By Edward Boltz

# The Separate-Filings Rule Is Neither Practical nor Equitable for Debtors or the Estate

The separate-filings rule is often described as the most technically precise approach to allocating joint tax refunds between spouses in bankruptcy — yet precision is not always justice. For debtors, and for trustees and attorneys alike, the approach can operate as a solution in search of a problem — one that multiplies costs, delays access to relief, and injects unnecessary litigation into already fragile household finances.

The opinion in *In re Quevedo*[1] provides the launching point for this discussion. The court adopted the separate-filings rule — borrowed from *In re Crowson*[2] — to determine how spouses' joint tax refunds should be divided. While the opinion is meticulous, it also reveals why this "accurate" method is ill-suited to the everyday realities of consumer bankruptcy practice in this district.

## A Rule that Ignores the Cost of Compliance

The separate-filings rule requires that the court, trustee or parties recreate two hypothetical tax returns — one for each spouse — as if they had filed "married filing separately." Those hypothetical returns must apportion every line item of income, deduction, credit and withholding. In theory, this isolates each spouse's "true" share of the refund. In practice, it demands the time and expertise of a professional tax preparer.

However, who pays for that work? Not the estate. Under *Lamie v. United States Trustee*,[3] a chapter 7 debtor's attorney or accountant cannot be compensated from estate assets. This means that low-income families — often those most reliant on the Earned Income Tax Credit (EITC) — must pay for a certified public accountant or tax-software analysis before they can even file for bankruptcy. For many, this extra cost might be prohibitive, delaying or preventing access to the fresh start that Congress intended.

## Costs Shifted to Trustees — and to Creditors

Proponents respond that trustees can simply retain professionals at the estate's expense to perform these calculations. However, every dollar spent hiring tax-preparers or litigating competing hypothetical returns is a dollar that does not go to creditors. For estates with modest refunds — $1,000 or $2,000 — professional fees could easily exceed any benefit of administration.

Moreover, each separate-filings-rule calculation will be inherently subjective, as "income, withholdings, credits, and other tax attributes all have meaningful impacts on tax refunds ... [and] determining each spouse's ownership interest in a refund ... can be similarly complex." Reasonable experts will differ on how to apportion the standard deduction or refundable credits. The result will be more contested hearings, more fee applications and further reductions in meaningful dividends.

## Chapter 13 Debtors Will Pay the Price

These burdens will not be limited to chapter 7. In chapter 13, the already-higher attorney's fee for representing "the interests of the debtor" is compensable under 11 U.S.C. § 330(a)(4)(B) as a priority administrative expense through the chain of 11 U.S.C. §§ 503(b)(2) and 507(a)(2). If separate-filings-rule analyses become standard, consumer practitioners might need to hire tax professionals or spend hours reconstructing returns. Those costs will be passed into the plan, increasing administrative expenses, extending repayment periods and reducing dividends to nonpriority unsecured creditors.

For chapter 13 trustees — whose offices handle thousands of cases annually — the idea of obtaining or auditing hypothetical separate returns for every married debtor is fanciful. As a practical matter, most trustees will simply acquiesce to a 50/50 allocation or decline to pursue small refunds. Thus, the very "accuracy" that the separate-filings rule promises will vanish in routine practice, replaced by inconsistent, *ad hoc* settlements.

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1 *In re Quevedo*, No. 23-80195, 2024 WL 3754885 (Bankr. M.D.N.C. Aug. 9, 2024).
2 *In re Crowson*, 431 B.R. 484 (B.A.P. 10th Cir. 2010).
3 *Lamie v. United States Trustee*, 540 U.S. 526 (2004).

# Consumer Counterpoint: Filings Rule Is Neither Practical nor Equitable

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## "Complexity Is No Excuse"? Sometimes It Is

The *Quevedo* opinion echoed the admonition from *Crowson* that "simplicity cannot come at the expense of accuracy," but bankruptcy has always balanced equity against efficiency. Section 704 directs trustees to administer the estate "as expeditiously as is compatible with the best interests of parties-in-interest." In low-asset consumer cases, efficiency is equity: Every dollar spent on litigation diminishes and delays the debtors' fresh start and the creditors' recovery alike.

The rule's defenders claim that it "protects each spouse's true legal interest." In reality, it privileges higher-income households who can afford professional preparation. Low-income families — those most dependent on refundable credits like the EITC and child tax credits — bear the brunt of the uncertainty. If the separate-filings rule were to become entrenched, trustees and courts should expect a cascade of new disputes: competing expert reports, motion practice and delayed discharges.

Further, this accuracy is illusory when the underlying data are hypothetical. No one actually files the separate returns; every figure is an estimate. All participants in the bankruptcy system already face escalating caseloads and limited budgets, and each additional procedural hurdle compounds the administrative burden. Requiring separate-filings analyses in every married-filer case is neither sustainable nor necessary. The Fourth Circuit's decision in *Bunker v. Peyton*[4] recognized that joint cases create separate estates, but it did not mandate separate accounting for every marital asset. Courts routinely treat household goods, bank accounts and even vehicles as jointly owned without forensic tracing. Tax refunds and credits should be no different.

## The Myth of Benign Compromise

Advocates of the separate-filings rule often reassure that "trustees will negotiate and compromise on issues of non-exempt equity," implying that the practical burden will be softened by professional reasonableness. Trustees are not abstractions; they are human — no better or worse than any of us — and they respond to incentives. In a system where chapter 7 trustees receive only a *de minimis* fee in true "no-asset" cases, the temptation can be strong to convert routine filings into "asset" cases that generate statutory commissions under 11 U.S.C. § 326(a) and, frequently, additional compensation through attorney's fees for litigation or settlement administration.

