

TAX REFORM BILL 2022

On August 8th, the Colombian Government introduced a new Tax Reform Bill before Congress.

Hereinbelow, we present our general comments on some aspects that we highlight from this Tax Bill. However, this text does not summarize or analyze all the proposed measures.

Considering that this Tax Bill proposes several measures that may affect the tax burden of the taxpayers (individuals and companies) in different manners, we recommend calculating the possible tax impact of the Tax Bill using the current economic situation of the taxpayer and assessing the effects that the Tax Bill would have on the taxpayer's concrete situation if it passes through Congress without any changes.

A.

TAXATION OF LEGAL ENTITIES

1. Tax Rates

- The Tax Reform Bill does not propose to modify the general corporate income tax rate (35%), but it increases the capital gains rate applicable to Colombian and foreign legal entities from 10% to 30%. The temporary 3% income tax surcharge applicable to the financial entities would become permanent.
- The rate applicable to dividends paid by Colombian companies to foreign legal entities would increase from 10% to 20%. However, this rate may be limited if the dividend's beneficial owner is an entity located in a jurisdiction with which Colombia has a Double Tax Treaty ("DTT") in force. For more information on the network of DTTs in Colombia, we recommend consulting our [2022 Tax Overview](#).

2. Changes in Tax Benefits

The Tax Bill seeks to eliminate a large amount of the currently existing tax benefits, such as some incentives for investments in hydrocarbons and mining; the special 9% income tax rate applicable to publishing companies; the exempt income for specific hotel and ecotourism services; and some incentives for the so-called orange economy and the mega-investment regime; among others.

In addition, it proposes the suppression of the possibility of crediting 50% of the local turnover tax ("ICA") against the income tax liability. It also prohibits the deduction of royalties paid for the exploitation of non-renewable natural resources.

Regarding some specific tax incentives, it proposes to limit their benefit to 3% of the taxpayer's net taxable annual income. Among the limited benefits, we highlight the following: (i) the discount for investments in environmental projects; (ii) the exemption of profits distributed to workers through stock-option plans; (iii) the deductions provided for employee education; (iv) the deduction applicable to public shows infrastructure investments; and, (v) the discount for donations to non-profit entities.

The Tax Bill also includes an acquired rights rule that aims to guarantee access to tax benefits consolidated in favor of taxpayers before the entry into force of the tax reform. However, the scope of this provision is not entirely clear; therefore, its application should be analyzed on a case-by-case basis to determine if the benefits applicable to the taxpayer can be considered "consolidated tax benefits".

3. Changes in the Free Trade Zone's Regime:

To benefit from the preferential 20% income tax rate currently enforced, Free Trade Zone users would need to obtain the approval of an Internationalization Plan and comply with a minimum amount of exports that the Government would define. Furthermore, single-business free trade zones would lose this regime's benefits and be subject to the general income tax rate (35%).

4. Significant Economic Presence ("SEP")

To tax the profits of foreign companies that do not have a physical presence in Colombia but have some business connection with the country due to their digital presence or interaction with the Colombian market, the Tax Bill proposes introducing the concept of SEP.

Under the SEP, foreign companies that maintain a deliberate and systematic interaction with users or clients located in Colombia would be subject to income tax on their attributable income. A SEP would exist if any of the following requirements are met: (i) obtaining gross income equal to or greater than approx. USD 278,000 during the fiscal year, derived from transactions with persons in Colombia; (ii) using a Colombian website or domain; or (iii) interacting with more than 300,000 Colombian users during the fiscal year.

We emphasize that although the purpose of this regulation may be taxing activities related to the digital economy, the application of the SEP can result in taxing other sectors of the economy. Hence, it is advisable to evaluate, in specific cases, the interaction between this regulation and the provisions of the DTTs signed by Colombia.

5. Definition of Place of Effective Management ("POEM")

Foreign companies effectively managed from Colombia are considered Colombian companies for tax purposes.

The Tax Reform Bill proposes to modify the definition of POEM. Therefore, it is recommended that foreign entities effectively managed from Colombia verify their corporate governance regime to analyse their exposure to be deemed as having their POEM in Colombia.

6. Imports not subject to VAT

Although the Tax Bill does not contemplate significant modifications to the VAT regime, it proposes eliminating the VAT exclusion on imports of products for less than USD 200 through postal traffic, urgent shipments, or fast delivery. Goods imported from countries with which Colombia has a Free Trade Agreement in force that contemplates this provision will maintain the exclusion.

7. Tax on Exports of Crude Oil, Coal, and Gold

The Tax Bill proposes a new tax on the export of certain types of oil, coal, and gold. It seeks to tax the profits obtained by companies in the mining-energy sector, so it applies to the proceeds from exports, and its levied on the price per unit exported that exceeds the base prices of each product established by the Tax Bill. The applicable rate would be 10%.

