

OPINION OF THE NEBRASKA COURT OF APPEALS

(Designated for Permanent Publication)

Case Title

JOEL GUTHARD, APPELLEE,
v.
JENNIFER GUTHARD, APPELLANT.

Case Caption

GUTHARD V. GUTHARD

Filed April 14, 2020. No. A-18-498.

Appeal from the District Court for Buffalo County: WILLIAM T. WRIGHT, Judge.
Affirmed.

Nathan P. Husak and Lorealea L. Frank, of Bruner Frank, L.L.C., for appellant.

Elizabeth J. Klingelhofer, of Jacobsen, Orr, Lindstrom & Holbrook, P.C., L.L.O.,
for appellee.

GUTHARD v. GUTHARD

Filed April 14, 2020. No. A-18-498.

1. **Modification of Decree: Child Support: Appeal and Error.** Modification of child support is entrusted to the discretion of the trial court. An appellate court reviews proceedings for modification of child support de novo on the record and will affirm the judgment of the trial court absent an abuse of discretion.
2. **Evidence: Appeal and Error.** In a review de novo on the record, an appellate court reappraises the evidence as presented by the record and reaches its own independent conclusions with respect to the matters at issue.
3. **Judgments: Words and Phrases.** A judicial abuse of discretion requires that the reasons or rulings of the trial court be clearly untenable insofar as they unfairly deprive a litigant of a substantial right and a just result.
4. **Child Support: Rules of the Supreme Court.** Interpretation of the Nebraska Child Support Guidelines presents a question of law.
5. **Judgments: Appeal and Error.** When reviewing questions of law, an appellate court resolves the questions independently of the lower court's conclusions.
6. **Modification of Decree: Child Support: Proof.** A party seeking to modify a child support order must show a material change in circumstances which (1) occurred subsequent to the entry of the original decree or previous modification and (2) was not contemplated when the decree was entered.
7. **Child Support: Rules of the Supreme Court: Words and Phrases.** The Nebraska Child Support Guidelines provide that in calculating the amount of child support to be paid, a court must consider the total monthly income, which is defined as income of both parties derived from all sources, except all means-tested public assistance benefits which includes any earned income tax credit and payments received for children of prior marriages and includes income that could be acquired by the parties through reasonable efforts.
8. **Child Support: Rules of the Supreme Court.** The Nebraska Supreme Court has not set forth a rigid definition of what constitutes income, but instead has relied upon a flexible, fact-specific inquiry that recognizes the wide variety of circumstances that may be present in child support cases.
9. **Child Support: Taxation: Equity: Rules of the Supreme Court.** Income for the purposes of calculating child support is not necessarily synonymous with taxable income. A flexible approach is taken in determining a person's income for purposes of child support, because child support proceedings are, despite the child support guidelines, equitable in nature.
10. **Child Support: Employer and Employee.** Income for the purposes of calculating child support should not be based on income that is speculative in nature and over which the employee has little or no control.
11. **Taxation: Corporations: Words and Phrases.** Subchapter S is a tax status designed to tax corporate income on a pass-through basis to shareholders of a small business corporation.

12. **Taxation: Corporations.** Since a subchapter S corporation is not taxed on its earnings, the various income, expense, loss, credit, and other tax items pass through and are taxable to or deductible by shareholders in a manner analogous to that which is applicable to partners.

13. **Child Support: Corporations.** Any determination whether and to what extent the undistributed earnings of an S corporation should be deemed available income to a parent-shareholder for child support purposes must be based on the particular circumstances presented in each case.

14. ____: _____. A fact-specific inquiry is necessary to balance considerations that a well-managed corporation may be required to retain a portion of its earnings to maintain corporate operations and survive fluctuations in income, but corporate structures should not be used to shield available income that could and should serve as available sources of child support funds.

15. ____: _____. Relevant factors to weigh in determining what portion of undistributed corporate earnings may be available to a shareholder for child support purposes should include the following considerations: (1) the shareholder's level of control over the corporation's distributions--as measured by the shareholder's ownership interest, (2) the legitimate business interests justifying the retained corporate earnings, and (3) the corporation's history of retained earnings and distributions to determine whether there is any affirmative evidence of an attempt to shield income by means of retained earnings.

16. **Child Support: Rules of the Supreme Court: Presumptions: Proof.** If the moving party shows that the nonmoving party earns or can reasonably expect to earn a certain amount of income on a regular basis, a rebuttable presumption of including such income arises under the Nebraska Child Support Guidelines. After the moving party has met its burden of proof, the nonmoving party must produce sufficient evidence to rebut the presumption that the application of the guidelines will result in a fair and equitable child support order before deviation from the guidelines is appropriate. If the nonmoving party can show that the included income is speculative in nature and over which the person has little or no control, the presumption of including the income is rebutted and it shall be excluded from the calculation.

