THE CUBIST CHARACTER OF THE CONCEPT OF "TAX RESIDENCE" IN THE AUTOMATIC EXCHANGE OF TAX INFORMATION BETWEEN COLOMBIA AND PANAMA

BY PUBLIO CORTÉS

The word "marriage" has a different meaning depending on the culture you are referring to. Although it is the same word, the concept varies. It will probably not be the same to say "marriage" in a small traditional Mexican town than in Abu Dhabi or in the Chueca neighborhood of Madrid. The same thing happens with legal concepts: you have to be well aware of what you are talking about, conceptually, not only by name, to know what the applicable rule of law is. In Private International Law that is part of the institution of qualification. In short: it is necessary to know that we all talk about pears or apples at the same time, because otherwise we can fall into a deaf dialogue.

Something similar occurs with the concept of "Tax Residence" in the Automatic Exchange of Financial Account Information for Tax purposes (CRS), protected by the MAC convention and promoted by the OECD Global Forum. In the analysis of the matter, the concept of "Tax Residence" appears several times, but it is not always in the same sense. It is similar to Ana Torroja's painting of *bifrontism*, but the legal analyst must be sure that he is looking at the correct face, at the right time.

In this short report we will focus on the issue, taking as reference the application of the CRS between Panama and Colombia, especially since in Colombia, last September 25th, the term to benefit from the Standardization Tax expired (it was a tax, not an amnesty!), which is closely related to the declaration that Colombian taxpayers must make about their assets abroad and the implementation of the CRS for the first time this year between Colombia and Panama, in regards to the information of the 2019 fiscal year.

However, the approach is substantially the same if it is the CRS applied between Panama and any other country that has a world income criterion in terms of Income Tax.

Basic difference of the authority to tax in Panama and Colombia

The authority to tax is the State authority to collect income tax and is determined based on the element that links said State with the event that generates the tax. Most of the States of the world use the "subjective" link and the "objective" link together, that is; if a person, individual or corporation, has a certain particular status that relates him to that State, he is taxed for all of his income, whether from inside or outside the territory. But, at the same time, those who do not have that status also pay taxes based on territorial source. That is what Klaus Vogel calls "full tax liability." Such is the case of Colombia.

As explained in articles 9, 10, 12 and 12-1 of the Colombian Tax Statute (ET), that “particular status” that an individual must have is the “Fiscal Residence”: Whoever has it is taxed in Colombia by the “world income” and for income from “national source”. On the other hand, who does not have it, but generates income within Colombia, is also taxed but exclusively on “national source” income. And - in the case of corporations- the link comes from being classified as a "*Sociedad Nacional*", which has a legal definition.

Corporations who fit the definition are subject to "full tax liability", those who do not, only pay income from Colombian source.

Panama, for its part, uses **only** the "objective" or "source" link as a determinant of the authority to tax, that is, the status of the person does not matter. As indicated in article 694 of the Fiscal Code (CF), it is sufficient that the income is generated within the territory of Panama or simply qualified by law, as income from a "Panamanian source", for the State to have the authority to tax it in regards to the taxpayer (individual or corporation) who is considered associated with that income.

While in Colombia it is important for the Tax Administration (DIAN) to know who has a "Tax Residence" or is a "*Sociedad Nacional*" to know what type of taxpayer they are (if world income or only from national sources), in Panama the status of "Fiscal Resident" or "*Sociedad Nacional*" is not at all relevant for the Tax Administration (DGI) to determine the criteria for linking the State's tax authority.

In other words, while for some taxpayers in Colombia it is an exciting sport to try not to be considered "Tax Resident", or "*Sociedad Nacional*", nor that their income is from "national source", to avoid paying the Income Tax and Complementary, for some taxpayers in Panama, the same sport is simpler: it is enough to prevent the income that is earned from being classified as a "Panamanian source" and voilá: it does not pay.

