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Outsourcing

Philippines

Angara Abello Concepcion Regala & Cruz

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Law and Practice

Contributed by Angara Abello Concepcion Regala & Cruz (ACCRALAW)

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Angara Abello Concepcion Regala & Cruz (ACCRALAW) is the country's premier law firm with a cohesive multi-disciplinary team of legal professionals who possess in-depth knowledge in specialised fields of law, backed by extensive experience of over 40 years in the practice of law in the Philippines. From a core group of seven lawyers at its inception in 1972, the firm has grown to a prestigious service organisation of more than 160 lawyers and 160 non-legal personnel. Its principal offices are in Bonifacio Global City, Taguig, Metro Manila. The firm has full-service branches in thriving

business commercial centres in the Visayas and Mindanao - Cebu City and Davao City. ACCRALAW's clientele represents the full spectrum of business and industry, including many multinational corporations operating in the Philippines. Servicing the firm's clients are seven practice departments and two branches, which offer timely, creative and strategic legal solutions matched with cost-efficient administration and expert handling of clients' requirements.

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1. Outsourcing Market

1.1 IT Outsourcing

Information technology (IT) has been in a constant state of growth, with IT outsourcing experiencing changes over the years as it became a common business strategy across the globe.

Typically, in the Philippines, IT outsourcing includes software applications services, data centre operations, help desk support, network operations and, to a limited extent, disaster recovery.

Currently, robotic process automation (RPA) is an emerging trend in business process automation. In an RPA system, an action list is developed by the system. By watching the user perform certain tasks, automated activities ensue after a set of demonstration actions by the user. It uses artificial intelligence (AI) and machine learning capabilities to handle a high volume of repeatable tasks that previously required humans to perform. Big companies in the country such as Convergys Philippines, Infosys and Accenture have already started using this.

1.2 BP Outsourcing

With regard to business process (BP) outsourcing, captives and shared service centres (SSCs) have provided an alternative to outsourcing to third-party vendors. Captives and SSCs have proven their ability to normalise operations and improve the efficiency of some processes. In a captive service model, a company uses a wholly owned subsidiary instead of a third-party vendor in order to maintain complete control over processes and delivery, as well as to keep critical activities within the organisation. Philippine entities normally set up as regional operating headquarters, of global companies such as JPMorgan Chase, Shell, Procter & Gamble, have started to use this model.

On the other hand, the rise of AI threatens to displace some BP outsourcing workers as fewer workers are needed for the jobs which are now in transition to automation.

Moreover, according to the IT and Business Process Association of the Philippines (IBPAP), the ongoing tax reforms in the country will also have an influence on the BP outsourcing industry. As outsourcing is price-sensitive, the Philippines cannot afford to be “too expensive” compared to chief rival India, which has both the scale and skills, according to IBPAP. Despite the effect of automation and the tax reforms, the IBPAP said the BP outsourcing industry is targeting to grow its workforce to 1.8 million by 2022 from the current 1.2 million.

1.3 New Technology

The developments in new technology emerging in Philippine IT and BP outsourcing industries come with the effect

of lesser manpower but higher revenue for the companies which are involved in the process of automation. Tasks which usually involve calculations, maintenance of records and transactions which have previously been done by employees have started to be done automatically by machines with the capable software and AI.

Despite such improvements in technology, AI and automation, coupled with the impact of both geo-political developments and the local political noise raised about current government programmes (the tax reform in TRAIN 2 and the proposed constitutional revision), the growth in the IT-BP outsourcing industry or in the service export industry has started to decline, with only a growth of about 9% in 2-17 as compared to double-digit growth, sometimes even upwards of 20%, for the past five to ten years.

The developments in technology have likewise brought blockchain and smart contracts into our jurisdiction. Considering the capabilities introduced by blockchain technology, there may be a wider adoption of the same in commercial applications and transactions. However, given that blockchain is still a relatively new concept in public policy in this jurisdiction, it might take more time for the Philippines to embrace such technology and its capabilities fully, depending on how the government responds.

