

BY JAMES C. LANIK

Should Courts Use the Separate-Filings Rule to Allocate Tax Refunds Among Spouses?

When spouses file a joint chapter 7 petition, two estates are created,¹ although those estates are typically jointly administered.² The allocation of joint tax refunds between spouses in a chapter 7 case is a complex issue that requires careful consideration of each spouse's state law ownership interests in the refund.³ Applications of those state law rules could affect the outcome of the analysis or could preclude the use of one or more of the rules discussed in this article.⁴

Courts have developed four primary tests to determine the ownership of tax refunds to spouses who have filed a joint tax return:

- the withholding rule;
- the income rule;
- the 50/50 rule; and
- the separate-filings rule.

Each of these tests offers a different approach to allocating the refund, based on differing rationales and often resulting in vastly different outcomes. Before getting into the debate about which approach is best, the following are brief synopses of each framework.

The *withholding rule*, which is the approach of the majority⁵ of courts, allocates the refund based on the proportion of taxes withheld from each spouse's income, thereby reflecting the direct financial contributions made by each spouse through tax withholdings.⁶ On the other hand, the *income rule* allocates the refund based on the proportion of income

each spouse contributed, which considers the overall financial input of each spouse into the household.⁷ This approach has largely been superseded by the withholding rule.⁸

The *50/50 rule* is a more straightforward approach, dividing the refund equally between the spouses, regardless of their individual contributions or financial circumstances. This rule is often favored for its simplicity and ease of application.⁹ The *separate-filings* rule bases the allocation of the refund between the spouses on each spouses' hypothetical liability as if they had filed returns as married filing separately.¹⁰

The Separate-Filings Rule: We Can Do It the Easy Way, or the Right Way

The separate-filings rule is increasingly being recognized as the most equitable and precise method for determining ownership of a joint tax refund in bankruptcy cases. This rule is supported by a robust body of legal principles and case law, including such notable cases as *Quevedo* and *Crowson*. These cases underscore the importance of accurately reflecting each spouse's individual tax liability and contributions when allocating joint tax refunds.

The separate-filings rule offers the more nuanced approach by allocating the refund based on what each spouse would have received if they had filed separate tax returns. This rule is derived from guidance from the Internal Revenue Service (IRS) and is considered to provide a more accurate reflection of each spouse's true legal interest in a joint refund. It takes into account factors other than the spouses' respective incomes or withholding percentages.

*In re Crowson*¹¹ underscores the importance of getting these calculations right, even though doing so might be complicated and difficult. The *Crowson*



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¹ 11 U.S.C. § 302(a). See also Fed. R. Bankr. P. 1015(b)(1).

² "[W]hen spouses file a joint Chapter 7 petition, separate bankruptcy estates are created." *In re Bunker*, 312 F.3d 145, 150 (4th Cir. 2002); see also *In re Feltman*, 285 B.R. 82, 86 (Bankr. D.D.C. 2002) ("A husband and wife remain separate debtors even if they file a joint petition. Even though 11 U.S.C. § 541(a) provides that the commencement of a case under § 302 'creates an estate,' it is well established that despite the filing of a joint petition, separate estates continue to exist as to each debtor unless the court orders substantive consolidation. Accordingly, a joint petition simply results in two different debtors' bankruptcy cases being commenced by a single petition and treated as a single case for administrative purposes.") (internal citations omitted); *In re McAlister*, 56 B.R. 164, 166-67 (Bankr. D. Ore. 1985) ("Thus, although a joint petition by a debtor and such debtor's spouse is permitted under 11 U.S.C. § 302(a) for ease of administration, the estates of each spouse are, in legal effect, separate or several.");

³ Each state's respective laws on the nature of property rights between spouses will bear heavily on the analysis of how to allocate a federal tax refund. A 50-state survey of those property laws exceeds the scope of this article, which will focus on the main tests overlaid by courts on the applicable state's property laws.

