Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

MAY 16, 2024 • Nº 88

HIGHLIGHTS

- GDP growth projections for 2024 and 2025 have been revised to 2.0% and 1.9%, respectively.
- The dynamism of economic activity and the discouragement of inflation expectations also led to adjustments in the scenario for the Selic rate.
- The projection for the central government's primary deficit in 2024 was revised from 0.9% of GDP to 0.8% of GDP.
- Gross debt is expected to end 2024 at 77.6% of GDP.
- Complementary Bill No. 68/2024 regulates the Tax Reform.
- Change in consumption taxation on goods and services aims for simplification without increasing the burden or reducing revenue.
- The regulation details the rules for implementation, governance, and transition to the new system.
- The IFI highlights potential points of tension in the proceedings of PLP No. 68/2024.
- The IFI warns that the greater the exceptions introduced, the smaller the positive impact on the economy and the higher the national reference rate.

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IFI UPDATES SHORT-TERM PROJECTIONS

The Independent Fiscal Institution (IFI) presents here its Fiscal Follow-up Report No. 88, from May 2024. Through the RAF (kept here in its original acronym, as well as all other acronyms of Brazilian institutions, taxes and programs), the IFI fulfills its institutional mission of monitoring the fiscal and budgetary scenarios and the most relevant events that impact public finances.

RAF No. 88 comes to light after the revision of fiscal targets by the Federal Government, extending the timeframe for the necessary fiscal adjustment to produce primary surpluses that will allow the stabilization of the public debt-to-GDP ratio. The previously projected targets for 2024 and 2025, which foresaw a primary surplus of 0.5% of GDP this year and 1.0% the following year, were reduced to a zero deficit in 2024 and a primary surplus of 0.25% in 2025. The IFI updated its primary deficit projection to 0.8% of GDP in 2024 and 0.4% in 2025, due to a moderate growth in RGPS and non-administered revenues [the ones not collected by the Federal Revenue Office].

Another important factor was the change in the Central Bank's stance, following the detection of greater uncertainty regarding fiscal outcomes and unanchored inflation expectations. Combined with the rigidity of American monetary policy, this led the Copom to slow the pace of reductions in the base interest rate. As a result of this scenario, the IFI adjusted its projections for the SELIC rate at the end of the period from 9.50% to 10.00% in 2024 and from 8.50% to 9.00% in 2025.

Also noteworthy is the IFI's revision of economic growth projections, as favorable economic indicators, especially retail sales and capital goods production, point to an expansion in household consumption and investments. The labor market also shows improvements, with a reduction in unemployment and an increase in real incomes. The IFI projects GDP growth of 2.0% in 2024 and 1.9% in 2025. (**Page 4**)

The fiscal scenario is volatile, impacting projections about its budgetary effects and its interface with monetary policy, since several variables and events, both on the revenue and expenditure side, are still open, fueling uncertainties about the future of the fiscal equation. The actual result of the collection of taxes on offshore funds, fixed-odds betting and economic grants, as well as the result of the proceedings before the Administrative Council for Tax Appeals (CARF), are still relatively unknown. Additionally, there are significant fiscal impact decisions with a definitive configuration: the payroll tax relief for labor-intensive economic sectors and small municipalities, the constitutional amendment (PEC) that reinstates quinquennial bonuses for certain public service categories, and the level of compensation for tax credits. The consequences of these factors could lead to important changes in the fiscal projections. And this does not consider the additional expenses that will inevitably be incurred in support of Rio Grande do Sul, which is the victim of a serious socio-environmental crisis. (**Page 8**)

RAF No. 88 also presents, as a special topic, a description of the content of PLP No. 68 of 2024, which regulates tax reform in relation to taxes on the consumption of goods and services, indicating possible points of tension that could arise during its processing. The IFI highlights, in line with the main studies produced so far on the impacts of tax reform, that the greater the number of exceptions introduced, the higher the national reference rate will be and the smaller the positive effects on economic growth, productivity, and employment. (**Page 13**)

Happy reading!

Marcus Pestana
IFI Executive Director

Alexandre Andrade
IFI Director

Vilma Pinto
IFI Director

Update on short-term macroeconomic projections

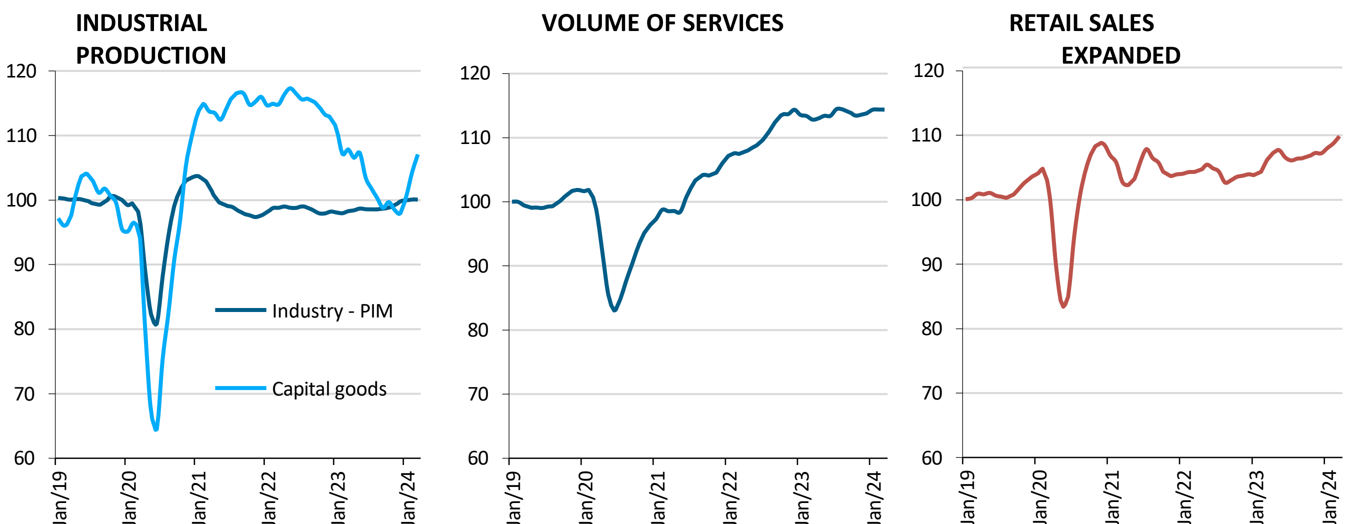
Rafael Bacciotti

Since the last revision, published in February, favorable economic indicators, especially retail sales and the capital goods production, suggest an expansion in household consumption and investment in the first quarter. *Labor market data also shows improvements, with a reduction in unemployment and an increase in real incomes. While current inflation is showing signs of slowing down, expectations for the coming years remain above target, amid increased external and internal uncertainties. In response to these challenges, the Central Bank reduced the pace of cuts in the base interest rate.*

Since the last revision of short-term macroeconomic projections in February[1], economic activity has shown positive signs, particularly in retail sales and industrial production of capital goods (Graph 1). In the first quarter, industrial production, the volume of services and expanded retail sales advanced, in that order, by 0.3%, 0.5% and 2.5% compared to the last quarter of 2023, considering the seasonally adjusted series. In the same comparison, the production of capital goods increased by 9.3%. These data suggest robust household consumption and a recovery in investments during the period.

GRAPH 1. ECONOMIC ACTIVITY INDICATORS

(QUARTERLY MOVING AVERAGE, SEASONALLY ADJUSTED, DEC/19 = 100)

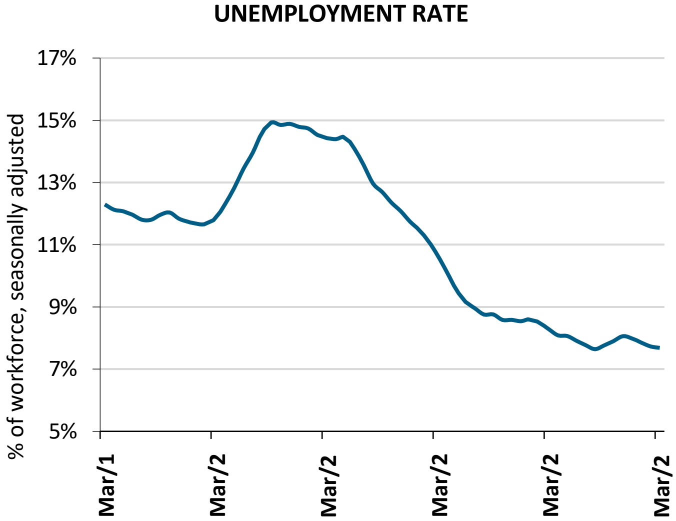


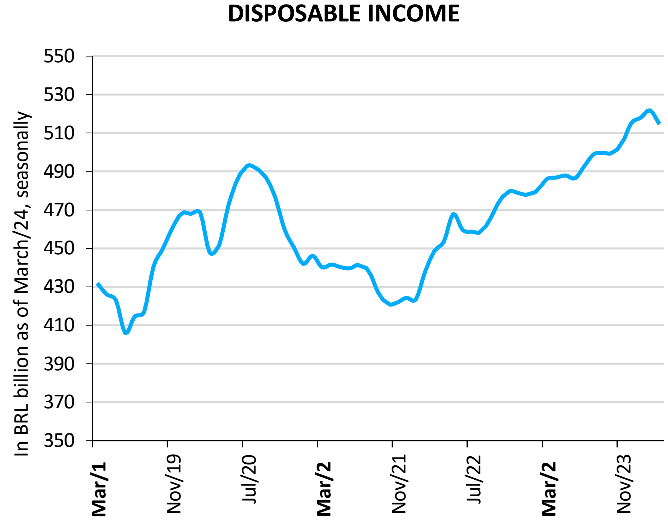
Source: IBGE.

Labor market indicators also evolved positively, exceeding our expectations. The data from the Continuous National Household Sample Survey (PNAD Contínua), available for the quarter ending in March, show a reduction in the unemployment rate, accompanied by increases in real incomes (Graph 2). The labor income mass grew by 5.9% in cumulative terms over the past twelve months, while disposable income, an indicator calculated by the Central Bank that incorporates other sources of income besides work, increased by 6.6% over the same period, reflecting still significant effects of the expansion of social benefits.

[1] Report available at: https://tinyurl.com/yc5n4c9t

GRAPH 2. LABOR MARKET INDICATORS

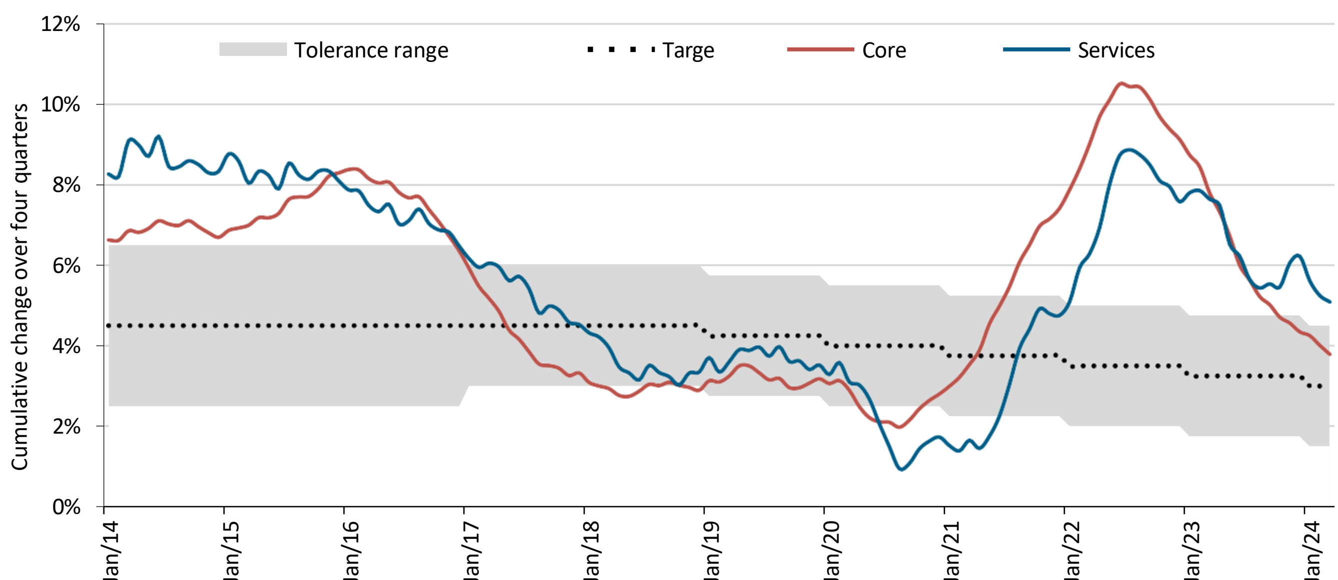




Source: IBGE.

The Broad Consumer Price Index (IPCA) continued its disinflationary trend, registering an increase of 3.7% in the twelve months ending in April, down from 3.9% observed in the previous month. In addition, the average of core inflation, indicators calculated by the Central Bank to capture the trend in prices by disregarding volatile items, fell from 3.8% in March to 3.5% in April, moving closer to the center of the target (Graph 3). It is important to note that the slowdown in services prices is occurring more gradually, reflecting a scenario of stronger economic activity and a dynamic labor market.

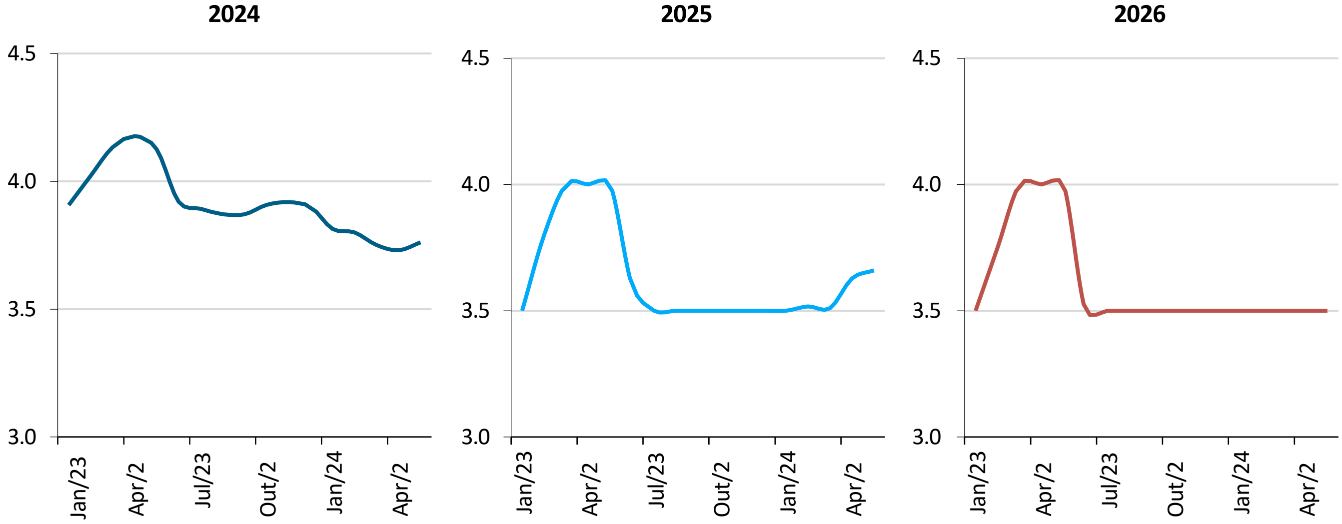
GRAPH 3. CONSUMER INFLATION (IPCA)



Source: Central Bank and IBGE.

Inflation expectations for this and the next few years remain above the target (3.0%), as shown in Graph 4. The projections for the 2025 IPCA in the Focus Bulletin, which were previously stagnant at 3.5%, now stand at 3.7%, signaling an increase in economic agents' concerns about controlling inflation on the monetary policy horizon.

GRAPH 4. FOCUS BULLETIN: INFLATION EXPECTATIONS



Source: Central Bank

The change in inflation expectations for 2025 occurs in a context of increasing uncertainties. Volatility in the external environment has increased in response to the Federal Reserve's (Fed) stance, which postponed the interest rate reduction cycle due to unexpected increases in inflation. Domestically, the situation was marked by the change in the primary balance target for next year in the Budget Guidelines Bill (PLDO 2025), from a surplus of 0.5% of GDP to a zero deficit. This has intensified the market's concerns about the sustainability of the public debt in the medium term. These events may have contributed to the increase in the risk premium and the depreciation of the BRL against the dollar in April (Graph 5).

GRAPH 5. NOMINAL EXCHANGE RATE (BRL/US$)

Source: Ipeadata.

The increase in uncertainties, both external and internal, between the Monetary Policy Committee (Copom) meetings in March and May, in an environment of resilient economic activity and labor market, along with unanchored inflation expectations, led the Central Bank to slow the pace of base interest rate cuts. At the May meeting, the Copom adjusted the Selic rate by 0.25 percentage points (p.p.) to 10.5% p.a., changing the previous indication of a possible 0.5 p.p. cut.

The evolution of the data and the increase in uncertainties since the last update of the IFI's short-term scenario prompted the reassessment of macroeconomic variable projections, as evidenced in Table 1. Of particular note is the adjustment to the GDP growth outlook, revised from 1.6% to 2.0% in 2024, and from 2.0% to 1.9% in 2025. The average unemployment rate was also adjusted, especially in 2024, from 8.4% to 7.8%, rising again slightly in 2025, to 8.3% of the workforce. The projection for the Selic rate was also changed, from 9.5% p.a. to 10.0% p.a. at the end of 2024 and from 8.5% p.a. to 9.0% p.a. at the end of 2025.

TABLE 1. SHORT-TERM PROJECTIONS

Variable	2023	2024	2025
Nominal GDP (BRL billion)	10,856.1	11,546.3	12,251.2
Nominal GDP (% average annual variation)	7.7	6.4	6.1
Real GDP (% average annual variation)	2.9	2.0	1.9
GDP deflator (% average annual variation)	4.7	4.3	4.1
IPCA (% year-over-year change in December)	4.6	3.8	3.4
Unemployment rate (% of workforce)	8.0	7.8	8.3
Wage bill (% average annual change)	6.9	4.8	1.9
Exchange rate (BRL/US$ end of period)	4.84	4.91	4.96
Selic (% end of period)	11.75	10.00	9.00

Prepared by: IFI.

It is important to note that the economic scenario became more challenging after the tragedy in several municipalities in Rio Grande do Sul, caused by heavy rains and flooding. Some analysts have already begun to estimate the impact on GDP and inflation[2]. However, to date, these impacts have not been incorporated into the IFI scenario. The magnitude of these effects can begin to be assessed after the indicators released in May.

[2] According to an article in Valor Econômico, available at: https://tinyurl.com/3trdckrc

IFI projection for central government primary deficit in 2024 updated to 0.8% of GDP

Alexandre Andrade and Vilma Pinto

Based on the definition of new macroeconomic parameters for 2024 and 2025, the IFI updated the scenario for fiscal variables in the short term. The central government's primary deficit has been revised from 0.9% of GDP last February to 0.8% of GDP now. The projection for gross debt was practically unchanged. The IFI expects the main indicator of public debt to reach 77.6% of GDP at the end of this year.

Introduction

This section presents updated projections for the central government's primary balance in the short term (2024 and 2025). There was a slight improvement in the 2024 primary deficit projection, from 0.9% of GDP to 0.8% of GDP, and another in the 2025 primary deficit, from 0.8% of GDP to 0.4% of GDP.

In 2024, specifically, the reduction in the deficit estimated by the IFI was due to the increase in the projected net revenue for the General Social Security System (RGPS) by 0.1 percentage points of GDP, which raised the projection for the net primary revenue by the same magnitude. The primary expenditure projection remained at 18.9% of GDP.

For 2025, the reduction in the central government's primary deficit projection was due to an increase in the estimates of net revenue for the RGPS (+0.1 p.p. of GDP) and non-administered revenues (+0.1 p.p. of GDP), as well as a reduction in the total primary expenditure projection by 0.2 p.p. of GDP.

In May, the IFI presents an update on the short-term macroeconomic and fiscal scenario. The medium-term scenario will be reviewed in June. On that occasion, the effects of the tax reform will be incorporated into the figures.

Revision of short-term projections

Table 2 shows the new IFI estimates for the short term. The projections from February 2024 were also included for comparison purposes. The projection for total primary revenue in 2024 went from BRL 2,582.5 billion (22.4% of GDP) in February to BRL 2,602.2 billion (22.5% of GDP) in May.

