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COMMENTS

NET WORTH AND PROOF OF TAX EVASION

On December 6, 1954, the Supreme Court of the United States approved a method of establishing a criminal violation of the Internal Revenue Code which materially lessens the amount of evidence required of the government to obtain a conviction. The Court was faced with the problem of allowing a practical method of proving a criminal violation of the revenue laws on the one hand, while still preserving to the accused his right to require the government to prove him guilty and not force him to prove himself innocent. On that day in four companion cases, the Court delivered its answer to the problem by affirming lower court decisions which approved the so-called net worth method of establishing taxable income.

The net worth method, as used by the government, is one by which the prosecution is enabled to prove taxable income by first establishing the value of the total assets of the defendant at the beginning of the tax year for which he was indicted for tax evasion. This is called the opening net worth. Second, the government then shows the expenditures of the defendant during the year in question. The next step is for the government to show the value of the total assets of the defendant at the end of the year.

The expenditures of the taxpayer are added to his closing net worth. From this total is taken the opening net worth and the income reported by the taxpayer on his return. The result of this calculation is the amount of income of the taxpayer which he did not report on his return. The following formula illustrates this calculation:

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\text{(Expenditures + closing net worth)} - \text{(Opening net worth + reported income)} = \text{Unreported income.}
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The prosecution in all four cases was under § 145 (b) of the Internal Revenue Code of 1939, 26 U.S.C.A. § 145 (b) (1945). The section provides: "Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution."

The provision of the Internal Revenue Code of 1954 which now covers the situation in the cases is § 7201, 26 U.S.C.A. § 7201 (1954) which reads: "Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than five years, or both, together with the costs of prosecution."


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From the unreported income, any non-taxable income is deducted of which the government has been apprised. The prosecution then argues to the jury that the remaining sum constitutes the unreported taxable income for the year. The factual situations in the cases necessitate some variation on this general statement of the net worth method and it is necessary for the government to establish more than just unreported taxable income before a conviction can be obtained. These aspects are considered later in the paper. The operation of the net worth method can be seen by considering how it was used in the four cases decided by the Supreme Court.

The case in which the net worth doctrine is most extensively treated is *Holland v. United States*, the unanimous opinion of the Court being delivered by Mr. Justice Clark. Mr. and Mrs. Holland were convicted of willfully attempting to evade or defeat their income tax for 1948 by understating their tax liability. Mr. Holland was indicted for tax evasion for 1946 and 1947, and both were charged with evasion for 1948. He was acquitted of the charges concerning 1946 and 1947. The government introduced evidence tending to show an increase in the defendants' net worth for the year 1948 of approximately $32,000 while the reported income was only $12,000 and also showed a possible source of income by proving that the hotel and restaurant owned by the Hollands could have accounted for this increase, based on the profits reported by the former owners. It was the contention of the Hollands that the money expended during the period of prosecution represented an accumulation which they had saved for a considerable number of years prior to 1946 and therefore the government's opening net worth figure was understated. They maintained that the money, totaling $113,000, plus hundreds of shares of stock, was kept in a canvas bag, a suitcase, and a metal box with $104,000 of it accumulated prior to 1933, and that it was not until 1946 that any of it was spent. The government attempted to refute this contention by showing that during the period the defendants claimed they were accumulating, they maintained a very low standard of living, were forced to separate for eight years because it was to their economic advantage, and allowed their furniture to be taken because of a balance of $92.20 owing on it.

On appeal from their conviction, the defendants contended that the net worth system is not an accurate method of determining income, that the effect of its use is to shift the burden of proof to the taxpayer to show that the increases do not reflect taxable income for the period of prosecution, and that the method should be restricted to situations where the taxpayer keeps either inadequate or no records. The Court, while recognizing the inherent weaknesses and dangers of convictions based upon this system, approved its use although

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3 348 U.S. 121 (1954).

4 The Court was unanimous in all of the net worth cases except the Calderon case, in which Mr. Justice Douglas dissented without opinion. The opinion of the Court was delivered by Mr. Justice Clark in all four cases.
cautioning the lower courts to exercise care to protect the rights of the defendant.

In the second of the net worth cases, Friedberg v. United States,⁵ the contention of the defendant on appeal was limited to the adequacy of the government's proof of the opening net worth. He maintained the government failed to take into consideration, in determining his opening net worth, a hoard of cash and securities valued at between $50,000 and $100,000, which the defendant claimed he had at that time. The government, to show that he did not have any such sum before 1944, the first year of prosecution, established that Friedberg had no taxable income from 1922 to 1937 except when he paid nominal taxes for 1923 through 1925. Also a mortgage on his home was foreclosed in 1937 and a deficiency judgment resulting therefrom for $3500 could not be collected in 1939. In 1940 a levy on a judgment for $13.76 was returned nulla bona. The Court held that from the above facts the jury could conclude that the defendant did not have such a reserve.

The next case in the series was Smith v. United States⁶ where the defendant's principal contention was that a statement containing an admission of his opening net worth should not be admitted in evidence. Smith was under the impression that he was settling a civil tax liability, with no thought of prosecution, when he signed the statement prepared by the government and his accountant. The defendant maintained that the statement was inadmissible because of the government's promise of immunity from criminal prosecution and further that the statement was not sufficiently corroborated by independent evidence. The government denied a promise of immunity. The Court held that the question of immunity was one of fact for the jury, and that their findings were supported by the evidence. As to the defendant's second contention, the Court held that the statement was sufficiently corroborated to be admissible, even though the corpus delicti was not established independently of the admission.

