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"One-on-One" Uncorroborated Testimony: The Dilemma of Prosecutors, Defense Attorneys, and the Courts in Fraud, Waste, and Abuse Cases

*Richard A. Nossen**

Prosecutors, defense attorneys and the courts are increasingly confronted with the "one-on-one" case. Particularly in the adjudication of offenses involving fraud, waste, and abuse, all participants in the judicial system are struggling with the problem of one-on-one, uncorroborated testimony.

I. The Problem

A claims to have paid off *B*. Of course, *B* denies having received illegal payments. *A*'s credibility as a prosecution witness is often weakened because (1) he is facing an indictment; (2) he has already pled guilty to the crime in question and is awaiting sentence; or (3) he has already been sentenced and is hoping for a modification of sentence if he "cooperates" during *B*'s trial. Seldom is there any corroborative evidence to support *A*'s testimony that he paid off *B*, since such payoffs are generally made in currency. On the other hand, *B* vehemently denies having received illegal funds from *A* or anyone else. *B*'s credibility is often strengthened because (1) he holds a high political office or a responsible position in private industry; (2) he has no criminal record; and (3) he produces an array of character witnesses during trial who testify favorably as to his reputation in the community, reinforcing his "cloak of innocence."

In the one-on-one situation the prosecutor must decide whether or not to present the case to a grand jury, and he is often under considerable pressure from the public and press. The defense attorney faces the hazard of defending a client who may be withholding

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the truth, often a fatal blow during trial. The judge, too, must wrestle with problems generated by the one-on-one dilemma, such as ruling on motions to dismiss the case because of insufficient evidence, determining guilt or innocence in non-jury trials, or deciding on the extent of punishment after the jury has returned a questionable guilty verdict. The one-on-one dilemma is encountered at the investigative level as well when a supervisory investigator or attorney must decide whether to commit valuable investigative resources to a lengthy investigation which may prove fruitless.

The dimensions of the one-on-one problem have grown in recent years due to the proliferation of so-called white collar financial crimes involving political corruption and fraudulent business practices. The problem has further compounded because most criminal investigators and their supervisors, as well as many prosecutors, are inhibited in the investigation and prosecution of fraud, waste, and abuse cases by their insufficient understanding of accounting fundamentals and the corresponding fear that they will be unable to interpret, analyze or explain complex financial transactions to a jury.

II. The Solution

In recent years one solution for the one-on-one problem has emerged, the highly successful use of video-tape recordings. However, there are a myriad of cases in which, for various reasons, the video-tape technique cannot be applied. One viable solution that is now being successfully applied in the prosecution of some of these one-on-one financial crime cases employs a modified version of the Internal Revenue Service (IRS) "net worth" technique.

For over fifty years the IRS has used a net worth computation to satisfy one of the elements of proof necessary to obtain a conviction for income tax evasion. The computation primarily determines the extent to which a taxpayer has increased his wealth annually over a period of several consecutive years. If the IRS can prove that a taxpayer's total expenditures exceeded his reported annual income in several years, the IRS has established one of the three elements of income tax evasion: that the taxpayer understated his income on which a tax was due and owing.[1]

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1 In proving the crime of income tax evasion the government must prove the three elements of the crime: (1) that an additional tax was due and owing, United States v. Schenck, 126 F.2d 702 (2d Cir.), *cert. denied*, 316 U.S. 705 (1942); Gleckman v. United States, 80 F.2d 394 (8th Cir. 1935); (2) that an attempt was made to evade or defeat the tax, O'Brien v. United States, 51 F.2d 193 (7th Cir.), *cert. denied*, 284 U.S. 673 (1931); and (3) that the attempt was willful, United States v. Murdock, 290 U.S. 389 (1933).

