

## Divorce: What's in a tax return?

The detail review of a divorcing couple's tax return can provide attorneys with a plethora of information that may help their clients attain a more financially equitable divorce settlement.

Just a glance at the first page of form 1040 can show if someone is self-employed, has investment income, other income from properties, or income from a closely-held business. A detail review of the supporting schedules can provide significant data that can have an impact on child support, spousal maintenance, and the property division.

Self-employed individuals report their income on Schedule C. A review of the form with its supporting schedules can show a "wealth" of information. What is being depreciated and over how long a period of time? Are other expenses such as travel, entertainment, gifts, or office supplies comparable to the same expense items found in similar businesses? Are these expenses legitimate business expenses, i.e. reasonable and necessary for the production of income or, are they of a personal nature that should be added back to determine the true net income of the owner? What about the gross income (sales or fees) of the business? I always recommend the review of at least the prior three year's tax returns to assess the consistency of the income. Was the business growing until the year of separation? Why? Is there a base of income that is paid because of vested renewals or fees? This could lead to an uncovered marital asset.

Schedule E will list income from other business interests. If a partnership interest is shown, a review of the partnership tax return and associated partnership agreement should be considered. Along with analyzing and comparing the income and expenses, the value of the partnership could be another marital asset. The same holds true if the spouse is a shareholder in an S Corporation. The evidence of ownership in a closely-held business, either a C or S corporation, may also require a detail review of those company's financial statements and Board Minutes. The examination may reveal additional income recorded as shareholder loans, deferred compensation, deferred bonuses, additional employee benefits, additional retirement plans, etc.

What about the rental income or loss that will also be shown on Schedule E? Are the expenses related to the operation of the rental property or are they personal expenses? What's being depreciated? What is the value of the building (another possible marital asset)? Are there any rental losses that could not be deducted but can be used in future years?

Comparing amounts on Schedule B, interest and dividends, for the last three years can also be revealing. What's happened to Bank accounts where interest was recorded in one year and not the next? What about dividends that have also "disappeared"? A review of the Brokerage statements may reveal additional accounts that have not been listed as a marital asset. An analysis of the related Schedule D may show that stocks or bonds may have been sold. Where were the proceeds deposited? Is the account shown as an asset?

Not all divorce cases require this kind of analysis; however, if there is any doubt about a spouse's income or there is a concern about "hidden" assets, this type of review may provide a more accurate picture of the couple's finances.

*This article was written by John Faggio and was published in Howard County's Business Monthly, February 2005. It has been updated by the author on June 24, 2009.*