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31.01 *OVERVIEW*

The net worth method of proof is an indirect method of proof. An indirect method of proof is used to reconstruct taxable income when the government is unable to establish income through direct evidence. The specific item method of proof discussed in detail in Chapter 30, *supra*, proves income with direct evidence -- testimony and records that document money paid for services rendered or products sold. When a defendant purposely fails to maintain books and records, or when a defendant does not use bank accounts to deposit receipts or to pay business expenses, the government must use other evidence to prove an individual had taxable income for a given tax year. The basic premise of the net worth method of proof is that if a defendant has more wealth at the end of a given year than at the beginning of that year, and the increase does not result from nontaxable sources such as gifts, loans, and inheritances, then the increase is a measure of taxable income for that year. ***Holland v. United States***, 348 U.S. 121, 125 (1954); ***United States v. Giacalone***, 574 F.2d 328, 331-32 (6th Cir. 1978); *see also* ***United States v. Gomez-Soto***, 723 F.2d 649, 655 (9th Cir. 1983); ***United States v. Schafer***, 580 F.2d 774, 777 (5th Cir. 1978).

The government must conduct a very thorough financial investigation, including a search for readily identifiable gifts, loans, inheritances, or other nontaxable sources which may account for accumulated wealth during the year. Since the government is estimating the defendant's income using circumstantial evidence, there are heightened requirements in the net worth method of proof to ensure that the government's evidence is sufficiently reliable to prove beyond a reasonable doubt that the defendant had taxable income. When proving income for a particular year by showing an increase in a defendant's net worth, the government is also saying that the defendant did not buy any of the identified assets with savings or money earned, and taxed, in a prior year.

A net worth computation reveals not only that the defendant had income but how that income was spent. In essence, the computation depicts the financial life of a defendant, both prior to and during the prosecution period. *See* ***Holland***, 348 U.S. at 125, 132-33; ***United States v. Mastropieri***, 685 F.2d 776, 778 (2d Cir.1982). It is important when constructing a net worth computation to include only items or transactions that have tax consequences. For this reason, under the net worth method, nontaxable items received during a prosecution year must be eliminated from the computation of additional taxable income.

The following is a simplified example of a net worth calculation:

SIMPLIFIED NET WORTH FORMULA

	Assets		$650,000
Less:	Liabilities	-	$200,000
	Net worth at end of 2006		$450,000
Less:	Net worth at beginning of 2006	-	$150,000
	Increase in net worth - 2006		$300,000
Add:	Personal, non-deductible expenditures		$100,000
Less:	Nontaxable sources of income	-	$ 50,000
	Potential taxable income		$350,000
Less:	Taxable income reported 2006 tax return		$125,000
	Unreported taxable income - 2006		**$225,000**

31.02 ***DESCRIPTION OF NET WORTH METHOD***

The First Circuit described the net worth method as follows:

> The Government makes out a prima facie case under the net worth method of proof if it establishes the defendant's opening net worth (computed as assets at cost basis less liabilities) with reasonable certainty and then shows increases in his net worth for each year in question which, added to his nondeductible expenditures and excluding his known nontaxable receipts for the year, exceed his reported taxable income by a substantial amount. The jury may infer that the defendant's excess net worth increases represent unreported taxable income if the Government either shows a likely source, or negates all possible nontaxable sources . . . . [T]he jury may further infer willfulness from the fact of underreporting coupled with evidence of conduct by the defendant tending to mislead or conceal.

United States v. Sorrentino, 726 F.2d 876, 879-80 (1st Cir. 1984) (citations omitted); *see also* ***Holland v. United States***, 348 U.S. 121, 125 (1954); ***United States v. Terrell***, 754 F.2d 1139, 1144 (5th Cir. 1985); ***United States v. Wirsing***, 719 F.2d 859, 871 (6th Cir. 1983); ***United States v. Greene***, 698 F.2d 1364, 1370 (9th Cir. 1983); ***United States v. Goldstein***, 685 F.2d 179, 181-82 (7th Cir. 1982); ***United States v. Goichman***, 547 F.2d 778, 781 (3d Cir. 1976) (*per curiam*); ***United States v. O'Connor***, 273 F.2d 358, 361 (2d Cir. 1959).

The Fifth Circuit summarized the steps necessary to establish income when applying the net worth method of proof:

> The government established its case through the "net worth" approach, a method of circumstantial proof which basically consists of five steps: (1) calculation of net worth at the end of a taxable year, (2) subtraction of net worth at the beginning of the same taxable year, (3) addition of non-deductible expenditures for personal, including living, expenditures, (4) subtraction of receipts from income sources

> that are non-taxable, and (5) comparison of the resultant figure with the amount of taxable income reported by the taxpayer to determine the amount, if any, of underreporting.

United States v. Schafer, 580 F.2d 774, 775 (5th Cir. 1978).

31.03 *USE OF NET WORTH METHOD*

31.03[1] *Inadequate Books and Records*

The net worth method of proof frequently is used when it would be difficult or impossible to establish the defendant's taxable income by direct evidence. ***United States v. Dwoskin***, 644 F.2d 418, 423 (5th Cir. Unit B 1981). Sometimes a defendant will intentionally fail to keep books documenting his income and expenses. In such a case, "willfulness may be inferred by the jury from that fact coupled with proof of an understatement of income." ***Holland***, 348 U.S. at 128.

At other times, a defendant's books and records are inadequate, false, or not available to the government. *See, e.g.,* ***United States v. Shetty***, 130 F.3d 1324, 1331-32 (9th Cir. 1997); ***United States v. Notch***, 939 F.2d 895, 897-98 (10th Cir. 1991); ***United States v. Stone***, 531 F.2d 939, 940 n.1 (8th Cir.1976); ***United States v. Hom Ming Dong***, 436 F.2d 1237, 1240 (9th Cir. 1971). Although a defendant's books and records can be helpful, they are not essential. "[I]n a typical net worth prosecution, the Government, having concluded that the taxpayer's records are inadequate as a basis for determining income tax liability," seeks to establish taxable income by the net worth method. ***Holland v. United States***, 348 U.S. 121, 125 (1954); ***United States v. Ayers***, 924 F.2d 1468, 1475 (9th Cir. 1991) (quoting ***Holland***); ***United States v. Blandina***, 895 F.2d 293, 295 (7th Cir. 1988) (same); ***United States v. Scrima***, 819 F.2d 996, 999 (11th Cir. 1987) (same).

31.03[2] *Adequate Books and Records*

The government may use the net worth method in situations in which the defendant had "adequate" books and records. As the Supreme Court stated in ***Holland v. United States***:

> The net worth technique, as used in this case, is not a method of accounting different from the one employed by defendants. It is not a method of accounting at all, except insofar as it calls upon taxpayers to account for their unexplained income. Petitioners' accounting system was appropriate for their business purposes; and, admittedly, the Government did not detect any specific false entries therein. Nevertheless, if we believe the Government's evidence, as the jury did, we must conclude that the defendants' books were more consistent than truthful, and that many items of income had disappeared before they had even reached the recording stage. . . . To protect the revenue from those who do not 'render true accounts', the Government must be free to use all legal evidence available to it in determining whether the story told by the taxpayer's books accurately reflects his financial history.

348 U.S. at 131-32. Thus, the state of the defendant's records has no bearing on whether the net worth method of proof may be used. *See also* ***McGrew v. United States***, 222 F.2d 458, 459 (5th Cir.

1955) (*per curiam*) (rejecting defendant's claim that the government's use of the net worth method of proof was improper because the government did not make a preliminary showing regarding the state of the defendant's records); ***United States v. Vanderburgh***, 473 F.2d 1313, 1314 (9th Cir. 1973) (*per curiam*) (government may use the net worth method of proof even where the defendant contends that he maintained an allegedly complete and adequate set of books of account).

31.03[3] ***Use With Other Methods***

The government is not limited to a single method of proof and may use the net worth method in conjunction with other methods of proof. *See*, *e.g.*, ***United States v. Abodeely***, 801 F.2d 1020, 1023 (8th Cir. 1986) ("The government may choose to proceed under any single theory of proof or a combination method, including a combination of circumstantial and direct proofs"); *see also* ***United States v. Smith***, 890 F.2d 711, 713 (5th Cir.1989) (net worth and specific items methods of proof combined in a section 7201 prosecution).

31.04 *PROOF OF NET WORTH -- REQUIREMENTS*

In using the net worth method, the government must:

1. Establish an opening net worth with reasonable certainty, *i.e.*, the defendant's net worth at the beginning of the prosecution year.
2. Establish the defendant's net worth at the end of the prosecution year, with any excess over opening net worth representing the net worth increase.
3. Establish a likely source of taxable income from which the jury could find the net worth increase sprang; or, in the alternative, negate nontaxable sources of funds.
4. Negate "reasonable explanations" by the defendant inconsistent with guilt.

Holland v. United States, 348 U.S. 121, 125, 132-38 (1954); ***United States v. Massei***, 355 U.S. 595, 595 (1958) (*per curiam*) ("should all possible sources of nontaxable income be negatived, there would be no necessity for proof of a likely source" of income); ***United States v. Notch***, 939 F.2d 895, 898 (10th Cir. 1991); ***United States v. Blandina***, 895 F.2d 293, 301 (7th Cir. 1989); ***United States v. Koskerides***, 877 F.2d 1129, 1137 (2d Cir. 1989); ***United States v. Scrima***, 819 F.2d 996, 999 (11th Cir. 1987) (quoting ***Holland***); ***United States v. Scott***, 660 F.2d 1145, 1147 (7th Cir. 1981); ***United States v. Dwoskin***, 644 F.2d 418, 419-22 (5th Cir. Unit B 1981); ***United States v. Hamilton***, 620 F. 2d 712, 714 & n.1 (9th Cir. 1980); ***United States v. Goichman***, 547 F.2d 778, 781 (3d Cir. 1976) (*per curiam*); ***United States v. Bethea***, 537 F.2d 1187, 1188-89 (4th Cir. 1976); ***McGarry v. United States***, 388 F.2d 862, 864 (1st Cir. 1967).

31.05 *OPENING NET WORTH*

31.05[1] *Proof -- "Reasonable Certainty"*

Net worth increases are determined by establishing a defendant's net worth at the beginning of a given year and then comparing this opening net worth with the defendant's net worth at the end of the year. December 31 of the year preceding the first prosecution year (the opening net worth) is the point from which net worth increases are measured. For example, if the first prosecution year, or the year to be measured, is 2007, then the defendant's net worth as of December 31, 2006, would be the opening net worth from which to determine whether the defendant's net worth increased or decreased in 2007. The defendant's 2007 ending net worth would in turn become the opening net worth for 2008, and so on.

The establishment of an opening net worth is like the foundation of a house. Each asset purchased or personal expenditure made is a brick added on top of the foundation. In criminal tax cases, the defendant's specific intent to violate the law is proved through circumstantial evidence. Often, no one piece is conclusive; rather, it is the accumulation of many bricks over several years that proves the government's case beyond a reasonable doubt. Since the net worth increase for a particular year is determined by subtracting the opening net worth from the ending net worth, the accuracy of the opening net worth can not be understated. The Supreme Court described the need to establish an opening net worth, and the standard of proof required to do so:

> [A]n essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets. The importance of accuracy in this figure is immediately apparent, as the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset.

Holland v. United States, 348 U.S. 121, 132 (1954).

While every effort should be made to obtain all of the assets and liabilities of the defendant at the starting point, the government does not have to establish the starting point, or opening net worth, to a mathematical certainty. ***Holland***, 348 U.S. at 138; ***United States v. Gardner***, 611 F.2d 770, 775 (9th Cir. 1980). It is sufficient if the government establishes the defendant's opening net worth with reasonable certainty -- more than this is not required. ***Holland***, 348 U.S. at 132; ***United States v. Terrell***, 754 F.2d 1139, 1145 (5th Cir. 1985); ***United States v. Sorrentino***, 726 F.2d 876, 879 (1st Cir. 1984); ***United States v. Greene***, 698 F.2d 1364, 1372 (9th Cir. 1983); ***United States v. Goldstein***, 685 F.2d 179, 181 (7th Cir. 1982); ***United States v. Breger***, 616 F.2d 634, 635 (2d Cir. 1980) (*per curiam*); ***United States v. Carriger***, 592 F.2d 312, 313 (6th Cir. 1979); ***United States v. Honea***, 556 F.2d 906, 908 (8th Cir. 1977) (*per curiam*); ***United States v. Goichman***, 547 F.2d 778, 781 (3d Cir. 1976) (*per curiam*).

