TAX EXPENDITURES COUNTRY REPORT

Brazil

Paolo de Renzio

Manoel Pires

Natalia Rodrigues

Giosvaldo Teixeira Junior

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Authors

Paolo de Renzio, Senior Adjunct Professor, Brazilian School of Public and Business Administration (EBAPE), Getúlio Vargas Foundation.

Manoel Pires, Coordinator of the Centre for Fiscal Policy and Public Budgeting, Brazilian Institute of Economics (IBRE), Getúlio Vargas Foundation and Researcher at the University of Brasilia.

Natalia Rodrigues, PhD Candidate, Brazilian School of Public and Business Administration (EBAPE), Getúlio Vargas Foundation, PhD Fellow at the Harvard Centre for International Development, and Attorney for the National Treasury in Brazil.

Giosvaldo Teixeira Junior, Undergraduate Student, University of Brasilia, and Research Assistant, Brazilian Institute of Economics (IBRE), Getúlio Vargas Foundation.

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List of abbreviations

ADCT   Ato das Disposições Constitucionais Transitórias [Act on Transitional Constitutional Provisions]

ADI   Ação Direta de Inconstitucionalidade [Direct Action on Unconstitutionality]

AFRMM   Adicional de Frete para Renovação da Marinha Mercante [Freight Surcharge for the Renewal of the Merchant Navy]

BNDES   Banco Nacional de Desenvolvimento Econômico e Social [National Bank for Economic and Social Development]

CIDE   Contribuição de Intervenção no Domínio Econômico [Contribution for Intervention in the Economic Domain]

CGU   Controladoria-Geral da União [Office of the Comptroller General of the Federal Union]

CMAP   Conselho de Monitoramento e Avaliação de Políticas Públicas [Public Policy Monitoring and Evaluation Council]

COFINS   Contribuição para o Financiamento da Seguridade Social [Contribution for the Financing of Social Security]

CONFAZ   Conselho Nacional de Política Fazendária [National Treasury Policy Council]

COMSEFAZ Comitê Nacional de Secretários de Fazenda, Finanças, Receita ou Tributação dos Estados e do Distrito Federal [National Committee of Secretaries of Treasury, Finance, Revenue or Taxation of the States and the Federal District]

CONDECINE Contribuição para o Desenvolvimento da Indústria Cinematográfica Nacional [Contribution to the Development of the National Film Industry]

CPS   Contribuição para a Previdência Social [Social Security Contribution]

CSLL   Contribuição Social sobre o Lucro Líquido [Social Contribution on Net Profit]

DARF   Documento de Arrecadação de Receitas Federais [Document for the Collection of Federal Revenue]

DGT   Demonstrativo de Gastos Tributários [Statement of Tax Expenditures]

EC   Emenda Constitucional [Constitutional Amendment]

DIRPF   Declaração de Imposto de Renda Pessoa Física [Personal Income Tax Declaration]

GPS   Guia da Previdência Social [Social Security Payment Form]

TE   Tax expenditures

ICMS   Imposto sobre Circulação de Mercadorias e Serviços [Tax on the Circulation of Goods and Services]

IFI	Instituição Fiscal Independente [Independent Fiscal Institution]
II	Imposto de Importação [Import Tax]
IOF	Imposto sobre Operações Financeiras [Tax on Financial Transactions]
IPI-I	Imposto sobre Produtos Industrializados – Operações Internas [Tax on Industrial Products – Domestic Transactions]
IPI-V	Imposto sobre Produtos Industrializados – Vinculado à Importação [Tax on Industrial Products – Linked to Imports]
IPTU	Imposto sobre Propriedade Territorial Urbana [Urban Land Tax]
IPVA	Imposto sobre a Propriedade de Veículos Automotores [Motor-Vehicle Ownership Tax]
IRPF	Imposto de Renda Pessoa Física [Personal Income Tax]
IRPJ	Imposto de Renda Pessoa Jurídica [Corporate Income Tax]
IRRF	Imposto de Renda Retido na Fonte [Income Tax Withheld at Source]
ISS	Imposto sobre Serviços de Qualquer Natureza [Tax on Services of Any Kind]
ITCMD	Imposto sobre Transmissão Causa Mortis e Doação de Bens ou Direitos [Tax on Inheritance and Donation of Goods and Rights]
ITR	Imposto sobre a Propriedade Territorial Rural [Rural Land Tax]
JCP	Juros sobre Capital Próprio [Allowance for Corporate Equity]
LDO	Lei de Diretrizes Orçamentárias [Law on Budgetary Guidelines]
LAI	Lei de Acesso à Informação [Law on Access to Information]
LOA	Lei Orçamentária Anual [Law on the Annual Budget]
LRF	Lei de Responsabilidade Fiscal [Law on Fiscal Responsibility]
MEI	Micro-Empreendedor Individual [Individual Microentrepreneur]
MP	Medida Provisória [Provisional Measure]
MSE	Micro and Small Enterprise
OGU	Orçamento Geral da União [General Federal Budget]
ORT	Outras Renúncias Tributárias [Other Revenues Forgone]
GDP	Gross Domestic Product
PIS–PASEP	Programa de Integração Social [Social Integration Programme] – Programa de Formação do Patrimônio do Servidor Público [Programme for the Funding of Public Servants]
PLOA	Projeto de Lei Orçamentária Anual [Annual Budget Bill]

PPA	Plano Pluri-Anual [Multi-year plan]
RFB	Receita Federal do Brasil [Brazilian Federal Revenue Service]
SN	Simples Nacional [Simplified National Taxation System]
STR	Sistema Tributário de Referência [Benchmark Tax System]
SUDENE	Superintendência do Desenvolvimento do Nordeste [Development Bureau for the Northeast]
TCU	Tribunal de Contas da União [Federal Court of Auditors]

Executive summary

Tax expenditures in Brazil corresponded to 4.78% of Gross Domestic Product (GDP) in 2023, taking only the federal level into account. If state-level tax expenditures are included, the share reaches 7.2% of GDP in 2023.

Transparency: the Statement of tax expenditures (DGT) is published annually as an annex to the Annual Budget Bill (PLOA), with much detail on tax expenditures (TEs) and the associated methodology. However, some measures that imply forgone revenue are not included in the definition of TEs by the Brazilian Federal Revenue Service (RFB), and these affect the levels of transparency. The existence of TEs at the subnational level further complicates the transparency issue.

Complexity of the institutional framework: There are several complications regarding the definition and estimation of TEs, and the roles and responsibilities of the various actors involved in its formulation, approval, monitoring and evaluation. Many TE proposals are not properly formulated and costed, making the effective use of this fiscal policy tool more difficult.

Evaluation challenges: The impact of policies that involve TEs have not commonly been evaluated, especially because they are not structured in such a way as to facilitate such a task, which requires the clear identification of objectives, indicators and targets. In 2019, the Public Policy Monitoring and Evaluation Council (CMAP) was created to evaluate the impact of subsidies and TEs. The CMAP has already conducted 34 evaluations of indirect expenditures (subsidies), but its recommendations have not yet resulted in concrete changes to policies involving tax expenditures.

Fiscal sustainability: The sheer volume of revenue that the government fails to collect as a result of tax expenditures – estimated at 6.9% of GDP for 2024, including state-level TEs – points to the need for reforms to help reduce the negative impact of TEs on public accounts and on fiscal sustainability. Reforms should include a clear assessment of the benefits that TEs bring, including in relation to economic development and inequality.

Recommendations: Improve and standardise the definition of TEs – including all measures that imply forgone revenue – and the related calculation methodologies; standardise the presentation of revenue forgone at the state level and standardise the calculation methodology to enable the creation of a single, comprehensive database; create mechanisms to incorporate the results of CMAP evaluations into the formulation of public policies; include initiatives in the ongoing tax reform process to reduce and rationalise tax expenditures, coordinated between the different levels of government.

Brazil at a glance (2023)

Population
216.4
(million)

GDP
R$ 10.9
US$ 2.2
(in trillion)

Per-capita GDP
R$ 50,162
US$ 10,044

37.9%
(of GDP)
Total government revenue

45.7%
(of GDP)
Total government expenditures

60.9%
(of GDP)
Public net debt

TAX STRUCTURE

Net tax revenue, 2023

Type of tax	Billion R$	Billion US$	% total
Direct taxes	1,121.5	224.6	31.9
Indirect taxes	1,369.7	274.3	38.9
Social contributions*	935.8	187.4	26.6
Other	94.4	18.9	2.7
Total taxes and contributions	**3,521.4**	**705.1**	**100**

*payroll tax: Contributions to the National Institute for Social Security (INSS), to the Public Servants' Social Security, taxes on salaries for education, Severance Guarantee Fund (FGTS) and "Sistema S" (a group of 9 professional support organizations).

Sources: World Bank Group (2024). National Treasury Department (2024b) and Pires (2024). Anuário Estatístico do Brasil (2023), BRL/USD exchange rate (2023) = 4.99.

Tax expenditures key figures (2023)

Annual
reporting since
1989

128
Reported provisions

R$ 519
US$ 104
Total revenue forgone
(in billion)

4.8%
Total TE as a % of GDP

24.0%
Total TEs as a % of total
revenue

Source: Ministry of Finance (2024). Anuário Estatístico do Brasil (2023), BRL/USD exchange rate (2023) = 4.99.

Note: This report provides data from 2019 to 2024, including estimates for 2019, 2020 and 2021 and forecasts for 2022, 2023 and 2024.
Only tax expenditures at the federal level are included on this page.

Key governance and institutional features

The rules on tax expenditures (TE) consist of a multitude of instruments and involve several institutional stakeholders. Despite being attached to the budget, the proposals for new TEs are analysed in isolation and without connection to the budget, discouraging cost considerations and comparisons with competing direct expenditures.

Legal basis and key stakeholders

In Brazil, the laws regulating tax expenditures (TEs) are sparse. The Constitution of the Republic stipulates the following requirements:

(I)   Specific legal requirement:[1] TEs can only be created by ordinary or complementary laws,[2] which follow an extensive procedural process in the National Congress and go through specialist committees[3] and public hearings. Provisional measures (MPs), which are exclusively within the jurisdiction of the head of the executive branch of government, are also used to create TEs in Brazil, but their validity is limited to

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[1] Article 150, Section 6.

[2] An ordinary law is the general type of legislation in the Brazilian legal system, approved by a simple quorum in both houses of the Legislative Branch. As far as the tax system is concerned, ordinary laws are responsible for creating, amending and abolishing taxes. A complementary law (*lei complementar*) is a type of legislation whose function is to explain or complement a particular issue already enshrined in the Constitution. The quorum for approval is an absolute majority (Article 69 of the Federal Constitution). With regard to tax matters and more directly related to TEs, complementary laws are responsible for defining differentiated and favoured treatment for microenterprises and small businesses, for example, including special or simplified regimes in the case of some taxes (Article 146 of the Federal Constitution).

