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Italy

*The Delega Fiscale and the
Strategic Orientation of Tax Reform*

September 2012

**Michael Keen, Ruud de Mooij, Luc Eyraud,
Justin Tyson, Stephen Bond, and Lawrence Walters**

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ITALY : THE *DELEGA FISCALE* AND THE STRATEGIC ORIENTATION OF TAX REFORM

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Contents	Page
Preface.....	4
Acronyms.....	5
Executive Summary.....	6
The <i>Delega Fiscale</i> and the Strategic Orientation of Tax Reform.....	7
I. Tax Reform and the <i>Delega Fiscale</i>	8
A. The Importance of the <i>Delega Fiscale</i>	8
B. Recent Tax Reforms: Aims, Challenges, and Unfinished Business.....	8
C. Building on Progress.....	11
II. Observations on the Articles of the <i>Delega Fiscale</i>	12
III. An Assessment of the <i>Delega Fiscale</i>	36
Tables	
1. Summary of Largest Tax Expenditure Items.....	19
2. Gambling and Games in Italy, 2011.....	34
Figure 1. Gambling Revenues and Tax Rates, 2006–11.....	34
Box 1. Decomposing the IVA Policy Gap.....	17
Appendix I. Text of the <i>Delega Fiscale</i>	40

PREFACE

In response to a request for technical assistance on tax policy from Dr. Vieri Ceriani, Undersecretary of State in the Ministry of Economics and Finance (MEF), a mission from the International Monetary Fund's Fiscal Affairs Department (FAD) visited Rome, Italy during the period July 12–27, 2012. The mission comprised Mr. Michael Keen (head), Ruud De Mooij, and Luc Eyraud, (both FAD); Justin Tyson (EUR); and Lawrence Walters and Stephen Bond (both experts).

The mission met with Professor Mario Monti, President of the Council of Ministers; Vittorio Grilli, Minister of Finance; Dr. Vieri Ceriani, Undersecretary of State (MEF); Professor Fabrizia Lapecorella, Director General of the Tax Department (MEF); and senior representatives of institutions listed at the end of this report.

The mission is extremely grateful for the outstanding support provided by Dr. Vieri Ceriani, Professor Fabrizia Lapecorella, Dr. Cosimo Scagliusi, and Dr. Maria Teresa Monteduro in organizing and facilitating the work of the mission.

ACRONYMS

ACE	<i>Aiuto alla Crescita Economica</i> —‘Aid for Economic Growth,’ an Allowance for Corporate Equity form of business tax, introduced in December 2011.
BOI	Bank of Italy
DF	<i>Delega fiscale</i> —framework law for tax reform proposals
DIT	Dual Income Tax
EU-ETS	European Union Emissions Trading System
FAT	Financial Activities Tax
GAAR	General Anti-Avoidance (or ‘Abuse’) Rule
ICI	<i>Imposta Comunale sugli Immobili</i> —local property tax, replaced by the IMU in December 2011.
IMU	<i>Imposta Municipale</i> —property tax introduced in December 2011(replacing the ICI).
IRAP	<i>Imposta Regionale sulle Attività Produttive</i> —regional production tax, an origin-based value added tax.
IRES	<i>Imposta sul Reddito delle Società</i> —Corporate Income Tax.
IRI	<i>Imposta sul Reddito Imprenditoriale</i> —new business income tax envisaged in the <i>delega fiscale</i> .
IRPEF	<i>Imposta sul Reddito delle Persone Fisiche</i> —personal income tax.
IVA	<i>Imposta sul Valore Aggiunto</i> —value added tax (VAT).
MEF	<i>Ministero dell’Economia e delle Finanze</i> —Finance Ministry
NWT	Net Wealth Tax
PIT	Personal Income Tax
SC	Social Contribution

EXECUTIVE SUMMARY

The *delega fiscale* (DF) provides a framework for significant structural improvement. It is (understandably) silent on some of the most challenging problems of the current tax system, notably the high labor tax wedges and narrowed base of the *Imposta sul Valore Aggiunto* (IVA). Nonetheless, implementing the strategic directions of change it sets out would substantially improve core parts of the tax system.

Three sets of measures go to core elements of tax design and implementation:

- ***Bringing cadastral values closer to market values.*** Realistic alignment of cadastral prices with market prices is essential for greater fairness in property taxation, paving the way for its more effective use as a central element of the local public finances.
- ***Establishing greater certainty and transparency for taxpayers and tax authorities.*** The central goal of protecting taxpayers' rights while safeguarding revenue from abuse will be substantially furthered by clarifying when tax schemes will be regarded as abusive; ensuring criminal procedures do not apply when fraud is not an issue; and encouraging companies to better manage risky tax positions.
- ***Unifying the treatment of retained earnings across different types of business.*** This is a further welcome step toward easing distortions of business decisions on organizational form and investment levels, careful attention to detail being needed to ensure that these important objectives are fully realized.

Other provisions of the DF would also bring marked improvements in a range of areas.

Routine analysis and assessment of tax gaps is critical to improving compliance; regular reporting of tax expenditures and building on extensive recent work is key for transparent review of their effectiveness; recognizing the importance of green taxation is a step toward returning Italy to a leadership role in the area; and VAT grouping, while having a revenue cost, can significantly reduce distortions from VAT exemption in key sectors.

Much detail remains to be spelled out, and some provisions could be made more effective... Cadastral revaluation could be eased, for example, by making use of self-reporting; and allowing the *Imposta sul Reddito Imprenditoriale* (IRI) as an option adds complexity and can only lose revenue.

...but the essentials of the DF are sound and build on strengths of the current system that have been reinforced by recent reforms. Introduction of the Allowance for Corporate Equity (ACE) was an important step toward greater neutrality for businesses' investment and financing decisions, taking Italy closer to a form of 'dual income tax' (taxing capital income at a low flat rate, labor income at progressive rates). Recent measures, including the property tax increase and taxes on financial securities, suggest a desire to supplement this with tools bearing on forms of wealth. Among the issues that remain is whether an explicit wealth tax, and/or a strengthening of inheritance taxes, might have a greater role to play.

THE *DELEGA FISCALE* AND THE STRATEGIC ORIENTATION OF TAX REFORM

This report reviews the DF,¹ currently with parliament, and the strategic directions for tax reform for which it could pave the way. The aim is not to review all paragraphs and sub-paragraphs, some of which are very detailed and context-specific, but to focus on the core strategic choices that the DF represents, with a particular focus on policy aspects.

The discussion is structured as follows. Section I places the DF in the broader context of the design of the Italian tax system, and recent changes to it. Section II then considers its key provisions, leading to an overall assessment in Section III. A series of appendices elaborate on technical issues.

¹ “Draft Law Concerning the Powers Delegated to the Government to Lay Down Legal Provisions for a More Equal, Transparent, and Growth-Oriented Tax System.” The text reviewed in this report is in an appendix.

I. TAX REFORM AND THE *DELEGA FISCALE*

A. The Importance of the *Delega Fiscale*

1. **The DF sets out principles to guide key elements of subsequent structural tax reform, rather than delivering reform in itself or altering the overall level of taxation.** It empowers the government to introduce, within nine months of its entry into law, legislative decrees consistent with the principles it sets out.² The focus of the DF is wholly on the structure of the tax system, in that among the guiding principles is the requirement that the overall package of reforms be revenue-neutral:³ questions as to the overall level of revenue are thus left aside, and so are not addressed in this report.

B. Recent Tax Reforms: Aims, Challenges, and Unfinished Business

2. **The principles set out in the DF need to be assessed relative to both the wider structure of and recent developments in the Italian tax system.** Key elements of this context are

The system has many aspects of a Dual Income Tax

3. **A ‘dual income tax’ (DIT)⁴ taxes labor income at progressive rates but capital income at a low single rate.** It differs from a ‘comprehensive’ income tax in distinguishing between capital and labor income (rather than subjecting the sum of the two to a single progressive scale) and from an ‘expenditure’ tax in that it taxes the normal return to capital. To avoid arbitrage opportunities and facilitate implementation, the textbook prescription is to set the corporate income tax rate equal to the single rate on capital income.⁵

4. **Several features of the Italian tax system have DIT features...** including the single and very similar rates applied to rental income (21 percent);⁶ interest income (20 percent) other than from government debt (12.5 percent); dividends not associated with a “qualified”

² Article 1. In addition, Article 16 provides that these decrees may be revised, consistent with the principles of the DF, within 18 months of their entry into force.

³ Article 17.

⁴ The term is also used to refer to the form of corporate tax implemented in Italy for some years around the turn of the century (which was essentially akin to an ACE but with a reduced (rather than zero) rate on the imputed return to equity). Throughout this report, it has the meaning given in the text.

⁵ If the corporate tax rate exceeds the flat tax on interest income, for instance, there is a tax gain from lending to corporations.

⁶ In this case, as an option to taxation under the *Imposta sul Reddito delle Persone Fisiche* (IRPEF).

(i.e., substantial) shareholding⁷ (20 percent or more); and capital gains on most financial instruments (20 percent).

5. **...though there remain some differences from the textbook DIT.** These include the taxation of (49.72 percent of) dividends under progressive *Imposta sul Reddito Imprenditoriale* (IRPEF) rates for qualified shareholdings, the potential taxation of capital gains on real estate at the IRPEF rate (with an option to pay at 20 percent), and the absence of any attempt to apply differential taxation of labor and capital income to unincorporated businesses. Notable too is that distributed corporate earnings (in excess of a normal rate of return) are taxed at effective rates that are close to the top marginal IRPEF rate rather than the rate on interest income.⁸

6. **The DIT has many merits, and, though not without drawbacks, has provided a coherent anchor for tax reform in Italy.** Pioneered in (and still being perfected by) Nordic countries, such a structure has several potential merits: perhaps most compelling, the increased international mobility of financial capital makes it increasingly difficult to tax capital income at rates as high as the top marginal rate felt appropriate for labor taxation.⁹ Potential drawbacks of the DIT are the need, in principle, to distinguish capital from labor income—when small businesses can readily shift between the two—and the perception of inequity in charging a lower tax rate on those, likely to be among the better off, more heavily dependent on capital income. Progress toward a DIT has in any event provided a coherent and practicable framework for strengthening tax design in Italy—in the process of unifying previously very dissimilar rates on different forms of interest income, for instance, and providing a setting for the ACE. The essential structure, moreover, appears to be widely accepted. There is thus a very strong case for measures that further implement the underlying principles of the DIT, and address such weaknesses as remain.

Taxation of property and consumption has increased...

7. **The introduction of the *Imposta Municipale (IMU)* at the start of 2012 fundamentally reformed, and increased, property taxation.** In replacing the previous *Imposta Comunale sugli Immobili (ICI)*, it brought primary residences back into the tax base and scaled up cadastral values (by 49 percent overall). The marked increase in property tax

⁷ Two percent or more for listed companies; 20 percent or more for unlisted companies.

⁸ Given an *Imposta sul Reddito delle Società (IRES)* rate of 27.5 percent, the effective tax rate for non-qualified shareholdings is 42 percent ($= (0.275) + (0.2) \times (1 - 0.275)$); for a qualified shareholder paying IRPEF at the top (state) marginal rate of 43 percent it is (a little over) 43 percent ($= 0.275 + (0.43) \times (0.5) \times (1 - 0.275)$).

⁹ There are others. A low rate on capital income may, for instance, ease the distortions that arise from the inability, in practice, to tax all forms of capital income at the same rate (the difficulty of taxing capital gains on accrual, in particular, making it hard to equalize their treatment with that of, say, interest).

revenue to which this led—a projected €10.7 billion (around 0.7 percent of GDP) in 2012—also has important implications for longer-term reforms aimed at increasing municipalities’ ability to finance their activities (both overall and at the margin) from local taxation rather than transfers from the state. In particular, recent reforms of municipal finance, tax autonomy, and equalization schemes in the context of greater fiscal federalism will likely have to be revisited;¹⁰ these wider issues of fiscal federalism, however, are beyond the scope of this report).

8. **In 2011, the standard IVA rate was increased and taxes on some luxuries introduced.** The increase in the standard IVA rate from 20 to 21 percent in 2011 does not, however, address the more fundamental point that Italy has one of the weakest performing VATs in the EU: reflecting the presence of reduced rates and imperfections of compliance. C-efficiency (the ratio of IVA revenue to the product of aggregate consumption and the standard rate) remains one of the lowest in the EU (41 percent, compared to an unweighted OECD EU average of 58 percent).¹¹ New excises on boats and private planes are clearly targeted on the very wealthy, but the limited revenue they raise (0.3 percent of GDP) means that they can have only very limited distributional effects.

