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Simplex Nacional: Monotax Regime for Own-Account Workers, Micro and Small Entrepreneurs Experiences from Brazil



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Simples National: Monotax Regime for Own-Account Workers, Micro and Small Entrepreneurs

Experiences from Brazil

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“There is a growing interest world-wide to support more than 60 per cent of the world’s workforce operating in the informal economy”

Foreword

Efforts to support the formalization of the informal economy have accelerated across the globe after the historic adoption of International Labour Organization (ILO) Recommendation 204 Concerning the Transition from the Informal to the Formal Economy in 2015. With the launch of the Sustainable Development Goals (SDG), there is growing interest world-wide to support more than 60 per cent of the world’s workforce operating in the informal economy through the transition to formality. The notion that economic growth, while a necessary condition, is insufficient to reduce informality is widespread in the debates of post-global financial crisis, and most recently in the context of the fourth industrial revolution.

Several countries, especially in Latin America, have made significant progress in reducing informality among small enterprises and their workers through a multi-faceted policy mix, providing incentives and information, whilst reducing administrative red tape. In 2014, the ILO’s Programme for the Promotion of Formalization in Latin America and the Caribbean (FORLAC) issued a paper on Policies for the Formalization

of Micro and Small Enterprises in Brazil, which identifies the experiences and challenges faced by the government of Brazil to develop and continuously adapt the policy mix to reduce informality in micro and small enterprises.

With a view to inform the policy debate in a wider group of countries, the ILO started to collect additional information on trends, achievements and lessons learned since 2014. This was done in the context of the ILO’s mandate to gather and disseminate knowledge on promising practices that can inspire new initiatives in other parts of the world. This is particularly timely as many countries are currently testing new approaches to foster a transition to formality for informal operators and enterprises, in line with the guidance as provided by Recommendation 204 concerning the Transition from the Informal to the Formal Economy.

The purpose of this paper is to share information with policy makers and other stakeholders across the world on promising practices and lessons learned on the Brazilian experience with respect to the monotax system. It has been prepared in the context

of a South-South Expert Knowledge Sharing Forum on Policy Innovations and Lessons Learned on Enterprise Formalization, which took place in the Philippines in July 2018. The event, which was organised by the ILO Country Office for the Philippines in partnership with the ILO Enterprises Department and the International Training Centre of the ILO (ITC-ILO), enabled experts and representatives from governments, social partners and other stakeholders from the Philippines to engage with experts of the Global South on good practices and lessons learned, while exploring opportunities to replicate or adapt effective initiatives. The

workshop was technically supported by the ILO Country Office for Brazil and the Decent Work Team for the Southern Cone in Santiago, Chile, whereas the ILO Partnerships and Field Support Department contributed with South-South and Triangular Cooperation funds. Special appreciation is due to Hideki Kagohashi and Anne Posthuma from the ILO, for their coordination, technical support and inputs to produce this paper, as well as Rogério Nagamine Costanzi from IPEA and Helmut Schwarzer from the ILO for their technical contributions.



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List of Acronyms

BASCF	Brazilian Association of Secretaries of Finance of the Capital Municipalities <i>Associação Brasileira das Secretarias de Finanças das Capitais, ABRASF</i>
BRL	Brazilian Reals
CLL	Consolidation of Labour Laws <i>Consolidação das Leis do Trabalho, CLT</i>
FAO	Federal Attorney's Office <i>Procuradoria-Geral da Fazenda Nacional, PGFN</i>
FRSB	Federal Revenue Service Brazil <i>Secretaria da Receita Federal do Brasil, RFB</i>
IME	Individual Micro Entrepreneur <i>Microempreendedor individual, MEI</i>
NCFP	National Council of Finance Policy <i>Conselho Nacional de Política Fazendária, CONFAZ</i>
NCM	National Confederation of Municipalities <i>Confederação Nacional de Municípios, CNM</i>
NRLE	National Registry of Legal Entities <i>Cadastro Nacional de Pessoa Jurídica, CNPJ</i>
MSEs	Micro and Small Enterprises <i>Micro e Pequena Empresas, MPE</i>
RMC	Registration Management Committee <i>Comitê para Gestão da Rede Nacional para a Simplificação do Registro e da Legalização de Empresas e Negócios, CGSIM</i>
SN	Simples National <i>Simples Nacional, SN</i>
SNMC	Simples National Management Committee <i>Comitê Gestor do Simples Nacional, CGSN</i>
SSMSE	Special Secretariat of Micro and Small Enterprises <i>Secretaria Especial da Micro e Pequena Empresa, SEMPE</i>

INTRODUCTION

Introduction

104
Million Brazilians
are **economically**
active

84%
of Brazil's population
lives in **urban areas**

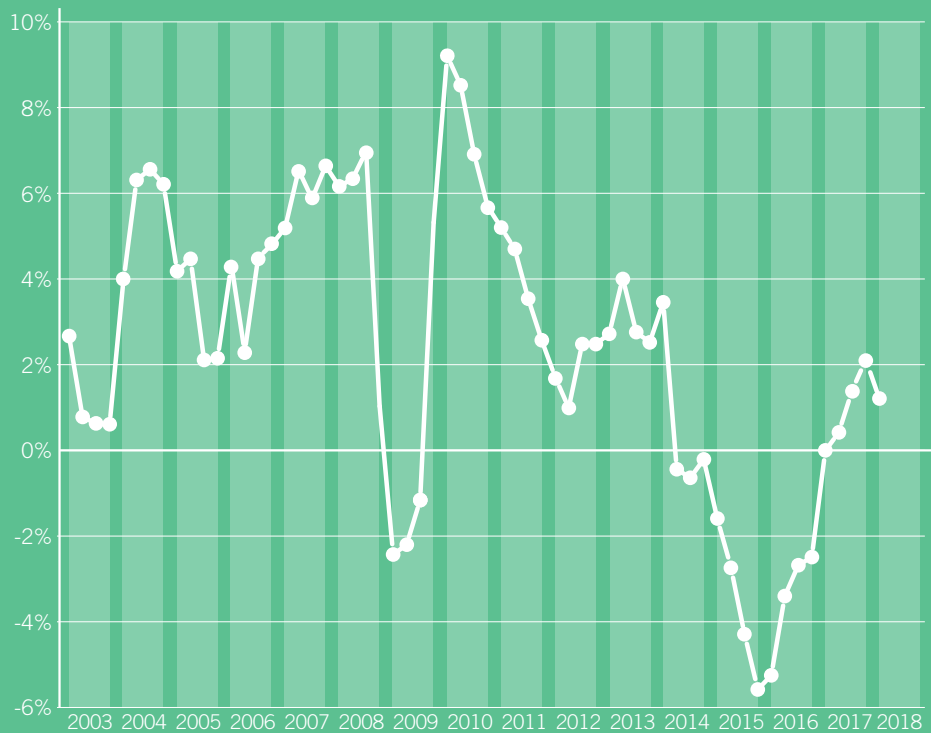
“ Many governments are exploring effective ways to reduce informality and create decent jobs through the introduction of monotax regimes ”

This paper provides an overview of a monotax regime that was introduced in Brazil at the end of the 20th century, aiming to create jobs and reduce informality among enterprises and their workers. The regime, referred to as Simples Nacional (SN) / *Simple Nacional (SN)*, provides a monotax and simplified procedures for own-account workers and micro and small enterprises (MSEs) / *Micro e Pequena Empresas (MPE)* on issues that affect these enterprises, such as business registration, taxation, social security, financial inclusion and government procurement. It includes, amongst others elements, a special statute called Individual Micro Entrepreneur (IME) / *Micro-Empreendedor Individual (MEI)* and a simplified tax and social security regime for own-account workers and micro and small enterprises. The own-account workers and MSEs regime and the IME regime are sub-sets of the Simples Nacional regime. To avoid confusion, this paper refers separate-

ly to the IME regime on the one hand, and the monotax regime for MSEs on the other hand, in the cases when a regime for each of these target groups is referred to separately.

The paper describes the nature and operation of the tax and social security components of the Simples Nacional regime, outlines its evolution, describes formalization trends, highlights its strengths and weaknesses and extracts lessons learned. The purpose of this paper is to share information on modalities of the regime and identify policy recommendations. This is a particularly important case study to document, as many governments around the world are currently exploring effective ways to reduce informality and create decent jobs through the introduction of monotax regimes for enterprises at the bottom of the pyramid.

FIG 1 Gross Domestic Product (GDP) Growth Rate (%)¹



¹ Source: IBGE (2018)

A. Socio-economic situation in Brazil (2003-2018)

Brazil is a vast country: it is the fifth largest country in terms of its territorial size and it has 209 million inhabitants, of which an estimated 104 million people are economically active². Furthermore, 84.4% of the population is concentrated in urban areas, which represent only 1.6 % of the country's territory³. Brazil is a federative republic with unique characteristics: it consists of a union of 26 states, the federal district and 5,570 municipalities. The states, federal district and municipalities are not subordinated to the union. Instead, each entity has some political, administrative, tax, budgetary and fiscal autonomy.

The Brazilian economy experienced a decade of consistent growth between 2003 and 2013 during which inequality declined and poverty rates were reduced drastically. Furthermore, during this period, the share of the population living below the extreme poverty line declined from 11.1% to 3.8%⁴, and the Gini Coefficient declined from 0.555 to 0.491 between 2004 and 2015.

However, GDP started to decline from 2014 onwards, dipping into recession and then showing modest recovery in 2017 and 2018, as seen in Figure 1 and the Gini Coefficient grows to 0.496 in 2018.

These economic fluctuations impacted upon the labour market, in which unemployment reached historically low levels between 2012 and 2014 and then rose in subsequent years, as seen in Figure 2. In addition to the growth of unemployment, there has been a reduction in formal employment since 2016, which went hand in hand with an increase in informal employment, as can be seen in Figure 3.

In Brazil, the private sector has a high number of micro and small enterprises, which accounted for 97.8% of all formally registered companies in 2011, as seen in Table 1⁵. Their employment impact also was substantial, which was represented by their contribution of 54.2% of all formal jobs.

