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ESTABLISHING A BUSINESS ENTITY IN THE PHILIPPINES

ILN CORPORATE GROUP

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I. Types of business entities

As a general rule, foreign equity is allowed to conduct and participate in business in the Philippines, through any of the following modes:

1. **By investing in a domestic stock corporation.**

   A domestic corporation is a corporation which is organized under Philippine law. It is an artificial being which has a personality separate and distinct from the shareholders, thus, the liability of shareholders is limited only to their capital contribution. Other than their capital contribution, the shareholders' other assets are beyond the reach of the corporation's creditors. Foreign capital may invest in a domestic corporation either by acquiring shares of stock in an existing domestic corporation, or by contributing capital to one that is still in the process of incorporation.

2. **By operating through a local subsidiary which may be owned entirely or partially by the foreign business entity.**

   A local subsidiary is a domestic corporation, incorporated under Philippine law, which is wholly or majority-owned by the foreign business entity. It is considered domestic because of its local incorporation but is also seen as foreign because of its ownership and the fact that it acts in furtherance of the interests of the foreign "parent" corporation. However, as it is deemed a domestic corporation pursuant to law, it enjoys a legal personality separate and distinct not only from its shareholders, but also from the foreign "parent" corporation.

3. **By establishing a domestic branch office or a Philippine affiliate.**

   A branch office in the Philippines is an extension of an already-established foreign business entity, usually engaged in exactly the same activities as the foreign "parent" corporation. As a mere extension, and operating only through a license, a branch office does not have its own legal personality separate and distinct from the foreign business entity. Because of this, the foreign "parent" corporation will most likely be held responsible for any liabilities which the local branch incurs, even beyond the investment of the foreign business entity. An affiliate office may be an entity which is formed in the Philippines by the foreign business entity, or an existing Philippine business entity which is constituted as an affiliate. It has the same objective as a domestic branch, which is to be an extension of the foreign business entity.

4. **By establishing joint venture arrangement with a local corporation.**

   A joint-venture arrangement is essentially a business partnership between two or more companies, but it is not a legal entity in itself unless the joint venture partners decide to incorporate a joint venture corporation. Usually, but not always, a new corporate entity is born out of the joint venture arrangement, specifically to carry out the business or single undertaking which necessitated such a new corporate entity in the first place.

5. **By establishing a Philippine representative office.**

   A representative office is a promotional or marketing office for a foreign business

entity, which acts as a market research tool, communications interface, or product training arm for the foreign business entity it represents. Because of its limited role disseminating information about the foreign business entity's products and services, it does not have the legal personality to conclude contracts on its own. It also cannot derive income locally from such operations.

6. **By establishing a regional operating headquarters.**

   Usually connected to a multinational corporation, a regional operating headquarters is an office which is established in the Philippines for the limited purposes of offering qualifying services to the multinational corporation's affiliates, branches, and subsidiaries, and which are allowed to earn income from these activities only, despite the fact that it is actually considered a foreign business entity under Philippine law.

7. **By establishing a regional area headquarters.**

   Also, usually connected to a multinational corporation, a regional area headquarters is an administrative office, tasked with supervising and coordinating the different branch offices, subsidiaries, or affiliates, within the Asia-Pacific region, of such multinational business entity. It is prohibited from earning income from or concluding revenue-generating business in the Philippines and does not deal directly with the clients and external contacts of the multinational corporation.

8. **By merging or consolidating with an existing domestic corporation.**

   A foreign corporation can merge with a domestic corporation, and the surviving corporation absorbs the other corporation. A foreign corporation may also consolidate with a domestic corporation to form an entirely new entity- a single corporation.

9. **By entering into a management contract with an existing domestic corporation.**

   Under this arrangement, a foreign business entity undertakes to manage all or most of the business of an existing domestic corporation for a period not exceeding five years.

10. **By entering into technology transfer agreements.**

    A technology transfer agreement is a contract between a foreign business entity and domestic business entity, the object of which is the transfer of knowledge or the transfer and licensed use of all forms of intellectual property. The foreign corporation assumes no risk in the venture of the domestic corporation. Even if the domestic corporation is not profitable, it is still obligated to pay royalties for the use of the foreign technology.

II. Matters to be Considered when Choosing a Particular Business Entity Type

1. **The nature of the business.**

   It is important to consider the kind of business to be conducted because, under Philippine laws, some businesses require particular business entity types. A bank, for example, must always be a stock corporation. If the business is an energy generation or mining or any other operation which will use the natural resources of the Philippines, then only a joint venture between the government and the private business entity is possible. Furthermore, in such a joint venture, only 40% of the private business entity can be owned by foreign equity. If the brands of

the foreign business entity are already well-known locally, then a domestic affiliate may be the best choice.

