A Game Theory View of Family Law: Planning for a 500% Family Tax

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A Game Theory View of Family Law: Divorce Planning For a 500% “Family-Tax”

Steven J. Willis*

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INTRODUCTION

Tax, estate, and bankruptcy planning are huge industries because money matters to people; indeed, the love of it is the root of all evil. Divorce planning is less common, but it “matters” more because the consequences—and temptations—are so great.

Why would your author—a tax lawyer and CPA—be fascinated with family law? Consider marginal rates, which may shock readers. Top U.S. marginal income tax rates range from about 37% to about 50%: if I earn an extra dollar, I owe up to 50 cents extra tax. Estate marginal rates range from 0% to 40%; if I die with an extra dollar, my estate pays up to 40 cents extra tax. Bankruptcy margins are 100%: if I keep a dollar from creditors, thus, I avoid paying 100%. In family law, however, marginal rates can range from 500% to over 700%. For each extra income dollar, I risk paying $5 to $7 additional alimony, child support, and property division. Comparatively, traditional taxes almost shrink to insignificance.

Tax, estate, and bankruptcy law fundamentally deal with income, deductions, assets, and liabilities: what they are and when they are. So does accounting. Family law—so far as it covers who gets what—focuses on the same things. Thus, tax and accounting skills transfer seamlessly to family law. Hence, this Article.

The Article covers:

   I. Tax Rates and Margins. Other than in family law, “tax rates” mostly affect the wealthy. In bankruptcy, all debtors are
essentially equal. In contrast, marginal “family-tax” rates affect middle income-earners the most.

II. Family Law Rates and Margins. This quantifies and illustrates the “family-tax.”

III. Reality Versus Perceptions.
   A. Is the “Family-Tax” Rate Real? Yes, but it is also a perception.
   B. Is this Merely a Battle of Experts. No, because the playing field is unlevel.

IV. Conclusion. This is worth understanding, but little can be done to make it right.

This Article does not cover what states should do about high marginal “family-tax” rates. That is for another article. This Article also does not cover in depth the techniques, herein called “tricks,” to create the illusion of marginal income changes. That, too, is a different article, although any tax planning article provides useful illustrations.1 Some readers may balk, thinking family law practitioners are not expert tax planners, so why should they consider the topic. But that is the ultimate point. Tax planning rests on 37% to 50% marginal rates. In contrast, family law planning—which is fundamentally tax planning—may superficially affect only one year, but it has a magnified impact over many years resulting in extraordinary marginal rates. Family practitioners may not want to be knowledgeable tax planners, but perhaps they should. This Article explains the consequences of understanding planning, or not. One need not play the game, but one should know others are playing.

I. TAX RATES AND MARGINS

This section surveys income tax, estate and gift, and bankruptcy marginal rates. That perspective is important because planning to avoid them is so common. The tools involved also apply to family law. Notably, income

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1 For a discussion of tax planning plus a consideration of its morality, see Steven J. Willis, Masks, Magic, and Games: The Use of Tax Law as a Policy Tool, 4 AM. J. TAX POL’Y 41 (1985) [hereinafter Willis, Masks]. For other articles on family law games, see Steven J. Willis, How a Spouse Can Profit by Paying Partner’s Principal, 49 N.M. L. REV. 283 (2019) [hereinafter Willis, Spouse], and Steven J. Willis, Naked Stripping for Alimony and Child support Tax Benefits, 73 TAX LAW. 861 (2020) [hereinafter Willis, Alimony].
and estate tax rates can seem insignificant when compared to the much higher “family-tax” rates.

A. Income Tax Rates and Margins

The top marginal U.S. income tax rate is 37%. Additionally, wages are subject to a 1.45% excise. Wages greater than $200,000 suffer an additional 0.9% excise. The total maximum marginal rate is thus 39.35% for wages.

A marginal rate applies to the last dollar of income. For example, in 2023 an individual with $499,999 taxable income owes $150,689.15 tax. That is an average tax rate of 30.14%. If that person, however, earns another dollar, the extra dollar suffers a 35% marginal rate, resulting in a tax bill 35 cents higher. Each additional dollar suffers a 37% rate, resulting in increased tax of 37 cents for each dollar. The 30.14% average is interesting, but not relevant for tax planning.

People plan at the margins because that is where reality bites. Individuals earning under $9,525 are subject to a 10% rate—not much disincentive to produce more. But taxpayers earning $500,000 face a 37% rate on ordinary income, which arguably produces incentives not to recognize it currently or perhaps not to produce it. As recently as 1981, the highest rate was 70%, and as recently as 1963, it was 91%. In 1945, the highest marginal rate was 94%. One might legitimately wonder why anyone would bother earning the marginal dollar if one could only keep six cents.

State and local taxes are also significant. Florida—one of two states examined herein—has no income tax. Thus federal tax rates are also the state rates. New York, in contrast, imposes significant state and city income tax rates.

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2 I.R.C. § 1(j)(2) imposes a 37% maximum marginal rate. Beginning in 2026, the maximum rate is 39.6%. Id. §§ 1(a)-(e).
3 Id. § 3101(b)(1) imposes a 1.45% excise on wages to fund Medicare.
4 Id. § 3101(b)(2)(C) imposes a 0.9% tax on wages exceeding $200,000 for single taxpayers.
5 Id. § 1(j)(2)(C) (providing a tax table).
6 The average rate is 150,689.15/499,999. This is for taxable income, which is gross income minus myriad deductions. Id. § 63(a).
7 Some income was subject to a 10% rate, and some to 12%, 22%, 24%, 32% and 35% rates. Id. § 1(j)(2)(C).
9 Id. (for taxable income exceeding $200,000 for individual filers).
10 Id.
11 Florida has no income tax for natural persons. FLA. CONST. art. VII, § 5(a). Florida exempts sole proprietorships, partnerships, L.L.C.s taxed as partnerships, and most S-corporations from income tax. FLA. STAT. § 220.02(1) (2021); id. § 220.22(4) (2018); FLA. DEP’T OF REVENUE, GT-800017, FLORIDA CORPORATE INCOME TAX 1 (2016). The 2023 Florida marginal rate would be 25.45%.
taxes, which total 12.696%. They are not additive to federal rates because state taxes—with complicated exceptions—are deductible for determining federal tax. New York thus has a total marginal rate of about 50% and Florida a total rate of 39.35%. Most examples herein use lower rates because hypothesized income is lower.

B. Estate and Gift Tax Rates

As shown below, income tax marginal rates affect the “family-tax” analysis. In contrast, estate and gift tax rates do not. They are, however, relevant for perspective. Both estate and gift taxes are subject to graduated marginal rates, which means the higher the estate or gift value, the higher the tax rate. The highest federal estate and gift tax rate is 40%.

Estate planning is big business. Many lawyers, accountants, insurance agents, and brokers advise clients on how they might legally avoid paying that 40%. This mostly affects the wealthy, as estates under $12,920,000 are generally exempt from the tax. As with divorce planning, estate planners use accounting tricks to move value out of an estate, rely on legal provisions to make value “disappear,” and consider foregoing wealth so as not to pay the 40%. Readers should put that into perspective. A large estate planning industry exists to save 40 cents per dollar “planned,” but a far smaller divorce planning industry exists to save perhaps $7 per dollar “planned.”

C. Bankruptcy Law

Bankruptcy planning exists to help debtors keep at least some property. Each dollar protected—perhaps as an exempt homestead or exempt tools of the trade—is a dollar not paid to creditors. If paid to creditors, a dollar is effectively subject to a 100% “bankruptcy tax.” From the debtor’s perspective, payments to creditors must feel like a tax. That same perspective exists in family law: not paying a dollar of alimony, child support, or property division is akin to not paying a tax. Significantly, the “family-tax” avoided through divorce planning can be many times larger than the “bankruptcy tax.”

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13 I.R.C. § 164(a).
14 Id. § 2001(c).
15 Id.
17 PETER SPERO, ASSET PROTECTION: LEGAL PLANNING, STRATEGIES AND FORMS ¶ 12.02 (2023) Westlaw WG&L.
avoided through bankruptcy planning.\textsuperscript{18} Further, the tools used in divorce planning are not altogether different from those used in estate and bankruptcy planning.

\section*{II. FAMILY LAW RATES AND MARGINS}

Divorce planning unquestionably exists. Experience, observation, and logic suggest it is less common than tax planning, estate planning, or bankruptcy planning. Yet the stakes are higher. Admittedly, one might have moral issues helping clients pay less to former spouses. Planning to pay less child support might seem particularly repugnant. Nevertheless, the tools for it exist and lawyers will inevitably use them. If one is repulsed by them, one might at least contemplate the benefit of understanding the tools so that one might defeat them in litigation or through legislation. This Article aims to quantify those tools. It explains and illustrates some of them. A later article can focus on attacking them; but to attack the tools, one must first appreciate their magnitude and develop a general understanding.

The “family-tax” has three components: child support, alimony, and property division. The calculations can be tedious, but the results are dramatic. To illustrate the “family-tax” components, consider this example:

\textit{Spouses A and B} divorce after a 20-year marriage with children ages 3, 5, and 7. Spouse A has the children 20\% of the overnights and Spouse B the remaining 80\%.\textsuperscript{19} Spouse A has $120,000 after-tax income. Spouse B has zero income.\textsuperscript{20}

The following discussion focuses on Florida Spouse A and New York Spouse A. It examines changes in a single year.\textsuperscript{21} It considers the components separately and combined: some people pay only child support or only alimony or only divide property. Others do all three.

\textsuperscript{18} For bankruptcy planning, managing to keep a dollar is worth a dollar. For family law planning, changing income by a dollar can save $5.

\textsuperscript{19} Florida child support allocations are a function of parental over-nights with the child. An 80/20 split would not likely result in adjustments. That simplifies the calculations. See \textsc{Fla. Stat.} § 61.13 (2023) (parental time-share); \textit{id.} § 61.30(11)(b) (effect of time-sharing on child support).

\textsuperscript{20} Because of differing tax rates, Florida Spouse A and New York Spouse A differ. Florida Spouse A has approximately $161,000 in wages, which generates $12,266.90 social security/Medicare taxes and $28,716 income tax, using 2023 rates, single filing status, the standard deduction, and ignoring child credits/deductions, netting to $120,017.10, which rounds to $120,000. In contrast, New York Spouse A has wages of approximately $182,000, generating $12,571.90 social security/Medicare taxes, approximately $18,000 of state/city income tax, and approximately $31,000 federal tax, using 2023 rates, single filing status, and $25,000 itemized deductions, netting to $120,000.

\textsuperscript{21} Focusing on one year simplifies the analysis. Courts may consider income from additional past years, but they, by definition, only consider future years in modification litigation: prior to that, the income does not exist. The current year would logically be weighted the greatest.
A. Child Support

1. General Calculations

Child support obligations are a percentage of income.\textsuperscript{22} At $120,000 income, New York’s marginal child support for three children is 29%.\textsuperscript{23} Florida’s is 9.5%.\textsuperscript{24} Each marginal after-tax dollar results in a 29 cent New York obligation or 9.5 cents in Florida. Those obligations continue until the youngest child reaches twenty-one in New York\textsuperscript{25} or eighteen in Florida;\textsuperscript{26} hence the New York obligation is 29 cents per year for fourteen years, then 25 cents for two years, and 17 cents for two.\textsuperscript{27} The Florida obligation is 9.5 cents for eleven years, then 7.5 cents for two, and 5 cents for two.\textsuperscript{28} These are best evaluated in present value terms, adjusted for alimony.\textsuperscript{29} Initially, I value child support \textit{unadjusted} for alimony.


\textsuperscript{24} FLA. STAT. § 61.30(6)(b) (2023). Florida child support for three children and $10,000/month combined income is $2,795. Marginal income dollars add 9.5 cents. Parents owe a percentage equal to their income-share.

\textsuperscript{25} N.Y. FAM. CT. LAW § 413(1)(b)(2) (Consol. 2021).

\textsuperscript{26} FLA. STAT. § 61.14(9) (2023); \textit{see also} id. § 743.07(1).

\textsuperscript{27} At $120,000 income, New York’s marginal child support for two children is 25% and for one child it is 17%. \textit{See supra} note 23.

\textsuperscript{28} At $120,000 income, Florida’s marginal child support for two children is 7.5% and for one child it is 5%. \textit{See supra} note 24.

