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TAXATION IN ITALY

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In this set of papers we compare the fiscal systems of several European countries. This chapter is dedicated to the Italian fiscal system.

We are mostly interested in four aspects of the fiscal systems:

1. The structure of taxation in terms of % of GDP for various taxes and contributions;
2. The taxation structure as described by the Implicit Tax Rate (ITR) as % of taxable income on labor, capital and consumption;
3. Administrative complexity of fiscal systems in terms of bureaucratic procedures and required human resources in man-hours;
4. Level of fiscal decentralization, i.e., fiscal autonomy of local government entities with respect to the central administration.

Because of the European nature of the comparison, we mainly exploit international databases: this will enhance the homogeneity and thus the comparability of the data. There are two main sources of fiscal data for European countries:

1. Eurostat, which publishes data spanning for at least a decade about tax levels, ITR levels, deficits, debt, expenditures, and much more;
2. The World Bank, whose "Doing Business" report estimates the administrative complexity of the fiscal systems.

Some datasets may not be available internationally. In this case local statistical agencies such as, for Italy, ISTAT, can be used, but data may not be homogeneous across countries, and comparison may be more difficult, even when data are available for all the countries of interest.

Taxation: definition

Money owed to the government can be classified in a variety of ways. It can be a tax for a service, such as waste disposal; general taxation not linked to a specified service, such as income taxes; or compulsory contributions, such as taxes for pension plans. In this paper we consider all compulsory payments to the government as taxes without distinctions.

In this paper we are mostly interested in distinguishing between taxes which impinge upon consumption, labor, and capital, based on the widely accepted principle that taxing productive activities is more inefficient than taxing consumption. This has been recommended by the European Commission as one of the reforms which Renzi should implement.

Most taxes on consumption come in the form of VAT and excise duties. Taxes on labor are retirement or unemployment or insurance contributions and personal income taxes as paid on labor income (but in part they are also paid on capital income). Taxes on capital are wealth taxes, including taxes on real estate, corporate income taxes, taxes on personal income as paid on capital income.

The distinction is not always meaningful: a tax such as the IRAP, in Italy, is paid by firms on both labor expenditures and capital expenditures, for instance. Thus, IRAP is in part a tax on labor, and in part a tax on capital. The section on Implicit Tax Rates uses Eurostat data and classification has been done by Eurostat, and is uniform across countries.

Levels of taxation

This section shows the evolution of taxation as a percentage of GDP in the last years. Total taxation, including contributions, and receipts from specific taxes such as VAT or Personal Income Taxes are shown. Data are provided by Eurostat in the "Main national accounts tax aggregates" database.

Figure 1 shows the tax receipts as percentage of GDP in Italy in the last years, as compared to the average EU-27 level, as reported by Eurostat, from 1995 to 2013. The large increase immediately before the onset of the euro-crisis (in 2006) and the further increase in the last two years of more several recession are evident. Italy's fiscal policy has contributed more than its fair share to the ails of the real economy in the last years, because of the difficulties in reducing public outlays.

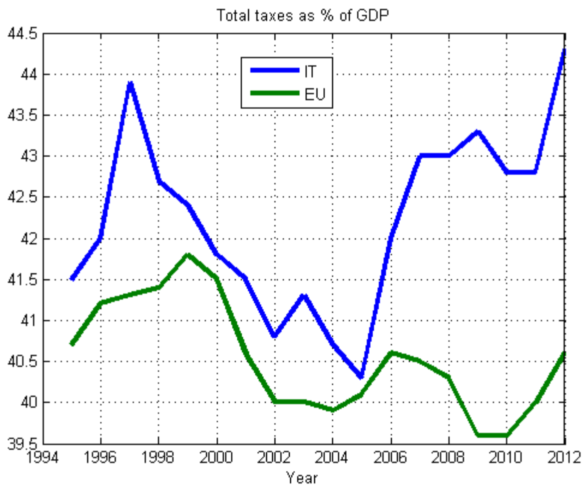

FIGURE 1 – Total taxation

Figure 2 shows VAT receipts in Italy and in the EU. As mentioned previously, the weight of consumption taxes as on GDP is quite limited in Italy, and the high level of taxation shown in the previous Figure is mainly obtained from taxation on labor and capital. This is an inefficient way to levy taxes, with a negative impact on GDP which together with overall high taxation and debt levels reduce the potential for economic growth. However, growth is not due to fiscal factor.

