Update on Changes in Peruvian Law

Year-old implementing regulations are causing changes; report discusses procedures and requirements, and tax aspects

BY JOSE BARREDA ZEGARRA*

Almost 12 years have lapsed since Decision 24 was approved by the Commission of the Andean Pact and incorporated into the national legislation of the member countries of the Andean Group. Two years have lapsed since a new civilian government took charge of office in Peru and almost one year has lapsed since new implementing regulations were adopted in respect to foreign investments and transfer of technology in this country. It appears to be time to review the treatment of agreements pertaining to transfer of technology, technical assistance, licensing of patents, trademarks and other industrial property elements, so as to determine whether the Peruvian approach is to be considered as a negative or positive approach.

Two basic regulations were enacted during 1981, which, in a way, confirm a new approach adopted by the government on treatment of the mentioned agreement. One is related to the procedure and formal requirements set by CONITE (National Commission for Investments and Foreign Technologies). The other is related to the tax regulations. Whether this new legislation constitutes an amendment of the original approach of the Peruvian Government is to be discussed in this article.

Decision 24 of the Andean Pact incorporated into the Peruvian Legislation by Decree Law No. 18900, establishes in Article 18 that all agreements related to importation of technology and to patents and trademarks must be examined and submitted for approval of the National Competent Organization entity which evaluates the effective contribution of the imported technology. It estimates the probable profits, the prices of the goods incorporating the technology or other specific forms of quantification of the effect of the imported technology.

Article 19 states that all agreements pertaining to importation of technology must contain, at least, clauses related to the identification of modality by which the technology is imported, contractual value of each of the elements involved, and term of validity of the agreement. Articles 20 and 25 list clauses which will not be accepted and will be considered as restrictive in agreements. Finally, Article 51 establishes that any agreement related to transfer of technology must be subjected to the Peruvian Legislation and that controversies must be submitted to the Peruvian courts.

The National Commission for Investments and Foreign Technologies passed on October 23, 1981, a regulation pertaining to the procedures to be followed for approval of license agreements as well as the terms of the agreements which must be approved by the government as a condition for validity. As opposed to Decision 24 and, in a certain way, extending the right of the government to analyze agreements, this resolution considers that all agreements related to transfer or licensing of technologies, patents, trademarks, or "other elements of industrial property of foreign origin" and to be performed in Peru, must be approved by CONITE. This general statement incorporates any agreement, contract, or related acts or compromises which consider the grant of technical knowledges through formulas, designs, manufacturing instructions, processing instructions, technical specifications, information on quality control, capacity of personnel, marketing and administrative assistance or any other modality to be considered as a provision or grant of technical knowledges; the right to use or to exploit commercial systems; the right to use or to exploit patents; the right to use or to exploit trademarks and the right to use or to exploit industrial models, industrial designs or other elements of industrial property.

Technical services, understanding those derived from sporadic services, or specific short-time service not constituting the provision of technical knowledge and to be paid by a fee independent of the volume of production or sales, are not subjected to the resolution of CONITE. Therefore, those agreements need not to be approved by the government so as to recognize their validity.

It is therefore, clear that almost all the agreements pertaining to elements of industrial property and transfer of technology are subjected to the resolution of CONITE and subjected to the approval prior to recognition of validity of the same by the parties and the government. As an exception, technical services in benefit of corporations located in Peru and not constituting a transfer of technical knowledge, will not be under the scope of the regulations, provided that it is paid by a flat fee and not by a percentage of volume of production or sales.

PROCEDURAL ASPECTS

All agreements signed by a foreign corporation and naming a local entity as licensee or franchisee, must be filed before CONITE for approval within 60 working

**Jose Barreda Zegarra, Lima, Peru; a related paper by Mr. Barreda Z. was published in the September 1980 issue of* Les Nouvelles.

days after the date of subscription of the agreement. In case the agreement is filed within such term and then approved by the government, the resolution will recognize validity starting from date of celebration. In case the agreement is deposited before CONITE for approval after the 60-day term has expired, the resolution to be issued by CONITE will recognize validity starting only from the date of filing.

The above-mentioned procedural aspect is also valid for amendments of existent agreements, provided the same have been recognized and approved by CONITE.

In case a party wishes to record a termination of the agreement, such decision of termination must be recorded before CONITE within 60 days after the termination date. Termination will be recognized by CONITE in accordance with the terms of the agreement. If the petition is filed after this period has lapsed, CONITE will recognize the termination starting from the date of resolution recognizing such termination.

All agreements to be deposited before the government must be in the Spanish language. If a different language has been used, an official translation into Spanish made by the Foreign Office or by a translator appointed by the Foreign Office, will be necessary. The petition to be filed before CONITE must be accompanied by certified copies of the trademark registrations, of the letter-patent or the registration of any other element of industrial property licensed, as well as certain economic information. This must be given in accordance with an annex to Resolution No. 005-81 approved by CONITE and which expressly deals with the type of technology to be licensed, or patents, or trademarks, economic information dealing with local purchase or importation of new materials, reinvestment programs, machinery to be used by the licensee, new labor posts to be opened as a consequence of the agreement, volume of production, sales and estimated profits.

