



**Proposal for the Design and Implementation of  
Monotax in Colombia (adjusted version with  
comments from government entities)**

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## 1. CONCEPTUAL FRAMEWORK

### 1.1. Theoretical basis of Monotax and Latin-American evidence of its Implementation

Almost all Latin American countries apply simplified and special tax regimes for small taxpayers. In fact, only El Salvador, Panama and the Bolivarian Republic of Venezuela lack this type of differential tax system. In contrast, in Bolivia, Chile, Mexico, Peru and Uruguay more than one of these schemes are applied simultaneously (Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013). Colombia is not far behind, whatever your Tax Code with the simplified VAT system to natural persons<sup>1</sup> with gross receipts, contracts and bank appropriations below a certain threshold (and some other conditions)<sup>2</sup>, exempting them from the obligation to check, charge VAT, declare and take the corresponding accounts.

Now, there are several motivations that led each country to these simplified regimes for small taxpayers, but largely have to do with the organizational strategy and control of tax administrations (Junquera and Pérez, 2001). However, countries like Brazil, Argentina, Uruguay and Peru, aiming to objectives of economic and social policies that go beyond the mere organizational and management control tax issue, opted for a special simplified regime for self-employed person of very low income and / businesses or small size (even street) called Monotax. As its name indicates<sup>3</sup>, the Monotax is replaced by a single tax, and generally reduced lump sum, that collection of taxes that, under the general scheme, the person must pay.

Indeed, the historical context and the corresponding legislative process in those countries that have implemented the Monotax reveals intentions at the time of: i) simplifying the process of paying taxes to these people and businesses, ii) make them tangible taxed benefits ( when the system includes social security benefits) and iii) encourage by relieving them of their tax burden.

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<sup>1</sup> All legal persons, regardless of size, belong to the common system.

<sup>2</sup> The requirements for a person to be sheltered by the simplified scheme are: i) in the previous year (2014) would have had total gross income of less than \$ 109,940,000, ii) not be held in the previous year (2014) sales contracts of goods or provision of taxable services for individual value and more than \$ 90,701,000, iii) does not hold in the current year (2015) sales contracts for goods or provision of services taxed by individual value exceeding \$ 93,321,000 and, iv ) that the amount of their bank appropriations, deposits or financial investments during the previous year (2014) have been equal to or less than \$ 123,683,000, v) the amount of their bank appropriations, deposits or financial investments during the year ( 2015) are equal to or less than \$ 127,256,000,vi) which has at most a business establishment or office, vii) that the business establishment, office, home, local or business not under activities are carried franchise, concession, royalties, licensing or any other system involving the exploitation of intangibles, and viii) non-customs user.

<sup>3</sup> According to the Royal Spanish Academy the word monkey

es un elemento compositivo (prefijal) que proviene del griego (μόνος) y que se aplica en la formación of nouns and adjectives with the meaning of "unique" or "one". For its part, the tribute word originates from the Latin (tributum) and means "monetary obligation established by law, the amount of which is intended to support public burdens."

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This with the very clear purpose of advancing the formalization and visibility of low-income self-employed and micro-businesses.

For example, in Peru, and to "the situation of informality and low compliance with these companies, in 1994 a simplified scheme (RUS, which remains valid) was established, which main objective was precisely the simplicity of its determination ... "(Sanchez, Rodriguez and Zumaeta, 2000). Meanwhile, in Argentina the authorities implemented in 1998 Monotax as a way "to simplify compliance with tax and social security obligations of small taxpayers and thus incorporate informal workers to the field of social security" (Calero, 2012).

Ultimately, "the single tax emerges as a simple alternative that facilitates compliance with formal obligations to small taxpayers ... It is intended that companies disclose information and that both individuals and economic activities, see the dividends of formality ... I mean, increase benefits and lower the legal costs of it "(Bustamante, 2013).

At this point it is worth opening a parenthesis and ask why there is so much business and labor informality in Latin America? Actually, there are many hypotheses.

One, and perhaps the most popular states that informality is associated with certain sectors of the population which does not get the benefits of tax. So, the high payroll taxes and the respective contributions to social security that do not correspond to the value of the benefits received by the workers would be one of the main reasons why people leave the labor market Formal (Perry and Maloney, 2007).

It has also been argued that informality has to do with the high cost (in terms of time, effort and money) to formalize. Thus, informality would be attributable to a mass of entrepreneurs who goes ahead despite restrictions and regulations imposed by rules and excessive bureaucracy, which end up forcing small business owners to take refuge in the informal sector (Diaz, 2014 - citing: De Soto, 1986; Ghersi, 1989; Bustamante et al, 1990).

Another approach has to do with the economic cycle. For example, in the Argentine case "... in addition to the general trend in the medium term, during times of crisis, many taxpayers sought escape routes to continue operating, for example, performing maneuvers tax evasion or unfolding in the informal sector of the economy "(Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).

Of course, informality has also been associated with low expected costs not taxed due to the limited enforcement by the state. In other words, it is assumed that those who are informal are, at the same time, difficult to identify and control. They are "difficult to control groups and of large numbers" (Junquera and Perez, 2001).

Additionally, certain cultural factors are mentioned as causing informality. "Under this perspective, the formalization of business is not part of the cultural values of migrants from rural areas, which is a secondary priority for micro and small entrepreneurs" (Diaz, 2014 - citing: Golte and Adams, 1987; Adams and Valdivia, 1991).

In any case, the logic indicates that under the problem of informality there are also individual reasons why a person (self-employed, employer, etc.) decides not to pay taxes. Indeed, when combined, on the one hand, the complexity of the tax code of a country as well as cumbersome which may be the procedure for paying such taxes and, on the other hand, the lower administrative capacity and accounting of the small potential contributor, the result cannot be other than informality.

Closing parenthesis and whatever the case, the data shows that the magnitude of the problem of informality in Latin America is very large. In the case of Argentina, Peru, Brazil and Chile more than a third of those working (employees or not) do so in conditions of informality, with the highest informality being Peru and Chile the lowest (Maurizio, 2015). Indeed, in Peru informal employment accounts for about 60% of the economically active population, a percentage that has declined compared to 2003 (66.3%) but it remained stable between 2008 and 2011 (Diaz, 2014). In terms of business informality (no registration with the tax administration) the proportion of informal borders in Peru is of 72% and is much higher in micro and small enterprises (Infante and Chacaltana, 2014).

Now, one of the metrics behind the high levels of informality in Latin America is the high weight of the self-employed and unpaid family workers in total employed population, with Bolivia (58.5%), Peru (51.5%), Colombia (48.6%), Guatemala (48.1%), Nicaragua (47.1%), Dominican Republic (45.9%), Paraguay (43.4%) and Ecuador (41.8%) countries exhibiting the highest percentages (see Annex ECLAC Statistical taken in Amarante and Perazzo, 2013).

In the case of Colombia the problem of informality is very large and data speaks for itself. During October-December 2014 (latest data available from the Great Integrated Household Survey - GEIH - DANE) the percentage of people who worked in the informal sector was 49.41% in 23 major cities (and 48.19% in the 13 cities and traditional metropolitan areas). Worse, out of the total of self-employed people in 23 cities (4'583,000 individuals), the 80.75% was billed as an informal (i.e., 3'701,000 people).

More surprising they still remain outside of the formal labor market of those 23 cities the 79.61% who were classified as "employer or employer". Another surprising fact of the survey is that 19.49% of employees in the 23 cities (i.e., those who

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in these urban centers work in a company or business with any type of contract or labor relationship) were also classified as informal.

The GEIH reveals that only 34.16% of employed persons have pension coverage nationwide. And while 92.48% of workers have health insurance, the 44.59% of them belong to Subsidized Regime. Finally, it is worth mentioning that the DANE data show that 39.28% of employees in the country has a verbal contract type (the percentage in the 23 major cities is of 28.54%). These data undressing the magnitude of the phenomenon of informality in Colombia.

Moreover, the magnitude of the problem of informality should not be understood only in the light of the aggregate figures, but must be examined under the lens of the consequences that this phenomenon brings. Of course, the phenomenon of "Informality reflects underdevelopment" (Perry and Maloney, 2007). But the problem goes far beyond. It turns out that the empirical evidence points to a positive and strong correlation between informality and poverty of households. For example, data from Argentina, Peru, Brazil and Chile show that the incidence of poverty is between two and five times higher in informal workers when compared with the income from formal labor market (Maurizio, 2015).

Furthermore, data from these four countries show that informal workers receive significantly less income earned by formalized workers due to two effects that multiply themselves: on the one hand, their hourly income is lower and, on the other, the number of hours they work is also lower (Maurizio, 2015). Colombia data also show a link between being informal and receiving lower labor income (Parra, 2012).

On the other hand, the lower hourly earnings and lower demand (fewer hours worked) that characterizes the informal seems to be correlated with labor productivity. Again the case of Peru is illustrative: while in the sectors with higher level added per worker the formal employment rate fluctuates between 72% and 82%, in the sectors of lower labor productivity less than 10% of workers are in formal employment (Diaz, 2014).

Consequently, the labor market segmentation between formal (typically in modern and high labor productivity sectors) and informal (usually in traditional and low labor productivity sectors) seems to be correlated with the levels of poverty and inequality in Latin America. "These differences in productivity are transferred to the income of the employed and are therefore a determining factor of the poor distribution of income. A segmented labor market with these characteristics makes it difficult to reduce poverty and inequality "(Infante and Chacaltana, 2014).

Likewise, those who work in the informal sector tend to: i) be excluded from the pension system or social security (health, pension and unemployment insurance), ii) be excluded from the formal banking system

entrepreneurship as a tool and / or consumption smoothing, iii) perform in conditions that disregard labor legislation. And as if that were not enough, there is also empirical evidence showing a higher prevalence and weight of informality in women, young and elderly (Maurizio, 2015). This undoubtedly exacerbates the problem of inequality derived from informality.

Given the magnitude of the phenomenon of informality in Latin America, it is not surprising that in several countries has been designed and implemented public policies to mitigate the undesirable consequences. One of these policies has been the Monotax system for people teeny economic dimension. This system has been implemented in countries like Brazil, Peru, Argentina and Uruguay.

As mentioned above, the Monotax replaced by a single tax, and generally reduced lump sum, that collection of taxes payable by the person (natural or legal) under the general regime. As will be seen below, the Latin American countries that have implemented the Monotax sought the self-employed low income and micro businesses felt a relief, on the one hand, in terms of red tape and logistical complexity when it comes to paying taxes and, on the other hand, in terms of its direct taxation. This with the very clear purpose of advancing the formalization and visibility of these people and businesses.

## 1.2. How Does Monotax work?

A first element that is essential when building a Monotax system is the delimitation. This refers to the conditions to be met by a person or a business to be there and generally defined in two dimensions. First, a threshold billing, sales or gross income is established. Second, limits are set in terms of certain physical or economic variables that are easy to measure and control: local size, amount of rent, energy consumption, number of employees, unit sales prices, etc.

Almost always the system secretes into several categories to taxpayers depending on the thresholds for each criterion of demarcation. The higher the category the highest the threshold and, naturally, the higher the amount of the tax.

For example, in Argentina Monotax system opens in 11 categories. The first category applies to Monotax payers reaching to be below the following ceilings: i) gross income up to \$ 48.000 pesos (about \$ US 5,500), ii) local size up to 30 m<sup>2</sup>, iii) annual energy consumption up to 3,300 KW, and iv) the amount of annual rent to \$ 18.000 pesos (about \$ US 2,100). The highest category sets the following limits:

i) gross income up to \$ 600.000 pesos (about \$ US 70,000), ii) local size up to 200 m<sup>2</sup> iii) annual energy consumption up to 20,000 KW, and iv) the amount of annual rent to \$ 72.000 pesos (about \$ US 8,100).

