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COLOMBIA

The following is a review of recent developments in Colombian law and legal activities.

I. INTRODUCTION

The importance of coffee exports to the Colombian economy has been confirmed by the events of recent months. Even the short-term favorable prospects, which were anticipated last year following the sudden rise in the price of coffee, rapidly disappeared with the dramatic turnaround in the coffee market. Since the beginning of 1986, the price of coffee on international markets has fallen more than forty percent. The inability of the International Coffee Organization (ICO) to reach an agreement on a new system of export quotas among member countries reinforced the declining price trend. The government in Bogotá is exhibiting an attitude of prudent restraint rather than alarm in the face of these developments. However, experts believe that it would be appropriate to clearly recognize the importance of the outcome of negotiations within the ICO and of movements in the price of coffee on international markets to the country's economy.

In April 1987, the government issued a floating rate note (FRN) for \$50 million on the eurobond market in London. Because of the prudent management of its foreign debt, Colombia is the only Latin American country with access to international capital markets. However, the rate Colombia was obliged to offer in London compares unfavorably with the rates granted by international banks to Argentina and Mexico for the restructuring of their respective foreign debts. In May, the Minister of Finance announced a program of foreign indebtedness of approximately \$4 billion. He emphasized the necessity for significant participation by private international banks in the financing plans of the government. In the course of the next two years a substantial portion of the country's foreign debt will have to be amortized, and the granting of new credits will be essential in order for Colombia to pay debts already contracted and, at the same time, finance new projects.

The foreign debt crisis affecting most Latin American coun-

tries was probably one of the motives inducing the member countries of the Andean Pact (Bolivia, Colombia, Ecuador, Peru, Venezuela) to amend Decision 24 of the Cartagena Agreement Commission dealing with foreign investment and technology transfers. The amendments agreed upon did not go as far as some had hoped, especially in the area of technology transfers, but the substantial amendment of the legal rules governing foreign investment is evidence of a new attitude on the part of the member countries of the Andean group with respect to international economic relations.

II. NEW MEASURES ON FOREIGN INVESTMENT AND TECHNOLOGY TRANSFERS

Decision 220 of the Cartagena Agreement (Andean Pact), which went into force on May 18, 1987, replaces the controversial Decision 24 of 1970. The new decision provides for more flexible legal rules governing foreign investment and accords national governments powers to adopt measures in certain important areas. These include: the sectors reserved for national investment, the rate of profit remittance and reinvestment, and sales of shares held by national investors in local companies.

The measures adopted on July 10, 1987 and July 17, 1987, by the Colombian government by virtue of powers granted by Decision 220, mark an important turning point in Colombian policy in the area of foreign investment and technology transfers. They generally make these activities more attractive by eliminating or reducing many of the constraints imposed by the former Decision 24 and by increasing the rate of remittance of profits abroad. This report presents a summary of these new and important measures.

A. *Resolution 44 of CONPES*

This Resolution was adopted on July 17, 1987 by the National Council on Economic and Social Policy (CONPES). Its most important features are the following:

(a) The basic annual rate of profit remittance abroad by a foreign investor is fixed at twenty-five percent of the registered value of his investment at the Exchange Office of the Central Bank. Under Decision 24, the rate was twenty percent. For investments in mining exploration and production, the remittance rate is

twenty-five percent increased by the annual average prime rate in New York.

(b) A higher rate than the basic annual rate may be authorized by CONPES in cases of foreign investment projects of particular importance for the national economy, for those involving particularly high risks, or whose return will only be realized in the long term rather than in the short or medium term.

(c) The reinvestment of profits generated after December 31, 1986, in the same company or the capitalization of such profits by a foreign investor will not be authorized except in the following two cases:

(i) the investor may reinvest part of the profits not transferred abroad on condition that he purchase bonds issued by the Industrial Development Institute (IDI) in an amount equal to the reinvestment;

(ii) the National Planning Department may authorize capitalization of profits made after January 1, 1987, on condition that the investor make a new investment of an equal amount by means of imported currency, equipment or machinery.

(d) The special limits on profit remittances authorized under CONPES Resolution 36 of 1983, in cases of foreign investments made in certain agro-industrial and manufacturing sectors, will no longer be available. However, investments made on the basis of Resolution 36 while that provision was in force will continue to benefit under its special terms if the investor so elects.

