INTERNATIONAL BAR ASSOCIATION

COLOMBIA GENERAL REPORT

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1. Summary

At the end of 2018, the Colombian Congress enacted Law 1943 of 2018 ("Financing Law") which became effective as of taxable year 2019. It introduced tax changes in order to increase tax collection to make up the government's budget deficit while increasing Colombia´s competitiveness. Consequently, corporate income tax rate decreased as individuals tax income rates and dividend tax rate increased. Incentives for certain investments and special anti-abuse rules were adopted along with modifications to international taxation provisions.

2. Income and Equity Tax

a. *Income tax rate*

By means of Financing Law, corporate income tax rate for 2019 is 33% but will be reduced by 1% each year until it reaches 30% in 2020. Correspondingly, the tax base to determine the alternative minimum income tax was reduced from 3.5% in 2018 down to 1.5% in 2019 and it will reach 0% in 2021. On the other hand, individual's maximum marginal income tax rate increased from 33% up to 39%.

However, Financing Law provided preferential income tax rates for certain industries and investments. Hotels built within the following 4 years will be taxed at a rate of 9% during the following 10 years. Furthermore, taxpayers that undertake mega investments – higher than USD 305,000,000 approx. - will be taxed at a 27% rate. Mega investors can also enter into stability contract with the Colombian government, in order to ensure the benefit for 20 years.

On the other hand, financial entities will be subject to a corporate income tax rate of 37%.

b. *Dividends tax*

Financing Law increased dividends tax rate when they are distributed to Colombian tax residents, non-Colombian tax residents and foreign entities. Additionally, as from 2019, dividends distributed among Colombian entities will be subject to a 7.5% withholding tax, which can be credited by the ultimate beneficial owner or the foreign investor.

As from taxable year 2019, dividends distributed to Colombian tax residents, which were taxed at a corporate level, are now subject to a 15%, when the amount distributed is greater than USD 3,000 approx. Furthermore, dividends distributed by a Colombian company to its foreign shareholders are subject to a withholding tax of

7.5%. Before fiscal year 2019, the maximum tax rate for dividends distributed to individuals was 10% and for foreigners was 5%.

On the other hand, dividends out of profits that were not taxed at the corporate level will be taxed at a combined effective tax rate of 38.025% in 2019.

It is important to bear in mind that dividends out of profits generated before fiscal year 2017 can be distributed as exempt income as long as they were taxed at the corporate level.

c. *Equity tax*

In order to increase tax collection, Financing Law introduced the equity tax for individuals that at January 1 of 2019 had a net equity greater than USD 1,667,000 approx. The equity tax rate is 1% and it will apply for fiscal years 2019, 2020 and 2021.

This tax also applies to foreign entities who own assets in Colombia different than assets, receivable accounts and portfolio investment worth more than USD 1.667.000 approx.

d. *Thin capitalization rule*

Financing Law modified the thin capitalization rule. Before fiscal year 2019, thin capitalization rule applied to every kind of indebtedness. With the modifications of Financing Law, the thin capitalization rule will only apply to indebtedness with related companies in a more stringent manner. The 3:1 equity-debt ratio in order to be able to deduct interest was reduce to 2:1; therefore, interests from debts that surpasses such ratio cannot be deducted for tax purposes.

In this sense, as from 2019 tax deductibility of interest, derived from indebtedness with unrelated parties, will not be limited by the thin capitalization rule.

3. International taxation

a. *Indirect sale of assets located in Colombia*

A new triggering event of the Colombian capital gain tax was included by Financing Law. As from fiscal year 2019, the indirect sale of assets located in Colombia will be taxed in Colombia as if they have been sold directly in Colombia. Therefore, the gain out of the indirect sale will be subject to a 10% or 33% rate depending on the holding period. In this sense, the sale of shares in foreign companies or entities will be taxed in Colombia when they own assets located in Colombia.

However, such tax will not be triggered if: (i) the shares are listed in a recognized stock exchange market, have a high liquidity and the ultimate beneficial owner does not hold more than 20% of them; or (ii) the fair market value and the basis in books of the assets located in Colombia represent less than 20% of the total assets of the foreign entity.

b. *Colombian Holding Company Regime.*

Financing Law included the Colombian Holding Company Regime, which will grant certain tax benefits to national companies with investments abroad, as well to its shareholders.

