No. 24-

IN THE

Supreme Court of the United States

RYAN C. PATTERSON,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

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

PETITION FOR A WRIT OF CERTIORARI

JASON M. SILVER
Counsel of Record
SILVER LAW PLC
7033 East Greenway
Parkway, Suite 200
Scottsdale, AZ 85254
(480) 429-3360
jsilver@silverlawplc.com

Counsel for Petitioner

120391

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

QUESTION PRESENTED

Whether, under the Constitution of the United States, as amended, and applicable Federal rules and controlling case law, the United States, relying on an indirect method of proof, namely, the bank deposits method of analysis, can establish at trial an element of the crime charged (26 U.S.C. 7201)—specifically, that there is an additional tax due and owing—solely by the testimony as to the conclusions of such analysis by the agent who purports to have conducted it, where, if conducted, such analysis was admittedly not preserved such that it could be disclosed to the defendant for review prior to trial, as required by Rule 16 of the Federal Rules of Criminal Procedure, or admitted into evidence, thus depriving the defendant of the opportunity to meaningfully challenge, by cross-examination or otherwise, the alleged determinations of agent as to the taxability or not of the deposits involved, which determinations necessarily form the basis of the agent's conclusions.

PARTIES TO THE PROCEEDINGS

The parties to the proceeding are named in the caption. The Petitioner is Ryan C. Patterson. The Respondent is the United States of America.

STATEMENT OF RELATED PROCEEDINGS

United States v. Patterson, No.2:21-cr-00724-JJT-1, U. S. District Court for the District of Arizona. Judgment entered March 30, 2023.

United States v. Patterson, No. 23-631, U. S. Court of Appeals for the Ninth Circuit. Judgment entered December 31, 2024. Mandate issued February 13, 2025.

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Mr. Patterson was charged with violating 26 U.S.C. § 7201 ("§7201") for 2014, 2015, and 2016. He was convicted by a jury after trial in the United States District Court for the District of Arizona, Judge John J. Tuchi, presiding. Mr. Patterson appealed his conviction to the Court of Appeals for the Ninth Circuit. The Memorandum Opinion was issued by a panel on December 31, 2024, denying Mr. Patterson's appeal. The decision is unpublished but can be found at 2024 WL 5252239. A copy of the Memorandum Opinion and Judge Collins's dissent, is attached at Appendix 1-12. The Ninth Circuit denied Mr. Patterson's petition for rehearing *en banc* on February 5, 2025. A copy of the Order is attached at Appendix 13.

JURISDICTION

Mr. Patterson's petition to the Court of Appeals for the Ninth Circuit for rehearing *en banc* was denied on February 5, 2025. Mr. Patterson invokes this Court's jurisdiction under 28 U.S.C. § 1254(1), having timely filed this petition for writ of certiorari within ninety days of the issuance of the Ninth Circuit Court's Order denying his petition for rehearing *en banc*, as provided by Supreme Court Rule 13(3).

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

United States Constitution, Amendment VI (in relevant part):

"In all criminal prosecutions, the accused shall enjoy the right... to be informed of the nature and cause of the

accusation [and] to be confronted with the witnesses against him…."

26 U.S.C. § 7201, Attempt to evade or defeat tax:

"Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution."

Federal Rule of Criminal Procedure 16. Discovery and Inspection (in relevant part):

(a) Government's Disclosure

(1) Information Subject to Disclosure

* * *

(E) *Documents and Objects.* Upon a defendant's request, the government must permit the defendant to inspect and to copy or photograph books, paper, documents, data, photographs, tangible objects, buildings or places, or copies or portions of any of these items, if the item is within the government's possession, custody, or control and:

(i) the item is material to preparing the defense;

> (ii) the government intends to use the item in its case-in-chief at trial; or
>
> (iii) the item was obtained from or belongs to the defendant…

Federal Rule of Evidence 1006. Summaries to Prove Content:

The proponent may use a summary, chart, or calculation to prove the content of voluminous writings, recordings, or photographs that cannot be conveniently examined in court. The proponent must make the originals or duplicates available for examination or copying, or both, by other parties at a reasonable time and place. And the court may order the proponent to produce them in court.

Federal Rule of Evidence 403. Excluding Relevant Evidence for Prejudice, Confusion, Waste of Time, or Other Reasons:

The court may exclude relevant evidence if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence.

Internal Revenue Manual ("IRM") 9.5.9.7: Bank Deposits Method of Proving Income, attached at Appendix 22a-59a.

STATEMENT OF THE CASE

A. Mr. Patterson's Trial and the Bank Deposits Method of Proof Explained.

After investigation, including an analysis of various bank accounts, Mr. Patterson was indicted in 2021 and charged with violations of 26 U.S.C. § 7201 for 2014, 2015, and 2016. 9-ER-1781. At trial, the Government sought to prove the first element of §7201, an additional tax due and owing, by means of the bank deposits method of proof, an indirect method of proof used in both civil and criminal contexts.

As indicated, a bank deposits analysis, or "BDA" (the acronym by which it is colloquially known) necessarily involves determinations and decisions on a government agent's part as to (1) which bank accounts should be included in the universe of bank accounts subjected to the BDA; (2) which deposits should be included to determine the "gross deposits;" (3) the non-taxability of any deposit to determine "Reductions to Gross Deposits," which is then subtracted from "gross deposits" to yield a determination of Defendant's "taxable gross receipts;" (4) the allowance or not of some amount of cost of goods sold to be deducted from "gross receipts" to determine "gross income;" (5) the allowance or not of the amount of expenses claimed on the income tax returns to be deducted from "gross income" to determine "total income;" (6) if applicable, the allowance or not of some amount of AGI ("adjusted gross income") adjustments to be deducted from "total income" to determine "corrected AGI;" (7) if applicable, the allowance or not of personal deductions and exemptions to be deducted from "corrected AGI" to

determine "taxable income;" and finally, (8) a comparison of the government's conclusion as to Defendant's "taxable income" to the "taxable income per return" to reach a conclusion as to the government's position on the amount, if any, of a deficiency, i.e., taxable income Defendant is alleged to have failed to report. *See United States v. Slutsky*, 487 F.2d 832, 836-37 (2d Cir. 1973); *United States v. Esser*, 520 F.2d 213, 217 (7th Cir. 1975); *United States v. Stone*, 770 F.2d 842, 844-845; *United States v. Morse*, 491 F.2d 149, 152 (1st Cir. 1974); *United States v. Boulet*, 577 F.2d 1165, 1167 (5th Cir. 1978); Internal Revenue Manual 9.5.9.7.4.

It is comparison between the conclusions of the government agent as to taxable income based on her analysis and the income reported on the relevant tax returns that makes the bank deposits method of proof an indirect method. By comparison, a specific items method is a direct method in which "the government attempts to document specific transactions that were not completely or accurately reflected on the subject's income tax return." IRM 9.5.9.4(1). In a "specific items" case, the additional income derives from the inclusion in income or not of each specific item at issue. In a BDA, no specific item of deposit is at issue; rather, it is the fact that the total amount of taxable deposits exceeds the taxable gross receipts on the return that establishes a "deficiency," also articulated as "an additional tax due and owing" Thus, the method of proof is "indirect."

Once the government has, in the course of the analysis described above, identified which deposits it believes are non-taxable, however, a universe of taxable deposits is necessarily created (by elimination of non-taxable

deposits), with respect to which a defendant may take issue. In this sense and at such stage, then, the bank deposits method of proof starts to look like a specific items method. A defendant is able to review the analysis and know with respect to which deposits he may be able to reduce the government's determinations as to taxable receipts by placing them in controversy. In other words, having met its burden of proof by indirectly demonstrating the existence of a deficiency, a defendant can then select from the deposits not determined to be non-taxable, and present evidence that the government's implicit determination of taxable gross receipts is in error with respect to one or all of the deposits in the universe of taxable deposits. Moreover, it is in this context that having the burden shift from the government to the defendant (or taxpayer, in the civil context) is both logical and fair, as explained below.

The material differences between the use of a bank deposits analysis in the criminal context and civil context is that, in the criminal context, (a) the Government bears the burden of proof beyond a reasonable doubt as to all elements of the crime charged, including that of the existence of a deficiency (as opposed to bearing only a burden of production in the civil context, where a taxpayer typically bears the burden of proof by a preponderance standard); and (b) the Government conducts such analysis without the input of the defendant due to Fifth Amendment concerns (whereas in the civil context, because the taxpayer bears the ultimate burden of proof and because Fifth Amendment concerns are rarely involved, it becomes incumbent on the taxpayer to challenge the determinations of the IRS and offer explanations as to why certain deposits should be moved from taxable to

nontaxable, and moreover, it is advantageous to do so before trial, even if it only narrows the number of deposits, the taxability of which the parties disagree and intend to dispute at trial).

Thus, the government's burden of production in a civil case (and the burden then imposed upon a taxpayer) mirrors the burden imposed upon it to prove unreported receipts at trial in a criminal prosecution before the defendant bears any burden to establish the non-taxability of those deposits the government has determined have "the appearance of income" (as explained in more detail below, a process conducted without a defendant's input and as a result of excluding from the universe of deposits determined on their face to be nontaxable). "[O]nce the government proves unreported receipts having the appearance of income and gives defendant credit for the deductions he claimed on his return, as well as any others it can calculate **without his assistance**, the burden is on defendant to explain the receipts, if not reportable income…." *Slutsky*, 487 F.2d at 842, *quoting United States v. Lacob*, 416 F.2d 756, 760 (7th Cir. 1969) (*emphasis added*). "Put another way, once the existence of unreported receipts is established, 'the defendant remains quiet at his peril.'" *Id.*, *quoting Holland v. United States*, 348 U.S. 121, 139 (1954). Similarly, once the Government meets its requisite burden of production in the civil context, the burden shifts and "[t]he taxpayer bears the burden of proving that the government's determinations of income based on the bank deposits method are erroneous by establishing that the deposits at issue are derived from a nontaxable source." *Scott*, T.C. Memo. 2012-65, *citing Burley v. Commissioner*, T.C. Memo. 2011-262 (2011).