Recognition of those economic structures is not meant to imply that trustees are venal; it simply recognizes that incentives drive behavior. When the separate-filings rule transforms what would have been a straightforward 50/50 allocation into a complex question of hypothetical accounting, it creates opportunities — and pressures — for trustees to litigate marginal differences. Even a few hundred dollars of disputed refund can justify an objection when it means the difference between a flat $60 administrative fee and a percentage-based commission.

The result is not more "compromise," but more negotiation under duress. Debtors — often represented by counsel working under fixed or capped fees — lack the resources to fight prolonged disputes over tax apportionment. They are encouraged to settle — not because the trustee's position is correct, but because it is cheaper to concede. Thus, the separate-filings rule skews the system toward settlements driven by structural asymmetry, not equity.

Absent explicit pressure from bankruptcy judges and the U.S. Trustee Program (or in North Carolina and Alabama from Bankruptcy Administrators) to encourage abandonment or settlement of EITC funds, including through resisting applications for fees for the attorney for the estate, the claim that trustees will exercise discretion benignly is not a comfort. The more complex and subjective the governing rule, the greater the incentive and opportunity for human judgment — and self-interest — to shape outcomes. Bankruptcy should minimize those temptations, not multiply them.

## Policy Reform: Toward Uniform Protection of Benefits and Tax Credits

The most troubling implication of the separate-filings rule is its treatment of the EITC. The *Quevedo* court held that EITC and additional child tax credits are not exempt under N.C. Gen. Stat. § 1C-1601(a)(12), which protects "alimony, support, separate maintenance, and child *support payments*."[5]

An article by Dr. **Michael D. Sousa**[6] deepens the moral and policy argument for protecting the EITC. He demonstrates that the current bankruptcy regime often allows trustees to seize EITC refunds, effectively diverting antipoverty benefits intended for working families into administrative expenses and token creditor distributions. As Dr. Sousa powerfully illustrates, this practice perpetuates class inequality by enabling the state to shield middle-class assets such as home equity and retirement funds while simultaneously stripping the working poor of essential subsistence income. His research exposes how the trustee compensation model compounds this inequity: In many cases, the majority of seized EITC funds go to trustee commissions and legal fees rather than to creditors. Dr. Sousa's policy prescription is clear: Congress and the states should reform exemption statutes to categorically exclude refundable tax credits from the bankruptcy estate, restoring coherence to the fresh start doctrine and reaffirming bankruptcy's humanitarian foundations.

4 *Bunker v. Peyton*, 312 F.3d 145 (4th Cir. 2002).

5 Emphasis added.

6 Michael D. 151 F.4th 1228 (10th Cir. 2025), "Seizing Welfare from the Bankrupt," *Univ. of Cincinnati Law Rev.* (Aug. 22, 2024), Vol. 93, No. 2, Univ. of Denver Legal Studies Research Paper, ssrn.com/abstract=4934050 or dx.doi.org/10.2139/ssrn.4934050 (unless otherwise specified, all links in this article were last visited on Oct. 31, 2025).

The Tenth Circuit's recent decision in *Cohen v. Garcia-Morales*[7] provides a persuasive additional counterpoint to the restrictive treatment of refundable tax credits in bankruptcy. In *Garcia-Morales*, the court recognized that the EITC functions not as an ordinary tax overpayment but as a targeted public welfare benefit designed to lift low-income working families out of poverty. Rejecting the notion that these credits should be mechanically treated as property of the estate, the Tenth Circuit observed that the EITC reflects Congress's policy choice to reward labor participation and reduce reliance on traditional welfare.

By emphasizing the EITC's redistributive purpose and social function, the opinion in *Garcia-Morales* underscores that bankruptcy law should interpret property interests in light of legislative intent, not solely through the lens of revenue collection. This approach provides an equitable framework that is more consistent with the fresh start principle, particularly for low-income families whose survival depends on the annual infusion of these refundable credits.

The Tenth Circuit's reasoning in *Cohen v. Garcia-Morales* and Dr. Sousa's critique of EITC seizure converge on a shared insight: The bankruptcy system should not cannibalize the very tools designed to prevent poverty. When the law treats the EITC as a mere tax overpayment rather than a social-welfare benefit, it undermines both congressional intent and the equitable spirit of bankruptcy relief. Recognizing and exempting the EITC would reaffirm the system's moral and practical goal: to provide low-income families with a genuine fresh start, not a fleeting reprieve followed by deeper hardship.

A growing number of states have acted where courts could not. For example, New Mexico amended its exemption statute to protect "refundable federal and state tax credits." As the National Consumer Law Center recently emphasized in its report,[8] the seizure of tax refunds and credits undermines the core antipoverty purpose of these programs and perpetuates economic instability among the working poor. Both other states — and ultimately Congress — should follow this guidance by expressly exempting refundable credits such as the EITC and child tax credit from collection and bankruptcy administration.

## Keep Bankruptcy Simple — and Humane

The separate-filings rule might satisfy an accountant's craving for mathematical precision, but it frustrates the Bankruptcy Code's core purposes: to provide debtors with a fresh start and to distribute estates efficiently. More pragmatically minded bankruptcy courts should adopt a hierarchy: Liberally apply exemption in favor of debtors, presume equal ownership, protect refundable credits, encourage stipulated resolutions, and pursue legislative change. abi

7 *Cohen v. Garcia-Morales*, 151 F.4th 1228 (10th Cir. 2025).

8 "New Report Examines the Harms of Seizing Tax Refunds to Collect Criminal Justice Debt," Nat'l Consumer Law Ctr. (Jan. 30, 2025), nclc.org/new-report-examines-the-harms-of-seizing-tax-refunds-to-collect-criminal-justice-debt.