Republic of the Philippines
Department of Finance
Securities and Exchange Commission

OFFICE OF THE GENERAL COUNSEL

SEC-OGC Opinion No. 16-18
RE: Ownership, Control, and Administration of an Online English School.

21 July 2016

PUNONGBAYAN AND ARAULLO
Unit 603, 6th Floor Ayala Life-FGU Center
Biliran Road, Cebu Business Park
6000 Cebu City

Attention: **MR. WENDELL D. GANHINHIN**
Director, Tax Advisory and Compliance

Dear Mr. Ganhihin:

This refers to your letter dated 28 January 2015, requesting for a legal opinion on the ownership, control and administration of an online English school, on behalf of your client, **Nightingale, Inc.** (*Nightingale Japan).*

You mentioned in your letter that your client Nightingale Japan is duly organized and existing under the laws of Japan and is now processing the establishment of a Philippine subsidiary *(Nightingale Philippines)* which would operate an online English tutorial service in Cebu, Philippines. You disclosed that the online English school would also be registered with the Philippine Economic Zone Authority (PEZA) as an export-enterprise and would cater primarily to foreign nationals based outside the Philippines, particularly from Japan, through the use of any or all medium/media, including but not limited to, the telephone, internet and all kinds of web-based interaction. *The English school might also cater to foreign residents in the future*. You further disclosed that Nightingale Philippines shall be one hundred percent (100%) owned by Nightingale Japan, the Board of Directors of which shall be composed of five (5) members, two (2) of whom shall be Japanese nationals, and the other three (3) members are Filipino citizens.

Hence, you seek confirmation of your position that the ownership, control and administration of the online English school can be undertaken 100% by a foreign company for the following reasons:

1. It is exempt from the ownership requirement for educational institutions as provided under Section 4(2), Article XIV of the 1987 Philippine Constitution; and

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2. It is an export-oriented enterprise under Republic Act No. 7042, otherwise known as the Foreign Investment Act of 1991 (FIA) as amended, which is not covered by the restrictions on the extent of foreign ownership.

Under the Education Act of 1982[1], educational institution refers to schools. The school system is synonymous with formal education, which "refers to the hierarchically structured and chronologically graded learnings organized and provided by the formal school system and for which certification is required in order for the learner to progress through the grades or move to the higher levels."[2]

Section 25, Chapter 3 of the Education Act, in relation to *People v. Filomena Foster*[3] citing Section 2 of Act No. 2706, as amended, requires that only an educational institution can engage in the private business of providing technical vocational or training programs to its students, viz—

> Section 25. Establishment of Schools.- All schools shall be established in accordance with law. The establishment of new national schools and the conversion of existing schools from elementary to national secondary schools or from secondary to national secondary or tertiary schools shall be by law: Provided, That **any private school proposed to be established must incorporate as either a non-stock or a stock educational corporation in accordance with the provisions of the Corporation Code of the Philippines.** This requirement to incorporation may be waived in the case of family-administered pre-school institutions.
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> The term "private school or college" shall be deemed to include any private institution for teaching, managed by private individuals or corporations, which is not subject to the authority and regulations of the Bureau of Education or of the University of the Philippines, or of the Bureau of Public Welfare, and which offer courses of kindergarten, primary, intermediate or secondary instruction or **superior courses in vocational, technical, professional or special schools by which diplomas or certificates are to be granted or titles and degrees conferred (People v. Foster).** (Emphasis Supplied)

Offering the English language as a training course or program for public consumption, in general, is considered offering "technical vocational education."[4] Educational institutions offering Technical Vocational Education Training is within the regulatory power of the Technical Education and Skills Development Authority (TESDA). Relative thereto, it is imperative to look at a previous Opinion[5] of TESDA, which imparts the following:

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[1] Batas Pambansa Blg. 232.
[2] Commissioner of Internal Revenue v. Court of Appeals and Young Men's Christian Association of the Philippines, Inc., G.R. No. 124043, 14 October 1998.
[3] G.R. No. L-12828, 13 April 1959.
[4] Memorandum of TESDA to the Securities and Exchange Commission dated 30 September 2013, invoking Section 4(22) of TESDA's Manual of Policies and Guidelines on the Establishment and Operation of Public and Private Technical-Vocational Education and Training Institutions which defines "Technical Vocational Education" as *any program at the post-secondary educational level oriented towards skills proficiency leading to certificates or diploma in preparation for a particular occupation or group of middle-level occupations. Short-term programs of instruction, including the acquisition of technical knowledge and skill lasting less than a year, are generally considered as technical-vocational educational activities, irrespective of the training provider in which such programs are offered.*
[5] *Id.*

(1) If the domestic corporation purely caters to foreign clients abroad who wish to enhance their English language skills through informal **on-line tutorial class instruction for a fee and <u>does not</u> issue any Certificate of Training or Diploma for Program Completion to their successful on-line students, it cannot be considered as engaged in formal technical-vocational education or training activities**, and hence, not under the jurisdiction of TESDA.

(2) If the domestic corporation offers English program for a fee and at the end of the training program **<u>is issuing any Certificate of Training or Diploma for Program Completion to its successful students</u>**, **<u>it is considered engaged in formal technical vocational education</u>**, regardless of whether the same is performed on-line or within a regular classroom atmosphere and regardless of whether its students are foreigners or not, and hence, under the jurisdiction of TESDA.[6]

Accordingly, if a corporation wishes to engage in the business of providing technical vocational education or training program based on the foregoing standards, it follows that, being an educational institution, it must comply with the 60%-40% Filipino-Foreign equity requirement, subject to limitation and exceptions prescribed by law.[7]

Article XIV, Section 4 (2), of the 1987 Constitution specifically provides nationality restrictions for educational institutions:

"Section 4.

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"(2) Educational institutions, other than those established by religious groups and mission boards, shall be owned solely by citizens of the Philippines or corporations or associations **at least sixty per centum** of the capital of which is owned by such citizens. The Congress may, however, require increased Filipino equity participation in all educational institutions.

The control and administration of educational institutions shall be vested in citizens of the Philippines.

No educational institution shall be established exclusively for aliens and no group of aliens shall comprise more than one-third of the enrolment in any school. **The provisions of this subsection shall not apply to schools established for foreign diplomatic personnel and their dependents and, unless otherwise provided by law, for other foreign temporary residents.**"

From the foregoing, all educational institutions, ***other than those established by religious orders and mission boards, and those established for foreign diplomatic personnel and their dependents, and for other foreign temporary residents***, is subject to 40% foreign ownership limitation. Likewise, foreigners are not allowed any control and administration of educational institutions, thus are barred from becoming members of the

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[6] *Id.*
[7] *Id.*

Board of Directors/Trustees of educational institutions. This prohibition/restriction against foreigners applies to all persons who are not citizens of the Philippines, including natural-born citizens of the Philippines who have lost their Philippine citizenship by acquiring naturalized citizenship.[8]

Coming now to the first argument, the facts are insufficient to make a categorical opinion on whether Nightingale Philippines is an educational institution (*i.e.* whether it shall be offering the online tutorial class as a formal training course or program for a fee and shall provide Diplomas or Certificates of Program Completion). If Nightingale Philippines shall be issuing Certificates of Training or Diplomas for Program Completion, then it shall be engaged in a formal technical vocational education or training activities, hence considered as an educational institution; otherwise, it is not. If it is an educational institution, the rule is that all educational institutions, other than those established by religious orders and mission boards, and those established for foreign diplomatic personnel and their dependents, and for other foreign temporary residents, are subject to 40% foreign ownership limitation.[9]

Foreign equity participation in export enterprises shall be allowed up to one hundred percent (100%) provided that the products and services of such enterprises **do not fall within Lists A and B of the FINL.**[10]

Given that Nightingale Philippines would cater *initially and exclusively* to foreign nationals abroad, it falls within the meaning of "export enterprise". However, it is subject to the determination whether or not it is an educational institution. If it is an educational institution, then it falls under List A of the FINL, and as such, subject to limitation and exceptions prescribed by the pertinent laws as aforementioned.