1.4 Other Key Market Trends

Recently, there has been an increase in local start-up companies going into digitisation of transactions and processes, especially financial technology. Based on a study by QBO Innovation Hub and PwC Philippines, there are now more than 300 start-ups in the Philippines. According to the 2017 Philippine Startup Survey, 54% of the founders who answered the survey started their businesses between 2016 and 2017. This implies a high level of confidence in the country's economic and government environment.

2. Regulatory and Legal Environment

2.1 Legal and Regulatory Restrictions on Outsourcing

Articles 106 to 109 of the Labour Code and its implementing rules, Department of Labour and Employment (DOLE) Department Order No 174 series (“DO 174”) of 2017, provide the rules on contracting or outsourcing, including the rights and obligations of the parties to this arrangement and restrictions on the exercise of such rights.

DO 174, which amended the Rules Implementing Articles 106 to 109 of the Labour Code, became effective on 3 April 2017 and superseded Department Order No 18-A which previously governed contracting arrangements in the Philippines. DO 174 applies to “an arrangement whereby a customer agrees to put out or farm out with a contractor or

subcontractor the performance or completion of a specific job, work, or service within a definite or predetermined period, regardless of whether such job, work, or service is to be performed or completed within or outside the premises of the principal.” This involves a trilateral relationship among the principal (or customer), who decided to farm out a job, work or service to a contractor; the contractor (or supplier), who undertakes the performance of a job, work or service; and the employees of the contractor, who accomplish the job, work or service.

It must be noted, though, that certain critical industries are excluded from the scope of DO 174. The DOLE Secretary issued on 9 June 2017 DOLE Department Circular No 1, series of 2017, which clarified the non-applicability of DO 174 to certain industries and contractual relationships. The said issuance clarifies that DO 174 does not cover information technology-enabled services involving an entire or specific business process, such as: business or knowledge process outsourcing (including call centre activities), legal process outsourcing, IT infrastructure outsourcing, application development, hardware and/or software support, medical transcription, animation services, or back office support. Also excluded from the application of DO 174 are contractual relationships such as contracts of sale, lease, carriage, growing/growership, toll manufacturing, management, operation and maintenance. DO 174 also does not cover the contracting out of jobs or works to a professional, or individual with unique skills and talents who performs the job or work him- or herself for the principal.

DO 174 is likewise inapplicable to the construction industry, private security agencies and banks (to a certain extent), as there are separate issuances governing these businesses as will be explained below. The provisions of the Civil Code, on obligations and contracts, instead of the Labour Code, apply to the above excluded transactions.

In a contracting arrangement governed by the Labour Code, no employer-employee relationship exists between the customer and the employees of the supplier, provided the supplier complies with the requirements of law and is considered a legitimate independent contractor.

A contracting arrangement is considered legitimate if the following requirements are complied with:

- the contractor is registered in accordance with existing regulations;
- the contractor or subcontractor is engaged in a distinct and independent business and undertakes to perform the job or work on its own responsibility, according to its own manner and method;
- the contractor or subcontractor has substantial capital to carry out the job farmed out by the principal on its account,

manner and method, and investment in the form of tools, equipment, machinery and supervision;

- in performing the work farmed out, the contractor or subcontractor is free from the control and/or direction of the principal in all matters connected with the performance of the work, except as to the results thereto; and
- the service agreement ensures compliance with all the rights and benefits for all the employees of the contractor or subcontractor under the labour laws.

DO 174 prohibits a labour-only contracting arrangement, which is defined as: (i) an arrangement where (a) the supplier does not have substantial capital or investments in the form of tools, equipment, machineries and supervised work premises, among others, and (b) the supplier or subcontractor does not exercise the right of control over the performance of the work of the employee; or (ii) the supplier does not exercise the right of control over the performance of the work of the employee. In a labour-only contracting arrangement, the customer is considered to be the direct employer of the supplier’s employees.

