

International **Comparative** Legal Guides



Outsourcing **2020**

A practical cross-border insight into outsourcing law

Fifth Edition

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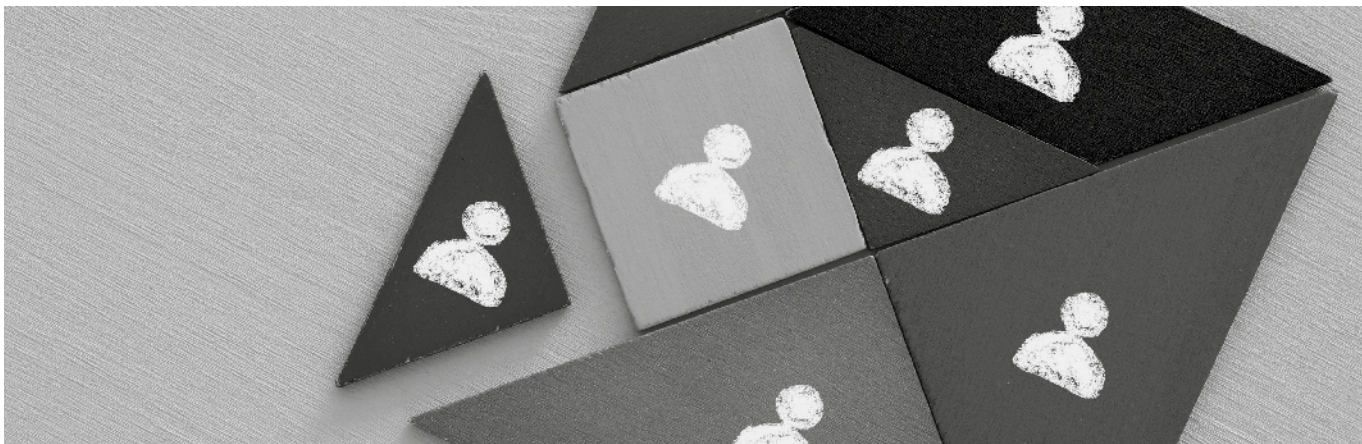
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1 Regulatory Framework

1.1 Are there any national laws or regulations that specifically regulate outsourcing transactions, either generally or in relation to particular types of outsourcing transactions (e.g. business process outsourcings, IT outsourcings, telecommunications outsourcings)?

The Philippine Labor Code, specifically Articles 106 to 109, govern contracting and sub-contracting arrangements and prescribe the conditions for regulating sub-contracting and the rights and obligations of the parties to this arrangement.

In this connection, the Department of Labor and Employment (DOLE) issued Department Order No. 174 (DO 174), series of 2017. DO 174 governs an arrangement whereby a principal 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. It contemplates a trilateral relationship between: the principal, who has decided to farm out a job, work, or service to a service contractor; the service contractor, who undertakes the performance of the job, work, or service; and the employees of the service contractor, who accomplish the job, work, or service.

In this type of arrangement, provided the contractor is a legitimate independent contractor, the principal does not create an employer-employee relationship between himself and the employees of the contractor. Thus, the employees of the contractor remain the contractor's employees and his alone.

A contracting arrangement is legitimate if the following circumstances concur:

1. the contractor is registered in accordance with DO 174;
2. the contractor carries a distinct and independent business and undertakes to perform the job, work, or service on its own responsibility, according to its own manner and method, and free from control and direction of the principal in all matters connected with the performance of the work except as to the results thereof;
3. the contractor or subcontractor has substantial capital or investment; and
4. the service agreement ensures compliance with all the rights and benefits under labour laws.

DO 174 prohibits labour-only contracting and declares the principal as the direct employer of the contractor's employees. It renders the principal jointly and severally liable with the contractor for the payment of the employees' money claims. Labour-only contracting is defined as:

1. an arrangement where:
 - a. the contractor does not have substantial capital or investments in the form of tools, equipment,

machineries, supervision work premises, among others; and

- b. the contractor or subcontractor does not exercise the right of control over the performance of the work of the employee; or
2. the contractor does not exercise the right to control the performance of the work of the employee.

