Methods of Proof

Proof

Proving a financial crime is to show by documenting where a subject's money came from and where it went.

Follow the money!!!!!

Proof

- What does Methods of Proof mean?

- What are we proving?

- Who are we proving it to?

- How accurate do we have to be?

Proof vs. Evidence

- Proof is the end result or effect of evidence, while evidence is the medium or means by which a fact is proved or disproved

- Evidence refers to pieces of information and facts.

- Proof is the logical conclusion we arrive after analyzing the evidence.
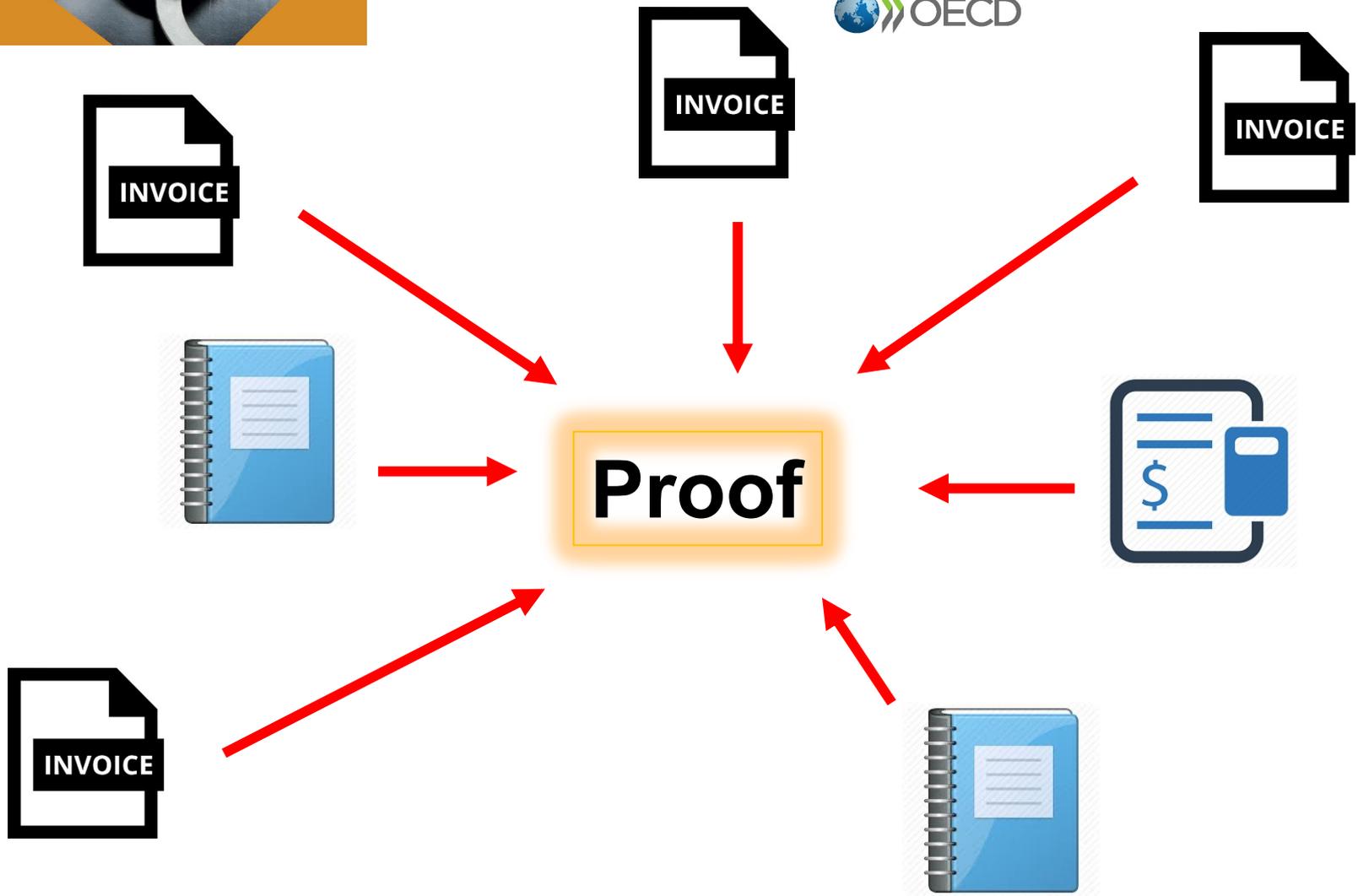
Proof is what you get by analyzing all the evidence.

Methods of Proof

Direct

- Specific Item

Indirect

- Net Worth

- Expenditures

- Projection Method

SPECIFIC ITEMS METHOD

Definition:

- Specific items of income not reported on tax return

- Specific items of expenses overstated on tax return.

Specific Items Method

Direct method:

- Supported by direct evidence

- Proves a fact

- Does not prove that everything else reported is correct

- Can be supported with an indirect method

The Direct/ Specific Items Method

An investigation of *specific transactions* that were not completely or accurately reflected on the subject's income tax return.

It is supported with direct evidence making it the most difficult for the subject to refute.

