

## Tax Reform in Italy: Hopes and Misgivings

1. The problem of the reorganization of the Italian fiscal system was taken up for the first time by a Tax Reform Commission — of which I was the Vice-President — which worked from August 1962 to May 1963 (1). In September 1964, a Study Group on the implementation of the tax reform was appointed, of which I was again Vice-President. This Study Group with the help of seven working parties was able to submit by 3 November 1964 a five-year program (afterwards included in the Five-Year Economic Development Program for 1966-1970), and, by 16 March 1965, a Progress Report (63 pages of text and 101 pages of appendices). On the basis of these studies the Minister of Finance sketched to the Finance and Treasury Committee of the Chamber of Deputies (2) the broad outlines of the new tax system and of the administrative reorganization. In order to find a practical solution to each single problem, within the general program, the Study Committee resumed its work, in February 1966, on the basis of a preliminary draft, prepared by myself and incorporating the findings of the various study groups (243 articles in a rough outline and a comment of 134 pages) (3).

Later on, however, there was a change in the orientation of the Committee, regarding both the methods of work and the fundamental aspects of the reform; this forced me to ask the Minister, in June 1966, to relieve me of my position as Vice-President.

The work of the Committee was soon resumed, vigorously, under the leadership of Professor Visentini, who in February 1967

---

(1) *Stato dei lavori della Commissione per lo studio della riforma tributaria*, Giuffrè, Milan, 1964.

(2) "Lo stato dei lavori per la riforma tributaria", in *L'attività tributaria nel 1964*, Ministry of Finance, Rome, 1965, pp. XVII-XLVIII.

(3) My views on the general plan for the reform are expressed in my lecture courses at the University of Rome for the Academic Years 1965-66 and 1966-67 (*Lezioni di Scienza delle finanze*, La Goliardica, Rome, 1966, and *L'imposta sul valore aggiunto*, Edizioni Ricerche, Rome, 1967).

was able to submit to the Minister the draft Bill accompanied by a detailed report.

That there should be disagreement, as I have pointed out, when moving from a theoretical plan to the implementation stage, will be readily grasped; it is enough to think of the interests affected by a major reform of a nation's tax structure. Old problems, which time may have smoothed over, come to the surface again, and new ones arise, or appear in a different light.

Some of these problems are particularly difficult and sensitive, even on a technical level, for their contrasting aspects of fairness and economic expediency, not always mutually compatible and generally implying value judgements. Such judgements, of course, diverge according to the person formulating them, which leads to dissent, often of a radical kind, also because of the varying importance attached to the expected effects of alternative and partially incompatible choices. Often it is not even possible to foresee clearly enough — even after suitable empirical research — the effects of alternative solutions, as they so largely depend on individual and psychological reactions capable of changing in time; even though, in the long run, some uniformities may become manifest.

2. A first problem — on which, after the lesson of the Vanoni reform, I have always insisted and with particular vigour — is that of adapting our tax Administration to the requirements of the new system in respect to number, quality and territorial distribution of the staff (employed in assessment), their mentality and general attitude, as well as their equipment and operational techniques, especially with a view to an intelligent extension of automation. More efficient and modern administrative services are required, particularly in view of: the substitution of a "personal tax" for "schedular taxes"; the withholding at source, extended to all direct taxes; their direct payment (rather than through inscription in rolls), also with reference to the planned "value-added tax", which requires a closer check on periodical payments and tax declarations; the improvement of assessment machinery, implying the discontinuance of "agreed settlements" and "inductive assessments", however disguised.

No reform of the fiscal system, and especially no structural reform, can be carried out by legislative fiat: before it, there must be an efficiency improving reform of the tax Administration and

Offices. And it is not a matter of legislation alone: the continued and diligent attention of the Finance Minister will be required, together with an adequate allotment of funds by his colleague at the Treasury; also, there should be no political meddling.

