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***Holterman v. Holterman*: Distributive Award Payments Cannot Be Deducted from Payer's Income in Computing Child Support or *O'Brien* Strikes Again**

By Charles McEvily

On June 10, 2004, the Court of Appeals rendered a lengthy decision upholding a trial court's refusal to adjust a husband's child support obligation by the amount that he must pay as a distributive award of his enhanced earning capacity. The real world result, according to the strident dissenting opinion, forces the non-custodial father, earning \$183,000 a year as an emergency room physician, to live on \$16,389 during the first year following entry of the judgment and to live on \$36,389 the next year.

Case Summary

In *Holterman v. Holterman*,¹ the court was faced with a 19-year marriage involving a husband who was a third-year medical student at the time of marriage. While the husband completed his medical education, the wife contributed to the household income. Three years after marriage, the wife was diagnosed with chronic fatigue syndrome and fibromyalgia. The parties agreed that the wife should become a homemaker due, in part, to her condition. Two children were born during the marriage. By the year 2000, the husband was earning \$181,837 and received a small additional stipend. The trial court awarded the wife 35% of the marital portion of the husband's enhanced earning capacity in the form of fifteen annual distributive award payments of \$21,288, which included interest. In addition, the court awarded the wife maintenance of \$35,000² a year for five years and then \$20,000 per year for the remainder of her life and child support of \$34,875 annually. Other marital assets were equally divided, with the wife receiving sole title to the marital residence which was encumbered with a mortgage and attendant carrying costs of about \$26,500 per year. Out of the \$91,163 in annual payments awarded to the wife, only the \$35,000 in maintenance was tax deductible to the husband.

Neither the trial court nor the Appellate Division, Third Department adjusted the husband's child support obligation by the \$21,288 granted to the wife as a distributive award. In fact, the issue does not appear to have been raised in the Appellate Division.³

On his appeal to the Court of Appeals, the husband argued that, *inter alia*, the trial court should have deducted his annual equitable distribution payments to the wife from his income and added the same amount to the wife's income in calculating child support. The

husband cited the wife's expert in support of his argument. The expert had conceded during trial that his opinion, based only on intellectual honesty, was that requiring the husband to pay child support based on income that had been awarded to the wife would be to award the same income stream twice. The husband also cited the "double dipping" cases of *McSparron* and *Grunfeld*.⁴

Majority Opinion

The five judge majority concluded that the statutory language of the CSSA⁵ does not permit any adjustment of child support due to a distributive award.

[T]he CSSA does not provide for the deduction of distributive awards from income, whether based on enhanced earning capacity due to a professional license or otherwise. Nor does the CSSA authorize the inclusion of a distributive award as income to the parent receiving the award. This lack of inclusion in either the list of permissible statutory deductions or the definition of income is understandable because distributive awards "reflect, not income, but a property distribution," of the marital assets (Scheinkman, New York Law of Domestic Relations § 14.36, 2003 Pocket Part, at 131 [11 West's NY Prac Series 1996]). Indeed, the Domestic Relations Law, which defines a distributive award as "payments provided . . . in lieu of or to supplement, facilitate or effectuate the division or distribution of property," makes clear that distributive awards should not be treated as income for tax purposes (Domestic Relations Law § 236 [B] [1] [b] ["Distributive awards shall not include payments which are treated as ordinary income to the recipient under the provisions of the United States Internal Revenue Code"]). Had the Legislature intended to make distributive awards deductible from one parent's income and includable in the other's, it could easily have so provided. Simply put, it appears that the Legislature did

not wish to have a child's lifestyle and support altered based on a distributive award. In sum, husband's proposed methodology conflicts with the plain language of the CSSA.⁶

