REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
MANILA

EUGENIO PEREZ,
Petitioner,

versus

B. T. A. 189

J. ANTONIO ARANETA, Acting
Collector of Internal
Revenue,
Respondent.

x - - - - - - - - - - - - - x

February 13, 1956

D E C I S I O N

On September 3, 1952, respondent assessed against petitioner the sum of ₱369,708.27 as deficiency income tax and 50% surcharge from 1945 to 1950. Upon request for reconsideration of said assessment, respondent reduced the amount to ₱186,-170.43 in a letter dated July 9, 1953. Subsequently, the said amount was increased to ₱197,179.85 in a letter of respondent dated November 6, 1953. Upon refusal of respondent to consider further requests for reinvestigation and reexamination of the case, petitioner appealed to the then Board of Tax Appeals. This case is now before this Court by virtue of Section 21 of Republic Act No. 1125, which requires that all cases pending in said Board of Tax Appeals on the date of approval of said Act on June 16, 1954 shall be transferred to this Court and shall be heard and decided by the latter to all intents and purposes as if they had been originally filed therein.

Before the hearing of the case on the merits, counsel for petitioner filed a motion raising the question of the propriety of the use of the "net worth method" applied by respondent in the investigation of the incomes and increases in net worth of petitioner and in the assessment of his deficiency income tax during the years in question. It was alleged in said motion that the use of the "net worth method" is invalid as the Income Tax Law does not permit its use in proving undeclared income, and since this issue is a prejudicial question, the same should first be disposed of before the petition for review is heard. In a resolution dated October 4, 1954, this Court ruled that-

> "X X X the question as to whether the 'Net Worth Method' is arbitrary and unjust is a matter that counsel for the petitioner should prove at the trial of this case, particularly how it was so in the case of his client. It would be too premature for the Court to decide the legality or the illegality of the method at this stage of the proceedings without knowing fully the facts upon which an intelligent decision could be based. Piecemeal decisions are looked upon with disfavor by the Supreme Court. (Director of Lands vs. Sanz, 45 Phil. 117.)"

During the hearing, another question was raised by counsel for petitioner. He asked that he be allowed to present additional evidence in chief after respondent shall have presented his evidence in chief and after the latter shall have rested his case. This was opposed by counsel for respondent on the grounds that it is irregular and violative of the procedural law. The issue was resolved by this Court in its Resolution of April 15, 1955, which reads, in part, as follows:

> "Acting on the verbal motion of counsel for the petitioner that he be allowed

to present additional evidence in chief after the respondent shall have rested his case and it appearing:

"That counsel for the petitioner has already formally presented a great portion of his evidence in chief during the past hearings of this case with the exception of his last witness, the petitioner herein, who was not then available, he being confined at John Hopkins Hospital in Baltimore, Maryland, U.S.A.;

"That on motion of counsel for the petitioner, Letters Rogatory was issued by this Court in order to obtain the deposition of the petitioner in the United States, although the same was not served upon him because of his early return to the Philipines before said Letters Rogatory could be served upon him;

"That because of petitioner's sudden return to the Philippines, his counsel thereby manifested that the petitioner would be presented in person as a witness in his own behalf before this Court without the need of taking his deposition in the United States, to which suggestion respondent's counsel agreed;

"That after the issuance of the Letters Rogatory and without expecting at the time the early return of petitioner from the United States, the respondent was allowed after the petitiener had rested his case, to proceed with the presentation of his evidence in chief and at the last hearing of this case on March 22, 1955, the petitioner himself should have been presented to testify in his own behalf as per previous reservation and agreement, but counsel for the petitioner suddenly change front by requesting instead that the respondent continue presenting his evidence and after the latter shall have rested his case, the petitioner should be allowed to testify in his behalf as evidence in chief and not limited merely to rebuttal;

"That to allow counsel for the petitioner to present his additional evidence in chief after the respondent shall have rested his case is most irregular; it would create confusion in the proceedings; it would indefinitely prolong the trial of this case to the serious detriment of the opposing party and would be in utter disregard of section 1, Rule 33 of the Rules of Court;

"That it would not prejudice the interest of petitioner any if he were to testify now in his behalf as agreed upon by the partied nad then recalled as a rebuttal witness after the respondent is through with the presentation of his evidence in chief;

"That there exist that presumption of regularity in favor of respondent's deficiency income tax assessment against the petitioner and the burden of proving the same to be illegal and irregular lies in the latter which he may do through his evidence in chief or on rebuttal; and

"What while it is true that under section 8 of Republic Act No. 1125, this Court is not required for the sake of expediency to follow strictly the technical rules of evidence in the trial of tax and customs cases before it, such discretion will not be exercised by the Court in favor of either party if the result would be to prolong the case unnecessarily instead of expediting its early adjudication.

