

Income Determination & Valuation of a Business in Divorce

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2016 IDFA Workshop:
Canadian Series
October 19-21, 2016 | Calgary, AB

Impact of a Business within a Family

- A business within a family will have a significant impact on determining **support payments** and a **division of assets** during a divorce.
- Understanding the accounting of a business and how a business is valued is imperative to **negotiating a fair settlement**.

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Consider this...

- Income can be manipulated, hidden or may have been originally presented for tax, bank or other purposes that may not be a fair representation of an individual's earnings.
- Valuations vary based on assumptions as well as fair market values of assets held within a corporation.

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Notice to Reader

- One the basis of information provided by management, we have compiled the balance sheet of the corporation as at December 31, 2016 and the statement of income and retained earnings for the year then ended.
- We have not performed an audit or a review engagement in respect of these financial statements and, accordingly, **we express no assurance thereon.**
- Readers are cautioned that these statements may not be appropriate for their purposes.




Income Determination from a Small Business

- Line 150 on the Personal Tax Return may be manipulated based on
 - Tax Planning
 - Accounting Policies
 - Fraud




Valuation

- The value of a business is subject to changes in fair market values and a number of assumptions
- Net Asset Approach
- Multiple of Income
- Earnings Based Approach




Personal Tax Return - Line 150

- Total Income
 - **Employment**
 - **Dividend**
 - Interest
 - Rental
 - OAS/ CPP
 - Pensions
 - Support Payments




Tax Planning

STATEMENT OF INCOME	Salary	Dividend	Divorce Planning
Revenue	200,000	200,000	200,000
Expenses	100,000	100,000	100,000
Salary	100,000	-	-
Income before tax	-	100,000	100,000
Corporate tax	-	13,500	13,500
Income available to distribute	-	86,500	86,500
Dividend	-	86,500	-
Retained Earnings	-	-	86,500





Tax Planning

- Revenues
 - Cash based vs. Accrual
- Expenses
 - Non-taxable benefits (health, insurance premiums)
 - Vehicle millage
 - Home office
 - Phone
- Balances sheet loans at prescribed rate





Accounting Policies

- Notice to Reader Statements may not follow GAAP
- Accounting policies are not the same as tax policies





Accounting Policies

- Revenue Recognition
 - Earned vs. Deferred Revenues
 - Timing
- Expenses
 - Non-taxable benefits (health spending, life insurance premiums, non-cash gifts)
 - Non-cash expenditures (amortization, bad debt)
 - Timing



Fraud

- Revenues
 - Deposits made to another account
 - Deposits made as Shareholder Loans
 - Cash not deposited to corporate accounts
 - Barter



Fraud


- Expenses
 - Over claiming management fees to third parties
 - Dividends paid to non-shareholders
 - Fictional expenses



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Fraud Detection


- Variance Analysis two years prior to separation
 - Measure variances with economic factors and other similar businesses within the industry
- Agree expenses with invoices and payments
- Trace employment expenses to T4 filings
- Trace management remuneration to personal tax returns



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Valuation

- Estimation of the value of a business as a measure in splitting assets in a divorce.



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Valuation Approaches

- Net Asset Based
- Earnings Based
- Excess Earnings Based



Net Asset Based Approach

- Assets less Liabilities
- Liquidation value of the company, taking into account the income tax consequences of any asset appraisal increments or write downs
- Consider changes in values (FMV)
 - Marketable Securities
 - Property





Earnings Based Approach

- The present value of the future benefits of ownership of the Company.
 - Inherent Assumptions:
 - Normalized earnings
 - Capitalized (discount) rate





Excess Earnings Based Approach

- The present value of the future benefits of ownership of the Company.
 - Inherent Assumptions:
 - Normalized earnings
 - Capitalized (discount) rate on tangible assets
 - Capitalized (discount) rate on intangible assets
 - Fair Market Value of tangible assets



Valuation

- Likely looking at a range and can negotiate something in-between



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