While the majority stated that the express language of the CSSA does not permit the income reallocation requested by the husband, they also concluded that his argument would be

unworkable in many instances because it fails to address situations where a licensed parent satisfies a distributive award obligation by making a lump sum cash payment or transfers a non-cash asset (such as interest in real property) rather than making periodic cash payments over a number of years. For instance, in this case, if a lump sum distributive payment had been ordered, under husband's methodology the payment would have been deducted from his income and applied to wife, offsetting all of husband's earnings or other income for that year and shifting the entire child support burden to wife, who is not employed. Wife then would necessarily have to meet the support obligation from the proceeds of her distributive award. Likewise, if a spouse satisfies a distributive award by transferring his or her title and equity in real property to the other spouse, the value of the one-time transfer would skew the transferor's income for CSSA purposes under the husband's proposal. The result in these scenarios would clearly be inequitable to the recipient spouse and the children.⁷

The majority opinion acknowledges the financial burden that the trial court's decision placed upon Dr. Holterman and opines that it agrees that the husband is correct that the reallocation of income is a factor for the trial court to consider under paragraph (f) of the CSSA.

We agree with husband that a distributive award to be paid by one parent to the other pertains to the financial resources of the parties and therefore is an appropriate paragraph (f) factor that the trial court may consider when awarding child support. However, on this record, we cannot say that Supreme Court abused its discretion by failing to modify husband's child support obligation based on his distributive award obligation.⁸

The reader is left to wonder what factors in the record were not disclosed in the decision of the Court of Appeals which would warrant such a harsh financial result for Dr. Holterman.

Dissenting Opinion

Judge Smith, in a powerful and methodical dissent in which Judge Read concurs, rejects the majority's construction of the statute based upon the escape clause included in the CSSA, which requires the court to determine whether the non-custodial parent's pro-rata contribution for child support is "unjust or inappropriate."⁹ Judge Smith finds it hard to imagine a circumstance where the result could be more unjust or inappropriate than Dr. Holterman's, since the doctor must now support himself on a mere \$16,000 per year.

To emphasize the inequity that can occur under the majority's approach, dissenting Judge Smith presents examples of how the holding by the majority works a severe injustice. For example, assume that the sole source of income for a married couple is from a rental property, which was declared solely on the husband's tax return during the marriage, and the court equally distributes the rental property and income upon divorce. Under the majority decision, all of the rental income would be attributable to the husband and none to the wife, despite the fact that the husband has only half the income left post-divorce from which to pay child support.

This extreme example, argues Judge Smith, highlights the injustice of Dr. Holterman's position. Since 35% of the marital portion of his enhanced future income stream was awarded to his wife, Dr. Holterman is paying child support on income that is actually being received by his wife.

This anomaly results, argues Judge Smith, from the fictions created over the past 19 years from the seminal case of *O'Brien*.¹⁰ The application of *O'Brien* in the *Holterman* case was performed by the wife's expert testifying that Dr. Holterman's income was comprised from two fictional computations. Out of his total income of \$183,000, \$69,000 related to earnings without a medical license and \$114,000 flowed from the enhanced earnings from the medical license. The trial court awarded the wife 35% of the marital portion of the present value of that enhanced earning capacity. The marital portion of the enhanced earnings was 70% of \$114,000, or \$79,800. Thirty-five percent of this income, or \$27,930, was awarded to the wife as a distributive award. Had it been awarded as maintenance, the CSSA statute would have required that amount to be deducted from Dr. Holterman's income in calculating his child support obligation. However, because it was awarded as a distributive award, Dr. Holterman lost the deduction. Thus, he must pay 25% of that now

lost income, or \$6,982 (rounded to \$7,000 by Judge Smith), as child support.

