Family Law

PARENT TRAP

By Mitchell A. Jacobs and Karen Brown

In two recent 6th District Court of Appeal decisions, the court ruled on 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 Section 4057(b)(5).

Imputing Income

Section 4057(b) presumes guideline support is the correct amount of 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 (2007), and *In re Marriage of Williams*, 150 Cal.App.4th 1221 (2007) — offer insight into how income is attributed to assess earning capacity and how that discretion is limited. *Schlafly* also clarifies when a benefit should be treated as a special circumstance and, therefore, taxable income.

The *Williams* case conclusively held, absent a prior showing under Section 4057(b), that the application of the guideline formula would be unjust or inappropriate based on the parties' circumstances and that the equity in a residence owned by a party is not a source of child support. These cases provide a glimpse of the factual scenarios confronting the practitioner, as well as providing guidance on how to approach the conundrum of child support when a party has investment assets and other sources that arguably may justify departing from the guideline.

In *Schlafly*, the trial court ordered guideline child support to the father but declined to include his mortgage-free house in the guideline calculation. Instead, the court imputed $3,000 a month to his income for his mortgage-free housing in addition to imputing income at a 3 percent rate of return on his stock portfolio, among other orders. Despite the father's argument that the court should have used the actual rate of return on his portfolio, the 6th District upheld a higher imputed rate of return, noting that Section 4058 gives the trial court the right to consider earning capacity from employment earnings as well as invested assets.

Furthermore, relying on *In re Marriage of Dacumos*, 76 Cal.App.4th 150 (1999), the court emphasized that "just 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." Based on the evidence and the father's admission, the trial court determined that a guaranteed return of 3 percent was more reasonable on the invested funds. The justices found that the trial court had not exceeded its discretion in making that determination.

This case also held that the imputation of income is not a deviation from the guideline but, more important, an input in the guideline calculation. Despite the father's contention that the trial court should have stated (in writing and 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.

Special Circumstances

Schlafly also decided an issue that provides a good example of what can be identified as a special circumstance justifying departure from guideline calculation. The father tried to argue that the trial court erred when it deviated from the guideline by adding $3,000 to his income as the value of his mortgage-free home. The justices upheld the trial court's finding but reasoned that *In re Marriage of Loh*, 93 Cal.App.4th 325 (2001), was a stronger and more legally accurate precedent on which to base its decision than *Stewart v. Gomez*, which the trial court relied on as the legal cornerstone for Schlafly's claim.

Although the appellate court agreed that the situation constituted special circumstances, it likened the appellant's benefit to that from a spouse or partner. That is, the benefit was equivalent to taxable income and was distinguishable as being employment-related. In placing their logic on the *Loh* case, the justices distinguished employee benefits that are not actual funds but that reduce the recipient's living expenses from those that are transferred from a third party. Thus, the mortgage-free housing was upheld as a special circumstance. Implicit in the court's reasoning was its disinclination to extend the meaning of Section 4058(3) of the Family Code, which refers to employee benefits and the reduction of living expenses.

The *Williams* court similarly emphasized the need to up the ante on the return on investments, per *Schlafly*, when it exercised its discretion to impute income to underused and underproducing assets or, as it stated, "non-income-producing investment assets." The parties were both wealthy and both unemployed, having previously made a stipulation for support based on earning capacity. The father moved for modification of the child-support order, arguing that the mother's changed financial circumstances justified a reduction in his child-support obligation. The mother opposed the motion and sought an increase in child support on the ground that their stipulation regarding the father's earning capacity had failed to include a return on his multimillion-dollar investments.

Home Equity

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

The justices pointed out that the issue of whether income may be imputed to home equity had been determined in *In re Marriage of Henry*, 126 Cal.App.4th 111 (2004), in which the court had held in the negative, noting that the broad definition of income in Section 4058 was not 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."

The court also discussed *In re Marriage of de Guigne*, 97 Cal.App.4th 1353 (2002), in which the appellate court affirmed an upward award of child support three times greater than statutory guidelines but consistent with Section 4053, in that parents are required to support their children at a level commensurate with their ability. The decision also had followed Section 4057 in providing for

In a discussion of cases subsequent to *Cheriton*, the *Williams* justices recounted how the general principle had been followed 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 (2006). The justices also quoted *Schlafly*, from just two months prior, for this general proposition. The court found no limitation on any particular source of income, be it a return on investment, an inheritance or lottery winnings. The standard of living, station in life, ability to pay and lifestyle are the relevant issues when the best interests of children are being measured.

These two cases are helpful in providing an overview of the trial court's discretion in attributing income for the purpose of assessing earning capacity. In some situations, the court's reach into the investor's assets is unlimited. When determining actual earnings and earning capacity, the standard is governed by broad concepts such as ability to pay and standard of living. In its reach to achieve earning capacity based on the best-interests-of-the-child standard, the trial court liberally imputes income from invested assets based on a reasonable, not actual, rate of return.

In other situations, the court may deem assets a 'special circumstance' that justifies a departure from the guideline formula for support payments. These exceptional situations require careful evidentiary presentation to the trial court so as to avoid the pitfalls that Williams suffered. Practitioners should be prepared to show departure based on actual evidence that it is unjust or inappropriate to support deviance from a formula amount.

Mitchell A. Jacobs is a certified family law specialist and **Karen Brown** is an associate with the Law Offices of Mitchell A. Jacobs in Los Angeles.