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# Doing business in the Philippines for Business Process Outsourcing (BPO) companies

2014 edition

# Content

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*Ma. Victoria C. Españo*
*Chairperson and CEO*

# Foreword

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This guide has been prepared for the assistance of those interested in doing business in the Philippines. It does not cover the subject exhaustively but is intended to answer some of the important, broad questions that may arise. When specific problems occur in practice, it will often be necessary to refer to the laws and regulations of the Philippines and to obtain appropriate accounting and legal advice. This guide contains only brief notes and includes legislation in force as of December 31, 2013.



# Country profile

## Summary

The Philippines is a unique mosaic of East and West. Filipinos are basically of Malay descent, although over the centuries the population has been enriched by infusions of Chinese, Arabic, Spanish and American blood. This varied ancestry can be discerned in the physical features of the people and in their cultural values, customs and traditions, songs, dances, food and festivals. More than 90 percent of Filipinos are Christian, and the large majority (80.9 percent) of the Christian population is Catholic. The remaining 10 percent practice Islam or indigenous religions.

## Geography and population

Situated in Southeast Asia, the Philippines is one of the largest archipelagos in the world, composed of some 7,107 islands grouped into three geographic regions: Luzon in the north, Visayas in the middle, and Mindanao in the south. Manila, the national capital, is on the island of Luzon. Based on the results of the 2010 Census of Population, the Philippines has an estimated population of 92.34 million. Population density is estimated at 308 per square kilometer of land.

## Political and legal system

The constitution provides for a presidential system of government composed of three separate and equal branches: the bicameral legislative branch composed of the House of Representatives and the Senate; the executive branch headed by the president; and the judicial branch headed by the Supreme Court. The three branches of government operate independently under a system of checks and balances.

The country consists of regions, provinces, chartered cities, municipalities, and *barangays* (villages). The Philippines has 17 regions, 81 provinces, 144 chartered cities, 1,490 municipalities, and 42,027 *barangays*. The *barangays* are the smallest political unit. Local governments are responsible for these smaller political units and are similar to the executive branch in structure and function. A province is headed by a governor, while a city or municipality is headed by a mayor. A city or municipality is composed of *barangays*, each headed by a *barangay* captain. All heads of local government are assisted by a board of councilmen.

Entities doing business in the Philippines must operate under laws at the national and local levels. These laws govern antitrust and securities matters, labor relations, banking and finance, insurance, product safety and quality requirements, advertising and sales practices, and environmental standards. National laws also govern such matters as corporation and partnership structures and operations.

## Language

The country's official national language is Filipino, although English is almost universally understood and is the medium of communication in business, schools and government. There are eight major dialects spoken by the majority of Filipinos: Tagalog, Cebuano, Ilocano, Hiligaynon or Ilonggo, Bicolano, Waray, Pampango, and Pangasinense. There are about 76 to 78 major language groups, with more than 500 dialects. Spanish, Chinese and Arabic are also spoken by small minorities. Dates are written MM/DD/YY. A full stop (period) is used for the decimal point, and long numbers are written with a comma (99,999,999.00).

## Business hours/time zone

Normal business hours are for eight hours, generally from 8:00 a.m. to 5:00 p.m., Monday to Friday, with lunch break from noon to 1:00 p.m. Some private enterprises are open on Saturdays. Commercial banks are generally open for client transactions from 9:00 a.m. to 5:00 p.m., from Monday to Friday while there are some banks that are open on weekends. Technology has also enabled certain services to be available 24 hours a day, seven days a week. Philippine time is eight hours ahead of the Greenwich Mean Time (GMT) and 13 hours ahead of the U.S. Eastern Standard Time (EST).

## Public holidays

The Philippines observes the following public holidays:

| | | |
|---|---|---|
| New Year's Day | Regular holiday | January 1 |
| Chinese New Year | Special non-working day | Variable |
| Araw ng Kagitingan | Regular holiday | April 9 |
| Maundy Thursday | Regular holiday | Variable |
| Good Friday | Regular holiday | Variable |
| Black Saturday | Special non-working day | Variable |
| Labor Day | Regular holiday | May 1 |
| Independence Day | Regular holiday | June 12 |
| Ninoy Aquino Day | Special non-working day | August 21 |
| National Heroes Day | Regular holiday | August 25 |
| All Saints Day | Special non-working day | November 1 |
| Bonifacio Day | Regular holiday | November 30 |
| Chris Christmas Day | Regular holiday | December 25 |
| Rizal Day | Regular holiday | December 30 |
| Last Day of the Year | Special non-working day | December 31 |

For the year 2014, December 24 and 26 have also been declared as additional special non-working days by Proclamation No. 655.

Proclamations declaring national holidays for the observance of Eid'l Fitr (End of Ramadan) and Eidul Adha (Feast of Sacrifice) will be issued.

## Economy

The Philippines has a free market economy with an active private sector. The government has privatized most government-owned or -controlled corporations and continues to pursue structural reforms liberalizing imports, deregulating vital industries, and relaxing investment rules.

The country believes in strengthening its industries to compete globally. The country has also been actively attracting investments, largely through legislation that aims to invite foreign participation in key areas of the domestic economy. The government is pursuing policies to integrate the Philippines more closely into the regional and world economies while recognizing the need to provide safety nets for displaced workers.

### Economic growth

In 2012, the gross national income (GNI) was US$425.2 billion based on purchasing power parity (PPP). Based on PPP, GNI per capita in 2012 was US$4,380. According to the Asian Development Outlook 2013 Update in October, the country's GDP for 2013 was 7.0% and it was nudged up to 6.1% for 2014.

### Employment levels

As of April 2013, total employment was at 37.8 million people or 92.5 percent of the estimated 40.9 million persons in the labor force. About 52.6 percent are employed in the services sector, 31.3 percent are in agriculture-related activities, and 16.1 percent are in industry. Many are English-speaking and highly trainable. Resident foreign firms and overseas contractors who employ Filipinos attest to their capabilities as blue-collar workers, technicians, professionals and managers.

### Living standards

According to the 2011 ECA International's Location Ratings Survey , the Philippines was among the top 30 best locations in Asia for expatriates to live. The annual survey conducted among Asian expatriates compares living standards in 265 Asian locations based on categories such as climate, air quality, health services, housing and utilities, isolation, social network and leisure facilities, infrastructure, personal safety and political tensions.

