

FINANCIAL ISSUES IN DIVORCE: IT'S ONLY MONEY!

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1. What is income available for support?

A. Background.

A party's net income must be determined to make both spousal support and child support orders. Child support determinations are subject to statutes (Family Code §4050, et seq.) and items that are included within the definition of "income" are specifically enumerated (Family Code §§4058 and 4059).

B. Gross income.

i. Family Code §4058(a)(1) and (2) set forth the statutory basis for the determination of annual gross income and requires the following items to be considered:

Wages

Salary

Commissions

Bonuses

Annuities

Royalties

Interest

Trust income

Rents

Dividends

Pensions

Business receipts less expenditures (from the proprietorship of a business)

Unemployment insurance benefits

Worker's Compensation benefits

Disability insurance benefits

Social Security benefits

Spousal support actually received

ii. Under Family Code §4058(a)(3) and (b), the court has discretion to consider the following as income:

Employee benefits

Self-employment benefits

Earning capacity

iii. Employee and self-employment benefits.

The court may consider "employee benefits or self-employment benefits, taking into consideration the benefit to the employee, any corresponding reduction in living expenses, and other relevant facts." Family Code §4058(a)(3).

These benefits typically include the following:

Expense accounts

Personal expenses paid through company

Vehicle allowances

Company credit cards

Pension and profit-sharing plans

Medical reimbursement plans

Payment for unused sick leave

Education benefits

Day-care privileges

Health or social club membership

iv. Earning capacity.

Generally, the actual earnings of a party are used in setting support, absent a showing of a deliberate attempt to reduce income. See *Philbin v. Philbin* (1971) 19 CA3d 115. *In re Marriage of Regnery* (1989) 214 CA3d 1367, earnings capacity is composed of (1) the ability to work. . . ; (2) the willingness to work. . . ; and (3) an opportunity to work. . . . If the three factors are present, the court must apply the earning capacity standard; if ability to work or the opportunity to work is lacking, earning capacity is absent and the application of the standard is inappropriate.

C. Items not included in income.

Family Code §4058(c) specifically exempts the following from income:

i. Child support actually received:

(a) from the current payor

(b) from a previous relationship.

ii. Need-based public assistance income.

D. Overtime and second jobs.

i. The general rule is that earning capacity should not be based upon an extraordinary work regimen, but instead upon an objectively reasonable work regimen as it would exist at the time the determination of support is made. *In re Marriage of Simpson* (1992) 4 CA4th 225.

E. Fluctuating and bonus income.

i. Under Family Code §4064, the court may adjust the child support order as appropriate to accommodate seasonal or fluctuating income of either parent.

ii. Speculative bonuses or fluctuating income can be treated as follows:

a. Omit the bonus income, and require that a certain proportion of the bonus be paid as additional support when received.

b. Base an order on an average of reported income from previous years.

c. Base an order on a historic minimum, and require a certain percentage of any additional income over that amount to be paid as support.

d. If the fluctuations are seasonal, the annual income can be divided by 12, or the payments can be weighted depending upon when income is received.

F. Calculating net income.

i. Family Code §4059 allows the following deductions from gross income to arrive at net income:

Mandatory union dues

Mandatory retirement contributions

Health insurance - for parent and children obliged to support

Support actually being paid for another child per a duty of support

Spousal support (another relationship) actually being paid pursuant to court order

Job-related expenses

Hardship deductions allowed by statute

Actual Federal and state income tax liability

Social Security or self-employment contributions

2. **Business value - is the business worth pursuing?**

A. Financial statement approaches.

i. Balance sheet tests.

Evaluate the business' statement of assets and liabilities to determine if any equity (assets over liabilities) exists. Adjustments to the financial statements may need to be made for accounts receivable, fixed assets, real estate, or marketable securities.

ii. Income statement tests.

Evaluate income statement to determine if income in excess of reasonable owner's compensation exists. Adjustments to the income statement should be made for owner's compensation, owner benefit expenses, unreported revenue, and extraordinary items.

iii. If the business does not have positive equity or earn income in excess of reasonable value of owner's services, it is unlikely that value exists, in the absence of a clear market for the sale of its goodwill.

3. **The smokescreen of financial documents.**

A. Important financial documents (for businesses):

i. Balance sheet - statement of assets and liabilities of a business at a particular date. Assets will be stated at historical cost, which may require adjustment. Cash-basis financial statements exclude important assets such as accounts receivable and work-in-process.

ii. Income statement - statement of revenues and expenses of the business. In small businesses, it is reasonable to assume that expenses may be overstated by personal charges to the business. Revenues may be understated because of unreported income.

iii. General ledger - the accounting record that summarizes each asset, liability, revenue and expense account. By reviewing the general ledger, one can see the detailed increases and decreases to each account during the year.

iv. Cash receipts journal - the accounting record that records the detail of each receipt of the business during the year.

v. Cash disbursements journal - the accounting record that records the detail of each expenditure of the business during the year. In small businesses, the checkbook is often the cash disbursements journal.

vi. Bank statements for each account.

vii. Brokerage statements for each account.

viii. Loan application files.

ix. Aging of accounts receivable - a detailed list of accounts receivable that categorizes each receivable into age groups. Obviously, more current receivables tend to be better than older receivables.

x. Work-in-process ledger - work-in-process is work that has not yet been billed to the client. It is work performed that is "before" it becomes an account receivable.

xi. Notes payable - copies of all notes payable and the loan application file.

xii. Premises lease.

xiii. Depreciation schedule - a list of fixed assets that includes cost, purchase date, depreciation taken and remaining undepreciated balance.

xiv. Agreements restricting the transfer of shares.

xv. Employment agreements.

B. Important financial documents (for individuals):

i. Personal tax returns.

ii. Personal check registers.

iii. Personal bank statements.

C. Practical considerations:

i. It is most effective to develop an understanding of the accounting system of the business and make a focused document request, rather than obtaining thousands of financial records.

ii. The early involvement of a financial consultant is helpful to understand the accounting system and identify the necessary documents.

iii. It may be necessary to communicate with and/or depose the chief financial officer of the business to understand the accounting system.

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