\textsuperscript{29} Florida and New York child support are a function of alimony. FLA. STAT. § 61.30(2)(a)(9) (income increases by alimony \textit{ordered}); id. § 61.30(3)(g) (income decreases by alimony \textit{paid}); N.Y. DOM. REL. LAW § 240(1-b)(b)(5)(ii)(I) (Consol. 2023) (alimony received or ordered); id. § 240(1-b)(b)(5)(vi)(C) (alimony paid or to be paid). Florida courts view alimony, child support, and property division as interrelated: appellate courts must examine them “as a whole.” Canakaris v. Canakaris, 382 So. 2d 1197, 1202 (Fla. 1980) (“As considered by the trial court, these remedies are interrelated; to the extent of their eventual use, the remedies are part of one overall scheme. It is extremely important that they also be reviewed by appellate courts as a whole, rather than independently.”); Hamlet v. Hamlet, 583 So. 2d 654, 657 (Fla. 1991); Dorsey v. Dorsey, 266 So. 3d 1282, 1284 (Fla. Dist. Ct. App. 2019). Viewing them together is realistic only if they are in the same format. Evaluating current awards with contingent-deferred support is cumbersome. Reducing deferrals to present value makes evaluation workable. Little evidence exists that courts make such determinations. \textit{See}, e.g., Clements v. Clements, 990 So. 2d 383 (Ala. Civ. App. 2007). The court upheld a judgment (a wife received $450,945 and husband $664,479) as not “plainly or palpably wrong or inequitable.” \textit{Id.} at 391. The court found a 40/60 split acceptable;
For this example, the marginal Florida child support liability has a present value of $1.11. 30 The New York liability is $4.05 31 per marginal income dollar. These amounts are unadjusted for general risk, 32 modification however, it did not value the $1,473/month child support or $1,500 alimony. See id. Child support had an approximate $130,000 present value. The younger child was six and the older was seventeen. Child support of $1,473 per month for one year equals $17,676. Child support of $997 per month for eleven years has a present value of $112,352.77. Together they approximate $130,000. Payment ($PMT$) = 997, nominal interest rate ($I/YR$) = 2.5, number of payments ($N$) = 132, mode = $Beg$, and present value ($PV$) = -115,194.65. If that is reduced to its present value one year earlier (date of trial), it had a value of $112,352.77. See Schedule of Basic Child support Obligations, ALA. ADMIN. OFF. OF CTNS., https://www.alacourt.gov/docs/ChildSupportObligations.512022.pdf, for the relative amounts of child support for one and two children in Alabama. Alimony, if for twenty-four years (which facts support), had an approximate $325,000 value. $PM T = 1,500, I/YR = 2.5, N = 288, mode = Beg$, and $PV = -325,285.19$. Viewed that way, wife received $905,000 and husband $210,000, an 81/19 split.

30 Using an HP 10Bii calculator, set payment ($PMT$) at 0.095, nominal interest rate ($I/YR$) at 2.5, number of payments ($N$) at 11, mode at begin ($Beg$), and present present value ($PV$). The answer is 0.926446073, which reflects the present value of marginal child support for the next eleven years. The children are then eighteen, sixteen, and fourteen. Spouse A no longer owes support for the oldest child. For the remaining children, the obligation drops to 7.5 cents per marginal income dollar. Enter $PMT = 0.075, I/YR = 2.5, N = 2$, mode = Beg$, and press $PV$. This yields 0.148170732, representing the present value of child support until the next child reaches eighteen. Reduce this amount to present value: $FV = 0.148170732, N = 11, I/YR = 2.5$, and $PV = 0.11292755$. The remaining child is sixteen and marginal child support drops to 5 cents. Set $PMT = 0.05, I/YR = 2.5, N = 2$, mode = Beg$, and $PV = 0.098780488$. Reduce that to present value: $FV = 0.098780488, N = 13, I/YR = 2.5$, and $PV = 0.071657373$. The total present value is approximately 1.11 (0.926446073 + 0.11292755 + 0.071657373). For simplicity, these and later calculations treat each payment as due at the beginning of the year. They would likely be spaced monthly, which reduces the present value to about 1.10, an immaterial difference.

31 Assume that $PMT = 0.29, I/YR = 2.5, N = 14$, mode = Beg, and $PV = 3.475123642$. The children are twenty-one, nineteen, and seventeen. Next, enter $PMT = 0.25, I/YR = 2.5, N = 2$, mode = Beg$, and $PV = 0.493902439$. Reduce to present value: $FV = 0.481856038, N = 16, I/YR = 2.5$, and $PV = 0.332704998$. The remaining child is nineteen. Thus, $PMT = 0.17, I/YR = 2.5, N = 2$, mode = Beg$, and $PV = 0.335853659$. Reduce to present value: $FV = 0.335853659, N = 13, I/YR = 2.5$, and $PV = 0.243635087$. Total present value is approximately 4.05 (3.475123642 + 0.332704998 + 0.243635087). Time spent with children is not a New York statutory factor; however, courts consider whether a non-custodial parent’s share is unjust. N.Y. DOM. REL. LAW § 240(1-b)(g) (McKinney 2023).

32 Risk is an important factor in valuing financial obligations. To Spouse B, Spouse A’s obligation has risk: Spouse A may die, lose income, or refuse to pay. Spouse B’s perspective, however, is irrelevant to Spouse A’s behavior, which is a function of Spouse A’s perspective. Spouse A will make financial/accounting decisions—such as whether to earn/defer income or incur/accelerate expenses—assuming he/she will be alive, will continue work, and will honor obligations. At least those would be the rational assumptions.
risk, inflation, or taxes. Thus the marginal New York “child support tax” is 405%. The Florida “child support tax” is 111%.

2. Tangent on Lower Income Levels and Cliffs

At lower income levels, the Florida margin is higher but is subject to quirky brackets which change at $50/month intervals. For example, at $50,000 combined parental income, a $1,000/year income increase produces a Florida “child support tax” rate of 464%. An income change from $49,800 to $50,000 produces a $1,000/month child support increase for two children. At $51,000, the amounts are $1,667/month for three, $2,555/month for four, and $2,269/month for five. At $52,000, the amounts are $3,333/month for six, $4,222/month for seven, and $4,999/month for eight.

33 Predicting child support modifications is difficult. Assuming increases and decreases are equally likely, risk is irrelevant. Spouse A risks an increase if Spouse A’s income-share increases, but a decrease if the share drops. Typically, modifications require a new petition, new court costs, new attorneys’ fees, and new expert witness fees. Spouse B will often lack the funds for these costs. A court may order Spouse A to pay Spouse B’s costs, but perhaps not. This Article, however, focuses on planning prior to the divorce and its impact at the time of the divorce. Subsequent events do not alter that focus for forgone income and increased expenses. Subsequent events due to income-deferral or deduction-acceleration planning are relevant. The larger the deferrals and accelerations, the greater the impact of a modification and thus logically the greater the chance one will occur. They will unlikely be annual, which would be both expensive to the parties and annoying to the court. Thus, the magnitude of Spouse A’s planning is relevant. Modest, and probably moderate, planning seem unlikely to prompt modification risk. Further, planning can occur not only in the divorce year, but also in modification years, lessening the modification risk.

34 Inflation is theoretically irrelevant. If the obligation inflates, so will the discount rate. Neither child support nor interest rate changes correlate precisely with inflation. This Article uses 2.5% as the non-risk, non-inflation rate of interest. Others place it lower, which would increase family-tax rates substantially. STEVEN J. WILLIS, FINANCE FOR LAWYERS 130, 146–54 (2021) (discussing the San Francisco Federal Reserve Bank, repeated his conclusions two years later, stating: “My own view is that r-star today is around 0.5% . . . . When put into a historical context, r-star stands at an incredibly low level—in fact, a full 2 percentage points below what a normal interest rate looked like just 20 years ago.”). John C. Williams, The Future Fortunes of R-star: Are They Really Rising?, FED. RSVR. BANK OF S.F. ECON. LETTER, May 21, 2018, at 1, 1. For some tax purposes, the Treasury uses a 3.5% real rate-of-return (ignoring inflation). Treas. Reg. §1.509(a)-(i)(5)(ii)(C) (2015) (minimum asset return for non-functionally integrated supporting organizations).

35 Until 2017, alimony was generally paid with pre-tax dollars. With proper planning, that remains possible. See Willis, Alimony, supra note 1. Child support has never been deductible for tax purposes; however, with proper planning, the payor can shift the tax obligation to a lower-taxed parent. Id.

36 As shown supra note 31, a marginal income dollar produces a marginal obligation of $4.05, which is 405% of the marginal dollar.

37 As shown supra note 30, a marginal income dollar produces a marginal obligation of $1.11, which is 111% of the marginal dollar.

38 See supra note 24 for the Florida guidelines.

39 With $50,000 combined income ($4,167/month), child support is $1,654/month for three children, $1,329/month for two, and $854/month for one. At $51,000, the amounts are $1,687, $1,355, and $872. Thus the $1,000 income increase prompts annual increases of $396 for eleven years, $312 for two years, and $216 for two years. The present value is $4,641.15. Thus, PMT = 396, I/YR = 2.5, N = 14, mode = Beg, and PV = 3,861.82. The children are eighteen, sixteen, and fourteen. Next, PMT = 216, I/YR = 2.5, N = 2, mode = Beg, and PV = 616.39. Reduce that to present value: $4,641.15. N = 11, I/YR = 2.5, and PV = 469.78. The remaining child is sixteen. Thus, PMT = 216, I/YR = 2.5, N = 2, mode = Beg, and PV = 426.73. Reduce to present value: $4,641.15. N = 13, I/YR = 2.5, and PV = 309.56. The total present value is ($3,861.82 + $469.78 + $309.56), which equals $4,641.15.
to $50,400, faces a 389%\textsuperscript{41} “child support tax” averaged over the $600. A change from $49,800 to $50,399 experiences a zero marginal rate because the child support remains the same. But a $1 change from $50,399 to $50,400 causes child support to increase, in present value terms, by $2,335.38,\textsuperscript{41} an astronomical 233,538% marginal rate. The rate applies only to that $1 increase or to a $1 decrease from $50,400 to $50,399.

Because child support is a function of combined parental income, the various “cliffs” or “pressure points” can be particularly consequential. If Spouse A decreases income by $1/year, A saves $2,335.38. However, if Spouse B increases his/her income by $1, the $2,335.38 increased liability returns and falls fully on Spouse A.

The “cliff” effect is noteworthy: for income below $120,000, tiny changes can have enormous impact, albeit only at specific points. Also noteworthy is the higher average marginal rate.\textsuperscript{42} While tax and estate planning mostly benefit the wealthy—who face the highest tax rates—divorce planning has its greatest impact at modest income levels where higher family tax rates apply. That point is relevant if we were to consider what courts and legislatures should do about the “family-tax.” This Article, however, faces the tax as it is, not as it should be. Significant planning for clients at the $50,000 combined income level is likely too expensive to be realistic; nevertheless, counsel should be aware of the pressure points at which small changes can significantly alter results. At the hypothetical $120,000 levels, planning is more realistic. New York does not have the cliff effect.\textsuperscript{43}

\textsuperscript{40} With $49,800 combined income ($4,150/month), child support is $1,654/month for three children, $1,329/month for two, and $854/month for one. At $50,400 ($4,200/month), the amounts are $1,670, $1,342, and $863. Thus the $600 income increase prompts annual increases of $192 for eleven years, $156 for two years, and $108 for two years. The present value is $2,335.38. First, $PMT = 192, I/YR = 2.5, N = 11$, mode = Beg, and $PV = 1,872.40$. The children are eighteen, sixteen, and fourteen. Next, $PMT = 156, I/YR = 2.5, N = 2$, mode = Beg, and $PV = 308.20$. Reduce that to present value: $FV = 308.20, N = 11$, $I/YR = 2.5$, and $PV = 234.89$. The remaining child is sixteen. Thus, $PMT = 108, I/YR = 2.5, N = 2$, mode = Beg, and $PV = 213.37$. Reduce to present value: $FV = 213.37, N = 13$, $I/YR = 2.5$, and $PV = 154.78$. The total present value is ($1,872.40 + $308.20 + $154.78), which equals $2,335.38. Thus, $2,335.38/600 = 3.8923$ or 389.23%.

\textsuperscript{41} See discussion supra note 40.

\textsuperscript{42} As shown earlier, the Florida marginal rate at $120,000 income is 111%, but at $50,000 income it is 389%.

