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Trojan v. Trojan, 208 A.3d 221 (R.I. 2019)

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Family Law. *Trojan v. Trojan*, 208 A.3d 221 (R.I. 2019). For the purposes of calculating child support obligations, the undistributed pass-through income of an S corporation is not automatically included in a parent's gross income. If a court finds that S corporation distributions are used to pay for a parent's personal debts, however, those funds are included in a parent's gross income for the purposes of calculating child support obligations.

FACTS AND TRAVEL

Joel and Denise Trojan married in July 1990.¹ In March 2014, Joel filed for divorce citing irreconcilable differences; Denise filed a counterclaim seeking child support for their minor child Tiffany.² On the first day of trial, Joel and Denise entered into a consent order in which they agreed upon joint custody of Tiffany, Joel was awarded all reasonable rights of parenting time, the marital estate was divided equally, and neither party would address the conduct or fault of the other in connection with the court's consideration of equitable distribution and alimony.³

That same day, Denise moved for temporary allowances, claiming that during the course of the divorce the parties had shared a joint marital account from which Denise had supported herself and Tiffany.⁴ Denise alleged that the account was depleted and Joel had stopped depositing money into the account approximately one month before the trial began.⁵ Denise argued that Joel was earning \$1.8 million per year and, pursuant to the child support guidelines worksheet, she would be entitled to

1. *Trojan v. Trojan*, 208 A.3d 221, 224 (R.I. 2019). Consistent with the Court's opinion, Joel Trojan, Denise Trojan, John Trojan, and Tiffany Trojan will be referred to by their first names.

2. *Id.* To protect the anonymity of the minor child, the court assigned her a pseudonym. *Id.* at 223.

3. *Id.* at 224.

4. *Id.*

5. *Id.*

\$16,000 per month in child support.⁶ Joel responded by arguing that there was “at least a million dollars” in the joint account when the parties agreed to divide the account equally, and as a result Denise received \$505,000 around the same time that she filed for temporary allowances.⁷ Additionally, Joel argued that Denise’s calculation of his earnings was incorrect because it included “pass-through income that he received from Century Drywall, Inc. (Century), an S corporation of which Joel was the sole shareholder.”⁸ Denise chose to pursue child support in the amount of \$16,000 per month because, according to Denise, Joel was receiving distributions in addition to a salary from Century.⁹

Thereafter, Denise’s counsel conceded, “the child doesn’t need [\$]16,000 a month,” and the trial justice concluded that he was “not going to entertain a motion for temporary allowances in anticipation of the divorce hearing[,]” but rather “hear it all at the same time[,]” and that he would consider awarding retroactive child support if necessary.¹⁰ Accordingly, Joel voluntarily paid Denise \$2,444 per month in child support from January 2016 until final judgment was entered in December 2016.¹¹ In August 2016, a decision pending entry of final judgment was entered, which incorporated, but did not merge, the marital settlement agreement and continued the child support issue, to which neither party sought review.¹²

Subsequently, at the child support hearing later that year, the court heard testimony from Joel, Denise, and Justin Amico, CPA, who was the accountant for Century and also prepared the parties’ personal income tax returns.¹³ Mr. Amico testified that Century retained its profits from December 31, 2013 through December 31,

6. *Id.*

7. *Id.*

8. *Id.* Century originally had three shareholders: Joel Trojan, his brother John, and his brother-in-law Michael Elliott. *Id.* at 225. By December 2013, Joel had purchased the interests of both John and Mr. Elliott, becoming the sole shareholder. *Id.*

9. *Id.* at 225.

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

2015, which increased shareholder equity.¹⁴ Mr. Amico also testified that Alliant Insurance Services, Inc., a bonding company, required that Century increase its equity to \$10 million in order to receive bonds.¹⁵ Additionally, Mr. Amico testified that, in his opinion, compliance with this requirement was a “legitimate business interest because there was a risk that [Century] would not be able to secure bonds as it bid on future work if it was undercapitalized.”¹⁶ Lastly, Mr. Amico testified that in 2015, Century had \$2,692,793 in net income, of which \$1,641,150 was distributed to Joel.¹⁷

Joel then testified that Denise had received \$2,725,660 in cash from him, in addition to an interest in various bank accounts, brokerage accounts, real estate, and other investments.¹⁸ Joel also testified that since Denise moved for temporary allowances, he had begun to make voluntary monthly child support payments in the amount of \$2,444 per month.¹⁹ Joel arrived at the \$2,444 figure by completing a child support guideline worksheet based on his 2015 wages and taxable interest.²⁰

Denise then took the witness stand and provided the court with a list of expenses that she alleged were necessary to maintain Tiffany’s lifestyle.²¹ These expenses included:

\$700 to \$800 per month to spend at the mall and for other activities with her friends; \$575 every four to six weeks for hair extension maintenance; over \$200 per month for hair products; \$275 per month on manicures, pedicures, and acrylic nails; \$150 to \$200 every two weeks on cosmetics; \$150 to \$200 per month on foot reflexology and massages; between \$10,000 to \$11,000 per year for vacations,

14. *Id.* Mr. Amico testified that as of December 31, 2014, Century’s total stockholder equity was \$7,310,276 and, according to an “Equity Rollforward Sheet,” by the close of 2015 stockholder equity had increased to \$8,361,919. *Id.*

15. *Id.* at 225–26.

