No. _____

In The
Supreme Court of the United States

PAUL BURKS,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS
Appendix

Page:

Opinion
U.S. Court of Appeals for the Fourth Circuit
entered August 23, 2018 ..... App. A

Order Denying Motion
U.S. District Court for the Western District of North Carolina
Entered June 20, 2016 ..... App. B

Order Denying Petition for Rehearing
U.S. Court of Appeals for the Fourth Circuit
entered September 18, 2018 ..... App. C

Motion to Dismiss Count 4 and Exhibits
U.S. District Court for the Western District of North Carolina
Entered June 20, 2016 ..... App. D

UNPUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 17-4143

UNITED STATES OF AMERICA,

Plaintiff - Appellee,

v.

PAUL BURKS,

Defendant - Appellant.

Appeal from the United States District Court for the Western District of North Carolina, at Charlotte. Max O. Cogburn, Jr., District Judge. (3:14-cr-00208-MOC-DSC-1)

Argued: March 22, 2018 Decided: August 23, 2018

Before WILKINSON and TRAXLER, Circuit Judges, and Leonie M. BRINKEMA, United States District Judge for the Eastern District of Virginia, sitting by designation.

Affirmed by unpublished opinion. Judge Brinkema wrote the opinion, in which Judge Wilkinson and Judge Traxler joined.

ARGUED: Noell Peter Tin, TIN, FULTON, WALKER & OWEN, PLLC, Charlotte, North Carolina, for Appellant. Amy Elizabeth Ray, OFFICE OF THE UNITED STATES ATTORNEY, Asheville, North Carolina, for Appellee. **ON BRIEF:** Jacob H. Sussman, C. Melissa Owen, Emily D. Gladden, TIN, FULTON, WALKER & OWEN, PLLC, Charlotte, North Carolina, for Appellant. Jill Westmoreland Rose, United States Attorney, OFFICE OF THE UNITED STATES ATTORNEY, Charlotte, North Carolina, for Appellee.

APPENDIX A

Unpublished opinions are not binding precedent in this circuit.

BRINKEMA, District Judge:

After a jury trial, Paul Burks was found guilty of conspiracy to commit mail and wire fraud, substantive mail and wire fraud, and conspiracy to defraud the United States by impairing the lawful functions of the Internal Revenue Service. He was sentenced to 176 months incarceration concurrent on the counts involving mail and wire fraud, and 60 months concurrent on the conspiracy to defraud count, as well as being ordered to forfeit $244 million. He appeals these convictions arguing that the district court erred by not granting his pretrial motion to dismiss the tax fraud conspiracy charge, by denying his motion for judgment of acquittal as to the tax fraud conspiracy, and by prohibiting him from admitting certain documentary evidence during the government's case-in-chief. Finding no error, we affirm Burks' conviction.

I

On October 24, 2014, a federal grand jury in the Western District of North Carolina returned an indictment charging Burks with one count each of conspiracy to commit wire and mail fraud, in violation of 18 U.S.C. § 1349 (Count 1); mail fraud, in violation of 18 U.S.C. § 1341 (Count 2); wire fraud, in violation of 18 U.S.C. § 1343 (Count 3); and conspiracy to defraud the United States, in violation of 18 U.S.C. § 371 (Count 4). In broad terms, the indictment alleged that Burks and a number of co-conspirators had operated a Ponzi scheme through two businesses that Burks owned, Zeekler and ZeekRewards, by representing to investors, known as "affiliates," that through investing in ZeekRewards, they could share in the massive profits generated by

Zeekler when, in reality, Zeekler generated relatively little revenue and ZeekRewards' revenue was based almost entirely on affiliates' investments.

In addition to describing the background of Burks' scheme and the manner and means of conducting the mail and wire fraud schemes, the indictment included a number of specific allegations to support the tax fraud charge, including that Burks and co-conspirators paid themselves large sums that they diverted from the victims, including $10.1 million to Burks or his family members; used multiple bank accounts and "internet based electronic payment services ('e-wallets')," some of which were located abroad, to deposit affiliates' funds and make Ponzi payments to affiliates; failed to keep accurate and complete records of these accounts; and issued IRS Forms 1099 that reported combined affiliate income of more than $108 million for the year 2011 even though ZeekRewards actually paid affiliates less than $13 million for that year. JA 27-28. As a result of these false Forms 1099, affiliates filed false tax returns with the IRS reporting income that they had not actually received. In addition, the indictment alleged that ZeekRewards, Zeekler, and parent company Rex Venture Group LLC ("RVG") failed to file any corporate tax returns or make corporate tax payments.

Based on these background facts, the indictment alleged in Count 4 that Burks "did unlawfully, voluntarily, intentionally and knowingly conspire, combine, confederate, and agree with other individuals both known and unknown to the Grand Jury to defraud the United States for the purpose of impeding, impairing, obstructing, and defeating the lawful Government functions of the Internal Revenue Service of the Treasury Department in the ascertainment, computation, assessment, and collection of the revenue:

to wit, income taxes." JA 32. In addition, Count 4 alleged two overt acts that were committed in furtherance of the conspiracy: first, that Burks and his co-conspirators "filed or caused to be filed false IRS Forms 1099 in the names of victim-investors with the IRS which reported fictional income," and second, that Burks and his co-conspirators "opened numerous bank accounts and used e-wallets, including e-wallets based in foreign countries, to receive and disburse the fraudulent payments in the scheme." *Id.*

Before trial, Burks moved to dismiss Count 4, arguing that at the end of each day, ZeekRewards would give each qualifying affiliate an "award" that the affiliate could redeem either as cash or by purchasing more VIP bids which constituted a reinvestment into ZeekRewards and that the income reported for each affiliate on his or her Form 1099 was based on the total value of that affiliate's awards for the year, not just on the awards that were paid out in cash. According to Burks, the Forms 1099 properly reflected the affiliates' income under the doctrine of "constructive receipt," which includes in a taxpayer's income not just income actually received by the taxpayer but any income that is credited to the taxpayer's account, set apart for him, or otherwise made available for him in the taxable year. Burks further argued that to the extent the appropriate application of the constructive receipt doctrine to these awards was debatable, the government could not, as a matter of law, show that Burks had willfully caused false Forms 1099 to be issued to investors and therefore could not prove that he had intended to interfere with the lawful functions of the IRS.

The district court denied Burks' motion, concluding that the indictment appropriately alleged each element of a conspiracy to defraud the United States. In

addition, the court explained that the parties' disputes over whether the non-cash awards qualified as income under the constructive receipt doctrine and whether Burks willfully issued false Forms 1099 were questions of fact for the jury to answer at trial.

After the district court denied Burks' motion to dismiss Count 4, the case proceeded to a three-week trial. The evidence introduced at trial established the following facts.

In 2003 Burks formed and was the sole member of Rex Venture Group LLC ("RVG"), which conducted various business ventures involving the internet sale of products and multi-level marketing ventures. J.A. 2258-63. None of these activities was very successful. During the time period at issue in this case, RVG had two divisions: Zeekler, a penny auction website, and ZeekRewards, a multi-level marketing program ostensibly developed to generate increased public interest in Zeekler's auctions.

Zeekler, which Burks founded in 2010, held online penny auctions that allowed customers to bid on desirable consumer goods like cameras and iPads. As co-conspirator Dan Olivares ("Olivares"), Zeekler's software developer and information technology specialist, explained at trial, Zeeker's auctions primarily raised revenue from the purchase of bids rather than from the price paid for the auctioned item:

> Well, it works like you buy bids. Let's say you buy them in packs of, like, 25, 50 or a hundred bids per pack and each of these bids are – cost about 60 cents per bid. Okay. And then you go to the auction and you bid on one and you spend one of those bids. Okay. But the price on the auction starts at 1 cent. So you're going to bid and every time you bid it's going to increase it by 1 cent. So it starts out at 1 cent. You spend 60 cents by clicking the bid button. And it's now 2 cents. Okay. And then when that happens, the time – there's a timer on there that's counting down and when

> that happens it raises the time by 20 seconds. So that extra 20 seconds gives another person an opportunity to bid. Okay.
>
> And so what happens is one person bids, it goes up to, you know, 2 cents. Another person bids, it goes up to 3 cents. Then the time drops under 20 seconds. Okay. So it's now 20, 10, and at the end of the timer it ends, like the auction ends, and whoever is the last bidder wins.
>
> So you keep bidding and bidding and meanwhile you've spent, you know, 60 cents times however many bids you've put in, okay. And then you buy the – and then when the timer runs out, which it doesn't for a while because every time somebody bids, it increases the timer to 20, because it's under 20 and there's a limit, but that's details.
>
> So when the auction ends, the last person who bid gets it at, I don't know, a dollar 50. But that also means that there were 150 bids at 60 cents that were spent on that auction. So if you think about it, it's kind of like everybody kind of participates in paying for the auction when they bid. And then when it's over, the final person – the final person who wins it, pays the leftover – I mean, the displayed price. So it's a little like a game and it's like – it is an auction and it's a little like a game.