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Meanwhile, Uruguay's Monotax regime only has 4 categories: one for single-person businesses and 3 for societies. The gross income of sole monotax payers must be below \$ 542.302 Uruguayan pesos (about \$ US 22,300). In contrast, the fact that companies are covered by the system must have gross income lower to \$ 903.837 Uruguayan pesos (about \$ US 37,100). 3 categories in which these companies are classified depend on whether you have 1, 2 or 3 members. Regardless of the category business assets or society cannot exceed \$ 451.919 Uruguayan pesos (about \$ US 18,600) and size of the room must be below 15 m<sup>2</sup>.

In Peru there are 6 categories that are segmented based on gross income or monthly purchases of monotax businesses. The first category sets a limit monthly gross income or purchases under \$ 5,000 soles (about \$ US 1,650). The highest category supports monthly gross income or acquisitions up to \$ 60,000 soles (about \$ US 19,700). In any case, annual gross income or purchases cannot exceed \$ 360,000 soles (approximately \$ US 118,000) and fixed assets of the business must be less than \$ 70.000 soles (approximately \$ US 23,000).

In the Brazilian Monotax, limit eligibility is also a function of annual gross income: i) \$ 60,000 reais for the category Individual Micro entrepreneur (approximately \$ US 23,000), ii) \$ 360,000 reais (approximately \$ US 140,000) for the category of Microenterprise and iii) \$ 3'600,000 reais (approximately US \$ 1,400,000) for Porte Small Company category.

In short, "when giving a concept of small business or small business in the Latin American tax field is the variable volume of the determining gross income. From a practical point of view it seems like the best solution, at least in the initial stage of accession. The weakness of the census and the weight of the informal economy suggest a strategy of simplicity in the implementation process ... It is at a later stage in which to prevent degradation of the system must carry out checks of taxpayers including through variables physical or economic and conduct a census debugging work "(Junquera and Perez, 2001).

A second element to be defined when implementing a Monotax system is the reach in terms of taxes it replaces. The regime of each country is different but usually Monotax unifies the direct and indirect taxes of the national or federal level as income tax and sales tax or value added. Import taxes are generally excluded. Sometimes, as in Brazil, the Monotax also replaces assessments of territorial order (departments and municipalities).

In most cases (the exception is Peru), the Monotax also replaces pension or social security contributions so that, perceiving tangible benefits - especially



health, which are beginning to perceive from the time that remains sheltered by the insurance - the person has a greater incentive to participate and remain in the system.

Another central feature of Monotax system has to do with the payment methodology. That is, how much you pay, how to pay and the frequency of payments. Of course, one should not forget that the essence (and hook) of the system is, on the one hand, its simplicity (for which payments are typically lump sum) and on the other, the lightening of the tax burden (so that quotas tend to be minimal).

For example, in Uruguay monthly payments, depending on the category of monotax payers, range (approximately) between \$ US 22 and \$ US 30 if not opted for health coverage, or between \$ 78 and \$ 175 if opted for such insurance. Additionally, monotax payers are only required to carry a checkbook with consecutive bills issued by the tax administration.

The monotax payers of Peru make monthly payments that are in the approximate range of \$ US 7 to \$ US 200, depending on the category. They should only submit payment vouchers that support purchase - business sales in chronological order and are not required to keep books.

In Argentina, the monotax payers make monthly payments with fixed fee which is approximately between \$ 50 and \$ 360 depending, of course, of the category. Meanwhile, the taxpayer sheltered by the Monotax in Brazil pays monthly installments starting at the equivalent of about \$ US 17 (Individual category Micro entrepreneur).

### **1.3. Advantages of Monotax**

#### ***Simplicity***

As already stated, the heart (and main hook) of any Monotax structure is its simplicity. In fact, in Argentina the slogan with which the Monotax was socialized read: "Simple, very simple ...". And it can not be a coincidence that the Brazilian system is named precisely SIMPLES.

Surely it is the simplicity of Monotax that makes it highly attractive for both the taxpayer and tax administration. On the one hand, this simplicity can provide tax administration a control system (Sanchez, Rodriguez and Zumaeta, 2000). On the other hand, simplicity generates the small business owner, producer or self-employed person "greater legal certainty and security for the fulfillment of their tax obligations" (Junquera and Pérez, 2001), thanks to which "it encourages greater participation by taxpayers in these regimes "(Sanchez, Rodriguez and Zumaeta, 2000).

Therefore, it cannot be a coincidence that the evidence shows that in Brazil and Mexico the programs

of administrative simplification (for example, to pay taxes or obtain operating licenses) increase registration fees of formal enterprises, with improvements in the capacity to generate income and employment of these firms (Perry and Maloney, 2007).

## ***Economic growth***

The theory of the financial lifecycle of the company (Berger and Udell, 1998) states that new and small businesses not only drag a greater level of risk but also the lack of collateral and credit history have greater access to formal credit and therefore are required to be financed by their own funds or, for example, with credit from suppliers (which is more expensive than going to the formal financial system) and its profitability and cash flow are in this stage, quite narrow. Although this theory has been empirically evaluated with mixed results<sup>3</sup>, conceptually, it makes sense to expect the formalization induced by the Monotax by releasing some degree credit restrictions of small business owner, which ends up improving their performance.

On the other hand, any simplified system means less indirect tax pressure and generally in Monotax systems also direct (Junquera and Pérez, 2001); that is, inevitably it increases the competitiveness of small business. So, through this transmission mechanism is also expected that the Monotax regime improves the performance of small business.

However, although the evidence is limited, one that is available suggests substantial gains in efficiency of firms leaving informality and begin to pay taxes (Fajnzylber and Maloney, 2007). Indeed, the data show that the formalization attributable to exogenous factors (such as the introduction of a monotax system) correlates with better performance of enterprises, which should result in higher rates of economic growth (Fajnzylber and Maloney, 2007). According to the authors, this may be associated with the formalization of a business which increases its access to credit and because it also becomes eligible for state support programs (eg technical assistance).

In Mexico, for example, there is empirical evidence to the effect that the earnings and profits of micro firms that pay taxes are significantly higher than those informal firms of similar size and entrepreneurial ability (Fajnzylber, Maloney, and Rojas, 2009).

In the case of Brazilian Monotax (simple system) the available evidence supports the same hypothesis. For example, data show that incentives to formalize attributable to SIMPLES significantly increased access to credit by businesses sheltered by the system,

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<sup>4</sup> See for example (Sanchez - Vidal and Martin - Ugedo, 2008) for the Spanish case and (Barona y Gómez, 2010) for the results with a database of 130 entrepreneurs in Cali.

also leading them to projects with higher levels of investment and longer time horizons (Monteiro and Assunção, 2006). But in addition, the data show that the new companies that chose to operate formally (and paying taxes) under the SIMPLES system have higher levels of income, profits, contract workers, use of capital, labor productivity and total factor productivity (Fajnzylber Maloney, and Rojas, 2011).

Ultimately, the available empirical evidence can buy the idea that "when the company is small it is mono taxer and as it grows will assume other responsibilities ... and fulfilling its formal obligations ... formality becomes an indicator of company health. "(Bustamante, 2013). Naturally, increases in health of companies translate into higher rates of economic growth.

### ***Equity and Poverty Reduction***

By inducing the expansion of the formal sectors, that as noted, tend to be characterized by higher levels of labor productivity, the Monotax system induces a redistribution of income in favor of those who happen to be informal (and less productive) to be formalized. That is, the formalized probably will earn higher levels of income due to higher compensation per hour and greater number of hours worked (due to increased productivity).

Thus the Monotax contributes to dilute the labor segmentation between formal and informal, as well as poverty and in this way to improve income distribution. As seen above, data from Latin America suggest this (Maurizio, 2015; Infante and Chacaltana, 2014; Diaz, 2014) and data from Colombia would point in the same direction (Parra, 2012).

Of course, if the Monotax incorporates social security or social security coverage (which can even accelerate the increase in labor productivity of those who formalize), then an even faster reduction in poverty and inequality levels must be expected.

### ***More efficient allocation of resources of tax administration***

Every organization has limited human resources. Tax administrations do not escape this reality and therefore must also optimize the use of this scarce human capital. The Monotax system allows tax administration free its more qualified staff more and apparatus of investigation / intelligence official to the control and monitoring groups or sectors most relevant taxpayers in terms of collection or latent risk of evasion (Junquera and Perez, 2001).

However, in economies where the largest volume of revenue is concentrated in a small percentage of taxpayers (and the weight of tax collection actually or potentially sheltered by a simplified regime taxpayers weighs very little) efficient segmentation

Of human resources tax administration becomes more effective. And this seems to be the rule in the Americas: in the member countries of CIAT5 between 0.35% and 2% of taxpayers generate between 51% and 75% of the collection (Junquera and Pérez, 2001).

On the other hand, there is also evidence showing a significant reduction in the ratio of taxpayers for inspection personnel (i.e., an increase in capacity control) when taxpayers are segmented by modules. For example, in Spain this ratio fell from 1.330 to 445 taxpayers for cash inspector between 1991 and 1995, following the introduction of the system of modules in the reform of the income tax or personal income tax Individuals (Gordon, 1999).

## ***Information***

The Monotax undoubtedly increases the amount of information of individuals and companies that is available to the authorities.

For tax administration the benefit is clear. It will enter a wealth of information about people who were not previously taxed. This allows, on one hand, to cross new information that was not available before and hereinafter may be compared with that provided by traditional contributors. On the other hand, this cluster of new information will help "shape the exact location of the taxpayer, which will result ... in a better and more professional debugging census" (Junquera and Perez, 2001). That is, more information available to the tax administration in its task of controlling and mitigating tax evasion both of which are taxed and those who choose to enter the system.

But the greater visibility of those microbusinesses and self-employee that didn't pay tax and much less were registered (eg for operating licenses) allows a gain for the state that goes beyond mere tax administration. Indeed, you can get dividends efficiency for the state in terms of health regulation, control of industrial safety, monitoring compliance with labor legislation, the quality of official statistics and even development of intelligence work<sup>6</sup>

## **1.4. Disadvantages of Monotax**

### ***Fall collection in short term***

The main risk that emerges from Monotax system is the imminent fall of short-term tax collection. This is because taxpayers migrate to the new system taxed under other schemes of higher tax burden. However, you should note two things.

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<sup>5</sup> Inter-American Center of Tax Administrations.

<sup>6</sup> Do not forget that the problems of micro-trafficking in Colombia are closely linked to micro chains in the neighborhoods.

First, in the medium term as a result of the higher level of economic growth that is expected with the introduction of Monotax, the collection must increase. At least, that is what data says in some of the countries that opted for the Monotax (Lemgruber - Viol and Rodriguez, 2000).

Second, the Monotax should not be seen as a source of increased tax collection in the short term, but as a tool to stimulate the generation of formal employment and economic and social inclusion; ie as a tool to help formalize and thus improve income distribution (Bustamante, 2013). In this statement match several authors: "If that drop occurs, and it seems that this is so, it cannot be unlinked from one of the main objectives of these schemes, which is to incorporate the informal sector into the system ..." (Junquera and Perez, 2001). Some even go further: "... the poor results achieved in tax collection matters should not be weighed too much and although terse, the amounts of revenue obtained should be included in the set of benefits derived from the application of Monotax, considered part of a political tax strategy that looks to reduce the levels of informality..." (Cetrángolo, Goldschmit, Gómez – Sabaíni y Morán, 2013).

### ***Involution: Fraud, Evasion and Dwarfism***

Experience shows that Monotax system work well in its first stage: lower implementation costs and increase the number of taxpayers by incentives derived from the simplicity of the system, the lower tax burden and, in some cases, the inclusion of benefits social security (Junquera and Pérez, 2001). However, if the tax administration does not evolve in their ability to control this new category of taxpayers, for example through actions and mechanisms reality check of the statements of the people who sheltered themselves under the new regime, it is possible that the system involutions for abuse of the same taxpayers.

