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# Easterday and the Erosion of the Financial Inability Defense

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# *Easterday* and the 'Inability to Pay' Defense for Tax Crimes

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This report concerns federal tax crimes involving willful failure to pay. There has been controvery for decades about whether and when the taxpayer-defendant's financial inability to pay the taxes may defeat conviction. The most recent judicial utterance on this question is the *Easterday* case in which a divided panel of the Ninth Circuit rejected the defense.

This report explores the controversy over the financial inability defense, and it traces the development of the willfulness element of tax crimes. The report concludes that, notwithstanding *Easterday*, the defense should remain viable in the right circumstances.

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Several tax crimes in the code involve failure to pay known or assessed tax liabilities. For generations, there has been controversy over whether a taxpayer's lack of funds from which to make payment should preclude conviction for those crimes. The potency of the financial inability defense[1] has waned over the years. The recent decision of a divided Ninth Circuit panel in *Easterday*[2] continues that trend, but the defense should still have life in some situations and some courts.

Part I of this report describes the tax crimes to which a financial inability defense may be relevant. Part II discusses *Easterday*. Part III traces the evolution of the defense and the willfulness element. Part IV analyzes the multiple views that have emanated from the courts on the existence and contours of the financial inability defense.

Finally, Part V evaluates whether the defense still has or should have any vitality. Prosecutors might attempt to read *Easterday* and other cases as unequivocally rejecting the defense, regardless of context. Part V refutes that absolutist position. Instead, it argues that context — especially the reason for a defendant's lack of funds — should matter a great deal. *Easterday* and other cases may have narrowed the range of acceptable reasons for financial inability, but they should not be viewed as having eliminated them. Although its sphere of activity has been circumscribed, the defense still has life.

## I. Relevant Crimes

The inability to pay defense potentially relates to several tax crimes.[3] One example is section 7201, which is usually applied against evasion of assessment of tax but is sometimes asserted for evasion of payment. Conviction under section 7201, a felony, carries the stiffest punishment of the applicable tax crimes but requires proof of at least one affirmative act of evasion.[4] Although courts have recognized many acts sufficient to meet this element,[5] mere failure to pay is not enough to support a conviction.[6]

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[1]Throughout this report, I use "defense" in a broad sense to include financial inability both as an avenue for negating an element of the prosecution's prima facie case and as an affirmative defense.

[2]The Ninth Circuit filed its original opinion on August 22, 2008. By an order dated April 27, 2009, the court amended its opinion but did not change its result. *United States v. Easterday*, 564 F.3d 1004 (9th Cir. 2009), *Doc 2009-9548, 2009 TNT 80-8*, *amending* 539 F.3d 1176 (9th Cir. 2008), *Doc 2008-18259, 2008 TNT 165-36*, *aff'g* 2007 WL 2023500 (N.D. Cal. July 12, 2007), *Doc 2007-16624, 2007 TNT 138-12* (denying motion for judgment of acquittal or for a new trial).

[3]For a detailed description of tax crimes under the code, see John A. Townsend, Larry A. Campagna, Steve R. Johnson, and Scott A. Schumacher, *Tax Crimes*, chs. 2A & 2B (2008).

[4]*E.g.*, *Spies v. United States*, 317 U.S. 492 (1943).

[5]*See* Townsend et al., *supra* note 3, at 20-27.

[6]Evasion of payment typically "involves conduct designed to place assets beyond the government's reach after a tax liability has been assessed," *United States v. Mal*, 942 F.2d 682, 687 (9th

**(Footnote continued on next page.)**

Section 7203 covers a variety of tax derelictions, including willful failure to pay tax or estimated tax. Compared with section 7201, section 7203 has both advantages and disadvantages for the government. Lacking an affirmative act requirement, section 7203 may be the easier charge on which to convict. As a misdemeanor, however, conviction under section 7203 may entail lesser punishment.

Section 7202 is a "fairly rarely invoked" felony.[7] It criminalizes willful failures to collect and pay over taxes to the IRS by persons under a legal obligation to do so. Typically, this involves businesses and their owners failing to collect and pay over income tax withholding or employment taxes. Section 7202 is the criminal analog of section 6672, the civil trust fund recovery penalty. In a down economy, these sections should be major concerns of business owners.

One reason for the relative rarity of section 7202 prosecutions is the difficulty of convincing juries of the defendant's willfulness. Juries are often sympathetic to an owner laboring to keep his struggling business afloat, even through the device of not paying over required taxes.[8] Accordingly, Congress enacted section 7215, which punishes as a misdemeanor some conduct that might also fall under section 7202. Section 7215 is linked to section 7512(b), which authorizes the IRS to notify persons responsible for withholding that they have failed to collect and pay over taxes and which compels compliance by those persons. Thereafter, continued failures are criminally punishable under section 7215.

## II. *Easterday*

Jack Easterday operated a chain of nursing homes through a parent corporation and subsidiaries. For periods between 1998 and 2005, the companies accurately reported total payroll tax liabilities of nearly $45 million, but they paid only about $26 million of those reported liabilities. Numerous IRS notices requesting payment and stating the IRS's intent to levy did not result in payment. Easterday cooperated with the IRS and took full responsibility for the delinquency but continued to have periods of nonpayment.[9] Presumably, Easterday's cooperative behavior helped persuade the government not to assert section 7201 violations against him.[10]

However, this behavior did not deter the government from prosecuting under a different section. In 2005 the government charged Easterday with 109 counts of failing to pay over taxes in violation of section 7202, each count representing a different quarter for the various companies. The government probably calculated that the large number of failures to pay, spread out over several years, would overcome the lack of jury appeal that, as noted in Part I, has sometimes caused the government to eschew section 7202 as the vehicle for prosecutions.

Easterday's defense was that he lacked the financial ability to pay the taxes. At trial, his witnesses testified that the nursing homes struggled financially, generating losses exceeding $20 million between 1996 and 2005. Easterday used whatever receipts the businesses produced to pay other bills to keep the nursing homes operating. Easterday asked the district court to give the following jury instruction:

> The word "willfully" means a voluntary, intentional violation of a known legal duty, and not through ignorance, mistake, negligence, even gross negligence, or accident. In other words, the defendant must have acted voluntarily and intentionally and with the specific intent to do something he knew the law prohibited; that is to say, with the intent either to disobey or disregard the law.
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> * * *
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> In the context of this case, in order for the government to meet its burden of willfulness beyond a reasonable doubt, it must prove that on the dates the taxes were due, the taxpayer possessed sufficient funds to be able to meet his legal obligation to the government or that the lack of sufficient funds on such date was created by (or was the result of) a voluntary and intentional act, without justification in light of the financial circumstances of the taxpayer.[11]

The second paragraph of the proposed instruction was derived almost verbatim from the Ninth Circuit's earlier decision in *Poll*.[12]

The court gave the requested instruction, but the jury found it confusing. The jurors indicated in a note that they were unclear as to the meaning of "without justification in light of all the financial circumstances of the taxpayer." The district court responded with an additional instruction:

> Evidence that the defendant caused the corporation to pay other expenses may be evidence that the defendant's failure to assure that the corporation paid its taxes was willful. Evidence that the defendant caused the corporation to pay other expenses in a particular quarter knowing that the taxes had not been paid in previous quarters and that funds would not be available to pay the taxes in the current quarter, may be evidence that the defendant's failure to assure that the corporation paid its taxes was willful.[13]

Easterday objected to this further instruction, arguing that it effectively eliminated his inability-to-pay defense under *Poll*. After the jury returned a guilty verdict, Easterday moved for a new trial on the same grounds.

