



Special Taxation Regimes for Taxpayers with Lower Capacity

*Theory and Strategies in
Tax Policy and Administration
in Latin America*

Darío González



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GLOSSARY

ECLAC	Economic Commission for Latin America (UN)
CPP	Employer's Social Security Contribution (Brazil)
IMEBA	Tax on the Transfer of Agricultural Goods (Uruguay)
INSS	National Institute of Social Security (Brazil)
PIT	Personal Income Tax
CIT	Corporate Income Tax
IT	Income Tax
MEI	Micro Individual Entrepreneur (Brazil)
MIDES	Ministry of Social Development (Uruguay)
NRUS	New Single Simplified Regime (Peru)
OECD	Organization for Economic Cooperation and Development
ILO	International Labor Organization
UN	United Nations
RER	Special Income Regime (Peru)
RESIMPLE	Simplified Regime for Small Companies
RIMPE	Simplified Regime for Popular and Entrepreneurial Businesses (Ecuador)
RMT	MSE Tax Regime (Peru)
RRSS	Social Security Resources
RST	Simplified Tax Regime
RTS	Simplified Taxation Regime

PROLOGUE

This study focuses on the taxation of special regimes for taxpayers with lower tax capacity in Latin American countries.

It can be argued that, given the economic and social context, these countries were compelled to be creative and innovative in their tax policy regarding so-called small taxpayers.

The region is characterized by a predominantly low-income taxpayer base, with large sectors involved in the so-called informal economy, resulting in a high level of informality.

That context also provided an opportunity for larger taxpayers in the economic chain (industry, commerce, services) to take advantage of this situation and engage, either wholly or partially, in the so-called underground economy to maximize their income, thereby eroding tax revenues.

Tax administrations with limited capacity in terms of both human and material resources, especially technological resources, focused their target on taxpayers with higher tax capacity, where the additional potential tax to be collected through a tax audit was greater.

This adverse cost-benefit relationship led to this sector of taxpayers often being isolated from controls, creating what I have termed “the fiscal island of informality,” which in many cases became a space distant from taxation.

This led to two distinct universes within the tax system: one comprised the sector that complied with its obligations, while the other consisted of a sector where there was a tacit fiscal tolerance of underground activity.

Gradually, it became evident that these small taxpayers were supplied by a chain of suppliers or service providers with higher tax capacity. Due to the absence of logical conflicts of interest in the tax system (for example, in VAT the computation of input tax credit, in income tax the deduction of costs), and not being required to issue invoices or tax receipts, they also took advantage to develop all or part of their activities without registering, generating a significant level of evasion in the general tax regime.

In this context, dense economic trade knots were created, with transactions not only involving goods lacking fiscal records but also originating from smuggling and illicit activities.

Another factor driving fiscal misconduct was the loss of fiscal discipline due to the social contagion resulting from non-compliance and the lack of effective action by tax administrations.

Initially, tax experts from central countries and international organizations did not give the theoretical and pragmatic importance that the issue deserved, as they did not share the same economic and social context and therefore the underlying problem.

The present topic was tangentially analyzed, and most of the time, authors were limited to studying only the special regime applied in the country under analysis, without leveraging the extensive regional experience. This occurred due to the lack of comparative studies that could point out the strengths and weaknesses of these regimes.

Subsequently, a new approach emerged, credited to two tax experts, Richard Miller Bird y Milka Casanegra de Jantscher (1992)¹. With an essentially pragmatic vision, they departed from the traditional theory of developed countries and proposed heterodox but efficient courses of action for both tax policy and administration in emerging countries.

They argued that both taxation and policy were the art of the possible, and that was what tax policy makers in emerging countries should focus on. They emphasized that public finance texts overlooked the fundamental role played by tax administration in restoring macroeconomic balance and promoting equity and efficiency.

Hence, their work filled a gap in the theory by linking tax policy with tax administration reform, aiming to find new methods that lead to improving taxpayer compliance.

Among the tax topics that inexplicably had not been addressed by doctrine, despite their relevance, they pointed out, among others, the regimes for small taxpayers.

In their work, they argued that “in developing countries, tax administration is tax policy,” meaning that, in Latin American countries, the definition of a successful tax policy must consider the actual capacity of the tax administration.

¹ Bird, Richard Miller and Jantscher Milka Casanegra de (1992) “Improving Tax Administration in Developing Countries”, FMI.

<https://www.elibrary.imf.org/display/book/9781557753175/9781557753175.xml>

“La Administración Tributaria en los países del CIAT”, Bird Richard and Casanegra de Jantscher, Instituto de Estudios Fiscales (1992), Madrid.

Otherwise, the inefficient implementation of that policy in practice will not only result in the failure to achieve the objectives of tax policy but also, in many situations, the opposite effect of what is intended.

In this line of thought, Shome (2000)² argued that “...the mark of an advanced tax system is seen, on one hand, in the degree to which there is maximum correspondence between tax administration and the original policy objective, and on the other hand, in the extent to which the feasibility of implementation is considered when conceiving a tax.”

During the 1970s and 1980s, tax legislation generally applied a sales threshold as a parameter for exempting small taxpayers from VAT and a minimum exemption threshold in the Income Tax.

Obviously, the lack of invoicing or under-invoicing improperly allowed many taxpayers with considerable tax capacity to qualify for exemption, thereby extending non-compliance to significant sectors of economic agents.

For small taxpayers, whether they were eligible for exemption or the general regime, their “comfort zone” was informality, where they obviously had the greatest economic benefit.

It was in this context that what I term “first-generation regimes” began to be promoted, which were simplified regimes specifically for VAT, achieved through the application of various presumptive techniques.

The lack of success of these schemes ultimately stemmed from flaws in their design and the pursuit of misguided objectives.

After decades, and understanding the causes of their weaknesses, second-generation regimes began to be implemented, which included an integration of the substituted taxes, with the essential objective being simplification.

As a culmination of this evolution, what I’ve labeled as “third generation” regimes emerged. These regimes integrate social security resources (pension or health) with the aim of achieving social inclusion and promoting formal employment for micro and small businesses.

² “*La tributación en América Latina: tendencias estructurales e impacto en la administración, La política fiscal en América Latina: una selección de temas y experiencias de fines y comienzos de siglo*”, Shome, P. (2000): “Seminar and Conference Series”, N° 3, LC/L.1456-P, Santiago de Chile, The Economic Commission for Latin America and the Caribbean (ECLAC). “Taxation in Latin America: Structural Trends and Impact of Administration”, 1999, IMF, Washington.

Regarding the taxpayers of these regimes, there was also an evolution. Initially, the focus was on single taxpayers (individuals), and in a second stage, attention was also directed towards micro and small businesses.

It is worth noting that the strategies for individual small taxpayers differ from those for micro and small businesses, as they have different objectives that must be taken into consideration by tax policy makers.

This has led to the application of new tax strategies according to the taxpayer, and as a result, the formulation of new regimes.

An aspect of fiscal sociology to consider is that small taxpayers, due to their high quantitative representation, organized themselves and became a significant political consideration for governments. This limited the adjustment of regimes by government authorities.

All this copious practice with dissimilar results allows for generating a critical analysis of both best practices and the unintended effects that their application has led to in the tax systems of countries in the region.

The central point is that tax policy makers, often under considerable pressure and facing logical urgencies due to tight deadlines, must develop proposals without having access to a comprehensive analysis of the issues involved, in order to make the best decisions possible.

Therefore, this study aims to provide a comprehensive contribution based on the experience of the last 50 years of its application in the countries of the area, highlighting from its main characteristics to the strategies that have been implemented and their results.

The objective of this research is not only to target tax policy makers and tax administration managers but also academics and research centers. The aim is to provide them with more elements for the evaluation of special regimes, further enriching the debate they often entail.

The current document methodologically consists of two sections. The first section covers the theory of these regimes, including their essential aspects such as objectives, characteristics, taxpayers, object, tax calculation (presumptive technique), general characteristics like unity or multiplicity, substituted taxes and social security resources, and trends in their application.

While the second section has an eminently pragmatic objective regarding the application of these regimes in recent decades, consisting of conducting a critical analysis of best practices, as well as the unintended side effects they have brought to the Latin American tax system.



TITLE I
THEORY OF SPECIAL REGIMES

In taxation, there is an extensive body of doctrine or tax literature regarding the so-called classic or orthodox taxes.

From professors at leading universities to taxation experts and even international research centers, a solid theory has been developed regarding Taxes on Income, Taxes on Wealth, Taxes on general consumption, and Taxes on specific goods and services.

However, because special regimes for small taxpayers are frequently applied in peripheral countries (with Latin America³ and Sub-saharian⁴ Africa being notable examples), they have not received the same level of theoretical interest from central countries. Apart from some generic research on their application by certain international organizations, there hasn't been as much focus on their theoretical study.

This theoretical void has resulted in the establishment of regimes in countries without prior consideration through comparative benchmarking evaluations to utilize best practices and mitigate unintended consequences. Consequently, in many instances, regrettably, failed experiences have been replicated, leading to predictable negative outcomes.

The denomination of these regimes, both in doctrine and legislation, varies, making it necessary to clarify the correct terminology to avoid misunderstandings.

Originally in Latin America and the Caribbean, they were generally referred to as “Simplified Taxation Regimes,” regardless of the designation given by each particular legislation.

Currently, the designation “SIMPLE Regime” is prevailing in some countries, while in others, they have a specific denomination given by the legislator, often based on the acronym of its official name.

In the international concert, these have also been referred to as “Preferred Tax Regimes” (ILO), “Tax Regime for Minor Taxpayers” (IMF)⁵, “Presumptive Tax Regime”⁶ and “Régimes

³ Source: Own information (2023): 15 Latin American and Caribbean countries implement these tax regimes.

⁴ IMF (2007): In this African subcontinent, 25 countries applied preferential regimes for taxpayers with lower contributory capacity. Meanwhile, according to the IDB (2006), 31 countries in Latin America implemented them.

⁵ IMF (2022) “Peru Technical Report – Régimen Tributario para Contribuyentes Menores y Zonas Económicas Especiales”, prepared by Roberto Schatan, Juan Carlos Benítez, Isaías Coelho and José Madariaga.

⁶ Rajaraman, Indira (1995) “Presumptive Direct Taxation”. Economic and Political Weekly Vol.30, No. 18/19 (May 6-13, 1995).

D’Imposition Forfaitaire”⁷, etc., to differentiate them from the General Tax Regime (“Régime Réel D’imposition”, “Standard Tax System”).

Considering the tax nature of the various special regimes existing for this sector of taxpayers, a definition and classification thereof shall be formalized.

“The Special Tax Regime for taxpayers with lower contributory capacity is considered as tax treatments, and where applicable, social security resources, which provide certain benefits within the tax system to enhance their tax compliance.”

As subspecies within these regimes, the following can be highlighted: a) Presumptive Simplified Regimes, b) Simplified Regimes of Formal Obligations, and c) Preferred Regimes.

The Presumptive Simplified Regimes are those that, by applying a presumptive tax technique, determine the resulting tax, which replaces the taxes and, where applicable, the social security resources provided by the legislation.

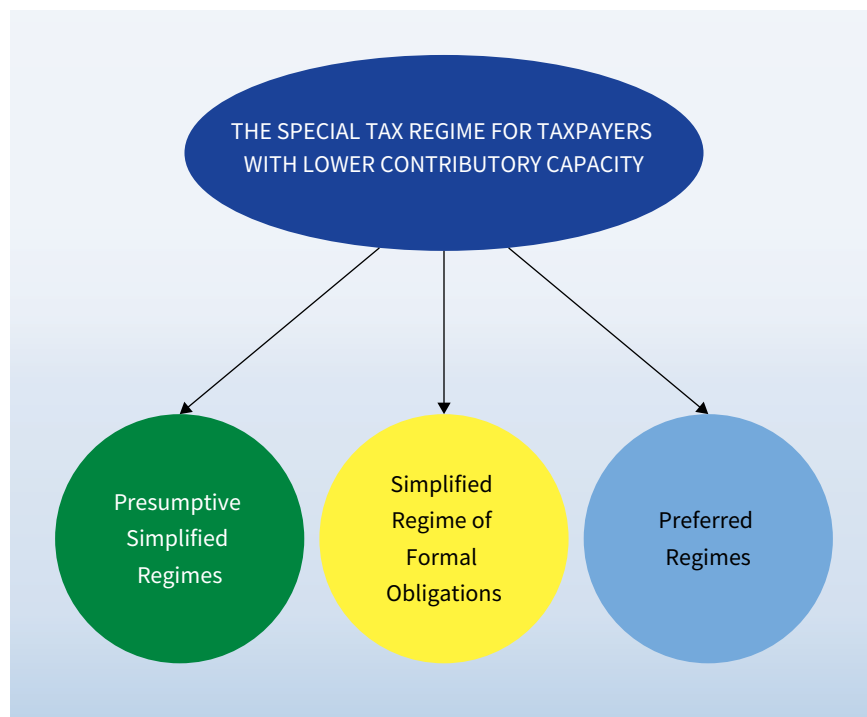
Indeed, in addition to simplifying formal obligations, Presumptive Simplified Regimes aim to reduce the tax burden on taxpayers with lower contributory capacity.

On the other hand, Simplified Regimes of Formal Obligations aim to ensure that small taxpayers continue to pay taxes under the general regime, but their primary goal is to reduce compliance costs by simplifying the formal obligations they bear.

Meanwhile, Preferred Regimes are limited to granting fiscal benefits and social security resources to small businesses within the taxation of the general regime.

⁷ Mos-Monserrat, Colin, Ribaut, Brys (2023) “La Conception des Régimes d’Imposition Forfaitaire”, OCDE. <https://www.oecd-ilibrary.org/docserver/acd81d56-fr.pdf?expires=1720830048&id=id&accname=guest&checksum=B7CED47BBCDC4D84E101C538C82863EF>

Figure 1. Special Regimes



Therefore, of the three mentioned regimes, only the Presumptive Simplified Regimes replace the taxes and social security resources of the general regime with a new tax determined based on the application of presumptive tax techniques.

The Simplified Regime of Formal Obligations only improves tax compliance but does not replace the taxes of the general regime.

Preferred Regimes maintain the formal obligations for complying with taxes under the general regime but decrease the tax burden by granting certain fiscal benefits, typically in Corporate Income Tax (reduction of tax rates, deductions, tax credits), and in the Employer's Contribution to Social Security Resources.

Hence, from a theoretical standpoint, the general analyses to be formulated will be based on the concepts of the institutes according to the definitions given previously.

However, it is important to clarify that regarding the mention of each special regime, it will be based on the official designation given by each country.

The designation of the institute under analysis does not change its tax nature, and to understand it, it is necessary to analyze its essence and the essential elements that configure it.

The development of this section will focus on the objectives, essential elements, and general characteristics of these regimes, distinguishing between those aimed at individual taxpayers and those targeting micro and small businesses.

Regarding the objectives of each class of subjects, methodologically, the most prioritized ones in each will be described, acknowledging that some sought-after objectives are shared by both classes of subjects.

Furthermore, in developing this theme, careful consideration is given to the historical evolutionary framework of these regimes. The objective is to examine the strategies employed during each period of their evolution.

Finally, an analysis will be conducted on their general characteristics and the current trend they exhibit in the tax systems of countries in the region.

Objectives

It is considered desirable objectives of this type of regimes the following:

1. Simplification

Simplification implies making a tax system simpler, easier to comply with, both in terms of fulfilling formal obligations and substantial ones.

As its generic name suggests, simplification has been the first and primary objective of these regimes.

For individual taxpayers, simplicity has its reason for being in the fact that it is practically impossible for small taxpayers with minimal or no administrative organization to settle taxes under the general regime due to its high complexity and the associated high cost.

In many cases in countries of the region, for this sector, the cost of complying with formal obligations has sometimes even exceeded the tax to be paid. But this phenomenon can be argued to not be exclusive to the region, as it has global reach.

In European countries, Eichfelder and Vaillancour (2014)⁸, highlight the existence of a considerable number of studies indicating a high relevance of the compliance costs of 'bureaucracy' formal obligations in relation to the tax burden. In their research, the sum of formal compliance burdens often ranges between approximately one-third and two-thirds of the tax to be paid.

⁸ Eichfelder, S. and F. Vaillancour (2014), Tax Compliance Costs: A Review of Cost Burdens and Cost Structures, <http://dx.doi.org/10.2139/ssrn.2535664>

Obviously, this burden increases as the economic relevance of the obligated subjects and the administrative structure they possess decreases. Specifically, in low-income individual taxpayers, where such organization is nonexistent.

Among the main administrative costs ('administrative burdens'), the OECD (2020)⁹ points out the following: a) formal filings, b) provision of information, c) record keeping, d) withholdings, e) audits, f) the high complexity of legislation, and g) the high bureaucratic level.

“It can be argued that the lower the ability to contribute, the higher the indirect compliance cost, often exceeding what individual taxpayers should pay in taxes. In the case of micro and small businesses, administrative costs under the general regime can consume one to two-thirds of the tax burden.”

Therefore, the original formulators of tax policy aimed to make tax compliance easier under the general tax regime, although initially, the focus was specifically on addressing the issues of Value Added Tax on individuals.

The success of the VAT implied its extension to the widest possible range of goods and services, as well as to all economic agents.

Applying exemption to subjects whose income fell below a threshold had brought about many deviations in its implementation and difficulties in tax administration control. Therefore, there was a push to replace VAT exemption with a simplified regime for liquidating and paying the tax.

Unfortunately, in the origins of this strategy, many of these regimes, it can be noted, were complicated, that is, contrary to the objective they had set, which led to failure in their implementation.

As is well-known, Value Added Tax (VAT) in Latin American and Caribbean countries follows the financial method, which is the European approach. This method calculates the input tax credit against the output tax to determine the resulting tax liability.

Many simplified VAT regimes initially sought to adopt the financial method, and the liquidation formula was determined through a presumed tax liability by category, computing the actual tax credits (so that small taxpayers could demand invoices from their suppliers).

⁹ OECD (2020): Forum on tax administration “Supporting SMEs to Get Tax Right Series Strategic Planning”.

Few small taxpayers who joined were generally not from the informal sector, which was the intended target, but rather taxpayers who switched from the general regime to enjoy its benefits.

Obviously, such a change was possible because it was supported by underreporting sales by many taxpayers, thereby avoiding exceeding the threshold allowed for joining the regime.

This led the authorities to establish limits on the computation of credits up to a certain percentage of debits, depending on the economic activity, thus creating a “minimum tax.”

However, since the liquidation method had the same complexity as the general regime, it was challenging for small taxpayers, leading to low levels of adherence, causing a crisis in the system, and ultimately its repeal.

“It is contradictory that a simplified regime ends up being complicated, which unfortunately has happened on many occasions.”

This loss of simplicity occurred because many of these regimes sought to emulate, in their legislative technique, the tax assessment of the general regime they were replacing, in order to determine as precisely as possible, on a presumed basis, the value added or income.

Another mistake that was often made was also to seek greater equity in the resulting tax burden. Unfortunately, in doing so, the axiom that “greater simplicity leads to less equity and vice versa” was overlooked.

Simplicity in determining the tax burden involves facilitating the calculation through the use of parameters, averages, indices, etc., so the result may be more beneficial for some taxpayers and more detrimental for others compared to the same income level.

“When the goal is simplicity, it’s necessary to reasonably sacrifice a certain degree of equity, thus avoiding the complexity that comes with providing specific treatment to the multiple situations that may arise in reality”

To determine the exact or more equitable tax burden, orthodox taxes of the general regime are available. Therefore, it’s not possible to resort to the development of simplified regimes based on complex tax calculation, which are intended to replace due to their complexity.

Subsequently, other forms of simplified presumptive assessment, both for VAT and Income Tax, were based on a percentage of sales or purchases to determine the tax, or on the determination of a fixed fee per category. These modalities are the most simplified and have been widely accepted in their application.

However, this simplification in taxpayer compliance must be accompanied by a simplification of control by the tax administration.

It should not be overlooked that a simplified regime for tax assessment can be complicated for control, and vice versa. The key to tax policy should be to develop a simplified regime in both respects.

If not achieved, experience indicates that over time, such a regime will cause greater asymmetries and distortions, requiring continuous reforms and instability in tax compliance until its definitive dissolution.

The taxpayers targeted by this regime have been referred to by the tax administration as “hard-to-control taxpayers” González (1994)¹⁰ or “hard-to-tax,” distinguished by the economic activity they engage in or their economic size. They are characterized by: a) the number of taxpayers involved, b) their poor organizational level, c) the inability to impose rigorous accounting practices, and d) their tendency to operate in the informal sector.

In this hard-to-tax core, the following taxpayers have been highlighted: a) small artisans, b) small retail and wholesale traders, and c) small primary producers (agriculture, livestock farming, forestry, artisanal fishing, hunting, mining), d) transporters, and e) service providers.

Hence, the need for simplification is mutual, both for the tax administration and for taxpayers with lower contributory capacity.

Distortions have been accentuated depending on where the emphasis has been placed, whether on simplifying the assessment or on control. Experience indicates that it is necessary to find a middle ground in formulating this kind of regime, which has not proven easy to achieve in practice.

¹⁰ González, Darío (1994) “*La Administración de Contribuyentes de Difícil Control*”, “CIAT Technical Conference” “*Solución de Aspectos Críticos en el Control de los Tributos*”
https://www.ciat.org/Biblioteca/ConferenciasTecnicas/1994/Espanol/Argentina_bariloche_tema_1_1994_gonzalez_argentina.pdf

2. Formality

In the social and economic context of our region, there are very high rates of informality that hinder control of evasion throughout the chain of production, transformation, distribution, and service provision.

Therefore, from the State's perspective, the objective of a simplified regime is primarily a matter of tax administration rather than tax policy, as is generally believed.

Tax informality is when taxpayers are not registered and therefore do not fulfill their tax obligations, neglecting their contribution to public finances.

At the outset of the implementation of VAT, some tax policy formulators argued that small taxpayers were not of fiscal interest due to their limited economic contribution, and it was considered that they should be exempt from the tax.

Within this line of thinking, there are two positions: a) exemption from both tax payment and registration, and b) exemption from tax payment, but with the obligation of registration and compliance with certain formal duties.

Exemption was generally established based on the parameter of gross income or the level of billing. This allowed, due to the difficulty of controlling this indicator, many taxpayers with higher contributory capacity to fraudulently categorize themselves as exempt, shifting the burden of proof to the tax administration.

Deficiencies in controlling business volume led, through social contagion, to non-compliance spreading to other economic sectors with higher economic capacity and increased informality levels.

It also created unfair competition among economic agents, between those who formalized their businesses and those who chose to remain outside of taxation, simulating a low level of income.

For tax administrations, it is not acceptable to have a limited register that does not allow obtaining useful information to cross-reference data and detect areas of evasion within the universe of higher-income taxpayers.

Therefore, in formalizing this universe of taxpayers, the essential goal should be to obtain the necessary information to control the providers or service providers of greater magnitude.

Its objective also consists of fostering a tax compliance culture, so that, in light of their potential economic progress, they are more inclined to register and fulfill their tax obligations within the general regime.

The central objective should not be revenue collection because regimes that placed it as the central axis for this universe of taxpayers were a failure. And this is logical because potential adherents to it have a low level of contributory capacity, and therefore, the potential tax revenue is meager.

“Engelschalk, Michael y Loeprick, Jan (2015)¹¹ argued that the objective of this category of regimes is not to significantly increase tax revenues but to strengthen tax compliance through formality”

Therefore, the strategy of exempting VAT based on a threshold of gross income was set aside in most countries in the region, with them instead implementing presumptive simplified regimes.

In Latin America, currently only three (3) countries¹² exclusively apply VAT exemption for having an income level below the threshold determined by legislation. Two (2) other countries apply it, but subsidiarily to a special tax regime.

From a socio-economic perspective, formality entails benefits for the small taxpayer, as it allows them to integrate into formal economic circuits, access subsidized credit, become a contractor for the government or its agencies, as well as a supplier to the private sector, etc.

Indeed, there are countless benefits they can obtain. However, due to a lack of economic awareness, many small taxpayers prefer to continue their underground economic activities despite the disadvantages it entails.

While this rationale in Latin America and the Caribbean (LAC) may have been reasonable in the last century, where the State only viewed them as taxpayers and its main interest was to collect taxes, the response of public policies has been changing. The focus has shifted towards the economic and social inclusion of this broad universe, concurrently implementing policies to promote their inclusion.

In this new context, in addition to creating presumptive simplified tax regimes where the indirect and direct compliance costs were reduced, both in terms of formal and substantive obligations, the State, through its financial agents, granted them credits at soft rates and

¹¹ Engelschalk, Michael y Loeprick, Jan (2015) “MSME Taxation in Transition Economies: Country Experience on the Costs and Benefits of Introducing Special Tax Regimes”, World Bank Group.

¹² El Salvador, Panama y Venezuela exclusively apply VAT exemption for having an income level below the threshold determined by legislation. Honduras, while also having a Simplified VAT Regime, applies VAT exemption up to a certain income level as well.

various subsidies. Additionally, through the respective ministries or social development agencies, they were provided with working capital (tools, machinery, etc.), management courses, business connections, etc., to enable them to develop their economic activities.

For healthy economic development, it is essential to implement instruments that facilitate formalization because it constitutes a bridge towards social inclusion and cohesion in a region that is unfortunately characterized as the most unequal in the world.

The magnitude of the problem is reflected in the figures of labor informality in Latin America and the Caribbean, which according to the ILO (2020) and IMF (2020) stands at 58 %.¹³

As stated by Cavallo, Galindo, Nuguer y Powel (2022)¹⁴ from the IDB, informality not only prevents the increase in taxes necessary for consolidation but also inhibits the government's ability to target social transfers and combat tax evasion, two of the major sources of inefficiency in fiscal policy.

Their conclusion is that even the best-designed fiscal reforms can fail if informality is not reduced. On the other hand, they emphasize that there is ample room to increase revenue and reduce tax evasion by reducing labor informality through fiscal policy.

From the perspective of fiscal psychology/sociology, informality can be motivated by individual rational decision-making, social contagion, or as a consequence of economic exclusion from the system.

From a decision-making perspective, two essential factors contribute to this phenomenon: a) the cost/benefit analysis of informality, and b) the perception of risk stemming from tax authority¹⁵ control.

Hence, it is incumbent upon the tax authority to devise appropriate strategies to reverse this situation, as its inaction only exacerbates the magnitude of the existing problem.

¹³ It is present across the entire income distribution spectrum; although it is higher in the poorest quintile, where it reaches 80%, more than 40% of workers in the richest quintile are also employed in the informal economy.

¹⁴ "Cavallo, A., Galindo, A., Nuguer V. y Powell Andrew (2022): "From Recovery to Renaissance. Turning Crisis into Opportunity". Latin American and Caribbean Macroeconomic Report, IDB.
<https://flagships.iadb.org/en/MacroReport2022/From-Recovery-to-Renaissance-Turning-Crisis-into-Opportunity>

¹⁵ González, Darío (2020): "Tax informality in LAC: are we still fishing inside the fish tank?", Blog CIAT,
<https://www.ciat.org/ciatblog-tax-informality-in-lac-are-we-still-fishing-inside-the-fish-tank/?lang=en>

3. Social inclusion

This objective began with what I have termed “third-generation regimes,” meaning when, in addition to replacing taxes, resources from social security were included.

Considering that Latin America is the most unequal region in the world, it is hopeful that there are currently six active regimes for small individual taxpayers, each with different scopes and modalities.

“According to Thuronyi (2004)¹⁶, ensuring access to social security resources can encourage individuals to formalize their activities”

This author argues that a simplified regime can be a bridge that allows for the expansion of social protection to a large number of self-employed workers and possibly their employees and/or dependents, as well as their families, who previously operated in the informal sector.

In the so-called “third-generation regimes,” which had the *Monotributo* in Argentina (Simplified Regime for Small Taxpayers) as their epicenter starting in 1998, the objective of these regimes was also to include a broad universe of small individual taxpayers to receive the benefits of social security (retirement, pension, etc.) and health insurance (services from union social security funds instead of public hospitals).

This regime is fulfilled through the payment of a fixed monthly fee, which has three components: a) tax, b) pension, and c) health insurance.

