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Global Tax Alert

News from Americas Tax Center

Colombia enacts tax reform for 2019

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On 28 December 2018, Colombia enacted tax reform (Law 1943 - Tax Reform). The Tax Reform makes numerous changes to the Colombian tax rules that generally apply from 1 January 2019.

Business taxation

The Tax Reform reduces the corporate income tax (CIT) rate from 33% in 2018 to 32% for 2020, 31% for 2021 and 30% for 2022 and onwards. The Tax Reform also repeals the 4% surcharge imposed on corporate income, making the total tax rate 33% for 2019, as opposed to 37% (33%, plus the 4% surcharge). The Tax Reform establishes different tax rates for financial institutions with taxable income of more than 120,000 Tax Units (approximately US\$1.3 million). The Tax Reform imposes a tax rate of 37% for 2019, 35% for 2020, and 34% for 2021 on the income of those financial institutions. Under certain conditions, income from some activities, such as hospitality services in new or refurbished hotels, new theme park projects, ecotourism parks, agritourism, and nautical docks, is subject to a 9% CIT rate for 10 to 20 years, depending on the activity.

The Tax Reform increases the dividend tax on distributions to foreign nonresident entities and individuals from 5% to 7.5%. In addition, the Tax Reform establishes a 7.5% dividend tax on distributions between Colombian companies. The tax will be charged only on the first distribution of dividends between Colombian entities, and may be credited against the dividend tax due once the ultimate Colombian company makes a distribution to its shareholders (nonresident shareholders (entities or individuals) or to Colombian individual residents). The dividend tax on local distributions does not apply if the Colombian companies are part of a registered economic group, or the distribution is to a Colombian entity qualifying for the new Colombian holding company (CHC) regime.

The presumptive income tax rate (i.e., an alternative tax based on a percentage of the net equity of the last year) is reduced from 3.5% to 1.5% in 2019 and 2020 and 0% for 2021 and onwards.

In determining net taxable income, taxpayers may deduct all paid taxes related to their economic activity, except for the debit tax (only 50% is deductible, regardless of whether the tax relates to the income-producing activity), and the equity tax, which is not deductible. In addition, the Tax Reform allows taxpayers to claim 50% (100% from 2022) of paid industry and commerce and debit (i.e., financial transaction tax) taxes as a credit against their income tax liability.

The thin capitalization rule ratio is modified from 3:1 (which includes all debt that generates interest with local and foreign entities, related or unrelated) to a 2:1 ratio that only considers debt transactions involving related local and foreign parties (including back-to-back transactions involving foreign third parties). The thin capitalization rule does not apply: (1) when companies are subject to the authority of the Superintendence of Finance; (2) to some factoring activities (i.e., financial transactions in which a business sells its accounts receivable to a third party at a discount); (3) when taxpayers have unproductive periods; or (4) to infrastructure projects for public services and transportation carried out by special purpose vehicles.

Investors in a private equity fund (PEF) generally will no longer benefit from deferring the recognition of income, unless the PEF meets certain requirements. The Tax Reform provides a transitory rule to allow existing PEFs to adjust to the new rules. The transitory rule is effective until 30 June 2020. After that date, investors in PEFs will have to recognize accumulated deferred income.

The Tax Reform also establishes rules for determining the market value of goods and services, shares and real estate to prevent taxpayers from using low values when conducting transactions.

Income tax incentives

The Tax Reform creates an income tax exemption for gross income below 80,000 tax units (approximately US\$850,000) that derives from certain entrepreneurial activities related to technological and creative industries, or agricultural activities. The exemption period is 7 years for income derived from technological and creative industries and 10 years for income derived from agricultural activities. The gross income requirement does not apply to entities devoted to TV production-related activities.

For so-called mega investment projects, those involving an investment of at least 30 million tax units (approximately US\$320 million) over 5 years and generating 250 jobs or more, the Tax Reform establishes benefits for 20 years, such as a 27% income tax rate, a dividend tax exemption, the possibility of depreciating assets over 2 years, and presumptive income tax and equity tax exemptions. The benefits do not apply to the exploration of non-renewable resources. Taxpayers may enter into legal stability agreements for mega investment projects to ensure that future changes to the tax law will not affect the benefits. To enter into a legal stability agreement, taxpayers will need to pay a premium equal to 0.75% of the investment.

International tax measures

The Tax Reform subjects indirect transfers of Colombian assets/shares to tax in Colombia, if the Colombian assets/shares account for 20% or more of the book or fair market value of the foreign entity that is being transferred.

Under the Tax Reform, permanent establishments (PEs) are subject to taxation on worldwide-source income (in the past, they were only subject to tax on Colombian-source income). In addition, the Tax Reform does not allow taxpayers to deduct interest expenses that are attributable to a PE and are not subject to withholding tax in Colombia. The Tax Reform does not, however, modify the rule that allows taxpayers to deduct interest expenses when the transfer pricing rules apply.

The Tax Reform establishes the CHC regime for which Colombian companies may apply if they meet certain requirements. Under this regime, dividends received from,

and proceeds from the sale of, certain non-Colombian entities are not taxable in Colombia. In addition, for nonresident shareholders, dividends distributed by a CHC, and proceeds from the sale of a CHC's shares (the proportion of the gain derived from foreign nonresident entities owned by the CHC), generally are not subject to tax in Colombia. If the CHC receives dividends from a Colombian subsidiary, the 7.5% dividend tax does not apply. The regime does not apply if the shareholder of the CHC is in a tax haven.

