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ESTABLISHING A BUSINESS ENTITY IN COLOMBIA

ILN CORPORATE GROUP

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"Establishing a Business Entity in Colombia"
Mr. Juan Ignacio Gamboa Uribe
Partner
GAMBOA, GARCÍA & CARDONA ATTORNEYS – Bogotá

"Establishing a Business Entity in Colombia"
Mr. Daniel García Piñeros
Partner
GAMBOA, GARCÍA & CARDONA ATTORNEYS – Bogotá

"Establishing a Business Entity in Colombia"
Ms. Mónica Pastor
Partner
GAMBOA, GARCÍA & CARDONA ATTORNEYS – Bogotá

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DOING BUSINESS IN COLOMBIA

1. Preliminary Considerations:

In Colombia, a foreign company is able to act and do business by itself, for example, by contracting with local entities or investing foreign currencies. Entering contracts, such as joint ventures, with local corporations or persons, depends on commercial negotiations, more than on legal requirements. Foreign investment, on the other hand, is subject to different regulations and to the Central Bank supervision and regulation (more information below). However, when a foreign company, not only has investments in Colombia, but also desires to perform "Permanent Activities" in its territory, legal provisions require it to establish a branch or a subsidiary in Colombia (Article 471 of the Commercial Code). Colombian legal provisions do not provide general criteria for what should be understood as "Permanent Activities", however article 474 of the Commercial Code contemplates a non-taxative list of activities that are considered as permanent, which are:

1. "Opening commercial establishments or business offices, even if they only provide technical or consulting services.
2. Intervene as a Contractor in the execution of works such as a construction or rendering of services.
3. Participate in any way in activities of management, use or investment of funds from private savings.

4. Engaging in the resource-extraction industry and/or any of its areas or services.
5. Obtain a concession from the Colombian Government, being assigned a concession, or participate in the exploitation of one.
6. The conduction of shareholders' meetings, boards of directors, management, or administration in the national territory".

The performance of any of the aforementioned activities usually implies the execution of other related activities such as hiring employees, owning, or renting physical premises and other services, which suggests that there is an intention of conducting permanent activities in Colombia. This will result in the obligation to constitute a branch or a subsidiary company in Colombia. In both of these scenarios the local vehicle will necessarily have to observe Colombian provisions, which include compliance with capital contributions and dividend distributions. A capital contribution or the designation of an amount of assigned capital is simply a contribution of capital, in the form of money or property. A dividend distribution refers to the distribution to the parent company or shareholders of the local vehicle, of its net profits earned in the last financial year, after deducting any reserves or deficit carried forward from earlier years.

2. Elements of a Branch Office:

First, we would like to establish that a branch office is not considered to be an independent legal entity, but an extension or commercial establishment of its home office. The branch is considered as a legal entity, which for purposes of its activity has to comply with all Colombian regulations. Taking this into consideration, under Colombian provisions, the establishment of a branch office will require the assignment of the following elements: (i) the purpose of the company which in Colombia is known as "objeto social;" (ii) the domicile of the company; (iii) the term of duration of the branch office and the causes for termination; (iv) an initial Capital Contribution to the branch office, which must be paid in full when it is first established; (v) the designation of a general agent with one or more alternates, whom will represent the company in all of the business deals to be celebrated in Colombia; (vi) designate an auditor, who must reside permanently in Colombia.

The capital contribution will not be understood as the payment of equity as in an ordinary subsidiary, but it will enter the branch assigned capital for the development of its operations. The designation of the amount of assigned capital must be paid in full when it is first established and since its source is a foreign company it will be considered as a foreign investment and as such it must comply with the obligatory registration before the Bank of the Republic within the next three months since the reimbursement of the assets is effectuated. There is no minimum capital required for the incorporation of an Office branch in Colombia, however any increase of the assigned capital of a branch requires an amendment of the incorporation document by the pertinent corporate body abroad. The amended document must be formalized by a public deed in Colombia. However, the branch may alternatively receive supplementary investment to its assigned capital from its home office abroad. In this case, the supplementary investment does not alter the assigned capital of the branch and therefore does not require an amendment to the incorporation document. The funds will be registered in the branch's "supplementary investment to assigned capital"

account, which is managed as a current account between the branch and its home office. The only formality required is the registration of all supplementary investments received from the home office in the preceding financial year, which in conclusion results in a very easy method to finance the office branch. Please note that Article 490 of the Commercial Code establishes that in no case the effective capital of the branch may decrease to an amount inferior to 50% of its assigned capital.

