

# Latin America\*

## I. Argentina

Argentina continues to struggle with inflation, foreign debt, and deficit. The latest effort, the recently announced "Plan Primavera," continues to rely on some old standby remedies. These include agreements with industrialists to hold on prices (but no space controls, and reference prices above market prices), a call for employment reduction in government companies, and continuing efforts to privatize government-owned companies. The latter, in particular are controversial.

One element of the Plan Primavera may be of greater interest to the international business community, because it affects prices of exports to and from Argentina. Under current exchange rules, there are two exchange rates, the commercial and the financial. Dollars are more expensive in austral terms at the financial rate. Australs are more expensive in dollar terms at the commercial rate. The current spread between the two rates is about 20 percent.

Under current export rules, an Argentine exporter is required to sell for foreign currency, and to repatriate that foreign currency to Argentina and sell it to the government for australs. The exchange rate is either the commercial rate (for most traditional exports) or a fifty-fifty mix of the commercial and financial rates (for most industrial goods). Conversely, an Argentine importer generally can purchase foreign currency from the government to pay for imported goods only at the financial rate (with a few exceptions, e.g., fuel oil). The government thus has put itself in the enviable position of buying low (cheap dollars from exporters) and selling high (expensive dollars to importers). The spread is expected to cover something on the order of two percent of GNP.

## II. Brazil

The most significant recent legal developments in Brazil are: (a) the enactment of legislation liberalizing trade and domestic industrial policies (the New Industrial Policy); and (b) the enactment of legislation creating preferred export zones in certain areas of Brazil (Export Zones).

### A. NEW INDUSTRIAL POLICY

The New Industrial Policy is reflected primarily in Decree-Laws Nos. 2433 and 2434, both of May 19, 1988. These Decree-Laws contain new

---

\*Prepared by Jorge Cubas, Sebastião Mattos, Paul Slocomb, and Tom Studwell, Baker & McKenzie, Chicago, Illinois.

rules regarding: (1) establishment of new industrial sectorial projects approved by the "Conselho de Desenvolvimento Industrial" (CDI—Industrial Development Council); (2) tax incentives for research and development implemented under the rules for a "Programa de Desenvolvimento Tecnológico Industrial" (Technological-Industrial Development Program); (3) restatement of the tax and financial benefits available to industrial companies established under Brazilian law pursuant to the "Befiex" program (Benefícios Fiscais a Exportação—Export Tax Benefits); and (4) tariff reductions for most products.

The CDI (a governmental agency under the Ministry of Industry and Commerce) is empowered to grant import tariff reductions for machinery and equipment that are to be fixed assets (up to 90 percent reduction), raw materials (up to 80 percent reduction), and accelerated asset depreciation for approved projects. To qualify, applicants must fulfill certain commitments and prerequisites aimed, for example, to improve competition within the industrial sector, eliminate bottlenecks, and improve the use of human resources.

Companies qualifying under a Technological-Industrial Development Program will be entitled to: (1) deduction of research and development expenses for Brazilian income tax purposes; (2) duty reduction (up to 90 percent) on imports of raw materials and components; (3) accelerated depreciation for machinery and equipment; (4) income tax credits and reductions based on royalties paid to obtain new technology; and (5) deduction for income tax purposes of royalties paid for "high technology" or capital goods, provided the royalties do not exceed 10 percent of sales.

Industrial companies wishing to qualify for the Befiex program must assume an export commitment (measured in U.S. dollars), generally over a ten-year period. During that period the industrial company must maintain a yearly positive balance of payments favorable to Brazil. In exchange, the industrial company is granted: (1) import duty exemption or reduction for equipment, machinery, apparatuses, raw materials, parts, and components up to an overall U.S. dollar ceiling agreed upon by the Company and Befiex; (2) extended income tax loss carryforward privileges (six years, versus the normal four years); and (3) accelerated depreciation for machinery and equipment. The Befiex program is administered by a separate agency within the Ministry of Industry and Commerce.

In addition to the above "special" programs, most companies doing business in Brazil will benefit from the tariff reductions and other trade liberalization measures. These include practical elimination of the so-called "similarity" test (except for certain sectors of the computer industry and for companies qualifying for special government programs, e.g., Befiex), whereby importation of goods "similar" to those manufac-

tured in Brazil was effectively precluded. In addition, the "I.O.F." tax (Imposto sobre Operacoes Financeiras—Tax on Financial Transactions) applied on a Brazilian importer's payment to a foreign exporter was eliminated. I.O.F. rates range from 10 percent to 25 percent of the value of the transaction.

## B. EXPORT ZONES

Decree-Law No. 2452, enacted on July 29, 1988, empowers the Brazilian executive power to grant to qualifying companies in Brazil the right to establish operations within certain export zones. These export zones are expected to be established in the Amazon and in Northeast Brazil. Authorization to establish operations within an export zone will be granted for a twelve-year period. The period will be renewable for equal successive periods.

