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THIRD DIVISION

[G.R. No. 210528. November 28, 2018]

COMMISSIONER OF INTERNAL REVENUE, *petitioner, vs.* **J.P. MORGAN CHASE BANK, N.A. – PHILIPPINE CUSTOMER CARE CENTER,** *respondent.*

SYLLABUS

1. REMEDIAL LAW APPEALS; PETITION FOR REVIEW ON CERTIORARI UNDER RULE 45 OF THE RULES OF COURT; PROPER REMEDY WHEN THE ISSUES RAISED INVOLVE PURELY QUESTIONS OF LAW; THERE IS A QUESTION OF LAW WHEN THERE IS DOUBT OR CONTROVERSY AS TO WHAT THE LAW IS ON A CERTAIN SET OF FACTS; CASE AT BAR.— The Commissioner of Internal Revenue invoked the correct remedy. Rule 45 applies to issues raised before this Court that involve purely questions of law. In *Villamor, Jr. v. Umale*, this Court held: There is a question of law "when there is doubt or controversy as to what the law is on a certain [set] of facts." The test is "whether the appellate court can determine the issue raised without reviewing or evaluating the evidence." Meanwhile, there is a question of fact when there is "doubt . . . as to the truth or falsehood of facts." The question must involve the examination of probative value of the evidence presented. To resolve the issue on the taxability of the transaction between respondent and PeopleSupport, this Court is required to interpret Task Order #2 to the Agreement. Petitioner asserts that the Agreement between respondent and PeopleSupport merely involved a lease of information technology infrastructure, which is not covered by PeopleSupport's PEZA registration. This issue is a question of law. It does not require us to examine the probative value of the evidence presented. The Petition essentially requires this Court to determine the scope of the Agreement and the scope of activities covered by the fiscal incentives granted to People Support.

2. TAXATION; REPUBLIC-ACT NO. 7916 (SPECIAL ECONOMIC ZONE ACT OF 1995, A S AMENDED);

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IMPLEMENTING RULES AND REGULATIONS; RULE XIII, SECTION 5 THEREOF; PEZA-GRANTED INCENTIVES SHALL APPLY ONLY TO REGISTERED OPERATIONS OF THE ECOZONE ENTERPRISE AND ONLY DURING ITS REGISTRATION WITH PEZA; CASE AT BAR.— Rule XIII, Section 5 of the Implementing Rules and Regulations of Republic Act No. 7916 specifies that PEZA-granted incentives shall apply only to registered operations of the Ecozone Enterprise and only during its registration with PEZA. In other words, tax incentives to which an Ecozone Enterprise is entitled do not necessarily include all kinds of income received during the period of entitlement. Only income actually gained or received by the Ecozone Enterprise related to the conduct of its registered business activity are covered by fiscal incentives. x x x Following the rulings and the PEZA Memorandum Circular, it is clear that the registration of an activity with PEZA is an essential requirement to enjoy tax incentives under the law, and only income arising from or directly related to the conduct of the Ecozone Enterprises' registered activities are covered by tax incentives under the Philippine Economic Zone Act of 1995. Hence, to qualify for the income tax holiday incentive, respondent must satisfactorily show that its transaction with People Support is a registered activity or embraced within the latter's registered activities with the PEZA.

3. **ID.; ID.; ID.; ID.; TAX INCENTIVES PARTAKE OF THE NATURE OF TAX EXEMPTION WHICH MUST BE STRICTLY CONSTRUED AGAINST THE TAXPAYER; CASE AT BAR.—** As Court of Tax Appeals Presiding Justice Del Rosario pointed out in his Dissenting Opinion: While Certification No. 2007-067 dated June 27, 2013 states that [People Support] has a site in 6780 Ayala, there is nothing therein that shows that the leasing activity conducted by [People Support] in the 6780 Ayala site is registered with PEZA and entitled to incentives. In my mind, respondent has the burden of proving by preponderant evidence that [People Support] is registered with PEZA as a facility-provider and that [PeopleSupport]'s income from the lease of its physical plant space, infrastructure[,] and other transmission facilities to respondent is entitled to the ITH incentive. Considering that respondent failed to establish that [PeopleSupport] is registered with PEZA as a facility-provider and that [PeopleSupport]'s

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> income from the lease of physical plant space, infrastructure[,] and other transmission facilities to respondent is entitled to ITH incentive, it is my humble view that the income received by PPI from respondent is subject to regular corporate income tax imposed under Section 27(A) of the 1997 [National Internal Revenue Code], as amended. Tax incentives partake of the nature of tax exemptions. They are a privilege to which the rule that tax exemptions must be strictly construed against the taxpayer apply. One who seeks an exemption must justify it by words "too plain to be mistaken and too categorical to be misinterpreted."

APPEARANCES OF COUNSEL

Office of the Solicitor General for petitioner.
Sycip Salazar Hernandez & Gatmaitan for respondent.

D E C I S I O N

LEONEN, *J.*:

Respondent's lease of the physical plant space, infrastructure, and other transmission facilities of PeopleSupport (Philippines), Inc., a Philippine Economic Zone Authority (PEZA)-registered Export Enterprise, is not covered within its registered activities. Thus, income derived from it is subject to the regular corporate income tax.

This Petition for Review on Certiorari[1] seeks to reverse and set aside the Court of Tax Appeals En Banc Decision[2] dated

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[1] *Rollo,* pp. 36-55.

