Colombia

International Estate Planning Guide

[IBA Private Client Tax Committee]

Contact:
Monica Reyes
Reyes Abogados Asociados, Bogota
mreyes@reyesaa.com

Updated 04/2021 with amendments by law 2010, 2019

I. Wills and disability planning documents

A. Will formalities and enforceability of foreign wills

In Colombia, a testament is a solemn act that must comply with the formal requirements established by civil law in order to be valid and binding.

A will, like any other legal act, must fulfil the essential requirements for validity, which are that the testator has legal capacity to grant the will, that his or her consent is not impaired by vices such as error, duress or fraud, and that the act has a lawful purpose and cause.

Depending on the type of will, the law has established certain specific formalities for its validity.

Under Colombian legislation, wills are classified as solemn or privileged. In turn, solemn wills may be open or sealed and privileged wills are classified as verbal, military or maritime wills.

A solemn will must always be recorded in writing and executed before competent witnesses. At least two of the witnesses must be domiciled at the place where the will is granted and they must be able to read and write.

In an open will, also known as a nuncupative or public will, the testator makes his or her dispositions public before three witnesses and a notary, when the latter is present. The witnesses must copy the words of the testator verbatim and, at the end of the proceeding, read and sign the will. In a sealed will, on the other hand, the witnesses and notary are not required to know the content of the dispositions contained in the will. However, the sealed deed must be presented before a notary and five witnesses, declaring *viva voce* that the deed contains the will.

Privileged wills, however, may omit some of the formalities by reason of specific circumstances expressly determined by law.[1] Nevertheless, a privileged will must meet three requirements: (1) the *viva voce* statement of the testator regarding his or her desire to make a will, which must be unequivocally declared; (2) that the persons whose presence is necessary in the granting of the will be before the testator; and (3) that the act be continuous, in such a way that it may be only interrupted exceptionally for brief intervals, when required by reason of an accident. The validity of this type of will is provisional and, therefore, once the exceptional situation is overcome, the requirements of a solemn will must be complied with.[2]

In relation to the content of a will, the law provides that it must indicate the full name, place of birth, nationality, domicile and age of the testator, as well as the circumstance of being of sound mind and the names of the testator's spouse and children, together with the information on each of the witnesses and the notary, indicating the place, day, month and year of execution of the will. Errors in content do not imply the nullity of the testament, provided there is no uncertainty regarding the identity of the testator, notary or witnesses.

The allocations to be made must be determined or determinable, underlining the fact that the will of the testator is limited by the forced allocations established by Colombian law. These allocations are mandatory for the testator, and therefore, even contradicting what is expressly provided in the will, they will be observed when they have not been applied.

Forced allocations include alimony due by law to certain persons; the marital share, that is, the portion of the assets of the decedent that the law assigns to the surviving spouse who lacks the necessary means for a decent subsistence and the legitimes, which are the compulsory portions assigned to certain persons known as legatees.[3]

Law 1934, 2018 excluded the quarter portion of the estate for accretions to the inheritance of the legitimate heirs, which was compulsory prior to 2 August 2018.

In accordance with the above, only as of the third order of inheritance, that is, if no descendants or ascendants survive the testator, may he or she dispose freely of the entire estate. Otherwise, the testator may make allocations at discretion on a percentage equalling 50 per cent of his or her assets.

On the other hand, the validity of wills granted abroad is subject to these having been made in compliance with the laws of the state where they were executed, leaving evidence thereof, proof of their authenticity and their legal translation, where applicable.

If the will is granted abroad in compliance with Colombian regulations, the following requirements must be met for its validity: (1) that the testator is a Colombian national, or a foreigner domiciled in Colombia; (2) that the will is authorised before a Colombian consulate; (3) that the witnesses are Colombians or foreigners domiciled in the city where the will is executed; and (4) that the rules of a solemn will are observed**.**

B. Will substitutes (revocable trust or entities)

It is important to point out that while the Colombian law does not contemplate the common law trust, there is an institution with similar characteristics, known as a civil law trust or *fiduciae*.

The establishment of a civil law trust implies the imposition of an encumbrance on all or part of the estate of the trustor. When this ownership is retained by the trustor or is transferred to another person, it is done on condition that it will be passed on to a third party upon the occurrence of a specific event.

As a substitute for the testament, the use of a civil trust is useful to transfer the assets of a future *de cujus*, through the designation of the spouse and other heirs as beneficiaries of the trust, once a condition is met, which in this specific case is the death of the trustor.

Therefore, a civil trust involves three parties: the trustor, the trustee and the beneficiary or beneficiaries. The trustor is the person who delivers the assets by way of a trust to the trustee; the trustee is the person to whom the property is entrusted until the condition is fulfilled, with the charge of transferring it to the beneficiary; and the beneficiary is the person in whose favour the restitution is to be made once the condition is fulfilled.

The trustee holds the full right of ownership and usufruct of the assets for the duration of the trust, except as otherwise stipulated, bearing in mind that the trust ownership may be established on the bare title, reserving the proceeds for the beneficiaries. When the person dies, the ownership of his or her assets passes to the beneficiaries in the proportion established in the document constituting the trust ownership, without the need of a probate hearing.

From a tax point of view, this mechanism is taxable, given that if the trust is gratuitous, at the time of occurrence of the condition, in every case, it generates a taxable occasional gain for the beneficiary.

On the other hand, even if they do not constitute will substitutes as such, in order to minimise the tax burden at the time of the succession and as an instrument for administration of the estate of the decedent during his or her lifetime and after his or her death, certain corporate schemes may be used both in Colombia and abroad, through corporate forms contemplated in Colombian law, such as limited partnerships and simplified stock companies (sociedad por acciones simplificada or SAS).