The IRS uses the net worth computation in the prosecution of cases when books and records necessary for calculating a taxpayer's income and expenses are unavailable. The Supreme Court of the United States has upheld the use of the net worth technique in criminal tax evasion cases.[2] The IRS's net worth computation is based on the following formula:

Line Number		
1.	Taxpayer's Net Worth—12/31/81	$ 257,000
2.	Taxpayer's Net Worth—12/31/80	−146,000
3.	Increase in Net Worth in 1981	$ 111,000
4.	Add: Living Expenses (not included above)	+ 35,000
5.	Total Income	$ 146,000
6.	Less: Non-taxable Sources of Income	−26,000
7.	TAXABLE INCOME	$ 120,000
8.	Less: Income Reported in Return	−32,000
*	UNREPORTED INCOME	$ 88,000

The IRS net worth formula is usually applied to two or more prior consecutive years in order to show a pattern of illegality. As used by the IRS, the formula has no application in the investigation or prosecution of non-tax financial crimes. The necessity to credit the taxpayer for "non-taxable income" (line 6 in the above formula) makes the computation highly complex. Thus, the sophisticated nature of "non-taxable income" adjustments—the non-taxable portion of capital gains, deferred income, depreciation, etc.—requires that investigators and prosecutors have a sufficiently firm grasp of tax law to identify transactions that need an adjustment and later explain the adjustments to the jury during trial.

Stripped of its tax law complexities, a modified version of the IRS net worth formula can be applied in the investigation and prosecution of non-tax financial crimes. The formula, in its modified form, can be used to corroborate other evidence of a financial crime, thus overcoming the one-on-one dilemma. The modified computation is based on the following formula:

2 Holland v. United States, 348 U.S. 121 (1954); Friedberg v. United States, 348 U.S. 142 (1954); Smith v. United States, 348 U.S. 147 (1954); United States v. Calderon, 348 U.S. 160 (1954).

Line Number		
1.	Investigative Subject's Net Worth — 12/31/81	$ 257,000
2.	Investigative Subject's Net Worth — 12/31/80	−146,000
3.	Increase in Net Worth in 1981	$ 111,000
4.	Add: Living Expenses (not included above)	+35,000
5.	Total Expenditures	146,000
6.	Less: Legitimate Sources of Income	−58,000
7.	EXPENDITURES MADE WITH FUNDS FROM ILLEGITIMATE OR ILLEGAL SOURCES	$ 88,000

Note that the above computation, through Line 4, is exactly the same as the IRS computation.

Beginning with Line 5, however, the complexities of the IRS computation (regarding non-taxable sources of income) have been eliminated. There is no longer any reference to income taxes. The sole purpose of the above modified net worth formula is to: (1) determine total *expenditures* of an individual and not his total income (Line 5); and (2) to compare the individual's total expenditures to his *legitimate* sources of available funds (Line 6). If, as in the above illustration, the individual's total expenditures *exceeded* his funds available from *legitimate* sources, the government has strong corroboration for other evidence of the financial crime, and the one-on-one problem is solved.

In a series of conferences and training seminars over the past ten years, I have presented the modified net worth formula to countless numbers of auditors, criminal investigators, and prosecutors from cities all over the world. Employing comparative schedules similar to those illustrated in this article, I have demonstrated not only the relative simplicity of the modified formula, but also its applicability to the detection, investigation and prosecution of non-tax financial crimes. During my presentations I have stressed that the modified formula facilitates the investigation of white collar crimes, including political corruption cases and racketeering violations. Moreover, it requires very little understanding of tax law, since the formula has been stripped of its tax complexities. And finally, the modified formula provides admissible circumstantial evidence, useful in corroborating other evidence of the particular financial crime.

III. A Test of the Modified Net Worth Formula: *People v. Tempera*

The modified net worth formula is applicable to fraud, waste, and abuse cases. Due to Suffolk County, New York District Attorney Patrick Henry's willingness to commit investigative and prosecutorial resources to a lengthy investigation and subsequent trial, the formula has successfully survived an actual test.

In the fall of 1981, Suffolk County Assistant District Attorney James O'Rourke and Assistant District Attorney Mark Cohen were faced with a classic one-on-one dilemma. The Suffolk County Commissioner of Labor was under indictment for multiple charges of perjury resulting from his denials, before a county grand jury, that he had received kickbacks from the recipients of CETA grants which he had approved.[3]

The prosecutors recognized the difficulties inherent in convincing a jury "beyond a reasonable doubt" that a public official with no criminal record received kickbacks, when the primary evidence of these kickbacks was the uncorroborated testimony of those who allegedly paid him. But investigators Steve Drielak and Steve Enoch, employed by the Suffolk County District Attorney's office, under the guidance of prosecutors O'Rourke and Cohen, had gathered considerable information concerning the defendant's expenditures over the past several years, the same years that the defendant was allegedly "on the take." With this information, O'Rourke decided to offer into evidence an array of documents concerning the defendant's expenditures. The purpose of the evidence was to show that the defendant was spending more money each year than he had available from *legitimate* sources, thereby creating an inference that he must have had an *illegitimate* source of funds.