Once the government has established the defendant's opening net worth with reasonable certainty, the defendant remains silent "at his peril." ***United States v. Stone***, 531 F.2d 939, 942 (8th Cir. 1976); *see also* ***Holland***, 348 U.S. at 138-39. In its net worth calculation, the government deducts all known nontaxable sources of funds. A thorough financial investigation will check for possible loans by subpoenaing financial institutions, and for potential inheritances received from family members by checking local probate records. If the defendant received money from a source of which the government is not aware, the defendant must provide that information to the government for verification. It is in the defendant's interest to disclose such information to the government, since a nontaxable source of funds that eliminates the taxable income for a particular year may leave the government unable to prove an element of tax evasion: additional tax due and owing. For example, perhaps a defendant was the favorite nephew of his aunt who lived in Italy, and upon her death he received $100,000 in stocks in 2002. An investigation into the defendant's 2003, 2004, and 2005 taxable income must include this $100,000 in the opening net worth figure. IRS special agents are trained to ask about potential nontaxable sources of income when they do an initial interview of the target at the beginning of their criminal investigation.

31.05[2] ***Thorough Investigation a Necessity***

An extremely thorough investigation is crucial in proving that the government established the defendant's opening net worth with reasonable certainty. When the government chooses to proceed against a defendant using the net worth method of proof, "the Government assumes a special responsibility of thoroughness and particularity in its investigation and presentation." ***United States v. Hall***, 650 F.2d 994, 999 (9th Cir. 1981); ***United States v. Terrell***, 754 F.2d 1139, 1145 (5th Cir. 1985) (the government must conduct a meticulous investigation, and the investigation techniques and figures are subject to close scrutiny). "The Government must affirmatively prove an initial amount available to the taxpayer, with evidence that excludes the possibility that the defendant relied on previously accumulated assets rather than unreported taxable income . . ., without refuting all possible speculation as to sources of funds . . . ." ***United States v. Breger***, 616 F.2d 634, 635-36 (2d Cir. 1980) (citing ***United States v. Marshall***, 557 F.2d 527, 530 (5th Cir. 1977)).

A good example of a thorough and detailed investigation is found in ***United States v. Terrell***, 754 F.2d 1139 (5th Cir. 1985), in which the defendant was convicted of evasion for the years 1976 through 1979, and the government began its investigation of Terrell's funds with the year 1967. Noting that "we can only be surprised by appellant's attack on the thoroughness of the Government's investigation," the court described the investigation as follows:

> The investigation consumed three and one-half years. Approximately 20 agents canvassed public records to determine the extent of appellant's holdings. Thirty banks were contacted, and twenty banks produced documents or witnesses. Nearly 300 potential witnesses were interviewed, many of them several times. IRS agents identified

> in excess of 70 assets purchased and sold by Terrell, and questioned third parties involved in these transactions. Additionally, every expenditure made by Terrell was traced, including all cashier's checks traced back to their sources to determine how they were purchased.

Terrell, 754 F.2d at 1147-48. For another example of the detailed steps required to conduct a net worth investigation, *see* ***United States v. Sorrentino***, 726 F.2d 876, 880 (1st Cir. 1984).

The consequences of a less than thorough financial analysis are suggested by ***United States v. Smith***, 890 F.2d 711, 713 (5th Cir. 1989), in which the Fifth Circuit stated that "[w]e join the Seventh Circuit in observing that sloppy or mediocre financial and accounting evaluation upon which a conviction is obtained can be the genesis for reversal." (citing ***United States v. Achilli***, 234 F.2d 797 (7th Cir.1956)).

If after a thorough investigation, the government is unable to establish an opening net worth with reasonable certainty, the net worth method of proof may not be used to prove unreported income.

31.05[3] ***Evidence Establishing Opening Net Worth***

A legally sufficient opening net worth computation requires an extensive and thorough investigation by the Internal Revenue Service. The opening net worth must include all of the defendant's assets that are reasonably discoverable, including assets derived from nontaxable sources of funds such as gifts, loans, and inheritances, as well as assets derived from taxable income. It is critical to identify assets purchased in the years preceding the first prosecution year, both for an accurate opening net worth figure and as the potential source of funds to purchase assets in the prosecution years. Similarly, if assets derived from nontaxable sources were omitted from the opening net worth, but included in the first year's computation, the taxable income for the first year would be incorrectly inflated.

For example, assume that the prosecution year is 2005 and in 2004 the defendant inherited $100,000, which is not accounted for in the opening net worth. Stated another way, the 2005 opening net worth is understated by $100,000. If the defendant purchases a house for $100,000 in 2005, which is reflected on the defendant's 2005 net worth as an asset, the net worth computation would incorrectly attribute a net worth increase of $100,000 to the defendant in 2005. The effect of this error would be to overstate the defendant's income because the defendant had the $100,000 on hand at the end of 2004, and the spending of those funds should not be attributed to income earned in 2005. It is important that loans, gifts, inheritances, and other nontaxable sources of funds be identified for both the years prior to the initial prosecution year as well as during the years for which taxable income is being computed. The funds in prior years affect the opening net worth, while nontaxable sources of funds obtained during a prosecution year are subtracted from the net worth increase to compute corrected taxable income for that year.

In ***United States v. Breger***, 616 F.2d 634, 635 (2d Cir.1980) (*per curiam*), the defendant had been convicted of tax evasion and filing false income tax returns for the years 1972 through 1974. In upholding the starting point established by the government at trial, the court commented:

> We think the Government met its burden here. It used information gleaned from a 1969 mortgage application, traced a real estate and cash inheritance from appellant's mother in 1968, and investigated bond statements and checking accounts in order to ascertain appellant's access to funds as of January 1, 1972. We note that appellant adduced no specific evidence, such as a cash hoard, to suggest that the starting point was inaccurate or misleading.

Breger, 616 F.2d at 636.

Prior income tax returns of a defendant are relevant and can play a significant role in developing a defendant's opening net worth. In ***United States v. Mackey***, 345 F.2d 499, 504 (7th Cir. 1965), the starting point of the net worth computation was December 31, 1955, and the court upheld the prosecution's use of "the income tax returns of defendant and his wife from 1929 through December 31, 1955, as a guide in determining defendant's net worth at the starting point." Additionally, net worth statements submitted by the defendant either to the government or to financial institutions can be particularly helpful in establishing an opening net worth. *See*, *e.g.*, ***United States v. Dwoskin***, 644 F.2d 418, 420 (5th Cir. Unit B 1981); ***United States v. Balistrieri***, 403 F.2d 472, 479 (7th Cir. 1968), *vacated on other grounds*, 395 U.S. 710 (1969), *reaff'd on remand*, 436 F.2d 1212 (7th Cir. 1971).

In ***United States v. Mastropieri***, 685 F.2d 776, 785 (2d Cir. 1982), the court noted that less stringent standards with respect both to establishing opening net worth and to negating nontaxable income sources were justified in a case where the defendants were shown to have gone to great lengths to conceal their unreported increases in wealth. While the court observed that the investigation in that case should not be regarded as a model, the case does furnish an example of a number of the steps that must be taken to establish an opening net worth. ***Mastropieri***, 685 F.2d at 779, 783.[1]

For additional cases holding that the government's evidence was sufficient to establish the defendant's opening net worth with reasonable certainty, *see* ***United States v. Greene***, 698 F.2d 1364, 1372 (9th Cir. 1983) (jury could draw adverse inferences from the late stage at which defense evidence was disclosed in spite of a motion for reciprocal discovery, defendant's failure to reveal the existence of a Liechtenstein bank account to his return preparers, and defendant's claim to have retained no records with respect to $100,000 he testified he had sent to a third party who had

[1] As an evidentiary matter, the ***Mastropieri*** court criticized the fact that the record did not contain the "form of letter or letters" which the special agent sent to the banks, brokerage firms, and lending institutions that he canvassed as a part of the investigation. ***Mastropieri***, 685 F.2d at 779 n.3. This concern suggests that care should be taken in drafting such letters, because they may be used later to demonstrate the effort made to locate the defendant's assets and liabilities.

purportedly later returned the funds to defendant); ***United States v. Goldstein***, 685 F.2d 179, 181 (7th Cir. 1982) (evasion charged for three years, conviction on only one year, sufficient if opening net worth established for year of conviction); ***United States v. Dwoskin***, 644 F.2d 418, 420 (5th Cir. Unit B 1981) (opening net worth based on a financial statement signed by the defendant and submitted to a bank); ***United States v. Schafer***, 580 F.2d 774, 778-80 (5th Cir. 1978); ***United States v. Giacalone***, 574 F.2d 328, 331-33 (6th Cir. 1978); ***United States v. Honea***, 556 F.2d 906, 907-08 (8th Cir. 1977); ***United States v. Mancuso***, 378 F.2d 612, 616-17 (4th Cir. 1967), *amended on other grounds on rehearing*, 387 F.2d 376 (4th Cir. 1967); ***United States v. Goichman***, 407 F. Supp. 980, 987-88 (E.D. Pa. 1976), *aff'd*, 547 F.2d 778 (3d Cir. 1976).

31.05[4] ***Opening Net Worth Not Established***

In a relatively small number of cases, the courts have found the government's proof of the defendant's opening net worth insufficient to support a conviction. For the most part, these are earlier cases, but they furnish examples of pitfalls that must be avoided if the opening net worth is to be established with reasonable certainty.

For an example of an erroneous opening net worth computation, *see* ***United States v. Achilli***, 234 F.2d 797 (7th Cir. 1956), *aff'd on other grounds*, 353 U.S. 373 (1957). In ***Achilli***, one count of a three-count conviction was reversed because the value of a residence sold by the defendant in the first prosecution year was erroneously omitted from the opening net worth computation and the error accounted for almost 80 percent of the deficit shown by the government's computation. 234 F.2d at 804.[2] Since the tax return was the only evidence with respect to the time when the defendant acquired the property, the government conceded that the property should have been included as an asset in the computation of the defendant's net worth as of December 31, 1945. ***Achilli***, 234 F. 2d at 804; *see also* ***United States v. Keller***, 523 F.2d 1009, 1011 (9th Cir. 1975) (because the government failed to pursue leads provided by defendants to support their claim that the basis in their property was $20,000 higher than that assumed by the government, the opening net worth for 1967 was not reasonably certain and the evidence as to the 1967 count was insufficient to go to the jury).

When using the net worth method of proof to prove unreported income, the IRS agent should be asked if every known asset is included in the net worth computation. On occasion, the agent will intentionally omit items from the net worth schedules. One example would be an asset purchased prior to the prosecution years, owned throughout the prosecution years, and still owned at the end of the years at issue. This asset would be valued at cost each year, even if it significantly appreciated during the prosecution years. The direct examination of the agent should include a discussion of

[2] The error seems to have resulted from an oversight by the government, because the sale of the residence omitted from the defendant's opening net worth was reported in the capital gains schedule of the defendant's 1946 return. 234 F.2d at 804.

what items were omitted and what effect, if any, the omission had on the soundness of the government's net worth computation.

31.06 *CASH ON HAND*

31.06[1] *Definition -- Need to Establish*

As one court observed, "the most frequent challenge to the government's computations in a net worth case is the opening cash balance." ***United States v. Schafer***, 580 F.2d 774, 779 (5th Cir. 1978). A defendant's claim of cash on hand is commonly referred to as a cash hoard defense. A typical cash hoard defense asserts that the defendant in earlier years received money from such sources as gifts from family members or friends, or an inheritance, which he or she then spent during the prosecution period. The Supreme Court described the cash hoard defense as follows:

> Among the defenses often asserted is the taxpayer's claim that the net worth increase shown by the Government's statement is in reality not an increase at all because of the existence of substantial cash on hand at the starting point. This favorite defense asserts that the cache is made up of many years' savings which for various reasons were hidden and not expended until the prosecution period. Obviously, the Government has great difficulty in refuting such a contention.

Holland v. United States, 348 U.S. 121, 127 (1954).

While it is often difficult to disprove the existence of a cash hoard, the government can often prove acts that are inconsistent with a person's having had a substantial amount of currency available to spend. Such proof might include evidence that the defendant took out of a high interest rate loan to purchase a vehicle or home furnishings or that the defendant made frequent ATM withdrawals in small increments. While some of these facts make the existence of a cash hoard less likely, the government must still establish, with reasonable certainty, the amount of cash that the defendant had in his or her possession at the beginning of the tax period. ***United States v. Wilson***, 647 F.2d 534, 536 n.1 (5th Cir. 1981) (*per curiam*). The necessity for establishing cash on hand "with reasonable certainty" is well summarized in ***United States v. Terrell***, 754 F.2d 1139, 1146-47 (5th Cir. 1985):

> The question of whether a defendant has a substantial amount of cash-on-hand at the beginning of the indictment period must be carefully investigated because the existence of a cash hoard could greatly distort the net worth evaluation. Unaccounted for funds that surface during the course of the net worth evaluation might be explained by the fact that a defendant accumulated large sums of cash which he kept on hand and began to spend during the indictment period.

