

Mercer Capital's Family Law Valuation and Forensic Insights

# Navigating Tax Returns

Tips and Key Focus Areas for Family Law Attorneys and  
Divorcing Individuals/Business Owners

[www.mercercapital.com](http://www.mercercapital.com)



# Navigating Tax Returns

## Tips and Key Focus Areas for Family Law Attorneys and Divorcing Individuals/Business Owners

This piece is designed to assist family law attorneys and their clients better understand tax returns because knowing how to navigate tax returns can be very useful in divorce proceedings.

The information contained in tax returns can provide support for marital assets and liabilities, sources of income and potential further analyses. Reviewing multiple years of tax returns and accompanying supplemental schedules may provide helpful information on trends and/or changes and could indicate the need for potential forensic investigations.

This information originally appeared in Mercer Capital's *Family Law Valuation and Forensics Insights* newsletter, a monthly publication distributed by email as well as located on our website.

While we do not provide tax advice, Mercer Capital is a national business valuation and advisory firm and we provide expertise in the areas of financial, valuation, and forensic services.

For more information about us, see pages 23-24 or visit <https://mercer.cr/FamilyLaw>.

# Navigating Tax Returns

Tips and Key Focus Areas for Family Law Attorneys and Divorcing  
Individuals/Business Owners

## Table of Contents

|  |           |
|--|-----------|
| <b>Part I: Form 1040</b> .....   | <b>1</b>  |
| Why Would Form 1040 Be Important In Divorce Proceedings? .....   | 2         |
| Key Areas of Focus for Family Law Attorneys and Divorcing Parties .....  | 2         |
| Conclusion .....   | 5         |
| <br>   |           |
| <b>Part II: Schedule A (Form 1040) Itemized Deductions</b> .....   | <b>7</b>  |
| Why Would Schedule A (Form 1040) Itemized Deductions<br>Be Important In Divorce Proceedings? .....             | 8         |
| Key Areas of Focus for Family Law Attorneys and Divorcing Parties .....  | 8         |
| Conclusion .....   | 11        |
| <br>   |           |
| <b>Part III: Schedule K-1 and Relevant Business-Related Schedules</b> .....                                    | <b>13</b> |
| Why Would Schedule K-1 Be Important in Divorce Proceedings? .....  | 14        |
| Key Areas of Focus for Family Law Attorneys and Divorcing Parties .....  | 14        |
| Additional Relevant Business-Related Schedules and<br>Why Each Could Be Important in Divorce Proceedings ..... | 17        |
| Conclusion .....   | 20        |
| <br>   |           |
| <b>About the Authors</b> .....   | <b>21</b> |
| <br>   |           |
| <b>Mercer Capital Family Law Litigation Support Services</b> .....   | <b>23</b> |
| <br>   |           |
| <b>Mercer Capital Litigation Team</b> .....  | <b>24</b> |

# Part I Form 1040

Form 1040 is used by taxpayers to file an annual income tax return. It calculates the total taxable income of the taxpayer(s) and determines the amount that should be paid or refunded. There are five filing statuses - single, married filing jointly, married filing separately, head of household, and qualified widow(er) with dependent children.



# Why Would Form 1040 Be Important In Divorce Proceedings?

Form 1040 provides a general understanding of a taxpayer’s financial status and can be a guide to finding additional information about one’s finances. It can serve as a starting point to get a picture of an individual’s (or couple’s) income(s), assets and liabilities, and lifestyle. Form 1040 is supplemented with additional schedules and documentation which lend detail and insight into one’s lifestyle and financial matters. Ultimately, for divorce purposes, multiple years of tax returns should be reviewed and can be a source of inputs for the marital estate subject to division, as well as data for further financial analyses like income determination and lifestyle analysis/pay and need analysis.

Below is a snapshot from Form 1040:

|   |  |  |            |  |
|---|--|--|------------|--|
| Attach Sch. B if required.  | <b>1</b>   | Wages, salaries, tips, etc. Attach Form(s) W-2                                     | <b>1</b>   |  |
|   | <b>2a</b>  | Tax-exempt interest  | <b>2a</b>  |  |
| Standard Deduction for—<br>• Single or Married filing separately, \$12,400<br>• Married filing jointly or Qualifying widow(er), \$24,800<br>• Head of household, \$18,650<br>• If you checked any box under Standard Deduction, see instructions. | <b>3a</b>  | Qualified dividends  | <b>3a</b>  |  |
|   | <b>4a</b>  | IRA distributions  | <b>4a</b>  |  |
|   | <b>5a</b>  | Pensions and annuities   | <b>5a</b>  |  |
|   | <b>6a</b>  | Social security benefits   | <b>6a</b>  |  |
|   | <b>7</b>   | Capital gain or (loss). Attach Schedule D if required. If not required, check here | <b>7</b>   |  |
|   | <b>8</b>   | Other income from Schedule 1, line 9   | <b>8</b>   |  |
|   | <b>9</b>   | Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your <b>total income</b>        | <b>9</b>   |  |
|   | <b>10</b>  | Adjustments to income:   |            |  |
|   | <b>a</b>   | From Schedule 1, line 22   | <b>10a</b> |  |
|   | <b>b</b>   | Charitable contributions if you take the standard deduction. See instructions      | <b>10b</b> |  |
| <b>c</b>  | Add lines 10a and 10b. These are your <b>total adjustments to income</b>         | <b>10c</b>   |            |  |
| <b>11</b>   | Subtract line 10c from line 9. This is your <b>adjusted gross income</b>         | <b>11</b>  |            |  |
| <b>12</b>   | <b>Standard deduction or itemized deductions</b> (from Schedule A)               | <b>12</b>  |            |  |
| <b>13</b>   | Qualified business income deduction. Attach Form 8995 or Form 8995-A             | <b>13</b>  |            |  |
| <b>14</b>   | Add lines 12 and 13  | <b>14</b>  |            |  |
| <b>15</b>   | <b>Taxable income.</b> Subtract line 14 from line 11. If zero or less, enter -0- | <b>15</b>  |            |  |

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2020)

## Key Areas of Focus for Family Law Attorneys and Divorcing Parties

**Line 1: Wages, Salaries, and Tips** – Line 1 details wages, salaries, and tips. This amount should match the income reported in Box 1 of the Form W-2. *The amount on Line 1 is not gross income.* It is likely that there are pre-tax deductions, such as contributions to a 401(k) account. You should refer to the underlying W-2(s) for more information about these deductions as well as gross income.

**Line 2 & Line 3: Interest and Dividends** – An entry in Line 2 indicates interest income, while an entry in Line 3 indicates dividend income. *Both point to ownership of assets and documentation of these assets should be requested.* Furthermore, income earned from interest and dividends can be considered as a source of income when calculating spousal and child support. Details about interest and dividend income can be found on Schedule B, Form 1099-INT, and Form 1099-DIV

**Line 4: IRA Distributions** – An entry in Line 4 shows distribution from an individual retirement account, *signaling that the taxpayer has an IRA account and documentation of these assets should be requested.* A withdrawal from a retirement account may also point to possible dissipation of marital assets, if not readily identifiable or available by account documentation. Details about retirement distributions are on Form 1099-R.

**Line 5: Pensions and Annuities** – An entry in Line 5 indicates existence of pensions and annuities, which may be wholly or partially marital property. *These must be carefully considered for property division as well as sources of income when calculating spousal and child support.*

**Line 6: Social Security Benefits** – Like pensions, *Social Security benefits should be considered as sources of income when calculating spousal and child support.* Details can be found on Form SSA-1099, which is a form provided to the taxpayer who receives these benefits. Estimates of an individual's future monthly payments can be extracted from the Social Security Administration website.

**Line 7: Capital Gains or Losses** – Line 7 indicates capital gains or losses, which means that an asset (or multiple assets) was sold and some sort of monies were made or lost on the transaction. *Not only does this information indicate ownership of assets, it can also be important in tracing analyses as well as other forensic analyses when reviewing several years of tax returns.* Details can be found in Schedule D and Form 8949.

**Line 8: Other Income** – An entry in Line 8 should be reviewed further as it often indicates income from gambling winnings or other unusual sources (for example, prizes, jury duty pay, or the taxable portion of disaster relief payments). Information about the sources of other income can be found in Form 1099-MISC (miscellaneous income) or Form W-2G (which is a form that records gambling winnings). *However, these incomes are typically not recurring in nature, and are not always reported which may require scrutiny and potential forensic analyses.*

**Line 9: Total Income** – *This line is the summation of above lines and yields total income of the taxpayer and can give you information about how the taxpayer earns their income.* This number may be used when determining spousal or child support as it does not include any adjustments.

**Line 11: Adjusted Gross Income** – *Adjusted Gross Income (AGI) is the amount used to determine one's taxable income.* The AGI is total income less adjustments. A few common adjustments are deductions for educator expenses, health savings account deductions, and student loan interest deductions. Many of these adjustments are optional, and excessive use could potentially be used to skew spousal or child support amounts. Therefore, gross income (line 9) is often considered over AGI when determining spousal or child support amounts. More information on the adjustments claimed can be found on Schedule 1.

**Line 13: Qualified Business Income (QBI) Deduction** – If the taxpayer is taking this deduction, *it indicates that they own a business, which should lead to requests for related business documents.* The QBI deduction is for pass-through businesses, therefore, a Schedule C or Schedule K-1 should also be included with the tax return. Examples of pass-through businesses are sole proprietorships, LLCs, partnerships, and S Corporations.

