



TAX LITIGATION ISSUES

Expert Analysis

Uncharged Act Evidence In Criminal Tax Cases

Rule 404(b) of the Federal Rules of Evidence prohibits the admission at trial of evidence of other crimes, wrongs or acts when offered to prove the “character of a person in order to show action in conformity therewith” or a propensity to commit a crime. Such evidence is admissible for other purposes, however, including proof of motive, opportunity, intent, preparation, plan, knowledge, identity, or absence of mistake or accident.

Anyone who tries criminal cases knows the devastating impact of Rule 404(b) evidence. In a close case, prosecutors frequently attempt to offer such evidence, and while jurors are presumed to follow the court’s limiting instructions, human nature suggests that the evidence will inevitably taint their perception of the defendant.

Rule 404(b) evidence is especially problematic in criminal tax cases where the government bears the heightened burden of proving that the defendant acted willfully. While prosecutors will often offer evidence under Rule 404(b) purportedly to demonstrate that the defendant violated a known legal duty, the defendant suffers the prejudice associated with the perception that he is generally a tax cheat. Thus, threshold questions of the admissibility of Rule 404(b) evidence looms especially large in criminal tax cases.

Two recent district court decisions, one from the Eastern District of New York, demonstrate the broad scope of evidence the government attempts to offer in criminal tax cases and the careful analysis applied by

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district judges ruling on the admissibility of such evidence.

Second Circuit Approach

The U.S. Court of Appeals for the Second Circuit takes an “inclusive approach” to other acts evidence, allowing for its admission “for any purpose except to show criminal propensity” unless its probative value is substantially outweighed by its potential for unfair prejudice.¹ Thus, a prosecutor attempting to offer Rule 404(b) evidence must first identify a permissible purpose for presenting the evidence and then persuade the district judge that the defendant will not be unfairly prejudiced by the evidence. Moreover, evidence offered under Rule 404(b) to show the defendant’s knowledge or intent

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“must be ‘sufficiently similar to the conduct at issue to permit the jury’ to draw a reasonable inference of knowledge or intent from the prior act.” Such similarity is measured by the degree to which the prior act “approaches near identity with the elements” of the acts charged in a criminal case.²

In *United States v. Ellett*,³ the defendant James Ellett was charged with income tax

evasion and failure to file an income tax return. At trial, the district court allowed the government to present evidence of the defendant’s federal and state tax history for years not charged in the indictment. In reviewing these evidentiary rulings on appeal, the Second Circuit noted the deference to be afforded the trial judge: in order to obtain a reversal, the defendant must persuade the appellate court that the trial judge abused his discretion and acted “in an arbitrary and irrational fashion” in admitting Rule 404(b) evidence.

The court rejected Mr. Ellett’s challenge in a summary order, noting that a defendant’s past taxpaying record is admissible as circumstantial evidence of willfulness. Although Mr. Ellett’s defense at trial (that he did not believe he was obligated to pay taxes) was not inconsistent with his historical failure to file, the court followed a line of cases holding that the failure to file returns in the past is evidence of an intent to evade: “Ellett’s failure to pay federal income tax in uncharged years was undoubtedly relevant because it tended to show that his failure to pay tax in the charged years was willful—that is, that he ‘knew of [his] duty, and that he voluntarily and intentionally violated that duty.’”⁴ Accordingly, the district court did not abuse its discretion in allowing the government to submit the uncharged acts evidence.

The Second Circuit also has held that although it is the generally “favored practice” to require the government to wait until its rebuttal case to present similar act evidence, such evidence may be admissible in the government’s case-in-chief where it is apparent that the defendant will dispute the issue of willfulness. For instance, before the admission of any evidence, a defendant may propose jury instructions raising the issue of intent or may raise the issue during

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the cross-examination of a government witness. In these situations, a court is within its discretion to allow the government to submit other act evidence before the defendant has presented his case.⁵

'United States v. Cadet'

Recently, in *United States v. Cadet*,⁶ Judge Nicholas G. Garaufis of the U.S. District Court for the Eastern District of New York considered the admissibility of several types of uncharged acts. In *Cadet*, the defendant Joseph Cadet was charged with aiding and assisting the preparation of false tax returns in violation of 26 U.S.C. §7206(2) based on allegations that he had obtained unwarranted tax refunds for his clients by claiming improper deductions on their tax returns. At trial, the government sought to introduce evidence (a) that Mr. Cadet did not file his personal tax returns from 2002 through 2005; (b) that his business entities did not file returns from 2003 through 2005; and (c) that he paid his employees in cash and failed to report their earnings as well. The prosecution argued that this evidence showed that Mr. Cadet acted willfully in preparing fraudulent tax returns for his clients and intended to defraud the government. Mr. Cadet responded that the evidence was irrelevant and would "invite[] the inference that he was 'generally a cheater when it came to taxes.'"

