

10 June 2020

Global Tax Alert

News from EY Americas Tax

Colombian Government issues new thin capitalization regulations

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On 29 May 2020, the Colombian Government issued Decree 761, which contains the regulations to implement the thin capitalization rules established in Law 2010 of 2019 (i.e., the tax reform).

Background

Law 2010 of 2019 re-enacted the modifications to the thin capitalization rules that were previously introduced by Law 1943 of 2018, which was declared unconstitutional due to procedural flaws.

Under the thin capitalization rules, a taxpayer generally may not deduct for income tax purposes interest paid on loans that are acquired, directly or indirectly, from related parties and exceed a 2:1 debt-to-equity ratio, considering the taxpayer's net equity on 31 December of the preceding year.

Likewise, debts acquired from third parties in which a related party grants a warranty, acts in a back-to-back operation, or substantially acts as a creditor in any other transaction are subject to the thin cap limitation. The thin cap limitation will not apply if the creditor issues a certificate stating that the loan is not substantially acquired from a related party.

Decree 761

In Decree 761, the Government re-incorporated into the income tax regulations most of the thin cap regulatory provisions issued under Law 1943 of 2018, and modified some of the regulations as follows:

- ▶ Included the term “real creditor,” which refers to any related party that is substantially considered as either a total or partial creditor of the debt, despite not formally appearing as the creditor of record
- ▶ Defined a “warranty” as an operation through which a related party backs a debt acquired by another related party from an unrelated creditor in a way that, by means of such warranty, the related entity should be considered the real creditor
- ▶ Amended the definition of the expression “any other operation in which substantially such related parties act as creditors,” by defining it as a transaction, in which the real creditor of the debt is a related party of the borrower, regardless of not appearing as the creditor of record

For the certificate issued by third-party creditors, the decree establishes:

- i. The third-party creditor must issue the certificate when the debt is formally acquired from the third party.
- ii. The third-party creditor must issue the certificate each tax year at the debtor's request before the debtor files its annual income tax return.
- iii. The certificate may be issued by representative offices in Colombia of foreign financial entities; for syndicated loans, each of the creditors should issue the certificate, in accordance with their participation in the loan.

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EYG no. 003992-20GbI

1508-1600216 NY
ED None

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