

ACQUIRING IN THE PHILIPPINES*

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"We believe that the Philippine economy is in its strongest position in the past decade and that conditions are now firmly in place for achieving sustainable growth."

The Philippines: Economic Recovery Underway
Salomon Brothers
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In the Philippines, optimism is high that sustainable growth lies ahead. This is basically due to the government's coordinated liberalization and rationalization of micro and macro economic policies. The following economic policies and reforms have brought about a liberalized economic and financial environment in the Philippines that make it attractive to both local and foreign investors:

1. *Foreign Investment Act of 1991* - This law simplified the entry procedures for foreign investments and allowed greater participation (up to 100 percent) in business enterprises except in very limited areas.

2. *Foreign Exchange Liberalization* - This resulted in the lifting of 40-year old restrictions on virtually all foreign exchange transactions. Foreign investments including profits and dividends can now be immediately and fully repatriated. Foreign currency can be freely brought into the country. Foreign exchange receipts

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of Philippine residents need not be surrendered or sold to the banking system for Pesos. Foreign exchange can be fully sold and purchased outside the banking system.

3. *Import and Export Liberalization* - The importation of most commodities has been deregulated. The tariff structure has also been simplified to reduce protection of locally made commodities. Under the ASEAN Free Trade Agreement (AFTA), tariff rates will be gradually reduced until they reach the 0 percent to 5 percent level. Only a few local industries -- specifically infant industries that produce intermediate goods needed by the economy -- will enjoying protective tariffs.¹

The export of commodities that generate foreign exchange earnings for the country is supported and encouraged. Export receipts of exporters are not required to be surrendered or sold to the banking system for Pesos. The government has also simplified export procedures and removed the inspection, commodity clearance, and export clearance requirements previously imposed.²

4. *Promotion of Investment Guaranties and Incentives* -- All branches of the Executive Department are coordinating their efforts to attract foreign investments. Greater incentives have been made available for activities favored by the government such as Build-Operate-Transfer (BOT) projects and their variants, and the mining industry. Foreign investors enjoy basic guaranties for their investments and a number of incentives from the Board of Investments (BOI), export processing zones and economic zones are available. These guaranties and incentives are outlined in the materials which form part of this paper.

5. *Privatization of Government-Owned and Controlled Corporations.*

¹THE PHILIPPINES: YOUR COMPETITIVE EDGE, at 7.

²*Id.*

6. *Membership of the Philippines in the Multilateral Investment Guaranties Agency (MIGA).*

7. *Extension of Land Lease Period* - A new law which allows leases for 50 years renewable for 25 years provides foreign investors, who are disqualified from acquiring lands in the Philippines, a certain degree of security of tenure.

It is with some bases that both the government and the private sector are saying that now is a good time to invest in the Philippines. This is essentially as a result of the following developments:

a. Sustained economic growth has started, as evidenced by a rising GNP.

b. The energy problem which hampered trade and investments in 1993 is under control; regular power supply is secured with the completion of a number of fast-track power projects and the construction of new base-load projects.

c. Both domestic and export markets are growing.

d. Reconciliation and peace initiatives with dissidents, insurgents and separatists have substantially succeeded. The resulting political stability has enabled the government and the people to focus on reforming the economy.

e. The government is vigorously pursuing the development of infrastructure support to production areas, including identified regional industrial centers, tourism development sites and agro-industrial areas.

f. The economy has been opened up and the most recent reforms allow the wider participation of foreign investment in nearly every aspect of the economy.³

In addition to the foregoing developments, the following factors are recognized as providing additional advantages for investing in the Philippines:

³See PHILIPPINE GUIDE FOR EUROPEAN BUSINESS, at 16.

1. *Strategic location.* The Philippine archipelago is located at the southern rim of the Asia mainland. It lies at the crossroads of eastern and western business, trade, and culture.

2. *Highly educated professionals and workers.* Filipinos are among the best educated and most easily trainable people in Asia. The Philippines is the third largest English-speaking nation in the world.

3. *A democratic government.* The country has a long history of democratic tradition.

4. *Growing market.* The country, with over 60 million population, offers a large and profitable consumer market.

5. *Rich natural resources.* The country has rich natural resources and the government is giving all its support towards the promotion and development of the mining industry.

6. *Well developed legal system.* The legal system is well developed and is a mixed common and civil law system. Both European and Western investors will be familiar with the system.

FOREIGN INVESTMENTS:

GENERAL ISSUES AND REGULATIONS

A. *Governing Laws*

A foreign company may do business in the Philippines subject to the provisions of the Corporation Code [Batas Pambansa Blg. 68 (1980)], the Omnibus Investments Code [Executive Order No. 226 (1987)] (*hereinafter*, the Investments Code), and the Foreign Investments Act [Republic Act No. 7042 (1991)] (*hereinafter*, the FIA). However, the particular business in which the company intends to engage may call for the application of other laws. Banks, for example, are also governed by the General

Banking Act [Republic Act No. 337 (1948)], while insurance companies are regulated under the Insurance Code [Presidential Decree No. 612 (1976)].