Undoubtedly, the system can be provided for tax evasion and fraud by creating artificial or use of small companies (or fractionation medium enterprises) to reduce the tax burden on large companies.

Additionally, there is a risk of fraud and evasion in the billing system that is required to monotax payers: "... from the point of view of suppliers concealment sales and from the point of view of customers generating invoices for nonexistent transactions "(Junquera and Perez, 2001). In this case the recommendation is clear: "... tax credit documents should never be admitted that the taxpayers issued t under the simplified system, because if they are for end consumers it would have no tax significance, whereas if issued to other taxpayers , also not in the regime, it would be promoting the issuance of

*false invoices at no cost to the issuer, as their yields or estimated fees would remain unchanged"*(Junquera and Pérez, 2001).

It may also be the phenomenon of dwarfism. This is the incentive not to grow not pass the general system in which more taxes are paid. Dwarfism is not necessarily fraudulent but reduces economic growth. All this (fraud, evasion and dwarfism) means immobility to the general regime which, in turn, generates some loss in terms of collection and equity. "This possible loss refers to the cost generated by attitudes of" fiscal dwarfism 'avoidance and tax evasion that the Monotax could lead to the existence of certain perverse incentives that act as barriers to exit therefrom into the general scheme, a situation in which the simplified scheme ceases to be an 'intermediate bridge' between the two regimes and becomes 'shelter' for taxpayers,

Indeed, some authors argue that in Peru, four years after the establishment of the Single Tax in 1994 (RUS System), it became "an open invitation to evasion door, and ... the cost of management regarding its performance is extremely expensive" (Sanchez, Rodriguez and Zumaeta, 2000).

So, if once Monotax is introduced to the tax administration itself it does not evolve in monitoring and effective control system, it is very likely that the kinds of fraud, tax evasion and dwarfism derived therefrom become a problem. Indeed, "once the initial stage is over a rethinking of administrative action with respect to this group of taxpayers is necessary ... if this initial phase is not completed with a subsequent control, reclassification, through other variables that aren't the volume of transactions, the system clearly degenerates, and not by increasing their complexity, but because of the lack of subsequent action by census purification of re-categorization and control "(Junquera and Pérez, 2001).

Some countries have tried to alleviate dwarfism and tax fraud attributable to banning trade relations with the monotaxer with large companies. For example, stating that after a certain period of time such formal companies that buy monotax payers and can no longer deduct such purchases as accounting expenses. In other cases, (Peru, Uruguay) Monotax blanket system only protects businesses that sell to consumers.

## 2. INTERNATIONAL EXPERIENCE

### 2.1. Countries

#### *Brazil*

In Brazil Monotax genesis dates back to December 5, 1996 with the issuance of Law No. 9317. This rule gave rise to the Federal SIMPLES system (Integrated System of Payment of Taxes and Contributions of Micro and Small Porte ). It is important to note that the Federal SIMPLES was based on the Constitution of 1988:

Art. 179: "The Union, the States, the Federal District and the municipalities dispense micro and small enterprises according to their legal definition, differentiated legal treatment, in order to further them through simplification of their administrative, tax, pension obligations and credit, or the elimination or reduction of these by law. "

SIMPLES law unified<sup>6</sup> taxes of federal order: i) income tax of legal persons, ii) social contribution tax on industrialized products, iii) on net income, iv) contribution to the financing of social security, v) contribution to the PIS / PASEP<sup>7</sup> and vi) employers' social security contribution. Social security includes the health component.

The law also empowered states and municipalities to adhere (by agreement) the Federal SIMPLES with: i) the state tax on transactions relating to the circulation of goods and provision of transport services (ICMS), and ii) the municipal tax on services of any nature (ISS).

Note then that tax simplification and relieving fiscal pressure on all levels (federal, state and municipal), designed by the Constitution as an instrument for encouraging micro and small enterprises, formed the historical context and motivation of economic policy during the gestation of Monotax in Brazil. But also, as the Federal SIMPLES established that contributions to social security by the employer were tied to the turnover of the company and not the value of the payroll, interest on the economic authorities of the moment is also evidence to advance the formalization of the labor market.

However, the results regarding adherence to Federal SIMPLES by states and municipalities were not satisfactory: few municipalities adhered, none of the states that signed the agreement remained and several states ended up creating their own simplified systems - SIMPLES Paulista, SIMPLES Carioca, SIMPLES Candango - (Federal Revenue of Brazil, 2010).

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<sup>7</sup>This is a tax on payroll in a consistent contribution to the Social Integration Program (PIS) and the Asset Building Program for Public Servants (PASEP).

That is why in 2003 there was carried out a constitutional reform that facilitated federal integration - state - Municipal tax matters allowing with a Complementary Law a "single system of tax collection and contributions of the Union of the States and of the municipalities to be created." ICSM - So in 2006 the Complementary Law No. 123, which created the National SIMPLES, unifying the same taxes of the previous SIMPLES (6 federal level, 1 state

- And 1 municipal - the ISS -), but this time making mandatory the inclusion of competition state taxes (ICMS) and municipal (ISS) in the new unified tax system.

Subsequently, the Complementary Law No. 128 of 2008 established in the Brazil monotax concept Individual Micro Entrepreneur (MEI). As a historical and policy context, the idea was to attack informality, because at that time the Brazilian Institute of Geography and Statistics estimated at 10.3 million the number of entrepreneurs in informality and outside the social security system (Federal Revenue, 2010). MEI was defined as the natural person or individual entrepreneur (in the commercial, industrial and service sectors) with annual turnover of up to \$ US 20,500. The MEI was imposed a monthly tax lump sum of US \$ 35 that covers its contribution to the social security system, as well as payment for ICMS (state) and ISS (municipal), being exempt from the 6 federal taxes.

## ***Argentina***

In Argentina the Monotax was born to the legal life with Law No. 24977 of 1998 entitled "Simplified Regime for Small Taxpayers (RS) - Monotax". The historical and economic policy was discussed and approved the Law shows that it was motivated primarily by the formalization of small independent worker or employer context. "In that sense, the Argentine Monotax was conceived as an instrument of tax policy to include in the formal system to those small taxpayers (mainly self-employed, as professionals, businessmen, traders, self-employed, etc.) that were not entering their taxes, either because they were never registered in the system or because they had auto-alienated from it "(Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).

The Monotax replaced with a fixed monthly sum: i) the added value tax, ii) the income tax and iii) contributions to social security (including health component). The pension component of Monotax not only harbored the self-employed, but admitted, under certain conditions, the monotaxer employer enroll certain number of employees in the new system.

Monotax regime was quickly restored with the issuance of Law No. 25539 of 1999, which took effect in 2000. On the one hand, the law amended the pension component of Monotax and on the other hand, created a social security regime especially for domestic workers (Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).



Law No. 25865 of 2004 reformed the Monotax system again providing, among other things, segmenting it between the provision of services or locations and other activities. This reform also provided that the monotax payers employers pay for all of their workers pension contributions established in the general scheme. It is worth mentioning that in this reform the Monotax was created for small potential contributors (Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013). In addition, Law 25865 created the Social Monotax (MS) "in order to facilitate and promote the incorporation into the formal economy of people living in social vulnerability engaged in production, trade and service activities, only as self-employed" (Calero , 2012).<sup>8</sup>.

Subsequently, with the issuance of Law No. 26565 of 2009, begins the fourth stage of the scheme. With this reform, among other things, the new thresholds of gross income and other physical parameters that define the admissibility of Monotax system were established. The annual value of rents was also introduced as a new variable of admissibility. In addition, payment was increased by the pension component, allowing the extension of health coverage to members of the family group by contributing additional fixed for each of them. Finally, it is worth noting that this rule also created the Regime of Social Inclusion and Promotion of freelancing, setting as gross income threshold was the same as the Social Monotax.

Currently the Argentine Monotax has 11 categories, with a maximum gross income ranging from approximately US \$ 2.700 to US \$ 35,000 (US \$ 23,000 in the case of locations and / or services). Monthly payments start at approximately \$ US 35 and \$ US 175 reach (\$ US 215 in the case of locations and / or services). In the case of the variable area affected ceilings starting at 30m<sup>2</sup> and reach 200m<sup>2</sup>. The threshold of maximum annual power consumption in 3.300 KW begins and ends at 20,000 KW. For the annual value of the rents they were established as those ceilings ranging roughly from \$ US 1,000 to \$ US 5,000.

Some consider the whole body of reforms to Argentine Monotax since its creation (which does not include only those laws but also numerous decrees and resolutions of the Executive) has unleashed a high dose of instability in the system, generating not only distortions in terms the incentives created, but also difficult to assess the scheme as a public policy. "This process of continuous change is a serious impediment to evaluate the effects of the system in relation to the recruitment of a greater number of taxpayers or reduction

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<sup>8</sup> Law No. 26223 of 2007 became permanent the MS provided the conditions of income (turnover) and social vulnerability of the person be maintained.

*of existing labor informality, as well as it is difficult to assess the incentives that regime generates in various universes of taxpayers ..."*(Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).

## **Uruguay**

The Uruguayan Monotax was created by Law No. 17296 of 2001. As in other countries, the goal was to formalize economic activities of small dimension such that they began to pay taxes by a single tax all national taxes (excluding import) and the respective contributions to the social security system.

Interestingly, Law 17296 was the Law on the National Budget of this year (2001) and not a tax reform or a law whose purpose was solely the creation of Monotax. Indeed, of the 650 articles contained in this Budget Law only 7 were needed to give life to Monotax, the following being particularly relevant:

"Article 590 (Subjective Reach) .- The owners of sole proprietorships of small economic size that develop commercial activity on public roads and in public spaces, both street and stable, may choose to pay in place of the special social security contributions generated by its own activity, and all existing national taxes, excluding levied on imports, a single tax.

*Only those taxpayers who meet all of the following conditions will be included in the definition of the preceding paragraph:*

- A. *Occupy a maximum of four people, including the owner of the sole proprietorship.*
- B. *Revenues from commercial activity during the year do not exceed the limit set in paragraph E) Article 33 of Title 4 of the Revised Text 1996.*
- C. *Make their sales of goods and services in cash without the use of credit cards, purchase orders or the like, or the granting of self-financing.*
- D. *Don't exploit more than one position simultaneously ...*

Article 592 (Unified tax obligation) .- *The amount of the single tax will be calculated on a notional salary equivalent to a national minimum wage, rates applicable in respect of social security contributions and taxes collected by the Social Security Bank (BPS) in force, excluding the so called complement of mutual quota. The only tax that does not include social security contributions and payroll taxes applicable for dependents, which are governed by the existing rules to the effective date of this law ...*

Article 595 (Features) .- *The affiliates retain all rights arising inclusion and affiliation to the social security system, except for medical assistance*

*health insurance. Notwithstanding the foregoing, the above will have the option to access the referred benefit, in which case they must pay the supplement for mutual respective fee.*

*Article 596 (Options) .- The Executive Branch shall regulate all matters related to the exercise of the options set out in Articles 590 and 595 of this law. "*

Several subjects arise. First, the scheme was introduced without the proper political erosion of tax reforms. On the contrary, to articulate to a Budget Law the birth of Monotax probably generated positive political returns both for the executive and the legislature political. Second, by giving powers to the Executive for its regulation, long technical discussion in Congress was avoided, thus avoiding the risk of deformation of the original idea, and also facilitating the implementation of the system by the state technocracy specializing in the theme.

Third, the calculation of the amount was made by an elemental formula (what a person must pay minimum wage for contribution to social security). This can drag a short-term fiscal imbalance (as is natural in such systems) as the Monotax replaces not only social security contributions but also other national taxes (other than import).

