

Forensic Forum

published by the Barson Group

Volume 4 - Issue 3

Fall 2005

Lifestyles of the Slick and Infamous

Especially since the dawn of *Crews*, much attention, some would say excessive attention, has been given to the matter of determining the lifestyle "enjoyed" during the marriage. In theory, it almost sounds rather simple - but as we all know, in practice this has become anything but simple, and is often an expensive exercise. The purpose of this article is to attempt to address, from the perspective of litigation oriented accountants, some of the issues involved in developing a truly reliable/accurate lifestyle analysis (LSA).

NUMBER OF YEARS - Perhaps one of the first, if not absolutely the first, issue to address in doing an LSA, is the timeframe, the number of years we are to include. The need is to determine the lifestyle during the marriage. However, there has been no definitive statement as to exactly what that means - and indeed, since there are many situations that are not the norm, there may not be an easy way to define this. Are we talking about the lifestyle during the last year of the marriage, the last three years, the last five years, or the entirety of the marriage? There seems to be a default to using the last three full years of the viable marriage. Even then, what with perhaps a separation of a couple of years prior to the filing of the divorce complaint, dramatic (and often not even dramatic) changes or fluctuations in the income/fortunes of the marital estate, the different agendas etc. - by no means can three years be considered inviolate. In fact, our firm and the author of this article handled the accounting part of the remand on *Crews*. We used as many years of the entirety of the marriage for which we had support - which was eight years prior to the filing of the complaint.

One possibility to consider - in order to shorten the time span necessary, facilitate the job and save on costs - would be to take one year and assume that one year was fairly representative of the lifestyle for whatever period you might otherwise analyze. Obviously, this is something that has to be thought through carefully by counsel and client, and probably would be best if it were agreed to by both sides so as to avoid a battle between

.....continued on page 2

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.

The Barson Group
60 East Main Street
P.O. Box 8018
Somerville, NJ 08876

Tel: 908-203-9800
Fax: 908-203-9399
E-mail: kal@barsongroup.com



Calendar

Recent and Upcoming Speeches Include:

April 2005

02 & 20 - ICLE - Unreported Income (Mt. Holly; Fairfield)

May 2005

07 - NJSCPA/Family Law Section - Cutting Edge Issues in Business Valuation (Iselin)

September 2005

20 - Middlesex County Bar - Forensic Accounting (New Brunswick)

29 - AAML - Valuation in the Extreme (Atlantic City)

November 2005

15 - CPA Club - Investigative Accounting Process in Litigation (Saddle Brook)

21 - Judicial College - Tax Aspects of Settlements (Fort Lee)

December 2005

9 - Florida Institute CPAs - Basics of a Financial Investigation (Ft. Lauderdale) (full day course)

Ongoing

The BARSON GROUP CLE Series

- June 22, 2005
- September 12, 2005
- November 19, 2005

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 (April 2005)
- **Article - Divorce Taxation** - New Jersey Lawyer (January 24, 2005)
- **Article - Litigation Awards: A Taxing Problem** - New Jersey Lawyer (September 5, 2005)
- **Article - Forensic Accounting - A Force for Good** - to be in American Journal of Family Law (late 2005)

* * * * *
Janet Barson & Laura Johnson
(Editorial, Design & Layout)

dissimilar analyses. For most families, as long as income has been fairly constant over the past few or several years, and as long as the spending habits haven't changed dramatically, using one year (most likely the year prior to the filing of the complaint or perhaps the year before that) would probably provide a fairly reliable conclusion.

DISCOVERY/ACCESS TO RECORDS - "Speaking" as forensic accountants who have done many LSA's, the matter of access to records is our biggest problem with this type of work and the biggest obstacle for our doing it in a timely, complete, efficient and cost effective manner. It is all well and good to decide that we need to do an LSA that covers the last three years of the marriage. However, all too often, we are faced with horrendous basic discovery problems - the records are simply not readily available. Many times, after several items of correspondence back and forth, and finger pointing, it is finally agreed by all that authorizations need to be sent to various financial institutions so as to secure the documents we need. This brings in a whole slew of additional problems - such as who signs for what, coordinating signing between the parties and counsel; determining to which institutions authorizations have to be sent, even when you know the institution, finding out where to send the authorization; following up with these institutions when they inevitably take their sweet time, dealing with institutions that have merged, no longer exist or did not retain the records the way you want them; the cost of securing this type of information; dealing with the problems such as we are provided with bank statements but no cancelled checks so that it is literally impossible to determine how the money was spent.... If our charge is indeed to provide a detailed and complete LSA, these types of issues may present insurmountable obstacles. The way to address this is to get practical, and accept the need for certain agreed to shortcuts or limitations. Unfortunately, all too often, one side or the other has a problem with that type of approach - whether the problem is reasonably or unreasonably expressed.

NON-RECURRING ITEMS - What do we do about aberrations, unusual or non-recurring items? We had a case not long ago where the couple bought a car every two years. Since we were doing a several year LSA, we felt that using the car purchases as such (the family carried no debt) was reasonable, and we simply averaged them over the several year LSA. The other side (in what was clearly a ridiculous and unreasonable position) suggested that the purchase of the cars were non-recurring aberrations which should not be factored into the LSA at all. It took quite a bit of arguing to get them to simply agree that, at the least, a reasonable lease expense proxy should be used. Perhaps that was reasonable, though frankly the reality of how this family lived was a more reliable barometer of the LSA than concocting a hypothetical lease expense. In a similar vein, are items such as paying for a wedding, a once-in-a-lifetime family vacation, covering a large uninsured loss, etc. It would probably be reasonable to either do some form of averaging or leveling of these expenses, or perhaps to recognize (again depending very much on the financial wherewithal of this family unit) that these non-recurring type expenses were in lieu of what otherwise would have been savings. After all, savings are a component of lifestyle - aren't they?

