NINETEENTH JUDICIAL CIRCUIT OF VIRGINIA
Fairfax County Courthouse
4110 Chain Bridge Road
Fairfax, Virginia 22030-4009
703-246-2221 • Fax: 703-246-5496 • TDD: 703-352-4139

October 12, 2021

Dr. Erica M. Allen Winslow
12005 Grenshaw Drive
Fairfax, Virginia 22030
eallenm@hotmail.com
Self-Represented

John L. Bauserman, Jr., Esquire
PO Box 1403
Fairfax, Virginia 22038
jblaw22@gmail.com
Counsel for Sean C. Winslow

Re: *Erica Monique Allen Winslow v. Sean Charles Winslow*
Case No. CL–2014–3101

Dear Dr. Winslow and Mr. Bauserman[1]:

In this child support guideline calculation matter, a key issue before the Court is whether a party may offset real estate rental income with the reasonable expenses necessary to operate and maintain the properties.

The Court holds a party who owns income producing real estate may deduct reasonable business expenses from that income for the purpose of calculating the presumptive child support guidelines if (1) the real estate investment is operated as a business, and (2) the offsetting expenses are reasonable.

[1] Plaintiff-Dr. Winslow will be referred to as "Mother," and Defendant-Mr. Winslow will be referred to as "Father" herein. The parties have two minor children, [redacted]' and [redacted]'

I. FACTUAL OVERVIEW: FATHER OWNS INCOME-PRODUCING REAL ESTATE.

Father is the current recipient of child support from Mother and is the likely recipient of child support after any modification. The Court is tasked with calculating his income for child support presumptive guideline purposes. Father owns two residential real estate properties that he leases as investments. From these properties, he earns $32,820 per year income. (FEX 8.) One produces annual gross income of $20,700, the other $12,120. However, they both lose money on a net basis. The former lost $14,904 and the latter lost $5,213 in 2019.[2] (*Id.*) He has owned them since 2003 and 2006 and, he testified, his net losses have been habitual. He persists in owning them, however, as they are building equity.

Father asks the Court to offset his income from each property with the losses from the corresponding property when calculating the child support guidelines. Alternatively, he asks for a deviation from the guidelines to reflect the economic reality.

To prove he is in the business of owning and leasing the real estate, Father offered two facts. First, he owns and leases two separate properties. (*Id.* and Father's Tr. Test.) Second, he itemizes his expenses against each property on his tax returns on Form 1040, Schedule E, which the Court admitted into evidence. (FEX 8.). The tax returns assert the properties are single-family residences in New Jersey, and that he has no personal use of either one. The evidence at trial proved both Father and Mother reside in Fairfax. (Tr. Test.)

Father does not claim to be in the full-time business of real estate ownership and leasing. He did not testify as to how much work he performs related to the real estate. However, he does not spend much money for management, suggesting some active involvement. Outside his real estate investment, Father works full-time as a founding CEO of a consulting company where he earns the bulk of his income. Neither property is held as a limited liability company or other business organization. There was no evidence he uses a trade name, advertises, manages his properties, or manages real estate for others.

The expenses Father reports on his tax returns are common to real estate ownership and changed little between 2018 and 2019. (*Id.*) He does not report depreciation or principal payments on his loans. (*Id.*) His major expenses are interest and taxes. (*Id.*)

The Court entered a "Memorandum Order Modifying Child Support" September 23, 2021, calculating guideline child support amounts without including Father's real estate leasing income on the theory that his completely offsetting expenses on those properties were business

[2] Father did not offer data for 2020 or 2021.

expenses. It now, *sua sponte*, reconsiders that finding and the judgment.[3] It avouches its prior ruling and, by this Opinion Letter, revises and extends its rationale.

II. ANALYSIS: ONE MAY DEDUCT REAL ESTATE EXPENSES FROM REAL ESTATE INCOME IF ONE TREATS INCOME-PRODUCING REAL ESTATE AS A BUSINESS AND THE EXPENSES ARE REASONABLE.