Fourth, in any case, this first version of Monotax in Uruguay was severely restricted: i) was limited to businesses street or public space, ii) businesses selling on credit or term were excluded, iii) the scope was narrowed to businesses that exploit a single physical place and iv) only trading activities were sheltered. Fifth, social security benefits did not include health insurance and also left outside dependents (unless an additional amount is paid).

Now, in the early years of the Monotax, results in labor formalization were not satisfactory and, therefore, there was a first reform. "Due to the limited success of the original proposal regarding the inclusion of workers in the informal sector, in 2007, on the occasion of the Tax Reform Act, certain amendments were introduced to ease the requirements in the regulations" (Amarante and Perazzo, 2013).

Indeed, Law No. 18083 of 2006 (which came into force in 2007) amended the Uruguayan Monotax expanding its coverage to: i) small local private space, ii) manual craft production activities, iii) facto companies (before only family and unipersonal were included, iv) sole proprietorships and credit sales, v) a higher threshold billing, vi) sales activities not only to final consumers but also to large companies and the state included. Even the conditions were relaxed regarding contracted dependents (Amarante and Perazzo, 2013).

# Design and Implementation of Monotax in Colombia

In 2011 Law No. 18874 was issued, which created the Social Monotax MIDES for individuals and households in poverty and socio-economic vulnerability:

"Article 1. (Subjective Reach) .- Those who produce and sell goods and provide services, have no dependent personnel and comply with the conditions set out in the following articles, may choose to pay in place of the special social security contributions generated by their own activity and all existing national taxes, excluding levied on imports, a unified tax provision to be called Social Monotax MIDES. The following subjects will be included in the definition referred to in the preceding paragraph:

- A. *Personal endeavors.*
- B. *The joint venture projects consist of a maximum of four members.*
- C. *Associative composed exclusively of family enterprises, with up to fourth degree of consanguinity or second degree, provided that the number of members does not exceed five.*

*A condition to be included in this system is that all members of the aforementioned subjects integrate households that are below the poverty line that determines the National Statistics Institute, or members of households in socioeconomic vulnerability in terms of those referred to in Article 2 of the Law No. 18,227 of December 22, 2007 and its regulations. For this purpose, it is understood that personal ventures refer to sole proprietorships and partnership ventures refer to fact companies."*

Finally, Decree No. 66 of 2011 extended the boundaries of the Monotax system to new "collective" as: i) caregivers of bicycles, cars and motorbikes, ii) property windscreen wipers and automotive, iii) guides, iv) pet walkers and coaches, v) services using radio spots up to 5 hours per week, vi) sex workers, among others.

Today the approximate monthly contribution of a monotax payers in Uruguay (uninsured) is between \$ 22 and \$ 30 depending on the category. If the person chooses to have health coverage, the contribution is approximately between \$ 78 and \$ US175, depending on whether or not you have children (or dependent children or older with disabilities) and / or spouse.

## **Peru**

In Peru the Monotax was born with Legislative Decree No. 777 of December 31, 1993 under the name Single Simplified Regime (RUS). The scheme sheltered natural persons and companies generating income from third category<sup>9</sup> whose gross income do not exceed certain

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<sup>9</sup> They are the third category income from trade, industry or mining; of the farm, forestry, fisheries and other natural resources; the provision of commercial, industrial or similar nature services such as transport, communications, nursing homes, hotels, warehouses, garages, repair, construction, banking, financial, insurance, bonds and capitalization; and, in general, any other activity that constitutes

# Design and Implementation of Monotax in Colombia

Threshold<sup>10</sup>. This first version of the Peruvian Monotax replaced, by paying a single tax, payments for income tax and general sales tax.

As in other countries the system has undergone numerous regulatory changes. Indeed, Law No. 26750 of 1997 expanded the universe of potential beneficiaries to non-professionals individuals with incomes of fourth category<sup>11</sup>. Subsequently, Law No. 27035 of 1998 expanded among other things: i) the number of categories in the system and ii) the overall gross income threshold to qualify for the same.

But fund reform occurred in 2003 with the Legislative Decree No. 937 (as amended by Law No. 28659 of 2005 and Legislative Decree No. 967 of 2006) that gave birth to the new RUS (NRUS). The new scheme unified in a single tax - monthly payment - income tax, general sales tax and municipal promotion tax, further reducing the tax burden vis a vis the general scheme. The physical metrics of admissibility were also eliminated.

Today are eligible for the NRUS Individuals or companies that are active in the sectors of industry, commerce, and / or services as well as non-professional individuals who perform a trade (without labor relationship). Finally, the monotax payers of Peru must make their monthly payment, payment vouchers showing that support purchase - business sales chronologically. Although not required to keep books, payment vouchers submitted by the taxpayer can not be any bill, but tickets of sale, tickets or tapes issued by certain registering machines<sup>12</sup>.

It is important to note that in the case of Peru the Monotax has not included contributions and benefits for the social security system.

## ***Spain***

Spain is there is no Monotax as such. However at the time (Law No. 18 of June 6, 1991, which came into force in 1992) a reform was implemented to segment modules of income tax on individuals which differs from income tax levied on companies or legal entities (IS) -. The reform sought, inter alia, streamline the tax administration in terms of: i) information available, ii) release of resources for the control of large and medium taxpayers, and iii) control to tax fraud. "Prior to this regime the applicable systems to small business generated a very high

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usual business of buying or production and sale, exchange or disposition of property, arising from the activity of mediators trade agents, auctioneers and auctioneers, notaries, and any other income not included in the other categories.

<sup>10</sup> At that time \$ 8.400 soles per month (about \$ US 4,000 at the time).

<sup>11</sup> Fourth category is income that accrues in the development of an office without any labor relationship.

<sup>12</sup> Those tapes cash registers that emit no right to tax credit or be used to support spending and / or cost for tax purposes.

*Fraud and there were difficulties and problems when making checks by inspection"*(Junquera and Pérez, 2001).

The reform introduced easily measured physical parameters for the respective segmentation modules (as with Monotax scheme). Although the new system increased the direct tax burden, the great incentive for people to adhere to the same was the simplification of formal requirements and when to tax obligations (as also happens with monotax payers).

In terms of increased efficiency of the Spanish Tax Administration the results were classified as "very satisfactory". (Junquera and Pérez, 2001). So, the Spanish is relevant because it proves that the segmentation or stratification of the physical taxpayer, at least in terms of income tax can (as also waiting laminator system Monotax) increase the efficiency of tax administration.

Of course, in Spain later came many reforms to its system of personal income tax (Rueda, 2012) <sup>13</sup>, but these reforms charted goals that transcend purposes analogous the Monotax squeme being studied here (for example the 1998 reform sought generation employment and harmonization of the Spanish tax system with that of other countries of the Union).

## **2.2. Formalizing outcomes:**

The data available in the literature suggest positive and satisfactory results in terms of labor and business attributable to the implementation of systems of Monotax in Latin America.

To begin, it is important to mention that there is strong micro evidence - econometric showing that the SIMPLES system (Monotax in Brazil) significantly reduced informality in several dimensions (Fajnzylber, Maloney, and Rojas, 2011). There is also evidence that suggests that the pre-existence of SIMPLES state regulations create obstacles to the formalization of firms and an adverse environment for investment, so that, when confronted by a simpler tax system with fewer formalities and lower rates, increased formalization and the incentive to invest in small businesses (Monteiro and Assunção, 2006).

Meanwhile, in the Uruguayan case the evidence also points to significant gains in labor formalization: while in 2006 only 6% of self-employed workers protected by any pension insurance were under the regime of Monotax, in 2010 the percentage was 23 % (Amarante and Perazzo, 2013).

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<sup>13</sup> Law No. 40 of 1998, Law No. 46 of 2002, Legislative Decree No. 3 of 2004, Law No. 35 of 2006, Royal Decree - Law No. 2 of 2008, Royal Decree - Law No. 8, 2010, Law No. 38 of 2010, Royal Decree - Law No. 13 of 2011.

In Argentina data also reveal highly positive results in terms of formalization. For example, one of the metrics used to take the pulse of the results concerning the award is the ratio of the payments made to the system by the tax component and the number of active contributors in it. This ratio measures the impact of Monotax in terms of the provision of self-employed workers to actually pay taxes. Well, statistics show that while up to 2007 this metric stood slightly above 60%, from 2008 it reached levels between 80% and 90% (Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).

The Argentine Monotax also exhibits very satisfactory results in labor formalization - pension. "While the simplified regime Monotax showed a considerable increase over the last decade, as they came to tripling the number of active registered in the pension component (1.4 million), in the autonomous regime was evident very mild increase during the same period (with variations), enrollment remained below the 400,000 active contributors "(Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013). Moreover, while between 2004 and 2012 the weight of self-employed in the Argentine Integrated Retirement System (SIPA) was between 5% and 6%, the weight of the self-employed workers skyrocketed from 8.8% to 17.7% Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).

In Peru the data also reveal important gains in formalization thanks to the Monotax (RUS). This progress is particularly evident from the biennium 2003 - 2004, thanks to which in December 2011 there already were 700,000 registered RUS taxpayers (Diaz, 2014). This in contrast to the first four years of operation of the system (1994-1998), when the degree of informality not only did not reduce but increased from 17.69% to 28.48% (Sanchez, Rodriguez and Zumaeta, 2000) 14.

Of course, not all outcomes of formalization derivatives of Monotax systems in Latin America are outstanding. For example, in Uruguay the data also reveal an even larger gap between the reached level of formalization and its potential. Of the 122,000 people who were employed and, therefore, potential monotax payers in that country, only 17,500 were sheltered by social security under the regime of monotax and 70.8% of the total potential monotax payers in 2010 was helpless on social security (Amarante and Perazzo, 2013).

Using a probit model the same authors found that the probability of making contributions to the monotax system increases with income per hour and the skill level of the person, which "access to protection remains limited to workers with lower income"

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<sup>14</sup> However, the results in the other countries in terms of number of registered taxpayers see the next subchapter.

(Amarante and Perazzo, 2013). They conclude that the alternative to Social Monotax MIDES, in response to this reality, still requires further evaluation.

Still, it is not risky to point out, as observed of all available literature, the results in terms of labor and business formalization that can be attributed to Monotax are quite positive.

### **2.3. Outcomes in the matter of Number of Contributors:**

When evaluating systems of Monotax depending on the number of taxpayers who fail to attract such schemes, the results also show satisfactory as inferred from the data that has been estimated in the available studies.

For example, in Uruguay the results have been evaluated by some as positive, especially after the reform of 2007. "This growth was relatively slow until 2007, and from there a strong increase is detected. The number of registered companies almost doubled at the first half of 2007 compared to the same period in 2003. In fact compared, since the second half of 2007, once implemented changes to the regime, a strong and sustained increase was seen in the number of active and payments companies, as well as the number of people covered, which almost sextupled in this period<sup>15</sup>"(Amarante and Perazzo, 2013).

As mentioned in the previous section, the evidence in Peru seems to be equally positive, especially from 2003 to 2004 when the number of registered taxpayers soared to reach 700,000 in 2011 (Diaz, 2014).

The Argentine case also gives very satisfactory results in terms of the number of registered taxpayers, even from the first year of implementation and during the recessionary phases of the economic cycle. "First it should be noted that the number of taxpayers registered in the Monotax has shown tremendous growth since its introduction in 1998. Although in its early years the recessionary cycle of the Argentina's economy threatened the consolidation of the regime, while generated scarce tax resources, this was not to the detriment of the number of active contributors, which increased year by year "(Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).

Of course, during Argentina's economic recovery, the number of registered monotax payers grew much more: "the flow of Monotax payers accompanied the economic recovery, accumulating more than 2 million registered in 2007, to stay around that value until It entered into force with reform of 2009 (Act No. 26565). Thereafter, again a trend of sustained growth and consolidation of the system was observed which reached

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<sup>fifteen</sup> The period analyzed by these authors arrive until April 2011.



*having a total of more than 2.7 million registered (including all subregimes) to January 2013"*(Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).

