TAX INCENTIVES COMMISSION:
KEY FINDINGS

PUBLIC CONSULTATION

Presentation by the DIAN-OECD Technical Secretariat on behalf of the Tax Incentives Commission
The TIC has identified and reviewed all tax expenditures.

Definition: Tax expenditures are provisions in the tax legislation that modify the tax liability of specific groups of individuals or businesses.

Four reform categories:
(i) Maintain
(ii) Reform
(iii) Conditional reform
(iv) Unclear whether to reform
Successive policymakers and legislators have introduced tax expenditures in an attempt to address Colombia’s structural economic deficiencies, and have largely failed.

Almost yearly piecemeal reforms have tried to counteract the system’s imbalances.

To compensate for the narrow tax base, high tax rates are imposed upon those who cannot avoid paying tax in Colombia.

Highly distortive taxes (financial transaction tax, ICA, VAT on investment) have been implemented to help balance the budget.

And more tax expenditures have been introduced to recompense taxpayers for high tax rates, further narrowing the tax base and limiting the tax revenues.

The tax system has become excessively complex, calling for a fundamental tax base broadening reform that restores efficiency, equity and raises more revenues.
COVID-19 pandemic has increased the fiscal deficit. Fundamental reform will be necessary to raise the tax revenues to reduce it.

Balancing act: not too quickly or the tax reform may harm the economic recovery, but not too slowly or growth in fiscal deficit could scare investors and credit rating agencies.

Abolishing individual TEs within each tax will be ineffective because of the wide range of TEs. Ambitious tax base broadening packages are necessary to be effective.

Some recommendations will only be feasible if broader systemic tax reforms are made and may require long transitional periods.
Changing the way tax policy is made is crucial if improvements are to be sustainable

1. Stronger mandate and greater resources for DIAN to produce an annual, standalone, item-by-item, tax expenditure report

2. Mandatory framework chapter in each new tax law that provides the rationale for the reform and a detailed economic assessment

3. Create an independent body of public finance experts to assist the Ministry of Finance in (i) developing a strategy for implementing the suggested reforms and (ii) the economic assessments of tax proposals
SYMPTOMS OF A DYSFUNCTIONAL TAX SYSTEM
The overall tax burden on businesses would be very high without tax expenditures.

**Average business tax burden**

- **T1**: Income tax, CREE and surcharges / Accounting profits
- **T2**: Income tax, CREE and surcharges + Non-deductible VAT + Turnover tax (ICA) + Debit tax + Customs tariffs + VAT on fixed assets + Property tax + Stamps + Public lighting + Wealth tax + Stamp duty tax) / Profits before all taxes

Source: DIAN (2020)
Business taxes distort how corporations choose to distribute dividends

Distribution of gross income by individuals that file a PIT return across the personal income distribution, 2018

Source: DIAN
The proliferation of tax expenditures and insufficient monitoring result in extremely low effective tax rates.

Effective tax liability on income earned at the individual level as a % of total income, 2018

Source: DIAN and MoF
The narrow tax base limits revenue raising capacity, despite Colombia’s multitude of taxes

Tax revenue (as % of GDP)

Source: OECD Revenue Statistics (2018)
Colombia forgoes more tax revenue than any other Latin American country

Source: DIAN; CEPAL (2019)
REFORMS BY TAX AREA
Enhance the role of the Personal Income Tax

- Significantly reduce the number of exempt and non-taxable income items
- Avoid tax allowances that increase with income
- Lower the basic tax allowance and reduce the number of PIT brackets; avoid increasing statutory PIT rates
- Tax pensions at a fair effective rate
- Improve the design of taxes levied on personal capital income
- Use market values (not historical) to determine taxable income
- Strengthen tax enforcement, particularly on the self-employed
Broaden the VAT base and improve its design

- Reduce the number of excluded and exempted goods and services
- Ensure that the VAT compensation mechanism reaches all the poor and increase the value of compensation when the VAT base is broadened
- If the compensation system cannot reach all the poor in the short run, continue the 0% tax rate on the basic needs goods basket in the short term
- Goods and services that cannot immediately be taxed at the standard VAT rate because the compensation system cannot be fully implemented, or that would result in a too high tax increase, could be taxed at the reduced VAT rate
- Increase the reduced VAT rate from 5% to a rate in the range of 10-12%
- Have VAT on investment in fixed assets credited within the VAT
- Bring (Special Permanent) Free Trade Zones within the standard VAT regime to prevent abuse
Improve the design of the business tax regime

- Replace **municipal turnover tax (ICA)** with recurrent taxes on immovable property (or grants/transfers or tax revenue sharing)
- Abolish **financial transaction tax**
- Significantly broaden **CIT base, work towards aligning the tax treatment across sectors**, and over time abolish **CIT recapture tax**
- Avoid **non-profit based business taxes**, and lower **standard CIT rate** to an **internationally competitive level**, then merge the FTZs within the standard CIT regime
- Do not reform the **SIMPLE regime** in the short run; encourage businesses to join from sectors with low take-up
- Strengthen the agricultural sector’s formalization strategy and **tackle the problems faced by the sector at source** (e.g. infrastructure investment)
- **Redesign profit-based TEs into cost-based TEs** (ZESE and ZOMAC)
THANK YOU!

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