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Transfer of Technology to Colombia: A Proposal to Modify Decision 24

ROBERT J. RADWAY*

I. INTRODUCTION

The debate on technology transfer to Latin America and other developing countries for a long time has centered around “black box” technology.¹ It was presumed by the developing country economists, once it was discovered that technology was the key to development, that acquiring control over inventions and the patent system would facilitate the adaptation of foreign technology to local needs. A number of studies were undertaken to analyze the process of technology transfer, primarily involving license agreements, and the resulting information provided the basis for the technology transfer legislation that emerged throughout the 1970s. Technology (“black box”) had to be purchased, not leased. Outright purchase would include the right to use the technology after the expiration of the agreement (commonly thought of in terms of a patent license). It was believed that this would facilitate the adaptation process.

The thesis of this article is that it is not the “black box” that is the heart of the technology required for industrialization. Rather, it is the unpatented know-how and the technical assistance, which are referred to as “intangible technology,” that is the true essence required for commercialization of the technology, industrialization, and social and economic development.

The Latin American countries have been the leaders among the developing countries in passing laws regulating the transfer and control of technology. Within Latin America, the technology transfer policies of the countries comprising the Andean Common Market (ANCOM) have established one of the most controversial regimes directed toward

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¹ “Black box” technology refers to the notion that technology can be defined as consisting of a discrete piece of hardware, e.g., a computer, which can then be transferred. This author takes issue with such a characterization and uses the “black box” idea as a starting point only.
this end. ANCOM Decision 24\textsuperscript{2} effectively set forth a code regulating the development and transfer of technology within the subregion.

Article 21 of Decision 24 declares that when "intangible technological contributions" are made "to a foreign enterprise by its parent company or some other affiliate of the same enterprise, payment of royalties shall not be authorized nor will any deduction be accepted for this reason for tax purposes." Since all contracts regarding the importation of technology (broadly defined) must be approved and registered by the appropriate agency of the respective member country in order to be valid and binding, Article 21 has become an important factor in a risk analysis bearing on decisions to transfer technology.

This article is a brief for the position that intangible technological contributions, particularly in the form of licenses of unpatented know-how and technical assistance, are the most vital forms of technology for development, and their transfer should, therefore, be encouraged by any reasonable means. Since the bulk of this form of technology is transferred by transnational corporations (TNCs) to their local subsidiaries, and Article 21 has the effect of limiting such transfers by making them unprofitable, it is time to call for a modification of Article 21.

II. BACKGROUND

Colombia has the most extensive history of direct regulation of licensing and technical assistance agreements of any of the countries in the Andean Pact, and is second only to Brazil in all of Latin America in this regard. Since 1967, the right to remit foreign currencies for payment of royalties, commissions, trademarks, patents, and technical services has been directly regulated by Decree Law 444,\textsuperscript{3} as amended and regulated by Decree 688 of 1967.\textsuperscript{4} In that same year, the deductibility of payments for the transfer of intangible property rights, including technical assistance fees and royalties of all kinds, was made

\begin{itemize}
\item \textsuperscript{3} Decree Law 444 of March 22, 1967, 30 Legislacion Economica 191 (1967).
\item \textsuperscript{4} Decree Law 688 of April 20, 1967, 30 Legislacion Economica 247 (1967).
\end{itemize}
subject to prior approval by the taxing authority under Law 63. As applied, this approval has been used in conjunction with the policies of the Royalty Committee under Decree Law 444, adding the possibility that these payments will be non-deductible as well as non-remittable.

The Royalty Committee, comprised of representatives of the Ministry of Development, the National Planning Department, the Superintendent of Foreign Trade, the Prefect of Exchange Control, and the Head of the Office of Exchange (Central Bank), was established in 1967 to approve technology agreements in accordance with a stated criteria. The experience acquired, and the body of statistical knowledge developed by the Royalty Committee regarding the nature of royalty and technical assistance agreements was transmitted directly to the organizing committees for the Andean Pact in the late 1960s, and provided the raw material and the motivation for the formulation of the Andean Group policies, and particularly Decision 24.

This analysis advances the thesis that a rigid application of the policy on licensing royalties and technical assistance payments, particularly to transactions between companies with common capital, is in many situations, contrary to the goals of Colombian national policy. It is believed that a more flexible approach, such as that adopted by Mexico or Argentina, would continue to accomplish the necessary screening and discouragement of non-essential technology, while at the same time permitting the introduction of needed foreign technology and technical assistance to supplement local resources.