Subsequently, however, in DOLE Department Circular No. 1, series of 2017, DOLE clarified the applicability/non-applicability of DO 174 to certain industries and contractual relationships. As DO 174 applies only to a trilateral relationship in a contracting/sub-contracting arrangement, it 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. Similarly, it does not cover contractual relationships such as contracts of sale, lease, carriage, growing/growership, toll manufacturing, management, operation, and maintenance and contracting out of a job or work to a professional or individual with unique skills and talents who himself performs the job or work for the principal, as these contracts are governed by the Philippine Civil Code and other special laws.

On Particular Types of Outsourcing Transactions

Banking Transactions

Inherent banking functions, such as deposit taking, cannot be outsourced. Under Circular No. 765-12 of the Central Bank of the Philippines, inherent banking functions are defined as follows: (i) services normally associated 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, a bank, offshore banking unit, quasi-bank, trust entity, nonstock savings and loan association, pawnshop, foreign exchange dealer, money changer, remittance agent, electronic money issuer and other financial institution, also known as "covered institutions", may outsource to a counterparty the gathering of the minimum information or documents required to be obtained. Ultimate responsibility for knowing the customer and for keeping the identification documents shall, however, lie with the covered institution, which must comply with several conditions including having a written service level agreement approved by the board of directors of both covered institutions, the counterparty having a reliable and acceptable customer identification system and training programme in place, and having

all identification information and documents turned over within 90 calendar days to the covered institution, which shall carefully review the documents and conduct the necessary risk assessment of the customer.

In addition, the Central Bank of the Philippines issued Circular No. 268, which allowed outsourcing of banking functions such as IT systems/processing, data imaging, storage and retrieval, clearing and processing of checks, printing of bank deposit statements, credit card services, printing of bank loan statements, credit investigation and collection, processing of export, import and other trading transactions, messenger, courier and postal services, security guard services and vehicle service contractors.

Business Process Transactions

In excluding the BPO and the KPO industries from the coverage of DO 174, the DOLE explained that DO 174 does not cover information technology (IT)-enabled services involving an entire or specific business process such as BPOs, KPOs, legal process outsourcing, IT infrastructure outsourcing, application development, hardware and/or software support, medical transcription, animation services, and back office operations/support.

Construction Services

In excluding the Construction Industry from the coverage of DO 174, the DOLE explained that the Philippine Contractors Accreditation Board (PCAB) registers all contractors, whether general or subcontractors in the construction industry, and already regulates the same by ensuring compliance with 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 coordination and harmonisation of policies and programmes on occupational safety and health in the construction industry).

Security Services

For the purpose of ensuring the rights of private security personnel to minimum benefits mandated by law, the DOLE issued Department Order No. 150-16, Series of 2001 (DO 150-16), entitled 'Revised Guidelines Governing the Employment and Working Conditions of Security Guards and Similar Personnel in the Private Security Industry', which applies to all private security agencies or operators and their principals or clients.

Information and Communications Services

Republic Act No. 10844 created the Department of Information and Communications Technology (DICT), which will serve as the primary government entity to plan, promote and help develop the Information and Communications Technology (ICT) sector in the Philippines. The law institutionalises government support and the continuity of the programmes created for the further development of the ICT/BPO sector in the Philippines. As such, the DICT and agencies attached to it, is expected to be more vigilant in enforcing laws related to data privacy legislation such as the Data Privacy Act of 2012, Access Devices Regulation Act of 1998, E-commerce Act and the Cybercrime Prevention Act of 2012.

1.2 Are there any additional legal or regulatory requirements for outsourcing transactions undertaken by government or public sector bodies?

Generally, government agencies may avail from outsourced services through an institutional contract of a service which

covers a lump sum of work for services to perform janitorial, security, consultancy, and other support functions for a maximum period of one year. Contracting by government agencies is subject to the provisions of R.A. 9184 or the Government Procurement Act and pertinent budgeting, accounting and auditing rules and regulations.

1.3 Are there any additional legal or regulatory requirements for outsourcing transactions undertaken in particular industry sectors, such as for example the financial services sector?

The Insurance Commission issued Circular Letter No. 2018-72, or the Guidelines on Business Process Outsourcing Activities of Insurers/reinsurers, which prohibits insurance providers from outsourcing functions or business processes that are directly related to doing or transacting insurance business. The following functions or business processes cannot be outsourced:

1. solicitation activities, except for some instances allowed by an earlier Circular Letter;
2. the decision whether or not to underwrite risk/s;
3. the decision whether or not to approve or reject an insurance/reinsurance claim; and
4. loss adjustment.