[3] In relation to tax benefits, proposals that create expenditures or deal with public finances are required to pass through the Finance and Taxation Committee (Comissão de Finanças e Tributação, CFT) and the Constitution, Justice and Citizenship Committee (Comissão de Constituição e Justiça e de Cidadania,CCJC), which respectively judge their compatibility with the Federal Budget and assess their Constitutionality.

60 days, which can be extended for an equal period, after which they lose their effectiveness. The preference for using MPs is due to the fact that such legal acts, once the requirements of relevance and urgency are met, take effect immediately after being published, and can be converted into law in the National Congress using an urgent procedure, unlike a regular bill.

(II) Complementary law on public finances: [4] The formal requirements for granting tax expenditures can be found in Complementary Law 101/2000, also known as the Law on Fiscal Responsibility (LRF). This law establishes the concept of revenue forgone and requires that a legal instrument must be accompanied by an estimate of the financial budgetary impact and, if the loss is not taken into account in the budget's revenue forecast, an offsetting measure must be presented. [5] In 2016, Constitutional Amendment (EC) No. 95 introduced Article 113 into the Act on Transitional Constitutional Provisions (ADCT), which states that any legislative proposal that creates forgone revenue must be accompanied by an estimate of its financial and budgetary impact.

(III) Estimated tax expenditures as an annex to the Annual Budget Bill (PLOA): [6] Tax expenditure is dealt with in the Statement of Tax Expenditures (DGT), drawn up by the Brazilian Federal Revenue Service (RFB) as an annex to the Annual Budget Bill (PLOA). It should be noted that there is no consensus on the definition of TEs or its nomenclature (e.g. revenue forgone, tax exemption, tax benefit, etc.). This vagueness will be discussed in the section on calculation methodology.

(IV) Autonomy of federative entities in relation to the taxes within their jurisdictions and within the limits established by law: [7] States and municipalities have autonomy to create benefits related to the taxes within their jurisdictions. For example, states can create incentives in the ICMS (Tax on the Circulation of Goods and Services) and the municipalities in the ISS/ISSQN (Tax on Services of Any Kind). In this sense, the process of creating taxes and the associated laws is specific to each federal entity, causing tax wars between states and municipalities in the case of taxes that are levied at their source (Coelho, 2021).

According to the Constitution, the actors who can formally present a bill on TEs at the federal level are all those who can present laws in general. [8] However, it is possible to say that the National Congress is the main actor in the creation of tax expenditures, since all new incentives must pass through the Legislative Branch. In any case, the support of the Executive Branch is essential, not only to mobilise its base in the National Congress, but above all for the bill's subsequent sanctioning.

As far as implementation is concerned, TEs are regulated by the Brazilian Federal Revenue Service (RFB) through normative instructions that determine how the process of applying, managing and monitoring the benefits will be carried out. In addition, the RFB categorizes the benefits as tax expenditure (TE) or other forgone tax revenue

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[4] Article 163, I.

[5] Article 14, I, II and Section 1.

[6] Article 165, Section 6.

[7] Article 155, II, Section 2, XII, g.

[8] With regard to tax benefits, the initiative for a law is not exclusive to the President of the Republic but can be exercised by any member of the National Congress, falling under the general rule set out in the introduction to Article 61 of the Constitution. Furthermore, although it has budgetary impacts, it is essentially a tax matter, which is why the restriction in Article 165 of the Constitution does not apply.

(ORTs) and includes them into the reports, as well as monitors the receipt of these benefits, as a way of preventing fraud, applying customs control, combating tax evasion, and so on (Gerbase & Lopes, 2021).

The Statement of Tax Expenditures

Tax expenditures fall into the general category of "tax benefits" or, as described in the Law on Fiscal Responsibility, they are considered as forgone tax revenues and must be included in the Statement of Tax Expenditures (DGT), presented as an annex to the Annual Budget Bill (PLOA). A TE is defined by the RFB as "indirect government expenditure, carried out through the tax system, aimed at meeting economic and social objectives and constituting an exception to the Benchmark Tax System (STR), reducing potential revenue collection and, consequently, increasing the economic resources available to the taxpayer".[9]Forgone tax revenue consists of benefits realized through a type of indirect public spending, occurring through the tax system, representing a deviation or an exception to the characteristics to be expected of a given tax. It is at the discretion of the RFB to decide which benefits will be characterised as TE and, depending on the STR, the benefit may or may not be considered as such. This issue will be explored further in the section on calculation methodology.

Benefits that are not classified as TEs by the RFB are characterised as Other Forgone Tax Revenue (ORTs), even if they have similar characteristics, as they reduce potential revenue collection and are implemented through the tax system. This differentiation has a real effect in terms of transparency. While TEs have a certain degree of transparency, with annual estimates of revenue forgone appearing alongside the budget laws and quantitative analyses broken down by region and by tax, the ORTs do not include these same elements, appearing in a separate document and only with estimates of their fiscal impact for three years and no historical series. This is a methodological choice of the RFB, which considers ORTs to be general tax benefits, introduced by less onerous tax legislation, as it believes that changes of this nature create a new tax benchmark rather than modify the existing one (Gerbase & Lopes, 2021). In any case, according to Article 4 of RFB Ordinance No. 150/2021, for any legislative proposal submitted by the Executive Branch that implies a reduction in tax revenue, an estimate of the fiscal impact must be drawn up, regardless of whether or not the measure is formally considered a measure of forgone tax revenue according to Article 14, Section 1 of the LRF.

Although the DGT appears as an annex to the PLOA, it is important to contrast the creation of indirect expenditures with direct government expenditures, i.e., to compare tax expenditures with budgetary expenditures. The latter have a well-structured creation process that has to go through several stages, are approved annually and have fiscal targets that limit expenditures. On the other hand, the proposals for new TEs are analysed in isolation and without connection to the budget, discouraging cost considerations and comparisons with competing direct expenditures. In other words: tax expenditures do not go through the budget implementation stage, because they are off-budget expenditures. Once approved, beneficiaries only enjoy the benefits until the end of the specified period, if one exists.

As for the content of the DGTs, the last document made available, published in March 2024, begins with a brief overview of the concepts and methodology to be applied. Then, information is presented on the review of the applied methodology, highlighting items for which the estimates may have suffered a significant impact. The

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9   http://receita.economia.gov.br/dados/receitadata/renuncia-fiscal/demonstrativos-dos-gastos-tributarios/conceito-de-gasto-tributario.

data show the historical series of the actual basis in nominal values, as a percentage of the tax burden and of GDP, as well as the segmentation of these data by region (without delimitation by federal state), by type of tax and by budget function. The statement also highlights the items with the largest amounts of forgone revenue. As for the period of validity and the items that are categorized as tax expenditures, the document highlights a table at the end that describes the item, its legislation, its period of validity and the amount of the forgone revenue for the fiscal year analysed, as well as the type of tax. The document also makes an international comparison with Latin American countries. Over the years, there has been a standardisation in the structure of data disclosure, as well as in the classifications given, which allows for greater comparability of the information provided.

Transparency[10]

There are gaps in transparency at various stages of the cycle of public policies that use TEs. As far as the formulation is concerned, when a Provisional Measure is used to set up TEs for a particular economic sector, it generally does not deal exclusively with the matter, which goes against the Constitution's criterion of specificity of laws.[11] Another weakness of Provisional Measures in relation to ordinary laws is that they are not examined by specialist committees of the National Congress, but only by joint committees formed exclusively to give favourable or unfavourable opinions on Provisional Measures, and they go straight to the Plenary. As a result, the normal procedure for a bill is shortened, which can prevent proper debate.

With regard to estimates of the financial and budgetary impact, these are usually presented by the Executive Branch in the Explanatory Memorandum accompanying the Provisional Measure, or in the justification for the bill initiated by the executive branch, which is often not the case when a TE is created by ordinary or complementary law initiated by the Legislative Branch itself. Data from the National Treasury show that, between 2018 and 2020, two-thirds of the proposals involving forgone tax revenue drafted by the Legislative Branch were rejected by the Ministry of Finance because they did not contain estimates of revenue loss or offsetting measures (Graner, 2020). The problem persists when drafting the converting bill (Projeto de Lei de Conversão, PLV), since the National Congress can, through parliamentary amendments, increase tax incentives without adjusting the estimates.[12] The Law on Fiscal Responsibility (LRF) requires offsetting measures to be presented in the Fiscal Targets Annex as 'instituted forgone revenue' in the period, but Article 14, Section 2 of the LRF is not considered automatically applicable, requiring that a supplementary rule be issued to enable its implementation (Procuradoria-Geral da Fazenda Nacional, 2024).

As far as the public policy implementation stage is concerned, there has been some progress. In 2021, Complementary Law No. 187 was published, which amended Article 198 of the National Tax Code (Law No. 5,172/1966) to exclude from the protection of tax secrecy legal entities that receive tax benefits. This represents

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[10] In this transparency analysis, all forgone tax revenue will be considered, as will the related decision-making and management processes, and not just what the RFB classifies as TEs.

[11] One example of a Provisional Measure that instituted a tax benefit was MP No. 563/2012, which created the "Programme to Incentivise Technological Innovation and Consolidation of the Motor-Vehicle Production Chain – Inovar-Auto". This Provisional Measure instituted a series of other special tax regimes and public policies, such as the One Computer per Student Programme, in violation of the stipulation that tax benefits must be established in specific laws.

[12] One example of this was MP No. 563/2012, which established various tax expenditures, including the payroll tax exemption (Articles 43 to 46), with the respective estimate of forgone tax revenue (Ministério da Fazenda, 2012). In the Legislative Opinion on PLV No. 18/2012, parliamentary amendments included other sectors in the list of TE beneficiaries, without adjusting the estimates previously drawn up by the Ministry of Finance (Congresso Nacional, 2012).

a major achievement for the transparency of TEs. In compliance with this provision, the Office of the Comptroller General of the Federal Union (CGU), the federal government body responsible for the defence of public assets, transparency and the fight against corruption, publishes on the Transparency Portal (Controladoria-Geral da União, 2024) the names of the biggest beneficiaries of tax benefits in terms of the volume of funds granted, detailing the search by tax or government programme.

A new transparency measure also came into force this year. Article 43 of Law 14,973/2024 requires legal entities to submit their tax benefits in the Declaration of Incentives, Exemptions, Benefits and Immunities of a Tax Nature (DIRBI), in the format in RFB Legislative Instruction 2,216/2024. By August 2024, more than 50,000 companies reported benefiting to the tune of almost R$ 100 billion for the year (Fernandes, 2024).

