

Editorial

Tax reform: scope and limitations

In the last days of 2014, the President passed the new tax reform (Law 1739 of 2014) that goes into effect since January 2015, which, according to Santos, “it does not affect neither the middle class of the country nor the small and medium companies”. The President also stressed that the new tax revenues “are used for social and productive investment”.

In principle, it was said that it was a financing law for the 2015 budget, which was by \$12.5 billion underfunded, but at the end, it became a major tax reform for the next four years.

In the discussion in the Congress, the project was criticized by both analysts and businessmen, and led to confrontations between government and business groups, even those that were characterized by supporting government initiatives. Under the new law, the capital gains tax, which ended its force in 2014, became the wealth tax, payable by 32,000 companies and 52,000 individuals¹.

It is important to note that rates are marginal and progressive. Let us see for 2015, if we take the case of companies, the first \$ 2,000 million (a rate of 0.20%), from \$ 2,000 to \$3,000 million (0.35%), from \$ 3,000 to \$ 5,000 million (of 0.75%), \$ 5,000 million onwards (1.15%). For individuals, also in 2015, rates were for the first \$ 2,000 million (a rate of 0.125%) of 2000-3000 million (0.35%), from \$ 3,000 to \$ 5,000 million (0.75%) and \$5,000 million onwards (1.50%).

For the period that will in force the income tax, companies will pay a maximum of 1.15% in 2015, of 1% in 2016, of 0.4% in 2017 and in 2018 the tax will be removed. In contrast, individuals in the period 2015-2018, will pay an annual maximum of 1.5%.

Moreover, the tax of 4 per thousand is maintained, which, as the capital gains tax, had to expire in 2014; in Law 1739 it was stipulated its remove from 2019. For that year it will be reduced to 3 per thousand, to 2 per thousand in 2020 and in 2021 will be 1 per thousand, from 2022 it will end. It should be noted that the reform changed the alternative minimum tax (AMT, and IMAS by its acronym in Spanish), created by Law 1607 of 2012. This change reduced AMT threshold. The decision will affect employees, as with the previous tax reform, workers could opt for MAT, provided they had less than 4,700 tax value units -TVU- (about 126 million pesos) taxable income. In the current reform, the limit was lowered to 2800 TVU (about 79 million pesos). This decision was

¹ It should be specified that wealth means the total gross value minus debt by the taxpayer, and also the amount paid for this tax will not be deducted from income or the income taxes for equity (CREE by its acronym in Spanish). Both for companies and businesses, the tax base applies to those tax subjects that the first of January 2015 have equal or higher than \$ 1,000 million net worth. In the case of legal persons, this tax shall be paid until 2017 and the individuals will do so until 2018.

made because the Colombian tax office (DIAN by its acronym in Spanish) detected a significant number of taxpayers who applied the AMT and had favorable balances in the tax returns of 2013, especially those who accrued a monthly salary between \$ 5.9 and \$ 12.9 million. In fact, if the limit of AMT is reduced, many taxpayers will bow by National AMT (IMAN by its acronym in Spanish) and it is very likely that instead of having credit balances, after liquidation, they obtain balance due.

A standardization tax was created, which will be in force for the years 2015 2017, for those taxpayers who in past income statements have not included all assets, do so and regularize their status with the IRS. This alternative is very important because evasion and tax avoidance in Colombia are very high. According to the DIAN, VAT evasion is of 40% and the related to income tax is of 50%, representing approximately \$ 50 billion. If we were to reduce substantially this practice, we would have enough resources and we would not be in the need for tax reform every two years.

For some analysts and businessmen, the fact of changing the capital gains tax for wealth tax was made having into account the approaches of Thomas Piketty in his book *The capital in the XXI century*. He argues that the growth rate of the economy is less than the rate of return on capital, therefore, the concentration of wealth is growing and the only way to combat it is directly taxing capital. However, it is good to clarify that the capital gains tax exists since 2002 -creating to finance the war-; now the ideal is that if the peace process is consolidated, with the resources generated by the aforementioned tax, post-conflict costs shall be borne. However, economic inequality in Colombia is considerable, as we have a Gini coefficient of 0.54 (one of the most unequal countries in the world), i.e, income and wealth are concentrated in a few.

Current tax reform does not tax dividends from business owners, because in the Congress it was argued that doing so it will incur in double taxation, while labor income to lower the ceiling of MAT, will have a strong assessment and, therefore, the reform will not contribute to distributional equity, as the current tax structure favors capital income and affect negatively income from work.

Perhaps the most important of the last reform, is the recommendation to form a committee that will propose to the country a comprehensive tax reform, understood as that which covers entirely taxation of people and companies, and also ensure criteria of equity and progressiveness. But, how far into the commission will remain vested interests. Everything depends on those who integrate it and their ideological orientations, and how far their findings are technical and objective or respond to special interests.