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COLOMBIA

The following is a brief synopsis of recent political and economic developments in Colombia.

Elected in May by a comfortable majority, Mr. Virgilio Barco became President of the Republic on August 7, 1986. For the first time in thirty years, the principal opposition party (the Conservative Party) refused to participate in the government comprised exclusively of Liberals. Since the Liberal Party held both houses of Congress, President Barco's administration hesitated before submitting the first elements of its legislative program to Congress. When the Finance Minister, Mr. Gaviria, finally submitted the tax reform to Congress in October, a near disaster arose since the administration had great difficulty in combatting the Liberal congressmen's lack of discipline and interest in participating in parliamentary debates. However, President Barco finally succeeded in rallying his congressmen and senators, and the bill was adopted at the very end of the 1986 parliamentary session.

The Barco government has an ambitious plan of rural, urban, economic and social reform whose objective is to stimulate economic recovery, particularly in international trade, while eliminating the "absolute poverty" which afflicted large sectors of both the rural and urban population. Additionally, the new government had to react to the increased activity by guerrilla movements. These movements seem to concentrate in certain remote areas of the country and target pipelines and other petroleum installations that have both political and economic importance. Some observers believe that Mr. Barco's efforts in this area may have been impeded by the refusal of the Conservatives to share in governmental responsibility.

On the international front, Colombia has received approval from the World Bank for the management of its external debt. In addition, at the end of 1986 the government made a second drawing on the US \$1 billion jumbo loan which was signed in 1985 with the international commercial banks. Finally, after having undertaken a placement of "samurai" bonds on the Japanese market with outstanding success, the government is preparing to enter the European bond markets in 1987.

I. TAX REFORM

Law 75 of 1986, voted by Congress on the eve of the end-of-year festivities, constitutes the most important tax reform in twelve years. The measures, which sought to simplify the tax structure and reduce the marginal tax rate for individuals, are similar, in many respects, to the principal objectives of President Reagan's tax reform proposals that successfully passed Congress. Other elements of Law 75, in particular the amnesty offered to delinquent taxpayers and the power accorded to the President of the Republic to reform the structure of the tax administration, are designed to address Colombian considerations.

Among the principal elements of the tax reform package are the following:

(a) *Unification of Corporate Tax Rates.* A uniform rate of thirty percent, which will be applicable to all types of business entities, will be phased in over fiscal years 1986, 1987 and 1988. Amounts saved by corporations in 1986 as a result of the new lower tax rates shall be used to either finance expansion of corporate activities, to increase their capital, or to purchase assets approved by the government.

(b) *Elimination of the Double Taxation of Dividends and Income From Participation in "Sociedades de responsabilidad limitada" and Other Types of Business Organizations.* The burden of taxation on income generated by business organizations will fall exclusively on the organizations themselves and not on their owners or shareholders (except in the case of foreign owners or shareholders). Owners and shareholders (other than shareholders of companies listed on the stock exchange and participants in pension or mutual investment funds) will be responsible for the business organization's income tax, in proportion to their interest in the organization. Where the distributed profits of the organization exceed seven percent of the amount of income and capital gains tax payable by the organization, such excess is considered to be taxable income of the owners or shareholders, and the organization must make provisions for retention at source of tax payable on such amounts.

(c) *Gradual Reduction of Tax Deductibility for Increases in Interest Payments and Other Financial Costs Arising From Inflation.* This measure will be accompanied by a corresponding gradual elimination of income and capital gains tax on the inflationary

component of the increases in the value of interest and other financial income received by corporate taxpayers. On interest received by individual taxpayers on bank accounts, public debt instruments, and bonds and commercial paper issued by companies listed on the stock exchange, the proposed tax relief would take complete and immediate effect as of the 1986 fiscal year.

(d) *Simplification of Personal Income Tax.* The tax base will be broadened by eliminating a wide range of deductions, discounts and exemptions. The tax threshold will be considerably raised and marginal tax rates reduced — the top marginal tax rate has been reduced from forty-nine percent to thirty percent.

(e) Capital gains tax will in nearly all cases be assessed at the same income tax rate (e.g., gains will be taxed at a rate of thirty percent for corporations and other business organizations).