Even the impact appears to be more pronounced in the most vulnerable sectors of Argentine independent workers (those sheltered by the Social Monotax<sup>16</sup>): "At the end of 2006 there were enrolled in the MS 25.094 effectors and by 2011, that figure rose to 475,192, representing an increase between ends of 1794% or 19 times" (Calero, 2012). In addition, it is estimated that by 2012 taxpayers registered in the Social Monotax already reached a figure close to 540,000 (Calero, 2012).

In Brazil the number of taxpayers sheltered by the SIMPLES was estimated at almost 5.5 million by 2011. While this figure represented only 3.6% of all taxpayers, it is also true that the figure is not at all negligible when measured relative to its potential, it is equivalent to 6% of the labor force, 23.3% of employed and 28.6% of independent workers (OECD, UN, ECLASC, CIAT, 2012). Moreover, the number of registered at SIMPLES appears to have doubled for ANO 2014: nearly 9.5 million<sup>17</sup>.

As in Argentina, the force of attraction unleashed by the Brazilian Monotax was even greater when the system opened a category focused on the most vulnerable sectors (Individual Micro Entrepreneur or MEI<sup>18</sup>). Indeed, between January and June 2010, the amount entered in the MEI went from 76.888 to 427,560 (Federal Revenue of Brazil, 2010).

## **2.4. Results in tax collection matters:**

Unlike the results in terms of execution and number of taxpayers who end up adhering to Monotax system, results in tax collection matters are not so good. Even "as often seen in most of the implemented simplified regimes in Latin America, tax revenues generated by the application of Monotax are very low in relative terms, either as a percentage of GDP or as a proportion of total domestic revenue "(Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013).

In Argentina this percentage hovered around 0.23% - 0.24% of GDP until 2009 (year of the last reform) year from which it increased reaching 0.36% in 2012 (Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013). In Uruguay and Peru derivative collection from the Monotax system was estimated in 2011 only 0.05% and 0.10% of GDP, respectively - and by 0.09% and 0.34% of total tax revenue, respectively - (OECD, UN, ECLASC, CIAT, 2012). In Brazil, the estimate for the same year (2011) is a little higher: 0.97% of GDP and 2.84% of total tax revenue (OECD, UN, ECLASC, CIAT, 2012).

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<sup>16</sup> Subregime introduced by the 2004 reform - Law 28565 -, see Chapter 2.1 behind.

<sup>17</sup> <http://www.classecontabil.com.br/noticias/especialistas-pedem-atencao-antes-de-inscricao-no-simples>

<sup>18</sup> Created with Complementary Law No. 128 of 2008, see Chapter 2.1 behind.

However, in Brazil there is evidence of a reduction of 13% in collection originated in small taxpayers four years after the introduction of Monotax (single system) in 1996 (Lemgruber - Viol and Rodriguez, 2000). However, such a fall *"It can be considered normal for a program that has the ultimate goal of increasing revenues, and consistent with the explicit tax reduction provided for in legislation"* (Lemgruber - Viol and Rodriguez, 2000).

Again, at this point it is worth invoking a warning that has already been mentioned in the first chapter: the Monotax system should not be seen as a source of increased tax collection in the short term, but as a tool to stimulate the generation of formal employment and economic and social inclusion; ie as a tool to help formalize and thus improve income distribution (Bustamante, 2013), so that "... the poor results achieved in tax collection matters should not be weighed too much and although terse, the amounts of revenues obtained should be included in the set of benefits derived from the application of Monotax, considered part of a strategy of tax policy that seeks to reduce levels of informality ... "(Cetrángolo, Goldschmit Gomez - Sabaini and Moran, 2013) .

## 3. A PROPOSAL FOR COLOMBIA

The political process of decision making (and legitimation of these) to implement a Monotax in Colombia have a great chance in the discussion and processed by the Congress of National Development Plan 2015 - 2018. Of course, the technical process - administrative implementation will be conditioned to the degree of development of the country's tax administration (Junquera and Perez, 2001).

Although there is already a first draft proposal for a system of Monotax in Colombia (see Bustamante, 2013) in the literature, is worth going a little deeper into this idea. The first is to invoke the magnitude of the problem of informality in the country and the consequences it generates in labor productivity, poverty and inequality (see Chapter 1) as very powerful reasons to advance the design and implementation of a monotax payer system in Colombia. Especially if one considers that the results in the reduction of informality that have been documented in other countries that have opted for the Monotax are positive (see Chapter 2 above).

### 3.1. Decision Tree:

The implementation of a structure of Monotax in Colombia requires solving the corresponding decision tree (Junquera and Pérez, 2001).

#### *Level 1 - Tributes*

The first level of decision has to do with the taxes to be replaced by the Monotax. This, in turn, requires determining whether the taxes to be sheltered by the monotax payer structure are only of national reach<sup>19</sup> or additionally could include those within municipal<sup>20</sup> / departamental<sup>21</sup> reach. It is important to note that the inclusion of taxes of regional order (municipal / provincial) in a potential monotax payer system will require not only law reforms but also of the Constitution. In Latin America the only country that has managed to extend the structure of Monotax to the regional level (without injury) has been Brazil (see Chapter 2 above).

Now, at this level of the decision tree it is also necessary to determine whether the contributions - benefits in social security will be picked up or not by the Monotax. Remember that Monotax systems in Brazil, Argentina and Uruguay include them, while in Peru the social security is excluded (see Chapter 2 above). If such contributions are included – it is necessary,

<sup>19</sup> Income Tax (internal and external), property, tax on financial transactions, timbre, tariffs, global tax on gasoline.

<sup>20</sup> Industry and commerce, property taxes, vehicles, gasoline surcharge.

<sup>twenty-one</sup> Registration, spirits, beer, cigarettes and snuff, gasoline surcharge.

Naturally, to point out the reach in terms of social protection that the monotax remains sheltered with (if coverage also includes only pension or health and occupational hazards).

## ***Level 2 - Subjective Area of Application***

The second level of the decision tree points to the subjective area of Monotax. This requires to specify, on the one hand, the type of taxpayer has to adhere to the scheme and, on the other hand, the type of activities that can be sheltered. That is, whether the Monotax is only going to shelter individuals (natural) or also cover legal persons (and / or fact companies). Additionally, this involves determining whether the system will support only the activity of the trader (stable and / or hawker), artisan and small or micro industry or if, in addition, the activities of independent professionals will be included. With respect to the latter, some studies suggest that the inclusion in the Monotax of independent professional creates an increased risk of fraud but, at the same time, a bigger productivity in the matter of collection by unity of threshold billed income.

At this level of the decision tree it is also necessary to decide whether the activities of the rural sector are to be included or not in the Monotax system. On this point it is worth noting that, while the extent to the rural sector significantly magnifies the potential for formalization that is sought with this fiscal tool, it is also true that this would increase the administrative burden and system control. For example, this is why "Spain only included this sector in the fourth year of entry into force of the simplified regime" (Junquera and Pérez, 2001).

Two other elements that must be resolved at this level is the treatment that will be given to taxpayers who exercise more than one economic activity, as well as to apply to the spouse and children of monotax payers (in the social security component). About the first one, the decision should depend on the capacity of the tax administration to control the system (and avoid frauds by including in the system of activities that by its nature it should not pay). On the second one, it is important to note that productivity in terms of collection will be greater among higher social security benefits that the household of monotax payers can receive (although the net fiscal cost is probably higher).

## ***Level 3 – Target Area of Application***

On a third level of the decision tree should be anchored with the variables which will define the system. It establishes those variables from which the taxpayer and tax administration will know whether or not the person is classified as monotax payer. The first is to define the economic variables that determine the eligibility to the scheme and then specify certain physical variables to narrow further not only for admission but also to remain in it.

Usually, the economic variable used to set the threshold at which a person is classified as monotax payer is the volume of gross income. This happens in the Monotax systems in Brazil, Argentina, Uruguay, and Peru (see Chapter 1 above). However, these countries also resort to other economic variables to complement the delimitation: i) amount of rent (Argentina), ii) volume of assets (Uruguay) and iii) the amount of monthly purchases (Peru). It is important to note that the VAT Simplified Regime in Colombia uses multiple cutting economic variables: gross revenue, sales, banking appropriations, deposits and financial investments.

With respect to physical variables that can be used to narrow further the admissibility and remain in the system the possibilities are many. For example, recall that in Argentina are used (see Chapter 1): i) property size and ii) annual consumption of electricity. Meanwhile, in the case of Uruguay the physical variables are used (see Chapter 1): i) the number of partners and ii) size of the premises. For Colombia has been proposed to use (Bustamante, 2013): i) the number of establishments or locations where the activity occurs (maximum one), ii) size of the property (maximum 30m<sup>2</sup>, like the minimum Argentina category), and iii) number of workers (maximum four) 22.

At this point we should also frame the treatment criteria to extraordinary income of monotax payers (eg an inheritance), as well as those that are not related to economic activity (eg, a pension).

Finally, considering that the values that display the monotax payers for economic variables delimitation (and for some of the physical) are likely to fluctuate month to month, it is also necessary to establish the calculation methodology is applied on these variables. In other words, it is necessary that at this level it is also determined whether there will be used, for example, annual averages, semi-annual averages, quarterly averages or, in contrast, the highest value recorded during the year (or for some period during the year) .

#### ***Level 4 - Mobility***

The fourth level of the decision tree for structuring a Monotax has to do with the conditions for entering and exiting the system. Indeed, it is essential to decide whether or not monotax payers should formally express their intention to enter or quit the system. However, "if the purpose is to attract the informal sector the only feasible solution would be an explicit commitment ... to allow minimal census control" (Junquera and Pérez, 2001). Thus, it is then necessary to define the set of documents that the person must submit to the tax administration

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<sup>22</sup> The proposal (Bustamante, 2013) also includes another type of variable legal order: i) the main economic activity must represent at least 70% of sales or total revenues, vi) not be required to submit income statement, vii) non-customs user, viii) not develop business that exploits intangible assets (franchise, concession, royalties, etc.).

to enter and quit the system and the time you have to do before and / or after each tax year. On this point it is worth remembering that the key is simplicity.

## ***Level 5 - Formal Obligations***

A fifth level in the decision tree requires setting formal obligations that will be required to the monotax payers in terms of accounting records and invoices. Here it is worth noting that the simplified VAT system in Colombia exempts the taxpayer both keep books, and to issue invoices for their activity.

This contrasts, for example, with the Peruvian Monotax. Remember that although in this system (see Chapter 2 back) books and records are not required, the taxpayer must submit payment vouchers that support the purchase - business sales chronologically. Moreover, those receipts can not be any bill, but tickets of sale, tickets or tapes without the right to tax credits that are issued by certain cash registers.

## ***Level 6 - Controls***

At this level of decision-making it is necessary to define the controls that mitigate the risk of involution for fraud, evasion and dwarfism.

About this is important to remember that most countries that were analyzed do not support tax credit with the documents issued by the monotax payers. This is because, if they are to end consumers, it is clear that there is no tax impact, but if issued to other taxable persons outside the system, there would be a perverse incentive to issue, for example, false bill at no cost to the monotax payer, for their contributions would not change.

Remember also that some countries have sought to mitigate dwarfism and tax fraud attributable to the system prohibiting monotax payers trade relations with large companies (see Chapter 1 above). For example, stating that after a certain period of time such formal companies that buy a monotax payers cannot deduct such purchases as accounting expenses. In other cases, (Peru, Uruguay) Monotax blanket system only shelters businesses that sell to consumers.

## ***Level 7 - Payments***

Level seven of the decision tree determines the payment of Monotax Methodology: how much you pay, how to pay and the frequency of payments. As to the first, the decision should be based, for example, in theoretical models and econometric work to infer the amount that maximizes adherence to the system, the collection and reducing informality. This in turn requires the use of databases both from tax administration and the labor market. Of course, one should not forget that the essence (and hook) of the system is,

On one hand, its simplicity (for which payments are typically lump sum) and on the other, the lightening of the tax burden (so that quotas tend to be minimal).

