

COLOMBIA

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I INTRODUCTION

Colombia is litigation-prevalent. The litigation proceeding normally lasts between eight and 10 years as from the beginning of the tax audit until a final ruling is issued by the highest tax court on appeal. Per statistics, taxpayers usually win the tax controversies subject to litigation. However, the costs and expenses accrued by the taxpayers in litigations are non-recoverable (whether they win or not). So matters normally subject to litigation by taxpayers are the ones where significant amounts are under discussion. Note that no fee must be paid by the taxpayer to file for litigation. An insurance policy or a guarantee is also not required. The only condition is that the representation is carried out by a licensed attorney.

Per legal regulations, Tax Authorities are not entitled to resolve tax controversies through less adversarial mechanisms. However, there have been certain occasions in which the Colombian Lawmaker has enacted temporary settlement facilities for tax controversies. In these events, usually the taxpayer had to pay the total higher tax in discussion plus a reduced amount of the penalties and the interest accrual. Such amounts: (1) were established by the law; (2) were non-negotiable; and (3) depended on the phase/stage of the tax controversy.

There is no permanent less adversarial way of resolving a tax dispute. But it is likely that on the next tax reform issued by the Congress, a similar temporary settlement facility to the one explained, will be permitted.

II COMMENCING DISPUTES

Regardless of the tax or return under discussion, the proceedings explained below will be the same. Local tax authorities are also obligated to follow such when executing audits for the collection of their local taxes.

i Challenging tax returns

The Colombian Tax Authorities are entitled to challenge tax returns only during the statute of limitations of such returns. In Colombia, the period of the statute of limitations varies depending on the return and other circumstances.

As general rule, the statute of limitation of a tax return is three years as from the last permitted filing day, or as from the date the return was actually filed when filed late. However, if the taxpayer requested a reimbursement refund of a balance in its favour, said

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three years will be counted as from the filing for the refund. If the taxpayer must comply with the transfer pricing regime, the period of the statute of limitations will be increased to six years as from the deadline to file the tax return.

If the tax return assessed tax losses, the statute of limitation will be between 12 or 15 years depending on when such tax loss was offset. A tax return where tax losses were offset (not assessed) will have a statute of limitation of six years.

The proceeding that the Tax Office carries out when challenging a tax return is as follows.

Challenge brief

The Tax Office issues a challenge brief proposing the challenges to the tax return. In this document, which is not yet an official assessment, the Tax Authority may question any aspect of the tax return (i.e., income, costs, expenses, deductions, tax benefits, tax credits, etc.) and propose a penalty for inaccuracy equal to 100 per cent of the assessed lower balance in favour or the higher tax.

Response to the challenge brief

Three months as from the notification of the challenge brief, the taxpayer is entitled to file a response. This response can be filed by the legal representative of the legal entity, or by the person subject to audit: no licensed attorney is needed at this stage. In responding, the taxpayer should present its arguments and claims, and may file the proof and evidence that supports its position. Note however, that filing a response to the Service's challenge brief is not a requirement to further subject the controversy to litigation.

The taxpayer also may accept the Tax Office's proposal at this stage. In this event, it will have to pay the proposed higher tax or reimburse the lower balance in favour, plus any lateness interest accrued. The penalty for inaccuracy will be reduced to 25 per cent.

Official assessment

Six months as from the deadline to file the response to the challenge brief, the Tax Office is obligated to notify to the taxpayer the official assessment. This document can confirm entirely or partially what was proposed in the challenge brief. At this stage, the Tax Office is not allowed to propose challenges not originally included in the challenge brief.

Motion for reconsideration

Within the two months after the official assessment has been notified, the taxpayer is entitled to file a motion for reconsideration. This motion will be decided by the legal division of the Tax Office. At this stage, proof and evidence can also be requested by the taxpayer.

In case the taxpayer did not file a response to the challenge brief, this motion becomes obligatory to be able to file for litigation in the future. In the event such response was filed, the motion for reconsideration is voluntary and instead the taxpayer can directly file for litigation.