Among the three main revenue groups, non-administered revenue went from BRL 1,673.9 billion (14.5% of GDP) in February to BRL 1,676.7 billion (14.5% of GDP) in May. Although there was an upward revision in the estimate for economic growth this year, from 1.6% to 2.0%, the projection for the nominal GDP growth this year remained practically the same due to the downward revision in the estimate for the implicit GDP deflator. Additionally, the IFI revised the expectation of the materialization of some of the revenue measures proposed by the Executive in 2024, specifically the revenue from the taxation of investment grants and the collection of income tax on closed-end funds. Table 3 shows the impacts considered by the IFI with the measures contained in the 2024 Annual Budget Law (LOA). The same table compares with Table 4 of RAF No. 85 (pg. 11), of February 2024[3].

Regarding the collection of federal taxes on investment grants within the scope of the state ICMS, the IFI revised downward the (already relatively low) estimate of collections, due to the Executive's downward adjustment in the 1st Bimonthly Report on the Evaluation of Primary Revenues and Expenditures (RARDP) for 2024 (from BRL 35.3 billion in the 2024 Budget Law to BRL 25.9 billion in the RARDP). As explained in the referenced RAF No. 85 and in past editions of this report, there is a high risk of materialization for this revenue due to legal disputes initiated by taxpayers within the Judiciary.

[3] Page to access the document: https://tinyurl.com/5n8vxw7t.

The IFI revised downward the expectation of income tax collections on exclusive funds because almost the entire amount expected for the year has already been received by the public treasury (taxation on the stock). There remain, still in 2024, the collections related to the semiannual taxation (known as *come-cotas*), in May and November.

TABLE 2. IFI ESTIMATES FOR THE CENTRAL GOVERNMENT'S PRIMARY BALANCE - BRL BILLION AND % OF GDP (2024 AND 2025)

Baseline scenario	2024				2025			
	Feb/24		May/24		Feb/24		May/24	
	BRL billion	% of GDP	BRL billion	% of GDP	BRL billion	% of GDP	BRL billion	% of GDP
1. Total primary revenue	2,582.5	22.4%	2,602.2	22.5%	2,757.1	22.5%	2,786.2	22.7%
Administered revenue [collected by the RFB]	1,673.9	14.5%	1,676.7	14.5%	1,787.5	14.6%	1,794.8	14.6%
Net collection for the RGPS	610.5	5.3%	627.4	5.4%	646.5	5.3%	664.6	5.4%
Non-administered revenue [not collected by RFB]	298.1	2.6%	298.2	2.6%	323.1	2.6%	326.8	2.7%
2. Revenue-sharing transfers	508.2	4.4%	509.7	4.4%	539.9	4.4%	544.2	4.4%
3. Net primary revenue [1-2]	2,074.3	18.0%	2,092.5	18.1%	2,217.2	18.1%	2,241.9	18.3%
4. Total primary revenue	2,183.5	18.9%	2,187.1	18.9%	2,310.5	18.9%	2,295.8	18.7%
5. Primary balance [3-4]	**-109.2**	**-0.9%**	**-94.5**	**-0.8%**	**-93.3**	**-0.8%**	**-53.9**	**-0.4%**

Source: National Treasury Secretariat and Siga Brasil. Prepared by: IFI.

Returning to the figures presented in Table 2, the IFI has revised upwards the projection for net collection for the RGPS in 2024, from 5.3% of GDP (BRL 610.5 billion) in February to 5.4% of GDP (BRL 627.4 billion) now. This change was due to the recent performance of this revenue, which has been boosted by the growth of the wage bill and formal employment in the economy.

The projection for 2025 has also been revised upwards (from 5.3% of GDP to 5.4% of GDP). Part of the explanation is due to the expected behavior of the labor market. Another factor explaining the 0.1 percentage point increase in RGPS revenues in 2025 is the partial reimposition of payroll taxes, as provided for in Bill No. 1,847 of 2024[4].

There will be an annual progressive increase in the tax rate on the payroll, namely, 5% in 2025, 10% in 2026, 15% in 2027, and 20% in 2028. For the understanding of what is presented in Table 3, the tax exemption would be BRL 20.0 billion in 2024, which would be reduced to BRL 15 billion in 2025, then BRL 10 billion in 2026, and BRL 5 billion in 2027. As of 2028, there would be no waiver and the exemption would be finalized.

[4] Page of the proceedings of the matter: https://tinyurl.com/7uxrh5v4.

TABLE 3. MEASURES CONVERTED INTO LAW OR PENDING IN CONGRESS WITH AN IMPACT ON CENTRAL GOVERNMENT REVENUE IN 2024 (BRL BILLION)

Budget impact in 2024				
Measure	Tax	Legislative proposal	Impact considered by the Executive Branch (BRL billion)	Impact considered by the IFI - baseline scenario (BRL billion)
Total [1+2+3]			**275.4**	**108.9**
Legislative measures mentioned in the 2024 Budget Bill (PLOA) and converted into law [1+2]			**145.2**	**59.5**
Revenue collected by the RFB [1]			**144.3**	**58.6**
Investment grants	IRPJ, CSLL, PIS/Cofins	Law no. 14,789, of December 29, 2023	25.9	4.8
Fixed-odds betting	Income tax, other administered revenue	Law No. 14,790, of December 29, 2023	0.7	0.7
New simplified taxation system (RTS)	Import tax	RFB Normative Instruction 2,146, of June 29, 2023	-	-
Closed-end funds - stock and flow	IR [Income Tax]	Law no. 14,754, of December 12, 2023	13.3	14.9
Taxation of financial assets held abroad by individuals (offshores)	IR [Income Tax]	Law no. 14,754, of December 12, 2023	5.6	5.6
Change in the calculation of interest on equity	IRPJ [Corporate Income Tax], CSLL	Law no. 14,789, of December 29, 2023	-	-
Credit recovery at CARF	IR, CSLL, PIS/Cofins, IPI, social security, others	Law no. 14,689, of September 20, 2023	98.8	32.6
Revenue collected by other bodies [2]			**0.9**	**0.9**
Fixed odds lottery fees	Control and inspection fees	Law No. 14,790, of December 29, 2023	0.9	0.9
Other income [3]			**129.3**	**48.5**
Reinstatement of fuel taxes	PIS/Cofins	Provisional Measures No. 1,175 and No. 1,178, of 2023	30.0	30.0
Exclusion of ICMS from the calculation basis of PIS/Cofins credits	PIS/Cofins	Law no. 14,592, of May 30, 2023	57.9	5.8
Transfer prices	IR, CSLL	Law no. 14,596, of June 14, 2023	20.0	20.0
Revocation of the Perse tax benefit	PIS/Cofins in 2024; PIS/Cofins, IRPJ and CSLL in 2025	Provisional Measure No. 1,202, of December 29, 2023	6.0	-
Partial exemption from the Social Security Contribution on Gross Revenue	Social security contribution	Bill No. 1,847 of 2024	-5.6	-20.0
Limitation on the compensation of credits resulting from court decisions	PIS/Cofins	Conversion Bill No. 1 of 2024	24.0	15.7
IRPF exemption for those earning up to 2 minimum wages per month	IRPF	Law No. 14,848, of May 1, 2024	-3.0	-3.0