Analogous as the two may be, the burden on the government (burden of proof beyond a reasonable doubt in the criminal context versus only a burden of production in the civil context) is arguably more onerous in the criminal context than the civil, but certainly no less. Moreover, in the criminal context, the government assumes "a special responsibility of thoroughness and particularity in its investigation **and presentation**." *Stone*, 770 F.2d at 845 (*emphasis added*), *citing United States v. Hall,* 650 F.2d 994, 999 (9th Cir. 1981); *Slutsky*, 487 F.2d at 841. Not only must the Government perform "an adequate and full investigation of those accounts was conducted in order to distinguish between income and non-income deposits…," but it **must introduce evidence thereof at trial.** *See Morse*, 491 F.2d at 152–154 (*emphasis added*); *Kirsch v. United States*, 174 F.2d 595, 601 (8th Cir. 1949). Jury Instruction No. 16 summed up the government's burden to demonstrate with reasonable certainty those elements required of the BDA and clearly instructed the jury that, if the government failed to meet such burden, Mr. Patterson must be found not guilty.

The typical defenses against a conclusion by an agent that certain deposits are nontaxable (and by implication that the remaining deposits are taxable) are highlighted in IRM 9.5.9.7.6(1), which provides:

> The chief defense contentions in bank deposits investigations (other than lack of criminal intent) are:
>
> a. That the sporadic nature or unconventional amounts of the deposits indicate that prior accumulated funds, not current receipts, or non-taxable funds are involved,

b. That the deposits reflect, in whole or in substantial part, non-income items or income items attributable to other years,

c. That the deposits are a duplication of current year income items already accounted for by the subject.

Therefore, the ability to raise or effectively maintain such defenses require that a defendant have before him, at minimum, the analysis of the government's agent as to, not just the overall conclusions of taxable income, but the specific deposits the government agent determined, using her training, skill, and experience (and without the defendant's input) were not facially non-taxable and, by implication which deposits were not removed from the universe of taxable deposits and therefore remained in the agent's determination of taxable income.

To meet its burden of establishing at trial, as it must, the element of the existence of a deficiency, i.e., an additional tax due and owing, the government called as a witness the IRS cooperating revenue agent (a civil agent designated to assist special agents assigned to the investigation of criminal targets, hereinafter "the agent") to testify that she performed a BDA on Mr. Patterson's accounts and established a deficiency. Assuming *arguendo* that the agent did, in fact, conduct a BDA, the agent testified she followed the procedures set forth in the IRM in conducting a BDA on the thousands if not tens of thousands of deposits made into the 24 bank accounts in the name of Mr. Patterson or businesses with which he was associated. Such testimony does not, however, establish that he determinations as to which deposits were

nontaxable were incontrovertible, let alone correct, even if her determinations as to each deposit were reasonable based on her the information she had available to her at the time, which of course did not include any input by Mr. Patterson. Moreover, upon cross-examination of the agent, she could not produce her analysis. In fact, she admitted that no documented BDA ever existed to be produced, despite representations by the government's attorneys to the judge (in response to Mr. Patterson's contention that no such analysis was disclosed as required by Fed.R.Crim.P 16 and Fed.R.Evid. 1006) that the BDA was disclosed as an attachment to the Special Agent's Report ("SAR"). The transcript of the chambers conference on the issue demonstrates that the government attorneys fundamentally misunderstood what a BDA is, believing that summary charts prepared and setting forth the agent's overall conclusions constituted the analysis.

As such, to this day, neither the government nor Mr. Patterson know which of the thousands of deposits were determined by the agent to be non-taxable and which ones were left in the universe of taxable deposits used to calculate the taxable receipts that get compared to the receipts on the tax return(s) to establish the element of a deficiency or additional tax due and owing. There was only the agent's uncorroborated testimony that she conducted a BDA and that the amounts set forth on certain summary charts (Exhibits 395 and 397) prepared by either the special agent or persons unknown, in evidence at the time but subsequently stricken, were reflective of her ultimate conclusions that she contended she wrote down on "sticky notes" at the end of her analysis. Upon discovering no BDA existed in documentary form and that the agent was unable to provide information as to which deposits she determined were taxable, Defendant

moved to strike the agent's testimony, which motion was denied, even as the District Court Judge acknowledged that the agent failed to show her analysis, as discussed in more detail, below, in conjunction with the points raised in Ninth Circuit Court of Appeals Judge Collins dissent to the memorandum opinion issued by the Ninth Circuit Court of Appeals.

Mr. Patterson was thus foreclosed from cross-examining the agent as to the analysis she claims to have conducted in the investigation of his bank accounts, all of which was done, of course, without Mr. Patterson's input or involvement. The defenses contemplated (and set forth in the IRM section cited above) were thus put out of reach of Mr. Patterson, since the government could not state which deposits were subject to contention. In fact, with respect to an exhibit introduced that purported to contain a few dozen checks allegedly constituting an exemplar of deposited checks the agent testified she believed were included in taxable receipts, Mr. Patterson was able to establish that a number of such checks were from another entity owned by Mr. Patterson and thus should have been treated as non-taxable transfers, and certain others were deposited in 2017, a year which was not charged, and thus should not have been included in the analysis. Despite demonstrating that certain checks the agent believed she included in her determination of taxable receipts were not taxable, however, since this smattering of cherry-picked checks were the only checks identified by the government as included in such determination, this extremely limited line of questioning (about a few dozen deposits out of thousands, if not tens of thousands), was the extent to which Mr. Patterson could cross-examine the agent as to the determinations she made in the course of her analysis.

In addition, the lack of a documented BDA to put in evidence had, or should have had, repercussions on evidentiary rulings beyond the admissibility of the agent's testimony. While the summary charts, marked as Exhibits 395 and 395, were subsequently (and properly) withdrawn from evidence after the lack of a documented BDA was discovered, the agent's summary testimony, which should have been subjected to the same analysis, was not stricken. Moreover, the summary charts were yet allowed to be used as demonstrative exhibits (or "illustrative" evidence, in the parlance of new Federal Rule of Evidence 107), despite a lack of supporting evidence in the record, as required. *See Gordon v. United States*, 438 F.2d 858, 876 (5th Cir.), *cert. denied*, 404 U.S. 828 (1971); *Fagiola v. National Gypsum Co, AC&S Inc.*, 906 F.2d 53, 57 (2nd Cir. 1990), citing *United States v. Conlin*, 551 F.2d 534, 538-39 (2d Cir. 1977), *quoting Gordon, supra; United States v. White*, 737 F.3d 1121, 1135 (7th Cir. 2013); *Gomez v. Great Lakes Steel Div. Nat. Steel Corp.*, 803 F.2d 250, 257-258 (6th Cir. 1986); *Oertle v. United States*, 370 F.2d 719, 728 (10th Cir. 1966).

Finally, as Circuit Court of Appeals Judge Collins keenly spotted and articulated in his dissent, in permitting such charts to be put before the jury and serve as the government's proof of an element of the crime charged, the District Court Judge engaged in circular reasoning: the agent's testimony that such charts reflect her ultimate conclusions was held to constitutes sufficient evidence in the record to justify their use as demonstrative exhibits during closing arguments. This type of evidentiary bootstrapping should not be permitted.

With only the voluminous boxes of raw bank records in evidence, but with the summary charts setting forth

the agent's purported conclusions available for use as demonstrative exhibits during closing, the jury deliberated for four hours and found Mr. Patterson guilty. Motions for a judgment notwithstanding the verdict and for a new trial were timely filed raising the issues above, among others, but were denied, and Mr. Patterson appealed his conviction to the Court of Appeals for the Ninth Circuit.

B. The Appeal to the Ninth Circuit

Following briefing and oral argument, a panel of the Ninth Circuit issued a Memorandum Opinion on December 31, 2024, affirming Appellant's conviction, with Circuit Judge Rawlinson and District Judge Fitzwater (hereinafter, "the majority") rejecting Appellant's various arguments, including his assignment of error to the District Court's denial of his motion to strike the agent's summary testimony and the resulting allowed use of the summary charts during closing. Appendix at 2a-5a.

In his dissent, Judge Collins noted the various evidentiary requirements abrogated by the District Court. Concluding that the absence of the BDA ("key evidence" on which the Government relied") "did not satisfy" the Federal Rules of Evidence (Appendix at 7a), Judge Collins stated, "[a]lthough the Government here was arguably 'thorough in its investigation' concerning 'non-income deposits,' it was far from 'thorough in its…presentation' on that score at trial." Appendix at 7a, *citing United States v. Boulware*, 384 F.3d 794, 811 (9th Cir. 2004) ("The critical question is whether the government's investigation has **provided sufficient evidence** to support an inference that an unexplained excess in bank deposits is attributable to taxable income") (emphasis added); *see United States v.*

Stone, 770 F.2d 842, 844-845 (9th Cir. 1985). In his view, "the key evidence on which the Government's bank-deposit analysis was based did not satisfy the requirements of the Federal Rules of Evidence, and [Appellant's] motion to strike that evidence should have been granted in full." Appendix at 7a.

Judge Collins also noted that the District Court Judge applied evidentiary rules inconsistently to grant Mr. Patterson's motion to strike the summary charts but deny his motion to strike the agent's summary testimony, contrasting the District Court's withdrawal of summary charts under Rule 1006 and its refusal to strike the agent's summary testimony under the same rule. Appendix at 10a-11a. Judge Collins agreed with the District Court's rationale that the summary charts did not comply with Rule 1006 because, in the absence of a documented BDA, the government could not comply with the production requirement of the rule, the purpose of which is to "ensure that all parties have a fair opportunity to evaluate the summary." Fed.R.Evid 1006, advis. comm. note (2004 amend.). Moreover, the requirements of Rule 1006 are not met if "the proponent has not adequately laid a foundation for the summary, chart, or calculation unless the proponent can show the work, so to speak, that underlies it."

Thus, in Judge Collins view, the District Court rightly withdrew the Government's two summary charts because they had "not been shown to be 'rationally based on the perception of the witness and helpful to the trier of fact,' given that—as the district court recognized here—'[the agent] didn't keep a record precisely of which [deposits] she included and which ones she disregarded, [and]

more importantly, the jury doesn't know which ones.'" Appendix at 9a, *quoting* District Court Judge Tuchi's comments at trial. Judge Collins rejected, however, the District Court's holding that "the same analysis did not apply to [the agent's] oral testimony…," noting that this Court has "squarely held that 'a summary, either oral or written, may be received in evidence' but 'the summary must meet the requirements of Rule 1006. Appendix at 10a, *citing United States v. Aubrey*, 800 F.3d 1115, 1130 (9th Cir. 2015) (citation omitted); *Square Liner 360, Inc. v. Chisum*, 691 F.2d 362, 376 (8th Cir. 1982); *United States v. Johnson*, 594 F.2d 1253, 1257 (9th Cir. 1979); and 31 CHARLES ALAN WRIGHT AND VICTOR J. GOLD, FEDERAL PRACTICE AND PROCEDURE § 8044, at pp. 545-45 (2d ed. 2021).

