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SEIZING WELFARE FROM THE BANKRUPT

*Michael D. Sousa**

ABSTRACT

The earned income tax credit (EITC) is currently the largest means-tested antipoverty program in the United States that assists low-income working families surviving along the edges of poverty. A central component of the national welfare system, the EITC has lifted millions of families with children out of poverty and has produced myriad benefits for their everyday lives. But most of the poor and near-poor endure in the low-wage labor market and often lead turbulent financial lives, plagued by precarious employment along with deleterious material and psychological constraints in budgeting for daily expenses. For the segment of these families also burdened by unwieldy debts, bankruptcy laws offer a fresh financial start in life, in part by allowing debtors to exempt certain property from the reach of creditors.

However, in most jurisdictions, EITC refunds, unlike many middle-class assets, are not exemptible in bankruptcy and can be seized by trustees to both enrich themselves and to distribute to creditors. Adopting a critical theory framework, this Article maintains that capturing EITC refunds from low-income working families who resort to filing for bankruptcy is inequitable and perpetuates class inequality. Low-income working families are doubly exploited in our harsh economy, first by the low-wage labor market and second by the bankruptcy system. As such, this Article proposes several statutory changes to fully protect EITC refunds in bankruptcy as a matter of fundamental equity.

I. INTRODUCTION

Lillian Morris filed for Chapter 7 bankruptcy pro se in the state of Kansas in October 2005.[1] A school teacher at the time, Morris had a monthly net income of just $1,161.63—translating into $13,939.56 in yearly income—but her monthly expenses amounted to $1,524.00, meaning that her expenses exceeded her take home pay by approximately $362 per month.[2] In the three years leading up to her bankruptcy filing, Morris averaged $14,960 in annual income, and experienced two bouts of

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1. Morris v. Morris (*In re* Morris), No. 05-18787, 2008 WL 819296, *1 (Bankr. D. Kan. Mar. 26, 2008).

2. *Id.*

unemployment.[3] When Morris filed for bankruptcy protection, she had a total of $70 in her bank account, $50 cash on hand, approximately $1,000 worth of household goods and clothing, and was owed $15,000 in back child support.[4] Her only significant asset was a mobile home worth $50,000, but the mobile home was encumbered by a mortgage in excess of its value.[5] Morris owed approximately $25,000 to unsecured creditors, including seven payday lenders, overdraft fees on her bank account, and $14,544 for the prior repossession of her automobile.[6] Because her liabilities well exceeded her assets, Morris was the perfect candidate to file bankruptcy, seeking a "fresh start" in her financial life along with a discharge of most of her unmanageable debts.[7] In bankruptcy parlance, Morris's case was a "no-asset" Chapter 7 case: because Morris had no assets for the bankruptcy system to liquidate and distribute to her creditors, no payments to creditors would take place.

In addition to supporting herself, Morris claimed four dependents on her 2005 income tax return.[8] As a low-income working parent with several dependents, Morris received a federal earned income tax credit refund of $3,788 in March 2006 for the 2005 taxable year. When the Chapter 7 bankruptcy trustee learned of this tax refund, he quickly demanded that Morris turn over the money for distribution to her creditors in accordance with the bankruptcy laws.[9] But by that point, Morris had used the money to pay her living expenses. When she learned of the trustee's demand, Morris was "shocked," believing that the trustee "would have no claim to the earned income tax credit," which, in her view, "belonged" to her and her dependents.[10] Undeterred, the trustee again demanded that Morris turn over the $3,788. The trustee threatened Morris with legal action, claiming that if she did not turn over the funds, he would seek to revoke her bankruptcy discharge and saddle her with at least $500 in attorneys' fees.[11] Morris responded to the bankruptcy trustee in writing:

> Please proceed with a revocation of discharge, as I don't have any money to feed myself and my dependents. I can't pay you any minimum of attorney fees, as I barely can pay my electric and water bill. I am sorry that

3. Voluntary Petition, *In re Morris*, 2008 WL 819296, at *3 (No. 05-18787).

4. *Id.* at *8.

5. *Id.* at *9.

6. *Id.* at *13-15.

7. Homaidan v. Sallie Mae, Inc. (*In re* Homaidan), 646 B.R. 550, 592 (Bankr. E.D.N.Y. 2022) (noting that the discharge of debt through bankruptcy enables an individual debtor to experience a fresh start in life).

8. *In re Morris*, 2008 WL 819296, at *2.

9. *Id.*

10. *Id.*

11. *Id.* at *3.

> I can't pay you money. Please do not beat me down any further than I already am. Your words are freightening [sic] and upsetting. Don't spend any more time and just go ahead with your revoke.[12]

Remaining steadfast in his pursuit of Morris's earned income tax credit refund, the bankruptcy trustee served writs of garnishment against Morris's bank account on at least two occasions, resulting in a recovery of $404 (on one occasion, Morris's bank account was already overdrawn). Morris then retained legal counsel and learned for the first time that, under Kansas law, her earned income tax credit refund belonged to her bankruptcy estate and could be intercepted by the bankruptcy trustee.[13] The trustee made good on his promise and sued Morris, seeking to revoke her discharge and arguing that Morris knew not to spend any refund without his prior consent.[14] According to the trustee, because Morris "knowingly" did not turn over the earned income tax credit refund, her discharge should be revoked. The bankruptcy court ultimately declined to revoke Morris's discharge, finding that she had no intent to deceive the bankruptcy system, in part because she subjectively believed that the moneys did not qualify as refunds.[15] While Morris kept her bankruptcy discharge, the court entered a judgment in favor of the bankruptcy trustee for the unreturned earned income tax credit, along with accruing interest, and a lien upon her exempt assets and future tax refunds.[16] Over the next two years, Morris repaid the trustee the sum of approximately $3,054.03.

As a result of the $3,054.03 extracted from Morris, the bankruptcy trustee effectively converted her once no-asset case into an asset case with funds available to pay her unsecured creditors. However, and under the current bankruptcy paradigm for compensating Chapter 7 trustees, the trustee himself received a total of $1,782.01 in compensation and reimbursement expenses—including $324.94 for hiring himself as an attorney to prosecute the action to revoke Morris's discharge—representing approximately 58% of the total amount recovered. Morris's unsecured creditors, however, collectively received a distribution of $1,272.02, representing only approximately 41% of the recovery.[17]

The Morris bankruptcy case highlights a disturbing dynamic lurking within the consumer bankruptcy system. As discussed more robustly below, the earned income tax credit (EITC) is currently the largest needs-based antipoverty program in the United States, comprising an essential component of the public safety net for low-income workers with

12. *Id.*
13. *Id.*
14. *Id.* at *5.
15. *Id.* at *6.
16. *Id.* at *9-10.
17. Trustee's Final Report, *In re Morris*, 2008 WL 819296, at *8-10 (No. 05-18787).

children.[18] Stylized as a refundable tax credit, the EITC is a public welfare program using "the rules and procedures of the federal income tax system to make payments to low-income workers based upon their earnings and total income."[19] Authorized pursuant to § 32 of the Internal Revenue Code,[20] low-income taxpayers receive a cash transfer denominated as a refundable tax credit that is contingent upon the recipient engaging in the workforce.[21]

Simply put, if the amount of the eligible credit exceeds a family's income tax liability for a given year, the Internal Revenue Service will refund the balance.[22] The size of the EITC refund depends upon various factors, including labor force participation and the amount of earned wages, age, marital status, and number of dependents.[23] According to the most recent Internal Revenue Service data, 26 million taxpayers received a total of $59 billion for the EITC in 2020.[24] Though orchestrated through the federal tax system, in reality the EITC is a public welfare cash assistance program that subsidizes the wages of low-income working families living in poverty or subsisting just above the federal poverty line.[25] Since its inception in 1975, the EITC program has lifted millions of families out of poverty and produced a host of salutary benefits for the lives of low-income working families struggling to exist in the United States' harsh economic environment.[26] As one scholar has noted, "[f]or a low-income family, EITC cash flow may mean the difference between shelter and homelessness; sustenance and hunger; reliable gas, electric, and telephone services and chronic shut-off notices; employment and relentless joblessness; and an opportunity for education and unavoidable

18. Bruce D. Meyer, *The Effects of the Earned Income Tax Credit and Recent Reforms*, 24 TAX POL'Y & ECON. 153, 153 (2010).

19. Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 534 (1995).

20. Section 32(a)(1) of the Internal Revenue Code provides as follows: "[i]n the case of an eligible individual, there shall be allowed as a credit against the tax imposed by this subtitle for the taxable year an amount equal to the credit percentage of so much of the taxpayer's earned income for the taxable year as does not exceed the earned income amount." 26 U.S.C.A. § 32 (West 2024).

21. Jennifer Sykes et al., *Dignity and Dreams: What the Earned Income Tax Credit (EITC) Means to Low-Income Families*, 80 AM. SOCIO. REV. 243, 244 (2014) (characterizing the EITC program as "the largest cash transfer to the poor").

22. Hilary Hoynes, *The Earned Income Tax Credit*, 686 ANNALS AM. ACAD. POL. & SOC. SCI. 180, 181 (2019).

23. MARGOT L. CRANDALL-HOLLICK ET AL., CONG. RSCH. SERV., R43805, THE EARNED INCOME TAX CREDIT (EITC): HOW IT WORKS AND WHO RECEIVES IT 1 (2023).

24. *Id.*

25. *See* S. REP. NO. 94-36, at 35 (1975) ("Since the credit is refundable, eligible individuals with low incomes on which little or no income tax is due are to receive a cash payment equal to the amount of the credit reduced by any tax due.").

26. Jacob Bastian & Katherine Michelmore, *The Long-Term Impact of the Earned Income Tax Credit on Children's Education and Employment Outcomes*, 36 J. LAB. ECONS. 1127, 1128 (2018).

absenteeism."[27]

Most of the poor and near-poor subsist in the low-wage labor market and often lead turbulent financial lives, characterized by precarious employment prospects and numerous psychological and budgetary difficulties.[28] Because of the exploitative relationship between low-wage workers and their employers, the working poor exist on the economic margins of society and "often manage the irregularity of their financial lives by taking on costly debt."[29] Consequently, when a triggering event such as a job loss, family separation, or medical illness occurs, it can reasonably prompt them to seek debt relief by filing for bankruptcy protection.[30] For those who do turn to the bankruptcy system, debtors may legally exempt certain property from the reach of bankruptcy trustees and creditors under either federal or state exemption statutes.[31] And despite the breadth of empirical scholarship demonstrating the financial, physical, and psychological benefits that the EITC bestows upon low-income working families, only fifteen states to date specifically protect EITC refunds as exemptible personal property in bankruptcy. In an additional seven states, courts have shielded EITC refunds from the reach of creditors by construing their state exemption statutes liberally to incorporate the EITC. However—and quite unforgivingly—twenty-nine jurisdictions (including the District of Columbia) provide no protections for low-income working debtors seeking to shield their EITC refunds from the bankruptcy process.

The current regime for exempting EITC refunds from bankruptcy creditors is an assemblage of laws that fall into a typology with four different outcomes based on the debtor's place of filing: (1) absolute protection for EITC benefits; (2) protection for EITC benefits in states having generally-worded exemption statutes that protect "public

27. Francine J. Lipman, *The Working Poor are Paying for Government Benefits: Fixing the Hole in the Anti-Poverty Purse*, 2003 WISC. L. REV. 461, 463-64 (2003).

28. JOEL F. HANDLER & YEHESKEL HASENFELD, BLAME WELFARE, IGNORE POVERTY AND INEQUALITY 7 (2007); Jennifer L. Romich & Thomas Weisner, *How Families View and Use the EITC: Advance Payment Versus Lump Sum Delivery*, 53 NAT'L TAX J. 1245, 1252-53 (2000); Anne L. Alstott, *Why the EITC Doesn't Make Work Pay*, 73 LAW & CONTEMP. PROBS. 285, 303 (2010).

29. Sarah Halpern-Meekin et al., *The Rainy Day Earned Income Tax Credit: A Reform to Boost Financial Security by Helping Low-Wage Workers Build Emergency Savings*, 4 RSF: RUSSELL SAGE FOUND. J. SOC. SCIS. 161, 172 (2018).

30. Sara S. Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair*, 88 N.Y.U. L. REV. 515, 523 (2013). *See also* HANDLER & HASENFELD, *supra* note 28, at 6 ("Millions of people who are not 'officially' poor are just above the poverty line. One medical bill, a disappearing job, one extra expense for necessities sends a family below the poverty line."); Laura Tach et al., *"As Good as Money in the Bank": Building a Personal Safety Net with the Earned Income Tax Credit*, 66 SOC. PROBS. 274, 275 (2019) (noting that "low-skilled workers are disproportionately likely to experience incomes losses associated with unemployment, health shocks, and family disruption").

31. 11 U.S.C.A. §§ 522(b)(1)-(2) (West 2024).

assistance" benefits;[32] (3) no protection for EITC benefits in states whose exemption statutes only afford protection for "local" public assistance benefits;[33] and (4) states whose exemption statutes offer no protection for EITC benefits at all.

Providing debtors with property exemptible from creditor capture ensures that debtors are not completely deprived of their means of support, leaves the debtor—and family—with the bare necessities of life, and safeguards the debtor from being left destitute and consequently becoming a "public charge."[34] If exemption laws are truly geared towards leaving debtors with the bare necessities of life, then permitting bankruptcy trustees to seize EITC refunds from low-income working families is both unjustifiable and inexcusable.

The purpose of this Article is two-fold. First, it exposes the bankruptcy system by revealing the mechanisms through which low-income working families may be stripped of their welfare benefits while wealthier debtors can protect substantial assets—most notably retirement plans and home equity—from creditors under both state and federal law. There is nothing neutral nor natural about this class disparity. As argued elsewhere, the bankruptcy laws are a social construction that oftentimes reproduce the interests of the dominant classes.[35] Second, and given this differential outcome, this Article advocates for several simple statutory changes to rectify this bankruptcy class inequality.[36] While bankruptcy has long been identified as a financial refuge for the middle-class,[37] low-income individuals and families like Lillian Morris also resort to bankruptcy when their financial situations become bleak and inescapable. The tone of this Article is not doctrinally neutral but rather undergirded by principles of critical theory. In its broadest perspective, critical theory strives to abolish social injustice, particularly in relations stemming from the dynamics of capitalism.[38] Critical theory challenges existing

32. *See, e.g.*, 735 ILL. COMP. STAT. 5/12-1001(g)(1) (West 2024) (exempting a "debtor's right to receive a social security benefit, unemployment compensation, or public assistance benefits").

33. *See, e.g.*, S.C. CODE ANN. § 15-41-30(A)(11)(a) (West 2024).

34. Sw. State Bank v. Quinn, 424 P.2d 620, 624 (Kan. 1967).

35. *See generally* Michael D. Sousa, *Consumer Bankruptcy in the Neoliberal State*, 39 EMORY BANKR. DEVS. J. 199 (2023).

36. Other scholars have also highlighted the class inequalities embedded in the national bankruptcy laws. *See, e.g.*, Nathalie Martin, *Poverty, Culture and the Bankruptcy Code: Narratives from the Money Law Clinic*, 12 CLINICAL L. REV. 203 (2005); Linda E. Coco, *The Cultural Logics of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Fiscal Identities and Financial Failure*, 40 CRITICAL SOCIO. 711 (2014).

37. TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 238 (2000). For demographic and descriptive insights into those who file for bankruptcy, see generally Pamela Foohey et al., *Portraits of Bankruptcy Filers*, 56 GA. L. REV. 573 (2022).

38. Max Horkheimer, *Traditional and Critical Theory*, *in* CRITICAL THEORY: THE ESSENTIAL

institutional structures to unmask social inequalities aiming to achieve less domination, exploitation, and social differential.[39]

This Article's theoretical claim is straightforward: low-income working families are doubly exploited, first by the oppressive low-wage labor market driven by neoliberal economic policies,[40] and second by the bankruptcy system that prioritizes the interests of trustees and creditors by permitting the seizure of EITC benefits. In doing so, this Article is separated into the following component parts. Section II offers the reader a condensed historical sketch of the EITC and explains how the EITC functions statutorily to assist low-income households with children. Section III surveys the disciplinary literature exploring the various ways in which the EITC brings value to the lived experiences of recipients and their families. Section IV then shifts the discussion to address the structure of the consumer bankruptcy system, the nature of property exemptions, and why bankruptcy trustees might be systematically driven to seize low-income debtors' EITC benefits. Section V provides the reader with an overview of the fractured national bankruptcy exemption scheme for EITC benefits. From this, Section VI argues how the current assemblage of exemption statutes that allow the seizure of EITC benefits from low-income debtors is inexcusable and inequitable, particularly considering the various ways in which the bankruptcy system protects middle-class assets and a myriad of other public benefits. Finally, Section VII concludes and provides some statutory recommendations for reforming the bankruptcy system to fully exempt EITC benefits from bankruptcy trustees and creditors.

II. THE EARNED INCOME TAX CREDIT: HISTORY AND OPERATION

The United States public welfare state is an enormously complex structural system that spreads throughout all levels of government and includes social programs like Medicaid, Medicare, Supplemental Security Income, Temporary Assistance for Needy Families (TANF), the Food Stamp Program, and the EITC.[41] From this list, the EITC is the most effective antipoverty component of the United States public welfare

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READINGS 253 (David Ingram & Julia Simon eds., 1992). *See also* STEVEN M. BUECHLER, CRITICAL SOCIO. 55 (2014) ("For critical sociology, capitalism is the dominant force in the modern world.").

39. BERNARD E. HARCOURT, CRITIQUE & PRAXIS: A CRITICAL PHILOSOPHY OF ILLUSIONS, VALUES, AND ACTION 48 (2020).

40. The term "neoliberal" is commonly employed to characterize the current phase of American capitalism, "featuring market-emulating governance, financialisation, privatization, the reduction of citizens to 'human capital,' [and] a profound antipathy to progressive redistribution." Gareth Dale, *Justificatory Fables of Ordoliberalism: Laissez-Faire and the "Third Way,"* 45 CRITICAL SOCIO. 1047, 1049 (2019).

41. HANDLER & HASENFELD, *supra* note 28, at 74.

state.[42] Federal expenditures on the EITC dwarf those of other needs-tested antipoverty programs, such as TANF and SNAP/Food Stamps.[43] As one commentator has noted, the EITC "is intended to be a response to the needs of people who have earned income but who do not have enough money to satisfy their basic needs."[44] More specifically, the EITC targets taxpayers and their families who subsist along the margins of the federal poverty line, particularly single, low-wage working women with children.[45]

The rich political history of the EITC and its ascendancy as a cornerstone of the United States welfare state has been ably recounted by others.[46] Consequently, this Article will provide only a brief sketch here. By way of background, the United States has always had a historically, politically, and culturally queasy relationship with providing welfare to the needy. Armed with the hegemonic discourses of self-reliance, industry, and "pulling yourself up by your bootstraps," Americans cling to the trope that the less fortunate can move themselves out of poverty by simply working hard enough.[47] This has translated into a political philosophy that "poverty can be reduced by incentivizing individuals to work, or to work more."[48] Accordingly, the general approach to public assistance in the United States—particularly beginning in the mid-twentieth century—is to assist poor households achieve self-sufficiency by incentivizing or requiring work as a condition of receiving benefits.

In the late 1960s, and with the rise of a reinvigorated conservative movement, welfare programs that provided direct cash assistance to the able-bodied poor came under intensifying scrutiny. And as the United States slipped into a series of economic crises in the early 1970s—including wage stagnation, oil embargos, high inflation, heightening

42. *Id.* at 81. *See also* Meyer, *supra* note 18, at 153 (noting that the EITC "is now the largest antipoverty program for the nonaged in the United States").

43. Greg M. Shaw, *Changes in Public Opinion and the American Welfare State*, 124 POL. SCI. Q. 627, 629-30 (2009). *See also* CRANDALL-HOLLICK ET AL., *supra* note 23, at 15 ("Today the EITC is the largest need-tested, antipoverty program that provides cash benefits.").