JA 455-56.

Throughout 2010, Zeekler was not profitable. As a result, in January 2011, Burks created ZeekRewards, a complicated multi-tiered marketing system, in an attempt to advertise Zeekler's auctions and increase traffic to Zeekler. Although the specific aspects of the ZeekRewards system changed over time, the basic idea was that individuals, known as "affiliates," would advertise Zeekler's penny auctions in exchange for a portion of the auctions' profits. Affiliates bought into the system by paying a monthly subscription fee; purchasing a certain number of "VIP bids," which operated in Zeekler's auctions just like normal bids (which were known as "retail bids") but cost $1.00 rather than 60 cents and could be given away to third parties as samples; and placing an online ad each day to promote Zeekler. Affiliates were expected to help grow both the

ZeekRewards and Zeekler businesses, and they were provided with significant monetary incentives to market Zeekler and recruit new affiliates. Specifically, an affiliate received a commission on each bid that was purchased by a new affiliate that he or she recruited into the program, and affiliates who met the requirements of the program qualified to participate in a profit sharing arrangement, which involved the affiliates splitting a daily pool of money, known as the Retail Profit Pool ("RPP"). Each qualifying affiliate's share of the RPP on a given day was determined by the affiliate's VIP Point balance on that day, and affiliates earned VIP Points by buying VIP bids and selling retail bids.

To recruit affiliates, Burks represented that Zeekler was a successful business and that the affiliates shared in up to 50 percent of the auction's daily profits through the RPP. According to the materials provided to affiliates, at the end of each day, Burks would calculate Zeekler's earnings for that day and then designate a percentage of those earnings as that day's RPP.[1] To divide the RPP among qualifying affiliates, Burks would select a daily "compounder" that was applied to each affiliate's VIP Points balance to determine his or her daily award. For example, if the compounder on a given day was 1% and an affiliate had a balance of 1,000 VIP points, the affiliate would receive a $10 award at the end of the day. Each affiliate could then choose whether to receive the award in cash; to reinvest the entire award by using it to buy additional VIP bids, thereby

[1] The evidence at trial indicated that RVG and Burks at least sometimes represented to prospective investors that the RPP was comprised of 50 percent of Zeekler's profits each day; however, at other times, RVG and Burks represented that the RPP was comprised of up to 50 percent of the auction's daily profits, with the exact percentage determined each day by a proprietary formula.

increasing the affiliate's point total; or to receive a portion of the award in cash and reinvest the rest of it. The default setting on the ZeekRewards website reinvested 100% of the award, and both Burks and the ZeekRewards website encouraged affiliates to reinvest at least 80% of their daily awards.

Theoretically, the compounder should have been chosen each day such that, when applied across all qualifying affiliates' VIP Point balances, it resulted in a combined award equal to the portion of that day's profits that Burks intended to designate as the day's RPP; however, RVG did not keep track of its profits and expenses and did not maintain sufficient financial records to allow it to determine each day's earnings with any degree of accuracy. Instead, Burks usually pulled the compounder number out of thin air, often using the same compounder that had been used on the same day of the week the previous week and other times picking a compounder in advance. The compounder figure ranged from approximately 0.3 percent to 3.42 percent and averaged 1.4 percent, a number that was chosen by Burks to provide a consistent return and make the program appear stable.

By the second half of 2011 and throughout 2012, the ZeekRewards program—although not Zeekler—grew at an explosive rate. Between the middle of 2011 and August 2012, ZeekRewards' daily cash flow increased from less than $20,000 to more than $10 million. Even though ZeekRewards was ostensibly developed as a marketing division to help promote Zeekler's auctions, the explosion of interest in ZeekRewards did not translate into a similar increase in participation in Zeekler's auctions. Instead, many

affiliates purchased VIP bids but never gave them away[2], and 98 percent of all incoming funds were from the VIP bid purchases and affiliates' subscription fees, rather than from purchases of retail bids or auction activity. This structure resulted in a classic Ponzi scheme: ZeekRewards affiliates were led to believe that they were accumulating stable and large returns on their ZeekRewards investments based on the success of Zeekler's auctions but, in reality, Zeekler was unsuccessful and any returns to affiliates were based almost entirely on the revenue from affiliates investing in the ZeekRewards program.[3]

Despite the minimal revenue from the penny auctions, when affiliates brought concerns about the sustainability of ZeekRewards' business model to Burks's attention, he repeated his misrepresentations that Zeekler's success was driving the affiliates' awards. For example, when one affiliate sent a concerned email because a prospective recruit, who was a compliance analyst at a bank, told him that the "opportunity sounded very familiar to a [P]onzi scheme," Burks responded that a Ponzi scheme "is a fraudulent investment opportunity that pays returns to separate investors, not from any actual profit earned by the organization, but from their own money or money paid by subsequent

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[2] Until August 2011, affiliates received points for each VIP bid that they purchased, even if the bid was never given to a third party or used in a Zeekler auction. In August 2011, Burks changed the model and required affiliates to give away their VIP bids; however, affiliates were allowed to give them to a "company bid pool" rather than third parties and, throughout this time, the purchase of retail bids remained flat.

[3] As Olivares explained, Burks and the other co-conspirators recognized early on that this business model was "unsustainable in general" because the awards that each affiliate was receiving were "not tied to the sale of products" and, as a result, RVG always risked running out of cash to make the affiliates' payments. JA 546.

investors" and that, to the contrary, the ZeekRewards "system is based entirely on actual profits earned by our online businesses." JA 2459-60. Similarly, with Burks' approval, RVG advertised the sustainability of the ZeekRewards system based on the representation that "the ratio of shoppers to affiliates is so high" when, in reality, the affiliates far outnumbered the Zeekler shoppers. JA 2511-12.

As a result of this explosive growth, ZeekRewards risked attracting the attention of regulators, and the company took a variety of steps to deflect any such attention. For example, Burks intentionally chose to use the word "compounder" rather than "interest" to describe the daily rate of return on each affiliate's VIP Points to avoid attracting the attention of the Securities and Exchange Commission. In addition, in August 2011, Burks changed the RPP system so that VIP bid points, which had previously expired when the affiliate had received a 125% return on the purchase, instead expired after 90 days. This change was designed to avoid the appearance of guaranteeing a 125% return, which Burks believed could have created the potential for SEC involvement. The company also engaged in discussions about opening a data center in the Cayman Islands because their attorneys had advised them that doing so would be the "best for legal reasons" in that the "IRS, regulators, [J]ustice [D]epartment[,] and [A]ttorney [G]eneral[] cannot get in there." JA 2098. Moreover, in early 2012, RVG issued Forms 1099 to approximately 9,000 affiliates, which helped give the company the appearance of legitimacy.

Despite these measures, various individuals and business contacts raised concerns about RVG's practices, and federal authorities began to look into the company. Specifically, a number of affiliates complained about the Forms 1099 because RVG had

included as non-employee compensation the total combined value of each affiliate's daily awards, regardless of whether the affiliate had received the awards in cash or had reinvested the award by purchasing more VIP bids. As a result, of including both cash payments and the purported value of affiliates' award points in the Forms 1099, those forms reflected compensation amounts that were much larger than the affiliates' actual cash earnings and, in aggregate, the forms reflected that the affiliates had received more than $108 million in non-employee compensation in 2011, even though less than $37 million had been deposited into RVG's bank accounts throughout the year.

In addition, officials at NewBridge Bank, where RVG had maintained an account for years, grew increasingly concerned about the growth in deposits and filed multiple suspicious activity reports with the United States Treasury. Eventually, in April or May 2012, NewBridge terminated its relationship with RVG. After failing to find another bank that was willing to handle its business, RVG set up accounts with at least three different e-wallet companies, some of which were in foreign countries. The e-wallets resulted in substantial co-mingling of funds because affiliates could both pay into the e-wallets when purchasing VIP bids and also receive their daily awards from the same e-wallet balances. This transition to the e-wallet platforms compounded the difficulties created by RVG's already-haphazard accounting practices.

