Foreign Investments: The Elephant in the Room

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I. INTRODUCTION

The laws covering foreign participation in the Philippine economy are a spectrum of red and black hues that waver between the permissive and the restrictive. They represent a tug-of-war between the desire to preserve the national patrimony and the pursuit of foreign investments to fuel national economic development.

II. THE CONSTITUTION: THE SENTINEL OF *INTRAMUROS*

The Constitution, written with memories of a revolution against foreign rule, stands guard at the portals of the legal system — a legal system designed as a citadel of Filipino patrimony; the *Intramuros* that Philippine corporate lawyers have to contend with. From its post, the Constitution delineates the boundaries of foreign participation in the economy. Thus, the Constitution

allows for foreign participation of up to 40% in corporations that will join the State in co-production, production-sharing agreements, or joint ventures in the exploitation, development, and utilization of natural resources. In the same breath, it also declares that such endeavors are under the full control and supervision of the State.[1] The Constitution provides the same limitation on foreign equity ownership in corporations with respect to private land ownership;[2] and to the permissible 25-year lease of alienable lands of the public domain of not more than 1,000 hectares, renewable for another 25 years.[3] The same rule applies to franchises, certificates, or any other form of authority to operate public utilities for a period of not more than 50 years,[4] and to educational institutions other than those established by religious groups.[5] There are also certain activities where the Constitution places even greater restrictions. Thus, the Constitution limits the practice of all professions to Filipinos but allows legislation to make exceptions.[6] Mass media is limited to corporations wholly-owned and managed by Filipino citizens,[7] and foreign equity is limited to 30% in corporations engaged in advertising.[8] Finally, the Constitution provides a general rule where the Congress may, upon recommendation of the nation's economic planning agency, reserve certain areas of investments to Filipino citizens or to associations or corporations at least 60% of the capital of which is owned by

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1. PHIL. CONST. art. XII, § 2, para. 1.
2. PHIL. CONST. art. XII, § 6.
3. PHIL. CONST. art. XII, § 3, para. 1.
4. PHIL. CONST. art. XII, § 11.
5. PHIL. CONST. art. XIV, § 4 (2).
6. PHIL. CONST. art. XII, § 14, para. 2.
7. PHIL. CONST. art. XVI, § 11 (1).
8. PHIL. CONST. art. XVI, § 11 (2), para. 2.

Filipino citizens, with the power to prescribe an even higher percentage of Filipino ownership.[9]

The 1987 Constitution expanded the nationalist economic provisions found in the 1935 Constitution, which reserved certain economic activities to corporations with no more than 40% of its equity in the hands of foreign interests. [10] The Anti-Dummy Law, [11] enacted a year later in 1936, encapsulated the zealous spirit against colonialism and criminalized the circumvention of limitations on foreign ownership.[12] This sentiment saw its strongest legislative expression in the total prohibition of foreign participation in the retail trade in the 1950s.[13]

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9. PHIL. CONST. art. XII, § 10.

10. 1935 PHIL. CONST. arts. XII & XIII, § 8 (superseded 1973).

11. An Act to Punish Acts of Evasion of the Laws on the Nationalization of Certain Rights, Franchises or Privileges, Commonwealth Act No. 108 (1936); An Act to Amend Sections One, Two and Two-A Of Commonwealth Act Numbered One Hundred And Eight, Entitled 'An Act to Punish Acts of Evasion of the Laws on the Nationalization of Certain Rights, Franchises or Privileges,' as Amended, and to Insert Between Sections Three and Four Thereof a New Section to be Known as Section Three-A, Republic Act No. 134 (1947); Amending Commonwealth Act No. 108, As Amended, Otherwise Known As "The Anti-Dummy Law", Presidential Decree No. 715 (1975); & An Act Amending Further Commonwealth Act No. 108, as Amended, so as to Declare the Common-Law Relationship Between an Alien and a Filipino Citizen a Prima Facie Evidence of Violation of the Provisions of Section Two-A of Said Act, Republic Act No. 6084 (1969).

12. *Id.*

13. An Act to Regulate the Retail Business, Republic Act No. 1180, § 1 (1954). This provision reads —

> Section 1. No person who is not a citizen of the Philippines, and no association, partnership, or corporation the capital of which is not wholly owned by citizens of the Philippines, shall engage directly or indirectly in the retail business: Provided, That a person who is not a citizen of the Philippines, or an association, partnership, or corporation not wholly owned by citizens of the Philippines, which is actually engaged in the said business on [15 May 1954], shall be entitled to continue to engage therein, unless its license is forfeited in accordance herewith, until his death or voluntary retirement from said business, in the case of a natural person, and for a period of ten years from the date of the approval of this Act or until the expiration of the term of the association or partnership or of the corporate existence of the corporation, whichever event comes first, in the case of juridical

III. PIONEER LEGISLATION ON FOREIGN DIRECT INVESTMENTS

With its legislative history of anti-colonialism, it is ironic that the Philippines may very well have been the first country in Asia to create a legal framework for foreign investment in an era clouded by protectionist policies. Half a century ago, in 1967, the Philippines already had the Investment Incentives Act[14] which recognized the right of foreign investors to repatriate earnings from their investment, as well as the proceeds from liquidating the investment in the currency originally made.[15] It also allowed them to remit, at the exchange rate prevailing at the time of remittance, such sums that may have been necessary to meet the payments of interest and principal on foreign loans and foreign obligations arising from technological assistance contracts.[16] Further, it guaranteed them freedom from expropriation and requisition,[17] and granted them protection over intellectual property rights and some limited capital gains tax benefits.[18] A year later, in 1968, the Foreign Investment Regulations Act [19] came into effect and further emphasized the role of foreign investments in national development.[20] A 1969 law[21] conceived of the concept of an export manufacturing zone

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persons. Failure to renew a license to engage in retail business shall be considered voluntary retirement.

Id.

14. An Act Prescribing Incentives and Guarantees to Investments in the Philippines, Creating a Board of Investments, Appropriating the Necessary Funds Therefor and for Other Purposes [Investment Incentives Act], Republic Act No. 5186 (1967).

15. *Id.* § 4.

16. *Id.*

17. *Id.*

18. *Id.* § 5.

19. An Act to Require that the Making Of Investments and the Doing of Business Within the Philippines by Foreigners or Business Organizations Owned in Whole or in Part by Foreigners Should Contribute to the Sound and Balanced Development of the National Economy on a Self-Sustaining Basis, and for Other Purposes, Republic Act No. 5455 (1968).

20. *Id.*

21. An Act Making Mariveles, Province of Bataan, a Port of Entry by Amending Section Seven Hundred One of the Tariff and Customs Code of the Philippines, as Amended, Providing for the Establishment, Operation and Maintenance of a Foreign Trade Zone Therein; Creating a Foreign Trade Zone Authority; and Authorizing the Appropriation of the Necessary Funds Therefor, Republic Act No. 5490 (1969).

through the establishment of a "foreign trade zone" in Mariveles, Bataan with the avowed purpose of stimulating foreign trade and allowing for goods to be brought into the zone to "be stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated, or be manufactured[.]"[22] In 1972, that law was expanded to allow for the establishment of so-called "export processing zones" in other parts of the country.[23] In 1973, in a bid "to make [ ] the Philippines the business and financial capital of Southeast Asia[,]" a law was enacted to allow for regional headquarters to be organized and registered in the Philippines.[24] Foreign investment initiatives were focused on channeling these investments to manufacturing for the export markets and the accumulation of foreign exchange.[25]

IV. THE TROIKA: EXPORTS, DOMESTIC MARKET, AND RESOURCES

It can be observed that there are three horses that pull the foreign investment carriage: exports, the domestic market, and resources. The legislative approach differs for each investment driver, although objectives may overlap in parts. As a result, legislation on foreign investments has evolved into a spectrum, with incentives on one end and regulatory restrictions on the other, the former addressing investments in an export economy, and the latter addressing investments that exploit natural resources. In between these two ends of the spectrum is a domestic market including areas with restrictions against foreign participation. For foreign investments, the most dramatic changes for foreign investments in the legislative landscape occurred in the 1990s. Three key legislations should be examined in this regard: the Omnibus Investments Code of 1987,[26] the Special Economic Zone Act of 1995[27] — which both deal with incentives

22. *Id.* § 2.

23. Creating the Export Processing Zone Authority and Revising Republic Act No. 5490, Presidential Decree No. 66 (1972).

24. Prescribing Incentives for the Establishment of Regional or Area Headquarters of Multi-National Companies in the Philippines, Presidential Decree No. 218, whereas cl. 1 (1973)

25. *Id.* § 8.

26. The Omnibus Investments Act of 1987 [OMN. INVESTMENTS CODE], Executive Order No. 226 (1987).

27. An Act Providing for the Legal Framework and Mechanisms for the Creation, Operation, Administration, and Coordination of Special Economic Zones in the Philippines, Creating for this Purpose, the Philippine Economic Zone

for exporters — and the Foreign Investments Act of 1991[28] that deals mainly with the domestic market.

A. Exports — An Incentive-Driven Orientation

In the area of exports, the basic legislation is the Omnibus Investments Code of 1987, the objective of which, among others, is to increase the volume and value of exports by attracting foreign investments by means of fiscal incentives.[29] A companion law is the Special Economic Zone Act of 1995, which proclaims as its purpose the establishment of a legal framework and mechanisms for special economic zones, industrial estates, and export processing zones. It also conceives of transforming highly selected areas into developed agro-industrial, commercial, tourist, and banking investment, as well as financial centers.[30] In practice, the economic zones consist mostly of centers for information technology or for manufacturing.[31]

A registered enterprise under the Omnibus Investments Code of 1987 may be foreign owned, but 60% of its outstanding capital stock must be Philippine-owned within 30 years from the date of registration. The rule does not apply, however, to registered enterprises which export 100% of theis production.[32] Under the Omnibus Investments Code of 1987, the general rule is that registered enterprises must export at least 70% of their total production.[33] In the case of an enterprise located in an economic zone under the Special Economic Zone Act of 1995, there is no nationality requirement to apply for registration; however, if more than 40% of its

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Authority (PEZA), and for Other Purposes [The Special Economic Zone Act of 1995], Republic Act No. 7916 (1995).

28. An Act to Promote Foreign Investments, Prescribe the Procedures for Registering Enterprises Doing Business in the Philippines and for Other Purposes [Foreign Investments Act of 1991], Republic Act No. 7042 (1991).

29. OMN. INVESTMENTS CODE, arts. 2 (1) & (3).

30. The Special Economic Zone Act of 1995, § 3.

31. There are 358 operating economic zones as of 31 October 2016. 68% of these or 243 operating economic zones are Information Technology Parks or centers, 20% or 73 Operating Economic Zones are Manufacturing Economic Zones, and the remaining percentage is shared by agro-industrial economic zones, tourism economic zones, and Medical Tourism Parks or Centers. Philippine Economic Zone Authority, Operating Economic Zone Map, *available at* http://www.peza.gov.ph/index.php/economic-zones/list-of-economic-zones (last accessed Aug. 10, 2017).

32. OMN. INVESTMENTS CODE, art. 32 (b).

33. *Id.* art. 32 (a).

working capital is owned by foreign nationals, the enterprise must export at least 70% of its production.[34] If at least 60% of its working capital stock is owned by Philippine nationals, the percentage required to be exported goes down to 50%.[35]

The Omnibus Investments Code of 1987 is administered by the Board of Investments (BOI).[36] The BOI grants incentives to registered enterprises and prepares the Investment Priorities Plan (IPP).[37] The IPP specifies the activities and generic categories where investments are to be encouraged, identifying the products and commodities for the domestic or export market. This may include whether such investments are to be accorded pioneer or non-pioneer status.[38] Pioneer enterprises are those (a) enterprises engaged in manufacturing, processing, or production, and are not merely assemblers of goods or products that are not being produced in the Philippines in a commercial scale; or (b) enterprises engaged in other innovative pursuits, such as those involving untried formulas, designs, methods, processes, or materials or those in agricultural, forestry, or mining activities that can attain national goals of self-sufficiency, or have social benefits, including non-conventional fuel production or utilization. [39] Enterprises other than pioneer enterprises are non-pioneer enterprises.[40]

The Special Economic Zone Act of 1995, on the other hand, is administered by the Philippine Economic Zone Authority (PEZA).[41] The function of the PEZA is essentially to create policies for the establishment of economic zones. It is also tasked to regulate and supervise these zones and the enterprises within them.[42] Business establishments operating in the economic zones and registered with PEZA will be entitled to the same fiscal incentives granted under the Omnibus Investments Code of 1987.[43]

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34. Philippine Economic Zone Authority, Rules and Regulations Implementing The Special Economic Zone Act of 1995, rule 1, § 2 (j) & rule III, § 1, ¶ 3 (1995).

35. *Id.*

36. OMN. INVESTMENTS CODE, art. 3.

37. *Id.* art. 7 (1) & (3).

38. *Id.* art. 26.

39. *Id.* art. 17.

40. *Id.* art. 18.

41. The Special Economic Zone Act of 1995, §12.

42. *Id.* §§ 12 (a) & (b).

43. *Id.* § 24.

The package of incentives found in the Omnibus Investments Code of 1987 and the Special Economic Zone Act of 1995 can be divided into three classes. The very first class of these includes the internal revenue taxes and local government taxes. The second class concerns external taxes. The third class involves non-fiscal incentives.

For internal revenue taxes, perhaps the most aggressive magnet for foreign investments is the corporate income tax incentives. These include the income tax holiday, which conveys to foreign investors the message that the country is serious in providing a good climate for investments and innovation. The income tax holiday runs four years from the start of commercial operations for non-pioneer companies, and six years for pioneer companies.[44] The income tax holiday is extendible yearly for an additional two years, but cannot exceed a total of eight years. Extensions may be granted if the project meets the prescribed ratio of capital equipment to number of workers set by the BOI; if there is utilization of indigenous raw materials at rates set by the BOI; or if the net foreign exchange savings or earnings amount to at least US$500,000 annually during the first three years of operation.[45] An additional income tax exemption proportionate to the expansion undertaken by registered firms may also be granted for a period of three years from the start of the commercial operations of the expansion.[46]

Business establishments operating in economic zone enterprises are exempt from both local and national taxes and, in lieu thereof, must remit five percent of their gross income to the national government.[47] If the zone registered enterprise is already enjoying an income tax holiday under the Omnibus Investments Code of 1987, it may avail of the five percent gross income tax system after the expiry of the income tax holiday.[48]

There is also an exemption for an economic zone registered enterprise from "any and all local government imposts, fees, licenses[,] or taxes."[49] However, zone registered enterprises are liable for real estate taxes, including taxes for machineries that are attached to real properties. If these machineries are actually installed and operated in an economic zone for manufacturing,

44. OMN. INVESTMENTS CODE, art. 39 (a) (1).

45. *Id.*

46. *Id.* art. 39 (a) (2).

47. The Special Economic Zone Act of 1995, § 24.

48. *See* Bureau of Internal Revenue, BIR Ruling No. DA-227-02 (Nov. 29, 2002).

49. OMN. INVESTMENTS CODE, art. 78 (a).

processing, or industrial purposes, they shall not be subjected to real estate taxes for the first three years of operation of the zone registered enterprise.[50]

On the expense side, there is an additional deduction for labor expense for the first five years from registration equivalent to 50% of the wages corresponding to the increment in the number of direct labor for both skilled and unskilled workers. This may be doubled if the project is located in a less developed area identified by the BOI and the National Economic and Development Authority (NEDA).[51] The additional deduction is with the proviso that the prescribed ratio of capital equipment to labor is met,[52] and that the registered enterprise is not availing of the income tax exemption for expanding firms.[53] For enterprises within the economic zone, there is also an additional deduction equivalent to 50% of the value of training expenses incurred in developing skilled or unskilled labor and for management training, to be deducted from the national government's share in the gross income tax of five percent.[54]

The Tax Code[55] also provides for a zero rate for value added taxes (VAT) to registered enterprises,[56] and the exemption from branch profit remittance tax of export zone enterprises that are organized as branches of a foreign corporation.[57]

In the case of external taxes, under the Omnibus Investments Code of 1987, registered enterprises are entitled to tax and duty exemptions for the importation of capital equipment and spare parts, provided that the machinery in question is not manufactured locally in sufficient quantity, comparable quality, and at a reasonable price; and that it will be used exclusively by the registered enterprise.[58] Registered enterprises are also

50. *Id.* art. 78 (a) & (b).

51. *Id.* art. 39 (b).

52. *Id.* arts. 39 (b) & 40.

53. *Id.* art. 39 (a) (2).

54. *Id.* art. 42.

55. National Internal Revenue Code [NAT'L INTERNAL REVENUE CODE], Republic Act No. 8424 (1997).

56. *Id.* § 106 (A) (2) (a) (3) & § 108 (B) & Rules and Regulations Implementing The Special Economic Zone Act of 1995, rule XIV, § 1 (A) (1). *See also* Bureau of Internal Revenue, Revenue Regulation No. 04-07 [BIR RR No. 04-07], §§ 5 & 12 (Feb. 7, 2007).

57. NAT'L INTERNAL REVENUE CODE, § 28 (A) (5).

58. OMN. INVESTMENTS CODE, art. 39 (c).

entitled to simplified customs procedures, [59] while registered export enterprises have access to the bonded warehousing system.[60] For exporters of non-traditional products, there is an exemption from wharfage dues and export tax.[61] Exemption is also accorded to breeding stocks and genetic materials within 10 years from date of registration.[62] Tax credits are granted for breeding stocks, genetic materials, and raw materials equivalent to the national internal revenue taxes and customs duties should these have been paid instead of waived. [63] For economic zone registered enterprises, merchandise, raw material, supplies, articles, equipment and spare parts, and other imports for processing or manufacturing are exempt from both customs and internal revenue laws.[64] This means that imports by such economic zone enterprises are customs and duty-free, and exempt from the VAT on importation.[65] Hence, the Supreme Court recognizes the economic zones as a separate customs territory, effectively creating the legal fiction of a foreign territory.[66]

Non-fiscal benefits include the authority to employ foreign nationals for enterprises in economic zones;[67] however, their numbers are not to exceed five percent of its workforce without the express authority of the Secretary of Labor and Employment.[68] The foreign employees of economic enterprise zones, their spouses, and their unmarried children, have special multiple entry visa privileges for a period of three years to reside in the Philippines, and are exempt from alien certificates of registration and emigration clearance certificates.[69]

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59. *Id.* art. 39 (e).

60. *Id.* art. 39 (k).

61. *Id.* art. 39 (m).

62. *Id.* art. 39 (i).

63. *Id.* art. 39 (i) & (j).

64. OMN. INVESTMENTS CODE, art. 77 (1) & Rules and Regulations Implementing The Special Economic Zone Act of 1995, rule VIII, § 1.

65. The VAT on importation is imposed by the Bureau of Customs. NAT'L INTERNAL REVENUE CODE, § 107.

66. Commissioner of Internal Revenue v. Seagate Technology (Philippines), 451 SCRA 132, 146-47 (2005) (citing The Special Economic Zone Act of 1995, § 8 & VICTOR A. DEOFERIO, JR. & VICTORINO C. MAMALATEO, THE VALUE ADDED TAX IN THE PHILIPPINES 227 (1st ed. 2000)).

67. OMN. INVESTMENTS CODE, art. 76, ¶ 1.

68. The Special Economic Zone Act of 1995, § 40.

69. OMN. INVESTMENTS CODE, art. 76, ¶ 3.

Riding the wave of reforms in the late 1990s, the Omnibus Investments Code was amended in 1999 to provide a better framework for regional headquarters, regional operating headquarters, and regional warehouses.[70] The law's intention is to create a regional hub in the Philippines for international business. The Regional or Area Headquarters (RHQ) acts as an "administrative branch of a multinational company engaged in international trade which principally serves as a supervision, communications[,] and coordination center for its subsidiaries, branches[,] or affiliates in the Asia-Pacific Region and other foreign markets and which does not earn or derive income in the Philippines."[71] The Regional Operating Headquarters (ROHQ) "derives income in the Philippines by performing qualifying services to its affiliates, subsidiaries[,] or branches in the Philippines, in the Asia-Pacific Region and in other foreign markets."[72] The qualifying services referred to by the law are a range of services — from general administration, business planning, and financial advisory services, to marketing and promotion, research and development, and product development, including essential services such as sourcing raw materials, logistics, technical support, and data processing.[73] A RHQ and a ROHQ may also operate a regional warehouse. The regional warehouse is a supply depot for storage and

70. An Act Providing for the Terms, Conditions and Licensing Requirements of Regional or Area Headquarters, Regional Operating Headquarters, and Regional Warehouses of Multinational Companies, Amending for the Purpose Certain Provisions of Executive Order No. 226, Otherwise Known as the Omnibus Investments Code of 1987, Republic Act No. 8756 (1999).

71. *Id.* § 2 (2).

72. *Id.* § 2 (3).

73. *Id.* § 4. The actual list of qualifying services are as follows:

(1) General administration and planning;
(2) Business planning and coordination;
(3) Sourcing/procurement of raw materials and components;
(4) Corporate finance advisory services;
(5) Marketing control and sales promotion;
(6) Training and personnel management;
(7) Logistics services;
(8) Research and development services, and product development;
(9) Technical support and maintenance;
(10) Data processing and communication; and
(11) Business development.

Id.

safekeeping and may also engage in some of the production processes. If the production process is viewed as a transformation of inputs, the regional warehouse essentially serves the beginning and the end of this process. Hence, the regional warehouse can serve as storage of spare parts, components, semi-finished products, and raw materials; it can also be a site for the final processing of the end products — that is, labeling, marking, packing, or alterations to fit customer requirements.[74]

RHQs and ROHQs are given tax incentives. The RHQ is exempt from income tax, while the ROHQ enjoys a special rate of 10%; however, the ROHQ's income from Philippine sources is subject to a branch tax remittance.[75] RHQs are subject to a VAT of zero percent while ROHQs are subject to the usual VAT under the National Internal Revenue Code.[76] RHQs and ROHQs enjoy exemption from all local government taxes[77] and enjoy duty free importation of training materials and equipment which are unavailable locally.[78] Even the personnel of RHQs and ROHQs enjoy special privileges. Both Filipino and foreign employees enjoy a special personal income tax rate of 15%.[79] Moreover, foreign personnel of RHQs and ROHQs, and their dependents, spouses, and unmarried children under 21 years old, are exempt from paying the travel tax and enjoy multiple entry visa privileges similar to those of foreign nationals working for economic

74. *Id.* § 7. This provision provides —

> (1) The activities of the regional warehouse shall be limited to serving as a supply depot for the storage, deposit, safekeeping of its spare parts, components, semi-finished products[,] and raw materials including the packing, covering, putting up, marking, labelling and cutting or altering to customer's specification, mounting[,] and/or packaging into kits or marketable lots thereof, to fill up transactions and sales made by its head offices or parent companies and to serving as a storage or warehouse of goods purchased locally by the home office of the multinational for export abroad. The regional warehouse shall not directly engage in trade nor directly solicit business, promote any sale, nor enter into any contract for the sale or disposition of goods in the Philippines[.]

Republic Act No. 8756, § 7.

75. *Id.* § 6 & NAT'L INTERNAL REVENUE CODE, § 28 (A) (6).

76. Republic Act No. 8756, § 6.

77. *Id.*

78. *Id.*

79. *Id.* § 5 & NAT'L INTERNAL REVENUE CODE, § 25 (C).

zone enterprises, provided that they work exclusively for the RHQ or ROHQ, with a salary of at least US$12,000 per annum.[80]

There are few simple requirements and restrictions imposed by law. To register in the Philippines, RHQ are required to remit US$50,000.[81] The amount for ROHQs is US$200,000.[82] The RHQ cannot derive income from within the Philippines, or interfere in the management of local subsidiaries, or solicit or market goods.[83] Meanwhile, ROHQs cannot service branches, subsidiaries, or affiliates other than those it has declared upon registration with the Securities and Exchange Commission (SEC).[84]

B. Domestic Market — Opening Doors and Setting Boundaries on Equity Restrictions

The Foreign Investments Act of 1991 (FIA) lays down some basic rules for foreign participation in the local economy. But while the FIA declares that it is state policy to attract, promote, and welcome foreign investments, it does so within the bounds of the existing rules restricting foreign ownership that have already been delineated in the Constitution and in the statute books.[85] The law acknowledges the potential for foreign investments to significantly contribute to the country's industrialization and socio-economic development but directs it where it can expand Filipino employment and increase the volume of exports as well.[86] Thus, the FIA has been described as "the basic law governing foreign investments in the Philippines, irrespective of the nature of business and area of investment."[87]

The outstanding feature of the FIA is that it allows entry into the domestic market of enterprises where foreign equity can be as much as 100%. Such enterprises are denominated as "domestic market enterprises," and are defined as entities which consistently fail to export 60% of their

80. Republic Act No. 8756, § 4 & Board of Investment, Rules and Regulations Implementing Republic Act No. 8756 Amending Books III and IV of Executive Order No. 226, Otherwise Known as the Omnibus Investments Code, as Amended, § 9 (1999).

81. Republic Act No. 8756, § 3.

82. *Id.*

83. *Id.*

84. *Id.* § 4.

85. Foreign Investments Act of 1991, § 2.

86. *Id.*

87. Heirs of Wilson P. Gamboa v. Teves, 682 SCRA 397, 435 (2012).

output.[88] In this case, foreign participation, which normally is limited to 40%, may be as much as 100%, provided that the minimum paid-in capital of the enterprise is US$200,000. The paid-in capital refers to the total investment in the business that has been paid in, whether cash or property, and not just the foreign equity participation. It also includes the additional paid-in capital for purposes of determining whether or not an enterprise has met the minimum required paid-in equity capital of US$200,000 for a domestic market enterprise.[89] The requisite total equity capital for foreign participation exceeding 40% of the equity of an enterprise is lowered for domestic market enterprises which involve advanced technology or employ at least 50 direct employees. In such cases, the total paid-in-equity capital may be the equivalent of at least US$100,000.[90] "Advanced Technology" here refers to a higher degree or form of technology than what is domestically available. The technology should be (a) necessary for the development of certain industries; (b) subject to guidelines of the Department of Science and Technology; and (c) appropriate and adaptable to local conditions, such that it can be eventually be transferred and applied to available indigenous technology.[91] The direct employees here refer only to Filipinos hired and engaged under the control and supervision of the enterprise for the production of goods or performance of services, excluding personnel hired as casual or seasonal workers, learners, apprentices, or any employees of subcontractors or those under fixed term employment.[92]

The FIA states that, as a general rule, there are no restrictions on the extent of foreign ownership of export enterprises[93] where foreign equity may be as much as 100%.[94] Export enterprises are those enterprises that

88. Foreign Investments Act of 1991, § 3 (f).

89. Implementing Rules and Regulations of Republic Act No. 8179, rule 1, § 1 (p) (1999) & Securities and Exchange Commission, Opinion addressed to Emerald Headway, Opinion No. 47-03 (Sep. 30, 2003). *See also* Securities and Exchange Commission, Opinion addressed to Valdes, Valdes, Rodulfa & Associates, SEC Opinion No. 10-05 (July 12, 2005).

90. Foreign Investments Act of 1991, § 8, ¶ 2.

91. Implementing Rules and Regulations of Republic Act No. 8179, rule 1, § 1 (o).

92. Implementing Rules and Regulations of Republic Act No. 7042, rule 1, § 1 (z) (1991) (as amended).

93. Foreign Investments Act of 1991, § 2, ¶ 2 .

94. *Id.* § 6.

export 60% or more of its output, whether it be in manufacturing, processing, or in services, including tourism.[95]

Central to the FIA is the concept of a foreign investment negative list. As the name suggests, the list enumerates where foreign equity is prohibited in whole or in part or regulated. To be sure, the foreign negative list does not create new restrictions; it merely inventories what is already stated in the Constitution or the statute books. The foreign negative investment list has two components: List A which enumerates economic activities reserved to Philippine nationals by the Constitution or by law, and List B which contains activities that are regulated pursuant to law. The latter includes defense-related activities requiring prior clearance from the Department of National Defense, or activities which are against public health or morals.[96] The list is to be issued at the recommendation of the NEDA, by executive order, at intervals of not more than two years.[97] The Philippines is now on its Tenth Regular Foreign Investment Negative List.[98]

The impetus of liberalization started by the FIA led to reforms in other areas of interest to foreign investment. Unlike the provision of the Omnibus Investments Code of 1987, its amendments, and the Special Economic Zone Act of 1995, these reforms did not carry with them any incentives, but merely opened up the privilege of investing in specific areas of economic activity.

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95. *Id.* § 3 (e).

96. *Id.* § 8. In the case of List B, the law provides the following enumeration:

> (1) which are defense-related activities, requiring prior clearance and authorization from Department of National Defense (DND) to engage in such activity, such as the manufacture, repair, storage and/or distribution of firearms, ammunition, lethal weapons, military ordinances, explosives, pyrotechnics and similar materials, unless such manufacturing or repair activity is specifically authorized, with a substantial export component, to a non-Philippine national by the Secretary of National Defense; or
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> (2) which have implications on public health and morals, such as the manufacture and distribution of dangerous drugs, all forms of gambling, nightclubs, bars, beer houses, dance halls, sauna and steam bathhouses[,] and massage clinics.
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> *Id.*

97. *Id.* § 8, ¶ 5.

98. Office of the President, Tenth Regular Foreign Investment Negative List, Executive Order No. 184 [E.O. No. 184] (May 29, 2015).

In the field of banking and finance, the Foreign Banks Liberalization Act[99] liberalized the entry and operations of foreign banks and financial institutions in the Philippines; the General Banking Law of 2000[100] allowed for limited entry of foreign investment in domestic banks of up to 40%; and the Financing Company Act[101] increased the allowable foreign equity to 60% from 40%.[102] A related structural change was the much welcomed repeal in 1996 of the archaic Uniform Currency Law,[103] a law from 1950 mandating that all transactions be pegged in the Philippine peso.[104]

The doors for foreign investment in retail trade were given a small opening by the Retail Trade Liberalization Act of 2000[105] — a misnomer, for considering the rather high bar that foreign investors must overcome to participate in this endeavor, it can hardly be called liberal.[106]

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99. An Act Liberalizing the Entry and Scope of Operations of Foreign Banks in the Philippines and for Other Purposes, Republic Act No. 7721 (1994).

100. An Act Providing for the Regulation of the Organization and Operations of Banks, Quasi-Banks, Trust Entities and for Other Purposes [General Banking Law of 2000], Republic Act No. 8791, § 11.

101. An Act Amending Republic Act No. 5980, as Amended, Otherwise Known as the Financing Company Act [Financing Company Act of 1998], Republic Act No. 8556 (1998).

102. *Id.* § 6.

103. An Act to Assure Uniform Value to Philippine Coin and Currency, Republic Act No. 529 (1950).

104. An Act Repealing Republic Act Numbered Five Hundred Twenty-Nine as Amended, Entitled "An Act to Assure the Uniform Value of Philippine Coin and Currency", Republic Act No. 8183 (1996).

105. An Act Liberalizing the Retail Trade Business, Repealing for the Purpose Republic Act No. 1180, as Amended, and for Other Purposes, Republic Act No. 8762 (2000).

