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Introduction

Colombia first introduced transfer pricing regulations through Act 788 in 2002; in 2003, Act 863 specified and clarified the scope. Subsequently, the Regulatory Decree 4349 of 2004 (Regulatory Decree) enacted the enforcement of the formal and substantial transfer pricing obligations.

Colombian regulations regarding transfer pricing apply from fiscal year 2004 (in Colombia calendar year equals fiscal year for all companies), are consistent with the Organisation for Economic Co-operation and Development (OECD) Guidelines, and are part of a government effort to prevent income tax avoidance. The transfer pricing rules address specific issues such as financial transactions, application of the interquartile range, adjustment to the median when the taxpayer's margins or prices fall out of the interquartile range, and considerations of the industry and/or life business cycles.

Colombian tax authorities (*Dirección de Impuestos y Aduanas Nacionales*, or DIAN) are entitled to assess taxpayers' transactions subject to the rules as from year 2005.

Statutory rules

Transfer pricing rules apply to taxpayers engaging in cross-border transactions with foreign related parties. These rules impact only the income and complementary tax computation regarding ordinary and extraordinary income, expenses (costs and deductions) and the determination of assets and liabilities between related parties. Therefore, the rules do not affect the determination of other taxes under such transactions, such as industry and trade tax, value-added tax and customs.

All transactions with related parties are subject to the rules, including transfer or use of tangible and intangible property, provision of services and financial transactions such as loans and investments.

Regarding the application of any of the transfer pricing methods, the rules clarify that income, costs, gross profit, net sales, expenses, operating profits, assets and liabilities should be determined based on Colombian generally accepted accounting principles (GAAP).

Related economic party or related party

The concepts of 'related economic party' and 'related party' should be considered synonyms and are basically defined by references to other rules that include situations ranging from statutory to economic dependency and control of companies by individuals. In this matter, Section 260-1 of the Colombian Tax Code remits to the following regulations:

- Commercial Code, which addresses the meaning of ‘subordinated’ or ‘controlled entity’ (Sections 260 and 261), including branches and agencies (Sections 263 and 264).
- Section 28 of Act 222 of 1995, which defines the concept of ‘group’ and the notion of ‘unity of management and purposes’.
- Sections 450 and 452 of the Tax Code, which addresses subordination levels.
- Finally, unless otherwise proven, transactions among residents domiciled in Colombia and residents domiciled in tax havens will be considered to be transactions among related parties (as of today, only a draft of possible countries and jurisdictions considered by the national government as tax havens is known).

Transfer pricing methods

Following the OECD Guidelines, the transfer pricing rules specify the methods for the transfer pricing analysis, as well as the comparability factors that should be taken into consideration when assessing controlled transactions in relation to those performed by independent third parties in comparable transactions. In Colombia, Section 260-2 of Tax Code establishes the following six transfer pricing methods:

- Comparable uncontrolled price (CUP).
- Resale price (RPM).
- Cost plus (CPM).
- Profit split (PSM).
- Residual profit split (RPSM).
- Transactional net margin (TNMM).

Best method rule

Transfer pricing rules do not establish a ranking for selecting a transfer pricing method, nor do they provide guidance as to the specific cases in which the methods will have to be used. In practice, taxpayers should select the most appropriate method applicable to the transaction(s) under review and adequately support the rejection of the other methods.

The most appropriate method is the one that better reflects the economic reality of the transaction, is compatible with the company’s enterprise and commercial structure, has the best quantity and quality of information, contemplates a better degree of comparability, and requires fewer adjustments.

Tested party

For the application of transfer pricing methods that require the selection of a tested party, the Colombian transfer pricing rules do not determine which party should be subject to analysis. Therefore, it is permissible to choose as the tested party either the local or the foreign related party when conducting the transfer pricing analysis.

Formal obligations

Income tax payers obliged to fulfil transfer pricing requirements are those that perform transactions with related parties located abroad that at year-end exceed the established caps of gross equity equal to or higher than 100,000 taxable units (TU) or gross income equal to or higher than 61,000 TU, as well as those taxpayers that engage in transactions with residents or those domiciled in tax havens. For FY 2012 one TU is equivalent to 26,049 Colombian pesos (COP) (adjusted every year by inflation) approximately USD 14.71, at an exchange rate of COP 1,800 per USD.

