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Divorce & Financials: Breaking Them Up Is Hard to Do

November 2, 2022

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Meet the Presenters



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Agenda

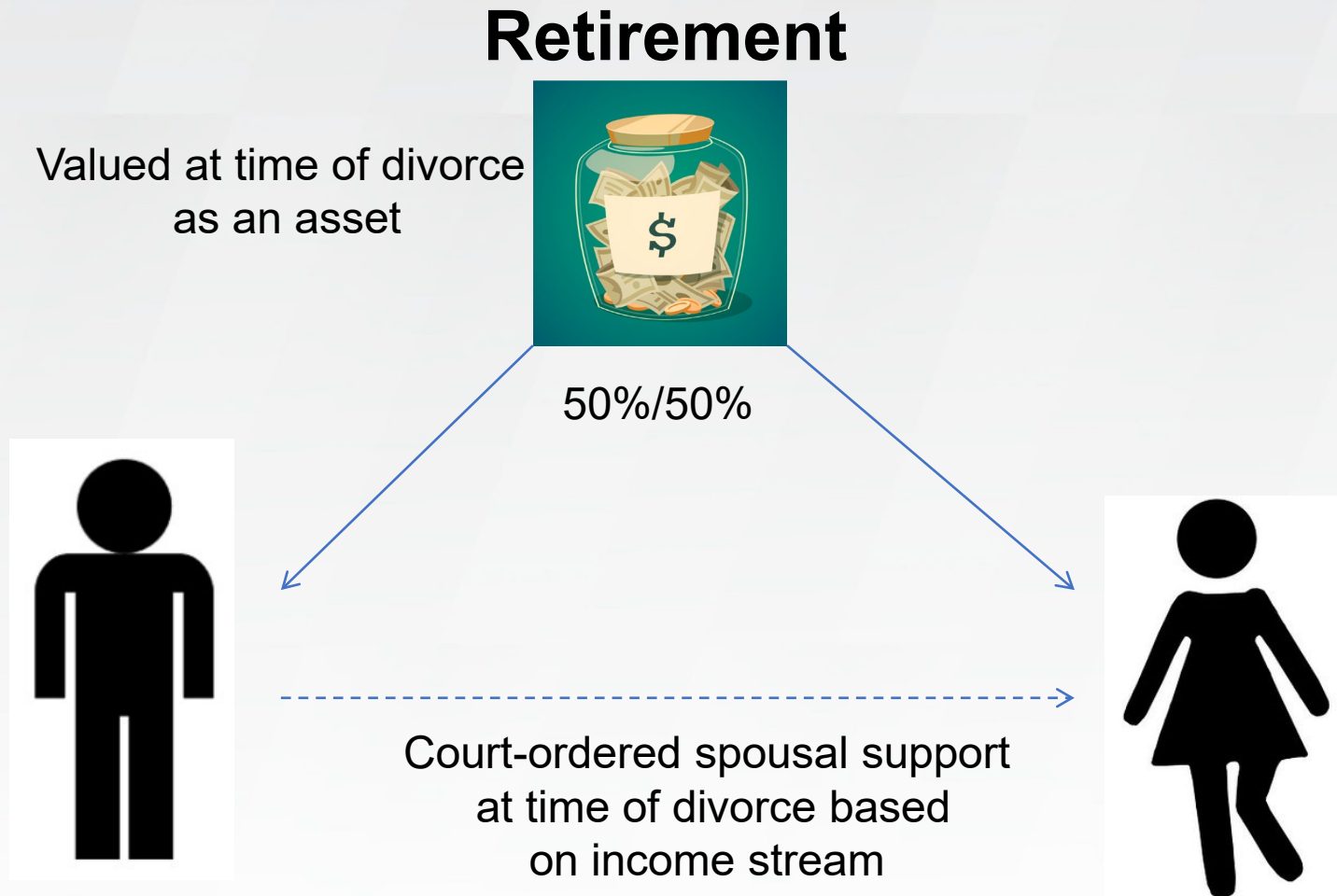
- Double dipping
- Tax implications related to property settlements
- Other complicated financial issues, including virtual assets
- Other financial games played in divorce

“Double Dipping”

CONCEPT

- Value once for division of property
- Value *again* for determination of spousal support, maintenance, or child support

