

METHODOLOGY

ADDITIONAL RESEARCH: PILOT STUDIES

PAYING TAXES UNDER THE SIMPLES NACIONAL TAX REGIME

Subnational Doing Business in Brazil 2021 includes a second pilot study, designed to analyze the process of paying taxes under the Simples Nacional tax regime. This pilot study covered the same five locations in Brazil (Amazonas, Ceará, the Federal District, Minas Gerais, and Rio Grande do Sul), analyzing two scenarios of firms that opt for this tax regime: a micro commercial business and a small manufacturing business. These two scenarios were selected to cover the situation of both micro and small firms under this regime. This section describes the case study assumptions and methodology used to collect these data. Scores are not calculated for this pilot study. This data was not included in the aggregate ease of doing business score for the five topics covered in this report.

This pilot study uses two scenarios of firms that opt for the *Sistema Integrado de Pagamento de Impostos e Contribuições das Microempresas e das Empresas de Pequeno Porte* (Integrated System for Payment of Taxes and Contributions by Micro and Small Enterprises) or Simples Nacional, a simplified tax regime for micro and small firms in Brazil. This study records the taxes and mandatory contributions that the firms must pay in a given year, as well as measures of the administrative burden of paying taxes and contributions and complying with

postfiling procedures. Taxes and contributions measured include the profit or corporate income tax, social contributions and labor taxes paid by the employer, property taxes, property transfer taxes, dividend tax, capital gains tax, financial transactions tax, garbage collection taxes, vehicle and road taxes, and any other small taxes or fees.

This study measures all taxes and contributions that are government mandated (at any level—federal, state, or municipal) and that apply to the two scenarios and have an impact on the firms' financial statements. It measures all imposed charges that affect business accounts. This measure may include, for instance, government-mandated contributions paid by the employer to a required private pension fund or workers' insurance fund.

For the purpose of calculating the total tax and contribution rate, only taxes borne are included. For example, taxes similar to VAT are excluded (provided that they are recoverable) because they do not affect the accounting profits of the business—that is, they are not reflected in the income statement. They are, however, included for the purpose of the compliance measures (time and payments), because they add to the burden of complying with the tax system.

Two case scenarios are used to measure the taxes and contributions paid by firms under the Simples Nacional tax regime, and the complexity of this regime's tax compliance system. These case scenarios use a set of financial statements and assumptions about the transactions made over the course of the year. In each case, tax experts from a number of different firms compute the taxes and mandatory contributions due based on the standardized case

studies' assumptions. Information is also compiled on the frequency of filing and payments, the time taken to comply with tax laws, the time taken to request and process a VAT refund claim, and the time taken to comply with and complete a corporate income tax correction. To make the data comparable across locations, several assumptions about the businesses and the taxes and contributions are used.

Assumptions about the businesses

The commercial microenterprise:

- Is a limited liability, taxable company that pays taxes under the Simples Nacional tax regime.
- Started operations on January 1, 2018. At that time the company purchased all the assets shown in its balance sheet and hired all its workers.
- Operates in the capital city of each of the five locations covered in this pilot study.
- Is 100% domestically owned and has five owners, all of whom are natural persons.
- At the end of 2018, has a start-up capital of 1.02 times income per capita (\$9,323 or R\$32,728).
- Is a micro retail shop performing general commercial activities. It sells products such as clothes or shoes at retail. It does not participate in foreign trade (no import or export) and does not handle products subject to a special tax regime—for example, liquor or tobacco.
- At the beginning of 2019, owns two plots of land, one building, machinery, office equipment, information technology (IT) equipment, and one truck, and leases one truck.
- Does not qualify for investment incentives or any benefits apart from those related to the age or size of the company, or the tax regime applied by the firm.

