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Tax Evasion Confusion in the Ninth Circuit  
by Prof. Kim Stanley, Golden Gate University School of Law

It is well settled that the crime of tax evasion under IRC §7201 has three fundamental elements. The statute requires the government to prove (1) the existence of a tax deficiency, (2) willfulness in the attempted evasion of taxes, and (3) an affirmative act constituting an evasion or attempted evasion. However, two recent Ninth Circuit tax evasion cases have muddied the waters – resulting in opposite outcomes – and have tax practitioners questioning the court’s reasoning.

In the first case, United States v. Boulware, the Ninth Circuit affirmed the defendant’s tax evasion conviction even though the district court refused to instruct the jury that the funds he diverted from his small corporation might not constitute a taxable dividend under IRC § 301 if the corporation lacked earnings and profits. If the diverted funds were not taxable to Boulware as a dividend, his failure to report the income was not fraudulent and would not create a tax deficiency, essential elements supporting the government’s tax evasion charge. This case is on its way to the US Supreme Court, which granted the defendant’s petition for certiorari in September 2007.

In the second case, United States v. Kayser, the defendant again complained of a faulty jury instruction, but this time the Ninth Circuit agreed and reversed his tax evasion conviction. The court ruled in Kayser that the district court should have instructed the jury that business deductions the defendant claimed on his corporation’s tax return instead might have been used to eliminate his unreported individual taxable income. Consequently, the court ruled that the government fell short of establishing that the defendant had a tax deficiency and did not meet its burden of proving each of the elements of tax evasion under IRC § 7201. The common question in both cases: may a person defend against a tax evasion charge by arguing that he might have owed no tax at all had he reported the transaction differently? By answering “no” in Boulware and “yes” in Kayser, the Ninth Circuit’s confused and irreconcilable analysis does not withstand scrutiny.

United States v. Boulware

Michael Boulware was the founder, president, and sole owner of a closely held corporation, Hawaiian Isles Enterprises (“HIE”). By 1985, HIE had a number of business ventures that included tobacco distribution, coffee processing and sales, arcade games and vending machines, and was reporting gross receipts of over $55 million. Boulware was indicted for tax evasion, among other crimes, on the Government’s claim that he had diverted to himself more than $10 million from HIE and failed to report or pay tax on this income for years 1989 through 1997. Boulware was convicted on the four counts of tax evasion and appealed. On the first appeal of his conviction, the Ninth Circuit reversed because the district court erroneously excluded evidence that a Hawaii state court had adjudicated Boulware’s rights in certain funds diverted from HIE.
On retrial, Boulware raised a new argument – the so-called “return of capital” defense. Boulware wanted to put on expert testimony to explain to the jury that the money he diverted from HIE might not constitute his personal taxable income if the funds were a return of his capital investment in the corporation. Under IRC § 301, if a corporation has no current or accumulated earnings and profits for the taxable year in which a distribution is made to a shareholder, the distribution is not treated as a taxable dividend. Rather, the distribution is characterized as a nontaxable return of the shareholder’s basis in his stock of the corporation, and any distribution in excess of the shareholder’s stock basis is treated as capital gain from the sale or exchange of the stock. Similarly, IRC § 316 defines a dividend as any distribution by a corporation to a shareholder “out of its earnings and profits.” Boulware argued that the jury should be instructed that if HIE did not have earnings and profits during the year he diverted the funds, the funds would have been a nontaxable return of his capital investment. In such circumstances, he argued that his failure to report the diverted corporate funds as taxable income was not fraudulent because the diversion would not have created a tax deficiency, thus eliminating an essential element of the crime for which he was charged.

