The Foreign Investment Laws of Latin America: Present and Future

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We propose to review most of the foreign investment laws of Latin America in order to establish basic differences or similarities among them—if any—and try to determine Latin America's trends in that field. First of all, a foreign investment law is determined by the political motivations and the economic needs of the respective countries. You can't expect a leftist or nationalistic government to offer many incentives to foreign investors. Changes in political ideas and philosophies change foreign investment laws. Since we will not discuss here the future political environment of Latin America, we have to limit our statements to the assumption that in years to come, until the end of this century, Latin America will follow a political philosophy based on the principles of democracy and a pragmatic attitude favorable to foreign investment due to the economic needs of the region.

Our subject will not cover petroleum laws related to exploration or production of crude which are generally favorable to foreign investors due to the exploration and production activity needs in Latin America and the substantial amounts of capital to be invested in those risk activities. We will neither discuss industrial incentive laws which have been established by some of the Latin American countries for the purpose of attracting industrial and tourist activities. These laws contain tax exonerations in order to promote industrialization or tourism and incentives are given to both foreign and local investors.

We will focus our comments on laws which regulate foreign investment in general, laws that restrict, to a greater or lesser degree, the participation of foreign capital in the business activities of the region or simply exclude or prohibit such participation.

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I. Restrictions in General to Foreign Investments or for Sectors of the Economy

Generally speaking the foreign investment laws make a distinction between types of business activities to establish different regulations for each of them. Some of the activities are reserved to the government, others are the exclusive rights of nationals and there are sectors open to foreign investors and to nationals. In the latter case, local participation is generally required. That is the case under the Mexican Foreign Investment Law (1973)[1] and under Decision 24[2] of the Andean Pact countries. In Mexico's case, at least 51 percent of the capital of the corporation should be controlled by Mexicans[3] and for the Andean countries a majority of the capital by local investors is a condition to enjoy the benefits of free trade between member countries of the Cartagena Agreement or Andean Pact[4] (Venezuela, Colombia, Peru, Ecuador and Bolivia). Capital control by nationals must also be reflected in management control.[5] In addition, such laws generally create a monopoly for the state of some industries, including activities which have traditionally been carried out by the private sector, i.e., hydrocarbons and basic petrochemicals. Consequently, they constitute an impediment to free enterprise and free competition in activities previously carried out by the private sector.

Notwithstanding the above, governments have created mechanisms within their governmental structure to alleviate such restrictions when the economy of the country demands a different approach to foreign enterprise. Mexico, as an example, has created the National Investment Commission which is entitled to grant 100 percent participation to foreign investors in a particular business, corporation or enterprise, if the Commission considers it convenient for the benefit of the country.[6] The Andean countries have established several reservations within the framework of Decision 24 in order to allow foreign participation—including total control of the business, in some sectors of the economy.[7]

There are sectors of the economy in the Andean countries with different regulations established by some of the countries regarding foreign capital due to the reservations made with respect to Decision 24. That situation is confusing and even chaotic. As an illustration of this, we have the case of Ecuador, which is applying different rules than those of Decision 24 to insurance, commercial, banking and financial institutions and other sectors

[1]Law to Promote Mexican Investment and Regulate Foreign Investment, Diario Oficial (DO), March 9, 1976 [hereinafter cited as Foreign Investment Law].

[2]Decision 24 of December 31, 1970, of the Commission of the Cartagena Agreement, as amended.

[3]Foreign Investment Law, *supra* note 1, article 5.

[4]Decision 24, *supra* note 2, article 27.

[5]Foreign Investment Law, *supra* note 1, article 5.

[6]*Id.*, article 5.

[7]Decision 24, *supra* note 2, article 38.

of the economy.[8] In Bolivia's case, the investment law[9] is applied to any industrial activity within the country. That situation may be in conflict with Decision 24.

II. Limitations to the Repatriation of Capital and Profits

Most of the foreign investment laws establish limitations for the repatriation of capital and profits. Some of them impose direct restrictions and other indirect limitations through the mechanism of taxation on the repatriation of profits or dividends.

In the case of the Andean countries, the restriction to the repatriation of profits is a direct one. Simply, annual profits cannot be remitted in excess of 20 percent of the registered capital.[10] In the case of Uruguay, Argentina and Brazil an indirect method of taxation is controlling the remittance of profits in excess of certain percentages of the capital registered.

The Uruguayan Foreign Investment Law[11] guarantees repatriation of capital and profits when the investment is registered with the government and a contract is signed between the government and the investor. However, if the profits are in excess of 20 percent of the registered capital, a 40 percent tax is imposed on the excess.[12] Brazil and Argentina apply a similar tax on excess profits although the tax base and rates are different. In Brazil, the tax is 60 percent on the profits remitted in excess of 25 percent of the registered capital,[13] and in Argentina the tax is 25 percent for the excess of profits remitted above 20 percent of the registered capital.[14]

The above-mentioned taxes are, of course, in addition to the normal corporate income tax and the normal rate imposed on remittance of profits/dividends which must be paid without any exemption to the government.