Experience shows, however, that the reform of the administrative machinery is a much longer process than that required for the preparation of new legislation. Several years are in fact needed to work out and put into effect a modernization plan for the Tax Administration. Unfortunately, the progress made in the last few years towards meeting this basic requirement has been disappointingly slow. And though much concern is being felt on this problem, and many interesting studies have been undertaken, actual fulfilment is still a distant goal. I therefore believe that it is essential to re-examine the time-schedule for implementation as it is assumed in the Five-Year Program.

This is not meant to be a criticism. One conclusion is, however, inescapable: the slowness of the progress so far made greatly jeopardizes the chances of attainment of the target. If anything is to be done at all, without, at least, making matters worse than they actually are, we must realize that the tax Administration are not in a position to carry out a reform — in the true sense of the word — nor are they likely to be in the near future.

It would seem more logical, then, to accept the facts as they are and give up the idea of a thorough modernization of our tax system, falling back — though regretfully for one like myself, who has urged such a reorganization for decades — from such an ambitious program, for which unfortunately we are not ready, into a temporary rearrangement of the present system, at least till conditions are ripe. Though it is admittedly quite hard for our ruling classes to have to confess their inability to streamline our tax Administration, this would be an honest and healthy position to take.

The Study Committee, as the Commission before it, did attach a great deal of importance to the question of administrative efficiency, advancing a series of practical suggestions and asking for the needed political assurances. Since, however, progress was so slow, rather than go on planning a modern tax system, quite unrealistic in the present institutional framework, it would have been far better to accept the facts and suggest intermediate solutions, limited in scope, but compatible with the level of our administrative efficiency and suited to the mentality of our taxpayers.

3. This said, it will be easy to understand the misgivings stemming from the wide scope given to the reform project. In fact, during the first stage of its activities, the Committee did confine its attention to direct taxation and the I.G.E. (the present multiple stage sales tax). Later on, the investigation was broadened to cover the capital gains tax on real estate, the inheritance and gift tax, the municipal consumption tax (*Imposta comunale di consumo*), all other local-authority taxes, as well as a number of indirect levies, some of them hard to reconcile with the proposed new system and, consequently, to be abolished or altered.

An idea of the range of the reform is given by Table 1, which shows the annual revenues collected from levies that, according to the Committee's conclusions in the first stage of its work, are to be replaced (4).

DIRECT TAX REVENUE  
(1966 - in milliards of lire)

TABLE 1

Taxes and surtaxes (schedular taxes) . . . . .	1,343.2	
" <i>complementare</i> " (a) and Company Taxes . . . . .	310.0	
Municipal family tax . . . . .	139.7	
C. of C. tax (paid by members of the Chambers of Commerce) . . . . .	28.1	
Additional . . . . .	253.0	2,074.0
Tax collectors' premiums . . . . .		74.2
I.G.E. (multiple-stage sales tax) (less reimbursements on exports, but including refunds) . . . . .		1,320.0
Total . . . . .		3,468.2

(a) The progressive tax on a person's total income, whatever its source.

Total revenue from these sources (taxes to be replaced) thus amounted to 3,468.2 milliard lire, corresponding to about one half of total tax-revenue for all levels of Government, including all kinds of surtaxes (6,816.6 milliard lire). The new tax rates were to be calculated on the assumption of an unchanged total tax yield; a lowering of the tax rate would be possible only by stamping down evasion, abolishing exemptions and special tax deals. Nevertheless, it became apparent that a tax reform was, like any other reform,

(4) *L'attività tributaria nel 1965*, Ministry of Finance, Rome, 1966.

quite expensive, owing to the cost of implementing it as well as the likely temporary short-fall in yield.