98%

Of all **formally registered** companies in Brazil are Micro and Small Enterprises

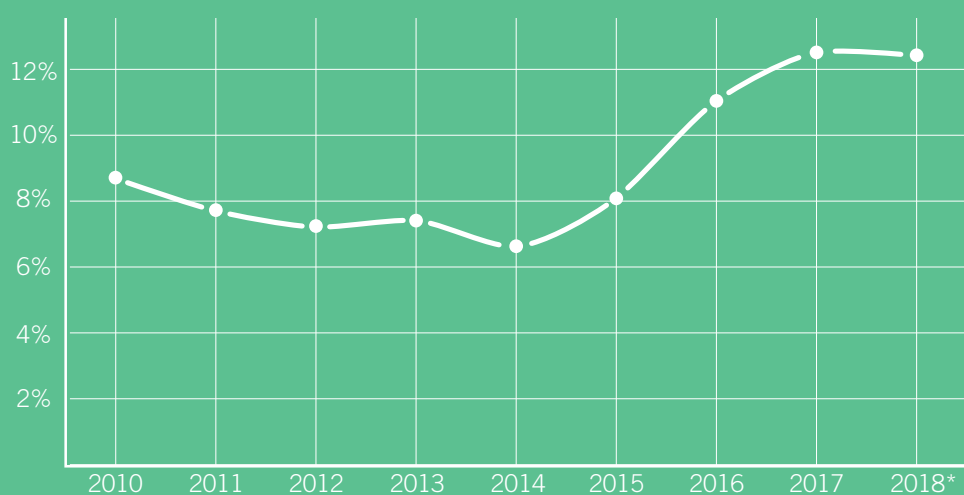
² IBGE, 2018

³ IBGE, 2010 and World Bank, 2017: 2018201720162015201420132012201112%10%8%6%4%2%2010 <https://databank.worldbank.org/data/source/health-nutrition-and-population-statistics>

⁴ Individual income below USD 1.90 per day. Source: UNDP, 2018.

⁵ This includes those registered as *Individual Micro Entrepreneur*.

FIG 2 Average unemployment rate: 2010 – 2018 (%)⁶



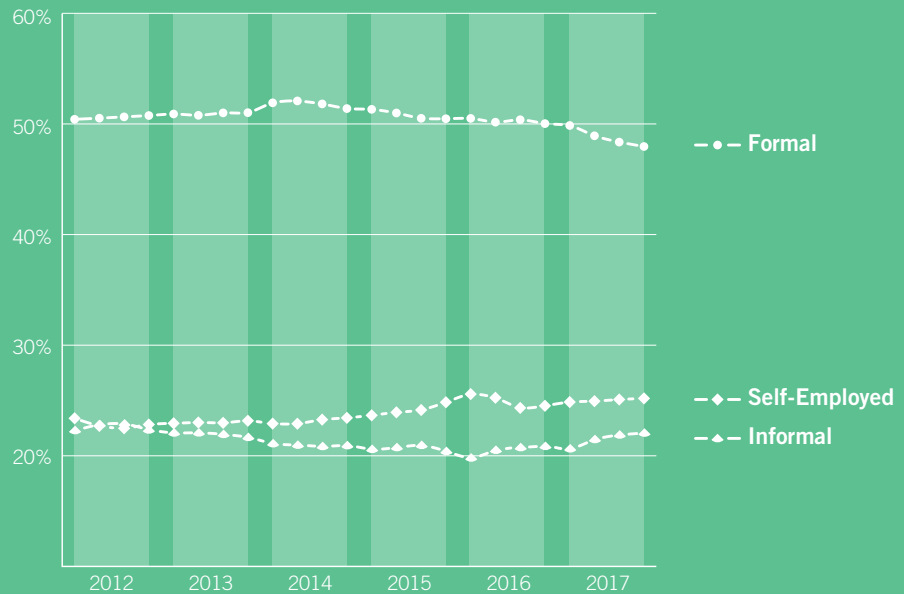
*Data reflect the first two trimesters of 2018.

⁶ Source: IBGE (2018). This series of unemployment data is gathered based on Carvalho (2016), where the unemployment data as obtained from the Monthly Employment Survey (PME) are reconciled with the National Continuous Household Sample Survey (PNADC).



“The first step to formalize an enterprise in Brazil is to obtain a unique business registration number called the National Registry of Legal Entities (NRLE) which is issued by the Federal Revenue Office of the Ministry of the Economy.”

FIG 3 Employment status: formal/informal wage employment and self-employment (in %)⁷



⁷ Source: IBGE(2018) 'Formal/informal wage employment' refers to employees with/without a formal labour contract. 'Self-employment' refers to formal self-employed (registered as MEI) and informal self-employed.

20+
Million workers are employed by Micro and small enterprises

63%
of businesses in Brazil are **Micro enterprises**

TABLE 1 Number of formally registered enterprises and employment by firm size (2011)

Size	Number of formally registered enterprises	Enterprises (%)	Employment by firm size*	Workers employed (%)
Micro and small enterprises	7,241,808	97.8	20,470,780	54.2
Individual Entrepreneurs (IME)**	1,664,447	22.5	1,698,999	4.5
Micro enterprises	4,685,702	63.3	10,181,308	27.0
Small enterprises	891,659	12.0	8,590,473	22.7
Medium & Large Enterprises	159,908	2.2	17,292,138	45.8
Total	7,401,716	100.0	37,762,918	100.0

* To estimate the number of employees, it was assumed that each enterprise has one manager.

** These data refer to 2011, yet by 2018, the total number of IME had reached 6.9 million registrations

B. Defining formalization and semi-formality in Brazil

Employment in the *informal economy* includes jobs in the informal sector as well as informal employment outside of the informal sector (i.e. in the formal sector and households). *Employment in the informal sector* takes enterprises⁸ as starting point of the analysis and assesses their level of formalization, mainly in terms of registration. Informal employment on the other hand takes jobs as the starting point and considers the effective access to social protection and other benefits and entitlements associated with the job.

What does enterprise formalization mean in Brazil? The first step to formalize an enterprise in Brazil is to obtain a unique business registration number called the National Registry of Legal Entities (NRLE) which is issued by the Federal Revenue Office of the Ministry of the Economy. Based on this business registration number, one can register the enterprise at the state and/or municipal level. The related requirements vary depending on the business activity. Enterprises need to hold a NRLE to conduct some transactions, such as accessing the banking system and issuing invoices. The NRLE thus provides a legal and formal status, and can be seen as the ‘birth certificate’ of an enterprise.

What does formalization of employment mean in Brazil? To define formalization of employment, it is important to differentiate between employees in the public and the private sector. Labour relations of private sector employees are established through a set of comprehensive labour laws, called the Consolidated Labour Laws (CLL) / *Consolidação das Leis do Trabalho (CLT)* dating from 1943. The CLL remained valid until the recent labour law reform process which was launched in 2017. Employees in the public sector are not covered under the CLL legislation, as specific laws apply to them. Workers’ labour rights, as laid out under Brazilian law, are linked to a signed work (the *carteira de trabalho*) and social security card (the *previdência social*), which is signed by the employer. The employer’s signature thus establishes the formal employment re-

lationship and provides labour rights such as a salary at or above the national minimum wage, paid annual leave, unemployment insurance, paid maternity/paternity leave, a weekly rest day, a 13th salary and subsidized transportation to work.

Semi-formality: Even though formality is clearly defined, in reality it is not always so clear whether a worker or an enterprise operates formally or informally, as there are various degrees of ‘semi-formality’. This paper therefore does not refer to a dichotomy of two parallel sectors (the ‘formal’ versus the ‘informal’ sector). Instead, it refers to a continuum with varying degrees of formality.

The concept of semi-formality is further illustrated by the following examples:

- **Partial registration and licensing:** A vendor who sells sandwiches in a van on the street and who has registered his business under the Individual Micro Entrepreneur (IME) statute is considered a formal entrepreneur by the federal government. Yet, if the entrepreneur has not obtained a sanitary surveillance license or an operating license, the business is informal from the perspective of the state and municipality, as it does not meet their licensing requirements.
- **Under-declaration of turnover:** A shop owner who sells clothes may meet all registration requirements, yet if he or she keeps part of the sales outside the accounting records and reports less turnover at the tax office, then this shop owner pays less taxes and thus operates semi-informally.

“Even though formality is clearly defined, in reality it is not always so clear whether a worker or an enterprise operates formally or informally.”

22%

Of employees in Brazil were **informal** in 2017



⁸ ILO Recommendation 204 on the Transition from the Informal to the Formal Economy refers to ‘economic units’, which includes enterprises, entrepreneurs and households. However, this publication uses the term ‘enterprises’.

“ There are various degrees of ‘semi-formality’. This paper therefore does not refer to a dichotomy of the ‘formal’ versus the ‘informal’ sector. Instead, it refers to a continuum with varying degrees of formality.”

- **Under-declaration of labour:** The owner of an IT company has formally registered his business and declares all turnover with the tax office. Yet if he has not issued a signed work and social security card for all employees, and/or if he effectively pays some employees a higher amount than what is recorded in their labour contracts, he operates semi-informally.
- **Formal actors engage in the informal economy:** In large Brazilian cities, street vendors regularly partner with established commercial trading companies to sell their goods in front of the company store. The purpose of this collaboration is not (primarily) to avoid taxes, but rather to occupy a market space which, if not occupied by this ‘contracted’ street vendor, would be occupied by any other vendor who would compete with the products from the established company.
- **Informal actors engage in the formal economy:** An informal entrepreneur in

the services sector requests a formal business that operates in the same sector to issue a formal invoice or receipt on her behalf. The formal business thereby also assumes payment of the corresponding taxes. This enables the informal entrepreneur to take on ‘legality’ for some of its operations.

Section II describes the Simples National regime targeting own-account workers and MSEs. It provides an overview of the modalities, eligibility criteria, benefits and obligations of these entrepreneurs. Section III describes how the Simples National regime is managed and lays out the roles of various actors at the union, state and municipal level. Section IV identifies to what extent own-account workers and MSEs and their employees have formalized or informalized their status over time. It also provides an analysis of such patterns by economic sub-sector and identifies challenges in relation to the monotax regime. Section V draws findings, lessons learned and policy implications.





**MONOTAX REGIME
FOR OWN-ACCOUNT
WORKERS, MICRO
AND SMALL
ENTREPRENEURS**

Monotax regime for own-account workers, micro and small entrepreneurs

1984

Was the year when the **micro enterprise statute** was created

2006

Marked the launch of **Simple National** for Micro and Small Enterprises

2008

Marked the creation of a special statute for **Individual Micro Entrepreneurs**

In Brazil, a series of measures have been put in place to create an enabling environment for own-account workers and micro- and small enterprises as a way to create jobs and encourage formalization. The legal and policy framework dealing with these entrepreneurs has evolved through a gradual process which was spread out over more than three decades. During this period, a monotax regime has been created for own-account workers, micro enterprises and small and medium-sized enterprises (SMEs).