Two approaches (Basic and Aggregate)

The Basic Approach
Example

The reconciliation		**As per investigation**	
Total Income as filed per Subject's return	$100 000	Additional sales found during searches	
Sales per Subject's books and records		Sale 5 – Client A	$ 50 000
		Sale 6 – Client E	$ 30 000
Sale 1-Client A	$ 20 000	Sale 7 – Client F	$ 70 000
Sale 2-Client E	$ 30 000	Sale 8 – Client H	$ 60 000
Sale 3- Client H	$ 40 000		
Sale 4- Client O	$ 10 000	Unreported Sales	$ 210 000
	$100 000		
Different	0		

The Aggregate Approach
Example

Sales Documented by 3rd Parties:

- Witness A $ 50,000
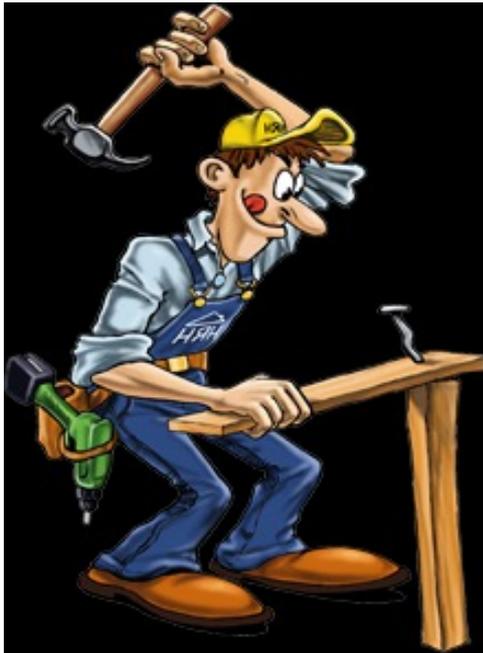- Witness B   100,000
- Witness C   50,000
Verified sales by investigation $200,000

Less: Reported Sales per tax return   ($150,000)

Equals: Unreported Sales $ 50,000

Understatement of Income

Numerous items of income not reported.

– Sales revenue

– Salaries, commissions, fees.

– Proceeds from narcotics, extortion, gambling, etc.

Understatement of Income

Overstatement of Expenses

- Amount of expenses overstated or false

- Expense not deductible

- Suspect (or related party) benefitted if a personal expense

- Suspect personally involved and knew amount on tax return overstated or were false

Disposition of Funds

- Helps develop proof of willfulness

- Documents that unreported income not used to pay business expenses

- Demonstrates unreported income supported suspect's lavish lifestyle

Example – lavish lifestyle
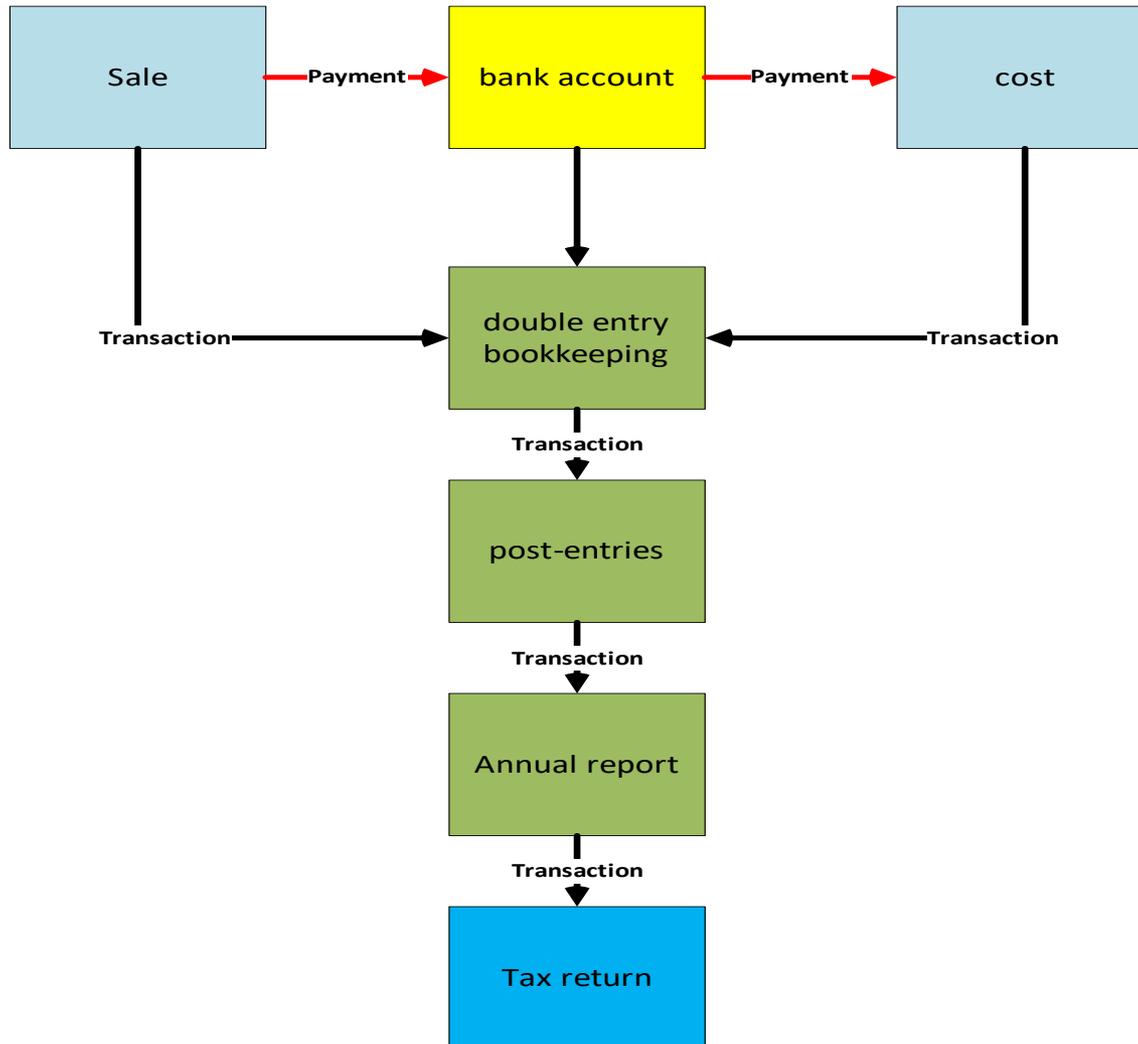
Investigating – Direct Method of Proof

