

EUGENIO PEREZ, PETITIONER AND APPELLANT, VS. THE COURT OF TAX APPEALS AND THE COLLECTOR OF INTERNAL REVENUE, RESPONDENTS AND APPELLEES.

G.R. No. L-10507. May 30, 1958

Ponente: REYES, J.B.L., J.

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REYES, J.B.L., J.:

This is an appeal by certiorari to review the decision of the Court of Tax Appeals in the case of Eugenio Perez vs. J. Antonio Araneta as acting Collector of Internal Revenue (B.T.A. 189), whereby the petitioner was ordered to pay the sum of P41, 547.77 as deficiency income taxes and surcharges corresponding to the years 1947, 1943, 1949 and 1950, more particularly as follows:

For 1946

-

none

" 1947

-

P 5,110.47

" 1948

-

9,360.45

" 1949

-

2,053.38

" 1950

-

25,023.00

This amount was arrived at by the Court of Tax Appeals on the basis of petitioner-appellant's increase in net worth.

It appears from the records that petitioner filed his income tax returns for 1947, 1948, 1949 and 1950 on March 1,

1943, May 10, 1949, February 23, 1950 and February 23, 1951 respectively, and paid taxes thereon as follows:

Year

Net Income

Income Tax Paid

1947

P 9,012.10

P 361.57

1948

6,921.01

145.26

1949

6,396.24

113.77

1950

7,643.51

167.00

On September 3, 1952, respondent Collector of Internal Revenue assessed against the petitioner the sum of P369,708.27 as deficiency income taxes and 50% surcharge from 1945 to 1950, but which amount was later reduced to P186,170.43, upon petitioner's request for reconsideration. Subsequently, however, the said amount was increased to P197,179.85 in a letter of the said respondent, dated November 6, 1953. Upon his (Collector of Internal Revenue) refusal to consider further requests for reinvestigation and reexamination of the case, the petitioner appealed to the then Board of Tax Appeals by filing a petition for review, as amended March 23, 1954. An answer to this petition was filed by the respondent Collector of Internal Revenue on April 13, 1954. This case was later transferred to the Court of Tax Appeals by virtue of Republic Act No. 1125.

In making the deficiency assessments, the Collector employed what is known as the "net worth" technique and started by determining the opening net worth of petitioner at the start of the year 1947 which he fixed at P936.72, as follows:

1946

Assets

Lot No. 1, Block 35, Quezon City----- P 66.67

Lot No. 2, Block 32, Quezon City----- 1,349.08

Lot No. 4, Block 32, Quezon City ----- 2,240.00

Furniture & Fixtures----- 5,000.00

Initial subscription in the Far

Eastern Construction Corporation-- 2,500.00

Current account deposit balance

with Phil. National Bank ----- 5,000.00

Back pay received from

U.S. Army-----P 1,013.33

Back pay received from

Phil. Congress -- P 7,200.00

Back pay received from

Phil. Congress -- 15,557.14

23,770.47

Total Assets ----- P44,707.19

Deduct adjustment of back pay:

From U. S. Army P 1,013.33

From Phil. Congress 7,200.00

From Phil. Congress 15,557.34

23,770.47

Total adjusted assets - P23,770.47

Liabilities

Salary loan with the Phil. Na-

tional Bank----- P 20,000.00

Net worth as of end of 1946 - P 936.72

=====

Thereafter, the increases in the taxpayer's net worth were determined:

1947

Assets

Lot No. 1, Block 35, Quezon City ----- P 66.67
 Lot No. 2, Block 32, Quezon City ----- 1,849.08
 Lot No. 4, Block 32, Quezon City ----- 2,240.00
 Residential Building & Improve-
 ments----- 35,210.00
 Furniture and fixtures ----- 5,000.00
 Current account deposit balance with
 the Philippine National Bank ----- 22,165.18
 Total assets ----- P 66,530.97

Deduct adjustment of back pay:

Cost of residential
 improvements from
 back pay -P3 5,210.00
 Unexpended balance of
 back pay----- P2,327.96

37,537.96

Total adjusted assets

P 28,992.97

Liabilities

Salary loan with the Phil. Na-
 tional Bank----- P 2,653.71
 Net worth as of end of 1946 -- P26,339.26
 Deduct: Net worth as of be-
 ginning of 1947 ----- P 936.81[(x)]
 Increase in net worth in 1947-----P25,402.54

[(x)](Note) This amount of P936.72 is
the net worth of the petitioner-
appellant on December 31, 1946.