In 1984, the **micro enterprise statute** was created by law to provide differentiated treatment for micro enterprises with respect to their tax and labour obligations as well as their access to bank loans and business development services. From then onwards, additional laws and policies have been introduced to streamline, eliminate or reduce their administrative, tax, social security and credit obligations.

In 1996, the **Simple Federal** regime was created by law which introduced a monotax (or monotributo), **for micro and small enterprises**. It combines six tax and social security payments into one lump-sum amount. Three years later, a new law introduced the **micro and small enterprise statute**. This law expanded the preferential treatment with respect to administrative, tax, social security, labour, credit and business development.

⁹ ILO, 2014

Despite these government efforts to favour micro and small enterprise growth and formalization based on tax alleviation and simplification of administrative and accounting procedures, the initial results in terms of formalization were not positive. Between 1980 and 2000, the rate of informal employment in Brazil rose on average by 0.2% per year⁹.

In 2003, a **constitutional amendment** was introduced to **streamline and integrate the monotax system** at the union, state, district and municipal level.

As can be seen in Table 2, the government of Brazil introduced additional measures between 2006 and 2009 to further simplify and streamline requirements for own-account workers and MSEs:

- **Simple National regime for micro and small enterprises:** In 2006, the Simple National regime for MSEs was introduced. This regime, which replaced the Simple Federal scheme, operationalised the MSE statute and further simplified the administrative and tax burden for MSEs. It includes all matters that affect MSEs, including tax matters. It also allows MSEs to file one single annual, simplified tax declaration, replacing the tax declarations that they until then had to present at the federal, state and municipal levels. It exempts MSEs from paying additional social contributions at federal



level and reduces a few other fiscal obligations. In addition to taxation and social security, the monotax regime also relates to a number of other issues, such as simplified regulations and registration procedures, as well as better access to government procurement.

- Regime for Individual Micro Entrepreneurs (IME):** In 2008 a special statute for own-account workers and entrepreneurs with up to one employee was created, as a sub-set of the Simples National scheme. Additional eligibility criteria apply and have been adapted over time. Under the IME statute, one can register as IME, and thus formalize while accessing tax and social security benefits. The Individual Micro Entrepreneur pays a nominal fixed amount each month, which varies according to the economic activity. This lump sum payment includes a municipal services tax, a state level tax for the movement of goods and a national social security contribution. The IME is exempted from other

taxes and contributions such as corporate income tax, social security tax and contributions to the social integration program. In addition to these tax advantages, the IME statute is also attractive for entrepreneurs as it includes them in the social protection system.

In the years after the introduction of the monotax regime for own-account workers and MSEs, several adaptations have been made. The turnover thresholds for each of these regimes have increased substantially, whereas the eligible activities have expanded. The lump sum payment for Individual Micro Entrepreneurs has been decreased, due to a political decision.

Sections A and B below outline the eligibility criteria, obligations and benefits of the Simples National regime. Annex 1 provides more information on the legal and regulatory framework for own-account workers and MSEs and how it evolved over time.

“Between 1980 and 2000, the rate of informal employment in Brazil rose on average by 0.2% per year”

TABLE 2 Overview of tax regimes for entrepreneurs in Brazil

	Monotax regime “Simples National”		Regular regime
Target Group	Own-account workers with up to one employee	Micro and small enterprises	
Eligibility Criteria	Eligibility depends on the type of business (own-account worker), the number of employees, turnover threshold and type of economic activity ¹⁰ .	Eligibility depends on the turnover threshold, type of business and type of economic activity ¹¹ .	Regime for enterprises that are not eligible, or not opting for monotax regime
Status	‘Individual Micro Entrepreneur’ statute	MSE statute	
Characteristics	Simplified tax return requirements, tax advantages, access to social protection, access to bank account with reduced rate, etc. ¹²	One single annual, simplified tax declaration, exemptions from paying additional social contributions and reduced fiscal obligations	
Type of taxation	Monthly lump-sum monotax ¹³	Monthly monotax with variables rates, based on gross turnover ¹⁴	Progressive tax regime
Filing requirements	Simplified filing requirements ¹⁵	Simplified filing requirements ¹⁶	Standard filing requirements

¹⁰ See section II-C

¹¹ See Annex 2

¹² See section II-B

¹³ See Table 4 for information on taxes and contributions that are included in the monotax

¹⁴ Ibid.

¹⁵ See Table 4 for information on filing requirements.

¹⁶ Ibid.

A. Monotax regime for Micro and Small Enterprises

The main objective of the voluntary monotax regime for MSEs is to create jobs, yet it has also reduced informality. This regime, which came into effect in 2007, allows eligible MSEs to make one monthly monotax payment. The scheme divides enterprises into five categories based on their annual turnover and type of economic activity. For each category, a specific tax bracket has been defined, as shown in Table 3. To minimize effects of seasonality, the tax rate is determined based on the sales over the last 12 months. It includes taxes and employer's contributions to social security, as described in Table 4. All tax transactions under this regime are made via internet, based on the Simples National Portal. It is not possible to do any transaction offline, although tax payments can be done at the bank.

9,6
Million Reals is the **maximum gross turnover** for MSEs in the Monotax regime

Obligations:

- Eligible MSEs make a monthly tax declaration and pay a single monthly amount with taxes which vary depending on their annual gross sales and the nature of these sales. (e.g. trade, manufacturing, services, etc.);
- MSEs must maintain electronic invoices for their sales and purchases, as well as a cash register.

Benefits:

- **Easier and predictable tax payments.** Instead of paying six federal taxes and social security contributions, one state tax and one municipal tax separately at each level and having to comply with varying payment dates and calculation methods, the MSEs can now do a single payment and comply with tax and social security requirements. Under the monotax regime, MSEs can file one single annual, simplified tax declaration. This replaces the tax declarations at the federal, state and municipal level that enterprises outside the monotax regime for MSEs are required to submit.
- **Reduced tax burden.** The monotax system has effectively reduced the total amount of taxes to be paid by these entrepreneurs: It does not only integrate eight taxes and social security contributions at the federal, state and municipal level. It also waives these entrepreneurs from other tax and social security obligations.
- **Increased social security coverage** for own-account workers.
- **Access to public procurement opportunities.**
- **Access to bank accounts with a reduced interest rate.**

TABLE 3

Tax rates under the monotax regime for MSEs

Class	Activities	Effective rates
I	Commerce	4.00% to 15.11%
II	Manufacturing	4.50% to 18.95%
III	General Services	6.00% to 24.50%
IV	Labour Intensive Services ¹⁶	4.50% to 20.75% ¹⁷
V	Intellectual Services ¹⁸	15.50% to 24.25% ¹⁹

¹⁶ Building, Cleaning, Attorney Services and Surveillance.

¹⁷ In Class IV, the enterprise falls under the SN, yet the employer's contribution to social security is due outside the SN (in other words: these enterprises pay the employer's contribution to social security as any other enterprise outside the SN).

¹⁸ Physicians, Engineers, Consultants, etc.

¹⁹ If the ratio between payroll and turnover is equal to or greater than 28%, the entities in the Class V shall pay the same rates of the Class III.



- **Workers benefit from the same social security rights and other workers' rights** as workers of enterprises that are outside this regime.

Social security coverage: Brazil has four social contributions earmarked for social security, all of them included in Simples Nacional: CSLL, COFINS, PIS/Pasep and social contribution for pensions and social security benefits. The first three are intended for the general purposes of the Brazilian social security, namely: medical care, assistance and social security benefits. The last contribution, intended only for pensions and other social security benefits, is paid by the employers (within the Simples Nacional), and by the employees (by withholding tax). The social security benefits are: public pension; Invalidation & survivor benefits; Health & maternity benefits; and Family allowance (death/imprisonment). In Brazil, medical care is granted by the public system.

Eligibility criteria: The monotax regime is accessible for MSEs with gross annual sales

of up to Brazilian Reals (BRL) 4,800,000 (or USD 1,230,769)²⁰ in the domestic market, plus BRL 4,800,000 for exports. Registration under this monotax regime is accessible for commercial, industrial and service companies, with the exception of some specific sectors²¹. An entrepreneur who has tax debts cannot adhere to or remain in the scheme²². Annex 2 provides additional information on eligibility criteria.

Technological innovations: The monotax regime operates with a software package which contributes to the success of the scheme. When an entrepreneur submits the annual gross sales and the sectorial activity or activities linked to these sales, a software package calculates the taxes that are due. The system automatically creates the tax return each month upon submission by the taxpayer of the gross annual sales over the last 12 months. When the entrepreneur makes the tax payment, the amounts are allocated to each tax, and the credit of the tax amounts is automatically made to each respective tax administration.

“The main objective of the voluntary monotax regime for MSEs is to create jobs, yet it has also reduced informality.”

²⁰ For currency conversions, this document applies the exchange rate of February 2019.

²¹ The following activities are excluded: financial activities, electric power production chain activities, production and wholesale trade of cigarettes and firearms, sale or assignment of labour, allotment and incorporation of real estate; import or manufacture of automobiles and motorcycles; import of fuels.

²² Yet this requirement was weakened in 2011 and 2018 as entrepreneurs were allowed to pay tax debts over a period of 60 months and 180 months, respectively

TABLE 4 Taxes and contributions included in the monotax regime for MSEs

The monotax regime unifies the following taxes and social contributions:

Federal taxes and contributions:
<ul style="list-style-type: none"> • Corporate income tax (<i>Imposto de Renda das Pessoas Jurídicas</i>) • Tax on manufactured goods (<i>Imposto sobre Produtos Industrializados</i>) • Social contribution on net income (<i>Contribuição Social sobre o Lucro Líquido</i>) • Social security tax (<i>Contribuição para Financiamento da Seguridade Social</i>) • Contribution to the social integration program and the public service employee fund (<i>Programas de Integração Social e de Formação do Patrimônio do Servidor Público</i>) • Employer social security contribution (<i>Contribuição Previdenciária Patrona</i>)
State Tax
<ul style="list-style-type: none"> • Tax on operations related to the circulation of goods and on provision of interstate and inter-municipal transportation and communication services (<i>Imposto sobre Operações Relativas à Circulação de Mercadorias e sobre Prestações de Serviços de Transporte Interestadual e Intermunicipal e de Comunicação</i>)²³
Municipal Tax
<ul style="list-style-type: none"> • Tax on General Services (<i>Imposto sobre Serviços de Qualquer Natureza</i>)

²³ The ICMS is a tax as VAT, but in Brazil is a state tax. This tax is not levied on services, except for transport and communications services.