The last of the foundation cases of the net worth doctrine was United States v. Calderon⁷ where the Court was faced with the problem of having sufficient corroboration of the defendant's admission to a government agent concerning his opening net worth which was necessary to sustain the convictions for tax evasion in 1946, 1947, 1948, and 1949. Although there was not sufficient proof without that admission to sustain three of the four convictions, the defendant at the trial testified in such a manner as to show that over the four-year period he was guilty of evading taxes. The Court struggled with the requirement that one be proved guilty of tax evasion for each year individually and seemed to solve the problem by a series of inconsistent statements which can only lead to confusion. The Court held:

⁵ 348 U.S. 142 (1954).
While the evidence as a whole must show a deficiency for each of the prosecution years, the corroborative evidence suffices if it shows a substantial deficiency for the over-all prosecution period. . . . Although the evidence was insufficient to corroborate the opening net worth directly, we find the independent proof of tax evasion entirely adequate. 8

NET WORTH BEFORE THE HOLLAND CASE

This is not the first time that the Supreme Court has been presented with the problem of net worth in some form. In United States v. Johnson 9 the Court was required to pass on the use of a net worth system to establish the income of several gambling establishments which it was alleged the defendant owned. In this case the books of the establishments were destroyed, so the government had no recourse to the business records to prove income. The principal contention of Johnson was that he had no interest in the gambling houses and therefore their income was not taxable to him "... the only real problem before the jury [was] when he [Johnson] swore that he 'never had any financial interest in any gambling club. . . ." 10

After showing that Johnson actually controlled the clubs, the government then proceeded to show the taxable income of the clubs by the use of a net worth method. Although Johnson never seriously contended that this method was inappropriate, the Court summarily disposed of the argument by pointing out that when there are no actual records in existence, this is the only practical way of proving an income. If the Court were to have held otherwise, it would allow a taxpayer to escape conviction for income tax evasion by the simple expedience of disposing of all of his business and personal records.

The Johnson case differed from what we now know as the classic net worth case by virtue of the fact that there was no contention of a non-taxable source of income. All the income involved in the case was admittedly taxable; the net worth method was used to determine the amount of the income. Thus the case was never considered to give a blanket approval to the net worth method.

The net worth method came into its own at the much publicized trial of Al Capone when the government used the income tax laws to do what federal and local officials had been trying unsuccessfully for years to accomplish—convict the most important gangland leader of the prohibition era of a crime. 11 The method was used to show the amount of income received from the sale of beer to the speakeasies of the Chicago area. This evidence did not need to stand on its own however, but acted only to corroborate direct evidence of the income. Capone's principal defense other than procedural matters was that the profits of the enterprise were not actually his and therefore not taxable to him. The discussion of the net worth method by the Court of Appeals was limited as the

9 319 U.S. 503 (1943).
10 Ibid., at 516.
11 Capone v. United States, 51 F. 2d 609 (C.A. 7th, 1931).
court was only called upon to approve the method as corroborative rather than primary evidence.

The next year the same court had occasion to pass upon net worth in a similar case—both as to facts and personalities. In Guzik v. United States the business manager and financial consultant found that the government had as much interest in his income tax returns as those of his now incarcerated associate's. The only important difference in the two cases was that Guzik's income was purportedly from gambling receipts while that of Capone was from the purveying of beer. These cases acted as the pioneers in obtaining judicial approval for the use of net worth in criminal prosecutions. Prior to the recent pronouncement of the Supreme Court, the use of the net worth method has been approved and extended by the lower courts.

Establishing the opening net worth

The whole structure of a net worth prosecution is built upon the establishment of the opening net worth. In order for the government to be able to prove that the expenditures of the taxpayer during the period of prosecution were attributable to income received in that year and not from prior savings, the government needs to establish that this is not possible due to lack of any fund from which such expenditures might come.

The government is faced with a difficult problem in attempting to establish an opening net worth. It must be careful to include all of the assets of the individual at the beginning of the period. To obtain the necessary information, the government usually approaches the taxpayer first. If the taxpayer does not furnish this information, the government is placed in a position of having to send its investigators out to obtain the data. The real and personal property of the taxpayer must be evaluated. The government needs to locate his banking facilities to discover his cash assets and obtain possible clues as to other property which he may own. Obtaining this information is a long and tedious process which will effect a practical limitation on the use of the method. Even after all of this investigating, there is no assurance that at the time of the trial the taxpayer will not be able to show other assets which were not included by the government and which would effectually negate the prosecution's case.

The method preferred by the government to establish the opening net worth of the taxpayer is to obtain an admission, as this is the simplest and most eco-

12 54 F. 2d 618 (C.A. 7th, 1932).
13 Lest the reader think that this difference is not important, let him compare Rutkin v. United States, 343 U.S. 130 (1952) with Commissioner v. Wilcox, 327 U.S. 404 (1946) where income from extortion was held taxable, while income from embezzlement was considered non-taxable.
nomical method of establishing it. From the taxpayer's standpoint the discussion of his opening net worth with a government agent is fraught with danger. Although the taxpayer may be under the impression that it might be a routine inquiry or connected only with the settlement of a civil tax liability, his admission as to the value of his assets as of a given date may be used to establish the opening net worth in a criminal prosecution. Although the taxpayer usually is only too willing to give to the government agent all the information which he desires, and in most situations this is not only proper but desirable, in the instances where the taxpayer has already acted to give rise to a possible criminal prosecution he might by such statements give the government all the information it needs to obtain the conviction. Therefore in those instances it might be better for the taxpayer to have legal counsel before making any statements to the agent. The defendants' positions in the Smith and Calderon cases will serve to illustrate this point.

