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30.00 SPECIFIC ITEMS

30.01 GENERALLY

The specific items method of proof is a direct method of proof used to establish unreported income. This method of proof differs from the indirect methods of proof (net worth, bank deposits, and expenditures) in that it focuses on specific financial transactions and does not attempt to reconstruct the defendant's overall financial situation. The specific items method primarily relies on direct evidence, although circumstantial evidence may also be introduced.[1] By contrast, the indirect methods generally rely on circumstantial evidence to prove an understatement of income. Using the indirect methods of proof, the government shows "either through increases in net worth, increases in bank deposits, or the presence of cash expenditures, that the taxpayer's wealth grew during a tax year beyond what could be attributed to the taxpayer's reported income, thereby raising the inference of unreported income." ***United States v. Black***, 843 F.2d 1456, 1458 (D.C. Cir. 1988). The government often resorts to indirect methods of proof when the defendant deals in cash and has maintained inadequate records from which the defendant's income can be reconstructed.

The advantages of the specific items method of proof are that it is easy for the prosecutor to present and for the jury to understand, it generally involves less evidence and has relatively simple criminal computations compared to the indirect methods, and the government does not have to follow all of the technical requirements of the indirect methods of proof. The objective of the specific items method is to prove that a defendant earned more money than is reflected on the defendant's tax returns, or that reported deductions, expenses, or credits are either nonexistent or overstated. Both testimonial and documentary evidence may be introduced. This evidence may include admissions of the defendant, the defendant's books and records, bank records, the testimony of inside witnesses (*e.g.*, the defendant's employees and ex-spouse), testimony and documentation of witnesses engaged in the transactions that have been reported inaccurately, and the testimony of the defendant's accountant.

There are four general categories of specific items cases:

[1] . See, e.g., United States v. Marcus, 401 F.2d 563, 565 (2d Cir. 1968) (defendant's income from check cashing service determined by multiplying standard check fee by amount of checks cashed).

1. Unreported income, where the evidence establishes that the total amount of income received is greater than the amount reported;

2. Unreported income, where the evidence establishes that identified items of income were not reported;

3. Failure to report a business or other source of income;[2]

4. Overstated deductions or expenses, including fictitious deductions and legitimate deductions that are inflated.

Generally, specific items cases will deal with income rather than deductions or expenses. The government usually attempts to produce evidence that the defendant received income that was either not shown at all on the return or underreported on the return. ***United States v. Thompson***, 518 F.3d 832, 853 (10th Cir. 2008); ***United States v. Hart***, 70 F.3d 854, 860 n.8 (6th Cir. 1995); ***United States v. Marabelles***, 724 F.2d 1374, 1377 n.1 (9th Cir. 1984); ***United States v. Horton***, 526 F.2d 884, 886 (5th Cir. 1976); *see also* ***United States v. Genser***, 582 F.2d 292, 295-96 n.1 (3d Cir. 1978); ***United States v. Allen***, 551 F.2d 208, 210 (8th Cir. 1977); ***United States v. Bray***, 546 F.2d 851, 856-57 (10th Cir. 1976).

As a practical matter, there are four basic steps to developing a specific items case involving unreported income: (1) proving that the relevant amounts are taxable income to the defendant, (2) proving the income was received by the defendant, (3) proving the income was not reported, and (4) showing the defendant's personal involvement in the failure to report the income and in the disposition of the unreported income.

While the government must show that the defendant received unreported taxable income, it need not show how the defendant spent the money after it became his or her income. ***United States v. Martin***, 525 F.2d 703, 707 (2d Cir. 1975) (district court correctly instructed jury that government had to show that embezzled funds were

[2] . *See* Section 12.00, False Returns, *supra*, for a discussion of cases in which a defendant reports a false source of income, but accurately reports the amount of income and is prosecuted for filing a false income tax return under 26 U.S.C. § 7206(1). *See also* ***United States v. DiVarco***, 484 F.2d 670, 673 (7th Cir. 1973).

unreported taxable income to defendant but that government need not show how defendant spent the money after it became his income).

30.02 UNREPORTED INCOME -- OVERCOMING AMOUNTS REPORTED ON RETURN

In this type of specific items case, the proof establishes that the total income received is greater than the total reported. Thus, the evidence establishes that the defendant failed to report income by proving more income than the amount reported on the return. It is not necessary to show which particular items were not reported. For example, if the defendant reports real estate commissions of $20,000 and the evidence establishes real estate commissions of $60,000, then there is $40,000 in unreported income. It makes no difference whether a particular commission was reported. *See*, *e.g.*, ***United States v. Marabelles***, 724 F.2d 1374, 1378 & n.2 (9th Cir. 1984) (government proved gross receipts from defendant's painting business substantially in excess of reported amounts); ***United States v. Horton***, 526 F.2d 884, 886 (5th Cir. 1976) (amount of legal fees testified to by attorney-defendant's clients exceeded legal fees reported).