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For the enforcement of the obligations, taxpayers should report on the informative return all transactions entered into with foreign related parties, regardless of the amount. However, for supporting documentation purposes, only those transactions exceeding 10,000 TU by type of transaction are subject to a transfer pricing analysis.

Following is a short description of the requirements regarding the individual and consolidated informative returns, and the supporting documentation.

Individual informative return

Pursuant to the regulatory decree, the return must contain the following:

- Form fully completed.
- Taxpayer's fiscal identification.
- Income tax ID and country of domicile of the related parties involved in the controlled transactions.
- Transfer pricing method used to determine the prices or profit margins.
- Interquartile range obtained in the application of the transfer pricing methodology.
- Assessment of sanctions, when necessary.
- Electronic signature of the taxpayer or its legal representative, its agents or the special agent.
- If applicable, adjustment included in the income tax return.

Consolidated informative return

In cases of control or holdings, when the controller or headquarters or any of its subordinated entities must file an individual informative return, the controller or head office must file a consolidated informative return listing all transactions, including those involving affiliates that are not required to file the individual informative return. Additional considerations:

- In cases of joint control, the DIAN must be informed, in writing, which of the controllers will file the consolidated return.
- When the controller or head office has a branch and one or more subsidiaries in Colombia, the branch is required to file the consolidated return.
- When there is no branch, the subordinate with the higher net equity at 31 December of the related fiscal year would be responsible for complying with this formal obligation.
- The content of the consolidated return is similar to that of the individual return. However, all transactions performed by the related parties must be consolidated by type of transaction.

Filing of the informative returns

The forms of the informative returns are generally due in mid-July and should be filed through the Electronic Media and Payment System. The forms to be used are N° 120 for the individual informative return and N° 130 for the consolidated informative return.

Supporting documentation or transfer pricing study

The supporting documentation should be prepared and filed through the Electronic Media and Payment System on a yearly basis and it is generally due in August/September of the following year to the related fiscal year. If applicable to the type of transaction and the method selected, the supporting documentation must contain among other the following information:

General information:

- Description of the taxpayer's organisational and functional structure.
- General description of the business.
- Equity composition with name, income tax ID and ownership percentage of partners or shareholders.
- General description of the industry or sector to which the company belongs, indicating the taxpayer's position in it.
- Name, income tax ID, domicile, description of the business purpose and activity of the related parties, including ownership details and subsidiaries. The facts that give rise to the relationship must be informed.

Specific information:

- Detailed description of each type of transaction.
- For contracts or agreements, parties, purpose, terms and prices must be specified.
- For transactions with residents or those domiciled in tax havens, a copy of the documentation that certifies that the transaction took place must be included.
- Functional analysis by type of transaction, including a short description of the activities, classification of used assets and inherent risks of the transactions, among others.
- General information about commercial strategies.
- Information about the industry and description of substitute goods or services.
- Politic or normative changes that could affect the result of the transaction.
- Method used by the taxpayer in the transfer pricing analysis, selected in accordance with the best-method rule;
- Profit-level indicator used in the analysis.
- Identification and determination of the comparable companies, information sources, inquiry dates and indication of the rejection criteria of non-accepted comparable companies.
- Technical adjustments' description and, when needed, generic description of the principal differences between Colombian accounting practice and the accounting practices in those countries where the comparable companies are domiciled.
- Detailed conclusions of the level of compliance with arm's-length standard.

Annex information:

- Financial statement (general purpose).
- Balance sheet, profit and losses statement, production costs statement and sales costs statement segmented by type of transaction.
- Copy of the contracts or agreements.
- In economic or special business situations, pertinent supporting information, such as marketing studies, projections and reports must be attached.

Other regulations**Related rules**

The following Tax Code provisions do not apply whenever taxpayers' transactions are analysed according to transfer pricing rules:

- Determination of the gross profit in case of transfer of assets (Section 90).
- Other non-deductible payments (Section 124-1).
- Non-deductibility of losses in case of transfer of assets to economic related parties (Section 151).

