

“RECENT DECISIONS HIGHLIGHT TRIAL COURT’S DISCRETION TO IMPUTE INCOME AND DETERMINE SPECIAL CIRCUMSTANCE JUSTIFYING DEVIANCE FROM GUIDELINE CHILD SUPPORT”

By Mitchell A. Jacobs and Karen S. Brown *

In two recent Sixth Appellate District decisions, the Court had opportunity to opine on what it deemed is the appropriate exercise of judicial discretion by the trial court to: 1) make a guideline support award after imputing income based on the best interests of the children standard and 2) determine “special circumstances” justifying deviance from guideline child support under Family Code §4057(b) (5). Section 4057(b) presumes that guideline support is the correct amount of child support. That presumption may be rebutted by admissible evidence showing that the application of the formula “would be unjust or inappropriate due to special circumstances...” The two decisions: In re Marriage of Schlafly 149 Cal.App.4th 747, 57 Cal.Rptr.3d 274 (2007) and In re Marriage of Williams 150 Cal.App.4th 1221, 58 Cal.Rptr.3d 877 (2007) gave insight on how the court will attribute imputation of income to assess earning capacity but how that discretion is not unlimited. They also clarify when a benefit should be treated as a special circumstance and taxable income. The Williams case also held that tapping the equity in a residence owned by a party is not a source of child support without a prior showing under section 4057(b) that the application of the guideline formula would be unjust or inappropriate based on the parties’ circumstances. These cases provide a glimpse of the variety of factual scenarios a practitioner may confront and how one might approach that conundrum of how to deal with child support awards when there are investment assets and departing from guideline.

In Schlafly, the trial court ordered guideline child support to father for two daughters based on a 50% timeshare to father, but declined to include his mortgage-free house in the guideline calculation, instead imputing \$3,000 a month to his income for his mortgage-free housing in addition to imputing income at a 3% rate of return on his stock portfolio, among other orders. Despite father's argument that the court should have used the actual rate of return on his portfolio, the Sixth District found that to be a minimal amount and upheld the higher imputed rate of return pointing out that section 4058 gives the trial court the right to consider earning capacity from employment earnings as well as invested assets. Furthermore, in reliance upon In re Marriage of Dacumos (1999) 76 Cal.App.4th 150, 90 Cal.Rptr.2d 159 (2000) the court emphasized that "[J]ust as a parent cannot shirk his parental obligations by reducing his earning capacity through unemployment or underemployment, he cannot shirk the obligation to support his child by underutilizing income-producing assets." (Id at p. 155). Based on the evidence and father's admission, the trial court had determined that a guaranteed return of 3% was more reasonable on the invested funds. The justices found the trial court had not exceeded its discretion in making that determination. This decision was made in conformance with the great liberality and general trend of prior cases and legislative enactment to allow the trial court a wide latitude of decision making when it comes to interpreting the earning capacity doctrine of section 4058(b) for the best interests of the child.

The other point established by this case, is that the imputation of income *is not a deviation from guideline; but more importantly an input in the guideline calculation*. Father was confused when he advanced the argument that the court was not required to state there were "special circumstances" to support imputation of a higher rate of return on investments. Despite

father's contention that the trial court should have stated in writing on the record its reasons for deviating from the guideline when imputing a higher rate of return to his investments, there was no basis for this requirement because **imputing income cannot be construed as a special circumstance.**

The Schlafly decision, however, also involved an issue that is good text book on what can be identified as and did in fact end up being a special circumstance justifying a departure from guideline calculation. Father tried to argue that the trial court erred when it deviated from guideline by adding \$3,000 to his income as the value of his mortgage-free home. The Sixth District upheld the trial court's finding but reasoned that the case of In re Marriage of Loh 93 Cal.App.4th 325, 112 Cal.Rptr.2d 893 (2001) was a stronger and legally more accurate precedent on which to base its decision than Stewart v. Gomez on which the trial court relied. The trial court's reliance on another case analogized that housing provided by an Indian reservation provided the legal cornerstone for Mr. Schlafly's claim. The appellate court agreed it was a special circumstance, but likened appellant's benefit to be a benefit source as if from a spouse or partner. This was taxable income and distinguishable from when the benefit was employee related. In placing their logic on the Loh case, the justices distinguished employee benefits which reduced the payor's living expenses based on funds that do not exist from those that derive from a third party. They saw an inconsistency with those orders as from when the housing is provided by a new partner or spouse deeming those taxable benefits. Thus, the Sixth District upheld the mortgage-free housing as a special circumstance. Implicit in the court's reasoning, was its disinclination to extend the meaning of §4058(3) of the Family Code which refers to employee benefits and the reduction of living expenses.

The Williams court similarly emphasized the theme of the need to up the ante on the return on investments as the trial court had in Schlafly when it exercised its discretion to impute income to underutilized and what it deemed under-producing assets or as it stated, “non-income producing investment assets.” (supra at p. 1239). Here, the father failed to show that the increase in guideline resulting from court’s imputation of income to his investments did not serve the best interests of the children, and therefore, the trial court did not err in attributing the 3 percent return it applied. The parties were wealthy and both unemployed having previously made a stipulation for support based on earning capacity. Father had moved for modification of child support order, arguing that mother’s changed financial circumstances justified a reduction in his child support obligation. Mother opposed the motion and sought an increase in child support on the ground that their stipulation regarding father’s earning capacity had failed to include a return on his multimillion-dollar investments.