**Line 37: Amount You Owe Now** – Line 37 indicates the incremental amount owed based on the total tax liability less any federal tax withholding, estimated payments, and credits. *Reviewing the amount owed or amount to be refunded over several years can potentially uncover intentional over or under payment. However, business owners or self-employed individuals who pay quarterly taxes may have fluctuating incomes from year to year. It is important to understand that quarterly tax payment estimates are based on prior year realized income levels, which may or may not be the reason for over or under payment.* A financial expert can accurately assess these types of scenarios.

|   |  |  |           |  |
|---|--|--|-----------|--|
| <b>Amount You Owe</b><br>For details on how to pay, see instructions. | <b>37</b>  | Subtract line 33 from line 24. This is the <b>amount you owe now</b> . . . . . ▶ | <b>37</b> |  |
|   | <b>Note:</b> Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details. |  |           |  |
|   | <b>38</b>  | Estimated tax penalty (see instructions) . . . . . ▶                             | <b>38</b> |  |

## Conclusion

Knowing how to navigate key areas of Form 1040 can be quite useful in divorce proceedings. Information within the tax return can provide support for marital assets and liabilities, determination of spousal and child support, and potential further analyses. Reviewing multiple years of tax returns is typical as multi-year overviews may reveal trends, provide helpful information, and may even indicate the need for potential forensic investigations.



## Part II

# Schedule A (Form 1040) Itemized Deductions

Schedule A (Form 1040) Itemized Deductions is an attachment to Form 1040 for taxpayers who choose to itemize their tax-deductible expenses rather than take the standard deduction.

## Why Would Schedule A (Form 1040) Itemized Deductions Be Important In Divorce Proceedings?

Schedule A provides information regarding marital property – assets and debts – and may reveal information about the taxpayer's lifestyle and financial position. *Reviewing the detailed information can potentially lead to further investigation such as uncovering dissipation of assets, discovering hidden assets, or providing an overview of true historical spending.*

Taxpayers have the option on Line 12 of Form 1040 to elect the standard deduction or the itemized deductions from Schedule A. At the time of this piece's publication, the standard deduction ranges from \$12,400-\$24,800 depending on the selected filing status of the taxpayer(s). Both deductions reduce the amount of Taxable Income on Line 15 on Form 1040. If the taxpayer's qualified itemized deductions are greater than their standard deduction, the taxpayer typically forgoes the standard deduction and files Schedule A with Form 1040. *For divorce purposes, reviewing the taxpayer's elections over a historical period may also provide further insight into the financial snapshot of the estate over time.*

## Key Areas of Focus for Family Law Attorneys and Divorcing Parties

**Lines 5b and 5c: State & Local Real Estate Taxes, State & Local Property Taxes** – Entries on Lines 5b and/or 5c show taxes paid on property. Line 5b focuses on state and local taxes paid on real estate owned by the taxpayer(s) that were not used for business, while Line 5c concentrates on state and local personal property taxes paid on a yearly basis based on the value of the asset alone.

*If these lines are filled, it should lead to further questioning about what these properties are and if they are marital property. The amount of tax paid could also give insight into the taxpayer's assets. Greater state and local real estate taxes entered on Line 5b usually indicate more expensive real estate. Similarly, a larger entry in Line 5c representing taxes on personal property indicate high-priced assets, such as an expensive car.*

|                       |   |           |
|-----------------------|---|-----------|
| <b>Taxes You Paid</b> | <b>5</b> State and local taxes.   |           |
|                       | <b>a</b> State and local income taxes or general sales taxes. You may include either income taxes or general sales taxes on line 5a, but not both. If you elect to include general sales taxes instead of income taxes, check this box . . . . . <input type="checkbox"/> | <b>5a</b> |
|                       | <b>b</b> State and local real estate taxes (see instructions) . . . . .   | <b>5b</b> |
|                       | <b>c</b> State and local personal property taxes . . . . .  | <b>5c</b> |

**Line 8: Home Mortgage Interest** – A home mortgage represents any loan that is secured by the taxpayer’s main home or second home. A “home” can be a house, condominium, mobile home, boat, or similar property as long as it provides the basic living accommodations. The rules for deducting interest vary, depending on whether the loan proceeds are used for business, personal, or investment activities. The deduction for home mortgage interest depends on factors such as the date of the mortgage, the amount of the mortgage, and how the mortgage proceeds are used.

*An entry in Lines 8a-e indicates the taxpayer(s) has a home mortgage loan and documentation of the loan should be requested. This line is an indication of property ownership, and therefore, a potential marital asset (or separate asset if that scenario is applicable).* Form 1098, the Mortgage Interest Statement, will provide more detailed information.

|   |   |           |
|---|---|-----------|
| <b>Interest You Paid</b><br><small>Caution: Your mortgage interest deduction may be limited (see instructions).</small> | <b>8</b> Home mortgage interest and points. If you didn’t use all of your home mortgage loan(s) to buy, build, or improve your home, see instructions and check this box . . . . . <input type="checkbox"/>   |           |
|   | <b>a</b> Home mortgage interest and points reported to you on Form 1098. See instructions if limited . . . . .  | <b>8a</b> |
|   | <b>b</b> Home mortgage interest not reported to you on Form 1098. See instructions if limited. If paid to the person from whom you bought the home, see instructions and show that person’s name, identifying no., and address . . . . .<br>▶ _____ | <b>8b</b> |

**Line 14: Gifts to Charity** – A charitable contribution is a donation or gift made voluntarily to, or for the use of, a qualified organization without expecting to receive anything of equal value. Qualified organizations include but are not limited to nonprofit groups that are religious, charitable, or educational.