\textsuperscript{43} New York rates are flat; however, New York issues charts for child support calculation for incomes below $200,000. Those charts have cliffs at $100 income increments. \textit{Child Support Standards Chart}, N.Y. STATE OFF. TEMP. & DISABILITY ASSISTANCE DIV. CHILD SUPPORT SERVS. (Mar. 1, 2023), https://childsupport.ny.gov/ dse/pdfs/CSSA.pdf.
3. Back to General Calculations

From Spouse A’s viewpoint, marginal obligations differ little from a marginal tax, except they are much higher. For $120,000 after-tax income, Spouse A’s marginal New York tax rate is about 33.15%,\(^44\) while in Florida it is 25.45%.\(^45\) In contrast, the New York marginal “child support tax rate” is 405%\(^46\) and the Florida rate is 111%\(^47\). Marginal rates significantly impact tax planning; higher rates produce planning opportunities because the client’s return increases. Because of its higher marginal rate, child support planning can be even more impactful than tax planning, which is prolific.

4. Florida Calculations

i. Increased Income

If Florida Spouse A increases taxable income by $1,000, A owes $254.50 additional tax, resulting in $120,745.50. Spouse A owes $70.82\(^48\) extra annual child support with the amount dropping as each child reaches eighteen. The present value of the fifteen years of increases is $827.51,\(^49\) ignoring alimony and property division. Spouse A will view the $254.50 income tax as a tax. The $70.82 per year increased child support is also easily viewable as a tax. The $827.51 present value of the entire award is also best viewable as a

\(^{44}\) I.R.C. § 1(j)(2) imposes a 24% marginal tax rate for $120,000 taxable income. I.R.C. § 3101(b)(1) imposes a 1.45% tax on “wages.” Spouse A’s business income share would likely be wages. See I.R.C. § 3121(d) (Treasury may recharacterize S-corporation income as wages); INTERNAL REVENUE SERV., DEP’T OF THE TREASURY, INSTRUCTIONS FOR FORM 1120-S 17 (2022) (construing I.R.C. § 3121(d) as also applying to the individual shareholder). For 2023, if Spouse A’s wage income were under $160,200, A would owe (unless self-employed) an additional 6.2%.

\(^{45}\) INTERNAL REVENUE SERV., DEP’T OF THE TREASURY, PUBL’N 15 (CIRCULAR E), EMP.’S TAX GUIDE 24 (2023). At the hypothesized $182,000 New York wage level, that totals to a 25.45% federal marginal rate. The state marginal rate is 6.41%. N.Y. DEP’T OF TAX’N & FIN., INSTRUCTIONS FOR FORM IT-201 57 (2020). The New York City rate is 3.876%. Id. at 69. Ignoring inter-relationships between those and federal taxes, the total New York marginal rate for $182,000 income is about 10.25%, but adjusted for federal tax, it is about 7.7%. The combined rate is approximately 33.15%.

\(^{46}\) Florida has no income tax for natural persons. FLA. CONST. art. VII, § 5(a). Florida exempts sole proprietorships, partnerships, L.L.C.’s taxed as partnerships, and most S-corporations from income tax. FLA. STAT. § 220.02(1) (2023); FLA. STAT. § 220.22(4) (2023) (exempting most S-corporations); FLA. DEP’T OF REVENUE, CORP. INCOME TAX 1. Spouse A’s 2021 Florida marginal rate would be 25.45%.

\(^{47}\) See supra note 31 and accompanying text.

\(^{48}\) See supra note 30 and accompanying text.

\(^{49}\) An after-tax income of $745.50 times the annual 9.5% marginal child support rate equals $70.82.

\(^{49}\) An income of $745.50 times the 111% “child support tax” equals $827.51. See discussion supra note 30 for the 111% computation.
current “child support” tax. The increased obligation exists now and would not exist but for the increased current income.50

Notice the bottom line. Before the increased income, Spouse A received $120,000. After increasing income $1,000, Spouse A had only $119,917.99.51 If Spouse A were rational and well-informed, Spouse A might reasonably question, “Why work harder? I work more, I get less.” Spouse A has some solace in having supported the government more and in supporting his/her children more, albeit through ex-spouse B.

ii. Decreased Income

Alternatively, suppose Florida Spouse A reduces income $1,000, dropping it to $119,000. This could result from an additional $1,341.38 expense or by similarly reducing gross income. Spouse A saves $341.38 tax to produce a net $1,000 decrease, although the tax savings might be temporary.52 Spouse A’s child support obligation initially drops $108, and in present value terms by $1,265.69.53 The lower child support is permanent, absent a modification.

Notice the bottom line. Spouse A reduces income by $1,341.38 but increases net worth by $266.55 Spouse A has more money from earning less. Spouse A pays less to the government, which likely pleases Spouse A. Spouse A pays less to Spouse B, which Spouse A might also view positively. Plus, Spouse A may work less.

50 This ignores omitted adjustments as explained supra notes 32–35.
51 A $1,000 income plus $120,000 less $254.50 tax less $827.51 child support obligation equals $119,917.99. This accrues the entire increased 15-year obligation in present value terms. The obligation is real and is unlikely to disappear: if Spouse A were to later decrease income, Spouse A would risk having the reduction imputed. Both Generally Accepted Accounting Principles (“GAAP”) and International Financial Reporting Standards (“IFRS”) require accrual accounting because it presents a far more accurate measure of income and wealth than does cash or cash-flow accounting.
52 The Florida 25.45% tax rate times $1,341.38 equals $341.38, which Spouse A would save by having less income.
53 If, instead, Spouse A merely deferred the income to a later year (or accelerated a future expense), the $341.38 tax would merely be deferred and not saved, absent future planning.
54 The 111% rate applies for increases above $120,000. Changes below that level trigger a higher “child support tax.” For the hypothesized numbers, the rate is 126.57%. Initially, support drops by $108/year for eleven years, then by $84 for two years, and finally by $60 for two years. To compute the present value, \( PMT = 108, I/YR = 2.5, N = 11, \) mode = Beg, and \( PV = 1,053.22. \) The children are eighteen, sixteen, and fourteen. Next, \( PMT = 84, I/YR = 2.5, N = 2, \) mode = Beg, and \( PV = 165.95. \) Reduce to present value: \( FV = 165.95, N = 11, I/YR = 2.5, \) and \( PV = 126.48. \) The remaining child is sixteen. Thus, \( PMT = 60, I/YR = 2.5, N = 2, \) mode = Beg, and \( PV = 118.54. \) Reduce to present value: \( FV = 118.54, N = 13, I/YR = 2.5, \) and \( PV = 85.99. \) Total present value is \( ($1,053.22 + $126.48 + $85.99) = $1,265.69. \)
55 Spouse A reduces income by $1,341.38, saving $341.38 in tax and saves $1,265.69 in present value child support. The net is $120,265.69 after taxes and after accruing child support.
5. New York Calculations

   i. Increased Income

If New York Spouse A increases income $1,000.00, Spouse A owes $331.50 additional tax, resulting in $120,668.50. Spouse A owes $193.87 extra annual child support with the increase dropping as each child reaches twenty-one. The present value of eighteen years of increases equals $2,707, ignoring alimony and property division. Spouse A will view the $331.50 additional tax as a tax but should also view the $2,707 as a 405% “child support tax” on the increased net income.

Notice the bottom line. Before the increased income, Spouse A had $120,000. After increasing income by $1,000, Spouse A has only $117,961.07 after tax and the increased support obligation. Perhaps Spouse A would be pleased knowing the government and his/her ex-spouse received more money, but perhaps not. More likely, Spouse A thinks “I worked harder to earn an extra $1,000. But I ended up with over $2,000 less. Together, my ex-spouse and the government took the entire $1,000 plus another $2,000.”

Arguably, Spouse A would only notice the current $193.87 child support increase; however, that is almost certainly mistaken. Spouse A will logically feel “I must pay this for eighteen years.” If Spouse A seeks a new spouse, he/she will reasonably view Spouse A as having extra “baggage”—the obligation to pay the child support (all of it, not just the marginal) for many years. Although they may not reduce the obligations to present value, they are likely to approximate them mentally.

Spouse A is logically less likely to value the $1,000 income as also continuing for eighteen years. Perhaps it will not continue. It nevertheless creates the continuing increased obligation, absent Spouse A seeking an expensive—and unlikely—downward modification. Or perhaps Spouse A

56 See supra note 44 (accounting for the New York tax rate).
57 An after-tax income of $668.50 times the 29% marginal child support tax equals $193.87.
58 The 405% “child support tax” times $668.50 equals $2,707.43.
59 A $1,000 income plus $120,000 less $331.50 tax less $2,707.43 accrued child support equals $117,961.07.
60 Courts may impute income if a spouse works less. Florida has similar, but distinct, rules for imputing service-income for alimony and child support. FLA. STAT. § 61.30(2)(b) (2023) (imputed income for child support for under-employed spouse); FLA. STAT. § 61.08(3)(e) (2023) (imputed income for alimony). The child support statute rebuttably presumes an amount equal to the “median income of year-round full-time workers . . . .” FLA. STAT. § 61.30(2)(b) (2023). A court may not impute service-income “at a level that a party has never earned in the past, unless recently degreed, licensed, certified, relicensed, or recertified and thus qualified for, subject to geographic location . . . .” FLA. STAT. § 61.30(2)(b)(2)(b) (2023). Thus, if Spouse A stops earning the extra $1,000, the court will likely impute the income to him/her and thus continue the obligation. If, instead, Spouse A did not accept the extra work, the increased obligation would not exist. Indeed, if Spouse A merely deferred the work for a year, the obligation would
places little value on the continued wage increase because it requires continued additional effort, which costs Spouse A time and energy. Spouse A might logically view the continued wage as forced—metaphorically as indentured servitude. Spouse A must continue the extra work to pay the extra tax, child support, alimony, and property division. Logically, Spouse A views the increased child support, alimony, and property obligations as real and as negatives. Spouse A likely also views the increased work obligation, at least in part, negatively.  

### ii. Decreased Income

Alternatively, suppose New York Spouse A reduces income by $1,000, dropping it to $119,000. This could result from incurring $1,495.89 additional expenses or by similarly reducing gross income. Perhaps Spouse A spends the money painting his/her office, which was due for a paint job. Thus, it is a matter of timing and not an extra expense. Spouse A saves $495.89 tax to produce a net $1,000 income reduction, although the savings might be temporary. Spouse A’s child support obligation drops $4,050 in present value terms. The child support decrease is permanent, absent a modification, which Spouse A could avoid by future planning.

Once again, the bottom line is illuminating. Spouse A reduces nominal income by $1,495.89 but increases net worth by $3,050. Spouse A has more money from earning less. Spouse A pays less to the government, which pleases Spouse A. Spouse A also pays significantly less to Spouse B, the ex-spouse. Plus, Spouse A works less or receives a cost-free paint job. Spouse A might consider saving the windfall in a children’s education account.
without funneling it through Spouse B. Spouse A might think “I work less, the government takes less, my ex-spouse gets less, I keep my current income, and I can save $3,000 for my kids or perhaps take them on a holiday. Or, I have my office painted and it cost me nothing. Where is the downside?”

The downside is that Spouse B receives $4,050 less child support over the ensuing eighteen years in present value terms. Effectively, Spouse B pays for the paint job as well as for the savings account or vacation. Whether that “hurts” the kids is debatable. States may not require an accounting to show “child support” is expended supporting the children. Spouse B would likely say that it is spent for the children, but Spouse A may be doubtful.

B. Alimony

Alimony obligations vary and are subject to different factors than child support. Some states have guidelines, while many others—such as Florida—do not. Alimony obligations vary by marriage length as well as spousal employment opportunities. In the example, Spouse B is a good candidate for alimony: Spouse B has minor children, no work history, and a long marriage. One commonly used alimony calculator predicts the obligation as 30% of the payor’s income less 20% of the recipient’s. Thus, a dollar increase in Spouse A’s income produces a 30% marginal alimony rate.

have approximately $6,317 in current, uninflated dollars. If inflation averages 3% over the ensuing eighteen years, Spouse A will accumulate approximately $10,617 in a tax-free educational savings account. See I.R.C. § 529(c)(1).

Like many states, Florida and New York lack any effective requirement that a recipient spouse account for how child support is spent. Payors may ask courts to order an accounting. See FLA. STAT. § 61.13(1)(a)(2) (2023) (“The court initially entering a child support order has continuing jurisdiction to require the obligee to report to the court on terms prescribed by the court regarding the disposition of the child support payments.”). Also, misapplication of child support is a misdemeanor. See FLA. STAT. § 827.08 (2023) (“A person shall be deemed to have misapplied child support funds when such funds are spent for any purpose other than for necessary and proper home, food, clothing, and the necessities of life, which expenditure results in depriving the child of the above-named necessities.”). New York payors can seek a modification if child support misuse constitutes a “substantial change in circumstances.” N.Y. FAM. CT. LAW § 451(3)(a) (Consol. 2023); see also N.Y. PENAL LAW § 260.06 (Consol. 2023) (non-support of a child).