The trial court ruled that father’s earning capacity should include a reasonable return on approximately \$ 14 million in investments (including home equity of \$ 6 million in his Pebble Beach estate), in addition to the agreed-upon attribution of monthly employment income, and the trial court increased the monthly child support award. Father appealed the support increase; and in respect of the income attribution claims made regarding his estate, the appellate court agreed with father’s contention that income cannot be attributed to home equity absent a showing of special circumstances under Family Code section 4057(b) but rejected the claim that attribution of a return on his investments was not necessary to ensure that the children's reasonable needs were met.

The justices first pointed out that the issue of whether income may be imputed to home

equity had been previously determined in In re Marriage of Henry 126 Cal.App4th. 111 (2004), and the court had rejected that proposition noting that the broad definition of income in section 4058 was not boundless so as to “reach so far as to include the increase in equity of a parent’s residence, forcing the parent to sell or refinance the home in order to make court-ordered support payments.” (Id at p. 119). The court also discussed In re Marriage of de Guigne 97 Cal.App.4th 1353, (2002) wherein the appellate court affirmed an upward award of child support approximately 3 times greater than statutory guidelines but which was consistent with section 4053 in that parents are required to support their children at a level commensurate with their ability, and it also followed section 4057 providing for deviation from guideline support where there are special circumstances when the formula amount would be inappropriate. That case was ordered on the basis of evidence presented to the court of special circumstances including imbalance in the type of housing and lifestyle available to the children and father if guideline child support was ordered.

Unlike de Guigne, the mother in Williams failed to make a showing of special circumstance, under section 4057, and for this reason, it was held the trial court erred in including a hypothetical 3 percent return on father’s home equity in determining his income for purposes of calculating guideline child support. Therefore, this case conclusively held home equity may not be considered for the purpose of calculating child support absent a showing of special circumstances under section 4057(b), that render guideline support unjust or inappropriate.

Father also improperly asserted that mother needed to show that imputation of income to his investment assets as a pre requisite to meet the needs of the children. As far as calculating

the parent's assets and earning capacity, those properly can be assessed from invested assets. In re Marriage of Cheriton 92 Cal.App.4th 269, 283 (2001). Or a court may deem assets a "special circumstance" as per section 4057(b)(5) justifying a departure from the guideline calculation. However, these are exceptional situations and the ordinary garden variety situation posed by most cases are support obligations based on actual earnings and earning capacity. Unfortunately, father missed the point that the needs of the children supersede all else and do not have to argued before any imputation of income is made.

In a discussion subsequent to Cheriton, the Williams justices recounted the historical line of cases which upheld the general principle that the trial court may impute income from a party's assets for the purpose of calculating earning capacity. "[W]here the supporting party has chosen to invest his or her funds in non-income producing assets, the trial court has discretion to impute income to those assets based on an assumed reasonable rate of return." In re Marriage of Pearlstein 137 Cal.App.4th 1361, 1373-1374 (2006). The justices also quoted Schlafly from just two months prior for this general proposition as well. In applying the general line of applicable case law to their facts, they refuted father's arguments and misinterpreted reliance on Cheriton that imputation of income to investment assets were necessary only to the extent that the children's reasonable needs were not met and proven by the non-supporting parent. This thrust was rejected because the focus in Cheriton was on the best interests of the children and whether the trial court's disregard of the father's substantial wealth resulted in too low a support award. Thus, there is no limitation on any particular source of income, be it a return on investment, inheritance or the lottery for that matter. The standard of living, station in life, ability to pay and concepts of lifestyle are the relevant issues when the best interests of the children are being

measured. Father had the shoe on the wrong foot: It was father's burden to prove that the imputation of income to his investments *did not serve his children's best interest*; not for mother to prove that the imputation of income was allowed only to the extent necessary to meet their reasonable needs. Therefore, the imputation of a 3 percent rate of return on his investments assets was proper.

In reviewing these two cases, it is helpful to see how wide a latitude the trial court has in exercising its discretion in the attribution of income to assess earning capacity. The court's reach is unlimited as to the variety of assets and sources as the investor may hold. When assessing actual earnings and earning capacity, the standard is governed by broad concepts of ability to pay and standards of living. The trial court applies its discretion to earning capacity based on the best interests of the child standard. It will liberally impute income from invested assets based on a reasonable rate of return. As we have seen, that principle has divergent application to a variety of investments such as stock; whether it be growth or dividend, rental property, stock portfolios which can be sold, lump sum inheritance and other holdings. In other situations, the court may deem assets a 'special circumstance' that justify a departure from guideline formula for support payments, and these exceptional situations require careful evidentiary presentation to the trial court so that the pitfalls that befell Mrs. Williams are avoided. One will be prepared to show the departure based on variance or some factor that is unjust or inappropriate to support formula amount.

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