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Cir. 1991), but "prior acts may suffice to prove evasiveness in particular circumstances," *United States v. McGill*, 964 F.2d 222, 229 (3d Cir. 1992), *cert. denied*, 506 U.S. 1023 (1992).

[7]*Easterday*, 564 F.3d at 1007. However, the government has been prosecuting under section 7202 more frequently in recent years.

[8]*See* U.S. Dep't of Justice, *Criminal Tax Manual*, section 9.03.

[9]*Easterday*, 564 F.3d at 1006.

[10]Lying to the IRS and engaging in other acts of deception are common affirmative acts asserted in section 7201 prosecutions. *E.g.*, *United States v. Beacon Brass Co.*, 344 U.S. 43, 44-46 (1952).

[11]*Easterday*, 2007 WL 2023500, at *1.

[12]*United States v. Poll*, 521 F.2d 329, 333 (9th Cir. 1975); *see infra* text accompanying note 67 for a discussion of *Poll*.

[13]*Id.*

The court granted the motion, and the case was transferred to a new judge for retrial.

At the second trial, the court refused to give Easterday's requested *Poll* instruction on the grounds that it failed to adequately reflect the state of the law and the evidence in the record.[14] Instead, the court instructed: "The tax laws do not permit an employer to choose to use the monies held in trust for the United States for other purposes, such as to pay business expenses."[15] However, the court did give a good-faith instruction that "the government had the burden of proving the defendant did not have a good faith belief that he was complying with the tax laws, and that defendant's belief could be in good faith even if it was unreasonable."[16] As a result, "all of the evidence admitted in the first trial was admissible in the second because it was relevant to defendant's good faith belief that he was not violating a known legal duty."[17] In other words, "the government still had to prove beyond a reasonable doubt that defendant did not believe that he could use the monies held in trust to pay other expenses, at least in his particular circumstances."[18]

At the conclusion of the second trial, the jury convicted Easterday on 107 of the 109 counts. He unsuccessfully moved for a judgment of acquittal or for a new trial, and he was sentenced to 30 months imprisonment, followed by three years of supervised relief.

Easterday appealed, urging that denial of his financial inability instruction at the second trial was in error. The Ninth Circuit panel disagreed, and it affirmed the conviction. The court rejected *Poll*, believing it to be inconsistent with the contemporary understanding of willfulness and "inconsistent with common sense, for we think it unlikely that . . . a defendant could succeed in arguing that he did not willfully fail to pay because he spent the money on something else."[19]

The panel then considered whether it was free to act on its disagreement with *Poll*. *Poll* (like *Easterday*) was a panel opinion. In general, panel opinions bind subsequent panels of a circuit until overruled by the full circuit.[20] An exception applies, however, when supervening authority is clearly irreconcilable with the panel opinion.[21] Two of the panel judges thought post-*Poll* Supreme Court decisions addressing the willfulness element (*Pomponio*[22] and *Cheek*[23]) constituted supervening authority, permitting *Poll* to be put aside.[24] One judge dissented, taking the view that *Poll* "is bad law" but nonetheless was controlling for the *Easterday* panel.[25] Easterday's petition for rehearing *en banc* was denied.[26]

## III. Evolution of the Financial Inability Defense

Willfulness is an element of all four of the tax crimes described in Part I, and ability to pay (or lack thereof) relates to that element, arguably either as part of the government's obligation to prove willfulness or as an affirmative defense. Part III sketches the early strength of the financial inability defense. It then traces the evolution of the willfulness doctrine generally. As noted in Part II, this evolution was key to *Easterday*.

### A. Early Strength of the Defense

The standard for willfulness decades ago was more felicitous to those accused of criminal nonpayment of tax than today's standard. This was so for three reasons: (1) former law required, as a condition of willfulness, that the defendant have an "evil" motive; (2) former law suggested that willfulness was a higher standard in felony cases than in misdemeanor cases; and (3) former law required more for willfulness in nonpayment cases than in cases of nonfiled returns.

*Evil motive*: In 1933 the Supreme Court stated that bad faith or evil intention is an element of criminal tax offenses.[27] This principle was sometimes implemented in a pro-defendant fashion. For instance, in one case involving section 7203 and its predecessor, the appellate court held that some facts — that the failure to pay was "stubborn, obstinate, and perverse," that it "was marked by careless disregard," and that it lacked justification — "neither singly nor cumulatively, are self-sufficient to establish 'willfulness.'"[28] The trial court had found that evil motive existed because the defendant "knowingly and intentionally defaulted nine times running without exception."[29] However, the circuit court reversed, saying: "A 'series of defaults' made 'knowingly and intentionally' may well be probative of the element of 'evil motive,' and strongly suggest its existence, but they do not . . . make 'inescapable' the 'conclusion' of its existence."[30]

In *Andros*, a section 7203 case, even the government conceded that "the element of willfulness must include some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer. . . . Mere laxity, careless disregard of the duty imposed by law, or even gross negligence, unattended by evil motive are not probative of the element of willfulness."[31]

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[14]A trial court may deny a proposed instruction if there is insufficient evidence in the record to support it. *E.g.*, *United States v. Meyer*, 157 F.3d 1067, 1074 (7th Cir. 1998).

[15]*Easterday*, 564 F.3d at 1007.

[16]*Easterday*, 2007 WL 2023500, at *2.

[17]*Id.* at *3.

[18]*Id.*

[19]*Easterday*, 564 F.3d at 1010.

[20]*E.g.*, *Ross Island Sand & Gravel v. Matson*, 226 F.3d 1015, 1018 (9th Cir. 2000) (per curiam).

[21]*Miller v. Gammie*, 335 F.3d 889, 900 (9th Cir. 2003).

[22]*United States v. Pomponio*, 429 U.S. 10 (1976) (per curiam).

[23]*Cheek v. United States*, 498 U.S. 192 (1991). *Pomponio* and *Cheek* are discussed in Subpart III.B *infra*.

[24]*Easterday*, 564 F.3d at 1010-1011.

[25]*Id.* at 1011-1015 (Smith, J. dissenting).

[26]*Id.* at 1005.

[27]*United States v. Murdock*, 290 U.S. 389, 398 (1933).

