

[Criminal Tax Manual](#)

[prev](#) • [next](#)

TABLE OF CONTENTS

32.00 EXPENDITURES.....	1
32.01 GENERALLY.....	1
32.02 REQUIREMENTS FOR ESTABLISHING AN EXPENDITURES CASE .....	2
32.03 CONCEPTS APPLICABLE TO EXPENDITURES CASES .....	4
32.03[1] Opening Net Worth .....	4
32.03[2] Cash on Hand .....	5
32.03[3] Cash Hoard Defense.....	5
32.03[4] Duplication of Expenditures.....	6
32.03[5] Likely Source of Income .....	6
32.03[6] Summary Exhibits .....	7
32.04 JURY INSTRUCTIONS.....	7

## 32.00 EXPENDITURES

### 32.01 GENERALLY

The expenditures method of proof measures spending that exceeds reported income in a given tax year. In contrast with the net worth method of proof, the taxpayer is not accumulating assets, but is spending money on items such as clothing, travel, vacations, restaurant meals, vacations, entertainment, and the like. Yet the expenditures method of proof and the net worth method of proof are very similar. The two computations are merely accounting variations of the same basic approach, with the expenditures method being an outgrowth of the net worth method. Many of the principles and foundational requirements of the net worth method of proof apply to the expenditures method. *United States v. Breger*, 616 F.2d 634, 635 (2d Cir. 1980); *Taglianetti v. United States*, 398 F.2d 558, 562 (1st Cir. 1968), *aff'd*, 394 U.S. 316 (1969); *United States v. Caserta*, 199 F.2d 905, 906 (3d Cir. 1952). Accordingly, when the theory of prosecution is based on an expenditures case, reference should be made to [Section 31.00](#), *supra*, which examines the net worth method of proof.

The validity of the expenditures method of proving tax fraud has long been acknowledged by the courts. In *United States v. Johnson*, 319 U.S. 503, 517-18 (1943), the Supreme Court expressly approved the use of the expenditures method to establish unreported income. Subsequently, in *Caserta*, the Third Circuit defined the expenditures method of proof as follows:

It starts with an appraisal of the taxpayer's net worth situation at the beginning of a period. He may have much or he may have nothing. If, during that period, his expenditures have exceeded the amount he has reported as income and his net worth at the end of the period is the same as it was at the beginning (or any difference accounted for), then it may be concluded that his income tax return shows less income than he has in fact received. Of course it is necessary, so far as possible, to negative nontaxable receipts by the taxpayer during the period in question.

*Caserta*, 199 F.2d at 907.

The expenditures method of proof tracks a taxpayer's expenditures for consumable goods and services (*i.e.*, items which do not increase one's net worth), instead of for assets (*i.e.*, items such as stocks, bonds, or real estate) that increase one's net worth. Furthermore, the expenditures method is distinct from the examination of cash expenditures in support of the bank deposits method of proof. *See, e.g., United States v. Conaway*, 11 F.3d 40, 43 (5th Cir. 1993); *United States v. Abodeely*, 801 F.2d 1020, 1024 (8th Cir. 1986).

One advantage of using the expenditures method of proof, as distinct from the net worth method, is well summarized by the *Taglianetti* court:

The government proceeded on a 'cash expenditure' theory. This is a variant of the net worth method of establishing unreported taxable income. Both proceed by indirection to overcome the absence of direct proof. The net worth method involves the ascertaining of a taxpayer's net worth positions at the beginning and end of a tax period, and deriving that part of any increase not attributable to reported income. This method, while effective against taxpayers who channel their income into investment or durable property, is unavailing against the taxpayer who consumes his self-determined tax free dollars during the year and winds up no wealthier than before. The cash expenditure method is devised to reach such a taxpayer by establishing the amount of his purchases of goods and services which are not attributable to the resources at hand at the beginning of the year or to non-taxable receipts during the year.

*Taglianetti*, 398 F.2d at 562 (footnotes omitted).