2.2 Industry-Specific Restrictions

Security Services

The DOLE issued Department Order No 150-16, series of 2001, entitled “Revised Guidelines Governing the Employment and Working Conditions of Security Guards and Similar Personnel in the Private Security Industry”. This applies to private security agencies and their principals. This was issued to ensure that the rights of private security personnel meet the minimum benefits provided for by the law.

Construction Services

As mentioned earlier, the construction industry is excluded from the coverage of DO 174. The DOLE explained that it is the Philippine Contractors Accreditation Board (PCAB) which registers all contractors. Moreover, the construction industry is already governed by the following government issuances:

- DOLE Department Order No 19, series of 1993 (Guidelines Governing the Employment of Workers in the Construction Industry);
- DOLE Department Order No 13, series of 1998 (Guidelines Governing the Occupational Safety and Health in the Construction Industry); and
- DOLE-DPWH-DILG-DTI and PCAB Memorandum of Agreement-Joint Administrative Order No 1, series of 2011 (on co-ordination and harmonisation of policies and programmes on occupational safety and health in the construction industry).

Banking Functions

Under Central Bank of the Philippines Circular No 765-12, inherent banking functions cannot be outsourced. These functions are defined as follows: (i) services normally associ-

ated with placement of deposits and withdrawals, including the recording of deposit accounts; (ii) the granting of loans and extension of other credit exposures; (iii) position-taking and market risk-taking activities; (iv) managing of risk exposures; and (v) strategic decision-making.

However, under Central Bank Circular No 268, the Central Bank of the Philippines allowed the outsourcing of banking functions such as “printing of bank loan statements and other non-deposit records, bank forms and promotional materials; credit investigation and collection; processing of export, import and other trading transactions; transfer agent services for debt and equity securities; property appraisal; property management services; messenger, courier and postal services; security guard services; vehicle service contracts; janitorial services; and such other activities as may be determined by the Monetary Board”.

2.3 Legal or Regulatory Restrictions on Data Processing or Data Security

Republic Act No 10173 or the Data Privacy Act of 2012 (DPA) and its Implementing Rules and Regulations (IRR) govern the collection and processing of personal data by any natural or juridical person in the government or in the private sector, as either a personal information controller or personal information processor.

Section 11 of the DPA sets out the general criteria for the processing of personal information. It provides that processing shall be allowed, subject to compliance with the requirements of the DPA and other laws allowing disclosure of information to the public and adherence to the principles of transparency, legitimate purpose and proportionality. Personal information must be:

- collected for specified and legitimate purposes determined and declared before, or as soon as reasonably practicable after collection, and later processed in a way compatible with such declared, specified and legitimate purposes only;
- processed fairly and lawfully;
- accurate, relevant and, where necessary for purposes for which it is to be used in the processing of personal information, kept up to date; inaccurate or incomplete data must be rectified, supplemented or destroyed or its further processing restricted;
- adequate and not excessive in relation to the purposes for which it is collected and processed;
- retained only for as long as necessary for the fulfilment of the purposes for which the data was obtained or for the establishment, exercise or defence of legal claims, or for legitimate business purposes, or as provided by law; and
- kept in a form which permits identification of data subjects for no longer than is necessary for the purposes for which the data was collected and processed, provided that personal information collected for other purposes may be processed for historical, statistical or scientific purposes,

and in cases laid down in law may be stored for longer periods, and provided, further, that adequate safeguards are guaranteed by said laws authorising their processing.

The DPA also sets out the specific and separate criteria for the lawful processing of personal information and sensitive personal information.