⁴ "We caution that these rules will not apply in all cases. For example, the division of a joint tax refund might be different in community property states. In addition, in some jurisdictions, exemption laws may be invoked to exclude some or all of the contested tax refund from the estate." *In re Crowson*, 431 B.R. 484, 496 (B.A.P. 10th Cir. 2010).

⁵ *In re Quevedo*, No. 23-80195, 2024 WL 3754885, at *10 (Bankr. M.D.N.C. Aug. 9, 2024).

⁶ See, e.g., *In re Kleinfeldt*, 287 B.R. 291, 292 (B.A.P. 10th Cir. 2002); *In re Culp*, 631 B.R. 252, 254-55 (Bankr. E.D. Mich. 2021); *In re McInerney*, 609 B.R. at 504-07; *In re Gartman*, 372 B.R. 790, 795-96 (Bankr. D.S.C. 2007).

⁷ See, e.g., *In re Rice*, 442 B.R. 140, 144 (Bankr. M.D. Fla. 2010); *In re Kestner*, 9 B.R. 334, 336 (Bankr. E.D. Va. 1981).

⁸ *In re Quevedo*, No. 23-80195, 2024 WL 3754885, at *10 (Bankr. M.D.N.C. Aug. 9, 2024).

⁹ *In re Barrow*, 306 B.R. 28, 31 (Bankr. W.D.N.Y. 2004); *In re Hejmowski*, 296 B.R. 645, 646 (Bankr. W.D.N.Y. 2003); *In re Aldrich*, 250 B.R. 907, 913 (Bankr. W.D. Tenn. 2000).

¹⁰ *In re Crowson*, 431 B.R. 484, 492 (B.A.P. 10th Cir. 2010); *In re Lee*, 508 B.R. 399, 405 (S.D. Ind. 2014); *In re Quevedo*, No. 23-80195, 2024 WL 3754885, at *13 (Bankr. M.D.N.C. Aug. 9, 2024).

¹¹ 431 B.R. 484 (B.A.P. 10th Cir. 2010).

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court began its analysis with the proposition that incomes and withholdings are not the only circumstances through which a refund can occur, writing:¹²

The Crowsons' tax refund arose not only from [the] Debtor's withholding, but also from three tax credits that generated refundable overpayments: the earned income credit, the additional child tax credit, and the recovery rebate credit. Section 6401 of the Internal Revenue Code treats these credits as payments. Even when a taxpayer has no tax liability, these credits may constitute overpayments. These overpayments may be refunded by the IRS to "the person who made the overpayment" under [26 U.S.C. § 6402].

The court also analyzed the IRS revenue rulings, in particular Revenue Rulings 74-611 and 80-7. To create¹³

a formula for determining each spouse's rights in a joint refund for the purposes of offset, the IRS borrowed its previously established method of determining a decedent's separate tax liability (or refund) generated by a joint return with the surviving spouse. This Court is therefore of the opinion that allocating tax liability and credits between a decedent's estate and the surviving spouse, or between spouses for the purpose of offsetting only one spouse's refund against a prior liability, is analogous to allocating the tax liabilities and refunds between a bankruptcy estate and a non-filing spouse.

In *Quevedo*, an unreported case from the Middle District of North Carolina, the court also emphasized the separate-filings rule as a method that aligns with IRS revenue rulings, which recognize that each spouse has a distinct interest in the reported income and any overpayment when filing jointly:¹⁴

Under both federal and North Carolina law, taxpayers who file joint returns are jointly and severally liable for the taxes owed. *See* 26 U.S.C. § 6013(d)(3); N.C. Gen. Stat. § 105-153.8(e). And both the federal government and North Carolina provide mechanisms for relief from that joint liability. Section 6015 of the Internal Revenue Code provides, among other things, relief for "innocent" spouses and separation of liability for certain spouses who are divorced, separated, widowed, or not living together. 26 U.S.C. § 6015(b)-(c). Critically, the IRS awards proportionate relief under § 6015(c), allocating deficiencies or refunds as if the taxpayers had filed separate returns. *See* 26 U.S.C. § 6015(d)(3)(A). North Carolina directly incorporates 26 U.S.C. § 6015 through N.C. Gen. Stat. § 105-153.8(e).

