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Virtual businesses owned by foreign corporations — Are they doing business in the Phl?

TOP OF MIND

BETZY C. NUEVO

We are now in the information age, and experiencing an era of quick-evolving technology. With such evolution, many types of businesses arose. From the traditional set-up requiring the physical presence of both the suppliers and customers, we can see nowadays that sales occur even without such physical presence. Examples of such businesses are online gaming, online stores, and business process outsourcing. These newly developed arrangements are widely exploited by businesses, including foreign corporations. Thus, the question on when foreign online business may be considered as doing business in the Philippines becomes more relevant.

First off, we will need to identify what a foreign corporation is and what the requirements are when they wish to transact business in the Philippines. Section 123 of the Corporation Code of the Philippines will find significance as it defines a foreign corporation as one that is formed, organized, or existing under any laws other than those of the Philippines, and whose laws allow Filipino citizens and corporations to do business in its own country or state. The provision further states that a foreign corporation shall have the right to transact business in the Philippines after it obtains a certificate of authority from the appropriate government agency and a license to transact business in this country.

However, not all transactions made by a foreign corporation require a license. In the 2002 case of *MR Holdings, Ltd. vs. Sheriff Carlos P. Bajar et. al. (G.R. No. 138104)*, the Supreme Court found that mere ownership by a foreign corporation of a property in a certain state, unaccompanied by its active use in furtherance of its business purpose, is insufficient to constitute the entity as doing business in our country. Fast forward to the 2007 case of *B. Van Zuiden Bros., Ltd. vs. GTVL Manufacturing Industries, Inc. (G.R. No. 147905)*, the Supreme Court also declared that foreign corporations, whose transactions pertain to mere exportation of goods, without doing any specific commercial act within our country, are not considered as doing business in the importing

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country. Further in the 2012 case of *Steelcase, Inc. vs. Design International Selections, Inc., (G.R. No. 171995)*, the Supreme Court held that foreign corporations are not deemed to be conducting business in the Philippines merely by appointing a distributor.

When then, are foreign corporations considered as doing business in the Philippines? In determining whether or not a foreign corporation is considered doing business, the facts are considered on a case-by-case basis. SEC-OGC Opinion No. 17-03 issued on April 4, 2017 finds particular significance as it found an occasion to determine whether a foreign corporation, transacting through online means, can be deemed to be doing business in the Philippines.

The factual circumstances surrounding said opinion involved a foreign corporation proposing an online platform that offers various content and services, such as an online community and online gaming system. The online platform is an internet-based system, wherein persons in the Philippines can participate in the online community, and purchase and use content from the foreign corporation's services. This, notwithstanding the company having no physical presence in the Philippines. The said foreign corporation will further undertake activities such as offering and selling its services on the internet to persons located in the Philippines, accepting online payments in any currency, marketing or advertising the online platform in the Philippines through online and printed publications, and television and radio commercials, and hiring independent contractors to market and advertise its products, as well as selling prepaid cards in relation to its online gaming services.

In determining whether the above activities of said foreign corporation constitute doing business in the Philippines, the SEC used the "twin characterization" and "sliding scale" tests.

The "twin characterization test" was discussed by the Supreme Court in the case of *Mentholatum Co., Inc. vs. Mangiliman (G.R. No. 47701)*. In the said case, a foreign corporation is considered "doing business" in the Philippines when (1) the company is continuing the body or substance of the business or enterprise for which it was organized or whether it has substantially retired from it and turned it over to another, and (2) the company is engaged in activities which implies a continuity of commercial dealings and arrangements, and contemplates, to that extent, the performance of acts or works or the exercise of some of the functions normally incident to, and in progressive prosecution of, the purpose and object of its organization. The twin characterization test aims to identify whether transactions made by the foreign corporation constitute continuing the body or substance of its main business in our country, and determine if it intends to continue the same for some time.

On the other hand, the "sliding scale test" is discussed in the above opinion as a test specifically "tailored to internet activities to determine the level or types of activities that will constitute minimum contacts for jurisdictional purposes." Using this test, the courts determine whether or not it has personal jurisdiction over the foreign corporation by identifying the nature of the company and the quantity of its commercial activity conducted in the internet.

