



# **Methodology for Measuring the Fiscal Effect of Regional Tax Expenditures in Colombia**

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## 1. Introduction

The concept of tax expenditure refers to the revenue the treasury foregoes as a result of applying preferential tax regimes with a view to aiding or stimulating certain economic sectors, activities, regions, or agents. Defined in this way, tax expenditures are additional tools for governments to utilize in state intervention, which aim to achieve similar results to those that can be obtained through direct public expenditure. As such, they should be subject to the same controls and transparency criteria as the latter.

Tax expenditure reports are a step forward in this area, contributing greatly to the transparency of governments' economic and social policies. However, measuring the fiscal impact of tax expenditures is a complex task, and for that reason it is often postponed in developing economies, despite being of utmost importance. Direct budgetary expenditure, a more visible concept, tends to be debated and analyzed interminably, particularly when it comes to the public sector budget. By contrast, tax incentives are rarely subjected to such scrutiny. In general they are concealed in income forecasts and are debated in parliament only when they are to be first approved.

In Colombia, Law 819 (2003), known as the *Ley de Responsabilidad Fiscal* (Fiscal Responsibility Law), outlines a package of rules and procedures for budgets, responsibility, and transparency which requires the public finances administration, both national and regional, to keep updated reports about the amount of public money is spent and how it is allocated. In particular, Article 1 of the law establishes the national government's duty to present a Medium-Term Fiscal Framework (*Marco Fiscal de Mediano Plazo*, MFMP) on an annual basis to the Financial Committees of the Senate and of the Chamber of Representatives (*Comisiones Económicas del Senado y de la Cámara de Representantes*), which should contain, among other things, an estimate of the fiscal cost of the current tax expenditures in the tax legislation.

On a regional level, Article 5 of Law 819 establishes that governors or mayors must present an MFMP, for information purposes, to their respective assembly or council; this should forecast public income and expenditure looking ahead over three or more years, so that the local authorities can have a midterm view in the process of planning regional development. In terms of tax expenditure, this report is required to have an estimate of the fiscal cost of the tax exemptions that were granted in the previous period, as well as an estimate of the fiscal cost of the projects of ordinance or agreement in the previous fiscal period.

On the other hand, Article 7 of this same law establishes that “at all times, the financial impact of a bill, ordinance or agreement, which demands expenditure or which grants tax benefits, should make itself explicit and should be compatible with the Medium-Term Fiscal Framework.” At the same time, it indicates that in order to do this, the tax expenditure, as well as the sources of additional income that will finance this cost, should be revealed in the relevant explanation of motives and in the official papers.

Nevertheless, the advances made in terms of legislation on the stability of regional public finances in Colombia still need additional political measures to consolidate regional financial management. In reality, what is missing today is a methodological guideline to orientate the activities of the regional bodies so as to fulfill the legal mandate. What actually happens in practice is that not all the municipalities are able to fulfill this mandate.

To achieve this, a methodology for evaluating and estimating the tax expenditures needs to be drawn up, which should offer mechanisms to evaluate the initial tax regime, the structure used by the regional body, and the receivables of the autonomous body’s financial period, which appear as tax expenditures. This will be a tool for the regional authorities in Colombia to develop criteria for measuring and to decide objectively if it is justifiable to maintain the tax benefits established in their respective jurisdictions. Bearing in mind that the possibility of giving greater tax benefits arises in property and trade and industry taxes, the methodology would be mainly directed towards these, though will not rule out the possibility of repeating it on other taxes.

### **General Objective**

In keeping with what has just been outlined here, the general objective of the consultation is to develop a methodology to estimate tax expenditures at a regional level, based on the particular case of Colombia, so as to achieve the following: (i) act as a guide for the regional bodies in Colombia so they can fulfill the requisites of Law 819 (2003), in terms of measuring the financial effect of the tax benefits granted in the regulations of the relevant region; ii) to be presented as a paper for discussion in the regional seminar “*Gastos Tributarios: Reduciendo Abusos y Mejorando la Efectividad* (Tax Expenditure: Reducing Abuses and Improving Effectiveness) in 2010.

## Specific Objectives

In order to achieve the general objective, the following specific objectives have been drawn up:

1. Propose a methodology for measuring tax expenditures, in keeping with the experience of measuring them in Colombia and other countries.
2. Guide the team from the State Department of Fiscal Support (*Dirección General de Apoyo Fiscal*) (DAF) of the Ministry of Finance and Public Credit (*Ministerio de Hacienda y Crédito Público*) (MHCP) about the variables that should be borne in mind when it comes to tackling the measurement of regional tax expenditures.
3. Classify the main tax benefits allowed in the property and trade and industry municipal taxes, so that it is possible to rate them for measuring.
4. Apply the resulting methodology to the specific case of the municipality of Santa Cruz de Lorica, so as to measure the fiscal impact of the tax expenditures of the property and trade and industry taxes.
5. Propose mechanisms for introducing the use of the methodology to regional bodies.

## 2. General Theoretical Framework for Tax Expenditures<sup>1</sup>

### 2.1 What are Tax Expenditures?

The main purpose of any tax system is to collect enough revenue to finance public spending. Every citizen has to contribute a part, whether it is taken from his or her income, consumption, or wealth, which will go to finance state property, social expenditure, or any other activity that has a positive economic effect on society.

However the way this revenue is collected is not random. Certain standards are expected of the tax system, such as efficiency, equity, and simplicity. Efficiency refers to the fact that taxes should be collected interfering as little as possible in people's decision making. Equity here has a double meaning: both horizontal and vertical. Taxes should be horizontally equitable; in other words, they should affect people who have the same contributory power in the same way. And at the same time they should be vertically equitable, inasmuch as people with greater contributory power should pay proportionately higher tax. Finally it is preferable to have a

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<sup>1</sup> This chapter is based on Villela et al. (2009).

simple tax system rather than a complex one, as it could lead to reduced costs linked to taxes, such as administrative and compliance, and less opportunity for evasion and avoidance.

Governments often use the tax system to foster specific objectives of financial policy, such as encouraging saving, stimulating employment, or protecting national industry. In these circumstances, the tax system performs a similar role to public expenditure, but by means of the state foregoing all, or part, of the revenue that it would have received from certain taxpayers or activities. This relinquishment is what is known as tax expenditure.

It should be pointed out that tax expenditures could affect these qualities of efficiency, equity, and simplicity of the tax system in a different way. However, insofar as they favor a specific group of taxpayers or activities, the result will inevitably be a loss of horizontal equity. From this point of view, it is possible to say that tax expenditure budgets also act as reports showing the degree of horizontal inequity in taxation. Tax expenditures can be regarded as a transfer of public resources that is undertaken through reducing tax obligations in relation to a regulation or benchmark tax, rather than by direct expenditure.

One of the main difficulties when it comes to defining and identifying tax expenditures in a particular legislation lies precisely in agreeing on a regulation or benchmark against which tax legislation provisions can be contrasted. In the same way, quantifying the tax expenditure can be radically different depending on the adopted definition, which, among other things, makes it difficult to make reliable comparisons between the magnitudes of tax expenditures in different countries. From the technical point of view, tax expenditures can take on different forms, among which include the following:

- Exemptions: income or transactions that are excluded from the tax base. In the legal regulations they are found under different classifications, such as exemptions, relief, tax-free transactions, tax breaks, etcetera.
- Allowances: amounts that can be deducted from the tax base.
- Credits: amounts that can be deducted from tax liability.
- Rate relief: tax rates below the usual rate.
- Deferral: postponement or delay in paying tax.

According to the OECD (1996), identifying tax expenditures is an exercise in classification, which consists of dividing the tax provisions into those that are part of a

benchmark or rule and others which are deviations from this rule. When a tax provision deviates from the benchmark or rule, it is deemed a tax expenditure. The same report points out that usually the benchmark tax includes rate structure, accounting conventions, the deduction of mandatory payments, provisions to facilitate administration, and provisions relating to international fiscal obligations.

