Colombia enacts extensive tax reform

On 29 December 2016, Colombia’s government enacted a structural tax reform that makes extensive changes to the tax treatment of companies, individuals and nonprofit entities, as well as changes to withholding taxes, VAT and other indirect taxes and tax administration (for prior coverage, see World Tax Advisor, 11 November 2016). Unless otherwise stated, the new rules generally apply as from 1 January 2017.


Income tax for companies

**Tax rates:** The income tax for equality (CREE) (9% for 2016) and the CREE surtax (6% on net income exceeding COP 800 million for 2016) are eliminated. In conjunction with this change, the corporate income tax is modified to account for the elimination of the CREE, and the effective tax rate will be reduced as from 2018.

The standard corporate income tax rate, which was 25% for 2016 (not including the CREE and CREE surtax; the effective rate including the CREE and surtax was 40%), is 34% for taxable year 2017, reducing to 33% as from 2018. A temporary income tax surcharge will be levied for taxable years 2017 and 2018, at a rate of 6% for 2017 and 4% for 2018 on net income exceeding COP 800 million. These changes are summarized below:

- **Total effective tax rate for 2017:** 40% (34% income tax + 6% income tax surcharge);
- **Total effective tax rate for 2018:** 37% (33% income tax + 4% income tax surcharge); and
- **Total effective tax rate for 2019 and subsequent years:** 33% income tax (no income tax surcharge).

Two annual advance payments of the income tax surcharge will be required in an amount equal to 100% of its value, calculated based on the taxable base for the income tax in the previous year.

Additionally, the income tax rate for companies operating in free trade zones is increased to 20% (15% in 2016).

**Presumptive minimum income base:** The presumptive minimum income calculated annually for income tax purposes is increased from 3% to 3.5% of a company’s net tax equity.

**Dividends and income from profit participations:** Dividends and income from profit participations received by Colombian companies will be considered taxable income, regardless of whether they are paid out of profits that have been taxed at the level of the distributing company (previously, dividends paid from previously-taxed profits were exempt).

Dividends and income from profit participations received by nonresidents (companies, other entities and individuals) from profits that have not been taxed at the corporate level will be subject to a 35% withholding tax, plus a special rate of 5% (i.e. a total effective tax rate of 40%). If the dividends are paid from profits taxed at the corporate level, they will be subject only to the 5% rate. (Previously, dividends paid from profits that had not been taxed at the corporate level were subject to a 33% rate, while dividends paid from previously-taxed profits were exempt.)

**Controlled foreign companies (CFCs):** The tax reform introduces a CFC regime. Under the regime, a Colombian tax resident that owns a direct or indirect participation of at least 10% in a foreign entity that is considered a CFC will be taxed currently on its proportionate share of the CFC’s income (including passive income), costs, expenses and deductions. A foreign entity will be considered a CFC if it qualifies as a subordinated or controlled company according to the commercial regulations and is considered a foreign related party of the Colombian resident.

**Deductions:** Certain deduction limitations and other modifications are introduced for corporate income tax purposes:

- Payments between related parties regarding intangibles created in Colombia are not deductible.
- Intangible assets acquired (independently or as part of a business or businesses) between related companies cannot be amortized.
- A specific rule applies for amortizing investments related to the exploration, development and construction of mines, wells and oil and gas fields.
- The deduction for gifts and entertainment expenses (e.g. for parties, meetings and celebrations) in relation to customers, suppliers and employees is limited to 1% of the company’s accrued net taxable income.
• Donations made to nonprofit entities and entities that are considered “non-income taxpayers” may be deducted from the income tax base, but the deduction cannot exceed 25% of the value of the donation.
• For the deduction of costs and expenses related to the import of technology contracts to be accepted, the taxpayer must register the contract with the tax administration within six months after the contract is signed, and must register any modifications to the contract within three months after the modification is made.
• Goodwill generated after 31 December 2016 will not be amortizable.

Payments to low or no-tax jurisdictions: For a taxpayer to deduct costs and expenses associated with payments to companies, entities or individuals located or incorporated in low or no-tax jurisdictions, or to entities benefiting from a preferential tax regime, tax must be withheld on the payment (if applicable) and the taxpayer must comply with the transfer pricing and foreign exchange rules. However, these rules do not apply to payments related to certain transactions registered with the central bank.

Other changes affecting companies:

• Some income tax exemptions are eliminated.
• The exchange rate regime is modified. Previously, adjustments for exchange rate differences generated on the recording of assets/liabilities in foreign currency were calculated and treated as revenue or an expense for tax purposes at the end of the taxable year. The new law provides that revenues, costs, deductions, assets and liabilities in foreign currencies must be recorded at the time of initial recognition at the representative market rate. Exchange rate differences will be recorded only when the liabilities are paid or liquidated or the assets are disposed of or credited to an account. Only realized exchange differences will be recognized for tax purposes.
• Companies may use the US dollar or other exchange currencies as their functional currency. However, since the currency accepted for tax purposes is the Colombian peso (COP), such companies will need to maintain a multi-currency registration system.
• If a collaboration agreement establishes a guaranteed return on investment for any of the parties, the contribution made by that party cannot be treated merely as a contribution, but must be treated as the provision of services or a sale.
• Certain changes are made in relation to the tax accounting for inventory.

