REPUBLIC OF THE PHILIPPINES
COURT OF TAX APPEALS
QUEZON CITY

FIRST DIVISION

****

ORION LAND, INCORPORATED, Petitioner,	**C.T.A. CASE NO. 7086**
	Members:
- versus -	**ACOSTA,** *Chairperson* **BAUTISTA,** and **CASANOVA,** *JJ.*
COMMISSIONER OF INTERNAL REVENUE, Respondent.	**Promulgated:** JAN 10 2008; 2:00 pm

x -x

DECISION

CASANOVA, J.:

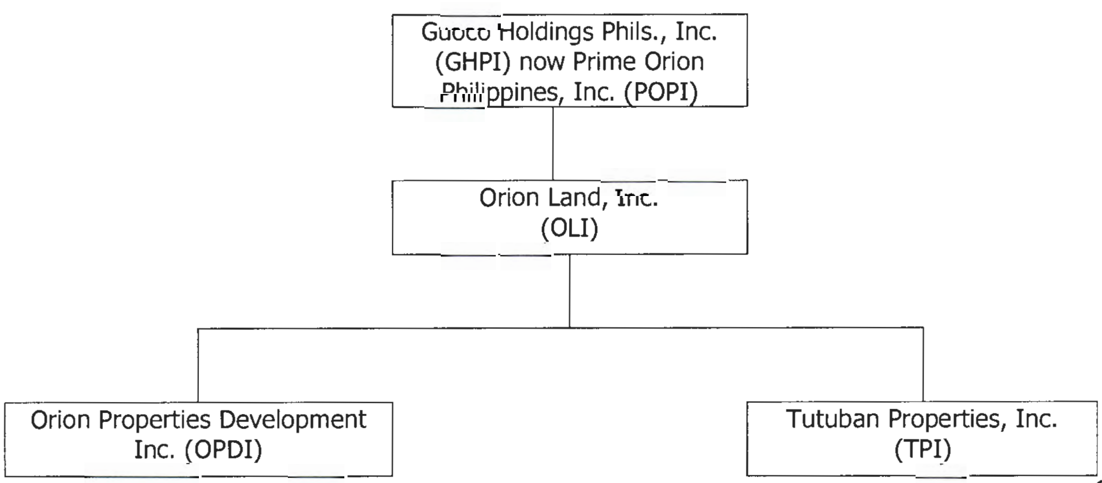
This *Petition for Review,* filed on October 20, 2004, is seeking the cancellation of the deficiency assessment by the Commissioner of Internal Revenue holding petitioner Orion Land, Inc. liable for deficiency Income Tax for the Fiscal Year (FY) ending June 30, 2001 in the amount of P85,054,588.87, including surcharges and interest, and alleged deficiency Value-Added Tax in the amount of P27,133,312.84, including surcharges and interest.

As culled from the records of the case, the facts are as follows:

Petitioner Orion Land, Inc. (OLI) is a domestic corporation duly organized and existing under the laws of the Republic of the Philippines, with principal address at 20th Floor, LKG Tower, 6801 Ayala Avenue, Salcedo Village, Makati City.[1]

Respondent, on the other hand, is the Commissioner of the Bureau of Internal Revenue (Commissioner) who was duly appointed and empowered to perform the duties of his office, including, among others, the power to decide, cancel, and abate tax liabilities pursuant to Section 204 (B) of the 1997 National Internal Revenue Code (Tax Code).[2]

OLI is allegedly a part of a group of companies of which it is deemed as the parent company of Orion Properties Development, Inc. (OPDI), and Tutuban Properties, Inc., (TPI) OLI's parent company, on the other hand, is Prime Orion Philippines, Inc. (POPI), formerly Guoco Holdings Phils., Inc. (GHPI).[3] Shown below is its corporate structure:[4]



[1] Joint Stipulation of Facts and Issues, par. 1, Rollo p. 108.
[2] Ibid. par. 2.
[3] TSN, June 30, 2005, p.16; Petition for Review, pars. 20-21, Rollo p.7.
[4] Exhibit "J," Rollo p. 182.