44. Jennifer Bird-Pollan, *Who's Afraid of Redistribution? An Analysis of the Earned Income Tax Credit*, 74 MO. L. REV. 251, 272 (2009).

45. Meyer, *supra* note 18, at 156, 177.

46. *See generally* Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit*, *in* MAKING WORK PAY: THE EARNED INCOME TAX CREDIT AND ITS IMPACT ON AMERICA'S FAMILIES 15-66 (Bruce D. Meyer & Douglas Holtz-Eakin eds., 2001); *see generally* Jonathan Barry Forman, *Improving the Earned Income Tax Credit: Transition to a Wage Subsidy Credit for the Working Poor*, 16 FLA. ST. U. L. REV. 41 (1988); *see generally* Mary Leto Pareja, *Earned Income Tax Credit Portability: Respecting the Autonomy of American Families*, 117 W. VA. L. REV. 1 (2014).

47. Monica Fisher et al., *Working Yet Poor: A Quantitative Analysis for the United States*, 28 J. POVERTY 244, 244 (2024).

48. Brian C. Thiede et al., *America's Working Poor: Conceptualization, Measurement, and New Estimates*, 42 WORK & OCCUPATIONS 267, 268 (2015).

income inequality, and rising payroll taxes—the number of families on welfare increased dramatically, nudging Congress to reexamine the welfare system in the United States.[49] By this time, an "anti-welfare, pro-work sentiment" pervaded the national political landscape.[50] Avoiding governmental dependency became the main concern for elected officials, and they proposed a reformed welfare system that would reward work, stimulate economic growth, and minimize administrative costs.[51] Among various welfare reform ideas swirling about during the early 1970s—including calls to adopt a Friedmanite negative income tax and President Nixon's Family Assistance Plan[52]—the antecedents to the EITC program can be traced to Senator Russell Long's "work bonus" proposal in 1972. Specifically, his proposal called for wage subsidies for low-income workers together with a "work bonus" that would be phased out at certain specified income levels.[53] Senator Long maintained that his proposal "would offset social security taxes, act as an earnings subsidy, and 'prevent the taxing of people onto the welfare rolls.'"[54]

With the economy slipping into a recession in 1974, President Ford proposed the Tax Reduction Act of 1975, which, among other tax measures seeking to stimulate a lagging economy, introduced the EITC that directly drew from Senator Long's earlier "work bonus" proposal.[55] The EITC program began as a modest endeavor aimed at offsetting Social Security payroll taxes and the rising costs of living for low-income households by providing a refundable tax credit.[56] The legislative history of the EITC program makes it abundantly clear that the most significant underlying objectives were to "assist in encouraging people to obtain employment, [thus] reducing the unemployment rate and reducing the welfare rolls."[57] Consequently, the EITC was designed with dueling tenets, namely, to act as a safety net for the low-income working poor

49. *See generally* Tayyab Mahmud, *Precarious Existence and Capitalism: A Permanent State of Exception*, 44 SW. L. REV. 699 (2015) (detailing the economic changes in American society during the 1970s).

50. Ventry, Jr., *supra* note 46, at 16.

51. *Id.* at 18, 30.

52. *Id.* at 17-20.

53. *Id.* at 22.

54. *Id.* (citation omitted).

55. *Id.* at 25 (citation omitted).

56. Hoynes, *supra* note 22, at 181. The Senate Report accompanying the Tax Reduction Act of 1975 articulated the following justifications for establishing the EITC program: "This new refundable credit will provide relief to families who currently pay little or no income tax. These people have been hurt the most by rising food and energy costs. Also, in almost all cases, they are subject to the social security payroll tax on their earnings. Because it will increase their after-tax earnings, the new credit, in effect, provides an added bonus or incentive for low-income people to work, and therefor, should be of importance in inducing individuals with families receiving Federal assistance to support themselves." S. REP. NO. 94-36, at 11 (1975).

57. *Id.* at 33.

while economically incentivizing individuals and families to enter the formal labor force.[58]

The EITC is designed as a refundable tax credit.[59] Thus, any credit due that exceeds an individual or family's annual income tax liability is refunded to the taxpayer in the form of a refund check.[60] But because the credit is refundable, an EITC recipient need not owe any income taxes in a given year to receive the benefit.[61] The EITC itself is structured with three distinct regions. In the first—the "phase in" region—the EITC acts as an earnings subsidy; that is, the EITC phases in as a percentage of earned income (the "credit rate") until the credit reaches its maximum level.[62] As illustrated by Figure 1, the credit rate ranges from 7.65% to 45% for both unmarried and married taxpayers, depending on the number of qualifying children. The more qualifying children unmarried or married taxpayers have, the larger the EITC benefit will be. In the second—the "plateau" region—the EITC operates as a lump sum subsidy where the EITC credit remains at a static maximum level between the "earned income amount" and the "phaseout amount threshold."[63] In the final region—the "phaseout"—the credit "gradually decreases in value to zero at a fixed rate . . . for each additional dollar of earned income or AGI (whichever is greater) above the phaseout amount threshold."[64]

58. Tim Dowd & John B. Horowitz, *Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support*, 39 PUB. FIN. REV. 619, 620 (2011).

59. A taxpayer must fulfill the following requirements in order to be eligible for the EITC: (i) the taxpayer must file a federal income tax return; (ii) the taxpayer must have earned income; (iii) the taxpayer must satisfy certain residency requirements; (iv) the taxpayer's children must satisfy relationship, residency, and age requirements to be considered "qualifying children" for the credit; (v) for childless workers, they must be between the ages of twenty-five and sixty-four years old; (vi) the taxpayer's investment income must be below a certain threshold; (vii) the taxpayer must not be disallowed the credit due to prior instances of fraud or a reckless disregard of the rules during prior claims for the EITC; and (viii) the taxpayer must provide Social Security numbers for themselves, their spouse, and any children for whom the credit is claimed. 26 U.S.C.A. § 32 (West 2024).

60. Nada Eissa & Jeffrey B. Liebman, *Labor Supply Response to the Earned Income Tax Credit*, 11 Q.J. ECONS. 605, 605 (1996).

61. CRANDALL-HOLLICK ET AL., *supra* note 23, at 1.

62. *Id.* For example, as Figure 1 indicates, if an unmarried taxpayer with one qualifying child earns exactly $11,750, their earned income credit rate would be 34% of wages, leading to an EITC refund of $3,995.

63. *Id.* at 5.

64. *Id.*

Number of Qualifying Children	0	1	2	3 or more
unmarried taxpayers (single and head of household filers)				
credit rate	7.65%	34%	40%	45%
earned income amount	$7,840	$11,750	$16,510	$16,510
maximum credit amount	$600	$3,995	$6,604	$7,430
phaseout amount threshold	$9,800	$21,560	$21,560	$21,560
phaseout rate	7.65%	15.98%	21.06%	21.06%
income where credit = 0	$17,640	$46,560	$52,918	$56,838
married taxpayers (married filing jointly)				
credit rate	7.65%	34%	40%	45%
earned income amount	$7,840	$11,750	$16,510	$16,510
maximum credit amount	$600	$3,995	$6,604	$7,430
phaseout amount threshold	$16,370	$28,120	$28,120	$28,120
phaseout rate	7.65%	15.98%	21.06%	21.06%
income where credit = 0	$24,210	$53,120	$59,478	$63,398

Figure 1: EITC Parameters by Marital Status and Number of Qualifying Children, 2023.[65]

As Figure 1 illustrates, the amount of the EITC is based upon several factors, most notably the marital status of the taxpayer, the number of qualifying children, and, of course, the annual earnings for the taxpayer and their spouse (if married). Of particular significance in Figure 1 are the maximum credit amounts for both unmarried and married taxpayers. For an unmarried or married taxpayer with no qualifying children, the maximum EITC refund is $600. For those with one qualifying child, the maximum EITC refund is $3,995. For those with two qualifying children, the maximum EITC refund is $6,604. And for those with three or more qualifying children, the maximum EITC refund is $7,430. While the maximum credit amounts equate to seemingly generous wage subsidies of 35%, 40%, and 45%, bankruptcy trustees routinely seek to seize these maximum annual tax credit refunds between $600, $3,995, $6,604, and $7,430 to not only enrich themselves, but to also pay towards unsecured debt.[66] According to Internal Revenue Service data for 2020, the average EITC refund for taxpayers with no qualifying children was $295. For those with one qualifying child, the average credit was $2,276. For those with two qualifying children, the EITC average credit amounted to $3,722. And for taxpayers with three or more qualifying children, the average EITC refund was $4,139.[67]

65. CRANDALL-HOLLICK ET AL., *supra* note 23, at 5 (2023).
66. *Id.* at 20.
67. *Id.*

As researchers have repeatedly found, the EITC is most significant for low-income, unmarried single mothers who have a greater probability of falling within the EITC phase-in range.[68] Overall, taxpayers with qualifying children receive 96% of EITC refunds.[69] Eligible recipients typically receive their EITC refunds in a lump sum payment during the months of February, March, or April following the processing of income tax returns.[70] This coincides with the months when many consumer debtors choose to file for bankruptcy, frequently utilizing their tax refunds to defray the entry costs of bankruptcy in terms of attorneys' fees and court filing fees.[71] On average, EITC refunds for low-income working families are equivalent to approximately three and a half months of income.[72] And while the EITC benefits taxpayers by oftentimes lifting them and their families out of poverty, critics have called the EITC, by itself, insufficient, given other structural impediments such as a low-income labor market and the high cost of daily commodities like food, clothing, and housing.[73]

Since its inception, the EITC program has undergone major economic expansions in the tax acts of 1986, 1990, and 1993.[74] And after the effective dismantling of traditional entitlement-based welfare in 1996 through the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA)—which replaced Aid to Families with Dependent Children (AFDC) with TANF—the EITC program has become the most important cash transfer program for low-income working families.[75] As noted, single parents with children generally account for about three quarters of EITC credit payments.[76]

The EITC is a hybrid of a wage subsidy and a means-tested welfare

68. Kate W. Strully et al., *Effects of Prenatal Poverty on Infant Health: State Earned Income Tax Credits and Birth Weight*, 75 AM. SOCIO. REV. 534, 535 (2010); Kerry A. Ryan, *EITC as Income (In)Stability*, 15 FLA. TAX REV. 583, 604 (2014). *See also* Hoynes, *supra* note 22, at 187 (noting that "EITC spending disproportionately goes to single parents with children").

69. CRANDALL-HOLLICK ET AL., *supra* note 23, at 19.

70. David H. Rehkopf et al., *The Short-Term Impacts of Earned Income Tax Credit Disbursement on Health*, 43 INT'L J. EPIDEMIOLOGY 1884, 1885 (2014).

71. Ronald J. Mann & Katherine Porter, *Saving Up for Bankruptcy*, 98 GEO. L.J. 289, 319-22 (2010).

72. Sara LaLumia, *The EITC, Tax Refunds, and Unemployment Spells*, 5 AM. ECON. J.: ECON. POL'Y 188, 218 (2013).

73. Anne L. Alstott, *Why the EITC Doesn't Make Work Pay*, 73 LAW & CONTEMP. PROBS. 285, 297-312 (2010).

74. Eissa & Liebman, *supra* note 60, at 607.

75. Hilary Hoynes et al., *Income, the Earned Income Tax Credit, and Infant Health*, 7 AM. ECON. J. ECON. POL'Y 172, 172 (2015). *See also* Ryan, *supra* note 68, at 603 (discussing the heightened saliency of the EITC as a major antipoverty initiative in light of the 1996 Personal Responsibility and Work Opportunity Reconciliation Act and the overall retrenchment in the entitlement structure of welfare).

76. Hoynes et al., *supra* note 75, at 179. *See also* Meyer, *supra* note 18, at 157 (finding that 73% of all EITC payments received in 2003 benefited single parents).

program, albeit administered through the income tax system.[77] Though firmly encapsulated as a part of the public welfare state, the EITC is not ordinarily considered to be welfare per se by politicians or the general public. Unlike other direct cash assistance transfer programs, the EITC is administered through the Internal Revenue Service in the form of a wage subsidy and a refundable tax credit that conditions labor force participation on the receipt of benefits.[78] Precisely because the EITC supports low-income families while encouraging workforce participation, it has historically received bipartisan political support from both liberals and conservatives.[79] In this vein, the EITC has been aptly described as a "work-based safety net administered through tax refunds."[80] More perniciously, however, the EITC also enjoys broad support from the business community "because it functions as a generous handout to corporations" by allowing them to supplement the measly wages they pay to low-wage workers through income subsidies provided by the EITC.[81]

Due to its hybrid nature, the EITC may be conceptualized through three different prisms. From the perspective of the Internal Revenue Service, the EITC is treated as a tax overpayment distributed through a tax refund.[82] From a larger macro-perspective, the EITC is a major component of the national social safety net. And from the perspective of low-income families receiving the EITC, it functions as a wage supplement, rewarding such families for their hard work and improving their financial lives.[83] But the current vulnerability of EITC payments, as exemplified by a bankruptcy trustee's ability to capture and distribute them to creditors, stems from the United States Supreme Court decision

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77. Ryan, *supra* note 68, at 585. *See also* Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867, 1903 (2005) ("The EITC is a transfer program with the protective coloration of a tax program. That coloration is not sufficient to disguise completely its transfer nature, but it does confuse the issue enough that EITC overpayments are viewed as much less objectionable than welfare overpayments.").

78. HANDLER & HASENFELD, *supra* note 28, at 88. *See also* Dennis J. Ventry, Jr., *Welfare by Any Other Name: Tax Transfers and the EITC*, 56 AM. U. L. REV. 1261, 1269 (2007) (noting that one "potential benefit of delivering social welfare through the tax system rather than through direct expenditure programs may involve our desire to hide these programs in the tax system").

79. HANDLER & HASENFELD, *supra* note 28, at 82 (noting that "[b]oth liberals and conservatives continued to support the EITC on the grounds that it both encouraged work and reduced the tax burdens of low-earning families"); Meyer, *supra* note 18, at 153 ("The goal of the EITC has been to transfer income while encouraging work. This feature led to the political support for its initial adoption and for its subsequent expansions.").

80. Tach et al., *supra* note 30, at 278.

81. MATTHEW DESMOND, POVERTY, BY AMERICA 58 (2023).

82. 26 U.S.C.A. §§ 6401-6402 (West 2024).

83. *See, e.g.*, Greene, *supra* note 30, at 522 (finding that receiving the EITC motivates recipients to work "and gives them a sense of pride in receiving a tax refund based on their work"). *See also* Romich & Weisner, *supra* note 28, at 1254 (finding that EITC recipients view their payments "as a time when they can get caught up on their bills and feel a little ahead for a while").

in *Sorenson v. Secretary of the Treasury of the United States*.[84] In *Sorenson*, the Court considered whether a woman could intercept, as a condition of her receiving AFDC payments, EITC payments due to a former husband to offset past-due child support payments assigned to a state government.[85] In answering this inquiry in the affirmative, the Court first had to identify the nature of EITC refunds. Rather than place substance over form and define the EITC as a welfare program, the Court interpreted §§ 6401 and 6402 of the Internal Revenue Code strictly, holding that EITC refunds were merely "overpayments" of tax and were "inseparable from [their] classification as an overpayment of tax."[86] In so holding, the Court interpreted the EITC not as a type of welfare grant, but rather as a vehicle "meant to negate the disincentive to work caused by Social Security taxes."[87] And because the EITC is payable in a lump sum, the Court treated it as akin to excess earned income withholdings clearly reachable by the state intercept program.[88] Relying upon the Supreme Court's characterization of the EITC as not in the nature of welfare but rather as overpayments of earned income—like generic tax refunds—bankruptcy courts have repeatedly held that EITC payments constitute assets in bankruptcy that trustees can seize for the benefit of creditors.[89]

Before turning to the intricacies of bankruptcy law and the mechanisms through which EITC payments may be subject to capture and distribution to creditors, this Article turns to empirical studies across various disciplines in investigating the myriad ways in which EITC payments benefit low-income working families in their quotidian lives.

III. DISCIPLINARY STUDIES ON THE EFFECTIVENESS OF THE EITC FOR LOW-INCOME HOUSEHOLDS

There is a vast and extraordinarily robust literature in the disciplines of public health, labor policy, epidemiology, economics, tax policy, and sociology that investigates the impacts of the EITC across major life domains for individuals, families, and their dependents. While it is beyond the scope of this Article to provide an encyclopedic account of these studies, addressing several of the major findings teases out how the EITC benefits low-income families and how they utilize their EITC

84. 475 U.S. 851 (1986). Indeed, another commentator has made the same claim. *See* Jennifer E. Spreng, *When "Welfare" Becomes "Work Support": Exempting Earned Income Tax Credit Payments in Consumer Bankruptcy*, 78 AM. BANKR. L.J. 279, 292-93 (2004).

85. 475 U.S. at 853-54.

86. *Id.* at 859.

87. *Id.* at 858.

88. *Id.* at 863-64.

89. *See, e.g.*, Trudeau v. Royal (*In re* Trudeau), 237 B.R. 803, 807 (B.A.P. 10th Cir. 1999); *In re* Parker, 352 B.R. 447, 451-52 (Bankr. N.D. Ohio 2006).

refunds to support themselves financially. These considerations advance this Article's central claim: EITC benefits should be protected from seizure by trustees acting for the benefit of themselves and creditors in the bankruptcy system.

Health and epidemiological studies have uncovered various pro-social benefits associated with the receipt of EITC benefits. For example, since poverty is highly correlated with worse child health and behavioral outcomes, studies have demonstrated that receiving the additional income provided by the EITC, particularly for children of unmarried mothers, promotes child development, health and birth weights, and reduces child abuse and neglect.[90] Other epidemiological studies have shown improved diets among EITC recipients.[91] Public health studies have uncovered that receiving EITC benefits protects women from intimate partner violence in the forms of physical isolation and economic coercion.[92] Health economic studies have found that receiving the EITC leads to significantly lower probabilities of smoking among white women.[93] Labor economists and tax policy analysts have repeatedly demonstrated that the EITC program increases both labor force participation and longitudinal earnings among low-income families with children.[94] Scholars have also demonstrated that the EITC positively affects intergenerational mobility; EITC exposure increases the probability of teenage children completing both high school and college, which, in turn, translates into increased probabilities for their own labor market

90. Rita Hamad & David H. Rehkopf, *Poverty and Child Development: A Longitudinal Study of the Impact of the Earned Income Tax Credit*, 183 AM. J. EPIDEMIOLOGY 775, 782 (2015) (finding that EITC receipt improves children's behavioral problems); Gordon B. Dahl & Lance Lochner, *The Impact of Family Income on Child Achievement: Evidence from the Earned Income Tax Credit*, 102 AM. ECON. REV. 1927, 1951 (2012) (finding that EITC receipt improves children's math and reading scores); Strully et al., *supra* note 68, at 556 (finding that EITC receipt increases birth weights which may later reduce negative outcomes for children's life chances); Hoynes et al., *supra* note 75, at 205 (finding that the EITC expansion in 1993 was associated with decreases in low birth weights and increases in average birth weights); Lawrence M. Berger et al., *Income and Child Maltreatment in Unmarried Families: Evidence from the Earned Income Tax Credit*, REV. ECONS. HOUSEHOLD 1345, 1361 (2017) (finding that the additional income occasioned by the EITC results in small to modest decreases in parental neglect).

91. Rehkopf et al., *supra* note 70, at 1891.

92. Rachel A. Spencer et al., *The Impact of Temporary Assistance for Needy Families, Minimum Wage, and Earned Income Tax Credit on Women's Well-Being and Intimate Partner Victimization*, 266 SOC. SCI. & MED. 1, 5 (2020).

