

A11-1225

State of Minnesota
In Court of Appeals

Kathy Lynn Haefele,

Appellant,

v.

Douglas Alan Haefele,

Respondent.

**BRIEF AND APPENDIX OF RESPONDENT
DOUGLAS ALAN HAEFELE**

Alan C. Eidsness (I.D. No. 26189)
Melissa J. Nilsson (I.D. No. 034722X)
220 South Sixth Street, Suite 1800
Minneapolis, MN 55402
(612) 339-2500

*Attorneys for Appellant
Kathy Lynn Haefele*

Kay Nord Hunt (I.D. No. 138289)
Diane M. Odeen (I.D. No. 284142)
LOMMEN, ABDO, COLE,
KING & STAGEBERG, P.A.
2000 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
(612) 339-8131

Vija L. Brookshire (I.D. No. 293271)
MESSERLI & KRAMER, P.A.
1400 Fifth Street Towers
150 South Fifth Street
Minneapolis, MN 55402
(612) 672-3733

*Attorneys for Respondent
Douglas Alan Haefele*

The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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STATEMENT OF THE ISSUES

- I. DID THE DISTRICT COURT ABUSE ITS DISCRETION IN DETERMINING APPELLANT’S GROSS INCOME FOR PURPOSES OF HER MINN. STAT. § 518A.34 CHILD SUPPORT OBLIGATION BY INCLUDING DISTRIBUTIONS MADE TO APPELLANT TO REIMBURSE HER FOR TAXES PAID ON SUBCHAPTER-S CORPORATE DISTRIBUTIONS?

The district court held that tax distributions were part of Appellant’s gross income and should be considered for the purposes of calculating child support.

Minn. Stat. § 518A.29.

Minn. Stat. § 518A.30.

Rutten v. Rutten, 347 N.W.2d 47 (Minn. 1984).

Hubbard County Health & Human Services v. Zacher, 742 N.W.2d 223 (Minn. Ct. App. 2007).

- II. DID THE DISTRICT COURT ABUSE ITS DISCRETION WHEN IT DETERMINED THAT THE FUNDS WHICH WERE DISTRIBUTED TO APPELLANT FROM DURA-SUPREME AND HELD BY TK INVESTMENTS WERE NOT CORPORATE “RETAINED EARNINGS” AND ARE GROSS INCOME FOR PURPOSES OF MINN. STAT § 518A.34 CHILD SUPPORT CALCULATIONS?

The district court held that corporate distributions are properly considered as part of gross income for purposes of calculating child support.

Minn. Stat. § 518A.29.

Hubbard County Health & Human Services v. Zacher, 742 N.W.2d 223 (Minn. Ct. App. 2007).

Ludwigson v. Ludwigson, 642 N.W.2d 441 (Minn. Ct. App. 2002).

STATEMENT OF THE CASE AND FACTS

A. The Parties' Marriage Was Dissolved by Judgment and Decree Entered in December 2000.

The 10-year marriage of Appellant Kathy Lynn Haefele ("Mother") and Respondent Douglas Alan Haefele ("Father") was dissolved on December 15, 2000. (Appellant's Appendix ["APP"] 01-09.) As Mother points out in her Appellant's Brief, under then-existing law only Father's income was taken into consideration in determining child support obligations. (Appellant's Brief, p. 3.) As set out in the December 15, 2000 Judgment and Decree, for purposes of determining child support, the parties established "a base child support obligation of \$1,794 per month" on Father, "assuming a gross annual income from salary and bonus of \$108,000 per year." (APP 04.) Mother was not employed, but received income and distributions in excess of taxes of approximately \$48,000 per year from her nonmarital interest in two family businesses, Dura-Supreme, Inc. ("Dura- Supreme") and Howard Lake Properties, LLC ("Howard Lake"). (APP 03-04.) Dura-Supreme is an "S-Corporation" where the company income is reported by the owners on their individual income tax returns. (Appellant's Addendum ["ADD"] 05-06.)

B. Based on the Enactment of Minn. Stat. § 518A.26, et seq., Father Sought a Modification in His Child Support Obligation.

Child support guidelines with the enactment of Minn. Stat. §§ 518A.34 and .35 have changed significantly since the parties' divorce. (See APP 33.) One of the primary changes was to take both parents' income into account, rather than focusing on the non-custodial parent. (*Id.*) The new formula, Minn Stat § 518A.34, adopted on January 1,

2007, takes all income into consideration, as well as the percentage of parenting time exercised by the noncustodial parent. (ADD 03.)

