

## **WHAT HAPPENS WHEN THE W-2 FORM DOESN'T FIT?**

By Todd R. Warren

Your client walks into your office at the initial office consultation and proceeds to describe in great detail the lavish lifestyle that she, her husband, and the children have enjoyed for many years. She describes the large home in the suburbs, the expensive cars, the travel and the unlimited monthly spending. You inquire as to how this wealth was amassed and the conversation slowly starts to deteriorate into conjecture and a shrug of the shoulders. Your client hands you the most recent personal tax return and it shows an annual net income which is so low it cannot possibly be right. When you mention this, she quickly responds that her husband prepared the returns and you will have to ask him about it. The husband is represented by Attorney X. Before your client leaves, she mentions in passing that she has \$200 in her checkbook and needs money right away.

Now what do you do? A temporary support issue may be coming at you and the tax return is the only document you have. Never fear, you may be able to get prepared faster than you think.

Discovery is usually the first option to consider. The obvious place to start is with a Rule 214 Request for Production of Documents. If you think a hearing is on the horizon, the rules require that you must diligently pursue this line of discovery *before* you issue a Rule 237(b) Request asking that the other party appear in Court with essentially the same information. *See Committee Comments to Illinois Supreme Court Rule 237(b)*.

As you start receiving information, you may want to consider other avenues of discovery which may expedite the process:

- a. Look at Schedule B on the tax return to see if any bank accounts are listed which generate interest or dividends. Your client may also have similar information reflecting what accounts exist or have been utilized historically to support the family. You may want to issue a short subpoena to those banks requesting production of at least the account statements and sources of deposit for each account during the last 2-3 years. This information usually can be produced within a 2 week period.
- b. Look at Schedule E on the tax return to see if any rental or partnership income is identified. The supporting schedules to the return should identify the names of the properties or entities generating the revenue and the amounts that are taxable. You may find that certain Sub-Chapter S Income is listed in that section which may be available for payment of support. (It may be that the company has always distributed the Sub-Chapter S income to its shareholders but only stopped this year because the company suddenly needs more “working capital”).

- c. If the parties have any personal or corporate loans, you may want to consider issuing subpoenas to the bank requesting copies of the loan applications and loan files which often disclose significant amounts of helpful information. When the Bank tells you it will take 2 months to copy everything, offer to review the information at the Bank before anything is copied so you can prioritize what is important. You may get lucky and find that the loan application submitted when the big house in the suburbs was purchased may differ substantially from the reported income on the tax returns.
- d. You may also consider issuing a subpoena to the employer requesting copies of all payments received, whether in the form of salary, bonus, advances, loans, expense reimbursements, perquisites and the like. Though this usually takes the form of W-2 forms or 1099 statements, you may also ask for copies of the actual payroll and loan ledgers which will help you determine when and how payments have historically been made. Often times you may also find that the other party may be receiving “loans” or “repayments of shareholder loans” which would not otherwise show up on the personal tax returns. Likewise if the company has historically distributed the Sub-Chapter S income it may be recorded on a 1099 form rather than the W-2 form.
- e. If the other party is self-employed, or perhaps a shareholder or employee of a family business, you will also want to see copies of the corporate tax returns and financial statements, which may also disclose other payments that are being made for their benefit which may not constitute income. If you get lucky, you may find that many personal expenses are being paid directly through the business.
- f. Review the corporate tax returns and related documents to see if the other shareholders are compensated differently than your client’s spouse. If two shareholders own the same amount of shares, but one is being paid more than the other, it may be a place to probe further.
- g. If you receive the personal bank records in time, look at the sources of deposit to see if they line up with the reported income. You may find substantial “unexplained” deposits or transfers of funds to or from other accounts which may have been previously unknown.
- h. Likewise, especially if the other party is self-employed, look at the corporate revenue as reported on the corporate returns and compare it to the deposits made into the corporate checking account. If the amounts do not line up, perhaps revenues are being skimmed or deposited elsewhere for another purpose.

Maybe this investigation will answer all of your questions. Maybe you will find nothing. You still however, are faced with opposing counsel's argument that "the gross income on the tax return is \$50,000, and after taxes are paid, 25% of the net is &\*\$^#@ for child support and 15% (or so) of the net is &\*\$^#@! for maintenance". Now what?

There are some recent cases which may help.