The district court, however, refused to allow Boulware to introduce evidence concerning the return of capital defense. Citing United States v. Miller, the district court ruled that Boulware had to show not only that the funds he diverted from HIE could have been a nontaxable return of capital, but also that they were, in fact, intended to be a return of capital at the time of the transfer. Since Boulware did not proffer evidence tending to establish that the corporation’s records reflected the distribution of funds as a return of capital, the court rejected his instruction. He was again convicted on all counts. On appeal of his second conviction to the Ninth Circuit, Boulware argued that the district court erred in refusing to instruct the jury on the return of capital defense. The Ninth Circuit concluded there was no reversible error and affirmed his conviction.

a. The return of capital defense

The Ninth Circuit did not write on a blank slate in Boulware. The return of capital defense has long been recognized in civil tax cases; courts agree that under IRC §301 a distribution of corporate funds are taxable income to the shareholder only to the extent the corporation had earnings and profits during the year in which the distribution occurred. Although the federal courts of appeal disagree about the use of the return of capital defense in criminal tax evasion cases, the Ninth Circuit had addressed the issue in its 1976 opinion United States v. Miller. The defendant in Miller was convicted of tax evasion for diverting $197,000 from a small corporation he controlled. On appeal, Miller argued that the diverted funds, although not reported as his income, did not cause a tax deficiency because the corporation lacked earnings and profits during the year he diverted the funds. Characterizing this defense as “an extremely technical argument,” the Ninth Circuit acknowledged that the corporation “was not shown to have had any earnings and profits during the period under consideration.” However, the court explained that even if Miller’s return of capital defense were accepted, by his own admission he still would have had a tax deficiency of $1,699 long term capital gain.
which was, in the court’s view, “substantial enough” to support a tax evasion conviction under IRC § 7201.\textsuperscript{17}

Nevertheless, the \textit{Miller} court went on to discuss whether the corporate funds Miller diverted were taxable as income or were a return of his capital investment in the corporation.\textsuperscript{18} Starting from the shaky premise that it is normally “relatively unimportant” in a tax evasion case to characterize the nature of diverted funds “since the primary question is not the amount of the evasion but whether the taxpayer intended to evade and defeat his taxes,”\textsuperscript{19} the Ninth Circuit confirmed that this characterization was “more critical” in \textit{Miller} because “there are no corporate earnings and profits from which a dividend could be paid.”\textsuperscript{20} The court conceded that “[i]f the corporation has no earnings and profits and if the taxpayer’s cost basis of the stock exceeds the amount of the diverted funds, the application of the constructive distribution rules . . . would permit the taxpayer to escape conviction . . . .”\textsuperscript{21} The court was obviously troubled by the anomaly that Miller could be found guilty of willfully attempting to evade taxes (by engaging in fraudulent activities and hiding the diverted funds on corporate records as nontaxable loan repayments) but that, due to an “after-the-fact categorization” of the diverted funds as a return of capital, he could escape a tax evasion conviction because the diverted funds were taxable as a dividend due to the lack of corporate earnings and profits.\textsuperscript{22}

Ultimately, the \textit{Miller} court held that the constructive distribution rules of IRC §301 could be applied in tax evasion cases, but not “automatically.”\textsuperscript{23} The court felt the primary focus in a tax evasion case should be whether the defendant \textit{willfully intended} to evade taxes by diverting corporate funds, rather than the nature or characterization of the diverted funds –

Where the taxpayer has sought to conceal income by filing a false return, he has violated the tax evasion statutes. It does not matter that that amount could have somehow been made nontaxable if the taxpayer had proceeded on a different course. [fn. omitted] To apply the constructive distribution rules to this situation would nullify all of the taxpayer’s prior unlawful acts.\textsuperscript{24}

