VENEZUELA

The following is a review of recent revisions in Venezuelan laws which effect foreign investment, technology and taxation.

I. EXCLUSION FROM DECISION 24 RESTRICTIONS

In addition to tourism (already excluded from foreign investment restrictions by a previous decree), agriculture, agribusiness, and construction of realty are excluded from restrictions on foreign investments and dividend limitations. It is expected that regulations will be issued shortly defining the term "agribusiness" and that opening agriculture and agribusiness to foreign investors will reduce the country's dependence upon imported foodstuffs.

II. REGISTRATION OF DIRECT FOREIGN INVESTMENT IN DOLLARS

Registration of the direct foreign investment base (DEI) which is the basis for calculating remittable dividends, would be permitted in dollars rather than in bolivars, as was the case under prior law. A special transitory provision permits the reregistration in dollars of "old capital" (capital registered prior to February 18, 1983), presently recorded in bolivars, at the rate of exchange prevailing at the time of prior registration.

To date, dividend remittances were calculated at twenty percent of DFI net-after-dividend-tax, which with the devaluation of the bolivar in the free market to thirteen-plus bolivars to the dollar resulted in an effective return, measured by dollar investment, of less than 6.6%. To avoid a possible surge in demand for additional foreign exchange as a result of the stepped-up dollar remittance base, dividend remittances on the reregistered dollar DFI are limited to seven percent (net-after-dividend-tax) for 1985, 1986, and 1987. This will increase to twenty percent in 1988.

III. REGISTRATION OF FOREIGN LOANS

All foreign loans must be registered with the Superintendency of Foreign Investments (SIEX). However, loans for periods of less than two years do not need prior SIEX approval; mere notification within sixty days of contract date will suffice.
In the case of modifications to loan agreements for more than two years, prior approval of SIEX is not required if the amendments are for the purpose of lowering interest rates or extending repayment terms, provided remaining loan conditions are not made more onerous. No prior SIEX approval is necessary for refinancing existing loans if the refinancing is in accord with the Venezuelan exchange controls and applicable legislation, as long as notice of this refinancing is filed with SIEX within sixty days of contract date.

IV. TRANSFORMATION AGREEMENTS

The Ministry of Finance is specifically authorized to suspend the obligations of foreign-controlled companies where in the opinion of the ministry, sufficient reasons exist to justify such suspension. This provision will benefit primarily those companies which were either required to nationalize under Decree 2031 of February 1977, or to register as mixed companies after January 1, 1974.

V. DIVIDEND REMITTANCES

The National Executive may authorize dividend remittances in excess of the twenty percent net-after-dividend-tax percentage which is generally applicable. It is expected that the government will grant such exceptions as an incentive to investors in certain industries. For example, Colombia and Peru permit additional remittances as a stimulus to exports, import substitutions, decentralization, etcetera.

The new regulations spell out six situations where the foreign investor can declare a dividend in excess of the generally permitted percentage. The excess dividend can be used to pay national, state, or municipal taxes due by the foreign investors. The shareholder may lend back the amount of the excess dividend to the declarer as a loan and, with SIEX approval, the excess may be invested in certain specified securities.

Unauthorized dividends in excess of the legally permitted percentage will be fined up to the amount of the excess, in addition to the requirement to pay back the excess dividend to the company.
VI. CAPITALIZATION OF DEBT

Subject to prior SIEX approval, foreign debt can be capitalized, even if the effect is to convert previously national or mixed companies into foreign owned entities. But the permission to convert debt into equity must be based upon a promise to revert into a national or mixed company.

VII. TECHNOLOGY AND TECHNICAL ASSISTANCE

The new regulations did not eliminate the necessity for registering distribution agreements or obtaining prior approval for trademark licenses which did require payment of consideration. Both these provisions had been included in prior drafts of the new regulations.

SIEX is now empowered to approve technology and technical assistance agreements for up to fifteen years, rather than the previous five years. Also, the contract may impose a requirement of confidentiality for a period of time equivalent to the duration of the contract itself.

Foreign-controlled companies may, without prior SIEX approval, make payments to parent companies and affiliates for “occasional specific services.” These are defined as services necessary in resolving unforeseen problems (emergency repairs, for example). With prior SIEX approval they may pay for other special services. For example, engineering for plant expansion or technical assistance for installation of special equipment.

VIII. REINVESTMENT OF PROFITS IN VENEZUELAN CORPORATIONS

Pursuant to Decision 24 and prior Venezuelan regulations, up to seven percent of profits may be allotted to the DFI as an automatic right. The new norms will permit a company to accumulate this seven percent annual increment right in one or more fiscal years. This would allow for a carry-forward as well as a carry-back in the event that profits in a given year do not permit the reinvestment on an annual basis.

IX. DECREE ON WITHHOLDING OF TAXES

Decree 987, published in the Official Gazette dated January
16, 1986, instituted far-reaching changes to the rules on withholding of taxes, which extended the scope of withholding requirements to new areas. While not increasing the amount of taxes ultimately to be paid, its extension of the obligation to withhold in commercial, professional and other arenas not previously covered will have a considerable impact on the administration of many businesses and professions. It will convert many people into withholding agents, and place upon them corresponding civil and even penal law responsibilities.

Decree 987 was brought out hastily to amend the harsh impact of Decree 963. It should be noted that Decree 963, which creates somewhat different withholding rates in some cases, was in effect for the month of January 1986, and payments made during January (and subject to withholding) were governed by Decree 963’s rules.

Activities to which the Obligation to Withhold was Extended by the New Decree

Decree 987 effected both the activities which are covered and the amount to be withheld. The following is a list of the most important changes:

(a) Royalties and payments for technical assistance and technological services are to be paid only to persons domiciled in Venezuela. There had been a withholding obligation regarding payments made to persons neither domiciled nor residing in Venezuela, but not for payments made to persons either domiciled or residing in Venezuela.