(f) A wide-range amnesty will be offered to delinquent taxpayers to clear up the huge backlog of cases pending before the tax authorities. For example, any case involving sales or stamp tax which has been pending for at least ten years will be presumed to have been determined in favor of the taxpayer.

(g) The government will be given extensive powers to reorganize the tax administration, adopt a new tax code, generally eliminate the taxation of inflationary components of the nominal value of taxpayers' income or capital gains and adopt measures with the purposes of stimulating "sociedades anonimas" in order to increase the number of shareholders of such corporations and to "democratize the ownership of the means of production."

(h) All peso amounts referred to in the tax legislation will be automatically adjusted in accordance with changes in the Consumer Price Index for the twelve-month period beginning on October 1 of each year.

(i) Investment in Colombian corporations will not be included in the "patrimonio liquido" (roughly equivalent to net worth) for the purpose of calculating a taxpayer's "presumed income" (which is basically a percentage of his net worth). Where a taxpayer's presumed income is higher than his declared income, tax will be calculated on presumed income.

For foreign companies and natural persons with business interests in Colombia, the following aspects of the tax reform package will be of particular interest:

(a) Colombian source income received by non-resident foreign-

ers will, unless otherwise provided, be taxed at thirty percent. However, the government is authorized for a period of two years, from the promulgation of Law 75, to reduce the thirty percent rate so that it "harmonizes" with tax changes in countries with foreign investments in Colombia with regard to tax credits available in such countries for taxes paid in Colombia.

(b) Dividends received by foreign corporations from investments in Colombia will be taxed at thirty percent (formerly the rate ranged from twenty to forty percent depending on the corporation's country of origin).

(c) The basic tax rate on income, other than dividends, received by non-resident corporations will be thirty percent; this includes interest, commissions, royalties, fees for services and profits from branches or from business organizations other than *sociedades anonimas*.

(d) The remittance tax on income from a Colombian branch operation will be raised from twenty to thirty percent of the net amount after payment of income tax.

(e) All amounts paid to foreign companies under turn-key and construction contracts will be deemed Colombian source income and will be subject to a withholding of one percent of the gross amount (this provision will only apply to contracts signed, modified or extended after the new legislation came into force).

(f) The basic remittance tax rate on contracts, not otherwise covered by specific provisions, will be one percent of the total value of the contract and withholding will be made at the rate of one percent of the gross amounts paid or assigned under the respective contract (this provision will only apply to contracts signed, modified or extended after the new legislation came into force).

(g) Stamp duty will henceforward be payable even on contracts signed outside Colombia if such contracts are deemed to have legal or economic effects in Colombia. The basic rate of stamp duty will be 0.5% of the contract amount. However, foreign debt instruments are specifically exempt from such tax.

(h) Debts owned by Colombian branches, agencies, subsidiaries or affiliates of foreign companies to such foreign companies will, for tax purposes, be considered a part of the patrimony of the respective branch, agency, subsidiary or affiliate. This will effectively raise the "presumed income" of the respective branch, agency, sub-

sidiary or affiliate.

(i) The various import taxes currently in force will be replaced by a single tax of eighteen percent on the CIF value of most imports. This tax will be levied in addition to applicable customs duties.

In the upcoming weeks and months, decrees and regulations will be issued covering detailed aspects of the tax reform package adopted by Congress.

II. THE SUPREME COURT DECIDES APPLICABLE LAW IN PUBLIC DEBT CONTRACTS

In a decision published in late November of 1986, the Supreme Court upheld the constitutionality of Section 239 of Decree 222 (1983), which provides that the performance of public debt contracts may be governed by foreign law when performance of the parties' obligations will take place abroad (in accordance with Decree 2875 (1983) if drawdowns or repayments are made outside Colombia). Likewise, Colombian public entities may agree to submit to the jurisdiction of foreign courts. The decision of the Court was greeted with relief, both by international banks and by the Colombian government, since the judges in a decision of March, 1986, had decided unequivocally that it would be unconstitutional for the national government, or any public entity, to allow external debt contracts to be governed by the law of a foreign country or submit to the jurisdiction of foreign courts. Also, in the March decision, the Court reaffirmed its decision of 1976 in which it declared that submission to foreign law and courts could only be accepted where multilateral or bilateral international agreements between Colombia and other countries so provided.