8. Other Measures:

The Tax Bill proposes that under the SIMPLE regime, individuals and/or smaller companies engaged in specific economic activities opt for an alternative income tax assessment based on their gross income. In addition, it reduces the applicable tax rates for some economic activities and creates a new category for education, human healthcare, and social assistance activities.

The Tax Bill also proposes the creation of taxes that aim to discourage the consumption of sugar-sweetened beverages and ultra-processed foods. It also seeks to modify the current Carbon Tax and Consumption Tax on single-use plastics.

B.

TAXATION OF INDIVIDUALS AND FAMILIES

1. Income Tax and Capital Gains Tax

- For Colombian tax residents, the applicable rate for income tax, capital gains, and dividends would be unified. Such unified rate would be the current existing marginal rate that ranges between 0% and 39%, depending on the taxpayer's net income. Hence, the differential rates applicable to capital gains (10%) and dividends (10%) would be eliminated.
- In the specific case of **dividends**, those distributed by Colombian companies to resident and non-resident individuals would be subject to a 20% withholding tax. However, this 20% withholding applied to tax residents would not be the final tax and may be credited to the income tax liability declared in the income tax return.
- The distribution of profits that were not taxed at the company's level in favor of Colombian tax residents would be subject to an income tax effective rate ranging between **35%** and **60.4%**.
- We highlight that the project does not contemplate a transition regime on dividends. This generates uncertainty regarding the taxation on dividends from profits generated: (i) as of December 31st, 2016 (currently untaxed); and (ii) from January 1st, 2017, to December 31st, 2022 (currently taxed at a 10% rate).
- For non-resident individuals, the income tax rate would remain at 35%, the rate on capital gains would increase from 10% to 30%, and the rate on dividends would increase from 10% to 30%.
- We highlight the impact that these changes may have on the tax burden on inheritances since the tax on capital gains would increase from 10% to rates of up to 39%.
- We emphasize that it is proposed to reduce the amount exempt from **pensions**. Although there are controversies regarding the wording of this specific point in the Tax Reform Bill, government officials have stated that the final purpose would be to tax pensions that exceed USD 2.335 per month.
- It is proposed that **life insurance indemnities** exceeding approx. USD 28,800 would be taxed for the beneficiary.

- The Tax Bill includes an express prohibition of deducting from the corporate income tax certain payments related to shareholders' personal expenses that are not related to the company's income-producing activity. In addition, it provides that these personal expenses made by companies would also be considered income for their beneficiaries and, therefore, would be taxed at a rate between 0% to 39%.

2. Wealth Tax:

- The Tax Bill proposes a permanent Wealth Tax applicable to (i) tax resident individuals on their worldwide assets; (ii) non-resident individuals on their assets held in Colombia; and (iii) certain foreign companies that have assets in Colombia other than certain types of investments on their assets held in Colombia.
- The tax would be levied on taxpayers' net worth equal to or greater than approx. USD 700,638. The applicable marginal rate would be calculated by imposing a 0.5% rate for the net worth between USD 700,638 and USD 1,168,000 and a 1% rate for the amount exceeding USD 1,168,000.
- Unlike the previous versions of the Wealth Tax, the shares' value in national companies or entities that are not listed on the Stock Exchange must be calculated based on their **intrinsic value**, according to the net fiscal net equity of the legal entity, instead of being calculated at their fiscal cost. Shares listed on the Stock Exchange must be recognized at their listed value. This means that, in many cases, the taxable base of this tax is much higher than the taxable base filed by the same taxpayer in past versions of net-equity taxes. We suggest reviewing the effect this change would have on a case-by-case basis.
- Assets held through trusts, private interest foundations, insurance with a material savings component, investment funds, or other fiduciary businesses in Colombia or abroad must be declared by their final beneficiary. We highlight that various aspects of the application of the concept of final beneficiary to the wealth tax are still unclear. The value at which the rights in these entities must be declared is the net value of the underlying assets. We emphasize that there is no legal definition of the "**net value of the underlying assets**" concept.
- We highlight that assets located in certain jurisdictions with which Colombia has a DTT in force can be subject to a limitation on this tax. The application of these provisions should be reviewed on a case-by-case basis.

C.

ASPECTS NOT INCLUDED

Unlike previous tax reforms, the Tax Reform Bill presented did not include:

- New Regularization Tax.
- Mutual Agreement Termination Procedures.
- Reduced statute of limitations.
- Determination of the net taxable income through the presumptive income tax assessment.

If you have any queries regarding any of this matters please contact:
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