1.4 Is there a requirement for an outsourcing transaction to be governed by local law? If it is not to be local law, is there any generally accepted norm relating to the choice of governing law?

No, there is no requirement for outsourcing transactions to be governed by local law, except if the arrangement is one which is covered by DO 174. Philippine law recognises the parties' choice of governing law. However, if the parties fail to so stipulate, the applicable law is that of the State that has the most significant relationship to the transaction and the parties.

2 Legal Structure

2.1 What are the most common types of legal structure used for an outsourcing transaction?

For outsourcing transactions covered by DO 174, these are generally done through a contractual arrangement between two corporate entities. However, entering into an outsourcing arrangement with single proprietorships, partnerships, or cooperatives is also allowed. BPOs and KPOs in the country usually deal directly with client corporate entities abroad, although some have been likewise servicing local corporations. Some services may also be rendered by individuals or professionals considered as independent contractors.

3 Procurement Process

3.1 What is the most common type of procurement process that is used to select a supplier?

There is no common type of procurement process used to select a supplier.

4 Term of an Outsourcing Agreement

4.1 Does national or local law impose any maximum or minimum term for an outsourcing contract?

No; there is no maximum or minimum term for an outsourcing contract.

4.2 Does national or local law regulate the length of the notice period that is required to terminate an outsourcing contract?

No; national or local law does not regulate the notice period for the termination of an outsourcing contract.

5 Charging

5.1 What are the most common charging methods used in outsourcing transactions?

In contracting or subcontracting arrangements covered by both DO 174 and DO 156-16, charges are usually based on a cost-plus method, that is, the cost of the number of contractors' employees deployed to the principal with a minimum administrative fee, the amount of which depends on the type of employee deployed. For employees covered by DO 174, there is a minimum administrative fee of 10%, whereas for security guards and private security personnel covered by DO 156-16, the minimum administrative fee is 20%.

5.2 What other key terms are used in relation to costs in outsourcing transactions?

For BPOs and KPOs, parties agree on various Service Level Agreements (SLAs), usually based on the Key Performance Indicators (KPIs) relevant to the type of service that is outsourced.

6 Transfer of Assets

6.1 What formalities are required to transfer, lease or license assets on an outsourcing transaction?

The formalities for the transfer, lease, and license of assets of outsourcing transactions are similar to those of regular business industries, except the transfer of assets when the transferor is an outsourcing business registered with the Philippine Economic Zone Authority (PEZA).

A transfer or sale of assets is usually preceded by a Contract to Sell containing conditions and requirements to be fulfilled before a Deed of Absolute Sale is executed. The Deed of Absolute Sale is usually notarised and signed by both parties. If the transferor is PEZA-registered, a letter of authorisation is required from PEZA before the sale can be made.

As to licensing of assets, a licence agreement is entered into by the contracting parties. If it involves the transfer of systematic knowledge for the manufacture of a product, the application of a process, or rendering of a service, and the transfer, assignment, or licensing of all forms of intellectual property rights, a technology transfer arrangement is executed. It must comply with Sections 87 (Prohibited Clauses) and 88 (Mandatory Provisions) of Republic Act No. 8293 to be enforceable.

6.2 What are the formalities for the transfer of land?

For validity, sale of land to a Filipino citizen or a qualified Filipino corporation (at least 60% owned by Philippine stockholders) should be made in writing. This is usually effected through a notarised deed of absolute sale. A letter of authorisation from PEZA is also necessary for PEZA-registered outsourcing businesses. Title to the land is transferred only in the name of the buyer if the sale is registered with the Registry of Deeds. For lease of land, a notarised lease agreement is executed.

6.3 What post-completion matters must be attended to?

In any sale of land or other assets, taxes should be paid to avoid future deficiency assessments. For capital assets (i.e., generally, those not used in business), the capital gains tax (CGT) should be paid, while for ordinary assets, the income forms part of the regular business income and subject to the corporate income tax. The corresponding documentary stamp tax (DST) should also be paid.

For sale of land, in addition to the CGT and DST, local transfer tax should be paid to the local government unit. Thereafter, tax clearances are secured from the Bureau of Internal Revenue (BIR) and City Treasurer's Office and certificate authorising registration (CAR) from the BIR before registration with the Registry of Deeds. The new buyer then applies for a new tax declaration in his name.

