Tennessee Family Law

Valuation & Forensic Insights for Attorneys

First Quarter 2019

In This Issue

This quarter's issue of the *Tennessee Family Law Newsletter* focuses on several aspects of spousal support or alimony. Specifically, the newsletter focuses on the Tennessee standard of needs and ability to pay, along with a discussion of lifestyle analysis services that can assist attorneys in determining the proper amount of spousal support. We highlight a court case decision that provides insight into some of the factors that the court considers when determining the level of spousal support.

Additionally, we discuss the collaborative practice model as an alternative to litigated divorces and all of the financial services that can be provided to assist attorneys in that process. Finally, we provide a brief overview of the tax law changes that took effect beginning January 1, 2019 regarding spousal support.

We appreciate the great feedback from this newsletter and encourage you to provide any suggested content topics to **Scott Womack** or **Karolina Calhoun**.

What Is a Lifestyle Analysis and Why Is it Important?

A lifestyle analysis is an analysis of each party's sources of income and expenses. It is used in the divorce process to demonstrate the standard of living during the marriage and to determine the living expenses and spending habits of each spouse. It is typically a more in-depth analysis than the financial affidavits required in the divorce process and is prepared by a forensic accountant. The details in the analysis serve as verification of net worth and income, and expense statements submitted by both spouses can help a judge determine the equitable distribution of marital assets as well as alimony needs.

The lifestyle analysis pulls together all considerations and provides a visual of income and expenses over the remaining life expectancy. Through illustration of the aggregate sources of income(s) and expenses over time, one can discern what funds are actually required (and if these funds are available) to maintain standard of living, i.e., to fund expenses. The exercise then yields relative analyses (percentage comparisons and trend analyses), and ultimately, an illustration of net worth at a point in time, as well as net worth accumulation over time.

Factors Considered for Spousal Support

In Tennessee, the Decree for support of spouse is under § 36-5-121(i). Careful consideration must be given to the factors listed in the statute when determining historical lifestyle (standard of living) as well as reasonable need into the future. Twelve factors assist in determining whether the granting of an order for payment of support and maintenance to a party is appropriate, as well as determining the nature, amount, length of term, and manner of payment. Refer to § 36-5-121(i) for the **full listing**.

Although each of the factors must be considered when relevant to the parties' circumstances, the first factor, "the relative earning capacity, obligations, needs, and financial resources of each party, including income from pension, profit sharing or retirement plans and all other sources," has presented the two most important components: the disadvantaged spouse's need and the obligor spouse's ability to pay.

Hence arises the "pay & need analysis," also known as the "lifestyle analysis."

Sources of Financial Information Used in the Analysis

The following documentation provides financial information used in the analysis and is typically requested during the discovery process.

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

The Process: Building a Lifestyle Analysis

There are many moving pieces in constructing the lifestyle analysis, and the components can be quite different from case to case. During the preliminary stages, the financial expert/ forensic accountant will obtain pertinent documents from the aforementioned documentation in order to create the marital balance sheet (and potential separate property) and assess historical and current earnings and expenses/spending habits. Additionally, the expert may also assist in building a budget based on historical expenses. The expert will review retirement plans and annual contributions, brokerage accounts, cash & savings accounts, their respective average rates of return as well as varying tax obligations. The risk tolerance of the individuals can even be considered in relation to future rates of return. For example, a person with ample disposable cash may be willing to invest in riskier ventures where the return may be higher, than a person who chooses to invest conservatively due to limited disposable cash.

The investigative process may even lead the parties to establish the "true income" of a spouse who is suspecting of perpetrating fraud and determine any possible hidden assets or dissipation of marital assets.

Ultimately, the lifestyle analysis illustrates the sources of income, tax obligations, and disposable cash before and after expected expenses. This tool is valuable because it leads to further analyses such as relative analyses of gross earnings comparisons and after-tax disposable cash comparisons, among others. The analysis allows comparison on relative terms not just dollar amounts.

Another valuable result of the lifestyle analysis is the ability to assess the parties' net worth at multiple points in time. The net worth accumulation analysis illustrates the differences of the division of net worth at the date of divorce, and the division of net worth at the date of death. Additionally, it illustrates the net worth accumulation between those two points in time. This process may highlight 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, the illustration can assist the trier of facts in determining the disadvantaged spouse's need and the obligor spouse's ability to pay.

For a fact pattern and step-by-step illustration, **refer to my Lifestyle / Pay & Need Analysis presentation** from the 2018 AICPA Forensic & Business Valuation Conference.

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 non-qualified), 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

Conclusion

In financial situations that may be scrutinized by regulators, courts, tax collectors, and a myriad of other lurking adversaries, the financial, economic, and accounting experience and skills of a financial expert are invaluable. The details in the lifestyle analysis can help determine the equitable distribution of marital assets as well as alimony needs.