...and that of labor somewhat fallen

9. **Expanded deduction of labor costs under the *Imposta Regionale sulle Attività Produttive (IRAP)*, and of the labor component of the IRAP against the *Imposta sul Reddito delle Società (IRES)*, go some way to reducing labor taxes.** The effects seem likely to be fairly modest, however: the former apply only to those under 35 and women on permanent contracts, while the latter imply an effective rate reduction of less than 1 percent.¹² The overall revenue cost of these measures was put at only about €1.6 billion in 2012—and an increase in the regional surcharge on the IRPEF offset this.¹³

¹⁰ See, for example, legislative decree No. 23 of 2011 on municipal federalism (http://www.portalefederalismofiscale.gov.it/portale/it/c/document_library/get_file?uuid=085a7e51-5da5-429f-b5c0-b62f8015f99f&groupId=10157).

¹¹ Some care is needed in such international comparisons; the authorities believe, for instance, that the upward-adjustment of GDP for the informal economy is more complete in Italy than in some other countries. How to assess the performance of the IVA is discussed further in Section II.

¹² Assuming the standard IRAP rate of 3.9 percent, since 10 percent of the IRAP was deductible already, the reduction in the effective rate on labor costs is $(0.9) \times (0.039) \times 0.275 = 0.0097$.

¹³ To the extent that these effects effectively finance a reduction employer’s labor cost by increasing taxes on final consumption (of commodities and housing services), the effect will have been equivalent to a fiscal devaluation: reducing the euro price of exports (assuming the reduction in labor costs to have been passed on) and increasing the relative price of imports in Italy (the increase in IVA affecting both imports and domestic production), but the cut in labor costs only the latter. Any effect is likely to have been modest, however: even assuming the IRPEF surcharge was borne by workers, the extent of the shift was likely under 1 percent of GDP, and part of the property tax falling on commercial properties is likely if anything to have raised production

(continued)

Tax distortions to firms' financing and investment decisions have been reduced

10. **The recent introduction of an Allowance for Corporate Equity (*Aiuto alla Crescita Economica*; ACE) has eased the tax bias toward debt finance and made equity injections more attractive.** By providing a tax deduction for a notional return on additional equity injected into companies, this system reduces the cost of such finance and eases the tax incentive to use debt rather than equity finance. These are very attractive properties—the importance of avoiding tax incentives to artificially high leverage, especially but not only for financial institutions, has emerged only too clearly since 2008. Given too the positive experience of several countries with ACE or similar systems,¹⁴ many now advocate widespread adoption of the ACE.¹⁵ With its own past experience of forms of business taxation with ACE-type features, this is an area in which Italy has been a leader—and is now once again.

C. Building on Progress

11. **Some significant weaknesses of the current tax system remain.** Labor tax wedges are high—the implicit tax on labor is the highest in the EU in 2010—and the effectiveness of the IVA in performing its basic function, of raising substantial revenue as a broad-based consumption tax, remains poor.¹⁶ There is considerable complexity: in the tendency to offer taxpayers options such as substitute taxes, in the creeping piecemeal complications in deductions from, and deductibility of, the IRAP—and more generally in the vast range of tax expenditures.¹⁷ And administrative and judicial concerns continue to dampen taxpayers' confidence. The recent increases in taxes on transactions and particular forms of wealth—real property and some financial assets—raise wider issues as to the role of such taxes in the wider tax system.

12. **Continued progress requires sustaining and pursuing further the basic aims underpinning the developments described above:** building a coherent income tax structure along DIT lines, making fuller use of potentially less distorting taxes, and enhancing neutrality in relation to business decisions. The DF must be judged largely on whether it provides a framework for their continued and wider application.

costs. The design and likely impact of fiscal devaluations are discussed by de Mooij and Keen (2012) and, with reference to Italy, Eyraud (2012).

¹⁴ Reviewed in Klemm (2007).

¹⁵ The Mirrlees Review (Mirrlees et al., 2011) recommends its adoption by the U.K., for instance, and IMF (2010a) is supportive. De Mooij (2011) elaborates on these issues.

¹⁶ Discussed in Section II.

¹⁷ Discussed in Section II.

II. OBSERVATIONS ON THE ARTICLES OF THE *DELEGA FISCALE*

13. **This section provides observations on the various articles of the DF.** Not all of the provisions are reviewed: many reflect very particular features of Italy’s circumstances and legal traditions; others lie largely beyond the tax policy remit of the report. The focus is on the key strategic decisions represented by each substantive Article.¹⁸ A short summary assessment follows in Section III.

Article 2— *Review of the immovable property cadastre*

14. **The update and reform of cadastral values and cadastral management envisaged in this article of the DF—one of the most important and detailed—are widely and rightly regarded as essential.** Revenue from the tax as a percent of GDP is broadly in line with other EU and OECD countries, though within this range there is room for Italy to increase collections from this source. The key structural issue is equity. Current taxable values are over 20 years old. Real estate prices since then have increased six-fold in some regions, and by only half that in others, and there are similar variations within every major city in Italy. This asymmetry and variability across the country, and within market areas, makes the current cadastre unfair and inefficient. Simple adjustments to overcome disparities in assessed values are untenable. The revaluation called for in Article 2 articulates the government’s response to this very real need.

15. **The valuation methods proposed are consistent with international best practice, shaped to the Italian context.** There are many ways to implement an effective property tax system.¹⁹ The valuation methods proposed in the DF are recognized internationally as an appropriate basis for effective and fair property taxation in advanced economies. Appropriately, Article 2 reflects a pragmatic adaptation of these methods to Italian circumstances and history.

16. **The substantial increase in taxable values could finance a large reduction in IMU rates—and perhaps even more beneficially in transactions taxes.** The taxable base for housing is still less than half the average market value nationally, so that comparable revenue at the national level could be raised after comprehensive revaluation with less than half the current tax rate. A strong case can be made, consistent with the overall terms and aims of the DF, for using some of this revenue increase to reduce distortionary taxes on transactions related to real property.

17. **Applying any common national rate structure to a revalued base will mean substantial (and broadly progressive) revenue shifts between and within jurisdictions,**

¹⁸ Articles 1 and 16, which set out deadlines and procedures for the DF and related legislation, are omitted.

¹⁹ Walters (2011).

because there is such wide disparity in the current ratio of market value to taxable value. The likely impact of revaluation is most easily gauged for housing. Here revaluation to market value will likely nearly triple revenues at current rate and credit structures. If revenue neutrality at the national level is desired, continuing to apply common rate across all municipalities would mean a significant redistribution of aggregate revenues. Some regions would see increases as large as 30–50 percent; others would see declines of the same magnitude. Since the degree of undervaluation tends to be higher where market values are higher, this redistribution would be broadly progressive. The implications, within the wider structure of fiscal federal relations, will need close consideration.

18. **The impact on individual households is likely to be similarly dramatic.** At present, the average owner-occupied home in Italy has a tax obligation of €152 (ignoring the credit for children still at home). But this value varies substantially across the country. In Basilicata, the tax on the average primary residence is €7, while in Lazio it is €309. With revaluation, taxes on owner-occupied housing are likely to increase in some regions by as much as 70 percent, while in other areas they are likely to be zero for the median homeowner.

19. **The suggestion that cooperation with municipalities be enhanced is welcome and could be expanded, perhaps by developing municipal cadastral commissions in some cities.** As the cadastral revisions become public, there will undoubtedly be property owners who feel that the new value is incorrect. Article 2 mentions provincial and central cadastral commissions charged with resolving these disputes. An additional option to consider is a cadastral commission at municipal level for medium and large cities, consisting of land owners from the municipality who are not public employees, but have some training in the valuation methods employed by the Land Agency. These municipal commissions would serve without remuneration and would function as the first level of appeal for disputes that cannot be resolved informally with the Land Agency. In addition, municipalities should be assigned some role in maintaining the accuracy of the cadastre. Experience in many other countries is that this task is best seen as a partnership between local government and land record managers. As local reliance on the property tax increases, local governments will likely be quite willing to assist in these roles.

20. **Implementing Article 2 without incurring additional costs will be a major challenge, and the crucial task of maintaining the cadastre and cadastral values will require resources.** Maintaining land and building records for over 83 million parcels, market information for 30,000 reference market areas, and carrying out individualized appraisals for over one million specialized cadastral properties will strain the Land Agency. Some of the management tasks can be effectively shared with municipalities and other local agencies. But this too will require resources. And once updated, the cadastral values must be maintained and updated every two to three years, otherwise the current valuation inaccuracies and inequities will quickly return. One approach that has proven effective in other countries is to dedicate a small portion of the property tax revenue for the maintenance of the assessment

and collection system. Determining the exact share will require a careful analysis of budget needs at both the central and local level, but some such allocation should be considered.

21. **One option for collecting additional required data is self-declaration by the taxpayer.** It has proven feasible in other countries to require the taxpayer to complete an objective description of their property as part of the tax collection process. For sure, not all taxpayers will complete the additional form and some will submit erroneous data. The Land Agency will need an audit staff and strategies (perhaps for instance targeting regions in which particular problems are anticipated) as well as procedures to verify samples of submitted data, with well-publicized appeals procedures and penalties for those who deliberately falsify data. But many taxpayers will submit reasonably accurate data—and self-reporting would considerably reduce the cost of gathering additional information. Such an approach would not be perfect or costless, but might provide a fruitful way to accelerate progress.

22. **It will be important to review property tax exemptions, particularly those relating to agricultural land.** This is quite consistent with Article 4 of the DF. Roughly 60 percent of the land in Italy is currently exempted from the property tax. Broadening the base of the property tax further could substantially reduce tax rates or enhance local revenues. This is not to say that all exemptions are unjustified. Rather, the argument is that all exemptions from the property tax merit careful review to assure that their objectives remain valid and that they are sufficiently effective, including relative to other policy instruments, in achieving them.

23. **The reform of the property tax needs to be viewed within the wider context of strengthening fiscal federal relations.** A need for some form of explicit equalization system is readily apparent from the distribution of IMU collections already received in the first installment in 2012: some regions collected twice the national average, while others are at only one-half the national level. Moreover, the equalization schemes already envisaged, but not yet implemented, under earlier fiscal federalism reforms will need to be reconsidered in light of the revisions to the tax base.

Article 3—*Estimating and Monitoring Tax Evasion*

24. **‘Tax gap’ analysis of the kind envisaged—quantifying revenue losses from imperfect compliance—can be an important step toward fairer and more efficient taxation.** Understanding the scale of these losses, whether from deliberate evasion or other sources of imperfect implementation of the tax rules, can suggest scope for increasing revenue in ways that do not penalize or further distort the behavior of the compliant, and which increase the horizontal equity of the system. And publicizing their extent can build public support for measures to do so.

25. **Tax gap analysis can also help to monitor and incentivize the performance of the revenue agency and identify emerging risks.** Caution is needed in comparing tax gaps across countries, as methodologies and local circumstances may vary widely. Comparisons for a given country over time, however, can be helpful both in assessing the effectiveness of interventions by the revenue agency and in identifying emerging compliance risks. It is striking, for instance, that the Revenue Agency's estimates suggest that the IVA gap continued on its downward trend throughout the hard times of recent years—in most countries, slowdowns are associated with widening compliance gaps (as businesses finance themselves in part by delaying remitting tax).²⁰ This is a puzzle that may be useful to explore further.

26. **The DF refers only to 'top-down' analysis—based on national accounts—but there is a need for other methods, too.** This is for two reasons:

- ***Quantifying the overall gap does not in itself help design interventions.*** Estimates of the aggregate gap in themselves are uninformative about the specific nature of imperfections in compliance, and hence for the design of responses by the revenue administration.
- ***There are some taxes for which the method is ill-suited.*** The DF calls for analysis to be provided for all the main taxes. The top-down method is relatively straightforward, and has already been developed in Italy for the IVA and IRAP since in each case the base is closely related to national account aggregates and rates do not vary greatly across taxpayers. It could also be applied to the IMU (along lines spelled out in Walters, 2012). For the IRES and IRPEF, comparing national accounts data with declared incomes can (and, we understand, has) been used to estimate the gap between the actual and potential tax base. More is needed in these cases, however—especially for the IRPEF—to estimate the gap in terms of tax payments themselves, since the tax theoretically due in these cases depends critically not only on economy-wide aggregate but also on their distributions across taxpayers.

27. **'Bottom-up' and other forms of analysis are needed to address these limitations.** While the full methodology of the former is rarely disclosed, the essence is to gross up revenue losses discovered on audit or criminal investigation,²¹ using information on the criteria guiding audit selection,²² to arrive at estimates for the full population. In this way, the

²⁰ See Sancak, Velloso, and Xing (2010).

²¹ This assumes of course that audits succeed in identifying undisclosed amounts.

²² If it is felt inappropriate to share these criteria outside the tax administration, such analyses would need to be conducted by the administration itself.

U.K.—which has been a leader in this area²³—arrives at estimates of the IVA revenue losses due to a variety of sources, such as non-registration and missing trader fraud, enabling it to identify specific areas in which interventions are likely to be most productive of revenue. For the IVA, this approach thus complements top-down results. In other cases—notably personal taxation—use of operational information, combined potentially with eclectic use of survey information (on household income and consumption, for instance) is the only realistic possibility.²⁴

28. **Annual calculation and publication of the results of tax gap analyses, as envisaged in the *DF* is important...** While some details of the methods used will likely need to remain confidential, as they reflect operational practices, publication of the results themselves is critical to monitoring the revenue administration and sustaining public pressures for action. And annual calculation is needed to identify emerging challenges and trends.