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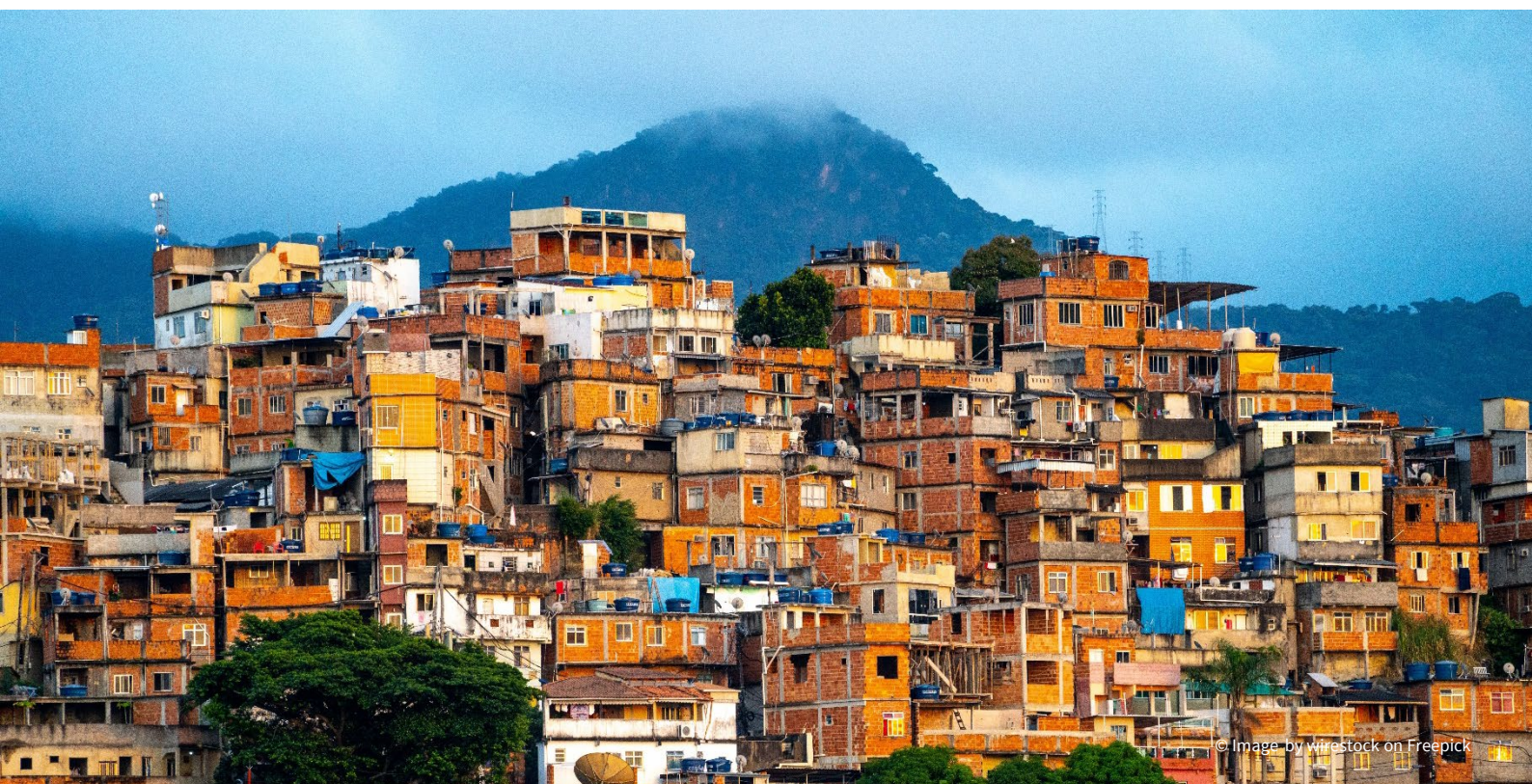
Tax expenditures transparency

The quality and scope of TE reports in Brazil is reflected in the **Global Tax Expenditures Transparency Index (GTETI)**, where it is ranked in **7th place among 105** countries evaluated.

15.3/20

Dimension 1 – **Public Availability**
This dimension captures the extent to which TE reports are made available to the public. It considers the regularity of reporting, the timeliness of data, the online accessibility, and the reader-friendliness of the document.

12.6/20

Dimension 2 – **Institutional Framework**
This dimension evaluates how well the institutional framework promotes transparency and accountability in TE policymaking. It assesses the legal basis for TE reporting, the requirement to submit reports to parliament, the assignment of the responsibility to report to a specific public authority, and the consideration of TEs in the country's budget cycle and medium-term strategy.
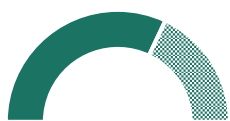
12.8/20

Dimension 3 – **Methodology and Scope**
This dimension analyses the extent to which TE reports cover all TEs available at the national level, the level of specification of the reference benchmark system against which TEs are assessed, and the method(s) used to calculate revenue forgone.

15.0/20

Dimension 4 – **Descriptive TE Data**
This dimension assesses the information available in the report to identify and explain the nature of different TEs. It evaluates the extent to which the report specifies the policy objective(s) of TEs. Also, it analyses the availability of TE data regarding the type of TE (tax credit, deduction etc.), beneficiaries, time frames, and the legal basis under which TEs are granted.

9.6/20

Dimension 5 – **Evaluation**
This dimension analyses the extent to which revenue forgone estimates are provided in the report, including levels of (dis)aggregation and the time span of revenue forgone estimates (previous years and forecasts). Further, it assesses the availability of information on TE evaluations, considering both the existence of ex-ante and ex-post evaluation frameworks, and the scope of publicly available evaluations.

Source: Redonda et al. (2024)

Monitoring

The RFB monitors TEs from a technical aspect, analysing their volume and the main beneficiaries, overseeing the receipt of these benefits, and providing an updated list of current TEs.[13] However, this body does not monitor TEs in terms of drawing up indicators and measuring targets.

Evaluation framework

Ex ante:

The Ministry of Finance is an important body in the process of ex ante evaluation of bills involving tax expenditures. Although not binding, the technical opinion is an important indication of the government's opinion on the tax issues involved, influencing the position of parliamentarians.

In 2016, Federal Senate Resolution No. 42 created the Independent Fiscal Institution (IFI), a technical body linked to the Legislative Branch, which publishes estimates for the construction of fiscal and budgetary scenarios, measuring the impact of relevant fiscal events, and other objectives. The IFI can act ex officio or at the request of a senator. Its opinions and technical notes are made available to the public (IFI, 2024) and guide the decision-making process of senators in drawing up public policies, but they are not binding. An example of the IFI's work with TEs is the development of tax collection scenarios for measures to offset payroll tax reductions (Casalecchi, 2024).

Ex post:

Evaluating the results of policies that involve TEs is uncommon, not least because they are not structured in such a way as to enable this task, which requires the clear identification of objectives, indicators and targets. It is also unusual for there to be any kind of deadline, such as a period of validity, revalidation or periodic evaluation, that would provide an opportunity to analyse the benefit, possibly proposing corrections or its discontinuation (Pellegrini, 2014).

This scenario began to change in 2019, with the creation of the Public Policy Monitoring and Evaluation Council (CMAP), subordinate to the Ministry of Planning and Budget and currently governed by Decree No. 11,558/2023. Its main objective is to evaluate public policies that are funded by direct (budgetary) or indirect (including TEs) expenditures. The policies that will be evaluated are selected annually, based on Goal Programs in the Multi-Year Plan (PPA). To date, the CMAP has published 34 subsidy evaluation reports, which include TEs.[14]

Oversight

According to the Constitution, the Federal Court of Auditors (TCU) is the body responsible for overseeing the use of public resources by government officials, including forgone tax revenue.[15]

The TCU (Tribunal de Contas da União, 2014, 2016) recommended to the Office of the President that, when analysing legislative proposals containing TEs, it should observe the appropriate instrument for this purpose, i.e., a specific law that deals exclusively with the matter or the corresponding tax. With regard to the use of

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[13] RFB Ordinance No. 319 of 11 May 2023.
[14] More information on the CMAP's evaluations can be found in the Evaluation section of the report.
[15] Articles 70 and 71.

Provisional Measures, the constitutional deadline of sixty days, extendible for an equal period, for converting the Provisional Measure into law is too short for a full debate in the legislative houses, given the relevance and complexity of the issue (Tribunal de Contas da União, 2018b; 2018a).

The TCU also recommended that the technical committees of the House of Representatives and the Federal Senate begin to verify compliance with the requirements of Article 14 of the LRF when analysing proposals for legislative acts that grant or expand forgone revenue (Tribunal de Contas da União, 2016; 2018b). However, considering that decisions are ultimately within the jurisdiction of the members of congress, the regulatory act usually ends up not following these requirements, since the National Congress generally does not debate budgetary and practical issues in depth during the implementation of certain public policies (de Pinho, 2018).

With regard to the federal government, the TCU recognises progress in terms of complying with recommendations on data availability, transparency, increasing the accuracy of TE estimates, as well as the creation of the CMAP. However, it points out that there is still a need for improvement in aspects of the stages of formulation, operationalisation and monitoring of policies involving TEs, which have been included in a list of high risk areas for the government.[16] Such recommendations involve the definition of "objectives, targets, indicators, term of validity, management body, quantitative and qualitative information necessary for the monitoring and evaluation processes (…), a policy coordination and supervision unit that guides the formulation of public policies, as well as identification and definition of the roles of the essential bodies at this stage." (Tribunal de Contas da União, 2020).

Subnational entities

In a federal system like Brazil's, subnational governments (states and municipalities) also have the prerogative to use tax expenditures as part of their fiscal policies.

According to an estimate by the International Monetary Fund, subnational TEs represent at least 1.2% of national GDP, while the revenue collected by subnational entities represents 10% of national GDP (International Monetary Fund, 2019). The federal government's budget documents do not deal with subnational TEs, which is dealt with in the respective LDOs, hindering the realisation of adequate and comprehensive estimates of forgone tax revenue (Coelho, 2021). The lack of clear, uniform legislation reaching subnational governments is responsible for producing a great deal of conceptual and methodological heterogeneity and a lack of transparency about TEs.

As will be explained in the next section, each state applies its own concept of TE. In some cases, TE is more linked to the impact on revenue. This means that many governments fail to publish their TEs properly, claiming that a fiscal stimulus may have increased revenue rather than reducing it. In many cases, the data needed for this report were not publicly available for consultation and were obtained through requests based on the Law on Access to Information (LAI) (Law No. 12,527/2011).

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[16] https://sites.tcu.gov.br/listadealtorisco/transparencia_e_efetividade_das_renuncias_tributarias.html

Benchmark

TE provisions are defined as deviations from the benchmark tax system. This includes deviations from the standard tax base, deviations from the standard tax rate, or changes in the tax period benefitting the taxpayer. Nevertheless, the definition of what should be attributed to the benchmark tax system and what should be marked as a TE provision is not always clear-cut.