The establishment of a limited partnership allows the testator to have control of the company, in the form of an administrating or managing partner, and to structure the assignment of his or her assets with new capitalisations, through which the heirs will gradually increase their rights or shares in the capital of the company.

Likewise, SAS have a flexible and dynamic regulatory framework in which the autonomy of the shareholders prevails. This corporate form enables the establishment of types of shares that assign the control of the company to one of the shareholders, through multiple votes or fractioning of votes stipulations for the election of boards of directors or other collegiate bodies of the company. In addition, SAS offer the possibility of establishing minimum or maximum amounts of corporate capital which may be controlled by a specific shareholder and special restrictions for the negotiation of the shares issued by the company.

The implementation of foreign companies also allows a testator to manage his wealth in the jurisdiction he considers most favourable for tax and corporate purposes. The transfer of funds abroad in order to make investments in assets is permitted in the country, provided that the funds allocated for such purposes are channelled through the exchange market.

As in the case of Colombian companies, these offshore schemes allow the transfer to the beneficiaries of the title to the assets that represent the estate of the testator, retaining the power to manage the estate, and to receive the profits thereof until his or her death.

C. Powers of attorney, directives and similar disability documents

Under Colombian civil law, all persons have legal capacity to acquire rights and contract obligations, except for those who the law declares disable, that is those who, despite their status as legally capable persons, cannot govern themselves or manage their affairs.[4] These persons must act through a representative.

Legal disabilities have been established in order to protect the interests of certain persons who, for one reason or another, do not have full discernment or lack the necessary experience to be able to express their will, acquire rights and bind themselves in a sufficiently clear manner and therefore are disqualified to execute legal acts.

Disabilities may be general or specific. General disabilities refer to all types of legal transactions, while specific disabilities only refer to certain acts and are expressly stipulated by the law. In accordance with the Civil Code, said general disabilities may in turn be absolute or relative. Thus, individuals with absolute mental disability,[5] children who have not reached puberty and deaf-dumb individuals who cannot make themselves understood, are considered to be absolutely disabilities and their acts are subject to absolute nullity; on the other hand, adult minors and squanderers who are under judicial interdiction are considered to be relatively incapable, given that their acts may be admissible under certain circumstances and in certain specific cases determined by law. This disability results in relative nullity.

In order to protect the interests of disabled persons, the law has created guardianships, which include tutorships and curatorships. A tutorship is exercised over children who have not reached puberty and is always of a general nature, while a curatorship may be general or special. The latter refers to a specific act or a particular transaction.

On the other hand, Law 1306 of 2009 provided that when the value of the productive assets of an individual with absolute mental disability or of a minor, exceed 500 legal monthly minimum wages, or even if these do not exceed 500 legal monthly minimum

wages but the judge deems it necessary, the administration of the assets will be turned over to a trustee.

Likewise, Law 1306 of 2009 created the measure of disability for persons suffering from behavioural deficiencies, prodigality or business immaturity, and who, as a consequence thereof, may place their wealth at serious risk. These individuals may be disqualified to enter into certain legal transactions, at the request of their spouse, relatives up to the third degree of consanguinity and even by the individual himself. This may also be imposed as an accessory measure at the request of creditors or *ex officio* by the judge, in estate liquidation proceedings and in cases of payment through the assignment of the assets of individuals.

II. Estate administration

A. Overview of administration procedures

In Colombia, a succession may be testate, intestate or mixed, that is, it may be governed on the one hand by testamentary dispositions and in all matters not provided for by the decedent, by civil law.

When the testator dies, an unsettled succession arises and its settlement may be carried out through a judicial proceeding or be processed before a notary public. An unsettled succession only disappears from the legal world when the judgment approving the partition or the public deed is executed, or when it is recorded, in the case of the allocation of real properties.

The following persons may take part in the probate proceedings:[6]

- the surviving spouse or domestic partner for purposes of the liquidation of the community property or community estate;
- the heirs in matters related to inheritance rights;
- legatees for a testamentary disposition in their favour;
- assignees of the inheritance right;
- creditors, who may come forward until the inventory and appraisal hearing, as their legal interest to become a party is exhausted upon its occurrence;
- an executor, who is not entitled to a portion of the inheritance; his legitimation to intervene derives from his capacity as executor of the will by the testator;
- the National Tax and Customs' Authority (Dirección de Impuestos y Aduanas Nacionales or DIAN) will intervene in the proceedings when the amount of the assets exceeds 700 UVT,[7] that is COP 25,416,000 (approximately $6,947.64) for the year 2021.

Considering the existence by law of forced allocations that limit the will of the testator, both in testate and in intestate and mixed successions, the estate (determined after the liquidation of the community property, if any), is reduced by these allocations. Therefore, hereditary credits, any taxes that may be incurred, allocations for support and the marital share are deducted from the decedent's estate. The result is the net estate available for partition, which must be made completed subject to the legitimes.

Generally, the stages of the succession proceedings are the following:

1. An order is issued declaring the liquidation proceedings open and recognising the parties interested therein. Notwithstanding the order, there may be future recognitions.[8]

2. The request for acceptance of the inheritance is formalised. It seeks to generate an act of acceptance or renunciation by the heir. At this stage, the spouse may opt for the conjugal share or for the property acquired during the marriage, as explained in the section on marital property below.
3. Inventory and appraisal of assets and liabilities: This stage may be lengthy, considering that objections to appraisals by the intervening parties are permitted.
4. Partition: Once the assets of the decedent have been cleared, a partition takes place, through which the distributions corresponding to each heir are made, in accordance with the will or the law. The executor may be designated by the parties by joint agreement, by the judge or by the testator him or herself, when there is a will. The judge must validate the partition and, if appropriate, issue a judgment approving it.

