

Published in *Family Advocate*, Vol. 33, No. 4, (Spring 2011) p. 12–14. © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.



DISCOVERING UNREPORTED INCOME

Ethical, practical, and procedural consequences

BY CARLTON R. MARCYAN

FREQUENTLY our clients tell us that a spouse has income greater than reported or has received hidden benefits from a business. Sometimes this proves to be true; however, many times not. Every so often, though, the client's suspicions are well founded. The other side of the coin is when the attorney suspects his or her own client of failing to properly disclose income or assets, whether to a court or taxing authority.



ETHICAL Issues

Certainly, counsel for a party who suspects the spouse of failing to report or hide income is obligated to take reasonable steps to investigate the claim. Rule 1.3 of the ABA Model Rules of Professional Conduct (Model Rule) requires counsel to be reasonably diligent in representing a client. The more difficult issue is the lawyer's obligation when his or her own client is suspected of such activity. Model Rule 1.2 reads, in part, that "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent..." That same rule goes on to say "...but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law." In a divorce case, counsel and client are normally engaged in an ongoing process and not restricted to a single event that happened in the past, such as in a personal injury case.

Should an attorney become aware of a client's ongoing criminal or fraudulent activity and provide advice to the client on the best way to "handle it" before a divorce tribunal, that attorney is in a very precarious situation, not only with respect to a licensing court, but before the IRS and the federal government. Tax evasion is a felony (I.R.C. section 7201), and a divorce lawyer representing a client involved in that activity must realize that he "...may be charged with conspiracy to impede collection of a federal tax as well as with a separate charge of impeding." 18 U.S.C. § 371. Obstructing or impeding the administration of the IRS, including the collection of tax owed, is also a felony under I.R.C. § 7212.

Woe to the divorce lawyer who advises a client in such affairs or learns of these ongoing activities. It is best for the

divorce lawyer to promptly bring in tax counsel with expertise in criminal matters, as a lack of understanding of the consequences could result in the divorce lawyer's having to withdraw from ongoing representation. With some exceptions, Model Rule 1.16 states that the lawyer "shall withdraw" if the representation will result in violation of the rules of professional conduct or other law. Thus, in addition to outside tax counsel, it is wise to confer with counsel expert in professional responsibility. The fee you expect to receive in the divorce case may be dwarfed by the cost to you personally in defending yourself before the IRS, a federal prosecutor, and your state's attorney-disciplinary board.

At the beginning of each new case, it is good practice to advise your client that his or her disclosure to you of "hidden" assets or income places you in an ethical dilemma. A client's incomplete financial disclosure, inaccurate interrogatory response, or deposition or trial testimony may not be ignored. You, as counsel, must either correct the record, seek to withdraw from representation, or possibly both. Some years ago I took over an existing case in which my client had made misstatements and committed perjury that was as yet undetected. We painstakingly corrected earlier court filings with amendments, presented supplements to deposition transcripts, and filed amended tax returns in an attempt to "come clean" before opposing counsel used the prior statements to his advantage and the IRS acted upon them. In this instance, we were able to turn the case to our advantage by admitting the wrongdoing to the court, and our client avoided criminal penalties imposed by the IRS. Of course, complete cooperation from your client is required as is the assistance of criminal defense and tax counsel to anticipate and preempt sanctions to the greatest extent possible.



PRACTICAL Issues

Consider this scenario: after much discovery and with the aid of your forensic accountant, you, the divorce lawyer, have substantial proof that the other spouse has hidden assets and that the income

generated from those assets is in a third party's name. How is this evidence best presented? Should you reserve it for an upcoming evidentiary hearing, bring it out in a pretrial conference, or use it as leverage in an upcoming settlement conference?

The answer largely depends on the following:

- Opposing counsel's recognition of his client's (and maybe counsel's) risk;
- Opposing counsel's control over the client;
- The opposing client's understanding of risk and possible criminal liability;
- Your own client's exposure and possible liability for earlier jointly filed tax returns;
- Your client's potential success in seeking "innocent spouse" status with the IRS.
- The likelihood of the judge's reporting tax fraud to the IRS and relevant state taxing authorities;
- The likelihood of courtroom personnel's reporting such testimony to the IRS in the hope of receiving a "Whistleblower's Award" pursuant to I.R.C. § 7623(a) and (b);
- The adequacy of your expert witness's testimony before the divorce judge to support the fraud claim and "make it stick";
- Your ability to "prove up" the fraudulent activity without an expert and through the opposing spouse or his employee(s);
- The persuasiveness of

your presentation of evidence before the judge, whether in pretrial or trial, “killing the goose that lays the golden egg.”

