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# **Business Perspective on SME Taxation, Policy & Administration**

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**Brazilian Micro and Small Business Support Service**



# Core Questions

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## • **Post-1945 international scenario**

- dynamic process of convergence of tax systems
- facts that took place within a certain territory have influence on economic agents within other territories
- New economic activities

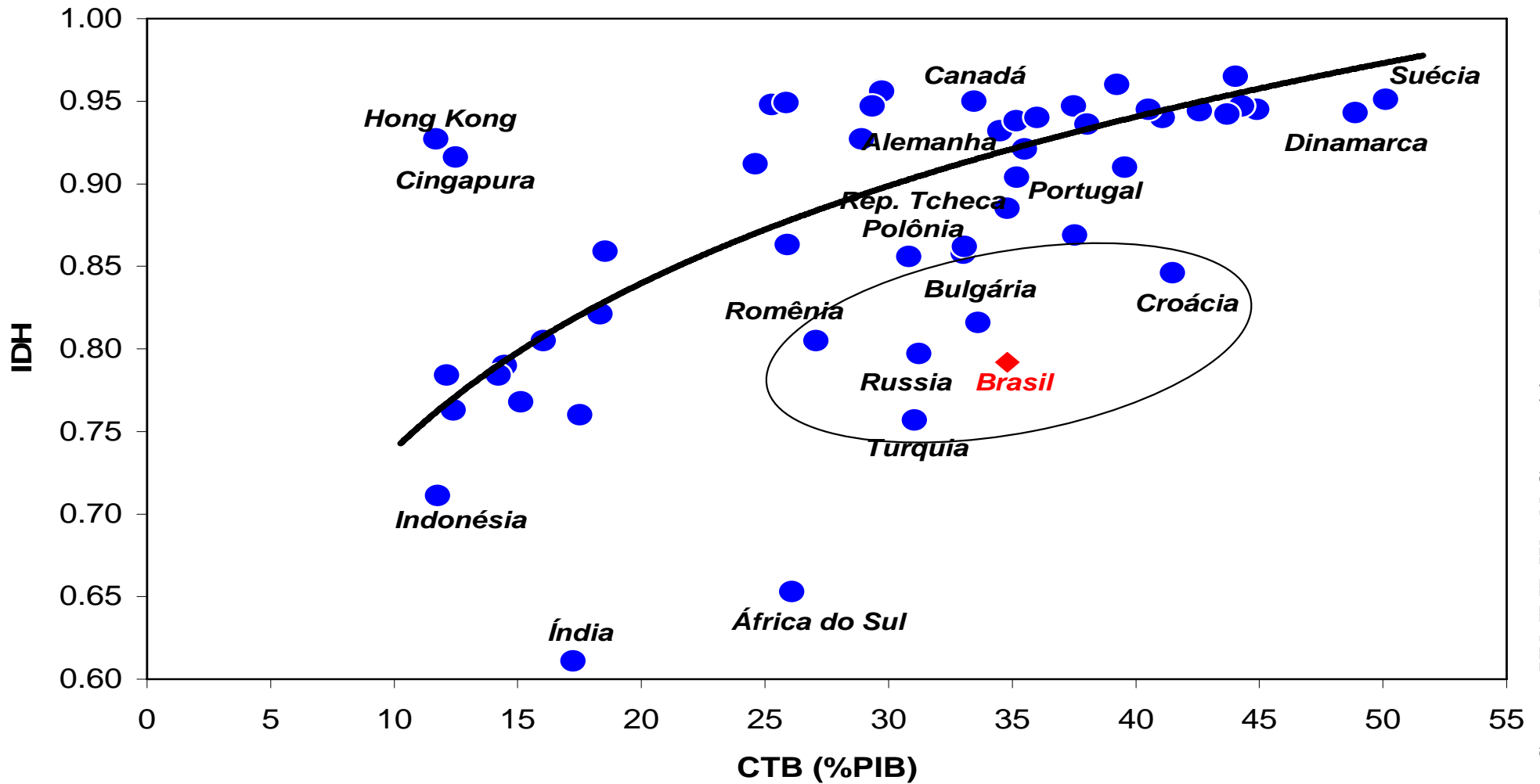
## • **Developing countries**

- Imbalanced social structures and excessive concentration of wealth
- High index of tax evasion
- Unlike developed countries, there is no consciousness of the civic duty to pay taxes
- 97% to 99% of participation of small business