"WHEREFORE, the motion of counsel for the petitioner that he be allowed to present additional evidence in chief after the respondent shall have rested his case must be, and the same is, hereby denied."

This case was thereafter submitted for decision after the filing of an "Amended Agreed Stipulation of Facts," which is incorporated herein by reference. The issues raised by counsel for petitioner are stated by him in his memorandum dated November 15, 1955 and filed with this Court on November 29, 1955, to wit:

"(a) The legality of the so-called 'net worth method' used by respondent in computing the net income of petitioner. (Amended Petition for Review, par. (a), page 5.)

"(b) The legality of the imposition of the 50 per cent surcharge as fraud penalty. (Amended Petiton for Review, par. 11, page 3; par. 13, page 4)

"(c) The application of the law on prescription for the collection of taxes on respondent's deficiency income tax assessments against petitioner covering the tax years 1946, 1947 and 1948. (Amended Petition for Review, par. 14, page 4; par. (a), page 5.)

"(d) The proper treatment for personal exemptions and deductible expenses allowed by law. (Amended Petition for Review, par. 15, page 4; par. 17, page 5.)"

The "Net Worth Method."

The so-called "net worth method" in the field of income taxation is an indirect method of proving unreported income. There are, generally, five known methods of establishing income tax deficiencies of taxpayers, to wit:

"1. The defendant's own books and records, if made available by lawful means. When truthful, the defendant's own books and records will usually establish the nature and source of the unreported income; if false, they will afford at least a starting point from which matters of income may be verified from other sources. x x x

"2. Books and records and corroborative statements of third persons who have dealt with the taxpayer, often establishing payment of moneys which would constitute taxable income to the taxpayer.

"3. Bank deposits and bank records.

"4. Increase in net worth; including investments, purchases of property and other business transactions by the taxpayer.

"5. Analysis of expenditures, to show that expenditures were in excess of declared or available income or that expenditures for claimed items of deductions were fictituous or overstated.

"The purpose of each of these methods is to establish taxable but unreported income; any combination of the methods may be resorted to by the government to support its case." (Harry Graham Balter, Fraud Under Federal Tax Law, 2nd ed., pp. 414-415.)

The net worth technique for determining income may be expressed in the following formula: Increase in Net Worth + Non-deductible Expenditures - Non-Taxable Receipts = Taxable Net Income. (Samuel Byer, "The Net Worth Technique for Determining Income," Proc. NYU 13th Ann. Inst. on Fed. Taxation 1058 [1955].) "The net worth expenditures method is based on the accounting formula that an increase in net worth, plus non-deductible disbursements, minus non-taxable receipts equals taxable net income." (Aviakan, "The Net Worth Method of Establishing Fraud," Proc. NYU 11th Ann. Inst. on Fed. Taxation 707 [1952].) The procedure for determining taxable net income under this formula has been described as follows:

"The net worth at the beginning and end of the taxable year is computed by subtracting liabilities from assets and the increase in net worth is, of course, determined by comparing the beginning and ending net worth. Non-deductible expenditures (except capital expenditures which appear as assets) like living expenses, gifts, x x x income tax payments and like are added to the increase in net worth. From this sum is subtracted the total of non-taxable receipts like gifts, inheritances, non-taxable interest, etc. These non-taxable receipts must be subtracted because they are either included in the ending assets or may have been used to pay for some non-deductible expense." (Samuel Byer, "Net Worth Technique for Determining Income," supra.)

The Supreme Court of the United States, in a recent case, has given a short exposition of the net worth formula thus:

> "In a typical net worth prosecution the Government, having concluded that the taxpayer's records are inadequate as a basis for determining income tax liability, attempts to establish an 'opening net worth' or total net value of the taxpayer's assets at the beginning of a given year. It then proves increases in the taxpayer's net worth for each succeeding year during the period under examination and calculates the difference between the adjusted net values of the taxpayer's assets at the beginning and end of each of the years involved. The taxpayer's non-deductible expenditures, including living expenses, are added to these increases, and if the resulting figure for any year is substantially greater than the taxable income reported by the taxpayer for that year, the Government claims the excess represents unreported taxable income. In addition, it asks the jury to infer willful ness from this understatement, when taken in connection with direct evidence of 'conduct, the likely result of which would be to mislead or conceal.' Spies v. United States, 317, US 492, 499, 87 L. ed. 418, 423, 63 S. Ct. 364." (Holland v. U.S., 348 US 121.)

