# *Colombian Tax Reform Unveiled*

October, 2016

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# Background

1. As recently as October 19th, 2016 the Government released the set of draft tax rules which Congress will now consider.

2. The Government's expectation is that the tax bill be passed before year end. Changes are expected as the legislative debate unfolds.

3. No tax amnesties are included.

4. Some of the BEPS' actions are considered for adoption.

5. Draft rules to impact direct, indirect and other forms of taxation.

6. Transition of IFRS to tax accelerates

7. Grandfather rules

8. Net wealth tax continues to be set to expire in 2017 (2018 for individuals)

# Dividend Tax

✓ 10% for non-residents whether paid out of taxed or untaxed profits (except where treaty relief available).

35% for non-residents if paid out of untaxed profits (except where treaty relief is available).

Grandfather rule: Dividend tax only to apply to profits obtained beginning 2017.

✓ 5% or 10% (subject to amount) for resident individuals if paid out taxed profits. Otherwise, 35%.

# Direct Taxation

**CREE tax to disappear by the end of 2016.**

| | Taxpayer | Rate | Additional Rate* | Year |
|---|---|---|---|---|
| **Income tax** | **Resident** | **34%** | **5%** | **2017** |
| | | **33%** | **3%** | **2018** |
| | | **32%** | | **2019 and on** |
| | **Free Trade Zone** | **24%** | | **2017** |
| | | **23%** | | **2018** |
| | | **22%** | | **2019 and on** |
| | **Non residents** | **34%** | **5%** | **2017** |
| | | **33%** | **3%** | **2018** |
| | | **32%** | | **2019 and on** |
| **Capital gains** | **All** | **10%** | | |

*** Subject to taxable income being in excess of**

# Direct Taxation (continued)

- Tax loss carry forward to limit to 8 years (no grandfathering).

  Statute of limitations to run for 8 years (up from 5) for returns where losses are used or incurred. Additional 3-year SoL if loss used in the last two years. Standard SoL to run for three years (up from 2 years).

- Non-residents' withholding taxes (except where treaty relief is available):
  - to reduce to 15% (down from 33%) for royalties, rentals, fees, etc.
  - To grow to 15% (up from 10%) for technical services , consulting and technical assistance) as well as interest for cross-border debt with maturity for 1 year or longer.
  - to grow to 15% (up from 0% down from 33%) for management services, deductibility now more likely to proceed.

- Contracts registration with Tax Authority required within three months following execution (applicable for import of technology-like contracts).

- Royalties recognized to non-resident (or Free Trade Zone-located) related parties are not deductible if connected with an intangible created locally.

# Direct Taxation (continued)

- Tax haven rules replaced by low or non-taxable jurisdictions and preferential tax regimes. Withholding tax to apply to the extent of domestic source income and deductibility subject to demanding requirements including substance.

  Disallowance of deductions incurred with parties located or resident of low or non-taxable jurisdictions and preferential tax regimes if effective beneficiary is the same local taxpayer recognizing the expense.

- Disclosure required to identify effective beneficiaries of subsidiaries, permanent establishments and other forms of presence of non-residents.

- IFRS to be used for tax purposes and transition rules are proposed to regulate tax recognition of revenue, costs and expenses until realization takes place. Timing differences and deferred tax recognition are set to apply to reconcile IFRS to tax.

  VAT paid on the purchase/import of capital assets to be deductible from income tax.

# Direct Taxation (continued)

- Depreciation expenses to be subject to annual caps. Useful lives to be driven by the asset's circumstances.
- Amortization of investments subject to an annual cap of 20%. Deferred taxes to be recognized due to timing differences.
- Presumptive taxable base to be measured as 4% (up from 3%) of the taxpayer's net equity as of the end of the prior year.
- Entertainment expenses to be deductible subject to a cap of 1% of the taxpayer's taxable revenue. Employment expenses from litigation to be deductible when incurred provided requirements for salary deductions are met.
- Deductibility of costs and expenses for current year can be supported by invoices with a date of a subsequent year, provided they transaction is demonstrated to relate to the current year.
- Donations and charitable expenses to be credited against tax instead of deductible.