(e) The special rules governing profit remittances related to foreign investments made in the Popayan region and in border regions will not be affected by the new Resolution, but CONPES Resolution 41 of 1985, which provided for special rules with respect to reinvestments in projects mainly devoted to production for export is repealed.

B. Decree 1265 of July 10, 1987

This Decree, which went into force on July 13, 1987, creates, in effect, a new legal framework for foreign investment in Colombia. Its principal elements are the following.

1. *Foreign Investment*

(a) All direct foreign investment in Colombia must receive the prior approval of the National Planning Department (DNP). Investments in mineral exploration and production, in the transformation of minerals, or in hydrocarbon refining, transport and distribution, must also receive the favorable opinion of the Ministry of Mines and Energy. Investment projects for petroleum or natural gas exploration and production, will not require approval by DNP and may be undertaken with the authorization of the Ministry of Mines and Energy. Investments in free zones require only the approval of the Ministry of Economic Development and of the governing body of the free zone in question (Law 109 of 1985, Art. 9).

(b) The only sectors reserved to national investors are public services, communications in all areas and by all methods, television programming, the distribution and exhibition of films, internal transport of passengers, except tourist transport, and housing construction. All other economic sectors may receive direct foreign investment.

However, investments in the financial services sector are subject to laws and decrees dealing specifically with that area. Except for certain specific cases, foreign investment in this sector is severely limited as a consequence of Law 55 of 1975 on the "Colombianization" of banks which, *inter alia*, prohibits foreign investors from controlling more than forty-nine percent of the capital of a Colombian financial institution.

(c) A more rapid decision-making process with respect to foreign investment has been established. The principal stages are as follows:

(i) presentation, where required, of an application for approval of the investment to the DNP;

(ii) a request from DNP for additional information, if required, which must be made within fifteen working days of presentation of the request for approval;

(iii) decision by DNP within forty-five working days of presentation of the application for approval, or from presentation of the additional information requested by DNP, where required. If no decision is made before the deadline established in the decree, the application will be considered to have been approved;

(iv) registration of the authorized investment at the Exchange

Office, which must be applied for before the deadline fixed for that purpose by DNP; and

(v) new companies, must obtain an operating permit from the Superintendant of Corporations. The Superintendant must take measures to ensure that no foreign or mixed enterprises, and no branch of a foreign company, be established in Colombia where DNP authorization has not been obtained.

(d) DNP authorization of a foreign investment will become inoperative if the foreign investor does not fulfill all conditions attached to the authorization by DNP, or if registration of the investment at the Exchange Office is not applied for within the period allotted for that purpose by DNP. The Exchange Office must, upon request by DNP, cancel registration of a foreign investment if an unauthorized operation has been undertaken, or if the investor has not fulfilled the conditions attached to the authorization issued by DNP;

(e) Registration of a foreign investment accords the investor in question the right:

(i) to remit profits in foreign currency abroad up to an annual percentage of his registered investment determined by CONPES;

(ii) to reinvest profits in accordance with the rules for that purpose determined by CONPES;

(iii) to capitalize additional profits in accordance with the rules established by CONPES;

(iv) to remit amounts abroad in foreign currency received as a consequence of the sale in Colombia of the investment, liquidation of the Colombian enterprise, or a reduction in its capital, and on condition that all Colombian taxes related to such transactions have been paid.

(f) Foreign investment may now be undertaken by means of a direct contribution to the Colombian company, or by the purchase of shares or participations held by national investors in the company. This second method was previously forbidden by Decision 24. Before the sale of shares or participations in a local company by nationals to foreign investors may be authorized by DNP, such shares or participations must be offered publicly to national investors. The decree recognizes three exceptions to the obligation of offering shares or participations to national investors before their sale to foreign investors:

(i) if the foreign investor who wishes to purchase the shares or participations is likely, in the opinion of DNP, to provide a significant increase in the capital of the Colombian company or a technology of interest;

(ii) if the sale in question covers less than ten percent of the shares or participations of the company;

(iii) if the sale is a giving in payment (*dación en pago*) of shares belonging to national investors to their foreign creditors in order to pay foreign currency debt;

(g) If a foreign investor sells his shares or participations in Colombia, he will have the right to repatriate the proceeds of such sale after having paid applicable Colombian taxes, but this right will not be recognized if the sale of shares is made to the Colombian company which had issued them. If the foreign investor wishes to sell his shares or participations to another foreigner, he must obtain the prior authorization of DNP. The Colombian tax authorities must certify that capital gains tax, income tax and any other tax applicable to the transaction have been paid prior to such authorization. Capital gains are taxed at the rate of thirty percent.

