

The distributive impact of income taxes in Brazil

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Income inequality has been one of Brazil's most significant socio-economic characteristics throughout its history. Although there has been a significant reduction since the end of the 1990s, its persistence and magnitude are still internationally notorious.

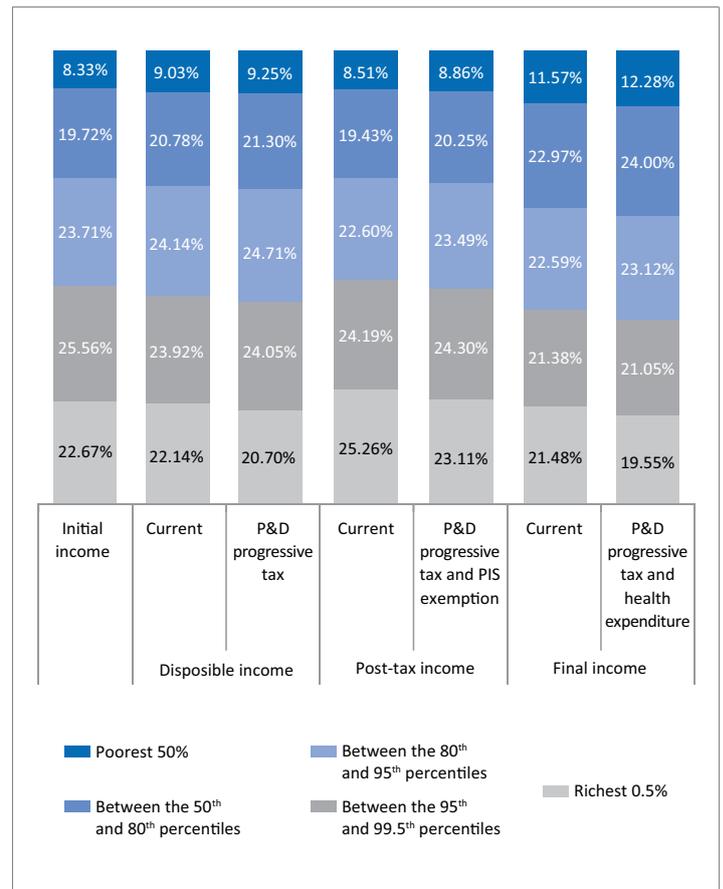
This One Pager seeks to synthesise the results of a study relating Brazilian inequality with its tax system, whose regressive nature must be overcome to enable a more egalitarian society. The Brazilian tax system places undue emphasis on indirect taxes—which comprise over 51 per cent of its gross tax burden. The country's insistence on taxes on goods and services (indirect taxes)—to the detriment of taxes on income and property (direct taxes)—undermines the real application of the principle of contributive capacity, resulting in a regressive system whereby families with less income proportionally finance a larger share of the State.

In the study, we analyse this disturbing national quirk in light of the evolution of the tax systems of certain central countries and draw comparisons with their current legislation. In addition to being normatively biased, Brazilian tax legislation has several technical limitations for the application of more efficient and equitable taxation on property and income. We undertake an exercise applying the Pareto interpolation method, using the 2008–2009 Household Budget Survey and the Large Numbers of Individual Income Tax Declarations (DIRPF), to estimate the level of inequality resulting from changes to personal income tax legislation. The key variable in the analysis is the reinstatement of taxation on profits and dividends, which are currently tax exempt. To that end, we have developed two simulations: one taxing profits and dividends at a 15 per cent flat rate, and the other at a progressive rate varying between 15 per cent and 27.5 per cent.

The results indicate a small improvement in income distribution, which is modest given the high level of income concentration in the country. On the other hand, there is a significant increase in revenue, between BRL22 billion and BRL39 billion, depending on the model for the taxation of profits and dividends. The most significant effect is on post-tax income, in which the regressive nature of indirect taxation contributes to practically nullify the redistributive effects of direct taxation. This is the synthetic numerical expression of inequality in the Brazilian tax system: the emphasis on indirect taxation, to the detriment of direct taxation, only contributes towards even more income concentration by disproportionately taxing the poorest population.

Finally, we performed a counterfactual exercise, whereby the additional revenue generated by the adoption of taxes on profits and dividends was used to fund an increase in public expenditure in several areas. The result was an improvement in income distribution (see Figure 1).

FIGURE 1
Distribution of earnings by income level, 2008



Source: Authors' elaboration.

Reference:

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