B. Monotax regime for own-account workers (IME)

This regime, which came into effect in 2009 as a sub-set of the Simples National regime, allows own-account workers with very low gross sales to register under a special, formal statute called *Individual Micro Entrepreneur* (IME). Its main objective is to reduce informality. At the time of its introduction, there were about 13 million informal entrepreneurs in Brazil, most of which were self-employed. Other objectives of the regime were to create and strengthen a tax culture and awareness among the population, especially among small entrepreneurs, to stimulate a culture of civil responsibility and to increase the social protection among these entrepreneurs. To formalize informal entrepreneurs, the regime focused on simplifying registration, filing and payment processes and reducing the frequency and amount of information required to file tax returns.

“ The main objective of the monotax regime for own-account workers is to reduce informality.”

- **Obligations:** Entrepreneurs that are registered as IME pay a monthly nominal monotax of BRL 55.9 (or USD 14.34) which includes state and municipal taxes as well as a social security contribution.²⁴ The IME is exempt from other federal enterprise-related taxes. The IME is not required to issue an invoice when selling to private persons, yet he/she should issue an invoice when selling to corporate entities. However, it is mandatory for an IME to make purchases based on an invoice. As the IME regime is a sub-set of the Simples National regime, Individual Micro Entrepreneurs are subject to the same other general requirements as MSEs that are outside this regime.

Benefits:

- Simplified online registration through a portal which includes the trade register, tax office and social security office.
- Temporary operating license upon registration.
- Tax advantages.
- Simplified tax return requirements.
- Access to social protection.
- Access to public procurement opportunities.
- Access to bank accounts with a reduced interest rate.
- Access to social security, such as a basic state pension²⁵; disability and survivor benefits; health and maternity protection, and family allowance in the event of imprisonment or death of the household's breadwinner. Access to medical care is not included as in Brazil, as residents in Brazil have the right to free public health care.
- An IME who hires an employee, pays a discounted rate of 8% of the employer's social security contribution²⁶. The employee receives a discounted rate of 8% of the worker's contribution to the social security in his salary.
- **Eligibility criteria:** The IME statute is available for own-account workers and employers with up to one employee²⁷ that have an annual gross sales of up to BRL 81,000 (or USD 20,769), and that operate from one single establishment without branches. The Simples National Management Committee (SNMC) / *Comitê Gestor do Simples Nacional (CGSN)* selected some economic activities that are eligible for the IME statute. Entrepreneurs that engage in intellectual activities (such as accountants, doctors, lawyers, etc.) are excluded from the IME statute.



²⁴ The social security component in the monotax was initially set at 11% of the minimum wage. In 2011 it was reduced to 5% of the minimum wage.

²⁵ Access to the basic state pension is available for the entrepreneur, not for the workers

²⁶ The normal rate of this contribution is 20%.

²⁷ The employee should earn the minimum wage.

C. Differences between the regimes for own-account workers and MSEs

In Brazil, the states and municipalities have certain autonomy with respect to taxation and regulation. This has posed some challenges to harmonize create tax regulations and move towards a uniform approach that applies at the municipal, state and union level. To address this issue, various initiatives have been undertaken to coordinate, integrate and unify the respective legal provisions at each level. Furthermore, several changes have been introduced to make the regimes accessible to a larger number of entrepreneurs.

- **Eligibility criteria:** Under this regime, criteria have been gradually expanded to increase the turnover threshold for eligible entrepreneurs. At its inception in 2008, the turnover threshold for Individual Micro Entrepreneurs was set at BRL 36,000 (or USD 9,837) yet by 2018 it reached BRL 81,000 (or USD 20,769), which reflects an increase of 225%. Similarly, the threshold for MSEs increased from an initial BRL 720,000 (or USD 194,531) in 1996 (Simples Federal) to BRL 4.8 mn (or USD 1,279,624) in 2018 (Simples National) which is an increase of 667 per cent. Secondly, the range of economic activities has been expanded.

- **Vertical integration:** Several measures have been taken to enhance vertical integration between the different levels of government in Brazil, as a way to streamline the tax system at the federal, state, district and municipal levels. One example is the constitutional amendment in 2003, which paved the way to establish a single system for the collection of taxes and contributions from the federal, state, federal district and municipal level. At the initial stages of this regime this vertical integration took quite some effort, as the trust between each of these government levels was only built slowly. Yet over time, this situation has improved substantially. The Simples National experience has served as inspiration for other federative initiatives, such as the electronic invoicing system and the new *eSocial* system which will unify all obligations with respect to labour and social security.

Table 5 outlines differences between the monotax regime targeting Individual Micro Entrepreneurs and that targeting MSEs. These relate mainly to the turnover threshold, the eligibility criteria and the type of taxation.

“The Simples National experience has served as inspiration for other federative initiatives, such as the electronic invoicing system and the new *eSocial* system which will unify all obligations with respect to labour and social security.”





TABLE 5 Differences between the monotax regime for IMEs and MSEs

Topic	Monotax regime for Individual Micro Entrepreneurs (IME)	Monotax regime for MSEs
Turnover threshold	BRL 81,000 (or USD 20,769)	BRL 4,800,000 (or USD 1,230,769) in the domestic market, plus BRL 4.800.000 for exports.
Eligibility	Own-account workers and employers with not more than one employee.	Micro and small enterprises.
Type of taxation	Monthly monotax.	Monthly monotax with variables rates, based on gross turnover.
Taxes included	<ul style="list-style-type: none"> • Personal social security contribution. • Tax on inter-state and inter-municipal transport and communications services. • All service tax. • Exempt from all other taxes.²⁸ 	<ul style="list-style-type: none"> • Corporate income tax • Tax on manufactured goods • Social contribution on net income • Social security tax • Contribution to the social integration program and the public service employee fund. • Employer Social Security Contribution. • Tax on inter-state and inter-municipal transport and communications services. • All service tax.
Tax and social contributions	IMEs that pay wages below to the Personal Income Tax-exempt level would be required to withhold only contributions from their employees.	
Filing requirements	<ul style="list-style-type: none"> • Annual tax return, based on three questions: <ul style="list-style-type: none"> - What were the total sales? - Of this total sale, how much was the sale of goods? - Did you hire an employee? • Monthly sales summary (yet it is not required to submit this). • Exempt from filing financial statements. 	<ul style="list-style-type: none"> • Monthly tax return. • Monthly cash accounting (yet it is not required to submit this). • Monthly electronic sales and purchasing record.²⁹ • Exempt from filling financial statements.
Withholding contributions from employees	Personal social contributions.	Personal social contributions. Personal Income Tax.

²⁸ If an employee is hired, the employer will pay 8% of the employer's social security contribution. The normal rate this contribution is 20%.

²⁹ This registration is not necessary if the taxpayer uses electronic invoices.



MANAGEMENT OF THE MONOTAX REGIME

Management of the monotax regime

A. Simples National Management Committee

The Simples National regime is managed by the Simples National Management Committee (SNMC), which is responsible for the development and oversight of tax regulation as well as national fiscal integration between the various levels of government. It reports to the Ministry of Finance, and consists of members from the federal government, states and municipalities. This management committee was established, amongst others, to put in place the inter-federative regulation. The committee publishes resolutions - normative regulatory acts, intended for tax administrations and taxpayers. It means that the SNMC does regulation by the 3 levels of government at the same time. Yet the operational autonomy of each federative entity is preserved. The management committee can represent the federal government, states and municipalities and act on their behalf.

The roles of the management committee, union, states, municipalities, tax administrations and federal attorney's office are defined as follows:

- **Regulation:** The Simples National Management Committee is responsible for regulation and specifies technology solutions for the implementation of the monotax regime, with the participation of the three levels of government.
- **Oversight:** The union, states and municipalities are responsible for the development and oversight of the regulation, as they are part of the SNMC.
- **Tax administration:** The Federal Revenue Service of Brazil (FRSB), states, federal districts and municipalities are responsible for operational issues relating to taxpayers, such as approval of eligibility, exclusion, monitoring, control, audit, administrative litigation.
- **Judiciary:** The Federal Attorney's Office (FAO) / *Procuradoria-Geral da Fazenda Nacional (PGFN)* is responsible for registration of pending debts and judicial execution, unless the state or municipality has an agreement with the PGFN to do so.

“ The Simples National Management Committee is responsible for the development and oversight of tax regulation, and for national fiscal integration between the 3 levels of government. ”

TABLE 6 Composition of the Simples National Management Committee

Government Level	Government Body
Union: 2 members	<ul style="list-style-type: none"> • Federal Revenue Service of Brazil (FRSB) <i>Secretaria da Receita Federal do Brasil (RFB)</i>³⁰
State: 2 members	<ul style="list-style-type: none"> • National Council of Finance Policy (NCFP) <i>Conselho Nacional de Política Fazendária (CONFAZ)</i>
Municipality: 2 members	<ul style="list-style-type: none"> • Brazilian Association of Secretaries of Capital Finances (BASCF) <i>Associação Brasileira das Secretarias de Finanças das Capitais (ABRASF)</i> • National Confederation of Municipalities (NCM) <i>Confederação Nacional de Municípios (CNM)</i>

³⁰ The RFB President is a member.

I B. Other relevant entities

In addition to creating the Management Committee, the Simples National Law also established the following entities:

- **Registration Management Committee (RMC) / Comitê para Gestão da Rede Nacional para a Simplificação do Registro e da Legalização de Empresas e Negócios (CG-SIM)** handles openings, licenses, modifications and closings of companies. This committee reports to the Ministry of Industry and Commerce.
- **Permanent Forum of Micro and Small Companies**, created to deal with other (non-tax) issues such as government pro-

urement, enterprise development, access to finance, labour and social security issues. This entity is in the structure of the Special Secretariat of Micro and Small Enterprises (SSMSE) / *Secretaria Especial da Micro e Pequena Empresa (SEMPE)*.

Furthermore, the Brazilian Autonomous Service of Support to MSEs / *Serviço Brasileiro de Apoio às Micro e Pequenas Empresas (SEBRAE)* engages in training, development and advocacy of MSEs. This parastatal organization represents the interests of these enterprises in the public and private sector and aims to advance their development.

