



Family Law Accounting News

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David Cantor, CPA/ABV has been working almost exclusively in Family Law Accounting since 1990 in both Arizona and California.

He has worked on over 1,000 Family Law cases and has experience in all aspects of Family Law Accounting including Business Valuations, Separate Property Tracings, Calculation of Income For Purposes of Determining Maintenance and Support as well as many other financial issues.

Mr. Cantor has testified in Court over 100 times as an expert witness.

DETERMINING INCOME FOR CHILD SUPPORT/SPOUSAL MAINTENANCE WHEN YOU HAVE SELF-EMPLOYED INCOME

What is thought of as being a relatively simple task in a family law matter is often the most misunderstood and mistake-prone task. ARS §25-320 defines “Gross Income” of the parents, with the caveat that “Terms such as ‘Gross Income’ and ‘Adjusted Gross Income’ as used in these guidelines do not have the same meaning as when they are used for tax purposes.”.....so let the games begin.

Without repeating §25-320 verbatim, the basic concept is to include income from various sources, including self-employment net income. It is the self-employed net income that often causes the problems. Remember, self-employed income can be from a Sole-Proprietorship (Schedule C), Partnership (Form 1065) or a Corporation (Form 1120 or 1120S). The bottom line is, if the spouse in question has an ownership interest in the business and can control the income and expenses beyond normal operations of the business, there is a good chance they are self-employed for purposes of determining income.

For purposes of this article, unreported income (or any income manipulation for that matter will not be addressed, but should always be addressed if the facts and circumstances dictate). Instead, I will focus on the some of the expenses paid and deducted by the business that are either personal in nature (perquisites) or may not reflect the actual ongoing cash operations of the business, as well as undistributed income.

Depreciation/Asset Acquisition – Depreciation represents the allocation of the cost of an asset over the estimated useful life of that asset (this amount can be different for tax vs. financial statement reporting). This is not necessarily representative of the actual cash spent during the period being analyzed. For example, a business may buy new office furniture for \$30,000 by doing a five year financing plan. For tax purposes they may be able to deduct the entire \$30,000 in the year of purchase, but only spent \$6,000 cash during the year of purchase. In this example, the depreciation exceeds the actual cash spent by \$24,000 (\$2,000 per month) and represent reported expenses of \$24,000 more than actual cash spent. Over time, this will eventually even out, but if you are dealing with temporary maintenance/support, this can skew the results if this issue isn’t properly addressed.

Health Insurance – I bring this item up only to point out that while the paying spouse may be having their health insurance paid for by the business, the recipient spouse has to utilize their own post tax funds to pay for their (as well as possibly the children's) health insurance. Just an item to keep in mind.

Perquisites – These amounts represents personal expenses paid and deducted by the business. Some common categories of perquisites can be auto, travel, meals, insurance, cell phone and entertainment. While these items not only increase the income of recipient, they can also come into play if a Marital Standard of Living is being prepared and were ongoing during the marriage.

Cash vs Accrual – This issue can be complex when a business's financial statements and tax returns are prepared on an accrual basis versus cash basis. On accrual basis reportings, you will usually see accounts receivable as well as accounts payable. The important factor to remember is that on the accrual basis, income is reported when earned, not when payments are received and expenses are recorded when they are incurred and not when paid, resulting in a 'timing difference'. In simple terms, this means that the income being reported may not necessarily be indicative of actual cash transactions. When dealing with accrual basis reports, a close look should be made at these timing differences, especially if you are dealing with temporary maintenance/support.

Principal On Note Payments Paid/Received –While interest expense and interest income amounts on obligations are reported on the income statements, the actual principal payments made or received on these same obligations are not reflected on the income statements. While principal payments do not impact income, they can impact ability to pay maintenance/support in that if a business is receiving note payments, there is an additional source of cash, or if the business is paying off a note, there is an additional cash expenditure that is not available to the business owner. Keep in mind, that if there is a note payable related to a depreciable asset, the depreciation expense and related note payment need to be addressed hand in hand so that a possible double count of expenses/expenditures is not made.

Undistributed Earnings – When a corporation pays a salary to the owner, there are occasions when the business still shows net income at the end of the year. The question is; should this income be included in the income of the owner. In order to determine the answer, you need to address why the income wasn't taken as salary. The reason for not taking the income as salary may be one of the reasons previously discussed (note payments, accrual basis accounting or asset acquisition) or it could be to keep cash in the business for future expansions, projected downturns in the business.....or divorce planning. The bottom line is that when you see undistributed income, you need to ascertain if there was a legitimate business purpose for not taking this income as salary and thus possibly being available to pay maintenance or support.

There are no hard and fast rules in determining income. An important reminder is that the **facts and circumstances** of each case will ultimately dictate how these and other issues are handled. Just remember that these are a few of the common issues that arise in determining a spouse's income and need to be addressed to adequately defend your client's position.

Please feel free to contact me with questions on this, or other Family Law accounting questions.

Calculation Reports For Family Law Business Valuations – A Less Expensive Alternative

A relatively new type of valuation engagement is the Calculation Engagement. These engagements are less expensive than the valuation engagement, but can often be used to facilitate settlement when an outstanding issue is the business value.

Calculation engagements (which have certain requirements detailed in the American Institute of Certified Public Accountants Statement on Standards For Valuation Services No. 1) are agreed upon procedures by the valuation consultant and the client(s) as to the valuation assignment. These procedures do not include all of the procedures that would be considered necessary in a valuation engagement.

This type of valuation is often used to get an idea of the business value without incurring the expense of the full valuation engagement. It should be noted that the results of calculation engagement may not be the same as if the full valuation engagement had been performed.

If there are no complex issues and all of the documents are provided as requested (and of course there is cooperation from the parties), calculation engagements **can be prepared for as little as \$2,000.**

Considering that a swing in value of just \$5,000 can mean a cost or benefit to your client of \$2,500, a calculation of value is a small price to pay to ensure that your client is well informed on the value of a community asset.

It should be noted that in all probability a valuation consultant will NOT testify to a calculation engagement that they have performed. However, if it is determined that the case is headed to Court and testimony will be needed, additional work can be performed to convert the calculation report into a valuation report which the consultant would testify to.

Whenever you retain someone to perform a business valuation for you, make sure that they are credentialed in business valuations (ABV, CVA, ASA....). This will ensure that you are hiring someone who has proven knowledge in the area of business valuations.

FREE CLE CLASSES IN YOUR OFFICE

Cantor Forensic Accounting offers free 2 hour CLE* classes at your office. Working with you, I can customize a class on any Family Law accounting issue to meet your office needs and fulfill a minimum of two hours of CLE. Topics can include:

- ◆ Business valuation issues related to marital dissolutions
- ◆ Calculation of income
- ◆ Separate property tracing
- ◆ Document requests
- ◆ Marital Standard of Living
- ◆ Income tax issues related to marital dissolutions
- ◆ Reimbursement claims
- ◆ Stock option allocations

Please call me to receive more information on these classes.

*The State Bar of Arizona does not approve or accredit CLE activities for the Mandatory Continuing Education requirements of Specialists. This activity may qualify for up to two hours toward your annual CLE requirement for the State of Arizona, including two hours of advanced level training in the area of Family Law. A minimum of 5 attorneys are required to attend.