In this country, this first step was completed in 2004 with the creation of the “*Monotributo Social*,” which aimed to protect individuals who conducted economic activities as self-employment (very small taxpayers) and were registered in collaboration programs of the Ministry of Social Development.

Taking into account the vulnerability of these small taxpayers, they are exempt from the tax component, subsidized for the pension component, and only required to contribute 50% of the health component.

¹⁶ Thuronyi, Víctor (2004), “Presumptive Taxation of the Hard-to-Tax”, Chapter 4, “Tax Law Design and Drafting”, “Contributions to Economic Analysis”, Volume 268, Pages 101-120.

This Ministry is the implementing authority for these programs and is responsible for the National Registry of Local Development and Social Economy Providers, with the nomenclature of activities related to local development and social economy.

It should be involved in designing social policy actions aimed at promoting the generation of new employment opportunities within the framework of local development, implementing their registration, and promoting associated, mutual, and cooperative management.

At the same time, it establishes guidelines for assisting entrepreneurs in management processes with the aim of strengthening the development of their socio-productive capacities within the framework of the social economy.

According to its principles, the implementation of public policies that address changing social needs is necessary in order to optimize results for the benefit of the most vulnerable sectors.

As the responsible authority, this Ministry is in charge of verifying compliance with the requirements to join this regime, approving adhesions, or formulating exclusions where necessary.

The strategy behind this regime was to achieve social inclusion by emphasizing the so-called “perception of benefit” so that small taxpayers would voluntarily join.

Until then, the objective of simplified tax regimes was based exclusively on the “perception of risk,” meaning through the application of sanctions under the Tax Code (e.g., fines, closures, etc.) in case of non-compliance or formalization.

The inclusion of social security and health insurance resources also entailed the “one-stop shop” approach to streamline the procedures for these entities.

Until then, they had to register with the tax administration (taxes), the social security administration (retirement, pensions, etc.), and with health insurance providers (health insurance).

This involved multiple procedures, regulations, and enforcement entities, which increased the time and administrative cost of compliance, thereby leading to reluctance to formalize due to excessive bureaucracy.

These two regimes were later complemented by the Social Inclusion and Promotion of Independent Work Regime, based on the application of a percentage on the billing that provides social security coverage.

Uruguay followed this strategy by implementing the *Monotributo* in 2007, through which contributions to the DGI (taxes) and the BPS (social security resources and optional health coverage) are unified)¹⁷.

Starting in 2012, the *Monotributo* Social MIDES was also created for people below the poverty line or in a situation of socio-economic vulnerability. Participants make a progressive social security contribution and do not have to pay it when their activity is suspended. Medical coverage through FONASA is optional for this regime if they pay the additional fee.

Later, Brazil, which already had the SIMPLES system for micro and small businesses at the enterprise level, created the MEI (Micro Individual Entrepreneur) from 2009 onwards. This was aimed at the millions of self-employed workers who until then were carrying out their activities without legal protection and consequently, without access to social security resources¹⁸.

The common objective of the indicated regimes is to assist self-employed individuals with low billing levels who engage in certain activities by simplifying their obligations, thereby granting them access to social benefits as determined by each legislation.

What stands out about this strategy is that it falls within the active policies of the State aimed at formalizing small self-employed taxpayers, with its main objective being their social inclusion.

4. Supplier control

In the early stages of simplified regimes, especially concerning VAT, the focus was on improving revenue collection according to the taxpaying capacity of small taxpayers.

It didn't take long to realize that the revenues that could be obtained were meager given a broad universe of low-income taxpayers, and that such management implied a high cost of control and the diversion of its scarce human resources.

Hence, the objective for tax administration managers shifted from merely collecting taxes from them to their registration and the requirement or issuance of invoices or receipts, to control the suppliers, namely, taxpayers with higher earning capacity.

¹⁷ They do not make contributions to the DGI; instead, they exclusively contribute to the BPS (Social Security Bank).

¹⁸ It grants retirement benefits based on age, disability benefits, sickness benefits, maternity benefits, family assistance, and death benefits.

In other words, what started as a tax policy issue evolved into a tax administration matter that extended beyond monitoring their own activity and level of invoicing.

“Requiring invoices from suppliers and issuing them, especially within the framework of online electronic invoices (e-invoices), allows the tax administration to obtain sensitive data in real-time to enhance control”

In this way, the tax administration can more effectively control the production, marketing, and distribution chains that precede them, as well as the service provisions of which they are recipients.

Over time, this led to the creation within the tax administration of organic units with specific competencies, which conducted extensive audits based on technological advancements, for the expedited detection of deviations at a low control cost.

Hence, there was a shift from intensive (individual and in-depth) and high-cost audits to extensive ones through the cross-referencing of relevant parameters to determine deviations in the affiliated subjects.

In this progress, the application of “online” electronic invoicing or the use of fiscal registers has been of great relevance in tax administrations that have incorporated them into mandatory formal obligations.

Once this field intelligence is obtained, it is appropriate to apply intensive scrutiny with precise data on their deviations to taxpayers of greater fiscal significance preceding them in the economic chain, as well as to exclude small taxpayers who have improperly joined the regime.

Certainly, the conflict of interest within tax formalities, regarding the computation of input tax credit in VAT or the allocation of expenses in the Income Tax, lacks significance in informality or exemption without registration.

Modern tax administration has been aptly defined as a massive information system operating within the tax regulatory framework. Therefore, the lack of information or its deficiency renders its functions and the control objectives that define its essence ineffective.

Hence, the value that should be highlighted in the economic transactions of small taxpayers or micro and small enterprises is their role as sources of information.

In information systems, leaving “windows open” leads to the progressive deterioration of the database.

In an era where tax authorities are increasingly emphasizing artificial intelligence, it's worth noting that AI relies on data provided by taxpayers themselves, along with data obtained from external sources.

The inadequacy of both internal and external data would entail the failure of any management effort, highlighting the utmost importance of revitalizing the sources of internal data and increasing collaborative efforts to obtain external data.

Objectives**1. Promotion**

The importance of MSMEs (Micro and Small-Medium Enterprises) has been repeatedly emphasized due to their vital role in the economy, driven by their dynamism, productivity, adaptability, and innovation.

As affirmed by the Economic Commission for Latin America and the Caribbean (ECLAC) of the United Nations, small enterprises represent key actors in increasing the potential growth of Latin America¹⁹.

These enterprises are characterized by significant heterogeneity in their access to markets, technologies, and human capital, as well as their linkages with other firms, factors that affect their productivity, export capacity, and growth potential.

While only about 10% of Latin American SMEs export part of their production, in Europe, the fraction of exporting SMEs accounts for at least 40% of the total.

These lags in productivity and export capacity represent one aspect of the high structural heterogeneity of the region's economies (ECLAC, 2010).

Such heterogeneity is also one of the causes of acute social inequality in Latin America, as the significant differences in productivity (among sectors and among companies) reflect and reinforce gaps in terms of capabilities, adoption of technical progress, bargaining power, access to social networks, and options for upward occupational mobility throughout working life.

In Latin America, SMEs form a highly heterogeneous group, ranging from self-employed microenterprises operating informally to innovative companies with high efficiency and export capacity.

¹⁹ <https://www.cepal.org/es/temas/pymes/acerca-microempresas-pymes>

“The challenge lies in overcoming several structural weaknesses of Latin American economies, where SMEs are key but fragile components”

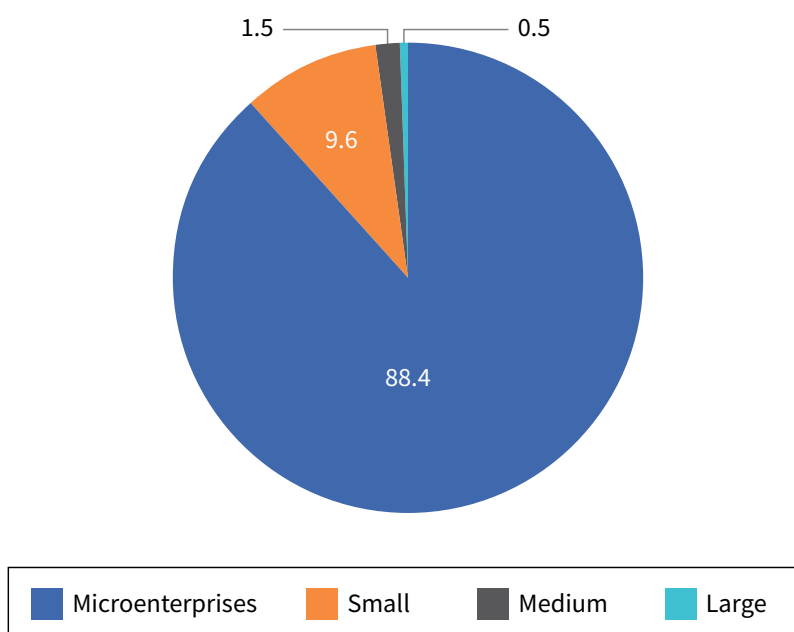
Within the SME group, the most vulnerable sector is that of small and micro enterprises, where all the indicated issues are exacerbated. Therefore, the government can foster them through active policies.

The three major challenges they face, compared to large enterprises, for their development are: a) tax burden, b) labor costs, and c) access to credit.

In this chapter, the tax and labor costs they face will be developed, and active policies applied in countries of the region to address these issues will be discussed.

According to the study “*Mipymes en América Latina: un frágil desempeño y nuevos desafíos para las políticas de fomento*” by Marco Dini and Giovanni Stumpo (2020), published by ECLAC, the following graph describes the distribution of companies by size in the region²⁰:

Figure 2. Latin America. Distribution of Companies by size – 2016 (In percentages)



Source: Dini and Stumpo ECLAC (2020)

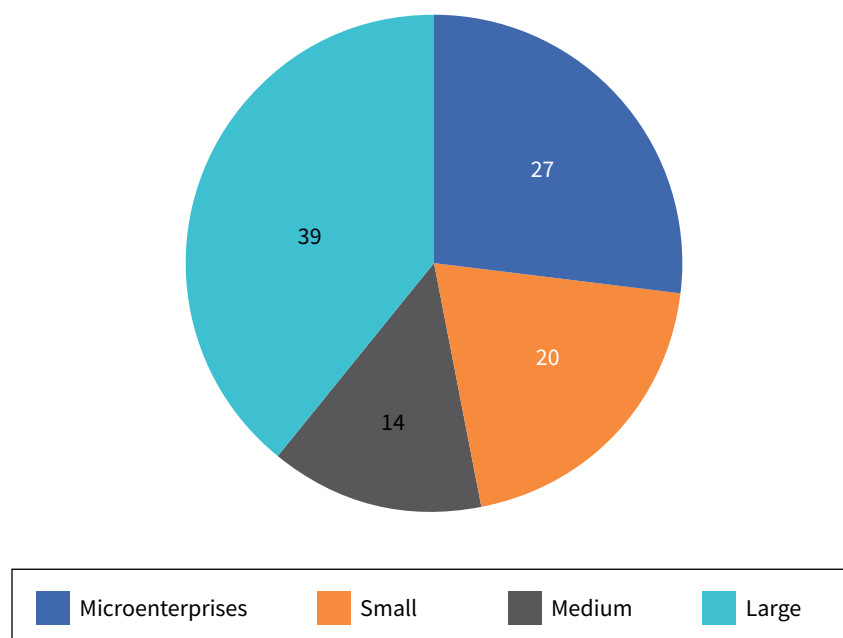
²⁰ <https://repositorio.cepal.org/server/api/core/bitstreams/2c7fec3c-c404-496b-a0da-e6a14b1cee48/content>

To grasp its magnitude, the graph shows that microenterprises in Latin America constitute 88.4%, and small enterprises 9.6% of the total, meaning together they total 98% of the region's companies.

The microenterprise sector is the majority in all sectors of the economy, particularly notable for its impact in the wholesale and retail trade sector, as well as in community, social, and personal activities. The small enterprise sector also has a primary presence in the wholesale and retail trade sector and, in second place, in the manufacturing industry.

The following figure illustrates the participation of companies in employment according to their size:

Figure 3. Latin America. Employment participation by companies – 2016 (In percentages)



Source: Dini y Stumpo ECLAC (2020)

Micro and small enterprises represent 47% of employment, and when combined with medium-sized enterprises, they account for 61%.

On the other hand, their contribution to GDP is relatively low, revealing deficiencies in their productivity levels. Microenterprises have a labor productivity of 6%, and small enterprises have 23% compared to large enterprises²¹.

²¹ However, in the EU, the level of labor productivity in microenterprises is 42%, and in small enterprises, it reaches 58%.

Hence, countries in the region have implemented promotion policies regarding financing, entrepreneurship, innovation, market development, productive articulation, technical assistance, training, public procurement, and in the focus of this study, through the implementation of special tax regimes and social security resources.

In the study by Dini and Stumpo (2020) from ECLAC, according to the selected countries in Latin America, the distribution of promotion instruments is observed by type of policy, namely:

Table 1. Latin America. Number and type of promotion instruments.

Country	Argentina	Brazil	Chile	Colombia	El Salvador	Mexico	Uruguay
Financing	11	18	18	6	6	8	5
Entrepreneurship	6	7	11	10	4	5	4
Innovation	8	11	4	4	0	4	9
Market Development	3	4	6	6	2	5	3
Productive articulation	5	3	7	3	1	1	2
Technical Assistance	2	3	3	5	2	4	3
Training:	2	2	5	4	1	2	2
Public Procurement	1	1	2	1	3	3	1
Total: 262 tools	38	49	56	39	19	32	29

Source: Dini and Stumpo ECLAC (2020)²²

This table succinctly details the distribution of the 262 instruments considered, by country and by area of intervention. The areas that attract the most attention from countries is, firstly, financing, which gathers nearly one-third of the instruments considered (27%), followed by entrepreneurship (17%) and innovation (15%). Much less common are instruments dedicated to public procurement for MSMEs (4%).

According to the (2015)²³ there are two main reasons put forward in support of tax preferences for micro and small businesses. The first argument suggests that there are market failures that particularly affect them due to their small size or age.

²² The report excluded special tax regimes.

²³ bibliographic citation made.

The second reason is that the tax system has a disproportionately adverse impact on these businesses due to their small size, which disadvantages them in comparison to larger ones.

It highlights that their economic importance lies in representing a significant proportion of employment and taxable commercial income and contribute significantly to value-added generation and exports, both directly and indirectly.

As part of this strategy, an example can be cited such as the Simplified Tax Regime (RST) implemented since 2019 in Colombia, which provides the following benefits: payroll subsidy from the Formal Employment Support Program (PAEF), coverage of credits and interest rate subsidies, and commissions for microloans granted by the National Guarantee Fund, access to programs such as those led by INNpulsa Colombia or the Ministry of Commerce, tax discount for financing the registration and/or renewal of commercial registration granted by the Bogotá District, possibility of participating in contracts or tenders with the government, access to advisory and support programs, ease of obtaining low-interest loans aimed at financing business development, access to insurance, access to domestic and international markets, etc.

2. Simplification of formal obligations

Regarding micro and small enterprises, the ILO (1998) (2007) (2015) in its conclusions and recommendations maintained that the formalization of the economy is one of its priorities for the business growth of this universe, based on three aspects: a) formalization of businesses and job creation in the formal economy, b) policies that facilitate the transition from the informal economy to the formal economy, and c) policies to prevent the “informalization” of employment in the formal economy²⁴.

“According to the ILO, among the main causes of informality in MSMEs (Micro and Small-Medium Enterprises) would be the complexity of procedures and inadequate regulation for the characteristics of the enterprises”

²⁴ Marchese, Marco (2021): “Preferential tax regimes for MSMEs Operational aspects, impact evidence and policy implications”, <https://webapps.ilo.org/static/english/intserv/working-papers/wp033/index.html>

For a certain opinion, the primary support in tax matters that should be provided to micro and small enterprises should be limited to facilitating tax compliance through simplification of formalities and collaboration by the tax administration to facilitate accounting management and tax settlement through a web application generally referred to as the “MSME portal”.

Their goal is to streamline compliance and the associated indirect administrative costs, while keeping the taxation of this business sector within the general regime, with certain specified benefits.

Several factors influence tax compliance costs, among which those highlighted in a report by the European Commission (2007) can be singled out:

- a) The number of taxes that must be complied with,
- b) The frequency of changes in tax laws,
- c) The complexity of the tax system,
- d) The existence of different tax administrations according to each jurisdiction (national, subnational, and/or local),
- e) The difficulty associated with interpreting unclear tax laws,
- f) The multiple deadlines for tax payments throughout the fiscal period, and the costs of tax advisory services, among others.

In this regard, a study conducted by the CE/GFK/KPMG (2018) and CE/VVA/KPMG (2022)²⁵, regarding the compliance cost of SMEs on that continent demonstrates the significant impact of the indirect cost of fulfilling tax obligations, measured as a percentage of revenue.

Table 2. Tax compliance costs for European companies.

Company (Size)	Cost (% of sales)
Micro enterprise	2,6 %
Small enterprise	1,4 %
Large enterprise	0,7 %

Source: European Commission, VVA, KPMG (2022)

This study was conducted based on data from 3.000 companies across 6 economic sectors in 20 European countries.

²⁵ European Commission, GFK, KPMG (2018) “Study on the tax compliance cost for SMEs”.

<https://op.europa.eu/en/publication-detail/-/publication/70a486a9-b61d-11ec-b6f4-01aa75ed71a1>

European Commission, VVA, KPMG (2022): “Tax compliance costs for SMEs: An update and a complement Final Report”.

From the analysis of the obtained data, it is observed that the cost of tax compliance as a percentage of gross company income increases considerably as the company size decreases.

Considering, as demonstrated by the European Commission, that despite the simplification of formal compliance measures, significant cost asymmetries still exist in relation to large companies, additional measures are proposed.

Therefore, from another perspective, simplifying formal obligations to reduce compliance costs would not be sufficient. They argue that tax benefits should also be applied to decrease their tax burden.

The study asserts that, on average, a company with fewer than ten employees tends to face a regulatory cost that is approximately double the cost of a company with more than ten but fewer than twenty employees, and roughly three times greater than the cost of companies with more than twenty but fewer than fifty employees. For larger companies, the burden per employee is only one-fifth or one-tenth of that for small businesses”.

The following table summarizes these conclusions:

Table 3. Comparative Analysis: Increase in Compliance Costs for a Small Business (less than 10 workers) Europe.

Small enterprise Staff	Company/Staff	Cost increase compared to small business (-10 employees)
(- 10)	(+ 10) (- 20)	200 %
(-10)	(+ 20) (- 50)	300 %
(-10)	(+ 50)	500 a 1.000 %

Source: European Commission /GFK/KPMG (2018)

According to the mentioned report “Tax Compliance Cost for SMEs” by VVA/KPMG (2022) published by the European Commission, it is estimated that businesses in the 28 European countries included in the study spend a total annual amount of around 204 billion euros to comply with tax obligations. This is approximately equivalent to 1.3% of the GDP of these countries.

That cost amounts to nearly 180 billion euros for micro-enterprises and over 20 billion euros for small enterprises.

It’s evident that these costs impact their productivity, leading to the conclusion that in Latin America, due to the prevailing bureaucratic regulations, the consequences are even greater.

Therefore, the report in Europe, as expected, concludes that most of these costs occur in microenterprises, as demonstrated in the following table:

Table 4. Total cost of tax compliance in European countries (204 trillion euros)

Company (size)	Cost (% of total)
Micro	87 %
Small	10 %
Medium and Large	3 %

This cost consists of compliance with VAT. This cost consists of compliance with VAT, CIT²⁶, contributions to social security, property taxes, and regional and local taxes.

The next table shows the average percentage of compliance costs as a share of revenue (both direct and indirect) transferred to the Treasury, based on the size of the companies, namely:

Table 5. Compliance cost as a percentage of taxes remitted to the Treasury

Company (size)	Cost (% of taxes paid to the Treasury)
Micro	30,1
Small	15,6
Medium	8,8
Large	5,9

Source: CE/VVA/KPMG (2021)

While for Microenterprises it represents 30.1% of taxes paid, for Small enterprises it's 15.6%, for Medium enterprises it's 8.8%, and for Large enterprises it's 5.9%.

In Latin America, Chile's central strategy focused on reducing compliance costs. This was implemented from 2007 through the Simplified Taxation Regime, and starting from 2020 through the following regimes targeting micro, small, and medium-sized enterprises (SMEs): a) General Pro SME Regime, and b) Transparent Pro SME Regime.

²⁶ Corporate Income Tax.

Under the “General Pro SME Regime,” the tax result is determined, as a general rule, based on income received and expenses paid. Companies are required to maintain complete accounting records with the option to choose simplified accounting.

The tax authority (SII) proposes a tax return to the company based on information from the Purchase and Sales Registry (RCV) provided by the taxpayer. The simplified taxable base is determined according to income received and expenses paid. Companies are exempt from maintaining records of business income (RRE).

In the “Transparent Pro SME Regime,” business owners are subject to final taxes (individuals with or without domicile or residence in Chile, or legal entities without domicile or residence in Chile), and they determine their tax result, as a general rule, based on income received and expenses paid. They are exempt from maintaining complete accounting records.

“The importance of formalization and the consequent compliance with formal obligations requires public policies that support this objective”

In Peru, the diagnosis carried out by ComexPerú, a business association that seeks to contribute with policy proposals, is relevant.

Regarding micro and small enterprises (SMEs), they develop the so-called Formal Capacity Index (FCI), which aims to assess the capabilities of informal SMEs to formalize themselves, based on business characteristics such as accounting practices, ownership of premises for operations, access to basic services, and employment characteristics²⁷. Thus, they can assess how likely a SME is to be registered with the SUNAT (tax administration)²⁸, also considering the department where it operates.

This diagnosis represents a significant contribution to the state, enabling it to promote relevant public policies to address the obstacles faced by micro and small enterprises in achieving formalization and subsequent compliance with tax obligations.

In Brazil, the work of SEBRAE (Brazilian Service of Support for Micro and Small Enterprises) also stands out, as a private entity that promotes the competitiveness and sustainable development of micro and small enterprises.

²⁷ According to ComexPeru, 86.7% of micro and small enterprises (MYPES) were informal in 2022.

²⁸ The Formal Capacity Index (FCI) in 2022 averaged 0.248 nationwide.

These organizations conduct research and studies related to these enterprises, and through their ongoing interaction with their challenges, they provide valuable insights for the state to formulate specific policies to address the issues they face within the socio-economic context of their respective countries.

3. Tax burden reduction

For a second stance, the promotion in tax matters and, if applicable, in social security resources, should be based not only on reducing compliance costs but also on reducing the tax burden.

For this strategy, it's not enough to facilitate tax compliance solely through simplifying formal obligations. As a development policy, the tax burden on micro and small enterprises should be reduced compared to large companies.

This strategy also extends, beyond taxes, to social security resources to promote formal employment and, consequently, social inclusion and cohesion.

According to the ILO (2021)²⁹ and the OECD (2015), the following alternatives can be considered for reducing the tax burden and the OECD (2015), the following alternatives can be considered for reducing the tax burden:

- a) the creation of a more favorable presumptive tax regime,
- b) the establishment of a preferential regime within the general system through: i) the application of lower tax rates on Income Tax and Social Security Contributions, and ii) the granting of tax benefits.

3.a. Presumptive simplified regimes

Regarding the implementation of presumptive business regimes, the pioneer in this strategy in Latin America was Brazil, with the enactment first of SIMPLES (1996) and subsequently of SIMPLES NACIONAL (2007) aimed at micro and small enterprises.

²⁹ ILO (2021), "Preferential tax regimes for MSMEs: Operational aspects, impact evidence and policy implications", ILO Working Paper, No. 33, International Labour Organization, https://www.ilo.org/global/publications/workingpapers/WCMS_803925/lang--en/index.htm

This regime replaces both taxes and social security contributions, namely: a) Corporate Income Tax, b) Social Contribution on Net Income (CSLL), c) Social Integration Program (PIS), d) Contribution for Social Security Financing (COFINS), e) Tax on Industrialized Products (IPI), f) Tax on Circulation of Goods and Services (ICMS), g) Service Tax (ISS), and h) Social Security Employer Contribution (CPP).

The calculation of the single tax is determined using the presumptive technique of applying a percentage to gross revenues, progressively based on the level of billing and differentiated by economic activity (See Annexes V). Regarding formalities, it applies simplified accounting and regularization facilities.

“The resulting tax is lower than what a company would owe under the general regime, which is why it is considered a beneficial presumptive tax regime”

In Brazil, for the purpose of determining the Social Security Employer Contribution (CPP) under the general regime, it is calculated based on a percentage of the workers' payroll, allocated to the INSS (National Institute of Social Security).

However, under the SIMPLES NACIONAL, it is included in the DAS³⁰, meaning the single payment form, where it is applied, according to the Annex in which the activity is classified, a percentage of gross revenues³¹.

Under this scheme, the burden of social security resources on micro and small enterprises does not increase based on the number of employees or their payroll, but rather on their level of billing.

This constitutes a promotion of employment registration because the number of workers and their salaries do not affect the amount of CPP.

In the initial years of implementing SIMPLES NACIONAL, this technique and the reduction of the tax burden resulted in the registration of over 500,000 employees who were previously in the informal sector.

³⁰ Document of Collection of SIMPLES NACIONAL

³¹ Except for the services included in Annex IV, which are taxed under the general regime.

3.b. Preferential Regimes

3.b.1. Reduction of the tax rate on Corporate Income Tax and Social Security Contributions

The other modality is configured by Preferential Regimes that reduce the tax burden for micro and small enterprises within the general taxation framework concerning Corporate Income Tax and Social Security Contributions, by applying a reduction from the existing rates.

“As stated by the ILO (2021), it essentially consists of a lower rate of the corporate income tax (IRS), granted to companies that meet certain eligibility criteria”

These Preferential Regimes only apply to companies formed as corporations, and eligibility requirements primarily concern income or revenue thresholds, but may also include additional parameters such as asset levels or the number of personnel dedicated to the activity. Unlike the Presumptive Simplified Regimes, the taxable base is based on taxable profits.

This benefit for micro and small enterprises can be granted within a special regime or within the general regime.

Within a special regime, Peru offers the MSE Tax Regime (RMT) for micro and small enterprises, which is granted to small businesses with a billing limit and applies the exclusion of taxpayers with direct or indirect capital links that exceed an annual income threshold in aggregate.

The reduction of the tax rate in the Corporate Income Tax (CIT) applies up to a certain annual income with a rate of 10%, while the excess is taxed at the general rate of 29.5%.

Differentiated rates are applied to favor lower-income companies within the general CIT regime of the tax system, for example, Argentina (20 and 25%, with the general rate being 30%), Costa Rica (5%, 10%, 15%, and 20%, with the general rate being 30%), El Salvador (25%, with the general rate being 30%), Guatemala (Small Businesses 5 and 7%), Venezuela (15 and 22%, with the general rate being 34 %) ³².

³² González, Darío (2022): “Impuesto sobre las Sociedades: su aplicación en América”, Blog CIAT. <https://www.ciat.org/ciatblog-impuesto-sobre-las-sociedades-su-aplicacion-en-america/>

This strategy is applied in OECD countries such as Belgium, Canada, France, Hungary, Korea, Luxembourg, the Netherlands, Portugal, Spain, and the United States.³³

Regarding the reduction of the Social Security Contributions rate for SMEs, Argentina can be cited as an example.

3.b.2. Tax benefits

According to the OECD “Tax Policy Studies” (2015) titled “Taxation of SMEs in OECD and G20 Countries,” tax benefits that can be granted to these companies are classified according to the tax policy instruments used, namely: i) increased deductions, ii) tax credits, and iii) exemption or reduction of tax obligations and/or social security contributions.

Preferential regimes provide benefits to small businesses within the general tax framework, specifically in Income Tax, through various instruments aimed at reducing the tax burden for this segment of taxpayers.

Within point i), accelerated depreciation is considered to stimulate investment, as it constitutes a fiscal incentive for small businesses. This allows them to reduce the tax burden by deducting the cost of new assets acquired more rapidly.

Another highlighted topic is the application of loss carryforwards (tax losses). For instance, this is of great importance for new SMEs, as they are more likely to incur losses in their initial years. A more flexible measure in its application (such as a higher percentage of carryforward, granting an extended period for allocation, etc.) entails fiscal benefits to stimulate their development during their most critical years.