17. **Child Support: Corporations: Taxes: Evidence: Proof.** Distributions made to a shareholder of a subchapter S corporation, as reported on a schedule K-1, should not be included as income for purposes of calculating child support for those portions of the distribution intended to offset the shareholder's personal tax liability on his or her proportionate share of the S corporation's pass-through earnings. However, if the evidence establishes that the total distribution exceeds the shareholder's tax liability on his or her proportionate share of the S corporation's pass-through earnings, such excess portions of the distribution may be included as income for child support purposes unless the evidence demonstrates that such excess amounts are reasonably expected to be applied to future tax liabilities.

MOORE, Chief Judge, and PIRTLE and BISHOP, Judges.

BISHOP, Judge.

Jennifer Guthard appeals from the decision of the Buffalo County District Court denying her request for an upward modification of Joel Guthard's child support obligation. To determine Joel's income for child support purposes, Jennifer sought inclusion of his salary; nonpassive income, distributions, and "in-kind" benefits from Joel's 50-percent ownership in an S corporation; and rental income from another business. Limited by the evidence presented to it, the district court declined to include income beyond Joel's salary for child support purposes. Finding no abuse of discretion, we affirm.

BACKGROUND

Jennifer and Joel were divorced in December 2004. Pursuant to the decree, Jennifer was awarded custody of the parties' two children, born in 2002 and 2004, subject to Joel's specified parenting time. Joel was ordered to pay child support in the amount of \$1,137 per month; this was based on his earning capacity of \$69,000 per year and Jennifer's earning capacity of \$19,968 per year.

Joel filed a complaint to modify in March 2016 and, subsequently, an amended complaint in May, seeking to modify his parenting time schedule and establish a procedure for reimbursement of noncovered medical expenses. Jennifer filed a "counter complaint" alleging that Joel's income had increased, thus warranting an upward modification of his child support obligation.

At the modification trial in March 2018, the district court was informed that the parties had, for the most part, agreed on a modification of the parenting plan. The only issue addressed at trial which is relevant to this appeal is the modification of child support. Jennifer asked the court to include Joel's 2016 schedule K-1 (K-1) of "approximately \$300,000" from his 50-percent ownership in a corporation when determining his income for purposes of child support. Joel and the accountant who prepared his personal tax returns testified, and numerous exhibits, including Joel's tax returns and K-1's, were also received into evidence.

Joel testified that he and Brad Snyder are each 50-percent owners of GAS Electrical Services, Inc. (GAS Electrical), which is a subchapter S corporation. The corporation was originally started by Snyder in 2005. GAS Electrical is an industrial electrical contractor that works on ethanol plants; the corporation is based out of Iowa and "would be an Iowa corporation with a Nebraska corporation, along with being licensed in South Dakota, Kansas, Missouri, [and] Colorado." Joel said that Snyder is "the paperwork guy" for the corporation and that Joel is "the work guy." Joel said that he is "more a field guy going from job site to job site" and that he is "on the road more often than not" because "everything is on the road." Joel does "all the electrical aspects in the field" and supervises employees. At the time of trial, the corporation had 9 to 12 employees, but has had up to 32 employees.

Joel denied that he kept track of the business and its finances. When asked if he reviewed business expenses and financial statements, Joel responded, "We go through [sic] maybe once every year." When asked if he had any control in deciding when assets are bought or sold by GAS Electrical, Joel said "my co-partner buys his parts, I buy my parts and things on that order";

he agreed he had a 50-percent say in the assets of the company. Joel also agreed that he and Snyder decide together how income is going to be distributed and how much money is going to be retained in the business. They also determine the compensation of all employees of GAS Electrical, including their own; Joel and Snyder get the same salary. Joel's salary was \$50,000 in 2015 and was \$65,000 in 2016 and 2017 (he did not give himself a raise in 2017 despite stating that 2016 was an "exceptional year" for the business). Joel said that the business pays a percentage of insurance premiums, he drives a company-owned vehicle (the company pays for the fuel, tires, and all vehicle expenses), he has a company credit card ("[f]or road expenses on fuel only and whatever material [he] might have to do"), and the company pays for his cell phone. And as will be explained below, Joel also receives distributions from GAS Electrical to pay his personal income taxes.

