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Colombia

Alienação Fiduciária of Fungible Goods

Both panels of the Federal Supreme Court have established case law to the effect that, in view of paragraph 3 of article 66 of Law No. 4728/65, as reworded by Decree-Law No. 911/68, fungible goods may be the object of *alienação fiduciária* - a Brazilian concept involving the transfer of the ownership of a purchased good in order to guarantee the financing of the purchase of that good (2nd Panel of the Federal Supreme Court, ruling on extraordinary appeal No. 99.629).

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The following is a brief summary of recent legislation and judicial decisions affecting the activity of foreign enterprises and individuals in Colombia:

New Income Tax Law

Law 009/83 adopted by Congress in May, 1983 has amended the income tax law in several important respects. Some of the changes enacted by Congress simply confirm measures which the government adopted in late 1982 and early 1983 as part of its economic emergency program. Many of the emergency decrees imposing new taxes were declared unconstitutional by the Supreme Court.

With respect to income from foreign investment the new law provides as follows:

i) Where dividends are paid by Colombian *sociedades anónimas* (S.A.) to non-resident shareholders,[1] a 40% withhold-

1. For tax purposes a company is "foreign" if it has been incorporated outside Colombia and is "national" if incorporated in Colombia, regardless of the extent of foreign shareholder participation. However, according to the foreign investment law (decree 1900/73) an enterprise is "foreign" if more than 51% of its shares are owned by non-nationals; or is otherwise controlled to the same extent by such investors; and is "national" only if a minimum of 80% of its shares, or other means of control are held by nationals. Where nationals hold between 51% and 80% of shares or other means of control, the enterprise is considered to be "mixed." It is, therefore, possible for a company to be "national" for tax purposes while being "foreign" or "mixed" for investment law purposes.

The investment law determines the extent to which profits and capital can be remitted

ing tax is payable, such withholding to be made by the Colombian entity (§§ 47 (a) and 48).

ii) The withholding rate on such dividends is 20% where the tax rate on dividends received in the foreign investor's home country is at least 70% of the income tax rate applicable to Colombian sociedades anónimas (§ 48).

iii) Where the foreign investor receives income as a result of his interest in a *sociedad de responsabilidad limitada* or similar enterprise, that income is subject to a 40% withholding tax, in the hands of the Colombian entity (§ 47 (b)).

iv) In all cases where income or capital gains are transferred abroad to a foreign investor a remittance tax is payable. There are two exceptions to this rule; namely, dividends from *sociedades anónimas* and interest payments on foreign loans, which, in view of the income tax law and decree 231 of 1983, are not considered to be national source income. This tax is fixed at 20% for profits made in Colombia by branches of foreign firms, and 12% for income generated from an interest in a *sociedad de responsabilidad limitada* or other similar enterprise held by a foreign investor. Where a withholding tax is payable on the same income, the remittance tax is calculated on the net value of income after withholding tax (§ 46 (a) (b) and 2). This "netting" applies to income received from *sociedades de responsabilidad limitada,* but not to profits which the foreign investor received from branch operations.

v) Subsidiaries, branches or agencies of foreign firms in Colombia cannot deduct amounts paid to the parent company for administrative costs, royalties or the cost of acquiring intangibles from taxable income (§ 51).

With respect to royalties, technical services fees and similar items received by foreign taxpayers, the situation is as follows:

i) Royalties arising from technology or "know-how" transfer arrangements and payments made as consideration for technical services, are subject to both withholding tax of 40% (§ 47 (c)) and a remittance tax of 12% of the net value after withholding tax (§ 46 (c) and 2). These bring total tax liability to 47.2% of

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abroad and who is considered to be a "foreign investor" for the purpose of such remittance. The tax law determines the extent to which such permitted remittances are taxable and the applicable tax rates. The rates of corporate income tax applied to the various classes of national corporations (including foreign or mixed "enterprises"), together with the complex system of tax credits and discounts, have not been substantially affected by the new tax law. The principal reform effected by the law is to alleviate double taxation on dividends received by shareholders of public companies (*sociedades anónimas abiertas*) and to a lesser extent, dividends received from other *sociedades anónimas*.

the gross amount.

ii) On payments for the lease of movies or the use of computer programs, the withholding and remittance taxes are calculated respectively on 60% and 80% of the gross value and net value after withholding tax of such payments (§§ 46 (d) and 47 (d) for movies, and §§ 46 (e) and 47 (e) for computer programs).

Certain categories of income are deemed not to be national source income and are not subject to tax. These include income from loans made abroad to Colombian *corporaciones financieras*, loans to finance trade made through banks and *corporaciones financieras*, loans made abroad to Colombian, foreign or mixed enterprises whose activities are considered to be of significance for the economic and social development of the country and whose activities are related to energy, water and sewage supply, telecommunications, public health, education, mining and petroleum exploration and development. Technical services performed outside Colombia are also exempt if the Royalties Committee has certified that such services could not be performed in Colombia and the foreign supplier of services has no branch in Colombia (§§ 49 and 50).

Decree 222/1983 - Administrative Contracts

This decree was adopted by the Government pursuant to powers delegated by law 19 of 1982 and replaces decree 150 of 1976 as the instrument governing contracts made by the public sector. The complex new decree includes controversial provisions for unilateral modification and interpretation of contracts by public entities and obligatory termination clauses. Consultancy contracts can only be made with foreign entities where the *Fondo Nacional de Proyectos de Desarrollo* (FONADE) certifies that no Colombian consultants are available for the work involved (§ 127).

