



Issues, cases, practice
management tips and news for
Forensic and Valuation Services
Section members

FVS Consulting Digest

Issue 6 – November 2011

Using Forensic Tools in Equitable Relief Claims

By Marta Alfonso, CPA, CFF, CIRA, JD, Jorge Gutierrez, CPA, JD, and Luis O. Rivera, CPA, CFF, CFE

Using Forensic Tools in Equitable Relief Claims

By Marta Alfonso, CPA, CFF, CIRA, JD, Jorge Gutierrez, CPA, JD, and Luis O. Rivera, CPA, CFF, CFE



MARTA ALFONSO



JORGE GUTIERREZ



LUIS O. RIVERA

In a surprising change in attitude, the Internal Revenue Service in [IRS Notice 2011-70](#) removed the two-year limitation in which an individual taxpayer can request equitable relief from joint and several liability under Internal Revenue Code Section 6015(f). The extended IRS deadline may result in increased requests for equitable relief and, as a result, the potential for additional forensic tax engagements to compile, formulate and analyze details on whether an equitable claim can be supported. This article provides an overview of the accounting work a forensic tax professional might perform to assist an attorney with proving up a spousal relief claim, and some tips on doing it.

IRC Exemptions

The Internal Revenue Code provides several exemptions that relieve a taxpayer's joint and several obligations (i.e., tax liability, penalties and interest) (assuming the taxpayers had not elected to file separately). Allocation of married taxpayers' tax obligations can arise in various circumstances, including but not limited to an IRS recovery action for delinquent taxes or an IRS examination of a married taxpayer return. An application for equitable relief under Section 6015(f) is suitable if the client is not eligible for innocent taxpayer relief, separation of liability relief or relief under community

property law.¹ Among other considerations, to apply for equitable relief, the client must establish that, considering all the facts, it would be unfair to hold the client liable for the understated or underpaid tax. The client must have prepared a non-fraudulent return or not have failed to file the returns in question. In addition, the income tax liability involved must pertain to the other taxpayer, and the client would not have known or had reason to know that the funds to pay the tax liability were misappropriated. Additional factors considered by the IRS include whether the client was separated or divorced from the taxpayer, whether a significant economic hardship would be incurred if relief is not granted, and whether a legal obligation existed under a divorce decree or agreement to pay the tax.² The IRS will also examine whether the client received a significant benefit from the underpayment of taxes and whether the client made a good faith effort to comply with federal income tax laws. A forensic tax professional can help identify and compile the facts and circumstances that will be considered by the IRS in determining whether a taxpayer will be able to obtain relief from joint and several liabilities.

The Interview Process

The tools that can be used to surface relevant information for the taxpayer's request for equitable relief include asset and witness identification, interviews, asset tracing, financial analysis and document collection and analysis. As a starting point, the client interview is crucial in gathering the facts and circumstances that will be relevant to determine whether the evidence supports a request for equitable relief. The interview will identify relevant facts and financial documents to be sought from the client and or other sources, including:

2011 FVS Volunteer Award Recipients Announced

Robert F. Reilly, CPA/ABV/CFF, from Willamette Management Associates in Illinois, was recognized at this year's AICPA National Business Valuation Conference for receiving this year's top honor of being inducted into the AICPA BV Hall of Fame.

Gary R. Trugman, CPA/ABV, from Trugman Valuation Associates based in Florida, was recognized as the 2011 BV Volunteer of the Year.

The annual FLS Volunteer of the Year Award was presented to Robert "Bob" Gray from ParenteBeard's Dallas office at the 2011 AICPA National Forensic Accounting Conference.

These volunteers have made tremendous contributions to the ongoing success of the CFF and ABV credentials. We would like to congratulate each of these recipients and thank them for their ongoing efforts to advance the FVS profession.

1 An intensive evaluation of the facts and circumstances must be performed to identify potential pitfalls that will preclude a spousal taxpayer from being considered for the various types of relief from joint and several liabilities. For example, if a spousal taxpayer has been involved in a fraudulent scheme to transfer marital property to each other or a third party to avoid payment of income taxes owed or to defraud an ex-taxpayer, a creditor or business partner, then spousal tax relief cannot be obtained (even if the transfer was pursuant to a marital settlement agreement). If a spousal taxpayer knew or had access to information to conclude that the tax positions taken were not correct when the tax return was signed, then it may not be possible to obtain a spousal tax relief. Other facts and circumstances, such as cohabitation during the divorce proceedings, will likely render a separation of liability determination difficult if not impossible to pursue.

2 See I.R.C. Section 6015(f) and IRS Publication 971.

continued on page 6

Using Forensic Tools, continued from page 5

- An employment and educational history of each taxpayer,
- The taxpayers' immigration status in the United States, and other foreign tax matters,
- The taxpayers' period of residency in the specific states,
- The taxpayers' period of cohabitation during the marriage, and current status,
- The taxpayers' involvement in the activity that created the erroneous item at issue,
- Individual personal and business financial practices (involvement in house/business finances),
- Efforts to understand the financial matters of the household and businesses and the actions taken by the taxpayer,
- The existence of spousal or domestic abuse,
- The history of asset transfers during their marriage, if applicable,
- Any changes in marital legal status, if applicable,
- The types of tax returns filed by the taxpayers, and filing status,
- The dates of tax filings,
- The history and amounts of the tax obligations incurred,
- The identification of the erroneous items, if any,
- Amounts and types of underreported income to which the tax may correspond (i.e., underreported income, incorrect deductions or credits, or unsupported tax basis),
- Location of cash accounts and assets,
- The collection of financial information supporting the taxpayer's representations regarding their involvement in financial matters of the household or spousal businesses, and
- The use of the proceeds from the underlying transaction causing the tax liability.