Sometimes we see charitable giving allocated as a line item in a divorcing individual's future budget. While this may not necessarily be an expense necessary for traditional living expenses, if, historically, the parties donated significant monies, this can be captured on historical charitable donation deductions and ought to be evaluated on a case-by-case basis. *As a tip, sometimes these gifts may be captured elsewhere than a personal tax return, such as a trust's estate tax return.*

|   |  |    |    |
|---|--|----|----|
| <b>Gifts to Charity</b><br><small>Caution: If you made a gift and got a benefit for it, see instructions.</small> | 11 Gifts by cash or check. If you made any gift of \$250 or more, see instructions . . . . .   | 11 |    |
|   | 12 Other than by cash or check. If you made any gift of \$250 or more, see instructions. You <b>must</b> attach Form 8283 if over \$500. . . . . | 12 |    |
|   | 13 Carryover from prior year . . . . .   | 13 |    |
|   | 14 Add lines 11 through 13 . . . . .   |    | 14 |

**Line 16: Other Itemized Deductions** – Only certain expenses qualify to be deducted as other itemized deductions including gambling losses, casualty and theft losses, among others. *If there is an entry in Line 16, more detailed information on these deductions may be necessary.*

A common “other itemized deduction” is for gambling losses, which may lead to further questioning and could potentially be dissipation of marital assets. Another example is the federal estate tax on income in respect of a decedent. Income in respect of a decedent (IRD) is income that was owed to a decedent at the time he or she died. Examples of IRD include retirement plan assets, IRA distributions, unpaid interest, dividends, and salary, to name only a few.

Along with other estate assets, IRD is eventually distributed to the beneficiaries. While most assets of the estate are transferred free of income tax, IRD assets are generally taxed at the beneficiaries’ ordinary income tax rates. However, if a decedent’s estate has paid federal estate taxes on the IRD assets, the beneficiary may be eligible for an IRD tax deduction based on the amount of estate tax paid. *This is an example of a potential separate asset, however, the IRD could also be a marital asset depending on the beneficiary designation and/or potential commingling of assets.*

*Items included within other itemized deductions should typically be reviewed and potentially investigated further as they may represent assets, liabilities, and/or sources of income, whether marital or separate.*

|  |  |  |    |
|--|--|--|----|
| <b>Other<br/>Itemized<br/>Deductions</b> | 16 Other—from list in instructions. List type and amount ▶ |  | 16 |
|  |  |  |    |

## Conclusion

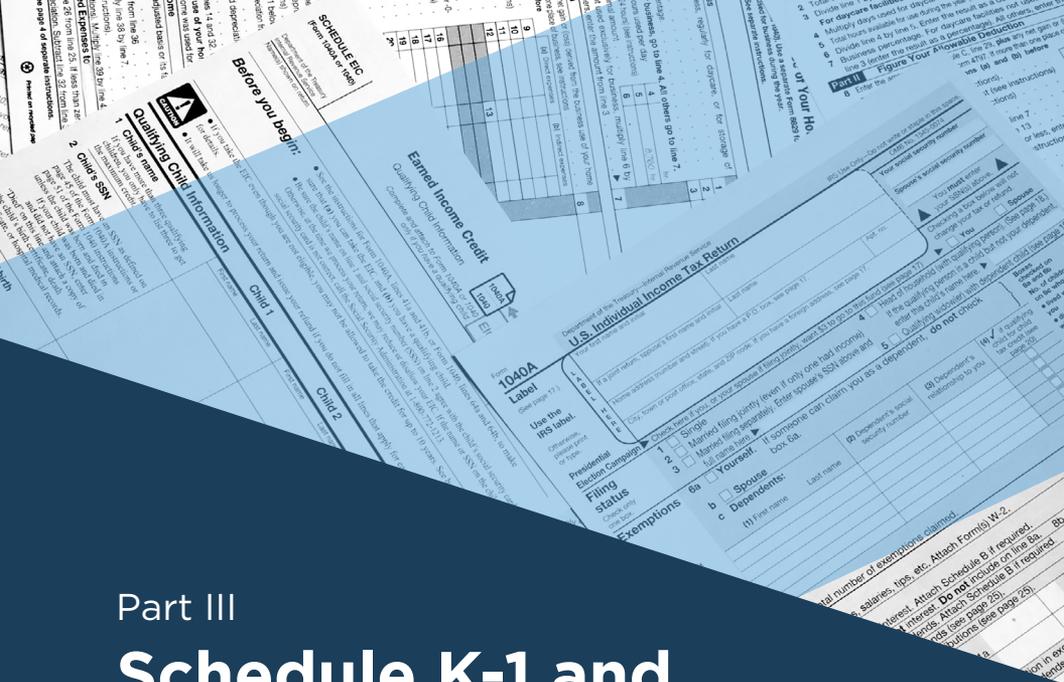
Understanding how to navigate key areas of Schedule A (Form 1040) can be very helpful in divorce proceedings. Information within Schedule A can provide support for marital assets and liabilities, sources of income and potential further analyses. Reviewing multiple years of tax returns and accompanying supplemental schedules may provide helpful information on trends and/or changes and could indicate the need for potential forensic investigations.

