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STATE OF MINNESOTA
IN COURT OF APPEALS
A08-2172

Hubbard County Health & Human Services, petitioner,
Respondent,
Beth A. Hadrava, petitioner,
Respondent,

vs.

Shane L. Zacher,
Appellant.

Filed October 20, 2009
Affirmed in part, reversed in part, and remanded
Stoneburner, Judge

Hubbard County District Court
File No. 29FX06000159

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Considered and decided by Wright, Presiding Judge; Kalitowski, Judge; and Stoneburner, Judge.

U N P U B L I S H E D O P I N I O N

STONEBURNER, Judge

Appellant father challenges the determination of his child-support obligation, arguing that the child support magistrate (CSM) erred by (1) failing to deduct taxes when calculating his net income; (2) including loans from his parents as income; and (3) failing to apply the new child-support law to his post-2006 support obligation. Respondent mother, by notice of review, challenges the CSM's failure to (1) include undistributed Subchapter-S corporation earnings in father's income; (2) include in-kind income in calculating father's income; and (3) allocate child-care expenses. We affirm in part, reverse in part, and remand.

FACTS

I. Pre-remand proceedings

Appellant Shane L. Zacher (father) was never married to respondent Beth A. Hadrava (mother) but they have three children, who were born in 2002, 2004, and 2006. In November 2005, respondent Hubbard County Health and Human Services (county) and mother brought an action to establish paternity and child support for the two older children. Father admitted paternity and, in February 2006, based on the parties' agreement, was ordered to pay child support in the amount of $560 per month, beginning December 1, 2005, and past child support of $10,323.79 for December 1, 2003, through November 30, 2005. Allocation of child-care expenses was reserved, and a review hearing was scheduled for after the anticipated birth of the third child. For reasons not

explained in the record, this hearing occurred approximately two years after the third child was born.

Evidence at that hearing established that father has been employed by Next Innovations, Ltd. (NIL) since 2002. NIL was a Subchapter-C corporation when it was purchased by father's father (grandfather). NIL became a Subchapter-S corporation in January 2005. In March 2005, father became a 15% shareholder. Grandfather owns a 65% interest in NIL, and the remaining 20% is owned by father's brother. Father earns wages from NIL, reflected on W-2 forms and income tax returns. In addition, NIL's earnings are reported on each owner's individual tax return in proportion to the ownership interest of each.

Father's tax returns show that in 2005, his share of NIL earnings was $53,098. But grandfather's accountant testified that none of NIL's 2005 earnings were actually distributed to the owners. A distribution to reimburse each shareholder for the taxes paid on *corporate earnings* was anticipated at the time of the hearing and occurred after the hearing.

The CSM concluded that NIL's undistributed earnings constituted income for the purpose of determining father's net monthly income, resulting in a guidelines child-support obligation of $1,400 per month from January 1, 2005, through March 31, 2006, for two children and ongoing support of $1,575 per month beginning April 1, 2006, for three children. Allocation of child-care expenses was again reserved because mother was not employed outside of the home and was not incurring child-care expenses.

Father appealed, challenging the inclusion of undistributed Subchapter-S corporation earnings in the calculation of his net income. In December 2007, this court held that undistributed earnings of a Subchapter-S corporation that have been retained for a business reason are *not* income to a minority shareholder for the purpose of establishing a child-support obligation, and remanded to the CSM for a determination of the factual issue of whether NIL's earnings had been retained for a business reason. Father had the burden of proof on remand to establish that NIL's earnings were retained for a business reason. *Hubbard County Health & Human Servs. v. Zacher*, 742 N.W.2d 223, 225 (Minn. App. 2007).

II. Hearing on remand

On remand, the CSM conducted an evidentiary hearing to determine whether NIL's earnings were retained for a business reason and to address other issues raised by the parties as necessary to establishing father's child-support obligation, including (1) whether loans to father from his parents and rent-free housing are income for child-support purposes; (2) allocation of child-care expenses; and (3) whether Minn. Stat. § 518.551, subd. 5(b) (2004) (old law) or Chapter 518A (new law), which applies to child-support filings made after January 1, 2007, applies to determine father's 2007 and ongoing support obligation.

A. Reason for retention of NIL's earnings

Grandfather testified that he has sole authority to determine how much of NIL's earnings to retain or distribute. Grandfather owns several businesses and frequently reinvests earnings from a business into that business in order to keep it financially sound.