Father made a motion on September 29, 2010, to modify his child support and insurance obligations pursuant to the current child support guidelines. (APP 24.) Mother made a counter-motion seeking past-due child support payments and payments for damage to a garage door. (APP 22, ADD 02.) The child support arrearages were caused by Mother misplacing the checks electronically sent by Father twice a month, and failing to cash them in a timely fashion. (Respondent's Appendix ["R.A."] 1-2, 17.) Father had accidentally damaged Mother's garage door, and had paid for its repair but not for repainting. (R.A. 18.)

At the time he sought modification, Father had changed jobs and had a gross average income of \$178,056 per year. (Appellant's Confidential Appendix ["CA"] 34; ADD 03.) Mother was still unemployed, but the income from the family businesses had increased significantly. (CA 35.) The district court was charged with determining how to calculate Mother's income. (ADD 03.)

C. Mother Had Received Substantial Corporate Distributions Which the Trial Court Ruled Constituted Gross Income as Defined by Minn. Stat. § 518A.29.

At the time of the modification request, Mother was still an owner of 20% of Dura-Supreme. (CA 11.) Her brother, Kevin Stotts ("Kevin"), also owned 20%, and the remaining 60% was owned by brother Keith Stotts ("Stotts"), who was the President of the

company. (Id.; CA 02.) Another family-owned entity, TK Investments, LLC (“TK Investments”) had also been formed. (CA 03; CA 09.)

Beginning in 2007, Stotts and Dura-Supreme Chief Financial Officer Gene Schweiss (“Schweiss”) began to make plans for the business to expand from \$89,000,000 to \$150,000,000 in gross sales. (CA 07-08; CA 11-12.) Mindful that this expansion would require a significant financial investment, Dura-Supreme began exploring bank financing. (CA 08.) One limiting factor to bank financing, however, was the requirement that the owners provide a personal guaranty. (Id.) In order to avoid this and retain the limited liability nature of the company, Schweiss and Stotts began to explore other options. (CA 08-09.) Dura-Supreme increased the amount of receivables collected, deferred equipment purchases and facilities expansions and otherwise reduced operating costs. (CA 09.)

As a result of this financial planning, Dura-Supreme began to acquire significant cash reserves. (CA 09.) The company’s “legal counsel and . . . audit firm suggested that [Dura-Supreme] remove ‘excess’ cash reserves to another entity as a means of lowering [its] corporate retained earnings exposure to risk of unknown corporate liabilities.” (CA 09.) The money could be placed in a new entity, and then lent back to Dura-Supreme at a favorable interest rate. (Id.)

Stotts spoke to Mother about the plan to move excess cash from Dura-Supreme to the new entity, TK Investments, via distributions to the shareholders. (CA 02-03, CA 12.)

Stotts told Mother that she “needed to do this for the company’s success and protection and [she] agreed” to the plan because she depended on her income from Dura-Supreme to support her and her children. (CA 03.) Mother became a member and a 1/3 owner of TK Investments, with Kevin and Stotts each holding a third as well. (CA 12.) Stotts retained 100% of the voting rights of TK Investments. (Id.) TK Investments is a separate legal entity and unaffiliated with Dura-Supreme or Howard Lake. (Respondent’s Confidential Appendix [“R.C.A.”] 1-23.)

TK Investments is governed by a Member Control Agreement. (R.C.A. 02; ADD 08.) The Member Control Agreement provides that there is no continuing obligation to contribute capital to the company:

No Member shall at any time have any obligation to make any Capital Contributions to the Company in addition to those provided for in Section 2.1 (initial capital and interests). On behalf of the Members, Dura Supreme, Inc. shall be permitted to transfer all or a portion of any *dividend distribution*, as authorized by the board of directors of Dura Supreme, Inc., directly to the Company, and, as directed by Dura Supreme, Inc., such *dividend distributions* shall be deemed to be an additional capital contribution to the Company on behalf of the Members.

(R.C.A. 02) (emphasis added).

Pursuant to its plan to limit corporate liability while still having access to cash for future expansion, Dura-Supreme began to make large distributions to Mother: \$885,300 in 2007; \$2,647,000 in 2008; \$1,417,149 in 2009; and \$1,294,200 in 2010. (CA 35.) The following chart illustrates Mother’s gross income:

	2007	2008	2009
Dura-Supreme Distributions	\$ 885,300	\$ 2,647,000	\$ 1,417,149
Howard Lake Distributions	\$ 53,628	\$ 9,996	\$ 2,275
Interest and Dividends	\$ 8,299	\$ 5,826	\$ 8,669
Total Gross Income	\$ 947,227	\$ 2,662,822	\$ 1,428,093