[28]*United States v. Palermo*, 259 F.2d 872, 880-881 (3d Cir. 1958), *rev'g* 157 F. Supp. 578 (E.D. Pa. 1957).

[29]*Palermo*, 157 F. Supp. at 582.

[30]*Palermo*, 259 F.2d at 880-881.

[31]*United States v. Andros*, 484 F.2d 531, 535 (9th Cir. 1973) (Ely, J., dissenting) (citing the government's brief) (citations omitted). For further discussion of *Andros*, see *infra* text accompanying notes 57-61.

*Felony versus misdemeanor*: A number of pre-*Poll* cases held that "willfully" had a more stringent meaning for tax felonies than for tax misdemeanors.[32]

*Nonpayment versus nonfiling*: In *Spies*, a landmark 1943 tax evasion case, the Supreme Court suggested that willfulness:

> may well mean something more as applied to nonpayment of a tax than when applied to failure to make a return. Mere voluntary and purposeful, as distinguished from accidental, omission to make a timely return might meet the test of willfulness. But, in view of our traditional aversion to imprisonment for debt, we would not without the clearest manifestation of Congressional intent assume that mere knowing and intentional default in payment of a tax where there had been no willful failure to disclose the liability is intended to constitute a criminal offense to any degree. We would expect willfulness in such a case to include some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer.[33]

### B. Evolution of Willfulness Doctrine

The above three aspects of prior law were undercut by the refinement of the willfulness element by a trilogy of Supreme Court cases. The first was *Bishop* in 1973, in which the Court reversed a defendant-favorable circuit court decision in a prosecution under section 7206(1) for willful filing of a false tax return.[34] The Court noted that the element of willfulness is common to the major tax crimes — whether felony or misdemeanor and whether for nonfiling, nonpayment, or other transgressions — and it remarked, "The word 'willfully' in these statutes generally connotes a voluntary, intentional violation of a known legal duty."[35] However, the Court clouded this meaning by citing with approval earlier decisions that had referred to bad motive or evil purpose.[36]

The second case was *Pomponio*,[37] in which the Court confirmed the *Bishop* holding that willfully has the same meaning in all the tax crime sections.[38] The Court also removed the confusion left by *Bishop*. The *Pomponio* Court noted the references to phrases like "bad faith," "evil intent," "evil motive," and "want of justification" in prior decisions. However, it stated, "Our references to other formulations of the standard did not modify the standard. . . . Willfulness in this context simply means a voluntary, intentional violation of a known legal duty."[39]

The final case of the trilogy was *Cheek*.[40] *Cheek* settled the general definition of willfulness for purposes of the tax crimes, slamming the door on some of the earlier constructions of the term. *Cheek* held:

> Taken together, *Bishop* and *Pomponio* conclusively established that the standard for the statutory willfulness requirement is the "voluntary, intentional violation of a known legal duty." . . . Willfulness, as construed by our prior decisions in criminal tax cases, requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of the duty, and that he voluntarily and intentionally violated that duty.[41]

*Easterday* was not the first case in which the Ninth Circuit followed the trilogy's definition or clarification of willfulness.[42] One prior decision attempted to harmonize the trilogy and earlier cases. It stated: "The government may prove willful conduct by establishing either: (1) that the defendant acted with a bad purpose or evil motive, or (2) that the defendant voluntarily, intentionally violated a known legal duty."[43] Of course, this is just window dressing. The two prongs are in the disjunctive, and the second swallows the first. The second will always be present when the first is, but the converse is not true. Thus, this dual formulation makes bad purpose or evil motive a dead letter as a practical matter.[44]

Not surprisingly, therefore, it was clear in the Ninth Circuit, well before *Easterday*, that the trial court need not include bad faith or evil motivation in a willfulness instruction.[45] Appropriately, then, the *Poll* instruction sought by Easterday did not include these notions.[46]

## IV. Divergent Views on the Defense

Part IV describes some of the important cases, especially circuit court cases, in the uneven path of the financial inability defense. Part V will build on this foundation to evaluate the current vitality of the defense.

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[32]*E.g.*, *United States v. Fahey*, 411 F.2d 1213, 1214 (9th Cir.), *cert. denied*, 396 U.S. 957 (1969) (section 7203 case); *Abdul v. United States*, 254 F.2d 292, 293-294 (9th Cir. 1958) (section 7203 case).

[33]*Spies v. United States*, 317 U.S. 492, 497-498 (1943); *see also United States v. Voorhies*, 658 F.2d 710, 715 (9th Cir. 1981); *United States v. Jannuzzio*, 184 F. Supp. 460, 469 (D. Del. 1960).

[34]*United States v. Bishop*, 412 U.S. 346 (1973).

[35]*Id.* at 360.

[36]*Id.* at 360-361.

[37]*Pomponio*, 429 U.S. 10 (1976) (per curiam).

[38]*Id.* at 12. Although pleasingly symmetrical, this result was not compelled by statutory construction. There is a "consistent meaning" canon under which courts often give the same meaning to the same word appearing in different subsections of a statute or even in different, but related, sections. *E.g.*, *Ratzlaf v. United States*, 510 U.S. 135, 143 (1994). However, with comparable frequency, courts give different meanings to the same word in different places. The consistent meaning canon is honored in the breach about as often as in the observance. *See,*

**(Footnote continued in next column.)**

*e.g.*, Steve R. Johnson, "Supertext and Consistent Meaning," *State Tax Notes*, May 25, 2009, p. 675, *Doc 2009-9545*, or *2009 STT 99-4*.

[39]*Pomponio*, 429 U.S. at 12.

[40]498 U.S. 192 (1991).

[41]*Id.* at 201.

[42]*See, e.g.*, *United States v. Bishop*, 291 F.3d 1100, 1106 (9th Cir. 2002), *Doc 2002-13125*, *2002 TNT 114-12*, *cert. denied*, 537 U.S. 1176 (2003); *United States v. Gilbert*, 266 F.2d 1180, 1185 (9th Cir. 2001), *Doc 2001-24707*, *2001 TNT 188-21*.

[43]*United States v. Powell*, 955 F.2d 1206, 1211 (9th Cir. 1992).

[44]*Cf. United States v. Hawk*, 497 F.2d 365, 368 (9th Cir. 1974), *cert. denied*, 419 U.S. 838 (1974) (concluding that neither bad purpose nor evil motivation is an independent element of willfulness).

[45]*E.g.*, *Powell*, 955 F.2d at 1210; *United States v. Kelley*, 539 F.2d 1199, 1204 (9th Cir. 1976), *cert. denied*, 429 U.S. 963 (1976).

[46]*See supra* text accompanying note 11.

The financial inability defense persists in some quarters despite the Supreme Court willfulness trilogy. Some pretrilogy precedents remain, having not been renounced by the courts that decided them or by higher courts. Also, new decisions embracing or implying the validity of the defense were issued after one, two, or even all three of the trilogy cases had been handed down. Here are some of the milestones along the evolutionary path of this issue.