Example of Double Dipping



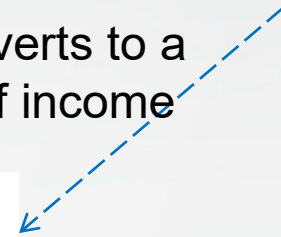
Example of Double Dipping

Retirement

Reaches retirement age



Asset converts to a stream of income



Wants new cash flow from retirement added to income stream available for spousal support



Double Dipping for Business

“The theory is that when a business is valued using a capitalization of earnings approach, it is double dipping to both distribute the business and then base spousal support on the income the business produces”

Morgan, *“Double Dipping”: A Good Theory Gone Bad*, 25 J. Am. Acad. Matrim. Law. 133, 142 (2012)

- Income approach used (not always allowed)

Double Dipping Example

BUSINESS

Compensation
\$500,000



	No Add Back	Add Back
Business Economic Income	\$ 100,000	\$ 100,000
Excess Compensation Add Back	-	300,000
Income Stream for Valuation	100,000	400,000
Cap Rate	20%	20%
Value for Equitable Distribution	<u>\$ 500,000</u>	<u>\$2,000,000</u>

Should compensation of \$200,000 or \$500,000 be used to calculate spousal support?

One or the other

- \$500,000 business value with annual compensation of \$500,000
- \$2,000,000 business value with annual compensation of \$200,000

Source: BVUpdate- June 2012

Double Dipping

Concept widely recognized, but ...

Not all jurisdictions have embraced its theory

“We find no inequity in the use of the individually fair results obtained due to the use of an asset valuation methodology normalizing salary in an on-going close corporation for equitable division purposes, and the use of actual salary received in the calculus of alimony. The interplay of those calculations does not constitute double dipping.”

Steneken v. Steneken, 873 A.2d 501 (N.J. 2005)

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Property Settlements

Goal: equalization of assets

- Gather list of all assets & liabilities
 - Need their fair market value
 - Need their cost basis

Challenge: Not all assets are created equally

- Deferred tax obligations
- Hidden losses (capital loss carryovers, net operating losses)

Property Settlements

Need to think about more than fair market value

Retirement Account

Market Value:	\$1,000,000
Tax Basis:	<u>0</u>
	1,000,000
Federal Tax:	<u>15%</u>
Deferred Tax Liability:	(\$150,000)
Net Value:	\$850,000

Investment Account

Market Value:	\$1,000,000
Tax Basis:	<u>(\$500,000)</u>
	\$500,000
Federal Tax:	<u>15%</u>
Deferred Tax Liability:	(\$75,000)
Net Value:	\$925,000

NOT ALL ASSETS ARE CREATED EQUAL

Deferred Tax Effect

Stock Investment A

Market Value:	\$ 1,000,000
Tax Basis: <u>(500,000)</u>	
500,000	
Federal Tax: <u>15%</u>	
Deferred Tax Liability: <u>75,000</u>	
Net Value:	\$ 925,000

Real Estate (House)

Market Value:	\$ 1,000,000
Tax Basis: (750,000)	
Residence Gain	
Exclusion: <u>(250,000)</u>	
- 0 -	
Federal Tax: <u>15%</u>	
Deferred Tax Liability: <u>- 0 -</u>	
Net Value:	\$ 1,000,000

Capital Loss Carryover – The Basics

- What is a Capital Asset?
 - IRS defines as “almost everything you own and use for personal or investment purposes is a capital asset.” Examples include a home, personal use items like household furnishings, and stocks or bonds held as investments. Does not include inventory or property used in a business
- Taxpayers are allowed to deduct capital losses to the extent of the lesser of
 - \$3,000, or
 - The excess of capital losses over capital gains

Excess capital losses can be carried forward **indefinitely**

Capital Loss Carryover – Where to Find?

Part III Summary

16 Combine lines 7 and 15 and enter the result **16** **-130,373.**

- If line 16 is a **gain**, enter the amount from line 16 on Schedule 1 (Form 1040), line 13, or Form 1040NR, line 14. Then go to line 17 below.
- If line 16 is a **loss**, skip lines 17 through 20 below. Then go to line 21. Also be sure to complete line 22.
- If line 16 is **zero**, skip lines 17 through 21 below and enter -0- on Schedule 1 (Form 1040), line 13, or Form 1040NR, line 14. Then go to line 22.