FIG 4 Organization of the tax system under the monotax regime

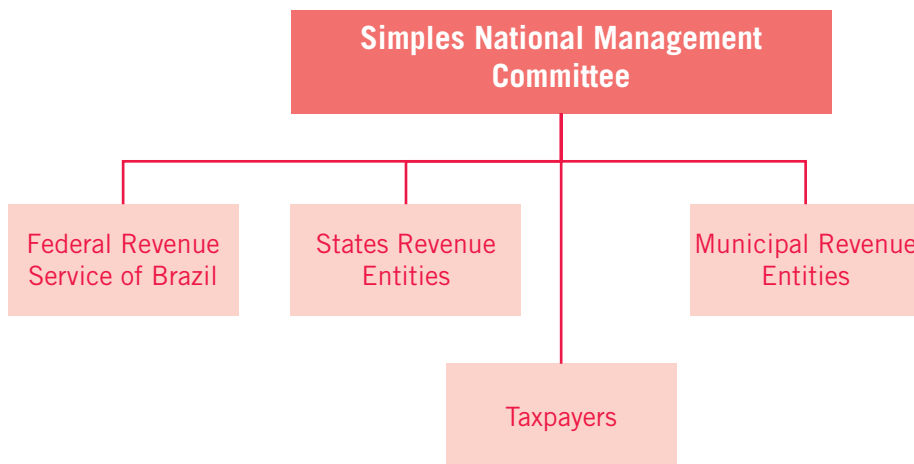
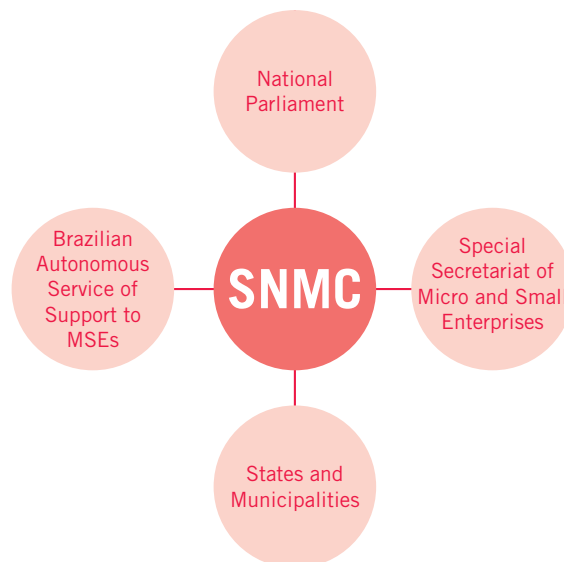


FIG 5 Position of SN Management Committee vis-à-vis other stakeholders on tax issues



FORMALIZATION TRENDS

Formalization trends

7.7
Million **IMEs** were registered by 2018

5
Million **MSEs** were registered by 2018

Formalization of enterprises: The regimes for the Individual Micro Entrepreneur and for MSEs have had a positive impact on formalization. In 2018, there were 7.7 million registrations under the Individual Micro Entrepreneur regime, whereas 5 million MSEs were registered under the monotax regime (Figure 6). Three out of four enterprises (78%) have indicated that their sales have increased after they formalized³¹. The main motivations to register under these regimes are to gain access to social security, to be able to formalize the enterprise and to be able to issue formal invoices (Table 7).

Formalization of workers: The monotax regime has also created conditions to formalize workers. The enterprises registered under this regime reported to the Federal Revenue Service of Brazil³² that they employed 7.8 million formal employees by the end of 2008³³. At the end of 2017, this number rose to 10.6 million, which represents a quarter (26.7%) of the total formal employees in Brazil (Figure 7).

Not all registrations under the IME regime have taken place by informal own-account workers. Table 8 shows that many registrations under this regime were done by for-

“The monotax regime has created conditions to formalize workers.”

³¹ SEBRAE (2017). Perfil do microempreendedor individual. Brasília

³² Source: Secretariat of Social Security of the Ministry of Economy. (GFIP numbers - the monthly declaration of jobs and wages).

³³ These figures are based on the declarations made by enterprises that have opted for the Simples National regime.

Small business entities estimate that small businesses hold about 60% of formal jobs in Brazil, yet these calculations are based on different criteria. SEBRAE, for example, applies different criteria to define small companies.

FIG 6 Total number of registrations as IME and MSEs (in thousands)

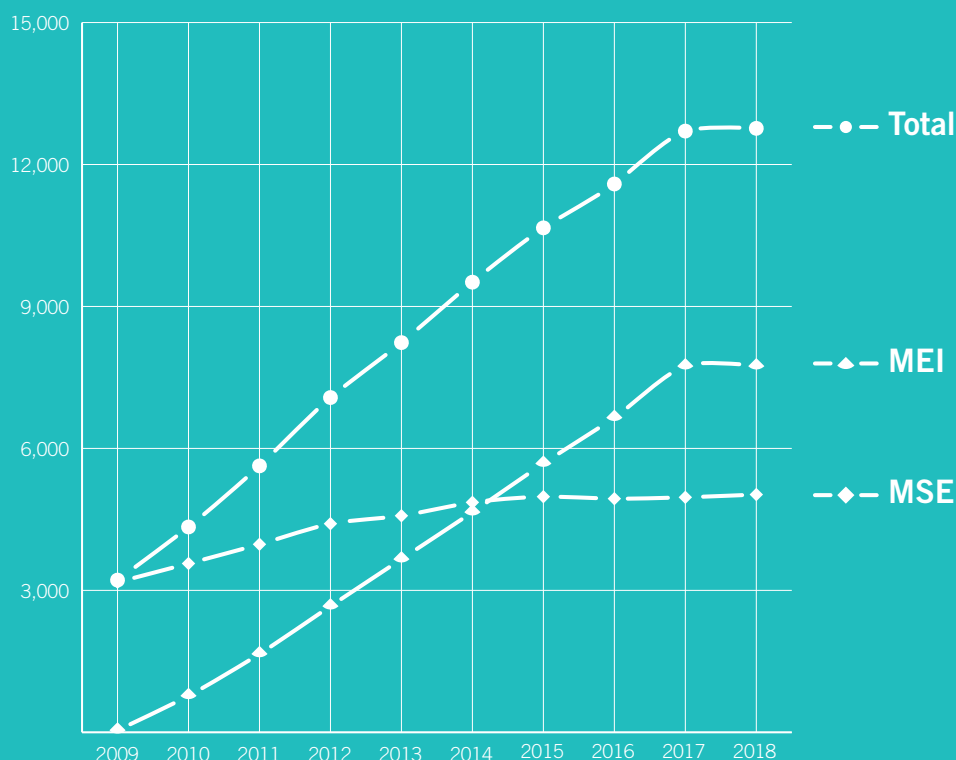


TABLE 7

Reasons to register as IME – 2016³⁴

Motivation	%
Social security	32.2
Enterprise formalization	22.4
Permission to issue invoices	10.3
Growth possibilities	8.7
Avoid problems with state inspection	6.7
Facility to create a company	5.9
Low (or no) formalization cost	3.7
Possibility to cheaper/better purchases	1.7
Possibility to sell with credit/debit cards	1.3
Getting loans as an enterprise	1.2
Possibility to sell to other companies	1.1
Possibility to sell to the government	0.3
Others	4.5
Total	100.0

³⁴ Source: Sebrae, 2017

merly formal employees, followed by informal entrepreneurs and informal employees. Formal employees may have left or been dismissed from a wage job and ventured into self-employment. Yet there is also a possibility that some formal employees were fired and subsequently contracted as IME as this is less costly for the employer.

Disguised employment relationship:

There exist some cases in which former wage workers have changed their status from formal employee to Individual Micro Entrepreneur, even though they remained working for the same company in the same function - yet with reduced labour rights - based on a contracted outsourcing arrangement³⁵.

³⁵ The IME programme has been used in some cases for maintaining an employee through a disguised employment relationship. (http://repositorio.ipea.gov.br/bitstream/11058/8327/1/cc_38_nt_desequilibrio_financeiro_MEI.pdf).

FIG 7

Formal employees by category (in Million)

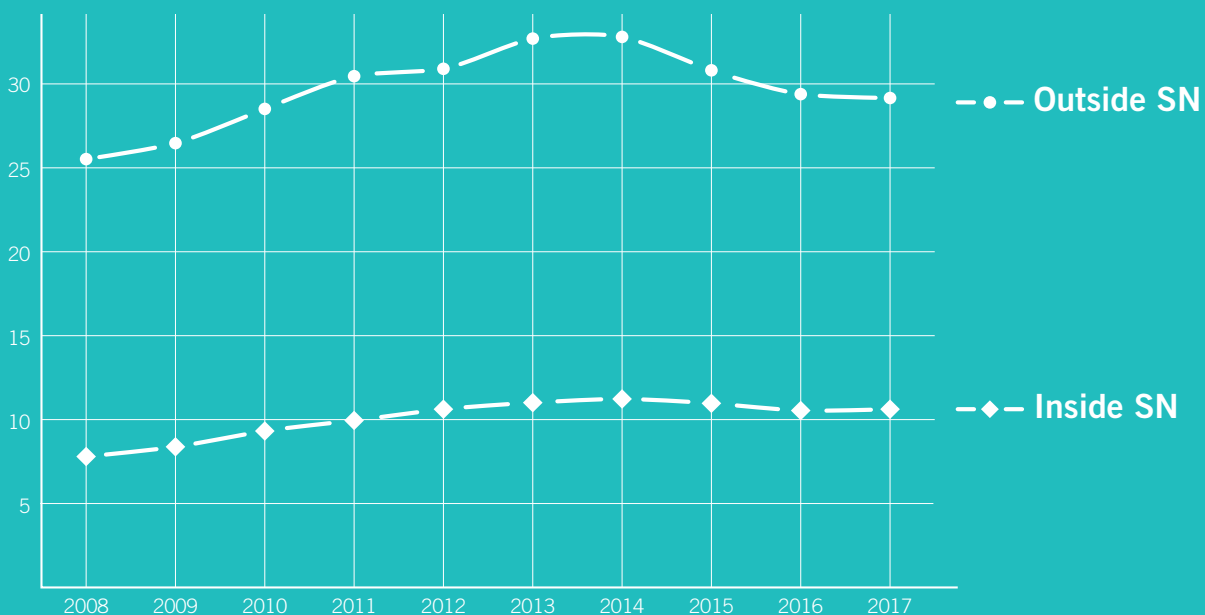


TABLE 8 Occupation before registering as IME (%)³⁶

Motivation	2013	2015	2017
Formal employee	41	45	50
Informal entrepreneur	31	22	23
Informal employee	16	16	13
Housewife	6	8	6
Government employee	2	3	3
Student	2	3	2
Formal entrepreneur	1	2	2
Unemployed	1	1	1
Retired	-	1	1