III. COLOMBIAN GOVERNMENT TECHNOLOGY POLICY

The present policy is based upon maximum utilization of locally-produced raw materials, and includes the objective of adding value to the highest degree within Colombia in order to create more jobs and reduce unnecessary imports. This encourages the creation and installation of small processing plants in the outlying regions of the country, close to the areas where crops or other raw materials are produced.

This policy also promotes the introduction of technology in which labor-intensive processes will replace capital-intensive processes developed in countries where labor costs are higher than in Colombia. To emphasize the importance of this kind of technology, attractive financing has been made available by the government for the development of such products or processes.

Another basic aspect of the policy is to disaggregate technology packages to obtain only those elements of the package not otherwise available locally. It has long been known that many large foreign investments made by multinational corporations have included elements of the package (such as financing) which can be broken down and sometimes obtained at lower cost locally or from other sources.

Along with the aforementioned objectives, the policy emphasizes adaptation of technology to local conditions. Raw materials may have different levels of quality in each country. Variations exist in environmental and climatological conditions, soil, handling and storage techniques, and even in the chemical composition of water. Thus, various processes must be adapted to conditions prevailing in Colombia or the processes simply will not be economically feasible.

The utilization of national companies in the metalworking or light engineering industry is another priority and shall be incorporated wherever possible. In order to implement this objective, the system for licensing imports has been designed so that "INCOMEX" will coordinate its operations with other appropriate agencies to accomplish this objective. The Institute of Technology Research (IIT) will also evaluate the applications for products in this sector. It is understood that this local preference occasionally will involve higher prices charged by less efficient local companies, but this is preferred in order to improve the efficiency of local industry.

Finally, a major concern and objective of the government is the improvement of quality control in the food processing and manufacturing industries. Efforts in this field have been underway for many years, but the Government of Colombia currently faces a dilemma. Some

8. These nations includes the United States and other industrialized countries, such as those of Western Europe and Japan.

9. This is the concept known as "unbundling" or disaggregation. See Radway, Negotiating with Latin American Governments: Technology Transfer and Service Agreements, 9 LAW. AM. 283 (1977).

10. Instituto Colombiano de Comercio Exterior (Colombian Government agency responsible for import and export permits for foreign investors).

11. Instituto de Investigaciones Tecnológicas (Colombian Government Technology Research Institute).
producers have become accustomed to protective conditions and have not been required to improve their quality to desired levels. At the same time, fluctuations in economic conditions, particularly in the balance of payments, have resulted in such a degree of control that import competition has not been a major challenge to some of these inefficient producers.

IV. TECHNOLOGY AND COLOMBIAN DEVELOPMENT

A. Definition of Technology

Technology has been defined in various ways. It encompasses, at least, all of the knowledge necessary for the productive functioning of a single operation, an enterprise or, perhaps, an entire society. The term customarily embraces “hardware,” such as equipment, machinery, products, factories, water treatment and distribution facilities, storage and processing facilities, and simple tools. In addition to hardware, the term also includes “software,” such as the intangible experience, knowledge, and “know-how” only partially embodied in specifications, as well as engineering designs and models, systems of calibration, metrology and standardization training systems, techniques, and manuals. This intangible concept also covers the skills of integration, coordination, communication, and management of all of the elements of a productive system. The term may or may not involve patents and trademarks, the transfer of the rights to use those assets (traditionally referred to as “industrial property rights”), and technical and managerial assistance in any element of the productive system.

B. Contributions of Technology

Technology, therefore, can make a contribution to the production and the economics of manufacturing and food processing systems. It may take the form of new products or processes, or improvements to existing products or processes. In the food processing industry, technology frequently may take the form of advances in research. The commercialization of new developments is an ill-defined area, based on experience in recent years.

12. A shorter definition would be “the experience and knowledge as applied to improve productivity or productive efficiency.” See THE CONTRIBUTION OF TRANSNATIONAL ENTERPRISES TO FUTURE WORLD DEVELOPMENT 5-11 (1979) (report prepared by the Industrial Sector Advisory Group to the Secretary-General of the United Nations Conference on Science and Technology for Development).
A significant, but inadequately understood, form of technology in manufacturing derives from the experience of operating machinery or equipment in different countries with widely varying conditions, including considerable variation in raw materials, feedstock, or other input. This type of intangible technology tends to resolve critical production problems and constitutes a small investment for the large return it brings in substantially reducing "down" time and work stoppages.

C. Vital Elements: Training and Adaptation

Technical assistance can be seen as providing an appropriate means to transfer from the supplier to the recipient the benefit of the supplier's experience with the process of commercialization and the adaptation of the technology to the conditions prevailing in the receiving country. The two central and vital elements of this process are: (a) training; and (b) adaptation assistance through experience transfer.