(CA 15; ADD 20.)¹

Some of the money distributed to Mother was invested in TK Investments, initially through the Stotts Family Revocable Trust, and later directly by Mother. (ADD 04.) Mother argued to the district court that the amount she invested in TK Investments – \$1.6 million in 2008 and \$1.09 million in 2009 – should not be considered as gross income for purposes of calculating child support because it served the same function to the corporation as retained earnings, which were excluded pursuant to Hubbard County Health & Human Servs. v. Zacher, 742 N.W.2d 223 (Minn. Ct. App. 2001). (ADD 05, 07; CA 15.) If these amounts were excluded, Mother’s average gross income was \$146,947 per year – an amount which still exceeded the income of Father. (CA 04-05.) In opposition, Father asked the Court to find that Mother’s gross income was \$1,759,252 per year, based on the corporate distributions and other imputed income. (ADD 05, 12-14.)

¹ Income for 2010 is excluded because the district court considered only Mother’s income for 2007 - 2009 in determining her average income. (ADD 16.) This decision was not appealed.

In considering this dispute, the district court looked to the definition of “gross income” found in Minn. Stat. § 518A.29(a):

any form of periodic payment to an individual, including, but not limited to, salaries, wages, commissions, self-employment income under section 518 A.30, workers’ compensation, unemployment benefits, annuity payments, ~~military and naval retirement, pension and disability payments~~, spousal maintenance received under a previous order or the current proceeding, Social Security or veterans benefits provided for a joint child under section 518A.31, and potential income under section 518A.32.

(ADD 06.) The district court noted the breadth of this definition, as well as the specificity of Hubbard County in discussing retained earnings not distributed to company shareholders, and the undisputed evidence that the Dura-Supreme funds were uniformly characterized as “dividend distribution” by both Dura-Supreme and TK Investments.

(ADD 06-09.) The district court also found that Mother had a choice whether to transfer funds to TK Investments under the Member Control Agreement. (ADD 09.)

The district court found it irrelevant that Mother was not attempting to shield income from consideration like the parent in Hubbard County, and that Dura-Supreme appeared to have legitimate business reasons for the transfer of funds. (ADD 09.) Instead, the district court found dispositive the fact that the monies had actually been distributed to the shareholders. (Id.) Whether the funds were subsequently available to Mother was irrelevant under the statute:

The Court finds that the distributions transferred to TK Investments on Petitioner’s behalf are no different than income received by Petitioner that is set aside to pay any mandatory expense such as a home mortgage or car expense. The income apportioned to those expenses is technically not

available for child support purposes, but are included in the calculation of the obligor's gross monthly income.

(ADD 10.)

D. Mother Received Distributions to Pay for Her Taxes, Which the Trial Court Ruled Constituted Gross Income per Minn. Stat. § 518A.29 and .30.

In addition to the shareholder distributions, Mother received distributions from Dura-Supreme to pay taxes on her portion of the corporate income. (CA 13-15.) Her tax distributions were \$777,800 in 2007; \$567,500 in 2008; \$254,650 in 2009; and \$394,200 in 2010. (CA. 15.) Mother argued that these payments should be excluded from gross income as "ordinary and necessary expenses required for . . . business operation." (ADD 10); see Minn. Stat. § 518A.30 (Income from Self-Employment or Operation of a Business). The district court rejected this argument and held that the expansive statutory definition of "gross income" in Minn. Stat. § 518A.29 was clearly meant to include all pre-tax income, and thus required including the Dura-Supreme tax distributions in Mother's income for purposes of calculating child support obligations. (ADD 11-12.)

E. Other Claims Before the Trial Court Were Addressed, But Are Not the Subject of This Appeal.

There were several other claims before the district court which have not been appealed. Father requested that income be imputed to Mother because distributions by TK Investments and Howard Lake were possible but had been retained by the companies. (CA 35; ADD 12.) The district court denied this motion. (ADD 14.)

The parties disagreed on which years should be included in averaging Mother's income. (ADD 14-15.) The district court ruled for Father, and averaged Mother's income

over 2007, 2008 and 2009. (ADD 16.) During this 3-year period, Mother's average income was \$1,679,380.60. (ADD 20.) Mother's average income would have been higher had 2010 been included. (See CA 35.)

Father sought to have income imputed to Mother under Minn. Stat. § 518A.32 because she was voluntarily unemployed. (ADD 16-18.) After analyzing case law on the imputation of income, the district court denied Father's request and stated:

The case law indicates that the purpose of imputing income to a voluntarily underemployed or unemployed parent(s) is to prevent parents from shirking their financial responsibility to support their children. The Court finds [Mother] is not shirking her financial responsibility. [Mother's] gross monthly income for the purposes of determining child support without an imputation of income will far exceed the average American's gross monthly income. [Mother] can hardly be seen as a parent who is attempting to shirk her financial obligations, especially when she has the parties' minor children the majority of the time and has a greater income available for support than [Father].