Concerning the repatriation of capital, generally speaking, there is no problem if the capital is duly registered. However, some countries—like Argentina[15] and Chile[16]—establish that registered capital cannot be repatriated until the expiration of three years starting from the date of registration with the government.

Mexico does not establish any limitation on the repatriation of capital and profits. In addition, there is no exchange control in Mexico. Central America has no foreign investment laws (only Industrial Incentive Laws,

[8]Decree No. 900-B of Novembver 10, 1976, Diario Oficial, November 26, 1976.

[9]Investment Law of Bolivia, Decree Law No. 10045 of December 10, 1971.

[10]Decision 24, *supra* note 2, article 37.

[11]Law No. 14179 of March 28, 1974, as amended, published in the Official Daily of April 5, 1974.

[12]*Id.*, article 6.

[13]Law No. 4131, as amended by Law No. 4390 of September 11, 1964, article 43.

[14]Argentina Foreign Investment Law, as amended. Revised text by Decree No. 1062-80, article 16.

[15]*Id.*, article 13.

[16]Decree Law No. 1748 of March 11, 1977, article 4.

not covered herein). However, there are exchange controls and in the case of El Salvador, the general rule, with exceptions for industrial activities duly classified by the government, is that profits cannot be remitted in excess of 10 percent of the registered capital.[17] Panama has neither foreign investment law nor exchange control. Consequently, the repatriation of capital and profits is freely carried out.

Chile, although it has some time limitation for the repatriation of capital, as mentioned before, has established a guarantee to the foreign investor on income tax. The law guarantees[18] to the foreign investor an income tax no higher than 49.5 percent for a ten-year period from the day the contract is signed between the foreign investor and the government; also, a similar guarantee in regard to indirect taxes and customs duties covers the importation of machinery and equipment necessary for the plant's production. The law also establishes[19] the principle that the foreign investor cannot be discriminated against as compared to the local investor. A special appeal is established by the law,[20] so that the foreign investor may obtain the elimination of any discriminatory resolution or practice which may affect his business activities. The access to, or use of local credit[21] would not be considered a discriminatory activity or a limitation to the foreign investor.

The Chilean law[22] requests express authorization by the government: (1) for any investment by foreign investors higher than U.S. $5 million; (2) if the investment is to be carried out in business sectors conducted by the government or in public services such as telecommunications; or (3) when made by a foreign government or a public institution of such foreign government. The above-mentioned provisions are similar—in some respects—to the Argentinian law[23] which also requires express approval by the government, or an agency of the government, when the investments are in excess of certain amount or in special sectors of the economy (i.e., energy).

The tax guarantee contained in the Chilean Foreign Investment Law reminds us of the mathematical formula used in Peru to reflect changes in income tax for some companies under special incentive investment laws such as the Petroleum Law. We believe that this is a good solution adopted by Peru to guarantee the foreign investor that the rate of return—after taxes—is not going to change substantially if new taxes are imposed by the government.

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[17]Decree No. 147 of May 30, 1961, article 40.
[18]Decree Law No. 1748, *supra* note 16, article 7.
[19]*Id.*, article 9.
[20]*Id.*, article 10.
[21]*Id.*, article 11.
[22]*Id.*, article 16.
[23]Argentina Foreign Investment Law, *supra* note 14, article 6.

III. Comparative Income Tax Situation

Although, we are not reviewing the tax situation of foreign investment in Latin America, it is useful to have a general knowledge of how the countries are treating foreign investment through the most direct of taxes—income tax. In Appendix A we can see that Peru is the country with the highest combined income tax rate (68.5 percent). The combined income tax rate is the corporate income tax plus remittance of profits-dividend tax. The second is Nicaragua with 67 percent, and the third is Venezuela with 60 percent. The average combined income tax rate for Latin America is about 50 percent.

IV. Transfer of Technology

I would like to make some comments on the transfer of technology. Mexico,[24] Argentina,[25] Brazil[26] and the Andean countries[27] have laws related to the transfer of technology by foreigners to local businesses. In each country there is a registry for the transfer of technology contracts. We can consider that Argentina has the least restrictive transfer of technology law. After the new law was enacted in Argentina in March 1981, only agreements between affiliates for the transfer of technology are subject to approval by the authorities.[28] Other contracts are registered with the authority for information purposes.[29] The only penalty in the absence of approval of a contract by the authority—case of affiliates—or lack of presentation for information purposes—case of third parties—is that the payment for the transfer of technology will not be accepted as a deduction for income tax purposes but such payment (to foreigners) will be permitted. However, the contracts will be considered valid from a legal point of view.[30] The situation is not the same with the other countries in which the contract, if not duly approved by the authority, will not be considered valid in the country.

