

NO. A06-2228

State of Minnesota  
In Court of Appeals

Shane L. Zacher,

*Appellant,*

vs.

Beth A. Hadrava,

*Respondent.*

RESPONDENT'S BRIEF

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## FACTS/PROCEDURAL HISTORY

Appellant, Shane L. Zacher, and Respondent, Beth A. Hadrava, are the parents of Holden James John Zacher, Shae Leon Zacher, and Tatiana Faye Hadrava. Appellant was personally served with the summons and complaint on November 30, 2005. (A-22) References to appendix, are to the appendix within the brief submitted by the Appellant. The Respondent raised questions at the initial hearing held on February 16, 2006, with regard to past income, as well as ongoing income of the Appellant. (A-23). The Child Support Magistrate deemed it appropriate to reserve the issue of past support to allow for adjustment of the past support obligation after completion of discovery. (A-23)

Respondent served discovery on the Appellant on December 22, 2005. (A-23) The first hearing was held on February 16, 2006. At this point, the Appellant had yet to respond to discovery. (A-23) 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. Pelltier, 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.

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. (A-26) Finally, Respondent submitted a letter to the Child Support Magistrate, in which it was requested that Appellant produce the documents,

that were requested nearly six months previously. Respondent understood that the documents would be received ten days before the scheduled hearing set for June 16, 2006. Respondent received a letter dated June 2, 2006 and found that the Appellant had produced his Schedule K-1 but not his tax returns for the calendar year 2005. Upon contacting the Appellant's attorney, Respondent was initially informed that he K-1 and the tax returns were the same thing. Only after reading his counsel the Court's order and demanding the returns were the returns produced. Respondent related this incident to the Magistrate at the June hearing. T. p. 4 and 5. (A-27)

During the hearing held on June 16, 2006, Mr. Pelltier, an employee of the Appellant's company, stated that Appellant had never actually received the corporate profits that he reported on his tax returns but never made any mention of or gave an explanation of the inavailability of funds to the shareholders. T. p. 43, 52, During the hearing, Appellant and Pelltier had ample opportunity to provide information to the Child Support Magistrate regarding the purpose of retaining profits within the corporation. However, no such information was produced. Under the circumstances, the Child Support Magistrate concluded that the Appellant is a shareholder in a successful company that is experiencing growth. (A-29) The Appellant failed to offer any evidence that the the earnings were retained for a legitimate reason. There was no testimony to that effect or that the SSC income was tied up and therefore unavailable to Appellant or the other shareholders.

In the 2004 calendar year, Appellant received a bonus check in excess of \$22,500.00. (A-29) At this point Next Innovations, Ltd. was a identified as a C-

corporation (T. at 28). At one point during the hearing held on June 16, 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 in the previous year.

Appellant is one of only three shareholders in Next Innovations. (T at 27). The other two shareholders are Jason Zacher, his brother, and John Zacher, his father. (T. at 27). The percentages of actual ownership in the company never were exactly disclosed or documented, although the Appellant claims that his father , John Zacher, is the majority shareholder (T. at. 27 and 57). No corporate records or minutes were produced at the hearing.

Upon the conclusion of t the hearing, the magistrate attributed the Appellant's share of corporate profits to his income for purposes of calculating his support obligation because his share of profits is a regular source of income. (A-29) The magistrate noted that the Appellant's income is subject to fluctuation, but determined that his 2005 tax returns were the best available current information. (A-29) On July 6, 2006 the Child Support Magistrate ordered that Appellant pay \$1,575.00 per month in ongoing child support. (A-31) Because there is no definitive treatment of Subchapter S Corporation distributions in Minnesota case law the magistrate and trial court used their discretion in determining the Appellant's ongoing child support obligation and imputed

his share of profits in his income to determine his child support obligation. (A-30 and 36). The amount of child support ordered is not a deviation from the Minnesota child support Guidelines. (A-30)

### **ARGUMENT**

#### **APPELLANT HAS FAILED TO ESTABLISH THAT THE TRIAL COURT ABUSED ITS DISCRETION IN AWARDING CHILD SUPPORT.**

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.

Appellant's child support obligation was ordered based on the Minnesota Child Support Guidelines. There has been no abuse of discretion on the part of the child support magistrate or the trial court. The child support magistrate ordered the amount based on the Appellant's net monthly income and the child support ordered is not a deviation from the Minnesota Child Support Guidelines. The child support magistrate held three hearings before the case was concluded. He heard testimony from Appellant and Mr. Peltier, the comptroller for Next Innovations Ltd., and made his findings of fact based on the facts presented by both parties. The magistrate's findings of fact and transcript support the Order of the Court. Additionally, the trial court made the same conclusion and affirmed the decision based on the record.