If the taxpayer accepts the Tax Office's challenges at this stage, it will also have to pay the higher tax in discussion or reimburse the lower balance in favour assessed, plus the delay interests accrued. The penalty, however, will only be reduced to 50 per cent.

2 In Spanish '*Requerimiento Especial*'.

Decision of the motion for reconsideration

The Tax Authority has one year to decide the motion for reconsideration filed by the taxpayer. If the decision to the motion is not properly notified to the taxpayer within the year, the controversy is deemed to be ruled in favour of the taxpayer. In Colombia, this situation is called *silencio positivo*. Note that although there is a deemed *silencio positivo* the taxpayer must sue for a Court to recognise it.

A situation of *silencio positivo* is likely to be recognised by a Tax Court. So national tax authorities are very careful that they do not have that situation. Local tax authorities are not so aware of avoiding said *silencio positivo*, and they commonly notify the motions filed after the deadlines.

Litigation

As from the notification of the decision that decides the motion for reconsideration or as from the notification of the official assessment,³ the taxpayer has four months to sue before the lower tax court. In this phase, representation by a licensed attorney is mandatory. The judicial proceeding has the following stages.

Lawsuit admission

The tax court analyses if the lawsuit complies with the general formal requirements for lawsuits, such as the filing date, the power of attorney, its jurisdiction, a proper representation, etc. If it considers that such requirements are met, it will admit the lawsuit.

In the event it considers that a requirement was not met, it will order the plaintiff to file an amendment to the lawsuit. This amendment must be filed 10 working days as from the notification of the decision that required such.

Because of the current backlog in the tax court, as from the filing of the lawsuit until a decision is issued by the tax court concerning its admission, may take approximately two to six months.

Hearings

After both parties have filed their claims, the tax court will schedule an initial hearing. In such, with the parties' consent, the tax court will decide what will be the main aspects in discussion and also will determine which evidence will be considered for the judicial process. This hearing is always mandatory and it is commonly scheduled approximately one year after the filing of the lawsuit.

If there is evidence to be shown, another hearing will be scheduled. This will not be mandatory, and if it is not executed it will speed up the judicial process. Also, the parties' concluding arguments can be presented through a hearing whenever the judge considers it necessary. If not, it will require the parties to present such in written form, which will also speed up the process.

³ In case the taxpayer filed the response to the challenge brief and it is not interested in filing a motion for reconsideration against the official assessment.

First instance ruling

Approximately 1.5 years after the closing arguments have been presented by the parties, the lower tax court will issue a first instance ruling. From the initial filing of the lawsuit until a first instance ruling, two to three years may have passed.

Appeal

Ten working days as from the date the first instance ruling has been notified, parties are entitled to file an appeal. Such appeal will be decided by the Higher Tax Court of Appeals, approximately in two to three years. The decision over the appeal will be the final one.

ii Auditing taxpayers that did not file tax returns

The Tax Office is entitled to audit the taxpayers that did not comply with its obligation to file tax returns. This proceeding can be executed by the Tax Authority within five years of the final due date to file the tax return. The main stages of the proceeding will be as follows.

Notice requesting the filing of the return

The Tax Office will issue a notice requesting the taxpayer to file the tax return. In this stage, it will propose a late filing penalty that will depend on the return in discussion and on the taxpayer's situation (e.g., it can be calculated according to the tax due, the gross income, the balance in favour, and the days of delay, etc.).

Response to the notice

The taxpayer has one month as from the date the notice was notified to file the return or file a response explaining the reasons is not obligated to such filing. If the taxpayer files the return at this stage, it will have to pay the total tax assessed, the interests and the penalty assessed.

Resolution that imposes penalty and official assessment

If the taxpayer does not file the return, the Tax Office will begin two separate proceedings: (1) one imposing the penalty for not executing such filing; and (2) another assessing the tax obligation. These proceedings will be carried out as follows.

