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BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

Tennessee Family Law

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In This Issue

This quarter's issue of the *Tennessee Family Law Newsletter* examines two critical analyses of marital dissolution – one a forensic service and one a valuation service. In both, we offer examples with specific fact patterns and a discussion of the analysis.

First, we have a personal goodwill analysis example. Tennessee is a state that recognizes personal and enterprise goodwill and, in turn, provides for a methodology that appropriately captures and/or allocates the two to separate assets for non-division or marital assets for division.

Additionally, we provide an in-depth overview and example illustration of the lifestyle analysis, also know as the pay and need analysis. This reprint was originally published in the November/December 2020 issue of NACVA's *The Value Examiner*. A lifestyle analysis assists the marital dissolution process in many ways, including assessing division scenarios and settlement alternatives such as different alimony proposals, assisting with negotiations during mediation, and supporting the trier of fact in determining the equitable distribution of marital assets and alimony needs.

Lastly, in 2021, we will pivot our *Tennessee Family Law Newsletter* to a monthly insights email to further assist you in complex and current forensic, valuation, and other financial matters in the family law area. We appreciate the great feedback from the previous issues of this newsletter and encourage you to provide any suggested content topics or ideas that you'd like to see in the future to **Scott Womack** or **Karolina Calhoun**.

Personal Goodwill: An Illustrative Example of an Auto Dealership

This article discusses important concepts of personal goodwill in divorce litigation engagements. The discussion relates directly to several divorce litigation cases involving owners of automobile dealerships. These real life examples display the depth of analysis that is critical to identifying the presence of personal goodwill and then estimating or allocating the associated value with the personal goodwill. The issues discussed here pertain specifically to considerations utilized in auto dealer valuations, but the overall concepts can be applied to most service-based industries. It is important that the appraiser understands the industry and performs a thorough analysis of all relevant industry factors.

Personal goodwill was an issue in several of our recent litigated divorce engagements. It is more prevalent in certain industries than others and varies from matter to matter. However, although there are several accepted methodologies to determine personal goodwill, there is not a textbook that discusses where it exists and where it doesn't. Before any attempts to measure and quantify it, an important question to ask is "Does it exist?" Often with ambiguous concepts like personal goodwill, the adage "you know it when you see it" is most appropriate.

In this article, we examine personal and enterprise goodwill using a specific fact pattern unique to the auto dealership industry. Beyond this illustrative example, the analyses can be applied in other industries, but must be considered carefully for the unique facts and circumstances of each matter.

What Is Personal Goodwill?

Personal goodwill is value stemming from an individual's personal service to a business and is an asset that tends to be owned by the individual, not the business itself. Personal goodwill is part of the larger bucket of an intangible asset known as goodwill. The other portion of goodwill, referred to as enterprise or business goodwill, relates to the intangible asset involved and owned by the business itself.[1]

Commercial and family law litigation cases aren't typically governed by case law resulting from Tax Court matters and can differ by jurisdiction, but Tax Court decisions offer more insight into defining the conditions and questions that should be asked in an evaluation of personal goodwill. One seminal Tax Court case on personal goodwill is *Martin Ice Cream vs. Commissioner.*[2] Among the Court's discussions and questions to review were the following:

- Do personal relationships exist between customers/suppliers and the owner of a business?
- Do these relationships persist in the absence of formal contractual relationships?
- Does an owner's personal reputation and/or perception in the industry provide intangible benefit to the business?
- Are practices of the owner innovative or distinguishable in his or her industry, such as the owner having added value to the particular industry?

Another angle with which to evaluate the presence of personal goodwill, specifically to professional practices, is provided in *Lopez v. Lopez.*[3] *Lopez* suggests several factors that should be considered in the valuation of professional (personal) goodwill as:

- The age and health of the individual;
- The individual's demonstrated earning power;
- The individual's reputation in the community for judgment, skill, and knowledge;
- The individual's comparative professional success
- The nature and duration of the professional's practice as a sole proprietor or as a contributing member of a partnership or professional corporation.

Why Is Personal Goodwill Important?

Many states identify and distinguish between personal goodwill and enterprise goodwill. Further, numerous states do NOT consider the personal goodwill of a business to be a marital asset for family law cases. For example, a business could have a value of $1 million, but a certain portion of the value is attributable and allocated to personal goodwill. In this example, the value of the business would be reduced for personal goodwill for family law cases and the marital value of the business would be considered at something less than the $1 million value.

How Applicable/Prevalent Is Personal Goodwill in the Auto Dealer Industry?