Grandfather testified that his decision on whether to retain or distribute NIL's earnings is based on the overall viability and functioning of NIL. Grandfather testified that NIL owes him more than one million dollars, and distribution is limited by agreements with a bank that require NIL to maintain a certain amount of net worth to keep loans from being called due, which would put NIL out of business.

Father's W-2s reflect his wages from NIL, and his state and federal income tax returns reflect tax liability for wages as well as for NIL income attributed to him. NIL's accountant testified that NIL distributes to each owner an amount estimated to be sufficient to reimburse that owner for the tax liability on NIL's income attributed to him. At times, NIL overestimated the amount necessary to meet tax obligations created by NIL distributions, but any overpayments were applied to the next year's taxes. In 2006, such an overpayment to father was applied not only to the next year's tax obligation but also to pay off a loan that NIL had made to father. NIL income was not distributed to cover taxes owed by owners on wages.

B. Loans to father from his parents

Testimony at the hearing established that father has received several undocumented, interest-free loans from his parents as well as substantial gifts for Christmas and his wedding. Father has no specific plan for repaying the loans, but both father and grandfather testified that father is expected to repay the loans. The evidence shows that grandfather and his wife provided $54,199.50 in loans to father at irregular intervals in the one-and-a half to two years prior to the hearing.

C. Father's rent-free housing

At the time of the hearing on remand, father and his wife were living rent-free in a home valued at more than $450,000 and owned by one of grandfather's companies. The home was for sale, and father and his wife lived in the house to make it more marketable and to look after the property. Father and grandfather characterized the arrangement as "house sitting." Grandfather testified that the fair-rental value of the property was $800 per month.

D. Child-care expenses

Mother requested allocation of child-care costs. She testified that the children now attend daycare, the cost of which fluctuates from month to month, but is "in the neighborhood of $600 per month."

E. Applicable statute

The CSM asked the parties to address, in post-hearing written arguments, the issue of which law applies to the determination of father's child-support obligation. Mother argued that because the litigation began when the old law applied, all calculations should be under the old law, unless father shows grounds for modification under the new law, in which case, the new law should apply to calculations beginning in 2007. Father agreed that the old law applies to child-support calculations for 2005 and 2006. But father argued that he had shown grounds for modification under the new law, including (1) mother's recent employment; (2) that work-related daycare expenses now exist; and (3) that father experienced changes in gross income in 2007 and 2008. Father argued that

these changes constitute substantial changes that meet the criteria for modification under the new law.

III. Post-remand order

By order issued in June 2008, the CSM held that NIL's undistributed income was retained for legitimate business purposes and should not be included in the calculation of father's income for the purposes of establishing his child-support obligation. But the CSM held that loans received by father from his parents should be included in father's income. The CSM did not address mother's request to attribute the value of rent to father's income.

In calculating father's net monthly income, the CSM disallowed a deduction for state and federal income taxes paid on father's NIL wages. Without specifically addressing which law applies to the determination of father's child-support obligation or why, the CSM calculated father's past and ongoing child-support obligations under the old law and concluded that the obligation was $987 per month from January 1, 2005, through March 31, 2006, and $1,362 per month effective April 1, 2006. The CSM failed to address the issue of allocation of child-care expenses.

Both parties sought review of the order. Father argued that (1) loans from his parents should not have been included in his income; (2) deductions for state and federal income taxes paid on wages should have been allowed; and (3) the CSM erred by failing to address which law applies and failing to apply the new law to determination of his 2007 and ongoing child-support obligation. Mother argued that (1) father failed to meet his burden that NIL income was retained for legitimate business purposes such that NIL's

earnings should have been included in his income; (2) the value of father's free rent should have been included as income; (3) the CSM should have addressed the issue of which law applies; and (4) child-care expenses should have been allocated. The CSM denied both motions for review. This appeal by father and notice of review by mother followed, asserting the issues raised in their post-hearing motions.