³⁶ Source: Sebrae, 2017

TABLE 9 Trends in occupations per economic activity and status prior to the crisis (2012 to 2014) in %³⁷

Clas.	Activities	Formal employees	Informal employees	Self employed ³⁸	IME
A	Agriculture, forestry and fishing	-6.14	-7.53	-10.61	55.07
B	Mining and quarrying	-1.10	-31.00	-16.51	68.75
C	Manufacture	6.87	-4.41	3.14	69.52
D	Electricity and gas	-12.71	-44.77	61.91	-
E	Water supply, sewerage, waste management and remediation	12.04	0.57	-4.92	86.21
F	Construction	5.09	6.82	14.17	93.42
G	Trade; repair of motor vehicles and motorcycles	8.28	-4.09	9.42	69.57
H	Transportation, storage and mail	9.40	-9.71	5.01	95.25
I	Accommodation and food service activities	17.88	9.50	5.75	75.07
J	Information and communication	5.29	-26.27	53.19	106.22
K	Financial and insurance activities	13.18	-5.45	6.70	-
L	Real estate activities	32.25	-19.92	35.72	-
M	Professional, scientific, technical activities	5.74	-1.83	25.05	81.79
N	Administration and support service activities	11.51	-2.48	18.29	69.15
O	Public administration and defence, compulsory social security	-4.26	-5.03	-13.70	-
P	Education	17.75	33.07	11.67	93.14
Q	Human health, residential care and social work activities	13.53	8.55	28.60	169.74
R	Arts, entertainment and recreation	20.02	0.41	2.35	96.78
S	Other services	19.76	5.90	12.52	69.65
T	Activities of households as employers	-1.21	-1.89	-	-

³⁷ In Table 9 and Table 10, the values highlighted in red reflect a reduction > 5% during the indicated timeframe, whereas those marked in blue reflect an increase of < 5%.

³⁸ This category includes both self-employed operators under the IME and those that are outside the IME.

This trend has occurred in particular at times of economic downturn and increasing unemployment³⁹.

As can be seen in Figure 3 (section 1-A), the share of formal wage employment has gone down between 2012 and 2017 by two percentage points whereas self-employment has increased by two percentage points. This pattern is confirmed in Table 9 which shows that the period prior to the economic crisis saw a significant increase in formalization (in 15 out of 20 economic activities), which went hand in hand with a reduction of informality (in 15 out of 20 economic activities).

Yet after the crisis, a reversed pattern occurred. Formal employment went down in most occupations, whereas informality grew extensively: both self-employment and IME registrations increased in almost all occupations, as can be seen in Table 10.

For each occupation, the extent to which employees shifted to self-employment versus to the IME statute differs. Some occupations such as construction, manufacturing, trade, repair of motor vehicles and motorcycles as well as professional, scientific and technical activities, saw an increase in IME registrations at the expense of formal wage employment. This suggests that some occupations are more prone to abuse of the IME statute.

“After the crisis, formal employment went down in most occupations, whereas informality grew extensively.”

³⁹ A recent study suggests that rates of formalization have been higher than this disguised employment relationship, although it recognizes that the latter does take place.

TABLE 10 Trends in occupations per economic activity and status prior to the crisis (2012 to 2014) in %⁴⁰

Clas.	Activities	Formal employees	Informal employees	Self employed	IME
A	Agriculture, forestry and fishing	-0.66	-13.80	-16.54	62.58
B	Mining and quarrying	-14.87	-14.23	-9.31	-3.70
C	Manufacture	-16.41	-2.07	19.87	62.28
D	Electricity and gas	1.19	-1.25	159.86	-
E	Water supply, sewerage, waste management and remediation	-25.80	-12.56	27.33	77.22
F	Construction	-38.00	0.96	-3.14	80.87
G	Trade; repair of motor vehicles and motorcycles	-5.04	4.24	9.74	57.63
H	Transportation, storage and mail	-4.69	21.65	30.43	94.32
I	Accommodation and food service activities	-1.34	24.08	61.56	73.23
J	Information and communication	-14.97	19.15	31.25	91.04
K	Financial and insurance activities	-8.14	-0.12	38.45	-
L	Real estate activities	-9.04	11.86	26.55	-
M	Professional, scientific, technical activities	-11.07	1.69	49.24	107.85
N	Administration and support service activities	0.90	9.56	28.67	80.92
O	Public administration and defence, compulsory social security	-14.73	-2.82	-86.35	-
P	Education	13.91	41.21	41.74	96.67
Q	Human health, residential care and social work activities	16.05	30.73	22.15	262.98
R	Arts, entertainment and recreation	-8.39	7.94	8.42	152.80
S	Other services	-2.24	7.55	29.58	62.71
T	Activities of households as employers	0.58	11.72	-	248.57

⁴⁰ In Table 9 and Table 10, the values highlighted in red reflect a reduction > 5% during the indicated timeframe, whereas those marked in blue reflect an increase of < 5%.

**FINDINGS,
LESSONS LEARNED
AND POLICY
IMPLICATIONS**

Findings, lessons learned and policy implications

27%
of Brazil's **formal employees** work for entities registered under the monotax regime

A. Findings and lessons learned from the monotax regime

The monotax regime for individual micro entrepreneurs and MSEs which has been implemented in Brazil, has achieved significant positive results. It reduced informality among enterprises and workers, while workers in these enterprises benefit from the same social security rights and advantages as other workers⁴¹. Yet, despite the positive results, the IME regime entails some challenges, which are outlined below. The effectiveness of the monotax regime also depends on its alignment with other public policies and legal and normative instruments that have also influenced formalization of work and enterprises. Results should also be seen in the political and economic context in which the regime operates.

Formalization: By mid-2018, 6.9 million persons registered under the Individual Micro Entrepreneur regime. The monotax regime counts 4.8 million MSE registrations. By late 2017, the entities registered under the monotax regime employed 10.6 million employees. This represents a quarter (26.7%) of the total formal employees in Brazil. Yet it should be noted that there have been some displacement effects. In other words: not all formal registrations under these regimes are made by previously informal employees or entrepreneurs (either own-account workers or employers). Particularly at times of economic downturn, some patterns of disguised employment relationships have been identified. The full impact of the economic crisis on the formalization of workers and enterprises requires further analysis.

Access to social security: The monotax regime for own-account workers and employers with up to one employee and MSEs has increased access to social protection for these target groups in terms of basic public pension; invalidity and survivor benefits; health and maternity benefits and family allowance in case of death or imprisonment of the breadwinner. Access to social security was mentioned by one out of three (32.2%) respondents as the main motivation to adhere to the Individual Micro Entrepreneur regime.

Motivations to formalize: Entrepreneurs have found the monotax regime attractive as it allowed them to access social security services. The motivation to operate in a formal environment has also been very important. In Brazil, the monotax regime enables entrepreneurs to operate formally, which in turn opens opportunities to benefit from various public policies designed for IME (e.g. government procurement, to open a formal bank account and access loans with



“The monotax regime has increased access to social protection for own account workers and MSEs”

⁴¹ Although possible effects of migration from other tax schemes for the SN are still being studied by the RFB.

reduced interest rate). Table 7 shows that many respondents mentioned formalization-related issues, such as company formalization (22.4%), permission to issue invoices (10.3%), and avoidance of problems with state inspection as important motivations to adhere to this regime.

Simplification: The federative political system in Brazil has made it challenging to develop a universal regime that applies a single tax and social security *monotax* which is valid at federal, state and municipal levels. The amount of time and effort that this has required, cannot be underestimated. Yet the simplification has had good effects. The vast number of registrations under the IME scheme has been achieved due to simplified registration, filing and payment processes. A qualitative research carried out by SEBRAE among MSEs found that these enterprises were highly satisfied with the tax simplification under the SN regime, as it has become easier to register, pay and file tax returns. This is important as compliance costs are proportionally higher for micro and small businesses compared to larger enterprises, as it is more difficult for them to comply with all tax and accounting obligations of regular taxation schemes. Furthermore, the regime provides predictability of payments that are due through the introduction of a

lump-sum amount for taxes and social security contributions. This simplification and predictability on its own is very important for own-account workers and MSEs, irrespective of whether the monotax implies a reduction in the actual amount of taxes to be paid by them.

Graduation: Individual Micro Entrepreneurs that graduate to the monotax regime for MSEs, will pay substantially more taxes (4% of annual turnover under the SN regime, compared to USD 13.60 under the IME regime). Due to this large difference in tax burden between both regimes, the graduation from the monotax regime for IME to the monotax regime for MSEs is hampered. The threshold of the monotax regime for MSEs is also very high (USD 1,230,769 in the domestic market and the same amount for exports). The low progressivity of the IME regime may act as a disincentive to grow or as an incentive to operate in semi-formality. The graduation from the monotax regime for MSEs to the regular regime used to be a challenge as well, yet in 2018 a new form of taxation was established in the monotax regime for MSEs, which introduced more progressive taxation to address this graduation issue. As a result of the new taxation approach, the highest tax rate only applies to the portion of turnover that

32%

Of surveyed IMEs mentioned **access to social security** as the main reason to formalize

TABLE 11

Simplex National – Tax Collection (2007 - 2018) - Brazilian Real (million)⁴²

Year	Federal		State		Municipal		Total
	Value	%	Value	%	Value	%	
2007 ²	6,050	72.2%	1,789	21.3%	542	6.5%	8,380
2008	17,648	73.0%	4,901	20.3%	1,639	6.8%	24,188
2009	19,928	74.3%	5,024	18.7%	1,884	7.0%	26,836
2010	26,698	75.1%	6,259	17.6%	2,575	7.2%	35,531
2011	31,916	75.5%	7,132	16.9%	3,247	7.7%	42,294
2012	32,258	75.8%	7,493	16.1%	3,751	8.1%	46,501
2013	41,415	76.2%	8,559	15.7%	4,409	8.1%	54,383
2014	47,342	76.4%	9,470	15.3%	5,171	8.3%	61,983
2015	53,170	76.5%	9,845	14.2%	6,476	9.3%	69,525
2016	54,446	76.2%	9,949	13.9%	7,026	9.8%	71,421
2017	58,461	76.0%	10,743	14.0%	7,752	10.1%	76,956
2018	67,192	76.5%	11,898	13.6%	8,720	9.9%	87,806
Total	459,552	75.9%	93,060	15.4%	53,191	8.8%	605,774

⁴² Source: Brazilian Federal Revenue Service. Simplex Nacional Portal.