Under the DPA, cross-border sharing of data is allowed if consent is obtained and the following conditions are complied with:

- Data-sharing for commercial purposes, including direct marketing, must be covered by a data-sharing agreement, and:
 - (a) the data-sharing agreement must establish adequate safeguards for data privacy and security, and uphold the rights of data subjects; and
 - (b) the data sharing agreement must be subject to review by the National Privacy Commission (NPC), on its own initiative or upon complaint of a data subject.
- The data subject must be provided with the following information prior to collection or before his or her data is shared:
 - (a) identity of the personal information controllers or personal information processors that will be given access to the personal data;
 - (b) purpose of data-sharing;
 - (c) categories of personal data concerned;
 - (d) intended recipients or categories of recipients of the personal data;
 - (e) existence of the rights of data subjects, including the right to access and correction, and the right to object; and
 - (f) other information that would sufficiently notify the data subject of the nature and extent of data-sharing and the manner of processing.

2.4 Penalties for Breach of Such Laws

The DPA imposes the penalties of imprisonment and a fine for prohibited acts which include unauthorised processing of personal information, accessing personal information due to negligence, improper disposal of personal information, and processing of personal information for unauthorised purposes. These prohibited acts are punishable by imprisonment ranging from one year to six years and a fine ranging from PHP500,000 to PHP2 million. A combination or series of these prohibited acts is punishable by imprisonment ranging from three years to six years and a fine of not less than PHP1 million but not more than PHP2 million.

2.5 Contractual Protections on Data and Security

The IRR of the DPA require that each personal information controller is responsible for personal information under its control or custody, including information that has been

transferred to a third party for processing, whether domestically or internationally.

A “personal information controller” refers to a natural or juridical person, or any other body that controls the processing of personal data, or instructs another to process personal data on its behalf. On the other hand, a “personal information processor” refers to any natural or juridical person or any other body to which a personal information controller may outsource or instruct the processing of personal data pertaining to a data subject.

A personal information controller shall be accountable for complying with the requirements of the DPA, its IRR, and other issuances of the Commission. It shall use contractual or other reasonable means to provide a comparable level of protection to the personal data while it is being processed by a personal information processor or third party.

Under Section 25 of the IRR of the DPA, personal information controllers and personal information processors shall implement reasonable and appropriate organisational, physical and technical security measures for the protection of data.

Organisational Measures

The employer must designate a data protection officer who shall be accountable for ensuring compliance with applicable laws and regulations for the protection of data privacy and security.

Likewise, the employer must implement a data protection policy that provides for organisational, physical and technical security measures, taking into account the nature, scope, context and purpose of the processing. The policy must incorporate the following:

- provision(s) ensuring that only personal data which is necessary for the specified purpose is processed;
- procedures limiting the processing of data, to ensure that it is only to the extent necessary for the declared, specified and legitimate purpose;
- a procedure for the collection of personal data, including procedures for obtaining consent, when applicable;
- documentation and recording of the data processing system and activities; and
- management, supervision and training of employees as to the processing, handling, storing and accessing of personal data;

Physical Measures

Physical security measures refer to the following:

- implementation of policies and procedures to monitor and limit access to and activities in the room, workstation or

facility, including guidelines to proper use of and access to electronic media;

- designing of office space and workstations to provide privacy to anyone processing personal data; and
- security against natural disasters, power disturbance, external access, mechanical destruction of files and equipment, and other similar threats.

Technical Measures

Technical security measures refer to the policies aimed at protecting the employer’s computer systems used in the processing and storage of personal data. This includes the maintenance of the confidentiality, integrity, availability and resilience of the processing systems and services. The employer must implement a policy regarding regular monitoring of the system for security breaches, reasonably foreseeable vulnerabilities in the computer network, and measures for taking preventive and corrective action against security incidents.

3. Contract Models

3.1 Standard Supplier Customer Model

In this jurisdiction, the standard supplier–customer contract between the principal and its supplier is the service agreement. Under DO 174, the service agreement must ensure compliance with all the rights and benefits for all the employees of the supplier under the law. Moreover, under Section 11 (b) of DO 174, the agreement should contain the following provisions: (i) specific description of contracted job or work; (ii) term or duration of service; (iii) place of work; (iv) terms and conditions governing the contracted arrangement; (v) agreed amount of contracted job or work; (vi) administrative fee of not less than 10% of the total contract cost; and (vii) provision on the issuance of the bond(s) which the customer may require from the supplier.

