

# In the United States Bankruptcy Court

## for the Northern District of Iowa

### Western Division

ROGER D. HORNBY and  
CYNTHIA A. HORNBY

*Debtor(s).*

Bankruptcy No. X90-00207S

Chapter 7

### MEMORANDUM AND ORDER RE: OBJECTION TO EXEMPTIONS

The matter before the court is the trustee's objection to the debtors' claim of exemption in income tax refunds. 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

Roger and Cynthia Hornby each claim as exempt [\(1\)](#)

a \$733.50 interest in state and federal income tax refunds totaling \$1,467.00. According to his 1989 W-2 forms, Roger Hornby's 1989 income totaled \$10,719.28 (\$1,645 at County Inn and \$9,074.28 at Spencer Super Valu). Of this amount, \$314 was withheld for federal income taxes and \$333 was withheld for state income taxes. Cynthia Hornby's 1989 income totaled \$292.27. None of her 1989 income was withheld for federal or state income taxes. The debtors also claimed a \$3,000 capital loss on their 1989 federal and state returns.

The debtors filed a return claiming a \$1,147 federal income tax refund. Of this refund, \$314 was claimed for taxes withheld from Roger Hornby's income. The remaining \$833 was claimed as an earned income credit. The debtors' state income tax liability for 1989 was \$13. Because \$333 had been withheld from Roger Hornby's wages for Iowa income taxes, the debtors claimed a state income tax refund of \$320.

### DISCUSSION

Debtors filed their Resistance to objection to Exemptions on April 20, 1990. However, at that time, no objection by the trustee had been filed. On May 29, 1990, the trustee filed an Application for Filing Objection to Exemption. Attached to the application were two exhibits. Exhibit A is a letter from the trustee to the attorney for the debtors dated March 28, 1990 which states the trustee's objection to the debtors' claim of their tax returns as exempt property. Attached to the letter is an "Objection to Exemptions." The objection was not file stamped. Exhibit B is a copy of the debtors' resistance to the trustee's objection.

Trustee's Application for Filing Objection to Exemption was filed more than two months after debtors last amended their B-4 schedule. Therefore, trustee's objection was not timely. Bankr. R. 4003(b). The trustee's application asks, however, that the objection be considered as timely. The issue of timeliness has not been raised by the debtors. At the hearing on the trustee's application, the parties proceeded on the merits without any discussion of the timeliness issue. By failing to raise the issue at the time of the hearing, the debtors have waived any objection to the late filing of the trustee's objection to exemption.

The trustee contends that because none of Cynthia Hornby's 1989 wages were withheld for federal or state income taxes,

the debtors' entire 1989 tax refund is attributable to the wages of Roger Hornby, and Cynthia Hornby may not claim any of it as exempt. Debtors argue that the earned income credit claimed by the debtors on their 1989 income tax refund was affected by Cynthia Hornby's 1989 wages, and therefore she is entitled to a share of the earned income credit. Debtors also argue that their federal and state tax calculations are affected by a \$3,000 capital loss carryover. This loss arose from net operating losses from a meat store formerly operated by the debtors. It is impossible to discern from the 1989 tax returns to which of the debtors this loss is attributable. However, debtors argue that the loss, part of which was Cynthia's, increased the amount of the debtors' tax refund and that, therefore, part of the refund should be hers.

The trustee is correct in asserting that Cynthia Hornby may not claim as exempt any portion of the debtors' tax refund which arises solely from the refund of taxes withheld from Roger Hornby's wages. This court has held that a spouse is not entitled to claim a tax refund exemption if he or she did not contribute to the tax withholdings. In re Couron, Bankr. No. X90-00442S, slip op. at 3 (Bankr. N.D. Iowa, July 16, 1990); in re Gran, Bankr. No. X89-00291S, slip op. at 3 (Bankr. N.D. Iowa, July 14, 1989). Therefore, because Cynthia Hornby had no income tax withheld in **1989**, she is not entitled to receive any portion of the refund of withholding taxes. In re Couron, Bankr. No. X90-00442S at 3; In re Gran, Bankr. No. X89-00291S at 4.

To be eligible for an earned income credit, an individual must realize some earned income. 26 U.S.C. § 32(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).

Because an individual must realize some earned income in order to qualify for an earned income credit, a spouse has an interest in the credit, and therefore is entitled to claim a portion of the credit as exempt, only if the spouse realized earned income that year. See In re Couron, Bankr. No. X90-00442S slip op. at 6 (Bankr., N.D. Iowa, July 16, 1990).

An individual's earned income credit is based on the individual's earned income, and can be determined by tables prescribed by the Secretary of the Treasury. 26 U.S.C. § 32(f)(1). At zero earned income, an individual's earned income credit would also be zero. As earned income rises, so does the earned income credit until the individual reaches the maximum allowable earned income credit. At this point, increases in the individual's adjusted gross income (which may include earned income as well as other sources of income) reduce the individual's earned income credit. 26 U.S.C. § 32(b).

Consequently, the earned income of each spouse will always affect the calculation of their earned income credit. Moreover, increases in each spouse's adjusted gross income can only reduce their earned income credit. The court concludes that the earned income credit should be divided between debtors in proportion to the amount of earned income, as defined by 26 U.S.C. § 32(c)(2), that each spouse contributed to the total earned income upon which the credit was based.

In 1989, Roger Hornby received \$10,719.28 in earned income and Cynthia Hornby received \$292.27 in earned income. The debtors' percentage contributions to their total earned income

are as follows:

Roger Hornby -- \$10,719.28 divided by \$11,011.55 = 97%

Cynthia Hornby -- 292.27 divided by 11,011.55 = 3%

Roger Hornby's interest in the debtors' federal and state income tax refunds is as follows: the federal withholding tax refund of \$314 plus the state withholding tax refund of \$320.00 plus \$808.01 of the debtors' earned income credit (97% x \$833) for a total of \$1,442.01. [\(2\)](#)

Cynthia Hornby had no interest in the debtors' federal and state withholding tax refunds, and her interest in the debtors' earned income credit is \$24.99 (3% x \$833). Therefore, Cynthia Hornby is entitled to an exemption in the debtors' 1989 federal income tax refund of \$24.99. To the extent that this decision contradicts that of In re Gran, Bankr. No. X89-00291S (Bankr. N.D. Iowa, July 14, 1989), the latter decision is overruled.

## CONCLUSIONS OF LAW

Roger Hornby has an interest in the debtors' 1989 federal and state income tax refunds in the amount of \$1,442.01. Therefore, Roger Hornby is entitled to claim up to \$1,000.00 of these refunds as exempt under Iowa Code § 626.6(9)(c).

Cynthia Hornby has an interest in the debtors' 1989 federal income tax refund in the amount of \$24.99. Therefore, Cynthia Hornby is entitled to an exemption in this refund of \$24.99 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

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1. Iowa Code § 627.6(9)(c).
  2. Roger Hornby has claimed only \$733.50 of this refund as exempt. However, he may claim up to \$1,000.00 of this refund as exempt under I.C. § 627.6(9)(c). He may wish to amend his B-4 schedule to increase his claim of exemption to \$1,000.00.