Part of its company policy is an inter-company lending program wherein the parent company sometimes borrows money from banks or financial companies and extends the loaned amount to its subsidiaries. In such instance, the parent company pays interest to banks and/or financial companies for the loan and at the same time charges the subsidiary for interest on the financial support. In the transaction giving rise to this petition, POPI/GHPI, lent money to OLI, and the latter extended assistance to its subsidiary Orion Properties Development, Inc. (OPDI), which is deemed as the "final user" of the funds. [5]

Hence, pursuant to the inter-company lending policy, on June 15, 1999, the Board Members of petitioner, confirmed by unanimous vote the corporate advances given (and to be given) by OLI to its subsidiary Guoco Property Development, Inc. Such advances were charged with interest based on the actual cost of OLI's borrowing (*i.e.*, passed-on interest) or at such rate as may be agreed upon by the parties.[6]

Almost six (6) months thereafter, or on January 25, 2000, OLI filed its Annual Income Tax Return showing a taxable loss for the FY ending June 30, 1999. In the succeeding years, petitioner reflected taxable losses in its annual tax return until fiscal year ending June 30, 2004. The losses are tabulated below:[7]

EXHIBIT	FISCAL YEAR	TAXABLE INCOME/LOSS
O	June 30, 1999	(P 11,492,532.00)
P	June 30, 2000	(P 11,651,491.00)
N	June 30, 2001	(P 11,708,290.00)
T	June 30, 2002	(P 282,576.00)
U	June 30, 2003	(P 62,239.00)
V-39	June 30, 2004	(P 331,280.00)

[5] TSN, June 30, 2005, Ibid., pp.15-16.
[6] Commissioner's Report, Exhibit "V-32"
[7] Rollo pp. 191-192, 193-195, 188-190, 246-248, 249-251; Commissioner's Report.

Then, on September 8, 2003, OLI received from the Commissioner a Letter Notice dated September 1, 2003 stating that based on the records that the Bureau of Internal Revenue obtained from OPDI, interest expense was paid by the latter to OLI as shown below:[8]

MONTH	FUND BORROWED-OLI	INTEREST
July 31, 2001	839,347,358.73	10,900,822.84
August 31, 2001	850,248,181.57	11,481,872.60
September 30, 2001	861,730,054.17	10,680,950.13
October 31, 2001	585,037,757.34	8,034,548.36
November 30, 2001	593,072,305.70	7,751,544.00
December 31, 2001	600,823,849.70	7,935,555.90
January 31, 2002	608,759,405.60	7,656,341.68
February, 2002	616,415,747.28	7,002,380.15
March, 2002	623,418,127.43	7,840,703.81
April, 2002	116,665,955.60	2,285,712.55
May, 2002	-	-
June, 2002	-	-
Total interest expense of OPDI		**81,570,432.02**

The Bureau of Internal Revenue (BIR) added further that OPDI deducted from its income interest expense paid to OLI in the amount of P138,108,836.00 [9] from July 1, 2000 up to June 30, 2001 which OLI did not declare in its income tax return. Hence, it assessed petitioner with the following deficiency taxes:[10]

	Fiscal Year	**Fiscal Year**	
UNDECLARED REVENUES	**June 30, 2001**	**June 30, 2002**	**Total**
Interest Income- interest expense by OPDI and payable to OLI	138,108,836.00	81,570,432.02	219,679,268.02
Delinquency Tax Due	44,194,827.52	26,102,538.24	70,297,365.76
Add: 20% interest from 9/2/01 to 10/2/03 (.4167)	18,415,984.00		
20% interest from 9/2/02 to 10/2/03 (.2167)		5,656,420.00	24,072,404.00
Total Delinquency Income Tax	62,610,811.52	31,458,958.24	94,069,769.76

Petitioner was given a period of five (5) days from receipt of the letter to contest the deficiency assessment and whether it will avail of the Voluntary

[8] Exhibit "B," Rollo pp. 152-153.
[9] Ibid.
[10] Joint Stipulation of Facts and Issues, par. 3, Rollo pp. 108-109; Exhibit "B-1," Rollo. p. 153.

