

Tax Alert

Tax Reform Bill 2022

New Colombian Government submits a tax reform bill to the Congress

On August 8th, 2022, the new Colombian Government submitted to the Colombian Congress a tax reform bill which expects to collect revenues of COP25 trillion for 2023 (1.72% of the GDP), increased to COP50 trillion by 2026, through the reduction on tax evasion.

This alert highlights the most relevant topics of the proposal.

Corporate income tax ("CIT") rates

The general CIT rate of 35% will remain the same. However, several existing reduced CIT rates (generally 9%, or in some cases 2%) applicable to certain hotels, theme parks, ecotourism services, some late maturity crops (e.g., cocoa, rubber, oil palm, citrus, and fruit trees), some publishing companies, international shipping services, performed by vessels registered in Colombia, among others, would be eliminated and the 35% CIT would be applicable.

The 3 percentual points CIT surtax applicable to financial institutions (currently in force until 2025), would become permanent (i.e., total nominal CIT rate of 38%).

Industrial and services users of Free Trade Zones ("FTZ") would require complying with some exportation thresholds set by the Colombian Government in order to keep benefiting with the reduced CIT rate, which is generally 20%. The one-entity FTZ would be subject to the 35% CIT.

Dividends paid to non-residents out of profits subject to taxation at the corporate level would be subject to a 20% rate (currently dividend tax is levied at a 10% rate).

Non-resident (companies and individuals) and Colombian residents companies' capital gains tax rate would be increased to 30% (currently 10%).

Tax deductions, benefits, and incentives

Elimination of the possibility of claiming 50% of the industry and commerce tax effectively paid as a tax credit. Therefore, this tax would be treated 100% as a tax deduction.

Certain expenses such as the payment of club memberships or certain payments to employees to help in the acquisition of housing, among others, would be not deductible.

The value of a specific list of non-taxable income, special deductions, exempt income, and tax credit should not exceed 3% of the net taxable income before being reduced by special deductions.

The tax bill proposal providers for the elimination of several special tax treatments such as: the characterization as non-taxable income for some gains in the transfer of shares listed in the Colombian stock exchange, as well as income derived from certain stock dividends; deemed costs and expenses applicable to coffee crops; several income tax exemptions (e.g., those applicable to some entrepreneurial activities related to technological and creative industries, activities related with the development of the agricultural sector as well as forestry plantations, fluvial transportation, construction of low-income housing, among others); the mega-investment regime; the special economic and social development zones regime (Zese); certain benefits related to the film and publishing industries. However, as a transitory measure, in those cases where the requirements to obtain the benefit have been met by a given taxpayer, such benefit would be still applicable for such taxpayer for the term that it was originally contemplated.

Changes to the concept of "effective place of management"

The tax reform lowers the bar to consider that a foreign company has its effectively place of management in Colombia (and thus becomes a Colombian tax resident). This since the proposed test would be focused on the place where day-to-day activities are carried out, rather than where strategic and decisive decisions are taken.

Taxation of non-resident entities with significant economic presence in Colombia

The tax reform establishes the concept of "significant economic presence", under which foreign entities would be taxed as if they have a permanent establishment in Colombia and the income related to such "significant economic presence" would be considered as Colombian source income.

According to the proposal, a non-resident entity will trigger a "significant economic presence" in Colombia when:

- Its gross income derived from transactions concluded with customers located in Colombia is higher than 31.300 tax units (approx. USD \$ 297,000). during the relevant taxable year, **or**
- Uses a website with a Colombian domain, **or**
- Has interactions with more than 300,000 or more users located in Colombia, during the relevant taxable year.

In the case that the activities in Colombia are developed by different related parties, the criteria mentioned above will be analyzed considering the transactions of all related entities.

Payments to non-residents with a significant economic presence in Colombia, would be subject generally to a 20% withholding tax. The collection mechanism would be subject to regulations in the case of payments made by individuals who use Colombian methods of payment (e.g., credit cards issued by banks in Colombia).

Furthermore, the tax reform provides that in the case of foreign entities which are resident in a tax treaty jurisdiction, the provisions of the relevant tax treaty will prevail over the Colombian domestic law.

Individual taxation

Dividends and capital gains obtained by Colombian resident individuals would be subject to the ordinary progressive rates between 0% to 39% (currently these items are generally subject to a 10% rate),

The annual limit of the 25% exempted labor income is reduced from 2.880 tax units (approx. USD \$27.400) to 790 tax units (approx. USD \$7.500). The annual 40% overall limit of exempted income and deductions related to the general basket is reduced from 5.040 tax units (approx. USD \$48.000) to 1.210 tax units (approx. USD \$11.500).

The annual exempted income for pensioners would be reduced from 12.000 tax units (approx. USD \$114.000) to 1.790 tax units (approx. USD \$17.000).

Equity tax

The proposal includes a new permanent equity tax on Colombian resident individuals' worldwide net worth (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 3.000 million (approximately US\$750.000) as of January 1st of each year. The equity tax rates are between 0.5% and 1%.

Additional tax measures

The tax reform includes some additional changes focused in certain sectors or activities as follows:

- It is proposed a tax on single use plastics used for packaging, wrapping, or packing goods. The rate would be 0.00005 tax units (COP 2 approx.) for each gram of the

container, packaging or packing. The taxpayers of this tax would be producers and importers of single-use plastics.

This tax would not be deductible for income tax purposes.

Single-use plastics used to wrap, pack or package medicines and hazardous waste material according to current regulations are excluded. In addition, the bill states that this tax will not be levied when the taxpayer obtains the Circular Economy Certification -CEC, which will be regulated by the Ministry of Environment.

- New national consumption taxes would apply to sugary beverages (some dairy products would be exempted) and ultra-processed foods. In the case of sugary beverages, the tax rate would vary between COP \$0, \$18 or \$35 per 100 ml, depending on the level of sugar. For ultra-processed foods the tax would be of 10%. The consumption taxes responsible would be the producer or the importer and their related parties (if any).
- The sale, importation or self-consumption of coal will be subject to the existing carbon tax. The carbon tax responsible party would be the purchaser or the producer when it uses the carbon for its own benefit. Coking coal would not be subject to carbon tax. The applicable rate would be COP \$ 20,500 (USD \$ 5 approx.) per ton.
- Finally, the tax reform includes some additional measures to the oil and gas and mining sectors:
 - Exports of certain subheadings of oil, coal and gold would be subject to a windfall tax at a 10% rate over the exportation value in excess of some reference values.
 - Royalties paid to the government for the exploitation of non-renewable natural resources would not be deductible for income tax purposes.
 - The accelerated amortization in a term of 5 years for investments in exploratory activities between 2017 and 2027 would be repealed.
 - The certificate of tax credit (CERT) for new investments in oil and gas and mining would be repealed.

If you need additional information, or require our advice in this matter, please do not hesitate to contact us.

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