93. Susan Averett & Yang Wang, *The Effects of Earned Income Tax Credit Payment Expansion on Maternal Smoking*, 22 HEALTH ECONS. 1344, 1356 (2013).

94. Eissa & Liebman, *supra* note 60, at 635; Molly Dahl et al., *Stepping Stone or Dead End? The Effect of the EITC on Earnings Growth*, 62 NAT'L TAX J. 329, 343 (2009); Raj Chetty et al., *Using Differences in Knowledge Across Neighborhoods to Uncover the Impacts of the EITC on Earnings*, 103 AM. ECON. REV. 2683, 2717-18 (2013); David Neumark & Peter Shirley, *The Long-Run Effects of the Earned Income Tax Credit on Women's Labor Market Outcomes*, 66 LAB. ECONS. 101878, 101897 (2020).

participation during young adulthood.[95]

Studies have additionally demonstrated that receiving the EITC acts as a temporary safety net during periods of economic shock or family upheaval, and also functions "as a long-term mechanism of providing assistance to taxpayers with children who are entrenched in the lowest-income brackets."[96] In addition, receiving the EITC in the first quarter of the calendar year assists low-income families in smoothing out consumption during the remainder of the year.[97] At the more microlevel, studies have uncovered how recipients expend their EITC refunds. Families use the moneys in numerous ways tied to their economic and social mobility, including: (1) paying overdue bills like utilities and paring down existing indebtedness (including credit cards and payday loans); (2) purchasing durable goods such as appliances, furniture, home electronics, children's clothes, and school supplies; (3) affording school tuition; (4) buying vehicles for transportation or making needed automobile repairs; (5) paying rent and for housing; (6) stockpiling food and other goods for use during leaner times throughout the year; and (7) building up savings.[98] The flexibility to utilize EITC refunds in these various ways also plays a significant and beneficial psychological role for low-income working families. As one study found, even though the material benefits of receiving EITC refunds did not move families "very far up the income ladder, families did *feel* better off knowing that they had a more secure footing on that ladder."[99]

The EITC refunds enable low-income working families to maintain consistent consumption throughout the year and potentially save some of their refund moneys in the likely event of a future economic shock or income disruption. Further, the EITC fosters economic security among families and promotes subjective feelings of social inclusion, allowing recipients to believe in the possibility of future social mobility.[100] Indeed,

95. Bastian & Michelmore, *supra* note 26, at 1142.

96. Tim Dowd & John B. Horowitz, *Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support*, 39 PUB. FIN. REV. 619, 621 (2011).

97. Lisa Barrow & Leslie McGranahan, *The Effects of the Earned Income Tax Credit on the Seasonality of Household Expenditures*, *in* MAKING WORK PAY: THE EARNED INCOME TAX CREDIT AND ITS IMPACT ON AMERICA'S FAMILIES 362 (Bruce D. Meyer & Dennis Holtz-Eakin eds., 2001).

98. For the empirical studies making such findings, *see generally* Sykes et al., *supra* note 21; *see generally* Timothy M. Smeeding et al., *The Earned Income Tax Credit: Expectation, Knowledge, Use, and Economic and Social Mobility*, *in* MAKING WORK PAY: THE EARNED INCOME TAX CREDIT AND ITS IMPACT ON AMERICA'S FAMILIES 301 (Bruce D. Meyer & Dennis Holtz-Eakin eds., 2001); Andrew Goodman-Bacon & Leslie McGranahan, *How Do EITC Recipients Spend Their Refunds?* 32 ECON. PERSPS.: REV. FROM FED. RSRV. BANK CHI. 17 (2008); H. Luke Shaefer et al., *Do Single Mothers in the United States Use the Earned Income Tax Credit to Reduce Unsecured Debt?*, 11 REV. ECONS. HOUSEHOLD 659 (2013); Romich & Weisner, *supra* note 28; Greene, *supra* note 30, at 522; Halpern-Meekin et al., *supra* note 29, at 172; Tach et al., *supra* note 30.

99. Tach et al., *supra* note 30, at 289.

100. Sykes et al., *supra* note 21, at 256-58.

as the findings from one empirical study elucidate, "the EITC seems to bolster one's sense of being part of the U.S. mainstream . . . and making purchases with their EITC dollars made them feel like they were 'not poverty stricken,' 'in the middle,' or like 'real Americans.'"[101] Yet, in the majority of jurisdictions, all of these propitious benefits from the EITC are denied to low-income working families when they file for bankruptcy. And while some may argue that the "privilege" of discharging one's debts through bankruptcy will allow these low-income working families to move ahead financially,[102] this does not justify the inequitable treatment between them and their wealthier bankruptcy counterparts who can protect a good amount of wealth and assets from trustees and creditors. The stratified labor market economy already abuses low-income working families, and the bankruptcy system should not add to that abuse by permitting trustees to strip such families of their welfare benefits.[103] The following Section offers a hearty discussion of how the bankruptcy system tolerates that outcome.

IV. FOUNDATIONAL CONSUMER BANKRUPTCY LAW, THE NATURE AND SCOPE OF BANKRUPTCY EXEMPTIONS, AND TRUSTEE DUTIES AND MOTIVATIONS

A. Foundational Consumer Bankruptcy Law

Article I, § 8, Clause 4 of the United States Constitution provides that Congress shall have the power and ability to establish "uniform Laws on the subject of Bankruptcies throughout the United States."[104] It has been repeatedly noted that consumer bankruptcy law serves two distinct purposes: first, to provide an individual debtor with a fresh financial start in life, free from preexisting indebtedness; and second, to enable the debtor's creditors to realize an equitable distribution of the debtor's available assets.[105] The four bankruptcy acts enacted over the course of the nineteenth century—in 1800, 1841, 1867, and 1898[106]—primarily

101. *Id.* at 260.

102. Cronk v. Bushey (*In re* Bushey), 568 B.R. 821, 831 (Bankr. D.N.M. 2017) ("A bankruptcy discharge is a privilege not a right.") (citation omitted).

103. Michael D. Sousa, *Bankruptcy Stigma: A Socio-Legal Study*, 87 AM. BANKR. L.J. 435 (2013).

104. U.S. CONST. art. I, § 8, cl. 4.

105. Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 50 (1986) ("One firmly established tenet of time-worn bankruptcy lore holds, of course, that the bankruptcy system serves two functions: the protection and payment of creditors; and the provision of shelter and a 'fresh start' to overburdened debtors.").

106. For a detailed history of the federal bankruptcy laws enacted during the nineteenth century,

focused on the financial returns to creditors, with the possibility of a fresh financial start and the shedding of oppressive debt through a discharge as "incidental and subordinate" to the process, namely, simply serving as inducements for debtors to cooperate with their creditors in the collection and distribution of property.[107] However, during the Great Depression—and widespread financial calamity for millions of families—the idea of the "fresh start" as a central component of the consumer bankruptcy process assumed greater prominence.[108] The concept of the consumer bankruptcy fresh start is famously connected to the United States Supreme Court decision in *Local Loan Co. v. Hunt*, where the Court articulated the purpose of the bankruptcy laws: to give "the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt."[109]

Under the present Bankruptcy Code, consumer debtors can file for bankruptcy under Chapter 7, Chapter 13, or Chapter 11.[110] Around 60% of all consumer bankruptcy cases fall under Chapter 7 of the Bankruptcy Code.[111] Approximately 95% of these Chapter 7 filings are considered no-asset filings with no monetary distribution to unsecured creditors.[112]

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see generally Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5 (1995); Charles J. Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325 (1991); Rhett Frimet, *The Birth of Bankruptcy in the United States*, 96 COM. L.J. 160 (1991); Vern Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226 (1976); F. REGIS NOEL, A HISTORY OF THE BANKRUPTCY LAW (1919); CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY (1935).

107. *In re* Swofford Bros. Dry Goods Co., 180 F. 549, 556 (W.D. Mo. 1910). *See also* William J. Woodward, Jr., *Exemptions, Opting Out, and Bankruptcy Reform*, 43 OHIO STATE L.J. 335, 340 (1982) ("Giving the debtor relief from debt was initially an incidental benefit of the discharge, originally designed to induce the debtor to gather honestly all assets.") (citation omitted).

108. *See* Jay L. Zagorsky & Lois R. Lupica, *A Study of Consumers' Post-Discharge Finances: Struggle, Stasis, or Fresh Start?*, 16 AM. BANKR. INST. L. REV. 283, 283 (2008) ("Bankruptcy's central theoretical objective, from the perspective of the individual debtor, is to afford debtors the opportunity for a 'fresh start.'"); Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 CORNELL L. REV. 67, 68 (2006) ("The principal theory of consumer bankruptcy in America is that it provides a 'fresh start' to debtors.").

109. Loc. Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (citations omitted). The centrality of the fresh start as a philosophical focal point for individual bankruptcies cemented itself in the post-World War II era with the exponential rise in consumer filings from 1946 through 1967. Woodward, Jr., *supra* note 107, at 340.

110. The use of Chapter 11 by individual debtors has historically been an infrequent event.

111. CHARLES J. TABB, THE LAW OF BANKRUPTCY § 1.23, at 92 (2d ed. 2009) ("A [C]hapter 7 liquidation case is the norm. The majority of all bankruptcy filings, over 60%, are liquidation bankruptcies under [C]hapter 7.").

112. Richard M. Hynes & Nathaniel Pattison, *A Modern Poor Debtor's Oath*, 108 VA. L. REV. 915, 920 (2022); *see also* Dalié Jiménez, *The Distribution of Assets in Consumer Chapter 7 Bankruptcy Cases*, 83 AM. BANKR. L.J. 795, 797 (2009) (finding that 93% of Chapter 7 individual debtors "did not have any

Moreover, just 5.7% of Chapter 7 consumer bankruptcies distribute anything to either general unsecured creditors or priority unsecured claims.[113] Once a Chapter 7 bankruptcy petition is filed, the Bankruptcy Code mandates that a bankruptcy trustee be appointed to serve in the case.[114] The primary function of a bankruptcy trustee in a Chapter 7 liquidation proceeding is to collect and distribute "property of the estate"[115] that is otherwise not exempt from the bankruptcy process and, in turn, distribute any proceeds from the liquidation of the assets to creditors in accordance with the priority scheme set forth in the Bankruptcy Code.[116] In exchange for turning over any non-exempt assets to the bankruptcy trustee for liquidation, Chapter 7 allows the debtor to retain their post-petition earnings free from the claims of pre-bankruptcy creditors.[117] The goal of a consumer debtor in a Chapter 7 bankruptcy case is to obtain a discharge of their pre-petition debt.[118] Most debtors receive a discharge of their personal debts.[119]

In contrast to Chapter 7, Chapter 13 of the Bankruptcy Code generally enables individual debtors to retain their pre-petition assets in exchange for repaying a portion of their future disposable income to creditors through a court-approved repayment plan, lasting from three to five years.[120] The Bankruptcy Code protects a Chapter 13 debtor from their

unencumbered non-exempt assets that could be distributed to unsecured creditors"); Richard M. Hynes, *Non-Procrustean Bankruptcy*, 2004 U. ILL. L. REV. 301, 326-27 (2004) (noting that the bankruptcy system "yields nothing for unsecured creditors in approximately ninety-five percent of cases filed in Chapter 7").

113. Hynes & Pattison, *supra* note 112, at 932.

114. 11 U.S.C. §§ 701-702 (West 2024).

115. Upon the commencement of a bankruptcy case, § 541(a)(1) of the Bankruptcy Code provides for the creation of an estate which is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C.A. § 541(a)(1) (West 2024). § 541 "divests a debtor of the property he or she owned at the time of the filing and vests that property in a bankruptcy trustee." *In re* Robinson, 764 F.3d 554, 559 (6th Cir. 2014).

116. *In re* Tarrant, 349 B.R. 870, 875 (Bankr. N.D. Alaska 2006) ("A 'Chapter 7 trustee's duty is to reduce to money the legal or equitable interests owned by the debtor in these various assets so that the proceeds may be distributed to unsecured creditors in accordance with [§] 726.'") (citing *In re* Talbert, 268 B.R. 811, 819 (Bankr. W.D. Mich. 2001)).

117. *See* 11 U.S.C.A. § 541(a)(6) (West 2024) (noting that post-petition earnings of an individual debtor are excepted from the bankruptcy estate).

118. Notably, "a bankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor *in personam*—while leaving intact another—namely, an action against the debt *in rem*." Johnson v. Home State Bank, 501 U.S. 78, 84 (1991).

119. Hynes & Pattison, *supra* note 112, at 929 (noting that the "overwhelming majority of modern debtors who choose Chapter 7 receive a discharge of substantially all of their debts without having to forfeit any assets to general creditors"); *see also* Sara S. Greene, Parina Patel & Katherine Porter, *Cracking the Code: An Empirical Analysis of Consumer Bankruptcy Outcomes*, 101 MINN. L. REV. 1031, 1089 (2017) ("Chapter 7 cases nearly always end in a discharge, and it is typically received within four to six months of filing.").

120. 2 NANCY C. DREHER & JOAN N. FEENEY, BANKRUPTCY LAW MANUAL § 13:1 (5th ed. 2021); *see also In re* McCollum, 348 B.R. 377, 393 (Bankr. E.D. La. 2006) ("As part of the deal a debtor makes

creditors' collection efforts by instituting an automatic stay until the repayment plan is developed and later approved by the court.[121] In a Chapter 13 bankruptcy case, a "standing trustee" serves as the principal administrator in the proceeding.[122] Unlike the Chapter 7 trustee, the Chapter 13 trustee does not sell the debtor's property. Rather, the Chapter 13 trustee's main responsibility is to collect a debtor's plan payments and to distribute the funds to the creditors in accordance with the court-approved plan.[123] That said, however, like the Chapter 7 trustee, the Chapter 13 trustee must also investigate the debtor's financial affairs and oppose the entry of a discharge, if warranted.[124] A Chapter 13 debtor receives a discharge of preexisting debts only after making all payments under the court-approved plan.[125]

More specifically, two legal policies serve to undergird the fresh start principle in the realm of consumer bankruptcy law whether an individual debtor chooses to file for either Chapter 7 or Chapter 13: the dischargeability of most types of prepetition debts, and the ability to exempt certain property from the reach of creditors.[126] The first is the ability of a debtor to discharge most forms of unsecured indebtedness.[127] The entry of a discharge releases an individual debtor's personal obligation to repay any prepetition unsecured debt and additionally serves as a permanent injunction against any act to collect upon a discharged debt.[128] Although most Chapter 7 consumer bankruptcy debtors receive a

with his or her creditors when electing to file under [C]hapter 13, as opposed to [C]hapter 7, the debtor retains all pre-petition property in exchange for committing all post-petition disposable income to the payment of creditors under a plan of reorganization.") (citing *In re* Burgie, 239 B.R. 406, 410 (B.A.P. 9th Cir. 1999)).

121. 11 U.S.C.A. § 362(a) (West 2024).

122. 2 DREHER & FEENEY, *supra* note 120, at § 13:9.

123. *Id.*

124. 11 U.S.C.A. § 1302 (West 2024).

125. 11 U.S.C.A. § 1328(a) (West 2024).

126. William T. Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C. L. REV. 769, 801 (1980) ("This fresh start objective is basic to the bankruptcy law of the United States and is dependent upon two key federal policies: the discharge policy and the exemption policy.") (citations omitted).

127. *See, e.g.*, Richard E. Flint, *Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor*, 48 WASH. & LEE L. REV. 515, 515 (1991) ("The essence of our consumer bankruptcy law is the discharge."); Garran Glenn, *Essentials of Bankruptcy: Prevention of Fraud and Control of Debtor*, 23 VA. L. REV. 373, 380 (1937) (noting that the "privilege" of a discharge of one's debts was "one of the greatest of liberal reforms" of bankruptcy law); Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1393 (1985) ("Discharge, the doctrine that frees the debtor's future income from the chains of previous debts, lies at the heart of bankruptcy policy.").

128. George H. Singer, *Section 523 of the Bankruptcy Code: The Fundamentals of Nondischargeability in Consumer Bankruptcy*, 71 AM. BANKR. L.J. 325, 325 (1997). *See also In re* Hawkins, 377 B.R. 761, 766 (Bankr. S.D. Fla. 2007) ("A Chapter 7 discharge, 11 U.S.C. § 727, voids all

discharge of their debts, the Bankruptcy Code limits the availability of the discharge in two important ways. First, § 727(a) provides that a debtor will receive a discharge of debt unless the debtor has engaged in some form of bad behavior,[129] while § 523(a) makes certain types of debts presumptively non-dischargeable for policy reasons, such as: (1) money or credit obtained by actual fraud; (2) domestic support obligations; (3) tax liabilities; and (4) student loans.[130] For Chapter 13 debtors, not only do the exceptions to discharge provided by § 523(a) apply, but § 1328(a) also imposes additional forms of non-dischargeable debts such as criminal fines, restitution, and legal financial obligations.[131]

B. The Nature and Scope of Bankruptcy Exemptions

The second component of the fresh start is the ability of a debtor to exempt certain assets from the reach of creditors. This component forms a foundational principle of consumer bankruptcy law.[132] The concept of exempting certain property from creditor collection actions is straightforward: an exemption gives debtors a legal right to retain property free from the claims of creditors.[133] Every state and the District of Columbia has crafted jurisdiction-specific state exemption statutes that apply to residents only in that particular state.[134] Scholars have long-maintained that property exemption statutes serve four distinct social policies: (1) to leave the debtor with some property necessary for their physical subsistence; (2) to afford the debtor an opportunity to rehabilitate

of the debtor's personal liability on a debt."). The injunction against the post-petition collection of discharged debts is provided by § 524(a)(2) of the Bankruptcy Code, which states as follows: "A discharge in a case . . . operates as an injunction against the commencement or continuation of an action, the employment of process, or an act to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived." 11 U.S.C.A. § 524(a) (West 2024).

129. 11 U.S.C.A. § 727(a) (West 2024).

130. 11 U.S.C.A. § 523(a) (West 2024).

131. 11 U.S.C.A. § 1328(a)(3) (West 2024). And in a Chapter 13 case, the entry of the discharge is delayed until the debtor successfully completes all proposed payments under the approved repayment plan. 11 U.S.C.A. § 1328(a) (West 2024).

132. Schwab v. Reilly, 560 U.S. 770, 791 (2010) (We agree that "exemptions in bankruptcy cases are part and parcel of the fundamental bankruptcy concept of a 'fresh start.'") (citation omitted). *See also* Douglass G. Boshkoff, *Fresh Start, False Start, or Head Start?*, 70 IND. L.J. 549, 559 (1995) (maintaining that a component of the fresh start policy is the protection of exempt property). Ronel Elul & Narayanan Subramanian, *Forum-Shopping and Personal Bankruptcy*, 21 J. FIN. SERVS. RSCH. 233, 233 (2002) ("One of the foundations of modern bankruptcy law is the idea that certain property should be exempt from seizure by creditors.").

133. Vukowich, *supra* note 126, at 779. *See also* Nohinek v. Logsdon, 628 P.2d 257, 258 (Kan. Ct. App. 1981) ("An exemption is a right granted by law to a debtor to retain a portion of his property free from judicial seizure and sale by his creditors.").