106. *Id.* § 5. Retail ventures with paid-up capital less than the peso equivalent of US$2.5 million (Category A) is limited to Filipinos. Full foreign ownership of retail enterprises with paid-up capital between US$250 million and US$750 million (Category B) was permitted after two years from the enactment of the law. Full foreign ownership is also allowed for enterprises that have paid-up capital greater than US$750 million (Category C) as well as those that are engaged in the retail of high-end or luxury items (Category D). The investment for opening a store in Categories B and C should not be below the peso equivalent of US$830,000; in Category D, the paid-up capital should be a peso equivalent of US$250,000 per store. *Id.*

Private lands, by constitutional mandate, can only be held by corporations with a maximum of 40% foreign equity.[107] This is a formula from the 1930s[108] that is still in force today. However, foreigners may acquire condominium units and shares in condominium corporations up to 40% of the total and outstanding capital stock of a Filipino-owned or controlled corporation.[109] Moreover, foreign investors in the Philippines can lease private lands for a maximum period of 75 years. The Investors' Lease Act,[110] which took effect in 1993, allowed for lease agreements with foreigners entered into for a period of 50 years, renewable once for 25 years,[111] for purposes of and in connection with the establishment of industrial estates, factories, assembly or processing plants, agro-industrial enterprises, land development for tourism, industrial or commercial use, and/or other similar priority productive endeavors.[112]

Mining will always be a sensitive subject of discussion with respect to foreign investment. The fact that the industry involves natural resources — the grand scale of mining projects and how it affects individuals, as well as the community, and the environment — makes mining the target of both legislative and regulatory attention. At its core are fundamental questions on its very rationale for existing, as it involves issues of national patrimony and the preservation of natural resources for future generations. Thus, the Constitution declares that the exploration, development, and utilization of natural resources shall be under the full control and supervision of the State.[113] Consequently, legislative efforts to liberalize the economy in the 1990s approached mining with kid gloves. The Philippine Mining Act of 1995[114] provides that foreign-owned corporations — those in which less than 50% of the capital is owned by Filipino citizens — may participate in

107. PHIL. CONST. art. XII, § 7.

108. 1935 PHIL. CONST. art. XIII, §§ 1 & 5 (superseded 1973).

109. An Act to Define Condominium, Establish Requirements for its Creation, and Govern its Incidents, Republic Act No. 4726, § 5.

110. An Act Allowing the Long-Term Lease of Private Lands by Foreign Investors [Investors' Lease Act], Republic Act No. 7652 (1993).

111. Investors' Lease Act, § 4 (1).

112. Implementing Rules and Regulations of Investors' Lease Act, rule II, § 1. *See also* The Special Economic Zone Act of 1995, § 30. It provides that lands in economic zones may be similarly leased to foreign investors. *Id.*

113. PHIL. CONST. art. XII, § 2.

114. An Act Instituting a New System of Mineral Resources Exploration, Development, Utilization, and Conservation [Philippine Mining Act of 1995], Republic Act No. 7942 (1995).

large-scale mining as grantees of exploration permits, mineral processing permits, or financial or technical assistance agreements (FTAA).[115] The mining law limits foreign-owned corporations to activities that require the commitment of massive financial resources. Mining exploration involves sinking large sums of money in the hope of a find while mineral processing is a highly technical and expensive endeavor. As for FTAAs, to refer to this mining activity as large-scale is an understatement. By law, such agreements can cover as much as 1,000 meridional blocks onshore and 4,000 meridional blocks offshore.[116] A meridional block is one-half minute latitude by one-half minute longitude — approximately 81 hectares.[117]

Other than foreign-owned corporations where Filipinos own less than 50% of the capital stock, foreign investors can still participate in areas reserved for Filipino citizens by owning up to 40% of the capital stock of a corporation. This is referred to as a "qualified person" under the Philippine Mining Act of 1995.[118] In contrast to the large scale activities that a foreign-owned corporation is limited to, the qualified person can participate in "mineral agreements" which include mineral production and sharing agreements (MPSA), co-production agreements, and joint venture agreements.[119] The MPSA grants a contractor, i.e., a qualified person, the exclusive rights to conduct mining operations; meanwhile, the co-production agreement is where the government provides inputs other than the mineral resources, while the joint venture agreement is where the government and contractor have equity shares.[120] In contrast to the massive scale of the 1,000-block onshore and 4,000-block offshore FTAA, a mineral agreement, which includes the MPSA, is, for corporations, limited to 100 blocks onshore in any province, and in the entire Philippines, 200 blocks onshore and 500 blocks offshore.[121]

Meanwhile, the Philippine Mining Act of 1995 had to stand in suspended animation for almost a decade as its constitutionality was being threshed out with the Supreme Court, before finally being declared valid in

115. *Id.* §§ 3 (t) & (aq).

116. *Id.* §§ 34 (a) & (b).

117. *Id.* §§ 3 (b), 3 (c), & 10.

118. *Id.* § 3 (aq).

119. *Id.* § 3 (aq) & § 26 & Department of Environment and Natural Resources, Revised Implementing Rules and Regulations of Republic Act No. 7942, Otherwise Known as the "Philippine Mining Act of 1995" [DENR Administrative Order No. 40-96], § 32 (b) (Dec. 19, 1996).

120. Philippine Mining Act of 1995, § 26.

121. *Id.* § 28.

2004.[122] A love-hate relationship soon evolved between the government and the mining industry, beginning with a declared national policy to revitalize the mining industry in 2004;[123] decelerating to a moratorium in the grant of new mineral agreements in 2012;[124] and now performing a pirouette with the executive department's tough stance on the mining industry, which ended with the Commission of Appointments' rejection of the appointment of the president's annointed overseer.[125] At present, forays of foreign-owned corporations in the other areas where they are permitted are few in number compared to the number of MPSAs — an indication of the prohibitive scale and risks of these types of projects, not to mention the regulatory hurdles involved. Today, there are a total of only four mineral processing plants, five FTAAs, and 26 exploration permits compared to 317 MPSAs.[126] The legal controversy of foreign participation in the mining industry would be with respect to the MPSAs, where foreign participation is permitted up to 40% of the outstanding capital stock of a corporation and Filipinos own at least 60% of the outstanding capital stock.

Since 2004, the year the Supreme Court declared the Philippine Mining Act of 1995 valid, a grand total of US$9 billion has been invested in the

122. La Bugal-B'Laan Tribal Association, Inc. v. Ramos, 445 SCRA 1, 238-39 (2004).

123. Office of the President, National Policy Agenda on Revitalizing Mining in the Philippines, Executive Order No. 270, Series of 2009 [E.O. No. 270, s. 2009] (Jan. 16, 2009).

124. Office of the President, Institutionalizing and Implementing Reforms in the Philippine Mining Sector Providing Policies and Guidelines to Ensure Environmental Protection and Responsible Mining in the Utilization Of Mineral Resources, Executive Order No. 79, Series of 2012 [E.O. No. 79, s. 2012], § 4 (July 6, 2012).

125. *See* ABS-CBN News, DENR's Lopez: Gov't stand on mining is non-negotiable, *available at* http://news.abs-cbn.com/business/09/30/16/denrs-lopez-govt-stand-on-mining-is-non-negotiable (last accessed Aug. 10, 2017); Trisha Macas, Duterte willing to let go of P70B from mining, to keep Gina Lopez as environment secretary, *available at* http://www.gmanetwork.com/news/money/companies/602837/duterte-willing-to-let-go-of-p70b-from-mining-to-keep-gina-lopez-as-environment-secretary/story (last accessed Aug. 10, 2017); & *CA rejects Gina Lopez' appointment*, PHIL. DAILY INQ., May 3, 2017 *available at* http://newsinfo.inquirer.net/893946/ca-adopts-panel-resolution-to-reject-gina-lopez-appointment (last accessed Aug. 10, 2017).

126. *See* Mines and Geosciences Bureau, Mining industry statistics as of 22 June 2017, *available at* http://mgb.gov.ph/attachments/article/162/MIS (2015)%20(1)%20(1).pdf (last accessed Aug. 10, 2017).

mining industry.[127] In 2016, the mining industry produced ₱101.9 billion in revenue, of which ₱101.2 billion was generated by large scale metallic mining.[128] In the same year, the industy generated taxes, fees, and royalties for the government in the amount of ₱22.69 billion and employed 218,000 people.[129] In 2016, export revenue for the mining industry stood at US$2.3 billion, representing 4.1% of total exports.[130]

V. STRUCTURES WITHIN STRUCTURES: THE SEARCH FOR PERMISSIBLE FOREIGN OWNERSHIP

A. The Search for Acceptable Corporate Structures to House Foreign Investments

Barriers to foreign investment to protect the patrimony of the nation gloss over an inconvenient truth. For many endeavors, Filipino capital is insufficient, Filipino access to foreign markets is limited, or Filipino technology and knowhow ranges from the non-existent to the inadequate. This has resulted in efforts to search for openings through a careful examination of what will fall within or outside of the barriers set by law or Constitution, or to search for structures within the boundaries reserved for Filipino ownership.

The SEC was the laboratory for such ideas. One attempt in 1987 was to limit the meaning of shares to only voting shares,[131] and as a result, foreign ownership of non-voting shares can exceed the 40% limitation. The SEC in this instance explained that the term

> 'capital' denotes the sum total of the shares subscribed and paid by the shareholders, or secured to be paid, irrespective of their nomenclature to be issued by the corporation in the conduct of its operation. Hence, non-voting preferred shares are considered in the computation of the 60-40% Filipino-alien equity requirement of certain economic activities under the Constitution.[132]

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127. *Id.* Mines and Geosciences Bureau, Mining industry statistic (Release Date 5 August 2016), *available at* http://mgb.gov.ph/images/MIS_1997-present-5Aug16.pdf (last accessed Aug. 10, 2017). Figure was arrived by adding up the numbers identified in the tables as "Total Mining Investment Data from the Revitalization Program under E.O. 270 (MGB)."

128. *Id.*

129. *Id.*

130. *See* Mines and Geosciences Bureau, *supra* note 126.

131. Securities and Exchange Commission, Opinion addressed to Supreme Technetronic Corporation (Apr. 14, 1987).

132. *Id.*

In another query involving finance companies, the proponent successfully argued that the reckoning between foreign ownership vis-à-vis Filipino ownership should be based on the number of shares and not the par value of the shares.[133] The par value of shares of the proponent was ₱25,000 for the shares to be issued to foreigners and ₱200 for the shares to held by Filipinos.[134] In accepting the proponent's proposed corporate structure, the SEC explained that to determine whether or not a corporation has complied with the minimum 60% Filipino ownership, one need only to consider the total outstanding capital stock entitled to vote, regardless of the par value of the shares, and regardless of whether or not the shares are fully paid.[135] This structure was approved for another financing company where the par value of the shares held by the foreigners was to be pegged at ₱200,000 and the shares to be issue to Filipinos was to ₱200.[136]

The more common corporate practice in dealing with foreign ownership in industries with restrictions on foreign equity is to rely on structures consisting of layers of corporate ownership, involving two or more corporations and with two or more layers of ownership. The target of the layering is on the portion of the outstanding shares, reserved for Filipinos by law or the Constitution, in a corporation engaged in what is referred to as a nationalized activity. At the bottom of the structure is the operating company engaged in an economic activity where foreign ownership is restricted. The shares of the operating company pertaining to the Filipino equity participation subject to legal prescription against foreign ownership, usually 60% of the capital, shall be held by a holding company. Typically up to 40% of the equity of the holding company in turn would be held by foreign shareholders. There are other structures in the corporate world that will have another holding company holding 60% of the outstanding capital of the holding company. This can go on for several layers, with one holding company holding shares in another holding company that holds shares in still another holding company, and so forth. The consequence is that the multi-layered structure allows foreign investors to invest more funds in the enterprise through the holding company or layers of holding companies outside of the designated limits for foreign equity in the operating company.

133. Securities and Exchange Commission, Re: Reclassification of Shares; Required Equity under the Financing Company Act, SEC-OGC Opinion No. 09-10 (May 19, 2009).

134. *Id.* at 1-2.

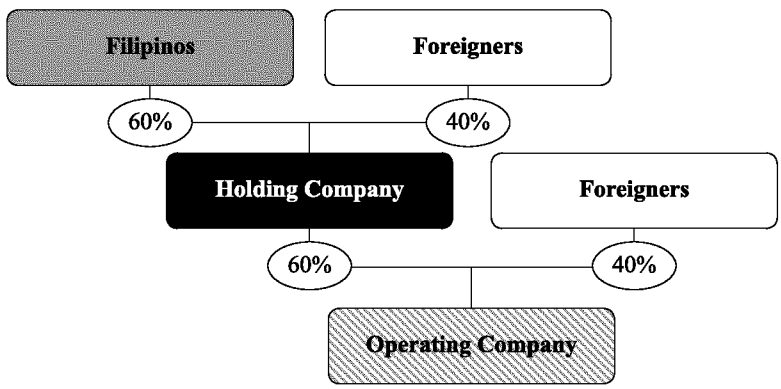
135. *Id.* at 3 (citing Securities and Exchange Commission, Corporate Nationality under the FIA; Reclassification of Shares of Stock; Required Equity under th Financing Company Act, SEC-OGC Opinion No. 06-36 (Sep. 21, 2006)).

136. *Id.*

From the legal stand point, the layering of foreign equity in a holding company or a series of holding companies reduces the analysis of compliance with laws on foreign ownership into a mathematical exercise of computing share ownership.

To illustrate, consider a structure with only one Holding Company. In the following diagram, the percentages refer to the portion of the shares held by the shareholder in the corporation below the percentages. Thus, the Filipinos own 60% of the Holding Company and the Holding Company owns 60% of the Operating Company.

Figure 1. Illustrative Structure of an Operating Company with One Holding Company for Foreign Investments



One mathematical approach is to multiply the percentage of the Filipino equity portion of the Operating Company against the percentage of the Filipino equity portion of the Holding Company and the result would be the Filipino equity participation in percentage in the operating company. Applying this method in the diagram above, the 60% equity share of the Filipino in the Holding Company would be multiplied by the 60% equity share of the Holding Company in the Operating Company. The result is that only 36% of the outstanding capital of the Operating Company is Filipino-owned and the conclusion would be drawn that the Operating Company is not qualified to undertake commercial activities where a 60:40 ratio between Filipino and foreign shareholders is required. This approach is called the Grandfather Rule. Mathematically, the Grandfather Rule renders useless the layering of corporate ownership as it erases any possibility of a foreign shareholder injecting capital into the project beyond the designated limits for foreign equity in the Operating Company.

The other approach would be to simply deem as Filipino-owned any shares in an operating company that are owned by a holding company, the total outstanding shares of which are at least 60% Filipino-owned. This is known as the Control Test. The application of the Control Test will give effect to the intent to increase foreign equity funds into an enterprise beyond its 40% stake in the operating company without running afoul with the prescription against exceeding foreign equity limitations. Applying the Control Test to the diagram in the previous page, the 60% equity in the Operating Company held by the Holding Company will be deemed Filipino owned since 60% of the outstanding capital of the Holding Company is Filipino owned. Consequently, the corporate structure shown in the above diagram will pass muster under the Control Test and will fail under the Grandfather Rule.

A corollary to the Control Test is when the shares held by Filipinos in the holding company are less than 60%. A further step is taken by multiplying the percentage of the Filipino equity portion of the operating company against the percentage of the Filipino equity portion of the holding company. This could be referred as the "Control Test Corollary."[137]

B. SEC's 50-year Odyssey with the Control Test

In a 1988 Opinion,[138] the Department of Justice (DOJ) applied the Grandfather Rule in a situation where the holding company has an equity ratio between Filipinos and foreigners of 70:30. The holding company held 60% of the shares of the operating company and the remainder of the shares were foreign held. The DOJ concluded that foreign equity in the operating company was 58%[139] and the Filipinos held only 42%.[140] The DOJ opined

137. While some may call this an application of the Grandfather Rule, the Author begs to differ. The Grandfather Rule calls for multiplication of the shares in the investee corporation or Operating Company against the shares of the investor corporation or Holding Company regardless of the percentage of Filipino equity in the investor corporation or Holding Company. The Control Test Corollary calls for the upward multiplication only in cases where Filipino equity in the investor corporation falls below 60%. Hence, it is a true corollary to the Control Test which does not require further investigation once the magic 60% Filipino equity ownership is achieved in the Holding Company.

138. Department of Justice, DOJ Opinion No. 084, Series of 1988 (Apr. 26, 1988).

139. *Id.* The Opinion multiplied 30% foreign shareholding in the holding corporation by the 60% it owned in the operating company, resulting in 28%, and to this it added the 40% foreign shareholding to arrive at 58%.