Assessment and Abatement Program (VAAP), as stated in Revenue Regulations 12-2002, as amended.[11]

In response to the letter, OLI requested that it be given a period of thirty (30) days to contest the assessment.[12] Commissioner denied this request on September 19, 2003 giving petitioner instead an additional period of five (5) days to disprove the assessment.[13]

Then, on October 13, 2003, petitioner communicated to the Commissioner of its intent not to avail of the VAAP.[14] On November 4, 2003, OLI received Letter of Authority No. 2000-00047145 authorizing Revenue Officer Maria Lina M. Aficial to examine petitioner's books of accounts.[15] Come March 10, 2004, an Invitation for an Informal Conference was received by OLI giving it fifteen (15) days therefrom to contest alleged deficiency tax assessments for the FY ending June 30, 2001 in the amount of P56,502,895.30, including surcharge and interest, broken down as follows:[16]

Income tax

Taxable Income (Loss) per ITR	P	(11,708,290.00)
Add: Interest Income undeclared per ITR		130,072,868.38
Adjusted Taxable Income	P	118,364,578.38
Taxable (P118,364,578.38 x 32%)	P	37,876,665.08
Less: Tax Payment/Creditable Tax		-
Deficiency Income Tax	P	37,876,65.08
Add: 25% Surcharge		-
20% Interest (10-16-01 to 03-30-04) (49.11%)		18,601,230.22
Compromise Penalty		25,000.00
TOTAL Deficiency Income Tax	P	56,502,895.30

[11] Ibid. par. 4, Rollo p. 109.
[12] Ibid., par. 5, Ibid. ; Exhibit "C," Rollo p. 154.
[13] Ibid., par. 6, Ibid. ; Exhibit "D," Rollo p. 155-157.
[14] Ibid.; Exhibit "E," Rollo p. 158
[15] Ibid., par. 7, Rollo p. 109; Exhibit "F," Rollo p. 159.
[16] Ibid. par. 8, Rollo pp. 109-110; Exhibit "G," Rollo pp. 160-161.

Thereafter, a Preliminary Assessment Notice (PAN),[17] dated May 7, 2004 was received by petitioner on May 12, 2004 showing the computation of deficiency income taxes of P 84,223,252.77 and deficiency Value Added taxes (VAT) of P 26,873,768.27 that were computed as follows:

Date	JV No.		Amount
7/31/2000	00-07-214	P	9,675,312.13
8/31/2000	00-08-223		9,808,616.43
9/30/2000	00-09-232		9,622,991.00
10/31/2000	00-10-243		10,076,340.80
11/30/2000	00-11-252		11,850,581.05
12/31/2000	00-12-261		12,885,542.98
1/31/2000	00-01-272		11,984,505.00
2/28/2001	01-02-282		10,496,613.55
3/31/2001	01-03-293		11,233,841.94
4/30/2001	01-04-302		10,644,660.66
5/31/2001	01-05-312		11,127,338.65
6/30/2004	01-06-315		10,666,524.19
Interest Income		**P**	**130,072,868.38**

Deficiency Income Tax

Taxable Income (Loss) per Return			P	(11,708,290.00)
Add: Adjustments				
1. Undeclared interest Income	P	130,072,868.38		
2. Undeclared Professional Fees		120,000.00		130,192,868.38
Total			P	118,484,578.38
Add: NOLCO				11,708,290.00
Taxable Income (Loss) per Audit			P	130,192,868.38
Tax Due (32%)			P	41,661,717.88
Less: Tax payments/credits				-
Deficiency Tax			P	41,661,717.88
Add: 50% Surcharge	P	20,830,858.94		
20% Interest (10-16-01 to 5-25-04)		21,730,675.95		42,561,534.89
			P	84,223,252.77

Deficiency Value Added Tax

Taxable Sales per VAT Returns	P	-
Add: Undeclared Interest Income		130,072,868.38
Total Taxable Sales per Audit	P	130,072,868.38
Output Tax	P	13,007,286.84
Less: Payment/Tax Credits		
Carried forward from previous period		402.00
Deficiency VAT	P	13,006,884.84

[17] Ibid. par. 9; Exhibit "H" and "H-1," Rollo pp. 164, 166-167.