Rental income to a party must ordinarily be included as part of that parties' gross income for child support guideline purposes. VA. CODE ANN. § 20-108.2(C) ("[For calculating guideline child support] 'gross income' means all income from all sources, and shall include . . . rental income . . ."). However, "[g]ross income shall be subject to deduction of reasonable business expenses for persons with income from self-employment, a partnership, or a closely held business." *Id.*

There is no controlling authority to clarify when a trial court must apply this deduction, other than the guideline statute. In four unpublished opinions from the Court of Appeals of Virginia concerning whether real estate income may be offset by expenses related to the real estate, the appellate court twice held that offsets were required or permitted, and twice held they were not permitted.

In *Howard v. Howard*, Record No. 1400-93-4, 2000 WL 979949 *2 (Va. Ct. App. Jul. 18, 2000), a panel of the Court of Appeals affirmed a trial court for excluding real estate rental income of a jointly owned condominium from the calculation of child support because Virginia Code § 20-108.2(C) permitted deduction of reasonable business expenses. After the deductions, the trial court determined there was no net rental income attributable to the condominium. Implicitly, the trial court found the real estate leasing to be a business. Consistent with this holding, seven years later, a panel of the appellate court reversed a trial court for failure to offset real estate rental income of a beach house with the mortgage expense on the property. *Dega v. Vitus*, Record No. 2512-06-42007 WL 2301669 *4 (Va. Ct. App. Aug. 14, 2007). Again, it implicitly held the trial court had to consider whether the leasing was a business and whether the mortgage expense was a reasonable business expense.

More recently, panels of the Court of Appeals affirmed trial courts for refusing to offset real estate rental income with property expenses. In *Moore v. Moore*, Record No. 0314-20-4, 0315-20-4, 2020 WL 6277427 (Va. Ct. App. Oct. 27, 2020) the divorcing couple owned five

[3] On September 29, 2021, less than a week after the Court issued its Order, the Virginia State Bar's Family Law Section distributed its Fall 2021 "Virginia Family Law Quarterly." Craig W. Sampson, *Rental Proceeds in the Calculation of Gross Income*, 41 VFLQ 5 (Fall 2021). In it, a commentator addressed an alleged ambiguity in three unpublished opinions from the Court of Appeals of Virginia on the issue of properly applying rental proceeds in the calculation of gross income for presumptive child support guideline purposes. These three unpublished opinions variously held that trial courts should and should not deduct expenses from real estate rental income. The parties in the instant case did not present these cases to the Court, the Court had not previously read them, and no one highlighted that this area of the law was unsettled. Therefore, the Court, *sua sponte*, issued a suspending order to have time to verify its ruling.

rental properties that they self-managed. *Id.* at *5. Only three of the properties were rented and the father's evidence was very vague as to the expenses. *Id.* No mortgage encumbered any property. *Id.* The appellate court wrote:

> "[n]o cases stand for the proposition that Father's *claimed* rental property expenses are 'reasonable business expenses for persons with income from self-employment, a partnership, or a closely held business within the meaning of Code § 20-108.2(C)."

Id. at *10 (emphasis supplied). If taken as an absolute legal principle, this would mean one could never deduct expenses from rental income. However, this would contradict Virginia Code § 20-108.2(C), which clearly was not what the Court of Appeals panel sought to do. Rather, in the context of the unique facts in *Moore*, where the father failed to prove his expenses, it simply means that through his vague accounting he could not deduct his unproven, *claimed* expenses. Better accounting—or trial proof—could have saved his offsets.

The appellate court panel continued to say:

> "We further decline Father's request to expand the ruling in [*Dega*] (requiring consideration of any mortgage expense paid on a property when determining the party's income), to include other expenses associated with owning a rental home like maintenance, repairs, taxes, and utilities."

If the *Moore* opinion was published, this Court would assume this statement means that, in cases of a business, one may deduct mortgage payments but no other expenses of owning leased real estate. However, in context of that case, the Court concludes the Court of Appeals meant that there was no mortgage to be deducted and the father simply failed to prove his other damages. Had the Court of Appeals panel sought to declare that rental home expenses could never be deducted from the gross rental income—whether the rental was operated as a business or not—it would have certainly published its opinion.

