

TAX AND FOREIGN EXCHANGE MATTERS TO TAKE INTO ACCOUNT WHEN REFINANCING DEBTS IN FOREIGN CURRENCY

In the current situation of the country due to the public health emergency of COVID-19, Colombian companies have a tax opportunity arising from the high devaluation of the Colombian Peso (COP) against foreign currencies. By restructuring their debts in foreign currency, Colombian companies may have the opportunity to materialize the financial difference in FX rate in their income tax return.

In order to take advantage of this tax opportunity, Colombian companies must be very careful in the way they restructure their debt in foreign currency and its respective execution, from legal, tax, accounting and FX points of view.

In recent years, Colombian companies had to recognize in their financial statements the effect of the FX difference derived from their debts in foreign currency which reduced their financial gain. However, they have not been able to recognize the FX difference in their income tax returns, since it can be recognized only when the debt is partially paid or liquidated.

Taking into account that the liquidation of the debt would allow the companies to realize the FX difference for tax matters, the key aspect for the companies is to find a mechanism that allows the debt to be settled without affecting the cash flows. In practice, there could be different mechanisms to consider that the debt has been settled without using own cash.

The restructuring of the debt is one of them.

In this order of ideas, please find below three alternatives for restructuring the debts in foreign currency. We will present the different issues that should be analyzed in order to achieve the realization of the FX difference for tax matters:

1. Renegotiation the foreign currency debt with the same creditor:

To the extent that the tax law does not provide rules as to when a debt should be considered as settled, and also does not provide a specific treatment for this case, we consider that, in application of article 21-1 of the Tax Code, IFRS should apply.

From an accounting point of view, the renegotiation of the terms and conditions of a debt in foreign currency with the same creditor could lead to the liquidation of the initial liability and the recognition of a new one, provided that the new conditions are substantially different from the originals.

The conditions would be considered as substantially dissimilar if there is a difference of at least 10% between (i) the present value of the discounted flows under the new conditions (discounted at the effective interest rate of the original liability) and (ii) the discounted present value of the flows that still remain from the original liability. It is important for the taxpayer's financial team to previously analyze that such condition is met, and also to document the entire financial analysis.

Under this alternative, we consider that the Colombian companies could recognize a tax deduction for the difference in exchange rate, without the need to use its available cash.

In order to support the renegotiation and comply with the FX regime, the taxpayer must submit a new form before the Exchange Market Intermediary (Intermediario del Mercado Cambiario "IMC"), including the modified terms of the contract (i.e. amount, term, interest rate and among others) and attaching all the documents that support the actual renegotiation of the debt.

Once the operation is approved by the IMC, it will directly send it to the Central Bank (Banco de la República) for proper registration. The changes must be reported within the fifteen (15) business days following the occurrence of the renegotiation, consequently allowing clarity before the National Authorities, specifically for the capital or interest transfers to be carried out afterwards.

2. To acquire a new debt with another creditor and pay the original debt:

If incurring in a new debt to use the proceeds to pay the original debt, the difference in FX would be realized for tax purposes. The terms and conditions of the new credit should not differ substantially from those of the original credit for purposes of the tax recognition of the difference in exchange rate.

The debtor may acquire a new credit either in Colombian Pesos or in foreign currency, from intermediary banks or companies. In this situation, depending on the condition of the creditor and previous to the disbursement, a new Form must be registered before the IMC, attaching the new credit agreement or its equivalent document. With the disbursed resources, the payment can be made and the initial registration of the external indebtedness can be canceled.

It is advisable to check the viability of receiving foreign currency through a clearing account. This will allow efficiencies in tax and financial matters for coverage, by being able to agree and receive a single currency.

3. Debt sale (new creditor for the original liability):

This option would operate practically as a portfolio sale. When the debtor contracts a second loan in the same currency to pay a previously subscribed credit, the disbursement of the new credit can be made directly to the initial creditor, and would result in the cancelation of the original credit. The report of a new credit through the submission of a new form to the IMC would be required.

In this way, the original liability would be settled and the FX difference would be realized for tax purposes.

For taxpayers, it will be essential to carefully study the circumstances under which the debt is restructured and to document them properly. Offsetting a tax deduction derived from a FX difference, without having properly cancelled the liability could result in the exposure to a higher income tax due, and also to penalties and delay interest.

Likewise, companies that restructure their debts must rigorously comply with the foreign exchange regime. Otherwise they could face penalties of up to 200% of the amount of restructured liabilities.

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