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# A long way from tax justice: the Brazilian case

Lena Lavinás

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#### **Contact Address**

Hochschule für Wirtschaft und Recht Berlin

IMB - Prof. Hansjörg Herr

Badensche Str. 52

D-10825 Berlin

E-mail: [glu.workingpapers@global-labour-university.org](mailto:glu.workingpapers@global-labour-university.org)

<http://www.global-labour-university.org>

**Layout:** Harald Kröck

**Editing:** Barbara Schmitz

# A LONG WAY FROM TAX JUSTICE: THE BRAZILIAN CASE

Lena Lavinás

In collaboration with Thiago Andrade Moellmann Ferro

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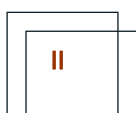
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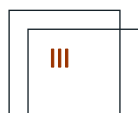
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## ABSTRACT

This paper presents the major characteristics of the Brazilian tax system, after underlining the modifications it went through since 1988, when the country adopted a new and democratic Constitution. One important feature is the marked incidence of indirect consumer and production taxes (49% of all tax revenues) in place of direct taxes on income, inheritance, and capital gains. This imbalance between indirect and direct taxes explains, in large part, the elevated regressivity of the Brazilian tax system, which both expresses and reproduces the profound inequalities that characterize Brazilian society.



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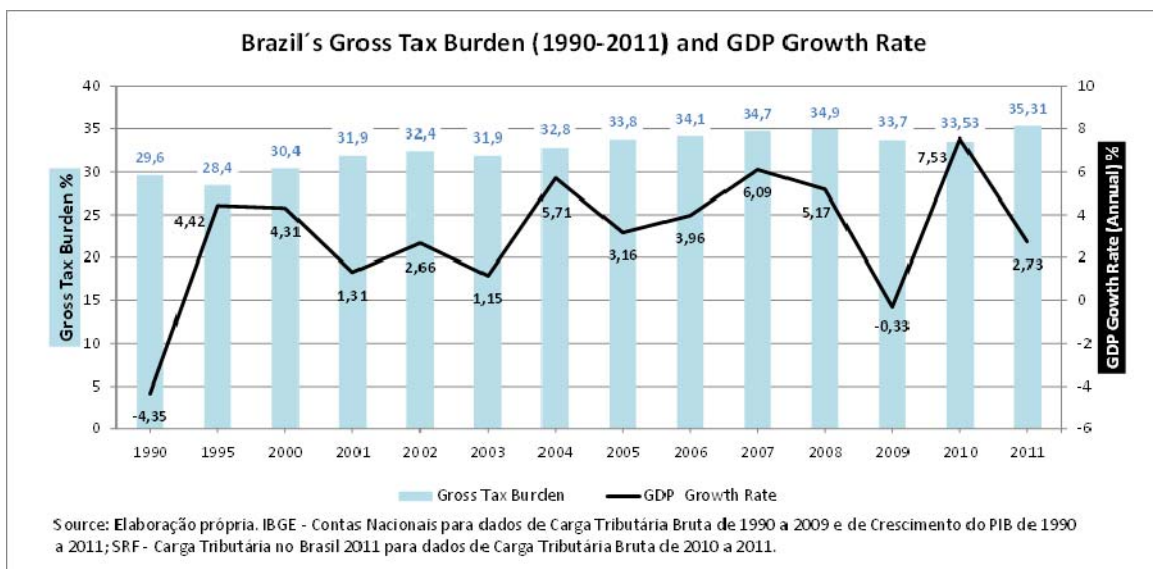
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## 1. INTRODUCTION

Specialists tend to highlight two essential features when they describe the Brazilian tax system. First, the elevated level of the gross tax burden is said to be “[...] far above average among emerging economies [...]” and second, it causes distortions that jeopardise the quality of Brazil’s tax system through its redistributive impact (Afonso, Soares, and Castro 2013).

As a matter of fact, the country’s gross tax burden increased from 14% of GDP at the end of the 1940s<sup>1</sup> to just over 35% in 2011. And thus, it became one of the highest tax burdens paid in South America (Breceda, Rigolini & Saavedra 2009; Gómez Sabaini & Jimenez 2012). Graphic 1 shows the recent development of the tax burden and its associated GDP growth rates during the period between 1990 and 2011.

Graphic 1



In 2011, Brazil’s gross tax burden reached 35.31%, which is close to the average rate among OECD countries and, thus, separates itself from the Latin American average by around 20% of GDP. The highest increases of taxes were registered during the 1960s, when the military ruled the country taxes rose to 25% of GDP, and during the late 1990s when the economy followed a new stabilisation plan the tax burden rose above 30% (SRF 2011).

The Brazilian tax system is biased. To present this one can compare the indirect consumer and production taxes to the direct taxes on income, inheritance, and capital gains. In this regard, the Brazilian tax system is very similar to the prevailing types seen across Latin America, where its “[...] indirect taxes on goods and services, which affect the entire population regardless of income level,

<sup>1</sup> The Contas Nacionais do Brasil (Brazilian National Accounts) began keeping records in 1947 (Varsano 1998).

constitute a disproportionate share of total tax income [...]” (Arnson and Bergman 2012).

In 2010, the OECD computed that the weight of these indirect taxes on goods and services were around 34% for its member countries, in contrast to this the weight of direct taxes only represented around 33%.<sup>2</sup> In Brazil, indirect taxes on consumption (ICMS- General Consumption Tax -, or value-added tax) contributed to 49.22% of the tax revenue in 2011. Brazil portrays a regressive taxation system. None of the goods and services, especially not those broadly consumed by the poorest people of the population, are wholly exempt from taxes. Contrary, taxes on income (individual or corporate) and other gains comprise to only 19.02% of the tax revenue. Additionally, estate taxes amount to just 3.70% (SRF 2012). Payroll taxes account for 25.76%, or ¼ of the tax burden, which is the highest rate among all direct taxes – despite the fact that 47.6% of the labour market is engaged in the informal sector (IBGE 2011 or Brazilian National Bureau of Census).

The literature on public finance has solidified that most direct taxes are progressive and the higher the taxes are the greater is the progressivity (Barr 2004; Gardner 2007). In Brazil, however, regressive taxation remains penalizing those at the tail end of the income distribution, which represent people with extremely high consumption, workers and employers. Moreover, wealth is not taxed. A most blatant example for this is the estate tax. Hereditary succession is taxed at the state level with rates varying between 2% and 4%. Further, inheritances and donations are exempt from an income tax in Brazil. Afonso, Soares, and Castro (2013) summarized the situation as following: “[...] the types of taxes that would be fair from a distributive point of view play a secondary role in the Brazilian tax system, increasing its distortions.”

This biased structure of the tax system translates directly into the system’s low contribution to improve inequality in Brazil. Over the course of the 2000s, the Gini index, calculated using employment income, fell from 0.566 in 2001 to 0.501 in 2011. This is depicted in Graphic 2 below.

The improvement of the Gini coefficient was in large part due to Brazil’s achievement of sustained economic growth in the decade in question and to an increase in formal employment<sup>3</sup> and, consequently, formal salaries (Graphic 2). In particular, the minimum wage acknowledged a real increase over 93% between January 2001 and December 2012 (Lavinias 2012; Lavinias 2013).

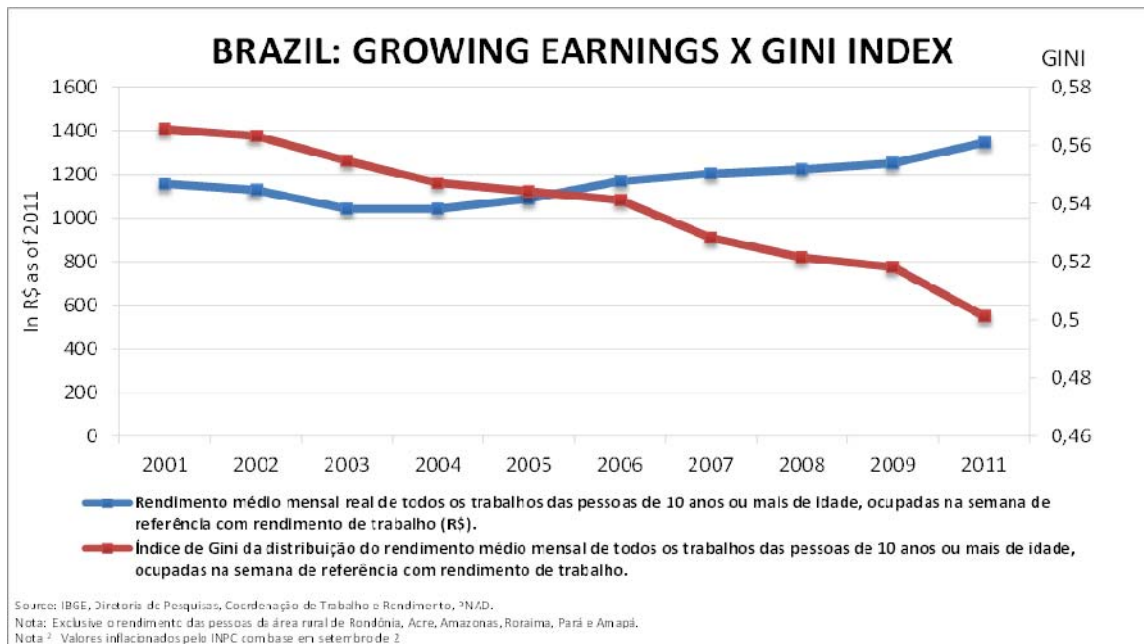
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<sup>2</sup> Estimates drawn by Gómez Sabaini & Jimenez (2012) for the year 2006 calculate that this is the second-highest percentage, compared to other regions of the world. Only sub-Saharan Africa, with a low tax burden and fairly inadequate structure, has more indirect taxation as a percentage of its tax burden.

<sup>3</sup> Between 2003 and 2011, there was a net creation of more than 13 million formal jobs, making the percentage of informal labor (including unprotected and undeclared work as well as unpaid work) fall to 47.60%, as opposed to 57.30% in 2003.