Further, the fact that Nightingale Philippines shall be registered with the PEZA does not necessarily mean that it is exempt from the application of the FIA. In a previous Opinion of the Commission, it opined that:

> "Giving flesh to the above provision[11] is Section 1, Rule III, Part II, of The Implementing Rules and Regulations ("IRR") of the PEZA Law which reads:

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[8] SEC Opinion dated 10 November 2014 addressed to Herrera Teehankee and Cabrera, citing SEC Opinion dated 27 March 2009 addressed to Picazo Buyco Tan Fider and Santos; SEC-OGC dated 5 August 2014, addressed to Nonato Nonato and Nonato Law Offices, citing SEC Opinion dated November 10, 1992, addressed to Mr. Eleno L. dela Cruz.

[9] SEC Opinion dated 27 March 2009 addressed to Picazo Buyco Tan Fider and Santos.

[10] Section 6 of FIA provides:

> "Section 6. Foreign Investments in Export Enterprises. — Foreign investment in export enterprises **whose products and services do not fall within Lists A and B of the Foreign Investment Negative List provided under Section 8 hereof** is allowed up to one hundred percent [100%] ownership. (Emphasis and underscoring supplied)

Relatively, Rule VI, Section 1 of the Implementing Rules and Regulations of FIA provides:

> "Section 1. Allowable Foreign Equity Participation. Foreign equity participation in export enterprises shall be allowed up to one hundred percent (100%) **provided that the products and services of such enterprises do not fall within Lists A and B of the FINL.**"

[11] "Section 7 of Republic Act No. 7916, otherwise known as The Special Economic Zone Act of 1995 ("PEZA Law"), as amended, states that:

"Section 1. Qualification of Applicants. — Any person, firm, association, partnership, corporation, or any other form of business organization, regardless of nationality, control and/or ownership of the working capital thereof may apply for registration as an Export or Free Trade Enterprise within the ECOZONE in any sector of industry, international trade and commerce, except duty-free retailing and wholesale trading of imported finished products for purposes of serving the domestic market. **Furthermore, if the area of investments of the said Enterprises falls within Lists A and B of the Foreign Investments Act of 1991, then the applicable nationality, ownership or control requirements of the said law shall be observed.**

Applications for ECOZONE Developer/Operator, Domestic Market, Utilities, Facilities, Tourism or Service Enterprises **shall comply** with the applicable nationality, control and/or ownership requirements of the working capital thereof in accordance with the pertinent provisions of the Philippine Constitution, Foreign Investments Act of 1991 and other existing laws and regulations."

Thus, unless your case falls within any of the exceptions enumerated in Section 3 of the Retail Trade Liberalization Act, the fact that a retail enterprise is PEZA-Registered does not mean that said business entity is exempt from the application of the RTLA vis-à-vis the FIA. xxx"[12]

It shall be understood that the foregoing opinion is rendered based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the courts, or upon the Commission in other cases of similar or dissimilar circumstances.[13] If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Please be guided accordingly.

CAMILO S. CORREA
General Counsel

"Section 7. ECOZONE to be a Decentralized Agro-Industrial, Industrial, Commercial/Trading, Tourist, Investment and Financial Community.
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Foreign citizens and companies owned by non-Filipinos in whatever proportion may set up enterprises in the ECOZONE, either by themselves or in joint venture with Filipinos in any sector of industry, international trade and commerce within the ECOZONE. Their assets, profits and other legitimate interests shall be protected: Provided, that the ECOZONE through the PEZA may require a minimum investment for any ECOZONE enterprise in freely convertible currencies:

[12] SEC Opinion dated 23 January 2008 addressed to Regina S. Peralta.

[13] SEC Memorandum Circular 2003-15, No. 7.

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