COLOMBIA

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INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

Recent tax reforms have recognized several corporate reorganizations as tax neutral transactions. Current tax rules recognize mergers, spin-offs and capital/in-kind contributions as tax neutral transactions. These new rules (introduced and developed since 2012) require certain conditions to be complied with for these reorganizations to be carried out in a tax neutral manner; among other things, tax neutral status depends on different business purpose criteria and corporate documentary.

On December, 2016 the Colombian Congress approved a tax reform (Law 1819 of 2016) that introduced several modifications that could affect M&A and private equity deals in Colombia (minimum price of shares for tax purposes, CFC rules, obligation to disclose the ultimate beneficial owner of local funds and companies, new GAR, etc.)

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVE?

Colombia is in the process of being accepted within the OECD. The country is also part of the development of BEPS as a guest jurisdiction. As mentioned, a tax reform was enacted in 2016 (Law 1816 of 2016) which introduces certain rules that follow the BEPS actions, such as the CFC rules and exchange of information rules. This tax reform also improved the general anti abuse rule allowing it to have practical effects; however, Colombia has not adopted any measure to implement BEPS action plan 6 or 15.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES BETWEEN AN ACQUISITION OF SHARES AND AN ASSET DEAL IN YOUR COUNTRY?

A) Acquisition of shares

Generally, the transfer of shares of Colombian companies generates Colombian source income for the seller. The capital gain generated on the transfer of shares is subject to capital gains tax in Colombia at a rate of 10%; provided, that the shares which are sold have been held for more than two years.

The recent tax reform establishes that in a share deal the purchase price should not be lower than the shares' equity value (book value) increased by 15%, unless the seller proves otherwise. This rule is only applicable to shares in Colombian companies not listed on the Colombian stock exchange.

The transfer of shares of a Colombian company as a consequence of a merger or a spin-off of the foreign holding company abroad is not subject to taxes in Colombia provided that the value of the assets located in Colombia, owned by the group of companies to which the companies participating in the merger or spin-off belongs, represents less than 20% of the total value of the assets of such group of companies. In a share deal the target company remains in existence and, therefore, the tax liabilities of the target remains with it after the closing of the transaction.

In addition, in a share deal the target company maintains its tax attributes such as net operating losses and tax credits without any modification or limitation due to the change in its control.

The acquisition of shares does not have immediate implications for the buyer. The tax basis of the shares is the purchase price and the tax basis of the assets of the target company remains the same and is not stepped up. Bear in mind that the difference between the book value of the target company and the purchase price paid for it (so-called goodwill or “crédito mercantil”) cannot be amortized for tax purposes.

The sale of shares of a Colombian company is not subject to VAT, stamp or registration tax. The sale of social quotas of limited liability companies is subject to registration tax at a rate of 0.7% on the transfer value.

B) Asset deal

Under Colombian tax law in an asset deal the pre-closing tax liabilities of the seller are not, as a general rule, assumed or transferred to the buyer of the assets.

An exception to this rule has been established in Bogotá in connection with the turnover tax (or industry and commerce tax) applicable in this city. In this case, the buyer of a commercial establishment or ongoing concern (“establecimiento de comercio”) is jointly and severally liable with the seller for the pre-closing industry and commerce tax liabilities of the seller (associated to industry and commerce tax associated to the activities of the commercial establishment).

In an asset deal, the purchase price paid by the buyer will be the tax basis of the acquired assets. In this manner, the tax basis of the assets is stepped up to their fair market value (at which the seller transferred the assets). This step-up would increase the depreciation or amortization deductions corresponding to the acquired assets.

Existing tax attributes of the seller, such as net operating losses do not carry over the buyer of the assets.

The sale of assets not excluded or exempted from the value added tax, are subject to this tax, generally at rate of 19 %. The sale of used fixed assets is not subject to VAT.

Additionally, if the buyer is an income tax withholding agent, it will have the obligation to apply a 2.5% withholding tax on the amount paid or accrued for the acquisition of the assets.

