REGULATION OF TRANSNATIONAL CORPORATIONS UNDER PHILIPPINE LAW

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For the past ten years, Philippine policy towards the foreign investor has been one of attraction. This became official with the passage of Republic Act 5186 in 1967, in which it was declared "to be the policy of the state to welcome and encourage foreign capital to establish pioneer enterprises that are capital intensive and would utilize a substantial amount of domestic raw materials, in joint venture with substantial Filipino capital, whenever available." [1]

A study made in 1971 revealed that although the Philippines was regarded as a country with considerable investment opportunities and attractions, the investment climate was not attractive enough due to, among others, the uncertainty of the economic climate and the peace and order conditions. [2] With the advent of martial law however, the situation has improved markedly. Securities and Exchange Commission (SEC) figures showed an increase of 380% in the amount of paid-up capital of foreigners in newly registered firms from September, 1972 (when martial law was declared) and June, 1973. [3] Domestic corporations with foreign equity totalled 3,840 for the period 1967 to 1976, and out of these 63% or some 2,406 firms were registered during the period between 1972 and February, 1977. [4] Even European investment, which previously came in quite slowly, picked up substantially, accounting for 24% of the total foreign investments proposed for the period from October, 1973 to August, 1974. [5] No doubt, the country's vast natural resources, the improved peace and order situation, its capable work force and low wages, are among the more important

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[1] See Section 2, Republic Act No. 5186 (1967), otherwise known as the Investment Incentives Act.

[2] See *Bulletin Today*, May 6, 1977, p. 14.

[3] See "The Philippines: American Corporations, Martial Law and Underdevelopment", 57 IDOC, Corporate Information Center of the National Council of Churches of Christ in the U.S.A., November, 1973, p. 29.

[4] See *Philippine Prospect*, Department of Public Information, September, 1974, p. 1.

[5] See *Bulletin Today*, October 24, 1974

factors, aside from the fiscal incentives, which have attracted foreign investment in the last five years.

As a developing country, the Philippines is indeed in need of outside capital to help it on the road to national progress. At the same time, however, it must at all times retain overall control of its economy. Thus foreign capital is welcomed but under specified conditions and restrictions, which serve as safeguards against alien domination of key sectors of the economy. The Philippine Constitution and various statutes have clearly delineated the areas of the economy where the Filipino must at all times keep control, limiting foreign equity to a specified percentage. These nationalization laws require anywhere from a bare majority to 100% Filipino ownership. Under the Constitution, however, these nationality requirements may be waived by the President in international treaties or agreements should the national welfare and interest so require.[6]

In the retail trade and the operation of rural banks and of the mass media, the law requires 100% Filipino ownership. Aliens cannot acquire land, whether public or private, except by hereditary succession, although domestic corporations with no more than 40% alien equity can do so, subject to area limitations.[7] Even requisition and procurement contracts of the government and any of its instrumentalities can be awarded only to contractors or bidders who are Filipino citizens or corporations with at least 60% Filipino stock ownership, unless reciprocity can be established.[8]

Aside from the provisions of the Philippine constitution requiring a minimum of 60% Filipino equity in mining and agricultural corporations, there are other restrictions designed to prevent monopolies in these sensitive areas of the economy.[9] Thus, an agricultural corporation is absolutely prohibited from having any interest at all in another agricultural corporation. On the other hand, a mining corporation, foreign or domestic, and its stockholders are allowed to own as much as 40% of the outstanding voting stocks provided it is in not more than one other mining corporation. The latter in turn is prohibited from acquiring any interest in any other mining corporation. A non-mining corporation, domestic or foreign, may acquire or hold not more than 30% of the outstanding capital stock entitled to vote in each of not more than three domestic mining corporations. But a stockholder of such non-mining corporation is prohibited from owning stocks

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[6] See Article XIV, Sec. 15, Constitution of the Philippines.
[7] *Ibid.*, Sec. 11.
[8] See Rep. Act No. 5183 (1967).
[9] See Section 13, pars. (5) and (5A), Act 1459 (1956), otherwise known as the Corporation Law, as inserted by Rep. Act 5167 (1967).

in any of these three mining corporations. A non-agricultural corporation however, can own stocks in any number of agricultural corporations, as long as it does not own more than 15% of the outstanding voting stocks in each of such agricultural corporations. No natural person, Filipino or alien, may own in more than one mining or agricultural corporation, more than 15% of the outstanding voting stocks of each such mining or agricultural corporations (although there is no restriction if he owns stocks in only one mining or agricultural corporation).