Tax expenditures at the national level

Tax expenditure estimates are made available by the RFB through the Statements of Tax Expenditure (DGTs), accessible online in spreadsheets with data from 2008 to 2024.[17] In addition, tax expenditure forecasts are made available based on the Annual Budget Bill (PLOA). The historical series of projected DGTs begins in 1989. For earlier periods, the tables are made available in PDF, which requires more effort to collect, analyse and subsequently evaluate.

The RFB also publishes supplementary materials, including a methodological information document, which presents individualised measurement techniques for the items that make up the DGTs, explaining the "revenue forgone method". Other material that has been released since 2019 includes the Instituted Exemptions (*Desonerações Instituídas*) spreadsheet, which contains all the new exemptions made in the last fiscal year. This document also covers offsetting measures, the period of validity and the classification of a given item as a tax expenditure. For some of the new forgone revenue, estimates are presented for the current year and the following two years. Items classified as a tax expenditure are subsequently incorporated into the DGT. The others constitute Other Forgone Tax Revenues (ORTs) and are not continuously monitored, which clearly limits the level of transparency. Some ORTs are classified as part of the benchmark system and consequently do not appear in the financial impact estimates. This is the case, for example, with Allowance for Corporate Equity (JCP) and the exemption of dividends and presumed profit. In other cases, the basis for the decision on classification is not always clear, since the document does not provide any justifications.[18]

Finally, other supplementary material released by the RFB includes a document entitled "Concepts and Classification Criteria", which defines the concept of tax expenditure, the benchmark tax system for each of the associated taxes and, finally, the justification for the classification of a tax expenditure, which is segmented by tax. As an example, justifications for classifying some items as tax expenditure are included. A payroll tax reduction "[…] is a Tax Expenditure because it alters the basis for social security contributions, potentially reducing collections. Furthermore, this is a benefit with a purpose other than the fiscal nature of the tax." A similar classification is given to the Simplified National Taxation System: "[…] This is a tax system that causes a reduction in collections […] and that does not affect all taxpayers. Thus, despite the fact that Simplified National Taxation System companies pay their contributions on revenue, the drop in revenue caused by this system means that the Simplified National Taxation System is considered a Tax Expenditure." Another example is the exemption from import tax for industries established in the Manaus Free Trade Zone in the state of Amazonas:

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[17] https://www.gov.br/receitafederal/pt-br/centrais-de-conteudo/publicacoes/relatorios/renuncia

[18] This is said explicitly, because in the period prior to 2019, the RFB published the list of tax benefits and periods of validity in the DGTs. From 2019 onwards, these items are explained in a separate document, which provides a better visualisation of the new exemptions and their impacts for the coming fiscal years.

"[…] The exemption from Import Tax is a Tax Expenditure, as it is an exception to the rules on the incidence of the tax and is conditioned to the geographical region of the taxpayer in order to combat regional inequality." (Receita Federal do Brasil, 2020)

With regard to calculating the estimate of revenue loss, the RFB opts for the forgone revenue method, which analyses tax expenditure items in isolation and does not take into account "that the suppression of one item may lead to a change in the measurement of other tax expenditures (…) [the method] makes it possible to draw a parallel between direct expenditures (general budget) and indirect expenditures (via the tax system) in a timely and comprehensive manner (…)". In other words, the estimated value ultimately represents the examination of one item, without taking into account the joint effect of a set of tax exemptions.

In general, given the plurality of taxes and types of exemptions, there is limited standardisation in calculation methodologies, which can be divided into: a) direct calculation, in which the value of the tax expenditure results directly from taxpayers' declarations;[19] b) estimates based on aggregated data, in which the value of the tax expenditure is the result of a simulation of the normal assessment of the tax, based on considerations regarding the volume taxed; c) micro-simulations, in which individualised information from taxpayers is used, simulating normal taxation (without incentives). The tax expenditure will finally be calculated by the difference between the simulated amount due and the amount actually due as determined by the taxpayer (Receita Federal do Brasil, 2024).

The RFB describes the process involved in estimating forgone revenues: "Once the exemptions that fall within the concept of Tax Expenditure have been identified, the circumstances of the taxable event, what the taxable calculation basis will be, and the applicable rates are identified. From there, a tax simulation is built that estimates the amount of tax that would be due if the normal tax parameters were applied to the exempt situation" (Receita Federal do Brasil, 2024a).[20]

Taxes on consumption

The taxes on consumption that make up tax expenditure include PIS-PASEP (Social Contribution to PIS–PASEP), COFINS (Contribution for the Financing of Social Security), IPI-I (Tax on Industrial Products – Domestic Transactions), IOF (Tax on Financial Transactions) and CIDE (Contribution for Intervention in the Economic Domain).

PIS and COFINS are the main federal taxes on consumption. Although they are separate taxes, they have the same basis, but are separate because they provide finance for different public policies.[21] There are two different calculation systems for PIS and COFINS: the non-cumulative system, with a rate of 9.25%, which allows credits to be deducted on the acquisition of inputs; and the cumulative system, with a rate of 3.65% and no credits. The non-cumulative system is closer to the concept of a consumption VAT, even though it is not broad-based, given that the system of credit utilisation is restricted.

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[19] Taxpayers would be "responsible for calculating and demonstrating the value of the benefit enjoyed" ("Methodology for calculating tax expenditure", 2023).

[20] The TE statistical data by type of tax used in this section refer to the forecasts released by the 2023 PLOA, the latest available report that publishes information with this classification.

[21] COFINS finances social security and PIS finances employment policies (unemployment insurance and salary bonuses) and generates resources for the BNDES to offer credit.

According to RFB estimates, the total TE associated with PIS/COFINS amounts to R$ 130 billion (equivalent to 28.65% of total TE and 1.23% of GDP) in 2023. The main TE associated with PIS/COFINS is the exemption for the basic food basket (R$ 34.8 billion), the Simplified National Taxation System (R$ 29.7 billion), the Manaus Free Trade Zone (R$ 14.03 billion), chemical products (R$ 9.4 billion) and medicines (R$ 8.6 billion). These five types of TE total R$ 96.5 billion, equivalent to 0.9% of GDP and 21.2% of the total TE.

An interesting case is the tax on industrialised products (IPI), which has differentiated rates for each type of product in such a way that it is not possible to define a general rule. The RFB considers a favoured treatment as IPI-related TE if it benefits a certain group of manufacturers within the production chain of the same product. This includes exemptions that benefit companies based in specific regions of the country, such as the north, or specific exemptions for companies entitled to special treatment for reasons of economic development. In 2023, the IPI TE corresponded to R$ 47.5 billion, or 0.45% of GDP.

Personal income tax

The income taxes on individual incomes that make up tax expenditure include IRPF (Personal Income Tax) and IRRF (Income Tax Withheld at Source).[22] In the case of the IRPF, taxation under this type of tax consists of applying progressive rates, depending on the level of income, to a calculation basis, which is made up of the sum of certain types of income minus the allowed legal deductions.

Deductions from the calculation basis that do not result from income tax structural criteria are considered deviations from the normal tax design and therefore constitute tax expenditures. This is the case with deductions for health and education expenses. Financial income that has its tax burden reduced or even eliminated (exemption of savings income, mortgage bills, incentivised debentures, etc.) are deviations from the general rule and are also considered tax expenditures.

Currently in Brazil, income from dividends earned by individuals is exempt from income tax. This exemption was adopted in order to establish complete integration between individuals and legal entities, taxing this income exclusively for legal entities such as companies, and exempting it when it is received by individual beneficiaries. According to the RFB (2020), "the form and degree of integration of personal and corporate income tax, more specifically the treatment of dividends, is considered part of the general structure of income tax and, as much as this choice may raise questions about tax justice with impacts on the fairness of the system, it is considered part of the current benchmark tax system."

Among experts, this treatment resulting from a conceptual interpretation of the system is controversial, since it involves a major revenue loss. Currently, the income distributed to company shareholders reached a record of R$ 830 billion in 2022, which is equivalent to 8.2% of that year's GDP.

The total TE associated with the IRPF is R$ 75.6 billion, equivalent to 0.71% of 2023 GDP and 16.58% of total TE. The main TEs associated with the IRPF are tax deductions resulting from medical expenses (R$ 24.5 billion, 0.23% of GDP), pension deductions for serious illnesses (R$ 20.7 billion, 0.19% of GDP), pension deductions for people

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[22] In the case of IRRF, these are delimited into both personal and corporate income tax. The justification is that, in DGTs, IRRF is not segmented between individuals and companies. On the basis of the conceptual classification and the description of the benefiting programmes provided by the RFB, this expands to individuals and companies.

over 65 years of age (R$ 12.8 billion, 0.12% of GDP) and tax deductions resulting from severance pay (R$ 10 billion, 0.09% of GDP).

Corporate income tax

The taxes levied on legal entities that constitute tax expenditure include IRPJ (Corporate Income Tax), CSLL (Social Contribution on Net Profit) and IRRF (Income Tax Withheld at Source).

The basis for calculating income tax and CSLL is actual profit. The IRPJ rate is 15% plus an additional 10% on the portion of profit that exceeds R$ 240,000 per year and the CSLL rate is 9% for legal entities in general and 15% for financial legal entities. It is possible to carry forward losses made in previous fiscal years to be used as a way of reducing profits made in future years. Losses from previous fiscal years can be offset against current profits up to a limit of 30% of the profit.

Presumed profit is a simplified taxation system for companies that is optional for those with annual revenue of up to R$ 78 million. Presumed profit companies pay their corporate taxes based on revenue rather than profit. The presumed profit base varies between a minimum of 8% and 12% of IRPJ and CSLL, respectively. The maximum percentage rises to 32% for both taxes for certain types of services.

For many companies, the factor of presumed profit constitutes a major tax incentive, because as it is an optional regime, companies opt for presumed profit to the extent that they obtain a reduction in the taxes due. The RFB does not classify presumed profit as a tax expenditure, as it believes that this is a regime that seeks tax simplification, and it is considered part of the benchmark tax system.

The Simplified National Taxation System (*Simples Nacional*) is a broad business tax regime in Brazil aimed at companies with maximum revenue of R$ 4.8 million, with the aim of simplifying the system for small businesses. The company pays only one collection document, referring not only to IRPJ/CSLL, but also to the other taxes levied on production or consumption (such as IPI, PIS/COFINS, ICMS and ISS, as well as the employer's social security contribution in some cases), and the amount is apportioned *a posteriori* between the various taxes and spheres of the federation, based on an arbitrary proportion of the total that is levied on each of them.

The total TE associated with corporate taxation (IRPJ and CSLL) is R$ 99.7 billion in 2023, 0.94% of GDP and 21.85% of total TE. The Simplified National Taxation System is the largest TE in Brazil. In 2023, the total tax incentive was estimated at R$ 88.5 billion, 19.41% of the total federal TE and 0.82% of GDP. The portion of the Simplified National Taxation System tax exemption resulting only from corporate taxation (IRPJ and CSLL) was R$ 32 billion, 7% of the total federal TE and 0.3% of GDP. Table 1 below summarises the main tax elements of presumed profit and the Simplified National Taxation System, according to the main sectors.