In the second stage of its work the Committee broadened the scope of the reform still further, even beyond the already wide limits of the Five-Year Program, providing for the abolition of some minor local levies (13.5 milliard lire), or (indirect) State taxes (27.5 milliards), certain excise taxes and corresponding custom duties (34.3 milliards), and of the municipal consumption tax (319.5 milliards) and suggesting changes in the registration, stamp, mortgage, and licence taxes (roughly, some 140 milliards). Also, the tax on the net total estate (estate duty, as distinct from succession duty) was abolished (about 20 milliards). This meant a further loss of between 500 and 600 milliard lire, (about 15 per cent) which, under the above basic assumption, would have to be recouped by raising the new tax rates, particularly with reference to the sales tax.

The jacking-up of tax rates from the original plan and the danger of a greater loss in revenues, especially in a strained budgetary situation that hardly permits any decline, are elements that cannot but deepen our concern.

Furthermore, the decision to deal at one and the same time with the fiscal reorganization of both central and local Governments (covering also aspects that have little to do with the taxes being reformed), and the shift to the central Budget of unknown new burdens running into the hundreds of milliards of lire (5), make the cost of the reform intolerable for our Budget.

It is not only for the implicit risk of a loss of revenue that the wide scope of the reform causes concern; no less alarming is the additional strain on the administrative structure, fragile enough as it is, of so many far-reaching innovations. The broadening of the scope of the reform is a second reason for my dissent from the orientation prevailing during the second stage of the Committee's work.

4. There is also a third aspect, linked closely with the one that was just outlined, i.e. that of sectoral priority. By common observation the sizeable evasion of I.G.E. (about 40 per cent) results not so

(5) Some local services are to be transferred to the Exchequer, and the contributions paid by the Treasury to local authorities are larger than the losses that the reform would cause them.

much from the wish to escape payment of the tax itself as from the high level of income tax rates; businessmen, rightly or wrongly, fear that if the tax authorities get to know the total invoiced by them (on which the I.G.E. is paid), income tax assessment will be affected. Many firms do not make use of invoices and adopt fictitious names to conceal the purchaser's identity.

Such being the facts, they must, in my opinion, be taken into account; this means that a direct taxation reform should come before the I.G.E. reform, both in order to determine a wider diffusion of business accounting — which would at first be required solely for income tax purposes — and in order to remove the main reasons for the evasion (through a reduction in the income tax rate). The I.G.E. reform should take place only when conditions exist for its more accurate assessment.

Hence, the deadlines for the coming into force of the various groups of new taxes should have been already set, with priority being given to direct taxes, also in order to obtain the required postponement by the Common Market of the set schedule for the introduction of the value-added tax (6).

The establishment of such deadlines (the need to proceed by stages, conveniently separated in time, is generally recognized) would also have enabled the Administration to schedule its own reorganization over time according to a plan for the fulfilment of which it would have borne the responsibility.

5. There are further considerations concerning each single tax covered by the reform.

The personal income tax is to become the corner-stone of direct taxation. Alongside it, various other purposes will be served by the tax on corporations, on income derived from real property and on capital gains.

The personal income tax, which is obviously constructed after the pattern of the existing "*complementare*" (7) is going to absorb most of the four "schedular" taxes, relative surtaxes and additionals, as well as the municipal family tax. It is particularly with respect to this tax that the negative effects will be felt of

(6) Cf. C. COSCIANI, "Su alcuni problemi di politica tributaria italiana", in *Temi Tributaria*, No. 1, 1964, and "Tempi per l'attuazione della riforma tributaria", in *Tributi*, March, 1965.

(7) The progressive tax on a person's total income, whatever its source.

the failure to equip and reorganize the offices by the time the reform comes into force. The lack of an efficient tax register (enabling each single source of income to be automatically assigned to the individual taxpayer), which is only realizable by means of modern electronic computers, makes it extremely difficult to check on tax declarations and/or on the payment and deduction for taxes withheld at source (this system is to be extended and generalized, so as to make the payment of the tax coincide, as closely as possible, with the receipt of income).