See also ***United States v. Pinto***, 838 F.2d 426, 431 (10th Cir. 1988). If a cash hoard is the source of funds used to accumulate assets, then the purchase of the assets should not be considered taxable income in the year during which the funds were spent.

One of the most common explanations for spending of unexplained wealth is a loan or inheritance from a relative. One way to defeat a claim that a relative or friend was the source of

unexplained funds is to show that the alleged donor did not have sufficient resources to give the defendant the amount claimed. This may be done in two ways: 1) review the tax filing history of the relative and 2) construct a basic net worth of the relative. If the relative bought a house and only put 5% down and obtained a mortgage at a high interest rate, it is unlikely that that person had a cash hoard, since one likely would have been used toward a larger down payment on the house. Similarly, research of vehicles purchased and amounts of liens on those vehicles will give a snapshot as to the relative's basic financial status. *See* ***United States v. Breger***, 616 F.2d 634, 636 (2d Cir.1980) (*per curiam*).

While cash on hand does include the money that a defendant habitually carries in his pocket, the concept of cash on hand is more expansive. It includes all monies or cash readily available to the defendant that are not deposited in a bank or other institution. Thus, cash on hand can include monies that the defendant had in his safe or his business (*see* ***United States v. Calderon***, 348 U.S. 160, 162 (1954)) and cash kept in a safe deposit box and money buried in the defendant's backyard (*see* ***United States v. Bethea***, 537 F.2d 1187, 1190 (4th Cir. 1976); ***United States v. Carter***, 462 F.2d 1252, 1255-56 (6th Cir. 1972)).

If the defendant claims during the investigation to have had a cash hoard, the IRS agent will ask very detailed questions to attempt to learn the amount of this cash hoard, its source, when it was received, where it was kept, who else was aware of its existence, the denomination of the bills, and whether it was always kept in the same place. The defendant should be asked to identify which particular assets were purchased with the funds from this cash hoard so the government can contact the seller-witness to verify that currency was in fact exchanged during the sale. It is important to note that a cash hoard is only relevant if the defendant used those funds to purchase assets or make expenditures during the prosecution years. If the cash hoard remained the same throughout the prosecution period, it had no effect on the defendant's net worth analysis. *See* ***United States v. Giacalone***, 574 F.2d 328, 331-33 (6th Cir. 1978).

When assets are included in a net worth schedule, the source of funds used to purchase the asset will be known. If a cashier's check was used, the bank can be subpoenaed to see whether the funds were withdrawn from a customer's bank account or if currency was provided. If the cashier's check is more than $10,000 and was funded with currency, Title 31 requires the bank to complete a Currency Transaction Report (CTR) which is filed with the IRS through FinCen (Financial Crimes Enforcement Network). If currency was used to purchase an asset and that currency cannot be traced to a withdrawal from a known bank account, then the government must produce evidence from which an inference can be drawn that the cash hoard was <u>not</u> utilized during the indictment period. Otherwise, any available cash on hand must be subtracted from the computation reflecting the net worth increase and nondeductible expenditures. If it cannot be established that the cash hoard remained constant throughout the prosecution period, then it must be assumed that any computed

net worth increase and nondeductible expenditures were funded by the spending of funds in the cash hoard. *See* ***McGarry v. United States***, 388 F.2d 862, 866-67 (1st Cir. 1967).

31.06[2] ***Jury Question -- Burden of Proof***

The existence of cash on hand at the beginning of the prosecution period presents a factual issue for determination by the jury. *See* ***Holland v. United States***, 348 U.S. 121, 134 (1954); ***United States v. Calderon***, 348 U.S. 160, 162-63 (1954); ***United States v. Breger***, 616 F.2d 634, 635 (2d Cir. 1980) (*per curiam*); ***United States v. Carter***, 462 F.2d 1252, 1256 (6th Cir. 1972); ***McGarry v. United States***, 388 F.2d 862, 868 (1st Cir. 1967); ***United States v. Vardine***, 305 F. 2d 60, 64-65 (2d Cir. 1962) (conflicting testimony left to the jury and government properly based its net worth summary on its version of the facts); ***Fowler v. United States***, 352 F.2d 100, 107 (8th Cir. 1965).

The foregoing cases demonstrate that as long as there is evidence from which a jury can conclude that the government has established the amount of cash on hand with reasonable certainty, the defendant is not entitled to a judgment of acquittal on this issue. *See*, *e.g.*, ***United States v. Blandina***, 895 F.2d 293, 302 (7th Cir. 1989); ***United States v. Wilson***, 647 F.2d 534, 536 n.1 (5th Cir. 1981).

Once the government has established that a thorough investigation failed to uncover evidence of cash on hand, the burden shifts to the defendant to come forward with evidence of cash; the defendant remains silent at his or her peril. ***United States v. Mackey***, 345 F.2d 499, 506 (7th Cir. 1965). This burden arises because "[w]hether defendant had substantial sums of cash at the starting point is a matter within defendant's knowledge." ***Mackey***, 345 F.2d at 506; *see also* ***Holland***, 348 U.S. at 138-39; ***Fowler***, 352 F.2d at 107; ***United States v. Holovachka***, 314 F.2d 345, 354 (7th Cir. 1963).

31.06[3] ***Amount of Cash on Hand***

The net worth computation must reflect the amount of the defendant's cash on hand for each year. After the initial cash on hand has been established, the government must, for each subsequent year, determine the amount of any prior cash that the defendant still had on hand as well as any additional cash the defendant received during the particular year. Any cash on hand acquired during a prosecution year which is still on hand at the end of that year will increase the defendant's net worth (unless the cash on hand was derived from a nontaxable source, such as a gift or inheritance).

In some instances, cash on hand may be appropriately reflected as zero. *See*, *e.g.*, ***United States v. Mastropieri***, 685 F.2d 776, 779 (2d Cir.1982); ***United States v. Goichman***, 407 F. Supp. 980, 986 (E.D. Pa.), *aff'd*, 547 F.2d 778 (3d Cir. 1976). In other instances, the evidence may be such that cash on hand can be reflected as a nominal amount. *See*, *e.g.*, ***United States v. Carriger***, 592 F.2d 312, 314 (6th Cir. 1979) (cash on hand had no effect on the defendant's net worth because the evidence established that the defendant had $500 in cash on hand at the beginning of the

prosecution period and $500 on hand at the end of the prosecution period); ***United States v. Goldstein***, 685 F.2d 179, 181 (7th Cir. 1982) ($100).

The facts of a case may be such that the evidence justifies an assumption that any cash on hand that did exist remained constant, though unknown, throughout the period covered. This situation arose in ***United States v. Giacalone***, 574 F.2d 328 (6th Cir. 1978). In ***Giacalone***, the defendant was a professional gambler, and the net worth statement assumed the existence of a bank roll of cash which remained approximately the same throughout the period covered. 574 F.2d at 332. In its computation, the government used a dash rather than a dollar amount to represent the cash on hand. The dashes symbolized an unknown, presumably constant, amount. ***Id***. at 331-32. The court concluded that the use of dashes did not invalidate the net worth statement and that "[t]he effect of using the dashes is no different from the use of zeroes approved in ***United States v. Goichman***, [407 F. Supp. 980 (E.D. Pa. 1976), *aff'd*, 547 F.2d 778 (3d Cir. 1976)]." ***Giacalone***, 574 F.2d at 333. Reflecting cash on hand with dashes was a practical solution because it avoided "the untenable assumption that a professional gambler could operate without any cash." ***Giacalone***, 574 F.2d at 333. *Accord*, ***United States v. Scrima***, 819 F.2d 996, 999 (11th Cir. 1987) (floating cash or "dash" method approved in prosecution of a marijuana smuggler).[3]

The government need not prove the cash on hand at the beginning of each year with evidence independent of the other years. ***United States v. Goldstein***, 685 F.2d 179, 181 (7th Cir. 1982); *accord* ***United States v. Pinto***, 838 F.2d 426, 431-32 (10th Cir. 1988).

31.07 *EVIDENCE OF CASH ON HAND*

31.07[1] *Effective Rebuttal to Cash Hoard Defense*

Evidence developed during the course of a thorough financial investigation may be used to prove actions inconsistent with a cash hoard. For example, an individual with a cash hoard would not

- withdraw money at ATMs in $20-$40-$60 increments;
- obtain high interest rate loans;
- borrow relatively small amounts of money from friends/relatives to buy assets or pay bills;
- pay high fees to cash checks;
- be charged NSF fees for bounced checks in his or her bank account;
- pay over time for appliances, furniture, carpeting, etc.; or
- engage in other spending, or manifest a *lack* of spending, inconsistent with a person who had access to significant sums of currency.

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[3] There also may be instances where the government investigation indicates a negative cash position, *i.e.*, that an analysis of the defendant's financial transactions in years prior to the prosecution period indicates that the defendant spent more than was available on the basis of his prior returns.

In establishing cash on hand and disproving a claim of a cash hoard, the government may use circumstantial evidence. In ***Holland v. United States***, 348 U.S. 121, 132 (1954), the defendants claimed opening cash on hand of $113,000, and the government allowed $2,153.09. The government did not introduce any direct evidence to dispute the defendant's claim. Instead, the government relied on the inference that anyone who had the cash the defendants claimed to have had would not have "undergone the hardship and privation endured by the Hollands all during the late 20's and throughout the 30's." ***Id***. at 133. The case also provides an excellent example of a thorough investigation, in which the government traced the financial picture of the Hollands as far back as 1913 (the first prosecution year was 1948), and serves as a model for the type of circumstantial evidence that is admissible to refute a cash hoard defense. Another example of the government's defeating a cash hoard defense by "painstakingly" tracing the defendant's finances over a period of years is in ***Friedberg v. United States***, 348 U.S. 142, 143 (1954) (decided the same day as ***Holland***); *see also* ***United States v. Carter***, 462 F.2d 1252, 1255-56 (6th Cir. 1972); ***United States v. Ford***, 237 F.2d 57, 59-63 (2d Cir. 1956), *vacated as moot*, 355 U.S. 38 (1957); ***Gariepy v. United States***, 189 F.2d 459, 461-62 (6th Cir. 1951).

It is not sufficient for the government to prove that the defendant was poor at an early point in his life; the government must introduce evidence that demonstrates the defendant's financial history up to the opening net worth of the first prosecution year, the starting point for the net worth computation.

31.07[2] ***Admissions of Defendant***

In establishing an opening net worth, the government will often rely on statements made by the defendant to third parties as well as to investigating agents. *See*, *e.g.*, ***United States v. Goldstein***, 685 F.2d 179, 182 (7th Cir. 1982) (admissions in the form of financial statements); ***Holland v. United States***, 348 U.S. 121, 128 (1954) (statements made to agents). Statements made by a defendant regarding his financial assets may be introduced at trial as admissions. Fed. R. Evid. 801(d)(2)(A).

A defendant's loan applications and financial statements provided to financial institutions are excellent evidence to establish cash on hand prior to prosecution years and to rebut a cash hoard defense. A distinction must be made, however, between admissions made by a defendant prior to the crime (pre-offense admissions) and admissions made after the crime (post-offense admissions).

31.07[2][a] ***Pre-Offense Admissions***

Admissions made by a defendant prior to the crime do not have to be corroborated. ***Warszower v. United States***, 312 U.S. 342, 347 (1941); ***United States v. Soulard***, 730 F.2d 1292, 1298 (9th Cir. 1984); ***United States v. Hallman***, 594 F.2d 198, 200-01 (9th Cir. 1979) (*per curiam*)

(corroboration not required of admission in financial statement filed by the defendant with a bank prior to the investigation conducted by the Internal Revenue Service); ***Fowler v. United States***, 352 F.2d 100, 107 (8th Cir. 1965) (loan application was filed before crimes in controversy occurred, and admissions made on application need not be corroborated).

31.07[2][b] ***Post-Offense Admissions***

As a general rule, post-offense admissions must be corroborated. ***United States v. Calderon***, 348 U.S. 160, 163-65 (1954); ***Smith v. United States***, 348 U.S. 147, 152-53 (1954). Generally speaking, in a criminal tax case, a post-offense admission would be a statement made after the filing of a false tax return or, if no return was filed, after the tax return was due.

