REGIONAL DEVELOPMENTS

Latin America*

During late 1987 and early 1988, Latin America experienced a flurry of legislative activity, which generally reflects the continuing preoccupation with the balance of payments problems of the region. Various countries took steps to refine their debt-equity conversion programs. Significant developments also took place to enhance the opportunities for foreign investment and export activities. Aside from these developments, Brazil enacted a law governing software programs, which has been long-awaited and the topic of great discussion.

I. Argentina

Since we last discussed Argentina's debt conversion program in the Spring 1988 issue of *The International Lawyer,* that program has undergone modification and has attracted more favorable bids and participation than had been anticipated in some sectors. In the interim, there also has been a significant liberalization in the country's foreign exchange control rules. For the time being, at least, Argentina effectively is a free-exchange jurisdiction.

Less favorable, at least from the point of view of foreign investors in Argentina, are recent changes in the tax system designed to increase the government's revenues. The more significant or interesting of these changes are described below.

One change institutes a system of compulsory savings for 1988 and 1989. The rate is 40 percent. Computation of the base to which the rate applies is complicated, but the practical effect in most cases likely will be close to a 40 percent surtax on the income tax that otherwise would be owing. Amounts paid as compulsory savings will earn interest and be subject to certain adjustments, but will not be repayable to the taxpayer for five years.

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Another change replaces earlier provisions regarding a tax on a bank's debits to, inter alia, a customer's checking account. In general, such debits attract tax at a 0.7 percent (seven per mil) rate. Seventy percent of the amount of such tax collected by a bank on debits to a customer's checking account may be credited by that customer against its income tax liability. The amount of the credit cannot exceed what otherwise would be the customer's income tax liability, and excesses cannot be carried back or forward.

The obvious intent of these tax amendments, and the earlier provisions they replace, is to provide a ready source of current revenue for the government. That intent had been defeated, at least in part, under the earlier provisions. Argentines issued checks to bearer, or checks to order, that were repeatedly endorsed. They were not deposited, so the tax was not incurred with respect to each payment by check. Circulating checks became the effective equivalent of Argentine currency.

To reduce this perceived abuse, the change in the tax on debits to accounts is accompanied by fascinating amendments to the Argentine law regarding checks. Bearer checks cannot be drawn in any amount in excess of 700 Australs (the limit is to be adjusted annually by the Central Bank). Moreover, checks drawn in favor of a determined person cannot be transferred by endorsement or delivery, except by endorsement to a bank for purposes of collection. This assures a debit upon which the tax will apply. In order to collect the tax, Argentina has defeated the negotiability of a check, a prototypical negotiable instrument!

Changes also were introduced in Argentine income tax law. The most significant change limits the use of net operating losses. First, a two-year moratorium is placed on the use of net operating losses to offset taxable income of a later year. Second, once the moratorium expires, net operating losses of prior years (in general, there is a five-year limit) will be available to offset only 50 percent of what otherwise would be the taxable income of a current year.

II. Brazil

The most significant recent legal developments in Brazil are (i) the issuance of long-awaited regulations governing debt-to-equity conversions, and (ii) the enactment of the software law.

A. Debt-to-Equity Conversions

The proposals for a conversion program discussed in the Spring 1988 issue of *The International Lawyer* have given rise to two different sets of regulations. The first set of regulations, embodied in Resolution No. 1,416 of the Central Bank of Brazil dated November 17, 1987, lasted only for

approximately two months. Resolution 1,416 required the "securitization" of the Brazilian foreign debt as a condition precedent to any conversion. This requirement met with significant opposition from the international banking community. In large part to overcome this negative reaction, the National Monetary Council approved the new rules, contained in Central Bank Resolution 1,460 of February 1, 1988, which now govern debt-to-equity conversions in Brazil.

Both Resolutions 1,416 and 1,460 empower the Central Bank to establish quantitative ceilings on the amount of debt which may be converted into equity under this program.

Subject to these ceilings, three basic types of foreign debt qualify for conversion under Decree 1,460: (i) compulsory U.S. dollar deposits with the Central Bank made under the so-called "Deposit Facility Agreements" (DFA) executed between the Central Bank and nonresident creditor banks (i.e., "rolled-over" debt); (ii) debt represented by voluntary deposits with the Central Bank made pursuant to Resolutions 230 and 432; and (iii) debt that has yet to mature.