140. *Id.* The Opinion multiplied 70% Filipino shareholding in the holding corporation by the 60% it owned in the operating company, resulting in 42%.

that the Grandfather Rule is to be applied each time a corporation has foreign shareholdings. The then Secretary of Justice Sedfrey A. Ordoñez explained that it is "implicit in the constitutional provisions"[141] that the nationality requirements can only be satisfied if share ownership also meets the criteria of beneficial ownership. Hence, "an arrangement which attempts to defeat the constitutional purpose should be eschewed[,]"[142] and without the application of the Grandfather Rule, the presence of foreign stockholders "could diminish the effective control of Filipinos."[143]

Barely nine months later, on 19 January 1989, Secretary Ordoñez again issued DOJ Opinion No. 18[144] on the application of the Control Test, without referring to it by its now well-known nomenclature. The opinion noted that "it appears that[,]"[145] as early as 28 February 1967, the SEC has already promulgated rules that mandated that a corporation shall be considered "as of Philippine nationality"[146] if 60% of its outstanding shares are held by Filipinos. The SEC regulation illustrated this with an example where such a corporation "of Philippine nationality"[147] holds 100,000 shares in another corporation, in which case all of the 100,000 shares shall be recorded as Filipino-owned. But if less than 60% of the shares of the same corporation, i.e., the holding corporation, are held by Filipinos, the 100,000 shares shall be multiplied by the lesser percentage. If only 50% of the holding corporation capital stock is held by Filipinos, only 50,000 shares of the 100,000 shares held by the holding corporation in the other corporation shall be counted as Filipino-owned, and the other 50,000 shares shall be recorded as foreign-owned. Since the rules in the 1967 SEC regulation were reiterated by the SEC on 7 September 1972 and these rules were approved by the Secretary of Commerce and Industry on 12 September 1972, the Justice Secretary declared that the SEC rule should be applied. He further explained that his opinion nine months earlier "is not meant to overrule the aforesaid SEC rule."[148] The opinion concluded that the Grandfather Rule

141. Department of Justice, Opinion addressed to Gov. Lilia Bautista of the Board of Investments, DOJ Opinion No. 130, Series of 1985 (Oct. 7, 1985).

142. *Id.*

143. DOJ Opinion No. 084, Series of 1988 (emphasis supplied).

144. Department of Justice, Opinion addressed to the Chairman of the Securities and Exchange Commission, DOJ Opinion No. 018, Series of 1988 (Jan. 19, 1989).

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

"will not apply in cases where the 60-40 Filipino-alien equity ownership in a particular natural resource corporation is not in doubt."[149]

Thus, the Control Test was already in use half a century ago, and was, in fact, documented as a 1967 regulation of the SEC. Also, it is apparent that if the good Justice Secretary were aware of the 1967 regulation nine months earlier, he would have applied the Control Test and decided the matter quite differently in the 1988 opinion. He may have not applied the Grandfather Rule since in that opinion, Filipinos owned 60% of the outstanding shares of the holding corporation.[150] It also is apparent that the Justice Secretary eschewed, to borrow his expression, the Grandfather Rule in his 1989 Opinion No. 18.

The 1989 DOJ Opinion No. 18 became the oft-quoted basis for subsequent applications of the Control Test by the SEC. In fact, in a meeting on 2 November 1989, the Commission *en banc* of the SEC formally "resolved to adopt the method of determining corporate nationality on the basis of the Opinion of the [DOJ] 18[, series of] 1989 dated [19 January] 1989."[151] The SEC explained that it "voted and decided to do away with the strict application/computation of the 'grandfather rule' and instead applied the so called 'control test[.']"[152] Thereafter, for 21 unbroken years, successive SEC opinions reiterated the 1989 DOJ Opinion No. 18 and the Control Test to the exclusion of the Grandfather Rule.[153] During this

149. *Id.*

150. DOJ Opinion No. 084, Series of 1988.

151. Securities and Exchange Commission, Opinion addressed to Atty. Maurice C. Nubla (Dec. 14, 1989) & Securities and Exchange Commission, Opinion addressed to Atty. Eduardo F. Hernandez (Jan. 2, 1990).

152. Securities and Exchange Commission, Opinion addressed to Gold Fields Philippines Corporation (May 30, 1990).

153. *See, e.g.*, Securities and Exchange Commission, Opinion addressed to Attys. Barbara Anne C. Migollos and Peter Barot (Nov. 6, 1989); Securities and Exchange Commission, Opinion addressed to Atty. Maurice C. Nubla; Securities and Exchange Commission, Opinion addressed to Atty. Eduardo F. Hernandez (Jan. 2, 1990); Securities and Exchange Commission, Opinion addressed to Gold Fields Philippines Corporation (May 30, 1990); Securities and Exchange Commission, Opinion addressed to Carag, Caballes, Jamora, Rodriguez & Somera Law Offices (Sep. 21, 1990); Securities and Exchange Commission, Opinion addressed to Mr. Francis F. How (Mar. 23, 1993); Securities and Exchange Commission, Opinion addressed to Director Angeles T. Wong of the Philippine Overseas Employment Administration (Apr. 14, 1993); Securities and Exchange Commission, Opinion addressed to Messrs. Dominador Almeda and Renato S. Calma (Nov. 23, 1993); Securities and

period, the FIA of 1991 came into effect and defined "Philippine national" to be among others, "a corporation organized under the laws of the Philippines of which at least [60%] of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines."[154] The

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Exchange Commission, Opinion addressed to Roco Bunag Kapunan Migallos & Jardeleza (Dec. 7, 1993); Securities and Exchange Commission, Opinion addressed to Atty. Ruby U. Alvarez (July 16, 2001); Securities and Exchange Commission, Re: Corporations considered as Philippine Nationals, SEC Opinion No. 04-49 (Dec. 22, 2004); Securities and Exchange Commission, Re: Control Test Rule, SEC-OGC Opinion No. 07-17 (Sep. 27, 2007); Securities and Exchange Commission, Opinion addressed to Mr. Rafael C. Bueno, Jr, SEC-OGC Opinion No. 07-18 (Nov. 28, 2007); Securities and Exchange Commission, For: Nationality Requirement of Public Utility Concessionaire, SEC-OGC Opinion No. 07-20 (Nov. 28, 2007); Securities and Exchange Commission, For: Control Test Rule, SEC-OGC Opinion No. 07-21 (Nov. 28, 2007); Securities and Exchange Commission, Opinion addressed to Attys. Ruby Rose J. Yusi and Rudyard S. Arbolado, SEC-OGC Opinion No. 08-03 (Jan. 15, 2008); Securities and Exchange Commission, Control Test: Alien Acquisition of Land, SEC-OGC Opinion No. 09-09 (Apr. 28, 2009); Securities and Exchange Commission, Re: Ownership Structure of a Land Owning Corporation, SEC-OGC Opinion No. 10-23 (Aug. 18, 2010); & Securities and Exchange Commission, Foreign Equity in Ship Management and Ship Manning Corporation, SEC-OGC Opinion No. 08-10 (Feb. 8, 2010).

154. Republic Act No. 8179, § 3 (a). This states —

> a. The term 'Philippine national' shall mean a citizen of the Philippines; of a domestic partnership or association wholly owned by citizens of the Philippines; or a corporation organized under the laws of the Philippines of which at least sixty percent (60%) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines; or a corporation organized abroad and registered as doing business in the Philippines under the Corporation Code of which one hundred percent (100%) of the capital stock outstanding and entitled to vote is wholly owned by Filipinos or 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 (60%) of the fund will accrue to the benefit of Philippine nationals: Provided, That where a corporation and its non-Filipino stockholders own stocks in a Securities and Exchange Commission (SEC) registered enterprise, at least sixty percent (60%) of the capital stock outstanding and entitled to vote of each of both corporations must be owned and held by citizens of the Philippines and at least sixty percent (60%) of the members of the Board of Directors of each of both corporations must be citizens of the Philippines, in order that the corporation, shall be considered a 'Philippine national.'

definition of a Philippine national did not make its debut in the FIA, but a similar definition can be found in the Omnibus Investments Code of 1989[155] and its predecessor, the Investment Incentives Act enacted in 1967,[156] the same year of the issuance of the SEC Regulation cited in DOJ Opinion No. 18 containing an early expression of the Control Test.[157] The SEC lost no

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Id.

155. OMN. INVESTMENTS CODE OF 1989, art. 15. It provides —

> Article 15. 'Philippine national' shall mean a citizen of the Philippines or a domestic partnership or association wholly-owned by citizens of the Philippines; or a corporation organized under the laws of the Philippines of which at least sixty per cent (60%) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines, or a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least sixty per cent (60%) of the fund will accrue to the benefit of Philippine nationals; Provided, That where a registered and its non-Filipino stockholders own stock in a registered enterprise, at least sixty per cent (60%) of the capital stock outstanding and entitled to vote of both corporations must be owned and held by the citizens of the Philippines and at least sixty per cent (60%) of the members of the Board of Directors of both corporations must be citizens of the Philippines in order that the corporation shall be considered a Philippine national.

Id.

156. Investment Incentives Act, § 3 (f). To wit —

> (f) 'Philippine National' shall mean a citizen of the Philippines; or a partnership or association wholly owned by citizens of the Philippines; or a corporation organized under the laws of the Philippines of which at least sixty per cent of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines; or a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine National and at least sixty per cent of the fund will accrue to the benefit of Philippine Nationals: *Provided*, That where a corporation and its non-Filipino stockholders own stock in a registered enterprise, at least sixty per cent of the capital stock outstanding and entitled to vote of both corporations must be owned and held by the citizens of the Philippines and at least sixty per cent of the members of the Board of Directors of both corporations must be citizens of the Philippines in order that the corporation shall be considered a Philippine National.

Id.

157. A SEC regulation dated 28 February 1967, cited in DOJ Opinion No. 18, Series of 1989, dated January 19, 1989, provides that —

time in embracing the FIA definition of Philippine national as one that "expressly embodied" the Control Test,[158] and the SEC noted that the FIA implementing rules also state explicitly that the Control Test shall be applied for the purpose of determining corporate nationality.[159] The SEC opinions

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> Shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality. Thus, if 100,000 shares are registered in the name of a corporation or partnership at least 60% of the capital stock or capital respectively, of which belong to a Filipino citizens, all of the said shares shall be recorded as owned by Filipinos. But if less than 60%, or, say, only 50% of the capital stock or capital of the corporation or partnership, respectively belongs to Filipino citizens, only 50,000 shares shall be counted as owned by Filipinos and the other 50,000 shares shall be recorded as belonging to aliens.
>
> DOJ Opinion No. 018, Series of 1988.

158. Securities and Exchange Commission, Opinion addressed to Mssrs. Dominador Almeda and Renato S. Calma & Securities and Exchange Commission, Opinion addressed to Roco Bunag Kapunan Migallos & Jardelez.

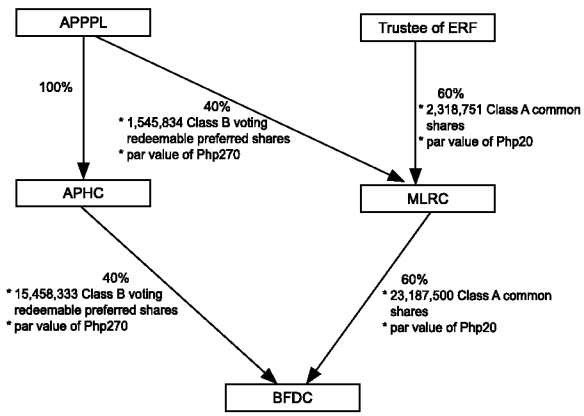
159. SEC-OGC Opinion No. 09-09; SEC-OGC Opinion No. 07-17; SEC-OGC Opinion No. 08-03; & Rules and Regulations Implementing the Foreign Investments Act, rule 1, § 1 (b). The latter provides that —

> (b) Philippine national shall mean a citizen of the Philippines or a domestic partnership or association wholly owned by the citizens of the Philippines; or a corporation organized under the laws of the Philippines of which at least sixty percent (60%) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines; or a corporation organized abroad and registered as doing business in the Philippines under the Corporation Code of which 100% of the capital stock outstanding and entitled to vote is wholly owned by Filipinos or 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 (60%) of the fund will accrue to the benefits of the Philippine nationals; Provided, that where a corporation and its non-Filipino stockholders own stocks in Securities and Exchange Commission (SEC) registered enterprise, at least sixty percent (60%) of the capital stock outstanding and entitled to vote of each of both corporations must be owned and held by citizens of the Philippines and at least sixty percent (60%) of the members of the Board of Directors of each of both corporation must be citizens of the Philippines, in order that the corporation shall be considered a Philippine national. *The control test shall be applied for this purpose.*

upholding the Control Test from 1993 up to 2010 consistently cited both the DOJ Opinion and the FIA definition for Philippine national in upholding the Control Test as the prevailing doctrine over the Grandfather Rule.[160]

On the whole, these SEC opinions considered shares as Filipino-owned if held by a holding company with a 60% Filipino equity. The SEC issued two opinions in 2010 with diagrams helpful to this Article. The first shown in the diagram below has the operating company, "BFDC" that will own land, "APPPL" which is Singaporean, and the "Trustee of ERF" which is Filipino.

Figure 2. Illustrative Case from SEC-OGC Opinion No. 10-23[161]



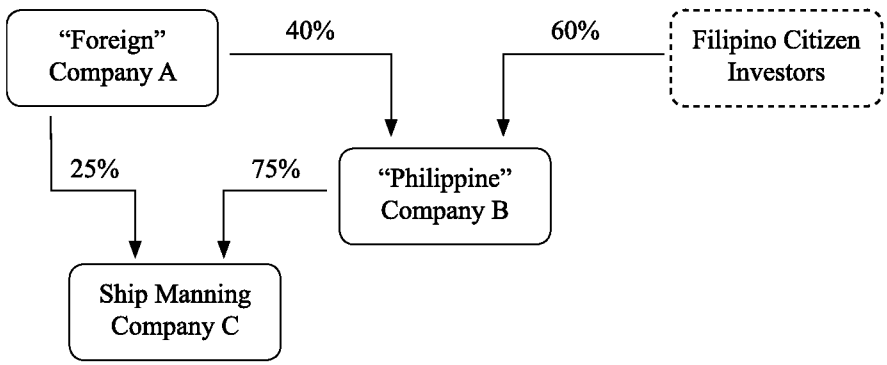
Id. (emphasis supplied).

160. *See, e.g.*, Opinion addressed to Mr. Francis F. How; Opinion addressed to Director Angeles T. Wong of the Philippine Overseas Employment Administration; Opinion addressed to Mssrs. Dominador Almeda and Renato S. Calma; Opinion addressed to Roco Bunag Kapunan Migallos & Jardeleza; Opinion addressed to Atty. Ruby U. Alvarez; Opinion addressed to Atty. Priscilla B. Valer; SEC-OGC Opinion No. 07-17; SEC-OGC Opinion No. 07-18; Securities and Exchage Commission, Opinion addressed to Santiago & Santiago Law, SEC-OGC Opinion No. 07-20 (Nov. 28, 2007); Securities and Exchange Commission, Opinion addressed to Atty. Andre Navato Jr., SEC-OGC Opinion No. 07-21 (Nov. 28, 2007); SEC-OGC Opinion No. 08-03; SEC-OGC Opinion No. 09-09; SEC-OGC Opinion No. 10-23; & SEC-OGC Opinion No. 10-08.

161. Securities and Exchange Commission, SEC-OGC Opinion No. 10-23, addressed to Attys. Teodulo G. San Juan, Jr. and Erdelyn C. Go (Aug. 18, 2010).

The second, shown in the following diagram, involves a manpower agency where foreign ownership is limited to 25%.[162] The diagram below is self-explanatory.

Figure 3. Illustrative Case Involving a Manpower Agency from SEC-OGC Opinion No. 10-08[163]



In both cases, as in the other queries, the SEC simply attributed Philippine nationality from the fact that 60% of the outstanding shares of the holding companies — "MLRC" in the first diagram and "Philippine" Company B" in the second diagram — and concluded that the shares held by the holding companies in the operating companies — 60% equity in "BFDC" in the first diagram and 75% equity in "Ship Manning Company C" in the second diagram — are Filipino-owned. Thus, in both cases, the corporate structures were deemed compliant with the statutory restrictions on foreign equity. There are also numerous SEC opinions, which involve other highly regulated economic activities, such as mining,[164] water extraction,[165] and grantees of public utility franchises.[166]

162. SEC-OGC Opinion No. 10-08 & A Decree Instituting a Labor Code Thereby Revising and Consolidating Labor and Social Laws to Afford Protection to Labor, Promote Employment and Human Resources Development and Insure Industrial Peace Based on Social Justice [LABOR CODE], Presidential Decree No. 442, art. 27.