Joel testified that he and Snyder also formed *SnyGut LLC* in 2016 or 2017; they are each 50-percent owners. *SnyGut* owns a bar, which the company leases out to another individual for \$1,200 per month. Joel acknowledged that his annual percentage of the rental income is \$7,200, "[m]inus whatever maintenance and all that [sic] other fees would be." However, on cross-examination, he said that the rent is paid to *SnyGut* and that the \$7,200 was not paid to him.

Errol Coslor, a certified public accountant, testified that he has prepared individual tax returns for Joel since 2005; Coslor is not the accountant for GAS Electrical. Coslor explained that the election to be taxed as an S corporation is basically an election to have the shareholders pay the income tax, rather than having the corporation pay the income tax. He also explained that a K-1 is issued by an S corporation showing income items and deductions that are to be included on the individual shareholder's tax return. Joel agreed that the business income reported on his K-1 represents half of the business income for that year; he also believed that amount was after his salary and taxes were paid. Further, Coslor indicated that the K-1 does not need to be attached to the tax return, but, rather, the income just needs to be reported. When asked if there was a common practice year after year to estimate how much K-1 income there would be from the corporation, followed by a real distribution of funds to make the estimated tax payments, Coslor responded, "I believe so, yes." Joel testified that in 2017, he prepaid \$108,000 for taxes to the federal government and \$12,000 for taxes to Nebraska; when asked how he could make those payments when he takes a \$65,000 salary, Joel responded that the money for the tax payments comes from distributions from the business. He acknowledged that the distributions are based on the estimated taxes and that the company has "never" hit it right on the exact number of the actual tax liability; for example in 2016, he received distributions of \$137,625 to pay taxes of \$133,143.

While Coslor was being questioned about Joel's 2016 personal tax return, it was pointed out by Jennifer's counsel that on the schedule E tax form there was a box that said nonpassive income from the K-1; counsel asked Coslor what the difference was between passive income and nonpassive income. Coslor responded that "nonpassive income means that the individual's active in the business, passive means that he's not active in the business." When asked if he knew for sure how much Joel actually received in distributions in 2016, Coslor stated, "The K-1 should be a good indication of how much he received"

Coslor explained that, with respect to non-S corporations, the Internal Revenue Service (IRS) has rules that allow it to assess a tax if the retained earnings exceed a certain amount. If a corporation's retained earnings exceed \$250,000, the IRS can assess an additional tax, or penalty, for excessive earnings, but there are several exceptions (e.g., if the corporation needs to accumulate earnings for expansion, purchases of buildings, purchases of land, or a potential downturn in its cyclical business). Coslor confirmed that those rules do not apply to a corporation that has made a subchapter S election.

According to the evidence, Joel received wages, tips, and other compensation directly from GAS Electrical as follows: \$75,000.11 in 2011, \$46,250.12 in 2012, \$50,000.09 in 2013, \$50,961.62 in 2014, \$50,000.07 in 2015, and \$65,000.04 in 2016. Joel also testified that his salary did not increase from 2016 to 2017.

Joel's K-1's reflect the following amounts of his proportionate share of the S corporation's pass-through ordinary business income and distributions: 2011 income of \$21,723, distribution of \$13,150; 2012 income of \$15,936, distribution of \$46,633; 2013 income of \$114,362, distribution of \$61,375; and 2016 income of \$399,649, distribution of \$137,625. There were no K-1's offered or received with regard to 2014 or 2015, but Joel's schedule E shows \$96,256 in nonpassive income (and "Section 179" expense of \$2,350) from GAS Electrical in 2014 and \$195,902 in nonpassive income (and "Section 179" expense of \$6,300) in 2015.

No corporate tax returns or financial statements of GAS Electrical were offered by either party.

In its order filed on April 20, 2018, and as relevant to this appeal, the district court had to determine what should be attributed to Joel as income for child support purposes. The court found that Jennifer did not meet her burden to prove that the retained earnings in GAS Electrical were "excessive or inappropriate" so as to be considered income for purposes of child support. The court stated, "Without evidence to what was reasonable for a Sub S corporation such [as] GAS Electrical . . . to retain under the circumstances, it is extremely difficult for the Court to determine that any earnings retained were excessive or inappropriate." The court noted case law that concluded it was appropriate to include in the obligor parent's income the distributions made to the parent to assist the parent in making estimated income tax payments; however, the district court presumed that was to allow averaging of income for a 3-year period, and in the instant case, there were no K-1's received into evidence for 2014 or 2015. The district court also found there was no evidence of the "in kind" value of the benefits Joel received from the company. Further, there was no evidence of the net monthly income received from SnyGut. The district court denied Jennifer's request for an upward modification of Joel's child support obligation.