### Part III

# Schedule K-1 and Relevant Business-Related Schedules

This section concentrates on Schedule K-1 (Form 1065 or Form 1120-S) and additional business-related schedules.

Entities taxed as general partnerships, limited partnerships, limited liability partnerships, limited liability corporations, and S corporations prepare a Schedule K-1 for each of its owners. The Schedule K-1 identifies the owners of the business and specifies the percentage of equity, profits, and losses that will be attributed to each for tax purposes, among other information. K-1s must be distributed to each owner and filed with the entity's tax return. Owners then utilize the K-1 when preparing their personal tax returns to substantiate the profits and/or losses they are claiming.



## Why Would Schedule K-1 Be Important in Divorce Proceedings?

Schedule K-1 provides information regarding the business, the individual partner (or member or shareholder), as well as the portion of taxable income or loss that is attributable to each owner. A business owner may not receive a salary and, therefore, might not get a Form W-2 Wage and Tax Statement. Schedule K-1 provides the details on profit and loss allocated to the individual from the business. Sometimes other agreements are in place for bonus sharing, etc. and the K-1 reflects each business owner's proportionate share of taxable income or loss.

*The K-1 provides evidence of ownership in a business, details the percentage of ownership, and shows business gains and losses for the year allocated to the specific owner, among other information. The business ownership (whether 100% or an interest in the business) may be divisible within the marital estate. If multiple business interests exist, each entity would generate a separate K-1 per owner. The Schedule K-1 can also be used in conjunction with other documents for income determination purposes.*

## Key Areas of Focus for Family Law Attorneys and Divorcing Parties

**Part II of Schedule K-1, Information about the Partner** – provides details on each individual partner such as the type of entity, partner's share (beginning and ending) of profit, loss, capital and liabilities, and the beginning and ending capital account of the individual. **Box G** indicates if the taxpayer is a general, limited, or other type of partner. Another item to pay close attention to is **Box J** which is the line that states "Check if decrease is due to sale or exchange of partnership interest." If checked, more information may need to be requested to understand the transaction, amended agreement, or other type of sale or exchange.

*While the K-1 offers helpful information on business ownership percentages and annual profit or loss, additional documentation of the business entity should be requested when performing a business evaluation and/or in conjunction with other forensic services such as income determination.*

**G**  General partner or LLC member-manager  Limited partner or other LLC member

**H1**  Domestic partner  Foreign partner

**H2**  If the partner is a disregarded entity (DE), enter the partner's:  
 TIN \_\_\_\_\_ Name \_\_\_\_\_

**I1** What type of entity is this partner? \_\_\_\_\_

**I2** If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here

**J** Partner's share of profit, loss, and capital (see instructions):

|         | <b>Beginning</b> |   | <b>Ending</b> |   |
|---------|------------------|---|---------------|---|
| Profit  | _____            | % | _____         | % |
| Loss    | _____            | % | _____         | % |
| Capital | _____            | % | _____         | % |

Check if decrease is due to sale or exchange of partnership interest

**Box L** – titled **Partner's Capital Account Analysis** presents the ending capital account for the individual partner by showing the following: the beginning capital account, plus capital contributed and current year net income (loss) for the year, less withdrawals and distributions, if any.

*One should pay attention to the information presented on the Partner's Capital Account Analysis because it may be a starting point for evidencing distributions (which may or may not be included in W-2 salary), and investments into a business such as a capital call.*

| <b>Partner's Capital Account Analysis</b>      |                 |
|--|-----------------|
| <b>Beginning capital account</b>               | \$ _____        |
| Capital contributed during the year            | \$ _____        |
| Current year net income (loss)                 | \$ _____        |
| Other increase (decrease) (attach explanation) | \$ _____        |
| Withdrawals and distributions                  | \$ ( _____ )    |
| <b>Ending capital account</b>                  | <b>\$ _____</b> |

**Part III of Schedule K-1** – is Partner’s share of current year income, deductions, credits, and other income. A few of the individual boxes are explained below.

