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Taxation of Foreigners and Extraterritoriality of Colombian Income Tax Legislation

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TAXATION OF FOREIGNERS AND EXTRATERRITORIALITY OF COLOMBIAN INCOME TAX LEGISLATION

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Under current Colombian income tax legislation everyone, including business entities, is subject to the income tax whether domiciled in the country or not, on income produced in Colombia. The tax on patrimony also applies to domiciliaries and non-domiciliaries, but is not levied upon corporations or partnerships. Ownership of the patrimony is immaterial; it is sufficient for the imposition of the tax that the patrimony be held in Colombia and that it be incorporated in the national economy.

In short, Colombia has and exercises the right to:

1. tax income derived from sources within the country and property located within its boundaries, and
2. tax persons by reason of nationality (Colombian) or residence, regardless of the source of their income or the situs of the property which produces it.

Thus, natural persons, either nationals or foreigners, residing in Colombia, are taxable on income derived from all sources, within or without the country. Non-residents of Colombia are only taxable on income earned within the country. Resident foreigners are taxable on income derived from Colombian sources only, provided the State of which they are citizens grants reciprocal tax treatment to Colombian nationals. Generally speaking, residence is considered to be the continuous or discontinuous abode in the country for more than six months.

Domestic or foreign juristic persons are taxable only on income derived from Colombian sources. However, income from dividends, participations (distributive shares of partnerships), interest and rents obtained abroad by Colombian juristic persons, is taxable in Colombia. Colombian companies are those organized under the laws of Colombia; foreign companies are those organized under the laws of a foreign country.

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Since it is apparent that certain taxpayers are taxable only on income earned from sources within the country, it is necessary to establish what constitutes income within this category. The following is so considered:

1. Income from real property located in Colombia.

2. Profits from the sale of real property located in the country.

3. Income derived from personal property exploited in the country.

4. Interest from credits held in the country or economically linked thereto. Bank overdrafts, as well as interest from transitory credits resulting from the importation and exportation of merchandise are excepted.

5. Earned income or services rendered by juristic persons when the work or activity is carried out in Colombia except for those non-resident foreigners who render services in the filming of motion pictures. These are subject to certain specific conditions.

6. Profits or royalties resulting from the exploitation of industrial, commercial, artistic or intellectual property in the country.

7. Dividends or participations derived from Colombian companies domiciled in the country or from foreign companies which, pursuant to their by-laws, distribute profits in Colombia.

8. Annuities, if the beneficiary is a resident of Colombia, or if the price of the annuity is economically linked to the country.

9. Profits derived from the exploitation of farms, mines, natural deposits and timberlands located in the country.

10. Profits derived from the manufacture or industrial processing of merchandise or raw material when a permanent establishment exists in the country, regardless of the place where the products are sold.

11. Revenue from commercial activities such as the purchase and sale of merchandise, commissions, etc., when there is a permanent establishment in the country or the products sold are physically in Colombia.

Income from the use or sale of trademarks, patents and other intangibles is taxable. When the sale of intangibles involves the transfer of ownership, 30% of the sales price is regarded as taxable income. This rule is also applicable to intangibles contributed to the capital of Colombian companies, even though the transfer may not involve all rights

of ownership. In order to be entitled to the deductions on intangibles, the price paid for such intangibles must be previously approved by the Division of National Taxes. The provision which limited the deduction of royalties paid abroad to the amount approved by the Committee created by Decree 688 of 1967 was invalidated by the Council of State.

In general, compensation for personal services, interest, rents and royalties, etc., may only be allowed as costs, deductions or exemptions whenever the taxpayer indicates the name and tax identification number of the beneficiary and the amount of payment or credit. When the beneficiary resides abroad, the amount paid or credited is deductible only when it is proven that the income tax withheld — 12% of the amount paid or credited — has been deposited at the appropriate revenue office.

The following items are deductible without being withheld at the source:

1. Payments to commission agents abroad, in connection with the purchase or the sale of merchandise, raw materials or other property, as long as those payments do not exceed 2½% of the amount of the operations for the taxable year; and

2. bank overdrafts or payments of interest on short term credits resulting from the importation or exportation of merchandise or on bank overdrafts, as long as those payments do not exceed 9% per annum of the amount of each overdraft or credit. Monies paid in excess of these amounts are not deductible, unless the foregoing limitations are amended by the Ministry of Finance.

Normally, payments for services rendered abroad are not taxable in Colombia. Moreover, in the case of non-residents, if the property — tangible or intangible — is considered to be owned abroad, the revenue therefrom is not taxable in Colombia.