## • **Competitiveness shock**



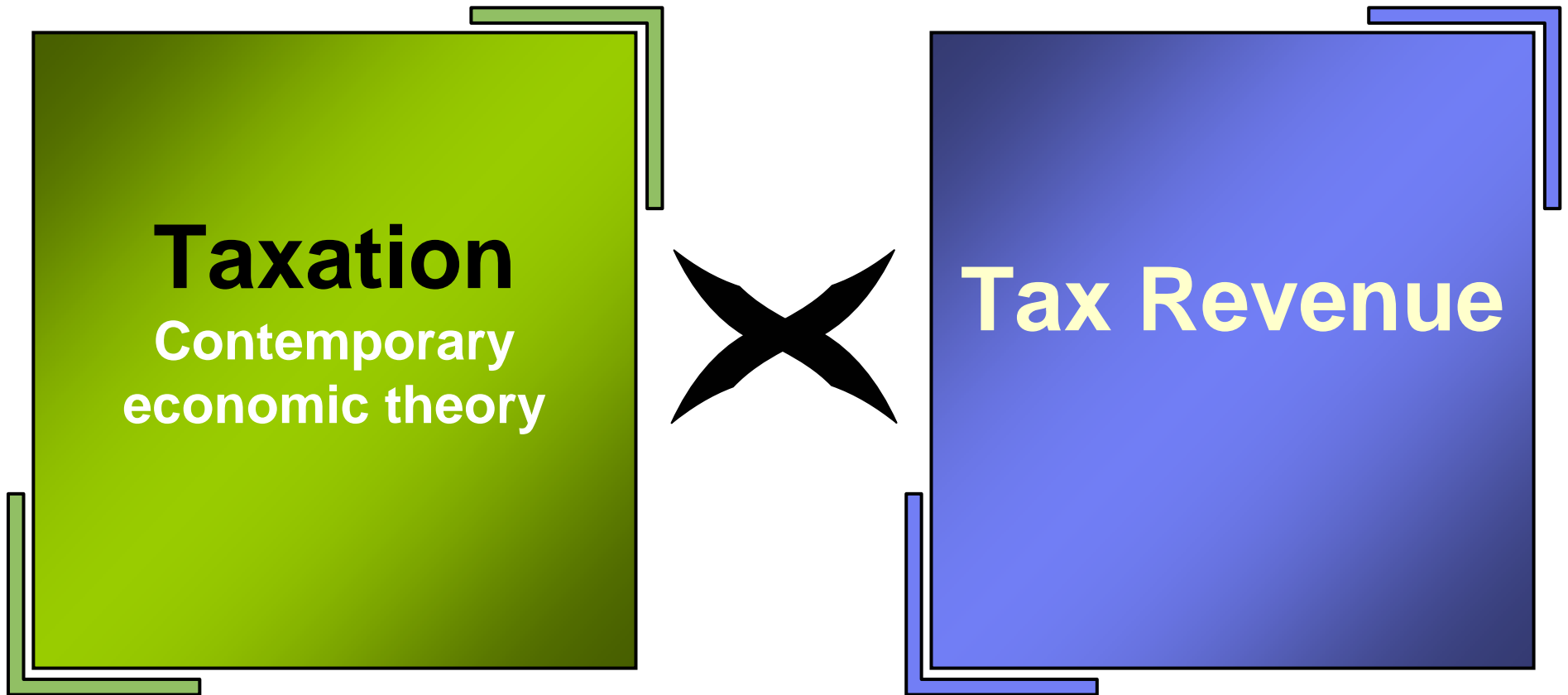
# Tax Burden & HDI (2004)