6.4 How is the transfer registered?

The Registry of Deeds is the government agency in the Philippines tasked with the registration of real properties. Before the Registry of Deeds transfers the name in the title to the purchaser, he requires the following:

1. copy of the deed of absolute sale;
2. official receipt evidencing payment of transfer tax;
3. CAR including official receipts for payment of CGT and DST;
4. real property tax clearance from the City Treasurer's Office;
5. original copy of the owner's duplicate of TCT (in the name of the seller);
6. original or certified true copy of the latest tax declaration;
7. notarised secretary's certificate containing resolution of the board of directors of the seller approving the sale;
8. notarised secretary's certificate containing resolution of the board of directors of the buyer approving the sale;
9. articles of incorporation of the buyer and by-laws; and
10. SEC certificate that the articles of incorporation of the buyer have been registered.

A minimal registration fee is also paid to the Registry of Deeds to process the transfer of title in the name of the purchaser.

7 Employment Law

7.1 When are employees transferred by operation of law?

Under Philippine law, the obligation to retain employees will depend on the underlying transaction which will prompt the transfer. It is only during mergers or consolidations where employees are transferred by operation of law.

7.2 On what terms would a transfer by operation of law take place?

The surviving or consolidated corporation in either a merger or consolidation has the obligation of absorbing the employees and other liabilities of the merged or consolidated entities and thus would have to absorb the employees of the non-surviving corporation and honour their length of service and employment terms with the non-surviving corporation.

The employees of a service contractor may be deemed as the employees of the principal, if there is a finding that the arrangement may be a labour-only contracting arrangement.

7.3 What employee information should the parties provide to each other?

Under Philippine law, there are no required disclosures between the parties regarding employee information. However, any disclosures made concerning an employee's personal information or sensitive personal information must conform to the requirements of Republic Act No. 10173 or the Data Privacy Act of 2012 (Data Privacy Act). See discussions in question 7.7 and section 8.

7.4 Is a customer/supplier allowed to dismiss an employee for a reason connected to the outsourcing?

The principal (or customer) may separate employees for redundancy by reason of the legitimate outsourcing of particular function/s performed by the affected employees.

7.5 Is a supplier allowed to harmonise the employment terms of a transferring employee with those of its existing workforce?

Yes, harmonisation is allowed provided that the affected employees of the principal agree with the terms of the transfer. Normally, though, such transfers are under the same or no less favourable employment terms as those in place with the principal.

7.6 Are there any pensions considerations?

The benefits provided for in a retirement plan must not be below that which is provided by Philippine law. Under Philippine law, the minimum amount of retirement pay should be equivalent to at least one-half (½) of a month's salary plus the equivalent per month of the annual 13th month's pay, or a total of 22.5 days' pay, for every year of service, a fraction of at least six months being considered as one whole year.

Mandatory retirement is upon reaching 65 years of age, while optional retirement is allowed upon reaching 60 years of age, provided service of at least five years has been rendered.

Additionally, under Section 32 (B)(6)(a) of the National Internal Revenue Code, retirement benefits received under a reasonable private benefit plan are exempt from income tax provided certain requirements are met.

7.7 Are there any offshore outsourcing considerations?

Disclosure of sensitive personal information as defined under the Data Privacy Act is generally prohibited, save for the

well-defined exceptions under the Data Privacy Act. This refers to information: a) about an individual's race, ethnic origin, marital status, age, colour, and religious, philosophical or political affiliations; b) about an individual's health, education, genetic or sexual life of a person, or to any proceeding for any offence committed or alleged to have been committed by such person, the disposal of such proceedings, or the sentence of any court in such proceedings; c) issued by government agencies specific to an individual which includes, but is not limited to, social security numbers, previous or current health records, licences or their denials, suspension or revocation, and tax returns; and d) specifically established by an executive order or an act of Congress to be kept classified.

8 Data Protection Issues and Information Security

8.1 What are the most material legal or regulatory requirements and issues concerning data security and data protection that may arise on an outsourcing transaction?

The relevant law in this case is the Data Privacy Act which provides for extra-territorial application when, among others, the processing relates to personal information about a Philippine citizen or a resident, the entity processing information has links to the Philippines, or the service contract is entered into in the Philippines.