E.g., N. Y. DOM. REL. LAW §§ 236 Part B (6)(c)–(d) (Consol. 2023).

Id.; FLA. STAT. §§ 61.08(2)(b), (3)(b)(a) (2023).

E.g., FLA. STAT. § 61.08(3)(e) (2023).

As with child support, alimony often lasts many years. Permanent alimony can last until either spouse dies, subject to modifications. Typically, a recipient’s re-marriage or co-habitation terminates alimony. Arguably, the higher the alimony, the lower the re-marriage risk because re-marriage is costly. In the example, Spouse B has been out of the labor force for at least ten years in a long-term marriage with three young children. Spouse A plausibly must pay Spouse B alimony for ten to twenty years.

For each marginal income dollar, the present value of Spouse A’s New York alimony obligation plausibly increases $2.69 and the Florida obligation by $4.79. To Spouse A, that is a New York 269% “alimony tax” or a Florida 479% tax. Combined with child support—including child support/alimony interrelation—the New York marginal “family support” tax is plausibly 552% and the Florida rate is 557%. Comparatively, the marginal income tax rates of about 33% and 25% appear insignificant.


76 A 20-year Florida marriage plausibly results in twenty years of alimony, although it could be longer. Fla. Stat. § 61.08(5) (2023). Set PMT = 0.3, I/YR = 2.5, N = 20, mode = Beg, and PV = 4.79366740.

77 Computations use pre-tax dollars. Until 2018 alimony was tax-deductible by payors and includible by recipients; hence, pre-tax dollars were appropriate. In 2018 the deductibility/inducibility was nominally repealed, which supports the use of after-tax dollars. That reduces the percentages by one-fourth to one-half. Because post-2018 alimony and child support can result in exclusions/inclusions, using pre-tax dollars remains defensible. See Willis, Alimony, supra note 1, at 867.

78 Spouse A’s New York alimony present value rate is about 269%. Because Spouse A and Spouse B share child support by relative income, Spouse A’s child support present value rate is 70% of the child support 405% rate, equaling 283.5%. Combined with alimony, that adds to a 552.5% rate.

79 With 30% alimony, Spouse A’s income is $84,000 and Spouse B’s is $36,000 (30% of 120,000). Spouse A’s child support share drops to 70% of the amounts computed. See discussion supra note 30. Thus, Spouse A’s “child support tax” drops from 111% to 77.7%. The combined “alimony tax” and “child support tax” is 479.4 + 77.7 = 557.1%.
1. Florida Alimony Calculation with and Without Child Support

   i. Increased Income

   If Florida Spouse A increases income by $1,000, Spouse A owes $254.50 additional tax, resulting in $120,745.50. Spouse A owes $223.65 additional annual alimony, with a $3,570.95 present value, ignoring child support and property division. Spouse A views the $254.50 tax as a tax but should also view the $3,570.95 accrued alimony as a 479% “alimony-tax.”

   Spouse A and Spouse B now share child support with Spouse A owing 70% and Spouse B, 30%. Spouse A’s present value marginal child support share would be 77.7%. Combined with alimony, Spouse A owes Spouse B $5.57 per marginal dollar—in present value terms—for combined alimony and child support. Thus, Spouse A’s $745.50 after-tax wage increase generates combined child support and alimony obligations with $4,152.44 present values.

   Notice the bottom line. Spouse A’s gross income increases from $161,000 to $162,000. Spouse A’s after-tax income increases to $120,745.50. Spouse A’s nominal take-home, after taxes, alimony and child support increases from $82,043.50 to $82,515.77. That is an annual income statement viewpoint in which Spouse A keeps $472.27 of the $1,000, ignoring property division. But viewing this on Spouse A’s balance sheet, Spouse A’s net worth drops from $82,043.50 to $78,636.56. That is an accrual viewpoint, which, in an accountant’s eye, is superior.

   Spouse A (and anyone contemplating marrying Spouse A) would likely take the balance sheet viewpoint. They may not accurately value future obligations, but they will view them as existing currently. Prior to the change, Spouse A would view the 20-year $36,000 alimony as a
$575,240.09\textsuperscript{88} debt. Spouse A would view the child support award as a $22,869.81\textsuperscript{89} debt. The total is $598,109.90. But with the $1,000 increased wage, Spouse A would see the alimony and child support obligations increasing $4,152.44 to total $602,262.34. Creditors and potential future spouses would likely have that same viewpoint. That is a real debt payable over twenty years. It might decrease, but it also might increase. Plus, we still have not considered the property division consequences.

Spouse B will view the alimony and child support awards as assets: tax-free annuities worth almost $600,000. This will be particularly apparent to Spouse B if he/she seeks re-marriage, which would trigger an alimony loss. From Spouse B’s viewpoint, remarriage costs $575,000.

Spouse B also will view child support and alimony as potential taxes. Suppose Spouse B begins earning $30,000/year after tax.\textsuperscript{90} Using the common alimony formula, Spouse B’s alimony drops by $6,000/year\textsuperscript{91} and Spouse B’s child support share increases facially by $4,494,\textsuperscript{92} but A’s drops by only $1,644.\textsuperscript{93} For the first year, Spouse B experiences a 25.5% “family-

\textsuperscript{88} The \textit{PMT} = 36,000, \textit{I/YR} = 2.5, \textit{N} = 20, \textit{mode} = \text{Beg}, \text{and} \textit{PV} = 575,240.09.

\textsuperscript{89} For eleven years, Spouse A owes 70% of $2,795: $1,956.50. Then, for two years, Spouse A owes 70% of $2,228: $1,559.60. Finally, for two years, Spouse A owes 70% of $1,437: $1,005.90. See Fla. Stat. § 61.30(6) (2023). The \textit{PMT} = 1,956.50, \textit{I/YR} = 2.5, \textit{N} = 11, \textit{mode} = \text{Beg}, \text{and} \textit{PV} = 19,079.91. After the oldest child reaches 18, \textit{PMT} = 1,559.60, \textit{I/YR} = 2.5, \textit{N} = 2, \textit{mode} = \text{Beg}, \text{and} \textit{PV} = 3,081.16. Reduce to present value: \textit{FV} = 3,081.16, \textit{N} = 11, \textit{I/YR} = 2.5, \text{and} \textit{PV} = 2,348.29. For the last child, \textit{PMT} = 1,005.90, \textit{I/YR} = 2.5, \textit{N} = 2, \text{mode} = \text{Beg}, \text{and} \textit{PV} = 1,987.27. Reduce to present value: \textit{FV} = 1987.27 \textit{N} = 13, \textit{I/YR} = 2.5, and \textit{PV} = 1,441.61. The sum of the present values is ($19,079.91 + $2,348.29 + $1,441.61), which equals $22,869.81.

\textsuperscript{90} If Spouse B starts a business, Spouse B must earn about $37,000 to generate $30,000 after-tax, using 2023 rates. The key figure is the after-tax amount of $30,000, but the before-tax amount adds some perspective. Spouse B would likely file as a head of household, which would generate a $20,800 standard deduction in 2023. I.R.C. § 63; Rev. Proc. 2022-38, 2022-45 I.R.B. 445. Spouse B may have other deductions or credits, which are extraneous to the example. Spouse B’s major tax would be the self-employment tax, which would be $5,661 (15.3% of $37,000). I.R.C. § 1491. Spouse A would deduct half of that amount for determining section 62 adjusted gross income. I.R.C. § 164(f). If Spouse A had $37,000 gross income and deductions of $20,800 (standard deduction) and $2,830.5 (half of $5,661), Spouse A would have taxable income of $13,369.50. Spouse A would be in a 10% tax bracket (ignoring other deductions and credits) which would generate a tax of $1,336.95. I.R.C. § 1. In short, $37,000 less $6,997.45 taxes ($5,661.50 plus $1,335.95) equals $30,002.55.

\textsuperscript{91} Using the calculator cited supra note 71, alimony equals 30% of Spouse A’s income minus 20% of Spouse B’s. Thus, 20% of $30,000 is $6,000.

\textsuperscript{92} Because combined parental income increases $30,000, total child support increases from $33,540 to $36,390, a $2,850 increase (9.5% of 30,000). Spouse A has $90,000 income after alimony ($120,000 minus $30,000) and Spouse B has $60,000. Spouse B’s child support share increases from 30% of $33,540 to 40% of $36,390 (from $10,062 to $14,556). The increase is $4,494 in the first year, which would appear to be a 14.98% tax.

\textsuperscript{93} Spouse A’s child support share changes from 70% of $33,540 to 60% of $36,390 (from $23,478 to $21,834) a $1,644 decrease. That would appear as a 5.48% tax to Spouse B who receives less because he/she has greater income. Spouse B suffers the entire increased $2,850 child support in theory, but in practical terms nothing requires Spouse A to spend the $2,850 which Spouse B owes to himself/herself. Thus, logically Spouse B will view only the $1,644 decrease as a tax.
tax” on top of about 19% income tax. Spouse B likely experiences higher childcare, transportation, clothing, and household chore costs, as well. Counsel must explain to Spouse B that by starting the business—perhaps to help with divorce related costs—Spouse B must likely continue the effort. Quitting in a year or two would risk having the court impute income to Spouse B. In present value terms, Spouse A’s alimony obligation to Spouse B drops by about $95,873,\(^4\) which Spouse B suffers because of his/her added work. Spouse A’s child support obligation to Spouse B drops, in present value terms, by $19,332.91,\(^5\) for a total $115,206 decrease. If small businesses are worth about four times earnings,\(^6\) then Spouse B’s new venture is worth $120,000. What Spouse B gains from the effort, Spouse B loses from a decreased annuity from Spouse A. It almost zeros out. If rational and well-informed, Spouse B will think, “Why bother?”

\(\text{ii. Decreased Income}\)

Alternatively, suppose Florida Spouse A reduces income by $1,000, dropping it to $119,000. Spouse A’s alimony obligation drops $300/year, with a $4,793.67\(^7\) present value. Child support drops $75.60\(^8\) initially, with a $885.98\(^9\) present value.

Recall, Spouse A’s decrease may result because Spouse A painted his/her office at a $1,341.38 cost. The expense saved $341.38 tax plus immediately $375.60 in alimony and child support. The paint job cost only $624.40 out of pocket, which is akin to 50% off. Because child support and alimony are a function of Spouse A’s income at the time of the divorce, Spouse A would save the present value of the continued reductions, absent a modification. As a result, the paint job saved Spouse A $4,679.65.\(^{100}\)

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\(^4\) The \(PMT = 6,000, I/YR = 2.5, N = 21,\) mode = Beg, and \(PV = 95,873.35\).

\(^5\) As computed supra note 93 for eleven years, Spouse A’s payment to Spouse B drops $1,644/year. Then for two years it drops from 70% of $26,736 to 60% of $28,846 ($1,407.60/year). Then from 70% of $17,244 to 60% of $18,744 ($824.40/year for two years). The present value is $16,032. The \(PMT = 1,644, I/YR = 2.5, N = 11,\) mode = Beg, and \(PV = 16,032\). After the oldest child reaches eighteen, \(PMT = 1,407.60, I/YR = 2.5, N = 2,\) mode = Beg, and \(PV = 2,780.87.\) Reduce to present value: \(FV = 2,780.87, N = 11, I/YR = 2.5,\) and \(PV = 2,119.43.\) For the last child, \(PMT = 824.40, I/YR = 2.5, N = 2,\) mode = Beg, and \(PV = 1,628.69.\) Reduce to present value: \(FV = 1,628.69, N = 13, I/YR = 2.5,\) and \(PV = 1,181.48.\) The sum of the present values is \((16,032 + 2,119.43 + 1,181.48),\) which equals $19,332.91.

\(^6\) See discussion infra notes 120–121.

\(^7\) The $1,000 income decrease times the 479.367% “alimony-tax” equals $4,793.67, which Spouse A would not owe. See the computation supra note 76.

\(^8\) Child support drops from $2,795/month to $2,786/month which is $108/year. Spouse A’s 70% share of the decrease is $75.60.

\(^9\) The child support present value decreases by 70% of the $1,265.69 computed supra note 54.

