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**KAPUNAN & CASTILLO LAW OFFICES
ESTABLISHING A BUSINESS ENTITY IN THE PHILIPPINES**

ILN CORPORATE GROUP



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ESTABLISHING A BUSINESS ENTITY IN THE PHILIPPINES

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 in order 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 of 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

A domestic corporation is formed by 5 up to 15 incorporators. 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. There must also be a treasurer’s affidavit stating under oath that the required 25% payment and 25% subscription of the authorized capital stock has been complied with. Depending on the nature of the business, certifications are also required from the concerned government agencies which regulate each particular industry. Consularized 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 consularized in the Philippines Embassy where the parent company is situated. The processing of the approval can take about two weeks from the submission of complete documentary requirements.

3. Joint Venture Arrangement

In as much as the joint venture arrangement usually results in a new corporation, 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

documents coming from the foreign company based abroad and duly consularized by the Philippine Embassy in said jurisdiction. 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 as long as they exist under the laws of another country, and as long as 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 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 \$ 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 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 area headquarters in the Philippines;

- And endorsement from the Philippine Board of Investments; and
- Proof of inward remittance of at least 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.

All corporations are required to have at least 5 up to 15 Directors, the majority of which must be residents of the Philippines. 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.

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 Radio Communications Network	Up to 20%
Private Recruitment for Local or Overseas Employment	Up to 25%
Contracts for the Construction and Repair of Locally-Funded Public Works, except: <ul style="list-style-type: none">• Projects covered in R.A. 7718; and• Projects which are foreign funded or assisted and required to undergo international competitive bidding	Up to 25%
Contracts for the Construction of Defense-related Structures	Up to 25%
Advertising	Up to 30%
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,	Up to 40%



Agencies, or Municipal Corporations	
Project Proponent and Facility Operator of a Build-Operate-Transfer Project Requiring a Public Utilities Franchise	Up to 40%
Operation of Deep Sea Commercial Fishing Vessels	Up to 40%
Adjustment Companies	Up to 40%
Ownership of Condominium Units, Where the Common Areas in the Condominium Project are Co-Owned by the Unit-Owners or by a Corporation	Up to 40%
Lending Companies	Up to 49%
Financing companies regulated by the Securities and Exchange Commission	Up to 60%
Investment houses regulated by the Securities and Exchange Commission	Up to 60%

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.

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.