Readers of this space know that in any writing pertaining to litigation matters, we always try to avoid the absolutes: always and never. The concept of personal goodwill is easier identified and more prevalent in service industries such as law practices, accounting firms, and smaller physician practices. Does that mean it doesn't apply to more traditional retail and manufacturing industries? In each case, the fundamental question that should be first answered is "Is this an industry or company where personal goodwill could be present?" For the auto dealer industry, the principal product, outside of the service department, is a tangible product – new and used vehicles. In order for personal goodwill to be present in this industry, the owner/dealer principal would have to exhibit a unique set of skills that specifically translates to the heightened performance of their business.

We are all familiar with regional dealerships possessing the name of the owner/dealer principal in the name of the business. However, just having the name on a business doesn't signify the presence of personal goodwill. An examination of the customer base would be needed to justify personal goodwill. It would be more difficult to argue that customers are purchasing vehicles from a particular dealership only for the name on the door, rather than the more obvious factors of brands offered, availability of inventory, convenience, etc. An extreme example might be having a recognized celebrity as the name/face of the dealership, but even then, it would be debated how materially that affects sales and success. Auto dealers attempt to track performance and customer satisfaction through surveys, which could provide an avenue to determine this value (if, for example, factors that influenced the decision to buy listed Joe Dealer as being their primary motivation) though this is still unlikely and would be subject to debate.

Another consideration of the impact of a dealer's name on the success/value of the business would be how actively involved the owner/dealer principal is and how directly have they been involved with the customer in the selling process. Simply put, there should be higher bars to clear than just having the name in the dealership for personal goodwill to be present. In more obvious examples of personal goodwill in professional practices, the customer usually interacts directly with the owner/professional such as with the attorney or doctor in our previous examples. How often does the customer of an auto dealership come into contact or deal directly with the owner/dealer principal, or do they generally engage with the salespeople, service manager, or the general manger?

Another factor that often helps identify the existence of personal goodwill is the presence of an employment agreement and/or non-compete agreement. The prevailing thought is that an owner of a business without these items would theoretically be able to exit the business and open a similar business and compete directly with the prior business. Neither of these items typically exist with an owner of an auto dealership. However, owners of auto dealerships must be approved as dealer principals by the manufacturer. The transferability of a dealer principal relationship is not guaranteed, and certainly an existing dealer principal would not be able to obtain an additional franchise to directly compete with an existing franchise location of the same manufacturer for obvious area of responsibility (AOR) constraints. So, does the fact that most dealer principals don't have an employment or non-compete agreement signify that personal goodwill must be present? Not necessarily. Again it relates back to the central questions of whether an owner/dealer principal is directly involved in the business, has a unique set of skills that contributed to a heightened success of the business, and does that owner/dealer principal have a direct impact on attracting customers to their particular dealership that could not be replicated by another individual.

Conclusion

Personal goodwill in an auto dealership, and in any industry, can become a contested item in a litigation case because it can reduce the enterprise value consideration, reduced by the amount allocated to personal goodwill. As much as the allocation, quantification, and methodology used to determine the amount of personal goodwill will come into question, several central questions should be examined and answered before simply jumping to the conclusion that personal goodwill exists. Instead of arguing whether the value of an auto dealership should be reduced by some percentage, the real debate should center around the examination of whether personal goodwill exists in the first place. The difference in reports from valuation for experts in litigation matters generally falls within the examination and support of the assumptions (that lead to differences in conclusions). If present, personal goodwill for an auto dealership, or any company in any industry for that matter, must exist beyond just having the owner's name in the title of the business.

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[1] In the auto dealer industry, goodwill and other intangible assets are referred to as Blue Sky value.
[2] *Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189 (1998).
[3] In re *Marriage of Lopez*, 113 Cal. Rptr. 58 (38 Cal. App. 3d 1044 (1974).

Tennessee Case Review

Patel v. Patel

In this case, the parties raised the matter to appeals for two issues: 1) whether the trial court erred in awarding Wife alimony in futuro of $7,500 per month, and 2) whether Wife is entitled to attorney's fees.

The parties divorced after a 13 year marriage in which the family was initially solely supported by Wife's $40,000 annual income. However, at the time of divorce, Husband was earning approximately $850,000 per year and Wife was not employed but was a full-time student (due to frequent moves but also a mutual decision). The trial court found that long-term alimony was appropriate given Wife's contribution to Husband's earning capacity, her inability to achieve his earning capacity despite her efforts at education, and the parties' relatively high standard of living during the marriage.

At the beginning of the marriage, the husband was a full-time medical student earning no income. Across the husband's education and career, the parties moved from Georgia to Kentucky to Florida to Ohio, and finally to Jackson, Tennessee. During separation, Wife enrolled in a college to obtain a Bachelor's Degree in Accounting and hoped to eventually enroll in a Master's Degree program. Wife was a full-time student at the time of trial.