1948

Assets

Lot No. 1, Block 35, Quezon City----- P 66.67

Lot No. 2, Block 32, Quezon City----- 1,849.08

Lot No. 4, Block 32, Quezon City ----- 2,240.00

Residential building & improve-

ments----- 35,210.00

Furniture and fixtures ----- 5,000.00

365 shares of stock of the Hind

Sugar Co., Inc.----- 49,640.00

Current account deposit balance

with the Phil. National Bank----- 6.046.73

Total assets----- P100,052.48

Deduct adjustment of back pay:

Cost of residential

building and improve-

ments from back pay

funds----- P35,210.00

Unexpended balance of

back pay----- 2.327.96

37.537.96

Total adjusted assets- P62,514.52

Liabilities

None

Net worth as of the end of 1948 P62,514.52

Deduct: Net worth as of beginning of

1948-----

26,339.26

Increase in net worth in 1948 --- P36,175.26

1949

Assets

Lot No. 1, Block 35, Quezon City----- 66.67

Lot No. 2, Block 32, Quezon City----- 1,849.08

Lot No. 4, Block 32, Quezon City ----- 2,240.00

Lot No. 1, Block 227-A, Quezon City 30,000.00

Lot No. 11, Block 264, Quezon City- - 9,163.86

Lot No. 13, Block 264, Quezon City--- 5,220.02

Lot No. 15, Block 141, Quezon City--- 1,545.20

Lot No. 41-c-2-a-1, San Mateo, Rizal

Province ----- 27,114.00

Residential building and improvements- 35,210.00

Furniture and fixtures -----5,000.00

Automobile-station wagon----- 6,260.00

365 shares of stock of the Hind

Sugar Co., Inc----- P49,640.00

Investment in the Freedom Magazine

Publications----- 9,000.00

Subscription in the Congressional

Club----- 1,293.06

Current account deposit with P. N. B. - 5,311.52

Total assets ----- P147,147.35

Deduct adjustment of backpay:

Cost of residential building

and improvements---- P35,210.00

Unexpended balance of back

pay----- 2,327.96

37.537.96

Total adjusted assets P109,609.39

Liabilities

Salary loan with the Phil. National

Bank ----- 542.10

Mortgage loan with the China Bank

Corporation (Mrs. Perez)----- 30.000.00

P33.548.10

Net worth as of the end of 1949 P 76,061.79

Net worth as of the beginning

of the year----- 62.514.52

Increase in net worth in 1949 P13.547.27

1950

Assets

Lot No. 1, Block 35, Quezon City----- 66.67

Lot No. 2, Block 32, Quezon City----- 1,849.08

Lot No. 4, Block 32, Quezon City ----- 2,240.00

Lot No. 1, Block 227-A, Quezon City 30,000.00

Lot No. 11, Block 264, Quezon City- - 9,163.86

Lot No. 13, Block 264, Quezon City--- 5,220.02

Lot No. 15, Block 141, Quezon City--- 1,545.20

Lot No. 41-c-2-a-1, San Mateo, Rizal

Province ----- 27,114.00

Lot No. 2, Block 310, Quezon City --- 4,074.90

Residential building and improvements- 45,210.00

Furniture and fixtures -----5,000.00

Automobile-station wagon----- 7,492.00

365 shares of stock of the Hind
 Sugar Co., Inc----- P49,640.00
 Investment in the Freedom Magazine
 Publications----- 9,000.00
 Subscription in the Congressional
 Club----- 1,293.06
 Current account deposit with P. N. B. - 5,311.52
 Total assets ----- P204,200.31