Despite these problems, Burks continued to market ZeekRewards and seek new affiliates. For example, in July 2012, months after Burks first learned that the SEC was investigating ZeekRewards, RVG hosted a "Red Carpet Event," where the ZeekRewards program was promoted to 1200 guests. In the promotional materials used at the event,

Burks did not disclose the pending SEC investigation but stated that the company had "developed a compliance program" that would "keep Zeekler free from legal/government entanglements and ensure it will be running strong for years to come." JA 2531-32.

The scheme finally crumbled when, on August 17, 2012, Burks and RVG entered into a voluntary agreement with the SEC to close RVG, Zeekler, and ZeekRewards. In total, during the life of ZeekRewards, RVG's income consisted of $818 million in VIP bid purchases, $96 million in subscription payments, and only $18 million in retail bid purchases and other auction-related revenue. That is to say, even though ZeekRewards affiliates were recruited with representations that the Zeekler auction was stable and profitable and that their returns would come from those profits, the overwhelming majority of RVG's income came from affiliates' purchases, not from Zeekler's auctions. Almost 90 percent of ZeekRewards affiliates lost money through their participation in the program and their combined losses were approximately $755 million. In addition, the daily RPP award was, on average, approximately 3.5 times the daily revenue but, because the majority of affiliates chose to reinvest the vast majority of their daily awards, RVG was able to disburse substantially less cash than it received each day. Lastly, between May 2011 and April 2012, Burks paid himself more than $10 million from RVG accounts.

Burks moved for a judgment of acquittal on Count 4 at the close of the government's case and again at the close of his own case, arguing that there was not sufficient evidence for the jury to conclude that he had participated in any agreement to impede the lawful functions of the IRS. The district court denied both motions.

The jury found Burks guilty on all four counts, indicating on the verdict form that they found that he had committed Overt Act B, related to the opening of bank accounts and e-wallets to receive and disburse payments.

II

Burks first argues that the district court erred in refusing to dismiss Count 4 before trial and, furthermore, that this error infected the jury's verdict on the remaining counts because some prejudicial evidence was only admitted based on its relevance to the charge in Count 4.

A district judge's legal conclusions in resolving a pretrial motion to dismiss an indictment are reviewed *de novo*, and factual findings are reviewed for clear error. *United States v. Zhu*, 854 F. 3d 247, 253 (4th Cir. 2017). Federal Rule of Criminal Procedure 12(b)(3) allows a defendant to move before trial to dismiss the indictment for failure to state an offense. To overcome such a motion, the indictment must include every essential element of the offense. *See United States v. Perry*, 757 F.3d 166, 171 (4th Cir. 2014). In general, it is "sufficient that an indictment set forth the offense in the words of the statute itself." *Id.* (internal quotation marks omitted). Furthermore, if the indictment meets this standard, it "is valid on its face" and the court may not "review the sufficiency of evidence supporting" the indictment because a valid "indictment returned by a legally constituted and unbiased grand jury" is "enough to call for trial of the charges on the merits." *United States v. Wills*, 346 F.3d 476, 488-89 (4th Cir. 2003).

The parties agree that Count 4 alleges what has come to be known as a *Klein* conspiracy. *See United States v. Klein*, 247 F. 2d 908, 915 (2d Cir. 1957). The elements

of a *Klein* conspiracy are not in dispute. They consist of (1) an agreement between two or more persons (2) with the intent to impede or obstruct the IRS in the collection of revenue and performance of its duties and (3) the performance of an overt act to further that agreement. *United States v. Vogt*, 910 F. 2d 1184, 1202-03 (4th Cir. 1990).

The indictment properly alleged each of these elements. Specifically, the indictment alleged that Burks "did unlawfully, voluntarily, intentionally and knowingly conspire, combine, confederate, and agree with other individuals" to "defraud the United States for the purpose of impeding, impairing, obstructing, and defeating the lawful Government functions of the Internal Revenue Service of the Treasury Department in the ascertainment, computation, assessment, and collection of the revenue: to wit, income taxes." JA 32. This portion of the indictment properly charged the first and second elements of a *Klein* conspiracy: an agreement with the intent to impede the IRS in the collection of revenue. In addition, the indictment alleged two specific overt acts that were undertaken in furtherance of this conspiracy: the issuance of false IRS Forms 1099 that misrepresented the amount of income that affiliates had received in 2011 and that the co-conspirators intended would be filed with the IRS, as well as the opening of numerous e-wallet accounts and failure to keep accurate records.

Accordingly, the indictment appropriately alleged each element of a *Klein* conspiracy[4] and the district court did not err in denying Burks' pretrial motion to dismiss Count 4.[5]

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[4] In spite of the indictment properly alleging each element of a *Klein* conspiracy, Burks argues, based on *United States v. Mallas*, 762 F.2d 361 (4th Cir. 1985), that the indictment should have been dismissed before trial because as a matter of law, whether to report both cashed-out and reinvested awards as income on the Forms 1099 raised a sufficiently vague question of tax law that Burks could not have acted with the required intent to defraud. Burks supported this argument with citations to Treasury regulations, case law from the United States Tax Court, and an opinion letter drafted by an experienced tax lawyer. This argument is unpersuasive.

First, as is evidenced by Burks' attempt to submit evidence that went far beyond the four corners of the indictment, his argument was not raised in the appropriate context. The resolution of such a question about the application of the tax laws to the specific facts of the case is a quintessential role of the jury. The problematic nature of Burks' argument is only highlighted by *Mallas* itself. In that case, the court determined that the appropriate application of the tax laws to the defendants' conduct was highly debatable and therefore that their convictions could not be sustained; however, this determination only occurred after a full jury trial. Therefore, *Mallas* does not indicate that it is appropriate for the district court to conduct a mini-trial to determine how clearly the tax laws apply to the facts of the case when evaluating a pretrial motion to dismiss.

Second, even on the merits, Burks' argument about the Forms 1099 is unpersuasive. In essence, Burks argues it was correct to include as income on the Forms 1099 both awards received in cash and those reinvested because the reinvested awards counted as income that the affiliates had "constructively received." Under the tax regulations, income is constructively received by a taxpayer when it is "credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given." 26 C.F.R. § 1.451-2(a). The Forms 1099 that RVG issued to its affiliates indicated that the affiliates together constructively or actually received more than $108 million of income in 2011; however, RVG's revenues in 2011 were only $37 million. Based on this revenue stream, it would have been impossible to conclude that more than $108 million was "made available [to affiliates] so that [they] may draw upon it at any time" and, therefore, it was not vague or highly debatable whether the affiliates had constructively received all of the income that the Forms 1099 reported. Accordingly, even on the merits, Burks' argument is unavailing.

(Continued)

III

Burks next argues that the district court erred in denying his motion for acquittal on Count 4 and, specifically, that the government failed to introduce sufficient evidence to support a *Klein* conspiracy conviction because there was no evidence that the conspirators intended to impede the IRS.

The denial of a motion for acquittal is reviewed *de novo*. *United States v. White*, 810 F.3d 212, 228 (4th Cir. 2016). In deciding such motions, the "question is whether, 'viewing the evidence in the light most favorable to the prosecution, *any* rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt.'" *Id.* (emphasis in original) (quoting *Jackson v. Virginia*, 443 U.S. 307, 319 (1979)).

The government introduced more than sufficient evidence to allow a reasonable jury to find that Burks and his co-conspirators entered into an agreement with the intent to impede the lawful functions of the IRS. For example, the government introduced

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Third, even accepting Burks' argument about the Forms 1099, the indictment alleged a second overt act: that Burks and his co-conspirators created numerous e-wallet accounts and failed to keep appropriate records in an attempt to stymie the IRS. Therefore, the indictment appropriately alleged each element of a *Klein* conspiracy even disregarding the overt act involving the Forms 1099.