Husband testified that he planned to move to Florida and his base pay upon moving to Florida after the divorce would be approximately $450,000. Husband admitted, however, that this figure did not account for the bonuses that Husband had historically received and had caused his income to increase substantially. Wife's sole income at the time of the divorce amounted to approximately $2,000 per year in dividends.

Each of the parties created a budget of estimated forward expenses. During proceedings, each party claimed that the other was controlling the parties' finances, refusing to permit the other to fund basic expenses. With regard to expenses, Husband claimed as an expense $10,000 per month for savings in the event that he is sued for malpractice and his insurance does not cover the entire award, costs for his parents' health insurance, considerable maintenance on his car, and large charitable contributions. With regard to Wife's expenses, Husband contended that they were inflated over historical actual expenses. Husband testified that expenses incurred by Wife following the separation were for extravagant gifts to family that were not representative of the parties' lifestyle throughout the marriage.

Demonstrating the marital estate and standard of living, the parties had accumulated a level of wealth during the marriage, including two cars, several retirement accounts, and savings accounts. Husband paid off the mortgage of their Jackson, Tennessee home during the pendency of the divorce. As such, the parties had no debt at the time of the divorce and considerable assets. During the marriage, the parties also took several vacations, both in the United States and outside the country.

The trial court made the following statement on the earnings capacity of each party:

> ***Husband's gross earning capacity is currently about $850,000 per year. His net income based on his effective tax rate for 2016 would be in the range of about $550,000. Husband owes no debt, and will have significant assets from the property division. Wife's current income is zero essentially, but when she finishes school, if she is able to obtain employment in her field, and achieve a CPA designation, her gross income should be in the range of $55,000 according to testimony. If she pursues a Master's Degree and achieves it, her earning capacity could increase to $85,000 per year. Thus, there is a significant difference between the Husband's and Wife's earning capacity. Their obligations are about the same.***

The appellate court made the following conclusion on earnings capacity:

> ***..the evidence does not clearly and convincingly show that Wife did not significantly contribute to Husband's career and resulting earning capacity. Rather, the evidence supports the trial court's finding that Wife made tangible and intangible contributions to the Husband's increased earning capacity.***

Considering the factors for spousal support unique to this matter, the trial court found that the alimony in futuro of $7,500 per month alimony was appropriate given: 1) Wife's contribution to husband's earning capacity, 2) Wife's inability to achieve Husband's earning capacity despite her efforts at education, and 3) the parties' relatively high standard of living during the marriage. Discerning no reversible error, the appellate court affirmed the trial court in all respects. Also, given the considerable property awarded to Wife in the divorce, the appellate court declined to award attorney's fees incurred on appeal in this case.

A financial expert witness can significantly assist in the court's determination of divorcing parties' ability and need to pay in its determinations for spousal support. The analysis is a complex matter and calls for the expertise and analysis of a financial expert. Refer to our piece, **"What Is a Lifestyle Analysis and Why Is it Important?"** for more information about the process, analysis, and support that can be provided by a financial expert.

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Mercer Capital in the News

Speaking Engagements

NOV
9-11

Three Mercer Capital professionals participated in this year's *AICPA Forensic & Valuation Services Conference.*

Z. Christopher Mercer, FASA, CFA, ABAR presented "Advanced Valuation Issues in Gift and Estate Tax" with Natalya Abdrasilova (Wipfli LLP) and "Valuing S Corps and Other Flow-Through Entities Post TCJA" with Chris Treharne (Gibraltar Business Valuations).

Travis W. Harms, CFA, CPA/ABV presented "Strategic Performance Measurement: What Moves ROIC" and "Wall Street vs. Main Street: Stock Market vs. Closely Held Business" with Lisa Cribben (Wipfli LLP).

Karolina Calhoun, CPA/ABV/CFF presented "Transaction Method – Maneuvering the Databases" with Gary Trugman (Trugman Valuation Associates, Inc). In addition to her speaking duties, Karolina served as the Valuation Chair of the conference.

JAN
6

Karolina Calhoun, CPA/ABV/CFF will speak next year on the topic of "What is a Business Valuation and When do Your Clients Need One?" at the *Financial Planning Association of Memphis'* monthly meeting in Memphis, TN.

JAN
7

Karolina Calhoun, CPA/ABV/CFF will speak on the topic of "Cautionary Tales of Valuation Adjustments and Potential Forensic Implications in Litigation" at the *Florida Insitute of Certified Public Accountants' (FICPA) Valuation, Forensic Accounting & Litigation Services Conference.*

Podcast

Valuation Dates in a Litigation Context

In this episode of the FVS Section Podcast, Karolina Calhoun and Hubert Klein (EisnerAmper LLP) discuss the importance of valuation dates in a litigation context and how the COVID-19 pandemic has impacted the importance of valuation dates. Since the COVID-19 pandemic is such an impactful economic event, the resulting valuations could be significantly different before and after the event. Valuation experts and attorneys must take this into consideration.