Graphic 2

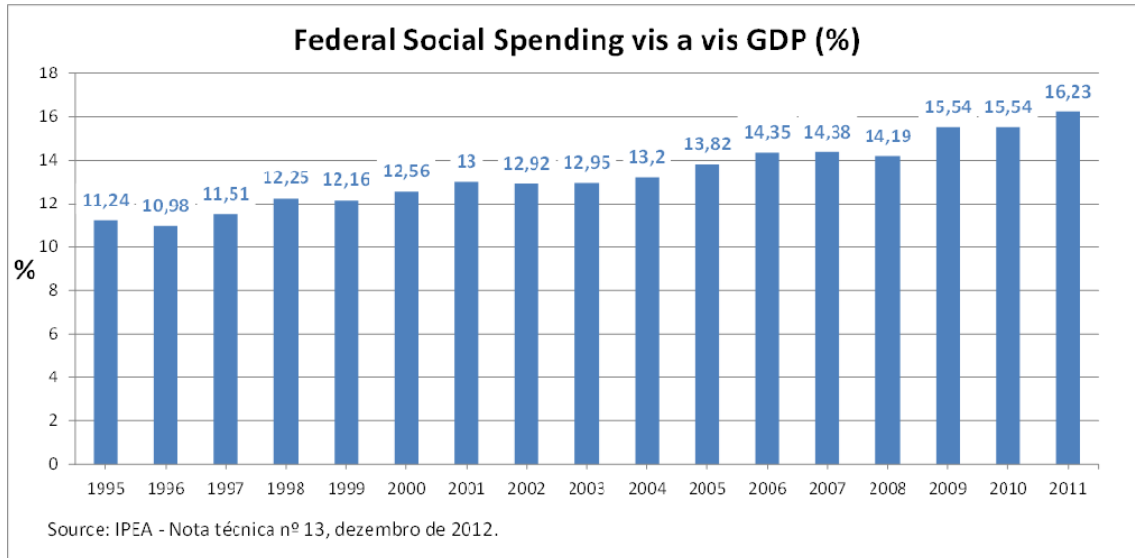


At the same time, the Brazilian Social Security created in 1988 gained institutional strength and was able to increase its monetary transfers to the most socially vulnerable groups living in poverty. The Bolsa Família (45 million beneficiaries at an annual cost of \$10.25bn) or the Continuous Cash Benefit Program (4 million beneficiaries, for an annual sum of \$15.1bn) transferred money to the elderly or disabled people that, in particular, live in families below the poverty line<sup>4</sup> (Fonseca and Lavinás 2013). Moreover, the Brazilian social security system standardized the minimum pension for urban and rural workers based on minimum wages and, further, it extended the right of pensions to groups with low contributive density. Consequently, the Brazilian social security system exerts significant redistributive measures. Data from the 2011 Brazilian National Household Survey (PNAD) demonstrated that the combination of minimum cash transfers, pensions and survivors benefits did provide monetary benefits between US\$32 and US\$310 a month to 85% of those Brazilians over the age of 65. Nevertheless, the poor people are mainly represented by children, adolescents and working-age adults, whereby the elderly only comprised to around 1.12% of the poor people in 2011.

<sup>4</sup> Brazil has no official poverty line. In practice, two income levels are used, which depends on the program in question. In the case of the Bolsa Família, poverty is defined by a per-capita familial income below R\$140 or \$63.63 per month, and destitution by an income of R\$70 or \$31.81 per month.

Therefore, the reduction in inequality and poverty<sup>5</sup>, as mentioned above, was the result of the economic recovery experienced and the expansion of social spending that reached 16.23% of GDP<sup>6</sup> in the year 2011 (IPEA 2012). Graphic 3 shows the recent evolution in federal social spending<sup>7</sup> vis-à-vis GDP.

**Graphic 3**



According to the United Nation Development Programme (UNDP), in 2013, Brazil was still the 17<sup>th</sup> most unequal nation in the world (The World Factbook 2014). This can mainly be attributed to its existing tax system that, as Afonso (2013a) put it, “[...] reproduces the economic, social, and political inequality of the country. It impedes social levelling.” This is an additional characteristic the Brazilian tax system has in common with the taxation standards across Latin America, “[...] where the redistributive effect of transfers is far greater than any such effect from taxes. The estimated average of the redistributive impact of taxes in the OECD is 13 times greater than corresponding estimates for Latin America, while this ratio drops to 3.5 with regard to the impact of redistribution through transfers [...]” (Gómez Sabaini & Jimenez 2012).

Although income distribution by quintiles developed positively during the last decade, they reveal an unfathomable inequality between the wealthiest and the least fortunate (see Graphic 4). From 2001 to 2011, the poorest 20% of the

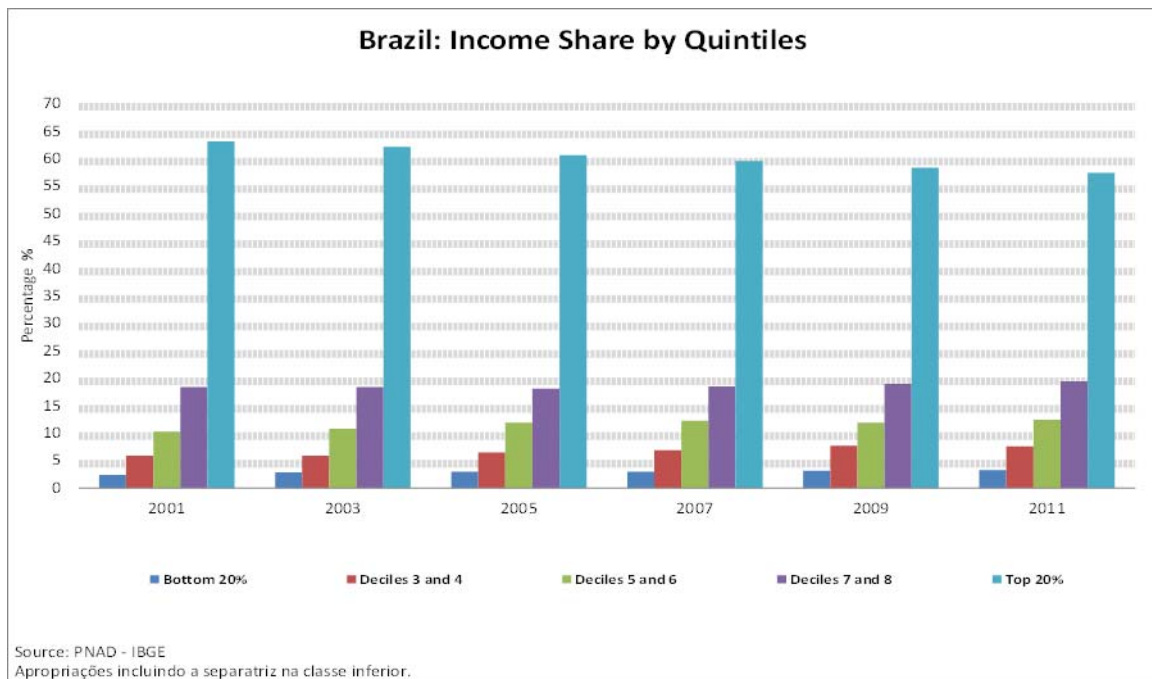
<sup>5</sup> From 2001 to 2011, according to PNAD data, the incidence of poverty, measured purely by income level, fell from 35.8% to 11%. In the case of indigence, the level fell from 15.9% to 4.4% (Lavinias 2013). In other words, 15.4% of the Brazilian population still faces great vulnerability and penury.

<sup>6</sup> One sees that contributory (social welfare) and noncontributory (social assistance) monetary transfers within the Social Security system comprised to 10.4% of GDP in 2012 (ANFIP 2013).

<sup>7</sup> The most recent data from the National Accounts on total social spending, including all three levels of government, are from 2009. According to José Roberto Afonso, in that year, such spending came to 24.68% of GDP. Federal spending accounts for the majority of social expenditures. Before examining constitutional transfers from federal to subnational entities, federal spending totals approximately 80% of public social spending. However, when one considers the transfers effected to states and municipalities, federal social spending comes to 53.3% for the year in question.

population only earned 3.24% of national income,<sup>8</sup> as opposed to 2.39% ten years earlier. Even though they increased their share of national income by almost 50%, they still remain at a level that is practically negligible by any standard. In 2009, for the first time in the country's history, the bottom half of Brazil's population accomplished to earn more than 15% of national income and held 16.17% by 2011. Meanwhile, the top 20% of the population owned 57.35% of national income in 2011, although their income had gradually declined since 2001. The richest 1% had a larger share of income than the poorest 40%, holding 11.69% and 10.81% of national income, in 2011 and 2011, respectively.

**Graphic 4**



Despite this evolution of income equality, the Gini index of land distribution remained practically static between 1985 and 2006, where it was estimated at 0.857 and 0.854 respectively (IBGE). The Imposto Territorial Rural or Rural Land Tax (ITR), which is administered at the federal level, has only a marginal presence of 0.04% in total tax collection. In 2010, half a billion Reals were collected, which is equivalent to 0.01% of GDP. The ITR was designed to promote land redistribution and to finance agrarian reform. It taxed agricultural properties according to its size and usage and aimed to discourage land holdings as a store of value.

One should keep in mind that the states and municipalities manage all other property taxes.

<sup>8</sup> Data from the IBGE's National Household Sample Survey (PNAD) measure declared income (family income from all sources) after fiscal transfers (contributory and noncontributory) and before taxes. Hence, it does not measure disposable income. Neither does it take into account inherited wealth nor other gains derived from financial holdings. In fact, if it were possible to measure the concentration of wealth in all forms, Brazil's Gini index would be much higher than it already is.

Another odd feature of the Brazilian tax system in terms of property is the fact that taxes levied on automotive vehicles are higher than those of urban real estate and land. This is due to the absence of a public housing policy during the last 60 years,<sup>9</sup> given lack of long-term financing in order to buy a house on one hand and incentives to car purchasing on the other, including short-term financing and tax breaks.