B. *Meaning of Doing Business*

The term *doing business* has been given a technical meaning by law, and generally refers to all "acts that imply a continuity of commercial dealings or arrangements, and contemplates to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of, commercial gain or the purpose and object of the business organization."⁴ It includes soliciting orders or service contracts, opening offices, appointing representatives or distributors domiciled in the Philippines or who in any calendar year stay in the country for periods that total at least 180 days, or participating in the management, supervision or control of any domestic company in the Philippines.⁵ However, it does not include the mere investment by a foreign company as a shareholder in a domestic company, the exercise of rights as such shareholder or having a nominee director to represent its interests in such corporation.

C. *Allowable Foreign Investments*

The FIA took effect on June 30, 1991, and came into implementation in November of the same year. It was intended to attract foreign investments in enterprises that expand employment opportunities, enhance the economic value of agricultural products, promote the welfare of the consumer and expand the quality and volume of export products.⁶

The FIA clarified that, as a general rule, export and domestic market enterprises are open to foreign investment to the

⁴FIA, sec. 3 (d).

⁵*Id.*

⁶FIA, sec. 2, par. 1.

full extent of their equity.⁷ Before the promulgation of the FIA, the Investments Code required prior BOI approval before an entity which is not a Philippine national⁸ may do business in the Philippines (or, for that matter, for any foreign investment in excess of forty percent of the outstanding capital stock of a domestic enterprise. The FIA removes this requirement and permits non-Philippine nationals not intending to avail of incentives⁹ to do business in the Philippines or to invest in up to 100 percent of the capital of an export or domestic market enterprise. However, foreign investments are still prohibited or limited in areas reserved to Philippine nationals by the Constitution, special laws and the provisions of the FIA. For example, the exploration, development and utilization of natural resources are activities reserved to corporations at least 60 percent of the capital of which is owned by Filipino citizens, except for large scale projects under a financial or technical assistance agreement with the government where 100 percent foreign equity is allowed.

1. Export enterprises

The FIA, under Sec. 3 (e), defines an export enterprise as an enterprise wherein a manufacturer, processor or service enterprise exports 60 percent or more of its output, or wherein a trader purchases products domestically and exports 60 percent or more of such purchases. Foreign investments in export enterprises are allowed up to 100 percent of the equity of the enterprise, provided that its products and services do not fall under the Negative

⁷Id, par. 2.

⁸The INVESTMENTS CODE defines a *Philippine national*, as (i) a Philippine citizen; or (ii) a domestic partnership or association wholly-owned by Philippine citizens; or (iii) a corporation organized under the laws of the Philippines of which at least sixty percent of the capital stock outstanding and entitled to vote is owned and held by Philippine citizens; or (iv) a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least sixty percent of the fund will accrue to the benefit of Philippine nationals. This definition has been preserved in the FIA. See sec. 3(a).

⁹Incentives are offered under the INVESTMENTS CODE.

Lists.¹⁰ An export enterprise that is not a Philippine national must be registered with the BOI, to which it must render periodic reports to ensure compliance with its export ratio requirements.

2. Domestic market enterprises

A domestic market enterprise is an enterprise that produces goods for sale or renders services to the domestic market entirely or, if exporting a portion of its output, fails to consistently export at least 60 percent thereof.¹¹ Foreign investments in domestic market enterprises are allowed up to 100 percent of its capital, unless these investments are prohibited or limited under the Negative Lists.¹²

A domestic market enterprise may change its status to an export enterprise if it consistently exports at least 60 percent of its production over a three-year period.

D. Foreign Investments Restrictions

The areas of economic activity where foreign investments are prohibited or restricted are defined in the FIA's Negative Lists.

1. Negative Lists

The FIA contemplates two Negative Lists: (1) the transitory Negative List already provided under sec. 15 of the FIA, which

¹⁰The concept of Negative Lists is discussed in detail below, under Section 7, par. 2 of the FIA. For this purpose, the enterprise must apply with the Securities and Exchange Commission (SEC) for registration as an export enterprise, following the regular procedures provided for original registration by a company as an export enterprise under the Rules and Regulations Implementing the FIA (*hereinafter*, the Rules), Rule VII, sec. 2, par. 2. The application must be supported by copies of reports showing compliance by the applicant enterprise with the export ratio requirements for export enterprises, under Rule VII, sec. 2, par. 2, in relation to Rule VI, sec. 3.

¹¹*Id.*, sec. 3(f).

¹²*Id.*, sec. 7, par. 1.

applied during the three-year period after the effectivity of the Rules, and (2) the regular Negative List to be formulated by the National Economic Development Authority (NEDA), to take effect upon the expiration of the three-year transitory period. The First Regular Negative List is now in effect.¹³

Each Negative List consists of three separate lists. List A enumerates the areas of activity reserved to Philippine nationals by the Constitution or special laws.

Under the First Regular Negative List, the activities that fall under List A, and the allowable extent of foreign investments therein, are:

- a. No foreign equity -
 - (i) Mass media;¹⁴
 - (ii) Services involving the practice of a licensed profession;¹⁵
 - (iii) Retail trade;¹⁶
 - (iv) Cooperatives;¹⁷
 - (v) Private security agencies;¹⁸
 - (vi) Small scale mining;¹⁹

¹³See EXEC. ORDER (EO) No. 182, sec.4, as amended by EO No. 269.

¹⁴Constitution (Const.) Art. XVI, sec. 11 (1), par. 1.