In case there is a single heir, the inheritance will be allotted to him or her. This allotment substitutes the partition.

If after the succession proceedings have been concluded, new assets of the testator which were not included in the inventory, or new assets of the community property or estate, are found, or when the executor failed to distribute certain inventoried assets, there may be an additional partition if there are several interested legatees. In this act discussion may arise regarding the existence of persons with equal or better rights who did not come forward in the succession proceeding. In that case, they must file an action to claim their inheritance right against whoever holds it, through a proceeding known as a demand for probate of the decedent's estate.

The other procedure for the liquidation of the succession, that is, the processing of the liquidation before a notary public, may be carried out in all cases, provided the heirs, legatees, surviving spouse or assignees thereof, are fully capable and act by joint agreement.

B. Intestate succession and forced heirship

In those cases where there is no testament, or if there is a will, when it is invalid, there is an intestate succession, in which the assets of the decedent are allocated to the persons whom the law has established as holders of the right to inherit in the order prescribed by civil law.

As previously mentioned, Colombian law establishes forced heirship in relation to alimony support, the marital share and the legitimes. The law establishes the legatees, that is, the descendants, or if there are none, the ascendants of the deceased, as forced heirs.

The legatees are entitled to 50 per cent of the decedent's estate.

The order of succession is made up by the descendants in the first place, the ascendants in second place, third the siblings followed by their children, the surviving spouse in the fifth place and finally, in the absence of all of the foregoing, the state, through the Colombian Family Welfare Institute (Instituto Colombiano de Bienestar Familiar or ICBF).

C. Marital property

In Colombia, there is a community property system. This community property exists from the moment of the marriage or declaration of domestic community,[9] and is dissolved by reason of death, divorce and/or mutual agreement. However, as long as there is a legal tie, the community property is not visible, in such a way that the civil, commercial and tax obligations of the spouses operate individually.

As provided in Article 1781 of the Civil Code, the assets of the community property include the salaries and emoluments of every nature arising from office or employment, obtained during the marriage by each of the spouses, as well as all proceeds, yields, pensions, interest and profits of any kind derived either from the community property or from the assets belonging to each of the spouses and which are earned during the marriage.

In addition to the foregoing, the community property includes:

- the money that either spouse or domestic partner brings to the marriage, or is acquired during it, and which must be restored in the same amount from the community property;
- the fungible goods or movable property that either spouse or domestic partner brings to the marriage, or are acquired during it, and that must be restored from the community property according to the value they had at the time of their contribution or acquisition; and
- all assets which either spouse or domestic partner acquires during the marriage for valuable consideration.

The assets acquired before the marriage or domestic partnership, and those subsequently received by donation, inheritance or legacy, do not become part of the community property and are deemed to belong to each of the spouses or domestic partners. However, the proceeds, income, profits or value increases produced by these assets during the marriage or domestic partnership are part of the community property.

On the other hand, the liabilities of the community property include the external liabilities, consisting of the obligations chargeable to the unsettled estate and in favour of third parties, and the internal liabilities, which in turn consist of the obligations chargeable to the unsettled estate for the benefit of the spouses.

The spouses may exclude any assets that are part of their own wealth from the community property, by establishing specific provisions in the marriage articles (prenuptial agreements).

Likewise, the community property may be liquidated without affecting the marital relationship or domestic partnership, by partitioning the assets as the parties may decide by mutual agreement. Third parties, who do not intervene in this process, are protected through the establishment of the joint and several liability of the spouses and domestic partners, with respect to obligations vis-à-vis third parties

Upon the death of one of the spouses or domestic partners, if there is community property, the surviving spouse may decide whether to participate in the succession proceedings as spouse or heir. The decision must be communicated before the inventory and appraisal stage, indicating whether he or she opts for a portion of the decedent's estate as legatee or for the marital property. If he or she opts for the marital share, the unsettled assets of the inheritance and the community property are merged into a single unit.

In the case the surviving spouse opts for the marital property, he or she may carry on the administration of the assets of the community property until the partition is made.

Within the same succession proceedings there may be a combination of liquidations, that is, the liquidation of the succession and that of the community property or community estate between domestic partners. However, the inventories and appraisals must be made separately in order to identify the assets and liabilities corresponding to each of the estates.

The assets of the community property must be distributed among the parties in equal shares, as established in civil legislation, or as stipulated in the prenuptial agreement, in case there is one.

D. *Tenancies, survivorship accounts and payable upon death accounts*

As of the moment of death, the assets of the decedent become part of the estate. The administration of said estate may be carried on through different procedures, depending on whether the succession is testate or intestate, or whether the assets belong to the community property.

In the first case, the administration and tenancy of the assets of the decedent's estate correspond to the executor, or if there is no executor, to the heirs who have accepted the inheritance.[10]

The executor may only refuse the designation for a justified cause. Otherwise, the person designated as executor will give ground for disqualification from inheritance. This designation cannot be delegated, except in those cases where the testator has so provided, and it is not transferable to the heirs of the executor.[11] It should be pointed out that the executor must answer with respect to his administration for up to ordinary negligence, and the heirs or legatees shall likewise be entitled to demand guarantees from the executor regarding the security of the assets, when the executor has possession thereof.

