

# COMMONWEALTH of VIRGINIA

Department of Taxation  
Richmond, Virginia 23282

## MEMORANDUM

TO: William J. West, Supervisor  
Technical Services Section  
Office Services Division

FROM: Danny M. Payne, Director *Danny*  
Tax Policy Division

DATE: April 25, 1984

SUBJECT: Set-Off Debt Collection Program  
Amending Filing Status 4 Returns

This will reply to your memorandum of December 14, 1983 regarding the amendment of individual income tax returns by persons filing separately on a combined return for purposes of reducing the amount of refund available for debt set-off.

### Issues

Virginia Code § 58-19.7(E) defines a "refund" for purposes of the set-off debt program as

a refund belonging to a debtor resulting from the filing of a return where husband and wife have elected to file a combined return and separately state their Virginia taxable incomes under the provisions of § 58-151.012(b)(2). (Emphasis added.)

The emphasized language is the result of a 1982 legislative change which was intended to clarify that we could not set off the entire refund payable to a husband and wife pursuant to a filing status 4 return, but would instead be allowed to hold only that portion of the refund belonging to the debtor. Consequently the opportunity does present itself for spouses to file amended return, shifting deductions to the non-liable spouse thus increasing the tax liability of the liable spouse. Of

course the result of this is to decrease the amount of the refund attributable to or "belonging to" the debtor.

The second situation which has arisen is the attempted application by taxpayers using filing status 4 of Revenue Ruling 80-7 relating to the attribution of a refund between spouses. Taxpayers have attempted to amend returns using the formula set forth in this revenue ruling.

#### Discussion

For purposes of the set-off debt collection program, it is necessary for the department to determine each spouse's property interest in a refund to insure that only the liable spouse's interest is actually used to satisfy a set-off claim. Since filing status 4 returns require separate computation of each spouse's tax liability and separate accounting for each spouse's credits, the determination of the refund interest of each is readily ascertainable by subtracting the credits from the liability.

When an amended return is filed which reduces the liable spouse's interest in the refund, the effect of such return is to convey the property interest in such refund from the liable party to his/her spouse. Since the overall effect on the total refund is either decrease or no change, the presumption is that the amendment is made solely to change the property interest in the refund.

Virginia Code § 55-80 voids conveyances, assignments or transfers of property where the intent is to delay, hinder, or defraud creditors. In interpreting this section, the Supreme Court has held that transactions between husband and wife are subject to close scrutiny to insure that the purpose of the conveyance, assignment or transfer is not merely to put the spouse's property beyond the reach of the creditors, and has further held that in such cases, the presumptions are in favor of the creditors. See Richardson v. Pierce, 105 Va. 628, 54 S.E. 480 (1906), and Morrisette v. Cook and Bernheimer Co., 122 Va. 588, 95 S.E. 449 (1918).

Therefore, where, after notification of set-off, a husband and wife file an amended return which results in a reduced property interest in the refund for the liable spouse, a fraudulent conveyance has occurred and pursuant to Virginia Code § 55-80, the transaction is void. Thus, the department should not accept any such amended returns.

However, an amended return which reduces the married couple's total tax liability should be accepted, even if the debtor's interest in the refund is reduced. While the effect of this type of amendment may be to defeat the set-off process, the test of proof is much more difficult, if

not impossible, to meet since the effect of the amended return is not only to defeat the set-off but also to increase the refund.

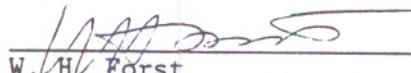
In challenging amended returns on the basis of the fraudulent conveyance principle, it is critical that we maintain records which demonstrate the proper sequence of events, i.e., the filing of a status 4 return, the notification to the taxpayer of set-off and thereafter the filing of an amended return.

The second mechanism which taxpayers have attempted to utilize to reduce the amount of the refund, the use of Revenue Ruling 80-7, is clearly unacceptable. Revenue Ruling 80-7 relates exclusively to the determination of each spouse's interest in a refund resulting from the filing of a joint return. The use of Filing Status 4 clearly distinguishes the case at hand from that described in Revenue Ruling 80-7. Where a joint return is filed, some computational mechanism is necessary to ascertain each spouse's interest in the refund. However, where spouses file separately on a combined return, they have elected to separately state their tax liabilities and credits on the face of the return and no additional computation is necessary or appropriate.

Finally, where any adjustment is made to a return subject to set-off after the set-off has been finalized, i.e., funds have been transmitted to the claimant agency, such amendment will be treated as though a refund check had been issued to the taxpayer(s). The debtor has been notified of the debt and has been afforded a right of appeal to the claimant agency. Once these remedies are exhausted and the funds transferred in full or partial settlement of the claim, the refund has been made to the taxpayer's creditor on behalf of the taxpayer. Therefore if an amended return is filed subsequent to this point, it takes on the status of any other after-refund amendment and the appropriate action should be taken.

If you have any questions relative to this memorandum, please let us know. The policy set forth herein will be incorporated into the Individual Income Tax Regulations.

Approved

  
W.H. Forst  
State Tax Commissioner

April 25, 1984

Date

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cc: Assistants Attorney General  
Division Directors  
Office of the Commissioner