For the distribution of dividends, since the branch office is not an entity with independent judicial capacity but an extension of the foreign company, there is not a dividend distribution as such, but a distribution of its net profits at the end of the corresponding financial year, which must be previously approved by the competent superintendence (Article 496 of the Commercial Code). These net profits may only be disbursed if the branch has complied with the legal reserve provision established in article 452 of the Commercial Code.

3. Elements of a Subsidiary Company

For the establishment of a subsidiary company, the investor must choose the appropriate corporate form. Colombian provisions establish several forms of association. However, it is common for foreign investors to take the form of a limited liability company, a simplified shareholding company or a corporation as a mechanism for their activities in Colombia. Nonetheless, for tax purposes abroad, sometimes investors prefer to adopt corporate forms that relate to collective associations, such as the "company limited by shares" (Sociedad en comandita por acciones).

The incorporation process of a company in Colombia is similar for all types of companies. Entities are constituted by public deed or private document, and they form a legal entity independent of its associates. The document of incorporation must include the type of company that is being constituted, its name, its domicile, a description of the company's purpose and activities to be developed, the amount of social capital, the administrative organs of the entity with their respective faculties, how profits will be distributed, its term of duration, which dispute resolution mechanism is established, among others. Also, said document must come with apostille in case the shareholders do not reside in the country, and must be accompanied by a copy of the identity documents of the shareholders and the people that will be appointed in the management and legal representation positions of the entity. Likewise, some forms shall be submitted and signed by the person who will be appointed as the legal representative.

The entities that are constituted must be registered before the Chamber of Commerce with jurisdiction in the place agreed as registered office and the act of creation must be registered in the corresponding Commercial Registry. Furthermore, a tax registration before the National Direction of Tax and Customs must be made, in order to obtain the company's tax identification number.

It is important to mention that there are no specific requirements in order to be shareholder or director, however, the creation of an entity implies the signing of the social contract (incorporation document), therefore shareholders or directors must be legally able to consent to be bound, that is, to be able to obligate by themselves, under the terms of article 1502 of Colombian Civil Code.

Finally, there are no specific restrictions for foreign citizens to establish companies in Colombia. However, it is necessary to consider that if they are going to perform functions in the

company, which would imply residing within the Colombian territory, a study of each particular situation should be done to determine what type of visa they require, whether a work visa or visa of owner partner, depending on the situation. However, it is not required under Colombian legislation that shareholders and / or legal representatives of companies reside in the country.

Now, the main characteristics of each type of corporate entities are described below.

(i) Corporation (Sociedad Anónima – S.A)

Under Colombian provisions, the establishment of a corporation will require the assignment of the following elements: (i) the purpose of the company which in Colombia is known as "objeto social;" (ii) the domicile of the company; (iii) the term of duration and the causes for termination; (iv) Capital Contributions (v) Corporate bodies: Board of Directors and Legal Representative; (vi) Designation of an auditor.

Corporations "S.A." must be created with at least five (5) shareholders, none of which may own ninety-five percent (95%) or more of the share capital at a single time. The liability of shareholders is limited to the amount of their capital contributions, which is represented by shares.

The capital of the Corporation is divided into shares of equal value and is classified into three categories: (i) Authorized or stated capital which represents the total number of subscribed shares plus the amount of shares that are in reserve, if any. (ii) Subscribed capital, which represents the shares that have been issued to the shareholders and may never exceed the corporation's authorized capital. Any issuance of shares over and above the authorized capital requires a prior increase in authorized capital by an amendment to the bylaws. (ii) Paid-in capital, which represents the shares paid by the shareholders. Upon incorporation of a Corporation, at least 50% of the authorized capital must be subscribed, and at least one-third of the value of the issued shares must be paid. The remainder must be paid within a one-year period. Further increases of authorized capital do not require subscription of any particular percentage of capital.

At the ordinary annual general meeting, the board of directors submits the financial statements of the Corporation for the previous fiscal year to the shareholders for approval. Once the board has approved the financial statements, the shareholders determine the allocation of the Corporation's distributable profits, if any, for the preceding year. Ten percent (10%) of the corporation's net profits must be allocated to a legal reserve until such reserve reaches an amount equal to at least 50% of the subscribed capital of the Corporation. The remainder of the net profits if any, is allocated as determined in the bylaws or by the shareholders and may be distributed as dividends. The corporation must distribute as dividend at least 50% of its annual profits, unless at least 78% of the shareholders vote otherwise. If the total amount of all the reserves of the Corporation exceeds the Corporation's outstanding capital, it must distribute 70% of its annual profits. No dividends shall be distributed if previous losses that affect the capital have not been met. The dividend payment will be in cash, however, the dividend may be paid in the form of bonus shares of the same company, if so provided by decision of the general assembly by a vote of no less than eighty percent of the shares represented.