(ADD 19.)

As for the counterclaims, the district court noted that Father had agreed he owed Mother child support arrearages and had already paid the amount claimed for damage to the garage door. (ADD 21.)

Finally, the district court calculated child support obligations pursuant to the new statutory scheme, based on finding Mother's average income to be \$1,679,380.60. (ADD 20, 22-25.) The result was a shift to Mother of 90% of the child support obligation. (ADD 20-21.) The calculations under the guidelines have not been appealed.

ARGUMENT

THE TRIAL COURT DID NOT ABUSE ITS DISCRETION IN ITS ORDERED MODIFICATION OF CHILD SUPPORT.

A. The Standard of Review Is Abuse of Discretion.

It is long-settled law in Minnesota that “a district court has broad discretion to provide for the support of the parties’ children,” and that this discretion is abused only if child support obligations are established “in a manner that is against logic and the facts on the record or it misapplies the law.” Hermann v. Hermann, ___ N.W.2d ___, 2011 WL 6306631 (Minn. Ct. App.) (R.A. 29), *citing* Rutten v. Rutten, 347 N.W.2d 47, 50 (Minn. 1984). This discretion extends to the modification of child support orders. Putz v. Putz, 645 N.W.2d 343, 347 (Minn. 2002).

Notwithstanding this broad discretion, certain cases have noted that it is a question of law whether a source of funds constitutes “income” under the child support statutes. See Sherburne County Soc. Servs. v. Riedle, 481 N.W.2d 111, 112 (Minn. Ct. App. 1992) (“Riedle”); County of Nicollet v. Haakenson, 493 N.W.2d 611 (Minn. Ct. App. 1993), *citing* Riedle; Hubbard County Health & Human Services v. Zacher, 742 N.W.2d 223, 227 (Minn. Ct. App. 2007), *citing* Riedle. This standard is appropriate for this limited issue because the interpretation of statutes is subject to de novo review. Krueger v. Zeman Const. Co., 781 N.W.2d 858, 867 (Minn. 2010).

The statutory definition of “gross income” is both broad and non-exclusive. Minn. Stat. § 518A.29. As long as there is a reasonable basis in fact, determination of income

under the statute for purposes of child support should be affirmed. Williams v. Williams, 635 N.W.2d 99, 102 (Minn. Ct. App. 2001). In other words, “the district court’s discretion must be exercised within the [broad] limits set by the legislature,” and is only abused when unsupported by facts or logic. Putz, 645 N.W.2d at 347.

B. The Trial Court Did Not Abuse Its Discretion in Including Tax Distributions as Part of Mother’s Gross Income.

Mother asserts that it was error for the district court to include corporate distributions to her as income because those payments were intended to relieve her of the tax burden of being a shareholder of an S-Corporation, and is hence an “ordinary and necessary business expense” deductible under Minn. Stat. § 518A.30. (Appellant’s Brief at 13.) Although presented first, this argument is derivative of Mother’s argument that the corporate distributions invested in TK Investments should be considered corporate “retained income.” (Appellant’s Brief at 22.)

1. The statutory guidelines are clear.

Courts are bound by the statutes as written. The court may not supply by construction that which the legislature purposefully omits or inadvertently overlooks. Asian Women United of Minnesota v. Leiendecker, 789 N.W.2d 688, 693 (Minn. Ct. App. 2010). Statutes are to be construed in a way which gives effect to all provisions. Minn. Stat. § 645.16. Legislative intent is found primarily in the statutory language. Brayton v. Pawlenty, 781 N.W.2d 357, 363 (Minn. 2010). Only if the language is ambiguous may the statute be construed to discern the legislative intent. Id.

Minnesota law governing child support calculations was significantly revised recently, and beginning in 2007 child support obligations are calculated using both parent's gross income. Minn. Stat. § 518A.29. Gross income is "[t]otal income from all sources before deductions, exemptions, or other tax reductions." Black's Law Dictionary (9th ed. 2009). The statute makes no provision for discounting child support obligations because of taxes paid; in fact, the statute specifically includes pre-tax income placed in employee benefit programs in the definition of "gross income." Minn. Stat. § 518A.29(a). This focus on gross income was an intentional move away from the previous statute's focus on the obligor's net income, and was intended by the legislature to simplify calculation of child support. (APP 33.)

