Bankruptcy and Tax Refunds

Question: I filed for bankruptcy in 2008 and it was also discharged in 2008. Is this going to change my tax refund?

Answer: A tax refund is essentially an interest free loan that taxpayers make to the government by having too much money withheld from their paychecks. The potential for a tax refund is an asset that debtors must list in their bankruptcy petition. In many cases, the debtors can claim the tax refund as "exempt", which allows them to keep the refund.

Although bankruptcy is a federal law, it is usually state law that determines whether a debtor's property is exempt and beyond the reach of the bankruptcy trustee. Most debtors in California are able to take advantage of California's flexible "wild card" exemption to keep any anticipated tax refund.

The amount of the potential tax refund can impact the timing of a debtor's bankruptcy case. If a refund might exceed the debtor's available "wild card" exemption, it might be wise to delay filing of the bankruptcy to allow the debtor to receive the refund and spend it on necessary living expenses.

In other cases, the size of the refund might not warrant a delay in filing. To help properly plan a bankruptcy filing we recommend that debtors file their tax return as soon as possible, avoiding the temptation to file for an extension.

Exemption laws vary by state, so it is important to consult an experienced bankruptcy attorney to determine what impact a bankruptcy will have on your tax refund. Debtors in Southern California are encouraged to contact us for a free consultation.

***About the Author**: Carl H. Starrett II has been a licensed attorney since 1993 and is a member in good standing with the California State Bar and the San Diego County Bar Association. Mr. Starrett practices in the areas of bankruptcy, business litigation, construction, corporate planning and debt collection.*