The rate of withholding will be the corporate graduated rates, assuming the recipient of the payment is a corporate entity. These rates vary from eighteen percent to fifty percent, depending on the amount of taxable income. Article 6, paragraph 4 of the Decree provides that the withholding is to be made on ninety percent of the amount paid in the case of royalties; fifty percent of the amount paid in the case of technological services; and thirty percent of the amount paid in the case of technical assistance. These figures are the same as the presumptions of income for offshore technical services under Decree 476. These percentages are applied to onshore technical services only for the purposes of calculating the amount to be withheld; the ultimate tax liability will be calculated by applying the corporate tax rates to the net taxable
income.

It is now provided under article 21 of the Decree, that petroleum, mining and similar corporations must report to the tax authorities all payments for technical assistance and technological services, and all relevant taxes withheld, on a quarterly basis. This further tightens the administrative control over such payments.

(b) All commissions are now subject to a two percent withholding. This will make it advisable to avoid, if possible, the indiscriminate use of the word “commission” in contracts. Commissions paid to local banking, financial, and insurance corporations will not be subject to withholding.

(c) Interest paid by corporate entities to persons either domiciled or residing in Venezuela is now subject to a five percent withholding tax provided the amount withheld would exceed fifty bolivars. Interest paid to or by local banking, financial, and insurance corporations will not be subject to withholding taxes.

(d) Payments made by corporate entities to all contractors and sub-contractors, for construction work performed in Venezuela, are now subject to a one percent withholding. “Contractor” is defined broadly in article 3, and includes those carrying out the construction of roads, buildings, homes, plants, ports, dams, refineries, pipelines, factories, ships and aircraft, dredging, and maintenance and repair work.

(e) Payments made by real estate managers are now subject to a one percent withholding tax.

(f) Prizes paid by racetracks to horse or dog owners are now subject to a one percent withholding tax.

(g) Payments by racetracks or horse owners to jockeys, veterinary surgeons, or trainers are now subject to a three percent withholding tax.

(h) Payments for the renting or leasing of moveable goods by corporate entities are now subject to a three percent withholding tax. This will affect all equipment leasing contracts. However, such payments made to local banking, financial and insurance corporations will be exempted.

(i) Payments by credit card corporations for goods and services are now subject to a two percent withholding tax.

(j) Payments by insurance, reinsurance, or insurance brokerage corporations domiciled in Venezuela to individual insurance
brokers and agents either domiciled or residing in Venezuela are now subject to a two percent withholding tax.

(k) Payments for the acquisition of a "fondo de comercio" are now subject to a five percent withholding. Article 23 provides that the Mercantile Registry cannot register the transaction without producing the tax receipt evidencing the withholding tax.

(l) Payments by insurance corporations to persons undertaking the repair of their insureds' damaged property or to hospitals and other health centers attending to their insureds are now subject to a withholding tax of one percent.

(m) Payments made to "non-mercantile professional institutions" such as hospitals and clinics, law firms and offices of professionals such as doctors, lawyers, engineers, economists, and accountants are now subject to a withholding tax of three percent. Previously, such payments were subject to withholding if made by a corporate entity or to non-domiciled persons. Now, payments made by individuals to domiciled persons are subject to withholding as well. This will place a considerable administrative burden on professional firms, hospitals and clinics.

The Rates of Withholding Were Appreciably Altered by the New Decree.

The most important changes are listed hereunder:

(a) Payments of non-mercantile professional fees made by corporate entities were previously subject to withholding. The rate was five percent if the fees were paid to individuals or partnerships, and twelve percent if they were paid to corporations. However, it was also provided, by article 4 of Decree 2825 of August 29, 1978, that the amount of the fees were deemed to be fifty percent and twenty percent of the amount paid, respectively. This meant that the effective withholding rates were 2.5% and 2.4%, respectively. Article 4 of Decree 987 now provides that, in both cases, the withholding rate is three percent.

(b) The withholding rate for commissions paid to real estate brokers is now two percent. It was previously seven percent for commissions paid to individuals or partnerships, and fourteen percent for commissions paid to corporations.

(c) The withholding rate continues to be the graduated corporate rates or interest paid to persons not domiciled or resident in...
Venezuela, other than to foreign financial institutions. Now, the income is deemed to be eighty-five percent of the amount paid. This, in effect, reduces the withholding base by fifteen percent. For interest paid to non-domiciled foreign financial institutions, the withholding rate remains fifteen percent.

(d) The withholding rate for dividends paid to individuals or partnerships domiciled or resident in Venezuela is now five percent. It was previously seven percent.

There are changes that Decree 987 implemented. Express provisions are made for repayment of taxes withheld when the tax return shows the taxpayer's liability to be less than the amount withheld, and for set-off by the taxpayer of the amount over-withheld against other tax liabilities. In practice, neither a refund or right of set-off will be recognized by the Tax Administration without a tax audit of the applicant.

Detailed new rules were instituted concerning withholding of tax on undistributed profits of holding companies. Failure to withhold and to pay the amount to be withheld to the tax authorities can lead to a fine of up to twice the amount to be withheld; if the amount withheld is appropriated by the withholder, it will lead to imposition of a jail sentence of up to two years. In addition, there is a sanction applicable to many payments with respect to which there is a withholding obligation that failure to withhold results in nondeductibility of the payment for tax purposes. These sanctions do not apply to most of the payments referred to above, since the new decree does not expressly provide for such a sanction. The income tax law which provides for sanctions is not usually construed broadly enough to include payments like those required in Decree 987.

Office of Thomas L. Hughes
Attorney at Law
New York, New York