Among the advantages cited by the expatriates in the Philippines were the mix of Western culture and Asian traditions, making it easier for them to interact with the locals and adapt to their surroundings; access to recreational activities; availability of educational facilities; and value-for-money housing and shopping.

### Cost of living

Living costs vary widely; the cost of living in Metro Manila is the highest in the entire country. But no matter where you are in the Philippines, the cost of living will be dramatically lower than in a comparable area in a Western nation. Based on the 2011 Cost of Living Survey by Mercer, Manila is among the cheaper cities, ranking 134th out of 214 major cities, with the costliest cities ranked higher. Asian cities in the survey include Tokyo (2nd), Osaka (6th), Singapore (8th), Hong Kong (9th), Nagoya (11th), and Seoul (19th) which are among the costliest cities in the region. Southeast Asian cities in the survey include Jakarta (69th), Bangkok (88th), Kuala Lumpur (104th) and Hanoi (136th).

As published by the Global Property Guide in 2013, the average price of condominiums located in the Philippines' premier city center ranges from US$88,000 to US$823,000 for properties as small as 30 square meters and as large as 280 square meters. On the other hand, the monthly rent for condominiums in prime areas ranges from US$540 for a 30-square meter property to US$5,040 for a 280-square meter property.

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# BPO industry analysis

**Growth of BPO**

One of the fastest-growing and dynamic industries in the country today is the Business Process Outsourcing (BPO) industry. BPO is defined as "the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administrates, and manages the selected process or processes based on defined and measurable performance metrics." It may also be referred to as information technology enabled services (ITES) considering that it is mostly based on the use of information technology.

In the Philippines, the major components of the BPO industry are:

1. contact center – provides a number of inbound and outbound services for sales, technical support, directory, etc.
2. software development – analysis, design, customization, etc. of systems software
3. animation/creative services – process of giving illusion of movement to cinematographic drawings or models thru 2D, 3D, etc.
4. data transcription – provision of transcription services for interpreting oral dictation of health and legal professionals
5. back office processing – services related to finance and accounting, and HR administration
6. engineering design – includes design for civil works, buildings, electronics, etc.

*(Source: National Statistical Coordination Board)*

According to Everest Group, the Philippines, as an offshore delivery location, has matured tremendously over the last few years. It almost doubled its share in the global IT-BPS market during 2008 and 2014, to become the second largest offshore location of the world.

In The Tholons' 2014 Top 100 Outsourcing Destinations Report, Manila became the second most important place for outsourcing as it dislodged Mumbai on the second spot. Seven other Philippine cities were listed in the list including Cebu which ranked no. 8.

Also, the Philippines was named the "Offshoring Destination of the Year" for three years by the United Kingdom's National Outsourcing Association in 2007, 2009 and 2010. According to the Philippine IT-BPO Road Map 2011-2016 report released by the Business Processing Association of the Philippines (BPAP), the country's advantages over other alternative sites lie specifically in its talent pool, infrastructure, and business environment.

To boost the development of the BPO industry, the government has earmarked a P500-million fund to provide short-term training for the voice, software development, animation and health-care services to ensure the continued supply of qualified labor for the industry.

Based on IBPAP data, the BPO industry earned US$16 billion in 2013, which comprised about 6 percent of the country's gross domestic product (GDP). In the same year, the IT-BPO industry increased the total headcount of local BPO full-time employees to 900,000. The industry is targeting a goal of US$25 billion in annual revenues, and 1.3 million labor workforce by 2016.

# Regulatory environment

### Restrictions on foreign ownership

Starting in 1991, with the enactment of the Foreign Investments Act (FIA), investments have been substantially liberalized. The few restrictions that remain generally arise because of constitutional limitations and health and security reasons. Under the FIA, foreign ownership in a domestic corporation is allowed up to the extent of 100 percent, provided that the corporation is not engaged in an area of economic activity falling under the Foreign Investment Negative List (FINL). The FINL enumerates specific areas of economic activity that are reserved only to Philippine nationals, as well as those where foreign equity or participation is allowed but limited to a certain percentage. In particular, BPO services are not included in the FINL and can thus be wholly foreign-owned, subject to minimum capitalization requirements.

### Government approvals and registration

Corporations and partnerships must be registered with the Securities and Exchange Commission (SEC) to secure their primary license or certificate of registration. Single proprietorships must register with the Bureau of Trade Regulation and Consumer Protection of the Department of Trade and Industry (DTI).

If the entity is qualified to avail of incentives based on particular laws, registration with the government agency implementing the incentive law is also required for the incentives to apply.

### Post-SEC registration requirements

After registration with the SEC, the corporate entity must register with the tax authority, i.e., the Bureau of Internal Revenue (BIR), the local government unit (LGU) of the city or municipality where it will do business, Social Security System (SSS), Home Development Mutual Fund, Pag-IBIG (government mandated housing fund for employees), and Philippine Health Insurance (government mandated health insurance for employees).

### Import and export controls

The Philippines has been liberalizing its markets through a progressive tariff reduction program and a shift to a tariff quota system as part of its commitments under the General Agreement on Tariffs and Trade (GATT) Uruguay Round. The import duties on most products are now significantly lower than in the past, when the government's policy was oriented towards protectionist import substitution.

Most goods are freely exportable, unless the trade is prohibited under international agreements. Certain commodities are regulated or prohibited from being imported for reasons of public health and safety, national security, international commitments, and development of local industry. Regulated commodities require clearances from government agencies prior to their importation. Prohibited commodities may not be imported under any circumstance.

All commodity exporters may retain 100 percent of the foreign exchange proceeds from exports and may freely use these for any purpose.

### Price controls

Price controls are generally not imposed on commodities. However, under Republic Act 7581 or the Price Act, the President can impose a price ceiling on basic commodities if any event causes artificial and unreasonable increases in the prices of basic or prime commodities. The Price Act also empowers the DTI to procure, purchase, import, or stockpile any basic or prime commodity and to devise ways and means of distributing these goods at reasonable prices in areas where there is a shortage of supply or a need to effect changes in prevailing prices.

