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# Using the Tax Return to Determine the Real Income of the Estate

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Investigative Account  
214 707-1318  
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# Agenda

- **Real (Gross) versus Taxable Income**
- **The 411 on the 1040**
- **Net Resources (Available for Payment of Child Support)**
- **Summary**

# Real Versus Taxable Income

- Real (Gross) Income includes all of the income a person receives during a year from any source unless explicitly tax exempt
  - ❑ Wages
  - ❑ Bonuses
  - ❑ Interest
  - ❑ Dividends
  - ❑ Alimony
  - ❑ Business Income
  - ❑ Capital Gains
  - ❑ Rental Real Estate, Royalties, Partnerships, Trusts, etc.
  - ❑ Other: Prizes/Awards, Gambling Winnings, Cancelled Debt

# Real Versus Taxable Income

- Taxable Income is the amount of income after all allowable deductions or exemptions have been subtracted from the total income received.
  - Medical (HSA/FSA)
  - Retirement (401k, IRA)
  - Education (Tuition, Loan Interest)
  - Itemized/Standard Deductions
  - Exemptions

# The 411 on the 1040

## ■ Sections of the IRS Form 1040

- ❑ Filing Status
- ❑ Exemptions
- ❑ Income
- ❑ Adjusted Gross Income
- ❑ Tax and Credits
- ❑ Other Taxes
- ❑ Payments
- ❑ Refund / Amount Owed
- ❑ Signatures

# The 411 on the 1040

## ■ Things to Consider

### □ **General**

- Age – 62, 65, 70½ trigger retirement, Social Security, & Medicare events
- Address – did they or will they move? Escrow?

### □ **Filing Status**

- Changes
  - From/To Head of Household, From/To Married or Single

### □ **Exemptions**

- Are dependents aging out? New dependents?

# The 411 on the 1040

## ■ Things to Consider (cont.)

### □ **Income**

- Wages (W-2)
- Interest & Dividends (Schedule B)
- Alimony Received
- Business Income (Schedule C)
- Capital Gains (Schedule D)
- IRA & Pension Distributions (how much is left? RMD?)
- Rental Real Estate, Royalties, Partnerships, S Corporations, Trusts (Schedule E)
- Social Security Benefits

# The 411 on the 1040

## ■ Things to Consider (cont.)

### □ The 411 on the W-2

#### ■ Box 1 Wages, Tips, Other Compensation

- Need to see the pay stub to determine if there was a bonus

#### ■ Box 5 Medicare Wages and Tips

##### □ Net of pre-tax deductions

- Retirement plans
- 401(k)
- HSA/FSA
- Insurance Premiums



# The 411 on the 1040

- Things to Consider (cont.)
  - The 411 on the Schedule C
    - Add back non-cash deductions
      - Depletion (Line 12) & Depreciation (Line 13)
    - Add back personal expenses
      - e.g. Personal Residence Maid Services, Travel, Family Salaries, Charitable Contributions, Family Cell Phone Plans
    - Any Extraordinary Income
      - e.g. Sale of Assets, Lawsuit Settlements, Insurance Checks
    - Any Extraordinary Expenses
      - e.g. Lawsuit Settlements, Insurance Checks

# The 411 on the 1040

- Things to Consider (cont.)
  - The 411 on the Schedule E
    - Add back non-cash deductions
      - Depreciation Expense or Depletion (Line 18)
    - Add back personal expenses
      - e.g. Personal Residence Maid Services, Travel, Family Salaries, Charitable Contributions, Family Cell Phone Plans
    - Any Extraordinary Income
      - e.g. Sale of Assets, Lawsuit Settlements, Insurance Checks
    - Any Extraordinary Expenses
      - e.g. Lawsuit Settlements, Insurance Checks

# The 411 on the 1040

- Things to Consider (cont.)
  - Business Entity Type
    - C corporations pay a corporate income tax on reported income.
    - The income of S corporations is passed through to the shareholders, who pay personal income tax on it.
    - Partnership income is passed through to the partners, who pay personal income tax on it. Although income may be undistributed by the partnership, the entire tax liability is passed through to the partners.

