

Identifying and Presenting Evidence of Tricky Forms of Income for Support Purposes

By Julie Auerbach, AAML Penn Fellow | [Astor Weiss Kaplan & Mandel, LLP](#)

In any support case, the practitioner must identify all forms of income that fall within the state's definition of income for support purposes. Income for support purposes is typically defined differently from income for tax purposes. Different states use different definitions of income. For example, some states include gift and inheritance as income for support purposes while others do not.

Pennsylvania defines income available for support as follows:

"Income." Includes compensation for services, including, but not limited to, wages, salaries, bonuses, fees, compensation in kind, commissions and similar items; income derived from business; gains derived from dealings in property; interest; rents; royalties; dividends; annuities; income from life insurance and endowment contracts; all forms of retirement; pensions; income from discharge of indebtedness; distributive share of partnership gross income; income in respect of a decedent; income from an interest in an estate or trust; military retirement benefits; railroad employment retirement benefits; social security benefits; temporary and permanent disability benefits; workers' compensation; unemployment compensation; other entitlements to money or lump sum awards, without regard to source, including lottery winnings; income tax refunds; insurance compensation or settlements; awards or verdicts; and any form of payment due to and collectible by an individual regardless of source.

23 Pa.C.S.A. § 4302.

Additionally, there are certain forms of income that may not be expressly included in a state's statutory definition of income, but are included on the basis of case law.

Disputes often arise as to whether or not certain forms of income should be included in a support calculation. These "tricky" forms of income include phantom income, deferred compensation, business and employment perquisites, income from a trust, gift, or inheritance, and "paper only" deductions on tax returns. There are other forms of income that while may not be difficult to prove, may escape attention from the litigants, such as electronic forms of payments or the income of a spouse or partner as a basis to deviate from the support guidelines.

The first part of this presentation will discuss how to identify and include these tricky forms of income and sometimes overlooked forms of income in a support calculation. The second part of this presentation will discuss best practices in identifying and presenting these forms of income to the court.

I. IDENTIFYING TRICKY FORMS OF INCOME

A. WHERE TO LOOK

The first step in identifying types of income is to obtain and review the parties' tax information such as tax returns, W2s, K1s and 1099s. If one of the parties owns a business, you will want to look at the business tax returns and other financial information related to the business. This is particularly important when looking for phantom income and perquisites. A comprehensive interview with your client as well as formal discovery requests is important in capturing all forms of income. It may be necessary to hire a forensic accountant to assist in this process.

Loan applications and financial statements provide another good source of information as to income. Loan applications for mortgages often require a listing of all forms of income. The loan application or financial statement may also reveal income producing assets. It is not uncommon for an individual to list their income higher on a mortgage application than on their tax returns, for purposes of obtaining loan approval.

The social security administration sends a printout or email link every year to each tax payer listing their reported income for all years that they paid into social security. Obtaining this printout is particularly helpful in situations where you are trying to establish the earning capacity of an individual.

If the individual is engaged in a business or employment where electronic payments may be received, you will want to ask for these records, including bank records showing the deposits of these payments. Uber and Lyft provide transaction summaries of fares received by their drivers. Zelle and Venmo also provide transaction summaries.

Cash businesses are not as prevalent as they once were but an expert is able to investigate the business and cash receipts and estimate the income of a business owner to some degree of certainty. Another way to determine the amount of cash coming in is to look at the expenses incurred and paid, including both the business and personal expenses of the individual. Obtaining bank records, credit card statements and other expense records is necessary for this purpose.

B. TYPES OF TRICKY INCOME

1. PHANTOM INCOME

Phantom income is money that is includible in income under the federal tax code but not actually received. Phantom income can arise through business pass-through income or discharge of indebtedness.

Partnerships and S corporations do not pay income taxes through their entities. Instead, they pass through the income to the owners who report it on their individual tax returns, usually at a lower tax rate. The income allocation is reported to the IRS on a Schedule K1.

Cancellation of debt income arises when an outstanding debt is satisfied or forgiven for less than its face value. For example, a credit card company may agree to take less than the balance due in full and final settlement of the debt. As a result, the credit card

company will issue a 1099 reporting the forgiveness of the amount in excess of the agreed upon settlement. The amount of the debt forgiveness is treated as taxable income.

Review of tax returns and other tax forms is necessary to identify phantom income. Once identified, the practitioner must determine whether the phantom income is treated by their state as income for support purposes.