Foreign engineers who contract with public entities are obliged to have Colombian associates on the project with at least 40% participation. Preference is given to Colombian engineers over foreign engineers, if all of the other factors are equal (§ 107).

All foreign enterprises seeking to contract with public entities must have a branch in Colombia, if the object of the contract is permanent, or must appoint a legal representative where the object of the contract is temporary. This rule does not apply to foreign public entities whose capacity to contract is attested by a certificate from their country's embassy or consulate in Colombia (§ 7).

Where a contract is awarded to a consortium, each member of the consortium will be severally responsible for its execution.

Decree 222 governs the procedure for contracting private foreign loans, these do not, however, include credit lines or similar operations of publicly owned banks (§ 221). In the case of private foreign loans contracted directly by the national government, approval of the project to be financed must be obtained from the National Council on Economic and Social Policy and approval to negotiate with a particular foreign lender, must be obtained from the Department of Finance based on a prior favorable opinion of the Interparliamentary Commission on Foreign Credit.

Where loans are contracted by "decentralized agencies," such as utilities, permission to negotiate is required from the Department of Finance, based, in part, on a favorable opinion by the National Planning Department concerning the project to be financed. The contract may be signed only when the government adopts an executive resolution which will be adopted on the recommendation of the General Directorate of Public Credit. A simplified procedure is provided for credits of less than US $5 million. Where the guarantee of the national government is sought, approval for such a guarantee must be obtained from the National Council of Economic and Social Policy.

One should note that the steps outlined above constitute the principal thrust of the decrees. Each step is preceeded or succeeded by a series of authorizations and approvals detailed in the decree.

Decree 222 maintains the requirement that foreign loan agreements must be governed by Colombian law and courts. This rule applies not only to contracts signed in Colombia but also to those signed elsewhere, which will be executed in Colombia. Section 239 has an important nuance; contracts which are to be "verified" abroad may be governed by foreign law. The meaning of "verified," however, is unclear. According to one of the authors of the decree, the expression covers loans such as Eurobond transactions where the bonds are issued abroad. If this is indeed the meaning of the term "verified" then the scope of application of foreign law will be narrow since Colombian entities are rarely involved in Eurobond transactions. Nevertheless, as a matter of practice in fixed-rate subsidized interest transactions, the parties may stipulate to apply foreign law.

Decree 222 is designed exclusively to cover project financing to public entities. In a recent policy statement, the government affirmed that foreign loans would be sought only to finance investment (El Tiempo, Bogotá, March 31, 1983). Several influential economic advisory groups, however, are urging the government to consider recourse to foreign borrowing as a means of financing its own deficit without "crowding out" private borrowers in the domestic capital market.

Limits on Lending and Guarantees by Banks

In an effort to avoid over-exposure by banks through loans or guarantees to particular clients, decree 3363 of 1982 requires the limitation of unsecured loans and guarantees to any single entity to 7% of its paid-up capital and reversed assets. This limit is raised to 15% where the loans or guarantees are secured by charges on real estate as long as the value of the property charged is at least 20% greater than the amount of the loans or guarantees it secures.

Foreign medium and long-term credits for development purposes are not subject to the constraints imposed by the decree. There is no definition of "development lending" but it is understood that the term covers investment in infra-structure and public services. The above-mentioned limits can be raised to 10% for unsecured transactions and 25% for secured transactions where the project to be financed or guaranteed is considered to be of significance for national economic and social development according to criteria established by the National Council on Economic and Social Policy. The limits can also be raised where the particular financing has been approved by the Monetary Board (*Junta Monetaria*).

The financial institutions covered by the decree must comply with its requirements by December 21, 1984. The decree applies to publicly owned banks as well as private sector institutions but does not apply to *corporaciones de ahorro y vivienda* (whose functions are similar to those of savings and loan associations in the United States).

Foreign Arbitration and the CORELCA Case.

In its recent decision in *CORELCA v. Westinghouse Interna-*

tional Corporation, the Council of State, Colombia's highest administrative law court, invalidated a clause in an agreement between a public utility and a private U.S. supplier providing for foreign arbitration. In fact, the arbitration in question would have been carried out by Colombia arbitrators in Colombia according to the rules of the International Chamber of Commerce. Having affirmed that such arbitration was indeed "foreign", the Council held that it was not in conformity with Colombian constitutional requirements. According to the Constitution, only courts established by the state can render binding decisions. While the law does recognize arbitration clauses it requires that all arbitration be carried out according to the terms of the Code of Civil Procedure. As far as the Council of State was concerned, the ICC arbitration did not fall within that category even though the arbitrators would be qualified to act in compliance with the Code under Colombian law.

It is important to note that, though invited to do so by Westinghouse, the Council of State did not discuss what effect Colombia's ratification of the 1958 New York Convention on International Arbitration would have on the prohibition of foreign arbitration. The Council decided that the Convention would not apply to contracts made before September 26, 1979, the date of Colombia's ratification.

This may imply that the Convention is applicable to agreements made after that date and that foreign arbitration could thus be stipulated. In practice, the agencies whose approval is required for licensing and technology transfer agreements (Royalties Committee) and technical services agreements (Exchange Office), still insist that where arbitration is provided for, it must be governed exclusively by Colombian law.

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