

Towards the Consistent and Equitable Treatment of Phantom Income in Determining Domestic Support Obligations

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Timothy M. Todd, *Phantom Income and Domestic Support Obligations*, 67 **Buff. L. Rev.** 365 (2019), available at [SSRN](#)

Professor Todd's article addresses an issue at the intersection of divorce/family law, federal income tax law, and, even, trusts and estates law. For me, the article highlights that the ideal situation for spouses in a divorce (if, among other things, money were no object) is for each of them to have their own divorce/family law attorney, tax attorney, and estate planning attorney. That, or have Professor Todd on call.

The issue addressed in the article is how "phantom income" should be treated by courts in determining a domestic support obligation (whether child support or spousal support or a modification to either one, hereinafter "DSO"). "Phantom income" is "amounts that are includible as [gross] income under the federal tax code but that have not resulted in any actual current cash receipt." (P. 386.) Individuals obligated to make DSO payments "have argued that phantom income should not be included when calculating such obligations because the individual's ability to pay has not materially changed." (P. 386.) Because those individuals never received any current cash receipt, they contend that the court should not increase a DSO based on any phantom income.

Professor Todd briefly discusses three types of phantom income: business pass-through income, cancellation of debt (COD) income, and imputed income from below-market loans and original-issue discounts. (Pp. 376-80.) He then reviews eight cases in which state courts addressed how phantom income should be treated in determining DSOs. A Kentucky court concluded that COD income was not "gross income" for child-support purposes. *Kelley v. Kelley*, No. 2012-CA-002213-MR, 2014 WL 5359745 (Ky. Ct. App. Oct. 3, 2014). (Pp. 380-82.) A Virginia court, however, concluded that COD income is includible in gross income for child-support purposes. *Reigler v. Riegler*, 90 Va. Cir. 29 (2015). (Pp. 382-83.) The courts in two California cases concluded that COD income is gross income for child-support purposes. *In re Marriage of Kirk*, 266 Cal. Rptr. 76 (Ct. App. 1990) and *Riddle v. Riddle*, 23 Cal. Rptr. 3d 273 (Ct. App. 2005). (Pp. 384-86.) In Ohio, COD income is gross income for spousal-support purposes, *Poitingner v. Poitingner*, 2005-Ohio-2680, and for child-support purposes, *Cyr v. Cyr*, 2005-Ohio-504; and business pass-through income is gross income for spousal-support and child-support purposes, *Marron v. Marron*, 2014-Ohio-2121. (Pp. 386-90.) Finally, a Colorado case addressing a tax withholding-type payment was found to be gross income for child-support purposes (though Professor Todd aptly notes that this payment is not phantom income because another payee did receive the cash). *In re Marriage of Stress*, 939 P.2d 500 (Colo. App. 1997). (Pp. 388-90.)

Professor Todd proposes two solutions regarding the treatment of phantom income in determining DSOs. The first proposal is "to keep the status quo rule that implicitly (and sometimes explicitly) incorporates the tax definition of [gross] income and includes phantom income in support calculations," and, the second, "to implement a charging-order-type remedy to balance the concerns of payors and payees vis-à-vis phantom income." (P. 401.) Professor Todd's first proposal, which is "the simplest and easiest option," reflects "the apparently majority rule" as seen from his survey of eight cases (which Professor Todd notes "does not purport to be an exhaustive survey of all related cases"). (P. 401.)

The first proposal, Professor Todd concedes, does not solve two timing asymmetries that he identifies. Category 1 asymmetries are "situations in which cash was received in the past, but the 'income' occurs now; for example, cancellation of debt income," and Category 2 asymmetries are "situations in which the income occurs now, but cash

may (or may not) be received in the future, such as pass-through business income.” (P. 401.) Additionally, this first proposal “does not provide clear answers to issues such as tax exclusions, administrative exclusions, and other issues that are specific to tax policy and administration but have no analog in domestic support contexts.” (P. 402.)

While the administrative exclusions and non-analogous issues are beyond the scope of this jot, I wish to discuss one tax exclusion. Professor Todd notes that gifts are excluded from federal gross income “but represent a true asset (or cash) increase” and represent “additional assets a family could use for consumption but that are outside the definition of [federal] gross income.” (Pp. 402-03.) The first proposal of a “strict incorporation of tax concepts does not solve all the phantom-income issues and related issues”, and, “[f]ortunately, there are cases that recognize that [gross] income for tax purposes and [gross] income for DSO purposes (especially for child support) are not coterminous.” (P. 403.) I think that Professor Todd, to add to his argument, could have noted that Kentucky’s and Virginia’s statutes (as seen in his survey of cases) are broader than the federal tax code because they each define gross income for child-support purposes as including “gifts” and “prizes.” I also wonder whether a discussion of inheritances, which are excluded from federal gross income, would be apt.

Professor Todd’s second proposal, a charging-order-type remedy specific for DSOs, can be tailored to a particular divorcing couple. Pursuant to a charging order, “when cash distributions are made from the entity, the distributions for the debtor-member are paid to the holder of the charging order (the creditor).” (P. 403.) This remedy is “ideal in Category 2 situations—those in which there is the potential for a cash flow in the future” so that the charging order can be applied (in an ideal situation, specifically) “against the source of that potential future cash flow.” (P. 404.) I believe that Professor Todd’s proposed charging-order-type remedy, perhaps, invokes yet another issue—whether DSOs (under governing state law or as contracted between the parties) survive the death of the payor or the payee.

I learned a lot reading Professor Todd’s article. The treatment of phantom income in determining DSOs involves the intersection of divorce/family law, federal income tax law, and trusts and estates law. Drafters would be wise to tailor DSOs not only to governing law but also to the divorcing couple’s specific financial situation, including, among other things, their specific assets, income streams, and possible future receipts of property.

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