However, despite the fact that in Panama the status of "Tax Resident" or "*Sociedad Nacional*" is not a requirement for an Income Tax person to be considered as "taxpayer", our Tax Code has a definition of "Tax Resident" for individuals and another for corporations. What is the usefulness of these definitions? Well, it turns out that they had to be enacted because they are used to determine to whom a Double Tax Convention (DTC) of which Panama is a party can apply, because, as we know, these agreements are only applicable "to persons who are residents of one or both Contracting States ".

Well, as you can see: that hackneyed statement of some Panamanian lawyers who sailed near the shores of Tax Law was never entirely accurate, according to which "Panama is super special and

unique because it charges territorial rent." The reality is that I do not know of any real country that does not collect territorial source income tax. What makes Panama different (although we are not the only ones either), is that **only** income tax is paid on territorial source income and the same does not happen on world income. We do not have "full tax liability" in Panama.

Perfect. All clear then. Let's go to the CRS.

The four (4) facets of the concept of "Tax Residence" in the CRS Panama Colombia

When speaking of Automatic Exchange of Information on Financial Accounts for tax purposes, the concept of "Tax Residence" appears on the scene several times.

It is normal for the Attorneys in Panama to think about the definition of our CF and, in the case of Colombia, that the point is associated with the definitions of "Tax Resident" and of "*Sociedad Nacional*" of the ET. This natural reaction is not entirely correct and deserves some remarks to avoid confusion.

Actually, the concept of "Tax Residence" in the practical application of the CRS appears under 4 hats, some similar and others not so much. Like a cubist painting, it has superimposed figures and you have to be sure which outline and from what perspective you are looking at it.

Let's see:

(1) **Fiscal Residence of Panama and the Financial Institution subject to reporting**: Within the CRS system there are parameters in the Panama Law, which include the Standard, whereas it is defined which are the entities of Panama that are obliged to carry out the Due Diligence work to identify accounts and reportable persons before the DGI, who, in turn, must send the information to DIAN through the established channels. When determining which are these Financial Institutions, there is a type that is required to be "Tax Resident" of Panama. In that case, the applicable criterion is the definition of the CF of Panama.

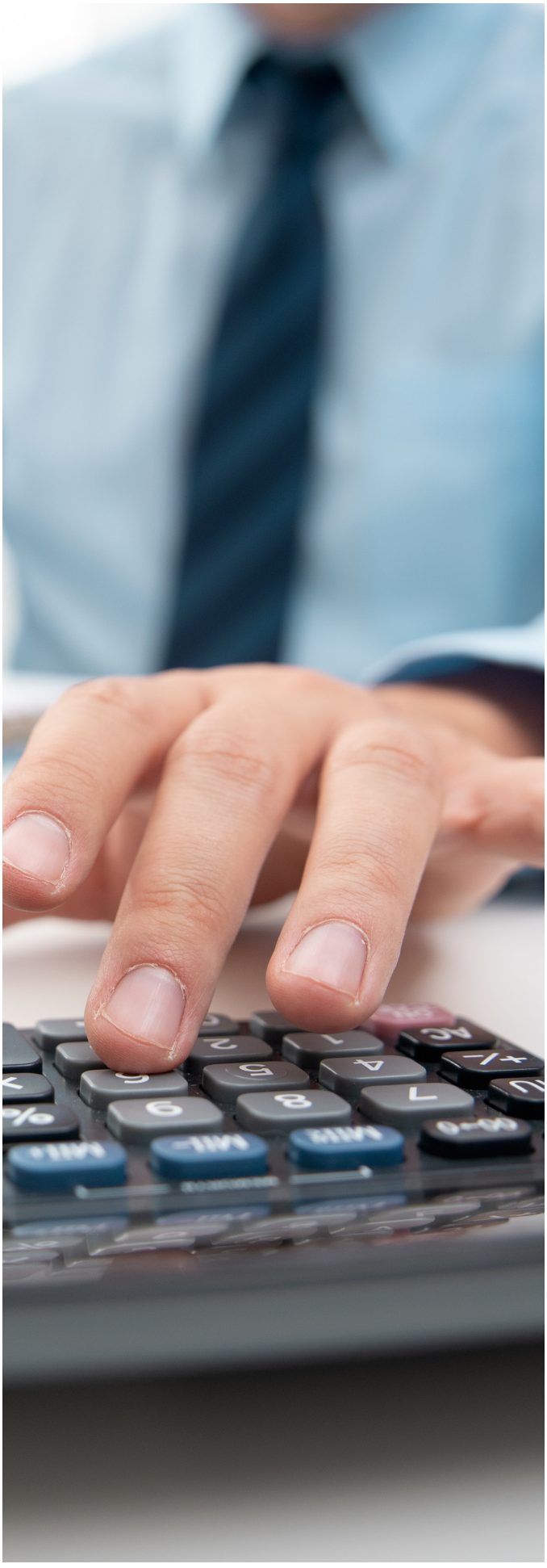
(2) **Fiscal Residence of Panama and the "Wider Approach"**: The concept of "Wider Approach" means that Panamanian Financial Institutions subject to reporting must carry out due diligence processes with respect to all account holders who do not have the Tax Residence of Panama. As such institutions are under Panamanian tax jurisdiction, if the doubt arises as to