**Box 1** – represents the taxpayer’s share of Ordinary Business Income, or Loss, from the corporation. The individual’s income amount is further categorized within Form 1040 depending on whether the income is deemed active or passive. Passive income includes money earned from interest, dividends, and rental property. Active income includes pass-through income or loss, wages and salaries (these may also be included on an individual W-2) or supplemental income. **Refer to Schedule E – Supplemental Income and Loss** for information on the income; specifically Line 28, which includes column (H) for passive income and column (K) for active or nonpassive income.

| <b>Part III Partner’s Share of Current Year Income, Deductions, Credits, and Other Items</b> |                                 |           |                                 |
|--|---------------------------------|-----------|---------------------------------|
| <b>1</b>   | Ordinary business income (loss) | <b>14</b> | Self-employment earnings (loss) |

**Box 12 – Section 179 Deduction** – is an immediate expense deduction that business owners have the option to utilize for purchases of depreciable business equipment rather than capitalizing and depreciating the asset over a period of time (referred to as straight-line depreciation). This allows businesses to lower their current-year tax liability rather than capitalizing an asset and depreciating it over time in future tax years, i.e., the tax reduction is taken in full versus in smaller amounts over a period of time. The Section 179 deduction is offered as an incentive for small business owners to grow their business with the purchase of new equipment. To qualify, the property is limited to items such as cars, office equipment, business machinery, and computers; this property also must be used for business purposes more than 50% of the time to qualify. This deduction election will also be reported for the individual taxpayer on Form 4562 – Depreciation and Amortization.

|           |                       |
|-----------|-----------------------|
| <b>12</b> | Section 179 deduction |
|-----------|-----------------------|

*Information on the K-1 can guide questions to ask and subsequent documents to request in order to understand and evaluate business interest(s).*

## Additional Relevant Business-Related Schedules and Why Each Could Be Important in Divorce Proceedings

**Form 4562 – Depreciation and Amortization** is used to claim deductions for the depreciation or amortization for tax purposes. Other uses include making an election under section 179 to expense certain property, and to provide information on the business/investment use of automobiles and other assets. Individuals and businesses can claim deductions for tangible assets, such as a building, and intangible assets, such as a patent. Section 179 property does not include property held for investment, property used outside of the United States, or property used by a tax-exempt organization.

The **Depreciation & Amortization Schedule** can assist the divorce process by providing a listing of depreciable assets. While the form refers to all as “property,” the term stems from an accounting identification of “property, plant & equipment.” These types of assets typically qualify for depreciation, while intangible assets are typically those that qualify for amortization. Amortization is similar to the straight-line method of depreciation in that an annual deduction to taxable income may be allowed over a fixed time period. The taxpayer can amortize such items as costs of starting a business, goodwill, and certain other intangible assets. **Part VI – Amortization** is the last section of Form 4562, where the business amortization costs are described and listed to calculate amortization for the year for the individual taxpayer.

*Depreciation and amortization can be found on both the balance sheet and the income statement. Annual and accumulated depreciation/amortization are contra-assets to the respective underlying asset on the balance sheet. On the income statement (also referred to as the profit and loss statement), depreciation and amortization are expense items.*

One other focus area for divorcing parties is **Part V – Listed Property** – specifically, **Section A – Depreciation and Other Information – Lines 26 and 27**. These lines are used to determine depreciation for property used more or less than 50% in a qualified business use, respectively. Generally, a qualified business use is any use in trade or business; however, it does not include investment use, leasing to a 5% or less owner, or the use of property as a compensation for services performed. Column (C) – Business/investment use percentage is where this is displayed.

| <b>Part V Listed Property</b> (Include automobiles, certain other vehicles, certain aircraft, and property used for entertainment, recreation, or amusement.)<br><b>Note:</b> For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete only 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.<br><b>Section A—Depreciation and Other Information (Caution: See the instructions for limits for passenger automobiles.)</b> |                               |   |                            |  |                        |                          |                               |                                 |  |
|---|-------------------------------|---|----------------------------|--|------------------------|--------------------------|-------------------------------|---------------------------------|--|
| <b>24a</b> Do you have evidence to support the business/investment use claimed? <input type="checkbox"/> Yes <input type="checkbox"/> No <b>24b</b> If "Yes," is the evidence written? <input type="checkbox"/> Yes <input type="checkbox"/> No   |                               |   |                            |  |                        |                          |                               |                                 |  |
| (a)<br>Type of property (list vehicles first)   | (b)<br>Date placed in service | (c)<br>Business/investment use percentage | (d)<br>Cost or other basis | (e)<br>Basis for depreciation (business/investment use only) | (f)<br>Recovery period | (g)<br>Method/Convention | (h)<br>Depreciation deduction | (i)<br>Elected section 179 cost |  |
| <b>25</b> Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use. See instructions .   |                               |   |                            |  |                        |                          | <b>25</b>                     |                                 |  |
| <b>26</b> Property used more than 50% in a qualified business use:  |                               |   |                            |  |                        |                          |                               |                                 |  |
|   |                               | %   |                            |  |                        |                          |                               |                                 |  |
|   |                               | %   |                            |  |                        |                          |                               |                                 |  |
|   |                               | %   |                            |  |                        |                          |                               |                                 |  |
| <b>27</b> Property used 50% or less in a qualified business use:  |                               |   |                            |  |                        |                          |                               |                                 |  |
|   |                               | %   |                            |  |                        | S/L -                    |                               |                                 |  |
|   |                               | %   |                            |  |                        | S/L -                    |                               |                                 |  |
|   |                               | %   |                            |  |                        | S/L -                    |                               |                                 |  |