Finally, Judge Collins recognized that the District Court's inconsistent application of the Federal Rules of Evidence turns Rule 1006 on its head, commenting:

> Indeed, the distinction drawn by the district court makes no sense, because it would allow the proponent of a summary to evade the strictures of Rule 1006 through the simple expedient of having the witness orally recite the summaries and calculations.

Appendix at 11a. The District Court effectively executed an end run around Rule 1006, the requirements of which are supposed to ensure reliability of summary witnesses and the exhibits about which they testify. Ultimately, Judge Collins concluded that Mr. Patterson was thus denied his right to "effective cross-examination." Appendix at 10a. In contrast, the majority summarily and without analysis

simply held that Steele's testimony was "not inadmissible hearsay, irrelevant, or unfairly prejudicial," and any "error did not affect [Appellant's] substantial rights," which presumably included the right to sufficient cross-examination to mount a defense to which he was entitled. Appendix at 2a.

Mr. Patterson timely filed a Petition for Rehearing *En Banc*, which was denied by an Order issued on February 5, 2025.

REASONS FOR GRANTING THE PETITION

A. This Court should clarify the rules governing the disclosure, production, presentation, and admissibility of summary evidence, whether charts or testimony, which rules are designed to ensure the government has met its burden of proof with respect to its investigation, determination, and presentation at trial of indirect methods of proof such as a BDA, such that a defendant knows what the government has determined and can effectively prepare for and cross-examine a summary witnesses with regard to her determinations and raise all defenses to which he is entitled.

The issue here is of exceptional importance. As Appellant opined on brief, it "is beyond troubling" that under the District Court's view of the evidentiary rules, the government can obtain a conviction where, without any corroborative evidence in the form of a legally sufficient BDA, an agent takes the stand and simply testifies that she has conducted and determined that a deficiency exists, essentially declaring that the government has met its

burden as to an element of the crime, and do so without producing the analysis itself or what determinations were made to arrive at such conclusions. As Judge Collins put it:

> Effectively, what the Government did…was ask the jury to accept, based on [the agent's] barebones say-so, that she determined that [Appellant] underreported his income. The rules of evidence require more than this sort of take-my-word-for-it approach.

Appendix at 10a. The lack of documentary evidence (of the very method the government chose to establish an additional tax due and owing) precluded Defendant from effectively cross-examining the agent in any detail on the determinations she made during the course of her analysis, let alone such ultimate conclusions. Because there was nothing in evidence that reflects which deposits the agent identified were non-taxable and which remained as presumptively taxable, Defendant was precluded from exploring why any such deposits remaining as net taxable deposits should not have been reclassified as nontaxable for the purposes of establishing that there was a deficiency. As Judge Collins recognized, "[the agent] should have supplied all of the supporting detail on which she relied to [Mr. Patterson], and the failure to do so here denied him 'effective cross-examination." Appendix at 10a, *citing Square Liner 360, Inc.*, 691 F.2d at 376.

As argued above, the failure to produce a documented BDA would not pass muster even in the civil context, since the government would not be able to meet its burden of production. *Scott*, T.C. Memo. 2012-65, *citing Burley*, T.C. Memo. 2011-262 (2011). This Court should use this

opportunity to make clear that in the criminal context, where a BDA is relied upon to establish an element of the crime charged, the "rules of evidence require more than [a] take-my-word-for-it approach" by the testifying agent, in the words of Judge Collins. Appendix at 10a; *see Morse*, 491 F.2d at 154-155.

In any context, criminal or civil, it cannot be permissible for the government to satisfy its burden of proof simply by putting an agent on the stand and having her declare that a deficiency exists without being able to show how she arrived at such a conclusion, which would then open the door to defendant's and taxpayer's ability to challenge such declaration.

To permit the government to simply call an employee as a witness to make an uncorroborated and thus unassailable declaration that some element of a crime is established is no different than an uncorroborated and unassailable declaration that a defendant has committed a crime. That is not a constitutionally-approved method of determining guilt. The government must do more than make such conclusory declarations before imposing criminal sanctions for alleged conduct. Nor is it sufficient in response to suggest that a jury could and should have recognized the lack of evidence, appreciated the insufficiencies in evidence, and thus not convicted a defendant. Such view ignores the various safeguards put in place to govern the admissibility of evidence and the role of a judge in interpreting such rules, not to mention where a jury has, in voting to convict, clearly not appreciated deficiencies in the government's case in chief, a judge's ability to render a verdict notwithstanding the jury's verdict.

The issue is also critically important given the dearth of guidance with respect to the use of BDAs in criminal trials, which, as shown above, requires an understanding of their use generally. Yet, tellingly, there appear to be no criminal cases involving the circumstances at issue here, where a BDA was relied on by the government to establish the element of a tax due and owing, but no such analysis was introduced at trial or, in fact ever existed in documentary form, let alone having been produced for review or use in cross-examination. *Morse* is the most analogous case. There, underlying documents upon which the agent's analysis was based were not introduced into evidence, even though the analysis itself was introduced and admitted. Yet, in the First Circuit's opinion, even this failure, though not as egregious as the absence of the analysis itself, rendered the government's witness's testimony inadmissible hearsay. *Morse*, 491 F.2d at 154-155. Clarity is desperately needed on this point lest all indirect methods of proof become subject to a "doctrine of declaration," whereby the government does what it did here: simply declare established the conclusions of such method without any analysis or corroboration.

It is also clear from the record that the government was unaware that no such BDA existed in documentary form or was disclosed or produced to Mr. Patterson. In fact, the government did not appear to understand what constituted such an analysis, other than that its cooperating revenue agent claimed to have conducted a BDA and had some conclusory figures for the government's use in creating summary charts about which it believed the agent could testify. *Id*. As such, the evidentiary conundrum presented is unique, and the lack of precedent thus unsurprising.

The government's lack of comprehension notwithstanding, the trial was Mr. Patterson's only opportunity to challenge the agent's determination. Yet, he was deprived thereof because the agent failed to memorialize her analysis by taking the simple step of preserving it by saving a copy of her spreadsheet on her computer. Moreover, though the Government initially contended that it satisfied its duty under Rule 1006(b), to "make the underlying originals or duplicates [of a summary, chart, or calculation] available for examination or copying, or both, by other parties at a reasonable time and place" (Fed.R.Evid. 1006(b)), without a BDA in existence in a documented, memorialized form, it is not possible that the Government met this requirement.

Finally, beyond general principles involving Rule 1006 and summary witnesses, in the context of the government's reliance on a BDA, it is the analysis, coupled with the testimony of the summary witness evidencing the reliability of the conclusions reached, that satisfies the government's burden of proving the element of a tax due and owing beyond a reasonable doubt. Yet, Mr. Patterson was deprived of his opportunity to effectively cross-examine the agent because, in the absence of her analysis, she could not testify as to which deposits (of thousands of deposits across 24 bank accounts for three years) she identified were non-taxable on their face and which ones she "left in" her calculation of taxable deposits. Indeed, she admitted that she would have to "reinvent the wheel" to provide any specifics as to thousands of deposits allegedly reviewed to determine whether taxable or not.

The effect of failing to preserve and present the BDA the government relies upon to meet its burden needs to

be addressed and articulated. The memorialized analysis must exist in sufficient form to apprise a defendant of the analysis and expose it to the crucible of cross-examination. In addition, such analysis must be provided to the defense for review ahead of trial in satisfaction of Fed. R.Crim.P. 16(a)(1) and Fed.R.Evid. 1006(b). Finally, it must be available for use at trial to provide the opportunity for a constitutionally-sufficient cross-examination of the summary witness in cases where the government chooses to rely on such witness and her BDA as its method of proving beyond a reasonable doubt, as it must in a prosecution under 26 U.S.C. § 7201, the element of an "additional tax due and owing."

CONCLUSION

For the foregoing reasons, Mr. Patterson respectfully requests that this Court issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

DATED this 16th day of April 2025.

Respectfully submitted,

JASON M. SILVER
Counsel of Record
SILVER LAW PLC
7033 East Greenway Parkway, Suite 200
Scottsdale, AZ 85254
(480) 429-3360
jsilver@silverlawplc.com

Counsel for Petitioner

APPENDIX

TABLE OF APPENDICES

APPENDIX A — MEMORANDUM OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT, FILED DECEMBER 31, 2024

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 23-631
D.C. No. 2:21-cr-00724-JJT-1

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

RYAN C. PATTERSON,

Defendant-Appellant.

Appeal from the United States District Court
for the District of Arizona
John Joseph Tuchi, District Judge, Presiding

Argued and Submitted September 13, 2024
Phoenix, Arizona

Before: RAWLINSON and COLLINS, Circuit Judges, and FITZWATER,* District Judge. Dissent by Judge COLLINS.

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* The Honorable Sidney A. Fitzwater, United States District Judge for the Northern District of Texas, sitting by designation.

Appendix A

MEMORANDUM[**]

Defendant-Appellant Ryan C. Patterson ("Patterson") was convicted following a jury trial of three counts of tax evasion, in violation of 26 U.S.C. § 7201. He challenges several evidentiary rulings, the denial of his motion for judgment of acquittal, and several sentencing decisions. We have jurisdiction under 28 U.S.C. § 1291, and we affirm. Because the parties are familiar with the facts of this case, we do not recount them here except as necessary to provide context for our decisions.

1. The district court did not err in overruling Patterson's objections to, and his motion to strike, the testimony of IRS revenue agent Debra Steele ("Steele"). Steele's testimony about her bank deposits analysis ("BDA") was not inadmissible hearsay, irrelevant, or unfairly prejudicial, and it did not violate Patterson's Sixth Amendment right of confrontation. Even if we assume without deciding that the district court plainly erred in failing to exclude Steele's testimony regarding Patterson's tax returns as improper expert testimony or lay opinion testimony, that error did not affect Patterson's substantial rights, so he is not entitled to relief. *See United States v. Gomez-Norena*, 908 F.2d 497, 500 (9th Cir. 1990) (holding that unpreserved evidentiary objections are reviewed for plain error); *see also United States v. Olano*, 507 U.S. 725, 734, 113 S. Ct. 1770, 123 L. Ed. 2d 508 (1993) (holding there is no plain error where substantial rights are not affected).