From this initial interview, an intensive evaluation of the facts and circumstances must be performed to identify the strengths and weaknesses in a spousal taxpayer's request

for equitable relief from exemption from joint and several tax liability. At the outset, the forensic tax professional should establish the appropriate rapport to obtain the necessary information by making the taxpayer feel at ease. The initial client interview should be as interactive as possible, with the tax professional using follow-on and open questions to obtain as much information and history from the taxpayer's recollection as possible. The interviewer should also observe the taxpayer's body language and demeanor in responding to questions to evaluate the quality of the information being provided. The information gathered from the interview process and the examination of documents should corroborate the client's recollections and representations that the tax professional would be making to third parties. The client's inability or unwillingness to answer relevant inquiries can weaken a client's case presented to the IRS and may be a red flag about the client's candor or the reliability of the information provided.

Skillful acquisition and early analysis of the client facts and circumstances will make it easier to properly set and manage a client's expectations about the outcome of their request for spousal tax relief. The determination of whether a spousal taxpayer "did not know" or "had no reason to know" will be based on the IRS' detailed consideration of all the facts and circumstances, including the type of error, how the error occurred and its materiality (the amount involved) relative to the tax return. In addition, the IRS will consider the taxpayers' financial situation, the ownership of any assets involved, the client's educational background and business experience, and the extent of the client's participation in the activity that caused the error.³

Compiling and Corroborating Documents

A second forensic tool, document compilation and analysis, involves pulling together documents that support the facts and circumstances obtained in the interview.

³ See *Virginia D. Sykes v Commissioner*, TC Memo 2009-197, in which the wife was denied innocent taxpayer relief as she had knowledge of her and her ex-husband's personal finances and those of his law practice and, therefore, had knowledge that duplicate expenses were recorded as deductions on their tax returns and that a gain on real property sales was not included in the marital tax return.

continued on page 7

Using Forensic Tools, continued from page 6

The location of assets and collection of financial information supporting the taxpayer's representations regarding his or her involvement in financial matters of the household or business are critical. Assets can be located and compiled from both personal and public records, such as bank statements, property tax records, commercial databases and court filings, including wills, probate or representations made in civil litigation.

A forensic tax professional should not only compile information from the taxpayer but also seek to corroborate that information with independent, third-party sources where possible and legally permitted. If the taxpayer's earnings went to purchase an asset that is registered, such as a car, boat or plane, the public registration records of the asset--a third tool involving asset tracing of the ownership to the other taxpayer--could be a critical fact in an equitable relief claim. The use of information on social media that is publicly available and legally accessed may also corroborate a taxpayer's claims about the existence of or access to assets. Documentary evidence may also lead to other bases for not sharing joint or several tax liabilities, such as the detailed examination of the circumstances leading to an installment agreement involving the taxpayers to determine if both taxpayers would be liable for the tax.

Additional extremely useful techniques include indirect methods of income analyses that corroborate that a petitioning taxpayer had neither knowledge of nor reason to know of any understatement and that quantify changes in a taxpayer's wealth and trace the quantified changes to the taxpayer's return. A lifestyle analysis derived from a taxpayer's bank and credit card records that identify sources and uses of cash can corroborate a taxpayer's earnings and whether he or she had access to untaxed proceeds that were not reported on a joint tax return (and therefore, the taxpayer had no knowledge of any unreported amounts). The Net Worth Method can also be used to evaluate and analyze whether a taxpayer's wealth materially changed between

tax reporting periods. It is particularly useful to the forensic professional in evaluating and corroborating potential underreported income as compared to reported income on the taxpayers' tax returns. Independent analyses by a forensic professional can bolster a taxpayer's petition for equitable relief.

Finally, the forensic professional should apply the IRS industry audit guides to isolate indicators of fraudulent conduct. Because the IRS' decision-making analysis is based on facts and circumstances, isolating indicators of fraud and determining the responsible party of the conduct can enhance a taxpayer's claim for equitable relief. The professional can perform either random or statistically derived forensic tests on taxpayer records and transactions to demonstrate that no evidence of fraud existed during the time the petition for equitable relief is sought. In addition, the forensic professional can assist the taxpayer in identifying other conduct or acts that indicate fraud.

Taxpayer Credibility Is Key

In petitions for equitable relief, a taxpayer's credibility is an important component in the IRS determination. Tax professionals should adopt forensic techniques and tools that prepare the most effective presentation of the facts and circumstances of the taxpayer's assertions in a claim for equitable relief. Independently prepared analyses by a forensic accountant can provide effective third-party corroboration in a taxpayer's petition for equitable relief, thus enhancing credibility with the IRS.

Marta Alfonso, CPA/CFF, CIRA, JD, is a principal in the Management Advisory Services Department at Morrison Brown Argiz & Farra, LC in Miami, Florida.

Jorge Gutiérrez, CPA, JD, is a Partner in the law firm, Boyd & Jenerette, P.A. in Miami, Florida.

Luis O. Rivera, CPA, CFF, CFE, is a partner in the consulting and advisory professional forensic services firm, MRW Consulting Group, LLP, in Fort Lauderdale, Florida. ■

DOL to Re-Propose Rule on the Definition of Fiduciary

The AICPA FVS Section has been actively working with the Department of Labor on the department's proposed rule to redefine the term "fiduciary." Under the DOL's initial proposal, valuation analysts would be held to a fiduciary standard if they prepare valuations for ESOPs or other benefit plans. On Sept. 19, the DOL announced it would re-propose the rule in light of the comments received. Read the [DOL press release](#) for more information and visit the FVS web site to stay up to date with our [advocacy efforts](#).