

# *Colombia Oil & Gas Industry 2014*

## An Overview



The Oil & Gas industry in Colombia is in an important historical moment in order to increase production and reserves with the aim of achieving permanency and sustainability of the sector. This document presents an overview of the main economic, political, environmental and regulatory aspects to consider when investing in the sector in Colombia.

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# Foreword

Legal, tax, and political stability in Colombia, and its strong economic performance have positioned the country as one of the fastest growing countries of the region and as one of the most attractive emerging markets for foreign investment at the present time. Over the last ten years, Colombia has taken decisive steps towards making the Oil & Gas Industry grow and it continues to play a predominant role in the country's economy.

To maintain this economic growth, the Colombian government has implemented strategies to increase the level of oil and gas reserves as well as develop investment in mid-stream and downstream infrastructure projects to respond to actual needs. Off-shore and non-conventional oil projects and the use of new technologies for recovery are the most relevant strategies that would allow the country to meet its goals in terms of economic growth; all this within a balanced policy of environmental sustainability and a caring relationship with communities.

Navigating through the regulatory and tax environment is critical when it comes to doing business in emerging markets. The Exploration and Production industry is no exception and countries often present unique challenges and opportunities including, inter alia, a highly regulated business environment, fast-changing tax framework, political sensitivities, communities, environment, sustainability, etc.

For many years PwC has assisted Exploration and Production companies operating in Colombia with regulatory, tax, audit, sustainability and other consulting services. Over 100 industry-focused specialists work every day to enhance value and assist Exploration and Production companies.

This document offers an insight into a number of relevant topics that provide an overview of the Oil & Gas industry in Colombia such as: trends in exploration and production; infrastructure projects; use of new technologies; relations with communities; environmental and sustainable development and tax and regulatory perspectives.



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# Industry Overview



## Global Context

Currently, some megatrends impacting economic development and markets globally have been identified. The population growth within the emerging markets in contrast to the decline of some developed economies has led to important changes in global economic power, implying that a large demand will be in these new emerging markets.

These changes in markets, including lack of resources, suggest major increases in risks and complexity of projects. In the Oil & Gas industry, new technologies in search of shale and deep waters reserves are being developed. In this context, operational efficiency, a skilled workforce, effectiveness in supply chain management and monitoring of costs are even more important.

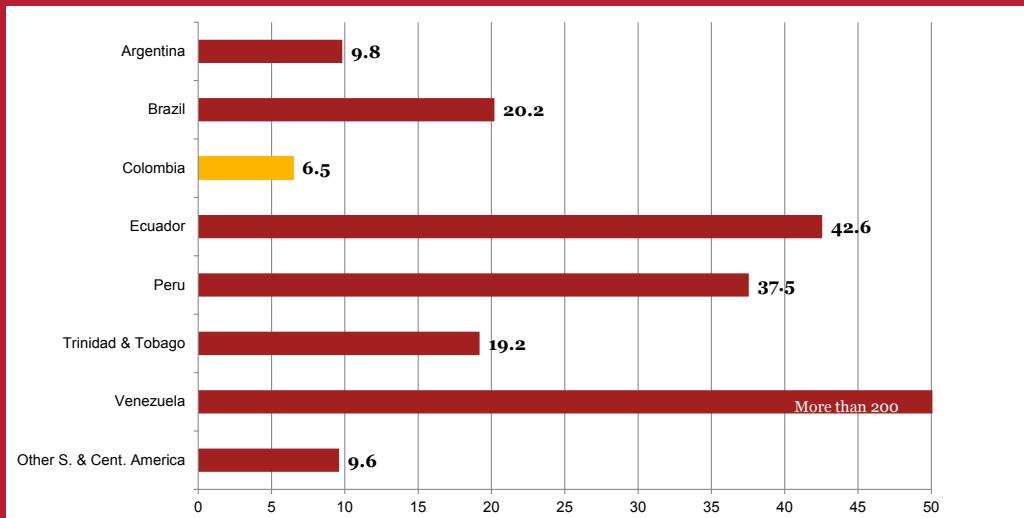
Due to increases in regulations on carbon emissions, coal power plants are being changed for natural gas power plants.

Manufacturers and petrochemical companies have also joined this trend, finding lower costs by using natural gas, which is also more environmentally friendly.

Thanks to technological developments that allow shale production on a large scale in United States, it is becoming possible to achieve energy independence, and there is a rebirth in the manufacturing and chemical industry in the country. As well as the technological developments of exploratory and pad-drilling, there is increased use of open-hole completions and sliding sleeves to reduce completion time and costs. Cloud-based “digital oilfield” platforms enable companies to transform data into real time operational decisions.

Currently Colombia, compared to other South and Central American countries, has reached stagnation in production and reserve levels. The government and private sector are working together in order to turn around this trend through new methods to increase recovery and production factors in the oil fields.

### South and Central America oil reserve-to-production ratios, 2013 (years)



Source: BP Statistical Review of World Energy 2014

# Colombia's Main Indicators

## Colombia's Main Indicators

### Geography

Official name:	Republic of Colombia
Head of state:	President Juan Manuel Santos
Political system:	Republic
Capital:	Bogotá
Area:	1.14 million square kilometers
Population:	48.32 million
Climate:	Tropical coastal and eastern regions with cooler highlands

### Economy

Currency:	Colombian peso, COP\$ (USD\$1: COP\$2,047.03)
GDP:	USD\$ 3.78 billion (2013)
GDP per capita:	USD\$ 7,826 (2013)
GDP growth:	4.7% (2013), 4.6% (forecast 2014)
Inflation rate:	2% (2013)
Unemployment:	9.6% (2013)
Public debt:	39.6% of GDP (2013)
Ease of doing business:	34 out of 189 countries (2014)
Global competitiveness:	69 out of 148 (2013)

### Resources

Proven oil reserves:	2.38 thousand million barrels (2013)
Oil production:	1,004 thousand barrels per day (2013)
Proven gas reserves:	5.73 trillion cubic feet (2013)
Gas production:	1.22 billion cubic feet per day (2013)

Source: The Oil&Gas Year Colombia 2014, BP Statistical Review 2014, CIA World Factbook, World Bank, Colombia Central Bank (Banco de la República).

## ***Resources, reserves, production and infrastructure***

The production and crude oil reserves in the country have been characterized by its cyclic behavior, geographical concentration, and limited significant size fields. As well as the general issues related to reserve replacement and production thereof.

