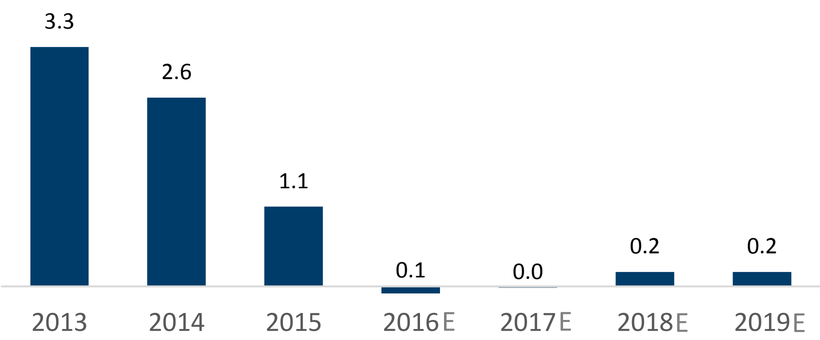
Considerations about the proposed fiscal reform

October 2016

Tax Reform – Why is it needed?

1. Government Revenues from Oil (% of GDP)

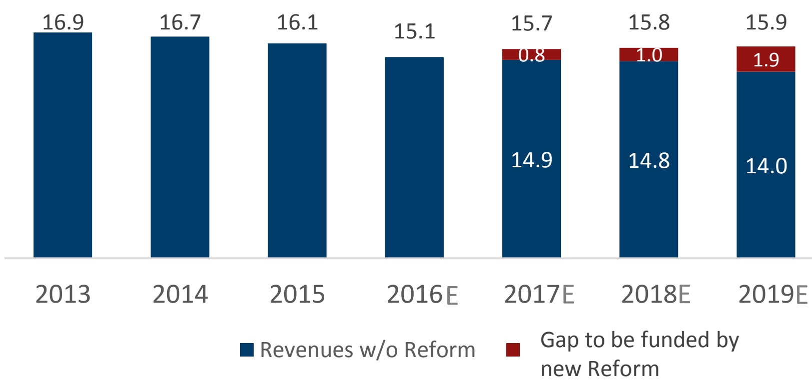
Oil revenues amounted to USD 8 bn. or 3.3% of GDP in 2013. As the price of oil declined, Government's revenues from this sector decreased to close to 0% of GDP.



2. Taxes derived from the fiscal reform of 2014 were "temporary"

Taxes such as the wealth tax and the CREE surcharge (created in 2014) will fade away in 2018 - 2019. The 4x1000 tax is also slated to disappear.

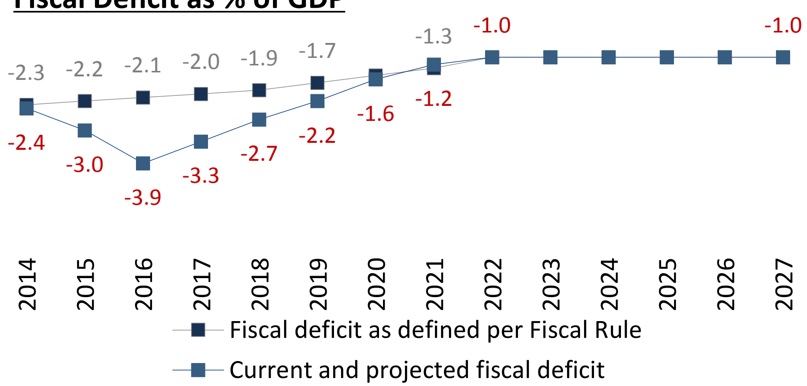
Fiscal Revenues as % of GDP



3. The Fiscal Rule forces an improvement in the Fiscal Deficit

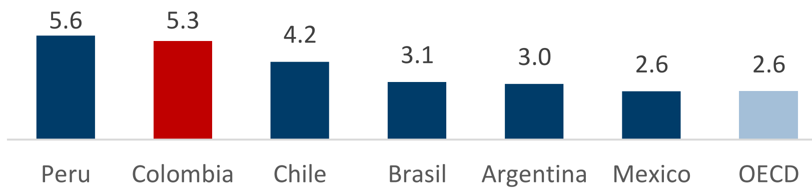
The Fiscal Rule requires Government to improve its fiscal deficit to 1.0% of GDP by 2022. Every percentage point represents close to COP 8 bn (USD 2.7 bn.) based on Colombia's GDP of 2015

Fiscal Deficit as % of GDP



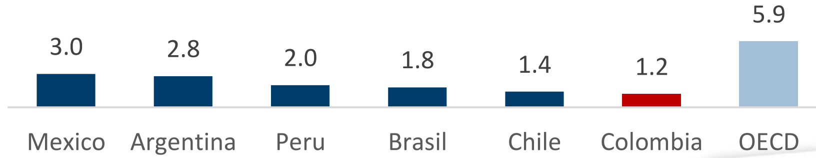
4. The current income tax burden on the largest corporations is not sustainable