In ***Smith***, the defendant's opening net worth was based on a signed net worth statement given to the investigating agents by the defendant, as well as other extrajudicial admissions made by the defendant. 348 U.S. at 152. The Court found that the government could corroborate the defendant's statement in one of two ways: either (1) by substantiation of the opening net worth directly or (2) by independent evidence as to the defendant's conduct during the prosecution years "which tends to establish the crime of tax evasion without resort to the net worth computation." ***Smith***, 348 U.S. at 157-58. The government successfully relied on the second method to corroborate the defendant's post-offense admissions in ***Calderon***, by showing a substantial increase in the defendant's assets that were sufficiently at variance with his reported income to support an inference of tax evasion. ***Calderon***, 348 U.S. at 166-67.

Corroborative evidence of post-offense statements by a defendant regarding cash on hand is sufficient if it shows a substantial income deficiency for the overall prosecution period. It is not necessary for the corroborative evidence, as opposed to the evidence as a whole, to establish that there was a deficiency for each of the years in issue. ***Calderon***, 348 U.S. at 168; *accord* ***United States v. Vardine***, 305 F.2d 60, 64-65 (2d Cir. 1962) (evidence that defendant periodically borrowed money to meet payrolls and other indebtedness and that there were frequently judgments outstanding against him tended to corroborate figures defendant gave to agents).[4]

The Fifth Circuit, however, has held that it is not always necessary to corroborate post-offense admissions as to cash on hand. In ***United States v. Normile***, 587 F.2d 784, 786 (5th Cir. 1979), proof of cash on hand was based on the defendant's statement to the agent that "he kept no more than $100 in cash because he did not feel safe having larger amounts around." In response to the defendant's claim that the government failed to corroborate this statement, the court stated that

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[4] Where corroboration is required, the jury should be instructed on that requirement. *See* ***United States v. Marshall***, 863 F.2d 1285, 1288 (6th Cir. 1988) (reversing a jury verdict because the jury was not instructed that a defendant's extrajudicial statements must be corroborated with independent evidence).

it "was not necessary for the government to seek to corroborate the taxpayer's statement; indeed the inherent secrecy of the cash hoard makes it impossible for any but the keeper to know even of its existence, let alone the amount." ***Normile***, 587 F.2d at 786. Nevertheless, the court found that independent evidence of substantial bank accounts did "tend to corroborate" the defendant's admission, even though the government introduced no evidence to corroborate the admission directly. ***Id***. at 786-87; *see* ***United States v. Terrell***, 754 F.2d 1139, 1147 (5th Cir. 1985) (corroboration requirement does not necessarily extend to admissions relating to cash-on-hand); ***United States v. Scrima***, 819 F.2d 996 n.3 (11th Cir. 1987) ("the government is not required to corroborate the taxpayer's statement with respect to his cash on hand at the beginning of the tax period. After everything possible is done to verify the opening net worth, the issue of the amount of the defendant's cash hoard is properly submitted to the jury."); ***United States v. Wilson***, 647 F.2d 534, 536 n.1 (5th Cir. 1981) (*per curiam*); *but see* ***United States v. Meriwether***, 440 F.2d 753, 756-57 (5th Cir. 1971) (reversing for instructional error where "[t]he jury, if properly instructed, might well have failed to find any sufficient corroboration of [the defendant's] cash on hand").

31.07[3] ***Tax Returns As Admissions***

"Statements made in an income tax return constitute admissions." ***United States v. Dinnell***, 428 F. Supp. 205, 208 (D. Az. 1977), *aff'd without published opinion*, 568 F.2d 779 (9th Cir. 1978); *see* ***United States v. Hornstein***, 176 F.2d 217, 220 (7th Cir. 1949) (cost of goods sold). Items reported on tax returns that are the subject of the prosecution, as well as tax returns filed in prior years, are pre-offense admissions which do not have to be corroborated. ***United States v. Burkhart***, 501 F.2d 993, 995 (6th Cir. 1974) (citing cases). The government may take the defendant's reported income as an admitted amount earned from designated sources. A defendant's tax returns are admissible as statements under Fed. R. Evid. 801(d)(2)(A).

The defendant's income tax returns are frequently used in a net worth case as a guide in determining the defendant's net worth at the starting point. *See*, *e.g.*, ***United States v. Mackey***, 345 F.2d 499, 504 (7th Cir. 1965). Admissions found in the defendant's tax returns for earlier years can be particularly helpful in negating a cash hoard defense when the returns show that reported income in previous years was insufficient to enable the defendant to save any appreciable amount of money. ***Friedberg v. United States***, 348 U.S. 142, 143-44 (1954); ***Holland v. United States***, 348 U.S. 121, 133-34 (1954); ***United States v. Terrell***, 754 F.2d 1139, 1147 (5th Cir. 1985); ***United States v. Hamilton***, 620 F.2d 712, 715 (9th Cir. 1980); ***United States v. Bush***, 512 F.2d 771, 772 (5th Cir. 1975) (*per curiam*) (defendant's tax return reflecting zero cash on hand supported government position); ***United States v. Ross***, 511 F.2d 757, 761 (5th Cir. 1975); ***United States v. Carter***, 462 F.2d 1252, 1255-56 (6th Cir. 1972); ***United States v. Northern***, 329 F.2d 794, 795 (6th Cir. 1964) (*per curiam*) (value of machines in inventory taken from defendant's tax return);

Leeby v. United States, 192 F.2d 331, 333 (8th Cir. 1951).

31.07[4] ***Statements Given to Financial Institutions***

Loan applications and financial statements given to financial institutions are valuable evidence to prove a defendant's cash on hand and to identify other assets and liabilities. In ***United States v. Dwoskin***, 644 F.2d 418, 420 (5th Cir. Unit B 1981), the government established the defendant's opening net worth, including cash on hand and cash unrestricted in banks, based on a signed financial statement the defendant had submitted to a bank. The government did not include in its cash on hand figure $11,000 in an account on which the defendant held as a trustee for his children because there was no evidence that the defendant used the funds. ***Id***.

Financial statements also can be used to impeach a defendant testifying at trial. Thus, in ***Bateman v. United States***, 212 F.2d 61, 67 (9th Cir. 1954), the defendant testified that he had $13,000 in cash, and the government introduced, "as competent impeaching evidence," a financial statement that the defendant had given a bank showing cash of only $100.

31.07[5] ***Defendant's Books and Records***

The defendant's business books and records may be introduced as admissions and as records of a regularly conducted business activity pursuant to Fed. R. Evid. 803(6). *See* ***United States v. Hornstein***, 176 F.2d 217, 220 (7th Cir. 1949). The defendant's books and records may be used to establish the value of assets and liabilities in the opening net worth computation as well as to refute an attack on the computation of cash on hand. For example, in ***United States v. Mackey***, 345 F.2d 499, 505-06 (7th Cir. 1965), an annual statement of the defendant's corporation revealed that the corporation had less cash than the amount claimed by the defendant. Finally, the defendant's books and records are useful to establish the defendant's financial status in years prior to prosecution and the defendant's business activities during the prosecution years.

31.07[6] ***Statements of Accountants and Attorneys***

When the defendant directs the investigating agents to his or her accountant or bookkeeper for questions relating to taxes, any statements made by the accountant or bookkeeper constitute admissions of the defendant under Rule 801(d)(2)(D) of the Federal Rules of Evidence, irrespective of whether the defendant has authorized the making of the particular statement. *See* ***United States v. Parks***, 489 F.2d 89, 90 (5th Cir. 1974) (*per curiam*). And because admissions by a party opponent do not constitute hearsay, the investigating agents may properly testify at trial about those statements. ***United States v. Diez***, 515 F.2d 892, 896 n.4 (5th Cir. 1975); ***Hayes v. United States***, 407 F.2d 189, 192 (5th Cir. 1969). Statements of the defendant's bookkeeper or accountant when authorized by the defendant to make a statement concerning the subject are also admissible. Fed. R. Evid. 801(d)(2)(C); ***Parks***, 489 F.2d at 90.

These cases relied upon the absence of an accountant-client privilege because the defendant, knowing that mandatory disclosure of much of the information therein is required on an income tax return, had no reasonable expectation of privacy in documents and information provided to return preparers. ***Couch v. United States***, 409 U.S. 322, 333-34 (1973). The Court in ***Couch*** also noted that no confidential accountant-client privilege exists under federal law and that no state-created privilege has been recognized in federal cases. 409 U.S. at 335.

Note that the cases discussed above were decided prior to the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998) (the Act). Section 7525 of the Internal Revenue Code now provides:

> Confidentiality privileges relating to taxpayer communications
>
> (a) Uniform application to taxpayer communication with federally authorized practitioners.--
>
> (1) General rule.--With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.
>
> (2) Limitations.--Paragraph (1) may only be asserted in --
>
> (A) any noncriminal tax matter before the Internal Revenue Service; and
>
> (B) any noncriminal tax proceeding in Federal court brought by or against the United States.
>
> (3) Definitions.--For purposes of this subsection--
>
> (A) Federally authorized tax practitioner.--The term 'federally authorized tax practitioner' means any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code.
>
> (B) Tax Advice.--The term 'tax advice' means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice described in subparagraph (A).

Thus, by its own terms, the Act does not create an unlimited accountant-client privilege. The Act provides that the privilege may only be asserted in (A) any non-criminal tax matter before the Internal Revenue Service and (B) any non-criminal tax proceeding in Federal court brought by or against the United States. IRC § 7525(2)(A) & (B). Furthermore, it only applies to communications between a defendant and a federally authorized practitioner. Thus, the privilege is not available in a criminal investigation or criminal court proceeding, but would apply in the context of a civil audit.

Additionally, the Act specifically excludes from the privilege any written communications regarding corporate tax shelters. 26 U.S.C. § 7525(b). That Section provides:

> (b) Section not to apply to communications regarding corporate tax shelters.--The privilege under subsection (a) shall not apply to any written communication which is--
>
> (1) between a federally authorized tax practitioner and--
>
> (A) any person,
>
> (B) any director, officer, employee, agent, or representative of the person, or
>
> (C) any other person holding a capital or profits interest in the person, and
>
> (2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in section 6662(d)(2)(C)(ii)).

"Person" is defined under Internal Revenue Code Section 7701(a)(1) as "an individual, a trust, estate, partnership, association, company or corporation." Tax shelters are defined under § 6662(d)(2)(C)(ii):

> (ii) Tax shelter. . . . [T]he term 'tax shelter' means--
>
> (I) a partnership or other entity,
>
> (II) any investment plan or arrangement, or
>
> (III) any other plan or arrangement,
>
> if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

26 U.S.C. § 6662(d)(2)(C)(ii). Thus, *written* communications with a representative of a corporation in connection with efforts to persuade the corporation to participate in a tax shelter are excluded from the privilege.

In cases in which the accountant has been employed by the defendant's attorney to assist the attorney in communicating with the client and rendering legal advice, statements of the accountant may fall within the attorney-client privilege. *See* ***United States v. Gurtner***, 474 F.2d 297, 298-99 (9th Cir. 1973); ***United States v. Mierzwicki***, 500 F. Supp. 1331, 1335 (D. Md. 1980). The most familiar situation occurs when the attorney hires an accountant to assist the attorney's representation of the defendant. *See* ***United States v. Kovel***, 296 F.2d 918, 920-23 (2d Cir. 1961). A ***Kovel*** accountant is protected by an extension of the attorney-client privilege.

In the case of attorneys, statements made by a defendant's attorney may be admissible as admissions of a party-opponent pursuant to Fed. R. Evid. 801(d)(2) if it is shown that the statements are not barred by the attorney-client privilege. A statement by a defendant's attorney is not privileged if it was authorized by the client and concerned the subject authorized. ***United States v. Ojala***, 544 F.2d 940, 945-46 (8th Cir. 1976). In ***Ojala***, the court admitted into evidence the attorney's statement that the defendant's failure to file was not the result of his political beliefs. ***Id***. at 945. The court found that the "statements were made in an unequivocal manner by one who was acting

as the appellant's attorney at the time, and that they referred to a matter within the scope of the attorney's authority." ***Id***. at 946. The court also noted that the defendant was present when the statement was made and voiced no objection. ***Id.***

Another court admitted into evidence a statement by a defendant's attorney which contradicted the defendant's assertion that he had filed his tax returns. ***United States v. O'Connor***, 433 F.2d 752, 755 (1st Cir. 1970). The ***O'Connor*** court observed that the attorney's statement did not exceed the scope of the attorney's actual authority. ***Id***. at 756. The court further observed that it might rule otherwise if there had been evidence that the defendant told his attorney not to make the statement or to "confine himself to the position adopted by defendant." ***Id***. The court found that it was "clearly within the power and duty of the attorney to do what he could, in his own best judgment, [to aid the defendant]." ***Id.***

Note, however, that courts have generally held that the preparation of tax returns does not constitute legal advice within the scope of the attorney-client privilege. ***United States v. Frederick***, 182 F.3d 496, 500-01 (7th Cir. 1999); ***In Re Grand Jury Investigation (Schroeder)***, 842 F.2d 1223, 1224 (11th Cir. 1987) (collecting cases); ***United States v. Lawless***, 709 F.2d 485, 487-88 (7th Cir. 1983); ***United States v. El Paso***, 682 F.2d 530, 539 (5th Cir. 1982); ***United States v. Gurtner***, 474 F.2d 297, 298-99 (7th Cir. 1973); *but see* ***Colton v. United States***, 306 F.2d 633, 637 (2d Cir. 1962) ("There can, of course, be no question that the giving of tax advice and the preparation of tax returns . . . are basically matters sufficiently within the professional competence of an attorney to make them prima facie subject to the attorney-client privilege.").