Add:	50% Surcharge	P	6,503,442.42		
	20% Interest (7-26-01 to 5-25-04)		7,363,441.01		13,866,883.43
				P	**26,873,768.27**

This time, the BIR included an amount of P120,000.00 as undeclared professional fees arising from discrepancies in entries in OLI's financial statements and its filed returns (per FS- P50,000.00; per returns –P170,000.00). The undeclared expense was treated by the BIR as undeclared source of income based from the ruling of the High Court in *Perez vs. CTA and CIR*, L-10507 dated May 30, 1958.[18]

The BIR likewise included amounts for NOLCO claimed by OLI from its losses in FY 2001 and deficiency VAT on its alleged undeclared interest income.[19]

On May 31, 2004, OLI was served a Formal Assessment Notice (FAN) showing adjusted deficiency income taxes totaling to P 85,054,588.87 and deficiency VAT in the amount of P27,133,312.84 computed as follows.[20]

Deficiency Income Tax

Taxable Income (Loss) per Return			P	(11,708,290.00)
Add: Adjustments				
1. Undeclared interest Income	P	130,072,868.38		
2. Undeclared Professional Fees		120,000.00		130,192,868.38
Total			P	118,484,578.38
Add: NOLCO				11,708,290.00
Taxable Income (Loss) per Audit			P	130,192,868.38
Tax Due (32%)				41,661,717.88
Less: Tax payments/credits				-
Deficiency Tax			P	41,661,717.88
Add: 50% Surcharge				20,830,858.94
20% Interest (10-16-01 to 6-30-04)				22,562,012.05
			P	**85,054,588.87**

Deficiency Value Added Tax

Taxable Sales per VAT Returns	P	-
Add: Undeclared Interest Income		130,072,868.38
Total Taxable Sales per Audit	P	130,072,868.38

[18] Exhibit "H-1," Rollo pp. 166-167; Answer, par. 5, Rollo p. 70.
[19] Exhibit "I-1," Rollo p. 170-171.
[20] Joint Stipulation of Facts and Issues, par. 10, Rollo p. 111; Exhibit "I," Rollo p. 168-169.

Output Tax			13,007,286.84
Less:	Payment/Tax Credits		
	Carried forward from previous period		402.00
Deficiency VAT		P	13,006,884.84
Add:	50% Surcharge		6,503,442.42
	20% Interest (7-26-01 to 6-30-04)		7,622,985.58
		P	**27,133,312.84**

In response thereto, petitioner sent a protest letter to the Commissioner contesting the validity of the FAN and sent various supporting documents to the BIR on August 10, 2004.[21] Despite petitioner's defenses, a Preliminary Collection Letter dated September 7, 2004 was received by OLI on September 20, 2004 requiring the latter to settle its tax deficiencies in the amount of P112,187,901.71 within ten (10) days from receipt of the letter.[22]

Petitioner wrote several clarificatory letters[23] but receiving no response from the Commissioner, OLI thought it best to treat the collection letter as a denial of its protest letter. Hence, it filed its Petition for Review before this Court on October 20, 2004 citing Section 228 of the Tax Code: [24]

"SEC. 228. Protesting of Assessment.-

xxx xxx xxx

> If the protest is denied in whole or in part, or is not acted upon within one hundred eighty (180) days from submission of documents, the taxpayer adversely affected by the decision or inaction may appeal to the Court of Tax Appeals within thirty (30) days from receipt of the said decision, or from the lapse of one hundred eighty (180)-day period; otherwise, the decision shall become final, executory and demandable."

