

Virginia Family Law Quarterly



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Message from the Chair

Steve Raynor, Chair Family Law Section

Looking back over the last year, it’s important to recognize the significant contributions of several Family Law section members, including Susan Butler, the Past-Chair who has been a pleasant, talented, and engaged Board member. She was instrumental in the Board’s CLE programs for the first several years of her tenure, she was an effective officer, and she continues (with Pat Maurer) to be in charge of the CLE program of the Virginia Chapter of the American Academy of Matrimonial Attorneys.

The Board is very appreciative of the contributions of former Board members Mary Commander, Brian Jones, Michelle Jones, and Judge Richard Wallerstein. Larry Diehl, Brian Hirsch and Dan Gray are recognized for their exceptional and ongoing contributions to family law in Virginia.

In response to the pandemic and its impact on the judicial system, Rich Garriott, Andy Richmond and many others have stepped up to help at the state level, and Kyle Farmer and many others have been active and engaged at the local level. A sincere “thank you” to the judges and family law attorneys from around the state who have worked hard on behalf of the bar and the public to consider and address pandemic-related issues and challenges.

I welcome new Board members Regina Amick, Judge Elliott Bondurant, Carolé Krogmann, Debra Powers, and Craig Sampson. They will serve the initial two years of their four-year term on the Board’s CLE committee, and I’m confident they will be valuable contributors to the Board and to the Section.

The Board’s priorities include producing the

annual Fall and Spring CLE programs in partnership with Virginia CLE; publishing the *Virginia Family Law Quarterly*; updating as necessary the Section’s booklets and video for the general public; maintaining the Section’s website (which is a component of the VSB’s website); presenting the Service and Lifetime Achievement Awards; and collecting and disseminating relevant survey data.

Please contact me directly if you have questions or comments regarding the section and its activities. Thank you.

Steve Raynor, Chair ❖

TABLE OF CONTENTS

Editor’s Note, Brian M. Hirsch	2
Upcoming Events	2
How to Submit an Article	2
Articles	
Judicial Exceptions to Protective Orders Craig W. Sampson	3
Where do the Parents Live? Cost of Living Comparisons in Child Support Deviations Brittani L. Lemonds and Ronald R. Tweel	6
Is a Tax Refund “Income” When Computing Child Support? Nicholas C. Erickson	9
Cases of the Quarter	13
Board of Governors	19

Is a Tax Refund “Income” When Computing Child Support?

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I. Introduction

The obligation to provide child support in Virginia is purely statutory and distinct from a number of different states. Virginia begins the calculation of child support based upon the gross income of the parents. Issues arise when a parent receives a substantial federal or state income tax refund in one year on income that was earned and withheld in a prior year. Should this tax refund be included in that parent’s current gross income? There are no reported cases in Virginia addressing how tax refunds should be treated for child support calculation purposes and the Virginia Code instructs Virginia courts to include “all sources income,” except for certain enumerated categories.¹

A number of other states have reviewed this issue and have nearly unanimously concluded that tax refunds are not includable if – like Virginia – that state bases its child support calculation on “gross income.” Those states that use the “net income” method of income calculation (*i.e.*, taking out taxes and other permissible deductions from the beginning) may include the tax refunds to offset taxes actually paid. But because Virginia is a “gross income” state, tax refunds are based on income earned in a prior year and should not be included in the gross income calculation for the current year.

II. Virginia’s Method of Calculation of Child Support Obligations

For the purposes of child support calculation, § 20-108.2(C) of the 1950 Code of Virginia, as amended, defines “gross income” as

all income from all sources, and shall include, but not be limited to, income from salaries, wages, commissions, royalties, bonuses, dividends, severance pay, pensions, interest, trust income, annuities, capital gains, social security benefits except as listed below, workers’ compensation benefits, unemployment insurance benefits, disability insurance benefits, veterans’ benefits, spousal support, rental income, gifts, prizes or awards.

Virginia courts have found “any income from any source is subject to inclusion [as gross income] unless specifically excluded.” *Rieger v. Rieger*, 90 Va. Cir. 29, 31 (Fairfax Cir. 2015) (citing *Frazer v. Frazer*, 23 Va. App. 358, 377-378 (Ct. App. 1996). Additionally, “when determining child support, the emphasis should be on including, not excluding, income especially where including the income more accurately reflects a parent’s economic condition and financial circumstances for that year.” *Howe v. Howe*, 30 V. App. 207, 216 (Ct. App. 1999) (finding a one-time gift of \$10,000 should be included in gross income).