In Smith the government's proof of opening net worth was based on a statement given by the defendant to an Internal Revenue agent in the belief that all that was involved was the settlement of a civil tax liability. He thought that the case would be closed when he paid his tax and penalties. In the Calderon case the situation was similar to that of Smith in that the basis of the government's opening net worth allegation was the admissions of the defendant while talking to the government agent and signing a statement prepared by his accountant and the government agent. Calderon maintained at the trial that he relied on his accountant as to the accuracy of the statement he signed while the accountant testified that he had not verified the particular figures in the written statement. While recognizing the danger of admitting the statement, the Court nevertheless held that these were circumstances for the jury to consider in giving credence to the statement, and allowed its admission in evidence.

The opening net worth in the Holland case was not so easily established. The government had to make an independent investigation to ascertain his assets. The opening net worth figure arrived at by this investigation was $32,803.09 in assets with liabilities of $12,650.50. Holland admitted that this was true in so far as it went, but he contended that he had in addition $113,000 in currency and a considerable amount of stock which he had accumulated over a period of years prior to the period of prosecution. In this case it was the job of the prosecution to negate the possibility of the existence of such a hoard, which was done by showing the defendant's impoverished condition during the years he was supposedly accumulating this fund.

The handling of the opening net worth in the Friedberg case was similar to that of Holland. The government used a negative approach by submitting that he had no cash on hand and also that his standard of living was low and many

debts were left unpaid during the years in which Friedberg claimed to have accumulated between $50,000 and $100,000, which he contended was his opening net worth. The type of evidence which the government uses to negate claimed hoards is illustrated in the Friedberg case. There the government introduced all the income tax forms which the taxpayer had filed to show that he did not receive, from taxable sources at least, sufficient income to enable him to accumulate such a sum. It also showed the various judgments rendered by state courts against the defendant which were never collected. A loan application was also introduced where the taxpayer stated his total assets. The Court was of the opinion that this was sufficient to allow the jury to decide that the defendant had no cash assets at the beginning of the period of prosecution.¹⁸

It might be noted that Smith's wife was also indicted with him but that a motion for acquittal was granted as to her. It is significant that the net worth statement concerning Smith and his wife was signed only by him and that the government was then enabled to obtain a conviction against him, but that his wife, who didn't sign an opening net worth statement of any type, was acquitted. Therefore it becomes evident that it is extremely difficult for the government to obtain a net worth conviction without an admission by the taxpayer concerning his opening net worth.

USE OF LEADS TO SOURCES OF INCOME

In order to establish an opening net worth figure that is representative of the taxpayer's financial status at the beginning of the period of prosecution, an investigation into possible sources of his current financial position must be undertaken. It is incumbent upon the government to produce an accurate figure of opening net worth. Therefore the question is presented as to how extensive its investigation of these possible sources must be. How far back into the taxpayer's past must the government go to ascertain income from which possible savings could be derived? Would it have to check for possible non-taxable sources of income, such as gift or inheritance, by looking at the records of the local probate court or other depositories of such records? Is it necessary to check with the banks and other places where similar funds can be kept in the vicinity of the taxpayer to determine what reserves he has on hand? How extensive need the check be with the taxpayer's creditors to find out whether he made any statements concerning his financial status which may be used as admissions, and also to discover any liabilities which would reduce his net worth?

The answers to these questions differ depending upon the amount of co-operation, or lack thereof, by the taxpayer with the government agents. The taxpayer may give to the agent either no leads, leads that are remote, or relevant leads that are reasonably susceptible of being investigated. Pertaining to the

situation when defendant has furnished the agent with relevant leads, the Court pointed out:

While sound administration of the criminal law requires that the net worth approach—a powerful method of proving otherwise undetectable offenses—should not be denied the Government, its failure to investigate leads furnished by the taxpayer might result in serious injustice. It is, of course, not for us to prescribe investigative procedures, but it is within the province of the courts to pass upon the sufficiency of the evidence to convict. When the Government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt. Such refutation might fail when the Government does not track down relevant leads furnished by the taxpayer—leads reasonably susceptible of being checked, which, if true, would establish the taxpayer's innocence. When the Government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the Government's case insufficient to go to the jury. ¹⁹

The Court thus recognizes the danger of requiring the taxpayer to assume the burden of proving his opening net worth when he furnishes the government such leads. The Court felt that this requirement of checking will tend to mitigate against the dangers inherent in this type of prosecution.

In the case where the leads furnished by the taxpayer are of the remote type, the duty imposed upon the government to follow them up is less exacting. By remote type of lead, it is meant that type of statement made by the taxpayer which indicates a source of present assets which would be difficult, if not impossible, to verify, by virtue of the fact that records or other evidence of the transaction are not available because none were ever made or because they are now missing. The difficulty of investigation may also be due to the remoteness in time of the incident or that some of the parties have since died. An example of this would be when the taxpayer claims that he received a gift from a relative who is now deceased and that he retained the gift and did not start spending it until the period of prosecution. In the *Holland* case the defendant claimed that he had held money received from the sale of two cafés in the 1920's and the sale of gold in 1933 totaling $113,000 which he did not start to spend until 1946. The government did not investigate this explanation given it by Holland. Nevertheless, the Court, in allowing the conviction to stand, held that since these transactions were so remote, in conjunction with evidence of subsequent events, the jury could have found that even if the situation in 1933 was as claimed by Holland, he did not have such a sum on hand at the beginning of 1946.

