

# The Aftermath of the Tobacco Tax Reform in Brazil

## Key Findings

- The mixed structure (ad rem and an ad valorem components) of the selective tax (ST) should be maintained in the tax reform because it might increase tax revenues while avoiding that cheaper cigarettes become excessively affordable for the most vulnerable social groups.
- To avoid any setback in the anti-smoking policy, the ST should be set to prevent any state from losing tax revenue. This would avoid both a decrease in prices and increase in cigarette consumption across states.
- In one hypothetical scenario, with 92% ad valorem and 3,75 BRL per pack, cigarette consumption would decrease by 25%, prevalence would reduce by 7.44% to 11.46%, while the average tax burden would reach the recommended 75% by the WHO.

## Introduction

Brazil is currently undergoing a comprehensive tax reform. The key elements were defined in the Constitutional Amendment which was ratified in December 2023 (EC 132/2023). The reform introduces a harmonized value-added tax system (VAT) for all goods and services (through a dual VAT tax: IBSs and CBS) along with a selective tax (ST) for products that are harmful to health or the environment, including tobacco. The precise tax structure and tax rates of the ST are currently under discussion in the Senate (PLC 68/2024). This policy brief summarizes alternative scenarios simulations for the ST and their effects

on prices, consumption, tax collection, and tax burden on cigarettes. The products subject to ST are listed in the Annex XVII of the bill, that contains the tax code (international nomenclature - NCM/SH\*). Tobacco products (*Produtos fumígenos*) subject to ST are under codes: 2401, 2402, 2403 and 2404. Therefore, not only cigarettes (NCM Code 2402.20.00) are subject to the ST, but other tobacco products too will be subject to this tax. The simulations considered in this policy brief concern only cigarettes, by far the most widely consumed tobacco product. It is worth noting that only products under Code 2402 will be mandatorily subject to cumulative ad rem and ad valorem ST.

**Table 1. Tobacco products subject to Selective Tax (ST) (Annex XVII of the PLC 68/2024)**

NCM CODE	DESCRIPTION
<b>24.01</b>	Unmanufactured tobacco; tobacco refuse.
<b>24.02</b>	Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.
<b>24.03</b>	Other manufactured tobacco and manufactured tobacco substitutes; “homogenized” or “reconstituted” tobacco; tobacco extracts and essences.
<b>24.04</b>	Products containing tobacco, reconstituted tobacco, nicotine, or tobacco or nicotine substitutes, intended for inhalation without combustion; other nicotine containing products intended for the intake of nicotine into the human body

## Methodology and Results

We developed a static partial equilibrium model based on data provided by official sources that is used to simulate the effects of the tax reform on the cigarette market and the associated tax

collection. Unfortunately, the tax collection in the recent years does not accurately reflect cigarette consumption in Brazil because of an Extraordinary Appeal to the Brazilian Supreme Court (STF), RE 574706 (Theme 69) regarding the

calculation of PIS/COFINS had a huge impact on federal revenue collection. Therefore, we consider 2019 as the baseline because in this year the tax collection was not yet fully contaminated by such change in the PIS/COFINS tax basis, and there was a good database on the health data side (PNS, 2019). The National Health Survey (PNS) offers socioeconomic data enabling the calculation of cigarette demand price elasticities, employing the methodological framework comprehensively detailed in Divino et al. (2022). We will also consider the most recent value of the minimum

price for a 20-cigarette pack which has been updated to 6.50 BRL since September 1, 2024. Then we simulate four scenarios. In summary: Scenario I: ST replicates the average tax burden in the baseline with greater weight on the ad valorem ST component; Scenario II: ST replicates the average tax burden in the baseline with greater weight on the specific ST component; Scenario III: ST is chosen to avoid any state from have a decrease in tax burden; Scenario IV: ST is set to decrease consumption by 25%.

**Table 2. Summary of tax reform scenarios**

DESCRIPTION	BASILINE	SCENARIO I	SCENARIO II	SCENARIO III	SCENARIO IV
<b>Selective Tax (ad valorem)</b>	.	<b>77%</b>	<b>55%</b>	<b>90%</b>	<b>92%</b>
<b>Selective Tax (specific - BRL per pack)</b>	.	<b>2,25</b>	<b>2,75</b>	<b>3,00</b>	<b>3,75</b>
<i>Specific component (share of the ST)</i>	.	56,20%	68,57%	59,29%	64,02%
<b>Total tax revenue (millions)</b>	<b>1001,97</b>	<b>1019,02</b>	<b>1022,32</b>	<b>1080,08</b>	<b>1089,21</b>
<i>% Change</i>	.	1,70%	2,03%	7,80%	8,71%
<i>Average tax burden</i>	68,43%	68,43%	68,43%	73,25%	<b>75,63%</b>
<b>Total consumption (millions/month)</b>	<b>179,92</b>	<b>177,96</b>	<b>178,11</b>	<b>152,96</b>	<b>134,95</b>
<i>% Change</i>	.	-1,09%	-1,01%	-14,99%	<b>-25,00%</b>
<b>Average Prevalence</b>	<b>12,39%</b>	<b>12,30%</b>	<b>12,32%</b>	<b>11,83%</b>	<b>11,46%</b>
<i>Average % Change</i>	.	-0,73%	-0,50%	-4,50%	-7,44%

## Conclusions & Recommendations

- The mixed structure of the ST, comprising both a fixed and an ad valorem component, should be maintained.
- The selective tax must be carefully chosen to effectively assume its designated role as an excise tax on harmful products. By simply maintaining the current tax burden as part of the tax reform could result in certain states experiencing a decline in tax collection, which may lead to decreased prices and an increase in cigarette consumption.
- It is essential that the Selective Tax, incorporating both ad valorem and specific components, be designed in a way that prevents any state from losing tax revenue.

## References

(1) Divino, J. A., Ehrl, P., Candido, O., & Valadão, M. (2022). *Tobacco tax reform and demand-switching effects between the licit and the illicit markets in Brazil*. Institute for Health Research and Policy, Tobacconomics Working Paper 22/8/1.

\* NCM stands for Nomenclatura Comum do Mercosul, and SH for Harmonized System - HS).

Such a design would avoid both a decrease in prices and an increase in cigarette consumption nationwide.

- To avoid any increase in cigarette affordability, it is crucial that tax rates and cigarette prices are adjusted annually to account for inflation and changes in the purchasing power of the population.
- It is prudent to consider applying these findings to other harmful products, such as substitutes for cigarettes (e.g. vaping products). If these products are not subjected to the ST, they could become more attractive, potentially leading former cigarette smokers to switch demand, thereby compromising some of the positive effects of the tax reform.