6. The change from a "schedular" to a "personal" income tax requires, first, a high degree of homogeneity in the various elements of income — to avoid obvious inequities — and, secondly, the inclusion of all income, without exception, to avoid deviations from the principle of progressive taxation, even when some components of income are entitled to exemption.

The first requirement poses the question of the real estate income tax, which is assessed by the cadastre system; the second one that of exemptions and of individual income assessment, with particular reference to interest and dividends.

As to the first problem, it will take seven years to bring the cadastre up to date as to ownership records, appraisals and classifications, valuation of buildings still "unknown" to the Registry, and, above all, reform of the system as a whole, to make it "flexible". If the personal income tax comes into force before that time, income from this source will lack the required minimum homogeneity with other incomes (wages and salaries, for example), although it will be lumped in together with them. Such inequity may be tolerable now that the personal income tax represents only a fraction of the total tax paid, but will become unacceptable tomorrow, when the personal income tax will be the main form of taxation.

Nor would it be wise to proceed with the revision of the cadastre valuation coefficients before re-examining the present cadastre classification, which is largely superseded.

7. Turning now to the question of the taxation of *interest and dividends*, we find that the conflicting points of view on this subject reflect its delicate nature and the varying significance of the elements conditioning them.

Two problems should be distinguished, i.e., that of introducing a withholding tax and that of individual taxpayer assessments. In the first case the tax payment, at least in part, is made to coincide in time with the production of income while, in the second case, an attempt is made to assess simultaneously the total income of the taxpayer, whatever its source.

As for the first problem, it should be borne in mind that the existing schedular tax on income from interest on loans, deposits and bonds (*Ricchezza mobile* category A) is directly collected from the debtor and that there already exists a withholding tax on dividends (apart from the category B profit tax, which will be in part shifted to the personal tax). Since the schedular tax is to be abolished (except in the case of the new municipal tax on income from total wealth), it will be necessary to re-examine the case of the above-said category A tax for the purpose of setting the withholding tax rate in conformity with the personal income tax scales, after taking into account, as far as feasible, the "income bracket" where these types of income most frequently belong.

Various points may be raised with respect to the problem of individual assessment.

As for interest paid by banks on deposits, there seems to be general agreement that a fiscal control of bank deposits is inadvisable, as it would involve the violation of bank secrecy, a step for which our economy is not ready, as yet. Moreover, bank deposits are temporary liquid balances and the rate of interest is relatively low. If taxed, depositors might shift them into other forms of liquidity outside the banking system, with undesirable results. When individual balances are concerned, they are anyway relatively modest and the low tax-yield could not justify the enormous amount of control necessary. Bank deposits are the first manifestation of the small man's inclination to save; as soon as they become large, the money is invested elsewhere, in bonds, stock, flats and so on.

When they belong to a firm they are part and parcel of its income and, as such, already accounted for. Also, due to the typical form in which these liquid assets are kept (i.e. sight deposits) the rate of interest is low and, often, bank charges have to be paid; often interest on overdrafts cancels out interest on deposit balances.

No one suggests total exemption on such income. Probably a withholding tax at source for interest payments looks like the best solution, the more so as bank interest is even today subject to the category A schedular income tax. Nor do I think, as some do, that payment at source should be final and replace the personal income tax. The bank should be legally obliged to claim the tax from the depositor; the latter should be entitled, if he so wishes, to have it treated as a withholding tax. This would apply in general to firms (who would otherwise be taxed on an element of cost) or to persons subject to an income tax rate lower than the withholding tax on interest.