Within this context of extreme inequality the debate about the tax system and its structure, and composition becomes relevant and important. However, this issue remains completely unresolved at the national level. After the return of democracy, each administration tried to enhance the tax reform, but none was successful (Rezende 1996; Varsano 1998; Brami-Celentano & Carvalho 2007). Despite the decentralization of funds and powers among the three levels of government (federal, state, and municipal),<sup>10</sup> the Brazilian tax system of the 21<sup>st</sup> century is quite similar to the one that prevailed in the 1960s. The topic is so incendiary and polarizing that different methodologies compete to estimate the exact size of the Brazilian tax burden,<sup>11</sup> and a variety of methods have been used to classify taxes. All, however, have the same characteristics and lead to a taxation system that is socially unjust, regressive, and inefficient from an economic point of view. The latter is mainly due to a cumulative effect, and because tax rates and its calculations often vary among subnational levels, which give rise to tax competition.

This paper will systematically present information about the functioning of the Brazilian tax system and its characteristics. It will, further, demonstrate various governmental powers of gathering tax revenue, and show data that allows a characterization of the recent evolution of the Brazilian taxation system highlighting its dominant features. To achieve this, we will use official figures from the Brazilian Federal Revenue Office (RFB), the Secretary of the National Treasury (STN) at the Ministry of Finance, the Brazilian Institute of Geography and Statistics (IBGE), and the Association of Fiscal Auditors of the Federal Internal Revenue Service (ANFIP), to name only a few. Additionally, we draw on the vast body of literature about this topic available to us. Whenever possible, the data will range from 1990 up until today. However, in several instances the methodologies were changed over time making it difficult to conduct temporal analyses over the course of two decades in a comparable fashion, therefore, we will focus our analyses on the 2000s.

This paper is divided into five parts. Section 2 summarizes the changes, between the two latest tax reforms implemented in Brazil; the 1967 reform, passed under the dictatorship, and the 1988 reform, which consolidated a return to a state of

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<sup>9</sup> A new housing program would only be created in the late 2000s by the federal government: *Minha Casa, Minha Vida* (My House, My Life), which on its own does not quite constitute a housing policy. It targets low-income groups and links financing to the national Growth Acceleration Plan (PAC).

<sup>10</sup> Brazil is a federation with 27 states and 5,565 municipalities, according to IBGE's 2010 census. Nearly 55% of all Brazilian municipalities have fewer than 10,000 inhabitants – small population centers, hence, with low revenue potential.

<sup>11</sup> Federal Revenue Secretariat, Ministry of Finance; Brazilian Institute of Geography and Statistics, Ministry of Planning; Institute of Tax Research; scholars such as Afonso et alii.

law. In this brief summary special emphasis will be given to the 1988 creation of the Social Security Budget, which is one of the three budgets of the Federative Republic of Brazil.<sup>12</sup> Section 3 presents a detailed outline of the structure, the composition, and the evolution of the principal taxes that comprise the tax system. The tax burden, as stipulated by legislation, is the sum of all taxes, fees, and contributions the State extracts from the economy (Afonso, Soares, and Castro 2013). The principal focus of this section will return to a characterization highlighting the inequity of the regressive taxation in Brazil. Section 4 demonstrates other noteworthy features of the Brazilian tax system. For example, it will discuss the creation of the national VAT (Value Added Tax) that was one of the most important features of the tax reform. The VAT and its unsettling consequences for the Social Security Budget and public social spending has been debated about for the past two decades. It, practically, represents the only mechanism that currently serves to redistribute income and, thus, produces well-being. Finally, the last section will outline the absence of tax legislation that reduces gender inequality. Further, it will synthesize different conclusions and discuss various perspectives and challenges to the commitment of making Brazil a more egalitarian country through the implementation of a tax system that emphasizes principles of social justice, equity, and solidarity.

## 2. MODIFICATIONS TO THE BRAZILIAN TAX SYSTEM SINCE 1988

The military coup of 1964 led to an authoritarian government in Brazil. Through the repression of democratic freedoms and political opposition, the executive branch of this regime implemented a number of reforms, including some that dealt with taxes. According to Oliveira (2010), the tax structure born of the 1967 reforms was designed to expand the state's financing capacities, create a system of fiscal incentives to support strategic sectors for development, and to funnel resources to large projects meant to sustain economic growth. In this sense, the government's power to tax would strengthen the federal sphere through an authoritarian process of political centralization.

Rezende (1996) wrote that the 1967 reform introduced important changes in the tax code, which sought to make the system of taxation more modern: "Thus, the state sales tax, which was cumulative, was substituted by the ICM (Tax on Circulation of Merchandise – goods and services), a non-cumulative tax, while the municipal tax on industries and professions, which took in some tertiary activities, was substituted by the ISS (Tax on Services). Federal powers were broadened with the creation of the IOF (Tax on Financial Transactions), and by its being granted a monopoly on the taxation of fuel, power, communications, and minerals [...]" (Rezende 1996). However, as the author pointed out, the military regime simultaneously reformulated the mechanism for transferring federal income to

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<sup>12</sup> Brazil has three budgets: the Fiscal Budget, the Social Security Budget, and the Budget for State-Owned Companies.

subnational levels through the creation of the State and Municipality Participation Fund (FPM). Hence, although resources were concentrated in the national sphere, a parallel definition of new parameters for the division of funds to other federal entities persisted.

Until 1988, direct taxes slightly outweighed indirect taxes in terms of total tax revenue. By way of illustration, we recall that from 1982 to 1987 the former contributed 50% or more to all tax collections (Varsano et alii 1998). After 1988, when the passage of the Citizens' Constitution began, an inversion and a trend toward a steady rise in the proportion of indirect taxes above 50% can be observed.

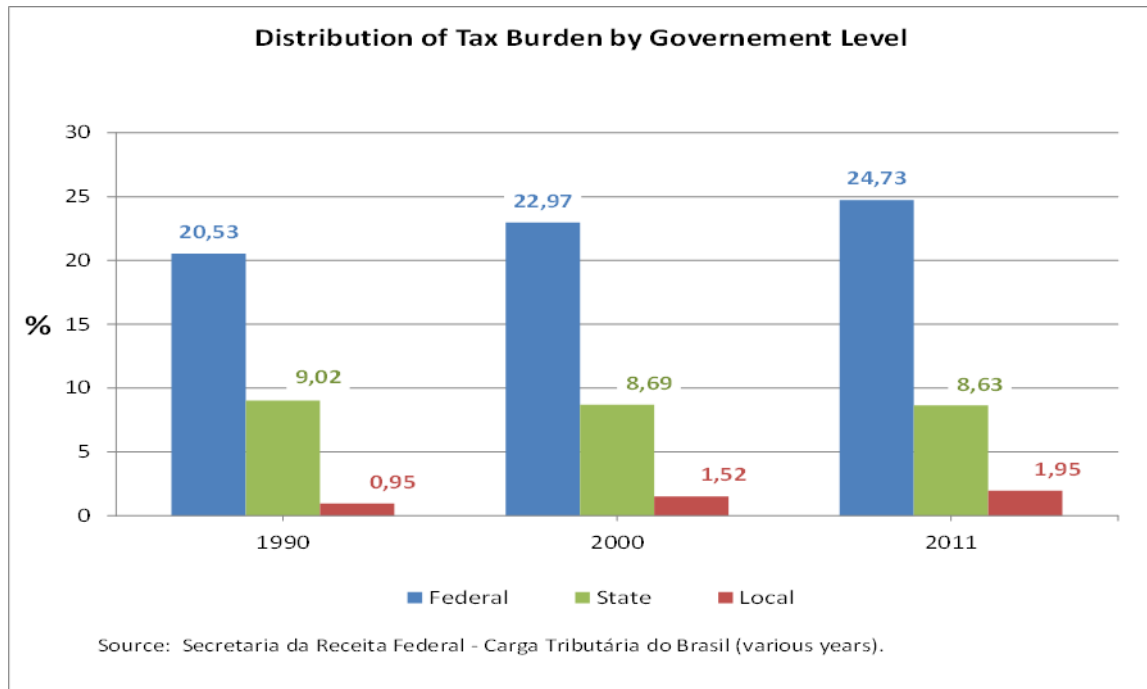
The Citizens' Constitution re-established a democratic state of law, promoting political, fiscal, and administrative decentralization through the adoption of a new federal pact based on the fiscal autonomy of federal entities at the three levels of government (federal, state, and municipal). Subsequently, it marked a fundamental watershed in Brazil. It inaugurated important advances such as the appearance of an autonomous tax system among the federative units and the consolidation of new social rights including the creation of a national Social Security System, which was provided with its own fees and contributions and a budget that was specific to the program.

## 2.1. Fiscal and Administrative Decentralization

States and especially municipalities were among the most favoured federal entities, now legislating their own taxes and allocating them freely. The ICMS, which is administered by the states, appeared as a substitute for the national, unified and special taxes and became the principal source of the country's tax revenue. According to the SRF (2012) it contributed to 20% of national tax revenue in 2011. The system instituted for sharing resources stipulated that federal entities control their own tax bases and pass on tax revenues in a single direction – that is, the federal government transfers resources to states and municipalities, and in turn states may transfer funds to municipalities.

This decentralization aimed to limit the concentration of power at the federal level to eliminate the mark of an authoritarian regime. Despite this measure, Graphic 5 demonstrates the federal government's growing participation in the tax burden as a percentage of GDP over the past 20 years. It clearly increased from 20.53% in 1990 to 24.73% in 2011. The municipal level also doubles its participation, but still accounts for less than 2% in 2011.

Graphic 5



In other words, the federal government was responsible for collecting 70% of all taxes, as opposed to the states' 24.4% and the municipalities 5.5% in 2011 (see Table 1 below). In comparison to the percentages of 1990, when each level of government took in 67.3%, 29.6%, and 3.1% respectively, (SRF 2011; Varsano et alii 1998), the percentages of Table 1 reflect a progressive centralization of tax revenues at the national level.

Decentralization allowed each state and municipality to legislate and levy taxes on the circulation of goods and services and on assets. Table 1 sums up the powers of various subnational entities in terms of levying taxes. One must emphasize that in practice, this power is the prerogative of the large municipalities (measured by inhabitants).<sup>13</sup> In terms of mandatory contributions for state or municipal pensions, around half of all Brazilian municipalities, in particular those of smaller populations, do not use this structure, and their workers contribute to the General Social Welfare Policy (the public RGPS – Brazilian Pay as You Go System).