whether or not an account holder or the person who controls it, is a Panamanian Tax Resident, the provisions of the Panama CF must be applied to determine whether or not it is from Panama.

(3) **Tax Residence of an account holder or of a controlling person of an account holder entity, both from a jurisdiction subject to reporting**: If we start by establishing that it is the Panamanian Financial Institutions subject to report that are the ones doing the due diligence and those that provide information financial institution to the Tax Administration of Panama (DGI), to be then sent to the DIAN in Colombia, from the Colombian perspective it could be thought that the Panamanian Financial Institution or the DGI, at some point, should enter to assess, BEFORE submitting the information, if the data of persons to be reported to DIAN are truly "Tax Residents" or perhaps "*Sociedades Nacionales*" according to the ET of Colombia.

I extend the argument a little further: one might think that the DGI in Panama should verify if the information that is going to be sent to the DIAN, indeed it refers to what the ET calls "Tax Residents" and/or "*Sociedades Nacionales*". And if they do not fit that definition, then there is no need to report the data. Well, this does NOT happen. I only mention it to dismiss it.

The reason why it does not work that way is because the Panama Law and the Global Forum Standard do not require it. And this makes a reasonable logical and practical sense: In the case of Panama, the CRS applies with 64 jurisdictions by 2020 it is not only about Colombia. Therefore, it would be totally impractical for Panama to have to review whether the information submitted for Austria meets the definition of Tax Resident for Austria, and also for South Africa, India and all 64 jurisdictions.



What happens in the practice, according to the Standard and the Panama Law, is that the Panamanian institutions subject to reporting have to apply a series of rules where, little by little, they are looking for "signs" that the account holder or the controlling person may have the Tax Residence of a Reportable Jurisdiction. We are talking about "signs" such as physical or email addresses, place of incorporation of the companies, self-declarations, addresses "in charge of", powers of attorney, etc., which in some way allow associating the account with a Reportable Jurisdiction.

With the rules applied precisely, if the evidence points to a country, then the person should be treated as a Tax Resident of that country for tax purposes.

Of course, nothing prevents the person from having provided the Financial Institution with a Certificate of Tax Resident, for example, from Colombia, duly valid, in which case their status would no longer be an indication, but rather full proof.

(4) **Tax Residence so that the information sent via CRS may have specific tax effects in Colombia**: Once the information reaches the DIAN, the ET is fully applicable, to determine whether or not the persons reported are actually “Tax Residents" or "Sociedad Nacional" of Colombia.

Final Comments

From the point of view of International Taxation, the “Common Reporting Standard” is generating a new scheme of interactions and approaches. In the case of Panama, we already see that the definitions of "Tax Resident" that were approved in Domestic Law to make the application of DTC viable, now also serve as a reference for automatic exchange. In the case of Colombia, the information that is going to be received by the DIAN is not necessarily already processed. In many cases, this information will deserve a "test" of Tax Residence" or "*Sociedad Nacional*" according to the ET, so that it can have effects in specific cases.

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