The proof required to overcome reported income can be fairly simple. The prosecutor can call witnesses to testify as to the amount of money paid to the defendant, add the amounts up, and compare the total to that shown on the return. Although there are a number of cases that lend themselves to this approach, it is not always practical. For example, it would impractical to call as witnesses hundreds of a retailer-defendant's customers. Locating enough of the customers to overcome reported income would be doubtful at best. In such a situation, specific items is not an available or practical method of proof. As a rule of thumb, this is usually the case when the defendant has reported a substantial gross income and his or her business is such that the income is derived from large numbers of customers, any one of whom has only paid the defendant a relatively small amount, and there is no available evidence beyond the testimony of the individual witnesses, such as books and records reflecting the amounts received from customers.

30.03 UNREPORTED INCOME -- IDENTIFIED INCOME ITEMS NOT ON RETURN

In this second type of specific items case, the items of income reported on the return can be identified and, therefore, any other items of income necessarily represent unreported income. The unreported income may include an entire category of income,

such as capital gains or taxable interest. *See, e.g.*, ***Azcona v. United States***, 257 F.2d 462, 464 (5th Cir. 1958) (the defendant reported only his salary from the police department and no other income, where the evidence established that he also received graft payments).

This second group of cases also may include situations where the defendant has reported some, but not all, of the income in a particular category, and the government can identify all of the items that make up the reported amount. Any additional items of income necessarily constitute unreported income.

In this type of specific items case, if the government has obtained the defendant's books and records, a common approach is to reconcile the books and records to the return so as to determine which particular items of income have been reported. Assuming the government has been able to establish that the return reports only those income items recorded in the books and records, any items of income not reflected in the books and records necessarily represent unreported income. Often, the defendant's bookkeeper, office manager, secretary, and return preparer are the key witnesses in the case. The office employees can testify as to the office procedures used to record income, any instructions given to them by the defendant, and any admissions the defendant made regarding unreported income. The return preparer can testify regarding the information used to prepare the return. Generally, the return preparer has been given inaccurate summary documents or incomplete records by the defendant. If the criminal case began with an examination audit, the Revenue Agent may also be called to testify regarding the reconciliation of the books and records to the return. Note that the government is not required to verify or corroborate reported amounts of income. The government may take the defendant's reported income as an admitted amount earned from designated sources. ***United States v. Burkhart***, 501 F.2d 993, 995 (6th Cir. 1974). Reconciliation of the books and records to the return is of great benefit to the government. If the government can prove exactly what was reported and what was not reported, it lends credibility to the government's case.

The return alone often will lend itself to this type of specific items case. Thus, if the return fails to report any interest income, proof of the receipt of interest income will ordinarily establish unreported income. The prosecutor must be wary, however, of the defense that alleged unreported items of income were in fact reported, but in the wrong category or on the wrong line on the return. For example, assume the evidence establishes

that the defendant received $3,000 in interest income and did not report any income designated as interest income. If, however, the defendant reported $6,000 in miscellaneous income and the prosecutor is not able to identify the source of the reported miscellaneous income, then the government may have no answer the allegation that the defendant did in fact report the $3,000 in interest income as part of the $6,000 reported as miscellaneous income. For this reason, every effort should be made to document the sources of reported income.

For examples of specific items cases involving identified income items not reported on the return, *see, e.g.*, ***United States v. Thompson***, 518 F.3d 832, 851-53(10th Cir. 2008) (foreign commission checks totaling more than $2,800,000 not reported on tax returns), *petition for cert. filed*, 76 U.S.L.W. 3655 (U.S. Jun 09, 2008) (NO. 07-1539); ***United States v. Allen***, 551 F.2d 208, 210-11 (8th Cir. 1977) (rental income and real estate commissions not reported on return); ***United States v. Venditti***, 533 F.2d 217, 219 (5th Cir. 1976) (77 checks representing business income not reported on return); ***United States v. Parr***, 509 F.2d 1381, 1383-86 (5th Cir. 1975) (funds derived from extortion and graft not reported on return); ***Swallow v. United States***, 307 F.2d 81, 82 (10th Cir. 1962) (funds diverted from business not reported on return).

30.04 FAILURE TO REPORT BUSINESS OR SOURCE OF INCOME

When an individual receives and does not report income from a business enterprise during the course of a year, the specific items method of proof can be used to show that the defendant filed a false return or failed to file a required return. The government would have to prove through the testimony of insider and customer witnesses that the defendant operated the business, prove the unreported income through the witnesses' testimony, bank records, and business records, and, if appropriate, show that the defendant did not inform his or her return preparer of the existence of the business. A leading opinion on this type of case is ***Siravo v. United States***, 377 F.2d 469 (1st Cir. 1967). Siravo reported wage income on the tax returns he filed for three of the prosecution years and did not file a return for the fourth year. He did not report gross receipts from a jewelry manufacturing business he operated. Siravo was charged with one count of failing to file a return, in violation of 26 U.S.C. 7203, and with three counts of subscribing to a false return, in violation of 26 U.S.C. 7206(1), in that he "failed and omitted to disclose . . . substantial gross receipts from a business activity." ***Siravo***, 377 F.2d at 471-72.