### **32.02 REQUIREMENTS FOR ESTABLISHING AN EXPENDITURES CASE**

The requirements for establishing an expenditures case are similar to those required for establishing a net worth case. Thus, in an expenditures case, the government must:

1. Establish an **opening net worth** with reasonable certainty **and** demonstrate that the taxpayer's expenditures **did not result from cash on hand, or the conversion of assets on hand** at the beginning of the period;

2. Establish through independent evidence that the expenditures charged to the taxpayer are **non-deductible**;
3. Establish a **likely source of income** from which the expenditures sprang, or **negate nontaxable sources** of income; and
4. Investigate all relevant, **reasonable leads** which are reasonably susceptible of being checked.

*Taglianetti v. United States*, 398 F.2d 558, 562-63 (1st Cir. 1968), *aff'd*, 394 U.S. 316 (1969) (cited in *United States v. Sutherland*, 929 F.2d 765, 780 (1st Cir. 1991)); *United States v. Caswell*, 825 F.2d 1228, 1231-35 (8th Cir. 1987); *United States v. Breger*, 616 F.2d 634, 635-36 (2d Cir. 1980); *United States v. Gay*, 567 F.2d 1206, 1207 (2d Cir. 1978); *United States v. Marshall*, 557 F.2d 527, 529-30 (5th Cir. 1977); *United States v. Fisher*, 518 F.2d 836, 841-42 & n.7 (2d Cir. 1975); *United States v. Penosi*, 452 F.2d 217, 219-20 (5th Cir. 1971); *United States v. Caserta*, 199 F.2d 905, 907 (3d Cir. 1952); *see also United States v. Pinto*, 838 F.2d 426, 431-32 (10th Cir. 1988); *United States v. Marrinson*, 832 F.2d 1465, 1469-70 (7th Cir. 1987); *United States v. Citron*, 783 F.2d 307, 315-16 (2d Cir.1986).

Reference should be made to [Section 31.00](#), *supra*, in which the net worth method of proof is discussed.

It should also be noted that the Seventh Circuit and the District of Columbia Circuit have approved a variation of the expenditures method, which is called the cash method of proof. *United States v. Hogan*, 886 F.2d 1497, 1508-11 (7th Cir. 1989); *United States v. Khanu*, 662 F.3d 1226 (D.C. Cir. 2011). This method “focuses on the taxpayer’s sources and uses of income.” *Hogan* at 1509; *Khanu* at 1229. When using this method, the government is required to present evidence relating to the taxpayer’s cash expenditures. *Khanu* at 1229 *citing United States v. Touchin*, 899 F.2d 617, 619 (7th Cir. 1989). In this method of proof, the government compares the defendant’s cash expenditures with her or his known cash sources, including cash on hand, for each tax period. *Hogan* at 1509; *Khanu* at 1229. If such expenditures exceed sources, the excess is presumed to be unreported income. *Touchin* at 620; *Khanu* at 1229.

### **32.03 CONCEPTS APPLICABLE TO EXPENDITURES CASES**

Although the government has essentially the same burden in an expenditures case that it has in a net worth case, there are some differences that require discussion.

#### **32.03[1] Opening Net Worth**

The requirement that the government must establish the defendant's opening net worth with reasonable certainty is derived from *Holland v. United States*, 348 U.S. 121, 132 (1954). However, the government's method of proving an expenditures case is slightly different from the net worth method employed in *Holland*. This distinction was examined by the *Taglianetti* court:

In a typical net worth case, as *Holland*, precise figures would have to be attached to opening and closing net worth positions for each of the taxable years to provide a basis for the critical subtraction. In a cash expenditures case reasonable certainty may be established without such a presentation, as long as the proof . . . makes clear the extent of any contribution which beginning resources or a diminution of resources over time could have made to expenditures.

*Taglianetti*, 398 F.2d 558, 565 (1st Cir. 1968), *aff'd*, 394 U.S. 316 (1969).

