Forensic Forum

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Calendar

Recent and Upcoming Speeches Include:

February 2004

5 New Jersey Bureau of Securities – Using Tax Returns to Trace Funds & Find Assets (Newark)

21 ICLE – Cutting Edge Financial Issues in Divorce (Fairfield)

March 2004

27 Family Law Section – Goldman & Anti-Goldman (Las Vegas)

June 2004

16 The Shenkman Series – Shareholder Agreements (Teaneck)

August 2004

4 ICLE – Divorce Taxation (Fairfield)

September 2004

29 CPA Club of New Jersey - Business Valuation (West Orange)

October 2004

27 ICLE – Divorce Taxation (Mt. Laurel)

December 2004

9 CPA Club of New Jersey - Business Valuation (Saddlebrook)

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Our Litigation Team

- Kal Barson, CPA/ABV, CFE
- Vincent Bianco, MBA
- Marizoil Delossantos, CPA
- Beth Doblosky, CPA, JD
- Stacey Jung
- Eric Malinowski, CPA
- Marshall Morris, CPA, ABV, CFE (Director of Forensic Services)
- Sean Weiland, MBA

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- Janet Barson & Laura Casill (Editorial, Design & Layout)

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Fraudulent Conveyance – Make My Day

One of the more outrageous commercial litigation cases we have handled (outrageous from the point of view of the outright blatant fraud committed by one of the parties) involved proving on behalf of our client that a particular (and substantial) customer had fraudulently conveyed it's assets to another company it created so as to deliberately evade paying its creditors (our client). These types of situations are particularly difficult and particularly galling. At the risk of some brief editorializing, it is unfortunate that our system doesn't make an example of more of these thieves (and indeed, what is involved here is theft) by putting them in jail and thereby impressing upon the business community that these types of actions are not merely civil wrongdoings, but criminal wrongs.

Back to the case at hand. The obvious broad procedure was for us to review the books, tax returns and various financial records of both the old (now defunct) company and the new company. Also, to the extent we felt it relevant and had access to certain documents, we reviewed outside third-party information. We did a thorough and detailed analysis of selective records, and were able to prove some truly outrageous conduct. The following is illustrative of what we found:

• Money was transferred (checks cut) from the old company (Old) to the new company (New) with no supporting documentation.

• Checks were drawn from Old, payable to the major shareholder of Old, deposited in his bank account, and on the same day in the same amount, a check from his personal bank account was drawn to and deposited in New.

• The companies were in the same business.

• The companies had the same customers.

• An analysis of the weekly postings to the sales sub ledger revealed that many customers had a lockstep reduction in the volume of business they did with Old concomitant with an increase in the volume they were doing with New.

• In fact, when weekly sales to many of these customers were combined for Old and New, the total was almost identical to what these customers were doing with Old before the shifting process began.

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Divorce Taxation: The Basics – our new book, 40 pages explaining Divorce taxation in layman's terms, is available – complimentary copies for the asking. Contact us if you haven't received your copy.

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• The general ledgers of each of the companies had intercompany accounts reflecting activity between Old and New.

• The companies used the same bank.

• A note obligation of Old to its bank was recast, in the exact same amount outstanding, to become the obligation of New (it should be noted that the note was personally guaranteed so that the owners of the business could not avoid paying the bank).

• The companies had the same employees – they didn't miss a beat, with the last payroll for Old actually being paid by New.

• The bank account of Old was closed out by having a check drawn against it for the remaining balance, and that check directly deposited into the bank account of New.

• A financial statement was prepared combining Old and New, almost like a consolidated financial statement.

• We obtained a current D & B report on New – which listed the history and supplier reference sources of Old as one of the attributes of New.

• The ownership structure (percentage owned by each of a few shareholders) was identical between Old and New.

There wasn't even a casual attempt to camouflage the fact that New was exactly the same as Old, with simply a different name on the door. It never ceases to amaze us how some people don't have a problem sleeping at night knowing that what they have done is not only unethical and dishonest, by barely a hairsbreadth away from outright theft.

FOCUS ON FUN

Accountants & Humor – a Sociological Fable

An individual who conducted seminars promoting a firm's tax services and advocating tax strategies for turning personal expenditures into deductible business expenses, was convicted of conspiracy to defraud the United States and aiding in the preparation of false returns. United States v. Fletcher, No. 02-2307 (8th Cir. 3/6/03)

Donald Fletcher told prospective clients that he knew of "secret" provisions hidden in the Code – provisions that accountants and attorneys were not trained in – allowing deducting a cat as a rodent control device, and the cost of a bird as aerial surveillance. Clients were persuaded to sign a participation agreement agreeing to pay either a percentage of their gross income or a percentage of the tax savings generated by his services. One client who operated a home day care center deducted veterinary food costs for her family pets as security and rodent control expenses. A doctor and his wife deducted as a security expense $17,384 in health care costs incurred for the heart condition of the wife's intravenously fed, non-mobile, 11 year-old German shepherd. A dentist deducted $12,000 in wages allegedly paid to his minor children when no such wages were ever paid.