CONITE will consider the following aspects in evaluating agreements:

1. Drafting of the agreements not violating Decision 24 of the Andean Pact and in accordance with the formal requirements of Resolution No. 005-81-EF.
2. Contractual conditions set forth in the agreement and comparison with contractual conditions which have been stated in similar cases by other parties.
3. Effects on technological development by the licensee, including aspects such as manufacturing processes, utilization of local-made goods or services.
4. Effects on balance of payments.
5. Contribution to the development plans of the government or of the Andean Region and effects on ecology.

In case the petition for approval is filed along with the documentation stated by CONITE, CONITE must issue a decision approving the agreement within 60 working days after filing. In case no decision is issued within this period, the agreement will be deemed as automatically approved and CONITE should thereafter issue a resolution formalizing this automatic approval. In case an objection is raised by CONITE to any of the terms of the agreement, or to the economic information filed, the 60-day term is suspended until the time the interested party complies with the requirement. Counting of the 60 days will resume from that point.

The Director General of CONITE is authorized to approve all agreements containing a provision for payment of a 5% royalty or less, provided that a disagregation has been made and a specific percentage has been allocated to trademarks, patents and technical assistance. But it does not necessarily mean that any agreement fixing a 5% royalty will be approved. However, it must be stated that no more than 1% is allowed for royalties of trademarks and that a local corporation, considered to be a subsidiary or an affiliate of the licensor, will not be allowed to pay any royalty whatsoever in accordance with Article 21 of Decision 24 of the Andean Pact.

Contracts providing for royalties in excess of 5% will have to be approved in respect of such excess of royalties, by the Board of Directors of CONITE. Even though there is an administrative provision which allows payment of an excess of 5%, this is not easy to obtain. A resolution approving that additional royalty will be passed whenever it is shown that exportations will take place—that as a consequence of manufacturing of local goods, importations will be diminished, or that new jobs will be created for Peruvian personnel. In our experience, however, the maximum to be approved would not easily exceed 6% and only provided that all three conditions as stated above, are met, and that in addition it can be shown that the technology involved can be easily absorbed by the licensee and will benefit the country because it meets the development of programs of the government.

SUBSTANTIVE ASPECTS

Although in practice it was widely understood that the agreements were only valid once the resolution approving the same was passed by CONITE, the government has for the first time expressly conditioned the recognition of validity of the agreement until the date the resolution approving the same is issued.

Article 12 states: "The agreement will only generate rights and obligations between the parties in the terms and conditions established by the resolution issued by CONITE. The agreements, its modifications and extensions not approved by CONITE, will not produce any legal effect between the parties or against third parties and, consequently, cannot be enforced before any authority for corporate, tax, exchange-control, or other matters and its performance cannot be claimed before the National Courts." A question arises whether the "confidentially" aspects are involved within the limitation and whether any of the parties can sue the other when a breach of confidentiality has happened before the date of issuance of the resolution by CONITE.

In accordance with local practice, the applications for approval, amendment, or renewal of the agreements are filed only by local enterprises, and CONITE will approve the petition filed only in case economic information is filed before it, in accordance with the present regulation. It can be very easy for the licensee, therefore, to delay as much as possible the issuance of a resolution approving the agreement if it is not in his best interest to obtain the approval.

In the meantime and based on confidence of the licensee, a licensor may give full information as established in the contract so to enable the licensee to start production. However, if the agreement is not approved and the licensee passes on information to third parties, the licensor will not be in a legal position to sue the licensee and demand payment of damages since the agreement cannot be validated before any authority in Peru. Even more, in accordance with Article 51 of Decision 24 of the Andean Pact, all contracts related to transfer of technology, patents, and trademarks must be necessarily submitted to Peruvian Courts and Peruvian Legislation. If the licensor sues the licensee in a court with seat in his place of domicile, the resolution passed by the particular court cannot be executed in Peru.

It appears to be clear, therefore, that the licensor should not give the licensee full information on manufacturing processes, techniques, and designs until the time the local authorities issue a resolution approving the terms of the agreement.

The question of confidentiality, however, has been treated in a different way when the agreement is terminated. Article 20c establishes that obligations imposed on the licensee demanding the maintenance of the information given in secret, even after the termination of the agreement, will not be considered a restrictive practice and will be enforceable in Peru.

