SECOND DIVISION

[G.R. No. 216601, October 07, 2019]

AEGIS PEOPLESUPPORT, INC. [FORMERLY PEOPLESUPPORT (PHILIPPINES), INC.], PETITIONER, V. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

D E C I S I O N

J. REYES, JR., J.:

The Facts and The Case

The facts of this case, as found by the Court of Tax Appeals-First Division (CTA-Division) are not in dispute:

> Petitioner Aegis People Support, Inc. is a domestic corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office at PeopleSupport Center, Ayala corner Senator Gil Puyat Avenues, Makati City. It is registered with the Board of Investments (BOI) under its former name PeopleSupport (Philippines), Inc., with Certificate of Registration No. 2003-059 dated April 22, 2003 as a new and pioneer IT Export service firm in the field of Customer Contact Center. As such, it was issued a Certificate of ITH[1] Entitlement CE No. 2008-000145 issued on March 24, 2008.
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> Also, petitioner is registered with the Philippine Economic Zone Authority (PEZA), under its former name PeopleSupport (Philippines), Inc., as a new Ecozone IT (Export) Enterprise to engage in the establishment of a contact center which will provide outsourced customer care services and business process outsourcing (BPO) under Amended Registration Certificate No. 03-17-IT dated June 19, 2007. Petitioner is likewise registered with the BIR as an income taxpayer, with OCN No. 9RC0000247326 on March 9, 2000.
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> On the other hand, respondent is the duly appointed Commissioner of the Bureau of Internal Revenue (BIR) empowered to perform the duties of said office including, among others, the power to decide, approve and grant refunds or tax credits of erroneously or excessively paid taxes, as provided by law.
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> On April 15, 2008, petitioner filed with the BIR, through the electronic filing

and payment system (eFPS), its Annual Income Tax Return (ITR) for taxable year 2007, under reference No. 120800002188132. Thereafter, petitioner filed its amended Annual ITR for taxable year 2007 *via* the BIR's eFPS, under Reference No. 120800002209352 on April 29, 2008. On the same date, petitioner filed its Audited Financial Statements with the Revenue District Office (RDO) No. 47 of the BIR.

Meanwhile, on December 3, 2008, petitioner amended its Articles of Incorporation changing its name from PeopleSupport (Philippines), Inc. to Aegis PeopleSupport, Inc.

Subsequently, on April 8, 2010, petitioner filed with the BIR Revenue District Office (RDO) No. 47, an administrative claim for refund or issuance of tax credit certificate (TCC) and an Application for Tax Credits/Refunds (BIR Form No. 1914) for its excess payment of income tax for taxable year 2007 in the amount of P66,177,830.95.

Respondent's inaction on petitioner's administrative claim for refund prompted the filing of the instant Petition for Review on April 15, 2010.

Respondent posted an Answer to this petition, through registered mail, on June 7, 2010 interposing the following special and affirmative defenses:

6) Assuming but without admitting that Petitioner filed a claim for refund, the same is still subject to investigation by the Bureau of Internal Revenue;

7) Petitioner failed to demonstrate that the tax, which is the subject of this case, was erroneously or illegally collected;

8) Taxes paid and collected are presumed to be made in accordance with the laws and regulations, hence, not creditable or refundable;

9) It is incumbent upon the Petitioner to show that it has complied with the provision of Section 204(C) in relation to Section 299 of the 1997 Tax Code, as amended;

10) In an action for tax credit or refund, the burden is upon the taxpayer to prove that he is entitled thereto, and failure to discharge the said burden is fatal to the claim (*Emmanuel & Zenaida Aguilar v. Commissioner, CA-GR No. Sp. 16432, March 20, 1990 cited Aban, Law of Basic Taxation in the Philippines, 1st Edition, p. 206*);

11) Claims for refund are construed strictly against the claimant, the same partake the nature of exemption from taxation (*Commissioner of Internal Revenue v. Ledesma, 31 SCRA 95*) and as such, they are looked upon with disfavor (*Western Minolco Corp. vs. Commissioner of Internal Revenue, 124 SCRA 121*).