D E C I S I O N

On appeal from a CSM's order, this court uses the same standard to review issues as would be applied if the order had been issued by a district court. *Brazinsky v. Brazinsky*, 610 N.W.2d 707, 710 (Minn. App. 2000). "The district court's determination of net income must be based in fact and it will not be overturned unless it is clearly erroneous." *Schisel v. Schisel*, 762 N.W.2d 265, 272 (Minn. App. 2009). This court will reverse a district court's order regarding child support "only if we are convinced that the court abused its broad discretion." *Gully v. Gully*, 599 N.W.2d 814, 820 (Minn. 1999). A district court abuses its discretion when it establishes a child-support obligation in a manner that is against logic and the facts in the record or when it misapplies the law. *Rutten v. Rutten*, 347 N.W.2d 47, 50 (Minn. 1984).

Whether a source of funds is considered to be income for child-support purposes is a legal question reviewed de novo. *Sherburne County Soc. Servs. ex rel. Schafer v. Riedle*, 481 N.W.2d 111, 112 (Minn. App. 1992). But whether distributions from Subchapter-S corporations should be treated as income for child-support purposes is generally treated as a question of fact. *Williams v. Williams*, 635 N.W.2d 99, 103 (Minn. App. 2001).

I. The record supports the finding that NIL retained earnings for legitimate business purposes.

Mother argues that father failed to meet his burden of proving that NIL retained earnings for a legitimate business purpose. Alternatively, mother argues that even if there was a legitimate business purpose for NIL to retain earnings, the district court failed to follow this court's direction on remand to consider whether father's interest in NIL should be considered a resource for child-support purposes. *See Zacher*, 742 N.W.2d at 228 (remanding for a determination of whether NIL's undistributed earnings are income to father or a resource for the purpose of child support).

The record contains the testimony of the controlling owner of NIL (grandfather) and NIL's accountant explaining the reasons for retention of NIL's income and explaining why father's wages declined from $56,439.17 in 2004 to $31,030 in 2005 and $27,265 in 2006, while NIL income attributable to him increased from zero in 2004 to $53,098 in 2005 and $129,071 in 2006.

Grandfather testified that, in 2004, NIL was a Subchapter-C corporation and that father had no ownership interest. Due to unexpectedly good earnings that year, to avoid corporate taxes, NIL's income was distributed, resulting in father receiving a bonus. Avoidance of corporate taxes led to the subsequent restructuring of NIL as a Subchapter-S corporation.

Grandfather testified that a new product distributed in 2004 caused NIL sales to "[take] off tremendously." He testified that the corporation was quite profitable until 2007 but in 2005 the profit was used to pay down some credit lines, and the only

distributions received by father in 2005 and 2006 were amounts sufficient to pay taxes on the corporate income attributed to him.

Grandfather testified that a certain amount of earnings have to be retained due to agreements with the bank that provides financing for NIL. Because this evidence supports the CSM's finding that NIL's retention of earnings was for legitimate business purposes, the finding is not clearly erroneous, even though some evidence in the record could support an inference that father's income was manipulated. *See Stiff v. Assoc. Sewing Supply Co.*, 436 N.W.2d 777, 779–80 (Minn. 1989) (stating that "[a]lthough the record also contains testimony which, if believed, would support different findings of fact more favorable to the respondent, when the record contains credible evidence to support the fact findings and those findings support the [district] court's conclusion," an appellate court may not reverse).

Mother argues that father's interest in NIL is a resource that should be considered for child support because father earns commissions. But commissions are included in father's W-2 income that was considered by the CSM. And there is no evidence to support mother's assertion that father's ability to receive interest-free loans from his parents results solely from father's interest in NIL. Mother has not identified any interest father has in NIL that was not considered by the CSM.

II. The CSM erred by failing to deduct state and federal income taxes father paid on W-2 income for purposes of calculating father's net income.

Under the old law used by the CSM to determine father's net monthly income for child-support purposes, "net income" is defined as total monthly income less, among

other things, federal and state income tax. *Id*. The CSM specifically disallowed a deduction for father's state and federal income taxes on his W-2 wages. The disallowance appears to stem from the CSM's finding that "[u]nder the usual course of the business operations of [NIL], the corporation pays the state and federal income tax liabilities of [father]." But the evidence in the record supports a finding that NIL pays the tax liability for income attributed to father for distributions from NIL. There is no evidence in the record that NIL provides additional funds for father's tax liability for W-2 wages. The CSM's finding that NIL pays these taxes is clearly erroneous. The CSM erred by failing to deduct taxes on father's wages as mandated by the law. We reverse the calculation of father's net monthly income and remand for recalculation that appropriately deducts state and federal income taxes paid by father in 2005 and 2006. *See infra* at V.