In recent years, it has been found that most effective transfers result from the utilization of the following modes or methods: (1) practical demonstrations by experienced experts (home office personnel); (2) personal visits by experienced experts (discussions); (3) training programs at the home office; and (4) attendance at meetings and trade fairs. The institutions that are singularly well-placed and qualified to provide the critical links in the chain are the transnational corporations.

Private corporations operate to satisfy the economic interests of the sources of capital with which they have been organized. In order to enlist the capabilities, particularly the training and technical assistance that lie in the experience of the transnationals, the proper investment environment must exist. In addition to a political climate of stability, a proper legal framework for the promotion of investment and the development and acquisition of technology is essential.

13. Saeng, Food Technology Transfer in Latin America 9, paper presented at Symposium of Food Technology in Latin America (Annual Meeting of Institute of Food Technologists, Dallas, Texas, June 1978). This has been identified in a series of surveys conducted for various industries over the last few years. This is eminently logical in that "commercialization" of any given technology is a form of technology itself.
V. THE LEGAL FRAMEWORK IN COLOMBIA

A. Decree 444

In Colombia, this legal framework consists of Decree 444, as amended by Decree 688. Both laws were enacted in 1967. Decree 444 was enacted to provide international exchange and foreign trade rules in order to promote economic and social development and to strengthen the balance of payments by a variety of means. These include: (a) the promotion and diversification of exports; (b) correct use of the available foreign exchange; (c) control of the demand for foreign exchange, with special regard to preventing speculative transactions and the flight of capital; (d) encouragement of foreign capital investment in accordance with the general interests of the national economy; (e) the repatriation of capital and regulation of Colombian investments abroad; and (f) the establishment and maintenance of a level of reserves sufficient for the normal management of international exchange.

Chapter VII of Decree 444 contains provisions with respect to payments in foreign currency for various services, including royalties, trademarks and patents, "services," and "technical, scientific or artistic services" (provided that the services are socially, economically, technically, and culturally useful to the country). Article 2 provides that, in order for remittances to be made abroad for royalties, commissions, use of trademarks, patents, and the like, all contracts executed as of the effective date of that law and all extensions of pre-existing contracts had to be registered at the Office of Exchange (of the Central Bank), after being approved by the Royalty Committee.

B. Decree 1234

In 1972, the enactment of Decree 1234 provided certain criteria for the contents and registration of contracts involving transfer of technology.

14. See note 3 supra.
15. See note 4 supra.
16. Decree Law 444 of 1967, Article 1; see note 3 supra. Colombian President Carlos Lleras Restrepo was concerned with the extreme fluctuations in the price of coffee as well as other factors severely affecting the economic cycles in that country at the time.
17. Id. at art. 1.
18. Id. at arts. 93 and 102.
19. Id.
20. Id. at art. 101.
21. Article 2 refers to conformance with the provisions of Chapters VII and VIII of Decree Law 444, which includes Articles 93 et seq.
technology. The law also established criteria for approval of these agreements.

C. Decree 1900

In 1973, Decree 190023 was enacted. It is effectively implemented Decision 2424 of the Andean Pact, known as the Common Rules for Treatment of Foreign Capital and of Trademarks, Patents, Licenses, and Royalties. These three laws, as amended, constitute the basic legal framework for the attraction of foreign capital and technology to supplement national resources in the movement toward economic development in Colombia.

VI. APPLICATION OF THE LAWS: ROYALTY COMMITTEE POLICIES AND IMPLEMENTATION

Earlier in this article, the composition of the Royalty Committee was set forth. That Committee has functioned quite actively since 1967, and it appears that particular behavioral patterns have emerged. It seems that certain basic attitudes exist on the part of the individual members of the Royalty Committee which are expressed in the form of the approvals granted and policies promulgated.

There appears to have been an absolute prohibition on the payment of know-how license royalties from majority-owned TNC subsidiaries to their foreign parents or to any other affiliated enterprise. In addition, there appears to have been an absolute prohibition on payments of technical assistance fees among similarly related enterprises. This would suggest that certain underlying attitudes regarding TNCs have dominated the policy-making process within the Royalty Committee in its denial of these intra-company payments.