31.07[7] ***Accountant's Workpapers***

An accountant's workpapers can be useful in establishing opening net worth figures for cash on hand, other assets, and liabilities. An accountant's workpapers are records that the accountant kept in the ordinary course of business, and they should be admissible as exceptions to the hearsay rule pursuant to Fed. R. Evid. 803(6). Ordinarily, the accountant will testify that he or she obtained the information upon which he or she relied either from the defendant directly or from an employee providing information on the defendant's behalf.

31.07[8] ***Analysis of Source and Application of Funds to Establish Opening Cash on Hand***

Another method of establishing an opening cash on hand figure is to analyze the defendant's available finances for the years leading up to the starting point. This method is known as a source and application of funds. Using this method, the government determines the amount of money available to the defendant during the earlier years and the amount that the defendant spent.

For example, if the evidence demonstrates that the defendant had $100,000 available from all sources, both taxable and nontaxable and that the defendant spent $90,000, this would leave only $10,000 as cash on hand. This was the approach taken in ***United States v. Terrell***, 754 F.2d 1139,

1143 (5th Cir. 1985), in which, on the basis of a source and application of funds analysis showing that the defendant's expenditures in prior years exceeded his reported income plus nontaxable gifts by $229,000, the defendant was not credited with any cash on hand. As in the case of establishing opening net worth, a thorough investigation is required to support a source and application of funds analysis sufficient to establish cash on hand with reasonable certainty. ***Terrell***, 754 F.2d at 1146-47; ***United States v. Goichman***, 407 F. Supp. 980, 994-95 (E.D. Pa.), *aff'd*, 547 F.2d 778 (3d Cir. 1976).

31.08 *NET WORTH ASSETS*

31.08[1] *Reflected at Cost -- Generally*

As a general rule, when establishing the net worth of a defendant, assets are reflected at cost and not at fair market value. Thus, if a defendant buys a house for $350,000, the house is reflected as a net worth asset at $350,000, even though the house may be worth $600,000 in the year for which the defendant's net worth is being determined. This is because the net worth method is concerned with actual costs and expenditures; an increase in value may result from appreciation rather than the receipt of taxable income. ***United States v. O'Connor***, 237 F.2d 466, 473 n.6 (2d Cir. 1956). *See* ***United States v. Terrell***, 754 F.2d 1139, 1145 (5th Cir. 1985) (using a cost basis to determine net worth means that assets preexisting the indictment period are a source of nontaxable funds only to the extent of basis); ***Hayes v. United States***, 407 F.2d 189, 193 (5th Cir. 1969) (cost of partially constructed apartments taken from defendant's income tax return; and cost of land based on information furnished by the defendant's accountant).

As an exception to this general rule, cost is not used when the Internal Revenue Code dictates that a basis other than cost be used in determining tax consequences. Some examples of situations where an asset would be reflected at a figure other than cost are inheritances (*see* 26 U.S.C. § 1014(a)(1), basis of property acquired from a decedent is the fair market value of the property at the date of the decedent's death) and gifts (*see* 26 U.S.C. § 1015, basis of property acquired by gifts and transfers in trust shall be the same as it would be in the hands of the donor/grantor). Additionally, if services are paid for in property, then the fair market value of the property is included as compensation in gross income. Treas. Reg. § 1.61-2(d). In this situation, property received in exchange for services would be reflected at its fair market value in the net worth computation.

31.08[2] *Across-the-Board Assets*

An across-the-board asset is an asset the defendant owned in the opening year and continued to own throughout the prosecution years, with no increase or decrease in the cost of the asset. Since a net worth computation measures changes, an across-the-board asset does not affect a defendant's net worth. For example, assume that the prosecution years are 2005 through 2008 and the defendant purchased stock for $10,000 in 2004 and still owned the same stock at the end of 2008. There would

be no change in the basis of the stock, and the effect on the defendant's net worth would be zero. Because an across-the-board asset does not affect the net worth computation, it has been held that it is not error to leave such an asset out of the net worth computation. ***United States v. Mackey***, 345 F.2d 499, 505 (7th Cir. 1965).

It is sufficient for the government to identify with reasonable specificity the basis in every asset, including cash, with respect to which a purchase or sales transaction occurred in the tax years in question. It is not necessary for the government to establish the basis for every asset the defendant owns. ***United States v. Schafer***, 580 F.2d 774, 778 (5th Cir. 1978). As long as omitted assets were across-the-board assets, there would be no affect on the net worth computation.

In ***United States v. Tolbert***, 406 F.2d 81, 84 (7th Cir. 1969), the government's net worth computation reflected the defendant's accounts receivable as an across the board asset for all of the years in question. The government figure was based on a statement the defendant had given the agents. ***Id***. There was testimony at the trial that the accounts receivable had increased during the prosecution years. ***Id***. The court rejected the defendant's argument that it was reversible error not to reflect the alleged increase, observing that if the accounts receivable did increase during the prosecution years, the error in failing to reflect the increase was in the defendant's favor and did not prejudice him. ***Id***. The court determined that there would be prejudice only if the evidence showed that the accounts receivable had decreased during the prosecution years (because this would have been a source of funds for cash received or spent during the prosecution years). ***Tolbert***, 406 F.2d at 84; *see also* ***United States v. Scrima***, 819 F.2d 996, 999 (11th Cir. 1987) ("government employed the floating cash or dash formula where cash is an unknown but constant factor throughout the net worth period"); ***United States v. Terrell***, 754 F.2d 1139, 1145 (5th Cir. 1985); ***United States v. Dwoskin***, 644 F.2d 418, 421 (5th Cir. Unit B 1981).

31.08[3] ***Bank Accounts and Nominee Accounts***

Money in the bank represents an asset in a net worth computation. In the usual situation, it is a relatively simple matter to determine how much money the defendant had in the bank at the end of each year, with the balance being reflected in the net worth statement. A bank reconciliation must be done to subtract outstanding checks and to add in transit deposits to properly reflect the balance at the end of the year.

When tax fraud is taking place, it is quite common for the defendant to intentionally maintain bank accounts that are not in his or her own name, instead placing them in the names of friends, relatives, or business entities. From an analysis of the deposits made and checks written on the account, the government may be able to establish that the funds are actually the defendant's and that the name on the bank account is nothing more than an attempt to conceal the defendant's control of the account. In such an instance it is proper to include the bank account as an asset in the

defendant's net worth computation. In ***United States v. Balistrieri***, the Seventh Circuit rejected the defendant's attack on the propriety of including in his net worth computation cash that had been deposited into a joint bank account held in the defendant's name and the name of his nineteen-year-old son. The court found that the jury had ample grounds to believe that the money was in fact the defendant's, since the government proved that the defendant controlled the account and withdrew a substantial amount from it. ***Balistrieri***, 403 F.2d 472, 479 (7th Cir. 1968), *vacated and remanded on other grounds*, 395 U.S. 710 (1969), *aff'd after remand*, 436 F.2d 1212 (7th Cir. 1971); *see also* ***Talik v. United States***, 340 F.2d 138, 141 (9th Cir. 1965) (attributing to defendant entire balance in joint bank account held in names of defendant and defendant's daughter was justified because either the account belonged to defendant or any money belonging to daughter was a gift from her parents).

31.08[4] ***Assets and Liabilities of Husband and Wife or Children***

In determining a defendant's opening net worth, consideration must be given to assets and liabilities of a non-defendant spouse and children to determine whether or not they should be included in the net worth computation. If the net effect of inclusion would be *de minimis*, such assets and liabilities need not be included in the government's computation. *See* ***United States v. Goichman***, 407 F. Supp. 980, 995-96 (E.D. Pa.), *aff'd*, 547 F.2d 778 (3d Cir. 1976). A failure to conduct such an investigation of the defendant's spouse resulted in a reversal in ***United States v. Meriwether***, 440 F.2d 753 (5th Cir. 1971). The court held that the government failed to establish with reasonable certainty a definite opening net worth of the joint income of Meriwether and his wife, saying that the government "came near ignoring Mrs. Meriwether." ***Meriwether***, 440 F.2d at 755-57.

In contrast, the Ninth Circuit held that the government is not required to establish the net worth of the defendant's spouse as part of its prima facie case. ***United States v. Hallman***, 594 F.2d 198, 200 (9th Cir. 1979) (*per curiam*). Instead, the government's duty to investigate spousal assets arises only under its obligation to negate reasonable explanations or leads furnished by the defendant. ***Id***. A thorough financial investigation should always consider the assets and liabilities of a spouse.

A somewhat different issue is whether the government can use a joint net worth statement for both husband and wife. The Fifth and Sixth Circuits have answered in the affirmative. In ***United States v. Brown***, 667 F.2d 566 (6th Cir. 1982) (*per curiam*), both husband and wife were tried and convicted of income tax evasion. The court concluded that the government's use of a joint net worth statement was "justified in this case," even though the wife was the nominal owner of the business that was the source of the unreported income, because "the financial affairs of the two defendants were so intertwined as to justify a joint reconstruction of their income." ***Brown***, 667 F.2d at 568. In a non-defendant spouse case, ***United States v. Giacalone***, 574 F.2d 328, 333 (6th Cir.1978), the government's evidence showed that the defendant's wife earned no income prior to and during the

prosecution years, that she made some nondeductible expenditures with funds furnished by her husband, and that she and her husband filed joint returns. Because the defendant was charged with attempting to evade taxes owed by both him and his wife and "her financial transactions were intertwined with those of her husband," the court approved the government's use of a joint net worth statement. ***Id***. In ***United States v. Smith***, 890 F.2d 711, 714 (5th Cir. 1989), the Fifth Circuit relied on ***Brown*** and ***Giacalone*** in rejecting a defendant's claim that the government was required to exclude assets of the defendant's spouse and child to ensure the accuracy of the net worth analysis. In ***Smith***, the government excluded both the income of the defendant's daughter and gifts to the defendant's wife and daughter before arriving at a final net worth determination of the defendant and his spouse. 890 F.2d at 714. The court of appeals approved the government's action, stating that the "fabric of the financial blanket is so closely woven that a computation of net worth on the joint income of the spouses is clearly permissible." ***Id***.

31.08[5] ***Real Property***

Real property is reflected in the net worth computation at cost. Direct evidence of the cost is commonly established through the transfer tax charged when the deed was recorded, as the tax is usually a percentage of the sales price. Certified copies of public records such as deeds and mortgages are admissible as hearsay exceptions. Fed. R. Evid. 803(14). In addition, escrow files of title companies should be obtained to identify the source of funds used to purchase the real estate. These records would also be admissible under the business records hearsay exception. Fed. R. Evid. 803(6).

31.08[6] ***Partnership Interest***

When the defendant has invested money in a partnership, the defendant's share of the partnership capital is reflected as an asset. ***United States v. Mancuso***, 378 F.2d 612, 614-15 (4th Cir.), *amended*, 387 F.2d 376 (4th Cir. 1967). In ***Mancuso***, the government had little direct evidence to establish the percentage interest the defendant had in the partnership. 378 F.2d at 615. Therefore, the government allocated an equal share of the partnership capital to all the partners, including the defendant, which corresponded to the distribution of profits as reported on the partnership tax returns. ***Id***. at 615-16. The government agent testified that this "conformed to the ordinary legal presumption that in absence of evidence of an agreement to the contrary the partners' interests are equal." ***Id***. at 616.