Income tax collections from companies as % of GDP



80% of the tax collection in Colombia comes from 1% of the companies

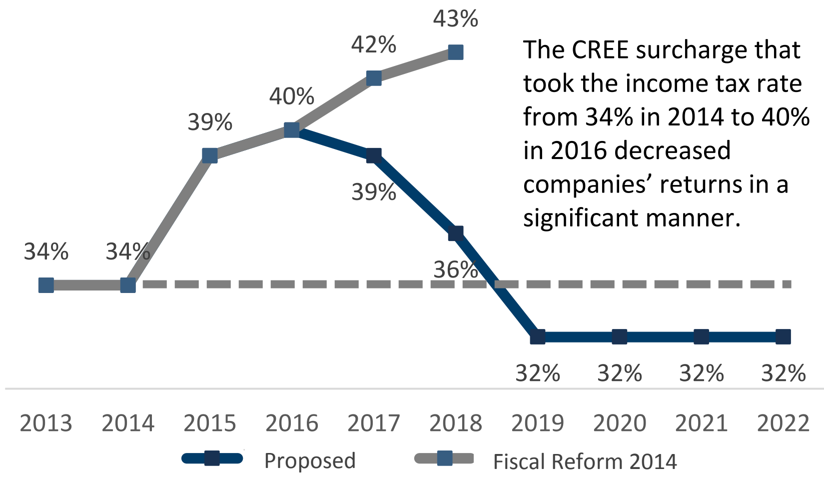
Income tax collections from individuals as % of GDP



Source: ***Tax Reform initiative submitted to Congress and Presentations of the Ministry of Finance***. This document has been prepared as a summary of the Tax Reform presented to congress by the Colombian Ministry of Finance and is solely based on the content of the Tax Reform Initiative and on the explanations provided by the Ministry of Finance with respect to the same. Accordingly, this presentation is not intended to be thorough, to express an opinion or to constitute an advise on the foregoing.

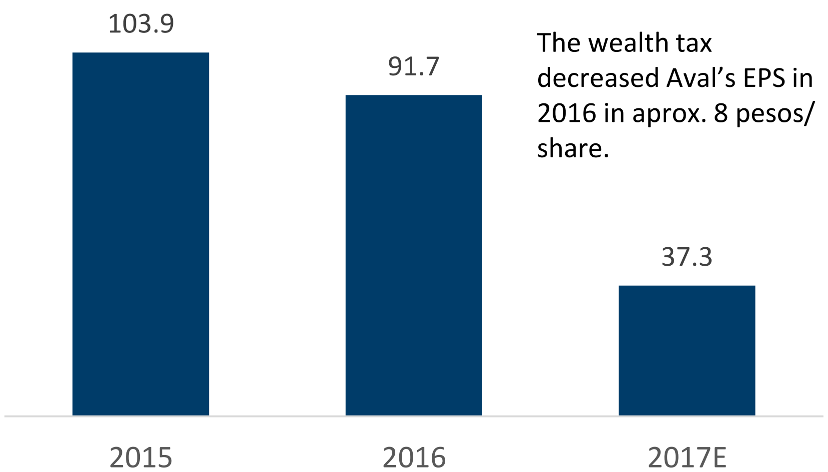
Tax Reform – Main aspects of the proposed Fiscal Reform (1/2)

1. Decline in corporate income tax to 32% from current 40%



2. Elimination of the Wealth Tax in 2018

Consolidated Wealth Tax Paid by Grupo Aval (US millions)



3. The 4x1000 tax on financial transactions will continue

- This "temporary tax" was supposed to disappear in 2018.
- Because Government has identified it as a steady source of income and one of easy collection, the Reform proposes its continuance.
- This tax contributes with 0.8% of GDP (aprox. USD 2.3 billion/ year)

4. Broadening of tax payer base

- More than 400,000 new individuals will declare and are expected to pay taxes. However, lower income population with a monthly income of less than COP 3 million, which represents more than 80% of the total, will continue to be exempt.

5. New simplified taxes on small businesses

- A simplified tax regime is expected to facilitate SMEs to declare and pay taxes

6. Increase in VAT

- VAT increases from 16% to 19% taking this tax to LATAM levels.
- Key exemptions: basic goods, education, medicine, public transportation, low and mid income housing.

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Tax Reform – Main aspects of the proposed Fiscal Reform (2/2)

7. New taxes on consumption

- New taxes: New houses with value over USD274,000, cigarettes, sugar drinks, gasoline, and news papers, among others.

9. Other matters

- Improvements in capacity and tax collection effectiveness in DIAN (local tax authority).
- Severe sanctions to large tax evaders.