Another interesting aspect of the policy of the Royalty Committee is with respect to the distinction made under the law between technical assistance and technical services. The foreign currency to be remitted for the payment for technical services rendered from abroad need only be registered with the Exchange Office of the Central Bank, according to the letter of the law.25 The criteria of the

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24. See note 2 supra.
Central Bank include whether the cost of the services exceeds the usual price, and whether the services are socially, economically, technically, or culturally useful for the country.\textsuperscript{26}

Agreements involving royalties to be paid for licenses of industrial property rights, however, must be registered with the Royalty Committee.\textsuperscript{27} The criteria to be applied by the Royalty Committee in evaluating and approving these agreements include the usefulness of the contract in the economic and social development of the country, the possibility of producing the product without the license, the effect on the national balance of payments, the status of international practice in the area, the size of the market for which the product is designed, and other considerations.\textsuperscript{28} Thus, Colombian legislation establishes more stringent tests for "royalty payments" than for "technical fees."

Normal capital investments must be approved by the National Planning Department and the Central Bank. Thus, where a capital investment is to be made that involves some technical services and possibly technical assistance provided from abroad which would be compensated in foreign currency, it is arguable that this application need not be brought before the Royalty Committee at all. It appears, however, that in some cases, foreign investors have given up requests for payments for technical assistance or services in return for the necessary investment approval from the Royalty Committee.

The imbalances which these laws were designed to correct are well known,\textsuperscript{29} and they are not the subject of this article. Nor will there be any attempt to comment on the appropriateness of various types of provisions in license agreements which the laws expressly prohibit. It can be assumed that the effectiveness of this legal regime has been evaluated by officials within the Colombian Government since its enactment in 1967.

There is a strong perception on the part of many TNCs, however, that the regulatory climate in Colombia, including the restrictive conditions for registration of capital or technology agreements, has been responsible in varying degrees for the decisions made by some of the companies not to participate actively in the Colombian market.

\textsuperscript{26} Id., art. 102, at 203.  
\textsuperscript{27} Id.  
\textsuperscript{28} See note 23 supra.  
\textsuperscript{29} See, e.g., Vaitsos, Opciones Estratégicas en la Commercialización de Tecnología: El Punta de Vista de los Países en Desarrollo, COMERCIO EXTERIOR (May 1971).
On the other hand, the National Monetary Board has manifested a totally different attitude with its Resolution 29 of December 1978. This Resolution permits the reinvestment of "limbo money" of up to fifty percent of registered capital in the same and ongoing operations of the foreign company, on the condition that it reinvest the remaining fifty percent in certain types of development bonds to be issued by the Institute of Industrial Development. This step has been viewed by many members of the foreign investment community as a very encouraging sign.

The inference is clear that a more flexible approach to the application of the legal framework to foreign capital and technology is necessary. The analysis of the technology agreements to be registered should be conducted on a qualitative basis in addition to the quantitative basis now applied. The success of regulation and control systems in Mexico, for example, is due to a pragmatic enforcement flexibility that permits the government officials to decide on a case-by-case basis whether or not the technology may be useful to the country's economic and social development. The distinctions must be based upon the reasonableness of the proposed transactions, and practical and political considerations, including the accomplishment of national policies.

VII. RELATIONSHIP BETWEEN CAPITAL AND TECHNOLOGY

Earlier in this article, a definition of technology was provided by describing its function. Capital, one of the traditional factors of production as identified by classical economists, includes human resources, currency, equipment, and technology—both tangible and intangible—as described herein.

A. Allocation of Limited Resources

The government of any country, developing or industrialized, must allocate its resources to the accomplishment of its objectives. The

30. Resolution 29 of 1978 of the National Council of Economic and Social Policy, a division of the National Planning Department, 53 LEGISLACION ECONOMICA 348 (1979).
31. "Limbo money" is defined as earnings in excess of 27% (formerly 19% before ANCOM Decision 103), or the amount in excess of 20% to be remitted as dividends, plus 7% to be reinvested. See Radway, Venezuela: Certain Legal Considerations for Doing Business, 8 CASE W. RES. J. INT'L L. 301 (1976).
32. Instituto de Fomento Industrial (Colombian Government Industrial Development Institute).
34. See Sec. III supra.
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objectives that governments set forth to accomplish include those characterized as social, economic, or political. No government ever had adequate resources to allocate for the accomplishment of all of its objectives. The Government of Colombia is no exception. Government planners and those responsible at the highest levels must make careful evaluations and assign priorities. Resources will then be allocated in accordance with the potential return likely to be generated. This is true with human resources as well as with budgeted funds or appropriations, equipment, and technology.

The problem faced by the TNCs is very similar. They too have limited resources and insufficient personnel to assign to all of the projects they wish to undertake worldwide. They also do not have adequate capital to finance research and development, as well as investment projects in those countries identified as potentially profitable, in addition to funding continuing operations at home. Thus, decisions to allocate their resources, including personnel, funds, equipment, and technology, will be made only after a careful evaluation of cost, benefit, and relative priorities.