Other elements to be defined at this level (form and frequency of payment) will function naturally from the structure and logistical capacity of tax administration. However, the way it usually works is that the same taxpayer estimates the category that classifies the beginning of the fiscal period and subsequently deposited in a bank monthly payment corresponding to its category.

## ***Level 8 - Deductions***

The eighth decision level for the implementation of Monotax has to do with the structure of withholdings that must be synchronized with the system. The literature suggests (see Junquera and Pérez, 2001) that the monotax payer: i) be a retaining agent which corresponds to provide their workers the social security system (if the system includes legal persons), ii) is also held subject in a level of income for professional services (as long as the system includes professionals - see level 2 or Subjective Area of Application).

In any case, it is essential that the Monotax system is accompanied by a "rule that remains the obligation to withhold by those forced tributaries carrying out transactions with those who do not prove their inclusion in the simplified scheme, as one more way in an attempt to narrow the informality "(Junquera and Pérez, 2001).

## ***Level 9 - Sanctions***

Finally, we must provide the sanctions and fines to act as mechanisms of punishment and deterrence to defrauding the system. At this level you must first consider whether additional rules to what is already established in codes are required. In any case, it is important to ensure a rule that punishes falsehood in the express statement that the taxpayer should do, just like the falsehood in the volume of when gross income is declared. The severity of the punishment and the penalty is usually imposed gradually and proportional to the failure.

### **3.2. Simulation:**

It is useful to have as reference point some orders of magnitude of values of collection and government spending that could throw a hypothetical Monotax in Colombia. For this purpose is presented in this section simulation of these systems. Naturally, this kind of simulation, in its most basic and simple, requires at least some assumptions about levels 1 to 3 and 6 of the decision tree set forth in the previous section. Specifically, for the exercise here proposed the following assumptions are made:

- Level 1:
  - Include two national taxes: income tax and domestic VAT. Other taxes of the domestic sphere (ex .: property tax) are not included as, in practical terms, that duty is irrelevant to the small taxpayer.
  - Include a contribution to the social security scheme in a consistent contribution to the system of Periodical Economic Benefits (BEPS).
- Level 2:
  - Sheltering only natural persons (self-employed and domestic workers) so that the simplified VAT system disappears (at least conceptually) for new monotax payers without bleeding of legal persons (atomized or divided) is generated to the new Monotax system (with the resulting tax effect).
  - Include the full spectrum of commercial, craft activities, manufacturing, of (even professional) services and the rural sector. This in contrast to (Bustamante, 2013) who suggests to include only trade in the first stage of the system.
- Level 3:
  - Set thresholds for eligibility in terms of monthly statutory minimum wage (SMMLV) according to the following categories:
    - Category 1: gross annual income up to 12SMMLV.
    - Category 2: gross annual income up to 24SMMLV.
    - Category 3: gross annual income up to 48SMMLV.
- Level 6:
  - Set the following structure for payment of Monotax:
    - Category 1: \$ X pesos monthly



Category 2: \$ 2.5X pesos

Category 3: \$ 4X average monthly weights

It is important to note several things.

First, the maximum potential monotax income is significantly below the threshold that exempts income declare to a natural person in Colombia in 2015: 1,400 UVT's or what is equal to, 61.44 SMMLV<sup>23</sup>. Assuming that all other delimitation variables to be applied are, at least, those who today also apply to exempt an individual to declare income (gross assets below 4,500 UVT's, purchases and lower consumption at 2,800 UVT's, consumption lower credit card 2,800 UVT's, bank allocations, deposits and less than 4,500 UVT's) financial investments, then it is clear that potential monotax payers of this proposal did not declare income before entering the system.

Second, and derived from the above, the estimable income under this hypothetical Monotax model represents a net gain for tax revenues of the Nation, because those classified as monotax payers didn't declare income or declare VAT (on the above parameters of admissibility potential monotax payers also belong to the Simplified Regime VAT).

Third, note that the model implies that the increase in the contribution from one category to another is constant (1.5X). While the escalation between Categories 2 and 3 is lost, it is also true that it simplifies analysis and, in any case, it is always possible to simulate the model by increasing a little (to restore progressivity) the contribution of Category 3.

Fourth, in fiscal spending it comes from the significant contribution that the state should make by the BEPS. Recall that according to the latest GEIH only 34.16% of employed people in the country have pension coverage (the percentage should be even lower for employed and domestic workers).

Fifth, health benefits are included for several reasons. First, according to GEIH the 92.48% of the employed in the country already have health insurance, with 44.59% of them in the Subsidized Regime. So, the health insurance does not seem to be the major attraction of a potential Monotax payer in Colombia. In fact, the Subsidized Health is something that has gone against labor formalization. Something different would be that the registration of the person as monotax payer to remain in the Subsidized Health became mandatory. But this does not seem to be feasible from a political point of view.

However, according to the Great Integrated Household Survey (GEIH), the country had 3,970,000 employed and 382,000 domestic employees during the quarter October to December 2014.

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<sup>23</sup> By 2015 the value of the UVT is \$ 28.279 pesos and the SMMLV is \$ 644.336.

This result is robust to the results of microbusiness module that was included in the survey between April and December 2013. Indeed, in that module 3,895,000 microbusinesses of self-employed workers were identified in the country. So, it is quite reasonable to assume an amount of 4,500,000 potential self-employed workers for this year (including self-employed, domestic workers and those who have not been identified by surveys).

On the other hand, said microbusiness module of the GEIH in 2013 is very important because it gave further light on the distribution of income of who operate these businesses (86% of which 3,895,000 of self-employed workers then identified):

- 39.5% below 1 SMMLV.
- 23.3% between 1 and 2 SMMLV.
- 37.2% more than 2 SMMLV.

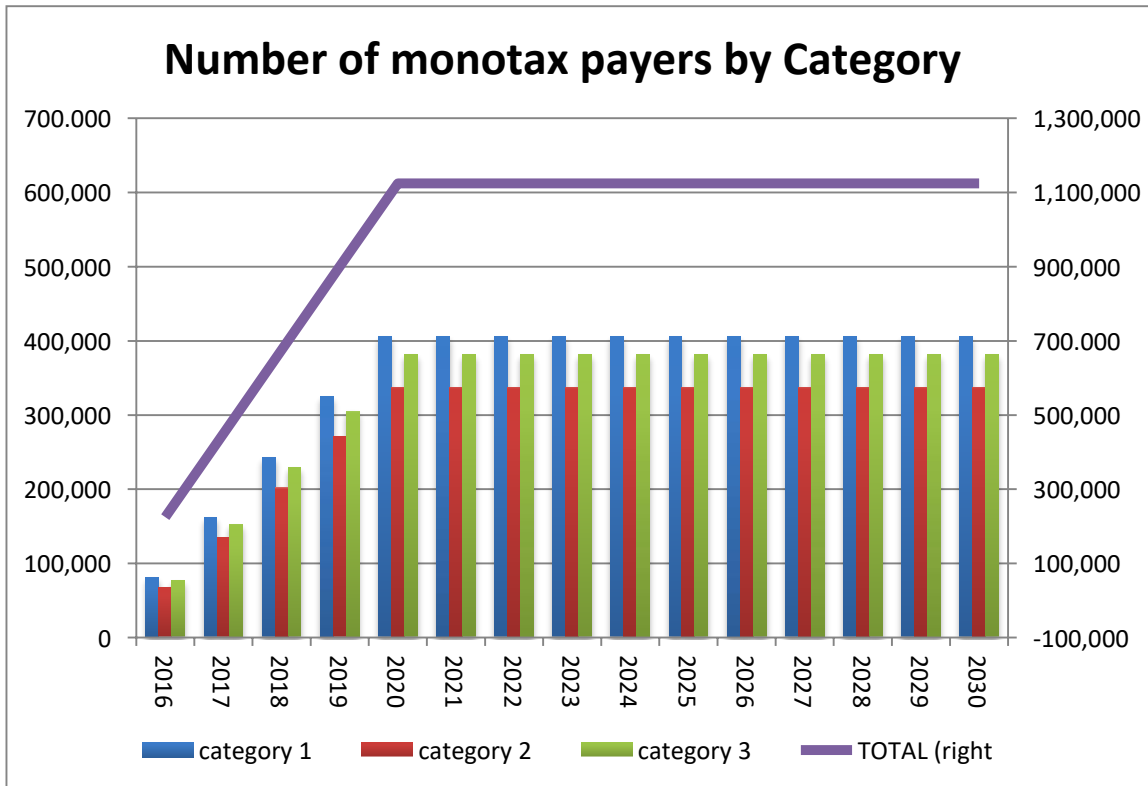
Assuming that 100% of household employees earn an income between 1 and 2 SMMLV, then the income distribution by categories system would be:

- Category 1: 36.03%
- Category 2: 30.03%
- Category 3: 33.93%

It is important to note that in the previous distribution there may be a bias. Indeed, it is quite possible that the subset of self-employed workers identified by the module GEIH of microbusinesses during April-December 2013 does not replicate the same distribution of income of the total microbusinesses (self-employed workers + employers). However, the distribution of self-employed workers' subset of itself should be very approximate to the distribution of the total set that is used here, whatever that 86% of the total set corresponds to the subset of self-employed workers.

Recent cases have to do with the speed of accession to the system. For this exercise, it is going to be assumed that the Monotax system begins with slow growth (as in the cases of Peru and Uruguay) and converging linearly and after 5 years to a maximum of 25% of self-employed workers in the country (similar to results in Brazil SIMPLES). It is further assumed that this rate of accession shall be homogeneous by categories. The following chart illustrates the evolution in the number of monotax payers by category between 2016 and 2030:

Figure 1



Note that the amount of monotax payers start at 225,000 and converges to 1'125,000 (use the right axis of the graph). This amount is consistent with what has been observed in other Latin American countries that have opted for the Monotax. Note also that in every moment of time, the categories that collect more and less monotax payers collect are the No. 1 and No. 2, reflecting the distribution of income taken as explained earlier. It is important to note that if these assumptions in terms of number of registered contributors to the system were to be met, the impacts on labor formalization (at least pensionary) would be extremely positive for Colombia.

The following graphs show the simulation result is presented in terms of net tax effect as a function of two variables: i) percentage of contribution to BEPS and ii) the amount of the monthly contribution goes. Actually Figures 2 to 3 can be understood as a sensitivity analysis of the net tax effect of the model in two dimensions: i) setting at 50% the percentage of the contribution to be BEPS to gradually bring it to 70% of the total contribution, ii) fixing at \$ 20,000 monthly contribution for Category 1 (with the corresponding equivalents in the other 2 categories) to gradually bring it up to \$ 50.000<sup>24</sup>.

<sup>24</sup> It is important to note that in some cases the contribution to ending BEPS making mono taxpayers (especially in Category 3 when the percentage will BEPS or the amount of the contribution is high enough) may exceed the maximum allowed. Anyway this does not affect the purpose of the exercise is to get some orders of magnitude of the potential results of a Monotax like that here is simulated.

