

NO. A06-2228

State of Minnesota
In Court of Appeals

Shane L. Zacher,

Appellant,

and

Beth A. Hadrava,

Respondent.

APPELLANT'S REPLY BRIEF

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ARGUMENT

I. THE FACTS RECITED IN RESPONDENT'S BRIEF ARE IRRELAVENT, RIFE WITH FALSE AND MISLEADING INFORMATION AND INCLUDE INFORMATION NOT CONTAINED IN THE RECORD.

A. Facts Regarding Discovery

Nearly all of the facts recited in Respondent Beth Hadrava's Brief regarding the discovery process during the child support proceeding in the district court are irrelevant and convey information not contained in the record.

Ms. Hadrava states in her brief:

When Respondent requested the Appellant produce documentation regarding the profit-sharing from the Appellant's business, the Appellant initially denied through his attorney that Appellant was a shareholder. It was not until the Child Support Magistrate asked why Appellant had not furnished the requested documents that Mr. Pelletier, one of the Appellant's witnesses, disclosed the Appellant's status as a shareholder in the company and reported that he could not file his taxes until Next Innovations had completed the tax documents for the company.

(R. Brief, p. 2)¹

None of these statements are cited or supported by the record, but are merely groundless allegations raised for the first time on appeal. Ms. Hadrava and the Court received Mr. Zacher's 2005 tax return, including the Schedule K-1, prior to the June 15, 2006 hearing and to the satisfaction of the Court. T. p. 4. Thus, Ms. Hadrava's vague complaints about the discovery process are irrelevant on appeal.

¹ R. Brief refers to Ms. Hadrava's Brief.

Ms. Hadrava further states in her brief: "At the review hearing held on April 20, 2006, Respondent made the Child Support Magistrate aware that the Appellant had yet to make his income tax records for the 2005 calendar year available." Ms. Hadrava cites to A-26 of Mr. Zacher's Brief, which is the first page of an Order for Continuance issued by the Child Support Magistrate on April 27, 2006. Ms. Hadrava twists the information provided in the Order for Continuance. Nowhere in the Order does it mention that Ms. Hadrava made the Child Support Magistrate aware that Mr. Zacher had yet to make his income tax records for the 2005 calendar year available. (A-26) The Court simply made a Finding of Fact that Mr. Zacher's "income tax records for calendar year 2005 were not available at the time of hearing but will be available on or before June 1, 2006." (A-26). Further, while Ms. Hadrava related her complaints about Mr. Zacher's tax returns to the Court at the June 15, 2006 hearing (R. Brief, p. 2), she admitted that she in fact received the tax returns prior to the hearing. T. p. 5. Neither the child support magistrate nor the trial court judge made a finding that Mr. Zacher failed to comply with discovery requests. Thus, Ms. Hadrava's continuing complaints to this Court are irrelevant and inappropriate.

B. Facts Regarding Retention of Corporate Profits

Ms. Hadrava also contends that Mr. Zacher produced no information at the June 15, 2006 hearing regarding "the purpose of retaining profits within the corporation." R. Brief, p. 3. In cases where a corporation is owned and operated by one person who is the sole shareholder, an analysis of whether or not it is

necessary to retain profits for business capital purposes is required. See Hertz v. Hertz, 304 Minn. 144, 229 N.W.2d 42 (1975)

Here, it was established at the hearing that Mr. Zacher is only a 15% shareholder in Next Innovations, Inc. and has no control over whether corporate profits are retained for business capital purposes. Additionally, Ms. Hadrava had ample opportunity to ask Mr. Pelltier and Mr. Zacher questions regarding the retention of corporate profits. She failed to do so. Therefore, an analysis of the purpose of the retention of corporate profits was unnecessary.

C. Facts Regarding Mr. Zacher's 2004 Bonus

Ms. Hadrava also misleads this Court with the following statements:

At one point during the hearing held on June 16 (sic), 2006, Appellant stated that he had been a shareholder since March of 2005 (T at 56). However, the Appellant received profits in the form of a bonus in excess of \$22,500.00 in the 2004 calendar year. (A-29) Again, no explanation was given for the sudden necessity to retain the shareholder's profits in the company and no documentation was provided to show a decline in sales or other such reason that the shareholders would have good cause to accept this so-called pass through income in spite of the disbursement of profits the previous year.

(R. Brief, p. 4).