29. **...but (as with some other aspect of the *DF*) the resources required should not be underestimated.** While top-down methods for the IVA and IRAP have already been applied in Italy, these are, as noted above, in some respects the simplest cases. And while establishing an expert committee with oversight in this area is wise, (Article 2.1(c)), the expectation that this highly specialist and time-consuming work comes at no budgetary cost is unreasonable. It may be appropriate to cap this cost, but the cap cannot plausibly be zero if it is to be of adequate quality.

30. **To further guide reform priorities, there is scope to develop integrated analyses of weaknesses of both tax policy and administration.** For the IVA, the overall shortfall of C-efficiency²⁵ from 100 percent can in principle be decomposed into terms relating to both the ‘tax gap’ in the sense above—perhaps better referred to as a compliance gap (as in IMF, 2010b)—and a ‘policy gap’ reflecting the extent that the consumption actually taxed is not all brought into tax at the standard rate. For Italy, for instance, OECD (2010a) reports that C-efficiency in Italy was around 41 percent in 2008; combining this with a compliance gap of around 30 percent, as the studies of the Revenue Agency suggest, implies a policy gap also of around 41 percent: that is, revenue was around 41 percent of what it would have been had the then-standard rate been applied to the actual consumption brought into the IVA. These calculations are illustrative, in that they derive from distinct data sources that are not fully

²³ An excellent account of the methodologies used in relation to VAT, excises, income tax, social contributions, and other taxes is in HMRC (2011).

²⁴ Some techniques may be helpful even though they yield no estimate of the tax gap: a narrowing differential between the income and consumption reported in household surveys, for instance, can suggest improved compliance (Ivanova, Keen, and Klemm, 2005).

²⁵ This is the ratio of VAT revenues to the product of the standard IVA rate and consumption; Ebrill et al. (2001) discuss the strengths and weakness of this as an indicator of IVA effectiveness; OECD (2010a), which refers to this as the ‘VAT revenue ratio,’ discusses issues in its calculation.

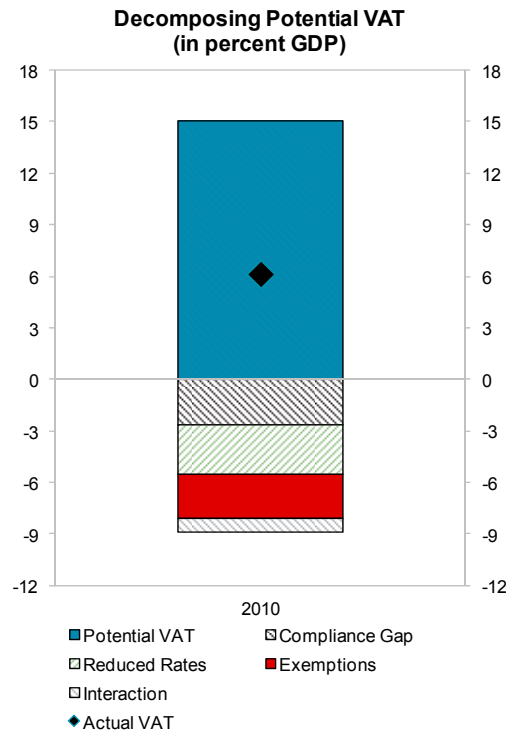
comparable. Nonetheless, they give some sense of the relative potential of design and compliance improvements: halving the compliance gap, maintaining all tax rates unchanged, would thus raise about 1.3 percent of GDP; halving the policy gap,²⁶ keeping the standard rate unchanged, would raise about 2 percent.²⁷ (The policy gap can in turn be decomposed into elements reflecting rate differentiation and the operation of exemptions: Box 1 illustrates for Italy). A similar approach has not yet been developed for other taxes, but there is potential to do so for those in which a uniform rate is a natural benchmark.

Box 1. Decomposing the IVA Policy Gap

De Mooij and Keen (2012) show that the policy gap can be further decomposed down as

$$(1\text{-policy gap}) = (1\text{-exemptions}) \times (1\text{-rate dispersion})$$

where the first term captures the impact of exemptions (sectors, activities), and the second measures the effect of non-standard VAT rates on collections (usually lower rates). The recent report of the *Ministero dell'Economia e delle Finanze* (MEF) on tax expenditures²⁸ in Italy implies rate dispersion at about 0.25 percent; combined with a policy gap of 41 percent, this implies an “exemptions gap” of 0.22 percent in 2006. In percent of GDP (2010), this means lost revenue of 2.5 due to exemptions (including those mandatory under EU rules, which of course Italy cannot unilaterally remove), 2.9 due to lower rates, and 2.6 due to non-compliance. This leads to actual revenue collection of just over 6 percent of GDP—as opposed to potential revenue, at an unchanged standard rate, of 15 percent of GDP.



²⁶ De Mooij and Keen (2012) show how the policy gap can in turn be decomposed into elements reflecting rate differentiation and the operation of exemptions.

²⁷ These calculations use the ratio of IVA revenue to GDP in Italy of 6 percent of GDP (OECD, 2010a).

²⁸ Ministero dell'Economia e delle Finanze, 2011, *Gruppo di lavoro sull'erosione fiscale: Relazione Finale*, <http://www.mef.gov.it/documenti/open.asp?idd=28892>.

Article 4—Monitoring and Restructuring of Tax Erosion

31. Identifying and quantifying tax expenditures are critical for a complete understanding, and informed public discussion, of the overall impact of the tax system.

‘Tax expenditures’ are government revenues foregone as a result of differential or preferential treatment, relative to some benchmark system, of specific sectors, activities, regions, or agents. They can take many forms, including allowances (deductions from the base), exemptions (exclusions from the base), rate relief (lower rates), credits (reductions in liability), and tax deferrals (postponing payments). Tax expenditures can have major consequences for the fairness, complexity, efficiency, and effectiveness of not only the tax system itself but, since they often serve purposes that might be (or are also) pursued through public spending, of the wider fiscal system.

32. Article 4(1) of the DF is in line with best practice for the transparent and, no less important, regular disclosure of tax expenditures. It provides for the annual publication of a list of tax expenditures according to criteria and methods that will be supported by an external review body. This is consistent with—indeed goes somewhat beyond—the standards set out in the IMF *Code of Good Practices on Fiscal Transparency* and the OECD *Best Practices for Budget Transparency*, which specify that information be provided at the time of the government’s annual budget on all fiscal activities, irrespective of the institutional arrangement under which they take place, including tax expenditures.²⁹

33. Very substantial work has already been undertaken on the quantification of tax expenditures in Italy. A report, commissioned by the *Ministero dell’Economia e delle Finanze* (MEF), identifies and costs 720 measures of this kind, classified according to their intended purpose (Table 1 lists the 20 largest items).^{30,31} One complication in quantifying tax expenditures, and comparing them internationally, is in identifying the appropriate benchmark regime against which to measure deviations—on which there is no general agreement. The MEF report, by choosing general taxation principles rather than current legislation as the benchmark, provides very extensive coverage by international standards—which gives a strong basis for meeting the requirement of this article and facilitates

²⁹ International Monetary Fund, 2007, *Code of Good Practices on Fiscal Transparency*, Article 3.1.3, <http://www.imf.org/external/np/fad/trans/code.htm> and OECD, 2002, *Best Practices for Budget Transparency*, <http://www.oecd.org/dataoecd/33/13/1905258.pdf>.

³⁰ Ministero dell’Economia e delle Finanze, 2011, *Gruppo di lavoro sull’erosione fiscale: Relazione Finale*, <http://www.mef.gov.it/documenti/open.asp?idd=28892>.

³¹ One set of items listed, but not quantified, are those tax expenditures mandated by EU rules. Though natural, in that there is no possibility of recovering these revenue losses, and common practice, in a wider context this does risk these provisions escaping the scrutiny they deserve.

Table 1. Summary of Largest Tax Expenditure Items¹

Description	Value (billions)	Percent GDP	Comment
Personal Income Tax			
Tax credit for wage income from employment, pensions, self-employment and similar income	37.73	2.40	This regime is a substitute for the fact that Italy has no lower personal income tax threshold
Tax credit for dependent relatives	10.50	0.67	This benefit is sometimes considered a measure of ability to pay and part of the benchmark system rather than a tax expenditure
Tax exemption (excluded from base) for contributions to welfare and pension schemes for employees	10.10	0.64	Pension contributions are excluded and pension income is taxed
Lower PIT rates for payment of separation allowances and "golden handshakes"	5.10	0.33	Unwinds tax progressivity that would come from what is effectively multi-year income in one period
Tax exemption (excluded from base) for compulsory contributions to welfare and pension schemes for self-employed	4.31	0.27	Pension contributions are excluded and pension income is taxed
Tax credit for medical expenses and health assistance services			Considered to have welfare objective
	2.36	0.15	
Tax exemption (excluded from base) for income from the "family support" check	1.83	0.12	The Family Support check is an income support expenditure program run by INPS
Substitute tax (10 percent) on productivity related bonuses			Partially a labor market policy to incentivize decentralized bargaining
	1.48	0.09	
Lower PIT rates for payment of arrears to employees	1.22	0.08	Unwinds tax progressivity that would come from receiving past years' income in the current period
Tax credit for interest paid on mortgage for principal residence (or construction of principle residence)	1.34	0.09	
Capital Taxation			
Various financial substitute taxes (lower rates) on interests, dividends, capital gains and other forms of return	13.17	0.84	Substitute tax regime by-passes the requirement to tax capital income according to the progressive PIT schedule by mimicking a DIT regime

Table 1. Summary of Largest Tax Expenditure Items (concluded)

Description	Value (billions)	Percent GDP	Comment
Reduced rates on the interest and bonuses from government securities and other forms of public debt e.g., postal bonds	1.38	0.09	Supports government bond market
Substitute tax in lieu of registrations, stamp duty, mortgages etc. for government concessions	2.23	0.14	
Corporate Income Tax			
Domestic and foreign-source dividends received by a resident corporate taxpayer are 95 percent exempt from IRES.	8.38	0.53	Measure to avoid double taxation
Substitute tax (16 percent) for capital gains from goodwill, trademarks and other intangible assets resulting from extraordinary operations, such as restructuring and mergers	7.43	0.47	Tax provision to promote dynamism and incentivize new activity
Full deduction from IRAP tax base of SSC costs related to permanent workers; full deduction from PIT and CIT tax base of IRAP on labor costs (plus partial deductibility of interests costs) ²	6.69	0.43	Provision mainly to reduce labor tax wedge
Substitute tax for capital gains arising from "extraordinary" operations, such as mergers, divisions, and transfers of companies	6.40	0.41	Measure to favor restructuring, which brings higher depreciation charges (lower taxes) from corporate in the future
Substitute tax on capital gains from revaluation of assets held on the balance sheet at historical cost	4.18	0.27	Generates current revenue for the authorities in exchange for higher depreciation charges (lower taxes) from corporations in the future
Value-added Tax			
VAT reduced rate (10 percent)	24.60	1.57	Mainly food items, cultural/educational products and new dwellings
VAT reduced rate (4 percent)	14.60	0.93	Mainly food items, medical and pharmaceutical products, restaurants and hotels, new owner-occupied housing
Sum of largest tax expenditure items	167.27	10.66	

¹ Earlier estimates of tax expenditures related to the property market are excluded in light of the recent changes to property taxation.

² Full deduction of IRAP labor costs from PIT and CIT was introduced in Law 214/2011 and is not explicitly costed in the table, which instead includes estimates based on earlier lump-sum deductions per employee.

subsequent updating.³² One especially welcome feature of the MEF study that will be important to preserve is the indication of the intended purpose of each item.

34. **Quantifying tax expenditures is only an (essential) first step to analyzing them and—as importantly, Article 4(2) envisages—reducing those not generating offsetting benefits.**³³ This is not always straightforward, in that their impact on behavior is often hard to identify; even then, however, some sense can be given of whether it is plausible that the response could be large enough to warrant the revenue cost incurred. It is also important to compare tax expenditures with alternative spending measures and, more generally, to assess them in the light of what can be achieved on the spending side. For example, some of the tax expenditures with social objectives, such as the dependent relative tax credit or the IMU credit for children still living at home, potentially overlap with the objectives of social assistance programs run by the National Institute for Social Security (INPS) and the relative costs and merits of both delivery options need to be considered.³⁴

35. **Tax expenditures can compromise fairness and efficiency, may be poorly targeted to their intended beneficiaries—and are vulnerable to lobbying.** Tax expenditures can be a poor way of pursuing equity objectives. In a progressive tax system, for instance, any policy that reduces taxable income will benefit most those in the highest marginal tax bracket (and convey no benefit to those out of the tax system)—a strong argument for using tax credits (or spending measures) instead. And while the large tax expenditures associated with the reduced IVA rates in themselves increase progressivity, much of the benefit from them will go to the better off, so that the same equity objectives could likely be pursued at less revenue cost through social spending. Tax expenditures can also create unintended or unwelcome distortions: the current deduction of mortgage interest, for instance, may have been appropriate when imputed income from owner-occupation was effectively taxable, but now simply encourages leveraged housing finance. And special interest groups may find it easier to argue for tax breaks than for explicit spending support—those tax expenditures that benefit particular sectors should be carefully scrutinized.

