



MERGERS AND ACQUISITIONS

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Taxation of Cross-Border
Mergers and Acquisitions

2010 Edition

TAX

Colombia

Introduction

Cross-border mergers and acquisitions (M&A) activity in Colombia has been increasing in recent years, essentially because the government has been reforming the tax system to improve the granting of effective tax benefits to foreign investors and creating a “stability” legislative regime to protect new investments from the negative impact of legal amendments.

The following chapter will analyze, from a general tax standpoint, the main issues potential foreign investors should consider when deciding to invest in Colombia.

Recent Developments

- Colombia has begun to agree double taxation treaties (DTTs). Treaties with Spain, Switzerland, Canada, and Chile have been signed, treaties with the United States and Mexico are being negotiated and in the immediate future the government plans to negotiate treaties with another 15 countries.
- A tax benefit for investments in productive fixed assets has been established, granting an additional deduction of the 30 percent of the value of acquisition of the asset on top of the depreciation expense. The benefit can be transferred to the shareholders.
- It is now possible to sign legal stability contracts with the government to protect new investments from adverse changes in the law. Some taxes can be included in the legal stability contracts to keep them enforceable after an amendment.
- A special free trade zone regime has been implemented, granting its users a reduced income tax rate of 15 percent.
- The national stamp tax rate has been progressively reduced to 0 percent 2010.

Asset Purchase or Share Purchase

A foreign investor may acquire a Colombian company by purchasing either its shares, or its business assets. Usually acquisitions are carried out by purchasing shares in a Colombian entity, because this produces no direct tax liability for the foreign investor. Additionally, dividends paid to foreign investors are not subject to

withholding tax provided they are paid out of profits that have been taxed at the company’s level. Nevertheless it’s important to analyze the purchase of business assets option taking into account that investments in real (tangible) productive fixed assets qualify for a special deduction of an additional 30 percent of the acquisition value of the asset on top of the depreciation expense.

In both cases the subsequent sale of shares or business assets would produce a taxable capital gain. Bear in mind that for year 2011 equity tax will be applied to net equities which are higher than COP 3,000 million (USD 1.5 million approximately); hence a business assets purchase in year 2010 could derive in an equity tax liability for the buyer in year 2011.

Purchase of Assets

In a purchase of business assets, real estate tax (land/property tax) liabilities will remain attached to the acquired assets; hence the purchaser could be liable for such tax.

Profits obtained from the use of the acquired assets will be subject to income tax and, in certain cases, would be deemed as a permanent activity in Colombia. Bear in mind also that carrying out permanent activities in Colombia requires incorporation of a branch in the country.

Profits derived from the sale of assets could produce a taxable capital gain; the sale of assets could be subject to VAT.

Purchase Price

The purchase price is the price agreed by the parties provided it does not diverge by more than the 25 percent from the fair market price of goods of the same kind at the date of the sale. A real estate sale price cannot be lower than its fiscal cost, the valuation recorded in the land registry office or the price recorded in the previous year’s real estate tax return.

Transactions carried out between Colombian taxpayers and foreign related parties are subject to transfer pricing rules.

Goodwill

Colombian regulation does not recognize goodwill in acquisitions of assets. However, in share acquisitions tax law allows the recognition of goodwill on the difference between the acquisition price and the book value of the shares, provided that the purchaser takes control over the Colombian entity. Goodwill can be amortized over a minimum term of five years against taxable profits.

Depreciation

Depreciation expenses of a company's fixed assets used during the tax year concerned are recognized and accepted by the tax authorities. Useful life terms and depreciation methods are established by law and are mandatory. If the real productive fixed assets special 30 percent deduction was applied to the assets, then they must be depreciated by the straight line method.

Tax Attributes

In principle tax benefits attached to the business assets cannot be transferred to the purchaser. However, if the transaction is structured as a spin-off, the tax benefits could be transferred.

Value-Added Tax (VAT)

VAT is levied at the rate of 16 percent on the sale of tangible movable goods located in Colombia at the time of the sale, services rendered within Colombian territory and importation of tangible movable goods. Sales of fixed assets and/or shares are exempt from VAT.

Transfer Taxes

National stamp tax was levied on documents which contain obligations with effects in Colombia, but stamp tax rate has been progressively reduced since 2007 and finally eliminated for 2010.

Real estate tax (land tax) is a municipal (local) tax levied on real estate in the municipality. The rates vary from 0.10 percent and 0.33 percent of the value of the real estate.

