

Memo To: Alexsei Demo US, Attorneys Alexsei

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Regarding:

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### Issue

In the context of spousal support and child support orders, how do courts assess a spouse's income when the income is based on commission and fluctuates significantly from year to year?

### Conclusion

The monthly net disposable income is computed for the purpose of calculating support obligations by dividing the annual net disposable income by 12. There is a presumption that the most recent 12-month period of earnings will be an appropriate time period for calculating monthly net disposable income. However, the court may adjust the amount as appropriate to accommodate the fluctuating income of either parent or if the monthly net disposable income figure does not accurately reflect the actual or prospective earnings of the parties at the time the determination of support is made. ([Cal. Fam. Code § 4060](#); [Cal. Fam. Code § 4064](#); [In re Marriage of Riddle](#))

In cases where a party has fluctuating income, the time periods used to calculate the party's monthly net disposable income must be fair and representative. ([In re Marriage of Riddle](#))

The formula to calculate child support set out by the statute requires the parents' monthly net disposable income to be a nominal static dollar amount at the time the order is made. The formula does not admit one parent's income to be a fluctuating variable while the other parent's

income is assumed to be static. ([\*In re Marriage of Hall\*](#))

In [\*In re Marriage of Riddle\*](#), the husband appealed a trial court's child support and spousal support orders based on the trial court's calculation of his monthly net disposable income. The husband was employed as a commissioned financial advisor firm for a major investment firm. The commission-based nature of the husband's employment caused his monthly income to fluctuate. The trial court based the husband's monthly net disposable income on two months' earnings. The California Court of Appeals found that it was an abuse of discretion to refer to such a small sliver of time to calculate the husband's monthly net disposable income.

## Law

In California, the manner by which a court shall calculate monthly net disposable income for support orders is codified at [Cal. Fam. Code § 4060](#). The monthly net disposable income is calculated by dividing the annual net disposable income by 12. However, the courts have the discretion to adjust the net monthly income amount appropriately if the calculation does not accurately reflect the prospective earnings of the parties:

The monthly net disposable income shall be computed by dividing the annual net disposable income by 12. If the monthly net disposable income figure does not accurately reflect the actual or prospective earnings of the parties at the time the determination of support is made, the court may adjust the amount appropriately.

The court also has the discretion to adjust a child support order to accommodate the fluctuating income of either parent, as set out in [Cal. Fam. Code § 4064](#):

The court may adjust the child support order as appropriate to accommodate seasonal or fluctuating income of either parent.

In [\*In re Marriage of Riddle\*, 125 Cal.App.4th 1075 \(Cal. Ct. App. 2005\)](#) ("*Riddle*"), the husband appealed a trial court's child support and spousal support orders based on the trial court's calculation of his monthly net disposable income. The husband was employed as a commissioned financial advisor firm for a major investment firm. The commission-based nature

of the husband's employment caused his monthly income to fluctuate. The trial court based the husband's monthly net disposable income on two months' earnings. The California Court of Appeals found that it was an abuse of discretion to refer to such a small sliver of time to calculate the husband's monthly net disposable income (at 1082-1083):

*Rosen* involved a goodwill calculation, hence the focus of the court was on average annual income. The present case, by contrast, involves a support order so the focus, as we might deduce from *County of Placer*, is not on long-term prior average earnings calculated over many years in order to obtain a reliable figure, but on immediate prospective earnings on which support must be paid. Even so, the basic principle which *Rosen* applied to goodwill is also soundly applicable to support orders. Indeed, it is a principle familiar to anyone who has ever read Darrell Huff's 1954 classic, *How to Lie with Statistics* (often used as a textbook in high school critical thinking courses), or had a course in elementary statistics or logic: A sample must be representative of what is being sampled. (5) So what was implicit in *Rosen* as regards a goodwill calculation we will now make explicit as regards to support orders: It is a manifest abuse of discretion to take so small a sliver of time to figure income that the determination essentially becomes arbitrary. And under the facts of this case, no other word but "arbitrary" properly describes the trial court's selection of the last two months to determine Husband's income. A mere two months is an embarrassingly short period on which to predict the annual income of a commissioned salesperson who works in the financial markets. And it is particularly too short under the record before us, where Husband's income for the previous 14 months, previous calendar year, and immediately preceding 12 months were all (a) pretty consistent in themselves (\$7,591.12, \$6,611.05, and \$8,394, and if you used W-2 medicare wages, \$5,429) but (b) wildly inconsistent with the two month period January-February 2003 (\$21,950).