In the seminal *Spies* case, the Supreme Court referred to "want of justification in view of all the financial circumstances of the taxpayer."[47] This opened the door for lower courts to develop, or at least explore the possibility of, a financial inability defense.

Some courts responded enthusiastically to that invitation. An example is *Goodman*, a 1961 district court case.[48] A lawyer had failed to pay income taxes for 10 straight years. The government charged him under section 7203. The court held that the evidence was insufficient to sustain the charge, finding that the lawyer's behavior "did not indicate a consistent program of divestment of assets and attachable income with a purpose of defeating tax collection. For the most part these circumstances reflect the defendant's insolvency."[49]

The government had complained that the defendant had used borrowed money to pay other creditors in preference over the government. The court firmly rejected this argument: "I think it is obvious that there is no requirement that a person must borrow money or agree to an assignment of his fees [from his legal practice] in order to pay his income tax liabilities, nor is there any requirement that a person prefer the government as a creditor."[50]

A prominent evasion of payment jury trial also deserves mention. Robert "Bobby" Simone was a criminal trial lawyer who had defended many of the prominent organized crime figures in the Philadelphia area. He was indicted under section 7201 for evading payment of more than $900,000 of income tax over nine years, the government contending that he had used many means to conceal his ownership of various assets.[51] This 1984 prosecution was the first evasion of payment case the government had brought in Philadelphia.[52]

> The key to [Simone's] defense was his self-portrait of a compulsive gambler. . . . [He] produced two psychiatrists and one psychologist who agreed that his gambling had turned him into a man out of control. While the lawyer was neither insane nor suffering from a major mental illness, neither was he a man who had willfully evaded paying taxes, they concluded.[53]

There was also a financial inability aspect to Simone's defense. He argued that because of his gambling he had a negative net worth, and he "used the money to pay other creditors,"[54] specifically, the underworld figures from whom he borrowed money to gamble. As Simone put it: "Who was I supposed to pay, the IRS or the loan sharks? The interest is about the same, the health aspect is a little different."[55]

One interesting aspect of *Simone* is that the court — after two of the trilogy cases had been handed down — allowed the defense to present the financial inability defense. Another interesting aspect is that the various defenses succeeded. After a two-week trial that included testimony from about 70 witnesses, the jury took less than two hours to find Simone not guilty.[56]

The pre-*Easterday* course of the financial inability defense in the Ninth Circuit includes *Andros*, a section 7203 opinion issued about three months after *Bishop*, the first case of the trilogy.[57] The *Andros* court held: "To establish the offense of a willful failure to pay the taxes assessed, the Government was required to prove that the financial circumstances of the taxpayer were such that . . . the taxpayer possessed sufficient funds to be able to meet his legal obligation to the Government."[58]

Although *Andros* recognized the defense, the defendant did not prevail. The circuit court was reviewing a jury verdict in favor of the government, so it read the record in the light most favorable to the government.[59] The defendant offered no evidence himself and instead tried to establish his financial inability only through cross-examination. The majority concluded that he had not succeeded in doing so.

One of the judges thought the defendant had succeeded, however, and voted to reverse the conviction. That judge thought the cross-examination showed that the taxpayer was:

> a gambler, that he had habitually followed the practice of "kiting" checks, that he was overdrawn in one of his bank accounts to the extent of $27,000, overdrawn in other bank accounts to the extent of $35,000, indebted to the extent of $9,100 because of this check kiting activity, indebted to one Alessio in the sum of $23,500, and indebted to a horse [race track] in the amount of $15,000. There was also evidence of other debts owed by Andros, including one of $30,000 that arose from a loan from his mother and which was evidenced by a mortgage.[60]

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[47]317 U.S. at 498.

[48]*United States v. Goodman*, 190 F. Supp. 847 (N.D. Ill. 1961).

[49]*Id.* at 857.

[50]*Id.* at 856.

[51]Jim Smith, "Mob Lawyer Indicted in Tax Fraud," *Phila. Daily News*, Mar. 1, 1984, at 3.

[52]Michael D. Schaffer and Frederic N. Tulsky, "Robert F. Simone, Defense Lawyer, Acquitted of Income-Tax Evasion," *Phil. Inquirer*, July 24, 1984, at B03.

[53]Fredric N. Tulsky, "'A Lawyer of Notoriety,' v. the IRS," *Natl L.J.*, Aug. 6, 1984, at 8.

[54]Smith, *supra* note 51.

[55]Kit Konolige, "Lawyer's Gambling He'll Win Own Case," *Phila. Daily News*, July 11, 1984, at 6.

[56]Schaffer and Tulsky, *supra* note 52.

[57]*Andros*, 484 F.2d 531 (9th Cir. 1973).

[58]*Id.* at 533-534.

[59]*Id.* at 534.

[60]*Id.* at 535 (Ely, J. dissenting).

The recited debts are significant because neither the majority nor the dissent suggested the defendant was obliged to pay the IRS first, in preference over his other creditors. Indeed, the dissent stated: "Having itself established that Andros . . . owed more money to others than the amount which was then in his possession, the government did not, and could not, prove beyond a reasonable doubt that Andros was on that date financially able to pay the taxes in question."[61]

Some other circuits identified the financial inability language in *Andros* as dicta and disagreed with it. In *Tucker*, a Fifth Circuit section 7203 case, the defendant argued that he could not pay the taxes when due because he had very low (or negative) bank balances and no other assets. The court saw the argument as "border[ing] on the ridiculous."[62] It added: "As a general rule, financial ability to pay the tax when it comes due is not a prerequisite to criminal liability under section 7203. Otherwise, a recalcitrant taxpayer could simply dissipate his liquid assets at or near the time when his taxes come due and thereby evade criminal liability."[63] Some other decisions — including prominently the Sixth Circuit's decision in *Ausmus* — also rejected *Andros*.[64]

But cases like *Tucker* and *Ausmus* did not sweep the field. This may be because of the extreme facts of these cases, in the form of the defendants' lavish consumption. Tucker's expenditures included two trips to the Virgin Islands, one trip to Guadalajara, several thousand dollars spent on jewelry, a new pleasure boat and new car for his son, dues paid to two expensive clubs, and payments totaling more than $2,000 to a woman he was dating at the time.[65] On those facts, one can readily agree that an inability to pay defense borders on the ridiculous.[66] On other facts, it may not.