(h) In conformity with Decision 220 of the Andean Pact, the transformation of a subsidiary of a foreign company into a "mixed" enterprise will be compulsory only if the company wishes to benefit by preferred access to the Andean market. DNP will grant the maximum transformation deadline of thirty years provided for in Decision 220, will determine other applicable conditions and will supervise the carrying out of this process. Transformation may be undertaken by the sale to national investors of shares or participations held by foreign investors or by an increase in the company's capital. Foreign natural persons may be considered by DNP to be national investors, if they fulfill the following conditions:

(i) if they hold visas or residence permits which permit them to be investors in Colombia;

(i) if they undertake their investment by importing foreign currency to which the remittance rights mentioned in point (e)(i) above apply, are Colombian residents for at least one year without an annual interruption of more than ninety days and renounce the benefits of remittance abroad; or

(ii) if they have undertaken or are undertaking an investment

with resources which do not permit them the remittance rights mentioned in point (e)(i) above, and are Colombian residents for at least one year without an annual interruption of more than ninety days. Special rules exist in this area for nationals of the other member states of the Andean Pact.

(j) Foreign enterprises will have access to all credit facilities in pesos except for development credits of a long-term nature. Access to such development credits must be based on a line of credit granted by a multilateral agency such as the World Bank or the Inter-American Development Bank. Access to export promotion facilities will be available on the same basis as national or mixed enterprises.

(k) Foreign natural or corporate persons may apply to DNP for authorization to import currency to purchase residences for themselves or their employees. The amount actually imported by such persons for such purpose must be registered with the Exchange Office and this will give such persons the right to repatriate the proceeds of the sale of their residence.

2. *Technology Transfers*

(a) The Royalties Committee may authorize the payment of royalties by a Colombian subsidiary to its foreign parent, or to a foreign subsidiary of a common foreign parent, for the transfer of technology, if such technology is new, or if it will be used in the production of goods for export. The old Decision 24 had forbidden such payments, but Decree 3548 of 1983 (which is repealed by Decree 1265) permitted them if the subsidiary were engaged in the transformation process toward becoming a mixed enterprise, or if that obligation had been suspended because more than fifty percent of the subsidiary's inputs were of Colombian origin or more than twenty-five percent of its production were exported.

(b) The Royalties Committee must make a decision with respect to a request for approval of a technology transfer contract or a licence of trademarks, patents, copyrights or other similar rights, within forty-five working days of presentation of the application and, where such decision is not made, the application will be considered as having been approved. Within fifteen working days of presentation of an application, the Committee may request additional information, and in such cases, the deadline for making a decision will run from the date of presentation of such

information.

III. PROVISIONS FOR CONTROL OF CREDIT

Decree 415 of February 27, dealing with controls on the granting of credit by financial institutions, evoked loud protests in banking circles. A new Decree, 547 of March 20, was adopted with a view to clarifying and "complementing" Decree 415. In reality, the government amended some of the more controversial provisions of Decree 415.

The bankers' protests concentrated on section seven of Decree 415 which imposes a limit on the availability of credit to 100% of the Colombian net worth of the applicant entity. Financing to small and medium enterprises would have been greatly affected, since both individuals and Colombian enterprises tend to underestimate their net worth for tax reasons. Decree 547 specifies that this limit applies only to persons whose principal domicile is abroad. Local branches of foreign companies would be covered by this measure, but Colombian subsidiaries would be considered entities domiciled in this country. Even in the case of entities domiciled abroad, an exemption is provided for financing of activities which, in the opinion of the National Council on Economic and Social Policy, are of interest for the economic or social development of the country.