¹⁵*Id.*, Art. XII, sec. 14, *par.* 2, including engineering, medical and allied professions, accountancy, architecture, criminology, chemistry, customs brokerage, forestry, geology, marine deck officership, marine engine officership, master plumbing, sugar technology, social work, library science and law..

¹⁶REP. ACT NO. 1180 (1954).

¹⁷REP. ACT NO. 6938 (1990).

¹⁸REP. ACT NO. 5847 (1969), as amended.

¹⁹REP. ACT NO. 7076 (1991).

(vii) Utilization of marine resources (except deep sea fishing);²⁰

(viii) Rice and corn industry, except as may be authorized by the National Food Authority.²¹

b. Twenty-five percent foreign equity -

(i) Private recruitment, whether for local or overseas employment;²²

(ii) Contracts for the construction and repair of locally-funded works, except (y) infrastructure/ development projects covered in Rep. Act No. 7718, also known as the Expanded BOT Law; and (z) projects which are foreign funded or assisted and required to undergo international competitive bidding.²³

c. Thirty percent foreign equity - Advertising.²⁴

d. Forty percent foreign equity -

(i) Exploration, development and utilization of natural resources;²⁵

(ii) Ownership of private lands;²⁶

(iii) Operation and management of public utilities;²⁷

(iv) Ownership and administration of educational institutions;²⁸

²⁰CONST., Art. XII, sec. 2.

²¹REP. ACT NO. 3018 (1960), as amended.

²²LABOR CODE, Art. 27.

²³Commonwealth Act (COM. ACT) No. 541 (7940), as amended BY PRES. DECREE NO. 1594; Letter of Instruction No. 630, REP. ACT NO. 7718.

²⁴CONST. art. XVI, sec. 11(2).

²⁵*Id.*, Art. XII, sec. 2, par. 1. Except in the context of a financial and/or technical assistance agreement for large-scale exploration, development and utilization of minerals.

²⁶*Id.*, Art. XII, sec. 7.

²⁷*Id.*, Art. XII, sec. 11.

²⁸*Id.*, Art. XIV, sec. 4(2).

(v) Financing companies;²⁹

(vi) Construction:

(a) Contracts for the supply of materials, goods and commodities to government-owned or controlled corporations and government agencies;³⁰

(b) Private domestic and overseas construction contracts;³¹

(c) Contracts for the construction of defense-related structure;³²

(vii) Project proponent and facility operator of BOT project requiring a public utility franchise.³³

List B reserves four areas of economic activity to Philippine nationals:

a. Defense-related activities requiring prior clearance from the Department of National Defense, unless such activity has a substantial export component and is specifically authorized by the Secretary of National Defense.³⁴ These include the manufacture, repair, storage and distribution of firearms, ammunition, military ordnance, explosives, pyrotechnics and similar materials.

b. Activities which have implications on public health and morals, such as the manufacture and distribution of dangerous drugs, gambling and the operation of nightclubs, bars, dancehalls, saunas and massage clinics.³⁵

c. Small and medium-scale domestic market enterprises with a paid-in capital of less than the equivalent of US\$500,000,

²⁹REP. ACT NO. 5980 (1969).

³⁰REP. ACT NO. 5183 (1967).

³¹REP. ACT NO. 4566 (1965).

³²COM. ACT NO. 541.

³³CONST., Art. XII, sec. 11; Rep. Act No. 7718.

³⁴FIA, sec. 8(b)(1).

³⁵*Id.*, sec. 8(b)(2).

unless these involve advanced technology as determined by the Department of Science and Technology.³⁶

d. Export enterprises which use depleting natural resources as raw materials with paid-in capital of less than the equivalent of US\$500,000.³⁷

List C enumerates investment areas which are already adequately exploited and do not require further foreign investments. The FIA provided for a transitory Negative List C naming three activities that were reserved to Philippine nationals.³⁸ Executive Order No. 182 issued by the President on June 22, 1994, and which took effect on October 24, 1994, limited the Negative Lists only to Lists A and B found in the FIA. No investment area or activity was listed in List C since no petition for inclusion was submitted to NEDA. Hence, the areas previously included in the transitory Negative List C are no longer reserved to Philippine nationals. Any amendment to the list shall only be made once a year.

2. Strategic Industries

Section 10 of the FIA also directs the NEDA to formulate a list of industries that are strategic to the development of the economy. The list shall specify, as a matter of policy and not as a

³⁶*Id.*, sec. 8(b), par. 2.

³⁷*Id.*

³⁸The activities under the transitory Negative List C under the FIA were:

a. Import and wholesale activities not integrated with the production or manufacture of goods.

b. Services requiring a license and subject to regulation by government agencies other than the BOI and the SEC which, at the time that the FIA took effect, are restricted to Philippine nationals by administrative rules and regulations. Under the Rules, travel agencies, tourist lodging services and insurance agencies are included under this enumeration.

c. Enterprises owned in the majority by a foreign licensor for the assembly, processing or manufacture of goods for the domestic market which are being produced by a Philippine national as of the date that the FIA took effect under a technology license duly registered with the Central Bank (now known as the *Bangko Sentral ng Pilipinas*) or the Technology Transfer Board.

legal requirement, the desired equity participation of the government or of Philippine investors in each such industry. This list is subject to amendments to reflect changes in the economic needs and policy directions of the government. The NEDA shall use the following criteria to determine the industries that may be included in the list:

- a. The industry is crucial to the accelerated industrialization of the country;
- b. It requires massive capital investments to achieve economies of scale for efficient operations;
- c. It requires highly specialized or advanced technology which necessitates transfer and proven production techniques in operations;
- d. It is characterized by strong backward and forward linkages with most industries existing in the country; and
- e. The industry generates substantial foreign exchange savings through import substitution and collateral foreign exchange earnings through export of part of the output that will result with the establishment, expansion or development of the industry.³⁹

ESTABLISHING A PRESENCE IN THE PHILIPPINES

In general, there are four ways by which a foreign company may establish a presence in the Philippines. It may set up a branch office, a domestic subsidiary, a representative office or a regional headquarters. If the foreign entity wishes only to undertake general promotion, coordination or liaison functions and does not intend to engage in income-producing activity in the Philippines, it may opt to establish a representative office or a regional headquarters. If the foreign entity wishes to actually conduct business in the Philippines, it should organize either a local branch or a domestic subsidiary.

³⁹FIA, sec. 10, par. 2.

In some instances, foreign investors chose to establish a partnership to avail of certain tax advantages in their home countries. It is also possible to do business as a sole proprietorship.

Since the most common modes of establishing a presence in the Philippines are through the establishment of a branch or a subsidiary, the following discussion will be limited to such modes of establishing business presence.

Both the establishment of a branch or a domestic subsidiary requires registration with the Securities and Exchange Commission (SEC).

A. Opening a Branch office

Previously, a foreign company intending to do business in the Philippines was required to obtain BOI approval for the purpose. The FIA now requires registration with the SEC only. It should be noted, however, that if the intended business activity is covered by Negative List A (for example, exploitation, development and utilization of natural resources except in the context of a financial and/or technical assistance agreement), a Philippine branch may not be set up to engage in that activity.

The application must be accompanied by the following:

1. A certificate duly executed under oath by the authorized official or officials of the jurisdiction of incorporation of the applicant, attesting that Filipino citizens and enterprises are accorded substantially similar rights to do business in the foreign country and that the applicant is an existing corporation in good standing;⁴⁰ and.

2. A statement under oath of the president or other person authorized by the applicant, showing to the satisfaction of the SEC (and other governmental agency in a proper case) that the applicant is solvent and in sound financial condition, and setting

⁴⁰CORP. CODE, sec. 125, par. 2

forth the assets and liabilities of the applicant as of the date not exceeding one year immediately prior to the filing of the application.⁴¹

The SEC is directed to issue the license or otherwise effect the registration of the applicant within 15 working days upon submission of complete supporting documents.

Upon the issuance of the license, the foreign corporation may commence to transact its business in the Philippines and continue to do so for as long as it retains its authority to act as a corporation under the laws of the country of its incorporation, unless such license is revoked, surrendered, suspended or annulled. The foreign corporation's right to continue transacting business in the Philippines is also conditioned on the following additional requirements:

1. Within 60 days after the issuance of the license, the company shall deposit with the SEC for the benefit of present and future creditors of the company in the Philippines, securities with an actual market value of at least P100,000;⁴²

2. Within 6 months after each fiscal year of the company, the SEC shall require the company to deposit additional securities equivalent in actual market value to two percent of the amount by which the company's gross income for the fiscal year exceeds P5,000,000;⁴³

3. Within 60 days after the coming into effect of any amendment to its articles of incorporation or by-laws, it is required to file with the SEC a duly authenticated copy of the articles of incorporation or by-laws, as amended, indicating these amendments;⁴⁴

4. The foreign company shall obtain an amended license from the SEC in the event it changes its corporate name or desires to pursue in the Philippines other or additional corporate

⁴¹*Id.*, sec. 125, par. 3.

⁴²CORP. CODE, sec. 126, par. 2.

⁴³*Id.*

⁴⁴*Id.*, sec. 130.

purposes, by submitting an application therefor to the SEC, favorably indorsed by the pertinent government agency in the proper cases;⁴⁵ and

5. Whenever the foreign company becomes a party to any merger or consolidation, it shall, within 60 days after such merger or consolidation becomes effective, file with the SEC a copy of the duly authenticated articles of merger or consolidation. However, if the company is the absorbed corporation, it shall, at the same time, file a petition for withdrawal of its license.⁴⁶

The SEC will also require the foreign company to deposit additional securities if the actual market value of the securities on deposit has decreased by at least ten percent of their actual market value at the time they were deposited. On the other hand, the SEC may release part of the additional securities deposited with it if the gross income of the company has decreased, or if the actual market value of the securities on deposit has increased by more than ten percent of the actual market value of the securities at the time they were deposited. The SEC may allow the company to substitute other securities or those already on deposit as long as the company is solvent. The company shall be entitled to collect the interest or dividends on the securities deposited. After it has ceased to transact any business in the Philippines, these securities shall be returned to the company upon its application and submission of proof that it does not have any liabilities to Philippine residents, including the government of the Philippines.⁴⁷

B. Incorporation of Philippine Subsidiary

Prior to the enactment of the FIA, the incorporation of a Philippine subsidiary in which foreign equity participation exceeded 40 percent of the outstanding capital stock required prior BOI approval. At present, registration with the BOI is required only if the corporation intends to avail of investment incentives.