B. Separate Characteristics and Separate Returns

Each category of capital, as defined above, possesses separate characteristics. The application of each capital asset, therefore, is differentiated by the requirement for a separately identified return for the investment of the asset. For example, a human resource (i.e., an individual technician or engineer) offers his or her services to the employer in return for a salary. So, too, the owner of a piece of equipment—a capital asset—offers the use of that equipment in return for a payment designed to offset the depreciation in value and amortization of the cost of the asset plus a small profit. This could be in the form of a lease rental or similar payment. Invested capital generates a return in the form of a dividend, i.e., a rental for the use of the money invested for a period of time.

C. Tangible Technology Entitled to a Return

In the same manner, when a corporation offers technology that it has developed through extensive research and development over a period of years and has perfected it by the experience in commercializing that particular technology, also developed at great expense over the years, that asset is entitled to a separate economic return. This is without regard to whether the contribution of that technology is made
to a related or affiliated corporation, such as a subsidiary in a foreign country. Thus, for the license of the right to use certain patents or trademarks granted to its subsidiary, a TNC is entitled to the contribution of a royalty from its subsidiary in that foreign country. This is in the form of a rental payment for the use of that capital asset and the technology it has developed at great expense.

D. Intangible Technology: Technical Assistance

A transnational corporation will also assign various technicians, engineers, or others with substantial experience to assist the subsidiary in commercializing the use of the technology granted by the patent license. For this separate capital allocation, the corporation is entitled to an entirely separate return in the form of a fee for technical assistance, notwithstanding that there is a capital relationship between the parent and its foreign subsidiary taking the form of a majority equity ownership.

E. Intangible Technology: Training

Finally, for the training which the parent corporation renders to the employees of its subsidiary in the form of technical services, it is entitled to an entirely separate payment or compensation in the form of a technical services fee for the allocation of the human resources assigned to conduct the training in the foreign country or in the home office. Like the individual employee who receives separate returns for totally different types of capital contributions, the TNC is entitled to separate returns for its different contributions of capital (including invested equity, technology, and the assignment of human resources in the form of technical assistance or technical services for training or otherwise). A parallel illustration of this analysis is that a Colombian company must pay interest on a loan, whether it is provided from a Colombian bank, a foreign bank, or its foreign parent company.

The dilemma is now defined. To obtain these services, the majority-owned subsidiary must reimburse the home office for the costs of the engineer, technician, or operations specialist, including a reasonable profit, or at least a contribution to the general and administrative overhead costs of assigning home office personnel abroad. The Colombian subsidiary, however, is barred from making such payments for this "intangible technology" by Article 21 of Decision 24, as
implemented by Decree 1900, in conjunction with Article 1(j) of Decree 1234.35

VIII. Theories Believed used to Justify the Denial of Intra-Company Payments for Intangible Technology

There are essentially two theories which have been adopted by Colombia and other Latin American countries, particularly in ANCOM, Argentina, and Brazil at different times, to prohibit the payment of royalties or technical assistance fees from majority-owned local subsidiaries to their foreign parent.

A. Economic Unity Doctrine

The first of these is the so-called “economic unity theory,” first adopted in Argentina in the famous Parke-Davis36 and Swift de la Plata37 cases in the early 1970s. The Swift case involved the insolvency of the Argentine subsidiary and the rights of creditors and debtors in an extremely complex factual situation. The facts of the Parke-Davis case are more straightforward. The two cases differ substantially, however, in that the Swift case had significant political overtones. The confrontation that ensued between the Argentine government and the foreign parent company (Deltec), therefore, appears to have been based more on emotional and political reactions than on legal principles and the interpretation of the facts. The Parke-Davis case, on the other hand, appears to have involved more of a direct application of the economic unity doctrine. This doctrine declares that the subsidiary is a mere instrumentality of its foreign parent corporation, and therefore, the legal and economic consequences of the actions of the subsidiary are to be imputed to its foreign parent. The inference from this theory is that nothing of value is being provided to the subsidiary which would not otherwise be provided, so the parent should not be permitted to receive royalties or fees for intangible technological contributions made to the subsidiary.

