In re Marriage of Asfaw v. Woldberhan (2/27/07 – 2007 DJDAR 2721)

Depreciation of rental property may not be deducted from "annual gross income" in calculating child support in California since it requires no cash.

As the Court properly observed, this is the first reported California case addressing the issue of a depreciation deduction in calculating income available for support. This case addresses only child support, not spousal support.

The Court's reasons for disallowing a depreciation deduction were as follows:

1. The legislative history of Family Code Sections 4058 and 4059 and former Sections 4021 and 4022 shows that express references to the tax code definitions of gross income were originally included but later removed. Had they survived, a stronger argument for a depreciation deduction could be made.

2. Code Section 4021 changed its language from "expense directly incurred in carrying on a trade or business" as opposed to its enacted version of "expenditures required for the operation of a business". The court pointed out that "expenditure" is defined as "to pay out or distribute; spend". "Expense" is defined in an accounting sense as "an item of outlay incurred in the operation of a business allocable and chargeable against revenue for a specific period". Depreciation does not require an actual payment of cash. Furthermore, depreciation is not "required" for the operation of a business.

3. Portions of California Welfare and Institutions Code and the California Code of Regulations (CCR) pertaining to the amount a parent contributes to the state for a disabled child does not allow a deduction for depreciation.

4. While other states have ruled both ways, several recognize that depreciation is a "fictional loss" that provides a tax savings and additional cash to the parent to meet the child support obligation.

5. The overriding policy in California statutes is to place the interest of the children “as the state’s top priority”.

Query – Given this case, should principal contributions be an allowable deduction? Would it make a difference in cases involving real estate (appreciating asset) versus equipment (depreciating asset)?