In *Rieger*, the circuit court found “cash flow is not commensurate with income” and “if something is determined to be ‘income’ for tax purposes, it should be determined to be income for child support purposes.” *Rieger*, 90 Va. Cir. at 35 (finding loan forgiveness to be income in the year it was forgiven for child support calculation purposes).

III. Federal Tax Refunds are not Taxable

Assuming the circuit court in *Rieger* is correct

that income for tax purposes should be income for child support purposes, the reverse must also be true. *See Rieger*, 90 Va. Cir. at 35. Under Internal Revenue Service guidance, Federal income tax refunds received are not taxable in the following year. *See IRS Publication 525*, pg. 23 (2018) (“Refunds of federal income taxes aren’t included in your income because They’re (sic) never allowed as deduction from income.”). However, State income tax refunds are taxable if the taxpayer itemized their deductions and claimed a State income tax deduction, because that income was not taxed in the year earned. *See IRS Publication 525*, pg. 23-24 (2018).

Therefore, the IRS never considers Federal income tax refunds as income and only considers State income tax refunds to be income if previously deducted. Because Virginia does not engage in re-calculating a party’s tax deductions – like “net income” states discussed below – there is no need to distinguish the type of tax refund received because all taxable income was earned in the prior year.

IV. Certain States Calculate Child Support Based upon “Net Income”

Generally, states take two views on calculating income for child support purposes and adjust their child support guidelines accordingly. In the “net income” states (such as California, Illinois, Minnesota (prior to 2008), Mississippi, Pennsylvania, and Wyoming), courts calculate “net income” for child support calculation purposes after removing allowable deductions, such as taxes. Other states (such as Alabama, Kentucky, Indiana, Minnesota (after 2008), Ohio, and Virginia) calculate child support based upon the “gross income” of a party from all sources, except for limited enumerated exceptions.

For those states that use the net income method, the concern is that a party would overwithhold his or her taxes in order to artificially reduce his or her net income. There is no overwithholding concern in “gross income” states because all income is included in the year earned.

For example, Illinois calculates net income for

child support purposes and includes income tax refunds. “If a person overwithholds his estimated taxes from his pay, the overwithholding is an overpayment of taxes, which should be added back into a person’s net pay when determining the person’s net income.” *In re: Marriage of Blume*, 59 N.E.3d 135, 144 (Ill. 3d Dist. Ct. App. 2016). Therefore, in order to equalize the taxes actually paid versus the tax refund received, “[t]he proper method for computing net income is to calculate the amount of Federal and State income tax which a person actually pays by taking into consideration the disparity that may exist between the amount of tax withheld, as reflected on a W-2 form, and the tax eventually paid.” *In re: Marriage of Pylawka*, 661 N.E.2d 505, 509 (Ill. 2d Dist.Ct. App. 1996).

Here, the trial court erred in determining [father’s] net income. Under the court’s approach, a parent owing a support obligation could manipulate net income by simply overwithholding. Instead, we agree . . . that a tax refund should be included to determine net income. *Id.*²

Other “net income” states have taken a similar approach. “California’s [child support] statute requires the parent’s state and federal tax refunds to be added to the parent’s annual net disposable income when all of the parent’s income tax withholdings and estimated income tax payments have been deducted from his or her gross income.” *In re: Marriage of Morton*, 27 Cal. App. 5th 1025, 1042 (Cal. 5th Dist. Ct. App. 2018).³

V. Virginia and Other “Gross Income” States Take a Different Approach

In “gross income” states, all sources of income are included, so there is no need to adjust the income calculation for tax obligations to compensate for overwithholding.

In comparing the two most popular methods of child support calculation, the Court of Appeals for Kentucky thoroughly examined this issue in its

unpublished opinion in *Hahn v. Commonwealth*, 2007 Ky. App. Unpub. LEXIS 117 (Ky. Ct. App. 2007), and concluded that it would be inappropriate to include subsequent tax refunds in current gross income. Contrary to the net income method used in other states, “a tax refund received the following year would *not* be attributed as income in the year it is received, because it is already attributed to gross income in the year it was earned.” *Id.* Just as in Virginia,

Kentucky employs the gross income method of calculating child support. . . . The Legislature has directed that the trial court consider the obligator’s pretax, gross income when calculating child support. . . . [T]his means that [father’s] withholdings in 2004 (a portion of which was refunded in 2005) were to be attributed as income – if at all – solely in 2004.

