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TAX LAW FOR BUSINESS

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Doing business through the Internet

The characterization of the term "doing business" in the Philippines has evolved from a judicial pronouncement to its present-day definition as now provided in our statutes. Nonetheless, its concept remains the same as that explained by the Court in a 1941 decision in the Mentholatum Co. (GR L-47701) case. That archaic case remains relevant up to these days, especially in so far as it explained the twin-characterization test in determining whether a foreign corporation is considered doing business in the Philippines.

Essentially, the hallmark of what constitutes doing business in the Philippines would pertain to the concept of "continuity". It is not really the number of the transactions, but, more important, the intention of a foreign entity to continue the body or substance of its business in the country, which may determine whether it is engaged in business in the Philippines.

The application of the rule, however, has become a challenge these days with more businesses consummated with the aid of e-commerce, online platforms or through the Internet. As network boundaries overlap and go beyond national borders, questions arise as to where an entity is considered doing business. Questions include issues related to servers being located somewhere else, absence of employees or agents in a certain jurisdiction and no physical presence, among others. This struggle has raised an array of different approaches and analyses that vary widely from jurisdiction to jurisdiction.

Recently, the Securities and Exchange Commission (SEC) still applied the Mentholatum doctrine in concluding that a foreign entity is considered doing business in the Philippines. Said foreign entity is operating online platforms outside the Philippines but offers various content and services, such as online community and an online gaming system, which are accessible to Philippine clients.

Interestingly, however, the SEC expounded its opinion and adapted a new test that is tailored to Internet activities. The test is known as the “sliding-scale test”. Historically, the first case to establish an independent test/sliding-scale test for how the Internet affects personal jurisdiction was the Zippo Manufacturing (Zippo) case from the United States District Court for the Western District of Pennsylvania. Zippo was one of the first cases to examine the new reality of e-commerce, in which companies can do more than just advertise; buying and selling products and services online from and to customers around the world. Many of the cases after Zippo have adopted this sliding-scale approach. (Prewitt and Callahan. “Jurisdiction on the Information Age.” 2017)

According to the SEC, the sliding-scale test determines the level or types of activities that will constitute “minimum contacts” for jurisdictional purposes. This is based on the premise that the likelihood that “personal jurisdiction” can be constitutionally exercised is directly proportionate to the nature and quantity of commercial activity that an entity conducts over the Internet. At one end of the sliding scale are “active web sites”, or situations where one clearly does business over the Internet, which establish personal jurisdiction. At the opposite end of the spectrum are “passive web sites”, where one simply posts information on a web site and which alone generally does not generate sufficient contacts with a foreign state to establish personal jurisdiction. In the middle of the spectrum are “interactive web sites” and the exercise of jurisdiction is determined by examining the level of interactivity on a case-by-case basis.

In applying the sliding-sale test, the SEC concluded that the foreign company was clearly doing business over the Internet end of the scale or active web site, as there exists in this case sufficient "minimum contacts" with Philippine-based clients. For instance, the SEC noted that it generates sufficient contacts and business over the Internet, as it offers for sale and is engaged in the selling of content and services to account holders in the Philippines.

Although the SEC adapted a new test in an effort to articulate the proper legal standard in articulating what constitutes "doing business" in the Philippines in so far as doing business through the Internet is concerned, it repeatedly emphasized that, in determining whether a foreign corporation is considered doing business in the Philippines, the facts are to be considered on a case to case basis. Further, even with this new concept, it appears that 1941 twin-characterization test espoused in the Mentholatum case remains relevant.

Overall, the SEC's analysis demonstrates the extent to which the Philippines will go in asserting our jurisdiction. While one can embrace the wonders of the Internet's global electronic reach, one must also embrace the burden and responsibility of a global presence.

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