

Questions on Economic Report on Alternative Child Support Cost Schedules and Related Issues, 2016

Economist's Responses, *Initial Draft*

1. Adjustment for cost of 2nd HH:

- a. What % of all states includes adjustment for 2nd HH?

The only state that the economist is aware of using such an adjustment is Kansas.

- b. Does the adjustment include the principle/equity in the home?

The IRS housing allowance includes payment on a mortgage or rent. As such, a mortgage payment usually (not always) includes some payment on principal. Given that adults with children and separating often have paid a mortgage only for a limited number of years, the payment on principal is likely very modest. Also, with outlays being used in Consumer Expenditure Survey data, the underlying income shares data are based on spending inclusive of payment on principal.

- c. Is the adjustment to some extent a duplication of the self-support reserve built into the CR32 [Current Rule 32]?

The best answer may simply be to state the process. The self-report reserve is the last step in constructing the child support table. For the version with the second household adjustment, that adjustment is made first and then the self-support adjustment is made. Within the self-support portion of the table, the issue is how much net income is left over after meeting poverty threshold needs and applying that income to what are estimated to be child costs. The second household adjustment does not change the self-support calculation but because the table with this adjustment is lower, the self-support region is smaller since the obligor more quickly reaches the region where the self-support adjustment has no impact.

2. Is the Federal poverty threshold adjusted for the "Alabama cost-of-living" [Ala. COLA]? [page 9]

No. The 2016 tables use the Federal poverty threshold as published. This is also the case for CR32 for the threshold then in effect.

3. How does a switch from "expenditures" to "outlays" is the benefit the children? [Page 7]

This switch to outlays is essentially a necessity due to data availability. The Bureau of Labor Statistics chose to make this switch. Outlays based spending data are all that are available. Outlays more closely represent current spending by households. For example, expenditures as defined in Federal data include the full purchase price of a motor vehicle. Outlays only include current payments.

The choice does not directly address the issue of to what extent either measure better reflects the best interests of the child.

Additionally, the Rothbarth methodology likely is minimally affected by the switch to outlays. The Rothbarth methodology compares income levels needed to restore the level of well-being of the household before and after having children. The level of well-being is measured by spending on an adult good (adult clothing) and not directly on spending on children. This income equivalence methodology uses income equivalence comparing either changes in expenditures or changes in outlays for the same time period for each study. So, the switch likely had little impact on the income equivalence concept of child costs.

4. What would be the major value to children for switching away from the 2016 Rothbarth with COLA's, which is identified by the Report, as being the most closely aligned with the CR32 cost table (with up-to-date calculations)? [Page 7]

This study took the view of looking at which approach—income realignment or cost of living adjustment better and more equitably adjusted national data to Alabama conditions. Both approaches attempt to adjust national data to Alabama circumstances regarding the local cost of raising children. Neither approach directly addresses the issue of value to children except as attempting to measure what is actually spent on children in Alabama. If one measure more accurately estimates what is spent on children in Alabama, then that might be considered of value to children.

There also is the issue of equitably applying an adjustment to national data to reflect Alabama circumstances. Income realignment is based on shifting national spending percentages from national percentiles of income distribution to Alabama percentiles of income distribution—with Alabama having fewer households at the upper end of U.S. income percentiles. This methodology compresses the national income distribution to a narrower income distribution in Alabama. The limitation is that one cannot narrow down income distributions at lower income levels. The impact of realignment is to lower the cost table for middle and upper income households but negligibly at lower incomes. This report sees differential treatment for lower and upper incomes using this methodology.

The COLA based methodology is applied the same across all income levels.

5. Why aren't we presented with a proposal that is based solely on principles embedded in CR32 with only economic updates? [charts page 33-34]

It is unclear what "principles embedded" is in reference to—economic principles, legal principles, or both. From an economic perspective, CR32 and the Rothbarth 2016 have the same starting point for the economic foundation. Both—at the time developed—use the most recent study by David Betson. Each study used recent data from the Consumer Expenditure Survey. For CR32, the data available were based on expenditures by households as collected by the U.S. Bureau of Labor Statistics and the Rothbarth 2016 used Consumer Expenditure Survey data which is now collected and organized by outlays. There is no choice regarding outlays or expenditures since BLS now only provides outlays based data. So, the underlying basis for the update is essentially the same except for the use of COLA instead of income realignment. A COLA adjusts all income

levels while income realignment has little impact on modest incomes for child "costs" in the schedule.

6. Does the chart on p.23 reflect an accurate representation of the under reporting of income at the lower income brackets?

The latest Betson study (2010) is based on Consumer Expenditure Survey data that partially corrects for under reporting of income. The data still appear to have problems recording all income as clearly indicated by the column for "Current Consumption as % of Net Income." Percentages that sharply exceed 100 percent of net income indicate a sizeable underreporting of income. This almost certainly leads to an overstatement of household spending (even though calculations in constructing the child cost tables limit the percentage to no more than 100 percent) and, in turn, on spending on children.