16. *Id.* at 226.

17. *Id.* Joel used the distributions to pay taxes on the corporation’s net income, the note payment obligations to John and to Mr. Elliott, and a premium on his life insurance policy. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* at 226–27.

21. *Id.* at 227.

including the cost of bringing one of Tiffany's friends along; \$425 per month on clothing and shoes; and \$150 per month for functions attended by Tiffany.²²

The trial justice found that these expenses were "not only incredulous, but outrageous in some fashion, concerning hair extensions, acrylic nails, foot reflexology, the clothing amount per month, and a number of other expenses."²³ Additionally, the trial justice found that Joel's gross salary for 2015 was \$278,344, and that Joel was the sole shareholder of Century, and as such, Century's 2015 income of \$1,051,643 was retained for a legitimate business reason and not to shield or manipulate Joel's income to reduce his child support obligation.²⁴ The trial justice relied upon Mr. Amico's testimony, finding it to be "uncontradicted" and "very informative and quite credible[.]"²⁵

Ultimately, the trial justice found that Century's total distributions to Joel in 2015 "did not inure to Joel's benefit," and should not be included as part of Joel's gross income calculation for child support purposes because they "had not been dispensed to enhance Joel's lifestyle since the year 2011."²⁶ Final judgment was entered on December 28, 2016, and on that same day, Denise timely appealed the trial justice's child support calculations to the Rhode Island Supreme Court (the Court).²⁷

ANALYSIS AND HOLDING

On appeal, Denise argued that because the trial justice "misinterpret[ed] and disregard[ed] the formula set forth in the R.I. Child Support Guidelines," the child support issue was therefore a

22. *Id.*

23. *Id.* at 228. The trial justice admittedly endorsed theories advanced in *Downing v. Downing*, 45 S.W.3d 449 (Ky. App. Ct. 2001), where the appellate court held "[b]eyond a certain point, additional child support serves no purpose but to provide extravagance and an unwarranted transfer of wealth." *Id.* at 456. The appellate court recognized this reasoning is referred to as the "Three Pony Rule," that is, "no child, no matter how wealthy the parents, needs to be provided more than three ponies." *Id.* (citing *Matter of Marriage of Patterson*, 920 P.2d 450, 455 (Kan. Ct. App. 1996)).

24. *Trojan*, 208 A.3d at 227.

25. *Id.*

26. *Id.* at 227–28.

27. *Id.* at 228–29.

question of law, subject to *de novo* review.²⁸ The Court disagreed, noting that “[i]t is well established that the appropriate award of child support is to be determined by the trial justice in his or her sound discretion, and we shall not disturb such a determination on review absent a clear abuse of that discretion.”²⁹ Additionally, Denise argued that the trial justice’s decision did not comport with Rhode Island General Laws section 15-5-16.2(a)³⁰ by failing to order interim child support while the divorce was pending, and also that the trial justice erroneously calculated Joel’s child support obligation by failing to include Century’s distributions in Joel’s gross income.³¹

As for the interim child support, Denise argued that the trial justice did not adhere to section 15-5-16.2 because he did not formally award any child support until one year after Denise had requested interim support.³² Furthermore, Denise argued that the trial justice erred when he “prematurely and peremptorily denied

28. *Id.* at 229.

29. *Id.* (quoting *Mattera v. Mattera*, 669 A.2d 538, 542 (R.I. 1996)).

30. 15 R.I. GEN. LAWS § 15-5-16.2(a) states:

(a) In a proceeding for divorce, divorce from bed and board, a miscellaneous petition without the filing of divorce proceedings, or child support, the court shall order either or both parents owing a duty of support to a child to pay an amount based upon a formula and guidelines adopted by an administrative order of the family court. If, after calculating support based upon court established formula and guidelines, the court, in its discretion, finds the order would be inequitable to the child or either parent, the court shall make findings of fact and shall order either or both parents owing a duty of support to pay an amount reasonable or necessary for the child’s support after considering all relevant factors including, but not limited to:

- (1) The financial resources of the child;
- (2) The financial resources of the custodial parent;
- (3) The standard of living the child would have enjoyed had the marriage not been dissolved;
- (4) The physical and emotional condition of the child and his or her educational needs; and
- (5) The financial resources and needs of the non-custodial parent, provided, that in establishing a child-support order, incarceration may not be treated as voluntary unemployment.