31.08[7] ***Errors in Net Worth Computation***

If there is an error in the net worth computation for one of the prosecution years, the error will not necessarily affect other prosecution years. ***United States v. Keller***, 523 F.2d 1009, 1012 (9th Cir. 1975) (error did not carry over to a subsequent year since the asset was disposed of in the prior prosecution year). Moreover, even if an error does affect all of the prosecution years, the

government is not required to prove its case to a mathematical certainty. If a substantial understatement remains after accounting for the error, then a guilty verdict will be upheld. ***Id***.

31.09 *LIABILITIES*

The government must present evidence of a defendant's liabilities. These liabilities are subtracted from assets in arriving at the defendant's net worth. As with assets, the defendant's liabilities must be established with reasonable certainty. For examples of evidence establishing liabilities, *see* ***United States v. Schafer***, 580 F.2d 774, 780 (5th Cir. 1978). Testimony by the investigating agent as to the amount of an asset, a liability, or any item in the net worth computation, is inadmissible hearsay without independent documentation or third-party testimony. *See* ***United States v. Morse***, 491 F.2d 149, 153-55 (1st Cir. 1974) (a bank deposits case, but the principle is applicable to a net worth case).

Conversely, when the agent's investigation reveals that there were no liabilities, the agent can testify about his or her personal efforts to identify liabilities and inability to find any liabilities. Such testimony is based upon what action was taken and thus is not hearsay. ***United States v. Dwoskin***, 644 F.2d 418, 423 (5th Cir. Unit B 1981); ***Morse***, 491 F.2d at 154 n.8; ***United States v. Lanier***, 578 F.2d 1246, 1255 (8th Cir. 1978); ***United States v. Robinson***, 544 F.2d 110, 114-15 (2d Cir. 1976); ***United States v. Jewett***, 438 F.2d 495, 497-98 (8th Cir. 1971); ***United States v. DeGeorgia***, 420 F.2d 889, 891-92 (9th Cir. 1969); ***Charron v. United States***, 412 F.2d 657, 660 (9th Cir. 1969); ***McClanahan v. United States***, 292 F.2d 630, 637 (5th Cir. 1961) ("[t]his, in fact, is frequently the only way in which a negative fact can be proved"). *See also* Fed. R. Evid. 803(7) and 803(10).

31.10 *NONDEDUCTIBLE EXPENDITURES*

31.10[1] *Added to Net Worth Increase*

When the ending net worth is subtracted from the opening net worth, the result is called the net worth increase. This amount is further adjusted by adding the defendant's nondeductible expenditures during the year, including living expenses, for items which are not reflected as assets on the net worth statement. ***Holland v. United States***, 348 U.S. 121, 125 (1954); ***United States v. Terrell***, 754 F.2d 1139, 1144 (5th Cir. 1985); ***United States v. Hamilton***, 620 F.2d 712, 714 n.1 (9th Cir. 1980); ***United States v. Skalicky***, 615 F.2d 1117, 1119 (5th Cir. 1980) (citing ***Holland***); ***United States v. Hiett***, 581 F.2d 1199, 1200 n.1 (5th Cir. 1978). "The taxpayer's nondeductible expenditures are added to the adjusted net values of the defendant's assets at the end of the subject year and, consequently, increase the figure to be compared with the opening net worth." ***Hamilton***, 620 F.2d at 716; *see also* ***United States v. Scrima***, 819 F.2d 996, 999 (11th Cir. 1987).

31.10[2] ***Burden on Government***

The government has the burden of establishing that the expenditures added to the net worth increase are nondeductible expenditures, as opposed to deductible expenses such as business expenses. Any addition to the net worth increase must be limited to nondeductible expenditures. ***Fowler v. United States***, 352 F.2d 100, 103 (8th Cir. 1965). The government must establish the nature of an expenditure by independent documentary or testimonial evidence. Admissions by the defendant may establish whether expenditures are personal or business. Checks with a notation of "personal" written on them constitute a pre-offense admission. ***Fowler***, 352 F.2d at 103; *see also* ***United States v. Altruda***, 224 F.2d 935, 939-40 (2d Cir. 1955) (admitted personal living expenses added to the net worth increase). It is improper to designate an expenditure as personal based solely on a review of the defendant's checks by the investigating agent and the agent's testimony that a check is either for a personal or business purpose. The agent's testimony is inadmissible hearsay. ***Greenberg v. United States***, 280 F.2d 472, 476-77 (1st Cir. 1960).

A nondeductible expenditure made by or on behalf of a spouse, child, or any third party can be added to the defendant's net worth increase, where it can be shown that the defendant furnished the funds for the expenditure. ***United States v. Giacalone***, 574 F.2d 328, 333 (6th Cir. 1978) (government proof traced a number of nondeductible expenditures by the wife to funds furnished by the defendant); *cf.* ***United States v. Lawhon***, 499 F.2d 352, 355-56 (5th Cir. 1974) (defendant provided funds for certificates of deposit held in the names of children); ***United States v. Balistrieri***, 403 F.2d 472, 479 (7th Cir. 1968) (funds deposited by defendant into bank account in name of defendant and his minor son), *vacated and remanded on other grounds*, 395 U.S. 710 (1969), *aff'd after remand*, 436 F.2d 1212 (7th Cir. 1971).

31.10[3] ***Nondeductible Expenditures -- Examples***

> Proof of non-deductible expenditures such as food, clothing, shelter and gifts is one factor in the net worth and expenditures method of proof. . . . Government tax experts routinely add living expenses to their net worth schedules.

United States v. Scott, 660 F.2d 1145, 1173 (7th Cir. 1981); *see* ***United States v. Hamilton***, 620 F.2d 712, 716 (9th Cir. 1980).

In ***Scott***, the only daily living expense the government included in its net worth calculation was food. As Attorney General of the State of Illinois, Scott traveled on state business, and his travel vouchers were used as a basis for arriving at his unreimbursed food expenditures. ***Scott***, 660 F.2d at 1151. In addition to food expenses, the government's net worth computation included cash travel expenses for personal trips that the government was able to document and the purchases of a stamp collection and a diamond ring. ***Scott***, 660 F.2d at 1150-51.

Living expenses may be based on information provided by the defendant, often at an initial interview by investigating agents. A juror will know what the basic cost of living is in his or her own judicial district, but the government should document the expenditures by issuing subpoenas and conducting interviews. Sources of information could include the landlord or mortgage holder, the telephone company, the internet service provider, the cable company or satellite dish company, a health care provider, lienholder on vehicle, and a landscaping or pool cleaning service. With the prevalence of debit cards, it is important to remember that many retail outlets permit the cardholder to get cash back. Therefore bank statements in and of themselves are not sufficient to document funds spent on groceries -- a $100 withdrawal may be $50 in groceries and $50 cash back. Subpoena the records of each entity on the bank statement to determine the amount of the withdrawal that was actually used to obtain goods or services. Personal insurance premiums and federal income taxes paid by a defendant may also be added to the net worth increase. ***Dawley v. United States***, 186 F.2d 978, 980 (4th Cir. 1951). In ***Armstrong v. United States***, 327 F.2d 189, 192-93 (9th Cir. 1964), nondeductible expenditures included living expenses, payment of insurance premiums, fees paid to an attorney, bond premiums, and other nondeductible expenditures. Travel expenses were added to the net worth increase as nondeductible expenditures in ***United States v. Sorrentino***, 726 F.2d 876, 880 (1st Cir. 1984). Gifts, vacation trips, payments for a maid, and gifts for a spouse and third parties are further examples of nondeductible expenditures. ***United States v. Goichman***, 407 F. Supp. 980, 989 (E.D. Pa.), *aff'd*, 547 F.2d 778 (3d Cir. 1976).

Where the government is unable to trace expenditures for household goods or services, personal entertainment, or personal care items, the jury can properly conclude that the defendant must have incurred some expenses for these items and that such expenses would have added to the defendant's net worth increase and expenditures, beyond what the government proved. ***Scott***, 660 F.2d at 1151. Permitting the government's expert witness to testify that she did not take into consideration the defendant's personal expenditures for food and clothing in the net worth calculations does not permit the jury to improperly speculate as to the defendant's personal expenses. ***United States v. Notch***, 939 F.2d 895, 900 (10th Cir. 1991). In ***Notch***, the Tenth Circuit recognized that "[t]his conservative approach to the net worth computation made the analysis appear more credible" and can be viewed "as showing that the jury need not consider personal expenses in order to conclude that defendant understated his income." ***Id***.

31.11 *REDUCTIONS IN NET WORTH*

The purpose of the net worth computation is to arrive at taxable income, so the computation must reflect only items with tax consequences. Therefore, nontaxable items received by the defendant during the prosecution period must be eliminated or accounted for in the net worth computation. The following types of nontaxable items must be subtracted from the total reflecting the net worth

increase and nondeductible expenditures: gifts received, inheritances, nontaxable pensions, the nontaxable portion of capital gains, veterans' benefits, dividend exclusions, tax-exempt interest, proceeds from life insurance, and any other nontaxable items.

An example of the treatment of such an item is found in ***United States v. Holovachka***, 314 F.2d 345 (7th Cir. 1963). In that case, the defendant had purchased bonds for investment purposes and received monies during the prosecution year representing the repayment of principal and nontaxable interest:

> Government treated the principal repayments as a tax free return of capital which correspondingly decreased defendant's investments in such bonds for those years. The yearly interest payments received on these bonds were considered to be tax free and were accordingly deducted from defendant's net worth. The trial court properly instructed the jury that the repayments of principal and the earned interest constituted non-taxable income.

Holovachka, 314 F.2d at 355.

Technical items and items that are clearly mistakes and not due to fraud are also deducted from the defendant's computed net worth. In a criminal tax case the purpose of the net worth computation is to measure the unreported taxable income based on intentional acts of the defendant. Thus, the underreporting of an income item as the result of an inadvertent error of the defendant, or of the defendant's accountant, should not be included in the defendant's net worth computation.

In ***United States v. Altruda***, 224 F.2d 935, 940 (2d Cir. 1955), the defendant's accountant explained to the examining agent prior to trial that the defendant had made "errors" in underreporting income from realty holdings, and the defendant was given credit for those amounts in the government's net worth computation. In ***United States v. Allen***, 522 F.2d 1229, 1231 (6th Cir. 1976), a technical adjustment was made, reducing the net worth computation to allow for an error discovered in one of the adding machine tapes used in preparing the defendant's return. The net effect was that the adjustment allowed the entire deduction claimed by the defendant on his return, and the defendant was not charged with the error in the net worth computation. ***Id***.

31.12 *ATTRIBUTING NET WORTH INCREASES TO TAXABLE INCOME*

31.12[1] *Generally*

The net worth method of proof requires evidence supporting "the inference that the defendant's net worth increases are attributable to currently taxable income." ***Holland v. United States***, 348 U.S. 121, 137 (1954); ***United States v. Dwoskin***, 644 F.2d 418, 422 (5th Cir. Unit B 1981); ***United States v. Hom Ming Dong***, 436 F.2d 1237, 1241 (9th Cir. 1971); ***United States v. Mackey***, 345 F.2d 499, 506 (7th Cir. 1965). "Increases in net worth, standing alone, cannot be assumed to be attributable to currently taxable income." ***Holland***, 348 U.S. at 137-38.

There are two ways of supporting an inference that net worth increases are attributable to currently taxable income:

1. Proof of a likely source of taxable income. ***Holland***, 348 U.S. at 137-38.
2. Negating non-taxable sources of income. ***United States v. Massei***, 355 U.S. 595, 595-96 (1958) (*per curiam*).

Either method is sufficient. *See* ***United States v. Sorrentino***, 726 F.2d 876, 879-80 (1st Cir. 1984); ***United States v. Scott***, 660 F.2d 1145, 1151 (7th Cir. 1981); ***Dwoskin***, 644 F.2d at 422; ***United States v. Grasso***, 629 F.2d 805, 808 (2d Cir. 1980); ***United States v. Hiett***, 581 F.2d 1199, 1201 (5th Cir. 1978). Nonetheless, in order to convince the jury that the government's financial investigation was very thorough, it may be wise to try to do both if possible.

31.12[2] ***Proof of Likely Source of Taxable Income***

The government can establish a likely source of taxable income through direct or circumstantial evidence. The applicable rule requires "proof of a likely source, from which the jury could reasonably find that the net worth increases sprang." ***Holland v. United States***, 348 U.S. 121, 138 (1954). It is not necessary for the government to prove by direct evidence that the unreported income reflected by the net worth computation actually came from the likely source established. ***United States v. Mackey***, 345 F.2d 499, 506-07 (7th Cir. 1965); *see also* ***United States v. Smith***, 890 F.2d 711, 714 (5th Cir. 1989) (likely source of income could be indicated by business operations; investments in mineral interests, real estate, stocks, bonds, and commodities; and gambling activities); ***United States v. Greene***, 698 F.2d 1364, 1373 (9th Cir. 1983) (the government need not prove a specific source, but only a likely source, and evidence established real estate sales, interest income on loans, and unreported securities transactions as likely sources of taxable income); ***United States v. Hom Ming Dong***, 436 F.2d 1237, 1241-42 (9th Cir. 1971) (grocery store ownership provided likely source).