Apparently the Supreme Court will be satisfied that the government has sufficiently established its case without investigating into the remote type of lead. It was considered an impossible task for the government to check this sort of lead.

The Court did not actually consider the situation where the taxpayer furnishes no leads and in effect refuses to co-operate with the government's in-

vestigation of his assets at the beginning of the period of prosecution. Therefore we cannot be sure how much evidence of an opening net worth the Court would require in this situation. However, the Court in the *Holland* case recognized the dangers inherent in the use of the net worth system in a criminal prosecution and because of this there would seem to be little likelihood that the Court would tolerate the government attempting to build its proof of opening net worth on a summary investigation. The government in all probability would be required to show a reasonable inquiry to ascertain the financial status of the defendant even after the refusal of cooperation.

**ESTABLISHING THE EXISTENCE OF UNREPORTED TAXABLE INCOME**

After the opening net worth has been determined, the government usually attempts to show expenditures made during the year of prosecution which could not be accounted for, by taking the opening net worth in addition to the reported income of the taxpayer, and subtracting his closing net worth. The resultant total, which represents the total unreported income for the period in question, indicates a source of taxable income, or possibly non-taxable income from gifts and inheritances. The problem of the government at this point in the case is to establish that the unreported receipts are classified in the former category. The position of the prosecution at this stage of the proceedings is thus stated by the Court:

Increases in net worth, standing alone, cannot be assumed to be attributable to currently taxable income. But proof of a likely source, from which the jury could reasonably find that the net worth increases sprang, is sufficient.21

It is now incumbent upon the government to produce evidence of these reasonable sources of taxable income. In the *Holland* case, a likely source of taxable income was established as being the hotel and restaurant owned and operated by the defendants. It was shown that over $12,500 of receipts in 1948 were not reflected in the books of the business. Also the reported income of the enterprise under Holland's management was considerably less than that reported by the previous owner even though the business had seemed to increase. The Supreme Court held that this was sufficient proof of a taxable source of income from which a jury could reasonably find that the increases in net worth had resulted, so the government had sustained its burden on this point.

When the prosecution involves more than one year, a problem is presented as to how the government will show which year the unreported taxable income was received. Under the annual accounting concept, which considers each year's taxes as a separate item, the proof of which year the evasion was accomplished should be required of the prosecution. The proof of exactly which year the unreported taxable income was attributed to is especially difficult in those cases where the prosecution is for several years and the proved opening net worth of the taxpayer would cover the expenditures of one year, but not of

21 Ibid., at 137, 138.
the others. In such a case, the classic theory of the annual accounting concept would require that the government prove exactly which years the unreported taxable income was attributable to, as the evasion for each year is to be considered a separate offense. The Court was faced with this problem in the Calderon case where the question was the extent of the corroboration of the defendant's extra-judicial admissions that indicated a deficiency in each of the years of prosecution. The corroborative evidence only indicated a deficiency for the period as a whole. The Court considered that this was sufficient, stating:

While the evidence as a whole must show a deficiency for each of the prosecution years, the corroborative evidence suffices if it shows a substantial deficiency for the over-all prosecution period.\(^\text{21}\)

Thus, the Calderon case holds that, at least as far as the corroborative evidence is concerned, the "niceties of the annual accounting concept" need not be followed. If the departure from the use of the annual accounting concept is extended, the need of the government to establish the exact year of the receipt will be diminished. The Calderon case may be a step toward the reduction in the requirement that the prosecution show the exact year of the receipt. The weakening of this requirement will make the case of the prosecution easier to prove. From the holding of the Calderon case the evidentiary requirement that is placed on the prosecution would appear to be that the government must prove unreported taxable income for the entire period of prosecution, and then introduce some evidence that the evasions occurred in each of the years charged in the indictment. But the amount of evidence that is demanded for this later purpose seems slight. The use of the annual accounting concept in criminal net worth prosecutions is, while not being abolished, reduced in importance, so as to make relying on it as a defense, of doubtful sagacity.

Another problem facing the Court, caused by the necessity to ascertain the year of the unreported taxable income, was the assumption made by the government that the year assets were discovered by the Internal Revenue Service was the same as the year of their receipt by the taxpayer. In the Calderon case a government agent testified that assets were regarded as income in the year of their discovery. The propriety of this practice was not commented on by the Court. The lack of a need on the part of the government to prove any specific amount of taxable income that was not reported may have influenced the Court in this attitude. But there is still a need of showing that at least some of the income was attributable to each of the years of the prosecution in order to convict for all, and because many of the sentences imposed are concurrent should not cause the Court to overlook this requirement.