### Use of land

Ownership of private land is limited to Filipinos or corporations at least 60 percent of the outstanding capital of which is owned by Filipino citizens. However, foreigners are allowed to lease private land for a period of up to 75 years. They can also purchase up to 40 percent of the total available condominium units and townhouses in a single proprietary block. It is generally necessary to obtain permission from the local government for new construction, renovations, or changes in land use.

### Exchange control

The Bangko Sentral ng Pilipinas (BSP), the Philippine Central Bank, has fully liberalized foreign exchange policies, allowing full and immediate repatriation of capital and remittance privileges of income by foreign investors subject, however, to certain precautionary conditions under the Anti-Money Laundering Act. Foreign exchange may be freely sold and purchased outside the banking system. Foreign exchange expenditures obtained from the banking system no longer require the prior approval of the BSP. Similarly, foreign exchange may be sold by authorized agent banks without prior approval of the BSP for payment on foreign exchange transactions, except for certain foreign currency loans still covered by BSP regulations. Foreign exchange receipts, acquisitions, or earnings may be sold for pesos (even to unauthorized agent banks or outside the banking system); retained; deposited in foreign currency accounts (whether in the Philippines or abroad); or used for any other purpose.

### Registration of foreign investment with the BSP

The registration of foreign investment with the BSP is not mandatory. However, if the foreign exchange needed to fund the repatriation of capital or remittance of profits shall be sourced from the Philippine banking system, the banks will require a BSP Certificate of Registration.

### Government incentives

Government incentives are generally granted under the Omnibus Investment Code of 1987, which integrates the country's basic laws on investments and is administered by the Board of Investments (BOI). Fiscal and non-fiscal incentives are granted to enterprises located in areas that are given high priority by the government, such as export-oriented ventures, projects locating in less-developed areas, and enterprises registered with the PEZA or other economic zones. Incentives generally given include fiscal incentives (e.g., income tax holiday, additional deduction of labor expenses from taxable income subject to certain conditions, and various tax exemptions and tax credits); non-fiscal incentives (e.g., simplification of customs procedures for imports and exports); and incentives specific to regional or area headquarters. Additional incentives are available to enterprises engaged in selected economic activities as specified by special laws.

# Setting up a business

### Registration with the Securities and Exchange Commission (SEC)

Companies intending to set up BPOs in the country are required under Philippine laws to register with the SEC to obtain a corporate or juridical personality and/or license to transact business within the Philippines. The SEC is the primary government agency administering the registration and operation of corporations under the Corporation Code.

### Business entities available to BPOs

BPOs in the Philippines may take the form of either a subsidiary or a branch. In the case of a branch office, it can be set up either as a regular branch or a regional operating headquarters (ROHQ).

### Legal attributes

**a. Subsidiary**

A subsidiary is a stock corporation organized under Philippine laws and as such, is deemed a domestic corporation even if majority of its capital stock is foreign-owned. It has a legal and juridical personality separate and distinct from its parent company. The liability or exposure of the parent company is limited to its investment in, or subscription to, the capital stock of the subsidiary. The properties and assets of the parent company are not directly exposed to potential liabilities of the subsidiary.

**b. Branch**

Corporations organized and registered under the laws of any foreign country may establish a Philippine branch by securing a license to do business in the Philippines. A branch is merely an extension of the legal and juridical personality of the foreign head-office. It does not exist independently of the head office and as such, the assets and properties of the foreign head office may be exposed to the liabilities of the branch.

**c. ROHQ**

An ROHQ is a branch of a foreign entity but it is limited to performing the following qualifying services to its affiliates, subsidiaries, or branches in the Philippines, in the Asia Pacific region, and in other foreign markets:

- General administration and planning
- Business planning and coordination
- Sourcing/procurement of raw materials and components
- Corporate finance advisory services
- Marketing control and sales promotion
- Training and personnel management
- Logistics services
- Research and development services, and product development
- Technical support and maintenance
- Data processing and communication
- Business development

An ROHQ cannot offer qualifying services to entities other than its affiliates, branches or subsidiaries. It cannot engage, directly or indirectly, in solicitation or marketing of goods and services, whether on behalf of its mother company, branches, affiliates, subsidiaries or any other company.

## Registration requirements, minimum capitalization and fees

**a. Subsidiary**

**Registration requirements**

To register a subsidiary, the incorporators, who must number at least five but not more than 15 individuals, must file with the SEC the proposed Articles of Incorporation specifying the company name and purpose, principal office, capital ownership, and other information together with By-Laws and the following documentary requirements:

- SEC Name Verification Slip
- Treasurer's Affidavit
- Affidavit of incorporator or director undertaking to change corporate name
- For corporations with foreign equity: Proof of remittance by non-resident aliens and foreign corporate subscribers who want to register their investment with the BSP
- For corporations with more than 40 percent foreign equity: SEC Form No. F-100
- For corporations with PEZA, Subic Bay Metropolitan Authority (SBMA) or other economic zones application:
- Certificate of Authority or endorsements from said government agencies
- For call centers: Business plan/modus operandi and list of prospective clients
- Additional requirements based on the kind of payment of subscription

**Minimum paid-in capital requirement**

The law does not impose a minimum authorized capital stock, but it requires that at least 25 percent of the authorized capital stock be subscribed at the time of incorporation, and that at least 25 percent of the total subscribed capital must be paid-up. In all instances, however, the minimum paid-up capital for a corporation should be at least P5,000. If the subscriber is an alien or a non-resident foreign corporation, the amount subscribed must be fully paid up.

If foreign equity in a domestic market enterprise (DME) exceeds 40 percent, it is required to have a minimum paid-up capital equivalent to US$200,000. A DME is one that produces goods for sale, or renders services to the domestic market entirely, or if exporting a portion of its output, fails to consistently export at least 60 percent thereof. The required minimum capitalization may be reduced to US$100,000 if the company will undertake activities involving advanced technology as determined by the Department of Science and Technology or if it will employ at least 50 direct employees. If, however, the entity exports at least 60 percent of its services, the required minimum capital will not apply.

**SEC filing fees**

The filing fee for a subsidiary is computed at 1/5 of 1 percent of the entity's authorized capital stock plus 1 percent of said computed fee as SEC legal research fee.

**Documentary Stamp Tax (DST)**

Upon incorporation of the subsidiary, DST at the rate of .5 percent of the shares subscribed shall be paid within five days after the close of the month when the corporation was incorporated.