In its petition, OLI alleged that the Commissioner erred in assessing it with deficiency income tax arising from interest income it received from OPDI. It

[21] Ibid., par. 12, Ibid, Exhibit "J", p. 174.
[22] Ibid., par. 13, Ibid.; Exhibit "K," Rollo p. 183
[23] Ibid., par. 14-15, Ibid.; Exhibit "L," Rollo p. 184; Exhibit "M", p. 185.
[24] Ibid. par. 16, Rollo pp. 111-112.

explained that the interest income received was mere reimbursements of interest charges by the banks and financial institutions to POPI, who in turn passed it on to OLI which further passed it on to OPDI. Hence, OLI derived no additional income from the interest charges.[25] Since the interests were mere reimbursements and not income, the Commissioner likewise erred in charging petitioner for deficiency VAT.

Petitioner, further contested the finding of discrepancy in the professional fees amounting to P 170,000.00 as against those entries in its financial statements of P50,000.00, resulting to a difference of P120,000.00. It alleged that the claim has no basis considering that the return it filed clearly declared as a deduction P50,000.00 for "Outside Services."[26]

With regard to the Net Operating Loss Carry Over (NOLCO), OLI counters respondent's claim that it is not entitled thereto is erroneous. From the year 1999 up to June 30, 2000, petitioner incurred losses which it did not offset against its gross income. Therefore, the same was properly utilized in the succeeding year.[27]

OLI also alleged in its petition that the surcharges imposed were baseless as there was no fraudulent intent to conceal its income.[28]

Respondent's Special and Affirmative Defenses,[29] contained in its Answer, are enumerated below:

> "xxx xxx xxx
>
> 3. The assessments in question were made and issued in accordance with law, rules and regulations.
>
> 4. It was disclosed that petitioner has transactions in the normal course of business with its subsidiaries and affiliates principally

---

[25] Petition for Review, par. 21, Rollo p.7.
[26] Ibid., par. 26, Rollo p.8-9; Exhibit "N-1" Rollo p. 190.
[27] Ibid., pars. 27-31, Rollo pp. 9-10.
[28] Ibid., pars. 38-42, Rollo pp. 12-13.
[29] Answer, pars. 3-8, Rollo pp. 70-71.

consisting of interest and non-interest bearing advances payable on demand. The subsidiary to whom advances were made and interests were charged was ORION PROPERTY DEVELOPMENT, INC. (OPDI), of which petitioner did not declare such interest income, in violation of Section 32 (A) of the 1997 Tax Code.

5. It was discovered from the petitioner's books of accounts that there has been discrepancy of P120,000.00 on professional fees (per FS-P50,000.00; per Returns- P170,000.00), hence, adjustment was made to taxable income. The undeclared expense is considered undeclared source of income as cited in the case of Perez vs. CTA and CIR, L-10507 dated May 30, 1958, for it has been held that unreflected sources of funds not accounted for in the taxpayers income tax returns led to the interference that part of his income has not been reported, subject to income tax rate of 32% pursuant to Section 27 of the 1997 Tax Code.

6. The investigation of petitioner's books of accounts revealed that it had carried over the net operating loss incurred during the year in the subsequent year, in conformity with the provision of Section 34 (D)(3) of the 1997 Tax Code. It is appropriate that such loss should be taken into consideration in computing the correct income tax liability for the current year in order to recapture the income tax benefit realized in the following year because of such carry over.

7. The undeclared interest income of P130,072,868.38 which was subjected to deficiency income tax is likewise subject to value-added tax (VAT) as imposed under Section 106 of the 1997 Tax Code.

8. All presumptions are in favor of the correctness of the tax assessment (Interprovincial Autobus vs. Collector of Internal Revenue, 98 Phil 290).

xxx xxx xxx"

Both parties presented various pieces of evidence both testamentary and documentary. However, respondent was deemed to have waived his right to present documentary evidence when it failed to file its formal offer on time.[30] With the

[30] TSN, April 13, 2007, pp. 3-4.

admission of petitioner's memorandum, *sans* respondent's memorandum, this case was submitted for decision on August 31, 2007.