Table 1. Taxation of profits under special regimes, rates on revenue.

Sector	Simplified National Taxation System		Presumed Profit	
	Total Rate	IRPJ/CSLL	Presumed Basis	IRPJ/CSLL
Trade – 1	4–11.1%	0.36–2.61%	8% and 12%	2.28–3.08%
Industry – 2	4.5–15%	0.41–2.4%	8% and 12%	2.28–3.08%
Services – 3	6–19.5%	0.45–9.75%	8–32% and 12–32%	2.28–10.88%
Services – 4	4.5–15.75%	1.53–10.24%	32%	7.68–10.88%
Services – 5	15.5–19.25%	6.2–9.72%	32%	7.68–10.88%

Source: Gobetti (2024).
Note: The figures adjacent to the sector refer to the annex of the law. The most important annexes have been selected.

The other TEs associated with corporate taxation are deductions for medical expenses for company employees totalling R$ 12.6 billion (0.12% of GDP and 2.8% of total TE) and incentives associated with development policies for the North and Northeast regions (SUDAM and SUDENE): R$ 14.5 billion (0.14% of GDP, 3.18% of total TE). In addition, there is TE for donations, spending on research and innovation, tax incentives for sponsoring sports and cultural events, social security, education and spending on IT products.

Social security contribution (CPS)

Among the deductions involving the social security contribution (CPS) is the payroll tax reduction, which has a differentiated rate for specific sectors. The wage bill is used to calculate the payroll tax and the respective reduction. The potential revenue collection is estimated based on the number of employees. The TE is the difference between these two amounts. For other cases, only the contribution rate on the baseline amount applies.

TEs related to CPS reached R$ 65.9 billion in 2023, equivalent to 0.62% of GDP and 14.46% of total TE. The main TEs are the Simplified National Taxation System (R$ 23.7 billion, 0.22% of GDP), philanthropic entities (R$ 13.4 billion, 0.13% of GDP), payroll tax reduction (R$ 9.4 billion, 0.09% of GDP) and MEI (Individual Microentrepreneur), a programme to formalise small entrepreneurs and self-employed workers who have an annual revenue of up to R$ 81,000 (R$ 5.2 billion, 0.05% of GDP).

Other

The remaining taxes that make up tax expenditures include AFRMM (Freight Surcharge for the Renewal of the Merchant Navy), CONDECINE (Contribution to the Development of the National Film Industry), ITR (Rural Land Tax), II (Import Tax) and IPI-V (Tax on Industrial Products – Linked to Imports). The calculation methodology for AFRMM is quite varied, depending on the legislation associated with the programme. In general, the values are extracted from the basis according to the tax benefit and multiplied by the percentage of GDP distributed by budget functions, arriving at the tax expenditure. Meanwhile, the tax on imports is the result of multiplying the amount imported by the associated rate.

State-level tax expenditures

The state-level tax expenditures considered here are the forgone revenues disclosed in the Laws on Budgetary Guidelines (LDO) for each state.[23] The Statements for Estimating and Offsetting Revenue Forgone are included in the latest LDOs approved by each state. It is common for some states to only disclose their LDOs from 2010 onwards, which made it necessary to use LAI (Law on Access to Information) requests to obtain data from 2002 to 2009. Not all states responded to the requests for information, resulting in under-reporting, especially in the early years of the survey.[24]

Looking at the data, it is possible to observe heterogeneities between states, and over the years in the same states. Firstly, a variety of interpretations of the concept of forgoing and offsetting of revenue can be identified. As a consequence, some states do not declare forgone revenue in the period considered (the case of Paraná, Sergipe and Ceará for many years), or declare forgone revenue but consider (often only in qualitative terms) that the forgone revenue is automatically offset in the budget planning process, or creates an overall increase in revenue (the case of Alagoas, Pernambuco, Pará, Mato Grosso do Sul, among others).

For example, the state of Alagoas published the programmes that benefited from TE without any estimate of the revenue forgone, assuming that the amount would be offset by an increase in total revenue collected. The state of Ceará, on the other hand, has not published an estimate of revenue forgone for many years, using the justification that no new benefits have been granted. In addition, it was argued that the benefits already granted were "expunged from estimated revenue".

While some states did not disclose revenue forgone, but tried to justify the offsetting, others only commented on a regulatory loophole that allowed them, at the time, not to disclose revenue forgone. The state of Mato Grosso do Sul, for example, applied an interpretation derived from the National Treasury Secretariat (STN) Ordinance No. 249/2010 that there was no exemption to be reported in the following situations: "1) prior to the enactment of Complementary Law No. 101/2000; 2) arising from past tax incentives, offset in a period prior to the baseline period (2012–2014); 3) arising from national legislation." (Estado do Mato Grosso do Sul, 2012).

Another observed heterogeneity relates to the segmentation of the published exemptions. While some states delimit exemptions by the sector receiving the benefits, others do so by the associated legislation or by the type of tax concerned. For many years, states have done little to standardise the methodology for segmenting data, which obviously makes it difficult to compare and analyse, as well as standardize the calculation methodology.[25] Finally, all states reported ICMS exemptions. Some even disclose IPVA and ITCMD incentives, which generally account for less than 10% of total incentives for most states.

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[23] In this section, for each state reported, the categorisation of tax exemptions chosen by the state will be replicated, which can range from tax benefit to forgone revenue, tax-related exemption, and tax expenditure, among others.

[24] For more details on the methodology used for state-level data collection and access the database, please access the technical note available here: https://observatorio-politica-fiscal.ibre.fgv.br/series-historicas/outros/metodologia-de-estimacao-dos-gastos-tributarios-estaduais-e-dados-do-tecr

[25] The state of Alagoas, for example, disclosed the beneficiary programmes in a segmented way. In an excerpt from the 2015 LDO, it even mentioned that the incentive estimates made in previous periods used different criteria, due to "a [lack of] defined and approved calculation methodology". In addition, in some years it failed to disclose a programme for the sugar-cane alcohol sector, claiming that it was not clear how to calculate the tax benefit that would later be included in the reports.

In short, a significant difference in methodological procedures is adopted between different states, and in the same state over time. It is difficult to conduct analysis between states, as there is no standardised methodology for estimating revenue forgone.

Some states identify revenue forgone as a tax expenditure: this has recently been the case for both São Paulo and Espírito Santo. While São Paulo uses the average tax rate as a basis for calculating revenue forgone, the state of Espírito Santo estimates ICMS tax expenditure based on the difference between potential and actual ICMS revenue collection. In the case of Santa Catarina, which has undergone considerable methodological change in recent years, the 2024 LDO highlights: "The state of Santa Catarina adopted the principle of prudence in calculating revenue forgone, calculating it based on the difference between hypothetical revenue collection without the incentive and the actual revenue collection with the incentive. This does not take into account the fact that a company may have relocated to or remained in the state exclusively because of the benefit granted, and that any possible revocation would result in it migrating to another state that is more attractive from a tax point of view." (Estado de Santa Catarina, 2024)[26].

Another important aspect reported in the LDOs as a justification for revenue forgone is to ready the state for "tax wars". In this sense, given the autonomy of the states in deciding their tax rates, there is competition to attract investment by guaranteeing tax benefits. The National Treasury Policy Council (CONFAZ), with the aim of reducing the impacts of tax expenditure, established rules for the creation of new exemptions, which must be voted on by the Council, made up of all the treasury secretaries of each state. The aim is to guarantee reciprocity in ICMS transactions between the states. However, many states grant incentives outside the CONFAZ agreements, stimulating tax competition. In retaliation, the states that feel harmed file lawsuits with the Federal Supreme Court questioning the constitutionality of the incentives, leading to a high level of legal uncertainty. After all, if revenue forgone is aimed at developing underprivileged regions, the mechanism of tax wars undermines the initial intention, since if all states provide the incentive, the exemption loses its effect (Assembleia Legislativa do Rio Grande do Sul, 2022).

The impact of tax wars on the measurement, evaluation and monitoring of TEs at the subnational level is quite significant: "The condition that the tax provision generates a loss of revenue, for example, is perhaps what gives rise to the most discussion about ICMS, since, in the context of tax wars, it is common to hear the argument that the granting of some tax benefits for the installation of new investments would not represent forgone revenue because, without them, the ventures would not materialise. In some cases, this may be true, but it is very difficult to know for sure whether the investment would not have actually occurred in the absence of the incentives. Furthermore, from a national point of view, the loss of ICMS revenue as a result of the tax competition between states is unquestionable." (Gobetti, 2024).

Tax Statements Manual

The National Treasury Secretariat (2024a) frequently develops and updates the Tax Statements Manual, with rules for harmonisation to be observed permanently by the government, aimed at both the national and subnational levels. The Estimation and Offsetting of Revenue Forgone are presented in Statement No. 7 of the

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[26] Additionally, the case of the Federal District stands out, as it is one of the few states that clearly details new exclusions, inclusions and increases, as well as their impact on the estimates. For this purpose, two documents are made available with the estimated revenue forgone. The first covers the results and the second highlights the methodology used, detailing changes in the legal landscape that led to new increases.

Manual. It identifies the taxes for which forgone revenue is foreseen, highlighting the type of incentive, the "sectors/programmes/beneficiaries", the forgone revenue projection for the LDO baseline year and for the following two fiscal years, and the measures to offset the expected loss of revenue.

In general, over the years, the rules have been followed by the RFB in the DGTs. The same procedure did not occur for states that have different structures for presenting information. However, at a subnational level, especially since 2020, a greater structuring can be seen, with more description of programmes and benefits, and methods of offsetting. Moreover, states that previously did not disclose any information now present estimates of forgone revenue and offsetting measures. The great benefit of this greater homogeneity will be greater comparability of revenue forgone by type of tax and benefiting sector.

However, the Manual does not indicate the methodology for calculating the estimated exemption, nor any suggestions regarding the description of the calculation method used. Some states, in turn, use the baseline year in terms of an actual base (this is the case of Alagoas and Pará in some years), while others make a projection. Finally, some states, as reported throughout this section, divide the benefits into microregions (Espírito Santo and Pernambuco are illustrative examples) (Secretaria do Tesouro Nacional, 2024a).

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Moreover, states that previously did not disclose the figures now present estimates of forgone revenue and offsetting measures. The benefit of this greater homogeneity will be improved comparability of revenue forgone by type of tax and benefiting sector.

Revenue forgone

The forgone tax method estimates the loss of revenue incurred by the government due to the creation of a TE. This involves comparing the amount of revenue actually collected with the amount of revenue that would have been collected in the absence of the TE, without taking into account the taxpayers' behavioural responses.

