

Global Tax Alert

News from Americas Tax Center

Colombia proposes tax reform

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Colombia's Executive Power has proposed a tax reform bill that would reduce the corporate income tax, modify the international tax rules, reduce the value-added tax (VAT) and increase individual income tax rates, among other changes. This bill will be debated in Congress, likely until the end of this year. Even though the bill is subject to change during the debates, it is highly likely that some form of this law will be enacted.

Business taxation

The bill would reduce the corporate income tax rate from 37% (33% tax rate, plus a 4% surcharge) to 33% for 2019, 32% for 2020, 31% for 2021 and 30% for 2022 and onwards. The bill would repeal the 4% surcharge. For income from hospitality services in new or refurbished hotels, the bill would establish a 9% corporate income tax rate for 20 years.

A 5% tax rate would apply to dividends distributed between Colombian companies. Additionally, the presumptive income tax (which is an alternative income tax determined as a percentage of the net equity of the previous year) would be reduced from the current 3.5% to 3% in 2019, 1.5% in 2020 and 0% for 2021 and onwards.

In determining net taxable income, taxpayers could deduct paid taxes and contributions that relate to their economic activity. In addition, the bill would allow taxpayers to claim 50% of paid industry and commerce and debit (i.e., financial transaction tax) taxes as a credit against their income tax liability.

Investors in a private equity fund (PEF) would not benefit from the deferral of the recognition of income, unless: (i) the PEF is closed and registered on a Colombian stock exchange, or (ii) the single ultimate beneficiary (including his or her close family) does not own 20% or more of the PEF and none of the beneficiaries have control over the PEF distributions.

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

Individual taxation

The bill would reduce the income baskets from five to two - a general basket and a dividends basket. The bill would eliminate the current exemptions and deductions. Instead, gross income would be reduced with social security payments. The bill would establish a standard deduction equal to 35% of a taxpayer's income (once reduced with social security payments), which will be capped at 240 tax units per month (2,880 tax units per year, approximately US\$31k per year). Additionally, the bill would increase the highest bracket of the general basket from 33% to 37%.

The bill would include pension income in the general basket and would eliminate the income tax exemption for pension income below approximately US\$10k per month.

Income tax incentives

The bill would create an income tax exemption for gross income below 80,000 tax units (approximately US\$ 850k) that is derived from certain entrepreneurial activities related to technological and creative industries, or agricultural activities. The exemption period would be 5 years for income derived from technological and creative industries and 10 years for income derived from agricultural activities.

For so-called mega investments, those involving an investment of at least 50 million tax units (approximately US\$535 million) over five years and generate 50 jobs or more, the bill would establish benefits for 20 years, such as a 27% income tax rate, a dividend tax exemption, the

possibility of depreciating assets over two years, and a presumptive income tax or equity tax exemption. The benefits would not apply to the exploration of non-renewable resources, infrastructure projects, and projects related to the operation and construction of free trade zones. The bill would allow taxpayers to enter into legal stability agreements for mega investments to ensure that changes to the tax law would not affect the benefits. To enter into a legal stability agreement, the bill would require taxpayers to pay a premium equal to 0.75% of the investment.

International tax measures

The bill would subject permanent establishments (PEs) to taxation on worldwide source income (currently, they are only subject to taxation on Colombian source income). The bill would not allow taxpayers to deduct interest expenses that are attributable to a PE and are not subject to withholding tax. The bill would not, however, modify the rule that allows taxpayers to deduct interest expenses when the transfer pricing rules apply.

In addition, the bill would subject indirect transfers of Colombian assets to tax in Colombia, but certain exceptions would apply.

The bill also would establish a holding company regime. Under that regime, dividends received from, and proceeds from the sale of, certain non-Colombian entities would not be taxable in Colombia. In addition, for nonresident shareholders, dividends distributed by a Colombian holding company, and proceeds from the sale of a Colombian holding company's shares, generally would not be subject to taxation in Colombia. The regime would not apply if the shareholder of the Colombian holding company is in a tax haven.

A 20% withholding tax would apply to payments abroad for services, royalties, movie sales (currently 15%), and software licenses (currently 26.4%). The withholding tax on payments abroad for management and direction fees would increase from 15% to 33%. The 15% withholding tax on interest would apply to payments on derivative transactions associated with credit agreements. This generally would be 15% for loans with a term of one year or more, or 20% for loans with a term under one year.

