Forensic Forum

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The Innocence of the Dead

For those with a slight tilt to the macabre in sense of humor, the IRS, in Revenue Ruling 2003-36 has determined that an executor may seek innocent spouse relief on behalf of the decedent's estate as long as the decedent satisfied the relevant requirements for innocent spouse relief while alive.

The IRS considered two similar situations where husband and wife claimed deductions on their joint income tax return relating to investments owned entirely by one of them. The IRS audited those returns, and disallowed deductions, causing significant increases in taxes. I'm not sure if this is socially relevant, but in both cases it was the husband's property, the husband had done wrong, the wife was claiming innocent spouse – and in both cases it was the wife who died.

Anyway, back to the facts. In one situation, the wife had filed form 8857, Request for Innocent Spouse Relief, and then died while her request for relief was pending. The executor of her estate pursued the request for Innocent Spouse Relief. In the other case, while the facts were essentially identical, the wife died before she was able to file the 8857. In that situation the executor of her estate filed form 8857, seeking relief.

The IRS ruled that the executor of the estate has both theauthority to pursue an existing request for innocent spouse relief and also the authority to file a request for innocent spouse relief. In both situations, that ability was predicated on the fact that the decedent had satisfied the applicable requirements for innocent spouse relief while alive. The IRS agreed that the executor, as a fiduciary, has broad authority. It further concluded that since that authority is as broad as being able to make or disaffirm joint returns, it was natural to accept that the executor also had full authority relevant to innocent spouse issues. Chalk up one for the fallen angels.

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Personnel Happenings

- **Marshall Morris** was appointed Chair of the Matrimonial Services Committee of the NJ Society of CPAs
- **Kartik Shah** earned the coveted ASA designation - he is now a Senior member of the American Society of Appraisers
- **Beth Doblosky**, CPA, JD joined the Barson Group. Besides being a CPA, she earned her law degree from Boston University.
- **Eric Malinowski**, CPA joined the Barson Group, bringing with him 15 years of public and private accounting experience.

Calendar

Recent and Upcoming Speeches Include:

September 2002

18 The Shenkman Series - Business Valuation (Teaneck)

26 AAML - *Brown vs. Brown* (Atlantic City)

October 2002

25 NJ Society CPAs Mega Conference - Lifestyle Analysis (Iselin)

January 2003

24 ICLE - *Brown vs. Brown*

May 2003

09 NJ Society CPAs Mega Conference - Standard of Value (Iselin)

December 2003

17 The Shenkman Series - Investigative Accounting (Teaneck)

Ongoing

The BARSON GROUP CLE Series

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Our Litigation Team

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Sean Weiland, MBA
Janet Barson (Editorial, Design & Layout)

*Marshall is co-chair of the Standard of Value Subcommittee (of the Matrimonial Accounting Committee of the NJ Society of CPAs). This sub-committee has been charged with developing a white paper on the standard of value appropriate for divorce cases - and coordinating that effort with the judicial and legal communities.

Focus on the Economy

........By Michele L. Dushkin, CPA

It is important in the valuation process to understand and consider the general economic climate at the date of the valuation as well as the outlook for the future. The reasons are three-fold.

• First, an understanding of the economic outlook is fundamental to develop reasonable expectations about the subject company's future prospects.

• Second, Revenue Ruling 59-60 requires that, "a sound appraisal of closely-held stock must consider current and prospective economic conditions at the date of appraisal, both in the national economy and in the industry or industries with which the corporation is allied".

• Third, the general economic outlook as of the appraisal date should be considered, since the economy affects the availability of alternative investment opportunities at any given time.[1]

It is important to correctly interpret the economic information and indicators that are released each month and understand their implications on the subject business. Many businesses operate in the economic environment at both national and local levels. Often decisions made by management are influenced by the larger economic environment as well as by local issues. In some industries, foreign economic conditions also influence local economies.[2]

Understanding the economy and utilizing it as a predictor of the future is an art, in part reliant on the plethora of economic data available. The U.S. government has many economic data-gathering agencies; as a result, crucial economic information is available soon after it is captured. In addition, hundreds of private organizations provide relevant economic information and analyses.[3]

A question usually is – which economic factors will affect the business being valued. Perhaps it would help to identify where the company is in the business cycle. The National Bureau of Economic Research has a Business Cycle Dating Committee that maintains a chronology of the U.S. business cycle that is widely used in the analysis of business conditions.[4] The Committee identifies the month when the economy reached a peak in activity and a later month when the economy reached a trough (lowest point in a business cycle or on a statistical graph). The time in between is a recession, a period when the economy is contracting. The following period is an expansion. Economic activity is below normal or diminished for some part of the recession and for some part of the expansion. Some call the diminished activity a slump.[5] March 2001 marked the peak in business activity, the end of a record 10 year expansion and was the start of the 10th recession since WWII commenced. The expansion lasted 10 years, the longest in NBER's chronology.[6] This recession was marked by sharp declines in industrial production and sales that weakened nearly all regions of the U.S.[7]

One of the broadest economic indicators is the employment rate. In addition, personal income, sales of manufactured goods and industrial production are reviewed on a monthly basis. It is believed by the NBER that these four indicators are the most important measures in developing a business chronology.

The Gross Domestic Product (GDP) is an amalgam of many economic indicators which individually can be studied and can provide useful information about the overall economy. The GDP measures the dollar value of all goods and services produced in the U.S. economy in one year. The GDP is made up of spending by consumers, investment firms, government and foreign (exports minus imports) sectors.