In an intestate succession, the heirs acquire the possession of the inheritance from the moment of its denouncement;[12] this legal fiction is known as lawful possession of the inheritance. The purpose of the lawful possession is for the inheritance not to be considered heirless or with no apparent owner, as well as to allow the heirs to assign their option right (inventory benefit), that is, their right to accept or renounce the inheritance or legacy and to exercise the joint administration of the estate.[13]

Where there is community property, the assets that are included are managed by the surviving spouse.[14]

Before the formal inventory is taken and it is completed, the administrators of the estate are required to hold the assets representing the decedent's estate under deposit (the law indicates that any personal property must be kept under lock and key). When the inventory and appraisals become final, the administrators may dispose of the assets in order to pay the liabilities of the decedent, and if the money available is insufficient in order to pay the debts of the inheritance or legacy, the spouse, the executor or any one of the heirs, may request the sale of certain assets in a public auction, or at a stock exchange, where applicable. If there is real estate property, any of the heirs may ask the judge to issue the decree of effective possession in favour of all the heirs, and to order its recording in the Registry of Public Instruments. This recording grants the heirs the power to dispose of the real estate.

Likewise, considering the fact that under tax law an unsettled estate is subject to income taxes from the date of the death until the execution of the decision approving the partition, or of the issuance of the public deed, the executor or the heirs who have accepted the inheritance, must act as representatives of the succession before the state, in order to comply with the formal tax obligations, such as the filing of tax returns, and to make the corresponding payments at the estate's expense.

There are certain regulations in Colombia that are similar to the tenancy systems in other countries. Among them is that contemplated in Law 258 of 1996, known as encumbrance as Family Dwelling. This encumbrance applies to real estate properties acquired in full by

one or both spouses, either before or after the marriage, and intended as a place of abode for the family. The main consequences of the encumbrance as Family Dwelling are, on the one hand, the non-attachability of the property designated as such,[15] and on the other hand, that, in order to sell the property, the encumbrance must be lifted through a public deed signed by both spouses.

Upon the death of one of the spouses or domestic partners, the encumbrance as Family Dwelling is extinguished, unless the under-aged heirs that are inhabiting the property request that the judge, for justified cause, maintains the encumbrance for as long as necessary, although this term may not extend beyond the date on which the under-aged reach the age of 18 or become emancipated.

Likewise, Law 70 of 1931 consecrates the institution known as the Unattachable Family Property, which may be established in favour of designated beneficiaries on the full ownership of a real estate property that is not held jointly and severally, is not subject to an encumbrance by mortgage, subject to security for payment of an annuity or to antichresis and which value at the time imposition of the Family Property restriction is not greater than 250 monthly minimum wages, (ie, COP 227,131,500 ($62,087,98) for 2021). In the event of the settlor's death, the family property subsists in favour of the surviving spouse. In the event of the death of both spouses, the family property restriction subsists in favour of the children, until they reach the age of 18.

Regarding *survivorship accounts* and *payable upon death accounts,* under Colombian legislation, in order for the decedent to designate the individuals he or she chooses as beneficiaries of his or her bank deposits, a collective deposit must be set up.

The foregoing, given that although it is feasible for bank deposits (checking or savings) to have multiple holders through collective or joint accounts, in the case of joint accounts, that is, those held in the name of two or more individuals acting jointly to dispose of the funds deposited in them, the concurrence of the signatures of all holders is necessary in order to make withdrawals and, therefore, upon the death of one of the holders no withdrawals may be made and the portion of the funds corresponding to the deceased holder must be determined in the inventory during the appraisal stage of the succession.

In collective deposits, on the other hand, when one of the holders of a savings or checking account dies, the balance may be reimbursed to the other holders. The same applies to time deposit certificates established in favour of several persons containing the clause 'and/or'; when the principal dies and at the time of maturity of the certificate, the financial institution may pay its amount to the other beneficiaries.

Regarding the funds held by the *de cujus* in financial institutions, there is a special benefit that allows banking institutions to release, up to a specified amount, the balances of funds deposited in savings accounts, checking accounts, or amounts represented in time deposits or cashier's checks, without demanding proof of the succession proceedings. The maximum amount that may be released by the banks without requiring a succession proceeding is published annually by the Financial Superintendency and equals the sum of COP 63,656,530 (approximately $17,400.95) for the period between 1 October 2020 and 30 September 2021.

The Colombian pension system, however, provides for the extension of the pension of the decedent to the heirs. Under the pertinent legislation, the spouse or domestic partner of a deceased pensioner or affiliate to the pension system is entitled to receive the survivor's pension, until death.[16] Children under the age of 25 who are financially dependent on the deceased at the time of death are also considered beneficiaries, provided they are unable to work by reason of their studies, as well as any disabled children of any age if there is

economic dependency, for as long as their disability conditions subsist. If the pension is assigned only to the spouse, the latter will be entitled to the full amount thereof, but if there are also children that have been entitled, the pension will be distributed, 50 per cent for the spouse and 50 per cent for the children.

In the absence of a spouse, domestic partner and entitled children, the parents of the deceased or any disabled siblings may be the beneficiaries, but only if they depended economically on the deceased.

III. Trusts, foundations and other planning structures

A. Common techniques

As mentioned above, the most widely used mechanisms in Colombia's jurisdiction for family estate planning consist in corporate structures in Colombia and abroad and in the use of civil and commercial trusts. Foreign trusts are not commonly used by Colombian nationals, except in the case of persons who own assets and/or business abroad. Likewise, nationals who own assets abroad frequently establish private foundations, notwithstanding that, as discussed below, these foundations, are treated as limited liability companies for Colombian income tax purposes and founders and beneficiaries, as partners in commercial companies or as fiduciary agreements for equity tax and normalisation purposes and beneficiaries as fiduciae beneficiaries except that these are not established, in which case the settlor will be deemed liable for income tax in all other instances.