**In Re The Marriage of Takata**, 304 Ill.App.3d 85, 709 N.E.2d 715, 237 Ill.Dec. 460 (2<sup>nd</sup> Dist., 1999), the Court found that the Husband's testimony regarding his income was not credible. He admitted that he had failed to report his income for over six years, even though he was under a direct Court Order requiring that he do so. He claimed that his gross income was \$8,000 per year, but when he engaged in the same employment during the marriage he earned close to \$30,000/gross per year. The Court concluded that without credible evidence of the Husband's income, the Trial Court was compelled to make an award of child support that was *reasonable* in the case. *The figure set by the Court for child support was \$125/week, which computes to roughly 25% of a net annual income figure of \$26,000.*

**In Re The Marriage of Severino**, 298 Ill.App.3d 224, 698 N.E.2d 193, 232 Ill.Dec. 355 (2<sup>nd</sup> Dist., 1998), the parties were married for 25 years. They purchased a million dollar home and a Ferrari in the same year that the Husband reported his annual *gross* income at \$116,000. The Husband was the vice-president and only active shareholder of a company the parties founded during the marriage. The Trial Court found that the Husband was "less than candid" about his financial activities, including a finding that he had deposited \$400,000 in his sister's name. *The figure set by the Court for maintenance was \$6,500/month and for child support was \$2,816/month. This figure translated to roughly 100% of the Husband's reported gross income.*

**In Re The Marriage of Hassiepen**, 269 Ill.App.3d 559, 646 N.E.2d 1348, 207 Ill.Dec. 261 (4<sup>th</sup> Dist., 1995) the parties had started a business together and were now divorcing. The Husband continued to run the business, but was disputing his actual income received on an annual basis. The Wife argued that the profit and loss statements for the business should have been used as the benchmark for determining the Husband's actual annual income. The Husband argued that the parties' personal tax returns for the last 3 years should have been used. At Trial, the Husband produced his current year personal tax return for the first time. When questioned on cross-examination, the Husband asserted the 5<sup>th</sup> amendment and refused to testify concerning the personal tax returns. The Court barred the Husband from relying upon the personal income tax returns, but held that "*the Wife was free to make any legitimate use of them any way she wishes*". *The Court also refused to accept the Husband's argument that the income on the profit and loss statements should be divided by 2 since his Wife was his "partner" and attributed all of the reported income to him for purposes of determining monthly support.*

**In Re The Marriage of Baptist**, 232 Ill.App.3d 906, 598 N.E.2d 278, 174 Ill.Dec. 81 (4<sup>th</sup> Dist., 1992) the parties had entered a Judgment wherein the Wife agreed to retain a 50% lienholder's interest in the Husband's business(es) and would receive 50% of the income disbursed by the businesses. Additionally, the Husband was to pay the Wife \$500 per month until she remarried, died or reached the age of 65. The Husband was also ordered to pay child support of \$250 per month for one child. After the divorce, the Husband remarried and transferred 50% of his interests in the business(es) to his new wife. When his first wife filed a Motion seeking an increase in child support, the Husband opposed claiming that his income was reduced from the time of the Judgment. The Court held that the monthly payments the Husband was making to his first Wife were not deductions from his income in determining child support because they were not *prior* maintenance obligations as defined by the statute. They were *current* obligations and thus not deductible. *In light of the transfers of business interests to his new wife, the Court went on to find that his new spouse's income was relevant to the determination of the Husband's actual net available income for support to his first wife and family.*

**Ivanyi v. Granoff**, 171 Ill.App.3d 411, 526 N.E.2d 189, 122 Ill.Dec. 49 (2<sup>nd</sup> Dist., 1988) is often cited in cases where there are disputes as to whether or not allegedly passive or non-recurring income should be included in the calculation of net income of a payor spouse. In this case, the Husband successfully argued that the interest, dividend and capital gain income reported on his personal tax returns "were not actually received by him" and therefore should not have been included in the calculation of his net income for support purposes. The Husband had an expert testify at the hearing concerning these issues. The Wife did not. In making its ruling, the Court found, "*While it may be appropriate to apply tax law principles in the determination of a supporting party's net income, there is no authority for the position that the Internal Revenue Code Bible be used to determine the meaning of net income.*" Parenthetically, the Court also stated, "*I watched these proceedings through discovery and through trial and the Wife was faced with an extremely difficult situation. She was faced with a tax return that was prepared by a 'genius' of an accountant. This doctor (the Husband) has the most unusual income structure of anybody I have ever seen.*" The moral of this story is to recognize when you are out-manned and find your own "genius" accountant to help you.