The government is not limited to showing a single likely source of taxable income but can introduce evidence of as many possible sources of taxable income as the investigation has developed. *See*, *e.g.*, ***Feichtmeir v. United States***, 389 F.2d 498, 502 (9th Cir. 1968) (evidence showed that the defendant had interests in eight operating businesses, investments in real estate, a trust deed, a joint venture, stocks and bonds, and an undisclosed Mexican source of income).

Likewise, the government does not have to show that the likely source was capable of generating the entire amount of unreported income charged in the indictment. ***United States v. Costanzo***, 581 F.2d 28, 33 (2d Cir. 1978). The court found that extensive proof supported the inference that the defendant's bakery was a likely source of unreported taxable income because the bakery was large enough to generate substantial amounts of unreported cash receipts. ***Id***.

Once the government has introduced evidence of a likely source of taxable income, the government has no burden to negate *all* possible nontaxable sources of the unreported income. Nonetheless, the government has an obligation in net worth cases to conduct a thorough financial investigation, which would include searching for common nontaxable sources of funds.

Evidence of specific items of unreported income is admissible to show a likely source from which the net worth increases may have come. ***United States v. Schafer***, 580 F.2d 774, 777 n.5 (5th Cir. 1978) (citing ***Holland***, 348 U.S. at 138). In ***United States v. Hagen***, 470 F.2d 110, 111 (10th Cir. 1972), the defendant claimed surprise and argued that the government introduced evidence as to specific items of unreported income to an extent that the specific items proof "changed the theory of the case or in any event overshadowed the net worth proof." Although the court agreed that the specific items evidence assumed such a large role at the trial that "at the end it became difficult to say whether it still was a net worth case," the court found no error. ***Id***. at 112. The court concluded that "the Government followed and met the requirements of ***Holland v. United States***. The evidence of specific items was proper as indicated to show willfulness, but it was also proper to show a likely source under ***Smith v. United States***, 348 U.S. 147, 75 S.Ct. 194, 99 L.Ed. 192 [(1954)] and ***United States v. Calderon***, 348 U.S. 160, 75 S.Ct. 186, 99 L.Ed. 202 [(1954)]." ***Hagen***, 470 F.2d at 113.

Confusion as to the government's method of proof can be avoided by clearly designating in a response to a motion for a bill of particulars and in proposed jury instructions the method of proof to be relied upon by the government. For example, net worth method and specific items method, or net worth method corroborated by specific items of unreported income.

31.12[3] ***Illegal Sources of Income***

There is no requirement that the likely source of income be a legal source. ***James v. United States***, 366 U.S. 213 (1961). "[G]ross income means all income from whatever source derived . . . ." 26 U.S.C. § 61.

When illegal activity is the source of unreported income and the government can prove the crime of the illegal activity, it is advisable to indict both the tax crime and the crime that is the likely source of the unexplained wealth. If it is not charged, the court may limit the evidence to prove the illegal source of income, because of the possibility of undue prejudice. *See*, *e.g.*, ***United States v. Tunnell***, 481 F.2d 149, 151 (5th Cir. 1973) (likely source of the defendant's net worth increases could have been income from prostitution activities at a motel the defendant operated).

It must be clear that the purpose of introducing evidence of illegal activities is to establish a likely source of income, and the evidence must not be introduced or alluded to in a manner calculated to inflame the jury. In ***United States v. Abodeely***, 801 F.2d 1020, 1022 (8th Cir. 1986), the government presented evidence that the defendant derived his unreported income from illegal

prostitution and from legal gambling activities. After a lengthy discussion of the Rule 403 probative value/prejudice balancing test, the court concluded that it had

> no conceptual difficulty with the evidence concerning prostitution. While it is certainly prejudicial, it is highly probative of unreported taxable income. The gambling evidence, while having less direct probative value, is much less prejudicial, and indeed if its admission was error (which this court does not conclude), the error was harmless beyond a reasonable doubt. After all, having been shown that Abodeely ran a bar and a brothel, even the most straitlaced Iowa jury could hardly have been adversely affected by a showing of his participation in the legal, though perhaps sinful and worldly in the eyes of a midwestern jury, activity of gambling in Nevada.

Abodeely, 801 F.2d at 1026; *see also* ***United States v. Smith***, 890 F.2d 711, 716 (5th Cir. 1989) (defendant not unfairly prejudiced by introduction of evidence concerning his gambling activities); ***United States v. Tafoya***, 757 F.2d 1522, 1526-28 (5th Cir. 1985) (income from payments for attempted assassinations; bank deposits case); ***United States v. Vannelli***, 595 F.2d 402, 405-06 (8th Cir. 1979) (evidence of defendant's prior misdemeanor convictions of misappropriation of funds held admissible to show intent, opportunity, scheme, or plan from which unreported income could be derived and to show potential source of unreported income; bank deposits case); ***United States v. Windham***, 489 F.2d 1389, 1391 (5th Cir. 1974) (evidence of defendant's income from performing illegal abortions). The illegal sources for generating income are virtually limitless. *See*, *e.g.*, ***United States v. Dall***, 918 F.2d 52, 53 (8th Cir. 1990) (*per curiam*) (illegal importation of veterinary drugs); ***Clinkscale v. United States***, 729 F.2d 940, 942 (8th Cir. 1984) (*per curiam*) (prostitutes turned over to defendant income he failed to report).

Skimming of business receipts is another example of a likely source of taxable income which a jury could conclude accounts for the defendant's increase in net worth. *See* ***United States v. Koskerides***, 877 F.2d 1129, 1137-38 (2d Cir. 1989) (two diners operated as cash businesses may be likely source of unreported income where previous owner had much higher revenue than defendant and testimony indicated the possibility of skimming); ***United States v. Sorrentino***, 726 F.2d 876, 880 (1st Cir. 1984); ***United States v. Hamilton***, 620 F.2d 712, 715 (9th Cir. 1980) (jury could have found that the likely source of taxable funds was the illegal diversion of money from slot machine revenues)[5].

[5] In ***Hamilton***, 620 F.2d 712 (9th Cir. 1980), the court upheld as admissible, and found most convincing, the testimony of a statistical expert who had examined the slot machines, reviewed their reported performance, compared their performance with similar machines at other casinos and with the manufacturer's built-in specifications, and concluded that the odds against the machines' performing as poorly as the records indicated were greater than two billion to one. ***Hamilton***, 620 F.2d at 715.

Testimony of customers can establish the source of income for narcotics traffickers. *See* ***United States v. Scrima***, 819 F.2d 996, 999 (11th Cir. 1987); ***United States v. Palmer***, 809 F.2d 1504, 1505 (11th Cir. 1987); ***United States v. Lewis***, 759 F.2d 1316, 1328, 1336 (8th Cir. 1985); ***United States v. Horvath***, 731 F.2d 557, 563 (8th Cir. 1984); ***United States v. Heyward***, 729 F.2d 297, 301 (4th Cir. 1984);[6] ***United States v. Enstam***, 622 F.2d 857, 860 (5th Cir. 1980); ***United States v. Browning***, 723 F.2d 1544, 1547 (11th Cir. 1984).

When the defendant has an illegal source of income and is not charged with the crime that gave rise to the income, the government should ensure that the jury instructions clearly state that the defendant is on trial for the particular tax offense, not for the illegal activity that is or may be the source of unreported income. *See* ***Windham***, 489 F.2d at 1389 (commenting that this was done in ***United States v. Tunnell***, 481 F.2d 149 (5th Cir. 1973)). Limiting instructions are also advisable. *See* ***Palmer***, 809 F.2d at 1505 (11th Cir. 1987) (trial court properly maintained jury's focus on tax issues and properly minimized any possible prejudice by giving clear limiting and final instructions).

31.12[4] ***Negating Nontaxable Sources of Funds***

It is well established that "[s]hould all possible sources of nontaxable income be negatived, there would be no necessity for proof of a likely source." ***United States v. Massei***, 355 U.S. 595, 595 (1958) (*per curiam*). The Fifth Circuit summarized the government's burden where the defendant has failed to provide any leads as to nontaxable sources of funds:

> We therefore hold that in an income tax evasion case based on the net worth method of proof, when the taxpayer gives no leads as to nontaxable sources, the government satisfies its burden of negating all possible nontaxable sources within the meaning of ***Massei*** by showing that it conducted a thorough investigation that failed to reveal any nontaxable source.

United States v. Hiett, 581 F.2d 1199, 1202 (5th Cir. 1978). In response to the defendant's argument that the government must negate every possible source of nontaxable funds, the court in ***Hiett*** noted that this would be an impossible task because:

> [It] would require the government to exhaust the inexhaustible to conduct an absolutely limitless investigation. It would cast the government in the role of a conjurer, forcing it to pull nontaxable sources out of a hat. Appellant would require the government to embark on a Magellan-like expedition in order to prove that the unreported income was taxable. Not only would the government have to circle the globe in its search, it would also have extraorbital responsibility, since appellant's position requires it to prove a cosmic negative. To state appellant's position is to establish its absurdity. If ***Massei*** and ***Holland*** are to have viability in our jurisprudence, they cannot be read to sanction such a result.

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[6] This case is of particular interest because the court admitted evidence that the defendant's plane was found in Georgia in 1980 loaded with over 4,000 pounds of marijuana and the prosecution years were 1978 and 1979. ***Heyward***, 729 F.2d at 301.

Id. at 1201; *accord* ***United States v. Notch***, 939 F.2d 895, 899 (10th Cir. 1991); ***United States v. Schipani***, 362 F.2d 825, 830 (2d Cir.) (government can meet its burden under ***United States v. Massei*** by negating all *reasonably* possible sources of nontaxable funds), *vacated and remanded on other grounds*, 385 U.S. 372 (1966). The investigating agent may testify that his investigation failed to uncover any sources of nontaxable funds. ***United States v. Dwoskin***, 644 F.2d 418, 423 (5th Cir. Unit B 1981); ***United States v. Penosi***, 452 F.2d 217, 219 (5th Cir. 1971).

Consequently, it is sufficient if the government's evidence establishes that there was a thorough investigation "which removes any reasonable doubt that the defendant's unreported income came from non-taxable sources." ***United States v. Hiett***, 581 F.2d 1199, 1202 (5th Cir. 1978); *see also* ***United States v. Smith***, 890 F.2d 711, 714 (5th Cir. 1989).[7]

31.13 *REASONABLE LEADS DOCTRINE*

31.13[1] *Duty to Investigate Reasonable Leads*

Defendants frequently give the government's agents leads indicating the specific sources from which claimed cash on hand was derived, "such as prior earnings, stock transactions, real estate profits, inheritances, gifts, etc." ***Holland v. United States***, 348 U.S. 121, 127 (1954). The ***Holland*** reasonable leads doctrine places on the government the duty of "effective negation of reasonable explanations by the taxpayer inconsistent with guilt" -- a duty limited to the investigation of "leads reasonably susceptible of being checked, which, if true, would establish the taxpayer's innocence." ***Holland***, 348 U.S. at 135-36.

Thus, the government's duty to investigate leads provided by the defendant hinges on the presence of two factors: (1) the defendant's explanation must be relevant and reasonable, and (2) the explanation must be reasonably susceptible of being checked. ***Holland***, 348 U.S. at 135-36; ***United States v. Anderson***, 642 F.2d 281, 285 (9th Cir. 1981) (loan from acquaintance in Nigeria not a reasonable lead and not reasonably susceptible of being checked).