The definition of income for purposes of determining an obligor's support obligation is non-specific at best and clearly the child support magistrate did not err as

a matter of law by including such profits as income. Further, because there is no definitive treatment of S-corporation distributions the magistrate and trial court were well within their discretion to include the Appellant's share of profits in his income. Appellant reports his share of corporate profits on his tax return annually which allows the magistrate and trial court to conclude this is in fact periodic payment.

Because this is a closely held corporation and the three men that are shareholders in corporation are members of the same immediate family the question has to be asked, "Why were the corporate earnings retained rather than distributed as they were in the year previously?" There was no evidence or testimony offered that would allow the magistrate or trial court to draw the conclusion that there was a necessity or legitimate reason of any sort to retain the profits that were reported on the Appellant's income tax returns. No documentation of any sort was provided regarding the corporation's financial status or need to retain profits. The burden of proof rests on the shareholder, Appellant, to show that profits were reinvested for a reason other than to shield income from child support. Therefore, the magistrate's findings of fact and Order do not constitute an abuse of discretion or err as a matter of law.

Appellant has a duty to, but has not significantly contributed, to the support of his children. Respondent Hadrava began seeking child support, and has filed all of the necessary documents to ensure that a just and equitable amount of support is ordered by the courts. The matter has been heard on three separate occasions and was finally concluded on June 6, 2006. The magistrate's findings of fact and Order are supported by the transcript and record in this matter. The trial court affirmed the decision on September 26, 2006.

One of the down falls of a subchapter S-corporation is the fact that a parent may be able to shield income from child support obligations by causing the corporation to retain earnings the parent normally receives as income. It seems clear that in the case at hand that Appellant, his brother and father tried to do just this. Respondent is also aware of at least one other bonus that Appellant received in which there is no record. Further, it is obvious that Appellant's close family relationship to the alleged majority shareholder puts the Appellant in a position to have a significant level of control over distributions and access to cash when he so desires. 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. It was also not until recently that Next Innovations, Ltd. began retaining profits in the company. Before child support was sought, Appellant received bonuses as a means of profit sharing. In a closely held corporation such as this it seems evident that the shareholders are very likely aligned and more than willing to aid Appellant in keeping his child support obligation to an absolute minimum. There was no evidence offered to explain why corporate profits were retained by any of the Appellant's witnesses, nor was there any documentation introduced to clarify why profits were not disbursed to the shareholders.

There is no definitive treatment of subchapter S-corporation distributions within the realm of child support so it becomes necessary for the courts to carefully weigh all of the evidence, and that includes the Appellant's failure to make a case for why corporate profits would be retained without any explanation or legitimate reason.

The magistrate and trial court were without justification to come to any other conclusion based on the testimony of the witnesses and the evidence provided. In no

way did the magistrate or trial court abuse their discretion in determining the Appellant's child support obligation, but rather that they recognized the potential for the the Appellant to manipulate SSC income to avoid or reduce his child support obligation.

Respondent would invite the Court to review the facts of the unpublished decision cited by Appellant, Worms v. Worms, a copy of which Appellant includes in his appendix. Obviously, Worms is readily distinguishable from the present case. In Worms, the child support recipient sought review of an order of the trial court awarding child support. She challenged the award because the trial court did not include income passed through to her husband's income tax returns from a subchapter S corporation. The evidence in that case was that the recipient's parents had gifted shares in the corporation to all seven of their children approximately 15 years earlier. Shortly thereafter, they began to pass through income to their children's tax returns, primarily as a means of providing funds for their grandchildren's college education's. The record in that case showed that the only funds passed through went directly to education. It was also clear that the parents were, in effect, paying their children's income taxes incurred in connection with the pass through.

Obviously, the present case is a very different situation. The Worms court was dealing with a situation that had been in place for many years. Unlike the present case, there was no evidence from which the trial court could have concluded that the party obligated to pay child support was manipulating the situation to avoid payment of support. There is no evidence in the present case of a legitimate estate planning

purpose for the arrangement as was present in Worms. In other words, Worms provides no legal support for Appellant's claims.

CONCLUSION

For the reasons set forth above, the Respondent respectfully requests an Order of this Court affirming the decision of the trial court in its entirety.

Dated February 9, 2007

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