

Inter-American Center of Tax Administrations – CIAT

44th CIAT GENERAL ASSEMBLY



THE ROLE OF TAX ADMINISTRATIONS IN THE GLOBAL CRISIS

Topic 2.2

**INSTRUMENTS AND TECHNIQUES FOR THE MEASUREMENT AND
ANALYZE OF TAX EXPENDITURE**

**Federal Revenues of Brazil
(RFB)**

**Montevideo, Uruguay
April 12-15, 2010**

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SUMMARY

The key objective of this work is to explain the experience of Brazil in the gauging of indirect Tax Spending. It addresses aspects dealing with the legal framework, adopted concepts and methodologies, sources of information, the situation of tax spending analysis, and a brief overview of the results obtained.

It certainly is worth mentioning that the scope of this work is limited to the taxes that are part of the province of the Union. This is so because Brazil, as a Federal Republic made up by the Union, the States/Federal District, and Municipalities, has autonomous tax structures and administrations.

1- BACKGROUND

The Brazilian System has been permeated by tax exonerations in order to meet the most varied objectives, including the incentive to the development of economic sectors and the promotion of the even distribution of revenues among the country's geographic regions in order to curb the significant inequality existing among them.

Up until the beginning of the 1980s, when despite the Tax System's coexistence with these exonerations, there indeed was no official word on the systematization of the role of tax benefits, let alone on the quantification of its costs; in other words, there was no official word on what amounts were not being collected as a result of these benefits.

The first efforts made in Brazil to identify and quantify the costs derived from the concession of tax incentives were made at the beginning of the 1980s; however, they were basically restricted to academic activities¹ and focused on the income tax of individuals and corporations.

1 Villela, (Luiz Arruda – i) “Gastos Tributários e Justiça Fiscal: O Caso do IRPF no Brasil” [Tax Expenditures and Fiscal Justice: The case of the IRPF in Brazil] – 1981 – PUC – RJ, ii) “Uma proposta de gastos tributários no Brasil” [A Proposal for Tax Expenditures in Brazil] – 1986 – Revista de Finanças Públicas [Public Finances Magazine], no. 366, and “iii) A identificação dos Gastos tributários no Brasil” [The Identification of Tax Expenditures in Brazil] – 1989 - INPES/IPEA.

In 1988, Brazil passed significant political and administrative reforms within the framework of a National Constituent Assembly, which had been set up to draft a new Constitution for the country. Specifically regarding Fiscal Policies, on that occasion, changes to the Tax System were introduced and general rules for the preparation of the Federal Budget were established, having as a pivotal point an increase in transparency in the evaluation of public accounts, as a consequence of the discussions on the issue, which had already been studied by society at large.

Among the rules for the improvement of the Budget, it is worth mentioning the establishment, in the Constitution, of the compulsoriness of drafting the regional Report, which would be discussed along with the budget bill and the estimate for the amount that would not be collected as a result of the concession of tax benefits.

That same year, 1988, a commission within the Ministry of Finance was established. It was made up by officials from the Secretariat of Economic Affairs (SAE) and the Secretariat of Federal Revenues (SRF), and its objective was to comply with the constitutional mandate. This is how the first Statement on Tax Benefits (DBT) was drafted, and it was incorporated into the General Budget of the Union (OGU) in 1989. The legal duty of drafting the following annual reports fell into the Secretariat of Federal Revenues.

In the preparation of this first report, difficulties typical of the beginning of any process took place either because of having to face what was unknown until then or because of technical or legal reasons, such as the lack of clarity regarding the concept of tax spending that would be adapted to the characteristics of the Brazilian Tax System, the non-existence of historic series, the variety of incentives, and the precariousness of adequate information and statistical sources.

At the time, however, what was more important was the decision to implement the constitutional mandate and begin the process. The fact of having a list of all benefits distributed by type of tax and a corresponding amount, however precarious, became a major gain, taking into account that the improvement of technical and legal matters would definitely take place along the process.

This is what in effect has taken place from the beginning until now. The basic sources of information, especially the Tax Returns of individuals or corporations, with the alteration or creation of fields for the collection of data directly for the application of the methodology of the estimate, were improved to an extreme. It is also worth mentioning that there was a closer rapprochement with the external bodies that are responsible for the administration of resources stemming from tax benefits and, thus, are repositories of information useful for the process.

