

## Calculating Child Support Income for the Self-Employed

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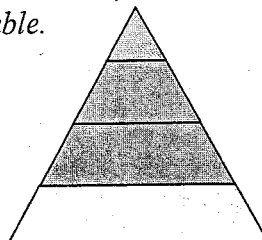
Theme: Child Support Income Differs from IRS Income in most cases  
Gross Income: 2011 Guidelines: Gross receipts minus ordinary and necessary expenses “required” for self-employment or business operation.

- (1) **Gross Income.** “Income” means a parent’s actual gross income from any source, including but not limited to income from employment or self-employment (salaries, wages, commissions, bonuses, dividends, severance pay, etc.), ownership or operation of a business, partnership, or corporation, rental of property, retirement or pensions, interest, trusts, annuities, capital gains, social security benefits, workers compensation benefits, unemployment insurance benefits, disability pay and insurance benefits, gifts, prizes and alimony or maintenance received from persons other than the parties to the instant action. When income is received on an irregular, non-recurring, or one-time basis, the court may average or pro-rate the income over a specified period of time ...
- (2) **Income from self-employment or operation of a business.** Gross income from self-employment, rent, royalties, proprietorship of a business, or joint ownership of a partnership or closely held corporation, is defined as gross receipts minus ordinary and necessary expenses required for self-employment or business operation. Ordinary and necessary business expenses do not include amounts allowable by the Internal Revenue Service for the accelerated component of depreciation expenses, investment tax credits, or any other business expenses determined by the court to be inappropriate for determining gross income. In general, income and expenses from self-employment or operation of a business should be carefully reviewed to determine an appropriate level of gross income available to the parent to satisfy a child support obligation. In most cases, this amount will differ from a determination of business income for tax purposes.

Expense reimbursements or in-kind payments (for example, use of a company car, free housing, or reimbursed meals) received by a parent in the course of employment, self-employment, or operation of a business are counted as income if they are significant and reduce personal living expenses.

**Ordinary and necessary expenses do not include (add back, include as income):**

- Accelerated depreciation component automatically; straight-line depreciation in discretion of Court. Straight-line depreciation is computed by taking the purchase price of the asset and dividing by the asset's depreciable life, *Holland v. Holland*, 169 N.C.App. 564, 610 S.E.2d 231 (2005). **Argue:** depreciation is a paper loss and does not represent any monies actually spent from gross receipts, *Lawrence v. Tise*, 107 N.C. App. 140, 419 S.E.2d 176 (1992); some employees have assets that depreciate too without deduction from income for child support calculation. On disallowing depreciation and bad debt incurred in accrual accounting tax computation, look at *Cauble v. Cauble*, 133 N.C. App. 390, 515 S.E.2d 708 (1999).
- Investment tax credits (IRS Form 3468)
- Expenses determined by court to be inappropriate (KYJ, KYJ, KYJ):
  1. NCP who worked out of his home would have had expenses whether in business or not: utilities, phone, truck lease, home and truck maintenance, personal property taxes, *Kennedy v. Kennedy*, 107 N.C. App. 695, 421 S.E.2d 795 (1992).
  2. May include as income: home office, personal vehicle, bad debts, depreciation, repayment of business loan principal, utilities, phone, vehicle lease and maintenance, insurance, personal property taxes, hygiene, cell phone, *Head v. Mosier*, 197 N.C. App. 328, 677 S. E.2d 191 (2009), citing *Cauble* and *Kennedy*.
  3. Mortgage principal, *Lawrence v. Tise*: rental property expenses can include repairs, property management and leasing fees, real estate taxes, insurance, mortgage interest.
- Cash reserves of corporation available for child support, even if (chosen to be) encumbered (secured, as by a creditor bank), *Barham v. Barham*, 127 N.C. App. 20, 487 S.E.2d 774 (1997); and *Cauble*.
- "Significant" reimbursement/in-kind payments that reduce personal living expenses (need to value): cost-free housing, vehicle, *Spicer v. Spicer*, 168 N.C. App. 283, 607 S.E.2d 678 (2005), *Leary v. Leary*, 152 N.C. App. 438, 567 S.E.2d 834 (N.C. App. 2002) (where NCP owned no personal vehicle), *Gibson v. Gibson*, 24 N.C. App. 520, 211 S.E.2d 522 (1975). Personal expenses paid for with business account: lease, maintenance, vehicle tax payments, fuel, meals, entertainment, rent, groceries, cash advances, *Robinson v. Robinson*, 707 S.E.2d 785 (N.C. App. 2011); consider also: clothing, phone, travel, vacations, etc.
- Calculate based upon present earnings, no imputing without finding of bad faith, *Ford v. Wright*, 170 N.C. App. 89, 611 S.E.2d 456 (2005), *Holt v. Holt*, 29 N.C. App. 124, 223 S.E.2d 542 (1976). Ordinarily calculate on the current income, not averaging, *Holland v. Holland*, but if financial records are incomplete, not abuse of discretion to use past years to "aid in determining" current income, *Moore v. Onafowora*, 703 S.E.2d 744 (N.C. App. 2010).
- Need sufficient findings of fact on business expenses, *New Hanover CSE v. Rains*, 193 N.C. 208, 666 S.E.2d 800 (2008).
- Need sufficient findings of fact on ownership and "The Pyramid": evidence must support findings, findings must support conclusions, and conclusions must support the order/judgment, *Cauble v. Cauble*.