** This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

2. The district court did not abuse its discretion in allowing the government to use Exhibits 395 and 397 as demonstrative aids[1] after they had been withdrawn from evidence. *See Lies v. Farrell Lines, Inc.*, 641 F.2d 765, 773 n. 9 (9th Cir. 1981) (citation omitted) ("The admissibility of demonstrative evidence in particular is largely within the discretion of the trial judge."). Although the district court did not explicitly cite Rule 403 or recite the elements of Rule 403's balancing test when considering this issue, its explanation indicates that it conducted a proper Rule 403 analysis to determine whether the exhibits should have been allowed as demonstrative aids.

3. The district court did not err in admitting Exhibits 81, 440, and 413. Exhibits 81 and 440 were admitted pursuant to the parties' stipulation, which obviated the need for foundational testimony by a witness with personal knowledge. And to the extent that Patterson raises a relevance challenge to Exhibits 81 and 440, the district court's decision to admit them was reasonably supported by the record. The district court did not err in admitting Exhibit 413 based on lack of personal knowledge because Steele testified that she created the exhibit.

4. The government produced sufficient evidence to allow a reasonable juror to convict Patterson under 26

1. Under new Federal Rule of Evidence 107, which took effect December 1, 2024, a "demonstrative aid" is now called an "illustrative aid," the use of which is governed by Rule 107. We use the term "demonstrative aid" and follow the law in effect at the time of trial, while recognizing that new Rule 107(a) and Rule 403 adopt substantially similar standards.

U.S.C. § 7201. The government produced evidence that a BDA was performed, consisting of (1) a spreadsheet listing all deposits made into 24 bank accounts for Patterson and the companies he owned during the relevant tax years; (2) Steele's testimony about the steps she took to analyze the deposits; and (3) summary charts reflecting the conclusions of Steele's analysis. The absence of documentary proof of the intermediate steps that Steele completed does not mean that no analysis occurred or that no BDA exists. *See United States v. Boulware*, 384 F.3d 794, 811 (9th Cir. 2004) (explaining that BDA performer's testimony detailing procedure and methodology can constitute sufficient evidence that government conducted "adequate and full investigation" of defendant's accounts). And Steele's failure to calculate Patterson's "cash on hand" did not render the BDA insufficient because the government's evidence, if credited by the jury, allowed a rational juror to find that the government adequately accounted for "cash on hand" by demonstrating that it was immaterial. Ultimately, for purposes of determining whether the evidence was sufficient to convict Patterson, the precise amount of the taxes that Patterson evaded is inconsequential; it is enough that the government produced sufficient evidence for a rational juror to find that Patterson evaded some quantum of tax. *See United States v. Marashi*, 913 F.2d 724, 735 (9th Cir. 1990) (quoting 26 U.S.C. § 7201) ("The language of § 7201 does not contain a substantiality requirement. It simply states that willful attempts to evade 'any tax' under the Tax Code is a felony.").

5. The district court did not err at sentencing in applying a "sophisticated means" enhancement under

U.S.S.G. §§ 2T1.1 and 2T1.4. Steele testified that the government had to undertake the laborious exercise of subpoenaing 24 bank accounts and analyzing the thousands of deposit records associated with them to perform the BDA, which indicates that Patterson used sophisticated means to carry out his offenses. *See United States v. Jennings*, 711 F.3d 1144, 1147 (9th Cir. 2013). And the government's evidence of methods that Patterson used to conceal income—asking customers to make checks out to him personally, failing to record some of his business income, providing incomplete financial records to his tax preparers, and instructing Patterson's companies' secretary/bookkeeper to get rid of financial records—supported application of the enhancement, even if the district court did not explicitly refer to that evidence.

6. The district court did not clearly err in its factual findings when determining the amount of tax loss. The district court's findings were not "illogical, implausible, or without support in the record." *United States v. Sanmina Corp.*, 968 F.3d 1107, 1116 (9th Cir. 2020) (citation omitted).

AFFIRMED.

Appendix A

COLLINS, Circuit Judge, dissenting:

Defendant-Appellant Ryan Patterson was charged in a three-count indictment with having willfully evaded his income taxes by signing and submitting false tax returns for 2014, 2015, and 2016. *See* 26 U.S.C. § 7201. He was convicted after a jury trial and sentenced to 20 months in prison. Because I conclude that his convictions were the result of prejudicial evidentiary error, I would reverse and remand for a new trial. I therefore respectfully dissent from the majority's judgment affirming Patterson's convictions and sentence.

At trial, the Government relied on "a bank-deposits method of proof" to establish that Patterson had substantially underreported his income on the relevant tax returns. *United States v. Boulware*, 384 F.3d 794, 811 (9th Cir. 2004). We have described the requirements of that method of proof as follows:

> When using the bank-deposits method of proof, the government must conduct an adequate and full investigation to remove non-income deposits, such as transfers between bank accounts. "The critical question is whether the government's investigation has provided sufficient evidence to support an inference that an unexplained excess in bank deposits is attributable to taxable income." Although the government must be especially thorough in its investigation and presentation, "it is well settled that the government is not obliged to

> prove the exact amount of a deficiency so long as the taxpayer's understatement of income is substantial."

Id. (citations omitted). Although the Government here was arguably "thorough in its investigation" concerning "non-income deposits," it was far from "thorough in its . . . presentation" on that score at trial. *Id.* In my view, the key evidence on which the Government's bank-deposit analysis was based did not satisfy the requirements of the Federal Rules of Evidence, and Patterson's motion to strike that evidence should have been granted in full.

At trial, the Government presented the testimony of IRS Agent Debra Steele, who explained the general method she applied in performing her bank-deposit analysis. After the voluminous bank records had been scanned into an Excel spreadsheet, Steele separated the bank deposits that she thought were not income from those that she thought were income by moving the non-income items to the bottom of the spreadsheet. She then totaled up the remaining income deposits at the top of the spreadsheet, and she wrote down the resulting number, which she considered to be the "gross receipts," on a "sticky note." She then deducted the full expenses claimed by Patterson in order to determine what she believed to be Patterson's net profit or loss. She then created two charts, one comparing the gross receipts listed on each of Patterson's returns with the total gross receipts she calculated for each year, and the other comparing the net profit or loss shown on the returns with her calculations of net profit. Steele admitted, however, that she did not

save the Excel spreadsheet that showed how she divided the various line entries of bank deposits into those that she believed were income deposits and those that she believed were non-income deposits. Steele only had her bottom-line gross-receipt and net-profit numbers for each of the three years, and those numbers were listed on her two charts (which were initially admitted into evidence) and were orally read by her into the record.

Patterson moved to strike Steele's testimony and the two exhibits, relying principally on Rules 1006 and 403. The district court granted the motion as to the two charts, but not as to Steele's testimony. The court held that the charts were not admissible as summaries of voluminous evidence under Rule 1006 because, given that Steele did not save any of her work, there was no record as to *which* of the voluminous bank-record entries were being summarized. But the court held that Steele's oral testimony was "[u]ngoverned by Rule 1006" and that the same analysis therefore did not apply to that testimony. The court thus allowed Steele's testimony to stand, but it withdrew the two charts from evidence and instead classified them as permissible non-evidence demonstratives.

I agree with the district court's ruling that the summary charts did not comply with Rule 1006. That rule states that the proponent of a "summary, chart, or calculation" concerning the "content of voluminous writings" "must make the originals or duplicates" of the underlying materials available to the "other parties at a reasonable time and place." FED. R. EVID. 1006 (2023). The district court correctly held that this requirement

is not satisfied if the proponent does not identify *what portions* of the content of *which* documents are being summarized. *Cf.* FED. R. EVID. 1006, advis. comm. note (2004 amend.) (reaffirming that the purpose of the production requirement is to "ensure that all parties have a fair opportunity to evaluate the summary").

Moreover, the proponent has not adequately laid a foundation for the summary, chart, or calculation unless the proponent can show the work, so to speak, that underlies it. "Rule 1006 evidence by its very nature embodies an opinion that it accurately interprets or summarizes the contents of the voluminous source material," and where that evidence is presented "in the form of a lay opinion, as it usually will be, Federal Rule of Evidence 701 applies and the proponent must show that the opinion is rationally based on the perception of the witness and helpful to the trier of fact." 31 CHARLES ALAN WRIGHT AND VICTOR J. GOLD, FEDERAL PRACTICE AND PROCEDURE § 8043, at p. 535 (2d ed. 2021) (hereinafter "WRIGHT AND GOLD"). In my view, the underlying opinions behind the summaries and calculations in Steele's charts have not been shown to be "rationally based on the perception of the witness and helpful to the trier of fact," given that—as the district court recognized here—"she didn't keep a record precisely of which ones she included and which ones she disregarded, [and] more importantly, the jury doesn't know which ones." To support the opinions underlying these calculations, Steele had to provide sufficient intermediate detail to the jury about how her methods were actually applied to this enormous mass of data (*e.g.*, perhaps by tallying up the various subcategories

of income items and non-income items and defining more clearly the criteria for classifying a given entry as falling into a particular subcategory). Additionally, Steele should have supplied all of the supporting detail on which she relied to Patterson, and the failure to do so here denied him "effective cross-examination." *Square Liner 360, Inc. v. Chisum*, 691 F.2d 362, 376 (8th Cir. 1982). Effectively, what the Government did at Patterson's trial was to ask the jury to accept, based on Steele's barebones say-so, that *she* had determined that Patterson underreported his income. The rules of evidence require more than this sort of take-my-word-for-it approach.

Although the district court thus correctly withdrew the charts from evidence, the court erred in holding that the same analysis did not apply to Steele's oral testimony. Nothing in the text of Rule 1006 limits its applicability to physical exhibits, and Steele's oral recitation of her bottom-line calculations was "a summary . . . or calculation to prove the content of voluminous writings" within the plain language of the rule. Indeed, we have squarely held that "a summary, either oral or written, may be received in evidence," but "the summary must meet the requirements of Rule 1006." *United States v. Aubrey*, 800 F.3d 1115, 1130 (9th Cir. 2015) (citation omitted); *see also Square Liner 360, Inc.*, 691 F.2d at 376 ("We are satisfied that protection of the integrity of Rule 1006 requires its application to Chisholm's oral testimony from his summaries and calculations." (citing *United States v. Johnson*, 594 F.2d 1253 (9th Cir. 1979)); *Johnson*, 594 F.2d at 1257 (applying Rule 1006 in holding "that the district court improperly allowed the Government to *ask* Mr. Harbert about the

summary" (emphasis added)); *see also* 31 WRIGHT AND GOLD, *supra*, § 8044, at pp. 545-46 ("While a chart is necessarily in tangible form, summaries and calculations may be in tangible form or may be presented as testimony" (footnotes omitted)). Indeed, the distinction drawn by the district court makes no sense, because it would allow the proponent of a summary to evade the strictures of Rule 1006 through the simple expedient of having the witness orally recite the summaries and calculations.