The district court correctly looked to the language of the statute to determine that "gross income" included all income from business operations, and that Mother's interpretation of "ordinary and necessary business expenses" under Minn. Stat. § 518A.30 would contradict the clear meaning of Minn. Stat. § 518A.29. (ADD 11-12.) This interpretation of the statutory scheme is also in accord with the purpose of the business expenses "deduction" when calculating the amount of income to be considered - to omit from consideration the expenses which were necessary to actually *produce* the business income. See In re Marriage of Wiese, 203 P.3d 59, 63 (Kan. Ct. App. 2009). This determination is an issue of fact within the broad discretion of the district court. See id.; Zakrowski v. Zakrowski, 594 N.E.2d 821, 824 (Ind. Ct. App. 1992).

Because the district court's interpretation of the statute was in accord with its clear language, and because the court had discretion to consider what expenses were "ordinary and necessary" to the production of S-Corporation income, the holding below should be affirmed.

2. The foreign cases cited by Mother are distinguishable.

The statute is clear. There are no Minnesota decisions that support Mother's argument. Instead, Mother would have this Court apply the logic of the courts of Florida, Pennsylvania, Indiana and Kansas. She bases her reliance on foreign authority on the fact that the Court in the Hubbard County case looked at authority from these states.

(Appellant's Brief at 13-18.)

Hubbard County examined whether income retained by an S-Corporation was properly considered as part of gross income under the previous child support statutes. Hubbard County, 742 N.W.2d at 226-27 (examining Minn. Stat. § 518.54, subd. 6 (2004)). These statutes used the parent's "net monthly income." Id. at 226; see also Minn. Stat. § 518.551, subd. 5(b) (2004). Net income specifically excluded income taxes paid. Id. There was no question presented to the Court relating to earnings actually distributed to the shareholders, nor was the issue of tax distributions yet before the Court.² Id. at 226.

² The Hubbard County case was remanded, and eventually came before this Court again, where taxes were deducted in order to calculate the father's net income under the old law. Hubbard County Health & Human Servs. v. Zacher, 2009 WL 3364256, *5 (Minn. Ct. App. 2009) (R.A. 9).

The Hubbard County Court cited foreign authority to illustrate that other courts had excluded retained income from an S-Corporation from consideration when calculating child support. Hubbard County, 742 N.W.2d at 227. It used these cases to fashion a rule in keeping with established Minnesota law, noting the possibility that a shareholder might manipulate S-Corporation earnings to avoid child support obligations. Id., *citing Williams v. Williams*, 635 N.W.2d 99, 103 (Minn. Ct. App. 2001). If corporate earnings were not distributed, and the retention was motivated by a legitimate business reason, the retained earnings could be excluded from consideration as income for purposes of establishing child support. Hubbard County, 742 N.W.2d at 227.

But the Hubbard County Court refused to decide that undistributed earnings were not income as a matter of law, and instead remanded the matter to the district court to determine based on the facts of the case. Id. at 228. The Court further noted that:

resolving the question of whether the undistributed earnings of [the corporation] should be considered to be income to Zacher for child-support purposes does not necessarily end the inquiry. The ultimate determination of a child-support obligation is based on the obligor's ability to pay. Strandberg v. Strandberg, 664 N.W.2d 887, 889 (Minn. Ct. App. 2003). And the statute allows the district court to consider "all . . . resources of the parents" in deciding whether to deviate from the guidelines. Minn. Stat. § 518.551, subd. 5(c)(1) (2004). Therefore, even if the district court determines that there is a business reason for [the corporation] to retain earnings, and therefore the undistributed earnings are not income to Zacher for purposes of child support, the district court must then consider whether Zacher's interest in [the corporation] is a resource that should be taken into consideration in determining his ability to pay child support.

Hubbard County, 742 N.W.2d at 228.

The foreign cases cited by the Hubbard County Court and relied upon by Mother naturally deal with the application of the child support statutes in those states. All of these cases deal with situations where the S-Corporation retained earnings and distributions were made to offset the taxes paid by the shareholders.

In Brand, the Kansas Supreme Court applied the Kansas Child Support Guidelines. In re Marriage of Brand, 44 P.3d 321, 326 (Kan. 2002). These guidelines allow consideration of “historical information,” such as whether the income was available during the marriage, and also indicate that corporate income must be “received” in order to be considered as parental income. Id. at 327-28. The Kansas guidelines also factor in the effect of taxes after first establishing the parties’ gross income. In re Marriage of Unruh, 88 P.3d 1241, 1246 (Kan. Ct. App. 2004). Because the statutory scheme was flexible, the Brand court found that the court below did not abuse its discretion when it held that retained corporate income and related tax distributions were not “received” by the parent for purposes of calculating child support. Brand, 44 P.3d at 330. However, distributions used to pay income tax on money actually distributed to the shareholder by an S-corporation is properly included in gross income under Kansas law. In re Marriage of Matthews, 193 P.3d 466, 471 (Kan. Ct. App. 2008).