# The 411 on the 1040

- Things to Consider (cont.)
  - **Adjusted Gross Income (Deductions)**
    - HSA
    - Moving Expenses (non-recurring)
    - Self-Employed SEP, SIMPLE, and Qualified Plans
    - Penalty on Early Withdrawal of Savings (Recurring?)
    - Student Loan Interest (Balance? Separate Property?)
    - Tuition and Fees (Recurring?)

# The 411 on the 1040

- Things to Consider (cont.)

- **Tax and Credits**

- Standard or Itemized Deductions (Schedule A)
- Exemptions
  - Changes in the number due to children aging out

- **Other Taxes**

- Additional tax on IRAs (early withdrawal penalty) (Line 59)
- Household Employment Taxes (Line 60a, Schedule H)

# The 411 on the 1040

## ■ Things to Consider (cont.)

### □ **Payments**

- Estimated Tax Payments and Amount Applied from Prior Year (Line 65)
- American Opportunity Credit (Line 68) (When ending?)

### □ **Refund / Amount Owed**

- All or some of the refund to the next year (Line 77)

### □ **Signatures**

- Third-party prepared?

# The 411 on the 1040

- Things to Consider (cont.)
  - The 411 on the Schedule A
    - Medical and Dental Expenses (Line 4), Non-recurring?
    - Real Estate Interest & Taxes Paid (Line 9), Escrowing?
    - Gifts to Charity (Line 19)
    - Casualty and Theft Losses (Line 20), One-time?
    - Job Expenses and Certain Miscellaneous Deductions, (Line 27), Non-recurring?
    - Other Miscellaneous Deductions (Line 28), e.g. Gambling Losses – Reimbursement Claim?

# Net Resources

- Sub Chapter B, FAM 154.062 Net Resources
  - Resources Include:
    - 100 Percent of **ALL** Wage and Salary Income ...
    - Interest, Dividends, and Royalty Income
    - Self-Employment Income
    - Net Rental Income (Add Back Depreciation)
    - All Other Income
      - Severance, Retirement, Pensions, Trust Income, Annuities, Capital Gains, Social Security Benefits, VA Benefits, Workers' Comp, Gifts, Spousal Maintenance, Alimony



# Net Resources

- Sub Chapter B, FAM 154.062 Net Resources
  - Resources Exclude:
    - Social Security Taxes
    - Return of Principal or Capital (not income)
    - Accounts Receivable
    - Payments for Foster Care of a Child
    - Federal Income Tax based on the Single Person Rate
    - Expenses for the Cost of Health Insurance for the Obligor's Child Ordered by the Court
    - Other (Refer to Family Code for the complete list)

# Summary

- To quickly Determine the Real Income from the Tax Returns involves adding back depreciation and personal expenses that were deducted from business and rental income
- Understanding the tax return and the “considerations” discussed above will allow you to address the impact of future changes in the Real Income

# Summary

- Tax Documents Needed:
  - Form 1040
  - W-2's
  - Schedule C
  - Schedule D
  - Schedule E
  - Additionally, you will need to inquire as to any personal expenses that were included as deductions on Schedules D and E

# Summary

(Gray cells are for data entry.)

Tax Return Summary	Line #	Husband	Wife	Totals
<b>Form 1040</b>				
Income (a)	22	\$ 200,000		\$ 200,000
Adjusted Gross Income Deductions	36	\$ 9,795		\$ 9,795
Adjusted Gross Income (AGI)	37	\$ 190,205	\$ -	\$ 190,205
Total Tax (d)	63	\$ 45,255		\$ 45,255
Tax Payments	74	\$ 49,506		\$ 49,506
(Refund) or Owed	(75) / 78	\$ (4,251)	\$ -	\$ (4,251)
Effective Tax Rate (d) / (a)				22.63%

W-2 Detail	Box #	Husband	Wife	Totals
Wages, Tips, Other Compensation	1		\$ 37,136	\$ 37,136
Pre-Tax Deductions (b)		\$ -	\$ 8,641	\$ 8,641
Medicare Wages and Tips	5		\$ 45,777	\$ 45,777