- Books and records
- Bank records
- Tax returns
- Interview
- Standard of Living

Summary

- The Direct method of proof is an easy way to prove unreported income (but you also have to use the Net Worth)

- The Key to proving a financial crime is follow the flow of funds and movement of money

- Methods of proof help investigators do that

| Sale | →Payment→ | bank account | →Payment→ | cost |

```
Sale ──Payment──▶ bank account ──Payment──▶ cost
  │                    │                      │
Transaction           │                 Transaction
  │                    ▼                      │
  └──────────▶ double entry bookkeeping ◀─────┘
                       │
                  Transaction
                       ▼
                  post-entries
                       │
                  Transaction
                       ▼
                 Annual report
                       │
                  Transaction
                       ▼
                  Tax return
```

Ghost employee

An individual on the payroll of a company who doesn't actually work for the company - can be real or fictitious

Ghost employee

➢ Payroll and employee lists (such as time and attendance records)

➢ Personnel files, employment applications, tax withholding forms (if applicable), and applicable employment identification numbers

➢ Payroll cheques, direct deposits or other payment methods

Ghost employee

➢ Compare personnel office employee records with the payroll records

➢ Verify the employee's claimed employment identification numbers
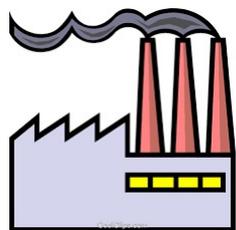
➢ Look for inflated salaries and travel expenses
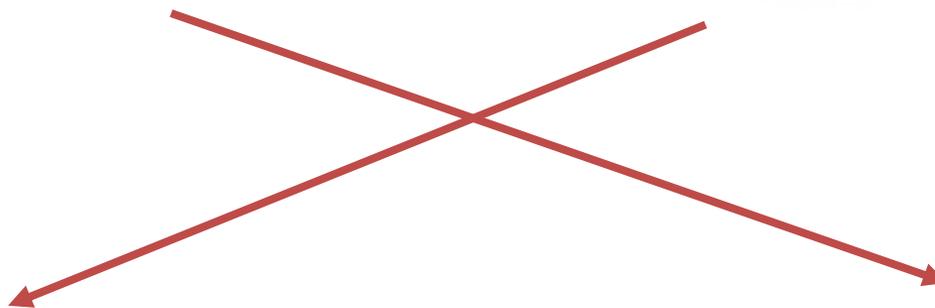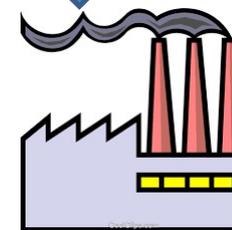
Ghost employee

"Largest case in Denmark of human trafficking"

