Colombian government passes major tax reform, including rate increases and new taxes

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In brief

The Colombian government has passed a major tax reform package that introduces a temporary net wealth tax assessed on net equity on domestic and foreign legal entities, repeals the previously scheduled rate decrease for the income tax on equality (CREE for its Spanish acronym), introduces a CREE surcharge until 2018, and increases domestic law income tax withholding rates on cross-border payments, among other significant changes.

The tax reform law was signed by the Colombian President on December 23, 2014 and will take effect on January 1, 2015.

In detail

The tax reform law includes the following key provisions.

Net wealth tax (impuesto a la riqueza)

The law provides for a temporary net wealth tax (NWT) that will be assessed annually on net equity for tax years 2015 through 2017 (2018 for individuals). The NWT will apply to domestic entities, as well as nonresidents that hold any wealth in Colombia, directly or indirectly via branches or permanent establishments (PEs). With respect to wealth held in Colombia indirectly via a branch or PE, the taxable base will be the net equity attributable to the PE, as determined in accordance with a transfer pricing study.

The law provides that NWT will be triggered to the extent that, as of January 1, 2015, a taxpayer's net wealth (net equity) in Colombia equals or exceeds $1 billion Colombian pesos (approximately US $425,000). Once the applicability of the tax is determined as of January 1, 2015, the relevant taxable base will be determined *annually* for 2015, 2016 and 2017 as follows:

- The taxable base for 2015 will be the net wealth as of January 1, 2015.
- If the net wealth on January 1, 2016 or 2017 is greater than the January 1, 2015 amount, the taxable base for the relevant year will be the *lesser* of (i) the January 1, 2015 net wealth amount, increased by 25% of the immediate prior year inflationary index, or (ii) the actual net wealth amount on January 1, 2016 or 2017.
- If the net wealth on January 1, 2016 or 2017 is lower than the January 1, 2015 amount, the taxable base for the relevant year will be the *greater* of (i) the January 1, 2015 net wealth amount, decreased by 25% of the immediate prior year inflationary index, or (ii) the actual net

wealth amount on January 1, 2016 or 2017.

Note that a prior version of the tax reform bill had proposed locking the taxable base using the January 1, 2015, net wealth amount for all relevant years. The mechanism included in the new law marks an important change to that original proposal.

The NWT rate table (converted to US dollars) for companies is as follows:

Over (USD)	Not Over (USD)	Rate 2015	Rate 2016	Rate 2017
0	850,000	0.20%	0.15%	0.05%
850,000	1,275,000	0.35%	0.25%	0.10%
1,275,000	2,125,000	0.75%	0.50%	0.20%
2,125,000	And up	1.15%	1.00%	0.40%

The law includes the following important exemptions from the NWT taxable base:

- the value of shares in Colombian companies, whether held directly or indirectly through trusts or similar vehicles;
- the tax value of Colombian receivables related to an active financing business, including yields, held by non-Colombian resident financial entities; and
- the tax value of international leases (including financial returns) into Colombia.

NWT paid is not deductible or creditable for Colombian income tax purposes.

CREE tax

The tax reform law permanently extends the current 9% CREE tax rate, which was previously scheduled to decrease to 8% for 2016 and future years. The law additionally introduces a temporary CREE surcharge, beginning in 2015, for taxpayers whose CREE taxable income for the year in question exceeds approximately US $340,000. The CREE surcharge will be 5% in 2015, 6% in 2016, 8% in 2017, and 9% in 2018, bringing the total CREE rate to 18% for 2018.

Note: The CREE surcharge is based on CREE taxable income from the prior year and is payable in advance. That is, the 2015 CREE surcharge will be based on 2014 CREE taxable income and will be paid on the 2014 CREE tax return.

Exploration and production companies operating in Colombian offshore free trade zones are generally exempt from the CREE surcharge.

In general, the new law allows CREE taxpayers to:

- deduct tax losses incurred beginning in 2015 for CREE tax purposes
- claim foreign tax credits against their CREE tax liability, subject to certain limitations, and
- offset CREE taxable income with presumptive taxable income carryforwards over a five-year period.

The law additionally clarifies that recaptured income, transfer pricing, and thin capitalization rules apply for CREE purposes.

Income tax

The tax reform law:

- generally taxes any Colombian-source income earned by nonresident entities that is not attributable to Colombian PEs or branches at the rates of 39% (2015), 40% (2016), 42% (2017), and 43% (2018);
- exempts from income tax principal, interest, commissions, or other financial yields derived in connection with lending, insurance, re-insurance, or other financial activities that taxpayers enter into with governmental financial entities located in countries with which Colombia has executed financial cooperation agreements with respect to these areas;
- amends the current foreign tax credit calculations on dividend income;
- introduces a 5% withholding tax rate on interest income earned by nonresidents in connection with loans or bond-like instruments with terms of 8 years or more, the proceeds of which are used for certain public-private partnership infrastructure projects;
- exempts entities engaged in the factoring business from the Colombian thin capitalization rules; and
- taxes foreign exchange gains or losses in connection with shareholdings outside of Colombia only when the relevant investment is sold or otherwise transferred.

Other provisions

The law provides certain additional provisions, as follows:

Tax amnesty -- litigation

The law provides for reductions of 20% or 30% of penalties and interest for any tax assessments subject to litigation as of the effective date of the law, provided that 100% of the relevant tax assessment is paid. However, when only a penalty is being litigated, a 50% penalty reduction is available.

The amnesty is available until September 30, 2015 (settlement agreement must be signed by this date).

Tax amnesty -- administrative assessments/claims

For administrative assessments/claims that are initiated as of the law's enactment date but are not yet in litigation, a 100% penalty reduction would be available provided the tax liability assessed is paid in full. However, when the assessment is only penalty-driven, a 50% reduction is available.

The law also provides that penalties for failure to file tax returns may be reduced by 70% if 100% of the unpaid tax is paid in full.

The amnesty is available until October 30, 2015.

Tax amnesty -- outstanding tax liabilities

The law provides that penalties arising from unpaid taxes prior to 2013 may be reduced by 80% if the outstanding tax is paid in full on or before May 31, 2015. However, if payment is made after May 31, 2015, but no later than 10 months after the enactment date of the law, the penalties may be reduced by 60%.

When only penalties are due, a 50% penalty reduction is available if the penalties are paid on or before May 31, 2015. If payment is made after May 31, 2015, but no later than 10 months following the enactment date of the law, the penalties may be reduced by 30%.

The takeaway

US MNCs with Colombian subsidiaries, branches, or PEs should evaluate how the new law may affect their business operations, particularly in view of the new NWT, CREE tax increases/surcharges, and higher domestic law withholding tax rates on cross-border payments.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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