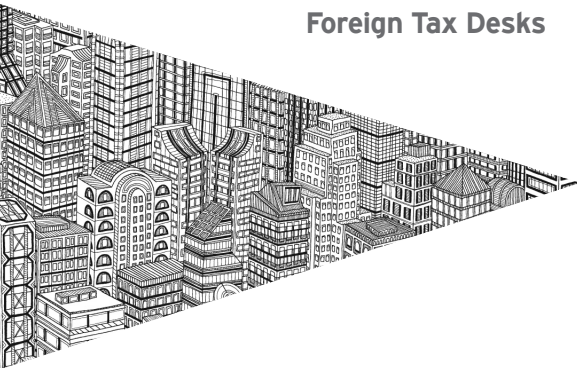


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Colombia eliminates restrictions on foreign debt; intercompany loans now possible

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On 28 October 2011, the Board of Directors of the Colombian Central Bank issued rules that loosen the restrictions on foreign debt, which will provide flexibility to companies operating in Colombia. More specifically, Resolution No. 5 of 2011 (Resolution No 5) permits Colombian residents to contract foreign indebtedness from any nonresident. Pursuant to section 24 of this rule, "*Colombian residents may contract loans in foreign currency from nonresidents, regardless of the term of payment and the destination of the funds.*"

This new provision constitutes a major change to Colombia's foreign exchange control policy, as it eliminates the restriction set forth in Resolution 8 of 2000, under which Colombian companies were only entitled to obtain loans from foreign lenders recognized as financial institutions by the Colombian Central Bank, thus excluding any possibility for intercompany loans. This restriction made the use of back-to-back loans a common and accepted practice.

Under the provisions of Resolution No. 5 Colombian residents may validly obtain loans from all types of foreign entities, opening the door to intercompany loans as a valid mechanism for the funding of Colombian operations, even if the entity acting as a lender is not a financial entity. The assignment of an identification code from the Colombian Central Bank will be required.

It is important to consider that the following tax effects and requirements are triggered on intercompany loans:

- ▶ The foreign loan must be reported to the Central Bank prior to or simultaneously with its disbursement in order to comply with foreign exchange regulations. In addition, disbursement of the funds and repayment of the principal and interest must be channeled through the foreign exchange market (i.e., commercial banks of foreign bank accounts registered and reported with the Colombian Central Bank).
- ▶ The loan transaction will be subject to transfer pricing regulations, as it is a transaction with a related party abroad. These rules require that, (1) the conditions of the loan should be determined in

accordance with the arm's length principle; and (2) the operation should be subject to the formal transfer pricing compliance obligations (filing of a transfer pricing informative return and preparation of transfer pricing contemporaneous documentation).

- ▶ Interest payments abroad will be subject to 14% income tax withholding if the term of the loan is equal to or greater than one year (33% if granted for a term less than one year). A reduced income tax withholding may apply if the creditor and beneficiary of the interest payment are resident in a jurisdiction with which Colombia has a tax treaty (i.e., Spain, Chile and Switzerland).
- ▶ Interest payments will be deductible for income tax purposes (as well as any exchange losses),

provided that the transaction complies with transfer pricing requirements.

- ▶ The liability on the loan held with a foreign related party will be disregarded as such for tax purposes, and it will be considered an increase in the equity of the Colombian company. This will have an impact in the determination of equity based taxes such as the income tax under the presumptive income system and the equity tax. The above applies unless the foreign related party that grants the loan is a resident of a jurisdiction with a tax treaty with Colombia that includes a non-discrimination clause (i.e., Spain, Chile and Switzerland). In this situation, the liability should be accepted for tax purposes.

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