The government meets its burden when it "investigates reasonably possible sources of non-taxable income and explores whatever leads the taxpayers or others may proffer." ***United States v. Mastropieri***, 685 F.2d 776, 785 (2d Cir. 1982). The government is not required to do the impossible. ***United States v. Greene***, 698 F.2d 1364, 1371 (9th Cir. 1983). Once the government establishes a prima facie case, the defendant "'remains quiet at his peril.'" ***Mastropieri***, 685 F.2d at 785 (quoting ***Holland***, 348 U.S. at 139); *accord* ***United States v. Goldstein***, 685 F.2d 179, 182 (7th Cir.1982) (information on nontaxable sources should be supplied by the defendant). Although

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[7] The Second Circuit has suggested that "less stringent standards with respect both to establishing opening net worth and to negating non-taxable income sources are justified in a case like this where defendants were shown to have gone to such lengths to conceal their unreported increases in wealth." ***United States v. Mastropieri***, 685 F.2d 776, 785 (2d Cir. 1982).

the burden of proof never shifts from the government, the defendant has the *burden of production* regarding any reasonable leads. ***United States v. Vardine***, 305 F.2d 60, 63 (2d Cir. 1962). It is up to the defendant to furnish the reasonable leads. ***United States v. Notch***, 939 F.2d 895, 899 (10th Cir. 1991); ***United States v. Caswell***, 825 F.2d 1228, 1234 (8th Cir. 1987). The government is not required to pursue "phantom clues as to some mysterious sources and assets." ***United States v. Hamilton***, 620 F.2d 712, 715 (9th Cir. 1980).

For cases in which the court found that the defendant's explanations were not reasonable or reasonably capable of being checked, *see* ***United States v. Londe***, 587 F.2d 18, 20 (8th Cir. 1978) (lead found to be completely lacking in credibility and did not warrant follow-up beyond the production of the individual as a government witness, which did occur); ***United States v. Potts***, 459 F.2d 412, 414 (7th Cir. 1972) (the government's failure to investigate leads from witnesses whose credibility was tenuous did not require a reversal); ***United States v. Hom Ming Dong***, 436 F.2d 1237, 1242-43 (9th Cir. 1971) (when leads are "sketchy" and the defendant furnishes little useful information, there is less of a burden on the government); ***United States v. Ford***, 237 F.2d 57, 64 (2d Cir. 1956) (claims of gifts so vague that they were not susceptible of further investigation), *vacated as moot*, 355 U.S. 38 (1957); ***Smith v. United States***, 236 F.2d 260, 267 (8th Cir. 1956) (defendant's explanation that his funds came from old mailbags and old iron pots not reasonably susceptible of being checked).

Moreover, there is "at least a minimal burden upon the taxpayer, once he chooses to furnish leads to the government, to aid in the investigation of the purported nontaxable source." ***Hom Ming Dong***, 436 F.2d at 1242-43; ***United States v. Terrell***, 754 F.2d 1139, 1146 (5th Cir. 1985) (defendant has a burden to furnish leads, and the government cannot be faulted for failure to identify any possible basis in cattle, where the government was diligent in following up on all leads relating to the cattle, despite fact that defendant was uncooperative in providing leads); *see also* ***United States v. Blandina***, 895 F.2d 293, 302-03 (7th Cir. 1989) (scope of government's investigation of reasonable leads does not require government to subpoena records that defendant refused to turn over).

For examples of adequate government investigations of leads that were provided by defendants and were susceptible to investigation, *see* ***United States v. Smith***, 890 F.2d 711, 714-15 (5th Cir. 1989) (court rejected a "reasonable leads" challenge regarding gifts to the defendant); ***United States v. Koskerides***, 877 F.2d 1129, 1138 (2d. Cir. 1989) (government negated defendant's claim that he had received nontaxable funds from family and friends in Greece).

When the defendant advances a specific explanation of the source of funds expended and that explanation is proved false, the government need not pursue possible nontaxable sources. ***Feichtmeier v. United States***, 389 F.2d 498, 503 (9th Cir. 1968). However, if the government fails to investigate reasonable leads provided by the defendant that might reasonably explain his or her

net worth increase in a manner inconsistent with guilt, the trial judge can consider such leads as true and find the case insufficient to go to the jury. ***Holland***, 348 U.S. at 135; ***Vardine***, 305 F.2d at 63. The court can direct a verdict on any count where there would not be a substantial tax deficiency if the lead is assumed to be true. ***United States v. Keller***, 523 F.2d 1009, 1011 (9th Cir. 1975) (because the government failed to pursue leads that were reasonably susceptible of being checked, the opening net worth for 1967 was not reasonably certain, and the evidence as to the 1967 count was insufficient to go to the jury).

The failure to track down reasonable leads, however, is not always fatal to the government's case. If the uninvestigated lead is assumed to be true and there remains a substantial unexplained tax deficiency, then reversal of a conviction (or a directed verdict) is not warranted. *See* ***Scanlon v. United States***, 223 F.2d 382, 388-89 (1st Cir. 1955) (government's failure to investigate this lead would require acquittal of the defendant if the government's case turned on that evidence but even assuming this lead to be true, the government's evidence was sufficient to convict); ***United States v. Anderson***, 642 F.2d 281, 285-86 (9th Cir. 1981) (even if the defendant's explanation were true, there would be more than $100,000 of unexplained income, and this difference would be sufficient to support the conviction).

The Ninth Circuit has held that if there is a challenge to the sufficiency of the government's investigation, it becomes a jury question whether or not the government was unreasonable in its failure to investigate alleged leads. ***United States v. Greene***, 698 F.2d 1364, 1371 (9th Cir. 1983).

The government's failure to investigate leads by the defendant has also been challenged unsuccessfully in the grand jury context. One court refused to dismiss an indictment, finding the defendant's contention that the government failed to exhaust leads during the grand jury investigation insufficient to warrant dismissal of the indictment. ***United States v. Todaro***, 610 F. Supp. 923 (W.D.N.Y. 1985). In ***Todaro***, the court held that the pre-trial motion to dismiss was premature because the matter was for trial. 610 F. Supp. at 925 (citing ***Holland***, 348 U.S. 121, and ***United States v. Scott***, 660 F.2d 1145, 1167 n.42 (7th Cir. 1981)).

31.13[2] ***Leads Must Be Reasonable and Timely***

In addition to furnishing leads that are reasonable and reasonably susceptible of being checked, the defendant must furnish the leads in a timely manner. Timeliness is measured by whether the government has sufficient time to investigate the leads prior to trial. *See* ***United States v. Dwoskin***, 644 F.2d 418, 423 n.4 (5th Cir. Unit B 1981) (had leads been provided during the investigative process, the government would have had an obligation to pursue them to the extent that they were relevant and reasonably susceptible of being checked); ***United States v. Sorrentino***, 726 F.2d 876, 881 n.2 (1st Cir. 1984); ***Smith v. United States***, 236 F.2d 260, 263-64 (8th Cir. 1956).

If there is no evidence that the defendant gave leads to the government before trial and the

defendant testifies at trial that the net worth increase was attributable to nontaxable sources, the issue is one for the jury. ***United States v. Vardine***, 305 F.2d 60, 65 (2d Cir. 1962). Similarly, a lead furnished "on the eve of indictment" is too late. ***United States v. Procario***, 356 F.2d 614, 617 (2d Cir. 1966) (a bank deposits case, but the same principle applies in a net worth case).

31.14 *NET WORTH SCHEDULES*

At the close of its case, the government typically calls a summary expert witness who summarizes the evidence and introduces schedules reflecting the government's net worth computation. The testifying agent need not be involved in the investigation or original preparation of the government's case, but may be recruited specifically to testify as an expert at trial. It is well established that a government agent can summarize the evidence and introduce into evidence computations and schedules reflecting the defendant's net worth. ***Costello v. United States***, 350 U.S. 359, 360 (1956); ***United States v. Johnson***, 319 U.S. 503, 519 (1943); ***United States v. Lewis***, 759 F.2d 1316, 1329 n.6 (8th Cir. 1985) (summary exhibit used to verify the net worth theory); ***United States v. Sorrentino***, 726 F.2d 876, 884 (1st Cir. 1984); ***United States v. Skalicky***, 615 F.2d 1117, 1120 (5th Cir. 1980); ***United States v. Gardner***, 611 F.2d 770, 776 (9th Cir. 1980); ***United States v. Allen***, 522 F.2d 1229, 1234 (6th Cir. 1975); ***United States v. O'Connor***, 237 F.2d 466, 475 (2d Cir. 1956); Fed. R. Evid. 1006.

The net worth schedules must be based upon evidence in the record; otherwise, the schedules are not admissible. *See*, *e.g.*, ***Sorrentino***, 726 F.2d at 884; ***Allen***, 522 F.2d at 1234; ***United States v. Diez***, 515 F.2d 892, 905 (5th Cir. 1975); ***O'Connor***, 237 F.2d at 475; *see also* ***United States v. Thompson***, 518 F.3d 832, 859-60 (10th Cir. 2008) (specific items case), *petition for cert. filed*, 76 U.S.L.W. 3655 (Jun 09, 2008) (NO. 07-1539); ***United States v. Bishop***, 264 F.3d 535, 547 (5th Cir. 2001) (specific items case); ***United States v. Citron***, 783 F.2d 307, 316 (2d Cir. 1986) (cash expenditures method).

The government's net worth computation is not required to give effect to contentions of the defendant. Rather, the government's summary or net worth computation is based on a selection of evidence that supports the government's contentions. It is a summary of evidence tending to prove guilt, and it reflects the government's version of the facts. ***United States v. Diez***, 515 F.2d at 905; ***United States v. Lawhon***, 499 F.2d 352, 357 (5th Cir. 1974) (jury was instructed that the summary chart presented only the government's view of the case); ***Holland v. United States***, 209 F.2d 516, 523-24 (10th Cir.) (charts purporting to graphically show the government's case based upon the government's version of the evidence used in closing argument to the jury), *aff'd*, 348 U.S. 121 (1954); *see also* ***Bishop***, 264 F.3d at 547 (citing ***Flemister v. United States***, 260 F.2d 513, 517 (5th Cir.1958)). As a matter of tactics, however, there may be situations where the evidence is in conflict and the government computation will reflect the view that is more favorable to the defendant.

31.15 *JURY INSTRUCTIONS*

In a net worth case, detailed, comprehensive jury instructions on the method of proof are essential. "Charges should be especially clear, including, in addition to the formal instructions, a summary of the nature of the net worth method, 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); ***United States v. Wirsing***, 719 F.2d 859, 861-62 n.4 (6th Cir. 1983) (citing ***Holland***).

Convictions have been reversed where the trial judge failed to give full explanatory instructions on the net worth method. ***United States v. Tolbert***, 367 F.2d 778, 781 (7th Cir. 1966); ***United States v. O'Connor***, 237 F.2d 466, 472-73 (2d Cir. 1956); *see also* ***United States v. Hall***, 650 F.2d 994, 999 (9th Cir. 1981) (bank deposits case). "[T]he complete lack of any instruction on the nature of the [net worth] method and its concomitant assumptions and inferences affects a substantial right of the accused and constitutes plain error. . . and requires a reversal despite the lack of an objection by the defendant to such omission." ***Tolbert***, 367 F.2d at 781.

For sample net worth jury instructions, *see* the section on jury instructions, *infra*.

31.16 *SAMPLE NET WORTH SCHEDULE*

On the next page is a sample net worth computation contained within the materials used to train IRS special agents in the net worth method of proof.

NET WORTH **September 2008**

ASSETS	**12/31/2003**	**12/31/2004**
Cash on Hand	$1,000.00	$1,000.00
Cash in Account	2,200.00	-
1st Northern Bank		
Acct. #000-000-0		
Series EE Savings Bonds	0.00	-
Securities	4,000.00	12,000.00
Business Inventory (merchandise)	7,500.00	12,500.00
Bar Equipment	11,000.00	11,000.00
Booths (Bar)	0.00	6,000.00
Land and Building	0.00	90,000.00
Goodwill	32,000.00	32,000.00
Cadillac	16,250.00	16,250.00
TOTAL ASSETS	**$73,950.00**	**$180,750.00**
LIABILITIES		
Buyer & Company (margin account)	$0.00	($3,600.00)
William Barker (note)	(31,000.00)	(19,000.00)
Mortgage (1st Northern)	0.00	(40,000.00)
Accumulated Depreciation	0.00	(10,838.00)
TOTAL LIABILITIES	**($31,000.00)**	**($73,438.00)**
NET WORTH	**$42,950.00**	**$107,312.00**
Less: Prior Year's Net Worth		($42,950.00)
Net Worth Increase		$64,362.00
Add:		
Federal Income Taxes Paid		1,200.00
Life Insurance Premium		2,325.00
Personal Interest		33.34
Less: 1/2 SE Tax Deduction		(4,807.60)
ADJUSTED GROSS INCOME		**$ 63,112.74**
Less:		
Standard Deduction		(9,700.00)
Exemptions		(6,200.00)
CORRECTED TAXABLE INCOME		**$ 47,212.74**
Less: Taxable Income per Return		(2,439.00)
ADDITIONAL TAXABLE INCOME		**$ 44,773.74**