The treatment of these types of phantom income varies across the states. With regard to debt forgiveness, in the unpublished Kentucky case of *Kelley v. Kelley*, 2014 Ky. App. Unpublished Lexis 777, 2014 WL 5359745, the court held that the definition of gross income did not include compensatory loan forgiveness. Conversely, in the Virginia case of *Rieger v. Rieger*, 90 Va. Cir 29 (2015), the court included as income a forgivable loan received from the employer.

Phantom income related to a business presents particularly tricky issues as it is capable of manipulation to avoid child support. For example, a business owner who is divorcing may retain the profits in the business to reduce the income available for support.

In the Pennsylvania case of *Sichelstiel v. Sichelstiel*, 272 A.3d 530 (Pa. Super. 2022), the court held that earnings retained for a legitimate business purpose may be excluded from income. "Father presented uncontested testimony and evidence that he was a minority owner; and there was no finding, nor evidence to support the inference, that the businesses attempted to shield income from Father's support obligation by retaining his earnings instead of distributing them. Therefore, we conclude Father met his burden to prove he had no control over the decision to retain or distribute earnings." *Id* at 538.

The person seeking to exclude the retained earnings will want to present tax returns and the K1s. But that might not be enough. The trial court is required to make a credibility determination as to whether the earnings were retained for legitimate business purposes. Tax returns and K1s do not demonstrate why the earnings were retained. It is suggested that offering the testimony of other owners, shareholders or partners would be advisable.

Sometimes a minority interest in a business may show a lack of control over the decision to retain earnings. However in closely held businesses, such as family businesses, a minority interest in and of itself may not be sufficient to demonstrate a lack of control. Presenting a shareholder or partnership agreement that details the decision-making authority of each owner could demonstrate the amount of control the individual has to retain or distribute earnings.

In the Ohio case of *Poiting v. Poiting*, 2005-Ohio-2680, because of concerns of income manipulation, it was determined that credibility assessments as to whether retained earnings could be manipulated should be left to the credibility findings of the trial court. In *Marron v. Marron*, 2014 Ohio 2121, the retained earnings were included in income where evidence that father exercised significant control over the companies was presented.

Another issue that may arise is a "double dip." If the retained earnings are being considered as part of the business valuation for divorce purposes, it should not also be included for support purposes as it would result in counting the same money twice. The

issue of “double dip” arises with other forms of income as well, such as deferred compensation which will be discussed below.

2. TRUST INCOME

Trust income can be treated as a form of income for support purposes. Some trusts provide for mandatory income distributions while others provide that income distributions are discretionary. Even when it is discretionary, if there is a history of recurring income distribution the court could include it as income. Whether the trust is irrevocable or revocable could impact on the inclusion of income for support purposes.

A careful review of the trust document as well as the historical distributions is needed to determine whether it should be included as income.

In the Georgia case of *In the Interest of R.F.*, 295 Ga. App. 739 (2009), the Court found that trust income was within the definition of income under the support statute. In the Wisconsin case of *Stevenson v. Stevenson*, 2009 WI 29, 316 Wis.2d 442, 765 N.W. 2d 811 (2009), undistributed income from a valid nongrantor trust was to be included as income for support purposes. Alabama also includes trust income when calculating child support. *Kean v. Kean* 189 So.3d 61, 2015 Ala.Civ. App. LEXIS 169 (2015).

3. GIFTS OR INHERITANCE

Some states include gifts and inheritance while others do not. Courts often look to the recurring nature of the gift in determining whether or not to include it. Other states may not include it but may use it as a basis to deviate from the guideline support order. Still other states may not include the gift or the inheritance, but will include the income generated from the gift or inheritance.

States that include gifts by statute are Texas (Tex Fam. Code Ann. Section 154.062(b)(5) (West 2013); Colorado (Colo.Rev. Stat. Ann. Section 14-10-115(50(U) (West 2014) and North Dakota (N.D.Admin.Code 75.02-04.1 – 01 (4)(b)). Some states that include the gifts pursuant to case law are Arizona and Maryland. Alaska excludes gifts. *Nass v. Seaton*, 904 P.2d 412, 415 (Alaska 1995) Connecticut excludes gifts from spouses or domestic partners but not gifts from other individuals. See Conn. Agencies Regs. Section 46b-215a-1(11)B)9v)(2014; see also *Lusa v. Grunberg*, 923 A.2d 795, 805 (Conn. App.Ct. 2007).

4. DEFERRED COMPENSATION

Deferred compensation takes several forms. It includes stock options, restricted stock and salary income that may be deferred for a number of years. Each type will be discussed below.

i. Stock Options/Restricted Stock;

Stock options are the right to buy shares of stock at a certain price at a certain date. Employee stock options are typically not vested when received. The stock is granted at a certain price and exercisable in the future only after a certain time period has occurred. For example, stock options may vest over a 5-year period at

the rate of 20% per year. Once the stocks are fully vested, they can be exercised, i.e, they can be sold.