36. **But not all tax expenditures are necessarily bad.** In some cases, they may replicate effects that are treated elsewhere as part of the benchmark system: the largest single tax expenditure in Italy, for instance, is a tax credit that serves essentially the same purpose (of excluding the lowest income from tax) as basic tax-free amounts served elsewhere. Many

³² Since 2010, annual State Budget documents have included a list of all tax expenditures, but only at the central government level and measured against current legislation—a narrower benchmark than that of the MEF Report.

³³ Some large tax expenditures have already been cut with recent reforms. The revaluation of cadastral values will eliminate previously identified tax expenditures related to property and transfers taxes.

³⁴ Some work has been done on the overlap in terms of objectives between social welfare programs and tax expenditures, but more is needed to understand the overlap in terms of beneficiaries and the cumulative effect in terms of public support to target groups.

countries offer preferential tax treatment for pension savings: how far doing so stimulates additional savings is contentious, but the commonality of the practice needs to be recognized. Delivering benefits in the form of tax reductions may in some cases be more administratively convenient than establishing new special schemes.

37. **Particular caution is needed in aggregating tax expenditures** because the aggregate revenue gain from eliminating two tax advantages may differ from the sum of the gains from eliminating each in isolation.³⁵

Articles 5–10—Chapter II: Fighting Tax Evasion and Revising the Relationship between Tax Authorities and Taxpayers

38. **One of the most important—and welcome—aspects of the DF is the focus on reducing tax uncertainties faced by taxpayers and tax authorities, while guarding against avoidance/abuse.** There is a clear need, as private sector representatives and the authorities agree, for greater certainty and clarity in identifying and dealing with potentially contentious tax matters.

39. **Three broad areas of action proposed in the DF together offer a coherent framework for improvement:** reassuring taxpayers by reducing the scope of criminal actions (Article 8), providing a clear definition of, and protection against, abusive schemes (Article 5), and fostering transparency and responsiveness in identifying and managing uncertain tax positions (Article 6).³⁶

Decriminalization

40. **The rapidity with which tax matters currently lead to criminal charges is a major concern of taxpayers.** Once the sum at issue exceeds 10 percent of declared income or €2 million, criminal charges may be levied—and these amounts are, for any sizable business, quite low. Thus, issues that would be administrative matters in other countries quickly escalate into criminal ones. Ultimately, it seems, criminal sanctions are rarely (if ever) imposed when there is no question of tax fraud. Nonetheless, exposure to criminal

³⁵ Suppose, for instance, that some sector benefits from both a narrowed tax base and a reduced tax rate. Then the sum of the tax expenditures associated with each understates the revenue gain from eliminating both (because, for instance, the revenue gained by increasing the rate is greater once the base has been broadened). The direction of bias, could, however, be in the opposite direction, with the aggregate of tax expenditures overstating the revenue gain from eliminating all.

³⁶ Many of the provisions in these articles reflect detailed matters of practice and legal structures in Italy, and are not commented on here.

charges imposes personal stress and carries reputational risks for individuals and firms³⁷ (and can be hard to explain to foreign investors); and carrying the formal possibility of penalties that are never imposed, because too harsh, undermines the credibility of the wider tax enforcement system.

41. **Criminal sanctions are generally, and appropriately, reserved in most countries for matters of tax fraud or evasion—and Article 8 aims at establishing this in Italy, too.** The hardship that criminal investigation imposes presumably gives a very strong incentive for taxpayers to be fully compliant. But it is also clearly perceived as in a fundamental sense unjust, and less objectionable ways to encourage compliance can be found (as other provisions in this chapter, discussed below, aim to do). Details beyond the scope of this report clearly matter (such as whether the maximum jail term of six years envisaged is appropriate). What is clear, however, is that removing the routine application of criminal charges would greatly increase the confidence of the private sector, and do little to hamper effective tax administration.

A General Anti-Avoidance (or ‘Abuse’)³⁸ Rule (GAAR)

42. **It seems widely agreed that recent jurisprudence has increased uncertainty as to—and widened the range of—the circumstances in which tax schemes will be struck down.** Article 37-bis³⁹ sets out a general principle of artificiality in tax arrangements, though limiting its application to specified transactions. More recently, however, a series of Supreme Court decisions, based on constitutional principles, appear to have widened and muddled the circumstances in which tax schemes may be overturned (even, it was reported to the mission, when the tax law explicitly offered the course taken as an option for the taxpayer).

43. **Adoption of a GAAR, as envisaged in the DF and as done in many though by no means all countries, can ease this uncertainty—for both taxpayer and tax authorities.** Details vary, but the essence of a GAAR is to allow tax authorities to disregard arrangements that have no clear business rationale other than to reduce tax liability. They thus at least make clear to all concerned what the basic test will be.

44. **Paragraph 1 of Article 37-bis provides a natural starting point for a GAAR, though many important details would need to be specified.** This provision is in just the spirit of a GAAR, stating that

³⁷ Indeed it is in principle possible for criminal charges to be upheld even if the taxpayer wins on the tax issue in dispute.

³⁸ Terminology in the U.K., where adoption of such a rule is anticipated, replaces ‘avoidance’ with ‘abuse’.

³⁹ Of Presidential Decree No. 600 of 29 September 1973; this entered into force in 1997.

*The tax authorities have the power to disregard for tax purposes acts, facts and legal arrangements, also in their functional connection, lacking a valid business purpose, aimed at by-passing rights and duties provided for by tax rules, and at obtaining tax reductions and tax reimbursements which would not be legally available.*⁴⁰

45. **This appears to have been widely accepted as general principle**, and so—with removal of the limitation to specific transactions that follows in Article 3—could, it would seem, provide a reasonable basis for a GAAR in Italy. But much more is needed than this, for instance: to ensure that the rule does not overturn the purpose of any deliberate tax incentives (which only work in so far as they lead precisely to decisions that would have no business rationale in their absence); and to determine the applicability of administrative penalties (as well as interest) for disallowed schemes (to avoid giving taxpayers a ‘one-way bet’ in testing contentious schemes). But the essential notion of avoidance/abuse in 37-bis seems to have widespread support.

46. **Establishing an Advisory Panel can help build taxpayers’ trust in the application of a GAAR.** Such a panel of independent experts is proposed in the U.K., for example: it would have no powers of decision but would be free to comment on decisions in specific cases. This has played an important part in building acceptability for proposals in the U.K. France has a broadly similar committee whose advice is non-binding but places the burden of proof on the party whose position it does not support and might also serve a useful purpose in Italy, given the recent dissatisfaction with the application of anti-avoidance decisions.⁴¹

Enhancing the relationship between taxpayers and tax administration

47. **There is increasing interest in building more transparent and cooperative relationships between tax administration and taxpayers—especially the largest—along the lines of Article 6.** This means taking transparency and dialogue to levels beyond those usual in large taxpayer offices, by establishing agreed rules of behavior for both sides. OECD (2010b) sets out a framework for such a relationship in relation to banks, and such schemes have been adopted in South Africa and the U.K.—this also seems to be the first intended group in Italy.⁴² This framework anticipates that taxpayers would commit, for instance (and inter alia), not to engage in aggressive tax planning, and to notify and discuss with the revenue administration tax issues subject to significant uncertainty; in return, the tax

⁴⁰ Translation for this report.

⁴¹ A consultative committee on anti-avoidance rules operated in Italy from 1998 to 2007, but was criticized for inconsistency and lack of independence from the tax administration.

⁴² There are other examples not limited to banks: under the Dutch Horizontal Monitoring program initiated in 2005, for instance, the taxpayer commits to notify the Dutch Tax Administration of any issues with possible and significant tax risk; in return, the revenue authority provides timely advice on the disclosed issues

administration might commit to consider sharing its assessment of such schemes or providing advance rulings. Penalties might also be reduced in relation to schemes that were notified to the tax administration.

48. **There is scope for mutual benefit in such arrangements, making the envisaged experimentation very worthwhile.** Experience in relation to commitments not to engage in aggressive tax practices has not been wholly encouraging,⁴³ but the potential for mutual benefit from a habit of disclosure seems clear. Both sides enjoy reduced uncertainty, and theory suggests further benefits: since positions disclosed are likely to be ones for which the taxpayer has a strong case, the tax administration gains from its greater ability to focus on undisclosed tax positions and the increased likelihood that strong positions will not be challenged.⁴⁴ Experience with such schemes is generally regarded as encouraging,⁴⁵ though ultimately an ability to identify and challenge undisclosed positions, and ensure strong compliance more generally, remains critical—suggesting that, as appears to be the intention in Italy, it is wise to begin by applying the scheme to a small and critical group of taxpayers.

Article 11—*Unification of taxation on business income and on income from self-employment and provision of lump-sum schemes for smaller taxpayers*

49. **Neutrality in the treatment of capital income has been significantly improved by recent reforms, especially by introduction of the ACE.** This eliminates the tax on the normal return to equity at the level of the business. It thus neutralizes the preferential tax treatment of debt finance, which was present under the old system. With the ACE, interest and normal equity returns are taxed only at a personal level. Returns above that are taxed at both the corporate and the individual level.

50. **Present tax arrangements are not neutral, however, between different organizational forms.** The concern raised is that retained profit of a corporation is subject to IRES, and liable for tax at personal level only if the profit is realized; corporations can thus postpone personal tax payment by deferring realization. Partnerships and sole proprietorships, however, do not have this option as their entire accrued business income is liable for IRPEF. On the other hand, to the extent that income is distributed, these groups are generally tax favored, since the top marginal rate of the progressive IRPEF—which is an upper limit to the average rate—is either exactly equal to (for qualified shareholdings) or one

⁴³ Of one scheme in the U.K., a treasury spokesman is reported as saying: “The government is clear that these are not transactions that a bank that has adopted the code should be undertaking” (*Guardian*, “Barclays £500m tax loophole closed by Treasury in rare retrospective action”; 28 February 2012, available at <http://www.guardian.co.uk/business/2012/feb/28/treasury-closes-barclays-tax-schemes>).

⁴⁴ De Simone, Sansing, and Seidman (2012).

⁴⁵ The OECD’s Forum of Tax Administration is currently undertaking a review of its use and impact.

percentage point above (for non-qualified shareholdings) the effective average rate implied by the combination of the IRES and dividend taxation (42 percent). Moreover, the ACE itself is particularly beneficial for those paying IRPEF rather than IRES, both because the notional return to equity is then deducted at a higher rate (at least for those with reasonably high incomes) and because they enjoy the allowance with respect to all equity, whereas IRES payers receive it only in respect of equity built up since the introduction of the ACE.

51. **The *Imposta sul Reddito Imprenditoriale* (IRI) proposed in Article 11(a) of the DF would substantially ease these distortions.** The IRI, the team understand, would be levied—at the same rate as the IRES—on retained earnings; all outflows to owners or managers would be deductible (as of course would be the ACE allowance) but fully taxable at personal level under the IRPEF (with no attempt to differentiate between returns to labor and capital incomes). Firms liable to IRI would thus be taxed exactly like corporations with respect to their retained earnings; and the difference in respect of distributions would depend on the gap between the IRPEF rate and the effective combined rate of IRES and dividend tax—which at higher income levels is small. The reform would thus bring considerably greater neutrality between those currently taxed under the IRES and partnerships, sole proprietors and others now taxed under the IRPF. (Greater neutrality would also be served, it should be noted, by narrowing differences in tax bases, for instance in the period for which losses may be carried forward). This would be an important finishing touch in Italy’s move toward a business-neutral tax for entrepreneurs.

52. **While the aim of the IRI reform is to improve neutrality, the likely impact on investment is also of interest—but uncertain.** Clearly, the tax rate on reinvested earnings will fall for sole proprietorships and partnerships entering the IRI regime. But this may not make retention-financed investment more attractive for them, since tax is ultimately due on the consequent earnings when they are paid out—at the IRPEF rate, both now and under the IRI regime. On the other hand, by increasing the availability of internal finance the reduced rate on retained earnings may help overcome barriers to investment from any capital market imperfections that restrict these firms’ access to external finance. The impact on investment from this aspect of the reform is thus unclear, and merits further study: but the potential neutrality gains seem clear, and the impact on overall investment may in any event be dominated by wider effects on the business climate from the full package of reforms.