Deduct adjustment of backpay:
 Cost of residential building
 and improvements---- P35,210.00
 Unexpended balance of back
 pay----- 2,327.96

37,537.96

Total adjusted assets P166,682.31

Liabilities

Mortgage loan with the China Bank
 Corporation (Mrs. Perez) -----25,000.00
 Balance of mortgage with the R. F. C.
 (Mrs. Perez)----- 9,360.00

Total liabilities----- P34,360.10

Net worth as of the end of 1950--- P 132,322.25

Deduct: Net worth as of the be-
 ginning of the year----- P 76,061.79

Increase in net worth in 1950 --- P 56,260.46

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The Court of Tax Appeals declared the "net worth" method of determining understated income to have been validly and properly applied; found that the consistent underdeclaration of income, unexplained acquisition of

properties, and the fact of petitioner's having claimed fictitious losses evidenced fraudulent intent, and ordered him to pay deficiency income taxes and surcharges in the sum of P241,547.77, summarized as follows:

50%

Year

Deficiency

Surcharge

Total

1946

None

1947

P 3,406.98

P 1,703.49

P5,110.47

1948

6,240.30

3,120.15

9,360.45

1949

1,369.23

648.62

2,053.85

1950

16,682.00

8,341.00

25,023.00

and to pay the costs. Against the decision of the Court of Tax Appeals, the petitioner applied for a review by this Supreme Court, and his petition was given due course.

The three major issues in this appeal, as stated by the petitioner's counsel in his written memorandum filed with this Court on June 8, 1957, are: (1) whether the appellee Collector of Internal Revenue is empowered by law to

investigate appellant's (petitioner) income tax returns for 1947, 1948, and 1949 and to enforce collection of the alleged deficiency income taxes for said years by summary proceedings of distraint and levy more than three years after the income tax returns covering them were filed; (2) whether the use of the "net worth" method by the respondent in computing appellant's net income is valid; and (3) whether the 50% surcharge imposed upon the appellant is legal and justified.

In view, however, of the rulings of this Court, particularly in the cases of *Collector of Internal Revenue vs. A. P. Reyes* (G.R. No. L-86S5, Jan. 31, 1957) and *Collector of Internal Revenue vs. Jose Avelino* (G. R. L-9202, November 15, 1956), reiterating a long line of decisions to the effect that the three-year prescriptive period under section 51 (d) of the National Internal Revenue Code constituted a limitation to the right of the government to enforce the collection of income taxes by summary proceedings of distraint and levy, though, it could proceed to recover the taxes due by the institution of the corresponding civil action (*Philippine Sugar Estate Development Co., Inc. vs. Juan Posadas*, 68 Phil.216; *Collector of Internal Revenue vs. Villegas*, 56 Phil. 554; *Juan; de la Vina vs. El Gobierno de las Filipinas*, G. R. 42669, January 29, 193&), the Collector in his Reply Memorandum (in lieu of oral argument) concedes that the summary distraint and levy to collect the deficiency income taxes assessed against appellant Perez, for the years 1947, 1948 and 1949, should be declared invalid. Nevertheless, the appeal of the taxpayer vested jurisdiction on the Court of Tax Appeals to review and determine his tax liability for the aforesaid period.