46%
of all Individual Micro
Entrepreneurs were in
tax arrears in 2018

“The monotax
scheme has
effectively
reduced the total
amount of taxes
to be paid by
the registered
entrepreneurs”

exceeds the turnover threshold.

Illicit registrations: Some operators are illicitly registered under the IME regime which affects its sustainability. In some cases, this contributes to precarious work.

- *Economic activity:* Some persons indicate that they conduct an economic activity that is eligible under the IME scheme, whereas they actually conduct another activity which is not eligible.
- *Turnover threshold (dwarfism):* Some operators under-declare their turnover and register as IME to reduce tax payments.
- *Sub-dividing an enterprise into two or more entities ('horizontal split'):* This occurs when an enterprise is split in several parts, which are each registered separately as Individual Micro Entrepreneur as a way to remain below the threshold established in the tax regime. For example: a business owner may register one IME in his/her name, another IME in the name of the spouse, another IME in the name of the son, etc., if the total sales of that company would be above the IME threshold⁴³. This may enable the entrepreneur to pay less taxes than if he/she would have registered the enterprise as a whole under the monotax regime for MSEs. There are examples where in a supermarket, each of the check-out counters is registered with a separate NRLE. In other words: each of them is legally registered as a different company.
- *Disguised employment relations:* Cases have been identified in which some employees have been dismissed and contracted by their previous employer as Individual Micro Entrepreneur to conduct the same

type of activity under precarious work with eroded working conditions. It has been noted that this type of contractual arrangement occurs particularly during periods of economic downturn, and in sub-sectors such as (building) construction, manufacturing, trade, repair of motor vehicles and motorcycles as well as professional, scientific and technical activities. In the first years after the creation of the IME regime, this risk was low as this was a period with high economic growth and a strong increase in formal employment. Yet the economic crisis went hand in hand with a flexibilisation of labour relations, which was aggravated by a recent reform of the labour law.

Taxation: The monotax scheme has effectively reduced the total amount of taxes to be paid by the registered entrepreneurs. Despite this, tax evasion is high. About 46% of all Individual Micro Entrepreneurs were in arrears in 2018 (Table 12). Due to the vast number of entrepreneurs that registered under the SN regime, tax revenues have increased substantially over time (Table 11). Yet it is difficult to draw conclusions as some enterprises have shifted from other tax regimes to the SN regime. One reason why this shift occurred, is that the turnover thresholds of the SN regime have been increased over time whereas the eligible activities have been expanded. The impact of these possible migrations is still being analyzed by the Federal Revenue Service of Brazil. Nevertheless, it is clear that part of the increase in tax revenues under the monotax regime is due to the achievements of the scheme to reduce business informality.

Sustainability of the IME regime: The viability of the regime is affected by sever-

⁴³ For example: a small commercial enterprise invoices R\$ 240,000 per year. The enterprise should pay in Simples National BRL 800 every month. Instead, it creates 3 IME (fraudulently), and pays monthly BRL 146.

TABLE 12 **IME Tax arrears (%)⁴⁴**

2012	2013	2014	2015	2016	2017	2018
51,3	52,6	53,1	53,4	58,6	59,7	45,6

⁴⁴ Source: Federal Revenue Service. In 2017, the Simples National Management Committee cancelled the registration (CNPJ) of non-performing MEIs over the last two financial years, which probably explains the reduction in default in 2018.

al factors. It is highly subsidized in actuarial terms: the contributions are inadequate to cover social security benefits, which puts its sustainability at risk. Legislative changes have been introduced to relax the criteria for enterprises that are eligible for the IME regime, despite opposition from the tax administrations. The turnover threshold of the IME regime has been gradually increased from approx. USD 9,837 at its inception to USD 20,769 today. According to a study carried out by the Institute of Applied Economic Research, this threshold is incompatible with the realities of low-income workers⁴⁵. The eligible economic activities have also been expanded over time. The lump sum tax has been reduced to half of its original value, from approximately USD 28 at its inception in 2009 to approx. USD 13.60 today. The study has noted that legislative changes, which have resulted amongst other factors from a political lobby of groups representing MSEs, have endangered the sustainability of the regime. Furthermore, as mentioned above, tax evasion is high as about 46% of all Individual Micro Entrepreneurs are in arrears. This has put further pressure on the scheme.

The original social security contribution component in the lump-sum tax represented 11% of the minimum wage. This was insufficient: The personal contribution to social security by the self-employed that have not opted for the IME regime is 20%. Yet this imbalance was justified as the purpose of this approach was to prevent future pressures on the Brazilian social welfare budget⁴⁶. In 2011, a law was introduced which reduced the personal social contribution component in the lump-sum tax from 11% to 5% of the minimum wage. This further affected the financial sustainability of the IME regime, as employees outside the IME regime pay a higher social security contribution, which is set at 8% of the minimum wage. As a result, the social security benefits for Individual Micro Entrepreneurs will be eroded in the future, which diverts from the logic behind the creation of the IME regime.

At the time when the IME statute was created, the contribution rate of 11% implied a subsidy, which was consistent with the objectives such as; reducing informality; registering low-income entrepreneurs with the social security regime; facilitating access to a limited number of social security benefits;

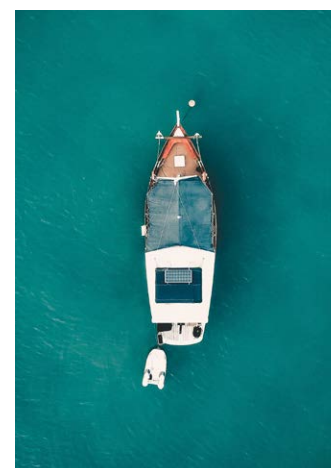
“Countries that aim to replicate or adapt the model from Brazil, should seek a balance between the desired and the supportable level of subsidies.”

and reducing the pressure on non-pension benefits in the future by increasing contributions among low-income groups. However, the reduction of the contribution rate to 5% broke this logic. This rate is even lower than the rate that applies to employees outside the IME regime. As a result, the IME regime has become unsustainable.

If the contribution is not increased back to the initial rate of 11%, then it is likely this will continue to attract false IMEs, which will further affect the sustainability and viability of the scheme. If the difference between tax rates was smaller, there would be less incentive to fraud, and controls would be easier. On contrary, the likelihood of fraud increases with larger subsidies.

Therefore, as a general rule, the government can set its own social and economic objectives, decide what goals to strive for and which areas to subsidize. Yet it should keep in mind that every special regime has to be controlled, whereby contribution rates need to be carefully calculated so as not to affect the sustainability of the regime. The main purpose of a special tax regime is not necessarily to reduce the tax burden, but rather to achieve a simplification for low-income groups. Therefore, it is not necessary to have large subsidies.

A lesson from the experience in Brazil is that it is not the model that creates a problem, but rather the excessively low level of contribution, based on heavy subsidies. The model can thus be replicated, based on an important simplification of tax systems - making it easier to calculate and pay taxes - and to establish realistic and feasible ways for tax administrations to exert controls. The system should also be designed in a way that calibrates the desired and the supportable level of subsidy. Furthermore, this study recommends that it would be important to identify approaches to decrease subsidies over time and/or with business growth.



⁴⁵ In: http://www.ipea.gov.br/porta1/images/stories/PDFs/conjuntura/180117_CC38_desequilibrio_financeiro_MEI.pdf

⁴⁶ Brazilian law provides for assistance benefits for people with very low family income, for the elderly or disabled.

“ Monotax regimes for own-account workers and MSEs can make an important contribution to formalization of enterprises and workers. Such regimes must be adequately designed and tailored to a low-income target group that is excluded from social security. ”

A study⁴⁷ published in January 2018, highlighted the financial imbalances of the IME regime, pointing out that *“It is difficult to accept that a worker with a turnover of BRL 81 thousand⁴⁸ per year, given the Brazilian income standard, is considered low income, and that he cannot afford a contribution higher than 5% of the minimum wage. This parameter generates an inadequate targeting and high social security subsidies, even for workers who are among the 50% richest in Brazil.... For this reason, it would be crucial to restructure the MEI to at least try to correct its inadequate targeting. As it was seen, the fiscal (financial and actuarial) imbalance generated by the MEI is very high.”* An important analysis shown in this study is that the educational level of many registered IMEs is very similar to that of employees with a formal contract and higher than that of those who are outside the IME regime. This result raises the suspicion that there may have been a migration of some employees with a formal contract to the IME regime, which has negative effects on financing.

Sustainability of the monotax regime for MSEs: With respect to the monotax regime for MSEs, there is also a ‘cost’ for the government as enterprises that are registered under this regime pay less taxes than those that are

outside the regime. When determining the tax rates under this regime, it was not considered that a main advantage of tax schemes for MSEs relates to tax simplification, and that the creation of a substantial difference in tax burden affects their sustainability. In 2018 a more progressive tax system was established in the monotax regime for MSEs to address the sustainability and graduation concerns. A second factor affecting sustainability of the regime is that the threshold is very high, which opens up the scheme to a vast number of enterprises. This may jeopardize the sustainability of the monotax regime for MSEs as well. The turnover threshold for MSEs has been increased from an initial BRL 720,000 (or USD 194,531) in 1996 (Simples Federal), BRL 2.4 mn (or USD 648,440) to BRL 4.8 mn (or USD 1,279,624) in 2018 (Simples National). Yet, companies with a turnover of USD 1.3 million are not micro or small enterprises. This shows that the threshold is set far too high and it is not in line with the reality of small enterprises.

⁴⁷ In: http://www.ipea.gov.br/portal/images/stories/PDFs/conjuntura/180117_CC38_desequilibrio_financeiro_MEI.pdf

⁴⁸ USD 21,884 (February 2019 exchange rate).

I B. Policy implications

Motivations and capacity to formalize: Monotax regimes for own-account workers and MSEs which are based on a monotax system can make an important contribution to formalization of enterprises and workers. Small entrepreneurs have indicated that access to social security and advantages of operating formally are their main motivations to enroll under these regimes. The simplicity of administrative procedures and predictability of payments are important success factors.

Targeting: Such regimes must be adequately designed, based on the characteristics and payment capacity of the respective target groups. In terms of the turnover threshold, it is important that a monotax regime for own-account workers seeks to target workers with a low contributory capacity and low levels of education who have not contributed to social security before. The regime should also seek to analyze the profile of informal self-employed workers that are excluded from social security, in order to design the access criteria according to this profile. It should also actively search for informal entrepreneurs who have never contributed to



the social security to enroll in the regime. This can help to avoid abuse by others with a higher payment capacity who are attracted to the regime due to the large difference in tax and social security payments.