After being qualified as an expert witness, I testified as to the impact or effect of the evidence of the defendant's expenditures. I was able to demonstrate that the defendant expended substantially more money than he had available from legitimate sources over a period of four years, the same years that he was allegedly "on the take."[4]

Accordingly, the prosecution was able to offer the jury corrobo-

3 For affirmance of the trial court's decision, see People v. Tempera, 462 N.Y.S.2d 512 (1983). The prosecution is documented in the following newspaper articles from Newsday: Jan. 29, 1982, at 3; Feb. 9, 1982, at 19; Feb. 11, 1982, at 17; Feb. 19, 1982, at 12; March 11, 1982, at 23; May 22, 1982, at 3.

4 *See* Newsday, Feb. 19, 1982, at 12. The use of the net worth tactic "will be one of the biggest issues" on appeal, according to Tempera's attorney. Newsday, March 11, 1982, at 23.

ration of the direct evidence of payments to the defendant, thereby enhancing the credibility of the witnesses who paid him. Following the guilty verdict, several jurors remarked to the press that the "net worth" evidence was the deciding factor during their lengthy deliberations.[5]

IV. Admissibility of the Net Worth Corroborative Evidence

While the use of the net worth concept in income tax evasion cases has been sustained by the Supreme Court,[6] in *Tempera* the admissibility of net worth evidence as *corroboration* of other evidence was at issue. In convincing the court that evidence concerning the defendant's "net worth" was properly admissible, the prosecutors in *Tempera* stressed that such evidence has been applied and approved as probative circumstantial evidence in numerous cases concerning crimes other than tax evasion.[7] For example, in two leading narcotics cases the United States Court of Appeals for the Second Circuit approved the prosecutions' use of net worth evidence to corroborate other evidence of the substantive offenses. In *United States v. Barnes*,[8] the court sustained the admissibility of the defendants' tax returns which listed large amounts of income under the headings of "other" and "miscellaneous."[9] "Not only was [this evidence] probative of the conspiracy and the substantive counts," said the Second Circuit, "but, as to Barnes, it was offered to show an element of the offense of conducting a 'continuing criminal enterprise,' 21 U.S.C. § 848, *i.e.*, that the defendant obtained 'substantial income or resources' from the enterprise."[10] In *United States v. Hinton*[11] the court approved admission of evidence that the defendants had failed to file tax returns.

5 *See* Newsday, March 11, 1982, at 23.

6 *See* note 2 *supra* and accompanying text.

7 It has been used in narcotics prosecutions, *see, e.g.*, United States v. Barnes, 604 F.2d 121, 147 (2d Cir. 1978), *cert. denied*, 446 U.S. 907 (1980); United States v. Hinton, 543 F.2d 1002, 1012-13 (2d Cir.), *cert. denied*, 429 U.S. 980 (1976); United States v. Tramunti, 513 F.2d 1087, 1105 (2d Cir.), *cert. denied*, 423 U.S. 832 (1975); United States v. Falley, 489 F.2d 33, 38-39 (2d Cir. 1973); in robbery cases, *see, e.g.*, United States v. Pensinger, 549 F.2d 1150, 1152 (8th Cir. 1977); United States v. Cavallino, 498 F.2d 1200, 1204-06 (5th Cir. 1974); United States v. Jenkins, 496 F.2d 57 (2d Cir. 1974), *cert. denied*, 420 U.S. 925 (1975); and in larceny cases, *see, e.g.*, United States v. O'Neal, 496 F.2d 368, 370-71 (6th Cir. 1974); United States v. Amerine, 411 F.2d 1130, 1131-32 (6th Cir. 1969); Leonard v. State, 22 So. 564 (Ala. 1897); Commonwealth v. Burnes, 182 A.2d 232, 237 (Pa. Super. Ct. 1962), *cert. denied*, 371 U.S. 948 (1963); Commonwealth v. Montgomery, 52 Mass. (11 Metc.) 534, 537 (1846).

