

# Addressing Informality Through Simplified Enterprise Forms and a Special Legal Status

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## Key Takeaways:

- **Simplifying Business Registration:** Streamlining business registration processes can effectively reduce bureaucratic barriers that deter entrepreneurs from entering the formal sector. This simplification has the potential to promote entrepreneurship and encourage formal business growth.
- **Facilitating Tax Compliance:** Special legal statuses can simplify tax compliance for small businesses, by lowering administrative burdens, enhancing competitiveness, while also reducing strain on tax administration. This approach contributes to fostering a conducive business environment.
- **Incentives for Micro and Small Enterprises (MSEs):** While simplified registration can lower entry barriers, other challenges like limited access to markets and financial services need addressing. Various incentives for formalisation linked to special legal statuses are explored. These include, among others social protection and access to finance, that can equip MSEs with resources and safety nets to expand and operate successfully in the formal economy. By promoting formalisation these incentives could contribute to sustainable economic growth and job creation.
- **Balancing Positive and Negative Impacts and Ensuring Effective Design and Monitoring:** Policymakers must carefully consider the positive and negative impacts of implementing a special legal status for MSEs and should strategically design and monitor policies related to MSE special legal status to ensure they meet objectives. Lessons learned include focusing on transition mechanisms to the general tax regime, addressing misuse of incentives, and regular evaluation to enhance effectiveness.

The policy note provides an overview of the 2023 DCED report [Addressing Informality Through Simplified Enterprise Forms and a Special Legal Status](#). It explores the fundamental characteristics of streamlined enterprise structures and provides insights on successful policy objectives. Furthermore, it briefly explores the various observed effects before concluding with a summary of valuable lessons derived from the analysis of five country case studies detailed in the full report.

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## → What are the key features of simplified enterprise forms?

The key features of simplified enterprise forms encompass several crucial aspects. Firstly, these forms aim to make it easier for small businesses to register their business with the relevant authorities. Examples of this include simplified registration procedures, as seen in the “Auto Entrepreneur” model in Morocco, simultaneous registration for tax, trade, and social security, as found in the “MEI” (Microempreendedor Individual) scheme in Brazil, and online registration, exemplified by the Ecuadorian “SAS” (Simplified Stock Company).

Secondly, these forms seek to alleviate the tax burden and enhance compliance for MSEs. This involves the implementation of reduced and predictable tax rates, as observed in the “Simples Nacional” (Simplified National Tax Regime) framework in Brazil, and the introduction of unified tax regimes, exemplified by the “REMPE” (Special Regime for MSEs) in Cabo Verde. Additionally, simplified bookkeeping practices and digital tax payment mechanisms contribute to enhancing compliance.

A third key feature revolves around making formalisation more appealing to entrepreneurs. Simplified enterprise forms apply different types of incentives. In many of these regimes, entrepreneurs pay a reduced ‘integrated’ tax which combines fiscal and social payments. In return, they are fully or partially covered for social security, as seen in the “MEI” and “Monotributo” (Simplified Tax Regime) systems in Brazil and Argentina. Furthermore, some of these regimes, such as “Monotributo,” also extend healthcare coverage to entrepreneurs, further incentivising formalisation and contributing to their overall well-being. Other examples of incentives include access to finance and business development support.

## → What is the approach for agricultural enterprises?

Globally, the informal nature of the agricultural sector has prompted legal reforms to encourage MSEs to formalise, yet challenges differ by region and context. These challenges encompass limited resources, limited access to markets and finance, and below par infrastructure. Overall, from the cases assessed, it is more common to include agriculture in (or not explicitly exclude agriculture from) the scope of generic simplified legal forms, rather than create simplified legal forms for agriculture specifically, as seen in Argentina and Brazil, where benefits for small enterprises extend to small agricultural ventures. Argentina’s “Monotributo” covers primary agricultural activities and offers exemptions and reductions for contributions, while Brazil extends benefits like simplified licensing, market access, and credit to small agricultural enterprises. Colombia’s more recent “SAS” regime, applicable to all enterprises including rural ones, focuses on simplifying business processes and governance.

## → Approaches to Enhance Special Legal Status Effectiveness

Informality is influenced by a range of factors, and reducing it requires well-coordinated and multi-faceted approaches. The success of formalisation incentives under regimes like special legal statuses depends on clear communication and understanding among entrepreneurs. Governments employ various strategies to enhance the effectiveness of simplified legal reforms, including inter-agency cooperation, training, and capacity building. Access to capital is a challenge for many MSEs, leading countries to offer financial incentives such as subsidised loans and credit guarantees. Special legal statuses often also grant MSEs access to exclusive public procurement opportunities. Awareness campaigns play a vital role in encouraging formalisation, while Business Development Services (BDS)

provide essential support by offering external functions and helping entrepreneurs develop competencies. Intragovernmental cooperation, exemplified by one-stop shops, streamlines processes and reduces compliance costs, contributing to the success of formalisation policies.