THE ELEMENT OF WILLFULNESS

Another element necessary to the government's case is that the willful intent to evade the tax must be present, as required by the Internal Revenue

The defendants in all four of the net worth cases were charged with the willful attempt to evade and defeat their income taxes, not with the charge of willful failure to pay a tax. In the *Holland* case, the evidence of the prosecution established, at most, an increase in the net worth of the taxpayer not reflected in his books. No errors in the records of Holland are shown; there is just a naked increase in his net worth. In the past, some affirmative action was required for conviction, in addition to the bare unreporting of income. This usually consisted in some errors or omissions in the taxpayer's books and records. In the *Holland* case, there was no evidence of any irregularity in the books to supply the affirmative act usually needed. This failure of the Court to require any specific affirmative act would seem to eradicate the line between the evasion of taxes and the charge of willful failure to pay a tax. Proof of a willful failure to pay a tax is now sufficient to establish a case of the willful attempt to evade a tax. The blending of these two concepts is indicated by a statement of the Court:

> But when the Government uses the net worth method, and the books and records of the taxpayer appear correct on their face, an inference of willfulness from net worth increases alone might be unjustified, especially where the circumstances surrounding the deficiency are as consistent with innocent mistake as with willful violation. On the other hand, the very failure of the books to disclose a proved deficiency might indicate deliberate falsification.22

The specific affirmative act requirement is thus apparently dispensed with by the Court. This blending of evasion and the failure to pay is further illustrated by the Court's citing of the case of *Spies v. United States*,23 a case dealing with the willful failure to pay, rather than to evade.

In the case of *Smith v. United States*24 the Court also considered the willfulness element. In the brief discussion of willfulness in this case, the statement is made that when the opening net worth is established, the remainder of the net worth calculation, as to unreported increases in assets, "amply establishes a consistent understatement by petitioner of his taxable income; and from this the jury could infer willfulness."25 A consistency in unreporting large amounts of income, proved by the net worth method, is declared to be sufficient evidence from which a jury may find a willful evasion, such evidence being considered hardly sufficient by the *Spies* case to support a charge of willful failure to pay the tax. The need of an affirmative act to show willful evasion seems to be no longer required.

In the other two net worth cases, *Calderon* and *Friedberg*, the Court did not discuss the problem of willfulness. The evidence of this element of the crime is not stated; there is just the declaration that there is sufficient evidence of tax evasion.

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23 317 U.S. 492 (1943).
25 Ibid., at 157.
Thus, as to the element of willfulness in a net worth prosecution, the need of proof on behalf of the government of some affirmative action on the part of the taxpayer apart from the ordinary buildup of a record of unreported income inherent in the net worth system of proof, appears to be no longer necessary. This development will ease the burden of establishing a criminal violation of the revenue laws on the part of the government. Willfulness will now seem to follow automatically from the proof of the other elements in the case, no proof of a particular incident indicating it being necessary. The use by the Court of the term "tax evasion" in the Friedberg and the Calderon cases to indicate all the elements of the crime, including willfulness, without an attempt to separate them further, indicates that the willful attempt to evade, as an element of the offense, has now lost its separate identity, and the jury will be permitted to infer it from evidence of the other elements of the crime of willful tax evasion.

THE BURDEN OF PROOF

In the ordinary criminal case, the burden of proof rests on the prosecution to show that the accused is guilty beyond all reasonable doubt. This rule is also considered to apply to criminal violations of the Internal Revenue Code. Even in the net worth cases the Court declares this to be the rule. The most serious question as to where the burden of proof rests concerns evidence of the taxable source of the net worth increases shown by the prosecution to the jury. Where there are no leads furnished by the defendant, and if the defendant claims that the increases in net worth are from non-taxable sources, the burden of introducing evidence on this point seems now to rest on the taxpayer. The only duty on the part of the government is to investigate those leads of the defendant that are reasonably susceptible of being checked; otherwise the defendant is left the responsibility of showing that the increases in his net worth were the result of non-taxable sources, and not taxable income. In support of this, the Court relies on the case of Yee Hem v. United States, a case concerning the validity of a presumption created by statute that opium found in one's possession is presumed to have been imported after April 1, 1909. The Court held this presumption valid and upheld the conviction. The applicability of this case to the net worth doctrine is difficult to see. In the Tot v. United States case the presumption is created by statute, and there is no statutory presumption that all income is taxable created by the Internal Revenue Code. Also, under the holding in the case of Tot v. United States the creation of a presumption, even by statute, must be reasonably connected with the facts to be proved. The presumption held invalid in this case was that created by § 2(f) of the Federal Firearms Act. It provided that the possession of a firearm by any person convicted of

26 268 U.S. 178 (1925).
27 319 U.S. 463 (1943).
a crime of violence should be presumptive evidence that the firearm was shipped in interstate commerce, and also that the receipt occurred after the effective date of the statute (July 30, 1938). The lack of a rational connection between the facts proved and the ultimate fact presumed is given as the reason for holding the presumption invalid. Applying this principle to the Court-created presumption that an increase in net worth is attributable to taxable income, can it be said that it is a rational presumption from the proof of income that it is from a taxable source, any more than the firearm was transported in interstate commerce? On this question the Court appears to now take a more liberal view of the creation of a presumption.

Also cited by the Supreme Court in its net worth cases was the case of Rossi v. United States29 on the question of burden of proof. This case was a prosecution for the operation of an unlicensed distillery, the burden of proof being placed on the defendant to show that he had a license. This holding is in keeping with the general rule that the burden of producing evidence of a license is on the defendant when this is relied on as a defense. The extension of this rule to the net worth case on the basis that the proof of a license is analogous to the proof of a non-taxable source of income does not seem warranted. For the defendant to produce a license when he is relying on this as a defense does not place much of a burden on him, as all the defendant has to do is to produce the license. This would be comparatively easy for the accused, but almost impossible for the government to go through all of its records in order to show that no license had been issued, and it is primarily because of this difficulty that this burden is placed on the defendant. But when this rule is applied to the net worth cases, the effect is not the same as in the license cases. The difficulty of the taxpayer in satisfying a jury that the increase in net worth was from a non-taxable source may be just as great to him as it would be to the government. Finding evidence of old transactions, as of gifts made a long time ago, may be next to impossible for the defendant as well as the prosecution. Also, if the defendant is obliged to produce evidence that the income that he is spending during the period of prosecution is income of another year that he did not report in his return of that year, when this is relied on as a defense, the accused runs the risk of adversely influencing the jury by this admission, as well as possibly building evidence for another prosecution.