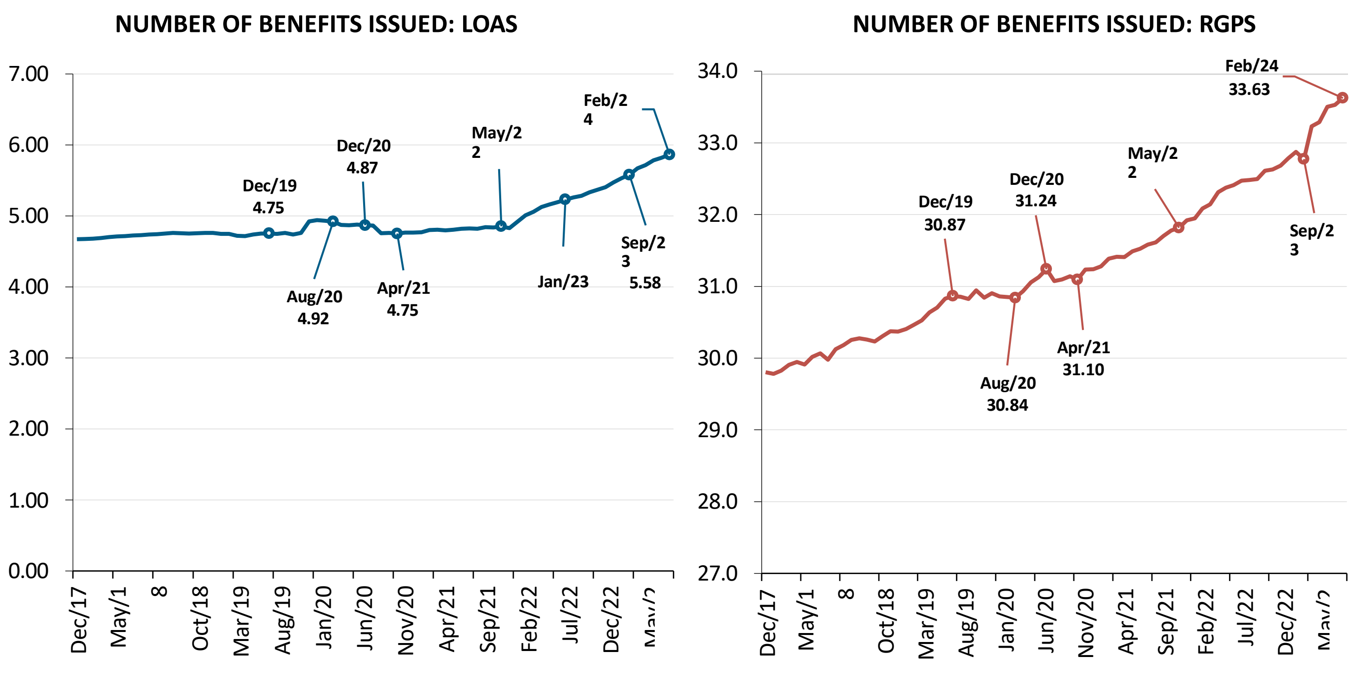
Source: 2024 Budget Law (LOA), 1st Bimonthly Report on the Evaluation of Primary Revenues and Expenditures for 2024, and IFI. Source: IFI.

These changes in revenue projections in 2024 would increase the central government's net primary revenue from BRL 2,074.3 billion (18.0% of GDP) to BRL 2,092.5 billion (18.1% of GDP). In 2025, the IFI's new projection for net revenue is BRL 2,241.9 billion (18.3% of GDP).

We now move on to a brief analysis of the primary expenditure projections, which have undergone marginal changes. The IFI's estimate for primary expenditure in 2024 went from BRL 2,183.5 billion (18.9% of GDP) in February to BRL 2,187.1 billion (18.9% of GDP) now. The projection for next year was reduced from BRL 2,310.5 billion (18.9% of GDP) to BRL 2,295.8 billion (18.7% of GDP). These figures are reported in Table 2.

The main discrepancies between the IFI's numbers and the Federal Government's budget are concentrated in social security and social benefits. The IFI's expenditure projection for these items takes into account the recent evolution of benefits issued under the Organic Law of Social Assistance (Loas) and the RGPS, as well as demographic indicators, the new policy for real minimum wage appreciation, and rules for adjusting benefits above the minimum wage. There is an observed acceleration in the number of benefits issued, both in the social security and social assistance domains. The graphs below show the evolution in the number of benefits issued between 2017 and February 2024 (the last month with available data) for Continuous Cash Benefits (BPC) and social security benefits of the RGPS.

GRAPH 6. NUMBER OF BENEFITS ISSUED (IN MILLIONS)



Source: SPREV. Prepared by: IFI

Another factor of divergence between the numbers expressed in the 1st Bimonthly Report on the Evaluation of Primary Revenues and Expenditures for 2024 and those of the IFI is the incorporation of the extraordinary credits necessary for relief actions in Rio Grande do Sul, due to the floods that have affected the state.

It is worth noting that the IFI figures for the primary balance indicate difficulty in achieving the targets set out in the 2024 Budget Guidelines Law (LDO). Thus, to incorporate this risk of the need for adjustment to meet the target, the IFI's scenario also diverges from that presented in the 1st Bimonthly RARDP in terms of discretionary spending. Table 4 below describes the main differences between the figures presented in the RARDP and those of the IFI. It is worth noting that the RARDP for the first two months had already identified the need for a budget block in the amount of BRL 2.9 billion.

TABLE 4. CENTRAL GOVERNMENT PRIMARY BALANCE - 2024 (BRL MILLION IN CURRENT VALUES)