This doctrine is analogous to the common law doctrine referred to as “piercing the corporate veil.” In Anglo-American law, the legal result of separate legal or corporate entities will be disregarded by the courts only when it can be shown that a corporation is a mere

35. See Decree Law 1234, supra note 22, at 25.
37. Id.
instrumentality or agent of another corporation or individual which owns most of its equity or voting stock. Mere ownership of such a majority, however, does not alone justify departure from the protection traditionally afforded by incorporation under Anglo-American common law principles. There must be such domination of finances, policies, and practices that the controlled corporation has no existence of its own and acts as a mere business conduit for its principal. The principle is essentially an equitable one that the "corporate veil" will be pierced only when it is essential to hold the "real" party liable as a matter of justice. These rigid standards or tests must be satisfied under Anglo-American law in order to invoke this doctrine. To the author's knowledge, there is no parallel civil law concept in Colombia or the other Latin American countries.

The Parke-Davis economic unity doctrine was reversed by subsequent decisions of higher courts in Argentina. The concept found its way into the Foreign Investment Law, which was also "reversed" when that Law was superseded in 1976. It seems, therefore, that the economic unity doctrine was invoked more as a political act than as a matter of law based on juridical principles.

B. Taxation Theory

Many sources have suggested that the motivation for the rule prohibiting payment of license royalties or technical assistance fees from a local subsidiary to its controlling foreign parent has its origins in principles of taxation. Thus, in most of the countries where the law prohibits such payments, the law also specifies that such payments will not be deductible for purposes of computation of the profits tax of the local subsidiary.

For many years, the International Fiscal Association, in its deliberations, has considered the taxation consequences of various payments from a subsidiary to its foreign parent. One concept, which is possibly the one that gave rise to the so-called economic unity theory, centers on the distinction between a "permanent establishment" and a legal

41. E.g., Nattier, Brazil in TECHNOLOGY TRANSFER: LAWS AND PRACTICE IN LATIN AMERICA 145, 158 (1978).
subsidiary. The permanent establishment is, from a legal point of view, a dependent division of the company, otherwise referred to as a "branch." The establishment is not legally independent and is, therefore, not entitled to receive royalty payments for intangible contributions, although profits from the permanent establishment are taxable in the country of domicile as if it were an independent legal entity. These distinctions are very technical, but wholly supportable from a legal point of view. Taxes on branch profits are generally withheld at the source, so that the host country is assured of its proportionate share of the tax revenues from the income generated by the economic activities of the branch.

Changes in the tax rules in recent years in capital exporting (industrialized) countries have further complicated this already complex field. Home country tax authorities, such as those in the United States, have long provided dividend exclusions when the accounts of related corporations are consolidated in the annual statement. Changes in rules affecting the timing of the imposition of taxes on the accumulated earnings or profits of a subsidiary of a U.S. corporation have significantly affected decisions concerning declaration of dividends from those subsidiaries to their foreign parent.

Considerable opinion exists that the concept of a permanent establishment or branch, as distinguished from an independently incorporated subsidiary, is not well understood in developing countries generally. This confusion has been observed in statements and transactions regarding activities of these branches and the treatment of capital and income taxes. Because of this confusion, it seems likely that the prohibition on intra-company royalty and technical assistance payments is a result of a suspicion of tax evasion. The tax consequences of this prohibition are that the subsidiary pays a higher tax in the host country. The commercial consequences, however, may be to discourage the allocation of these capital resources (intangible technological contributions) from the foreign parent to its majority-owned subsidiary.

IX. RELATIONSHIP OF TRANSNATIONALS TO LOCAL COMPANIES

Much has been said but little has been written or documented about the relationship of TNCs to local companies. What has generally been expressed in public, as well as in the literature that is available,

42. Such practices are commonly known as "deferral" principles.
are accusations and allegations concerning transfer pricing and other practices described earlier.

A. Relationship Between Parents and Affiliated Companies

Transnational corporations provide the intangible technological contributions to their affiliates that exploit the tremendous experience gathered from operations in developing countries all over the world. While no two countries share identical conditions, these firms bring impressive perspective, insight, and sheer experience to their local affiliates. Moreover, it is clear that the TNCs do not necessarily provide this intangible technology to their affiliates in developing countries. In direct contrast to the notion of "obligation" underlying the economic unity theory mentioned earlier, the transnationals are concerned about each transaction paying its own way.

When the international vice-president of a TNC receives a request from the general manager of a plant in a developing country, that vice-president must negotiate with some of his domestic (U.S.) divisions to acquire the services of the appropriate technician, engineer, or other specialist to be sent to Colombia for technical assistance or training. These transactions are executed on an inter-divisional work account basis, which means that the international division must reimburse the domestic division for the assignment of the individual involved. Therefore, where laws and policies like those prevailing in Colombia prevent reimbursement by the subsidiary, the cost-benefit analysis results in a negative "bottom line." The decision is thus made that the assignment cannot be economically justified and will not be made.