[5] Because the district court's refusal to dismiss Count 4 was proper, we need not determine whether any prejudice resulting from this decision infected the other counts; however, we observe that the district court appropriately gave limiting instructions when allowing the introduction of evidence that was only admissible as to Count 4. JA 1557. Because "we assume that juries abide by the instructions given to them," *United States v. Hager*, 721 F.3d 167, 189, even if the district court had been incorrect to deny Burks' motion to dismiss, we would not hold that this error infected the other counts of conviction.

evidence that Burks and his co-conspirators operated a business with nearly a billion dollars in revenue and did so without maintaining any accurate business records or ledgers; that both RVG and Burks repeatedly failed to file income tax returns; that members of the conspiracy repeatedly discussed how to structure their scheme to avoid attracting the attention of federal regulators, including specifically discussing on at least one occasion the potential opening of a data center in the Cayman Islands where the IRS could not operate; and that after the company's bank grew suspicious of the large volume of deposits and filed multiple suspicious activity reports with the United States Treasury, RVG opened a number of e-wallet accounts and comingled funds in those accounts in a way that made it difficult to determine how much money was flowing in and out of the company. Even without considering the false Forms 1099, this evidence was more than sufficient to allow the jury to find that Burks and his co-conspirators had the intent to impede the lawful functions of the IRS. *Cf. United States v. Sturman*, 951 F.2d 1466, 1473 (6th Cir. 1991) (holding that the intent element of a *Klein* conspiracy was adequately alleged where the defendant "set up a complex system of foreign and domestic organizations, transactions among the corporations, and foreign bank accounts" that "prevent[ed] the IRS from performing its auditing and assessment functions").

This conclusion is bolstered by the evidence concerning the false Forms 1099. As discussed above, Burks and his co-conspirators issued 9,000 Forms 1099 that, in aggregate, misstated the income that the affiliates had received from ZeekRewards by a staggering degree. The evidence at trial indicated that the co-conspirators' purpose in preparing these false returns was to lend an air of legitimacy, stability, and profitability to

their scheme, which purpose necessarily includes the intent to have the affiliates file the false Forms 1099 with the IRS and thereby impede the IRS's ability to perform its duty of appropriately determining the taxes owed by each affiliate. Therefore, although Burks and his co-conspirators may have had a multiplicity of purposes in mind when issuing the false Forms 1099, the intent to impede the IRS was much more than a "collateral effect" of the agreement but was instead "one of its purposes." *Vogt*, 910 F.2d at 1202.

Accordingly, the government introduced sufficient evidence at trial to allow a reasonable jury to conclude that Burks and his co-conspirators had the intent to impede the IRS and the district court properly denied his motion for acquittal on Count 4.

IV

Lastly, Burks argues that the district court erred by not allowing him to introduce certain documentary evidence during the government's case-in-chief under Fed. R. Evid. 106, which provides that if "a party introduces all or part of a writing or recorded statement, an adverse party may require the introduction, at that time, of any other part – or any other writing or recorded statement – that in fairness ought to be considered at the same time." During its direct examination of Olivares, the government introduced communications between Olivares and Burks in which Olivares asked for the day's compounder and Burks responded almost instantaneously. During cross-examination of Olivares, Burks attempted to introduce separate conversations between Olivares and Burks in which Burks took longer to respond. In addition, when the government introduced RVG emails showing that Burks had approved advertising language that was misleading, Burks attempted to introduce other communications in which he criticized

other advertisements for being misleading. With one minor exception, the district court refused to allow Burks to introduce the exhibits during cross-examination and instead required him to wait until his own case to do so.

We "review decisions to admit evidence for abuse of discretion." *United States v. Vidacak*, 553 F.3d 344, 348 (4th Cir. 2009) (internal quotation marks omitted). Under this standard, we may not substitute our "judgment for that of the district court" and may only reverse if the district "court's exercise of discretion, considering the law and the facts, was arbitrary or capricious." *Id.* (internal quotation marks omitted). In this case, the district court did not abuse its discretion in refusing to admit the evidence under Rule 106, and Burks was not prejudiced by the district court's decision to force him to wait until his own case to admit the evidence in question, for three reasons.

First, Rule 106 did not apply to the evidence in question because "there was no partially introduced conversation that needed clarification or explanation." *United States v. Wilkerson*, 84 F.3d 692, 696 (4th Cir. 1996). The purpose of Rule 106 "is to prevent a party from misleading the jury by allowing into the record relevant portions of the excluded testimony which clarify or explain the part already received." *Id.* In this case, the conversations introduced by the government were not themselves partial or misleading. Instead, they were complete conversations or email exchanges that showed Burks at least sometimes responding almost immediately to a request for the day's compounder and at least sometimes approving misleading language. Although the evidence the defense wished to introduce may have, like any defense evidence, provided a counter-balance to the government's inculpatory evidence, it would not have completed

it or clarified any misleading aspect of the government's evidence. Accordingly, on its face, Rule 106 did not apply to the evidence and the district court did not abuse its discretion in declining to admit it during the government's case-in-chief.

The propriety of the district court's decision is reinforced by the particular nature of the evidence that Burks wished to introduce because none of the evidence was especially exculpatory. The exhibits showing Burks' nearly immediate provision of the daily compounder were used to support the argument that Burks often drew the compounder out of thin air rather than appropriately deriving the compounder from a formula based on the day's revenue and the aggregate number of VIP Points held by affiliates. The government supported its view of the compounder as a fictitious figure with multiple types of evidence, including that Burks often told Olivares to simply use the compounder that had been used the week before and sometimes pre-selected the compounder before knowing what the day's revenue would be. The documents that Burks wished to introduce—showing that he sometimes took a few minutes before responding to Olivares' inquiries—were hardly exculpatory given all the other evidence about how the compounder was calculated. Similarly, to support the fraud-related elements, the government did not need to show that Burks always approved of misleading advertisements but only that he sometimes made or approved of materially false or misleading statements. Accordingly, the evidence that Burks sometimes criticized particular misleading advertisements was not especially relevant and the district court did not err in refusing to admit it during the government's case-in-chief.

Lastly, even if the district court's decision were erroneous, it was harmless error because defense counsel was not prevented from asking Olivares during cross-examination about whether Burks sometimes paused before responding to the compounder inquiries or occasionally criticized misleading language in advertisements. Moreover, Burks was able to introduce the evidence during his own case. In light of the avenues that Burks retained for both attacking the government's evidence and, later, introducing his own, he was not materially prejudiced by the district court's refusal to allow him to admit the evidence during the government's case-in-chief, and any error would be harmless.

V

For the foregoing reasons, we hold that the district court properly denied Burks' motions to dismiss Count 4 of the indictment, for a judgment of acquittal, and to introduce evidence under Rule 106. Therefore, the district court's judgment is

AFFIRMED.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
DOCKET NO. 3:14-cr-00208-MOC-DSC

UNITED STATES OF AMERICA,	)	
	)	
	)	
	)	
Vs.	)	ORDER
	)	
PAUL BURKS,	)	
	)	
Defendant.	)	

THIS MATTER is before the court on defendant's Motion to Dismiss Count Four. Count Four of the Indictment. Count Four charges defendant with conspiracy to impede the IRS by, in part, providing affiliates with false Forms 1099 for tax year 2011. Arguing constructive receipt of income and that Zeek affiliates believed they had a right to receive payment of funds appearing as earnings, defendant moves to dismiss Count Four.

Review of Count Four reveals that the United States has alleged each element of the offense. Further, whether or not the government's evidence will prove those elements is a matter for resolution at trial. Finally, defendant's theory of constructive receipt is a defense and not a bar to the government bringing such charge. While of little moment at this point inasmuch as the Grand Jury has found probable cause, the government has forecast evidence which, if proved at trial, could support a finding by a jury that defendant conspired to impede the IRS by providing false FORMS 1099 for tax year 2011. The government's responsive proffer indicates that as part of the scheme to defraud affiliates, defendant and others encouraged affiliates not to draw out "earnings" that they believed they had earned, but which earnings did not in fact exist. The government contends that defendant and others issued 1099s to affiliates in 2011 of approximately

APPENDIX B

$96 million, when in fact the company earnings were only $37 million. Thus, the government appears to contend that the scheme's use and issuance of the 1099s not only perpetuated the fraud on the affiliates, it also impeded the operations of the IRS. The government further argues that defendant's constructive receipt theory is defective as not only can defendant not show that the money was "set apart" for each affiliate, as defendant could not set apart funds that were never received.

A motion to dismiss is governed by Rule 12(b)(3)(B), Federal Rules of Criminal Procedure. That rule provides that the court may dismiss a count where the indictment "fails to invoke the court's jurisdiction or to state an offense." Fed.R.Crim.P. 12(b)(3)(B). An indictment is defective if it alleges a violation of an unconstitutional statute, or if the "allegations therein, even if true, would not state an offense." United States v. Thomas, 367 F.3d 194, 197 (4th Cir. 2004). Here, the court finds no reason to dismiss Count Four. The motion will be denied and defendant may renew the motion at the conclusion of the government's evidence.