This method of proving unreported income, according to respondent in a decision rendered in another case, "is based upon the general theory that money and other assets in excess of liabilities, after an accurate and proper adjustment of non-deductible and non-taxable items of a taxpayer not accounted for by his income tax returns, leads to the inference that part of his income has not been reported." (See letter of Collector of Internal Revenue to

Senator C. N. Recto, May 6, 1954, XX Lawyers Journal, p. 101, Feb. 28, 1955; see also Balter, Fraud Under Federal Tax Law, 2nd ed. 1953, p. 421.)

In Holland v. U.S., supra, the Supreme Court of the United States made a brief historical sketch of the net worth method, its early application and recent developments. It appears that the net worth method was first utilized in the cases of Capons v. United States, 51 F 2d. 609, 76 ALR 1534 (1931, CA 7th 111) and Guzik v. United States, 54 F 2d 618 (1932, CA 7th 111), to corroborate direct proof of undeclared income. And in U.S. v. Johnson, 319 U.S. 503, 67 L ed 1546, 63 S Ct 1233, the U.S. Supreme Court approved the use of the method to support the inference that the taxpayer, who was known as an operator of various gambling houses upon which no income was declared, "had indeed received unreported income in a 'substantial amount.'" "It was," according to the Court, "a potent weapon in establishing taxable income from undisclosed sources when all other efforts failed." Since the decision in the Johnson Case, the use of the method has been extended to "run-of-the-mine cases regardless of the tax deficiency involved." As its use in ordinary income-bracket cases greatly increases the chances for error, the Court issued the warning that the dangers inherent in this method "must be consciously kept in mind in order to assure adequate appraisal of the specific facts in individual cases."

Having explained in some detail the meaning of the net worth method and the procedure generally followed in the investigation of net worth cases, we will now consider the issue raised- whether the net worth method of proving unreported income, as used and applied in the United States, may be utilized here under existing law. It is the contention of counsel for the Government that the net worth technique is permitted under Section 15 of the National Internal Revenue Code, which provides that-

> "When a report required by law as a basis for the assessment of any national internal-revenue tax shall not be forthcoming within the time fixed by law or regulation, or when there is reason to believe that any such report is false, incomplete or erroneous, the Collector of Internal Revenue shall assess the proper tax on the best evidence obtainable. x x x"

and also under Section 38 of the same Code, which provides:

> "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Collector of Internal Revenue does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year, as defined in section 84, or if the taxpayer has no annual accounting period, or does not keep books, or if the taxpayer is an individual, the net income shall be computed on the basis of the calendar year."

Both parties agree that Section 38 of our Revenue Code is a copy of Section 41 of the U.S. Internal Revenue Code of 1939. It is contended on behalf of respondent that the use of the net worth method by the Commissioner of Internal Revenue of the United States was authorized under Section 41 of the 1939 U. S. Internal Revenue Code, On the other hand, counsel for petitioner contends that none of the cases decided by American courts which recognized the power of the U. S. Commissioner to employ the net worth method ever declared that such power was derived from Section 41. He claims, income tax returns and "to determine the correct amount of the tax. " Since no similar provision appears in our law, it is alleged that the use of the method is unauthorized and illegal. The case of Holland v. U. S., <u>Supra</u>, has been cited in support of this view. (See pages 6&9, Memorandum of Counsel for Petitioner, November 15, 1955.) This being a case of first impression in this jurisdiction, we have s studied with care the question raised by petitioner.

The consensus of opinion among well-known authorities on Federal income taxation in the United States is that the power of the Commissioner of Internal Revenue to use the net worth method springs or is derived mainly from Section 41 of the Internal Revenue Code of 1939 (Section 446 of the 1954 Code). Samuel Byer, a New York attorney and formerly Agent, Conferee, Technical Advisor in Appellate Division, U. S. Internal Revenue Service, in an article "The Net Worth Technique for Determining Income," (Proc. NYU 13th Ann. Inst. on Fed. Taxation 1055 [1955], while expressing the opinion that Section 41 "does not represent the authority for use of the net worth or any other indirect method" because he believes that it proceeds from the broad general investigatory provisions of the Code, has this to say: "The proposition that the Commissioner's authority to use the net worth method or any other indirect method in determining income, is rooted in or stems from Section 41 of the Internal Revenue Code of 1939 has been supported by the courts so frequently that the mere mention of the indirect technique for determining income calls forth a recitation of the provisions of that section. Support for the proposition is not lacking in discussion by able tax men." In an addendum to the same article, prompted by the decisions of the U. S. Supreme Court on December 9, 1954 in four net worth cases, one of which is Holland v. U. S., <u>supra</u>, Mr. Byer made a searching analysis of the decisions in said cases and his opinion is that Section 41 does not preclude the use of the net worth method. We quote:

> "That first pressing question decided is whether the dangers and shortcomings of the net worth technique should 'foreclose is use.' The Supreme Court's answer is a flat NO.
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> "The second is whether it is relevant to refer to Section 41 for the purpose of denying the government the right to use the net worth technique. The Court again said NO. Its opinion explains that Section 41 'refers to methods such as the cash receipts or accrual method which allocate income and expenses between years' and that 'Congress never intended to make Section 41 a set of blinders which prevents the government from looking beyond the self-serving declarations in a taxpayer's books. The United States has relied for the collection of income tax largely upon the taxpayer's own disclosures the government must be free to use all legal evidence available to it in determining whether the story told by the taxpayer's books accurately reflects his financial history.'"

It appears to us to be well established that the prevailing view in the United States is that the use of the net worth or any indirect method of proving unreported income is permitted under Section 41 of the U. S. Internal Revenue Code of 1939 (Section 446 of the 1954 Code). Section 38 of our Revenue Code having been patterned after Section 41 of the U. S. Code, the construction placed upon that section by the U. S. courts has a strong persuasive force in this jurisdiction. We have no doubt, therefore, that Section 38 of our Revenue Code as it is worded permits the use of the net worth method by the Collector of Internal Revenue where direct proof of under-declaration of income is not available by any other means. We have come across an opinion of counsel for petitioner to the same effect, which we quote:

> "It has been observed that in many instances the amount of income taxes paid by individuals is grossly disproportionate to the yearly increase in their wealth. In view of the difficulty encountered in the determination of the true net income of such individuals by the ordinary process of consideration of taxable income and deductions, the Bureau of Internal Revenue has adopted the 'inventory method' (net worth method) of determining net income. x x x
>
> "The method is criticized as arbitrary and unreliable means of determining the true net income. The taxable increase in the net worth may include nontaxable income. But this criticism is, however, overcome by the fact that the increase in net worth represented by exempt or nontaxable income is not to be included and that <u>the authority of the Collector of Internal Revenue to adopt the method is clearly granted by section 38 (See page 337), and by section 15 of the Tax Code, empowering the Collector to assess the proper tax on the best evidence obtainable.</u>" (Florentino Amansec, The Law on Income Taxation, pp. 364-365; underscoring supplied.)

The opinion of counsel for petitioner quoted above was made in 1949 (his book was published in that year). It was an impartial and an unbiased opinion, coming as it did from one who had then no net worth case to defend or prosecute and at a time when he could speak with a certain degree of authority on the subject. He was at that time a supervising income tax examiner of the Bureau of Internal Revenue. We have also taken note of the fact that Sections 15 and 38 of the Revenue Code have not undergone any change or amendment from the time said Code was enacted in 1939 to the present.

There appears to be no reason for a change in the interpretation of the law, specially so because the path charted by court decisions has remained unchanged.

We are, therefore, of the opinion that the Collector of Internal Revenue is empowered under Section 38 of the Revenue Code to utilize the net worth or any other indirect method of determining unreported income in cases where direct proof of under-declaration is unavailable. However, we agree with the U. S. Supreme Court that the method "is so fraught with danger for the innocent that the courts must closely scrutinize its use." We will heed that warning.

Counsel for petitioner maintains that, assuming that the net worth method is applicable to this case, his client is not liable to pay any deficiency income tax on the basis of the amended stipulation of facts. (Page 14, Memorandum of Counsel for Petitioner, Nov. 15, 1955.) Apparently, counsel for petitioner admits that the requirements for the use of the net worth method have been fully satisfied, no question having been raised in regard thereto.

In the amended stipulation of facts, which was signed by the incumbent Collector of Internal Revenue, the parties agreed to eliminate the bank withdrawals as part of the assets of petitioner. And in the memorandum of counsel for the Government, the deficiency tax for 1946 has been eleminated, and admission that there was no tax defficiency for that year. We shall, therefore, consider only the alleged income tax deficiencies of petitioner for the years 1947, 1948, 1949 and 1950.