Imposing the penalty

After the deadline to respond to the notice, the Tax Office has six months to issue a resolution confirming the penalty for not filing the return. Against this resolution, the taxpayer is entitled to file a motion for reconsideration also two months as from the date said resolution has been notified. The proceeding from then on until a final ruling is issued, is the same one explained in Section II.i under the headings 'Decision of the motion for reconsideration' and 'Litigation'.

Assessing the tax obligation

The Tax Authority will issue an official assessment determining the tax obligation due. In such, the Tax Office will indicate the taxpayer's tax liability, but it will impose no penalty since such is executed through the proceeding explained under the previous header.

Here, the proceeding carried out until a final ruling is issued, will be the same one as explained in Section II.i under the headings 'Motion for reconsideration', 'Decision of the motion for reconsideration' and 'Litigation'.

iii Imposing additional penalties

Regulations also provide other tax-related penalties that can be imposed by the Tax Office. Some examples of such are penalties for the unfair recognition of a balance, not filing the information required by the Tax Office, committing tax abusive conducts, not issuing invoices and the reduction of tax losses, etc.

The proceeding to impose such penalties can be the one explained in Section II.i or Section II.ii under the heading ‘Imposing the penalty’.

iv Amending tax returns after the due date

Taxpayers in Colombia may amend their tax returns after they have been filed. However, there are specific deadlines to execute such. Once such deadlines have expired, the only possibility to carry out an amendment, will be if the taxpayer accepts the Tax Office’s proposals in the proceeding described in Section II.i.

But note that instead of beginning the proceeding in such Section, the Tax Office can issue a notice (instead of a challenge brief.) claiming the amendment of the return. Here, the penalty proposed will lower as of such proceeding: 20 per cent of the higher tax due or the lower balance in favour assessed.

v Amendment of tax returns within the due dates

In Colombia, the process and deadlines to amend the returns, are as follows.

Amendment to increase the tax due or reduce the balance in favour

This amendment can be executed electronically within two years as from the final due date to file the return. Penalties and interest will be triggered. The penalty will be equal to 10 per cent of the higher tax due or the lower balance in favour. Delay interest will be calculated at a 30 per cent annual effective rate (approximately).

This amendment replaces the first tax return filed, but the initial period of the statute of limitations will not be modified.

Amendment to reduce the tax due or increase the balance in favour

This amendment can also be executed electronically. The deadline is one year as from final due date to file the return. However, the statute of limitation will be modified: it will not be counted as from the final date to file the return but from the date the amendment was filed. No penalties will be triggered.

vi Requesting tax exemptions

In Colombia, tax reliefs can only be claimed through tax returns. Notwithstanding, some tax reliefs need to be granted by government authorities before they can be claimed by taxpayers in their returns.

III THE COURTS AND TRIBUNALS

In Colombia, only in the capital city are there specialist tax tribunals. Outside the capital city, the tribunals are not tax-focused since they deal with all types of controversies against

government entities. To determine the jurisdiction in which a tax lawsuit should be filed, two main rules need to be considered: (1) the amount under discussion, and (2) the place where the tax return was filed.

The highest-level court for tax purposes is the Supreme Tax Court. Below there is the State Administrative Tribunal and, finally, the court of the lowest rank is the administrative judge. If the amount in discussion is lower than 100 statutory salaries,⁴ the lawsuit should be filed before the administrative judges, and the court of appeal will be the State Administrative Tribunal. If the amount in discussion is greater than 100 statutory salaries, the lawsuit should be filed before the State Administrative Tribunal, and the court of appeal will be the Supreme Tax Court.

In each level/instance, the judicial process lasts approximately three years. So litigation can take around six years as from filing the tax lawsuit until a final ruling is issued by the court of appeals. Note that it is likely that tax controversies are not concluded with issuing the first ruling. Parties usually file for appeals. Actually, the Tax Office will always file an appeal, otherwise it might be investigated by the National Controller.