53. **The special regime for very small businesses envisaged in Article 11(b) has some appeal, though alternatives could also be considered.** The cost of tax compliance for micro taxpayers is often disproportionate compared to their tax payments, so that a simplified regime for this group can have significant appeal. A lump-sum payment is clearly the simplest of all. However, the risk of the lump-sum approach is that the revenue administration loses control over businesses if no, or very little, information is collected about taxpayers’ income. To keep them within the administration’s control, an alternative regime that could be considered is the cash-flow tax. Such a tax could well be extended to other, somewhat larger firms that do simplified accounting. The advantage of the cash-flow tax is that it offers relief for small businesses that is equivalent to the ACE (which is not

granted to firms with simplified accounting). Note, however, that the introduction of a cash-flow tax might require a transitional period, as some firms might have significant interest obligations (which would not qualify as a cost under a cash-flow regime).

54. **Making the IRI optional, as envisaged in Article 11(c), runs significant budgetary risk.** Optionality is obviously attractive for business: they could, and presumably would, all else equal, opt for whichever regime offers them the lowest tax liability. The converse is of course a risk to government's revenue. Moreover, options can tend to significantly complicate the tax administration, increasing both administration and compliance costs. If a compulsory regime would be too burdensome for some companies in the short term, optionality might be considered during a short transitional period. But ultimately, there should ideally be a single regime for all businesses other than the smallest enterprises. Determining the set of companies for which the IRI is to be mandatory would be a critical element in the final design of the reform.

Article 12—Rationalization of the determination of business income and net production

55. **This provides in general terms for the clarification and review of a wide range of tax provisions, highlighting especially those relating to international matters.** Little detail is provided on which comments can be offered; the broad aim of addressing uncertainties, eliminating unnecessary complexities (in a tax system that has a fairly clear overarching structure but many complicated details), and adapting to changing circumstances is an objective clearly to be welcomed. The international environment in which tax policy is shaped, in particular, is changing rapidly, so that tax rules require ongoing monitoring and revision (not least in the light of emerging European case law). One such issue raised in several discussions, by both the private sector and the authorities, is the concern that current CFC rules are significantly more burdensome than elsewhere. It is important that such rules serve the purpose of safeguarding revenue by discouraging avoidance of taxation through the accumulation as passive income in low tax jurisdictions of income more properly taxable in Italy. This though needs to be balanced against the needs to provide a certainty to business that they currently feel is lacking, and to limit costs of administration and compliance. This area is one clearly needing close attention.

56. **The ACE can change the significance of some of the issues flagged in the article.** For example, accelerated depreciation for tax purposes was favorable for companies under the previous IRES system because it offered a more valuable deduction due to discounting. Under a 'textbook' ACE, however, accelerated tax depreciation would make no difference for firms in the sense that faster depreciation in this period leads to a lower value of equity next period and so reduces the amount of ACE that is granted in later years. The overall effect would be that the rate of depreciation has no impact on the present value of the

associated tax deduction.⁴⁶ Differences would arise, of course, in terms of cash-flows to the firm, and to the extent that the tax rate may change over time. Nonetheless, the ACE would in principle make the precise determination of depreciation rates less material than under a standard income tax. This is only so, however, if the notional return is calculated on equity that reflects tax rather than accounting depreciation. This is not the case in Italy, however—implying that the ACE does not fully realize its neutrality potential. Similar issues arise in relation to the limitations to the deductibility of loan devaluations (mentioned in Article 12(1)(a))—which imply that banks are forced to spread these losses over an 18-year period—which will have no effect on the net present value of the tax payments if losses deducted against tax also reduce equity for tax purposes.⁴⁷ Whether the ACE indeed achieves this effect requires closer attention than the mission has been able to give to the similarities and differences between book and tax equity, and regulatory capital.

Article 13—Rationalization of IVA and other indirect taxes

Grouping rules for IVA

57. **Significant distortions can arise from unrecovered input IVA in exempt activities—most notably in the financial sector.** Exemption means that while IVA is not charged on sales, IVA paid on inputs cannot be recovered, with effects that cascade through the system as the prices charged by exempt businesses to other firms increase to reflect their increased input costs. This violates the fundamental aim of the IVA of taxing consumption rather than production, generating social costs of three types:

- *A distortion of real decisions* as businesses rearrange their affairs to avoid this input tax—including by artificial vertical integration of their activities (and, indirectly, as the effect on businesses input costs ripple through the production chain);
- *A competitive disadvantage* within the EU,⁴⁸ to the extent other member states charge lower IVA rates on exempt activities—of particular concern in Italy given a perception that banks are taxed more heavily there than elsewhere, for instance through the limitation of deductibility to 95 percent of interest paid;

⁴⁶ This neutrality property of the ACE depends on how exactly it will be applied. In particular, unrealized depreciation should appear as equity on the balance sheet of the firm as it is used for tax purposes.

⁴⁷ Of course, immediate realization would affect the liquidity of the bank. A 2011 reform provides that deferred tax assets of banks can be transformed into liquid assets as the central government recognizes it as an eligible claim, independent of a bank's future profitability.

⁴⁸ Exports to third countries of financial services and other exempt items are generally zero-rated (that is, input IVA is recoverable).

- *A loss of transparency*, as the effective rate at which final consumption items are taxed reflects also the cascading input taxes, in ways reflecting complexities of production relationships.

58. While these difficulties potentially arise in relation to all exempt activities, they are a particular concern—in Italy as elsewhere—in relation to the financial sector (exempt on the bulk of its activities) and, it seems, education and health services.

59. **There is a strong case for adopting IVA grouping rules, consistent with EU requirements,⁴⁹ proposed in the DF, to ease these distortions.**⁵⁰ By enabling companies within a group to be treated for IVA purposes as a single taxpayer, such rules eliminate IVA on intra-group transactions. They do not eliminate the difficulty, since unrecovered input IVA will still arise on purchases from companies outside the group—but they can ease it, both directly and indirectly, by making artificial schemes to avoid unrecovered input IVA redundant. Sixteen member states currently allow IVA grouping, though with significant differences in detail.

60. **Grouping will reduce revenue, and planning possibilities need attention.** The revenue loss is simply the converse of the tax saving to grouping companies (and since grouping would be optional, taxpayers would choose to group only if it reduces their liability). The Italian Bankers' Association reported unrecovered input IVA in Italy of around €1.7 billion, and an estimate (some years old) that grouping would cost around €500–600 million. (In the U.K., the cost of grouping was put at around £800 million in 1998). There are also avoidance issues to address. Some countries, for instance, have allowed non-taxable persons to be included in IVA groups: this provision (currently the subject of infringement proceedings against some member states) allows the recovery of input tax that would not be recoverable even if, for instance, exemption were replaced by zero-rating.⁵¹ The point appears to have been especially important in relation to holding companies, which are likely to be non-taxable persons (being regarded as conducting no economic operations) but nevertheless incur substantial IVA on management and other services that they would not normally be able to recover.⁵²

⁴⁹ Article 11 of the VAT Directive (2006/112/CE, 28 November 2006) allows member states to offer VAT grouping (and requires prior consultation with the VAT Committee) that, but does not provide common rules; Commission (2009) sets out the European Commission's views on how these should be applied. Van Doesum and Van Norden (2009) argue that these views are overly restrictive on the application of grouping.

⁵⁰ By reducing input tax, grouping can also help companies otherwise due refunds but experiencing delay or difficulty receiving them.

⁵¹ As a matter of economic principle, one might argue that such input costs should indeed be recoverable to avoid the distortions set out above.

⁵² Other planning schemes revolve around timing transactions when in and out of the group (supplying services to a group member while in the group, purchasing them from third parties when outside): see Millar (2004).

61. **While grouping will increase the competitiveness of financial institutions within the EU, it may also somewhat exacerbate concerns—not unique to Italy—that financial services are under-taxed relative to other commodities.** The IVA exemption of financial services—which is standard in the EU, and very common elsewhere—reflects conceptual difficulties in levying the tax on margin-based services.⁵³ Simply eliminating input taxation (by, for instance, zero-rating financial services) would eliminate the difficulties noted above, but would also mean that the final consumption financial services are favored relative to other goods and services in not being subject to IVA.⁵⁴ There has been long-standing discussion within the EU of cash-flow forms of taxation by which the IVA might be applied to financial services, but these remain some way from implementation.⁵⁵ An alternative suggestion has been to instead apply a ‘Financial Activities Tax’ (FAT) on the sum of wages and profits of financial institutions, as an (imperfect) substitute for the IVA. In Italy, the IRAP on financial institutions already has much the same structure as a FAT; and is applied at a somewhat higher standard rate than that for the generality of sectors (4.65 percent rather than 3.9 percent), which goes some way to address the distortion between sectors at issue in this context. The limitations on interest deductibility may have a somewhat similar effect. A full assessment of the tax treatment of the financial sector in the light of lessons learned since the crisis of 2008, however, is beyond the scope of this report.

Registration duty and similar

62. **The review of the wide range of transactions taxes envisaged is welcome, given their potentially distortionary effects.** A strong case can be made for using some of the revenue that might be raised by the revaluation of cadastral values, in particular, to reduce those most likely to adversely affect transactions in the housing market.

Article 14—Environmental taxation

63. **The strong interest in more effective environmental taxation signaled in Article 14 is welcome.** Italy was among Europe’s frontrunners in green taxation during the late 1990s, when it introduced several new environmental taxes and charges on, for example,

⁵³ The difficulty, for instance, is in allocating the spread between a bank’s borrowing and lending rates (which reflect the value of the services it provides), between the two sides of the transaction—as is needed for crediting mechanism to work. On this, and the cash-flow approach mentioned below, see for example, Ebrill et al (2001).

⁵⁴ The deeper issues here—whether more revenue would be raised by applying an effective VAT to financial services than is raised by the current denial of input credits, and of whether financial services ought to be taxed at all—remain contentious. See, for instance, Huizinga (2002) and Lockwood (2010).

⁵⁵ Other schemes to limit input taxation of financial institutions have been proposed and implemented in some non-EU countries, such as zero-rating of dealings with registered businesses (as in New Zealand). Huizinga (2002) proposes combining this with cash-flow treatment of transactions with all others.

NO_x emissions, batteries, lubricant oil, waste, water, and noise. In 1998, it also launched an ambitious proposal for a carbon tax,⁵⁶ which was foreseen to gradually increase over time. At this point, Italy was among the five European countries with the highest share of environmentally related taxes: well over 3 percent of GDP. Since then, however, the importance of green taxes has declined. The carbon tax, introduced in 1998, was repealed a year later when oil prices increased. Other environmental taxes did not keep pace with GDP and by 2010, Italy ranked twelfth in the EU in terms of the revenue-to-GDP share of environmental taxes—a performance that falls short of Italy’s past leadership position.

64. A leading feature of Article 14 is the envisaged enactment of the principles set out in the proposed Energy Tax Directive, “coordinated” with its implementation elsewhere. This proposed directive⁵⁷ aims to better align the taxation of energy products with the energy and climate change objectives of Europe’s 2020 strategy,⁵⁸ and in particular to secure that emissions not within the current EU-Emissions Trading Scheme (EU-ETS)—which currently covers only around half of EU carbon emissions⁵⁹—receive broadly comparable fiscal treatment to those within. Its coverage would thus be primarily emissions from motor fuels (diesel, gasoline, LPG), heating fuels used by firms and households (fuel oils, kerosene, gas, coal) and the agricultural sector. Minimum excise rates on fuels, for instance, would be revised to include a minimum CO₂-related component, based on a price of € 20/t CO₂ and a minimum energy related component of € 9.6/GJ for motor fuels and € 0.15/GJ for heating fuels.

65. The extension of effective and broadly comparable carbon pricing to sources outside the EU-ETS is a coherent objective⁶⁰—but at rates in the current draft directive

⁵⁶ Article 8 Law No.448/1998.

⁵⁷ COM(2011)/169. The proposal might be revised in light of the negative (but non-binding) vote of the European Parliament in April 2012. The Directive requires unanimity in the European Council to be enacted.

⁵⁸ This, for example, sets targets for CO₂ emission reductions, renewable energy and energy efficiency: see <http://ec.europa.eu/europe2020/>.

⁵⁹ The EU-ETS (Directive2003/87/EC) requires covered firms to hold allowances for their carbon emissions. These can be traded on the EU market, which ensures that the marginal cost of emission reduction is minimized across covered activities. The EU-ETS covers emissions from around 11,000 installations (power stations, combustion plants, oil refineries, iron and steel, cement, glass, lime, bricks, ceramics, pulp, paper, and board). Since 2012, the aviation sector is also covered. In 2013, the scope of the ETS will be extended to other sectors (petrochemicals, aluminum industries) and other greenhouse gas emissions (N₂O and per fluorocarbons). Countries will also auction more allowances, instead of foregoing revenue by grandfathering them as was done before.