7. When adding the element of 2nd HH expenses, are additional sources of income or cost associated with additional household members factored in?

No. The IRS housing allowance is based on one adult income and one adult spending.

8. If Alabama's income share model is based on the assumption of one household cost for both parents, why is the non-custodial parent affected differently than the custodial parent? [page 27]

As a clarification, the income shares methodology in Betson's study uses data only from intact households. That is, both parents live in the same housing and share only one set of housing costs (mortgage or rent and utilities). While two-adult housing generally is larger and more expensive than one adult housing, it is not double one adult housing costs. Two parents living together share the housing costs with each parent's share averaging less than one adult housing costs. Overall, there is more income available after housing costs for spending on other things (including children) than income available for two one adult sets of housing costs. The intact family standard overstates what income (after housing) is actually available.

If the noncustodial parent is required to pay child support based on costs according to income available for intact families, then the payment exceeds what it would be if based on actual available income after spending on two sets of housing costs. In turn, the custodial parent receives support based on available income for intact families. However, the custodial parent would spend received child support as if the custodial parent were in a one parent household because that generally is the case. There is no constraint requiring the custodial parent to spend more on the child as would be the case for intact families. The noncustodial parent is required to pay according to intact family available income while the custodial parent can choose to spend according to one parent available income.

9. Are the second mortgage and utilities cost based on the actual amount expended by each parent or the same amount factored in for both parents? Is the amount different for each parent based on where each parent lives? If a parent moves will that necessarily a recalculation of the child support? Does a parent get the benefit of the 2nd HH deduction if that parent is living with someone else and not actually incurring those additional costs?

For this report, the IRS housing allowance built into the adjustment is based on an average of the two parents' incomes. So, the adjustment reflects the potential one adult housing situation

for either parent. There is no location differential—it is based on all counties in Alabama on a combined basis. If a parent moves, it is possible the court could consider a deviation for differences in housing costs. Federal regulations require a uniform statewide presumptive formula.

Regarding the issue of whether a parent should get a second household adjustment if there is another adult in the household, it can be complex on a case-by-case basis while the presumptive adjustment is relatively simple. First, any potential adjustment to the adjustment should apply to both custodial and noncustodial parents with a new partner. A key issue might be whether the second adult has any income or not. This raises the issue of whether second spouse income should be part of presumptive income of the biological parents. Traditionally, states only look presumptively at incomes of biological parents (or adoptive parents of the child).

10. How many states use the Kansas variation of Income Sharing to include a reduction for average expenditures per child based on a 2nd HH? [page 28]

As noted earlier, this economist is only aware of Kansas using a second household adjustment. Kansas chose to make this adjustment because it more closely fits case facts than the use of intact family data. This is consistent with the legal concept that a legal presumption is rebutted if the presumption does not fit case facts.

11. Why change from the income realignment method to the COLA method [page 30] when Alabama's methods have never been "disproved" [page 29]?

The income realignment method treats different income classes differently—benefitting mainly middle and upper income situations. The income realignment method does not reflect cost of living but simply assumes that spending patterns track income distribution. The COLA method affects all income levels in the same manner. This is appealing from an equity perspective. As a final comment on this question, this report stated the appropriateness of realignment has neither been proven nor disproved. It simply is not known either way as economically sound but strongly appears to not meet an equity standard.

12. In determining the "appropriate cost" for maintain a 2nd HH, aren't the IRS figures based on one family rather than two separate families? Does the 2nd HH use the same "one-adult cost" for both families? How is that different from the amount that is taken into consideration as a self-support reserve? [page 31]

The IRS figures used in the second household adjustment are based on a "family" of just one adult. The second household adjustment is derived from one adult housing allowances (based on average income of the two parents of the child in the child support case). It is applied to net income (resulting in reduced net income) which is applied to child spending percentages for intact families. This mixing of one adult and intact family data is a matter of necessity due to what data are available. To date, this is the best know methodology to approximate spending on children based on net income available after taking into account reduced available net income from second housing expenses.

13. Should items such as cell phone service, cable TV and internet be used to reduce child support? [page 32]

These items are included in household spending for the intact family spending attributed to the custodial parent, not just the noncustodial parent's housing costs. The key point is what is the appropriate measure of available net income that more closely fits case facts? Net income inclusive of housing costs (attributed the same to both parents) is an appropriate foundation for ability to pay that reflects case facts.

It should be remembered that these housing allowances are set by the IRS. Allowed spending on the items included is not generous but relatively basic.

This question might be better expressed as does an intact family standard overstate ability to pay and, in turn, appropriate spending on children?

14. Please briefly explain the charts in Chapter VIII.

These charts compare presumptive awards for the alternative estimates of 2016 child costs. They are based on scenarios for select income level for the noncustodial parent with the custodial parent having 50 percent, 100 percent, or 150 percent the income of the noncustodial parent. The horizontal axis shows the noncustodial parent's gross income. This can be discussed in more detail during the presentation.