The Ninth Circuit in \textit{Miller} left open the door for a tax evasion defendant to raise a return of capital defense where there is “some demonstration on the part of the taxpayer and/or the corporation that such distributions were \textit{intended} to be such a return.”\textsuperscript{25} (Emphasis added.) In a footnote, the court further explained that once a taxpayer assumes control of diverted corporate funds he commits the crime of tax evasion if he fails to report the funds as income or fails to “make any adjustments in the corporate books to reflect a return of capital . . . .”\textsuperscript{26} Because defendant Miller “presented no concrete proof that the amounts were considered, intended, or recorded on the corporate records as a return of capital at the time they were made,” the court held that it had no factual basis on which to conclude that they were nontaxable corporate distributions.\textsuperscript{27}
The *Miller* decision represents a “middle of the road” position. A majority of circuits (Eleventh, Sixth, and Third) now require the government in a criminal tax evasion case to prove only that the taxpayer had “actual command” over the diverted corporate funds; whether corporate earnings and profits existed in the year the defendant diverted the funds is wholly irrelevant.\(^{28}\) In contrast, the Second Circuit allows defendants in both civil and criminal cases involving diverted corporate funds to raise the return of capital defense.\(^{29}\) In rejecting the reasoning of the other circuits, the court explained that if all the government must do to prove criminal tax evasion is to show that a taxpayer had “actual command” over diverted corporate funds and took affirmative acts to evade paying taxes, the government no longer has to prove the existence of a tax deficiency, thereby eliminating that element of the crime under § 7201.\(^{30}\) In such situations, the government would bear a higher burden of proof in a civil tax matter – in which diverted funds are taxable only on a showing that there were corporate earnings and profits – than in a criminal tax evasion prosecution, clearly a nonsensical result.\(^{31}\) The Second Circuit’s conclusion is straightforward -- “[t]he diversion of the funds cannot constitute a criminal offense, despite criminal intent, if no taxes are due.”\(^{32}\) For these reasons, the Second Circuit allows a criminal defendant to raise lack of corporate earnings and profits as a defense in criminal tax evasion cases, provided the diversion of funds itself was lawful.\(^{33}\) The court expressly disagreed with *Miller* that a tax evasion defendant must establish that diverted funds were intended to be treated as a return of capital\(^{34}\) --

\[I\]n return of capital cases, a taxpayer’s intent is not determinative in defining the taxpayer’s conduct. That is, the taxpayer or the corporation need not have described the distribution at issue as a dividend or a return of capital at the time it was made; rather, the realities of the transaction – including the amount of the shareholder’s basis and the corporation’s earnings and profits, as well as the amount of the distribution – govern its characterization for tax purposes.\(^{35}\)

**b. Boulware’s limitation on the return of capital defense**

In *Boulware*, the defendant wanted to put on expert testimony to explain that the funds he diverted might not constitute taxable income if they were a loan repayment, or used by him for corporate purposes, or if HIE had insufficient earnings and profits to characterize the funds as constructive dividend distributions under IRC § 301. The district court ruled, however, that his offer of proof failed *Miller’s* threshold – he must show not merely that the funds could have been a nontaxable return of capital, but that they were, in fact, intended to be a return of capital at the time of the transfer.\(^ {36}\) On appeal, Boulware renewed the argument that applying *Miller’s* intent requirement “creates a disconnect” between civil and criminal tax liability by allowing a criminal conviction in the absence of proof that the unreported diversion of corporate funds caused a tax deficiency.\(^ {37}\) The Ninth Circuit affirmed, however, holding that it was bound by *Miller*, and that the district court properly had required Boulware to first lay a factual foundation that the diverted amounts “were considered, intended, or recorded on the corporate records as a return of capital at the time they were made.”\(^ {38}\) The court reiterated the *Miller* rationale that --
[w]here the taxpayer has sought to conceal income by filing a false return, he has violated the tax evasion statutes. It does not matter that the amount could have somehow been made non-taxable if the taxpayer had proceeded on a different course. 39

In a concurring opinion, Judge Thomas stated that the court’s decision, while consistent with Miller, allows a defendant to be “criminally sanctioned for tax evasion without owing a penny in taxes to the government,” which was, in his view, “in flat contradiction with the tax evasion statute’s requirement of ‘the existence of a tax deficiency.’” 40

United States v. Kayser

Following a few months after its opinion in Boulware, the Ninth Circuit was again faced with whether Miller precluded a criminal tax evasion defendant from instructing the jury that he might not have had a tax deficiency if he had alternatively characterized his income or expenses. In United States v. Kayser, 41 the Ninth Circuit agreed that Miller did not preclude a defendant from reporting his income and deductions in one way and then arguing for an alternative characterization at trial, and reversed the conviction.