False invoices and documents

- Follow the money

- Look at dates, numbers, names and addresses
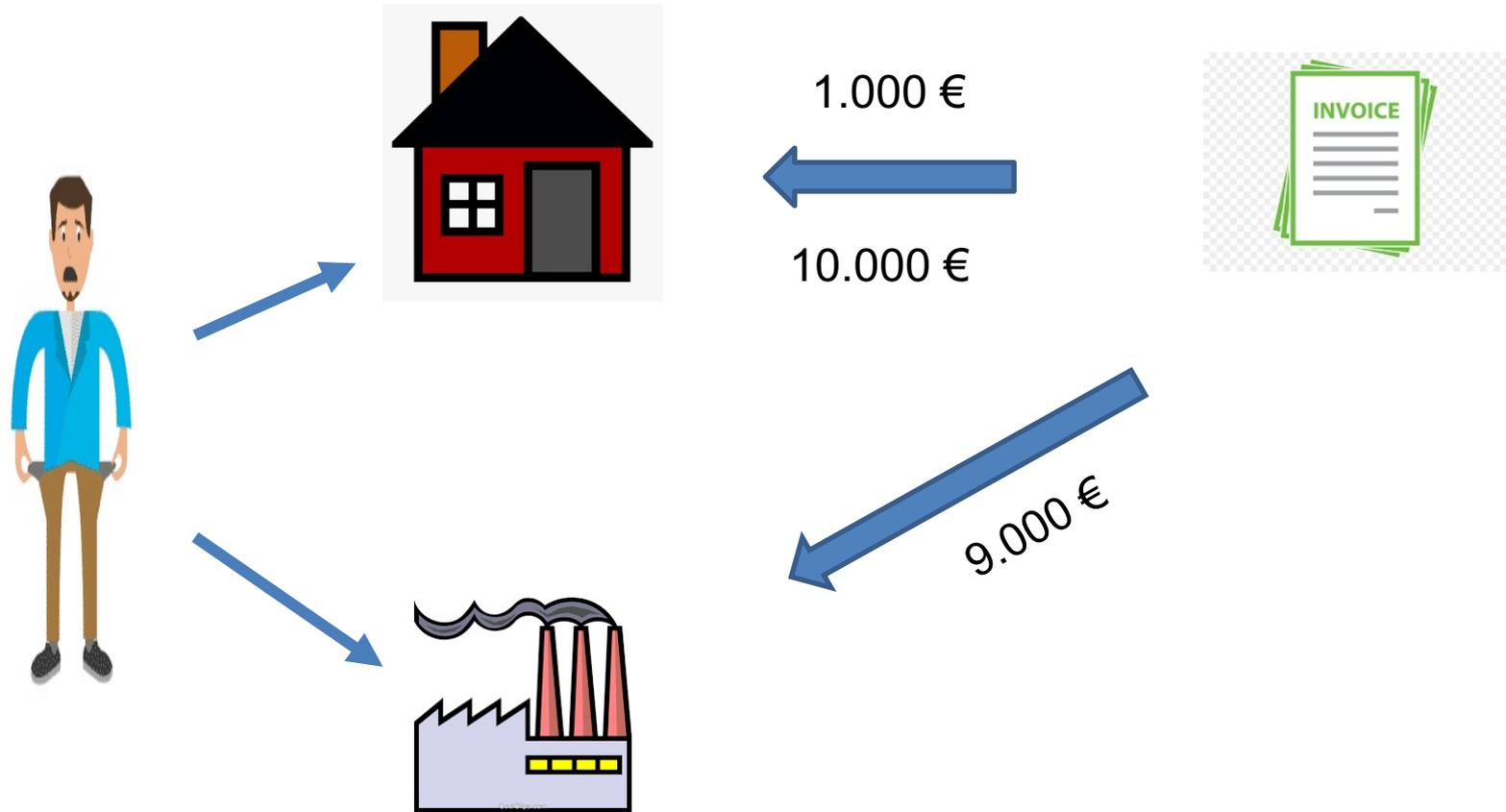
- Assets and liabilities connecting to the documents

Overbilling Schemes

➢ Notations on invoices or other billing documents, extra or special charges.

➢ Discrepancies between the purchase order or invoice amount and the amount of payment.

➢ Unusually large amounts appearing on particular bills, or bills which break a consistent pattern as shown on the books and records.

1.000 €

10.000 €

9.000 €

Porsche 911

BAT L. . . .
Sascha Fehrenbach
Apothekerholz 3
24623 Brokenlande
Tel(04327)354 & Fax 429
Steuer-Nr.: 24 068 00623

```
*          53,15 Liter SÄULENR    4 *
*Benzin bleifrei    A      75,15 EUR*
```

```
                              VISA
Terminalnummer            85500588
Karte PAN          ###########
Gültig bis:                06/2012
Tracenummer                  13070
VU-Nr.                  4556802321
GenehmigungsNr.             152510
Betrag                       75,15
```

Karte akzeptiert

56,32

KUNDENBELEG

```
              VISA         75,15 EUR
```

```
TOTAL              75,15 EUR
```

```
MWST 19,00% A            12,00 EUR
            NETTO         63,15 EUR
```

```
#41304  15.07.07 15:24  B02  K.0001
```

Dank & Gute Fahrt

Bundesautobahn
Tankstelle Hasselberg Ost
A7 Richtung Hannover
34593 Knüllwald-Oberbeisheim
Tel 05685-9220109
Fax 05685-9220113

```
*          56,26 Liter SÄULENR  3*
*SUPER        A        82,36 EUR*
  1,464 EUR/Liter
```

```
  Zwischensumme       82,36 EUR
          VISA
Beleg    7594
```

```
          VISA       82,36 EUR
```

```
TOTAL             82,36 EUR
```

```
MWST 19,00% A        13,15 EUR
        NETTO   6/5,2?  21 EUR
```

```
#55068 15.07.07 12:14 B13 K.0002
```

Vielen Dank
Gute Fahrt!
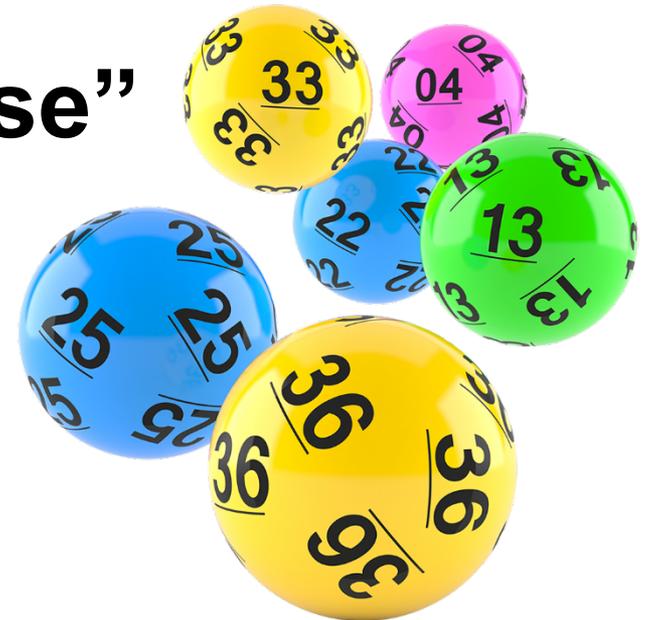
```
StNr. Kraftst.        33630026
StNr.                 490843
```