While finding that the government had offered a valid non-propensity purpose for offering the tax history evidence, the court nevertheless held that evidence regarding Mr. Cadet's failure to file personal tax returns was only "marginally relevant" to the issue of whether he acted willfully in the preparation of false tax returns for his clients. "Failing to file one's personal tax forms lacks the requisite 'substantial similarity' to fling forms containing false information on behalf of others." Rather, the court opined that evidence regarding the defendant's personal tax history would only demonstrate that he had engaged in other misconduct with the IRS and, therefore, had a propensity to disregard the tax laws—exactly the sort of evidence prohibited by Rule 404(b).

The government also sought to present evidence of interactions between Mr. Cadet and an undercover agent posing as a taxpayer

in need of tax return preparation. The proposed evidence showed that, after preparing a return that reported tax liability of more than \$3,000, Mr. Cadet offered to take another look at the return using more "creative financing" for a higher fee. After the agent took the bait, Mr. Cadet prepared a second return which calculated the agent's entitlement to a refund of more than \$2,400.

The government argued that this evidence is admissible, despite the fact that Mr. Cadet's preparation of the agent's return was not charged in the indictment, because it showed Mr. Cadet's *modus operandi*, motive and intent. The court found that, unlike the defendant's personal tax history, there was "sufficient similarity" between the charged conduct and the uncharged acts. "Both acts involve [d]efendant's preparation of false returns for others in exchange for a fee, and the [g]overnment claims that [d]efendant's conduct with the agent is identical to his conduct with his other clients."⁷

Considering the non-propensity purposes of the evidence proffered by the government, the court found that it was relevant to the issue of willfulness and to rebut claims that Mr. Cadet had relied on inaccurate information provided by his clients or had made a mistake. By contrast, Judge Garaufis rejected the government's argument that the evidence demonstrated Mr. Cadet's *modus operandi*, finding it lacked proof of "idiosyncratic details" similar between the charged and uncharged acts. "The general similarities claimed by the [g]overnment—[d]efendant's asking for a higher fee in exchange for including false deduction—is not 'so unusual or distinctive as to be like a signature.'"⁸

Finally, Mr. Cadet argued that the undercover agent's evidence should be excluded under Federal Rule of Evidence 403, which provides for the exclusion of relevant evidence "if its probative value is substantially outweighed by the danger of unfair prejudice." Finding the uncharged acts evidence to be highly probative on a number of issues, the court opined that the risk of unfair prejudice was small given that Mr. Cadet's interactions with the undercover agent were no more "sensational or disturbing" than those acts charged in the indictment. Further, to prevent any possible prejudice, the court noted it would provide a limiting instruction to the jury, requiring it to consider the

evidence only for the permissible purposes for which it was admitted.⁹

'United States v. Reiss'

In excluding the evidence of Mr. Cadet's personal tax history, Judge Garaufis cited *United States v. Reiss*,¹⁰ a case from the U.S. District Court for the District of Minnesota that further demonstrates the variety of Rule 404(b) evidence that can be at issue in criminal tax cases. In *Reiss*, the defendant, Richard

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E. Reiss, also a tax preparer, was charged under §7206(2) with aiding the preparation and fling of 86 false tax returns. Before trial, the defendant moved in limine to preclude the government from presenting evidence of uncharged acts, both in its case-in-chief and in rebuttal.

First, the government sought to offer evidence that, in a separate action, Mr. Reiss had agreed to pay penalties to the IRS for understating tax liability on his clients' tax returns for the years 1984 through 1986 due to negligence or intentional disregard of internal revenue rules and regulations. The government also sought to offer evidence that the IRS had imposed civil penalties against Mr. Reiss for willfully or negligently overstating deductions in some returns he prepared in 1986 and 1987. The government sought to use the evidence in its case-in-chief to demonstrate Mr. Reiss' knowledge of the unlawful nature of his conduct.

Rejecting the defendant's arguments that the evidence should be excluded under Rule 404(b), the court found that the imposition and payment of civil penalties put Mr. Reiss on notice that his conduct violated federal law thereby showing his intent, knowledge and the absence of mistake. Mr. Reiss also objected that the civil penalties were not close in time to the offenses charged in the indictment. The court found that fact alone did not

render the evidence inadmissible, stating that “[c]ourts do not employ an absolute rule regarding the number of years that can separate offenses. Instead, they apply a reasonableness standard and examine the facts and circumstances of each case.”¹¹ On the basis of the similarity of the conduct for which Mr. Reiss paid civil penalties and the current charges, the court concluded that evidence of the uncharged acts was not prohibited by Rule 404(b).