3.2 Alternative Contract Models

Aside from entering into contracting arrangements with service contractors, Philippine companies have also tried other approaches which suit their business needs, one of which is multi-sourcing. In this arrangement, companies engage various service providers instead of having only one service provider handle the whole business process. This lets companies choose the best service provider for a specific function or service. This likewise helps promote healthy competition among the service providers.

Some companies, on the other hand, enter into a joint venture with other companies for a new project or a business activity. In this arrangement, an association of persons or companies jointly undertake some commercial enterprise, generally contribute assets and share risks.

3.3 Captives and Shared Services Centres

In the Philippines, the captives and SSCs are a significant part of the IT-BP outsourcing industry. IT-BP outsourcing industries have been generating millions of jobs and revenues for the past years. According to a report by SSON Analytics, while the BP outsourcing industry was the primary growth driver in the Philippines in 2010, the country's SSC industry has since then taken the lead in development, with a 64% surge from 2010 to 2015. In fact, by 2017, a quarter of all the SSCs in the ASEAN region were housed in the Philippines, a third of which have headquarters in the United States and predominantly service global markets.

It is worth noting that almost 80% of the SSCs in the Philippines are focused on value-added activities such as invoice queue management, cash applications, general ledger, fixed assets, etc. Likewise, according to the SSON Analytics reports, while 80% of the service centres in the country are found in the Metro Manila (National Capital Region), there is also significant talent distributed in the other regions of the country.

4. Contract Terms

4.1 Customer Protections

We are assuming that by "customer" is meant the principal with whom the contractor (or supplier) has a contract.

Usually the contractual protections for the customer in an outsourcing arrangement pertain to compliance with labour and social legislation, as those involving the wages and benefits of the supplier's employees, for the purpose of avoiding the joint or solidary liability of the customer with the supplier. This is so because, even in cases of legitimate contracting, the customer is still jointly and severally liable for the unpaid wages and benefits of the employees. Thus, as a form of security, the customer may, pursuant to Article 108 of the Labour Code, require the supplier to furnish a bond equal to the cost of labour under contract, on condition that the bond will answer for the wages due to the employees should the supplier fail to pay the same.

Furthermore, the customer may include the following stipulations in the service agreement:

- submission of the employment contracts of the contractor's employees to the principal;
- a condition that the consideration of the service agreement will only be paid after the supplier has paid in full all wages, salaries and other benefits due to the contractor's employees and has made all the required contributions to the Social Security System, the Home Development Mutual Fund, the Employees Compensation Commission and Philippine Health Insurance;

- to avoid the onset of an employment relationship between the customer and the supplier's employees, provisions should ensure that it is the supplier which has the right to control the means and method of how its employees will perform the work, with the customer only having control as to the desired results, if only to avoid the customer being considered as the employer;
- a "free and harmless" clause whereby the supplier holds the customer free from any and all liabilities that may arise from the outsourcing arrangement. A stipulation on liquidated damages may also be included in the agreement; and
- posting of a bond by the supplier which will answer for the wages due to the employees should the supplier fail to pay the same.

With respect to remedies, as against the contractor, the customer may enforce the service agreement through arbitration or civil action depending on the agreement between the parties. On the other hand, if the employees file a case against the supplier and implead the principal, the latter may file a motion to dismiss on the ground of lack of employer-employee relationship.

4.2 Termination

The customer and the supplier may stipulate in the service agreement that either party will be able to terminate the contract with or without cause and after serving the other party a formal notice and the observance of an agreed-upon notice period.