Reviewing Suspect´s Payments

Bank account information
Depositing and withdrawals
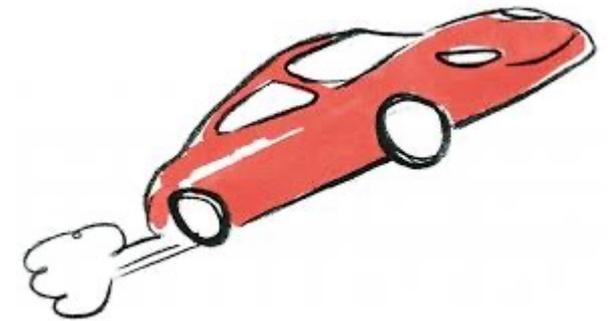Deliveries
Lucky dispositions

Lucky dispositions

"The Lottery Case"

The Net Worth Method

More wealth at the end of the year Than at the beginning of that year – needs income !!
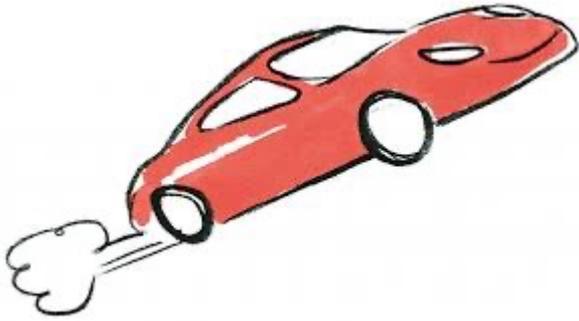
FUNDAMENTALS OF A NET WORTH

- A Net Worth is used to show the court that the subject incurred personal expenditures and accumulated more wealth than he/she had available to them from reported sources of income during the Net Worth period.

- The Net Worth <u>does not provide direct evidence of tax evasion</u>.

- It quantifies the amount of money and places it in the hands of the accused.

1/1	0 €
House	100.000 €
Car	10.000 €
Debt	0 €
31/12	110.000 €

Lottery

1/1	0 €
House	100.000 €
Car	10.000 €
Debt	0 €
31/12	110.000 €

Unreported income

Underlying Theories

The concept of a Net Worth is simple.

- That unreported net income can only be used in four ways:
  - To buying assets
  - To save it
  - To paying off debts
  - To pay for personal expenditures/ spending it

Net Worth

No income

| Net Worth 1/1 2014 | → | 2014 | → | Net Worth 31/12 2014 |

Expenditures
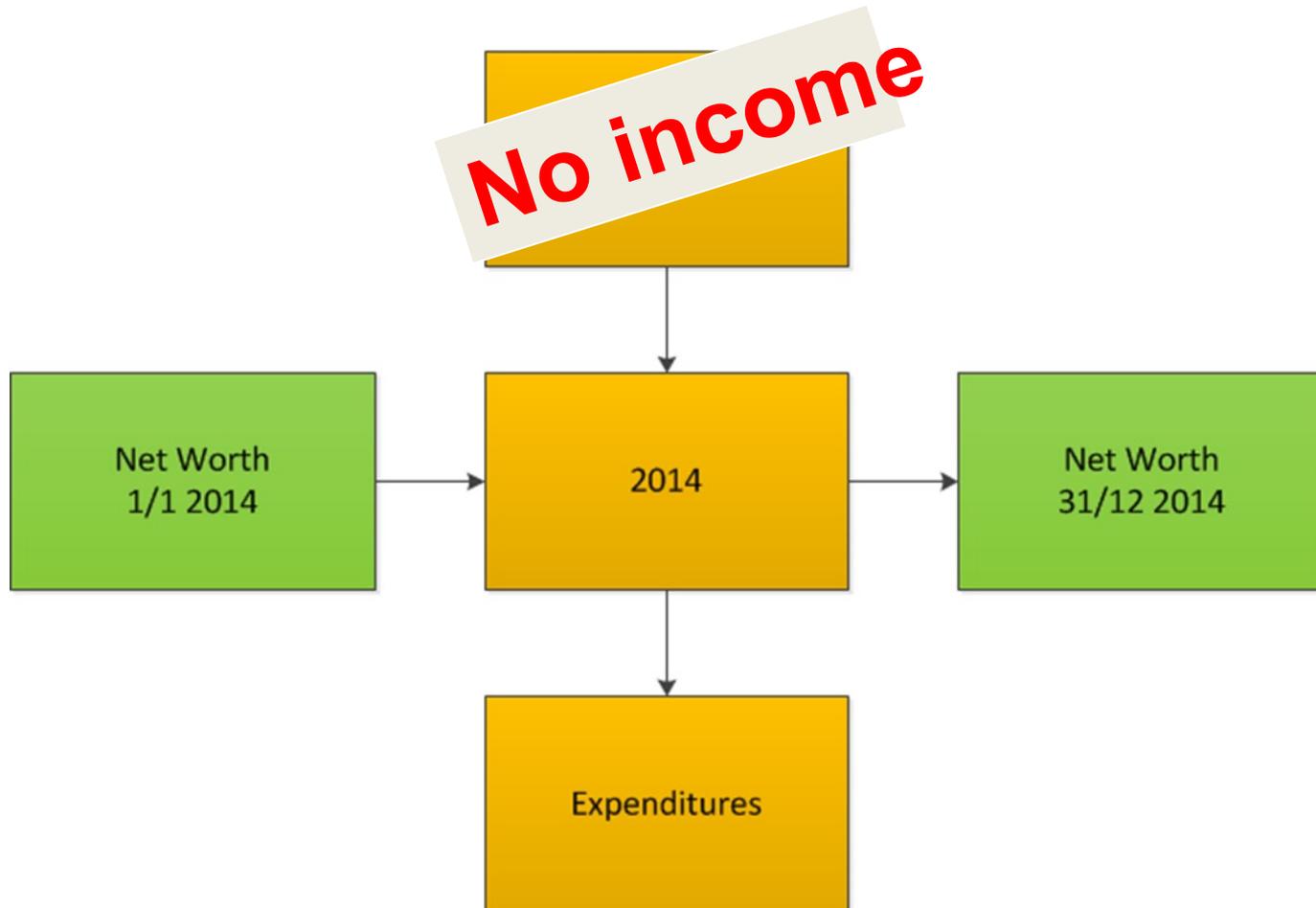
How do we use Net Worth in Denmark