[2] *Id*. at 56-70. The Decision was penned by Associate Justice Esperanza R. Fabon-Victorino and concurred in by Associate Justices Juanito C. Castañeda, Jr., Lovell R. Bautista, Erlinda P. Uy, Caesar A. Casanova, Cielito N. Mindaro-Grulla, and Amelia R. Cotangco-Manalastas of the Court of Tax Appeals En Banc, Quezon City. It was dissented by Presiding Justice Roman G. Del Rosario (pp. 71-76). Associate Justice Ma. Belen M. Ringpis-Liban inhibited.

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July 15, 2013 and Resolution[3] dated December 18, 2013 in CTA EB No. 876. The Court of Tax Appeals En Banc denied the Commissioner of Internal Revenue's appeal and affirmed the December 21, 2011[4] and February 17, 2012[5] Resolutions of the Court of Tax Appeals Second Division, which ruled that the income from the lease of PeopleSupport (Philippines) Inc.'s transmission facilities is exempt from withholding tax, and granted J.P. Morgan Chase Bank N.A.–Philippine Customer Care Center's claim for refund.[6]

JP Morgan Chase Bank, N.A. – Philippine Customer Care Center (J.P. Morgan–Philippines) is the Philippine branch of American corporation J.P. Morgan Chase Bank, N.A. It is registered with the Securities and Exchange Commission to engage in call center and business process services, information technology, information technology–enabled services, and customer care services.[7]

On May 1, 2007,[8] J.P. Morgan–Philippines entered into Task Order #2 to the Master Service Provider Agreement (Agreement) with PeopleSupport (Philippines), Inc. (PeopleSupport), a

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[3] *Id*. at 77-79. The Resolution was penned by Associate Justice Esperanza R. Fabon-Victorino and concurred in by Associate Justices Juanito C. Castañeda, Jr., Lovell R. Bautista, Erlinda P. Uy, Caesar A. Casanova, Cielito N. Mindaro-Grulla, and Amelia R. Cotangco-Manalastas of the Court of Tax Appeals En Banc, Quezon City. It was dissented by Presiding Justice Roman G. Del Rosario. Associate Justice Ma. Belen M. Ringpis-Liban inhibited.

[4] *Id*. at 96-102. The Resolution, in the case docketed as CTA Case No. 7962, was penned by Associate Justice Caesar A. Casanova and concurred in by Associate Justices Juanito C. Castañeda, Jr. and Cielito N. Mindaro-Grulla of the Second Division of the Court of Tax Appeals, Quezon City.

[5] *Id*. at 110-113. The Resolution, in the case docketed as CTA Case No. 7962, was penned by Associate Justice Caesar A. Casanova and concurred in by Associate Justices Juanito C. Castañeda, Jr. and Cielito N. Mindaro-Grulla of the Second Division of the Court of Tax Appeals, Quezon City.

[6] *Id*. at 101-102.

[7] *Id*. at 57.

[8] *Id*. at 139, Comment.

Philippine Economic Zone Authority (PEZA)-registered Economic Zone IT (Export) Enterprise, which enjoys an income tax holiday period from May to July 2007. Under the Agreement, PeopleSupport would provide and lease transmission facilities to J.P. Morgan-Philippines for a fee.[9]

The Agreement stated:

III. DESCRIPTION AND SCOPE OF SERVICES

Supplier shall provide the following services to [JP Morgan]:

A. Scope of Services.

Supplier will provide physical plant space in its facility located at 6780 Ayala Avenue, Makati City 1227 Philippines (the "Facility") that will allow JPMC personnel to perform certain services for the benefit of JPMC. Supplier will provide all voice and data infrastructure needed for JPMC personnel to perform their intended function(s). Supplier will further provide all workstation infrastructure (as further detailed below) that is compatible with JPMC specifications to support JPMC work types to be performed at Supplier's location. Supplier will provide workstation voice and data bandwidth as set forth below. Supplier will also provide all infrastructure necessary to conduct telephone call recording, workstation screen data capture, and data storage per the requirements of JPMC. Additionally, Supplier will provide the platform and support for inbound telemarketing activities that will be performed by JPMC employees located in the Facility. This platform and support will be consistent with all service requirements as set forth in Task Order #1 currently executed between PeopleSupport, Inc. and JPMorgan Chase Bank, National Association.

. . . . . .

V[.] SUPPLIER/JPMC INTERACTION

Supplier and JPMC agree to the following:

- Supplier will assign an account manager mutually agreeable to JPMC and Supplier.
- The account manager must be proactive, responsive[,] and solution oriented.

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[9] *Id*. at 57.

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- The account manager should have expertise in, or direct linkage to, Supplier's facilities, security and information technology.
- The account manager must have the ability to effectively manage or address the Services to ensure optimum results for JPMC.
- The account manager will be responsible for facilitating communication between JPMC and Supplier.
- Supplier will notify JPMC of any staff reassignments involving the account manager or other designated [k]ey personnel.
- JPMC will provide a point of contact(s) ("POC") that will serve as a liaison between the Supplier and JPMC.
- JPMC will provide POC(s) during Supplier's hours of operations.
- JPMC POC(s) will provide feedback or updates regarding escalations or concerns made by the Supplier."[10] (Emphasis in the original)

From May to July 2007, J.P. Morgan-Philippines paid PeopleSupport ₱56,913,080.40, and withheld tax amounting to ₱2,845,654.02.[11]

On August 10, 2007, J.P. Morgan-Philippines filed its Monthly Remittance Return of Creditable Income Taxes Withheld for July and paid ₱3,705,125.61, including the ₱2,845,654.02 withheld tax from PeopleSupport.[12]

On August 16, 2007, however, J.P. Morgan–Philippines reimbursed PeopleSupport the amount of ₱2,845,654.02 after having realized that it had erroneously withheld taxes on its payments to PeopleSupport, as the latter enjoys the income tax holiday. PeopleSupport acknowledged the reimbursement in

[10] *Id.* at 19-20.