ORDER

IT IS, THEREFORE, ORDERED that defendant's Motion to Dismiss Count Four (#68) is **DENIED** without prejudice.

Signed: June 20, 2016

Max O. Cogburn Jr
United States District Judge

FILED: September 18, 2018

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 17-4143
(3:14-cr-00208-MOC-DSC-1)

UNITED STATES OF AMERICA

Plaintiff - Appellee

v.

PAUL BURKS

Defendant - Appellant

O R D E R

The court denies the petition for rehearing and rehearing en banc. No judge requested a poll under Fed. R. App. P. 35 on the petition for rehearing en banc.

Entered at the direction of the panel: Judge Wilkinson, Senior Judge Traxler, and Judge Brinkema.

For the Court

/s/ Patricia S. Connor, Clerk

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
No. 3:14-CR-208-MOC

UNITED STATES OF AMERICA

vs.

PAUL BURKS

MOTION TO DISMISS COUNT FOUR OF THE INDICTMENT

Mr. Burks, through undersigned counsel, moves to dismiss Count Four of the Indictment on the grounds that the interpretation of laws governing taxability of commissions paid to ZeekRewards affiliates is vague and/or highly debatable such that it was a legal impossibility for an individual to "willfully" violate the law in this circumstance. Accordingly, principles of Due Process require dismissal of this count of the indictment. *See United States v. Mallas*, 762 F.2d 361 (4th Cir. 1985). In support of this motion, Mr. Burks shows the following:

Count Four of the indictment alleges that Mr. Burks and others conspired to impede the lawful functions of the Internal Revenue Service by falsely attributing income to ZeekRewards' affiliates. Specifically, Count Four alleges that Mr. Burks and his alleged co-conspirators "unlawfully, voluntarily, intentionally and knowingly" caused to be filed false IRS Forms 1099 in the names of ZeekRewards affiliates which reported fictional income. [Doc. 1 ¶ 50] The income was fictional, the indictment alleges, because the Forms 1099 issued that year reflected a total of $108 million paid to affiliates, while the actual amount paid out was allegedly less than $13 million. [Doc. 1 ¶ 37]

APPENDIX D

The explanation for the apparent discrepancy is that, as the indictment also acknowledges, the Forms 1099 issued to ZeekRewards' affiliates were based on "all constructive income received." [Doc. 1 ¶ 28] Under this doctrine, affiliates were subject to tax for all income they were entitled to claim, whether or not they actually claimed and received it. *See* 26 C.F.R. § 1.451–2 (income not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time). Further, affiliates were also subject to tax for the value of bids they chose to repurchase in lieu of a cash payment. *See* Treas. Reg. § 1.61-1(a) ("gross income means all income from whatever source derived"); Treas. Reg. § 1.61-1(d) (gross income includes income realized in any form, whether in money, property or services, and that income can be realized "in the form of property, as well as in cash").

As set forth in the attached memorandum, the applicability of the constructive receipt doctrine is substantiated by a review of the applicable regulations, a review of the relevant rulings of the Internal Revenue Service, and the opinions of experienced tax counsel. As Mr. Burks can demonstrate to this Court, the applicable laws are vague and the government's position is highly debatable. The defense position is at least as, if not more, plausible than the government's interpretation. Pretrial dismissal of Count Four is therefore appropriate.

WHEREFORE Mr. Burks asks this Court to set this matter for pretrial hearing and dismiss Count Four of the indictment.

Respectfully submitted this the 7th day of June, 2016.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that s/he has served the foregoing pleading with the Clerk of Court using the CM/ECF system, which will send notification of such filing to counsel for the government:

Jenny Grus Sugar
jenny.sugar@usdoj.gov

Corey Ellis
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This the 7th day of June, 2016.

/s/ Noell P. Tin

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
No. 3:14-CR-208-MOC

UNITED STATES OF AMERICA
vs.
PAUL BURKS

MEMORANDUM OF LAW IN SUPPORT OF
MOTION TO DISMISS COUNT FOUR OF THE INDICTMENT

Count Four alleges an almost unheard of type of *Klein* conspiracy: one in which the alleged wrongdoers are charged with conspiring to report *more* taxable income than the government says they were required to report. This counterintuitive allegation hinges on the equally novel proposition that by issuing Forms 1099 based on the doctrine of constructive receipt, Mr. Burks was attributing "fictional income" to affiliates and committing tax fraud.

The doctrine of constructive receipt is codified in IRS and Treasury regulations, various administrative rulings, and a body of case law from the federal courts. In simplest terms, it means that income is recognized at the point that a taxpayer has a vested right to receive immediate payment in money or property, even if the taxpayer's actual receipt of the payment comes at a later date. As the indictment acknowledges, ZeekRewards affiliates who deferred receipt of cash awards were issued Forms 1099 based on this doctrine.

As the authorities cited below make clear, the legal premise underlying Count Four—that constructive receipt should be equated to or treated as synonymous with tax fraud—is highly debatable or simply wrong. Where the law is vague or highly debatable, a defendant actually or

imputedly lacks the requisite intent to violate it as a matter of law. *See United States v. Mallas*, 762 F.2d 361 (4th Cir. 1985). Accordingly, Mr. Burks moves to dismiss Count Four on the grounds that it is a legal impossibility to willfully violate the law in this area.

I. RELEVANT BACKGROUND INFORMATION

Count Four of the indictment alleges, in pertinent part, that in 2012 Mr. Burks and his alleged co-conspirators caused to be filed false IRS Forms 1099 in the names of ZeekRewards affiliates with the IRS which reported fictional income. [Doc. 1 ¶ 50] The income was fictional, the indictment alleges, because the Forms 1099 issued that year reflected a total of $108 million paid to affiliates, while the actual amount paid out was less than $13 million. [Doc. 1 ¶ 37] The indictment also acknowledges that ZeekRewards affiliates were issued Forms 1099 for 2011 based on "all constructive income received." [Doc. 1 ¶ 28] Thus, the issue raised by the allegations in Count Four is whether constructive receipt is the equivalent of tax fraud or is, rather, a correct interpretation of the applicable laws.

II. THE LEGAL STANDARD

"[T]he element of willfulness protects the average citizen from criminal prosecution for innocent mistakes in filing tax forms that may result from nothing more than negligence or the complexity of the tax laws. Willfulness requires the voluntary, intentional violation of a known legal duty as a condition precedent to criminal liability." *United States v. McKee*, 506 F.3d 225, 236 (3d Cir. 2007) (citing *Cheek v. United States*, 498 U.S. 192 (1991); *United States v. Pomponio*, 429 U.S. 10, 12 (1976)). By definition, "voluntary intentional violation of a known duty" requires that the duty involved be knowable. *Mallas*, 762 F.2d at 363. Criminal

prosecution for violation of an unclear duty itself violates the clear constitutional duty of government to warn citizens whether a particular conduct is legal or illegal. *Id.*

In *Mallas*, the Fourth Circuit vacated the tax evasion convictions of two investment advisors based on a tax shelter they promoted involving investments in coal mines. The prosecution hinged on the question of whether annual advance minimum royalties were properly deductible as a business expense. The Fourth Circuit found the applicable tax laws were "vague" and "highly debatable" to the degree that both the government and the defendants were able to articulate plausible theories as to which interpretation was correct. In vacating the convictions, the Fourth Circuit stated:

> Grave penalties rest in this case on an unsubstantiated theory of tax law: that the defendants promoted fraudulent deductions if the Trinity coal holdings were not sufficient to warrant complete recoupment of all advance royalties at the beginning of the lease but were sufficient to warrant complete recoupment of all advance royalties as each annual payment fell due.[3] Whatever eventual success this proposition may enjoy as an interpretation of tax law—a destiny we do not influence here—present authority in support of the theory is far too tenuous and competing interpretations of the applicable law far too reasonable to justify these convictions.
>
> * * * * *
>
> Contrary to the conclusion of the government, however, a determination that the prosecution theory of § 1.612–3(b) is "reasonable and well-supported" does not prove that "defendants' claim that they could not have known what the law required is frivolous." Defendants, too, advance a "reasonable and well-supported" reading of § 1.612–3(b).

Mallas, 762 F.2d at 363-364.

Here, the prosecution's claim that issuing Forms 1099 based on constructive receipt constituted criminal tax fraud is undermined by the applicable tax regulations, case law, and the opinions of experienced tax counsel. The defense interpretation of the applicable laws is, at a

minimum, reasonable and well supported to the degree that criminal court is not the appropriate forum to resolve the government's claim.