Excluding Argentina, with its flexible transfer of technology law, the rest of the countries in Latin America with transfer of technology laws (Mexico, Brazil and the Andean Pact countries) do not allow the following restrictions in the transfer of technology contracts:

a. Grant-back clauses which require the licensee to give up innovations developed with the licensor's technology;

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[24]Law on the Registration of Transfer of Technology and Use and Exploitation of Patents and Trademarks, (DO), December 30, 1972.

[25]Transfer of Technology Law No. 22426 of March 12, 1981.

[26]Ato normative No. 15 of the Instituto Nacional da Propriedade Industrial of September 11, 1975.

[27]Decision 24, *supra* note 2.

[28]Transfer of Technology Law, *supra* note 25, article 2.

[29]*Id.*, article 3.

[30]*Id.*, article 9.

b. The licensee's efforts to export cannot be restricted if this adversely affects the national interests;
c. A licensee's research and development efforts cannot be restricted;
d. The foreign supplier cannot limit the licensee's production or set sales prices;
e. A licensee cannot be required to sign an exclusive sales or representation contract with the licensor;
f. A licensee cannot be required to submit contractual disputes to foreign courts;
g. A licensee cannot be required to buy equipment, tools, parts or raw materials only from a certain supplier.

The registration of transfer of technology contracts includes not only technical know-how, technical assistance and services related to the administration and operation of enterprises, but also agreements containing trademarks, licenses, and patent licenses. Another interesting aspect that is unique in the Mexican law is that trademark license agreements relating to the licensee's use of a foreign licensor's Mexican mark shall contain a clause to the effect that the licensee shall also use on its Mexican-made products a Mexican origin mark owned by the licensee. Without such a clause, the agreement cannot be registered.[31] However, the obligation to use a trademark of Mexican origin, together with a foreign one on articles produced in Mexico, has been suspended for the past four years.

One additional aspect worth noting concerns the payment of commissions by the licensee to the licensor for the use of technology or the payment of royalties for the use of trademarks and/or patents. In Mexico, the Registry for the Transfer of Technology generally does not authorize a payment in excess of 3 percent of the gross sales of the licensee. In Argentina, royalty payments for the use of trademarks are prohibited if the agreement is between affiliates[32] and in the Andean countries the payment of royalties for trademarks that are not used is also prohibited.[33] In Brazil, only payments up to 5 percent of the gross income of the licensee which is related to the transfer of technology contract or the products to which the trademark agreement refers are deductible for income tax purposes.[34] However, Brazil, as in the case of Argentina, prohibits the payment of royalties for the use of trademarks and patents when the agreement for their use is between affiliates.[35]

[31]Law on Inventions and Trademarks, (DO), February 10, 1976, article 128.
[32]Transfer of Technology Law, *supra* note 25, article 5.
[33]Decision 24, *supra* note 2, article 25.
[34]Law No. 4131, as amended, *supra* note 13, article 12.
[35]*Id.*, article 14.

V. New Tendencies for Patents and Trademarks

Even though we will not review the Patents and Trademarks Laws, we have to be aware of the new tendencies in Latin America concerning the registration and use of patents and trademarks. Many of these tendencies have been already incorporated in some legislations. As an example, Mexico[36] and the Andean countries[37] prohibit the grant of patents for inventions related to pharmaceutical products, medicines, foods and beverages for human or animal use, fertilizers, plaguicides, herbicides and fungicides. We also note a new tendency to require the actual use of patents during the license period. Otherwise, an obligatory non-exclusive license to use the patent may be authorized by the government if requested to do so by an interested party. The amount of royalties payable and other terms for such a license must be approved by the authorities. The patent will expire if a valid request for an obligatory license is not made during the fourth or fifth year of the patent's concession. That tendency is already contained in outstanding legislation such as that of Mexico[38] and the Andean countries.[39]

Concerning trademarks, the requirement of use as a condition for the renewal of the trademark at the end of the concession is a general tendency in Latin America. Also it is a tendency in countries within the framework of Common Markets to accept the use of a trademark in any one of the Common Market countries as evidence of use in the other countries in order to grant renewal rights. The tendency has been confirmed in the legislation of the Andean countries.[40]

VI. Retroactivity versus Non-Retroactivity in the Foreign Investment Laws

In Mexico's case, the requirement in the 1973 law for majority participation by Mexican capital does not apply retroactively to foreign investment made prior to the law's enactment. However, new investments, new business lines or capital increases by companies having done business even before 1973 are affected to that extent by "Mexicanization" requirements when made after 1973.[41] The phase-out process or transformation into national or mixed enterprises for foreign investment doing business in the Andean countries is only a condition to enjoy the benefits of the Cartagena Agreement. The advantages deriving from the duty-free program of the Cartagena Agreement shall be enjoyed only by products manufactured by national or mixed enterprises of the member countries, as well as by foreign enterprises which are in the process of being transformed into national or

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[36] Law on Inventions and Trademarks, *supra* note 31, article 10.