<sup>13</sup> Nearly half of all Brazilian municipalities, generally small settlements, take most of their tax revenue from constitutional transfers.

Chart 1

2011	As % of GDP	As % of the tax burden		As % of GDP	As % of the tax burden
<b>STATE TAX REVENUES</b>	<b>8,63</b>	<b>24,44</b>	<b>LOCAL TAX REVENUES</b>	<b>1,95</b>	<b>5,52</b>
ICMS - Tax on Goods and Services	7,18	20,32	ISS - Taxes on Services	0,93	2,63
IPVA - Tax on the Ownership of Automotive Vehicles	0,58	1,65	IPTU - Tax on Urban Properties	0,47	1,32
ITCD - Tax on Inheritances and Donations	0,07	0,19	ITBI - Tax on Real-estate Sales (Transfer of Property)	0,18	0,5
Contributions to the State Social Insurance (Civil Servants)	0,35	0,98	Contributions to the Municipal Social Insurance	0,15	0,41
Other State Taxes	0,46	1,3	Other Local Taxes	0,23	0,65

Source: RFB 2011

In addition to detailing the distribution of taxes across levels of government and displaying the total value of tax revenue collected in 2011, Table 1 also indicates that there exist two separate budgets at the federal level. First, the Fiscal Budget and, second, the Social Security Budget, whereby the latter represents the greatest source of tax revenues in the country accounting to 13.12% of GDP, or to over a third of total tax revenue.

Table 1

Tax Revenues 2011	R\$ MILLION	US\$ MILLION	% GDP	% Tax Revenues
Federal Government Revenues	1.024.710,68	545.058,87	24,73	70,04
<i>Fiscal Budget</i>	366.013,93	194.688,26	8,83	25,02
<i>Social Security Budget</i>	543.551,07	289.122,91	13,12	37,15
<i>Other</i>	115.145,68	61.247,70	2,78	7,87
State Revenues	357.506,71	190.163,14	8,63	24,44
Local Revenues	80.734,57	42.943,92	1,95	5,52
<b>TOTAL</b>	<b>1.462.951,95</b>	<b>778.165,93</b>	<b>35,31</b>	<b>100</b>

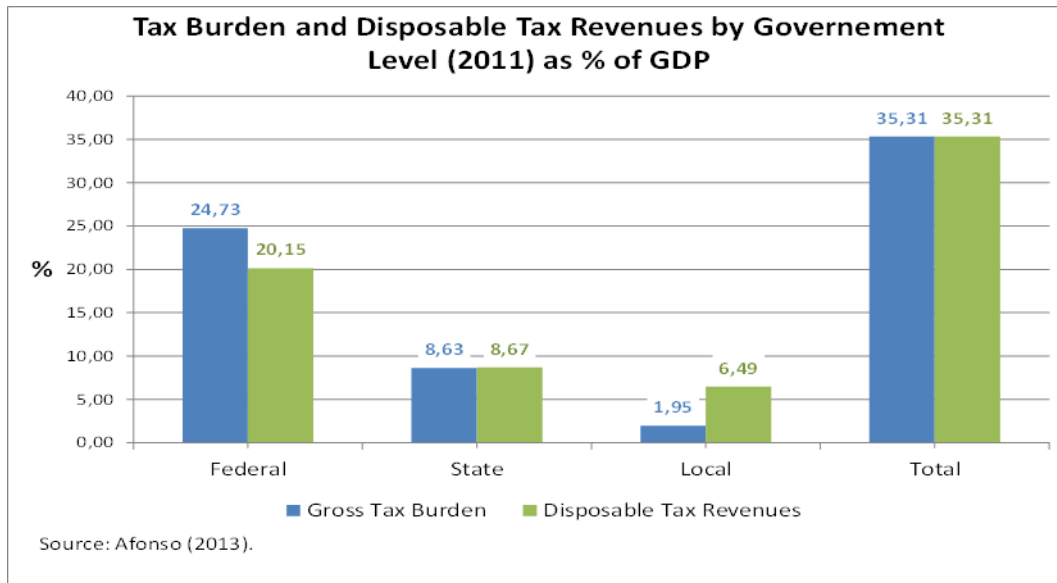
Source: SRF; Carga Tributária no Brasil 2011 - Análise por Tributos e Base de Incidência.

Exchange Rate (Brazilian Central Bank as of December 2011) R\$/US\$ = 1.88

One important proviso remains to be mentioned. Although the federal sphere expanded its take on the tax burden between 1990 and 2011, revenues available at each level of government differed from the figures exclusively measured in terms of local taxes (Afonso 2013). The new definition of the constitutional division of tax revenues adopted in 1988 mandated that the federal government passes funds on to subnational spheres and the states to the municipalities. This is what Graphic 6 presents, where the data from tax burden and available revenue for the year 2011 are depicted.



Graphic 6



Graphic 6 reveals that the federal government registered the greatest loss of (disposable) tax revenue, while local government received the greatest benefits from intergovernmental transfers. Hence, tax decentralization, or municipalisation as some would refer it to (Afonso 2013), indeed expanded through the new federal pact.

## 2.2. Specific Taxes for Social Security

A comprehensive Social Security System was built at the National Constituent Assembly in 1987-88, amidst a heated national debate over the path the Brazilian nation ought to take after proscribing its authoritarian government. The program's design was influenced by the mobilization of a number of social sectors that engaged in constructing a Brazilian welfare state. In Article 194, the new Constitution declared that "Social security comprises an integrated whole of actions initiated by the Government and by society, with the purpose of ensuring the rights to health care, social insurance and social assistance." (Brazilian 1988 Constitution, Title VIII, Chapter II, article 194). For the first time, a clear and well-defined concept of social security was formulated and applied. It was tied to the public provision of health services, pension benefits and included compensatory mechanisms to combat poverty. Notably, the incorporation of social assistance under the umbrella of Social Security is an extremely relevant institutional innovation. Until this point, care for the poorest and destitute had been limited to charity and philanthropic organisations. Until 1988, social welfare was not a legal obligation of the State.

The new system, thus, rejected the right of socioeconomic protection based on a work-oriented context, where workers' welfare was limited to a concept of insurance.<sup>14</sup> New privileges based on citizenship rights rather than on work statuses, allowed to extend social protection to all layers of the population without any exceptions.

The tripod of contributive social insurance targeted means-tested assistance and universal health care that comprises Social Security rests on its own financing system, as outlined in Article 195 of the Constitution: The Social Security Budget. The government introduced social contributions to subsidize the new model of social protection. Thereby, it aimed to diversify the taxation base and to shield revenues from the eventual adverse economic cycles, where countercyclical spending tends to grow. In addition to payroll taxes, social welfare is now financed through taxes on corporate revenues and profits. The Social Security Budget is, thus, composed of the following funding sources:

#### I. Revenue from Social Contributions

- a) Contribution to Social Insurance (Payroll) – mandatory contributions<sup>15</sup> from employees and employers, optional for freelancers and other categories, guaranteeing the right to a number of welfare benefits<sup>16</sup> in case of definitive or temporary cessation of activity. Rates range from 5-20%, depending on the kind of employment the taxpayer holds. These contributions are tied to the payment of contributory benefits;
- b) COFINS (Contribution to the Financing of Social Security) – based on the total revenue taken in by private-law legal entities (companies), taxed at a rate of 7.6% in 2011;
- c) CSLL (Social Contribution on Net Income) – draws from net gains reported by legal entities (companies), with a rate of 9% applied to businesses in general and 15% for legal entities in the financial sector (banks, insurance agencies, and capitalization);
- d) PIS/PASEP (Social Integration Plan/Civil Servants' Investment Program) – workers' contribution to subsidize unemployment insurance and wage benefits (a salary of one annual minimum wage).
- e) Other contributions,<sup>17</sup> including taxes levied on lottery revenues.

#### II. Other Revenues from Entities within Social Security (Ministries)

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<sup>14</sup> An individual contract affirming the existence of a personal right of the contributor or member of the system, which guarantees a future benefit proportionate to his or her current contribution.

<sup>15</sup> Almost 100% of payroll taxes are federal, as states and municipalities can only tax the payrolls of their own civil servants.

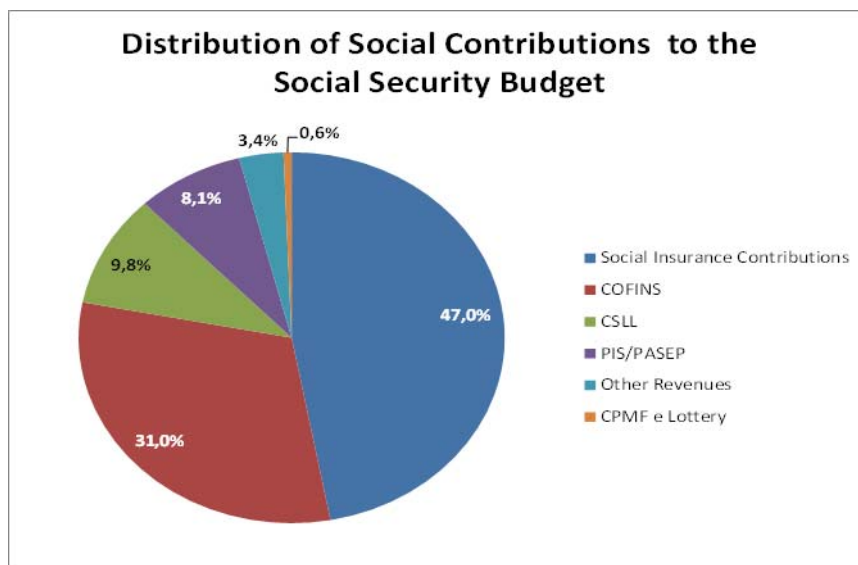
<sup>16</sup> Contributory benefits ensured by Social Security: old-age retirement; survivors; retirement due to contribution time; disability retirement; special retirement (rural workers); illness aid; worker's compensation; reclusion aid;; salaried maternity leave (six months for formally employed women or civil servants); dependency allowance (for workers with monthly remuneration below 1.5 minimum wages with children below 16 years old).

<sup>17</sup> Rural Contributions, Contribution to Civil Servants' Investment Program, and Military Healthcare Fund, among others.