134. For a historical account of the development of exemption statutes in the United States, see generally Alan N. Resnick, *Prudent Planning or Fraudulent Transfer? The Use of Nonexempt Assets to Purchase or Improve Exempt Property on the Eve of Bankruptcy*, 31 RUTGERS L. REV. 615 (1978).

financially and earn future income; (3) to protect the debtor's family from the harshness of poverty; and (4) to shift the burden of providing the debtor and their family with a minimal level of financial support from the state to the debtor's creditors.[135] Taken together, exemption laws aim to leave a debtor and their family with the basic material necessities in life and to ensure that the debtor and their family do not become so destitute as to require public assistance.[136]

Although the fifty state and District of Columbia exemption statutes can best be described as a patchwork of differing laws,[137] the throughline is that each one designates the various forms of property the debtor may claim as exempt—both real and personal—in addition to specific dollar limitations associated with each type of property.[138] Exemption statutes commonly allow a debtor to claim an exemption in the following types of property: (1) a homestead; (2) a motor vehicle; (3) household goods, furnishings, and other types of personal property (e.g., clothing, family photos); (4) jewelry; (5) tools of the trade; (6) insurance benefits; (7) pension and retirement benefits; and (8) certain public benefits such as workers' compensation and unemployment compensation.[139] While these forms of property may serve as the foundational bedrock for exemption statutes, the dollar limitations for each category of property vary wildly from state to state, as perhaps best exemplified by the homestead exemption. For example, Michigan allows for a $46,125 homestead

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135. *Id.* at 621. *See also* Vukowich, *supra* note 126, at 784-87 (noting that the historical purposes of exemption laws include: (i) protecting the debtor's family members and dependents; (ii) preserving the family unit, primarily through some exemption for the homestead; (iii) protecting against the debtor's reliance upon welfare and public assistance; and (iv) enabling a debtor's financial rehabilitation, primarily through exempting wages and tools of the trade from creditor collection). By way of one statutory example, the Wisconsin state exemption statute describes its purpose in the following terms: "[t]his section shall be construed to secure its full benefit to debtors and to advance the humane purpose of preserving to debtors and their dependents the means of obtaining a livelihood, the enjoyment of property necessary to sustain life and the opportunity to becoming public charges." WIS. STAT. ANN. § 815.20 (West 2024).

136. Fin. One v. Bland (*In re* Bland), 793 F.2d 1172, 1173 (11th Cir. 1986) (citation omitted). *See also* First Bank of Catoosa v. Reid (*In re* Reid), 757 F.2d 230 (1985) ("'The purposes of the exemption statute are to prevent improvident debtors from becoming subjects of charity by preserving to them sufficient definitely classified property that they may maintain a home for themselves, and to prevent inconsiderate creditors from depriving them of the necessities of life.'") (citation omitted); Sw. State Bank v. Quinn, 424 P.2d 620, 624 (Kan. 1967) ("The whole purpose of policy of our exemption laws has been to secure to an unfortunate debtor the means to support himself and his family, to keep them from being reduced to absolute destitution and thereby public charges.").

137. Lawrence Ponoroff, *Exemption Limitations: A Tale of Two Solutions*, 71 AM. BANKR. L.J. 221, 222 (1997) ("Perhaps in no arena, however, are the differences from state to state as marked as they are with respect to exemptions from execution.").

138. Gary E. Sullivan, *A Fresh Start to Bankruptcy Exemptions*, 2018 BYU L. REV. 335, 356 (2018).

139. *See, e.g.*, COLO. REV. STAT. ANN. § 13-54-102 (West 2024).

exemption ($69,200 if the debtor is sixty-five or older or disabled)[140] while Wyoming permits a $100,000 homestead exemption.[141] Nevada has a homestead exemption of $605,000;[142] Kentucky allows only a $5,000 homestead exemption,[143] while Florida and Texas have incredibly generous homestead exemptions, ordinally enabling a debtor to shield the home in its entirety.[144]

State exemption statutes play a prominent role in the United States bankruptcy system. While the Bankruptcy Acts of 1800 and 1841 only afforded debtors in bankruptcy the ability to exempt property from a limited list of federal exemptions, the Acts of 1867 and 1898 incorporated state exemption laws, making them applicable and accessible to debtors in bankruptcy.[145] This historical shifting nature of permitting state or federally designated exemptions in the bankruptcy process can be attributed to political squabbles related to federalism and states' rights, as well as cultural and economic distrust between eastern mercantile states and rural, agrarian geographies in the west and the south.[146]

In the 1960s, Congress commenced the task of examining the efficacy of the 1898 Bankruptcy Act for a twentieth century modern society and pledged to rewrite the nation's bankruptcy laws as needed. As part of this process, in 1970 Congress created the Commission on the Bankruptcy Laws of the United States to undertake this assessment. Finding that deference to the varied state exemption laws was unjustifiably "intolerable for what is supposed to be a national, uniform system,"[147] the Commission recommended the "abolishment of any reference to non-bankruptcy law for bankruptcy exemptions and the adoption of an exclusive list of federal bankruptcy exemptions."[148] The issue, however, remained political. The House of Representatives version of what would become the modern Bankruptcy Code—enacted in 1978 as the

140. MICH. COMP. LAWS ANN. § 600.5451 (West 2024).

141. WYO. STAT. ANN. §1-20-101 (West 2024).

142. NEV. REV. STAT. ANN. § 21.090 (West 2024).

143. KY. REV. STAT. ANN. § 427.060 (West 2024).

144. *See* TEX. PROP. CODE § 41.002 (West 2024) (allowing an exemption of ten acres for an urban home and two hundred acres for a rural home); FLA. CONST. art. 10, § 4 (permitting an exemption of one hundred sixty acres for a homestead located outside of a municipality or one-half of an acre for a homestead located within a municipality).

145. Woodward, *supra* note 107, at 338-39; Laura B. Bartell, *The Peripatetic Debtor: Choice of Law and Choice of Exemptions*, 22 EMORY BANKR. L.J. 401, 403-04 (2006); William H. Brown, *Political and Ethical Considerations of Exemption Limitations: The "Opt-Out" as Child of the First and Parent of the Second*, 71 AM. BANKR. L.J. 149, 155-59 (1997).

146. Richard E. Mendales, *Rethinking Exemptions in Bankruptcy*, 40 B.C. L. REV. 851, 854-58 (1999); Lawrence Ponoroff, *Constitutional Limitations on State-Enacted Bankruptcy Exemption Legislation and the Long Overdue Case for Uniformity*, 88 AM. BANKR. L.J. 353, 363 (2014).

147. COMM'N ON THE BANKR. LAWS OF THE U.S., REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, 169 (1973).

148. Brown, *supra* note 145, at 159.

Bankruptcy Reform Act—allowed a bankruptcy debtor to choose between federal bankruptcy exemptions or the debtor's domiciliary state exemptions (in addition to any federal non-bankruptcy exemptions).[149] The Senate version, however, provided the debtor with no choice, believing that states should control applicable exemptions in bankruptcy. That is, a bankruptcy debtor would be required to claim available exemptions only under applicable state law.[150]

To end the political stalemate, a last-minute compromise between the competing congressional bills was reached, culminating in §§ 522(b)(1) and (b)(2) of the present Bankruptcy Code.[151] In what is colloquially known as the "opt out" provision, §§ 522(b)(1) and (b)(2) together provide that each state (and the District of Columbia) may prohibit their residents from choosing the federal bankruptcy list of exemptions in § 522(d) by "opting out" of the federal bankruptcy scheme, consequently limiting their citizens to the exemptions under state law and non-bankruptcy federal law.[152] To date, thirty-one states have exercised the opt-out provision provided by §§ 522(b)(1) and (b)(2) of the Bankruptcy Code.[153] As one commentator ably noted regarding the opt-out provision shortly after the promulgation of the 1978 Bankruptcy Reform Act, "[c]onsidering the tremendous variances in the state exemption laws, there is not *an* exemption policy, but rather numerous, significantly different exemption policies incorporated" into the Bankruptcy Code.[154]

Despite the vast differences among the fifty state exemption statutes in dollar amounts and in the categories of property protectible by debtors in bankruptcy, this dynamic does not offend the uniformity requirement of the constitutional bankruptcy clause. The United States Supreme Court held in *Hanover National Bank of the City of New York v. Moyses* that the uniformity provision is "geographical, and not personal."[155] More particularly, the Supreme Court in *Moyses* justified the divergent state

149. *Id.* at 160.

150. *Id.*

151. Section 522(b)(1) allows individual debtors to exempt property from the bankruptcy estate, thereby shielding it from liquidation by the bankruptcy trustee. 11 U.S.C.A. § 522(b)(1) (West 2024). In turn, § 522(b)(2) permits a state to "opt out" of the exemption scheme provided by the Bankruptcy Code. 11 U.S.C.A. § 522(b)(2) (West 2024). If a state elects the "opt out" provision, debtors filing for bankruptcy relief in that state may only claim property which would be exempt under state law.

152. 11 U.S.C.A. §§ 522(b)(1)-(2) (West 2024).

153. The following states have opted-out of the exemptions provided by the Bankruptcy Code: Alabama, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Mississippi, Missouri, Montana, Nebraska, Nevada, North Carolina, North Dakota, Ohio, Oklahoma, South Carolina, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. RICHARD LEVIN & HENRY J. SOMMER, 4 COLLIER ON BANKRUPTCY ¶ 522.01 (16th ed. 2020).

154. Vukowich, *supra* note 126, at 801.

155. 186 U.S. 181, 188 (1902).

exemption paradigms as complying with the constitutional uniformity requirement so long as "the trustee takes in each state whatever would have been available to the creditor if the bankruptcy law had not been passed. The general operation of the law is uniform, although it may result in certain particulars differently in different states."[156]

Since the political compromise resulting in §§ 522(b)(1) and (b)(2), scholars and commentators have questioned and challenged the scope of bankruptcy exemptions along several different fronts. One scholar questions whether exemption statutes potentially incentivize debtors to either forum-shop and relocate to states with more favorable exemption statutes prior to filing for bankruptcy, or to file for bankruptcy based upon the generosity of the applicable exemption statute, thereby increasing bankruptcy filing rates.[157] Others criticize the continued opt-out scheme or argue for a revision of the Bankruptcy Code to permit only federally-

156. 186 U.S. 181, 190 (1902). Since the *Moyses* decision, several courts have similarly concluded that the opt-out provision contained in § 522(b) of the Bankruptcy Code passes constitutional muster under the geographical uniformity requirement. *See, e.g.*, *In re* Earned Income Tax Credit Exemption Const. Challenge Cases, 477 B.R. 791, 798 (Bankr. D. Kan. 2012) ("The Bankruptcy Clause requires Congress to provide federal procedural uniformity, but does not necessarily require that the effect of bankruptcy exemptions will be uniform from state to state so long as those exemptions are uniform *within* a state.") (emphasis in original), *aff'd*, *In re* Lea, 2013 WL 4431267 (D. Kan. Aug. 16, 2013). Rhodes v. Stewart, 705 F.2d 159, 162 (6th Cir. 1982) (holding that the federal opt-out exemption scheme "is an exercise of the legislative prerogative to establish a 'uniform law' and therefore falls within that scope of authority provided to Congress in the Bankruptcy Clause") (citations omitted); Schultz v. U.S., 529 F.3d 343, 351 (6th Cir. 2008) (holding that the constitutional uniformity requirement "does not deny Congress power to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems . . . appl[ied] equally to all creditors and debtors").

157. *See, e.g.*, Elul & Subramanian, *supra* note 132, at 235 (finding that "while there is strong evidence that households who are at risk for filing will seek out high-exemption states should they find themselves moving for some reason, they are unlikely to move simply for this reason"); Michelle J. White, *Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1, 46 (1987) ("Thus, the model suggests that both economic conditions and the exemption level are of similar importance in determining the number of Chapter 7 bankruptcy filings. While both are statistically significant, neither effect is strikingly important quantitatively."). *But see* Kartik Athreya, *Fresh Start or Head Start? Uniform Bankruptcy Exemptions and Welfare*, 30 J. ECON. DYNAMICS & CONTROL 2051, 2067 (2006) (employing a theoretical statistical model and concluding that exemption levels are associated positively with bankruptcy filing rates). *See also* Nathaniel Pattison & Richard M. Hynes, *Asset Exemption and Consumer Bankruptcies: Evidence from Individual Filings*, 63 J.L. & ECONS. 557, 576 (2020) (finding that while exemption differences do not affect bankruptcy filing rates in the main, for debtors with home equity, an increase in the exemptible amount of home equity increases Chapter 7 filings). Nevertheless, these theoretical and empirical claims have been questioned since the promulgation of the Bankruptcy Reform Act of 1978. *See, e.g.*, Woodward, *supra* note 107, at 362 (arguing that "the statutorily defined amount of exempt property in or out of bankruptcy is likely to assume, in most cases, a subordinate role in the debtor's decision about bankruptcy"); Ponoroff, *supra* note 137, at 243 (contending that "the fact that exemption policy under the Bankruptcy Code is left almost entirely to the states in most bankruptcy cases has certainly not had a perceptible effect in controlling the absolute number of bankruptcy filings").

designated exemptions to promote uniformity.[158] Other scholars contest the continued great disparity between state-specific exemption statutes and the available exemptions prescribed under the Bankruptcy Code.[159] Additionally, scholars deliberate and problematize the contours of a debtor's ability—or inability—to convert non-exempt assets to exempt assets prior to the bankruptcy filing, thereby protecting and shielding certain property from impending creditors in the bankruptcy process.[160] And finally, researchers uncovered the racialized advantages of exemption laws based upon property ownership and asset valuations.[161]

To effectuate their humanitarian and beneficent aims, courts construe exemption laws liberally, generally in favor of the debtor seeking to exclude scheduled property from the reach of creditors.[162] A debtor is required to list any property they wish to exempt in the schedules accompanying the bankruptcy filing and, unless a party successfully challenges any claimed exemption, the listed property is exempt from creditors.[163] In Chapter 7 cases, the debtor retains exempt property and the bankruptcy trustee cannot execute or liquidate it to pay creditors.[164] The protection against a forced liquidation of otherwise exempt property is not relevant to a Chapter 13 case where a debtor retains their assets and

158. *See, e.g.*, Brown, *supra* note 145, at 209 (arguing for the abolishment of the "opt out" provision as it is "incongruous to a national bankruptcy fresh start policy"); Ponoroff, *supra* note 137, at 221 (advocating for uniform federal exemptions); Mendales, *supra* note 146, at 867 (arguing for the replacement of the current exemption scheme in favor of permitting a debtor to exempt a fixed total value of property of any kind); Vukowich, *supra* note 126, at 814 (maintaining that the continued reliance upon state exemption laws is unwarranted); Daniel A. Austin, *Bankruptcy and the Myth of "Uniform Laws*," 42 SETON HALL L. REV. 1081 (2012) (contending that the incorporation of state law into the Bankruptcy Code violates the bankruptcy uniformity requirement).

159. *See, e.g.*, Woodward, Jr., *supra* note 107, at 353 ("A central problem with most state opt-out legislation, then, is the uncertainty it has generated about the status of interests immune from creditors under state common law and therefore not found within a state's exemption statutes."); Poronoff, *supra* note 137, at 222 (arguing that the exemption structure of the Bankruptcy Code introduces vast differences from state to state).

160. *See, e.g.*, Brown, *supra* note 145, at 191-93 (addressing the lack of clarity in the Bankruptcy Code or case law regarding a debtor's ability to engage in prebankruptcy planning); *see also* Juliet M. Moringiello, *Distinguishing Hogs from Pigs: A Proposal for a Preference Approach to Pre-Bankruptcy Planning*, 6 AM. BANKR. INST. L. REV. 103, 104 (1998) ("One type of debtor behavior that is not explicitly forbidden by the Bankruptcy Code and which is the subject of a patchwork treatment by the courts is the practice of converting non-exempt property to exempt property on the eve of bankruptcy.").

161. *See, e.g.*, Matthew Bruckner et al., *Bankruptcy in Black and White: The Effect of Race and Bankruptcy Code Exemptions on Wealth*, 28 MICH. J. RACE & L. 217, 219 (2023) (finding that "exemption laws advantage white debtors relative to Black debtors by allowing homeowners and holders of certain personal property to retain some or all their equity in those assets when they exit bankruptcy.").

162. *In re* Smith, 643 B.R. 363, 367 (Bankr. W.D. Okla. 2022). *See also* Jubber v. Bird (*In re* Bird), 577 B.R. 365, 382 (B.A.P. 10th Cir. 2018) (noting that "exemption laws must be liberally construed in favor of the claimant of an exemption to effect their humanitarian purposes") (citation omitted).

163. 11 U.S.C.A. § 522(l) (West 2024). A party objecting to any property listed as exempt "has the burden of proving that the exemptions are not properly claimed." F.R.B.P. 4003(c).

164. *In re* Devries, 650 B.R. 869, 874 (Bankr. N.D. Ohio 2023).

in exchange devotes all of their "disposable income" to fund a three- or five-year repayment plan.[165] That said, exemptions are relevant in Chapter 13 for two interdependent reasons. First, exempting property in a Chapter 13 case intersects with the "best interest of creditors" test of § 1325(a)(4), which provides that a debtor must distribute value (i.e., payments or property) under the plan to repay each allowed unsecured claim an amount "not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under Chapter 7."[166] By effectively exempting property in a Chapter 13 case, the exemption enables the debtor to use a lower hypothetical liquidation value for the best interest of creditors test, thereby reducing the amount the debtor would otherwise need to pay to creditors by excluding the exempt property from the liquidation estimation. Second, courts have concluded that exempt property in the nature of income—such as workers' compensation benefits and personal injury settlements—may still be considered in satisfying the "disposable income" requirement of § 1325(b), resulting in the diversion of these additional moneys to pay creditors under the approved plan.[167] For EITC recipients, this means that their tax credit refunds—whether exempt or not—may be considered as additional disposable income that needs to be calculated and added to the stream of payments to creditors under the plan.

In the minority of jurisdictions that enable a debtor to select the bankruptcy exemption scheme, § 522(d) of the Bankruptcy Code sets forth a comprehensive list of special exemptions.[168] To align with the purposes of state exemption laws, Congress indicated that exemptions were designed to provide a debtor "with the basic necessities of life" and to "not be left destitute and a public charge."[169] The listed exemptions track the types of real and personal property that a debtor may exempt

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165. Section 1325(b)(1) of the Bankruptcy Code provides: "If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan." 11 U.S.C.A. § 1325(b)(1) (West 2024).

166. Section 1325(a)(4) provides: "The court shall confirm a plan if the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under [C]hapter 7 of this title on such date." 11 U.S.C.A. § 1325(a)(4) (West 2024).

167. *See, e.g.*, *In re* Graham, 258 B.R. 286, 290 (Bankr. M.D. Fla. 2001) (noting that the majority of courts have found that despite § 522(c), this does "not operate to render any income from exempt property immune from treatment as 'disposable income'") (citation omitted).

168. 11 U.S.C.A. § 522(d) (West 2024). The dollar amounts for the exemptions contained in § 522(d) are adjusted every three years to take into account increases in the costs of living. 11 U.S.C.A. § 104(a) (West 2024).

169. Clark v. O'Neill (*In re* Clark), 711 F.2d 21, 23 (1983) (citing H.R. REP. NO. 595 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6097).

under state exemption statutes. By way of examples, § 522(d)(1) permits an individual debtor to claim a homestead exemption up to $27,900 in value, namely, the equity above any existing judicial liens and security interests against the property;[170] § 522(d)(2) enables a debtor to claim an exemption of up to $4,450 in value in one motor vehicle;[171] § 522(d)(3) allows a debtor to exempt up to $14,875 in aggregate value—and up to $700 in value in any single item—in any household furnishings, household goods, wearing apparel, appliances, books, animals, or musical instruments held primarily for the personal, family, or household use of the debtor or the debtor's dependents;[172] § 522(d)(4) allows a debtor to claim an exemption up to $1,875 of value in jewelry held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;[173] § 522(d)(6) gives the debtor the ability to exempt up to $2,800 in tools of the trade;[174] and § 522(d)(5)—the wildcard exemption—affords a debtor to claim an exemption of up to $1,475 in aggregate interest in "any property," plus up to an additional $13,950 of any unused amount from the homestead exemption provided by § 522(d)(1).[175] One of the congressional purposes behind the wildcard exemption rested in not discriminating against non-homeowners.[176] The wildcard exemption applies to any possible property interest, including cash, intangibles, deposit accounts, causes of action, and public assistance benefits already received by the debtor.[177] And for present purposes, the wildcard exemption of § 522(d)(5) enables a debtor to exempt tax refunds in a bankruptcy case.[178] Importantly, most state exemption statutes do not provide for a general wildcard exemption.[179]

C. Trustee Duties and Motivations

Once appointed, a trustee is both the designated representative of, and

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170. 11 U.S.C.A. § 522(d)(1) (West 2024). If a joint case is filed by a married couple, the dollar amounts contained in § 522(d) are doubled. RICHARD LEVIN & HENRY J. SOMMER, COLLIER CONSUMER BANKRUPTCY PRACTICE GUIDE ¶ 13.05 (2023).