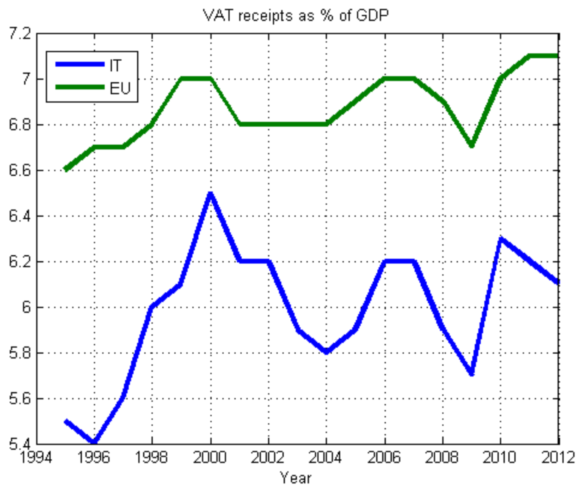

FIGURE 2 – VAT receipts

Figures 3 shows total income taxes in Italy and in the EU, personal income taxes (dashed), and corporate income taxes (dotted), all as fraction of GDP. Comparative personal and corporate data are not available for the EU.

FIGURE 3 – Income tax receipts, total (Italy and the EU), personal and corporate (only for Italy)

Figure 4 shows contributions in Italy and the EU. Contributions as percentage of GDP have increased in Italy above the European average in 2007. It is evident that most of the contributions are paid by employers, whereas employees pay a much lower fraction of total contributions. Contributions of self-employed people (not shown) are slightly higher in Italy than in EU, probably because of the larger fraction of self-employed.

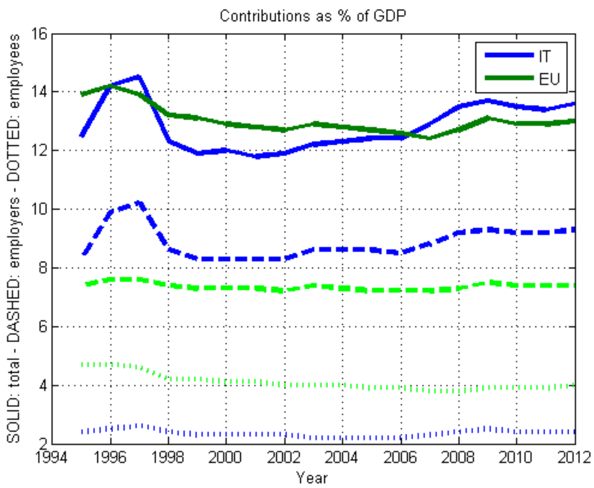

FIGURE 4 – Compulsory contributions (paid by employers, employees, and total)

Tax receipts from the Personal Income Tax (IRPEF) are very high relative to GDP, whereas corporate taxes seem high but not higher than in other EU countries. However, these figures show tax receipts as percentage of GDP, whereas a more relevant measure of the tax burden would be to show tax receipts as percentage of the relevant tax base: what is the fraction of consumption, labor income and capital income which goes in consumption, labor or capital taxes? This is the question which Implicit Tax Rates try to answer.

Implicit tax rates

Implicit tax rates (ITR) are provided by Eurostat for consumption, labor and capital. The relevant database is "Implicit tax rates by economic function". Consumption ITR is the fraction of consumption expenditures which go in taxes. Labor ITR is the fraction of labor income which is owed to the government. And finally, Capital ITR is the fraction of capital income which go in taxes.

