

CLIENT ALERT

# Colombia Introduces Final Regulations Expanding the Investment Tax Deduction and Other Incentives for Non-Conventional Renewable Energy Projects in Major Effort to Support Sustainable Growth

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## AUTHORS

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Last year, the Colombian Congress implemented critical reforms<sup>1</sup> to the investment tax deduction and other tax incentives for business investments in non-conventional renewable energy,<sup>2</sup> energy efficiency<sup>3</sup> and demand-response projects that were first introduced by Law 1715 of 2014 (“Law 1715”). In June 2020, the Ministry of Finance issued final tax regulations (Regulation Number 829 of 2020 (“Regulation 829”)) to clarify the scope of the incentives and provide greater legal

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<sup>1</sup> Through the enactment of Law 1955 of 2019.

<sup>2</sup> As used herein, “non-conventional renewable energy sources” for purposes of the tax incentives discussed herein are (i) solar; (ii) wind; (iii) biomass; (iv) geothermal; (v) waves and tidal; and (vi) nuclear.

<sup>3</sup> Energy efficiency under Colombian law is a broad and dynamic concept subject to the interpretation of multiple governmental authorities. In general terms, energy efficiency refers to any project or technology that allows a reduction of electric consumption. In recent years, the *Unidad de Planeación Minero Energética* (“UPME”) and the Ministry of Mines and Energy have considered LED lighting projects, cooling districts and industrial combustion upgrades as energy efficiency projects allowing them access to the tax benefits created by Law 1715. Note, however, that the classification of new projects and technologies will remain subject to the discretion of these governmental authorities.

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certainty to developers, investors and other players in the sector. The Congress enacted Law 1715 in 2014 to encourage energy generation from non-conventional renewable sources, diversify Colombia's electricity generation matrix to ensure reliability of the electric supply and avoid future blackouts caused by disruptions to hydroelectric generating potential due to climate and weather changes affecting rainfall and water availability in the country.

As noted above, Law 1715, together with the subsequent amendments passed in 2019 and Regulation 829, provides certain tax benefits for investments in non-conventional renewable energy, and also enables the participation of new players in the electricity generation market, known as self-generators and co-generators,<sup>4</sup> which are expected to increase competition in the market and create a number of new business opportunities. Since the adoption in 2014 of Law 1715, more than 570 non-conventional renewable projects have been registered with the competent authorities. Of those projects, 519 are solar projects<sup>5</sup> and 141 are being registered directly by industrial players.<sup>6</sup> Colombia's government is looking to achieve 2,500 MW of installed capacity (or 10% of the country's generating capacity) from non-conventional renewable sources by 2022. Regulation 829 and other recent reforms and regulations reinforce that the development of non-conventional renewable energy generation and related industries is a priority for the Colombian government.

The following provides a brief description of the incentives covered under Regulation 829 that may be available starting in 2020:

### **Investment tax deduction ("ITD")**

Under Law 1715 and Regulation 829, taxpayers can receive a deduction for corporate income tax ("CIT") purposes of up to 50% of the total amount invested in: (i) new projects; (ii) plant expansion projects; and (iii) research & development in connection with non-conventional renewable energy sources. Note that, in each case, whether an investment qualifies for the ITD will be subject to analyses with respect to additional criteria and other specific factors.

The ITD may be taken by a taxpayer that (i) files an income tax return in Colombia **and** (ii) generates energy from non-conventional renewable sources for supply to third parties or for self-consumption ("Taxpayer"), subject to the satisfaction of further requirements under Regulation 829 and applicable law. The extent to which a Taxpayer must directly own and operate generating assets remains subject to further review of the applicable regulations and regulatory framework by Colombian tax counsel. The outcome of these determinations, among others, may expand the range of financing structures available to developers, investors and businesses interested in non-conventional renewable energy assets in

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<sup>4</sup> Co-generators and self-generators do not need to be legally incorporated as actors in the energy system and can own and operate a non-conventional renewable generation system and trade excess electricity not used for their own consumption into the national grid.

<sup>5</sup> Also, 22 biomass energy, 21 small scale hydropower, and 14 wind energy projects were registered and claimed tax benefits.

<sup>6</sup> See the final report on non-conventional renewable projects applying for registration to obtain the tax benefits issued by the UPME in 2019, available [here](#).

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Colombia. For example, finance leases with irrevocable purchase options may complement certain features of the ITD, provided that the Taxpayer recognizes the asset for accounting and CIT tax purposes and subject to a number of additional tax and other considerations.

Under Regulation 829, all or a portion of the available ITD may be taken starting in the tax year during which the project enters its operating stage through any of the following 15 tax years.<sup>7</sup> Previously, the ITD was available for five tax years counting from the year the investment was made. The amount of the ITD taken in a given tax year cannot exceed 50% of the Taxpayer's ordinary income (taking into account allowable costs and deductions) for such year. Thus, the ITD may be claimed up front as long as the 50% limit is not exceeded.

### **Accelerated depreciation on machinery, equipment and other assets acquired or built by the taxpayer**

For purposes of determining CIT liability, the Taxpayer will be entitled to deduct up to 20% of the tax basis of the assets (i.e., cost of acquisition) as a depreciation deduction, which could be claimed over five years rather than the deductions more typically allowed for machinery and equipment of 2%–10% taken over 10–20 years. Note that Taxpayers may claim both the ITD and accelerated depreciation provided they satisfy certain conditions.

### **Value added tax ("VAT") exemption**

Purchases of assets or services will be exempt from VAT as long as such assets or services are attributable to the construction, operation or expansion of qualifying projects, or to research and development subject to certain additional requirements. This tax incentive would not apply to energy efficiency or demand-response projects.

### **Customs duties relief**

Equipment and machinery imported to Colombia that will be used in the construction of qualifying non-conventional renewable energy projects will be eligible for zero-rated tariffs. Note that, in order to qualify for such treatment, the imported equipment and machinery cannot also be available from domestic manufacturers, but for non-conventional renewable energy projects, Colombian alternatives are generally not available.

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<sup>7</sup> For example, if the project enters the operating stage in 2020, the ITD can be taken in any tax year from 2020 through 2035.

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### **Conclusion**

The tax incentives discussed herein may provide opportunities to support the development of non-conventional renewable energy in Colombia using a range of investment and financing structures potentially involving features such as finance leases and pass-through legal arrangements, among others. Given Colombia's extensive regulation of its energy market aimed at ensuring the quality and coverage of service, as well as the complexity of its tax code and roles played by local governmental authorities, the evaluation of these opportunities will require careful consideration on a case-by-case basis from various regulatory, local and international tax and other perspectives, which should be analyzed further by local counsel. Our team is available to discuss and answer any questions on the issues raised above and to liaise with our extensive contacts at law firms and institutions in Colombia.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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