(ii) Company Limited by Shares (Sociedad en comandita por acciones)

Under Colombian provisions, the establishment of a Company Limited by Shares will require the assignment of the following elements: (i) the purpose of the company which in Colombia is known as "objeto social;" (ii) the domicile of the company; (iii) The term of duration and the causes for termination; (iv) Capital Contributions (v) Corporate bodies: Legal Representative; (vi) Designation of an auditor.

This type of structure has two groups of partners: managers and limited partners. Managers are responsible for the administration of the entity, while the limited partners make capital contributions in order to finance the needs of the entity. The managing partners are jointly responsible for the operations of the company, while the liability of limited partners is limited to the sum of its corporate contributions.

The capital once again is divided into the same three categories mentioned above. The capital will be conformed with the contributions of the limited partners or with those of these joined simultaneously with those from the managing partners. Upon incorporation of a corporation, at least 50% of the authorized capital must be subscribed for, and at least one-third of the value of the issued shares must be paid. The remainder must be paid within a one-year period.

Regarding the profits and distribution of dividends the same process mentioned above applies. Specifically, corporate profits are distributed among the managing partners and limited liability partners in the manner stipulated in the contract (incorporation document). Where not specified, profits are distributed among the limited partners in proportion to their shares, but the benefit of the managing partners must be met first.

(iii) Limited Liability Company

Under Colombian provisions, the establishment of a Limited Liability Company will require the assignment of the following elements: (i) the purpose of the company which in Colombia is known as "objeto social;" (ii) the domicile of the company; (iii) The term of duration and the causes for termination; (iv) Capital Contributions (v) Corporate bodies: Legal Representative and Board of Directors (not mandatory) (vi) Designation of an auditor, if the assets or income of the company exceed certain limits established by law (i.e., if the gross assets of the company at the end of the preceding year exceed or are equal to 5,000 minimum legal wages, or if its gross income in the preceding year exceeds or is equal to 3,000 minimum legal wages).

The capital once again is divided into the same three categories mentioned above. The capital of the company is divided into shares of equal value. The capital of the company must be entirely paid-in at the moment of incorporation and every time a capitalization takes place the corresponding article of the bylaws must be amended. Such amendment must be formalized by means of a public deed and the amount of capitalization must be paid upon the formalization of the decision. Partners are entitled to transfer their shares, but all other partners have a statutory right of first refusal proportional to their existing participation, unless the bylaws provide otherwise. In other words, the partners shall have the preferential right to acquire the outstanding shares of the company on a first basis, whenever the other partners decide to sell their stake. As a general rule, the liability of the partners is limited to the amount of their

capital contribution, however Colombian labor provisions establish that, the partners will be jointly liable for the employment obligations towards the company's employees; and tax laws provide that partners of a limited liability company are jointly liable for all the income tax obligations of the company.

Regarding the profits and distribution of dividends the same rules mentioned for Corporations will apply.

(iv) Simplified Shareholding Company (S.A.S: Sociedad por Acciones Simplificadas):

Under Colombian provisions, the establishment of a Simplified Shareholding Company will require the assignment of the following elements: (i) the purpose of the company which in Colombia is known as "objeto social", however it may have an indeterminate object; (ii) the domicile of the company; (iii) The term of duration which in this case may be indefinite, and the causes for termination; (iv) Capital Contributions (v) Corporate bodies: at least a Legal Representative (vi) Designation of an auditor, only if the assets or income of the company exceeds the limits established by law, which were mentioned above. In this case there is no minimum or maximum of shareholders required. This corporate structure foresees the possibility of having only one (1) shareholder. The liability of shareholders is limited to the amount of their capital contributions, which is represented by shares.

The capital once again is divided into the same three categories mentioned above. It will be divided into shares of equal value. In this particular case, there are no limits imposed on capital ratios in order for shareholders to subscribe and pay it. However, a deadline is imposed regarding the payment of subscribed shares, for which they must be fully payed in the term of two (2) years following the incorporation. This is an advantage offered by this type of corporation, as it provides a generous window for the payment of capital contributions.

Regarding the dividend distribution, in this type of corporations, freedom will be the general rule. It is permitted to establish in the bylaws of the corporation the rules that shareholders consider should apply for dividend distributions. For example, shareholders may stipulate that there will be no dividend distributions.