[11] *Id.* at 57.

[12] *Id.* at 57-58.

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its August 16, 2007 Official Receipt No. 1660 and July 23, 2008 letter.[13]

On August 7, 2008, J.P. Morgan–Philippines filed before the Bureau of Internal Revenue District Office No. 50 (South Makati) an application for refund of ₱2,845,654.02.[14] However, due to the latter's inaction, it later filed on August 10, 2009 a Petition for Review before the Court of Tax Appeals.[15]

The Commissioner of Internal Revenue filed an Answer on September 9, 2009, arguing that J.P. Morgan–Philippines failed to show that the tax was erroneously or illegally collected.[16] Assuming it was, she added that J.P. Morgan–Philippines was not the proper party to ask for refund as it was merely a withholding agent. She further argued that the claim for refund, if allowed, should be in the name and with the express authority of PeopleSupport.[17]

In its September 23, 2011 Decision,[18] the Court of Tax Appeals Second Division denied J.P. Morgan–Philippines' claim for refund. It found that while J.P. Morgan–Philippines was the proper party to file the claim for refund,[19] the lease of transmission facilities was outside PeopleSupport's registered activities with PEZA.[20] It ruled that the income from the lease was subject to the regular income tax, and thus, the tax was correctly withheld.[21]

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[13] *Id*. at 58.

[14] *Id*.

[15] *Id.*

[16] *Id*. at 82-83, Court of Tax Appeals September 23, 2011 Decision.

[17] *Id*. at 58.

[18] *Id*. at 80-95. The Decision, docketed as CTA Case No. 7962, was penned by Associate Justice Caesar A. Casanova and concurred in by Associate Justices Juanito C. Castañeda, Jr. and Cielito N. Mindaro-Grulla of the Second Division of the Court of Tax Appeals, Quezon City.

[19] *Id*. at 87.

[20] *Id*. at 93.

[21] *Id*. at 94.

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On J.P. Morgan–Philippines' Motion for Reconsideration, the Court of Tax Appeals Second Division reversed itself in its December 21, 2011 Resolution,[22] and granted the claim for refund. It ruled that under the Agreement, PeopleSupport would supply the whole package of infrastructure and information technology support services to J.P. Morgan–Philippines, which includes the lease of its transmission facilities. Consequently, the lease of transmission facilities was an activity related to PeopleSupport's registered activities; hence, the rental income from this lease was exempt from withholding tax.[23]

The Commissioner of Internal Revenue filed a Motion for Reconsideration, but it was denied in the Court of Tax Appeals Second Division Resolution[24] dated February 17, 2012.

The Commissioner of Internal Revenue filed an Appeal before the appealed to the Court of Tax Appeals En Banc, but it was denied. In its July 15, 2013 Decision,[25] the Court of Tax Appeals En Banc ruled that the scope of PeopleSupport's services under the Agreement was within its registered activities with PEZA, i.e. the establishment of a contact center to provide outsourced customer care and business process outsourcing services. It also held that providing support services for maintenance and repair of the facility was part of PeopleSupport's obligation to J.P. Morgan-Philippines.[26]

The Commissioner of Internal Revenue filed a Motion for Reconsideration, but it was likewise denied in the Court of Tax Appeals En Banc Resolution[27] dated December 18, 2013.

Hence, this Petition was filed.

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[22] *Id*. at 96-102.

[23] *Id.* at 101-102.

[24] *Id*. at 110-113.

[25] *Id*. at 56-70.

[26] *Id*. at 67.

[27] *Id*. 77-79.

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To comply with this Court's April 21, 2014 Resolution,[28] J.P. Morgan–Philippines filed its Comment,[29] to which the Commissioner of Internal Revenue filed a Reply.[30]

The issues for this Court's resolution are:

First, whether or not the Petition for Review on Certiorari raises a factual question; and

Second, whether or not J.P. Morgan–Philippines' lease of physical plant space, infrastructure, and other transmission facilities is related to the PEZA–registered activities of PeopleSupport, and is thus, exempt from withholding taxes.

Petitioner states that PeopleSupport is registered with PEZA to provide outsourced customer care and business process outsourcing services.[31] It is granted an income tax holiday and other fiscal incentives, which apply only to income derived from its registered activities under the Implementing Rules and Regulations of Republic Act No. 7916, or the Special Economic Zone Act of 1995.[32]

The Agreement, petitioner argues, was essentially a lease of physical plant space, infrastructure, and other transmission facilities of PeopleSupport for the use of respondent's personnel.[33] She submits that this activity is not necessarily related to PeopleSupport's PEZA–registered operations, but an entirely different activity that should be covered by a separate registration.[34] Thus, PeopleSupport's income from the lease is subject to regular income tax.[35]

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[28] *Id.* at 128.

[29] *Id.* at 138–153.

[30] *Id.* at 171–186.

[31] *Id.* at 42.

[32] *Id.* at 44.

[33] *Id.* at 45–46.

[34] *Id.* at 47.

[35] *Id.* at 49.

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Respondent counters that the Petition should be dismissed for failure to raise questions of law.[36]

Respondent points out that the terms "outsourced customer care services"[37] and "business process outsourcing services"[38] commonly mean the "contracting out of operations and responsibilities of specific business functions (or processes) to a third-party service provider."[39] Under their Agreement, respondent contracted out to PeopleSupport the operations of maintaining and managing the infrastructure and transmission facilities that the latter provided. From PeopleSupport's standpoint, it rendered to respondent business process outsourcing services that are information technology-based.[40]

Finally, respondent argues that PeopleSupport's services under the Agreement fall within or are related to its registered activities with PEZA.[41] Thus, the income that PeopleSupport derived from its services is exempt from income tax.[42]

In her Reply,[43] petitioner contends that: (1) a factual review is warranted as she has discussed in her Petition how the inference of the Court of Tax Appeals was manifestly mistaken,[44] and the Decision was based on a misapprehension of facts;[45] (2) the Agreement was essentially a lease of physical facilities[46] and the information technology support services PeopleSupport

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[36] *Id.* at 143.