BUY-SIDE

4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?

Under Colombian legislation there are no rules that allow the stepping up of the value of the tangible and intangible assets of the target company in the case of share deals.

5. WHAT ARE THE PARTICULAR RULES OF AMORTIZATION OF GOODWILL AND SIMILAR INTANGIBLE ASSETS IN YOUR COUNTRY?

Under the tax reform introduced by means of Law 1819 of 2016 goodwill (“plusvalía” or “crédito mercantil”) cannot be amortized for tax purposes.

Notwithstanding this, there is a transitional regime for the outstanding balance of goodwill originated before the enactment of Law 1819 of 2016 that allows the amortization for tax purposes of such balance in a period of five years from 2017.

6. WHAT ARE THE LIMITATIONS ON THE DEDUCTIBILITY OF INTEREST EXPENSE? ARE THERE SPECIAL INTEREST LIMITATIONS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

As a general rule, interest paid on loans obtained for the acquisition of assets different from shares are deductible for income tax purposes.

Regarding interest paid on loans obtained in order to finance the acquisition of shares, it is important to take into account that under Colombian law costs and expenses related to non-taxed income or exempted income, are not deductible. In addition, in the case of the acquisition of shares by Colombian companies, as a general rule, the dividends that correspond to profit subject to income tax at the corporate level are considered for Colombian income tax purposes as non-taxed income of the Colombian company that acquired the shares. According to this provision, the Colombian Tax Office has stated that interest paid on loans obtained by Colombian companies for the acquisition of shares is not deductible if in the corresponding taxable year, the borrower has obtained non-taxed dividends. If during the corresponding taxable year, the borrower has obtained dividends subject to income tax (i.e., dividends that correspond to profits not taxed at the corporate level) or has not obtained dividends, the interest paid is deductible. Interest paid on loans obtained by individuals for the acquisition of shares are deductible as a general rule since the dividends received by individuals are subject to tax.

it is important to note that Law 1607 of 2012 introduced a thin-capitalization rule to the Colombian tax system. According to this rule interest generated by liabilities of which the total average amount during the year does not exceed an amount equal to 3 times the net worth of the taxpayer on 31 December of the previous year, are fully deductible for income tax purposes. On the contrary, the interests that exceed this limit must be treated as non-deductible expenses. This rule is applicable to foreign and local loans, and also to loans granted by related and by non-related parties.

Corporations, entities or special purpose vehicles incorporated with the purpose of building social interest housing projects and priority housing projects have the right to deduct the interests generated by liabilities of which the total average amount during the year does not exceed an amount equal to 4 times the net worth of the taxpayer on 31 December of the previous year.

The thin capitalization rules are not applicable to entities that are subject to the supervision of the Financial Superintendence and corporations, entities or special purpose vehicles that obtain financing to carry out public services infrastructure projects.

7. WHAT ARE COMMON STRATEGIES TO PUSH-DOWN THE DEBT ON ACQUISITIONS?

One of the strategies that is used to push-down debt on acquisitions is the use of a special purpose company for purposes of obtaining the loan to carry out the acquisition of a Colombian target company. After the acquisition, the special purpose company may be merged with the target company, where the target company is the surviving entity, in order to push-down the debt into the target company. This is relevant for the purposes of amortizing debt but it may not allow for the amortization of goodwill derived from the purchase of shares (the amortization of the goodwill is not deductible according to current rules as already mentioned in this document).

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There are no incentives for equity financing under Colombian tax law.

9. ARE LOSSES OF A TARGET COMPANY AVAILABLE AFTER AN ACQUISITION IS MADE? ARE THERE ANY RESTRICTION ON THE USE OF SUCH LOSSES?

Generally, net operating losses of the target company can be offset against taxable income obtained by the target company in the following 12 taxable periods. Colombian tax law does not provide for a carry-back rule.