## b. Branch

**Registration requirements**

To set-up a Philippine branch, there is a need to file an application for License to Do Business with the SEC together with the following documentary requirements:

- SEC Name Verification Slip
- Certified copy of Board resolution authorizing the establishment of a branch office in the Philippines and designating the resident agent to whom summons and other legal processes may be served on behalf of the foreign corporation and stipulating that in the absence of such agent or upon cessation of its business in the Philippines, any summon of legal processes may be served to the SEC as if the same is made upon the corporation at its home office
- Financial statements for the immediately preceding year at the time of filing the application, certified by an independent Certified Public Accountant of the home country
- Authenticated copies of the Articles of Incorporation/By-laws/Partnership with an English translation thereof if in a foreign language
- Proof of inward remittance such as bank certificate of inward remittance or credit advice of the assigned capital of the branch
- Resident agent's acceptance of appointment

All documents executed and signed abroad must be notarized and duly authenticated by the Philippine Embassy or Consular Office in the home country of the foreign corporation's head office.

**Minimum capital requirement**

Since a branch is an extension of a foreign entity, it is required to have an assigned capital equivalent to US$200,000. However, this can be reduced subject to the same conditions applicable to a subsidiary.

**SEC filing fees**

The SEC filing fee for a branch is equivalent to 1 percent of the assigned capital plus 1 percent of said computed fee as SEC legal research fee.

**Branch securities deposit**

Within 60 days after issuance of its SEC license, a branch is required to deposit with the SEC securities worth at least PhP100,000 in the form of government bonds or securities, shares of stock in "registered enterprises," shares of stock in domestic corporations registered in a stock exchange, or shares of stock in domestic insurance companies and banks, or any combination of these securities. In addition, "within six (6) months after each fiscal year, the SEC shall require the branch licensee to deposit additional securities equivalent in actual market value to two percent (2%) of the amount by which the licensee's gross income for that fiscal year exceeds Pesos: Five Million (Php5,000,000)." The SEC shall also require deposit of additional securities if the actual market value of the securities on deposit has decreased by at least 10 percent of their actual market value at the time they were deposited.

### c. ROHQ

**Registration requirement**

To register an ROHQ, an application shall be filed with the BOI together with the following supporting documents:

- Corporate Name Verification Slip
- Duly accomplished application form
- Certification that it is engaged in international trade with affiliates, subsidiaries, or branch offices in the Asia Pacific region or other areas
- Board resolution from principal office of foreign entity that it is authorized to establish an ROHQ in the Philippines

**Required investment**

An ROHQ is required to have an initial investment equivalent to US$200,000.

**BOI filing fee**

The fee is PhP4,500 plus 1 percent of this amount as legal research fee.

## Post-SEC registration requirements

After issuance of the SEC Certificate of Incorporation or License to Do Business, the BPO company will register with the following government agencies:

### Registration with the BIR

On or before the commencement of business, the BPO company must register with the BIR Revenue District Office that has jurisdiction over its place of business. The registration shall include the taxpayer's name, business style, place of business and such other information as may be required.

An annual registration fee of PhP500 for every separate or distinct establishment or place of business shall be paid upon registration and every year thereafter on or before the last day of January.

The BPO company shall issue duly registered receipts or sales or commercial invoices, prepared in accordance with the regulations, for each sale or transfer of merchandise or for services rendered valued at PhP25 or more.

### LGU, Social Security System (SSS), and others

**Local government unit**

An entity is required to register with the LGU where it will do business within 30 days from issuance of the SEC certificate of registration/license to transact business. Annual renewal of the local government permit must be done on or before the 20th of January.

**SSS, PhilHealth and Pag-IBIG**

The moment that an entity has at least one employee, said entity shall be required to register with the SSS, PhilHealth and Pag-IBIG. Employer contributions for these agencies are remitted on or before the tenth day of the month following the date of employment of the employees.

# Overview of national and local taxes applicable to BPOs

## National taxes

### Income tax

**Subsidiary**. Being a domestic corporation, a subsidiary is subject to income tax on its worldwide income, i.e., income from all sources within and without the Philippines.

**Branch**. For tax purposes, a Philippine branch of a foreign corporation is treated as a resident foreign corporation, and as such, is subject to income tax only on its Philippine-sourced income, i.e., income derived from all sources within the Philippines. A branch is not subject to tax on its foreign-sourced income.

Except for the above rules, a BPO entity that is set up either as a subsidiary or branch is generally subject to the same tax rules. However, there are certain tax incentives available to qualified BPOs as discussed in the following sections:

**a. Regular corporate income tax (RCIT)**

The regular corporate income tax is 30 percent on net taxable income, i.e., gross income less allowable deductions. As a rule, all items of income shall be included in the computation of taxable income subject to 30 percent tax rate, except for some items of income that are subject to final tax (passive income) or are exempt by provision of law.

In computing net taxable income, an entity is allowed to deduct all ordinary and necessary expenses paid or incurred in carrying on its trade or business; interest on indebtedness related to the business; taxes; losses; bad debts; depreciation; charitable and other contributions; research and development and pension trust contributions for the retirement benefits of employees, subject to compliance of requirements for deductibility.

However, in addition to the foregoing allowable deductions, a branch may, subject to certain conditions, also deduct a portion of the head office expenses, which is effectively connected with the branch's trade or business but which cannot be definitely allocated to the Philippine branch operations (i.e., overhead expenses incurred by the head office in connection with finance, administration, marketing, research and development, other support services, etc.)

A corporate taxpayer has an option to claim optional standard deduction (OSD) equivalent to 40 percent of gross income in lieu of the standard itemized deductions enumerated above. Once the option to claim OSD is made, it shall be irrevocable for the taxable year in which the option was taken.

**b. Minimum corporate income tax (MCIT)**

An MCIT of 2 percent of the gross income shall be imposed beginning on the fourth taxable year immediately following the year in which a company commences business operations. The MCIT is payable when it is greater than the computed RCIT and shall be paid in lieu of the RCIT.

Any amount of MCIT paid in excess of the RCIT shall be carried forward and credited against the RCIT for the three immediately succeeding years.

**c. Net operating loss carry-over (NOLCO)**

Carryover of net operating losses incurred in any taxable year immediately preceding the current taxable year, that has not been previously offset as deduction from gross income is allowed up to the next three consecutive years following the year of such loss, provided that there is no substantial change in the ownership of the business or enterprise.