### → **What were the impacts of Simplified MSE regimes on business formalisation?**

Various studies have explored the impacts of simplified MSE regimes on business formalisation using diverse methodologies. For instance, Argentina's Monotributo system led to substantial enterprise growth, particularly during the COVID-19 pandemic when many unemployed individuals opted for self-employment. In Ecuador, the Simplified Joint Stock Company (SAS) regime facilitated formalisation, becoming the most popular corporate form with 66% of new incorporations. In Cabo Verde, the REMPE regime saw a significant increase in enterprises from 1,439 in 2016 to 6,049 in 2019. In Brazil, the Simples Nacional and MEI regimes markedly increased registered MSEs, with a total of 21.6 million in 2023. These regimes also show higher survival rates and offer benefits like social security access. However, impact studies on the MEI and Simples Nacional regimes in Brazil have varied, with some finding positive effects on formalisation, while others found mixed results, indicating the need for more comprehensive data and sector-specific analysis.

### → **What were the impacts of MSE special legal statuses on tax compliance and public revenue generation?**

The literature extensively demonstrates that MSE special legal statuses not only benefit businesses, but have also positively impacted tax compliance and public revenue generation. For example, the REMPE regime in Cabo Verde dramatically increased tax declarations submitted, while Brazil's Simples Nacional saw tax collected under the special legal status grow from 4.2% to 8.4% of total federal revenues between 2007 and 2018. The Monotributo regime in Argentina enhanced tax compliance, particularly payment receipts. Studies across Brazil, Mexico, and Argentina revealed that entrepreneurs value reduced compliance costs and that business creation would diminish without these regimes. Ecuador's SAS regime also significantly contributed to tax collection, with the Internal Revenue Service collecting around \$218 million from SAS alone.

### → **What were the impacts of MSE special legal statuses with respect to job creation and increased social protection?**

MSE special legal statuses have demonstrated positive impacts on social protection and the job creation. The MEI program increased social insurance coverage for self-employed workers, rising from 33% to 41.7% between 2009 and 2015. Ecuador's SAS corporate structure led to approximately 25,000 workers registering with social security, with around 40% being women. Simples enterprises in Brazil notably contributed to net job creation, adding over 1.6 million new formal job posts from 2017 to 2019, contrasting with job cuts in other firms. MEIs in Brazil also served as a source of income for a majority of entrepreneurs, but challenges in sustaining formalisation were observed. An evaluation in Brazil revealed that the MEI program's subsidised benefits might have negative impacts on the social security system in the long term, prompting the need for restructuring. Additionally, developments like Morocco's introduction of income tax withholding for auto-entrepreneur contractors and Brazil's evaluation that recommends a study to reform contribution rates underline the ongoing efforts to balance these impacts.

## Case Studies

The report summarized through this note examines five distinct case studies of Simplified Legal Status for Micro and Small Enterprises (MSEs) in Brazil, Argentina, Morocco, Ecuador, and Cabo Verde. The table below provides an overview of the main characteristics of each of these case study legal statuses; lessons learned from these case studies are also explored in this section.

Country	Morocco	Ecuador	Brazil	Brazil	Cabo Verde	Argentina
<b>Simplified Status</b>	Auto Entrepreneur	SAS	Simplex	MEI	REMPE	Monotributo
<b>Year of Introduction</b>	2013	2020	2006	2008	2014	1998
<b>Legislation</b>	Loi nº114-13	Ley Orgánica de Emprendimiento e Innovación	Lei Complementar 123/2006	Lei Complementar 123/2006	Lei nº 70/VIII/2014	Ley N° 24.977
<b>Revenue Threshold</b>	<ul style="list-style-type: none"> <li>•500,000 DH (~48,1k USD) for industrial, commercial or craft activities</li> <li>•200,000 DH (~19.2k USD) for services</li> </ul>	No	The Simplex has gross revenue limit of R\$ 4,800,000.00 (~USD 923.805,26)	Earn accumulated gross revenue of up to R \$ 81,000.00 (~USD 15,5k) or proportional to the months of the year in case of starting activity. For the Autonomous Cargo Carrier MEI the accumulated gross revenue limit is up to R \$ 251,600.00 (~USD 48,4k)	Annual turnover, which cannot exceed 10,000,000 ECV (~96,238 USD)	<ul style="list-style-type: none"> <li>•For activities related the commerce sector the annual gross income cannot exceed ARS 8,040,721.19 (~40,554.46 USD).</li> <li>•For activities related to the services sector the annual gross income cannot exceed ARS 7,247,514.92 (~36,553.82 USD)</li> </ul>
<b>Employee Criteria for eligibility</b>	Companies cannot have employees	No	No	Maximum of 1 employee	Maximum of 10 employees	No
<b>Single Tax</b>	Yes	No	Yes	Yes	Yes	Yes
<b>Social Security Coverage</b>	Yes	No	No	Yes	Yes	Yes
<b>Healthcare Coverage</b>	Yes	No	No	No	No	Yes
<b>Simplified Registry</b>	Yes (RNAE)	Yes	No	Yes (Portal do Empreendedor)	Yes (Casa do Empresário)	Yes (AFIP portal)