Family Law Services

Mercer Capital is a national business valuation and financial advisory firm with offices in Memphis, Nashville, Houston, and Dallas. We bring a team of experienced and credentialed experts and over 35 years of experience to the field of dispute analysis and litigation support. Services for family law attorneys and advisors are listed below.

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- Valuations and Determination of Personal vs. Enterprise Goodwill and Active vs. Passive Appreciation
- Valuations of Stock Options, Restricted Stock, Pensions, Notes, and Other Investment Assets
- Valuation of Employment Contracts and Compensation Agreements
- Business Damages
- Lost Profits Analysis

Forensic Services

- Assistance with Financial Affidavits
- Equitable Distribution Analysis
- Lifestyle Analysis
- Pay and Need Analysis
- Income Determination
- Alimony Calculation
- Classification of Assets and Liabilities
- Tracing Services
- Dissipation Analysis
- Business Damages
- Lost Profits Analysis

Advisory Services

- Expert Witness Testimony
- Serving in Mediation, Arbitration, or as Court-Appointed and/or Mutually Agreed-Upon Experts
- Serving as the Financial Neutral in a Collaborative Divorce
- Assistance with Discovery
- Critique of Opposing Expert Reports
- Impact of Transactions on Valuation
- Economic Research
- Public Securities, Market, and Industry Research
- Assistance with Depositions and Cross-Examination
- Developing Case Strategy
- Preparation of Demonstrative Exhibits

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- Family Offices
- High-Wealth Individuals
- Others in Need of Neutral, Independent Experts

Our Qualifications

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- Technical and Industry Expertise
- National Reputations for Independence and Objectivity
- Valuation and forensic credentials from the AICPA, the American Society of Appraisers, the CFA Institute, the Royal Institute of Chartered Surveyors, and the National Association of Certified Valuators and Analysts
- Trained in Collaborative Law

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ADDENDUM

Constructing a Lifestyle Analysis: A Multipurpose Analytical Tool in Marital Dissolution Engagements

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Constructing a Lifestyle Analysis

A Multipurpose Analytical Tool in Marital Dissolution Engagements

By Karolina Calhoun, CPA, ABV, CFF

A lifestyle analysis is a multifaceted analytical tool that includes several detailed analyses and can be very helpful in marital dissolution engagements. It involves a more in-depth analysis than the financial affidavits typically required in the divorce process.

A lifestyle analysis provides an overview of each party's sources of income and expenses, historically and into the anticipated future, using the facts and circumstances unique to each particular case. The analysis pulls together all considerations and provides a visual representation of disposable cash and estimated expenses over the remaining life expectancy. Through illustration of the aggregate sources of income and expenses over time, one can discern which funds are actually required, and whether these funds are available to cover expenses, i.e., to maintain standard of living. The details in the analysis serve as verification of net worth (assets and liabilities), historical earnings, historical standard of living, and reasonable expenses going forward.

The process also yields relative analyses, such as percentage comparisons and trend analyses, historically and into the anticipated future. Ultimately, the lifestyle analysis provides an illustration of net worth at a point in time, as well as accumulation over time—an informative tool when assessing alternative settlements. The conclusions provide valuable financial analytics, as well as charts, graphs, and demonstratives.

A lifestyle analysis assists the marital dissolution process in many ways, including assessing division scenarios and settlement alternatives (such as different alimony proposals), assisting with negotiations during mediation, and supporting the trier of fact in determining the equitable distribution of marital assets and alimony needs. These analyses can be quite complex and should be performed by a competent financial expert or forensic accountant who will be able to define and analyze the financial aspects of a case as well as effectively communicate the findings and conclusions.

Factors Considered for Spousal Support

Careful consideration must be given to the factors listed in a specific state statute when determining historical lifestyle (standard of living) and reasonable need into the future. Spousal support statutes vary state by state and certain factors impact the process, such as length of marriage and ages of the divorcing parties. Nonetheless, if spousal support is a consideration in the case, the factors most frequently weighed in the determination are each party's earnings ability and need—that is, the disadvantaged spouse's need (for alimony) and the obligor spouse's ability to pay. Hence, the applicability of "lifestyle analysis," also known as a "pay and need analysis."

Sources of Financial Information Used in a Lifestyle Analysis

The following documentation, usually requested for three- to five-year time ranges, provides financial information used in the analysis.