III. CONSTRUCTIVE RECEIPT GOVERNED THE ISSUANCE OF FORMS 1099 TO ZEEKREWARDS AFFILIATES

A. Constructive receipt defined.

Under the governing regulation, "income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given." 26 C.F.R. § 1.451–2, Treas. Reg. § 1.451–2. As the United States Tax Court explained:

> The concept of constructive receipt is well established in tax law ... Following the regulatory definition, courts have held that income is recognized when a taxpayer has an unqualified, vested right to receive immediate payment. *See Martin v. Commissioner*, 96 T.C. 814, 823 (1991); *Ross v. Commissioner*, 169 F.2d 483, 490 (1st Cir. 1948) ... Normally, the constructive receipt doctrine precludes the taxpayer from deliberately turning his back on income otherwise available. *See Martin v. Commissioner*, *supra*; *Young Door Co. v. Commissioner*, 40 T.C. 890, 894 (1963) ... In any event, the essence of constructive receipt is the unfettered control over the date of actual receipt. *See Hornung v. Commissioner*, 47 T.C. 428, 434 (1967).

Ames v. C.I.R., 112 T.C. 304, 312 (1999).

Constructive receipt is thus not a novel concept in tax law.

B. ZeekRewards affiliates constructively received income each time Rex Venture Group set the Daily Reward.

Consistent with the above-cited authorities, affiliates were in control over the timing of when they received awards from Rex Venture Group. As set out in an opinion letter from tax attorney Curtis Elliott, whose resume and letter are attached hereto as **Exhibits A and B**, the relevant facts are as follows:

> At the end of each day, the Company would determine the day's profits and provide qualifying Members with an award (the "Award"). This Award was allocated by VIP Points accumulated by the qualifying Member. Each qualifying Member could elect to receive their award as cash or could use this award's cash balance to purchase sample bids.
>
> Each qualifying Member could select what percentage of their award would be used to purchase sample bids instead of receiving the award in cash. Qualifying Members could select – in five percentage increments – between 100% bid repurchase and 0% bid repurchase (which would indicate the entire reward to be paid in cash). By selecting a percentage of the daily Retail Profit Pool Award to be received in cash of less than 100%, the remaining percentage of the Award was issued in the form of additional bids, that if subsequently given away could be converted into Points, thereby increasing the Member's share of Retail Profit Pool allocation for subsequent increased participation in the Retail Profit Pool. The default selection for qualifying Members was 100% bid re-purchase, although the choice always remained with the qualifying Member.
>
> Depending on the daily decision made by each qualifying Member, the Awards received by a qualifying Member may have consisted entirely of cash, entirely of bids, or some percentage combination of both. The Form 1099s issued to each VIP Member included the amount of cash awarded and the value of bids repurchased with their daily Award to and received by each Member.

In other words, *whether* ZeekRewards affiliates were paid in cash or repurchased bids, and *when*, was up to the affiliate. But these were accessible from the point that Zeek determined the Retail Profit Pool award. As a result, affiliates were in constructive receipt of income from the point that it was made available to them.

C. Experienced tax counsel agree that ZeekRewards affiliates constructively received income.

At the same time Mr. Burks is facing a tax fraud charge before this Court, the Receiver for Rex Venture Group is in litigation with the lawyer who provided the opinion for the company, and advised Mr. Burks accordingly, that ZeekRewards affiliates constructively received income. That attorney is Howard Kaplan, who at one time worked for the IRS and has 30 years' experience practicing in tax law. As the Receiver has alleged in parallel civil litigation, in February 2012, Mr. Kaplan advised Mr. Burks and the company as follows:

> I concur that because of the way your plan is structured, there is constructive receipt [of affiliate income] because of the choice your affiliates have. Perhaps it can be compared to dividend reinvestment, where one chooses to buy more stock rather than cash out the dividends.[1]

Civil litigation notwithstanding, the fact that experienced tax counsel gave Mr. Burks this advice underscores the degree to which reasonable minds can and do disagree over the law's requirements.

In further support of the reasonableness of this position, the attached opinion letter from Curtis Elliott[2] states:

> It is my opinion that each Member who elected bid repurchase as their Award would reasonably be treated as being in constructive receipt of gross income at the time the bonus percentage was calculated and the resulting in kind bid repurchase were set aside and credited to such Member's account. The fair market value of any such Points awarded were therefore properly included in the Member's gross income and properly reportable on the 1099s issued by the Company, to the extent of the Point award's fair market value.

Relevant authorities which support this opinion include Revenue Ruling 68-365, 1968-2 C.B. 418; Revenue Ruling 70-331, 1970-1 C.B. 14; and *Denver & Rio Grande Western Railroad Company v. United States*, 318 F.2d 922, 11 A.F.T.R. 2d 1600 (Ct. Cl. 1963). This opinion, and cited authorities, lends further credence to the legitimacy and reasonableness of the defense position.

D. Failure to account for constructive receipt of income can also lead to criminal prosecution.

Another measure of the debatability of the government's position with respect to Count Four is the fact that willful failure to report constructively received income can support a tax prosecution as well. In *United States v. Kottwitz*, 614 F.3d 1241 (11th Cir. 2010), *opinion*

[1] *Bell v. Kaplan*, No. 3:14-cv-352 [Doc. 1 ¶ 43]

[2] Mr. Elliott is a partner in the Charlotte law firm of Culp Elliott & Carpenter, whose practice is exclusively devoted to tax law.

vacated in part on other grounds, 627 F.3d 1383 (11th Cir. 2011), the Eleventh Circuit upheld the convictions of three defendants for various forms of tax evasion and tax fraud. The Eleventh Circuit's analysis upholding convictions for underreporting income includes the following passage:

> Income should be included in an individual's gross income during the year that it is received by the taxpayer. 26 U.S.C. § 451(a); 26 C.F.R. § 1.301–1 (a dividend becomes taxable when it is "unqualifiedly made subject to [the shareholders'] demands."); *Avery v. Comm'r of Internal Revenue*, 292 U.S. 210, 215 (1934) (a dividend becomes taxable to the shareholder upon actual receipt). The receipt of income can be actual or "constructive." "Constructive receipt" of income occurs when it is "is credited" to the taxpayers account and he can draw upon it. 26 C.F.R. § 1.451–2(a). Constructive receipt does not occur, however, "if the taxpayer's control of [the received income] is subject to substantial limitations or restrictions." *Id.* A constructive dividend is a corporate disbursement for the benefit of a shareholder and must be reported by the shareholder as income. *United States v. Mews*, 923 F.2d 67, 68 (7th Cir.1991).
>
> Although the personal expense entries in Circle's books could not have been characterized as dividends or balanced in relation to Junior's and Senior's shareholder interests until the end of Circle's accounting year, the jury possessed sufficient evidence to convict on Counts Three, Four and Five.

Kottwitz, 614 F.3d at 1268-1269 (internal footnotes omitted).

The fact that one can be criminally prosecuted for willfully reporting constructively received income, or willfully failing to report constructively received income, is the clearest illustration of the vagueness of the law and is the evil the *Mallas* opinion sought to address.

CONCLUSION

As the Fourth Circuit made clear in *Mallas*, "The uncertainty of a tax law, like all questions of vagueness, is decided by the court as an issue of law." 762 F.2d at 364 (citing *United States v. Critzer,* 498 F.2d 1160, 1162 (4th Cir. 1974). Accordingly, Mr. Burks, through undersigned counsel, respectfully asks the Court to set this matter for hearing and dismiss Count Four.

Respectfully submitted this the 8th day of June, 2016.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that s/he has served the foregoing pleading with the Clerk of Court using the CM/ECF system, which will send notification of such filing to counsel for the government:

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This the 8th day of June, 2016.

/s/ Noell P. Tin

CE&C
CULP ELLIOTT & CARPENTER, P.L.L.C.
Attorneys at Law

In memory of Partner
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1958 - 1992

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W. Curtis Elliott, Jr.
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June 8, 2016

Via Email: ntin@tinfulton.com

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Re: Expert Report Regarding Constructive Receipt of RPP Awards used for Bid Repurchase

Dear Noell,

You have requested that I analyze certain tax issues in the pending criminal proceedings brought by the U.S. Government against Paul Burks ("Mr. Burks"), former President and CEO of Zeekler.com, in the matter of United States of America v. Paul Burks, 3:14-CR-208-MOC.