31. *Trojan*, 208 A.3d at 229.

32. *Id.* Denise argued that the trial justice should have awarded interim child support on two occasions; first, on December 16, 2015 (the first day of trial), and on July 26, 2016, the day the marital settlement was entered. *Id.*

her request for \$16,000 per month in child support without first calculating child support under the guidelines.”³³ The Court held that the trial justice acted “well within the bounds of his discretion” in not awarding interim child support, and pointed to Denise’s counsel’s own admission that Tiffany did not require \$16,000 per month in child support.³⁴ Moreover, Denise’s counsel acknowledged that Denise had been supporting herself and Tiffany with the funds from the joint marital account, which she received just one week prior to her request.³⁵ The Court then held that Denise had waived her appeal by not raising the issue again at the hearing on July 26, 2016.³⁶

The Court next examined Denise’s argument that Century’s net income and distributions should have been included in Joel’s gross income for calculating child support obligations.³⁷ The Court noted that, at first glance, the child support guidelines appear to require that all sources of income, whether earned or unearned, should be included as part of a parent’s gross income for purposes of calculating child support obligations.³⁸ The Court explained, however, that Family Court Administrative Order No. 12-05³⁹ requires the trial justice to conduct a “careful[] review” of the expenses and income of a business to determine the appropriate amount of gross income actually available to the parent to satisfy a child support obligation.⁴⁰ The Court held that the trial justice

33. *Id.* at 230.

34. *Id.*

35. *Id.* Denise had received approximately \$505,000 from the joint marital account. *Id.*

36. *Id.*

37. *Id.* at 231.

38. *Id.* at 232.

39. Administrative Order No. 12-05 states:

For purposes of these guidelines, “income” is defined as actual gross income of the parent, if employed to full capacity or potential income if unemployed or underemployed. Gross income includes, but is not limited to, income from salaries, wages, commissions, bonuses, dividends, severance pay, pensions, interests, trust income, annuities, capital gains, social security benefits, worker’s compensation benefits, gifts, prizes, and alimony or maintenance received, and all other forms of earned/unearned income. Specifically excluded are benefits received from means-tested public assistance programs.

Id.

40. *Id.*

conducted a “careful[] review,” and noted that here, the trial justice looked beyond Joel’s tax returns and heard an “abundance of testimony from Mr. Amico” before concluding that Century’s net income and distributions to Joel should not have been included into Joel’s gross income calculation.⁴¹

Denise then argued that because Joel was the sole shareholder of Century, 100% of Century’s 2015 net income should be included in Joel’s 2015 gross income for the purposes of calculating child support obligations, and therefore the trial justice erred in excluding Century’s net income from Joel’s gross income even though it was listed on Joel’s W-2 form.⁴² The Court affirmed the trial justice’s reliance on a Massachusetts Supreme Judicial Court case, *J.S. v. C.C.*, which held that “pass-through earnings” from a closely held S corporation should not automatically be included, but rather courts should make a “specific determination about what portion (if any) of that pass-through income *realistically and fairly is or should be deemed available to the shareholder for purposes of paying support.*”⁴³

The Court next sought to determine whether the trial justice erred in excluding a \$1,235,846 distribution from Century to Joel that was used to pay his “personal” income taxes.⁴⁴ The Court again turned to *J.S.* and noted that, “[c]ourts in several jurisdictions have held that the portion of a distribution designated to pay taxes on earnings legitimately retained by the corporation is not available to a shareholder parent to satisfy a child support obligation.”⁴⁵

Next, the Court turned to Denise’s argument that the trial justice erroneously excluded Century distributions that were used to buy out Joel’s former partners and acquire sole ownership of

41. *Id.* at 233.

42. *Id.*

43. *Id.* at 233–34 (quoting *J.S. v. C.C.*, 912 N.E.2d 933, 941 (Mass. 2009)). The court in *J.S.* went on to list relevant factors that should be considered in determining what portion of undistributed income may be available to a shareholder for child support obligations: (1) “the shareholder’s level of control over corporate distributions” as measured by his or her ownership interest; (2) “the legitimate business interests justifying” the decision to retain corporate earnings; and (3) whether there was “affirmative evidence of an attempt to shield income by means of retained earnings.” *J.S.*, 912 N.E.2d at 942–43.

44. *Trojan*, 208 A.3d at 236.

45. *Id.* (quoting *J.S.*, 912 N.E.2d at 944).

