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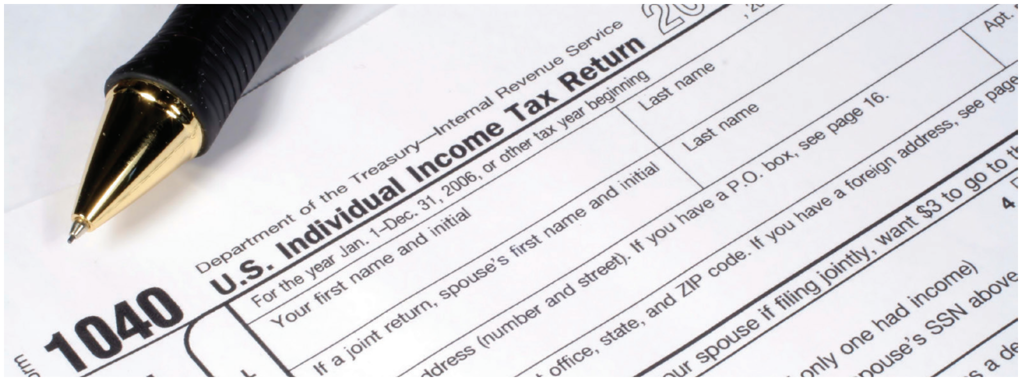
FORENSIC ACCOUNTING

Determining Income Available for Child Support and Spousal Maintenance

By David Cantor, CPA/ABV

"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." This section from Arizona Revised Statute §25-320(5) clearly states that gross income for support purposes is not derived by looking at a tax return. However, the tax returns and financial statements are the starting point for determining gross income.

While many sources of income are straightforward, such as wages, and interest and dividends from bank and brokerage accounts, most other sources require a little (or maybe even a lot) of digging to determine if the amounts are truly gross income as intended by §25-320. Unfortunately, there are many subtle accounting issues related to income that get overlooked or misapplied in trying to accurately determine the paying spouse's true gross income that can have a significant impact on support and maintenance.



Business Income – If the spouse owns a business, the starting point would be to look at the income attributable to the spouse, which would include salary, distributions, draws and profits left in the business. A more detailed look at the financial statements or tax returns would be the next step. If there is depreciation, this amount would impact taxes, but it doesn't represent pure cash expenditures. This could be a possible increase to gross income for the paying spouse. But the opposite can be true if the business routinely purchases assets that exceed the current year's depreciation, resulting in an adjustment to reduce gross income. Another issue is debt service. If the business is paying off a loan, the interest expense is reflected on the tax return reducing income, but the actual principal payment is not reflected. Therefore, a decrease to gross income may be warranted for that principal payment. A final common issue in determining true business income is perquisites (personal expenses paid and deducted by the business). These amounts actually reflect tax-free income to the business owner and in some cases can have a significant impact on gross income. When these issues exist, it is important to identify each one and justify why any adjustments are being made for them.

Recurring vs. Non-Recurring Income – §25-320 also addresses the issue of recurring vs. non-recurring income. If the amount is not recurring, it may not necessarily be includable as gross income. Perfect examples of these are infrequent capital gains from sales of stocks or other assets, annual performance bonuses or granting of stock options, just to name a few. In each case, it is imperative that you look at the source of the income, the reason it occurred and make a determination as to its ability to happen again. For example, if there is a history of performance bonuses that occur once or twice a year, they are probably recurring and includable (although they would need to be annualized for purposes of support and maintenance calculations). Then there might be the case when a spouse received shares of stock for their high school graduation and sold it 20 years later…..the only stock transaction they ever made. This would be a good example of non-recurring income. You need to focus on the purpose of each transaction before making a determination whether it is recurring or non-recurring.

When income is not income….but it is income – There may be circumstances where a source of income is considered non-recurring (the aforementioned stock sale, for example) for determining support. Suppose that transaction netted $500,000 in proceeds. While the $500,000 might not be included in income, what about the potential earnings that the $500,000 will generate? §25-320(5)(G) states "The court shall not take into account the impact of the disposition of marital property except……or to the extent that such **property generated income to the parent.**" So an argument can be made that the potential interest income the $500,000 generates can be considered as gross income.

These are just a few examples of how determining gross income is not as obvious as just looking at tax returns and financial statements. It is important that you review and understand the financial implications of the transactions that relate to the parties involved. Remember, no two cases are alike and each case needs to be analyzed based on their own unique facts and circumstances.

David Cantor, CPA/ABV of Epps Forensic Consulting has been practicing family law accounting since 1990 in both Los Angeles and the Phoenix area. His experience includes support and maintenance calculations, business valuations, separate property tracings, marital standard of living determination as well as many other family law-related issues. Mr. Cantor has been involved in numerous high net worth cases. For more information, please call 480-620-8486 or visit www.eppsforensics.com.