When the burden of establishing the source of the net worth increase as non-taxable income, at least in the period of prosecution, may very well be just as much a burden on the defendant as on the government, there is no logical reason for saying that this burden will be placed on the defendant. The reasoning of the license cases that it is much easier for the defendant to show a license is not applicable here, as it may be just as hard for the accused to account for the increases as for the prosecution to do so. In such a case the better rule would seem to require the prosecution to assume the burden of proof, as it possesses

29 289 U.S. 89 (1933).
the investigative facilities to make such a study, which the defense may not be
able to do.

As to the problem of the establishment of a non-taxable source of the tax-
payer's increases in net worth, in the situation where no reasonable leads are
given by the taxpayer, the burden seems to rest on the defendant under the net
worth cases. Even when the defendant furnishes what the Court calls reason-
able leads, all the government must do is to investigate them, but need not prove
the taxability of the source of the increase. The defendant now must account for
increases in his assets or run the risk of a conviction of a criminal violation of
the Internal Revenue Code.

THE CORROBORATION OF CONFESSION RULE

It is a well established rule that the defendant in a criminal case cannot be
convicted on his confession alone. There must be some other independent evi-
dence of the crime. The rationale of this rule is to prevent a conviction based
exclusively upon the statement of the defendant, which experience has proven
is often in error. It reduces the possibility of obtaining a conviction based on a
confession taken from the defendant by coercive means. Although there is a
rule against the admission of an involuntary confession, in many cases it may
be difficult or impossible for this to be established. Experience has often shown
that some individuals with psychotic disturbances will confess to a crime that
either was never committed or was committed by someone else. Many
times when a major crime is exposed in the headlines of the newspapers, the
police are confronted with at least one person who could not possibly have
committed the crime, but nevertheless confesses to same. In some instances
this type of individual has even been able to pass lie detector examinations while
maintaining guilt.

While the need of corroboration is universally accepted, there is a wide
divergence as to the extent of such corroborative evidence needed to admit the
confession or admission. Varying tests for the sufficiency of the corroborative
evidence have been promulgated by the courts. One test requires that there be
proof of the corpus delicti independent of the admission beyond reasonable
doubt. Another view requires independent proof of the entire corpus delicti by
a preponderance of the evidence. Some courts have required substantial evi-
dence to establish independently the entire corpus delicti. The fourth view
calls for the prosecution to produce substantial independent evidence which
would tend to establish the truthfulness of the statement. Evidence of the
corpus delicti is only necessary as to those elements not admitted. A final state-

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81 United States v. Fenwick, 177 F. 2d 488 (C.A. 7th, 1949).
ment of the corroboration rule requires that the independent evidence tend only to establish the confession, with no need to establish the corpus delicti independently.\textsuperscript{38}

While the Supreme Court had previously required the corroboration of admissions to have them introduced as evidence, the extent of the corroboration that is necessary had not been determined by that Court. The net worth cases, especially Smith v. United States,\textsuperscript{348} and the case of Opper v. United States,\textsuperscript{348} decided the same day, announce the rule of corroboration to be that it is sufficient if the corroboration merely fortifies the truth of the confession, without independently establishing the crime charged. In the Smith case the Court states the rule:

All elements of the offense must be established by independent evidence or corroborated admissions, but one available mode of corroboration is for the independent evidence to bolster the confession itself and thereby prove the offense "through" the statements of the accused.\textsuperscript{38}

The federal rule on the extent of corroboration of a confession or admission thus, as a result of the net worth cases, is that the corpus delicti of a crime need not be established independently of the admissions of the defendant, as long as there is independent evidence which would tend to establish the trustworthiness of the statement. That the rule will not be restricted to tax cases, where there can be no establishment of a corpus delicti independent of the guilt of an individual, is shown by the Opper case. That case was a prosecution for inducing a federal employee to accept compensation for services to be rendered in connection with a federal contract. Although there was not sufficient evidence to establish the corpus delicti independent of the defendant's admissions, the other evidence of the trustworthiness of the statements was sufficient corroboration, and the conviction was affirmed.

Prior to the net worth cases, the federal courts showed little uniformity as to the amount of corroboration necessary. All of the five previously enunciated rules were followed at one time or another by the various lower federal courts, making a specific rule hard to determine.\textsuperscript{39} Two general lines of cases can be perceived, however. One line follows the holding in Daeche v. United States\textsuperscript{40} to the effect that the corroborative evidence is sufficient if it touches the corpus delicti and it goes to fortify the truthfulness of the admission. This line of cases now appears to be adopted by the Supreme Court. The other principal line of

\textsuperscript{38} Pearlman v. United States, 10 F. 2d 460 (C.A. 9th, 1926).
\textsuperscript{348} 348 U.S. 147 (1954).
\textsuperscript{348} 348 U.S. 84 (1954).
\textsuperscript{40} Smith v. United States, 348 U.S. 147, 156 (1954).
\textsuperscript{40} 250 Fed. 566 (C.A. 2d, 1918).
cases follows the case of *Forte v. United States*[^41] and requires substantial evidence, independent of extra-judicial declarations by the defendant, of the entire *corpus delicti* of the crime. Both of these principal rules have modifications.

