

# **Double Taxation Agreement between Panama and Colombia**

## **Notes of Interest**

- **What was agreed to with Colombia?**

Last April 28, Panama entered into a Double Taxation Agreement (DTA) with Colombia. This agreement will include a clause for exchanging tax information upon request.

- **Why is Colombia talking about an automatic exchange of information?**

Panama and Colombia also agreed to enter into an exchange of letters between their Foreign Ministries whereby they agreed to sign an Agreement on the Automatic Exchange of Financial Information by 2018, if and only if Colombia is able to guarantee that it has the ability to receive information securely and meet confidentiality requirements precluding the possibility that the information provided could be used by third parties for purposes other than those that would be covered by this Agreement.

This paragraph confirms statements made by Minister Dulcidio De La Guardia, who said:

“In 2018, Panama will initiate the Automatic Exchange of Tax Information bilaterally, following the Organization for Economic Cooperation and Development’s (OECD) CRS methodology, only with those countries ensuring data confidentiality and protection and only with those countries meeting international standards on this issue. If Colombia meets these standards, in 2018 we will follow that road. If not, we will maintain the exchange of information ‘upon request’.”

This is in line with the National policy on the automatic exchange of tax information announced by President Juan Carlos Varela, who said that it would be initiated bilaterally, beginning in 2018, and in accordance with the OECD’s CRS methodology, with any country meeting the conditions to ensure that the information provided is not wrongfully used.

- **What benefits does the DTA bring to Panama?**

With this DTA between Panama and Colombia, the existing economic complementarity between both countries is strengthened and bilateral cooperation is ensured to meet the expectations of greater tax cooperation.

Similarly, Panama consolidates itself as a suitable market in which those Colombians that deem it convenient to maintain their capital within our national territory can do so in full compliance with the legislation of both countries.

- **What does Colombia gain with this DTA?**

Colombia's interest in this DTA is not the repatriation of capital but the legalization of the Colombian depositors' status in our country.

- **When will the DTA be signed and when will it be enacted?**

It is expected that the Double Taxation Agreement will be signed by both countries sometime this year. Certain stages of the process must be completed for it to be enacted, such as the approval by the Cabinet Councils in both countries, the ratification by their National Assemblies, and, in the Colombian case, validation by the Constitutional Court. After these procedures are completed, the Agreement will be signed by the Presidents of both Republics.

- **Will the Control Foreign Corporation (CFC) regime be applied?**

No. This is an important achievement for Panama. By means of the non-application of the CFC regime that Colombia may approve in the future, the tax on the Colombian resident will be deferred when the passive income is generated through a corporation, a foundation and/or a trust fund in Panama. It is worth noting that these instruments must be accredited as tax residents in Panama, which requires a greater degree of formality and substance. The important thing about this milestone is that despite its contradicting one of the OECD's BEPS Recommendations, it was able to be included in an agreement already negotiated and agreed to with a jurisdiction which is in full process of joining the OECD.

- **Does Colombia recognize the Special Regimes offered by Panama?**

Yes, Colombia committed itself to recognizing the special regimes offered by Panama that have served to attract foreign investment to our country, generating employment and development. Colombia proposed excluding Panama's special regime from the scope of application, but this was unacceptable from day one. The Panamanian negotiating team was given the task of explaining what each special regime was and of noting that all of them must have the approval of the Panamanian State and fulfill the specific requirements for receiving the incentives that the country provides. Panama asked Colombia to include a clause in the protocol of the Agreement listing each and all of the special regimes Panama currently has and to specifically indicate that the expression "special tax regime" in the Agreement will only apply to special tax regimes other than those mentioned above, that do not require the realization of substantial activities and that generate a passive income that is disproportionate to the various passive incomes contained in the Agreement

- **What did you agree to in the Limitation of Benefits Clause?**

In the Agreement's Limitation of Benefit (LOB) Clause, it was agreed that this clause would not be applicable to those taxpayers conducting activities in Panama as third-State investors under a special regime (accepted by Colombia in the Agreement). This milestone is important because it validates the use of Panama as a regional and logistics center, even when the use of Panamanian services, under a special regime, is not for Colombian or Panamanian investors but for third (other) States. For example, if the original proposal made by Colombia on the LOB Clause had been accepted, many corporations under the SEM Regime would be subject to tax withholding that differed from the agreed reduced rates when billing their services to Colombia. It is worth noting that the LOB is part of the BEPS recommendations to combat abuse of agreements. Although each country has the option of choosing the LOB or a general anti-abuse clause, it is expected that in the agreement to be negotiated, the choice made by the other country will be accepted even though the first country did not choose that option. This achievement is a very important technical milestone for Panama.