The Superior Court of Pennsylvania held that it was error for a trial court to consider S-Corporation retained earnings when establishing child support obligations. Fennell v. Fennell, 753 A.2d 866, 869 (Pa. Super. Ct. 2000). This holding was in accord with Pennsylvania law, where support obligations are set based on “the actual disposable

income of the parties” and the net income considered “must reflect actual available financial resources.” Id. at 868 (citation omitted). This is markedly different than Minnesota, where the parents’ gross rather than net income is used to calculate support.

The McHugh case cited by Mother is a Florida case not relied upon by Hubbard County. The McHugh court also dealt with earnings retained by an S-Corporation, and the related tax distributions to the shareholder. McHugh v. McHugh, 702 So.2d 639, 640-41 (Fla. Dist. Ct. App. 1997). The McHugh court specifically noted that if the earnings had been distributed to the shareholders, it would have been considered income. Id. at 641.

Indiana law, like Kansas law, also allows for consideration of whether S-Corporation retained earnings were available to the parents during the course of the marriage. Tebbe v. Tebbe, 815 N.E.2d 180, 183-84 (Ind. Ct. App. 2004). Because the S-Corporation retained earnings and tax distributions would not have improved the children’s standard of living had the marriage remained intact, the Tebbe court held that these funds were properly excluded from consideration in calculating child support. Id. at 184. Again, the consideration of marital disposable income and standard of living is in contrast to Minnesota’s consideration of the post-dissolution “gross income” of both parents.

Other state courts have included tax distributions as shareholder income for calculating child support - even if the tax distributions reflect income which was retained by the S-Corporation. Nebraska courts have held that tax distributions used to offset

retained earnings were properly included as income because they were “actually received” by the shareholder. Coffey v. Coffey, 661 N.W.2d 327, 348 (Neb. Ct. App. 2003). South Dakota courts also include the tax liability of S-Corporations as income to the parent shareholder, even when the tax distribution was never received by the shareholder but instead paid by the corporation and added to the shareholder’s accounts receivable. Nace v. Nace, 754 N.W.2d 820, 824 (S.D. 2008).

An Arkansas father who was a minority shareholder in a family S-Corporation argued that the retained earnings and income taxes paid on those earnings should not be included in calculating his child support obligations under the Arkansas Family Support Chart. Anderson v. Anderson, 963 S.W.2d 604, 606-07 (Ark. Ct. App. 1998). The Arkansas Court of Appeals affirmed the chancery court below, which found that “it would be inequitable to give [the father] credit for income taxes paid on those retained earnings” since he did benefit from them by having his corporate equity increased - a benefit not shared by the mother and which not decrease the father’s income for child support purposes. Id. at 608. The Anderson court held that to exclude the father’s income taxes paid on his corporate earnings would inappropriately allow the father to favor his own long-term financial interest at the expense of his children. Id. at 609.

Finally, Missouri courts have held that the entire amount of income retained by a family-owned S-Corporation should be included as income for purposes of calculating child support. Kiem v. Kiem, 945 S.W.2d 603, 605 (Mo. Ct. App. 1997).

In looking to other states, the Hubbard County Court considered only the narrow issue of whether undistributed earnings of an S-Corporation should be considered when calculating child support obligations. 742 N.W.2d at 227. It did not blindly follow the law of foreign jurisdictions, but instead analyzed the logic in light of Minnesota precedent. Id. at 228 (rejecting Kansas and Pennsylvania law placing burden of proof on child support obligee instead of on minority shareholder). And the Hubbard Court recognized that the district court had the discretion to craft a child support order based on all the resources of the parents, including undistributed corporate income. Id.

Because Hubbard County and the cases cited by Mother did not address the issue of distributed corporate income, and because all the cited cases recognized the district court's ultimate discretion to fashion a remedy, the district court's order including tax distributions as part of Mother's gross income should be affirmed.

3. Minnesota law regarding child support does not provide for S-Corporation income to be treated the same as C-Corporation income.

Mother boldly asserts that since C-Corporations pay their own taxes, tax distributions should be deducted from the gross income of S-Corporation shareholders for purposes of calculating child support obligations under Minnesota law. (Appellant's Brief at 18-22.) This issue was not raised before the district court. (See Petitioner's Memorandum of Law (submitted under seal to the district court, January 20, 2011). This Court will not ordinarily hear an issue which was not presented to the district court. Roby v. State, 547 N.W.2d 354, 357 (Minn. 1996). For this reason alone, Mother's argument

regarding the effect of different corporate forms on the calculation of gross income for child support should be rejected.

