# *The Commandments*

## *(Pertaining to Self-Employment and Support)*

## *(Revised Post January 1, 2007)*

### *Commandment I - We shall not assume that all self-employed persons are attempting to avoid their obligations of support.*

Self-employment is a perfectly legitimate and honorable means of earning income and is, in fact, the backbone of our economy.

We should never presume, consequently, just because someone is self-employed, that they are attempting to unfairly avoid or limit their obligations of support. Some are; there is no question about that. Because *some* self-employed persons attempt to adversely affect their obligations of support, however, does not mean *all* self-employed persons abuse the system.

### *Commandment II - We shall not presume self-employed persons are our enemies.*

Although calculating income for self-employed parties is sometimes difficult, that does not mean those parties are *trying* to be difficult.

### *Commandment III - Notwithstanding Commandments I and II we shall not treat income for tax purposes as income for child support purposes.*

Commandment III does not, notwithstanding the belief of many self-employed parties to the contrary, conflict with or contradict Commandments I and II.

Although we continue to disallow, pursuant to Minnesota Statutes Section 518A.30, certain deductions in determining gross income for child support purposes that are otherwise perfectly legitimate and appropriate for tax purposes (i.e. accelerated depreciation deductions and the like) *that does not mean every self-employed party is attempting to avoid or otherwise adversely affect their obligations of support*.

### *Commandment IV - We shall not ignore gross income, sales or receipts.*

It is tempting, in self-employment cases, to accept, at face value, reported gross sales and receipts, and to immediately begin scrutinizing reported business expenses. We do, after all, have some, albeit limited, guidance from both the legislature and the appellate courts regarding the analysis of business expenses. We have very little, if any, guidance from either the legislature or the appellate courts, however, regarding the scrutiny of reported gross business income.

There are certain types of businesses that are particularly problematic in this regard. Bars, restaurants, coin laundries and the like are, by their very nature, cash businesses, and at least some consideration should be given to whether all of that cash is reported, either for tax or support purposes.

In this regard, reference should also be made to Commandment IX.

### *Commandment V - We shall make clear to self-employed parties that they have the burden of proving their claimed business expenses are ordinary and necessary.*

Income from self-employment is defined as "gross receipts minus cost of goods sold minus ordinary and necessary expenses required for self-employment or business operation". Minn. Stat. § 518A.30. The statute also makes clear, however, that the "person seeking to deduct an expense, including depreciation, has the burden of proving, *if challenged*, that the expense is ordinary and necessary". Id. (Emphasis added).

The statute expressly provides, consequently, that a party does not have to justify an expense unless that expense is first "challenged". In other words, we cannot simply disregard a business expense as inappropriate or not ordinary and necessary without first challenging that expense and allowing the person claiming that expense an opportunity to defend it.

### *Commandment VI - We shall not automatically disregard claimed depreciation deductions.*

It is inappropriate to simply disregard claimed depreciation deductions as "paper losses or expenses". Although there is nothing wrong with making clear that the burden rests with the self-employed party to prove their depreciation deductions are "ordinary and necessary", and therefore deductible, they must be given an opportunity to do that. Totally disregarding the deduction deprives them of that opportunity.

Bear in mind Commandments I and II. Accelerated depreciation, if properly applied, is a perfectly legal, appropriate and legitimate method of reducing *taxable* income. The presence of accelerated depreciation deductions on a tax return does not mean the taxpayer is attempting to adversely affect their obligations of support; it simply means the taxpayer is attempting, within legal means, to limit their exposure to federal and state income taxes.

Most of us claim itemized deductions in excess of the standard deduction on our own individual tax returns each year. That does not mean we are *evading* taxes, which is illegal; it simply means we are *avoiding* taxes, which is perfectly legal, legitimate and appropriate.

Although Minnesota Statutes Section 518A.30 expressly precludes the use of accelerated depreciation expenses in calculating gross income for child support, that does not preclude depreciation deductions of any kind. It simply means accelerated depreciation should be converted to straight-line depreciation, which is allowed.

### *Commandment VII - We shall not allow BOTH deductions based on mileage for business use of a vehicle, based on Internal Revenue Service-approved mileage rates, AND actual expenses relating to that vehicle, to include depreciation.*

Vehicle expenses are allowed based on *either* the standard mileage rate, currently $.55 per mile, *or* the actual costs relating to that vehicle such as gasoline, oil, repairs and the like, *but not both*. This prohibition also applies to depreciation deductions. Depreciation is treated as an actual cost relating to vehicle operation, just like gasoline. Consequently, a self-employed party may not claim *both* the standard mileage rate, as a vehicle expense deduction, *and* depreciation relating to that vehicle.

### *Commandment VIII - We should consider allowing a deduction for the employer's share of self-employment taxes in determining gross income for child support.*

Under previous law, guideline child support was based on the obligor's *net* income, which was defined as gross income less certain statutorily allowed deductions, including, but not limited to federal and state income taxes and federal social security and Medicare taxes.

Self-employed persons are liable for *both* the employer and the employee's share of social security and Medicare taxes. The only break they receive in doing so is in being allowed to pay 15.3-percent (7.65-percent x 2) of only 92.35-percent of gross earnings, to avoid having to pay tax on a tax.

Self-employed parties were previously allowed, consequently, a deduction for social security and Medicare taxes based on *15.3-percent of 92.35-percent of their gross earnings*, and not just 7.65-percent of their gross earnings.

Child support is currently, however, based on *gross*, as opposed to net income which, again, is defined as "gross receipts minus … ordinary and necessary expenses *required for self-employment or business operation"*.

The employer's share of both social security and Medicare taxes is, at least in the opinion of this author, an "ordinary and necessary expense required for self-employment or business operation". A deduction should, consequently, be allowed based on 7.65-percent of the party's gross earnings in calculating their gross income for child support.

### *Commandment IX - As in every case, once income is determined for a party we shall compare that income against their reported monthly living expenses.*

We require parties to provide statements of their monthly living expenses for a reason. In self-employment cases, as in every case, once gross income for support purposes is determined we should compare that against each party's reported monthly living expenses.

If any party, whether self-employed or not, reports gross monthly income of $500, and monthly living expenses of $2,500, there is a problem somewhere, *particularly if they are current in those expenses*. Unless that party is receiving some form of assistance in meeting their expenses (gifts or loans, credit card advances, etc.), they are either overstating their expenses, understating their income, or both.

### *Commandment X - We shall apply the concept of voluntary unemployment or underemployment to all parties, including self-employed parties.*

If a self-employed party is reporting income substantially below their actual ability to earn income, you should apply the same standard of voluntary underemployment to them you would any other party.

A person is voluntarily underemployed unless they can establish their present situation is temporary and will ultimately result in an increase in income, is the result of a bona fide career change that outweighs the adverse effect of diminished income on the child, or they are physically or mentally incapacitated or incarcerated (unless the incarceration is due to their non-payment of support). Minn. Stat. § 518A.32, subd. 3.

The burden of proof is on the party to prove they are not voluntarily underemployed. The burden of proof is not on the other party or the County to prove they are voluntarily underemployed.

Moreover, a finding that the party is acting in bad faith with respect to their obligations of support is *not* a predicate to a finding of voluntary underemployment.

Consequently, if a party is earning substantially less self-employment income than they have the capacity, based on "employment potential, recent work history, and occupational qualifications in light of prevailing job opportunities and earnings levels in the community" they reside to earn, consideration should be given to whether they are voluntarily underemployed and, if so, income should be imputed to them pursuant to Section 518A.32, subd. 3.