Under point ii), tax credits for investment are highlighted, considered more useful compared to reducing the general tax rate for small businesses, as they stimulate investment.

These credits are typically obtained as a percentage of qualifying expenses, thereby reducing the acquisition cost of capital goods.

Tax credits are also applied to reduce the amount of tax payable on taxable income. These include tax credits for R&D (Research + Development) or innovation, investment tax credits, credits for employment, healthcare, or other forms of expenditure.

³³ OECD (2015) “Taxation of SMES in OECD and G20 countries”.

The third point encompasses tax benefits granted through the reduction or exemption of tax obligations as well as social security contributions.

Benefits on social security for small businesses aim to reduce or exempt them, promoting formal employment. This is an active policy applied in the international context.

Under this strategy, Argentina provides tax benefits to Micro and Small Enterprises (MSEs) within the general tax system framework, including: a) exemption and postponement of deadlines for export duties, b) exemption and computation with Income Tax and Social Security Contributions for debit and credit taxes, c) uniformity of income tax advances, d) extension of VAT payment deadlines, e) exclusion from VAT withholding and perception, f) special payment plan for debts, g) 90% reduction in Social Security Contributions for manufacturers of capital goods, h) fiscal quota priority in the knowledge economy, i) mandatory electronic credit invoice in operations with a large company, and j) reduction of Social Security Contributions.

1. Subjects

With regard to individual taxpayers (natural persons), two categories have been distinguished: a) very small taxpayer and b) small taxpayer.

Similarly, at the business level, the following categories can be highlighted: a) microenterprise, b) small enterprise, and c) low-level medium enterprise (Tier 1).

“There is no generally accepted international definition of a small taxpayer or micro and small enterprise. Therefore, it varies according to the legislation of each country when considering the parameters for conceptualizing it”

In Latin America and the Caribbean (ALC), there are specific regimes for natural persons and others for legal entities or juridical persons. However, there are also regimes that accept both subjects (such as the Simplified Trust Regime in Mexico, Simplified Taxation Regime in the Dominican Republic, RIMPE Entrepreneurs in Ecuador, Simplified Tax Regime RST in Colombia, etc.).

To determine the taxpayer of the tax obligation in these regimes, besides the described subject’s status, certain parameters are established to essentially prevent the benefits granted by the regime from being fraudulently exploited by taxpayers of greater economic significance.

Therefore, subjects considered small taxpayers in one country may not be so in another. In other words, as mentioned, there is no single definition.

Furthermore, as many countries have multiple special tax regimes concurrently, each of them defines the taxpayer according to the specific parameters it applies.

There could even be more than one definition of an individual small taxpayer or small enterprise within a country.

In addition, in some countries, the concept also varies depending on the subject matter being legislated (tax, labor, financial, etc.).

Regarding the terminology used to refer to small individual taxpayers (natural persons), it also varies from country to country. While some countries use the term “small taxpayer,” others may refer to them as “self-managed taxpayers,” “entrepreneurs,” or conceptualize them as a microenterprise³⁴.

In tax theory concerning Income Tax, one category comprises the benefits derived from personal work (professions, trades, etc.), while the other is based generally on entrepreneurial activities, often involving companies.

However, it is worth noting that within the latter category, many legislations also include sole proprietorships. The distinguishing feature of a sole proprietorship is that it combines personal labor contributions with the use of capital in the activities undertaken.

On the contrary, in some simplified regimes, these definitions are often blurred, and individuals who perform tasks solely based on personal labor, most of which are for survival, are also referred to as microenterprises.

In some legislations, individuals are classified as natural or legal persons to determine their possible adherence to regimes. However, in other countries, this classification may be irrelevant.

For example, in Brazil, the MEI (Micro Individual Entrepreneur) regime, as its name suggests, applies to individuals. However, for enrollment purposes, the individual must first register with the CNPJ (National Register of Legal Entities), which identifies companies. In other words, simply registering with the CPF (Register of Natural Persons) is not sufficient. Therefore, formally, small individual taxpayers are all considered legal entities.

The following table shows the regimes in force in LA, according to the taxpayer to which they are addressed, the individual, the company or the mixed regimes that cover both types of taxpayers:

³⁴ While in some countries, being registered as a legal entity is a requirement for being in the microenterprise regime, in others, such a requirement is not necessary.

Table 6. Special Taxation Regime for taxpayers with lower taxable capacity in Latin America

Application		Subject		
Country	Amount	Individual	Company	Mixed
Argentina	4	3	--	1
Bolivia	3	3	--	--
Brazil	3	1	2	--
Chile	5	3	2	--
Colombia	2	--	--	2
Costa Rica	1	--	--	1
Cuba	1	1	--	--
Ecuador	2	1	--	1
El Salvador	--	--	--	--
Guatemala	5	3	--	2
Honduras	1	--	--	1
Mexico	1	--	--	1
Nicaragua	1	1	--	--
Panama	--	--	--	--
Paraguay	2	--	2	--
Peru	3	1	2	--
Dominican Republic	1	--	--	1
Uruguay	4	2	1	1
Venezuela	--	--	--	--
Total	39	19	9	11

Source: own (2023)

It should be noted that of the 39 (thirty-nine) regimes implemented in the countries of the region under investigation, 19 (nineteen) apply exclusively to individuals (natural persons, natural or human), while 9 (nine) apply exclusively to companies (micro and small).

In turn, there are 11 (eleven) regimes that apply to both subjects (mixed).

“Therefore, to avoid misunderstandings in the present study, we will apply the concepts of individual taxpayer (very small and small) and micro and small enterprise according to the definition provided by each country’s respective legislation”

As a general rule, it can be argued that the most commonly used parameter to define a small individual taxpayer is gross income (revenue, volume of operations). However, other indicators are also applied, such as physical magnitudes, assets, personnel involved in the activity, inventory of goods, etc., albeit to a lesser extent.

To classify a company by size, the parameters commonly used are gross income and personnel involved in the activity. However, in some legislations, assets are also considered.

Some legislations make the generic classification of SMEs, but others distinguish between micro, small and medium-sized enterprises (in some countries subdivided into section I and section II). That is why in the generalized statistics they appear globalized as SMEs.

According to the research formulated by González-Díaz, R.R. and Becerra Pérez, L. A. (2021)³⁵, this table describes the indicators taken into consideration by Latin American countries to determine the size of a company:

Table 7. Companies by size. Criteria for classifying them. Latin America

Country	Number of employees	Annual sales	Assets
Argentina	X	X	--
Bolivia	X	X	X
Brazil	X	X	--
Chile	X	X	--
Colombia	X	--	X
Costa Rica	X	X	X
Ecuador	X	X	X
El Salvador	X	X	
Guatemala	X	X	X
Honduras	X	--	--
Mexico	X	X	--
Nicaragua	X	X	X
Panama	X	X	

(continue)

³⁵ “PYMES en América Latina: clasificación, productividad laboral, retos y perspectivas”, CIID Journal, N° 01/2021. [file:///C:/Users/Dario/Downloads/Dialnet-PYMESEnAmericaLatina-8528337%20\(1\).pdf](file:///C:/Users/Dario/Downloads/Dialnet-PYMESEnAmericaLatina-8528337%20(1).pdf)

Table 7. Companies by size. Criteria for classifying them. Latin America

Country	Number of employees	Annual sales	Assets
Paraguay	X	X	X
Peru	X	X	--
Dominican Republic	X		
Uruguay	X	X	X
Venezuela	X	X	--

Source: CIID (2021)

2. Parameters

To determine when we are dealing with a small taxpayer for tax purposes, multiple indicators have been used.

In some countries, only one indicator has been used, but in most cases, the determination of this subject is based on the application of several indicators simultaneously, which provides a more precise concept.

The concern of tax policy makers has been to find parameters that not only allow for a more precise economic definition of a small taxpayer but also are easily controllable by the tax administration to prevent the unwanted inclusion of other agents of greater economic significance.

Among the main parameters applied, one can mention: a) gross income (sales or turnover), b) net income, c) level of purchases, d) economic activity, e) gross or net assets, f) self-management or a certain number of persons involved in the activity, g) sales in public areas or the use of certain economic units (premises, vehicles, etc.), h) maximum unit selling price, i) rental value of the premises, j) electricity consumption, and k) affected area.

The main indicators applied are described below:

a) *Gross income*

Historically, in the formulation of these special regimes, there has been a temptation for maximum simplicity to apply solely gross income (turnover or sales level) as the parameter for conceptualizing the small individual taxpayer or enterprise.

As early as 1952, a UN Conference aimed at determining the best presumptive simplified regime for Francophone African countries concluded that while gross income was the easiest parameter to assess, it was also the easiest to evade, and therefore the most difficult to control by tax administrations, thus advising against its exclusive application.

“Obviously, due to the ease of concealing income (sales and services rendered) and expenses (purchases), and consequently their difficult verification by the tax administration, this parameter has been used in conjunction with other indicators that are easily verifiable to prevent tax fraud”

As is logical, the use of turnover (sales) volume should not be an absolute value, as there is an asymmetry between economic activities with high turnover but low profitability and those with high profit margins.

Therefore, various income thresholds are used as caps for gross income to conceptualize the small taxpayer, depending on the economic activity undertaken.

To avoid “tax dwarfism,” many legislations apply it in conjunction with other reference measures (for example, Chile’s General Pro SME Regime together with effective capital).

b) Net income

The use of this parameter is complex and therefore entails the same obstacles as its determination in orthodox taxes.

Therefore, while theoretically its use may be considered, in practice, it transforms a simplified regime into a complicated one, meaning it undermines, as mentioned, the nature of these regimes and the objectives they pursue.

“It has been specifically applied in regimes aimed at small or low-level medium enterprises to determine their eligibility for the sector that receives tax benefits, especially in Income Tax”

Exactly, it is generally applied to SMEs within the general regime to determine their eligibility for specific tax benefits.

This approach is frequently observed in OECD countries, and in Latin America, its application can be seen in the Tax Regime for Micro and Small Enterprises (SMEs) in Peru.

c) Purchase level

While the sales level is generally the most commonly used indicator, some regimes have also taken into account the purchase level.

“The aim is to have better control over purchases made from formalized suppliers, as it is more challenging to control the volume of sales to final consumers”

That’s the case with Costa Rica’s Simplified Taxation Regime. In this regime, this parameter is not only used to determine the status of a small taxpayer (individual or legal entity) but also forms part of the calculation of the resulting tax.

It is also applied in the Simplified Taxation Regime of the Dominican Republic for subjects engaged in the marketing of goods, whose purchases or imports cannot exceed the established purchase amount in the legislation³⁶.

Some legislations to determine the status of a small taxpayer apply both the parameter of purchases along with income³⁷, such as the New RUS of Peru.

In the Monotributo system of Argentina, the level of purchases is not used to classify the small taxpayer, but it is used to exclude them from the regime when they exceed a certain amount³⁸.

d) Economic activity

This indicator has been of great importance in determining the status of a small taxpayer. There are activities that cannot opt for a preferential regime, and depending on each regime, they are excluded from it.

³⁶ It coexists with three other simplified regimes based on income.

³⁷ In addition to the use of other parameters.

³⁸ The 80% in goods and the 40% in services in the last twelve months of the top income of the last category, according to economic activity.

“When using this indicator, its pragmatic nature should be highlighted, as it emerges as an ideal complement to the gross income parameter”

Each legislation determines which activities are not covered by its regime, considering them to be highly profitable, difficult to control, or incompatible with the nature of a small individual taxpayer or business.

As an example, in Brazil’s SIMPLE NACIONAL, 105 activities are excluded.

Considering the specific characteristics of each activity, many countries in Latin America have even created special regimes for certain economic activities.

Among these regimes, the primary sector of the economy (agriculture, livestock, artisanal fishermen, mining, etc.), transportation, street vendors, and supplementary trades stand out.

e) Assets or capital

The economic assets used in an enterprise demonstrate the importance of that activity. Therefore, some regimes have considered them to determine the status of a micro or small business, and others have also used them to calculate the tax.

“While the most appropriate approach would be to use net assets due to the difficulties in their determination and subsequent control by the tax administration, in many cases, it has been preferred to consider gross assets, but with a reduced allowable value”

Generally, the value of assets in general has been considered, or specific assets used in primary activities or transportation have also been considered.

In Brazil, the concept of effective capital is applied to determine the status of micro and small enterprises. This means it is the asset excluding values that do not represent effective investments, such as intangible, nominal, transient, and nominal values with which the taxpayer begins their activities.

This indicator is also applied in the New RUS (Unified Simplified Regime) and Special Income Regime of Peru, in the Presumed Agricultural Income Regime of Chile, in the Integrated Tax System of Transportation, and in the Unified Agricultural Regime of Bolivia.

The value of the inventory of goods is a requirement to belong to the Simplified Fixed Fee Regime.

f) *Self-management or persons involved in the activity*

Self-management means carrying out the economic activity on one's own, i.e. without the contribution of personnel. This data would indicate the lower magnitude of income to the extent that it is complemented by other indicators (economic activity, gross income, etc.).

That's why many regimes for very small or small taxpayers establish it to determine the eligibility of subjects for participation.

Other legislations accept having dedicated personnel for carrying out the activity, but with a limit.

While this factor is widely used to determine the evolution of small businesses, it entails a distortion, as exceeding it to avoid being excluded from the special regime may incentivize hiring unregistered personnel, thus promoting labor informality, both for inclusion and for maintaining continuity in the preferential regime.

“It's important to distinguish between the concepts of ‘employees in a dependent relationship’ and ‘individuals dedicated to the activity’”

The first one only includes an employment relationship, which can constitute a factual issue and present difficulties in resolution in an audit.

On the other hand, the concept of individuals dedicated to the activity is broader and includes not only employees in a dependent relationship but also the entrepreneur's family members, temporary collaborators, etc.

Therefore, the indicator “individuals dedicated to the activity” is more useful in an audit, as the mere confirmation that a person is carrying out the activity at the taxpayer's premises is

sufficient evidence to demonstrate whether the entrepreneur or micro and small business has exceeded the limits of the special regime.

Many regimes apply to individual taxpayers, such as Uruguay's Monotributo for sole proprietorships or informal partnerships, and Argentina's Social Inclusion and Promotion of Independent Work Regime, where hiring employees is not permitted.

Cuba's Simplified Taxation Regime also does not allow for employees in the business.

In other regimes, such as Brazil's MEI (Micro Individual Entrepreneur), individuals are allowed to have personnel dedicated to the activity, but they are limited to only one employee.

The Monotributo system in Argentina was unique in this regard. Upon its inception, depending on the category, individuals could have no employees, then up to two, and in the highest categories, the limit was three.

Subsequently, in a reform, it was included as a requirement for the highest categories to have a mandatory number of employees in order to be part of the regime.

Currently, individuals can have employees without limit, but it will depend on the income level declared by the taxpayer and the level of cost involved, for their inclusion to be sustainable.

An important point to highlight in the Objective Estimation Method for Personal Income Tax and the Special Simplified Regime for Value Added Tax in Spain is that the number of personnel affected varies more precisely depending on the economic activity being carried out.

Regarding business level in Brazil's SIMPLES NACIONAL, the limit of employees varies from micro to small enterprises, and according to the activity they perform, whether industrial, commercial, or service-oriented, outside of those categories.

g) Street vending or permitted economic units

Some regimes, especially for very small individual taxpayers, apply exclusively to workers who conduct their sales in the public thoroughfare under subsistence conditions.

As an example, one can cite the Monotributo Social MIDES (Uruguay), Régimen de Suplementeros (Chile), Monotributo Social, and Régimen de Inclusión Social y Promoción del Trabajador Independiente (Argentina), among others.

Other regimes allow for economic units such as a physical store or establishment, vehicles, etc., to conduct their activities, but in some cases, limiting their quantity, such as in Brazil's MEI (1 establishment), Peru's Nuevo RUS (1 operating unit), Argentina's Monotributo (up to 3 economic units), Bolivia's RTI (up to 2 vehicles), among others.

“It's evident that this parameter seeks to determine the status of a small taxpayer, beyond gross income or purchasing level, aiming to define their classification as a small-scale contributor”

As mentioned, given that income or purchases can be easily concealed, this complementary parameter aims to prevent taxpayers with greater economic significance from joining the same regime.

h) Maximum unit selling price

The purpose of this indicator is to prevent businesses selling products above a certain price from joining this regime.

Part of the assumption is that due to the nature of the goods they sell, they have a high level of turnover that they could conceal. Therefore, it is presumed that businesses selling these products typically exceed the gross income set as the maximum limit for joining the simplified regime.

“The sale of certain expensive products leads to the presumption that whoever sells them is not precisely a small-scale taxpayer”

Furthermore, as mentioned, given the high difficulty for tax administration to prove the actual turnover level, this parameter is easily verifiable by simply observing the price list at the point of sale.

The same does not apply to service provision due to the high variability of service prices, which do not allow for presumptions regarding their turnover solely based on the value of a service.

In the Monotributo system of Argentina, this parameter is applied to determine the status of a small taxpayer. The former RUS system in Peru applied this parameter, but it was repealed in the New RUS, giving priority instead to an extensive list of prohibited activities.

The strategy followed by legislations in this topic is to apply a wide range of permitted economic activities. However, to prevent “fiscal dwarfism,” they establish a maximum unit selling price as a requirement or, conversely, exclude economic activities presumed to have greater economic significance, discarding this indicator.

i) Rental value of the premises

Its use aims to exclude premises in economically significant areas or in high-end commercial centers from these regimes, implying that their turnover is high enough to absorb the cost of rent.

“Therefore, even if they declare income below the permitted threshold, they are excluded from the regime if the premises exceed the allowed rental value limit”

This factor does not refer to the rent price paid based on a lease contract, but rather to the actual rental value in the market, whether the premises are owned or rented.

Its verification constitutes both a reason to prevent adherence to the regime and, if already adhered to, a basis for exclusion.

The Monotributo system in Argentina applies it for the purpose of auditing businesses that are enrolled in the regime.

j) Electricity consumption

In the Monotributo system of Argentina, it is used to determine the category of the small taxpayer, and if the consumption exceeds the permitted limit for the highest category, it leads to their exclusion from the regime.

However, in the objective Estimation Method for Personal Income Tax (Modules) and the Special Simplified Regime for Value Added Tax in Spain, it is used to determine the calculation of the tax to be paid.

In Spain, electricity consumption refers to the electricity billed by the supplying company, measured in units of 100 kilowatt-hours (kWh). When the invoice distinguishes between “active” and “reactive” energy, only the active energy is considered for computation.

When using a surface area exceeding the permitted limit in the Monotributo, it’s considered that one is not dealing with a small taxpayer.

k) Surface area affected by the activity

This physical magnitude aims to prevent large establishments, where it is presumed that their owners do not qualify as small taxpayers, from being included in the regime.

It’s applied in Argentina’s Monotributo system. The regulations specify its application for urban centers with populations exceeding a certain threshold. It’s also excluded for certain activities that have intensive use of space (e.g., garages).

It’s applied in Spain’s Module Regime, where “locales” are understood as constructions, buildings, or facilities, as well as surfaces, covered or uncovered, open or not to the public, used for carrying out the activity.

The unit of the “local surface” module is the square meter (m²), and it distinguishes separately one or more of the following modules: a) Independent local surface, b) Non-independent local surface, c) Manufacturing local surface.

As mentioned, while in the Spanish regime, this physical magnitude is used to determine the tax calculation by multiplying the assigned value per square meter, in the case of Argentina’s Monotributo (similarly to electricity consumption), the surface area is applied as a limit for each category. If the surface area exceeds the limit of the highest category, it implies exclusion from the regime.

In other words, the use of a larger surface area than that permitted is not considered to be a small taxpayer.

According to each legislation, the concept of surface to be computed varies. In Spain, under the Module Regime, “locations” are understood as constructions, buildings, or facilities, as well as surfaces, covered or uncovered, open or not to the public, used for carrying out the activity.

In contrast, in Argentina's Monotributo, only the surface area for customer service is computed.

3. Tax calculation (Presumptive technique)

Presumptive tax regimes are based on a presumed calculation of the tax to be paid ("régime d'imposition forfaitaire").

While in those regimes that replace a single tax, it is exclusively applied to that tax, in contrast, in regimes that replace a multitude of taxes and, in some cases, also social security contributions, this presumptive calculation method is applied to the entirety of the included obligations.

Among the main formulas of presumptive techniques applied in Latin America and the Caribbean (LAC), the following can be distinguished: a) percentage on gross income or purchases, b) fixed fee, c) presumed income, d) presumed added value, e) substitution of the taxpayer, f) assets, g) physical magnitudes, and h) agreement between the tax administration and taxpayers.

Finally, the trends of presumptive techniques applied in countries of the region will be outlined.

Main presumptive techniques applied:

a) Percentage over gross receipts or purchases

A common form of special regime involves using the presumptive technique of applying a percentage of gross income, known as turnover tax.

"In practice, this technique has two main alternatives regarding gross income: a) applying a tax rate or b) a profitability coefficient"

Regarding the applicable tax rate, there are two modalities: i) applying a uniform rate to all activities, or ii) applying multiple rates depending on the economic activities carried out.

According to the OECD (2020)³⁹ theoretically, a single high tax rate implies a high effective tax burden on businesses with lower profit margins, such as percentages of their sales or service provisions.

Additionally, it imposes a higher tax burden on less efficient companies, thus tending to discourage capital allocation to business activities when their profit margins are below average.

In this general tax rate technique, it can either be uniform for the entire regime or, conversely, increase progressively according to the income levels attained by the subjects. In other words, it can be applied proportionally or progressively.

In the progressive tax rate, a specific rate is generally applied for each class of economic activity, which increases according to the gross income they have.

The different tax rates are based on the varying level of profitability or value added that the legislation presumes for the activity carried out. Obviously, similar economic activities are grouped into certain categories or annexes, and the same tax rates are applied to them.

This system implies greater equity than the general single tax rate, but it also involves a certain level of distortion by presuming profitability or added value solely based on revenue.

The other alternative within this technique is to apply a profitability coefficient, meaning determining the taxable income as a percentage of those revenues in a first phase, and applying a nominal profitability coefficient established by legislation to this taxable base to determine the resulting tax to be paid⁴⁰.

Another technical variant involves directly applying the profitability coefficient or factor to the gross revenues obtained from each economic activity.

Brazil applies the alternative of applying multiple tax rates according to economic activity in the SIMPLES NACIONAL, and Peru does so in the RER. On the other hand, Costa Rica applies the method of applying a profitability coefficient in the Simplified Taxation Regime (RTS).

³⁹ OECD (2020): “Supporting SMEs to Get Tax Right Series Strategic Planning”, Forum on tax administration.

⁴⁰ For example, the case of Italy.

“This presumptive technique, due to its simplicity in tax calculation, is widely used by Latin American and Caribbean countries in their presumptive simplified regimes. However, as previously mentioned, if it is applied exclusively, it is also the most difficult to control”

When it comes to income, simply not invoicing or under-invoicing, in a context of very high informality as in Latin America and the Caribbean, implies that taxpayers of greater economic significance may join it and pay a preferential tax improperly.

This reality was also highlighted by Engelschalk (2007)⁴¹, as he argued that systems based on turnover (billing) promote underreporting, which can be problematic when administrative control capacities are weak and/or when cash payments are common.

The same can be said regarding purchases, to which is added in countries of the region, the exploitation of informal chains or under the guise of being a final consumer, to avoid recording the transaction.

Hence, it would be useful for this indicator to be complemented by others that help prevent fraudulent practices for improperly joining these regimes.

It can be noted that this factor was generally applied to presumptive simplified regimes for micro or small businesses.

The SIMPLES NACIONAL of Brazil was the pioneering regime and the model that several countries in the area have considered. It determines the tax based on a percentage of gross revenues, progressively according to the level of billing, and differentiated by economic activity, which are grouped separately into V Annexes.

Subsequently, the Dominican Republic applied this model in its Simplified Tax Regime (RST), which has four sub-regimes: three based on income (income for individuals, income for corporates, and income for the agricultural sector). The remaining one is based on purchases made by obligated entities engaged in the marketing of goods.

⁴¹ Engelschalk, M. (2007), “Designing a tax system for micro and small businesses: guide for practitioners”, No. 42435, World Bank Group, Washington, D.C., <https://documents.worldbank.org/en/publication/documentsreports/documentdetail/980291468158071984/%20designing-a-tax-system-formicro-and-small-businesses-guide-for-practitioners>

Colombia also followed this model with the implementation of the Simple Taxation Regime, which has 6 groups according to the economic activity carried out, and the tax to be paid is determined through different tax rates in each group based on the income obtained.

Among others, this technique is also applied in the Special Income Tax Regime (RER) of Peru, the Optional Simplified Regime on Income from Profitable Activities, the Small Taxpayer Regime⁴² and the Special Agricultural Taxpayer Regime⁴³ in Guatemala, the Simplified Trust Regime RESICO in Mexico, etc.

Regarding the purchases parameter, this technique is applied in Costa Rica in the “Simplified Taxation Regime,” where the tax calculation involves multiplying purchases by the authorized sales factor, determining the tax to be paid for the General Sales Tax. A similar calculation method is used for Income Tax, so the combined sum is the payment that replaces both taxes.

To determine gross income, the billing of the small taxpayer is generally considered, but in Mexico’s Simplified Trust Regime, it is also required that this income must be collected⁴⁴.

b) Fixed fee

Determining a fixed fee to calculate the tax to be paid is the simplest technique for the small taxpayer. It avoids complex and costly calculations, accounting, record-keeping, etc., and allows for simpler planning for their payments.

Although many regimes require the assistance of a tax advisor, their task is minimal, and therefore the cost of their services is low.

“Once the category, group, or annex applicable to the taxpayer is determined, the legislation establishes an updated fixed value to be paid”

Internationally, it is referred to as “régime basé sur un montant d’imposition fixe” and “regime based on a lump-sum taxation method.”

⁴² Both conventional and electronic regimes.

⁴³ Idem.

⁴⁴ This country has been characterized by the priority given to the accrual rather than the accrual approach.

The regimes that use this technique are aimed at very small or small taxpayers who are individual taxpayers.

In this line of thought, Thuronyi (2004) argued that regimes based on a fixed amount of tax represent the simplest modalities, as they allow for a transparent and predictable tax burden, resulting in low compliance costs for small taxpayers as well as for tax administration management.

Continues to argue that generally, these regimes are applied to individuals who work alone with low incomes and have a low level of knowledge of accounting and tax regulations.

The fixed fee can be standardized across all included activities or differentiated based on whether it's for commerce, industry, or services, or for each specific economic activity.

Generally, a distinction is made between commerce, industry, and service provision. A higher fee is usually assigned to the service provision activity at the same billing level, as it is characterized by higher value-added and profitability.

In some regimes, due to the high level of value-added or presumed income obtained from the provision of certain services, taxpayers providing them may not be eligible for this type of regime.

It is logical that the fixed fee technique entails a certain level of inequity because the classification into a category with a specific amount to pay involves taxpayers with different levels of profitability and added value. Therefore, it will benefit some more than others.

As mentioned earlier, simplification works against equity and vice versa because for the determination of categories and fixed fees, average coefficients or indices are used.

Once these types of regimes are established, Bucci (2020)⁴⁵ argues that they gain great popular acceptance, which leads to serious difficulties for tax policymakers when they consider reforming them, and even more so when contemplating their repeal.

The Monotributo of Argentina applies this technique by category. Since this regime includes not only taxes but also contributions to social security, including health insurance, the fixed fee has three components: a) tax component, b) social security component, and c) health component (healthcare).

⁴⁵ Bucci, V. (2020), "Presumptive taxation methods: a review of the empirical literature", *Journal of Economic Surveys*, Vol. 34/2, pp. 372-397, <https://doi.org/10.1111/joes.12304>

This subdivision makes sense due to the different destination of the funds once the fixed fee is paid into the public treasury. However, for the small taxpayer, according to their category, it is encompassed in a fixed fee.

Brazil considered the Model of Argentina's Monotributo and implemented the MEI (Micro Individual Entrepreneur) through the payment of a fixed fee called DAS for economic activity, which is defined in three sectors: a) commerce or industry, b) provision of services, and c) provision of services and commerce.

The majority of the DAS is directed towards social security, with a tiny portion allocated as tax (substitute for ICMS and ISS).

The issuance of the fixed fee payment slip is done via the web for greater simplification. The difference from the Argentine regime is that the MEI does not incorporate the health component.

