

**UNITED STATES v. WATKINS**  
**79-2 U.S.T.C. ¶ 9548 0979)**  
**44 AFTR2d 79-5222 (1979)**

(Timber issue only)

*Editor's Summary*

*Key Topics*

**CUTTING AS SALE OF EXCHANGE**

- Theft
- Used as evidence of
- Who may make election

*Facts*

An individual was convicted of tax evasion. The conviction was appealed, in part on the basis that evidence derived from the individual's election under Sections 631(a) and 1231 was prejudicial. The individual harvested timber in both his own name and on behalf of other logging farms on a contractual basis. Analysis of his accounting records showed that in 1973 he had sold 1.4 million board feet more timber than he had acquired through his logging operation. The taxpayer contended that the excess was obtained from a tract which he had logged on his own account, while the Government contended that it was obtained from a tract being logged on a contract basis. A taxpayer who cuts stolen timber cannot claim Section 631(a) treatment for such timber, because he neither owns the timber nor has a contract right to cut and sell it on his own account. At trial, the taxpayer did not dispute the Government's contention that, the 1.4 million board feet did not qualify for Section 631(a) treatment. The taxpayer argued that the only purpose for presenting the evidence--to counter claims that the timber was harvested legally--no longer existed and was therefore prejudicial. :

*Court of Appeals*

Held: For the Government. The Court could not conclude that admission of the evidence was clearly prejudicial. The government used the evidence not merely to show that substantial tax was due and owing, but also to show that the taxpayer provided false information in an effort to avoid tax,

*Case Text*

Sneed, Circuit Judge: Watkins appeals from his conviction after jury trial on three counts of tax evasion, 26 U.S.C. § 7201. He attacks the district court's admission of three types of evidence. Our jurisdiction is based on 28 U.S.C. § 1291. We affirm.

## ***I. Procedural History***

Appellant Watkins was indicted June 29, 1977 on five counts. Three counts alleged that he willfully attempted to evade taxes for the years 1971 through 1973; two counts charged Watkins and others with stealing, and conspiring to steal, timber owned by the United States. The trial court ordered separate trial for the timber theft counts and the tax evasion counts. The theft charges were tried first and a mistrial declared after the jury was unable to reach a verdict. Thereafter the tax evasion counts were tried, and the jury convicted Watkins on each of three counts of attempted tax evasion. The trial judge sentenced Watkins to two and one-half years' imprisonment and imposed a \$5,000 fine.

## ***II. Alleged Errors of Trial Court***

Appellant in this appeal urges that his convictions should be reversed because the trial court erred in three respects. Concisely put, these alleged errors are as follows:

- I. The trial judge erred in admitting evidence of theft in the trial for tax evasion,
- II. The trial judge erred in admitting into evidence declarations of alleged co-conspirators,
- III. The trial court erred in admitting into evidence Watkins' failure to file federal income tax returns for the three successive years immediately preceding the first year for which tax evasion was charged.

We hold that no error was committed by the trial court. Each alleged error will be discussed separately.

## ***III. Evidence of Theft***

The government must carry the burden of proving an affirmative act of tax evasion to satisfy § 7201. *Spies v. United States* [43-1 USTC ¶ 9243], 317 U.S. 492, 63 S.Ct. 364, 87 L. Ed. 418 (1943). *See United States v. McNulty* [76-1 USTC ¶ 9215], 528 F. 2d 1223 (9th Cir.), *cert. denied*, 425 U.S. 972, 96S. Ct. 2170, 48 L. Ed. 2d 796 (1976). The government asserted at trial and argues here that certain evidence of theft was relevant to one of the affirmative acts charged. Appellant requested exclusion of the evidence on the ground that he had conceded the only fact to which the evidence was relevant and that the prejudicial impact of the evidence outweighed its probative value.

To understand the evidence to which appellant objects it is necessary to describe a provision of the federal income tax law, Section 631(a) of the Internal Revenue Code accords income from timber operations special treatment. It is a special elective provision that allows a taxpayer who meets the section's criteria to treat the cutting of timber as the sale and exchange of a capital asset under section 1231.<sup>1</sup> The necessary criteria are: (1) the taxpayer must have owned or had a contract right to cut timber and sell it for his own account; (2) the taxpayer must have cut timber for sale on his own account; and (3) the taxpayer must have owned or held a contract right to the timber for more than six months before the beginning of the year. A taxpayer who cuts stolen timber fails to meet these criteria and cannot claim section 631(a) treatment, because he neither owns the timber nor has a contract right to cut or sell it in his own name.