[37] *Id.* at 146.

[38] *Id.*

[39] *Id.*

[40] *Id.*

[41] *Id.* at 149.

[42] *Id.* at 150.

[43] *Id.* at 171-187.

[44] *Id.* at 173.

[45] *Id.* at 175.

[46] *Id.* at 178.

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would provide were merely incidental;[47] and (3) the lease of facilities is a new and additional product line that requires PEZA approval,[48] and respondent presented no evidence that PeopleSupport is registered with PEZA as a facility provider.[49]

Tax refunds must be granted only by a clear and unequivocal provision of law. Thus, petitioner submits that PeopleSupport's income derived from the lease of its facilities to respondent, not being a PEZA–registered activity, is subject to corporate income tax.[50]

I

The Commissioner of Internal Revenue invoked the correct remedy. Rule 45 applies to issues raised before this Court that involve purely questions of law. In *Villamor, Jr. v. Umale*,[51] this Court held:

There is a question of law "when there is doubt or controversy as to what the law is on a certain [set] of facts." The test is "whether the appellate court can determine the issue raised without reviewing or evaluating the evidence." Meanwhile, there is a question of fact when there is "doubt . . . as to the truth or falsehood of facts." The question must involve the examination of probative value of the evidence presented.[52] (Citation omitted)

To resolve the issue on the taxability of the transaction between respondent and PeopleSupport, this Court is required to interpret Task Order #2 to the Agreement. Petitioner asserts that the Agreement between respondent and PeopleSupport merely involved a lease of information technology infrastructure, which

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[47] *Id.* at 179.

[48] *Id.*

[49] *Id.* at 180.

[50] *Id.* at 182.

[51] 744 Phil. 31 (2014) [Per *J.* Leonen, Second Division].

[52] *Id.* at 44.

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is not covered by PeopleSupport's PEZA registration. This issue is a question of law. It does not require us to examine the probative value of the evidence presented. The Petition essentially requires this Court to determine the scope of the Agreement and the scope of activities covered by the fiscal incentives granted to PeopleSupport.

II (A)

Under Section 23 of Republic Act No. 7916, or the Special Economic Zone Act of 1995, as amended, business enterprises operating within economic zones are entitled to fiscal incentives. It states:

> Section 23. *Fiscal Incentives.* — Business establishments *operating within the ECOZONES* shall be entitled to the fiscal incentives as provided for under Presidential Decree No. 66, the law creating the Export Processing Zone Authority, or those provided under Book VI of Executive Order No. 226, otherwise known as the Omnibus Investment Code of 1987.
>
> Furthermore, tax credits for exporters using local materials as inputs shall enjoy the same benefits provided for in the Export Development Act of 1994.

Article 39(a)(1), Book VI of Executive Order No. 226, as amended,[53] enumerates the fiscal incentives granted to a registered enterprise, which include income tax holiday from four (4) to six (6) years, depending on whether the enterprise is registered as a pioneer or non-pioneer firm. It reads:

> Art. 39. *Incentives to Registered Enterprises.* — **All registered enterprises shall be granted the following incentives to the extent engaged in a preferred area of investment**;
>
> (a) *Income Tax Holiday.* —
>
> (1) For six (6) years from commercial operation for pioneer firms and four (4) years for non-pioneer firms, new registered firms shall be fully exempt from income taxes levied by the National Government. Subject to such guidelines as may be

[53] Republic Act No. 7918 (1995), Sec. 1.

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> prescribed by the Board, the income tax exemption will be extended for another year in each of the following cases: . . . (Emphasis supplied)

However, Rule XIII, Section 5 of the Implementing Rules and Regulations of Republic Act No. 7916 specifies that PEZA-granted incentives shall apply only to registered operations of the Ecozone Enterprise and only during its registration with PEZA. In other words, tax incentives to which an Ecozone Enterprise is entitled do not necessarily include all kinds of income received during the period of entitlement. Only income actually gained or received by the Ecozone Enterprise related to the conduct of its registered business activity are covered by fiscal incentives.

Executive Order No. 226 also provides that the incentives shall only be "to the extent engaged in a preferred area of investment."[54] The purpose of the income tax holiday was explained, thus:

> An income tax holiday is bestowed on a new project to encourage investors to set up businesses and to contribute to the country's economic growth. The fiscal incentive is also meant to help registered enterprises recoup their substantial initial investments by giving them a reprieve from paying income tax for a few years. *However, like any privilege, the income tax holiday comes with conditions and requirements which must be fulfilled for its continued enjoyment.*[55] (Emphasis supplied)

Revenue Regulations No. 20-2002[56] of the Bureau of Internal Revenue clarifies the tax treatment of income earned from

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[54] Executive Order No. 226 (1987), Sec. 39. The Omnibus Investments Code of 1987.

[55] *J.* Leonen, Dissenting Opinion in *Board of Investments v. SR Metals, Inc.,* G.R. No. 219927, October 3, 2018, <http://sc.judiciary.gov.ph/pdf/web/viewer.html?file=/jurisprudence/2018/october2018/219927.pdf> 7 [Per J. Del Castillo, First Division].