National companies qualified as Colombian Holding Company ("CHC") by the Colombian Tax Authority will have the following two major benefits: (i) items of income derived from dividends or sale of shares in foreign companies or investments will be exempt from income tax; and (ii) dividends distributed by CHC to non-Colombian tax residents or foreign entities will be deemed as foreign sourced income.

c. *Taxation of permanent establishments.*

In its first year as a member of the OECD, Colombia adopted through Financing Law the recommendation of the multilateral organism, to tax permanent establishments in Colombia for the worldwide income than can be attributable to them. Before Financing Law, only Colombian sourced income attributed to the permanent establishment was taxed.

d. *Withholding tax on outbound payments.*

Financing Law increased several withholdings tax rates for outbound payments. Some examples are payments for fees, royalties, personal services, consultancy, technical services and technical assistance that rose from 15% up to 20%. Payments made to parent companies, located abroad, for management or administration fees are now subject to a withholding tax rate of 33%.

The only withholding tax rate for outbound payments that decreased with Financing Law was the one regarding licensing of software. Now, such outbound payments are subject to a withholding tax of 20%, before they were subject to a 26.5%.

4. Tax abuse

a. *Criminal tax regime*

Non-compliance with tax regulations is starting to have criminal consequences in Colombia. Financing Law introduced two different conducts characterized as crimes: (i) undisclosed assets, undervalued assets or non-existent liabilities; and (ii) tax fraud.

The first crime modified by Financing Law states that taxpayers that do not disclose their assets, register them with a lower tax basis or register non-existent liabilities for a value greater than USD 1,183,000 will face prison for a period between 48 and 108 months, plus a fine of 20% of the value of the undisclosed asset or non-existent liability. Such fine could be increased in 50% if the value of the undisclosed asset or non-existent liability is higher than USD 2,012,300.

The second crime included by Financing Law established that a taxpayer can be subject to criminal sanctions when he/she fails to comply with the filing of his/her tax returns, includes non-existent costs or expenses or credits non-applicable tax credits or withholding tax. Under such scenario the taxpayer will face between 36 to 50 months of prison and be subject to a fine of 20% the tax fraud.

b. *Disclosure program for 2019*

Financing Law introduced a new disclosure program for taxpayers with undisclosed asset or non-existent liabilities at January 1st, 2019. According to Financing Law, such taxpayers will be in compliance if they report the undisclosed assets on the 25th of September, 2019 and pay a tax equal to 13% of the non-existent liability or the undisclosed asset. This means that criminal action will not be undertaken nor other fine will be applicable.

Additionally, if the undisclosed asset is located abroad, and the tax payer invests it in Colombia for more than two years, the taxable base of the tax will be reduced by 50%. Consequently, the effective tax rate will be as of 6.5%.

c. *Rules for the determination of price for services and goods*

Before 2019, for tax purposes goods had to be sold according to their fair market value. Pursuant to Financing Law, the price of services has to be determined at its fair market value, as well.

In the case of real state, the price paid shall be wire-transferred through the financial system, in order to be recognized as tax basis for income tax purposes. For tax purposes, the price for shares of Colombian companies that are not listed in a stock exchange market will be presumed to be 130% of its intrinsic value. This is a presumption than can be override with a technical appraisal.

5. Indirect taxes

a. VAT as a tax credit when payed for fixed assets.

As a way to increase the competitiveness of Colombian industries, Financing Law allowed taxpayers to offset as tax credit -for income tax purposes- the VAT paid for fixed assets. The VAT eligible as a tax credit is the one paid in the acquisition, import, formation or construction of fixed assets, including the VAT paid for rendered services. Such tax credit might be offset as a tax credit in any of the following taxable years.

b. Consumption tax for real state

Financing Law abolished VAT on the sale of real state. Nevertheless, it created an indirect tax with a rate to 2 % when the value of real estate transferred is greater than USD 280,000 approx. Nonetheless, social housing projects, as well as rural properties used for agricultural activities are excluded from such tax.