Italy, fifty years ago, passed a bunch of bills which overhauled its tax system. Thereafter, the old taxes, which had survived for about a century, were replaced by a set of ‘modern’ ones. The process was prompted by a law of delegation, which laid down the cornerstones of the tax reform to come: its principles – such as personality, progressivity, differentiation, simplification, and so on – were meant to steer the Country towards a new era of social justice and economic development. Things, regrettably, went otherwise.

With the important exception of Value Added Tax (VAT), whose implementation has always been dependent on European law, the guidelines of the 1970s Tax Reform were superseded in various ways, as summarized below. According to the law of delegation, the Italian tax jurisdiction had to stick to the personal progressive income tax (PIT): this notwithstanding, it soon reverted to the old schedular approach. In regard of corporate profits, the many attempts to deal with double taxation have been eventually dismissed. The idea of taxing income differently, whether earned or unearned, has been abandoned, or rather subverted, to the detriment of labour income. Tax returns of small businesses and self-employed are hardly likely to be controlled by the tax authority. Italy, there are few doubts about that, seems to be in desperate need of a new tax reform.

1 INTRODUCTION

After a long processing time Italy’s approved, in the early 1970s, a major reform (hereinafter, the Tax Reform) which shaped the tax system for the years to come, affecting both direct and indirect taxation. The Italian tax system, at the end of the 1960s, was mainly characterized by:

- a schedular income tax[1] modelled on the first English income tax, supplemented by a progressive surtax imposed on the overall taxpayer’s income,[2] and by a local family tax[3];
- a corporation tax that was a halfway house between a net wealth tax and a corporate income tax (CIT).[4] Indeed, its taxable base was twofold: a first tax rate applied to book equity, while a second one was imposed on income exceeding a threshold calculated as a percentage of the book equity;
- a cumulative multi-stage tax on sales which was applied, without any deduction of taxes previously paid by the supplier, to any kind of transaction.[5]

Such a system, according to a widespread opinion, was defective and needed modernization. Notably:

- the burden of indirect taxation was overwhelming, even as an effect of the many tax exemptions which reduced the taxable base[6];
- the income taxation had an eighteenth century flavour, being shaped as an ad rem tax system style, which lacked of significant personal features able to target the effective taxpayers’ ability;
- the general sales tax was distortive and non-neutral, determining a cascading effect due to the multi-stage application to any supply of goods and services, without deduction of taxes previously paid by the enterprises;
- on top of that, tax evasion was rampant.

Facing this situation, the Italian lawmaker appointed a Commission of experts, chaired by Professor Cesare Cosciani, to devise a comprehensive tax reform[7]: this led to the approval, in 1971, of a law of delegation[8] to steer the subsequent enactment of a bunch of legislative decrees that overhauled the Italian tax system.
In a nutshell, the reform was built on the following pillars:

- a personal progressive income tax (hereinafter, PIT), with a bracketed tax rate system applied to a taxable base formed by the taxpayer’s total income, regardless of its sources. With such a choice the Italian tax system got rid of the special taxes which, according to the previous schedular approach, were applied separately to each category of income;
- a CIT that replaced the previous hybrid tax on net wealth and excess profits;
- a surtax on capital income to enact the principle of differentiation;
- a value added tax shaped according to the European directives, in place of the previous cumulative multi-stage tax on sales.

In the next sections this author will try to deepen, with regard to the above-mentioned tax areas, the following points:

- what was the situation when the idea of a comprehensive tax reform matured in the 1960s;
- what were the choices that the Italian reformers were facing in light of the different viable alternatives;
- finally, what has been the legacy, as well as the shortcomings, of the Tax Reform, also with a glance at how the current Italian tax system is likely to evolve over the next few years.

2 The Evolution of Income Taxation in the Light of the Principles of Personality and Progressivity

As regards the taxation of income, the Italian legal system, at the end of the 1960s, consisted of four special taxes on lands, buildings, agriculture, plus a residual schedule encompassing labour, business and capital income.

Each of these taxes was levied at its own proportional rate, with the exception of business income, which was imposed at progressive rates. As a result, the Italian tax system was characterized by unequal treatment and the principle of horizontal equity was violated. Two different taxpayers, earning the same amount of income, would indeed be taxed differently dependent on the source of that income.

