

PART ONE

FAMILY LAW LITIGATION AND FINANCIAL EXPERTS

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CHAPTER 1

INTRODUCTION

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1.1 INTRODUCTION

Similar to other areas of U.S. law, family law has developed from societal and legal changes. Various states have developed different regional and individual legal systems for divorce. No single text can adequately present the depth of collective knowledge of family law forensic accountants. Family law accounting is the blending of law, accounting, finance, business, and related topics. Each jurisdiction adopts different approaches in its family law statutes and case law. Jurisdictions do take notice of how other states resolve divorce issues and occasionally adopt them or close facsimiles of other states' solutions. This text should be used only in consultation with a family law attorney and possibly other professionals, such as tax attorneys, actuaries, property appraisers, and others.

1.2 DEVELOPMENT OF PROPERTY LAW

Generally accepted accounting principles (GAAP) have evolved over time. So has property law in divorce cases. But property law has not been as dependent on accounting standards in family law as in other areas of the law. Generally accepted accounting principles are central in financial reporting and have developed hand in hand with public securities law. Family law has been less influenced by GAAP and in some cases has chosen non-GAAP solutions to financial issues. Thus the definition of *property* is based on legal constructs with little or no concern for the accounting or financial theories of those who must put a number or value to the result of divorce statutes, case law, and custom in the various states.

Forensic accountants learn to reconcile, if possible, the GAAP definitions of assets to property definition for any particular issue in their jurisdiction. If reconciliation is

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not possible, accounting and financial techniques can be modified to accommodate the incompatible legal concepts.

1.3 U.S. PROPERTY SYSTEMS

There are two general property systems with significant variations: community and equitable property systems. Community property states are generally in the West and equitable states are in the East and South.

Community property states create community property in addition to separate property. In general, property owned at marriage and inherited or received by gift during marriage are separate. Properties created during marriage from personal efforts are characterized as community. The value of community property generally is divided equally between the spouses and each receives his or her separate property.

Equitable property states use much the same concepts as community states, but equitable property may be determined and awarded to the spouses in a fair and equitable method. Separate property generally is awarded to the separate spouse in either system.

1.4 ROLE OF FAULT IN DIVORCE

Fault can play a role in divorce. Some states, such as California, have no-fault dissolutions. Neither party can be awarded more than half of the community property based on consideration of fault. Other states allow courts to award more of the community or marital property to one spouse based on fault of the other spouse.

1.5 SUPPORT

There is a universal obligation for parents to support their children. But there are no standard methodologies for determining support. Most states base child support on custody time and earnings of the parents. Forensic accountants frequently assist in determining earnings available for support.

Spousal support—alimony—is usually an obligation of the higher-earning spouse to pay the other spouse for a limited time. The amount and duration of alimony varies substantially in different jurisdictions. It can be influenced by the income of the parties, length of marriage, needs of the supported spouse, marital standard of living, and income or property of the spouses. Forensic accountants frequently assist determining property, income, and needs of the parties.

1.6 PROPERTY VALUATION

Businesses, stock options, patents and copyrights, retirement plans, and other assets need to be valued prior to division. Each type of asset requires a different approach not only due to its character but also due to local statutes and family law cases. Forensic accountants perform valuations of a variety of assets and property.

1.7 PROPERTY DIVISION

Dividing property is a strategy requiring an understanding of valuation techniques, applicable income tax rules, and family law. Property division affects not only the immediate

expectations of the parties but their future financial needs as well. There may also be an element of financial planning in property divisions.

1.8 INCOME TAX

Property valuation, division, and support all involve income and related taxes. Valuation of property may involve the potential tax on embedded gain. Some jurisdictions limit the extent to which value can consider imbedded income tax. Property divisions may be accomplished without income tax. Some property divisions can create unwanted tax consequences.

Support can take several forms: child, spousal, and family support. The tax effect of support is generally that child support is not deductible, and spousal and family support is deductible as alimony. Alimony may be limited by recapture rules and recharacterized as child support if modified by an event associated with a child.

General income tax problems of a couple usually will manifest themselves during the divorce. All manner of income tax problems can surface and require solution during a divorce.

1.9 MARITAL FRAUD

Prior to the commencement of divorce proceedings, it is not uncommon to find that one or both spouses have hidden property from the other. Sometimes the concealment is a continuation of income tax fraud committed during the marriage. Marital fraud can be effective in removing property from the court's jurisdiction and can deprive a spouse from a fair division of property. Some states have severe punishment for marital fraud.

1.10 CONCLUSION

This first edition covers many common areas of family law for forensic accountants. Each chapter author or authors were selected for their knowledge and experience. Each chapter should be the beginning of knowledge and research on its topic. Local law, cases, and custom should be included in case preparation.