163. SEC-OGC Opinion No. 10-08.

164. *See* Opinion addressed to Gold Fields Philippines Corporation. The SEC Opinion was in response to a query involving the purchase of shares in a mining corporation and its holding corporation. In the query, the result of the transaction would be that the holding corporation will have a 60:40 equity ratio

In none of these opinions was the Grandfather Rule considered. The Control Test Corollary, however, was used in the case where Filipinos own less than 60% of the outstanding shares of the holding company.[167] A better example of how the Control Test Corollary works is demonstrated in a 2005 DOJ Opinion where the corollary was used simultaneously with the Control Test. The structure under consideration, as presented in the 2005 opinion, is reproduced in the next page.

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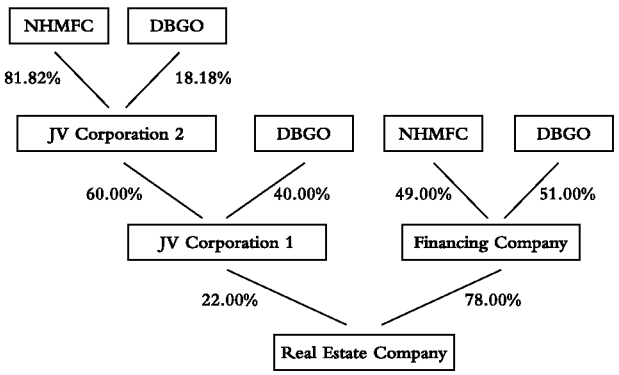
between Filipino and Australian and will own 20% of the mining corporation (Jericho Mining Corporation) and the 40% of the shares of the mining corporation will be Filipino-owned and the remaining 40% will be Australian owned. Applying the Control Test, the SEC deemed the proposed structure to be qualified to own mining rights. *Id.*

165. *See* Opinion addressed to Atty. Ruby U. Alvarez. In this Opinion, the query was in response to a plan to form a corporation (Project Company) which shall engage in the business of extraction and treatment of water. The capital of said Project Company shall have the following composition: 70% of its subscribed capital shall be owned by Corporation A, a 60% Filipino and 40% foreign owned entity. The remaining 30% of the capital of the Project Company will be owned by a foreign company. The opinion states, "it may well-be said that since the proposed equity structure of said company shall be 70% Filipino and 30% foreign, it is of Philippine nationality. This conclusion finds support in the clear and plain language of said test to the effect that shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered of Philippine nationality." *Id.*

166. *See* SEC Opinion No. 07-18; SEC-OGC Opinion No. 07-21; & SEC-OGC Opinion No. 07-20.

167. *See* Opinion addressed to Carag, Caballes, Jamora, Rodriguez & Somera Law Offices. In this matter, the SEC considered a corporation with only 44% of the shares owned by Filipinos and which intends to invest in 70% of the shares of stock of a proposed corporation and the rest or 30% to be subscribed by Filipinos. Here, the SEC multiplied 44% by 70% to arrive at 30.8% and added it to the 30% of the shares to be owned by Filipinos in the proposed corporation to arrive at the conclusion that the proposed corporation would be a Filipino Corporation since 60.8% of its capital stock will be deemed owned by Filipinos. *Id.*

Figure 4. Illustrative Case Involving the Control Test Corollary[168]



"DBGO" is the foreign entity in the diagram, and National Home Mortgage Finance Corporation[169] is a Filipino corporation. In this case, there are two layers of holding companies namely JV Corporation 2 and JV Corporation 1; the former being 81.82% Filipino-owned and, in turn, owning 60% of the latter's outstanding capital. This led to the conclusion that the 22% equity held by JV Corporation 1 in the operating company, the Real Estate Company in the diagram, is considered Filipino owned using the Control Test. On the other hand, only 49% of the outstanding capital of the Financing Company is Filipino-owned. As a result, the Opinion multiplied the 78% share equity held by the Financing Company in the Real Estate Company by 49% to arrive at 38.22% which would be a conclusion using the Control Test Corollary. Adding together the 22% held by JV Corporation 1 with the 38.22% of the Financing Company, the result would be 60.22%. Based on this, the DOJ concluded that the ownership structure of the Real Estate Company is legal, quoting extensively the 1989 Opinion No. 18 validating the Control Test as the prevailing rule.[170]

C. Doubts at the SEC and How it Entertains

Mathematics is the bane of lawyers. The reliance on mathematical formulas to analyze a legal question is an open invitation to befuddle legal minds.

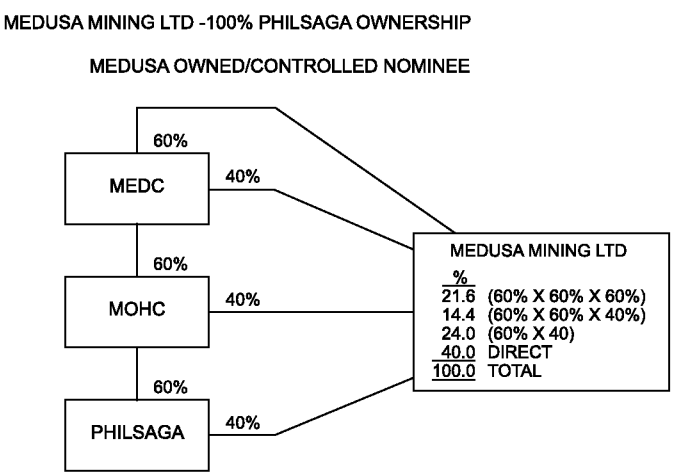
168. Department of Justice, Opinion No. 020, Series of 2005 (May 5, 2005).

169. Creating a National Home Mortgage Finance Corporation Defining Its Powers And Functions, And For Other Purposes, Presidential Decree No. 1267 (1977).

170. Department of Justice, Opinion No. 020, Series of 2005 (May 5, 2005).

Thus, in 2010, a cloud began to blur the application of the Control Test. In one query, the SEC deemed the ownership structure presented as largely hypothetical and applied the Control Test, but not without stating that the SEC is not precluded from using the Grandfather Rule where there is a doubt as to the actual extent of Filipino equity.[171] In that same year, the Control Test was challenged by a query from a small-scale miners association regarding the investments of Medusa Mining Ltd. (MML), an Australian company.[172] Prior to this, the SEC opinions cited were all queries posed by either the legal counsels or the officers of the companies that are the subject of the queries. In this matter, the query appears to be hostile to the company the SEC is being asked to examine. The question posed was whether MML violated the Anti-Dummy Law in structuring its investment in a mining structure and the following diagram was presented by the applicant.

Figure 5. Illustrative Case from SEC-OGC Opinion No. 10-31[173]



At the very top of the diagram is MEDC, where 60% of the equity is owned by Filipino individuals. MEDC, in turn, has a 60% stake in the equity of MOHC. In turn, MOHC owns 60% of PHILSAGA, the mining company. In all three companies, MEDC, MOHC, and PHILSAGA, MML has 40% equity. The opinion examines the Constitution and the Philippine Mining Act of 1995 — where mineral agreements are limited to corporations with at least 60% of the capital of which is owned by Filipino

171. *See* SEC-OGC Opinion No. 10-20.

172. *See* SEC-OGC Opinion No. 10-31.

173. *Id.*

citizens[174] — and noted that both the Constitution and the law uses the concept of "Philippine citizens" as defined in the Constitution[175] and refers only to natural persons. The opinion relied heavily on the case of *Palting v. San Jose Petroleum, Inc.*,[176] a 1966 decision of the Supreme Court which interpreted the provision on the exploitation of natural resources in the 1935 Constitution.[177] In this case, the Court had occasion to state that there can be no serious doubt as to the meaning of a citizen under the Constitution, as one who has a right to vote representatives to Congress and who is qualified to fill public office.[178] The SEC then proceeded to conclude that even if the *San Jose* case was decided under the 1935 Constitution, it is still the prevailing jurisprudence having yet to be overturned. According to the SEC Opinion,

> the Supreme Court suggests that a corporation engaging in a nationalized activity must be directly owned by citizens considering the text of the Constitution, and the fact that to allow indirect ownership of citizens through a series of intervening investing corporation would render it

---

174. *Id.* (citing PHIL. CONST. art. XII, §§ 2, 3 (g), 3 (aq) & § 26).

175. SEC-OGC Opinion No. 10-31 (citing PHIL. CONST. art. III, § 1).

176. Palting v. San Jose Petroleum, Inc., 18 SCRA 924 (1966).

177. 1935 PHIL. CONST. art. XIII, § 1 (superseded 1973). This states —

> Section 1. All agricultural, timber, and mineral lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces or potential energy, and other natural resources of the Philippines belong to the State, and their disposition, exploitation, development, or utilization shall be limited to citizens of the Philippines, or to *corporations or associations at least* [*60%*] *of the capital of which is owned by such citizens*[.]

Id. (emphasis supplied).

178. *Palting*, 18 SCRA at 936. The SEC Opinion quoted the decision at length, but below are the relevant portions —

> There could be no serious doubt as to the meaning of the word 'citizens' used in the aforementioned provisions of the Constitution. The right was granted to 2 types of persons: natural persons (Filipino or American citizens) and juridical persons (corporations 60% of which capital is owned by Filipinos and business enterprises owned or controlled directly or indirectly, by citizens of the United States). In American law, 'citizen' has been defined as 'one who, under the constitution and laws of the United States, has a right to vote for representatives in congress and other public officers, and who is qualified to fill offices in the gift of the people.'

Id.

> almost impossible to determine the citizenship of the natural persons who ultimately own and controls the shares of stock.[179]

The Opinion went on to state that the Control Test has no constitutional or statutory basis and administrative fiat as the mining law strictly adheres to the text of the Constitution. It then declared that it should be the Grandfather Rule which should be applied, and concluded from the facts illustrated in the diagram shown above that the total foreign equity in the joint mining venture is 87.04% against the Filipino equity of 12.96%. The SEC Opinion went further by stating that those responsible for the agreements behind this structure are criminally liable.

The SEC's Office of the General Counsel's opinion in the matter of Medusa Mining/PHILSAGA upsets decades of precedents on the Control Test. Subsequent SEC opinions after that dealt with the Control Test with a fair amount of evasiveness. In one opinion some four months later, the SEC stated that it does not render opinions or categorical answers on queries or issues that may require determination of substantial rights. The opinion mentioned the FIA and the 2005 DOJ Opinion No. 20 discussed earlier, but offered no conclusion.[180] In another opinion ten months later, the SEC merely quoted the definition of the FIA and the implementing rules that mentioned the Control Test, and alluded to the foreign negative list without offering any conclusion as to the status of the company requesting for an opinion.[181] In another opinion, the SEC applied both Control Test and the Grandfather Rule on a real estate venture, and, fortunately for the applicant, it passed both tests.[182] Subsequently, the SEC seems to take things into perspective when it applied the Control Test in a query on the SEC's "definitive stance on whether the 'Control Test' or the 'Grandfather Rule' should be applied for purposes of determining the Company's compliance with the 75% Filipino equity requirement for manning agencies."[183] All

179. SEC-OGC Opinion No. 10-31.

180. Securities and Exchange Commission, Re: Section 42 of the Corporation Code; Control Test and Grandfather Rule, SEC-OGC Opinion No. 11-26 (Apr. 19, 2011).

181. Securities and Exchange Commission, Re: Determination of Nationality of Corporation, SEC-OGC Opinion No. 11-42 (Oct. 12, 2011).

182. Securities and Exchange Commission, Re: Allowable Foreign Participation in a Corporation and in the Board of Directors; Place of Incorporation Test; Control Test and Grandfather Rule, SEC-OGC Opinion No. 12-02 (Feb. 2, 2012).

183. Securities and Exchange Commission, Re: Application of Control Test to Manning Companies, SEC-OGC Opinion No. 13-12 (Nov. 27, 2013).

these stand in stark contrast to the earlier opinions where definitive declarations were made as to the nationality of the corporations involved based on the Control Test.

What is ironic is that the 1966 *Palting* case is not even on point. As observed by Justice Marvic Mario Victor F. Leonen, the *Palting* case on which the SEC opinion in Medusa Mining/PHILSAGA is founded on had nothing to do with the Control Test or the Grandfather Rule. The case was promulgated prior to Republic Act No. 5186, or the Investment Incentives Act, in 1967 where the definition of Philippine national was established and which eventually found its way into the FIA.[184] In fact, the case also predates the 1967 SEC regulation which enunciates the Control Test.[185] Indeed, the controversy in the *San Jose* case has no common points with the debate on the Control Test as it concerns the public listing of a Panamanian company, San Jose Petroleum Inc. The proceeds of the listing will finance San Jose Oil Company Inc., which has 14 petroleum exploration concessions. 90% of the shares of San Jose Oil Company Inc., are owned by San Jose Petroleum, the Panamanian company, a majority of its interest of which, in turn, is owned by Oil Investments, another Panamanian company which, in turn, is 100% owned by two Venezuelan companies with 9,976 shareholders for one and 12,373 shareholders for the other scattered in 49 American states without any indication of the citizenship of the shareholders. At the time of the decision, the citizens of the United States (U.S.) enjoyed parity rights. While the Court did mention the 1935 Constitution, the decision was principally concerned with the provisions of the Laurel-Langley Agreement, specifically with respect to what is a "business enterprise owned or controlled directly or indirectly by citizens"[186] of the parties to the agreement.

The issue the Court resolved in 1966 was whether or not San Jose Petroleum, the Panamanian company, was an American business enterprise with parity rights in the Philippines. The Court concluded in the negative because, among others, it was not owned or controlled, directly or indirectly, by citizens of the U.S. In fact, it was owned by another Panamanian company, Oil Investments, which, in turn, is owned by two Venezuelan companies with a list of shareholders of unknown nationality

184. Narra Nickel Mining and Development Corp. v. Redmont Consolidated Mines, 722 SCRA 440, 481 (2014) (J. Leonen, dissenting opinion).

185. Opinion addressed to Gold Fields Philippines Corporation & DOJ Opinion No. 018, Series of 1989.

186. *Palting*, 18 SCRA at 939.

scattered over 49 American states.[187] Even granting, moreover, that the individual stockholders are American citizens, it is yet necessary to establish that the different states of which they are citizens allow Filipino citizens or corporations owned and controlled by Filipinos to engage in the exploitation of natural resources.[188] It is for these reasons that the Court set aside a SEC order allowing the listing of San Jose Petroleum, Inc. The Supreme Court made no suggestion that, in nationalized industries, only citizens can own the enterprise and that there is no room for holding companies or investor-corporations. Rather, it is due to the lack of data on the citizenship of thousands of shareholders obscured by several non-U.S. corporations that are registered in Panama and Venezuela, not to mention the absence of proof of reciprocity that made the Supreme Court reluctant to accord parity rights to San Jose Petroleum, Inc., under the Laurel-Langley Agreement.[189]

D. The Epic Battle of Narra Nickel: Control Test v. Grandfather Rule

The debate on the Control Test versus the Grandfather Rule came to a head in the case of *Narra Nickel Mining and Development Corp. v. Redmont Consolidated Mines*.[190] The controversy in this case stems from the interest of Redmont Consolidated Mines Corporation in exploring and mining the areas covered by the MPSA of the petitioners Narra Nickel Mining and Development Corporation, Tesoro Mining and Development, Inc., and MacArthur Mining, Inc. (hereinafter Narra, Tesoro, & McArthur, respectively). Narra, Tesoro, & McArthur eventually applied for an FTAA which was granted but later cancelled for violating the Constitution on alleged misrepresentation of its corporate nationality. To advance their cause, the petitioners relied heavily on the definition of Philippine national in the FIA[191] and the Control Test. The petitioners are mining corporations with several layers of corporate ownership built on the doctrine of the Control Test. In this instance, the Court found that the petitioners' corporate layering was used to circumvent the Constitution and applied the Grandfather Rule. The Court stated that it is the intention of the framers of the Constitution to apply the Grandfather Rule where corporate layering is

187. *Id.* at 933.

188. *Id.* at 937.

189. *Id.* at 927 & 933-37.