Source: UN, IMD World Competitiveness Yearbook  
Art: Idéias Consultoria



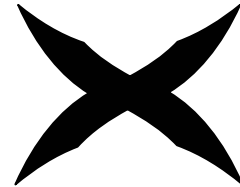
# Core Questions



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**Revenue**

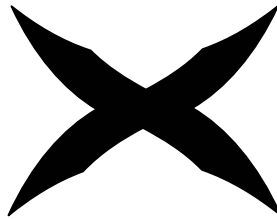


**Economic  
and Social  
Consequences**



# Core Questions

**“State  
convenience”  
principle**



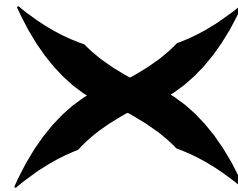
**“Taxpayer  
convenience”  
principle**



# Core Questions

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**Reform**

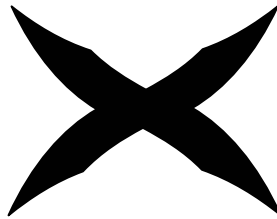


**Re-idea**  
Rethink the ideal  
bases, the spirit  
of the system



# Core Questions

**Assistencialism**



**Competitiveness  
factor**



# Relevant questions

- Financial operations tax – Collecting or fiscalizing?
- Tax anticipations and tax retentions – the difference between medicine and poison is the dose.
- Taxation chaos – drives taxpayers to taxation on a presumed taxable income basis (more simple), but more unjust.
- Capital goods – tax-exempt.

**Is alleviation of taxation enough?**



# Value Added Tax (VAT)

- End of cumulativeness highly harmful
- Fundamental for integration within economic blocks (135 countries use it, among them the signatories of Mercosur)
- Clearinghouse
- Agreements avoiding double taxation
- Total exemption in exports, since the beginning of the chain
- Simplified and favored system for small firms

Great integrated market, neutral, wide and capable of promoting the free flow of goods and services



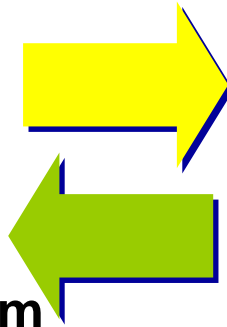
# Who pays the tax?

The final consumer?

In large informal economies this is not true anymore.

In unfair competition enterprises are also taxed directly and may pay (tax increase depreciates gains).

- ↳ Informality
- ↳ Tax evasion
- ↳ Frauds
- ↳ Fiscal war
- ↳ Distorted competitive federalism
- ↳ Unprepared for management



- ▶ High tax burden
- ▶ Red tape
- ▶ Necessity entrepreneurship
- ▶ Lack of public policies



# What is an expensive tax?

The one that cannot be included in the price.

- Low purchasing power of population
- Predatory competition (scale+informality+globalization)

Small firms fail due to scale and power of trade marks and functionalities as a result from research and innovation added to large credit and marketing.

Informality is a key factor.



# Irregular taxation

## Reinforces the problems of the expensive tax

**Regressive burden and indirect taxation - Emphasis in products and services, taxing equally the rich and the poor. Socially unfair.**

**Distorted and competitive federalism.**

**Brazil – Purchasing power of the poor is growing significantly.**



# Are small firms crucial to tax revenue for the countries?

## The Brazilian case

Firms that reported sales revenues less than U\$ 1.3 million

**97.6%**



Total gross income recorded in the country

**13.8%**

Subtracting substitute taxation, financial operations, differentiated percentages, taxing electric energy/telephone/alcoholic beverages...