[56] Revenue Regulations No. 20-2002 (2002). Clarifying the Tax Treatment of Income Earned from Unregistered Activities by Enterprises Registered under the Bases Conversion and Development Act of 1992 and the Philippine Economic Zone Act of 1995.

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unregistered activities by enterprises under the Bases Conversion and Development Act of 1992 and the Philippine Economic Zone Act of 1995. It states:

SECTION 1. TAX TREATMENT — Income derived by an enterprise registered with the Subic Bay Metropolitan Authority (SBMA), the Clark Development Authority (CDA), or the Philippine Economic Zone Authority (PEZA) from its registered activity/ies shall be subject to such tax treatment as may be specified in its terms of registration (i.e., the 5% preferential tax rate, the income tax holiday, or the regular income tax rate, as the case may be). *Nonetheless, whatever the tax treatment of said enterprise with respect to its registered activity/ies, income realized by such registered enterprise that is not related to its registered activity/ies shall be subject to the regular internal revenue taxes*, such as the 20% final income tax on interest from Philippine Currency bank deposits and yield or any other monetary benefit from deposit substitutes, and from trust funds and similar arrangements, the 7.5% tax on foreign currency deposits and the 5%/10% capital gains tax or ½% stock transaction tax, as the case may be, on the sale of shares of stock.[57] (Emphasis supplied)

Several Bureau of Internal Revenue rulings later determined the tax treatment of certain income derived by PEZA-registered enterprises.

In its Ruling No. DA-023-03,[58] the Bureau of Internal Revenue held that the sale by a PEZA-registered enterprise of its manufacturing plant and equipment, such as generator sets and others, is not within its registered activity, and therefore, is subject to regular income tax. The registered enterprise was engaged in the sale of disk drives.

Likewise, in Bureau of Internal Revenue Ruling No. DA-166-04,[59] the gain derived by a PEZA-registered enterprise from the sale of machineries and equipment, resulting from the foreign

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[57] Revenue Regulations No. 20-2002 (2002), sec. 1.

[58] The Ruling was signed by Deputy Commissioner Jose Mario C. Buñag on January 28, 2003.

[59] The Ruling was signed by Deputy Commissioner Jose Mario C. Buñag on April 5, 2004.

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exchange translation of their US Dollar denominated book value in pesos, was held subject to regular income tax. The company was registered with PEZA as an Ecozone Export Enterprise engaged in the assembly of semiconductor devices in plastic packages (integrated circuits).

Also, the granting of a foreign currency denominated loan to an affiliate[60] and investment in a time deposit account or any other Philippine currency bank deposit[61] were considered not related to the registered activities of an Ecozone Export Manufacturing Enterprise and Clark Freeport Zone Enterprise, respectively.

On September 15, 2005, PEZA issued Memorandum Circular No. 2005-032,[62] which provided:

On Gains on Foreign Exchange Transactions:

Foreign currency is normally used by Ecozone Export Enterprises for their registered activities, either as the functional currency or as a supplemental currency. On the other hand, it is also used by some Ecozone Export Enterprises for other activities which can be considered as "additional business opportunities" which PEZA has no control of.

The tax treatment of foreign exchange (forex) gains shall depend on the activities from which these arise. Thus, if the forex gain is attributed to an activity with income tax incentive (Income Tax Holiday or 5%

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[60] Bureau of Internal Revenue Ruling No. DA-209-06 was signed by Officer-in-Charge Pablo M. Bastes, Jr. on April 5, 2006. In it, the grant by Hitachi Cable Philippines, Inc. of a foreign currency denominated loan to its affiliate was considered not related to its registered activities.

[61] Bureau of Internal Revenue Ruling No. 320-11 was signed by Commissioner of Internal Revenue Kim S. Jacinto-Henares on August 22, 2011. In it, the investment of Our Lady of Mt. Carmel Medical Center in a time deposit account was held an unregistered business activity.

[62] Philippine Economic Zone Authority, Memorandum Circular No. 2005-032 (2005). Clarification of the Tax Treatment of (a) Gains on Foreign Exchange Transactions; and, (b) Sales of Production "Rejects" and "Seconds[,"] Scrap, Raw Materials, Packaging Materials and Other Production Supplies.

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Gross Income Tax), said forex gain shall be covered by the same income tax incentive. On the other hand, if the forex gain is attributed to an activity without income tax incentive, said forex gain shall likewise be without income tax incentive, *i.e.,* therefore, subject to normal corporate income tax.

The tax treatment of forex gains is illustrated as follows:

Activity	*Income Tax Incentive*	*Tax Treatment of Forex Gain*
Registered 1st Project	5% Gross Income Tax	5% Gross Income Tax
Registered 2nd Project	Income Tax Holiday	Income Tax Holiday
Other Activities	None	Normal Corporate Income Tax

On Sales of Production "Rejects" and "Seconds[,"] Scrap, Raw Materials, Packaging Materials and Other Production Supplies:

1. All local sales shall be subject to applicable duties and taxes (including VAT) prior to withdrawal thereof from the Ecozone.

2. For purposes of entitlement to income tax incentives (Income Tax Holiday or 5% Gross Income Tax), the following shall apply:

a. Sale of production "rejects" and "seconds" from the registered activity of the Export Enterprise shall be considered covered by the registered activity of said Enterprise. Thus, any income derived therefrom shall be covered by the applicable income tax incentive, *i.e.,* Income Tax Holiday or 5% Gross Income Tax.

b. Sale of recovered waste/scrap generated from processing of raw materials, including used packaging materials and other direct/indirect materials/supplies that have undergone processing/which have been used in production/processing activity registered with PEZA shall likewise be considered covered by the registered activity of an Export Enterprise. Any income derived therefrom shall likewise be covered by the applicable income tax incentive.

c. Sale of unprocessed, unused, obsolete or "off-specs" production inputs (direct/indirect materials/supplies) shall not be covered by

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the registered activity of an Ecozone Enterprise. Thus, any income derived therefrom shall be subject to normal corporate income tax, provided that the related cost shall be deducted only once for purposes of computing income.