Other authorities — including some post-trilogy authorities — did recognize the validity of financial inability as a defense. Thus, *Poll* (which, as seen in Part II, was a focal point for analysis in *Easterday*) reaffirmed *Andros*, albeit with a modification to allow the government an additional avenue for meeting its burden. The *Poll* court stated:

> To establish willfulness the Government must establish beyond a reasonable doubt that at the time payment was due the taxpayer possessed sufficient funds to enable him to meet his obligation or that the lack of sufficient funds on such date was created by (or was the result of) a voluntary and intentional act without justification in view of all the financial circumstances of the taxpayer.[67]

Many cases from other circuits took the same approach. These cases include the *Evangelista* decision from the Second Circuit,[68] the *Williams* decision from the Eleventh Circuit,[69] and the *Holbrook* decision from the D.C. District.[70]

The cases also were in tension as to whether the resources available to the defendant had to be used to pay the government first. The Seventh Circuit refused to give a financial inability instruction in *Lewis*, a section 7203 case.[71] The court observed:

> The judge is obligated to instruct the jury only on a defense theory that has some foundation in the evidence. That foundation was not laid. Lewis had money to pay the other expenses of his business; he just assigned a lower priority to paying . . . taxes than to meeting his other expenses. This does not show "inability to pay" and the judge was not required to give an instruction that was premised on such inability.[72]

Although the Seventh Circuit decided *Lewis* after two of the trilogy cases had been handed down, it did not categorically reject financial inability defenses. It held only that the defense had not been made under the particular facts. *Goodman*, described earlier, took an even stronger view, holding that the law did not require that the defendant use available funds to pay the IRS first, ahead of other business creditors.[73]

## V. Assessing the Vitality of the Defense

Part V rejects an absolutist view of *Easterday*, the trilogy, and other cases — a view that would consign the financial inability defense to the dustbin of discarded doctrines. Instead, the vitality of the defense should be assessed contextually, that is, the reason for the defendant's inability to pay the taxes in question should be ascertained. Hedonistic consumption clearly would not suffice, and under the preponderance of the case law, paying other business creditors in preference over the IRS likely would not suffice, either. However, reasons for financial distress that are largely beyond the taxpayer's

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[61] *Id.*

[62] *United States v. Tucker*, 686 F.2d 230, 233 (5th Cir. 1982), *cert. denied*, 459 U.S. 1071 (1982).

[63] *Id.* at 233.

[64] *United States v. Ausmus*, 774 F.2d 722, 724-725 (6th Cir. 1985).

[65] *Tucker*, 686 F.2d at 232.

[66] The facts of *Ausmus* were not described with comparable specificity. However, Ausmus conceded that he spent money on supporting his girlfriend, restaurant dining, entertainment, new suits, and sending his son to college. 774 F.2d at 723.

[67] *United States v. Poll*, 521 F.2d 329, 333 (9th Cir. 1975). *Poll* borrowed the end of the excerpted language from *Spies*, see *supra* text accompanying note 33, and *Poll* was the basis of the instruction requested by Easterday, see *supra* text accompanying notes 11 and 12.

[68] *United States v. Evangelista*, 122 F.3d 112, 119 (2d Cir. 1997), *Doc 97-23664, 97 TNT 158-8, cert. denied*, 522 U.S. 1114 (1998).

[69] *United States v. Williams*, 121 F.3d 615, 621 (11th Cir. 1997), *Doc 97-20982, 97 TNT 139-52, cert. denied*, 523 U.S. 1065 (1998).

[70] *United States v. Holbrook*, 15 F. Supp.2d 10, 17 (D.D.C. 1998).

[71] *United States v. Lewis*, 671 F.2d 1025 (7th Cir. 1982).

[72] *Id.* at 1028 (citations and internal punctuation omitted).

[73] *Goodman*, 190 F. Supp. at 856; *see supra* text accompanying notes 48 to 50; *cf. Sorenson v. United States*, 521 F.2d 325, 328 n.3 (9th Cir. 1975) (citing *Andros* and *Poll* as applicable to criminal tax but holding that a taxpayer had to pay the IRS in preference to other creditors for purposes of the civil 100 percent penalty under section 6672).

control should trigger the defense because uncontrollable factors make it hard to say that the defendant's failure to pay was willful.

One hopes that prosecutors would not pursue "uncontrollable failure to pay" cases. However, the discretionary safeguard is not foolproof. Thus, financial inability grounds of exculpation should remain part of the law. If the defense is raised at all, the judge should exercise the familiar gatekeeping function. The issue should go to the jury only if the record contains an adequate degree of evidence of an acceptable cause of financial inability.

### A. Absolutist View

One might attempt to argue that the inability to pay defense is no longer a part of the law under any set of facts. The *Easterday* panel majority read the trilogy as clarifying "that 'willfulness' means a voluntary, intentional violation of a known legal duty, and does not 'require . . . proof of any other motivation.'"[74] Mechanical, literal application of that verbal formulation arguably could categorically preclude an inability to pay defense.

However, such a mechanical approach should be avoided for four reasons: (1) in general, it often is a mistake to treat language in cases as having unbending, universal application, especially in contexts different from the particular facts of the cases ; (2) most post-trilogy financial inability cases have not accorded the language of the trilogy unbending application; (3) authority in other contexts lends support to a financial inability defense in the criminal tax context; and (4) in the confused case law environment, the rule of lenity supports application of the defense.

**1. Reading cases generally.** It can be a capital error to apply language from a case outside its context. This point was made by *Sears*,[75] an important civil tax case dealing with the deductibility of premiums paid to captive insurance companies. This issue has been controversial for decades,[76] and a staple citation in captive insurance cases has been the Supreme Court's 1941 decision in *Le Gierse*, which defined insurance.[77] The *Sears* court acknowledged the *Le Gierse* definition but cautioned that "it is a blunder to treat a phrase in an opinion as if it were statutory language. The [*Le Gierse*] Court was not writing a definition for all seasons and had no reason to."[78]

Similarly, none of the trilogy decisions were failure-to-pay cases,[79] so the Supreme Court had no reason to consider whether inability to pay can ever be a defense. The trilogy established a uniform definition of willfulness for tax crimes, but it did not command disregard of differences in the factual contexts of cases.

Three more points in this regard. First, the principle stated in *Sears* was not an invention of that case. From early in the life of our republic, the Supreme Court has taught: "It is a maxim, not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used."[80] This principle is no less true in tax than in other areas of the law. It has been invoked by the Supreme Court[81] and lower courts[82] in many tax cases. The principle was expressed thusly in one of those cases:

> Numerous general statements made by various courts and writers have been separated from their context and quoted by the [IRS] for [a broad] position. . . . Taken together, as they should be in connection with the case of context in which these expressions were used, they form no authority for the decision in this case.[83]

Second, the observation that judicial language should not be treated as legislative language is solidly grounded in how cases and statutes differ in origin and purpose. As leading scholars of legislation have explained:

> The common law is created by judges on a case-by-case, contextually sensitive basis. . . . This source of law resides in appellate opinions written in discursive form. What is authoritative about it is the holding (as opposed to dicta) of the opinion within that context. Contrast law by statute. It resides in canonical, not discursive form.[84]

This distinction is also observed in administrative law. Agencies often have power to both adjudicate (through the issuance of orders) and legislate (through the promulgation of rules). Because different procedural requirements attach to those powers, it is important to distinguish between orders and rules. It has long been held that rules (quasi-legislation) involve generalized determinations to govern the future conduct of groups of

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[74]*Easterday*, 564 F.3d at 1008 (quoting *Bishop*, 429 U.S. at 12).