- Previously we used it - as the basis for calculating taxable income

- Start of case

- Basis for searching - suspicious

- Along with other parameters

- As an estimated

- If unreported Income – need the source

		ASSETS
LESS	-	<u>LIABILITIES</u>
EQUALS		**NET WORTH**
LESS	-	<u>PRIOR YEAR'S NET WORTH</u>
EQUALS		**INCREASE/DECREASE IN NET WORTH**
ADD/ LESS	+/-	PERIOD DEFERMENT
LESS	-	NON-TAXABLE SOURCES
LESS	-	<u>REPORTED INCOME</u>
EQUALS		**CALCULATED PERSONAL EXPENDITURES**
ADD	+	KNOWN PERSONAL EXPENDITURES
EQUALS		**<u>UNREPORTED INCOME</u>**

ASSETS

- Cash on hand

- Money in bank

- Real Estate – residence and cottage

- Vehicles

- Investment accounts

- Loans receivable

Assets – Net Worth

	31/12 17	**31/12 18**
Money in bank	9.837 €	38.956 €
Real Estate	500.000 €	600.000 €
Car	10.000 €	10.000 €
Sub total	519.837 €	648.956 €

How to Determine Assets

- When was it received and from whom?

- How much did it cost?

- How was it paid for (currency, check, cashier's check)?

- What source of funds was used to receive it?

- What documentation exists for the purchase?

Investigating Assets

- What information do we have?

- What information do we want?

- Where do we find the information?

- What if we can't get the information?

Assets – Net Worth

	31/12 17	31/12 18
Money in bank	9.837 €	38.956 €
Real Estate	500.000 €	600.000 €
Car	10.000 €	10.000 €
Sub total	519.837 €	648.956 €

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	519.837	648.956
Less: Liabilities		
Net Worth		
Less: Prior Year		
Net Worth Increase (Decrease)		
Period Deferment		
Less: Non-Taxable Sources		
Less: Reported (Known) Income		
Calculated Personal Expenditures		
Add: Personal Expenditures		
Unreported (Illegal) Income		