Figure 2

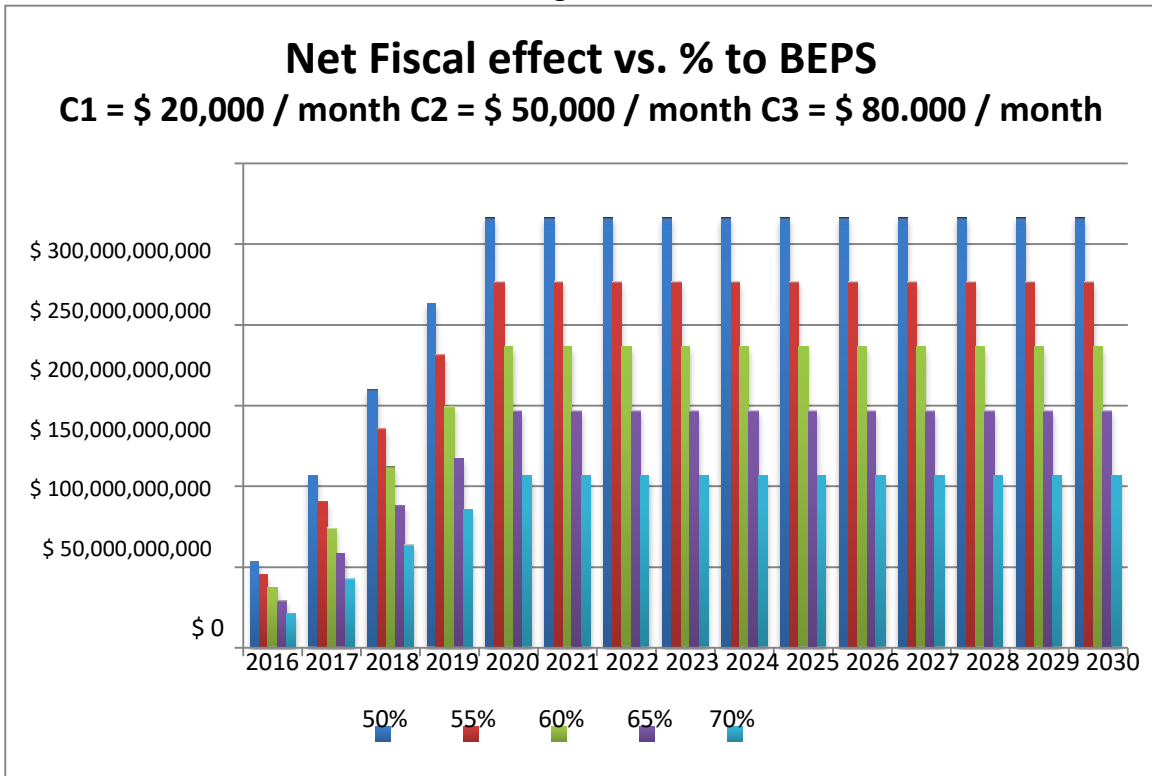


Figure 3

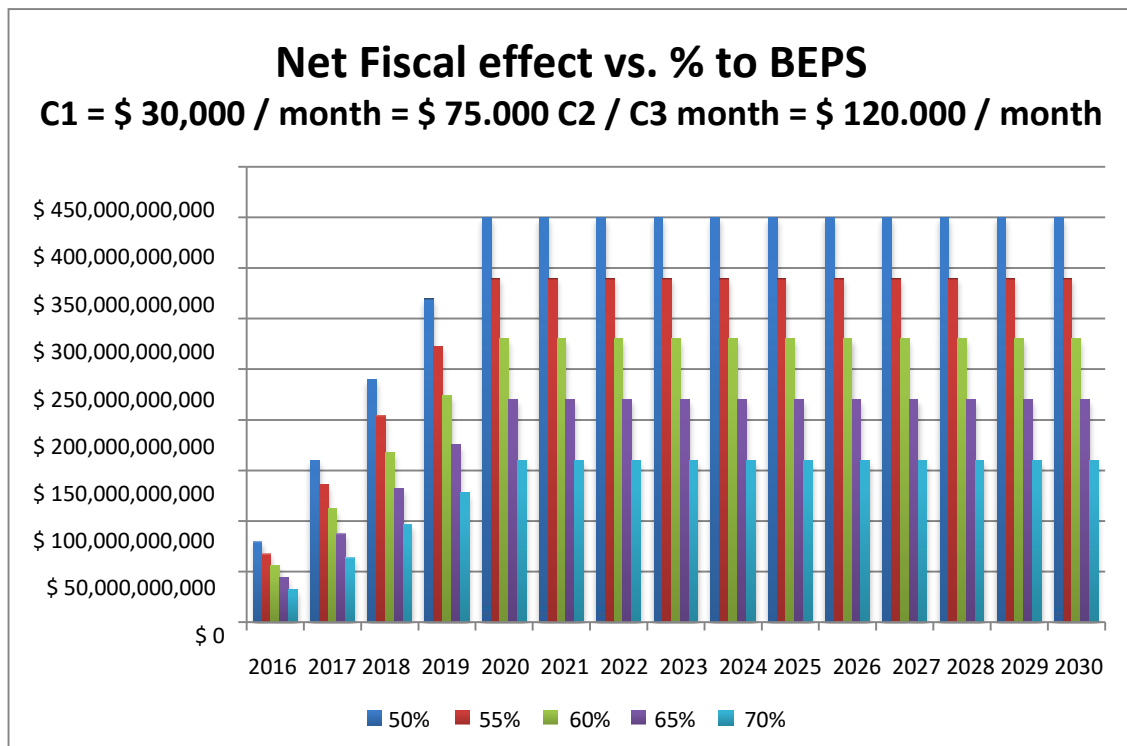


Figure 4

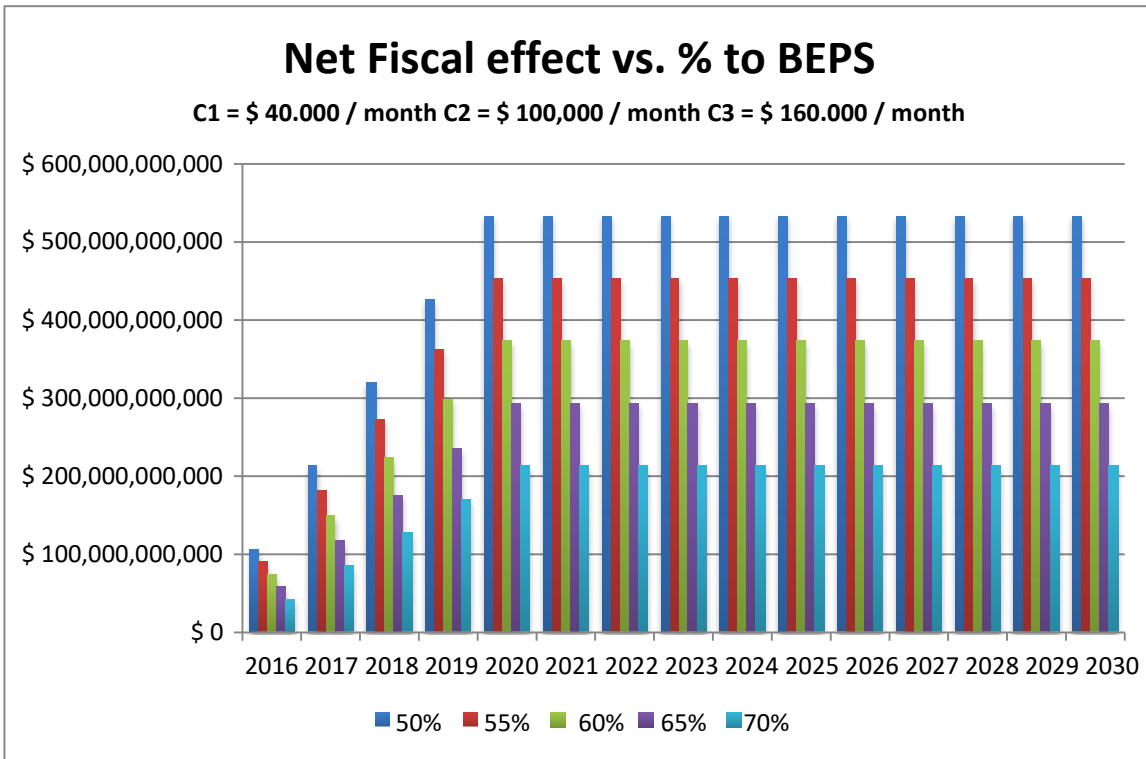
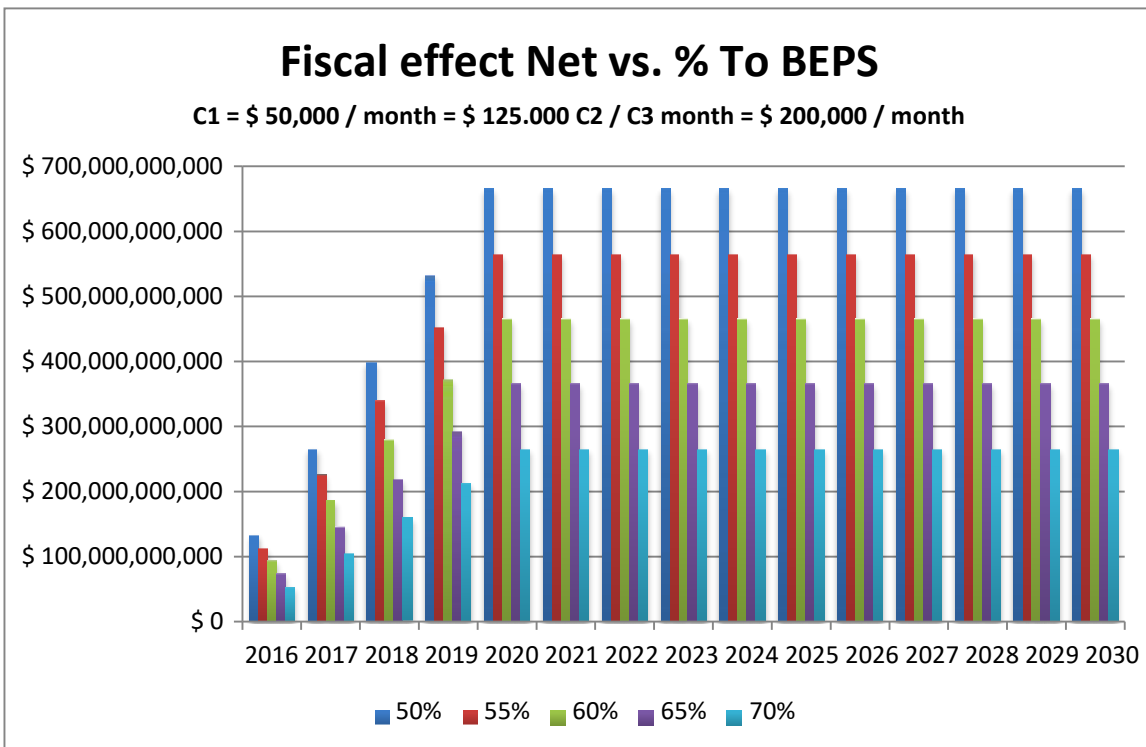


Figure 5



## 4. SUMMARY FINAL PRODUCTS TO SUPPORT BANKING OPPORTUNITIES IN THE DESIGN AND IMPLEMENTATION OF MONOTAX IN COLOMBIA

Below the minimum final products that were developed in this document are summarized:

- Submit a proposal for the design and implementation within the simplified taxation "single Tribute" aimed at small taxpayers as a measure of inclusion into the formal economy regime.

It has proposed the implementation of a monotax payers regime in the same spirit of those who have developed in Brazil, Peru, Argentina and Uruguay. That is, a simplified Monotax regime whose central purpose is to unleash a process of formalization initially associated with the pension aspect. Formalization process which purpose, as has been documented in the literature, index significantly on poverty reduction and economic growth.

- Create or propose a simple alternative tax which would facilitate compliance with formal obligations to small taxpayers.

The proposed Monotax only collects income taxes and VAT, unified by a single monthly payment of reduced amount (similar to the pay ranges in Uruguay and Peru), with observable benefits for the person using the scheme BEPS, without any sacrifice in terms of collection. On the contrary, this proposal should generate a positive net collection to the National Treasury. The proposed system includes the entire spectrum of commercial, craft activities, manufacturing, of services (even professional) and the rural sector. The scheme is really simple: three categories of possible monotax payers according to which the monthly contribution that should a person pay is defined.