Stamp duty, land tax, or registry tax as it is called in Colombia, is levied on the registration of the documents transferring the ownership of real estate with the Property Registration Office. In this case, the tax will be 1 percent of the price of the real estate included in the registered public deed.

Purchase of Shares

Investing in a Colombian company by purchasing its shares does not lead to a tax liability for the investor,

and dividends paid abroad are not subject to withholding tax provided the profits have already being taxed the level of the company. Dividends paid out of profits that have not been taxed at the company's level are subject to a 33-percent withholding tax, unless they are paid to a resident of a country that has an enforceable DTT with Colombia. In such cases the tax rate will be as stipulated in the treaty.

On the other hand, the sale of a Colombian company's shares, to residents or non-residents, does generate a tax liability in Colombia for the seller. The taxable income will be the positive difference between the sale price and the tax cost of the shares. The sale price cannot diverge by more than 25 percent from the market price of the shares on the sale date. The tax cost corresponds to the acquisition cost, plus tax adjustments.

Tax Indemnities and Warranties

Since in a share acquisition, the purchaser takes over the target company including all related liabilities, the purchaser usually requires more warranties and indemnities than in the case of a business assets acquisition. Where significant sums are at stake it is common for the purchaser to carry out a due diligence exercise, including a review of the target's tax issues.

Tax Losses

The general tax losses regime establishes that:

- losses can be used if the merging companies share the same economic activity before being merger;
- the losses originating in each merging company can be off-set against the taxable income of the merged company to the extent of the percentage the absorbed company's net equity represents of the absorbing company's equity;
- there have been no time or percentage limitations since 2007;
- losses incurred between fiscal years 2003 and 2006 have an eight years and a 25 percent limitation; and
- losses related to non-taxable income, or non-deductible expenses cannot be off-set.

Transfer Taxes

National stamp tax is levied on the execution of documents containing obligations with effects in Colombia if the amount of the obligations is above approximately USD 60,000. The rate for 2009 was 0.5

percent, but share purchase agreements were exempt from this tax and as of year 2010, the applicable rate is 0 percent in all cases.

Local jurisdictions (municipalities) are entitled to levy their own stamp duties.

Choice of Acquisition Vehicle

Several acquisition vehicles are available to a foreign investor purchasing a Colombian company, and tax effects differ for each vehicle.

Local Holding Company

Acquisitions can be structured through Colombian holding companies to recognize the goodwill in Colombia and to use the debt interest; however a merger with the target may be necessary.

Foreign Parent Company

A foreign parent company can be used as an acquisition vehicle to push the debt down to the Colombian target.

Non-Resident Intermediate Holding Company

If the foreign country taxes capital gains and dividends received overseas, an intermediate holding company resident in another country could be used to defer such taxes. The intermediate holding company can be incorporated in a country with an enforceable tax treaty with Colombia.

Local Branch

The foreign investor could purchase the business assets of a Colombian company through a branch incorporated in Colombia, but bear in mind that branches are Colombian tax payers, and subject to income tax, VAT, financial transactions tax, customs duties, and all local (municipal) taxes, such as industry and commerce tax, municipal stamp duties, etc. Branches are liable for all formal obligations related to these taxes, and will be required to file periodic tax returns.

It is important to note that branches are subject to income tax at 33 percent only on their national (Colombian) income and their national net worth, and that Colombian regulations do not allow branches to acquire shares in Colombian companies.

Joint Ventures

Certain activities can be carried out through joint ventures. However, since joint ventures are not considered legal entities separate from their members, on the termination of the joint venture each member will be liable for tax on profits earned from the activities performed directly by the joint venture.

Choice of Acquisition Funding

A foreign investor can use a Colombian acquisition vehicle and finance it with capital contributions, debt or a combination of both.

Debt

The main advantage of debt is the potential tax deduction of the installments, interest, and related expenses, such as guarantee fees, bank fees, financial costs, and exchange rate differences.

Foreign loans lent to Colombian companies whose activities are deemed to contribute to Colombia's social and economic development are not subject to income tax. The lender must be a financial institution registered with the Colombian Central Bank (Banco de la República). If these requirements are met interest payments made to the foreign financial institutions will not be subject to withholding tax. If the lender is a related party, the transaction will be subject to transfer pricing rules.