**What is left?**



# IMPACT OF SIMPLIFIED TAX REGIME (STR) AFTER ITS IMPLEMENTATION IN BRAZIL

## Reported Sales Revenues 1996 1997

| REGIME         | Quantity         | %            | Reported Sales Revenues (R\$ Millions) | %            | Quantity         | %             | Reported Sales Revenues (R\$ Millions) | %            |
|----------------|------------------|--------------|--|--------------|------------------|---------------|--|--------------|
| REAL PROFIT    | 206,623          | 6.88         | 893,225                                | 83.30        | 213,782          | 7.37          | 833,116                                | 80.90        |
| PRESUM. PROFIT | 786,499          | 25.95        | 142,931                                | 13.33        | 649,167          | 22.3          | 115,619                                | 11.23        |
| ME - STR       | 2,035,415        | 67.16        | 36,085                                 | 3.37         | 2,035,891        | 70.23         | 81,028                                 | 7.87         |
| <b>TOTAL</b>   | <b>3,030,537</b> | <b>100.0</b> | <b>1,072,242</b>                       | <b>100.0</b> | <b>2,898,840</b> | <b>100.00</b> | <b>1,029,767</b>                       | <b>100.0</b> |

**124% increase**



# IMPACT OF SIMPLIFIED TAX REGIME AFTER ITS IMPLEMENTATION

## Jobs

| Sales Revenues Intervals (R\$) |                | 1996           | 1998             | Difference     |
|--------------------------------|----------------|----------------|------------------|----------------|
| from                           | to             | (a)            | (b)              | (b-a)          |
| 0                              | -----  60,000  | 291,405        | 486,320          | 194,915        |
| 60,000                         | -----  90,000  | 91,041         | 159,652          | 68,611         |
| 90,000                         | -----  120,000 | 71,470         | 116,215          | 44,745         |
| 120,000                        | -----  240,000 | 140,395        | 233,310          | 92,915         |
| 240,000                        | -----  360,000 | 74,637         | 128,916          | 54,279         |
| 360,000                        | -----  480,000 | 46,519         | 80,537           | 34,018         |
| 480,000                        | -----  600,000 | 28,647         | 53,467           | 24,820         |
| 600,000                        | -----  720,000 | 23,207         | 44,545           | 21,338         |
| over 720,000                   |                | 5,887          | 11,910           | 6,023          |
| <b>Total</b>                   |                | <b>773,208</b> | <b>1,314,874</b> | <b>541,664</b> |

SOURCE: MF/SRF AND MPAS/INSS

# 70% increase



# State intervention x *laissez-faire*

**Taxation policies inducing competitiveness in countries that have external factors with much influence on enterprises  
(See “expensive tax”)**

**Economic principles of differentiated, simplified  
and favored treatment**

**Free initiative?**

**Adopted  
by almost  
the whole world**



# Riqueza perdida

De acordo com a McKinsey, o Brasil pode atingir no futuro a mesma renda per capita atual dos Estados Unidos caso consiga vencer cinco barreiras ao crescimento econômico que têm segurado o país



# Conclusion – Ideal Taxation System

## Basis VAT



SME

Big enterprises

SME - simplified and more favored system

**Utilization of taxation not only as a mechanism of tax revenue, but also to correct the imbalances of the market and social inequities.**



# Conclusions

- **Small businesses are the driving force of the economy of any and every country and due to this fact, they must be seen in a strategic way (jobs and income, local development, accelerated innovation, etc.)**
- **Taxation must always be rethought and modernized due to the speed of economic changes – Globalization, Internet, outsourcing, market externalities...**
- **Informality is a key factor in strategic taxation and in success indexes of formal enterprises.**
- **Taxation as a mere tax revenue mechanism must no longer exist. Instead, it might be used as a mechanism of correction of market imbalances through correcting social inequities and distortions in free competition, including unequal treatment for those that do not face equal conditions.**



# Conclusions

- **Tax as a mechanism of economic and social development. Tax as an economic, political and social fact.**
- **Distortions as lack of access to credit, technology, partnerships, among others, must be tackled at their roots.**
- **Small businesses must be seen as a vehicle of tax revenue in the economic chain and not directly.**
- **Homogeneous concept of SME. Concept of medium enterprise not very relevant, depending on these concepts.**
- **International integration of markets and the awful “cascade effect” require a VAT.**