Jennifer appeals.

ASSIGNMENT OF ERROR

Jennifer assigns that the district court erred by denying her request to modify Joel's child support obligation.

STANDARD OF REVIEW

[1] Modification of child support is entrusted to the discretion of the trial court. *Hotz v. Hotz*, 301 Neb. 102, 917 N.W.2d 467 (2018). An appellate court reviews proceedings for modification of child support de novo on the record and will affirm the judgment of the trial court absent an abuse of discretion. *Id.*

[2,3] In a review de novo on the record, an appellate court reappraises the evidence as presented by the record and reaches its own independent conclusions with respect to the matters at issue. *Id.* A judicial abuse of discretion requires that the reasons or rulings of the trial court be clearly untenable insofar as they unfairly deprive a litigant of a substantial right and a just result. *Id.*

[4,5] Interpretation of the Nebraska Child Support Guidelines presents a question of law. *Hotz v. Hotz, supra.* When reviewing questions of law, an appellate court resolves the questions independently of the lower court's conclusions. *Id.*

ANALYSIS

GENERAL PRINCIPLES OF LAW

[6] A party seeking to modify a child support order must show a material change in circumstances which (1) occurred subsequent to the entry of the original decree or previous modification and (2) was not contemplated when the decree was entered. *Fetherkile v. Fetherkile*, 299 Neb. 76, 907 N.W.2d 275 (2018). The Nebraska Child Support Guidelines establish a rebuttable presumption of a material change in circumstances when application of the guidelines “would result in a variation by 10 percent or more, but not less than \$25, upward or downward, of the current child support obligation . . . due to financial circumstances which have lasted 3 months and can reasonably be expected to last for an additional 6 months.” Neb. Ct. R. § 4-217.

[7] The Nebraska Child Support Guidelines provide that in calculating the amount of support to be paid, a court must consider the total monthly income. *Gangwish v. Gangwish*, 267 Neb. 901, 678 N.W.2d 503 (2004). See Neb. Ct. R. § 4-204 (rev. 2020). Total monthly income is defined as the

income of both parties derived from all sources, except all means-tested public assistance benefits which includes any earned income tax credit and payments received for children of prior marriages. This would include income that could be acquired by the parties through reasonable efforts. *For instance, a court may consider as income the retained earnings in a closely-held corporation of which a party is a shareholder if the earnings appear excessive or inappropriate.*

§ 4-204 (emphasis supplied).

[8,9] The Nebraska Supreme Court has not set forth a rigid definition of what constitutes income, but instead has relied upon a flexible, fact-specific inquiry that recognizes the wide variety of circumstances that may be present in child support cases. *Marshall v. Marshall*, 298 Neb. 1, 902 N.W.2d 223 (2017). Thus, income for the purposes of calculating child support is not necessarily synonymous with taxable income. *Id.* We take this flexible approach in determining a person's “income” for purposes of child support, because child support

proceedings are, despite the child support guidelines, equitable in nature. *Marshall v. Marshall, supra*. Thus, a court is allowed, for example, to add “in-kind” benefits, derived from an employer or other third party, to a party’s income. *Id.*

[10] “[T]he level of income should not be based on income that is ‘speculative in nature and over which the employee has little or no control.’” *Noonan v. Noonan*, 261 Neb. 552, 560, 624 N.W.2d 314, 322 (2001) (quoting *Stuczynski v. Stuczynski*, 238 Neb. 368, 471 N.W.2d 122 (1991) (addressing overtime wages)). It is logical to extend the principles stated in *Stuczynski* to encompass forms of income other than overtime wages. *Noonan v. Noonan, supra*. Consequently, if the evidence shows that a party actually earns or can reasonably expect to earn a certain amount of income on a regular basis, it is appropriate to consider such income in calculating child support. *Id.*

[11,12] A small business corporation may elect to be an S corporation so long as it meets eligibility and other requirements as set forth in the Internal Revenue Code. See I.R.C. § 1361 et seq. (2018). Subchapter S is a tax status designed to tax corporate income on a pass-through basis to shareholders of a small business corporation. *Bortolotti v. Universal Terrazzo & Tile Co.*, 304 Neb. 219, 933 N.W.2d 851 (2019). Since a subchapter S corporation is not taxed on its earnings, the various income, expense, loss, credit, and other tax items pass through and are taxable to or deductible by shareholders in a manner analogous to that which is applicable to partners. *Schnackel v. Schnackel*, 27 Neb. App. 789, 937 N.W.2d 234 (2019). The tax treatment of subchapter S corporations has been outlined as follows:

“Although a [s]ubchapter S corporation may distribute income, it is not required to do so. [Citation omitted.] Earnings are owned by the corporation, not by the shareholders. [Citation omitted.] Subchapter S corporations may accumulate profits, referred to as ‘retained earnings.’ Retained earnings are the net sum of a corporation’s yearly profits and losses. [Citation omitted.]