**d. Other income subject to special tax rates**

The regular income tax shall not apply on certain types of passive income that are subject to final tax. Examples of passive income subject to final tax are:

| Nature of income payment | Tax rate |
|---|---|
| Interest on foreign loans payable to non-resident foreign corporations (NRFCs) | 20% |
| Interest and other income payments on foreign currency transactions /loans payable to OBUs/FCDUs | 10% |
| Sale of shares of stock not traded in the stock exchange on net capital gain<br><br>1st P100,000 / amount in excess of P100,000 | 5% / 10% |
| Capital gains from sale or exchange of land and/or buildings classified as capital asset based on selling price or fair market value whichever is higher | 6% |
| All kinds of royalty payment to citizens, resident aliens and NRAETB (other than WI 380 and WI 341), domestic and resident foreign corporations | 20% |
| Branch profit remittances by all corporations except PEZA / SBMA / CDA-registered | 15% |
| On other payments to NRFCs | 30% |
| Interest on bank deposits and substitutes and trust fund to NRFCs | 30% |
| Interest income from expanded foreign currency deposit of NRFCs | Exempt |

### Withholding tax on income payments

As a payor of income to employees and suppliers of goods and services, the BPO company will be constituted as a withholding tax agent of the government. As such, it is obliged by law to withhold a certain percentage from income payments made by it and remit the taxes withheld to the BIR. Specifically, it shall withhold tax on:

- compensation paid to employees
- fringe benefits paid to supervisory or managerial employees
- various income payments it makes to suppliers, service contractors and other parties subject to expanded withholding taxes (EWT)
- payments to third parties that are subject to final withholding taxes (FWT)

### Dividends tax

Cash and/or property dividends paid by a subsidiary to its foreign parent company are subject to an FWT of 15 percent subject to the "tax sparing rule." If, however, the recipient of the dividends is a resident of a country with whom the Philippines has a treaty, the applicable preferential treaty rate will govern.

### Branch profit remittance tax

Profits remitted by a branch to its head office are subject to a final withholding tax of 15 percent. If, however, the recipient of the profits is a resident of a country with whom the Philippines has a treaty, the applicable tax treaty provisions will apply.

### Value-added tax (VAT)

Any person who, in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services, and any person who imports goods into the Philippines shall be subject to 12 percent VAT, if the annual gross sales/receipts exceed PhP1.9 million. It is an indirect tax that is generally passed on by the seller to the buyer.

The VAT payable to the government shall be the excess between the output VAT and the creditable input VAT.

**a. Input VAT**

VAT passed on by suppliers of goods and services to the Philippine branch as well as the VAT paid on importations shall be considered creditable input VAT of the Philippine entity. Generally, the input VAT is creditable in full against output VAT incurred in the period.

However, with respect to purchases of depreciable assets, the aggregate acquisition cost of which, in a calendar month, exceeds PhP1 million regardless of the acquisition cost of each capital good, the input taxes from these purchases should be spread evenly over the period of 60 months or the useful life of the capital goods, whichever is shorter.[1]

**b. Output VAT**

Generally, sale of services shall be subject to 12 percent VAT. However, export sales of services may either be zero-rated or VAT-exempt. A zero-rated sale of goods or services is a

[1] Section 4.110-3 of RR 16-2005, the Consolidated VAT Regulations, as amended.

taxable transaction for VAT purposes, but the same shall not result in any output tax as the applicable tax rate is zero.

The input tax on purchases of goods, properties or services related to such zero-rated sale shall be available as input tax credit against the output tax from transactions of the taxpayer that are subject to 12 percent VAT, if any, or can be recovered from government by applying for the issuance of tax refund.

#### Documentary stamp tax (DST)
In general, DST is imposed upon documents, instruments, loan agreements and papers, and upon acceptances, assignments, sales and transfers of the obligation, right or property incident thereto, including leases of land or buildings, loan agreements, original issuance and sales/transfers of shares, among others.

#### Taxes on importation
Import duties will be imposed on goods, equipment, machineries, supplies and other articles to be imported by the Philippine entity into the Philippines in accordance with the rates prescribed in the Tariff and Customs Code.

In addition, 12 percent VAT shall be imposed on importations based on the total value used by the Bureau of Customs (BOC) in determining tariff and customs duties, plus customs duties, excise taxes, if any, and other charges. The VAT on importation shall be paid by the importer prior to the release of such goods from customs.

### Local taxes
In addition to the abovementioned taxes, which are levied by the national government, business taxes will also be imposed by the local government unit where the entity will conduct its business. The major local taxes are the local business tax and real property tax.

#### Local business tax (LBT)
The imposable LBT depends on the local tax ordinance enacted by the city or municipality where the Philippine entity will do business. Most local tax ordinances provide for a schedule of gross sales or receipts where the imposable annual LBT is generally a fixed amount up to a certain level of gross sales or receipts for the preceding calendar year, plus a percentage of the excess sales or receipts. The city or municipal government prescribes the rate applicable for different types of business activities, but the rate cannot exceed 2 percent for a municipality or 3 percent for a city.

Tax period shall be calendar year and tax payments may be done annually or quarterly.

#### Real property tax (RPT)
In addition, the entity will be liable to RPT imposed by the province, or city or municipality within metropolitan Manila on real property owned by it such as land, building, machinery and other improvements located in its jurisdiction. The rate will be fixed by the concerned local government unit as follows:

- For provinces: not exceeding 1 per cent of the assessed value of the real property

- For cities or municipalities within Metro Manila area: not exceeding 2 percent of the assessed value of the real property

The assessed value is a prescribed percentage of the market value of the property and varies depending on the use of the property (i.e., residential, commercial, industrial and agricultural).

# Incentives available to BPOs

At present, the various investment laws that grant fiscal and non-fiscal incentives to call centres and business process outsourcing activities are:

- Executive Order No. 226, as amended [also known as the Omnibus Investment Code (OIC) of the Philippines]. This is being implemented by the BOI.

- Republic Act No. 7916, as amended (also known as Special Economic Zone Act or PEZA Law). The implementing agency is PEZA.