171. 11 U.S.C.A. § 522(d)(2) (West 2024).

172. 11 U.S.C.A. § 522(d)(3) (West 2024).

173. 11 U.S.C.A. § 522(d)(4) (West 2024).

174. 11 U.S.C.A. § 522(d)(6) (West 2024).

175. 11 U.S.C.A. § 522(d)(5) (West 2024).

176. Vukowich, *supra* note 126, at 781.

177. LEVIN & SOMMER, *supra* note 170, at ¶ 13.05. *See also* LEVIN & SOMMER, *supra* note 153, at ¶ 522.09[5] ("The debtor may claim the unused portion of the homestead exemption in any property even if the debtor has not used any portion of the exemption under [§] 522(d)(1) on homestead property.").

178. Matos v. Rivera (*In re* Matos), 478 B.R. 506, 513-14 (B.A.P. 1st Cir. 2012). *See also* LEVIN & SOMMER, *supra* note 170, at ¶ 13.05 (indicating that tax refunds are protectible under the § 522(d)(5) wildcard exemption).

179. Brown, *supra* note 145, at 183.

a fiduciary for, the bankruptcy estate.[180] Section 704 of the Bankruptcy Code establishes the duties of a Chapter 7 trustee.[181] Most relevant here is the responsibility of the trustee to "collect and reduce to money the property of the estate for which the trustee serves."[182] Indeed, the United States Department of Justice Handbook for Chapter 7 Trustees (Handbook) similarly provides that "[t]he principal duty of the trustee is to collect and liquidate property of the estate and to distribute the proceeds to creditors."[183] As the Handbook further instructs, "[a] [C]hapter 7 case must be administered to maximize and expedite dividends to creditors."[184] Thus, a critical element of a Chapter 7 trustee's fiduciary duties is to maximize the value of the estate for the greatest possible distribution of available assets to creditors, most prominently, unsecured creditors.[185] In attempting to maximize the distribution to unsecured creditors, trustees seek to liquidate non-exempt assets, pursue causes of action belonging to the bankruptcy estate, and institute avoidance actions against third-party defendants.[186] Another mechanism of augmenting the estate—and the distribution to creditors—is to review and object to any claimed exemptions.[187] While the Bankruptcy Code does not specifically delineate the ability to object to a claimed exemption, courts invariably hold that

180. 11 U.S.C.A. § 323 (West 2024). While the term "fiduciary" is not in the Bankruptcy Code, cases routinely refer to a Chapter 7 trustee as a fiduciary and to the trustee's obligations in a bankruptcy case as fiduciary obligations. *See, e.g.*, Salazar v. McCormick (*In re* Crestview Funeral Home, Inc.), 287 B.R. 832, 838 (Bankr. D.N.M. 2002) ("A bankruptcy trustee owes a fiduciary duty to the bankruptcy estate.").

181. *See generally* 11 U.S.C.A. § 704 (West 2024).

182. 11 U.S.C.A. § 704(a)(1) (West 2024).

183. UNITED STATES DEPARTMENT OF JUSTICE, EXECUTIVE OFFICE FOR U.S. TRUSTEES, HANDBOOK FOR CHAPTER 7 TRUSTEES 4-1 (Oct. 1, 2012). *See also* Lois R. Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 AM. BANKR. INST. L. REV. 17, 95 (2012) ("The [C]hapter 7 trustee's primary responsibility is to liquidate and administer a debtor's non-exempt assets and to maximize the return to creditors.").

184. EXECUTIVE OFFICE FOR U.S. TRUSTEES, HANDBOOK FOR CHAPTER 7 TRUSTEES, *supra* note 183, at 4-1.

185. U.S. v. Sims (*In re* Feiler), 218 F.3d 948, 952 (9th Cir. 2000) ("[T]he trustee's duty is to maximize the assets of the bankruptcy estate to allow maximum recovery for the debtor's creditors."); *In re* All Island Truck Leasing Corp., 546 B.R. 522, 532 (Bankr. E.D.N.Y. 2016) ("A [C]hapter 7 trustee is a fiduciary of the estate whose principal duty is to administer estate property so as to maximize distribution to unsecured creditors, whether priority or general unsecured.") (citation omitted); Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 352 (1985) (commenting that a bankruptcy trustee is directed to investigate the financial affairs of the debtor and "has the duty to maximize the value of the estate").

186. Spencer D. Solomon, *Keeping Things In-House: Increasing Scrutiny of the Chapter 7 Trustee's Selection of Counsel*, 55 S. TEX. L. REV. 665, 667 (2014) ("[Trustees] sell nonexempt assets; they review the debtor's financial affairs; they object to the debtor's discharge or exemptions if necessary; they sue creditors and other parties that received payments or other transfers prior to the petition date; and they sue parties in state court to defend or prosecute the debtor's rights and claims.").

187. Steven Rhodes, *The Fiduciary and Institutional Obligations of a Chapter 7 Bankruptcy Trustee*, 80 AM. BANKR. L.J. 147, 166-67 (2006).

doing so is within the responsibilities of the Chapter 7 trustee.[188] If a bankruptcy trustee can negate a debtor's claimed exemption in property, the property is then ripe for liquidation in a Chapter 7 case or will be considered in meeting the best interests of creditors test in a Chapter 13 case. In other words, successfully challenging a debtor's claimed exemption increases the distribution to unsecured creditors.

In exchange for administering the bankruptcy case and liquidating any available property, the trustee receives compensation which starkly differs between no-asset and asset Chapter 7 cases. For a no-asset Chapter 7 case—which again comprises most consumer bankruptcy cases—the trustee receives $60 in total compensation which is paid through debtors' filing fees,[189] unless a fee waiver is granted under 28 U.S.C. § 1930(f).[190] If a court grants the debtor a filing fee waiver, the trustee does not receive the $60 in compensation. This $60 figure has not changed since 1994.[191] Due to the significant time commitment in administering a Chapter 7 bankruptcy case, trustees have quite understandably groused that $60 is "woefully insufficient to cover the bare minimum cost of performing the trustee's many duties in a no-asset case."[192] The stingy compensation scheme in a no-asset Chapter 7 case "is justified by the theory that commissions received from asset cases will offset the nominal no-asset fee, such that the trustee earns overall, reasonable compensation for his or her service."[193] Consequently, in a no-asset Chapter 7 case, a bankruptcy trustee is personally and financially incentivized to scour the landscape for any property the debtor may have an interest in to liquidate

188. *In re* Cheatham, 309 B.R. 631, 633 (Bankr. M.D. Ala. 2004) ("It is also the duty of the Trustee to examine the debtor's claim of exemption and, when appropriate, make an objection."). *See also In re* Leach, 595 B.R. 841, 847 (Bankr. D. Idaho 2018) ("Trustees are only required to object [to any claimed exemptions] if: 1) the value of the property claimed as exempt exceeds statutory limits, 2) the type of property being exempted is improper, or 3) the cited bankruptcy code provision does not support the exemption."); Edmonston v. Murphy (*In re* Edmonston), 107 F.3d 74, 76-77 (1st Cir. 1997) (noting that "the statutory duty to administer nonexempt property of the [C]hapter 7 estate implicitly empowers the trustee to screen and oppose exemption claims which may not be allowable"). The handbook for Chapter 7 trustees promulgated by the United States Department of Justice contemplates that a trustee must object to a claimed exemption "if doing so benefits the estate. For example, if allowing the improperly claimed exemption would remove assets from the estate that should be available for payment of creditor claims, the trustee must object." EXECUTIVE OFFICE FOR U.S. TRUSTEES, HANDBOOK FOR CHAPTER 7 TRUSTEES, *supra* note 183, at 4-4, 4-5.

189. 11 U.S.C.A. § 330(b)(1)(4)(A) (West 2024).

190. 28 U.S.C. § 1930(f) (West 2024). Pursuant to § 1930(f), the court can waive the filing fees in a consumer Chapter 7 case "if the court determines that such individual has income less than 150% of the income official poverty line . . . applicable to a family of the size involved and is unable to pay that fee in installments."). *Id.*

191. JOAN N. FEENEY & MICHAEL J. STEPAN, 1 BANKRUPTCY LAW MANUAL § 4:12 (5th ed. 2024).

192. *Id. See also* Lupica, *supra* note 183, at 102 (finding that Chapter 7 trustees reported being overly burdened by administrative responsibilities imposed by the 2005 amendments to the Bankruptcy Code).

193. *Id.* at 106.

because if there is an eventual distribution to creditors—that is, an initial no-asset case later becomes an asset case—then §§ 326 and 330 of the Bankruptcy Code awards trustees with a sliding scale compensation based upon any amounts distributed to creditors.[194]

Should the trustee liquidate property and distribute funds to creditors, then in addition to the $60 base compensation, § 330(a) of the Bankruptcy Code enables the court to award a commission to the trustee based on the amount of assets administered in the case. More specifically, § 330(a)(1) allows the court to award to the trustee "reasonable compensation for [the] actual, necessary services rendered by the trustee."[195] To qualify for compensation, the trustee's services must be necessary and beneficial to the estate.[196] However, § 326(a) limits this compensation standard by imposing a ceiling on the amount that can be awarded to the trustee, on a sliding scale basis and predicated upon actual amounts distributed to creditors.[197] In a Chapter 7 case, the court can award reasonable compensation to the trustee in accordance with the following schedule: 25% on the first $5,000 or less; 10% on any amount in excess of $5,000 but not in excess of $50,000; 5% on any amount in excess of $50,000 but not in excess of $1,000,000; and additional compensation not to exceed 3% of any distributions greater than $1,000,000.[198] In Chapter 13 cases, § 326(b) does not allow compensation for trustee services; however, 28 U.S.C. § 586(e) provides that a standing Chapter 13 trustee will receive an annual salary in addition to a percentage fee from all payments received under the plan, not to exceed 10%.[199] The bankruptcy court may always reduce or deny a Chapter 7 trustee's compensation if the expended services did not materially benefit the estate.[200] But it is the trustee's duty to maximize the estate operating in conjunction with the compensation scheme of § 326(a) that allowed Morris's bankruptcy trustee to award himself approximately 58% of her EITC refund, depriving Morris of her welfare assistance and distributing less than 50% of the asset value to her creditors.

194. 11 U.S.C.A. § 326(a) (West 2024); 11 U.S.C.A. § 330 (West 2024).

195. 11 U.S.C.A. § 330 (West 2024).

196. 11 U.S.C.A. § 330(a)(1) (West 2024).

197. 11 U.S.C.A. § 326(a) (West 2024). *See also* 3 COLLIER ON BANKRUPTCY ¶ 326.01 (16th ed. 2024) ("Subsection 326(a) sets forth a sliding scale from which the maximum compensation for [C]hapter 7 trustees . . . is determined based on the total amount of moneys disbursed or turned over by the trustee.").

198. 11 U.S.C.A. § 326(a) (West 2024). In Chapter 13 cases, the bankruptcy court is authorized to compensate standing trustees for services rendered "not to exceed five percent upon all payments under the plan." 11 U.S.C.A. § 330(b) (West 2024).

199. 11 U.S.C.A. § 326(b) (West 2024); 28 U.S.C.A. § 586(e)(1) (West 2024).

200. 1 DREHER & FEENEY, *supra* note 120, at § 4:13. *See also* Ralph C. McCullough, II, *The Art of Getting Paid: A Case Law Analysis of Panel Trustee Compensation and Its Limitations*, 104 COM. L.J. 1, 4 (1999) (noting that the compensation award to the bankruptcy trustee is "within the sound discretion of the court").

In a snapshot study of Chapter 7 trustee compensation for cases closed between July of 2006 and June of 2011, most Chapter 7 asset cases were quite small, with approximately 61.7% involving under $5,000 in funds distributed to creditors.[201] Significant to this Article, the majority of Chapter 7 cases have been "small asset" cases of less than $5,000 in distributable funds to creditors.[202] And if most Chapter 7 cases are consumer bankruptcies, then it is apparent that these small asset cases stem primarily from individual debtors. Of these small asset cases, 24.7% of the distribution went to trustees' fees, 65.3% of the funds went to unsecured creditors, with the 9.9% remaining going towards secured creditors, attorneys' fees, and other expenses.[203] Using these figures merely as an illustration and a caution, if a Chapter 7 trustee in a consumer bankruptcy case finds assets and distributes $5,000 to unsecured creditors, the trustee will receive fees in the total amount of $1,295 ($1,235 [24.7%] + $60.00 fee). Unsecured creditors would receive a collective distribution of $3,705. Thus—assuming the durability of these figures—a Chapter 7 trustee in a small asset case would reap in compensation almost a quarter of all the funds available to creditor recoveries, much like what occurred in Lillian Morris's bankruptcy case. Indeed, these figures may not be far off the mark: two more recent empirical studies found that the average and median distribution to unsecured creditors in asset consumer Chapter 7 cases amounted to $3,489 and $3,416,[204] respectively. Consequently, it appears that most asset Chapter 7 consumer bankruptcy cases are "small asset" cases where the average distribution is oftentimes less than $5,000. Precisely because of the stingy $60 compensation fee in no-asset Chapter 7 cases, along with the possibility of a sliding scale commission if non-exempt assets are eventually uncovered, if trustees wish to make money, the bankruptcy system perversely incentivizes them to augment the estate to generate the largest pot of money possible with which to pay both themselves and the creditors.[205]

In the past, scholars and commentators have empirically questioned and challenged the existing trustee compensation scheme set out by the

201. Ed Flynn, *Chapter 7 Asset Cases and Trustee Compensation*, 33 AM. BANKR. INST. J. 1, 48 (2014).

202. *Id.*

203. *Id.*

204. *See* Lupica, *supra* note 183, at 144; *see also* Dalié Jiménez, *The Distribution of Assets in Consumer Chapter 7 Bankruptcy Cases*, 83 AM. BANKR. L.J. 795, 797 (2009).

205. *Cf.* Katherine Kruis, Comment, *Awarding Fair Compensation to Bankruptcy Trustees*, 27 SAN DIEGO L. REV. 993, 994 (1990) (arguing that in no-asset bankruptcy cases the "trustee is inadequately compensated for work performed").

Bankruptcy Code.[206] For example, Serena Laws conducted a qualitative study of bankruptcy trustees across the country—both Chapter 7 and Chapter 13—to uncover how trustees viewed their roles as fiduciaries charged with augmenting the bankruptcy estate for the benefit of creditors while at the very same time reflecting upon their own compensation for performing their duties.[207] Starting from the theoretical position that the American bankruptcy system is a marketized social welfare program under neoliberalism,[208] Laws argues that the meager trustee compensation system drives private trustees to inflate their own fees "in ways that can work against debtors, particularly low-income debtors and those living in low-wealth areas."[209] Laws contends that while bankruptcy trustees appear neutral, they are in fact "private contractors paid through fees and commissions that ultimately come from debtors whose cases they administer."[210]

Because of the perverse distribution incentive established through § 326 of the Bankruptcy Code, Laws argues that "trustees have a clear incentive to extract as many assets from debtors as possible to maximize their own payment."[211] According to interviews with bankruptcy trustees, Laws uncovered that the nominal $60 fee for each bankruptcy case administered "justified their aggressive pursuit of debtors' assets."[212] Two comments from Laws' trustee respondents are worth quoting to provide some first-hand account of how trustees may view their work in operating in an environment which compensates them only $60 per no-asset case. One trustee remarked:

> Sixty dollars is not a fee. It's what I leave as a tip when I go out to eat. But that's not what you're doing it for. You're doing it to hopefully get an asset case when you can bring in some money for creditors and also get a legal fee paid too.[213]

Another trustee respondent offered the following: "Sixty dollars . . . that's how little we get. So the incentive of course is to find assets, because our fiduciary duty[—]and we do also get paid in asset cases only."[214] The point in offering these excerpts is not to generalize

206. *See generally* Serena Laws, *What Kind of Relief? Consumer Bankruptcy and Private Administration in the Neoliberal American Welfare State*, 42 NEW POL. SCI. 333 (2020); Belisa Pang & Emile Shehada, *One Size Fits None: An Overdue Reform for Chapter 7 Trustees*, 131 YALE L.J. 976 (2022).

207. *See generally* Serena Laws, *supra* note 206.

208. This Author has argued the same in past research. *See generally* Sousa, *supra* note 35.

209. Serena Laws, *supra* note 206, at 340.

210. *Id.* at 343.

211. *Id.* at 344.

212. *Id.*

213. *Id.* at 345.

214. *Id.*

that all trustees are motivated to zealously search for assets in order to get paid more than the $60 no-asset fee in a self-interested manner, but rather to identify a structural feature of the bankruptcy system that harms vulnerable debtors. Indeed, as Laws concedes, the need to aggressively pursue debtor assets stems precisely from Congress's inadequate funding for the administration of bankruptcy cases.[215] And in the consumer bankruptcy system where debtors do not own much, if any, non-exempt property, most trustees rely on the pursuit of small asset cases with a tax refund oftentimes representing the only significant asset for distribution to creditors.[216]

Indeed, while the types of property that a trustee may seek to liquidate run the gamut, a frequent asset many individual debtors have is a federal tax refund.[217] Courts have unequivocally held that tax refunds are property of the bankruptcy estate, susceptible to interception by trustees for liquidation and distribution to unsecured creditors, assuming the debtor has not already used the funds prior to filing the bankruptcy petition.[218] Further, courts have also found that contingent interests in future payments—such as tax credit refunds—are also property of the bankruptcy estate.[219] Additionally, because the bankruptcy trustee steps into the debtor's proverbial shoes regarding bankruptcy estate interests, even if a debtor did not obtain a tax credit refund by the filing of the bankruptcy petition, the trustee may later request a tax credit refund check to which the debtor was otherwise entitled on the date of the bankruptcy petition.[220] In fact, one empirical study regarding the distribution of assets in consumer Chapter 7 bankruptcy cases found that the trustee captured a debtor's income tax refund in approximately 61% of the asset cases examined.[221] Accordingly, EITC refund payments associated with the taxable year prior to the filing of the bankruptcy case are equally property

215. *Id.* at 346.

216. *Id.* at 353-54. *See also* Pang & Shehada, *supra* note 206, at 1019 (noting that tax refunds "comprise a significant proportion of the assets recovered by trustees") (citation omitted).

217. Jiménez, *supra* note 204, at 808 (finding that a federal or income tax refund is often a source for an asset Chapter 7 consumer bankruptcy case). Pursuant to § 521(e)(2) of the Bankruptcy Code, debtors must furnish copies of their most recent tax returns to the bankruptcy trustee. 11 U.S.C.A. § 521(e)(2) (West 2024).

218. *See, e.g.*, Barowsky v. Serelson (*In re* Barowsky), 946 F.2d 1516, 1518 (10th Cir. 1991) ("Every court that has considered this issue has held that the portion of an income tax refund that is based upon the pre-petition portion of a taxable year constitutes property of the bankruptcy estate.") (citations omitted); *In re* Chesler, 608 B.R. 709, 711 (Bankr. D. Minn. 2019) ("Courts have long found that an income tax refund can be property of a bankruptcy estate.").