Decree 415 imposed a limit on the granting of unsecured credits to a single individual by financial entities equal to ten percent of the paid-up capital and reserves of the respective financial entity. In the case of secured credits, the limit is twenty-five percent of the paid-up capital and reserves of the entity. Higher limits have been provided for interbank operations (forty percent of capital and reserves), for credits granted by savings and loan associations (*corporaciones de ahorro y vivienda*) for the construction of buildings (seventy-five percent), for unsecured credits given to state industrial and commercial enterprises and for projects of interest for the development of the country in accordance with criteria established by the National Council on Economic and Social Policy.

Credit operations falling within the scope of Decree 415 include loans, letters of credit, bankers acceptances and factoring. Operations with the Central Bank, transactions guaranteed by the Financial Institutions Guarantee Fund and transactions with bank

subsidiaries abroad are not included. The two decrees also limit transactions made by financial institutions with their shareholders, families of such shareholders and companies which they control. These limits do not apply to credits granted to (*sociedades anónimas*) which are not closely held, nor credits given to shareholders having less than five percent of the shares of the lending institution, nor to credit transactions undertaken by institutions whose basic objects are the development or performance of the government's economic policies as determined by the National Planning Department.

IV. REORGANIZATION OF THE ENTERPRISE CAPITALIZATION FUND

Resolution 24 of 1987, adopted by the Monetary Board (Junta Monetaria) on April 29, dealing with reorganization of the Enterprise Capitalization Fund (the "Fund"), repeals Resolutions 55 and 67 of 1985. The principal points of the new resolution are:

(a) The resources of the Fund will be used to increase the capital of *sociedades anónimas* (SA's) and limited liability partnerships (Ltda's) now in existence and to capitalize new SAs provided the companies in question operate in the areas of agroindustry, manufacturing or mining.

(b) Colombian individuals and juridical persons, with the exception of financial institutions, as well as resident foreigners in Colombia, will be entitled to access to the Fund.

(c) Access to the Fund is made available by the Central Bank (Banco de la República) through the rediscounting of loans issued by authorized financial corporations (*corporaciones financieras*). Loans made by banks or by financial corporations not authorized for this purpose, may be rediscounted on certain conditions. The shares or convertible bonds purchased with loaned funds must be issued by authorized financial corporations through the system of guaranteed underwriting or the capitalization operation financed must be controlled by authorized financial corporations and at least fifty percent of the rediscounting must also be done through such authorized corporations.

(d) The Fund's loans conforming with point (c) must be used for the purchase of new share issues or of bonds convertible into shares made by existing SA's, for the purchase of shares issued by new SA's or for increasing the capital of existing Ltda's. The resources thus placed at disposition of such companies must be used

exclusively for the purpose of financing new investment projects other than the purchase of land or buildings.

(e) A limit of 800 million pesos is fixed for use of Fund resources for capitalizing SA's that are not closely held. The limit is 600 million pesos for other SA's and 200 million pesos for Ltdas. A person may not have access directly to more than 150 million pesos or indirectly (through his family or through companies which he controls) to more than 300 million pesos.

(f) The resources of the Fund may not be used to increase the participation of a shareholder or of a member of a Ltda. to more than twenty percent of the company in question. Persons possessing between eight and twenty percent participation may have access to the Fund in order to exercise preference rights to purchase new shares or participations, subject to the condition that the total percentage of their participation does not increase. Persons possessing less than eight percent participation may purchase new shares or exercise their preference rights on the condition that their total participation does not exceed the eight percent limit.

(g) The Fund's resources may be used to finance eighty percent of the purchase price of new shares of existing SA's, sixty percent of the purchase price of shares in other SA's and Ltda's, and seventy percent of the total price of convertible bonds issued by existing SA's that are not closely held.

(h) Loans granted by financial institutions to finance the purchase of shares in SA's or increasing the capital of Ltda's must be amortized within a five year period. The amortization period is three years for loans used to purchase convertible bonds. The interest rates on these loans range from the certificate of deposit rate (CDT) plus a margin of 1.5 points to the CDT rate plus 3 points. The rediscount rates range from the CDT rate less 1 point to the CDT rate less 3.5 points.

(i) Capitalization programs initiated by virtue of the prior legislation will continue to be governed by those rules.