We will continue the discussion in the next issue.

[1] Economic Outlook Update, 2Q 2002, Shannon Pratt
[2] Setting your sites on Domestic Data, Fay Hansen, Business Finance Magazine
[3] Ibid
[4] www.nber.org/March 91
[5] www.nber.org/cycles/november2001/
[6] Ibid
[7] NJ Review & Economic Outlook for 2002-2003, NJ Council of Economic Advisors

Is there an Odor?

Have you ever been presented with a report purporting to value a business and the conclusion of value takes you completely by surprise. Based on numerous experiences of recent vintage, that surprise all too often is well founded. We have seen far too many reports where the value conclusion fails that all important basic smell test. Indeed, despite 100 pages or so of almost impenetrable valuation jargon and impressive calculations, backed by all sorts of studies and industry analyses, if the conclusion of value does not pass the smell test, there is a good chance that the valuation report has got far more bluster than sound valuation logic.

Keep in mind it could very well be "your" expert who fails the smell test. And, you need to be candid enough to recognize that. Unfortunately, the right credentials (i.e., CPA, CVA, ABV, ASA, CBA) do not guarantee a quality work product – or an intelligent one. To put it bluntly, think of your own profession – surely you know of a number of attorneys who, despite having passed the bar, are not particularly competent, and/or tailor their work product to their client's demands. It is no different in any field – there are those who, once they have attained the requisite credentials, consider it a license to coast and to advocate their client's position regardless of whether it is justified or intellectually honest.

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Income- Lost and Found

There are many arenas where, as investigative accountants, we ply our profession. One of our more interesting situations involved a doctor who was ousted from his group practice. This case had elements of wrongful termination, a shareholder dispute and, of course, financial damages. As a result of being fired by his partners, this doctor had to set up his own practice anew, suffered less income and, arguably, was likely going to continue to realize less income for quite some time. Our assignment was to determine the damages he suffered – what was the diminution in his income as a result of the actions of his (former) partners.

Among the procedures we employed was a detailed analysis comparing his work load over the past few years based on the number of patients he saw and the number of hours he worked. This was rather well documented by the group practice's management information system and supported by appointment books. Also, the respective hours that each of the doctors was responsible for was fairly well established and in a sense public type information. We of course then compared that to what he was doing in his new (solo) practice – based on the hours he was maintaining, and the number of patients seen. Using these steps, we were able to develop a fairly solid understanding of the magnitude of the reduction in the gross revenues generated by this doctor – the difference between what he generated in his group practice and what he was now generating n his own practice. Obviously, a factor that helped in bringing reality to any figures was that by the time we became involved, he was already a couple of years into his own practice – and therefore we had real figures to use.

At this point, we were perhaps only half way through. As explained, we had determined the magnitude of the gross revenue shrinkage. However, his damages were not the top line (revenues) but rather the bottom line (net income). The expenses that he was incurring in his new practice were very well established. However, our contention was that there were significant revenues he was not realizing because he was no longer in the group practice. Increasing revenues tends to increase costs. To over simplify, it would be unlikely that a doctor grossing $300,000 a year would be able to increase that gross to $500,000 per year without also increasing costs. Therefore, we had to make certain assumptions as to what those additional revenues would have meant in additional costs (i.e., medical supplies, payroll, and perhaps even overhead).

With the preceding done, our next step was to determine the extent of the losses projecting into the future. This was deemed necessary because it was anticipated that the lower level of income would continue for at least several years. For this segment of our analysis, we used the history of the partnership (we had about ten years of tax returns) so as to determine the typical growth rate

experienced by it over a number of years. We also compared that to the rate of inflation in general, as well as the rate of medical fee inflation and published information as to the changes in the level of gross revenues experienced by doctors in that particular field. Also, as to the expenses of the medical practice, we factored in a level of inflation.

Finally, having done all that analysis, there was one step remaining – to present value the projected losses. That is, we had determined the losses, and then projected that for several years, based on certain assumptions. That provided us with a determination of the extent of the lost income for each of several years. However, the damages he suffered had to be expressed in today's dollars. Therefore, as a final and somewhat simple step, we brought this projected lost income stream back to the present. The result was a very supportable conclusion that this doctor had suffered significant economic loss because of the wrongful actions of his former partners.

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If you are dealing with a professional practice generating several hundred thousands of dollars a year, and netting 50% or so of that gross (a few hundred thousand dollars per year), how much sense does it make for a valuation report to suggest that the goodwill portion of the value of that practice (the total value minus the tangible assets) is

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Odor? ...continued from page 3

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Recent and Upcoming Media Situations:

BOOK: ***Second Edition of Investigative Accounting in Divorce*** by Kal Barson, published by John Wiley and Sons (December 2001)

CHAPTER: ***Divorce Taxation*** **-** NJ Family Law by Lexislaw (April 2003)

ARTICLE: ***Are Company Retained Earnings Marital Savings?*** - American Journal of Family Law (Summer 2002)

ARTICLE: Kal was quoted in an article on Family Limited Partnerships (valuation issues) in the October 2002 issue of Money Magazine

ARTICLE: ***Standard of Value in Divorce Business Valuation*** - by Marshall Morris - American Journal of Family Law (Spring 2003)

ARTICLE: ***Cursed Infirmities Impact on Valuation*** - to be in New Jersey Family Lawyer (August 2003)

ARTICLE: ***Forensic Accounting - A Force for Good*** - to be in New Jersey Family Lawyer (Fall 2003)

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