From the parties' stipulation of facts and issues, the questions for decision are as follows:[31]

1. whether or not it was proper for the respondent to impute interest income to petitioner arising from its inter-company advances to OPDI;
2. whether or not petitioner is liable for deficiency income tax on allegedly undeclared interest income from advances to OPDI considering that petitioner did not actually earn interest income on such advances;
3. whether or not the alleged undeclared interest income of the petitioner is subject to VAT;
4. whether or not there is a discrepancy in the amount of P120,000.00 in the professional fees reflected in the petitioner's income tax return;
5. whether or not petitioner is entitled to claim the NOLCO in the amount of P11,708,290.00 as allowable deductions; and
6. whether or not petitioner is liable to the imposition of 50% fraud surcharge penalty.

The first, second and third issues shall be decided concurrently.

Section 31 of the Tax Code defines "taxable income" as the "pertinent items of gross income specified in this Code, less the deductions and/or personal and additional exemptions, if any, authorized for such types of income by this Code or other special laws." However, taxable income does not include items received which do not add to the taxpayer's net worth, or redound to his benefit such as amounts merely deposited or entrusted to him.[32]

---

[31] Joint Stipulation of facts and Issues, Rollo pp. 112-113.
[32] Justice Jose C. Vitug and Pres. Justice Ernesto D. Acosta citing Commissioner vs. Tours Specialist, 183 SCRA 402, Tax Law and Jurisprudence, 2nd Edition, p.95.

Section 32 of the same Code specifically includes "interests" [33] as a source for gross income. "Interests" for use of money is defined as: [34]

> "the compensation allowed by law or fixed by the parties for the use or forbearance of borrowed money; payments a borrower pays a lender for the use of money; cost of using credit or funds of another"

A review of the records of the case prompted us to conclude that no benefit redounded to OLI from the inter-company lending transactions between itself, POPI and OPDI.

It appears that respondent based this deficiency interest income assessment from its review of petitioner's books of accounts. He presumed that the entries of interest charges against OPDI were interest income which OLI did not declare in its income tax and VAT returns.[35]

In its defense, petitioner presented to the Independent Certified Public Accountant (ICPA), Ms. Myra Celeste Dabalos, journal vouchers issued to OPDI by OLI for evaluation. The ICPA summarized these vouchers and compared them with the findings of the BIR.[36] Ms. Dabalos commented on the accuracy of the BIR findings considering a negligible difference between vouchers and the BIR schedule of P1.28.[37] Thereafter, a comparison of the interest charges[38] by GHPI to OLI and interest charged by the latter to OPDI were made and the findings show that the two sets of payments have no discrepancy.

Aside from these documents, the ICPA also summarized the accounting entries on interest charged by GHPI and the interest charged to OPDI which showed

---

[33] 1997 Tax Code, Sec 32 (A)(4).
[34] Black's Law Dictionary, 6th Edition, p. 812.
[35] TSN, August 1, 2006 pp. 9-10.
[36] Commissioner's Report, Exhibit "V," p.3; TSN, January 26,2006, pp. 13-15.
[37] Ibid.
[38] Exhibit "V-31."

that the entries on the journal vouchers were described as interest expense in loans/advances obtained from OLI's parent company, GHPI. The treatment of these interests by OLI as receivable from OPDI and as liability to GHPI were both corroborated by OLI's Vice-President Treasurer, Mr. Ronald Sugapong in its court testimony on June 30, 2005 [39] and by the ICPA in her report. [40] Mr. Sugapong's testimony further explained that the nature of the transaction is merely a reimbursement of the interest paid by OLI to POPI/GHPI, *viz*:[41]

"ATTY ARANAS:

Q. Can you please explain to us the nature of this inter-company advances that allegedly, Orion Land Inc., derived interest income from its subsidiary or affiliates? Can you please explain the nature of this transaction?

MR. SUGAPONG:

A. Orion Land is part of our Group of Companies. So the, Group of Companies has an inter-company lending policy x x x.

And under this scenario, interest expense incurred by the parent company is being reimbursed by the subsidiary company. Interest income allegedly received by the petitioner from its affiliates, OPDI, is simply reimbursement of the interest charges by the bank and of the financial institutions to the parent company. In this case, the interest charges now go to Prime Orion Philippines Incorporated. In return, GSPI pass this interest to Orion Land, the parent company. And later on, Orion land reimbursed this interest expense to OPDI, the final user of the funds.

xxx xxx xxx

[39] TSN, June 30, 2005, pp. 16-17.
[40] Exhibit "V," Commissioner's Report, p. 3 and p. 5.
[41] Supra, note 29.