Upon the evidence submitted and the amended stipulation of facts, counsel for respondent have computed the income tax deficiencies of petitioner from 1947 to 1950 at ₱41,511.77, including the surcharge of 50%. On the other hand, counsel for petitioner, after applying the net worth method, claims that his client does not have any income tax deficiency during the years in question, except during the year 1947 when petitioner incurred a deficiency tax of ₱1,196. 02. In fact, it is alleged that petitioner made an overpayment of ₱44,74 in 1948, ₱113.77 in 1949, and ₱28.00 in 1950.

The difference in the results between the two computations lies mainly in the inclusion by counsel for the Government and the exclusion by counsel for petitioner, of certain properties and investments of petitioner in arriving at his net worth at the end of the taxable years. Counsel for petitioner maintains that while said properties and investments were acquired by petitioner, respondent failed to produce evidence that they were held by petitioner at the end of the corresponding taxable year. (See pp. 18-21, Memorandum of Counsel for Petitioner, Nov. 15, 1955.) It having been admitted that said properties and investment were acquired by petitioner, the presumption is that his ownership thereof continues unless the contrary is shown. Petitioner, therefore, has the burden of proof to contradict the question of ownership, and certainly it was easy for him to have produced such evidence, if he had any, that he had transferred ownership of said propeties. Having failed to do so, it is to be presumed that he continued to be the owner of said properties, and his claim to the contrary solely on the ground that respondent failed to prove that he continued to own them to the end of the taxable years in question must be dismissed as untenable.

Another item which produced different results in the computations of counsel for both parties is the alleged indebtedness of petitioner to Atty. Juan T. David in the amount of ₱30,000. We have examined carefully the evidence adduced in support of the alleged indebtedness, and we agree with counsel for the Government that the existence of said loan has not been satisfactorily proven. The said amount is not, therefore, a proper deduction in the computation of petitioner's net worth.

Accordingly, we find the claim of counsel for petitioner that his coient did not incur a deficiency income tax, except during the year 1947, and that petitioner made overpayments during the years 1948, 1949 and 1950, is not worthy of consideration.

Legality of the imposition
of 50% surcharge

It is claimed on behalf of respondent that to the deficiency income tax of petitioner as established by the net worth method there should be added the surcharge of 50%. This surcharge is provided in Section 72 of the Revenue Code, and it is imposed in case of "willfull neglect to file the return or list within the time prescribed by law, or in case a false or fraudulent return or list is willfully made." The imposition of said surcharge is sought to be justified on the following grounds:

(1) "An analysis of the facts involved in his case indicate that the basis of assessments was due to the consistent disparity betwwen the income declared in the returns x x x and that found in the investigation, which is clearly indicatibe of fraud;" and

(2) "While it is true that fraud, being a state of mind, is seldom established by direct evidence, nevertheless, the same may be reasonably inferred from the substantial difference in petititioner's increase in net worth each year and the net income declared in his returns."

Counsel for petitioner vigorously insists that his client filed income tax return for the years in question under oath; that said returns "reflect truly and accurately all the income he had earned;" and that he paid income taxes ass originally assessed against him, to show that the imposition of the 50% surcharge is not in order. That the assessments underwent various changes (₱369,708.27 on September 3, 1952; ₱186,170.43 on July 9, 1953; ₱197, 179.85 on November 6, 1953) has also been advanced as an argument that "these assessments have lost the force and strngth of their presumed accuracy and that whatever differenced now berween the amounts of income taxes paid on the returns and the amounts of deficiency income taxes that may be found due under the method used by respondent would largely be due to unjustified assumption of umproven facts and to divergence in the treatment of figures arising from the inherent defects of the method as an income determining medium."

Petitioner filed income tax returns under oath for the years 1947 to 1950. The gross incomes and expenses shown in the returns, and the amounts of tax paid are as follows:

YEAR	GROSS INCOME	EXPENSES	TAX PAID
1947	₱16,000.00	₱6,967.90	₱ 361.57
1948	16,000.00	9,078.99	145.26
1949	16,000.00	9,603.76	113.77
1950	16,000.00	8,356.49	167.00

The gross income of ₱16,000.00 reported for each of the years involved was derived by petitioner exclusively from his salary. No other income from any other source was included in his gross income required by law to be shown in his income tax returns for said years. And yet after the applicatiom of the net worth method, on the basis of the amended stipulation of facts, it has been shown that in 1947, petitioner had a net income of ₱28,402.52; in 1948, ₱39,675.26; in 1949, ₱17,047.27; and in 1950, ₱61,060.46. If these figures are to be believed, there were substantial under-declarations of incomes in the income tax returns of petitioner for said years.

