

ADDENDUM TO

REPEAL OF THE FEDERAL TAX DEDUCTION FOR ALIMONY:

An Opportunity to Review` the Pennsylvania Formula for Spousal Support/Alimony Pendente Lite

Submitted to:
Supreme Court of Pennsylvania

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PURPOSE OF ADDENDUM

The August 28, 2018 report entitled *Repeal of the Federal Tax Deduction for Alimony: An Opportunity to Review the Pennsylvania Formula for Spousal Support/Alimony Pendente Lite* was prepared in advance of the September meeting of the Domestic Relations Procedural Rules Committee of the Pennsylvania Supreme Court. The purpose of the addendum is to reflect on the Committee's discussion and preliminary recommendations, which were included in the Committee's recommendation published for public comment.

PURPOSE OF AUGUST 28 REPORT

The major purposes of the August 28 report were to provide information for the Committee to discuss whether changes should be made to the Pennsylvania spousal support formula; and, if so, provide a framework for determining what changes would be appropriate. The framework consisted of six components of a spousal support formula:

- Whether the spousal support should be based on gross or net income;
- Whether child support or spousal support should be calculated first;
- Whether spousal support of the current action should be deducted/subtracted from the obligor's/obligee's income used to calculate child support;
- What percentages of obligor income and obligee income should be used in the formula;
- Whether there should be one or more formulas; and, if more than one formula, what the criteria should be for using one formula over another; and
- Whether there should be a cap or limitation imposed on the spousal support formula.

The six components were identified from spousal support formulas in other jurisdictions. For each component, the report discussed the pros and cons of various approaches, economic evidence relating to the component, and any mathematical considerations or issues. The Committee reviewed each of the components and, in addition, contemplated support outcomes resulting from numerous income scenarios using formulas with variations of the six components.

FINDINGS FROM COMMITTEE AND FOLLOW-UP COMMENTS

Income Basis of The Spousal Support Formula

The Committee favors the net-income basis of the current spousal support formula. Currently, Pennsylvania uses a net-income based for both its spousal support and child support guidelines. As stated in the August report analyzing the pros and cons of each income basis, there is no overwhelming reason for Pennsylvania to switch to a gross income basis.

Whether Child Support or Spousal Support Should Be Calculated First

The Committee favors changing the order of the calculations from a) calculating child support first, then spousal support to b) calculating spousal support first, then child support. As stated in the August report, Pennsylvania is the only jurisdiction not to calculate spousal support first. Calculating spousal support first will make Pennsylvania's approach consistent with other jurisdictions and other Pennsylvania support rules. Specifically, it would make it consistent with Rule 1910.16-4(e) which provides for the calculation of spousal support in situations where there are children (hence child support) and the custodial parent owes spousal support. In addition, Rule 1910.16-2(a) and (c), that address income available for child support, provide for the deduction of alimony paid; and, depending on the reasons for alimony payment, an adjustment to the income of the party receiving alimony.

Whether Spousal Support Should Be Added/Deducted from the Income of the Receiving/Paying Party

The Committee favors adding spousal support received to the income of the receiving party for purposes of calculating child support and subtracting spousal support paid from the income of the paying party for the purposes of calculating child support. This addition/subtraction of spousal support reflects the actual income of the party that is available for supporting the children. Although not mentioned in the August report, it is also consistent with 2016 rule revisions of the federal Office of Child Support Enforcement.¹ The federal rule requires that a state's child support guidelines consider all income in the calculation of child support, and encourages states to develop child support guidelines provisions that consider the actual income of a party (albeit, the use of actual income is encouraged to reduce the use of income imputation).

One concern of calculating spousal support first that was listed in the August report was the possible burden of recalculating child support if the amount of spousal support changes. If spousal support is added/deducted to the income of the receiving/paying party, this changes the income available for child support. This was not a concern shared by the Committee or Committee staff based on their experience and working knowledge of typical cases with spousal support orders.

Percentages of Income Used in the Formula

Currently, Pennsylvania provides two formulas:

- 30 percent of the difference between the obligor's monthly net income and the obligee's monthly net income when there are dependent children; and

¹ U.S. Department of Health and Human Services. (Dec. 20, 2016). "Flexibility, Efficiency, and Modernization in Child Support Enforcement Programs." *Federal Register*, Vol. 81, No. 244, p. 93562. <https://www.gpo.gov/fdsys/pkg/FR-2016-12-20/pdf/2016-29598.pdf>.

- 40 percent of the difference between the obligor's monthly net income and the obligee's monthly net income when there are no dependent children.