Item	2024: Evaluation Report of the 1st Bimonthly Balance			2024: IFI scenario, May 2024 reference			Difference between RARDP 2024 and IFI Scenario		
	BRL billion	GDP %	% Share	BRL billion	GDP %	% Share	BRL billion	GDP %	% variation
Net revenues	**2,175.2**	**18.8**	**99.6**	**2,092.5**	**18.1**	**95.7**	**-82.6**	**-0.7**	**-3.8**
Total primary expenditure	**2,184.5**	**18.9**	**100.0**	**2,187.1**	**18.9**	**100.0**	**2.5**	**0.0**	**0.1**
Social security benefits	**914.2**	**7.9**	**41.9**	**929.5**	**8.1**	**42.5**	**15.3**	**0.1**	**1.7**
Payroll and social charges	**374.6**	**3.2**	**17.1**	**373.9**	**3.2**	**17.1**	**-0.7**	**0.0**	**-0.2**
Continuous cash benefits	**103.4**	**0.9**	**4.7**	**100.0**	**0.9**	**4.6**	**-3.3**	**0.0**	**-3.2**
Salary Allowance and unemployment benefit	**79.6**	**0.7**	**3.6**	**77.5**	**0.7**	**3.5**	**-2.1**	**0.0**	**-2.6**
Selected mandatory expenses	**293.6**	**2.5**	**13.4**	**297.3**	**2.6**	**13.6**	**3.7**	**0.0**	**1.3**
Fundeb- Federal government supplementation	46.2	0.4	2.1	46.1	0.4	2.1	-0.1	0.0	-0.2
Federal District Constitutional Fund	3.8	0.0	0.2	3.1	0.0	0.1	-0.7	0.0	-19.0
Kandir Law	4.0	0.0	0.2	4.0	0.0	0.2	0.0	0.0	-0.3
Financial support for sub-national entities	3.6	0.0	0.2	3.6	0.0	0.2	0.0	0.0	0.0
Subsidies, grants and Proagro	20.4	0.2	0.9	22.5	0.2	1.0	2.1	0.0	10.5
Court judgments and court-ordered debt payments (cost and capital)	35.3	0.3	1.6	35.3	0.3	1.6	0.0	0.0	0.0
Public Employee’s benefits	18.6	0.2	0.9	18.6	0.2	0.8	0.0	0.0	0.0
Health (mandatory)	153.5	1.3	7.0	155.1	1.3	7.1	1.6	0.0	1.1
Education (mandatory)	8.4	0.1	0.4	9.2	0.1	0.4	0.8	0.0	9.4
Other branches (cost and capital)	**20.6**	**0.2**	**0.9**	**18.4**	**0.2**	**0.8**	**-2.3**	**0.0**	**-10.9**
Extraordinary credit, except PBF	**4.1**	**0.0**	**0.2**	**15.1**	**0.1**	**0.7**	**11.0**	**0.1**	**267.5**
Bolsa Família Program	**169.5**	**1.5**	**7.8**	**170.1**	**1.5**	**7.8**	**0.6**	**0.0**	**0.4**
Ordinary benefits	169.5	1.5	7.8	170.1	1.5	7.8	0.6	0.0	0.4
Extraordinary benefits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-
Other mandatory expenditure	**20.5**	**0.2**	**0.9**	**13.3**	**0.1**	**0.6**	**-7.2**	**-0.1**	**-35.2**
Discretionary expenditure	**204.4**	**1.8**	**9.4**	**191.9**	**1.7**	**8.8**	**-12.5**	**-0.1**	**-6.1**
Central Government primary balance	**-9.3**	**-0.1**	**-0.4**	**-94.5**	**-0.8**	**-4.3**	**-85.2**	**-0.7**	**911.6**

Source: IFI and STN. Prepared by: IFI

To conclude, Table 5 contains the updated short-term projections for the Gross General Government Debt (DBGG, in the original acronym), which remained practically unchanged. According to the IFI's new estimates, the DBGG should end 2024 at 77.6% of GDP (against 77.7% of GDP projected last February). In 2025, the indicator would rise to 80.1% of GDP, compared to the previous expectation of 80.2% of GDP.

TABLE 5. PROJECTIONS FOR GENERAL GOVERNMENT GROSS DEBT (DBGG) IN 2024 AND 2025, IN THE IFI BASELINE SCENARIO

Breakdown	2023	2024		2025	
		Feb/24 parameters	May/24 parameters	Feb/24 parameters	May/24 parameters
Consolidated Public Sector Primary Balance	-2.3%	-0.8%	-0.6%	-0.8%	-0.4%
Nominal GDP (BRL billion)	10,856	11,538	11,546	12,256	12,251
GDP - real growth	2.9%	1.6%	2.0%	2.0%	1.9%
Implicit GDP deflator	4.7%	4.4%	4.3%	4.2%	4.1%
Selic (% p.a.) - end of period	11.75%	9.25%	10.00%	8.50%	9.00%
Nominal implicit rate (% p.a.) - end of period	11.3%	9.7%	10.0%	8.7%	9.0%
Real implicit rate (% p.a.) - end of period	6.4%	5.6%	6.0%	5.0%	5.3%
DBGG (% of GDP)	**74.4%**	**77.7%**	**77.6%**	**80.2%**	**80.1%**

Source: IBGE, Central Bank and IFI. Prepared by: IFI.

Complementary Bill 68/2024 and the regulation of the tax reform

Marcus Pestana and Eduardo Nogueira

The Bill for the General Law on the IBS, CBS, and Selective Tax is the first of two proposed regulations drafted to implement Constitutional Amendment 132/2023, representing another important step in consolidating the new model of taxation on the consumption of goods and services.

The Executive Branch sent to the National Congress the Complementary Bill (PLP) 68/2024[5], which partially regulates Constitutional Amendment (EC) 132/2023[6], introducing substantial changes to the taxation of the consumption of goods and services.

This first bill, known as the General Law on the Goods and Services Tax (IBS), the Contribution on Goods and Services (CBS), and the Selective Tax (IS), addresses general norms, the operational model, imports and exports, cashback[7], basic food basket, differentiated and specific regimes, tax administration, and transition rules for the IBS and CBS. The bill also addresses the specific regimes of the CBS, the Selective Tax, the Manaus Free Trade Zone and Free Trade Areas, as well as the quinquennial evaluation of the new system.

According to the Federal Government[8], the bill is the result of the collective work of the Federal Government, the States, the Federal District, and the Municipalities. In addition to complying with Constitutional Amendment 132/2023, its premises include ensuring that the CBS and the IBS maintain the characteristics of a standard international Value-Added Tax (VAT), making the tax system simpler, fairer, more efficient, and more transparent, and using technical and objective criteria to define exceptions to the general rule and the incidence of the Selective Tax.

The submission of a second bill is also planned[9], which will address the law for the management and administration of the IBS. This bill will detail the IBS Management Committee, the model for IBS administrative disputes, the method for distributing the IBS among the States, the Federal District, and the Municipalities, and the method for reimbursing accumulated ICMS credit balances.

The need for changes in the national tax system has long been debated, with the World Bank considering it, in its Doing Business 2021 report[10], one of the most complex and inefficient in the world. Starting in 2019, the National Congress began addressing tax reform with an initial focus on consumption taxes through Constitutional Amendment Bill (PEC) 45/2019[11], presented in the Chamber of Deputies, and PEC 110/2019[12], in the Federal Senate.

The original text of PEC 45/2019 provided for the creation of a single VAT to replace five existing taxes[13]. It also proposed a single tax rate and the creation of a Selective Tax on products and services that are harmful to health. In the course of the proceedings, the concept present in PEC 110/2019 of a dual VAT was incorporated, segmented into an IBS, administered by States and Municipalities, and a CBS, managed by the Federal Government.

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[5] Available at: https://tinyurl.com/mr3ezb9r.
[6] Available at: https://tinyurl.com/5n6vaz42.
[7] A tax refund mechanism for low-income individuals aimed at reducing inequalities and making the tax system less regressive, meaning that lower-income people pay, proportionally, more consumption taxes than higher-income people.
[8] Available at: https://tinyurl.com/mryjwvsw.
[9] According to art. 18, II of EC 132/2023, the Executive Branch must send the bills referred to in the Constitutional Amendment to the National Congress within 180 (one hundred and eighty) days of enactment. Given that the Amendment was enacted on December 20, 2023, the deadline for submitting the second bill is July 16, 2024.
[10] Available at: https://tinyurl.com/mryra6px.
[11] Available at: https://tinyurl.com/bdee7j63.
[12] Available at: https://tinyurl.com/2rh2kvsr.
[13] Which are: Service Tax (ISS), Tax on the Circulation of Goods and Services including Interstate and Intermunicipal Transportation and Communication Services (ICMS), Tax on Industrialized Products (IPI), Social Integration Program (PIS), and Contribution for the Financing of Social Security (Cofins).