- **What was agreed to on the Pension Funds?**

Panama will not tax the interest earned in Panama by Colombian pension funds and will tax the dividends earned by these funds at a preferential rate when invested in the country. Panama may be able to collect part of the money from Colombian pension funds.

- **What was agreed to on the indirect sales of shares?**

Panama was able to maintain its right to tax the indirect sale of shares based on the time and percentage of shares held.

- **Among other positive aspects achieved by Panama during the bargaining are:**

- a) Colombia wanted the OECD guidelines to be used as the method accepted to interpret the Agreement. Panama requested these guidelines be used only for understanding positions in negotiating the Agreement;
- b) Panama convinced Colombia not to accept the proposed Clause on Tax Collection Assistance;
- c) Panama's equity tax (Notice of Operations) will be part of the Covenant, with a limit on the amount of the Colombian tax credit.

- **What was agreed to on the entry into force of the exchange of information (upon request)?**

It was agreed that the Clause on exchange of information upon request would enter into force one year after signing the Agreement — i.e. the clause will enter into force in June 2017 if, as announced, the Presidents of both countries sign the Agreement in June 2016. Regarding the fiscal year or period in which Colombia may request

information, it was agreed that requests could be made for all periods after December 31, 2015. In practice, Colombia may request information as of June 2017, but only regarding fiscal periods beginning after December 31, 2015. It is important to point out that Panama succeeded in getting the final Agreement to have the Protocol that was negotiated with other States and that clarifies the procedure and conditions that must be complied with for processing a —Colombian— information request. Under any agreed text in line with transparency standards, the exchange of information would impact the information of current Colombian customers on the Panamanian service platform. What could be negotiated was the fiscal period for which information could be requested. The only potential consequence for setting the date of the entry into force of the Agreement, or setting 2017 or 2018, as the date of information disclosure, is that Colombian customers of the service platform who were in non-compliance with Colombian taxation and decided to remain non-compliant, rejecting benefitting from the Colombia's current normalization program (similar to an amnesty), could move their capital to another jurisdiction that still had non-cooperative policies on transparency and the exchange of tax information.

With this DTA treatment, Panama confirms it is an ideal market in which those Colombians who decide to normalize their tax status in Colombia and want to benefit from the existing normalization program will have a reasonable period of time to modify their status, thanks to the period finally agreed on.

It is worth mentioning that one of the proposed options presented by Colombia during the course of the negotiating rounds was to provide information for periods prior to the signing (without limitation) and that the agreement for exchange would enter into force on the date the agreement was signed.

It is also worth noting that, if Panama had insisted on providing information only for periods after the enactment of the agreement or from 2017 onwards, the international community might have believed – however incorrectly – that Panama was protecting customers that did not want to normalize their tax status by giving them time to move their capital to another jurisdiction.

The normalization offered by Colombia is the best route, because Colombia only requires declaring the global equity of their tax residents and not that the money be repatriated to the country. With the achieved Agreement, Panama consolidates itself as a secure and reliable place for attracting Colombian capital.

- **What was agreed to on the prospective Automatic Exchange of Information?**

After Panama announced it was part of the CRS, Colombia requested the Agreement contain a “Most Favored Nation” Clause in which if, in the future, under a bilateral or multilateral Agreement, Panama agreed to exchange tax information automatically, this would apply to Panama and Colombia under the same conditions.

Panama was very clear in the negotiations that a Clause of that type was not acceptable to Panama. At the same time, there was agreement on an exchange of diplomatic notes, separate from the Agreement, that would make clear that Panama will have a CRS with Colombia once Panama has agreed to a CRS with another country and, at the same time, Colombia is considered to be a country guaranteeing confidentiality of information.

- **The step from “exchange upon request” to “automatic exchange” is conditioned**

The existence of a condition for the exchange of information to be automatic shows Panama’s willingness to be part of the new global environment in which we find ourselves, but does not obligate Panama to accept Colombia as the first country in the world to which it will give the CRS; on the contrary, if there is no new implementation agreement between the parties, and if Colombia does not pass the confidentiality assessment on the handling of received information, it is possible that the exchange could continue to be “upon request” for that year despite Panama already having implemented the CRS with another country.

- **A balanced agreement was achieved, aligned with the new world order on transparency and exchange of information**

If the agreement reached is well managed, Panama may be the preferred place for Colombian tax residents to diversify and maintain their savings abroad. Having passive income remain in Panama using substantive structures and at the same time having the Colombian pension funds invest in Panama under exemption conditions similar to those in Colombia may attract important cash flows that Panama could use for infrastructure and other projects the National Government wants to promote.

The acceptance of granting information to Colombia with a certain degree of retroactivity sends a clear message of Panama’s commitment to tax transparency, as the Nation’s authorized spokespersons have been proclaiming.

Panama, May 18, 2016.