A 20% withholding tax will apply to payments abroad for services, royalties, movie sales (currently 15%), and software licenses (previously 26.4%). The withholding tax on payments abroad for management and direction fees increases from 15% to 33%. A 15% withholding tax applies to loans with a term of one year or more, and a 20% withholding tax applies to loans with a term under one year.

The Colombian controlled foreign corporation (CFC) regime will not apply when the CFC's income is 80% or more active income.

The Tax Reform also adds requirements for claiming indirect foreign tax credits (FTCs), but indirect FTCs cannot be claimed for portfolio investments. The Tax Reform allows taxpayers to carry forward FTCs without limitation (previously capped at four years).

Rules to make the mutual agreement procedure (MAP) provided in tax treaties more viable are included. Agreements reached in accordance with the MAP will have the same applicability as a final judicial decision.

Individual taxation

The income baskets are reduced from five to three – a general basket, pension basket and a dividends basket. The tax rate applicable to the highest bracket is 39% (previously, the highest bracket of the labor income basket was subject to a 33% rate, and the capital and non-labor baskets were subject to a 35% rate). The labor income basket, capital basket, and non-labor basket are combined into the general basket.

The tax rate for dividends applicable to resident individuals increases from a range of 0% to 10% to a range of 0% to 15%.

Equity tax

The Tax Reform establishes a new equity tax on Colombian resident individuals' worldwide net worth that will apply for years 2019, 2020, and 2021 (nonresident individuals will be

taxed only on their Colombian assets). Nonresident entities will have to pay this tax on their assets owned in Colombia, such as real estate, yachts, artwork, boats, planes, and rights over mines or oil wells. In calculating this tax, nonresident entities should not consider shares in Colombian companies, accounts receivable from Colombian debtors, certain portfolio investments and financial lease agreements. For this tax to apply, the net equity of the taxpayer must be at least COP 5.000 million (approximately US\$1.5 million) as of 1 January 2019.

The equity tax rate is 1%.

Normalization tax

The Tax Reform establishes a tax amnesty to “normalize” (i) unreported assets; or (ii) nonexistent liabilities that were included on a tax return. The amnesty will apply only for 2019 (25 September 2019 is the due date for filing the normalization tax). The applicable tax rate is 13% of the value of the unreported assets or nonexistent liabilities. For money that is repatriated to Colombia before 31 December 2019, and kept in the country for two years, the tax rate is reduced to 6.5%. The normalization tax has a far-reaching scope and applies to assets in private foundations, assets in trusts, insurance with savings components, investment funds and other fiduciary business activities.

VAT and general excise (national consumption) tax

Restaurants and bars subject to the franchise regime are responsible for value-added tax (VAT). The Tax Reform, however, gives restaurants and bars six months to elect to be subject to the VAT or general excise tax.

On imports from free trade zones, the VAT will apply to the total amount of the product for customs purposes, plus the customs duties (before the Tax Reform, for certain free trade zones, the VAT on the importation was determined only on the foreign component of the product).

Soda and beer are subject to VAT in all phases of the production and supply chain (previously they were subject to one-phase VAT). The taxable base for beer is the sales price less the excise tax for beer. A transition period applies to the multi-phase VAT for beer. No transition period applies for soda.

The Tax Reform allows foreign services providers of digital services to opt into a VAT withholding tax collection system through debit and credit card issuers.

For VAT-responsible taxpayers, the VAT paid in the acquisition or construction of fixed assets may be taken as a credit against the income tax in the year that the VAT is paid (the year in which the depreciation / amortization begins, for constructed assets), or in the following years.

Small business tax (SIMPLE)

For small businesses (those with gross income below 80,000 Tax Units per year - approximately US\$850,000), the SIMPLE replaces the income tax, the general excise tax (when applicable) and industry and commerce tax. The SIMPLE rate ranges from 1.8% to 11.6% of a small business's gross income, depending on the business's economic activity and the amount of gross income.

Other measures

The Tax Reform will:

- ▶ Not impose penalties until 1 July 2019, on taxpayers that do not issue electronic invoices, to the extent that regular invoices are issued and technical and business reasons delay the implementation of electronic invoicing
- ▶ Require taxpayers subject to the SIMPLE regime to issue electronic invoices beginning 1 August 2019
- ▶ Introduce the possibility of paying the corporate income tax in kind (e.g., building a public road or a public school instead of paying the same amount in taxes)
- ▶ Require the tax authorities to notify, or serve their notices on, taxpayers via email
- ▶ Apply reduced interest rates and penalties if a taxpayer made payments required by a notice of deficiency or as a result of an official adjustment to a filed tax return (available only until September or October 2019)
- ▶ Establish an automatic refund for income tax and VAT for taxpayers that do not represent a big risk according to the Tax Office
- ▶ Reduce the statute of limitations to six months for FY 2019 and 2020 for income tax returns filed with a net income tax increase of more than 30% than the prior year (12 months if net income tax increase is 20%)
- ▶ Repeal the holding period for shares of companies that have entered into mergers or demergers

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