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Retirement Benefits

When Equal Division Does Not Yield Equal Income from Retirement Benefits Earned During Marriage: Recognizing and Responding to the Effect of Federal Pre-Emption and Regulation

*By Grace Ganz Blumberg**

This article will initially discuss two provisions of federal law that compromise state marital property distribution of spousal retirement benefits. The first of these provisions, an amendment to the Uniformed Services Former Spouse Protection Act (USFSPA) contained in Section 641 of the National Defense Authorization Act for Fiscal Year 2017 [codified at 10 USC § 1408], intentionally preempts state marital property law. The second provision concerns social security derivative spousal benefits. Although enacted in 1977, it has recently received considerable attention in state divorce courts, notably in the case of *In re Marriage of Peterson* (2016) 243 Cal. App. 4th 923, 197 Cal. Rptr. 3d 588. The article will conclude by considering legislation that California might enact to mitigate unequal receipt of income from retirement benefits earned during marriage, when such inequality

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natural child. In *Orange County v. Cole*, the Court of Appeal held that the inability to establish parenthood based on Family Code section 7613 does not prevent parenthood (and financial responsibility) from being established under Family Code section 7611(d).

Judicial interpretation of the intersection of these two statutes originated in *Jason P. v. Danielle S.* (2014) 226 Cal. App. 4th 167 (discussed at 2014 CAL. FAM. LAW MONTHLY No.7, at 187], in which the Court of Appeal held that section 7613(b) should be interpreted only to preclude a sperm donor from establishing paternity based upon his biological connection to the child, and not from establishing that he is a presumed parent under Family Code section 7611(d), based upon post-birth conduct. The court explained that the premise behind the category of presumed father is that an individual who has demonstrated a commitment to the child and the child's welfare — regardless of whether he is biologically the father — is entitled to the elevated status of presumed father. Thus, a sperm donor who has established a familial relationship with the child, and has demonstrated a commitment to the child and the child's welfare, can be found to be a presumed parent even though he could not establish paternity based upon his biological connection to the child.

Keep in mind that the father in *Jason P.* wanted to attain the status of presumed father, despite being a sperm donor and nonparent under Family Code section 7613. To the contrary, Brian Cole sought to avoid any financial obligation to the child under Family Code section 7613, but his conduct gave rise to presumed parent status under Family Code section 7611, subjecting him to a child support obligation.

These cases seem to be arising with increasing frequency. The ruling and rationale in both *Jason P.* and *County of Orange v. Cole* should be bookmarked for future reference in order to provide proper guidance and advice to clients who find themselves in these legally and emotionally conflicting situations.

References: CALIFORNIA FAMILY LAW PRACTICE AND PROCEDURE, 2nd ed., § 31.05[3] (paternity of sperm donor).

SPOUSAL SUPPORT

Modification

Court Properly Imputed Business Income to Husband Who Transferred Business to Second Wife for No Consideration

In re Marriage of Berman
(No. B272324; Ct. App., 2d Dist., Div. 8. 9/27/17)
15 Cal. App. 5th 914, — Cal. Rptr. 3d —, 2017 Cal. App. LEXIS 834
By Flier, J. (Bigelow, P. J., Grimes, J., concurring)

A trial court did not err in imputing business income to a former husband for purposes of spousal support, when, upon reaching retirement age, the husband transferred the business to his second wife, for no consideration.

Facts and Procedure. Kevin and Cathy's 32-year marriage was dissolved in 2006. In 2013, the parties stipulated to an order reducing Kevin's spousal support obligation from $9,500 to $4,000 per month. In 2015, Kevin requested an order terminating further spousal support. Kevin submitted a series of declarations explaining that when he recently turned 65, he retired and transferred his business, a private investigation and security firm ("the firm"), to his current wife. Kevin stated that he was not involved with the business, which his wife ran full time. A transmutation agreement, dated June 29, 2015, indicated that the business had been transferred from Kevin to his current wife for no consideration. Kevin's 2014 income tax return, submitted by Cathy, showed that Kevin had received $50,000 in salary and $220,000 in business income from the firm.

The court found that Kevin's retirement constituted a significant change of circumstances since the previous order, because he would no longer be receiving the $50,000 salary reported on his 2014 tax return. However, the court imputed business income to Kevin from the firm, as income produced from an asset that Kevin would have continued to own had he not transferred it to his current wife for no

consideration. Finding no evidence explaining why Kevin had not received consideration for the transfer, the court inferred that the transfer was made in bad faith, to allow Kevin to claim a reduced income. The court rejected Kevin's argument that there was no evidence that the firm would continue to generate the same income without Kevin working there, stating that Kevin had the burden of proving that it would not. After considering the section 4320 factors, the trial court reduced Kevin's support obligation by $500 per month, to reflect Kevin's loss of his $50,000 salary.