Adjustments	Line #	Husband	Wife	Totals
<b>Schedule C</b>				
Depletion and Depreciation	12 & 13	\$ -		\$ -
Personal (e.g. Travel, Family Salary, Charity, Maid, etc.)		\$ 5,000		\$ 5,000
<b>Schedule D</b>				
Capital Loss (also on 1040 Line 13)	21	\$ 3,000		\$ 3,000
<b>Schedule E</b>				
Depreciation Expense or Depletion	18	\$ 6,152		\$ 6,152
Personal (e.g. Travel, Family Salary, Charity, Maid, etc.)		\$ -		\$ -
<b>Total</b>				\$ 14,152

<b>Gross Income (a) +(b) + (c)</b>				<b>\$ 222,793</b>
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# Thank You! Questions & Follow Up:



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# **LARRY T. SETTLES, JR.**

## Investigative Accountant & Valuator

Larry Settles, a Registered Forensic Investigator, is a Certified Forensic Accountant with the CPA, ABV, and MAFF credentials, among others. He is President and Founder of Lord & Settles, LLC. He brings 30 years of experience including Big 4 Public Accounting (as a Partner at KPMG), corporate positions (as a Chief Financial Officer and as a Chief Operating Officer), valuing businesses and other interests, and family law (as a courtroom proven expert in tracing separate and community property, creative reimbursement claims, and finding the "hidden" assets, among other divorce related financial matters). Mr. Settles is trained in the interdisciplinary Collaborative Law process and serves as a neutral allied professional in such matters.

### Previous Professional Responsibilities

- Chief Operating Officer at Animato Corporation
- Partner with SunGard
- Partner with KPMG Peat Marwick
- Chief Financial Officer at EDS (SHL Systemhouse)
- Controller at Superconducting Super Collider
- Vice President at Metropolitan Financial
- Auditor at Arthur Andersen & Co

### Professional Memberships (past and present)

- National Association of Certified Valuators and Analysts (NACVA)
- NACVA Litigation Forensics Board (Current Chairman of the Board)
- American Board of Forensic Accountants (Former Board Member)
- Collaborative Divorce Texas
- American Institute of Certified Public Accountants (AICPA)
- Financial Forensics Institute
- Forensic and Valuation Services
- Texas Society of Certified Public Accountants
- Make-A-Wish Foundation Volunteer
- Special Olympics Volunteer
- Who's Who – multiple listings
- Board of Directors – multiple organizations
- Chief & EMT - Combine Fire Rescue Department

### Certifications

- Certified Public Accountant (CPA)
- Registered Forensic Investigator (RFI)
- Certified Forensic Accountant (CRFAC)
- Accredited in Business Valuation (ABV)
- Collaborative Law Financial Professional (FP)
- Master Analyst in Financial Forensics (MAFF)
- Chartered Global Management Accountant (CGMA) (Inactive)
- Certified Information Technology Professional (CITP) (Inactive)

**LORD & SETTLES, LLC**  
**Larry T. Settles, Jr., CPA/ABV, CRFAC, RFI, MAFF**  
**Investigative Accounting & Business Valuations**

Investigative, forensic, and other professional consulting services that I am asked to provide include:

- Assisting with the determination of the character of property as to separate or community, which may include preparing tracing schedules.
- Valuation of businesses, interests in businesses, intangible assets (including personal goodwill), stock options, restricted stock, and retirement plan benefits.
- Preparing proposed property settlement schedules for use during property settlement negotiations and analyzing various settlement offers.
- Preparing schedules of assets, liabilities, net worth and assisting in the preparation of court inventory schedules.
- Assisting with the determination of potential reimbursement and/or equitable interest claims as well as analyzing the validity of such claims, if any, made by the opposing party.
- Reviewing inventory listings of opposing party and, if necessary, subjecting such listings to certain investigative procedures to determine their completeness and accuracy.
- Assisting with case strategy, developing deposition inquiries regarding financial matters, and preparing production requests of records possessed by the opposing party.
- Mediation assistance including settlement proposal preparation and review and active participation at mediation
- Evaluating testimony of the opposing party's expert witness.
- Performing investigative procedures to determine if the opposing party has wasted or attempted to hide community assets and/or expended business assets for personal use.
- Providing expert witness testimony at deposition or trial in support of the work we have performed and the conclusions we have reached.
- Provide services as a Financial Neutral in Collaborative Law cases.