If a particular business is controversial or prone to litigation, then some entities, such as the domestic branch office, should be avoided to shield the parent corporation from liability. A domestic subsidiary, on the other hand, has the personality to sue and be sued without involving the foreign "parent" corporation.

2. **The specific activities sought to be undertaken in the Philippines.**

If the objective is simply to promote products and services, or to have an office that will act as a command center for a company's regional operations, and which office will not engage in the frontline selling of products and services, then establishing a representative office or a regional area headquarters will accomplish those things, without the hassle of incorporation or licensing.

3. **The tax treatment afforded to each entity.**

The Philippines employs a semi-schedular, semi-global tax scheme. Each activity is taxed differently, and particular activities are taxed differently for different entities. The tax treatment for each entity, thus, must always be part of any due diligence when deciding on the vehicle used to do business in the Philippines. To use the "branch or subsidiary" example, a domestic branch or local affiliate office will always be considered a resident foreign corporation under Philippine tax laws. This is because the branch does not enjoy a separate personality from the foreign entity. Hence, such branch will be taxed only on all its income derived from Philippine sources, and on remittances it made to the foreign "parent" company. On the other hand, a domestic subsidiary corporation is, for all intents and purposes, also a domestic corporation. As such, it is liable for income taxes for all revenue, whether sourced from the Philippines or internationally, following the residency rule.

III. Steps and Timing to Establish a Business Entity

More than differences in the steps required to constitute and establish them, it is important to note that different business entities also have different documentary and capitalization requirements, as will be discussed below.

1. Domestic Corporation

Under the former *Corporation Code of the Philippines*, it was required that a domestic corporation be formed by at least five (5) original incorporators. With the advent of *Republic Act No. 11232,* otherwise known as the *Revised Corporation Code of the Philippines ("RCC")* [1], this minimum requirement for incorporators was abolished. In fact, the *RCC* now allows the establishment of a *One-Person Corporation* ("OPC") composed of a single shareholder who may be a natural person, a trust, or an estate.

To establish a domestic corporation, a corporate name will have to be officially reserved and the Articles of Incorporation and By-Laws of the proposed corporation will have to be filed with the Securities and Exchange Commission. Depending on the nature of the business, certifications are also required from the concerned government agencies which regulate each

[1] The concerned government agencies have yet to issue the implementing rules and regulations for the RCC.

particular industry. Apostillized documents of the foreign corporate entity will have to also be submitted.

Generally, the Securities and Exchange Commission will take about a week to complete the processing of an application for incorporation. For certain companies, endorsements from other government agencies are required and this can add to the processing time by an additional period of two weeks.

2. Domestic Branch Office / Philippine Affiliate

Since it does not have a distinct legal personality, and only derives from the personality of its foreign "parent" company, the processing of an application for a permit for a domestic branch office requires the submission with the Securities and Exchange Commission of certain documents coming from the parent company which need to be apostillized where the parent company is situated. The processing of the approval can take about two weeks from the submission of complete documentary requirements.

In addition, the *RCC* also now requires that within sixty (60) days from the issuance by the Securities and Exchange Commission of a license to transact business to a branch office of a foreign corporation, said branch must deposit acceptable securities to the SEC with an actual market value of at least P500,000.00 for the benefit of present and future creditors of the licensee.

3. Joint Venture Arrangement

In as much as the joint venture arrangement usually results in a new business entity, the same discussion on the incorporation of a domestic corporation must be followed. That means the registration of a new name for the joint venture corporation, as well as the filing of its Articles of Incorporation and By-Laws with the Securities and Exchange Commission.

4. Representative Office

The requirements are the same as with a domestic branch, in that a representative office needs to be registered and licensed with the Securities and Exchange Commission through the submission of apostillized documents coming from the foreign company based abroad. The establishment of such an office, however, requires two certifications, an endorsement, and proof of remittance of capitalization, namely:

- A certification from the Philippine Consulate or Embassy or the Philippine Commercial Office or from the Philippine Department of Trade and Industry office in the applicant multinational corporation's home country, certifying that said foreign entity is engaged in international trade with affiliates, subsidiaries or branch offices in the Asia-Pacific region and other foreign markets;
- A certification from a principal officer of the applicant multinational corporation that it has been authorized by its board of directors to establish its regional operating headquarters in the Philippines;
- And endorsement from the Philippine Board of Investments; and
- Proof of inward remittance of at least US $ 30,000.00.