Kevin filed a motion for a new trial, a motion to vacate, and a motion to reconsider. He argued that the firm's business revenue in 2014 was the result of his efforts and that the firm could not be expected to earn the same level of income if he was not working there According to Kevin, the trial court was essentially forcing him to return to work to comply with its order. The court denied the motions, finding no evidence that Kevin could not have retired and remained an owner of the business. The court stated that the most reasonable inference from the evidence was that Kevin had given up his ownership interest in order to avoid paying spousal support and that he continued the receive the business profits, through his wife's ownership. If Kevin wished to modify support in the future, he could show a decrease in business income. Kevin appealed.

Standard for Modifying Spousal Support. A party who requests modification of spousal support has the burden of establishing a material change of circumstances. In determining whether a change has been shown, the court must reconsider the Family Code section 4320 factors, including the ability to pay support. The court may consider the party's earned and unearned income, as well as assets, in determining a party's ability to pay support. If the supporting party has reduced his or her income to avoid a support obligation, the court may hold the supporting party to his or her existing support obligations. Similarly, the appeals court explained, if the supporting party has structured the ownership of his or her assets to avoid a support obligation, the court may look past the apparent form of ownership to determine the supporting party's true interest in those assets and the availability of those assets to pay support [*citing* In re Marriage of Dick (1993) 15 Cal. App. 4th 144, 164-165].

Substantial Evidence Supported Trial Court's Finding that Transfer Was Made in Bad Faith. The appeals court found that substantial evidence supported the finding that Kevin transferred the firm to his current wife to avoid his support obligations. The evidence was undisputed that Kevin received no consideration for the transfer of the firm, which had generated $220,000 in business income for Kevin the previous year. In the absence of any evidence explaining the lack of consideration, the trial court could reasonably infer that Kevin had arranged the transfer to eliminate his business income on paper. The court could also infer that Kevin's current wife would act at his behest, that Kevin would continue to enjoy the benefits of the business income, and that Kevin continued to have the ability to pay spousal support, despite the transfer.

Kevin's Claim that Business Income Would Be Greatly Reduced Without His Services Not Supported by Evidence. Kevin argued that the spousal support order violated *In re Marriage of Reynolds* (1998) 63 Cal. App. 4th 1373, which held that a support obligor may not be required to work after the usual retirement age of 65 in order to continue to pay the same level of support. Kevin argued that the court's order effectively required him to continue working, because the firm's business income derived from Kevin's services and was greatly reduced without those services.

The appeals court rejected this argument, because Kevin had not presented any business records or other evidence establishing how much of the firm's income could be attributed to Kevin's labor or the impact of Kevin's absence on the firm's earning potential. The only evidence supporting Kevin's position came from his own declarations, which the trial court rejected. Given the lack of evidence, the court could reasonably conclude that Kevin did not establish a relationship between the firm's income and his labor, and failed to establish that such income could only be maintained if he continued working there.

Court Did Not Improperly Consider Current Wife's Income. Kevin also argued that the trial court violated Family Code section 4323(b), which prohibits the court from considering the supporting spouse's subsequent spouse's income when modifying spousal support. According to Kevin, because his wife now owned the firm, any future business

profits would be earned by her and could not be considered in modifying spousal support.

The appeals court disagreed. The trial court acted was not considering the wife's income; rather, it was declining to recognize Kevin's bad faith transfer of the firm. Having found that Kevin transferred the firm to avoid paying support while continuing to receive the firm's business income, the court did not abuse its discretion in imputing income to him as if the transfer had not occurred. Otherwise, the appeals court stated, supporting parties could use section 4323(b) to shield their assets through bad faith transfers to their new spouses, a result the Legislature could not have intended.

The appeals court also rejected Kevin's related argument that the order effectively forced his wife to work to support Cathy. The trial court found no credible evidence from which it could determine how the firm's income was derived, or how much of that income could be attributed to his wife's personal labor. Had the evidence determined that some or all of the income was earned through the wife's efforts, the appeals court explained, the outcome would have been different.

Court Properly Looked at Past Earnings as Guide to Future Earnings. Kevin argued that the court erred in basing its support order on the firm's 2014 earnings, when he still owned and operated the business, because there was no evidence that that it would continue to be as profitable with his wife at the helm. Once again, the appeals court found that in the absence of credible evidence as to how the firm earned revenue and how much of that revenue was due to Kevin's efforts, the court did not abuse its discretion in looking to the business's past earnings as a guide to future earnings. Nor did the court abuse its discretion in basing its determination solely on the firm's earnings in 2014, because that was the only tax return presented to the court and there was no evidence that 2014 was an outlier.

Commentary

Dawn Gray

The most interesting thing about this case for me was the distinction the court drew between ownership of a business and drawing an income from that business. There was no question that Kevin's income had dropped after his retirement, which may have constituted a change of circumstances sufficient to justify modification of spousal support. However, he also argued that his transfer of his business to his wife without consideration justified termination of support. This was, in the trial court's opinion, intentional impoverishment; the trial court "expressed doubt that the law permitted Kevin to divest himself of an income-producing asset and thereby terminate spousal support obligations." In other words, had he kept his interest in the company after no longer working there, it would have generated an income to him as an owner, or at least a return could have been imputed on the business as a valuable asset. Kevin's choice to give away this asset to his current wife and then "plead poverty" clearly did not impress the trial court.