As to the first type of debt, compulsory DFA deposits, the conversion into equity is made through a public auction in the stock market that fixes the discount to be applied against the face value of the debt. There will be two types of auctions: (i) those for investments to be made in the less developed regions of Brazil, such as the SUDAM and SUDENE areas; and (ii) those for investments made elsewhere in Brazil, São Paulo or Rio de Janeiro. The cruzado proceeds arising out of these auctions must be invested in: (i) the capital of new companies; (ii) the capital of existing companies; or (iii) the so-called "Foreign Capital Conversion Funds," which are like mutual funds to be managed under the stock market's supervision. Investments in Foreign Capital Conversion Funds enjoy preferred treatment; in particular, dividends distributed by these funds will be subject to a reduced withholding income tax rate.

Conversion of the second type of debt (voluntary deposits) and the third type of debt (unmatured credits) will not be carried out through an auction procedure. Instead, private parties will be free to convert such debt into equity at the discount fixed by the Central Bank and subject to the ceilings mentioned above.

Resolution 1,460 retains a series of conditions and limitations that also appeared in Resolution 1,416: (i) the converted proceeds must remain in Brazil for a period of at least twelve years; (ii) no debt may be converted into equity of companies that have repatriated capital during a thirty-six-month period prior to the particular conversion, unless the repatriated amount has returned to Brazil; and (iii) no converted debt may be invested in a manner that would transfer control of companies presently controlled by Brazilian residents to nonresidents. Moreover, converted

public sector debt may be invested only in the public sector, but converted private sector debt may be invested in the public or private sector. Finally, the Foreign Capital Conversion Funds may not acquire more than 5 percent of the voting capital or 20 percent of the total capital of any Brazilian company.

Resolution 1,416 contemplated certain additional restrictions that do not appear in Resolution 1,460. First, Resolution 1,416 provided that restrictions could be imposed on the remittance of dividends arising from investments of converted debt, at any time during the first four years after the conversion. Second and more importantly, Resolution 1,416 tied the entire conversion program to the securitization of Brazilian debt. In general, securitization involved the issuance of bonds (as opposed to cash) to the foreign creditors holding the debt that was to be converted into equity under the program. Accordingly, the foreign creditors effectively would have been required to defer receipt of the discounted value of their credits. As previously indicated, neither of these requirements appears in Resolution 1,460.

B. Software Law

On December 22, 1987, Law No. 7,646 of December 18, 1987, entered into force in Brazil. This law introduces various important new rules regarding the protection, licensing, and distribution of software in Brazil. Most significantly, software is now unequivocally susceptible of copyright protection in Brazil for twenty-five years, counted as of its first release in any country. However, foreign software is entitled to this protection only if citizens and residents of Brazil are able to obtain similar protection for their software in the particular foreign country.

Law 7,646 establishes that a software program, whether developed by a Brazilian or non-Brazilian company, must be registered with the Special Secretariat of Informatics (SEI) before it may be "commercialized" (i.e., marketed) in Brazil. Such registration is a condition precedent to the validity of any juridical "act" or "transaction" involving the program. To register software developed by non-Brazilian companies, SEI must previously determine whether "similar" programs, as defined in the law, have been developed in Brazil by a Brazilian company. The regulations implementing this Law presumably will clarify the procedure for obtaining such registration, as well as elaborate the criteria to be applied in determining whether "similar" programs developed by Brazilian companies exist in Brazil.

In general, only Brazilian companies may obtain the aforementioned registration and thereby commercialize software programs in Brazil. Non-

Brazilian companies, however, may apply for registration of programs to be used in connection with equipment that they are authorized to market in Brazil. In view of the so-called market reservation of "mini, micro and supermicro" computers to Brazilian companies, non-Brazilian companies presumably will be able to commercialize software programs only for mainframe computers. Non-Brazilian companies, however, may make their software products available in the Brazilian market through licensing or assignment arrangements with Brazilian distributors, provided that no "similar" software products have been developed by Brazilian companies. Such agreements must be submitted to the "competent agencies of the Executive Branch" for approval, which will be granted only if various prescribed conditions are satisfied.

Law 7,646 also provides that an end-user may import a single copy of a software program for its exclusive use. It is not clear under the law whether such imports are subject to the requirements discussed above. This and other issues raised by Law 7,646 presumably will be clarified under the implementing regulations, which are expected to be issued sometime in April.

III. Chile

Chile has recently introduced legislation permitting the establishment of mutual funds as vehicles for foreign investment in Chile. The government hopes by this device to increase foreign investment in its economy by adding the passive investment of institutional and portfolio investors.