In cases where a party has fluctuating income, the time periods used to calculate the party's monthly net disposable income must be fair and representative. While there are exceptions, [Cal. Fam. Code § 4060](#) creates a presumption that the most recent 12 month period of earnings will be an appropriate time sample for calculating monthly net disposable income for the purposes of child and spousal support in most cases (*Riddle* at 1083):

We also recognize, of course, that, as in *Rosen*, longer time samples are appropriate for measuring "average annual income" for purposes of goodwill valuations.

However, as regard support, we may say that statutes appear to create a presumption that the most recent 12 months is certainly *an* appropriate period in most cases.

In [\*In re Marriage of Hall\*, 81 Cal.App.4th 313 \(Cal. Ct. App. 2000\)](#), the California Court of Appeal reversed and remanded a trial court's child support order which required the father to pay the mother \$836 a month plus eight percent of his earnings above \$10,300 a month. The Court noted that this calculation differed from the statewide uniform guideline for determining child support orders as codified at [Cal. Fam. Code § 4055](#). The formula to calculate child support set out by the statute requires the parents' monthly net disposable income to be a nominal static dollar amount at the time the order is made (at 317-318):

Nevertheless, there are a few things that do manage to make themselves plain from the text, the primary one for purposes of the case before us is (as Robert's letter to the trial judge argued) that the formula does not admit one parent's income to be a fluctuating variable while the other parent's income is assumed to be static. The formula is always predicated on knowing what both parents' income is in nominal static dollars at the time the order is made. [...]

Further, the trial court's child support order could not be saved as an exercise of discretion because the trial court did not make the statements required by [Cal. Fam. Code § 4056](#), either in writing or on the record, as to why it was exercising such discretion (at 318):

In a word, the order made by the trial judge here, in which the order fluctuates as a percentage of only one parent's income, is a result that "differs" from the formula guideline on its face. Now, of course, a court *can* differ from the guideline formula. Section 4057, subdivision (b) expressly permits the court to make an order where application of the guideline formula is "unjust or inappropriate in the particular case." But if the court is going to do that, it must comply with the requirement in section 4056 that any deviation from the formula amount be justified either in

writing or on the record. Information required includes what the guideline formula is, the reasons for differing from the guideline, and the reason the amount is "consistent with the best interests of the children." (§ 4056, subd. (a)(1)-(3).)

In [\*County of Placer v. Andrade\*, 55 Cal.App.4th 1393 \(Cal. Ct. App. 1997\)](#), the California Court of Appeal reversed and remanded the trial court's child support order, which excluded bonuses and overtime from the father's net monthly income calculation for the purposes of determining his child support obligation. The issue was whether Andrade's past earnings, inclusive of overtime and bonus pay, accurately reflected his prospective earnings. The trial court excluded Andrade's bonus and overtime pay from his net monthly income, asserting that the trial court would not force a parent to work overtime. The Court of Appeal held that it was an error for the trial court to exclude bonus and overtime pay from the net monthly income amount, noting that [Cal. Fam. Code § 4058](#) is inclusive of bonus and overtime pay in its calculation of "annual gross income," from which the net monthly income amount is derived (at 1395-1396):

Family Code section 4055 provides a formula for determining the amount of child support based on the net disposable incomes of the parents. The court must calculate the "annual gross income" of the parent, defined in section 4058 as "income from whatever source derived," except as specified, including "but not limited to" wages and bonuses. From this is derived the parent's monthly net disposable income. Overtime is not excluded from the definition of "annual gross income" and the definition is broad enough to include overtime either under the term "wages" or within the inclusive "income from whatever source. . . ." Bonuses are specifically included in the definition of "annual gross income."