“Subchapter S status provides an alternate method of taxing a corporation’s income. [Citation omitted.] In a [s]ubchapter S corporation, income tax is paid by the shareholders rather than by the corporation itself. [Citation omitted.] When the tax is paid by the individual, the corporation avoids income tax liability. [Citation omitted.]

“A [s]ubchapter S corporation allocates various items of income to shareholders based upon the shareholder’s proportionate ownership of stock. [Citation omitted.] Allocations are itemized on an individual shareholder’s . . . K-1. [Citation omitted.]”

Coffey v. Coffey, 11 Neb. App. 788, 806-07, 661 N.W.2d 327, 345 (2003) (quoting *In re Marriage of Brand*, 273 Kan. 346, 44 P.3d 321 (2002)).

OVERVIEW OF ALLEGED ERRORS

At the time of the divorce decree in 2004, Joel was attributed an earning capacity of \$69,000 for purposes of calculating child support. His salary in the years leading up to the modification trial was as follows: \$75,000 (2011), \$46,250 (2012), \$50,000 (2013), \$50,961 (2014), \$50,000 (2015), \$65,000 (2016), \$65,000 (2017). At the time of trial in March 2018, Joel’s salary from GAS Electrical was still \$65,000 per year. Thus, there was no material change in circumstances warranting a modification of child support based upon Joel’s salary alone.

However, GAS Electrical was created after the parties' divorce, and therefore in addition to earning a salary, Joel had the ability to also benefit from the corporation's earnings. Based on Joel's federal income tax returns, his 50-percent share of the pass-through taxable income from GAS Electrical was as follows: \$21,106 (2011), \$15,936 (2012), \$114,362 (2013), \$93,906 (2014), \$189,602 (2015), and \$381,182 (2016). These figures are taken from Joel's federal tax returns, specifically the S corporation income reported on form 1040 at line 17 and the associated schedule E. The tax returns show a significant increase in GAS Electrical's ordinary business income after 2012, some of which the corporation distributed to its shareholders, but some of which it retained. The district court concluded the evidence did not support attributing to Joel for child support purposes any income beyond his salary. Jennifer claims the district court erred by not factoring into Joel's income the nonpassive income/retained earnings, distributions, and "in-kind" benefits Joel received from GAS Electrical, as well as the rental income he received from SnyGut.

NONPASSIVE INCOME/RETAINED EARNINGS

Jennifer contends the district court "abused its discretion by not considering Joel's nonpassive income." Brief for appellant at 6. As explained by Coslor, nonpassive income means that the individual is active in the business and passive income means the individual is not active in the business. In this case, Joel was actively involved in GAS Electrical, and thus, the S corporation's pass-through income was characterized as nonpassive income on schedule E of Joel's personal federal tax returns. Jennifer acknowledges that "the evidence indicated Joel's nonpassive income was retained by the [c]orporation and not actually received," but "the retained earnings were nevertheless excessive and inappropriate," brief for appellant at 8, and the district court should have considered such retained earnings which Jennifer claims Joel "sheltered in the [c]orporation," *id.* at 12.

We view Jennifer's argument to be focused on the inclusion of earnings retained by the S corporation when determining Joel's income for child support purposes. Although Jennifer suggests we do so, we find it unnecessary to consider any distinction between nonpassive income and passive income for child support purposes in this instance, other than noting that the nonpassive nature of the income at issue here indicates active involvement by Joel in producing that income. The issue in this case is not whether S corporation pass-through income is characterized as nonpassive or passive, but, rather, the issue is how much of that pass-through income is actually distributed to the shareholder and whether any income not distributed by the corporation is retained for legitimate business purposes. As set forth in the Nebraska Child Support Guidelines, "a court may consider as income the retained earnings in a closely-held corporation of which a party is a shareholder if the earnings appear excessive or inappropriate." § 4-204. Whether retained earnings are excessive or inappropriate necessarily implies that such earnings are not being retained for legitimate business purposes and could otherwise reasonably be expected to be distributed to a parent-shareholder for inclusion as income for child support purposes. Important to this issue is consideration of how much control Joel has over the income distribution and retention decisions as an equal owner of the S corporation, as well as whether the evidence supports that any retained earnings were excessive or inappropriate.