Companies resulting from mergers or spin-offs are allowed to offset net operating losses of the spun-off or merged companies up to an amount equivalent to the ratio of the equity of these entities within the equity of the company resulting from the merger or spin-off. This offset is only allowed if the economic activity of the entities involved in the merger or spin-off is the same before and after the operation.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

No. The scope of a tax due diligence of Colombian companies (or assets) should include the usual issues covered in a tax due diligence process. Depending on the specific industry of the company, or on the specific nature of the asset, special rules should be observed.

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

Under Colombian law, there are no indirect taxes imposed on the transfer of shares. The transfer of shares is not subject to VAT or any other transfer tax.

Section 530 of the Tax Code establishes that the transfer of shares is exempted from the stamp tax. In any case, stamp tax is currently at a 0% rate.

As mentioned, the transfer of social quotas of limited liability companies is subject to registration tax at rate of 0.7%.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

In general, costs and expenses can be deducted for income tax purposes as long as they are (i) directly related to the engaged activity, (ii) necessary, and (iii) proportional to the performed activities.

From 2014, the deduction of expenses and costs has been restricted in some cases. This rule has been introduced in order to promote the use of the banking system.

Cost related to the acquisition of shares is not deductible for income tax purposes (i.e., cost is the value of the asset for tax purposes and it is relevant at the time of an eventual sale).

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

Being a tax over added value, the VAT system allows taxpayers to credit input VAT against output VAT, provided that the former was levied on goods and services used in the production or manufacture of taxable goods and services. Additional restrictions may apply.

Note that there is no VAT on the sale of shares. VAT paid on expenses related to the acquisition of the shares is not deductible for VAT purposes.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION OF A DOMESTIC COMPANY BY A FOREIGN COMPANY?

Foreign companies can freely acquire participations in Colombian companies. The foreign exchange regime must be observed (i.e., registration of the investment in Colombia before the Central Bank) in order to repatriate dividends for instance. Foreign parent companies are subject to tax in Colombia only on their Colombian source income.

Dividends are considered Colombian source income. The foreign parent company will be subject to tax on dividends received from its Colombian subsidiary, if this local company distributes dividends out of profits not subject to tax in Colombia at corporate level, the dividends will be taxed at a rate of 35% plus a 5% withholding tax (this 5% withholding tax is applied after the deduction of the 35% withholding). If on the contrary, the Colombian company distributes dividends out of profits subject to tax in Colombia at corporate level, such dividends will be subject to 5% withholding tax.

Note that Law 1819 of 2016 introduced a tax on dividends that correspond to profits subject to income tax at the corporate level as abovementioned (5%) and it also modified the tax rate on dividends that correspond to profits not subject to tax at the corporate level (from 33% to 35%). These changes will apply to profits generated from 2017.

In general, DTTs in force with Colombia provide for withholding tax rates on dividends of 5% or lower. In general, these rates are not applicable to dividends paid out of non-axed profits which are subject to the 35% withholding tax.

15. CAN THE GROUP REORGANIZE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUPING?

Prior to 1 January 2013, all kinds of mergers and spin-offs were exempt from income tax, capital gain tax and value added tax in Colombia.

By virtue of Law 1607 of 2012 mergers and spin-offs between Colombian companies, or between Colombian and non-Colombian companies, and the transfer of goods located in Colombia as a result of off-shore mergers or spin-offs, will not be subject to income tax, capital gain tax nor value added tax, provided that certain requirements are met and subject to certain limitations.

Cross-border mergers or spin-offs where the absorbing or beneficiary company is non-Colombian will always be taxed.

Under Colombian commerce law, a merger occurs when two or more companies dissolve and, without liquidating, are absorbed by an existing company, or create a new company.

A spin-off occurs in the following two events: (i) when a company, without dissolving transfer one or more portions of its equity to one or more existing companies, or use them to create a new company, or (ii) when a company dissolves and, without liquidating divides its equity in 2 or more portions that are transferred to existing companies or are used to create new companies.