The values of both fixed fees are updated semi-annually in the Monotributo through the mobility index of social security benefits and annually in the MEI through the minimum wage.

In Uruguay, the Monotributo also applies a single fixed fee that includes the tax component and social security (BPS). In the event that the small taxpayer opts for the health component, the mutual component is integrated into the fee.

In this country, another regime for small taxpayers called IVA Mínimo (Minimum VAT) also applies, which substitutes said tax through the payment of a fixed fee by obligated individuals in certain economic activities⁴⁶.

In Bolivia's Simplified Taxation Regime (RTS), the calculation of tax is determined in 6 categories through a fixed fee. Capital is the exclusive parameter for categorization.

There is also an Integrated Simplified Regime for Transportation classified according to the type of transport, with presumed income determined by category and payment of a fixed fee.

c) *Presumptive income*

Regarding small taxpayers, some legislations have simplified presumptive regimes exclusively for Income Tax. To determine the presumed income, they are based on income or asset parameters or the selling price.

⁴⁶ Furthermore, for certain economic activities, a reduction of this fee is applied.

In Chile, there is the Presumptive Income Regime for small: a) farmers, b) transporters, and c) miners, regarding Income Tax.

The presumptive technique is based on agricultural properties as a percentage of the fiscal appraisal, on vehicle valuation in transportation, and on a percentage of the selling price of mining products.

In Brazil, the Presumptive Income Regime (Lucro Presumido) is applied, whereby companies up to a certain revenue limit can choose to adhere. The taxable base is determined based on gross revenues to which a “profit margin” is applied according to the activity undertaken, determining the applicable tax rate⁴⁷.

As it also replaces the Social Contribution on Net Income (CSLL), a percentage is applied to the taxable base to determine the resulting tax of this Contribution⁴⁸.

In Uruguay, concerning agricultural income of small producers, the Tax on the Sale of Agricultural Goods (IMEBA) is applied to the first sale that the agricultural producer makes to a subject registered in the IRAE (Tax on Income from Economic Activities), and depending on the product sold, rates ranging from 0.10 to 2.5 percent are applied.

Therefore, this rate applied to the taxable base of the sale determines the presumed income depending on the agricultural product sold.

It is also applied in the Simplified Tax Regime of the Dominican Republic for individuals and legal entities based on purchases dedicated to the trade of goods⁴⁹.

In the Personal Income Tax Objective Estimation Regime (Modules) in Spain, a presumed income is assumed for each included economic activity, based on established specific metrics.

This regime requires a very meticulous preliminary study by the tax administration, as well as ongoing adjustments as the economic context and variables change.

For this reason, it did not become a model for countries in the region, as they sought greater simplicity in formulating presumptive simplified regimes.

⁴⁷ The rates range from 1.6% to 32%. If they exceed a certain income threshold, an additional rate of 10% is applied to the excess.

⁴⁸ A general rate of 12% is applied, but for service companies, it is 32%.

⁴⁹ The percentage of gross margin determined by legislation according to the economic activity is applied to purchases, forming the net income, to which the tax rates of Income Tax for individuals or legal entities are applied, as appropriate.

d) *Presumptive value added*

The simplified regimes that replaced the Value Added Tax initially determined the value added presumptively.

In the 1980s, this technique was observed, which was configured by applying a presumed tax debit determined by legislation, deducting a real tax credit, that is, from purchases made.

In this modality, small taxpayers were categorized according to various parameters, and legislation determined a presumed tax debit for them. To reduce the tax payable, the real tax credit, i.e., the tax borne on their purchases, was subtracted from it.

The aim was for small taxpayers to request invoices for their purchases from their suppliers, thereby creating a “conflict of interest” that is the cornerstone of compliance in VAT.

Therefore, the control of suppliers was the objective, rather than the collection from small taxpayers who sold to final consumers.

In a second phase, considering that the obligated parties adhered to it to avoid paying taxes by using invoices for transactions they had not made, and with the aim of ensuring they paid at least a “minimum tax,” the attribution of real tax credit was limited to a percentage of the tax debit according to the economic activity (commerce, industry, or service).

In most countries, the failure of these regimes led to their repeal.

The Simplified Taxation Regime in Chile’s VAT system applies this technique for small traders, artisans, and service providers, as determined by the National Directorate of Internal Revenue.

In this scenario, a presumed tax liability called the “fixed fee” is established, which the taxpayer can deduct from their tax credits for purchases up to the limit of the fixed fee, with no carryover to future periods.

In the Simplified VAT Regime (Modules) in Spain, a value-added is presumed for each included economic activity based on specific magnitudes that have been employed.

As mentioned, this regime entails a very meticulous prior study by the tax administration, as well as ongoing adjustments as the economic context and applied variables change.

For this reason, it did not become a model for countries in the region, which sought greater simplicity in formulating their presumptive simplified regimes.

e) Substitution of the taxable person

Given the challenges of applying both the general regime and a specific regime to certain subjects, even if the latter were the simplest, some legislations devised regimes to replace small taxpayers as taxpayers of the value-added tax.

This replacement of the subject was transferred according to each legislation, either to buyers or to suppliers in their transactions with certain small taxpayers.

“The substitute obligor, being under the general regime, is more reliable for the tax authority. Additionally, this regime allows small taxpayers to be exempted from formal and material obligations”

Both the supplier and the first acquirer, depending on the regime, must collect or withhold⁵⁰ the presumed value-added tax from the substituted taxpayer and remit it to the tax authority.

Therefore, the taxpayer of the tax obligation was the withholder or recipient, who had to apply an additional tax to the general tax rate, which entails a presumed value added from the small taxpayer.

In Chile, this regime is called “change of VAT subject.” In the initial phase, it was applied only to purchases or sales of certain products or the provision of certain services. However, in a second phase (2018), it was applied considering the behavior and risk classification of taxpayers, an initiative that, according to the tax authority itself, is part of the Tax Compliance Model that the SII (tax administration) applies, considering its actions in proportion to the level of compliance of the taxpayers.

In this section, the focus is on the change of VAT subject regarding small taxpayers, particularly small agricultural producers (PPA).

They are defined as natural persons who are enrolled in the Presumptive Income regime under the Income Tax Law and who operate one or several agricultural properties whose total fiscal appraisal value does not exceed a certain amount or when the fiscal appraisal value exceeds this amount, but their sales have not exceeded the limit determined by the legislation.

⁵⁰ The difference between a perception and a retention is determined as follows: perception involves adding an amount to the transaction money by the seller, whereas retention involves subtracting an amount by the buyer, based on the percentage established in the legislation.

The withholding agents (new taxpayer) must withhold a percentage of the net amount from the sales made by small agricultural producers, allowing them to recover the input tax credit associated with their purchases and use of services made⁵¹.

Small artisan taxpayers, street vendors, and newspaper vendors in the Income Tax are retained by mining companies, municipalities, and publishing companies, thus fulfilling their tax obligations⁵².

In Argentina, there was a regime called “non-registered VAT taxpayer,” under which wholesale suppliers had to collect an additional 50% of the VAT rate from non-VAT registered buyers.

This regime led non-registered buyers to claim they were final consumers to avoid it, and suppliers turned a blind eye to maintain their clientele. Consequently, it was eventually repealed.

With the establishment of the Monotributo in 1998, Argentina introduced the “Uncategorized Subject in VAT” regime. Under this regime, if buyers or service recipients cannot prove their VAT or Monotributo registration status to their suppliers, an additional 50% of the VAT rate is collected.

Starting from 2023, this scheme also applies to operations carried out on digital platforms. To prevent fraudulent maneuvers as in the previous “non-registered responsible” regime, the status of “uncategorized subject” is not left to the discretion of the digital platform. Instead, it is presumed based on the quantity or accumulated amount of operations conducted within a certain period. The recipient subject is the administrator of the digital platform.

In Spain, the “Recargo de Equivalencia” regime is applied in the VAT system. This regime is intended for retail traders who sell more than 80% of their goods directly to the final consumer without transforming the product.

The supplier withholds an additional amount of VAT, based on the applicable VAT rate for the transaction⁵³, and remits it to the tax authorities.

This way, the small taxpayer neither declares nor pays this tax, due to the substitution of the taxpayer entailed by this regime.

⁵¹ The amount of the refund cannot exceed 70% of the tax withheld by the withholding agents, nor can it exceed a certain specified amount.

⁵² Instead, owners of artisanal workshops or workers and artisanal fishermen must file a sworn declaration and pay the Single Tax, which substitutes for the Income Tax.

⁵³ The additional rate ranges from 0.5 to 5.2%. For the sale of tobacco, the equivalent surcharge is 1.75%.

f) *Assets*

Fixed assets allow for reflecting differences in capital intensity between economic sectors and are more difficult to conceal than revenue levels when considering gross income.

But for its determination as well as for its control, a certain level of tax administration is required, which often lacks resources allocated to this function.

“Furthermore, as stated by the ILO (2021)⁵⁴, the use of this indicator can discourage investment in capital when the entity seeks to remain under the simplified regime to avoid taxation under the general regime”

This method of assessment is applied in the Unified Agricultural Regime (RAU) of Bolivia. Based on the hectares of an agricultural or livestock operation, values are assigned to each hectare according to its use, to determine the tax based on the values established in a table by the Internal Revenue Service (tax administration).

In Chile, a similar approach is also used to determine the presumptive income of agricultural activities based on applying a percentage to the fiscal valuation of real estate dedicated to the activity.

g) *Physical magnitudes*

This type of presumptive simplified regimes for small taxpayers was introduced in the Spanish tax system starting in 1992 under the name “*Régimen de Módulos*,” which includes both the *Régimen de Estimación Objetiva* of PIT (Modules) and the *Régimen Especial Simplificado del Impuesto al Valor Añadido*.

In this system, the net income or value added is determined based on objective parameters or modules set by the Ministry of Finance and Public Function for each activity, which include factors such as the number of employees, non-salaried personnel, installed electrical power, surface area of the premises, etc.

⁵⁴ ILO (2021), “Preferential tax regimes for MSMEs: Operational aspects, impact evidence and policy implications”, ILO Working Paper, No. 33, International Labour Organization, https://www.ilo.org/global/publications/workingpapers/WCMS_803925/lang--en/index.htm.

Those modules are subject to reduction coefficients (for employment and investment incentives) and a series of corrective indices: municipality population, duration of the activity season, new activities⁵⁵, and excess over certain limits.

Additionally, in the Objective Estimation modality, depreciation of fixed assets can be deducted.

For the Modules, depending on the activity, the fixed amounts for each of them are multiplied by the number of units used in the business operations (such as kilowatts in electricity consumption, number of workers, meters of bar length in bars and cafes, square meters of surface area, etc.).

Depending on the activity, certain corrective factors must be applied or not (for example, for being a small-sized company, seasonal activities, or for being in the initial stages of the business, among others).

This regime, which has sought to determine with the greatest possible precision the value added, or presumptive income of each economic activity based on the parameters or physical magnitudes used in them, and through the application of reduction or corrective indices, in practice, turns out to be extremely complex.

Therefore, this model has not been considered in Latin American tax systems, which have focused on simplicity rather than equity or a more precise presumptive value added.

h) Agreement between the tax administration and taxpayers

These kinds of presumptive simplified regimes are based on an estimation of each taxpayer's profits. As Engelschalk (2007) argues, these estimates serve as a basis for discussion between the taxpayer and the tax administration.

“To properly consider each taxpayer’s situation, this system requires frequent interactions with the tax administration, which can amplify discretionary behavior and administrative costs”

⁵⁵ First year 20%, second year 10%.

According to Alonso González (2007)⁵⁶, in 1957, Spain began to generalize the so-called “global assessments” or objective global estimates based on indices or coefficients, an objective taxation system that relied on technical studies to determine the total income earned by each profession. This was done to later distribute, within a specific territorial scope, the amount to be attributed to each individual using certain indices.

In this calculation, a series of expenses could be deducted (such as personnel, social security, insurance, and provision expenses). The resulting amount, adjusted after applying a series of coefficients, was subject to a proportional tax rate.

The reform of the tax system in 1964 did not entail its repeal but its reform and improvement, although in 1969 its gradual replacement by a general system based on the direct estimation of the taxpayer’s declaration began.

This type of technique remains in force in France within the Microenterprise Tax Regime and the Microsocial Regime. It is intended for individual microenterprises with a billing threshold based on their economic activity⁵⁷. It is automatically applied to new businesses unless there is an option for another regime.

The tax authority determines the lump-sum benefit (without considering actual expenses) and then taxes it with the income tax.

Social security contributions, on the other hand, are paid as they are collected, and only on these amounts (unless minimum contributions are requested).

These kinds of regimes, due to the administrative costs involved and the discretion they imply for tax authorities, are not implemented in the countries of the region.

i) Presumptive techniques applied

Below, techniques presumed to have been applied in simplified presumptive regimes will be described by country:

⁵⁶ Alonso González, Luis Manuel (2007) “*La Simplificación de la Tributación de las Empresas en España*”, *Crónica Tributaria* Nro 124/2007.

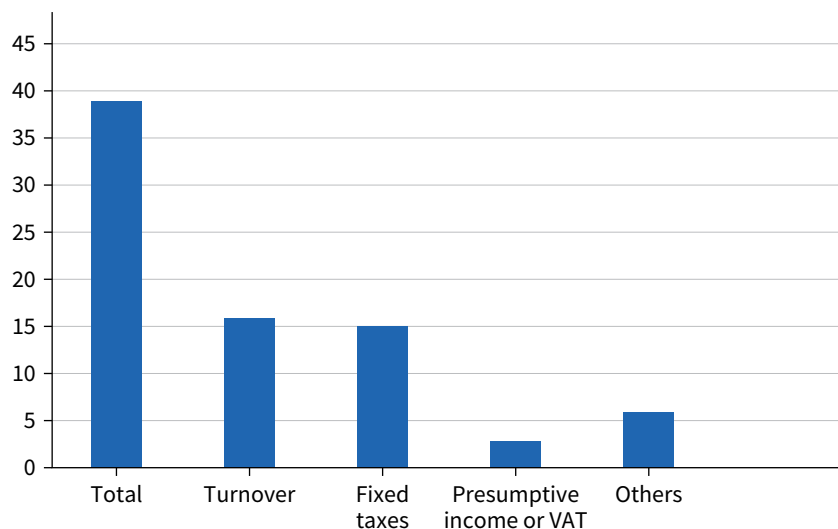
⁵⁷ There is a higher threshold for the sale of goods and food and lodging services. Another lower threshold applies to service providers and independent professionals. Some activities are excluded.

Table 8. Simplified Presumptive Regimes: Their application in Latin America

Application		Presumptive Technique			
Country	Number	Gross revenues or purchases	Fixed fee	Income or Presumptive Added Value	Other
Argentina	4	--	3	--	1
Bolivia	3	--	2	--	1
Brazil	3	2	1	--	--
Chile	5	--	2	1	2
Colombia	2	1	--	--	1
Costa Rica	1	1	--	--	--
Cuba	1	1	--	--	--
Ecuador	2	1	1	--	--
El Salvador	--	--	--	--	--
Guatemala	5	5	--	--	--
Honduras	1	--	--	--	1
Mexico	1	1	--	--	--
Nicaragua	1	--	1	--	--
Panama	---	--	--	--	--
Paraguay	2	1	1	--	--
Peru	3	1	1	1	--
Dominican Republic	1	1	--	--	--
Uruguay	4	--	3	1	--
Venezuela	--	--	--	--	--
Total	39	16	15	3	6

Source: own (2023)

Figure 4. Simplified Regimes. Presumptive techniques



Source: own (2023)

From this information, it is evident that the technique involving a percentage of gross income is applied in 16 regimes, making it the most common. However, it is closely followed by the fixed fee technique with 15 regimes, while specific techniques related to income or value added are found in 3 regimes, and other techniques are present in 6 systems.

“It is worth noting that out of the 19 countries analyzed in the region, there are 39 regimes in place. Only in 3 of these countries, there is an exemption from VAT without the application of any simplified regime”

On the other hand, in OECD countries (2015), regarding VAT, they have mostly adopted the strategy of exemption up to an annual income threshold⁵⁸. In this exemption, there are two modalities: a) with registration obligation or b) without registration obligation.

They adopted the first alternative in 22 (twenty-two) countries and the second in 6 (six) countries. Only 5 countries in the OECD do not apply the exemption, two of which are from Latin America (Chile, Spain, Mexico, Sweden, and Turkey).

On the other hand, regarding the Income Tax, 13 (thirteen) countries had adopted the modality of reducing the tax rate for SMEs.

⁵⁸ With some exceptions like Japan, where individuals or new companies have the capital threshold during the first two years.

Chapter IV

GENERAL CHARACTERISTICS

As mentioned in the respective chapter, among the Special Regimes, there are three categories: Simplified Presumptive Regimes, Simplified Formal Obligations Regimes, and Preferential Regimes.

Only simplified regimes that replace taxes and social security contributions are voluntary, meaning the obligation lies in paying taxes under the general regime, typically VAT and income tax.

Considering the special characteristics of this sector, these regimes have been created to improve tax compliance. Their main objectives for individual taxpayers include simplicity, formality, social inclusion, and supplier control.

Regarding micro and small businesses, the main objectives have been, according to respective legislations, promotion, simplification of formal obligations, and reduction of the tax burden.

Obligation is an essential element of taxes in the tax system, which levy, among other manifestations of the ability to contribute, consumption, income, and wealth.

“The simplified presumptive regimes, given their nature as substitutes for taxes in the general regime, are optional⁵⁹, meaning they are voluntary”

Given the improvements they entail compared to taxes or social security contributions in the general regime, these regimes are based on the perceived benefits to encourage the participation of taxpayers with lower capacity to contribute.

If they were mandatory, applying a presumptive technique to determine the resulting obligation could be deemed unconstitutional, as in some cases they might be considered confiscatory or violate proportionality, equity, the free exercise of economic activity, etc.

⁵⁹ With the exception of the Simplified Tax Regime of Cuba, which is mandatory for certain activities determined by the Ministry of Finance and Prices.

Presumptive techniques based on the “iure et de iure” principle (by full right), which do not admit evidence to the contrary, can be applied without legal conflicts if the regimes that contemplate them are voluntary in nature.

“This rule applies to substitutive simplified regimes. However, in simplified regimes regarding formal obligations and preferential regimes where the general regime applies, they merely grant certain tax benefits”

As highlighted, given the obvious difficulties in applying the general regime to taxpayers with lower tax capacity, especially very small or small taxpayers, initially they were exempted from VAT up to a certain billing threshold. Meanwhile, in the case of Income Tax, applying a non-taxable minimum meant they were exempt from the tax.

Then, simplified presumptive regimes were created, initially aimed at exclusively replacing VAT (in general) or Income Tax (in some activities), but over time they became integrated with these taxes and subsequently with social security contributions.

The first generation aimed to replace a specific tax (VAT, Income Tax, etc.), while the second aimed to replace several taxes together, and in a third generation, social security contributions were included.

It is worth noting that while some countries have long-standing regimes in place, others have had transient systems subject to constant tax reforms, either to modify their constituent elements or to replace them with others.

For example, in Mexico, the REPECOS (Regime for Small Taxpayers) was applied since the 1990s⁶⁰, then starting in 2014, the RIF (Incorporation Fiscal Regime) was implemented, and from 2022 onwards, the Simplified Trust Regime (RESICO) is being applied.

In contrast, in Brazil, the SIMPLES Regime has been applied, with modifications, since 1986, and in Argentina, the Monotributo has been in place since 1998.

In the implementation of special regimes, countries can opt for various strategies: a) regarding the number of regimes applied (unicity or multiplicity) and b) regarding the benefits granted (simplification of formal obligations or reduction of the tax burden).

⁶⁰ Since 1996, but with this designation since 1998.

1. Current regimes

Of the 19 countries analyzed in the region, currently 16 apply special regimes for taxpayers with lower capacity to contribute.

A total of 39 simplified regimes are currently being applied.

Here are the special regimes currently in force in Latin America by country:

Table 9. Special Taxation Regimes for taxpayers with lower taxable capacity Latin America

Country	Regime
Argentina	<ol style="list-style-type: none"> 1. Monotributo 2. Social Monotributo 3. Social Inclusion and Promotion of Self-Employment Regime 4. Subject not Categorized VAT
Bolivia	<ol style="list-style-type: none"> 1. Simplified Taxation Regime RTS⁶¹ 2. Integrated Tax System STI⁶² 3. Unified Agricultural Regime RAU
Brazil	<ol style="list-style-type: none"> 1. MEI 2. SIMPLES NACIONAL 3. Presumptive Income
Chile	<ol style="list-style-type: none"> 1. Single Tax IT⁶³ 2. Presumptive Income⁶⁴ 3. Simplified Taxation Regime VAT 4. Pro SMEs General 5. Pro SMEs Transparent
Colombia	<ol style="list-style-type: none"> 1. Simplified Tax Regime (RST) 2. Non-liable for VAT
Costa Rica	<ol style="list-style-type: none"> 1. Simplified Taxation Regime
Cuba	<ol style="list-style-type: none"> 1. Simplified Taxation Regime

(continue)

⁶¹ It applies to retail merchants, street vendors, and artisans.

⁶² It applies to transportation.

⁶³ Small artisanal miners, small merchants operating in public spaces, street vendors, owners of artisan workshops or workshops, and artisanal fishermen.

⁶⁴ Exploitation of agricultural real estate, land transport of goods and passengers, and mining.

Table 9. Special Taxation Regimes for taxpayers with lower taxable capacity Latin America

Country	Regime
Ecuador	<ol style="list-style-type: none"> 1. RIMPE Entrepreneurs 2. RIMPE Popular Businesses
El Salvador	VAT exemption (income threshold)
Guatemala	<ol style="list-style-type: none"> 1. Optional simplified regime on income from lucrative activities 2. Small Taxpayer Regime 3. Electronic Regime for Small Taxpayers 4. Special Regime for Agricultural Taxpayers 5. Special Electronic Regime for Agricultural Taxpayers
Honduras	ISV exemption (income threshold) <ol style="list-style-type: none"> 1. Simplified VAT Regime
Mexico	<ol style="list-style-type: none"> 1. Simplified Trust Regime RESICO
Nicaragua	<ol style="list-style-type: none"> 1. Simplified Flat Rate Regime
Panama	ITBMS exemption
Paraguay	<ol style="list-style-type: none"> 1. IRE SIMPLE 2. IRE RESIMPLE
Peru	<ol style="list-style-type: none"> 1. New RUS (NRUS) 2. RER 3. SME (RMT)
Dominican Republic	<ol style="list-style-type: none"> 1. Simplified Taxation Regime (RTS)
Uruguay	<ol style="list-style-type: none"> 1. MONOTRIBUTO 2. SOCIAL MONOTRIBUTO Mides 3. MINIMUM PAYMENT – VAT 4. IMEBA
Venezuela	VAT exemption (income threshold)

Source: own (2023)

2. Number of regimes (Unit or multiplicity)

This section focuses on the strategy on the uniqueness or multiplicity of these regimes in the countries of the region.

Initially, the general strategy was to adopt a single special regime in the country's tax system⁶⁵. However, over time, various regimes began to be created.

⁶⁵ A Simplified Regime was applied to VAT.

“The multiplicity arose from the need to create a specific regime based on the taxpayer’s status, whether an individual or a company, their size, economic activity, or the tax being replaced”

An important factor in determining the implementation of more than one special regime is the quality of the obligated subject to which it is directed. In some countries, due to the diverse characteristics and objectives that exist, a regime is applied for so-called “very small taxpayers,” another for small taxpayers, and another for companies.

While in other countries there are mixed regimes regarding the subject, both individuals and companies, as long as they meet the established parameters (for example, turnover below a certain amount, up to a capital limit, a certain number of employees, etc.).

Other factors of multiplicity have been: a) the economic activity carried out, b) the economic magnitude of the taxpayer, c) the tax replaced, and d) the granting of certain tax incentives.

“From the present study, it is observed that out of the 19 (nineteen) countries analyzed, 10 (ten) have adopted multiplicity, 6 (six) have adopted singularity, and only 3 (three) countries do not apply any preferential regime”⁶⁶

Within multiplicity, Chile and Guatemala are the countries that apply the most regimes, with a quantity of 5 (five) each, each with different objectives.

To observe the evolution of the strategy of the countries in the region regarding the singularity or multiplicity of the applied regimes, I have proceeded to compare the current data with the results of the research I formulated back in 2006 for the IDB⁶⁷.

A comparative table for 2006/2023 is attached below. A comparison of these data with those obtained in the research carried out by the IDB (2006) shows that:

⁶⁶ Instead of a special scheme, they apply VAT exemption up to a turnover threshold.

⁶⁷ González, Darío (2006): “Regímenes Especiales de Tributación para Pequeños Contribuyentes en América Latina”, IDB, Washington.
<https://publications.iadb.org/es/publicacion/13467/regimenes-especiales-de-tributacion-para-pequenos-contribuyentes-en-america>

Table 10. Special Taxation Regimes for taxpayers with the lowest taxable capacity – Latin America – Countries

	2006 ⁶⁸	2023
Uniqueness	8	6
Multiplicity	7	10
Without special regime	4 ⁶⁹	3 ⁷⁰

Source: own (2023)

From the Figure, it can be inferred that over the course of 17 years, there have been few significant changes in the countries applying special regimes, going from 15 (fifteen) to 16 (sixteen), while the number of countries not applying any special regime has decreased from 4 (four) to only three (three). During this period, Cuba transitioned from a general regime that taxed microenterprises to a special regime called the Simplified Taxation Regime.

“There is a trend towards multiplicity, as not only have the countries choosing this tax policy strategy increased, but also many countries have increased the number of their special regimes over this time (for example, Argentina, Brazil, Chile, Ecuador, Peru, etc.)”

However, Mexico stands out as an exception, as it was the only country that transitioned from a strategy of multiple regimes to the implementation of only one at present (Trust Simplified Regime – RESICO).

3. Benefits granted

a) *Simplification of formal obligations*

As previously highlighted, the compliance cost for small taxpayers has a significant impact on their finances. Therefore, countries internationally have implemented tax policies aimed at simplifying their compliance.

⁶⁸ Cuba and Guatemala were incorporated from the original study for the present analysis.

⁶⁹ Three regimes apply VAT exemption up to a billing threshold (El Salvador, Panama, and Venezuela). Cuba applied the Tax Regime for Microenterprises as the general regime of the tax system, and therefore, it cannot be considered a preferential regime.

⁷⁰ These three regimes apply VAT exemption up to a billing threshold (El Salvador, Panama, and Venezuela).

Chile has pursued a strategy focused solely on simplifying formal obligations since 2007 through the Simplified Taxation Regime, and starting from 2020 through the following regimes targeting micro, small, and medium-sized enterprises (SMEs): a) General Pro-SME Regime, and b) Transparent Pro-SME Regime.

It is also applied in the Simplified VAT Regime in Honduras. It was previously applied in the Simplified VAT Regime and in the current Non-VAT Responsible Regime in Colombia. In these latter two cases, the methodology of European countries granting VAT exemption with fiscal registration is applied.

The current strategy has not been extended in the tax systems of Latin America.

b) Reduction of the tax burden

For the current strategy, mere simplification of tax obligations is not sufficient in a simplified regime, as both individual taxpayers and micro and small enterprises face significant asymmetries with taxpayers under the general regime, which pose obstacles to their development.

Therefore, they apply regimes that, in addition to formal simplification and consequently reducing compliance costs, decrease the tax burden they bear compared to what they would have under the general regime.

This reduction is achieved through the substitution of the taxes they bear and, if applicable according to the country, the resources of social security.

This substitution is based on the determination of tax obligations and, if applicable, social security resources, through the application of various presumptive tax techniques that have been previously explained.

The replacement can involve a single tax or a multiplicity of taxes, and in some cases, it can be done concurrently with the substitution of social security resources.

“Out of the 39 (thirty-nine) current regimes, only 5 (five) exclusively replace VAT, 11 (eleven) exclusively replace IT, which are referred to as first-generation systems. On the other hand, 11 (eleven) regimes include various taxes, forming the second generation”

It is worth noting that 8 (eight) regimes are third-generation, meaning they also include social security resources.

In contrast, only (four) regimes are based exclusively on the simplification of formal obligations (simplified accounting, records, etc.).