Since COFINS and PIS/PASEP, for instance, affect the final consumption of every product, one might call them contributions paid by the whole population. In contrast to this, the rest is the responsibility of workers and employers, whereby the former contributes far more than the latter. Therefore, the Social Security Budget is a public fund to which all Brazilians contribute to, either through compulsory means like, social insurance, or through the form of various indirect taxes.

Graphic 7 presents the distribution of a variety of social contributions within the revenue linked to Social Security in 2012. It points out that mandatory contributions from employees and employers represent 47% of all resources. COFINS and PIS/PASEP, which are taxes levied on consumption, amount to 39.1%. The revenue obtained from corporate gains like, CSLL, contribute to only 9.8%. The Provisional Contribution on Financial Transactions (CPMF) was a tax created in 1996, it deals with the circulation of cash in the financial sector and intended to provide additional funds to the public health system. However, it was abolished in December 2007, because officials argued that it had unwanted side effects and that funds were diverted to sectors other than health care. This aggravated the financing problem of the universal Brazilian health care system.

**Graphic 7**



### 2.3 Taxes within the Fiscal Budget

Starting in 1988, the following taxes have exclusively been attributed to the federal government in order to comprise its Fiscal Budget:

- a) Foreign Trade Tax
- b) IOF (Financial Transaction Tax)
- c) IR (Income Tax) – on persons and legal entities
- d) IPI (Manufactured Goods Tax)
- e) ITR (Rural Land Tax)
- f) Federal Fees
- g) Other taxes

The Wealth Tax (or *Imposto sobre Grandes Fortunas (IGF)*) was created at the time,<sup>18</sup> but it was never regulated with any supplementary legislation<sup>19</sup> and, hence, was never implemented. It should have been included in the Fiscal Budget. The Wealth Tax would have been levied on all estates worth more than R\$2 million (approximately US\$1 million at current rates). A progressive tax would have been used, varying from 1% (estates from R\$2 million to R\$5 million) to 5% (for fortunes estimated to be greater than R\$50 million), using all wealth accumulated in Brazil and abroad as a reserve base. Wealth obtained through inheritance or donation would have been taxed as well, including artworks, salaries up to R\$300,000 a year (US\$136,600), and other goods considered to have significant social, economic, or ecological relevance (Sindifisco 2013).

Khair (2013) cited tax studies from the Brazilian Federal Revenue Office and affirmed that this tax would have been one of the most effective mechanisms to set off regressive taxation, given the extraordinary high concentration of wealth in the richest sectors of Brazil's society. According to the author, in 2000, the wealth declared in the Income Tax for Persona and Legal Entities reached 18.8% of GDP (almost twice the amount of all the wealth produced in the country).<sup>20</sup> That year, a flat-rate tax of 1% would have brought in tax revenue worth 1.89% of GDP, an extremely low estimate, given that, according to Khair (2013) "[...] a significant part of the value of declared goods (real estate and stock) is not updated as a result of income tax legislation itself." Khair (2013) went even further and wrote: "[...] an average [wealth] tax of 1% could eventually bring in revenue on the order of 4% of GDP." Keep in mind that in 2011, income tax (persons and legal entities) represented 6.16% of GDP. A Wealth Tax, then, would have

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<sup>18</sup> Clause VII, Article 153, Federal Constitution.

<sup>19</sup> In order to pass supplementary legislation in Congress, an absolute majority (half plus one) is required of the members in both houses (Câmara de Deputados and Senado).

<sup>20</sup> To have some idea of the degree to which income and wealth are concentrated in Brazil, one need merely note that in 2000 (base year 1999), out of 11 million declarants, only 4.3 million paid income tax. That is to say that the tax base is reduced, given the distortions of profound inequality. Receita Federal do Brasil, 2000.

provided revenues equivalent to 2/3 of that currently drawn in by income taxes, increasing progressive taxation within the Brazilian system.

Moreover, the tax reform currently circulating in Congress at the federal government's behest proposes that the Wealth Tax should be shared amongst the three levels of government, where roughly half of its revenue would be allocated to states and municipalities.

Despite stimulating decentralization of resources, the IGF has never been allowed to reach a vote in the National Congress, because it was argued that it would have limited tax potential and could clash with other taxes instead. Shelved for two decades, the debate on the taxation of large fortunes is dusted off at times of significant social mobilization, but the discussion generally returns to the status quo. Wealth remains strongly concentrated in this country, mainly due to the distortions present in the Brazilian tax system.

### 3. STRUCTURE AND COMPOSITION OF THE BRAZILIAN TAX BURDEN

Examining the year 2011, one can see that over half the Brazilian tax burden (including taxes, fees, and social contributions) came in the form of indirect taxes (17.38% out of 35.31%), levied on the consumption of goods and services. This clearly demonstrates how regressive taxes are, especially because there is no policy exempting the goods and services that are mainly consumed by the poorest people of the population. To illustrate this, one only needs to note that in 2008, ICMS, PIS, COFINS, and all other indirect national taxes represented on average 38% of the products' final prices (Khair 2008).

Table 2 presents this information synthetically highlighting the distribution of the tax burden between indirect and direct taxation measured by the taxation base. The second-most important source of revenue is social contributions in form of payroll taxes (9.1%). Wealth taxation in the form of income and capital gains taxes falls short of that obtained from mandatory contributions by workers and employers, contributing to just 8.03% of the tax burden.

The same table reveals that indirect taxes consist of nearly 50% of all tax revenue. Indirect taxation saw a slight reduction after remaining fairly stable around 60% (Khair 2008) for two decades from the 1990s to the 2000s.

Table 2

COMPOSITION OF TAX REVENUS BY CATEGORIES	% GDP	% OF TOTAL REVENUES
Goods and Services	17,38	49,22
Payroll	9,1	25,76
Income and Gains	6,72	19,02
Property and Wealth	1,31	3,7
Financial Transactions	0,77	2,19
Other	0,04	0,1
<b>TOTAL</b>	<b>35,31</b>	<b>100</b>

Source: SRF; Carga Tributária no Brasil 2011 - Análise por Tributos e Base de Incidência.

Many other scholars of the Brazilian tax system like Salvador (2007), recognized that this served as an instrument to facilitate the concentration of wealth. This arises not only from the regressive nature of the tax burden, which leans more heavily on consumption through cumulative indirect taxation, but also through the regressive use of income tax, where all sources of income are lumped together under the same tax, thus, harming smaller sources of savings. This, the rise in the tax burden (as observed in Graphic 1) and the mechanism known as DRU - Federal Government Resources Entitlements also called Disconnecting of Federal Revenue -, which allows tax officials to take funds from social contributions (tied to social-policy uses) to be spent them freely in their interest, increased wealth concentration even further. These points will be dealt with exclusively in the subsections below.

### 3.1 Regressive Indirect Taxation

The imbalance between indirect and direct taxes explains, to a large extent, the elevated regressive tax system in Brazil. Table 3 systematizes the results of estimates regarding the extent to which the burden of indirect taxation falls upon household income,<sup>21</sup> expressed in terms of minimum wages. These proxies were extracted by a number of authors for a range of different years and collected by Afonso (2013). In this data set, two trends can be crystallized. On the one hand, one can observe an increasing use of household disposable income across all income classes during the period between 1996 and 2008. This is a direct consequence of the rise in indirect taxation. On the other hand, there is the glaring fact that the poorest families, with household income up to two minimum wages per month have 53.9% of their income absorbed by taxes, which is the highest percentage of all. This disguises an even more severe degree of poverty and destitution than traditionally categorized by the poverty and indigence lines

<sup>21</sup> Income observed after fiscal contributive and non-contributive transferences and after taxes, fees, and social contributions. The authors used IBGE's Family Budget Survey (POF), a sampling of households conducted every five years. The next POF will be in 2013.

whose estimates are purely based on declared income measured after transfers and before taxes. These families' net income is less than the taxes they pay. Families who earn between two and three minimum wages have 41.9% of their income taken away by taxes. Perversely, this percentage falls as family income rises. Additionally, the percentages of absorbed income by taxes double for average income earners between 1996 and 2008. The group least affected by the increase in indirect taxes was those earning more than 30 minimum wages per month, which accounts to the wealthiest part of the population in Brazil.

This is one of the most stunning aspects about the Brazilian tax system showing drastic injustice and the reproduction of inequality on a socioeconomic level. Rezende, Afonso, and Silveira (2011) and Zockun and alii (2007) affirmed that the weight of indirect taxation, along with its highly regressive nature, is not balanced out by progressive direct taxes. We see that the poor not only toil under a heavier tax burden, which reduces their disposable income and exacerbates existing inequalities, but they also finance (through consumption and the levying of COFINS and PIS) the very Social Security revenue that goes to non-contributory welfare benefits (BPC - Non-Contributory Regular Pension - and Bolsa Família) that were designed to combat poverty. The theoretical principle of contributive capacity is thus ignored.

Among the products taxed most regressively are; basic foodstuffs, domestic fuel (cooking gas), electricity, clothing, and tobacco (Siqueira, Nogueira, & Souza 2010).

One IPEA – Brazilian Federal Think-tank, linked to the Ministry of Planning) - study indicates that over 50% of public social spending returns to the State in the form of taxes or contributions.

**Table 3**

<b>ESTIMATES ON THE DISTRIBUTION OF THE TAX BURDEN BY INCOME BRACKET MEASURED BY HOUSEHOLD INCOME EXPRESSED IN MINIMUM WAGES (MW)</b>			
<b>INCOME BRACKET</b>	<b>1996</b>	<b>2004</b>	<b>2008</b>
Up to 2 MW	28,2%	48,8%	53,9%
2 to 3	22,6%	38,0%	41,9%
3 to 5	19,4%	33,9%	37,4%
5 to 6	18,0%	32,0%	35,3%
6 to 8	18,0%	31,7%	35,0%
8 to 10	16,1%	31,7%	35,0%
10 to 15	15,1%	30,5%	33,7%
15 to 20	14,9%	28,4%	31,3%
20 to 30	14,8%	28,7%	31,7%
Over 30 MW	17,9%	26,3%	29,0%

Source: Afonso (2013) *apud* Zockun (2007) 1996 data; IPEA (2008); 2004 and 2008 data

### 3.2 Gross Tax Burden vs. Net Tax Burden

It is crucial, however, to understand the nature of the net tax burden, i.e. how much of what is levied returns to the population in the form of monetary transfers (monetary welfare benefits to families and individuals), subsidies, or transfers to non-profit organizations that provide services to families (private schools, private hospitals and health centres, asylums, etc.). This information is collected by the National Accounts Department at IBGE and is normally published with a lag following the annual reports circulated by the Brazilian Secretariat of Finance (SFB).