The final product of the effort to reform our Constitution materialized in Amendment 132/2023. From the beginning, it was decided not to alter the special regimes already existing in the constitutional text and complementary legislation, such as the Simples Nacional, the Individual Microentrepreneur, and the Manaus Free Trade Zone, in addition to other immunities and exemptions.

The idea of a single rate did not prevail either. The approved reform includes the provision for four rate brackets, distinguishing certain products and services: the full reference rate; a 30% reduction of the reference rate; a 60% reduction of the reference rate; and a zero rate. Additionally, various specific regimes for certain economic sectors were created.

Two pillars underpinned the entire process of discussion and deliberation within the National Congress: i) under no circumstances would there be an increase in the tax burden; and ii) the rate of the new dual VAT would be calibrated in such a way that there would be no loss of revenue for any entity of the Federation.

Although various differentiated and specific regimes have been introduced in the text of EC 132/2023, the central objectives of the reform have been preserved: i) an end to cumulative taxation; ii) transparency for taxpayers about how much tax they are paying for each operation in the consumption chain; iii) the existence of uniform national rules, reducing the level of litigation between the tax authorities and taxpayers at the administrative and judicial levels; iv) the end of the so called Fiscal War among states; v) simplification of the system; and vi) reduction in the number of taxes.

However, all the studies and projections made so far on the future impacts of the approved tax reform show that the greater the number of products, services and sectors benefiting from differentiated and specific regimes, the smaller the positive effects on output, productivity and employment, and the higher the national reference rate.

Even so, there is a technical consensus that the reform, due to its simplifying nature, will have an effective impact in favor of increasing the growth rates of the economy, employment and productivity, but on a smaller scale than would have occurred with the original version of PEC 45/2019, as demonstrated in the IFI Special Study No. 19/2024[14], "*Reforma Tributária: contexto, mudanças e impactos*" [Tax Reform: context, changes and impacts].

The study also notes that, in terms of the distribution of tax resources between regional and local governments, positive effects are projected toward greater equity in the federative dynamics. And that significant and unavoidable impacts will occur on the levels of sectoral tax burdens and relative prices. Meanwhile, IFI Technical Note 53/2023[15] systematizes the fiscal impacts of the tax reform with the creation of the various funds for compensation, regional development and the Amazon, and estimates what the additional GDP growth would have to be to finance the new expenses created.

The reform of consumption taxation in Brazil, therefore, has its cornerstone in the guidelines and provisions contained in Constitutional Amendment 132/2023. However, the detailing and regulation of the new rules and the new modus operandi of the national tax system were reserved for complementary and ordinary legislation, a goal embodied in the text of Complementary Bill (PLP) 68/2024, which will now be deliberated upon by the National Congress.

The national reference rate, projected by the Executive Branch, varies between 25.7% and 27.3%, with an average of 26.5%, of which 8.8% is related to the federal CBS and 17.7% pertains to the IBS of States and Municipalities. However, state and municipal governments will be able to reduce[16], within certain limits, or increase the IBS rates in their territory, in the portion allocated to the State or Municipality.

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[14] Available at: https://tinyurl.com/5etxyh98.
[15] Available at: https://tinyurl.com/3cnt7sk3.
[16] Considering the need to ensure the effectiveness of the withholdings referred to in § 1 of Art. 131 and Art. 132, both of the ADCT, Art. 360 of PLP 68/2024 establishes a rule prohibiting States, the Federal District, and Municipalities from setting IBS rates lower than those necessary for this purpose, during the period from 2029 to 2077.

PLP 68/2024 details in its annexes the 18 professions that will benefit from a differentiated regime with a 30% rate reduction, the 18 products that will make up the National Basic Food Basket (Annex I) with a zero rate, the products and services in areas such as health, education, people with disabilities, agribusiness, communication, sports and national security, information and cybersecurity (Annexes II to XII), with a 60% reduction from the reference rate, and various products and services in the areas of health, food, public transportation, cars for people with disabilities and taxi drivers, and science and technology, as well as purchases made by the public administration that will have a zero rate (Annexes XIII to XVI).

It is to be expected that a large part of the discussions in the National Congress will deal with the inclusion or exclusion of products, services and sectors that will benefit from differentiated regimes. As already mentioned, the IFI points out that the greater the exceptions, the smaller the positive impact on the economy and the higher the national reference rate.

The issues already raised[17] by the National Committee of Finance Secretaries (COMSEFAZ) regarding the rules for tax substitution, the operation and coverage of the Fund for the Compensation of Fiscal and Financial Benefits, the management of tax credits accumulated due to the time gap between the purchase of an input and the sale of the final product, the degree of autonomy for the implementation of cashback, credits generated by the Simples Nacional, Poverty Combat Funds, and the criteria for calculating ICMS revenue as a parameter for the future division of the IBS should also gain central importance.

The proposed regulation provides for the refund of a portion of taxes paid (cashback) to low-income families registered in the Unified Registry, with a family income less than or equal to 50% of the minimum wage. The refunds apply to taxes paid on energy, water, and sewage services (50% for the CBS and 20% for the IBS); natural gas and other cases (20% for the CBS and for the IBS); and for cooking gas cylinders (100% for the CBS and 20% for the IBS).

Individual Microentrepreneurs (MEI) will have a slight reduction in their contribution, paying BRL 7.00 plus the social security contribution. Starting in 2026, purchases from foreign websites will be subject to the consumption tax, even for those below $50, which are currently exempt.

PLP 68/2024 establishes the funding source for a national tax citizenship program of up to 0.05% of the revenue and the holding of prize draws as a way to encourage consumers to request receipts for their purchases.

The regulatory text reaffirms the principle of neutrality within the tax system, ensuring it does not distort consumption decisions and the organization of economic activity, except in cases provided for in the Constitution and the complementary law itself, which, as we have noted, are numerous and contradict the intention of neutrality.

The bill aims to regulate the constitutional text to address one of the chronic problems of the national tax system regarding the classification and categorization of services and products, which create legal uncertainty and fuel tax disputes. It seeks to level and unequivocally define all tangible and intangible goods, including rights.

PLP 68/2024 also defines the concepts of good, supply, supplier, purchaser, recipient, the objects of incidence, the differentiation of personal use and consumption, mixed operations involving goods and services, immunities, the taxable event, the moment when the tax-generating operation occurs, the location of the taxable event, enshrining theprinciple of destination-based taxation, the tax base, rates, assessment criteria, *split payment*[18], deductions, fines and interest, taxable persons, payment rules, tax credits, compensation, non-cumulative principle, deferral and suspension, immunity and exemption, reimbursement, statute of limitations and transfer of credits.

[17] Available at: https://tinyurl.com/2n5e6err.

[18] *Split payment* is one of the payment methods for IBS and CBS. The taxpayer will pay for the good or service and, at the moment of the transaction, the bank or the credit/debit card operator will separate the tax amounts for the respective tax authorities. Available at: https://tinyurl.com/4teaka4k.