The issues having been joined, this case was set for pre-trial on July 9, 2010. As directed by the Court, the parties filed their Consolidated Joint Stipulation of Facts and Issues on July 26, 2010 which was approved in the Resolution dated July 28, 2010.

During trial, petitioner presented two (2) witnesses, Liana Lorenzo and ICPA Katherine Constantino, in support of its claim. On the other hand, respondent's counsel manifested during the hearing held on November 17, 2011 that he would not present any evidence, as the issues involved in the instant case are purely legal.

On January 21, 2012, petitioner submitted its Memorandum; while respondent failed to file her Memorandum per records verification dated February 1, 2012. Accordingly, the case was submitted for decision on February 3, 2012.[2]

On July 9, 2012, the CTA-Division rendered a Decision[3] denying petitioner's claim for refund or issuance of tax credit certificate for insufficiency of evidence for petitioner's failure to present evidence in support of its allegation that the activities from which the amount of foreign exchange gain arose, were attributable to activities with income tax incentive, as it failed to establish the nature of the foreign exchange contracts entered by it with Citibank from which the subject foreign exchange gains were derived.

After the CTA-Division denied its Motion for Reconsideration in a Resolution dated March 4, 2013,[4] petitioner appealed the matter before the CTA *En Banc via* a Petition for Review.

In a Decision[5] dated August 4, 2014, the CTA *En Banc* denied the petition and affirmed the Decision and Resolution of the CTA-Division. In denying the petition, the CTA *En Banc* found the foreign exchange gains realized by the petitioner to have been derived from the foreign exchange contracts entered into by it with Citibank, and not from its registered activity as a contact center nor necessarily related to it as would entitle such income to income tax holiday and therefore, subject to a tax refund. The pertinent portion of its Decision reads:

We affirm the CTA First Division's ruling in the assailed Resolution and Decision denying petitioner's Petition for Review for insufficiency of evidence. Records show that while petitioner may have shown that its earned USD as a

> contact center is being used to purchase Pesos, through its hedging contracts with Citibank, in order to pay for the ordinary and necessary expenses of petitioner's customer-support business, the fact still remains that the subject foreign exchange gains were derived from the foreign exchange contracts entered into by petitioner with Citibank and not from its registered activity as a contact center nor necessarily related to it.
>
> It should be recalled that petitioner's primary purpose as a contact center as stated in its Amended Articles of Incorporation is "to engage in the business of customer support services by providing information and database service on the Internet including web-based applications in the Philippines and providing or furnishing any and all forms or types of services, data and facilities relating to providing information on consumer products and services through the internet; and, otherwise, to carry on and conduct a general business relating to internet services."
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> Likewise, its PEZA Certification shows that it is a registered Ecozone IT (Export) Enterprise engaged in the establishment of a contact center which will provide outsourced customer care services and business process outsourcing (BPO) services.
>
> On the other hand, petitioner's hedging activity involves the sale of specified amounts of dollar to the bank on pre-determined dates and at pre-determined exchange rates.
>
> Considering petitioner's hedging activity is outside of the registered activity as a contact center, then, the income tax holiday on its registered activity may not be extended to the said foreign exchange gains.[6]

Petitioner asked the CTA *En Banc* to reconsider its Decision, but the latter denied it in a Resolution[7] dated January 7, 2015.

Undaunted, petitioner is now before this Court by way of a Petition for Review on *Certiorari*,[8] raising the following grounds:

The Issues Presented

A. THE CTA *EN BANC* ERRED IN RULING THAT PETITIONER FAILED TO PROVE BY PREPONDERANCE OF EVIDENCE THAT ITS FOREX GAINS AROSE FROM ACTIVITIES THAT ARE INTEGRAL AND RELATED TO ITS CONTACT CENTER OPERATIONS.

B. THE CTA *EN BANC* ERRED IN NOT RECOGNIZING THAT PETITIONER'S FOREX GAINS SHOULD LIKEWISE BE COVERED BY INCOME TAX HOLIDAY ON THE BASIS OF THE REGULATION BY THE PEZA AND

NUMEROUS RULINGS BY THE RESPONDENT.