We have also noted that petitioner claimed deductions for "losses" in his income tax returns. The deductions claimed, including alleged losses, in his returns are itemizrd below:

1947 ...	Income declared, salary-		₱16,000.00
	Taxes	₱150.00	
	Interests	267.90	
	Losses	6,000.00	
	Contributions..x	570.00	
	Total deductions .	₱6,987.90	
1948.....	Income declared, salary -		₱16,000.00
	Taxes	661.50	
	Interests	517.49	
	Losses	7,500.00	
	Contributions.	400.00	
	Total deductions.	₱9,078.99	
1949 ...	Income declared, salary -		₱16,000.00
	Taxes	₱1,723.80	
	Interests ...	271.66	
	Losses	7,200.00	
	Contributions	408.30	
	Total deductions	₱9,603.76	
1950 ...	Income declared, salary -		₱16,000.00
	Taxes	926.49	
	Losses	6950.00	
	Contributions	480.00	
	Total deductions .	₱8356.49	

Among the circumstances generally recognized as justifying the imposition of the fraud penalty are: (1) intentional understatement of income, substantial in amount per se or substantial in relation to the total reported income; (2) intentional overstatement of deductions, substantial in amount per se or substantial in relation to the total reported income; and (3) recurrence of the understatement of income or overstatement of deductions for more than one tax year. (Balter, Fraud Under Federal Tax Law, 2nd ed, (1953), p. 226.)

From an annual income of ₱16,000 derived solely from salary, petitioner consistently deducted substantially big amounts of "losses," the nature and extent of which have not been explained. In 1947, petitioner claimed a deduction for "losses" in the amount of ₱6,000; in 1948, ₱7,500; in 1949, ₱7,200; and in 1950, ₱7,200, considerably reducing his taxable net income. Frankly, we have been unable to divide the nature of said losses, petitioner claiming he had never been in business.

The losses which are allowable as deductions from gross income under Section 30 (d) of the Revenue Code are, in the case of individuals:

1. Losses actually sustained during the taxable year and not compensated for by insurance or otherwise-

   (A) If incurred in trade or business; or

   (B) If incurred in any transaction entered into for profit, though not connected with the trade or business; or

(C) Of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from robbery, theft, or embezzlement;

2. Capital losses, to the extent provided in Section 34;

3. Losses on wash sales of stock, or securities; and

4. Wagering losses.

Obviously, the losses clained by petitioner in his returns could not have been incurred or suffered in the course of trade or busemess, his only income declared being his salary. It is possible that the losses could have been brought about by "fires, storms, shipwreck, or other casualty, or from robbery, theft or embezzlement," but this possibility immediately fibes way to sarious doubt because the alleged losses were more or less constant during all the years in question. It is quite improbable that petitioner could have been the victim of the same casualties during all those years. Neither could the alleged losses be attributable to capital losses ot losses on wash sales of stock or securities, because as clearly stated his only income reported was his salary. The said losses could be "WAGERING LOSSES," but these losses are deductible only to the extent of the gains or winnings. In any of the cases mentioned above, it is our opinion that the alleged losses constitute "intentionel overstatement of deductions, substantial in relation to the total reported income" or "overstatement of deductions for more than one tax year" which justify the imposition of the fraud penalty. (See Balter, Fraud Under Federal Tax Law, supra.)

With respect to the allegation that "assessments have lost the force and strength of their presumed accuracy" in view of the various alterations in the amounts of deficiency income tax determined by respondent, it is enough to state that in the use of the net worth method of proving unreported income errors are bound to be committed as the real facts are either unavailable to the Collector or are withheld by the taxpayer. In such cases, errors or mistakes, which the Collector must have to correct, cannot affect the imposition of the fraud penalty, unless it is shown that, after correction of the errors, nothing is left from which any inference may be drawn that the returns as filed are not tainted with fraud. The insistence of petitioner that the returns as filed by him are true and accurate can not be viewed in a different light.

We might also state that in the final computation of the deficiency income tax in this case as submitted by counsel for the Government, and apparently sanctioned by the Collector as he signed the amended agreed stipulation of facts, the changes or alterations made in the computation which brought down the assessed deficiency from ₱197,179.85 to ₱41,511.77 (which should be ₱41, 547.77) were prompted more by the sense of liberality of the Collector than anything else. We have to cite but one instance to prove this point.