Because the district court erred in admitting the testimony of Steele as to her calculations, the convictions should be reversed. On this record, it is likely that Steele's critical testimony, which occupied more than a day of the trial, was relied upon by the jury in concluding that Patterson had underreported his income. The error therefore cannot be deemed to be harmless. *See United States v. Mirabal*, 98 F.4th 981, 987 (9th Cir. 2024) ("We may only conclude that an error was harmless if it is 'more probable than not that the erroneous admission of the evidence did not affect the jury's verdict.'") (citations omitted)).

Because I would reverse Patterson's convictions on this ground, I need not reach any other issue raised on appeal except for Patterson's challenge to the sufficiency of the evidence. *See United States v. Irons*, 31 F.4th 702, 715 (9th Cir. 2022). However, in evaluating the sufficiency of the evidence, we must consider all of the evidence before the jury, including evidence that was improperly admitted. *See id.* (citing *Lockhart v. Nelson*, 488 U.S. 33, 40-41, 109 S. Ct. 285, 102 L. Ed. 2d 265 (1988)). Even though I think

that Steele's testimony lacked an adequate foundation and lacked sufficient explanatory detail to be helpful to the jury, it was still *some* evidence of underreporting of income. And, importantly, it was not the *only* evidence of underreporting. The bookkeeper for Patterson's businesses testified that some business payments were made by personal check to Patterson and were omitted from the software records provided to Patterson's tax preparers and that some payments were made in cash and were "under the table" payments. This is enough evidence to permit a rational jury to find Patterson guilty under "the lenient standard for evidentiary sufficiency." *See id.* at 716 (stating that "the relevant question is whether, after 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" (citation omitted)).

For the foregoing reasons, I dissent from the affirmance of Patterson's convictions and sentence. I would reverse and remand for a new trial.

APPENDIX B — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT, FILED FEBRUARY 5, 2025

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 23-631
D.C. No. 2:21-cr-00724-JJT-1

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

RYAN C. PATTERSON,

Defendant-Appellant.

Filed February 5, 2025

ORDER

Before: RAWLINSON and COLLINS, Circuit Judges, and FITZWATER,* District Judge.

Judge Rawlinson and Judge Collins have voted to deny the petition for rehearing en banc, and Judge Fitzwater so recommends. The full court has been advised of the

* The Honorable Sidney A. Fitzwater, United States District Judge for the Northern District of Texas, sitting by designation.

petition for rehearing en banc and no judge has requested a vote on whether to rehear the matter en banc. *See* FED. R. APP. P. 40. The January 10, 2025 petition for rehearing en banc (Dkt. 38) is denied.

APPENDIX C — JURY INSTRUCTIONS NO. 15 AND 16 OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA, FILED SEPTEMBER 23, 2022

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

No. CR-21-00724-001-PHX-JJT

UNITED STATES OF AMERICA,

Plaintiff,

v.

RYAN C. PATTERSON,

Defendant.

Filed September 23, 2022

END OF TRIAL JURY INSTRUCTIONS

9/22/22
Dated

/s/ John J. Tuchi
John J. Tuchi
United States District Judge

Appendix C

JURY INSTRUCTION NO. 15

The Defendant is charged in Counts One, Two and Three of the Indictment with tax evasion in violation of Section 7201 of Title 26 of the United States Code. For the Defendant to be found guilty of that charge in any Count, the Government must prove each of the following elements beyond a reasonable doubt as to that Count:

First, the Defendant owed more federal income tax for the calendar year charged in that Count than was declared due on the Defendant's income tax return for that calendar year;

Second, the Defendant knew that more federal income tax was owed than was declared due on the Defendant's income tax return;

Third, the Defendant made an affirmative attempt to evade or defeat such additional tax; and

Fourth, in attempting to evade or defeat such additional tax, the Defendant acted willfully.

Appendix C

JURY INSTRUCTION NO. 16

In this case the Government relies upon the "bank-deposits method" of proving unreported income.

Under this method of proof, when a taxpayer participates in an income producing business or occupation and periodically deposits money in bank accounts under the taxpayer's name or control, an inference is created that the deposits represent taxable income unless it appears that the deposits were actually redeposits or transfers of funds between accounts, or that the deposits came from nontaxable sources such as gifts, inheritances, or loans.

Similarly, when the taxpayer spends cash or currency from funds not deposited in any bank and not derived from a nontaxable source, an inference is created that the cash or currency is taxable income.

Because the bank-deposits method of proving unreported income involves reviewing the Defendant's deposits and cash expenditures that came from taxable sources, the Government must establish an accurate cash-on-hand figure for the beginning of the tax year.

But the proof need not show the exact amount of the beginning cash-on-hand as long as it establishes that the Government's claimed cash-on-hand figure is reasonably accurate.

Explanations or "leads" may be offered to the Government by or on behalf of the Defendant as to the

source of the funds used or available for deposits during the prosecution years such as gifts, loans, or inheritances. If such leads are relevant, reasonably plausible, and are reasonably susceptible of being checked, then the Government must investigate into the truth of the explanations. However, if no such leads are provided, the Government is not required to negate every conceivable source of nontaxable funds.

Because the Court has instructed you that you must decide each of the three counts separately for the three tax years in issue—2014, 2015 and 2016—you must evaluate for each of those years whether the government has demonstrated that it has addressed all elements required in the bank-deposits method with reasonable accuracy, including total deposits into the accounts, subtraction of non-income transactions, subtraction of non taxable amounts, and either subtraction of cash on hand for a given analysis year or demonstration that cash on hand for that year was immaterial.

If you conclude for a tax year in issue that the government has demonstrated that it has so addressed all of these requirements with reasonable accuracy, then you must find the government has established the Defendant's taxable income figure for that tax year through its bank-deposits analysis method and that it has satisfied the first element of Jury Instruction No. 15 for the Count associated with that tax year. But if you conclude for a tax year in issue the government has not demonstrated it has addressed all these requirements with reasonable accuracy, you must find the government has

not established the Defendant's taxable income figure for that year through the bank-deposits method and therefore has not satisfied the first element of Jury Instruction No. 15 as to that tax year; for the Count associated with that tax year you must find the Defendant not guilty.

Finally, for any charged tax year in which you decide the government has satisfied the first element of Jury Instruction No. 15, you must then decide whether the government has met the remaining elements for the count associated with that tax year.

APPENDIX D — CRIMINAL MINUTES—JURY TRIAL OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA, PHOENIX DIVISION, FILED SEPTEMBER 22, 2022

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA
PHOENIX DIVISION

CR-21-00724-PHX-JJT

UNITED STATES OF AMERICA,

Plaintiff,

vs.

RYAN C. PATTERSON,

Defendant.

Filed September 22, 2022

HON: JOHN J. TUCHI

CRIMINAL MINUTES—JURY TRIAL

PROCEEDINGS: ___FINAL PRETRIAL _X_JURY TRIAL __VOIR DIRE __JURY SWORN

Trial day #_8_

8:46 a.m. Court convenes. Jury is not present. Discussion held re: final jury instructions, exhibits and pending motions. For reasons as stated on the record, **IT IS ORDERED** granting in part and denying in part

Appendix D

Defendant's Motion to Strike Trial Exhibits 395 and 397 and the testimony of Revenue Agent Debra Steele (Doc. [135]). **IT IS FURTHER ORDERED** that exhibits 395 and 397 previously admitted on 9/15/2022 are withdrawn. 9:04 a.m. Court is in recess.

10:13 a.m. Court reconvenes. Jury is not present. Discussion held re: exhibits. 10:16 a.m. Jury is present. The Court reads the final jury instructions. Closing arguments. 12:19 Jury exits the courtroom and court is in recess.

12:28 p.m. Court reconvenes. Jury is present. Closing arguments continue. Bailiff is sworn to take charge of the jury. 1:07 p.m. Jury exits the courtroom for a lunch break before beginning deliberations. Discussion held re: attorney contact information, schedule, exhibits and pending motions. 1:11 p.m. Court is in recess.

2:28 p.m. Jury has returned from the lunch break and commences deliberations.

4:00 p.m. Jury has notified the Court they will be taking the afternoon break. 4:13 p.m. Jury has returned from the afternoon break and resumes deliberations.

5:05 p.m. Jury is excused for the day and will return on 9/23/2022 at 9:00 a.m. to continue deliberations. Court stands at recess until 9:00 a.m., 9/23/2022.

Time in Court: 3 hrs. 7 mins.
Start: 8:46 AM
Stop: 5:05 PM

APPENDIX E — INTERNAL REVENUE MANUAL

9.5.9.7 (11-05-2004)

Bank Deposits Method of Proving Income

(1) The bank deposits method of proving income utilizes bank account records to establish a subject's understatement of taxable income. When there is no, or insufficient, direct evidence of income and/or expenses, the government can still make its investigation indirectly through the use of circumstantial evidence.

(2) The theory behind the bank deposits method of proof is simple. There are only three things a subject can do with money once it is received, i.e., he/she can spend it, deposit it, or hoard it. Accounting for these three areas considers all funds available to the subject. If non-income sources are eliminated, the remaining currency expenditures, deposits, and increases in cash on hand will equal corrected gross income.

(3) The bank deposits method of proof requires the special agent to conduct a thorough analysis of the deposits and canceled checks which relate to any and all bank accounts controlled by the subject. Additionally, the special agent must document the subject's currency expenditures and cash on hand.

(4) If the subject reported income on the accrual basis, adjustments should be made in the bank

deposits method to reflect accrued income and expenses.

(5) The following represents an overview of the bank deposits method of proof formula. This particular overview illustrates the steps taken if the subject had business income and expenses.

	Total Deposits $
Add:	Currency Expenditures
	Increase in Cash on Hand
Subtract:	Non-Income Deposits and Items
Equals:	SUBTOTAL
Subtract:	Cost of Goods Sold
Equals:	GROSS INCOME
Subtract:	Business and Rental Expenses
Equals:	TOTAL INCOME
Subtract:	Adjustments to Income
Equals:	ADJUSTED GROSS INCOME
Subtract:	Personal Deductions and Exemptions
Equals:	CORRECTED TAXABLE INCOME
Subtract:	Taxable Income Reported
Equals:	ADDITIONAL TAXABLE INCOME

9.5.9.7.1 (11-05-2004)

Authority for Bank Deposits Method

(1) There is no statutory provision defining the bank deposits method of proving income and specifically authorizing its use by the Commissioner. The bank deposits method of proof is not defined by the USC or regulations. It is primarily based

upon the Supreme Court's decision in *Gleckman v. United States, 80 F. 2d 394 (8th Cir. 1935)*, which affirmed a lower court ruling that recognized the bank deposits method as an acceptable method of proving income.