For purposes of proper reckoning of incentives, Ecozone Export Enterprises with multiple activities are required to maintain separate books of accounts for each activity.[63]

Following the rulings and the PEZA Memorandum Circular, it is clear that the registration of an activity with PEZA is an essential requirement to enjoy tax incentives under the law, and only income arising from or directly related to the conduct of the Ecozone Enterprises' registered activities are covered by tax incentives under the Philippine Economic Zone Act of 1995.

Hence, to qualify for the income tax holiday incentive, respondent must satisfactorily show that its transaction with PeopleSupport is a registered activity or embraced within the latter's registered activities with the PEZA.

II (B)

PEZA lists on its website ten (10) activities[64] that are eligible for registration and fiscal incentives. These are:

1. **Export Manufacturing** — manufacturing, assembly or processing activity resulting in the exportation of at least 70% of production . . . Eligible firms shall qualify for registration as "Economic Zone Export Manufacturing Enterprise."
2. **IT (Information Technology) Service Export** — IT service activities, of which 70% of total revenues is derived from clients abroad. ("IT Service Activities" are activities which involve the use of any IT software and/or system for value

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[63] Philippine Economic Zone Authority, Memorandum Circular No. 2005-032 (2005).

[64] *Activities Eligible for PEZA Registration and Incentives*, Philippine Economic Zone Authority <http://www.peza.gov.ph/index.php/eligible-activities-incentives> (last accessed on November 28, 2018).

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addition) . . . Eligible firms shall qualify for registration as "IT Enterprise."

3. **Tourism** — establishment and operation within PEZA Tourism Special Economic Zones of sports and recreation centers, accommodation, convention, and cultural facilities and their special interest attraction activities/establishments, with foreign tourists as primary clientele. Eligible firms shall qualify for registration as "Tourism Economic Zone Locator Enterprise."

. . . . . .

4. **Medical Tourism** — medical health services, endorsed by the Department of Health, with foreign patients as primary clientele. Eligible firms shall qualify for registration as "Medical Tourism Enterprise" in a Medical Tourism Special Economic Zone Park or Center.

. . . . . .

5. **Agro-industrial Export Manufacturing** — processing and or manufacturing of agricultural products resulting in the exportation of its production . . . Eligible firms shall qualify for registration as "Agro-Industrial Economic Zone Export Enterprise."

. . . . . .

6. **Agro-industrial Bio-Fuel Manufacturing** — specialized manufacturing of agricultural crops and eventual commercial processing which shall result in the production of clean energy such as bio-fuels and the like. Eligible firms shall qualify for registration as "Agro-Industrial Economic Zone Enterprise."

. . . . . .

7. **Logistics and Warehousing Services** — (a) operation of a warehouse facility for the storage, deposit, safekeeping of goods for PEZA-registered Economic Zone Export Manufacturing Enterprises, and or (b) importation or local sourcing of raw materials, semi-finished goods for resale to - or for packing/covering (including marking / labeling) cutting or altering to customers' specification, mounting and/or packaging into kits or marketable lots for subsequent sale

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to - PEZA-registered Export Manufacturing Enterprises for use in their export manufacturing activities, or for direct export, or for consignment to PEZA-registered Export Manufacturing Enterprises and eventual export. Eligible firms shall qualify for registration as "Economic Zone Logistics Services Enterprise."

. . . . . .

8. Economic Zone Development and Operation:

8.a. Manufacturing Economic Zone Development / Operation —

. . . . . .

8.b. IT Park Development / Operation — development, operation and maintenance of an area as a complex capable of providing infrastructures and other support facilities required by IT Enterprises, as well as amenities required by professionals and workers involved in IT Enterprise, or easy access to such amenities. Eligible firms shall qualify for registration as "IT Park Developer / Operator."

. . . . . .

8.c. Tourism Economic Zone Development / Operation —

. . . . . .

8.d. Medical Tourism Economic Zone Development / Operation —

. . . . . .

8.e. Agro-Industrial Economic Zone Development / Operation —

. . . .

8.f. Retirement Economic Zone Development /Operation — . . .

9. Facilities Providers:

9.a. Facilities for Manufacturing Enterprises — . . .

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9.b. Facilities for IT Enterprises — construction as owner/ operator of buildings and other facilities inside IT Parks which are leased to PEZA-registered IT Enterprises. Eligible firms shall qualify for registration as "IT Park Facilities Enterprise."

. . . .

9.c. Retirement Facilities – . . .

10. Utilities — establishment, operation and maintenance of light and power systems, water supply and distribution systems inside Special Economic Zones. Eligible firms shall qualify for registration as "Economic Zone Utilities Enterprise."[65]

PEZA Board Resolution No. 00-411[66] or The "Guidelines on the Registration of Information Technology (IT) Enterprises and the Establishment and Operation of IT Parks / Buildings" defines "information technology," "IT enterprises," "IT parks and buildings," and "facilities-providers" in connection with PEZA registration and availment of incentives. It states:

I. Definition of Terms

… ... ...