⁴⁵*Id.*, sec. 131.

⁴⁶*Id.*, sec. 132, par. 1.

⁴⁷*Id.*, sec. 126, par. 2.

1. Legal Requirements

Under the Corporation Code, the following are, in general, the legal requirements which must be observed in the organization of a Philippine corporation:

a. There must be at least five, but not more than fifteen incorporators, all of whom must be natural persons and a majority of whom must be residents of the Philippines. Each incorporator must be an owner of at least one share of the capital stock of the corporation.⁴⁸ Corporations, being juridical persons, may not be incorporators, but may be subscribers, under Philippine law.

b. The incorporators must file articles of incorporation containing the matters generally set out under Section 14, and in the form prescribed under Section 15, of the Corporation Code, duly acknowledged before a notary public, if executed in the Philippines, or before a Philippine consular official, if executed abroad.⁴⁹

c. The articles of incorporation must be accompanied by an affidavit of the person designated to act as treasurer of the company prior to the company's registration (the treasurer-in-trust) certifying that at least 25 percent of the authorized capital stock of the corporation has been subscribed, and that at least 25 percent of the total subscription has been paid in cash or equivalent property at fair valuation. The paid-up capital cannot be less than P5,000.⁵⁰

2. Other Requirements

a. *Subscribers* - Where there are corporate or non-resident subscribers, the SEC requires, as a matter of policy, full payment of their subscriptions, unless certain supporting documents are submitted by the subscriber to show subscriber's ability to pay.

⁴⁸CORP. CODE, sec. 10.

⁴⁹*Id.*, sec. 14.

⁵⁰*Id.*, secs. 13, 15.

b. *Incorporators* - In general, all of the incorporators may be aliens, provided only that a majority of them are residents (not necessarily citizens) of the Philippines.⁵¹

c. *Directors* - Every director must own in his own right at least one share of the capital stock of the corporation of which he is a director, which stock shall stand in his own name on the books of the corporation.⁵² Thus, except for one qualifying share in the name of each director to be elected, all the shares of stock of the Philippine subsidiary may be held by the foreign corporation.

The Corporation Code also requires that a majority of the directors be residents of the Philippines.⁵³ In practice, this requirement is satisfied by appointing the Philippine lawyers of the foreign investors to act as directors if the foreign Investor does not have sufficient representatives that are residing in the Philippines.

d. *Shares of Stock* - Shares of a Philippine corporation may be divided into such classes, with such rights, voting powers, preferences and restrictions as may be provided in the articles of incorporation; provided that, except as otherwise provided in the articles of incorporation and stated in the certificate of stock, each share shall in all respects be equal to every other share.⁵⁴ Subject to certain exceptions and restrictions, any and all the shares may or may not have a par value.

The Corporation Code permits the issuance of shares not only for cash but also for property received by the corporation at a fair valuation equal to the par or issued value of the stock.

e. *Corporate Officers* - The president must be a director and the secretary both a citizen and resident of the Philippines.⁵⁵ The

⁵¹CORP. CODE, sec. 10.

⁵²*Id.*, sec. 23, par. 2

⁵³*Id.*

⁵⁴*Id.*, sec. 6.

⁵⁵*Id.*, sec. 25, par. 1.

Corporation Code does not impose any residency requirement on the treasurer. However, the Corporate and Legal Department of the SEC has opined that a treasurer must be a resident, considering the nature of his functions. Indeed, it may be preferable that for the treasurer (who may or may not be a director) to be a resident of the Philippines in order to have the required flexibility in the use of corporate funds and in the opening and operation of the company's local bank accounts.

3. Action by the SEC

The SEC is required to effect registration of the enterprise applying under the FIA within 15 working days after the submission of the complete requirements.⁵⁶ In case the application is disapproved, the SEC is also required to inform the applicant in writing of the reasons for the disapproval of the registration.⁵⁷

C. Branch or Subsidiary Corporation: A Comparison

There are certain accepted views as to the relative advantages and disadvantages of organizing a branch office vis-a-vis a subsidiary corporation.

1. Filing Fees and Coats

To open a branch office, basic filing fees in the amount of one percent of the actual inward remittance of the branch converted into Philippine Pesos (but in no case less than P1,000) must be paid to the SEC at the time that the application is filed.

In the case of a wholly-owned subsidiary, the SEC assesses basic fees in an amount equal to 1/10 of one percent of the authorized capital stock plus 20 percent but not less than P500,

⁵⁶ FIA, sec. 5.

⁵⁷ RULES, Rule IV, sec. 3(d).

upon the filing of the articles of incorporation. An additional P200 is collected upon the filing of the corporation's by-laws.

On the assumption that the minimum assigned or paid-in capital of the branch or subsidiary cannot be less than US\$500,000, the basic filing fees due in case the investor wishes to open a branch office is the peso equivalent of US\$5,000, and, if he wishes to incorporate a subsidiary, the peso equivalent of US\$600.

2. Facility of Registration and Incorporation

It will frequently take a comparatively shorter period to draw up incorporation papers for a domestic subsidiary and to obtain a certificate of incorporation from the SEC than for a foreign corporation to open a branch office and obtain a license to transact business in the Philippines. The longer period necessary to obtain a license to do business in the Philippines for a branch is attributable to the requirement that all documents supporting the application for a license must be acknowledged before a notary public or other officer authorized to take acknowledgments and authenticated before Philippine consular officers in the place of their execution.