Thus, the government must prove not only that yearly expenditures exceeded reported income, but also, either directly or inferentially, that those expenditures were made with currently taxable income. Unless both requirements are met, a conviction cannot stand. *See, e.g., United States v. Marshall*, 557 F.2d 527, 529 (5th Cir. 1977). It is critical to the expenditures method that the government present evidence establishing that the defendant did not liquidate assets acquired in a previous year or deplete a cash hoard to make the expenditures in issue.

Once the government establishes a starting point for the first prosecution year, it should then proceed to compute the total taxable and nontaxable receipts for each of the following consecutive years to prove its case. *Marshall*, 557 F.2d at 530. In *United States v. Bianco*, 534 F.2d 501, 504 (2d Cir. 1976), the government attempted to show that Bianco's beginning resources were nonexistent and thus could not have contributed at all to his expenditures during the tax years. The court described the extensive

investigation by the government into Bianco's financial background, and concluded that the "totality of this evidence clearly was sufficient for the jury to have concluded that Bianco had insufficient assets at the beginning of the prosecution period to have supported his expenditures in any of those years." *Bianco*, 534 F.2d at 505; *see also United States v. Fisher*, 518 F.2d 836, 841-42 (2d Cir. 1975) (government introduced evidence that Fisher had \$30,000 in bank accounts and that Fisher and his wife possessed no other assets).

There is no requirement in an expenditures case, as there is in a net worth analysis, to reflect the opening and closing net worth position of the taxpayer in a formal net worth statement. Thus, the prosecution may establish reasonable certainty of the taxpayer's opening financial position without such a presentation, as long as the expenditures analysis accounts for the extent to which any expenditure during the prosecution years could have been financed by resources available at the beginning of the period or by the subsequent conversion of such resources to cash. *Taglianetti*, 398 F.2d at 565. In a footnote, the *Taglianetti* court discussed various expenditures cases and the absence of any requirement that the prosecution introduce a formal net worth statement. *Taglianetti*, 398 F.2d at 565 n.7.

### ***32.03[2] Cash on Hand***

Although strictly speaking, proof of a formal statement of net worth is not required in an expenditures case, *see United States v. Conaway*, 11 F.3d 40, 43 (5th Cir. 1993), it is essential that the government establish the taxpayer's opening cash on hand. *See United States v. Citron*, 783 F.2d 307, 316 (2d Cir. 1986) (agent's investigation into the truth of a cash hoard defense was sufficient in establishing cash on hand). This requirement is recognized as the most difficult component of proof in such tax prosecutions. *Citron*, 783 F.2d at 316. (Note that in *Citron*, the Second Circuit reversed the convictions because the district court admitted into evidence a summary chart containing figures not demonstrably supported by the evidence. *Citron*, 783 F.2d at 317.)

### ***32.03[3] Cash Hoard Defense***

Just as in net worth cases, the cash hoard defense is commonly raised in expenditures cases. In asserting a cash hoard defense, the taxpayer contends that expenditures during the relevant years were made with previously accumulated funds

(cash on hand) and not with currently taxable receipts. *See* Sections [31.06](#) and [31.07](#), *supra*.

In *United States v. Radseck*, 718 F.2d 233, 239 (7th Cir. 1983), the government rebutted a cash hoard defense with testimony from the special agent “that in his experience in investigating thirty-five to forty attempted income tax evasion cases, people who have five bank accounts, thirteen savings and loan accounts and two brokerage accounts do not keep substantial amounts of cash on hand.” The court found that the inference that the defendant did not keep cash at home was a permissible one.

In *United States v. Gay*, 567 F.2d 1206, 1207 (2d Cir. 1978), the defendant testified at trial that he had a cash hoard of more than \$100,000 in spite of the fact that he had told the investigating agents that he and his wife had no more than \$13,000. The \$13,000 figure was used in the opening net worth computation. The court stated that “the jury was entitled to infer, as it apparently did, that appellant’s ‘cash hoard’ testimony was a belated and blatant concoction which was not entitled to any credit.” *Gay*, 567 F.2d at 1207.

