

In re Marriage of Pearlstein (3/28/2006 - 137 Cal.App. 4th 1361, 40 Cal.Rptr.3d 910)

This case stands for the principle that the sale and reinvestment of capital assets does not constitute income for purposes of support. Rather, the return on that capital investment, whether actual or imputed, is the proper measure of income for support. The Court also clarified that stock received as part of the consideration for the sale of an equity ownership in a business is not the equivalent or comparable to compensation in the form of incentive stock options.

This was a short term marriage of two years that produced one child. Shortly after an order for child support was made for \$800, H's business failed. He declared bankruptcy and sought a reduction in child support due to a change in circumstances. The court granted his request and lowered support to \$741 per month. H became employed in a new business established by his adult children of a former marriage. The business prospered and H was granted stock in the new company. Later the company sold and Husband received stock and cash installments from the buyer. The stock was subject to restrictions (most likely under SEC Rule 144) as to his ability to sell the shares.

There was considerable litigation relating to visitation and support. During an OSC hearing, H's expert calculated income for support by adding to wages a return on the stock and cash H received from the sale of the business.

The trial court ignored H's expert and calculated support based on wages and the cash and stock received in H's sale of his interest in the business. The court likened the stock received by H to incentive stock options, making its value includible in income as it emerged from its' SEC restriction.

The appellate court reversed, finding that capital transactions such as the sale of business equity in exchange for cash and stock of the acquirer was not income for support. Rather, the investment return on those assets, whether actual or imputed, constituted income for support.

The appellate court also distinguished the character of capital transactions from incentive stock options. The court made the distinction by pointing out the contractual "strings" normally attached to ISO's such as employee

retention, longevity, and company performance. None of these obligations were attached to the capital transactions of H.

The appellate court also stated the trial court has the discretion to treat the liquidation and current consumption of capital assets as income for support.