The implementing legislation, Law 18,657 of September 29, 1987, provides for the organization of Foreign Capital Investment Funds, defined as funds established in Chile with foreign currency provided by foreign investors for the purpose of investing in publicly traded securities of Chilean entities. Each fund must be administered by a Chilean corporation, which would be jointly and severally liable for compliance with applicable Chilean laws and regulations. Establishment of a Foreign Capital Investment Fund requires a favorable report from the Superintendent of Securities and prior authorization from the Foreign Investment Commission under the foreign investment statute (Decree Law 600) or of the Central Bank under the Foreign Exchange Law. Fund participations issued by the fund to foreign investors may not be redeemed prior to the termination of the fund, and capital invested in the fund may not be repatriated for a period of five years from the date of the investment. Profits earned on investments in the fund will be subject to a withholding tax of 10 percent.

IV. Colombia

In our two most recent discussions of Colombian developments we covered its new tax and foreign investment rules. Nothing of that magnitude has changed in the interim. Perhaps the most significant development is the expectation that new rules regarding foreign investment in the financial and other sectors and regarding technology transfers will be issued in the near future.

The new rules regarding investment in the financial sector would complement the foreign investment amendments made by Decision 220 of the Andean Common Market and Colombian Decree 1265 of 1987. The rules regarding the financial sector could not have been changed under Colombian law by Decree 1265, a presidential decree. Such a change will require action by Colombia's legislature. Unless a special session is convened, which is not expected, the legislature will meet again starting on July 20, 1988. It is expected that at such time the rules regarding investments in the financial sector will be significantly liberalized.

A draft of a new decree regulating technology transfers contains several provisions that may be viewed as being negative. For example, the draft decree explicitly prohibits clauses in technology transfer agreements that require the payment of minimum royalties, or that shift tax liability from a supplier of technology to the recipient or user of the technology. The decree also places special emphasis on the availability of export markets in the case of trademark licenses.

Other changes contained in the draft decree are more positive. For example, if an agreement is approved, it must be approved for a minimum term of four years. In practice, the Royalty Committee for some time has seldom issued approvals for more than three years. Thus, with a four-year minimum mandated, it may well prove possible to secure approval for a five- to ten-year term in particular cases. The draft decree also dispenses with the prior approval requirements for royalty-free trademark agreements (which are common between parent companies and their subsidiaries or affiliates). Such agreements will, however, have to be registered with the Industrial Property Office of the Superintendency of Industry and Commerce and must not contain restrictive clauses. If the Industrial Property Office does not return the application for noncompliance within ten days, the registration will be deemed to have been approved.

One important matter is left unsettled in the draft decree. Under Decision 220 and Decree 1265 royalties are allowed on agreements between related parties if the technology licensed is "new" technology, or if it is to be used for the production of goods for export. The draft decree proposes to define "new" technology for this purpose either as technology that is new to Colombia or as technology that is new to the recipient

enterprise. The latter formulation of course would be more favorable to non-Colombian licensors.

While to date no such provisions are contained in the draft decree, indications are that the new regulations will also liberalize foreign investment in some sectors, including advertising, in addition to covering the above-described technology transfer matters.

V. Mexico

On February 3, 1988, Mexico's National Foreign Investment Commission (NFIC) published a new General Resolution in the Official Gazette (Diario Oficial) which revoked all prior foreign investment resolutions and restated, reorganized, and consolidated the prior rules into one document. The General Resolution also made certain substantive changes.

Some procedures were streamlined and certain approval requirements eliminated. For example, under the General Resolution it will no longer be necessary for a foreign investor, acquiring shares from another foreign investor, to file a notice with the Executive Secretary of the NFIC expressly undertaking to comply with any commitments that the transferring foreign investor may have made with the Mexican Government.

More importantly, it will no longer be necessary for a foreign investor to obtain the approval of the Executive Secretary before purchasing shares owned by Mexican investors that, when added to all other shares owned by foreign investors, would amount to more than 25 percent of the capital of a Mexican company. Such acquisitions can now be made freely. Also, in the case of companies in which the capital already is more than 49 percent foreign-owned, foreign investors will now be permitted to acquire the remaining capital without seeking authorization.

The treatment of *maquiladoras* has also been further liberalized. A *maquiladora* may now acquire shares, equity interests, or fixed assets of other *maquiladoras*, or lease their businesses or essential assets, without obtaining authorization. *Maquiladoras* will also be permitted to engage in new fields of economic activity, so long as the users or consumers of the new activities or services are foreign companies, or other *maquiladoras* belonging to the same economic interest group.