Stock options can be treated as income for support purposes as well as assets for property division, but not both to avoid a “double dip.” Further, questions arise as to whether unvested stock options should be included as income for support purposes. Pennsylvania case law holds that once the options vest, regardless of whether they are exercised, they are included as income for support purposes. *Mackinley v. Messerschmidt*, 814 A.2d 680 (Pa.Super 2002).

Restricted stock is stock granted but not eligible to be sold until some future date. Once fully vested and eligible for sale, the restricted stock is income for support purposes. In *Normandin v. Normandin*, 634 S.W. 3d 589 (2020) the Supreme Court of Kentucky found that restricted stock units are earned over the period between grant and vesting unless evidence is presented to the contrary. If a divorce/separation occurs during this period, a portion of the restricted stock would be marital and a portion would be non-marital.

In the Connecticut case of *McKeon v. Lennon*, 321 Conn. 323, 138 A.3d 242 (2016) it was held that exercised stock options and restricted stock that had fully vested are income for support purposes. But those same forms of deferred compensation cannot also be considered as an asset in property division.

ii. Deferral of salary

Deferral of salary, another type of deferred compensation, is the right to defer certain amounts of a salary to a future date. Some deferred compensation is eligible to receive certain high rates of interest on the amount of the salary deferred into the future. Again, as with other forms of deferred compensation, questions may arise as to whether this deferred compensation is available for support even if not received. If the decision to defer compensation is within the sole control of the employee, a strong argument can be made that it is income available for support.

In *Leineweber v. Leineweber*, 102 A.3d 827 (2014) the Maryland Court found that deferred income should be included in the years it was earned, but not again in the years when it is received. *Verhines v. Hickey (In re Marriage of Verhines)* 2018 II App (2d) 171034, 129 N.E. 3d 181 (2018) also included deferred compensation as income available for support.

5. LUMP SUM SETTLEMENTS- PERSONAL INJURY AND WORKER'S COMPENSATION

When a parent receives a lump sum settlement, such as a personal injury or worker's compensation settlement, confusion may arise as to whether the entire lump sum should be included in the income available for support or whether it should be pro-rated over a period of time. Depending upon the size of the award, courts have typically pro-rated the award over a period of years to avoid the entry of an order that is very high and therefore requiring modification in a short period of time.

When faced with this type of issue, practitioners will want to propose an allocation for the court to consider – over one year for example, a couple of years or even a percentage of the lump sum, depending upon how much money is involved.

In *Mayfield v. Mayfield*, 2013 IL 114655, 989 N.E. 2d 601, the Supreme Court of Illinois upheld an award to Wife of 20% of Husband's worker's compensation award. It rejected Husband's position that the lump sum should be prorated over his life expectancy.

6. DEPRECIATION/REDUCTION IN MORTGAGE ON RENTAL PROPERTY

Depreciation entitles a tax payer to deduct wear and tear on rental real estate and business equipment. Rental income is reported on Schedule E of a tax return. Expenses related to the rental income are deductible. Depreciation, while deductible for income tax purposes, should be added back in for purposes of determining income available for support as it is not an out-of-pocket expense but instead a "paper deduction" only. Similarly, tax deductions for depreciation for business equipment should not be allowed when calculating income for support purposes. *Asfaw v. Woldberhan*, 147 Cal. App. 4th 1407, 55 Cal. Rptr. 323 (2007) held that depreciation is not a deductible expense from rental income. See also *In re: Marriage of Hein*, 62 Cal.App. 5th 519, 266 Cal. Rptr. 3d 150 (2020).

The reduction of principal in a mortgage payment is also arguably income available for support, as it is increasing the equity in the rental real estate. However, consideration needs to be given as whether to include the principal reduction of the mortgage payments if the asset is marital, as that could result in a double dip by counting the increased equity twice.

7. PERQUISITES

Personal expenses paid for through a business are a common occurrence when an individual is self-employed or has an ownership interest in a closely held business. When personal expenses are paid through a business, these expenses reduce the profits of the business and consequently the income received by the owners. Yet the owners receive a tax benefit by lowering the taxes of the business. These payments are therefore income to the owners and should be added into the owner's income for support purposes.

