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Experts Commission's Proposed Overhaul of Colombian Corporate Income Taxation[1]

In this issue, Colombian_Tax_Flash® provides a summary of the recent and main four (not all) recommendations in the area of corporate income taxation, from the Government appointed Tax Experts Commission for a core tax reform in Colombia. These recommendations come in a year in which the Government has already announced an upcoming tax reform, in a very distressed economic landscape and in the midst of the culmination of a Peace process that could put an end to the six-decade long internal conflict.

It is important to bear in mind that the Commission's recommendations go beyond the area of corporate income taxation, and cover individuals' income taxation, non-for-profit entities' taxation, VAT, sales tax, taxes on fuels, bank debits tax, royalties, local taxation, and certain aspects of the Colombian Tax Administration.

Whether the Government will adopt all of the recommendations of the Tax Experts Commission is uncertain, nonetheless anyone planning on, or currently doing business in Colombia should keep them in sight as part of the relevant information for short-term tax planning.

Background

Tax Act 1739 of 2014, the 2014 Tax Reform Act (the "2014TRA"), ordered the appointment of an Experts Commission to be entrusted with the duties to assess the current status of the Colombian tax system, and to recommend to the Government the necessary measures for a core tax reform driven by equity and competitiveness.

9 tax experts integrated the Commission on February 25, 2015. After 10 months from their appointment they finalized their work and on early January 2016 they tendered their report to the Government. Because the peace talks are the first priority of the *Santos Administration*, and despite the country's current fiscal situation, shortly after receiving the Experts

[1] This article was first published by the Author via Linkedin on February 8th, 2016.

Commission report the Government was quick in announcing that they did not intend to propose a tax reform any time soon; nonetheless, last week the Government confirmed that beginning the second half of 2016, they would be introducing in Congress a Tax Bill to be debated and adopted on or before year-end, case in which the new tax law would be enforceable, for the most part, as of January 1st, 2017.

The current economic landscape its not the best, a landslide fall of the crude oil prices, with no hope for a short-term recovery, and an approximate **40%** devaluation of the Colombian peso in a little bit more than a year, has compromised the Country's fiscal situation with its debt weighting more and its revenue expectations less, virtually overnight. This coupled with the short to mid-term social investment demands of the Peace process and the heavy dependence of the Country in crude oil related revenues, poses a challenge for a Government that needs to increase its revenue from tax collections in an already over-burdening tax system. Many interests are at stake and many sectors of society will be arm-wrestling their own in Congress; even the Inter-American Development Bank has shown its support for tax reform in Colombia and recently announced that the IDB too will be presenting to the Government a tax reform proposal of its own.

The scope and contents of the upcoming tax bill are currently unknown; as a matter of fact it is safe to assume that its study and preparation is only in its early stages, if it has at all begun. The recommendations of the Experts Commission are not mandatory and whether the Government will adopt some or all of them is uncertain, and whether this time around the Government will commit to the long-term welfare of the Country and not cave to the short-term needs of this Administration, introducing the long-awaited core tax reform instead of a revenue-focused reform, is even more uncertain. Nonetheless, in the following sections we will summarize the main four (not all) recommendations from the Commission in the area of Colombian corporate income taxation, to be kept in sight as part of the relevant information for short-term tax planning.

1. Corporate Income Tax

The assessment of the Experts Commission in this matter is that the Colombian corporate income tax system is unjustifiably complex, and its taxable base has been overtime eroded with the unorganized enactment of multiple deductions, exemptions and allowances. Additionally, the aggregated statutory tax rate on corporations is high above the average for Latin America; remember that since the

2012TRA the corporate income tax rate was reduced to **25%** but the 8-point reduction was replaced with the new supplemental income-tax like Equity Contribution ("CREE") currently at **9%**, and the tax burden later increased in the 2014TRA with a temporary surcharge on the Equity Contribution currently at **6%**, for a currently aggregated **40%** net taxable income based tax on corporations for FY2016, expected to increase in the following years under the current regime.