219. Law v. Stover (*In re* Law), 336 B.R. 780, 781-82 (B.A.P. 8th Cir. 2006).

220. Wylie v. Miller, 650 B.R. 504, 510 (E.D. Mich. 2022).

221. Jiménez, *supra* note 204, at 812.

of the estate and seizable by the bankruptcy trustee.[222]

In a second empirical study, the researchers sought to examine the behavior of Chapter 7 trustees from data drawn from four judicial districts across the country.[223] The underlying research question queried whether the spartan no-asset compensation scheme may lead to either an under-investigation of consumer cases or may incentivize trustees to overzealously "investigate every consumer case they get to make those cases worth their while, subjecting those debtors to excessive takings."[224] The authors described this dynamic as causing a distortion effect for the consumer bankruptcy system.[225] As might be expected, the authors concluded that the collection and distribution of assets in consumer Chapter 7 cases are not static, but rather based upon the proclivities of the individual trustees; namely, whether the trustee tended to under-investigate a no-asset case so as to reduce the administrative effort in overseeing the case—in relation to the $60 compensation for no asset cases—or whether a trustee "relentlessly" sought assets for distribution.[226]

The researchers found any under-investigating of the debtor's financial affairs to be "alarming" for several reasons.[227] First, a trustee not zealously investigating a debtor's financial affairs would result in one debtor unfairly experiencing a major windfall—assuming there were assets to distribute such as tax refunds—where another debtor under the supervision of another trustee might not.[228] From here, the authors contend that such under-investigation by bankruptcy trustees would in turn create incentives for debtors to hide assets from trustees, resulting in "a vicious cycle that enriches the dishonest at the expense of the honest."[229] The authors also found any relentless over-investigation of consumer debtor cases equally problematic since such trustee efforts would lead to extra work for debtors' attorneys.[230] The authors opine that such investigatory efforts would lead to debtors' attorneys "taking advantage of loopholes in the assignment protocols to avoid these

222. *In re* Moreno, 629 B.R. 923, 926-27 (Bankr. W.D. Wash. 2021); *In re* Garcia-Morales, 653 B.R. 660, 663-64 (Bankr. D. Colo. 2023). *See also In re* Beltz, 263 B.R. 525, 527 (Bankr. W.D. Ky. 2001) (noting that "the overwhelming majority of Courts include the EITC as property of the estate").

223. Pang & Shehada, *supra* note 206, at 1000.

224. *Id.* at 976.

225. *Id.* at 995.

226. *Id.* at 1000-04.

227. *Id.* at 1002.

228. *Id.* at 1002. On this note, the authors uncovered evidence suggesting that at least in one judicial district, "over 90% of tax refunds that should be collected for distribution are effectively ignored." *Id.* at 1001-02.

229. *Id.* at 1003.

230. *Id.*

trustees," namely, by engaging in forum shopping for less ardent Chapter 7 trustees.[231]

Accordingly, the authors contend that the best mechanism to resolve the potentiality for under-investigation and over-investigation in the compensation scheme for bankruptcy trustees is to disaggregate the compensation structure for business and consumer Chapter 7 cases.[232] Recognizing that Chapter 7 bankruptcy trustees are generally undercompensated for consumer cases, the authors argue that the bankruptcy flat fee of $60 "should be set higher so as to reflect the minimum amount of time a trustee spends on nonasset cases, and the fee level should be reset every other year to match the market rate (i.e., the comparable hourly rate for private lawyers)."[233] With respect to the available sliding scale compensation mechanism for asset cases under § 326, the authors propose that it "should have narrower brackets to reflect the fact that most consumers have less than $5,000 of distributable assets, which is the lowest asset bracket under the current system. The percentage rate of the lowest bracket, however, should be substantially higher to cover trustees' sunk cost for investigation."[234] Further, because Chapter 7 bankruptcy trustees most often are only going to receive the $60 flat fee due to the strong prevalence of no-asset consumer cases, the authors further recommend that the United States Trustee's Office more closely supervise bankruptcy trustees for such things as assessing asset case rates, case lengths, "and the frequency with which they collect tax refunds."[235]

While this Article does not disagree that Chapter 7 trustees should be compensated more generously by the bankruptcy system, if these suggested proposals are adopted, they would invariably lead to trustees aggressively seeking to intercept EITC benefits received by debtors in most jurisdictions that currently fail to protect these public benefits from trustee seizure. Trustees would be encouraged to do so as it would increasingly compensate them through a greater percentage of the tax refund disbursed to unsecured creditors, along with the enhanced supervision by the Office of the United States Trustee Program galvanizing trustees to increasingly scour for EITC refunds. Whether a trustee may be able to capture a debtor's EITC welfare payments depends upon the jurisdiction in which the bankruptcy filing occurs. Accordingly, this Article now turns to mapping out the fragmented nature of the system.

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231. *Id.* at 1003-04.

232. *Id.* at 1000-18.

233. *Id.* at 1000-24. *See also* Tally M. Wiener & Nicholas B. Malito, *On the Nature of the Chapter 7 Bankruptcy Trustee Fee*, 18 J. BANKR. L. & PRAC. 2, Art. 3 (2009) (recognizing the chronic under-compensation of Chapter 7 bankruptcy trustees).

234. Pang & Shehada, *supra* note 206, at 1024.

235. *Id.* at 1027.

V. THE TYPOLOGICAL LANDSCAPE FOR EXEMPTING THE EITC IN BANKRUPTCY

As noted in the introduction, the legal landscape regarding the protectability of the EITC as exempt property in bankruptcy currently represents an assemblage of at least four distinct outcomes dependent upon the debtor's jurisdictional residence and whether the state has elected to opt-out of the federal bankruptcy exemptions.[236]

A. Jurisdictions That Protect the EITC from Creditors

As of this writing, fourteen states have specifically enacted state statutes that exempt EITC benefits from the reach of creditors in bankruptcy: Nevada,[237] Ohio,[238] Maine,[239] Indiana,[240] Colorado,[241] Florida,[242] Oregon,[243] Kansas,[244] Louisiana,[245] Mississippi (not to exceed $5,000 in total income tax credit proceeds),[246] Nebraska,[247] Oklahoma,[248] Virginia,[249] and Minnesota.[250] On July 1, 2023, New Mexico amended its exemption statute to protect "refundable federal and state tax credits."[251] However, the statute does not explicitly exempt EITC benefits, but it is reasonable to presume that a New Mexico bankruptcy court would now

236. *See* 28 U.S.C.A. § 1408 (West 2024) (maintaining that a debtor must file in the jurisdiction in which they maintained their domicile or residence for the one hundred eighty days immediately preceding the commencement of their bankruptcy case or the longer portion of the one-hundred-eighty-day window if the domicile or residence was in more than one state).

237. NEV. REV. STAT. ANN. § 21.090(aa) (West 2024).

238. OHIO REV. CODE ANN. § 2329.66(A)(9)(f) (West 2024).

239. ME. REV. STAT. ANN. tit. 14 § 4422(13)(A) (West 2024).

240. IND. CODE ANN. § 34-55-10-2(c)(11) (West 2024).

241. COLO. REV. STAT. ANN. § 13-54-102(1)(o) (West 2024).

242. FLA. STAT. ANN. § 222.25 (West 2024).

243. OR. REV. STAT. ANN. § 18.345(1)(n) (West 2024).

244. KAN. STAT. ANN. § 60-2315 (West 2024).

245. LA. STAT. ANN. § 13:3881(A)(1)(6) (West 2024).

246. MISS. CODE ANN. § 85-3-1(i) (West 2024).

247. NEB. REV. STAT. ANN. § 25-1553 (West 2024).

248. OKLA. STAT. ANN. tit. 31, § 1 (West 2024).

249. VA. CODE ANN. § 34-26(9) (West 2024).

250. The Minnesota exemption statute provided that "[a]ll government assistance based on need, and the earnings or salary of a person who is a recipient of government assistance based on need, shall be exempt from all claims of creditors . . . ." MINN STAT. ANN. § 550.37 (West 2024). While § 550.37 does not specifically mention the EITC, the Bankruptcy Code for the District of Minnesota in *In re* Tomczyk held that an EITC refund satisfied the statutory language of all "relief based on need" and exempted the proceeds from distribution to creditors. *In re* Tomczyk, 295 B.R. 894, 897 (Bankr. D. Minn. 2003). On May 21, 2024, Minnesota Governor Tim Walz signed the Minnesota Debt Fairness Act (SF 4097) into law, which amends the state exemption statute to specifically include low income-based tax credits.

251. N.M. STAT. ANN. § 42-10-1(A)(7) (West 2024). While the statute does not specify the categories of protected tax credits, it is reasonable to assume that a court would include the EITC as falling under this broad designation.

include the EITC under this broad categorization. Prior to the 2023 amendment, the applicable New Mexico exemption statute only protected public assistance provided under the New Mexico Public Assistance Act.[252] In *In re Medina*—a New Mexico bankruptcy court decision issued prior to the 2023 amendment—the debtor attempted to exempt her $3,618 EITC refund under the state wildcard exemption (then limited to $500).[253] The Chapter 7 trustee objected to the claimed exemption for the EITC benefits. While the New Mexico bankruptcy court sustained the trustee's objection to the claimed EITC exemption above the $500 wildcard exemption, the court nonetheless foreshadowed how bankruptcy courts in New Mexico may rule on the exemptability of EITC benefits given the 2023 amendment. In *Medina*, the bankruptcy court stated in dicta that it considered EITC refunds to be a form of general, public assistance and touted their anti-poverty benefits for providing economic relief to low-income working households. The *Medina* court further disagreed with other courts that construe the EITC refund as merely an overpayment rather than a welfare grant.[254] Given the revised wording of the amended New Mexico exemption statute, it is likely that bankruptcy courts in the District of New Mexico will include the EITC under the label of "refundable federal tax credit," thereby adding another jurisdiction that protects the EITC, bringing the count to fifteen states.

But even in states that protect the EITC and allow for its exemption, the ability of low-income debtors to keep these funds from bankruptcy trustees and creditors is still not absolute. Some state exemption statutes are quirkily worded. For example, the Missouri exemption statute protects a debtor's "right to receive" public assistance benefits.[255] For debtors filing a Chapter 7 bankruptcy case, the Missouri courts have construed this language to mean EITC refunds expected by the debtor in the future. Thus, should the debtor receive their EITC refunds prior to filing for bankruptcy, those funds are no longer exempt from the reach of the bankruptcy trustee.[256] Moreover, should an EITC recipient choose to file under Chapter 13, despite their exemptability, courts have held that EITC refunds must be counted as income towards a proposed plan for repaying creditors in order for a debtor to satisfy both the best interests of creditors test as well as the "projected disposable income" requirement in the event

252. *In re* Medina, 2022 WL 17742527, *6 (Bankr. D. New Mexico 2022).

253. *Id.*

254. *Id.* at *5.

255. V.A.M.S. §513.430(10)(A) (West 2024).

256. *In re* Helmes, 2015 WL 6940634, *1-3 (Bankr. E.D. Mo. Nov. 9, 2015); Dittmaier v. Sosne (*In re* Dittmaier), 806 F.3d 987, 989-91 (8th Cir. 2015).

that a creditor or the bankruptcy trustee object to the plan.[257] Stated more starkly, if an EITC recipient chooses to file under Chapter 13 rather than Chapter 7, past and future EITC refunds will be considered as the debtor's income, a portion of which would need to be devoted to repaying creditors over time.

B. States That Specifically Have No Protection for the EITC

At the opposite end of the spectrum, there are sixteen states that do not specifically provide protection for the EITC or include any language exempting public assistance more generally: Texas, Massachusetts, Michigan, Washington,[258] Delaware, Wisconsin, Pennsylvania, Utah, Rhode Island, Vermont, North Dakota, New Hampshire, New Jersey, Arkansas, Hawaii, and North Carolina.[259] In these states, a debtor wishing to protect their EITC from the bankruptcy process must either rely upon a wildcard exemption provided under state exemption law, if available,[260] or the § 522(d)(5) wildcard exemption provided by the Bankruptcy Code in states that have not opted out of the federal scheme.[261]

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257. *See generally In re* Alonso, 570 B.R. 622 (Bankr. D. Idaho 2017) (holding that a debtor's EITC refund must be included in income calculations to determine the appropriate payments to creditors under the Chapter 13 plan); *see also In re* Royal, 397 B.R. 88 (Bankr. N.D. Ill. 2008).

258. Despite this, at least one bankruptcy court in the state of Washington has exempted an EITC refund under state law by incorporating it into the category of "federally administered needs-based program[s]." *In re* Moreno, 629 B.R. 923, 934 (Bankr. W.D. Wash. 2021).

259. For example, the state of North Dakota's personal exemption statute enables debtors to exempt Social Security benefits, veteran's disability benefits, disability benefits, or unemployment benefits, but no ability to shield EITC payments. N.D. CENT. CODE ANN. § 28-22-03.1 (West 2024). That said, as an opt-out state, North Dakota provides for a wildcard exemption in "other personal property" not exceeding $7,500. N.D. CENT. CODE ANN. § 28-22-03 (West 2024). The state of Vermont, as an opt-in state, allows debtors to select the exemptions provided by § 522(d) of the Bankruptcy Code or the state law exemptions. Like North Dakota, the Vermont state exemption statute specifically protects Social Security benefits, veteran's benefits, disability benefits, and alimony, support or maintenance payments, but not earned income tax credits. The Vermont exemption statute does have a wildcard exemption for "any property" not to exceed $400 in value, plus any unused exemption amounts in other statutory provisions. VT. STAT. ANN. tit. 12, § 2740 (West 2024). *See also* UTAH CODE ANN. § 78B-5-505 (West 2024) (enabling exemptions only for disability, illness, unemployment, and veterans' benefits); DEL. CODE ANN. tit. 10, § 4914(b) (West 2024) (providing no protection for general public assistance or EITC refunds but offering an aggregate $25,000 exemption in personal property).

260. Few state exemption statutes provide for a wildcard exemption. *See, e.g.*, N.C. GEN. STAT. ANN. § 1C-1601(a)(2) (West 2024) (permitting a state wildcard exemption "in any property," capped at $5,000 in the aggregate, for any unused portion of the homestead exemption). *See also* N.J. STAT. ANN. § 2A:17-19 (West 2024) (permitting an exemption under state law for "personal property of every kind," but capped at $1,000).

261. For example, debtors who file for bankruptcy in the state of Arkansas can elect either the applicable state exemptions or those provided by § 522(d) of the Bankruptcy Code. ARK. CODE ANN. §16-66-217 (West 2024). *See also* N.H. REV. STAT. ANN. § 511:2 (West 2024) (allowing debtors in New Hampshire to select a state wildcard exemption in "any property" not to exceed $1,000 in value, but because New Hampshire is not an opt-out state, a debtor could claim the § 522(d)(5) wildcard exemption

Some of these states—for example, Arkansas—have no state exemption statute protecting public assistance from the reach of creditors, so many debtors likely elect to utilize the federal exemptions provided by § 522(d) of the Bankruptcy Code.[262] However, § 522(d) inexcusably fails to specifically carve out an exemption and protection for state or federal earned income tax credits. That said, a possible pathway exists for debtors to potentially shield some portion or all of their EITC refunds from the bankruptcy trustee's collection efforts. But even this does not provide certainty to debtors who rely upon the federal exemptions contained in the Bankruptcy Code and for those who wish to retain their welfare benefits under federal law.

As noted earlier, § 522(d) lists the types of property—and accompanying monetary values—that a debtor may exempt from creditors through the bankruptcy process.[263] Without a specific exemption protecting the EITC, debtors would need to rely upon the wildcard exemption offered by § 522(d)(5), which provides that a debtor may exempt the "aggregate interest in any property, not to exceed in value $1,475 plus up to $13,950 of any unused amount of the exemption provided under paragraph (1) of this subsection."[264] In turn, § 522(d)(1) refers to the homestead exemption, which enables a debtor to shield up to $27,900 in aggregate value in real property that the debtor owns and uses as a residence.[265] Reading these two statutory provisions in tandem, and depending upon the particular debtor's circumstances, may yield wildly different results in individual cases regarding retainment of the EITC. For

if they choose the exemptions provided by the Bankruptcy Code); R.I. GEN. LAWS ANN. §9-26-4 (West 2024) (enabling debtors to choose either state law exemptions or those provided by the Bankruptcy Code; if debtors choose the former, there is a potential wildcard exemption in bankruptcy for up to $6,500 in "any assets"); MICH. COMP. LAWS. ANN. § 600.5451(1) (West 2024) (permitting debtors to choose between the state or federal bankruptcy exemptions); MASS. GEN. LAWS ch. 235, § 34 (West 2024) (allowing debtors to elect either the Bankruptcy Code exemptions or the state exemptions; if a debtor chooses the later, they may be able to protect some or all of their EITC pursuant to a wildcard exemption in the amount of $1,000 in aggregate value in "any personal property," plus up to $5,000 of any unused amounts under other sections of the statute). While the state of Texas exempts payments and benefits under local public programs, such as nutritional programs, there is no similar protection for EITC refunds. TEX. HUM. RES. CODE ANN. § 32.036 (West 2024). Since the state of Texas has not opted out of the Bankruptcy Code exemption scheme, debtors who file for bankruptcy in Texas may be able to shield some or all the EITC benefits under § 522(d)(5).

262. 11 U.S.C.A. § 522(d) (West 2024).

263. § 522(l) of the Bankruptcy Code directs that a debtor must file a list of property that they wish to exempt. 11 U.S.C.A. § 522(l) (West 2024). Pursuant to Federal Rule of Bankruptcy Procedure 4003(a), to claim an exemption in property it must be included on the schedule of assets that a debtor files usually along with the initial bankruptcy petition. FED. R. BANKR. P. 4003(a).

264. 11 U.S.C.A. § 522(d)(5) (West 2024). The purpose of the wildcard exemption is to prevent discrimination against debtors who do not own homes. RICHARD LEVIN & HENRY J. SOMMER, 4 COLLIER ON BANKRUPTCY ¶ 522.09[5] (16th ed. 2020).

265. 11 U.S.C.A. § 522(d)(1) (West 2024).

example, if a debtor who is expecting an EITC refund also owns a home and claims the full $27,900 allowance as an exemption under § 522(d)(1), then at best the debtor can protect up to $1,475 of their EITC refund from the reach of creditors. Indeed, courts have concluded that income tax refunds satisfy the "any property" language under the wildcard exemption.[266] However, the trustee would capture any EITC moneys above this $1,475 threshold and distribute it to the body of unsecured creditors. At the opposite extreme, if the debtor does not claim any portion of the $27,900 allowable homestead exemption, then the debtor may exempt a total of $15,425 in an EITC refund, assuming of course that the debtor has no other use for the § 522(d)(5) wildcard exemption to protect any other forms of property. Between these two extremes—that is, full use of the homestead exemption or no reliance upon the homestead exemption—the debtor may be able to shield none, a portion, or possibly all of their EITC refund depending upon the amount of the refund during the bankruptcy proceedings and whether the debtor had more pressing needs for the $1,475 presumptive exemption under § 522(d)(5).

Thus, if a state has not opted-out of the federal bankruptcy exemption scheme a debtor may be able to exempt all or a portion of their EITC refunds from the reach of creditors under the § 522(d) wildcard exemption. However, the reality is that for debtors in the sixteen jurisdictions that have opted out of the federal bankruptcy scheme, they will likely lose their EITC refunds in the process of obtaining the touted fresh start that bankruptcy provides. Appreciating this dynamic, one court lamented as follows:

> The debtors in this case are truly in need of a "fresh start" which the Bankruptcy Code was designed to provide. It is difficult to understand why more effort is not expended by other counsel, the trustees, and the courts to permit impoverished debtors to keep their earned income credit rather than expending time, effort and legal skills in trying to take the earned income credit away from such debtors.[267]

266. Leech v. Nichols (*In re* Nichols), 4 B.R. 711, 714-18 (Bankr. E.D. Mich. 1980). *See also In re* Meyers, 431 B.R. 823, 825 (Bankr. E.D. Wis. 2010) (protecting an income tax refund under § 522(d)(5)); *see also In re* Andrade, 2011 WL 1559241, *1 (Bankr. D.R.I. Mar. 16, 2011).