17 Are lines 15 and 16 **both** gains?
 Yes. Go to line 18.
 No. Skip lines 18 through 21, and go to line 22.

18 If you are required to complete the **28% Rate Gain Worksheet** (see instructions), enter the amount, if any, from line 7 of that worksheet **18**

19 If you are required to complete the **Unrecaptured Section 1250 Gain Worksheet** (see instructions), enter the amount, if any, from line 18 of that worksheet **19**

20 Are lines 18 and 19 **both** zero or blank?
 Yes. Complete the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for Form 1040, line 11a (or in the instructions for Form 1040NR, line 42). **Don't** complete lines 21 and 22 below.
 No. Complete the **Schedule D Tax Worksheet** in the instructions. **Don't** complete lines 21 and 22 below.

21 If line 16 is a loss, enter here and on Schedule 1 (Form 1040), line 13, or Form 1040NR, line 14, the **smaller of**:
 • The loss on line 16; or
 • (\$3,000), or if married filing separately, (\$1,500) **21** **-3,000.**

Note: When figuring which amount is smaller, treat both amounts as positive numbers.

22 Do you have qualified dividends on Form 1040, line 3a, or Form 1040NR, line 10b?
 Yes. Complete the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for Form 1040, line 11a (or in the instructions for Form 1040NR, line 42).
 No. Complete the rest of Form 1040 or Form 1040NR.

Schedule D (Form 1040) 2018

Part I Short-Term Capital Gains and Losses – Generally Assets Held One Year or Less (see instructions)

See instructions for how to figure the amounts to enter on the lines below.
 This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b				
1b Totals for all transactions reported on Form(s) 8949 with Box A checked	99,987.	103,346.		-3,359.
2 Totals for all transactions reported on Form(s) 8949 with Box B checked				
3 Totals for all transactions reported on Form(s) 8949 with Box C checked				
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824				4
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				5
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your Capital Loss Carryover Worksheet in the instructions				6 -99,673.
7 Net short-term capital gain or (loss). Combine lines 1a through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back				7 -103,032.

Part II Long-Term Capital Gains and Losses – Generally Assets Held More Than One Year (see instructions)

See instructions for how to figure the amounts to enter on the lines below.
 This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b				
8b Totals for all transactions reported on Form(s) 8949 with Box D checked	927,059.	744,167.		182,892.
9 Totals for all transactions reported on Form(s) 8949 with Box E checked	83,171.	19,469.		63,702.
10 Totals for all transactions reported on Form(s) 8949 with Box F checked	235,000.	249,770.	-15,394.	-30,164.
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824				11
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				12
13 Capital gain distributions. See the instrs. SEE .ST. 7.				13 1,545.
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your Capital Loss Carryover Worksheet in the instructions				14 -30,700.
15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column (h). Then go to Part III on the back				15 187,275.

BAA For Paperwork Reduction Act Notice, see your tax return instructions.

FDIA0612L 09/04/19

Schedule D (Form 1040 or 1040-SR) 2019

Harder to Identify (1040 Schedule D – Page 2)

Part III Summary

- 16 Combine lines 7 and 15 and enter the result.....
- If line 16 is a **gain**, enter the amount from line 16 on Form 1040 or 1040-SR, line 6; or Form 1040-NR, line 14. Then go to line 17 below.
 - If line 16 is a **loss**, skip lines 17 through 20 below. Then go to line 21. Also be sure to complete line 22.
 - If line 16 is **zero**, skip lines 17 through 21 below and enter -0- on Form 1040 or 1040-SR, line 6; or Form 1040-NR, line 14. Then go to line 22.

16 84,243.

- 17 Are lines 15 and 16 **both** gains?

Yes. Go to line 18.

No. Skip lines 18 through 21, and go to line 22.

Original Capital Gain	\$ 214,616
Less Capital Loss c/o	<u>(\$130,373)</u>
Net Capital Gain	\$ 84,243

- 18 If you are required to complete the **28% Rate Gain Worksheet** (see instructions), enter the amount, if any, from line 7 of that worksheet.....

18

- 19 If you are required to complete the **Unrecaptured Section 1250 Gain Worksheet** (see instructions), enter the amount, if any, from line 18 of that worksheet.....

19

- 20 Are lines 18 and 19 **both** zero or blank?

Yes. Complete the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for Forms 1040 and 1040-SR, line 12a (or in the instructions for Form 1040-NR, line 42). **Don't** complete lines 21 and 22 below.

No. Complete the **Schedule D Tax Worksheet** in the instructions. **Don't** complete lines 21 and 22 below.

How Should Loss Be Allocated?