## **2.2 Tax Expenditures as a Public Policy Tool**

Tax expenditures basically pursue three objectives: (i) to improve progressivity in the tax system; (ii) to make the tax structure more efficient; and (iii) to encourage the consumption of merit goods. In addition, some special treatments are based on the complexity, which sometimes exists in order to apply the general regulations, or in the obligations imposed on taxpayers to do certain activities or consumption; however, there is less agreement about whether this kind of deviation from the rule should be regarded as a tax expenditure.

Tax expenditures are one more instrument within the different instruments of public policy available to governments, such as direct budgetary action or regulatory action on certain activities. As such, they should be constantly subjected to evaluation, not only in terms of justifying certain state intervention, but also in their relative efficiency compared with the other tools available. Once the need to undertake a public policy in a particular area has been identified, an evaluation should be made of which is the best instrument for dealing with it. Some characteristics of tax expenditures that should be borne in mind during this evaluation are the following:

1. Targeting: from the beneficiaries' point of view, tax exemptions are more accessible than direct subsidies, as they work in a relatively automatic way, whereas a subsidy plan needs a system of application and selection of beneficiaries. From the state's point of view though, being automatic, tax exemptions are less focused, benefiting the target group as much as any other who fulfills or seems to fulfill the legal requirements.
2. Horizontal inequity: tax expenditures tend to create inequity in the horizontal sense, given that not everyone has the same preferences or needs as consumers. So, for example, when VAT exemptions are established, whether it is to improve progressivity or to



encourage the consumption of merit goods, it proportionally reduces the tax burden of families who have a preference for those goods that are exempt. This is a disadvantage for other families who have the same income level, but who happen to consume goods that are not exempt.

3. Causing evasion and avoidance: applying tax expenditures makes the tax structure more complex, which leads to an increase in evasion and avoidance. Slemrod (1989) sums it up in four points: first, the uncertainty caused around correctly interpreting the legal regulations; second, the undermining of the tax administration's fiscal capacity, given that auditing requires more time when the regulations are complex; third, the greater difficulty it imposes on taxpayers to fulfill their tax obligations, which leads them to fulfill only part of them whether out of ignorance or to compensate for the costs the system charges them; and finally, greater opportunities to manipulate the tax system—that is, more room for evasion and avoidance as the complexity of the tax regulations increases.
4. Increased costs of tax compliance: what usually happens is that the more tax incentives there are, the higher the costs are in time and money that taxpayers face in order to fulfill their tax obligations. These expenses do not always fall on the incentive's beneficiaries. For example VAT exemptions benefit the end consumers, but the greater costs of compliance which come from special registers for accounting for VAT-exempt sales and credits fall on the sales people. In the case of income tax, controlling exemptions depends on information that has to be provided by third parties.
5. Regressivity of tax expenditures in progressive taxes: tax incentives logically benefit people who pay taxes. With progressive tax, like personal income tax, the poorest groups are not affected, and therefore do not benefit from tax expenditures.
6. Tax expenditures create unexpected earnings: the majority of tax expenditures create stimuli so people do what they would have done anyway; so in the end the stimulus turns into an unexpected gift for the beneficiary. In other words, in order to give an incentive to one beneficiary the cost of several is assimilated.
7. Tax expenditures distort market decisions: just as a tax expenditure favors a specific sector of the economy, it will cause an unwanted rerouting of funds towards that sector. However this is not necessarily a disadvantage in those cases where the tax expenditure is

aiming to correct a distortion originally caused by the tax, as for example in the case of encouraging investment and savings.

8. Tax expenditures mean a rise in rates: in fact, to collect a specific amount, higher rates will be needed if part of the potential revenue is lost because of applying tax expenditures.

## **2.3 Tax Expenditure Budgets**

### **2.3.1 The Purpose of Tax Expenditure Budgets**

From a purely budgetary point of view, the difference between direct expenditure and tax expenditure is that, in the former, there are two stages: the receipt of revenue and the payment or transfer of the subsidy; while in the latter, the payment is covered by the revenue, so therefore it by-passes the two stages. In this sense, the traditional way of presenting revenue, free from tax expenditures, violates the budgetary principle of not paying/compensating revenue and costs.

From a public policy point of view, tax expenditures are an alternative tool of state intervention, aiming to achieve similar results as those that can be had through direct public spending. They should therefore be subject to the same controls and transparency criteria as the latter. Failing that, a less rigorous control of tax expenditures in relation to direct spending creates incentives to establish subsidies and transfers in the way of tax expenditures, putting aside the objective considerations which could justify that choice and putting the tax system's very function of collecting revenue at risk.

Tax expenditure budgets are financial reports that take responsibility for the problems mentioned earlier. They make the use of tax concessions transparent and facilitate appropriate control of these and the most efficient allocation of resources. There is no such thing as a standard format for tax expenditure budgets, so their structure and content differ from country to country. However, some elements that are often similar among countries are the following:

- Definitions, concepts, and coverage
- Description of the benchmark taxes
- Description of the tax expenditures
- Past tax expenditure estimates (at least one year back)
- Projected tax expenditures (at least one year forward)
- Methodologies for estimating

### 2.3.2 Methodologies for Estimating Tax Expenditure Costs

In existing literature written on tax expenditures “methods” for estimating tax expenditure costs stand out, which actually relate to three different measurable concepts: the foregone revenue, the earned revenue, and the equivalent direct expenditure.

The *foregone revenue method* measures the loss of revenue, which happens after introducing a tax expenditure. It supposes that there is no change in the taxpayers’ behavior. In other words, it presumes their behavior is the same as when the tax expenditure was applied. This method is also known as ex post measurement.

The *earned revenue method* tries to estimate the extra revenue that can be collected when a tax expenditure is eliminated. Unlike the previous method, here the changes in taxpayers’ behavior are examined. This is also called ex ante measurement.

In practice, the application of this method is fairly limited, as having estimates available of the elasticity of supply and demand of the goods or incomes favored by a preferential tax treatment is difficult. This method ought to consider changes in behavior related to tax evasion. Part of the potential revenue obtained from eliminating a tax expenditure will end up being evaded, which happens with a proportion of all tax revenue.

Finally the *equivalent direct spending method* estimates the subsidy or transfer, which would give taxpayers a tax-free/net income similar to what they would get if there was a tax expenditure.

Equivalent direct spending takes into consideration the fact that transfers normally form part of taxable income. So if one wants to estimate the tax expenditure on the same basis as a direct transfer, the amount of tax that would affect this transfer should be added. By contrast, in the case of tax expenditures which are categorized as tax subsidies, the previous adjustment is not necessary, as in general direct subsidies do not increase the taxable income of the taxpayers.

The question arises, of course, as to which is the best method for measuring tax expenditures. The answer is that it depends on the objective. If one wants to have an accurate estimate of the highest possible revenue that can be had by eliminating a particular tax expenditure, the most suitable would be the *earned revenue* method. However if the objective were to establish a parallel between a direct spending budget and tax expenditure budget, it would be best to use the *equivalent direct spending* method.

With regard to this, the OECD (2004) indicates that the “best practice” is to estimate tax expenditures by the *foregone revenue* method, but adjusting the results by an equivalent tax margin in cases where the equivalent transfer is subject to tax. As explained before, this practice is the same as applying the *equivalent direct spending* method. This recommendation is based on the fact that applying a different method would create a false idea that tax expenditures are alternatives that are relatively cheaper than direct spending.

### **2.3.3 Integration with the Budget Process**

Inasmuch as tax expenditures are a substitute for direct spending programs, it is preferable that they be subjected to the same rules of budgetary controls as these programs. From this point of view, a good practice is for the tax expenditures estimates to be integrated with the rest of the budgetary documentation sent annually to parliament. However, not all countries that prepare tax expenditure reports do this.