267. *In re* Barrett, 214 B.R. 632, 634 (Bankr. W.D. Okla. 1997).

C. States That Only Protect "Local" Public Assistance Benefits

In the third typology of EITC exemptability, currently twelve states—Alaska,[268] California,[269] Arizona,[270] Maryland,[271] Montana,[272] New York,[273] South Carolina,[274] South Dakota,[275] West Virginia,[276] Wyoming,[277] Tennessee,[278] Georgia,[279] and the District of Columbia[280]—have exemption statutes that only shield "local public assistance" benefits from capture by bankruptcy trustees. In essence, courts in these jurisdictions conclude that because the EITC is neither paid nor administered by a state or local public welfare program, EITC benefits are not protectible under state exemption statutes.[281] While reported decisions in these jurisdictions cite their support for the policy goals behind the EITC, these courts are unwilling to override the clear statutory definitions that the state exemption statutes provide and limit any exemptions to public assistance programs provided under state laws.[282]

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268. Generally, Alaska provides public financial assistance for a needy person who is aged, disabled, or medically infirm, or financial assistance to needy persons for purposes of subsistence (e.g., food, clothing, utilities, and shelter). *See* ALASKA STAT. ANN. § 47.25.300 (West 2024). *See also* ALASKA STAT. ANN. § 47.25.615 (West 2024). Both forms of local assistance are exempt from attachment by creditors. *See* ALASKA STAT. ANN. § 47.25.210 (West 2024). *See also* ALASKA STAT. ANN. § 47.25.550 (West 2024).

269. CAL. CIV. PROC. CODE § 703.140 (West 2024) (providing an exemption for "[a] social security benefit, unemployment compensation, or a local public assistance benefit").

270. ARIZ. REV. STAT. ANN. § 46-208 (West 2024) ("Assistance granted under this title is not transferable or assignable at law or in equity, and none of the money paid or payable under this title shall be subject to execution, levy, attachment, garnishment or other legal process, or to the operation of any bankruptcy or insolvency law."). The forms of public assistance under Arizona law that are exempt from levy, garnishment, or execution include Medical Assistance to the Aged, TANF, and the Child Care Food Program. *See generally* ARIZ. REV. STAT. ANN. §§ 46-201 to 46-362 (West 2024).

271. MD. CODE ANN. HUM. SERVS. CODE § 5-407 (West 2024) (exempting only local public assistance benefits).

272. MONT. CODE ANN. § 25-13-608 (West 2024) (exempting benefits the debtor "has received or is entitled to receive under federal social security or local public assistance legislation").

273. N.Y. DEBT. & CRED. LAW § 282 (McKinney 2024) (exempting a debtor's right to receive "a social security benefit, unemployment compensation or a local public assistance benefit").

274. S.C. CODE ANN. § 51-41-30(A)(11)(a) (West 2024) (protecting a debtor's "right to receive or property that is traceable to: a social security benefit, unemployment compensation, or a local public assistance benefit").

275. S.D. CODIFIED LAWS § 28-7A-18 (West 2024) ("Assistance granted under this chapter is not transferable or assignable at law or in equity. No money paid or assistance granted under this chapter is subject to execution, levy, attachment, garnishment, or other legal process, except as may be expressly authorized by law for purposes of recovery or recoupment by the department, or to the operation of any bankruptcy or insolvency law."). The local assistance benefits relate to the Temporary Assistance for Needy Families program. South Dakota does have a wildcard exemption for personal property in the aggregate amount of $7,000 if the debtor is the head of a household, or $5,000 if the debtor is not the head of a household that can be used to shield an EITC refund. S.D. CODIFIED LAWS § 43-45-4 (West 2024). This, however, assumes that the debtor would not need to utilize this wildcard exemption for any other personal property they may wish to retain from the reach of creditors.

D. Jurisdictions That Protect EITC Benefits Under General Public Assistance Exemption Statutes

Finally, the following seven states protect EITC refunds under state exemption statutes where the statutory language is not specifically limited to *local* public assistance benefits: Alabama,[283] Idaho,[284] Illinois,[285]

276. W. VA. CODE ANN. § 38-10-4(i)(1) (West 2024) (exempting a debtor's "right to receive a social security benefit, unemployment compensation, or a local public assistance benefit"). The West Virginia exemption statute, however, provides for a miserly $800 wildcard exemption "in any property" for any unused portion of the state homestead exemption. *See also* W. VA. CODE ANN. § 38-10-4(e) (West 2024).

277. WYO. STAT. ANN. § 42-2-113 (West 2024) (shielding public assistance and social services provided under the Wyoming Public Assistance and Social Services Act).

278. TENN. CODE ANN. § 26-2-111(1)(A) (West 2024) (exempting Social Sareecurity benefits, unemployment compensation, and state and local public assistance benefits). Tennessee does provide for an aggregate exemption in the amount of $10,000 for personal property that a debtor wishes to exempt from the reach of creditors. TENN. CODE ANN. § 26-2-103 (West 2024). Thus, it is possible that a debtor may be able to utilize this section to exempt all or a portion of an EITC refund. However, the ability to do so is predicated upon a debtor not having much, if any other, personal property they would like to exempt from the bankruptcy process.

279. GA. CODE ANN. § 44-13-100(a)(2)(A) (West 2024) (allowing an exemption for local public assistance benefits). The Georgia statute does provide for a wildcard exemption "in any property" up to an aggregate amount of $1,200, plus any unused portion of the homestead exemption not to exceed $10,000. GA. CODE ANN. § 44-13-100(a)(6) (West 2024).

280. D.C. CODE ANN. § 4-215.01 (West 2024) ("[p]ublic assistance awarded *under this chapter* shall not be transferable or assignable at law or in equity, and none of the money paid or payable to any recipient under this chapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or the operation of any bankruptcy or insolvency law.") D.C. CODE ANN. § 4-215.01 (West 2024) (emphasis added). The forms of local public assistance included in this exemption statute for public assistance includes provisions for Emergency Shelter Family Services, Interim Disability Assistance, and Temporary Assistance for Needy Families. D.C. CODE ANN. § 4-202.01 (West 2024).

281. *See, e.g.*, *In re* Builder, 368 B.R. 10, 10 (Bankr. D. Ariz. 2007). *See also* Nisselson v. Fasarakis (*In re* Fasarakis), 423 B.R. 34, (Bankr. E.D.N.Y. 2010) (holding that EITC benefits are not exempt under New York law because they do not satisfy the definition of "local public assistance"); *In re* Egorov, 2013 WL 6185401, *4 (Bankr. S.D. Cal. Nov. 22, 2013) ("Where the state statute does not include Tax Credits within the definition of public assistance benefits, the Tax Credits are not found exempt.").

282. *In re* Egorov, 2013 WL 6185401, *5 (Bankr. S.D. Cal. Nov. 22, 2013). *See also In re* Garrett, 225 B.R. 301, 303 (Bankr. W.D.N.Y. 1998) ("No matter how strong may be the equitable considerations that support the creation of an exemption, this Court has no authority to enlarge the legislature's designation.").

283. ALA. CODE § 38-4-8 (West 2024) ("All amounts paid or payable as public assistance to needy persons shall be exempt from any tax levied by the state or any subdivision thereof and shall be exempt from levy, garnishment, attachment or any other process whatsoever and shall be inalienable, and in the case of bankruptcy, shall not pass to the trustee or other person acting on behalf of the creditors of the recipient of public assistance.").

284. IDAHO CODE ANN. § 11-603(4) (West 2024) ("An individual is entitled to exemption of the following property: [b]enefits the individual is entitled to receive under federal, state, or local public assistance legislation.").

285. 735 ILL. COMP. STAT. 5/12-1001(g)(1) (West 2024) ("The following personal property, owned by the debtor, is exempt from judgment, attachment, or distress for rent: [t]he debtor's right to receive a social security benefit, unemployment compensation, or public assistance benefit.").

Iowa,[286] Missouri,[287] Connecticut,[288] and Kentucky.[289] The rationales for the various bankruptcy courts in these jurisdictions are identical. That is, without the modifier "local" before the term "public assistance," courts in these jurisdictions respect the public policy initiative behind the EITC in assisting low-income working families with everyday financial struggles, construe the exemption statutes liberally in favor of debtors, and respect the fresh start policy undergirding the consumer bankruptcy system—and thus consequently permit debtors to retain their refunds from creditors.[290]

VI. PROTECTION FOR MIDDLE-CLASS ASSETS AND OTHER PUBLIC BENEFITS IN BANKRUPTCY

While in most jurisdictions low-income debtors will likely be deprived of their EITC benefits, the Bankruptcy Code and state exemption statutes permit what many would consider middle-class assets to be entirely protected from the reach of trustees and creditors. This results in a class-based, inequitable bankruptcy system that exploits low-income families and reproduces social inequality. Starkly put, while the trustee may seize the average $2,276 EITC refund and pay down unsecured debt, millions of dollars in retirement accounts, pension plans, and home equity may be

286. IOWA CODE § 627.6(8)(a) (West 2024) (exempting a debtor's rights in "[a] social security benefit, unemployment compensation, or any public assistance benefit").

287. MO. ANN. STAT. § 513.430(10)(A) (West 2024) (protecting a debtor's right to receive "[a] social security benefit, unemployment compensation or a public assistance benefit").

288. CONN. GEN. STAT. ANN. § 52-352b(4) (West 2024) (exempting "[p]ublic assistance payments and any wages earned by a public assistance recipient under an incentive earnings or similar program"). As an opt-in state, if debtors in Connecticut elect to utilize the exemptions contained within the Bankruptcy Code, they may be able to protect some or all of their EITC refunds pursuant to the § 522(d)(5) wildcard exemption.

289. KY. REV. STAT. ANN. § 205.220(3) (West 2024) ("Public assistance shall not be assignable and shall be exempt from levy or execution. Furthermore, no assignment, pledge or encumbrance of any right to benefits due or payable under this chapter shall be valid. Public assistance benefits, as long as they are not mingled with other funds of the recipient, shall be exempt from any remedy for the collection of all debts, liens and encumbrances. No waiver of any exemption provided for in this subsection shall be valid.").

290. Brasher v. McGregor (*In re* Brasher), 253 B.R. 484, 488 (M.D. Ala. 2000) (holding that the statutory term "public assistance" may include EITC refunds). *See also In re* Jones 107 B.R. 751, 752 (Bankr. D. Idaho 1989) (holding the EITC exempt under Idaho's exemption for "public assistance legislation"); *In re* Fish, 107 B.R. 82, 84 (Bankr. S.D. Ill. 1998) (finding EITC refunds are exempt as "public assistance benefits" under Illinois law); *In re* Brockhouse, 220 B.R. 623, 625 (Bankr. C.D. Ill. 1998) (holding the EITC as exempt as a "public assistance benefit" pursuant to the Illinois exemption statute); *In re* Longstreet, 246 B.R. 611, 614-15 (Bankr. S.D. Iowa 2003) (holding that the modifier "any" before "public assistance benefit" is quite broad and includes EITC refunds); Flanery v. Mathison, 289 B.R. 624, 627-29 (W.D. Ky. 2003) (holding that the EITC was included in the term "public assistance" under Kentucky law); *In re* Goldsberry, 142 B.R. 158, 159 (Bankr. E.D. Ky. 1992) (holding that the EITC fits within the definition of "public assistance" under Kentucky law).

untouchable.[291] While not exhaustive, this Section offers a glimpse of the glaring disparity between the treatment of low-income and middle-class debtors in bankruptcy.

A. Social Security Benefits

The federal Social Security program is the most universally used public benefits program in United States history.[292] And while the progressivity of the Social Security program undoubtedly benefits low-income workers, the program has nevertheless been asserted to disproportionately and positively impact middle-class families.[293] Benefits from the largest social safety net program for older Americans are completely shielded from the reach of creditors in bankruptcy. Congress crafted Social Security payments to be fully exempt from creditor collection efforts as a matter of federal law pursuant to 42 U.S.C. § 407(a).[294] Further, unlike EITC refunds received by a debtor in a Chapter 13 case, the definition of "current monthly income" specifically excludes Social Security benefits, meaning that Social Security payments the debtor receives are not included as "disposable income" to be contributed towards making payments to creditors under a Chapter 13 plan.[295]

B. Contributions Towards Children's Education

As noted earlier, the commencement of a bankruptcy case creates an estate by operation of law and the estate includes everything in which the debtor has any legal or equitable interests.[296] While the scope of the estate is construed broadly and includes both tangible and intangible interests in property,[297] § 541(b) of the Bankruptcy Code specifically excludes certain

291. *Cf.* Todd J. Zywicki, *Institutions, Incentives, and Consumer Bankruptcy Reform*, 62 WASH. & LEE L. REV. 1071, 1084 (2005) (arguing that "both high wealth and high income households have the largest potential benefit from filing bankruptcy").

292. LEONARD J. SANTOW & MARK E. SANTOW, SOCIAL SECURITY AND THE MIDDLE-CLASS SQUEEZE 19 (2005).

293. *See, e.g.*, HANDLER & HASENFELD, *supra* note 28, at 87. (noting that Social Security and Medicare are transfer programs that benefit the middle class). *See also* Karen E. Dynan, Jonathan Skinner & Stephen P. Zeldas, *Do the Rich Save More?* 112 J. POL. ECON. 397, 418 (2004) (finding that wealthier households save more income over the life course than lower-income households, a portion of which is partly explained by the receipt of Social Security benefits).

294. 42 U.S.C.A. § 407(a) (West 2024) ("The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.").

295. 11 U.S.C.A. § 101(10A) (West 2024).

296. 11 U.S.C.A. § 541(a)(1) (West 2024).

297. Hopkins v. Frazier (*In re* Tews), 502 B.R. 566, 569 (Bankr. D. Idaho 2013) (citation omitted).

forms of property from the estate that can only be described as protecting middle-class assets from the debtor's creditors. In order to provide families with a safe harbor for funding educational opportunities for their children, grandchildren, or stepchildren, § 541(b)(5) excludes from the estate funds placed in an educational individual retirement account more than one year prior to the commencement of the bankruptcy case so long as the funds have not been pledged for an extension of credit and are capped at $2,000 per taxable year in accordance with § 4973(e) of the Internal Revenue Code.[298] For any funds placed in an educational individual retirement account between 720 to 365 days before the filing of the bankruptcy petition, a total amount of $7,575 is excluded from property of the estate.[299] In similar fashion, § 541(b)(6) excludes from property of the estate funds placed at least one year before bankruptcy in a § 529 qualified state tuition program; funds are capped at $7,575 for any contributions made between 720 and 365 days before bankruptcy.[300]

C. Retirement Funds and Spendthrift Trusts

In addition to excluding Social Security benefits and funds earmarked for educational expenses, several provisions in the Bankruptcy Code allow middle-class debtors to shield nest egg and retirement benefits from liquidation in bankruptcy. Section 541(b)(7) specifically excludes from property of the estate any wages withheld by the debtor's employer for any contributions towards an employee benefit plan sponsored under the Employee Retirement Insecurity Act of 1974 (ERISA), a governmental employee benefit plan, a deferred compensation plan under the Internal Revenue Code, a tax-differed annuity plan under the Internal Revenue Code, or a health insurance plan regulated under state law.[301] Section 541(c)(2) has also been held to apply to a debtor's interest in an ERISA-qualified pension so long as it contains an appropriate anti-alienation provision.[302] Thus, employer-sponsored retirement plans receive statutory protection from the bankruptcy process because these assets are not

298. 11 U.S.C.A. § 541(b)(5) (West 2024).

299. *Id.*

300. 11 U.S.C.A. § 541(b)(6) (West 2024).

301. 11 U.S.C.A. § 541(b)(7) (West 2024).

302. Patterson v. Shumate, 504 U.S. 753, 760 (1992). 11 U.S.C.A. § 541(c)(2) (West 2024) ("[A] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."). A debtor's property is excluded from the bankruptcy estate pursuant to § 541(c)(2) so long as three elements are met: (1) the debtor has a beneficial interest in a trust; (2) the interest has a restriction on transfer; and (3) the restriction is enforceable under either state or federal law. *In re* Hoffman, 22 F.4th Cir. 1341, 1344-46 (11th Cir. 2022).

within the definition of property of the estate.[303] ERISA plans are excluded in unlimited amounts and there is no requirement that the amounts be "reasonably necessary for the support of the debtor."[304] Additionally, courts have construed § 541(c)(2) to exclude both traditional individual retirement accounts (IRAs) and Roth IRAs from property of the estate so long as they too include a restriction on transfer that is enforceable under state law.[305]

Section 541(c)(2) also provides that if a debtor holds a "beneficial interest" in a trust, and the interest is subject to a restriction on alienation under non-bankruptcy law, the interest may also be excluded as property of the estate.[306] Since the enactment of the 1978 Bankruptcy Code, courts have interpreted § 541(c)(2) to mean that a debtor's interest in any spendthrift trust created under state law for asset protection purposes would be excluded from property of the estate and not reachable by creditors.[307] Spendthrift trusts have historically been attacked as a way "to form a privileged class, who could indulge in every speculation . . . and yet roll in wealth."[308] Spendthrift trusts afford those with the financial means—and with sophisticated legal counsel—to preserve wealth by placing assets into a trust res. Consequently, if a debtor in bankruptcy is the beneficiary of a trust that includes an enforceable spendthrift provision, the debtor's beneficial interest and all the property included in the trust res remain beyond the reach of creditors, primarily by its exclusion from the bankruptcy estate in accordance with § 541(c)(2).[309]

D. Additional Exemptions for Retirement Funds

While § 541(c)(2) excludes ERISA-qualified retirement assets from the bankruptcy estate *ex ante*—and if property is excluded there is no need to exempt it as well—§ 522(b)(3)(C) of the Bankruptcy Code intentionally

303. Tara Twomey & Todd F. Maynes, *Protecting Nest Eggs and Other Retirement Benefits in Bankruptcy*, 90 AM. BANKR. L.J. 235, 244 (2016) (noting that ERISA-qualified plans are excluded from the bankruptcy estate).

304. *Id.* at 245.

305. *In re Hoffman*, 22 F.4th Cir. at 1344.

306. 11 U.S.C.A. § 541(c)(2) (West 2024).

307. Twomey & Maynes, *supra* note 303 at 242. A "spendthrift trust" is a "trust created for the purpose of providing a fund for the maintenance of another" under which "the settlor provides that the beneficiary's interest is not subject to voluntary alienation by the beneficiary or to involuntary through attachment or other process at suit of their creditors." 60 CAL. JURIS. 3d *Trusts* § 127 (2024).

308. John K. Eason, *Retirement Security Through Asset Protection: The Evolution of Wealth, Privilege, and Policy*, 61 WASH. & LEE L. REV. 159, 168 (2004) (quoting JOHN CHIPMAN GRAY, RESTRAINTS ON THE ALIENATION OF PROPERTY V § 262 (2d ed. 1895)).