Mr. Reiss further argued that the evidence should be excluded under Rule 403. The court rejected this argument, noting that “[w]hile the evidence of prior civil penalties is undoubtedly prejudicial, Rule 403 ‘is concerned only with unfair prejudice, that is, an undue tendency to suggest decision on an improper basis.’”¹² Given the significant probative value of the evidence, the court allowed for its admission, subject to a limiting instruction restricting the jury’s consideration of the evidence.

The government also sought to introduce evidence that two of Mr. Reiss’ clients had obtained a judgment against him relating to his preparation of their 1997-99 tax returns. Because those returns were the subject of two counts in the indictment, the court found that it “form[ed] an integral part of the crime charged” and therefore the admissibility of the evidence regarding Mr. Reiss’ interactions with the clients was not limited by Rule 404(b).¹³

The court, however, rejected the government’s attempt to present evidence that Mr. Reiss did not timely file his personal tax returns for several years. The court found that the evidence was only marginally relevant to the allegations against Mr. Reiss regarding tax returns he prepared for others, improperly showing only that he had a propensity to disregard tax law. Thus, the prior acts evidence involved conduct “markedly different” from that at issue in the instant case, and any probative value was outweighed substantially by the prejudicial impact of the evidence.

The government also contended that it should be allowed to use the untimely tax filings evidence in its rebuttal case to respond to Mr. Reiss’ claims that he relied on others for the expense amounts reported on the tax returns he had prepared. The court rejected this argument, stating that “the fact that Reiss fled his personal income taxes in an untimely manner over a decade prior to the charged offenses bears no relevance to Reiss’s credibility or character as it relates to the willful preparation of fraudulent tax returns.” Accordingly, the evidence also was inadmissible under Federal Rule of Evidence 404(a), which prohibits the admission of evidence of a person’s character or a trait of character for the purpose of proving action in conformity therewith on a particular occasion.

The third type of Rule 404(b) evidence the government sought to introduce in *Reiss* related to the state Board of Accountancy’s revocation of the defendant’s CPA license in 1994 because Mr. Reiss had obtained credit cards in the name of one of his clients and improperly used the cards to buy merchandise. The court excluded evidence regarding the facts underlying the suspension, noting that the information was only marginally relevant to and the conduct was “markedly different” from the charges alleged against Mr. Reiss in the indictment. Thus, the potential prejudice substantially outweighed its probative value.¹⁴ The court held, however, that if Mr. Reiss’ license had been revoked while he had engaged in the conduct at issue in the case, the government would be permitted to inform the jury of the fact of the license revocation (but not the underlying facts).

Conclusion

Individuals facing criminal tax charges may have separately resolved disputes with the IRS in an administrative or civil case or may have prior, apparently unrelated,

problems with their tax filings. In addition, the government may, in its discretion, choose not to include in the criminal case all potential charges. While eliminating such allegations from an indictment is obviously positive, it is not the end of the matter as the government may attempt to offer evidence of uncharged acts under Rule 404(b). Because of the inherent prejudice associated with such evidence, a pretrial ruling that it is admissible will often tilt the scales in an otherwise close case. As *Cadet* and *Reiss* demonstrate, the mere fact that the government must show the defendant acted willfully does not give it carte blanche to “dirty up” the defendant with marginal evidence.



1. *United States v. Bok*, 156 F.3d 157 (2d Cir. 1998). (The author represented the government in this case.)
2. *United States v. Aminy*, 15 F.3d 258, 260 (2d Cir. 1994); *United States v. Peterson*, 808 F.2d 969, 974 (2d Cir. 1987).
3. 278 Fed. Appx. 82 (2d Cir. 2008). The court also issued a per curiam decision addressing Mr. Ellett’s claim that the government was obligated to give him the chance to litigate his tax position civilly or administratively before prosecuting him for tax evasion. See 527 F.3d 38 (2d Cir. 2008).
4. Id. at 85 (citing *Cheek v. United States*, 498 U.S. 192, 201 (1991)).
5. *Bok*, 156 F.3d at 166.
6. 2009 WL 2959606 (EDNY Sept. 1, 2009).
7. Id. at *3.
8. Id. (citing *United States v. Oskowitz*, 294 F. Supp.2d 379, 382 (EDNY 2003)). The court also noted that the evidence would serve to corroborate the testimony of Mr. Cadet’s other clients as to their interactions with him. It is, however, unclear whether corroboration alone is sufficient to warrant admissibility under Rule 404(b).
9. Id. at *4.
10. 2005 WL 2337917 (D. Minn. June 9, 2005).
11. Id. at *2.
12. Id.
13. Id. at *3.
14. Id. at *4-5.

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