The Colombian controlled foreign corporation (CFC) regime would not apply when the CFC's income is 80% or more active income. The bill also would add requirements for claiming indirect foreign tax credits (FTCs), but indirect FTCs

could not be claimed for portfolio investments. The bill would allow taxpayers to carry forward FTCs without limitation (currently capped at four years).

The bill includes rules to make the mutual agreement procedure (MAP) provided in tax treaties more viable. Agreements reached in accordance with the MAP would have the same applicability as a final judicial decision.

Equity tax

The bill would establish a new equity tax on Colombian resident individuals' worldwide net worth that would apply for years 2019, 2020, 2021 and 2022 (nonresident individuals would be taxed only on their Colombian assets). Nonresident entities would have to pay this tax on certain assets owned in Colombia, such as real estate, yachts, artwork, boats, planes, and rights over mines or oil wells. For this tax to apply, the net equity of the taxpayer would have to be at least US\$1 million approximately.

The equity tax rates would be 0.75% or 1.5%, depending on the amount of the equity. The bill would not allow taxpayers to claim the equity tax as a deduction or credit for income tax purposes.

Normalization tax

The bill would establish a tax amnesty to "normalize" (1) unreported assets; or (2) nonexistent liabilities that were included on a tax return. The amnesty would apply only for 2019. The bill would establish a 13% tax rate for the value of the unreported assets or nonexistent liabilities. For money that is repatriated to Colombia before 31 December 2019, and kept in Colombia for two years, the bill would establish a 6.5% rate.

VAT

The bill would reduce the general VAT rate from 19% to 18% in 2019, and to 17% in 2022 and onwards. The bill would eliminate the 5% VAT rate applicable to certain products and services.

The bill also would eliminate many of the VAT exclusions and exemptions, but would establish a VAT refund mechanism for low-income families.

The bill would maintain the exclusion from VAT for certain activities, such as health services, medicines, education, transportation, financial services, utilities, and residential

rents. Additionally, the bill would maintain the requirement for taxpayers to register as VAT responsible and collect the tax for remote services providers. The bill would, however, allow foreign service providers of electronic services or digital content to voluntarily opt into a VAT withholding tax collection system through debit and credit card issuers. This provision would accord with recently released Resolution 51.

The bill would allow VAT paid on the acquisition or construction of fixed assets to be taken as a credit against the income tax due.

Small business tax

For small businesses (those with gross income below 80,000 tax units per year - approximately US\$850k), the bill would establish a small business tax that would replace the income tax, VAT and the general excise tax (where applicable). The small business tax rate would be between 2.6% to 13.6% of a small business's gross income, depending on the business's economic activity and the amount of gross income.

Other proposals

The bill would:

- ▶ Not impose penalties in 2019 on taxpayers who do not issue electronic invoices, to the extent that regular invoices are issued and technical and business reasons delay the implementation of electronic invoicing
- ▶ 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 if a taxpayer made payments required by a notice of deficiency or as a result of an official adjustment to a filed tax return

The bill would repeal the following rules:

- ▶ The use of the valuation or self-valuation as the tax basis of real estate
- ▶ The non-deductibility of royalties related to the acquisition of finished goods
- ▶ The holding period for shares of companies that have entered into mergers or demergers

For additional information with respect to this Alert, please contact the following:

Ernst & Young S.A.S., Bogotá

- ▶ Margarita Salas margarita.salas@co.ey.com
- ▶ Luis Sánchez luis.sanchez.n@co.ey.com
- ▶ Ana María Barbosa anamaria.barbosa@co.ey.com
- ▶ Andres Britton andres.britton.arenas@co.ey.com

Ernst & Young, LLP, Latin American Business Center, New York

- ▶ Juan Torres Richoux juan.torresrichoux@ey.com
- ▶ Ana Mingramm ana.mingramm@ey.com
- ▶ Enrique Perez Grovas enrique.perezgrovas@ey.com
- ▶ Pablo Wejcman pablo.wejcman@ey.com

Ernst & Young LLP (United Kingdom), Latin American Business Center, London

- ▶ Jose Padilla jpadilla@uk.ey.com

Ernst & Young Tax Co., Latin American Business Center, Japan & Asia Pacific

- ▶ Raul Moreno, *Tokyo* raul.moreno@jp.ey.com
- ▶ Luis Coronado, *Singapore* luis.coronado@sg.ey.com

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