In these types of corporations there is no legal obligation to create legal reserves.

Finally, Colombian provisions have established that in the event of absence of regulation regarding any subject for this type of corporations, one must apply the regulations set forward for Corporations (Sociedad Anonima.)

4. Minority shareholders' rights and protection:

In addition to the legal protections already established in the commercial legislation, such as the right of inspection, the requirement to make certain decisions with a plurality of partners, and the existence of the right of withdrawal or qualified majorities for certain key decisions at the general meeting of shareholders, the commercial legislation brings several protection measures for minority shareholders if their rights are considered violated by the controlling shareholder.

Article 87 of Law 222 of 1995, establishes the possibility for shareholders or associates that represent not less than 10% of the share capital, or any of its administrators of companies, sole proprietorships or branches of foreign companies that as of December 31 of the immediately preceding year register a number of income or assets established by law, to request the Superintendency of Companies to

reform the clauses of the bylaws that violate legal norms, as well as the practice of administrative investigations when they are presented irregularities or legal or statutory violations. Companies that do not comply with the requirements related to the assets, can resort to the dispute resolution method of conciliation before the Superintendency of Corporations to resolve the conflicts which arise between the associates, or between them and the society. However, any of these implies fulfilling a procedure and a series of additional requirements.

Likewise, in accordance with the provisions of article 191 of the Commercial Code, administrators, fiscal reviewers and absent or dissident partners may challenge the decisions of the assembly or the board of partners which are product of the abuse of legal or statutory powers of the highest social body. Said challenge may be brought before the judge or arbitrator, as agreed by an arbitration clause in the bylaws, or before the Superintendency of Corporations (in the case of supervised companies).

5. Exchange regime compliance:

All payments for capital contributions, for both the assigned capital of the branch and the subscribed and paid capital of the subsidiary, are considered a foreign direct investment and as such must be registered before the Central Bank under Form No. 4. This form must include information such as the company's tax identification number, the legal representative's information, the amount of money that is being transferred and exchange rate, among others. In the event funds are brought as debt they must also be registered before the Central Bank, but in this case under Forms No. 3 and 6. Form No. 6 is particularly used when the funds are brought as Contributions for future capitalizations.

The profits and dividends to be distributed and thereafter paid to the parent company also need to be registered before the Central Bank, through the corresponding form.

6. Registration of situations of control and corporate groups

a) Situation of control: Although there are no specific grounds for such situation, it is understood that a situation of control exists when more than 50% of the capital belongs to the parent company, directly or indirectly, regardless of whether they are local or foreign companies or a person; when the parent company has the right to cast the votes corresponding to the minimum decision-making majority; when it has the necessary votes to elect the majority of the members of the board of directors; or when the parent company, directly or indirectly, and due to a business with the controlled company, is dominant in the decisions of the company's management (Articles 26 and 27 of Law 222 of 1995).

b) Corporate group: If, in addition to the existence of a situation of control in a company, there is a unity of purpose among several controlled companies, that is to say, when they pursue the same objective that has been determined by the parent company or belong to the same industrial sector or are complementary, there will be a situation of corporate group.

Both the situation of control and the situation of business group must be registered before the Chamber of Commerce within 30 days from the date of configuration of the situation.

7. Renewal of the commercial registration:

Individuals and legal entities registered with the Chamber of Commerce must renew their commercial registration annually. This obligation is performed by filling out and

submitting the corresponding commercial registration renewal form to the Chamber of Commerce of Bogota. The cost of the procedure depends on the value of the assets of the company or individual. It should be noted that failure to comply with the obligation to renew the commercial registration may result in financial penalties imposed by the Superintendence of Industry and Commerce.

8. Conclusions and Recommendations:

In order to determine which mechanism is the best for establishing business in Colombia, the first consideration that shall be made is if the activities that will be executed are permanent or not. If they are, the foreign company should evaluate whether a branch or a subsidiary best suits the company's purposes and structure.

The most common entities for commercial purposes are the Simplified Shareholding Company (S.A.S). This entity has a clear division between capital and responsibility, limiting, as a general rule, the liability of the investor to the amount of its participation.

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This memorandum is for information purposes only and reflects the existing regulations as of September 2022.

Under no account can it be considered as either a legal opinion or advice on how to proceed in particular cases or on how to assess them.

If you need any further information on the issues covered by this memorandum, please contact Mr. Daniel García Piñeros (dgarcia@gclegal.co)