In this section, total tax expenditures are calculated as the sum of tax expenditures at the federal level, made available by the RFB in the DGTs, and the forgone revenue disclosed in the Laws on Budgetary Guidelines (LDOs) at the state level for the equivalent period.

Figure 1. Tax expenditures as percentage of GDP
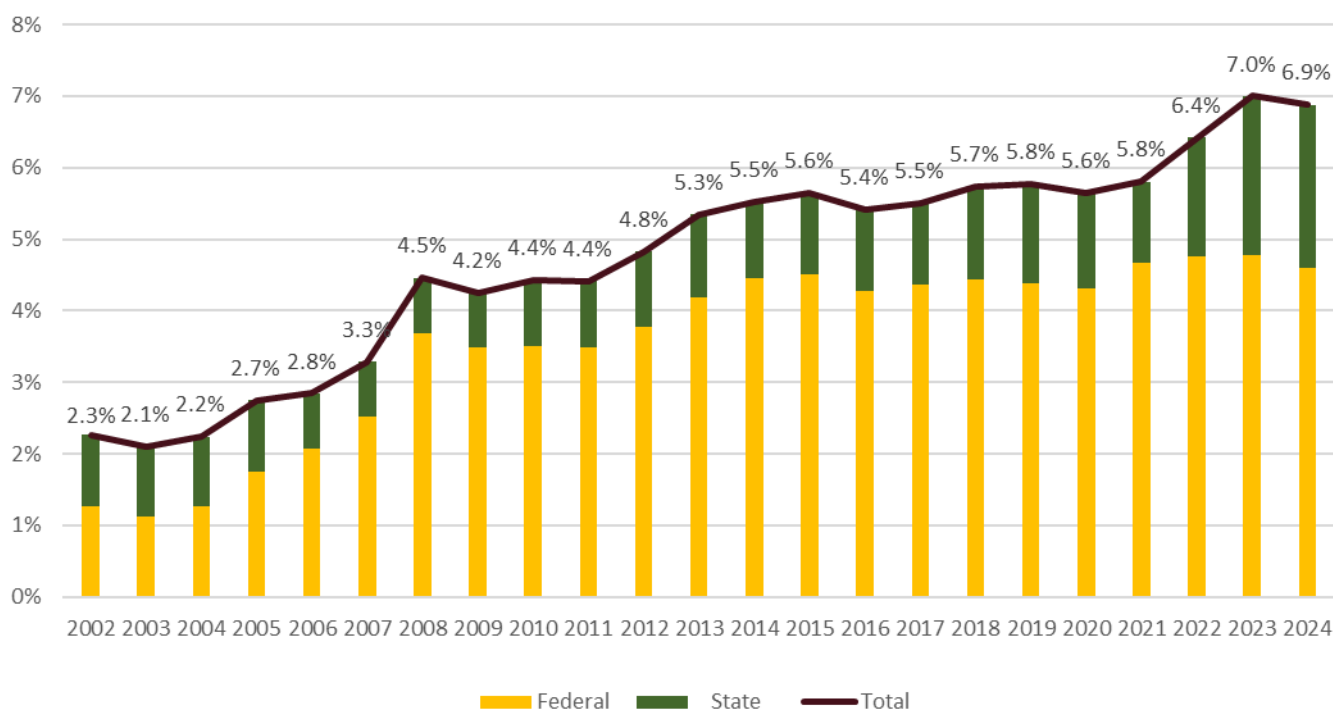
Source: Statements of Tax Expenditures – Brazilian Federal Revenue Service, State LDOs and SEFAZ/RS (2020).
Note: 2002–2007 and 2022–2024 are PLOA forecast while 2008–2021 are estimates for federal tax expenditures.

In relation to GDP, federal-level TEs have remained at around 4.5% of GDP, with the prospect of reaching a percentage close to 5% of GDP in 2023 and 2024, according to projections. If the revenue forgone by the states is added, the percentage increases by 1.5% to 2% over the years, totalling approximately 7% of GDP for the years 2023 and 2024. This increase in TEs over time is the result of a combination of factors: (i) more states began to disclose their forgone revenue; (ii) states improved disclosure, including new benefits with a more advanced calculation methodology; and (iii) revenue forgone increased. The IMF cites a COMSEFAZ study which indicates that estimates of revenue forgone at the subnational level are underestimated by half and could be as much as 4% of national GDP, due to methodological differences in calculations and the heterogeneity of concepts discussed in the previous section. It is worth noting that this amount does not consider revenue forgone at the

municipal level, with taxes such as ISS, IPTU, ITCMD and IPVA (Coelho, 2021). Based on these unofficial estimates, the total revenue forgone by exemption could be close to 10% of GDP.

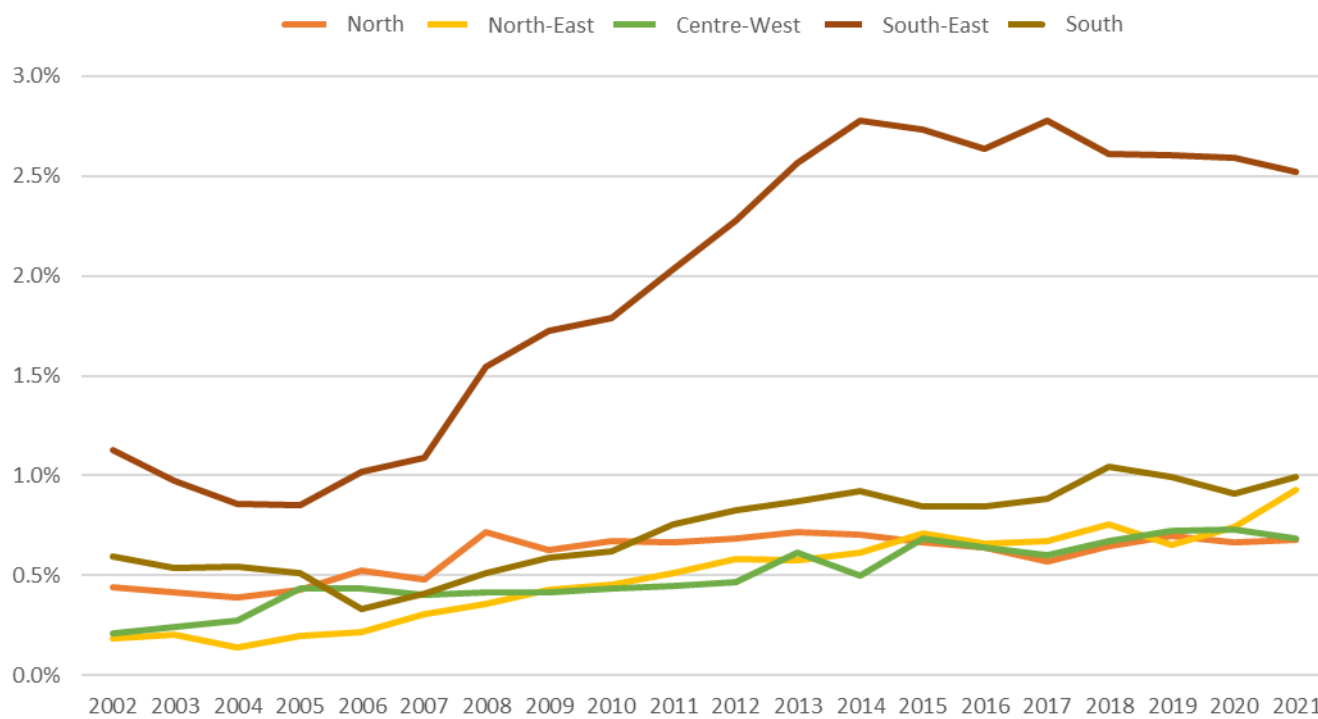**Figure 2. Tax expenditures as a percentage of GDP by region**

Source: Statements of Tax Expenditures – Brazilian Federal Revenue Service, State LDOs and SEFAZ/RS (2020).
Note: 2002–2007 and 2022–2024 are PLOA forecast while 2008–2021 are estimates for federal tax expenditures.

As for tax expenditure in relation to regionalised GDP, the Southeast region predominates in terms of revenue forgone, followed by the South and Northeast regions, which in recent years have come closer to the North, differing from the historical trend in which the North occupied second or third place.

In terms of regional collections, the North region leads the way, with exemptions that exceed its actual revenue collection. The Northeast region comes next, with levels above 50% of revenue collection in the final years of the analysis. The Southeast, Centre-West and South regions, on the other hand, still have less than 50% of revenue collection. Measured as a percentage of revenue, this data shows that the regions with the highest percentage of tax expenditure are those with the greatest demands for social development.

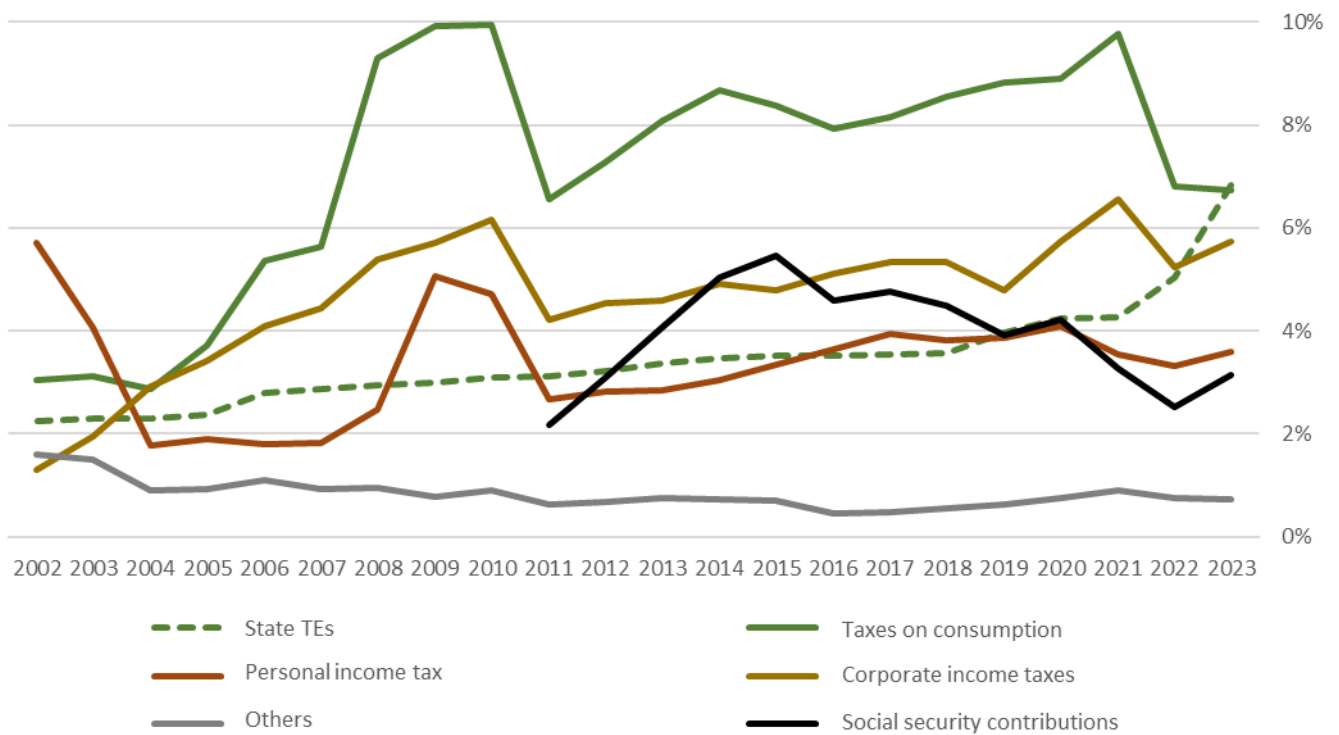**Figure 3. Tax expenditures as a percentage of total revenue collection**

Source: Statements of Tax Expenditures – Brazilian Federal Revenue Service, State LDOs and SEFAZ/RS (2020).
Note: 2002–2007 and 2022–2023 are PLOA forecast while 2008–2021 are estimates for federal tax expenditures. State-level TEs are included in taxes on consumption.