#### ***32.03[4] Duplication of Expenditures***

In establishing a taxpayer’s expenditures, the prosecution must take care to refrain from a duplication of expenditures. In *United States v. Caserta*, 199 F.2d 905, 907 (3d Cir. 1952), the court of appeals ordered a new trial because of the government’s duplication of expenditures. The prosecution had included in its calculation of unreported income both cash withdrawals from a bank account and expenditures for individual items, and failed to establish that the cash withdrawals were not applied to the cash purchases. *Id.* For a detailed explanation of such an error, *see Caserta*, 199 F.2d at 906-08. The error is not always fatal. *Cf. United States v. Radseck*, 718 F.2d 233, 238 (7th Cir. 1983) (the duplication of \$2,766 as both a personal expenditure and an increase in assets did not render the government summary exhibits inadmissible, because this error and others were revealed to the jury during cross-examination of the government’s summary witness and acknowledged by the government during closing argument).

#### ***32.03[5] Likely Source of Income***

In an expenditures case, as in a net worth case, the government must establish a likely source of taxable income or eliminate the possibility that the cash expenditures (or

increases in net worth) were financed with nontaxable sources of revenue. *See, e.g., United States v. Marrinson*, 832 F.2d 1465, 1472 (7th Cir. 1987); *United States v. Bianco*, 534 F.2d 501, 506-07 (2d Cir. 1976). From a purely legal standpoint, the government need not negate nontaxable sources when it has already established a likely source of taxable income. However, as a matter of trial strategy, it is advisable not only to establish a likely source of taxable income, but also to eliminate any nontaxable sources for the funds. Such an approach makes a good impression on both judge and jury, and enhances confidence in the verdict on review. And as noted above, the government is responsible for investigating leads of nontaxable sources that are reasonably susceptible of being checked. *Holland v. United States*, 348 U.S. 121, 135 (1954). Nevertheless, “[o]nce expenditures are established, the government cannot be expected to conduct an exhaustive nationwide investigation when the defendant supplies no relevant leads as to where he got the money he admittedly spent.” *United States v. Penosi*, 452 F.2d 217, 220 (5th Cir. 1971). *See also* [Section 31.12](#), *supra*. Still, if the investigation includes both approaches, the government’s case will be that much stronger.

### **32.03[6] Summary Exhibits**

In an expenditures case, the government is not required to include the defendant’s version of the facts in its summary exhibits. *United States v. Radseck*, 718 F.2d 233, 239 (7th Cir. 1983). This is also true in net worth cases. *See* [Section 31.14](#), *supra*.

## **32.04 JURY INSTRUCTIONS**

Just as in a net worth prosecution, it is essential in an expenditures case that the charge to the jury be “especially clear, including, in addition to the formal instructions, a summary of the nature of the . . . method [of proving income], the assumptions on which it rests, and the inferences available both for and against the accused.” *Holland v. United States*, 348 U.S. 121, 129 (1954); *accord United States v. Hall*, 650 F.2d 994, 998 (9th Cir. 1981); *United States v. Tolbert*, 367 F.2d 778, 780-81 (7th Cir. 1966); *United States v. O’Connor*, 237 F.2d 466, 472-73 (2d Cir. 1956); *see also United States v. Meriwether*, 440 F.2d 753, 756-57 (5th Cir. 1971) (reversing § 7201 conviction because trial court failed to instruct jury on method of proof).

A conviction on one count was reversed in *United States v. Carter*, 721 F.2d 1514 (11th Cir. 1984), *abrogated on other grounds by United States v. Lightney*, 886 F.2d 304

(11th Cir. 1989), where the court held that it was plain error to fail to instruct the jury on the expenditures method of proof:

We find that the omission of the required explanatory instructions concerning the cash expenditures method of proof in this case ‘goes to the very basis of the jury’s ability to evaluate the evidence,’ *Hall*, 650 F.2d at 999, and to the very core of the deliberative process necessary to guarantee the fairness of the proceedings. We therefore hold that the omission of the explanatory instructions required by *Holland* concerning the cash expenditure method of proof constituted plain error affecting appellant’s substantial rights.

*Carter*, 721 F.2d at 1539 (citations omitted).