"Information Technology" or "IT" is the collective term for the various technologies involved in processing and transmitting information, which include computing, multimedia, telecommunications, microelectronics[,] and their interdependencies. Also called "informatics" or "telematics," the term "IT" is now also often used to refer to the convergence of various information-based, broadcast[,] and mass media communication technologies (NITC 1997);

"IT Service Activities" are activities which involve the use of any IT software and/or system for value addition;

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[65] *Activities Eligible for PEZA Registration and Incentives*, Philippine Economic Zone Authority <http://www.peza.gov.ph/index.php/eligible-activities-incentives> (last accessed on November 28, 2018).

[66] *PEZA Board Resolution No. 00-411*, Philippine Economic Zone Authority, December 29, 2000 <http://www.peza.gov.ph/issuances/guidelines/Guidelines_IT.pdf> (last accessed on November 28, 2018).

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"IT Enterprises" are companies operating/offering IT services;

"IT Park" is an area which has been developed into a complex capable of providing infrastructures and other support facilities required by IT Enterprises, as well as amenities required by professionals and workers involved in IT Enterprises, or easy access to such amenities.

"IT Building" is a building, the whole or part of which has been developed to provide infrastructures and other support facilities required by IT Enterprises, and which may also provide amenities required by professionals and workers involved in IT Enterprises, or easy access to such amenities.

"Facilities-Providers" are owners/operators of buildings and other facilities inside economic zones/IT Parks which are leased to PEZA-registered locator enterprises.[67]

The Board Resolution also enumerates the information technology service activities eligible for registration with PEZA, which include:

- Software development and application, including programming and adaptation of system softwares (*sic*) and middlewares (*sic*), 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 out-sourcing using e-commerce;
- IT research and development; and
- Other IT[-]related service activities, as may be identified and approved by the PEZA Board.

An IT Enterprise operating any of the above-listed IT service activities may register with PEZA for availment of incentives provided under R. A. No. 7916, as amended by Republic Act No. 8748, provided it physically locates inside a PEZA-registered IT Park, Building or

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[67] *Id*.

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special economic zone, which is covered by the required Presidential Proclamation.[68]

II (C)

PEZA certified in its June 27, 2007 Certification No. 2007-067 that PeopleSupport is registered as an Economic Zone IT (Export) Enterprise with sites at the Asiatown I.T. Park, PeopleSupport Center, 6780 Ayala, Makati and SM Baguio Cyberzone Building.[69]

The Certification further confirms that PeopleSupport is registered with PEZA to "engage in the establishment of a contact center which will provide outsourced customer care services and [business process outsourcing] services."[70]

Moreover, the incentives granted to PeopleSupport under the Registration Agreement with PEZA dated August 12, 2003, and Supplemental Agreements dated February 20, 2004, July 14, 2005, May 15, 2007 and June 6, 2007,[71] are as follows:

1. Incentives under Book VI of EO 226 which includes the following:

    a. Corporate income tax holiday (ITH) for six (6) years for pioneer project and four (4) years for non-pioneer project effective on the committed date of start of commercial operations or the actual date of start of commercial operations, whichever is earlier; ITH entitlement can also be extended but in no case to exceed a total period of eight (8) years for pioneer project and seven (7) years for non-pioneer project provided specific criteria are met for each additional year and prior PEZA approval is obtained. Duly approved and registered 'Expansion' and 'New' projects are entitled to a three-year, and four-year ITH, respectively;

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[68] *Id*.

[69] *Rollo*, p. 42.

[70] *Id*.

[71] *Id*. at 16.

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b. Tax and duty free importation of merchandise which include raw materials, capital equipment, machineries and spare parts;

c. Exemption from wharfage dues and export tax, impost or fees;

d. VAT zero-rating of local purchases subject to compliance with BIR and PEZA requirements; and

e. Exemption from payment of any and all local government imposts, fees, licenses or taxes except real estate tax; however, machineries installed and operated in the ecozone for manufacturing, processing[,] or for industrial purposes shall not be subject to payment of real estate taxes for the first three (3) years of operation of such machineries; production equipment not attached to real estate shall be exempt from real property taxes.[72]

All income that PeopleSupport derived from its registered activities are "subject to such tax treatment as may be specified in its terms of registration."[73] Apropos, all income that it earned from rendering outsourced customer care and business process outsourcing services during its registration with PEZA are entitled to income tax holiday, and thus, are exempt from the payment of regular corporate income tax under Section 27(A). Consequently, they are not subject to the creditable withholding tax under Section 57(B) of the National Internal Revenue Code of 1997, as amended, and Section 2.57.2 of Revenue Regulations No. 2-98,[74] as amended.

II (C)

Respondent contends that "business process outsourcing," in its common use, refers to "the contracting out of operations and responsibilities of specific business functions (or processes) to a third-party service provider. Such functions are frequently

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[72] *Id.* at 16–17.

[73] Revenue Regulations No. 20-2002 (2002) Sec. 1.

[74] Revenue Regulations No. 2–98 (1998), Sec. 2.57.2.

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information-technology based and not limited to telemarketing activities."[75]

Respondent insists that it contracted out to PeopleSupport the function of "maintaining and managing the infrastructure and transmission facilities" provided by [PeopleSupport]."[76] It further contends that "information technology infrastructure and support services" is a business process, which it outsourced to PeopleSupport.[77]

This is misleading.

Tax incentives under the Philippine Economic Zone Act of 1995 are granted to information technology service activities, which refer to activities that involve the use of any information technology software and/or system for value addition, as defined in Board Resolution No. 00-411. These include "business processes outsourced using e-commerce."

The Department of Trade and Industry defines "business process outsourcing" as the "delegation of service-type business processes to a third-party service provider."[78] In the Philippines, this industry is generally divided into the following sectors: (1) contact centers; (2) back office services; (3) data transcription; (4) animation; (5) software development; (6) engineering development; and (7) game development.[79]

Inbound and outbound voice operation services for sales, customer service, and technical support comprise the contact center sector. Back office services, or knowledge outsourcing, refer to services related to finance, accounting, and human resource administration.[80]

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[75] *Rollo*, p. 146.