Deductibility of Interest

Interest payments are deductible, provided the loan was used in income-producing activities and provided withholding tax (33 percent) was applied to the payments. Interest payments shall be deducted in the same fiscal year in which they are made. Financial costs and expenses related to the debt are also deductible, provided they are related to the income producing activity.

Withholding Tax on Debt and Methods to Reduce or Eliminate

Interest paid on debt is generally subject to a withholding tax of 33 percent, but interest on foreign loans obtained by Colombian companies whose activities are deemed to contribute to the social and economic development of the country are not considered to be a Colombian-sourced income and, as a consequence, no withholding tax is applicable.

Checklist for Debt Funding

- A foreign lender shall be a financial institution.
- A foreign lender shall be registered with the Colombian Central Bank.
- If the lender is a related party, transfer pricing rules apply.
- Interest payments and financial costs and expenses are deductible.

- No withholding taxes apply if the Colombian vehicle's activity is considered as an activity that contributes to the social and economic development of the country.

Equity

Foreign investors can fund the Colombian vehicle through direct contributions to the capital of the vehicle. Profits transferred from the vehicle to the investor will not be subject to withholdings if they were taxed at the company's (Colombian vehicle) level. Profits that were not taxed at the level of the vehicle will be subject to a 33-percent withholding tax, but if the profits are paid to a resident of a country which has an enforceable double taxation treaty with Colombia the withholding rate will be lower.

Hybrids

In certain sectors an acquisition of assets can be carried out through hybrid instruments such that the Colombian target will recognize, for tax purposes, a deductible expense instead of recognizing a fixed asset (which would increase its equity) or a liability. For example, an international financial leasing operation can be structured for an infrastructure project.

Discounted Securities

The investment could be channeled through the acquisition of certain discounted securities, such as the BOCEAS, which are bonds that convert into shares at a certain price or at a discount once the bonds reach maturity or once a predetermined time has elapsed.

Other Considerations

Concerns of the Seller

A sale of shares or business assets to residents or non-residents generates a tax liability in Colombia for the seller. The taxable income will be the excess of sale price over the tax cost of the shares or business assets.

In the case of shares that are not traded in the stock market the sale price cannot diverge more than the 25 percent from its commercial price on the date of the sale. If the shares are publicly-traded the sale price will be its stock market value.

The tax cost of shares is the acquisition cost plus tax adjustments. The tax cost of business assets is historical cost less the relevant depreciation.

In a share transaction it is important to take into account that the portion of retained profits already taxed at the Colombian company level that corresponds to the shares being sold can be subtracted from the taxable

income derived from the sale. Profits that have not been taxed at the Colombian company level are taxable at a 33-percent rate.

A Colombian taxpayer should include in his/her income tax return as a capital gain the profits derived from the sale of shares or business assets owned for more than two years. If the shares were owned for less than two years capital gains should be included in the return as ordinary income.

Foreign investors must file an income tax return following a sale of shares within a month of the sale.

Finally, if the transfer of shares is the result of a merger or a spin-off transaction, the transfer does not have income tax effects in Colombia.

In transactions with foreign related parties transfer pricing rules apply.

Company Law and Accounting

The commercial code governs how companies may be incorporated, operated, reorganized, and dissolved. The principal types of companies are described here.

Corporation (SA)

A corporation must have a minimum of five shareholders. Each shareholder is liable up to the amount of its capital contribution as represented by negotiable shares. The corporation's capital is divided into authorized share capital, subscribed share capital, and paid up share capital. At the time of the company's incorporation, at least 50 percent of its authorized share capital must be subscribed, and at least 33 percent of its subscribed share capital must be paid-up. The balance must be paid during the year following the subscription.

Some characteristics of corporations:

- If a corporation needs to be capitalized, it may issue shares or bonds convertible into shares.
- When new shares are issued, they may be offered at a price higher than their face value to increase the corporation's net worth. This excess of the price of the shares over their face value, also known as the premium on share placement, is exempt from income and complementary taxes at the time of the capitalization, but will become part of a corporation's taxable income at the moment of its distribution.
- Stock may be sold at any time without restrictions, unless the corporation's by-laws provide for a

special procedure or lay down a preferential purchase option in favor of existing shareholders. When a corporation's shares are registered on the stock market, they may be freely traded.

