Doing Business in Colombia 2014

Legal and Corporate Taxation Framework in Colombia for the Mining Industry - An Overview

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Colombia Population	47,480,955
Oficial Language	Spanish
Top 3 industries	Petroleum Banking Industrial manufacturing
Mining Industry	
% of GDP	2.4%
Mining GDP composition	66% Coal, 20% Metallic Minerals, 14% Nonmetallic Minerals
Industry average growth 2010 - 2012	7.6%
Main mineral resources	Coal Gold Nickel/Ferronickel
Main Producers	Drummond Cerrejón Prodeco Colombian Natural Resources Cerromatoso
Source	Dane, Mundo Minero Magazine & La Nota Económica magazine

Colombia has been producing gold and other commodities such as nickel, copper and uranium, for many centuries, but exploration by foreign and domestic investors has grown tremendously in recent years. The Colombian mining industry contributed an average of 2.4% to the GDP between the years of 2000 and 2012, and went from USD 2.5 billion in 2000 to USD 6.1 billion in 2012.

1. Boletín Estadístico de Minas y Energía; Sector Minero (2010). Mining In Colombia Exploring the last Andean Frontier (2011)

Colombia is recognized in the mining world for having one of the largest coal reserves in Latin America and for being one of the largest producers and exporters in the continent. Ninety percent of Colombia's coal production comes from the reserves of Cesar and La Guajira departments. All of this coal is produced for foreign markets; 32% goes to the United States, 17% to the Netherlands, and 5% to the United Kingdom.

Mineral exports have increased significantly in the last 10 years. In 2000, mineral exports amounted to just over USD 1.2 billion and in 2012, it increased up to USD 12.8 billion.

Colombia possesses a rich store of natural resources ranging from minerals to energy, and agricultural products to fuels. In terms of species per land unit, Colombia is the second most bio-diverse country in the world, not only counting with an extensive freshwater resource, but also having the sixth-largest area of primary forests in the world.

Some of the main issues influencing the development of the mining sector in Colombia are:

Infrastructure

Colombia's mining industry is facing major challenges related to the infrastructure; currently, the roads and railways available are not adequate to import the needed machinery for mining and exploring, or to transport the exporting goods.

However, several projects such as *La Ruta del Sol* and *Las Autopistas de la Prosperidad*, are being developed to improve the infrastructural conditions of Colombia, helping the mining industry to reach its potential. Additionally, being that Colombia's territory has been unexplored for more than 40 years, it is considered as one of the most attractive countries for mining in Latin America, as well as in the world.

Recruiting and retaining a skilled workforce

Due to the current boom in exploration, there are not enough skilled people to keep up with the existing mining requirements and there are not many mining programs in universities to train people fast enough to meet the demand. This also is likely to take qualified labor costs up.

Illegal mines

There are mines operating without permission, which could lead to human and environmental risk. As this kind of mining continues to grow, legal mining is negatively impacted. Illegal mining has increased over the years, and due to the low standards in skilled labour, they do not face the current work shortages that legal mining has. Even though institutional efforts towards reducing illegality in the sector are being made, this problem is still predominant, with more presence in gold extraction. The challenge that it represents to the government and legal companies, is to make sure that the public can distinguish the difference between responsible mining, craft mining and illegal mining, in order to restore the good image of the industry.

Mundo Minero, Magazine (2011,2013)

Colombia has taken decisive actions in recent years to attract foreign investment through new laws that make the regulatory landscape more efficient and attractive to investors

a Permanent Establishment

Under corporate laws, to participate in the mining industry, non-resident companies must set up a permanent establishment, either a branch office or a subsidiary. However, as an exception, non-resident suppliers of works and services for the mining industry are not required to have a permanent establishment if the extent of the length of the work does not exceed 1 year.

Other triggering events include acting as a contractor for the construction of works or the provision of services, opening commercial establishments or business offices in Colombia, and participating in business activities with the purpose of managing or investing funds originated in private savings. The subject of permanent establishment has been provided by the law for commercial law purposes, but not for tax purposes (however, recently concluded Double Taxation Treaties set forth tax-specific permanent establishment rules).

