IOF overturned: what comes next?

XP Short Note

The overturning of IOF on National Congress poses an additional challenge for this and next year budget execution. We believe that the government has some room to avoid additional spending cuts in the next bimonthly report and should be able to count on extraordinary revenues to reach the lower limit of the target. We assign a low probability of a change in the target this year, but the challenges for 2026 are growing, and although it is too early to discuss it, we believe that the possibility of a change in 2026 target cannot be ruled out.

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Last night, the Brazilian National Congress overwhelmingly rejected the presidential decree that would have increased IOF tax rates. As a result, tax rates will return to their previous levels, and the government is expected to lose an additional BRL 10 billion in revenue this year and BRL 20 billion next year. Given this situation, we highlight below the possible effects of Congress' decision.

- **Bimonthly primary revenue and expenditure report:** It is not mandatory to prepare an untimely revenue and expenditure assessment report. In principle, budget legislation requires revenue and expenditure to be reviewed only every two months, and the next report will not be released until July 22. However, the government **has the possibility** of preparing an untimely report to increase spending cuts by BRL 10 billion, adopting a more cautious stance.

- **The government may challenge Congress' decision in the Supreme Court.** It is important to note that a judicial review does not automatically suspend the repeal of the decrees, unless the Supreme Court issues a preliminary injunction to that effect. It is impossible to predict the outcome of any legal dispute.

- **Measures to compensate for the loss of revenue from the IOF tax.** Only measures with an immediate impact can be included in the July bimonthly report. For example, the loss of IOF revenue could be offset by increasing dividends from state-owned companies since this revenue stream depends solely on administrative decisions. Conversely, oil auctions in uncontracted areas cannot be included in the projections immediately because the process requires legislative approval and completion of steps such as publishing a notice and a schedule. Other possibilities, such as reducing tax benefits, would require time to present, discuss, and approve a bill that would not take effect until 2026.

- **Change in primary balance target.** We see no room for change in the primary result target for this year and next at this moment. Regarding 2025, we believe the government will be able to reach the lower limit of the target even without the IOF thanks to extraordinary dividend revenues and regulatory measures related to oil exploration. As for 2026, it is still too early to decide, and the government may negotiate new measures to increase revenue for next year to offset the loss related to the IOF (BRL 20 billion). However, we emphasize that the 2026 target poses a greater challenge than in previous years given that spending should grow faster than revenue, mainly due to the expected economic slowdown next year. Therefore, we do not rule out a change in the target during the 2026 budget execution.

Below, we present our most up-to-date forecast, excluding the effects of the IOF.

BRL bn

Measures	2025			2026	
	Bimonthly report	Current	XP	Gov	XP
Credit recovery at board of tax appeals (CARF)	-	-	1,0	-	-
Tax transactions	31,5	31,5	20,0	-	-
Recovery of credits	15,5	15,5	-	-	-
Special control over the use of tax benefits	-	-	10,0	-	-
Compensation for the payroll exemption	7,0	7,0	7,0	7,0	7,0
increase in IOF tax rate	20,0	-	-	-	-
Taxation of exempt securities	-	-	-	2,6	1,2
Increase in betting tax	-	0,3	0,4	1,7	2,5
Change in CSLL for fintechs	-	0,3	0,3	1,6	1,6
Increase in interest on equity (IoE)	-	-	-	5,0	6,0
Change in tax compensations	-	10,0	2,0	10,0	2,0
Auction of oil uncontracted areas	-	15,0	-	-	11,0
Other	-	9,3	6,0	-	-
Total	74,0	88,8	46,7	27,87	31,28

Source: Budget bill, XP

BRL Mn

BREAKDOWN	XP 2025	XP 2026
TOTAL REVENUE	2.892.878,6	3.121.695
Revenue Administered by RFB	*1.842.290*	*1.994.872*
Import tax	92.375	100.834
Industrialized Products Tax (IPI)	90.207	96.605
Income Tax (IR)	859.372	929.828
Financial transactions tax (IOF)	73.831	79.472
Social security financing(Cofins)	387.380	417.179
Social security funds (PIS/Pasep)	107.538	115.812
Social contribution on net earnings (CSLL)	185.818	202.605
Social security contributions	*709.695*	*772.992*
Revenue Not Administered by the RFB	*340.894*	*353.831*
Exploitation of natural resources	127.234	144.832
Dividends and Shareholdings	56.171	48.945
TRANSFERS BY REVENUE SHARING	573.140	623.101
NET REVENUE	2.319.739	2.498.594
TOTAL SPENDING	2.408.708	2.612.640
Social Security Benefits	*1.034.091*	*1.135.155*
Personnel and Charges	*406.456*	*440.564*
Other Mandatory	*395.834*	*442.771*
Salary bonus and unemployment insurance	89.868	99.813
Elderly and disabled assistance (BPC/LOAS)	128.614	144.458
Subsidies and Grants	25.836	30.050
Expenditure Subject to Financial Programming	*572.326*	*594.150*
Mandatory with Flow Control	368.828	394.608
Discretionary expenditures	203.498	199.542
CENTRAL GOVERNMENT PRIMARY BALANCE	-88.969	-114.046
Spending under execution	20.000	20.000
PRIMARY BALANCE W/ UNDEREXECUTION	-68.969	-94.046
Spending not included in the target	45.323	55.100
PRIMARY BALANCE FOR TARGET CALCULATION	-23.646	-38.946
PRIMARY TARGET (LOWER BOUND)	-30.970	0
EFFORT REQUIRED (+)/SURPLUS RESOURCES (-)	-7.324	38.946

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