The U.S. Government has charged Mr. Burks with a conspiracy charge under 18 U.S.C.A. § 371, alleging that he participated in a conspiracy to defraud the United States. When the conspiracy is aimed at defrauding the Internal Revenue Service, this charge is frequently referred to as a *Klein* conspiracy, in which co-conspirators "defraud the United States by impeding, impairing, obstructing and defeating lawful functions of the Department of the Treasury in the collection of the revenue; to wit, income taxes.[1] This conspiracy charge stems from the issuance of Form 1099s (the "1099s") by Zeekler.com or the Rex Venture Group, LLC (the "Company") to members (the "Members") of ZeekRewards, an affiliate advertising division of the Company.

I have been provided and have reviewed the Zeekrewards website based on web pages dated May 14, 2012 and May 31, 2012. According to the terms of participation expressed on the Zeekrewards website, initial VIP Profit Points ("Points") could be acquired by Members and further enhanced subsequently under a profit participation plan. Each

[1] U.S. v. Klein, 247 F.2d 908, 915 (2d Cir. 1957), *cert. denied*, 355 U.S. 924 (1958).

DEFENDANT'S EXHIBIT 1

Member who met certain specified requirements would have an opportunity to be awarded a share in a profit participation pool by Members of up to 50% of the Company's daily net profits (the "Retail Profit Pool").

At the end of each day, the Company would determine the day's profits and provide qualifying Members with an award (the "Award"). This Award was allocated by VIP Points accumulated by the qualifying Member. Each qualifying Member could elect to receive their Award as cash or could use the Award's cash balance to purchase sample bids. Prior to knowing the daily profit Award, each qualifying Member would have to decide by selection on that Member's account page (hosted on the Company's website) of the percentage split of receiving cash versus purchasing additional bids. Each qualifying Member could select what percentage of their award would be used to purchase sample bids instead of receiving the award in cash. Qualifying Members could select – in five percentage increments – between 100% bid repurchase and 0% bid repurchase (which would indicate the entire Award to be paid in cash). By selecting a percentage of the daily Retail Profit Pool Award to be received in cash of less than 100%, the remaining percentage of the Award was issued in the form of additional bids, that if subsequently given away could be converted into Points, thereby increasing the Member's share of Retail Profit Pool allocation for subsequent increased participation in the Retail Profit Pool. The default selection for qualifying Members was 100% bid re-purchase, although the choice always remained with the qualifying Member.

Depending on the daily decision made by each qualifying Member, the Awards received by a qualifying Member may have consisted entirely of cash, entirely of bids, or some percentage combination of both. The Form 1099s issued to each VIP Member included the amount of cash awarded, commissions and the value of bids repurchased with their daily Award to and received by each Member. The conspiracy charge brought against Mr. Burks alleges that the 1099s improperly included the additional cash rewards that were used for repurchase awarded to the qualifying Members.

You have asked that I provide an opinion of whether it would be a reasonable interpretation of federal tax law to find that the qualifying Members were in constructive receipt of gross income equal to the fair market value of the awarded cash that was utilized for bid repurchase, and whether the fair market value of such in kind awards was properly reported on the 1099s issued to each Member.

Under Section 61 of the Internal Revenue Code, "gross income means all income from whatever source derived."[2] Treasury Regulations issued by the Internal Revenue Service (the "Service") provide that gross income includes income realized in any form, whether in money, property or services, and that income can be realized "in the form of property, as well as in cash."[3] If services of the taxpayer are paid for in property, "the fair market value of the property taken in payment must be included in income as compensation."[4]

[2] I.R.C. § 61.
[3] Treas. Reg. § 1.61-1(a).
[4] Treas. Reg. § 1.61-1(d).

Additionally, under the cash receipts and disbursements method of accounting in the computation of taxable income (which is the method utilized by almost all individual taxpayers), all items which constitute gross income (whether in the form of cash, property in kind, or services) are to be included in the taxable year in which those items are actually or constructively received.[5] Constructive receipt of an item of gross income occurs in the taxable year which it is credited to the taxpayer's account or otherwise set apart for him.[6] However, income is not received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions."[7]

The Service has issued Revenue Rulings that address when a taxpayer had income or wages includible in gross income when receiving bonus or award payments in the form of property in kind. In Revenue Ruling 68-365, the Service examined whether trading stamps issued by a company to its employees, in payment of sales commissions, were included in the definition of "wages".[8] The trading stamps were credited and set aside in an account for the salesman, who could thereafter use those stamps and redeem them in exchange for various items of merchandise at designated redemption centers. The Service found that "wages" "means all remuneration for employment, including the [fair market] value of all remuneration paid in any medium other than cash." Therefore the Service ruled that "the fair [market] value of trading stamps distributed by the corporation and set aside for its employees in payment of the commissions [was] includible in 'wages' for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages."

In Revenue Ruling 70-331, the Service has further held that prize points, awarded in kind to salesmen-employees of participating dealers that carried the taxpayer's products, were includible in the gross income of the employees when awarded.[9] Each salesman of a participating dealer would receive non-cash prize points based on sales made, as determined by the taxpayer. The points would be credited to the salesman's prize points account. The accumulated prize points in the account could thereafter be redeemed by each salesman for merchandise prizes that were listed in a catalog of awards. The Service found that "the fair market value of the prize points awarded to a salesman who reports his income on the cash receipts and disbursements method of accounting is includible in his gross income at the time the prize points are paid or otherwise made available to him, whichever is earlier."

Further support for immediate gross income inclusion of Points can be found in Denver & Rio Grande Western Railroad Company v. United States, 318 F.2d 922, 11 A.F.T.R. 2d 1600 (Ct. Cl., 1963). There the taxpayer, which was one of several railroads that purchased the Pullman Company's sleeping rail car business, received a "car note "as part of the transaction. This promissory note entitled the taxpayer to an immediate transfer to it of a

[5] Treas. Reg. § 1.446-1(c)(1)(i).
[6] Treas. Reg. § 1.451-2(a).
[7] *Id.*
[8] Rev.Rul. 68-365, 1968-2 C.B. 418.
[9] Rev. Rul. 70-331, 1970-1 C.B. 14.

sleeping car, or at the taxpayer's option, deferred cash at face value of the car note in a later tax year. The United States Court of Claims held the car note was immediately taxable to the taxpayer, even though the taxpayer elected to receive the deferred cash payment. The Court of Claims reasoned that the note was immediately taxable property in the taxpayer's hands upon its receipt because the taxpayer had received the equivalent of a dividend of a sleeping rail car since it could be taken at any time once the note was issued, and was unqualifiedly made subject to the taxpayer's demands. The Court of Claims added that in form and substance the promissory notes were payable immediately in heavy-weight sleeping cars and held the notes were taxable when issued.

The Awards issued by the Company are constructively received by the qualifying Members at the time that the daily net profit of the Company is determined and up to 50% of such daily profit for the Retail Profit Pool is allocated to the qualifying Members in accordance with their respective proportion of Points. The qualifying Member's pre-selected, percentage allocation of the Award to cash is applied to the Member's cash payout and the remaining percentage amount of the Retail Profit Pool Award is allocated and added to the Member's account as bids and credited to the Member's account. Once the daily net profit was calculated and the bonus percentage finalized, no substantial restriction remained on the Member's Award. At that point in time, each Member was in a position to use the updated Points balance toward the next Retail Profit Pool Award with the updated Points balance and could decide to take the next award of additional daily net profits in the form of all cash or a combination of cash and further VIP bid repurchase awards. Accordingly, each Member's Points awarded in kind were credited to and set aside in his account and that Member was in constructive receipt of the Award.

As confirmed by the Service's decision to include, at fair market value, the points and stamps received by the salesmen in Revenue Ruling 70-331 and in Revenue Ruling 68-365, the fair market value of any property awarded and set aside for the account of the recipient, constructively received, should be included in that recipient's gross income at the time that award in kind was credited to the recipient's account. Here, any sample bids constructively received by a Member by crediting such bids to his account should therefore be included in such Member's gross income at fair market value when credited.

It is my opinion that each Member who elected bid repurchase as their Award would reasonably be treated as being in constructive receipt of gross income at the time the bonus percentage was calculated and the resulting in kind bid repurchase were set aside and credited to such Member's account. The fair market value of any such Points awarded were therefore properly included in the Member's gross income and properly reportable on the 1099s issued by the Company, to the extent of the Point award's fair market value.

This opinion is strictly limited to the reasonableness of application of the constructive receipt doctrine to the timing of inclusion of Points in each Member's gross income. This letter expresses no opinion as to the fair market value of any of the awards of bid repurchase, subsequent additional Points Awards in kind, or on any other aspects of the case.