- Common types of perquisites are:
- Car payments
- Gym memberships
- Parking fees
- Cell phones
- Life insurance
- Gas/travel expenses
- Food expenses

To determine what personal expenses are paid through the business a thorough review of the financial information of the business and possibly an interview with the owner/s is necessary. For a small business, a review of bank and credit card statements may be

sufficient. However, the business owner may need to be interviewed to discuss what perquisites are paid through the business if the perquisites are not readily identifiable in the financial statements. General ledgers should be reviewed as well as any accounting software programs such as Quickbooks.

8. SALE OF REAL ESTATE/BUSINESS INTERESTS - GAINS DERIVED FROM DEALINGS IN PROPERTY

When a business or piece of real estate is sold, the capital gains may be treated as income for support purposes. Consideration must be given to whether or not the asset sold is a marital asset that has been or will be divided in property distribution. Further, the taxes incurred as a result of the sale must be considered. Finally, a decision needs to be made over what period of time the income should be allocated.

9. INCOME OF SPOUSE/PARTNER AS BASIS FOR DEVIATION

Under certain circumstances, a court may deviate from a support order based upon other income in the household from a spouse or partner. If the other income is substantial and alleviates the parent from paying certain expenses, as a result the parent has more income available for support purposes. *J.P.D. v. W.E.D.* 114 A.23d 887 (PA. Super. 2014).

But see Idaho Code Ann. Section 32-706(b) which precludes inclusion of parent's community property interest in the financial resources of a spouse who is not a parent unless compelling reasons exist. In *Hicks v. Hicks*, 206 W. Va 492, 526 S.E. 2d 14, the West Virginia court held that a new spouse's income was not to be included for child support.

10. CASH/ELECTRONIC PAYMENTS

If you believe that there may be cash, stocks or bonds in a safe deposit box, you can file for an ex parte order freezing the safe deposit box and require an inventory of the items in the box. These assets are not necessarily income, but may be derived from business dealings and may be income producing.

Records can be obtained from Venmo and Zelle regarding electronic forms of payment to help identify cash or other undisclosed income. Lyft and Uber provide records as well of trips made and fees earned, so these records should be obtained to determine the income generated from these ride sharing businesses.

II. PRESENTING TRICKY FORMS OF INCOME TO THE COURT

Once the income is identified, care must be taken when presenting evidence of the income. Clear and credible evidence should be presented demonstrating why the income should be included or excluded from a support calculation.

A. HIRING AN EXPERT

For more complicated incomes, hire a forensic accountant. You do not want to leave money on the table because you overlooked a potential form of income. A forensic accountant can alert you to forms of income you may not have been aware of or did not know to look for. Additionally, parents with multiple forms of income, business interests, and investments may require the employ of a forensic expert to capture all available income. The expert can then assist you in presenting the income to the court in a cogent and easily understandable format.

B. WITNESSES

Witnesses may need to be available to testify as to the availability of certain types of income, such as retained earnings or perquisites paid through a business. Such witnesses include other owners of the business, bookkeepers of the business and accountants. A trustee may be needed to show the discretionary nature of income distributions and a lack of control over the distributions by the parent receiving the trust income. A forensic expert may need to testify to explain particularly complicated forms of income.

C. EXHIBITS

It is important to present the right documents to the court to support your position on the respective type of income. Tax returns, shareholder agreements, general ledgers, Quickbook reports, bank and credit card statements, paystubs and employment agreements are all forms of evidence that should be introduced in your support case. Additional documents such as trust documents, stock reward letters and deferred compensation plan booklets may be necessary. But be mindful that when presenting complicated financial information to the court, it is advisable to provide clear explanations of the documents you are submitting, rather than assume that you can provide the document and the Judge will find the income in the document without input or direction from you.

D. DISCOVERY REQUESTS

Discovery of financial information may be needed. Tools to obtain such information are interrogatories, document requests, subpoenas and depositions. Sometimes subpoenas to obtain records directly from the financial institution, employer and even the Internal Revenue Service may be necessary. For example, a person may report their income in one way in a mortgage application and another on a tax return. Some individuals have two sets of books and even two sets of tax returns! Thus the information received from the other side may not be reliable and should not be taken at face value. Obtaining independent confirmation of income from third parties may be necessary.

III. CONCLUSION

Becoming familiar with different forms of income is essential to effective and

competent representation of support clients. Certain forms of income must be presented to the court with detailed explanations of the income with case and statutory law, to insure that all forms of income available for support are included in the support order.

Appendix

1. Individual Tax Return IRS form;
2. K1 IRS FORM;
3. Partnership Tax Return IRS form;
4. S Corporation Tax Return IRS form
5. Schedule C IRS form;
6. Schedule D IRS form
7. Schedule E IRS form;
8. Sample Social Security Statement;
9. Sample Request for Production of Documents.