As to the false return counts, Siravo argued that the failure to attach a Schedule C to his return reporting his gross receipts was not a false statement or misrepresentation of his taxable income but merely an omission. Rejecting this argument, the court said:

> [W]e hold that a return that omits material items necessary to the computation of income is not "true and correct" within the meaning of section 7206. If an affirmative false statement be required, it is supplied by the taxpayer's declaration that the return is true and correct, when he knows it is not.

Siravo, 377 F.2d at 472.

With respect to the failure to file count, the trial court properly instructed the jury that total receipts must be reduced by the cost of goods sold and other costs representing a return of capital to arrive at gross income for the manufacturing business, and that it was sufficient if the government showed that receipts exceeded cost of goods sold by at least $600. But the only evidence respecting the cost of goods sold was testimony that substantially all materials were supplied by the defendant's customers. ***Siravo***, 377 F.2d at 473. Siravo argued that "since labor costs are part of the cost of goods sold and since there was testimony that the volume of business was impossible for one man to handle, the government has not carried its burden of showing that he did not have labor costs offsetting the proved gross receipts." ***Id***. Holding that the government had no such burden, the court said that "[t]he applicable rule here is that uniformly applied in tax evasion cases -- that evidence of unexplained receipts shifts to the taxpayer the burden of coming forward with evidence as to the amount of offsetting expenses, if any." ***Id***. [3]

Note that if the defendant does come forward with evidence of offsetting costs or expenses in a failure to file case involving a manufacturing business, then the government has the burden of establishing that the costs and expenses either were not allowable or

[3] Defendants may attempt to rely on ***United States v. Francisco***, 614 F.2d 617 (8th Cir. 1980), to support an argument that the prosecution does bear the burden of proving cost of goods sold. In ***Francisco***, the defendant "stipulated to receiving 'gross compensation on sales' for each year in question in amounts in excess of $21,000[,] . . . figures [that] were calculated by subtracting the cost of goods sold from total sales." 614 F.2d at 618. Relying on ***Siravo***, the Eighth Circuit opined that the government has the burden of establishing "that gross receipts exceed the cost of goods sold by an amount sufficient to trigger the reporting requirements. The burden then shifts to the taxpayer to come forward with evidence of offsetting expenses." ***Francisco***, 614 F.2d at 618. Defendants may argue that this language indicates that the government has the burden of proving gross receipts *and* the cost of goods sold. Read in context, however, this language is not nearly that far reaching. Indeed, the court in ***Francisco*** never reached the question of which party bears the burden of proving cost of goods sold, because the defendant and the government entered into a stipulation that reflected those costs. Accordingly, ***Francisco*** does not conflict with ***Siravo***.

were insufficient to reduce gross income below the level triggering the filing requirement. On the other hand, where the charge is filing a false return, as were three of the counts in ***Siravo***, defense evidence as to offsetting costs and expenses would "not go to the materiality of the omitted receipts, but to the lack of mens rea in their omission." ***United States v. Taylor***, 574 F.2d 232, 237 (5th Cir. 1978).

In ***Taylor***, the defendant did not file Schedules F for the first two prosecution years and filed a false Schedule F that understated his livestock receipts for the third year. The court held that proof of unreported gross receipts was sufficient to sustain the conviction. "Requiring the government to prove the omission of gross income comes near to requiring the proof of additional tax liability. Such a definition of 'material' would seriously jeopardize the effectiveness of section 7206(1) as a perjury statute and would imperil the self-assessment nature of our tax system." ***Taylor***, 574 F.2d at 236.

In a failure to file case, ***United States v. Schutterle***, 586 F.2d 1201, 1205 (8th Cir. 1978) (*per curiam*), the Eighth Circuit held that evidence of bonus or commission payments from a corporation to the defendants, as local supervisors, was sufficient to establish gross income necessary to trigger the filing requirement. In ***Schutterle***, the government did not prove that the defendants actually sold any products, but proved only that the defendants received bonuses or commissions based on the volume of products purchased, presumably for resale. 586 F.2d at 1205. Rejecting defendants' argument that these payments from the corporation were merely discounts or rebates on volume purchases, the court of appeals stated the defendants had performed services for the corporation, as local distributors, and the payments were made in recognition of these services. Thus, the payments represented commissions that should have been reported as income. ***Id.***

Taking a contrary position on the burden of production, the Tenth Circuit in ***United States v. Brewer***, 486 F.2d 507, 509-10 (10th Cir. 1973), *overruled on other grounds by* ***United States v. Taylor***, 828 F.2d 630, 633 (10th Cir. 1987), reversed one count of a failure to file conviction for what the court characterized as "insufficient" evidence that the defendant earned enough income to trigger the filing requirement. The court stated that the evidence of a $17,000 sale of stock was a capital transaction, which "does not establish anything more than the fact that the defendant was a person of some means. It fell short of establishing that any part of these proceeds constituted income." ***Brewer***, 486 F.2d at 509; *but see* ***United States v. Gillings***, 568 F.2d 1307, 1310 (9th Cir.