Most recently tax legislation passed in December 2012 introduced a set of rules on permanent establishment for tax purposes, which fundamentally is driven by the fixed place of business test.

b Incorporation Vehicles

There are generally four corporate vehicles that are widely used by foreign investors to establish a presence in Colombia: corporations, limited liability companies, simplified stock corporations (SAS), and branch offices. Non-resident mining companies generally choose to set up branch offices as their vehicle to invest in Colombia. Coal, nickel and uranium mining branches belong to the special F/X regime.

c. Main Corporate Features of the Colombian Branch Office of a Foreign Company

A branch office is generally treated as part of its Home Office, the consequence of which is the absence of separate legal personality. However, in certain events for tax and Central Bank purposes, a branch office is recognized with an "independent" status. One of the consequences for this lack of independent legal status, is that the foreign home office is ultimately liable for the obligations of the Colombian branch. Most structures in Colombia therefore, use "blockers" or holding companies to form the Branch, which in turn are ultimately owned by Home Offices.

d. Registering a Colombian Branch Office of a Foreign Company or Incorporating a Subsidiary

To set up a branch office or incorporate a subsidiary in Colombia, the non-resident investor must satisfy certain paperwork requirements which include producing and incorporating several documents into a notary-signed-off deed, which is then registered with the Chamber of Commerce (as well as registering the branch or the subsidiary with the Ministry of Mines, where applicable – as it applies to service providers to the industry).

Incorporating a SAS can be the quickest route and may take over two weeks to create. However, registration of a branch office or a subsidiary with the Ministry of Mines can generally take one or even two months to complete.

e. Special F/X Regime – Branches

As noted above, a special F/X regime is available for branch offices of foreign mining companies that explore and exploit coal, nickel and uranium.

Under this regime, the Colombian branch is not required to bring back into the Colombian F/X market the foreign-currency proceeds collected from sales.

These are normally received and kept by the home office directly abroad. Correlatively, the branch is not allowed to purchase foreign currency in the Colombian exchange market to pay for imports and services nor can it engage in cross-border leases or debt.

f Limited F/X Regime Subsidiaries

Miners, other than coal, nickel and uranium players, are subject to the regular F/X regime which requires generally domestic sales to be paid in local currency as well as to repatriate proceeds from exports. These miners have access to the domestic FX market and can buy and sell currency as needed as well as they can engage in cross-border debt or leases into Colombia.

g Legal Stability Contracts

Beginning 2013 this framework is no longer available for new applicants. However, miners which may have been granted stability agreements are grandfathered until expiration of the agreements. Applications filed prior to about December 26, 2012 may, at the Government's discretion, be approved to provide legal stability.

h Other

To participate (upstream) in the mining industry, a license from the government mining authority is required. This is known as the "Mining Title". The government mining authority keeps a public register of mining title holders.

The mining title is generally granted for 20 years

a Income Tax

Beginning 2013 income tax rate went down to 25% while at the same time a new income tax for equality or CREE was introduced at 9% for years 2013 through 2015. Beginning 2016, the rate for CREE will be 8%.

Income tax liability is determined as a rule as the excess of reportable revenue over deductible costs and expenses ("regular taxable income – RTI"). There is however a minimum liability to be reported, which is established by an alternate computation method, the so-called presumptive income system ("PTI"). However, no PTI is required for the mining industry. CREE tax liability however, may, under the statutes, be based on PTI.

PTI is equal to 3% of opening tax equity (equal to tax equity at December 31 of the previous taxable year). The 25% is thus applied to the greater of RTI or PTI as income tax plus 9% (8% from 2016) for CREE purposes.

Any excess of PTI over RTI, as adjusted by inflation, may be set-off against regular taxable income during the following five (5) taxable years.

Tax losses incurred beginning 2007 may be carried forward to any future taxable year, with no amount limitations. These tax losses cannot be transferred to shareholders. CREE tax liability cannot be offset by tax loss carry-forward.

Statute of Limitations: While typically 2 years, it can be reduced to one year (or even less) if the current year's income tax liability exceeds that of the prior year by certain amount.

The statute of limitations for an income tax return where a tax loss has been determined or where a prior year tax loss is offset is of 5 years.

Mining exploration expenditures are amortized under the straight line or units-of-production methods over a period of 5 years at a minimum.

Unsuccessful exploration expenditures can be written off either in the year in which the failure of the exploration efforts is determined or in any of the (2) two following years.

Costs and expenses incurred abroad for the obtainment of local-source income shall be limited, as a rule, to 15% of the entity's net income before these expenses, except for certain exceptions provided by the law.

The 30% super-deduction for the acquisition of tangible producing fixed assets was repealed beginning 2011. For taxpayers that applied to the Legal Stability Regime prior to November 1st, 2010, the government may stabilize this benefit for three years only.

Income tax payers that stabilized the super-deduction before 2011 are still entitled to claim as deductible expense 30% of the acquisition cost of any productive, tangible fixed assets.

This deduction is available for the taxpayer in the year in which the qualifying assets are acquired (or built, as the case may be), while still 100% of the acquisition (or construction) cost is available as a tax amortization or depreciation base.