[76] *Id*.

[77] *Id*.

[78] *BPO Industry at a Glance*, Senate, January 2010 <https://senate.gov.ph/publications/AG%202010-01%20-%20BPO%20Industry.pdf> (last accessed on November 19, 2018).

[79] *Id.*

[80] *Id*.

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Providing information technology-enabled services is different from providing information technology facilities, infrastructure, or equipment. Service entails "useful labor or work rendered or to be rendered by one person to another."[81] Information technology facilities or infrastructures are the medium used to support the business processes and functions of companies.

PeopleSupport's registered activity of rendering "business process outsourcing services" refer to provision of information technology-enabled services that support certain business processes of its clients.

The Agreement between respondent and PeopleSupport pertains to the provision of physical plant space, voice and data infrastructure, all workstation infrastructure, and platform and support for inbound telemarketing activities.[82] In his Dissenting Opinion[83] to the Court of Tax Appeals July 15, 2013 Decision, Presiding Justice Roman G. Del Rosario observed that "respondent is not actually outsourcing its customer care functions or business processes to [PeopleSupport]. Respondent's own personnel shall actually perform the services using [PeopleSupport]'s physical plant space, infrastructure[,] and other transmission facilities."[84] Thus, the Agreement is essentially a lease of facilities outside the latter's registered activities, and thus, is not exempt from income tax.

PeopleSupport's leasing services to respondent are within the scope of the activity of a facilities provider/enterprise. Tax incentives that may be granted to an information technology service enterprise[85] are different from tax incentives granted to an information technology facilities provider/enterprise.[86]

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[81] *Commissioner of Internal Revenue v. American Express International, Inc.,* 500 Phil. 586, 598 (2005) [*J*. Panganiban, Third Division].

[82] *Rollo*, pp. 19–20.

[83] *Id.* at 25–30.

[84] *Id.* at 29.

[85] *Fiscal Incentives to PEZA-Registered Economic Zone Enterprises*, http://www.peza.gov.ph/index.php/eligible-activities-incentives/fiscal-incentives (last accessed on November 20, 2018).

[86] *Id.*

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PeopleSupport is registered with PEZA as an Economic Zone Information Technology (Export) Enterprise, not an Information Technology Facilities Provider/Enterprise. Incidentally, the Registration Agreement states the scope of PeopleSupport's registered activity, as follows:

> Article II
> Scope of Registrant's Registered Activity
>
> 2. The scope of the REGISTRANT's registered activity shall be limited to the establishment of a contact center which will provide outsourced customer care services and the importation of machinery, equipment, tools, goods, wares, articles, or merchandise directly used in its registered operations at Asiatown IT Park. *In the event the REGISTRANT decides to engage in a new or additional product line, directly or indirectly related to its registered activity, it shall apply anew with PEZA for the latter's approval.*[87] (Emphasis supplied)

The Registration Agreement explicitly requires the approval anew of the PEZA for new or additional activities of the registered enterprise, even though the same may be directly or indirectly related to its registered activity.

As Court of Tax Appeals Presiding Justice Del Rosario pointed out in his Dissenting Opinion:

> While Certification No. 2007-067 dated June 27, 2013 states that [PeopleSupport] has a site in 6780 Ayala, there is nothing therein that shows that the leasing activity conducted by [PeopleSupport] in the 6780 Ayala site is registered with PEZA and entitled to incentives. In my mind, respondent has the burden of proving by preponderant evidence that [PeopleSupport] is registered with PEZA as a facility-provider and that [PeopleSupport]'s income from the lease of its physical plant space, infrastructure[,] and other transmission facilities to respondent is entitled to the ITH incentive.
>
> Considering that respondent failed to establish that [PeopleSupport] is registered with PEZA as a facility-provider and that [PeopleSupport]'s income from the lease of physical plant space, infrastructure[,] and other transmission facilities to respondent is entitled to ITH incentive, it is my humble view that the income received

[87] *Rollo*, pp. 42–43.

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by PPI from respondent is subject to regular corporate income tax imposed under Section 27(A) of the 1997 [National Internal Revenue Code], as amended.[88]

Tax incentives partake of the nature of tax exemptions. They are a privilege to which the rule that tax exemptions must be strictly construed against the taxpayer apply.[89] One who seeks an exemption must justify it by words "too plain to be mistaken and too categorical to be misinterpreted."[90]

WHEREFORE, the Petition for Review on Certiorari is **GRANTED**. The July 15, 2013 Decision and December 18, 2013 Resolution of the Court of Tax Appeals *En Banc* in CTA EB No. 876 are **SET ASIDE**. Respondent's claim for refund is **DENIED**.

SO ORDERED.

Gesmundo, Reyes, Jr., and *Hernando, JJ.,* concur.

Peralta, J., on official business.

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[88] *Id.* at 30.

[89] *PLDT v. City of Davao,* 447 Phil. 571 (2003) [Per J. Mendoza, En Banc]; *Luzon Stevedoring Corp. v. Court of Tax Appeals,* 246 Phil. 666 (1988) [Per *J.* Paras, Second Division].

[90] *Sea-Land Service, Inc. v. Court of Appeals,* 409 Phil. 508, 513 (2001) [Per *J.* Pardo, First Division] citing *Commissioner of Internal Revenue v. P. J. Kiener Co., Ltd.,* 160 Phil. 149 (1975) [Per *J.* Martin, First Division].