**North Carolina Trial Judges' Bench Book for District Court,  
Chapter 3: Child Support Enforcement**

**Income from self-employment or operation of a business.**

- In the case of income derived from self-employment, rent, royalties, ownership or operation of a business, or joint ownership of a partnership or closely held corporation, gross income is gross receipts minus ordinary and necessary expenses required for self-employment or business operation [2011 Guidelines]
  
- **Income from self-employment or operation of a business includes or may include:**
  1. Undistributed net income of a closely-held (Subchapter C) corporation or partnership may be attributed to a parent who is a shareholder or partner if the parent could require distribution by virtue of the parent's legal interest in the corporation or partnership and retention of the income by the corporation or partnership is not reasonably necessary for business purposes. [See *Cauble v. Cauble*, 133 N.C.App. 390, 515 S.E.2d 708 (1999) (father owned a controlling corporate interest so that he might have directed distribution of corporate profits to his benefit).]
  2. Payments and reimbursements (including in-kind goods and services, such as free housing or use of a company car) received by a parent in the course of employment, self-employment, or operation of a business may be counted as gross income if they are significant and reduce the parent's personal living expenses [2011 Guidelines; *Leary v. Leary*, 152 N.C.App. 438, 567 S.E.2d 834 (2002) (no error when trial court added \$250 per month to father's gross income since he had the benefit of a company car).]
  
- **Ordinary and necessary business expenses:**
  1. Ordinary and necessary business expenses do not include accelerated depreciation or investment tax credits or any other business expenses determined by the court to be inappropriate for determining gross income. [2011 Guidelines; *Lawrence v. Tise*, 107 N.C.App. 140, 419 S.E.2d 176 (1992) (per the guidelines, accelerated depreciation is not to be deducted from a parent's gross income as an ordinary and necessary business expense); see also *Holland v Holland*, 169 N.C.App. 564, 610 S.E.2d 231 (2005) (trial court erred in treating all depreciation as accelerated depreciation which, under *Tise*, is not allowed as a deduction from a parent's business income).]

2. But a trial court has discretion to deduct from a parent's monthly gross income the amount of straight line depreciation allowed by the Internal Revenue Code. [*Lawrence v. Tise*, 107 N.C.App.140, 419 S.E.2d 176 (1992); see also *Holland v. Holland*, 169 N.C.App. 564, 610 S.E.2d 231 (2005) (trial court erred in treating all of father's farm equipment depreciation as nondeductible accelerated depreciation and by failing to exercise its discretion to deduct from father's gross income straight line depreciation allowed by Internal Revenue Code).]
3. In the context of businesses involving the rental of real property, ordinary and necessary business expenses generally include expenses for repairs, property management and leasing fees, real estate taxes, insurance, and mortgage interest. Payments on the principal amount of a mortgage loan are not considered ordinary and necessary business expense. [*Lawrence v. Tise*, 107 N.C.App. 140, 419 S.E.2d 176 (1992).]
4. A court may refuse to allow a parent to deduct business expenses for a home office or personal vehicle, bad debts, depreciation, and repayment of the principal on a business loan if it determines that the expenses are not appropriate for the purpose of determining gross income under the guidelines. [*Cauble v. Cauble*, 133 N.C.App. 390, 515 S.E.2d 708 (1999) (no error when court disallowed bad debt and depreciation expenses claimed by Subchapter C corp); *Kennedy v Kennedy*, 107 N.C.App.695,421 S.E.2d 795 (1992) (no error when court disallowed expenses for utilities, phone, truck lease, insurance, home and truck maintenance, and personal property taxes claimed by self-employed musician/father); *Lawrence v. Tise*, 107 N.C.App.140, 419 S.E.2d 176 (1992).