⁶⁰ As a response to the highly volatile and often low permit prices under the EU-ETS (which fails to strike the right balance between incremental abatement costs at different points in time and discourages firms from investing in low-carbon technologies) schemes have been proposed to impose a minimum carbon price on ETS-covered sources as a way of putting a floor on carbon prices: the U.K., notably, will impose a carbon price floor through a levy on power stations as of April 2013, with the permit price and levy summing to at least a

(continued)

would hardly affect Italy. The efficiency advantages of carbon pricing as a way to reduce emissions is stronger the wider is the set of emissions covered: otherwise, the cheapest methods of reducing emissions may not be exploited. For practical purposes, however, the draft directive would have little direct⁶¹ relevance to Italy, as the excise minima proposed are below the current rates of excise duty.⁶²

66. The structuring of fuel prices pointed to in the draft directive holds the prospect of a more thoughtful way of setting fuel excises. As in many countries, these taxes have been shaped by a series of essentially ad hoc choices: they may be seen as charging for road use, to correct for congestion externalities, or as simply revenue-raising instruments. Careful consideration of each component can lead to more coherent policy design: wider use of congestion pricing, for instance (now only applied in Milan), might allow some reduction of fuel excises. In this context, concern has been expressed that the principle of a minimum tax related to energy generated as such (which perhaps has a less clear rationale than the minimum carbon-related tax) may prove unduly onerous in relation to gas products.

67. Earmarking a large part of the revenue from new green taxes,⁶³ envisaged in Article 4, may have political appeal, but could significantly reduce their potential benefit. The DF provides that any new carbon tax revenues be used “as a matter of priority” to finance the promotion of renewable energy sources and measures that help disseminate low-carbon technologies. There is logic in this as providing reassurance that the funding of renewable energy policies will be sustained, to the extent that—as appears to be intended and appropriate—there is a corresponding cut in the distorting tax on electricity that currently finances renewables. More generally, earmarking can increase the acceptability of new taxes when it is feared government will make ineffective use of the additional revenue they raise.⁶⁴ But the value of another public euro spent on promoting renewable energies or low-carbon technologies needs to be weighed against its value in alternative uses, including borrowing or tax reductions. If, as seems especially plausible in present circumstances, these alternatives

minimum all-in carbon price set by the government. Such schemes have the merit of ensuring some revenue to the government (when the floor price is binding), even when permits are allocated for free; they have the disadvantage, however, that when the minimum tax exceeds the permit price, the fall in the demand for permits in the country adopting the scheme will lead, through a reduction in the permit price, to an exactly offsetting increase in emissions (and reduced incentive to invest in cleaner technologies) elsewhere. Moreover, the emission reductions in the country adopting such a scheme might be more costly at the margin than in the rest of Europe in light of the higher carbon price.

⁶¹ There would be an indirect and broadly beneficial indirect effect from the impact elsewhere, not only through reduced emission but also through an equalization of input costs.

⁶² Cingano and Faiella (2011) simulate scenarios of an additional carbon tax on the transportation sector in Italy, suggesting that significant emissions reductions can be achieved.

⁶³ Revenues will also increase as more allowances are auctioned from 2013.

⁶⁴ Brett and Keen, (2000).

yield higher social benefits, then earmarking will carry potentially significant costs. This makes it especially important to undertake cost–benefit analysis of these forms of spending, rather than simply forcing an automatic link by earmarking.

68. **Additional revenues from green taxes could, for instance, be used to reduce income taxes or social security contributions—a ‘green devaluation’.** Current tax wedges on labor income in Italy are high: cutting them could increase competitiveness, as discussed in Section I, and although (in contrast to financing this by an increase in VAT or residential property taxation) the increased environmental tax would likely quickly increase product prices to the extent that it bears on inputs, this would be a move toward socially more efficient pricing. Indeed with efficient recycling of the additional revenues raised, the economic costs of a green tax reform might be negligible, while the environmental benefits are significant.⁶⁵

Article 15—*Gambling*

69. **Article 15(1) seeks to rationalize and simplify the disparate laws governing gambling, including the excise tax regime.**⁶⁶ Its primary objectives are to bring regulations in line with EC standards; simplify a complex regulatory framework; and better align tax base and rates across different games.

70. **The current structure is indeed complex, and implicit rates have been falling.** Each form of gambling has its own legislative framework setting out tax bases, rates, and minimum payouts. Table 2 shows that implicit excise rates on different games—expressed both relative to ‘gross wagers’ (sales revenue, in the form of bets placed) and ‘gross revenues’ (sales minus winnings)—vary widely across games.⁶⁷ Gross wagers (winnings plus gross revenue) have been rising over the last six years, largely due to the rising popularity of games with higher player payouts, such as slot machines and online (distance) gambling. The overall implicit tax rate has been falling (Figure 1).

⁶⁵ De Mooij, Keen, and Parry (2012).

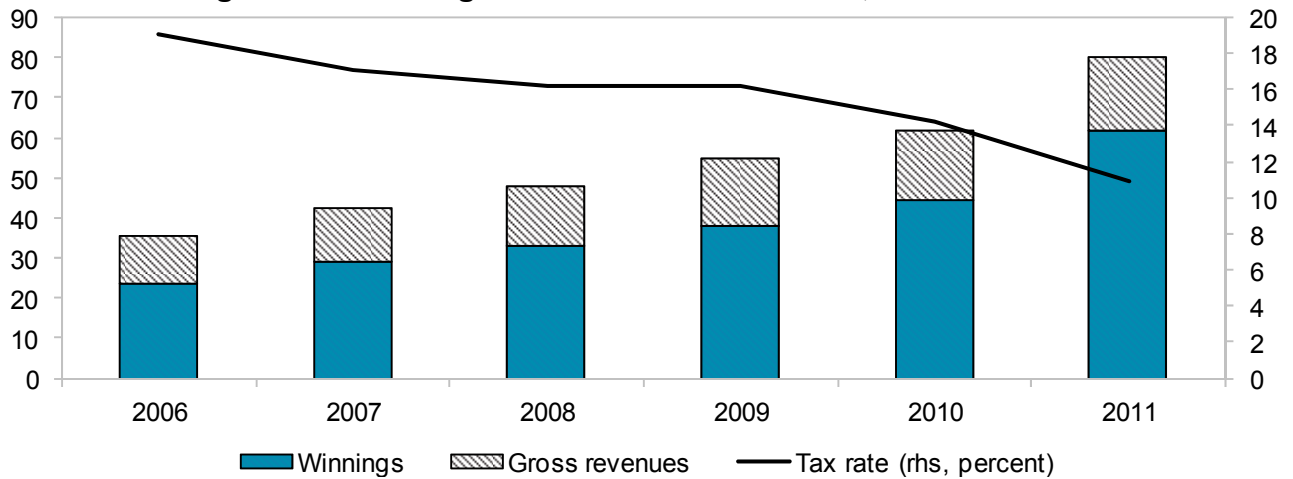
⁶⁶ Gambling retail establishments are also subject to normal income taxes, although these are not discussed in the Article or here.

⁶⁷ Although international comparisons are complicated by scarcity of data, it should be noted that rates vary very widely: Clotfelter (2005) and Cnossen, Forrest, and Smith (2009) give examples of rates that go from 2 percent (greyhound racing in Connecticut) to 50 percent (lotteries in Poland).

Table 2. Gambling and Games in Italy, 2011

Games (billion euros)	Gross Wagers (sales)	Winnings	Gross Revenue (player loss)	Tax	Implicit Tax Rate	
					Of gross wagers	Of gross revenue
Lotto	6.8	4.0	2.8	1.7	25.0	60.7
Other number games	2.4	1.0	1.4	1.1	45.8	78.6
Lottery	10.2	7.4	2.8	1.3	12.7	46.4
Sports Betting	3.9	3.0	0.9	0.2	5.1	22.2
Horse Betting	1.4	1.0	0.4	0.1	7.1	25.0
Bingo	1.9	1.3	0.6	0.2	10.5	33.3
Slot machines	44.9	35.7	9.2	3.9	8.7	42.4
Distance Gambling	2.3	2.0	0.3	0.1	4.3	33.3
Other	6.2	6.0	0.2	0.04	0.6	20.0
Total	80.0	61.4	18.6	8.6	10.8	46.5

Source: *Ministero dell'Economia e delle Finanze* (MEF).

Figure 1. Gambling Revenues and Tax Rates, 2006–11

71. **Key tax policy issues, in countries that opt for legalization and taxation, are the selection of the appropriate tax base and rate.** Theory offers no firm guidance as to whether gross wagers or gross revenue is the more appropriate—depending on which one views as better approximating the value of the service being provided. For Article 15(1), it seems to be envisaged that gross wagers will be the tax base for most games. Rates must balance conflicting objectives. If gambling is seen as a harmless form of entertainment, the starting point would be to tax it at rates similar to competing forms of entertainment. Further considerations raise conflicting objectives. A potentially inelastic tax base, and concerns at potential externalities and self-control problems⁶⁸ point to higher rates; limiting the risks of

⁶⁸ The problems of addictive gambling, arguably, are primarily suffered by the gambler rather than others. Standard externality arguments then do not apply, but ‘internality’ considerations—related to the difficulties such gamblers have in exercising self-control—may rationalize higher taxation to discourage initial steps to addiction and act as a commitment device addressing self-control problems: see, for instance, Gruber (2010).

illegal gambling (which has its own externalities) and the increased mobility of the base implied by the growth of offshore gambling, point in the opposite direction. Variations in the force of these considerations may suggest differential taxation across alternative games but, as in other areas, a close alignment of rates can offer significant advantages in administration and compliance.

72. **Offshore (online) gambling has emerged as a particular challenge.** Licensing to offer games can be linked with tax payment, but difficulties of enforcement combined with strong international tax competition for highly mobile providers have led to downward pressure on tax rates. For example, for some forms of online gambling where competition leads to very high player returns (winnings) in the order of 97 or 98 percent, gross revenues are taxed instead of gross wagers. Taxing gross wagers would force retailers to reduce payouts or face losses and might force providers into the informal sector (offshore). Developments in this area pose a clear challenge to the potential for raising or even maintaining revenue from gambling, but this objective has to be balanced with the benefits of encouraging legality of operation.

73. **Article 15(2) envisages allocating some of the revenues from gambling to address some of the social problems it creates.** Specific interventions are envisaged to prevent and treat compulsive gambling, and regulate advertising; and it appears that some gambling revenues will be earmarked toward these ends. While this type of earmarking of gambling revenues is not uncommon, as it reinforces the apparent benefit element of the tax and highlights the special concerns in the area, these advantages should be weighed against the greater rigidity that earmarking introduces into the public finances—an issue discussed at more length in connection with Article 14 above. Article 15(2), encouragingly, also envisages that some interventions would be funded through regular spending programs.

Article 17—Financial burdens

74. **The intention that the legislation implementing the DF be revenue-neutral is appropriate, but may need clarification.** Imposing revenue-neutrality makes clear that the focus of the reform is on structural improvement. Close analysis will be needed to ensure that revenue-losing measures—such as VAT grouping—can be matched with revenue-increasing ones; and that the winners and losers are identified. More immediately, it appears that the wording of the article is open to the interpretation that overall revenue may not fall, but could increase. To ensure a focused debate, it will be important to establish the authorities' intention unambiguously.

III. AN ASSESSMENT OF THE *DELEGA FISCALE*

75. **The DF provides a framework for significant improvement in both the design and the implementation of the Italian tax system.** Its provisions cover a wide and diverse range of tax matters, some more important than others but all having coherent aims and holding potential for improvement. They add up to a substantive and thoughtful package.

76. **Three sets of measures stand out as strengthening core elements of the tax structure:**

- ***Bringing cadastral values closer to market values.*** Property tax assessments are more than twenty years out of date, and relative property prices have diverged widely since then: in some regions, they have increased by 500 percent; in others, by less than half that. Realistic alignment of cadastral prices with market prices will be an important step to improved fairness in property taxation, and so pave the way for more effective use of this instrument and more coherent fiscal arrangements between central government and municipalities.
- ***Establishing greater certainty and transparency for taxpayers and tax authorities.*** Key directions to this end—protecting the rights of taxpayers while also safeguarding revenue against abusive practices—among those in the DF are provisions for clarifying the circumstances in which tax schemes will be regarded as abusive, ensuring that criminal procedures do not apply when fraud is not an issue, and fostering good practices for companies in managing and disclosing risky tax positions.
- ***Addressing distortions from the differential treatment of retained earnings in different forms of business.*** This is a further welcome step toward easing distortions of business decisions on organizational form and investment levels, careful attention to detail being needed to ensure that these important objectives are fully realized.