B. Relationship with Unaffiliated Companies

The situation is very different when the TNC is working together with a local company in which the former does not own a majority interest. Under these circumstances, the laws and policies in Colombia permit the TNC to receive royalty payments and technical assistance fees for intangible technological contributions.

But how much will the international vice-president fight for the appropriate specialists to be sent to Colombia for an unaffiliated (or minority participation) company where the TNC has less control over effective application of the intangible technology? The obvious inference is that, where there is both a capital and a technological contribution, the TNC has more at stake and, if the economic justification
were adequate, would very likely allocate the additional resources necessary to improve the efficiency, productivity, and economic benefit for these types of operations.

C. Necessity for Production Efficiency and Quality

There are serious political difficulties that must be faced by high-level government officials with respect to the troublesome area of improving production efficiency and quality. In order for a nation to improve production efficiency, promote exports, and be competitive on the international export market, it must utilize the experience, technology, and skill available to improve the production process and the efficiency of the workers. This sometimes results in the use of more capital-intensive equipment and technology. In Colombia and other ANCOM countries, however, there is a need for labor-intensive industry to absorb the new additions to the work force and create jobs for those willing and able to work. This conflict is invariably resolved by political decisions.

The problem is further complicated by the results when efficiency is not introduced into the system. Industries that receive protective assistance from the government have been producing at inefficient levels for many years. The prices of their products are completely out of line with those on the international market. The Colombian consumer bears the burden. Opening up the market to an increased amount of competition from imports would result in greater efficiency as local producers responded to the import competition. It would also result in displacement of some local producers, with the consequent effect on employment. Under most conditions, this is politically unacceptable. However, it is interesting to note that Argentina, Chile, and, to a lesser degree, Peru and Mexico, have recently modified their system of controlling imports to permit greater import competition and improve production efficiency in the long term, even at the cost of some displacement of local producers.

One of the important elements of improving production efficiency is the system of controlling quality in manufacturing and food processing. One of the most important contributions made by TNCs is the transfer of detailed procedures, manuals, specifications, and other data to provide flesh and muscle to the backbone of quality control systems. In addition, individual specialists, technicians, inspectors, and others in this field are sent on an ongoing basis from the TNC to its local subsidiary in order to provide continuing education in new techniques.
and the skills required to introduce and upgrade the quality control system. This is a clear example of the intangible technological contribution which Colombia must receive in order to accomplish its own goals.

D. Transnational Attitudes: Risk versus Payoff

The resources of the transnationals, as described above, include the worldwide experience of adapting technology in developing countries under a variety of climatic, environmental, cultural, social, and economic conditions. The capacity to furnish ongoing technical assistance to demonstrate, assist, and train the employees of the local subsidiary in the techniques and skills necessary to conduct an efficient and profitable operation are additional resources of these international firms. The present rigid application of the legal framework in Colombia results in the denial of a separate economic reward to the transnational for risking the allocation of these resources, with results that are inimical to the goals of the Colombian government.

X. ANCOM DECISION 24

Article 21 of ANCOM Decision 24 expressly prohibits the payment of royalties for intangible technological contributions that are provided to a local company by a foreign firm with majority interest in the local company. This restriction does not apply to the royalties for patent or trademark licenses under the same circumstances. Article 1(j) of Colombian Decree 1234 establishes the link between the technology and the capital of the enterprise as a criterion to be considered by the Royalty Committee in its evaluation of a proposed technology transfer agreement. In other words, the Colombian policy requires the Royalty Committee to examine whether or not this technology transfer also involves common capital of the two enterprises. In practice, the result has been the absolute denial of permission for royalty payments or technical assistance fees for these intangible technological contributions from a foreign parent to its controlled Colombian subsidiary.

Article 37 of Decision 24 limiting profit remittances to fourteen percent, has since been modified by Decision 103 to increase the

43. See note 2 supra.
44. See note 22 supra.
45. See note 4 supra.
ceiling to twenty percent. Decision 103 also provides that each member country may authorize higher percentages if it deems it appropriate or in its national interest to do so.\textsuperscript{47} The only other requirement is that the nation inform the Commission in Lima of its determination. These modifications evolved in response to a clear recognition that the economic reward was inadequate to attract the capital required to augment indigenous capital formation in the Andean Group and foster the necessary levels of economic development.