In Kayser, the taxpayer worked as an independent contractor for an internet shopping site, and incorporated a small corporation to receive the income he earned and claim business deductions. The government alleged that Kayser had received $104,000 of income in 1999 that should have been reported on his individual return; Kayser, however, reported that income on his corporate return. For 2000, the government established that Kayser failed to report his earnings on either his individual or corporate returns, but he did report some $49,026 of business deductions on his 2000 corporate return. 42 These business deductions created a net operating loss for the corporation in 2000 which he carried back and used to eliminate the corporation’s taxable income he had reported for 1999. 43

Kayser was indicted on two counts of attempted income tax evasion for 1999 and 2000 under IRC § 7201. At trial, Kayser argued that he had not willfully evaded paying taxes, and that the income he failed to report on his individual return for 2000 should have been offset by the $49,026 in business deductions he claimed, erroneously he now argued, on his 2000 corporate tax return. Kayser’s accountant testified that the expenses were typical business expenses actually incurred in 2000 and were substantiated by Kayser’s books and records. Kayser requested a jury instruction that if he had “unclaimed deductions which would have offset his tax liability such that there was no tax due and owing, then there is no tax deficiency.” 44 The district court declined to give this instruction, holding that Kayser had not introduced evidence that he had any previously “unclaimed deductions,” and that, under Miller, he could not use the deductions he already had reported on his corporate return to negate his individual tax deficiency. 45 The jury found Kayser guilty of tax evasion for 2000 but failed to reach a verdict on the tax evasion charge for 1999. 46
On appeal, the Ninth Circuit reversed Kayser’s conviction on the ground the jury should have been instructed that the $49,026 in business deductions he had reported on his corporate return might have been used to offset his unreported individual income in 2000. Beginning with the well recognized rule that a defendant in a tax evasion case may negate the existence of a tax deficiency with evidence of unreported deductions, the court held that Kayser was entitled to demonstrate at trial that his deductions could have offset his unreported individual taxable income, even though that position was inconsistent with his own tax reporting which had used the same deductions to offset his corporation’s taxable income. Neither Miller nor Boulware precluded this result, in the court’s view. To the contrary, the court offered that Miller’s return of capital defense failed only because the factual evidence supported the district court’s finding that the diverted funds were additional taxable salary rather than a loan repayment (as reported on the corporate books) or other nontaxable return of capital. The court concluded that “[t]he import of our holding in Miller is that a defendant remains free to present evidence that funds diverted from a corporation are a non-taxable return of capital, regardless of the manner in which he or the corporation originally reported the transaction.”

The court also distinguished Boulware, stating in a footnote that it “did not conclude that Boulware was bound by the manner in which he originally reported the transaction,” or that Boulware could not introduce evidence to support his return of capital defense. “Rather,” the court continued, “we held that under Miller, Boulware was required to show that the distribution was intended to be a return of capital,” and that the evidence he proffered did not establish that the diverted funds “were considered, intended, or recorded on the corporate records as a return of capital at the time they were made . . . .” The court summed up its holding in Kayser as follows –

[W]e hold that if Kayser had business expenses that were allowable offsets against his individual income, he had the right to show them and explain them as part of his defense for tax evasion. . . . The fact that Kayser improperly reported the deductions he now claims negate his individual deficiency . . . does not alter our conclusion. Kayser’s improper report of deductions on his corporate return does not change the underlying nature of these expenses . . . .”

In a biting dissent, Judge Kozinski stated that the majority’s holding in Kayser “jumped the rails” and was not only without support but in conflict with the Court’s rulings in Miller and Boulware. In his view, the majority erred because Kayser did not have “unused” deductions to offset his unreported income for 2000 – he had already used the $49,026 in business deductions to entirely eliminate his corporation’s 1999 taxable income. Thus, the case was unlike those where the defendants had failed to report allowable business deductions and so were not bound by any prior use or characterization of the deficiency-eliminating deductions.

Moreover, the majority was, in the dissent’s view, completely at odds with Miller and Boulware because neither defendant was allowed to argue for a nontaxable characterization of the funds unless the distributions were reflected as such in the
corporation’s records. Thus, even though the defendants could later claim, as a matter of “economic reality,” that the distribution was a return of capital, the court ruled it “was of no consequence, because contemporaneously maintained records did not support that re-characterization.” The dissent reiterated that the Court’s ruling opened the door for a defendant to be criminally convicted for tax evasion regardless whether he owed any taxes. Unlike Boulware, the dissent emphasized that Kayser did not hold the defendant to the manner in which he “papered” the transaction --