C. THE CTA *EN BANC* ERRED IN UPHOLDONG THE DENIAL OF PETITIONER'S CLAIM FOR REFUND OF ERRONEOUSLY PAID INCOME TAX FOR CY 2007. [9]

The pivotal issue for the Court's determination is whether petitioner's foreign exchange gains derived from its hedging contract with the Citibank is covered by Income Tax Holiday and subject to tax refund.

The Arguments of the Parties

Petitioner insisted that it is entitled to a refund or to be issued a tax credit certificate for the tax it erroneously paid for the foreign exchange (forex) gains it realized from the hedging contract it entered into with Citibank because said gains were attributable to its PEZA-registered activity as a contact center.

It explained that it renders customer care services to the U.S. based customers of its non-resident clients as part of its PEZA-registered activities of engaging in the establishment of a contact center that provides outsourced customer care services and business process outsourcing. Since the companies for which it rendered customer support services are based abroad, the payments received by it for and in consideration of such services were denominated in US Dollars (USD). Given that petitioner is operating in the Philippines, the operating expenses it incurred to enable it to render customer support services to its foreign clients which include rental and utility charges, cost of renovation and expansion, and payroll expenses are paid in Philippine Peso (PhP). The difference in the currency of its service revenues and operating expenses necessitated it to convert its USD-denominated income from its PEZA-registered activities to PhP, otherwise petitioner will be unable to pay for the ordinary and necessary expenses incurred by it in the conduct of its customer support business. Thus, to ensure that petitioner will have sufficient supply of PhP-denominated funds to finance its business expenses, it entered into a hedging contract with Citibank where they agreed to exchange USD to PhP for Calendar Year (CY) 2007 at a pre-agreed exchange rate of PhP 49.04 to USD 1.00 (forward contract price). At the time petitioner sold USD55,000,000.00 to Citibank, the prevailing exchange rate was PhP45.61 to USD 1.00, which was lower than the forward contract price. As a result of the use by the petitioner and Citibank of an exchange rate (based on the forward contract price) that was higher than the prevailing market rate, it realized forex gains equivalent to PhP189,079,517.00, computed as follows:

	Exchange Rate	**USD Sold**	**Peso Bought**
Forward Contract Price	49.04	$55,000,000.00	Php2,697,401,000.00
Market Rate	45.61	55,000,000.00	2,508,321,483.00

	Forex Gain		**Php189,079,517.00**[10]

Since its forex gains were realized when it converted its USD-denominated service revenue to PhP in order to finance its PEZA-registered contact center activities that enjoy ITH privilege, its forex gains must likewise enjoy the same ITH privilege because it is integral and related to its PEZA-registered activities.

Petitioner asseverated that its position finds support in Revenue Regulations No. 20-2002 and PEZA Memorandum Circular No. 32-2005 whereby the language by which said issuances were couched evinces a clear intention to extend the ITH privilege not only to income derived directly from PEZA-registered activities, but also to revenues earned from transactions that are inextricably linked to these registered activities. Consistent with these issuances, the Bureau of Internal Revenue issued several rulings[11] which held that a taxpayer need not prove that its forex gains came from its PEZA-registered activity before such gains may be covered by the applicable tax incentives. Rather, the preferential tax regime is automatically extended to forex gains that arose from transactions which, although different from the PEZA-registered activities, were necessary and related to the latter. In short, for as long as the forex gains were derived from transactions undertaken to enable the entities to perform their registered activities, the fiscal incentives granted to them under the law should likewise extend to their forex gains. Thus, petitioner contended that the CTA erred when it did not uphold the express mandate of the said administrative issuances, and instead ruled that it is not entitled to a refund because only income arising directly from an enterprise's PEZA-registered activities are exempt from the payment of income tax. Petitioner added that since the issuances did not add to, subtract from, or alter the conditions for the conferment of ITH privilege under Republic Act (R.A.) No. 7916,[12] the statute they seek to implement, the CTA *En Banc* had no justifiable reason not to apply the same in resolving its claim for refund.