B. *Fiduciary duties (trustees, board members, directors, etc)*

First, it is important to mention that, in addition to the Civil Trust described above, Colombian law contemplates commercial or mercantile trusts and escrows (*encargo fiduciario*).

The commercial trust agreement implies the transfer of the assets allocated to the fulfilment of a specific purpose to a free-standing trust fund, separated from the rest of the assets of the trustee, assigned to said purpose.[17] Only banking institutions and trust companies especially authorised by the Financial Superintendence, may act as trustees.

Regarding the duties of the trustee, it should be pointed out that as long as the commercial trust agreement is in force, the trustee may not assign the assets to any purpose other than that provided in the constitutive act, except that the settlor so decides, when the trust is not irrevocable. Therefore, the purpose established by the settlor in the trust agreement is the basis for determining the main acts which the trustee agrees to perform.

Article 1234 of the Commercial Code imposes on the trustee the duty to fulfil certain non-transferable obligations, namely, to:

- diligently perform all necessary acts to attain the purpose of the trust;
- hold the legal capacity for the protection and defence of the assets placed in the trust against acts of third parties, of the beneficiaries and even of the settlor himself;
- invest the earnings obtained from the trust in the manner and according to the requirements established in the constitutive act;
- seek the greatest profitability from the assets subject to the fiduciary business, except for a determination to the contrary in the Constitutive Act; and
- render verified accounts of its management every six months, and to transfer the assets to the appropriate person according to the Constitutive Act or to the law, at the end of the trust period.

According to commercial legislation, the trustee shall be liable for up to ordinary negligence in the fulfilment of its duties.

In this respect, the Colombian Financial Superintendency has ruled[18] that a trustee is required 'to act diligently and prudently, always seeking to fulfil the purpose established in the constitutive act, being required, in order to attain said purpose, to observe the non-assignable duties imposed both by the law and by the trust agreement, an action which must correspond to that required from every professional in relation to the administration of third-party affairs'.

Furthermore, in the matter of taxes applying on the funds of the trust, trustees must pay any value added and withholding taxes that may be incurred as a result of the transactions of the trust, as well as the corresponding default interest, penalties and indexation, where applicable.

In the matter of income taxes, trust companies are authorised to file a single return for all the free-standing trust funds they manage.[19] The National Government will specify which individual trusts are to be discriminated, in which case, the trustee will be required to file a separate tax return for the specific trust.

The trust company will keep a disaggregated listing in case the Tax Administration requires specific information.

When it is not possible to identify the beneficiary of a trust because, for instance, the trust is subject to certain conditions precedent or subsequent, earnings must be declared by the settlor, for income tax purposes.

Beneficiaries or trustors, on the other hand, must report for income tax purposes, the earnings obtained during the same tax year in which they accrue in favour of the free-standing trust fund, retaining their nature as taxable or non-taxable, and with the same description and tax conditions they would have if they were received directly by the beneficiary or the trustor.

An escrow, however, is characterised by the delivery of the assets without transfer of ownership by the settlor to the trustee to fulfil the purpose established for the benefit of a third party or of the settlor himself. In this regard, the Financial Superintendence (formerly the Banking Superintendence) in the Basic Legal Circular Communication, distinguished between a commercial trust and an escrow, assigning the latter to the rules of a mandate agreement.

In accordance with the foregoing, from a tax point of view, the trustee in an escrow complies with the duties of an agent and therefore must identify any income received on behalf of the principal and the payments made in his or her name in its accounts and must perform all tax withholdings derived from the transactions carried out by instructions of the trustor, but it will be the latter, in his or her capacity as principal when the principal is required to declare the income and to apply for the respective costs, deductions and deductible taxes, according to the information provided by the trustee.

In the case of a civil trust, the law provides that the trustee will have free management of the assets, given that until the condition is met, he or she is the owner of the assets in the trust. Nevertheless, the trustee is responsible for any impairments or deteriorations derived from acts or negligence. For tax purposes, bearing in mind that the trustee holds the ownership and possession of the assets placed in the trust until the condition occurs, the obligation to declare the assets and the revenues of a civil trust applies to the trustee, unless it is provided that the proceeds of the assets belong to the trustor. In this case, they must be reported by the latter.

C. *Treatment of foreign trusts and foundations*

Pursuant to Colombian exchange regulations, Colombian residents may set up trusts abroad, which shall be regarded as capital investments in the financial sector.

The amounts to be contributed to said trusts must be channelled through the exchange market, in the form of foreign currency and amounts entitled to reimbursement. The investment is deemed registered upon filing of the pertinent exchange declaration with the Banco de la República, in accordance with the regulations of said entity.[20]

IV. Taxation

A. *Domicile and residency*

As provided in Articles 9, 12 and 20 of the Tax Code, individuals, both national or foreign, not resident in the country, are only subject to income and complementary taxes on income or capital gains of national source. In the case of foreign investors holding a permanent establishment (PE) in Colombia, Article 66 Law 2010, 2019 established that income tax is assessed on the national and foreign income that is attributable to the PE.

Colombian residents are subject to taxes on global-source income, so that Colombian residents must report earnings on a worldwide basis. Foreigners residing in Colombia are only subject to taxation on their domestic and foreign income after 183 days of continuous or discontinuous permanence in Colombia including days of arrival and departure during any 365-consecutive calendar-day period.