As already stated, the formula for detemining unreported income by the net worth method is: (1) increase in net worth, plus (2) non-deductible disbursements, minus (3) non-taxable receipts, equals (4) taxable net income. Item (2) referring to nondeductible disbursements refers mainly to personal, living, or family expenses of the taxpayer which must be added to the increase in net worth to arrive at the gross income. In the case of petitioner, respondent reduced the estimated personal, living, or family expenses from ₱6,419.62 to ₱3,000 for the year 1947; from ₱128,161.50 to ₱3,500 in 1948; from ₱48,240.24 to ₱3,500 in 1949; and from ₱12,773.28 to ₱4,800 in 1950. No evidence has been adduced as to the approximate personal, living, or family expenses of herein petitioner, and for this reason we are forced to accept the appraisal by respondent for the purpose of arriving at petitioner's taxable net income. We are, however, very certain that petitioner himself would not admit that he spent for his personal, living, or family expenses less than ₱5,000 during each of the years in question. Petitioner can not, therefore, validly claim that in view of previous changes in the assessments, further reduction of the final computation of his income tax deficiencies would still be justified, unless he has reason to believe that the liberality of respondent could be stretched further.

Applicability of the statute of limitations upon the right of the Government to collect deficiency income tax.

The argument has been advanced that the right of the Government to collect the deficiency income tax assessed against petitioner, at least with respect to the taxable years 1946, 1947 and 1948, has prescribed, pursuant to Section 331 of the Revenue Code. On the other hand, respondent believes that Section 332 is the law applicable to the case.

Sections 331 and 332 of the Revenue Code provide -

> "Sec. 331. Period of limitation upon assessment and collection.-- Except as provided in the succeeding section, internal-revenue taxes shall be assessed within five years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period. For the purposes of this section a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day; Provided, that this limitation shall not apply to case already investigated prior to the approval of this Code.
>
> "Sec. 332 Exceptions as to period of limitation of assessment and collection of taxes. -- (a) In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time of the falsity, fraud, or omission.
>
> "(b) Where before the expiration of the time prescribed in the preceding section for the assessment of the tax, both the Collector of Internal Revenue and the taxpayer have consented in writing to its

> assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.
>
> "(c) Where the assessment of any internal-revenue tax has been made within the period of limitation above prescribed such tax may be collected by distraint or levy or by a proceeding in court, but only if begun (1) within five years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Collector of Internal Revenue and the taxpayer before the expiration of such five-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

Under Section 331, the Collector of Internal REvenue has 5 years after the return was filed within which to assess an internal revenue tax, and no proceeding in court without assessment can be begun after expiration of said period. However, under Section 332 (a), it is provided that in the case of a false or fraudulent return with intent to evade tax or of a failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within ten years after the discovery of the falsity, fraud, or omission. In connection with the issue as to the legality of the imposition of the fraud penalty, we expressed the opinion that the fraud penalty is applicable. Accordingly, it is also our opinion that the 10-year period provided in Section 332(a) within which a deficiency income tax may be assessed applies. There is no question that the assessments in this case were all made within 10 years from the date of discovery of the fraud. It follows that said assessments were validly made. And since under the law, the Collector of Internal Revenue has 5 years after assessment within which to collect the tax, it is obvious that the right of the Government to collect the deficiency income tax assessed against petitioner for the years 1947 to 1950 has not prescribed.

"The proper treatment for personal exemptions and deductible expenses allowed by laws"

The fourth issue raised by petitioner is to "the proper treatment for personal exemptions and deductible expenses allowed by law" does not appear clear to us. Counsel for petitioner, on page 25 of his memorandum of November 15, 1955, says:

> "Respondent might raise the propriety of the allowance of personal and additional exemptions because they have not been previously added to the increase in net worth or to the net income. The reason why the amounts fixed for personal and additional exemptions are not added to the increase in the net worth or to the net income is that they are included in the personal, living and family expenses defrayed from the amounts withdrawn from banks (bank withdrawals) which, by stipulation of the parties, are eliminated as part of the ner income. (Amended Agreed Stipulation of Facts, par. I, page 1). The law does not prohibit raxpayers from claiming personal and additional exemp-

> tions whether spent or not. Aside, therefore, from the stipulation, it is submitted that petitioner has the right to deduct personal and additional exemptions from his not been previously added thereto."

The statement thet the law "does not prohibit taxpayers from claiming personal and additional exemptions, whether spent or not" has particularly drawn our attention. Granting this to be true, we do not believe it has any application to the case of petitioner, It is unbelievable that petitioner did not actually spend any amount for personal, living, or family expenses. We have made a passing remark on this matter elsewhere in this decision, and the least said about it the better for all concerned.