- Tax returns
- Brokerage accounts
- Retirement, pension accounts
- Bank, debit card, credit card statements
- Personal financial statements
- Loan applications
- Insurance policies (especially those with cash surrender value)
- Mortgage statements
- Trusts, wills
- Deeds to homes, vehicles, motorboats, etc.
- Annuities, stock certificates, deposit box
- Business valuations
- Appraisals of tangible items (artwork, collectibles, etc.)

The Process: Building a Lifestyle Analysis, With an Illustrative Example

There are many variables, assumptions, and moving components to consider when constructing the lifestyle analysis, and the underlying facts and circumstances can be quite different from case to case.

Listing of Assets and Liabilities

During the preliminary stages of the lifestyle analysis, the financial expert/forensic accountant obtains pertinent data from the aforementioned documentation in order to assemble the marital balance sheet, which may also be referred to as an inventory listing of assets and liabilities. Depending on the facts and circumstances, this process may also include denotation or determination of separate versus marital assets and liabilities (examples of separate assets are inherited or premarital assets).

Table 1 is an illustration of a noncomplex marital balance sheet as of May 31, 2020, which is organized by asset type and includes a proposed division for each line item. Note: the client or attorney may request multiple proposed division scenarios in preparation for mediation or trial; thus, the balance sheet may become a fluid analysis during settlement negotiations or the financial expert may choose to save and present multiple versions.

Table 1: Marital Balance Sheet

#	Description	As of Date	Value	Debt	Equity	Child or Separate Account	Proposed Division			Notes
							Marital	Husband	Wife	
	Real Estate									
1	House - Memphis Drive	5/31/20	750,000	(100,000)	650,000		650,000	0	650,000	*0/100*
2	Condo - Memphis High Rise	5/31/20	500,000	(100,000)	400,000		400,000	400,000	0	*100/0*
	Real Estate Split						**1,050,000**	**400,000**	**650,000**	
	Cash and Investments									
3	Bank Checking Acct ending xxxx	5/31/20	10,000		10,000		10,000	5,000	5,000	*50/50*
4	Savings Checking Acct ending xxxx	5/31/20	50,000		50,000		50,000	25,000	25,000	*50/50*
5	Brokerage Acct ending xxx	5/31/20	250,000		250,000		250,000	125,000	125,000	*50/50*
	Cash and Investments Split						**310,000**	**155,000**	**155,000**	
	Retirement Plans									
6	Wife's 401k	5/31/20	1,000,000		1,000,000		1,000,000	0	1,000,000	*0/100*
7	Husband's 401k	5/31/20	1,000,000		1,000,000		1,000,000	1,000,000	0	*100/0*
	Retirement Split						**2,000,000**	**1,000,000**	**1,000,000**	
	Automobiles & Other									
8	Car- wife	5/31/20	35,000		35,000		35,000	0	35,000	*0/100*
9	Car- husband	5/31/20	35,000		35,000		35,000	35,000	0	*100/0*
10	Household Goods	5/31/20	50,000		50,000		50,000	25,000	25,000	*50/50*
	Automobiles & Other Split						**120,000**	**60,000**	**60,000**	
	Totals - Assets		3,680,000	(200,000)	3,480,000		**3,480,000**	**1,615,000**	**1,865,000**	
								46%	***54%***	
	Separate Assets									
11	Wife's inherited parent's checking account	5/31/20	50,000		50,000	50,000				
12	Wife's jewelry	5/31/20	40,000		40,000	40,000				
13	Husband's gun & watch collection	5/31/20	75,000		75,000	75,000				
	Liabilities - credit cards									
14	American Express ending xxxx	5/31/20		(4,500)						
15	Master Card ending xxxx	5/31/20		(3,000)						
	Subtotal			**(7,500)**	*Agree to split 50/50, accustomed to paying off debt/bills each month.*					

The financial expert will usually assess historical and current earnings to estimate ongoing earnings.

The balance sheet, just like a business financial statement, is but a reflection of a point in time. At first glance, the sample balance sheet appears to represent an equitable division of the marital estate (the 46 percent to 54 percent division is actually slightly advantageous to the wife). However, there are many more facts and circumstances present in this case that are not fully captured by the listing of assets and liabilities. Thus, the next steps in the lifestyle analysis will assist the divorce settlement process by considering and analyzing additional details.

Example Fact Pattern

For purposes of our example, assume the following facts:

- 30-year marriage
- Each spouse is 55 years old
- No children under 18
- An accustomed "nice" standard of living
- No business ownership interests
- Both spouses are employed and compensated with salary (one spouse's salary is much higher than the other) and have retirement benefits, but no fringe benefits
- No alimony is offered in the proposed settlement

Wife is not sure whether the proposed division of assets will accommodate her into the future, as alimony has not been offered in the proposed settlement. Per her counsel's recommendation, she has retained a financial expert to assist in determining spousal support using historical lifestyle and the need for alimony, and the obligor's ability to pay.