1978) (distinguishing ***Brewer*** as involving a sale of stock, not the sale of goods as part of a business); ***United States v. Bahr***, 580 F. Supp. 167, 171 (N.D. Iowa 1983) (holding that where the government establishes the existence of unexplained receipts sufficient to give rise to the filing requirement and follows up reasonable leads as to the cost of goods sold, then the government has made out a *prima facie* case of failure to disclose gross income and it is up to the defendant to establish any offsetting expenses).

In this vein, care should be taken to frame the indictment so as to conform exactly to the evidence to be offered. If the government can only prove the failure to report "gross receipts," then the indictment should allege that the defendant failed to report "gross receipts" and not charge that the defendant did not report "income." *See, e.g.*, ***Taylor***, 574 F.2d at 236.

30.05 OVERSTATED DEDUCTIONS OR EXPENSES

30.05[1] Generally

Cases involving overstated deductions or expenses fall into categories similar to cases involving understatements of income. In some, the evidence will establish that the defendant was not entitled to specific deductions claimed on a return. In other cases, the evidence will simply show that the defendant was entitled to a lesser deduction than that claimed on the return. [4]

There are a limited number of cases dealing with false or overstated deductions. Since deductions are subtracted from gross income in arriving at taxable income and the tax due and owing, they are material to the contents of an income tax return. ***United States v. Warden***, 545 F.2d 32, 37 (7th Cir. 1976). Generally, false deduction cases are proven by introducing evidence from the witnesses involved with the defendant in a transaction that is the subject of a deduction and comparing the records maintained by that witness with records maintained by the defendant. Often, the defendant's bank records prove that the deductions claimed were overstated. Many defendants attempt to support their false deductions by altering the amounts of checks or their payees and supplying the checks to the IRS, often with other false documentation, *e.g.*, phony invoices, receipts, and letters. Forensic analysis of these items generally establishes their

[4] Just as reporting a false source of income is prosecutable under section 7206(1) (*see* Section 30.01 n.1, *supra*, so, too, is a willful misstatement on a return as to the source of claimed deductions. *See* ***United States v. Bliss***, 735 F.2d 294, 301 (8th Cir. 1984) (*see also* Section 30.05[2], *infra*).

falsity with relative ease, particularly in the case of checks with altered amounts. Most defendants fail to realize that when checks are negotiated by the bank, the bank encodes the amount of the check on the face of the check, making it easy to determine the actual amount paid. Because the government must prove a negative, *i.e.*, that a claimed expense was not incurred at all or not incurred in the amount shown on the return, false deductions cases may entail problems of proof that are greater than those routinely encountered in cases involving the omission of income.

30.05[2] Individuals and Businesses

Cases involving individual taxpayers and businesses fall into many different fact patterns. The cases with the greatest jury appeal are those in which the defendant has diverted corporate funds to his or her personal use and deducted the diversions on the corporate return as some form of corporate expenses. The tax benefit to the defendant in these cases is twofold: the corporation's tax liabilities are reduced because personal expenses are improperly deducted as business expenses on the corporate tax returns, and the individual receiving the corporate diversion reduces his or her individual tax liabilities by failing to report the diversions as income on his or her individual returns. This was the fact pattern in ***United States v. Helmsley***, 941 F.2d 71, 75-78, 93 (2d Cir. 1991) (corporation's expenditures on its owner's personal estate renovation project improperly deducted as business expenses); ***United States v. Black***, 843 F.2d 1456, 1459-62 (D.C. Cir. 1988) (checks drawn on corporate accounts to pay personal expenses sufficient to sustain tax evasion conviction); ***United States v. Garcia***, 762 F.2d 1222, 1225-26 (5th Cir. 1985) (defendant improperly claimed personal expenses as business deductions); ***United States v. Greenberg***, 735 F.2d 29, 31-32 (2d Cir. 1984) (corporation's payment of owner's personal expenses improperly deducted as business expenses); and ***United States v. Nathan***, 536 F.2d 988, 990-91 (2d Cir. 1976) (defendant expensed Subchapter S corporation's checks that in fact he cashed for himself).

United States v. Bliss, 735 F.2d 294 (8th Cir. 1984), provides a good example of how to use the specific items method to prove that the defendant has claimed false deductions. The defendant wrote checks on his business bank account to a fictitious company, prepared phony invoices, and had his employees cash the checks, returning most of the money to the defendant. ***Id***. at 296. The government introduced the checks, false invoices prepared by the defendant, and the testimony of the employees who admitted that the checks were not for purchases claimed by the defendant. The employees

also testified that the defendant told them the money generated by the scheme was "tax free money" and instructed them to lie to the IRS after the investigation began. ***Id***. at 296-97. The Eighth Circuit rejected the defendant's challenge to the sufficiency of the evidence that he had filed false tax returns, describing the evidence of defendant's guilt as "overwhelming." ***Bliss***, 735 F.2d at 301.