\(^{100}\) The $1,341.38 cost less $341.38 tax, $885.98 child support, and $4,793.67 alimony equals $4,679.65.
2. New York Calculation

i. Increased Income

If New York Spouse A increases income by $1,000, A owes $331.50\textsuperscript{101} additional tax, resulting in $120,668.50. Spouse A owes $200.55\textsuperscript{102} additional annual alimony, with a $1,799.11\textsuperscript{103} present value, ignoring child support and property division. Spouse A will view the $331.50 tax as a tax but should also view the $1,799.11 increased alimony as a 269% “alimony-tax.”

Spouse A’s child support increases $135.71\textsuperscript{104} annually with a $1,895.20\textsuperscript{105} present value. Spouse A’s annual total support obligation increases $336.26, leaving Spouse A with only $432.24\textsuperscript{106} annually from the $1,000 extra income. Once again, the “family-tax”—ignoring property division—exceeds the income tax. In present value terms, Spouse A’s support obligation increases $3,595.31.\textsuperscript{107} At most, Spouse A will view the increased income as worth only $432. Upon reflection, Spouse A will quickly see the continuing increased obligations and thus the continuing need for the extra work from which he/she receives less than half.

If, instead, Spouse A delayed the extra work for one year, he/she would keep the after-tax amount of $668.50. Spouse A might see the “family-tax” increases in a New York modification hearing after three years,\textsuperscript{108} but Spouse A would also have time to plan for that.

ii. Decreased Income

Alternatively, suppose New York Spouse A reduces income $1,000, dropping it to $119,000. Spouse A’s alimony obligation drops $300/year,
with a $2,691.26\textsuperscript{109} present value. Annual child support drops $203\textsuperscript{110} initially, with a $2,835\textsuperscript{111} present value.

The hypothetical paint job nominally costs $1,495.89, but after tax, alimony, and child support, it appears to cost only $497,\textsuperscript{112} which is two-thirds off. In present value terms, ignoring property division, it saves Spouse A $4,526.26.\textsuperscript{113}

Suppose the paint job was a one-time expense, and Spouse A’s subsequent income returned to $120,000. Without further planning, Spouse A risks a three-year modification hearing,\textsuperscript{114} which could restore the alimony and child support savings. Still, Spouse A would have the savings for three years as opposed to the hypothesized ten and eighteen. Because near-term savings are more valuable than those for later years, the present value would be $1,472.49.\textsuperscript{115} It remains a profit from an expense. After taxes and using a three-year term, moving the paint job from next year to this year saves Spouse A $472.49.\textsuperscript{116} The paint is effectively free, and Spouse A has real money that should be simple to visualize because it is spread over only three years rather than eighteen. Plus, that does not include the property division consequences, which will likely save an additional $2,000.

\textbf{C. Property Division}

Property division, whether equitable-distribution or community-property, does not directly involve income; however, asset values vary by the income they produce. Generally, assets are worth the present value of their future utility. For financial assets, future income and principal streams inherently produce the present value. Spouse A’s closely held business’s value is a function of many things.\textsuperscript{117} Fair market value of assets less

\textsuperscript{109} The \textit{PMT} = 300, I/YR = 2.5, N = 10, mode = \textit{Beg}, and \textit{PV} = 2,691.26.
\textsuperscript{110} This equals 70\% of $290, which is 29\% of $1,000.
\textsuperscript{111} This equals 70\% of the $4,050 used \textit{supra} note 64.
\textsuperscript{112} This equals $1,495.89 less $495.89 tax savings less $300 alimony savings less $203 child support savings.
\textsuperscript{113} This equals $1,000 less $2,691.26 alimony savings less $2,835 child support savings, which equals $4,526.26.
\textsuperscript{114} See \textit{supra} note 108.
\textsuperscript{115} The \textit{PMT} = 503, I/YR = 2.5, N = 10, mode = \textit{Beg}, and \textit{PV} = 1,472.49.
\textsuperscript{116} Spouse A spends $1,495.89 but saves $495.89 tax and $1,472.49 alimony and child support.
\textsuperscript{117} Courts typically choose among three valuation methods. Testimony cited in a 2020 Nebraska appellate court’s opinion explained:

There’s asset approach, and what you’re doing there is you’re looking at the hard assets of the company, you’re looking at the liabilities of the company and you’re really just subtracting off those liabilities from the assets and coming up with what the value is. That’s kind of the asset approach.
liabilities is a common method for business valuation. Capitalization of earnings is another. While expert witnesses may combine methods, this part focuses on the present value of expected future earnings.

Publicly traded entities often trade at fifteen to twenty times earnings, and sometimes far more. Smaller, closely held businesses typically sell for lower earnings multiples, with three to four being plausible. Thus, each marginal-earnings-dollar can result in a four-dollar valuation increase.

1. Revised Example

For property division, consider this revised example:

*Spouse A*’s income results from operating a bakery in which *Spouse B* does not participate. *Spouses A and B* also have savings worth $500,000.

With annual $120,000 net income, the bakery might reasonably be valued at $480,000. In the property division, *Spouse A* likely receives the

There’s a market approach. Most people would be familiar with that from a real estate perspective. It’s—you know, when you’re do [sic] real estate you look at a house—if you can find a house across the street that sold and it’s the same as your house, it’s a good indication of what your house is. The same thing with business valuation. If you can find the sale of another business like your business that you’re valuing, it’s a good indication of what your business is worth. So that’s kind of the market approach.

And then the last approach is the income approach. Again, you’re looking at the financial benefits of the company, the income of the company and you’re translating that into a value. You’re converting that income stream to a value and that’s the income approach.


120 Valuing small businesses is complex and beyond this Article’s scope. Experts use multiple methods and various earnings measures, such as EBIT (earnings before interest and taxes) or EBITDA (earnings before interest, taxes, depreciation, and amortization). Some use revenue multiples and most use multi-year averages. The multiple varies by business size, with larger businesses having higher multiples. Very small businesses may result in a multiple of merely 1.5. Multiples vary by industry and business age. New businesses often fail, justifying a lower multiple than a more established firm. See, e.g., Ryan Hammon, *What’s the Value of My Business? The Ins and Outs of EBITDA Multiples*, CRONKHITE CAP. GRP. (Apr. 1, 2019), https://www.cronkhitecapital.com/articles/2019/4/1/business-valuation.

121 This is particularly true for retained earnings. The multiple is a function of expected future earnings. Current retained earnings may exist as cash or other marketable assets. That, combined with a conservative multiple of three for future earnings, produces four.
bakey and Spouse B receives $480,000. A and B equally split the remaining $20,000.

If the bakery increases after-tax income by $1,000, its value increases $4,000. As a result, Spouse B receives $4,000 additional cash, leaving only $16,000 for Spouse A and Spouse B to divide. Without the increased value, Spouse A receives $10,000 cash, but now Spouse A receives only $8,000. Thus, if the bakery earns one extra dollar, Spouse A loses two dollars of property division.

Before we look at the broader consequences of increased or decreased income, stop to consider the consequences to Florida Spouse A. Together, the family has $980,000—the bakery plus the savings. Spouse A receives the $480,000 bakery plus $10,000 and Spouse B receives $490,000. That is equal. But, as calculated earlier, Spouse A owes a debt to Spouse B of $598,109.90 and Spouse B has a $598,109.90 annuity receivable from Spouse A. Spouse A has a net worth of $108,109.90. Spouse B has a $1,088,109.90 net worth. Of the $980,000 family assets, Spouse B gets 111%. Spouse A receives less than zero.

To be fair, Spouse B could have “income” from the large amount of cash. If this “income” counts, then Spouse B receives less alimony and child support. However, it might not count. Perhaps a large portion is the family home, rather than cash. Living in the house is economic income. But for tax purposes and likely for family law purposes, it is irrelevant. Or Spouse B might invest in growth stocks which pay little, if any, dividends.

122 The alimony present value is $575,240.09. See discussion supra note 88. The child support present value is $22,869.81. See discussion supra note 89.

123 Spouse A has a bakery worth $480,000 plus $10,000 cash less a $598,109.90 obligation.

124 Spouse B has $490,000 cash plus annuities from Spouse A worth $598,109.90.

125 “The rental value of the building used by the owner does not constitute income within the meaning of the Sixteenth Amendment.” Helvering v. Indep. Life Ins. Co., 292 U.S. 371, 379 (1934).

126 Vermont and West Virginia statutorily exclude residences. VT. STAT. ANN. tit. 15, § 653(5)(A)(i) (2023); W. VA. CODE § 48-1-205(d) (2023). Many states exclude residences through courts. E.g., In re Marriage of Gibbs, 446 P.3d 968, 971–72 (Colo. App. 2019); In re Marriage of Minkler, No. B242915, 2013 WL 6157351, at *5 (Cal. Ct. App. Nov. 25, 2013) (distinguishing residences from other assets, finding husband’s all-cash purchase of a $600,000 residence was not an attempt to minimize investment income); Levine v. Levine, 29 So. 3d 464, 464–65 (Fla. Dist. Ct. App. 2010); Powell v. Powell, 107 S.W.3d 222, 225 (Ky. 2003) (declining to impute income on assets needed to purchase a residence); id. at 227 (Keller, J., concurring in part and dissenting in part) (noting that the marital residence obviated the need for rent).

127 States routinely include dividends in income but often exclude non-recurring gains. E.g., FLA. STAT. §§ 61.30(2)(a)(10), (14) (2023).

128 Florida has similar, but distinct, rules for imputing service-income for alimony and child support. Fla. Stat. § 61.08(3)(e) (2023) (alimony); id. § 61.30(2)(b) (2023) (child support). The child support statute rebuttably presumes an amount equal to the “median income of year-round full-time workers . . . .” Id. A court may not impute service-income “at a level that a party has never earned in the
inconsistent when dealing with under-performing assets. With modest planning, Spouse B could make any income from the $490,000 disappear.

2. Florida

i. Increased Income

The examples and the “family-tax” factors combined present Spouse A with a bleak picture. If Spouse A’s bakery increases gross income from $161,000 to $162,000, Spouse A receives an extra $745.50 after taxes, but annually pays $223.65 extra alimony and $49.58 extra child support. In addition, Spouse A receives $1,491 less cash in property division. Looking
just at the one year, Spouse A loses $1,018.73.\textsuperscript{133} In present value terms, Spouse A’s worth drops $4,897.94,\textsuperscript{134} despite the increased income. Spouse A has a strong incentive not to recognize the extra income. Spouse A’s overall “tax” rate is thus almost 590\%\textsuperscript{135} of the $1,000 gross income. The “family-tax” rate is a whopping 757\%\textsuperscript{136} of the $745.50 taxable income.

\textit{ii. Decreased Income}

Similarly, if Spouse A paints the bakery for $1,341.38, Spouse A saves $341.38 tax, $300 alimony, $75.60\textsuperscript{137} child support, and $2,000\textsuperscript{138} in property division. The immediate net cost is $1,375.60.\textsuperscript{139} The paint is free, and Spouse A has $1,375.60 more. Spouse A merely accelerated the paint job from next year to this year. Viewing the judgment as a whole—as Florida courts instruct—Spouse A’s net worth increases $6,679.65\textsuperscript{140} because Spouse A’s bakery earned $1,000 less after tax.

Alternatively, assume Spouse B obtains an alimony/child support modification in three years, restoring the consequences from the painting expense. The $2,000 property division award would not change. The present value of the three-year alimony reduction would be $878.23 and the three-year reduction in child support would be $221.31. Spouse A would have the deferred temporarily: Spouse A retains the ability to earn it, but by deferring it to next year, Spouse A does not create the extra “paper” value for the bakery and thus receives $1,491 more cash.

\textsuperscript{133} Specifically, $1,000 less $254.50 less $223.65 less $49.58 less $1,491 equals $1,018.73.

\textsuperscript{134} Spouse A receives $1,000 but pays $254.50 tax, owes $4,152.44 extra support, and receives $1,491 less cash. The net is $4,897.94.

\textsuperscript{135} Specifically, $254.50 income/excise taxes plus $5,643.44 family-tax ($4,152.44 + $1,491) equals $5,897.94 tax on $1,000, which approximates 590\%.

\textsuperscript{136} Specifically, $5,643.44/745.50 = 7.57, or 757\%.

\textsuperscript{137} See discussion supra note 98.