Using the data provided by the National Accounts Department at IBGE<sup>22</sup> for the period from 1995 until 2009 as presented in Graphic 8, one can observe that the net tax burden, i.e. the resources that do not return to the population and rather directly finance government action, remains relatively stable, particularly between 2001 and 2009, where it varied less than the increase in the gross tax burden. Then, we may suppose that the rise in the gross burden over this period, which ranged from under 30% of GDP in the late 1990s to 35.31% in 2011, aided a greater redistribution of national income via public spending.<sup>23</sup> Indeed, as the graphic shows, the volume of transfers as a proportion of GDP rose from 13.5% of GDP in 1995-2000 to 14.79% in 2009.

However, there is a second type of “transfer”, which is not taken into account as such and that is paid by the government to those bondholders who buy public debt securities tied to the basic interest rate<sup>24</sup> or the SELIC<sup>25</sup> prime rate. Lavinás and Cavalcanti (2007) estimated that between 1995 and 2005, a not insignificant portion of the gross burden – which could have been used to finance public projects addressing sanitation, housing, education, environmental issues, or agrarian reform – was rerouted to the richest sectors of society, which were first in line for the benefits of a policy of macroeconomic stability based on extremely high interest rates. The weight of this net interest in the public debt, as well as the net tax burden after payment of interest on public administration is also plotted in Graphic 8. From the mid-1990s to 2005, this mechanism for concentrating income and wealth consumed an increasing portion of GDP; 2.5% in 1995, peaking at 8.8% in 1999, and then falling back after the progressive reductions of the SELIC prime rate under the first Lula administration. It then sank to 6.7% of

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<sup>22</sup> One might note that the estimates of tax burden, gross and net, from the National Accounts Department at IBGE differ slightly from those released by the Ministry of Finance, which appear in Graphic 1. This springs from the use of cost-adjustment methodologies that revise their calculations retroactively, consolidating fiscal results from the three levels of government. Hence, the small differences observed between estimates – almost always on the order of tenths – do not reflect inconsistencies but rather different methodological adjustments between data-producing institutions. Calculation of net tax burden falls to the National Accounts Department.

<sup>23</sup> It was not possible for us to identify how funds are distributed among the three categories mentioned above.

<sup>24</sup> Prime Rate set by the Banco Central do Brasil.

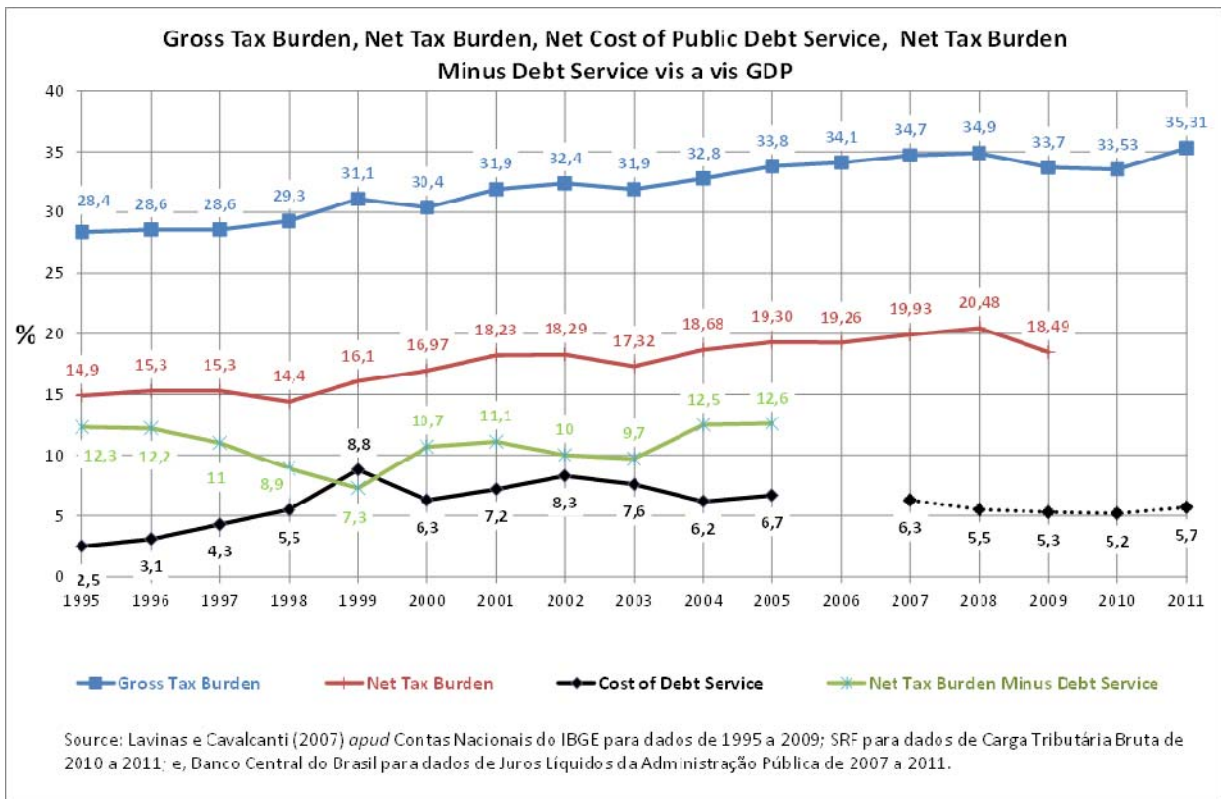
<sup>25</sup> SELIC stands as Special System for Settlement and Custody, which means the Brazilian interest prime rate set by the Central Bank.



GDP in 2005, and the percentage calculated by the Banco Central for 2012 was 4.9%.

We may thus consider that the taxes paid by the population are summarily confiscated and wind up appropriated by the wealthiest sectors of society with enormous property holdings, whose wealth and savings allow them to finance the public debt and obtain an extremely high rate of return on their investments.<sup>26</sup> This deteriorates the universal policies that aimed to promote well-being and to reduce income inequality.

Graphic 8



<sup>26</sup> Brazil holds a few records in this area, among them being the nation with the highest interest rates on the planet. The evolution of the SELIC prime rate may be found in Appendix 1.

### 3.3 Social Revenue Put to the Service of Macroeconomic Policy Instead of Promoting Redistribution

A similar form of seizure is executed by the DRU (Disconnecting of Federal Revenue). Since 1994,<sup>27</sup> the DRU reserved 20% of gross revenue from the Social Security Budget, drawn from non-Social Security contributions.<sup>28</sup> This confiscation of taxation is implemented in the name of forming a fiscal surplus, which represents forced federal savings at the expense of the reduction of public spending. Graphic 9 shows the evolution of this seizure during the period between 1995 and 2012.

As demonstrated by the graph below, absolute values increased steadily except during the years of the international financial crisis in 2008-9. This was due to increasing taxes on some social contributions, for example COFINS and CSLL, and the rise in revenue that was driven by the return to economic growth. From 2000 to 2012, R\$621.4 billion were taken from the Social Security Budget alone, which accounted to around US\$300 billion. This represented nearly four times the amount of federal health spending in 2012 (R\$80 billion or US\$40 billion). This universal policy was hollowed out by the constitution that funnelled resources (DRU) from its revenue base and through the misuse of public funds by attending to the population. The immediate result of this underfinancing is reflected in the paradox of Brazil who has a public health system (SUS – Unified Health System) with expenses totalling to around 4% of GDP, while private health costs accounted for 5.5% of GDP. If the resources the DRU is currently redirecting were applied to actual welfare programs such as Bolsa Família, whose costs accounted to R\$20 billion or US\$10 billion in the year 2012 (ANFIP 2012), extreme poverty and poverty would long have been abolished from the national stage.

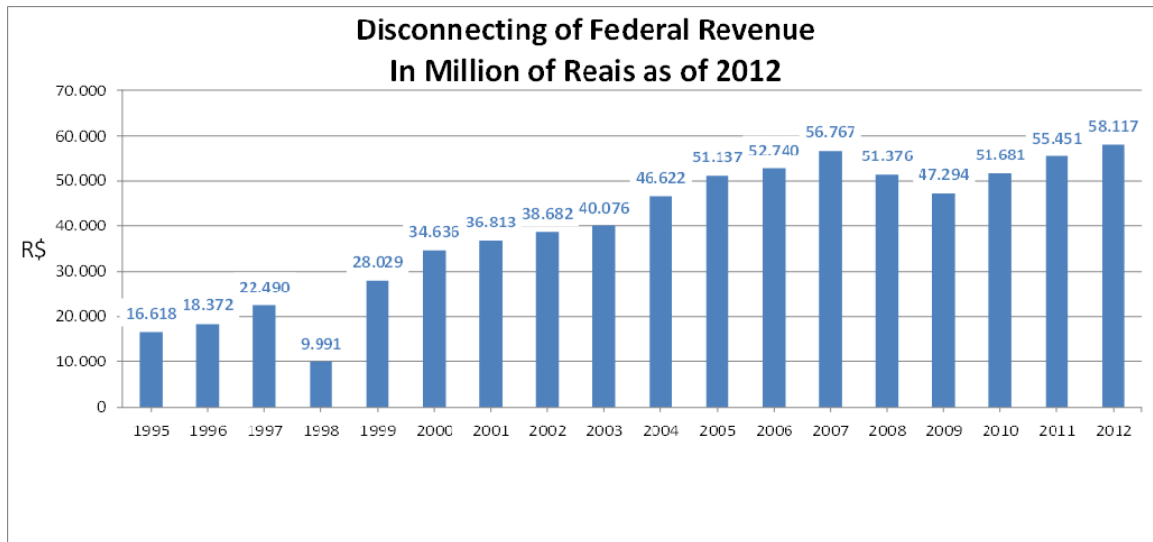
According to the Association of Fiscal Auditors of Brazil's Federal Internal Revenue Service (ANFIP), "DRU fulfils the role of emptying resources from the financing [of Social Security], reducing much of [its] surplus. This reduction does not appear in reports as a transfer of resources from Social Security to the Fiscal Budget. It is as if these funds were, by nature, part of the Fiscal Budget [...]" (ANFIP 2012).