FOR THE FOREGOING CONSIDERATIONS, the decision appealed from is hereby modified, as prayed for b y respondent, and petitioner is, accordingly, hereby ordered to pay the sum of ₱41,547.77, as deficiency income tax and surcharge corresponding to the years 1947, 1948, 1949 and 1950, more particularly itemized as follows:

<u>1946</u>

None

<u>1947</u>

Total assets during the year . . .	₱66,530.93
Less cost of residential house and unexoended balance of backpay ..	37,537.96
Total adjusted assets	₱28,992.97
Less liabilities during the year..	2,653.71
Net worth at the end of the year..	₱26,339.26

N Net worth at the end of the year . . .	₱ 26,339.26
Deduct net worth at the beginning of the year	936.74
Increase in net worth	₱ 25,402.52
Add living and family expenses . . .	3,000.00
Net income as per investigation . . .	₱ 28,402.52
Deduct net increase as per return . .	9,012.10
Net income under-declared	₱ 19,390.42
Net increase as per investigation . .	28,402.52
Deduct personal exemption	3,000.00
Amount subject to tax	₱ 25,402.52
Tax due thereon	3,768.55
Less amount already paid	361.57
Deficiency income tax	₱ 3,406.98
50% surcharge	1,703.49
Total amount due	₱ 5,110.47

1948

Total assets during the year	₱ 100,052.48
Less cost of residential house & unexpended balance of backpay . . .	37,537.96
Total adjusted assets	₱ 62,514.52
Less liabilities during the year . .	- - - -
Net worth at the end of the year . .	₱ 62,514.52
Deduct net worth at beginning of the year	26,339.26
Increase in net worth	₱ 36,175.26
Add: Living and family expenses . . .	3,500.00
Net worth as per investigation . . .	₱ 39,675.26
Deduct net increase as per return . .	6,921.01
Net income undeclared	₱ 32,754.25
Net increase as per investigation . .	₱ 39,675.26
Deduct : Personal exemptions	3,500.00
Amount subject to tax	₱ 36,175.26
Tax due thereon	₱ 6,385.56
Less: Amount already paid	145.26
Deficiency income tax	₱ 6,240.30
50% surcharge	3,120.15
Total amount due	₱ 9,360.45

1949

Total assets during the year	₱ 147,147.85
Less: Cost of residential house unexpended balance of backpay . . .	37,537.96
Total adjusted assets	₱ 109,609.89
Less: Liabilities during the year .	33,548.10
Net worth at the end of the year . .	₱ 76,061.79
Deduct: Net worth at the beginning of year	62,514.52
Increase in net worth	₱ 13,547.27
Add: Living and family expenses . .	3,500.00
Net increase per investigation . . .	₱ 17,047.27
Deduct: Net increase as per return .	6,396.24
Net income undeclared	₱ 10,651.03

Amount carried forward	₱ 10,651.03
Net income as per investigation	17,047.27
Deduct: Personal exemptions...	3,500000
Amount subject to tax	₱ 13,547.27
Tax due thereon	1,483.00
Less: Amount already paid	113.77
Deficiency tax due	₱ 1,369.23
50% surcharge	684.62
Total amount due	₱ 2,053.85

1950

Total assets during the year .	₱204,220.31
Less: Cost of residential house and unexpended balance of backpay	₱ 37,537.96
Total adjusted assets	₱166,682.36
Less: Liabilities during the year.......................	34,360.10
Net worth at the end of year.	₱132,322.25
Deduct net worth at beginning of year	76,061.79
Increase in net worth..	₱ 56,260.46
Add: Living and family expenses	4,800.00
Net increase as per investigation..................	₱ 61,060.46
Deduct net increase as per return	7,643.51
Net increase undeclared	₱ 53,416.95
Net increase as per investigation	₱ 61,060.46
Deduct: Personal exemption ..	4,800.00
Amount subject to tax	₱ 56,260.46
Tax due thereon	₱ 16,849.00
Deduct: Amount already paid..	167.00
Deficiency tax due .l........	₱ 16,682.00
50% surcharge	8,341.00
Toatl amount due	₱ 25,023.00

R E S U M E

1946	None
1947	₱ 5,110.47
1948	9,360.45
1949	2,053.85
1950	25,023.00
GRAND TOTAL	₱ 41,547.77

With costs against petitioner

SO ORDERED.

Manila, Philippines, February 13,1956.

ROMAN UMALI
Associate Judge

we con-

DECISION-
B.T.A. CASE NO. 189

CUR:

MARIANO NABLE
Presiding Judge

AUGUSTO M. LUCIANO
Associate Judge