An especially relevant event was the study conducted in 2003 to revise and improve the concept of tax spending in order to promote further standardization in relation to the understanding adopted at the world level. This enabled the realignment of incentives (inclusion and exclusion) and the direct

alignment with budgetary roles (Social Security, Health, Education, and so on), and it even promoted changing the term “tax benefit” to “tax expenditure,” making the annual report be called “Report on Tax Expenditures (DGT).”

2 – TAX SPENDING ESTIMATE

2.1 – Legal Framework

In Brazil, the drafting of the report using the tax spending estimate is a legal obligation of constitutional nature. This concept was introduced in the Federal Constitution enacted in 1988 in order to offer congressmen, during the analysis of the Budget, a broader vision of the actual government spending (direct and indirect) with a certain budgetary role. Thus, §6 of Article 165 states:

“Art. 165 (...)

(...)

§6 The draft budget bill shall be accompanied by a regional report on the effect on revenues and expenditures due to exemptions; amnesties; write-offs; subsidies; and benefits of financial, tax, and credit nature.”

Later, the so-called Law on Fiscal Responsibility (Complementary Law 101, of May 4, 2000), which deals with balanced public accounts, broadened the compulsoriness of the quantification of tax expenditures, expanding to the other entities of the federation (States and Municipalities) and making the rules even more transparent for the concession and quantification of the budgetary-financial impact. In addition, it outlined compensation measures, as established in Articles 5 and 14, described below:

“Article 5 The annual draft budget bill, drafted along with the pluri-annual plan and with budgetary guidelines and regulations of this Complementary Law in a compatible way:

(...)

II – shall be accompanied by the document referred to in §6 of Article 165 of the Constitution, as well as by the measures to compensate revenue waivers and the increase in compulsory expenditures that are continuous;”

“Article 14. The concession or expansion of the tax incentive or benefit which results in a revenue waiver must be accompanied by the estimate of the budgetary-financial impact in the fiscal year when its validity must begin and the following two years, and it must comply with what is outlined in the LDO and meet at least one of the following conditions:

I – the proponent must prove that the waiver was taken into account in the revenue estimate of the budget bill, in the form of Article 12, and that it will not adversely affect the fiscal goals outlined in the same annex of the LDO;

It – it must be accompanied by compensation measures, in the period mentioned in the main article, by means of an increase in revenues stemming from an increase in rates, the broadening of the base for the estimate, and the increase in or creation of the tax or contribution."

2.2 – Concept of Tax Spending in Brazil

Notwithstanding some coincidences at the world level regarding the concept of tax spending, there still are many differences that make it practically impossible to make direct comparisons. There is no single concept that could be universally accepted and adopted by all the countries that make tax spending estimates.

Certain tax exonerations can be understood by some as a rule for the correction of deviations from or of the promotion of equity and, therefore, do not include the amount estimated as tax expenditure, whereas for others, these same exonerations can be interpreted differently due to the characteristics of their own tax systems.

In Brazil, the concept used in the period of 1988 to 2003 referred to the term "tax benefit" as a synonym of "tax expenditure," and following this vision, the Secretariat of Federal Revenues used to draft, in the same period, the Report on Tax Benefits (DBT) on federal taxes.

However, that concept of tax benefit, adopted for the drafting of the report, failed, for instance, to follow the budgetary vision or, in other words, the possibility of replacing an indirect expenditure for a direct one. Consequently, some related tax benefits did not meet the concept of tax expenditures, and others that were considered tax expenditures were not considered among the constant tax benefits outlined in the report.

As an example, the deduction of the base of the estimate for the Income Tax of Individuals regarding dependants, especially children, is cited. For some years, this exoneration was classified as a Tax Expenditure. However, following the revision of the concept, this classification was no longer valid due to the fact that it was considered more of an element of promotion of tax equity and the progressiveness of the Income Tax of Individuals. In Brazil, there is no associated government program either, such as a stimulus for births.