Relatively simple examples of overstated deductions or expenses may be found in ***United States v. Ragen***, 314 U.S. 513, 523-24 (1942) (corporate profit distributions, i.e., dividends, were falsely expensed on the corporation's books and returns as commissions, resulting in an understatement of the taxable income and tax liability of the corporation); ***United States v. Pacheco***, 912 F.2d 297, 301 (9th Cir. 1990) (false partnership deductions); ***Spinney v. United States***, 385 F.2d 908, 911 (1st Cir. 1967) (dentist overstated deductions for dentures, dental supplies, and other professional expenses); ***United States v. Wilkins***, 385 F.2d 465, 467-68 (4th Cir. 1967) (defendant claimed $10,000 in deductions, government proved $7,000 were fictitious); ***United States v. Pechenik***, 236 F.2d 844, 845-46 (3d Cir. 1956) (corporation's capital expenditures improperly deducted as operating expenses, thereby understating taxable income); ***Eggleton v. United States***, 227 F.2d 493, 497-98 (6th Cir. 1955) (defendant overstated costs of used cars he purchased for resale); ***United States v. Berger***, 325 F. Supp. 1297, 1303 (S.D.N.Y. 1971) (domestic parent corporation improperly deducted expenses of its foreign subsidiary), *aff'd*, 456 F.2d 1349 (2d Cir. 1972).

30.05[3] Return Preparers

A large category of specific items cases with false deductions involves return preparers who falsely claim itemized deductions or expenses for their clients and who are prosecuted under Section 7206(2). As with the other false deduction cases, these may include deductions that are totally fictitious or legitimate deductions that are inflated. ***United States v. Damon***, 676 F.2d 1060, 1063-64 (5th Cir. 1982) (false Schedules C overstating business expenses); ***United States v. Haynes***, 573 F.2d 236, 238 (5th Cir. 1978) (false itemized deductions); ***United States v. Warden***, 545 F.2d 32, 37 (7th Cir. 1976) (false itemized deductions). These cases often involve false charitable deductions, child care credits, and Schedule C business expenses. They may also involve fictitious dependents.

30.06 DEFENDANT'S ADMISSIONS

30.06[1] Generally

The importance of the defendant's admissions in a tax case cannot be overstated. Admissions regarding income are available from many sources. Defendants often boast to friends, spouses, and co-workers that they are "cheating on their taxes." Many defendants leave a paper trail of admissions, which presents a view of their financial situation drastically different from that reflected on the income tax returns filed with the IRS. For example, most defendants file financial statements with lenders to obtain mortgages, loans, credit cards, and credit accounts with retailers. In these situations, it is in the best interest of the defendant to portray his or her financial situation as favorably as possible. Consequently, these financial statements can be very helpful in proving that the defendant was well aware he or she had more income than was reported.

Often, the most important admissions are those made on the defendant's income tax returns. The government frequently uses admissions made on income tax returns (1) that the defendant had prepared but never filed with the IRS ("dummy returns"); (2) which were filed delinquently; or (3) which were timely filed and are used to prove income, deductions, and expenses.

30.06[2] Dummy Returns

Many lenders require that tax returns be submitted with credit applications. Defendants often submit "dummy" returns that have not been filed with the IRS and report income substantially in excess of that reported to the IRS. These dummy returns often provide leads as to unreported sources of income, as well as income from known sources that has been underreported. Dummy returns are also extremely valuable in proving that the defendant acted willfully.

30.06[3] Delinquent Returns

A rare type of specific items case is one based on the defendant's own admissions as to income and expenses, corroborated by independent evidence. In a failure to file case, for example, if the defendant has filed delinquent returns that are determined to be correct, the government may be able to sustain its burden of proving that the defendant earned sufficient income to require the filing of returns by introducing the delinquent

returns and independent corroborative evidence of the income figures reported on the returns. *See* ***United States v. Bell***, 734 F.2d 1315, 1317 (8th Cir. 1984) (*per curiam*).

In ***Bell***, the defendant was the sole proprietor of a business that provided tip sheets to bettors at racetracks. 734 F.2d at 1317 On appeal, the court, relying on ***United States v. Smith***, 348 U.S. 147 (1954), recognized that the government cannot prove an essential element of a crime through only uncorroborated post-offense extrajudicial admissions of the defendant.[5] The court held, however, that testimony from various witnesses about the defendant's sale of tip sheets and receipt of income was "enough corroboration to render the income statements on his late-filed tax returns admissible." ***Bell***, 734 F.2d at 1317. The Sixth Circuit has suggested that a district court is required to instruct the jury that a defendant may not be convicted solely on the basis of his or her uncorroborated admissions, *see* ***United States v. Marshall***, 863 F.2d 1285, 1287-88 (6th Cir. 1988) (failure to instruct jury that it could not find defendant guilty of distribution of cocaine solely on basis of defendant's uncorroborated admissions was reversible error where "[t]he need for corroboration [was] apparent"), but the District of Columbia, First, and Seventh Circuits have rejected the Sixth Circuit's position, *see* ***United States v. Dickerson***, 163 F.3d 639, 642 (D.C. Cir. 1999) (because "the corroboration rule is undeniably, in part, a rule governing the admissibility of a defendant's out-of-court statements, . . . [a]nd [because] it is well settled that preliminary facts relating to the admissibility of evidence are questions for the court and not for the jury," the jury need not be separately instructed on rule barring conviction solely on defendant's uncorroborated admissions (internal citations omitted)); ***United States v. Singleterry***, 29 F.3d 733, 736 (1st Cir. 1994) (same); ***United States v. Howard***, 179 F.3d 539, 543 (7th Cir. 1999) ("We agree with the circuits that have held that a district court is not obligated to instruct the jury to make a specific finding as to whether the government presented substantial independent evidence to corroborate the defendant's confession" (citing ***Dickerson*** and ***Singleterry***)).