When analysed by type, taxes on consumption predominate in the tax expenditure statistics, especially due to PIS/COFINS. From 2011 onwards, the social security contribution (CPS) has become more relevant, reaching amounts between 4.5% and 5% of revenue collection in recent years. There is also an increase in revenue forgone at the state level for the years 2022 and 2023. The increase is due to methodological changes in the calculation of estimated revenue forgone by certain states, such as São Paulo and Santa Catarina, for example, and to the increase in revenue forgone resulting from the ICMS tax on fuel.

Currently, more than 70% of the total value of tax expenditures has an indefinite period of validity. As a result, a large part of the current benefits from tax expenditures are not forecast to expire. According to federal data, of the 128 tax-expenditure items in force, 95 will remain in force until 2073.

In terms of budget functions, at the federal level, Commerce and Services predominates with 22.13%, followed by Agriculture with 14.92%, Health with 14.11%, Industry with 12.83% and Labour with 9.98%. The programmes that benefited most include the Simplified National Taxation System, which accounted for 21.70%, Agriculture and Agroindustry with 12.12%, Exempt and Tax-Free Income (Personal Income Tax) with 8.85%, Regional Development with 7.91% and, finally, Non-Profit Entities with 7.56% and Fuels with 7.40%.

Figure 4. State tax expenditures as a percentage of revenue
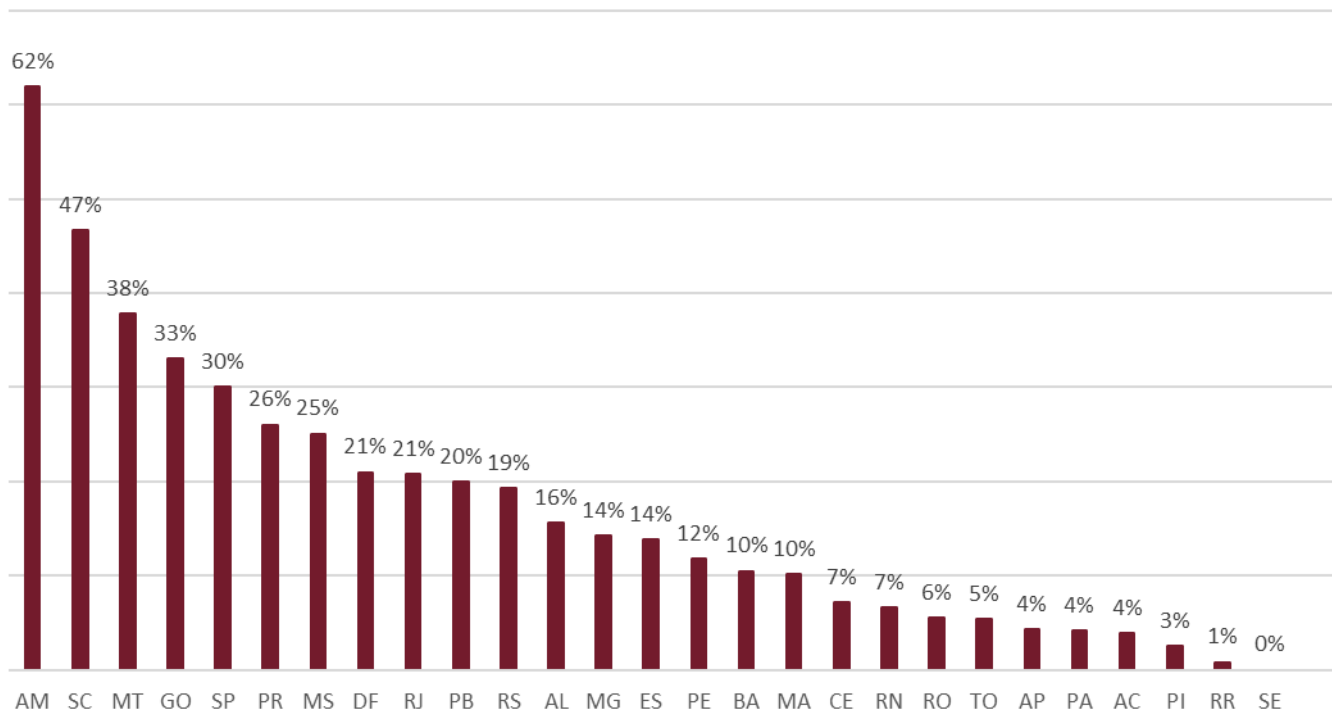
Source: 2023 State LDOs and IBGE [Brazilian Institute of Geography and Statistics]

Finally, the graph above considers revenue forgone by state. The pattern differs from regionalised tax expenditures. Some states in the North region, for example, do not have a level of revenue forgone similar to the rest of the region. The South region has a similar case, with Santa Catarina showing a comparatively high indicator. The expected relationship that less developed states would be more likely to forgo revenues cannot be observed in the graph above. This may be because (i) the forgone revenues have not generated the expected effect, (ii) the tax wars practised with ICMS incentives between various states have been cancelled out or (iii) the exemptions are poorly estimated. Notably, there is much room for improvement, both in the quality of the estimates and in the transparency and evaluation of the benefits.

Evaluation

The creation of a body responsible for evaluating public policies funded by TEs is recent. The choice of policies to be evaluated is made according to the Multi-Year Plan (PPA).

Before 2019, there was no body responsible for evaluating TEs. In this period, only evaluations by academic researchers were found. In relation to the SUDENE programme, for example, a positive effect of 30% was found in the generation of jobs in the tourism sector between 2002 and 2009 (Garsous et al., 2017). With regard to the SIMPLES programme, a 13% effect was found on the formalisation of retail companies, compared to companies in non-eligible sectors (Monteiro & Assunção, 2012). In addition, there are results showing that a reduction in informality among companies is not necessarily related to an increase in GDP or productivity (Ulyssea, 2018). When analysing the effect of the payroll tax reduction on jobs and wages in 2012, a positive effect of 15% was found in the number of jobs and a 2% increase in wages in the first few years (Scherer, 2015), but this effect dissipated over time (Freitas & Paes, 2022).

Since its creation in 2019, the Public Policy Monitoring and Evaluation Council (CMAP) has presented public-policy evaluation reports, which are made available online[27] and which, within each area, are separated into policies funded with direct and indirect expenditures. Among the 34 evaluations carried out by the CMAP in relation to indirect expenditures (subsidies), four reports stand out as particularly significant:

(I) Simplified National Taxation System (*Simples Nacional*, SN):

This is a shared tax collection, charging and inspection system applicable to micro and small enterprises. In 2020, SN tax expenditure was estimated at R$ 83.2 billion (approximately 25% of the total forecast in the DGT), representing 1.1% of GDP. No convergence was found between administrators regarding the programme's objectives, which prevents the development of indicators and targets for the policy and impedes its monitoring and evaluation (CMAP, 2020). In order to monitor the policy, the Interministerial Committee for the Evaluation of the Simplified National Taxation System (CIASN) was created in 2013, but it never acted effectively since its creation and was formally abolished in 2019.

One of the points highlighted in the report is the criticism of the concept of TE, which starts from the premise that there will be no change in companies' behaviour after the creation of the subsidy, proposing a new methodology (bunching) to carry out the estimates. One of the negative behavioural effects is the encouragement of tax-induced growth stagnation, i.e., damming up company growth so as not to leave the TE eligibility region (Nascimento & Mattos, 2023). The qualification limits for the Simplified National Taxation System are very high, such that the regime attracts several companies because of the lower tax burden. It is common for a large company to break off some operation in order to reduce its tax costs by creating a new company under the Simplified National Taxation System (SN) regime (Gobetti, 2024). The "Simples" scheme is much more than a tax simplification scheme; it represents a major tax exemption for companies, encouraging tax planning practices that result in high tax costs.

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[27]https://www.gov.br/planejamento/pt-br/acesso-a-informacao/participacao-social/conselhos-e-orgaos-colegiados/cmap/politicas/area

With regard to assessing the impact of the SN on employment and company dynamics, the report was based on an academic study that found a positive effect on the number of formal jobs – SN companies created 3% more jobs than companies that would have been eligible but did not opt for the Simplified National Taxation System – due to the increase in formal firms (Matsumoto, 2021). The CMAP report was sent to the National Congress and to the Presidency of the Republic in 2021 and, to date, no changes to the policy have been identified according to the terms indicated by the CMAP, particularly due to the lack of a governance structure.

As for the effectiveness of the policy in reducing tax regressiveness, a study by Sergio Gobetti points out that the Simplified National Taxation System increases inequalities, since 2% of Brazilians with companies in the SN System concentrate 20% of all dividends from this special regime (Globo, 2024). However, considering the weight that MSEs have in job creation, any revision of this exemption becomes very difficult (Barbosa, 2022).

(II) Individual Microentrepreneur (MEI):

This is a specific modality of the Simplified National Taxation System tax regime that provides simplified procedures, exempts registration costs and reduces the tax and social-security burden for microentrepreneurs with annual gross revenue of up to R$ 81,000 and up to 1 employee. In 2019, the estimated exemption was R$3.1 billion. The report warned of the risk to the sustainability of the social-security system, since the rate for MEI is 5%, lower than the 11% envisaged for the Simplified Social-Security Plan. In addition, there are risks of "*pejotização*"[28] and misuse of purpose by employers after the Labour Reform (Law No. 13,467/2017) (CMAP, 2021). With regard to the assessment of the impact of the MEI regime, the report was based on academic studies that found positive effects on the formalisation of companies, but not on the creation of new companies (Rocha et al., 2018). The report was sent to the National Congress and the Presidency of the Republic in 2022 and, to date, no changes to the policy have been identified along the lines indicated by the CMAP.