This is why in order to improve the concept that had been used until then and promote further standardization under the understanding adopted in other countries, the term "tax expenditure" started being used in effect to replace the term "tax benefit" as it is more adequate for the revision of the concept, which beginning in 2004, has been used following these criteria:

- a) They are indirect government expenditures incurred by means of the tax system, trying to address economic and social objectives;
- b) They are explained in the regulation that refers to the tax, becoming an exception to the tax system referred to, reducing the potential collection, and increasing the taxpayer's economic availability;

- c) They are compensatory in nature when the Government fails to adequately tend to the people regarding the services that are part of its responsibility;
- d) They are considered an incentive when the Government wishes to develop a certain economic sector or region.

As a complement to the aforementioned criteria, the following steps began to be taken to identify what is indeed considered tax expenditure in the set of exonerations of the tax system:

- 1) Determine all the tax exonerations taking as base the tax system as a reference;
- 2) Assess, using the established criteria, what are the exonerations that constitute direct expenditures and that can be replaced by direct expenditures linked to government programs.

The identification of the exonerations that constitute tax expenditures has the same tax law as a foundation. This is how the exonerations that stem from general tax rules applied to taxpayers, without distinction, and from rules that get the Tax System closer to constitutional tax principles are considered to be integral part of them, and therefore do not constitute tax expenditures.

2.3 – Sources of information

In Brazil, the quantification of tax expenditures is supported by internal and external sources of information.

2.3.1) Internal sources of information

The main internal sources of information are the Tax Returns filed by individuals and corporations at the Tax Administration. In this regard, it is worth mentioning that all corporations (companies) are obligated to submit their tax returns, listing even those items that are exempt or immune. This is how it was possible, since the beginning, to improve the way data was entered into the system, data that is essential to estimate and analyze tax expenditures through the alteration or creation of fields appropriate for the returns.

As an example, next we present some types of benefits whose information is included in specific fields in the tax returns of companies in general:

- a) Exemptions and reductions of the income tax due from companies that open in the northern and northeastern regions of the country with projects in economic sectors that are a priority for the development of these regions;
- b) Deductions from the base of the income tax estimate, subsidy expenditures incurred by corporations in the Workers' Food Program previously approved by the Labor Ministry;

c) Deductions from the income tax due from part of donations and sponsorships in favor of programs that support cultural and audiovisual activities;

d) Deductions from the income tax due from donations made to the Protection Fund for Children and Adolescents;

e) Deductions from the base of the income tax estimate for expenditures incurred in industrial or agricultural technological research and development activities;

f) Deductions from the base of the income tax estimate for donations made to teaching and research institutions;

g) deductions from the income tax estimate for expenditures incurred by companies, such as medical, dentist, pharmaceutical, and social security services for employees and leaders;

h) Sales taxed with a zero rate by the Pis and the Cofins, such as, for instance, the sales of books, paper, agricultural raw materials, and so on.

In addition to this, immune or exempt companies, as well as the companies that are part of the SIMPLES (simplified form to estimate a set of taxes), are obligated to file a specific tax return.

Just like corporations, individuals are also obligated to provide information, in their own fields of the tax returns to which they are subject, on deductions or reductions of taxes due, and the estimate base as a result of an incentive, such as education and health expenditures.

In addition to this, the Tax Return forms are revised annually to verify the need for adjustments and alterations, including those aimed at compiling information to subsidize the task of estimating tax expenditures.

2.3.2) External Sources of Information

The external sources of information also constitute a fundamental support for the tax expenditure quantification process. This information basically has its origin in the bodies that manage resources stemming from tax incentives, including the Manaus Free Zone, by means of the Manaus Free Trade Zone Superintendence (SUFRAMA); the Ministry of Science and Technology (MCT); and the Ministry of Development, Industry, and Foreign Trade (MIDIC).

As long as the Tax Administration requests it, these bodies forward all the information they have on the various forms of incentives whose funds they manage.

In this regard, it is especially worth mentioning, for instance, the Manaus Free Trade Zone, which registers, by type of merchandise, all the consolidated asset and liability entries by the various sectors of the economy. This enables

the creation of a data bank with information essential for the quantification process of the tax expenditures dealing with this specific area.

The role played by the external sources notwithstanding, there still is not an integrated network for data transmission.