On the second question, regarding the validity of the application of the "net worth" method in this jurisdiction, the respondent Collector of Internal Revenue bases his alleged right on sections 15 and 38 of the National Internal Revenue Code which provide:

"SEC. 15. ten 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". (Emphasis supplied)

"SEC. 38. General rule.—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 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." (Emphasis supplied)

The Court of Tax Appeals fully explained this method of proving unreported income in its decision: "The net worth technique for determining income may be expressed in the following formula: Increase in Net Worth plus Non-Deductible Expenditures minus Non-Taxable Receipts equals Taxable Net Income (Samuel Byer, 'Net Worth Technique for Determining Income', Proc. NYU 13th Ann. Inst. on Federal; 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-receipts equals taxable net income (Aviakan, 'The Net Worth Method of Establishing Fraud', Proc. NYU 11th Ann. Inst. on Federal Taxation, 707)".(p. 5, B.T.A. 189)

In the recent case of *Marion L. Holland vs. U.S.*, decided in 1954 (348 U.S. 121, 99 L. Ed. 127), the Supreme Court of the United States gave this brief exposition:

"In a typical net worth prosecution, the Government, having concluded that the taxpayer's records are inadequate as a basis for determining the 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 representing unreported taxable income (*Spies vs. United States*, 317 U.S. 492; 63 S. Ct. 364)."

This method of proving unreported income, according to the Court of Tax Appeals, is based upon the general theory that money and other assets in excess of liabilities of a taxpayer (after an accurate and proper adjustment of non-deductible items) not accounted for by his income tax returns, leads to the inference that part of his income has not been reported (p. 6, B.T.A. 189).

There is no question that the application of the "net worth" method of determining the taxable income of a taxpayer has been an accepted practice under the United States Internal Revenue Code (*Harris vs. Com'r.*, 174 F (2d) 70; *Louis Halle*, 7 TC 245, *aff'd.* 175 F (2d) 500; *Federal Income, Gift, & Estate Taxation* by Rabkin & Johnson, sec. 12.02, 1217 (a); *United States vs. Johnson*, 63 S. Ct. 1233). It is however, contended by the petitioner, that the application of the "net worth" method in the United States is based not under section 41 of the United States Internal Revenue Code (which is an exact copy of section 38 of our National Internal Revenue Code), but on section 57 thereof:

"SEC. 57.—As soon as practicable after the return is filed, the Commissioner shall examine it and shall determine the correct amount of the tax."

which has no counterpart in our Code. Moreover, he insists, section 38 of the Code does not authorize the Collector of Internal Revenue to change the method of accounting employed by the taxpayer unless such method does not clearly reflect the income .

The Supreme Court of the United States, in an opinion by Justice Clark in the *afforecited* case of *Holland vs. United States* (*supra*, affirming its former decision in the case of *United States vs. Johnson*, 319 U.S. 503, *supra*), although recognizing the danger to a taxpayer where the government seeks to prove tax evasion by the use of the net worth theory, and declaring that such danger requires that each net worth case be given close judicial scrutiny, unanimously affirmed its use. Referring to section 41 of the U. S. Internal Revenue Code, the court said that this section, expressly limiting the authority of the government to deviate from the taxpayer's method of accounting, had reference to true accounting methods and did not forbid the use of the net worth technique, which was not an accounting method at all, but merely an evidence of income (See also, *Estate of Bartley*, 22 U.S. Tax Ct. Reports 1230; *Hurley*, 22 U.S. Tax Ct. Reports 1264).

"The proposition that the commissioner's authority to use the 'net worth' method in determining income, is rooted in or stems from section 41 of the Internal Revenue 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". (Samuel Byer, "The Net Worth Technique for Determining Income") This seems to be the consensus obtaining in the United States (*Baiter*, *Fraud Under Fed. Tax Law*, sec. 224; p. 6, B.T.A. 139; Vol. 2, 1951 CCH 366.011), and no cogent reason is shown for deviating from it.