16. ARE THERE ANY PARTICULAR ISSUES TO CONSIDER IN CASE OF A TARGET COMPANY THAT HAS SIGNIFICANT REAL ESTATE ASSETS?

Notwithstanding rules under DTTs in force, under Colombian rules, there are no particular issues to consider in the case of an acquisition of shares of a company whose main assets are real estate.

In accordance with the general rule capital gains obtained from the transfer of shares of companies whose main assets are real estate are deemed to be Colombian source income and, therefore, are subject to taxes in Colombia.

It is necessary however to take into account the specific provisions of DTTs in connection with the capital gains obtained on a sale of shares of companies whose main assets are real estate. Currently, Colombia has entered into the following enforceable DTTs: Spain, Chile, Switzerland, Canada, Mexico, Portugal, South Korea, India and Czech Republic.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

FUnder Colombian legislation, there are no fiscal unity/tax grouping rules.

SELL-SIDE

18. DOES YOUR COUNTRY HAVE ANY SPECIAL TAX STATUS SUCH AS PATENT BOX FOR COMPANIES THAT HOLD INTANGIBLE ASSETS?

Colombia does not have any special status (such as a patent box regime) for companies that hold intangible assets.

19. DOES YOUR COUNTRY IMPOSE ADVERSE TAX CONSEQUENCES IF OWNERSHIP OF INTANGIBLES IS TRANSFERRED OUT OF THE COUNTRY?

Note that in-kind contributions (applicable to assets in Colombia of any nature) to entities outside of Colombia are deemed to be taxable transfers for Colombian income tax purposes and subject to the general rules on transfer of assets (see section 20 below) and to the transfer pricing regime whether the involved parties are related entities or not. Under the tax reform introduced by Law 1819 of 2016, royalty payments between related parties on intangibles formed in Colombia are not deductible for tax purposes.

In addition, royalty payments related to the acquisition of finished goods are not tax deductible.

20. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY? WHAT, IF ANY, GAINS ARISING IN AN M&A CONTEXT ARE ELIGIBLE FOR SPECIAL TREATMENT?

Under Colombian legislation, capital gains are taxed at a rate of 10%. In Colombia, there is no participation exemption regime.

Share deals

As a rule the transfer of shares of Colombian companies generates Colombian source income. The capital gain generated by the transfer of such shares is taxed in Colombia at a rate of 10%. This rule is applicable if the shares being transferred were held by the seller for two years or more, otherwise, the profit will be subject to income tax at a rate that could be up to 37% (year 2018) and 33% as of year 2019.

In a share deal the purchase price should not be lower than the shares' equity value increased in a 15%, unless the seller proves otherwise. This rule is only applicable to shares in Colombian companies not listed on the Colombian stock exchange. This will not apply if the transaction is subject to transfer pricing rules.

Any transfer of assets held by foreign non-resident entities in Colombia as a consequence of mergers or spin-offs is not subject to income tax in Colombia provided that the value of the assets located in Colombia, owned by the group of companies to which the companies participating in the merger or spin-off belong, is less than 20% of the total value of the assets held by such group of companies worldwide.

On the other hand the profits obtained from the sale of shares listed on the Colombian stock exchange will neither be subject to income tax nor to capital gains tax, provided that the sales do not exceed 10% of the outstanding shares of the respective company in a taxable year (Colombian Tax Code, Section 36-1).

Under the DTTs in force, in general, capital gains derived from the transfer of Colombian shares, are subject to tax in Colombia only if the shares is derive more than 50% of their value directly or indirectly from real estate located in Colombia. Some DTTs provide that the capital gain obtained from the transfer of Colombian shares is also subject to tax in Colombia if the seller has owned at any time during the 12 months prior to the sale, directly or indirectly, 25% or more of the capital of the Colombian company.