V. REFORMS TO THE RULES ON REPRESENTATION OF FOREIGN BANKS IN COLOMBIA

The Banking Superintendency has considerably softened the rules governing the activities of foreign bank representatives in Colombia. Under the old rules (Resolutions 2988 and 4698 of 1980),

permits granted to foreign bank representatives had to be renewed periodically and the representatives had to present quarterly reports on the activities of their respective banks in Colombia. Resolution 505 of 1987 provides that new permits and renewals of existing permits will have an indefinite validity. The quarterly reports have been replaced by the requirement to present annual reports within two months following the end of each year.

VI. POSTPONEMENT OF THE DEADLINE FOR "DEMOCRATIZATION" OF FINANCIAL INSTITUTIONS

Decree 365 of February 20, 1987, postpones the deadline for deconcentration of the ownership of Colombian financial institutions until January 1, 1992. As of that date, no person may directly or indirectly possess more than twenty percent of the subscribed and paid-up capital of a financial institution. The deconcentration program for the ownership of financial institutions must take place in accordance with the following calendar: The maximum ownership participation of any person in a financial institution will be fifty percent as of January 1, 1989, forty percent in 1990, thirty percent in 1991 and twenty percent in 1992.

Shareholders who do not observe these limits will not be permitted to exercise their preference rights for the purchase or the transfer of shares, and, in all cases, the exercise of preference rights must observe the limits imposed by the Decree. Financial institutions will not be entitled to inscribe in their registers, shares or contracts the possession or performance of that which would constitute a violation of the rules governing the deconcentration of the ownership of such institutions.

VII. REGULATIONS ADOPTED SUBSEQUENT TO THE TAX REFORM LEGISLATION

In the course of recent months, the government has adopted a series of measures to regulate aspects of Law 75 of 1986 dealing with tax reform.

(a) Decree 260 of February 6, regulates tax amnesties provided for in Chapter VII of Law 75. Among the amnesties so regulated are the following measures:

(i) taxpayers who made a complete inventory of assets which were omitted in prior declarations in their 1986 tax declaration will

not be subject to investigation with respect to such assets. If the taxpayer is a Colombian company, no tax will be payable by the shareholders or owners with respect to such assets; and

(ii) taxpayers who are the subject of investigation or against whom fines have been imposed by the tax authorities, may, on payment of a stipulated percentage on the amount claimed by the authorities, be deemed to have satisfied the requirements of the authorities in their case. Generally, the percentage payable increases according to the status of the inquiry and varies from twenty-five percent, if the inquiry is at its initial stage, to eighty percent if the investigation has been taken to the Council of State after November 6, 1985.

(b) Decree 400 of February 1987 provides, among other things, that Colombian SA's must allocate the amounts saved as a result of reductions in their taxes for fiscal year 1986 to increasing their paid-up capital, to the establishment of a non-distributable fund for expansion of their activities or to the purchase of securities issued by the Financiera Eléctrica Nacional on the primary market. The decree further declares that a company which seeks to benefit from the elimination of double taxation of dividends and distributable profits with respect to dividends and profits accumulated before January 1, 1986 and distributed after January 1, 1987, must have declared such amounts as being non-distributable profits in its income tax declaration for fiscal year 1985.

As provided in Law 75 the inflationary component of financial income and costs would be eliminated gradually for tax purposes. Specifically, 6.55% of amounts received in 1986 by taxpayers, other than individuals, as financial income will not be included in calculating their taxable income and 5.24% of interest and other financial costs paid in 1986 will not be deductible as expenses. These provisions do not apply to financial institutions, nor to loans granted by savings and loan associations for the construction of buildings.

(c) Decree 823 of May 6, provides that for the 1986 fiscal year, dividends received by foreign companies or other foreign entities with respect to which withholdings at source were made, will be taxed at the rate of withholding made according to Law 9 of 1983 and (after December 23, 1986) Law 75 of 1986. Under Law 9, the tax rate on dividends was forty percent with a special rate of twenty percent in the case of companies domiciled in certain "tax havens." Law 75 imposed a uniform rate of thirty percent. Decree

823 further provides that interest and other financial costs which may be deducted from taxable income, may, at the election of the taxpayer, be so deducted or may be used to increase the purchase price of assets in order to calculate capital gains tax with respect to the disposition of such assets.

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