The law defines three categories of information belonging to an individual, namely: 1) personal information; 2) privileged information; and 3) sensitive personal information, and regulates the manner by which the same is processed by the data processing entity.

Under Section 12 of the Data Privacy Act, the processing of personal information shall be permitted only if not otherwise prohibited by law and when at least one of the following conditions exists:

1. the data subject has given his or her consent;
2. the processing is necessary and related to the fulfilment of a contract with the data subject or in order to take steps at the request of the data subject prior to entering into a contract;
3. processing is necessary to protect vitally important interest of the data subject, including his life and health;
4. processing is necessary in order to respond to a national emergency, or to comply with the requirements of public order and safety, or to fulfil functions of public authority; or
5. processing is necessary for the purposes of the legitimate interests pursued by the Personal Information Controller or by a third party to whom the data is disclosed.

On the other hand, Section 13 of the same law provides that the processing of sensitive personal information and privileged information shall be prohibited, except in the following cases:

1. the data subject has given his or her consent, specific to the purpose prior to the processing, or in the case of privileged information, all parties to the exchange have given their consent prior to processing;
2. the processing of the same is provided for by existing laws and regulations. Provided, that such regulatory enactments guarantee the protection of the sensitive personal information and the privileged information; provided, further, that the consent of the data subjects is not required by law or regulation permitting the processing of the sensitive personal information or the privileged information;

3. the processing is necessary to protect the life and health of the data subject or another person, and the data subject is not legally or physically able to express his or her consent prior to the processing;
4. the processing is necessary to achieve the lawful and noncommercial objectives of public organisations and their associations. Provided, that such processing is only confined and related to the *bona fide* members of these organisations or their associations; provided, further, that the sensitive personal information is not transferred to third parties; and provided, finally, that consent of the data subject was obtained prior to processing;
5. the processing is necessary for purposes of medical treatment, is carried out by a medical practitioner or a medical treatment institution, and an adequate level of protection of personal information is ensured; or
6. the processing concerns such personal information as is necessary for the protection of lawful rights and interests of natural or legal persons in court proceedings, or the establishment, exercise or defence of legal claims, or when provided to government or public authority.

Under Section 67 of the Implementing Rules and Regulations of the Data Privacy Act of 2012 (IRR), any natural or juridical person or other body involved in the processing of personal data shall comply with the personal data processing principles and standards of personal data privacy and security already laid out in the Data Privacy Act. The IRR likewise imposed an obligation on personal information controllers to “implement reasonable and appropriate organization, physical and technical measures intended for the protection of personal information”.

8.2 Are there independent legal and/or regulatory requirements concerning information security?

Republic Act No. 1405 or the Bank Secrecy Law prohibits any person from disclosing any information in relation to the properties belonging to the depositors in custody of the bank. Section 2 of the law provides “all deposits of whatever nature with banks or banking institutions in the Philippines including investments in bonds issued by the Government of the Philippines, its political subdivisions and its instrumentalities, are hereby considered as of an absolutely confidential nature and may not be examined, inquired or looked into by any person, government official, bureau or office, except upon written permission of the depositor, or in cases of impeachment, or upon order of a competent court in cases of bribery or dereliction of duty of public officials, or in cases where the money deposited or invested is the subject matter of the litigation”.

9 Tax Issues

9.1 What are the tax issues on transferring the outsourced business – either on entering into or terminating the contract?

There are no tax issues on transferring the outsourced business unless the contract is sold/assigned for a consideration or price. In such case, the assignor is liable to gain income tax on the assignment of the contract.

9.2 Is there any VAT leakage on the supply of services under the outsourcing contract?

For services that are rendered to Philippine entities, i.e., subject

to 12% VAT, from the point of view of the service provider, while there is not VAT passed on by its employees (since compensation income is not subject to VAT), it has to pass on VAT to its customer. From the point of view of the customer, the passed-on VAT from its supplier is used as an input VAT credit against its own output VAT. There is VAT leakage to the extent that the output VAT exceeds the input VAT.

For services that are rendered to non-resident foreign entities, i.e., subject to zero-rated VAT, there is no VAT leakage, unless the service provider is unable to properly refund the input VAT credits. There is failure of refund when: (a) the claim is not properly substantiated; or (b) the claim is belatedly filed.