3. Flexibility of Operations

The internal affairs of a foreign corporation licensed to do business in the Philippines are governed by the law of the country of its creation. Therefore, operations through a branch office would make compliance with many of the provisions of the Corporation Code (which are applicable to domestic subsidiaries) unnecessary. Moreover, the operation through a branch office makes it possible for corporate meetings to be held, and corporate records (except those directly pertaining to the branch) to be retained at the principal office of the corporation.

4. Applicability of Local Laws

All of the assets of a branch office (including that of the head office) may be exposed to claims and judgments obtained against it in the Philippines. The limitation of exposure of the assets of a subsidiary, which is considered a separate entity from its parent, tends to argue for the use of a subsidiary.

5. Taxability of Income, Dividends and Profits

In respect of income taxation, both a branch and a subsidiary are subject to the same rates of corporate income taxes, that is, 35 percent of net income.⁵⁸ Branch profits remitted to head office are subject to a 15 percent tax rate,⁵⁹ as are dividends paid by a subsidiary to a foreign corporate stockholder, provided a tax sparing credit is available in the country of domicile of the recipient stockholder.⁶⁰ The difference in tax treatment between a branch and a subsidiary is that the tax rate of 35 percent is applied, in respect of a branch (which is considered a resident corporation) on its net income from all sources within the Philippines; while in respect of a subsidiary, on the net income from all sources within and without the Philippines.⁶¹

6. Items of Deduction

A local subsidiary of a foreign corporation, being a domestic corporation, is entitled to claim all business deductions allowable under the National Internal Revenue Code. On the other hand, a Philippine branch of a foreign corporation may deduct only such items as are specifically allowable or directly related to its Philippine income.

⁵⁸ NATIONAL INTERNAL REVENUE CODE, secs. 24(a), 25(a), 28.

⁵⁹ *Id.*, sec. 25(a)(5),

⁶⁰ *Id.*, sec. 25(b)(5)(2).

⁶¹ *Id.*, secs. 25(a), 24(a).

7. Applicability of Tax Credits

If a domestic corporation which is a subsidiary of a foreign corporation engaged in business outside the Philippines is taxed by a foreign country on its income earned outside the Philippines, such foreign income tax may be treated, subject to certain limitations, as a credit against its Philippine income tax.⁶² On the other hand, a foreign corporation is not entitled to claim credit for the taxes imposed by or paid to a foreign country to offset its Philippine income tax liability.⁶³ Where the local subsidiary to be set up in the Philippines is designed to conduct business activities not only in the Philippines but in other neighboring countries as well, the availability of foreign tax credit with respect to its Philippine income tax may be of some significance.

REQUIREMENTS UNDER ENVIRONMENTAL LAW

An entity doing business in the Philippines must comply with the requirements of applicable environmental laws of the Philippines. These laws seek to attain a balance between socio-economic growth and environmental conservation and protection.⁶⁴

The Department of Environment and Natural Resources (DENR) is the government agency primarily responsible for implementing the environmental policy of the state, and for carrying out the state's constitutional mandate to control and supervise the exploration, development, utilization and conservation of the country's natural resources.⁶⁵ As regards environmental management, conservation and pollution control, the DENR mainly acts through its Environmental Management Bureau (EMB), which absorbed and integrated the functions of the National Environmental Protection Council, the National Pollution

⁶² *Id.*, sec. 29(c)(3)(A).

⁶³ *Id.*, sec. 29(c)(3)(C).

⁶⁴ PRES. DECREE NO. 1586, sec. 1.

⁶⁵ EXEC. ORDER NO. 292, Title XIV, Ch. 1, sec. 1.

Control Commission,⁶⁶ and the Environmental Center of the Philippines.⁶⁷

A. Environmental Compliance Certificate

1. The EIS System

Presidential Decree No. 1586 (1978), titled as Establishing an Environmental Impact Statement System Including Other Environment Management Related Measures and for Other Purposes," established the Environmental Impact Statement (EIS) System, which classified projects and areas into those which are critical to the environment (*i.e.*, those which have high potential for negative impact to the environment) and those which are not.

Any person, including a corporation, is prohibited from undertaking or operating any environmentally critical project (ECP) or environmentally critical area (ECA) without first securing an Environmental Compliance Certificate (ECC) from the DENR.⁶⁸ An ECC is a certification that the proposed project will not bring about an unacceptable environmental impact and that the proponent has complied with the requirements of the EIS System.⁶⁹

Before the DENR issues an ECC to a proponent of an ECP, the project proponent must first submit 15 legible copies of an Environmental Impact Statement (EIS)⁷⁰ to the Environmental Management Bureau. On the other hand, a project proponent

⁶⁶ This does not include the adjudication of pollution cases, which power was assumed by the Pollution Adjudication Board. (EO No. 292, Title XIV, Ch. 1, sec. 13.)

⁶⁷ *Id.*, sec. 17.

⁶⁸ PRES. DECREE NO. 1586, sec. 4.

⁶⁹ DENR Administrative Order No. 21, art. 1, sec. 3.1.3.1(f).