- Has 4 workers, all are national citizens. The company pays for additional medical insurance for employees (not mandated by any law) as an additional benefit. If in this case reimbursable business travel and client entertainment expenses are considered fringe benefits, it is assumed that the company pays the fringe benefit tax on this expense or that the benefit becomes taxable income for the employee. The case study assumes no additional salary additions for meals, transportation, education, or others. Therefore, even when such benefits are frequent, they are not added to or removed from the taxable gross salaries to arrive at the labor tax or contribution calculation.
- Pays an annual salary of R\$12,835 (\$3,656) for each employee.
- Has a turnover of 10.5 times income per capita (\$95,970 or R\$336,910).
- Makes a loss in the first year of operation.
- Has a net profit margin of 12%.
- Distributes 50% of its net profits as dividends at the end of the second year.
- Sells one of its plots of land at a profit at the beginning of the second year.
- At the end of 2018, has a start-up capital of 10.2 times income per capita (\$93,228 or R\$327,284).
- Performs general industrial activities. It produces a light manufacturing good and sells its product at retail. It does not participate in foreign trade (no import or export), does not have any subsidiaries or branches, and does not handle products subject to a special tax regime—for example, liquor or tobacco.
- At the beginning of 2019, owns two plots of land, one building, machinery, office equipment, information technology (IT) equipment, and one truck, and leases one truck.
- Does not qualify for investment incentives or any benefits apart from those related to the age or size of the company.
- Has 15 employees—one manager, two assistants, and 12 workers. All are nationals. The company pays for additional medical insurance for employees (not mandated by any law) as an additional benefit. In addition, in some economies reimbursable business travel and client entertainment expenses are considered fringe benefits. If applicable, it is assumed that the company pays the fringe benefit tax on this expense or that the benefit becomes taxable income for the employee. The case study assumes no additional salary additions for meals, transportation, education, or others. Therefore, even when such benefits are frequent, they are not added to or removed from the taxable gross salaries to arrive at the labor tax or contribution calculation.
- Pays an annual manager salary of R\$28,878 (\$8,226), annual assistant salary of R\$16,403 (\$4,672), and annual worker salary of R\$12,835 (\$3,656).
- Has a turnover of 105 times income per capita (\$959,700 or R\$3,369,100).
- Makes a loss in the first year of operation.
- Has a net profit margin of 5.7%.
- Distributes 50% of its net profits as dividends to the owners at the end of the second year.
- Sells one of its plots of land at a profit at the beginning of the second year.

Assumptions about the taxes and contributions

- All the taxes and contributions recorded are those paid in the second year of operation (calendar year 2019). A tax or contribution is considered distinct if it has a different name or is collected by a different agency. Taxes and contributions with the same name and agency, but charged at different rates depending on the business, are counted as the same tax or contribution.
- The number of times the companies pay taxes and contributions in a year is the number of different taxes or contributions multiplied by the frequency of payment (or withholding) for each tax. The frequency of payment includes advance payments (or withholding) as well as regular payments (or withholding).

Tax payments

This study records the total number of taxes and contributions paid, the method of payment, the frequency of payment, the frequency of filing, and the number of agencies involved for each of the two case study companies, during their second year of operation. It includes taxes withheld by the company, such as sales tax, taxes similar to VAT, and employee-borne labor taxes. These taxes are traditionally

The small industrial business:

- Is a limited liability, taxable company that pays taxes under the Simples Nacional tax regime.
- Started operations on January 1, 2018. At that time the company purchased all the assets shown in its balance sheet and hired all its workers.
- Operates in the capital city of each of the five locations covered in this pilot study.
- Is 100% domestically owned and has five owners, all of whom are natural persons.

collected by the companies from the consumer or employee on behalf of the tax agencies. Although they do not affect the income statements of the companies, they add to the administrative burden of complying with the tax system and so are included in the tax payments measure.

The number of payments takes into account electronic filing. Where full electronic filing and payment are allowed and are used by the majority of businesses similar to the case study companies, the tax is counted as paid once a year even if filings and payments are more frequent. For payments made through third parties, such as tax on interest paid by a financial institution or fuel tax paid by a fuel distributor, only one payment is included even if payments are more frequent.

Where two or more taxes or contributions are filed for and paid jointly using the same form, each of these joint payments is counted once. For example, if mandatory health insurance contributions and mandatory pension contributions are filed for and paid together, only one of these contributions would be included in the number of payments.

Time

Time is recorded in hours per year. The indicator measures the time taken by each of the two company scenarios to prepare, file, and pay three major types of taxes and contributions: the corporate income tax, value added or sales tax, and labor taxes, including payroll taxes and social contributions. Preparation time includes the time to collect all information necessary to compute the tax payable and to calculate the amount payable. If separate accounting books must be kept for tax purposes—or

separate calculations made—the time associated with these processes is included. This extra time is included only if the regular accounting work is not enough to fulfill the tax accounting requirements. Filing time includes the time to complete all necessary tax return forms and file the relevant returns at the tax authority. Payment time considers the hours needed to make the payment online or in person. Where taxes and contributions are paid in person, the time includes delays while waiting.

