

**M.O. - Zappala, J.**

**[J-241-1996]**

**IN THE SUPREME COURT OF PENNSYLVANIA  
MIDDLE DISTRICT**

MARY JO LABAR,	:	No. 0048 M.D. Appeal Docket 1996
	:	
Appellant	:	Appeal from the Order of the Superior
	:	Court entered July 11, 1994 at
v.	:	2101PHL93 Remanding/Vacating the
	:	Order of the Court of Common Pleas of
	:	Northampton County dated May 28,
THOMAS S. LABAR,	:	1993 at DR-19632.
	:	
Appellee	:	434 Pa. Super. 612,
	:	644 A.2d 777 (1994)
	:	
	:	Argued: December 10, 1996
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**DISSENTING OPINION**

**MADAME JUSTICE NEWMAN**

**DECIDED: JUNE 8, 1999**

I believe that the trial court correctly determined Husband's disposable income when it included in its income analysis the depreciation deduction taken by Husband's Subchapter-S Corporation. Therefore, I must respectfully dissent.

Depreciation is the reduction in value of a firm's assets, through wear and tear, obsolescence, or other factors, and roughly measures consumption of capital. Trinova Corporation v. Michigan Department of Treasury, 498 U.S. 358, 364, n.1 (1991). Section

167 of the Internal Revenue Code<sup>1</sup> allows as a deduction from taxable income a reasonable allowance for the exhaustion and wear and tear of property used in a trade or business. See Newark Morning Ledger, Co. v. United States, 507 U.S. 546, 553 (1993). While this depreciation deduction has been a part of the federal tax system since 1909, this Court has not previously considered whether the amount of the depreciation deduction taken can be included in a party's "income" when determining his or her support obligations.

The Superior Court spoke on the issue in Cunningham v. Cunningham, 378 Pa. Super. 280, 548 A.2d 611 (1988), appeal denied, 522 Pa. 576, 559 A.2d 37 (1989), in which they reiterated that when determining gross income for purposes of alimony and equitable distribution awards, depreciation and depletion expenses allowed pursuant to the Internal Revenue Code should not automatically be deducted from gross income. Instead, a court should look to a party's "actual disposable income" and deduct depreciation expenses from income "only where they reflect an actual reduction in the personal income of the party claiming the deductions, such as where, e.g., he or she actually expends funds to replace worn equipment or purchase new reserves." Id. at 282, 548 A.2d at 613. In McAuliffe v. McAuliffe, 418 Pa. Super. 39, 44, 613 A.2d 20, 22 (1992), the Superior Court elaborated on this statement, noting that the "'new reserves' contemplated [in Cunningham] should not be read to mean an allocation for future expenditures or the expansion of a party's business. To the contrary, the cash outlays for 'new reserves' must be necessary for the continued

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<sup>1</sup>26 U.S.C. § 167.

operation and smooth running of the business."

In view of the fact that this Court has not spoken on the issue before today, I conducted a review of how other jurisdictions have responded to the issue. Courts in other jurisdictions have generally taken one of the following three approaches in deciding whether to include depreciation in a support obligor's income:

that (1) depreciation is a book figure which does not involve any cash outlay nor reduce actual dollar income and, therefore, should not be allowed as a deduction; that (2) depreciation diminishes income-producing capacity and leads to the eventual replacement of the asset involved thereby warranting its deduction, and (3) depreciation should not categorically either be deducted as an expense or treated as income, but rather that the extent of its inclusion, if any, should depend on the particular circumstances of each case.

Stoner v. Stoner, 163 Conn. 345, 351, 307 A.2d 146, 151 (1972).

Examples of the application of the various approaches include the Supreme Court of Alaska's determination that depreciation "is a means of reflecting on an annual basis the costs of capital equipment. Such costs are real and should not be disregarded unless it appears that equipment was acquired in order to avoid or reduce the obligor's child support obligation." Eagley v. Eagley, 849 P.2d 777, 781 (Alaska 1993). Montana's Supreme Court decided that "[n]on-cash deductions such as depreciation are not generally subtracted from gross receipts in determining gross income. Although § 46.30.1508(1)(c), ARM [Administrative Rules of Montana] allows depreciation for vehicles, machinery and other tangible assets to be deducted upon a showing of economic necessity, the rule does not require a district court to do so." In re Pedersen, 261 Mont. 284, 287, 862 P.2d 411, 413 (1993). North Dakota has a section in its administrative code that "specifically provides

that business expenses are to be included as part of an obligor's net income from self-employment for purposes of calculating child support." Houmann v. Houmann, 499 N.W. 2d 593, 594 (N.D. 1993). South Dakota Codified Law 25-7-6.6 states that, in computing income available for child support, a court "may allow or disallow deductions for federal income taxation purposes which do not require the expenditure of cash, including, but not limited to, depreciation or depletion allowances." See Grode v. Grode, 543 N.W. 2d 795, 804 (S.D. 1996).