In this section, preferential regimes that also reduce the corporate income tax burden in the general tax system are not included.

The same applies to those regimes referring to social security resources.

It is reminded that in this section, Simplified Presumptive Regimes are analyzed, meaning those that substitute taxes from the general regime. Therefore, Preferential Regimes applied within the general regime are not included.

The following table describes the number of the existing simplified presumptive regimes and the taxes and resources they replace:

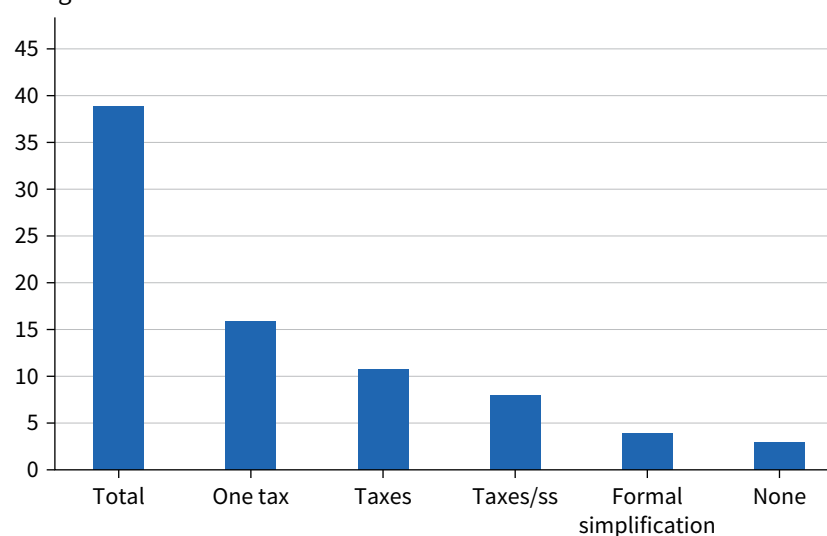
Table 11. Special Taxation Regimes for taxpayers with the lowest taxable capacity in Latin America

Application		Replacement				S/Replacement
Country	Amount	VAT	IT	Taxes	Taxes + RRSS	Simplification formal obligations
Argentina	4	1	---	---	3	--
Bolivia	3	---	---	3	---	--
Brazil	3	---	1	---	2	--
Chile	5	1	2	--	--	2
Colombia	2	--	1	--	--	1
Costa Rica	1	--	--	1	--	--
Cuba	1	--	--	1	--	--
Ecuador	2	--	1	1	--	--
El Salvador	--	--	--	--	--	--
Guatemala	5	2	1	2	--	--
Honduras	1	--	--	--	--	1
Mexico	1	--	1	--	--	--
Nicaragua	1	--	--	1	--	--
Panama	--	--	--	--	--	--

(continue)

Table 11. Special Taxation Regimes for taxpayers with the lowest taxable capacity in Latin America

Application		Replacement				S/Replacement
Country	Amount	VAT	IT	Taxes	Taxes + RRSS	Simplification formal obligations
Paraguay	2	--	1	1	--	--
Peru	3	--	2	--	1	--
Dominican Republic	1	--	--	1	--	--
Uruguay	4	1	1	--	2	--
Venezuela	--	--	--	--	--	--
Total	39	5	11	11	8	4

Figure 5. Simplified Regimes – Classes

Source: Own (2023)

Finally, with regard to the revenue obtained from them, it can be argued that this is not the main objective of these schemes, and this is demonstrated in practice.

“Small taxpayers, despite comprising the highest percentage of total taxpayers, according to a report by the IDB, have an average revenue collection ranging from 0.1% to 4% of total income in Latin American countries, depending on the country”⁷¹.

⁷¹ González, Darío (2017): “Regímenes Especiales de Tributación para Pequeños Contribuyentes”, EDICON, Consejo Profesional de Ciencias Económicas, Buenos Aires.

c) Inclusion of social security resources

In this study, third-generation regimes were characterised as those which, in addition to taxes, include social security resources in the substitution of social security resources.

These resources can be classified as: a) employer social security contributions, b) employee social security contributions in relation to employment, c) social security contributions of self-employed workers, and d) health insurance contributions.

This section includes Simplified Presumptive Regimes that encompass social security resources in some form. Therefore, Preferential Regimes where the general regime is applied and thus limited to applying a deduction for employer social security contributions, such as in the case of the Simplified Tax Regime (RST) in Colombia, are not included.

“It is worth noting that there are 8 (eight) regimes in the region that encompass these resources, belonging to regimes in Argentina (3), Brazil (2), Peru (1), and Uruguay (2)”

The regimes aimed at individuals, which substitute the personal social security contribution at a preferential cost, are six (6).

Only one regime substitutes the employer’s social security contribution, the SIMPLE NACIONAL of Brazil. Previously, the MONOTRIBUTO of Argentina also did so, but in a subsequent reform, that possibility was repealed, allowing only the contribution of the individual autonomous taxpayer.

However, the techniques used were different: the SIMPLE NACIONAL applies a percentage of gross income, while the MONOTRIBUTO applied the fixed fee technique for each registered employee.

Below, the table will detail the current regimes in the region that include social security resources and their respective concepts:

Table 12. Simplified Presumptive Regimes for taxpayers with the lowest taxpaying capacity in Latin America. Replacement RRSS.

Country	Regime	Personal contributions	Employer's social security contributions	Health insurance
Argentina	Monotributo	x	--	x
Argentina	Social Monotributo	x	--	x
Argentina	Social Inclusion and Promotion of Self-Employment	x	--	--
Brazil	MEI	x	--	--
Brazil	SIMPLES NACIONAL	--	x	--
Peru	NRUS	--	--	x
Uruguay	Monotributo	x	--	x
Uruguay	Monotributo Social Mides	x	--	x
Total	8	6	1	5

Source: own (2023)

While in the employer's social security contribution, as is customary in the general regime, a percentage is applied to the employees' payroll, in Brazil, under SIMPLES NACIONAL with preferential treatment, this contribution is replaced by a percentage of the billing, regardless of the number of employees and their payroll.

The amount of INSS⁷² paid through DAS depends on your company's activity and its annual gross income. For each main activity, a different tax rate must be paid. Simples Nacional has five annexes where activities and their tax rates are described, and for each range of annual gross income, a different rate must be paid.

With the creation of this regime, this country aimed to reduce the burden of employer social security contributions. Companies with labor-intensive operations benefit because the INSS contribution, as mentioned, is not based on the number of employees and their payroll, but rather through a tax rate defined by the economic activity and level of billing.

Conversely, companies with high levels of billing and few dependent personnel have a higher relative burden per employee. This implies a hidden subsidy from some companies to others.

⁷² National Institute of Social Security of Brazil.

However, certain economic activities under SIMPLES NACIONAL⁷³ are excluded from this substitution and must pay the employer's contribution under the general regime⁷⁴.

In Argentina, at the inception of Monotributo (which included not only individuals but also unregistered partnerships, irregular partnerships, and partnerships of persons), it also encompassed the employer's contribution to social security resources. However, in a subsequent reform, this possibility was repealed. In the Argentine case, unlike the Brazilian one, such contribution, while it existed, was a fixed fee per employee.

Regarding health insurance, there are 5 (five) regimes in three (3) countries that substitute it. The objective of this measure is to provide the beneficiary with health coverage better than that provided by the general public health service⁷⁵.

The last country to proceed with this coverage is Peru, which has included in the New RUS (NRUS) both categories of small taxpayers as long as they pay 3 consecutive installments for their affiliation to the Entrepreneurial SIS (Comprehensive Health System) with free benefits in all public health centers of the Ministry of Health and regional governments.

However, it is noted that in this country, it is not substituted simultaneously with the independent worker's social security contribution, as is done by the regimes of Argentina and Uruguay.

d) Substitution of local taxes

With the aim of improving simplicity, some regimes are not limited exclusively to the substitution of national taxes (Union, Federation, etc.) and, as detailed in the cases we have outlined, social security resources, but also encompass certain local taxes.

“This strategy falls within the framework of “single window” management, aiming to facilitate compliance for small taxpayers and achieve maximum simplification regarding formalities”

⁷³ Annex IV. For example, cleaning services, surveillance, construction of buildings and real estate.

⁷⁴ They must pay 20% of the payroll to INSS through DARF INSS (Federal Revenue Collection Document).

⁷⁵ In Argentina (Social Works), Peru (Comprehensive Health System), and Uruguay (Mutuals).

Brazil, with SIMPLES, was also a pioneer in this matter, motivated by the fiscal federalism existing in this South American country. In addition to national taxes and Union social security contributions, it included ICMS (state VAT) and ISS (municipal VAT on services).

In Argentina, Monotributo Unificado consolidates national and provincial procedures for tax payment to reduce administrative burden. It entails a fixed monthly fee and does not involve withholdings from bank accounts or debit and credit cards. Additionally, it eliminates the obligation to file monthly and annual gross income declarations (provincial tax).

The unified monotributo is intended for small taxpayers in the provinces of Entre Ríos, Mendoza, Córdoba, San Juan, Jujuy, Salta, Río Negro, Buenos Aires, Neuquén, Santa Cruz, Chaco, Catamarca, and Tierra del Fuego, who are subject to the provincial income tax of the adhering provincial tax administrations and the municipal and/or communal contribution.

This system allows for a single payment of the integrated tax, which includes: a) The national tax component (VAT and Income Tax), b) contributions to the Argentine Integrated Pension System (SIPA), c) contributions to the National Health Insurance System, d) the provincial Simplified Regime Gross Income Tax, e) the contribution affecting commercial, industrial, and service activities, provided that the municipality or commune has entered into a collaboration agreement with the Province for the collection of said tax.

In the Simplified Tax Regime (RST) of Colombia, a single annual declaration fulfills the formal duty to declare several taxes, including local taxes such as Industry and Commerce Tax, Signs and Billboards Tax, and Fire Service Surcharge.

This strategy proves effective in facilitating compliance, although it faces the difficulty that inter-jurisdictional agreements must first be reached, a process that often delays implementation.

4. Preferential regimes: benefits granted

The other modality is configured by Preferential Regimes that reduce the tax burden of micro and small enterprises within the general tax regime in the Income Tax through the following modalities: a) reduction of the corporate tax rate, and b) granting of tax benefits.

In the first modality, differentiated tax rates are applied to favor lower-income companies within the general regime of the CIT in the tax system. For example, Argentina (20% and 25%, with the general rate at 30%), Costa Rica (5%, 10%, 15%, and 20%, with the general rate at

30%), El Salvador (25%, with the general rate at 30%), Guatemala (Small Businesses 5% and 7%), Venezuela (15% and 22%, with the general rate at 34 %) ⁷⁶.

These benefits to micro and small businesses are generally granted within the general regime, although in some cases, they are included in a special regime.

Within a special regime, Peru grants it to small businesses under the Tax Regime for Micro and Small Enterprises (RMT) to those small businesses that have a billing limit and applies the exclusion of taxpayers with direct or indirect capital linkage that exceeds an annual income limit together.

The reduction of the CIT rate (Corporate Income Tax) is applied up to a certain annual income with a rate of 10%, while the excess is taxed at the general rate of 29.5%.

In OECD countries, this strategy is implemented by Belgium, Canada, France, Hungary, Korea, Luxembourg, the Netherlands, Portugal, Spain and the USA. ⁷⁷

Regarding the reduction of the Social Security Contributions rate for SMEs, Argentina can be cited as an example.

Regarding this, it is worth noting that in Europe, exemptions (through subsidies) and reductions in social contributions are granted to so-called social enterprises. These are companies engaged in commercial activities (business/economic dimension) with the aim of achieving a social or societal common good (social dimension) and have an organization or ownership system that reflects their mission (governance/inclusive ownership dimension).

According to the European Commission (2020) ⁷⁸, social enterprises can be identified by organizational definitions (prioritization of social objectives, specific restrictions on profit distribution, and governance) or by their purpose (prioritizing the integration of disadvantaged workers and/or those with disabilities).

⁷⁶ González, Darío (2022): “*Corporate Tax: its application in America*”, Blog CIAT.
<https://www.ciat.org/ciatblog-impuesto-sobre-las-sociedades-su-aplicacion-en-america/?lang=en>

⁷⁷ OECD (2015) “Taxation of SMEs in OECD and G20 Countries”, Tax Policy Studies.

⁷⁸ “Borgaza, C. et al. (2020): “*Las empresas sociales y sus ecosistemas en Europa*”, European Commission”
<https://www.emes.net/conferenciateruel/wp-content/uploads/2021/02/Informe-comparativo-On-line.pdf>

In contrast, in Latin America, its development and current treatment are still in their early stages⁷⁹.

Regarding the granting of tax benefits to small businesses within the general regime, particularly in the Income Tax, benefits are typically applied concerning accelerated depreciations, carrying forward of losses (tax losses), tax credits for investment, tax credits for R&D (Research + Development), and benefits that involve the reduction or exemption of tax obligations as well as social security contributions.

5. Trends in simplified schemes

It is appropriate to analyze over an extended period to understand the trend of these regimes and to gain insight into the tax strategy they have adopted in the past and currently.

In an initial phase, as noted since the 1970s/1980s, the trend was to replace VAT through a simplified regime. This was the tax with the highest collection, and tax strategists focused on the deviations they had observed in its compliance.

Among them, certain economic activities and taxpayers with lower contributory capacity stood out. The concern extended to the effects that this non-compliance had on the rest of the taxpayers, considering the social contagion it could provoke.

Subsequently, these regimes evolved into what are known as second and third-generation regimes.

In 2006, I conducted a study for the Inter-American Development Bank (IDB) to ascertain the prevailing regimes in the countries of the region and their main characteristics.

The same study remains extremely useful today, allowing for a comparison of the current situation with the prevailing special regimes and thus analyzing the current trend.

As a result, the next graph will present a comparative study of 19 countries between 2006 and 2023, classifying them by the taxes or resources replaced:

⁷⁹ Prado, Andrea (2020): “*Emprendimiento Social en América Latina: Buenas prácticas para llevar productos y servicios a poblaciones rurales de escasos recursos*”, INCAE Business School.

<https://cnnspanol.cnn.com/wp-content/uploads/2021/06/>

[Reporte-Emprendimiento-Social-en-Ame%CC%81rica-Latina_Andrea-Prado-INCAE_VF.pdf](#)

Table 13. Simplified tax regimes for lower capacity taxpayers in Latin America

Regimes		
Replacement	2006	2023
Regimes	31	39
Single tax	12	16
Taxes	11	11
Taxes and RRSS	5	8
Formal simplification	3	4
Countries without special regime	4	3

Source: own (2023)

After 17 years, it is observed that the total number of regimes has increased by 8 (eight), with a slight increase in regimes that replace only one tax by 4 (four), while those comprising more than one tax (generally VAT and IT) have remained constant during this period).

Integrated systems covering both taxes and social security contributions increased by 3 (three), while those considering only the formal simplification of small taxpayers increased by 1 (one) only. Currently, only 3 (three) countries do not apply special regimes, whereas in 2006, there were 4 (four).

“At first glance, there seems to be a trend towards the incorporation of new regimes in the tax systems of the region. Further analysis reveals that many regimes have been reformed or replaced by others in a dynamic and continuous process of reforms”

This demonstrates a high turnover rate and a search for best practices in the field. This provides essential material for analyzing the reasons behind failed experiences.

Of the simplified regimes in force in 2006, there are now 19 new ones. That is to say, 50% of the current regimes have been created over the analyzed period. This excludes the corrective reforms made to the old regimes that are still in force.

This implies that there is a constant observation by the policymakers of the countries in the region to analyze the results obtained by each regime. In case the proposed⁸⁰, objectives are

⁸⁰ However, in some countries, despite not achieving the expected results due to resistance from affiliated sectors, certain attempts to modify them have been unsuccessful.

not achieved, there has been the substitution or reform of existing regimes or the inclusion of new regimes to incorporate specific regulations that were not initially considered.

This demonstrates the interest aroused in both politics and tax administration by their effectiveness, and the need for their constant adaptation to the changing socio-economic and tax reality of the countries in the area.



TITLE II
TAX POLICY AND
ADMINISTRATION STRATEGIES

Tax policy makers have debated from the outset about the policy to be applied regarding individual small taxpayers. The focus has been on the following dilemma regarding VAT: exemption versus special regime. Concern did not reside in the Income Tax since, due to the application of the minimum non-taxable amount, they were not subject to this tax.

Supporters of VAT exemption argued that given the low level of income and administrative organization, its imposition is not of interest to the Treasury. In another context, most European countries have followed this strategy.

Fiscal interest was defined based on the level of billing or turnover. Legislation established the amount, thus taxpayers with lower billing were exempt, while those exceeding it were required to pay VAT under the general regime.

Obviously, the leap from exemption to imposition was enormous, not only due to the tax burden but also due to the costs of formal compliance. As mentioned in the first section on simplification, this cost for individuals sometimes meant doubling the tax burden, which became a serious obstacle.

There are two modalities for applying VAT exemption: a) without registration with the Tax Authority, and b) with registration and compliance with some formal duties.

The reaction of small taxpayers was to avoid VAT imposition as much as possible. As a result, they either did not invoice or artificially reduced their sales or service provision to avoid reaching the exemption threshold.

“This sector operates in the informal economy, which can reach significant proportions. As a side effect, it undermines the control over taxpayers with higher capacity to contribute”

The CIAT, in its Technical Conference of 1994, focused on it as the most important issue of the moment, analyzing it under the title of “Addressing Critical Aspects in VAT Control”⁸¹.

At that Conference⁸², the issue was also analyzed under the title “Administration of Hard-to-Control Taxpayers,” where taxpayers with lower contributive capacity, along with those engaged in certain economic activities, were the focus of tax management concerns.

⁸¹ CIAT (1994): “*Solución de Aspectos Críticos en el Control del IVA*”, Conferencia Técnica 1994. <https://biblioteca.ciat.org/opac/book/2238>.

⁸² González, Darío (1994): “*La Administración de Contribuyentes de Difícil Control*”, Conferencia Técnica del CIAT (1994). <https://biblioteca.ciat.org/opac/book/2238>

It was held that:

“Small taxpayers represent one of the most challenging sectors to control, with the aggravating factor that the experience of many countries in the region indicates that tax administrations are unaware of the identity of a large portion of these individuals, given the extent to which the underground economy prevails in many cases”

The characteristics of this sector include: a) the broad universe of taxpayers involved, b) their deficient organizational level, c) the impossibility of imposing rigorous accounting practices, and d) their tendency to operate in the informal economy.

Regarding the activities of the primary sector, the following were highlighted: a) the fragmentation of economic units, b) the familial nature of many of these operations, c) the slow adoption of technological innovation processes, and d) their difficult territorial location.

To these specific characteristics, both groups added a lack of tax awareness or tax culture, which constituted an obstacle to compliance, even as they evolved economically by increasing their business turnover.

For all these reasons, it was recommended, and most countries made the decision to create a simplified VAT regime to enable, among other objectives: a) fiscal registration, b) require them to comply with minimal formal obligations, and c) control their suppliers.

Various simplified regimes were implemented with different presumptive techniques, but due to the misguided strategy applied, they did not achieve success in terms of compliance within this sector.

The target subjects were natural persons or individuals, which did not address the more complex issue of micro and small enterprises.

Later on, in some countries, their inclusion was allowed through the same regime intended for natural persons or, more precisely, by creating a specific regime considering their particular characteristics and objectives.

In this initial stage, some countries also created specific simplified regimes for Income Tax for certain economic activities (transportation, primary sector of the economy, etc.), as long as they did not exceed the parameters established by the legislation.

In the so-called second-generation special regimes, the substitution of VAT was also extended primarily to Income Tax, aiming to simplify the cost of tax compliance to the maximum extent. In some countries, specific taxes were also included in these regimes.

In contrast, third-generation regimes expanded their scope to include not only taxes but also social security contributions. This expansion aimed to promote social inclusion for individuals, allowing them to access benefits such as retirement, pensions, disability support, etc. For micro and small enterprises, the inclusion of social security contributions aimed to reduce their overall business costs, thus fostering their development.

Within this strategic framework, a debate arose regarding whether the design of these special regimes fell solely under the purview of the economic policy sector within the Ministry of Economy of each respective country or if it was primarily a matter for the tax administration due to its causes and objectives.

“Another interesting debate revolves around whether the creation of a special regime is a matter of tax policy or tax administration”

Reconciling the positions, one could say that while it’s a matter of tax policy, its essence makes it of paramount importance for tax administration management.

Indeed, this is because fundamentally it’s not just a matter of orthodox tax imposition techniques, but rather of management. Hence, the involvement of the tax authority in its design and elaboration is of paramount importance.

Absolutely, it can be argued that the poor design of many of these regimes stemmed from the lack of active involvement of the tax authority in their creation.

As developed in Title I, there is a trend in the countries of the region towards the incorporation of new regimes in tax systems. Further analysis reveals that many regimes have been reformed or replaced by others in a dynamic and continuous process of reforms.

Of the simplified regimes in force in 2006, there are now 19 new ones. In other words, 50% of the current regimes have been created over the analyzed period. This does not include the corrective reforms made to the old regimes that are still in force.

So many changes imply a reality: many of the regimes created did not meet the objectives for which they were implemented.

Following the “Chesterton’s fence rule⁸³”, which means thoroughly considering the reasons why a special regime was established and its consequences, and then correlating the background with the unmet objectives, one can reasonably propose reforms to improve it.

Reforms without a prior analysis of the real causes that led to the failure of an institution could result in an even greater failure. Therefore, it is of utmost interest not only to understand the background of the tax reality of that country but also to learn about the best practices of countries in the region that operate in similar socio-economic contexts.

It is arguable that the evolution of these special regimes has not yet reached the point of maturity at the international level to consolidate a solid tax architecture.

The strategies vary from region to region, so while presumptive simplified regimes predominate in Latin America, they are also common in Sub-Saharan Africa and countries in Asia that were former Soviet Union members. In OECD countries, preferential regimes within the general tax system prevail, similar to those in Central and Eastern European countries.

The tight deadlines often imposed on tax policy makers undermine the success of reforming these regimes, as with any other reform effort.

In this section, both best practices and unintended consequences that have impacted the overall tax system will be analyzed within the strategies applied.

It has been observed that in the design of a special regime, the focus has been primarily on the objectives sought, but not as much attention has been paid to the unintended consequences it may entail.

Undoubtedly, the special regime is designed, and the tax authority’s management is developed in accordance with the objectives through established procedures.

Another aspect that hasn’t been given much consideration is the analysis of fiscal sociology regarding the behavior of small taxpayers towards the new regime or its reform.

Often, public authorities have erred on the side of voluntarism, but reality shows us that the effectiveness of a measure requires a comprehensive analysis of all the components at play.

⁸³ British writer, philosopher and journalist of the early 20th century. It is also known as “Chesterton’s Fence”, in which the author argued that in order to abolish or reform any institution, one must first know the background, i.e. the reasons why it was created, to avoid doing unthinkable harm by impulsive change. “Chesterton’s fence, the principle that forces you to think twice before making changes”, BBC (2024). <https://www.bbc.com/mundo/articles/c1r24dqjrxo>

The behavior of taxpayers is essential for the effective compliance of these regimes, which are largely voluntary⁸⁴. Another mistake was to extend the behavior of taxpayers from the general regime, which has greater administrative organization and tax culture, to small taxpayers, which has not proven to be accurate.

Each taxpayer sector exhibits different behaviors, and it's necessary to segment them for analysis: very small individual taxpayers and micro and small businesses. The latter should be approached from a business perspective.

Furthermore, another overlooked element was the territorial aspect or the location of small taxpayers. Depending on their geographical area, they exhibit very different behaviors and therefore also require specific measures.

Indeed, concerning the lack of consideration for unintended effects from the implementation of these regimes, the good news is that there are anti-abuse measures or best practices that can be applied to mitigate or prevent these deviations, which cause serious harm not only to the special regime but to the entire tax system as well.

The unfortunate reality is that these measures are rarely employed, and by the time the need for their implementation is recognized, it is often too late, given the distortion that the regime has undergone in its application and in the behavior of taxpayers.

Finally, it is worth noting that regimes based solely on risk perception have failed, while those that have succeeded have combined their strategy with the perception of benefit.

Therefore, this perception cannot be overlooked if changes in taxpayer behavior are sought, especially when many of them operate in the informal sector or under outdated special regimes with minimal levels of tax culture.

⁸⁴ Except for Cuba, where the special regime is compulsory.

Theoretical analyses by tax policy formulators were gradually reflected in the implementation of specific regimes, some of which, it is worth noting, were highly innovative and creative⁸⁵. However, as always, it was reality that demonstrated their success or failure.

Firstly, it is not appropriate to apply the theory of classical orthodox taxes to special regimes.

“Many grand theories have crashed against the simplest reality, so the initial conclusion regarding the appropriateness of these regimes, the definition of their characteristics, and their results, is eminently pragmatic”

Hence, the numerous stumbles observed in the last 50 years provide substantial material to leverage this valuable experience, to avoid repeating the same mistakes in creating new regimes.

However, the successes we have achieved also allow us to highlight best practices, even if some collide with the general theory of taxation, since these regimes, it is worth noting, have their own objectives and principles, as extensively developed in the first title.

Next, we will delve into the main best practices applied in the countries of the region:

1. Simplicity in assessment and control.

It was mentioned that these regimes should be simple, meaning easy to calculate and comply with for the taxpayer, but they should also be easy to monitor by the tax administration.

⁸⁵ An example can be cited in Mexico, a country that has been very innovative in designing tax measures both at the level of the orthodox general regime (such as the Asset Tax, IETU, etc.) and for small taxpayers (REPECOS, RIF, and currently RESICO). However, regarding special regimes for small taxpayers, it has not yet found the design that reaches the necessary level of maturity to solve the problems of informality among individual taxpayers and to implement policies to support micro and small businesses.

Some regimes were easy for taxpayers to comply with but difficult for tax authorities to monitor, while others were easily monitored by tax authorities but difficult for taxpayers to comply with.

Clearly, special regimes that were complicated for both taxpayers and tax authorities do not deserve our consideration. Instead, we should lament the poor strategy deployed and the unnecessary costs they have incurred.

The most accurate objective is to reach a reasonable middle ground so that it is as simple as possible for both parties involved, the active subject of the tax obligation (the Treasury) and the passive subject (the small taxpayer).

“Simplicity operates on a dual track and is not just “one way”. The special regime must be simple both for compliance by the small taxpayer and for monitoring by the tax administration”.

Another lesson learned was that these regimes, when limited to replacing a single tax such as VAT or Income Tax, should not employ a complex presumptive technique to approximate the closest income or value added to reality.

Simplicity is achieved through generalization based on indices, averages, estimates, indicators, etc., which allow inferring a level of income or value added of a general nature by economic sectors.

Applying techniques for each particular situation, with the introduction of multiple corrective indices, increases the complexity of the system.

Taxes under the general regime became complex due to the need to capture the real value added or income in the face of disparate economic transactions, thus necessitating the articulation based on multiple precise provisions to account for the myriad operations occurring in economic reality. However, this pursuit led to them becoming complex taxes to understand and calculate, with a high compliance cost.

“In special regimes, greater simplicity often means less equity, and vice versa. Greater equity tends to reduce simplicity, so it’s crucial to resist the temptation to make them overly complicated”

Pretending a regime to be both simple and equitable is unrealistic. These alternatives are contradictory. This confusion has led to the implementation of special regimes so complex that they are referred to as complicated regimes.

Therefore, it is contradictory for a simplified regime to be complicated, as it distorts its basic objective.

Although this reflection may seem like common sense, in practice, numerous regimes have made this basic mistake. In an attempt to avoid distortions in value added or income, they created provisions and a structure so complex that it only increased their complexity.

In practice, this utmost simplicity has been achieved concerning individual persons in simplified flat-rate regimes and concerning micro and small businesses through the application of a percentage on gross income, albeit with the caveats and characteristics that will be developed in specific points of this study.

2. Perception of risk and perception of benefit

In the realm of tax administration, there was a strategic error that took decades to correct, resulting in multiple failures in the implementation of these regimes. Initially, the exclusive objective was to increase revenue, and efforts were made to improve compliance based on the perception of risk, under intimations or threats to apply the punitive regime of the Tax Code, ranging from fines to the closure of premises.