On controls this document proposes that any tax credit derived from sales invoices or tickets issued by the monotax payers are not be supported.

- Set the target population (Natural Person and / or Legal) and the guidelines so that they can be included within the new simplified system of taxation.

The target population from PRONUS the proposal corresponds to individuals who are self-employed (including professionals) and household employees, with a gross income of less than 4 monthly legal minimum wages (SMMLV). Note that this contrasts with what is proposed by Bustamante (2013), who argues that the Monotax also applies to legal persons but only in the trade sector. The reason why this first document PRONUS gets away from this approach is twofold.

# Design and Implementation of Monotax in Colombia

First, because a public policy of this kind is not petty and therefore, according to Pronus requires a certain gradualness in its implementation. Not only because of the effort that can come in terms of logistical adaptation - management for tax administration, but also the inherent challenge in terms of assimilation by society and therefore communication, socialization and promotion from the state. Starting only with natural persons is a form of hosting that gradualism.

Second, because with the PONUS proposal the central purpose of any Monotax regime isn't sacrificed, namely, reducing social inequality through labor formalization. Indeed, with the implicit proposal in the simulation in this first document PRONUS could be unleashing a pension reform and thus attacking one of the largest sources of inequality and poverty in the country.

Calculations show that the target population as defined in this consultancy can estimate a medium-term coverage of more than one million monotax payers.

- Design parameters to be considered and requirements for individuals and informal businesses may belong to the new regime.

The parameters that define the system are as follows: i) lower gross income to 4 SMMLV across the spectrum of economic activities, ii) gross estate under 4,500 UVT's, iii) purchases and lower consumption at 2,800 UVT's, iv) consumption with credit cards less than 2,800 UVT's, v) bank appropriations, deposits and lower financial investments 4,500 UVT's. It is important to note, further, that under the above admissibility parameters potential monotax payers also belong to the VAT Simplified Regime.

However, within this universe of potential monotax payers three categories are established only according to the annual gross income:

Category 1: gross annual income up to 12SMMLV

Category 2: gross annual income up to 24SMMLV

Category 3: gross annual income up to 48SMMLV

- Propose a possible way of measuring tax payment as well as an estimate of the value of the contributions.

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The amount of the tax has been quantified using ranges approaching the Uruguayan and Peruvian schemes:

Category 1: \$ 20,000 to \$ 50,000 monthly

Category 2: \$ 50,000 to \$125,000 monthly

Category 3: \$ 80,000 to \$ 200,000 monthly

- Visits and meetings DIAN, MHCP and MCIT team.

On the specific questions of the entities, see Annex 1.

However, beyond socialization and by PRONUS with the technical teams of the DIAN, MHCP and MCIT, **a second stage of this project should include visits of officials of the DIAN and MHCP to some of the countries where Monotax is already implemented. This in order to assimilate, their technical counterparts in those countries, experience and knowledge in the design and implementation of this type of tax system and thus build a SWOT matrix, a panel of risks and a plausible timetable run for the implementation of the system in Colombia. It is also necessary that in this second stage micro-level data and econometric techniques are used that are beyond the reach of this first job, in order to establish in a timely manner, the limits, thresholds, rates and other technical elements of monotax**



## 5. CONCLUSIONS

From the previous chapters, we can conclude:

- The magnitude of the problem of informality in Latin America is huge.
- Empirical evidence shows a strong correlation between informality and poverty of households.
- Indeed, labor market segmentation between formal (typically in modern and high labor productivity sectors) and informal (usually in traditional and low labor productivity sectors) is linked to the levels of poverty and inequality in Latin America.
- But also those working in the informal sector tend to: i) be excluded from the pension system or social security (health, pension and unemployment insurance), ii) be excluded from the formal banking system as a tool for entrepreneurship and / or smoothing consumption, iii) perform in conditions that disregard labor legislation. This, obviously, exacerbates the problem of inequality derived from informality.
- In Colombia, the problem of informality is also very large: during October - December 2014 (latest data available from the GEIH DANE) the percentage of people who worked in the informal sector was 49.41% in 23 major cities (and 48.19% in the 13 cities and traditional metropolitan areas); of the total of self-employed workers in 23 cities (4'583,000 individuals), the 80.75% was catalogued as informal (ie, 3'701,000 people).
- Countries like Brazil, Argentina, Uruguay and Peru, aiming primarily at targets for labor formalization, chose to implement a scheme for self-employed Monotax of very low income and / or small size businesses (including street).
- The Monotax generates significant advantages in terms of: i) the simplicity to pay taxes, ii) economic growth, iii) equity and reducing poverty, iv) more efficient allocation for resources of tax administration, and v) generating information and databases for the authorities.
- Now the monotax system also carries risks on two fronts: i) short-term drop in tax collection, and ii) involution by fraud, evasion and dwarfism.

- However, in the medium term and as a result of the higher level of economic growth that is expected with the introduction of Monotax, the collection must increase.
- In addition, the Monotax should not be seen as a source of increased tax collection in the short term, but as a tool to stimulate the generation of formal employment and economic and social inclusion.
- The cases of Brazil, Argentina, Uruguay and Peru are an important precedent for implementing a system Monotax in Colombia.
- In these countries the results on labor formalization and number of taxpayers are relatively good.
- It is also observed, as expected, a drop in short-term tax collection.
- However, here we have simulated a system of Monotax that, besides inducing huge benefits on labor formalization (pension), generates net tax collection for the nation.
- In any case, the implementation of a Monotax system in Colombia requires the authorities to solve a decision tree of 9 levels: i) taxes to include, ii) subjective field of application, iii) objective field of application, iv) mobility to and from the system, v) formal obligations, vi) controls, vii) payments, viii) withholdings and ix) sanctions.
- The Development Plan on its axis equity opens up a huge opportunity to introduce this idea into the roadmap of the Nation.

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## APPENDIX 1

### ANSWERS TO THE COMMENTS ON THE LAST BROCHURE TO THE FINAL REPORT "MONOTRIBUTO PROPOSAL FOR COLOMBIA"

March 26, 2015

#### OBSERVATIONS

Among the main observations made by the representatives of these entities are the following:

- Specify what the precise question asked in the Integrated Household Survey to define "informal" and specify the statistics presented in the report.

Informality is defined in the GEIH from various technical filters that are formally established in the following document:

[https://www.dane.gov.co/files/investigaciones/boletines/ech/ech\\_informalidad/metodologia\\_informalidad.pdf](https://www.dane.gov.co/files/investigaciones/boletines/ech/ech_informalidad/metodologia_informalidad.pdf)

To sum it up(see pages 6 to 7 of the aforementioned document.): "Considers that employees have informal jobs if their employment relationship, in law or in fact, is not subject to national labor legislation, tax income, social protection or entitlement to certain employment (advance notice of dismissal, severance pay, paid annual leave or paid sick leave, etc.) ". This definition is taken from ILO: 17a. International Conference of Labor Statisticians - Geneva, December 2003.

A micro-establishment is defined as the physical space used to develop an economic activity of commerce, service industry where up to 9 people work and degree of informality is defined by 4 degrees:

Degree of informality	HOUSEHOLDS COMPANIES	
	MERCANTILE	ACCOUNTING
<b>Grade 1</b>	NO	NO
<b>Grade 2</b>	YES	NO
<b>Grade 3</b>	NO	YES
<b>Grade 4</b>	YES	YES

Meanwhile, the informal working population is one that meets any of the following characteristics:

1. individual workers and employees working in establishments, businesses or enterprises employing up to five persons in all its branches and agencies, including the employer and / or partner;
2. unpaid family workers;
3. without pay in business enterprises or other household workers;

# Design and Implementation of Monotax in Colombia

4. domestic servants;
  5. Day laborers or laborers;
  6. Self-employed persons working in establishments employing up to five people, except independent professionals;
  7. Employers in companies with five workers or less;
  8. workers or government employees are excluded.
- Review the problems currently facing the DIAN (mainly regarding evasion) in the simplified VAT system, and take this into account in the analysis presented in the report.

PRONUS document identified in Chapter 1.4 several risks when implementing a Monotax regime, several of which (if not all) also apply to the Simplified (RS) VAT system. To mitigate this problem, the document identified several alternatives to be evaluated: i) limit taxpayer relationships with companies that are outside of the RS; ii) limiting deductibility accounting of purchases made to those who are in the RS; iii) limit sales of the RS only to final consumers; iv) never admitting tax credit bills or tickets issued by who belongs to the RS.

- Assess how true the DIAN's affirmation is on CREE being a single tax scheme for legal persons. If so how does it change the proposal on the PRONUS report?

In the opinion of PRONUS this statement is not accurate for two reasons. First, because the CREE is an income tax that replaced only payroll contributions to SENA and ICBF. That is, the companies responsible for CREE continue liquidating, separately, their income tax, VAT, property, etc. Second, the CREE is not motivated in the same way as Monotax systems: the labor and business formalization. In other words, companies that pay CREE already are formalized (in fact are replacing previously paid contributions on payroll and they now pay on their income).

- Review the legal adjustment to the Colombian tax system that introduces the figure of "self-employed" how is the tax scheme defined for these people? And see if this changes the proposal submitted by PRONUS in the document.

According to Article 329 of Law 1607 of December 26, 2012:

*"It is understood as self-employed, all natural person resident in the country whose income comes in a proportion equal to or greater than eighty percent (80%) of carrying out one of the economic activities set out in Chapter II of Title V of Book I of the Tax Code. "*

According to the Tax Code (Article 340), economic activities that allow an individual to be classified as self-employed are:

- 1 Sporting and other recreational activities
- 2 Agriculture, forestry and fishing
- 3 Wholesale Commerce
- 4 Retail commerce



5 Trade of motor vehicles, accessories and related products

6 Construction

7 Electricity, gas and steam

8 Manufacture of mineral products and

others

9 Manufacturing of Chemical Substances

10 Manufacture of wood, cork and paper

11 food manufacturing

12 manufacturing textiles, clothing and leather

13 Mining

14 Service transport, storage and communications

15 Hotels, restaurants and similar

16 Financial services

So, at this point, for a natural person to be classified as self-employed it must meet two conditions:

- a) Its activity corresponds to one of those listed in points 1 to 16 above.
- b) Their income derived from such activity, representing at least 80% of their total income.

However, thereafter Article 3 of Decree 3032 of 27 December 2013 established three requirements to be categorized as self-employed:

- a) Provides the service at your own risk.
- b) Your taxable income is less than 27,000 UVT's.
- c) The liquid assets declared in the previous taxable period is less than 12,000 UVT's.

Given the above, and since established as limits on the eligibility income below 1,400 UVT's and lower equity 4,500 UVT's (which are the same limits apply to a person that is exempt from state income in the year presented by PRONUS ), it is clear that such exercise does not require modification to the current definition of "self-employed" and that, therefore, the tax scheme applicable to these people change only to the extent that the subject would fall into parameters admissible Monotax.

- Explore options as presented by the Ministry of Commerce, to offer added value to the merchant "in the process of formalization" such as the collection of taxes at various levels: national - departmental and municipal. That the collection is integrated (via a single platform) although constitutional issues such as taxes (income, VAT, ICA, commercial register, etc.) can not be integrated into a single tax.

In the opinion of PRONUS all these initiatives are laudable. Indeed, a single platform of taxation is something that would simplify life for the Colombian taxpayer very much (as it has been the only form of social security). What happens is that this type of tool, although it is something that the Colombian government could (and in respect of PRONUS should) aim, it is also something that requires much coordination and harmonious cooperation between national and regional entities involved that, linking it to the implementation of a Monotax system in the country could hamper and delay the execution. Again, PRONUS insists on simplicity and gradualness as essential requirements for the introduction of a Monotax system in Colombia.