The petitioner further contends that, conceding *arguendo* that the "net worth" method of proving taxable income is valid under section 38 of the National Internal Revenue Code, the requirements for its application in the instant case have not been fully complied with, i.e., that there is no sufficient basis upon which to establish an unreported income. An examination of the records of this case will disclose that this issue was not raised in the lower court. As a matter of fact, as the Court of Tax Appeals found, the petitioner was deemed to have impliedly waived this issue, for he made use himself of this net worth method in computing his taxable income , in the event that the

lower court should finally find the validity of this method in this jurisdiction under section 33 of the Code. It is well to note that while the issue was raised on whether or not section 38 sanctions the indirect method of proving unreported income, it was not questioned that the method would be justified under the present circumstances, should it be ultimately resolved that the aforesaid section authorizes the use of this method in tills country. it is well settled that issues not raised in the lower court cannot be raised for the first time on appeal (Spencer, Kellogg & Sons, Inc. vs. Celino, G. R. No. 46271, Oct. 13, 1939; Tiacho vs. Tan Si Kiok, 45 O.G. (6) 2466; Comments on the Rules of Court, Moran, Vol. I, p. 952, 52 Ed.).

However, assuming *arguendo* that this issue was properly raised in the lower court, the decisions of the Supreme Court of the United States, in the recent cases of *Holland vs. U.S.*, 343 U.S. 121; *David Friedberg vs. U.S.*, 207 F. 2d 777; *Daniel Smith vs. U.S.*, 210 F. 2d 496; and *U.S. vs. Edward Calderon*, 207 F. 2d 377, all decided December 6, 1954, establish the following requisites for the use of the Inventory (or Net Worth) Method:

First, the establishment, with reasonable certainty, of an opening net worth to serve as a starting point, from which to calculate future increases in the taxpayer's assets (see also, Byer, "The Net Worth Technique for Determining Income", *supra*). The Court of Tax Appeals fixed as the total assets of the petitioner as of 1947 the amount of P66,530.93, based on the Amended Stipulation of Facts of the parties. This opening net worth is not disputed by them in this appeal.

Second, the net worth increases must be attributable to taxable income.

Petitioner claims that no evidence was introduced to prove that he was engaged in an income producing business to which his increases in net worth may be attributed. Respondent, on the other hand, states that the petitioner failed to show that his bank balances, acquisition of assets and investments in various enterprises came from non-taxable income. It is easily discernible that the settlement of this question hinges, ultimately on who has the burden of proof to show that the net worth increases was derived from taxable income or non-taxable income. More concretely said, "Is the government required to show the specific sources of the alleged unreported income"?

In the decisions of the United States Supreme Court, among them the *Holland vs. U.S.* case, *supra*, direct proof of the source of the income was held not essential;

"But petitioners claim the Government failed to adduce adequate proof because it did not negative all possible nontaxable sources of the alleged net worth increases —gifts, loans, inheritances, etc. We cannot agree. The Government's proof, in our view carries with it the negations the petitioners' urge. Increases in net worth, standing alone, cannot be assumed to be attributable to a currently taxable income. But proof of a likely source, from which the jury could reasonably find that the net worth increases sprang, is sufficient. In the *Johnson* case, where there was no direct evidence of the sources of the taxpayer's income, this court's conclusion that the taxpayer 'had large unreported income was reinforced by proof...that for certain years his private expenditures exceeded the available declared resources'... This was sufficient to support the 'finding that he had some unreported income, which was properly attributable to his earnings'. There the taxpayer was the owner of an undisclosed business capable of producing taxable income."

In civil cases, as the one at bar, it has been held that the application of the net worth method does not require identification of the sources of the alleged unreported income and that the determination of the tax deficiency by the Government is *prima facie* correct. Such was the holding of the United States Court of Appeals in the case of *Thomas vs. Commissioner*, 223 F. 2d 53, decided on June 14, 1955:

"The petitioners contend that the Commissioner was unwarranted in using the net worth method of computing their income because they did keep certain records of their various business activities, because their income tax returns for the years in question accurately reflected the cash register tapes and other business records turned

over to the accounting firm by Joseph Thomas, and because the Commissioner failed to prove any additional source of income. These contentions are not enough. The fact that the taxpayers' books and other records were consistent with their income tax returns proves nothing more than that they were consistent; it does not establish that they were truthful. Similarly, the failure of the Government to find any source of the alleged unreported income does not necessarily establish anything more than that the source was well-hidden. Nor does the fact that books and records were kept prevent the Commissioner from resorting to the net worth method if he properly determined that the books and records did not accurately reflect the taxpayer's true income. That was expressly decided in *Holland vs. U. S.* * * *. There is no reason why use of the net worth method should be more circumscribed in the case of a deficiency determination, involving neither criminal nor even civil fraud penalties."