[75]*Sears, Roebuck & Co. v. Commissioner*, 972 F.2d 858 (7th Cir. 1992).

[76]*See, e.g.*, Stuart R. Singer, "When the Internal Revenue Service Abuses the System: Captive Insurance Companies and the Delusion of the Economic Family," 10 *Va. Tax Rev.* 113 (1990); Joseph C. Safar, Comment, "When Federal Tax Law Frustrates Policy: The Confused Rules Governing the Deductibility of Captive Insurance Premiums," 34 *Duq. L. Rev.* 105 (1995).

[77]*Helvering v. Le Gierse*, 312 U.S. 531, 539 (1941).

[78]*Sears*, 972 F.2d at 861.

[79]*Pomponio* and *Bishop* were tax perjury cases under section 7206(1). *Cheek* was a section 7201 evasion of assessment case.

[80]*Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 399 (1821); *see also Northern Nat'l Bank v. Trustees of Porter Township*, 110 U.S. 608, 615 (1884).

[81]*E.g., Zenith Radio Corp. v. United States*, 437 U.S. 443, 461-462 (1978); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955); *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 300 (1946).

[82]*E.g., W.W. Windle Co. v. Commissioner*, 65 T.C. 694, 712 (1976), *disapproved in other respects, Arkansas Best Corp. v. United States*, 485 U.S. 212, 216 and n.3 (1988); *Marquis v. Commissioner*, 49 T.C. 695, 701 (1968); *Waltham Netoco Theatres, Inc. v. Commissioner*, 49 T.C. 399, 406, *aff'd*, 401 F.2d 333 (1st Cir. 1968); *Simplified Tax Records, Inc. v. Commissioner*, 41 T.C. 75, 81 (1963); *Couzens v. Commissioner*, 11 BTA 1040, 1147 (1928).

[83]*Tide Water Oil Co. v. Commissioner*, 29 BTA 1208, 1220 (1934) (full-board reviewed).

[84]William N. Eskridge Jr., Philip P. Frickey, and Elizabeth Garrett, *Legislation and Statutory Interpretation*, 2-3 (2d ed. 2006).

persons, while orders (quasi-adjudication) entail determinations about persons or defined groups based on past conduct.[85]

In short, the admonition in *Sears* and other cases that judicial language not be treated as if it were legislative language reflects that cases and statutes are different sources of law. In the main, cases advert more to the individualized facts out of which a particular dispute arose. That contextual sensitivity must be taken into account in considering how the language of yesterday's cases applies to tomorrow's controversies.

Third, the distinction between judicial and legislative language advanced by the *Sears* court gains force when one realizes that even statutory language is not applied implacably, without regard to nuance and context. Many judges take, and therefore many decisions reflect, intentionalist or purposivist approaches to construing statutes.[86] Those judges do not treat statutory language as unbending.[87] Moreover, even textualist judges behave purposively in construing some types of statutes.[88]

**2. Financial inability cases.** The preceding section maintained that, in general, it can be dangerous to treat language in judicial opinions as absolute. This caution has been heeded in the specific context of federal tax crimes. *Bishop* itself — the first case of the trilogy — when speaking of "willfully" acknowledged: "We continue to recognize that context is important in the quest for the word's meaning."[89]

Moreover, as seen in Part IV, many cases upholding the financial inability defense, or in which the court seemed prepared to uphold the defense on better facts, were decided after one, two, or all three of the trilogy cases had been handed down.[90] Also, even some cases adverse to the defense left room for it — although sometimes only a little room. Thus, *Tucker*, on which *Easterday* partly relied, prefaced its limitation with the phrase "as a general rule."[91] *Easterday* itself left an eyelash of room, saying that, in tax, *Poll* is not completely buried but only "nearly completely buried."[92]

**3. Analogous areas.** Authority outside federal tax crimes bears on the financial inability question by way of analogy. Here, I discuss two lines of authority: one from nontax criminal law and the other from civil tax law.

First, willful failure to pay child support can be punished criminally under the Child Support Recovery Act.[93] The legislative history states that the element of willfulness was "borrowed from the tax statutes that make willful failure to collect or pay taxes a Federal crime" and that willfulness should be interpreted in the same manner for the two purposes.[94] It cites *Poll* with approval in that context.[95] *Easterday* acknowledged the continuing validity of *Poll* in child support nonpayment prosecutions, but it failed to mention the legislative history.[96]

The significance of this can be debated. The role of committee reports in statutory interpretation is a highly controversial subject.[97] Moreover, this sort of post-facto legislative history is often viewed as a suspect variety.[98] Still, the committee report adds something to the case for the existence of an inability to pay defense to tax crimes, especially because the report was issued after all three trilogy cases had been decided.

Second, section 6651 sets out civil penalties for several kinds of derelictions, including failure to pay amounts self-assessed on returns[99] or amounts subsequently assessed.[100] Both of those failure-to-pay penalties are subject to reasonable cause defenses. The applicable regulation provides:

> A failure to pay will be considered to be due to reasonable cause to the extent the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship . . . if he paid on the due date.[101]

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[85] *Bi-Metallic Inv. Co. v. State Bd. of Equalization*, 239 U.S. 441, 445-456 (1915); *see also Londoner v. City & Cty. of Denver*, 210 U.S. 373 (1908); Alfred C. Aman, *Administrative Law and Process*, section 1.02 (2d ed. 2006).

[86] *E.g., Chisom v. Roemer*, 501 U.S. 380, 403-404 (1991); *Public Citizen v. United States Dep't of Justice*, 491 U.S. 440, 463-465 (1989); *United Steelworkers v. Weber*, 443 U.S. 193, 201-207 (1979).

[87] *E.g., United States v. Missouri Pac. R.R. Co.*, 278 U.S. 269, 278 (1929). ("To take a few words from their context and with them thus isolated to attempt to determine their meaning, certainly would not contribute greatly to the discovery of the purpose of the draftsmen of a statute.") For review of the alternating tides of purposivism and textualism in Supreme Court decisions, see Thomas A. Bishop, "The Death and Reincarnation of Plain Meaning in Connecticut: A Case Study," 41 *Conn. L. Rev.* 825, 833-842 (2009).

[88] *See* Steve R. Johnson, "The Work Product Doctrine and Tax Accrual Workpapers," *Tax Notes*, July 13, 2009, p. 155, at 165-167, *Doc 2009-13526*, or *2009 TNT 131-9* (discussing statutes with common law origins).

[89] *Bishop*, 412 U.S. at 356.