In the case of interest from securities (the question was never raised for loans, in which case the current practice of individual assessment was never called in doubt), three different theses were manifest in the Committee. The *first thesis*, in order to avoid obstructing the financing of enterprises by the issue of bonds, would introduce a flat withholding tax; the *second thesis* would be in favor, in order to assure a fair distribution of the tax burden, of a withholding tax, subject to adjustment according to a procedure yet to be worked out, though the bonds will continue to be issued to the bearer; the *third thesis*, which I prefer, rejects any deviation from the principle of including such income as part of total income, on grounds of fairness and in order to avoid chain reactions affecting other incomes. At the same time this solution takes full account of existing fears about possible repercussions of this taxation on the capital market. All considered, I think it would be better not to make a choice now but to put it off to the time when the law is issued, i.e. in a few years. Only then will it be possible to judge on the merits of each solution. When the project is finally formulated, and the taxpayer knows the various tax rates, it will become possible to make a choice between the present system of the "*complementare*" (inclusion of such income in the total income), compulsory assessment by book inspection, or the withholding tax (subject to adjustment).

This third view was incorporated in the later versions of the Bill; unfortunately, however, another draft was afterwards inserted, by supporters of the first thesis, envisaging the adoption of a flat-rate; some passages in the report, perhaps not exactly reflecting the majority opinion, have led the public — and perhaps also the competent authorities — to believe that a choice was now

to be made between individual assessment and a flat tax. This has given rise to doubts and anxieties which the political organs have been unable to dissipate. The decision already taken to opt for the "flat" withholding tax, as statements of responsible authorities indicate, may perhaps be too rash. This withholding tax, however, would only apply to private bonds, as government securities are not included.

The case for postponing a decision receives further support from the fact that an E.E.C. Commission has also begun a study towards a solution of the problem at the Common Market level. The advisability of not committing our negotiators is obvious; we do not want to be in the position of having to alter legislation almost as soon as it has come into force, and in a sector where innovations must be kept to a minimum to avoid upsetting a very sensitive market.

In the case of dividends and of other kinds of income from shares (including the passage of reserves to capital), in whatever form, there is no reason for not keeping to the present system (with minor improvements) except for the size of the withholding tax. These incomes are mostly near the top of the income pyramid; if they were excluded from the calculation of total income, the principle of equity would be violated.

8. The question of the level of the personal income tax rates appears to require reconsideration. The recent project sets the maximum tax rate at 60 per cent for the income bracket of 500 million lire or more. But incomes above 200 million lire have been so rare that beyond this point the tax scale becomes purely theoretical. In fact, incomes will continue to cluster in the 2-5 million zone. If, after the reform, the single personal income tax is to yield as much as the combined existing schedular and personal taxes, it will be from these brackets that the major contribution must come. Countries with higher per capita incomes than ours have set their maximum tax rate at relatively lower levels. For example: in West Germany there is a maximum tax rate of 53 per cent for incomes above DM 110,000 (17.3 million lire) with a minimum exempt of DM 1,680 or 267,800 lire; in Great Britain there is a proportional income tax rate of 41.25 per cent (with a lower rate for the first £300 or 523,800 lire) and a surtax for incomes above £2,000 at a rate of 50 per cent for the part exceeding £15,000 (18.5 million lire); in Belgium the maximum rate

is 55 per cent for incomes above 5 million francs (62.5 million lire), with a minimum exemption of 30,000 francs (375,000 lire); in France, the maximum rate is 70 per cent on incomes above 72,000 francs (about 9 million lire) with a minimum exempt ranging from 1,600 to 3,200 francs (192,000-384,000 lire).

The average income level in Italy (about 660,000 lire a year), is still relatively low and even today — in spite of the rapid economic growth of the past years — a sizeable segment of the population is forced into particularly low living standards. As a result, it would seem equitable that incomes thirty times larger than the national average, (i.e. about 20 million lire) should bear a fairly high tax rate.

Consider the present combined level of all taxes paid by an unmarried wage, or salary, earner (income tax, complementary tax, the municipal family tax, and all the various additional (8).

TABLE 2

Income bracket (millions of lire)	Tax Rate (per cent)	Income bracket (millions of lire)	Tax Rate (per cent)
1	5.226	10	29.388
2	9.868	15	36.919
3	12.852	20	41.109
4	15.070	30	45.627
5	18.072	50	50.968

It is persons with an intermediate income of this size (for orientation the figure of 20 million can be used) who are the consumption leaders, those responsible for the so-called "demonstration effect", which, as known, can lead to social tensions, distorted priority scale in consumption and even to budgetary strains.

