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Tax Controversy 2022

Colombia: Trends & Developments
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COLOMBIA

Trends and Developments

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Trends and Developments of Tax Controversies in Colombia

In a schematic, clear and practical way, this document presents the main trends and the most relevant current developments of tax controversies in Colombia.

Tax controversies in Colombia have evolved and shown an exponential development in two main ways: first, the introduction of virtuality in the administration of justice for all actions that are carried out by the parties, judges, courts, and tribunals, as well as by third parties involved in the controversies.

Second, an element that has impacted tax controversies, and that undoubtedly is and will be a constant integrating aspect of the development of future disputes, is the application of the decisions of jurisprudential unification issued by the Council of State. Such decisions constitute a valid jurisprudential precedent, in which general rules and sub-rules of law are incorporated and therefore can be demanded by taxpayers in similar situations either within an administrative or a judicial process, and likewise, in some instances they may serve as a support basis to be used by the Tax Authority through expedited mechanisms, guaranteeing an agile and equal application of tax justice in similar cases.

Regarding trends in tax controversies, considering the matter in dispute, there are four focal points in the audit and control processes undertaken by the Tax Authority, which tend to increase the litigious acts against the legal posi-

tions considered by taxpayers when fulfilling substantial and formal tax obligations.

The first relates to the economic and commercial substantiality of the transactions carried out by taxpayers, providing that their conclusion and execution produce tax effects.

This trend has been monitored under a thorough investigation and audit conducted by the Tax Authorities, focusing on the business purpose derived from the actions developed by taxpayers, emphasising substantiality over formality, and therefore, contesting transactions that present a correct and formal appearance but lack business purposes.

The second relevant aspect in terms of trends in tax controversies is closely linked to the first, in regard to the growth in the demand for solid and complete defence files by taxpayers in relation to all the elements that are subtracted or detracted to determine the applicable tax, such as: liabilities, costs, expenses, discounts, discountable taxes, withholdings and tax benefits.

Thus, in addition to the substantiality of the transactions, the origin of the private tax determination will only proceed upon the existence of comprehensive evidentiary defence files, in which both the fulfilment of formal and substantial requirements, within the framework of evidentiary tax law, is incorporated.

The third integral element is related to the thorough, substantial and detailed audit of transfer pricing documentation.

In this regard, the Tax Authority has evolved from its previous position in which the investigations were focused on the application and appropriateness of comparability adjustments in transactions subject to the transfer pricing regime, to the current investigations, which are based on elements of the substance of the analysis of transactions between related parties, such as: the correct selection of the transfer pricing method; the economic indicators applied; the selection of comparable third parties; the acceptance and rejection of documentation; the functional analysis related to assets, functions and risks; the periodicity of the information used for the analysis; and the fulfilment of formal obligations.

Lastly, the fourth aspect related to the trends in current tax controversies, which although may seem contradictory to the above, is limited to a robust audit on the formal compliance with the obligation to submit tax information.

Under the existing tax obligations in Colombia, there is an obligation to submit information, which can originate both by regulatory requirement and by a direct and timely request from the Tax Authority.

This being the case, the failure to submit information, errors in the data transmitted, and late submission constitute a punishable fact.

This particular trend in tax controversies has been centralised in the punishable fact regarding the sending of information with errors from a formal and non-substantial point of view, such as, for example, matters related to the tax identification number of the parties of an operation, or whether those involved in an operation as

Colombian or non-residents, aspects that, being merely formal, have led to an increase in the penalties to be discussed before the Tax Authority.

Thus, both the trends and the developments in tax controversies in Colombia can be divided into two main areas: (i) the development of tax litigation and the jurisprudential basis related to tax controversies, and (ii) the principal matters of tax controversies.

Looking in detail at the integral aspects of these two main areas, we find the following.

The development of tax litigation and the jurisprudential basis in the context of tax controversies

As a result of the COVID-19 pandemic, justice in general, and especially that related to tax matters, swiftly moved towards a transition in the management of controversies starting with a justice system based on written actions and “in person” hearings to virtual formats.

Also, in recent years the number of unification judgments issued by the Council of State has increased significantly, in which multiple rules and sub-rules of law of general application have been defined, which integrate the tax system and allow taxpayers to focus and rely on them in cases in which a similar matter is disputed.

The impact that the virtual process on tax justice, like the judgments of jurisprudential unification, has generated in the development of tax controversies, is critical, so it must be addressed independently, given that a new system was established to access and interact within the context of the administration of justice, while on the other hand, a binding force was granted to the jurisprudential precedent against analogous or assimilable cases.

Given the different and independent relevance of these aspects, it is important to consider the impact of both developments related to tax controversies.