These characteristics are evidenced, on the one hand, by increases in production which has led to low international prices. On the other hand, generating decreases in the remaining reserves as oil is extracted at higher rates. Moreover, in recent years, the source of new reserves has gone from production in new fields, to increased recovery factors of mature fields. Finally, recent variations in the type of crude oil produced and the company profiles participating in the business, have been noticed<sup>1</sup>.

According to BP statistical, due to the current consumption, Colombia had in 2013 proven reserves of 2.4 trillion barrels, corresponding to a reserve to production ratio of 6.5 years. In order to maintain the sustainability of the industry, the importance of discovering new reserves of crude oil and improving the recovery factors from existing fields is a top priority. In the case of natural gas reserves amounting to 160 bcm (5.7 tcf), which are sufficient for 12.8 years of production.

1. Colombia Central Bank (Banco de la República)

### ***Key Indicators - Colombia's oil and gas industry***

Indicator	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>Reserves</b>										
Oil: Proved Reserves (Thousand million barrels)	1.48	1.45	1.51	1.51	1.36	1.36	1.90	1.99	2.20	2.38
Oil: Incorporated Reserves(Thousand million barrels)	128	0.17	0.25	0.04	0.52	0.57	0.36	0.54	0.46	0.44
Gas: Proved Reserves (Thousand million barrels)	4.20	3.99	4.34	4.41	4.38	4.74	5.41	5.46	5.73	5.73
<b>Production</b>										
Oil: Production (Thousand barrels daily)	528	526	529	531	588	671	786	915	944	1,004
Natural Gas: Production (Billion cubic feet per day)	0.61	0.65	0.68	0.73	0.87	1.02	1.09	1.06	1.16	1.22
<b>Consumption</b>										
Oil: Consumption (Thousand barrels daily)	225	230	235	234	233	239	250	269	285	297
Natural Gas: Consumption (Billion cubic feet per day)	0.61	0.65	0.68	0.72	0.73	0.84	0.88	0.86	0.95	1.04

Source: BP Statistical Review of World Energy 2014; ANH Informe de Gestión 2013

## **Colombia has 4 main challenges in order to increase its production and reserves:**

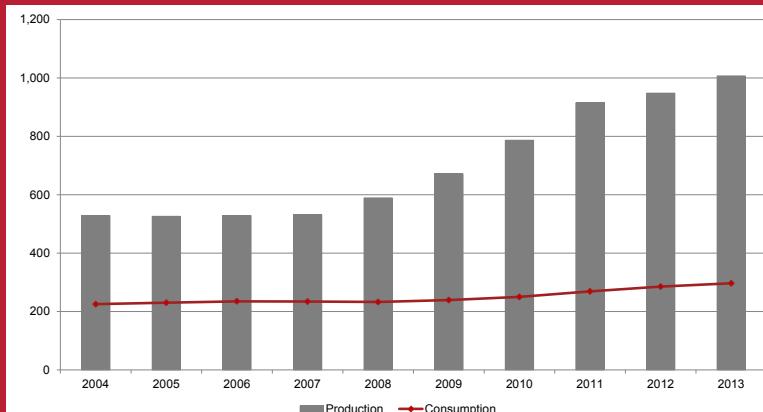
- 1. Improve the recovery factor from existing fields.**
- 2. Discover and process of heavy crudes.**
- 3. Non-conventional resources.**
- 4. Off-Shore.**



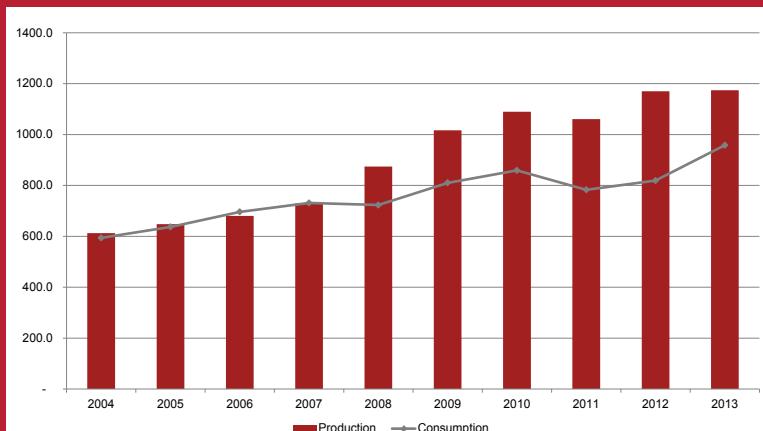
In order to increase the levels of oil reserves, areas of geographical concentration have been noticed. Companies are continuing to drill exploratory conventional wells in these areas, while pursuing secondary and tertiary recovery methods to increase reserves at existing fields. For the long term, Colombia is exploring the potential of its offshore and unconventional resources.

**Oil**

**Colombian Oil Production and Consumption (KBPD)**



**Colombian Natural Gas Production and Consumption (MMCFD)**



Source: BP Statistical Review of World Energy 2014

**Gas**

## **Infrastructure**

The oil infrastructure in Colombia faces many challenges at the moment. The need to increase crude oil transportation alternatives has led to new projects in transportation, storage and refining.

Among the most important we find:

**Puerto Bahía:** The company Pacific Infrastructure inaugurated Puerto Bahía in 2014. This marine terminal will support the hydrocarbons operations in the Caribbean region, serving as a complement for the Coveñas port. This \$600 million terminal will export crude oil and import naphtha diluent, which is required for heavy oil transportation in the country.

**Refinery of Cartagena:** one of the two refineries in Colombia. Presently, an expansion and modernization project is being completed amounting to USD6.5 billion which will allow for refining of 165,000 bbls per day with a conversion factor of 95% of refined products<sup>2</sup>.

**Meta Refinery:** in order to start the infrastructure project in the Llanos region, the environmental license for the construction of the \$1.5-billion, 40,000 barrels-per-day refinery was issued in May 2014. This project provides to the region with the opportunity to add significant value to the heavy crude produced in the area<sup>3</sup>.

**Pipeline Bicentenario:** in order to expand the Colombian pipeline network, the projects for the 2nd and 3rd phase of the Bicentenario pipeline are being assessed and will depend on production and reserves growth in the country. When completed, the pipeline will connect the Casanare region with the Coveñas port. The 1st phase started in 2013, with Cenit as the main investor, and contrast of 230 km between the Casanare and Arauca regions.