Arriving at the right answer requires a thorough review of each case’s unique facts. More times than not, the wise choice is to use your information as leverage to successfully negotiate a conclusion to the case. You will, however, encounter cases in which the fraudulent party is either oblivious to the risks or never believes the day of reckoning will arrive. It is in that instance that you must be ready to put on the damning evidence.



PRIVILEGE, forfeiture, and the Fifth Amendment

Remember, attorney-client privilege does not extend to advice given a client in the planning of criminal or fraudulent conduct. In matters of tax fraud, privilege is not absolute. The name of the client, the client’s financial status, tax payments, when and where matters were discussed, fee arrangements, and types of services may have to be disclosed. *U.S. v. Frank E. Haddad*, 527 F.2d 537 (1975).

Governments have continued to increase their exercise of

With the engagement of a forensic accountant comes the risk that your own client may have some level of culpability. For that reason and others, the best practice is for the attorney, rather than the client, to retain the services of the forensic expert, so that, at least initially, attorney-client privilege covers the expert’s work product. It may very well be that both parties are culpable of the criminal or fraudulent activity and no further action is taken. Should a government investigation ensue, the privilege could be asserted over the expert’s work.

forfeiture powers when confronting fraudulent and criminal citizens. Consider seriously this possibility. You may want to trace sources of funds for each marital asset to insulate against forfeiture and show that purchases were from funds derived from legal, not criminal, endeavors. Attorney’s fees may be subject to forfeiture as well.

Be ready for the fraudulent spouse to refuse to testify under oath, asserting his or her Fifth Amendment right against self-incrimination. Remember that in civil proceedings, including divorce, the court may draw an adverse inference against the party asserting this right.



PROCEDURAL Approaches

How evidence is presented has a great impact on its persuasiveness. Most people love to hear a good story, and judges are no exception. An author builds suspense, and a good trial lawyer does the same. It is surprising how a good story told at trial meets fewer objections than one badly presented. Truly great trial lawyers are able to tell a story so artfully that opposing counsel becomes enraptured and forgets to object. Some years ago, my cross-examination of the wife in a hotly contested divorce trial culminated in my assertion that she was a liar. Typically this would be met by loud objections from her counsel and a stern admonishment from the court. In this case, however, I encountered neither; her counsel and the judge were both nodding in agreement.

Build testimony as though your novel is unfolding. In a financially based case, establish a foundation of facts and

figures. Intertwine those facts and figures with human elements that bring life to the numbers. Then build on each point so that the listener begins to draw his or her own conclusion that coincides with your theory of the case.

The proofs presented to the court should be simple, understandable, and interesting. Presentation software programs, such as Power Point, Prezi, and Vue, to name just a few, help achieve these three elements. Gone are the days of a glassy-eyed judge following along at pencil point as an accountant explains the paper trail in mind-numbing detail on 14 columns of graph paper. Find a qualified computer graphics professional to work with your forensic expert to create easy-to-understand flowcharts, graphs, Excel analysis, and the like to help the court understand what your forensic accountant has examined and the findings of the report. Above all, make sure that if you employ a financial expert he or she can communicate a position well and is not afraid to defend it.

Conclusion

A divorce case involving unreported income and hidden assets is exciting and may make you feel like Perry Mason; however, recognize your limitations and the risks of handling such a matter. You could very well become the target of an investigation. Retain the best forensic accountant you can find and seek the assistance of good criminal and tax counsel to help you anticipate the pitfalls of your case. **FA**



Carlton R. Marcyan, JD, CPA, CFP, CDFA, is a partner and chair of Schiller DuCanto & Fleck, LLP, in Chicago. He was a researcher for the Review Staff of the IRS while a law student, an auditor and tax specialist with Coopers & Lybrand, and has been a litigator with his present firm since 1983.