Tax controversies as a result of virtual procedures

Although the administrative procedural regulations, in which tax controversies are aired, had already ruled on various elements for the digitalisation of files of matters in dispute, aiming to implement the virtuality in controversies, however with the situation derived from the COVID-19 pandemic, these processes were advanced to the point where, since June 2020, virtual processes were used for all the actions of the parties, third parties and judicial bodies in the context of an administrative tax dispute.

Thus, the submission of lawsuits related to tax matters, the response to those by the Tax Authority, the intervention of third parties with a legitimate interest in the process, and the orders and judgments are presented and incorporated into the process by digital means.

In the same way, all the hearings are held virtually, and their content is incorporated into the file for the process through the virtual tools accessed by the electronic links where the proceedings and the supporting documentation are saved.

This new implementation of virtual processes and communication technologies for tax controversies has been a significant advance, especially in relation to the timelines and agility of judicial decisions.

However, these favourable advances have generated in some cases, divergent positions regarding a legal aspect, which must be utterly evident in the context of a judicial discussion, the understanding of deadline dates and procedural opportunities.

In this regard, some provisions have indicated that the terms and dates must be considered from the day following the sending of the decision by emails, and others have suggested that the terms granted must be calculated from the day following the proof of receipt of the decision sent by email; the latter position was considered as the most accurate and guarantor of the rights of defence of the parties by the Constitutional Court.

As previously mentioned, virtual technology an excellent advance in tax controversies, however the understanding of the date on which the terms start, in this new way of litigation, must be unified in order to ensure legal certainty and due process; in the meantime, the most conservative position must be applied to avoid discussions regarding the timeframes of the proceedings.

In conclusion, the rise of tax controversies as a result of virtual processes is a significant and highly favourable advance for the interested parties, however, being a novel procedure, special care must be taken in all the hitherto grey areas of legislation under development.

The Jurisprudential Basis in the Context of Tax Controversies

Although an essential sector of the doctrine and of the tax litigants in Colombia focused on the mandatory nature of the jurisprudential precedents, with the introduction of the judgments of jurisprudential unification in administrative controversies multiple legal provisions were incorporated that support and sustain the binding nature of these decisions against subsequent analogous cases.

Judgments of jurisprudential unification are those issued by the Council of State, as the highest authority of administrative justice in Colombia, for reasons of legal importance or economic or social significance, or with the pur-

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pose of establishing or unifying jurisprudence, or specifying its scope.

In matters related to tax controversies, most judgments of jurisprudential unification have been delivered in which jurisprudence is established or unified.

Establishing jurisprudence refers to the determination of a position on the application of a legal provision that had not previously been carried out, while unifying jurisprudence corresponds to the definition of a determination on the existence of various previous jurisprudential positions.

Thus, unification judgments create rules or sub-rules of law applicable to subsequent cases in which the same assumptions of fact and law defined in said decisions are discussed.

In this sense, the rules and sub-rules incorporated and defined in these judgments represent a legal basis enforceable by taxpayers, both in the context of a discussion directly with the Tax Authority, and before the administrative judges.

Additionally, given the importance and enforceability of this type of judgment, in the administrative procedural regulations applicable to tax law, an expedited mechanism was defined to demand the fulfilment of these decisions directly from the Administrative Authority; this is known as the mechanism of extension of jurisprudence.

This mechanism of extension of jurisprudence requires that taxpayers be in the same factual and legal conditions as those determined in the unification judgment; this ruling recognises a right, and that the opportunity to file a lawsuit against the administrative acts on which the application of the unification judgment is requested has not expired.

The prominent cases that have been the subject of a unification judgment in national tax controversies are the following:

- requirements for the deductibility of expenses in income tax;
- rates of compensation for tax losses in merger processes by absorption;
- penalties for failing to comply with the obligation to send information;
- due process in the imposition of penalties;
- assessment of the penalties for improper tax refunds or compensation;
- intervention of joint and several debtors in a tax dispute; and
- statute of limitations of the income tax returns for taxpayers obliged to apply the transfer pricing regime.

In this vein, jurisprudential unification judgments are an essential development of tax controversies, as they are an ideal mechanism to support a tax treatment or position, require the application of a rule or sub-rule of law and anticipate the results in a discussion that has been the subject to such a judgment.

In conclusion, the performance of tax litigation in Colombia will have to be carried out in compliance with jurisprudence in general, and especially in relation to judgments of jurisprudential unification.

Hence, it is important to note the critical development that tax controversies have had in Colombia, both in terms of their set up, mechanisms and procedures to access justice, as well as in relation to the jurisprudential support in the context of a tax discussion directly with the tax authority or before the administrative judges.

The Main Matters of Tax Controversies

Although taxpayers in Colombia can initiate a tax dispute, through a refund request or an official

request, the Tax Authority usually undertakes controversies as part of investigation, audit and monitoring exercise within the statute of limitations.

In the exercise of this fundamental assignment of the Tax Authority, this entity determines research programmes or trends by which controversies with taxpayers will develop, without prejudice to deploying every type of investigation that it considers applicable.