For the substantiation, the claimant should prove that services were rendered for a non-resident foreign entity not doing business in the Philippines, and that the payment was made in foreign currency and, as a rule, actually remitted into the Philippines.

For the belated filing, the claimant should observe the 120+30-day rule in claiming input VAT (taxpayers should file the claim for refund with the Court of Tax Appeals within 30 days from the failure of the BIR to decide on the claim within 120 days from application). Since the landmark case of *CIR v. Aichi Forging Company of Asia, Inc.* in 2010, recent Supreme Court decisions have consistently ruled that the 120+30-day rule is mandatory and jurisdictional. Resulting from the strict application of this procedure, numerous claims for refund pending with the courts have been denied.

9.3 What other tax issues may arise?

Aside from the discussion in question 9.1, an outsourcing business may be incorporated in the Philippines. If so, it will be subject to the regular corporate income tax, VAT, local business taxes, and real property taxes. To minimise applicable Philippine taxes, an outsourcing business may register with the PEZA or the Board of Investments (BOI) as an IT enterprise. During the first four years of the PEZA or BOI-registered outsourcing company (since outsourcing businesses are generally considered as non-pioneer activities), it usually avails of the incentives under the Omnibus Investments Code, which include income tax holiday, exemption from local taxation, VAT zero-rating on export sales, tax and duty exemptions on certain importations, and simplification of customs procedures.

After the expiration of the income tax holiday of a PEZA-registered outsourcing company, it may avail of the special tax regime limiting the tax on their registered operations at five per cent on gross income, *in lieu* of all national and local taxes, except real property taxes. Real property tax is generally at two to three per cent of the assessed value of the taxable properties.

In addition, a foreign business enterprise performing the outsourcing business may be considered to have created a *permanent establishment* in the Philippines (i.e., a fixed place of business in which the business of the enterprise is wholly and partially carried on as enumerated in pertinent tax treaties). As such, it will be taxable in the Philippines as a resident foreign corporation (i.e., subject to tax on net income as opposed to gross income).

10 Service Levels

10.1 What is the usual approach with regard to service levels and service credits?

There are no specific provisions in Philippine law which will govern service levels and service credits for outsourcing transactions.

11 Customer Remedies

11.1 What remedies are available to the customer under general law if the supplier breaches the contract?

Article 1191 of the Civil Code of the Philippines provides for the remedy of rescission (or, more properly, the resolution) of the contract in the event of reciprocal obligations, should a party not comply with what is incumbent upon him. The breach must be substantial or serious in that it already defeats the object of the parties in entering into the contract. It is the injured party who may exercise this remedy and can choose between rescission or fulfilment of the obligation, with damages in either case.

11.2 What additional protections could be included in the contract documentation to protect the customer?

For outsourcing contracts covered by DO 174, the following stipulations are favourable for the outsourcing party:

- a condition that payment of the consideration of the service agreement will only be made once the contractor 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, Employees Compensation Commission, and Philippine Health Insurance;
- submission of the contractor's employees' employment contracts to the client; and
- retention by the contractor of the right to control the manner and the means of performing the work, with the client having the control or direction only as to the results to be accomplished, if only to avoid the client being described as the employer.

11.3 What are the typical warranties and/or indemnities that are included in an outsourcing contract?

For outsourcing contracts covered by DO 174, the following are typical warranties required of a service contractor:

- that it is registered as an independent contractor with the DOLE;
- that it will provide uninterrupted, efficient, and competent services;
- that it has secured all the necessary licences for it to engage in its business and will maintain its status as an independent job contractor of good standing;
- that it has tools, equipment, and facilities to carry out its obligations under the contract;
- that it offers its services to the public at large and that it has, in fact, several other clients, the current list of which it will furnish the client on a regular basis; and
- that it will ensure enjoyment by its employees of all their rights and benefits under the Labor Code and DO 174 including, but not limited to, safe and healthy working conditions, labour standards and benefits, right to self-organisation, and right to security of tenure.

12 Insurance

12.1 What types of insurance should be considered in order to cover the risks involved in an outsourcing transaction?

For contracting arrangements covered by DO 174, the service

contractor is required to post a surety bond in favour of the principal equal to the total labour costs under the subject contracts. The bond will answer for the wages due to the personnel of the service contractor which it may fail to pay.

13 Termination

13.1 How can a party to an outsourcing agreement terminate the agreement without giving rise to a claim for damages from the terminated party?