This was reiterated in the subsequent case of *Laughinghouse vs. Commissioner*, 227 F. 2d 477, November 16, 1955, in affirming the ruling of the Tax Court of the United States, which sustained a deficiency determination in income taxes with the use of the net worth method:

"Obviously, the petitioner's contention are based upon a misconception of the net worth plus expenditures method of proof employed in this case, which method is not a direct, but an indirect method of proving the receipt of unreported income. The theory of this method is that during the tax period, the aggregate nondeductible expenditures, plus any increase in net worth unaccounted for by gifts, or inheritances, constitutes the taxable income. If the sum thus derived is greater than the income reported, then the taxpayer has failed to return all of his taxable income. This indirect method of proving the receipt of unreported income clearly involves additional data and an accounting approach substantially different from the specific receipts and disbursements method customarily used by taxpayers. Moreover, the net worth plus expenditures method does not identify the sources of the total net income thus calculated, and the burden of disproving the net worth determination of taxable income is upon the taxpayer." (Emphasis supplied)

Considering that, normally, acquisitions of property are made from accumulations of taxable income, and where not so made, it lies within the peculiar province of the taxpayer to explain how such acquisitions were made with non-taxable resources, and that no such explanations were made, we see no error in the conclusion that appellant's increase in net worth was due to undeclared taxable income.

The last issue is the legality of the action taken by the Collector of Internal Revenue in imposing upon the petitioner the 50% surcharge provided under section 72 of the National Internal Revenue Code. This section authorizes the Collector to impose a surcharge of 50% of the amount of the tax or deficiency tax in a case of a false or fraudulent return. Appellant contends that no fraud has been shown by the Government to warrant the surcharge. In sustaining the Collector, the Court of Tax Appeals expressed the view; that the substantial under-declaration of income in the income tax returns of the appellant for four consecutive years, coupled with his intentional overstatement of deductions, made the imposition of the fraud penalty proper. Certainly, these findings of large; unreported income of the petitioner as found by the tax court, and as substantiated by the expenses and investments shown in the Amended Stipulation of Facts (Rec. p. 225), together with appellant's declaration of substantial and Unspecified "losses" (none of which were explained, since the appellant failed to testify more than suffices to sustain the findings of fraud, and do not warrant a reversal from us. At any rate, we have already ruled that —

"The question of fraud is a question of fact which frequently requires a nicely balanced judgment to answer (Mertens, Fed. Income Taxation, chapter 55) x x x. In passing upon petitions to review decisions of the Court of Tax Appeals, we have to confine ourselves to questions 1957). (*Gutierrez vs. Collector*, G. R. No. L-9771, May 31,

"On the matter of fraud, although it is fundamental that this is a fact which the Commissioner is required to prove by clear and convincing evidence, it, like other findings of fact, will not be upset unless clearly

erroneous. *Boyett vs. Commissioner*, 204 F. 2d 205. The Tax Court, in concluding that the tax deficiencies were due to fraud, expressed the view that consistent substantial understatements of income for a period of four years, together with a clear pattern of reporting deductions with accuracy in detail while being deliberately evasive in the matter of income, made it impossible to believe the understatements were due to inadvertence, negligence or honest errors. Circumstances such as these are competent upon which to base a finding of fraud. Cf. *Bryan vs. Commissioner*, 5 dr., 1954, 209 F. 2d 322, 828." (*Archer vs. Commissioner*, 227 F. 2d., 270, 274) (Emphasis supplied)