Perceived risk is considered as the psychological or subjective probability related to the degree of confidence or belief that a person has about the occurrence of an event.

Fiscal risk management is defined as the process of identifying, analyzing, and quantifying the probabilities of damages and secondary effects arising from tax non-compliance to adjust one's behavior to these probabilities.

The subjective belief of the evader that their misconduct can be detected and sanctioned, along with the assessment of the losses (economic and social) they may suffer, can motivate tax compliance behavior.

For taxpayers in general, one of the most significant factors influencing tax compliance is fiscal discipline⁸⁶, understood as the ability of taxpayers to fulfill their obligations consistently and accurately, driven by their perception of risk.

⁸⁶ González, Darío (2020): "Morality, conscience, and tax discipline: their role in tax compliance", Blog CIAT <https://www.ciat.org/morality-conscience-and-tax-discipline-their-role-in-tax-compliance/?lang=en>

Recently, behavioral insights techniques (“Behavioural Insights” – BI)⁸⁷ have been added to this, which serve to identify taxpayers’ behavioral problems, their causes, their perceptions, to subsequently determine the appropriate strategy for the reality, enabling a positive change in taxpayers’ compliance with tax obligations.

It places great importance on the social context as a determinant of taxpayer behavior and relies on proven behavioral evidence, which often contradicts behaviors based on rational decisions or classical theories of economic behavior (such as utility theory in economic psychology)⁸⁸.

While risk perception is a determining factor in the behavior of taxpayers with medium and high income levels, it has not been configured with the same weight concerning small taxpayers, where the perception of benefit has been a more significant factor.

The tax administration was unable to instill a motivating perception of risk in the behavior of individual small taxpayers, consequently, voluntary compliance was not attained.

This was primarily due to the large informal sector, the limited enforcement actions targeting this sector considering the cost-benefit ratio (driven by the low potential tax revenue to be collected), and the political pressure exerted by their associations through so-called “tax rebellions” in response to the mass controls carried out by the tax administration.

The contagious effect of this misconduct eventually solidified this attitude, against which fiscal authorities were unable to do much.

Therefore, in light of the failure of this strategy based solely on risk perception, it was deemed more viable to also foster a “perception of benefit,” that is, to increase the belief that tax registration and compliance would bring more benefits than drawbacks.

“In these regimes, those that based their strategy on applying both the perception of benefit and those that solely relied on the perception of risk were more successful”

⁸⁷ OCDE (2017). “Behavioural Insights and Public Policy. Lessons from Around the World,” Paris.

⁸⁸ González, Darío (2023): “The application of tax psychology/tax sociology and behavioral sciences to improve tax compliance”, Blog CIAT
<https://www.ciat.org/ciatblog-la-aplicacion-de-la-psicologiasociologia-fiscal-y-las-ciencias-del-comportamiento-para-mejorar-el-cumplimiento-tributario/?lang=en>

The original strategy, which solely aimed at increasing revenue from this sector under the threat of sanctions, gradually shifted to other objectives.

Simplification, formalization, social inclusion for individual taxpayers, promotion, reduction of compliance costs, and tax burden for micro and small businesses became the new desirable goals in their design.

In this new stage, in countries that implemented it, there was a massive increase in enrollments in these regimes, as taxpayers understood the benefits that registration brought them.

For example, this significant increase in adherents to special regimes compared to the total number of taxpayers is observed in several countries: in Brazil⁸⁹ the MEI has 15.634.106 adherents, the SIMPLES NACIONAL 22.457.156, in Perú⁹⁰ the RER has 552,500, the New RUS 1,491,400, the MYPE 1,046,700; in Argentina, the Monotributo independent has 2.241.228⁹¹, in Colombia⁹² the RST has 109.882⁹³, in Mexico⁹⁴ the RESICO has 1.475.616, in Uruguay⁹⁵ the Monotributo General and the MIDES have 46.198, etc.

However, this perception of benefit must be accompanied by the perception of risk, which currently manifests in the exclusion from the special regime in case of significant non-compliance with its requirements.

3. Formalisation

Informal labor is a structural characteristic in countries across Latin America and the Caribbean.

In the region, the phenomenon of informality is largely driven by social inequality, which is rooted in socio-economic, ethnic and racial, age-related, gender, and geographical location disparities.

⁸⁹ Source: “Receita Federal do Brasil”. Data up to October 2023.

⁹⁰ Source: SUNAT (Peru). Data as of November 2023.

⁹¹ Source: AFIP (Argentina). Data as of September 2023. Does not include adherents to the Social Monotributo, nor the “monotributistas” that also have an activity in relation of dependency.

⁹² Source: DIAN (Colombia). Data as of October 2023.

⁹³ Behavior of new enrollees: 2019 (7.1%), 2020 (12.9%), 2021 (19.4%), 2022 (25.8%) and 2023 (38.7%).

⁹⁴ Source: SAT (Mexico). Data as of the second quarter 2023.

⁹⁵ Source: BPS (Uruguay). Data up to 2022.

According to the ILO (2023)⁹⁶ the average informality rate in the labor markets of the region stood at 48 percent by mid-2023. However, in some countries, it exceeded 70 percent.

Informal occupations have contributed to the creation of between 40 and 95 percent of jobs between the third quarter of 2020 and the second quarter of 2023.

This data implies that informality rates continue to increase in countries across the region, which should draw the attention of policymakers to improve strategies aimed at reducing it.

In the analysis of this issue, many analysts consider small individual taxpayers who have joined a special regime for self-employed individuals as “formally” compliant with tax obligations. However, what should really be considered, in addition to registration, is whether they are actively engaged in economic activities.

“The objective of special regimes is not merely the registration of small taxpayers but, once registered, to ensure that they are active, meaning they submit the required declarations and payments”

This conclusion is reached because it has been observed that in many countries, a large portion of them, once enrolled in these regimes to obtain the credential and associated benefits, become inactive.

RESICO (Mexico) – RST (Colombia)

In this regime, it is observed that out of 3.000.000 small taxpayers in the registry, only 1.475.616 are active⁹⁷, and in Colombia’s RST, out of 124.500 registered, only a fraction is active 109.882⁹⁸.

⁹⁶ OIT (2023): “Panorama laboral de América Latina y el Caribe 2023”, <https://www.ilo.org/es/publications/flagship-reports/panorama-laboral-2023-de-america-latina-y-el-caribe>

⁹⁷ When the REPECOS regime was timely applied, the same distortion was evident. The Taxpayer Advocate’s Office had reported in 2013 that only 6% of those registered complied with their obligations.

⁹⁸ In Argentina’s Monotributo system, if a taxpayer fails to make payments for 10 consecutive months, they are automatically deregistered from the regime.

In this regard, the best practice to maintain an active registry is to exclude small taxpayers from the regime when they show no activity within a certain period of time⁹⁹.

“Another issue to consider in analyzing this sector is the high level of mortality among small enterprises”

MEI – SIMPLES NACIONAL (Brazil)

According to SEBRAE, the sector of individual microentrepreneurs (MEI) has the highest business mortality rate within five years, according to the Business Survival Survey (2020), conducted based on data from the Federal Revenue (tax administration) and field surveys.

From these studies, it is evident that the mortality rate in this business sector is 29%. Meanwhile, in the SIMPLES NACIONAL, microenterprises have a mortality rate of 21.6% and small enterprises of 17%.

When analyzing survival rates by sectors, the survey revealed that the highest mortality rate occurs in the commerce sector, where 30.2% close their doors within five years. This is followed by the manufacturing industry (27.3%) and services (26.6%). The lowest mortality rates are found in the extractive industry (14.3%) and agriculture (18%).

Minas Gerais has the highest mortality rate at 30%. The Federal District, Rondônia, Rio Grande do Sul, and Santa Catarina had a rate of 29%. Amazonas and Piauí had the lowest mortality rates (22%), followed by Amapá, Maranhão, and Rio de Janeiro (23%).

A study by SEBRAE suggests that three out of every 10 small taxpayers conclude their activities after five years in the MEI. Therefore, it emphasizes that to keep microenterprises active, knowledge of administration, planning, and finances is also required.

According to this organization, the strength of MEI is due to the improvement of the business environment in Brazil and the consolidation of the legal status of the Individual Microentrepreneur (MEI). With a straightforward opening process and low tax burden, MEI has been the primary option for those who want to start a business.

⁹⁹ In the Monotributo system, automatic deregistration occurs when there is no activity in the regime (declarations, payments) for a period of 10 consecutive months.

In comparison, the SIMPLES NACIONAL regime, designed for micro and small businesses with a higher billing cap than MEI, Azuara and others (2019)¹⁰⁰ argue that the adherence rates to SIMPLES NACIONAL are higher compared to the general regime. However, the deregistration rates are lower, implying higher survival rates of businesses in the presumptive regime compared to the general one.

As observed in Brazil, the informality rate varies from region to region depending on the economic and social structure of each, as also emerges from the study conducted in Peru by ComexPerú.

Given that the production of SMEs is mainly oriented towards the domestic market, their performance is strongly influenced by macroeconomic conditions. Therefore, situations of macroeconomic instability and GDP decline significantly affect both the production level and employment of these taxpayers.

Although the net result, in terms of employment, may be positive (especially for microenterprises), there is a reduction in real wages and an increase in labor instability, which is accentuated in the case of smaller companies¹⁰¹.

“Business mortality significantly decreases with a government promotion policy in place”

The success of MEI confirms that formalization policies yield better results when implemented as a comprehensive package (awareness-raising, regulatory simplification, tax incentives, financial incentives, and compliance) rather than as single, standalone policies (Jessen and Kluve, 2019).

In the same vein, Marchese (2021)¹⁰² argues that “... widespread formalization is the long-term result of the structural transformation of the economy and the implementation

¹⁰⁰ Azuara Herrera O., Pagés C., Rucci G., Amaral N., Ospino C., Torres J., González S. (2019): “The future of work in Latin America and the Caribbean. What are the most in-demand occupations and emerging skills in the region? IDB.

¹⁰¹ Although during times of crisis, self-managed enterprises within the subsistence economy tend to increase.

¹⁰² Marchese, Marco (2021): “Regímenes Tributarios Preferenciales para Mipyme. Aspectos operativos, pruebas de impacto y lecciones en materia de políticas públicas”, Working Paper 33, ILO.

of a variety of institutional policies. As such, preferential taxation can contribute to encouraging formalization, but only if it is part of a broader set of policies aimed at improving the overall business environment, increasing sectoral productivity (for example, value chain development), and business-level productivity (development services and business training), simplifying regulations, providing financial incentives, and enhancing enforcement.”

“The successful experience of countries has demonstrated that it is a sound strategy to implement a policy of social inclusion and cohesion for individuals and promotion for micro and small enterprises”

However, there is still an outstanding issue in the design of these regimes, as evidenced by the detailed cases of Brazil, Mexico, and Peru, where significant variation in the level of informality is observed among regions within the same country.

Therefore, it is not reasonable to apply the same response to dissimilar situations. The different socioeconomic and cultural context of each region enables the implementation of more beneficial measures for taxpayers in regions where there is a high rate of informality, higher than the average.

There are multiple measures that could be implemented for this purpose. Among them, in fixed-rate regimes, one could apply a corrective coefficient to decrease the rate in areas with higher informality. Alternatively, in regimes based on applying taxes on gross income, one could decrease the tax rate. Additionally, increasing subsidies for social security contributions could also be considered.

Therefore, it would be a good practice to take this situation into account and adopt specific measures to improve the perception of benefit for this sector of small taxpayers (individuals or micro and small enterprises), depending on the geographic area where they carry out their activities. This way, we can increase the motivation of these economic agents to formalize.

4. Number of regimes (uniqueness or multiplicity)

In the early stages of their creation, simplified regimes were aimed at natural persons and were generally applied to VAT. They were also applied in some countries to Income Tax.

The compliance cost had not decreased significantly because the taxpayer still had to comply with the rest of their tax and social security obligations under the complex general regime.

At the same time, authorities began to realize the importance of micro and small enterprises, as well as the specific obstacles they faced due to their weaknesses in fully developing in the economy.

This prompted, given their different issues and objectives, the need to create specific regimes for this sector.

“Given the different issues and objectives involved, regimes for individuals and those aimed at micro and small enterprises require different specific treatments”

It is up to the legislation of each country to define the subjects of each special regime: a) individuals, and b) micro and small enterprises.

Regarding individual taxpayers, their nature as natural persons is a key factor¹⁰³. Other requirements, apart from the level of billing, have been incorporated into their definition, such as assets, the number of economic units (premises, vehicles, etc.), personnel involved in the activity, level of acquisitions, etc.

Regarding micro and small enterprises, while some regimes require the status of a legal entity, others accept individuals¹⁰⁴ with the fulfillment of certain requirements regarding turnover, employees, assets, etc.

While certain international technical documents encompass SMEs from the small individual taxpayer to the medium-sized enterprise, in the present study, we have differentiated the subjects because they have different objectives and also require different tax treatment.

¹⁰³ In Brazil, regarding the MEI, a distinctive feature is observed. These subjects must register beforehand in the Registry of Legal Entities to join.

¹⁰⁴ In some cases, prior registration in the register for micro and small enterprises of the competent public authority is required.

Apart from the denomination, it is also recognized in such studies as in the Tax Dialogue International (2007)¹⁰⁵ that “...for a reasonable tax design, it is fundamental to recognize the diversity within the universe of SMEs (read taxpayers with lower contributory capacity¹⁰⁶)”.

Among individual taxpayers, a distinction is made between “very small taxpayers” and “small taxpayers.” The former refers to those in a vulnerable state who therefore require a different treatment with greater benefits aimed at achieving their formality and social inclusion through active state policies.

The primary interest in these regimes is formality and social inclusion, which is an issue of tax administration rather than prioritizing revenue collection.

Furthermore, within the tax treatment of micro and small enterprises, two alternatives are distinguished: a) application of a specific presumptive simplified regime or b) preferential treatment within the general regime.

“In practice, the joint treatment of a comprehensive special regime for both individuals and small businesses has not proven to be effective”

This is because these subjects have different needs and therefore require specific regimes with a different design to achieve the necessary objectives.

Furthermore, each segment requires different tax techniques to be applied, as well as to differentiate the most suitable benefits or promotion policies for each sector.

Conceptually, a specific simplified regime refers to the implementation of a presumptive regime that reduces compliance costs and/or tax burden.

On the contrary, we are dealing with a preferential regime for micro and small enterprises when the general regime is applied, but with the implementation of certain tax benefits for this sector¹⁰⁷.

¹⁰⁵ TDI (2007): “*Tributación de la Pequeña y Mediana Empresa*”, Background paper for the Buenos Aires conference.

¹⁰⁶ Own clarification.

¹⁰⁷ Typically, a reduction in the tax rates of the Income Tax or Social Security Contributions. In some countries, there is also the inclusion of offsetting the payment of some unorthodox taxes with orthodox taxes within the tax system.

Following this line of thought, it is appropriate to analyze the strategy followed by the countries in the region in this regard. In this regard, it can be observed that they apply multiple strategies in practice, namely:

- a) application of a single regime for individuals,
- b) multiple regimes for individuals,
- c) a regime for very small individual taxpayers and a regime for small taxpayers in general,
- d) single comprehensive regime for individuals as well as for micro and small businesses,
- e) a regime for individuals and a regime for micro and small enterprises,
- f) various schemes for individuals and for micro and small enterprises, and
- g) Several schemes for micro and small enterprises, and
- h) Several schemes for individuals and a preferential scheme for micro and small enterprises.

The diversity of strategies has been the characteristic so far, but it can also be argued that many have been successful while others have failed. Moreover, concerning those that have failed, the worst part is that their unintended effects have also spread to the overall tax system.

To clearly observe the strategies regarding the implementation of special regimes, the ones currently being practiced in the region will be described in a table, indicating the countries and their respective regimes as follows:

Table 14. Special tax regimes for small taxpayers with lower taxable capacity various strategies

Strategy	Country	Regimes
Single regime for individuals	Cuba Nicaragua	RST Simplified Flat Rate Regime
Various regimes for individuals	Bolivia	1-RTS 2-STI 3-RAU
A regime for very small individual taxpayers and a regime for small taxpayers in general	Uruguay	1-Monotributo 2-Monotributo Mides
Single regime for individuals as well as for micro and small enterprises.	Colombia Costa Rica Mexico Dominican Republic	RTS RTS RESICO RTS

(continue)

Table 14. Special tax regimes for small taxpayers with lower taxable capacity various strategies

Strategy	Country	Regimes
One regime for individuals and another for micro and small companies	Brazil	1-MEI 2-SIMPLES NACIONAL
	Ecuador	1-RIMPE – Popular Businesses 2-RIMPE – Entrepreneurs
One regime for individuals and several regimes for micro and small businesses	Peru	1-New RUS 2-RER 3-RMT
Various regimes for individuals and for micro and small companies	Chile	1- Flat Tax ISR 2- Presumptive Income 3- Simplified Taxation Regime VAT 4-Pro SME's General 5-Pro SME's Transparent
	Guatemala	1- Optional Simplified Regime on Income from Profit-making Activities 2- Small Taxpayer Regime 3- Small Taxpayer Electronic Regime 4- Special Regime for Agricultural Taxpayers 5- Special Electronic Regime for Agricultural Taxpayers
Various regimes for micro and small enterprises	Paraguay	1-IRE RESIMPLE 2-IRE SIMPLE
Various regimes for individuals and a preferential regime for micro and small enterprises in the general regime	Argentina	1-MONOTRIBUTO 2-MONOTRIBUTO SOCIAL 3- Social Inclusion and Promotion of Self-Employment Regime 4- Preferential regime for micro and small companies in the general regime

As observed from the provided table, there is no single trend in Latin America, and countries are creating regimes according to their specific needs.

However, a consolidated trend towards the multiplicity of regimes according to the subjects or economic activity included is observed.

5. Very small and small individual contributors

Three classes of subjects can be clearly distinguished: a) very small individual taxpayers, b) small individual taxpayers, and c) micro and small enterprises.

The objectives of individual self-management regimes are different from those aimed at micro and small enterprises, which is why the strategies have also been different.

Regarding very small taxpayers, considering that their taxation is focused solely on VAT¹⁰⁸, among the strategies of countries in the region, the following can be highlighted:

- a) exempting them from VAT up to a billing threshold (El Salvador, Panama, Venezuela)
- b) create a simplified VAT regime for them: b.1) with registration and compliance with minimal formal obligations (Colombia, Honduras), and b.2) with the payment of a minimum tax (Nicaragua)
- c) create a specific regime with tax exemption, but including social security contributions (Argentina, Uruguay).

“The strategy of exempting from VAT without registration or invoicing implies the non-formalization of this sector and the loss of benefits that could be obtained through formalization. It also disables a crucial source of information for tax administration to control its suppliers”

Creating a simplified VAT regime addresses the issue of information sourcing but does not resolve the problem of this sector in terms of achieving social inclusion.

Finally, the strategy of a specific regime with coverage of social security resources has proven to be the most comprehensive for the needs of this sector, achieving its formality, social security protection, and providing benefits for its economic development.

The issue of informality among very small taxpayers remains concerning in many countries in Latin America. Therefore, the strategy for this sector should be adjusted and made more proactive.

It should be understood that the strategy for this sector should not be solely focused on fiscal aspects.

The issue of informality in many countries in the region has not only remained unresolved but, on the contrary, continues to increase.

This is confirmed by the latest surveys conducted by national statistical offices. Despite potential differences in methodologies, these surveys are extremely useful for understanding the existing issues in the countries of the region.

¹⁰⁸ As they are not subject to Income Tax due to the application of the “minimum non-taxable threshold.”

Informality (Mexico)

According to Mexico's National Survey of Occupation and Employment (ENOE) for the second quarter of 2023, informality affected 55.2% of the workforce, which translates to 32.3 million workers out of a total of 58.5 million employed individuals.

Regarding one of the most vulnerable groups, street vendors, there were 1.61 million workers, of which 1.58 million were informal, representing 98% of the workforce.

It's concerning that compared to the first quarter of 2023, this sector had increased by 2.3%, indicating that the issue tends to worsen over time.

As is common in countries in the region, the figures vary when the analysis is conducted by region. For example, in Morelos, Aguascalientes, and Oaxaca, 100% of street vendors are informal. On the other hand, the region with the lowest informality among this group is Baja California, with 88.4%.

It is undeniable that the Simplified Trust Regime implemented in Mexico has not been a strategy that has mitigated the existing problem. This regime has been limited to simplifying the payment of Income Tax to make it simple, quick, and efficient¹⁰⁹

Informality (Venezuela)

The same diagnosis of informality can be extended to other countries in the region, such as the Bolivarian Republic of Venezuela, where according to the National Institute of Statistics, there are 5.8 million street vendors (referred to locally as "buhoneros") engaged in subsistence economy, accounting for 60% of the productive population.

Among the countries in the region with lower informality rates, Chile stands out, although informality remains a concern in this country as well.

¹⁰⁹ Lowering the income tax rates aims to reduce the tax burden on low-income earners.

Informality (Chile)

According to the INE (National Institute of Statistics), in its report for the second quarter of 2023, approximately 2.4 million people are engaged in informal employment in the country. This definition encompasses workers who do not contribute to the social security system (pensions, healthcare, unemployment insurance), as well as independent workers not registered with the SII (tax administration). The informality rate stands at 27.2%, indicating that nearly one-third of the active economic agents operate informally.

The concern lies in the increase in informality over the past 12 months, as it rose by 2.5%, equivalent to nearly 60,000 more individuals.

“In Latin American countries, besides the high levels of informality, the growing trend over recent years is a major concern. This underscores the urgency for authorities to implement effective measures to reverse this situation”

One successful strategy implemented by countries in the region was the establishment of sub-regimes for “very small contributors,” characterized by robust policies aimed at achieving social inclusion.

Social Monotributo (Argentina)

The case of Argentina’s Social Monotributo (2007) serves as an example of when the state implements an active social policy for this sector, extending beyond fiscal considerations.

In this country, where the Monotributo (1998)¹¹⁰ is applied, the Social Monotributo was created in 2007 for very small contributors with a high level of vulnerability. They must register with the Ministry of Social Development, and after assessing their real economic situation through ongoing audits, policies are implemented to support them, including training programs, provision of tools for their work, access to soft loans, etc. Additionally, they are exempt from paying taxes and social security contributions under the Monotributo scheme¹¹¹.

¹¹⁰ Regime for individual small taxpayers.

¹¹¹ They only need to pay 50% of the health fee (Social Security contributions).

Regarding small taxpayers in general, presumptive tax regimes have been established, replacing taxes from the general regime. In some countries, this involves a single tax (VAT), while in others, it includes multiple taxes (VAT, income tax).

The so-called third-generation regimes, those incorporating social security contributions into their framework, originated in 1998 with Argentina's Monotributo and have been the most successful in promoting formality.

Subsequently, this Argentine model was adopted by Uruguay with the Monotributo (2007) and for very small contributors through the Monotributo MIDES (2012).

This scheme was followed by Brazil with the creation of the MEI (2009).

“The integration of social security resources into the specific treatment of individual taxpayers has proven to be a significant inducement factor for their formalization”

Experience has shown, in the case of individual taxpayers, that strategies focusing solely on simplification and formality are insufficient without active public policies of assistance and cooperation, which should also encompass social security resources.

The benefits of this strategy are evidenced in the Brazilian case, as asserted by Rocha, Ulysea, and Rachter (2018)¹¹², who concluded that the MEI (Micro Individual Entrepreneur) regime, established in 2009, despite reducing tax and social security costs by fifty percent, had not achieved significant adoption.

Significant adoption occurred only after the 2011 reform, which reduced social security contributions from 11% to 5%.

Since then, adherence to this regime has continued to rise. According to the Receita Federal (Tax Administration), the number of individual microentrepreneurs (MEI) in Brazil surged from 9.7 million in February 2020 to 15.1 million in May 2023, marking a 55.6% increase.

The experience of the MEI regime demonstrates the importance that individual taxpayers attribute to social security, highlighting its perceived benefits¹¹³.

¹¹² Rocha R., Ulysea G. and Rachter L. (2018). “Do lower taxes reduce informality? Evidence from Brazil”, *Journal of Development Economics*, 134, 28-49; SEBRAE (2016), “Cinco anos do Microempreendedor Individual – MEI: um fenômeno de inclusão produtiva”, Brasília.

¹¹³ In 2020, the MEI had 11.3 million registered taxpayers, whereas in 2005, only 5.5 million were registered in this sector (OECD, 2015).

Similarly, Mas-Montserrat, Colin, Ribault, and Brys (2023)¹¹⁴ argue in an OECD working paper on taxation that single-tax regimes incorporating social security contributions have positive effects on the formalization of workers, especially the self-employed.

6. Micro and small enterprises: comprehensive policies

In many countries, there has been a growing awareness that the mere implementation of a simplified regime does not “per se” resolve all the issues faced by micro and small businesses.

In addition to reducing compliance costs and tax burdens, fostering policies play a crucial role.

“For simplified regimes to succeed, they must be part of a comprehensive policy aimed at promoting micro and small businesses”

Micro and small enterprises (Peru)

This country serves as an example to underscore the importance of micro and small enterprises (MSEs), where historically their participation in the business sector has been over 90%.

According to the National Household Survey (Enaho), in 2022, there were 6.1 million MSEs registered throughout the national territory, accounting for 96.4% of the total number of enterprises. This also indicated an increase from 2021 (+11.9%).

In addition to the growth of MSEs in the economy, there has also been a steady increase in informality within this sector in recent years, reaching 86.7% in 2022.

Despite the country having two regimes for micro and small enterprises, the RER (Special Income Regime) and the RMT (MSE Tax Regime)¹¹⁵, they have not proven attractive enough to encourage registration.

¹¹⁴ Mas-Montserrat, Colin, Ribault, Brys (2023). “La conception des régimes d’imposition forfaitaire”, Documents de travail de l’OCDE sur la fiscalité (2023). Paris.

¹¹⁵ This country also has a special regime for individual small taxpayers called NRUS (New Single Simplified Regime), which replaced the original regime known as RUS.

Experience has shown that the formalization and economic development of these entities require comprehensive policies that include access to credit, technical assistance, connectivity with the business world, access to public contracts, innovation, market development, training, etc.

Therefore, experience indicates that measures should not be limited to reducing voluntary compliance and tax burden but should also encompass promotion policies to counterbalance the weakness of this business sector, strengthen it, and promote its integration into the formal market.

Brazil's SIMPLES NACIONAL, aimed at micro and small enterprises, not only replaces national, subnational, and local taxes and contributions but also was the first regime to replace employer social security contributions¹¹⁶.

The benefits of social contributions for small businesses can be included not only in a special regime like SIMPLES NACIONAL but also through a preferential regime within the general framework, offering reductions or exemptions from contributions¹¹⁷.

7. Economic activities

The public revelation that high-income individuals with high public visibility were improperly enrolled in a simplified regime for small taxpayers has been scandalous.

Similar situations have arisen regarding the revelation that certain companies, through fraudulent maneuvers such as business division and underbilling, were obtaining benefits from a special regime.

Such situations undermine the credibility not only of the special regime but also of the tax system as a whole.

Undoubtedly, in addition to monitoring enrolled taxpayers and verifying their economic magnitude, certain economic activities must be excluded from these regimes, regardless of the declared invoicing by taxpayers.

“The conduct of certain economic activities, due to their potential profitability, is unacceptable within a regime designed for individual small taxpayers or micro and small enterprises”

¹¹⁶ The Monotributo, starting from 1998, followed this strategy, but it was later repealed in a subsequent reform.

¹¹⁷ For example, in Colombia, it's the Simple Tax Regime, while in Argentina, it's within the general regime.

The parameters of gross income and purchases alone are insufficient to qualify for enrollment in these regimes.

Therefore, the legislation of each country excludes certain economic activities from these regimes, considering them incompatible with the special regime and the benefits it provides.

It's observed that in this matter, there are two modalities:

- a) Exclusion limited to a few activities, and
- b) Broad exclusion

Within the first modality, one can cite Colombia's Simple Tax Regime, as it is limited to excluding certain activities.

