

**Self-employed Parties – Tax returns,
investigation, and discovery – Part 1**

Minnesota County Attorney's Association – Child Support Conference
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1040 Income Tax Form

- Current income of parents
- Clues to assets held
- Income trend (if several years of returns)
- Self employed status of parent
 - Entries on lines 12, 17, 18, and 21 on page 1 of 1040 (Schedule C, S Corporation, Rental income, Farm income)

**Child Support - Gross Income for the
self-employed**

- Self-employed tax returns may need adjustments
 - Some deductions allowed by IRS should not be allowed for child support
 - Expenses are exaggerated or include personal expenses

Case Law

It supports not relying on tax returns alone

The opportunity for a self-employed person to support himself and yet report negligible income is too well known to require exposition.

Ferguson v. Ferguson 357 N.W.2d 104, 108 (Minn. App. 1984)

The screenshot shows the website for the Office of the Revisor of Statutes. The header includes navigation links for House, Senate, Joint, Schedules, Legislators, Committees, Bills, Law, Multimedia, and Publications. Below the header is a search bar and a breadcrumb trail: 2017 Minnesota Statutes > DOMESTIC RELATIONS > Chapter 518A > Section 518A.30. The main heading is "2017 Minnesota Statutes" followed by "518A.29". The text of the statute is as follows:

518A.30 INCOME FROM SELF-EMPLOYMENT OR OPERATION OF A BUSINESS.
For purposes of section 518A.29, income from self-employment or operation of a business, including joint ownership of a partnership or closely held corporation, is defined as gross receipts minus costs of goods sold minus ordinary and necessary expenses required for self-employment or business operation. Specifically excluded from ordinary and necessary expenses are amounts allowable by the Internal Revenue Service for the accelerated component of depreciation expenses, investment tax credits, or any other business expenses determined by the court to be inappropriate or excessive for determining gross income for purposes of calculating child support. The person seeking to deduct an expense, including depreciation, has the burden of proving, if challenged, that the expense is ordinary and necessary.

History: 2005 c 164 s 15, 19; 1Sp2005 c 7 s 28; 2006 c 280 s 28

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This is a duplicate of the screenshot above, showing the same website content for section 518A.29 of the 2017 Minnesota Statutes.

Deductions Allowed by IRS but Not Allowed for Child Support*

- Depreciation
 - Cannot take Section 179 depreciation in MN - In re the Marriage of Ruehle v. Schmitz A03-1834
 - Cannot take accelerated depreciation in MN - Minn. Stat. Sec. 518.A30
 - If depreciation is allowed, it can only be straight line
- Business use of home
- Meals and entertainment expenses
- Half of vehicle expense

**Per Ramsey County's Interpretation of Minnesota Statutes and Case Law*

Other Deductions to Disallow

Deductions that are

- not substantiated or
- not ordinary and necessary in light of obligation to pay child support or
- are inappropriate or excessive
 - Some categories are ripe for overstatement

How to Identify which Expenses to Disallow

- Categories change from year to year
- Amounts are large compared to gross receipts
- Request documentation for expenses, checkbook register
- Numbers are repeated or round

Tax Returns are Not Accurate When All Income is not Included in Gross Receipts

- Deductions on Schedule C are large compared to income
- Get information from CP
 - How unreported cash was handled in past
 - How living expenses were met when reported income was very low
- Cash business operations
- Itemized deductions on Sch A - too large related to income

Income Attributed to Someone Else

- The best way to get some idea this is going on is from the other parent
- Parent may send in Married Filing Separate returns or claim he doesn't need to file
- Lifestyle is not supported by the income reported

When Tax Returns Should Be Disregarded

- Too much information provided but not in any organized format
- Information may appear credible, but there is a disconnect between reported income and itemized deductions and/or lifestyle
- Information totally lacks credibility

Clues to Assets

- Entries on other lines of Page 1 of 1040
 - Interest
 - Dividends
 - Schedule E

Look at itemized deductions

- Mortgage expense
- Real estate taxes

What to Use When Disregarding Tax Returns

- Minn. Stat. 518 A.28(c) and 518A.32 regarding potential income
- Salary survey
- Total household expenses
- Mortgage applications

Things to Consider

- Cash vs. Accrual accounting
 - Manipulation
 - Accurate reflection
- Payments on debt
- Non-recurring income

Testimony of Accountant

- Credentials
- Verify foundation
- Examine protocol
 - Standard practices
 - Any verification?
 - How long on account?
 - Has scope of engagement changed?
 - Do they ask about other income?
- 3 levels of financial statements
 - 1) Complied
 - 2) Reviewed
 - 3) Audited
 - If there has not been an audit, the numbers are only as good as what accountant received.

Discovery

- When a person is self-employed and the income is in question, back up documentation can be requested.
 - Checkbook register
 - General ledgers
 - Detailed profit and loss statements and balance sheets
 - Information provided to the accountant to do the returns
 - Reports on Quicken or Quickbooks
 - Mortgage or loan applications

Discovery Continued

- In Minnesota the parties are responsible for providing income verification, and the court can make adverse inferences based upon their failure to provide necessary information.
- The responsibility for income verification, whether it has been requested in discovery or not, is still theirs.

Conclusion

Calculation of income for the self-employed is more of an art than a science; it cannot be accomplished by rigid adherence to a set of rules.

Our goal is to set a child support order that is fair, appropriate and enforceable.

Questions?

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