III. The record does not support the finding that loans from father's parents are income.

The CSM found that grandfather "regularly" loaned money to father to help father meet his daily living expenses and pay attorney fees. Despite evidence in the record that the loans had been made in the 24 months prior to the hearing, the CSM "assumed" that the loans were made over a period of five years while father was employed by NIL and found that the loans averaged $903 per month and should be included in father's net monthly income.

Both the old and new laws provide that income for child-support purposes includes "any form of periodic payment to an individual." Minn. Stat. § 518.54, subd. 6

(2004); Minn. Stat. § 518A.29(a) (2008). We have held that "a gift [that] is regularly received from a dependable source . . . may properly be used to determine the amount of a child support obligation." *Barnier v. Wells*, 476 N.W.2d 795, 797 (Minn. App. 1991).[1]

Although mother argues that the loans were actually gifts, both father and grandfather testified that the amounts received were loans that are to be repaid. The record, therefore, does not support a finding that the amounts were gifts to father. And the CSM characterized the funds as loans, not gifts. There is no authority for treating a loan as income for child-support purposes.

Additionally, grandfather testified that the loans were made over the course of one-and-a-half to two years prior to the hearing. Loan dates were only provided for $24,100 of the amount loaned, showing that father received loans of different amounts at irregular intervals of two months, four-and-a-half months, three months, and four months. The record does not support the finding that the loans were made "regularly" and does not support averaging the total amount over a five-year period. Neither the character nor the timing of the funds received by father from his parents supports including those amounts in his income for child-support purposes. We therefore reverse the inclusion of these amounts in the calculation of father's income.

IV. The value of rent father receives for house sitting is income.

The CSM did not address the issue of whether the $800 rent benefit father receives for house sitting property owned by one of grandfather's businesses is income to father.

[1] In *Barnier*, the obligor received *gifts* in the same amount at the same time each year: $833 monthly from his father and $5,000 annually from his grandmother on his birthday, Easter, and Christmas. 476 N.W.2d at 796.

Mother, who, on appeal, argues that the old law applies, nonetheless relies on the new law to argue that the value of rent father receives for house sitting should be considered income.

Minn. Stat. § 518A.29(c) (2008), provides that "[e]xpense reimbursements or in-kind payments received by a parent in the course of employment, self-employment, or operation of a business shall be counted as income if they reduce personal living expenses." Father, also relying solely on the new law, argues that because the record does not show that housing is provided in the course of his employment with NIL, the district court correctly excluded the value of rent from father's income. We disagree. And we note that, under the old law, in-kind income was also included as income for child-support purposes. Minn. Stat. § 518.551, subd. 5(b)(1)(2006) (providing that income for child-support purposes "does include in-kind payments received by the obligor in the course of employment, self-employment, or operation of a business if the payments reduce the obligor's living expenses").

Father performs a service, house sitting, in exchange for housing. The fact that the service is performed for a corporation other than his primary employer is irrelevant. Father receives free rent in exchange for keeping up a property and making it more marketable by giving it a "lived-in" look, and father's personal living expenses are reduced by the value of the benefit. Father "earns" the rent he would otherwise pay by keeping up the property and giving it a "lived-in" appearance that benefits marketing of the property. Father also has control over the benefit, choosing to meet the owner's expectations that earn him this benefit. Plainly, this is the type of in-kind income that

both laws define as income for child-support purposes. On remand, the CSM shall consider father's rent benefit in the calculation of his income for child support.

V. Under the circumstances of this case, judicial economy mandates that, on remand, the new law be applied to determine father's post-2006 child-support obligation.

As requested by the CSM, both parties briefed the issue of which child-support guidelines should apply. The CSM did not provide any analysis or direct ruling on this issue but applied the old law, thereby implicitly holding that the new law does not apply to this matter.

The parties agree that the old law applies to the calculation of father's 2005 and 2006 child-support obligation. In briefing to the district court, mother stated that for calculation of 2007 and ongoing support, the old law should apply "unless [father] can demonstrate the existence of one of the special grounds for modification of existing orders [as set forth in the new law]," citing Minn. Stat. § 518A.39, subd. 2(j) (2006) (expired January 1, 2008) and Minn. Stat. § 518A.39, subd. 2(a) (2008). Section 518A.39, subd. 2(j) (2006) provided in relevant part:

> There may be no modification of an existing child support order during the first year following January 1, 2007, except as follows:
> (1) there is at least a 20 percent change in the gross income of the obligor; [or] . . .
> (4) there are additional work-related or education-related child-care expenses of the obligee . . . .[2]

Minn. Stat. § 518A.39, subd. 2(a) (2008) provides in relevant part:

[2] But modification under clause (4) could only be granted with respect to child-care support. Minn. Stat. § 518A.39, subd. 2 (j) (2006).