- When a married couple has a capital loss carryforward on their last joint return, that carryover should be allocated based upon each spouse's individual net capital losses giving rise to the carryforward
- The IRS will allocate the loss to the spouse actually suffering the loss
- Who does the loss belong to?

Include the Inherent Value as an Asset on Marital Balance Sheet?

**Smith v Smith
Marital Balance Sheet**

	Marital Estate	Husband	Wife
Scenario 1:			
Cash	26,000	13,000	13,000
Marital Home	650,000		650,000
Fidelity Investment	425,000	212,500	212,500
401k	595,000	595,000	-
IRA	125,000	125,000	-
Total	1,821,000	945,500	875,500
Cash to Balance 50/50 Division		(35,000)	35,000
		910,500	910,500
		50.0%	50.0%

	Marital Estate	Husband	Wife
Scenario 2:			
Cash	26,000	13,000	13,000
Marital Home	650,000		650,000
Fidelity Investment	425,000	212,500	212,500
Capital Loss Carryover	26,000	26,000	
401k	595,000	595,000	-
IRA	125,000	125,000	-
Total	1,847,000	971,500	875,500
Cash to Balance 50/50 Division		(48,000)	48,000
		923,500	923,500
		50.0%	50.0%

Net Operating Loss – How to Treat?

Part I		Additional Income	
1	Taxable refunds, credits, or offsets of state and local income taxes	1	
2a	Alimony received	2a	
b	Date of original divorce or separation agreement (see instructions) ▶		
3	Business income or (loss). Attach Schedule C	3	-1,555.
4	Other gains or (losses). Attach Form 4797	4	
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	5	-439,152.
6	Farm income or (loss). Attach Schedule F	6	
7	Unemployment compensation	7	
8	Other income. List type and amount ▶ NOL	8	-2,223,848.
	SEE STMT 4		
9	Combine lines 1 through 8. Enter here and on Form 1040 or 1040-SR, line 7a	9	-2,664,555.
Part II		Adjustments to Income	
10	Educator expenses	10	
11	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	11	
12	Health savings account deduction. Attach Form 8889	12	
13	Moving expenses for members of the Armed Forces. Attach Form 3903	13	
14	Deductible part of self-employment tax. Attach Schedule SE	14	
15	Self-employed SEP, SIMPLE, and qualified plans	15	
16	Self-employed health insurance deduction	16	
17	Penalty on early withdrawal of savings	17	
18a	Alimony paid	18a	
b	Recipient's SSN		
c	Date of original divorce or separation agreement (see instructions) ▶		
19	IRA deduction	19	
20	Student loan interest deduction	20	
21	Tuition and fees. Attach Form 8917	21	
22	Add lines 10 through 21. These are your adjustments to income . Enter here and on Form 1040 or 1040-SR, line 8a	22	0.

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Schedule 1 (Form 1040 or 1040-SR) 2019

Virtual Assets

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Source: <https://loveforquotes.com/t/meme-world?since=1361940037%2C6330650>

Virtual Assets

Digital & virtual assets

- Cryptocurrency
- Frequent flier miles & reward points
- iTunes music library
- Kindle digital book collection
- Blogs (income producing)
- eBay storefronts
- Online role-playing games (Farmville, Second Life, etc.)
- Domain names
- Digital artwork
- Digital photos

Frequent Flier Miles & Reward Points



- Review terms & conditions of program
 - Split to two accounts if allowed
 - Likely will be fees
- Research & come up with a value that is realistic & defensible
 - 50,000 pts = a \$1,500 first class ticket, then 400,000 pts *approximates* \$12,000

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iTunes & Kindle/E-Books



- User owns legal right to use software, not outright ownership of product



- Registered individual is only individual allowed to use product
- A judge's ruling may not supersede user agreement stating you can not transfer ownership

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Virtual Marketplaces



Linden Dollars



Gold



Cash



PED (Project Entropia Dollars)

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Other Financial Games Played

- Running personal expenses through company disguised as business expenses (hobbies, mistress, etc.)
- Paying salary to nonexistent employees then voiding checks after divorce
- Paying salaries or fees to relatives or friends for “services” then having it repaid after divorce
- Overwithholding income taxes or overpaying corporate tax to be refunded after divorce is finalized
- Create fake debt to friend or business colleague in order to reduce net asset value of company
- Holding off on new contracts or large jobs until divorce is finalized

QUESTIONS

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