2.4 – Methodology for the Estimate

The estimate for tax spending in Brazil is done by type of taxes and separately for each benefit item. This is why there is no single methodology that can be applied, taking into account that the various types of benefits have their own characteristics. Therefore, as a general rule, the preparation for the application of the method follows these guidelines:

- a) A list by type of taxes is drafted along with each type of benefit, which according to the concept used, will generate a tax expenditure;
- b) The most adequate source of information is selected for this specific item;
- c) The necessary information for the specific case is extracted; and
- d) The estimate is made.

In short, the following premises are adopted in the preparation of the estimate for the tax expenditure:

- The effects of the change are not considered in the behavior of taxpayers because of the concession of the benefit, assuming that the activities would be carried out, at the same level, if they were subjected to normal taxation;
- The possible indirect effects on the collection of other taxes caused by the concession of the benefit are not estimated.

Thus, by virtue of these premises, suppressing the tax benefits, an increase in collection would not take place at the same level as the values estimated for the Tax Expenditures. To do so, adjustments would be necessary, incorporating effects from suppositions about the change in the behavior of taxpayers given the new situation without benefits. Will the activities continue to be carried out at the same level? Would taxpayers spend less? Would compliance with the new tax obligation be in full?

It is worth stressing that the sources of information with actual data, which are used as base for the preparation of projections, have a time lag of approximately two years. Therefore, the projections for 2008 were made using real 2006 data as base.

Examples of data extracted from Tax Returns:

1) Deduction from the Taxable Income of Individuals

Data:

- Fiscal Incentive: Deduction of health expenditures from the taxable income
- Return: IRPF – 2006.
- Real value of the deductions: R\$ 24.334 billion.
- Average rate estimated from the IRPF-2006: 11%
- Tax Spending 2006

Estimate:

2006 Tax Spending = Real value of the deduction x the average rate of the IRPF

2006 Tax Spending = $24.334 \times 0.11 =$ R\$ 2.677 billion.

Projection for the 2008 Tax Spending = 2006 Tax Spending x Index of correction of the 2008 IRPF collection divided by the 2006 collection.

Projection for the 2008 Tax Spending = $2.677 \times 1.52 =$ R\$ 3.086 billion.

2) **Regional Development – Deduction from the Individual Tax Due.**

Data:

- Fiscal Incentive: exemption of taxes due to the establishment of a company in the Northeastern Region.
- Tax Returns: IRPJ – 2006.
- Real value of the tax deduction: R\$ 589 million.
- Tax Spending - 2006:

Estimate:

2006 Tax Spending = Real value of the deduction of the taxes due.

2006 Tax Spending = R\$ 589 million.

Projection of the 2008 Tax Spending = 2006 Tax Spending x Index of correction of the 2008 IRPF (Personal Income Tax) collection divided by the 2006 collection.

Projection of the 2008 Tax Spending = $589 \times 1.31 =$ R\$ 771 million.

3 – RESULTS

The information on the estimate for tax spending from a specific year is consolidated in a report called “Statement on Tax Spending (DGT),” which integrates the set of information on the Federal Budget that the central Executive Branch forwards to the Legislative Branch up until the last business day of August of the year preceding the budget's reference year. It is up to the Legislative Branch to analyze and turn into a law the budget document. It is worth mentioning that the data on tax spending are for informational purposes and, therefore, are not subject to the same treatment given by the Federal Budget to direct expenditures.

The “Statement on Tax Spending (DGT)” lists, in detail and by type of tax, all the types of tax benefits that according to the concept used trigger indirect expenditures by means of the tax system. In addition to this, there is a succinct description of the basic legislation and of the term of validity of each type of benefit. After the draft Budget Bill is submitted to the Congress, the Secretariat of Federal Revenues posts the Report on Tax Spending on its Internet page.

Below are some tables related to the 2009 estimate that illustrate the report:

3.1) – Consolidation by Type of Tax: it presents the values estimated for the 2009 Tax Spending, and they are presented in a consolidated form by type of tax.