77. **Several other provisions can also be expected to bring significant improvements in tax design and implementation (though precisely how is clearer in some cases than others):**

- ***Routine analysis and assessment of tax gaps—leading to better design interventions.*** Understanding the extent of and emerging trends in, revenue shortfalls is increasingly recognized as a critical tool for improving compliance. Substantial progress has been made in developing this capacity for analyzing the IVA and IRAP. This is already leading to better understanding of emerging trends, and—its ultimate aim—the design of responses to them. To deepen analysis of this kind, and extend it to other taxes, a more eclectic range of approaches will likely need to be used than indicated in the DF.
- ***Regular and thorough reporting of tax expenditures, leading to scaling back of those unwarranted.*** Here too there is substantial progress to build on, in the very

thorough (much more so than is the case in many other countries) enumerating, costing, and classification of tax expenditures recently produced by the ministry of finance. Regularizing this as part of the budget process will be an important step to transparency. The ultimate aim, of course, is to continuously monitor these with a view to eliminating or scaling back those found not to yield benefits commensurate with their costs, or better served by other means. It is the latter and difficult step that is ultimately critical.

- ***VAT grouping can significantly reduce distortions—but the revenue costs need investigating.*** Extending the ability to receive input costs will ease distortions from VAT exemption in key sectors. What remains is to identify how large this revenue cost is—and hence identify, as the DF requires, offsetting measures—and, for the longer term, reviewing the overall design of the tax treatment of the financial sector.
- ***The review of the international tax provisions envisaged is important to maintain coherence and competitiveness in this important area,*** though the lack of detail—and inherent complexity of the topic—has precluded useful comment here.
- ***Recognizing the importance of green taxation is welcome and could set the stage for a review of environmental taxation.*** The primary purpose of this provision is to prepare for introduction of a new Energy Directive, progress on which appears to be stalled. How great the scope is for strengthening other areas of environmental taxation—in relation to congestion pricing, for example—is unclear; there may be scope for a review of possibilities in this area.
- ***Simplification and clarification, in relation to gaming and in other areas, can only be welcome.***

78. **Some provisions could be made more effective in achieving their aims...** Cadastral revaluation could perhaps be eased, for example, by making use of self-reporting; and allowing the IRI as an option adds complexity and can only lose revenue.

79. **...and important details will need to be spelled out in the subsequent legislation.** Some of the articles are quite detailed (such as Article 2 on cadastral values); in other cases (such as Article 11 on the IRI, and Article 12(1)(b) on the review of international tax matters), implementation and evaluation will need particular care.

80. **The measures envisaged are potentially conducive to the growth objective stressed in the title of the DF, though the extent of this impact is unquantifiable.** Sustainability aspects would clearly be served by better designed environmental taxation. A fairer and more effective property tax could enable better use of a source that, some evidence suggests, is relatively growth-friendly, and which is key to local government finance and governance; it could also enable a reduction in high transactions taxes, which are likely to be especially distortionary. More informed responses to compliance problems, clarification of anti-abuse rules, and enhanced relationships with major taxpayers can all lead to revenue

gain that will aid consolidation or allow a reduction in more distorting taxes. All these and other effects can be expected to lead to modest efficiency and growth gains, but cannot meaningfully be quantified.

81. The DF builds on strengths of the current system that have been reinforced by recent reforms. The recent strengthening of the property tax, in particular—bringing the yield closer to advanced country norms—has already signaled an intention to shift toward tax bases that are likely less harmful to growth than alternatives, and to reinforce horizontal equity across taxpayers. Adoption of the ACE form of business tax has been an important step toward greater neutrality of the tax system in its treatment of investment and financing decisions—not least in the financial sector, where the potential costs of a tax bias toward debt finance are likely to be especially high. It takes Italy closer to a unique form of DIT, a model that continues to provide a coherent overall architecture for the income tax system.

82. The DF does not address some of the deepest weaknesses of the Italian tax system, but could not be expected to. It is silent, for instance, on the generally high labor tax wedges—in 2011, Italy had the sixth highest tax wedge on labor income among OECD countries (for a single worker at the average wage without children)—and on the narrowed base of the IVA (as discussed in Section II). Recent measures, including the property tax increase and taxes on financial securities, suggest a desire to supplement it with other tools bearing on forms of wealth. Among the fundamental issues that remain is whether an explicit, comprehensive tax of this form, and/or a strengthening of inheritance and gift taxes might come to play a greater role. Trying to resolve all the challenges that the Italian tax system faces in present extraordinarily difficult times would be highly ambitious. Instead, the DF focuses on a series of measures, across a broad and diverse range of tax concerns, on which there appears to be—and in some cases, has been for some time—both a significant degree of consensus and scope for real improvement. The condition of revenue-neutrality imposed on the measures to implement the principles it sets out is critical in this context, since it makes clear that the focus of the reform is on structural improvement, not on addressing wider issues as to the appropriate long-run scale of government or short-run fiscal position.

83. Maintaining and elaborating on the key principles set out in the DF will be critical if the prospect of significant improvements it offers is to be realized. The core proposals are, for the most part, relatively uncontentious from a technical perspective (though the detail will of course be critical, and there will be winners and losers, most notably from the cadastral revaluation). Many, indeed, have had considerable support for many years. Now appears to be a window of opportunity to realize these improvements.

Organizations Met by the Mission Team

- Agenzia delle Dogane—Italian Customs Agency
- Agenzia delle Entrate—Italian Revenue Agency
- Agenzia del Territorio—Italian Land Registry Agency
- Amministrazione Autonoma dei Monopoli di Stato—Independent Administration of State Monopolies, Ministry of Finance:
- Associazione Bancaria Italiana (ABI) —Italian Banking Association
- Associazione Nazionale Fra Le Imprese Assicuratrici (ANIA) —Association of the Italian Insurance Companies
- ASSONIME—Association of Italian Joint-Stock Companies
- Banca d'Italia—Bank of Italy
- Confederazione Nazionale Coldiretti—Italian Association of Farmers
- Commissione tecnica per l'attuazione del federalismo fiscale (COPAFF) —Technical Commission on Fiscal Federalism Implementation
- Confagricoltura—Confederation of Agriculture
- Confederazione Generale Dell'Agricoltura Italiana
- Confederazione Generale Italiana del Lavoro (CGIL) —Italian General Confederation of Labor
- Confederazione Italiana Agricoltori—Confederation of Italian Farmers
- Confederazione Italiana Sindacato Lavoratori (CISL) —Italian Confederation of Trade Unions
- CONFINDUSTRIA—Confederation of Italian Industry
- Council of Economic Advisers
- Dipartimento delle Finanze—Italian Tax Department, Ministry of Finance.
- General Electric—Tax Department
- INPS—National Institute for Social Security
- Istituto per la Finanza e l'Economia Locale (IFEL)—Institute for Finance and Local Economy
- Ministero dell'Ambiente e della Tutela del Territorio e del Mare—Ministry of Environment, Land and Sea
- Ministero dello Sviluppo Economico, Dipartimento per l'Energia—Ministry of Economic Development, Department of Energy
- Parliamentary Committee on Fiscal Federalism Implementation
- Procter & Gamble—Tax Department
- Rete Imprese Italia—Italian Businesses Network (SME Confederation)
- Unione Italiana del Lavoro (UIL) —Italian Labor Union

Appendix I. Text of the *Delega Fiscale*⁶⁹

**DRAFT LAW CONCERNING THE POWERS DELEGATED TO THE
GOVERNMENT TO LAY DOWN LAW PROVISIONS FOR A MORE EQUAL,
TRANSPARENT AND GROWTH-ORIENTED TAX SYSTEM**

Article 1

*(Powers delegated to the Government
to lay down law provisions for the revision of the tax system)*

1. The Government is empowered to adopt, within nine months of the date of entry into force of this law, one or more legislative decrees, aimed at a review of the tax system, in compliance with the principles and guiding criteria laid down in this law.

⁶⁹ Of June 7, 2012. Unofficial translation.

CHAPTER I

General provisions aimed at an equal and rational tax system

Article 2

(Review of the immovable property cadastre)

1. By the legislative decrees under Article 1 the Government is empowered to carry out a review of the immovable property cadastre by assigning each building unit the relevant asset value and cadastral rent, in particular applying the following principles and guiding criteria to urban building units registered in the building cadastre:
 - a) provide for co-operation procedures with the municipalities in whose territory the immovable property is located;
 - b) define the territorial areas of the immovable property reference market;
 - c) work with reference to the standard average values expressed by the market over the three-year period before the year of the entry into force of the decree;
 - d) re-determine the definitions of ordinary and special cadastral uses, on account of the changed economic and social conditions and the resulting different uses of the property;
 - e) determine the ordinary average asset value according to the following criteria:
 - 1) for building units with ordinary cadastral use, through an estimate procedure which:
 - 1.1) uses the square meter as standard of measurement, specifying the criteria for calculating the building unit surface;
 - 1.2) uses statistical functions suitable for expressing the relationship between market value, location and building characteristics of the property for each cadastral use and for each territorial area;
 - 1.3) where the values cannot be determined on the basis of the statistical functions under 1), the method described under following n. 2 applies;
 - 2) for building units with special cadastral use, through an estimate procedure which:
 - 2.1) operates on the basis of direct estimates with standardized methods and specific measurement parameters applied for each special cadastral use;
 - 2.2) if it is not possible to make direct reference to market values, uses the cost criterion for mainly owner-occupied property, and the income criterion for property for which profitability is the main characteristic;
 - f) determine the ordinary average rent for building units through an estimate procedure which:
 - 1) uses statistical functions suitable for expressing the relationship between average rental income, location and building characteristics of the property for each cadastral use and for each territorial area, where consolidated data on the rental market are available;
 - 2) if there is no established rental market, by applying to the asset values specific rates of return that can be derived from the market, in the three-year period preceding the year of entry into force of the legislative decree;
 - g) provide mechanisms for the periodic adjustment of the values and rents of urban building units, in relation to the changes of the parameters used to define the asset value and rent.

2. By the legislative decrees under paragraph 1, the Government is also empowered to pass provisions aimed at:
 - a) redefining the powers and composition of provincial cadastral commissions and of the central cadastral commission, ensuring that they include representatives of the Agency for the Territory, as well as qualified teachers and professionals in the field of economics and urban and rural valuation, statisticians and experts in econometrics, as well as magistrates belonging, respectively, to ordinary and administrative courts and tax commissions, also for the purpose of providing for preliminary rulings for the settlement of disputes;
 - b) ensure the co-operation between the Agency for the Territory and the municipalities;
 - c) provide that the Agency for the Territory may employ, by means of special agreements, technicians appointed by professional associations for the purposes of the surveys;
 - d) ensure, at national level by the Agency of the Territory, the uniformity and quality of processes and their co-ordination and monitoring, as well as the consistency with the market data for cadastral values and income in the relevant territorial areas;
 - e) notwithstanding the provisions of Article 74 of Law no. 342 of 21 November 2000, use appropriate, also collective communication tools in order to inform property holders about the new rents, in addition to the publication in the municipal notice board;
 - f) identify, reorganize, change and repeal the rules currently governing the building cadastral system;
 - g) identify the fiscal year as from the new rents and asset values are applied;
 - h) when the new cadastral values become effective for tax purposes, provide for the modification of the relevant tax rates and of any deductions, exemptions or allowances, aimed at avoiding an increase in the tax burden with particular reference to taxes on transfers.
3. The implementation of this Article shall not lead to any new or additional burdens for public finance. To this end, for the activities under this Article, the facilities and expertise already existing within public administrations shall be primarily used.

Article 3

(Estimate and monitoring of tax evasion)

1. By the legislative decrees under Article 1, the Government is empowered to pass provisions aimed at:
 - a) defining methods for detecting tax evasion, applicable to all the main taxes, based on a comparison between the national accounts data and those of the tax registry, using for this purpose, transparent criteria, stable over time and ensuring their adequate publicity.
 - b) providing that the results are calculated and published annually;
 - c) setting up a working group not entitled to attendance fees, refunds or remuneration, at the Italian National Institute of Statistics (*ISTAT*), made up of maximum fifteen experts appointed by the above Institute, the Ministry of Economy and Finance and other Ministries or public authorities concerned.

2. The Government draws up an annual report, in the framework of the budgetary procedure, on the strategy adopted and the results achieved in the fight against tax evasion.

Article 4

(Monitoring and restructuring of tax erosion)

1. Notwithstanding the provisions of Article 3, paragraph 2, the Government annually draws up, in the framework of the budgetary procedure, a report on tax expenditure, where tax expenditure means any form of exemption, exclusion, reduction of taxable income or of tax, preferential regime, based on methods and criteria stable over time, which also allow a comparison with spending programmes; the setting up of a working group, made up of maximum fifteen experts appointed by the Ministry of Economy and Finance and other administrations concerned and not being entitled to attendance fees, refunds or remuneration may be provided for, if necessary.
2. By the legislative decrees under Article 1 the Government is empowered to issue provisions aimed at eliminating, reducing or reforming tax expenditures that appear, in whole or in part, unjustified in light of the changed socio-economic situation or that are duplications, without prejudice to the priority to be given to the protection of family, health, economically or socially disadvantaged, artistic and cultural heritage, research and environment. By the same decrees the Government is also empowered to introduce measures intended to rationalise and stabilize the 5 per thousand tax return fund (*'5 per mille'*), on the basis of the increased revenue or the reduced costs achieved through the implementation of this Article.