Essentially, this case holds that in situations of intentional impoverishment, the trial court has the discretion to treat the supported spouse as if he had not divested himself of the asset, or the job, or whatever else could have produced an income. That's what the trial court did, reducing Kevin's spousal support obligation by $500 per month "to reflect [his] loss of $50,000 in salary upon retirement," but otherwise treating him as if he had not sold the business. That is certainly not new law. In *In re Marriage of Berger* (2009) 170 Cal. App. 4th 1070, 88 Cal. Rptr. 3d 766, for example, the Fourth District held that a payor cannot "unilaterally, and voluntarily, arrange his business affairs in such a way as to effectively preclude his children from sharing in the benefits of his current standard of living." In that case, the Fourth District reversed a trial court's order modifying temporary child support and terminating temporary spousal support, where the husband had elected to defer his income from his new business venture and live off of his separate property. He had voluntarily left a job in which he "had earned as much as $600,000 per year, to devote his full-time efforts to the job of president and chief executive officer of a landscape business. . . ." The court held that "in the circumstances of this case, Marc must be treated as currently earning his X—Scapes salary; and his voluntary choice to forgo receipt of that salary changes nothing for purposes of including it in his 'income' for purposes of establishing support obligations" [Berger at 1083]. The *Berman* court did the same thing.

It didn't help Kevin that the trial court did not believe him; its determination that he was not credible bound the appellate court. However, its findings that his testimony "that he did not transfer the business to avoid his support obligations" was not credible and that "the business transfer was a sham" were not necessary to impute business earnings to him. Deliberate avoidance of support obligations — the old *Philbin* rule — is not required for imputation of income. As the Fourth District said in *In re Marriage of Stephenson* (1995) 39 Cal. App. 4th 71, 76, 46 Cal. Rptr. 2d 8, "a supporting spouse's further obligation to support, and the level of that obligation, is predicated upon the enumerated statutory criteria including reasonable earning capacity under the circumstances regardless whether there is any evidence of deliberate avoidance of support obligation."

Commentary

Stacy D. Phillips and Kevin Martin

We frequently remind clients that how a court perceives them can be more important than the underlying facts of the case. Stressing the importance of always being perceived favorably by the court, we recommend to our clients that they adhere to the "New York Times test" and not take any action that they would not want broadcast by the New York Times. *In re Marriage Berman* should be required reading for all of our clients as it highlights why not following the New York Times test is so dangerous in family law litigation.

In *Berman*, Husband faced questions common to anyone owning and operating their own business: "What happens when I reach 65 and I want to retire? How do I reduce my spousal support obligations to account for my retirement?" Husband in *Berman* answered these questions by simply retiring and transferring ownership of his business to his new wife, without receiving consideration. Thereafter, Husband filed a request for order for a downward modification of spousal support and represented to the court that he (i) was no longer the owner of his business; (ii) was retired, and (iii) was not receiving income from the business. It appears that Husband was not worried how his one-sided transaction would be perceived by the court or his former wife.

The trial court did not look favorably on Husband, his transfer of the ownership of his business to his wife, or his attempt to modify his existing spousal support based upon his one-sided transfer. In the court's words: "The most reasonable inference from the evidence that was presented is that [Kevin] gave up his ownership interest, with the attendant right to receive the profits of the business, in order to avoid paying spousal support; and that he continues to receive the benefits of the business income, the business profits, via his wife's ownership of the business." Perceiving Husband's transfer as having been done in "bad faith," the trial court denied Husband a downward modification of spousal support (other than a minor reduction), disregarded the change of ownership of his business and imputed income from the business to Husband for the purpose of calculating spousal support. The Court of Appeal affirmed the trial court's ruling.

What does this mean for our clients who own and operate their own business? Can they retire? Will they receive downward modifications when they retire? How do they plan for the next generation of their business without fear of being viewed as "shirking" their support responsibilities? Our clients can accomplish all of these goals and still enjoy their retirement. The trick is they must follow the New York Times test. Our clients must act with the understanding that every action they take that reduces spousal support will be viewed negatively by their former spouse and skeptically by the court. To avoid a court perceiving our clients in such a way, they must act deliberately and candidly when dealing with the court and their former spouse. For example, with respect to retirement and transitioning a business, clients must be ready with documents that demonstrate that their retirement is not a sham and that the transfer of a business was an "arm's length" transaction. While such documentation may cost more in the short run, it will undoubtedly prove invaluable in future court proceedings.

Commentary

Marshall S. Zolla

The train wreck of husband's case was foreseeable before it even left the station. You've got to be kidding that husband took this case to trial, lost at