Income tax for individuals

Taxable base and rates: The maximum income tax rate for individuals is increased from 33% to 35%. Additionally, the calculation of income tax payable for individuals is modified – it must be computed by separating the income received from different sources (employment income, pensions, royalties, other non-employment income and dividends and profit participations), and aggregating the tax payable for each source of income. Special rules apply to stock-based compensation.

Alternative income tax computation systems, such as the national minimum alternative tax and the simple minimum alternative tax are abolished.

Dividends: If a Colombian resident individual receives dividends from profits that were not subject to tax at the corporate level, the dividends will be taxed at a rate of 35% plus a special rate ranging from 0% to 10%, depending on the amount of dividend income derived. If the profits from which the dividends are paid were taxed at the corporate level, the dividends will be subject only to the 0%-10% rate.

Simplified income tax for small businesses

An optional, simplified tax regime that replaces the national income tax and also covers certain social contributions is available to qualifying small businesses operated by individuals.

Special tax regime for nonprofit entities

Nonprofit entities now are considered income tax payers, subject to the same rules applicable to companies. To be considered eligible for the special tax regime for nonprofits, a nonprofit will have to request that status from Colombia’s tax administration and meet specific requirements.
Withholding tax rates

The withholding tax rates for payments to nonresident companies are as follows:

- Dividends: See under "Income tax for companies," above;
- Payments for interest, commissions, fees, royalties, leasing or professional services: 15% (previously, the rate on interest was 14% or 33% and 10% on the other payments);
- Consulting, technical assistance and technical service fees: 15% (previously 10%);
- Administrative services: 15% (previously 0% or 33%);
- International transportation services: 5% (previously 3%); and
- Other cases not otherwise regulated: 15% (previously 14%).

Indirect taxes

Value added tax (VAT):

- The standard VAT rate is increased from 16% to 19%.
- The taxable events for VAT purposes have been modified:
  - The sale or transfer of rights over intangible assets associated with industrial property will be subject to VAT at a 19% rate.
  - The provision of services (including the acquisition or the exploitation of intangibles from abroad in Colombia) will be subject to VAT regardless of whether services are rendered within the Colombian territory or overseas, as long as the beneficiary of the services is located in Colombia (previously, only services provided in Colombia were subject to VAT). The Colombian beneficiary will have to account for the VAT under the reverse-charge mechanism and pay the amount of VAT due.
- Annual VAT returns are eliminated; instead, VAT payers are required to file bimonthly or quarterly returns.
- The credit of two percentage points of VAT is eliminated as a tax discount on the importation of capital goods.

Other indirect taxes:

- The financial transactions levy is extended permanently, at the current tax rate of 0.4%.
- A national carbon tax is introduced, which is levied based on the carbon content of all fossil fuels, including all derivatives of petroleum that are used for energy purposes.
- New rules are provided for the municipal industry and commerce tax, including changes affecting the procedures for filing and payment and new rules to establish territoriality of the tax that will be effective as from 1 January 2018.

Tax administration

Provisional tax calculation: A "provisional tax calculation" is introduced to identify taxes that have been inaccurately reported or that have not been reported by the taxpayer, as well as omitted or improperly computed penalties payable due to noncompliance with formal obligations. The Colombian tax authorities will determine the tax due. The statute of limitations for returns amended or filed with respect to the provisional calculation will be six months from the date of filing or correction.

Statute of limitations: The general statute of limitations for tax returns is increased from two to three years from the due date to file the return or the application for a refund. Additionally, new provisions regarding the statute of limitations for returns that generate a tax loss and returns of taxpayers that are subject to the transfer pricing regime make the period six years from the filing due date or the actual filing date.

Jail for tax evaders: A taxpayer that: (i) intentionally omits assets, presents inaccurate information in relation to assets or declares nonexistent liabilities of a value equal to or greater than 7,250 minimum monthly legal salaries; and (ii) adjusts its income tax and social contributions, or the balance in favor of any of these taxes accordingly, may be punished by imprisonment of four to nine years and a fine of 20% of the asset value omitted.

Abuse in tax matters: The tax administration is authorized to recast or recharacterize transactions involving the use or implementation of one or more artificial legal acts or structures/transactions that have no apparent economic
and/or commercial purpose, to recalculate taxable income. The authorities are not required to demonstrate any additional subjective intent regarding tax abuse.

The mandatory disclosure regime for aggressive tax planning strategies that was proposed in the tax reform bill was not included in the final version of the law.

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