This grotesque distortion of logic, common sense and, perhaps, legislative intent is attributable to the fiction created in *O'Brien*. Judge Smith notes that New York stands alone among the fifty states of our Union in creating awards based upon *O'Brien* and opines it to be a failed experiment. The circuitous and frequently tortured computations involved in calculating the present value of future earnings and awarding that potential future income as a distributive award is analogous to rolling up a rug and then unrolling it again, according to Judge Smith. In effect, he observes, an expert was hired and paid to divide Dr. Holterman's income stream into two components and suggested awarding the wife 35% of each stream. Although such a round-about approach seems to be an apparent waste of time, Judge Smith's real objection to the process resides in the inequity the *O'Brien* formula has on increasing Dr. Holterman's child support by \$7,000 and ignoring the fact that 35% of one income stream has already been diverted to the wife. In addition, the rechanneling of income prevents Dr. Holterman from deducting the payment as maintenance under the CSSA formula. Lastly, the tax benefits of maintenance are impossible to achieve under an *O'Brien* reallocation of income because distributive awards are not deductible to Dr. Holterman.

The dissent notes that the inequity in the *Holterman* case is only the most recent example of how *O'Brien* creates unworkable and potentially unfair results in divorce cases. A distributive award based upon projected income from a particular professional practice is intrinsically dangerous because the future income may never materialize. Even Judge Meyer expressed concern about this in his concurring opinion in *O'Brien*. "[I]f the assumption as to career choice on which a distributable award payable over a number of years is based turns out not to be the fact (as, for example, should a general surgery trainee accidentally lose the use of his hands) it should be possible for the court to revise the distributive award to conform to the fact. . . ." ¹¹ The inequity of a false assumption is compounded by the majority decision in *Holterman*.

All these distortions convince Judge Smith that the other 49 states are correct in not following *O'Brien* and relying instead on awarding maintenance payments based upon actual future earnings.¹² While the dissent does not hold the trial court's decision wrong as a matter of law, Judge Smith would have remanded the case for consideration of the heavy financial burden placed on Dr. Holterman.

Practical Analysis

The majority holding in *Holterman* initially seems severe in failing to provide any relief to the titled

spouse in divorce cases involving the distribution of enhanced earning capacities under the *O'Brien* rule. Dr. Holterman, had he known the result of his divorce, probably would have moved to a state that did not follow *O'Brien*.

However, the majority did recognize that the shifting of income, which is required under *O'Brien*, is a "paragraph (f)" factor to be considered in making adjustments to child support to prevent the amount of child support from being "unjust or inappropriate" under the CSSA. While acknowledging that a distributive award under *O'Brien* is a "paragraph (f)" factor under "the financial resources of the custodial and non-custodial parent," the majority goes on to hold that the "Supreme Court [did not] abuse its discretion by failing to modify husband's child support obligation based on his distributive award obligation."¹³ The record that the court relies upon, however, is only the conclusive finding of the trial court that it "considered" both parents' incomes as well as the upper middle-class lifestyle that the children would have enjoyed had the parties not divorced. The children's frequent vacations, extravagant extra-curricular pursuits and private music lessons are explicitly cited as the trial court's findings justifying the failure to adjust the father's child support obligation.

This analysis demonstrates a major confirmation by the Court of Appeals that it wants to provide significant support to children, even if it imposes a crippling financial burden on the non-custodial parent.

One of the significant reasons for a non-titled spouse's (usually the wife) attorney to cite *Holterman* is that 100% of Dr. Holterman's \$183,000 income was used to compute child support, despite the fact that he did not have 100% of his income left after the application of *O'Brien*. Wives' attorneys will also cite the case because it awarded 35% of the husband's available gross income as maintenance for five years and 20% of his income for the rest of the wife's life.

Attorneys representing a titled spouse (usually the husband) may rely on *Holterman* to argue that, under the best of circumstances, a wife should be awarded no more than 35% of an enhanced earning capacity. In *Holterman*, the wife's income contributed to the support of the family while the husband completed his medical education and the trial court found that she sacrificed her own career objectives to advance her husband's. Moreover, Mrs. Holterman's medical condition was found to be chronic. But, whatever relief a husband may find in the portion of *Holterman* which awarded the wife 35% of enhanced earnings rather than 50% is cold comfort compared to the reality of Dr. Holterman's trying to live on \$16,000 in the first year following divorce.