8. Taxes on dividends

- Individuals with a dividend income of more than COP 29.7 million/ year will pay a 10% income tax.
- Dividends paid to local companies are exempt.
- Preferred shares are treated as financial liabilities for fiscal purposes. Its dividends should be accounted for as financial income when received, and thus should pay taxes.

Government's goals if fiscal reform is approved

1. Formalization of the economy
2. Sustainable employment generation
3. Higher GDP per capita
4. Higher Investment to GDP ratio
5. Lower Fiscal Debt levels
6. Fiscal deficit ratio improvement
7. Potential credit rating improvement

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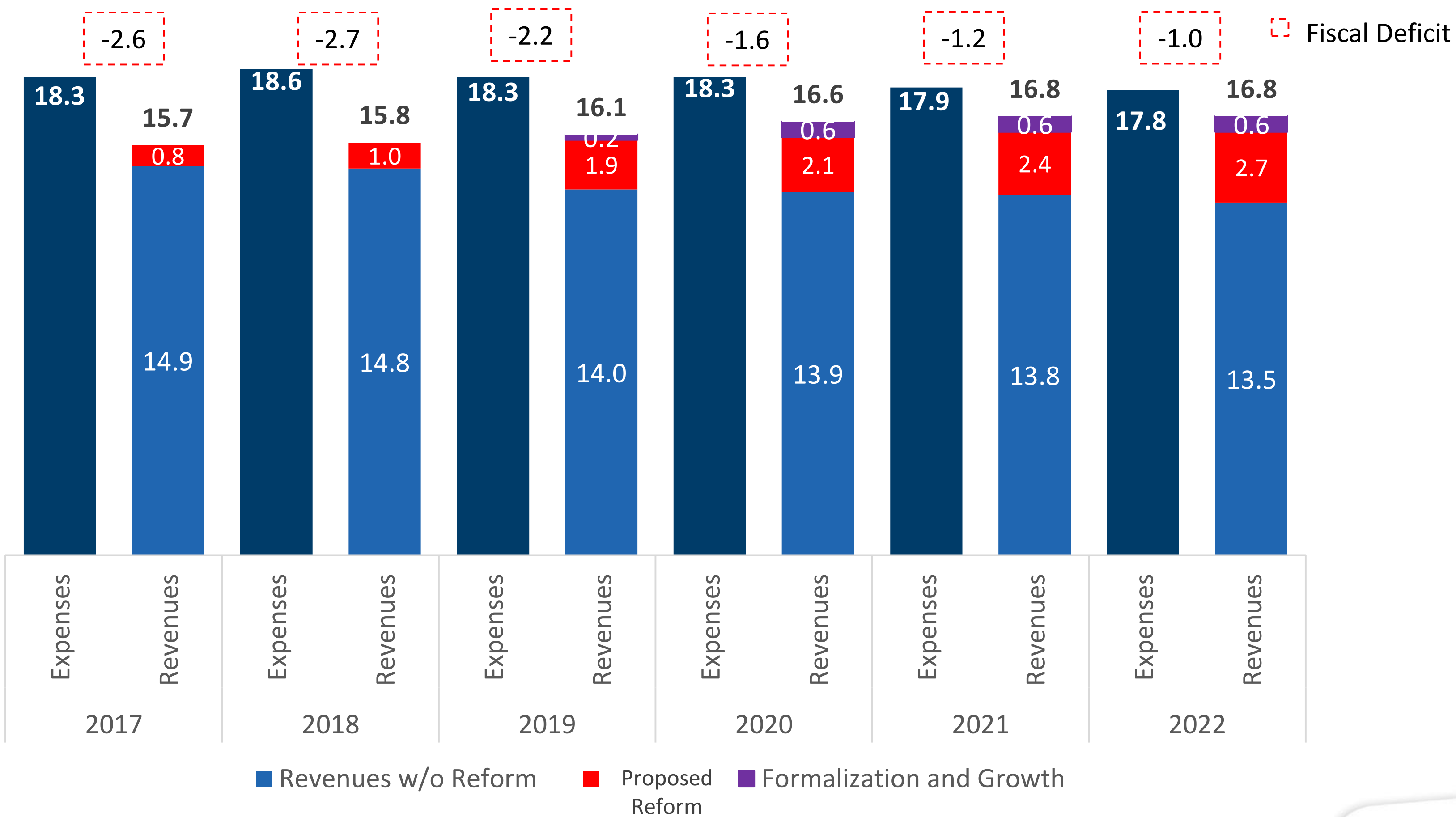
Tax Reform – expected improvements in Fiscal Deficit as % of GDP

Projected Fiscal Deficit (% of GDP)

- As the Government increases revenues from taxes, mainly from VAT, and decreases its debt levels, the Fiscal Deficit should improve.
- The current fiscal reform, if approved, will generate higher tax revenue to the Government by 2022 (reaching 2.7% of GDP).
- An additional 0.6% of GDP is expected to come from the “formalization and marginal growth of the economy”



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