In the case of foreign individuals residing in Colombia, net worth taxes on a global basis will be applicable from the first year of residence within the country.

Likewise, nationals who meet one of the following conditions, are considered residents, even if they themselves remain abroad:

- when the spouse or domestic partner or minor dependent children have tax residence in Colombia;
- when 50 per cent or more of their income is from national source;
- when 50 per cent or more of their assets are managed in the country;
- when 50 per cent or more of their assets are deemed to be possessed in the country;
- when having been required by the tax authorities, they do not prove their residency status abroad for tax purposes; or
- when the individual is a tax resident in a country qualified by the National Government as a low-tax jurisdiction, non-cooperative jurisdictions or preferential tax regime tax.[21]

Nevertheless, nationals who meet any of the conditions referred to above are not considered Colombian tax residents if, and when, they comply with one of the following requirements:

- 50 per cent or more of their annual income has its source in the jurisdiction of their domicile, or
- 50 per cent or more of the national's assets are located in the jurisdiction of their domicile.

B. *Gift, estate and inheritance taxes*

1. GIFT AND INHERITANCE TAXES

As previously noted, Colombian law establishes that unsettled successions are subject to income tax, and therefore earnings, revenues and assets previously belonging to the decedent and which are part of the succession, must be declared by the succession. Likewise, unsettled successions of deceased persons who were not residing in the country at the time of their death, do not qualify as Colombian residents and are only subject to income tax on revenues and capital gains of local source and with respect to the assets held in the country.

Inheritances, legacies and donations, and whatever is received as marital share, will be considered earnings subject to the Inheritance Tax, regardless of the location of the assets making part of the estate, in the case of a Colombian succession.[22]

The tax accrues on the date of execution of the partition or distribution decision. The amount of the capital gains received by reason of inheritances, legacies, donations and marital shares is the value of the property and rights on 31 December of the year immediately preceding the date of the settlement of the estate or upon execution of the donation or the legal act *inter vivos*, whereby assets are transferred gratuitously, as applicable.

In the case of the following goods and rights, the succession value is determined as follows:

- the value of cash sums will be assessed at nominal value;
- the value of gold and other precious metals will be assessed at market value;
- the value of vehicles shall equal the annual commercial assessment by the Ministry of Transport;
- the value of shares, contributions and other rights in companies will be determined at cost value;
- the value of credits will be nominal value;
- the value of assets and loans in foreign currencies will be market value, expressed in national currency;
- the value of securities, bonds, certificates and other negotiable instruments that generate interest and financial income will be cost plus discounts or returns accrued and not paid on the last day of the taxable period;
- the value of trust rights shall be 80 per cent of the net worth value;
- the net worth value of the rights in the trusts for the beneficiaries, is that corresponding to their participation in the liquid assets of the trust at the end of the year or on the date of the statement of account. For the beneficiaries, the assets retain the condition of mobilised or immobilised, monetary or non-monetary assets, they have in the trust;
- the value of the real estate shall be the higher value between the acquisition cost and the fiscal cost;
- the value of income or periodical payments from trusts, private foundations and other similar vehicles, established in Colombia or abroad, to individuals residing in the country will be the total value of the respective income or periodical payments; and
- the value of a temporary usufruct must be determined in proportion to the total value of the asset given in usufruct, at a rate of five per cent of the value for each year of the usufruct without exceeding 70 per cent of the value of the asset. The value of a life usufruct is 70 per cent of the total value of the asset given in usufruct. If the assets were acquired by the decedent during the year of death, the value of the asset may not be assessed for less than cost.

Current legislation determines that the transfer of the marital property does not constitute income that produces a net increase in the amount of net worth, and consequently is not taxed.

The assets listed below are exempt from tax on capital gains in the following amounts:

1. the first 7,700 UVT (COP 279,571,600/$76,422,85) of the value of the house owned by the deceased;
2. the first 7,700 UVT (COP 279,571,600/$76,422,85) of a rural real estate owned by the decedent. This exemption does not apply to houses or recreational farms;
3. the first 3,490 UVT (COP 126,715,000/$34,638,43) of the inheritance received by the surviving spouse and each of the heirs or legatees;
4. 20 per cent of the value of the assets and rights received by people other than the heirs or the surviving spouse by way of inheritances and legacies; and
5. 20 per cent of the assets and rights received from donations and other gratuitous acts *inter vivos*, without exceeding 2,290 UVT (COP 83,145,000/$ 22,728,26).

2. ESTATE TAX

Law 2010 of 27 December 2019 included a tax amnesty (*impuesto de normalización tributaria*) through which taxpayers may report the assets that have been omitted previously without paying any penalties. This inclusion implies the payment of a tax at a 15 per cent rate. The tax amnesty was applicable for the taxable year 2020.

For the purposes of this amnesty, the rights in private foundations held abroad, trusts or other fiduciary or foreign businesses are treated as fiduciary rights held in Colombia. Consequently, beneficiaries of the mentioned rights are required to include their shares in the trusts or in the foundations in the taxable basis for net equity tax. The shares in the trust are to be valued in accordance with the market value of any underlying assets.

The amount of the trust must be declared in Colombian currency, at the exchange rate (Tasa Representativa del Mercado or TRM) in force on the date or recognition.

Law 2010 of 2019 provides for an incentive to taxpayers that return the assets into Colombia, which consists in the reduction in 50 per cent of the taxable base for the normalisation tax of assets that are reinvested in Colombia for at least two years.[23]

C. *Taxes on income and capital*

Income producing an increase in value in the net worth will be subject to income tax in Colombia. Income may be in the form of cash or kind, ordinary or extraordinary, and of domestic or foreign source. As mentioned, individuals who qualify as Colombian residents are subject to tax on earnings of both domestic and foreign sources. Non-residents are subject to tax only on their income of domestic source.