Budget integration supposes that the tax expenditures ought to be presented side by side with the direct expenditures, both classified as budgetary functions and for the same amount of years, so as to be able to make an adequate comparison between the tax expenditure and direct expenditure programs that are pursuing the same ends. Ideally this “side by side” vision ought to facilitate decision making, to allow, for example, the replacement of a tax expenditure with a direct expenditure program, or vice versa. However, in practice these kinds of decisions are more complex. As Minarik (2008) points out, it is feasible to presume that a direct expenditure can be abolished in order to create or increase a different one, but less so when it comes to abolishing a major tax expenditure and when the additional revenue will go toward a new program of direct expenditure. The reason is that there are established limits as to what can be considered a tax burden or reasonable sized government.

Craig and Allan (2001) point out that integration of tax expenditures in the budget should also imply that a clear distinction is drawn between the new tax expenditures and the existing ones in the budget paperwork. This establishes a disciplined budget process for introducing new policy measures along with transparent mechanisms for evaluating the trade-offs between tax expenditure and direct expenditure.

The OECD’s best practices (2004) suggest that tax expenditures ought to be included within the confines of total expenditure, or failing that, a specific limit should be established for

them. At the same time, when the tax expenditures exceed the established limit as a result of policy changes a compensation should be made, whether by reducing other tax expenditures or by reducing the direct expenditure limit. Nevertheless, there are very few experiences of budget integration at this level.

### **2.3.4 Systematic Evaluation of Tax Expenditures**

It is of equal or greater importance to establish procedures for the systematic evaluation of tax expenditures, as it is to gather the necessary information on tax expenditures in budget documentation. In relation to this, the OECD guidelines on best practices suggest that tax expenditures should be reviewed in the same way as direct expenditures in the annual budget process, and should be subjected to special evaluation procedures, including the review of programs, which are normally applied to direct expenditure.

Following the argument of Tokman et al. (2006), evaluating a particular tax expenditure involves answering the following four sequential questions:

1. Is there justification for state intervention, on the basis of economic, distributive, or any other kind of efficiency?
2. Having proved state intervention can be justified, is there empirical evidence that the tax expenditure will be effective in reaching the objective?
3. Is the tax expenditure efficient in fulfilling its objective, in the sense of producing profits higher than its costs?
4. Are there alternative instruments that can make it possible to reach the sought-after objective more efficiently than tax expenditures?

Evaluation of tax expenditures should be done case by case on a regular basis, as the surrounding conditions constantly change, so a justifiable intervention at one time may not be justifiable at a later time, or the conditions of effectiveness and efficiency may change. Evaluating absolute and relative efficiency of tax expenditures should ideally take into account all the costs associated when the concession was granted, which of course must include the foregone revenue, but also the administrative costs, the compliance costs, and the costs linked with the risks of evasion and avoidance. In terms of relative efficiency, the benefits and costs of alternative public policy tools should be studied and compared with those of tax expenditures.

### **3. Identifying Tax Expenditures in Unified Property Tax and Trade and Industry Tax**

#### **3.1 Description of Unified Property Tax**

The Unified Property Tax is within Law 44 (1990), which combined four earlier taxes: the *Impuesto Predial* (Property Tax), the *Impuesto de Parques y Arborización* (Parks and Woodlands Tax), the *Impuesto de Estratificación Socioeconómica* (Socioeconomic Stratification Tax) and the *Sobretasa de Levantamiento Catastral* (Land Registry Surcharge). This is a municipal tax, and its administration, collection, and supervision are the responsibilities of the different municipalities.

##### *Tax Base:*

The taxable amount is the registry valuation as of the first of January of each year or the self-valuation. The former involves the land authority determining the value of the property by research and statistical analysis of the real estate market. As for the self-valuation, this is when the owner or landlord estimates the value of the property through an annual declaration, subject to certain minimum values. In any case it should be pointed out that to date only the Distrito Especial de Bogotá uses this method, while all the other municipalities use the registry valuation tax as set by the Instituto Geográfico Agustín Codazzi (Geographic Institute). The registry valuation should be updated at least every five years. It should also be readjusted annually by a percentage set by the national government, which should be no higher than the inflation target in the year in which the increase is set.

##### *Person liable:*

The person liable for tax is the owner, landlord/title holder, or usufructuary of the property. In the case of a transfer of property, it is the person making the transfer who is obliged to pay the tax relevant to that year, and in no circumstances should be passed on to the purchaser.

### Rates

The tax rate is set by the municipal councils, within a scale established by law, which rate of 1 to 16 per mille of the taxable amount. In accordance with the legal provisions, these rates should be established differentially and progressively, bearing in mind the following:

- a. Socioeconomic levels;
- b. Land use, in the urban sector; and
- c. When the registry was formed or updated.

In social housing and small rural properties devoted to agricultural production the minimum rates set by the respective council should be applied. As for urban land not yet developed and urban land not built upon, the law allows applying a tax of up to 33 per mille. In the year in which the property reevaluation comes into force, which should happen every five years, the resulting tax, based on the new evaluation, should not be more than double the tax paid in the preceding year.

### Exemptions set out by the law:

The exemptions set out by the law should be differentiated from the legal provisions that allow municipalities to establish their own exemptions. The latter will be analyzed in depth in section 3.4. Regarding the former, the following have been identified:

- Article 24 of Law 20 (1974) exempts from tax properties devoted to worship, diocesan staff, priests' and bishops' houses, and seminaries.
- Article 137 of Law 488 (1998) exempts from tax all land that is legally defined as a natural park or a public park belonging to state authorities.

### **3.2 Description of Trade and Industry Tax**

The Trade and Industry Tax is within the Law 1333 (1986). It is a municipal tax that has to be administered, levied, and controlled by the different municipalities. It is collected annually and taxes all commercial, industrial, and service industry activities carried out in the different municipal jurisdictions—directly or indirectly—by individuals, legal entities, or companies, whether a permanent activity or part-time, in specific properties, with or without commercial establishments.

Tax base:

The part subject to tax is the gross income of the previous year, excluding the following:

- Rebates
- Income resulting from sales of fixed assets and exports
- Tax levied on products whose price is regulated by the state
- Subsidies received
- Income resulting from exempt or nontaxable activities
- Income received from outside the municipality

Industrial activities will pay the tax in the municipality where the factory or industrial plant is located. In the case of public domestic services, the tax is charged in the municipality where the service is given to the end user. In addition, special situations are considered to designate the tax location in the distribution of oil by-products, electricity generation, advertising agencies, motorized land transport, and the financial sector.

Rates:

The rate established by the municipal councils is levied on the taxable base defined previously, within the following restrictions established by the Law:

- From 2 to 7 per mille for industrial activities
- From 2 to 10 per mille for commercial or service activities
- From 5 per mille for financial activities

Exemptions set out by law:

The following general exemptions have been identified:

- Basic production, agriculture, stockbreeding, and poultry farming but not including industrial food production or any industry where there is processed food however basic it may be;
- Production of national goods allocated for export;
- Working mines and quarries for salt, emeralds, and precious metals, when the municipality's royalties or shares are the same or higher than what is due to be paid for the trade and industry tax;



- Public education facilities, charity, cultural and sporting organizations, labor unions, nonprofit professional and trade associations, political parties, and hospitals belonging to or associated with the national health system, except when they undertake industrial or commercial activities, in which case they will be liable to tax according to those activities; and
- The first stage of transformation carried out in rural properties when they are agricultural production activities, with the exception of any industry where transformation is involved no matter how basic this may be.

The legal provisions that allow certain exemptions to municipalities will be analyzed under the heading 3.4.

### **3.3 Definition of Benchmark Taxes**

In order to identify the tax expenditures which have to be quantified, the benchmark taxes must be defined, against which the tax provisions established by the municipalities will be compared.

