



# Forensic Accounting Today

Newsletter of Ron J. Anfuso, CPA/ABV, An Accountancy Corp.

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## Federal Income Tax Issues:

**Brendon James Delong, Petitioner v. Commissioner of Internal Revenue, Respondent**

Since it is almost tax season, I thought it would be an appropriate time to mention a case of interest to Family Law Attorneys that was filed in March 2013. The points of issue of *Delong v. Commissioner of Internal Revenue* were whether Petitioner was entitled to deduct certain family support payments that were made to Petitioner's legally separated spouse. The other question was whether Petitioner was liable for an accuracy-related penalty, as a result.

The Superior Court's first support order obligated petitioner to pay spouse \$3,000 as family support for January 2008. The second support order required petitioner to continue to pay the spouse \$3,000 each month until the trial was held. The Superior Court indicated in the second support order that payments were for both spousal *and* child support with no specific allocation of the support designated for either. Furthermore, neither support order contained a condition that would terminate Petitioner's support payment burden should the spouse decease, a requirement of the tax code.

Respondent issued Petitioner a deficiency notice that disallowed the claimed support deduction for the family support payments. Petitioner challenged Respondent's determination.

### California Law

California Family Code establishes family support as an unallocated combination of spousal and child support. In California, spousal support obligation terminates upon death of the payee spouse. However, child support obligation continues after the payee spouse's death (*Cal. Fam. Code sec 4337* and *In re Marriage of McCann, 32 Cal.Rptr.2d639*). The Family Code does not address whether a family support obligation ends on the death of the payee spouse.

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## Why So Many Documents for a Business Valuation?

### Part I

By Ron J. Anfuso, CPA, ABV, CFF, CDFA, FABFA\*

The valuation and distribution of marital property is typically one of the most difficult and arguable issues to be dealt with in a divorce proceeding. The process can become considerably more complicated and expensive when the marital community owns an interest in a business. In such cases, a Forensic Accountant is often hired by the attorney to prepare a list of documents needed to perform a business valuation and then to conduct the valuation. The problem is that to perform an accurate assessment of the value of a business, the Forensic Accountant will need to review a considerable number of documents. When the list of documents is presented to the attorney, the attorney's reaction may be to request minimizing the number of reports due to the size of the case or the costs involved. Thus, it is imperative for the Forensic Accountant to be able to explain why the requested documents are essential to attain an accurate valuation. In this and subsequent issues of *Forensic Accounting Today*, I will concisely clarify the reasons why Forensic Accountants make these requests.

### Documents Forensic Accountants Require

**Financial Statements:** A good starting point is to review the business's financial statements to visualize the financial condition of the company based on its assets and income. Financial statements assist to form a standard for comparison to industry information and help indicate the amount of additional analysis that will be required. Forensic Accountants will be able to compute business ratios for profitability, leverage and liquidity. In addition, financial statements can help establish prior-to-marriage property tracing requirements. Careful review may also uncover discrepancies that could *red flag* the legitimacy of the financial statements.

### Do You Need a Financial Expert to Speak to Your Study Group or Bar Event?

Ron J. Anfuso can address any Forensic Accounting topic, including Moore/Marsden; marital standard of living and support needs analysis; financial specialists and Collaborative Law; gross cash flow available for support; DissoMaster™; divorce tax issues; divorce: what to expect; and business valuations. To discuss your group's needs, call Ron today!

\* For an explanation of these titles, please visit our website or request a copy of Issue 3 of *Forensic Accounting Today*.

## The Decision

In making its decision, The Court considered the similarity of support obligation under California law in *Berry v. Commissioner, T.C. Memo. 2005-91*. There, as in *Delong v. Commissioner of Internal Revenue*, the taxpayer was required to make family support payments and claimed spousal support deductions for the payments. In both instances, the Commissioner for each respective case argued the support obligation was not terminated upon the death of the spouse as required under 71(b)(1)(D). The Court, however, held as in *Berry* that there was no continuing liability for support payments past the death of the spouse in a family support obligation.

Subsequently, the Court needed to consider whether a portion of the support payments were designated as child support. In California, child support is defined as *any part of a payment that the terms of a divorce or separation instruments specifically fix as a sum that is payable for the support of the payor's spouse's children*. Since the support orders were an unallocated award, no portion of the payments were fixed. Therefore, the Court ruled no amount of the family support payments qualified as child support under section 71(c), thus rejecting the Respondent's argument. In addition, the Court ruled there was no underpayment of taxes for 2008. This decision relieved Petitioner from any liability for accuracy-related penalties.

Should you have questions concerning *Delong v. Commissioner of Internal Revenue* or wish to discuss this case in detail, please contact me or post your comment or question on our blog ([www.blog.anfusocpa.com](http://www.blog.anfusocpa.com)).

Ron

## Why So Many Documents: Continued from page 1

**Tax Returns:** Reviewing tax returns are invaluable because they are filed under the penalty of perjury. Studying returns also benefits the task because the Forensic Accountant can compare what was reported with what was stated on the financial statements. The Forensic Accountant will then be able to assess whether an aggressive tax position was taken. This can suggest the likelihood of perquisites, which may not only influence business valuation, but spousal support calculations, as well.

It is customary to have experts review five years of returns. Forensic Accountants consider this adequate enough to thoroughly analyze business cycles.

**General Ledgers and Journals:** These are essential because they provide thorough information behind the broad picture that financial statements and tax returns present. General ledgers and journals provide the details concerning all disbursements. Thus, the Forensic Accountant can inspect who and what was paid, as well as the dollar amount of all transactions.

**Paid Bills:** Paid bills assist in determining whether disbursements were made for the business, or for the owner (or shareholder). Because paid bills show whether disbursements were made for the business or for other expenditures, such as divorce legal fees, they are useful in determining the existence and amount of perquisites.

**Bank Statements, Canceled Checks and Brokerage Statements:** In some instances, bank statements and canceled checks can reveal what general ledgers and journals do not disclose. Together, these test the reliability of the records and books provided, as they can reconcile deposits and income. In some instances, bank and brokerage statements and canceled checks will also uncover previously undisclosed bank accounts.

**Income Tax Audits:** Federal and state agency audits may disclose unreported income and sales, and deductions of personal expenses. In addition, audits may reveal business entities or locations that were not previously known to exist. Reviewing the audit reports often save time and effort in establishing a business's actual earnings.

**Stockholder and Director Minutes:** Corporate minutes often discuss company plans, such as the purchase of new buildings or acquisitions. In addition, minutes may disclose salary information, authorizations for dividends, reasons for debt existence or appropriation of retained earnings. In some cases, the content of the minutes may include information that expose attempts to mislead the other party.

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The documents described in this article comprise only a few of those that are essential to the calculation of an accurate value of a business. In subsequent newsletters, we will cover many of the other documents Forensic Accountants require. This, as well as future issues of *Forensic Accounting Today* that will cover this subject, will also be made available for your review on our blog ([www.blog.anfusocpa.com](http://www.blog.anfusocpa.com)).

## FRUSTRATED



**Your forensic accountant missed the deadline AGAIN?**

*Completing work on time is not that difficult! Yet, we continue to hear frustrations from attorneys about some forensic accounting firms.*

Meeting deadlines requires meticulous planning prior to beginning work on a case. It also demands *careful* delegation and timely completion of tasks. **Most importantly, firms should never take on a case unless they have the qualified manpower to timely handle the work.** This is our policy! It's why referring attorneys know they can always count on us to meet their deadlines. Just ask them.

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