9.5.9.7.1.1 (11-05-2004)

Legal Requirements to Establish a Prima Facie Bank Deposits Investigation

(1) As a result of the *Gleckman* decision, the following evidentiary facts are used to establish a prima facie bank deposits investigation:

a. The subject was engaged in an income-producing business, activity, or profession.

b. The subject made periodic deposits of funds into his/her bank accounts, or into nominee bank accounts over which he/she exercised control.

c. The deposits into the above referenced accounts reflect current year income and an adequate investigation of deposits was made by the investigating special agent to negate the possibility that deposits arose from nontaxable sources.

d. Unidentified deposits have an inherent appearance of income.

(2) The fact that a subject deposited a sum of money in a bank account does not prove the funds deposited therein were taxable. The fact that the subject received and cashed a large check, in and of itself, does not prove the funds received were taxable. In order to establish those funds represented taxable income, the following must be shown:

a. The subject has a business or other regular income source.

b. The subject made regular deposits into an account.

c. The subject draws against the account for personal use.

d. There is testimony that the subject has income.

e. Deposited amounts exceed exemptions and deductions.

(3) The courts have held there is no necessity to disprove the accuracy of the subject's books and records as a prerequisite to the use of the bank deposits method.

Appendix E

9.5.9.7.2 (11-05-2004)

When to Use Bank Deposits Method

(1) The bank deposits method of proof is recommended as the primary method of proof when:

a. The subject's books and records are not available.

b. The subject's records are not complete and do not adequately reflect their correct income.

c. The subject deposits most of his/her income and uses bank deposits to calculate gross receipts on their return.

(2) In addition to being a primary method of proving income, the bank deposits method is also used to corroborate other methods of proof and to test-check the accuracy of reported taxable income.

9.5.9.7.3 (03-19-2012)

Method of Accounting

(1) The use of the bank deposits method of proof is not affected by the subject's method of accounting. The bank deposit analysis may reflect the subject's corrected taxable income by whichever method of accounting is used by the subject. Reflecting a certain accounting method in the bank deposit computation is accomplished by including certain accounts in the bank deposit analysis and omitting others. For instance, to

compute the income of a physician who uses the cash basis method, patient accounts receivable and business accounts payable at the beginning and end of each year would be omitted. If the physician used the accrual method of accounting, these accounts would be included in the bank deposit analysis.

(2) When a subject reports income on the accrual basis, adjustments must be made in computing gross receipts and deductions to account for accrued income and accrued expenses.

(3) Under the accrual basis, credit sales are included in income when the sales are made, not when the money is collected; purchases and expenditures are deducted when the liability is incurred rather than when the account is actually paid.

(4) These accounting adjustments are made by adding or deducting the increase or decrease in receivables and payables. Rather than compute the increase or decrease in the account receivables during a year, simply add the ending accounts receivable figure and deduct the beginning accounts receivable figure in computing gross income. The beginning accounts receivable figure is subtracted from the bank deposits computation of income because the accounts were collected and the proceeds deposited during the year. The ending accounts receivable figure is then added to the bank deposits computation because the funds are taxable and have not been accounted for in the subject's deposits, expenditures, or cash hoard.

(5) The same rationale applies to beginning accounts payable which were deducted in the prior year and ending accounts payable that need to be deducted in the taxable year in which they are accrued.

9.5.9.7.4 (03-12-2012)

Complete Bank Deposits Method of Proof Formula

(1) The full bank deposits method of proof formula is followed by sections that explain each formula heading and subheading:

BANK DEPOSIT METHOD OF PROVING INCOME

TOTAL DEPOSITS
Bank accounts: (Business/Personal/Nominee),
Checking accounts,
Savings accounts,
IRA and Keogh accounts,
Credit union,
Investment trusts,
Other accumulation accounts,
Brokerage accounts,
Certificates of deposits.
ADD: INCREASE IN CASH ON HAND
ADD: NON-NEGOTIATED INSTRUMENTS PURCHASED OR RECEIVED DURING YEAR AND HELD AT YEAR END
Cashier's checks,
Money orders,

Customer's checks,
US savings bonds.
ADD: OTHER
Amounts automatically withheld from wages,
Withheld taxes, health/life insurance premiums,
Retirement funds, savings, other payroll deductions.
ADD: CURRENCY EXPENDITURES
Business,
Personal (including cash gifts),
Capital (investment).
ADD: NON-CASH INCOME
Payments in kind,
Forgiveness of debt in lieu of payment,
Property in lieu of payment,
Constructive dividends,
Ending accounts receivable (if on accrual basis).
SUBTOTAL (TOTAL FUNDS AVAILABLE)

BANK DEPOSIT METHOD OF PROVING INCOME

LESS: NON-INCOME DEPOSITS AND ITEMS
Currency withdrawals,
Transfers between accounts and re-deposited items,
Checks to cash (and cashed third-party checks),
Loans, gifts, inheritances received,
Beginning accounts receivable (if on an accrual basis),
Decrease in cash-on-hand,
Exclusions under IRC,

Appendix E

Return of capital (Basis of stock and capital items),
Capital losses—carry forwards,
Bank errors and missing checks,
Returned customer checks,
Federal tax refunds and insurance proceeds,
Savings accounts withdrawals,
IRA and Keogh payments,
Life insurance proceeds,
US savings bonds redeemed,
Social security payments received,
Veterans benefits received,
Nontaxable portion of pensions and annuities,
Cost basis of property sold,
Child support payments received,
Travel expense reimbursement,
Repayments of loans made by others.
ADD: CAPITAL LOSSES EXCEEDING $3,000
EQUALS: SUBTOTAL GROSS INCOME (if there is no cost of goods sold)
LESS: COST OF GOODS SOLD
Beginning inventory,
Add: purchases,
Less: ending inventory,
Equals: cost of goods sold.
EQUALS: GROSS INCOME
(if cost of goods sold is involved)

BANK DEPOSIT METHOD OF PROVING INCOME

LESS: TOTAL BUSINESS EXPENSES
Add: business expenses per bank records,
Add: additional expenses identified,

Appendix E

Add: depreciation,
Add: ending accounts payable re: business expenses (if accrual basis),
Less: fraudulent expenses identified,
Less: beginning accounts payable re: business expenses (if accrual basis),
Equals: total business expenses.
EQUALS: TOTAL INCOME
LESS: ADJUSTMENTS TO INCOME
IRA deduction,
Spouse IRA deduction,
Moving expenses,
One half self employment tax,
Self employed health insurance deduction,
Keogh retirement plan and SEP deduction,
Penalty on early withdrawal of savings,
Alimony paid,
Total adjustments to income.
EQUALS: CORRECTED ADJUSTED GROSS INCOME
LESS: ITEMIZED DEDUCTIONS/STANDARD DEDUCTIONS (AS CORRECTED) AND PERSONAL EXEMPTIONS (AS CORRECTED)
EQUALS: CORRECTED TAXABLE INCOME
LESS: REPORTED TAXABLE INCOME
EQUALS: ADDITIONAL TAXABLE INCOME FOR CRIMINAL PURPOSES

Appendix E

9.5.9.7.4.1 (11-05-2004)

Total Deposits

(1) In the analysis of bank deposits, the sums deposited (or credited) to all of the subject's various accounts are totaled to determine gross deposits. This includes any interest and dividends credited to the subject during the investigation period. When the subject holds bank accounts in fictitious names, or with special titles such as trustee account or trading account, deposits to those accounts must also be included in the subject's total deposits. The analysis of bank deposits is not limited to bank checking and savings accounts, but includes deposits to:

a. Savings and loan accounts,

b. Credit union accounts,

c. Brokerage accounts (all credits to accounts),

d. Investment trusts,

e. Individual retirement accounts and Keogh plan accounts,

f. Certificates of deposits.

(2) If the subject itemized checks on a deposit slip and then deducted an amount for "less cash," only

the net amount deposited should be considered in computing income.

9.5.9.7.4.1.1 (11-05-2004)

Unidentified Deposits

(1) The source of individual deposits can often be identified by the subject's admissions, deposit slips, bank ledger sheets, transfer letters, bank microfilm, and the testimony of witnesses.

(2) In the event there are unidentified bank deposits, the following elements are required before treating unidentified bank deposits as current taxable receipts:

a. Evidence showing the existence of an income-producing business or activity,

b. Regular or periodic deposits having the inherent appearance of current receipts; occasional or irregular deposits may also be considered as current income if evidence supports this assumption.

(3) In the *Gleckman* investigation, deposits were principally derived from unidentified sources and the investigation was successfully prosecuted. It is far easier to present a bank deposits investigation to a jury when many of the deposits have been specifically identified as current

taxable income. For example, when multiple specific omitted sales are traced to the subject's bank accounts, but other deposits of a similar nature remain unidentified, the government's investigation is strengthened immeasurably. Through the specific identification of multiple omitted deposits, the special agent's assertion that unidentified deposits of a similar nature are current taxable income becomes more credible.

9.5.9.7.4.1.2 (11-05-2004)

Currency Deposits

(1) Currency deposits are subject to claims that the source of the deposits came from a cash hoard. If the subject raises this claim and it cannot be refuted, the amount of cash deposits in question must be included under "Non-income Deposits and Items" and subtracted from the bank deposits computation.

(2) However, this type of claim can often be refuted. By firmly establishing the beginning cash on hand, a special agent can rule out the cash hoard defense.

(3) The computation of gross receipts is based upon the assumption that most deposits are derived from a taxable source. The subject should be interviewed to determine whether or not there were any deposits made into the accounts from

non-taxable sources. The special agent should follow-up on any lead offered by the subject or uncovered during the course of the investigation that indicates certain deposits were from a non-taxable source.

9.5.9.7.4.1.3 (11-05-2004)

Starting Point

(1) In a bank deposits investigation, the starting point refers to the cash on hand at the beginning of the first year under investigation.