The benchmark tax should at least establish a benchmark rate and a taxable base. Furthermore, bearing in mind that the desired objective is to quantify the tax expenditures which come out of the municipalities' autonomy, and not those which are set in general in the laws which regulate both taxes, it will be necessary to consider as part of the benchmark tax the exemptions and other tax concessions set out in the law. Using these criteria, exemptions which, for example, benefit properties devoted to worship, in the case of property tax, or to income from primary production, in the case of trade and industry tax, will not be regarded as municipal tax expenditures.<sup>2</sup> On the other hand, those exemptions, which a particular municipality may grant, as an autonomous body, to certain taxpayers, certainly should be incorporated as a tax expenditure in the regional body's budget.

Regarding the rates, it is common practice when identifying tax expenditures in central government's taxes, like VAT and Income Tax, to establish as a benchmark rate the most generally used legal standard rate. Using this criterion in the municipalities would imply that each one of them would have to choose their own benchmark rate for each tax, which would coincide with the standard rate set by the municipal council, and be applied to the majority of

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<sup>2</sup> Notwithstanding that from a national point of view these exemptions are also tax expenditures, which could eventually be incorporated into the central government budget.

taxpayers. For example, if the rate set by the council for the trade and Industry Tax is 4 per mille, any rate set below that for the good of a particular group of taxpayers, would constitute a tax expenditure.

The latter approach has two problems. Firstly, it is common practice among municipalities to set a rate that is not low, different for each economic activity, property type or valuation status, among other criteria, in such a way that it becomes difficult to identify a more general rate of application. Secondly, it does not allow for transparency of the fiscal costs which comes from the autonomous decision to set low general rates, in relative terms. For example, if a certain municipality sets the lowest acceptable rate within the scale as a general rate for the trade and industry tax, this is a 2 per mille, then it would not show tax expenditures for reduced rates. By contrast, if another, more fiscally responsible, municipality, was to set the rate at seven per mille and at the same time, give a reduced rate of four per mille to a specific economic sector, it would have to report a tax expenditure of three per mille for the difference between the two rates.

One way of avoiding the above mentioned two problems, is to set the benchmark rate at the highest rate legally permitted. In other words, in the property law the benchmark rate would be set at 16 per mille and in the trade and industry law it would be 7 per mille for industrial activities and 10 per mille for commercial and service activities. Any rate lower than the highest legally permitted rate will be regarded as a tax expenditure.

This positioning has the disadvantage in some cases of overestimating the tax expenditure. For example, in the property law, the law itself, along with setting minimum and maximum rates, points out that these should be established in a differential and progressive way, which would mean that a municipality could not set the maximum rate as a general rule. However, as has been indicated, this positioning has good points such as simplicity and allowing an adequate comparison between the tax systems of the municipalities, which is why it will be used for the rest of this work and will be recommended for use in estimating tax expenditures in all the municipalities. Bearing in mind these considerations, the following definitions are proposed for benchmark taxes:

*Property Tax:*

- The persons liable are the proprietors, owners or usufructuaries of the property located in the jurisdiction of the relevant municipality.
- The taxable base is the registry valuation in force on January 1 each year

- The rate is equal to 16 per mille, corresponding to the maximum established by law. In the case of non-urbanized urbanized land and vacant urbanized land, the rate is 33 per mille.
- The benchmark tax includes the exemptions set out by the law.

#### Trade and Industry Tax

- The persons liable are individuals, legal entities or companies, who undertake industrial, trade or service activities.
- The taxable base is the gross income of the previous year, excluding exports, refunds, income from sales of fixed assets and subsidies.
- The rate is 7 per mille for industrial activities; 10 per mille for commercial and service activities; and 5 per mille for financial bodies. These rates correspond to the maximum authorized by law.
- The benchmark tax includes the exemptions set by law.

Having defined the benchmark taxes, the tax expenditures established in the tax statutes of each municipality can be identified with precision. Any tax provision that is set aside from the above definitions will constitute a tax expenditure.

### **3.4 Potential Tax Expenditures in Property Tax**

This subsection will identify those preferential treatments that the municipalities can potentially grant to specific taxpayers, in keeping with the attributes which tax legislation gives them in relation to property tax.

#### Exemptions:

- Law 1333 (1986), Article 258, allows municipalities and the Special District of Bogotá to grant municipal tax exemptions, including on property, to specific groups of taxpayers, for a limited period that should not exceed ten years. These exemptions should conform to the municipal development plans.
- Article 194 of Law 1333 (1986), establishes that real estate owned by public bodies, state industrial and commercial companies and national mixed economy companies,

could be taxed with the property tax to the benefit of the relevant municipality. This wording implies that the municipalities can opt for not taxing these kinds of properties.

- Article 24.1 of Law 142 (1994) establishes that the districts and municipalities can burden public service companies with rates, contributions or taxes which may be applicable to the rest of taxpayers who carry out industrial or commercial functions. So one deduces from this that the municipalities can opt to not impose the property tax on such companies.
- Article 24 of Law 20 (1974) establishes that ecclesiastical properties could be subject to the property tax in the same way and to the same extent as private properties, as long as all religious faiths are treated in the same way. As such, the municipalities are indirectly given the power to not tax these kinds of property. It should be recorded that the same Article makes it clear that properties devoted to worship, diocesan offices, Episcopal and priests' houses and seminaries are exempt. Therefore, strictly speaking, only the exemptions which the municipalities establish on other ecclesiastical properties should be considered municipal tax expenditures.
- Article 14 of Law 299 (1996) equips the municipalities with the power to exonerate, up to as much as 100% of the property law, land owned by botanical gardens or destined to that purpose, if and only if those institutions or their owners undertake environmental conservation activities subject to current legal provisions. The same Article also allows exemption from property tax those privately owned lands which are sanctuaries which suitably conserve vegetation and which measure no less than five hectares, or which have drawn up plans which are being carried out to run it, duly approved by the relevant environmental authority, or which have established a specific project of conservation in situ or ex situ with a legally recognized botanical garden.
- Article 10 of Law 322 (1996) authorizes the municipalities to set out special rates or exempt from payment of municipal taxes properties devoted to offices, workshops or training of the Fire Brigade.
- Article 45 of Law 418 (1997) authorizes municipalities to excuse from tax payments all victims of terrorist activity: fighting, attacks, massacres and so on.

### Reduced taxes/rates:

Article 4 of Law 44 (1990) establishes that the tax rate will range from 1 per mille to 16 per mille of the relevant valuation. The rates should be set in each municipality differentially and progressively, taking into account the socioeconomic levels, land use in the urban sector and when the land registry was set up or when updated.

In the case of building land not yet developed and developed land not yet built upon the rate could be set as high as 33 per mille.

This ruling allows the municipalities to fix the rates within the ranking and does not prevent them from setting different rates for the different activities, kinds of property or taxpayers. In accordance with the definition of Benchmark Tax, any rate below the legal maximum should be regarded as a tax expenditure.

The municipalities also have the authority to give discounts for prompt tax payment, which furthermore is usual practice. These discounts aim to encourage early payment of the tax and constitute a rate reduction that should be regarded as a tax expenditure.

Finally, some municipalities tend to offer amnesties to defaulting taxpayers. This is another kind of way of lowering the rate, which also qualifies as a tax expenditure.

### **3.5 Potential Tax Expenditures in Trade and Industry Tax**

We will now list those preferential treatments which the municipalities can potentially grant to specific taxpayers, in keeping with the attributes which tax legislation gives them in relation to trade and industry tax.

### Exemptions:

- Law 1333 (1986), Article 258, allows municipalities and the Special District of Bogotá to grant municipal tax exemptions, including on trade and industry tax, to specific groups of taxpayers, for a limited period which should not exceed ten years. These exemptions should conform to the municipal development plans.
- Article 24.1 of Law 142 (1994) establishes that the districts and municipalities can burden public service companies with rates, contributions or taxes which may be applicable to the rest of taxpayers who carry out industrial or commercial functions.