Capital ITRs are further divided in capital ITR proper, business income ITR (which does not consider wealth taxes), business income ITR for corporations and business income ITR for households and self-employed.

Figures 5-7 show the implicit tax rates on consumption, labor, capital, business income, business income of corporations, and business income of households and self-employed. For capital – and related – ITR there are no average European data. A benchmark may be constructed by averaging the ITRs of each European country, but this has not been performed.

FIGURE 5 – Consumption ITR

Consumption ITR is relatively low, suggesting that taxation is mainly shifted to productive factors.

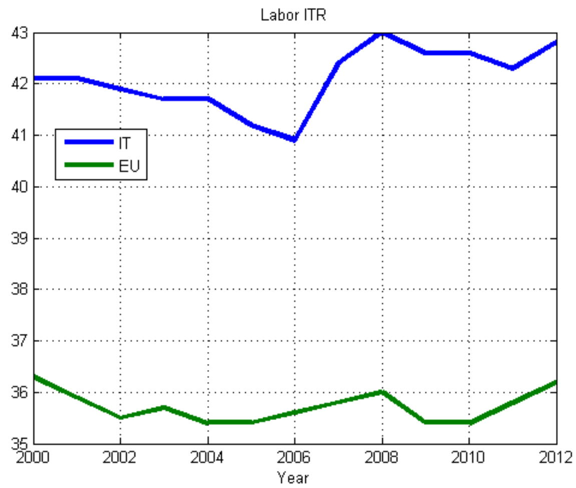

FIGURE 6 – Labor ITR

Labor ITR, on the other hand, is one of the largest in Europe, and this depends both on taxes and on contributions: Italy has the largest share of GDP spent for old age in Europe, and perhaps of the world.

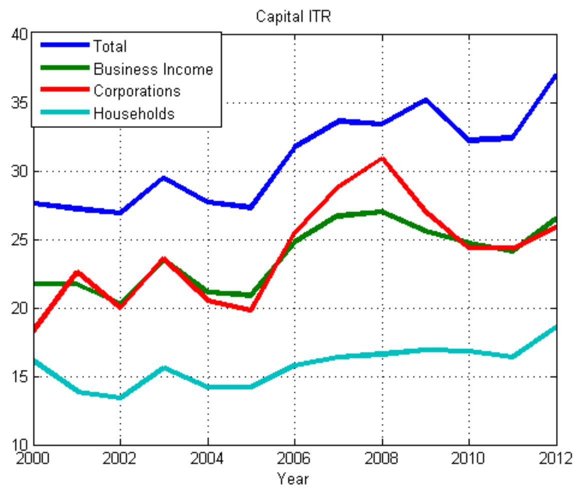

FIGURE 7 – Capital ITRs

Capital ITRs show that Italy is one of the worst countries in Europe also for what concerns taxation on investments, savings and entrepreneurship (Data on other European countries not shown). Taxation levels have consistently worsened with the recession, although tax hikes were evident also before the crisis.

It should be noted that data for ITRs are available only up to 2012. In the last two years, however, taxes on savings, excise duties, stamp taxes and taxes on real estate have further increased, and the ITRs may have worsened.

Administrative burden of fiscal procedures

The additional costs incurred by corporations and households because of tax receipts are not the only costs related to the fiscal systems. Paying taxes takes time, requires a certain number of administrative procedures, and may require additional resources, such as those incurred to have the services of accountants.

Especially for small firms, huge fixed costs incurred in the process of paying taxes may be a severe obstacle to efficiency and competitiveness. Given the large number of small enterprises in the Italian economy, the potential costs are significant.

Table I shows the World Bank's Doing Business data on Italy regarding the subfield of the index called Paying Taxes. The Doing Business index ranks economies against several dimensions related to public policies and services related to the quality of the environment in which businesses operate. The "Paying Taxes" sub-index is of course mostly interested in the fiscal system as it applies to corporations.