Century.⁴⁶ Denise argued that those distributions were used to pay what were essentially “personal debts,” and pointed to Joel’s testimony that he incurred a “personal debt” in the buyout, that he himself was paying down the debt to acquire a marital asset, and that Century was not obligated to pay the note.⁴⁷ In addition to Joel’s testimony, Mr. Amico testified that the buyout debts were “outside the business,” and ultimately enhanced the value of the marital estate.⁴⁸ The Court agreed with Denise and held that the Century “distributions used by Joel to satisfy his personal obligation in purchasing the sole ownership in Century should have been included in his gross income calculation to determine his child support obligation.”⁴⁹ The Court reasoned that the Family Court administrative order defined gross income as “gross receipts minus ordinary and necessary expenses required for self-employment or business operation[,]” and ultimately Joel’s purchase of his partners’ shares was not an “ordinary and necessary expense[]” for Century.⁵⁰

The Court next addressed Denise’s argument that the trial justice erred when he excluded a \$61,375 Century distribution that Joel used to pay an annual premium on a life insurance policy, to which Joel’s daughters, including Tiffany, were named beneficiaries.⁵¹ The Court agreed with Denise and held that the \$61,375 should have been included in Joel’s gross income for the purpose of calculating child support obligations because “that distribution was used to satisfy a personal debt that Joel chose to take on himself.”⁵²

Lastly, the Court addressed Denise’s argument that the trial justice erred in excluding other “substantial financial perks” Joel enjoyed, including “luxury automobiles, car insurance, gasoline, country club memberships, cell phones, and other expenses that he

46. *Id.* at 237.

47. *Id.*

48. *Id.*

49. *Id.* “Joel testified that on January 1, 2012, Mr. Elliott sold his shares to Joel” and his brother John for \$2.5 million, of which Joel was responsible for \$1.25 million. *Id.* Two years after the agreement with Mr. Elliott, Joel purchased John’s ownership shares in Century for \$7.2 million, leaving Joel as the sole shareholder of Century. *Id.*

50. *Id.* at 239.

51. *Id.*

52. *Id.* at 240.

financed through distributions from Century.”⁵³ While the record reflected that evidence of those “perks” was presented during the divorce trial to calculate the marital estate, a settlement agreement was eventually reached, thus resolving any prior issues with respect to the marital estate.⁵⁴ The only issues remaining subsequent to the settlement agreement were child support and medical, and therefore the Court held that by not raising the “substantial financial perks” issues at the September 28, 2016, child support hearing, Denise had waived those issues on appeal.⁵⁵

COMMENTARY

The Court held that the trial justice correctly excluded Century’s 2015 net income and the 2015 Century distribution to pay income taxes from Joel’s gross income, but remanded the case to recalculate Joel’s gross income upon inclusion of the 2015 Century distributions that were used to pay for stock buyouts and a life insurance policy.⁵⁶ These “personal” debts are easily distinguishable from the requirement that Century increase its equity to \$10 million in order to receive bonds. While the Court’s reasoning is surely sound, it is somewhat contradictory in that, at least as it pertains to the life insurance policy, the distribution did not “inure to [Joel’s] benefit.”⁵⁷ If anything, the life insurance policy, which named Tiffany as a beneficiary, was for *Tiffany’s* benefit. Although it is easy to see why the Court held that Joel undertook this debt personally, and therefore the distribution that was used to pay for his personal debt should be included in his gross income to calculate his child support obligations, one could argue that the distribution was already supporting the child. The Court, in deciding that the life insurance policy was “a personal debt that Joel chose to take on himself,” essentially categorizes the life insurance policy as an “[extra]ordinary and [un]necessary expense.”

53. *Id.*

54. *Id.*

55. *Id.* at 240–41.

56. *Id.* at 241.

57. *See id.* at 236.

CONCLUSION

The Rhode Island Supreme Court held that, for purposes of calculating Joel's child support obligations, the "distributions used by Joel to satisfy his personal obligation in purchasing the sole ownership in Century should have been included in his gross income calculation to determine child support obligation," and the distribution used to pay for Joel's life insurance policy should have been included into his 2015 gross income.⁵⁸ The case was remanded to the trial court to "recalculate the assets available to satisfy Joel's child support obligation."⁵⁹ The Court made sure to point out that, after the trial justice recalculates Joel's assets, the trial justice "may then deviate from the worksheet guidelines 'only if he or she finds that the recommended child support order would be inequitable to the child or to either parent.'"⁶⁰ In the end, the child support order must reflect "an amount reasonable or necessary for the child's support[.]"⁶¹ After all, "no child, no matter how wealthy the parents, needs to be provided more than three ponies."⁶²

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58. *Id.* at 237, 240.

59. *Id.* at 240.

60. *Id.* (quoting *Vieira v. Hussein-Vieira*, 150 A.3d 611, 618 (R.I. 2016)).

61. 15 R.I. GEN. LAWS § 15-5-16.2(a).

62. *Trojan*, 208 A.3d at 236 (quoting *Downing v. Downing*, 45 S.W.3d 449, 456 (Ky. App. Ct. 2001)).