Income of domestic source is considered to include earnings derived from the exploitation of both tangible and intangible assets in the country and from the provision of services in Colombia, either permanently or transitorily, with or without a commercial establishment. The following, among others, also constitute income of domestic source:

- capital income derived from real estate properties located in the country, such as rentals or encumbrances to secure the payment of annuities;
- profits derived from the sale of real estate property located within the country;
- earnings derived from real estate property exploited within the country; and

- interest derived from credits held in the country or economically related to it. Exempt from income tax are interests derived from transitory credits originated in the import of goods and in bank overdrafts.

The possession of assets must also be reported annually in the income tax return. The determination of the net worth or the assets declared in the income tax return is relevant for purposes of establishing the income tax basis, under the minimum presumptive income system which establishes the tax base for the minimum alternate tax on presumptive income.

The income tax basis ordinarily is assessed by subtracting from the sum of all ordinary and extraordinary income realised during the tax period, the costs attributable to such income and the pertinent deductions, thereby obtaining the net income which, except for applicable exemptions, will be taxable income.

The minimum alternate tax, on the other hand, is assessed on a special net basis established by law, under the presumption that the net worth of the taxpayer, for the immediately preceding period, produces minimum earnings equalling 0.5 per cent of the value of the net assets in the preceding year. The 0.5 per cent rate is applicable for the taxable year 2020; from 2021 onwards, the minimum alternate tax rate will be zero per cent.

In consequence, income tax is generally assessed on the ordinary net income and, as an exception, on the presumptive income, when it exceeds the ordinary income or when the latter does not exist, or a loss has been generated instead.

The applicable income tax for individuals is established progressively, with the maximum income tax rate for individuals being 39 per cent.[24] Any unsettled successions will be taxed on the aforementioned basis.

Under income tax regulations currently in force, trust agreements will be governed by the rules of the country where the agreement is entered into and performed.

Settlors of foreign trusts will only be required to report the investment abroad as long as they keep their share in the trust.

For income and complimentary tax purposes, any Colombian residents receiving periodical rentals from foreign trusts or private foundations, are subject to capital gains taxes at ten per cent.

Private interest foundations are equated to limited liability companies and are subject to income tax. Under that qualification, these entities are taxed on their Columbian-source income at the general rate of 31 per cent.[25]

Founders are required to report the value of their contribution as an investment abroad for the purposes of the alternate minimum income tax, that is, for the purposes of Colombian income tax. The assets will also be part of the basis for the net worth tax.

It should be noted that in Colombia, non-profit foundations and associations are subject to a special tax system.[26] For such purpose, Decree 2150 of 2017 consecrated the conditions that must be met by an entity to qualify as a non-profit corporation, foundation or association under the special tax regulations:

1. the main corporate purpose of the entity and any resources raised by the entity must be destined for health, sports, formal education, cultural, scientific or technological research, ecological or environmental protection activities or social development programmes;

2. said activities must be of general interest; and
3. their surplus must be totally reinvested in activities that correspond to the corporate purpose. The non-profit entities may not distribute earnings to the founders, managers, directors and so on. If that is the case, the entity will be excluded from the special tax system and will be taxed as a commercial entity.[27]

This system applies to foreign entities that evidence compliance with the three requirements established in the regulation, as stated by the Council of State in decision 16467 of 2010.

To be admitted within the special tax system, the entities must file a request to the tax authority, demonstrating the compliance of all the substantial and formal requirements stated above.

D. Tax reform 2021

The government has announced the decision to file a tax reform bill during 2021. Regarding income tax, the proposals included in such a tax reform bill will be enforceable as of 1 January 2022.

On 17 March 2021, the Commission of Experts on Tax Benefits published the white paper in which there are some recommendations to be considered in the next tax reform. Some of the main recommendations include increasing the effective rates applicable for individuals, both employees and independent; the reduction of the income tax basis and of the VAT basis were also suggested.

Income tax provisions in force for 2021 do not include taxes on equity and do not contemplate any amnesty referring to unreported assets held abroad. The new tax reform will probably include them.

Notes

1 An oral will only occurs in cases of imminent danger to the life of the testator. Similarly, in order to make a military will, the testator must be in a war expedition or campaign against the enemy or at a garrison in a territory under siege. A maritime will may only be made on board a Colombian warship at sea.

2 An oral will has no value if the testator dies after 30 days following its execution, or if having died before, the will has not been set down in writing within 30 days following the death. In the case of a military will, if the testator dies before 90 days following the date on which the circumstances of war that enable him to grant a military will have ceased, his or her will is valid, but if the testator survives this period, then the will becomes invalid. A maritime will is not valid unless the testator has died before disembarking or during a period of 90 days following disembarkation.

3 The following are legatees: (i) descendants; and (ii) ascendants.

4 According to Art 1502 of the Civil Code, capacity may refer to enjoyment or action. The former consists of the general legal competence of every individual or legal entity to hold rights and assume obligations. The capacity to act consists of the ability recognised by law to a person to bind him or herself, without the intervention or authorisation of another person.

5 Persons suffering from a severe or profound learning or behavioural condition or pathology, or mental impairment, are considered to suffer from absolute mental disability.

6 Whoever requests recognition as a party, must fully evidence such capacity, through documentary proof.

7 A UVT is a tax value unit. The value of a UVT for the year 2021 is COP 36,380 (approximately $9.94) at the rate of exchange in force for 26 March 2021, ie, $1 = COP 3,658.22.