In addition, there is no Minnesota precedent for the assertion that corporate tax structures should be taken into account when calculating gross income under Minn. Stat. § 518A.29 and § 518A.30. The clear language of the statutes does not provide for this manipulation of gross income, and the cases cited by Appellant do not support her argument - rather, they deal with the effect of equipment depreciation on a self-employed farmer's net income.³ See Reuter v. Reuter, 2008 WL 2102598 (Minn. Ct. App. 2008) (APP 30); Stevens County Soc. Servs. Dept. ex rel. Banken v. Banken, 403 N.W.2d 693 (Minn. Ct. App. 1987).

Quite simply, what Mother suggests is to carve out an exception from the statutory definition of "gross income" for S-Corporation shareholder parents. The new child support guidelines, however, use both parents' gross income specifically to make child support calculations more simple, not more complex. (APP 33) ("A fourth goal of the new guideline is to simplify the calculation of child support. This is accomplished in several ways, including: (a) Calculating support based upon gross income rather than net income."). The creation of a new exception would run afoul of this legislative goal and the language of the statutes.

³ Depreciation is specifically mentioned as a potential deduction from business income in the statutory scheme, but must be proven by the party seeking the deduction. Minn. Stat. § 518A.30. Because it is an issue of fact, the district court still has great discretion whether or not to allow the deduction. See Hubbard County, 742 N.W.2d at 228.

The new child support statutes provide that “ordinary and necessary expenses required for self-employment or business operation” may be deducted, and allow for some consideration of IRS business tax deductions. Minn. Stat. § 518A.30. But consideration of corporate tax liability obligations on the gross income of the parents is not included. The corporate form adopted by a company has consequences for its shareholders, and the decision of Dura-Supreme to be an S-Corporation rather than some other tax structure places its shareholder distributions squarely within “gross income.” While this may have disadvantageous effects on a shareholder parent’s gross income for purposes of child support, the statute contains no provisions for consideration of “available” or “discretionary” income. Mother’s argument to the contrary should be rejected.

C. The Money Transferred to TK Investments Was a Distribution and Not Retained Earnings.

The district court has considerable discretion when calculating “gross income” for purposes of child support calculations. See Ludwigson v. Ludwigson, 642 N.W.2d 441 (Minn. Ct. App. 2002) (judicial discretion not abused “by interpreting income as taxable income, which is a reasonable income concept”). Like its predecessor, the current statutory scheme contains a very broad, non-exclusive definition of income: “gross income includes any form of periodic payment to an individual.”⁴ Minn. Stat. § 518A.29

⁴ This is the exclusive definition used for purposes of calculating child support. Minn. Stat. § 518A.26, subd. 8 (“‘Gross income’ means the gross income of the parent calculated under section 518A.29.”) This definition comports with the tax definition of “gross income,” which adopts the federal definition of “all income from whatever source derived.” Minn. Stat. § 290.01, subd. 20; 26 U.S.C. § 61(a).

(Calculation of Gross Income); see also Hubbard County, 742 N.W.2d at 227 (noting that any periodic payment is income).

This statutory breadth allows the district court considerable latitude to consider other sources as well. For example, the value of the use of an employer's truck could properly be considered an in-kind payment to be considered in establishing a child support obligation. County of Nicollet v. Haakenson, 497 N.W.2d 611, 614-15 (Minn. Ct. App. 1993); Minn. Stat. § 518A.29(c) (allowing consideration of reimbursements or in-kind payments). The purpose of the new statutory scheme was primarily to make a system that would be perceived as fair, with the expectation that calculations would be simplified, compliance improved, and courts given greater flexibility in determining child support obligations. (APP 33.)

Mother argues that her S-Corporation distributions should be excluded from this broad definition because, like the retained earnings in Hubbard County, there were legitimate business reasons for the distributions and she was not trying to shirk her financial responsibilities. (Appellant's Brief at 22.) As an initial matter, Hubbard County does not apply to Mother's circumstances because it examined the predecessor statute, which focused on *net* income of the obligor. 742 N.W.2d at 226-27 (child support calculated using the obligor's "net monthly income" pursuant to Minn. Stat. § 518.551, subd. 5(b) (2004)). Nothing in the opinion suggests that the Hubbard County Court would have come to the same conclusion under the current statute which examines gross income.

And Mother's argument has another fatal flaw: there is no question that the monies invested in TK Investments were actually *distributed* to her. (CA 03) ("I received. . . distributions from Dura-Supreme"); (CA 09) ("excess' cash reserves were distributed to the shareholders"); (CA 14) (discussing annual corporate distributions to Mother). Whether or not there was a legitimate business purpose for the distributions or for her investment in TK Investments is irrelevant. The Hubbard County considerations apply only to earnings *retained* by an S-Corporation:

We conclude that the primary question that a district court must resolve in deciding whether the undistributed earnings of a Subchapter S corporation are [net] income to a minority shareholder who is a child-support obligor is whether the corporation *retained the earnings* for a business reason or *retained them* to enable the obligor to "shield income" or "manipulate" the amount of money he receives in order to reduce or avoid his child-support obligation.