It was established at the hearing that Mr. Zacher has been a minority shareholder since March 2005. T. p. 56. It was also established at the hearing that Mr. Zacher received a bonus in 2004 in the amount of \$24,124.25. T. p. 34. The bonus Mr. Zacher received in 2004 is something entirely different from a distribution of corporate profits. The trial court recognized this difference in Finding 11 of its order: "In calendar year 2004, [Mr. Zacher] did receive a bonus

in excess of \$22,500.00. However, this bonus was a one time event and is not a regular source of income for the [Mr. Zacher].” (A-29)

II. MS. HADRAVA’S ARGUMENT FURTHER CONFUSES THE FACTS AND MISCHARACTERIZES THE LAW .

In the first paragraph on page 7 of Ms. Hadrava’s Brief, she recites facts not contained in her own Facts section, or anywhere in the record. Statements such as “Respondent is also aware of at least one other bonus that Appellant received in which there is no record,” and “It is not outside the realm of possibility that Next Innovations, Ltd. Became a Subchapter S-Corporation primarily to shield Appellant’s income from child support,” are simply not supported by the record.

Additionally, Ms. Hadrava admits in her own argument that Next Innovations, Inc. retains corporate profits: “It was not until recently that Next Innovations, Ltd. Began retaining profits.” R. Brief, p. 7. There is no evidence supporting whether or not Next Innovations, Inc. began retaining corporate profits recently. And yet, again, she is confusing corporate profits with a bonus Mr. Zacher received in 2004.

Throughout her brief, Ms. Hadrava deliberately attempts to confuse the real issues. She claims that “the definition of income for the purposes of determining an obligor’s support obligation is non-specific at best” R. Brief, p. 5. To the contrary, the definition of income is openly delineated in Minn. Stat. §518.54, Subd. 6 as any form of periodic payment to an individual. The child support magistrate erred as a matter of law when he made a finding that the \$53,098.00 in

corporate profits reported on Mr. Zacher's K-1 is a regular source of income to Mr. Zacher. It is not a periodic payment to Mr. Zacher, as he never even received it.

She further confuses the issue in her assertion that the "amount of child support ordered is not a deviation from the Minnesota child support Guidelines." R. Brief, p. 5. Mr. Zacher has never argued that the child support magistrate abused his discretion by concluding that the amount of child support ordered deviated from the guidelines. He simply asserts that the child support magistrate and the trial judge abused their discretion when they found that Mr. Zacher receives corporate profits as a regular source of income and erred as a matter of law by including the corporate profits in Mr. Zacher's income.

Additionally, Ms. Hadrava mischaracterizes the law in her argument that "there is no definitive treatment of S-Corporation earnings, therefore individual inquiry on a case by case basis is necessary to determine if corporate profits should be imputed as income in determining an obligor's child support obligation." R. Brief, p. 5. It is established in the case law that if a minority shareholder has little or no control over the distribution of corporate profits, and he does not in fact receive a distribution, then corporate profits reported on his Schedule K-1 should not be included in his income for the purpose of calculating child support. See Hertz v. Hertz, 304 Minn. 144, 229 N.W.2d 42 (1975), and Marx v. Marx, 409 N.W.2d 526, 529 (Minn. App. 1987).

Finally, Ms. Hadrava mischaracterizes the Worms case cited in Appellant's Brief. She claims that the Worms case is distinguishable from the present case. In the Worms case, Timothy Worms's parents gifted him 111 shares of their subchapter S corporation's stock. The purpose of the gift was to provide future funds for the education of their children and grandchildren. The parents distributed annually an amount of funds equal to the highest tax owed by any shareholder for their portion of the corporation's income, something very typical for closely held corporations to do. The Worms court excluded the amount distributed to pay shareholder taxes from income because the funds were distributed for the sole purpose of paying corporate taxes and were not a source of income for the shareholders.

While the facts of the Worms case may be slightly different from the facts of the case at hand, the issue of whether corporate distributions should be included in a shareholder's income is the same. The Worms court stated:

Although cash distributions from Cool Air are reported on Timothy Worm's income tax returns as unearned income, that designation is not determinative in calculating income for child support. *See Marx v. Marx*, 409 N.W.2d 526, 528-29 (Minn. App. 1987) (substantial losses reported on tax returns were due to large deductions, and cash flow was more reliable indicator of income). Timothy Worm's receipt of cash distributions from Cool Air to cover his increased income tax liability is consistent with the 'pas-thru' nature of a Subchapter-S corporation.

(A-53)

Based on this, the Worms court determined that the district court did not err in excluding the Cool air distributions from Timothy Worms's income. In the

present matter, for the same reasons the Worms court did not include the distributions in Timothy Worm's income, the child support magistrate and the district court erred by including undistributed corporate profits reported on Mr. Zacher's 2005 tax return as income for the purpose of calculating child support.

CONCLUSION

Appellant Shane L. Zacher requests that this Court grant the relief requested in his main brief.

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