Part of the streamlining process also involved the elimination of certain older resolutions that had been rendered obsolete or unnecessary by more recent developments. For example, the prior Resolution 11, which dealt with transfers of shares or assets between foreign investors belonging to the same economic interest group, was revoked along with the other resolutions. No equivalent provision was included in the General Resolution, however, since it had been rendered unnecessary by the above-mentioned liberalization with regard to acquisitions of shares by foreign

investors in general. The same is true with regard to the prior resolutions dealing with publicly traded shares and closure of illegally opened new establishments.

Perhaps the most significant practical effect of the General Resolution will result from the greatly expanded powers granted to the Executive Secretary. This continues a trend that in recent years has resulted in a much faster and smoother approval process.

VI. Peru

On November 28, 1987, Peru published Supreme Decree 185-87-EF, which essentially compiles in a single piece of legislation the numerous amendments to the basic tax law (Legislative Decree 200) adopted over the recent years. This law retains the prior structure of Decree 200, which distinguished among various "categories" of income: Real Property Income (First Category); Income from Other Capital (Second Category); Commercial, Industrial, and Similar Income (Third Category); Income from Independent Work (Fourth Category); and Income from Dependent Work (Fifth Category). Dividend and royalty income continue to be classified as Third Category Income that, when paid to legal entities domiciled abroad, is subject to withholding tax at the rate of 15.4 percent and 45 percent, respectively. In contrast, interest income is exonerated from tax until December 31, 1990, if it arises from certain qualified loans granted by private foreign entities for the construction, acquisition, or installation of new fixed or operating assets required to establish or develop a local enterprise. Other specific types of interest payments abroad, such as those arising from qualifying loans, import financing credits and foreign credit lines of local banking institutions, are subject to withholding tax at a mere 1 percent. All remaining types of interest payments abroad are subject to withholding tax at 45 percent.

VII. Venezuela

In February 1988 the Venezuelan Government enacted legislation granting a new incentive to foreign investors in major export projects. Decree No. 1988 of February 3, 1988, and Exchange Agreement No. 6 of February 5, 1988, grant to qualifying projects an exemption from the obligation to sell foreign currency export proceeds to the Central Bank of Venezuela at the controlled rate of exchange (which at Bs. 14.50 to U.S. $1.00 was yielding roughly half the amount of Venezuelan currency than conversions at the free market rate on the effective date of the legislation). Of total export proceeds, only the amount required to fund local operating costs is required to be converted into bolivars at the

controlled rate. The balance may be retained by the exporter outside Venezuela.

The basic incentive contained in Decree No. 1988 was in fact introduced several months earlier in Decree No. 1723 of September 9, 1987, but in its original form it expressly excluded foreign investments made by means of debt-equity swaps under Decree No. 1521. Decree 1988 amends Decree 1723 in several ways, but most importantly by permitting projects partially funded via Decree 1521 swaps to qualify for the incentive.

The new incentive is available only to new industrial projects, or reactivations of existing projects, of national interest in the metallurgical, chemical, chemical-mechanical, pulp and paper, petrochemical, and mining sectors that contemplate the export of 80 percent or more of their production. To qualify for the incentive, investors must submit their proposed project to a Commission made up of the Ministers of Development and Finance and the Central Bank president. The Commission also will decide whether and in what amount the foreign investment in the project may be effected by means of a debt-equity swap. It may only permit swaps in projects if the foreign investment equals or exceeds twenty million dollars and then only up to a maximum of 50 percent of the foreign investment, or 80 percent if the investment is at least U.S. $100 million.

Companies that opt for the incentive of Decree No. 1988 are also permitted to take advantage of the tax benefits established in the Export Incentive Law. They are prohibited, however, from purchasing or selling foreign exchange in the free exchange market, obtaining local credit except for financing domestic sales, and subject to certain exceptions, purchasing foreign exchange at the controlled rate.

Exchange Agreement No. 6 requires that the conversion of the foreign exchange representing the initial investment in qualifying projects be made at the controlled rate of Bs. 14.50 to U.S. $1.00, the same rate currently applicable for all foreign investments. At the time of liquidating the project and repatriating the foreign capital, the then current controlled rate will also be applicable for converting local currency into foreign exchange. The controlled rate is not available for repatriating the proceeds of the sale of equity in the qualified project to national investors without specific approval of the Ministry of Finance, and then only after five years from the date of the commencement of exports.