So one deduces from this that the municipalities can opt to not impose the trade and industry tax on such companies.

- Article 45 of Law 418 (1997) authorizes municipalities to excuse from tax payments all victims of terrorist activity: fighting, attacks, massacres and so on.

#### Reduced rates:

Article 196 of Law 1333 (1986) establishes the following ranking of rates:

1. From two to 7 per mille for industrial activities.
2. From two to 10 per mille for trade and service activities.

By the same token Article 208 of the same legal batch sets a 5 per mille rate for entities belonging to the financial sector.

This ruling allows the municipalities to fix the rates within the ranking and does not prevent them from setting different rates for certain activities or taxpayers. In accordance with the definition of the Benchmark Tax, any rate below the legal maximum should be regarded as a tax expenditure.

As in the case of the property tax, the municipalities also have the authority to give discounts for prompt tax payment, which is usual practice in trade and industry law. These discounts aim to encourage early payment of the tax and constitute a rate reduction that should be regarded as a tax expenditure.

Similarly, some municipalities offer amnesties to defaulting taxpayers on this tax, which should also be regarded as a tax expenditure.

## **4. Methodology for Measuring the Fiscal Impact of Tax Expenditures in Property and Trade and Industry Taxes**

### **4.1 General Methodological Definitions**

It was pointed out in Section 2 that three concepts are associated with the fiscal impact of tax expenditures: foregone revenue, earned revenue and the equivalent direct expenditure. Of the three, we propose choosing that of foregone revenue, for two reasons. Firstly, because it is simpler, as unlike the method of earned revenue there is no need to make assumptions about behavioral changes. The simplicity of the method is a virtue, especially at a regional government

level, as they do not always have the right professional expertise to face complex methodologies. Secondly, because it is consistent with the best practices defined by the OECD, according to which from a budgetary point of view, it delivers a more accurate estimate of the resources which would have to be devoted to direct expenditure to achieve the same effect as a tax expenditure.

It would be even better to opt for the method of equivalent direct expenditure, for which you would have to add to the initially estimated fiscal cost the amount of income tax which would affect the possible direct expenditure. However, this kind of exercise has been considered too sophisticated for the current level of development of fiscal estimates in the municipalities.

As for the specific methodologies for calculating foregone revenue, they depend on the kind of tax expenditure to be estimated and on the available information in each case. Experience in other countries shows that in general you have to resort to a wide range of methods. Nevertheless, looking at the main characteristics they have in common, four types of methodology can be singled out:

*Directly obtaining it from revenue statistics:*

Although it is rare, it is possible that some tax expenditures are declared in a specific entry on the tax return form and are registered in an account in the municipal accounting system. In these cases, the foregone revenue will correspond exactly to the balance of this account.

*Estimates using aggregate statistics:*

These methodologies consist of undertaking simple arithmetical calculations on aggregate statistics, obtained mainly from tax returns, but also from other sources, like national accounts. This approach is appropriate above all when the cost of the tax expenditure is a simple proportion of the total transactions. A case in point would be, for example, exemptions from property tax. If statistics are available with the total of exempt valuations, the foregone revenue would be estimated as the aggregate total of exempt valuation multiplied by the tax rate. It is also appropriate to use this method to estimate the revenue foregone by applying reduced rates, simply using the “rule of three” on the actual takings of the relevant rate.

*Aggregate simulation methods:*

With this approach, as in the previous one, it is done with aggregate statistics primarily from tax sources, but also from national accounts, budget surveys and others. Unlike the previous one, this

case demands a greater stratification of the aggregate statistics, as well as the development of mathematical algorithms of relatively greater complexity.

Models of this type are applied to calculating deductions and exemptions of personal income taxes or to estimate the cost of VAT exemptions from input-product matrices.

Microsimulation models:

Microsimulation models analyze detailed individual data, which usually come from tax returns, although occasionally alternative or complementary sources of data are used, such as budget surveys or corporate financial statements. Sometimes the universe of taxpayers is used in the model, while at others a statistically representative sample is used. The former have the edge in terms of precision, but take longer and need technological tools that have a greater capacity. In the case of municipalities, given the relatively low number of taxpayers, a microsimulation using the universe of taxpayers would not be hugely expensive.

Basically the microsimulation recalculates the taxes which each taxpayer is due to pay, simulating changes in the tax code. The foregone revenue is calculated from the difference of revenue between the situations with the change in law and without. These models are particularly useful for calculating tax expenditures which benefit groups of taxpayers whose characteristics are not visible in the aggregate statistics; exemptions and tax deductions with progressive rates and to quantify the joint or simultaneous effect of the tax expenditures.

In the light of the kind of tax expenditures municipalities may grant to their taxpayers, the information currently available, or what they are likely to have in the near future, and of the simplicity of the calculations, it seems reasonable to recommend doing the estimations based on aggregate statistics. The following section describes in great detail suggested methodologies for estimating each kind of tax expenditure.

## **4.2 Specific Methodologies**

### **4.2.1. Exemptions**

The tax expenditure of the exemptions for a certain kind of property, when talking about the property tax, or for a certain type of economic activity, when talking about trade and industry tax, will be calculated like this:

$$(1) \quad GT_i^{Ex} = BIE_i \times t_i^{Max}$$



Where BIE is the exempt taxable base and  $t^{\max}$  is the maximum rate permitted by law. In the case of property tax this rate will be 33 per mille if the exempt property is building land not yet developed, or developed land not yet built on, and 16 per mille for the rest of exempt properties. As for the trade and industry tax, the maximum rate will be 7 per mille for industrial activities; 10 per mille for trade or service activities; and 5 per mille for financial bodies. The subindex  $i$  represents a particular group of properties or establishments, which are benefiting from the exemption.

It is recommendable to first get hold of a table of statistics showing exempt property or taxpayers, classified by the different legal rules which set out exemptions and indicating the number of properties or taxpayers exempt and the aggregate exempt taxable base. To this same table one would add a column with the legal maximum rate and the estimated tax expenditure, as can be seen in the example for the case of property tax, in Table 1.

It is always possible that some municipalities will not have enough information about exempt properties or taxpayers. In this case, it will first be necessary to outline the procedures which will make it possible to always obtain the required statistics, before doing the estimate. This will involve taking the following steps:

- Identifying all the exempt properties or taxpayers according to the different regulations which generate tax expenditures.
- Classify each exempt property or taxpayer according to the legislation which gives rise to the benefit.
- In the case of the property tax, request from the Instituto Geográfico Agustín Codazzi the fiscal valuation of each exempt property, as well as a constant update of this information.
- As regards the trade and industry tax, establish that exempt taxpayers should be obliged to present a tax return, showing the taxable base.

In the case of the trade and industry tax, it is also essential that the municipalities demand the exempt establishments present a tax return, indicating the exempt taxable base at least.