As stated in Article 19 of Decision 24 of the Andean Pact and Article 16 of resolution No. 005-81-EFC, all agreements must have, at least, the following clauses:

1. Identification of the contracting parties, with indication of place of incorporation, domicile, and name of each of the representatives.
2. Identification of the contractual nature and full detail of products to be manufactured under the terms of the agreement.
3. Identification of the modalities adopted when entering the agreement, such as grant of technical information, process instructions, designs, technical information, quality control information, managerial administrative assistance, right to exploit commercial systems, patents, industrial models and designs or right to use trademarks.
4. Effects on balance of payments and generation of incomes (royalty payments, substitutes of importation and exportation).
5. Nature of technology to be transferred, when applicable.
6. Contractual value of the agreement, identifying a percentage of royalties, considered for trademarks, patents, or other elements of Industrial Property.
7. Term of the agreement.
8. Expressed submittance to Peruvian Courts and Legislation.

In accordance with the practice, contracts not containing the above-mentioned conditions will not be accepted in Peru, and the parties will be required to amend the agreement so as to include those provisions. In addition, and even if not mentioned in the contract, CONITE will understand that each of the contractual parties will have, at least, the following rights and obligations:

1. To verify that effective transfer of technology is passed on the licensee.
2. To secure that the price of such transfer is, at least, as favorable as that paid by the other licensees in similar circumstances.
3. For the licensee, to maintain in confidence the full technical information received during the validity of the agreement, and to maintain the same in confidentially even after the termination of the agreement, unless the same is in the public domain or a consent of the licensor to divulge the information is given.
4. To provide full information needed for the execution of the obligations of the licensee.
5. To pay the royalty in the amounts, time, and conditions stated in the agreements.
6. To withhold the income taxes and to pay them to the government in due time.

Every license agreement considering a royalty-payment has to be approved by the government and the right of the licensor to demand payment will derive from the date on which the resolution of CONITE is issued, unless the resolution provides for a different date.

For the purpose of the law, royalty is any payment in cash or in values originated from services listed in Article 2 of the Resolution, independent of the way it has been calculated or fixed.

Consequently, lump-sums paid monthly, quarterly, biannually, or annually will also be considered as royalties and, therefore, will be subjected to the tax provisions stated for royalties, which are different from the tax stipulated by the government for technical services rendered abroad.

RESTRICTIVE PRACTICES

Since the adoption of Decision 24 of the Andean Pact, our government has been consistently enforcing clauses 20 and 25 of Decision 24, which list restrictive practices in patent and trademark licensing, know-how, and transfer of technical agreements. In addition, other clauses have been considered as restrictive, even though not expressly cited in ANCOM'S. Examples are clauses which oblige a licensee to pay minimum royalties or to expend minimum amounts in advertisement, or an amount equal to percentage of net sales.

Article 19 and 20 of Resolution 005 list the same restrictive clauses cited in Decision 24, but issues, at the same time, implementing regulations to a provision cited in Articles 20 and 25 stating that "other clauses with equivalent effect will also be considered as restrictive practices." From November 23, 1981, CONITE can only stipulate that such clauses with equivalent effect are those expressly cited in Article 20 of the Resolution. They are as follows:

1. Obligation imposed on the licensee to pay minimum royalties.
2. Restriction imposed to personnel of the licensee to carry out or to have access to the productive process or quality-control procedures.
3. Obligation imposed to the licensee exceeding the term of the agreement, except those related to confidentiality.
4. To hold licensee as the only responsible party of the effects of the technology, patents, or trademarks

licensed.

5. To force the licensee to purchase capital goods and raw material from a specific source, unless the licensor commits himself to sell at the price of the international market or less.

Finally, the government has reaffirmed: agreements related to quality control entered by the same parties to a license agreement, must form a part of the latter and will not generate a right for payment of royalties; intangible technological contributions cannot be computed as capital investment; and local subsidiaries cannot pay royalties to its principals or affiliates and those made will not be considered as tax-deductible.

In respect to the tax aspects, the government passed Decree 200 during 1981. It came into effect on January 1, 1982. The original text of the decree established that royalties payable to a foreign entity for the licensing of industrial property elements will be subjected to 25% tax to be withheld by the licensee at the time the application for remittance was made. Shortly before the coming into effect of this regulation, the 25% tax was increased to 55%, which is about the average being paid under the old tax system. No tax is charged on remittance.

For the purpose of the law, a royalty is considered to be any payment made in cash or in goods, to be made as a consequence of the use or exploitation of patents, trademarks, industrial models and designs, process, secret formulas and copyright, including the payment for any technical assistance given in the industrial, scientific or commercial activity.

As opposed to the original legislation, which considered a royalty an amount paid on basis of a certain percentage over sale or value of production or cost of production, the new legislation considers that royalty is any such payment made under any system and provided it corresponds to the use or exploitation of industrial property elements or copyrights or for technical assistance in any activity.

The beneficiary of royalty may deduct 10% of the income, until it covers the expenses incurred in the country for acquisition or registration of the goods being licensed. In case the beneficiary is not domiciled in Peru and provided it shows that they develop activities of research and development destinated to goods (tangible or intangible) which can be licensed and produce royalties, and additional 5% of the gross income can be deducted for tax purposes. Consequently, the 55% tax can be, at best, applied to 85% of the income which equals to an effective tax of 46.75%.