This test starts by classifying the websites that may be used by the entity as either (1) passive, (2) active and (3) interactive. At one end of the scale are "passive" websites, which are those that do not generate sufficient contacts since they are only used to post information. This type does not place foreign corporations under the jurisdiction of our courts. On the other end

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are "active" website, which are those that generate sufficient contacts through acts such as selling of contents and services over the internet. This, in turn, subjects foreign corporations to our court's jurisdiction. Found in between these two categories are "interactive" websites, which combine the elements of both active and passive websites. The courts determine whether it has personal jurisdiction over interactive website owners on a case-by-case basis.

As applied in the recent SEC opinion, the SEC ruled that the foreign corporation fulfilled the requirements of the twin characterization test. The SEC found that some of the activities of the foreign corporation such as the funding of the company's online wallet, offering and selling of its services, accepting online payments in any currency, marketing or advertising, and hiring of independent contractors for marketing or advertising of its products, and the selling of prepaid cards in relation to its online gaming services, indicate that the entity will be continuing the body or substance for which it was organized in the Philippines. Moreover, the SEC found that these activities will be consummated in the Philippines albeit virtually. The SEC found it relevant to note that the creation of accounts, funding of the online wallet, and payment and delivery of the online content and services will all be made in the Philippines. Likewise, the offering for sale and sale of online content and services will be also be made to an account holder in the Philippines. The funding of the online wallet was, moreover, found to be indicative of intent to continue business for a period of time as the maintenance of funds in such wallet will allow the account holder to resume his transactions on his account. Thus, a business relationship is maintained, notwithstanding the frequency or regularity of the transactions.

Moreover, the SEC also found that the foreign corporation satisfied the sliding scale test by identifying that the company has minimum contacts. The SEC found that the foreign corporation's website must be considered as an "active" website since it generates sufficient contacts and businesses over the internet through offering and engaging in sale of online content and services to account holders in the Philippines.

Having satisfied both the twin characterization and sliding scale tests, the SEC finally opined that the activities in which the foreign corporation plans to undertake constitutes as "doing business" in the Philippines. The foreign corporation is required to obtain a license to do business in the Philippines, should it wish to continue transacting here, and if it wishes to avoid the adverse consequences of non-compliance, as stated in Section 133 of the Corporation Code.

Pertinently, the said section states that unlicensed foreign corporations transacting business in the Philippines cannot maintain or intervene in any action, suit, or proceeding in any court or administrative agency of the Philippines. As explained in the 1990 case of *Granger Associates vs. Microwave Systems, et. al. (G.R. No. 79986)*, the purpose of the rule requiring corporations to obtain a license to do business in the Philippines is to enable the court to exercise jurisdiction over foreign corporations for the regulation of their activities in our country. Further, as the case cited, while foreign investors are always welcome in this land to collaborate with us for our mutual benefit, they must be prepared, as an indispensable condition, to respect and be bound by Philippine law in proper cases. Thus, foreign corporations who have not complied with the license requirement will be deemed as having no legal capacity to sue before Philippine courts.

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Do note, though, that there exists in jurisprudence an exemption to this general rule. In the 2010 case of *Global Business Holdings, Inc. vs. Surecomp Software, B.V. (G.R. No. 173463)*, a foreign corporation doing business in the Philippines without license may sue in Philippine courts a Filipino citizen or a Philippine entity that it had contracted with and benefited from. In the said case, the Supreme Court had occasion to rule that a party, after having acknowledged the personality of a corporation by contracting with it, is estopped from challenging the said personality. The principle derives from estoppel, and is applied to prevent a person contracting with a foreign corporation from later taking advantage of its noncompliance with the statutes, chiefly in cases where such person has received the benefits of the contract. Thus, we can see that our laws do not intend to put foreign corporations at a disadvantage by requiring them to secure a license. Merely, the law intends to compel the foreign entity desiring to do business in our country to respect and be bound by Philippine laws, and submit itself to the jurisdiction of our courts.

In totality, foreign corporations may consider the Philippines as a place having good business potential wherein they can invest their money and do business with confidence.

Betzy C. Nuevo is a supervisor from the tax group of KPMG R.G. Manabat & Co. (KPMG RGM&Co.), the Philippine member firm of KPMG International. KPMG RGM&Co. has been recognized as a Tier 1 tax practice, Tier 1 transfer pricing practice, Tier 1 leading tax transactional firm and the 2016 National Transfer Pricing Firm of the Year in the Philippines by the International Tax Review.