30.06[4] Timely Filed Returns

The foregoing should be distinguished from the situation in an evasion or false return case where the defendant has timely filed returns. In such a case, the government

[5] The justification for this rule is that post-offense statements made to an official charged with investigating the possibility of wrongdoing are often unreliable. *See* ***Smith v. United States***, 348 U.S. 147, 152-55 (1954). ***Bell*** involved delinquent tax returns filed after the defendant had been interviewed by special agents of the IRS concerning failure to file his returns. ***Bell***, 734 F.2d at 1317.

"may take the taxpayer's reported income as an admitted amount earned from designated sources" and need not corroborate this reported income. ***United States v. Burkhart***, 501 F.2d 993, 995 (6th Cir. 1974). Corroboration is not required because the statements in the defendant's return constitute pre-offense admissions and pre-offense admissions do not have to be corroborated. ***Warszower v. United States***, 312 U.S. 342, 347 (1941); *see* ***United States v. Pennell***, 737 F.2d 521, 536-37 (6th Cir. 1984) (narcotics and firearms); ***United States v. Soulard***, 730 F.2d 1292, 1298 (9th Cir. 1984) (use of credit application to establish cash on hand); *see also* ***United States v. Marshall***, 863 F.2d 1285, 1290-91 (6th Cir. 1988) (Krupansky, J., dissenting).

Similarly, in most cases, the government can rely on the deductions and expenses claimed on the defendant's tax return to prove the statutory offsets to gross income. Deductions claimed on a tax return are admissions and can be used to make a prima facie case. Fed. R. Evid. Rule 801(d)(2); ***United States v. Northern***, 329 F.2d 794, 795 (6th Cir. 1964).

Once the government allows the deductions and expenses claimed on the tax return as filed, plus any additional deductions the government can calculate without the defendant's assistance, the burden of going forward falls on the defendant to show any additional allowable deductions. ***United States v. Marabelles***, 724 F.2d 1374, 1383 (9th Cir. 1984); ***United States v. Lacob***, 416 F.2d 756, 760 (7th Cir. 1969); ***Elwert v. United States***, 231 F.2d 928, 933 (9th Cir. 1956); ***United States v. Bender***, 218 F.2d 869, 871-72 (7th Cir. 1955); ***United States v. Link***, 202 F.2d 592, 593-94 (3d Cir. 1953); *see also* ***United States v. Pacheco***, 912 F.2d 287, 303-04 (9th Cir. 1990) (district court did not err in refusing to allow defendant to introduce evidence regarding unclaimed deductions, where deductions were not allowable, as a matter of law); ***United States v. Garguilo***, 554 F.2d 59, 62 (2d Cir. 1977); ***United States v. Nathan***, 536 F.2d 988, 991 (2d Cir. 1976).

30.07 NO BURDEN TO FOLLOW REASONABLE LEADS

In specific items cases, the government has no burden to follow reasonable leads provided by the defendant, as it does in indirect method of proof cases. *See* ***United States v. Marabelles***, 724 F.2d 1374, 1379 n.3 (9th Cir. 1984); ***United States v. Lawhon***, 499 F.2d 352, 356-57 (5th Cir. 1974); ***United States v. Suskin***, 450 F.2d 596, 598 (2d Cir. 1971); ***United States v. Shavin***, 320 F.2d 308, 311-12 (7th Cir. 1963); ***Swallow***

v. United States, 307 F.2d 81, 84 (10th Cir. 1962); ***United States v. Nemetz***, 309 F. Supp. 1336, 1339 (W.D. Pa. 1970), *aff'd*, 450 F.2d 924 (3d Cir. 1971). "[W]here the government's case is based on evidence showing specific items of unreported income, the safeguards required for indirect methods of proof are not necessary, as the possibility that the defendant may be convicted because non-taxable income is mistakenly presumed to be taxable income, or because cash expenditures are mistakenly assumed to be made from taxable income, is not present." ***United States v. Black***, 843 F.2d 1456, 1459 (D.C. Cir. 1988).

30.08 PROPER CHARACTERIZATION OF METHOD OF PROOF

The government must be careful to characterize the method of proof properly in cases in which unreported income is proven by bank records. In many cases, the unreported income is proven by the introduction of checks which the defendant received or converted but did not report on the tax return. If the government can show by direct proof that each check was taxable income to the defendant, the method of proof is properly termed specific items.