## Lessons Learned

### *Effectiveness and Sustainability*

Simplified legal statuses for MSEs can be effective and sustainable, with positive impacts in reducing informality. While simplifying registration requirements for smaller enterprises has increased registered businesses, a comprehensive approach is needed, addressing barriers like limited market access and financial services. Substantive formalisation involves not only registration but also improved productivity, working conditions, and effective incentives such as access to finance, new market opportunities or social security. Ensuring a smooth transition from simplified to general tax regimes is essential to prevent prolonged reliance on the simplified status. Evaluating tax expenditure and regularly monitoring effectiveness are crucial; the Brazilian model showcases the importance of gradual subsidy reduction and the importance of tailoring requirements to enterprises' payment capacities. Electronic solutions provided by tax administrations, as seen in Brazil and Chile, streamline compliance. Yet, concerns exist about broad programs' impact on public expenditure, necessitating targeted and calibrated social protection benefits. Adequate design, enforcement and monitoring are essential to prevent unintended outcomes, avoid misuse and promote sustainable formalisation.

### ***Compliance and Enforcement Challenges***

Compliance and enforcement are challenges that policymakers encounter while designing simplified legal statuses for MSEs to encourage formalisation. While these regimes can improve tax compliance and reduce costs, concerns arise about potential misuse, such as evading taxes through illicit registration or enterprise splitting. Digital taxation, while advantageous, must consider digital inclusion to prevent exclusion. Reducing tax burdens could unintentionally incentivise abuse of the regime for unintended purposes, slow down business growth, and offering incentives like social protection requires cautious management to avoid moral hazards. Moreover, addressing disguised employment relationships is crucial to ensure the effectiveness of simplified regimes. Policymakers must navigate these challenges to ensure that these statuses meet their goals, promote formalisation, and contribute to sustainable and inclusive economic growth.

### ***Increasing Compliance***

Promoting a compliance culture is very important for the success of simplified legislation for MSEs. One such trend is "seamless taxation," where tax administrations integrate their systems with those used by MSEs, reducing compliance burdens through automated processes and real-time tracking. Examples like Chile's pre-filled tax returns and Brazil's experiments in this area showcase its effectiveness in enhancing compliance rates and simplifying tax obligations. Embracing these trends can lead to streamlined tax compliance for MSEs, encourage voluntary adherence, and create a supportive environment for their growth and success.

### ***Social Security as an Incentive to Formalise***

Countries have adopted successful strategies to encourage formalisation by using social security incentives and special legal statuses. These approaches offer benefits tied to social security, such as pension and health coverage, while reducing contributions. Initiatives like REMPE, Simples, and Monotributo have embraced this trend. The simplification of legal status also facilitates the transfer of entitlements for mobile workers, contributing to a comprehensive social security framework. Argentina and Brazil have integrated the self-employed into broader social insurance systems, exemplifying a progressive and inclusive approach to social security within the context of micro and small enterprises.

### ***Additional Measures and Support***

Additional support measures that can enhance the effectiveness of simplified legal regimes in promoting formalisation. These measures, such as access to finance, market opportunities, and new technologies, create a favourable environment for formal sector operation. For instance, Brazil's implementation of a one-stop-shop system and digital ID for online business registration streamlined the process, reducing time and costs. The COVID-19 pandemic accelerated the shift towards online registration, but policymakers must consider digital inclusion disparities by offering both online and in-person registration options, as demonstrated by Ecuador's SAS model, ensuring equal access to formalisation benefits for all entrepreneurs.

### ***Effects on Small Agricultural and Rural Enterprises***

The prevailing trend suggests that incorporating agriculture into generic simplified legal forms is more common than creating dedicated forms exclusively for the agricultural sector. Benefits for small agricultural enterprises are often

associated with existing generic simplified legal forms, rather than separate agricultural-specific forms. Regimes like Brazil's MEI and Argentina's Monotributo were originally designed for urban small businesses, but they were later extended to include agricultural enterprises. However, this led to concerns about pension benefits for rural entrepreneurs. Legislative amendments in Brazil and Argentina aimed to balance simplified business registration and tax compliance for rural entrepreneurs while ensuring their social protection. In contrast, Colombia's more recent SAS regime applies to all enterprises, including rural ones, simplifying registration and governance while reducing compliance costs and promoting access to finance for small and medium-sized enterprises. In light of these challenges and widespread informality, business environment reforms alone may not suffice to promote formalisation in the agriculture sector where additional interventions are often necessary.

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*The Donor Committee for Enterprise Development (DCED) Business Environment Working Group (BEWG) produced this Policy Brief. The BEWG is a platform to share information and knowledge on donor-supported business environment reform in developing countries and to identify and support good practices and new approaches in this field. For more related publications visit the [DECD BEWG website](#). Feedback is welcome and may be addressed to the DCED at [admin@Enterprise-Development.org](mailto:admin@Enterprise-Development.org).*

*For more resources and information on this topic, read the research report [Addressing Informality Through Simplified Enterprise Forms and a Special Legal Status \(DCED, 2023\)](#) which includes five country case studies. Gabriel Rizza Ferraz authored both this policy brief, and the associated report. With thanks to the World Bank, International Finance Corporation, International Labour Organisation, UN Food and Agriculture Organization and the United States Agency for International Development for providing guidance and advice.*