Most recently, in *Ellis v. Sutton-Ellis*, Record No.0710-20-1, 2021 WL 2546184 (Va. Ct. App., Jun. 22, 2021), a panel of the Court of Appeals affirmed a trial court for refusing to offset real estate rental income with the mortgage expense. It affirmed the implicit finding of the trial court that the party seeking the offset was not self-employed, nor in a partnership, nor in a closely held business. Interpreting Virginia Code § 20-108.2(C), it held mortgage payments under such circumstances are not appropriate reasonable business expenses relevant for deduction.

Since the above-cited decisions from the Court of Appeals are unpublished, synthesizing them for the purpose of restating a principle of law is inappropriate. *See* VA. CODE ANN. § 17.1-413 (unpublished decisions are not precedential). By looking at these cases and Virginia Code § 20-108.2(C), it seems trial courts must engage in a two-step fact finding process for evaluating offsets to real estate leasing income. First, the court must determine whether the party seeking

the offset is engaged in business. The General Assembly in Virginia Code § 20-108.2(C) could have directed courts to generally offset real estate rental income with all necessary expenses for the property, but it did not do so. Rather, it permitted offsets only for "reasonable *business* expenses." (Emphasis supplied). Second, the court must determine if the expenses are reasonable and legitimate. Thus, trial courts must make case-by-case factual determinations as to whether a party operates income-producing real estate as a business and whether that party proves the reasonableness of his or her business expenses.

The definition of "business" can be very broad. "Engaging in business" means "a course of dealing which requires the time, attention and labor of the person so engaged for the purpose of earning a livelihood *or profit*." *Young v. Town of Vienna*, 203 Va. 265, 267 (1962) (emphasis supplied). "Business" means "a commercial or industrial enterprise." It means "employment, occupation, profession, or commercial activity engaged in *for gain* or livelihood." BLACK'S LAW DICTIONARY (5th Ed. 1979) (emphasis supplied). But see, NEW OXFORD AM. DICTIONARY, 237 (3d ed. 2010) ("Business" is "a person's regular occupation, profession, or trade."). There is no requirement that one use a particular legal form, such as a corporation or limited liability company. There is no requirement that one earn an annual profit from the investment—sometimes the business goal is property appreciation—future gain. Nor is there any requirement that hold oneself out as operating the business – by maintaining separate bank accounts, having an office, possessing business cards, or otherwise having a stand-alone business entity. One can be a sole proprietor. There is nothing in the law that requires the real estate leasing business to be one's primary employment or even a large percentage of his or her employment. Of course, evidence of each of these can make one's claim of operating a business more credible.

Once a court determines a party is operating a business, it can permit offsets for reasonable business expenses. Of course, the proponent must persuade the court of both the expense and the reasonableness. There are some common expenses of real estate leasing that cannot be "expenses." For example, mortgage payments usually consist of a partial principal repayment and an interest payment. Interest on a loan obtained to do business is a normal business expense. However, repayment of the principal of the loan is not an expense. It is the growth of equity.[4] Similarly, depreciation is rarely an expense. This is a "reduction in value of an asset with the passage of time, due in particular to wear and tear." NEW OXFORD AM. DICTIONARY, 467 (3d ed. 2010). While this can be a loss, it is not an expense. The expense would be a repair of the wear and tear, if any, not the fact that the wear and tear diminished the value of the property. Were this to be otherwise, an increase in the value of property would be additional income that should logically offset property expenses.

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[4] The Court of Appeals likely reversed and remanded the case to the trial court in *Dega* for this reason. The trial court admitted evidence that a mortgage payment almost entirely subsumed the rental income from a beach house. Thus, there was evidence that the interest portion of the mortgage and, possibly, a tax and insurance component of the payment, could be deducted. This explains why the appellate court panel wrote, "the trial judge erred in failing to *consider* the mortgage payments made on the property from the rental proceeds when assessing the husband's income from the beach house. Therefore, we remand the case . . ." (Emphasis supplied). It did not order the trial court to blindly apply the full mortgage, rather it directed the trial court to consider the mortgage as part of its factfinding.

Other expenses could be reasonable or unreasonable, based on the facts. For example, a property owner could negate years of rental income by enhancing a property with a rare Auguste Rodin sculpture affixed to the façade. It could be hard to persuade a judge that this is a reasonable expense, of course.