**Pipeline Pacific (OAP):** the construction of the 750 km pipeline that would connect the Llanos region with a terminal port near Buenaventura is still under study and will depend on production and reserves growth. The OAP will have a capacity of 250,000 bpd of heavy crude oil with a potential expansion to 400,000 bpd. This pipeline will have the design and technology to transport heavy crude up to 15°API, therefore minimizing the need of diluent.

# Infrastructure Map of Colombia



# Main Oil & Gas actors fact sheets

## National Hydrocarbon Agency (ANH) Fact Sheet

Designed and established in 2003, the ANH took the regulatory duties from Ecopetrol the state owned oil company. With this change Colombia moved from an association contract system to a system that offers more autonomy to operators by the use of concession contracts. The ANH in addition to its regulatory duties seeks to maximize the return of the state and increase reserves and production.

In order to increase reserves, production and promote private investment in the country, the ANH have coordinated different Rounds through the years. The last one, The Round 2014 had a different component from the previous years; where the blocks offered this year have more exploratory risk.

## Colombia Oil & Gas bidding rounds (2007-2014)

Round	Blocks offered	Contracts signed	Subscription rate	Estimates investment (US million)
Ronda Caribe 2007	13	9	69%	94
Mini Ronda 2007	38	12	32%	236
Heavy Oil 2008	8	8	100%	453
Ronda Colombia 2008	43	22	51%	836
Mini Ronda 2008	102	41	40%	912
Ronda Colombia 2010	229	68	30%	1,402
Ronda Colombia 2012	115	50	43%	2,600
Ronda Colombia 2014*	95	26	27%	1,400

\*Preliminary results

Source: Colombia Ministry of Mines and Energy

## Ecopetrol Fact Sheet

### Company Profile

Ecopetrol S.A. is among the top 50 oil & gas companies in the world and the fourth-largest in Latin America. In terms of revenue, profit, EBITDA, assets and equity, Ecopetrol S.A. ranks first in Colombia and has presence in Brazil, Peru and the U.S. (Gulf of Mexico).

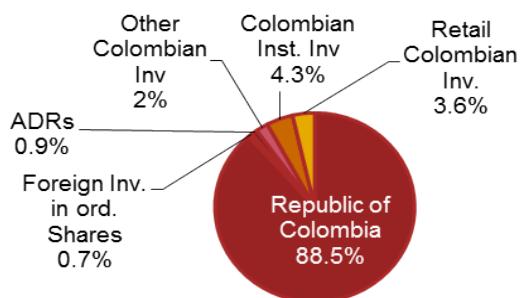
Ecopetrol S.A. operates in the following business segments:

1) Exploration and Production; 2) Transportation and Logistics; 3) Refining, Petrochemicals and Biofuels. Ecopetrol has stakes in the following companies:

- E&P: Hocol (100%), Savia (50%), Equion (51%), Ecopetrol America (100%), Ecopetrol Brasil (100%) and Ecopetrol Germany GmbH (100%)
- Transportation: Cenit (100%)
- Refining & Petrochemical: Reficar (100%) and Propilco (100%)
- Biofuels: Ecodiesel (50%) and Bioenergy (91%)

Ecopetrol's shares are listed in the Colombian Stock Exchange (ECOPETROL) and it's ADR's are listed in the New York Stock Exchange (EC) and the Toronto Stock Exchange (ECP). The Republic of Colombia is the major shareholder of Ecopetrol, with an interest of 88.5%.

### Ownership (June 2014)



### Credit Ratings (June 2014)

Local currency	Fitch	AAA /Stable
Foreign Currency	Moody's	Baa2 /Stable
	S&P	BBB /Stable
	Fitch	BBB /Stable

Source: Ecopetrol Investor Relations, August 2014

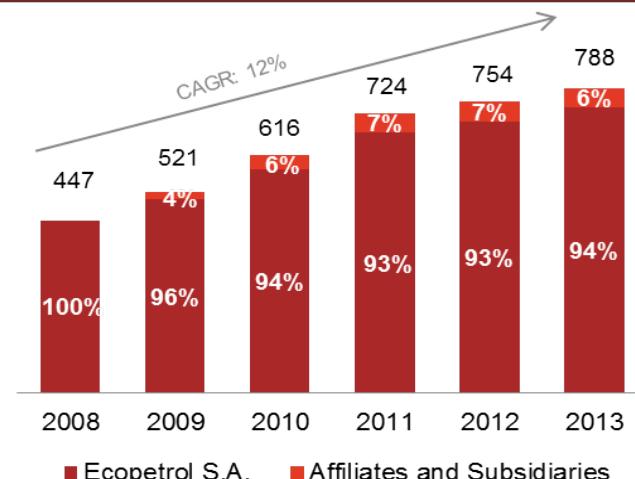
### Key Operational Figures (1H/14 Average)

Ecopetrol S.A. including interests in affiliates and subsidiaries

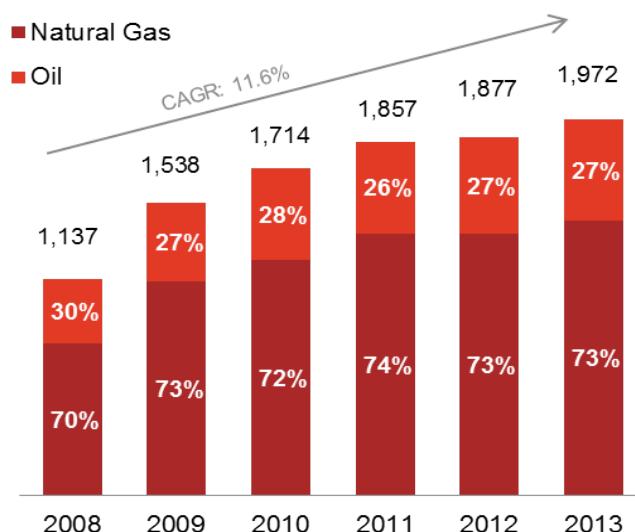
Production (crude and natural gas) 750 MBOED  
1P Reserves (crude and natural gas) 1,972 MMBOE\*  
Reserves Replacement Ratio 139%\*  
Sales Volume (Ecopetrol S.A.) 908 MBOED  
Export Sales (Ecopetrol S.A.) 522 MBOED

\*Dec 2013

### Production (MBOED)



### 1P Reserves Balance\* (MMBOE)



\*Ecopetrol S.A. including interests in affiliates and subsidiaries.  
SEC standards (net of royalties)

# Trends

The growing trend evidenced worldwide and in Colombia, where crude production in existing fields has decreased, reserves can only be offset with new discoveries, programs of secondary recovery techniques and the expansion of the country's oil frontier to offshore and non-conventional exploration. But consideration needs to be given to the fact that these projects require larger investments, may contain a higher risk to the environment and necessitate a constant need to work closely with the communities.

## Off-Shore

There is currently widespread optimism around offshore initiatives in Colombia, although offshore operations are more complex in an environmental sense than the conventional on shore methods used in Colombia over the past years. It is worth mentioning that deep-water offshore areas located in the country are relatively unexplored. At the moment there is only one operating field offshore, Chuchupa in the Guajira region (main source of Gas in Colombia).

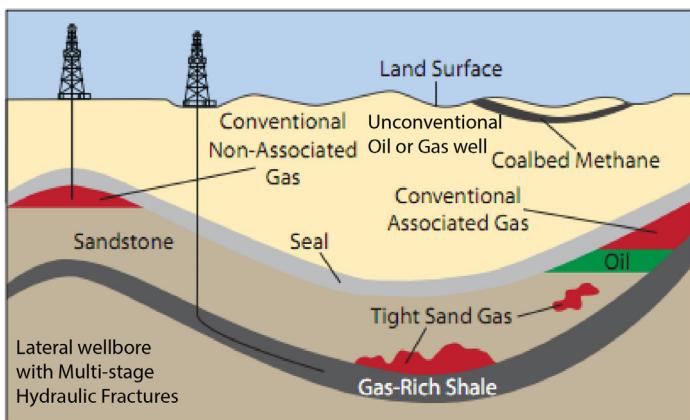
As mentioned before, one of the country's main challenges in the Oil & Gas industry is to increase its reserves. It is estimated that offshore exploration in the country could increase six times and triple gas reserves<sup>4</sup>, where the primary potential is off the Colombian Caribbean coast. In the last decade there have been more than 23 areas assigned, and 19 contracts are still operating. As a result of the Ronda 2014, five of 13 potential offshore operations were awarded.

Ecopetrol, Petrobras, Repsol, Shell, Anadarko, Equion and Statoil are some of the companies behind the offshore projects in Colombia.

This year, the association between Ecopetrol (30%), Petrobras (40%) and Repsol (30%) began drilling the Orca-1 exploration well in the Tayrona-1 block off the Colombian Caribbean coast. The cost is expected to exceed \$100 million, but if the Orca-1 well is a success, the offshore in Colombia will take a positive turn.

4. Colombia Energía, 9th edition- July 2014

## Non-conventional crude oil



Source: U.S Energy Information Administration and U.S. Geological Survey

In order to increase its production and oil reserves, Colombia has started to use non-conventional drilling and production techniques. This is confirmed by the results of the last Ronda Colombia 2014, where 41% of minimum safe investments came from non-conventional crude oil projects and from 2 offshore projects<sup>5</sup>. As well, Ecopetrol has already drilled five wells in the Middle Magdalena Valley to obtain information regarding the potential in the region for non-conventional crude oil using high technology developments.

There are 3 main challenges for the non-conventional drilling in Colombia<sup>6</sup>:

- 1.** Obtaining the technology and information to establish non-conventional projects.
- 2.** Developing the infrastructure and services that the development of these resources requires.
- 3.** Dealing with environmental and social issues associated with non-conventional crude oil drilling.

## New technologies

New methods to increase recovery and production factors in oil fields have been recently implemented in order to increase reserves and production in the country. Along with the technological challenge there are environmental matter that need to be dealt with and implemented in the country.

Various secondary and tertiary recovery combinations are among the methods being tested. In Colombia, they have been implemented through pilots or projects during the last stages of the fields. These methods are under continuous development and improvement by oil producing companies in the country. Some of these methods are: water injection, steam injection, injection of carbon dioxide (CO<sub>2</sub>), in-situ combustion, and chemical injection. They are all consisted with the Enhanced Oil Recovery (EOR) Methods already implemented in several countries.

At the moment, Ecopetrol and Pacific Rubiales are developing a primary recovery methods aimed to reduce gaps between wells.

In addition, the government approved fracking techniques and horizontal well drilling technique in order to overcome the production hurdle of one million barrels per day. As in other countries, this techniques have generated protests from environmental groups since there is uncertainty as to potential environmental damage.

It is necessary to keep on investing in and expanding development and exploration processes -such as non-conventional and offshore operations. The ANH seeks to expand the portfolio of potential oilfields and various types of hydrocarbon resources in the country.

5. Source: Portafolio 26/08/2014 - "No convencionales con futuro"

6. The Oil&Gas Year Colombia 2014

## **Communities**

Good relationships with communities and sustainable practices are an important part of the Colombian Oil and Gas industry. Public opinion is more demanding and people are getting conscientious about what is happening in their country, generally as a result of the spreading of information through social networks. This requires the oil and gas companies to deeply understand the needs and situations of the communities, in order to link these needs with the companies' sustainable practices.

Many companies, such as Pacific Rubiales and Ecopetrol are working on these issues. There is an Oil Municipalities Association, which links the social needs of the community with available resources, in order to invest those resources effectively. It is important that companies strive to positively impact the communities in a realistic way.

Not paying attention to the social issues arising from the business space, could result in serious harm to companies, through protests and blockades.

A company's responsibility is to come up with community investment plan and to clearly inform the local people what this consists of.

## Environment and sustainable development

Colombia has one of the world's largest biodiversity, but it also has a considerable amount of non-renewable resources. Developing the energy industry is a challenge, considering the sensitivity of environmental issues in the country.

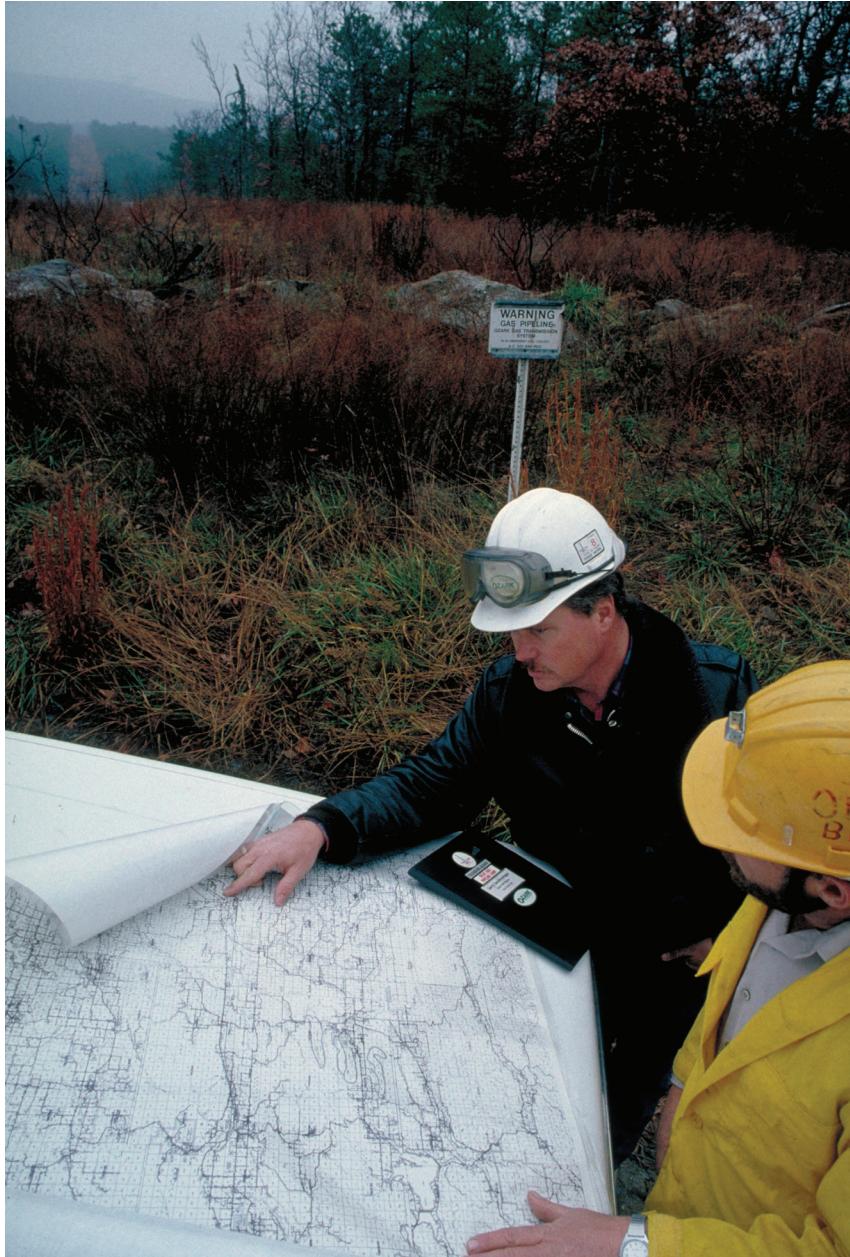
Companies have to do things the right way environmentally, in order to have a good relationship with local communities, otherwise the entire community will turn against them, affecting the company's operations.

There are zones that are protected from the development of mining or petroleum activities, such as the highlands and natural parks. But if the industry can progress effectively and responsibly in the rest of the country, exploiting these resources will result in significant benefits to the Colombian economy, better levels of employment and greater royalties for the benefit of the government and people.

There are three important environmental facts, considering the new unconventional extraction initiatives:

1. Water must be managed properly, considering that a lack of water will affect the population and agriculture.
2. The materials that are used for unconventional extraction, such as hydraulic fracturing fluids, must be used responsibly.
3. Seismic investigations must not be too invasive and companies must try to mitigate their environmental impact. Of course, the true impact of unconventional extraction is still not fully known. This topic is now heavily discussed all over the world, with different countries taking different decisions.

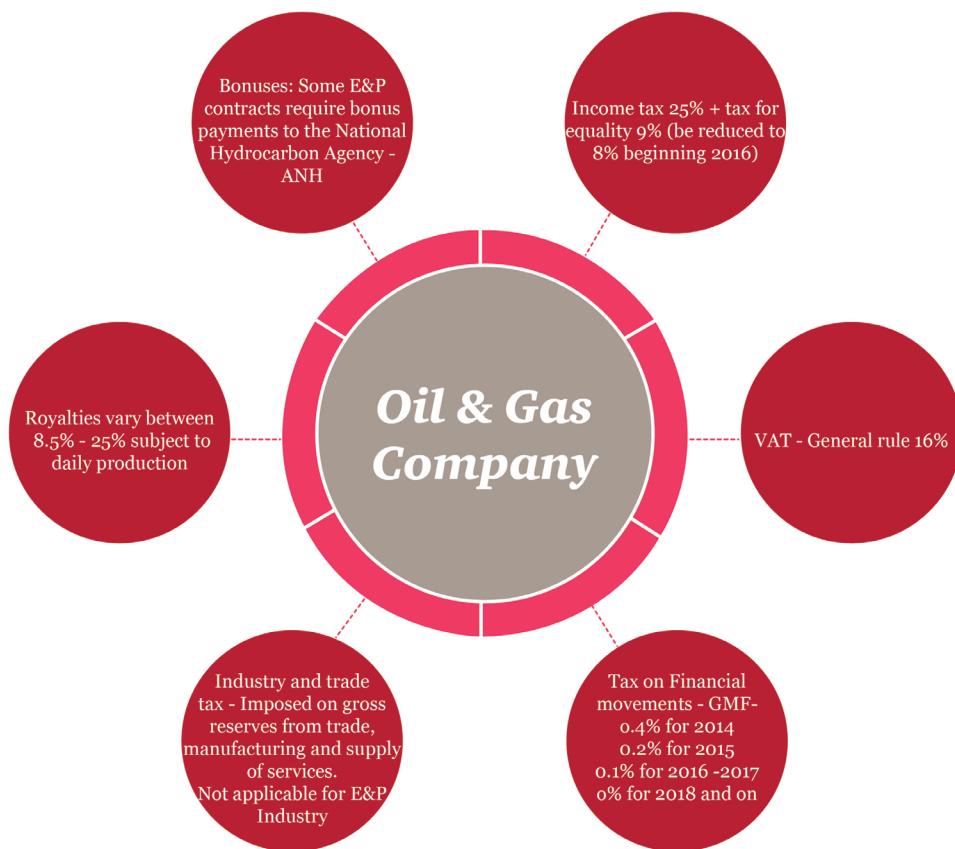
At the present time the average waiting time for an environmental permit is 14 months, but the Colombian government is working to reduce this time to 3.5 months, although there have been disagreements by the environmental groups.



# *Regulatory framework*

## *Legal and corporate taxation framework (Oil & Gas)\**

Colombia has taken decisive actions in recent years to attract foreign investment through new laws that make the regulatory landscape more efficient and attractive to investors.



\*As of the date of this publication, a possible tax reform is under review that could change this information.

**I.**

## **Corporate Taxation in Colombia for the E&P industry- An Overview**

### **a. Income Tax**

- Income tax rate is 25% plus an income tax for equality (CREE) of 9% (to be reduced to 8% in 2016).
- Income tax liability is determined as a rule as the excess of reportable revenue over deductible costs and expenses (“regular taxable income – RTI”).
- There is however a minimum liability to be reported, which is established by an alternate computation method, the so-called presumptive income system (“PTI”).
- PTI is equal to 3% of opening tax equity (equal to tax equity at December 31 of the previous taxable year). However, no PTI is required while in the exploration phase.
- The combined 34% is thus applied to the greatest between RTI or PTI.
- Any excess of PTI over RTI, as adjusted by inflation, may be set-off against regular taxable income at 25% (not permitted in the 9% calculation) during the following five (5) taxable years.
- Tax losses incurred beginning 2007 may be carried forward to any future taxable year, with no limitations on amounts against taxable income at 25%. These tax losses cannot be transferred to shareholders.
- Statute of Limitations: While typically 2 years from filing date.
- The statute of limitations for an income tax return where a tax loss has been determined or where a prior year tax loss is offset is of 5 years.
- Oil and gas exploration expenditures are amortized under the straight line or units-of-production methods over a period 5 years at a minimum.
- Unsuccessful exploration expenditures can be written off either in the year in which the unsuccessful exploration effort is determined or in any of the (2) two following years.
- Costs and expenses incurred with non-resident vendors are limited, as a rule, to 15% of taxable income determined before subtracting said expenses, except for certain exceptions provided by the law.
- Cross-border related party transactions must be arm's length and generally documented.
- Full cost or successful efforts method of accounting are generally permitted absent specific rules in local GAAP.
- IFRS will phase in gradually beginning 2014 to replace local GAAP.
- Double taxation treaties with Spain, Chile, Canada, Mexico and Switzerland are currently effective while treaties with India Portugal, Czech Republic, Korea and Belgium await completion of the required approvals or ratification.
- At the level of the Andean Community, Colombia, Peru, Ecuador and Bolivia have adopted double taxation regulations.
- No branch profits tax. However, dividends transferred out of untaxed Branch profits will generally attract income tax at 33%.

## **b. VAT**

- The general rule is that the sale of tangible personal property and the provision of services are subject to VAT at 16%, except where an exemption is available.

Oil sales are treated as follows:

- Direct export sales qualify for zero-rate treatment with all input VAT being refundable to the taxpayer upon request.
- Local sales for purposes other than refining are taxable at 16%, and the entire related input VAT can be credited against the tax charged on the sale. No refunds available.
- Local sales for refining are exempt from VAT, but no credits for input VAT are available.
- Temporary imports of heavy equipment for the oil sector are not subject to VAT. Permanent imports of heavy equipment for the oil sector are subject to VAT at 16%, with a two year term available for payment in certain circumstances.

## **c. GMF**

- A transactional tax imposed on the disposition of funds through the local banking industry.

The current rate is 0.4% and for income tax purposes 50% is deductible. This tax will phase out as follows:

- 0.4 % for year 2014
- 0.2% for 2015
- 0.1% for years 2016 -2017
- 0% 2018 and on

## **d. Industry**

A municipal tax imposed on gross revenue from trade, manufacturing and supply of services. Not applicable to the E&P (Exploration & Production) industry since the industry is the sector is subject to royalty payments to the Government (potentially due on non-operating revenue).

## **e. Real estate taxes**

Imposed on estate property held at 1st January of any given year (at rates that vary depending on usage, and can be as high as 1%) and fully deductible for income tax purposes.

## **f. Withholding taxes**

Generally all companies are required to collect withholding taxes from payments made to third parties, for income tax purposes and under certain circumstances for VAT and municipal tax purposes. Withholding tax collections must be reported and paid by the withholding collection agent on a monthly basis.

A 10% withholding tax applies to fees paid to non-resident service providers of consulting, technical assistance and technical services, whether supplied in Colombia or abroad.

No other services supplied from outside Colombia attract withholding tax.

A 1% self-withholding tax applies on the gross income derived from the export of hydrocarbons and other mining products.

Some services supplied inside Colombia attract withholding tax at 33%, except where Double Taxation Treaty relief is available.

## **g. Royalties**

E&P companies are required to pay royalties on production at rates that vary between 8.5% and 25% subject to the level of daily production. Royalties on E&P contracts signed before July 2002 are generally paid at the rate of 20%.

## ***h. Bonuses***

In some E&P contracts, the E&P company must pay the following economic rights to the National Hydrocarbon Agency (ANH):

- High prices: If the accumulated production of the exploitation area, including the volume of royalties exceeds five million barrels of liquid hydrocarbons, and in the event that the WTI price is higher than the price determined in the contract (PO), the contracting party shall pay at an agreed delivery point a participation for the production net of royalties according to the following formula:

$$Q = ((P - Po) / PxS)$$

*Q = Economic right payable to ANH*

*P = WTI price*

*Po = Reference price*

*S = Participation right*

- Right for the use of the subsoil and subsurface beginning with the second exploration phase, the E&P company must pay a fee in US dollars as follows:

## ***Fee paid by E&P companies in the 2nd exploration phase (us dollars)***

Size of contract area	First 100,000 hectares		Each hectare in addition to first 100,000	
	< = 8 months	> = 8 months	< = 8 months	> = 8 months
<b>Duration of the phase</b>			3,17	4,75
	2,38	3,17	2,38	3,17
<b>Within polygons A and B</b>	1,59	2,38	< = 8 months	> = 8 months
			3,17	4,75
<b>Outside polygons A and B</b>			2,38	3,17
	2,38	3,17	< = 8 months	> = 8 months
<b>Offshore</b>			0,79	

## ***Industry specific incentives & attributes***

- PE (Permanent Establishment) required engaging in the E&P business.
- No city or municipal taxes (Industry and Trade Tax) since E&P is subject to royalties. Territorial anti-double taxation principle.
- No income tax based on equity while in exploration (alternative form of taxation).
- 50% custom duties exemptions on import of selected machinery.
- Full tax write off of expenditures on successful assets against other producing assets (year of occurrence plus two more).
- Expenditures may be amortized under technical operating units or straight line.
- No VAT on temporary imports of qualified equipment (creditable against income tax for permanent imports).
- Royalties are deductible against income tax and CREE (A proposal to disallow royalties is under Congress' consideration).

## **II. Corporate law in Colombia for the E&P industry- An Overview**

### **a. Permanent Establishment (PE)**

- Required to participate in the E&P industry.
- Services companies also must have a PE.
- Double Taxation Treaties.

### **b. Incorporation Vehicles**

- Branches (Eligible for FX special currency treatment PE and services)
- Corporations:
  - LLC
  - Stock
  - Simplified Stock Corporations

### **c. Registering a Colombian Branch Office of a Foreign Company or Incorporating a Subsidiary**

- Formation takes over 3 weeks to complete.
- Registration with the Energy and Mining Authority takes over 2 months to complete.

### **d. FX**

- No exchange control – no prior approvals.
- Reporting needed to ensure repatriation rights over capital, dividends, etc.
- Sales proceeds (exports) must be repatriated unless special currency treatment is available.
- Special treatment only available for branches:
  - Can keep sales proceeds in foreign currency outside Colombia (local expenditure)
  - Unable to engage in debt/lease into Colombia
- Semi-special currency treatment for service companies.

# Accounting principles

## Implementation of IFRS in Colombia:

### Act 1314 of 2009

Group 1	Group 2	Group 3
Ruled by Decree 2874 of 2012	Ruled by Decree 3022 of 2013 and Decree 2119 of 2014	Ruled by Decree 2706 of 2012
<ul style="list-style-type: none"> <li>• Public Interest Entities</li> <li>• Listed Companies</li> <li>• Large Companies with specific requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Small and Medium Enterprises (SMEs)</li> </ul>	<ul style="list-style-type: none"> <li>• Microentreprises</li> <li>• Other small entities</li> </ul>
Reporting Date: December 31- 2015	Reporting Date: December 31- 2016	Reporting Date: December 31- 2015

In Colombia, the major characteristics of the accounting principles have been the high degree of influence by the tax authorities in their preparation; multiple rule makers issuing accounting pronouncements; historical cost concept prevailing for recognition purposes, and assessment of subsequent economic facts.

Given the lack of accounting standards specifically applicable to the Oil and Gas industry, some companies in the sector in Colombia use for their statutory accounting the standards enabled by both U.S. GAAP and IFRS.

Pursuant to the above, Colombia has initiated the process for adoption of IFRS, which demonstrates the evolution of the Country towards an accelerated process for internationalization and

good governance practices, with the growing financing through capital markets, the financial globalization and the dynamic regional integration processes, as major drivers.

Act 1314 of 2009 pointed out the competent authorities in charge of managing the implementation of the international financial reporting standards, as well as the procedure for their issuance, and determined the entities responsible for the supervising compliance with them, thus looking for integrating and homogeneous, understandable and high quality system.

#### Group 1: Larger Entities



#### Group 2: SMEs



# Why invest in Colombia? <sup>9</sup>

## Growing economic stability

Colombia offers investors a stable and predictable business environment, as well as a strong legal system. The Colombian law guarantees equal rights to domestic and international investors and a free flow of foreign capital.

Colombia is the sixth economy with best growth perspectives for 2014 according to The Economist.

## Growth forecast for 2014 according The Economist (annual % variation)



Source: The Economist

9. Source: ANH

## ***Unexplored potential to be discovered***

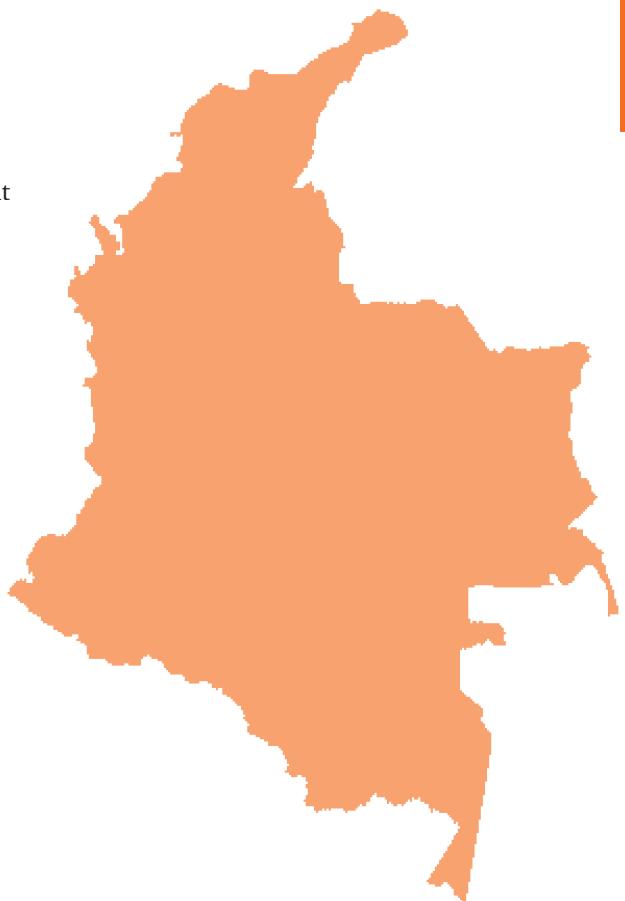
Recent information from Ecopetrol shows Colombia's reserves potential is estimated to be 47 billion barrels. A large portion of the territory is still unexplored. There is a big possibility of new discoveries in the Cusiana, Cupiagua, Caño Limón, La Cira-Infantas, and Chuchupa-Ballena fields. Such fields have proven reserves of more than a million barrels.

## ***Strategic geographical location***

Colombia has access to both the Pacific and Atlantic oceans, offering easy access to the Gulf of Mexico, Central America, North American coasts and South American and East Asian markets.