Because no two cases are alike, all components of the analysis must be carefully assessed. Complexities that may need further consideration include, but are not limited to:

- **Earnings capacity**: need for a vocational expert?
- **Differences in retirement plans** (such as tax structure & penalties): qualified vs non-qualified, Roth vs Traditional, pensions, etc.
- **Investment risk profiles**: risky vs risk averse (hence, annual returns may differ)
- **Alimony requested**: duration, dollar amount, type
- **Business ownership**: valuations, personal vs. enterprise goodwill, active vs. passive appreciation (i.e., marital vs. separate)
- **Deferred compensation:**
    - Stock options and restricted stock (both vested and unvested)
    - Election 83(b): timing of tax on restricted stock
    - Short-term and long-term incentive plans (bonuses), among others

A competent financial expert will be able to define and quantify the financial aspects of a case and effectively communicate the conclusion. For more information or to discuss your matter, please don't hesitate to contact us.

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Mercer Capital in the News

Upcoming Speaking Engagements

MAR 18

Karolina Calhoun, CPA/ABV/CFF and **Scott A. Womack, ASA, MAFF** will be participating in a CLE on collaborative law at the Cecil C. Humphreys School of Law (The University of Memphis) in Memphis, TN.

MAY 1

Karolina Calhoun, CPA/ABV/CFF will be participating in a divorce panel discussion at the Visions in Planning Conference hosted by the Financial Planning Association of Greater Memphis.

MAY 9

Z. Christopher Mercer, FASA, CFA, ABAR will present "How to Present Complex Finances to Judges" at the AAML/BVR National Conference in Las Vegas, NV.

Collaborative Divorce: An Alternative to Reduce Tension and Cost

In traditional divorces, each spouse engages a lawyer who fights hard to "win." Their weapons can include bringing in their own financial professional to value financial assets. Naturally the neutrality of those valuations may be suspect in the other party's eyes, even if the valuator follows all proper procedures.

In collaborative divorce, each spouse still hires a lawyer, but the goal is to reach a settlement that satisfies each party. Neutral consultants, such as financial and mental health professionals, are also frequently involved. The model is "trouble shoot and problem-solve" rather than "fight and win."

How Collaborative Divorce Works

The collaboration is carried out through a series of meetings in which the couples and their attorneys negotiate over issues such as property division, alimony, child support and custody. The meetings are quarterbacked by the mental health professional, who prioritizes the goals for each session, monitors the emotional climate, and keeps things on track.

The attorneys each are responsible to look out for the interests of their clients, but rather than using the law to win, they are more focused on making sure their clients understand the legal issues involved and how a court might view them.

The role of the financial professional, who is paid by both parties, is to provide an objective assessment of the financial issues involved. If one of the spouses has a business, the financial neutral provides an arm's-length valuation and can also serve to educate the other spouse about the business, if needed. After several meetings, the financial neutral produces a marital balance sheet, laying out the couple's financial landscape.

Advantages of Collaborative Divorce

While collaborative divorce is not for everyone, in the right settings it can have these advantages:

A Quicker Resolution

Divorces litigated through the court system can often take a year or more to reach a conclusion. The collaborative process can move faster because there is no waiting for motions to be filed and hearings to be held.

Lower Expense

Attorneys likely will have fewer billable hours since there is less engagement with the courts. There is only one financial consultant rather than two. In addition, because litigated cases tend to take more time, there may be a need for revised valuations as economic conditions change while the divorce makes its way through the process.

Less Acrimony

While there certainly can be tension between the two spouses during the collaborative process, the temperature tends to be lower when the working model is problem-solving rather than fighting. The addition of a mental health professional to the team also can serve to defuse tensions, and the neutrality of the financial professional can serve to reduce distrust.

More Control

When divorce cases reach the courtroom, subjective judgments by the judge can come into play. While Tennessee law spells out guidelines for judges in divorces, they still have latitude.

More Privacy

Divorce settlements litigated through the courts become public record. Settlements that result from the collaborative process do not. This can be of particular importance when one or both spouses are high-profile.

Conclusion

Collaborative divorce is not for everyone. Sometimes distrust between the parties has become so intense that litigation is the only way out. However, many divorcing spouses have found that a collaborative process can reduce tensions and cost and provide a result satisfactory to both parties.

Attorneys can benefit from numerous services provided by financial professionals in litigated and collaborative divorce matters. At Mercer Capital, we have two professionals who are trained in the Collaborative Practice and provide assistance to attorneys in collaborative and litigated divorce matters. Please contact us if we can be of assistance to you and your clients.