With the adoption of the rule more favorable to the prosecution, the Supreme Court has made the use of the net worth method of proof much easier because almost all of the cases involve some statement of the accused which the government seeks to have admitted into evidence. With the easing of the requirement as to corroboration thus making the extra-judicial admissions easier to have admitted into evidence, the prosecution will be able to use more of the statements of the taxpayer as evidence in a prosecution for tax evasion.

Probably the most important effects of the new corroboration rule will not be in revenue law violation prosecutions, but rather in the general area of criminal jurisprudence. Therefore in evaluating this rule, we must think in terms of the average criminal prosecution, where the dangers of false confessions and admissions are more acute. If we say that the reason for the rule—to prevent a conviction based on a false confession alone—is a principle to be encouraged, the question arises as to whether the present rule is sufficient to effectuate its principle.

The liberal view adopted by the Court which does not require the crime to be established independently, but allows the statements of the accused to furnish some of the elements, seems not to accomplish the end desired. As an example, in an arson prosecution the state establishes by independent evidence that the building in question was destroyed by fire, but not the cause of the fire. The defendant confesses to willfully setting fire to the structure. The independent evidence of the fire with the admission of the defendant establishes the *corpus delicti* of arson. Under the liberal view of corroboration all that is now required to have the statement admitted into evidence is to offer some independent proof of its truthfulness. This probably could be accomplished by simply proving by the testimony of a witness that the defendant was at the scene at the time the building burned. At this point there would apparently be enough evidence to support a jury's verdict of conviction. This would in effect allow a man to be imprisoned for the commission of a crime, the existence of which depends upon his statement—a result which the corroboration rule was originally intended to prevent. It is submitted that the rule as pronounced by the Court, although it will ease the burden on prosecutors, seems not to be compatible with our established concepts of criminal justice.

**THE DANGERS OF THE SYSTEM**

The Court, in passing on the net worth method of proof, chose from among a number of certiorari petitions four cases which it believed to be representative of the problem.[^42] In giving its reason for taking the cases the Court stated:


[^42]: On January 10, 1955, the Supreme Court vacated the judgments in the other cases and ordered them reconsidered in light of its opinion in the net worth cases, 348 U.S. 905 (1955).
We concluded that the method involved something more than the ordinary use of circumstantial evidence in the usual criminal case. Its bearing, therefore, on the safeguards traditionally provided in the administration of criminal justice called for a consideration of the entire theory.43

Mr. Justice Clark, speaking for the Court, pointed out a number of dangers inherent in the net worth system of prosecution. When the taxpayer maintains that he had a large hoard of money which should be taken into consideration in his opening net worth figure, the jury might be prone to disbelieve him or, if he is able to convince the jury, it might establish a fraud on his creditors which would tend to prejudice the jury against him.

Another danger is that the jury might be too impressed with the exhibits used by the government in this type of case. In the typical case, after the government accountants complete their calculations, they turn the figures over to the government signpainters who proceed to make large, graphic, multi-colored charts which portray the government’s version of the taxpayer’s financial history during the period of prosecution. The jury is allowed to take these charts into the jury room, so that the possibility of the jury accepting the figures that are graphically portrayed before them, without considering the merits of the evidence the charts illustrate, is greatly enhanced. The Court suggests that the instructions to the jury should be framed to guard against this risk of undue prejudice.

A further risk to the defendant when facing a net worth prosecution is that while he may know in his own mind that he had a larger opening net worth than the government is willing to concede, nevertheless he may be unable to remember the specific details to adequately recount his financial history in such a manner as to sound credible to a jury. If the transactions which give rise to this accumulation occurred a long time ago, the inability of the taxpayer to recall the facts would be natural.

Another time the testimony of the accused might tend to affect the jury adversely is the instance where the defendant is seemingly evasive in answering queries concerning his business transactions when in fact the lack of definite answers is caused by his loose business methods. Therefore the individual who does not have an adequate knowledge of his business transactions is placed in greater jeopardy since the jury is apt to deduce concealment rather than a lack of knowledge. It must be remembered in this regard that intent to evade taxes is necessary to constitute the criminal offense and that the understatement of income due to ignorance is not criminal.

The latter difficulty is especially important when the government shows certain transactions during the year of prosecution which were not reflected in the taxpayer’s books. This fact could be due to willful concealment or innocent mistake. All too often the jury is willing to jump to the conclusion that this type of omission is purposeful, without other evidence tending to show this to be true.

While the Court had no definitive solution to these problems, it cautioned the lower courts to take them into consideration in each case, saying:

Trial courts should approach these cases in the full realization that the taxpayer may be ensnared in a system which, though difficult for the prosecution to utilize, is equally hard for the defendant to refute. Charges should be especially clear, including, in addition to the formal instructions, a summary of the nature of the net worth method, the assumptions on which it rests, and the inferences available both for and against the accused. Appellate courts should review the cases bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation.