\textsuperscript{138} The bakery’s value appears to drop $4,000. As a result, Spouse A receives $2,000 extra cash. If the expense resulted from a mere deduction acceleration, the value drop would not be real. The bakery spends money painting the office but receives a better-painted office. For tax and accounting, Spouse A would not likely capitalize the cost, choosing instead to expense it. Economically, however, the paint exists—it is on walls rather than in cans. Eventually, it loses value, but that likely takes several years. Tax law and GAAP typically expense such items because they “even out” over time and they are \textit{de minimus}. For tax law, see generally the capitalization rules of I.R.C. § 263. Family law, however, does not examine an entity over time; instead, it typically examines a single year or two. That creates distortions; thus family-tax magnifies the \textit{de minimus} into the consequential.

\textsuperscript{139} This is the $1,341.38 cost less $341.38 tax saving less $300 alimony saving less $75.60 child support saving less $2,000 property division saving, which equals -$1,375.60.

\textsuperscript{140} Spouse A spends $1,341.38, saves $341.38 tax, saves $4,793.67 (lower alimony obligation), saves $885.98 (lower child support obligation), and receives $2,000 additional cash for a net $6,679.65 increase. The paint expense reflects traditional tax and GAAP accounting, but does not reflect a true cost, as the painted office would be nicer. The increase is probably closer to $7,679.65 because the value remains. The “paper” loss in value of the bakery would not be real because it merely involves an expense acceleration.
same bakery but would be better off by $2,099.54. All Spouse A did was accelerate the paint job by perhaps a few months. Or, instead of the painting, Spouse A might have purchased a new mixer or a new sign, done a “deep clean” of the bakery, repaired some equipment, or a combination of small items totaling $1,341.38. Each might have been on Spouse A’s “to do” list. Spouse A merely did them a bit early. Spouse B could have a dozen “experts,” but on what basis could an expert challenge these things which hide amongst perhaps hundreds or even thousands of routine business decisions? The answer is the expert could not. Spouse A could make similar future decisions, which would erase potential modification consequences.

3. New York

i. Increased Income

Combining examples and factors for New York has a similar impact. Increasing the bakery’s income from $182,000 to $183,000 results in an after-tax increase from about $120,000 to $120,668.50. Spouse A’s alimony increases annually by $200.55, child support by $135.71, and property cash division drops by $1,337. Looking just at the one year, Spouse A loses $1,000.94. In present value terms, A’s worth drops $4,362.99. Spouse A has a strong incentive not to produce the extra income or to defer it until next year.

ii. Decreased Income

Alternatively, suppose New York Spouse A reduces net income by $1,000, dropping it to $119,000. Spouse A’s alimony obligation drops $300/year, and $2,691.26 in present value. Annual child support drops $203 initially, with a $2,835 present value. Spouse A also receives

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141 This is because 30% of $668.50 equals $200.55.
142 This is because $668.50 (increased income) times 0.29 (child support rate) times 0.7 (Spouse A’s share of child support) equals $135.71.
143 Twice the $668.50 increased income is $1,337. See discussion supra note 129.
144 Spouse A would receive $1,000, pay $331.68 extra tax, $200.55 extra alimony, $131.71 extra child support, and would receive $1,337 less cash in property division for a net loss of $1,004.94.
145 Spouse A would receive $1,000, pay $331.68, owe $1,799.11 increased alimony obligation, $1,895.20 increased child support obligation, and would receive $1,337 less cash. The net is a loss of $4,362.99.
146 The PMT = 300, I/YR = 2.5, N = 10, mode = Beg, and PV = 2,691.26.
147 Specifically, 70% of $290. The $290 is 29% of $1,000.
148 Specifically, 70% of the $4,050 used supra note 64.
$2,000 more cash in the property division, although the “paper” value of the bakery would drop by $4,000. Ignoring the “paper” loss, Spouse A’s financial position would improve by about $7,500. That occurs from spending money Spouse A was going to spend anyway.

If, as is likely, the income decrease resulted from an acceleration of expenses, the $4,000 value drop would lack economic reality. It exists because of how family law valuations occur. First, they tend to be based on short terms, which magnifies distortions. Second, if the bakery were for sale, Spouse A would avoid the deduction accelerations, disclose them thoroughly, or choose to capitalize them. They would be known. In family law, however, they would be unknown, easily masked, and difficult to detect by Spouse B.

III. REALITY VERSUS PERCEPTIONS OF THE “FAMILY-TAX”

A. Is the Family-Tax Rate Real?

Yes and no. The answer is equivocal because the rate flows from family law’s artificially short timeframe as well as from the antagonistic nature of divorce. The rate is a perception. Perceptions often have real effects, so one should not dismiss them hastily. The game is real, even if the numbers are not.

Three issues are noteworthy:

- Family law accounting is not reality-based.
- Support obligations vary.
- Future income is uncertain.

Understanding these issues will help the reader understand the reality of the perception. First, consider a broader example, which has its own issues:

If Spouse A has $1 extra income, Spouse A has $5 extra obligations, using a 500% “family-tax” rate. Arguably, this comparison is false because Spouse A may earn the extra income in future years. Assuming a 20-year timeframe, the present value of the income stream, if it continues, is

149 Spouse A has $2,000 more cash, a $2,835 lower child support obligation, and a $2,691.26 lower alimony obligation for a $7,526.26 total. The paint expense is irrelevant because it is likely a short-term acceleration and merely affects cash flow rather than income or value. Tax law and GAAP allow such treatment because the elements recur frequently: what one might accelerate to this year, one loses for next year. I.R.C. sections 162 and 263 would permit expensing of such routine items. Also, small accelerations and deferrals tend to cancel out when one examines multiple years and longer timeframes, as occurs in both tax law and accounting. That longer timeframe tends not to exist in family law, which is the root of the problem.
From that standpoint, the family-tax is only about 32%.\textsuperscript{151}

1. Family Law Accounting is Not Reality-Based

Family law accounting is flawed. Unfortunately, the flaws are not easily overcome. Four factors are particularly significant. \textit{First}, family law accounting typically uses the cash method of accounting, which does not clearly reflect income.\textsuperscript{152} In contrast, GAAP and IFRS use accrual accounting. But accrual accounting is complex and expensive to apply. Requiring it is unrealistic.

\textit{Second}, family law typically focuses on one or two years, which makes manipulation much simpler.\textsuperscript{153} In contrast, audited financial statements typically compare multiple years.\textsuperscript{154} Ultimately, proper financial analysis considers all years. Looking at a bigger picture would be helpful, but it would also be expensive, complicated, and unrealistic.\textsuperscript{155}

\textit{Third}, audits are rare. They exist for big business, but for entities within the posited income framework, they are likely non-existent. Or, if an audit exists, it is also flawed, as discussed below in relation to experts.\textsuperscript{156} Requiring audits, especially multi-year ones, would be prohibitively expensive and likely impossible.

\textsuperscript{150} The $15.59 = 1, I/YR = 2.5, N = 20, mode = \textit{End}, and PV = 15.589. The calculation uses end mode because, unlike the obligation, the income would not exist immediately.

\textsuperscript{151} This is because $5/15.59 is approximately 32%.


\textsuperscript{154} See supra note 155 and accompanying text.
Fourth, family law too often relies on income reported for tax purposes, which is often the worst possible measure. Tax law exists to raise revenue, not to clearly reflect income. For political or economic purposes, it allows many artificialities. By often relying on “tax income,” family law puts a stamp of approval on legal manipulation. But tax books are typically the only ones people have. Reconciling tax statements with GAAP statements is complex. Requiring it in the family law arena is not feasible.

Thus, the accounting is not real, but it is what we have. And that will not change.

2. The Obligation Varies

The main example herein uses a long marriage, three young children, and a spouse who does not work outside the home. Change those facts and the resulting obligation may be higher, but it also may be significantly lower.

With these assumptions, the $5 obligation is realistic, albeit contingent. It is subject to child support or alimony modifications. Modifications, however, are expensive, requiring court costs, attorney fees, and expert witness fees. They are subject to statutory standards such as a “substantial” change or the passage of three years. They can cause obligations to increase or decrease. They are unlikely to occur frequently, let alone annually. Also, even short-term obligations are substantial. As shown earlier,

157 N.Y. DOM. REL. LAW § 240-1-b(5)(i) (2020). Although Florida does not refer to tax-return income, for business and rental income it uses tax terminology. FLA. STAT. § 61.30(2)(a)(3) (2023) (“Business income” means gross receipts minus ordinary and necessary expenses required to produce income.”) (tracking I.R.C. § 162); FLA. STAT. § 61.30(2)(a)(11) (2023) (“Rental income, which is gross receipts minus ordinary and necessary expenses required to produce the income.”) (tracking I.R.C. § 212).

158 For examples, see I.R.C. § 263 and related regulations (capitalization rules); id. § 704(b) (special allocations of income and deductions among partners); id. § 416(b) (repealed 1996) (artificial rules for accrual of deductions); id. § 197 (artificial intangible amortization); and id. § 168 (artificially short lives for depreciable assets).


160 FLA. STAT. § 61.14(1)(a) (2023) provides for alimony or child support modification if the “circumstances or the financial ability” of either party changes. FLA. STAT. § 61.13(1)(a)(2) (2023) allows child support modifications upon a “substantial change in the circumstances.” Guidelines may justify modification, but only if the change is at least 15% or $50. FLA. STAT. § 61.30(1)(b) (2023). New York provides for modification hearings upon a substantial change in circumstances, the passage of three years, or a 15% increase in income. N.Y. FAM. CT. LAW § 451(3)(b) (2019).

161 Marriage contracts may provide for waiver-of-alimony modification. FLA. STAT. § 61.079(4)(a)(4) (2023). Typically lump sum alimony and installment alimony are non-modifiable.

the “family-tax” is likely closer to 250% if we examine only three years. But a 250% rate—which is arguably 350%—is still shocking.

3. The Income Stream Is Uncertain

The “family-tax” rests on the existence or absence of future income. Increased income prompts large future obligations. The prior analysis values those future obligations, but mostly considers only a single year’s income. Arguably, the proper comparison is the present value of the future income with the present value of the resulting future obligations. Spouse A’s $1 income increase plausibly produces an obligation with a $5 present value. The income itself—if it continues—has a present value of $15.59 based on a twenty-year term and $8.75 based on ten years. With that viewpoint, the added obligation ranges from 32% to 57%. Those are hefty rates, but far lower than the 557% and 552% “family-tax” rates argued earlier.

But is the future income stream real? Maybe. The answer is complex. Added income may result because a court imputed it (or not), because the court or spouse altered the timing of it, or because a spouse performed (or failed to perform) extra work. Each source has its own analysis.

i. Imputed Income

Courts may impute asset income, although they often do not. That is central to the game theory. Spouse B will seek imputed income on Spouse A’s under-performing assets, and Spouse A will do the same for Spouse B’s. For example, Spouse B may invest the $490,000 property award in a residence. The use is economic income, but states typically do not recognize it as income. The tax savings apply to the non-imputed income, but the income continues, nevertheless. It is, however, irrelevant because it exists whether imputed or not. Only the consequences change.

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163 See supra note 116 and accompanying text. In that example, Spouse A saved $2,497 (including property division) by spending $1,000 after tax.
164 See supra note 163 and accompanying text. Spouse A also received the value from the expenditure which arguably creates a 350% return.
165 Family law uses current income to measure future obligations because current income predicts future income. Typically, states ignore isolated, non-recurring items. E.g., FLA. STAT. §§ 61.30(2)(a)(10), (14) (2023).
166 If current income increases $1, future obligations for child support and alimony typically increase by many times that amount.
167 See sources cited supra note 129 and accompanying text.
168 See sources cited supra note 126 and accompanying text.
Or a spouse may invest in growth stocks, undeveloped land, stripped preferred stock, market discount bonds, or a small business with retained earnings. Each produces economic income, which tax law mostly ignores.

169 General under-reporting issues involve “growth” stocks as opposed to those which pay frequent dividends. Legitimate, non-manipulative reasons exist for such investments. An owner-spouse may prefer capital appreciation because he/she has little need for current income. Tax law provides significant advantages to such investments. I.R.C. § 1(h). For family-support determinations, however, capital appreciation typically produces no putative income. For example, one investment may pay a 5% current dividend but show little appreciation. Another may pay no dividends but appreciate 5%. Family-support statutes often consider the first as producing 5% income and the second as producing zero. Fla. STAT. § 61.30(2)(a)(14) (2023). Before tax, the two are economically identical while after-tax, the second produces greater economic income.