**Table 1. Example of a Tax Expenditure Report of Exemptions from Property Tax**

Legislation	Property type	Number of properties	Exempt valuation (a)	Legal rate (b)	Tax expenditure (a)x(b)
Art. 258 Law 1333 (1986)		10	35,000,000	0.016	560,000
Art. 194 Law 1333 (1986)		0	0	0.016	0
Art. 24.1 Law 142 (1994)		0	0	0.016	0
Art. 24 Law 20 (1974)	Building land not developed or built on	2	2,000,000	0.033	66,000
	Other	8	15,000,000	0.016	240,000
Art. 14 Law 299 (1996)		1	800,000	0.016	12,800
Art. 10 Law 322 (1996)	Building land not developed or built on	1	1,000,000	0.033	33,000
	Other	0	0	0.016	0
Art. 45 Law 418 (1997)	Building land not developed or built on	1	600,000	0.033	19,800
	Other	5	4,000,000	0.016	64,000
<b>Total</b>		<b>28</b>	<b>58,400,000</b>		<b>995,600</b>

#### 4.2.2 Reduced Rates

The tax expenditure of reduced rates, for a certain kind of property, in the case of property tax, or for a certain kind of economic activity in the case of the trade and industry tax, will be calculated in the following way:

$$(2) \quad GT_i^{tr} = BI_i \times (t_i^{Max} - t_i)$$

Where BI is the taxable base,  $t_i^{max}$  is the maximum rate permitted by law and  $t_i$  is the effective rate applied by the municipality. The subindex  $i$  represents a particular group of properties or establishments, whom the reduced rate is applied to. At the same time, the tax expenditure associated with discounts for prompt payment will be calculated in this way:

$$(3) \quad GT_i^{pp} = BI_i \times (t_i - t_i^{pp})$$

Where BI (or TB?) is the taxable base,  $t$  is the effective rate applied by the municipality for each kind of property and  $t^{pp}$  ( $t^{pp}$  ?) is the reduced rate for prompt payment. It is important that the formula uses the effective rate ( $t$ ) and not the maximum rate that can be applied ( $t^{\max}$ ), so as to avoid accounting twice for part of the tax expenditure. In effect, in the equation (2) the difference between ( $t^{\max}$ ) and  $t$  has been counted, even for the taxpayers who benefit from the prompt payment.

Usually tax return forms include a box to jot down the discount for prompt payment. If this information is incorporated into the operative data bases of the municipalities, the tax expenditure can be easily estimated as the summation of the declared amounts found in these boxes. Other municipalities print the discounts they apply for prompt payment in the tax settlement form, depending on the date the tax is paid. In these cases the tax expenditure could be estimated as the difference between the calculated tax, before discounts, and the sum actually paid by the taxpayer.

In the case of property tax, the municipalities usually set up scales of rates for residential property and rural property, according to the valuation section or the socioeconomic level, and different rates for non-residential property, according to their specific purpose. In the case of trade and industry tax, it is common to set different rates for different groups of economic activities. With a view to contributing more information, it is recommendable that the tax expenditure report shows nonaggregated estimates according to the different categories of properties or taxpayers which are having reduced rates applied to them. By means of example, Tables 2 and 3 show what could be a tax expenditure report of reduced rates for the municipality of Barranquilla.

**Table 2. Example of a Tax Expenditure Report of Reduced Rates in Property Tax Municipality of Barranquilla (using fictitious data)**

Property type	Amount of properties	Taxable base (a)	Rate (b)	Benchmark rate (c)	Tax expenditure (a) x ((c)-(b))
Residential					
Level 1	350,000	525,000	0.0047	0.0160	5,933
Level 2	260,000	3,120,000	0.0056	0.0160	32,448
Level 3	148,000	4,884,000	0.0070	0.0160	43,956
Level 4	70,000	3,710,000	0.0083	0.0160	28,567
Level 5	21,000	1,638,000	0.0097	0.0160	10,319
Level 6	5,000	950,000	0.0110	0.0160	4,750
Uncategorized	1,000	9,000	0.0110	0.0160	45
Industrial	30,000	450,000	0.0115	0.0160	2,025
Commercial	60,000	1,020,000	0.0115	0.0160	4,590
Cultural	1,000	13,000	0.0115	0.0160	59
Recreational	900	15,300	0.0115	0.0160	69
Health	200	3,400	0.0115	0.0160	15
Institutional	250	4,250	0.0115	0.0160	19
National and District bodies	90	1,530	0.0160	0.0160	0
Development land not yet developed and Building land not built upon with a taxable base over 454 TVU (tax value unit).	3,000	51,000	0.0330	0.0330	0
Development land not yet developed and Building land not built upon with a taxable base under 454 TVU (tax value unit).	4,500	76,500	0.0120	0.0330	1,607
Not for development	700	3,500	0.0040	0.0160	42
Small rural	45,000	67,500	0.0057	0.0160	695
Medium-sized rural	18,000	270,000	0.0095	0.0160	1,755
Large rural	2,500	125,000	0.0150	0.0160	125
<b>Discounts for prompt payment</b>					<b>2,500</b>
<b>Total</b>	<b>1,021,140</b>	<b>16,936,980</b>			<b>139,518</b>

**Table 3. Example of a Tax Expenditure Report of Reduced Rates in Trade and Industry**  
**Tax: Municipality of Barranquilla** (*using fictitious data*)

Code	Name of activity	Number of companies	Taxable base (a)	Actual rate (b)	Benchmark rate (c)	Tax expenditure (a) x ((c)-(b))
<b>Industrial Activities</b>						
000101	Food production for human and animal consumption, with exception of drinks. Production of fertilizers and basic materials for agriculture and farming. Manufacturing pharmaceutical, chemical and botanical products	320	1,843,071	0.0042	0.007	5,160
000102	Production of non-alcoholic drinks and mineral water. Manufacture of garments, textiles, footwear and clothing. Cement manufacture and building material based on cement.	55	30,694	0.0054	0.007	49
000103	Manufacture of beer and other alcoholic drinks. Manufacture of tobacco products, cosmetics and perfumes, watches and jewelry.	8	16,647	0.0070	0.007	0
000104	Other industrial activities.	235	690,046	0.0070	0.007	0
<b>Commercial Activities</b>						
000201	Sales of food with exception of alcoholic drinks. Sales of chemical, agricultural and cattle products.	550	115,870	0.0042	0.010	672
000202	Sale of fuel and lubricants. Sale of pharmaceutical and medicinal products. Sale of materials for building, ironmongery and glass. Sale of printed matter, books, newspapers. Stationer's and sale of stationery and writing material and articles. Sale of new and second-hand vehicles.	200	7,959,186	0.0054	0.010	36,612
000203	Sale of cigarettes and liquors. Sale of perfumes, cosmetic products and toiletries in specialized establishments. Sales of motorbikes and trading in spare parts and accessories. Pawnbroker trading activities and dealing. Commercialization of	170	7,813,409	0.0100	0.010	0

<b>Code</b>	<b>Name of activity</b>	<b>Number of companies</b>	<b>Taxable base (a)</b>	<b>Actual rate (b)</b>	<b>Benchmark rate (c)</b>	<b>Tax expenditure (a) x ((c)-(b))</b>
	electrical energy.					
000204	Other commercial activities	400	5,836,015	0.0096	0.010	2,334
<b>Service Activities</b>						
000301	Education.	35	846,111	0.0020	0.010	6,768
000302	Transport, including rental. Social and personal services. Toilet, cleaning, medical, dental and veterinary services. Temporary employment agencies. Building and demolition equipment rental, including with staff and farming equipment rental. Services given by building contractors, builders and developers. Detective and security services. Waste disposal and sewage management and similar activities.	225	813,066	0.0054	0.010	3,740
000303	Accommodation services in hotels, hostels, apart-hotels, residences, motels, lodgings and so on. Services of restaurants, cafeterias, bars, grills, discotheques and similar. Pipeline transport. Public domestic services and complementary activities.	89	395,226	0.0100	0.010	0
000304	Other service activities	91	59,957	0.0096	0.010	23
<b>Financial Activities</b>						
000401	Activities for financial institutions	9	3,625,482	0.0050	0.005	0
<b>Discount for prompt payment</b>						15,345
<b>Total</b>		<b>2,387</b>	<b>30,044,786</b>			<b>70,706</b>

## **5. An Example of Tax Expenditure Estimation for the Municipality of Santa Cruz de Lorica**

### **5.1 Identifying Tax Expenditures in Unified Property Tax**

The tax code of the municipality of Lorica sets out a series of tax expenditures for the property tax, which will be classified into exemptions, reduced rates with regard to the benchmark rate of 16 per mille and reduced rates with regard to the benchmark rate of 33 per mille.