Courts in Colombia are independent of the Tax Office and any other government entity. Although, sometimes tax officers have been appointed as tax judges and magistrates. Tax experts from private corporations have been also chosen as tax judges or magistrates.

The rulings issued by a tax court are limited to: (1) the claims of the plaintiff; and (2) the Tax Office's allegations filed. However, if the judge considers that fundamental rights are being violated, he or she can go beyond his or her jurisdiction and decide over a matter not proposed or claimed during the judicial process. The decision over the appeal is also limited to what was claimed in such motion.

IV PENALTIES AND REMEDIES

As a general rule, tax offences in Colombia are not punished by criminal, civil or administrative regulations. If a tax penalty is imposed on a taxpayer because of an audit or of a litigation, for that sole reason it likely will not be liable for criminal, civil and administrative purposes.

Notwithstanding, the Criminal Colombian Code establishes two penalties related to tax offences. If a taxpayer obligated to collect withholding taxes does not transfer said taxes to the Tax Office within two months of their collection, it will be deemed as liable for criminal purposes. Also, if a taxpayer when filing its income tax return omits assessing its assets or includes non-existent debts for an amount equal to or greater than (approximately) US\$1,783,000, will also be punished with a criminal penalty. Both criminal liabilities involve prison time and fines. Note that under certain circumstances, the taxpayer could not be deemed as criminally liable when it: (1) pays the taxes due (with the delay interests); or (2) amends its tax return.

⁴ In 2017, a statutory salary in Colombia is equal to US\$220 (approximately).

V TAX CLAIMS

i Recovering overpaid tax

Taxpayers in Colombia are entitled to the reimbursement of the overpaid taxes. The process to recover an overpaid tax is the same regardless where the taxpayer is located (in Colombia or abroad).

The procedure to be executed to recover such, is as follows.

Filing a reimbursement application

Five years as from the date the payment was executed, the taxpayer must file an application for reimbursement before the Tax Office. This application does not have special legal requirements. It is just necessary to explain to the Tax Office the facts that caused the overpaid tax.

Decision over the reimbursement

Within 50 working days of the application being filed, the Tax Office must decide over the reimbursement. However, the Tax Office is entitled reject such petition requiring an amendment. The 50 working days will be again computed as from filing the amended application, and the Tax Office can extend the 50-day-period an extra 90 days if it considers there is evidence of inaccuracy.

Challenging the decision

If the Tax Office denies the reimbursement, the taxpayer is entitled to move for reconsideration against that decision. The proceeding from here on to challenge that decision, will be the same as the one explained in Section II.i under the headings 'Motion for reconsideration', 'Decision of the motion for reconsideration' and 'Litigation'.

ii Challenging administrative decisions

By the proceeding described in Section II.i, any decision issued by a Tax Authority can be challenged. Note that the existence of a legitimate expectation does not change the challenging process of the decisions issued by the Tax Office. That situation will be an argument only within the proceeding to be claimed by the taxpayer.

iii Claimants

In Colombia, only taxpayers who filed the returns are the ones entitled to file tax claims. Also, the taxpayer subject to audit is the one authorised to enter to litigation. The collector of an unlawful tax will be the one entitled to request the Tax Office for a refund. This can be executed by amending the return through the proceeding described in Section II.iv or by filing a reimbursement application as explained in Section V.i.

The taxpayer subject to the unlawful tax can request for reimbursement to the collector of the tax.

VI COSTS

In Colombia, regulations provide that the amounts disbursed by a party during a litigation are recoverable if the final ruling is favourable to such party. The defeated party will be the

one obligated to reimburse those amounts. Legal rules also determine that in processes where a public interest is in discussion, such order to reimburse is prohibited. Under this legal provision, the Tax Courts have always ruled that in tax litigations it is impossible to condemn the defeated party to reimburse the costs to the winning party. This has been the case law of past years.