Review of Historical Earnings, Determination of "True Income," and Estimate of Ongoing Earnings Level

At this point, the financial expert will usually assess historical and current earnings to estimate ongoing earnings. Following the abovementioned fact pattern, Table 2 presents a comparison of individual gross earnings of the divorcing parties, as well as selected trend metrics. Gross earnings can be reviewed as-is, or net of retirement deductions. Also, many couples file tax returns as married filing jointly; however, for this exercise, it can be meaningful to analyze each spouse's historical earnings, based on the facts and circumstances of the case.

During this part of the analysis, it is critical to consider perquisites; if present, they may affect the determination of "true income." Our example's fact pattern assumes no business interest and no fringe benefits, so further analysis is not necessary. Perquisites may be more common for private business owners or individuals who receive additional compensation in the form of benefits, such as non-business-related expenses, personal life insurance (not key person business insurance), country club dues, vehicle allowances, children's private school tuition payments, and the like. These types of fringe benefits would otherwise be paid with after-tax dollars, but if paid by a business as a benefit, they ought to be considered a form of compensation.

The expert must then review the trend in earnings. Is salary static? Does salary fluctuate? Does a salary increase potentially reflect a promotion or raise during the observed period? Is salary dependent on sales or company profit? Answering these types of questions may require insight from the client. Average earnings may be more relevant if an individual has a fluctuating salary history, while current or most recent earnings may be more relevant for an individual with a steady salary history. The financial expert will then make an informed selection of salary that reflects ongoing earnings.

Table 2: Comparison of Earnings

Wife's Earnings

Year	Gross Salary	Pre-tax Deductions-401k	Implied Gross Earnings after Deductions	Gross Monthly
2015	$75,000	$23,000	$52,000	$4,333
2016	76,500	23,000	53,500	4,458
2017	78,030	23,000	55,030	4,586
2018	79,591	24,000	55,591	4,633
2019	81,182	24,500	56,682	4,724
Average 2015-2019	$78,061	$23,500	$54,561	$4,547
Most recent (2019)	$81,182	$24,500	$56,682	$4,724
Selected	**$81,182**	**$24,500**	**$56,682**	**$4,724**

Husband's Earnings

Year	Gross Salary	Pre-tax Deductions-401k	Implied Gross Earnings after Deductions	Gross Monthly
2015	$450,000	$23,000	$427,000	$35,583
2016	500,000	23,000	477,000	39,750
2017	875,000	23,000	852,000	71,000
2018	505,000	24,000	481,000	40,083
2019	525,000	24,500	500,500	41,708
Average 2015-2019	$571,000	$23,500	$547,500	$45,625
Most recent (2019)	$525,000	$24,500	$500,500	$41,708
Selected	**$525,000**	**$24,500**	**$500,500**	**$41,708**

Source: Tax Returns Prepared by ABC CPAs

Wife's Gross Monthly Earnings as a % of Husband's Gross Monthly Earnings	*11%*	*Using selected values from above*
Wife's Earnings as a % of Total (Wife's & Husband's)	*10%*	*" "*
Husband's Earnings as a % of Total (Wife's & Husband's)	*90%*	*" "*

The financial expert may also provide analytics on percentages of total earnings. In the above example, wife's earnings represent 10 percent of total selected earnings and husband's earnings represent 90 percent of total selected earnings. This is a critical analysis that leads to the next steps of the lifestyle analysis, as it illustrates the ability to pay and potentially a need for alimony.

Note the breakdown of annual figures by month in Table 2. Counsel, clients, and the trier of fact commonly review monthly expenses (historical and budgeted), so it can be helpful to show a column for the monthly figures.

The next phase relates to the marital status quo, i.e., the historical standard of living, and assessing a realistic forward budget. The financial expert may be asked to assist with the budgeting process or the budget may be created independently of the financial expert.

Potential for Further Investigation

The process of determining the "true income"—assessing earnings and historical lifestyle and estimating forward expenses—may lead to further avenues of investigation. As the financial expert begins to assemble the variables (facts and circumstances unique to the case), this stage of the process may reveal fraudulent activities, such as hidden assets or dissipation of marital assets. Thus, the expert must be prudent and wary of facts that reflect possible arrangements in anticipation of marital dissolution, such as changes in compensation and trends in expenses.

Assembling the Sources and Uses of Cash

The expert will then conduct a pay and need analysis for each spouse, assembling and calculating the sources of income, estimated taxes, disposable cash, and uses of cash over the remaining life expectancy of each divorcing party.