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<sup>27</sup> In 1994, under the administration of President Fernando Henrique Cardoso, the Emergency Social Fund (FSE) was created, comprising resources from a number of sources, including 20% of the revenue of all contributions (social security and otherwise), from the Social Security Budget. All the budgets of all the federal ministries saw a linear cut of 20% of their revenue, including education, healthcare, labor, agrarian reform, etc. Transfer to states, municipalities, and the Distrito Federal also took a 20% cut. This measure was born of the fiscal necessities inherent to the monetary policies being used to stabilize the economy, implemented during the Real Plan, with astronomical costs in terms of the federal debt (ANFIP 2012). The FSE was renewed in 1996 and renamed the Fiscal Stabilization Fund (FEF). In 2002, it was dubbed the Disconnecting of Federal Revenue (DRU), and instead of acting over all social security revenues, it came to affect only non-welfare contributions, many of which are paid by the richer part of the population. This shift of resources away from the social arena has been such a blow that some have mobilized in the name of maintaining the entirety of their revenues. The Ministry of Education managed to approve a constitutional amendment in 2009 that abolished the DRU's jurisdiction over its resources. In practice, since 1994 this has served as yet another process of concentration of resources at the federal level.

<sup>28</sup> Section II.2 of this document explains the composition of social contributions in the Social Security Budget.

Graphic 9



### 3.4 Income Tax

Indeed, the Brazilian tax system poses serious obstacles to the functional distribution of income and the promotion of horizontal and vertical equality. Income tax, which ought to combat regressive taxation, instead exacerbates it. Afonso, Soares and Castro (2013) report that this perverse side to direct taxation in Brazil only worsened from the mid-1990s to the mid-2000s. “While families earning up to two minimum wages had their direct tax burden increased, families earning more than 30 minimum wages received a reduction in their direct tax burden [...]”

The ineffectiveness of direct taxation and its further deterioration in recent years stemmed mainly from the scarcity of such taxes, their low rates, and the high volume of waivers conceded to those taxpayers in the highest income brackets. In theory, progressive taxation will increase in direct proportion with the size of the income bracket exempted from taxation and the increase in the maximum marginal tax rate. Income tax in Brazil, however, does not obey this fundamental principle of tax justice.

Khair (2008) recalled that between 1983 and 1985, the chart for calculating income tax included 13 income brackets and rates ranged from 0% to 60%, thereby increasing at intervals of 5%. Since then, things have gone completely downhill. In 1989 the chart was changed so that it had only two brackets; a minimum and a maximum. Both were taxed at 10% and 25%, respectively. In 1995, three brackets were adopted ranging from 15% to 35%, and in 1998, the two-bracket system was adopted once again taxed at 15% and 27.5%, respectively. Table 4 displays the income tax brackets of 2012, and their respective rates.

Table 4

## INCOME TAX RATES (2012)

ANNUAL INCOME BRACKET (R\$)	ANNUAL INCOME BRACKET (US\$)	RATE (%)	INCOME TAX LEVIED (R\$)	INCOME TAX LEVIED (US\$)
Up to R\$ 19.645,32	Up to US\$ 9,630.00	-	-	-
R\$ 19.645,33 to R\$ 29.442,00	US\$ 9,630.01 to US\$ 14,432.41	7,5	1.473,40	669.73
R\$ 29.442,01 to R\$ 39.256,56	US\$ 14,432.42 to US\$ 19,243.44	15	3.681,55	1,673.43
R\$ 39.256,57 to R\$ 49.051,80	US\$ 19,243.45 to US\$ 24,045.00	22,5	6.625,79	3,011.72
Equal or Over R\$ 49.051,81	Equal or Over US\$ 24,045.01	27,5	9.078,38	4,126.54

Source: Secretaria da Receita Federal.

Exchange Rate (Brazilian Central Bank as of December 2012) R\$/US\$ = 2,04

Looking at the table, there are four different rates defined starting out from a relatively low exemption level of an annual salary of R\$19,645.32 or US\$9,630.00. The lowest rate is 7.5%, the second is 15%, the third contributes to 22.5%, and the highest rate accounts to just 27.5%, which is applied equally to all incomes above R\$49,051.81 or US\$24,045.01 a year. This demonstrates that monthly earnings of US\$2,000 and US\$200,000 are taxed at the same percentage, and, hence, the same income tax rate.

In regards to wages, taxes are levied on payroll (gross income) and when payments are made. A final adjustment takes place in the next fiscal year, when tax returns are filed.

The Brazilian income tax is levied on gross annual income minus legal deductions authorized by the Federal Revenue Service. This is an important concentrating mechanism within the income tax. The list of authorized deductions is long and some of them have no cap, like with healthcare expenses. In 2012, taxed families could deduct a fixed value of R\$1,974.12 per dependent plus entirety expenses on health of any kind and for any purpose including aesthetic surgeries, private health insurance with international coverage, etc. This unlimited deduction encourages the privatization of healthcare, a service that ought to be universal and free. Those who contribute to additional private pension funds are also allotted deductions, essentially sparing the savings of the rich. This measure is indirectly tied to the cap on contributions to the public system of the General Social Welfare Policy, today set at R\$4,159.00 or US\$1,890.45. This cap spurs demand for additional private pension funds running parallel with the financial system, which also benefits from meaty fiscal income tax deductions.

Afonso, Soares, and Castro's (2013) work was supported by a study conducted by the national union of federal revenue auditors. Sindifisco Nacional (2011) also called attention to the fact that "[...] the insufficient adjustment (or lack thereof) to the [income tax] brackets in past years is absorbing increasing numbers of low-income workers and burdening medium wage earners [...]" This means there is a deliberate effort made by successive economic teams to over-penalize the working class, who received real salary increases over the 2000s, and who – in the absence of indexed income tax brackets – end up being pulled into the orbit of the Federal Revenue Service. The volume of contributions to income tax has, thus,

increased through the inclusion of low-income workers, whose tax burden is growing steadily.

## 4. OTHER CHARACTERISTICS OF THE RECENT CHANGES IN THE BRAZILIAN TAX SYSTEM

### 4.1 Fiscal Waivers

The concession of tax benefits favourable to corporations has expanded considerably since the implementation of the '88 Constitution. Mancuso and Moreira (2013) analysed the years between 1988 and 2009. They observed that at least 52 legal mechanisms<sup>29</sup> were passed in that time, most of them at the initiative of the Executive branch involving three taxes that fund social policy. They are: the Contribution to the Social Integration Plan (PIS), which finances unemployment insurance and an annual wage benefit of one minimum wage for employees who receive up to two monthly minimum wages; the Social Contribution on Net Profits (CSLL); and the Contribution to the Financing of Social Security (COFINS). All bases were exclusively dedicated to fund Social Security initiatives like, healthcare, aid, and social security. The authors found the sum of the taxes accounting to those benefits computed to approximately R\$95.8 billion in 2007, which corresponds to R\$135.7 billion (as of December 2012)<sup>30</sup>, or approximately US\$66.5 billion.

Although the authors recognized that these benefits may have had positive effects on the society and the economy as a whole, they warned that currently these exemptions were almost all conceded without specific goals or without the adoption of oversight mechanisms to ensure efficiency and efficacy. Moreover, just two types of benefits out of the 52 mechanisms studied included criteria for evaluation and accountability. They conclude the federal executive branch employs a high degree of discretion in the concession of these corporate advantages, highlighting that “[...] it would be interesting if the [explanation of the motives justifying such a concession] presented revenue estimates, indicated goals and measurable results to be achieved – but this is rarely the case [...]” (Mancuso and Moreira, 2013).

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<sup>29</sup> These mechanisms run a wide gamut of benefits to capital, such as fiscal exemptions for a number of productive segments, etc. However, as the authors point out, there is no information available for the years in question, which means that the real total of the tax funds being waived is necessarily underreported.

<sup>30</sup> Implicit GDP deflator.

## 4.2 Tax Reform in Debate

In 2008, the government sent a proposal for a constitutional amendment<sup>31</sup> to Congress designed to simplify the fiscal structure, to eliminate taxes and to reduce cumulative charges in the name of rationalizing tax collection and, thus, aimed at making it more efficient. As pointed out by Zockun (2009) the federal government's interest in National VAT legislation might lead to more general and simple norms for taxation. Moreover, the tax would eliminate problems such as fiscal competition and allocative distortions of public resources across the nation particularly cumulative effects.<sup>32</sup> Salvador (2008), however, believed that "[...] the only tax principle that the PEC<sup>33</sup> 233/2008 was based upon is that of neutrality, leaving aside all other principles of taxation and constitutionality, especially those of contributive capacity, equality before the law, and progressivity [...]" Many scholars on the subject (Khair 2008; Delgado 2008; Salvador 2008) pointed to the absence of any commitment to tax justice and fiscal equity in this tax reform proposal. The amendment being discussed calls for:

- a) the creation of a national VAT, eliminating four federal taxes (COFINS, PIS, CIDE, and Education-Allowance) and putting an end to the plurality of funding sources as established by the '88 Constitution
- b) the elimination of the CSLL and its incorporation into the Corporate Income Tax (IRPJ)
- c) scaled exemptions on payroll taxes, reducing employer contributions to social security by six percent
- d) national unification of the VAT on sales and services (ICMS), administered at the state level, to avoid fiscal war
- e) the creation of a Revenue Equalization Fund (FER) to compensate for eventual losses of revenue from ICMS by the states
- f) the institution of a National Fund for Regional Development (FNDR) to reduce inequalities in economic development across regions.