Asset deals

Gains derived from the transfer of fixed assets owned for more than two years are considered as capital gains (*"ganancias ocasionales"*) subject to capital gains tax at a rate of 10%. Gains obtained by a Colombian company derived from the transfer of fixed assets owned for less than two years are ordinary income subject to income tax at a rate of 37% (FY 2018) and 33% as of 2019 for foreign companies, and Colombian-resident taxpayers.

Losses derived from the transfer of fixed assets owned for more than two years are considered as occasional losses and can only be offset against capital gains (*"ganancias ocasionales"*). Capital gains can only be offset by occasional losses (*"pérdidas ocasionales"*). Therefore, the loss derived from the transfer of fixed assets owned for more than two years does not reduce the ordinary net taxable income of the taxpayer.

Transactions between local related parties are not subject to transfer pricing rules; however, the sale price cannot be lower than 75% of the fair market value of the assets being transferred. Transactions between related parties located in the Colombian territory and in Colombian free trade zones are subject to the transfer-pricing regime.

In the case of the sale of intangible property created by the seller (e.g. trademarks, patents, trade names, etc.) the tax cost basis for the seller, for income tax purposes is zero. Therefore, the entire purchase price is subject to income tax.

21. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES ARE REINVESTED?

Currently, under Colombian legislation there are no fiscal advantages where the proceeds from the sale of assets are reinvested.

22. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

Currently, under Colombian legislation there are no substance requirements for holding/finance companies. Notwithstanding this, it should be noted that as from 2013, foreign companies may be deemed Colombian based companies for tax purposes if their effective place of management is located in Colombia. Substance criteria must be observed in these kinds of cases.

Please also note that Colombia's DTTs which are currently in force require that in order for an item of income to benefit from these DTTs, the entity/individual domiciled/resident in the other contracting state must be the beneficial owner of such income.

In addition, the 2016 tax reform introduced the CFC regime. Under this regime, any passive income obtained by the CFC must be attributed to the Colombian taxpayer in the fiscal year when it is accrued by the CFC, regardless of whether such entity has distributed or intended to distribute such passive income to the Colombian tax resident.

23. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

Under current tax law, mergers and spin-offs are non-recognition events. As such, they do not accrue income tax; value added tax or turnover tax. The requirement for this tax neutrality to apply is that no party involved in the reorganization (including the shareholders of the merged/spin-off entities) generate any sort of income or gain derived from such transaction.

Per the Colombian tax code, mergers and spin-offs will maintain their tax neutrality insofar as they meet certain requirements. Moreover, the shareholders of the companies involved will not have any taxable income derived from these processes provided that the requirements set-forth by law are met.

MANAGEMENT INCENTIVES

24. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES IN CONNECTION WITH SELLING OR BUYING A COMPANY?

SThe 2016 tax reform regulated the tax treatment of share-based payments and stock options, both for both companies and employees.

In the case of share-based payments, companies shall recognize the expense when it is accrued while employees shall recognize any income when the shares are delivered to them and they are registered as a shareholder.

The deductible expense for the company that delivers the shares is the fair market value of such shares which cannot be lower than the shares' equity value (book value) increased by 15%, in the case of shares not listed on a stock exchange. If the shares are listed on a stock exchange, the expense shall correspond to the value of the shares on the date of delivery of the shares. The income for the employee that receives the shares would be the same amount.

For the purposes of expense deductibility, companies must make social security contributions and operate withholding tax on labor payments.

On the other hand, in the case of stock options (employees acquire the right to exercise an option to buy shares) both the company's expense and the employee's income shall be recognized when the employee exercises the option.

The expense for the company shall correspond to the shares' equity value (book value) increased by 15% in the case of shares not listed on the stock exchange. If the shares are listed on a stock exchange the expense shall correspond to the value of the shares at the date of delivery of the shares. In these cases the employee has to recognize income in an amount equivalent to the difference between the price paid for the shares and the fair market value of the shares on the date on which the purchase option is exercised.

There are no specific rules related to management incentives in connection with selling or buying a company.

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