These high income groups also include some of the managerial staff who, with their stronger bargaining power in labor negotiations, have pushed up the ratios of maximum-to-minimum salaries to a higher level in Italy than in more developed coun-

(8) From a penetrating analysis by M. SARGINELLI, "The Overall Direct Tax Rate on Earned Incomes in Italy", in this *Review*, p. 220.

tries. These high salaries, gradually but unavoidably, drag up those of the lower grades thus contributing to excessive wage pressure. Private business salaries are much higher than those paid in equivalent Government jobs; hence, the Administration either loses its best-qualified staff, or must offer remunerations that it can ill afford.

For these income groups the new tax rate should not differ significantly from the existing one, especially in view of the fact that, for the lower income groups, a minimum tax of 10 per cent has been suggested (this is lowered substantially through deductions only in the case of the very lowest incomes). The maximum tax rate, which in Italy today should not be higher than 50 per cent, must fall somewhere in the 100 and 200 million range, rather than 500 million. These levels of the tax-rate seem, in my opinion, necessary not only on grounds of equity and expediency, but also in order to ensure that total tax revenue is adequate to cover losses from the elimination of other taxes.

The exemption limit should be maintained at about half the average level of income per head (i.e. about 300,000 lire) as in the case of the existing schedular income tax on wages and salaries (*ricchezza mobile*, cat. C<sub>2</sub>).

Will the Italian taxpayer, especially from the middle income class, understand these requirements? Will the executive and legislative powers be able to withstand the action of pressure groups (the case of the tax on the interest on bonds is a lesson) and enforce such an orientation? All that can be said is that, if the new tax rates diverge substantially from those suggested above, a dangerous leap in the dark would be taken.

9. Along with the personal income tax, the reform project includes also a *corporate* income tax which does not differ from the existing company tax, except for the system of calculating the tax basis.

One aspect of this tax that should be reconsidered is that of its relationship with the personal income tax.

The question as to whether there should be a separate, or additional, corporate income tax has been much discussed in theory. On a purely logical plane such a discriminatory tax treatment is generally accepted as justified for various reasons, such as the need to fill some of the "fiscal gaps" associated with the existence of corporations (undistributed profits in the case of the

income tax, or their capital in the case of the taxes on gifts or on the transfer of wealth). Some believe that this tax can be upheld on grounds of economic policy, as an income stabilizer, or for protecting small businesses, etc.

Alongside the question of whether a separate tax is justified, there is that of using it for the advance collection of the personal income tax.

What can be said is that if there are safeguards against tax evasion by partners, or shareholders, and if undistributed profits (which eventually lead to a higher value of shares) can be somehow taxed, then the case for separate corporate taxation is weakened, which means that the tax-rate should be proportionately lower.

In view of the above, it becomes impossible to accept the solution chosen by the Committee, viz. that of combining the two taxes (the corporation tax and the withholding tax on dividends) in a rather confusing way.

The corporation tax is expected to be set at 32 per cent; 30 per cent of the distributed dividend is the amount of the tax paid by the corporation on behalf of its partners or shareholders. Let's assume for purposes of illustration a corporate income of 1,000 units, on which a 32 per cent corporate income tax has to be paid, plus the 12 per cent municipal tax on income from wealth (or 12 per cent of profit), i.e. a total of 440. A part of this, i.e. 30 per cent of the dividend paid (30 per cent of 560 or 168) is considered as an advance payment of the personal income tax, made on behalf of shareholders (or partners). The latter will therefore have to show in their income tax statement an amount of 728 (560 is the dividend and 168 the tax credit) and will be entitled to a deduction of 168 from the total tax obligation.