(III) Deduction of medical expenses in the IRPF:

In 2023, tax expenditure from this policy was estimated at R$ 25 billion. Differently from what happens with education expenses, there is no limit on the deduction of private health expenses from income tax and this TE ends up favouring the population with the highest income (Coelho, 2021), i.e., the 20% with an income above the mandatory limit for declaring income. The report suggests ending the benefit, indicating that there would be no impact on the SUS (National Health Service), or setting a ceiling, as is already the case with education (CMAP, 2021a). The report was sent to the National Congress and the Presidency of the Republic in 2021 and, to date, no changes to the policy have been identified along the lines indicated by the CMAP, since Bill 2,337/2021 is still being processed in the Federal Senate.

(IV) PIS/COFINS exemption for the basic food basket:

In 2023, tax expenditure on this policy was estimated at R$ 35 billion. Among the points raised by CMAP are the exclusion of ultra-processed foods from the list of products in the basic food basket, as well as the reformulation of the policy, for the purpose of the exemption and application of a lower rate for all products (a reduction of 1.5%), along with an increase in the values of income-transfer programmes. In this way, the beneficiaries most

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[28] *Pejotização* is the "practice of setting up companies to provide regulated professional services (…) as an alternative mechanism in order to subject income from the work of self-employed professionals to the system of taxation of legal entities, with the displacement of the tax base to a less burdensome incidence (Receita Federal do Brasil, 2016).

affected would actually be the people with the lowest incomes, and not the richest, who in absolute terms benefit four times more than the poorest (Coelho, 2021).

The reports listed here indicate that there has been some progress in the evaluation stage of the policy cycle related to tax expenditures, but its impact on the decision-making process has yet to be felt. This mismatch can be noticed when analysing the results and recommendations of the programmes evaluated and the response (or lack of response) from administrative bodies. Their main added value has been to promote transparency and accountability and to foster an organisational culture of greater and better coordination and control (Silverwood-Cope & Ling, 2022).

On the other hand, the CMAP itself has already pointed out the fragility of the TE concept and the need to review it. REPETRO, for example, is a policy that has a high impact on public finances and does not appear in the DGT. Between 2015 and 2023, 267 companies in the oil and gas production chain obtained R$ 260 billion in tax exemptions (INESC, 2024), showing the overlapping of benefits and the consequent lack of transparency regarding their composition and volume (INESC, 2023).

In fact, the CMAP promotes individual analyses of benefits, but has yet to discuss systemic and cross-cutting reforms that could specifically enable agencies to monitor and evaluate benefits. This points to the CMAP's relevance as a body for *the ex-post* evaluation of public policies, but its insufficiency in solving management and governance problems (Silverwood-Cope & Ling, 2022). Without evaluating these policies together, it is not possible to obtain evidence about their cost-effectiveness (Coelho, 2021).

> " *In fact, the CMAP promotes individual analyses of benefits, but has yet to discuss systemic and cross-cutting reforms that could specifically enable agencies to monitor and evaluate benefits.*

Political economy and reform

Despite the legislative changes introduced to reduce TEs, the lack of specific regulations regarding objective criteria and performance targets, the multiplicity of instruments and the lack of formal appointment of an administrative body responsible for monitoring TE policy have hindered this process. In addition, many forms of TEs were exempted by such legislative changes, preventing their reduction.

In recent decades, TEs have proliferated in Brazil as a way of overcoming the complexity and high burden of the tax system, as well as the slowdown in the economy after the end of the commodities cycle. As a rule, the justifications given for the creation of TEs involve job creation, regional development, the formalisation of companies and poverty reduction (Coelho, 2021). Nevertheless, compared to other countries – whether rich or emerging – the TE/GDP ratio in Brazil is not high. In addition, part of the increase in the amount of TEs is due not only to the creation of new TEs, but also to changes in the basis for calculating the amount of forgone revenue, with the inclusion of social and social-security contributions in the RFB's calculation, as well as the expansion of the MSE revenue range and the consequent eligibility of more companies (Barbosa, 2022).

In 2016, EC No. 95 was approved, which instituted the New Fiscal Regime (*Novo Regime Fiscal*, NRF), based on a rule on the growth in expenditure that imposed a spending ceiling within the federal budget. However, tax expenditures were not affected by this rule, which ended up constituting an additional incentive encouraging its expansion (Coelho, 2021). The fact that tax benefits are explained in different statements that make up the supplementary information of the General Federal Budget (OGU), without being included in the main part of the budget, reduces the transparency of public resources. This is because the amounts forgone end up not being debated, remaining outside the control of fiscal rules, jeopardising both the decision-making process in the pursuit of public policies and the accountability of public agents.

According to the Secretariat of Economic Policy of the Ministry of Finance (2022), a series of tax benefits was instituted with the COVID-19 pandemic, which totalled R$ 28.3 billion in 2020 (around 0.38% of GDP). Among the tax expenditures that were created, it is worth highlighting the reduction of IOF rates on credit operations to zero, with estimated forgone revenue of R$ 18.6 billion in 2020 (Ministério da Gestão e da Inovação em Serviços Públicos, 2022). In the following years, in order to stimulate the resumption of economic activities, other tax-reduction measures were introduced, including the Programme for the Resumption of the Events Sector (*Programa para Retomada do Setor de Eventos*, PERSE-RFB), whose declared forgone revenue amount was R$ 9.6 billion between January and August 2024 (Receita Federal do Brasil, 2024b).

As a counterpoint to the expansion of indirect expenditures, Article 4 of EC No. 109/2021 established the need for a plan to gradually reduce tax incentives, accompanied by each rule that established them, as well as estimates of the financial and budgetary impact, so that by 2029 they do not exceed 2% of GDP. However, in addition to still awaiting regulation by a supplementary law to define objective criteria and performance targets, the provision also reserved six benefits from being included in the reduction plan, which add up to 2% of GDP (Coelho, 2021), such as the Manaus Free Trade Zone, the Simplified National Taxation System, the exemption of the basic food basket, the Constitutional Regional Development Funds and the granting of scholarships by higher education institutions. This creates a loophole for certain taxpayers to consider that these benefits have constitutional protection.

There have been some attempts to increase the restriction on the creation, control and transparency of TE through LDOs – for example, the institution of a periodic re-evaluation for tax expenditures with a term of more than five years; the provision of a five-year expiration clause; the need for an evaluation by the Ministry of Finance; and the establishment of spending statements that must accompany the LDOs (Silverwood-Cope & Ling, 2022). However, as the LDO is not a permanent law, these mechanisms can be created or abolished from one year to the next. In any case, the requirement to present an estimate of the financial-budgetary impact has been in Article 113 of the Act on Transitional Constitutional Provisions (ADCT) since 2016, and is considered by the Federal Supreme Court to be an "additional requirement for the formal validity of laws that create expenditure or grant tax benefits, [which is directed] at all federal levels".[29] Even so, this mechanism has not had the effect of reversing the trend for TE growth, either because most forms of TEs were established some time ago and have an indefinite term, or because of the merely informative effect of the recommendations of oversight bodies and the technical opinions of the ministries in relation to the members of the Legislative Branch.

In 2023, EC No. 132 was approved to reform the tax system. In this first stage, the aim was to improve taxation on consumption – which has a profound impact on the poorest segments of the population – by, among other mechanisms, adopting a less distorting tax system without increasing the tax burden. It turns out that the large number of tax benefits and differentiated regimes for some sectors makes it difficult to define the calibration of the new system: the more goods and services that receive favoured treatment, the higher the standard rate needed to maintain the current tax burden (CNN Brasil, 2024; Gobetti & Rocha, 2023). And the creation of countless exceptions (Brazil, House of Representatives, 2023) ends up contributing to maintaining the complexity of the Brazilian tax system.

In any case, even with the approval of many exemptions, greater harmonisation of the tax system and a reduction in TEs is expected. At the federal level, despite the exception of the Simplified National Taxation System and the Free Trade Zone, several forms of TEs are to be eliminated starting in 2029, when the tax reform starts taking effect. At the state level, the impact will also be great, because the reform of consumption tax weakens the logic of the tax wars between states that has underpinned many state tax benefits. During the transition period established by the reform, as the ICMS decreases, the number of benefits is also reduced. Furthermore, for a limited group of (costly) benefits, the reform has provided for compensating taxpayers with an amount equivalent to the reduction in the benefit, which will last until the end of the transition period at the latest. A drop in the volume of state TEs is therefore expected.

It is important to emphasise that EC No. 132/2023 established yet another attempt to control tax exemptions. Article 9, Section 10 states that the differentiated regimes relating to the new tax on goods and services, in the form of a future complementary law,[30] must be subject to a five-yearly cost–benefit assessment.

According to Barbosa (2022), in order to reduce TEs, the following are essential:

i.   a re-evaluation of the revenue limits and contribution rates for MSEs and MEIs, given their under-taxation in relation to the presumed-profit regime, which is the alternative immediately above the Simplified National Taxation System;

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[29] ADI 5816, Rapporteur Justice Alexandre de Moraes, Full Court, judged on 05/11/2019, DJE [Electronic Journal of Justice] of 25/11/2019.
[30] See Complementary Bill No. 108/2024, currently before the Federal Senate.

ii.   a review of income-tax exemptions and deductions, especially pensions due to serious illnesses and accidents at work, and the creation of a ceiling for health-expense deductions;

iii.   a review of the various sectoral exemption schemes, especially in the agricultural sector.

In addition to the various favoured treatments, other points deserve attention when it comes to creating more effective governance for TEs. Generally speaking, it is up to the Legislative Branch to formulate and/or approve the legal acts establishing TEs. However, the multiplicity of instruments, the lack of formal appointment of a management body to monitor the policy (as was evident in the CMAP's evaluation of the Simplified National Taxation System), as well as clear parameters on information on beneficiaries, deadlines, objectives, targets and indicators that the legal acts need to fulfil, prevents subsequent management by the Executive Branch. Both the creation and management of tax expenditures suffer from a certain lack of definition in the sharing of responsibility between central and sectoral bodies (Pellegrini, 2014), making coordination necessary between the administrators who execute the budget and those who evaluate TEs, in order to avoid overlapping objectives in the implementation of public policies, especially in subnational entities.

Moreover, the lack of consensus on the concept of TE ends up creating legal loopholes for the political and parochial use of this instrument in what is an extremely sensitive issue. In practice, to be effective, TE reform must be wide-ranging and coordinated between the different levels of government, tackling problems of efficiency and equity in conjunction with tax collection. This makes the changes more palatable by guaranteeing a nationally coherent tax system and by dividing the costs of reform among various groups.

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