On 20 September 2017, the Tax Supreme Court⁵ issued a ruling where it determined that the Tax Authorities, whenever defeated, can also be condemned to reimburse the costs accrued by the taxpayer. In opinion of the Court, it is unconstitutional to conclude that a Tax Authority can never be ordered to reimburse the costs accrued by a taxpayer unlawfully audited. This ruling differs from the case law of past years.

According case law, it is impossible for a taxpayer or the Tax Authority to recover the costs accrued during tax litigation. However, owing to the ruling issued on 20 September 2017, a possibility has been open for both.

VII ALTERNATIVE DISPUTE RESOLUTION

In Colombia, tax controversies cannot be resolved through alternative dispute resolution systems. The law expressly prohibits the negotiation of taxes and the settling of tax disputes. But through the last tax reforms, the Congress has allowed the settling of tax controversies under very specific conditions: (1) the amounts due by the taxpayer were determined by law and could not be reduced nor increased; (2) it was for short while; and (3) usually only destined for taxpayers in an audit or in litigation.

Such settling of tax controversies is not available. Yet it is likely that in the next tax reforms issued, a similar alternative dispute resolution system will be introduced.

VIII ANTI-AVOIDANCE

As from 2013, the Colombian tax system adopted a General Anti-avoidance Rule (GAAR):

A transaction or transactions will be deemed abusive for tax purposes when such involve the execution of artificial acts, contracts or legal transactions, that in appearance do not have an economic or commercial purpose, and that only seek to reduce the tax burden, regardless any other subjective intention.

The Tax Office may recharacterise for tax purposes a transaction executed by taxpayers that is deemed abusive. Said entity could assess higher taxes, interest and penalties. Recharacterising an operation for tax purposes, should be understood as '[t]he Tax Office's power to determine the real nature, form and characteristics of an operation executed by a taxpayer and assessing new tax effects'.

5 File No. 20560.

The GAAR also clarifies that an operation:

... would be deemed as artificial and that lacks economic or commercial purpose, when it is demonstrated, among other circumstances, that:

- 1. The act or operation is executed in such way that under economic or commercial terms is not reasonable.*
- 2. The act or operation generated an elevated tax benefit that does not reflect the economic or corporate risks taken by the taxpayer.*
- 3. The structure of the act or operation executed seems apparently correct, but its substance hides the real will of the parties.*

Provided that the GAAR is relatively new in Colombia, the Tax Authorities have not yet enforced it. Notwithstanding, it is expected that soon audits will be performed under such scope. The Tax Courts have also not ruled considering the GAAR; however, there are judicial tax precedents where taxpayers have been questioned for the misuse of legal forms for tax purposes.

A similar situation as the one described above, has happened with the rules about Controlled Foreign Corporations (CFCs) and the Base Erosion and Profit Shifting (BEPS) Action Plan. Such were mainly introduced on 2016, enforceable as of 2017, thus neither the Tax Office nor Tax Courts have yet enforced them. Regarding CFC rules, there is evidence that the Tax Authorities are carrying out investigations seeking their enforcement.

The execution of information exchange agreements to prevent or identify tax avoidance has become an institutional policy of the government. Colombia has executed the Multilateral Instrument and also has adopted the rules about common reporting standards (CRS). Recently the Tax Office exchanged tax information with the 36 countries under the basis of the CRS rules and also under FATCA. The purpose was to obtain information regarding assets possessed abroad by Colombian tax residents. It is expected that in financial year 2018, the CTC will be able to exchange tax information with approximately 62 countries.

All the above is anchored on the desire of the Colombian government to become a member of the OECD. Meeting international standards has been part of public agenda for the past six years. It is expected that soon, the Tax Authorities will be reinforced and trained for such standards to be met.

IX DOUBLE TAXATION TREATIES

The execution of double taxation treaties (DTTs) has also been on the public office agenda. The DTTs enforceable in Colombia are the ones executed with: Canada, Chile, the Czech Republic, India, South Korea, Mexico, Portugal, Spain, and Switzerland. Colombia has also executed DTTs with France, the United Arab Emirates and the United Kingdom, although they are not yet enforceable. These have been adopted according to the OECD Model Tax Convention.