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Conference Update

IACP Networking and Educational Forum: Collaborative Creativity

In October 2018, Scott A. Womack, ASA, MAFF attended the *19th Annual International Academy of Collaborative Professionals (IACP) Networking and Educational Forum: Collaborative Creativity* in Seattle, Washington. The national annual conference promotes the collaborative practice which is a voluntary dispute resolution process in which parties settle their divorce matter without resorting to litigation.

Scott presented **"Creativity in Financial Elements of a Collaborative Divorce"** with Cheryl C. Panther of (**Panther Financial Planning)**. Set against the backdrop of an actual collaborative case that both worked on, they highlighted different ways to utilize financial professionals in a collaborative case. The services provided by financial professionals in collaborative cases are the same services that are provided in litigated divorces.

For more information on collaborative divorce, see the article on **page 4**.

AICPA Forensic & Valuation Services (FVS) Conference

In November 2018, Karolina Calhoun, CPA/ABV/CFF, attended the *American Institute of Certified Public Accountants (AICPA) Forensic & Valuation Services (FVS) Conference* in Atlanta, Georgia. The national annual conference promotes education and networking opportunity geared towards forensic accounting and business valuation services professionals, litigation services consultants and experts, and CFOs, controllers and senior financial professionals. Karolina served on the planning committee for the conference and will sit on the committee again for the 2019 conference in Las Vegas, NV.

Karolina presented **"Lifestyle Analysis/Pay & Need Analysis"** at the conference and participated in the panel discussion "Collaborative Law the New Horizon."

For more information about lifestyle analysis services, please see the article on **page 1**.

Tax Law Changes Affecting Family Law

2019 Changes and Recap of 2018 Changes

2019 Changes

By now, many are familiar with the changes from the Tax Cuts and Jobs Act (TCJA), however, specific changes related to family law and alimony deductibility went into effect in 2019.

- **Alimony Payments.** Effective January 1, 2019, alimony payments are no longer deductible to the payer spouse, and are no longer taxed to the recipient spouse. This applies to divorces finalized, by settlement agreement or court order, on or after January 1, 2019. Under the prior law, alimony was deductible to the payer, reducing income and basis for taxes, and taxed to the recipient, increasing income and basis for taxes. The change is permanent and will not sunset, like some of the TCJA amendments.
- **Income from Trusts.** Also, under the prior law, income of a (alimony) trust paid to the ex-spouse was taxable to the recipient and not to the grantor. The TCJA eliminated that rule.
- **Existing Agreements and Modification Requests.** Existing alimony or marital dissolution agreements, as well as any modification requests, are grandfathered to pre-January 1, 2019 rules as per existing agreements, unless both parties mutually consent and specifically opt to implement new rules. Alimony modification requests made January 1, 2019 and after will require recognition of the changes of the tax law.

Recap of 2018 Changes

We discussed many of these in a **prior newsletter**. The changes are as follows.

- **Personal Exemptions.** Under the new tax law, personal exemptions are eliminated. Previously, personal exemptions were often used during divorce settlement negotiations with the parties splitting these deductions and sometimes one spouse compensating the other spouse to "purchase" the use of this exemption.
- **529 Plans**. The new tax law expands the use of 529 plans to include secondary education and other uses, whereas it was previously only available for college and higher education. Often, 529 plan accounts exist in a marital estate and become a topic discussed during settlement negotiations for how/when they will be used.
- **Business Valuation.** TCJA reduced corporate income tax rate from 35% to 21%. The valuation of C corporations could be higher simply due to the mechanics of income approaches to value a business, all other factors held equal.
- **Child Tax Credit.** The TCJA increased the credit to $2,000 and the income phase-out increased to $200,000 ($400,000 for joint filers).
- **Other Deductions.** TCJA repealed legal and accounting fees related to taxable alimony, divorce-related tax planning, and related analysis. The TCJA suspends the miscellaneous deductions through Dec. 31, 2025. This also applies to professional fees related to splitting of Individual Retirement Accounts or ERISA plans (e.g., QDRO fees).

For more information, **see this helpful reference**.

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Tennessee Case Review

Brecker v. Brecker, Tennessee Court of Appeals, Middle Section, October 29, 2018

This divorce case involved an appeal on the issue of an alimony award. The parties were married in 1990, and Wife filed for divorce in 2016. Husband was employed as an Executive Vice President at a construction company at the time of trial, and Wife held several bookkeeping jobs throughout the marriage but primarily worked as a homemaker. The parties had three adult daughters. Both parties retained financial and vocational experts to assist in the determination of Husband's income, the parties' historical expenses, Wife's future employment prospects, and her need for alimony.