RST – Exclusion of economic activities (Colombia)

Under this regime, the following economic activities are excluded:

- 1) microcredit, 2) asset management, 3) intermediation in the sale of assets, leasing of assets, and/or activities generating passive income representing 20% or more of the total gross income of the individual or legal entity, 5) factoring or “factoring”, 6) financial advisory services and/or credit structuring, 7) generation, transmission, distribution, or commercialization of electric energy, 8) manufacturing, importation, or commercialization of automobiles, 9) importation of fuels, and 10) production or commercialization of firearms, ammunition, gunpowder, explosives, and detonators.

In the second modality, we can cite Brazil, which has two special regimes: the MEI for individuals and the SIMPLES NACIONAL for micro and small enterprises.

MEI – SIMPLES NACIONAL – Exclusion of economic activities (Brazil)

The former excludes 34 activities (certain trades, manufacturing, services, etc.), while the SIMPLES NACIONAL is more comprehensive, excluding over 100 activities (certain trades, transportation, banks and financial entities, insurance, manufacturing, real estate, etc.).

Experience indicates that determining exclusions based on economic activity according to the economic context of each country is beneficial.

Régimen de Módulos – Exclusion of economic activities (Spain)

One can mention the case of Spain, where the Tax Reform of 2015 tightened requirements, resulting in the exclusion of around 150,000 self-employed individuals, particularly those in construction and maintenance activities (such as builders, carpenters, locksmiths, or plumbers), as well as industries like furniture manufacturing and road transportation.

In countries implementing this correct strategy, it has been observed that taxpayers with excluded economic activities falsely declare themselves to be engaged in permitted activities during registration to access the benefits of the regime.

Within the audit plan of the specific unit for small taxpayers, in addition to conducting checks on the parameters applied to verify compliance with the regime, it's also necessary to audit the actual economic activity to prevent such maneuvers.

Furthermore, it is opportune to promote certain economic activities that, due to their characteristics, require specific treatment to stimulate their development.

Among such activities, we can mention the knowledge economy and exports, which should have specific treatment with differentiated rules.

As analyzed in the first section, one of the issues in the economic development of Latin American countries and a contributor to social inequality is the growth of small businesses and their limited participation in exports compared to what occurs in European countries.

Therefore, among other measures, the revenue threshold for exporting companies should be increased compared to those exclusively operating in the domestic market. This measure was adopted in Brazil's SIMPLES NACIONAL.

Regarding the knowledge economy, in Argentina, a project called "Monotributo Tech" was developed for the creation of a special regime for small taxpayers in this key sector for the economy's growth¹¹⁸.

¹¹⁸ Apart from analyzing the specific measures it proposes, the strategy of providing special treatment can be considered valid. This project was approved in the Chamber of Deputies and was under consideration by the Senate in 2023.

8. Emigration to a higher regime

The objective of a simplified regime, besides providing coverage to small taxpayers, should also facilitate the transition to the general regime for enterprises that have an economic evolution that warrants it.

“The facilitation of migration to a higher regime in many experiences unfortunately was not achieved due to the “sharp jump” involved in such a transition, with the consequent significant increase in compliance costs and tax burden”

That “jump” in many situations has become an obstacle that has motivated many small taxpayers to avoid it by not reporting their actual sales or services in order to improperly remain in the special regime.

Regarding this issue, it is worth analyzing the Mexican strategy of the repealed Regime of Incorporation Fiscal (RIF) (2014-2021)¹¹⁹, whose main objective was the formalization of taxpayers operating in the informal economy, with the aim that after 10 years they could pay IT under the general regime.

This transition period was set at 10 years, starting in the first year with a 100% reduction in income tax, with a gradual reduction of 10% of the benefit each year, until fully paying this tax by the tenth year.

Regarding VAT, taxpayers with a revenue threshold for sales to final consumers were exempt.

As it did not achieve its objectives, the RIF was repealed because, as argued by Granados and Flores (2023)¹²⁰ the fiscal policy had failed in its attempts to reduce informal activities and build a tax-paying culture.

It can be emphasized that the gradual transition from one regime to another is appropriate, although the same cannot be said when it is mandatory for the entire universe of small taxpayers regardless of their economic level.

¹¹⁹ Despite its repeal, since 2022, taxpayers who were in the RIF, met the requirements stipulated by law, and exercised the option established by the SAT in a timely manner continue in the regime.

¹²⁰ Granados G.R. y Flores I.S. (2023). “El régimen simplificado de confianza en la ley del impuesto sobre la renta y su lucha contra la informalidad”, Boletín Mexicano de Derecho Comparado, Instituto de Investigaciones Jurídicas, UNAM, México.

Firstly, we could assume that most small taxpayers will remain in that situation, especially in cases of subsistence economy, and many others will close their businesses due to the high mortality rate of these small enterprises.

Therefore, it is not reasonable to compel them to migrate to the general regime, as it would entail compliance costs and tax burdens that would likely drive them into informality.

It should not be forgotten that micro and small enterprises in the region operate in limited local markets that depend on the evolution of domestic demand, have high birth and death rates, and often respond more to self-employment and survival strategies than to a dynamic of business development.

Now, regarding companies that have an economic evolution that allows them to be included in the general regime, a transition or bridge should be created to avoid a sharp leap.

“Experience indicates that migration to a higher regime should be facilitated through a bridge or transition to achieve a gradual change”

The situation varies according to each country’s tax system. Where this bridge becomes more important is when there is only one presumptive regime, and the economic development of both the individual and the company leads to direct entry into the general regime.

Different is the scenario where there is a lower-level presumptive regime, and before the general regime, there exists another presumptive regime of higher level, also of beneficial nature.

Therefore, the strategy regarding migration to a higher regime can be basically classified into two modalities: a) the “sharp leap,” which is applied in most countries, and b) the gradual transition, which unfortunately is applied in few cases.

In the first modality, migration is greatly hindered, as the compliance cost and tax burden increase abruptly, often leading to “fiscal dwarfism,” that is, fraudulently remaining in the simplified regime to continue enjoying its benefits.

But also, within a legal framework, many small businesses may be motivated to avoid their evolution and business expansion due to a tax optimization strategy.

In the second modality, we can cite the strategy followed by Brazil and Argentina, which although they have different nuances, both cushion the transition to the higher regime.

MEI – SIMPLES NACIONAL- Transition to the higher regime (Brazil)

As mentioned earlier, in this country, the Micro-Entrepreneur Individual (MEI) regime coexists up to a certain revenue level, and the SIMPLE NACIONAL for micro and small businesses with higher turnover.

Therefore, the small taxpayer who exceeds a certain revenue level does not enter the general regime but can join another special regime, which is the SIMPLES NACIONAL.

Additionally, before paying the Real Income Tax in the General Regime, they can choose to join another special presumptive regime up to a certain volume of their businesses, called the Presumptive Income Regime (Lucro Presumido).

The Brazilian Small Business Agency (SEBRAE, 2016) reported that between 50,000 and 70,000 companies migrate each year from MEI to SIMPLES NACIONAL.

Monotributo – Transition to the general regime (Argentina)

In the 2021 reform, Argentina's Monotributo, based on this transition-facilitating strategy, created a Voluntary Tax Promotion Regime for the General Regime, aimed at voluntary resignations, which lasts for 3 years. It includes a reduction in the VAT of the outstanding balance resulting from the difference between the debit and the tax credit for each period, set at 50% in the first year, 30% in the second, and 10% in the third.

Although this reform included a reduction in VAT over 3 years during the transition, it did not include a similar mechanism for the Income Tax, resulting in an incomplete strategy.

Also, starting in 2022, it created a Permanent Transition Regime to the General Regime that attempted to regulate the 12-month period prior to resignation or exclusion from the special regime when the taxpayer must retroactively assess their income under the general regime. In this context, it allows for the VAT credit that would have been invoiced to be recognized in the assessment of VAT for that period. Additionally, in Income Tax, it allows for it to be recognized as a deductible expense.

9. Management of tax administration

As stated by the OECD (2020)¹²¹ it is the responsibility of the tax administration to improve management in this taxpayer¹²² sector by undertaking the following actions:

a) Identifying the pressure points:

Understanding, considering, and addressing the compliance limitations of the sector involves identifying pressure points through direct interactions with companies or their representatives. The goal is to improve service mechanisms, support, and reduce formal tax obligations. This reduction should primarily begin with unnecessary or duplicate formal obligations. The latter is often observed in information requests. The overload originates from requests for various procedures over time, where new procedures and reports are requested without considering all existing ones.

b) Fair competition:

The tax authority's enforcement actions against micro and small informal businesses are crucial to maintaining competitiveness for formal businesses and ensuring fair burden distribution. This approach also helps prevent the negative social "contagion effect" that non-compliant businesses may cause.

c) Complementarity with other government agencies:

Implementing measures such as data sharing, joint activities, integrating procedures on their website, and eliminating certain requirements can help achieve this. In essence, moving towards a single digital office as much as possible, avoiding duplication of procedures and information requests.

d) Strategic planning for the sector:

Beyond immediate objectives, focusing on planning to improve computer systems and services for taxpayers in this sector, according to their needs, is essential.

In addition to these points highlighted by the OECD, the following actions can also be mentioned as being appropriate to apply:

1) Communications and notices:

Specifically improve communications with the taxpayer both in terms of notices and requirements,

¹²¹ OCDE (2020): Forum on tax administrations. Document cited.

¹²² It extends this scheme to medium-sized enterprises.

2) Digital management:

Priority should be given to the “machine learning” technique, i.e. when filling in the computer fields for their presentations, windows should be opened explaining what is intended with examples with a help for their elaboration.

3) Creation of the ADI (Integrated digital assistance):

For micro and small enterprises to have accurate and timely answers to their operational and technical questions.

10. Specific control unit

The lack of control in these regimes – as in any tax system – begins to cause deviations of such magnitude that end up undermining their effective implementation.

During international meetings, some tax authorities expressed that the regime in their country had not achieved the proposed objectives. However, when asked about the enforcement measures, they had implemented, they stated that few or almost none, because it is a problematic sector.

It might seem unbelievable, yet maintaining the belief that a regime can self-regulate is ultimately naive. This is a recurring error over time. Regardless of how well-designed it is, without effective oversight, it will inevitably become distorted over time.

In the field, there exists a valuable experience from a country¹²³ that once suffered from high migration of taxpayers from the general regime to the simplified regime. This occurred because the perception of enforcement in the latter was either non-existent or very low.

To reverse this situation, the organization modified its strategy and increased the likelihood of auditing taxpayers enrolled in the simplified regime to a greater extent than those with similar revenue levels in the general regime.

This paradigm shift was widely publicized, and the result was a significant migration of taxpayers from the simplified regime to the general regime.

This demonstrates the importance that the perception of enforcement has on taxpayers' behavior and emphasizes that tax authorities must not overlook its practical implementation.

¹²³ In Spain under the Modules Regime.

Not establishing a specific control unit, in other words, globalizing the oversight of this segment of taxpayers with those enrolled in the general regime, generally led to its neglect, given the low potential tax to be collected.

The unique characteristics of a special regime, along with the maneuvers to defraud it, demand on-the-ground expertise tailored to specific economic activities, geographic locations, economic circuits, and tax behaviors. This expertise should be accompanied by proprietary and third-party databases containing useful, optimal, and timely information for effective control.

As a second phase, it's crucial to highlight that once the improper inclusion of a taxpayer into these regimes is detected, their exclusion becomes another significant factor to consider.

In the general regime, Tax Codes regulate the procedures for adjustments made by tax inspection to the taxpayer. If the taxpayer rejects these adjustments, the process continues with a determination made by the tax authority, followed by an appeal process through administrative, administrative jurisdictional, and judicial instances.

However, in special regimes, there are automatic grounds for exclusion upon their mere confirmation. Hence, in some regimes, two procedures have been established: a) automatic exclusion through systemic controls, and b) automatic exclusion through on-site inspection.

Under the first procedure, exclusion occurs when the presence of any of the automatic exclusion criteria is verified. Consequently, the taxpayer's registration in the special regime is canceled, and they are re-registered in the general regime.

In the case of automatic exclusion due to an on-site inspection, it occurs when, after the conducted controls, the presence of any exclusion cause from the regime is detected. The acting official then notifies the small taxpayer of this circumstance and outlines the reasons that underpin the decision.

Upon appeal, the intervening administrative judge will assess the defense before issuing a resolution either declaring the exclusion sentence or its dismissal, as appropriate.

“In the special regimes, the ex officio or automatic exclusion of unduly adhered taxpayers through the application of a summary procedure has been very successful”

This procedure is applied in Argentina's¹²⁴ Monotributo system, and until the Covid pandemic, an average of 5,000 taxpayers were automatically excluded from the regime monthly.

The specific control unit, given the vast universe of small taxpayers, must carry out its extensive audit actions through the technological support of its database.

Although it may seem obvious at first, it is essential to verify an internal control of the operations conducted with those declared to have been carried out, in other words, their own inconsistencies. Subsequently, these should be cross-referenced with data obtained from withholding agents, perception, collection, or information, followed by their classification and analysis based on the economic activity performed.

The example in this database should be followed, obtaining data not only from the tax authority's own sources but also from contracts with third parties (especially databases of online transactions), as done by the IRS (Internal Revenue Service) of the United States. Under this approach, information on crypto assets, among other data, is obtained in the U.S.¹²⁵.

Control over small taxpayers – SAT (Guatemala)

Regarding the control of this sector of taxpayers, reference can be made to the 2023 report from the Guatemalan Tax Authority (SAT), which identified what it termed as the “taxonomy of tax non-compliance among exporters registered as small taxpayers.” In this report, it was found that these taxpayers primarily engaged in agricultural product exports but submitted nil or incomplete declarations, stating only domestic sales or services rendered in some instances.

A necessary review involves determining if there are expenses incompatible with the taxpayer's status as a small contributor. For this purpose, the information obtained from third parties is invaluable, achieved through cross-referencing the declared income of the small taxpayer with their expenses on payment cards, debit or credit, bank transactions, acquisition of vehicles, homes, premises, overseas travel, etc.

Several regimes, in addition to income, employ the presumptive technique to determine taxes or simply to monitor adherence to the regime. This includes tracking purchases of goods or payments for services received.

¹²⁴ AFIP General Resolution No. 4.309/2018.

¹²⁵ The IRS also uses them as a database to apply artificial intelligence.

The mandatory use of electronic invoicing, fiscal control units (cash registers that issue receipts), mobile invoicing, and web-based invoicing connected online with the tax authority are highly beneficial for the fiscal agency. These measures enable real-time monitoring of transactions.

With the implementation of these systems, the income or expenses of a small taxpayer are automatically recorded, enabling them to pay taxes accordingly. Additionally, if they exceed the authorized limit, they are automatically excluded from the special regime.

These regimes also require a streamlined procedure for the recategorization or adjustment of the tax due for small taxpayers who have enrolled in lower categories than appropriate or declared lower incomes or parameters than actual to pay less tax within the regime.

In summary, it can be argued that the existence of a specific control unit to detect deviations, along with streamlined processes for adjusting the tax to be paid within the special regime and for excluding taxpayers if the exclusion criteria are identified, is appropriate.

Due to its specificity, this procedure should be differentiated depending on the control, whether through computer-based methods or through on-site inspection.

11. Issuance of electronic tax receipts

The most technologically advanced administrations apply, concerning the tax receipts of small taxpayers, the obligation to issue them through one of the following modalities:

- 1)** Electronic invoice (online receipts): allows for issuing invoices, delivery notes, credit notes, and debit notes.
- 2)** Mobile invoicing: is a mobile application for generating electronic receipts, managing customer databases, products, services, and templates to customize the application to the needs of your business.
- 3)** Fiscal control unit: is a device approved by the tax authority for issuing receipts. It must be enabled and configured by an authorized technician from the equipment provider.
- 4)** Web-based invoicing: This service is optional for small taxpayers with lower incomes and allows for the issuance of receipts. It can be used from a computer or as a mobile application.

Some administrations, lacking technological advancement or in transition to it, still allow paper invoicing.

And others exempt small taxpayers from all types of invoicing, as is the case with the Simplified Taxation Regime (RTS) of Bolivia¹²⁶.

“It should be distinguished whether the use of electronic invoicing is accepted in a country without any regulation, or on the contrary, if such usage is connected to the tax authority’s databases for both control purposes and service provision”

This latter modality is relevant for tax authorities to control the economic transactions of this sector of taxpayers.

In contrast, the first modality (electronic invoicing without regulation) is not advisable, and even less so, the lack of invoicing, even in cases of exemption from VAT or in simplified regimes. This is because the tax authority loses an essential source of information for control.

Therefore, it is advisable that, in cases of VAT exemption under an income threshold and for small taxpayers enrolled in a special regime, the modality of registration and issuance of receipts (preferably electronic connected to the tax authority’s database) be adopted).

In some countries, such a measure may provoke resistance from organized small taxpayers who wish to avoid being monitored, as recently happened with those enrolled in Bolivia’s Simplified Regime, who are still exempt from issuing invoices.

Another example that can be cited is Costa Rica, where in the Simplified Taxation Regime for small taxpayers, they are not required to issue receipts for their sales¹²⁷; they only need to keep records of purchases and the “Purchase Register”.

Out of the 18 countries analyzed in the region, it is observed that ten (10) have already adopted electronic invoicing or an equivalent document connected to the tax authority’s database, while three (3) are in the process of massification, three (3) are in the project phase, and it is only in two (2) countries where it is not applied¹²⁸.

¹²⁶ La Razón, 28/7/23 “The National Tax Service reiterates that taxpayers under the Simplified Regime do not issue invoices.”

¹²⁷ Unless the sale exceeds 5% of a base salary or is requested by the buyer. Voluntarily, they can use electronic receipts using the emitter-receiver non-confirmant figure. If they do not choose this procedure, when their client is under the general regime and requests the receipt, they can issue a pre-printed receipt with certain information.

¹²⁸ González, D. y Zambrano, R. (2021): “Value Added Tax: its application in America ”, Blog CIAT.

This process, which begins with taxpayers in the general regime and includes a transition period, is ideal for extension to small taxpayers, as several countries have already done.

It is also appropriate for the inventory of business assets to be supported by purchase invoices. Otherwise, this circumstance should be considered as a reason for exclusion from the regime.

Concurrently with those enrolled in a special regime, they should be required, under penalty of exclusion if they fail to do so, to provide receipts for their purchases or services received. This is to control the chains of commercialization, distribution, and previous production.

It should be remembered that the perception of risk in these special regimes does not lie so much in the recategorization or adjustment of the tax to be paid at another rate, given the small difference in tax payable, but rather in the potential exclusion from the regime and the consequent loss of its benefits.

The implementation of a special regime for taxpayers with lower contributory capacity can lead to unintended effects on the tax system.

In this study, “unintended effects” are considered to be the negative, harmful, or detrimental consequences that the implementation of this type of regime has had on the tax systems of the countries in the region.

While tax policy makers focus on the objectives to be achieved with the creation, replacement, or adaptation of a special regime, they often do not pay much attention to the harmful effects it may entail. Therefore, they do not “ab initio” consider applying anti-abuse measures to neutralize them.

The objectives of tax policy and administration are clear and were defined in the first section for each sector of small taxpayers. However, it must be emphasized that these are theoretical objectives that have driven the creation of these regimes, but it is evident that their implementation has also entailed negative effects.

“The harmful effects of these regimes must be evaluated in order to adopt anti-abuse measures in their design or reform, or else accept the inevitable costs that the decisions taken may generate”

Beyond the cost-benefit relationship that any tax policy decision may entail, the expectation is to avoid or minimize unintended effects to improve the tax system.

It is important not to overlook the correlation between informality, special regimes, and the general regime, and that the measures taken in one segment impact the others, thus affecting the system as a whole.

From the outset, in the design phase, the negative consequences that could arise should be considered, and anti-abuse measures of the regime should be applied within the socio-economic and cultural context of each country.

“The tax doctrine or literature has primarily focused on the objectives sought and the characteristics of each regime, but has not paid the same attention to the harmful effects”

This unequal treatment has caused tax policy makers to pay less attention to the design of a special regime regarding unintended effects. There is a misconception that the benefits obtained by achieving the objectives would automatically nullify any deviations.

This neglect occurs in a context where the design of a special regime is generally carried out under urgent circumstances. It often uses existing models’ trends or fads as a benchmark, without investigating or considering to the same extent the negative effects they have had or currently have.

“The worst-case scenario, unfortunately, which has occurred many times, is not only that the special regime fails to achieve its set objectives but also that it causes distortions in the tax system”

Therefore, in this chapter, we will discuss the main unintended effects of special regimes observed in the countries of the region up to the present:

1. Fiscal dwarfism

In doctrine, the behavior of taxpayers whose economic magnitude does not match their declared fiscal status has been termed “fiscal dwarfism.”

That is, these are individuals or entities whose economic magnitude should place them under a higher or general regime, but they minimize their fiscal exposure to improperly join a smaller-scale special regime. In other words, they wrongly become “fiscal dwarfs.”

Another form of fiscal dwarfism occurs within the same special regime when the majority of adherents are positioned in the two lowest categories or at the lower gross income level, in order to improperly decrease their tax liability.

“For the analysis of the design of these special regimes, it is important to distinguish between fiscal dwarfism and tax optimization”

Fiscal dwarfism is a fraudulent behavior involving the fictitious reduction of parameters to join a regime of this nature or to pay less tax.

On the other hand, tax optimization refers to the legal behavior of a taxpayer who self-limits their economic growth in order to optimize their tax burden. Beyond a certain level of turnover, their tax liability may exceed the economic benefit they could obtain, due to changes in the tax equation it entails.

It is a topic of great importance that should be taken into consideration by tax policy makers.

One of the biggest mistakes made in managing these special regimes is thinking that they self-regulate, thus little importance is given to their deviations.

The aggravating factor is the loss of revenue from the general regime caused by these maneuvers, which should not be underestimated by the fiscal authorities.

One of the basic objectives of these regimes is to incorporate new taxpayers and prevent taxpayers from the general regime from improperly joining them through fiscal dwarfism to enjoy their benefits.

Therefore, tax administrations, once these regimes are established or their parameters are modified, should monitor transfers from the general regime in a specific module to prevent fraudulent maneuvers of this kind.

The objective of an individual simplified regime is to formalize participants in the underground economy or facilitate the creation of new ventures within the formal sector.

The greatest failure of a special regime is observed when taxpayers coming from the informal sector, or new ventures constitute a smaller proportion than taxpayers who join it by transferring from the general regime solely to reduce their tax burden.

2. Gross income fraud

Presumptive simplified regimes determine the resulting tax through a presumptive technique, meaning they replace several taxes, including some social security contributions, with a single tax¹²⁹.

¹²⁹ Some international scholars even classify them as single tax regimes. In this study, we use a different conceptual classification to define them.

Presumptive techniques aim to simplify tax calculation for taxpayers and control for tax administrations. However, it should be noted that often, prioritizing ease in tax assessment has made it difficult for tax authorities to enforce control.

In the countries of the region, the widely majority of regimes apply two techniques: a) percentage-based on gross income or purchases/services for regimes related to micro and small businesses, and b) fixed fee for individual taxpayers.

In modality a), regarding the applicable tax rate, there are two submodalities: i) a uniform rate is applied to all activities, or ii) multiple rates are applied based on the economic activities conducted.

The other alternative within this technique is to apply a profitability coefficient. This means determining the taxable profit as a percentage of the gross income in the first phase, and then applying a nominal profitability coefficient established by legislation to this taxable base to determine the resulting tax payable¹³⁰.

In Costa Rica, under the Simplified Taxation Regime (RTS), the presumed income for economic activities is determined by applying a specific profitability factor for each activity, based on purchases, rather than income.

A few regimes also determine presumed income or value added through specific techniques.

Regarding the technique of applying a percentage of gross income or purchases, it's important to highlight that it's challenging for tax administrations to control because the lack of issuance of invoices or authorized receipts, or payments in cash or through electronic means beyond the reach of tax authorities, allows for concealment.

“The presumptive technique of applying a percentage on gross income or expenses, while easy for taxpayers to calculate, poses challenges for tax administrations in terms of control”

It is observed that in the latest special regimes created for micro and small enterprises, there has been a trend towards applying this technique, often without effective control measures in place to address the deviations it may cause.

¹³⁰ As in Italy.

Gross income regimes can be subject to deficiencies in invoicing in the presence of weak tax administrations or payments made in cash or through electronic means beyond the reach of tax authorities.

Engelschalk (2007)¹³¹ has pointed out that for addressing these practices, solutions such as fiscal cash registers or the use of electronic invoicing are viable. However, it should be emphasized that the mere existence of such tools does not inherently improve tax compliance; there must also be oversight by the tax authority to prevent deviations.

Indeed, this is the case, as many frauds have been detected not only in relation to counterfeit or false invoices but also in electronic payments to avoid traceability. For example, the use of leased or third-party-owned “POSnet” (point-of-sale) terminals.

The failure to declare actual income causes multiple grievances, as it not only results in necessary revenue loss for the tax authorities but also creates unfair fiscal competition among taxpayers who have fraudulently joined this regime compared to compliant taxpayers under the general regime. Additionally, there is competition among those adhering to the same special regime based on the level of falsification of declared income.

The inaction of control by the tax administration exacerbates the issue at hand.

“It is advisable that the technique of applying a percentage on gross income or purchases not be applied exclusively, but rather be carried out concurrently with other techniques that allow for easy presumption of the level of billing”

Hence, if this technique is used, it is advisable to apply it concurrently with other parameters or indicators that easily detect the economic magnitude of the taxpayer and presume their level of billing.

Experience indicates that legislations that have attempted to prevent this fraud have resorted to the simultaneous use of other parameters. These could include the value of assets, units of operation utilized, personnel assigned to the activity, the use of certain physical magnitudes, the rental value of the premises, etc.

Another way to limit these deviations was by excluding certain economic activities from these special regimes. Some legislations have used this approach in a limited manner, while

¹³¹ Engelschalk M. (2007): “Designing a tax system for micro and small businesses: guide for practitioners”, World Bank Group.

others have done so extensively, covering activities ranging from commercial and industrial to service-based ones.

In accordance with the socio-economic context, fiscal discipline, and the prevalence of economic activities, each country should adopt parameters and exclusions that are appropriate for its own reality.

Field investigations and the deviations observed in compliance with the regime for each economic activity can also be very useful. This information can help in specifically limiting that activity with specific parameters, in addition to those applied generally.

As a summary, it can be argued that to prevent deviations, special regimes should implement specific measures: a) regulatory and b) auditing.

“Another fraudulent maneuver observed in practice has been the division of businesses through the use of so-called “straw” or “shell” companies

These maneuvers are often executed when the companies owned by one or a group of owners are formally placed under the ownership of straw owners, relatives, or even individuals under their dependency involved in the activity.

With this strategy, they aim not only to avoid exceeding the gross income limit but also the number of economic units allowed by the special regime.

The pandemic taught a valuable lesson, as tax administrations, out of necessity, relied solely on computerized inspections by cross-referencing data from their databases.

Once normalcy was restored, many administrations found that informality had increased, and certain deviations required the physical presence of inspectors at the locations where economic operations take place to detect them. Therefore, “post-COVID,” they emphasized the importance of conducting on-site audits.

“The tasks of on-site audits cannot be overlooked, as the physical presence of inspectors can detect even blatant deviations that might go unnoticed through computerized checks”

Hence, an Annual Audit Plan (AAP) should incorporate both computerized checks and on-site inspections to yield effective outcomes.

Finally, concerning micro and small businesses, it has been observed in countries with more than one special regime¹³² that arbitrage operations should not be allowed. This means that the free transfer of obligations from one regime to another according to the convenience of the company in each fiscal period should not be permitted, as it undermines tax authority control.

Therefore, such behavior should be prevented or limited by imposing a minimum duration of years in a regime¹³³.

3. Billing fraud

In practice, it has been observed that regimes allowing small taxpayers in a special regime to claim “input tax credit” in VAT for their invoicing have led to fraudulent maneuvers involving the issuance of invoices that do not support actual transactions. These invoices are then traded so that buyers can improperly offset them against the “input tax credit” of their operations.

While most simplified regimes in Latin America, due to detected fraud cases, have amended their legislation to disallow the granting of tax credits¹³⁴, there is still a regime that does so, such as the SIMPLES NACIONAL.

In this regime, adherents are allowed to grant it in operations with companies under the Presumed Income Regime or under the General Regime (Actual Profit), provided they meet several requirements, including reporting the percentage distribution of the ICMS (state VAT)¹³⁵.