- The shareholders meeting can deliberate and reach decisions in a place other than the corporation's main offices, and even abroad, if the total of the corporation's shares are represented at the meeting.
- Corporations must have a statutory auditor (revisor fiscal). They will also be under the surveillance of the Superintendent of Companies if their surveillance is not undertaken by any other superintendent, and their assets or revenues are higher than 30,000 minimum legal monthly wages (mlw) (approximately USD 6.7 million for 2009).

Limited Liability Company (Ltda)

A limited liability company may be organized with a minimum of two partners and a maximum of 25. The partners are liable up to the amount of their capital contributions, except for tax and labor liabilities, in which case partners can be severally and jointly liable along with the company in accordance with particular provisions. The capital of the company must be fully paid at the time of the incorporation and is divided into capital quotas of equal amount, which may be assigned in accordance with the provisions in the company's by-laws and Colombian law. The partners will, in addition, be jointly liable for the attributed value of any contributions in kind.

The limited company's highest direction and administration body is the board of partners, in which the partners will have as many votes as they own capital quotas in the company.

The capital quotas (stock) of limited liability companies may be assigned to other partners or third parties, after the approval of the board of partners. Every stock assignment implies a statutory amendment that must be legalized by a public deed and registered with the chamber of commerce of the company's domicile.

Partners are joint and severally liable for the tax and labor debts of the company in proportion to their capital contributions, taking into account the number of capital quotas they possess and the period during which their capital quotas were owned.

A statutory auditor is mandatory if the statutes so require, or when the assets are higher than 5,000 mlw

(approximately USD 1.2 million) or the revenues are higher than 3,000 mlw (approximately USD 675,000).

The limited liability company will be under the Superintendent of Companies' surveillance if its surveillance is not undertaken by any other superintendent and their assets or revenues are more than 30,000 mlw (approximately USD 6.7 million for 2009).

Limited Partnership (Sociedad en Comandita)

A limited partnership involves one or more administrator partners who commit themselves to joint and unlimited liability for the entity's operations (partners with unlimited liability); and one or more non-administrator partner(s) whose liabilities are limited to their respective capital contributions (silent partners).

The partnership capital consists of the silent partners' contributions and those of the administrator partners or partners with unlimited liability. However, responsibility for the company's management lies solely with the administrator partners.

Limited partnership entities can be sub-divided into simple limited partnerships and general shares partnerships. A simple limited partnership's capital is divided into partnership quotas, while a general shares partnership's capital is divided into shares.

Simplified Stock Corporation (SAS)

An SAS can be incorporated with only one shareholder and these kinds of entity have separate legal personalities from their shareholders (the equity of the SAS is completely independent of the shareholder's equity). The liability of the shareholders is limited to the amount of capital contributed. The structure of the SAS is simpler than other companies as:

- SAS does not need a board of directors (all management and representative activities can be carried out by the legal representative appointed by the shareholders) unless otherwise required in the bylaws; and
- the shareholders could directly take decisions usually implemented by directors, such as approval of financial statements, the dividend distributions, and all the corporate accounts.

An SAS can be incorporated with a private document. It is, therefore, not necessary to sign a public deed with a notary public, unless the shareholders contribute real property to the SAS. This means that the costs of incorporation are generally lower for a SAS than for

other types of company. On incorporation, the share capital does not need to be fully paid for a period of two years.

Merger

Under Colombian law, a merger of companies is a complex legal transaction by which one or several companies are dissolved, but not liquidated, to be absorbed by another company or to create a new company. The merger is achieved by means of an equity transfer representing all the assets and liabilities of the absorbed companies into another absorbing company, which may be newly-formed or pre-existing.

In this situation, the absorbing company or the new company acquires the rights and obligations of the dissolved companies as they were at the time of the execution of the merger agreement.

Tax Effect of Company Merger

The merger of companies does not imply a transfer or sale of assets between the merged companies. For this reason, this kind of transaction does not generate income tax effects for the companies participating, and no value-added tax (VAT) will arise.

Tax regulations stipulate that the absorbing or new company is responsible for paying the taxes, advances, withholdings, sanctions, interests, and other tax obligations existing in the merged or absorbed companies.

De-Merger or Spin-Off of Companies

In accordance with the commercial regulation (Law 222, dated 20 December 1995), there are two ways to spin-off companies:

- when a company, without being dissolved, transfers in a block one or several portions of its net worth or patrimony to one or more existing companies, or uses such portion(s) to set up one or more new companies; and
- when a company is dissolved, but not liquidated, and splits its net worth or patrimony into two or more portions that are either transferred to several existing companies or used to create new companies.