Chart I
2009 Tax Spending Forecast
Consolidation by Type of Tax

Tax	R\$ million	
	2009 Forecast	%
Income Tax	36.171	35
COFINAS	29.419	29
I. Industrialized Products	17.030	17
CSLL	6.087	6
PIS-PASEP	5.651	6
I. Imports / Linked IPI	6.427	6
Others	1.172	1
Total	101.956	100

Source: RFB

3.2) – Distribution by Geographic Region: it presents the estimate for the 2009 tax spending, classified by geographic region.

Chart II
2009 Tax Spending Forecast
Geographic Region

	R\$ million	
Region	Tax Spending	Part. %
North	22.170	21,7
Northeast	10.524	10,3
Central-West	5.257	5,2
Southeast	51.764	50,8
South	12.242	12,0
Total	101.956	100

Source: RFB

3.3) – Classification by Budget Sector: it presents the consolidation of tax spending by budget sector.

Chart III
2009 Tax Spending Forecast
Consolidation by Budget Sector

	R\$ million	
Budget Sctor	2009 Forecast	%
Commerce and service	32.258	33
Industries	20.817	20
Health	12.560	12
Labor	9.577	9
Agriculture	8.415	8
Education	4.056	4
Social security	4.015	4
Others	10.258	10
Total	101.956	100

Source: RFB

3.4) – Main Tax Expenditures: it presents the main tax expenditures.

Chart IV
2009 Tax Spending Forecast
Main Tax Expenditures

Tax expenditures	R\$ million	
	2009 Forecast	%
Micro and small companies	25.705	26
Manaus Free Zone	17.432	17
Non-profit organizations	9.941	10
Agriculture and agricultural industry	6.581	6
Exempt and non-taxable revenues - PF	6.425	6
Regional development	5.581	5
Medicines	5.058	5
Others	25.234	25
Total	101.956	100

Source: RFB

3.5) – Tax Expenditures related to Social Security Contributions: it presents the tax expenditures dealing with social security contributions. It is worth mentioning that this amount does not include the values listed in other charts. The legal justification to estimate the tax expenditures dealing with social security contributions was established beginning in 2007 as a result of the merger between the Secretariat of Federal Revenues and the Secretariat of Social Security Revenues.

Chart V
2009 Tax Spending Forecast
Social Security

Mode	R\$ million	
	2009 Forecast	%
Simple at the national level	9.617	54
Philanthropic institutions	5.832	33
Rural production exports	2.432	14
Information and Communication Technology	24	0,1
Total	17.905	100

Source: RFB

3.6) – Evolution of Tax Spending: it presents the evolution of tax spending in the years 2003 and 2009 and its percentage participation in terms of collection and the GDP.

Chart VI
Collection x Tax Expenditure
2003 to 2009

R\$ million

Period	Collection	Tax Expendit ure	Part. %	
			In Rev. Sec.	In GDP
2003	259.576	25.704	9,90	1,51
2004	296.856	34.322	11,56	1,77
2005	347.580	41.011	11,80	1,91
2006	372.912	57.586	15,44	2,48
2007	431.962	69.774	16,15	2,69
2008*	477.855	76.056	15,92	2,63
2009*	540.028	101.956	18,88	3,30

*Estimates

4 – CONCLUSION

In Brazil, contrary to the significant evolution of the quantification of Tax Spending, the analysis of its effects on economic sectors or geographic regions where it was introduced remains incipient. There are isolated and very embryonic initiatives by the academic sector and some other bodies, but there is no systematic execution of research and assessments capable of confirming the effectiveness of the benefit in terms of the achievement of its objectives, especially regarding an increase in the level of employment and tax revenues and an encouragement to invest.

In this regard, the RFB has promoted seminars with the participation of representatives from all the bodies that are involved in the process to gauge, manage and control Tax Spending. The objective of such seminars is to integrate the various key players involved in the process and discuss the estimate methodology while moving forward with the analysis process.

There currently are ongoing initiatives, especially in the area responsible for the execution of the Federal Budget – the National Treasury Secretariat – in order to integrate the direct (Federal Budget) and indirect (Tax Spending) expenditures as a means to making budget management more transparent.

A similar measure has been adopted by the Audit Court of the Union (TCU), which established the compulsoriness of presenting the information dealing with tax spending on the part of the management bodies.

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