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Colombia puts in place a preferential international shipping tax regime

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General considerations

Law 2133, dated August 4, 2021, implemented a new tax regime related to the flagging of ships and vessels in Colombia. The purpose of this law is to provide a regulatory framework that would help increase the numbers of ships registered under a Colombian flag, as Colombia lags considerably behind in this area when compared with other Latin-American countries.

To encourage the registration of vessels with the Colombian Maritime Authorities, Law 2133 establishes a special income tax regime under which any revenue arising from international shipping activities[2] related to the operation of ships registered in Colombia is subject to an income tax rate of 2% instead of the regular 31% corporate tax rate applicable for the fiscal year 2021.[3]

Moreover, this rule applies to both Colombian resident and non-resident entities and individuals, provided they perform international shipping activities with ships bearing a Colombian flag as, according to Section 4 of Executive Order 804 of 2001, both domestic and foreign companies and individuals can request the permit required for this activity.

As Colombian residents are taxed based on their worldwide income, any revenue from international shipping, regardless of its origin, is liable for taxation by domestic taxpayers at the 2% preferential tax rate (provided the activities are carried out with Colombian registered vessels or ships as mentioned).

However, as non-residents are only subject to income taxation for their Colombian sourced income, there is a special rule for calculating the taxable base for non-residents operating international shipping activities on a regular basis between Colombian and foreign ports through a branch or a permanent establishment (PE), which is:

<u>Taxable base:</u> (Colombian-sourced revenue related to international transport activities /global revenue from international transportation activities) % * (global revenue from shipping activities).

Hence, the 2% rate will apply the above-mentioned taxable base if the international shipping activity is carried out with Colombian registered ships and the non-resident is liable to file a tax

return in Colombia (if the activity is developed in Colombia regularly).

For further guidance on this rule, refer to the following example, in which the tax base is determined based on the information provided below:

Global revenue	1000
Colombian-sourced income (related to Colombian clients and shipping activities carried out within Colombia)	200
Proportion of Colombian-sourced revenue vs. global revenue (i.e., Colombian-sourced revenue related to shipping activities/global revenue from shipping activities)	0.20
Colombian taxable base (0.2*1000)	200

From a compliance standpoint, these branches or PEs are required to file annual tax returns and settle any outstanding tax payments, which are due in October of each year.

For completeness, non-residents performing this activity in Colombia directly (i.e., not through a branch or PE) are subject to a 5% withholding tax over the gross consideration of the fee as defined in Section 414-1 of the Colombian Tax Code (CTC), and no compliance obligation arises considering Section 592 of the CTC. However, if the payer is not a withholding Colombian, then they must file an income tax return within the deadlines and settle any outstanding tax related to its net Colombian-sourced income (i.e., less allowed costs and expenses for tax purposes) with the 2% rate if the services are rendered with Colombian registered ships.

Analysis of the criteria of Action 5 of BEPS

One cornerstone issue that must be addressed concerns whether this special tax regime could be deemed "harmful" from a tax perspective under the rules envisaged in Action 5 of BEPS, as the regime has not been peer reviewed by the BEPS inclusive framework. Nevertheless, an analysis of the matter, considering both the 5 key factors and the other 5 factors considered by BEPS, is as follows:

Five key factors	Comments	Assessment
The regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities.	Although there is a reduced tax rate (2% nominal), this fact *per se* does not imply that there is a harmful tax regime, as one must consider all the other factors.	Not applicable.
The regime is ring-fenced from the domestic economy.	The regime is not partly or fully insulated from the Colombian domestic economy, and both domestic and foreign companies can apply	Not applicable.
The regime lacks transparency.	The regime is completely open in terms of transparency.	Not applicable.
There is no effective exchange of information with respect to the regime.	The regime does not provide any disposition that hampers the exchange of information.	Not applicable.
The regime fails to require substantial activities.	Only taxpayers developing substantial shipping activities can apply.	Not applicable.

Regarding the other five factors specified in Action 5 of BEPS, the analysis is as follows:

Other five factors	Comments	Assessment
An artificial definition of the tax base.	The tax base is calculated based on a general and, hence, not a special formula.	Not applicable.
Failure to adhere to international transfer pricing principles.	Shipping companies are subject to the general transfer pricing rules without any special consideration.	Not applicable.
Foreign source income exempted from residence country taxation.	Such an exemption is not envisaged in this regime.	Not applicable.
Negotiable tax rate or tax base.	It is not possible to negotiate a special tax rate or tax base.	Not applicable.
Existence of secrecy provisions.	No secrecy provisions are in place.	Not applicable.

As one can see, the Colombian special tax shipping regime does not fulfill the requirements to be labeled as harmful based on the yardsticks provided in Action 5 of BEPS.

Impact over tax treaty distributive rules

One must point out that the Colombian special tax shipping regime would not apply if the branch were registered in Colombia by a company resident in a tax-treaty jurisdiction, as Section 8 of those treaties forbids the taxation *in situ* of any income arising from international transportation and hence the taxation is due in the location of the place of effective management (bearing in mind that Colombia has followed such a rule from the OECD's tax treaty model).[4]

Lastly, that same tax rule has been agreed in treaties to avoid double taxation with respect to international shipping conducted with Argentina, Brazil, Germany, and the United States.

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[2] Defined by Executive Order 804 of 2001 as "transportation that takes places between Colombian and foreign ports".

[3] The Colombian government recently presented a tax bill that would increase the corporate tax rate to 35%. However, the bill is still under debate in the Colombian congress.

[4] Colombia has signed tax treaties with Spain, Switzerland, Chile, Canada, India, Korea, Portugal, the Czech Republic, Mexico, and the United Kingdom. Treaties have been signed, but are not yet in force, with Italy, Japan, France, and the United Arab Emirates.

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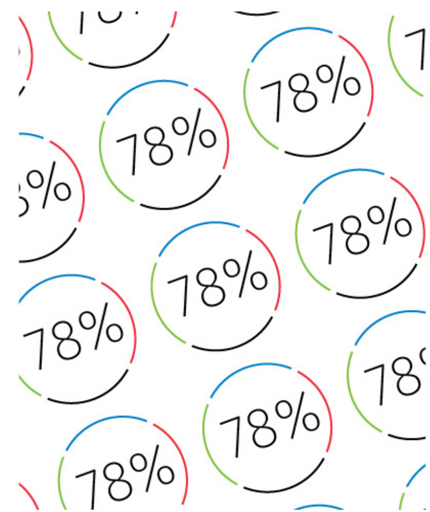

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