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January 2005

13 Florida CPA Society – Forensic Accounting (Ft. Lauderdale)

28 ICLE – Determination of Income (Iselin)

May 2005

7 NJSCPA/Family Law Section – Divorce Taxation (Iselin)

Ongoing

The BARSON GROUP CLE Series

- February 4, 2004
- April 12, 2004
- April 13, 2004
- April 21, 2004
- May 3, 2004
- June 1, 2004
- June 3, 2004
- June 8, 2004
- June 21, 2004
- October 2, 2004
- October 5, 2004
- October 6, 2004
- November 1, 2004
- November 2, 2004
- November 8, 2004
- November 11, 2004
- November 17, 2004

Recent and Upcoming Media Situations:

• ***Book – Second edition of Investigative Accounting in Divorce*** by Kal Barson, published by John Wiley and Sons

• ***Book – Divorce Taxation: The Basics –*** by the Staff of The BARSON GROUP

• ***Chapter – Divorce Taxation - NJ Family Law*** by Lexislaw (March 2004)

• ***Article – Detecting & Preventing Workplace Fraud*** – by Marshall A. Morris – Middlesex County Bar Advocate (January 2004)

• ***Article – Value to the Holder – Valuation's Nadir?*** – American Journal of Family Law (Summer 2004)

• ***Article - Elements of a Business Valuation Report*** by Marshall A. Morris –American Journal of Family Law (Fall 2004)

• ***Article – Forensic Accounting – A Force for Good*** – to be in New Jersey Family Lawyer (late 2004)

• ***Article – The CPA's Role in Estimating Business Damages*** by Marshall A. Morris – Middlesex County Bar Newsletter ***(late 2004)***

The Old Double Dip

A recurring issue in divorce litigation, one which has generated considerable current interest, is where one of the parties owns (an interest in) a business, and the interplay between support and business valuation. Many business valuations include a determination as to what the reasonable compensation is for the business owner. It is not unusual for that determination to conclude that the actual compensation taken by the business owner was in excess of reasonable compensation. That excess becomes a factor (is capitalized) in determining the value of the business – which in turn becomes a factor in determining how much the non-business spouse receives as part of equitable distribution. However, at the same time, the lifestyle enjoyed by the couple, and the figure which is typically used for determining ongoing support obligations, is that of the total compensation received by the business owner. Does this create a double dip for the benefit of the non-business spouse to the detriment of the business owner spouse?

Even if you do not believe there's a "double dip problem", there's clearly a possible double dip situation when the same total income package that constitutes support for the marital unit is also (that amount in excess of reasonable compensation) capitalized to arrive at the value for that business. That value in turn is then allocated between the spouses. In such situations, there's no escaping that the same income is being used both relevant to determining support, and as an element in determining value. To that extent, one might argue there's a double dip. That is not the same as saying there's a problem.

If you ascribe to the position that there is a double dip problem, there are a few ways to address it.

• You could artificially lower the value conclusion. This is playing a numbers game for which there's no support.

• You could play with the allocation percentages – giving a smaller than would otherwise be the percentage allocation to the non-business spouse. This one is kind of easy to do in concept, but probably plays havoc with social policy and real world practicalities.

• You could simply reduce the support obligation. However, that might be very detrimental to the one receiving support, especially if that person is also the custodian of the children. After all, double dip or not, they are (were) living on that income.

• You might do somewhat of a compromise, reducing the support for those years representing the number of years for which the income was capitalized. By way of simple illustration, if a 20% cap rate were used, the valuation is based on a multiple of five years of income. Thus, reducing the support for five years (so as to flush out this double dip concern), or perhaps defer five years worth of payments on the buyout of the business interest (if that is applicable), may address the double dip. This too comes with its own set of problems.

There are a number of counters to suggest the double dip argument is defective.

• It is possible, and not unusual, to value a business based on its gross revenues, or perhaps some form of units of production – without ever addressing the issue of the compensation or benefits received by the business owner. There are valid reasons for such an approach – including the greater reliability of the integrity of the top line (revenues) as compared to the bottom line (income or compensation to the owners). After all, how one runs his/her business or practice can be a very personal type situation, with some burdening a business with perquisites, or perhaps having a style of operations (whether leaner or fatter than might otherwise be the case) that another might not consider necessary or appropriate. By dealing with the top line, we eliminate these issues, as well as judgment or value calls as to whether certain expenses are necessary, recurring, personal or not.

• Relating to the preceding, there is a fairly substantial body of evidence to support that, for some types of businesses, there is a direct correlation between the sales price of the business and its revenues – a relationship many times every bit as strong as the relationship between the net income/compensation received from the business and the value of same. As such, no determination is or need be made as to reasonable compensation – and again value can be determined irrespective of compensation.

• Assuming of course that the business continues as successful as it was in the past, the owner's compensation will continue undepleted, despite the buyout of the spouse's interest in that business. That is exactly what happens most of the time. Notwithstanding any equitable distribution buyout obligation, compensation continues as it was in the past (often fluctuating, and often increasing) and the value of the business remains.

• The reality of the marital lifestyle is that in most situations the standard of living was fueled and maintained by the total income drawn from the business, not from some calculated "reasonable compensation" level. Thus, it would be inequitable to attempt to establish support predicated upon a lower hypothetical reasonable compensation level which

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is not reflective of how the couple or family lived. To try to take the offsetting value (for those who are concerned about a double dip) out of the value of the business and, therefore, out of equitable distribution, might leave no value to the business. After all, in many cases there is little income left in the business because the owners take out virtually everything.

• Any adjustment to the alimony/support would mean forcing on the receiving spouse (and often that also means the children) a standard of living lower than that which they were used to and which (arguably) can still be afforded.

• Arguably, the double dip issue has almost always been addressed, though implicitly or even accidentally rather than overtly. As almost all practitioners will tell you, the non-business spouse usually gets less than 50% of the assets despite the marital partnership concept, and similarly, that same spouse, who is usually the one receiving support payments, usually gets less than sufficient support to provide that person with a 50% share of the marital income (and that is the case usually even when there are children involved). Thus, whether by design, accident or tradition, our system has long provided for a cushioning of the payment obligation of both the buyout of the business interest as well as the income stream/support going forward.

• The so-called remedies would all create potentially significant social policy clashes - with the result that the "cure" may be far worse than the "disease".

While there are compelling arguments in favor of both sides, I personally prefer the double scoop (with sprinkles).

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