The same deductions cannot be used twice: He can either use them to wipe out his 2000 personal income or he can carry them back to wipe out his 1999 corporate income. Having chosen to do the latter when he filed his returns, the deductions are used up and are not available to offset his 2000 personal income. Contrary to the majority’s holding . . . Kayser does not have allowable deductions that were not reported on his return. Even if the deductions in question could have been treated as personal deductions, had Kayser claimed them as such on his individual return, the district court properly concluded that Kayser is stuck with the way he reported them at the time – which was as corporate deductions. To let him now go back and treat the deductions as applicable to his personal income allows for precisely the kind of heads-I-win, tails-the-government-loses scenario that Miller sought to foreclose.

Is form controlling substance?

One strains to reconcile the Ninth Circuit’s recent tax evasion rulings because the court first exalts form over substance in Boulware, and then completely ignores it in Kayser. Certainly the court understands that for a person to be liable for the crime of tax evasion under IRC § 7201, the government must prove not only that the defendant engaged in fraudulent behavior with an intention to evade his taxes, but that he actually had a tax liability to evade. If it turns out, after the fact, that notwithstanding his fraudulent behavior the defendant for some legitimate reason has no civil tax liability, there is no basis for a tax evasion conviction. The court got it wrong in both Boulware and Kayser.

Boulware acknowledges that its holding allows a conviction for tax evasion without proof there was a civil tax liability, but deflects by stating that result is mandated by Miller. In Miller, the court indeed opined that “it [didn’t] matter” that a tax evasion defendant’s civil tax liability “could have somehow been made non-taxable if the taxpayer had proceeded on a different course,” but was dealing with a defendant that conceded he would have a tax deficiency even with the return of capital defense. While one certainly cannot condone acts that are intended to defraud the government, the fact remains that the crime of tax evasion requires that those fraudulent activities result in the evasion of a tax that is actually owed. If the taxpayer can establish that despite fraudulent acts he does not owe any taxes, such as through unused deductions or credits, he has not committed the crime of tax evasion, as the courts have always acknowledged and the statute mandates.
Boulware holds that a tax evasion defendant may raise the return of capital defense only if there is contemporaneous evidence that the corporation intended the diversion of funds to be characterized as a return of the shareholder’s capital investment. No after-the-fact or technical arguments that the funds are somehow nontaxable will suffice. Yet this adherence to the form of the transaction is unusual in taxation – perhaps even unheard of. Particularly where, as here, it is the lack of form – i.e., any corporate indication that the funds were intended to be a return of capital – that has bound the taxpayer. If in substance the funds would not have constituted taxable income, and the taxpayer can prove that, it should not matter how the corporation papered the transaction.

Indeed, there is no requirement that a corporation have or record any “intention” regarding a distribution of funds to a shareholder. (And if that were the test, it certainly would be an easy thing for sole shareholders such as Boulware or Kayser to make such a recording on their corporate books.) Rather, the characterization of the funds in the hands of the shareholder as taxable or nontaxable is mandated by statute and turns on the objective existence of corporate earnings and profits, not on some subjective corporate “intention.” The court’s refusal to allow Boulware to put on evidence that HIE lacked earnings and profits precluded him from refuting an essential element of the charge against him. The court’s distinction that the characterization of the funds for civil tax purposes under § 301 is irrelevant in a criminal tax case is nonsensical because it is the existence of a civil tax deficiency that is an essence of the crime.

At the opposite end of the spectrum, Kayser acknowledged that substance governs form and that an asserted tax liability (as part of a criminal tax evasion case) can be eliminated through after-the-fact tax maneuverings by using otherwise unreported tax deductions. But in Kayser the form was the substance – the deductions had already been used in to offset the corporation’s taxable income. While the court acknowledged that the deductions could not be used twice, the ruling would allow the defendant to shift the already-used deductions from his corporate return to his personal return. That shift would have the effect of eliminating his individual tax liability, leaving his fraudulent act of omitting that income, standing alone, insufficient to support a tax evasion conviction. Although the deduction shift would have simultaneously created a tax deficiency on the corporate side, this deficiency arguably would not be sufficient to support a tax evasion conviction because he had not fraudulently omitted reporting the corporation’s income that year. In one fell swoop, the court allows the defendant to cover all his sins.