**Schedule L – Balance Sheet per Books, Schedule M-1 – Reconciliation of Net Income/(Loss), and Schedule M-2 – Analysis of Partner’s Capital Account** are also worthy schedules to review in conjunction with individuals who own business(es) or interest(s) in business(es). These schedules within Form 1065 or Form 1120-S for S corporations present the financial statements of the business and the activity on a capital account. If business financial statements, such as an income statement and balance sheet, are obtained, these schedules can be used in conjunction with the review of the financial records. **Schedule C Profit or Loss from Business** can also be helpful if the business owner is a Sole Proprietor, as this schedule is specific to sole proprietorships. As the name implies, this Schedule C provides income, expenses, cost of goods sold, and other expenses during the respective tax year.

Schedule L provides the beginning and ending balances on the items on the balance sheet. Schedule M-1 provides the reconciliation of income or loss. The reconciliation occurs because some items are allowed, disallowed, or capped for tax purposes, which may be present on the income statement of the business – travel and entertainment and depreciation are two examples included within Schedule M-1. As we previously discussed, the business may take all of its depreciation in one year for tax purposes, while using straight-line depreciation in accordance with GAAP (generally accepted accounting principles). Depending on the current tax laws, a maximum dollar threshold may be allowed for expensing travel and entertainment for tax purposes, while the business may choose to expense more for internal financial purposes.

*A review of Schedule M-1 can provide information about potential differences between profits or losses prepared for tax purposes versus internal financial reporting purposes.*

*Some small businesses may not maintain financial statements beyond the information presented in the tax return schedules; hence, it is important to understand which schedules and sections to review if your client owns an interest(s) in a business. However, for businesses that have financial statements, one should request multiple years of financial statements in addition to multiple years of tax returns and understand how to review the documents in conjunction with one another.*

*Reviewing the items listed in these schedules can provide useful information and lead to further document requests in order to review and evaluate business assets, business ownership(s), and active and passive income, among other information.*

## Conclusion

Understanding how to navigate key areas of Schedule K-1 and supporting schedules is often necessary in divorce proceedings. While we provided background on Form 4562, Schedule C, Schedule E, Schedule L, Schedule M-1, and Schedule M-2, there may be further supporting schedules with helpful information or indicators to request further information. Remember that each case presents different facts and circumstances, and tax returns may vary (specifically which schedules are included).

Information within the tax return and supporting schedules can provide support for marital assets and liabilities (specifically those associated with business ownership and/or other types of assets), sources of income, and potential further analyses. Reviewing multiple years of Schedule K-1s and accompanying supplemental schedules may provide helpful information on trends and/or changes and could indicate the need for potential forensic investigations.

## About the Authors



**Karolina Calhoun, CPA, ABV, CFF** is a senior member of Mercer Capital's Litigation Services team. She provides valuation and forensics services for family law, gift & estate planning, commercial litigation, transactions, and matters related to privately held businesses, dissenting shareholders, intellectual property, and personal goodwill. With her forensics accreditation, she provides economic and financial damages studies, asset tracing, lost profits, and lifestyle analyses.

Prior to joining Mercer Capital, Karolina was a Senior Auditor at EY in their Audit and Assurance Services practice.

In February 2022, Karolina was invited and admitted to the American Academy of Matrimonial Lawyers (AAML) Foundation, Forensic & Business Valuation Division. Karolina also serves on the AICPA Business Valuations Committee.

**Contact Information:** 901.322.9761 | calhounk@mercercapital.com



**Zac L. Lange, CPA** provides valuation and forensics services for family law, gift & estate planning, commercial litigation, transactions (M&A), and other matters related to privately held businesses, dissenting shareholders, intellectual property, and personal goodwill.

Prior to joining Mercer Capital, Zac was a Senior Audit Associate at EY in their Audit and Assurance Services practice.