- **Income Verification:** A written statement (or an employment verification form generated by the IV-D ACTS system) signed by the employer of a parent who is obligated to pay child support is admissible in a proceeding to establish, modify or enforce a child support order to prove the amount of the obligor's gross income. [G.S. 110-139(c1).]
  1. A court may impose sanctions against a parent who fails to provide suitable documentation of the parent's income [2011 Guidelines] [N.C.R. Civ.P.37(b).]
  2. Father's stipulation that he would not raise inability to pay child support as defense did not relieve him from full disclosure of his financial condition. [*Shaw v. Cameron*, 125 N.C.App.522, 481 S.E.2d 365 (1997) (error for trial court to limit the scope of discoverable information; to determine father's child support obligation under guidelines, mother was entitled to discover value and nature of father's interest in any partnerships or corporations and terms of any trust of which he might be beneficiary, as well as amount of related income).]

## 2011 Guidelines:

- Child support calculations under the guidelines are based on the parents' current incomes at the time the order is entered. Income statements of the parents should be verified through documentation of both current and past income. Suitable documentation of current earnings (at least one full month) includes pay stubs, employer statements, or business receipts and expenses, if self-employed. Documentation of current income must be supplemented with copies of the most recent tax return to provide verification of earnings over a longer period. Sanctions may be imposed for failure to comply with this provision on the motion of a party or by the court on its own motion.

### Civil Procedure Rule 37 (b)(2):

- Sanctions by Court in Which Action is Pending. – If a party ... fails to obey an order to provide or permit discovery, including an order made under section (a) of this rule or Rule 35, or if a party fails to obey an order entered under Rule 26(f) a judge of the court in which the action is pending may make such orders in regard to the failures as are just, and among others the following:
  - a. An order that the matters regarding which the order was made or any other designated facts shall be taken to be established for the purposes of the action in accordance with the claim of the party obtaining the order;
  - b. An order refusing to allow the disobedient party to support or oppose designated claims or defenses, or prohibiting him from introducing designated matters in evidence;
  - c. An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party;
  - d. In lieu of any of the foregoing orders or in addition thereto, an order treating as a contempt of court the failure to obey any orders ...

WORKSHEET: ADDBACK  
INCOME / SELF-EMPLOYED

OBLIGOR \_\_\_\_\_ TAX YEAR \_\_\_\_\_

NET INCOME FROM SCHEDULE C-LINE 31 \_\_\_\_\_

ADDBACKS:  
Deduction for business use of home - Line 30 \_\_\_\_\_  
Meals and Entertainment - Line 24b \_\_\_\_\_  
Depreciation - Line 13 \_\_\_\_\_  
Vehicle Expense - 1/2 of Line 9 + \_\_\_\_\_

SUBTOTAL \_\_\_\_\_

OTHER DISCRETIONARY ADDBACKS:  
Professional expenses - Line 17 \_\_\_\_\_  
Office Expenses - Line 18 \_\_\_\_\_  
Repairs and Maintenance - Line 21 \_\_\_\_\_  
Supplies - Line 22 \_\_\_\_\_  
Utilities - Line 25 \_\_\_\_\_  
Other Expenses - Line 27 \_\_\_\_\_  
\_\_\_\_\_ + \_\_\_\_\_  
\_\_\_\_\_

ANNUAL BUSINESS INCOME BEFORE TAXES \_\_\_\_\_

OTHER ADDITIONS:  
W-2 Income from other jobs \_\_\_\_\_  
Earned Income Credit - Line 66 1040 \_\_\_\_\_  
Child Tax Credit - Line 52 1040 + \_\_\_\_\_

TOTAL INCOME \_\_\_\_\_

DEDUCTIONS:  
Federal Taxes - Line 64 1040 \_\_\_\_\_  
Self-Employment Taxes - Line 58 1040 \_\_\_\_\_  
FICA and Medicare on W-2 Wages \_\_\_\_\_  
Health Insurance Deduction \_\_\_\_\_  
Reasonable Pension \_\_\_\_\_

ANNUAL INCOME \_\_\_\_\_  
MONTHLY INCOME \_\_\_\_\_

**SCHEDULE C  
(Form 1040)**

**Profit or Loss From Business  
(Sole Proprietorship)**

OMB No. 1545-0074

**2010**  
Attachment  
Sequence No. **09**

Department of the Treasury  
Internal Revenue Service (99)

▶ Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B.  
▶ Attach to Form 1040, 1040NR, or 1041. ▶ See Instructions for Schedule C (Form 1040).

