20 Jul 2021

KALEIDOSCOPE

Draghi Takes First Shot at Reforming Italy – Starting with Taxation

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After getting the vaccination program up to speed and reshaping the country's recovery plan, Prime Minister Mario Draghi is now focusing on the hard part of the job: actually reforming Italy. His government is starting with one reform that has the greatest potential to raise growth: that of taxation. Investors need to pay attention not only because of the significance of the reform on its own but also, and more importantly, because it will be an early signal of the political system's ability to tackle structural limits to Italy's to growth. It may also shape the direction of support from Brussels and determine whether or not we go back to a debate about how much Italy should get outside EU funds.

The Italian government would like to conclude by year end a fiscal reform that simplifies the personal income taxation regime. The parliament's public finances committee in early July approved a preparatory document detailing the preferred features of the reform and while also providing interesting preliminary insight into the project's details. The government is also asking parliament for legislative power, to expedite the process; hence, the document will give Draghi's government a sort of perimeter within which the power to legislate is given to the government.

Judging from the parliamentary commission's declarations, the general aim of the reform is to create a clear, simple dual-income taxation system for personal income. In this system, all income from non-investment activities would be taxed under the same single, progressive regime. Capital income would be taxed with the lowest personal income tax rate.

This would represent a major departure from the current system, where a jungle of exceptions, deductions, expenditures, and local authorities' additions create multiple taxation regimes for different types of personal income. The other stated aim is to simplify the declaration, payment, collection, and enforcement procedures.

Key features of the parliamentary commission's reform proposal include:
1) Reduction of personal income tax (PIT) mid rates (affecting medium incomes mostly) and leaps between rates, which create an incentive not to increase income or not to declare it.
2) Extensive simplification of the PIT regime: less tax expenditures (i.e. tax breaks for specific consumption patterns), creation of a single capital income category with single regime.
3) Corporate income tax redesign: elimination of the regional corporate tax and strengthening of incentives embedded in the main corporate tax's incentives for the green transition (greening of buildings, plants and cars, renewable energy production, and

phasing out of pro-oil incentives).The document also states its strong support to the G7 tax deal to use new resources to reduce labor and corporate tax pressure.
4) Reduction of value-added tax (VAT) rates and simplification (less exemptions/special regimes).
5) Fight against tax evasion: extension of the digital invoicing obligation to all subjects in exchange for digitization of tax declaration and payment systems, reducing the number and length of procedures and increasing tax collection efficiency.

These proposals are right in line with the government's intentions and are likely to be part of the government proposal. The government also intends to shift some of the tax pressure from labor to wealth (mostly housing), and measures here are likely to have high standing in the government's final project. As most Italian households store wealth in real estate, the unpopularity of such a measure must however limit expectations of meaningful change. Draghi has so far avoided the most contentious issues, focusing on low-hanging fruit that can bolster Italian productivity and growth, without creating too many tensions in the varied and possibly fractious alliance backing him.

The reform's potential to increase Italian growth is considerable. Italy is among the lowest-performing Organization for Economic Cooperation and Development (OECD) countries for cost, uncertainty, and time needed to comply with tax laws. The reform also confirms the Draghi government's intention to associate quality reforms to the quantity of investments to be deployed through the NextGenEU program to change the economy's growth trajectory. As ever, however, the devil will be in the details.

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21-1718025