SUMMARY OF TESTIMONY IN SUPPORT OF KANSAS SENATE BILL 12

Senate Judiciary Committee: January 31, 2011

My name is Paul Post. I have been a lawyer for over 36 years, and in private practice in Topeka since 1978. A significant percentage of my private practice involves representing persons and families filing for bankruptcy. I generally represent debtors rather than creditors. My bankruptcy practice for debtors is about evenly divided between filing Chapter 7 bankruptcies and Chapter 13 repayment plans.

As part of the bankruptcy process, debtors are required to list all of their assets, which includes income tax refunds which they expect to receive. The refunds also include the earned income credit. If a tax refund is received after the case is filed, the debtor is usually required to turn the tax refund over to the bankruptcy trustee, for distribution by the trustee to unsecured creditors. It is also possible for me to accept an income tax assignment to pay all or a portion of my attorney fees in connection with the case.

The amount of the income tax refund and earned income credit required to be turned over to the trustee varies depending on when the case is filed. If a bankruptcy is filed early in the year, but after the previous year's tax refund or earned income credit is received, then the trustee will only require turnover of that portion of the refund or EIC that was "earned" prior to the time that the case was filed. In other words, if a case is filed on April 1, which is one fourth of the way through the year, then one fourth of the tax refund or EIC must be turned over. As the year progresses, more or the refund or EIC must be turned over. If a bankruptcy is filed after the new year begins, but before the tax return is filed and the refund received, then all of the tax refund and EIC from the previous year is subject to turnover to the trustee.

A trustee has discretion to decline to accept a refund or the EIC. If the refund is small, then

a trustee may allow the debtor to keep the refund, since there would not be a meaningful payment to unsecured creditors arising out of the refund. In my experience, if the refund is less than $1,000.00, then the trustee may decline to administer the refund for the benefit of creditors. However, this is not always true, especially if there are other potential non-exempt assets which the debtor owns that may be required to be turned over.

Court decisions in the 1990's determined that the earned income credit was subject to turnover to the trustee. This credit is available to the "working poor" who have minor children dependent upon the working parent for support. A person cannot receive the earned income credit if he or she does not work or if there are no minor children at home. Oftentimes, depending upon the number of children in the family and the amount of income received, the EIC can be substantial, oftentimes amount to several thousand dollars. A working parent can receive the EIC even if no taxes were withheld on account of employment, which oftentimes happens with a parent who has a low wage and several children in the home. Since the EIC is available only to working parents, it is specifically intended to encourage persons with minor children to work outside the home – it is a work-incentive program that is part of our federal welfare system, and when combined with the Temporary Aid to Needy Families program (TANF), is intended to assist those families in meeting their basic needs after the TANF payments expire.

The court rulings which allowed bankruptcy trustees to require turnover of the earned income credit are at cross-purposes with the national welfare assistance programs. The effect of these decisions is to remove the money from families who need the funds essentially to survive, and allow the money to be distributed to creditors . The question becomes whether it is fair result to redirect money away from low incomes families who need the funds for essential survival, and pay it to creditors. This question can be answered by looking how unsecured creditors receive money from

the bankruptcy estate. The trustee is allowed to base a fee on 25% of the first $5,000.00 of recovered assets in a Chapter 7 case, with a 10% fee charged for sums received thereafter on amounts up to $50,000.00. A $5,000.00 earned income credit refund would result in a fee of $1,250.00 to the trustee. A Chapter 7 trustee may also charge additional expenses against the recovered asset. Most trustee's charge separately, and usually at an hourly rate, for actual legal work that benefits the estate, and this on top of the trustee fee previously discussed. The attorney fee charges usually add an additional $500.00 to $1,000.00 to the total bankruptcy estate expenses, which are deducted from the recovered asset. Again, using the hypothetical $5,000.00 earned income credit, fees could easily exceed $2,000.00, leaving the balance for unsecured creditors, who share *pro rata* in the net recovered assets based upon the amount of each claim compared to the entire recovery.

It is not uncommon for unsecured creditors to receive small distributions amounting to only a few dollars. Oftentimes, the original creditor has sold its claim to a collection agency or a company that buys claims in bankruptcy for cents on the dollar. Thus, the small amount of money paid to creditors in Chapter 7 may end up in the coffer of a speculator who has purchased another company's bankruptcy claim. This comes at the expenses of working parents who would otherwise use the earned income tax exemption to purchase needed goods and services in the local economy. Exempting the earned income credit would allow those low income families to keep this source of funds for the benefit of their children.