Country	Ranking	Procedures	Time	Total Tax Rate
Italy	138°	15	269	65,8
OECD High Income	-	12	175	41,3

TAB I – Italy's Performance in the Paying Taxes field of the Doing Business report

Italy's definitely not a country which encourages wealth creation: the fiscal bureaucracy is cumbersome and taxation levels high.

Taxation and federalism

Governments are divided in levels: in Italy there are four: the central government, Regioni, Province and Comuni (which more or less are equivalent to regions, counties, towns). The last three are considered local governments by OECD, while federal governments such as Germany's have an intermediate 'state government' level.

Local governments may be more or less autonomous, and this will influence their behavior: the more they are autonomous, in that local expenditures are met by local taxes, the more local voters will be interested in efficient and thrifty local institutions; the less they are autonomous, the less incentives the voters will have to check the inefficiencies of local governments, which will prefer to use public expenditures to obtain more votes at no cost for local tax-payers. The end result at the aggregate level of these incentives may be a bloated and inefficient public sector.

In simple words, funding local governments with centrally-originated transfers will create moral hazard, shifting the costs of public expenditures at the local level to the general tax-payer.

This is not to be considered strictly, however, government transfers may influence local incentives in different ways. Transfers which are fixed and determined by best-practice governments will produce the least "moral hazard". On the other hand, ex post discretionary transfer to distressed local governments will basically subsidize bad governance, and incentive more of it.

It is not possible to distinguish between the finer levels of local government with the OECD database because Regioni, Province and Comuni are squeezed in the same category. This is true both for taxes and for expenditures.

Central, state and local governments and social security funds are called S1311, S1312, S1313 and S1314 in the Eurostat database. An approximate index of fiscal autonomy of the local governments can be computed as the ratio of the sum of capital and current transfers from the central to the local governments and the expenditures of the local governments.

This is not correct because local governments are not further subdivided in Regioni, Province and Comuni, so that it is possible that transfers between levels of local government are hidden, although in principle they produce as much fiscal irresponsibility in the lower levels of government than central government handouts. Despite the limitations of the index, because moral hazard may depend more on the rules behind transfers than to the aggregate level of handouts, should be considered, but we still think this index is better than nothing in assessing the "federalism" of government expenditures and tax receipts.

Figure 8 shows the "fiscal autonomy index" for Italy in the last years.

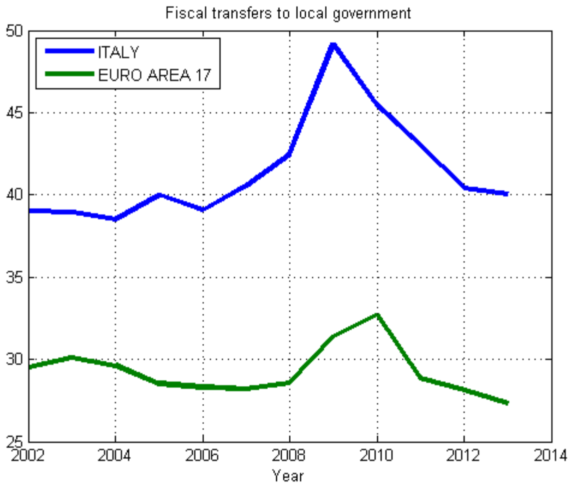

FIGURE 8 – Fiscal dependence of local governments on transfers

The figure shows that fiscal transfers to local governments have amounted to about 40% of local expenditures since 1998, but there has been an increase up to 50% during the crisis. Anti-cyclical transfers have the potential to create moral hazard, as the risk of bankruptcies during financial crises becomes more remote. Transfers should be reduced and made independent on financial conditions: at least, fiscal dependence should be reduced by 12% to reach the average European level, implying 28 billion euros of lower transfers to local governments, or about 2% of the Italian GDP.

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