A Case
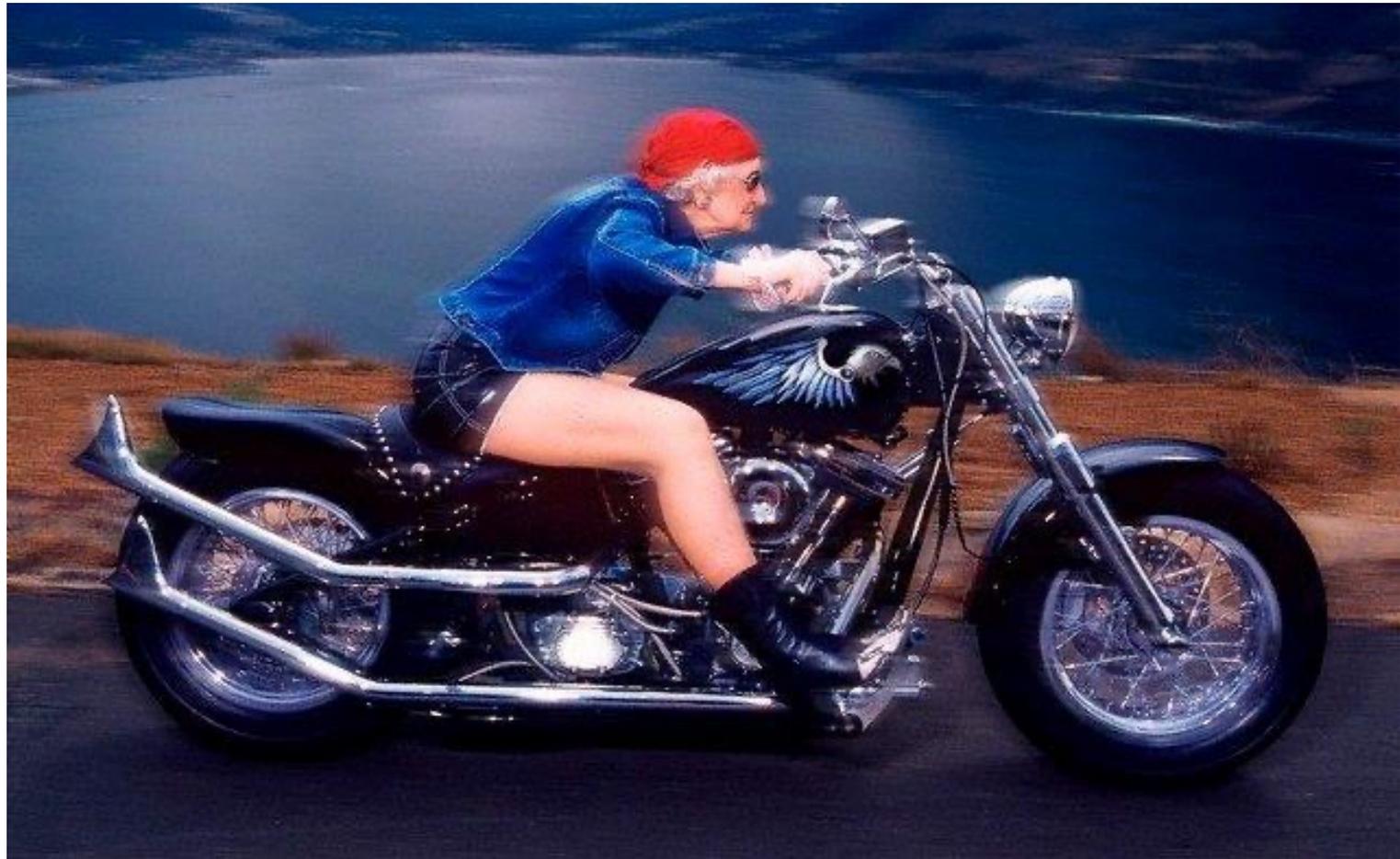
LIABILITIES

- Mortgage

- Credit Cards

- Line of Credit

- Loans

Liabilities

	31/12 17	31/12 18
Credit Cards	22.654 €	10.258 €
Mortgage	200.000 €	150.000 €
Car loans	10.000 €	8.000 €
Sub total	232.654 €	168.258 €

How to Determine Liabilities

- When was the liability incurred?

- Who was the creditor or lender?

- What was the original amount of the liability?

- What is the present balance due?
- What was the purpose of the loan or debt?
- How were the proceeds used and where were they deposited?
- What security (collateral), if any, was given for the debt?
- What documentation exists for the transaction and where is it?

Investigating Liabilities

- What information do we have?

- What information do we want?

- Where do we find the information?

- What if we can't get the information?

Liabilities

	31/12 17	31/12 18
Credit Cards	22.654 €	10.258 €
Mortgage	200.000 €	150.000 €
Car loans	10.000 €	8.000 €
Sub total	232.654 €	168.258 €

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	519.837	648.956
Less: Liabilities	(232.654)	(168.258)
Net Worth	287.183	480.698
Less: Prior Year		(287.183)
Net Worth Increase (Decrease)		193.515
Period Deferment		
Less: Non-Taxable Sources		
Less: Reported (Known) Income		
Calculated Personal Expenditures		
Add: Personal Expenditures		
Unreported (Illegal) Income		

Period deferment

Change in value of assets or liabilities.

Period deferment

Picasso's Musketeer Bust (1968)

Period Deferment – Net Worth

	31/12 17	**31/12 18**
Money in bank	9.837 €	38.956 €
Real Estate	500.000 €	600.000 €
Car	10.000 €	10.000 €
Sub total	519.837 €	648.956 €

Period deferment

- Example: (only the value)

Property 31/12 2017	500.000 €
Property 31/12 2018	<u>600.000 €</u>
Period deferment	100.000 €

Net Worth Formula	31 Dec 13	31 Dec 14
Assets	519.837	648.956
Less: Liabilities	(232.654)	(168.258)
Net Worth	287.183	480.698
Less: Prior Year		(287.183)
Net Worth Increase (Decrease)		193.515
Period Deferment		100.000
Less: Non-Taxable Sources		
Less: Reported (Known) Income		
Calculated Personal Expenditures		
Add: Personal Expenditures		
Unreported (Illegal) Income		

Non-Taxable Sources

- Lotto & Casino Winnings

- Insurance Proceeds

- Inheritance and Other Gifts

- Money from the Old Country

- Sale of Personal Assets

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	519.837	648.956
Less: Liabilities	(232.654)	(168.258)
Net Worth	287.183	480.698
Less: Prior Year		(287.183)
Net Worth Increase (Decrease)		193.515
Period Deferment		100.000
Less: Non-Taxable Sources		0
Less: Reported (Known) Income		
Calculated Personal Expenditures		
Add: Personal Expenditures		
Unreported (Illegal) Income		