The net tax payment of the company is thus reduced to 272, i.e. 27.2%, of which 12% is the municipal tax on wealth and 15.2% the true corporate income tax. The result is a hybrid. Much better and clearer if the two levies had been kept separate.

10. The tax on *income from wealth* is proposed as a local tax assessed by the Central Government. At first, i.e. by the first Study Group, in the early stages of the Committee work and by Minister Tremelloni, the tax was to be assessed on wealth, but subsequently it was decided to fall back on an income base.

I think the capital base would be best for a number of reasons, only briefly mentioned here as the reader can be referred to the



extensive literature favoring this view: wealth is in itself an indication of taxable capacity, additional to income, especially because the income-to-capital relationship is not uniform; a capital tax permits a tax deduction for losses on risky investments and encourages the search for the highest yield, especially for idle capital held for speculative purposes such as land for building development; furthermore, it falls on durable consumption goods (villas, parks, yachts, etc.) and discourages "conspicuous consumption"; for mixed incomes, it effects an automatic discrimination between income from labor and income from investment.

Such a tax seems also advisable considering the intention of introducing, right away, a capital gains tax, which, as now devised, will have the effect of keeping real estate from the market, especially if gifts and/or other unilateral transfers are not covered by it. A tax on real estate would, on the contrary, have stimulated sales, hence offering an offset for the capital gains tax.

The tax on income from wealth — apart from the artificial, but inevitable, discrimination regarding income of commercial enterprises — is nothing but a continuation of the existing "schedular taxes", with the added inconvenience of applying uniform tax rates to a disharmonious tax basis (particularly in the case of a cadastre assessed income), and the disadvantage, compared with the existing system, of making it impossible to offset inequities in assessment through a manipulation of the tax rate.

Moreover, it would have been better, in my opinion, to avoid using a single tax base (i.e. income) for all direct taxes and to appraise, at least in part, taxable income by the yardstick of total wealth. This would also have resulted in a less acute inducement to evasion.

The different decision taken results in a serious deformation of the original tax reform plan.

11. As to the *value-added tax* (VAT), there are two questions to be reconsidered, viz. the time and mode of its introduction and the level of the rates. Two points should be underlined, i.e.: the VAT should be introduced some time after the implementation of the new system of direct taxation; this tax and the corporate tax should be under the responsibility of the same tax authority because the amount invoiced — for sales and purchases — is one of the main factual bases for the assessment, in both cases.

Another difficult problem is that of the determination of the tax rates. According to fairly accurate estimates — which take into account the existing exemptions for agriculture and retail sales — the present I.G.E. rate of 4 per cent corresponds to a VAT of 13 per cent, meaning, at the same level of evasion, 100 milliards of lire each percentage point of taxation. If the municipal consumption tax is to be absorbed in the VAT, in order to recover its yield of about 300 milliards the VAT rate will have to go up to 16 per cent; an even higher percentage will have to be used if the yield of other abolished taxes is to be made up. Such a heavy average burden on the last producer or wholesaler would certainly be a further inducement to evasion — which becomes easier because the last producer, or the wholesaler sells to the retailer, or directly to the consumer, and cross-checking becomes impossible, because there is only one invoice, since the retailer is not particularly interested in having his purchases invoiced.

The question of distributing the total tax yield between the VAT and the single-stage sales tax is also worthy of particular attention.

A rate of 10 per cent, in the first period of implementation, may seem excessive for the VAT. It may well be wiser to keep it down to 8 per cent, while setting the single-stage average sales tax at 5, instead of 3, per cent (ignore the question of incorporating the municipal consumption tax and other ones, as was suggested by the first Study Commission). At the same time the VAT should apply to all services rendered by firms, which should be exempted, if at all, from the single-stage sales tax. This would dampen the inducement to evasion all along the productive cycle, while assessment would be made easier (assuming compulsory declaration at the end of the year of the total amount invoiced to all customers and by all suppliers).