8 The request for intervention may be filed until the judgment approving the partition is handed down.

9 The law presumes the existence of community property when there is a de facto marital union during a period of no less than two years. It should be highlighted that the Constitutional Court, through judgment C-029 of 2009 stated that the expressions 'singular, permanent and continuous union', 'domestic partner' and 'domestic partnership' contained in Colombian positive law must be read and interpreted in the sense that they all refer, all conditions being equal, to same-sex couples.

10 One or several executors may be appointed, in which case the judge may divide the administrative powers corresponding to each, at the request of the executors themselves or of a party with an interest in the succession proceedings; if there are any executors with common powers, they must authorise all acts and contracts related to the administration of the decedent's estate. All executors are jointly and severally liable, except when the testator has divided their powers or exempted them from such joint and several liability or when the judge makes the segmentation of functions.

11 The prohibition to delegate does not prevent the executor from entering into mandate agreements for the proper administration of the decedent's estate.

12 The denouncement of the inheritance is the call made by law to an heir or legatee to state his or her acceptance or renunciation at the time of the death of the deceased.

13 In case of discrepancies regarding the administration of the estate, the receivership of the assets may be ordered, at the request of any interested party. If there is no request for receivership, the judge may settle any conflicts between the spouse, heirs and executors through an incidental proceeding or a simple judiciary order. Once the performance of his duties has ended, the administrator of the succession must hand over the assets as appropriate, according to the relevant partition judgment or public deed and submit a report on his administration by presenting the relevant accounts to the judge for approval, under penalty of commencement of a separate proceeding for the rendering of accounts.

14 Art 595 of the Colombian Code of Civil Procedure.

15 The attachment is enforceable if the asset was mortgaged prior to the date of recording of the encumbrance as family dwelling, or after said date, if the mortgage was created in order to acquire, build or improve the dwelling subject to family encumbrance.

16 The members of the family group of the beneficiary of an old age or disability from common risk pension who dies and the members of the family group of a person affiliated to the system (not yet pensioned) who dies, are entitled to the survivors' pension, provided the deceased has contributed to the system for 50 weeks during the last three years immediately preceding the death.

17 Art 1227 of the Commercial Code provides: 'The assets subject to the trust are not part of the general security of the creditors of the trustee and only secure obligations contracted in furtherance of the intended purpose'.

18 Opinion No 2003018295-1, 23 May 2003.

19 It is provided for this purpose that the Tax Administration must assign a Tax Identification Number (Número de Identificación Tributaria or NIT) different from that of the trust company which identifies all managed trusts as a whole.

20 The exchange registration is not necessary when the transactions are carried out abroad with foreign currency that need not be channelled through the exchange market.

21 It is worth noting that since Law 1819 of 2016, the Colombian tax system has substituted the notion of 'tax havens' for low-tax and non-cooperative jurisdictions, as well as preferential tax regimes. The government has the task of listing the jurisdictions that fall within the above categories. However, the Tax Office has stated that regarding the preferential tax regimes, the taxpayer is required to verify whether the estate where the relevant economic activities take place, meets the conditions to qualify as a preferential tax regime as per Art 260-7.

22 From the tax compliance perspective, it is worth noting that Colombia has entered into agreements with different countries for the automatic exchange of information following the Common Reporting Standard (CRS). Colombia has also executed the exchange of information agreement with the United States under the Foreign Account Tax Compliance Act (FATCA).

23 Decree 1010 of 2020 establishes that the assets that may be reinvested are only financial assets that are transferred to local entities before 31 December 2020. Financial assets must remain in the country for at least two years and that the exchange control dispositions in force on the date of transfer are duly met.

24 Art 4 of Decree 359 of 2020 establishes the Progressive Marginal rates for Income tax applying to individuals and the relevant withholding tax rates.

25 For 2020, the statutory income tax rate was 32 per cent; for 2021, the tax rate is 31 per cent; and from 2022 onwards, the tax rate will be 30 per cent.

26 Entities belonging to this system are subject to income tax, but have the benefit of assessing the tax at the special rate of 20 per cent on the net profit or surplus, which shall be exempt in the portion reinvested for the fulfilment of their corporate purpose. Likewise, they will not be required to calculate the tax on the presumptive income system (minimum alternate income tax system), nor will they be subject to withholding taxes, except for income obtained from financial yields or industrial and marketing activities.

27 Art 1.2.1.5.1.41 of Decree 2516 of 2016 consecrates the events where there is a deemed indirect distribution of earnings by entities covered by the Special Tax Regime:

(i) When the remuneration to individuals in managing positions exceeds 30 per cent of the annual expenditure of the entity.
(ii) When payments for services, rentals, fees, commissions, interest, special bonus and similar, do not meet the market standards.

(iii) When any type of reimbursement for the Founder contributing the funds upon incorporating the non-profit organisation or for other donors contributing funds, is transferred.
(iv) When the entity is dissolved and liquidated without distributing the surplus in accordance with Art 649 of the Colombian Civil Code.
(v) When the Colombian tax authorities determine that any agreements or onerous transactions with founders, contributors, donors, legal representatives and administrators, spouses and relatives within the fourth consanguinity or affinity grade or within the only civil grade, or with legal entities where the mentioned individuals possess more than a 30 per cent share, constitute indirect distributions of the earnings in the non-profit entity under Art 356.1 of the Colombian entity.
(vi) When the provisions in para 3, Art 356-1 of the Colombian Tax Code on indirect distributions of excess profit and excess remuneration to directors and other managing positions are not complied with.