As previously mentioned, the leading audit trends are divided into four aspects:

- the substantiality of the transactions carried out by taxpayers;
- the strength of the defence files;
- the determination of transfer pricing; and
- the penalties derived from formal errors in the information submitted.

The main elements to highlight these four trends towards which tax controversies are currently directed are as follows.

The substantiality of the transactions carried out by taxpayers

The current investigation, audit and tax control programmes focus on a comprehensive analysis of the transactions carried out by taxpayers. As part of these programmes, the appearance of an operation is no longer the element that will generate the tax effects. In addition, the definite purpose of a transaction that caused a tax impact must be demonstrated.

Before the current trend, the origin of the deductibility of expenses generated in a transaction, for example, was supported by the signing of a contract, by the invoices issued relating to the transaction and by the accounting records.

The substantiality to which the tax system evolved, and the controversies derived therefrom, created a trend requiring support or motivation to incur in the returns. The substance of a transaction cannot rely on a mere tax effect, but the taxpayer should consider an economic or business intent.

In the proposed example, it would be necessary to evaluate the necessity and impact of the conclusion of the contract and the result derived from the execution of the agreement, among others.

This audit trend should not be confused with a limitation on taxpayers' transactions. This trend aims to determine the tax impact of transactions and not the conclusion or execution of agreements.

Thus, the tax effects of a transaction must be triggered under a substantial approximation, as part of a necessity and causality for the business development of the producing activity of a taxpayer. Therefore, tax effects derived from a transaction only supported from a formal position are not considered appropriate.

The strength of defence files

In line with the enforceable substantiality of the transactions carried out by taxpayers, evidentiary material that supports the determination has undergone a sophistication process. As a result, the origin of a tax determination is tied, restricted, and conditioned to the operation's integral evidentiary support, not simply to the formal aspects.

This tendency of control is based on the principle of evidentiary law. The party who is interested in demonstrating the legal effect derived from a fact is obliged to demonstrate the fact.

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In this sense, as the taxpayer is the main interested party in demonstrating that the tax return is correct, the probative responsibility of all the elements that establish the proper tax determination are upon the taxpayer.

Therefore, considering a defence file based on merely formal aspects, without proving the completeness of the facts, the Tax Authority will proceed with a controversy against the taxpayer. In the end, the taxpayer will be the one who bears the burden of proof, and if they do not comply, they will surely not obtain a favourable result in the decision on the controversy.

The determination of transfer pricing

Tax controversies regarding the application of transfer pricing regime have been a trend in Colombia since the introduction of this regime at the beginning of the new millennium. However, the current trend is not about the general object of the dispute but about the specific elements discussed.

The Tax Authority has improved the sophistication of its approach to the regime by questioning the integrality of the support of these transactions.

The paradigm shift in transfer pricing controversies has been evident. Previously, the main element under discussion was the application of comparability adjustments by taxpayers. Although it is still a subject of dispute, the Tax Authority now studies, discusses and contests all aspects related to the regime.

The primary trend in these controversies focuses on the use of transfer pricing methods, which have been developed by the Tax Authority, by repeatedly questioning the use of traditional operational methods in preference to results methods.

Likewise, the Tax Authority has been restricting the choice of comparable companies, the acceptance and rejection studies determined by taxpayers, and the functional analyses carried out.

Despite the depth of current transfer pricing controversies, discussions related to the fulfilment of the formal duties of the transfer pricing regime remain a critical control programme developed by the Tax Authority.

In this sense, controversies related to the transfer pricing regime have been affected by a focused trend, as have the two previous points on substantiality and burden of proof attributed to taxpayers.

Penalties resulting from formal errors in the information submitted

Despite the substantial trends in tax controversies, the Tax Authority has been simultaneously developing discussions based on simply formal aspects.

As previously explained, the Colombian tax penalty regime penalises non-compliance with all substantial and formal tax obligations.

Regarding non-compliance with formal obligations, an audit trend has developed. As a result, the Tax Authority has imposed penalties on taxpayers who send information with errors even though these are merely formal.

The formal errors, repeatedly penalised by the Tax Authority, relate to taxpayers that included incorrect tax identification numbers, the absence of a tax identification number of a third party located abroad, or the type of taxpayer, ie, if it is national or foreign.

This trend in controversies related to penalties is formalistic and far from the substantiality previously developed. Nevertheless, it has meant that, in the application of the constitutional principle of the priority of substance over form, legal provisions that regulated this penalty have been controverted, provided that the Tax Authority only imposes penalties upon the occurrence of an error that did not cause any damage.

In conclusion, although the audit trends are evolving based on the regulatory modifications and the transactions carried out by the taxpayers – and, in general, with the execution of different legal businesses – nowadays, economic substance and evidentiary material, without neglecting formal obligations, remain.

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