# Direct Taxation (continued)

Controlled Foreign Corporation ("CFC") rules introduced to apply to:

- Resident entities or individuals.
- Holding, directly or indirectly, 10% or more of CFC's capital or CFC's results.
- Control is presumed to exist when CFC is a resident in a low or non-taxable jurisdiction or is subject to a preferential tax regime.
- A CFC exists if any of the following is present:

  - CFC is controlled by a resident taxpayer,
  - CFC is a related party for transfer pricing purposes.
  - CFC is not a tax resident in Colombia.

- CFC's include companies, trusts, funds, private foundations, whether transparent or recognized as legal persons.

- Only passive income is in scope, such as dividends, unless related to active income, interests, unless the CFC is a financial institution and is not resident in a low or non-taxable or preferential tax regime jurisdiction.

- Passive income also includes royalties, assignment of rights, proceeds from sale or rentals of real estate.

# Direct Taxation (continued)

Controlled Foreign Corporation ("CFC") rules include:

- CFC's passive income, costs and expenses are to be recognized by the resident taxpayer when realized.

- Foreign tax credit will be available subject to Section 254 limitations.

- Subsequent distributions of CFC's income in the form of dividends will not be taxable. Gains on the sale of CFC may be untaxed to the extent related to profits subject to CFC recognition by resident taxpayer.

# Extractive Industries

- Items to capitalize in Evaluation and Exploration include seismic, acquisition  costs, drilling, etc. Capitalization to cease once commerciality or decision to develop made pursuant to the contract terms.

  Amortization to follow technical operating units on the basis of proved reserves.

  Grandfather provision for un-depleted investments through the end of 2016 which are to deplete over 5 years under straight line.

  Unsuccessful investments eligible for write-off in the year of occurrence or two years thereafter at maximum.

  Investments in Development and Production are to be treated for tax purposes under the standard rules.

- For end of production, depletion of balances to proceed in the year of determination or two years thereafter at maximum.

- VAT to apply to the sale of intangibles may potentially apply to sale of interests, farm-outs and the like (Fixed asset rule survives and may prevent taxation).

# Grandfather rules

Earnings obtained through the end of 2016 not subject to dividend tax.

Un-depleted investments as of the end of 2016 to be generally deductible over 5 years under straight line.

Depreciation balances to proceed based on the assets life and the applicable rules.

CREE's tax receivables through the end of 2016 refundable upon request or eligible for carry forward into income tax.

Goodwill yet to amortize through the end of 2016 to be deductible over 5 years under straight line.

Un-depleted investments as of the end of 2016 to be generally over 5 years under straight line over the concession contract's remaining life.

# Disclosures & GAAR

Effective beneficiary disclosures required for resident entities which are subsidiaries of resident or non-resident entities. Effective control, minimum shareholding and other are considered for application.

Aggressive tax planning strategies are eligible for disclosure by the taxpayers and advisors.

GAAR rules reformed to facilitate enforcement. Absence of business purpose to drive GAAR. Simplified procedure to render assessments to re-characterized abusive transactions is introduced.

# Miscellaneous

- City industry and trade taxes to be file for on a single tax form nationwide. Guidance introduced to facilitate determination of taxing city for supply of services and distribution of goods.

- Public lighting tax re-introduced following Constitutional Court's ruling

  Penalty framework relaxed to reduce costs subject to taxpayers' behaviors and background.

  Cash payments to vendors to be disallowed over a 4-year phase in rule.

  Carbon tax to apply to fossil fuels including petroleum derivatives. Deductible from income tax. Specific form of taxation based on carbon emissions.

- Sugar tax is introduced based on a specific form of levy.

  Banking tax (GMF), currently set to phase out, is to survive going forward.

- For cash taxes, authority is given to the Government to replace the withholding tax system for a profit-based estimated payments program.

# VAT

- General rate to rise to 19% (up from 16%). Certain supplies of tangibles and services to be taxed at 5%.
- Triggering event to include the sale of intangibles.

  Import of services rules expanded to be in scope, including digital-based services.
- Annual filing frequency to disappear. Frequency every two and four months to survive.

  Input VAT to be creditable over 4 or 6 months subject to applicable filing frequency.