This aims to achieve system simplification, lower compliance costs, decrease tax avoidance and evasion, and reduce the volume of litigation. Another objective set out in the project is to maintain the level of revenue during the transition period [19]. Thus, any change in legislation that impacts public revenues must be compensated by recalibrating the reference rate, which will be set through a Resolution of the Federal Senate.

Another important aspect of PLP 68/2024 is the detailing of the roles of the three levels of government in managing the new dual VAT, composed of the IBS and the CBS. This combines federative autonomy and tripartite cooperation through the division and sharing of responsibilities and the development of common management tools and digital platforms. The harmonization of IBS and CBS will be essential to achieving the central objectives of the reform.

The bill advances in establishing shared governance harmonized with the creation of Tax Administration Committees and Legal Support Committees. And the competencies and rules for oversight, issuance of infraction notices, document sharing, use of justifications and evidence produced by another governmental sphere, and sharing of process records and their results in a common digital environment.

It also regulates goods and services for personal use and consumption, as well as government purchases, with the IBS/CBS revenue fully allocated to the contracting entity, setting the rate to zero for others. The entire operation of the IBS and CBS is established with defined roles for the Federal Revenue Service of Brazil and the IBS Management Committee.

The bill regulates foreign trade operations with the complete tax exemption for exports, including inputs directed towards production for sale abroad, and the taxation rules for imported products and services.

Special customs regimes, particularly for oil and gas, Export Processing Zones, the Manaus Free Trade Zone, and Capital Goods, deserve special attention. The IPI, which will be zeroed out in 2027, will survive solely and exclusively to guarantee the competitiveness of products manufactured in the Manaus Free Trade Zone, applying to similar products produced in other regions, with the exceptions provided for in the bill. The benefits of the Free Trade Areas will remain until 2050.

PLP 68/2024 specifies the operating rules for differentiated regimes with lower rates, as well as specific regimes that address the economic dynamics of sectors such as fuels, financial services, health plans, lotteries, real estate, cooperatives, bars, restaurants, hotels, amusement and theme parks, public transportation, regional air transportation, travel and tourism agencies, football corporations, and diplomatic missions.

In these cases, the rules for differentiated taxation are detailed, addressing the taxable events, tax bases, rates, description of products with exceptional treatment, national uniformity, adjustments, generation or non-generation of credits, classification of eligible taxpayers for the regimes, forms of incidence, deductions, reducers, exclusions, assessment period, and ancillary obligations. The bill also regulates cases that allow for presumed credits and the specific regimes involving the *Universidade para Todos* (Prouni) [a Brazilian program providing scholarships for low-income students] and the automotive regime.

An essential part of the regulation is dedicated to the transition from the current system to the implementation of IBS and CBS. The great challenge of the reform will occur during this period, as the complexity of the system, which will decrease at the end of the transition, will be greater throughout the process due to the parallel coexistence of the two tax systems, the new and the old one.

The bill regulates the methods for determining tax rates, which will involve the participation of the Special Secretariat of the Federal Revenue Office of Brazil (RFB), the IBS Management Committee, and the Federal Accounting Court (TCU). It also addresses the reference revenues for their calculation, the limits of rate variation, the reductions in public administration contracts, the rebalancing of contracts affected by tax changes, the remaining credits of extinguished taxes and contributions, criteria and limits for compensating fiscal and financial benefits based on ICMS, the qualification of taxpayers,

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[19] The bill provides, in articles 330 and 361, a transition system between the current system and the new one, with the aim of ensuring that the migration between the two takes place gradually and safely, both for economic agents and for the federated entities. In this regard, the following are regulated: (i) rules for taxable events related to the year 2026; (ii) setting the reference rates for the CBS during the period from 2027 to 2033; (iii) setting the reference rates for the IBS (state, district, and municipal) during the period from 2029 to 2033; and (iv) setting the reference rates for the IBS and the CBS for the years 2034 and 2035, among others.

and the roles of the RFB and the tax administrations of the various federative entities for compensating accumulated credits and refunding improperly collected amounts.

PLP 68/2024 establishes and regulates the Selective Tax to be levied on products and services harmful to health and the environment, listed in Annex XVIII. There is a definition of the taxable event, the tax base, the non-incidence on exports, and the goods and services covered by the favored regimes, such as urban, semi-urban, and metropolitan public transportation services, as well as the non-cumulativity similar to the IBS and CBS. The rate will be set by ordinary law, with monthly assessment, payment by a single establishment to be specified in regulations, adjusted by the IPCA, and applying to imports of the products subject to the tax.

The bill also provides for a quinquennial evaluation of the effectiveness and results of the provisions set out in Constitutional Amendment 132/2023 regarding consumption taxes, such as cashback, the national basic food basket, differentiated regimes, and specific regimes, considering the impact on income inequalities, with the first round scheduled for the calendar year 2033.

The PLP repeals dozens of conflicting or outdated legal provisions with the approval of the reform, provides for federal compensation if the replacement of the IPI by the IS results in a reduction of resources shared through the Participation Funds for States and the Federal District (FPE) and for Municipalities (FPM), and maintains the allocation of a portion of the CBS (set at 18%) and the contribution to the PASEP as a capitalization mechanism for the Workers' Assistance Fund (FAT).

The initial intention expressed by the Federal Senate[20] and the Chamber of Deputies[21] is to conclude the discussions, voting, and approval of the bill by the end of 2024. It will be an important step in consolidating the new model of taxation on the consumption of goods and services, which will have positive impacts on production, productivity, employment, and federative equity, although these impacts will be diminished by the numerous exceptions introduced to favor certain products, services, and sectors.

[20] Available at: https://tinyurl.com/2jwkz9vz.
[21] Available at: https://tinyurl.com/5c5bcxmd.

IFI projections

SHORT TERM

IFI projections	2024			2025		
	Apr/24	May/24	Comparison	Apr/24	May/24	Comparison
GDP - real growth (% p.a.)	1.65	1.98	▲	1.96	1.93	▼
GDP - nominal (BRL billion)	11,537.88	11,546.26	▲	12,256.27	12,251.15	▼
IPCA - accumulated (% in the year)	3.88	3.83	▼	3.49	3.43	▼
Exchange rate - end of period (BRL/US$)	4.89	4.91	▲	4.95	4.96	▲
Employment - growth (%)	1.00	1.70	▲	1.02	0.92	▼
Payroll - growth (%)	2.52	4.75	▲	1.96	1.93	▼
Selic - end of period (% p.a.)	9.50	10.00	▲	8.50	9.00	▲
Ex-ante real interest (% p.a.)	5.35	5.23	▼	4.22	5.05	▲
Consolidated Public Sector Primary Balance (% of GDP)	-0.85	-0.62	▲	-0.76	-0.44	▲
of which Central Government	-0.95	-0.82	▲	-0.76	-0.44	▲
Net Nominal Interest (% of GDP)	5.99	6.97	▲	5.56	6.49	▲
Nominal Balance (% of GDP)	-6.83	-7.59	▼	-6.32	-6.93	▼
General Government Gross Debt (% of GDP)	77.66	77.60	▼	80.19	80.10	▼

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