CHAPTER II

Fight against tax evasion and avoidance and revision of the relationship between tax authorities and taxpayers

Article 5

(Rules on the abuse of rights and tax avoidance)

1. With the legislative decrees as of Article 1, the Government is delegated to implement the review of current anti-avoidance provisions in order to introduce the general principle of the prohibition of abuse of rights, extended to non-harmonised taxes, implementing the following principles and criteria
 - a) to define the abusive conduct as distorted use of legal instruments suitable to get a tax saving although such conduct does not infringe any specific provision;
 - b) to guarantee the taxpayer's freedom of choice between different operations entailing also a different tax burden, and, for such a purpose:
 - 1) to consider the aim of getting undue tax advantages as main reason of the abusive operation;
 - 2) to exclude the existence of an abusive conduct if the operation is justified for relevant reasons unrelated to taxation; to establish that such reasons are also those not necessarily producing an immediate profitability of the operation but meet organisational needs and consist in a structural and functional improvement of the taxpayer's business;
 - c) to provide for the unforceability against Tax Administration of legal instruments as of letter a) and the ensuing power of Tax Administration to deny the tax saving;
 - d) to regulate the regime of the proof laying on the Administration the burden to prove the abusive intention and the modes of functional manipulation and alteration of the legal instruments used as well as their compliance with an ordinary market logic and conversely laying on the taxpayer the burden to allege the existence of sound alternative or concomitant reasons unrelated to taxation justifying the use of such instruments;
 - e) to set forth the inclusion in the grounds of the tax assessment a formal and precise identification of the abusive conduct, in default of which it is void;
 - f) to lay down specific procedural rules ensuring an effective adversarial procedure with the Tax Administration and safeguarding the right of defence at any stage of the assessment procedure and in any stage and tier of the tax judgment;
 - g) to envisage that in case of appeal penalties and interest are collectable after the decision of the provincial tax court.

Article 6

(Tax risk management, business governance and tutoring)

1. By the legislative decrees as of Article 1 the Government is empowered to introduce law provisions setting forth forms of enhanced communication and cooperation between undertakings and Tax Administration, as well as business structured systems for tax management and control, for larger subjects too, with a clear responsibility allocation in the framework of the overall internal control system.
2. While introducing the provisions as of paragraph 1, the Government can also provide for incentives in the form of minor fulfilments for taxpayers and reduction of possible penalties.
3. By the legislative decrees as of Article 1 the Government is empowered to introduce law provisions to review and extend the so-called “tutoring” in order to guarantee an improved assistance to taxpayers, in particular to the smaller ones and being individuals, for the performance of their fulfilments, drawing up of tax returns and tax calculation.
4. By the legislative decrees as of Article 1 the Government is empowered to introduce law provisions to review tax rulings, to ensure a greater homogeneity also for the purposes of a better judicial protection and a greater timeliness in the drafting of opinions.

Article 7

(Simplification)

1. By the legislative decrees under Article 1 the Government also provides for:
 - a) the systematic review of the tax regimes and their reorganization so as to remove unnecessary complexities;
 - b) the revision of the requirements, with particular reference to unnecessary burdens or superfluous rules resulting, in whole or in part, in duplications, or being of little use to the Tax Administration in its control and assessment activities or, in any case, not in accordance with the principle of proportionality;
 - c) the revision, in the light of simplification and streamlining, of the functions relating to withholding agents and tax return filing, tax assistance centres and tax intermediaries, promoting the use of information technology.

Article 8

(Review of the penalty system)

1. Review of the penalty system according to the criteria of predetermination and proportionality vis-à-vis the seriousness of conduct, providing for liability to imprisonment of between a minimum term of six months and a maximum term of six years, by emphasising, on account of adequate penalty thresholds, the authoritative definition of the offence of fraudulent and counterfeiting conduct or conduct aimed at producing and using false documents; identification of the boundary between tax avoidance and evasion and related penalties; review of the regime for false declarations and of the administrative penalty system in order to better relate sanctions, in accordance with the principle of proportionality, to the actual seriousness of conduct involved; possibility of reducing penalties for less serious cases, or applying administrative rather than criminal penalties.
2. Definition of the scope of rules on the doubling of assessment terms, by providing that this doubling of terms applies only in the presence of the actual filing of charge pursuant to Article 331 of the Code of Criminal Procedure within a time limit related to the expiry of the normal time-limit.

Article 9

(Strengthening of knowledge and control actions)

1. By the legislative decrees under Article 1, the Government is empowered to introduce provisions for the strengthening of controls, according to the following principles and criteria:
 - a) strengthening of the use of targeted controls by the Tax Administration, through proper and complete use of the elements contained in databases and envisaging, where possible, synergies with other public authorities with a view to improving the effectiveness of the control methods;
 - b) introduction of the obligation to ensure absolute confidentiality in *knowledge and control actions* until the complete definition of the assessment; effective compliance, during control activities, with the principle of minimising the obstacles to the taxpayer's normal course of business, ensuring at any rate the respect of the principle of proportionality; strengthening of the inter partes procedure in the phase of investigation and subordination of the subsequent assessment and settlement acts to the exhaustion of the inter partes procedure;
 - c) strengthening and rationalization of traceability of payments, expressly providing for the payment methods subject to traceability;
 - d) strengthening of the use of e-invoicing.

Article 10

(Review of tax litigation and collection by local authorities)

1. By the legislative decrees under Article 1, the Government is empowered to introduce provisions to strengthen the taxpayer's right to judicial protection, as well as to enhance the efficiency of revenue collection powers of local authorities, according to the following principles and criteria:
 - a) provision of measures to speed up the settlement of disputes within the tax courts' jurisdiction, providing to this end for preliminary-ruling procedures to settle small pecuniary disputes.
 - b) extension of the conciliation proceedings to the appellate stage and to the judgment for revision;
 - c) enhancement of the tax courts' efficiency through a redeployment of court staff on the territory;
 - d) review of the legislation governing the revenue collection by local authorities, in order to ensure, in particular, the certainty, efficiency and effectiveness of their powers of recovery, competitiveness, certainty and transparency in the cases of outsourcing of such powers, as well as forms of guarantee concerning transparency, efficacy and timeliness of the acquisition by local authorities of the revenue collected.

CHAPTER III

Review of taxation depending on growth,
internationalization of businesses, and environmental protection

Article 11

*(Unification of taxation on business income and on income from self-employment
and provision of lump-sum schemes for smaller taxpayers)*

1. By the legislative decrees under Article 1, the Government is empowered to introduce provisions to redefine taxation on income according to the following principles and criteria:
 - a) assimilation of taxation on all business income or income from self-employment, including when in association with business partner, for current taxable persons liable to IRPEF and IRES, subjecting them to a single tax, in particular, providing for the deduction from the taxable base of the above single tax of the sums withdrawn by the artist or professional or partners or associates, or by the entrepreneur or partners, and inclusion of the above sums in the calculation of the entire income liable to IRPEF of the artist or professional and partners or associates and the entrepreneur or partners;
 - b) introduction for smaller taxpayers, of schemes which provide for the lump-sum payment of a single tax due to replace those due, upon condition of an unchanged trend of the total amount due, coordinating them with similar existing schemes;
 - c) possibility of providing for forms of optionality.

Article 12

(Rationalisation of the determination of business income and net production)

1. By the legislative decrees under Article 1, the Government is empowered to introduce provisions to reduce the uncertainties in determining income and net production and to promote the internationalization of economic operators active in Italy, in pursuance of recommendations from international institutions and the European Union, according to the following principles and criteria:
 - a) introduction of clear criteria, consistent with the rules on preparation of financial statements, in particular to determine the time of realization of loan losses, and extension of the tax regime for insolvency proceedings also to the new institutions introduced by the reform of bankruptcy law and the legislation on over-indebtedness, as well as to similar procedures provided for in other legal systems;
 - b) review of taxation rules on cross-border transactions, with particular emphasis on identifying the tax residence, on the transparency imputation regime of foreign controlled companies or companies that are affiliated, the regime for repatriating dividends from countries with preferential tax regimes, the regime for the deductibility of commercial transaction costs of entities established in those States, the regime for the application of cross-border withdrawals, the tax regime of permanent establishments abroad and those located in Italy of non-residents, the regime of relevant losses from group companies resident abroad;
 - c) review of the regimes for deduction of depreciations, overhead expenses and special categories of costs, safeguarding and specifying the notion of inherence and limiting differentiations between economic sectors.

Article 13

(Rationalisation of VAT and other indirect taxes)

1. By the legislative decrees as of Article 1 the Government is empowered to introduce law provisions for the transposition of Directive 2006/112/EC, according to the following principles and criteria:
 - a) rationalisation, for simplification purposes, of special systems depending on the particular nature of the sectors involved;
 - b) implementation of the VAT group regime as laid down in Article 11 of Directive 2006/112/EC.

2. By the legislative decrees as of Article 1 the Government is empowered to introduce law provisions to review registration duty, stamp duty, mortgage tax and cadastral duties, charges on government licences, insurance and entertainment according to the following principles and criteria:
 - a) simplification of fulfilments and rationalisation of tax rates;
 - b) unification or removal of particular cases.

Article 14

(Environmental taxation)

1. In view of the policies and measures adopted by the European Union for sustainable growth and *green economy*, as well as the Proposal for a Council Directive COM (2011) 169 amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity, the Government, by the legislative decrees as of Article 1, is empowered to introduce new forms of taxation aiming at preserving and guaranteeing environmental balance (*incentives and green taxes*) and to review the rules on excise duties on energy products depending on carbon content. The Government is therefore authorised to adopt, in line with the provisions of the aforesaid Proposal for a Directive, the principle of carbon tax exclusion for the sectors regulated by Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community and to envisage that the revenue from the introduction of the carbon tax is to be used as a matter of priority to finance the promotion system of renewable energy sources and environmental protection measures with particular reference to the dissemination of low carbon technology. The taking effect of the provisions of the legislative decrees provided for by this Article will be coordinated with the date of transposition in the Member States of the harmonised legislation on the matters at European level.

Article 15

(Public games)

1. By the legislative decrees under Article 1, the Government is empowered to implement the reorganization of the existing provisions relating to public games, applying the following principles and criteria:
 - a) organic and systematic collection of existing provisions according to their general application or sectorial legislation, of individual games as well;
 - b) adaptation of these provisions to the most recent standards, also developed by case-law, at European level;
 - c) formal co-ordination of provisions collected and explicit repeal of provisions that are inconsistent or outdated;
 - d) review of legislation concerning State taxes on individual games, expressly defining those that are fiscal in nature depending on the different types of public games, as well as of legislation on horse racing.

2. By the legislative decrees under Paragraph 1, the Government is also empowered to:
 - a) introduce specific provisions for the prevention, treatment and recovery of forms of compulsive gambling, based on scientific and technical guidelines and with implementation of specific projects, funded from the proceeds of appropriate sanctions, as well as by allocating to this end a specific share of the national health fund, to be allotted with CIPE decision implementing Article 1(34) of Law No 662 of 23 December 1996, at the proposal of the Minister of Health, in consultation with the Minister of Economy and Finance, in agreement with the Permanent Conference for Relations between the State, Regions and autonomous Provinces of Trento and Bolzano;
 - b) counter the forms of game advertising which fail to conform to what is considered to be lawful under current law, and however prohibit in all media any forms of misleading advertising or advertising not indicating, also in relevant information documents, the uncertainty of winning;
 - c) adequately protect minors from game advertising and however ensure, also combating different forms of attraction, the respect of the ban on games with money winnings, also duly regulating the location of suitable premises for games on the territory.

CHAPTER IV

Final provisions

Article 16

(Procedure)

1. The drafts of the decrees as of Article 1 shall be submitted to the parliament for the relevant Parliamentary Committees to express their opinions which are delivered within thirty days of the date of transmission. The term is deferred by ten days if explicitly requested by the Committees themselves to the relevant Chamber where it is necessary due to the complexity of the subject or the number of legislative decrees. If the deferral has been requested and limited to the subject for which it is granted, the terms to exercise the delegation are deferred by 10 days. After the expiration of the term set for the expression of an opinion or the possibly deferred one, a favourable opinion is considered to have been given.
2. The government is authorised to issue one or more legislative decrees laying down improving and supplementing provisions to this law within eighteen months of the date of entry into force of the legislative decrees themselves, in compliance with the principles and criteria set forth in this law and following the same procedure as of this Article.
3. By issuing the legislative decrees as of Article 1, the Government ensures the introduction of new law provisions through the amendment or supplement of consolidation acts and the organic provisions regulating the relevant subjects and the express repeal of incompatible legislation.
4. Within the same term as of Article 1, the Government is delegated to adopt one or more legislative decrees concerning the provisions possibly necessary for the formal and material coordination of the legislative decrees issued pursuant to this law with the other national laws and for the repeal of incompatible legislation.

Article 17

(Financial burdens)

1. No new or higher burdens for public finances, also in terms of revenue losses, shall ensue from the legislative decrees implementing this delegated power.

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