Id. (internal citations omitted).⁴

In 2008, Minnesota significantly changed its method of calculating child support to the “gross income” method. The change in the Minnesota child support statute was examined by the Minnesota Court of Appeals in 2009, which found

under the new child-support statute, gross income, not net income, acts as the basis for a child-support obligation. The gross-income calculation now required to determine support does not exclude the portion of an obligor’s income that is withheld to produce a tax refund. Therefore, any increase in income due to tax refunds is irrelevant to determining father’s support obligation.

Hesse v. Hesse, 778 N.W.2d 98, 104-105 (Minn. Ct. App. 2009) (internal citations omitted).⁵

The only exception among “gross income” states to the exclusion of tax refunds appears to be where

a party received a tax credit that was not earned in the prior year. *See Harbour v. Ridgeway*, 2005 Ohio App. LEXIS 2461 (Ohio 10th Dist. Ct. App. 2005) (finding Earned Income Credit is not a public assistance program, so that portion of a tax refund should be included in a parent’s gross income).

VI. Conclusion

For the reasons stated by the Kentucky Court of Appeals and the Minnesota Court of Appeals, if Virginia were to include tax refunds when calculating gross income for child support purposes, such a calculation would be tantamount to double counting the same earned dollar in the year earned (Year 1) and the year the tax was refunded (Year 2). Such double counting would be inaccurate and inequitable.⁶ One may rightfully assume that if this issue were analyzed by a Virginia court, it would resolve the issue in the same manner as the other “gross income” state courts that have reviewed it. ❖

Endnotes

1. The Virginia Code also defines certain limited deductions from gross income, including but, not limited to, benefits for public assistance and social services programs, Federal supplemental security income benefits, child support received, spousal support paid, half of self-employment taxes paid, and amounts paid in child support for additional children. See § 20-108.2(C) of the 1950 Code of Virginia, as amended.

2. The Supreme Court of Wyoming expressed a similar concern about income manipulation when it found

[a] review of the record in this case shows that the court considered the father’s receipt of a significant tax refund in 2000 for overpaid 1999 taxes as a matter affecting his cash flow during the year 2000. The father would have us base his child support obligation not on his actual after-tax income, but rather on an income that is artificially reduced by temporary overpayment of taxes. That would not comport with the statutory and case law definitions of income.

Ready v. Ready, 76 P.3d 836, 840 (Wy. 2003) (finding refund was properly included in income used to calculate father’s child support obligation).

3. In Pennsylvania, income tax refunds are included in income for child support calculation purposes, unless tax refunds were previously factored in the calculation of “monthly net income.” *See* Rule 1910.16-2 of the Pennsylvania Rules of Civil Procedure. “[T]he amount of child support awarded should be based upon

the parties' monthly net income" and Pennsylvania law defines "'income' as including 'income from any source' ... including ... 'income tax refunds.'" *K.B. v. J.B.*, 169 A.3d 1187 (Pa. Sup. Ct. 2017)(finding the Earned Income Credit may result in a tax refund and "[i]ncome tax refunds are property considered for support purposes.")

In Mississippi, the court calculates "adjusted gross income" which is gross monthly income "taking mandatory deductions for state and federal income taxes, social security, and Medicare" and adding back income tax refunds. *Coggins v. Coggins*, 81 So. 3d 285, 290 n.2 (Miss. Ct. App. 2012).

4. In summary, the Court of Appeals of Kentucky found "the tax refund received by [father] in 2005 should not have been attributed as gross income in 2005 because it was part of his gross income in 2004." *Id.* The Court also found "principles of both legislative intent and general equity demand that the same dollar not be attributed as income more than once." *Id.*

5. See also *Henningsen v. Henningsen*, 2957 N.E.2d 215 (Ind. Ct. App. 2011)(finding Indiana law "does not expressly require any tax refund received by a party to be included in the party's gross income for the purposes of calculating child support, and we decline to impose such a requirement.")

6. The inequality would be further exacerbated by IRS rules that penalize persons for underwithholding taxes, but make no penalty for overwithholding. If a person were to overestimate their tax burden in compliance with IRS regulations, they could be overburdened with additional child support obligations by the artificial increase in their income caused by double counting the tax refund.