The Court's previous decisions provided for possible submission to foreign law and courts without distinguishing between contracts where performance was abroad and those where performance was in Colombia. Whereas, in the Court's most recent decision, there is a clear distinction between performance of contracts in Colombia and performance abroad.

III. PROPOSED CHANGES TO THE LEGAL PRINCIPLES GOVERNING FOREIGN INVESTMENT

In November of 1986, the Barco administration presented to

Congress two bills whose adoption would have substantial effects on the legal framework governing foreign investment in Colombia since the enactment of Decision 24 of the Cartagena Agreement Commission.

Bill 178 provides for potential new foreign investment in banks, financial corporations, insurance and reinsurance companies and in commercial finance corporations, with the prior approval of the National Planning Department and the Banking Superintendency. Except in special circumstances (and with the prior approval of the National Council on Economic and Social Policy (CONPES)), foreign investors would not be authorized to hold more than forty-nine percent of the capital of any particular institution. A global limit of forty percent would be imposed on the participation of foreign investors in each category of financial institution.

In principle, foreign investment will be authorized only for subscription to new issues of shares or of bonds convertible into shares, but CONPES would authorize the purchase by foreign investors of shares or bonds already held by Colombians. The bill also provides for the possibility of foreign banks converting their loan exposure in Colombia into equity participation in the Colombian financial sector.

Bill 204 is essentially designed to provide the government with extraordinary powers to legislate in the area of foreign investment and contracts dealing with technology, patents and trademarks. This expansive power will permit Colombia to undertake with its partners in the Andean Pact (Bolivia, Ecuador, Peru and Venezuela) an in-depth revision of Decision 24 of the Cartagena Agreement Commission. For many years, Decision 24 has been a source of controversy and the subject of criticism in international commercial circles, particularly within several member countries of the Andean Pact. Some governments have even threatened to leave the Andean Group unless Decision 24 is profoundly revised or abrogated.

IV. AMENDMENTS TO THE NORMS GOVERNING REFINANCING OF PRIVATE ENTERPRISES

Adopted by the Monetary Board (Junta Monetaria), Resolution 92 (November 28, 1986) modifies the rules governing the availability of the special refinancing possibilities which are contained

in Resolutions 52 and 54 (1985). The modification provides access to the refinancing system for enterprises or institutions which have restructured their foreign debt with terms at least as favorable as those provided for in Resolution 33 (1984), even though such enterprises or institutions have chosen not to formally participate in that restructuring mechanism.

Pursuant to Resolutions 52 and 54, the Central Bank rediscounted credits given by banks and financial corporations to enterprises in the construction, steel or textile industry to facilitate the restructuring of debt. The provisions also provided for the granting of credits by the Central Bank to financial institutions in order to facilitate recapitalization. The facilities created by these resolutions apply only to those foreign debt obligations where refinancing had been formally assured by the mechanism created by Resolution 33 (1984). Accordingly, the Central Bank established a special line of credit in favor of Colombian commercial banks which had agreed to act as intermediaries between Colombian debtors and their foreign creditors for debt restructuring.

V. THE SUPREME COURT REESTABLISHES THE EXEMPTION FROM REMITTANCE TAX IN FAVOR OF PETROLEUM COMPANIES

In an October 1986 decision, the Supreme Court declared as illegal the provision of Law 7 of 1986 which abolished the exemption from the remittance tax of twelve percent or twenty percent accorded to petroleum companies by the tax reform of 1983 (Law 9 of 1983, Article 45). Law 7 is not actually a tax statute, but is designed to accord the national government the necessary authorization to contract debt obligations in Colombia and abroad. The section dealing with abolition of the remittance tax exemption has a purpose different from that which was provided for in the bill presented by the government to Congress. Such provisions (called "monkeys" in Colombian jargon) may only be presented by the government. The "monkey" in question was proposed by a congressman and not by the government and, for this reason, it was held to be unconstitutional.

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