- Other laws such as Republic Act No. 7227 (Bases Conversion and Development Act of 1992), as amended by Republic Act no. 9400, Republic Act No. 7903 (Zamboanga City Special Economic Zone Act of 1995) and Republic Act No. 7922 (Cagayan Special Economic Zone Act of 1995).

## BOI Incentives

### Registration requirements

To qualify for BOI registration, the specific activity of the registrant must be included in the Investment Priorities Plan (IPP), an annual issuance by the Philippine government that identifies priority investment areas of business activities that may be registered for incentives.

BPO is included in the 2013 IPP under a.) Creative Industries and Knowledge-based Services and b.) Service Exports.

Based on the specific guidelines implementing said IPP, Creative Industries and Knowledge-based services with original content includes but not limited to software development, animation, engineering and architectural design, product design and game and applications development.

Service export refers to service activities rendered to clients abroad and paid for in foreign currency with export requirement of at least 50% of its revenues, if Filipino-owned or at least 70% if foreign-owned. This covers non-voice business processing operations such as administrative and business services, transcription services, engineering and architectural services.

For contact centers, project must have a minimum investment cost equivalent to USD 5,000 per seat to qualify for registration. This amount covers cost of hardware and software, office furniture and fixture, building improvements and renovation, and other fixed assets except land, building and working capital. If the equipment used were leased, the same should be converted to assets in terms of commercial interest rates and amortized over a five-year period. If the equipment were consigned, the same should have an assigned value to be considered part of the project cost.

In case of call centers, revenue shall be unbundled to show breakdown of servicing domestic and overseas markets.

Generally, the minimum equity required to finance the project applied for registration shall be equal to 25 percent of project cost.

**Incentives granted to BOI-registered companies**

a. Income tax holiday (ITH) for a period of six years for pioneer projects and four years for non-pioneer projects, reckoned from start of commercial operations. For newly registered pioneer and non-pioneer enterprises, the ITH may be extended for an extra year under certain conditions, but in no case to exceed eight years.

   After ITH period, the BPO company shall be covered by the regular corporate income tax discussed above.

b. Value-added tax
   Export of services by a BOI-registered BPO shall be zero-rated for VAT. Export sales pertain to services rendered by the BPO to foreign clients that are not doing business in the Philippines and are paid for in inwardly remitted foreign currency. The sale of service to local customers shall be subject to 12 percent VAT.

   Purchases by BOI-registered BPO enterprises from VAT registered suppliers or contractors shall be effectively zero rated without need of prior BBIR approval. [BIR Ruling DA 452-07; BIR Ruling DA 193-06; BIR Ruling DA-(VAT-016) 0688-09]

c. Zero duty on importations of machinery and equipment
   Any importation of capital equipment, spare parts and accessories by enterprises registered with the BOI, whether export or domestic-oriented, shall be subject to 0 percent duty under certain conditions.

d. Additional deduction for labor expense
   For the first five years from registration, a registered enterprise shall be allowed an additional deduction from taxable income equivalent to 50 percent of the wages of additional skilled and unskilled workers in the direct labor force, subject to fulfilment of a prescribed capital-to-labor ratio. The allowable deduction is based on the increment in the number of direct labor in the year of availment against the previous year. This incentive shall not be availed of simultaneously with the ITH.

e. LBT exemption
   A BPO company registered with the BOI as pioneer or non-pioneer shall be exempt from LBTs for a period of six or four years respectively, from the date of registration. The exemption extends only to LBT and not to other taxes such as real property tax as well as other fees and charges imposed by the local government unit (LGU).

f. Employment of foreign nationals in supervisory, technical or advisory positions for a period of five years from date of registration. This limitation does not apply to the positions of president, general manager and treasurer of enterprises that are majority-owned by foreign investors.

   Spouses and unmarried children below 21 years old are permitted to enter and reside in the Philippines during the employment period.

g. Simplification of customs procedures

h. Unrestricted use of consigned equipment under re-export bond

i. Exemption from wharf age dues and any export tax, impost and fees on its non-traditional exports for ten years from date of registration

## PEZA Incentives

**Registration Requirements**

For an entity to qualify for PEZA registration, it must be (1) located in a building or zone declared as a PEZA zone and (2) engaged in an activity qualified for registration.

Under the PEZA Guidelines on Registration of IT Enterprises and Establishment and Operation of IT Parks/Buildings, IT service activities that may be registered with PEZA for enjoyment of incentives include:

- Software development and application including programming and adaptation of system software and middleware, for business, media, e-commerce, education entertainment, etc.
- IT-enabled services, encompassing call centers, data encoding, transcribing and processing, directories, etc.
- Content development for multi-media or internet purposes
- Knowledge-based and computer-enabled support services, including engineering and architectural design services, consultancies, etc.
- Business process outsourcing using e-commerce
- IT research and development
- Other IT related service activities as may be identified and approved by the PEZA Board

As of December 31, 2013, there are 40 IT parks and 157 IT centers in the Philippines where BPOs can locate to avail of the PEZA incentives. The latest list of PEZA IT parks/centers is attached for reference.

**Incentives granted to PEZA-registered companies**

**a. Corporate income tax incentives**

A newly registered entity is generally entitled to an ITH for four years for non-pioneer enterprises, or six years for pioneer enterprises. After the lapse of the ITH period, the PEZA-registered enterprise shall be subject to the special 5 percent tax on gross income earned, in lieu of all national and local taxes, except real property taxes on land owned by developers. The 5 percent special tax rate is not time-bound, and shall be available to the enterprise for the duration of its PEZA registration. The 2 percent MCIT does not apply to PEZA-registered firms.

**b. VAT**

Export sales of services of a PEZA-registered BPO company during the ITH period shall be zero-rated for VAT. Upon the lapse of the ITH, whereby the BPO company becomes subject to the 5 percent special tax, the export sale shall be exempt from VAT. Domestic sales shall be subject to 12 percent VAT.

Purchases by a PEZA-registered BPO company from a VAT-registered supplier outside the ecozone shall be subject to 0 percent VAT whether or not the company is under the ITH or 5 percent special tax.

**c. Tax and duty free importation of capital equipment**

Generally, PEZA-registered enterprises are exempt from payment of import duties and taxes on imported machinery, equipment and spare parts, subject to certain conditions. Importations of PEZA-registered enterprises are not subject to 12 percent VAT.