III. APPLICATION: FATHER MAY DEDUCT HIS BUSINESS EXPENSES.

The Court finds Father operated his two leased real estate properties as a business. He owns two properties and has leased them to third parties for years.

Real estate leasing includes many business-related tasks inherent in the ownership and property rental, such as obtaining and keeping tenants and building maintenance. Compare a situation where a party owns and operates a convenience store to one where the party owns and operates a rental property. The store owner may have a physical store, either by renting the facility or by owning it. Either way the store owner has a business expense—the rental payments or the interest payments. The store owner must have merchandise to sell, and purchasing these wares is an obvious business expense. Of course, the store owner incurs other business expenses, such as taxes, repairs, and insurance. It would be unfair to calculate presumptive child support guidelines on gross income from that store without offsetting all these business expenses.

In comparison, a party who owns and operates a single rental property stands in the same shoes as the store owner. The landlord must either buy the property (or lease it to sublease it). The landlord's expenses for taxes, repairs, and insurance are the same as for the store owner. It is a different business, but it is a business.

Father's real estate leasing is not his primary employment, but it does not have to be. The General Assembly could have stated this qualification, but never has.

Father persuaded the Court he operates his rental properties as a business. He offered a schedule of his federal tax returns that listed each of his expenses by category, showing that he segregates them. These expenses properly excluded depreciation and principal repayment on his mortgages. He did not offer evidence supporting each aggregated expense item, but the Court finds the amounts of each category appear consistent with the rental income and are reasonable.[5] It is persuasive that the expenses were similar between 2018 and 2019. Father testified his expenses were business expenses and the Court found him to be credible. Mother did not challenge any of the expenses at the trial. Both parties appeared to assume Father could deduct his property expenses against his rental income.

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[5] In contrast, Mother also operates a business. But, like the unsuccessful party in *Moore* who sought offsets for business expenses, and unlike Father in the present case, Mother did not offer a persuasive itemized list of expenses. Rather, like *Moore*, she came to court with vague expenses. She forced the Court to read, line-by-line, through incomplete bank statements to determine what items were business expenses.

In a different case with a different record the Court could be persuaded that one's real estate investment is not a "business"; the father in *Ellis* likely lost his case for that reason. The Court could be persuaded that one's business expenses are unproven or unreasonable; the husband in *Moore* clearly lost for that reason. However, in this case and on this record, the Court is so persuaded, as was the trial court in *Howard.*

IV. CONCLUSION.

Father's leased real estate investments are a business, and his expenses are reasonable business expenses that offset his rental income. Therefore, the Court awards a deduction of those expenses against his rental income for the purpose of calculating his child support obligation per Virginia Code § 20-108.2(C).

An appropriate Order is attached.

Kind regards,

[redacted]

David A. Oblon
Judge, Circuit Court of Fairfax County
19th Judicial Circuit of Virginia

V I R G I N I A:

IN THE CIRCUIT COURT OF FAIRFAX COUNTY

ERICA MONIQUE ALLEN WINSLOW,

Plaintiff,

v. CASE NO.: CL-2014-3101

SEAN CHARLES WINSLOW,

Respondent.

ORDER MODIFYING CHILD SUPPORT

This matter came before the Court, *sua sponte*, after it had suspended its "Memorandum Order Modifying Child Support" entered September 23, 2021, for review and reconsideration. It is now

ORDERED the Court avouches its September 23, 2021, Order which is now incorporated by reference into this Order; and

ORDERED the Court revises and extends its rationale for the September 23, 2021, Order though the Opinion Letter it issued October 12, 2021, which is also incorporated by reference to this Order.

THIS IS A FINAL ORDER. Either party may appeal within 30 days of entry of this Order.

[redacted]

Judge David A. Oblon

OCT 12 2021

Entered

PURSUANT TO RULE 1:13 OF THE RULES OF THE SUPREME COURT OF VIRGINIA, ENDORSEMENT OF THIS ORDER IS WAIVED BY THE DISCRETION OF THE COURT. DESIRED ENDORSEMENT OBJECTIONS MUST BE FILED WITHIN TEN DAYS.