For example, in ***Black***, 843 F.2d 1456 (D.C. Cir. 1988), the defendant wrote checks on corporate accounts for personal expenses. The defendant claimed that these corporate diversions were not taxable income but were nontaxable loans. 843 F.2d at 1459. Although the government's method of proof was specific items (the specific items being the company checks diverted for the defendant's personal use), the defendant argued that the method of proof was actually bank deposits/cash expenditures and that his conviction should be reversed because the government did not prove that the expenditures were not made with funds from non-taxable sources. ***Id***. at 1458. The D.C. Circuit rejected the defendant's argument even though the prosecutor, the government's expert witness, and the trial judge occasionally referred to the method of proof as the "personal expenditures method." ***Black***, 843 F.2d at 1461. The court concluded that "[i]f the statements by the prosecutor, the testimony of the Government's tax witness, and the trial judge's instructions to the jury, are each considered in light of the evidence actually submitted, it is clear that the Government presented direct proof that Black received specific items of taxable income and did not pay tax on that income." ***Id***. at 1460[6] ; *see*

[6] As described by the court: "[I]n the Government's view, Black received taxable income each time he wrote a check . . . to cover his personal expenses . . . [and] at no point in the trial was it suggested to the jury that evidence of personal expenditures, without more, would be sufficient to convict." ***Black***, 843 F.2d at 1459-61.

also ***United States v. Wilson***, 887 F.2d 69, 77 (5th Cir. 1989) (district court properly refused to give bank deposits instruction in specific items case in which proof of unreported income was based on the "transfer of specific and substantial funds" to defendants' bank accounts).

Similarly, direct evidence as to cash transactions could, in some circumstances, be a specific item of unreported income. For example, if witnesses testified that they paid the defendant in cash for services, those items could be included as income. However, the mere deposit of cash into a bank account without evidence that the cash was income to the defendant would not be sufficient to prove unreported income in a specific items case.

30.09 CRIMINAL COMPUTATIONS

30.09[1] Method Of Accounting

In computing the defendant's taxable income and tax for each prosecution year, the government generally is required to follow the accounting method used by the defendant. If the defendant was on the cash basis during the prosecution year, then the government's proof also must be computed on the cash basis, under which income is reported when it is received, and expenses are deducted only in the year in which they are actually paid. *See* ***United States v. Wiese***, 750 F.2d 674, 677 (8th Cir. 1984) (a bank deposits case stating the general rule that a cash basis taxpayer must report income in the taxable year of actual or constructive receipt). *See also* Treas. Reg. § 1.446-1(a)(1) & (c)(1)(i).

Similarly, if the defendant used a hybrid method of accounting, with some items treated on a cash basis and other items treated on an accrual basis, then the government also must use the same hybrid method in doing its computations. ***United States v. Marttila***, 434 F.2d 834, 836-37 (8th Cir. 1970).

The defendant also is bound by the accounting method used during the prosecution year when preparing computations for trial. In ***Clark v. United States***, 211 F.2d 100, 105 (8th Cir. 1954), the defendant had reported income during the prosecution years on the cash basis. The trial court excluded testimony from the defendant's expert on what the effect on taxable income would have been had the returns been prepared on the accrual basis, instead of the cash basis, on the ground that such testimony had no probative value. ***Id***. The court of appeals affirmed, agreeing with the

district court that "any hypothesizing of facts which had no probative basis was . . . wholly irrelevant and incompetent as a defense to the charge." ***Clark***, 211 F.2d at 105. Similarly, in ***United States v. Helmsley***, 941 F.2d 71, 85 (2nd Cir. 1991), the defendant followed one depreciation method during the prosecution years but argued at trial that allowable deductions would have offset tax deficiencies under another method. The court held that having selected a particular depreciation method, the defendant was not free to recalculate her taxes under another depreciation method. ***Id.***; *see also* ***United States v. Lisowski***, 504 F.2d 1268, 1275 (7th Cir. 1974) ("[w]hen the taxpayer has employed a hybrid or unauthorized accounting method, he is hardly in a position to complain when the computation employing that method is introduced to prove specific items of omitted income." (quoting ***Morrison v. United States***, 270 F.2d 1, 4 (4th Cir. 1959)); ***Fowler v. United States***, 352 F.2d 100, 106 (8th Cir. 1965).

30.09[2] Proper Income Allocation

The government cannot establish a tax deficiency by attributing income to a year in which it does not belong. ***United States v. Wilkins***, 385 F.2d 465, 469-71 (4th Cir. 1967).

30.09[3] Treatment of Known Deductions

Although there is no requirement in a specific items case that the government follow all reasonable leads provided by the defendant, see Section 30.07, *supra*, if, during its investigation, the government discovers unclaimed deductions or offsets, such as deductible purchases, salaries paid, interest expenses, or errors in the books and records in the defendant's favor, they must be allowed in the government's criminal computations of the amount of tax due and owing, even though not reported on the defendant's return. *See* ***United States v. Link***, 202 F.2d 592, 593-94 (3d Cir. 1953).