While assembling cash inflows and outflows in connection with the lifestyle analysis, the expert should review retirement plans and annual contributions, brokerage accounts, cash and savings accounts, annuities, insurance plans, and the like, to estimate respective average rates of return as well as varying estimated tax obligations. The expert might even consider the individual's risk tolerance in relation to future rates of return. For example, a person with ample disposable cash may be willing to invest in riskier ventures with a higher expected return on investment, and a person with limited disposable cash may choose to invest more conservatively.

For each spouse's analysis, income less deductions and estimated taxes will yield net disposable cash. The next output will deduct estimated expenses from disposable cash and yield either a deficit or surplus. This analysis is then extrapolated over the remaining life expectancy of wife and husband (the expert may choose to rely on the life expectancy tables provided by the Social Security Administration or another reliable source).

In the next steps, the financial expert, upon determining that there is a need for alimony and an ability to pay, will add alimony to the recipient (not taxed) and subtract it from the obligor (not deductible), to review the impact on the final deficit or surplus for each party.

Following our fact pattern, the pay and need analysis supported alimony of $5,000 per month for approximately 12 years, assuming both husband and wife retire at age 67. Without alimony, wife would have been in a deficit each year, quickly reducing her cash and investments balance, while husband would have enjoyed an even higher surplus and hefty wealth accumulation. Although statutory law and judicial precedent varies from state to state, the analysis supports the various factors typically considered—such as length of marriage, marital lifestyle, and each party's earnings ability and need—in determining the disadvantaged spouse's need (for alimony) and the obligor spouse's ability to pay.

Results and Illustrations from the Lifestyle Analysis

Ultimately, the lifestyle analysis illustrates—collectively and on an annual basis for the couple's remaining expected life—sources of income, tax obligations, and net disposable cash before and after expected (estimated) expenses. Another common output illustrated is the deficit or surplus based on the aforementioned inputs.

The financial expert may build scenarios for the client based on varying inputs, including different potential settlements of assets, varying alimony payouts (both amounts and duration), and even one-off life events, such as a future payoff of a home or a drop-off in children's tuition expenses. Keep in mind, however, that the analytical model is highly sensitive to any variable changes, so extreme caution is advised, including limiting the sharing of work product to printed versions (electronic or physical) and not sharing the Excel working files.

This analytical tool is valuable because it can illustrate pre- and post-alimony scenarios, as well as various alimony scenarios, and lead to further analyses, such as comparisons of relative gross earnings or after-tax disposable cash. See Figure 1 for an illustration of wife and husband's net disposable cash (after-tax and including alimony) using our fact pattern. These percentages and illustrations allow comparison on relative terms, not just dollar amounts, which can be particularly valuable in high net-worth cases, and assist the settlement process or the trier of fact.

The financial expert may build scenarios for the client based on varying inputs, including different potential settlements of assets, varying alimony payouts (both amounts and duration), and even one-off life events.

Figure 1: Comparison of Disposable Cash

After-Tax Measures: Include Alimony, Before Expenses			
Years Beyond Divorce	**W Net Disposable Cash**	**H Net Disposable Cash**	**% W to %H**
1	$105,845	$280,115	38%
2	107,010	286,631	37%
3	108,198	293,257	37%
4	109,410	300,015	36%
5	110,647	306,908	36%
6	111,908	313,939	36%
7	113,194	321,111	35%
8	114,506	328,426	35%
9	115,844	335,887	34%
10	117,209	343,498	34%
11	118,602	351,261	34%
12	120,022	359,179	33%