OECD-based transfer pricing regulations have been applied in Colombia. Under these regulations, cross-border transactions with foreign related parties must meet the arms-length standard. Taxpayers whose gross assets or revenue exceed certain thresholds are also required to submit TP filings.

Double Taxation Treaties with Mexico, Canada, Chile, Spain and Switzerland are presently in effect and it is expected that treaties with Korea, India and others come into effect over the next few years.

At the regional level (Andean Community), Colombia, Peru, Ecuador and Bolivia are parties to the source-based double taxation treaty set forth in Decision 578 of 2004.

Beginning 2013, thin cap rules are imposed on a 3 to 1 ratio on interest-bearing debt, whether domestic or cross-border and regardless of related or unrelated parties.

b) Dividend tax

Dividends are not taxed provided they are paid out of fully taxed earnings. Otherwise, they will be subject to income tax at 25% even if distributed by branches or subsidiaries.

c VAT

The general rule is that the sale of tangible personal property and the provision of services are subject to VAT at 16%, except where an exemption is available.

Mining sales are treated as follows:

- Direct export sales qualify for zero-rate treatment; with all input VAT being refundable to the taxpayer upon request.
- Local sales for purposes are generally taxable at 16%, and the entire related input VAT can be credited against the tax charged on the sale. No refunds available.

Temporary imports of heavy equipment are not subject to VAT under certain circumstances.

Definitive imports of heavy equipment are subject to VAT at 16%, with a two year term available for payment of the tax for equipment which CIF value of which exceeds 500,000 USD. The importer can also elect to credit the VAT payments against its income tax liability for the year of the import or for any subsequent year.

d Other Taxes

Financial transaction Tax: It is triggered as funds are disposed through the local banking system. The current rate is 0.4%. For income tax purposes 25% of the financial transaction tax is deductible for FY 2011 and 2012, 50% beginning 2013, until full phase out as follows:

0.4% for year 2014.

0.2% for year 2015.

0.1% for year 2016 and 2017.

0% for year 2018 and onwards.

Industry and trade tax: A (city) municipal tax that applies to revenue derived from industrial, commercial and services activities carried out in the territory of any given municipality. The mining industry, to the extent subject of royalties, is exempted from paying this tax on operating revenue. However, a bill is currently under consideration by Congress, provides authority to cities/municipalities to tax miners' operating revenue while at the same time making the liability not deductible for income tax purposes.

Real estate taxes: apply to real property held at January 1 of any given year (at rates that vary depending on usage, and can be as high as 1%) and are fully deductible for income tax purposes.

Surface Tax: (land rental fees) is a compensation charged by the State over the concession area during the exploration, assembly and construction phases. It is also applicable over extent areas that the contractor maintains for exploration during the extraction phase.

The exploration tax rate is assessed depending on the size of the property.

Withholding taxes

Generally all companies are required to collect withholding taxes from payments made to related/unrelated parties, for income tax purposes and under certain circumstances for VAT and municipal tax purposes. Withholding tax collections must be reported and paid by the withholding collection agent on a monthly basis.

A 10% withholding tax applies to fees paid to non-resident service providers of consulting, technical assistance and technical services, whether supplied in Colombia or abroad. No other services supplied from outside Colombia attract withholding tax.

A 1% self-withholding tax applies on the gross proceeds from the export of mining products.

Most services supplied inside Colombia attract withholding tax at 33%, except where Double Taxation Treaty relief is available.

Interest payments from Colombia to non-resident lenders attract withholding tax at 14%, 33% or treaty rates.

Royalties

Mining businesses are required to pay royalties on the value of production at the mouth or border of the mine (total sales less transportation and other costs associated with marketing), at rates that vary between 3% and 12% depending on the product (legislation is currently being considered to introduce changes).

A Bill currently under consideration by Congress, introduces a number of changes to royalties, including among other, increased rates for certain minerals, progressiveness and inability to deduct royalties for income tax purposes.

1%	*Construction materials, limestone, Plaster, Clay & Gravel.*
3%	*Non-metallic minerals.*
4%	*Gold and Silver.*
5%	*Coal (less than 3 million tons), Iron and Copper, Platinum & Metallic minerals.*
6%	*Gold downpour in concession agreements.*
10%	*Coal (more that 3 million tons) & Radioactive Minerals.*
12%	*Nickel & Salt.*

Seeing corporate social responsibility (CSR) as the right way to promote sustainable development for industries, mining companies have to figure out how to develop a viable mining project (artisanal, small or large) and attain a state of sustainable development in a local, regional and national context.

Colombia's governmental authorities expect to obtain a more balanced development within regions, enjoying the positive impacts of mining (local employment, vendor and supplier entrepreneurship, access infrastructure, technical skills education, among others) and reducing the negative ones. Of course, the country has to fix the high-level priorities regarding natural resources use and ecosystem preservation, in a crystal clear way such that every government branch or agency has to comply with and adapt to their policymaking and monitoring.