30.10 USING MULTIPLE METHODS OF PROOF

Proof of specific items of omitted income may be corroborated by circumstantial proof, such as the net worth method of proof. *See, e.g.*, ***Holland v. United States***, 348 U.S. 121, 126 (1954) (citing cases); ***United States v. Cramer***, 447 F.2d 210, 217-18 (2d Cir. 1971); ***Eggleton v. United States***, 227 F.2d 493, 497-98 (6th Cir. 1955); ***Lloyd v. United States***, 226 F.2d 9, 14 (5th Cir. 1955); ***Heasley v. United States***, 218 F.2d 86, 90 (8th Cir. 1955). The specific items method also may be corroborated by the bank deposits

method, *see, e.g.*, ***United States v. Tafoya***, 757 F.2d 1522, 1528 (5th Cir. 1985); ***United States v. Horton***, 526 F.2d 884, 886-87 (5th Cir. 1976); ***Canton v. United States***, 226 F.2d 313, 322-23 (8th Cir. 1955), or the expenditures method of proof, *see, e.g.*, ***United States v. McGuire***, 347 F.2d 99, 101 (6th Cir. 1965) (expenditure on large items); *see also* ***United States v. Abodeely***, 801 F.2d 1020, 1023 (8th Cir. 1986) (the government may also use a combination bank deposits and expenditures method of proof).

It has been held that, when an indirect method is used as corroboration only, the government may not have a duty to comply with all of the technical requirements of the indirect method, such as tracking down all leads in a net worth analysis. ***Tafoya***, 757 F.2d 1522; ***Cramer***, 447 F.2d at 218. Furthermore, it has been held that the use of an indirect method of proof as corroboration is permissible even though the government has stated in a bill of particulars that it would rely on the specific items method. ***Horton***, 526 F.2d at 887; ***McGuire***, 347 F.2d at 101. Common sense dictates, however, that the corroborating method of proof be designated as such in a bill of particulars to avoid needless argument and the possibility of an adverse ruling.

When an indirect method of proof is used to corroborate specific items, the jury should be instructed to limit its consideration of the indirect analysis to corroboration of the specific items proof only. ***Horton***, 526 F.2d at 887-88. Although failure to give such a limiting instruction may later be determined to be harmless error, there is always the risk that an appellate court could find otherwise.

The government also may use direct and indirect methods of proof in combination with each other in the same case. For example, in a three-year case, the government could prove unreported income in the first year by the specific items method, while proving unreported income for the next two years by the net worth method. ***United States v. Dawson***, 400 F.2d 194, 203 (2d Cir. 1968). Additionally, both direct and indirect methods can be used for the same year. *See* ***United States v. Scott***, 660 F.2d 1145, 1147-48 (7th Cir. 1981) (specific items and net worth); ***United States v. Rodriguez***, 545 F.2d 829, 832 (2d Cir. 1976) (specific items and expenditures methods); *see also* ***United States v. Hart,*** 70 F.3d 854, 860-61 (6th Cir. 1995) (specific items and expenditures methods); ***United States v. Smith,*** 890 F.2d 711, 717 (5th Cir. 1989) (part of income proven by specific items and part proven by bank deposits); ***United States v. Citron,*** 783 F.2d 307, 310 & n.4 (2d Cir. 1986); ***United States v. Meriwether***, 440 F.2d 753, 755-56 (5th Cir. 1971) (net worth and specific items); ***United States v. Lacob***, 416 F.2d 756,

759-60 (7th Cir. 1969) (bank deposits and specific items); ***Chinn v. United States***, 228 F.2d 151, 153-54 (4th Cir. 1955) (net worth and specific items for one year, specific items alone for another year); ***United States v. Bahr***, 580 F. Supp. 167, 170 (N.D. Iowa 1983) (bank deposits and specific items, with a percentage computation to calculate cost of goods sold).

In ***Meriwether***, for example, the government used two separate and distinct methods of proof in attempting to establish corrected taxable income -- the net worth and specific items methods of proof. 440 F.2d at 755. Neither method was used only as corroboration for the other, and the jury was instructed that it could rely on either method. ***Id***. at 756. [7] However, the government failed to establish the defendant's opening net worth with reasonable certainty. ***Id***. at 755-56. Because there was no way to determine which of the two methods of proof the jury relied upon in reaching its verdict, the conviction was reversed. ***Meriwether***, 440 F.2d at 755, 756-57. It is doubtful, however, that the holding of ***Meriwether*** survives ***Griffin v. United States***, 502 U.S. 46 (1991). In ***Griffin***, the Supreme Court held that a general jury verdict of guilty on a multiple-object conspiracy does not have to be set aside when the evidence is insufficient to support the conviction as to one object. ***Id.*** at 49. The Court reasoned that a general jury verdict is valid so long as it is legally supportable on one of the submitted grounds, even though that gives no assurance that a valid ground, rather than an invalid one, is the basis for the jury's verdict. ***Id. Griffin's*** reasoning would appear to apply to the situation encountered in ***Meriwether***.

[7] Where two methods of proof are used, the jury must be properly instructed on each method. ***Meriwether***, 440 F.2d at 756-57.