Name of proprietor \_\_\_\_\_ Social security number (SSN) \_\_\_\_\_

**A** Principal business or profession, including product or service (see instructions) **B** Enter code from pages C-9, 10, & 11

**C** Business name. If no separate business name, leave blank. **D** Employer ID number (EIN), if any

**E** Business address (including suite or room no.) ▶  
City, town or post office, state, and ZIP code

**F** Accounting method: (1)  Cash (2)  Accrual (3)  Other (specify) ▶

**G** Did you "materially participate" in the operation of this business during 2010? If "No," see instructions for limit on losses  Yes  No

**H** If you started or acquired this business during 2010, check here

**Part I Income**

<b>1</b> Gross receipts or sales. <b>Caution.</b> See instructions and check the box if: • This income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, or • You are a member of a qualified joint venture reporting only rental real estate income not subject to self-employment tax. Also see instructions for limit on losses.	<input type="checkbox"/>	<b>1</b>		
<b>2</b> Returns and allowances		<b>2</b>		
<b>3</b> Subtract line 2 from line 1		<b>3</b>		
<b>4</b> Cost of goods sold (from line 42 on page 2)		<b>4</b>		
<b>5</b> <b>Gross profit.</b> Subtract line 4 from line 3		<b>5</b>		
<b>6</b> Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)		<b>6</b>		
<b>7</b> <b>Gross income.</b> Add lines 5 and 6		<b>7</b>		

**Part II Expenses.** Enter expenses for business use of your home **only** on line 30.

<b>8</b> Advertising	<b>8</b>		<b>18</b> Office expense	<b>18</b>	
<b>9</b> Car and truck expenses (see instructions)	<b>9</b>		<b>19</b> Pension and profit-sharing plans	<b>19</b>	
<b>10</b> Commissions and fees	<b>10</b>		<b>20</b> Rent or lease (see instructions):		
<b>11</b> Contract labor (see instructions)	<b>11</b>		<b>a</b> Vehicles, machinery, and equipment	<b>20a</b>	
<b>12</b> Depletion	<b>12</b>		<b>b</b> Other business property	<b>20b</b>	
<b>13</b> Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	<b>13</b>		<b>21</b> Repairs and maintenance	<b>21</b>	
<b>14</b> Employee benefit programs (other than on line 19)	<b>14</b>		<b>22</b> Supplies (not included in Part III)	<b>22</b>	
<b>15</b> Insurance (other than health)	<b>15</b>		<b>23</b> Taxes and licenses	<b>23</b>	
<b>16</b> Interest:			<b>24</b> Travel, meals, and entertainment:		
<b>a</b> Mortgage (paid to banks, etc.)	<b>16a</b>		<b>a</b> Travel	<b>24a</b>	
<b>b</b> Other	<b>16b</b>		<b>b</b> Deductible meals and entertainment (see instructions)	<b>24b</b>	
<b>17</b> Legal and professional services	<b>17</b>		<b>25</b> Utilities	<b>25</b>	
<b>28</b> <b>Total expenses</b> before expenses for business use of home. Add lines 8 through 27	<b>28</b>		<b>26</b> Wages (less employment credits)	<b>26</b>	
<b>29</b> Tentative profit or (loss). Subtract line 28 from line 7	<b>29</b>		<b>27</b> Other expenses (from line 48 on page 2)	<b>27</b>	
<b>30</b> Expenses for business use of your home. Attach <b>Form 8829</b>	<b>30</b>				
<b>31</b> <b>Net profit or (loss).</b> Subtract line 30 from line 29.	<b>31</b>				
• If a profit, enter on both <b>Form 1040, line 12</b> , and <b>Schedule SE, line 2</b> , or on <b>Form 1040NR, line 13</b> (if you checked the box on line 1, see instructions). Estates and trusts, enter on <b>Form 1041, line 3</b> .					
• If a loss, you <b>must</b> go to line 32.					
<b>32</b> If you have a loss, check the box that describes your investment in this activity (see instructions).					
• If you checked 32a, enter the loss on both <b>Form 1040, line 12</b> , and <b>Schedule SE, line 2</b> , or on <b>Form 1040NR, line 13</b> (if you checked the box on line 1, see the line 31 instructions). Estates and trusts, enter on <b>Form 1041, line 3</b> .					
• If you checked 32b, you <b>must</b> attach <b>Form 6198</b> . Your loss may be limited.					
			<b>32a</b> <input type="checkbox"/> All investment is at risk.		
			<b>32b</b> <input type="checkbox"/> Some investment is not at risk.		

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 11334P

Schedule C (Form 1040) 2010