The Court acknowledged that [Cal. Fam. Code § 4064](#) gives courts discretion to adjust the monthly net income amount if it does not accurately reflect the party's prospective earnings at the time the order is made. However, the Court held that bonuses and overtime pay could not be excluded from a parent's net monthly income just because they occur sporadically. Instead, the trial court should assess whether the bonus and overtime amounts are likely to reoccur. In order for the trial court to properly exclude bonus and overtime pay from the monthly net income amount, the court must determine that the monthly net income amount does not accurately reflect the party's prospective earnings (at 1396-1397):

The court cannot deduct predictable overtime and bonuses in determining Andrade's prospective earnings merely because they occur sporadically. The mechanism for calculating Andrade's net disposable income is a monthly average. (§ 4060.) The question is whether the bonuses and overtime are likely to reoccur. Absent a determination that "the monthly net disposable income figure does not accurately reflect [Andrade's] . . . prospective earnings," it was error for the court to exclude overtime and bonuses in its calculation.

In [\*In re Marriage of Rosen\*, 105 Cal.App.4th 808 \(Cal. Ct. App. 2002\)](#), the California Court of Appeal held that the trial court's finding that a party's (Bruce) law practice had a goodwill value of \$42,500 was erroneous and instead, the Court assigned the law practice a goodwill value of zero. The Court held that the trial court improperly assigned an inflated goodwill value when it relied on Bruce's net income for 1995 alone to calculate excess earnings. Instead, the trial court should have used an average of Bruce's net earnings to calculate excess earnings because Bruce's net income was highly volatile, varied greatly from year to year, and his 1995 earnings did not reasonably illustrate Bruce's current rate of earnings (at 820-821):

Under the facts presented here, we believe Pat's expert "should have averaged it." The excess earnings method described in *In re Marriage of Garrity and Bishton* requires that one first determines, "a practitioner's average annual net earnings (before income taxes) by reference to any period that seems reasonably illustrative of the current rate of earnings." (*In re Marriage of Garrity and Bishton*, *supra*, 181 Cal.App.3d at p. 688, fn. 14, italics added.) The evidence showed Bruce's net income was volatile. The expert's own report shows Bruce to have had net income in 1992 of \$72,667, in 1993 of \$101,067, and in 1994 of \$71,362. Bruce's net income for 1995 alone is neither an average nor "reasonably illustrative" of his earnings. A reasonable trier of fact could not help but conclude the expert chose to use Bruce's net income from 1995 — one of Bruce's highest earning years — solely to inflate the value of goodwill.

[...]

Pat argues that under *In re Marriage of Garrity and Bishton*, *supra*, 181 Cal.App.3d

675, the trial court was not bound to use any particular time period over which to average income for calculating goodwill. The problem is that Bruce's net income for 1995 alone is not illustrative of Bruce's rate of earnings in light of the fluctuations in Bruce's income. Pat's expert admitted that had he averaged Bruce's income over any period of years he considered, goodwill value would be nominal or nothing.

#### Authorities

[Cal. Fam. Code § 4060, Cal. Fam. Code § 4060](#)

[Cal. Fam. Code § 4064, Cal. Fam. Code § 4064](#)

[In re Marriage of Riddle, 125 Cal.App.4th 1075 \(Cal. Ct. App. 2005\)](#)

[In re Marriage of Hall, 81 Cal.App.4th 313 \(Cal. Ct. App. 2000\)](#)

[County of Placer v. Andrade, 55 Cal.App.4th 1393 \(Cal. Ct. App. 1997\)](#)

[In re Marriage of Rosen, 105 Cal.App.4th 808 \(Cal. Ct. App. 2002\)](#)

[Cal. Fam. Code § 4055, Cal. Fam. Code § 4055](#)

[Cal. Fam. Code § 4056, Cal. Fam. Code § 4056](#)

[Cal. Fam. Code § 4058, Cal. Fam. Code § 4058](#)