XI. Recommendations

Two recommendations are offered for specific action. First, although the Royalty Committee has criteria which it has been applying to technology agreements under evaluation, it is believed that additional criteria should be adopted to permit an analysis of a more qualitative nature. Second, the specific provision under scrutiny herein should be modified to provide a more flexible tool for Colombian Government policy-makers.

A. Establishing Criteria for Intangible Technology

Intangible technological contributions will vary considerably. To establish appropriate criteria providing adequate safeguards for the payment of royalties or technical assistance fees from the local subsidiary to its foreign parent, a qualitative analysis should be applied. The two most common tests that have been generally accepted and appear to prevail in international practice include the “arm’s length” test\textsuperscript{48} and the “value-received” test\textsuperscript{49}. The former would evaluate the transaction

\textsuperscript{47} Id. at art. 10.

\textsuperscript{48} See Debatin, General Report, The Recognition of Services and License of Incorporeal Rights Between Parent Companies and Their Foreign Subsidiaries: Avoidance of Double Taxation in Case of Non-Recognition by Tax Administrators, 54A Cahiers de Droit Fiscal International (1969). Cahiers de Droit Fiscal International is the official publication of the International Fiscal Association. The “arm’s length test” refers to criteria that the price established between the supplier and the recipient of technology be equal to a price when the parties were dealing at arm’s length and were not related or affiliated entities. This is also referred to as a prevailing price on the international market. The latest Argentine law on technology transfer has adopted this approach in Article 9. See Radway and Ciacchino, supra note 7, at 228.

\textsuperscript{49} Id. The “value-received test” is also referred to in the Debatin Report in terms of satisfaction of a genuine interest of the recipient or royalties paid for something that is of benefit to the business in some way, even if the recipient is a subsidiary of the supplier. An interesting point is made in the Debatin Report: At this point the question arises whether and to what extent such an approach allows a line to be drawn between the field of royalties and that
to determine whether the amount paid would be approximately equal to that in a transaction among unrelated parties. The latter would look to the actual interests of the party receiving the intangible technological contribution to examine the benefit or value received.

Resolution (recommendation) 6 of the Seventh Latin American Tax Law Congress adopted in January 1976, regarding agreements between developing and developed countries concerning payments of royalties, technical assistance fees, dividends and interest, provides as follows: "For tax purposes, allied firms must be treated according to the general principles applying to independent firms, provided the respective control mechanisms are applied." Under the Resolution, like the position of the International Fiscal Association deferred to earlier, no discrimination would be made as to the source of the technology.

The result of the Royalty Committee policy (arising from Article 21 of Decision 24 \( ^{50} \) and Article 1(j) of Decree 1234 \( ^{51} \)) is to encourage the entry of foreign capital, because up to twenty percent \( ^{52} \) of registered profits can be remitted and fifty percent \( ^{53} \) of earnings reinvested with the purchase of bonds from the Ministry of Economic Development. Continuing contributions of intangible technology, however, the essential element which makes the capital more productive for the society and more adaptable to local conditions, are discouraged.

B. Modification of Article 21

The discussion above noted that Decision 103 had modified Decision 24 by raising the profit remittance ceiling to twenty percent in

\( ^{50} \) See note 2 supra.  
\( ^{51} \) See note 22 supra.  
\( ^{52} \) See Article 10 of ANCOM Decision 103, supra note 46.  
\( ^{53} \) See text accompanying note 32 supra.
order to continue to attract capital deemed essential for the economic growth and development of the region. It is suggested that, by analogy to the philosophy of Decision 103, a member country of the Andean Pact could modify the intra-company payments prohibition of Article 21 of Decision 24 in those cases where the member country makes the determination that such is justified to promote the national interest.

It is argued that intangible technological contributions are precisely the type of technology required for solving a range of problems faced by Colombia and other developing nations, including: (a) the production, marketing, and distribution problems of the food processing and manufacturing industries; (b) the development of remote (outlying) processing facilities near the sources of agricultural and other raw materials; (c) the development of an infrastructure of small suppliers to provide raw, semi-processed, and processed materials and other prerequisites to contribute to a more integrated and rational productive system; (d) the improvement of quality standards and control systems to augment production, increase efficiency, stimulate competition, and promote exports; and (e) the mobilization and training of human resources throughout all sectors of the national economy.

The intangible technological contribution is the key to successful transfer of technology, and to economic and social development generally. The Colombian Government stated many times during 1979 that it was reviewing its foreign investment and technology transfer policies in the context of a new National Development Plan. Article 21 of Decision 24 should be modified to attract technology and the capacity to manage technological innovation in conjunction with the New Plan. The time is right to initiate the change for the 1980s.