5. Regional Operating Headquarters

Under Philippine law, any multinational company may establish a Regional Operating Headquarters if they exist under the laws of another country, and if the multinational has branches, affiliates and subsidiaries in the Asia-Pacific Region and other foreign markets.

The establishment of such an office, however, requires two certifications, an endorsement, and proof of remittance of capitalization, namely:

- A certification from the Philippine Consulate or Embassy or the Philippine Commercial Office or from the equivalent office of the Philippine Department of Trade and Industry office in the multinational corporation's home country, certifying that said foreign entity is engaged in international trade with affiliates, subsidiaries or branch offices in the Asia-Pacific region and other foreign markets;
- A certification from a principal officer of the applicant multinational corporation that it has been authorized by its board of directors to establish its regional operating headquarters in the Philippines;
- And endorsement from the Philippine Board of Investments; and
- Proof of inward remittance of at least US $ 200,000.00.

6. Regional Area Headquarters

The requirements of a regional operating headquarters apply as well to a regional area headquarters, and only the amount of remittance varies, thus:

- A certification from the Philippine Consulate or Embassy or the Philippine Commercial Office or from the equivalent office of the Philippine Department of Trade and Industry office in the multinational corporation's home country, certifying that said foreign entity is engaged in international trade with affiliates, subsidiaries or branch offices in the Asia-Pacific region and other foreign markets;
- A certification from a principal officer of the applicant multinational corporation that it has been authorized by its board of directors to establish its regional area headquarters in the Philippines;
- And endorsement from the Philippine Board of Investments; and
- Proof of inward remittance in such amount as may be necessary to cover its operations in the Philippines which shall not be less than US $ 50,000.00.

IV. Governance, Regulation, Maintenance, and Reporting Requirements

In general, all corporations in the Philippines must submit, annually, a General Information Sheet and an Audited Financial Statement to the Securities and Exchange Commission. This includes branch offices, representative offices, regional area headquarters, or regional operating headquarters, even though they only act for and in representation of a foreign business entity and have no legal personality of their own.

The requirement for local shareholding depends on the industry in which the company will operate in. The Philippines has certain nationalized and partially nationalized industries, and any entity operating in such industries must

be either majority-owned, or wholly owned, by Filipino citizens.

With the introduction of the OPC, corporations no longer have a required minimum number of directors although the maximum is retained at fifteen (15) directors. Other entities which are not incorporated under Philippine law, but nevertheless do business in the Philippines, are required to appoint a Resident Agent who resides in the Philippines. The role of the Resident Agent is to be the person authorized, on behalf of the foreign entity, to receive legal notices and processes. Relevantly, the *RCC* requires a domestic corporation who acts as a Resident Agent of a foreign corporation to be of sound financial standing and must show proof that it is in good standing as certified by the Securities and Exchange Commission.

With the enactment of the *RCC*, certain corporations classified as "corporations vested with public interest" are required to have independent directors constituting at least 20% of their board of directors and to appoint a compliance officer.

Under Philippine corporate law, all shareholders, regardless of the class of shares, are guaranteed certain voting rights, more commonly known as "fundamental rights". The number and nature of shareholdings notwithstanding, any shareholder in any corporation may always vote on the following matters:

1. Any amendment of the articles of incorporation;
2. The adoption or amendment of the corporation's by-laws;
3. Any transaction or disposition of all, or substantially all the corporate property;
4. Any initiative to incur, create, or increase the corporation's bonded indebtedness;
5. Any increase or decrease of the corporation's capital stock;
6. Any initiative to merge or consolidate of the with another corporation;
7. The investment of corporate funds in another corporation or business; and
8. Dissolution of the corporation.

V. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions

Subject to certain restrictions, business entities may be up to 100% foreign funded. The biggest hurdle will always be the nationality requirements of business entities in certain industries. The restrictions on foreign equity in certain industries are summed up by Philippine foreign investment laws as the "Negative List".