While women's organizations may initially applaud the *Holterman* decision, a further analysis demonstrates

the danger of the holding to women who are the “titled” spouse. Suppose, for example, it was the wife who had achieved the enhanced earning capacity during the marriage. Upon divorce, she would pay the non-custodial husband \$21,000 per year for 15 years as a distributive award. Under *Holterman*, she could not deduct the award from her income stream, nor add it to the non-custodial husband’s income. Such an application of the rule would significantly reduce the income available for the children.

The analysis of the dissent in *Holterman* is clearly more sophisticated and accurate. Distributive awards of property *other* than enhanced earning capacity can be ignored in establishing child support. However, where future earnings are redistributed between a husband and a wife, they should be considered. The decision in *Holterman* clarifies that the Court of Appeals believes that it is the legislature, not the courts, that will have to address this issue. In addition, it appears that the legislature will also have to be the legal entity that must bury the *O’Brien* rule, which has promoted so much unnecessary and circuitous litigation in divorces.

Endnotes

1. No. 73, 2004 N.Y. LEXIS 1520 (June 10, 2004). Citations to the decision in this article refer to page numbers in the draft opinion, which can be found at <<http://www.nycourts.gov/ctapps/decisions/jun04/73opn04.pdf>>.
2. In order to avoid “double dipping,” the marital portion (70%) of the total income stream attributable to the husband’s medical degree (\$114,000) or \$79,800 was subtracted from Dr. Holterman’s gross income of \$183,000 leaving \$101,200 of income deemed available for maintenance payments. The maintenance award of \$35,000 constituted 34.6% of this income. After five years, maintenance payments are reduced to \$20,000 for life.
3. *Holterman v. Holterman*, 307 A.D.2d 442, 762 N.Y.S.2d 152 (3d Dep’t 2003).
4. *McSparron v. McSparron*, 87 N.Y.2d 275 (1995) and *Grunfeld v. Grunfeld*, 94 N.Y.2d 696 (2000).

5. Domestic Relations Law § 240 (1-b).
6. Decision, p. 7.
7. Decision, p. 7.
8. Decision, pp. 8-9.
9. “Under Domestic Relations Law § 240(1-b), the non-custodial parent must pay his or her ‘pro-rata share of the basic child support obligation,’ based on ‘income’ as defined in the statute, ‘[u]nless the court finds that the non-custodial parent’s pro-rata share of the basic child support obligation is unjust or inappropriate. . . .’ Thus, the statute expressly authorizes departure from the statutorily calculated ‘pro-rata share’ where a failure to depart would produce an ‘unjust or inappropriate’ result. The statute lists ten ‘factors’ to be considered in making a departure, of which the first is: ‘[t]he financial resources of the custodial and non-custodial parent, and those of the child.’ Where an income-producing asset changes hands as part of the divorce, the ‘financial resources’ of one party are greater, and those of the other are less, than the statutory formula assumes. If this is not an instance where the parties’ ‘financial resources’ render the ‘pro-rata share’ as calculated by statute ‘unjust or inappropriate’ I find it hard to imagine what such a case would be.” Decision, p. 13.
10. 66 N.Y.2d 576, 588, 498 N.Y.S.2d 743.
11. 66 N.Y.2d at 600, 498 N.Y.S.2d at 751.
12. “In the other 49 states, a professional license is not itself an asset subject to equitable distribution, although in many states the enhanced earning capacity reflected by a license may be considered in awarding alimony or maintenance, or in distributing other assets (see *e.g.* *Downs v. Downs*, 154 Vt 161, 574 A2d 156 [Vt 1990]; *In re Marriage of Olar*, 747 P2d 676, 680-681 [Colo 1987] [en banc]; *Drapek v. Drapek*, 399 Mass 240, 246, 503 NE2d 946, 950 [1987]; *Mahoney v. Mahoney*, 91 NJ 488, 501-505, 453 A2d 527, 534-536 [1982]; *DeWitt v. DeWitt*, 98 Wis2d 44, 60-61, 296 NW2d 761, 769 [1980]).” Decision, p.12.
13. Decision, p. 9.

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