In a sentence, to enhance Institutional quality in order to assure the natural capital transformation into other forms of capital (e. g. human capital) leading to comprehensive wealth increase, and demonstrate it.

Another challenge in the industry, is the ability to measure and disclose the impact of mining in a local and meaningful context to all stakeholders. Approximately 30% of Colombia's territory corresponds to ethnic groups, which by Constitution have preferences above normal civilians and have to be respected and treated according to their particular traditions.

This is important for international investors to understand if they are willing to operate near any of these particular groups, for both stakeholders and ethnic groups needs have to be taken care of.[3]

3. Mundo Minero; Un nuevo Horizonte (2011)
La Minería en Colombia: Impacto Socioeconómico y Fiscal (2008)

PwC is developing and advancing a decision making tool for this situation; Total Impact Management and Measurement[4]

Adequate use of royalties by the local governments to address local issues, is one of the challenges governments, communities and mining companies have to face. There is a shared responsibility not only to pay the right amount on a timely basis, but also to appropriately target the financial resources and to avoid corruption and bribery. Now more than ever, since our country is moving towards OECD inclusion and EITI adoption.

Local communities are increasingly more aware now of the impact of mining and are concerned about the use of vital resources, but communities must also consider how mining can enhance the lifestyle of communities. For this to happen, there must be a frequent and open dialogue with the communities, so they are more sensitive of what is being done and the potential impact it can cause.

Ending 2013, a Presidential Directive on Previous Consultation Process was issued and it proposes a set of modifications to the business as usual practice (PD 10, November 7th, 2013).

Communities can see mining companies as a desirable, useful and valuable neighbor, even a role model, or as the enemy preying on them. The difference rests in the procedures a company puts in place to ask, hear and check with them about the model of development they envision for a sustainable future and how a mining project fits and works into that kind of model.

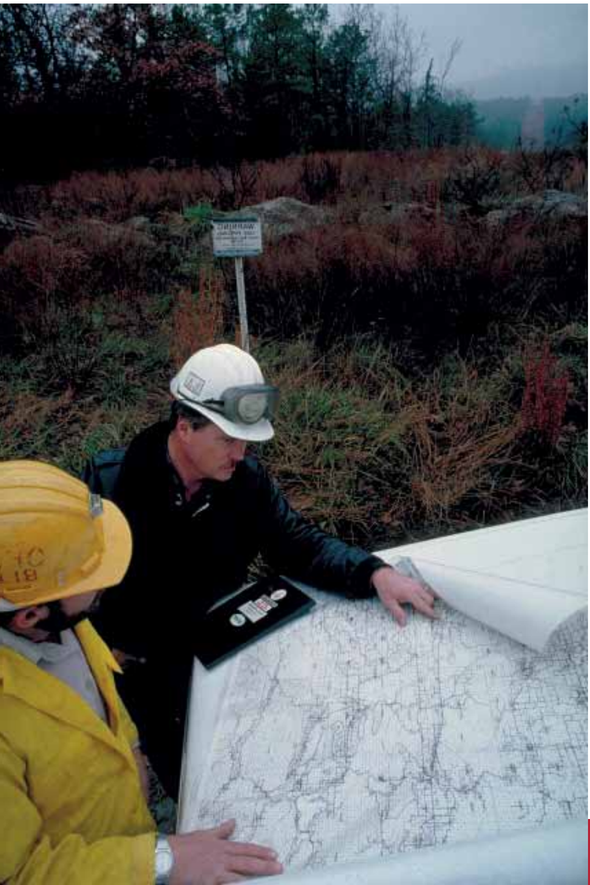
At some smaller mines, mining is done in a non-technical way. This practice is performed by people whose interest is to get the highest returns possible. This is a constant source of problems for communities whose environment is impacted negatively, and for environmental and mining authorities who granted mining rights and environmental licenses.

4. www.pwc.com/totalimpact

This is a challenge for the mining and environmental institutions, as it affects the image of mining sector as a whole and is a point of conflict with organizations and groups dedicated to promoting environmental protection and social prosperity.

Local mining and environmental authorities are strengthening and reviewing their planning and policy-enforcing activities in order to give clear signals to mining operators and communities on the mining zones, and explaining how a mining title could be used.

Academic institutions were commissioned to enhance mining planning data in controversial zones.These entities provide clear guidelines and regulations and communicate benefits for both the environment and the public, concerned with mining issues. Asomineros and Sector de Minería a Gran Escala (SMGE), are some examples of these supporting entities.



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