Qualifying industrial companies will enjoy: (1) full duty exemption; (2) exemption from I.O.F. tax (for insurance, currency exchange, and negotiable instruments transactions); (3) supplemental income tax levied on excess dividend distributions to shareholders domiciled outside Brazil; and (4) social security and some other fee reductions. In exchange for such benefits, the company must, *inter alia*: (1) commit to export all of its output; (2) refrain from obtaining local credit; and (3) fulfill minimum requirements regarding capital and local expenditures.

The applicant will fail to qualify if the products targeted for export are already exported by another company operating in Brazil, unless the applicant can demonstrate that the new exports will be "in addition to" (measured in U.S. dollar terms) existing exports.

## III. Chile

In the months leading up to the October 1988 presidential plebiscite, political events overshadowed legal developments in Chile. Nevertheless, some legislative changes are of interest to companies during business in Chile. Consistent with the government's economic strategy of reducing the overall tax burden on business, the basic import tariff was reduced from 20 percent to 15 percent in January, the withholding tax on profit remittances was reduced from 40 percent to 35 percent effective April 1, and the general VAT rate was reduced from 20 percent to 16 percent in June.

In addition, the Chilean Central Bank further refined and expanded the debt-to-equity conversion program, pursuant to which Chilean sovereign debt is acquired from foreign creditors and converted into equity in Chilean companies. One of the first and most successful of the many debt-to-equity swap regimes established in Latin America, the Chilean program has two parts, one for national investors and the other for foreign investors.

Regarding the national program, in March and May of 1988 the Central Bank adopted a series of resolutions that, in effect, allow Chilean homeowners to utilize debt equity swaps to acquire pesos at a bargain price to pay installments on their residential mortgages. Since the maximum benefit available to an individual mortgagor is U.S. \$6,000, this program will not significantly reduce Chile's multibillion dollar foreign debt. According to some commentators, however, it may win favor for the current government with an important part of the voting population.

Regarding the foreign program, in April 1988 the Central Bank promulgated regulations that clarify the procedures for effecting investments in Chilean investment companies by means of debt-to-equity conversions.

#### **IV. Colombia**

Important tax changes were introduced in Colombia at the end of 1987 and during the first half of 1988. Procedural changes came first. Most were aimed at tax avoidance. Prior rules required that taxpayers submit substantial supporting documentation together with their tax returns. These requirements were largely eliminated. Instead, taxpayers are to retain records supporting their tax returns for a period of five years, and the tax administration is free to inspect those records at any time. The tax authorities were also given greater access to information regarding bank, stock exchange, notarial, and other transactions. Finally in this regard, sanctions were stiffened, with penalties, *inter alia*, for failure to file, failure to supply information when requested, and failure to issue invoices complying with specific requirements.

The most significant change from a practical point of view, however, which affects virtually everyone in Colombia, is liberalizing rather than restrictive. The legislation entirely eliminated the use of tax clearance certificates (*certificados de paz y salvo*), which had been required in order to engage in a broad range of transactions and activities.

Foreigners were benefited by a May 13, 1988, reduction in tax rates. Decree 925/88 reduced the income tax withholding rate on dividends paid by Colombian companies to foreign investors in those companies from 30 percent to 25 percent, and totally eliminated the tax for capitalized dividends. The reduction is matched by an equivalent 30 percent to 25 percent reduction in the remittance tax rate on branch profits. Both the income tax withholding rate on dividends and the remittance tax rate on branch profits will reduce to 20 percent for 1989 and thereafter.

#### **V. Mexico**

Much has changed recently regarding foreign investments in Mexico. As many may recall, when the Foreign Investment Law was first enacted

in 1973, and for many years thereafter, it was very strictly enforced. One hundred percent foreign ownership was only freely available for companies that were already foreign-owned at the time the law was enacted, and for "maquiladoras." But even those majority foreign-owned companies were very limited in what they could do. In general they had to secure the authorization of the foreign investment authorities to do anything other than what they were doing before. New foreign investment had to take a minority position in any Mexican company, with Mexican partners holding at least 51 percent (60 percent in some fields) of the capital. New foreign majority participation typically required prior approval of the Foreign Investment Commission, which was seldom granted.

Today, the law remains in effect as originally enacted. It has never been amended. What has changed is the manner of its implementation. It is now easier to obtain approvals. The authorities are much more willing to approve a majority foreign investment, at least one that fits into Mexico's development scheme. Experience has shown that the floodgates are not open. The Mexican Government knows what it wants, what it needs and, more importantly, what it can afford to do politically. Foreign investment still is a particularly sensitive area.

The reason for the liberalization is not mere magnanimity on the part of the authorities. The push for liberalization is largely a result of the economic difficulties that Mexico has been experiencing. The government has come to realize that opening up foreign investment is one vehicle for overcoming these problems. To a large extent it has identified the factors that presumably will contribute to resolving, or at least ameliorating, Mexico's situation.