8 604 F.2d 121 (2d Cir. 1978), *cert. denied*, 446 U.S. 907 (1980).

9 604 F.2d at 147.

10 *Id.*

11 543 F.2d 1002 (2d Cir.), *cert. denied*, 429 U.S. 980 (1976).

The court explained that this evidence was offered in conjunction with other evidence demonstrating that the defendants had made large expenditures during the years of their alleged narcotics conspiracy.[12] Thus, "the Government's purpose was to negate the existence of any legitimate source for the money they had expended."[13]

Paramount to the prosecutors' argument for admissibility of the net worth evidence in *Tempera*, however, was the precedent from several corruption cases in which evidence of concealed wealth has been admitted. Like the *Tempera* case, both *United States v. Kenny*[14] and *People v. Connolly*[15] involved bribes and kickbacks.

In *United States v. Kenny*,[16] a case involving Hobbs Act extortion (18 U.S.C. § 1951), conspiring to defraud the United States (18 U.S.C. § 371), and Travel Act violations (18 U.S.C. § 1952), the trial court properly admitted $700,000 in bearer bonds, $50,090 in currency, and testimony concerning $1,200,000 in bank accounts. Despite the lack of a direct nexus between the funds and the alleged crimes, the Third Circuit affirmed the admission of this circumstantial evidence of excessive unexplained wealth where there was proof that the kickbacks in question were made in cash.[17] The classic conspiracy case of *People v. Connolly*[18] involved the Borough President of Queens County and various participants in a scandalous sewer project. In *Connolly*, the Court of Appeals of New York sustained the admission of evidence concerning defendants' financial transactions and bank accounts, explaining that this evidence was "competent upon the question of motive and to show sudden enrichment."[19]

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12 543 F.2d at 1012.

13 *Id.* at 1012-13. The court stated,

> The [trial] court so charged the jury as to the evidentiary use of the returns and explained that the jurors could in their discretion infer from the appellants' failure to file returns that they had no bona fide source of income upon which they could have drawn to make their large purchases.

Id. at 1013. The Second Circuit addressed the potential prejudicial effect of the net worth evidence in both *Barnes* and *Hinton*. *Barnes*, 604 F.2d at 147 ("If there was any prejudice stemming from the Government's use of the tax returns, it was of defendants' own making"); *Hinton*, 543 F.2d at 1013.

14 462 F.2d 1205 (3d Cir.), *cert. denied*, 409 U.S. 914 (1972).

15 253 N.Y. 330, 171 N.E. 393 (1930).

16 462 F.2d 1205 (3d Cir.), *cert. denied*, 409 U.S. 914 (1972).

17 *See* 462 F.2d at 1219-25.

18 253 N.Y. 330, 171 N.E. 393 (1930).

19 *Id.* at 342, 171 N.E. at 397. The court stated,

> During the period when Phillips was fraudulently attracting over $3,000,000 from the contractors which ultimately was paid by the city, and Connolly was in possession of over $145,000 more than his salary, Moore deposited in a bank over $60,000 more than his salary, over $52,000 of which sum was deposited in

These cases establish that net worth evidence is properly admissible in cases, like *Tempera*, involving financial crimes other than tax evasion. The net worth analysis provides probative circumstantial evidence which corroborates other evidence of the substantive crimes.

V. Conclusion

Cases involving fraud, waste, and abuse have proliferated in recent years, as have white collar crimes generally. Correspondingly, problems associated with one-on-one, uncorroborated testimony have increasingly plagued criminal investigators, prosecutors, defense attorneys, and the courts. A modified application of the IRS net worth formula can solve the one-on-one dilemma by providing admissible, circumstantial evidence of an individual's expenditures in excess of his legitimate sources of funds.[20] This evidence can corroborate other evidence of the substantive offense, corroboration often vital to the prosecution of financial crimes.

> cash. . . . The same reasons that made evidence of Connolly's financial transactions competent, made evidence of Moore's bank account competent.

Id. at 341-42, 171 N.E. at 397.

20 1 J. WIGMORE, A TREATISE ON THE ANGLO-AMERICAN SYSTEM OF EVIDENCE IN TRIALS AT COMMON LAW §§ 88, 89 & 154 (3d ed. 1940).