**d. Tax and duty free importation of construction materials**

e. **Tax and duty free importation of specialized office equipment and furniture.**

f. **Additional deduction for training expense**
One-half of the value of training expenses incurred in developing skilled or unskilled labor or for managerial or other management development programs may be deducted, to be charged against the 3 percent share of the national government in the special 5 percent tax on gross income.

g. **Local business tax**
PEZA-registered enterprises, whether under the ITH or the 5 percent special regime, shall be exempt from securing local government business permits. A PEZA-registered enterprise availing of the ITH incentive will be exempt from all local taxes, except real estate taxes. A PEZA-registered enterprise under the 5 percent preferential rate will be exempt from all local taxes, except real property tax on land owned by ecozone developers.

h. **Unrestricted use of consigned equipment**

i. **Other non-tax incentives**
Foreign investors with initial investments of US$ 150,000 or more in registered IT enterprises shall be granted permanent resident status. IT enterprises shall also be allowed to employ non-resident aliens required in its operations.

j. **Exemption from branch profit remittance tax**
Branches registered with the PEZA are exempt from the 15 percent branch profit remittance tax.

## Taxation of ROHQ

Tax attributes and incentives granted to an ROHQ are:

**Corporate income tax**
Income generated by an ROHQ from performing the qualifying services shall be subject to the preferential rate of 10 percent on net taxable income.

**Branch profit remittance tax**
Income derived from Philippine sources by the ROHQ, when remitted to the head office or parent company, shall be subject to branch profit remittance tax at the rate of 15 percent.

**VAT**
An ROHQ is subject to the 12 percent VAT on gross receipts derived from the domestic sale or exchange of services. Export services performed by an ROHQ for its affiliates shall be zero-rated for VAT.

**Withholding tax on compensation of alien and Filipino executives**
Alien executives or expatriates employed by an ROHQ and occupying managerial and highly technical positions shall be subject to a final tax of 15 percent of their gross income.

The same tax treatment shall apply to Filipinos occupying the same positions as defined above, whether or not there is an alien executive occupying the same position. Qualified Filipino employees shall likewise have the option to be taxed at either 15 percent of gross income or at the regular graduated tax rates of 5 percent to 32 percent on their taxable income.

**Local taxes, fees or charges**

An ROHQ is also exempt from all kinds of local taxes, fees or charges imposed by the local government unit, except real property tax on land improvements and equipment.

**Other tax and non-tax incentives**

An ROHQ shall enjoy tax and duty free importation of equipment and materials for training and conferences subject to certain conditions.

Foreign personnel employed by an ROHQ and their respective spouses and unmarried children below 21 years of age shall be issued multiple entry visas, valid for a period of three years, and extendible for another three years.

Alien executives of an ROHQ are entitled to tax and duty free importation of personal and household effects under certain conditions.

Personnel of an ROHQ and their dependents are also exempt from travel tax, upon recommendation of the BOI.

# Transfer pricing rules in the Philippines

Transfer pricing is generally defined as the pricing of cross-border, intra-firm transactions between related parties or associated enterprises. The transfer pricing regulations of a particular jurisdiction are generally designed to prevent related parties from concentrating profits in a low-tax country and minimizing profit in the high-tax country. In such a case, all transactions between the related parties must be conducted at arm's length.

In the Philippines, a transfer pricing guidelines was issued on 2013. The rules on transfer pricing expressly adopts the "arm's length principle". It is the intentionally recognized standard for transfer pricing between associated enterprises. This principle requires the transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party. Comparable situations or transactions must be identified and the similarities as well as the differences must be analysed to determine the arm's length price or margin of the independent party with its associated enterprises.  Also, an appropriate transfer pricing or benchmarking method must be applied.

Although transfer pricing documentation is not required to be submitted with the tax returns, there is a retention requirement for all the documents supporting the transfer pricing because it has to be submitted when required by the BIR. Moreover, the documentation must be contemporaneous, that is, it must exist or is brought into existence at the time the associated enterprises develop or implement any arrangement that might raise transfer pricing issues or review the arrangements when preparing tax returns.

Since most BPOs in the Philippines provide services to affiliate companies, transfer pricing is a relevant issue that must be considered to avoid future tax assessments resulting from failure to charge affiliates at arm's length prices. In such cases, preparation for tax audit is the key.

Transfer pricing audits by the BIR are conducted as part of the regular audit investigation. General rules on penalty apply to transfer pricing assessments. Deficiency taxes are subject to 20 percent per annum. Underpayment or late payment of taxes is subject to the 35 percent surcharge, which can be increased to 50 percent of the violation is considered wilful or fraudulent.

# Labor and employment in BPOs

### Availability of labor force

It is estimated that among the 38.0 million that make up the Philippines' labor force, literacy rate is at 97.5 percent. In 2009, 71 percent of the more than 450,000 college-degree graduates took courses that are suitable for IT-BPO services such as business accountancy, engineering and technology, IT/computer science & mathematics, medical sciences, architecture, and fine arts/humanities.

In contact centres, about 81 percent of the employees have a bachelor's degree; most work as agents. Those that are technically trained can also work as network administrators and systems integrators. Recently, the BPAP announced that call centres in the Philippines hired an additional 100,000 people in 2010, adding to the total of 525,000 employees.

### Wages

Daily minimum wages in the Philippines depend on the sector and region where the worker belongs. In the National Capital Region, the daily minimum wage for non-agricultural sectors and non-SMEs is PhP426.

Based on a study being conducted by the Board of Investments with data sourced from ZMG Ward Howell Philippines, the average sample salary rates for employees who have been with a company for one to two years (in US$) per IT and BPO job function is as follows:

### Social security

The SSS was created to provide private sector employees and their families with protection against the hazards of disability, sickness, old age and death. All private employees, including resident foreign employees, are compulsorily covered from the date of employment. Standard social security benefits include disability pension, retirement pension, funeral benefit, sickness allowance, maternity and paternity leave, and miscellaneous loans.

### Retirement

Compulsory retirement age is 65 years. An employee may also retire upon reaching the retirement age established in the collective bargaining agreement or other applicable employment contract. In the absence of such retirement plan or agreement, an employee may retire upon reaching the age of 60 if he has served the company for at least five years. Retirement pay is equivalent to at least one-half month's salary for every year of service.

