Republic of the Philippines
Department of Finance
SECURITIES AND EXCHANGE COMMISSION
SEC Bldg. EDSA, Greenhills, Mandaluyong City

December 7, 2007

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SEC-OGC Opinion No. 07-22
Re: Application of the Grand-father Rule to determine nationality of a corporation organized to engage in real estate business

Attention: Atty. Teodulo G. San Juan, Jr.

Gentlemen:

This refers to your letter dated November 16, 2007 requesting confirmation of your position that the proposed ownership structures (as presented in your attached diagram) of a corporation to be incorporated under Philippine laws for the purpose of owning real estate will not violate the nationality restrictions prescribed by the Constitution and applicable laws for land ownership.

Please be advised that under Section 7, Article XII of the 1987 Constitution, private lands may be transferred or conveyed only to individuals, "corporations or associations qualified to acquire or hold lands of the public domain," Those considered qualified are "... Filipino citizens, or corporations or associations at least sixty per centum of whose capital is owned by such citizens.[1]"

It is basic in corporate law that the nationality of a corporation serves as a legal basis for subjecting an enterprise or its activities to the laws, the economic and fiscal powers, and the various social and financial policies of the state to which it is supposed to belong. In Philippine jurisdiction, there are several tests employed to determine the nationality of corporations: The Place of Incorporation Test, The Control Test, War Time Test and the Investment Test or the so-called "Grandfather Rule."

[1] Section 2, Article XII of the 1987 Constitution

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The grandfather rule is the method by which the percentage of Filipino equity in a corporation engaged in nationalized and/or partly nationalized areas of activities, provided for under the Constitution and other nationalization laws, is computed, in cases where corporate shareholders are present in the situation, by attributing the nationality of the second or even subsequent tier of ownership to determine the nationality of the corporate shareholder.[2]

In recognizing and applying the grandfather rule, the SEC has adopted the formula of the Secretary of Justice (DOJ Opinion No. 18, s. 1989) 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 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. (SEC Opinion Nov. 23, 1993)

The DOJ, in one of its rulings, went further by stating that "...it is quite clear... that the "Grandfather Rule", which was evolved and applied by the SEC in several cases, will not apply in cases where the 60-40 Filipino-alien equity ownership in a particular natural resource corporation is not in doubt."

In your letter, you presented two proposed equity structures, accompanied by their corresponding diagrams. The percentage of foreign equity is the same in both Structure Option 1 and Structure Option 2. The only difference is in the par value of the shares which are foreign-owned vis-à-vis those that are Filipino-owned.

In your proposed equity structure designated as **Structure Option 1**, MB Company which is a Filipino company will own sixty percent (60%) of **Joint Venture Company 1** while AS Company, which is a Singaporean Company will own forty percent (40%). Said Joint Venture Company in turn, will own Twenty Two Percent (22%) of the proposed **Real Estate Company**.

In the same Structure Option 1, the same MB Company will own forty nine percent (49%) of another joint venture company, designated as **Joint Venture Company 2** while the same AS Company will own fifty one percent (51%). Said Joint Venture Company 2, in turn, will own seventy eight percent (78%) of the proposed **Real Estate Company.**

[2] Villanueva, Philippine Corporate Law, p. 54.

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Applying the DOJ Ruling to the proposed equity structure, Joint Venture Company 1 is automatically deemed as a Filipino corporation because sixty percent (60%) of its outstanding capital stock is owned by Filipino citizens. Under the control test its twenty two percent (22%) equity in the proposed real estate company is automatically considered as entirely Filipino-owned.

With regard to Joint Venture Company 2 however, we apply the Grandfather Rule considering that Filipino equity is less than sixty percent (60%). Under the DOJ Ruling, in such a situation where Filipino equity is less than sixty percent (60%), only the number of shares corresponding to such percentage shall be counted as of Philippine nationality. Applying the computation in said ruling, the percentage of Filipino equity in Joint Venture Company 2 amounted to 38.22%. Therefore, from the seventy eight percent (78%) equity of Joint Venture Company 2 in the Proposed Real Estate Company, only 38.22% shall be credited as Filipino-owned.

Adding said percentage (38.22%) to the (22%) equity of Joint Venture Company 1, which is considered as entirely Filipino-owned, the outcome is a 60.22% Filipino equity in the proposed Real Estate Company. Under said equity structure, the proposed Real Estate Company is considered as a Filipino corporation; and therefore, qualified to own, hold and convey land.

As stated, **Structure Option 2** has the same capital equity structure, with a difference only in the par value of the shares which are Filipino-owned vis-a- vis those shares that are foreign-owned. Therefore, the computation used for Structure Option 1 also applies to Structure Option 2.

It should be stressed that in both the proposed equity structures given in your letter, designated as Structure Option 1 and Structure Option 2, the minimum Filipino equity requirement for purposes of land ownership is met considering 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."[3]

Said interpretation was reiterated in SEC opinion No. 30-06 dated September 21, 2006, which declared that:

> "The computation of the sixty percent (60%) Filipino ownership for purposes of determining whether or not a corporation is a Philippine national is based on the total number

[3] SEC Opinion No. 49-04 dated December 22, 2004

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of outstanding capital stock entitled to vote-irrespective of the amount of the par value of the shares and likewise, regardless of whether or not such shares have been fully or partially paid."

For your information and guidance.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel