Bogota Foreign Investment Guide - 2025

Invest in Bogotá

Chapter 13.

Mergers and Acquisitions (M&A)

Processes

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Introduction

Colombia has established itself as an attractive destination for mergers and acquisitions (M&A), adopting international standards and sophisticated contractual structures, largely inspired by Anglo-American practice. Although robust, the Colombian legal framework has particularities that require a deep understanding to mitigate risks and maximize opportunities.

1. Acquisition Structures in Colombia

The acquisition of a business can be structured in different ways, depending on factors such as tax implications, regulatory requirements, and risks identified in the due diligence process. In practice, the most common options include:

I) The Sale and Purchase of Shares.
(II) The Acquisition of Assets.
(III) The Merger.
(IV) The Spin-off.
(V) The Sale and purchase of a Business Establishment.

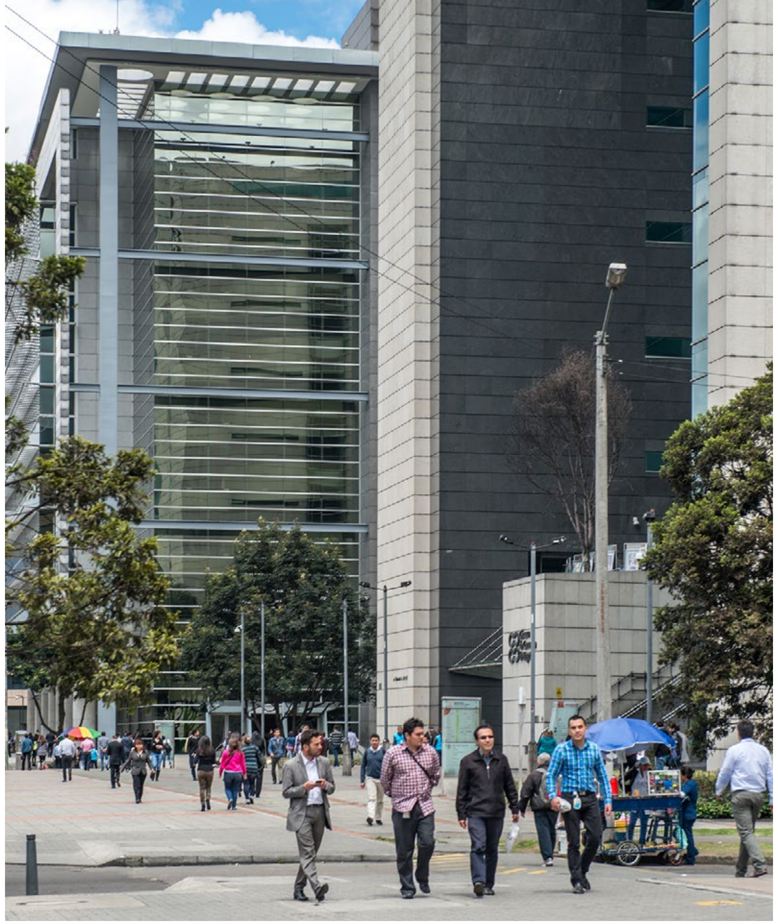
Each of these structures has different effects, and therefore the choice must be based on the specific characteristics of each transaction.

I) Sale and Purchase of Shares

In a sale and purchase of shares agreement, the object of the transaction is not the business assets directly, but the equity interests representing the company's capital. Although this is a seemingly simple structure, it may be subject to legal or statutory restrictions, such as observance of a right of first refusal on transfers. You should bear in mind:

• **Right of First Refusal on Transfers:** The transfer of equity interests may require authorization from the partners, or be subject to a right of first refusal on transfers, because it is provided by law (for example, limited liability companies) or in the bylaws (for example, corporations). Failure to comply with this requirement may render the transfer null and void or ineffective.

• **Tax Aspects:** The gain on the sale of equity interests may give rise to capital gains tax for the seller (if they have been held for two years or more as a fixed asset) or ordinary income tax (if they do not meet that term or condition). The tax is applied to the gain obtained, that is, the difference between the sale price and the tax cost, and must comply with the minimum sale price rules of Article 90 of the Tax Code (E.T.), which must correspond to fair market value, with a 15% variance being accepted. For shares, the value cannot be less than the book value per share increased by 30%[1].



II) Sale and Purchase of Assets

In this structure, the buyer directly acquires the assets, rights, and, in certain cases, liabilities of the business, without taking control of the legal entity that holds them. This modality allows the acquirer to select which assets to incorporate and which risks to exclude from the transaction, but it requires identifying and transferring each component individually, which implies greater operational and legal complexity.

[1] Law 1258 of 2008. "By which the Simplified Stock Company is created." Bogotá D.C., 2008, Official Gazette, 47194.

Although this structure is not subject to a right of first refusal as in the case of shares, it may be restricted in specific cases (for example, if assets and liabilities equivalent to 50% or more of net worth are transferred, approval by a qualified majority of the shareholders' meeting and registration of the transaction in the commercial registry are required). You should bear in mind:

• **Tax Aspects:** The gain on the sale of the assets will generate capital gains or ordinary income for the seller and will be calculated by applying the applicable rate to the gain on the sale of each asset considered individually.

III) The Merger

A merger operates through the absorption by one company, known as the absorbing company, of another company, known as the absorbed company, which is dissolved without being liquidated. The main effects are:

i) The transfer, en bloc, of the absorbed company's assets, liabilities, and equity to the absorbing company.

ii) The dissolution, without liquidation, of the absorbed company.

iii) The "shareholders of the absorbed company receive shares in the absorbing or newly created company, either through an increase in the absorbing company's subscribed capital or a primary issuance of its shares",[2] except where withdrawal rights are exercised or, in the SAS, where consideration consists of something other than shares in the absorbing company. The following should be taken into account:

[2] Reyes Villamizar, Francisco. La Sociedad por Acciones Simplificada. Second edition. Bogotá: Legis, 2010, p. 239.

• **Tax Aspects:** Under Articles 319-4 and following of the Tax Code, in acquisitive mergers and spin-offs, the transfer of assets between the companies involved is not considered taxable income or a sale for tax purposes, provided that: (i) the absorbing company maintains the same tax cost and the same classification of the assets, as fixed or movable, that the absorbed company had, without modifying the useful life or the basis for depreciation or amortization; (ii) for shareholders, partners, or participants, it is not considered that they have sold their shares or interests if at least 75% of them retain an equivalent shareholding in the new entity and receive at least 90% of the consideration in equity interests of the new company, keeping the same tax cost and the nature of the investment; and (iii) if any shareholder does not receive equivalent consideration, they shall be deemed to have sold their shares, and such sale shall be treated as a disposition.

IV) The Spin-off

Through this mechanism, a company transfers, en bloc, part or all of its equity to one or more companies, either already existing or newly created. The dividing company may remain in existence (partial spin-off) or be dissolved (total spin-off), depending on the scope of the operation.

Among the main effects of a spin-off are the transfer of equity to the beneficiary companies, the assumption of liabilities by the latter for the transferred obligations, and the proportional transfer of the partners of the dividing company, in accordance with the agreed exchange ratio. The following should be taken into account:

• **Tax Aspects:** As noted above, for tax purposes, mergers and spin-offs may be acquisitive or reorganization transactions, depending on whether the companies participating in the transaction are related parties, in which case they will be reorganization transactions, or not, in which case they will be acquisitive. Depending on the type of spin-off, and subject to certain requirements established in the Tax Code, the spin-off will have differentiated effects for the partners or the companies involved, as noted in the section on mergers.

V) The Sale and Purchase of a Business Establishment

Another mechanism for acquiring a business, similar to the sale and purchase of assets, is the acquisition of a business establishment. According to Article 515 of the Commercial Code, this is understood as the set of assets organized by an entrepreneur to conduct their activity. This includes, among other things, elements such as the brand, furniture, inventory, contracts, lease rights, receivables, intellectual property, and clientele. The following should be taken into account:

- **Corporate Aspects:** According to the Commercial Code, Articles 525 and following, the sale of a business establishment is presumed to be carried out en bloc, without the need to individualize the assets. A balance sheet and a detailed list of liabilities, certified by an accountant, must be provided to the buyer. The seller and buyer are jointly and severally liable for prior obligations, and the seller's liability ceases two months after registration of the transaction in the commercial registry, provided that the applicable legal requirements are met.

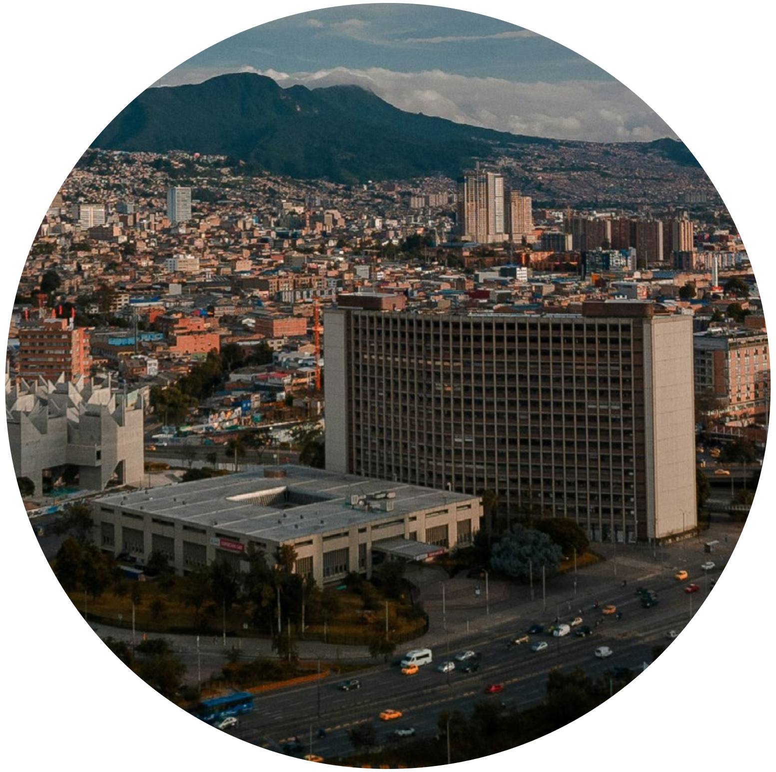
- **Tax Aspects:** The sale of a business establishment, understood as an economic unit in accordance with Article 525 of the Commercial Code, is classified as the transfer of a fixed asset. Therefore, it is subject to withholding at source on the total transaction value.

2. M&A Process: Key Stages

1) Due Diligence: For the buyer, it is of the utmost importance to conduct a thorough review of the target company, or of the assets to be acquired, in the case of a sale and purchase of assets, covering, among other things, legal, financial, tax, labor, environmental, and contractual aspects. The findings of due diligence may affect the transaction structure and, possibly, the business terms, as well as the contractual clauses.

2) Negotiation and Drafting of the Acquisition Contract: In addition to the applicable essential elements, it is common in Colombia to include representations and warranties, covenants, conditions precedent to closing, when signing and closing are not simultaneous, and indemnification clauses.

3) Obtaining Authorizations and Consents: Depending on the transaction, approval may be required from government authorities, for example, the Superintendence of Industry and Commerce on competition issues, the highest corporate bodies, creditors, or third parties.



4) Closing and Post-closing: closing implies consummation of the transaction. Subsequently, there may be post-closing obligations, such as compliance with covenants, among others.

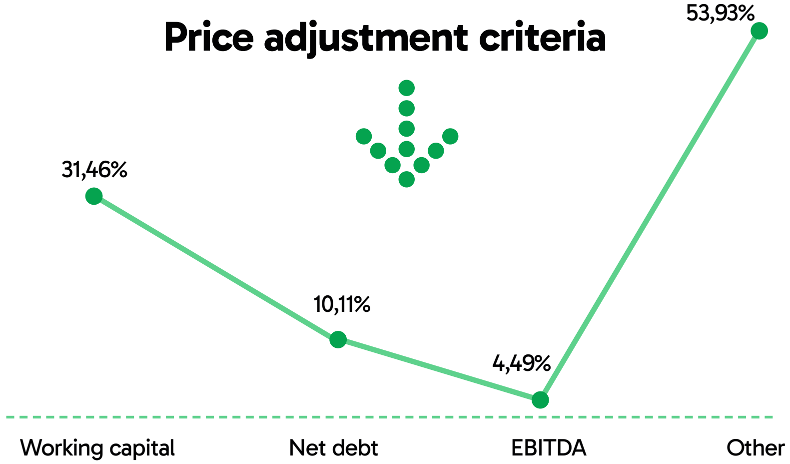
3.

Essential Elements of the Acquisition Contract

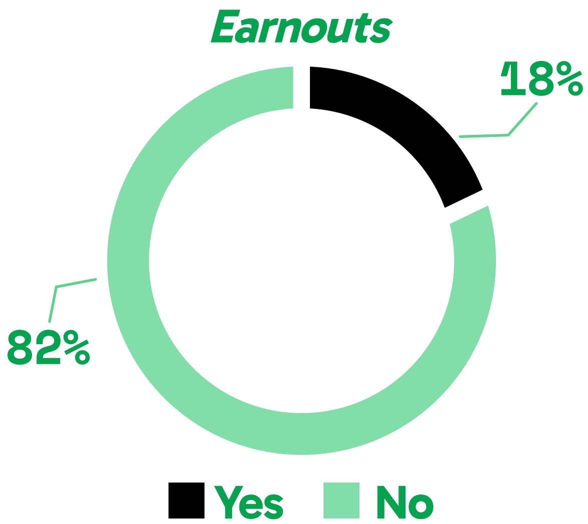
Acquisition contracts in Colombia have tended to adopt the Anglo-American style, including the incorporation of representations and warranties, conditions precedent to closing, when signing and closing are not simultaneous, covenants, and indemnification clauses, among others. Some of these clauses have particularities under Colombian law, which must be analyzed in detail:

a) Price and Adjustment Mechanisms: Under Colombian law, the price must be certain, that is, determined or determinable. The price may be fixed, subject to adjustments as of the closing date according to certain financial metrics, or it may include a contingent payment component, earnouts, subject to the achievement of post-closing targets.

In Colombia, according to the Deal Points 2024 report, hereinafter “Deal Points”, prepared by the M&A Research Group of Universidad de los Andes, the financial criteria most commonly used to make price adjustments include **working capital, net debt, and EBITDA,** although in more than half of the transactions other contractually defined criteria were chosen, as shown in the graph[3].



According to Deal Points, contingent payments or earn-outs were agreed in 18% of the transactions analyzed in 2024, as shown in the following graph[4].

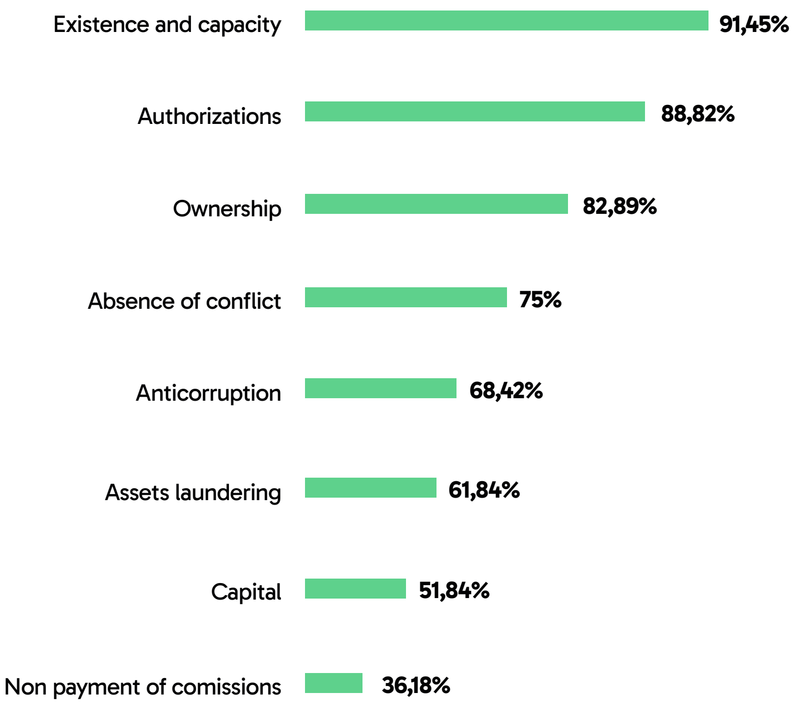


b) Representations and Warranties: These are statements that a party to the acquisition agreement makes about itself, its business, company, or assets. Their scope may be limited by materiality, knowledge, and disclosure schedules. According to Colombian arbitration case law, they are ancillary provisions to the principal obligations, and their falsity may constitute a breach of contract or a defect in consent, without implying obligations to give, do, or refrain from doing.
According to Deal Points, the representations and warranties most commonly treated as fundamental in M&A transactions in Colombia are the following:

[3] **Source:** Carreño Mendoza, Sergio, and Archila Correa, Santiago. Fusiones y Adquisiciones. Deal Points – Colombia, Nº 1, Deal Points 2024. M&A Research Group, Universidad de los Andes.

[4] Deal Points 2024, Table 2 (earn-outs).

FUNDAMENTAL R&W[5]



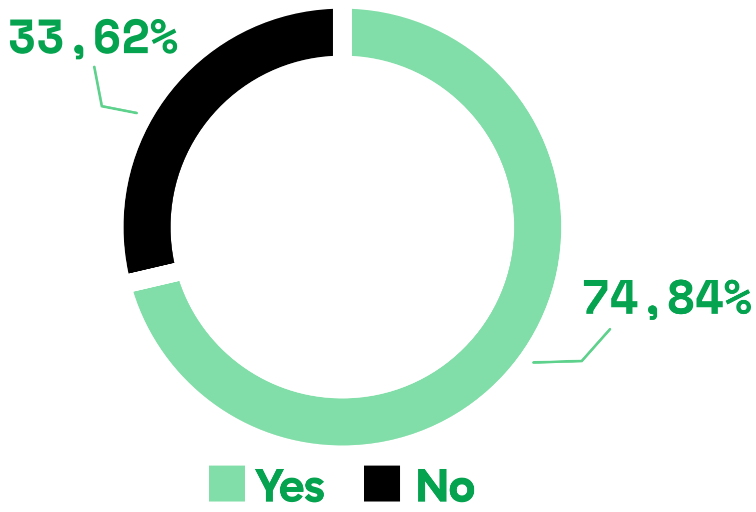
c) *Covenants:* These are obligations to do or not to do, which may operate between signing and closing, for example, regarding the ordinary course of business, or even after closing.

d) Conditions Precedent to Closing: Closing is usually conditional upon the accuracy of the representations and warranties, bring-down, compliance with covenants, absence of material adverse effects, and obtaining authorizations, among other conditions precedent applicable to each case as identified in due diligence and in accordance with the authorizations required to close the transaction.

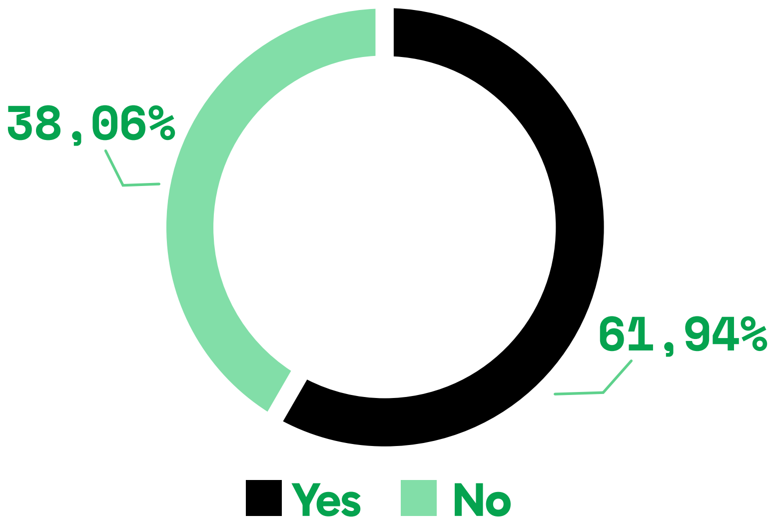
e) Indemnification Clause: Acquisition agreements usually include this clause, which provides that each party agrees to indemnify the other, and its affiliates if applicable, for losses arising from (i) false representations and warranties, (ii) breaches of the obligations set forth in the agreement, and (iii) possibly, special matters (special indemnities).

Indemnification clauses usually include limitations of liability, whether through time limits or quantitative limits, thresholds and maximum amounts. According to the Deal Points 2024 report, 74.84 % of transactions agreed on liability caps and 61.94 % established baskets, as detailed below:

Liability Limit (Cap)



Umbral (Basket)



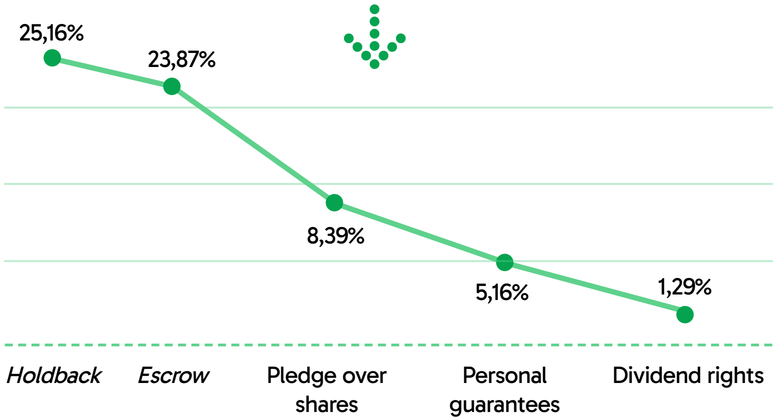
[5] *Deal Points 2024, Table 4 (Fundamental R&Ws).*

4.

Protection and Dispute Resolution Mechanisms

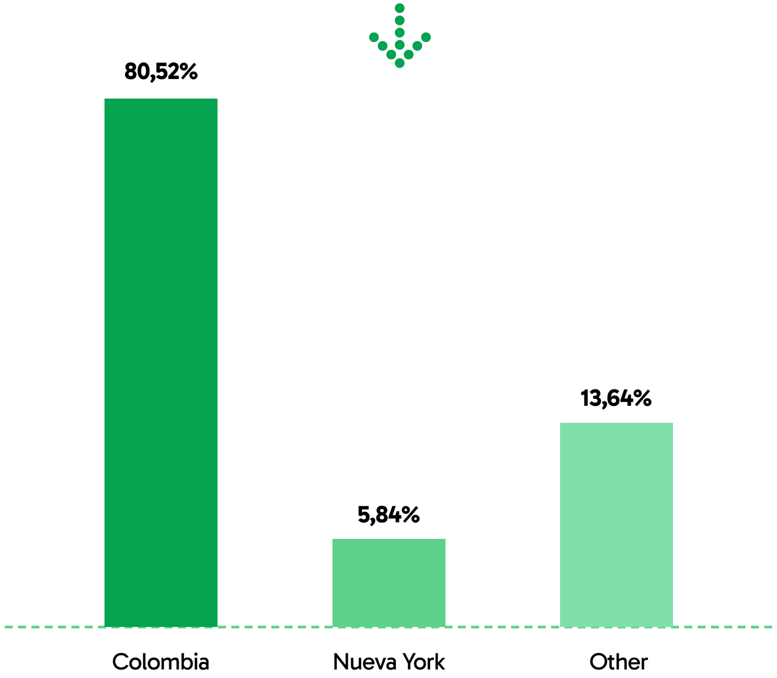
a) Indemnity Payment Guarantees: In Colombia, it is valid to agree on indemnity payment guarantees, such as escrows, holdbacks, or set-offs. Escrow is usually implemented through a security trust agreement, and together with the holdback it is among the most commonly used guarantees according to the Deal Points[6] study:

Type of guarantee



b) Dispute Resolution and Governing Law: In mergers and acquisitions, it is common to agree on arbitration because of its specialization and confidentiality. In international arbitration, the governing law may be different from Colombian law. According to Deal Points, 80.52% of transactions chose Colombian jurisdiction, followed by New York (5.84%), and others (13.64%)[7]:

Governing jurisdiction



[6] *Deal Points 2024. Table 6 (Type of guarantee)*
[7] *Deal Points 2024. Table 7 (Governing jurisdiction)*

5.

Foreign Exchange Considerations

All foreign investment in Colombia must comply with the foreign exchange regime, which requires registration with the Central Bank of Colombia. If the investment involves channeling foreign currency through an Foreign Exchange Market Intermediary (IMC, Intermediario del Mercado Cambiario) or a compensation account, registration is done automatically through the exchange declaration or the report of movements, without additional procedures.

If there is no channeling, the investor must register the transaction in the Foreign Exchange Information System (SIC, Sistema de Información Cambiaria). In the event of termination of ownership, the investment must be canceled or replaced within six months, as applicable, by registering the change of owners, destination, or recipient company.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