Moreover, petitioner contended that its right to the equal protection of the laws will be violated if its forex gains will be treated differently from the forex gains of other PEZA-registered firms that respondent has exempted from income tax in accordance with the decision of the CTA in *JP Morgan Bank, N.A. v. Commissioner of Internal Revenue*[13] and BIR Ruling No. DA-195-08.[14]

For her part, respondent Commissioner of Internal Revenue contended that the CTA-Division and *En Banc* correctly ruled that petitioner was not entitled to a tax refund or the issuance of a tax credit certificate because it failed to substantiate its claim that its forex gains were attributable to its registered activity. On the contrary, it had been established clearly that its forex gains were derived from its hedging activity — an activity without tax incentive, or an unregistered activity. Thus, subject to the normal corporate income tax. Respondent went on to state that it did not matter whether the forex gains realized from the hedging contract were used to finance the business of the petitioner. The fact remains that such gains were derived from its activities that were not registered with PEZA. Thus, the income tax holiday accorded to its registered operations cannot be extended to its forex

gains.[15]

The Ruling of the Court

The Court finds the instant petition meritorious.

At the outset, Section 4 of R.A. No. 7916 provides that enterprises located within the recognized economic or trade zones "are granted preferential tax treatment." Such incentive is further buttressed in Section 23 of the same law which provides that "[b]usiness 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 (EO) No. 226, otherwise known as the Omnibus Investment Code of 1987." In this case, the petitioner opted to avail of the benefit of an income tax holiday under Article 39 (a) of EO No. 226 which reads:

> (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 prescribed by the Board, the income tax exemption will be extended for another year in each of the following cases:
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> i. the project meets the prescribed ratio of capital equipment to number of workers set by the Board;
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> ii. utilization of indigenous raw materials at rates set by the Board;
>
> iii. the net foreign exchange savings or earnings amount to at least US$500,000.00 annually during the first three (3) years of operation.
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> The preceding paragraph notwithstanding, no registered pioneer firm may avail of this incentive for a period exceeding eight (8) years.
>
> (2) For a period of three (3) years from commercial operation, registered expanding firms shall be entitled to an exemption from income taxes levied by the National Government proportionate to their expansion under such terms and conditions as the Board may determine; Provided, however, That during the period within which this incentive is availed of by the expanding firm it shall not be entitled to additional deduction for incremental labor expense.

(3) The provision of Article 7 (14) notwithstanding, registered firms shall not be entitled to any extension of this incentive. (Emphasis supplied)

Concomitantly, the Secretary of Finance issued Revenue Regulation No. 20-2002 of which Section 1 states:

> SEC. 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 <u>not related to its registered activity/ies</u> 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. (Emphasis supplied)

The aforementioned provision means that any income earned by a PEZA-registered enterprise which is not related to its registered activities is *not* covered by the incentives granted under R.A. No. 7916 and EO No. 226.

As regards the tax treatment of gains on forex, PEZA issued Memorandum Circular No. 2005-032 which states:

> *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% 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.

At this juncture, the Court proceeds to determine whether the forex fluctuation "gains" of the petitioner under the hedging contract it entered into with Citibank is subject to the regular income tax under the NIRC.

In its rudimentary definition, a *hedge* (as *opposed* to ***speculation*** and ***arbitrage***) is an investment undertaken to reduce the risk of adverse price movements in an asset.[16] Simply put, it is a loose form of insurance against value or price fluctuations of a particular asset (such as cash in the form of foreign currency).[17] In the context of foreign currency exchanges, hedging involves contracting with a foreign currency broker to deliver or receive a specified foreign currency at a specified future date and at a specified exchange rate.[18] Here, a fully hedged transaction results in no exchange gain or loss to the company; and for a fee, *the broker assumes all the risks associated with exchange rate changes*.[19] This is because the equivalent amount or value of the foreign currency in legal tender remains to be a mere estimate until it is ***actually*** *converted* to local currency. Therefore, any occurring fluctuation in local currency value before the conversion of foreign currency does not result in the realization of any gain or loss.