### Fringe benefits

#### Holiday, vacation and sick pay

There are 11 regular and three special nonworking holidays. (See page 3 for a list of these holidays.) Employees are entitled to their regular daily wage on these days. Under the law, every employee who has rendered at least one year of service is entitled to a yearly service incentive leave of five days with pay. Most companies give two weeks of paid vacation for each year of service. Although it is not required by law, most companies also give two weeks of paid sick leave.

**13th-month pay**
Annual payment of a 13th-month salary is mandatory. Employees who resign or are separated from the company before the time of payment of the 13th-month salary are entitled to this benefit in proportion to the length of time they worked with the company during the year.

**Maternity leave**
Companies are required to pay female employees a daily maternity benefit for 60 days in case of normal delivery, and 78 days in case of Caesarean delivery for up to four deliveries. The maternity benefit (which companies advance to the employee and is subsequently reimbursed by the SSS) is a fraction of the employee's monthly salary computed according to specific guidelines. Many companies advance the employee's full salary and shoulder the amount that is not reimbursed by the SSS.

**Paternity leave**
Every married male employee is granted seven days of paternity leave for each of the first four deliveries of his legitimate spouse with whom he lives. This paid leave is not reimbursed by the SSS.

**Solo parent leave**
In addition to the leave privileges under existing laws, a solo parent employee [as defined under the Solo Parents Welfare Act of 2000 (RA 8972)] who has rendered service of at least one year is entitled to not more than seven working days of parental leave in a year .

**Healthcare**
Health insurance is automatic and compulsory for SSS members. The benefits include allowances for hospitalization, surgery, medicine and doctor's fees.

Although not required by law, many companies provide additional benefits in the form of premiums for health insurance, or reimbursable or fixed amounts of medical allowances. Employees are not taxed on premiums paid by employers for group health or hospitalization insurance and on medical benefits or reimbursements of up to P10,000 per year.

**Employment protection legislation**
Individual employee rights are governed by the Labor Code, the basic policies of which are to protect labor, promote full employment, ensure equal work opportunities regardless of sex, race or creed, and regulate the relations between workers and employers. Supplemental laws include the Magna Carta for Disabled Persons, Special Protection of Children Against Child Abuse and Discrimination, the Wage Rationalization Act, and the Anti-Sexual Harassment Act, among others.

**Unions**
The Constitution and the Labor Code guarantee workers' rights to self-organization. Union membership is most common in the manufacturing sector. One of the usual objectives of unions is to secure from the employer a labor contract that defines the rights and duties of both management and workers. The contract typically covers wages, hours of work, and working conditions.

There are currently no unions established in the BPO sector.

**Foreign nationals**
Entry visas and work permits are required for foreign personnel hired on either a permanent or temporary basis. The government has liberalized visa requirements for foreign entrants to encourage foreign participation in the economic development of the Philippines.

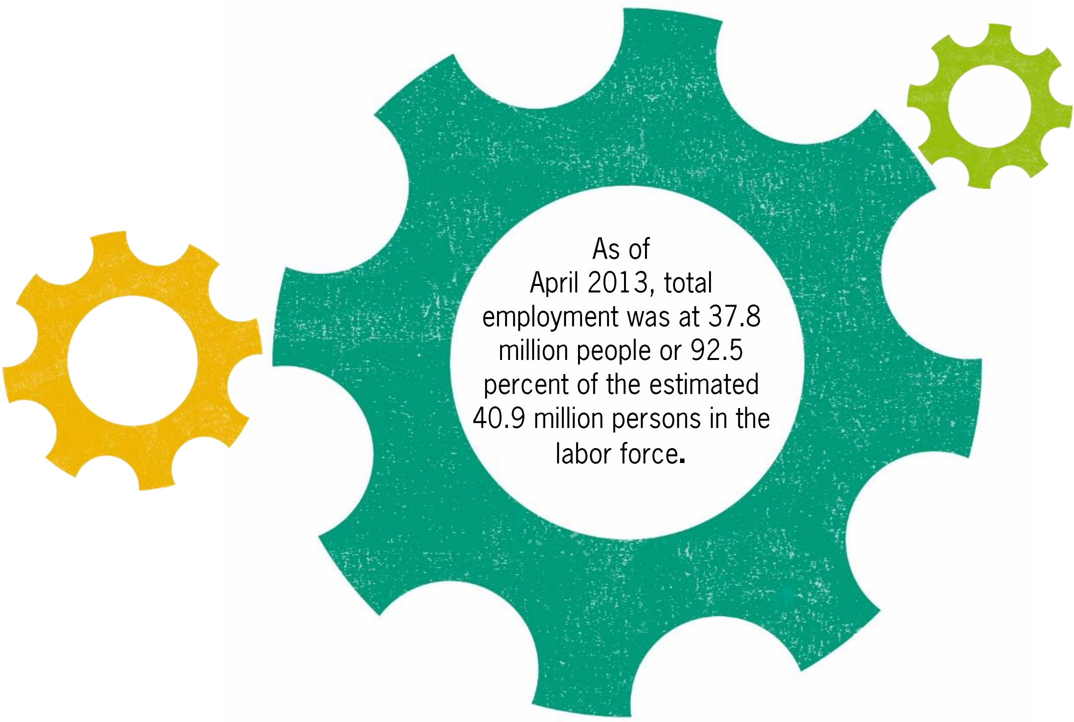
**Entry visa**

Foreign nationals may come to the Philippines for reasons of business, pleasure, or health with a temporary visitor's visa that allows stays for periods of 59 days, extendable to six months. To extend their stay, visitors must register with the Bureau of Immigration or with the office of the municipal or city treasurer in areas outside of Manila. Executive Order No. 408 allows foreign nationals, except some specifically restricted nationalities, to stay in the Philippines for up to 21 days without a visa.

**Work permits**

In general, foreign nationals seeking employment in the Philippines, whether residents or non-residents, must secure alien employment permits from the Department of Labor and Employment (DOLE). An employment permit is valid for one year from the date of issue and may be renewed subject to the approval of the DOLE. Executives of area or regional headquarters are exempt from the requirement to obtain alien employment certificates.

A Philippine company that wishes to employ a foreign national must apply for a permit with the DOLE on behalf of the foreign national. The petitioning company must prove that the foreign national possesses the required skills for the position and that no Filipino is available who is competent, able and willing to do the specific job for which the foreign national is desired.



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