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Colombia—Moderate Tax Reform

- The Petro Administration proposes 1.72% of GDP (COP 25 tn) tax reform

THE PETRO ADMINISTRATION PROPOSES 1.72% OF GDP (COP 25 TN) TAX REFORM

On Monday, August 8, one day after President Gustavo Petro took office, the new Finance Minister, José Antonio Ocampo presented the long-awaited tax reform proposal to Congress. The reform, which is packaged as “Tax reform for equality, and social justice”, aims to increase tax collection by COP 25 tn in 2023 (1.72% of GDP in 2023, table 1). The main revenue sources are individual and business taxes; from a sectoral perspective, the mining-related sector (oil, coal, and gold) would be hit by a new marginal tax.

Table 1: Colombia—Additional Income Expected by the Fiscal Reform by Source

	COP (bn)	% of GDP 2023	% of additional revenue
Income and wealth for individuals	8.1	0.56	32.6
Income taxes to business	5.1	0.38	22.1
Mining-related taxes (oil, coal, and gold)	7.0	0.48	27.9
Healthy and environmental-related taxes	2.5	0.18	10.5
Others*	2.2	0.15	8.7
Total additional revenue**	25.0	1.72	100.0

* Including reduction in fiscal spending. ** Numbers may not sum up to total due to rounding.
Sources: Scotiabank Economics, Colombia MoF, Fiscal Reform Proposal.

Our first take on the reform is positive. Despite the size of the proposal being more ambitious compared with past reforms, on average, the potential additional revenues are feasible. In sectoral terms, the mining sector will feel the highest pressure, an incidence that is aligned with the environmental policy advanced by Petro in his campaign.

The effects of the tax reform on debt issuance policy and the Fiscal Rule plan will be revealed when the government presents its new Budget. So far, Ocampo affirms that the government will comply with the fiscal rule. Given that, for now, we don't expect actions from credit rating agencies.

Key takeaways:

- **Carrot-and-stick approach:** The tax reform is intended to improving social welfare. After the pandemic, poverty increased, and the government is aiming to main some key social programs. That said, the size of the social program wasn't revealed. And while Minister Ocampo said that the National Budget will be modified to accommodate these programs, he also emphasized that the government will comply with the Fiscal Rule, with details to be provided in the Budget proposals.
- **Additional tax sources:** In 2023 about 33% of total additional tax revenues would come from individuals, with approximately 22% from business. Roughly 28% would come from green taxes on oil and coal, and about 11% of new tax revenues would be related to health and environmental taxes. The balance (8.7%) includes other measures, such as the elimination of the VAT holiday and reduction in fiscal spending.
- **Individual taxes (33% of additional revenue):** The reform proposes to simplify the tax code and consolidate all income sources into the same scheme (extraordinary income, pensions, salaries, etc.). The second main change is to reduce tax exemptions, limiting deductible income only up to 3%. That said, the MoF calculates an impact on the 2.4% of the population with higher incomes (34 thousand individuals). Similarly, wealth taxes will start for wealth above COP 3 bn (approximately USD 700k).

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- **Business taxes (22% of additional revenue):** The proposal would reduce some tax exemptions and make permanent the surcharge on the financial sector (3%). Additionally, the treatment of business in free trade zones will be conditioned to export activity.
- **Mining-related sector taxes (27.9% of additional revenue):** The mining sector will face a higher effective tax rate after the reform. In 2022 income tax rate for the mining sector is around 27%. In the proposal, the government intends to implement a 10% tax on exports made above-defined base price (table 2).

Rule for mining exports tax:

Tax = Exported value (spot price-base price / spot price) * 10%

Additionally, royalties would no longer be deductible from income taxes.

- **Health and environmental-related taxes (10.5% of additional sources):**

The government will implement taxes on sugary drinks and junk food. In the same vein, they will implement taxes for one-use plastic times and carbon taxes.

- **Other measures (8.7% of additional revenue):** The government plans to change some taxes in free trade zones, and some special tariffs on imports that don't comply with FTA rules.

What is next?

The government has said that the tax reform will follow the traditional process (wasn't sent with urgency). That said, the fiscal reform will be discussed in parallel with the National Budget, which in regular terms has to be approved by October 20. Our initial take is that the tax reform has a good chance to be approved by Congress.

Looking ahead, it will be important to monitor how the National Budget changes and what implies the tax proposals imply for the fiscal rule trajectory and debt issuance plans.

Table 2: Colombia—Base Prices for Mining Exports

	Current tax rate on exports	Base price of export
Oil	4.6%	48.00 USD/bbl
Coal	7.6%	87.00 USD/ton
Gold	7.8%	400.00 USD/oz

Sources: Scotiabank Economics, Colombia MoF.

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