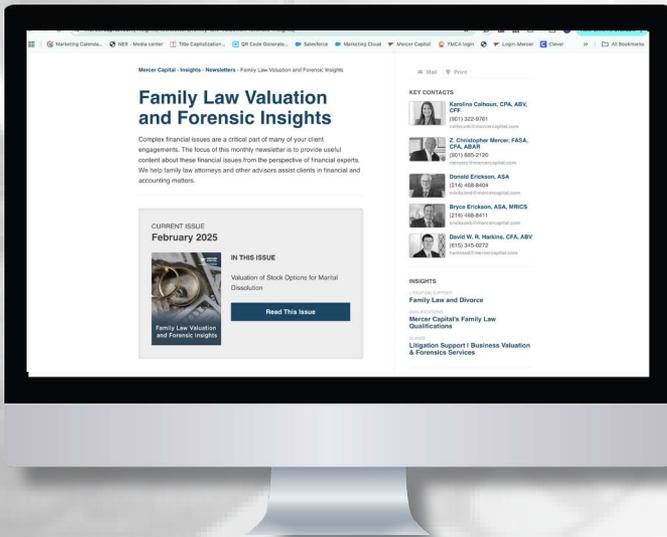
**Contact Information:** 901.322.9746 | langez@mercercapital.com

MERCER CAPITAL'S  
MONTHLY NEWSLETTER

# Family Law Valuation and Forensic Insights

Addressing Complex Financial & Valuation Issues

Complex financial and valuation issues are a critical part of many of your client engagements. The focus of this monthly newsletter is to provide useful content about these issues from the perspective of financial experts.



We help family law attorneys and other advisors assist clients in financial and accounting matters.



Scan the QR code to read  
previous issues and subscribe  
or visit <https://mer.cr/FLVFI>

# Mercer Capital

Mercer Capital is a national business valuation and financial advisory firm. We are frequently engaged to provide support in family law and divorce disputes.

We bring a team of experienced and credentialed experts and over 40 years of experience to the field of valuation, forensic analysis, and litigation support. Assisting our clients through the entire dispute process, we provide initial consultation and analysis, as well as testimony and trial support. We provide services to litigated divorces, as well as collaborative/mediated divorces. Our Litigation Services team brings national experience and subject matter and industry expertise.

## Valuation Services

---

- Valuations of Businesses, Interests in Businesses, Professional Practices, and Sports Teams
- Valuations of Intellectual Property, Tradename, and Other Intangible Assets
- Valuations and Determination of Personal vs. Enterprise Goodwill and Active vs. Passive Appreciation
- Expert Testimony
- Valuations of Stock Options, Restricted Stock, Pensions, Notes, and Other Investment Assets
- Valuations of Compensation Agreements
- Business Damages
- Lost Profits Analysis
- Assistance with Depositions, Mediations, and Trial Preparation

## Forensic Services

---

- Assistance with Financial Affidavits
- Equitable Distribution Analysis
- Lifestyle Analysis / Pay and Need Analysis
- Income Determination
- Alimony Scenario Analyses
- Classification of Assets and Liabilities
- Tracing Services
- Dissipation Analysis
- Business Disruption Analysis
- Damages Analysis
- Lost Profits Analysis
- Lost Wages Analysis
- Assistance with Depositions, Mediations, and Trial Preparation
- Expert Testimony

## Advisory Services

---

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

---

**Scan the QR code for information about Mercer Capital's Family Law Litigation Support Services**

or visit <https://mercer.cr/FamilyLaw>





**Karolina Calhoun,**  
**CPA, ABV, CFF**  
901.322.9761  
calhounk@mercercapital.com



**Z. Christopher Mercer,**  
**FASA, CFA, ABAR**  
901.685.2120  
mercerc@mercercapital.com



**Bryce Erickson,**  
**ASA, MRICS**  
214.468.8400  
ericksonb@mercercapital.com



**Donald Erickson, ASA**  
214.468.8400  
ericksond@mercercapital.com



**Matthew R. Crow,**  
**ASA, CFA**  
901.685.2120  
crowm@mercercapital.com



**Timothy R. Lee, ASA**  
901.322.9740  
leet@mercercapital.com



**Brooks K. Hamner,**  
**CFA, ASA**  
901.322.9714  
hamnerb@mercercapital.com



**David W. R. Harkins,**  
**CFA, ABV**  
615.345.0272  
harkinsd@mercercapital.com



**Sujan Rajbhandary,**  
**CFA, ABV**  
901.322.9749  
sujanr@mercercapital.com



**Kathryn Burke, CPA**  
832.209.7299  
burkek@mercercapital.com



**Zac L. Lange, CPA**  
901.322.9746  
langez@mercercapital.com



**Harrison Holt**  
615.345.6881  
holth@mercercapital.com

Mercer Capital brings analytical resources and over 40 years of experience to the field of dispute analysis and litigation support. We assist our clients through the entire dispute process by providing initial consultation and analysis, as well as testimony and trial support. Our Litigation Services team brings national experience in subject matter and industry expertise.

For more information or to discuss a potential matter in confidence, contact one of our professionals.



# Mercer Capital

1.800.769.0967

[www.mercercapital.com](http://www.mercercapital.com)

