt under Iowa Code § 626.6(9)(c). Only Gayle Couron is entitled to such an exemption. The 1989 federal and state tax refunds total \$1,364.00. Because this total exceeds the \$1,000.00 exemption limit allowed under § 627.6(9)(c), Gayle Couron may claim only \$1,000.00 of this refund as exempt property.

CONCLUSIONS OF LAW

Debtor Marvin Couron does not have an interest in the 1989 federal and state income tax refunds and is therefore not entitled to claim an exemption in them under Iowa Code 627.6(9)(c).

ORDER

IT IS ORDERED that trustee Donald H. Molstad's objection to exemption is sustained.

SO ORDERED THIS 16th DAY OF JULY, 1990.

William L. Edmonds
Chief Bankruptcy Judge