Although foreign investment was previously prohibited in the rice and corn industry, Presidential Decree No. 194 has allowed foreigners, under certain conditions, to participate up to 40% in the culture, production, milling, processing and trading (except retailing) of rice and corn. In the inter-island shipping industry, the requirement is that at least 75% of the capital be Filipino-owned.[10] In banking institutions, except rural banks, the law allows only 30% foreign equity, and requires at least 2/3 of the members of the board of directors to be Filipinos. The Monetary Board may however increase the 30% maximum to 40% with the approval of the President.[11] In financing companies the required Filipino equity is 60%.[12] In investment houses, at least a majority of the voting stock must be owned by Filipinos.[13]

The Philippine Constitution requires that the exploration, development, exploitation and utilization of natural resources be limited to citizens and to associations at least 60% of the capital of which is Filipino-owned, but allows such Filipino-owned or controlled corporations to enter into service contracts with any foreign person or entity for financial, technical, management, or other forms of assistance.[14] In this connection, Presidential Decree No. 87 has encouraged oil exploration by foreign investors through service contracts with the government, under which 40% of the proceeds goes to the foreign investor, free from taxes.

In the case of public utilities, which must also be 60% Filipino-owned, the new Constitution expressly allows foreign investors to participate in the governing bodies thereof proportionally to the amount of their holdings.[15] This provision has been carved over to all partially nationalized activities.[16]

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[10] See Rev. Administrative Code (Act No. 2778), secs. 1172, 1176, 1202, 1218.

[11] Secs. 12 and 13, Rep. Act No. 337 (1948) as amended, otherwise known as the General Banking Act.

[12] Sec. 6, Rep. Act No. 5980 (1969).

[13] Sec. 5, Presidential Decree 129 (1973).

[14] See art. XIV, sec. 9, Constitution of the Philippines.

[15] *Ibid.*, Sec. 5.

[16] Pres. Decree No. 715 (1975) amending section 2-A of the Anti-Dummy Law (C.A. No. 108).

Outside of multi-proportional representation in the board of directors, the Anti-Dummy Law prohibits any arrangement which would in any manner vest management and control of any nationalized enterprise in the hands of foreigners, or which allows disqualified persons to be an officer, employee or laborer of such an enterprise, except only technical personnel when specifically authorized. Violation of these prohibitions is santioned by fine, imprisonment and forfeiture of the enterprise's privilege to engage in business.[17]

The above-mentioned nationality requirements established by the Consti tution and existing statutes would be one of the first factors which must be considered by a transnational corporation wishing to invest in the Philippines. Assuming these requirements have been considered and either complied with or found not applicable, the next step is to decide which method of entry into the Philippine scene would be best suited to the transnational's needs. Subject to nationality requirements, it may organize a subsidiary as a domestic corporation, wholly owned by it or under its effective control. The subsidiarly would then have a legal personality of its own, independent of its parent company, and whose separate corporate existence existence would be respected unless there are justifiable reasons for piercing the veil of corporate entity.[18] Or it may merely establish a branch or agency, which would not have a separate legal existence from its parent, and which would be treated as a foreign rather than a domestic corporation. Service contracts with domestic companies would be another means of investment. In many cases, the investment comes in as a joint venture with Filipino capital either in an already existing corporation or in a newly organized domestic corporation. This latter method is the one most favored by the Philippine policy makers at present. Whichever method is used, the intervention and permission of some govermnent agency would in most cases be necessary. Where the investment remains just that, without any participation by the transnational in the supervision, management and control of the business and without the establishment of any branch or agency

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[17] Commonwealth Act 108 as amended. See also *Luzon Stevedoring Co. v. Anti-Dummy Board*, G.R. L-26094, August 18, 1972, 46 SCRA 474 (1972), decided before the new Constitution came into effect.