Tax Effect of De-Mergers or Spin-off

The tax effects of a splitting of companies as described earlier in the chapter are the same as for company mergers.

Transfer Pricing

Transfer pricing rules apply to income tax payers engaged in transactions with foreign related parties. All operations with foreign related parties shall be reported in the relevant return and the supporting documentation shall be prepared and kept available at any time for the tax authorities. Organization for Economic Cooperation and Development (OECD) principles are the guidelines for transfer pricing purposes in Colombia.

Foreign Investments of a Local Target Company

Colombian entities can invest in foreign companies, but must register such investments with the Central Bank. Taxes paid abroad can be credited against the Colombian liability (Colombian taxpayers pay their income tax on worldwide profits).

Comparison of Asset and Share Purchases

Advantages of Asset Purchases

- The price paid on acquisition of a fixed asset, adjusted for inflation up to 31 December 2006, can be used as the basis for depreciation or tax amortization.
- When used goods are acquired, the assets can be depreciated over the remainder of their useful life, after deducting the depreciation period used up by the seller.
- An asset purchaser does not take on any risk or contingency relating to the commercial or tax obligations of the selling company, unless the asset acquired carries a mortgage or pledge, or in the case of real estate the real estate tax (land tax) liability is transferred.
- It is possible to acquire only part of a business.

Disadvantages of Asset Purchases

- There is a possible need to renegotiate supply, employment, and technology agreements, and to renew licenses.
- The sale generally requires access to greater cash resources.
- The benefit of any losses incurred by the target company remains with the seller.
- Income derived from the economic exploitation of the assets in Colombia might be subject to withholding tax.

Advantages of Share Purchases

- The sale generally requires less capital outlay.
- The purchaser may benefit from existing supply and technology agreements.
- Dividends are not subject to withholding tax if they are paid out of profits that have already been taxed at the company's level.
- A share sale does not require registration duties, but the sale of real estate or other goods subject to registry requires a public deed to be executed and registered with the public document registry office, generating a notary fee (approximately 0.3 percent) plus a registration tax of 1 percent of the total price stated in the document.

Disadvantages of Share Purchases

- The purchaser acquires liability for the commercial obligations of the company up to an amount equal to his/her capital contribution.
- In the case of limited liability companies, the partners are severally and jointly liable for tax debts in proportion to their contributions and to the period during which they have owned the shares.
- Partners are also jointly liable for some labor liabilities of the partnership.

Withholding Tax Rate Chart

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends (*)		Interest ¹ (%)	Royalties (**) (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Bolivia ²	⁻³ 0% – 33%	⁻³ 0% / 33%	⁻³ 33%	⁻³ 33%
Ecuador ²	⁻³ 0% – 33%	⁻³ 0% / 33%	⁻³ 33%	⁻³ 33%
Peru ²	⁻³ 0% – 33%	⁻³ 0% / 33%	⁻³ 33%	⁻³ 33%
Spain	⁻⁴ 0%-5%-33%	⁻⁴ 0%-5%-33%	10%	⁻⁴ 10%

Notes

- Many treaties provide for an exemption for certain types of interest, such as interest paid to government institutions or to state-owned institutions (including governmental financial institutions), in respect of commercial debt claims in the case of the supply of goods, or loans for development purposes, or the promotion of exports, etc. Such exemptions are not considered in this column. Interest paid to foreign financial institutions duly registered with the Central Bank that are related to loans obtained in order to use them in activities of economic and social benefit to Colombia are not subject to withholdings.
 - In application of Decision 578 of the Andean Community.
 - Domestic rate applies; there is no reduction under the treaty. The source state has the exclusive right to tax and the other state shall consider royalties as exempt income.
 - State of residency of the taxpayer has the right to tax. Nevertheless, if the state of source taxes the dividends the rate can be no higher than 5 percent. Withholding will be 0 percent provided the beneficiary of the dividends has a participation of at least 20 percent of the capital of the company, they are paid out of exempted profits and they are reinvested for a term of three years. Technical services, technical assistance services, and advisory services are deemed to be royalties.
- * Dividends are not subject to income tax if they are paid out of profits that were previously taxed at the company level; otherwise general income tax rate of 33 percent applies.
- ** The taxable base for royalties from software exploitation is 80 percent of the payment.

KPMG in Colombia

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