## ***Investor friendly country***

Colombia's ease of doing business is evidenced not only for having a mark of 83.85 out of 100 in the Togy Investors Index, but being ranked 34 out of 189 countries in the "Ease of doing business rank", done by the World Bank, leading by the first time the ranking in Latin America. The royalties and tax models are among the most attractive in the world, providing flexibility and profitability to foreign investors in the Oil & Gas industry.



# FAQS



## Incorporation vehicles and F/X regime

### **1. What are the main incorporation vehicles used by foreign investors in the Oil and Gas industry?**

There are generally four corporate vehicles that are widely used by foreign investors to establish a business in Colombia: corporations, limited liability companies, simplified stock corporations (SAS), and branch offices. Non-resident Oil and Gas companies generally choose to set up branch offices as their vehicle to invest in Colombia. Those branches belong to the special F/X regime.



## Taxes

### **2. Do any taxes, other than those on income tax exist which could significantly reduce profits from Colombian operations?**

While the income tax is the most significant tax, the impact of other taxes and contributions, such as CREE, Industry and Trade Tax, GMF, bonuses and High Price clauses, should also be evaluated before making any investment decision.

*See “Corporate Taxation in Colombia” section for further discussion.*



## Labor

### **3. How are expatriated employees taxed?**

In Colombia, taxable income for expatriates is determined by all the payments received for the rendering of services within the country regardless the place of payment. Expatriate residents are taxed on worldwide income and equity at progressive rates not exceeding 33%. Nonresidents are subject to taxation on domestic source income at a 33% flat rate.



## **Infrastructure**

**4. How has Colombia's business infrastructure (transportation, telecommunications, energy, etc.) been prepared for the new development in Oil and Gas industry?**

At present, oil infrastructure in Colombia faces many challenges, such as, maintaining security and making transport conditions less vulnerable. There is a need to increase crude oil transportation alternatives. It is important to improve the country's roads, reduce risks and reduce truck transport costs.



## **Environment and communities**

**5. How the actual regulations and relations with communities affect foreign investors?**

Good relationships with communities and sustainable practices are at the core of the Colombian oil and gas industry. Public opinion is more demanding of companies, and people are more aware of what is happening in their country, especially in rural areas.

*See "Communities" section for further discussion.*



## **Development of non-conventional crude oil and offshore**

**6. How is Colombia located in terms of non-conventional reserves and offshore development?**

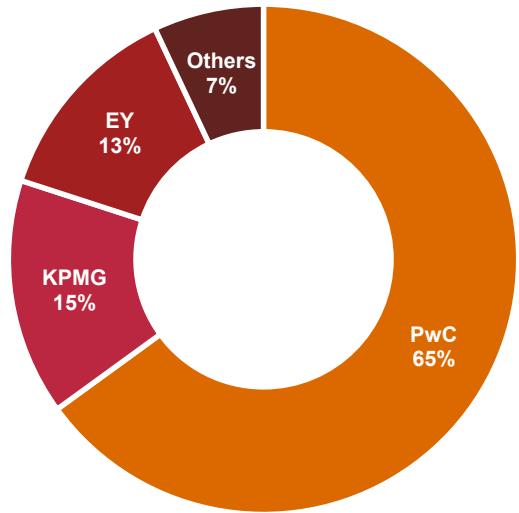
Due to a decrease in the remaining oil reserves in Colombia, the industry has begun to develop new techniques and strategies in order to increase the crude oil reserves in Colombia, looking for sustainable production in this sector. At the moment, 41% of investments in the sector have been allocated to non-conventional crude oil and offshore projects.

*See "Non-conventional" section for further discussion.*

# *How PwC can help*

## *Market share Oil & Gas in Colombia*

PwC Colombia audits the 65% of the Oil & Gas companies in revenues, from the 1000 largest companies in Colombia.



Source: 1000 largest companies in Colombia, Semana Magazine (May 11-18, 2014)

## *PwC solutions*

The Oil & Gas industry in Colombia deals with important challenges, where finding new reserves requires greater investment and improved technology. While needing to invest more, energy companies are also looking for ways to improve efficiency and lower costs, while managing the many risks of the business. Moreover, taking into account the issues on environmental permitting delays and social conflicts, which have overcome the industry's capability to keep growing.

The future of Colombia's Oil & Gas industry is in a crucial moment, where the right decisions need to be made in order to boost the industry's competitiveness.

With more than 100 years of experience worldwide helping energy companies and over 100 industry professionals in Colombia, PwC serves a broad range of domestic and international oil and gas companies in Colombia. We study industry trends and issues closely, so that we can better understand the challenges that our clients face, and how we can best help them to achieve success.

## ***Discover how we can help:***

### ***Audit and Assurance Services***

A team that analyses the financial performance of Oil & Gas companies and understands the issues and business challenges of the industry.

- Financial Statement Audits (prepared under local and international accounting standards)
- IFRS Assistance
- Statutory Audit
- Capital Market Transactions and Initial Public Offerings
- Audit on projects and/or programs financed by multilateral banks
- Special Purpose Audit Engagements

### ***Tax Services***

We have a team of tax & legal professionals who understand the nuances of the tax & legal regulations that impact the Oil & Gas industry.

- Legal Services
- Tax Consulting and Tax Compliance
- New Co
- Tax Management
- Merger and Acquisition Services
- Transfer pricing
- International Assignment Services - Expatriates

### ***Advisory/Consulting Services***

To boost performance, improve value and build trust in the Oil & Gas industries, we advise and assist with our extensive financial, analytical and business process skills.

- Operational Effectiveness
- Commodity Trading and Risk Management
- Capital Projects and Infrastructure
- Human Resource Services
- Governance, Risk and Compliance
- Information Technology Effectiveness
- Transactions and Deals
- Fraud and Forensic Services
- Sustainability and Climate Change Services
- Community Engagement and Development
- Social & Environmental Risk Management and Impacts
- Advisory & External Assurance on Community Benefit Program
- Knowledge Management

### ***Outsourcing***

Our outsourcing services allow private and public companies in the Oil & Gas industry to focus on its core business and outsource all the back office operations.

- Accounting, administrative and Financial Outsourcing
- Payroll Outsourcing
- Cloud Computing Solutions
- Transactions Affinity
- E-commerce Electronic Invoicing
- Documentation Filing Outsourcing
- Finances Factoring
- International Financial Reporting

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