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- Non-deductibility of losses derived from the transfer of a company's assets to its partners (Section 152).
- Cases in which occasional losses are not accepted (Section 312, paragraphs 2 and 3).

The majority of the above-mentioned rules aim to control transactions between related parties, albeit in a very general manner. As a result, it would not be appropriate to apply these rules in a case in which arm's-length values for controlled transactions would be analysed through transfer pricing rules.

It is also established that transactions to which transfer pricing rules apply will not be subject to the limitations on costs and deductions established in the tax code Section 260-7.

Until fiscal year 2009, Section 16, Act 1111 of 2006, established that the Colombian Ministry of Mines and Energy fixed the exportation sale price of minerals when they exceed USD 100 million. However, Section 67 of Act 1430 of 20 December 2010 repealed Section 16 of Act 1111.

Act 1370 of 2009 modified the first paragraph of Section 287 of the Tax Code, which states that for income-tax purposes, some accounts payable with related parties should be considered as equity. The modification consisted of including the definition of '*related party*' as stated in Section 260-1 (applicable as from FY 2010 onwards).

Tax havens

To determine if a country or jurisdiction qualifies as a tax haven, Act 863 of 2003 specified the criteria by which the national government can issue such qualification. A country or jurisdiction will be considered a tax haven if it fulfils the first requirement and any one of the other three listed below:

- Nonexistence of taxation or low, nominal rates as compared to those applied in similar transactions in Colombia.
- Lack of an effective information exchange, or the existence of regulations or administrative practices that could limit the exchange of information.
- Lack of transparency at a legal level, regulatory or administrative functioning.
- Absence of requirements for the development of a real economic activity that is important or substantial to the country or territory or the simplicity by which a jurisdiction accepts the establishment of private entities without a substantive local presence.

The Colombian government has the authority to issue through a decree the list of countries and jurisdictions considered to be tax havens. However, such a decree has not been issued to date.

On the other hand, for foreign policy reasons, the Colombian government has the authority to exclude a country or jurisdiction, even if it fulfils the above-mentioned characteristics.

Legal cases

Tax authorities have started transfer pricing audits, requesting that a taxpayer amend its income-tax return when failing to fulfil the arm's-length principle. It is expected that such requests will be brought before courts.

Burden of proof

The transfer pricing rules shift the burden of proof to the taxpayers, allowing them to develop their transfer pricing policies and to document all their cross-border related party transactions subject to the rules.

Tax audit procedures

Tax authorities have become more aggressive and have improved their transfer pricing knowledge. They have focused on:

- taxpayers failing to fulfil transfer pricing rules
- informative return formal penalties (e.g. late filing)
- requests for income tax return amendments for failure to comply with the arm's-length principle
- inter-company debt
- inter-company services fees, formalities to deduct and supporting documents to prove the benefit and rendering of the service.

It is expected that upcoming audits will focus on method selection and accepted/rejected comparables.

The audit procedure

Tax authorities use the regular or standard audit procedure, such as on-site examinations and/or written requests. During the examination, the tax authorities may request additional information and must be allowed to have access to the company's accounting records. In general, the audit procedure is as follows:

- Ordinary tax notice; in general, tax authorities grant 15 calendar days to answer it.
- Special tax notice; taxpayers have three months to answer it.
- Official assessment; taxpayers may appeal (two months) or file a complaint before a tax court (four months).
- If the taxpayer appeals, tax authorities have one year to issue a tax authority's final judgment. Once the tax authority's final judgment is issued, the taxpayer has four months to file a complaint before a tax court.
- Once the complaint is in a tax court, the process may take up to three and a half years.
- If the tax court's decision is adverse to the taxpayer, it may file a complaint before a final tax court. This process may take approximately 18 months.

Additional tax and penalties

Formal penalties for transfer pricing rules are established in Sections 260-10 and 260-11 of the Tax Code.