ATTY ARANAS:

Q. And what is your recording of this charged interest expense to your affiliates?

MR. SUGAPONG:

A. **Orion Land as the parent of OPDI, records this interest charges as liability to Prime Orion and a receivable due from OPDI.**

(emphasis supplied)

xxx xxx xxx"

Ms. Dabalos' findings, on the other hand, state that:[42]

"We have verified that the interest the company charged OPDI is equal to the interest GHPI charges to the company. Although the billing statements from GHPI to the Company and from the Company to OPDI has an immaterial discrepancy of P1.27, **the amount recorded in the Company's books as DUE From OPDI is equal to the amount recorded as Due to GHPI on these transactions. Thus, the Company did not incur income on these transactions."** (emphasis supplied)

From the foregoing, no taxable income actually redounded to OLI, as the interest it received was merely passed-on to it. It was merely deposited or entrusted to it for payment to POPI/GHPI. Furthermore, by definition of "interest" the actual lender of the funds or creditor is not really OLI as it was a mere conduit in the transaction.

Considering that the interest charged by OLI is not considered income, it cannot be thus subject to VAT.

As to the fourth issue, we likewise rule in petitioner's favor.

---

[42] TSN, Janaury 26, 2006, p. 13-14.

We cannot find any basis for respondent's assessment of the P120,000.00 discrepancy in professional fees. Nor is there a basis for petitioner's claim that the actual cost of professional services was actually P170,000.00. Documentary evidence [43] admitted show that the actual deduction for "outside services" for fiscal year 2001 is in the amount of P50,000.00. No claiming of deduction of P170,000.00 took place as consolidated by the ICPA with the company's ledger for professional fees.[44]

Petitioner's argument that the discrepancy of P120,000.00 was based on the adjustment entries due to the reversal of legal and secretarial fees to GHPI is well taken. It is substantiated by the inter-office memorandum[45] issued on June 29, 2001 by GHPI's legal department to OLI, affirming that beginning September 1, 2000, GHPI ceased issuing monthly billings to OLI and the finding of the ICPA of this fact.[46]

On the issue of whether or not OLI is entitled to claim NOLCO, we also rule in the positive.

In order to "recapture" the actual income of OLI in FY 2001, the BIR added back the NOLCO of P11,708,290.00 to its alleged deficiency income tax. Nonetheless, having ruled out the absence of deficiency income tax of OLI, the BIR no longer has a reason to disallow the same.

Furthermore, Section 34 (D)(3) of the Tax Code states that:

"SEC. 34. *Deductions from Gross Income.-*

xxx xxx xxx

[43] Exhibit "V-3-1," Commissioner's Report Exhibit "V."
[44] Exhibits "V-33" and "V-34," Ibid.
[45] Exhibit "V-35;" TSN, January 26, 2006, p. 15; Answer, par. 6, Rollo p.71.
[46] Commissioner's Report, Exhibit "V."

> **(3) *Net Operating Loss Carry-Over*.** - The net operating loss of the business or enterprise for any taxable year immediately preceding the current taxable year, **which had not been previously offset as deduction from gross income** shall be carried over as a deduction from gross income for the next three (3) consecutive taxable years immediately following the year of such loss: xxx
>
> For purposes of this subsection, the term *"net operating loss"* shall mean the excess of allowable deduction over gross income of the business in a taxable year. (emphasis supplied)
>
> xxx xxx xxx"

The provisions of the law are clear; a loss that has not been previously offset from gross income may be carried over to the three succeeding years. The law itself authorized petitioner such carry-over since OLI had no gross income in the years 1999 and 2000 to offset the losses with. In other words, since OLI was operating at a loss during these years, the carry-over to 2001 is proper.