Hubbard County, 742 N.W.2d at 227 (emphasis added).

Recognizing that this is a not a question of law but rather one of fact, the Hubbard County Court remanded the matter to the district court for determination. Id. at 228. Even an answer to the question posed would not be determinative, since the district court retained discretion to determine an obligor's ability to pay based on all resources. Id.

Mother would have the district court be guided by the intended business purpose of the distribution in determining whether to treat the earnings as "retained" by Dura-Supreme. But the district court was within its discretion to find that Mother had some choice in the distribution of excess corporate earnings, and its decision is well-supported by the record. While not a controlling shareholder, her consent to the business plan was required and she agreed to the scheme. (CA 03; CA 12.) Under the Member Control

Agreement, Mother had no obligation to continue to invest distributions in TK Investments. (R.C.A. 02.) Her agreement to use the distributions for the specific purpose of building outside cash reserves available to Dura-Supreme is irrelevant. And there is no authority for excluding these distributions from Mother's gross income.

To exclude "designated distributed earnings" from S-Corporations would create a scenario ripe for abuse. The concerns articulated by the Arkansas Court of Appeals in Anderson apply here as well:

A subchapter S corporation shareholder, such as appellant, would have an incentive to keep most or all of his shareholder income as [designated distributed] earnings by the corporation. The greater the percentage of [her] income that the shareholder has [designated]. . . the lesser will be [her] income available to pay child support. . . . It is wholly inconsistent with the purpose of the [child support guideline] to interpret it in such a way as to encourage child-support payors to minimize their child-support income.

Anderson, 963 S.W.2d at 609. While the district court found that Mother was not trying to shirk her financial obligations to her children, an interpretation of the child support statutes which allows "designated distributed earnings" to be excluded from gross income could be applied in other cases and erode the clear language and purpose of the statutes.

Finally, the district court was well within its discretion to apportion 90% of the child support expenses to Mother, who admits that her gross annual income is in excess of \$300,000. (Appellant's Brief at 29.) Two important considerations in setting a child support obligation are the party's ability to pay, and the ability of the district court to be flexible within the new guidelines. Hubbard County, 742 N.W.2d at 228 (APP 33) ("The final goal of the new guideline is to provide greater flexibility in setting child support

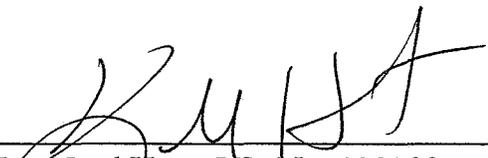
orders.”). The district court was within its discretion to find that Mother is able to pay for the support of her children with or without her corporate earnings invested in TK Investments.

CONCLUSION

For the reasons articulated above, Respondent Douglas Alan Haefele asks that the trial court’s Order be affirmed in its entirety.

LOMMEN, ABDO, COLE, KING & STAGEBERG, P.A.

Dated: December 28, 2011

BY 

Kay Nord Hunt, I.D. No. 138289
Diane M. Odeen, I.D. No. 284142
2000 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
(612) 339-8131

MESSERLI & KRAMER, P.A.
Vija L. Brookshire (I.D. No. 293271)
1400 Fifth Street Towers
150 South Fifth Street
Minneapolis, MN 55402
(612) 672-3733

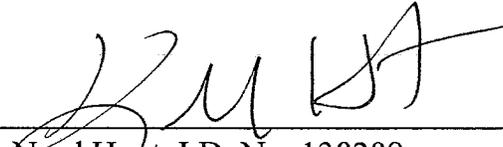
Attorneys for Respondent Douglas Alan Haefele

CERTIFICATION OF BRIEF LENGTH

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subds. 1 and 3, for a brief produced with a proportional font. The length of this brief is 5,986 words. This brief was prepared using Word Perfect 10.

LOMMEN, ABDO, COLE, KING & STAGEBERG, P.A.

Dated: December 28, 2011

BY 

Kay Nord Hunt, I.D. No. 138289
Diane M. Odeen, I.D. No. 284142
2000 IDS Center
80 South Eighth Street
Minneapolis, MN 55402
(612) 339-8131

MESSERLI & KRAMER, P.A.
Vija L. Brookshire (I.D. No. 293271)
1400 Fifth Street Towers
150 South Fifth Street
Minneapolis, MN 55402
(612) 672-3733

Attorneys for Respondent Douglas Alan Haefele