170 Per I.R.C. § 1272, holders accrue original discount interest at least annually. They have four options to accrue or to defer market discount. I.R.C. § 1276(b)(1) (recognition at disposition, ratable-accrual); id. § 1276(b)(2) (recognition at disposition, constant-yield-accrual); id. § 1278(b)(1)(B) (election to include currently using either ratable or constant-yield-accrual). Because it provides for maximum deferral, taxpayers have an incentive to elect constant-yield-accrual. Deferral distorts income. Taxpayers would be foolish to elect section 1276(b)(1), which accrues early ordinary income potentially offset by less-valuable later-year capital losses. In contrast, holders have two premium-amortization options. I.R.C. § 1272(a)(7); Treas. Reg. § 1.1272-2(b)(5) (2023). The code method is arithmetic, resulting in deferral, while the regulation method uses an economically-constant-yield method. Preferring income-deferral, taxpayers likely use the code method. That will defer income for family law.

172 Many states exclude earnings retained. Florida allows owner-spouses to exclude undistributed earnings upon showing a “corporate purpose.” Zold v. Zold, 911 So. 2d 1222, 1233 (Fla. 2005). Similarly, Massachusetts allows retention for “legitimate business interests,” J.S. v. C.C., 912 N.E.2d 933, 943 (Mass. 2009); Minnesota for “business reasons,” Hubbard Cnty. Health & Hum. Servs. v. Zacher, 742 N.W.2d 223, 228 (Minn. Ct. App. 2007) (remanding for a factual determination of a business purpose for retention versus a manipulative purpose); and Rhode Island for a “legitimate business purpose,” Trojan v. Trojan, 208 A.3d 221, 235 (R.I. 2019). A 2014 Michigan opinion suggested the owner-spouse must show the retained amounts were “required” and are “necessary and legitimate.” Diez v. Davey, 861 N.W.2d 323, 332 (Mich. Ct. App. 2014). Although seemingly a high standard, the court largely deferred to the owner’s business judgment. It reversed the trial court, which relied on the non-owner’s expert who questioned the retention as outside standard business norms. Id. at 333. Rejecting the Massachusetts three-prong test, the Michigan court emphasized two factors: historical distributions and owner-spouse manipulation. Id. at 333 n.5. This is a roadmap for a manipulative spouse: for two to three years pre-divorce, retain at the high-end of industry averages. Requiring a “corporate purpose” for accumulations is a low threshold, satisfied with modest planning. Requiring a “legitimate” purpose adds little as courts presumably disregard illegitimate purposes. As Zold explained, a decision to retain earnings to disadvantage a spouse or children is not a legitimate purpose. What would be legitimate and reasonable? A list is easy to discern:

- Working capital, including inventory procurement. E.g., In re Marriage of Hein, 52 Cal. Rptr. 3d 150, 158 (Cal. Ct. App. 2020); Zold, 911 So. 2d at 1232; Roberts v. Wright, 871 P.2d 390, 393 (N.M. Ct. App. 1994).
- Expansion. Generally, states do not accept this reason. Massachusetts precludes it: “Earnings retained in order to expand the business, on the other hand, have the potential of increasing the business’s value and thus the shareholder’s personal net worth, and might properly be viewed as income available for child support—just as a distribution invested in another corporation would be.” J.S., 912 N.E.2d at 943 n.15.
- Anticipated repairs/maintenance/improvements.
- Debt retirement.
- A “rainy day” fund for anticipated competition or a weakening economy.
Perhaps a court will impute it, prompting the changed obligation. Or perhaps the court will not, which means the owner-spouse played the game well, and no obligation resulted. In either scenario, the income exists economically. The consequences appear as increased obligations from imputed income or lesser obligations from hidden income. The obligation changes but the income stays the same. Thus, the income is irrelevant, even in the current year. As a result, the “family-tax” rates are higher, not lower, than previously argued because we should not count the income at all.

**ii. Timing Income**

As illustrated earlier, income and deductions may change merely because of timing. A spouse may accelerate an inevitable cost from next year to this year (reducing income) or may postpone income from this year to the next (also reducing income). Or the opposite may occur. The family law accounting changes and the obligations change. But the income is unchanged; it is merely a matter of when we acknowledge it. The present

- Anticipated product liability/litigation costs.

A roadmap for such purposes appears in regulations. Treas. Reg. § 1.537-2 (2023) (accumulated-earnings tax). While the regulation does not apply to S-corporations (I.R.C. section 1361(a) exempts S-corporations from most taxes, including section 531 (accumulated-earnings) and section 541 (personal-holding-company undistributed-income)), the government-sanctioned list includes many of the above purposes. Further help for accumulator/manipulators flows from an understanding of the tax law “business purpose” doctrine: transactions reducing tax must satisfy a business purpose, rather than a tax-avoidance purpose. The tax doctrine has existed for decades. Over time, it proved inadequate and morphed into more extensive doctrines, e.g., Gregory v. Helvering, 293 U.S. 465 (1935) (business purpose, substance versus form); Knetsch v. United States, 364 U.S. 361 (1960) (sham transactions); Comm’r v. Gordon, 391 U.S. 83 (1968) (step-transaction doctrine); and statutes, e.g., I.R.C. § 267 (related-party rules); id. § 269 (acquisitions-to-avoid tax); id. § 355 (controlled-corporation distributions); id. § 482 (income/deduction allocations among controlled businesses); id. § 531 (accumulated-earnings tax); id. § 541 (personal-holding-company tax), id. § 465 (at-risk); id. § 469 (passive-activity); id. § 704(b) (partnership allocations); id. § 7701(o) (economic substance), which are arguably inadequate to prevent manipulation. A taxpayer needing to establish a business purpose or economic substance (or to avoid the sham and step-transaction doctrines) faces a knowledgeable adversary in the IRS; nevertheless, such taxpayers are all-too-often successful. Whether manipulative spouses face such a sophisticated adversary is doubtful. Regardless, the family law weapons arsenal is less than the IRS’s.

173 In one case, a husband/father testified he “was going to begin a new contract paying him $31,250 per month.” Jolene H.W. v. David P.W., No. 13-0535, 2014 WL 1272539, at *4 (W. Va. Mar. 28, 2014). The court declined to impute extra income because the wife/mother failed to prove the contract was executed; instead, it merely involved “contractual negotiations.” Id. Whether it was executed is not a matter of public record, but deferred execution was in his interest because it reduced his share of total income and thus his share of child support; in addition, the extra income may have prompted an alimony obligation, or at least his wife thought it was important. Interestingly, the court found the wife failed to prove the contract was executed, as opposed to merely being “contractual negotiations.” Husband controlled that fact. The decision lacks sufficient information to determine the level of the potential family tax on the possible new contract which would have added $44,554 annual income; but, additional alimony and child support obligations could plausibly have exceeded the income (viewing a single year of income, which would be the norm).
value of the changed obligation is thus real. The present value of the income is not because the accounting does not represent the economics. Once again, the “family-tax” rates are higher, not lower, than previously argued because we should not count the income at all.

Imagine Spouse A being offered a $5,000 catering job. Spouse A conducts a cost/benefit analysis. Spouse A could use the money. But Spouse A is experiencing a divorce/support battle; hence, Spouse A might reasonably question “Is this a good time for new work?” Taking the client has a $25,000 cost.174

Given a choice between December or January work—assuming December but not January income count—Spouse A might choose January. Or the choice may merely involve when Spouse A collects. Spouse B’s counsel may inquire about opportunities and current projects, but eventually questions stop. Spouse A likely has many opportunities, some realistic and some not worth considering. Whether Spouse B can elicit accurate information from Spouse A—how many opportunities exist and a real evaluation of each—is doubtful.

If Spouse A collects nothing currently from clients, the scheme will be obvious and the consequences likely significant. But not collecting from a new client for incomplete work may not be noteworthy. To discover it, Spouse B’s expert must question Spouse A’s clients/customers. Financial audits routinely involve such questions,175 but they seem overreaching, if not destructive, in a divorce. Clients may react favorably to providers experiencing annual financial audits, but they likely react differently if questioned in a provider’s antagonistic divorce. Thus, Spouse B must weigh the potential costs of damaging Spouse A’s business.176

iii. Extra Work Income

Sometimes the income-dollar is real. Spouse A has economic asset/service-income and expects it to continue. For that, the family-tax approximates 32%.177 This involves routine wages, investment returns, or traditional business profits. For that, the family-tax is 30%, not 500%. Everyone will see it that way.

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174 If the family-tax rate is 500%, the $5,000 December income costs $25,000.
175 EXTERNAL CONFIRMATIONS, Clarified Statements on Auditing Standards No. 122, § 505 (AM. INST. OF CERTIFIED PUB. ACCTS. 2012) requires auditors to obtain external confirmation of material items.
176 Goodwill is an important asset. Sometimes it is marital and sometimes not. Regardless, it can be both valuable and fleeting. Bad publicity or public scandal can impair it, which hurts both the owner and those who rely on income it produces.
177 See discussion supra note 151.
This Article, however, is not about existing, recurring income. Instead, it concerns *marginal* dollars—those Spouse A may or may not produce. Those are dollars that planners and experts consider. Spouse A’s cost of producing/recognizing such marginal dollars is $5. The future stream is not particularly relevant. Spouse A has a $5 incentive *not* to produce the dollar *this year*, to allocate it to another year, or to hide it. Spouse A’s perspective focuses on the present because future family costs are a function of the present, not the future. That perspective arises because court orders continue until modified, but modifications are either difficult or barred. Spouse B’s gain from discovering/imputing that dollar is also $5, and the stream is not relevant to Spouse B other than to presume its existence. That it may require future work or investment activity by A is not Spouse B’s concern. Thus, Spouse B has a $5 incentive to discover/allocate/impute the current dollar to Spouse A.

Consider another perspective: a happy, continuing marriage. The “family-tax” applies, but people do not perceive it the same. Society expects people to support children and spouses and to share familial wealth. Happy, intact families do that as a matter of course. If Spouse A produces a dollar, Spouse A shares with Spouse B and likely with offspring by increased family expenditures. Spouse A’s family, including Spouse A, may desire the earning and spending to continue, thus creating the $5 obligation but also the $15.56 expected earnings. If Spouse A expects the dollar increase to be temporary, Spouse A can discuss that in a family environment and likely avoid the permanent obligation: “We can splurge now, but don’t expect it to continue.” If producing the dollar becomes burdensome, Spouse A and Spouse B will discuss it and proceed in the family’s best interests. Thus, producing the dollar has a $5 cost but matches with the $15.56 present value of future dollars in a dynamic situation.

Divorces create a less trusting environment. Incentives are personal, not mutual. The situation is not “we both win . . . or not.” It is “I win, you lose.” Modifications are not a matter of “Let’s talk about this burdensome extra work or this investment strategy.” They are “I want to work less or invest differently” answered by “That is your problem, pay me or talk to the judge.” Psychologically, that produces a 500% tax on each marginal income-dollar.\(^\text{178}\) Thus, the tax becomes the reality even if it arises from skewed perceptions.

\(^{178}\) How people react psychologically is difficult to predict. But a rational, informed actor faced with a $5 obligation resulting from a current income increase of $1 would likely focus on the $5 versus the $1 as opposed to the possibility that the $1 might itself continue. Couple that with an understanding of the difficulty the other spouse will likely have seeking a modification if the $1 income occurs in the future rather than the present. Such a rational, informed spouse seems likely to forgo or to defer the income.
If the added income results from extra work, Spouse A must continue working to fund the resulting obligation. Spouse A might perceive that as an additional obligation rather than opportunity.¹⁷⁹ Had Spouse A not earned the extra $1, Spouse A would not owe the $5 and would not feel obligated for increased work. To Spouse A, that is a $5 tax on the extra income-dollar coupled with forced future work. Had Spouse A not produced the dollar, Spouse A would retain the future opportunity to produce it. The retained opportunity would be subject to a potential family-tax but only if modification is realistic. Modifications, however, are often not. Because Spouse A controls work/investment opportunities, Spouse A plausibly perceives the obligation as a tax with no future-dollar offset. Spouse A plausibly views future dollars as more forced than real, or as something Spouse A could have had cost-free.

B. Is This Merely a Battle of Experts?

No. While experts are helpful in searching for income accuracy, they have multiple family law constraints which make the search difficult or impossible.