It is important to note, however, that under Section 13 of DO 174, in case of termination of employment caused by the pre-termination of the service agreement not due to authorised causes under Article 298 of the Labour Code, the right of the supplier's employees to unpaid wages and other benefits including unremitted mandatory contributions shall be borne by the party at fault, without prejudice to the solidary liability of the parties to the service agreement as may be provided by law.

4.3 Liability

When a person sustains an injury as a result of a breach of contract or a legal invasion of his or her rights, he or she is entitled to recover damages which are the pecuniary compensation, recompense or satisfaction for the injury sustained. The party injured is entitled to damages which reasonably arise naturally from the breach of contract (direct loss), and which were reasonably in the contemplation of both parties, at the time the contract was entered into, as the probable result of the breach (consequential or indirect loss).

In this jurisdiction, the courts award different kinds of damages which may be in the form of (i) actual or compensatory; (ii) moral; (iii) nominal; (iv) temperate or moderate; (v) liquidated; or (vi) exemplary or corrective. Actual damages contemplate an adequate compensation for such pecuniary

loss suffered by a person as he or she has duly proved. This includes the loss of what a person already possesses and the loss of a benefit that the person failed to receive because of the injury. Thus, this already compensates for the direct and the indirect losses. Moral damages may be recovered if there is physical suffering, mental anguish, serious anxiety, besmirched reputation, moral shock, social humiliation or a similar injury which is the result of another person's wrongful act or omission. Nominal damages are adjudicated in order that a right of a person, which has been violated, may be vindicated or recognised, and not for the purpose of indemnifying him or her for any loss suffered by him or her. Note that nominal damages cannot co-exist with actual damages. Temperate damages, which are more than nominal but less than actual damages, may be recovered when there was in fact a pecuniary loss, but its amount cannot be established with certainty from the nature of the case. Liquidated damages are those agreed upon by the parties to a contract, to be paid in case of breach thereof. Lastly, exemplary or corrective damages are imposed as a deterrent against socially deleterious actions. These are awarded in addition to moral, temperate, liquidated or compensatory damages.

For corporations and other juridical entities, generally moral damages cannot be awarded since, unlike a natural person, they cannot experience physical suffering or such sentiments as wounded feelings, serious anxiety, mental anguish or moral shock. However, the Supreme Court has recognised that when a juridical person has a good reputation that is debased, resulting in social humiliation, moral damages may be awarded. In other words, a corporation or other juridical entity can be an offended party in a defamation case and it can recover moral damages.

4.4 Implied terms

In our jurisdiction, parties are free to establish stipulations, clauses, terms and conditions as they may deem convenient, provided that they are not contrary to law, morals, good customs, public order or public policy. It is also standard that the law is deemed written into every contract. Thus, although a contract is the law between the parties, the provisions of positive law which regulate contracts are deemed written therein and shall limit and govern the relations between the parties.

In this connection, the Labour Code and DO 174 are the governing laws and regulations on contracting arrangements. Thus, deemed included in every service contract are Article 109 of the Labour Code and Section 9 of DO 174 which provide for solidary liability on the part of the customer and the supplier for purposes of enforcing the provisions of the Labour Code and other social legislation, in cases of violation of any provision of the Labour Code, including the failure to pay wages.

5. HR

5.1 Rules Governing Employee Transfers

In the context of outsourcing, DO 174 provides that where the termination results from the expiry of the service agreement, or from the completion of the phase of the job or work for which the employee is engaged, the latter may opt to wait for re-employment within three months to resign and transfer to another supplier-employer. Failure of the supplier to provide new employment shall entitle the employee to payment of separation benefits as may be provided by law or the service agreement.

Where due to the exigencies of a business that compel the customer to reduce the supplier's manpower dedicated to it, the affected employees of the supplier are usually placed on a floating status whereby they do not lose their employment status, but are usually compensated on a no work-no pay basis, with benefits dependent on each company's policy. Under prevailing jurisprudence, employees may be placed on floating status for a maximum of six months. Otherwise, they will have to be separated due to redundancy, paid separation pay of at least one month's pay or a month's pay per year of service (whichever is higher), and given a prior separation notice at least one month before their separation.