190. Narra Nickel Mining and Development Corp. v. Redmont Consolidated Mines, 722 SCRA 382 (2014) & Narra Nickel Mining and Development Corp. v. Redmont Consolidated Mines, 748 SCRA 455 (2015).

191 Foreign Investments Act of 1991, § 3 (a).

present citing the following excerpts from the Constitutional Commission —

> [Mr. José N. Nolledo]: Thank you.
>
> With respect to an investment by one corporation in another corporation, say, a corporation with 60-40 percent equity invests in another corporation which is permitted by the Corporation Code, does the Committee adopt the [G]randfather [R]ule?
>
> [Mr. Bernardo M. Villegas]:
>
> Yes, that is the understanding of the Committee.[192]

The Tribunal declared that the way the petitioners structured the ownership of the corporations is a scheme to circumvent the law and "creating a cloud in the Court's mind."[193] The Court then applied the Grandfather Rule, but not without declaring that

> the 'control test' is still the prevailing mode of determining whether or not a corporation is a Filipino corporation, within the ambit of [Section] 2, [Article] II of the 1987 Constitution, entitled to undertake the exploration, development and utilization of the natural resources of the Philippines. When in the mind of the Court there is doubt, based on the attendant facts and circumstances of the case, in the 60-40 Filipino-equity ownership in the corporation, then it may apply the 'grandfather rule.'[194]

The following diagrams represent the corporate structures utilized by petitioners Narra, McArthur, & Tesoro based on the figures supplied in the *Narra Nickel* Decision and Resolution.[195] The paid-in capital of each of the shareholders is indicated. It is assumed that the Filipino corporations at the very top of each chart are wholly owned by Filipinos, as no breakdown was supplied by the facts in the Decision or Resolution. These corporations are Palawan Alpha South Resource Development Corporation and Olympic Mines & Development Corporation. The total paid-in capital of the Filipino shareholders versus the foreign shareholders in each of the structures are summed up in one figure, regardless of whether it was invested in the Holding Company or in the Operating Company. By comparing the total paid-in sums of the foreign shareholders against the Filipino shareholder, one

192 *Narra Nickel Mining and Development Corp.*, 722 SCRA at 416 & *Narra Nickel Mining and Development Corp.* 748 SCRA at 466.

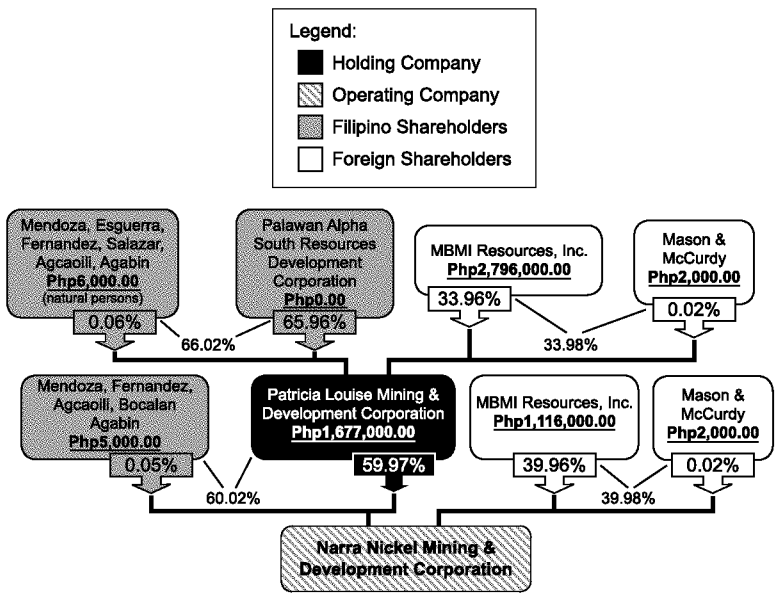
193 *Narra Nickel Mining and Development Corp.*, 722 SCRA at 419 (emphasis supplied).

194. *Id.* at 439.

195. *Id.* at 382, 419-25 & *Narra Nickel Mining and Development Corp.*, 748 SCRA at 482-88.

will discern that despite the larger 60% shareholding of the Filipino shareholders, the foreign shareholders paid-in far more capital than the Filipino shareholders. What is immediately apparent in the charts below is the fact that the ultimate Filipino corporate shareholders at the top of the charts paid nothing for their shares, a fact that did not go unnoticed by the Court.[196]

Figure 6. Corporate Structure of Narra Nickel Mining and Development Co.[197]



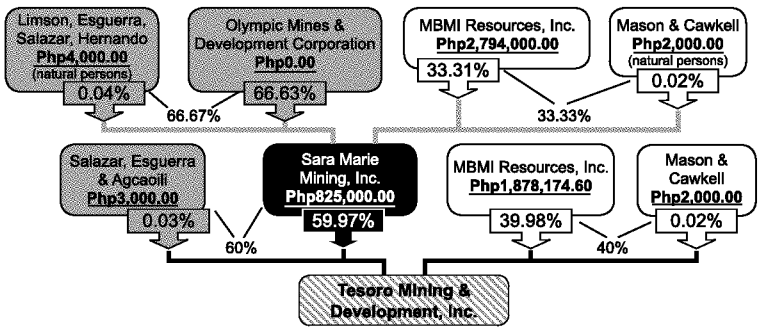
Total Paid-in Capital in the Structure:

Total Paid-in Capital of Filipino Corporate Shareholder in the Holding Company: Php0.00
Total Paid-in Capital of Filipino Shareholders & the 60:40 Holding Company: Php1,688,000.00
Total Paid-in Capital of the Foreign Shareholders: Php3,916,000.00

196. *Narra Nickel Mining and Development Corp.*, 748 SCRA at 455, 482, 485, & 488 (2015).

197. The image was created by the Author based on figures culled from *Narra Nickel Mining and Development Corp.*, 748 SCRA at 486-89.

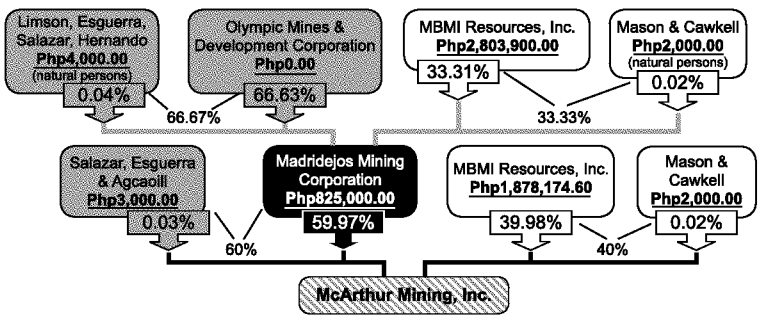
Figure 7. Corporate Structure of Tesoro Mining and Development, Inc.[198]



Total Paid-in Capital in the Structure:

Total Paid-in Capital of Filipino Corporate Shareholder in the Holding Company: Php0.00
Total Paid-in Capital of Filipino Shareholders & the 60:40 Holding Company: Php832,000.00
Total Paid-in Capital of the Foreign Shareholders: Php4,676,174.60

Figure 8. Corporate Structure of McArthur Mining, Inc.[199]



Total Paid-in Capital in the Structure:

Total Paid-in Capital of Filipino Corporate Shareholder in the Holding Company: Php0.00
Total Paid-in Capital of Filipino Shareholders & the 60:40 Holding Company: Php832,000.00
Total Paid-in Capital of the Foreign Shareholders: Php4,686,074.60

The *Narra Nickel* decision is now the controlling doctrine on the subject of the Control Test vis-à-vis the Grandfather Rule. To reiterate, the Control Test was considered the prevailing rule, but, in case of doubt, the Grandfather Rule will be applied. Consequently, the SEC, in a 2016

198. The image was created by the Author based on figures culled from *Narra Nickel Mining and Development Corp.*, 748 SCRA at 482-84.

199. The image was created by the Author based on figures culled from *Narra Nickel Mining and Development Corp.*, 748 SCRA at 484-86.

Opinion, quoted extensively from the *Narra Nickel* Decision and confirmed that the Control Test shall be used in determining corporate nationality.[200]

E. Lawyers Love Math: How to Compute the Number of Shares

In the interest of muddling further the discussion on the limits of foreign equity ownership with math calisthenics, the Supreme Court was asked to resolve the question of how to compute the percentage of outstanding shares in a corporation with more than one class of shares in the case of *Gamboa v. Teves*.[201] The case stems from the sale of 46.125% of the shares of Philippine Telecommunications Investment Corporation (PTIC) to First Pacific Company Limited (First Pacific), a company registered in Bermuda.[202] PTIC holds a significant amount of shares of Philippine Long Distance Telephone Company (PLDT) that the sale would effectively be an indirect sale of 6.3% of the outstanding shares of PLDT such that First Pacific's common shareholdings in PLDT will increase from 30.7% to 37%, resulting to an increase of foreign common shareholdings to 81.47%.[203] Since PLDT is a grantee of a telecommunications franchise, it is subject to the constitutional limit of 40%.[204] What the controversy over the sale unraveled is the fact that even prior to the sale, foreigners owned 64.27% of the common shares of PLDT.[205] Filipinos owned 99.44% of the preferred shares without voting rights, and the preferred shares constituted 77.85% of the authorized capital stock of PLDT.[206] Consequently, while foreigners owned more than 60% of the common shares entitled to vote, because of the overwhelming numbers of Filipinos owning the preferred shares and the fact that preferred shares constitutes more than three fourths of the total shares, Filipinos own more than 60% of all of PLDT's outstanding shares, both common and preferred.[207] In short, if one were to consider the totality of the shares, Filipino shareholders held more than 60% of the PLDT stock; but if one were to consider only the common shares, the Filipino shareholders owned only 35.73%.

200. Securities and Exchange Commission, Re: Application of Control Test to Manning Companies, SEC-OGC Opinion No. 16-19 (Aug. 11, 2016).

201. Gamboa v. Teves, 652 SCRA 690 (2011).

202. *Id.* at 700.

203. *Id.* at 700-01.

204. *Id.* (citing PHIL. CONST. art. XII, § 11).

205. *Gamboa*, 652 SCRA at 735.

206. *Id.* at 736.

207. *Gamboa*, 652 SCRA at 737 & *Gamboa*, 682 SCRA at 458.

Focusing on the constitutional provision that a corporation holding a franchise must have at least sixty per cent of its *capital* owned by Filipino citizens,[208] the Court declared that "the crux of the controversy is the definition of the term 'capital.'"[209] The issue is then whether or not the Constitution refers to the total outstanding capital stock or just the common shares.[210] In studying the question, the Court bewailed the fact that the dividends paid in 2009 for preferred shares which were mostly held by Filipinos was one-seventieth of what was paid to common shareholders. The Court went on to emphasize that legal and beneficial ownership of 60% the outstanding capital stock, as opposed to mere legal title, must be in the hands of Filipinos. Thus, the Court declared that "[f]ull beneficial ownership of [60%] of the outstanding capital stock, coupled with [60%] of the voting rights is constitutionally required for the State's grant of authority to operate a public utility."[211] Finally, the Court concluded that the Constitution refers only to shares of stock entitled to vote in the election of directors, which means currently only to common shares and not the total outstanding capital stock comprising of both common stock and non-voting preferred shares.[212]

In resolving the motion for reconsideration in *Gamboa*, the Court underscored that in the definition of "Philippine national" in the FIA, the Filipino-owned 60% of capital stock of the domestic corporation deemed as Philippine national should be entitled to vote[213] coupled with full beneficial ownership.[214] The Court went on to say —

> Thus, if a corporation engaged in a partially nationalized industry, issues a mixture of common and preferred non-voting shares, at least [60%] of the common shares and at least [60%] of the preferred non-voting shares must be owned by Filipinos ... In short, the 60-40 ownership requirement in favor of Filipino citizens must apply separately to each class of shares, whether common, preferred non-voting, preferred voting[,] or any other class of shares.[215]

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208. PHIL. CONST. art. XII, § 11.

209. *Gamboa*, 652 SCRA at 717.

210. *Id.*

211. *Id.* at 730, 735, & 737.

212. *Id.* at 723 & 744.

213. *Gamboa*, 682 SCRA at 439.

214. *Id.* at 443 (citing Rules and Regulations Implementing Republic Act No. 8179, rule 1, § 1 (b), ¶ 3 (1996)).

215. *Gamboa*, 682 SCRA at 445.

The SEC reacted promptly to the *Gamboa* pronouncements. Even prior to the resolution of the motion for reconsideration, the SEC elucidated, in an opinion, that the test for compliance with the nationality requirement is based on the total outstanding capital stock irrespective of the amount of the par value of the shares, and likewise without regard to whether or not such shares have been fully or partially paid. Moreover, "the term 'capital' without qualification ... should be interpreted to refer to the sum total of outstanding capital stock, irrespective of the nomenclature or classification as common, preferred, voting or non-voting."[216]

The SEC did take note that the Court's decision "construed the term 'capital' in Section 11, Article XII of the Constitution as shares of stock that can vote in the election of directors" but pointed out that the matter is still pending motion for reconsideration. [217] After the High Court resolved the motion for reconsideration, the SEC issued Memorandum Circular No. 8 which again noted in its whereas clause the Court's ruling that the term "capital" refers only to shares of stock entitled to vote[218] and proceeded to issue the following edict in section 2 of the circular, to wit —

> All covered corporations shall, at all times, observe the constitutional or statutory ownership requirement. For purposes of determining compliance therewith, the required percentage of Filipino ownership shall be applied to *both* (a) the total number of outstanding shares of stock entitled to vote in the election of directors; [and] (b) the total number of outstanding shares of stock, whether or not entitled to vote in the election of directors.[219]

Quite interestingly, even SEC Memorandum Circular No. 8 saw its day in court, so to speak. In the case of *Jose M. Roy, III v. Chairperson Teresita Herbosa*,[220] a crusading gentleman by the name of Jose Roy, III, filed a

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216. Securities and Exchange Commission, Re: Nationality Restrictions; Control Test and Grandfather Rule; Composition of the Board, SEC-OGC Opinion No. 11-44 (Oct. 27, 2011).

217. *Id.* (emphasis supplied).

218. Securities and Exchange Commission, Guidelines On Compliance with the Filipino-Foreign Ownership Requirements Prescribed in the Constitution and/or Existing Laws by Corporations Engaged in Nationalized and Partly Nationalized Activities, Memorandum Circular No. 18, series of 2013 [SEC Memo. Circ. No. 18, s. of 2013], whereas cl. 5 (May 20, 2013).

219. *Id.* § 2, ¶ 1 (emphasis supplied).

220. Jose M. Roy, III v. Chairperson Teresita Herbosa, G.R. No. 207246, Nov. 22, 2016, *available at* http://sc.judiciary.gov.ph/pdf/web/viewer.html?file=/jurisprudence/2016/november2016/207246.pdf (last accessed Aug. 10, 2017). The motion for reconsideration was denied. Jose M. Roy, III v. Chairperson Teresita Herbosa, G.R. No. 207246, Apr. 18, 2017, *available at*

petition for certiorari, in his capacity as a lawyer and taxpayer and invoking the "transcendental importance" of the *Gamboa* case, to assail the validity of, and to nullify, SEC Memorandum Circular No. 8.[221] According to Mr. Roy, the circular "practically encourages circumvention of the 60-40 ownership rule by impliedly allowing the creation of several classes of voting shares with different degrees of beneficial ownership, but at the same time, not imposing a 40% limit on foreign ownership of the higher yielding stocks."[222]The controversy centered on Section 2 of the Circular quoted above. The Court did take notice that the Section goes beyond requiring the 60-40 ratio in favor of Filipino nationals to just the voting stock by requiring the ratio on the total number of outstanding stock. The Court then took a cue from the definition of "beneficial owner" and "beneficial ownership" in the implementing rules of the Securities Regulations Code[223] and the concept under the FIA's implementing of "full beneficial ownership," that is, "[f]ull beneficial ownership of [60%] of the outstanding capital stock, coupled with [60%] of the voting rights, is required."[224] The question to be resolved for the Court is, who is the beneficial owner of a "specific stock" such that the voting or disposing power resides in such person? If a Filipino is recorded in the books of the corporation as owning a "specific stock" without having either the power to vote or dispose, then the stock is not beneficially owned by the Filipino. A Filipino who has either the disposing power or the voting power or both shall be counted as part of the 60% of the total outstanding stocks entitled to vote. The Court clarified that the "[*Gamboa*] Decision and Resolution Doctrine did *not* make any definitive ruling that the 60% Filipino ownership requirement was intended to apply to each class of share."[225] The Court concluded that since the SEC, in issuing the Circular in question, "acted pursuant to the Court's pronouncements in both the *Gamboa* Decision and *Gamboa* Resolution, then it could not have gravely abused its discretion."[226]

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http://sc.judiciary.gov.ph/pdf/web/viewer.html?file=/jurisprudence/2017/april2017/207246.pdf (last accessed Aug. 10, 2017) (motion for reconsideration).