Finally, on the imposition of surcharge: respondent, in his PAN[47] stated that the surcharge was imposed pursuant to Section 248(B) of the 1997 Tax Code stating that petitioner failed to "report sales, receipts or income in an amount exceeding thirty (30%) percent of that declared per return, which shall render the taxpayer liable for substantial underdeclaration of sales receipts or income and shall constitute a prima facie evidence of a false and fraudulent return."

Section 248 (B) of the 1997 Tax Code provides that:

> "SEC. 248. ***Civil Penalties.-***
>
> xxx xxx xxx
>
> (B) In case of willful neglect to file the return within the period prescribed by this Code or by rules and regulations, or **in case a false or fraudulent return is willfully made, the penalty to be imposed shall be fifty percent (50%) of the tax or of the**

[47] Exhibit "H," Rollo p. 164-165.

> **deficiency tax**, in case, any payment has been made on the basis of such return before the discovery of the falsity or fraud: *Provided,* **That a substantial underdeclaration of taxable sales, receipts or income, or a substantial overstatement of deductions, as determined by the Commissioner pursuant to the rules and regulations to be promulgated by the Secretary of Finance, shall constitute prima facie evidence of a false or fraudulent return**: *Provided, further,* That failure to report sales, receipts or income in an amount exceeding thirty percent (30%) of that declared per return, and a claim of deductions in an amount exceeding (30%) of actual deductions, shall render the taxpayer liable for substantial underdeclaration of sales, receipts or income or for overstatement of deductions, as mentioned herein." (emphasis supplied)

Since OLI was found not to have underdeclared its income, no surcharge can be imposed on it. Furthermore, no fraudulent intent to defraud the government can be found in OLI. It is worthy to note the ruling of the High Court in *Aznar vs CTA, 58 SCRA 519, G.R. No. L-20569. August 23, 1974,* which is stated thus:

> "From the above exposition of facts, we cannot but emphatically reiterate the well established doctrine that fraud cannot be presumed but must be proven. As a corollary thereto, we can also state that fraudulent intent could not be deduced from mistakes however frequent they may be, especially if such mistakes emanate from erroneous entries or erroneous classification of items in accounting methods utilized for determination of tax liabilities. xxx
>
> The lower court's conclusion regarding the existence of fraudulent intent to evade payment of taxes was based merely on a presumption and not on evidence establishing a willful filing of false and fraudulent returns so as to warrant the imposition of the fraud penalty. The fraud contemplated by law is actual and not constructive. It must be intentional fraud, consisting of deception willfully and deliberately done or resorted to in order to induce another to give up some legal right.
>
> xxx xxx xxx"

Respondent was correct in arguing that tax assessments are presumed correct, the taxpayer having the duty to prove otherwise. Nonetheless, petitioner has sufficiently overturned this presumption with the evidence it presented.

Respondent should be reminded that "assessments should not be based on presumptions no matter how logical the presumptions might be. In order to stand the test of judicial scrutiny, the assessment must be based on actual facts."[48] Respondent failed to sufficiently support its claims to substantiate his assessment. It is but proper that the deficiency tax assessment against petitioner be withdrawn.

WHEREFORE, in view of the foregoing, the *Petition for Review* is hereby **GRANTED.** Accordingly, the deficiency assessment by the Commissioner of Internal Revenue holding petitioner Orion Land, Inc. liable for deficiency Income Tax for the Fiscal Year ending June 30, 2001 in the amount of P85,054,588.87 and alleged deficiency Value-Added Tax in the amount of P27,133,312.84 are hereby **CANCELLED**.

SO ORDERED.

CAESAR A. CASANOVA
Associate Justice

WE CONCUR:

ERNESTO D. ACOSTA
Presiding Justice

LOVELL R. BAUTISTA
Associate Justice

[48] Law of Basic Taxation in the Philippines by Benjamin B. Aban in citing CIR vs. Benipayo, G.R. No. L-13656, January 31, 1962.

CERTIFICATION

Pursuant to Article VIII, Section 13 of the Constitution, it is hereby certified that the conclusions in the above Decision were reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

ERNESTO D. ACOSTA
Presiding Justice
Chairman, First Division