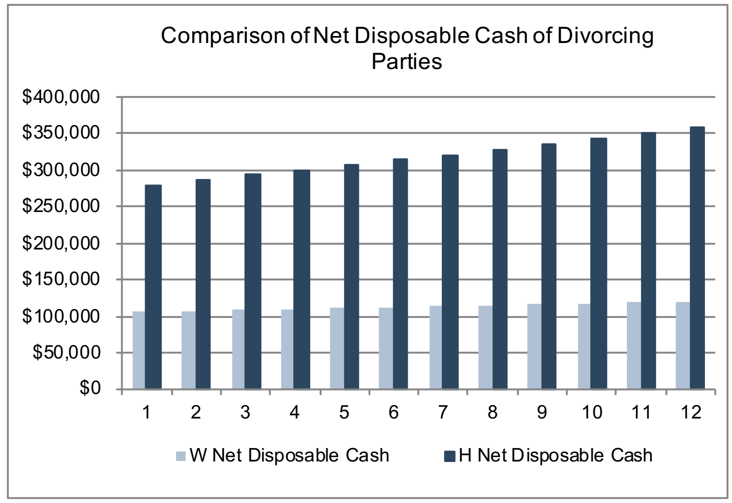
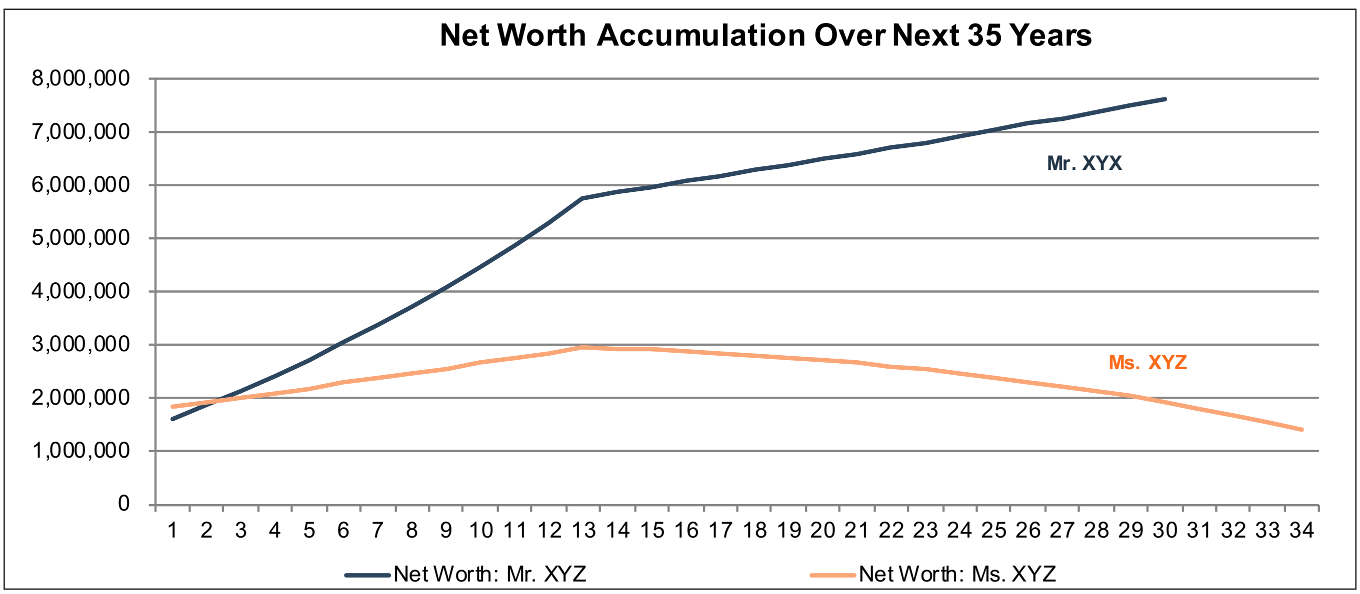


Figure 2: Net Worth Accumulation Analysis



Another valuable result of the analysis is the ability to assess the parties' net worth at multiple points in time. The net worth accumulation analysis (Figure 2) demonstrates the differences or similarities in the division of net worth at the date of divorce and at the date of death. Additionally, it illustrates the net worth accumulation between those two points in time. This may highlight that what appears to be reasonable at a point in time may or may not be reasonable when extracted over time. When used as trial demonstratives, these illustrations can assist the trier of fact in determining the disadvantaged spouse's need and the obligor spouse's ability to pay.

Concluding Thoughts

Because no two cases are alike, with facts and circumstances varying from case to case, all components of a lifestyle analysis must be carefully assessed. In many cases, complexities beyond those presented in the above example require further investigation. For example, in some cases it may be necessary to involve a vocational expert, value business ownership interests, assess personal versus enterprise goodwill, distinguish between marital and separate assets, value vested and nonvested stock options and restricted stock, or review deferred and incentive compensation.

In financial situations that may be scrutinized by regulators, courts, tax collectors, and other potential adversaries, an expert's financial, economic, and accounting experience and skills are invaluable. The details in the lifestyle analysis can help determine the equitable distribution of marital assets as well as alimony needs. These complex analyses are best performed by a competent financial expert who will be able to define and quantify the financial aspects of a case and effectively communicate the conclusion.

Sample Timeline of Events

- Obtain/request relevant documentation
- Review historical income and expenses/spending habits
- Obtain (or assist with) monthly budget for each spouse
- Review historical and current employment benefits, such as pensions, retirement plans (qualified and nonqualified), incentive plans, fringe benefits, etc.
- Build a lifestyle analysis/pay and need analysis with all sources of income, calculating after-tax disposable cash available to cover anticipated expenses through their life expectancy
- Use this resource during settlement negotiations for balance sheet allocation and alimony determination
- Illustrate the net worth at a point in time (divorce) and future point (expected life) to assist in the settlement phase and/or trial

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