Subsidiaries, branches and agencies of foreign companies located in Colombia, are not allowed to deduct from their income any expenses, commissions or fees paid or due their head offices or agencies abroad, relating to the management, technical assistance and exploitation or acquisition of intangibles. Interest, however, is deductible.

Expenses incurred abroad which have a causal connection with income taxable in Colombia are deductible if the taxpayer files a statement specifying the nature of such expenses with his return, and gives the names and addresses of the beneficiaries. When the payment constitutes taxable income in Colombia (which normally is not the case), the tax identification number (NIT) of the beneficiary must be given and proof presented showing deposit of the tax withheld at the source.

The deduction for expenses paid abroad was formerly limited to 10% of the taxpayer's taxable net income, computed before the deduction of the expenses. This limitation was invalidated by a decision of the Council of State dated April 9, 1970 and is, therefore, no longer applicable.

In a broad sense, the importation of capital is considered an increase of patrimony and not taxable income, provided the taxpayer establishes two fundamental points: the pre-existence of the capital or patrimony, and its importation. Proof of the existence of the property or foreign exchange may be established through bank certifications, affidavits or other acceptable means. In any event, it is necessary to prove both the pre-existence of the property, rights, stocks, etc., to be imported, as well as the importation itself. The certification of foreign entities must be duly legalized by Colombian diplomatic or consular representatives abroad.

The requirement that foreign investors prove the pre-existence of their capital, either in the form of foreign exchange or equipment, is one which, added to the many others in existence, militates against attracting foreign investors. The foreign investors may find that the value of his investment is treated as taxable income rather than patrimony, unless he has complied with the requisites referred to above.

As regards taxable income in Colombia of non-resident natural or juristic persons, whoever pays or credits such persons with interest, annuities, commissions, royalties, or for technical assistance, etc. — excepting dividends or participations — is required to withhold an amount equivalent to 12% of the amount paid or credited. Article 67 of Decree 154 of 1968 provided that non-resident juristic persons who were the beneficiaries of such payments were required to file an income tax return; the Council of State subsequently invalidated this requirement. In its decision of October 30, 1969, the Council ruled that the legal provisions regulated by Decree 154 did not make it mandatory for non-resident juristic persons to file a tax return to cover Colombian income from which the tax had been previously withheld. Decree-Law 1366 of 1967 — the law regulated — simply requires that 12% be withheld from the payments and that failure to withhold renders the payment non-deductible. In the opinion of the Council of State, the legislature considered that the procedure of withholding at the source in the proportion and manner indicated, satisfied the tax requirements. Thus, in violation of constitutional limitations, Decree 154 imposed an obligation not contemplated by the law, and one which the Government was not in a position to enforce.

Corporations which pay or credit dividends — not distributed in the

country — to foreign companies or other business entities or to non-resident natural persons, are required to withhold a tax on income of 12% of the amount paid or credited. Foreign companies or entities pay the tax on dividends at the foregoing rate only, and are under no obligation to file a return on dividends.

When part of the capital of companies other than corporations, is held by foreign companies or by other business entities which do not distribute dividends or profits in the country, or by non-resident natural persons, these companies are obliged to withhold an income tax of 18% on the distributive shares of the partners in the taxable net income of the company, after deducting the tax assessed against the company. The tax withheld must be deposited by the withholding entity during the period granted to the company within which to file its tax return.

Companies from which the 18% tax has been withheld, as well as non-resident natural persons from whom the tax on dividends, participations and other taxable income such as interest, annuities, royalties, etc. has also been withheld, are required to file an income tax return and to deduct from their private assessment the taxes withheld. This requirement was prescribed by regulatory Decree 154 of 1968. However, neither Decree Law 1366 of 1967 nor Law 63 of 1967 imposes any such obligation; they only prescribe that a fixed income tax be withheld on the taxable income paid to the aforementioned foreign companies and non-resident natural persons. In its decision of June 25, 1970, the Council of State invalidated that part of Article 69 of Decree 154 of 1968, which required foreign companies to file an income tax return in the case considered. Similarly the Council of State invalidated the pertinent provisions of Decree 154 which required non-resident natural persons to file an income tax return in the instances referred to above.

The Administrator of National Taxes of Cundinamarca recently imposed excessive fines on companies which allegedly kept their books improperly. Paragraph three of Article 122 of Decree 154 of 1968, which authorized the Administrator to impose such fines, was temporarily invalidated by the Council of State on the grounds that the article in question violated the laws which it was supposed to regulate. The fines levied were excessive, considering that failure to comply with the legal requirements regarding the manner in which the books were kept, did not result in a loss of revenue to the Government.