Relatedly, a "true hedge" can occur only when forward sales prices are fixed and the relation between commodity purchase and later sales price is insured against both increase and decrease of commodity prices.[20] Its aim is to insure against losses resulting from unfavorable changes in price at the time of actual delivery of what hedgers have to sell or buy in their business.[21]

In the instant case, petitioner may validly enter into a hedging contract to manage its foreign currencies on-hand earned as gross revenues. The third item listed as one of its Secondary Purposes in its Amended Articles of Incorporation[22] reads:

> 3. To **invest** and **deal** with the **money** and properties of the Corporation [in] **such manner** as may from time to time be **considered wise** or expedient for the **advancement of its interest** and to sell, dispose of or transfer the business, properties and goodwill of the Corporation or any part thereof for such consideration and under such terms as it shall see fit to accept. (Emphases supplied)

Such item undoubtedly authorizes the petitioner to enter into a hedging contract with a broker such as Citibank in order to protect its gross revenues in the form of foreign currency from being severely devalued in terms of local currency. Consequently, the Court considers hedging to be very much related to its registered activities and, hence, still subject to a preferential tax treatment under R.A. No. 7916 and EO No. 226.

WHEREFORE, premises considered, the petition is **GRANTED**. The assailed August 4, 2014 Decision and the January 7, 2015 Resolution of the Court of Tax Appeals-*En Banc* in CTA EB Case No. 996 are **REVERSED and SET ASIDE**. The respondent is ordered to refund or issue a Tax Credit Certificate in the amount of P66,177,930.95 in favor of the

petitioner representing the erroneous income tax it paid for the calendar year 2007.

SO ORDERED.

Carpio (Chairperson), Caguioa, Lazaro-Javier, and *Zalameda, JJ.*, concur.

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[1] Income Tax Holiday.

[2] CTA *En Banc rollo*, pp. 42-46.

[3] Penned by Associate Justice Erlinda P. Uy, with Presiding Justice Ernesto D. Acosta and Associate Justice Esperanza Fabon-Victorino, concurring; id. at 42-67.

[4] Id. at 69-77.

[5] Penned by Associate Justice Caesar A. Casanova, with Presiding Justice Roman G. Del Rosario and Associate Justices Juanito C. Castañeda, Jr., Lovell R. Bautista, Erlinda P. Uy, Esperanza R. Fabon-Victorino, Cielito N Mindaro-Grulla, Amelia R. Cotangco-Manalastas, and Ma. Belen M. Ringpis-Liban, concurring; *rollo*, pp. 111-124.

[6] Id. at 116-117.

[7] Id. at 128-133.

[8] Id. at 52-94.

[9] Id. at 61.

[10] Id. at 65.

[11] Id. at 69-74, referring to BIR Ruling Nos. DA-195-08, DA-375-08, DA-(IL-011) 107-08, DA-(C-295) 723-09, and DA-(IL 009) 089-10.

[12] THE SPECIAL ECONOMIC ZONE ACT OF 1995.

[13] Docketed as CTA Case No, 7962. On appeal to the CTA *En Banc*, the case was docketed as C.T.A. EB No. 876 and entitled *Commissioner of Internal Revenue v. JOP Morgan Chase Bank, N.A*.

[14] *Rollo*, pp. 52-94, 175-200.

[15] Id. at 147-159.

[16] https://www.investopedia.com/terms/h/hedge.asp (last visited: July 1, 2019).

[17] See: *Day v. United States*, 734 F.2d 375 (1984).

[18] Stice et al., *Intermediate Accounting*, 17th Ed. (2010), p. 503.

[19] Id.

[20] *Corn Products Refining Co. v Commissioner of Internal Revenue*, 215 F.2d 513 (1954).

[21] See: *United States v. New York Coffee and Sugar Exchange, Inc*., 263 U.S. 611 (1924).

[22] Court of Tax Appeals-First Division records, p. 28.
