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TOP OF MIND

By **MICHAEL ANGELO D. ADRID**

'Dummy' – Proofing MSMEs

A critical key in cultivating the progress of developing nations such as the Philippines, is the fully-realized adoption of an inclusive economic growth policy. Growth, in an inclusive sense, would mean that the elevation of living standards is commonly experienced, and that access to comfortable living is extended up to the grassroots level of our society at a sustainable level.



Hence, it is empowering to note that as a country, we have nurtured an economic environment that

encourages greater participation to the market. This accomplishment is strongly indicated by the emergence of micro, small and medium enterprises (MSME) as among the primary drivers of our economy. By definition, under Republic Act (RA) No. 7042 dated June 13, 1991, as amended (otherwise known as the Foreign Investments Act), an enterprise may be considered as belonging to the MSME sector if its paid-up capital is less than \$200,000.00, or its equivalent.

To quantify the influence of MSMEs over our economic growth, the Department of Trade and Industry (DTI) noted that in 2014, a staggering 99.6 percent of registered enterprises in the Philippines are MSMEs. Their presence translated to the creation of about five million jobs (roughly 63 percent of the total jobs generated in 2014) and the contribution of an estimated 36 percent of the total sales for that same year.

But notwithstanding the impressive proliferation of MSMEs in the Philippines, the globalization of trade places into serious inquiry the capacity of our homegrown MSMEs to thrive at the open market. This is especially so in view of the tendency of some established foreign economic players to dilute the market with their presence, which in effect, undercuts any healthy potential for competition. Thus, controls are in place to regulate the entry of foreign direct investments (FDI) into certain industries, such as MSMEs, which are identified to benefit from protectionist policies.

It is worth pointing out however, that the limitations on FDIs operate more as an exception to the general rule, rather than the status quo itself. In fact, the Foreign Investments Act, as amended, recognizes that the primary policy is still to encourage FDIs and permit full foreign equity participation in Philippine enterprises, save for those that are specifically distinguished as either belonging to nationalized or partially-nationalized industries. For this purpose, the 10th Foreign Investments Negative List (FINL-10) dated May 29, 2015, provides for the most recent guidance on which investment activities are reserved for Philippine nationals, and the extent of allowable FDIs over all the other industries. Complementing this policy is Commonwealth Act No. 108 dated Oct. 30, 1936 (otherwise known as the Anti-Dummy Law), as

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amended, which penalizes acts that are designed to circumvent FDI limits. These acts include, among others, the employment of foreigners in nationalized / partially-nationalized industries.

In this connection, the Securities and Exchange Commission (SEC) had the recent opportunity of reiterating the rules on foreign equity participation in MSMEs. In a SEC opinion issued through its Office of the General Counsel dated May 30, 2016 (SEC-OGC Opinion No. 16-13), the SEC confirmed that a local distributor of scientific and laboratory equipment, which is 40 percent owned by Malaysian nationals, is considered a small and medium sized domestic market enterprise subject to restrictions on foreign ownership.

At the onset, the SEC reiterated the rule under FINL-10, that for a domestic market enterprise (an enterprise which produces goods for sale, or renders service or otherwise engages in any business, in the Philippines) having a paid-up capital of less than \$200,000.00, the maximum allowable FDI should be no more than 40 percent. This foreign equity restriction shall not apply, however, if the enterprise involves advanced technology as determined by the Department of Science and Technology, or employs at least 50 direct employees. In this case, the minimum paid-up capital of US\$100,000.00 may be allowed to foreigners.

Considering the partially-nationalized character of MSMEs, the SEC further emphasized the rule against the employment of foreigners in this industry. Under Section 2-A of the Anti-Dummy Law, as amended, a partially-nationalized corporation cannot hire any foreigner to intervene in its management, operation, administration or control, whether as an officer, employee, or laborer therein, with or without remuneration, except as technical personnel whose employment may be specifically authorized by the Secretary of Justice.

The concept of restricting foreign employment in nationalized industries is actually aligned with our protectionist policy. Equally enlightening is the pronouncement of the Supreme Court in the case of Macario King vs. Pedro S. Hernaez (G.R. No. L-14859 dated March 31, 1962), where the High Court justified the restriction for reasons of "plugging any loophole or closing any avenue that an unscrupulous alien may resort to flout the law or defeat its purpose." Furthermore, the Supreme Court said that expanding the restriction to even non-control positions is a recognition that while one may be employed in a seemingly harmless position, it is possible for the said employee to later turn out as a mere conduit to advance the "evil designs of the employer." As such, a strict interpretation of the law is necessary in order to "stave-off any attempt at circumvention of the legislative purpose."

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On the other hand, the SEC in the same opinion, said that increasing the paid-up capital of the enterprise to more than or equal to US\$200,000.00, shall have the effect of removing the said enterprise from the coverage of FINL-10. Consequently, the FDI cap as well as the ban on foreign employment, shall no longer apply.

While the ideals of our protectionist policy are never misplaced, there is also an equally important yearning for our MSMEs to be able to participate in higher levels of the global value chain. However, foreign-sourced funding currently remains to be the more accessible source of funds for Filipinos intending to do business in the Philippines. This is because there are not as many available sources for local funding in the Philippines. For MSMEs therefore, the lack of access to local financing amidst the restrictions on foreign investments, poses a serious obstacle to this industry's growth and development.

Thus, in order to balance our FDI controls with the need to evolve our MSMEs, our state policy should prioritize the grant of a wider access to local funding for our MSMEs. This is to provide an effective alternative for foreign-sourced funding.

Furthermore, it is also vital for our current rules regulating FDIs to be regularly reviewed. That way, adjustments to the restrictions may be adopted, to provide an opportunity for the implementation of responsive measures which complements the current needs of the country.

As we continue to adopt a more globalized mindset, there is a gradual diffusion of that historical breed of protectionism which runs along national lines. Granted that an imminent confluence of the age-old dichotomy between protectionism and free trade may seem to be the stuff of myths, it is always helpful for us, as a nation, to keep an open mind towards finding the right mix between protecting our own and embracing our membership in the global community.

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