In addition to the basic income tax, a tax of 12% is imposed on the amount of payments or remittances of revenue, in money or in kind, to foreign companies which do not distribute dividends or profits in the

country. Such tax is withheld at the time of payment or remittance. The same tax is also levied on payments or remittances of profits made by subsidiaries, branches or agencies to their head offices abroad. This tax does not apply to dividends nor to interest on credits resulting from the importation or exportation of merchandise, capital goods or raw material or from other credits registered with the Exchange Control Office; neither does it apply to income reinvested in the country.

All payments or credits, other than the reimbursement of capital, made by partnerships to their partners (companies which do not distribute dividends or profits in the country) are regarded as participation remittances and are subject to the appropriate taxes. This apparently means that if a partnership pays interest or royalties to a partner which is a foreign company which does not distribute dividends or participations in the country, a tax of 18% is withheld in addition to a remittance tax of 12% under Article 74 of Decree 154 of 1968 and Article 32 of Decree 1366 of 1967. In cases where the tax has been withheld, unremitted balances are not regarded as patrimony subject to tax.

Persons domiciled in the country who make payments of interest or dividends on bearer bonds, stocks, certificates, etc., are required to withhold an income tax of 30% of the amount paid, at the time of payment. Withholding is only required when the interest or dividends are taxable in Colombia.

According to existing tax legislation, companies withholding the tax on dividends (12%) or participations (18%) paid to foreign companies, must withhold 40% when the foreign company which is the beneficiary *fails to prove* that more than 75% of its stock or capital belongs directly or indirectly to foreign natural persons not residents of Colombia. If the stock of the foreign company consists of bearer shares, the withholding tax is similarly fixed at 40% unless certain requirements are complied with.

Thus, even though the foreign company may be legally organized in accordance with the laws of its country of origin, has its domicile in that country, and the majority of its stockholders are citizens of that country, it appears that the tax laws of Colombia see fit to impose a higher tax on the corporation, not for violating the laws of its country of origin but for non-compliance with the tax laws of Colombia as regards the percentage — although insignificant — of Colombian stockholders.

To illustrate the point it may be well to take as an example a corporation organized under the laws of the State of Delaware. Such a

corporation may be legally organized, wholly or partially, by citizens of the United States, with or without participation of citizens of other countries, including Colombians, and without regard to the percentage of ownership of the different nationalities holding the corporate stock. In this case, the tax laws of Colombia impose a higher tax on such corporation even though the corporation is legally organized in accordance with the laws of Delaware; has its domicile in that State, and the majority of its stock is owned by United States citizens, if the foreign company does not prove, as required by Colombian law, that more than 75% of the stock held in such corporation belongs to non-resident foreigners. This means that in the absence of proof, the additional tax is imposed *ipso facto* upon the foreign company.

The question therefore arises whether Colombian tax law may have extraterritorial effect, and

1. impose upon foreign companies not domiciled in Colombia and legally organized in accordance with the laws of the country of origin a higher tax because of failure to comply with a requirement of Colombian tax legislation which, as non-residents, they are not obliged to know, and

2. impose a higher tax on such companies simply because the nationality of its stockholders or partners is not acceptable to Colombian law, notwithstanding the fact that the laws of the country of origin have been fully complied with and the majority of the stock is held by citizens of the country under which the company was organized. Colombian law fails to recognize that foreign partnerships in some countries and in many jurisdictions of the United States, are not regarded as legal entities distinct from the individuals who integrate them and as such are not taxable.

Under general legislation and pursuant to the Treaty of Peace, Amity, Navigation and Commerce of 1846 between the United States and Colombia, Colombian nationals residing in the United States have the same rights as United States citizens. Hence, such Colombian citizens, if they so desire, may freely form corporations or other companies with United States citizens.

If it is intended that Colombian nationals residing in Colombia not hold stock in foreign companies, the course to follow should be to impose a higher tax on Colombian nationals residing in Colombia who violate Colombian policy, and not on the foreign company legally organized under the laws of a foreign country by citizens of such country, holding the majority of the stock, and who eventually will have to pay the additional

tax levied by a Colombian law unknown to them. Besides the extra-territorial application of Colombian legislation, there is the heavy burden imposed by the requirement that a large foreign corporation with several thousand stockholders prove the percentage of foreigners who own its stock, a difficult if not impossible task.