If the court is correct in Kayser that a taxpayer may completely rewrite his tax return to immunize himself against criminal liability, consistency requires the same in Boulware. If a taxpayer has diverted corporate funds, but there is evidence that the corporation had earnings and profits during the year the funds were diverted, the diversion has not resulted in a tax deficiency and there is no crime. That the corporation failed to characterize the distribution in a particular manner at the time should not overcome the clear statutory authority that treats the distribution as a nontaxable return of capital.
1 E.g., Sansone v. United States, 380 U.S. 343, 351 (1965); United States v. Marabelles, 724 F.2d 1374, 1377-78 (9th Cir. 1984).
2 United States v. Boulware, 470 F.3d 931, 933 (9th Cir. 2006) (“Boulware II”), cert. granted, ___ U.S. ___, 2007 U.S. LEXIS 9076, 76 U.S.L.W. 3154 (September 25, 2007). The Supreme Court granted cert on the sole question: “Whether the diversion of corporate funds to a shareholder of a corporation without earnings and profits automatically qualifies as a non-taxable return of capital up to the shareholder's stock basis, see 26 U.S.C. § 301(c)(2), even if the diversion was not intended as a return of capital.” id.
3 United States v. Kayser, 488 F.3d 1070 (9th Cir. 2007).
4 Boulware II, 470 F.3d at 933.
5 Id.; United States v. Boulware, 384 F.3d 794, 799 (9th Cir. 2004) (“Boulware I”).
6 Boulware II, 470 F.3d at 933. Boulware was also indicted on one count of conspiracy to make a false statement to influence a financial institution in connection with HIE’s use of false invoices in applying for a loan and four counts of making a false statement to influence a financial institution in connection with the false invoices. He was convicted on all counts. Boulware II, 470 F.3d at 933.
7 Boulware II, 470 F.3d at 933.
8 I.R.C. § 301(c)(1)-(3) (2007).
9 United States v. Miller, 545 F.2d 1204, 1210-12 (9th Cir. 1976), cert. denied, 430 U.S. 965 (1977).
10 Boulware II, 470 F.3d at 935.
11 Boulware II, 470 F.3d at 934.
12 E.g., Truesdell v. Commissioner, 89 T.C. 1280, 1294-95 (1987); IRS Action on Decision CC-1988-025, 1988 AOD Lexis 22 (Sept. 12, 1988) (IRS will no longer argue that funds received in a shareholder capacity are ordinary income regardless of earnings and profits); DiZenzo v. Commissioner, 348 F.2d, 122, 125 (2d Cir. 1965) (in a civil tax evasion case the Tax Court erred in treating diverted corporate funds as ordinary income without considering whether the corporation had earnings and profits equal to the amount of the diverted funds).
13 Miller, 545 F.2d at 1211-12.
14 Miller, 545 F.2d at 1210.
15 id.
16 id.
17 Miller, 545 F.2d at 1211 n.7 (“Miller’s expert witness testified that the basis for Miller’s stock in [the corporation] was $128,200.00 . . . [c]onsequently, $68,800.00 of the $197,000.00 [in diverted funds] would have been subject to capital gains treatment. According to Miller’s calculations, given his claims of capital losses, he concluded that ultimately he owed taxes for only a long term capital gain of $1,699,000 for 1970.”)
18 Arguably this analysis is dicta given the court’s conclusion that even if his argument were correct Miller’s tax evasion conviction would stand on the basis of his conceded $1,699 capital gains tax deficiency. Furthermore, Miller was convicted based on the trial court’s finding that the diverted funds constituted additional salary to Mr. Miller, not a constructive dividend, which he failed to report as income.
19 Miller, 545 F.2d at 1211 (citing Goldberg v. United States, 330 F.2d 30, 40 (3d Cir.), cert. denied, 377 U.S. 953 (1964); Simon v. Commissioner, 248 F.2d 735, 737 (6th Cir. 1956)).
20 Miller, 545 F.2d at 1211.
21 id. at 1211-12.
22 Id. at 1212, 1214 (“[i]f the constructive distribution rules were automatically applied, an anomalous situation would result”).
23 Miller, 545 F.2d at 1214.
24 Id at 1214.
25 Id. at 1214-15.
26 Id. at 1214 n.12.
27 Id. at 1215.
28 See United States v. Williams, 875 F.2d 846, 850-52 (11th Cir. 1989); Davis v. United States, 226 F.2d 331, 335-36 (6th Cir. 1955), cert. denied, 350 U.S. 965 (1956) (where funds diverted from taxpayer’s wholly owned corporation was taxable income to him regardless whether the corporation had sufficient surplus to make the distribution a dividend); United States v. Goldberg, 330 F.2d 30, 38 (3d Cir.), cert. denied, 377 U.S. 953 (1964).
United States v. Bok, 156 F.3d 157, 162 n.1 (2d Cir. 1998); United States v. D’Agostino, 145 F.3d 69, 73 (2d Cir. 1998); United States v. Leonard, 524 F.2d 1076, 1083 (2d Cir. 1975) (allowing the defendant to raise the return of capital theory in a criminal tax prosecution so long as he meets his burden of going forward as to the corporation’s lack of earnings and profits), cert. denied, 425 U.S. 958 (1976); DiZenzo v. Commissioner, 348 F.2d, 122, 125 (2d Cir. 1965) (return of capital defense allowed in a civil tax deficiency case).