In 1972 the Supreme Court of Connecticut cogently addressed the depreciation issue in Stoner v. Stoner, *supra*. After noting that, "depreciation is a mere book figure which does not either reduce the actual dollar income of the defendant or involve an actual cash expenditure when taken," but rather "represents additional cash available to the defendant by permitting substantial tax deductions," the Court also recognized that a support obligor should not be compelled to exhaust all of his or her capital without an opportunity to preserve his or her business. The Court determined that depreciation should neither always be treated as an expense nor always characterized as a net profit. *Id.* at 353, 307 A.2d at 152. Instead, the Court announced a more flexible test and held that, "the amount of depreciation, if any, to be considered in determining the availability of net income for the purposes of alimony and support awards is best left to the court's discretion 'determined from all of the circumstances including the amount of depreciation claimed and the property depreciated.'" <sup>2</sup> *Id.*, 307 A.2d at 152<sup>3</sup> (emphasis added) (citation omitted).

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<sup>2</sup>This language was drawn from the opinion of the Superior Court in Commonwealth v. Miller, 202 Pa.Super. 573, 198 A.2d 373 (1964). Our Superior Court has made other

I agree with this approach and believe this Court should have adopted it. Allowing a trial court to consider all of the financial circumstances of the parties (including the possible inclusion in income of depreciation deductions legitimately claimed on federal income tax returns) allows a court the flexibility required to make a fair and just support award based on the specifics of the case before it.

In the case before us, the trial court justified its decision to include the depreciation deduction in Husband's income by noting that, while Husband described the improvements made to the business, he "made no mention of the amount of increased income generated by the improvements" and "did not testify as to whether the improvements were necessary to maintain the current level of income to the business." Trial Court Opinion, August 20, 1993 at 4. The court noted its concern that Husband was "building up equity in his business and creating a 'good bowling center for the community' at the expense of his children's support." Id. at 5. The trial court stated that it could not, and would not, permit this to occur. I believe the court was correct in this determination.

The Superior Court, in reversing, held that a two-part analysis was required to

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pronouncements on the issue since 1964, including its opinions in McAuliff v. McAuliff, supra, and Cunningham v. Cunningham, supra, which the Superior Court relied on in making its decision in the instant matter.

<sup>3</sup>Nineteen years later the Supreme Court of Iowa found the reasoning of the Connecticut Supreme Court persuasive and adopted its approach. The Court found that approach was consistent with the flexibility its guidelines provided to deviate from them "when equity and justice demand it." Gaer v. Gaer, 476 N.W. 2d 324, 328 (1991).

determine if depreciation expenses could be deducted from gross income when calculating a support obligation. The first part of the analysis was whether the expenses reflected an actual reduction in Husband's personal income, and the second was whether the capital outlays were reasonable or merely an attempt to shelter income from support obligations. The Court concluded that the claimed expenditures did reduce Husband's income, and presumed the expenditures were legitimate and necessary. Accordingly, the Court remanded for a recalculation of Husband's disposable income.

The Superior Court gave great deference to the fact that the Internal Revenue Code provides for depreciation expenses:

In general, there should be little concern over the amount of depreciation as it is limited to very specific regulations set forth by the Internal Revenue Code, which cannot be manipulated without risking income tax fraud. With this in mind, a finding of unreasonable depreciation expense by the court should be limited to those cases where there is evidence of blatant unreasonableness or vast changes in expenditures from one year to another.

Labar v. Labar, 434 Pa. Super. 612, 620-621, 644 A.2d 777, 781 (1994). While the Superior Court properly noted that depreciation expenses are legitimate deductions under the federal tax laws, I believe that it erred in concluding that they should be included in disposable income for support purposes only when unreasonable. In my opinion the appropriate inquiry to decide whether to include depreciation in support income is a review of all of the relevant circumstances of the particular situation presented. This is an inquiry of the trial court to be conducted in each case. In fact, in its Opinion, the trial court specifically noted that its "decision was based on the facts and circumstances in the case".

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Trial Court Opinion, August 20, 1993, p.6. Accordingly, I see no need to remand this matter for a recalculation of Husband's support obligation.

For the above stated reasons, I would reverse the Order of the Superior Court.

Mr. Chief Justice Flaherty joins this dissenting opinion.