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Colombi: Tax Review

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Beyond NAFTA—Colombia

Colombia Tax Review

I. Income Tax

As a general rule, foreign investors are taxed on Colombian-source income only. Taxable income is all operating receipts plus non-operating income cost of goods sold or cost of services minus general expenses incurred on the business during the year. The tax year is the calendar year. Taxpayers pay income taxes based on the higher of the following two bases:

- a. Taxable income as defined above.
- b. The so-called "presumptive income" (PI) which is, in fact, a minimum taxable income equal to 4 percent of opening Tax Equity for 1994 and thereafter.

Tax Equity is assets minus liabilities as reported on the income tax return. Taxpayers are required to report assets and liabilities on their returns: (i) to compute PI; and (ii) for the Tax Administration to check the level of taxable income as it relates to increases in Tax Equity.

Credit Balances of current accounts with related foreign entities (home office, parent company of other entities affiliated thereto) do not qualify as liabilities to compute Tax Equity.

The statutory income tax rate (before the remittance tax) is 37.5 percent from 1993 through 1997, which results from: (i) 30 percent, the regular statutory rate, plus (ii) a 25 percent surcharge on that rate, which is 7.5 percent over taxable income.

Since the extra 7.5 percent is deductible as it is paid (this would happen in 1996 for year 1995), the effective rate goes down to about 35 percent.

For cash flow, taxpayers should note too that they are required to advance, as a prepayment against the following year's tax liability, 75 percent of the net income tax minus the year's tax withholdings.

Capital gains are also taxed at the statutory income tax rate.

If a foreign investor (FI) sets up a branch, in addition to the income tax the branch would pay the *remittance tax* on book profits, at the following rates: (i) 8 percent for 1995; and (ii) 7 percent for 1996 and thereafter.

If the branch retains profits in Colombia for at least 10 years, it is exempted from paying remittance tax.

If, instead of a branch, a FI incorporates a subsidiary in Colombia (a limited liability company or a corporation), the FI would not pay the remittance tax shown in 6 above; instead, the FI would pay an additional income tax on its share in profits or dividends received from the subsidiary, at the same rates shown in 6 above. But in this case the FI would be exempted from paying this surtax if it retains profits in Colombia for at least five (5) years.

The remittance tax rates are not applicable to FIs who derive their profit from the production of hydrocarbons. In this case, remitted book profits are taxed at: (i) 15 percent in

1995; (ii) 12 percent in 1996 and thereafter; and (iii) 12 percent always if the profit is derived from new investments (i.e., investments made after 1 January 1993).

Since 1992 almost all taxpayers are required to adjust their book and tax items for inflation. Specifically, inflation adjustments apply to non-monetary assets, non-monetary liabilities, and tax equity. Any excess of the adjustment of non-monetary assets over the other adjustments is reflected in taxable income. Depreciation, amortization and inventory usage is based on adjusted costs.

II. Payment of Income Taxes

Income taxes are paid in two ways:

- a. Through tax withholdings. As a general rule, all Colombian-sourced payments are subject to withholdings in Colombia.
- b. On the income tax return, taxpayers compute an amount due or a refund as follows:
 1. Year tax liability minus Tax prepayment (prior year) minus Year withholdings plus Tax prepayment (next year)
 2. For a first-year taxpayer, amounts due are paid in two installments: 1/2 upon filing of the return (usually in May) and the second half about two months later.
 3. "Big taxpayers" have five installments to pay (from February through October). As its local operations grow, a foreign investor may be classified as a big taxpayer down the road.

Since 1993 payments for technical assistance or services provided outside of Colombia do not attract withholding taxes (in 1992 they attracted withholdings) and continue to be deductible. Management overhead expenses, royalties and other amounts charged for the acquisition or exploitation of intangible assets that are paid to (or credited in the account of) the parent company or a related "foreign office" (i) cannot be deducted for income tax purposes in Colombia; (ii) but they can be entered in the local books as valid expenses that reduce book profits as well as the related remittance tax.

Foreign general expenses (which are not subject to local tax withholdings) are deductible limited to 10 percent of taxable income as determined before deducting said expenses.

Customs duties, municipal or city taxes (industry and commerce taxes) and stamp taxes are deductible for income tax purposes. VAT taxes paid on the imports or local purchase of capital goods (other than automobiles) can be credited against the income tax for the year they are imported (any excess is added to cost). VAT taxes paid on local supplies are not deductible for income tax purposes; instead, they are carried on the VAT tax account and credited against VAT taxes charged to third parties.

III. Borrowing

The cost of local borrowing is deductible. As also is the cost of foreign borrowing from unrelated parties but foreign loans must meet certain conditions to be deductible as well as, to avoid withholdings in Colombia. They must be registered with the Central Bank, and they must relate to projects that foster the economic and social growth of the country.

IV. Other Taxes

A. INDUSTRY AND COMMERCE TAX

This is a city tax. Each town passes its own rules within the limits set by Law No. 14 of 1983 which defined as city-taxpayers those who carry out, within the jurisdiction of each town, industrial, commercial, or service activities. City taxes are paid on gross revenues at rates ranging from 0.2 percent to 1 percent.

B. STAMP TAXES

As a general rule, they are paid on written agreements executed in connection with Colombian income producing activities. Business offers that are accepted through a separate document are taxed. Labor contracts and invoices are not taxed. Currently, stamp taxes amount to 0.5 percent of the value of agreements, and are paid in halves by the parties (unless otherwise stipulated).

C. VALUE-ADDED TAX (IVA)

IVA taxpayers (generally anyone selling goods or rendering services inside Colombia) have to comply with the following: (i) register as an IVA vendor with the Tax Office; and (ii) carry an account on the books for entries related to the tax. This account must be called *impuesto a las ventas por pagar* (IVA payable) and has to be a General Ledger account (not an auxiliary ledger account).

The entries on this account are as follows: (i) debits, for IVA paid on imports or supplies (other than IVA creditable against the income tax as discussed in II above) or on sub-contracts, to third parties; and (ii) credits, for IVA charged to third parties.

File bimonthly returns, reporting: (i) the IVA charged to third parties (as a rule, this would amount to 14 percent of amounts invoiced thereto); and (ii) IVA taxes paid to third parties, or on imports. These are credited against the IVA charged to third parties. Net values are payable to the Tax Office.

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