T.C. Memo. 1950-248

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When a taxpayer consistently underreports substantial income and fails to maintain adequate records, the Commissioner may assess fraud penalties, even if the exact amount of the unreported income cannot be precisely determined.

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Summary

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Abraham Wolf challenged the Commissioner's determination of tax deficiencies and fraud penalties, which were based on a net worth calculation due to Wolf's inadequate books of account. Wolf argued that he possessed substantial cash assets at the beginning of the period and had borrowed funds during the period, which would reduce the amount of unreported income. The Tax Court upheld the Commissioner's assessment, finding Wolf's testimony unconvincing and unsupported by corroborating evidence. The court also found clear and convincing evidence of fraud based on the consistent underreporting of substantial income and the lack of adequate records.

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Facts

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Abraham Wolf failed to maintain adequate books of account for his business. The Commissioner determined Wolf's tax liability for 1942, 1943, and 1944 using the net worth method. Wolf stipulated to his assets at the end of each year, but reserved the right to introduce evidence of additional assets at the beginning of the period (December 31, 1941) and liabilities at the end of 1943 and 1944. Wolf testified he had approximately $50,000 in cash in a box at home on December 31, 1941, and borrowed approximately $9,000 from friends during the period. Wolf did not mention the cash box during the government investigation. He also did not provide corroborating evidence for the alleged loans.

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Procedural History

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The Commissioner determined deficiencies in Wolf's income tax and assessed fraud penalties. Wolf petitioned the Tax Court for a redetermination of the deficiencies and penalties.

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Issue(s)

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1. Whether the Commissioner's determination of tax deficiencies based on the net worth method was correct, given Wolf's claim of additional assets and liabilities.r
2. Whether the Commissioner presented clear and convincing evidence that any part of the deficiency was due to fraud with intent to evade tax, thus justifying the imposition of fraud penalties.r
3. Whether the Current Tax Payment Act of 1943 should apply to reduce the tax liability.

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Holding

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1. No, because Wolf failed to provide credible evidence to support his claims of additional assets and liabilities beyond those stipulated.r
2. Yes, because the consistent and substantial underreporting of income, combined with the failure to keep adequate records, constituted clear and convincing evidence of fraud with intent to evade tax.r
3. No, because part of the deficiency in 1942 was due to fraud, with intent to evade taxes, disqualifying Wolf from the forgiveness feature of section 6 of that act.

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Court's Reasoning

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The court found Wolf's testimony regarding the cash box and loans to be vague, noncommittal, and lacking in credibility. The court emphasized that Wolf never mentioned the cash box during the lengthy investigation. The court stated it was

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