[18] See Koppel Phil. v. Yatco, 77 Phil. 496 (1946). The Supreme Court cited with approval the case of U.S. v. Milwaukee Refrigerator Transit Co., 142E. 247, 255 (1905): "If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons."

in the Philippines, no government intervention is necessary unless the investment exceeds 30% of the total capital invested.[19] If a branch or agency is opened, the transnational would need a license from the Board of Investments and another from the SEC before it can start its branch operations.[20]

Should the preference be to pursue the business of the transnational enterprise through a domestic subsidiary, the latter's incorporation and organization must be governed by the provisions of the Corporation Law. Under this statute, there must be at least five incorporators, a majority of whom must be residents of the Philippines.[21] At least two members of the board of directors of the subsidiary must be residents of the Philippines, and each director must own at least one share of stock in his own right.[22] Aside from these, there are other requirements which must be met by the transnational which organizes a domestic subsidiary. Since in this case such transnational would necessarily participate in the supervision, management or control of the business, and would therefore be doing business in the Philippines, the transnational itself would need a permit from both the BOI and the SEC.[23] Failure to obtain these permits or licenses would not only mean that it cannot take advantage of the incentive benefits given by law under Republic Act 5186, but would also prevent the foreign corporation from suing before Philippine courts (although it may be sued), and would subject its local agents to criminal prosecution.[24] The BOI license will be granted only if certain specified conditions are present, the more important of which are that the operation of the business would not be inconsistent with the Constitution and pertinent laws nor with the Investment Priorities Plan, that the business activity contemplated would contribute to the sound and balanced development of the national economy, and that the field is one not adequately exploited by Philippine nationals.[25] The transnational would also be required to bring in such amount of capital as the BOI may deem necessary to protect those who may deal with the applicant.[26] In this connection, there has recently been an official move to limit the amount which a foreign investor may borrow from domestic financial institutions as part of its working capital. This

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[19] See secs. 1 and (b), Rep. Act No. 5455 (1968), otherwise known as the Foreign Business Regulation Act. See also BOI rules implementing Rep. Act 5455, Rule I, sec. 1(f)9.

[20] See section 69, CORPORATION LAW.

[21] *Ibid.*, sec. 6.

[22] *Ibid.*, sec. 30.

[23] See sec. 4, Rep. Act No. 5455 (1968).

[24] Sec. 69, CORPORATION LAW.

[25] Sec. 4, Rep. Act No. 5455 (1968).

[26] *Ibid.*

restricttion is in answer to the concerted complaint of Filipino businessmen that foreign investors do not bring in the expected amount of foreign capital but in fact use domestic funds which would otherwise be available to indigenous companies.

Once the domestic corporation is fully organized with the required permits and licenses, all its subsequent acts, contracts and operations would be governed exclusively by Philippine law. On the other hand, if a branch or agency is established in the in the Philippines, Philippine law would govern in all matters outside of those relating to the creation, formation, organization or dissolution of corporations or such as fix the relations, liabilities, responsibilities or duties of stockholders or officers of corporations to each other or to the corporation. In these latter matters, the law of the country where the foreign corporation which has established a branch here is domiciled would govern. [27]

Where the business involves the use of a trademark or patent, the transnational enterprise should register it with the Philippine Patent Office, if it wants to insure protection under Philippine law. [28] The trademark or patent, although registered in the name of the transnational corporation, may be used and exploited by its domestic subsidiary through a licensing agreement approved by the Director of Patents. [29]

Foreign investment and incentives thereto are basically governed by the Investment Incentives Act, the Export Incentives Act and the Foreign Business Regulation Act. The Investment Incentives Act Directs the BOI to study and prepare annually an Investment Priorities Plan which lists those specific areas of economic activity declared to be preferred and/or pioneer areas of investment. [30] A preferred area may be pioneer or non-pioneer. If an enterprise wishes to enjoy the benefits granted by the Investment Incentives Act, it must register with the BOI. To be entitled to registration, a corporation must be domestic, i.e., organized under Philippine laws; its business must be in a preferred area of investment as specified in the Investment Priorities Plan; it must be a Philippine national, i.e., at least 60% of its outstanding voting stock must be owned by Philippine citizens; and at least 60% of the members of its board of directors must be Filipino citizens. [31] However, under certain conditions, a domestic corporation, although more than 40% alien-owned, may register and enjoy the benefits of the Investment Incentives Act where it proposes to engage