D’Agostino, 145 F.3d at 73.

Id.

Id.

Id.; Bok, 156 F.3d at 162 n.1. The Second Circuit would not allow a taxpayer to raise the return of capital defense where the funds were diverted unlawfully, such as in the case of embezzlement, theft, a violation of corporate law, or in an attempt to defraud third party creditors. Id.

Bok, 156 F.3d at 162.

Bok, 156 F.3d at 163-64. However, because Mr. Bok failed to adduce any credible evidence regarding the earnings and profits of the corporation in the year the funds were diverted, the court held that the trial court properly declined to instruct the jury on the return of capital defense, and affirmed Bok’s conviction.

Boulware II, 470 F.3d at 934.

Id.

Id. at 935.

Id. at 934.

Id. at 938 (Thomas, J., concurring) (citing United States v. Marabelles, 724 F.2d 1374, 1380 (9th Cir. 1984)). Judge Thomas emphasized, however, that the outcome of the case would be the same even adopting the Second Circuit’s approach because, in its view, the return of capital defense in criminal cases does not apply if the defendant’s diversion of corporate funds was itself unlawful. Bok, 156 F.3d at 162; Truesdell, 89 T.C. at 1298 (return of capital defense allowed in civil cases only after determination that diverted funds were not unlawful, i.e., “stolen, embezzled, or diverted in fraud of creditors”). Thomas emphasized that because Boulware claimed to have diverted funds to defraud his ex-wife from her share of property in their divorce proceedings, the diversions would likely have been considered unlawful and the return of capital defense would have been denied on that ground. Boulware II, 470 F.3d at 938-39 (Thomas, J., concurring).

United States v. Kayser, 488 F.3d 1070 (9th Cir. 2007).

The evidence did not conclusively establish the amount of his 2000 individual income, only that it was either $41,765 or $53,445. Kayser, 488 F.3d at 1072 n.2.

Kayser, 488 F.3d at 1072.

Id.

Id. at 1072-73.

Id. at 1073.

Id.

Id., citing United States v. Marabelles, 724 F.2d 1374, 1378-79 (9th Cir. 1984); Elwert v. United States, 231 F.2d 928, 933 (9th Cir. 1956)).

Kayser, 488 F.3d at 1074-75 (citing Marabelles, 724 F.2d at 1379 n.3 and Elwert, 231 F.2d at 933).

Kayser, 488 F.3d at 1074-75.

Id. at 1075.

Id. at 1075 n.3.

Id.

Id. at 1075.

Id. at 1077-78 (Kozinski, J., dissenting).

Id. (Kozinski, J., dissenting).

Id. at 1078 (Kozinski, J., dissenting).

Id. at 1078 (Kozinski, J., dissenting).

Boulware II, 470 F.3d at 938 (Thomas, J., concurring).

Miller, 545 F.2d at 1214.