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Summary of Penalties

Case	Supporting Documentation		Informative Return		
	Inconsistent/ After deadline/ Not the requested/ Mistaken/ Does not permit verification	Not filed	Late filing	Amendment	Not filed
Rate	1%	1%	1% per month or month fraction	1%	20%
Base	Total value of transactions with related parties				
Cap	15,000 TU	20,000 TU	20,000 TU	20,000 TU	20,000 TU
Effect	Rejection of the cost or deduction				Could not be used as a proof
Different Base	0.5% of the net income reported in the income tax return of the same fiscal year or in the last income tax return filed. If there is no income, 0.5% of the total assets reported in the income tax return of the same fiscal year or in the last income tax return filed.				10% of the net income reported in the income tax return of the same fiscal year or in the last income tax return filed. If there is no income, 10% of the total assets reported in the income tax return of the same fiscal year or in the last income tax return filed.
Other Considerations			After tax notice, penalty will be doubled	Inconsistent information could be amended between the two years after the deadline established for the return and before the notification of the requirement.	

Section 260-2 of the Tax Code states that if the analysis of a transaction falls outside the range, the price or margin to be considered to be at an arm's-length nature will be the median of such range. In practice, and according to the type of transaction,

taxpayers should recognise additional taxable income or reject costs and deductions if they have failed to comply with this rule.

In addition, the paragraph of Section 260-10 states that:

‘In accordance with transfer pricing rules, there will be sanctionable inaccuracy with the inclusion in the income-tax return, informative returns, supporting documentation or in reports filed to tax authorities of false, mistaken, incomplete or disfigured data or factors, and/or the determination of income, costs, deductions, assets and liabilities in transactions with related parties, with prices or margins that do not match those used by independent parties in comparable transactions, which derive in a lesser tax or payable value, or in a greater balance in favour of the taxpayer. The applicable sanction will be the one established in Section 647 of the Tax Code, which can be up to 160% of the additional tax’.

It is important to bear in mind that amendments to the income-tax return can be made only if such return has its statute of limitations open, which in general terms is two years.

Use and availability of comparable information

Comparable information is required in order to determine arm’s-length prices and should be included in taxpayers’ transfer pricing documentation. Colombian companies are required to make their annual accounts publicly available by filing them to the Colombian Superintendent of Societies (*Superintendencia de Sociedades*). This financial information can be accessed through the Internet and is considered reliable data. PwC Colombia has made an important investment accruing and formatting this information so it can be used for supporting documentation purposes as of fiscal year 2007.

Limitation of double taxation and competent authority procedure

Where there is an agreement to avoid double taxation signed by Colombia with a foreign jurisdiction, in case such jurisdiction adjusts the profits (as a result of a transfer pricing audit) of the foreign related party, the taxpayer in Colombia is allowed to request a reciprocal adjustment, subject to approval of the Colombian tax authorities, on its income-tax return.

Notwithstanding such an agreement, it is necessary to harmonise the statute of limitations of the income-tax return in Colombia with what is pursued by the agreements to avoid double taxation in order to be able to request the reciprocal adjustment.

Currently, Colombia has enforced the following treaties to avoid double taxation: Andean Community (Bolivia, Ecuador and Peru), Spain (23 October 2008), Chile (1 January 2010) and Switzerland (1 January 2011).

In addition, there are treaties signed, in process and negotiation with the following countries: Belgium, Canada, Czech Republic, France, Germany, Japan, Mexico, Netherlands, Portugal, South Korea, and the United States.

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Advance pricing agreements

As of 1 January 2006, taxpayers can request an APA. These regulations refer to the content duration, time limits so that the APA may be authorised by the tax authorities, time limits so that taxpayers could request an APA, modification of an APA and cancellation of the agreement, among others.

Anticipated developments in law and practice

Law

Changes in the transfer pricing rules or enactment of new rules are not expected in the near future.

Liaison with customs authorities

There are no records or evidence of any direct communication between customs and tax authorities regarding transfer pricing.

OECD issues

Although Colombia is not a member of the OECD, the tax authorities have generally adopted the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, published by the OECD, as a specialised technical reference and not as a supplementary source of bylaw interpretation.

Joint investigations

There have been no requests to other tax authorities for specific information concerning transfer pricing.