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[27] Sec. 73, CORPORATION LAW.
[28] See Rep. Act No. 165 (1947), otherwise known as the Trademark Law
[29] *Ibid.*, Sec. 34.
[30] See Secs. 16(a) and 3(k), Rep. Act No. 5186 (1967).
[31] *Ibid.*, Sec. (1) and (f).

in a *pioneer* enterprise,[32] provided it cannot be readily and adequately exploited by Philippine nationals,[33] subject of course to nationalization laws. A basic condition in this case however, is that alien equity must gradually fade out so that at the end of thirty years, the registered enterprise shall become a Philippine national. This means that at the end of such thirty years, at least 60% of the capital must already be in Filipino hands, and two-thirds of its directors must be Filiipno citizens.[34]

It is also possible for a domestic alien-controlled corporation to be registered even in a preferred, non-pioneer area if the measured capacity of such area is not filled by qualified Philippine nationals within three years from its declaration as a preferred area, subject to a similar fade-out requirement as in a pioneer area.[35] Furthermore, the BOI has been granted the power to suspend, in appropriate cases, the nationality requirement imposed by statute, upon approval of the NEDA in big multinational projects pursuant to international complementation arrangements for the manufacture of a particular product on a regional basis.[36]

In approving applications of foreign investors, the BOI may lay down the terms and conditions for their entry as may be necessary to promote the objectives of the Investment Incentives Act.[37] These conditions may vary with each applicant and may cover matters such as the amount of required capitalization, the choice of products to be manufactured, the training of Filipinos in specified skills. These terms and conditions must appear in the certificate of registration,[38] without which the transnational cannot start operations. Violation of any of these conditions, and for that matter, of any law or regulation, may result in either the cancellation of its registration or the suspension of its enjoyment of incentive benefits, and possibly the refund of incentives previously enjoyed by it.[39]

All BOI registered enterprises are guaranteed certain basic rights. The Investment Incentives Act allows the repatriation of the entire proceeds

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[32] *Ibid.*, Sec. 3(h) defines a pioneer enterprise as one "(1) engaged in the manufacture, processing, or production, and not merely in the assembly or packaging, of goods, products, commodities or raw materials that have been or are not being produced in the Philippines on a commercial scale or (2) which uses a design, formula, scheme, method, process or system of production or transformation of any element, substance or raw material into another raw material or finished good which is new and untried in the Philippines: *Provided*, That the final product involves or will involve substantial use and processing of domestic raw materials, whenever available."

[33] *Ibid.*, sec. 19(a)(2).

[34] *Ibid.*, sec. 19(a)

[35] *Ibid.*, sec. 19, last paragraph.

[36] *Ibid.*, sec. 16(m).

[37] *Ibid.*, sec. 16(c).

[38] *Ibid.*, sec. 21(d).

[39] *Ibid.*, sec. 24(a).

of the liquidation of the foreign investment in the currency in which the investment was originally made and at the exchange rate prevailing at the time of repatriation, subject only to the right of the Monetary Board to impose foreign exchange restrictions in cases of emergency or national crisis. Earnings of such foreign investment may be remitted abroad under similar conditions.[40] The law also gives assurance against undue expropriation and requisition of property.[41]

