
EXPERT TESTIMONY IN TAX LITIGATION: OPINIONS OF FORENSIC ACCOUNTANTS IN COURT

Ishaan Deepak Joshi, MIT-WPU, Faculty of Law

ABSTRACT

In recent years, forensic auditing has rose to prominence. Former British Prime Minister and Exchequer Chancellor Gordon Brown stated, in reference to the fight against terrorism, "What use of fingerprint recognition was to the nineteenth century & Genetic analysis was to the twentieth century, financial data and forensic audit has become one of the most potent investigatory & intelligence tools available today." The efforts of governments and institutions to combat worldwide money laundering & tax evasion contributed to the rise in the demand for forensic accounting. Because forensic accounting is a relatively new discipline, little research has been conducted in this area.

Introduction

Relying on just what courts have stated about forensic accountants in judicial decisions, this paper examines the application of forensic accountants in tax litigation in depth. The results extend the insights gained from studies and polls in this field into concrete realms of case opinions. Recognizing how forensic audit experts have already been utilised in tax lawsuits in history will aid filers & their legal advisors in determining whether to retain such specialists in the future. Identifying the antecedents and credentials of professionals whose statements had been deemed either efficient or ineffective will also be beneficial. This research will assist forensic accountants in understanding possibilities and dangers, as well as the types of evidence that justices find persuasive.

In litigation, the function of expert witnesses is to assist the fact-finder in resolving contested issues by contributing their specialised knowledge. When conflicts among both payers as well as taxation authorities revolve around facts requiring an awareness and implementation of accounting problems, external auditors can aid the stakeholders in settling the issue. According to Crumbley, forensic accounting engagements are a specialised field of practise that arises from real or potential disputes or litigation. According to them, forensic denotes suitability to be utilized in a legal proceeding, in which the law is the standard by which forensic accountants are required to work and provide expert testimony. According to their comprehensive description, "Forensic Accounting is the process of classifying, documenting, resolving, deriving, grouping, disclosure, as well as confirming previous financial information or even other accounting functions for the purpose of resolving present or potential legal battles, or by using of this kind of past fiscal data to project future financial data for the purpose of resolving legal disputes."

American Institute of CPAs provided definition of forensic accounting includes "...to accumulate, evaluate, & analyse evidentiary issue as well as to construe and report information, which may entail either an audit or a consulting engagement." Instances of forensic audit utilisation encompass aid with business cessation, insolvency, revenue loss, financial reporting for holdings, anticompetitive predatory pricing, utility charge disputes, trademark dilution income, contractor or worker identification, contract infringement, enterprise stock valuation, stakeholders' disagreements, property allocation among intended

recipients, marital disputes, malicious prosecutions against CPAs, and tax matters including delinquent tax returns. Just before 1993, the phrase forensic accountant was also utilised by the courts.

The Frye Test

As the 20th century progressed, the legal system developed criteria again for validity of empirical proof. *Frye v. United States*, a landmark federal case decision from the Columbia District Circuit in 1923, addressed this same legitimacy of evidence predicated on the blood pressure systolic examination, a predecessor to today's polygraph. The court ruled that a modern scientific procedure must have attained widespread consensus in the particular discipline to which it pertains, and this is not sufficient for a competent individual specialist to attest that a technique is genuine. In the year 1975, more than fifty years well after Frye decision, the Fed Evidence Rules (FRE) were issued to govern both civil and criminal cases before federal judges. The initial FRE Rule 702 authorising the use of an independent expert read the following:

A testimony by a person recognized as an authority by expertise, competence, training, experience, or degree may attest in the manner of a judgment or otherwise if empirical, specialised, or other expert training would then assist the fact-finder in understanding the evidence or determining a contested fact. Even though some courts keep applying the Frye criterion, it has been supplanted by a series of standards for state law suits and the overwhelming majority of state court systems.

The Daubert Criterion

The 1993 *Daubert vs. Merrill Dow Pharmaceuticals* decision of the Supreme Court of the United States established the Daubert test, mandating state court judges to guarantee that expert evidence is pertinent and trustworthy. FRE Rule 702 was modified as follows: If science, technical, or other domain expertise will aid the trier of actuality in understanding the evidence or determining a material fact, a testimony by a qualified specialist may attest to it in the manner of an opinion and / or, if the testimony is relevant to the issue at hand.

1. The statement is supported by adequate facts or evidence;

2. The statement is based on sound principles and techniques, and
3. The testimony has applied consistently the rules and procedures to the case circumstances.

Through the *Daubert v. Merrill Dow Pharmaceuticals*, the U.S. Supreme Court recommended that the critical elements be taken into account by judges in determining whether an expert's testimony is credible and relevant towards the factual data: the principle or methodology has indeed been assessed; the tactic has indeed been exposed to peer assessment; the prospective error margin is known; the principle or methodology has widespread adoption; as well as the principle or methodology existed before the litmus test. Eventually, the *Joiner & Kumho Tire* decisions established the *Daubert* test's implementation.

According to *General Electric Company vs. Joiner*, appellate judges may review the admittance or refusal of expert evidence by a trial court judge for such an abuse of authority. *Kumho Tire vs. Carmichael* demonstrated that because a judge's gatekeeping duty extends to all expert testimony, regardless of whether it relates to scientific, technical, or other specialised knowledge. Part of the responsibility of forensic auditors who have been admitted as legal experts is to guarantee that such a testimony cannot be contested. Following is a discussion of the roles that fraud examiners could perhaps serve in tax litigation.