(2) Establishing a firm starting point is necessary in all bank deposits investigations involving cash deposits, currency expenditures, and increases or decreases in cash on hand. The special agent has the same obligation to firmly establish beginning cash on hand while employing the bank deposits method of proof as in the net worth method of proof. He/she is required to show that the income being charged to the subject is current taxable income and not funds accumulated in prior years in the form of a cash hoard. Additionally, establishing a firm ending cash on hand will enable the special agent to determine whether there has been an application of cash (in the investigation of an increase in cash on hand) and/or whether the subject has a source of non-taxable funds (in the investigation of a decrease in cash on hand). *(See IRM 9.5.9.5.5, Establishing the Starting Point.)*

Appendix E

9.5.9.7.4.1.4 (11-05-2004)

Brokerage and Security Accounts

(1) Deposits (credits) to a brokerage account are not treated any differently than any other type of deposits. However, when analyzing security account deposits, it is necessary to be familiar with what documents are available and with the terms associated with these statements. These include:

a. **Confirmation slips**—issued by brokerage houses to verify purchases and/or sale of stocks.

b. **Margin account**—a type of brokerage account through which the account holder is extended credit. Stocks can be purchased at a given percentage of their actual cost, the balance being owed to the brokerage firm. The account holder maintains a debit balance in this account.

c. **Cash account**—within a certain number of days (usually 3 banking days) after purchasing stocks, the account holder must remit the entire purchase price to the brokerage firm. No credit or debit balance is maintained.

d. **Street holdings**—an account holder can purchase stocks through his/her brokerage

firm and leave those stocks in the account. These shares are held by the brokerage firm on behalf of the account holder. The actual certificates being in the name of the brokerage firm. These stocks appear on the brokerage statements as security holdings or are noted as securities positions (PSN).

e. **Personal holdings**—after purchasing stocks through a brokerage firm, an individual may have those stocks delivered to him/her to become personal holdings. Certificates in the person's name are issued and sent to him/her along with a cover letter or securities delivered slip. Those shares will no longer appear on the brokerage statements as securities positions. Personal holdings of an individual must be traced through the appropriate stock transfer agent. Use the Moody's Handbook of Common Stocks as a reference to determine the stock transfer agent for a particular stock.

f. **Securities delivered**—noted as SEC DEL, indicates when the stocks were delivered or sent to the account holder to become personal holdings.

g. **Securities received**—noted as SEC REC, indicates when the account holder send funds to the brokerage firm to cover the purchase of stocks or a debit balance. It does not necessarily mean currency.

h. **Cash disbursed**—noted as CSH DSB, indicates when the brokerage firm issues a check to the account holder.

(2) One important difference between many brokerage statements and bank statements is that, when a stock is sold, the amount of the sale appears as a credit to the account on the date of the sale. If the account holder requests a portion of the proceeds of the sale to be paid to him/her by check, those proceeds are then shown as cash disbursed/check for that same date. The net deposit amount does not appear on the statement. When analyzing brokerage statements, the special agent must manually make the computation to net the deposit. Only the net amount should be picked up as a deposit.

9.5.9.7.4.2 (11-05-2004)

Cash on Hand Increase

(1) An increase in the subject's cash on hand is treated as a currency expenditure. Since the subject may contend that the unexplained deposits into the bank accounts came from a cash hoard, it is crucial to thoroughly establish and document any increase in the subject's cash on hand.

(2) The special agent must begin by documenting the cash on hand at the starting point and then

document cash on hand at the end of each year under investigation. The cash on hand increase (or decrease) is then determined for the first year of the investigation by subtracting the cash on hand at the starting point from the cash on hand at the end of the first investigative year. (Cash on hand decreases will be discussed later.)

(3) It is important to interview the subject early in the investigation to accurately identify a maximum cash accumulation for each year under investigation. *(See IRM 9.5.9.5.5.(11).)*

(4) All of this information is necessary to establish the consistency and reliability of the subject's statements. Usually, no direct evidence of cash on hand is available. Statements made about the source, amount, and use of funds can be corroborated or refuted with additional evidence.

9.5.9.7.4.3 (11-05-2004)

Non-Negotiated Instruments Purchased During the Year and Held at Year-End

(1) Non-negotiated instruments purchased or received during the year and held at the end of the year must be properly accounted for in the bank deposits formula. Non-negotiated instruments include:

a. Cashier's checks,

b. Money orders,

c. US savings bonds,

d. Travelers checks,

e. Non-negotiated income checks.

(2) When non-negotiated instruments are purchased by check, total deposits are increased by the amount of the non-negotiated instruments. Non-income items are increased by a like amount. This is similar to a transfer as money deposited in the bank is being converted to a non-negotiated instrument.

(3) If the subject receives a monetary instrument as a gift and has not negotiated it at year-end, total deposits and non-income items are each increased by the amount of the instrument.

(4) Total deposits are not increased to reflect the value of non-negotiated instruments purchased in currency. This amount is included as a currency expenditure in the bank deposits formula.

(5) Technically, if a cash basis subject received checks as income and had not negotiated them at year-end, they must be added to total deposits to accurately calculate income. The checks are income in the year they are received. However, if this is the subject's normal business procedure, then the relevance of this "timing" issue should be discussed with the Criminal Tax (CT) Counsel.

Appendix E

9.5.9.7.4.4 (11-05-2004)

Amounts Automatically Withheld from Wages

(1) Amounts that are automatically withheld from the subject's wages must be included when using the bank deposits method, unless they are included in deposits to another account. These items include withheld taxes, health and life insurance premiums, retirement fund contributions, savings account allotments, Federal Insurance Contributions Act (FICA), child support and or alimony payments, loan payments, and any other payroll deductions made by the employer for the benefit of the employee. The special agent should include only those items that are not included elsewhere in the computation. An example of an item that may appear elsewhere in the computation would be automatically withheld savings account allotments. These allotments would be picked up with the total deposits to the savings account.

9.5.9.7.4.5 (11-05-2004)

Currency Expenditures

(1) All documented cash expenditures, regardless of the source of the currency, are added to total deposits. Even in the most thorough investigations, there are certain currency expenditures that are impossible to document. These expenditures, i.e., groceries, laundry,

meals, gasoline, etc., cannot be added to total deposits unless they are fully documented. Only those currency expenditures which are documented, either directly or indirectly, can be included in the bank deposit computation.

(2) If the subject claimed business expenses on his/her return in excess of the amount of business expenses he/she paid by check, the balance should be treated as a cash expenditure and included in the bank deposits computation.

(3) If the subject alleges additional currency business expenses not claimed on the return, these should be allowed, after adding a like amount to the cash expenditures figure in the computation.

(4) Any documented expenditure made by the subject (business or personal) should be analyzed to determine what portion of that expenditure was made by check. If the amount of the expenditure exceeds payments made by check, the balance should be considered a cash expenditure and included in the bank deposits computation.

9.5.9.7.4.6 (11-05-2004)

Non-Cash Income Items

(1) In addition to currency expenditures, all non-cash items should be added to deposits. These items include:

a. Payments in kind,

b. Forgiveness of debts in lieu of payments,

c. Property received in lieu of payments,

d. Constructive dividends,

e. Accounts receivable increase, if the subject is on the accrual basis.

9.5.9.7.4.7 (11-05-2004)

Non-Income Deposits and Items

(1) All potential nontaxable sources of funds should be discussed with the subject during the initial interview. If the subject refuses to communicate with the special agent outside the presence of an attorney, consider contacting the subject's attorney. Explain to the attorney that if their client has received funds from nontaxable sources that could explain the apparent understatement of income, it would be to the subject's advantage to come forward with this information.

(2) It is the government's responsibility to elicit all available information concerning the subject's claims as to his/her nontaxable sources of funds. The special agent should attempt to obtain this information early in the investigation. The sooner the subject's claims can be verified or refuted, the

sooner the special agent can determine whether or not there is a viable investigation.

(3) All potential nontaxable sources of funds should be thoroughly investigated by questioning the subject's spouse, relatives, friends, and associates.

(4) The special agent should examine all available documents, i.e., (banking records, public records etc.,) and follow-up leads that could identify potential nontaxable sources of income and/or commingled funds.

(5) The special agent should determine the source or disposition of funds related to the acquisition and/or sale of assets.

(6) Nontaxable items will often appear as large or unusual deposits in the bank accounts.

(7) All funds from nontaxable sources must be accounted for when using the bank deposits method of proof to calculate the subject's potential understatement of income.

(8) Deducting nontaxable funds ensures that all deposits, cash expenditures, and increases in cash on hand which are included in the subject's gross income are derived from taxable sources. Failure to eliminate all known non-income deposits and items results in an overstatement

of income and could prove fatal to the criminal investigation. Examples of non-income deposits and items include:

a. Income earned in prior years,

b. Cash on hand decrease,

c. Loan proceeds received,

d. Repayments of loans made to others,

e. Gifts,

f. Inheritances,

g. Re-deposited items,

h. Transfers between accounts,

i. Return of capital,

j. Cashed third party checks,

k. Checks to cash and currency withdrawals,

l. Other non-income deposits and items specifically excluded by the USC,

m. Life insurance proceeds,

n. Tax-exempt interest,

o. Federal income tax refunds,

p. US savings bonds redeemed (cost basis),

q. Social Security payments,

r. Veterans' benefits,

s. Nontaxable portion of pensions and annuities,

t. Payments made to individual retirement accounts.

9.5.9.7.4.7.1 (11-05-2004)

Checks to Cash and Currency Withdrawals

(1) Currency withdrawals from accounts and checks payable to cash are generally treated as non-income items and must be discarded when computing gross income. Unless there is strong evidence to the contrary, the government usually cannot disprove the defense that the currency was:

a. Re-deposited by the subject later in the tax period,

b. Used as a source of currency expenditures already included in the bank deposits computation,

c. Used for a business expense paid in currency not previously claimed,

d. Used to increase cash on hand.

9.5.9.7.4.7.2 (11-05-2004)

Automated Teller Machines and Debit Card Transactions

(1) Automated Teller Machines (ATM) withdrawals are considered to be currency withdrawals. However, when an ATM card is used as a debit card to pay a merchant, the amount debited and paid to that merchant is not considered a currency withdrawal. (This is really an electronic check.)

9.5.9.7.4.8 (11-05-2004)

Cash on Hand Decrease

(1) Cash on hand is one of the most common and troublesome areas in any indirect method computation. Because a cash hoard defense is so difficult to refute, subjects frequently claim their cash hoard was of a sufficient amount to account for any understatement of income. The special agent must anticipate this potential defense and be able to prove that the subject had a large sum of cash which is not represented in the bank deposit computation.

(2) Evidence that may negate the existence of a cash hoard includes:

a. Written or oral admissions of the subject to the special agent(s) which indicate a small amount of cash on hand,

b. Financial statements prepared by the subject showing a low net worth,

c. Compromises of overdue debts by the subject,

d. Foreclosure proceedings against the subject,

e. Collection actions against the subject,

f. Tax return (or no returns filed) indicating little or no income in prior years,

g. Loan records,

h. Consistent use of checking and savings accounts,

i. Recurring overdraft on NSF charges or other bank penalties,

j. Minimum payments on credit card balance.