> The terms of an order respecting . . . support may be modified upon a showing of one or more of the following, any of which makes the terms unreasonable and unfair: (1) substantially increased or decreased gross income of an obligor or obligee; [or] . . . (7) the addition of work-related . . . child care expenses of the obligee . . . .

Minn. Stat. § 518A.39, subd. 2(b) (2008), provides in relevant part:

> It is presumed that there has been a substantial change in circumstances under paragraph (a) and the terms of a current support order shall be rebuttably presumed to be unreasonable and unfair if:
> (1) the application of the child support guidelines in section 518A.35 to the current circumstances of the parties results in a calculated court order that is at least 20 percent and at least $75 per month higher or lower than the current support order . . . .

Father produced evidence of changed circumstances including those that meet the requirements of both statutes and showed the calculation of support under section 518A.35 that trigger the presumption of substantial change in circumstance and unfairness. Father argued to the district court that these changes and calculations warranted application of the new law to calculation of child support beginning in 2007.

On appeal, mother argues that the old law applies because (1) the litigation began in 2005; (2) the 2006 decision was remanded to the district court for a limited purpose of examining whether undistributed Subchapter-S earnings were income to father; and (3) no motion for modification has been filed after January 1, 2007. Father concedes that no formal motion for modification was filed after January 1, 2007, but points out that the applicability of the new law was brought before the CSM and was briefed and argued, and that the scope of the hearing on remand was, by agreement of all parties and the

CSM, broadened to address all issues relevant to determining father's support obligation, including which law applies.

The applicability of a statute is an issue of statutory interpretation, reviewed de novo. *Ramirez v. Ramirez*¸ 630 N.W.2d 463, 465 (Minn. App. 2001). Chapter 518A became effective August 1, 2006. *See* Minn. Stat. § 645.02 (2008) (explaining that unless otherwise specified, each law enacted by the legislature takes effect on August 1 following its final enactment). And provisions used to calculate parties' child-support obligations "apply to actions or motions filed after January 1, 2007." 2006 Minn. Laws ch. 280 § 44, at 1145. Minn. Stat. § 518A.39, subd. 1 (2008), provides that the district court can modify a child-support order "on motion of either of the parties." Because neither the action nor any formal motion involving child-support modification was made after January 1, 2007, the CSM was not required to apply the new law. But mother conceded at oral argument on appeal that father can now move for modification under the new law. These parties have now been litigating child-support issues for four years and, because we are remanding this matter for a redetermination of father's child-support obligation, in the interest of judicial economy, and based on father's showing that he would be entitled to modification under the new law, we hold that on remand the district court shall apply the new law to the calculation of father's support obligation beginning in 2007.

VI. On remand, the CSM shall allocate child-care expenses pursuant to the applicable statute.

The old law provides that "[t]he court shall review the work-related . . . child care costs paid and shall allocate the costs to each parent in proportion to each parent's net income . . . unless the allocation would be substantially unfair to either parent." Minn. Stat. § 518.551, subd. 5(b)(2)(i)(E) (2004). The new law also requires the district court to order that work-related child-care costs be divided between obligor and obligee. Minn. Stat. § 518A.40, subd. 1 (2008).

The parties do not dispute that child-care costs have been and will continue to be incurred. Father appears to argue that because the July 2006 decision was remanded for consideration of the treatment of Subchapter-S distributions, the CSM did not abuse his discretion by failing to address allocation of child-care expenses. This is inconsistent with father's position at oral argument on appeal that the CSM correctly considered all factors relevant to determination of his child-support obligation at the hearing on remand. The issue of child-care costs had been reserved when there were no child-care costs, but mother presented evidence of child-care costs at the hearing on remand and the issue was briefed and argued. Under these circumstances, we conclude that it was an abuse of discretion to fail to address child-care expenses. We direct that, on remand, the allocation of child-care expenses be made as mandated by statute.

Affirmed in part, reversed in part, and remanded.