CONCLUSION

While the Court indicated many problems created by the use of the net worth system of prosecution, it did not seem to adequately supply the answers. The entire responsibility for the necessary protection of the defendant’s substantial rights was placed upon the trial court. The Court seems to indicate that, while it authorizes the use of the method hesitantly, it relies basically on the discretion of the trial judge to make certain that the government’s investigation into the financial operations of the defendant was sufficient to establish a true and complete picture of his taxable income. If in the opinion of the trial judge the testimony and other evidence does not indicate a thorough investigation, it then becomes the duty of the trial court to remove the case from the jury and direct a verdict of acquittal. Wide latitude is given by the Supreme Court to the Courts of Appeals to ascertain whether the trial judge performed this duty. It appears from the opinions that the Supreme Court is encouraging the appellate courts to weigh the evidence rather than merely passing upon its sufficiency, as is the usual practice at the appellate level.

If the case is determined to be sufficient to go to the jury, there still remains the problem of drafting instructions properly framed so as to explain what is required for the government to prove its case. Therefore the burden of preparing these technically accurate and practically complex instructions falls on the attorneys who handle net worth cases. However the Court, while requiring a clear statement of a complex cause of action, gives little if any indication to the draftsman as to the framing of the instructions. It is therefore left to future cases to determine what will constitute an adequate charge to the jury in a net worth prosecution.

While the net worth system of prosecution has now received judicial approval from our highest Court, there is still a practical limitation to its widespread use by the government. The investigation that is required in order to build up this type of case is extensive and therefore expensive. The time and manpower that is necessary to collect the evidence makes this method impractical in most cases since the Treasury Department has only a limited number of men available for this type of work. This would limit the actual use of the sys-

44 Ibid., at 129.
tem to the more flagrant cases. However, while the average taxpayer would not be subjected to such a rigid examination, the ability of the government to prosecute on this basis might act as a deterrent to the possible wayward taxpayer.

The Holland, Friedberg, Smith, and Calderon cases, despite the Court's protests to the contrary, effectually shift the burden of proof to require that the defendant establish his innocence and point up the importance of statements made by the taxpayer to government agents during the preliminary investigation of his case. With the Court allowing the jury to accept the government's statement of opening net worth, presume that unreported income is taxable income, and infer willfulness on the part of the taxpayer for not reporting the income, it is not difficult to conclude that the taxpayer now has the duty to establish his innocence. Much may be said on the side of the government about the difficulty in establishing a criminal tax evasion due to the fact that the proof of the source of income of an uncooperative taxpayer is difficult. The nature of the crime is personal since it cannot be shown that the crime has been committed without identifying the perpetrator. And the classic argument may also be used that we must protect the revenue and in order to do so we can not lay down such stringent requirements to obtain a conviction that the average evader would be able to escape retribution.

Most of the arguments of the prosecutor can be directed against many violations of the criminal law. It is submitted that the revenue laws should not be accorded special treatment. While we grant that it is important for a government to be able to obtain financial support from its citizens, we do not believe that the necessity of reducing the traditional safeguards of our criminal procedure has been adequately demonstrated.

It should be noted that the net worth method does not infringe upon the rights of the taxpayer when used in a civil case to obtain back taxes and penalties, since the presumption of innocence does not apply to a civil case. Because of this, the protection of the revenue argument is weakened since the government can obtain the money due it through a civil procedure without regard to whether or not a criminal violation of the Internal Revenue Code occurred. The shifting of the burden of proof thus seems unjustified.

Probably the principal lesson which should be learned from the net worth cases is the danger of the taxpayer's conversations with agents of the government. It can be seen that, at least in the Smith and Calderon cases, a conviction would have been unobtainable without the assistance of the taxpayer himself. Their admissions supplied some of the elements of the crime which the government probably would have been unable to establish. Therefore the taxpayer should be cautioned not to make statements concerning his tax liability when he has any reason to believe that he might be accused of criminal tax evasion. In those instances it is especially important that the taxpayer consult his attorney before making any admissions concerning his income for a given year, whether taxable or not, and his total assets as of a given date. The attorney should be
careful when advising his client to sign a statement which appears to be part of a civil tax liability, as this may later be used as the foundation for a criminal prosecution.

In conclusion, it is submitted that the net worth cases, taken as a whole, tend to weaken the position of the defendant, at least in this type of criminal prosecution. In this regard it should be noted that these cases have had their effect in general criminal law already in so far as the corroboration rule is concerned. Only time and subsequent cases will show how far the courts will be willing to allow this liberalization of the criminal law to be extended. It is hoped that it will not be too far.

REGULATION OF GAMBLING DEVICES IN INTERSTATE COMMERCE

On January 2, 1951, Congress passed "An Act to Prohibit Transportation of Gambling Devices in Interstate and Foreign Commerce." This act, more popularly called the Johnson Act, was designed to close the channels of interstate commerce to slot machines and similar devices and, by so doing, to lessen appreciably the revenue accruing to nation-wide crime syndicates. In addition, it was hoped that this legislation would assist state and local law officers in the enforcement of anti-gambling statutes. But in order to aid federal agencies in enforcing this prohibition, Congress imposed various restrictions and duties which have run afoul of the courts and have raised some interesting problems of constitutional law. As it shall be seen, the government has had some success and some failure in enforcing these restrictions and duties.

1 It was not the intent of Congress that all gaming devices were to be prohibited from interstate commerce. Specifically, it was stated that devices which are played purely for amusement were not to be included in the provisions of the act. The act is restricted to two types of gambling devices, one of which is the slot machine, while the other is that type of machine which is designed and manufactured to be operated by a coin and to deliver money or a prize as


3 Ibid.

4 This statute, being penal in character, provides for fines and/or imprisonment for violations, and for confiscation of any device used in violation of the act. 64 Stat. 1135 (1951), 15 U.S.C.A. §§ 1176-1177 (Supp., 1954).