The opinions herein are based solely on the facts assumed and stated herein, and could be subject to change, if such facts as assumed to be correct are either incomplete or inconsistent with other material facts. Lastly as requested, my curriculum vitae is included with, and attached to, this letter.

Sincerely,

W. Curtis Elliott, Jr.
For the Firm

W. CURTIS ELLIOTT, JR. – CURRICULUM VITAE

BACKGROUND

Curtis Elliott has practiced tax law since 1983. Mr. Elliott represents business owners and entrepreneurs in business and corporate matters, and provides tax counsel to larger corporate clients, business owners, individuals and trusts and estates. Mr. Elliott also has extensive courtroom litigating state and federal tax cases. He litigates federal tax controversies before IRS Administrative Appeals, the U.S. Tax Court and the Federal District Courts.

Mr. Elliott is a frequent speaker at numerous tax conferences across the country – see speaking engagements, below. He is a past Chair of the ABA Tax Section's Committee on Court Procedure and Practice, and a past Chair of its Committee on Appointments to the U.S. Tax Court. Additionally, Mr. Elliott is a co-author of the nationally published treatise entitled Valuation Practice in Estate Planning and Litigation, published by Clark Boardman and Callahan in 1994.

EDUCATION

- George Washington University National Law Center, LL. M., Taxation, highest honors (1984);
- University of South Carolina School of Law, J.D. (1980)
- University of South Carolina, B.S., Business and Accounting (1977)

BAR ADMISSIONS

- North Carolina (1980)
- South Carolina (1980)
- U.S. Tax Court (1984)

HONORS & AWARDS

- Inducted as a Fellow into the American College of Trust and Estate Counsel (ACTEC) 2016
- Selected by his peers for inclusion in The Best Lawyers in America (2008 - 2016), in the specialties of Tax Law, Trusts and Estates, Litigation – Trusts & Estates and Litigation & Controversy – Tax
- Named Best Lawyers 2013 Charlotte Litigation & Controversy – Tax Lawyer of the Year
- Fellow and former Member of Board of Regents of the American College of Tax Counsel
- Past Chair of the Committee on Court Practice and Procedure and the Committee on Appointments to the U.S. Tax Court of the American Bar Association's Tax Section
- Member of the Legal Elite Hall of Fame in Tax and Estate Planning by the North Carolina Business Magazine, based on peer recognition as the State of North Carolina's top winner more than twice in the specialty of tax and estate planning law.

TAX EXPERIENCE

- Mr. Elliott and a team at CEC recently represented a regional healthcare company as seller's counsel in its sale to a New York private equity firm for $140,000,000.
- Mr. Elliott has represented a high growth entrepreneur in partnerships with a private equity fund making numerous corporate acquisitions nationally. Many of the transactions used earnout financing.

- Won a dismissal of an estate tax case brought in U.S. District Court for the Western District of NC. The IRS sued 12 heirs (Mr. Elliott's clients) for estate taxes delinquent under IRS Code §6166. Mr. Elliott filed a motion for summary judgement. See U.S. v Godley, 3:13-CV-549 (2015).
- Mr. Elliott's client, a seller of a business, won a domicile income tax dispute of over $10 million against the NCDOR. Mr. Elliott handled the client's administrative appeal and served as co-counsel at the client's trial before the NC Office of Administrative Hearings. The trial ruling was upheld by the NC Court of Appeals.
- Mr. Elliott won a trial in U.S. Tax Court involving the federal estate tax value of a manufacturing business, saving the estate over $8 million in estate taxes and income taxes in Disanto v. Commissioner, TC Memo 1999-421.
- Represented a decedent's estate in NC Superior Court, and obtained a Declaratory Judgement that the decedent properly exercised a special power of appointment over NC Trust property.
- Mr. Elliott served as lead trial counsel in U.S. Tax Court in a case involving the qualification and valuation of a conservation easement on a tract of land located near Charleston, SC on the Cooper River. Salt Point Timber, LLC v. Commission, Dkt. No. 18057-14 (2015).
- Mr. Elliott successfully defended the owner of an inherited stock portfolio in U.S. Tax Court as an innocent spouse was found not liable for her husband's non-payment of federal income taxes.
- Mr. Elliott is representing a spouse in a U.S. Tax Court tax shelter dispute relating to innocent spouse claims by a divorced client and involving over $80 million of taxes, penalties and interest, pending.
- Mr. Elliott litigated a multi-million dollar tax dispute with IRS in U.S. Tax Court involving the sale and leaseback of fleet of Boeing 727 jet aircraft which was, favorably settled following Mr. Elliott's deposition of numerous witnesses, motion to compel discovery and motion for summary judgment.
- Successful defense of national medical device manufacturer in NC sales tax case.
- Mr. Elliott successfully litigated and settled a probate dispute between heirs involving executor's use of annuities to misappropriate probate assets.
- Mr. Elliott tried a sales tax case before the NC Income Tax Commission, resulting in a ruling in favor of a NASCAR team.
- Mr. Elliott litigated a NC income tax case before the Office of Administrative Hearings regarding the allocation of personal customer goodwill to shareholder in a sale of assets by C-Corporation, which was favorably settled.
- Mr. Elliott represented a building contractor client involving charges of tax fraud conspiracy, in the Western District of NC.
- Mr. Elliott conducted a valuation trial before NC Property Tax Commission, resulting in partial property tax reduction for the Federal Reserve Bank of Richmond, Charlotte Branch.
- Mr. Elliott won a trial in U.S. Tax Court in favor of taxpayer, sustaining deductions of sales distributorship.
- The cases mentioned above are illustrative of the matters handled by the firm. Case results depend upon a variety of factors unique to each case. Not all results are provided, and prior results do not guaranty a similar outcome.

PUBLICATIONS & ACTIVITIES

- Speaker, "Handling Tax Cases Before IRS Administrative Appeals," 2016 J. Nelson Young Tax Institute, UNC-Chapel Hill School of Law.
- Speaker, "Defending Family Partnerships and LLC's From IRS Attack - A Tax Litigator's Perspective," 35th Annual Estate Planning & Fiduciary Law Program - North Carolina Bar Association, Kiawah Island Golf Resort - Kiawah Island, SC, July 17-19, 2014.

- Mr. Elliott recently spoke on how to litigate estate and gift tax cases in the U.S. Tax Court in a nationally televised webinar, Litigating the Valuation of a Business: Perspectives of the Attorney & Expert Appraiser.
- Keynote Speaker, "Using Beneficiary Grantor Trusts - Tax and Planning Issues," M-Group 2012 National Advisors Conference, Key Biscayne, February 23-24, 2012.
- National Co-Moderator, NBI September 2011 Teleconference on "Recent Developments in IRS Tax Enforcement."
- Panelist and Speaker, "Using Trusts with Buy-Sell Agreements," Queens University Estate Planners Day, May 17, 2011.
- Moderator and Mock Trial Panelist, "Litigating the Valuation of a Business," Mecklenburg County Bar - CLE, December 8, 2010.
- Panelist and Speaker, "Defending the Innocent Spouse in Tax Court," 2010 North Carolina/South Carolina Tax Section Workshops, May 28, 2010 - May 30, 2010.
- Panelist and Speaker, "Tax Litigation Ethical Concerns in Responding to IRS IDRs and Requests for Formal Discovery," Court Procedure and Practice Committee, ABA Tax Section May Meeting, May 7, 2010.
- Moderator, "Trial Strategies in Complex Tax Prosecutions: Evidentiary and Procedural Challenges," ABA Tax Section, Committee on Civil and Criminal Tax Penalties, September 2009.
- Co-Author (with Briani Bennett), "Closely Held Business Interests and The Trustee's Duty to Diversify," *Trusts & Estates*, April 2009.
- Panelist at the ABA Tax Section Committee on Estate Planning entitled, "Using Trusts with Buy Sell Agreements," (Mid-Year Meeting, January 2009).
- Speaker on the topic of "Handling an IRS Estate Tax Audit" at the 2009 and 2011 North Carolina Bar Association Seminar, Estate Planning and the Marital Deduction, Greensboro, North Carolina.
- Panelist, "Tax Court Litigation Institute," 1999, Georgetown University Law Center.
- Author, "Scanlan, Federal Estate Tax Valuation and Subsequent Events," 1997, the National Association of Certified Valuation Analyst's Valuation Examiner Magazine.
- Moderator and Panelist, "Ethical Issues in Federal Tax Litigation," 1995 ABA Tax Section Committee on Court Procedure.