(3) It may be possible to reconstruct the subject's cash on hand from prior earnings records. If cash

on hand for an earlier period can be reasonably established, income earned from that period forward to the starting point could be used to establish a maximum available cash on hand. (*See IRM 9.5.9.5.5.1, An Indirect Approach for Establishing a Starting Point.)*

(4) If an investigation discloses an increase or decrease in cash on hand during the prosecution period, an adjustment to the bank deposits formula must be made. If there is an increase to cash on hand, it is added to deposits and currency expenditures in the bank deposits computation; at the same time, any decrease in cash on hand is considered a non-income item.

9.5.9.7.4.9 (11-05-2004)

Loan Proceeds

(1) Loan proceeds received by the subject must be accounted for as a non-income item. The key word in the above sentence is "received." The subject must have physically received the funds.

(2) If a subject has a mortgage on his/her home, the mortgage was paid directly by the lender to the seller of the home. Since no funds passed through the subject's hands, there is no need to account for any loan proceeds in this transaction.

(3) However, if the subject had obtained a loan from a lender and actually received the loan amount

in cash, a check that was subsequently cashed, or by way of a transfer of funds to the subject's account, the loan proceeds must be accounted for as a non-income item.

9.5.9.7.4.10 (11-05-2004)

Loan Repayments Received

(1) If the subject made a loan in prior years and contends that part of the understatement of income is in fact a repayment of that loan, the special agent must document the repayment of principal by contacting the borrower. All repayments of principal loaned by the subject should be treated as a non-income item.

9.5.9.7.4.11 (11-05-2004)

Gifts and Inheritances

(1) Monetary gifts, cash, checks, etc. must also be included as a non-income item in the bank deposits formula.

(2) The special agent should document the gift and determine whether the donor was financially able to make the gift. Obtain all of the necessary documents and other information from the donor. Check for filed gift tax returns, if applicable.

(3) If the subject received an inheritance, obtain all necessary documents and information from

the executor or administrator of the estate to verify the inheritance. Check for filed estate tax returns and check the probate records of deceased relative's estate. Any such inheritance is also treated as a non-income item.

9.5.9.7.4.12 (11-05-2004)

Transfers Between Accounts

(1) Transfers between accounts should be classified as non-income items.

(2) A subject who maintains several accounts, or one who has opened and closed accounts during the years under investigation, generally will have transfers between accounts. A detailed examination of deposit slips and account statements should be made to determine all possible transfers between accounts.

9.5.9.7.4.13 (11-05-2004)

Return of Capital

(1) Generally, any return of capital is classified as a non-income item in the bank deposits method. However, the treatment of assets sold in a bank deposits investigation differs depending on the nature of the asset, i.e., whether it was a personal asset, a business asset, or stock.

(2) When the subject sells a personal asset there is no allowable loss relative to the transaction. Instead, such transactions are treated as a return of capital which is limited to the cost basis or adjusted basis of the asset, if there is a gain, or the sale price if there is a loss. The following example is an illustration:

> If the subject purchased a vehicle in 1995 for $20,000 and sells it in 1996 for $15,000, the special agent would treat the $15,000 as a return of capital in the bank deposits formula for 1996. If the subject managed to sell the same vehicle for $30,000, the special agent would allow the subject a $20,000 return of capital reduction to the bank deposits computation.

(3) The above stated tax treatment applies only to personal assets that are sold. Using the same example above, if the subject traded in the 1995 vehicle on a 1999 model that cost $30,000, there is no return of capital. The subject did not physically receive the money. The return of capital was rolled into the new vehicle.

(4) The sale of a business asset or of stock is treated somewhat differently because it can result in an allowable taxable loss. The proper way to treat these assets is to use the cost (or adjusted basis) as the return of capital.

(5) When stocks and/or other business assets are sold, and the sale results in a net capital loss, that loss must be limited to $3,000 in accordance with USC loss limitations. This is done by adding back any disallowed loss to the bank deposits formula. See ADD: Capital losses exceeding $3,000 in the formula. *(See IRM 9.5.9.7.4, Complete Bank Deposits Method of Proof Formula.)*

(6) In order to compute the return of capital on a stock transaction, the special agent must first determine the subject's basis in the stock. If the stock sale (gain or loss) was reported on the subject's return, use the method the subject elected on their return when computing the gain or loss for the stock transaction.

(7) If stock sales are not reported on the return, and stock sales have been made during the period under investigation, the special agent should analyze any available evidence and determine if it is possible to identify the shares that were sold. If the subject only bought the stock on one occasion, then multiply the number of shares purchased by the purchase price and add in the sales commission. The total is divided by the number shares purchased to arrive at the basis per share. This figure is then multiplied by the number of shares sold to arrive at the basis for the shares sold. This figure is then subtracted from the sales price realized, not including the sales commission, and the resulting figure is the subject's gain or loss on the sale.

(8) An attempt to identify the shares sold can also be made by contacting the brokerage firm and comparing the date on the stock certificates being held with the information available on the statements. An example of this would be if the subject purchased 200 shares of SAYS stock in January 1996 with a basis of $10 per share. Then, in February 1996, the subject purchases 50 more shares of stock with the basis of $5 per share. In March 1996, the subject sells 100 shares of stock. It cannot automatically be assumed the 100 shares sold were the initial 100 shares purchased. However, if the brokerage firm is contacted and they are holding only the certificate for the 50 shares purchased in February 1996, then it can be concluded that the subject did indeed sell the initial 100 shares purchased.

(9) If the brokerage firm is not holding the stock certificates, and the special agent cannot determine from the available records which shares were sold, the special agent must resort to computing the gain or loss using the method which is most advantageous to the subject. This involves computing the basis of the stock using the Last-in, First-out (LIFO), First-in, First-out (FIFO), and Average methods. The sales commission should be included when computing the basis of the stock purchased. However, when stock is sold, the commission is not included in the computation. This computation is only made when the basis of the stock cannot determine the basis from available records.

Appendix E

9.5.9.7.4.14 (11-05-2004)

Cost of Goods Sold

(1) When dealing with a subject who reports business activity through a Schedule C, it may be necessary to include a cost of goods sold computation when utilizing the bank deposits method.

(2) A reduction in inventory is a situation where there is a deduction and no cash outlay. Whenever inventories are a factor in determining income, it is necessary to make an adjustment for changes in inventory, unless the subject ignored them on the return. This requires that the special agent compute the cost of goods sold. This is done by adding purchases to the beginning inventory and subtracting the ending inventory. The cost of goods sold is then included in the computation of gross income. These steps are illustrated in the bank deposits formula.

9.5.9.7.4.15 (11-05-2004)

Business Expenses

(1) All business expenses and costs must be allowed to the subject whether paid by check or in cash. If the analysis of checks or other evidence leaves doubt about the disbursements, it is preferable to allow all items, except those which are undeniably nondeductible, i.e., items such as personal expenses, investments, and gifts. When

canceled checks are not available for analysis and classification, every effort should be made to identify any and all items which constitute allowable expenses whether paid out of a bank account or from undeposited cash.

(2) Often, the total business expenses on a Form 1040, Schedule C will exceed the expenses for which checks or specific evidence of cash disbursements are found. In these instances, the amounts claimed by the subject should be allowed by assuming the difference was paid in cash. Increasing currency expenditures in the bank deposits formula offsets the effect of allowing business expenses paid in cash as a deduction.

(3) If personal or capital expenditures are improperly classified as business expenses, the deduction for business expenses will be overstated, gross receipts will be unaffected, and net taxable income will be understated. Without proof that personal or capital items were claimed fraudulently as business expenses, they cannot be disallowed.

(4) The allowable depreciation on all known depreciable assets must also be deducted. Depreciation is treated separately, since this is a deduction from which no cash outlay is required in the year the deduction is taken.

Appendix E

9.5.9.7.4.16 (11-05-2004)

Adjustments to Income

(1) All the available adjustments to income must be allowed in computing adjusted gross income. This would include applicable Individual Retirement Plan (IRA), Keogh and Simplified Employee Pension Plan (SEPP) deductions, moving expenses, one half of the self employment tax deduction, the self employed health insurance deduction, penalty on early withdrawal of savings, and alimony paid.

9.5.9.7.4.17 (11-05-2004)

Personal Deductions and Exemptions

(1) All allowable personal deductions, itemized or standard, and exemptions must be deducted from adjusted gross income to arrive at taxable income.

(2) Per statute, itemized deductions and personal exemptions may be subject to limitation or phase out depending on the subject's income. The special agent should make adjustments to these amounts as necessary.

Appendix E

9.5.9.7.4.18 (11-05-2004)

Technical Adjustments

(1) In a criminal investigation, reported taxable income can be increased only by the amount of the criminal adjustments. If an error was made in the preparation of a subject's return and income is understated, the amount must be included as a non-income item in arriving at taxable income for criminal purposes.

(2) If the subject unintentionally overstated expenses, no adjustment is necessary. The subject would be allowed the expenses per the return. Each non-fraud item must be separately allowed as claimed on the return or as corrected whichever is to the best interest of the subject. Technical adjustments in favor of the government cannot be made, offset, or netted against technical adjustments in favor of the subject.

9.5.9.7.5 (09-03-2020)

Schedules and Summaries in Bank Deposits Investigation

(1) Schedules and summaries are illustrative of those which may be submitted during trials when the bank deposits method of proof is used.

(2) An analysis of deposits is the vital part of a bank deposits investigation and too much importance cannot be placed upon its accuracy.

Appendix E

9.5.9.7.6 (11-05-2004)

Defenses in Bank Deposits Investigation

(1) The chief defense contentions in bank deposits investigations (other than lack of criminal intent) are:

a. That the sporadic nature or unconventional amounts of the deposits indicate that prior accumulated funds, not current receipts, or non-taxable funds are involved,

b. That the deposits reflect, in whole or in substantial part, non-income items or income items attributable to other years,

c. That the deposits are a duplication of current year income items already accounted for by the subject.

(2) The proof concerning what cash a subject had on hand at the beginning of the taxable year in question is relevant to the bank deposits method of proof.

(3) If the deposits or expenditures are from funds accumulated in prior years, they do not represent current income.

(4) The lack of proof of the amount of cash on hand would not preclude prosecution if all the requirements are met set forth in IRM 9.5.9.7.4.8, Cash on Hand Decrease.