Two conclusions emerge, first, not only does this tax reform proposal not prioritize a reversal of the regressive state of the Brazilian tax system, but secondly, it even seeks to dismantle the current Social Security funding model by eliminating social contributions on revenues and profits (COFINS, PIS, CSLL) that guarantee exclusive, tied funds. At the same time, it promises to reduce the participation of capital in the financing of social security (mandatory contributions), which would slowly be constituted by work contributions. It has

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<sup>31</sup> PEC 233/2008, drawn up by the Ministry of Finance. This is the second proposal for tax reform released by the federal government.

<sup>32</sup> A tax is cumulative when it "is levied on two or more stages of the circulation of merchandise, where the amount paid at previous stages cannot be discounted from the payment at the next" (Medeiros Neto, 2001).

<sup>33</sup> Constitutional Amendment Project in order to change the Constitution.

been estimated that this reduction in employer contributions would account to approximately 40% of social security revenue,<sup>34</sup> possibly creating a deficit. This deficit would serve as ammunition for those who support reforming Brazil's public General Social Welfare Policy (PAYG), justifying its progressive privatization.

As Fagnani (2008) pointed out, this reform expanded the discretionary power of the federal government over the financing sources of public policy and tore down the model enshrined by the Constitution of 1988. By limiting funding sources exclusively to Social Security will inexorably lead to a weakening of social policies, the financing of which will become an object of dispute within the Fiscal Budget and between levels of government. The Social Security Budget will not disappear, but it will get financed using resources from the General Social Welfare Policy (RGPS) – increasingly scanty resources, given employers' tax breaks – and from “[...] transfers of fiscal resources, determined constitutionally [...]” (Tonelli Vaz 2008). There will be competition over all kinds of fiscal expenses and social spending on health, social security, and aid. To sum it up, the two changes the Social Security financing proposed were, first, substituting social contributions with taxes and, second, end the exclusiveness of the Social Security Budget's funding sources. Out of these, the most worrisome is certainly the latter, as it would make Social Security's policies dependent on transfers from the Fiscal Budget, which would require great collaboration between civil society and the economic team.

## 5. BY WAY OF CONCLUSION

The Brazilian tax system does both express and reproduce the profound inequalities that characterize the Brazilian society. In addition to being markedly regressive and unjust, and penalizing the least socially advantaged people, it also lacks mechanisms to correct or compensate for gender-related inequalities.

The advantages allotted to women are limited to the mandatory or voluntary social contributions that comprise the General Social Welfare Policy (public). While men are obliged to contribute to Social Security for 35 years and usually only retire at age 65, this is made more flexible for women. Women are allowed to retire starting at the age of 60 after 30 years of contributions or earlier when they contributed for less years. Special treatment is also offered to rural workers of both sexes. Within this category, men and women may retire earlier than the general stipulated age – men at age 60 and women at age 55. Considering that in 2010 women's life expectancy was 7.2 years longer than men's, where women lived 77.4 years on average in contrast to 70.2 years for men. Here, an unequal treatment in favour of women exists, but it counterbalances the perverse effects and lack of opportunities stemming from the sexual and social division of work. The base value is the same for both sexes (one minimum wage), benefitting

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<sup>34</sup> Estimate by Tonelli Vaz (2008)



women, who have a lower contributive density. As a result of this measure, gender inequality among senior citizens (age 65+) is lower than gender inequality registered in the work market.

Besides social insurance contributions, there are no signs of proposals that are debated – not even by feminists or women’s movements – that would promote some kind of tax advantage through the federal income tax rates for single mothers or for women caring for elderly relatives at home.

We know that the majority of women work in precarious, part-time, low-wage jobs. However, there is no negative income credit legislation to encourage women to seek out more profitable employment that guarantees some sort of equalization through the tax credit over the course of the fiscal year.

All Brazilian cancer patients are exempt from income tax on their retirement and pension gains. This legislation, which does not discriminate by gender, thus, applies to women as well. The exemption also comes into effect in cases of neoplasia, of the breasts or otherwise.

It is likely that the complexity of the Brazilian tax system does inhibit the emergence of new proposals from social movements to pressure for institutional innovations in line with greater tax justice. One of the recurring calls is for the removal of taxes from the products included in the *cesta básica* (basic food basket)<sup>35</sup> naming a total of 13 items. This measure encountered many obstacles; however, it would require a federal agreement between all states, whereby the coordination of these has been too thorny to attempt.

The tax reform as currently discussed, which has been moving between the Chamber of Deputies, Senate, and the Executive Branch for years, does not include the population’s priorities. Although the Single Tax proposal,<sup>36</sup> which appears off and on in the national news radar, has seduced many with its simplicity and transparency.

At the end of 2012, the results of a national survey on the Degree of the Brazilian Population’s Aversion to Inequality were released (Lavinás coord. and alii 2012). The goal of the survey was to find out how the Brazilian population (aged 16 and older) perceived the recent reduction of indigence, poverty, and inequality in the country. In the same vein as similar international surveys, the investigation tackled the subject via the agreement or disagreement with a number of values enshrined in existing literature about well-being, social policy and public policy in general favourable to redistribution and income equality. The results indicated

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<sup>35</sup> The *cesta básica* was created in 1939, at the same time as the national minimum wage. Then as now, it contained 13 products, including meat, beans, rice, milk, flour, pasta, tomatoes, cooking oil, and bananas, normalizing the “standard” diet of the working class to serve as an index of the monthly value of the minimum wage. The program still functions today. The federal government has eliminated its taxes on such essential products (a very small percentage), but the state VATs continue hiking the prices of these products and making it more difficult for the poorest and most vulnerable families to feed themselves. VATs on the *cesta básica* vary from state to state and may reach 30%.

<sup>36</sup> One of the spokespeople for this idea is economist Marcos Cintra, who supports a Single Tax as a way of increasing the fiscal simplicity of the Brazilian tax system and reducing the nation’s tax burden. All taxes would be substituted by a single tax on financial transactions, at a rate of 2.65%. For more information, see [www.impostounico.org.br](http://www.impostounico.org.br)



that the average Brazilian approves of fiscal progressivity, but that this support does not necessarily translate into the defence of public or universal policies. Supporting the State and recognizing its relevant role in the fight against poverty and inequality does also not lead to a preference for Universalist measures, where values of social justice and equality are dominant. Brazilians are in favour of financing the common good and promoting social cohesion (in the sense that they support the principle of progressive taxation). This collective effort, however, adapted to the financial capacities of each individual, would not be designed to pave the way for universality and broad, unconditional redistribution, but rather ensures residual, targeted intervention on the part of the State. Support for redistribution, thus, seems not only conditioned but also restricted as well.

These results seem to explain the forces impeding greater interest in a broader debate about the tax system in Brazil, and its transformation in the name of a more just and egalitarian society. Additionally, one finds a vast ignorance of tax legislation and of its regressive and inequality-producing nature. The subject becomes the exclusive province of specialists. Pushed to the margins, the Brazilian people are forced to give up on creating a powerful instrument that redistributes income effectively promoting social justice.

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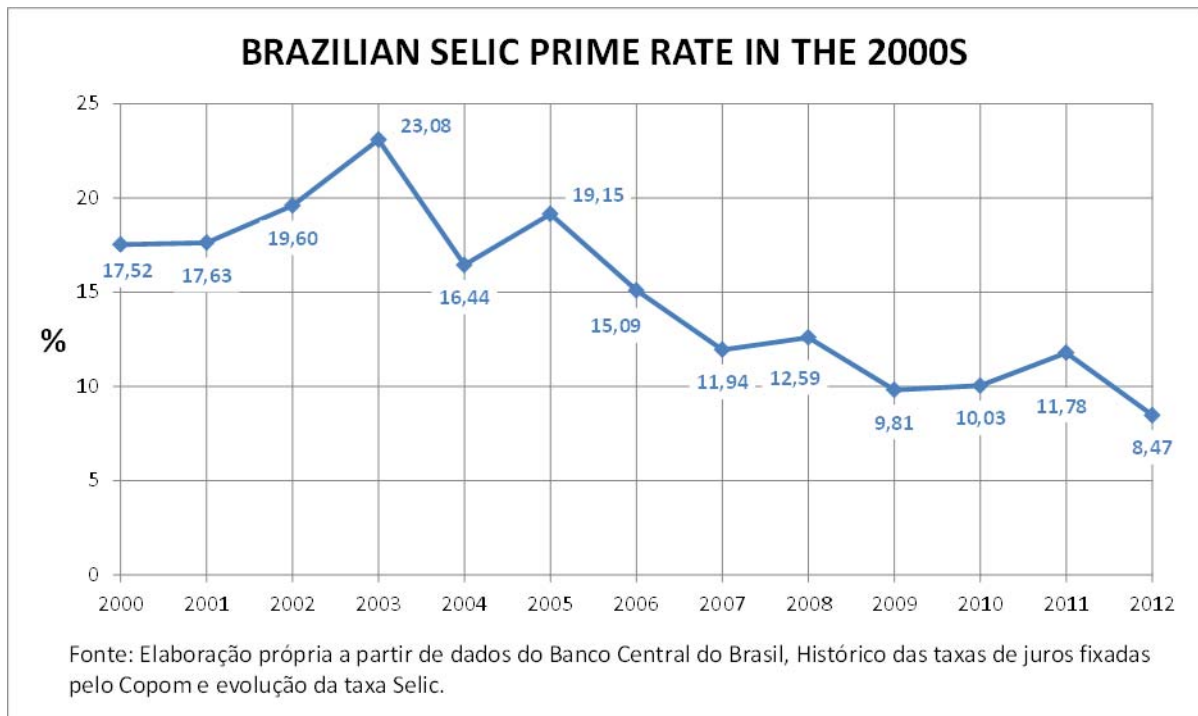
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## ANNEX



## About the authors

**Lena Lavinás** is currently Professor of Social Policy and Welfare Economics at the Institute of Economics at the Federal University of Rio de Janeiro. Most of her research focus on: 1) the assessment of public policies such as poverty reduction programs, notably cash transfers schemes, and technology interventions; 2) the impacts of social policies decentralization; 3) comparative analysis on welfare regimes in Latin America; 4) the reforms of the social protection system worldwide; 4) demographic changes and labor market issues, focusing on gender issues.

**Thiago Moellmann Ferro** is an economist. He is currently a graduate student at the University of North Dakota. His thesis aims at creating and estimating welfare measures across countries and over time, going beyond economic indicators.

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