DETERMINING THE GROSS INCOME AVAILABLE FOR CHILD SUPPORT

By Franklin R. Garfield

In *Hein v. Hein*, _____ DJDAR ___ (July 21, 2020), the Court of Appeal for the Fifth Appellate District clarified two principles of California family law. The first is intuitive and unexceptional: Paper losses do not reduce the amount of income available for child support. The second topples a line of cases that had been widely interpreted to stand for the proposition that a party's gross income pursuant to federal and state tax returns is presumptively correct.

In disallowing deductions for depreciation, the Court noted that Section 4058 of the *California Family Code* defines a parent's "annual gross income" to mean income from whatever source derived (with limited exceptions). The income generated by a party's ownership of a business is included pursuant to Section 4058(a)(2) which provides: "Income from the proprietorship of a business, such as gross receipts from the business reduced by expenditures required for the operation of the business."

On appeal, citing *Asfaw v. Woldberhan* (2007) 147 Cal.App.4th 1407, Jessica Hein contended that deprecation deductions do not constitute "expenditures required for the operation of the business." In *Asfaw*, the Second District Court of Appeal considered the statutory text and concluded that depreciation of rental property may not deducted from annual gross income when calculating child support. More than a decade later, the Fifth District Court of Appeal followed *Asfaw* with respect to the depreciation of motor vehicles in *Marriage of Rodriguez* (2018) 23 Cal.App.5th 625. The *Rodriguez* court noted that there was no material difference between deprecation attributable to rental property and motor vehicles; observed that depreciation did not actually reduce a party's income; and suggested that the claimed deduction for depreciation could not only be ignored, but could be added back to the income available for child support. The court concluded that under the current state of California law, depreciation deductions do not reduce a party's income available for child support. The Court also extended its holding to include expenses under Internal Revenue Code section 179, which authorizes a taxpayer to elect to treat the cost of acquiring certain business assets as a current deduction rather than to depreciate those asset over their useful lives.

The bulk of the *Hein* opinion is devoted to the issue of whether the amount of income set forth on a party's tax returns is presumptively correct. The court reviewed a series of cases starting with *Marriage of Loh* (2001) 93 Cal.App.4th 325 that supposedly stand for the proposition that "a parent's gross income, as stated under penalty of perjury on recent tax returns, should be presumptively correct." The trial judge applied that presumption; acknowledged that the presumption could be overcome by evidence sufficient to demonstrate that the tax return is incorrect; and ruled that the party challenging the tax return bears the burden of proof. The Court of Appeal reversed on all three counts.

To begin with, the appellate court distinguished *Loh* and a succession of subsequent cases that appeared to validate the proposition that a party's tax returns were presumptively correct by pointing out that none of them held that "the income tax returns of a self-employed parent's multiple wholly owned entities are presumed correct." After concluding that there was no presumption of correctness under the circumstances of this case, the court moved on to which party has the burden of proof.

The court began with section 500 of the *California Evidence Code* which states that the burden of proof as to a particular fact is normally on the party to whose case the fact is essential. If the general rule applied, Jessica would have the burden of proof because it was raised by her request for modification of child support. The court next focused on the procedure for deciding whether to alter the normal allocation of the burden of proof.

The court identified four factors to be considered.

The first factor is the knowledge of the parties concerning the particular fact. In this case, the knowledge factor weighed in favor of allocating the burden of proof to Martin Hein because he and the persons he employs manage the business. They indisputably have more knowledge about the income and expenses of the businesses than Jessica, who is wholly uninvolved.

The second factor is the availability of the evidence to the parties. That factor also militated in favor of allocating the burden of proof to Martin because, as the sole shareholder and president of both corporations, he had control over the financial records of the businesses.

The third factor concerns public policy. Given the legislature's determination that the "the interests of the children "[i]s the state's top priority," public policy also militated the favor in allocating the burden of proof on the question of his business income and expenses to Martin.

The court dismissed the fourth factor – the probability of the existence or nonexistence of the fact – as neutral.

On balance, the weight of the relevant factors justified shifting the burden of proof to Martin. The court concluded that no presumption of correctness applied to Martin's individual tax returns and the corporate tax returns of the companies he owned and operated and that Martin had the burden of proving the amount of the gross receipts of the businesses and the amount of the expenditures required for the operation of those businesses.

The court expressly extended its ruling beyond the propriety of deducting deprecation and section 179 expenses from gross income. Noting that Martin's gross income includes "[i]n the discretion of the court, employee benefits or self-employment benefits, taking into consideration the benefits to the employee, any corresponding reduction in living expenses, and other relevant factors" per section 4805(a)(3), the court stated: "It is improper to exercise this discretionary authority by referring to a presumption that tax returns are correct. In other words, the fact the amounts paid by the corporation to provide a particular benefit [were] properly reported as a deduction on the tax returns is not a 'relevant factor' to that benefit's impact on the recipient's income."

Hein is the first appellate case to expressly disapprove the presumption that income tax returns are correct with respect to a taxpayer's gross income along with the corollary that the other party has the burden of overcoming that presumption. To the contrary, when the amount of child support payable by a self-employed individual is the issue, there is no such presumption, and that individual has the burden of proving that all deductions from his or her gross income are expenditures required for the operation of the business.

The opinion in *Hein* also illustrates the disconnect that sometimes exists between theory and practice. The notion that tax returns are presumptively correct has never been accepted as a practical matter. Divorce lawyers and the forensic accountants they employ are aware that self-employed individuals and individuals employed by companies they control usually benefit from multiple perquisites (i.e., personal expenses masquerading as business expenses). Whether or not those perquisites may legitimately be deducted from gross income for tax purposes, they are routinely added back to the taxpayer's gross income, often as nontaxable income, to determine the amount of child support. The opinion in *Hein* is a step in the direction of harmonizing appellate law with the practice on the ground.

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