



Employer-Employee Reimbursements - 4th Circuit Approves Burden-Shifting Instruction in Criminal Tax Case

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In a criminal income tax evasion case, the government must of course prove every element of the offense beyond a reasonable doubt, including the defendant's willful failure to report income. In general, payments from an employer to an employee are includable in the employee's gross income, but certain employer reimbursements for business-related expenses qualify as deductions. But - with prison time at stake - which party has the burden of proving that supposed reimbursement payments from an employer to an employee qualify for allowable deductions?

In *United States v. Jinwright*, Nos. 10-5289, -5290 (June 22, 2012), an appeal from the Western District of North Carolina, the Fourth Circuit held that - even in a criminal case - the burden of proving allowable deductions rests squarely on the defendant, not the government. *Jinwright* was a prosecution for conspiracy and tax evasion of a husband and wife who served as co-pastors of an evidently prosperous North Carolina church. After a 4-week trial involving the testimony of more than 70 witnesses, the Jinwrights were convicted of willfully omitting more than \$3 million in taxable income from their joint returns, and were sentenced to 105 months' and 80 months' imprisonment, respectively.

The trial evidence showed that the Jinwrights were salaried employees (and directors) of Greater Salem Church ("GSC"). Mr. Jinwright, for example, received a salary from GSC of about \$300,000 during the final tax year in question. But the Jinwrights also received substantial non-salary benefits from GSC, including housing, travel, and vehicle allowances, bonuses, payments for children's tuition and federal income tax liability, and use for business-expenses of a GSC credit card. Taken together, the couple's total GSC compensation over seven years was nearly \$5 million. Counting as taxable income all GSC compensation by check and all "unsubstantiated" payments for business-related expenses, the IRS calculated that over a five-year period the defendants understated their taxable income by nearly \$2.5 million. Although the Jinwrights defended that they did not intend to avoid their tax obligations and thus did not act willfully, the government proved otherwise - for example, by showing that the Jinwrights instructed GSC employees to alter GSC financial records, and failed to inform their personal CPA about

GSC compensation other than salary and housing allowances.

A complication arose at trial, however, when three former GSC employees called to the witness stand by the government - a business administrator, a finance administrator, and an administrative assistant - described certain payments from GSC to the Jinwrights as "gifts." In each instance, the government objected that the testimony would mislead the jury that the compensation from GSC was nontaxable. In response, the trial judge - a total of four times - instructed the jury among other things that employer payments to an employee as reimbursements for business-related expenses "must be included in the gross income of the employee" unless certain conditions are met - namely, the expenses are "ordinary and necessary business expenses"; the "business nature of the expenses has been substantiated"; and "any unsubstantiated payments have been returned to the employer." See 26 C.F.R. section 1.62-2 ("Reimbursements and other expense allowance arrangements").

On appeal, the Jinwrights argued that the court's instruction about reimbursements effectively created a *presumption* that any GSC payments were includable in gross income, thus shifting to them the burden of proving that the unreported payments were deductible reimbursements for substantiated business expenses.

"Exactly," said the Fourth Circuit, in effect. Under the tax laws, the burden of showing a right to claimed deductions is on the taxpayer, not on the government. *And that circumstance remains true even in a criminal case.* Thus, the *Jinwright* court joined several other circuits in holding that, in a tax evasion case, once the government establishes unreported income from an employer, a presumption arises that the income was taxable as a matter of law. Under that presumption, the burden shifts to the employee to prove that the payments satisfied the tax law's reimbursement criteria and were deductible. Therefore, the court concluded in affirming the Jinwrights' convictions, the trial judge's burden-shifting instruction "contained no constitutional infirmity."

The *Jinwright* court distinguished another tax case, *United States v. Mogavero*, 521 F.2d 625 (4th Cir. 1975), a so-called "net worth" prosecution. In *Mogavero*, the challenged jury instruction impermissibly shifted to the defendant the burden of proving that he received certain unreported funds in the form of cash loans from his parents. In reversing Mogavero's convictions, the Fourth Circuit concluded that the instruction in question "cast[] the burden on the defendant to prove beyond a reasonable doubt that his parents were the source of his funds in order to gain acquittal." This was error, since in a net worth income tax prosecution "the burden of disproving a defendant's claimed source of nontaxable receipts rests on the government."

The contrast in the Fourth Circuit's criminal tax landscape is noteworthy. Under *Mogavero*, a criminal tax defendant shown to have unexplained net worth can require the government to *disprove* - beyond a reasonable doubt - the defendant's claimed nontaxable source of funds. But, *Jinwright* holds, once the government establishes unreported payments from an employer, an employee asserting that the payments were deductible reimbursements for business expenses must shoulder the burden of proof.

For more information about this topic, please contact the author or any member of the Williams Mullen eDiscovery and Information Governance Team.

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