[90] These cases include *Andros*, *Poll*, *Evangelista*, *Williams*, *Holbrook*, *Lewis*, and perhaps *Simone* (to the extent one can discern the reasoning behind a jury verdict).

[91] *Tucker*, 686 F.2d at 233.

[92] *Easterday*, 565 F.3d at 1010.

[93] 18 U.S.C. section 228.

[94] H.R. Rep. No. 102-771, at 6 (House Judiciary Comm. Aug. 3, 1992).

[95] *Id.*; *see also United States v. Ballek*, 170 F.3d 871, 874 (9th Cir. 1999), *cert. denied*, 528 U.S. 853 (1999) (citing *Poll* with approval in a criminal case under the Child Support Recovery Act).

[96] *Easterday*, 564 F.3d at 1010.

[97] *Compare* Antonin Scalia, *A Matter of Interpretation: Federal Courts and the Law* 29-37 (1997) (challenging the legitimacy and utility of legislative history) *to* Stephen Breyer, "On the Uses of Legislative History in Interpreting Statutes," 65 *Cal. L. Rev.* 845 (1992), and Patricia M. Wald, "Some Observations on the Use of Legislative History in the 1981 Supreme Court Term," 68 *Iowa L. Rev.* 195 (1983) (both finding the use of legislative history to be appropriate in particular circumstances).

[98] *See generally* Steve R. Johnson, "The Reenactment and Inaction Doctrines in State Tax Litigation," *State Tax Notes*, Dec. 8, 2008, p. 661, *Doc 2008-24362*, or *2008 STT 237-3*.

[99] Section 6651(a)(2).

[100] Section 6651(a)(3).

[101] Reg. section 301.6651-1(c)(1).

Thus, there is a financial inability defense to a civil tax penalty. It would be anomalous for the criminal tax law to fail to at least recognize a comparably expansive defense.

**4. Lenity.** In the current environment, defense counsel that wants to advance a financial inability defense in a criminal tax case might consider buttressing it with a lenity argument: "The rule of lenity requires ambiguous criminal laws to be interpreted in favor of defendants subject to them."[102] The Supreme Court has described the purposes of the rule thusly:

> This venerable rule not only vindicates the fundamental principle that no citizen should be held accountable for a violation of a statute whose commands are uncertain, or subjected to punishment that is not clearly prescribed. It also places the weight of inertia upon the party that can best induce Congress to speak more clearly and keeps courts from making criminal law in Congress's stead.[103]

The latter rationale — that the contours of crimes should be defined by legislatures, not by courts — is the reason we have largely abandoned common-law crimes, at least at the federal level.[104] That rationale was expressed in an earlier case as follows: "Because of the seriousness of criminal penalties, and because criminal punishment usually represents the moral condemnation of the community, legislatures and not courts should define criminal activity."[105] Similar reasoning likely underlies the old — but not always followed — precept that text is particularly important when the court is interpreting a criminal statute.[106]

To the extent that the status of financial inability as a defense to failure-to-pay tax crimes is ambiguous, the preference for clarification by Congress is triggered. The sole statutory guidance is the single word "willfully," which is undefined in the statutes themselves. Depending on how charitably one reads the judicial history, courts have changed their definition of willfully over time, or at least have emphasized different aspects of the definition. If a shifting lower court interpretation of a varying Supreme Court interpretation of the single statutory term squeezes out a defense recognized (although not universally) in many criminal cases over many decades, and if those interpretations result in denial in the criminal context of a defense recognized in the comparable civil context, we may have tilted too far in the direction of the judiciary, not Congress, defining criminality.

As noted above, the rule of lenity is applicable "only when we are uncertain about the statute's meaning."[107] Are the failure-to-pay tax crimes ambiguous enough to trigger the rule? The Supreme Court cautioned in *Muscarello*:

> The simple existence of some statutory ambiguity, however, is not sufficient to warrant application of that rule, for most statutes are ambiguous to some degree. The rule of lenity applies only if, after seizing everything from which aid can be derived, . . . we can make no more than a guess as to what Congress intended. To invoke the rule, we must conclude that there is a grievous ambiguity or uncertainty in the statute.[108]

That formulation seems to erect a high bar, although the degree of judicial disagreement and uncertainty described in this report may suffice to surmount even that bar. Yet a theme of this report has been that it often is erroneous to enthrone particular language in judicial opinions as binding in all times and seasons to the fullest extent its flourishes might bear. The above language may be another example of that theme. *Muscarello* was a 5-4 decision with unusual coalitions.[109] Moreover, it was part of a string of cases[110] that led many to wonder whether the Court was withdrawing from the lenity doctrine wholly or substantially.[111] However, the pendulum swings. More recent lenity jurisprudence "suggests that any reports of the lenity canon's demise may be exaggerated."[112]

**5. Summary.** I believe that it would be wrong to hear in *Easterday*, a divided-panel decision, the death knell of any financial inability defense to federal tax crimes. There is considerable case law, on tax crimes and in analogous areas, supporting the defense. And although the rule of lenity does not resolve the issue, it cannot readily be dismissed from the discussion. It is not good interpretation — either generally or specifically as to tax crimes — to read the trilogy so strictly that it precludes the defense under all circumstances. If the defense retains vitality, the question then becomes what contours the defense should have. That question is addressed in the next subpart.

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[102]*United States v. Santos*, 128 S. Ct. 2020, 2025 (2008) (plurality opinion); *see also Bell v. United States*, 349 U.S. 81, 83 (1955); William D. Popkin, *Materials on Legislation: Political Language and the Political Process*, 107-114 and 313-315 (5th ed. 2009).

[103]*Santos*, 128 S. Ct. at 2025.

[104]*See, e.g.*, Joshua Dressler, *Understanding Criminal Law*, 29-32 (4th ed. 2006).

[105]*United States v. Bass*, 404 U.S. 336, 348 (1971); *see also* Henry Friendly, "Mr. Justice Frankfurter and the Reading of Statutes," *in Benchmarks*, 196, 206 (1967) (noting "the instinctive distaste against men languishing in prison unless the lawmaker has clearly said they should").

[106]*E.g., United States v. Wiltberger*, 18 U.S. 76, 96 (1820) (Marshall, C.J., writing for the Court).

[107]*Scarborough v. United States*, 431 U.S. 563, 577 (1977).

[108]*Muscarello v. United States*, 524 U.S. 125, 138-139 (1998) (punctuation marks and numerous citations omitted).

[109]Justice Breyer wrote for the Court, joined by Justices Stevens, O'Connor, Kennedy, and Thomas. Justice Ginsburg penned a dissent, which was joined by Chief Justice Rehnquist and Justices Scalia and Souter. The dissent argued that the majority paid "scant attention to a core reason for the rule of lenity," the policy that legislatures, not courts, should define criminality. *Id.* at 149-150.

[110]*See, e.g., Holloway v. United States*, 526 U.S. 1 (1999); *Smith v. United States*, 508 U.S. 223 (1993).