Here it may be well to mention Section 891 of the United States Revenue Code of 1954, as amended, which states that whenever, under the laws of any foreign country, citizens or corporations of the United States are subjected to discriminatory or extraterritorial taxes, the rate of tax prescribed by the United States Revenue Code may be doubled in the case of the citizens and corporations of such foreign country.

An important element in Colombia's tax legislation is patrimony, i.e. the real and personal rights of a taxpayer to tangible or intangible property located in the country. The taxpayer must possess the patrimony, in the country, on the last day of the taxable year. For tax purposes, possession is the taxpayer's economic enjoyment of property. Taxable patrimony is linked to the economy of the country, brings profits to the country and enjoys the protection of the State. Accordingly, patrimony located abroad and which does not affect the Colombian economy is not taxable patrimony under a decision of the Council of State dated November 28, 1951.

Since the economic benefits of credits are enjoyed at the place of residence of the debtor, such credits are considered to be owned there. However, bank overdrafts or transitory credits resulting from the importation or exportation of merchandise are regarded as held in the country of residence of the creditor and are exempt. The economic tenure factor which justifies payment of the capital tax is not considered to exist in these special cases. Thus, in the case of overdrafts, monies credited by local banks to their foreign correspondents do not constitute taxable patrimony, provided the operations are of a transitory nature. Shares of stocks are held at the company's domicile. However, the stock of Colombian nationals — residing in the country — in foreign companies which, directly or through subsidiaries do business or have investments in Colombia, is regarded as stock held in Colombia.

Funds which the taxpayer may have abroad and are used in connection with the normal operation of his (its) business in Colombia, are considered held in the country. This rule applies to merchandise in transit. In this instance, it should be noted that the tax laws of Colombia tax merchandise in transit even though it may not be held in Colombia, and, what is more, may be held abroad. Normally, merchandise is in transit

the moment it is dispatched by the vendor. Thus, it may be inferred that Colombian tax laws impose the patrimony tax on merchandise which has not left the country of origin.

Regarding the patrimony or capital tax on funds held abroad by a taxpayer, the intention of the parties concerned defines the character of the relationship between a foreign bank and its depositors. The relationship may be that of bailee and bailor although as a rule it is that of debtor and creditor. Hence, Colombian tax legislation imposes the capital tax on credits (or deposits), whether the credit is held in Colombia or abroad, that is, whether the debtor resides in Colombia or abroad.

In substance, it can be said that, as a rule, credits are held and are taxable in Colombia, if the debtor resides in Colombia, and that property is taxable if located in Colombia. These fundamental principles of the territoriality of Colombian law are derived from the Civil Code which provides that Colombian law binds both nationals and aliens *residing in Colombia,* and that property — both real and personal — *located in Colombia* is subject to the provisions of Colombian law. Therefore, it is apparent that by taxing property which is located abroad and outside the territorial jurisdiction of Colombia, Colombian tax legislation is given extraterritorial effect.

Net patrimony is the gross patrimony minus any outstanding debts the taxpayer may have at the close of the last day of the taxable year. In order for debts to be recognized for tax purposes, the taxpayer must file with his return, a statement showing the names of his creditors, their tax identification number (NIT) and the amount of the debt. When the creditors are non-resident natural persons, the debtor is required to withhold and deposit the appropriate patrimony tax within the period provided for filing his tax return, including extensions. Proof of such withholding and deposit must be filed with the return. When the creditor is a foreign natural person residing abroad, the tax identification number is unnecessary. Since companies are not subject to the patrimony tax, there is no obligation to withhold that tax at the source.

Commercial debts resulting from the purchase of merchandise imported by the taxpayer domiciled in the country are not subject to withholding of the patrimony tax as long as they are entered in the taxpayer's books.

For tax purposes, debts between agencies, branches, subsidiaries or companies operating in Colombia and their foreign head offices or agencies, branches or subsidiaries domiciled abroad are considered as patrimony of the debtors engaged in business in Colombia. Where the

creditor and debtor are independent of each other the debt is deductible and, since the residence of the debtor is considered to be the place where the credits are held, the latter must withhold and deposit the patrimony tax to be paid by the creditor in Colombia. If the creditor is not subject to the patrimony tax, as in the case of business enterprises, the debt may be recognized by complying with the other requisites.

In conclusion it is stressed that while many of the main points of Colombian tax legislation affecting foreigners have been covered in this article, this study has not exhausted all aspects of the laws which may be of interest to foreigners, either natural or juridical persons.