#### Exemptions:

- a. Properties that belong to religious faiths and are used solely for worship and for accommodation for religious communities, for diocesan priests and archdeacons, bishops' and priests' homes and council seminaries are all exempt from this tax. Other properties or zones with a different purpose will be liable to the unified property tax.
- b. Properties owned by the *Liga contra el Cáncer, la Tuberculosis, la Epilepsia* (Organisation against Cancer, Tuberculosis and Epilepsy) and the *Cruz Roja Nacional* (National Red Cross) are exempt from the tax.
- c. Properties owned by the National Police, Civil Defense, Fire Brigade, the Public Prosecutor's office, and state schools are exempt.
- d. Exemption from the property tax will be granted for a period of five years to real estate used exclusively for:
  - i. Commercial centers with at least 15 commercial premises.
  - ii. Warehouses
  - iii. Residential complexes with over 50 homes completed
  - iv. Agro-industrial centers which are built as new from the moment the agreement which sets them up is valid.

#### Reduced rates relative to benchmark rate of 16 per mille:

Current rates, and the differential relative to the benchmark rate, are summed up in the following table.

**Table 4. Property Tax in the Municipality of Santa Cruz de Lorica: Annual Rates and Differential Relative to Benchmark Rate**

<b>Registry valuation</b>	<b>Annual rate (per mille)</b>	<b>Differential (per mille)</b>
<b>1. Urban Property</b>		
a. Homes		
From 0 to 5 million	5	11
From 5,000,0001 to 25 million	6	10
From 25,000,001 to 45 million	7	9
From 45,000,001 to 65 million	9	7
From 65,000,001 to 100 million	10	6
From 100,000,001 upwards	14	2
b. Commercial buildings	12	4
c. Industrial buildings	8	8
d. Buildings linked to the financial sector	15	1
e. Properties linked to mixed use	10	6
<b>2. Rural Properties</b>		
From 0 to 5 Million	4	12
From 5,000,001 to 10 million	5	11
From 10,000,001 to 20 million	6	10
From 20,000,001 to 50 million	7	9
From 50,000,001 to 100 million	9	7
From 100,000,001 upwards	12	4

Source: Tax Code of the Municipality of Santa Cruz de Lorica

Reduced rates relative to benchmark rate of 33 pe rmille:

Current rates, and the differential relative to the benchmark rate, are summed up in the following table.



**Table 5. Property Tax in the Municipality of Santa Cruz de Lorica: Annual Rates of Properties not Developed or Built upon and Differential Relative to the Benchmark Rate**

Kind of building	Annual Rate (per mille)	Differential (per mille)
a. Developable property not developed	22	11
b. Developable property not built upon	22	11
c. Developed property not built upon in a territorial area	16	17

Source: Tax Code of the Municipality of Santa Cruz de Lorica

## 5.2 Identifying Tax Expenditures in the Trade and Industry Tax

The Tax Code in the municipality of Lorica sets out a series of tax expenditures for the Trade and Industry Tax, which will be classified into exemptions, reduced rates relative to the benchmark rate of seven per mille and reduced rates relative to the benchmark rate of 10 per mille.

### Exemptions:

There is only one exemption considered in this tax, which favors for a period of five years industrial, commercial and service companies which set up in the municipality, if and only if they provide at least fifteen new, full-time jobs from the moment they start operating, for people originally from the municipality, or who have lived there for the previous five years. To date only one company has been able to avail itself of this exemption.

### Reduced rates, relative to the benchmark rate of 7 per mille:

Current rates for industrial activities, and the differential relative to the benchmark rate of 7 per mille, are summed up Table 6.

**Table 6. Tax on Industrial Activities in the Municipality of Santa Cruz de Lorica: Annual Rates and Differential Relative to the Benchmark Rate**

Code	Industrial activity	Current rate (per mille)	Differential (per mille)
101	Manufacture and production of food and drink, manufacture of footwear, clothes and other garments	5	2
102	Manufacture of primary products of iron and steel, manufacture of transport equipment	6	1

Source: Tax Code of the Municipality of Santa Cruz de Lorica

Reduced rates, relative to the benchmark rate of 10 per mille:

Current rates for commercial and service activities, and the differential relative to the benchmark rate of 10 per mille, are summed up in Tables 7 and 8.

**Table 7. Tax on Commercial Activities in the Municipality of Santa Cruz de Lorica: Annual Rates and Differential Relative to the Benchmark Rate**

Code	Commercial activity	Current rate (per mille)	Differential (per mille)
200	Exclusively wholesale distributors of cement, milk.	3	7
201	Shops, granaries, warehouses which sell provisions , grain and groceries	4	6
202	Building material sales; automobile sales including motorbikes, ironmongers', stationers', sale of both homeopathic and natural drugs. Exclusively wholesale sales of beer and liquor	5	5
203	Supermarkets, sales of veterinary drugs and agricultural supplies, sales of garments, clothes, footwear, fabrics, household appliances and furniture.	6	4
204	Sales of lottery tickets, raffle tickets, draws, secondhand shops, jewelry, luxury goods.	7	3
206	Other commercial activities	7	3

Source: Tax Code the Municipality of Santa Cruz de Lorica

**Table 8. Tax on Industrial Service Activities in the Municipality of Santa Cruz de Lorica: Annual Rates and Differential Relative to the Benchmark Rate**

Code	Service activity	Current rate (per mille)	Differential (per mille)
300	Services of official and unofficial private education, clinical laboratories, universities, technical colleges, magazine, book and newspaper publishing.,	4	6
301	Hairdressers', shoe shops, electronic services, mechanical repair workshops in general, videos, tailors'.	5	5
302	Services of transport, television broadcasting and programming.	6	4
303	Specialist consultancies, contractors' services in public building works, builders, consultants, advisers and town planners and film projection in cinemas, public shows (theatre, musical, leisure, circuses).	7	3
304	Real estate agents, private security for rental properties.	8	2
305	Private clinics, massage parlors, beauty parlors.	9	1
307	Other service activities	7	3

Source: Tax Code of the Municipality of Santa Cruz de Lorica

## 5.3 Estimates

### 5.3.1 Tax Expenditures in Property Tax

Through the DAF (State Department of Fiscal Support) it was possible to have access to the municipality of Lorica's property data base, which contains, among other data, the property identification, name of the owner, its classification and the fiscal valuation. The data base did not include mention of the exempt properties. Nevertheless, through the names of owners it was possible to recognize those which belonged to the churches and the National Red Cross. Estimates of these tax expenditures are shown in Table 9. As can be seen, the fiscal cost of the exemptions identified is estimated at \$ Col 18.1 million.

**Table 9. Tax Expenditures 2009: Property Tax Exemptions**  
Figures in nominal Colombian pesos

Legislation	Amount of properties	Exempt valuation (a)	Legal rate (b)	Tax expenditure (a)x(b)
Art. 258 Law 1333 (1986)				
Commercial centers with at least 15 commercial premises	N.I.	N.I.	0.016	N.I.
Warehouse	N.I.	N.I.	0.016	N.I.
Residential complexes with over 50 homes completed	N.I.	N.I.	0.016	N.I.
Agro-industrial centers	N.I.	N.I.	0.016	N.I.
Art. 24 Law 20 (1974), ecclesiastical properties	31	1,041,622,000	0.016	16,665,952
Art. 10 Law 322 (1996), Fire Brigade buildings	N.I.	N.I.	0.016	N.I.
Others			0.016	
League against cancer, tuberculosis and epilepsy	N.I.	N.I.	0.016	N.I.
National Red Cross	2	87,114,000	0.016	1,393,824
Total	33	1,128,736,000		18,059,776

Source: Author using information given by the DAF (State Department of Fiscal Support).

With the data currently available it has also been possible to estimate the tax expenditure by reduced rates for residential and rural buildings. However, there is still not enough information available to estimate the other lines. Table 10 shows the estimates obtained this way. This tax expenditure rose to \$ Col 1,597.0 million in 2009. From this total, 84 percent corresponds to reduced rates on residential buildings and 16 percent to reduced rates on rural properties.