Total tax and contribution rate

The total tax and contribution rate measures the amount of taxes and mandatory contributions borne by each of the two businesses in their second year of operation, expressed as a share of commercial profit. This pilot study reports the total tax and contribution rate for calendar year 2019. The total amount of taxes and contributions borne is the sum of all the different taxes and contributions payable after accounting for any allowable deductions and exemptions. The taxes withheld (such as personal income tax) or collected by the company and remitted to the tax authorities (such as VAT, sales tax, or goods and service tax), but taxes not borne by the company are excluded. The taxes included can be divided into five categories: profit or corporate income tax, social contributions and labor taxes paid by the employer (for which all mandatory contributions are included, even if paid to a private entity such as a required pension fund), property taxes, turnover taxes, and other taxes (such as municipal fees and vehicle taxes).

This pilot study uses the *Doing Business* methodology for calculating the total tax and contribution rate, which is broadly consistent with the Total Tax Contribution

framework developed by PwC. The total tax and contribution rate is designed to provide a comprehensive measure of the cost of all the taxes a business bears. It differs from the statutory tax rate, which merely provides the factor to be applied to the tax base. In computing the total tax and contribution rate, the actual tax or contribution payable is divided by commercial profit. Commercial profit is essentially net profit before all taxes and contributions borne. It differs from the conventional profit before tax, reported in financial statements. In computing profit before tax, many of the taxes borne by a firm are deductible. In computing commercial profit, these taxes are not deductible. Commercial profit therefore presents a clear picture of the actual profit of a business before any of the taxes it bears in the course of the fiscal year. Commercial profit amounts to 5.7% of turnover for the small industrial business and 12% of turnover of the micro commercial business.

Postfiling processes under Simples Nacional

Postfiling processes are measured based on four components: time to comply with refund of taxes similar to VAT; time to obtain this refund; time to comply with a tax correction; and time to complete a tax correction. For the refund components, this pilot study analyzes the taxes that apply in Brazil and are similar to VAT (ICMS, IPI, PIS and COFINS). For the tax correction components, the combined tax paid under the Simples Nacional method is considered. These components are analyzed inspired on the *Doing Business* postfiling index, but scores for these processes are not calculated.

The four components include the time to comply with and complete

a tax audit when applicable. The definition of a tax audit includes any interaction between the taxpayer and the tax authority after the filing of the tax return and payment of the tax liability due, including informal inquiries, formal inquiries, and formal tax audits to verify whether such taxpayers have correctly assessed and reported their tax liability and fulfilled other obligations.

The indicators are based on the following case study assumptions.

Assumptions about the ICMS, IPI, PIS and COFINS refund process

- In June 2019, the companies under Simples Nacional make a capital purchase.
- The value of the machine is 6.5 times income per capita of the economy for the small industrial business and 0.65 for the micro commercial business.
- Sales are equally spread per month.
- Cost of goods sold is equally expensed per month.
- The seller of the machinery is registered for ICMS, IPI, PIS and COFINS.
- Excess tax input incurred in June will be fully recovered after four consecutive months if the tax rates are the same for inputs and sales, and the machine and the tax reporting period is every month.
- Input ICMS, IPI, PIS and COFINS will exceed output of these taxes in June 2019.

Time to comply with ICMS, IPI, PIS and COFINS refund

Time is recorded in hours. The indicator has two parts:

- The process of claiming a tax refund. Time includes time spent by the firms on gathering information on these taxes from

internal sources, including time spent on any additional analysis of accounting information and calculating the tax refund amount; time spent on preparing the refund claim; time spent preparing any additional documents that are needed to substantiate the claim for the refund; time spent submitting the refund claim and additional documents if that submission is done separately from the submission of the standard tax return; time spent making representation at the tax office if required; and time spent completing any other mandatory activities or tasks associated with the tax refund.

- The process of an audit for ICMS, IPI, PIS and COFINS. This is captured if companies with a request for a cash refund due to a capital purchase are pooled into additional review in 50% or more of cases. Time includes time spent gathering information and preparing any documentation (information such as receipts, financial statements, and pay stubs) as required by the tax auditor and time spent submitting the documents requested by the auditor.