THE SAVINGS COMPONENT - That brings us to what we candidly believe is one of the least understood and least respected elements of what nevertheless is stated as a component of lifestyle - savings. We have seen, both explicitly stated by judges and implicitly factored in decisions, as well as how handled by attorneys, the disrespect (or perhaps more accurately the lesser respect) given to savings as compared to spending. In too many situations, the system more readily accepts spending as a lifestyle component than it does saving. The hypothetical two identical families, both with a \$200,000 lifestyle - but one that spends \$150,000 and saves \$50,000, and the other that spends the entire \$200,000 - tend to be treated very differently when it comes to the determination of alimony/support. More often than not, the family that spends it all will have that reflected fairly and fully in the alimony/support inclusion. On the other hand, with a family that saves a significant portion of its income, the alimony/support decision tends to be less, sometimes considerably less, basically ignoring or reducing the savings element.

The savings component issue is one of the more complex issues that need to be addressed in an LSA. Part of it is kind of simple - how much of the salary went into the bank/brokerage account. But, from there it gets much more complicated. For instance, what if money came in and out of a brokerage account during the year? It is important to

know what the net change was. Let's add to the confusion and complexity. One or both of the spouses has a 401(k) plan from the employer, as well as other exotic type benefits - perhaps a Flexible Spending Account, stock options, deferred compensation, awards, thrift savings plan, etc. In addition, some of these (typically the 401(k) if not others) have matching contribution components paid for by the employer, and not reflected on any W-2 or tax return.

It is fair to say that the elective type savings (i.e. the 401(k) plan and thrift savings plan) are part of the disposition of the income for the year - that part being in the form savings. What makes this a little more complex is that the cash flow never went into the hands of the marital unit, but was directly deducted from the payroll before it ever reached the family's bank account. Nevertheless, it is cash earned income which was intentionally set aside - invested, saved. Now add to the complexity an employer match. That is additional compensation, over which neither party has any direct immediate control. As long as that is considered additional earnings, it is also additional savings.

It gets far more complex when we deal with things like options, and deferred compensation. It gets even more complicated when the employee (one of the litigants) has the choice or ability to elect how much is going to be received in cash versus how much is going to be deferred or received in an option or otherwise. Are these options additional income which are therefore savings? We believe that the majority thinking in this area is that options are additional compensation, and thus would be additional savings. Clearly, the area of the savings component - including what is in the savings component and how it was handled - can be an extremely complex area. The presentation of same, correctly and fully, can be a critical element in arriving at the appropriate level of alimony/support.

INFLATION - Another element to consider, particularly if developing a multi-year LSA, is the matter of inflation.

FOCUS ON FUN

Accountants & Humor – a Sociological Fable

1. For those of our readers who like the truly esoteric in tax humor, consider that the Tax Court determined that a jobba plantation did not fall within the definition of a "grove, orchard or vineyard in which fruits or nuts are grown", an all important distinction, required for expenses such as plantings, to be capitalized. Consequently, the taxpayers properly deducted the expenses they incurred (meaning they did not have to capitalize them). The Court was not impressed with the IRS's contention that jobba bushes could theoretically be pruned into the shape of trees (it's a good thing this case did not turn on whether they could be pruned into other more interesting shapes). The Court rejected the IRS's argument that a plantation of such pruned bushes could be considered an orchard.

2. The IRS reported, as a result of one of its audits, about a man in Los Angeles who deducted the cost of his daughter's wedding as a casualty loss. When he was audited, the man, apparently rather serious about this, explained that his daughter's new husband had turned out to be a total disaster. For those of us with daughters, ain't that the truth.

If only doing one, two or even three years, an inflation adjustment is probably not all that important - especially in recent years when inflation has been quite modest. However, if doing a five or ten year or more LSA, inflation may be something that needs to be considered. Once we consider inflation, we have to address whether we should be looking at some broad based across the board CPI adjustment - or whether we should zero in on specific items. The latter, while perhaps more accurate, is certainly more difficult, therefore more expensive.

By way of example, for the last several years, the cost of telephone service has come down dramatically. Some people have even dropped their land-based phones in favor of only using cell phones. That brings in another factor - while the absolute cost of telephone service has declined significantly over the last several years, almost everyone now has a cell phone - ten years ago that was not the case. Thus, while the cost of telephone service has come down (negative inflation, or deflation), usage has expanded to where a cell phone is now almost a necessity. Or, consider the cost of housing. Mortgages (putting aside the matter

.....continued on page 4

of real estate taxes) typically are a long-term constant. However, over the last few years interest rates have declined. Therefore, even the same principal balance on a mortgage is now less expensive than it was five years ago. Should that be taken into account, and if so to what extent? Would it be relevant to assume that there should be a refinancing at today's lower rates even if that refinancing has not happened as yet.

To the other side, in general real estate taxes, health insurance premiums and fuel oil and gasoline have increased faster than has inflation. To what extent should such specific adjustments be made rather than taking a broad based CPI. Clearly, depending on the extent this approach is taken, inflation adjustments, or adjustments based on the change in the costs of how people live, might mandate dramatically different results/conclusions.

The proper completion of an LSA can be far more difficult, time consuming and complex than it might seem at the beginning of the case. Whether it be the sheer volume of transactions/statements that have to be reviewed, the complexity of the pay structure, the complexity of how these people lived, and what was normal or not in their spending habits - all of these combine to make this area potentially very complex, and at the same time extremely important in the eventual proper and fair conclusion of a divorce action.



Fall

PRSRRT FIRST CLASS
U.S. Postage
PAID
Union, NJ
Permit No. 451

The Barson Group
60 East Main Street
P.O. Box 8018
Somerville, NJ 08876-8018