LIST A

Foreign Ownership is Limited by the Constitution and Specific Laws

Industry	Allowed Foreign Equity
Mass Media, Except Recording	**None**
Practice of All Professions	**None**
Retail Trade, Paid-Up Capital of Less than US$2,500,000	**None**

Cooperatives	**None**
Private Security Agencies	**None**
Small-scale Mining	**None**
Utilization of Marine Resources in Philippine Waters, Including the Exclusive Economic Zone	**None**
Ownership, Operation and Management of Cockpits	**None**
Nuclear Weapons Trade and Manufacture	**None**
Biological, Chemical and Radiological Weapons and Anti-Personnel Mines Trade and Manufacture	**None**
Manufacture of Firecrackers and Pyrotechnics	**None**
Private Recruitment for Local or Overseas Employment	**Up to 25%**
Contracts for the Construction of Defense-related Structures	**Up to 25%**
Advertising	**Up to 30%**
Contracts for the construction and repair of locally funded public works, except infrastructure/development projects and projects which are foreign-funded or assisted and required to undergo international competitive bidding	**Up to 40%**
Exploration, Development, and Utilization of Natural Resources	**Up to 40%**
Ownership of Private Lands	**Up to 40%**
Public Utilities	**Up to 40%**
Ownership, Establishment, and Administration of Schools	**Up to 40%**
Culture, Production, Milling, Processing, and Trading, Except Retailing, of Rice and Corn, and Acquiring Rice and Corn and the Rice and Corn By-Products	**Up to 40%**
Contracts for the supply of Materials and Goods to Government-owned or Controlled Corporations, Companies, Agencies, or Municipal Corporations	**Up to 40%**
Operation of Deep-Sea Commercial Fishing Vessels	**Up to 40%**
Private radio communications network	**Up to 40%**

LIST B

Foreign Ownership is Limited by Reasons of Security, Defense, Risk to Health and Morals, and Protection of Small and Medium Enterprises

Industry	Allowed Foreign Equity
Manufacture, Repair, Storage, and Distribution of Products / Ingredients Requiring Philippine National Police Clearance (such as firearms and explosives; may be allowed for non-nationals if for export)	**Up to 40%**
Manufacture, Repair, Storage, and Distribution of Products / Ingredients Requiring Department of National Defense Clearance (such as tools for warfare; may be allowed for non-nationals if for export)	**Up to 40%**
Manufacture and Distribution of Dangerous Drugs	**Up to 40%**
Sauna and Steam Bathhouses, Massage Clinics, and Other Like Activities	**Up to 40%**
Gambling, Except Those Covered by Investment Agreements with PAGCOR and Operating within Special Economic Zones	**Up to 40%**
Domestic Market Enterprises with Paid-In Capital of Less Than US$200,000	**Up to 40%**
Domestic Market Enterprises which Involve Advanced Technology or Employ at Least 50 Direct Employees with Paid-In Capital of Less than US$100,000	**Up to 40%**

1. **Domestic Corporation**

   The minimum paid-up capital requirement of a domestic corporation is dictated almost entirely by the industry it seeks to operate in. As expected, insurance, finance, and investment companies have some of the most expensive capitalization requirements in the Philippines. Furthermore, the amount of foreign equity, and whether a company will engage in mostly export sales or domestic sales, will also result in variances in the capitalization requirements.

   Setting up a Philippine subsidiary of a foreign entity generally requires a capital outlay of at least US $ 200,000.00, as per Philippine foreign investment laws. This may be reduced if the Philippine Department of Science and Technology certifies that advanced technologies will be involved in the operations of the local subsidiary, or if it will employ at least 50 direct hire employees.

2. **Domestic Branch Office / Philippine affiliate**

   The capitalization requirement for a branch office or Philippine affiliate is the same as a local subsidiary, or US $ 200,000.00, which, again, may be reduced, if a certification that advanced technology will be used in the operations of the office, is obtained from the Department of Science and Technology.

In addition, within six (6) months after the fiscal year of a licensed branch office of a foreign corporation, the Securities and Exchange Commission may require the said branch office to deposit additional securities or financial instruments equivalent in market value to 2% of the amount by which the licensee's gross income exceeds P10,000,000.00.

3. **Representative Office**

A representative office must be funded, through an initial inward remittance, with at least US $ 30,000.00 to cover its operating expenses.

4. **Regional Operating Headquarters**

A regional operating headquarters in the Philippines must be capitalized by no less than US $ 200,000.00.

5. **Regional Area Headquarters**

Establishing a Regional Area Headquarters in the Philippines requires a capital expenditure of at least US $ 50,000.00 annually to cover operating expenses.

Qualified foreign investors are issued by the Bureau of Immigration, through the Board of Investments, a Special Investor's Resident Visa pursuant to the provisions of the Omnibus Investments Code of 1987. The Special Investor's Resident Visa is a special non-immigrant visa which allows the Visa holder to reside in the Philippines for an indefinite period if the required qualifications and investment amounts are maintained.

There are generally no restrictions for remitting funds out of the Philippines, if the remittance complies with Philippine banking, finance, and anti-money-laundering laws. However, depending on the vehicle chosen, there will be tax liabilities for the remittances from the Philippines to foreign jurisdictions.