It is undisputed that appellant harvested timber both in his own name and on behalf of other logging firms on a contractual basis. Through his accountant appellant presented the government with records of his timber business for 1973. Analysis thereof revealed that in 1973 appellant sold 1.4 million board feet of timber in excess of the amount he acquired through his logging operations. Again through his accountant appellant represented the excess derived from cutting on a tract of land know as Sesech Gulch, which appellant had logged in his own behalf. The government theorized that instead the excess had been Stolen by the appellant from the Ash Flat tract, which appellant had logged on behalf of another company. By falsely representing the source of the lumber, the government contended, Watkins sought to establish section 631 eligibility. Such conduct, the government concludes, constituted an affirmative act of tax evasion for purposes of § 7201.

At trial appellant's counsel repeatedly objected to the theft evidence. He stated that appellant did not dispute the Volume figures presented by the government as the amount of timber for which appellant was entitled to Claim section 631(a) treatment. These figures excluded the 1.4 million board feet which the government claims had been stolen. Defense counsel therefore argued the evidences' only purpose-- to counter anticipated claims that the excess timber was harvested legally no longer existed. But this evidence also was relevant to the inference to be drawn from appellant's statement that the excess timber volume must have come from Sesech Gulch. The government sought by the evidence not merely to show a substantial tax due and owing; but also to show that Watkins provided, through his accountant, false information in an effort to avoid tax.

The admissibility of this evidence turns upon the interrelationship of four Federal Rules of evidence. Fed. R. Evid. 401 defines "relevant evidence" as "evidence having any tendency to make the existence of any fact that of consequence to the determination of action more probable or less probable than it would be without the evidence." This standard is clearly met; the evidence tends to establish the required "affirmative act." *See Edwards v. United States* [67-1 USTC ¶ 9356], 375 F.2d 862, 866 (9th Cir. 1967), *overruled on other grounds, United States v. Bishop* [73-1 USTC ¶ 9459], 412 U.S. 346, 93 S.Ct. 2008, 36L. Ed. 2d 941 (1973). Fed. R. Evid. 402, the second applicable Rule, provides that relevant evidence is admissible unless otherwise excludable. Fed. R. Evid. 404(b) permits evidence of other crimes, wrongs, or acts for a proper purpose, but prohibits the use of such evidence to prove a criminal disposition. *See United States v. McDonald*, 576 F. 2d 1350 (9th Cir.), *cert. denied*, --U.S.-- and--, 99 S.Ct. 105 and 312, 58 L. Ed. 2d 124 and 320 (1978). A proper purpose includes proof of a "plan" by which taxes were evaded. The evidence in question here served that purpose thereby overcoming any bar of Rule 404(b). However, despite the relevance of the evidence, and the inapplicability of a specific exception to admissibility, Rule 403 gives a trial judge discretion to exclude the evidence. Rule 403 reads:

Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by consideration of undue delay, waste of time, or needless presentation of cumulative evidence.

The striking of the balance between the probative value of particular evidence and the danger of prejudice is unmistakably committed to the trial judge's discretion. *United States v. Riggins*, 539

F. 2d 682, 683 (9th Cir. 1976), *cert denied*, 429 U.S. 1045, 97 S.Ct. 749, 50 L. Ed. 2d 758 (1977). See *United States v. Curtis*, 568 F. 2d 643, 645-46 (9th Cir. 1978); *United States v. Butcher*, 557 F. 2d 666, 670 (9th Cir. 1977). We defer to the trial judge's assessment in the absence of a clear abuse of this discretion, We cannot say that admissions of the theft evidence was a clear abuse of discretion. The judge carefully instructed the jury as to the limited purpose for which the evidence was admitted. Prejudice may have been generated, but the balance struck was within the bounds of the trial judge's discretion.

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1 Section 631 requires that a taxpayer make a binding election to employ its Provisions on the return for the taxable year timber is cut. Such an election cannot be made on an amended return. Though it is arguable that Watkins may be precluded from: the benefits of section 63 l(a) for civil purposes, the government conceded at trial that, for the purposes of a criminal case, Watkins would be allowed the benefits of that section as if he had made the requisite election in each year.