⁷⁰ An EIS is a study on the environmental impact of a project. [DENR Administrative Order No. 22, art. 1, sec. 3.1.3.1(e)]. It identifies and predicts the changes in the environment associated with a proposed project, and examines the impact on the environment of the alternative methods of obtaining the objectives of the proposal. [Rep. Act No. 7942 (The Philippine Mining Act of 1995), sec. 4(u).]

locating in an ECA must first submit a Project Description (PD)⁷¹ to the DENR Regional offices before an ECC may be issued to it. The latter may also be required to submit an EIS, if deemed necessary.⁷²

The DENR may hold public hearings, in the case of environmentally critical projects, before it issues an ECC.⁷³

All ECPs shall be subjected to periodic compliance monitoring by the EMB, and all other projects, by the DENR Regional Offices.

2. List of ECP and ECA

Proclamation No. 2146 (1981) enumerated the areas and projects which are environmentally critical and within the scope of the EIS System established under Pres. Decree No. 1586.

Among those projects declared environmentally critical are major mining and quarry projects.

On the other hand, among those declared environmental critical areas are those which:

- a. constitute habitat for any endangered species of Philippine wildlife;
- b. are of unique, historic, archaeological or scientific interests;

⁷¹ A Project Description is a document substantially describing the proposed project, particularly those aspects which will likely cause environmental impact. [Rep. Act No. 7942, sec. 3.1.3.1(n)] Annotated outlines of the EIS and the Project Description may be obtained from the EMB.

⁷² *Id.*, Art. 2, sec. 2. All other projects, undertakings and areas not declared environmentally critical shall not be required to submit an EIS. However, its proponents may be required to provide environmental safeguards as necessary. [Pres. Decree No. 1586, sec. 5.]

⁷³ *Id.*, sec. 2.

- c. are traditionally occupied by cultural communities;
- d. are frequently visited by natural calamities; and
- e. have critical slopes.

B. Other Requirements

Other laws enumerate additional requirements in order to attain environmental conservation and protection. Among these are:

1. *Pres. Decree No. 705 (1975)*:⁷⁴ This prohibits the location, prospecting, exploration, utilization or exploitation of mineral resources inside forest concessions, unless proper notice has been served upon its licensees and the prior approval of the Director of the Bureau of Forestry is secured.⁷⁵

It further requires mine tailings and other pollutants to be filtered in silt traps or other filtration devices.

2. *Pres. Decree No. 1067*:⁷⁶ This prohibits any person, including a private corporation, from appropriating and using water without a water permit.⁷⁷ Appropriation of water without a water permit is punishable by a fine not exceeding P3,000.00 and/or imprisonment of not more than three years.

All water permits granted shall be subject to conditions of beneficial use,⁷⁸ adequate standards of design and construction, and other terms and conditions.⁷⁹

3. *Pres. Decree No. 984 (1976)*: This requires that a prior permit for the discharge of industrial wastes and other wastes which would cause pollution be secured by, among others,

⁷⁴ REVISED FORESTRY CODE OF THE PHILIPPINES.

⁷⁵ *Id.*, sec. 47.

⁷⁶ WATER CODE OF THE PHILIPPINES (1976).

⁷⁷ *Id.*, art. 13.

⁷⁸ Beneficial use of water is the utilization of water in the right amount during the period that the water is needed for producing benefits for which the water is appropriated. (*Id.*, Arts. 20 and 30.)

⁷⁹ *Id.*, Art. 18.

persons who would (i) increase the volume or strength of wastes in excess of the permissive discharge specified under any existing permit; or (ii) construct, install or operate any industrial or commercial establishment, or any extension, addition, or modification, which would increase the discharge of waste directly into the water, air, and land resources, or would otherwise alter their physical, chemical, or biological properties in any manner not lawfully authorized. Violation of this requirement may be punished with a fine not exceeding P1,000.00 for every day the violation continues and/or imprisonment from two to six years, in addition to the payment of damages for aquatic life destroyed.⁸⁰

4. *DENR Administrative Order No. 26 (1991)*: This requires industrial, commercial, and manufacturing establishments, whose activities are potential and actual sources of water, air, and land pollution, to appoint and designate a Pollution control officer. This officer will be responsible for, among others, attending to the requirements of the establishment prior to the construction or installation of pollution control facilities, monitoring activities pertaining to this construction and installation of these facilities, and supervising their operation and maintenance.⁸¹

5. *Pres. Decree No. 856 (1975)*.⁸² This requires, among others, that an entity shall not operate any industrial establishment without first obtaining a sanitary permit from the Secretary of Health or his duly authorized representative.

POSSIBLE INVESTMENT PITFALLS

There are a few pitfalls that a foreign investor ought to recognize in investing in the Philippines.

1. *Partially Nationalized Industries* - In partially nationalized industries where foreign equity is limited by law to a minority position (usually 40 percent), foreign investors are constrained to find a local partner that will acquire the required majority Filipino equity in the business. In most instances, the

⁸⁰ *Id.*, sec. 8, 9(b) and (d).

⁸¹ Sec. 3, 8.