The Committee favors reducing the percentage of obligor's monthly income in both formulas. As stated in the August report, lowering the 30 percent that is applied to the obligor's income in the dependent children formula and lowering the 40 percent that is applied to the obligor's income in the formula with no dependent children would offset the federal income tax change, yield amounts consistent with spousal support formulas in other jurisdictions, and yield amounts consistent with economic data. The percentages of obligor gross income used in other jurisdictions ranged from 20 to 35 percent. If these percentages were converted to a net-income basis they would be more (*i.e.*, about 25 to 45 percent, but the exact range would depend on the income of the obligated party.) Illinois, the only jurisdiction with a net-income basis to update its formula for tax reform, uses 33.3 percent as the percentage assigned to the obligor's net income. The economic data does not contradict this range for the percentages. The economic data, nonetheless, does not pinpoint a precise percentage to be used. The case scenarios in the August report suggest a reduction of about 5 percentage points to the 30 percent and 40 percent is appropriate (*i.e.*, 25 and 35 percent be applied to the obligor's net income) if the policy goal is to offset the impact of the repeal of the alimony deduction for federal income tax purposes. The percentage reduction should be more if more spousal support cases involve higher income parties owing spousal support and the policy goal is to offset the impact of the repeal of the alimony deduction for federal income tax purposes.

The Committee also favors applying unequal percentages to each party's income in the formula; namely, applying a smaller percentage to the obligor's income than the percentage applied to the obligee's income. As discussed in the August report, many jurisdictions apply unequal percentages to each party's income. Among formulas with unequal percentages in other jurisdictions, the percentage applied to the obligor's income is usually less than the percentage applied to the obligee's income. The tacit consequence of this is that some income gap is acceptable between the parties; that is, the policy principle behind spousal support is not income equalization when the percentage is less for the obligor than it is for the obligee.

As was the situation for the obligated party, the economic data does not pinpoint a precise percentage to be applied to the obligee's income in the spousal support formula. The percentages applied to the obligee's gross income in other jurisdictions range from 20 to 58 percent. When converted to a net-income basis, those percentages would be more. The closer the percentages (*i.e.*, the percentage of obligor income and the percentage of obligee income) are in the value, the stronger is the policy principle of income equalization.

Other jurisdictions with unequal percentages apply a 7.5 to 30 percentage point gap between the obligor's gross income and the obligee's gross income (*e.g.*, the post-tax reform spousal support formula for Colorado for combined incomes of \$10,001 to \$20,000 per month is 30 percent of obligor's gross income minus 37.5 percent of obligee's income, which is a 7.5 percentage point gap). The percentage point gap does not convert to net income because each party may be in a different tax bracket.

Nonetheless, the percentage assigned to each party is a balancing act. An increase to the obligor's percentage can offset a decrease to the obligee's percentage. For example, a spousal support formula based on the difference between 25 percent of the obligor's net income and 30 percent of the obligee's net income yields the same amount as a spousal support formula based on the difference between 30 percent of the obligor's net income and 35 percent of the obligee's net income when each party has the same income. However, if the obligee has no or less income than the obligor, the latter formula (where the percentage of obligor income assigned to spousal support is more) yields a larger amount of spousal support.

In all, the formulas in other jurisdictions, the consequences of tax reform, and the economic data support lowering the percentages applied to the obligor's income, and applying a higher percentage to the obligee's income.

More than One Spousal Support Formula and Criteria for Applying Formula

After consideration of the issues and various methodologies, the Committee concluded that a single formula methodology would not be appropriate. Instead, the Committee favors retention of two formulas: one to be applied to parties with children; and, the other to be applied to parties without children. Collapsing the two formulas into one formula would produce some significantly different results from what the current two-formula system produces now.

As stated in the August report, limited economic evidence exists that can inform what the percentage point difference should be between a formula for parties with children and those without children. The limited evidence, however, does suggest a percentage point difference of 10 percent or less is appropriate (*e.g.*, if 35 percent of the obligor's income is assigned to spousal support when there are no children and 25 percent of the obligor's income is assigned to spousal support when there are children, that would be a 10-percentage point difference).

Formula Cap

The Committee favors no cap. They believed it is unnecessary due to the recommended formula structure. Mathematically, the amount of spousal support would never exceed the percentage of income assigned to the obligated parent. The only exception would be a formula where the percentage of income assigned to the parent receiving support is less than the obligated parent's percentage. The exception is not of concern since the structure of the formula that the Committee favors is one where the percentage of income assigned to the parent receiving support is *more* than the obligated parent's percentage.