The Functions of Forensic Accountants in Tax Litigation

Michaelson observes that forensic accounting specialists can be divided into three categories: witnesses, consultants, and consultants. When accountants are summoned to attest as factual experts, they have been required to provide only first-hand, non-opinionated information. Michaelson describes the second function as that of an expert consultant, in which an auditor may counsel on an attorney's deliverables by strategy formation, examining documents, & providing extra help to settle a case. Consulting specialists owe their objectivity to the client, not the fact-finder, and may argue on their client's behalf in court. The third type is the expert witness. Michaelson observes that experts typically appear before a fact-finder (judge &/or the jury) to offer their opinion by either interrogation or trial testimony. They must've been able to meet either the *Daubert* test or the *Frye* criterion, where applicable. Di Gabriele notes that these standards foster an environment in which the impartiality of an authoritative

source must be transparent. Even though auditors can offer advice to attorneys, those who serve as expert must appear to be objective. The association must not cause jury members or justices to doubt their impartiality and fairness in rendering a verdict.

Summarization

In tax litigation, employing forensic accountants is an evolving area. This is the first study to examine genuine court cases. Forty instances were identified wherein accounting and audit expert testimonials met the Frye & Daubert Guidelines & published judicial rulings were available. They constitute a negligible percentage of any and all tax transactions. As the possibility of lawsuits should be weighed almost in all cases, the conclusions drawn from the evaluation of judicial decisions have ramifications for a substantial number of additional tax cases.

It was the responsibility of the forensic accountants to assist the fact-finders in comprehending the evidence. In tax disputes, there were 3 types of tasks for forensic accountants: fraud analysis, regulatory compliance, as well as business damage evaluation. Despite the absence of forensic accountant evidence on enterprise valuations for taxation purposes as in trials reviewed for this study, of that kind of valuation problems have been addressed with aid of expert testimony in tax disputes. In the past decade, forensic accountants had already broadened their expertise into this area, however this sort of task is rarely presented in tax matters.

A synthesis of the performance indicators of efficient specialists as observed by courts in their views broadens the published research beyond studies of accounting professionals, attorneys, & academics to an examination as to how courts interpret their worth. The judges deemed the expert's evidence futile for the following reasons: the work conducted was irrelevant, there were time constraints for specialist to finish the task, as well as the work wasn't really as per standards. The judges viewed favourably the accounting and audit professionals with the appropriate credentials & extensive expertise. Watters discovered that perhaps the proportion of forensic accounting assistance supplied by CPAs remained unchanged from the year 1998 all the way to 2003, the time period covered by the study. Each CPA-credentialed forensic expert was deemed to have provided persuasive testimony. The

conclusions of this research indicate that these experts have an entrepreneurial opportunity in the realm of tax lawsuits.

Conclusion

The explanations as to why filers opted on using forensic auditor evidence in the USA District Courts as well as Tax Courts but rather than the Federal Claims Court could be the subject of additional research. The motives again for apparent lack of forensic auditor evidence in business appraisal matters, the augmentation of this assessment to tax suits that employ expert testimony for such verification of records or information systems, as well as analogies with cases involving auditors in other legal fields including such securities & intellectual property, warrant further study. In addition, it would be useful to know whether accounting experts specialise in forensic audit and accounting or offer a wider spectrum of expert testimony services. Research Scholars could further examine the lawsuits to develop educational content for teaching forensic audit & accounting.

ⁱ References

- i. Cohen, M.A. 2001. How to Read Tax Court Opinions. 2001. Houston Business and Tax Law Journal, 1: 1-11
- ii. Crumbley, D.L. 2005. Qualifying as an Expert Witness. In: Pagano, W.J. and T.A. Buckhoff, Expert Witnessing in Forensic Accounting, R.T. Edwards, Chapter 5: 48-57.
- iii. Crumbley, D.L. and N. Apostolou. 2002. Forensic accounting: a new growth area in accounting. The Ohio CPA Journal, 61(3): 16-20.
- iv. Di Gabriele, J.A. 2008. An Empirical Investigation of the Relevant Skills of Forensic Accountants. Journal of Education for Business, 83(6): 331-338.
- v. Di Gabriele, J.A. 2011. An Observation of Differences in the Transparent Objectivity of Forensic Accounting Expert Witnesses. Journal of Forensic & Investigative Accounting, 3(2): 390-416.
- vi. Di Gabriele, J.A. 2008. An Empirical Investigation of the Relevant Skills of Forensic Accountants. Journal of Education for Business, 83(6): 331-338.
- vii. Di Gabriele, J.A. 2011. An Observation of Differences in the Transparent Objectivity of Forensic Accounting Expert Witnesses. Journal of Forensic & Investigative Accounting, 3(2): 390-416.
- viii. Frye v. United States. 1923. 293 F. 1013, D.C. Cir.
- ix. General Electric Company et al. v. Joiner et ux. 1997. 522 U.S. 136
- x. Kumho Tire Co. v. Carmichael. 1999. 526 U.S. 137.
- xi. Michaelson, W.M. 2005. Advocacy and the Expert Witness. In: Pagano, W.J. and T.A. Buckhoff, Expert Witnessing in Forensic Accounting, R.T. Edwards, Expert Witnessing in Forensic Accounting: 63-70

- xii. Telpner, Z. and M. Mostek. 2002. *Expert Witnessing in Forensic Accounting*. CRC Press.
- xiii. Brown, G. 2006. Meeting the Terrorist Challenge. Speech given to Chatham House, October 10, 2006
- xiv. AICPA. 2006. Business Valuation/Forensic Litigation Services Executive Committee.
- xv. AICPA. 2008. Hot Market for Forensic Services. *Journal of Accountancy*, 206(6): 29