Again, in the case of *Lee vs. Commissioner*, 227 F. 2d the same U.S. Federal Court of Appeals, in affirming the use of the net worth method, has this to say on the fraud issue:

"We find ourselves in agreement with the Commissioner in these contentions. Of the fraud issue, we think it need only be said that the Tax Court, in its unreported opinion, correctly placed the burden on the Commissioner, and, marshalling the evidence and making findings in accordance therewith, correctly, we think, determined that that burden was carried. It is settled law that where, as here, there is credible evidence supporting a charge that an understatement of income by taxpayer was due to fraud with intent to evade tax, whether the charge has or has not been proved is a question of fact for the Tax Court to determine. and its finding on this issue, just as any other issue of fact. is final unless shown to be clearly erroneous." (Emphasis supplied)

The same rule applies to the case of the P30,000.00 loans allegedly made by Attorney Juan F. David to the appellant, and which are claimed to be valid deductions from his net worth determination. Whether or not such loans were made as claimed is essentially a question of fact: and the absence of any credible note or document evidencing the alleged loans and their alleged partial repayment, leaves the entire issue dependent upon the testimony of the supposed creditor, whom the Court of Tax Appeals refused credence. Considering that the creditor is an attorney at law of long practice and established standing who must have been familiar with legal requirements and the notorious fallibility of debtor's memories; the large amount allegedly loaned; the indetermination of their maturity, and his passivity at their non-payment, we can not declare that the Tax Court's rejection of this item was not supported by substantial evidence or constituted an abuse of discretion.

Appellant invokes our decision in *Knowles vs. Insular Government*, 60 Phil. 461, to the effect that it is incumbent upon the Collector to establish his claim with certainty. The case is not applicable, for the items in the Collector's claim and which constitute the basis of his determination of the appellant's net worth from 1947 to 1950 are practically unconstested. The issue here centered on the justification for the use of the net worth method as basis for determining unreported income, and such issue is more of law than of fact.

In fine, we hold:

That section 38 of our National Internal Revenue Code authorizes the application of the Net Worth Method in this jurisdiction (*Baiter, Fraud Under Fed. Tax Law*, sec. 224; Vol. 2, 1951 CCH 386. *Oil, Byer Net Worth Technique for Determining Income*, supra; *Holland vs. U.S.*, supra; *Estate of Bartley*, 22 U.S. Tax Ct. rep. 1230; *Hurley*, 22 U.S. Tax Ct. Rep. 1264; 8 B.T.A. 189).

That no civil cases, the Government need not prove the specific source of income (this is reasonable on the basic assumption that most assets are derived from a taxable source and that when this is not true the taxpayer is in a position to explain the discrepancy, (see *Holland case*, supra);

That the determination of the tax deficiency by the Government has prima facie validity and the burden rests upon the taxpayer to overcome this presumption and to show to the satisfaction of the Tax Court that the determination was not correct (*Archer vs. Commissioner*, supra; *Thomas vs. Commissioner*, supra; *Laughinghouse vs. Commissioner*, supra; *William Lias*, 24 T.C. No. 23, May 26, 1955, *Virginia Law Review*, 41 p. 7; *Halle*, 7 T.C.

245, aff'd 175 F. 2d 500, 339 U.S. 949; Byer, "Net Worth Technique for Determining Income").

And finally, that no sufficient grounds exist to warrant a reversal of the findings of fraud of the lower court as being "clearly erroneous"; on the contrary, we find them supported by reason.

WHEREFORE, the decision appealed from, requiring appellant to pay the sum of P41,547.77 is affirmed, with the sole modification that the Collector's resort to summary distraint to enforce the taxpayer's liability for the years 1947, 1943 and 1949 is hereby declared improper and void. Costs against appellant. So Ordered.

Bengzon, Montemayor, Bautista Angelo, Labrador, Concepcion, Endencia, and Felix, JJ., concur.

Chief Justice Ricardo Paras and Justice Sabino Padilla and Alex Reyes took no part.

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