A total estimate of zero hours is recorded if the process of claiming a tax refund is done automatically within the standard tax return without the need to complete any additional section or part of the return, if no additional documents or tasks are required as a result of the input tax credit, and if, in 50% or more of similar cases, the company is not subjected to an audit. An estimate of half an hour is recorded for submission of documents if the submission is done electronically and is a matter of minutes. An estimate of zero hours is recorded in the case of a field

audit if documents are submitted in person and at the taxpayer's premises.

Time to obtain an ICMS, IPI, PIS and COFINS refund

Time is recorded in weeks. Time measures the total waiting time to receive a refund from the moment the request has been submitted. If companies with a request for a cash refund for taxes similar to VAT (ICMS, IPI, PIS and COFINS) due to a capital purchase are pooled into additional review in 50% or more of cases, time includes time to start the audit from the moment of claiming the refund; time spent interacting with the auditor from the moment an audit begins until there are no further interactions between firm and the auditor; time spent waiting for the tax auditor to issue the final audit decision from the moment the firm has submitted all relevant information and documents and there are no further interactions between the firm and the auditor; and time spent waiting for the release of the refund payment from the moment the final audit decision has been issued by the auditor.

Time also includes an average waiting time to submit the refund claim. The average waiting time to submit the refund claim is half a month if the refund claim is filed monthly. The average waiting time to submit the refund claim is one month if the refund claim is filed bimonthly. The average waiting time to submit the refund claim is one and a half months if the refund claim is filed quarterly. The average waiting time to submit the refund claim is three months if the refund claim is filed semiannually. The average waiting time to submit the refund claim is six months if the refund claim is filed annually. Time includes the mandatory carry forward time before a refund in cash

can be paid. The carry forward time is zero if there is no mandatory carry forward period.

If the ability to claim a refund for taxes similar to VAT is restricted to specific categories of taxpayers that do not include taxpayers similar to the case study companies the time to comply with refund and time to obtain refund is not considered in this pilot study.

Assumptions about the tax correction process under Simples Nacional

- An error in the calculation of the income tax liability leads to an incorrect Simples Nacional tax return and consequently a tax underpayment.
- The firm discovered the error and voluntarily notified the tax authority of the error in the tax return.
- The value of the underpaid tax liability is 5% of the tax liability due.
- The firm submits the corrected information after the deadline for submitting the annual tax return, but within the tax assessment period.

Time to comply with a tax correction under Simples Nacional

Time is recorded in hours. The indicator has two parts:

- The process of notifying the tax authorities of the error, amending the return, and making additional payment. Time includes time spent gathering information and preparing the documents required to notify the tax authorities; time spent submitting the documents; and time spent making the additional tax payment if the payment is done separately from the submission of the amended Simples Nacional tax return.

- The process of complying with a tax correction under Simples Nacional. This is captured if, in 25% or more of cases, the pool of companies that were exposed to additional review included companies that self-reported an error in the tax return, which resulted in their owing more in tax because of underpayment. The threshold used for assessing the tax audit is lower than the threshold used in the case of the cash refund for taxes similar to VAT. This is because the case study scenario of self-reporting an error in the tax return and resulting in an underpayment of the tax liability should only be an issue among a small sample of companies selected for a tax audit. Unlike a tax correction, it is common that a one-time request for a cash refund be exposed to a tax audit. Time includes time spent gathering information and preparing any documentation (information such as receipts, financial statements, and pay stubs) as required by the tax auditor and time spent by submitting the documents requested by the auditor.

An estimate of half an hour is recorded for submission of documents or payment of the income tax liability due if the submission or payment is done electronically in several minutes. An estimate of zero hours is recorded in the case of a field audit if documents are submitted in person and at the taxpayer's premises.

Time to complete a tax correction under Simples Nacional

Time is recorded in weeks. Time includes the time to start an audit from the moment the tax authority has been notified of the error in the

corporate income tax return; time spent interacting with the auditor from the moment an audit begins until there are no further interactions between the firm and the auditor; and time spent waiting for the tax auditor to issue the final tax assessment from the moment the firm has submitted all relevant information and documents and there are no further interactions between the firm and the auditor. Time to complete a corporate income tax correction is recorded as zero if less than 25% of companies will not go through an additional review.