12. The abolition of the *municipal consumption tax* and the recovery of the yield forgone by raising the average single-stage tax rate, involves four serious drawbacks:

(a) It would not be possible to attribute to each municipality the tax collected in its own territory. The consumption tax (in addition to the real estate tax) is the only justifiable local tax because it hits all consumers in the municipality — consumption being the least imperfect index of the use made of local public utilities.



(b) The economic nature of the tax is distorted: the more removed is the moment of imposition from that of consumption, the more this tax looks like an excise, rather than a consumption tax.

(c) Local independence in assessing and establishing the tax rate would be lost in an area where it should be preserved, especially if the family-tax is to be abolished; a minimum of local autonomy is needed in planning expenditures.

(d) Excessive unification of the taxable base — i.e. elimination of the base represented by retail sales — would be a further stimulus to evasion.

Hence the municipal consumption tax should be kept and extended to consumption of all goods and services (including actual rent or that of owner-occupied houses), at a uniform and relatively mild rate, variable from municipality to municipality, but within fixed limits (up to a maximum of, say, 5 per cent).

13. For brevity, I shall refrain from commenting on other aspects of the reform (in its latest version) such as the capital gains tax (difficult to enforce without an efficient tax administration), the inheritance tax (arguments for the abolition of the tax on total estate seem rather weak), and the abolition or revision of a series of other taxes, on which a decision should have been postponed.

*In conclusion*, it can be stated that the latest version of the tax reform project contains several features that are a step backward from the original draft, although the project can be regarded as a worthy effort towards modernization of the Italian fiscal system.

Two major preoccupations lead me to believe that neither this project, nor the one I had envisaged (9), are viable, i.e.:

(a) the weakness of the central organs of the State, which makes them unable to withstand pressure groups, who therefore may, sooner or later, succeed in deforming the project still further; and

(b) the weakness of the administrative machinery (so far it has not received the needed attention), which could not survive the impact of so radical a reform. Despite my optimism of yesterday (10), I therefore believe it would be better to fall back on a less

(9) On this theme see: C. COSCIANI, "Sugli ostacoli sociologici della riforma tributaria in Italia", in *Rivista Internazionale di Scienze Sociali*, 1966, fasc. VI.

(10) See: C. COSCIANI, "The Aims of a Taxation Reform in Italy", in the *Banca Nazionale del Lavoro Quarterly Review*, December 1963.

ambitious plan, which should, nevertheless, be a step towards the needed reform. This plan, to be promulgated before the end of the year, should be centered on the following proposals:

— consolidation into one single rate of all the various income tax additionals, keeping only the schedular taxes (i.e. taxes on the various categories of *ricchezza mobile*, on land, buildings, agricultural income), the corporate tax, the personal income tax ("*complementare*"), the municipal and provincial taxes and surtaxes on the above-said income sources. (This would enable to be seen clearly what the total incidence on each source of income actually is.) Moreover, the 1.5 per cent withholding tax on the "*complementare*" for wages and salaries should perhaps be abolished, as it is a nuisance. Possible adjustment of personal income tax rates on a marginal basis, rather than an average basis as now is the case;

— gradual lowering of the schedular tax rates according to a three stage plan from January 1st, 1968; the maximum personal income tax rate should be set at 60-70 per cent. Simultaneously, the gradual introduction of new assessment rules and penalties should be proceeded with, while there should be an energetic drive — directed from the center with exact instructions — to stamp out evasion; abolition as from January 1st, 1968 of the municipal family tax; the municipal consumption tax should be extended to cover all goods and services (including rents and goods now paying excise or similar taxes) and the rate of tax should be proportional and uniform, except for some items which today produce the bulk of this revenue. Gradual adoption of measures for the rehabilitation of local finance, with respect to both Treasury grants and expenditure control;

— lowering of the tax rates and cutting down of exemptions on the transfers of wealth.

It will only be a short step forward on the road to reform, but it will be a safe one and fruitful.

CESARE COSCIANI

Rome