**Table 10. Tax Expenditures 2009: Reduced Rates in Property Tax**  
 Figures in nominal Colombian pesos

Type of Property	Amount of properties	Taxable base (a)	Rate (b)	Benchmark rate (c)	Tax expenditure (a) x ((c)-(b))
Residential					
From 0 to 5 million	9,883	15,257,752,547	0.005	0.016	167,835,278
From 5,000,0001 to 25 million	5,596	63,524,029,000	0.006	0.016	635,240,290
From 25,000,001 to 45 million	966	31,651,293,000	0.007	0.016	284,861,637
From 45,000,001 to 65 million	275	14,663,424,000	0.009	0.016	102,643,968
From 65,000,001 to 100 million	174	13,650,760,000	0.010	0.016	81,904,560
From 100,000,001 upwards	169	31,469,129,000	0.014	0.016	62,938,258
Commercial buildings	N.I.	N.I.	0,012	0.016	N.I.
Industrial building	N.I.	N.I.	0.008	0.016	N.I.
Buildings linked to the financial sector	N.I.	N.I.	0.015	0.016	N.I.
Buildings of mixed use	N.I.	N.I.	0.010	0.016	N.I.
Rural properties					
From 0 a 5 millones	2,493	3,294,816,400	0.004	0.016	39,537,797
From 5,000,001 to 10 million	410	2,967,656,000	0.005	0.016	32,644,216
From 10,000,001 to 20 million	320	4,530,718,000	0.006	0.016	45,307,180
From 20,000,001 to 50 million	246	7,312,679,000	0.007	0.016	65,814,111
From 50,000,001 to 100 million	62	4,172,580,000	0.009	0.016	29,208,060
From 100,000,001 upwards	49	12,256,648,000	0,012	0.016	49,026,592
<b>Discounts for prompt payment</b>	<b>N.I.</b>				<b>N.I.</b>
<b>Total</b>	<b>20,643</b>	<b>204,751,484,947</b>			<b>1,596,961,947</b>

Source: Author using information given by the DAF (State Department of Fiscal Support).

### 5.3.2 Tax Expenditures in the Trade and Industry Tax

So as to quantify the tax expenditures of the trade and industry tax the municipality of Lorica, was asked, via the DAF, for a data base showing the 2009 tax returns. This database contains, among other information, the identification of the establishment and its proprietor, the taxable base, the tax value, the economic activity code and the rate applied to each establishment. Calculating the fiscal cost of the exemptions is relatively simple in this case, as there is only one exemption, for companies that provide at least 15 new full-time jobs, and to date only one firm has fulfilled those requirements. So this firm had to be identified in the data base and apply the benchmark rate to the taxable base declared. The calculation is shown in Table 11.

**Table 11. Tax Expenditures 2009: Exemptions in the Trade and Industry Tax**  
 Figures in nominal Colombian pesos

<b>Legislation</b>	<b>Amount of properties</b>	<b>Exempt valuation (a)</b>	<b>Legal rate (b)</b>	<b>Tax expenditure (a)x(b)</b>
Art. 258 Law 1333 (1986)				
Industrial, commercial or service companies which provide at least 15 new full-time jobs from the moment they start operating	1	180,189,166	0.016	1,801,892
<b>Total</b>	<b>1</b>	<b>180,189,166</b>		<b>1,801,892</b>

Source: Author using information given by the DAF (State Department of Fiscal Support).

Regarding reduced rates, the estimates are shown in Table 12, according to economic activities. As can be seen, there are 2,046 establishments which pay the tax, which adds up to a total, before prompt payment discounts are deducted, of \$ Col 95.1 million. The tax expenditure for reduced rates totals \$ Col 41.8 million, which is equivalent to 44 percent of the revenue. Out of this total, 80.3 percent are categorized into commercial activities, 17.4 percent in service activities and 2.3 percent in industrial activities.

The fact the tax expenditure is seen as negative for two groups of economic activities is quite noticeable. The reason behind it is that the municipality has established a minimum tax, equivalent to 80 percent of the current legal minimum daily salary. This leads to the fact that some low taxpayers pay a tax higher than they should if the maximum legal rate is applied to their taxable base.

**Table 12. Tax Expenditures 2009: Reduced Rates in Trade and Industry Tax**

Figures in nominal Colombian pesos

Code	Name of activity	No. of taxpayers	Taxable base	Rate	Benchmark rate	Actual revenue	Tax expenditure
<b>Industrial Activities</b>							
000101	Manufacture and production of food and drink, manufacture of footwear, clothes and other garments	28	511,964,383	5	7	2,602,730	981,021
000102	Manufacture of primary products of iron and steel, manufacture of transport equipment	4	8,526,300	6	7	56,442	3,242
000103	Other industrial activities	25	191,679,476	7	7	1,364,828	-23,072
<b>Commercial Activities</b>							
000200	Exclusively wholesale distributors of cement, milk.	1	32,186,333	3	10	96,559	225,304
000201	Shops, granaries, warehouses which sell provisions, grain and groceries	419	2,210,885,151	4	10	10,051,155	12,057,697
000202	Building material sales; automobile sales including motorbikes, ironmongers', stationers', sale of both homeopathic and natural drugs. Exclusively wholesale sales of beer and liquor	257	2,170,391,535	5	10	11,120,339	10,583,577
000203	Supermarkets, sales of veterinary drugs and agricultural supplies, sales of garments, clothes, footwear, fabrics, household appliances and furniture.	120	1,621,115,326	6	10	9,869,040	6,342,113
000204	Sales of lottery tickets, raffle tickets, draws, secondhand shops, jewelry, luxury goods.	3	4,587,000	7	10	34,584	11,286
000205	Sale of petrol-based fuels and activities defined as mercantile in sections 3, 5 and 6 of the Código del Comercio (Code of Commerce)	19	102,750,700	10	10	1,032,164	-4,657
000206	Other commercial activities	608	1,745,656,076	7	10	13,089,690	4,366,871
<b>Service Activities</b>							
000300	Services of official and unofficial private education, clinical laboratories, universities, technical colleges, magazine, book and newspaper publishing.	22	235,031,019	4	10	1,001,016	1,349,294

000301	Hairdressers', shoe shops, electronic services, mechanical repair workshops in general, videos, tailors'.	104	225,851,792	5	10	1,385,854	872,664
000302	Transport services and television broadcasting and programming.	14	109,785,018	6	10	678,187	419,663
000303	Specialist consultancies, contractors' services in public building works, builders, consultants, advisers and town planners and film projection in cinemas, public shows (theatre, musical, leisure, circuses).	5	16,654,893	7	10	116,999	49,549
000304	Real estate agents, private security for rental properties	17	58,076,747	8	10	471,917	108,851
000305	Private clinics, massage parlours, beauty parlours	2	1,154,556	9	10	20,168	-8,622
000306	Bars, Saloons, Motels, hotels, Inns, <i>Estancos</i> , <i>Estaderos</i> (government stores), snack bars, discotheques, social clubs, <i>Galleras</i> (for cockfighting), hydroelectric plants, electrical plants, mixed firms and public social services, telecommunication companies, satellite dishes, cable and satellite television.	162	2,506,757,359	10	10	25,330,699	-263,126
000307	Other service activities	230	1,654,133,807	7	10	11,775,632	4,765,706
<b>Financial Activities</b>							
000402	Other financial bodies	6	1,007,078,581	5	5	5,035,393	0
<b>Discounts for Prompt Payment</b>		<b>N.I.</b>					<b>N.I.</b>
<b>Total</b>		<b>2,046</b>	<b>14,414,266,051</b>			<b>95,133,396</b>	<b>41,837,361</b>

Source: Author's elaboration using information given by the DAF (State Department of Fiscal Support).

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