What will sell a majority foreign investment to the government, and to the public? Experience has shown that the most important factors include: (1) generation of foreign currency; (2) export potential; (3) new job creation; (4) size of the investment; (5) sophistication of the new technology involved; (6) local resource use; and (7) location of the company. In short, the prospective majority foreign investment must generate foreign currency, jobs, and development. To obtain approval for a majority foreign investment, the applicant must present the authorities with a package that provides for as many of the above factors as possible, and any others that would be attractive to the Mexican Government given its current objectives.

The package must also be realistic, however. A pattern has evolved whereby the authorities demand concrete commitments based on the applicant's representations in its foreign investment application. Contrary to past practice, the authorities no longer are attempting to extract commitments far beyond what the foreign investor proposes, but they are demanding that the applicant stand by the representations made in its application.

Another important point to bear in mind is that the authorities should be consulted prior to the filing of an application. The best way to proceed is for the applicant's attorneys or other outside representatives to discuss the proposal with the authorities in advance, in general terms and on a no-name basis, to test the waters. Based on these discussions, the applicant will be in a position to refine the proposal and make it even more attractive. At some point during this process the identify of the foreign investor can be revealed to the authorities, thus bringing into play the reputation, financial strength, and other positive characteristics of the foreign investor. Based on these discussions the final application can be prepared and the investor will have a very good idea of how the people who will be critically important in evaluating it will react, and what their recommendation to the Foreign Investment Commission is likely to be.

## **VI. Panama**

An interesting offshoot of the political crisis in Panama is likely to keep Panamanian and international jurists busy for years to come. That is the question of the legality of certain legislation enacted in Panama after the de facto removal from office of President Eric Arturo Delvalle on February 26, 1988. The procedures by which the Panamanian Legislature removed Delvalle from office and the Council of Ministers designated Manual Solis Palma as "Minister in Charge of the Presidency" are of questionable validity under Panama's Constitution. Consequently, all of the decrees issued by Solis Palma may be subject to legal challenge. These include, for example, various measures promulgated to counteract President Reagan's Executive Order of April 6, 1988, including decrees purporting to extend tax payment deadlines, to change tax withholding agents, and to extend the maturity of government checks.

Of equal interest is the validity of the various governmental acts taken by Mr. Delvalle after his de facto removal from office. For example, on June 17, 1988, the Panamanian Ambassador to the United States signed on behalf of Mr. Delvalle, as President of the Republic, an Executive Decree purporting to terminate the effect of a previous decree issued by Mr. Solis Palma relating to the timing of payment of fiscal obligations to the Panamanian Government. The validity of Mr. Delvalle's executive decree, of course, also depends on the legality of the legislative act that purported to remove him from office.

When the political crisis comes to an end, and regardless of whether the Noriega forces or the opposition emerges victorious, it may be expected that one or more of the decrees issued by Solis Palma or Delvalle will be subject to legal challenge.

## VII. Peru

By Supreme Decree No. 127-88-EF of August 8, 1988, the Peruvian Government extended until December 31, 1988, the prohibition contained in Supreme Decree No. 260-86-EF of August 1986 (discussed in the Winter 1987 edition of *The International Lawyer*), of all remittances of capital, profits, and royalties from Peru. The decree requires that all amounts distributed by Peruvian companies as capital, profits, or royalties be deposited with the Central Bank, in exchange for obligations of the Peruvian Government denominated in foreign currency.

## VIII. Venezuela

Legal developments in Venezuela thus far in 1988 have been overshadowed by the presidential election campaigns. Nevertheless certain new legislation is worthy of mention. In January 1988, the Congress enacted Venezuela's first Law of Protection of Constitutional Rights and Guaranties (*Ley Organica de Amparo sobre Derechos y Garantias Constitucionales*, G.O. No. 33,891, January 22, 1988). The law provides a procedural framework for the prompt redress of infringements of rights that are recognized in the Venezuelan Constitution but that, due to the absence of specific legislative provisions, have heretofore been difficult to assert by legal action. Because the law makes available a significant new cause of action that may be utilized to remedy a broad range of grievances in an expeditious proceeding, it is expected that legal actions under the new law will proliferate. Indeed, numerous actions have been filed and judgments issued at the time of this writing.

In February 1988, the Congress enacted a major reform of the General Law of Banks and Other Credit Institutions. Although a detailed analysis of the amendments is beyond the scope of this report, the general thrust of the legislation is to vest in the Central Bank and the Superintendency of Banks greater regulatory control over the banking industry. The most widely cited purpose for the increased level of regulation is that of avoiding major bank failures of the kind witnessed in the early years of this decade.

As expected, the Congress finally ratified both the Protocol Amending the Cartagena Agreement (May 15, 1988) and Decision No. 220 of the Commission of the Cartagena Agreement (July 25, 1988), thus giving each the force of internal Venezuelan law. As reported earlier, in the Spring 1988 issue of *The International Lawyer*, Decision No. 220 replaces Decision No. 24, as the common Andean Pact foreign investment law and relaxes many of the previous restrictions on foreign investment. Venezuela's formal adoption of Decision No. 220 is largely anticlimactic, because most of the major changes contained therein were already implemented in Venezuela's amended foreign investment regulations, De-