Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City

Office of the General Counsel

09 August 2012
SEC Opinion No. 12-13
Re: Citizenship of a Trust; Citizenship Requirement in Airline Company.

Atty. Loreto J. Dapon, Jr.
Dapon & Associates
Unit 404 La O'Centre
1000 Arnaiz Ave.
Makati City, Philippines

Dear Atty. Dapon,

This refers to your letter dated 10 June 2011, requesting an opinion, on behalf of your client, Corporation X. In your letter, you represented that:

> "Corporation X is a holding company and owns 11% shareholdings in an airline Corporation ('Corporation Y'). Presently, Corporation X is a 100% Filipino owned corporation. Corporation X wishes to restructure its shareholdings by allowing 51% of its shares to be subscribed by Atty. Z, a Filipino lawyer. Atty. Z holds the shares in trust for a 14 year old minor beneficiary, Ms. A, born out of lawful wedlock between a German national and a Filipino and hence Ms. A is likewise a Filipino citizen. Ms. A's father is a German national holding a 30% stake out of the 40% foreign ownership in Corporation Y. Ms. A's father, the legal guardian, executed a deed of trust in favor of Atty. Z to conclude the shareholding of Ms. A in Corporation X."

You had requested an opinion of the following queries:

> "1. Is the trust arrangement entered into between Ms. A's father and Atty. Z for the latter to hold in trust the proposed 51% shares in Corporation X for and on behalf of Ms. A until she reaches the age of majority valid?;
>
> 2. If the proposed restructure is adopted by Corporation X, is the airline Corporation Y, where Corporation X holds 11% shareholdings, in excess of the 40% foreign ownership limitation under existing Philippine laws, rules and regulations?; and
>
> 3. If the proposed restructure is adopted by Corporation X, is the Corporation x still considered 100% Filipino owned?"

x------------------------------------x

As to the first question, it involves the validity of a trust agreement or contract. We cannot render an opinion on that matter pursuant to the provisions of the Commission's *Guidelines on Requests for Legal Opinions*[1] ("Guidelines"). It provides that:

> "As a matter of policy, the Commission shall refrain from rendering an opinion on the following:
>
> x x x
>
> 5.2. Matters which involve the substantive and contractual rights of private parties who would, in all probability, contest the same in court if the opinion turns out to be adverse to their interest;
>
> 5.3. Matters which would necessarily require a review and interpretation of contracts or an opinion of the validity of contracts since interpretation of contract is justiciable in nature and contract review calls for legal examination of contract on a general basis and not on specific legal issues; x x x"

Before we discuss your second and third queries, we deem it necessary to impart the following:

Only up to 40% of the capital of public utilities, of which an airlines corporation is one, may be owned by foreigners. Sec. 11, Article XII of the Constitution provides:

> "Sec. 11. **No franchise, certificate, or any other form of authorization for the operation of a PUBLIC UTILITY shall be granted except** to citizens of the Philippines or **to corporations** or associations organized under the laws of the Philippines, **at least sixty per centum of whose capital is owned by such citizens**; x x x." (emphasis supplied)

In other words, a public utility corporation must therefore meet the minimum nationality requirement prescribed in Sec. 11, Article XII of the Constitution. Hence, for a corporation to be granted authority to operate a public utility, at least 60 percent of its capital must be owned by Filipino citizens. The evident purpose of the citizenship requirement is to prevent aliens from assuming control of public utilities, which may be inimical to the national interest.

The Commission has consistently opined that to compute the required percentage of Filipino ownership of a corporation engaged in a nationalized undertaking, the ownership of the shares of stock of a corporation is based on the total

---

[1] SEC Memorandum Circular No. 15 Series of 2003 (16 December 2003).

outstanding or subscribed/issued capital stock regardless of whether they are classified as common voting shares or preferred shares without voting rights.[2] We have further consistently said 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 shares,[3] and likewise without regard to whether or not such shares have been fully or partially paid.[4] This has been, thus, the general rule, such that when the provision merely uses the term "capital" without qualification (as in Sec. 11, Article XII of the 1987 Constitution, which deals with equity structure in a public utility company), the same should be interpreted to refer to the sum total of the outstanding capital stock, irrespective of the nomenclature or classification as common, preferred, voting or non-voting.[5]

Please note however that in its Decision dated 28 June 2011, the Supreme Court in *Gamboa v. Teves,* G.R. No. 176579, ruled that the word "capital" in Sec. 11, Art. XII of the 1987 Constitution refers to shares of stock that can vote in the election of directors. This decision is currently the subject of a Motion for Reconsideration.

In the recent Department of Justice ("DOJ") Opinion No. 020, series of 2005,[6] the DOJ stated the tests in determining the nationality of a corporation engaged in a nationalized business or activity, to wit:

> "*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 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.

[2] SEC Opinion No. 26-11 dated 19 April 2011 addressed to Mr. Edgardo C. de Leon, citing SEC Opinion No. 04-30 dated 28 April 2004 addressed to Marlene Caluya.
[3] *Id.,* citing SEC Opinion No. 04-49 dated 22 December 2004 addressed to Atty. Priscilla B. Valer of Romulo Mabanta Buenaventura Sayoc & De los Angeles.
[4] *Id.,* citing SEC Opinion No. 06-36 dated 21 September 2006 addressed to Atty. Tadeo F. Hilado of Angara Abello Concepcion Regala & Cruz Law Offices.
[5] *Id.,* citing SEC-OGC Opinion No. 09-10 dated 19 May 2009 addressed to Cochingyan & Peralta Law Offices, citing SEC-OGC Opinion No. 18-07 dated 28 November 2007 addressed to Rafael C. Bueno, Jr.
[6] *Id.,* citing Dated 5 May 2005 and addressed to then Secretary of the Department of Finance, the Honorable Cesar Purisima.

x x x

The above-quoted SEC Rules provide for the manner of calculating the Filipino interest in a corporation for purposes, among others, of determining compliance with nationality requirements (the 'Investee Corporation'). Such manner of computation is necessary since the shares of the Investee Corporation may be owned both by individual stockholders ('Investing Individuals') and by corporations and partnerships ('Investing Corporation'). The said rules thus provide for the determination of nationality depending on the ownership of the Investee Corporation and, in certain instances, the Investing Corporation.