Reported Income

Reported Total Income   140.000 €

Taxes paid   (30.000) €

                                          110.000 €

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	519.837	648.956
Less: Liabilities	(232.654)	(168.258)
Net Worth	287.183	480.698
Less: Prior Year		(287.183)
Net Worth Increase (Decrease)		193.515
Period Deferment		100.000
Less: Non-Taxable Sources		0
Less: Reported (Known) Income		(110.000)
Calculated Personal Expenditures		
Add: Personal Expenditures		
Unreported (Illegal) Income		

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	519.837	648.956
Less: Liabilities	(232.654)	(168.258)
Net Worth	287.183	480.698
Less: Prior Year		(287.183)
Net Worth Increase (Decrease)		193.515
Period Deferment		100.000
Less: Non-Taxable Sources		0
Less: Reported (Known) Income		110.000
Calculated Personal Expenditures		16.485
Add: Personal Expenditures		
Unreported (Illegal) Income		

PERSONAL EXPENDITURES

- Food – home & restaurant

- Clothing

- Entertainment

- Transportation

- Tobacco and alcohol

- Other – gifts, lottery tickets, life insurance and much more.

	Hele landet	Enlige uden børn	Enlige med børn	2 voksne uden børn	2 voksne med børn	Husstande med mindst 3 voksne
	kr. pr. husstand					
Forbrug I alt	**300480**	**187468**	**246764**	**340985**	**417211**	**454247**
Fødevarer og ikke-alkoholiske drikkevarer	36261	20322	34015	39122	55719	59480
Alkoholiske drikkevarer og tobak	6700	4775	5018	8473	7011	9055
Beklædning og fodtøj	11325	5952	9372	12748	18301	17536
Boligbenyttelse, elektricitet og opvarmning	98046	74384	87320	107180	119858	132367
Møbler, husholdningsudstyr og husholdningstjenester	15884	7764	11424	19612	25443	22580
Sundhed	7716	6247	4333	10851	6607	7062
Transport	40732	20548	28550	49133	59157	69804
Kommunikation	8497	5676	8837	8645	11238	14611
Fritid og kultur	29053	17298	21078	36407	35427	45894
Uddannelse	1446	874	3711	206	3519	3139
Restauranter og hoteller	16942	9074	10852	20429	23058	30061
Andre varer og tjenester	27879	14553	22253	28179	51872	42658
	antal					
Antal personer i husstanden	**2,1**	**1,0**	**2,5**	**2,0**	**4,0**	**3,7**
Heraf voksne	1,7	1,0	1,0	2,0	2,0	3,1
Heraf børn	0,4	0,0	1,5	0,0	2,0	0,6
Husstande i undersøgelsen	**2194**	**718**	**86**	**833**	**429**	**128**
Husstande i Danmark (1.000)	**2686**	**1040**	**123**	**829**	**438**	**257**
Antal personer i Danmark (1.000)	**5684**	**1040**	**305**	**1657**	**1730**	**951**

Investigating Personal Expenses

- What information do we have?

- What information do we want?

- Where do we find the information?

- What if we can't get the information?

Personal Expenditures

Food – home & restaurant	45.000 €
Clothing	2.000 €
Entertainment	1.000 €
Transportation	2.000 €
Tobacco and alcohol	1.000 €
Other	<u>4.000 €</u>
Total Personal Expenditures for 2018	55.000 €

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	519.837	648.956
Less: Liabilities	(232.654)	(168.258)
Net Worth	287.183	480.698
Less: Prior Year		(287.183)
Net Worth Increase (Decrease)		193.515
Period Deferment		100.000
Less: Non-Taxable Sources		0
Less: Reported (Known) Income		110.000
Calculated Personal Expenditures		16.485
Add: Personal Expenditures		55.000
Unreported (Illegal) Income		38.515

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	200.000	250.000
Less: Liabilities	(50.000)	(250.000)
Net Worth	150.000	0
Less: Prior Year		(150.000)
Net Worth Increase (Decrease)		150.000
Minimum Reported Income		?
Personal Expenditures		200.000
Total Income Per Net Worth		0

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	100.000	250.000
Less: Liabilities	(50.000)	(50.000)
Net Worth	50.000	200.000
Less: Prior Year		(50.000)
Net Worth Increase (Decrease)		?
Minimum Reported Income		?
Personal Expenditures		200.000
Total Income Per Net Worth		?

Net Worth Formula	31 Dec 17	31 Dec 18
Assets	200.000	50.000
Less: Liabilities	(50.000)	(250.000)
Net Worth	150.000	200.000
Less: Prior Year		(150.000)
Net Worth Increase (Decrease)		?
Minimum Reported Income		?
Personal Expenditures		200.000
Total Income Per Net Worth		?

FAMILY MEMBERS

- The financial information (assets, liabilities and personal expenditures) will be based on that of a shared household unit.

- Will include the suspect, a husband or wife or common-law partner, and any minor dependant children residing with them during the period.

- Could also include parents living with the suspect.

Typical Defences

The most prevalent defense presented is that the monies are from another source:

- Money from the old country

- Inheritance

- Gambling (not taxable in some countries)

- Loans from family and/or friends

- Gifts

A Case

The rich Uncle in America

Factors in a Strong Net Worth

- Documentation.

- Credibility.

- Presentation.

- Validity of Evidence.

No information at all !!

They always have information about –

how much they earn and from whom

Country to Country

Summary

The basic premise of the net worth method of proof is that if the taxpayer has more wealth at the end of a year than at the beginning of the year, and it does not result from non-taxable income/ reported income for that year

Unreported income