In addition to these guarantees, the law grants tax incentives in the form of tax exemptions, allowable deductions and tax credits. Although a pioneer enterprise is offered greater incentives than a non-pioneer one, many of the incentives than a non-pioneer one, many of the incentives are common to both. All imported machinery, equipment and spare parts are exempt from tariff duties and compensating tax.[42] If such machinery is purchased from a domestic manufacturer, a tax credit equivalent to 100% of the compensating tax and customs duties that would have been paid if such machinery had been imported will be given.[43] Various deductions from income are allowable, such as organizational, pre-operational[44] and labor training expenses.[45] The registered enterprise is also granted the privilege of accelerating depreciation of fixed assets,[46] and of carrying over the deduction for net operating loss for the first ten years of operation from six years immediately following such loss.[47] A pioneer enterprise is in addition promised exemption from all internal revenue taxes, except income tax, on a gradually diminishing basis, starting with 100% exemption for the first five years down to 10% for the thirteenth through the fifteenth year.[48] There are also non-tax incentives, varied in nature, including post operative tariff protection for pioneer enterprises, anti-dumping protection from government competition for all registered enterprises, pioneer or otherwise.[49] Pioneer enterprises are allowed to employ foreign nationals for five years after the firm begins operating.[50] Non-pioneer but preferred enterprises may also employ a limited number of aliens but only in supervisory, technical or advisory positions, also for a period of five years from

[40] *Ibid.*, sec. 16(h).
[41] *Ibid.*, sec. 4(d) and (e).
[42] *Ibid.*, sec. 7(d).
[43] *Ibid.*, sec. 7(e).
[44] *Ibid.*, sec. 7(a).
[45] *Ibid.*, sec. 7(k).
[46] *Ibid.*, sec. 7(b).
[47] *Ibid.*, sec. 7(c).
[48] *Ibid.*, sec. 8(a).
[49] *Ibid.*, secs. 8(c), 7(i) and (j).
[50] *Ibid.*, sec. 8(b).

the date of registration.[51] Even immigration rules have been relaxed so that a special non-immigrant visa may be issued to officers of foreign investment houses and foreign investors upon proof that they have made or intend to make investments in the country in an amount not less than $100,000, provided that actual investment is made within three months.

Under the Export Incentives Law of 1970,[52] similar incentives as those under the Investment Incentives Act are given to investors, registered export producers and registered export traders.[53] Additional incentives may be given by the BOI to a registered export producer which establishes its plant in an area designated by it as necessary for the proper dispersal of industry, or in an area which the Board finds deficient in infrastructure, public utilities, and other facilities.[54]

All the aforementioned incentives may be withdrawn or cancelled by the BOI partially or totally, where the registered enterprise has a paid-up capital of at least ₱500,000 and has earned for at least two years profits in excess of 33⅓ of equity even without such incentive benefits.[55]

Even where the area of investment is not a preferred one under the Investment Priorities Plan, a transnational corporation may be allowed to invest therein under the conditions laid down by the Foreign Business Regulation Act.[56] Under this law, where the foreign investment in a non-registered enterprise does not exceed 30% of the capital, prior authority from the BOI is not necessary. Should it exceed 30%, such BOI authority is required and will be granted provided such area of economic activity is not adequate exploited by Philippine nationals, would contribute to the sound and balanced development of the national economy on a self-sustaining basis, and is not otherwise inconsistent with the Constitution and other laws.[57] Since the investment is in a non-preferred area, no incentive benefits can be availed of by the investor.

Summarizing, a transnational corporation can invest in the Philippines:

(1) In all preferred pioneer enterprises, with BOI authority, as much as 100% of the capital of such enterprise to nationalization laws, provided such area is not adequately exploited by Filipino capital;

(2) In a preferred, non-pioneer enterprise, with BOI authority, up to 40% of the capital and, even in excess of that up to almost 100% if,

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[51] *Ibid.*, sec. 7(g)
[52] Rep. Act No. 6135 (1970).
[53] *Ibid.*, secs. 7 and 8.
[54] *Ibid.*, sec. 9(a).
[55] Sec. 16(p), Rep. Act No. 5186 (1967); as inserted by Pres. Decree 485.
[56] Rep. Act No. 5455 (1968).
[57] *Ibid.*, secs. 2 and 3.

in the latter case, Filipino capital cannot adequately exploit the same within three years from its declaration as a preferred enterprise, subject also to nationalization laws; and

(3) In non-preferred enterprises, without prior BOI authority, if the investment is not more than 30% of the outstanding capital; and should it exceed 30%, with BOI authority and only if the area of investment is not adequately exploited by Filipino capital, would contribute to the sound, balanced development of the national economy and would not conflict with the provisions of the Constitution and other laws.