Under the above-quoted SEC Rules, there are two cases in determining the nationality of the Investee Corporation. The first case is the 'liberal rule', later coined by the SEC as the Control Test in its 30 May 1990 Opinion, and pertains to the portion in said Paragraph 7 of the 1967 SEC Rules which states, '*(s)hares 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.*' Under the liberal Control Test, there is no need to further trace the ownership of the 60% (or more) Filipino stockholdings of the Investing Corporation since a corporation which is at least 60% Filipino-owned is considered as Filipino. SDECAI

The second case is the Strict Rule or the Grandfather Rule Proper and pertains to the portion in said Paragraph 7 of the 1967 SEC Rules which states, "*but if the percentage of Filipino ownership in the corporation or partnership is less than 60%, <u>only the number of shares corresponding to such percentage shall be counted as of Philippine nationality</u>.*" Under the Strict Rule or Grandfather Rule Proper, the combined totals in the Investing Corporation and the Investee Corporation must be traced (i.e., "grandfathered") to determine the total percentage of Filipino ownership.

Moreover, the ultimate Filipino ownership of the shares must first be *traced* to the level of the Investing Corporation and added to the shares directly owned in the Investee Corporation. . . .

x x x

In other words, based on the said SEC Rule and DOJ Opinion, the *Grandfather Rule* or the second part of the SEC Rule *applies only when the 60-40 Filipino-foreign equity ownership is in doubt* (i .e., in cases where the joint venture corporation with Filipino and foreign stockholders with less than 60% Filipino stockholdings [or 59%] invests in other joint venture corporation which is either 60-40% Filipino-alien or 59% less Filipino). Stated differently, where the 60-40 Filipino-foreign equity ownership is not in doubt, the Grandfather Rule will not apply." (Emphasis supplied).

As to the determination of the citizenship of shares of stock being held in trust (in this case, the 51% shares of stock in Corporation X), statutes and jurisprudence have not categorically answered the matter. However, by analogy, the following may be considered.

The Bangko Sentral ng Pilipinas had provided in its rules that the citizenship of a pension fund or a similar trust fund invested in bank shares shall be determined by the citizenship of the trustee and of the beneficiaries of the fund. If the trustee is foreign, the equity investment shall be considered foreign regardless of the citizenship of the beneficiaries. If the trustee is Filipino, or a majority of the board of trustees is Filipino, the citizenship of the beneficiaries of the fund shall be the basis for determining the extent of Filipino citizenship.[7]

The *Foreign Investment Act*[8] includes in its definition of a Philippine national 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.[9]

In a recent Opinion, it was opined that in order for a trustee of a trust fund for retirement benefits of employees to be considered a Philippine national, two requirements must be satisfied, namely: (1) the trustee is a Philippine national and (2) at least sixty percent (60%) of the fund will accrue to the benefit of the Philippine nationals.[10]

From the foregoing, in the determination of the citizenship of shares being held in trust, both the nationality of the trustee and of the beneficiary should be considered. In this case, the nationality of Atty. Z., who is the Filipino trustee, and Ms. A, who is the Filipina beneficiary, will be the basis of such determination.

We will begin with the third query because the second query is dependent on it. You already indicated in the letter that "*presently, Corporation X is 100% Filipino owned corporation.*" In which case, Corporation X will still be a 100% Filipino owned corporation even if the proposed restructure is adopted. The reason is that 51% of the shares of Corporation X to be subscribed will be held by Atty. Z, who is a Filipino trustee, in trust for the beneficiary Ms. A, who is also a Filipino, as above stated. Thus, Corporation X is still considered 100% Filipino.

---

[7] Manuals of Regulations of the Bangko Sentral ng Pilipinas, 07-11-1975, (1975).
[8] R.A. 7042.
[9] This definition is a reproduction of that contained in the Omnibus Investments Code as well as the Investment Incentives Act.
[10] SEC-OGC Opinion No. 01-A-09 dated 08 December 2009 addressed Mr. Demosthenes B. Donato of Donato Zarate & Rodriguez.

As to your second query, you stated that 40% of Corporation Y is owned by foreigners.[11] The 11% shareholdings held by Corporation X in Corporation Y is considered Filipino since the former will still be considered a 100% Filipino owned corporation. As to the remaining 49% of Corporation Y, absent any indication that the same is owned by corporations and absent any indication of doubt as to real ownership thereof, Corporation Y is still Filipino. In other words, the 11% shareholdings (owned by Corporation X) plus 49% (assumed to be owned by Filipinos) satisfies the minimum 60% Filipino ownership requirement. Hence, Corporation Y is compliant.

It is understood that the foregoing opinion is rendered based solely on the facts disclosed and described in the queries and relevant solely to the particular issues raised therein, and shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon the courts, whether of similar or dissimilar circumstances.

Very truly yours,

CAMILO S. CORREA
General Counsel

[11] Of which 30% is held by Ms. A's father, a German national.