Under Section 6 of DO 174 other illicit forms of employment arrangements are declared prohibited for being contrary to law or public policy. Under this section, also prohibited are such other practices, schemes or employment arrangements designed to circumvent the right of workers to security of tenure. In this connection, if the transfer of employees, as from one supplier to another supplier, was done to circumvent the right of workers to security of tenure or their right to self-organisation, then the same may constitute an illicit form of employment arrangement under DO 174.

5.2 Trade Union or Workers Council Consultation

There is no explicit requirement under the law for an employer to consult its workers before outsourcing some functions, unless there is an applicable collective-bargaining agreement.

However, as a matter of good faith, it is advisable for the customer to consult with the trade union or the works' council, if there is any in the company, not necessarily to secure approval but if only to inform them about the intended outsourcing which may impact the employees. Under Article 267 of the Labour Code, "Any provision of law to the contrary notwithstanding, workers shall have the right, subject to such rules and regulations as the Secretary of Labour and Employment may promulgate, to participate in policy and decision-making processes of the establishment where they are employed insofar as said processes will directly affect their rights, benefits and welfare." Jurisprudence requires that, pursuant to this provision, the employees should at least

be informed (though their approval need not be secured) of programmes affecting their rights and welfare. Under Article 259 (c) of the Labour Code, it is likewise prohibited “To contract out services or functions being performed by union members when such will interfere with, restrain or coerce employees in the exercise of their rights to self-organisation”. This constitutes unfair labour practice in the Philippines.

5.3 Market Practice on Employee Transfers

It is well settled under case law that transfer of employees within the company is an inherent right of the management. Although an employee has a right to security of tenure, this does not give him or her a vested right to the position so as to deprive the company of its prerogative to change his or her assignment to where he or she will be most useful. In a number of cases, the following reasons for the transfer of employees have been upheld by the Supreme Court: transfer due to standard operating procedure of the company, transfer due to business exigencies, transfer in accordance with predetermined and established office policy and practice, transfer to avoid conflict of interest, transfer occasioned by the abolition of position, and transfer pending investigation of irregularities.

For employees wanting to transfer to other outsourcing companies, it is the industry practice for the new employer to require resignations from, and a clearance issued by, the previous employer before accepting the new employees.

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6. Asset Transfer

6.1 Asset Transfer Terms

With regard to transfer of assets in relation to outsourcing, one of the considerations, especially in the IT and BP outsourcing industries, is whether or not to enter into a purely services-only arrangement or to include assets in the scope of the service agreement.

For the transfer of assets involved in outsourcing transactions, the formalities are similar to those of regular business industries. Thus, when there is a transfer of assets from one entity to another by way of sale, the provisions on sales under the Civil Code will apply.

In a transfer of assets, a Contract to Sell is first executed containing conditions to be fulfilled before a Deed of Absolute Sale is executed. Thereafter, the Deed of Absolute Sale is signed by the parties and notarised. However, if the transferor is registered with the Philippine Economic Zone Authority (PEZA) (with which any of the IT/BP outsourcing entities exporting services to foreign markets are registered, mainly to gain economic incentives), before the sale can be made, a letter of authorisation is first required from PEZA.

However, there are some assets, such as land, wherein the law requires certain formalities. For capital assets, or those assets generally not used in business, a capital gains tax should be paid. On the other hand, for ordinary assets, the income will form part of the regular business income and will then be subject to corporate income tax. A documentary stamp tax should also be paid upon execution of the instruments transferring assets.

For the sale of land, the local transfer tax should likewise be paid to the local government unit, on top the capital gains tax (if the real property is a capital asset). Before registration with the Registry of Deeds, tax clearances are secured from the Bureau of Internal Revenue (BIR) and the City Treasurer's Office as well as a certificate authorising registration from BIR.