309. *Id.* However, if the trust is self-settled, courts have disregarded the anti-alienation purpose of the trust and included the trust property as property of the estate pursuant to § 541(a)(1). *See, e.g.*, *In re* Tosi, 383 B.R. 1, 11 (Bankr. D. Mass. 2008).

expands the protections for retirement assets even in states that have opted-out of the federal exemption scheme.[310] In accordance with § 522 (b)(3)(C), a debtor may shield retirement funds from the bankruptcy process to the extent the funds are in an account that is exempt from taxation under §§ 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code.[311] These sections of the Internal Revenue Code deal with pension, profit-sharing and stock bonus plans; employee annuities; IRAs; and deferred compensation plans created by states, local governments, or non-profit organizations.[312] Because § 522(b)(3)(C) is a category of exempt property determined by federal bankruptcy law, a debtor's right to exempt any of these types of retirement funds from creditors will prevail despite any conflicting state exemption laws in jurisdictions that have opted-out of the federal bankruptcy exemption scheme.[313] A similar protectionary provision is included in § 522(d)(12) for debtors that are permitted to utilize the federal bankruptcy exemptions.[314] If a debtor exempts retirement funds under § 522(d)(12), for Roth IRAs, § 522(n) currently caps the amount exemptible at $1,512,350 in the case of an individual debtor. However, judges, in their discretion, may *increase* the amount "if the interests of justice so require."[315] While the foregoing provisions effectively serve to shield most, if not all, retirement assets from trustee capture and distribution to creditors, they protect the funds in the retirement plans. For those debtors who can avail themselves of the federal exemptions, § 522(d)(10)(E) further protects the payments that are made to debtors to the extent reasonably necessary for the support of the debtor.[316]

If state exemption laws control, the principal of a debtor's retirement fund in an ERISA-qualified plan will still be protected under § 541(c)(2) of the Bankruptcy Code. While discussing the treatment of non-ERISA retirement plans in each opt-out state is beyond the scope of this Article, a canvassing of state exemption statutes reveal that stock, pensions, and other retirement plans qualifying under the Internal Revenue Code guidelines are fully exempt under state law (limited only by statutory language affording protection to the extent reasonably necessary for the

310. 11 U.S.C.A. § 522(b)(3)(C) (West 2024).

311. *Id.*

312. LEVIN & SOMMER, *supra* note 153, at ¶ 522.10[9].

313. *Id.*

314. 11 U.S.C.A. § 522(d)(12) (West 2024).

315. 11 U.S.C.A. § 522(n) (West 2024).

316. 11 U.S.C.A. § 522(d)(10)(E) (West 2024). *See also* Rousey v. Jacoway, 544 U.S. 320, 334-35 (2005) (holding that rights to payments under an IRA on account of age are exempt from creditors). This may also be the case in opt-out states that protect payments under a plan. *See, e.g.*, CAL. CIV. PROC. CODE § 703.140(b)(10) (West 2024).

support of the debtor and any dependents).[317]

What this discussion signifies is both evident and inequitable. That is, consumer debtors who possess retirement accounts of the types described here may have them completely excluded from the reach of bankruptcy trustees and creditors (and at worst potentially capped at $1.5 million for Roth IRAs),[318] while the average EITC refund of $2,276 to help support low-income working families as a matter of federal law may be wrestled from them in most jurisdictions should they needfully file for bankruptcy.

E. Home Equity

Since the Great Depression, United States housing policy has placed a premium on homeownership for all Americans.[319] While homeownership rates among low-income households grew during the twentieth century—and precipitously prior to the Great Recession as a consequence of predatory lending practices—homeownership has traditionally been a province of middle-class socioeconomic status.[320] But beyond simply serving as a place of shelter and comfort, homes have become perhaps the most significant financial investment most families make to ensure economic security and to possess a valuable asset towards building wealth.[321] Forty-eight states and the District of Columbia have state exemption statutes that enable debtors to shield some amount of home equity from creditors in bankruptcy.[322] As indicated earlier, the amount of exemptible home equity varies significantly among the states from a low of $5,000 in the states of Kentucky and Virginia to virtually unlimited

317. *See, e.g.*, NEB. REV. STAT. § 25-1563.01 (West 2024); NEV. REV. STAT. ANN. § 21.090 (West 2024) (limited to $1,000,000); ARIZ. REV. STAT. ANN. § 33-1126 (West 2024); CAL. CIV. PROC. CODE § 704.115 (West 2024); OHIO REV. CODE ANN. § 2329.66 (West 2024); 735 ILL. COMP. STAT. ANN. 5/12-1006 (West 2024).

318. Clark v. Rameker, 573 U.S. 122, 124 n.1 (2014) (noting that irrespective of whether a debtor claims exemptions for retirement funds under federal or state law, they are both exempt).

319. Anne B. Shlay, *Low-Income Homeownership: American Dream or Delusion?*, 43 URB. STUDS. 511, 511 (2006).

320. Karen McCormack, *Credit and Credibility: Homeownership and Identity Management in the Midst of the Foreclosure Crisis*, 55 SOCIO. Q. 261, 261 (2014) ("Home ownership in the United States has become a key symbolic indicator of adulthood, citizenship, membership in the middle class, and creditworthiness."). *See also* Elizabeth Warren & Deborah Thorne, *A Vulnerable Middle Class: Bankruptcy and Class Status*, *in* BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS 33 (Katherine Porter ed., 2012) (noting that "owning a home has traditionally been an enduring, as well as a highly visible, symbol of middle-class achievement").

321. Dick Bryan & Mike Rafferty, *Political Economy and Housing in the Twenty-First Century—From Mobile Homes to Liquid Housing?*, 31 HOUS. THEORY & SOC'Y 404, 406-07 (2014).

322. The state of New Jersey does not provide for a state homestead exemption. However, because New Jersey is an opt-in state, homeowning debtors who file for bankruptcy in New Jersey may claim the homestead exemption under § 522(d)(1) of the Bankruptcy Code. 11 U.S.C.A. § 522(d)(1) (West 2024). This is similar to Pennsylvania, but properties held by the entireties in Pennsylvania have been held to be exempt in bankruptcy proceedings. *But see In re* Barsotti, 7 B.R. 205, 213 (Bankr. W.D. Pa. 1980).

exemptions in Florida, Texas, the District of Columbia, South Dakota, Arkansas, Iowa, Kansas, and Oklahoma (subject to acreage limitations but not capped at home values).[323] The homestead exemptions clearly serve to protect the sanctity of a debtor's home, but because exemption statutes are not limited by the financial portraits of the debtors themselves—but rather by the value of the home itself—it is fair to presume that irrespective of the amount of home equity exemptible from the bankruptcy process in any particular case, the bankruptcy system benefits middle-income households—who are the primary homeowners nationwide—and disadvantages lower-income bankruptcy filers who may not be homeowners with any equity to protect.[324] More broadly, permitting middle-class homeowners to shield significant wealth from the reach of creditors in bankruptcy while extracting welfare benefits from low-income working families reinforces economic inequality and promotes the legal system's reification of social stratification.

F. Other Types of Public Benefits and Non-Traditional Forms of Personal Property Excluded from Creditors

While not necessarily associated with the middle-class, in states that have opted-out of the federal bankruptcy scheme, or debtors that have chosen to utilize available state exemptions in jurisdictions that have not opted-out, § 522(b)(3)(A) allows debtors to exclude from creditors certain exemptions provided under federal law.[325] In addition to Social Security payments, debtors can exempt from creditors their foreign service annuity payments;[326] civil service retirement benefits;[327] wages due to a seaman or master of a merchant vessel of the United States;[328] veterans' benefits;[329] annuities and pensions provided under the Railroad Retirement Act;[330] the approximately $1,406.73 monthly pension

323. *Homestead Exemptions by State and Territory*, ASSET PROT. PLANNERS, https://www.assetprotectionplanners.com/planning/homestead-exemptions-by-state/ (summarizing homestead exemptions throughout the United States).

324. Jared Ruiz Bybee, *In Defense of Low-Income Homeownership*, 5 ALA. C.R & C.L. L. REV. 107, 124 (2013) (noting that "the value of a home accounts for, on average, 65% of a middle-class household's wealth, and, despite the housing crisis, remains a significant creator of wealth for families."). *See also* Todd J. Zywicki, *Institutions, Incentives, and Consumer Bankruptcy Reform*, 62 WASH. & LEE L. REV. 1071, 1087 (2005) ("The steady increase in home property values over the past thirty years has increased the effectiveness of the homestead exemption by increasing the amount of wealth available to be protected in bankruptcy.").

325. 11 U.S.C.A. § 522(b)(3)(A) (West 2024).

326. 22 U.S.C.A. § 4060 (West 2024).

327. 5 U.S.C.A. § 8346 (West 2024).

328. 46 U.S.C.A. § 11109 (West 2024).

329. 38 U.S.C.A. § 5301 (West 2024).

330. 45 U.S.C.A. § 231m (West 2024).

currently paid to winners of the Congressional Medal of Honor;[331] military annuities and pensions;[332] and Central Intelligence Agency Retirement payments.[333]

The various state exemption statutes also protect a host of other forms of benefits and common property, including fraternal benefit society benefits;[334] workers' compensation benefits;[335] veterans' benefits;[336] unemployment compensation benefits;[337] life insurance contracts and proceeds;[338] cemeteries and burial plots;[339] claims for negligence and tortious conduct;[340] bank deposits;[341] partnership property;[342] liquor, permit, and franchise licenses;[343] and military equipment.[344]

Further, in jurisdictions in which the debtor can elect exemptions under the Bankruptcy Code, § 522(d)(10) offers no haven for low-income working families hoping to retain their EITC from the reach of creditors. Sections 522(d)(10)(A)-(E) exempt a debtor's right to receive: (A) "a social security benefit, unemployment compensation, or a *local* public assistance benefit"; (B) "a veterans' benefit"; (C) "a disability, illness, or unemployment benefit"; (D) "alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor"; and (E) "a payment under a stock bonus,

331. 38 U.S.C.A. § 1562(c) (West 2024).

332. 10 U.S.C.A. §§ 1450(i), 1440 (West 2024).

333. 50 U.S.C.A. § 2094 (West 2024).

334. *See, e.g.*, FLA. STAT. ANN. § 632.19 (West 2024); NEB. REV. STAT. ANN. § 25-1563.02 (West 2024); N.H. REV. STAT. ANN. § 418.17 (West 2024).

335. *See, e.g.*, NEV. REV. STAT. ANN. § 616C.205 (West 2024); N.J. STAT. ANN. § 34:15-29 (West 2024); OR. REV. STAT. ANN. § 656.234 (West 2024); N.C. GEN. STAT. ANN. § 96-17 (West 2024).

336. *See, e.g.*, N.Y DEBT. & CRED. LAW § 282(iii)(2)(b) (West 2024); S.C. CODE ANN. § 15-41-30(11)(B) (West 2024); N.D. CENT. CODE ANN. § 37-26-06 (West 2024); ME. REV. STAT. ANN. tit. 14, § 4422(13)(B) (West 2024).

337. *See, e.g.*, N.Y. LAB. LAW § 595 (West 2024); TEX. LAB. CODE § 207.075 (West 2024); N.C. GEN. STAT. ANN. § 96-17; OR. REV. STAT. ANN. § 657.855 (West 2024); MICH. COMP. LAWS ANN. § 421.30 (West 2024).

338. *See, e.g.*, NEB. REV. STAT. ANN. § 44-371(1)(A) (West 2024); N.M. STAT. ANN. § 42-10-3 (West 2024); COLO. REV. STAT. ANN. § 10-7-205 (West 2024).

339. *See, e.g.*, UTAH CODE ANN. § 78B-5-505 (West 2024); ARK. CODE ANN. § 16-66-207 (West 2024); S.D. CODIFIED LAWS § 43-45-2 (West 2024).

340. *See, e.g.*, N.Y. DEBT. & CRED. LAW § 282(iii)(3) (West 2024); N.C. GEN STAT. ANN. § 1C-1601(a)(8) (West 2024); 31 OKLA. STAT. ANN. § 1(A)(21) (West 2024).

341. *See, e.g.*, OHIO REV. CODE ANN. § 2329.66(A)(3) (West 2024); OR. REV. STAT. ANN. § 18.348 (West 2024); VT. STAT. ANN. tit. 12, § 2740(15) (West 2024); WIS. STAT. ANN. § 815.18 (West 2024); ARIZ. REV. STAT. ANN. § 33-1126(9) (West 2024).

342. *See, e.g.*, W. VA. CODE ANN. § 47B-5-4 (West 2024); ALASKA STAT. ANN. § 09.38.100 (West 2024); DEL. CODE ANN. tit. 6, § 15.504 (West 2024).

343. *See, e.g.*, WYO. STAT. ANN. § 12-4-604 (West 2024); IDAHO CODE ANN. § 23.514 (West 2024); ALASKA STAT. ANN. § 09.38.015 (West 2024).

344. *See, e.g.*, ALA. CODE ANN. § 31-2-78 (West 2024); KAN. STAT. ANN. § 48-245 (West 2024); ME. REV. STAT. ANN. tit. 37-B, § 262 (West 2024).

pension, profit sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor . . . ."[345] The asserted justification for protecting these benefits is to save them for the debtor's future use and financial security.[346] And based upon the specific use of the term "local" before "public assistance benefit," at least one court has held that EITC payments are not exempt under § 522(d)(10)(A).[347]

Discussing these exemptible forms of public benefits and personal property is not to suggest that these exemptions do not serve salutary purposes, but instead to highlight the deficiency in our federal bankruptcy system that fails to specifically shield EITC refunds from the reach of creditors on an equal footing with such other benefits as workers' compensation, unemployment insurance, and veterans' benefits. Correcting this disparity is not difficult as a matter of law. The final Section offers ways to protect EITC refunds moving forward and offers avenues for future research on this subject.

VII. CONCLUSION: REFORMING THE LAWS TO FULLY EXEMPT EITC BENEFITS

Almost five decades ago, Congress established the EITC program to assist low-income working families beset by the rising costs of living and to promote a culture of work in reducing dependency on the government. One of the deep injustices of financialized neoliberal capitalism is that inequality has increased exponentially over the past fifty years and low-income working families remain mired in a brutish economy and unforgiving labor market. Low-income working families with children can expect to receive wage subsidies amounting to only several thousand dollars per taxable year. But the EITC remains a powerful tool for reducing poverty among the lowest wage earners in the United States.[348] Without the EITC, many families would live below the poverty line for sustained periods of time.[349]

The EITC consequently acts as a financial safety net for low-income working families with children surviving in the nation's lowest income

345. 11 U.S.C.A. § 522(d)(10) (West 2024).

346. *In re* Jones, 446 B.R. 466, 472 (Bankr. D. Kan. 2012). *See also* HENRY J. SOMMER, COLLIER CONSUMER BANKRUPTCY GUIDE ¶ 13.05[11] (2023) ("Rights to such entitlements must therefore be exempted if they are to be saved for the debtor's future use.").

347. *In re* Espey, 347 B.R. 357, 361 (Bankr. D. Minn. 2006).

348. Mary L. Pareja, *Earned Income Tax Credit Portability: Respecting the Autonomy of American Families*, 117 W. VA. L. REV. 1, 2-3 (2014).

349. Dorothy A. Brown, *The Tax Treatment of Children: Separate But Unequal*, 54 EMORY L.J. 755, 766 (2005).

brackets. Scholars have long maintained that the bankruptcy laws also form a component of the social safety net.[350] But because the current bankruptcy system does not protect EITC refunds as exemptible property in most jurisdictions, the two social safety net programs operate at cross-purposes, providing needed cash assistance to stave off poverty on the one hand, and wrenching from recipients the few thousand dollars they receive as EITC refunds should they happen to file for bankruptcy on the other. As a matter of fundamental equity, EITC recipients should not be deprived of their welfare benefits simply because they decided to seek the fresh start that the bankruptcy laws promise. These families have upheld their bargain by participating in the labor force as Congress envisioned. They should not be stripped of their EITC refunds by the bankruptcy system while wealthier debtors can protect assets from liquidation and distribution.

As demonstrated, the exemption laws tend to perpetuate our unequal class economy. A debtor with substantial assets may fare much better in the bankruptcy system due to our existing exemption laws than a debtor who is on welfare. If the general purposes behind exemption laws are to ensure that debtors are not left destitute, protect the dignity of the debtor, enable the debtor to rehabilitate financially, and insulate the debtor from the consequences of impoverishment,[351] then causing debtors to forfeit their EITC refunds is counterproductive and antithetical to the intentions behind exemption laws. As one scholar argued fifty years ago, "property should be exempt only if the exemption furthers the policies underlying the exemption laws."[352] If this call remains true, then EITC refunds are the quintessential example of property that should be completely exempt from creditors. These concerns are not limited to low-income working families because research has demonstrated that during economic downturns such as the Great Recession, the EITC acts as a stabilizer for higher-income families that become eligible for benefits if their incomes decline.[353]

There are straightforward ways to correct the distorted inequality of the Bankruptcy Code to fully shield EITC refunds from the reach of trustees and creditors. Since the EITC program has enjoyed historical bipartisan

350. Hynes & Pattison, *supra* note 112, at 326-27 ("Since at least the 1950s, scholars have understood that bankruptcy is part of a larger social safety net."); Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129, 130 (2005) (recognizing that bankruptcy can be an "'insurer of last resort,' providing some measure of protection to individuals who fall through cracks in other private and public institutions and legal regimes designed to promote economic security").

351. Resnick, *supra* note 134, at 621.

352. Vukowich, *supra* note 126, at 781.

353. Marianne Bitler, *The EITC and the Social Safety Net in the Great Recession*, 70 TAX L. REV. 533, 541 (2017).

support, the following suggested statutory changes should be implementable with little political tension, assuming these issues come to the attention of Congress. First, the most efficient way to fully protect EITC benefits in bankruptcy would be for Congress to add a subsection to § 32 of the Internal Revenue Code that directly parrots the non-assignability provision for Social Security benefits provided by 42 U.S.C. § 407.[354] Courts have construed § 407 as a protectionary provision that "automatically and completely excludes Social Security proceeds from the bankruptcy estate, and not as an exemption provision which must be claimed by the debtor."[355] And to safeguard EITC refunds from inclusion as disposable income under a Chapter 13 plan, Congress should also amend the definition of "current monthly income" in § 101(10A) of the Bankruptcy Code to carve out EITC refunds as it currently does for Social Security benefits.[356]

A second option for Congress to protect EITC refunds from capture by trustees and creditors is to amend § 541(c) of the Bankruptcy Code by adding a new subsection that explicitly excludes EITC refunds from the bankruptcy estate. This would obviate any need for debtors to claim an exemption for their welfare benefits and the ability to do so would no longer be dependent upon the jurisdiction in which the debtor files for bankruptcy. Consequently, removing EITC refunds from the bankruptcy estate would correct the fragmented nature of state and federal exemption laws currently disrupting low-income families from protecting their welfare payments in most jurisdictions. A third option would be for Congress to add a new subsection to § 522(b)(3) to completely shelter EITC refunds as exempt as a matter of federal bankruptcy law in opt-out states as it currently does for a slew of pension and retirement plans. While this would secure EITC refunds in the thirty-one opt-out states, this should be accompanied by an amendment to § 522(d)(10) to include a new subsection carving out the EITC explicitly as exemptible property, or at the very least removing the modifier "local" before "public assistance benefit" or adding "federal, state, or" to precede the word "local." Either of these easy wordsmithing changes would protect a debtor's right to exempt EITC refunds in states where debtors can elect the bankruptcy law exemptions.

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354. 42 U.S.C.A. § 407 (West 2024) ("The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law."). Courts have found that the non-assignability of Social Security benefits under § 407 preempts state collection laws. *See, e.g.*, Bennett v. Arkansas, 485 U.S. 395, 397 (1988); Finberg v. Sullivan, 634 F.2d 50, 63 (1987).

355. Carpenter v. Ries (*In re* Carpenter), 614 F.3d 930, 936 (8th Cir. 2011).

356. 11 U.S.C.A. § 101(10A) (West 2024).

In addressing the state of public assistance in the United States, the Supreme Court in *Goldberg v. Kelly* articulated as follows:

> Welfare, by meeting the basic demands of subsistence, can help bring within the reach of the poor the same opportunities that are available to others to participate meaningfully in the life of the community. At the same time, welfare guards against the societal malaise that may flow from a widespread sense of unjustified frustration and insecurity. Public assistance, then, is not mere charity, but a means to "promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity."[357]

It is time for Congress to heed these ideals and amend the federal laws to safeguard EITC refunds for the millions of low-income working families who benefit from the program each year and who may be deprived of their economic benefits in most jurisdictions in the United States if they seek debt relief under the cover of our national bankruptcy system. Doing so is a matter of fundamental equity and dignity.

357. Goldberg v. Kelly, 397 U.S. 254, 265 (1970).