[37] Decision No. 85 of the Commission of the Cartagena Agreement dated June 5, 1974, article 5.

[38] Law on Inventions and Trademarks, *supra* note 31, article 48.

[39] Decision No. 85, *supra* note 37, article 34.

[40] *Id.*, article 70.

[41] Foreign Investment Commission. Resolution No. 16 of July 21, 1977.

mixed enterprises pursuant to Decision 24.[42] Whether those provisions of Decision 24 are retroactive or not has been a matter of long juridical debate. The discussions have had some practical effects. In order to avoid the obligation of transformation (phase-out) for foreign enterprises, some countries of the Andean Common Market have expressly reserved some sectors of the economy from the application of Decision 24.

In other words, although the general rule of the Mexican and the Andean legislations regarding foreign investment is that foreign participation should not control the majority of the capital or management of a corporate entity, the reality due to economic situations has presented these countries with the opportunity to allow greater participation by foreign capital. From a pragmatic viewpoint, the question of retroactivity or non-retroactivity of the above-mentioned laws is irrelevant due to the several exceptions to the provisions of the laws allowed by the government.

For the rest of the Latin American countries, we have not seen any significant legal provisions related to foreign investment that might be considered retroactive in detriment of the economic interest of the investment. The tendency of the countries in Latin America to request local participation in the capital or management of a corporation in new projects or economy activities has nothing to do with retroactivity. Furthermore, the experience has demonstrated that if the project is substantial and requires significant capital and technology, the governments are willing to waive the requirements of local participation in the project since the quid pro quo obtained by the countries from the foreign investor is much higher than the weight of any philosophical considerations or nationalistic tendencies.

VII. Final Considerations

If we were willing to accept what we said at the beginning, that Latin America will follow until the end of this century a political philosophy based on the principles of democracy and a pragmatic attitude favorable to foreign investment, due to the economic problems and needs of the region, there may be a great opportunity for some of my ideas, which I personally consider to be good guidelines for the treatment of foreign investment in future legislation, to become a reality. Some of these ideas have been mentioned earlier and, in fact, are a reality in one or two of the foreign investment laws in our region. The rest of the ideas are not utopia and can be incorporated in future laws. Such guidelines are:

A. Unrestricted guarantee for the foreign investor for the repatriation of capital and profits;
B. Unrestricted guarantee for a number of years that the income tax applicable to the foreign investor will be the tax in effect when the

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[42] Decision 24, *supra* note 2, article 27.

foreign investment was accepted and registered with the government;

C. Similar guarantee with regards to taxes on dividends or remittance of profits paid to foreign investors on investments registered with the government;
D. Similar guarantee for indirect taxes (sales tax, consumption tax, etc.) for raw materials and products and with regard to custom duties for raw materials and other products not available locally necessary for the production of articles related to the foreign investment;
E. No price controls for products manufactured by the foreign investor in question for a reasonable number of years;
F. No discrimination in any respect against the foreign investor.

It is obvious that there could be many other ideas, perhaps much better than the ones we mentioned. However, they would have to be compatible with the legal environment of the region in order to be acceptable by governments. We, as lawyers, have an important role to play in the legislative process of our respective countries. Consequently, we should not lose any important opportunity that our opinion be heard within the democratic process in order to achieve a reasonable legislation on foreign investment which may benefit the country, or the region involved and which—on the other hand—will be a recognition of the role and involvement of foreign investment in the years ahead.

Appendix

CORPORATE INCOME TAX
TAX ON DIVIDENDS/REMITTANCE OF PROFITS
COMBINED INCOME TAX

Country	Corporate Income Tax (M) = Maximum Rate	Tax on Dividends/ Remittance of Profits	Combined Rate
Argentina	33	17.50	44.725
Bolivia	30	30	51.00
Brazil	40	25	55.00
Chile	48.57	—	48.57
Colombia	40	20	52.00
Costa Rica	45 (M)	15	53.25
Ecuador	20	40	52.00
El Salvador	30 (M)	22	45.40
Guatemala	48 (M)	12.1	54.29
Honduras	40 (M)	15	49.00
Mexico	42 (M)	21	54.18
Nicaragua	40 (M)	45	67.00
Panama	50 (M)	10	55.00
Paraguay	30 (M)	10	37.00
Peru	55 (M)	30	68.50
Rep. Dominicana	38 (M)	—	38.00
Uruguay	25	—	25.00
Venezuela	50 (M)	20	60.00