221. *Roy, III*, G.R. No. 207246, at 3-4.

222. *Id.* at 7.

223. *Id.* at 5 (citing Securities and Exchange Commission, Implementing Rules of the Securities Regulations Code, Republic Act No. 8799, §§ 3.1.2 & 3.1.8 (2015)).

224. Rules and Regulations Implementing the Foreign Investments Act of 1991, Republic Act No. 7042, rule 1, § 1 (b), ¶ 3.

225. *Roy, III*, G.R. No. 207246, at 31.

226. *Id.* at 33.

In a subsequent resolution resolving a motion for reconsideration, the Court reiterated that the pronouncement in the *Gamboa* Resolution, that the constitutional requirement on Filipino ownership should apply uniformly and across the board to all shares, was a mere *obiter dictum* and that the SEC circular is in consonance with concepts of "beneficial owner or ownership" and "full beneficial ownership."[227] Consequently, for the time being, the rule in SEC Memorandum Circular No. 8 stands — in arriving at the percentage of Filipino ownership, one should compute both the total outstanding shares with voting rights and the total outstanding shares regardless of the presence or absence of voting rights.

VI. FOREIGN OWNERSHIP: THE LIMITATIONS OF IGNORING THE OBVIOUS

It may be said that the Control Test has survived its dissection in the *Narra Nickel* case. It still is the prevailing doctrine in determining corporate nationality. But it is the re-emergence of the Grandfather Rule that perplexes. Examining the corporate layering in the SEC opinions where the Control Test was applied consistently for more than 20 years, one cannot detect any substantial difference between these and the two cases where the Grandfather Rule was applied, both in the 2010 SEC-OGC Opinion in Medusa Mining/PHILSAGA[228] and the *Narra Nickel* case.

In the *Narra Nickel* case, the Court's majority opinion found "membership and control structure nuances" that created "serious doubt" as to the actual extent of the participation of the foreign corporation in the equity of the petitioners Narra, Tesoro, & McArthur. In truth, the majority opinion identifies only two points in the corporate structure to justify this "serious doubt" to justify the application of the Grandfather Rule. First is the fact that the two ultimate Filipino corporate shareholders, Palawan Alpha South Resource Development Corporation and Olympic Mines & Development Corporation, paid nothing for their investments in the holding companies. And second, MBMI, the Canadian investor company, practically provided all the funds. [229]

The fact that the Filipino corporate shareholders contributed no funds into the holding companies is indeed distinctive and even a strange manner to organize the capital of corporate vehicles used for layering in the sensitive

227. *Roy, III*, G.R. No. 207246, at 4 (motion for reconsideration).

228. Securities and Exchange Commission, Foreign Ownership in a local mining corporation, SEC-OGC Opinion No. 10-31 (Dec. 9, 2013).

229. *Narra Nickel Mining and Development Corp.*, 748 at 482-88. *See also Narra Nickel Mining and Development Corp.*, 722 SCRA at 419-25 (emphasis supplied).

and controversial mining industry. One might say that this can be perceived as an abuse of the Control Test, and may have given the Court the impetus to apply the Grandfather Rule. But despite its oddity, it is not illegal and is, in fact, permitted. The Corporation Code[230] does not state that each subscriber must pay for his or her share upon subscription. What the Code provides is that at least 25% of the total subscription at the time of incorporation or the increase of authorized stock must have been paid upon subscription for purpose of incorporation[231] or upon filing of the certificate to increase the authorized capital.[232] Assuming that the shares issued by the holding companies to the two ultimate Filipino corporate shareholders were upon incorporation or as a result of an increase of authorized capital, the presumption of validity must be accorded to the manner which the holding companies were organized on the basis of the certificate of incorporation or the certificate of increase of authorized capital stock granted by no less than the SEC. There can be no misrepresentation drawn from this fact alone as to justify a cancellation of corporate registration. There being no allegation that

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230. Corporation Code of the Philippines [CORP. CODE], Batas Pambansa Blg. 68 (1980).

231. *Id.* § 13. This provision states —

> Section 13. Amount of capital stock to be subscribed and paid for the purposes of incorporation. — At least twenty-five percent (25%) of the authorized capital stock as stated in the articles of incorporation must be subscribed at the time of incorporation, and at least twenty-five (25%) per cent of the total subscription must be paid upon subscription, the balance to be payable on a date or dates fixed in the contract of subscription without need of call, or in the absence of a fixed date or dates, upon call for payment by the board of directors: Provided, however, That in no case shall the paid-up capital be less than five Thousand (₱5,000[ ]) pesos.

Id.

232. *Id.* § 38, ¶ 4. The pertinent provision reads as follows —

> [T]hat the Securities and Exchange Commission shall not accept for filing any certificate of increase of capital stock unless accompanied by the sworn statement of the treasurer of the corporation lawfully holding office at the time of the filing of the certificate, showing that at least twenty-five (25%) percent of such increased capital stock has been subscribed and that at least twenty-five (25%) percent of the amount subscribed has been paid either in actual cash to the corporation or that there has been transferred to the corporation property the valuation of which is equal to twenty-five (25%) percent of the subscription.

Id.

the paid-in capital, or rather the absence thereof on the part of the Filipino shareholders, was ever concealed. And, if the shares were issued as a result of a subscription from the unissued shares of the corporation, that is, it is a subscription that arose from neither the incorporation nor an increase of authorized capital, then the issuance of shares without payment upon subscription is explicitly permitted by the SEC. The SEC has had occasion to state that

> the board of directors, in the honest and reasonable exercise of discretionary powers, has the power to fix the amount that would be considered sufficient downpayment on subscription to the unissued shares of the corporation, which may be at [five percent], 20%[,] or none at all; and to prescribe the time and manner of payment of the subsequent subscriptions.[233]

The other "nuance" mentioned in the *Narra Nickel* Decision is that the foreign investors supplied almost all of the funds for the venture. The disparity between the investment of MBMI and the Filipino shareholders can, in fact, be easily confirmed by computing and comparing the paid-in capital of the foreign investors *vis-à-vis* the Filipino shareholders. But this is the inevitable mathematical result of the corporate layering where the foreign investor not only invests in the 40% equity of the operating company allocated to foreign participation, but also in the remaining 60% reserved for Filipino shareholders by way of allowable investments in the holding company or series of holding companies that own the 60% Filipino equity portion in the operating company. The same inescapable outcome will be obtained if one were to sum up all the paid-in capital in any of the structures that were deemed valid by the SEC under the Control Test in its prior opinions. Besides, in any business venture, especially in mining, the equity investment forms a very small part of the total capital made available to the venture. One can peruse any financial statement in the mining industry and check the balance sheet's liability and equity portion to find that for the most part a mining venture is funded by borrowings.

In sum, the doctrine that with sufficient *indicia* of doubt, the Grandfather Rule may be applied has not been well demonstrated in the *Narra Nickel* Decision. The result is an unstable doctrine leaving lawyers guessing on what can create the "doubt" or "serious doubt." With the same set of facts, one can apply either the Grandfather Rule or the Control Test arbitrarily.

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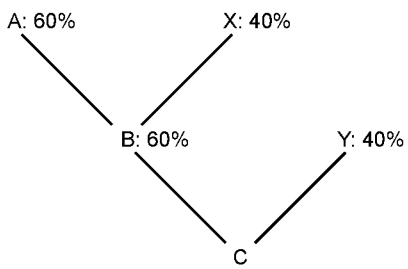
233. Securities and Exchange Commission, Foreign Ownership in a local mining corporation, Opinion No. 12-03 (Apr. 14, 2003).

Moreover, the Grandfather Rule, as pointed out by Justice Leonen in his dissent, is without statutory basis.[234] The *Narra Nickel* majority opinion found its moorings in an excerpt from the Constitutional Commission where the Grandfather Rule was discussed.[235] However, the fact that there is no constitutional provision on the Grandfather Rule that emanated from the quoted banter only tells us that the Grandfather Rule was not adopted by the Commission. As Justice Leonen puts it, it indicates at most the understanding between the two commissioners involved in the conversation.[236] Hence, just like in a restaurant where from a menu of delectable dishes several choices are considered, some recited and some discussed and others not, in the menu of proposals and ideas before the Constitutional Commission, the Grandfather Rule was mentioned, but not chosen.

On the other hand, the Control Test is founded in law. It is in the definition of Philippine national found in the FIA[237] and it has more than 50 years of regulatory history commencing from the 1967 SEC regulation mentioned in DOJ Opinion No. 18.[238] The Control Test, as its name suggests, is justified by the exercise of control by means of corporate layering. This was illustrated with simple clarity by Justice Leonen with the diagram below.

Figure 9. Illustration of the Control Test Provided by Justice Leonen[239]



234. *Narra Nickel Mining and Development Corp.*, 722 SCRA at 489 (J. Leonen, dissenting opinion).

235. *Narra Nickel Mining and Development Corp.*, 722 SCRA at 415-16 & *Narra Nickel Mining and Development Corp.*, 748 SCRA at 466.

236. *Narra Nickel Development and Mining Co.*, 722 SCRA at 489 (J. Leonen, dissenting opinion).

237. Republic Act No. 8179, § 3 (a).

238. Department of Justice, Opinion No. 18, Series of 1989 (Jan. 19, 1989).

239. *See Narra Nickel Development and Mining Co.*, 722 SCRA at 497 (J. Leonen, dissenting opinion).

Justice Leonen explains in his dissent, "[b]y owning 60% of B's capital, A controls B. Likewise, by owning 60% of C's capital, B controls C. From this, it follows, as a matter of transitivity, that A controls C; albeit indirectly, that is, through B."[240] In the final analysis, the Control Test is based on the Filipino ownership of 60% share in the capital of a corporation that is deemed a Philippine national, and is thus qualified to enjoy the economic rights granted by the law and the Constitution. And one needs to look no further than the Constitution as the source of that magic number of 60% which creates the conclusive presumption of Philippine corporate nationality.

VII. OF INCENTIVES AND FOREIGN INVESTMENTS: THE EXIT

Under the umbrella of the package of incentives granted by the Special Economic Zone Act of 1995 and the Omnibus Investments Code of 1987, the Philippines now has a flourishing business processing outsourcing (BPO) industry that currently employs 1.15 million full time employees and that had a revenue of US$22.9 billion in 2016.[241] The industry's numbers rival even that of the personal remittance of overseas Filipino workers, which amounted to US$29.7 billion in 2016.[242] In fact, it is projected that the BPO industry will generate US$38.9 billion and employ 1.8 million full time employees by 2022.[243]

The BPO industry prefers to use the acronym "IT-BPM" to refer to their sector, which spells out to mean "Information Technology — Business Process Management." This would emphasize that the industry is driven by information technology, and all the innovation, passion, and energy associated with it, and that they manage business processes, which requires the use of intellect, sophistication, and global understanding. It is deemed a more relevant term for the industry, and definitely friendlier and more

240. *Id.*

241. The association, "IT & Business Process Association of the Philippines Inc." commissioned market research company Frost & Sullivan to do the study. The result is the work entitled, "IT & Business Process Association Of The Philippines Inc., Accelerate PH Future-Ready Roadmap." IT & BUSINESS PROCESS ASSOCIATION OF THE PHILIPPINES INC., ACCELERATE PH FUTURE-READY ROADMAP 2022 55-56 (2017).

242. Bangko Sentral ng Pilipinas, Overseas Filipinos' (OF) Remittances for the Periods Indicated, *available at* http://www.bsp.gov.ph/statistics/keystat/ofw.htm (last accessed Aug. 10, 2017).

243. IT & BUSINESS PROCESS ASSOCIATION OF THE PHILIPPINES INC., *supra* note 241, at 55-56.

welcoming than the use of the word "outsourcing" — a less than positive word for the industry as it connotes the flight of jobs from the clients' country of origin into the Philippines.

In an independent study commissioned by the IT & Business Process Association of the Philippines Inc.,[244] India and the Philippines stood out as the world's leading destinations in the IT-BPM sector. But other countries, such as China, Mexico, Chile, Brazil, Poland, Indonesia, Thailand, Malaysia, and Vietnam, are in the market as well.[245]

These countries were chosen for the study for their offerings in contact center BPM, IT outsourcing, and non-voice BPM services. The comparative study puts the Philippines in a pool of 11 countries, the ten mentioned plus the Philippines. Sadly, the Philippines is at the bottom half of many criteria. The Philippines is fourth from the bottom in ease of doing business, world competitiveness, and business environment.[246] What was surprising to see is that the Philippines is ranked only seventh out of the 11 countries mentioned in people skills and availability.[247] In terms of global connectivity, i.e., a country's stage of readiness in five key technologies: broadband internet, big data analytics, data centers, cloud services, and Internet of Things (IoT), the Philippines and India are grappling with ICT infrastructure. This is despite the fact that the two nations are global leaders with increasing smartphone and mobile phone penetration. In the case of the Philippines, it again ranks fourth from the bottom in global connectivity, just ahead of India, Vietnam, and Indonesia.[248] It will not be news to the Philippine reader to learn that, in comparison with these competing

244. The association, IT & Business Process Association of the Philippines Inc. (IBPAP) commissioned the market research company Frost & Sullivan to do the study in order to create a five-year plan for the industry. The result is the work entitled, "IT & Business Process Association Of The Philippines Inc., Accelerate PH Future-Ready Roadmap" cited herein. This was narrated to the author by Manolito T. Tayag, who chaired the committee on this project dubbed "Roadmap 2022 Committee". Manolito T. Tayag is currently the Chairman of the IBPAP and the Country Managing Director of Accenture Philippines, Inc. Interview *with* Manolito T. Tayag *in* Valley Golf and Country Club (June 25, 2017 and prior dates).

245. IT & BUSINESS PROCESS ASSOCIATION OF THE PHILIPPINES INC., *supra* note 241, at 27-30.

246. *Id.* at 32-33.

247. *Id.* at 32.

248. *Id.* at 39. The Global Connectivity Index cited here is to be distinguished from international connectivity. The Philippines with its eight submarine cables is considered one of the strongest connected nations of the region. *Id.* at 123.

countries in the IT-BPM sector, the Philippines has the most expensive average fixed broadband cost per month at US$22.50 as compared to India at US$6.90, Indonesia at US$9.27, and Poland at US$12.36, and for this expense the Philippines is second from the bottom in average internet speed of 3.2 Mbps with India only slower than the Philippines at 2.8 Mbps. Compare this to Poland with an average speed of 11 Mbps making it the most cost-effective broadband service of the 11 countries.[249] In contrast, in terms of financial attractiveness, the Philippines ranks fourth highest with Indonesia leading in this regard, followed by India, then by Vietnam.[250]

The largest IT-BPM spenders can be traced to the wealthy English speaking countries, the U.S., the United Kingdom, and Canada.[251] The U.S. and Canada account for 61.3% of the global IT-BPM offshore demand.[252] It is here where the Philippines has its competitive advantages — the country tops the Business English Index in 2013 and also has the second highest in the Test of English as a Foreign Language (TOEFL) Internet-Based Test Total Scores in 2015. Philippines was noted in the study as the third largest English speaking country in the world with some 70% of the population being able to converse in English.[253]

The image of the IT-BPM industry in the public mind is that information technology drives this industry. What the public may not realize is that there is also the threat that information technology will drive it out. On a weighted average basis, the 2016 figures are that roughly 45.8% of the men and women in the IT-BPM sector in the Philippines are in low-skilled roles. Low-skilled roles are simple entry level, process driven tasks that require little abstract thinking or autonomy.[254] In connection to this, a statement in the study states that "the Philippines is considered the first choice and premium destination for contact center services driven by its strong base of service-oriented talent, affinity to Western cultures[,] and established base of BPM operators."[255] This paean to Filipino skills should not distract us from the peril of automation of contact center services. The study noted that one out of three low-skilled IT-BPM tasks have a 40% to

249. *Id.* at 38.