Sustainability of the regime: The payment amounts and rates should be set in such a way that they do not endanger the viability of the scheme: A tax regime for MSEs should not generate a high reduction in the tax burden as this creates an imbalance and reduces the scope for business growth. It should rather focus on tax simplification. A more progressive tax system for MSEs is important to facilitate a smooth transition from one regime to the next. This will encourage growth of enterprises, facilitate their graduation to the regular regime and avoid abuse of the system. If there is a large difference in the tax burden between tax schemes, companies will try to stay in the MSEs tax scheme by all means, producing economic tax distortions, such as *tax dwarfism* (unwillingness to grow a business) and a *horizontal split* of the company into two or more entities, to remain in an advantageous tax scheme.

Disguised employment relations and other forms of illicit registrations: The identification of eligible activities under the IME regime has been a useful yet insufficient measure to reduce the abuse of the regime. Tax dwarfism, horizontal split and other forms of abuse can be reduced by ensuring that the tax administrations carry out strong controls, which include data crossing, audits and alerts. An integration of control activities between the various tax authorities can help to strengthen such control mechanisms. To avoid the risk of disguised employment relations and a loss of labour protection and social security benefits, it is important that control activities are also integrated between the tax authorities and the Ministry of Labour. A better filtering must be done to identify the activities authorized to register, as a way to avoid as far as possible the weakening of formal working relations

and to increase control and enforcement mechanisms.

Management of the regime: A series of legislative changes and the shared management of the tax regime between the Federal Revenue Service of Brazil, states and municipalities made it possible to streamline, simplify and continuously improve the monotax system. This vertical integration was particularly important in the context of Brazil's federative system yet in other political contexts it is also necessary to ensure such vertical integration. The Simples National software package has contributed to the operationalization of this vertical integration, as it automatically creates the tax return for the taxpayer, allocates the amounts to each tax, and credits the tax amounts to each respective tax administration.

Adjustments of eligibility criteria: The design of a monotax scheme should be based on solid financial calculations and estimates. There is a risk that such considerations are lost over time due to strong pressures exerted by business entities and political forces. This is particularly the case when adjustments of the threshold and other eligibility criteria have not been defined by law on the basis of cumulative inflation, or any other pre-established rule. If for each readjustment a legal revision is necessary, there is a risk that the scheme will be adapted based on political rather than financial considerations. This may affect the sustainability of the scheme.

Integrated approach: The monotax regime is insufficient to singlehandedly address informality among workers and enterprises. Instead, it must be part of a coherent, integrated and coordinated long-term approach, which also addresses other policy areas. The related public policies and regulatory framework must be constantly monitored and evaluated in order to ensure their effectiveness, and to make the necessary adjustments whenever new challenges come up.

ANNEXES

Evolution of the legal framework for own-account workers and MSEs

Year	Law	What has changed?
1984	Law No. 7,256	<ul style="list-style-type: none"> This law was the first legal instrument which recognized the specifics of small firms. It established the <i>Microenterprise Statute</i>, which provided simplified and favoured treatment with respect to administration, taxation, social security, labour, credit and business development services (Brazil, 1984, art. 1, caput) for companies with revenues of up to 10 thousand National Treasury Bonds
1988	New Federal Constitution	<ul style="list-style-type: none"> The New Federal Constitution further strengthened the differentiated treatment for MSEs. It refers to a “favoured treatment for Brazilian companies established under Brazilian law that have their headquarters and administration in the country” (Brazil, 1988, item IX of art. 170). It mentions that the Federal Government, States, Federal District and municipalities “shall grant MSEs, as defined by law, different legal treatment, with the aim to encourage them to simplify their administrative, tax, social security and credit obligations, or by eliminating or reducing them by law” (Art. 179).
1996	Law 9.317 Simples Federal	<ul style="list-style-type: none"> This Federal law initiated the process of a “monotax” for MSEs which combined six payments (five federal taxes and the employers’ contribution to social security) into one single payment. The accession of States and Municipalities to the Simples Federal regime was optional. As a result, they did not join. The monotax varied, as it depended on the level of annual sales and the type of economic activity of the enterprise. The law established a turnover threshold of BRL 720,000 The law exempted small businesses from having to maintain accounting ledgers. Despite this innovation, this law on its own had little impact on the formalization of MSEs.
1998	Law 9.732	<ul style="list-style-type: none"> This law increased the turnover threshold from BRL 0.72 mn to BRL 1.2 mn.
1999	Law No. 9,841	<ul style="list-style-type: none"> This law introduced the MSE Statute. It expanded benefits through “differentiated and simplified legal treatment in administrative, tax, social security, labour, credit and business development” (art. 1, caput).
2003	Constitutional Amendment n. 42	<ul style="list-style-type: none"> This Constitutional Amendment was required to streamline and integrate the monotax system at the federal, state, district and municipal level; As a result of this Constitutional Amendment, it was possible to approve Complementary Law No. 123, in 2006 (Simples National); The tax administration in three levels of Government must create a single national taxpayer’s registry, and operate together, in Simples, the actions about collection, inspection and enforcement.
2005	Law 11.196	<ul style="list-style-type: none"> This law doubled the Simples Federal Threshold from BRL 1.2 mn to BRL 2.4 mn

Year	Law	What has changed?
2006	Complementary Law 123 - Simples National (or General Law for MSEs)	<ul style="list-style-type: none"> • Simples National targeted micro and small enterprises and operationalised the MSE statute. • The main objective was to create jobs, yet this law has also contributed to reducing informality among enterprises. • It allows MSEs to file one single annual, simplified tax declaration, replacing the tax declarations that they until then had to present at the federal, state and municipal levels. • It exempts MSEs from paying additional social contributions at federal level and reduces a few other fiscal obligations. • The accession of States and Municipalities to Simples National regime was mandatory. • This law includes all matters that affect, in one way or another, micro-enterprises and small businesses, including tax matters. It provides thresholds and conditions to be classified as micro and small enterprise; suggests a simplification and unification of licenses (permit, firefighters, sanitary surveillance, environment, etc.), establishes processes to open, maintain and close MSEs in order to reduce costs and bureaucracy, and establishes privileged treatment for MSEs in government procurement. • The Simples National was an upgraded version of Simples Federal (SF), and replaced the SF. • Simples National turnover threshold was retained (BRL 2.4 mn) • Formalization picked up significantly with the passing of this law.
2008	Complementary Law 128 ("IME")	<ul style="list-style-type: none"> • The General Law (Simples National) was amended to introduce a special simplified tax statute for Individual Micro Entrepreneurs (IME). • It targets own-account workers and entrepreneurs with not more than one employee. • Additional eligibility criteria apply, which have been adapted over time. • The registration process can be completed online through a single, simplified procedure. Upon registration, the Individual Micro Entrepreneurs receive a provisional license. • The Individual Micro Entrepreneurs pay a nominal fixed amount each month, which varies according to the economic activity, and which includes municipal services tax, ICMS at state level for movement of goods and national social security. • The IME is exempted from other taxes and contributions such as corporate revenue tax, social security tax and contributions to the social integration program. • In addition to offering numerous tax advantages for the IME, this new legal statute includes these workers in the social protection system. • For these Individual Micro Entrepreneurs, the turnover threshold was set at BRL 36,000
2011	Law 12.470	<ul style="list-style-type: none"> • The social contribution of the IME was decreased from 11% to 5% of minimum wage.

Year	Law	What has changed?
2011	Complementary Law 139	<ul style="list-style-type: none"> • The law increased the Simples National turnover threshold by 50% (from BRL 2.4 mn to BRL 3.6 mn) and it increased the IME threshold from BRL 36,000 to BRL 60,000 • The law also allowed the payment of tax debts over a period of 60 months.
2014	Complementary Law 147	<ul style="list-style-type: none"> • This law expanded eligibility criteria of the Simples National regime to also include activities in the intellectual services sector. • It introduced an extra threshold under the Simples National for exports. • It introduced standards to simplify the opening and closure of companies: it established the use of one single business registration number (the National Registry of Legal Entities - NRLE) as the sole identification of these enterprises, thus eliminating business registrations at the state and municipal level.
2016	Complementary Law 155	<ul style="list-style-type: none"> • This law increased the Simples National turnover threshold from BRL 3.6 mn to BRL 4.8 mn⁴⁹ from 2018 onwards. • The IME threshold was increased from BRL 60,000 to BRL 81,000 - equivalent of USD 20,769 • The progressive taxation in the Simples National was increased. Progressivity in the tax rate was stagnant at each step of the table. Then, when the taxpayer changed class on the table, the high tax rate was abrupt. Starting in 2018, the new tax rate table brought smoothness, gradually increasing the tax rate as turnover increased. • Eligibility criteria for the Simples National regime were expanded to include entrepreneurs in the alcoholic beverage industry.
2018	Complementary Law 162	<ul style="list-style-type: none"> • This law allowed the payment of tax debts over a period of 180 months, with reduction of late payment penalties and interest on late payments.

⁴⁹ USD 1,230,769

Eligibility criteria of the monotax regime for MSEs

Who can opt for the monotax regime for MSEs?

- **Turnover threshold:** enterprises with annual gross sales of up to BRL 4,800,000 (USD 1,230,769) in the domestic market, plus BRL 4,800,000 for exports.
- **Type of enterprise:** Trade, Manufacture and Services Business companies (except S/A); Individual Limited Liability Business; Individual Businessman (equated to legal entity).
- **Type of economic activity:** Registration under the Simples National regime is open to commercial, industrial and service companies, with the exception of some specific sectors, such as financial activities, production and wholesale trade of cigarettes and firearms, of the electric power production chain.

Who cannot opt for the monotax regime for MSEs?

The following entities are excluded:

1. Entities with government ownership or partnership;
2. Partners who are also owners or partners of other MSE company(s) under the SN regime, of which the sum of the turnover of all companies exceeds the SN threshold;
3. Partners who are also members of other company(s) outside the SN regime, of which this participation exceeds 10%;
4. Corporations (S/A) ;
5. Cooperatives;
6. Companies with foreign residence.

The following economic activities are excluded:

1. Financial Activities;
2. The electric power chain;
3. Production and wholesale trade of cigarettes and firearms;
4. Sell or assign labor;
5. Allotment and incorporation of Real Estate;
6. Import or manufacture of automobiles and motorcycles;
7. Import of fuels.

In addition, the taxpayer who has tax debts, and who has not made a debt repayment installment agreement, cannot adhere to or remain in the scheme.

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