Neither Tax Authorities or the Tax Courts have yet enforced such treaties. There is no ruling, case law or administrative decision that can provide guidelines for their application. Taxpayers, however, on a day-to-day basis have adopted the DTTs as legitimate tools for tax planning purposes.

X AREAS OF FOCUS

Although no ruling has yet been issued on the matter, there is a trend of the tax officers of ‘accusing’ taxpayer of tax avoidance during the execution of the audit as a way of convincing them to accept the challenges. Regulations establish that the Tax Office must demonstrate and explain the reasons to accuse of tax avoidance; however, taxpayers are particularly concerned regarding the proceeding carried out by the Tax Office. On the next few years, this will be an area of focus that will be interesting to analyse in the Colombian tax system.

The Tax Office has been interested in the compliance of the transfer pricing regime. Audits about this matter have increased during the past years. The area of the Tax Office focused on challenging the compliance of such regime has been reinforced. Taxpayers are facing audits based on substantial and qualified grounds. As a defence strategy, taxpayers have hired recognised experts to issue opinions supporting their position regarding the arm’s-length principle. It is likely these discussions are subject to litigation since, normally, significant amounts are under discussion.

XI OUTLOOK AND CONCLUSIONS

The system for resolving tax controversies in Colombia is not efficient. Tax Officers are overworked and so are the Tax Courts. The taxpayer must wait approximately 10 years for its tax situation to be resolved through a final ruling, and it cannot recover the costs incurred during those 10 years.

The Colombian legal system has a challenge to amend the above situation. Permanent alternative mechanisms to resolve tax controversies is an option that could be considered. But, the Constitutional Court’s case law has ruled that such alternative mechanisms are not sustainable from a constitutional standpoint.

Over the next few years it is expected that the Tax Office challenges will be based on information obtained via international treaties. In addition, tax officers will be focused on identifying tax avoidance since such represents a higher tax collection.⁶

⁶ The penalty for committing a tax abusive conduct is equal to 200 per cent of the higher tax or the lower balance in favour officially assessed when recharacterising the operation.

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Mr. Rodriguez represents clients in tax controversies and litigation before the Tax Office and the Tax Courts. He advises domestic and international clients in Colombia and Latin America in a variety of industries and projects, with an emphasis on international and domestic corporate taxation, outbound and inbound international investments and related M&A and corporate law issues. Mr. Rodriguez has experience in, among other matters: domestic and regional tax mitigation; tax treaties; income and withholding taxes; VAT and other indirect taxes; transfer pricing; tax controversies; debt-equity transactions; reorganisations and M&A; infrastructure projects and privatisations; financing, structuring and restructuring joint ventures; corporate and project finance; bilateral investment treaties; and in the coordination of regional tax planning advice. Mr. Rodriguez also advises high net worth families and individuals in a variety of international and domestic tax, international investments, and legal issues.

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Ms Giraldo is a lawyer who graduated from Universidad de Los Andes (J.D equivalent) with a Graduate Degree in Taxation. She is an associate of the tax group with experience in tax litigation and tax planning. Over the past years, she has acquired specialised knowledge handling tax controversies, and has represented clients' interests before the Tax Authorities and the Tax Courts. Her experience has allowed her to propose original defence strategies for clients. She has handled more than 100 tax litigations and has also settled approximately 50 controversies with the Tax Authorities, whenever the law in Colombia has allowed it.

Ms. Giraldo has represented individuals and corporations from diverse sectors of the economy, in controversies regarding: (1) national taxes (i.e., income tax, wealth tax, VAT, etc.); (2) local taxes (i.e., industry and commerce tax, stamp tax, real estate tax, local contributions, etc.); (3) tax penalties; (4) transfer pricing; and (5) other contributions.

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