250. IT & BUSINESS PROCESS ASSOCIATION OF THE PHILIPPINES INC., *supra* note 241, at 32.

251. *Id.* at 40.

252. *Id.* at 23.

253. *Id.* at 40-41. India was the highest scorer for the TOEFL Internet-Based Test.

254. *Id* at 87-88.

255. *Id.* at 88 (emphasis supplied).

60% likelihood of automation by 2020.[256] Mid-skilled roles, which involve complicated tasks that require abstract thinking and situational response, comprises 39.4% of the IT-BPM workforce. One out of six of the mid-skilled roles has a 40% to 60% likelihood for automation by technologies like machine learning and natural language processing. High-skilled roles which involve complicated tasks and specialized expertise, comprise only 14.7% of the IT-BPM workforce are the least likely to be threatened by automation, with only one out of 20 roles with a 15% to 20% likelihood of automation.[257] The study is however hopeful that, while technological changes may dampen growth in the low-end services such as voice and transcription services, it is hoped that the new technology will enable the sector to move up the value chain.[258]

In the meantime, the current administration's tax reform legislative program entitled the "Tax Reform for Acceleration and Inclusion," known by its acronym the TRAIN Bill, has trained its gun sights on the indirect VAT.[259] The administration's tax package, as prepared by the Department of Finance, takes on three daunting tasks. First, it seeks to raise funds on what the government needs to spend, i.e., one trillion pesos a year for the next six years on infrastructure, health, education, and social welfare.[260] Second, TRAIN simultaneously simplifies personal income taxes to benefit the poor and the middle class.[261] And third, TRAIN seeks to widen the revenue base from certain sectors such as low cost housing, indirect exporters, and the auto and oil industry.[262] In response to the administration's initiative, the House of Representatives approved House Bill No. 5636 which did not eliminate the indirect zero rating for services although eliminated it for goods upon the establishment of the enhanced VAT refund system that will

256. IT & BUSINESS PROCESS ASSOCIATION OF THE PHILIPPINES INC., *supra* note 241, at 89.

257. *Id.* at 87-89.

258. *Id.* at 90.

259. Department of Finance, Tax Reform for Acceleration and Inclusion Revised package 1 As of January 30, 2017 (A Draft PowerPoint Presentation by Department of Finance) at 37, *available at* http://www.dof.gov.ph/taxreform/wp-content/uploads/2017/02/Tax-policy-revised-package-1-HB4774-briefing.pdf (last accessed Aug. 10, 2017). The indirect VAT would be in Section 106 (A) (2) (a) (2), (3), & (4) of the National Internal Revenue Code for goods, and Section 108 (B) for services. *See* NAT'L INTERNAL REVENUE CODE, § 106 (A) (2) (a) (2), (3), & (4) & § 108 (B).

260. *Id.* at 7.

261. *Id.* at 29-34.

262. *Id.* at 37-46.

give the taxpayer the actual refund or denial of his application within 90 days from the filing of the VAT refund application.[263]

Congress' version of the tax reform package has been described as a watered down version of the administration's tax initiatives. Initially, the Department of Finance has been reported to have plans of convincing the Senate to hew closer to the administration's version.[264] The reported view of the Department of Finance is that while the Philippines has the highest VAT rate in Asia, its efficiency and revenue collection are far lower that its peers. It is their view the "outdated" Philippine tax system must be reformed by removing these multiple exemptions and broadening the VAT base. Finance officials argue that this would hit affluent segments of society and not the poor because these "tax privileges" mostly benefit well-connected sectors.[265] The idea is to broaden the VAT base to replace lost revenues from proposed lower income taxes.[266] Subsequently, the Finance officials appear to have backed down on the issue of indirect taxes, claiming that "certain industry stakeholders are likely misinterpreting" the bill and that there is nothing to fear.[267] The indirect VAT indeed is a strange skirmish for the Finance officials to fight as the alleged tax savings would have been based on the inability of government to process VAT refimds. This is a matter which has come to the attention of the Supreme Court when it commented that tax

263. *See* H.B. No. 5636, Committee on Ways and Means, H. Rep. No. 229, 17th Cong. 1st Reg. Sess., at 22 & 25 (2017) & NAT'L INTERNAL REVENUE CODE, § 106 (A) (2) (a) (2), (3), & (4) & § 108 (B).

264. Elijah Joseph C. Tubayan, *First tax reform tranche addresses PHL's fiscal weakness — Fitch*, BUSINESSWORLD, June 8, 2017, *available at* http://www.bworldonline.com/content.₱?section=TopStory&title=first-tax-reform-tranche-addresses-phls-fiscal-weakness----fitch&id=146390 (last accessed Aug. 10, 2017).

265. Audrey Morallo, *Tax Reform Program To Lift VAT Exemptions For Housing, Cooperatives*, PHIL. STAR, May 18, 2017, *available at* http://www.philstar.com/business/2017/05/18/1701240/tax-reform-program-lift-vat-exemptions-housing-cooperatives (last accessed Aug. 10, 2017).

266. ABS-CBN News, *Finance Dept To Hold Tax Reform Forum*, ABS-CBN NEWS, June 19, 2017, *available at* http://news.abs-cbn.com/business/06/19/17/finance-dept-to-hold-tax-reform-forum (last accessed Aug. 10, 2017).

267. Ben O. de Vera, *BPO firms' perks to stay under tax reform package, says DOF*, PHIL. DAILY INQ., July 7, 2017, *available at* http://business.inquirer.net/232692/bpo-firms-perks-stay-tax-reform-package-says-dof (last accessed Aug. 10, 2017) & Mary Grace Padin, *BPO tax perks stay, says DOF*, PHIL. STAR, July 8, 2017, *available at* http://www.philstar.com/business/2017/07/08/1717350/bpo-tax-perks-stay-says-dof (last accessed Aug. 10, 2017).

refunds must be released to the taxpayer without any unreasonable delay as a matter of fair dealing.[268]

However, a second tax reform package is in the offing where to offset the lower personal income taxes being proposed, the government will be proposing a "claw back" of incentives granted to by the BOI and PEZA, including the five percent gross income taxation.[269]

Quite understandably, the tax reform package has been a cause for concern for the IT-BMP sector. The Philippine IT-BPM industry is on the average 12% to 15% more expensive than its largest competitor, India. The threatened removal of the indirect zero-rating has been estimated to impact the sector with an effective cost disadvantage of 16% to 20%. The sector also fears that further cuts in its fiscal incentives with respect the income tax holiday and the five percent gross income tax system can translate to a 20% to 28% cost disadvantage. The industry is also apprehensive of the protectionist political climate in the U.S. coupled with the Philippines' internal security problems, and the perception in the U.S. of the current administration's view of their country.[270] Meanwhile, investments in the industry fell by 35% in the first five months of this year with the director general attributing this to a combination of U.S. President Donald John Trump's "America First" policy and the current administration's courtship of Russia and China.[271]

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268. Commissioner of Internal Revenue v. Acesite (Philippines) Hotel Corporation, 516 SCRA 93, 104 (2007).

269. *See* Ben O. De Vera, *DOF To Pitch Reduced Corporate Income Tax In Next Revenue Package*, PHIL. DAILY INQ., June 8, 2017, *available at* http://business.inquirer.net/230976/dof-pitch-reduced-corporate-income-tax-next-revenue-package (last accessed Aug. 10, 2017). *See also* Roy Stephen C. Canivel, *BPOs face tax perk removal*, PHIL. DAILY INQ., May 23, 2017, *available at* http://business.inquirer.net/230040/bpos-face-tax-perk-removal (last accessed Aug. 10, 2017).

270. Interview *with* Rey Untal, President and CEO of the IT & Business Process Association of the Philippines Inc. (IBPAP) *in* EDSA Shangri-la, Mandaluyong, Metro Manila (June 26, 2017). Mr. Untal cites figures gathered by the research team of IBPAP. *See also* Joann S. Villanueva, DOF to Submit Package 2 of Tax Reform Proposal in Q4 '17, *available at* http://www.pna.gov.ph/articles/991882 (last accessed Aug. 10, 2017).

271. Roy Stephen Canivel, *Trump's 'America first' stance, Duterte's foreign policy blamed for decline in IT-BPM investments*, PHIL. DAILY INQ., June 30, 2017, *available at* http://business.inquirer.net/232231/trumps-america-first-stance-dutertes-foreign-policy-blamed-decline-bpm-investments (last accessed Aug. 10, 2017) & Roy Stephen C. Canivel, *5-mo BPO investments down 35%*, PHIL. DAILY INQ.,

The Author recalls a conversation he had with Henry Schumacher, then the vice-president of the European Chamber of Commerce of the Philippines, some 15 years ago. The Author surmised that the call centers, as the IT-BPM industry was called in those days, were an internal brain drain that sucked up the best and the brightest from the country's universities only to answer telephones. Graduates, the Author opined, should sweat it out in local business, banks, or factories, to learn real skills. Schumacher begged to disagree. He directed the Author to watch this sector in the next decade as he believed that it would self-evolve due to its own internal drivers and would be doing amazing things far more sophisticated than just phone calls. Schumacher painted a picture where this industry on its own will create a real middle class — an empowered one — that will see upward mobility in their own lives and will have enough stake in society not to accept corruption or bad governance. He further added that the Author should watch this sector as one day, it will employ one million people. This Author came out of that conversation believing that Schumacher had too many dreams. But events proved that Schumacher was right.

Today, the IT-BPM industry employs 1.15 million people. It has created a middle class with a new understanding of the world and a sense of purpose and responsibility to society. It has transformed large swaths of Metro Manila into a bustling modern first world urban centers. It is also doing the same in cities all over the country. In Iloilo, the industry credits itself with creating 23,000 jobs which necessitated the construction of 11 hotels and a massive build-up of local housing.[272] The IT-BPM sector is said to have a multiplier factor of three, that is, for every job it creates in the sector itself, three more jobs are created outside of the sector.[273] This translates to 3.45 million

June 30, 2017, *available at* http://business.inquirer.net/232088/5-mo-bpo-investments-35 (last accessed Aug. 10, 2017).

272. Interview *with* Rey Untal, *supra* note 270.

273. *Id.* The figure of three jobs as a result of the multiplier effect of the IT-BPM sector is the conclusion of a study requested by Manolito T. Tayag when he was the chairman of the Roadmap 2022 Committee and is an integral part of the Roadmap project and the research by Frost & Sullivan. The study shows that one direct job in the IT-BPM sector generates 1.5 indirect jobs plus a further 1.5 induced jobs. Thus, the direct employment of one person in the IT-BPM sector creates three jobs outside the sector. The study by Frost & Sullivan divided the fact of job creation into three: direct jobs, indirect jobs, and induced jobs. Direct jobs are the jobs in the industry itself, the 1.15 million jobs mentioned. The indirect jobs are the jobs held by people whose services are necessary to the employees who work in the IT-BPM sector for them to perform their jobs, such as banking, telecommunication, and transport or for food. Induced jobs are those jobs that are spawned by the household

additional jobs generated by the IT-BPM sector outside of its industry. If we were to sum up all the current jobs in both the IT-BPM sector and the jobs created by its multiplier effect we would have a grand total of 4.6 million jobs. It is projected that by 2022 the sector would directly employ 1.8 million Filipinos and generate an additional 5.76 million jobs outside the sector provided that the fiscal environment remains stable and that the enablers needed by the industry to grow are put in place.[274] This would make a total of 7.56 million jobs by 2022. This explains the many new buildings being completed in rapid succession to serve the IT-BPM sector. But one tends to wonder what will be done with all those buildings if these IT-BPM enterprises shut down departments and empties entire building floors *en masse*. Is there a Plan B?

The study commissioned by IT & Business Process Association of the Philippines Inc. has revealed that, as in all things, the industry is not perfect. It is an industry vulnerable to challenges from within the country and competition from without.[275] The Philippines is second in the world in IT-BPM and this must have led many in government to assert that this industry should pay up. But the industry bears the burden of the inherent country weaknesses plaguing the Philippines. As mentioned, the study shows that the Philippines ranks in the bottom half in an industry sector basket of 11 countries, that is, in ease of doing business, world competitiveness, business environment, and global connectivity. Its lead role in the world in this industry seems to stem from the fact that the biggest demand for offshore IT-BPM is from the U.S. and Canada, and that the Philippines happens to be the third largest English-speaking country in the world. The Philippines tops all the 11 countries in business English, but ranked only 7th out of 11 in people skills and availability. The other area where the Philippines is above-average is financial attractiveness, which would mean that the current set of tax incentives in the statute books is working well. But there are menaces that lurk beyond the country's borders, ready to strike once an opportune moment is found. Aside from the Trump administration's protectionism, the study shows that in actual numbers, automation, and advances in artificial intelligence could potentially eliminate between 100,000 to 150,000 jobs in the next three years. The industry appears ready to meet such challenges.

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consumption or spending of IT-BPM sector workers, such as the jobs in the retail, hotels, or restaurants industry, or in the local tourism industry. Interview *with* Manolito T. Tayag, *in* Valley Golf and Country Club (Aug. 6, 2017).

274. *Id.* & Interview *with* Manolito Tayag, *supra* note 244.

275. *See* Ditas Lopez, Philippines Vows to Defend Its Outsourcing Empire, *available at* https://www.bloomberg.com/news/articles/2017-07-31/philippines-vows-to-defend-outsourcing-empire-as-china-rises (last accessed Aug. 10, 2017).

And instead of fighting automation, it has a strategy to seize the initiative in technological enablement by upgrading its skills and offering its services in big data analytics; it aims to be an essential element in the enhancement of efficiencies and security of IoT, artificial intelligence, and cloud computing. The industry seems determined that it will not contribute to the statistics of the unemployed due to automation.[276] In addition, it has a plan to work with government to work for inclusive growth and country competitiveness.[277]

With barbarians at the gate, the government proposes to make the industry's services more expensive and less competitive. While other nations aggressively subsidize their export industries, the country prefers to swim upriver. The removal of the incentives is an obsession focused on plugging a theoretical tax leakage whilst ignoring the massive drain arising from corruption. It is perhaps the consequence of democracy that the government can only see taxation in terms of numbers, millions more of the underprivileged versus only a million of the middle class. After all, these people who constitute this obstinate, irrepressible, entitled mob called the middle class are at the beaches on Election Day and when they do vote, their votes cannot be bought. As a consequence, the government appears to believe that it is time for this industry to exit from its umbrella of incentives. But the exit game is a dangerous game to play.

In the early part of this Author's career as a practicing lawyer, the Author and his classmates used to swap war stories on the effects of aggressive government action, both at the level of the national government and the local government, against clients in the manufacturing sector. The Philippines then had a large manufacturing sector which made everything from chemicals, to toiletries, to textiles. At the time, government confidence in the industry was optimistic and the comments were the same. They were too big to go away. They have too much invested here to just get up and leave. They should contribute, they should pay more, and they should give their due to social justice. This Author also recalls how he and his classmates were, in a few years, busy shutting off the lights in these factories.

VIII. THE GREAT FILIPINO MARKSMAN

From the incentives in the economic zones to the carefully constructed formulas under the Control Test, the Filipino has devised ways to make the

276. *See* IT & BUSINESS PROCESS ASSOCIATION OF THE PHILIPPINES INC., *supra* note 241, at 66-83.

277. *Id* at 137.

presence of foreign investment more palatable in the name of the spirit of nationhood and social justice as expressed in the Constitution. But the fact that foreign investment is not the mere crossing into the country's borders of money, but also of ideas, people, and markets that enrich Philippine society, is downplayed. These investments have changed people's lives and outlook in life and have given them new opportunities without leaving their families to slave away in far distant shores. But the elephant in the room is ignored. The Filipino insists that he and his resources are irreplaceable, that he is indispensable to his foreign partners, and that he is needed by foreign investors far more than he needs them. He has honed his sharpshooting skills in this regard, and has become an excellent marksman in shooting himself in the foot.