These frauds have also been observed, based on issuing documents without the backing of real operations, when special regimes allow the deduction of expenses for Income Tax purposes based on their invoicing.

¹³² For example, in Peru, the RER and RMT are in force for micro and small companies.

¹³³ Experience in Peru.

¹³⁴ For example, in the tax reform of 2012 in Guatemala, the Small Taxpayer Regime lost the ability to grant VAT tax credits for its operations.

¹³⁵ According to Article 23 of Law No. 123/06 (SIMPLES NACIONAL Law).

Anti-abuse measures for the Special Tax Regime on Income Tax/Module System (Spain)

For example, in Spain in 2012, a series of measures against tax fraud were approved, including the reform of the Module regime, aimed at ending the practice known as “moduleros”¹³⁶, which consisted of issuing false invoices for services or products not delivered to other companies while these companies benefited from deducting an expense that was not actually incurred.

Therefore, to avoid these deviations, the possibility of deductibility should be eliminated or limited to a certain amount or percentage.

Anti-abuse measures of the special income tax/monotributo regime (Argentina)

In the Monotributo system of Argentina, purchasers, lessees, or recipients of services from subjects included in said regime may only include in their Income Tax return transactions carried out with the same supplier up to a total of two percent (2%), and for all supplier subjects up to a total of eight percent (8%), in both cases based on the total of purchases, leases, or services rendered during the same fiscal year¹³⁷.

Many administrations initially believed, albeit erroneously, that the mere implementation of electronic invoicing and its derivatives (receipts, electronic invoicing platforms on official websites, etc.) would put an end to tax evasion.

Despite the widespread adoption of online electronic invoicing with tax authorities, fraud has not disappeared.

Far from it, while they are essential tools for improving tax compliance and control, various evasive maneuvers exist in countries that have implemented them. The adage “where there’s a will, there’s a way” applies in this situation.

¹³⁶ Taxpayers adhered to the so-called Module Regime.

¹³⁷ Law No. 24,977 (article 29) and Decree No. 1/2010.

From so-called fake or bogus¹³⁸ invoices issued through “factories”¹³⁹ run by complex criminal organizations (comprising IT professionals, accountants, legal experts, etc.), which involve everything from their fraudulent creation to the impersonation of fiscal identities, the establishment of “straw” or “shell” companies whose directors are often insolvent individuals, and the operations to place them in real formal companies by exploiting disloyal personnel within them, etc. This constitutes an illicit association with a high level of organization. Unfortunately, by the time it is discovered, a considerable amount of time has passed since the start of their operations, and therefore, they have harmed the treasury to a significant extent.

Therefore, to prevent their rapid detection, the application of a database with parameters considered abnormal is required, meaning the existence of significant deviations that could indicate the premature existence of these organizations, thus initiating preventive audit actions.

“The economic and financial capacity of taxpayers is an important parameter to use in determining the level of invoicing and initiating a tax audit by analyzing other data”

Although it’s true that this kind of fraud is more impactful in the general regimes because such invoicing grants VAT tax credits and deductibility in Income Tax, it also applies to special regimes due to deductibility in the latter tax.

“Regarding special regimes and the use of new electronic tools, two recurring evasive practices are observed: a) the improper use of “POS terminals” and b) the issuance of non-fiscal receipts”

The use of leased or third-party-owned point-of-sale terminals (“POS terminals”) has been observed to evade traceability in electronic payments.

Similarly, many transactions are also carried out with what are known as “non-fiscal receipts,” which are similar to fiscal receipts but lack value, and therefore are not reported to the tax authority.

¹³⁸ Popularly in Argentina they are called “truchas”.

¹³⁹ Referred to organizations that falsely issue them.

In this scenario, control can be more complex because consumers who receive them believe that they are official receipts and that the transaction has taken place within the bounds of legality.

It is worth noting that although in many countries it is mandatory to include the phrase “non-fiscal receipt” at the bottom of the document issued, indicating that it has no tax validity, this often goes unnoticed by the recipients.

An effective measure would be to prohibit this type of receipt and clearly define in the Tax Codes that its use “per se” constitutes documentary evidence of defrauding the public treasury. In addition to adjusting the taxes owed for its use, hefty fines should be imposed, and even direct closure of the business, with increasing penalties for repeat offenses by the taxpayer.

“It’s worth noting that the existence of electronic fiscal documents is inconsequential in the face of informality”

As indicated in a timely manner, informality not only reaches extremely high figures in the countries of our region, but together with sub-Saharan Africa, we have the “sad privilege” of having the highest rates globally.

“According to research from the IMF (2019), informality reaches 34% of GDP¹⁴⁰ in our region, while in North America, it only accounts for 9%”

The worrying aspect is that in the years following the pandemic, data provided by the National Statistical Institutes of several countries in the region indicate that informality continues to rise.

This data must be taken into consideration by public authorities. It’s not a minor detail. If it’s already worrying to maintain extremely high levels of informality, it’s even more concerning to observe that it continues to increase in countries across the region.

Therefore, while electronic fiscal receipts are an essential tool to prevent tax evasion, it must be emphasized that this applies to the formal economy. Thus, it remains a pending task for countries in the region to implement comprehensive policies aimed at formalizing the economy.

¹⁴⁰ Same level as Sub-Saharan African countries.

Regarding operations within the formal economy, there should be a specialized enforcement unit of the highest level within fiscal agencies aimed at investigating complex evasion schemes through the creation (factories) and use of counterfeit or false invoicing.

4. Symbolic fixed fee

Another presumptive technique commonly applied by countries is the fixed fee, specifically for small individual taxpayers.

The amount to be paid is determined by legislation based on the application of various indicators, averages, indices, etc., the resulting amount of which is determined by each country.

“The risk involved in this regime is that the fixed fee may become divorced from economic reality and from a reasonable tax burden, potentially turning into a merely symbolic fee”

It is undeniable that the fixed fee in special regimes aimed at small individual taxpayers is the simplest for tax compliance and also provides a benefit compared to the general regime. However, it must be reasonable and not excessive.

The experience of countries in the region has shown that privileged situations do not contribute to forming a tax culture and carry the same negative consequences as informality.

As the “spread” between the tax burden of the general regime and the special regime increases, so do tax avoidance maneuvers, leading to greater benefits.

When reality demonstrates the discrepancy between the fixed fee and what the small taxpayer should fairly pay, the responsibility falls on the policymakers in tax policy formulation. They have the obligation, as part of best practices, to update it within the framework of the country’s economic situation.

The fiscal sociology of countries in the region clearly shows that the complaints and blockades from small taxpayers regarding updates are related to indicators that could exclude them from the regime, rather than concerning the value of the fixed fee.

This latest update is an obligation of public authorities to minimally sustain the benefits of the regime and foster a tax culture.

“Authorities must update the parameters or indicators by which they have determined the fixed fee of the special regime to avoid asymmetries or deviations from its value with economic reality”

RTI y RTS (Bolivia)

In Bolivia’s Integrated Tax Regime for transportation and the Simplified Tax Regime, paying symbolic fixed fees and not having the obligation to issue invoices led to significant tax avoidance by taxpayers with higher contributory capacity¹⁴¹.

To exacerbate this situation, there’s the added issue regarding Bolivia’s Integrated Tax Regime, where according to the SIN (National Tax Authority)¹⁴², out of 10,000 registered transporters, only 3,000 were paying the symbolic fixed fee.

As mentioned in the informality topic, mere registration in a special regime is not sufficient to consider it resolved; it’s necessary to demand that these taxpayers remain active in the regime, meaning they fulfill formal obligations and payment duties.

Otherwise, they should be excluded from the regime after a period of inactivity determined by legislation¹⁴³. In other words, it’s necessary to prevent the special regime from becoming a “comfort zone” where benefits are obtained without obligations for the taxpayer.

The levels of billing and other parameters allowing for continued participation in the special regime should also be updated. It’s worth considering that in cases where countries did not update this threshold, perhaps as a tacit strategy to exclude taxpayers from the regime without abolishing it, the only result was that small taxpayers began to limit their invoicing fraudulently to remain in the regime. An additional benefit was the payment of a lower fixed fee.

¹⁴¹ Transportation of more than two units or in trade department stores.

¹⁴² 2017 Report.

¹⁴³ In Argentina, 10 months of inactivity is the cause for exclusion in the Monotributo (Single Taxpayer) system.

This situation is observed in Argentina's Monotributo system, as the gross income cap is updated by the pension mobility index, which was lower than the consumer price index. Thus, with high inflation rates, it fell behind¹⁴⁴.

Faced with this situation, the Medical Association of La Plata (AMP), which represents doctors in the city of La Plata, highlighted that due to the lack of updating the special regime's cap to real values, most of its members had decided to reduce their work capacity or engage in informal activities to avoid moving to the general regime¹⁴⁵.

The longer it takes to update the variables of these regimes, two negative effects will occur if they are not updated: 1) the parameters for remaining in the regime – those who choose the legal route will reduce their work capacity, while those who choose the illegal route will avoid invoicing or the parameter that would exclude them, and 2) the fixed fee, as they will pay less tax than they should, causing a greater “spread” with taxpayers with similar billing who are in the general regime.

Furthermore, given the large universe of taxpayers, their resistance creates tension in public opinion, and therefore political consequences.

5. Disguised dependency relationship

Regarding the implementation of special tax regimes for individuals, one of the significant deviations observed is that many employers, to avoid the formalities and costs associated with employing workers, force affected employees to issue invoices as self-employed workers under the guise of these types of regimes.

In cases of unjustified dismissal or to secure recognition of contributions to social security regimes, the worker must resort to the courts to prove the existence of a concealed employment relationship.

What's surprising about this situation is that not only is this deviation observed in the private sector, but also in some countries, it's the government itself that misuses it at the national, subnational, or local levels.

¹⁴⁴ In order to save critical situations, special laws have sometimes increased this parameter.

¹⁴⁵ La Nación Newspaper 11/1/24. “Asphyxia Tributaria”: doctors of La Plata denounce another factor that adds to the health crisis and reduces care.

This demonstrates that formality in employment relationships in the private sector faces a significant hurdle when it's the state itself that encourages practices that distort them.

“It’s positive that the tax authority monitors deviations from the regime that lead to a concealed employment relationship, as this practice results in the denial of labor rights and social security benefits”

While some countries have not focused on this issue and even encourage it, others have attempted to prevent this practice not only through inspection operations and subsequent penalties but also with the support of specific anti-abuse regulations.

Indeed, the Simplified Tax Regime in Colombia aims to prevent concealed employment relationships by stipulating that individuals residing in the country who, in the course of their activities, exhibit the elements of a de facto employment contract or a legal and regulatory relationship according to current laws cannot be subject to this regime.

The provision clarifies that the National Directorate of Taxes and Customs (DIAN), upon detecting such a situation, will proceed to exclude the taxpayer from the regime, without requiring a pronouncement from another judicial or administrative authority.

Marchese (2021), in a report prepared for the ILO, also noted the existence of labor fraud when companies require their workers to register in a special regime independently to avoid paying social security contributions.

Hence, beyond declarations and pronouncements, the concrete measures adopted to prevent disguised labor informality under a special regime as a self-employed worker are of value.

6. The politicization of special regimes

In many countries in the region, especially concerning regimes for individual taxpayers by economic activity or of a general nature, their affiliated members have carried out protest actions through their representative organizations to defend or extend the benefits of the special regime.

These actions to defend their rights are logical when dealing with a special regime with a reasonable tax burden. However, if over time, the regime has become a significant haven for tax avoidance or when the tax burden becomes symbolic, often, privileges are defended that distort the tax system.

The impact of fiscal sociology stemming from this sector was observed decades ago when mass on-site inspections were implemented as a enforcement strategy targeting small taxpayers located in specific commercial streets or areas.

The response was resistance to the actions of the tax administration, manifested through mass business closures, street protests, etc., which was termed by the media as “fiscal rebellion.”

This compelled the suspension of this strategy and its modification to an individual, in-person approach, or a more generalized computer-based method. In the worst-case scenario, control over the sector was avoided altogether to prevent conflicts.

“The concern arises from the persistence of exhausted special regimes that cannot be adapted or replaced by more modern and effective ones, given the political tension that such changes would generate”

This leads, in some cases, to the establishment of a “status quo” that creates asymmetries ultimately detrimental to the general tax system.

It has been observed that while in some countries regimes are periodically updated, in others, they remain unchanged for extended periods, leading to significant discrepancies with economic reality and fiscal policy objectives.

RTS (Bolivia)

In the Simplified Taxation Regime (RTS), after 5 years of merchants’ complaints through their associations, and amidst a tense atmosphere, the government finally updated the capital parameter to remain in the regime¹⁴⁶.

Therefore, it is reasonable to update the regimes periodically to prevent the magnitude of distortions from becoming obstacles to their updating.

In cases where time has shown that certain regimes have not met their proposed objectives and their unintended effects lead to a setback in those objectives, it would be reasonable to consider replacing such regimes.

¹⁴⁶ Los Tiempos, 26/10/2018: “After 5 years of protests, Government updates the Simplified Regime”.

7. Wrong design of the special regime

The successes or failures of designing a special regime for taxpayers with lower contributory capacity have immediate consequences on the tax system.

“The main flaws of a poorly designed regime are that it becomes a disincentive for businesses to grow and, concurrently, encourages reverse migration (larger entities opting into the small taxpayer regime)”

According to Engelschalk and Loeprick (2015)¹⁴⁷, experiences suggest that poorly designed special regimes for small businesses act as a disincentive for them to grow beyond the turnover threshold of the presumptive regime.

In other words, as previously indicated, such poor design acts as a brake on business growth to achieve “tax optimization” and avoid assuming the higher costs of the general regime, or it encourages evasive practices.

Hence, as indicated in the topic of best practices, in such cases, it would be appropriate to apply a transition regime for migrating to the general regime.

Another unintended effect of the poor design of the regime, according to the mentioned authors, is the migration to the special regime for small taxpayers by larger companies from the general regime, attracted by the opportunity to reduce their tax obligations.

Fully concurring with those observations, their realization implies distorting business development and, therefore, fundamentally contradicting the purpose of creating a special regime for taxpayers with lower contributory capacity.

Therefore, to address this structural issue, in addition to good design, anti-abuse rules identified in each analyzed topic should be applied.

¹⁴⁷ Engelschalk, Michael y Loeprick, Jan (2015): “MSME Taxation in Transition Economies: Country Experience on the Costs and Benefits of Introducing Special Tax Regimes”, World Bank Group

8. Other undesirable effects

While some special regimes have singled out a particular cause for the negative effects, it's important to note that there is usually a multi-causal aspect, meaning the coexistence of various factors that cause distortions in the regime.

“The issue is not the existence of causes leading to distortions, but rather the failure of these regimes to apply anti-abuse measures to prevent or at least minimize them”

Some authors have invoked the harmful effects as a sufficient cause to avoid the application of a special regime.

Comparing it to medical science, it would be like saying that if a patient has a disease, they should be killed so they no longer have it. In that field, no one would entertain such an absurdity.

In the field of taxation, it has often been argued in some countries and in international conferences that if the simplified regime applied in their country did not yield the expected results, it should not be incorporated into the system.

Indeed, there are some countries that are not applying any regime (although they are only three in Latin America), considering the difficulties that would arise from their introduction into the tax system.

In those countries where regimes have been applied and the desired objectives have not been achieved, instead of analyzing the reasons for the failure of that regime to make an improved redesign, they extend the consequences of that particular failure “erga omnes” for the future.

The same thing happened when I presented the Monotributo project in Argentina in 1998. Associations of professionals in economics and tax auditors vehemently argued that in Argentina, such regimes had been a failure, citing the unsuccessful experience of simplified VAT regimes that had been applied in the country.

After a quarter of a century of continuous and successful application of the Monotributo, the same associations acknowledged the wisdom of introducing the regime and the benefits it had brought.

As the ITD (2007)¹⁴⁸ maintains, designing tax systems for taxpayers with lower contributory capacity is inherently complex, as factors related to regulations and administration are closely intertwined more than any other aspect of tax design.

As a summary, it can be argued that when a special regime fails, it is due to defects in its design. In other words, when its implementation did not consider the essential objectives it should pursue, did not adopt anti-abuse measures to avoid distortions, and/or was not effectively controlled, considering its special characteristics regarding its technique and the universe of taxpayers it is aimed at.

It's worth acknowledging that in several instances, a correct design failed in practice due to a lack of control or failures on the part of the tax authority. There exists a close interdependence between the design of the regime and the administration's control that cannot be overlooked.

Which doesn't imply that, as with taxes in the orthodox general regime, there aren't what are known as "compliance gaps," meaning deviations in their fulfillment.

This also occurs in regimes that have been successful. This obliges authorities and tax authority managers to pay close attention and take measures aimed at improvement.

As a simple example, although this report has highlighted various positive aspects of Brazil's MEI regime in different topics, it's also important to mention the negative aspects that have been pointed out.

Thus, the ILO (2019) stated that "...on the negative side, cases of abuse of the MEI policy have been reported, such as fraudulent declarations (of turnover and business activity to maintain eligibility), undeclared labor relations, and splitting a company into multiple units to avoid exceeding the maximum turnover limit. Additionally, when the government reduced social security contributions from 11% to 5% of the minimum wage, the policy became more attractive to the target group, but there were also concerns that it could undermine the financial sustainability of the national pension system."

Beyond analyzing each specific regime, authors and international organizations have also highlighted general unintended structural effects of special regimes.

¹⁴⁸ The International Tax Dialogue (ITD) is an initiative of the European Commission (EC), the Inter-American Development Bank (IDB), the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the World Bank (WB), and the Inter-American Center of Tax Administrations (CIAT). Its aim is to facilitate greater cooperation in tax matters among governments and international organizations to share best practices and pursue common goals to improve the functioning of national tax systems.

This implies opening a debate of ideas from various authors and international organizations to highlight a plurality of ideas¹⁴⁹, including both best practices and the structurally unintended effects they may entail.

In this line of thought, Mas-Montserrat, Colin, Ribault, and Brys (2023)¹⁵⁰ maintain in a working paper on OECD taxation the following negative aspects that these regimes can entail:

- a)** Disincentivize the growth of companies.
- b)** Encourage tax optimization and evasion behavior.
- c)** Erosion of tax equity.
- d)** Cause institutional and administrative difficulties.

In a report prepared for the ILO, Marchese (2021)¹⁵¹ has synthesized the main criticisms leveled against these regimes, namely:

- a)** “Threshold effect” also called “concentration effects” or “growth traps” that discourage companies to grow beyond the allowed threshold or turnover ceiling.
- b)** Failure to respect the principle of tax equity, since companies just below or above the threshold may be subject to a very different effective tax rate.
- c)** Fraud of business division (horizontal splitting of companies).
- d)** Labor fraud when companies require their workers to register autonomously in a special regime in order to avoid paying social security contributions.
- e)** Deficient public policies may attract people with low qualifications to a professional career that is unsustainable over time (Shane, 2009). This would imply that the benefits granted, with their respective fiscal cost, would be unfounded in these cases, due to their lack of selectivity.

For its part, the report by TDI (2007)¹⁵² has indicated that:

- a)** In the design of special regimes, it is questionable that they are exclusively based on the size of the company for their differential treatment, disregarding the compliance costs of each sector, as this could provide a tax relief to subjects who do not require it¹⁵³.

¹⁴⁹ As St. Thomas Aquinas said, “Fear the man of a single book”.

¹⁵⁰ Mos-Monserrat, Colin, Ribaut, Brys (2023): “La conception des régimes d’imposition forfaitaire”, Documents de travail de l’OCDE sur la fiscalité (2023). Paris.

¹⁵¹ Marchese, Marco (2021) “Preferential tax regimes for MSMEs Operational aspects, impact evidence and policy implications”, Working Paper 33, ILO.

¹⁵² Cited document.

¹⁵³ In many countries, to avoid the distortion of reducing the tax burden on companies that, although eligible for special regimes based on their size, possess economic advantages that do not require public policy assistance, they are excluded from the regime based on the economic activity they engage in.

- b) The tax system is not usually the most effective means to influence the type of economic behavior that may be of concern to businesses¹⁵⁴.
- c) To avoid distortions, it should also be considered whether small businesses have access to capital markets, innovation, efficiency, the age of their creation¹⁵⁵, etc¹⁵⁶.

In the countries of the region, most tax experts are widely in favor of the implementation of these special regimes, but at the same time proposing that anti-abuse measures be adopted to prevent their unintended effects.

Therefore, it's not about killing the patient suffering from an illness, but about applying the necessary treatment for their strengthening.

The appropriate strategy must therefore be both regulatory and managerial of the regime. As mentioned earlier, any inaction or passivity from the tax authority tends to worsen the detected deviation.

No matter how perfect the design of a regime may be, if it's not enforced, and this lack of enforcement is perceived by taxpayers, non-compliance will be widespread.

Taxpayer behavior is strongly influenced by social contagion, according to behavioral theory. Therefore, the creation of pockets, activities, or areas lacking even minimal verification or control will lead to the spread of non-compliance.

To such an extent can this attitude go that, in many countries, there are actions that are illegal according to the current regulatory framework, but taxpayers believe they are within their rights, seriously affecting tax culture.

An anecdote worth mentioning is what happened in a country in the region when, facing a change in a special regime for small taxpayers, the Treasury authorities organized an explanatory talk with the leaders of the street vendors' association in the capital. They were asked to encourage their constituents to join and comply with the new regulations.

At the end of the meeting, in front of the press awaiting the meeting's outcome, those leaders stated that they would not support joining the regime because the authorities had demanded compliance with two unattainable requirements: not selling goods of contraband or illegal origin.

¹⁵⁴ Therefore, this document proposes the implementation of comprehensive policies for micro and small enterprises, including taxation as one of the topics.

¹⁵⁵ It argues for the need for favorable treatment for new businesses.

¹⁵⁶ While recognizing the difficulty of formulating a design that addresses them and, if established, the possibility for companies to evade them.

Therefore, the multifaceted nature of the unintended effects of these regimes must be addressed on a country-by-country basis, considering their history, culture, socioeconomic structure, and the strength of the tax administration. In other words, the analysis should focus on three aspects: a) fiscal sociology, b) tax policy, and c) tax administration.

As the ITD (2007)¹⁵⁷ has argued, although tax systems have addressed the issue of taxpayers with lower capacity in some way for many years, the topic has rarely taken a prominent place in tax policy and administration debates.

It also highlights that designing tax systems for this sector is inherently complex, as factors related to regulations and administration are more closely intertwined than any other aspect of tax design.

In conclusion, it asserts that the current interest in the subject, along with its diversity, complexity, and analytical novelties, make it a field that offers clear opportunities for generating new ideas and leveraging compatible international experiences.

Therefore, this document aims to be an additional contribution to existing ones so that tax policy makers, when designing or updating a special regime, can maximize best practices and minimize their unintended effects. It also serves as guidance for tax authorities to develop taxpayer services to facilitate compliance and specific control systems that recognize the unique characteristics of this taxpayer sector.

There is no doubt that these special regimes have made inroads into the tax systems of peripheral countries in our region, as well as in Sub-Saharan Africa, countries in Central Europe, the former Soviet Union, and Asian countries.

For brevity's sake, here are some key conclusions drawn from the extensive experience of Latin American countries:

¹⁵⁷ ITC (2017), Preliminary document for the Buenos Aires conference.

A. Best practices

1. The best practices on these regimes can be classified into: a) regulatory and b) tax administration management.
2. A special regime must be simple, i.e., easy both for the taxpayer to settle and for the tax administration to control.
3. From the point of view of tax sociology, it must generate both a perception of benefit to motivate taxpayers to be included and a perception of risk to avoid fraud.
4. They must tend to formalization, understood not only as tax registration, but also as active compliance with the formal and substantial obligations inherent to the system.
5. Systems that have applied several regimes depending on the economic activity or taxpayer (individuals or micro and small businesses) have been more accurate than those that applied a single general regime.
6. As for the taxpayers, due to their different characteristics, very small taxpayers, small individual taxpayers and micro and small enterprises require specific differentiated treatments.
7. In addition to the exemption or reduction of the tax burden for very small taxpayers, it is very positive to grant them subsidized social security benefits in order to achieve their social inclusion.
8. Presumptive “flat-rate” systems with the incorporation of social security and/or health insurance contributions as a partial subsidy were more successful for small individual contributors.
9. One pending issue of these regimes is to differentiate the treatment of small taxpayers by region or geographic area, considering that the rates of informality vary greatly among them, so it would be plausible to apply specific beneficial measures to taxpayers who carry out their economic activities in the most disadvantaged areas in order to facilitate their formality¹⁵⁸.
10. In the regimes for micro and small companies, presumptive systems based on the application of a percentage¹⁵⁹ of gross income or purchases, but with the concomitant application of other parameters or indicators to avoid fraudulent actions with the level of invoicing, have been more successful.
11. The success of schemes for micro and small enterprises is in turn closely linked to the implementation of comprehensive business development policies (technical assistance, business connectivity, public procurement, soft loans, training, etc.).

¹⁵⁸ For instance, a corrective coefficient could be applied to reduce the fixed fee, or a lower tax rate could be applied to income, or increased subsidies could be provided for social security resources in areas with higher rates of informality.

¹⁵⁹ Variable according to income level and the economic activity carried out.

12. The perception of the benefit in these regimes is a great motivation for tax compliance, together with the perception of the risk of being excluded from the regime.
13. In order to avoid deviations in its application, it is effective to determine a list of economic activities excluded from the special regime regardless of their level of turnover, as well as to expand the turnover threshold to promote certain activities such as the knowledge economy and exports.
14. In order to avoid an abrupt jump, a transition regime or “silver bridge” should be applied for the emigration from the special regime to the general taxation regime, aiming at a gradual incorporation to the final tax burden.
15. The erroneous belief that these regimes should not be controlled because they are residual of the tax system is a great strategic mistake that has harmed the tax system as a whole.
16. Specific control units should be created in the tax administrations for this sector of taxpayers, in order to design control actions with specific characteristics required to achieve effective compliance with the regime.
17. Technological advances and their massification make possible the extension of the electronic invoice application, the mobile biller (application), the use of fiscal controllers (approved ticket issuing machines) and the web biller, with an “online” connectivity with the computer platform of the tax administration.

B. Undesired effects

1. The “fiscal dwarfism”, i.e. that taxpayers of greater economic relevance do not declare their true turnover in order to make themselves artificially “dwarf” fiscally and be able to unduly enjoy the benefits of the special regime.
2. Erosion of the taxpayer base of the general regime¹⁶⁰.
3. Fraud in gross income or purchases, induced by the difficult control that this parameter entails for the tax agencies, which is carried out to remain in the regime or to be placed in the lowest categories of both fixed fees and income level.
4. The fraud of business division through “straw” or “shell” companies, both in the simplified presumptive regimes and in the preferential regimes that reduce the tax burden within the general regime.
5. The symbolic fixed fee, i.e. the lack of updating of its value.

¹⁶⁰ The main objective of these simplified presumptive individual regimes is to achieve the adherence of individuals who are in the informal sector or are new ventures, who, due to their low business volume, cannot comply with the general regime because of the high cost of compliance and the tax burden it entails. In the regimes for micro and small enterprises, benefits are granted to those with the actual level of invoicing permitted by legislation.

6. The fraud of issuing vouchers without the support of real operations, when in the simplified regimes they can grant “tax credit” in the VAT or the deductibility of expenses in the Income Tax.
7. The imposition by the company on workers to register in a special regime to invoice as self-employed, generating a covert dependency relationship to unduly reduce their labor costs with the consequent lack of protection of social security benefits for workers.
8. The politicization of the special regimes, through the trade associations that represent them or “per se”, to maintain or obtain excessive benefits.
9. Disincentivize business growth through a tax optimization strategy to avoid the abrupt change in the tax equation, by shifting to the general regime taxation.
10. Misguided public policies that subsidize inefficient companies instead of more efficient projects.
11. The decrease in collection for the sustainability of the social security systems in the systems that incorporate it with a symbolic contribution.
12. Poorly designed regimes lead to avoidance practices to migrate to the general regime and migration practices from the general regime to the special regime to unduly reduce the tax burden.

C. General summary

In the countries of the region, most tax experts and international organizations are broadly in favor of the application of these special regimes, through an effective design for the fulfillment of their objectives, complemented by the adoption of specific anti-abuse measures to avoid the undesired effects that they may entail.

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