The parties to an agreement normally stipulate that either party will be able to terminate the contract upon observance of a prior notice period agreed upon. No damages may be claimed upon invocation of such a provision.

For outsourcing arrangements covered by DO 174, if the dismissal of the contractor's employees is due to the pre-termination of the service agreement and not due to any of the authorised causes under Article 298 of the Labor Code (e.g., redundancy, retrenchment), then unpaid wages and other unpaid benefits, including unremitted legal mandatory contributions, shall be borne by the party at fault, without prejudice to the solidary liability of the parties to the service agreement.

13.2 Can the parties exclude or agree additional termination rights?

Yes, the parties may exclude or agree upon additional termination rights.

13.3 Are there any mandatory local laws that might override the termination rights that one might expect to see in an outsourcing contract?

Generally, local laws, especially the Labor Code and the Civil Code, are read into every contracting arrangement. Unless specifically prevented by applicable law, however, the parties are free to stipulate their respective termination rights, as long as these are not contrary to law, morals, and good custom, public policy or public order. For example, while parties may agree on liquidated damages to be awarded in case of breach of contract, Philippine courts may nevertheless strike the same down if these are unconscionable or inequitable.

14 Intellectual Property

14.1 How are the intellectual property rights of each party protected in an outsourcing transaction?

The intellectual property rights of each party may be protected by (1) the Intellectual Property (IP) Code of the Philippines (Republic Act No. 8293), and/or (2) a contract or licensing agreement. Improvements of IP rights or new IP rights that are created during the outsourcing relationship should be governed by the outsourcing agreement between the parties.

14.2 Are know-how, trade secrets and other business critical confidential information protected by local law?

Yes. While there is no specific law protecting trade secrets, local laws and jurisprudence recognise the confidentiality of trade secrets and other confidential business information.

14.3 Are there any implied rights for the supplier to continue to use licensed IP rights post-termination and can these be excluded from the agreement?

No. The rights of the supplier to use the customer's IP rights only arise from the customer's obligation under the outsourcing agreement. Thus, these rights are terminated upon the expiration of the contract, unless otherwise agreed upon.

14.4 To what extent can the customer gain access to the supplier's know-how post-termination and what use can it make of it?

A customer's right to access information regarding a supplier's intellectual creations may be established by agreement and terminates upon the latter's expiration, subject to any provision on warranties. In the absence of a non-disclosure agreement, the customer may have no liability for making public the knowledge obtained in the transaction with the supplier.

15 Liability

15.1 To what extent can a party limit or exclude liability under national law?

The parties are generally free to stipulate such terms and conditions as they see fit, including a limitation or exclusion of liability, as long as it is not contrary to law, morals and good custom, public policy, or public order.

15.2 Are the parties free to agree a financial cap on liability?

Yes, the parties are free to agree on a financial cap on liability. However, if the parties have agreed upon liquidated damages, whether intended as a penalty or indemnity for breach of contract, these may be reduced by Philippine courts if the same are found to be iniquitous or unconscionable or when the principal obligation has been partially performed.

Moreover, this financial cap applies only between the principal and the service contractor in an arrangement covered by DO 174. Thus, third parties, particularly the contractor's employees, may go after either the principal or the service contractor for payment of unpaid money claims due to the joint and several liability provided by DO 174 between the principal and the contractor. The cap mentioned above will not apply to these money claims.

16 Dispute Resolution

16.1 What are the main methods of dispute resolution used?

Primarily, the disputes are submitted to Philippine courts or quasi-judicial or administrative agencies depending on the subject matter of the dispute. Parties may also stipulate that disputes arising from the contract or agreement may be submitted for arbitration, as an alternative mode of dispute resolution, if the subject matter is not among those excluded by law as an issue that may be covered by arbitration.

17 Good Faith

17.1 Is there any overriding requirement for a customer and supplier to act in good faith and to act fairly according to some objective test of fairness or reasonableness under general law?

Yes. Under Article 19 of the Civil Code of the Philippines, persons in the performance of their duties must act in good faith. Additionally, Article 1173 of the same Code imputes fault or negligence on the part of the party obliged to render service for failing to exercise that diligence required by the nature of the obligation. If the contract does not state the diligence which is to be observed in the performance, that which is expected of a good father of a family shall be required.



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