The Commission considers that these factors attempt against the efficiency, the equity, and the revenue collection level of the income taxation system for corporations. The Commission's proposal in this regard is the elimination of both the income based Equity Contribution and its surcharge, and replacing the current corporate income tax with an income tax mainly based on accounting business profits, with isolated tax adjustments when needed to guarantee equal treatment among taxpayers, and preserving specific anti-abuse provisions to prevent undue tax avoidance strategies. Depending on the country's budget forecast, the Commission's proposed statutory business profits tax rate would be between **30%** and **35%**.

2. Dividends Taxation

Currently the Colombian corporate tax system does not provide for additional shareholder taxation upon receiving dividends, provided that the originating profits were effectively taxed at the corporate level. In other words, only if originating profits are untaxed at the corporate level, the corresponding dividends will be taxed at the shareholder level upon distribution.

For the Commission, this feature of the Colombian corporate income tax system has contributed to its inequity, impairing progressive taxation on the basis of the taxpayer's contributing capacity, while affecting revenue collection.

The Commission's proposal in this regard is the elimination of the current shareholder exemption on dividend distributions originating from profits already taxed at the corporate level. In its place, the Commission proposes a shareholder tax credit of the corporate income tax of up to **20%** of the shareholder's income tax liability on the corresponding dividends distribution.

On the one hand, if we assume that the future statutory business profits tax rate is **30%** and we also assume further dividend taxation on dividends at the proposed top rate of **35%**, the aggregated corporation-shareholder income tax would be **40.5%**, after the new **20%** shareholder level tax credit. On the other hand, if we assume that the future statutory business profits tax rate is **35%** and we also assume further dividend taxation on dividends at the proposed top rate of **35%**, the aggregated corporation-shareholder income tax would be **44.75%**, after the **20%** shareholder tax credit.

3. Wealth (Net-Worth) Taxation

For the last 20 years, approximately, corporations and individuals have been subject to taxation on their patrimony, under 4-yr. temporary versions of a net-worth tax that Congress keeps enacting as a short-term measure to provide the Government with revenue to mitigate budgetary deficits.

The Commission considers net-worth taxation imperfect and anti-technical, but is aware of the near-future budgetary challenges faced by this and upcoming Administrations; in this sense, its recommendation is to stop recurring to net-worth taxation as a separate tax, and in its place increasing from **3%** to **4%** the net-worth based taxable base used to determine the Alternate Minimum Taxable Income ("AMTI") under the regular corporate income tax.

Remember that as part of the current corporate income tax assessment process, taxpayers must compute their taxable income using both the regular method and the AMTI method; the latter currently consist in multiplying the taxpayer's net-worth as of December 31st of the immediately preceding year *times* **3%**.

4. Capital Gains

Lastly, the Tax Experts Commission considers that in the case of corporations, all capital gains should be treated as a regular item of income, therefore taxed at the statutory corporate income tax rate. Remember that since the 2012TRA the current general statutory rate for most capital gains realized by both corporations and individuals, is **10%**; should Congress adopt the Commissions recommendation, the general statutory rate for capital gains realized by corporations would be between **30%** and **35%**.

Final Recommendation

Whether the Government decides to adopt part or all of the Commissions' recommendations in the area of corporate income taxation, the current fiscal crossroads of the Colombian Government impose the need for Tax Reform in the short-term horizon. Regardless of whether the Government will adopt a long-term core and corrective reform to privilege the Country's future welfare, or if it will cave to the immediate revenue-increase needs of the Santos Administration, the reality is that in this year corporate income taxpayers have to be vigilant to the direction that the upcoming reform will take and how the proposed changes will potentially impact their new or ongoing business activities in Colombia.

Please bear in mind that this is a selective summary, for informational purposes only, that focuses on certain topics of interest. Therefore, it is not intended to be a detailed and comprehensive dissertation of the topics discussed. It is advisable that our readers do not exclusively rely on this document and thoroughly review their queries, seeking qualified advice from professional tax attorneys duly admitted to the practice of law in Colombia.

For more information on other changes in other pieces of legislation both at a national and local level, which are not featured in this issue of Colombian_Tax_Flash®, you can visit us on twitter @colombiatax.

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