Examination of Expenditures

According to statements made by Wife, the couple lived an extravagant lifestyle including frequent travel, luxury vehicles, lavish gifts, and a vacation home. Wife claimed $33,201 in monthly expenses at the trial. Wife's expert testified that the parties' joint average monthly spending was approximately $30,000 in 2014, 2015, and 2016, excluding large one-time expenses. However, this figure included expenses such as college tuition for one of the parties' daughters and car purchases. Husband testified that the parties' monthly expenses were between $12,000 and $15,000. The trial court entered an order declaring that the marital property totaled $5,526,811, dividing it approximately 49% to Wife and 51% to Husband. The trial court awarded Wife $15,000 per month in alimony in futuro and rehabilitative alimony of $3,500 per month for eighteen months. The trial court also determined that Wife could expect to earn no more than $35,000 per year, while Husband's income was approximately $90,000 per month.

On appeal, Husband raised the issue of whether the trial court awarded Wife more alimony than she needed. Husband argued that the parties spent no more than $15,000 per month, Wife inflated her expenses, and the trial court failed to consider investment income Wife could earn from certain properties awarded to her. The Court of Appeals notes that while Wife's expert's estimation of $30,000 of monthly expenditures included payments for "one-time purchases," some of these payments were actually recurring, such as car purchases, as the parties purchased new cars every few years.

Also, Husband noted that Wife's testimony of personal expenses were more than half the amount of her expert's estimate for the whole family's monthly expenses. Husband claimed that Wife's income and expense statement included many "exorbitant" expenses such as expenses for a new condo and a vacation home. In its opinion, the Court notes that the trial court considered the nature of Wife's expenses in its award and quotes the trial court's opinion as stating that Wife's monthly expense estimate is a "significant overstatement." The trial court excluded expenses related to the parties' adult children, a vacation home and its related maintenance, home repairs & yard maintenance, uncovered medical and dental expenses, car repairs, eating out, and vacations in its alimony determination.

Husband also raised an issue with Wife's estimation of expenses for gifts. Wife's expert's report indicates that the parties spent $432 per year on gifts; however, Wife testified that this amount was actually much higher as many gifts were purchased with cash. The Court of Appeals found Wife's testimony plausible, writing "it strains credulity that a family with three young adult daughters with a household income of over $1 million per year would spend less than $500 per year on gifts."

On the issue of investment income generated from certain properties, the Court found that the trial court considered these issues, and noted Husband's "undisputed ability to pay" the awarded alimony and the parties' "lavish lifestyle."

The Court affirmed the trial court's decision that Wife's need is in the range of $17,500 per month. However, the Court noted that the trial court's award is over Wife's stated need considering the eighteen month period of rehabilitative alimony. Based on the trial court's finding that Wife could earn up to $35,000 per year once she resumed work, Wife's income would be over the stated need when rehabilitative alimony and Husband's payment of Wife's health insurance premium is considered. The Court vacated the trial court's award of rehabilitative alimony and remanded the award for consideration of whether the award comports with Wife's need. The award of alimony in futuro was affirmed.

Using the Lifestyle Analysis

As shown in the case, determining divorcing spouses' needs and ability to pay can be a complicated issue. Cases involving a high-wealth couple with multiple sources of income can be especially complex. Divorcing spouses can consider engaging a forensic expert to provide perspective and assist in analyzing sources of income, historical accustomed lifestyle, and estimating expenses going forward, considering all necessary factors before presenting to the court. This lifestyle analysis, also referred to as pay & need analysis, can bring together all the components both at the current time and into the future or expected life period. Wife's expert's analyses assisted the Court's understanding of all the moving pieces (sources of income, historically accustomed lifestyle, estimated expenses, vocational abilities of both spouses, and the overall net worth) in order to determine alimony.

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MERCER CAPITAL
BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

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.

Valuation Services

- Valuation of privately held businesses and professional practices
- Valuation of intellectual property and other intangible assets
- Determination and valuation allocation of personal and enterprise goodwill
- Valuation of stock options, pensions, notes, & other investment assets
- Employment contracts and other compensation agreements
- Serving as the business valuation professional in a collaborative divorce

Forensic Services

- Classification of assets and liabilities
- Investigation of asset flight and/or dissipation of assets
- Asset-tracing of separate versus marital property
- Lifestyle/needs and ability to pay analyses for assistance to determine spousal support
- Tracing appreciation of separate retirement assets
- Identification of diverted or unreported income and double-counted expenses
- Identification of and interviewing parties of interest
- Data analysis
- Lost profits analysis

Advisory Services

- Expert witness testimony
- Serving as the financial neutral in a collaborative divorce
- Serving in mediation, arbitration, or as court-appointed and/or mutually agreed-upon experts
- General litigation support
- 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

Who We Serve

- Divorcing spouses
- Consulting for family law attorneys
- Courts, mediators, and others in need of neutral experts
- Business owners
- Family offices
- High-wealth professionals

Our Qualifications

- Deposition and testimony experience
- 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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