1. Legal Constraints

Unless both parties agree, law constrains experts. For example, states routinely use the cash-method.¹⁸⁰ Expert accrual-method evaluation will typically be legally irrelevant unless both parties agree, which they will not unless it helps both.¹⁸¹

¹⁷⁹ E.g., Schiller v. Schiller, 625 So. 2d 856 (Fla. Dist. Ct. App. 1993). Following a long marriage with two children during which Wife was unemployed, both spouses received approximately equal net assets: Wife $274,153 and Husband $263,269. Id. at 858. Wife received alimony equal to approximately half of Husband’s income. Id. at 861. Using a twenty-year alimony term, the $450/week alimony had a $368,219.09 present value. Specifically, \( PMT = 450, I/YR = 2.5, N = 1040, mode = \text{beg}, \) and \( PV = -368,219.09. \) The appellate court emphasized the need to view the judgment as a whole. Wife thus received $642,372.09 and Husband -$104,950.09. Of the $537,422 net, Wife received 119.5% and Husband negative 19.5%. How Husband reacted psychologically is not knowable, but he was likely hard-pressed to view continued work as anything other than compelled. If he stopped working, the Court would surely impute the income and require the continued alimony. See authorities cited supra note 126. Failure to pay the alimony would be enforceable with contempt and possible incarceration. While incarceration is not likely beyond a short period, his lawyer would surely explain the possibility. Husband would also likely think to himself, “If I work, a third goes to the government for various taxes and then half goes to my ex. Why bother? But if I quit, they can put me in jail?”

¹⁸⁰ See supra note 152. Well-trained experts can alleviate some problems with relying on “taxable income,” but only within the constraints of the family definition of income.

¹⁸¹ Accrual of income and expenses will typically differ from the cash method. It may be greater or lesser. Alimony and child support, as well as the valuation of a business, are zero-sum games. Net
States often refuse to impute income on a residence, albeit typically the largest asset.\textsuperscript{182} Experts arguing to impute such income will likely be told to address the legislature or a higher court.\textsuperscript{183} In Florida, as in other states, the “law” permits imputing income on “liquid” assets, at least for alimony.\textsuperscript{184} One of five Florida appellate courts has imputed real-property income.\textsuperscript{185} Experts in those districts are thus constrained at the trial level.

Courts, standard forms, and sometimes statutes focus on a few years around the time of the divorce.\textsuperscript{186} Experts may seek to consider many years surrounding the divorce but may not be allowed to do so.

\textsuperscript{182} See supra note 126.
\textsuperscript{183} Experts and attorneys can certainly argue to circuit courts for expansion of what constitutes imputed income. But without a supporting appellate opinion or statute, a trial judge is an unlikely vehicle for change.
\textsuperscript{185} See id. at 1045.
\textsuperscript{186} See discussion supra note 65.
For audits governed by the FASB, the SEC, IFRS, GAAS, and the PCAOB, single-year financial statements have some notation of incompleteness. To present a fair picture, they should be comparative for multiple years. Isolated statements can be misleading. Family law, however, typically considers isolated years and makes multi-year examinations difficult.

The FASB is the Financial Accounting Standards Board: “The FASB Accounting Standards Codification® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied to nongovernmental entities. The Codification is effective for interim and annual periods ending after September 15, 2009.” FIN. ACCT. STANDARDS BD., FASB ACCOUNTING STANDARDS CODIFICATION: ABOUT THE CODIFICATION 4 (2023).


The International Accounting Standards Board (IASB) is part of the IFRS Foundation. It is responsible for international financial reporting standards. IASB, supra note 190.


The consistency principle requires consistent year-to-year choices, assumptions, and judgments. Isolated financial statements are not as useful as statements in the context of many years. With multiple years, one can detect trends and can predict the future, which is often what lawyers must do: predict future income in tort or to determine alimony/child support obligations. Auditors must examine current statements in the context of prior years. See AUDITING STANDARDS, AS 2820: Evaluating Consistency of Financial Statements, §§ .01, .03 (AM. INST. OF CERTIFIED PUB. ACCTS. 2008); see also GENERALLY ACCEPTED AUDITING STANDARDS, Auditing Standards, § 150.02 (AM. INST. OF CERTIFIED PUB. ACCTS. 2001) (outlining the standards of reporting, which require consideration of consistency).

“In any one year it is ordinarily desirable that the statement of financial position, the income statement, and the statement of changes in equity be presented for one or more preceding years, as well as for the current year.” PRESENTATION OF FIN. STATEMENTS, Comparative Financial Statements, ¶ 2 (FIN. ACCT. STANDARDS BD. 2009). The SEC requires at least one comparative statement for consolidated statements. Regulation S-X, 17 C.F.R. § 210.3-01 (2018). For a discussion of the comparative rules and a comparison with IFRS, see PWC, supra note 154.
2. Training Constraints

Experts are not equal. Ideally, an expert would be a CPA, and a tax lawyer with significant family law experience. Such people exist, however uncommon. But that is only a beginning because just as CPAs and tax lawyers are not interchangeable, neither CPAs nor tax lawyers are fungible within themselves.

Accounting is complex. Some CPAs are auditors. Others focus on tax compliance and still others on business planning. To be an expert in a family law matter, an expert should be an auditor. But auditors are not fungible. An experienced oil-and-gas auditor may know little about grocery stores. Pharmaceutical auditors may know little about automobile repair shops. One must never believe CPAs are fungible.

The same is true of tax lawyers. One specializing in international tax may recall little about estate planning. One specializing in charities may not understand complex timing or partnership issues. Thus, spouses need CPAs specialized in the business at hand who are also similarly specialized tax lawyers. A high-earning/high-asset spouse likely has one or more with long experience. The other needs to find one. Thus, experts do not work on a level field.

3. Access Constraints

The asset-owning spouse’s expert has access to all years preceding and following the divorce. The other spouse’s expert will not easily have similar access. Auditing a single year is costly and time consuming. Jumping into a case, attempting to examine many years, and being available for future years can be prohibitively expensive. The playing field will never be level, at least not for most divorces, because experts begin at different places. An owner-spouse with advisers in place may suffer little added expert-for-the-divorce costs because those build on existing work. The non-owner-spouse’s expert must start from scratch.

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196 Auditing is a sub-specialty of accounting. A CPA who specializes in tax law is not traditionally an experienced auditor. Courts may accept non-auditors, but in the opinion of your author, that is ill-advised.

4. Cost Constraints

Audits are expensive. Audits looking for fraud or misrepresentation are more so. Many divorces are self-help, without even attorneys involved. People who can afford court costs and an attorney often cannot afford an expert. If they can, they may only have resources to ensure assets are properly tax-affected. That also involves restoring accelerated depreciation, checking for inventory method/valuation changes, accounting method changes, and capitalization gimmicks. Those are the “low-hanging fruit,” which the planner-expert may have planted so the other expert can

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198 A typical audit should have general procedures to detect fraud. If fraud is suspected, additional audit procedures are needed. AS 2401: Consideration of Fraud in a Financial Statement Audit, PCAOB, https://pcaobus.org/oversight/standards/auditing-standards/details/AS240 (last visited Dec. 15, 2023).


200 Tax accelerated depreciation does not reflect an economic expense: by definition it is accelerated beyond what is economically justified. In contrast, GAAP accelerated depreciation reflects the best information-estimate regarding economic reality. Many states, however, require straight-line depreciation for family law. E.g., LA. STAT. ANN. § 9:315(C)(4) (2016) (excludes the accelerated portion of tax depreciation, defaulting to straight-line). N.Y. FAM. CT. LAW § 413-1(b)(5)(vi)(A) (McKinney 2019). That, too, is accelerated because the tax straight-line amount uses a shortened year. While simple, straight-line depreciation is artificial and less likely than accelerated depreciation to reflect economic reality. Requiring straight-line depreciation is often inconsequential, if applied correctly. In the current year, newly acquired assets would be subject to lower straight-line depreciation. Existing assets would shift to straight-line; however, to be fair, prior periods would also adjust, increasing existing asset bases. That could have the impact of increasing deductions, not decreasing them.

201 Cost-of-goods-sold (“COGS”) is often imprecise. COGS sometimes uses specific identification, which only works well for expensive, non-fungible goods—jewelry, automobiles, airplanes. Even that is suspect because capitalization methods vary. Otherwise, entities choose both a valuation-method and a management-method. Valuation is traditionally a function of FIFO (first-in-first-out), LIFO (last-in-first-out), or average-costing. Entities must know which of many fungible items were sold and the historical cost. Each method has flaws. Over long periods, flaws are unimportant if entities are consistent, and comparisons involve the same method. Over short periods, each method can be distorting. Inconsistent use of methods is inherently distorting. Management-methods are either perpetual or periodic. Scanning-codes/RFID-tags have made perpetual systems more common.

202 Most humans and many small businesses use the cash-method. Both GAAP and IFRS require accrual. Albeit flawed, the cash-method can be fair if used consistently for many years. Within each accounting method are sub-methods for particular items, such as capitalization/depreciation. Method-changes are distorting and result in Qualified Opinions.

203 Capitalization is a sub-specialty in accounting and tax law. Material items with lives exceeding one-year are capitalized. See Treas. Reg. § 1.166-1(a)(1) (cash method); id. § 1461-1(a)(2)(i) (accrual method). Non-material items are expensed. Businesses use cost as an element of materiality. Perhaps $5,000 is immaterial. Treas. Reg. § 1.263(a)-5(d)(3)(i) (2023). Expensing $5,000 items in a large entity distorts little. In contrast, expensing it in small businesses can have $25,000 divorce-impacts.
save face by discovering something. More complex planning takes time to unravel. At some point, even clients who can afford experts cannot afford to go deep enough. Even if they can, they cannot afford to have one do it year after year.

Initially, a court may award “suit money,” requiring one spouse to pay the other’s costs and fees. The court may award attorney and expert witness fees at the litigation end, or intermittently. But common sense informs that judges have limits. They hesitate granting “fishing-expedition” fees, and certainly are reluctant to do so year after year for continuous monitoring in a series of modification petitions. But fishing is exactly what the expert may need to do, year after year.

5. Complexity Constraints

Even experts with experience, access, and funds face huge complexities. Book-tax reconciliation is complex, as are partnership accounting, capitalization rules, and a host of things beyond what this Article can reasonably explain. But that may be where the games are. Ultimately, whatever experts discover must be understandable by the attorney who must help walk the judge through it. Unraveling one or two schemes may be realistic, but many more will likely prompt glazed judiciary eyes. Perhaps the judge will realistically handle some such items, but a full expert examination can involve many. Whether that is a serious litigation strategy is a topic for elsewhere, but the existence of the constraint should be clear. The ultimate burden is necessarily on the challenger to show something is amiss. The challenger-expert must discover complex but amiss items and then simplify them sufficiently for the attorney and court to understand. The other expert has an incentive to re-complicate.

6. Perspective Constraints

Experts take the client’s perspective. The high-earner/high-asset/business-owner spouse’s expert has incentives to defer/accelerate income. That is not a search for reality; instead, it focuses on the short-term

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204 That is cynical, but the common-sense result of a 500% return.
206 See ACCT. STANDARDS CODIFICATION, supra note 159.
207 Partnership accounting requires multiple sets of complex books, each inconsistent with GAAP. E.g., Treas. Reg. § 1.704-1 (2021); see also Large Business & International Div., Internal Revenue Service, Partner’s Outside Basis (2021), https://www.irs.gov/pub/irs-utl/partners-outside-basis.pdf (discussing partners’ inside and outside bases, which require two sets of books).
208 See discussion supra note 85.
and the family-tax rate. The other expert has the opposite perspective, similarly short-term: put income in current years, impute if necessary and move deductions to out-years. Neither mimics an intact, trusting family.

A battle of experts with perspective constraints may work; however, it requires them to have similar training, similar access, similar funding, laws which model GAAP, no time constraints, and a highly qualified judge who can deal with many complexities. In an ideal world that would exist. In an ideal world, the court would have experts such as special masters. The cost of doing that may not quite be sufficient to boil oceans,209 but it would be high.

IV. CONCLUSION

What I say is correct. Admittedly, it appears complicated and can seem dense. A typical lawyer might not understand it. But that largely is the point. The calculations are accurate, but because lawyers often do not see the issues, the distortions continue. The solution is for all lawyers to be experts in both tax law and accounting. That is hardly realistic.

209 Will Rogers allegedly described the solution to WWI German U-Boats: “Boil the oceans. The boats will turn pink and pop to the top.” When asked “How?”, he answered, “I’m not into details.” The solution to family law imputing-income-problems is straightforward: use accrual-accounting, adopt accounting/tax weapons required to keep people somewhat honest, and make all lawyers/judges be a C.P.A./LL.M. (taxation). Implementation will be difficult.