The *Quevedo* court ultimately determined that the mere complexity of the separate-filings rule does not war-

rant choosing a different, but less accurate, approach. The fact that the separate-filings rule might "be complicated is no reason to reject it for a bright-line approach, which has the attraction of simplicity but fails to protect each spouse's true legal interest in and to the tax refund."¹⁵ This approach ensures that the allocation of refunds is not only fair but also consistent with federal tax law. The separate-filings rule accounts for each spouse's contributions, including tax credits and deductions, which might not be proportionate to income or withholdings. This comprehensive approach provides a more accurate reflection of each spouse's financial situation and legal interest in the refund.

Despite its complexity, the separate-filings rule is preferred for its precision in determining ownership interests. It provides a reliable calculation of each spouse's tax liability, ensuring that the allocation of refunds is both fair and consistent with legal principles. The rule's alignment with North Carolina law and IRS methodologies further strengthens its position as the most equitable method for determining ownership of joint tax refunds in bankruptcy cases.

In certain circumstances, the separate-filings rule might require an extensive and complicated analysis. However, as long as all of the parties-in-interest are aware of the applicable rule, settlements and consensual resolutions will still take place. As the *Crowson* court put it:¹⁶

We are not unsympathetic to the Trustee's concern that applying sophisticated calculations to determine the ratable shares of tax refunds may be more cumbersome than simply determining which spouse had wage withholding and allocating the refund accordingly. But, simplicity cannot come at the expense of the debtor's non-filing spouse. He should be permitted to benefit from those tax credits to which he contributed. The IRS's methods of allocation described in this opinion further that end. Whether a trustee should undertake this analysis should, like any other business decision a trustee makes, be decided case-by-case in the prudent exercise of his or her business judgment in the context of the economies of the particular matter. Whether a debtor or a non-filing spouse should incur the expense of mounting a defense to such an effort will be based upon the same reasoning. A disputed \$500 refund may not merit the effort, but a \$5,000 refund might.¹⁷

The *Quevedo* court agreed, writing that "[t]rustees in this district routinely negotiate and compromise on issues

¹² *Id.* at *13 (quoting *In re Duarte*, 492 B.R. 100, 108-09 (Bankr. E.D.N.Y. 2011)).

¹³ *In re Crowson*, 431 B.R. 484, 496 (B.A.P. 10th Cir. 2010).

¹⁴ Adjusted for inflation, these figures are \$742.46 and \$7,424.58. *See* CPI Inflation Calculator, www.bls.gov/data/inflation_calculator.htm (last visited on Oct. 31, 2025).

¹² *Id.* at 490.

¹³ *Id.* at 491.

¹⁴ *In re Quevedo*, No. 23-80195, 2024 WL 3754885, at *11-12 (Bankr. M.D.N.C. Aug. 9, 2024).

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of nonexempt equity, and joint tax refunds are no exception. The trustees and debtors must determine in each case whether the costs and uncertainties of litigation on a debtor's claimed exemption in a joint tax refund militate in favor of settlement."¹⁸

¹⁸ *In re Quevedo*, No. 23-80195, 2024 WL 3754885, at *13 n.15 (Bankr. M.D.N.C. Aug. 9, 2024).

Conclusion

The separate-filings rule offers a comprehensive and precise approach to allocating joint tax refunds in bankruptcy cases. The rule accurately reflects each spouse's individual tax liability and contributions, and ensures that the allocation of refunds is consistent with federal tax law and IRS methodologies and the goals of the bankruptcy system. The separate-filings rule should be the preferred method for determining ownership of joint tax refunds. **abi**

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