⁸² CODE ON SANITATION OF THE PHILIPPINES.

foreign investor is the project proponent and requires as a rule *control* over the management, operation and profits of the business. This cannot be legally assured without violating the Anti-Dummy Law (Commonwealth Act No. 108, as amended). The Anti-Dummy Law penalizes the use of a Filipino as a "front" by the disqualified foreign investor for the purpose of evading restrictions arising from nationalization laws. The law subjects the foreign investor and the Filipino dummy to criminal liabilities. Violation of the law could also result in the forfeiture of the franchise or businesses acquired or operated in violation of the law. Any corporation found violating the law shall likewise be dissolved. The law allows the dummy to report the violation and assist in the prosecution of the foreign investor. The dummy is also entitled to a reward in the sum equivalent to 25 percent of the fine actually paid, to or received by, the government and an exemption from the attendant criminal liabilities.

One practical way of addressing the concern of the foreign investor without violating the Anti-Dummy Law is for the foreign investor to find a *bona fide* passive Filipino investor who would rely on the expertise of the foreign investor in running the business and who should, accordingly, be expected to approve the recommendations of the foreign investor in respect of the operation and management of the business. In respect of profits, it is also important for the parties to be obligated contractually to a dividend policy that will assure the minority foreign investor that the majority Filipino investor would vote for the distribution of profits in accordance with the agreed policy.

It is also common practice to have a shareholders' agreement that would grant minority protection to the foreign investor in the form of high vote requirements for substantive corporate acts. This, however, would at the most merely give the foreign investor veto power over the approval of such corporate acts. The validity of such an arrangement is an issue which is still pending resolution by the Secretary of Justice. In any event, such minority protection should be reflected in the articles of

incorporation and by-laws of the joint venture company to be binding against third persons.

It is also possible to exercise practical "control" over the operation and management of the business if the foreign investor, although holding a minority position, retains the single largest block of shares. This is specially true for listed companies.

2. *Labor Liabilities* - when a foreign investor buys into an existing company, the investor effectively inherits the existing laborers and employees of the company and all the attendant liabilities and problems. It is usually preferable to, instead, purchase the business and assets and establish a new company to operate the business and the assets. In this way, the new company will generally not inherit the existing labor force of the seller.

3. *Tax Liabilities* - A purchase of shares in an existing company will also effectively pass on to the foreign investor the existing tax liabilities of the company. It is, therefore, preferable to, instead, purchase the business and the assets. otherwise, the buyer could require the seller to obtain a Bureau of Internal Revenue Tax Clearance for the company being sold for tax liabilities as of the date of sale.

4. *Bulk Sales Law* - This is an antiquated law which requires that in a sale of all or substantially all of the assets or business of the company, the consent of the creditors of the company should be obtained otherwise the sale shall be void. It is important in such a situation that the seller company warrant that such consent have been obtained or that the seller has no creditors.

A separate contract, independent of the sale documents, which commit the parties to effect an automatic resale of the assets immediately after payment of any unpaid complaining creditor could be executed. This will protect the buyer from a situation where the seller conspires with a minor creditor to avoid the sale because of a better offer from a third person.

5. *Confidentiality* - When the foreign investor takes the role of a seller, it is important for the investor to be protected against use of confidential information obtained as a result of due diligence conducted or disclosures made before any actual sale document is signed. This is especially important in a sale of mining assets or mineral rights. It is important in this situation that the buyer execute a Confidentiality Agreement in favor of the seller prior to, and independent of, the sale document.

RECENT TRENDS AND FURTHER DEVELOPMENTS

The Philippine government has effected the liberalization of a number of business activities to attract more foreign investors. These include the following:

1. Liberalization of the Banking Industry - The law allows the entry of foreign banks.
2. Liberalization of the Insurance Industry - The new rules permit the entry of additional foreign insurance corporations.
3. Liberalization of the Shipping Industry - This allow entry of additional operators in major routes.
4. Liberalization of the Aviation Industry.
5. Allowing 100 percent foreign equity in large scale mining.
6. Liberalization of the Motor Vehicle Development Programs.
7. Liberalization of the Telecommunications Industry.

There are also a number of future reforms intended to further ease the entry of foreign investment, namely:

- a. *Deregulation of the oil industry* - This will require a market-led pricing scheme for oil products. It will also open up the industry to more participants.

b. *Deregulation of the Transport industry* - This will require a market-oriented setting and route assignment for public utility operations.

c. *Amendments to the Foreign Investments Act* - This will effect a reduction from \$500,000 to \$150,000 of the minimum paid-in capitalization required for foreign firms serving the domestic market.

Recently, the Philippine Senate also approved the repeal of the Uniform Currency Act, an antiquated law which mandated the use of Philippine currency as a medium payment for any domestic obligations, except in certain instances. It is expected that the House of Representatives will approve a similar repeal the old law. This law had, in the past, put some constraints on the ability of foreign parties in a domestic transaction to shield themselves from foreign exchange risk.

The liberalization of the retail industry is also being deliberated by the legislative branch.

CONCLUSION

In conclusion, it is well to note that government's efforts to attain a more favorable business environment and regulatory framework for potential investors have so far opened up more investment opportunities in various infrastructure projects.⁸³

These investment opportunities have become apparent through the identification of the economy's medium-term infrastructure requirements based on the formulated thrusts, directions and priority activities of key economic sectors. These sectors include energy, transportation, communications, water resources, industry, tourism, bases conversion, social infrastructure and other development projects.⁸⁴

⁸³ HANDBOOK ON DOING BOT BUSINESS IN THE PHILIPPINES, at 13.

⁸⁴ *Id.*