[111]*See* Note, "The New Rule of Lenity," 119 *Harv. L. Rev.* 2420 (2006).

[112]Popkin, note 102 *supra*, at 110 (discussing *Santos*, 128 S. Ct. 2020).

### B. Causes of Inability to Pay

The second *Easterday* trial court referred to "the [defendant's] 'ability to pay' — whatever that may mean."[113] That was an insightful and helpful remark. At the end of the day, one must move past abstraction to give ability to pay concrete meaning. This subpart attempts to do so. It first contextualizes the defense, addressing particular circumstances under which the defense should and should not be considered. It then discusses whether prosecutorial discretion obviates the need for an inability to pay defense.

**1. Contexts.** The variety of life is such that no universal catalog of inability-to-pay situations is possible. The following, however, cover some of the major patterns.

*Personal consumption*: Financial inability resulting from hedonistic spending is no defense to civil failure-to-pay penalties.[114] Civil defenses do not set the boundary for criminal defenses, of course, but the same result has been reached — properly — in criminal failure-to-pay cases. For example, *Tucker* involved excessive personal expenditures that the court reasonably held inadequate to support a defense.[115]

*Business expenditures*: There is some foundation on which defense counsel might attempt to argue that spending to keep the defendant's business afloat is an acceptable basis for a financial inability defense. Language in *Goodman*, for example, could be enlisted in this cause.[116] However, *Goodman* is an old district court case. The weight of the authority, including *Easterday* itself,[117] is to the contrary. It would be a rare court or a rare set of facts that allowed a defendant to succeed on such an argument.

*Investment losses*: What if the defendant once had the wherewithal to pay his tax liability but was then deprived of it as a result of investment reverses? The regulation governing the civil failure-to-pay penalties provides that the taxpayer generally does not exercise ordinary business care and judgment by investing in speculative or illiquid assets, but does exercise such care and judgment "if he made reasonable efforts to conserve sufficient assets in marketable form to satisfy his tax liability and nevertheless was unable to pay all or a portion of the tax when it became due."[118]

Application of a similar approach in the criminal tax context could lead to interesting questions in Madoff or other scam situations. The timing of the loss in relation to the due date of tax payment, the amounts lost, the objectively and subjectively perceived levels of risk in the investment,[119] the number of required tax payments not made, whether the unpaid taxes were trust fund taxes, and other considerations all could be relevant.

In general, investment or comparable losses could, under the right circumstances, be adequate grounds for a financial inability defense. Indeed, the acceptable grounds should be broader for purposes of the failure-to-pay tax crimes than for purposes of the failure-to-pay civil penalty. The civil regulation adverts to whether the taxpayer exercised "ordinary business care and judgment." That standard is too restrictive to be applied criminally: "Criminal punishment is not imposed on a person for mistakes or misunderstandings, or for being duped."[120] That should include bad investments, even seriously unwise investments.

*Compulsive behavior*: Several failure-to-pay criminal cases have involved defendants who used the money they didn't pay to the IRS to finance their allegedly compulsive behavior, such as gambling in *Simone* and *Andros*. One might view this as a species of lavish personal consumption, thus unpromising. However, Simone was acquitted by a jury,[121] and Andros persuaded one of the three appellate panel judges.[122]

The probable distinction is that "normal" lavish consumption, such as the defendant buying a yacht, usually involves a deliberate decision by a rational mind, whereas compulsive or obsessive behavior involves a mind out of control. The defense has a better case for willfulness in the latter context. Whether the defendant really couldn't control his behavior is, of course, a question of fact and may well entail expert testimony.

*Expenditures prompted by emergency circumstances*: Probably the best case for the defense is when the defendant was rendered financially unable to pay the IRS by an emergency that all or most would recognize as of the highest moment. For example, Congress could not have intended, when writing the tax crimes in the code, to force citizens to forgo life-saving medical care as a condition of staying out of prison.

That much is obvious, but skillful counsel might spin this notion in surprising directions. For example, Simone told the jury that his choice was between paying the IRS and paying his loan sharks and that "the health aspect is a little different" between the two options.[123] By hinting at death or grievous injury from disgruntled underworld creditors, Simone added "emergency circumstances" to his defense.

**2. Prosecutorial policies.** There is an aspect missing from some of the foregoing examples: How would the most extreme of those examples ever get into court? It's unlikely a jury would convict a Madoff victim or a

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[113] *Easterday*, 2007 WL 2023500, at *3.

[114] Reg. section 301.6651-1(c)(1). ("A taxpayer who incurs lavish or extravagant living expenses in an amount such that the remainder of his assets and anticipated income will be insufficient to pay his tax, has not exercised ordinary business care and prudence.")

[115] *See supra* text accompanying notes 62 to 66.

[116] *See supra* text accompanying notes 48 to 50.

[117] *See supra* text accompanying notes 11 to 19.

[118] Reg. section 301.6651-1(c)(1).

[119] Not just doctrine, but also jury appeal would come into play at some point. The zanier the "investment," the more jurors might be inclined to convict, either because they conclude the transaction was really something other than an investment or because they hold the defendant's stupidity in contempt. The latter isn't a legal principle, but it's enough of a principle of human nature to support a franchise of television programs focusing on "The World's Dumbest."

(Footnote continued in next column.)

[120] *Baxter v. United States*, 2009 WL 1809927, at *12 (N.D. Ill. June 25, 2009).

[121] *See supra* text accompanying notes 51 to 56.

[122] *See supra* text accompanying notes 57 to 60.

[123] *See supra* text accompanying note 55.

defendant who paid for life-saving medical care. IRS special agents wouldn't forward those cases for prosecution, and IRS counsel, Justice attorneys, or U.S. Attorney's Office attorneys[124] would probably decline those cases if they were forwarded.[125] The government is interested in not wasting its resources and in maintaining a high conviction rate to bolster the deterrent effect of the criminal tax weapon[126] — to say nothing of honoring the claims of humanity, which prosecutors have been known to do from time to time.

Given all that, do we even need a financial inability defense? I believe the answer is yes, whether as an independent doctrine or as part of willfulness analysis generally. Hopefully, many cases potentially implicating the defense will have been weeded out of the system in the exercise of prosecutorial discretion, whether motivated by decency, self-interest, or both. But there will always be disagreement at the margins, and those margins might turn out to be broad. There will be cases in which the government chooses to proceed but that, to other eyes, implicate genuine financial necessity arising from acceptable causes. Prosecutorial discretion will be best exercised against the backdrop of a defense recognized by the law, and the defense should be available to judges and juries in cases in which prosecutorial discretion is not exercised.

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[124]For the roles of personnel in the investigation and prosecution of criminal tax cases, see Townsend et al., note 3 *supra*, at 6-10, 183-197 and 395-407.

[125]*Id.* at 159-173 (discussing government prosecution policies in criminal tax cases).

[126]*Id.* at 3-4.