In addition, the presence of four separate direct taxes prevented a consistent exemption of basic income, which requires a personal tax on the taxpayer’s overall income.

As far as it concerns vertical equity, it is worth noting that, according to the Italian Constitution, progressivity must characterize the Italian tax system. That said, in the years leading up to Tax Reform, the progressivity was seemingly achieved, although in a non-transparent way, only by means of the higher tax rates applicable to capital income: based on statistical observations, capital incomes proved to be more concentrated among wealthier individuals.

Further, on top of the abovementioned four taxes, a progressive surtax, characterized by a continuous tax curve, was imposed on the individual’s aggregate income above an exempt threshold, while municipalities could enact a local family tax on households income, at progressive rates. This notwithstanding, the revenue was negligible, mainly due to the high tax allowances.

All those different taxes caused complexity, distortions, inequality and high compliance costs: they were therefore repealed and replaced by a single personal PIT, applied to the taxpayer’s overall income, with the exception of some financial incomes. Moreover, the new personal tax provided for the exemption of basic income, with a personal allowance granted to all taxpayers, regardless of the source of their income.

Such a choice was influenced by the findings of the Commission charged with studying the tax reform, whereby it advocated a comprehensive tax base and the need of overcoming the previous separate taxes on different types of income. Actually, income schedules were maintained within the new taxation system, but they
played a different role, instrumental to the assessment of the various incomes and the functioning of the new progressive single tax.

The categorization of incomes, in the reformed system, has the effect of delimiting the taxable base, insofar as a productive source was required, and of making it easier to assess incomes. Taxpayers’ income was classified into five schedules, namely: land and property income, capital income, labour income, business income and a fifth residual miscellaneous category, while many other kinds of income (such as some capital gains) remained untaxed. In this respect, the concept of legal income enshrined in the Italian PIT departs from the idea of comprehensive income as famously elaborated by Schanz, Haig and Simons: to be taxable, earnings shall fit into one of the legal schedules.

Furthermore, the categorization is needed to provide for differentiated rules for determining each type of income. Following to the introduction of a single personal PIT on individuals, income classification into different schedules is only relevant to determine the taxable base for each source of income. Thus, for instance, income is assumed on a cadastral basis for land and immovable property; with regard to capital and employment income, production costs are non-deductible; business and self-employment income are taxed on effective basis, although the deductibility of some costs is limited or standardized. Once the various types of income have been determined according to the rules provided for each category, they are grouped together to form the overall income, which is taxed at progressive rates.

In its earliest configuration, Italian PIT had thirty-two brackets and tax rates, ranging from 10 to 72%. However, notwithstanding the steep pattern of nominal tax rates, the progressivity on high-income earners remained mostly ineffective, because the highest marginal rates affected only few taxpayers. In a perhaps surprising way, then, the current Italian PIT, despite having lower marginal rates compared to those of 1974, is more redistributive and more progressive.

The introduction of the PIT has also had administrative fallout, insofar that it prompted a major effect on taxpayers’ compliance and the system of collection at the source.

It is worth noting that Italy, sticking to the English experience, had long since adopted taxation at source: businesses, companies and other legal entities were required, in filing their tax returns, to include also other taxpayers’ income and pay taxes which they then recovered by means of withholding. This way, recipients of taxable items of income – such as employees, shareholders, bondholders, and the like – were exempted from all tax obligations.

The inception of the personal progressive tax on overall income modified dramatically that landscape. As a first outcome, it changed the nature of withholding, which became provisional: in the new tax system the recipient was charged with the incumbent of reporting income taxed at source, and entitled to deduct, from his/her tax liability, the amount withheld. This led to a second result: a spike in the number of annual tax returns filed by individuals, which soared from 4 to 22 million.

The foregoing also led to an overhaul of collection methods. Notably, for about a century Italian taxes were levied by means of enrolment, with the necessary intervention of the tax authority. However, when the tax system became massive, it proved impossible to continue the old practice, as this would have led to paralysis. This was solved by broadening the concept of voluntary compliance: taxpayers were obliged to self-assess liabilities according to their tax return, and to pay it directly to the Treasury with the intermediation of a bank, without having to wait for demands of payment issued by tax authorities.

3 The comeback of the schedular approach and the perceived urgence of a new tax reform

According to the original intent, the new Italian PIT was meant to be applied to the taxpayer’s overall income, in order to avoid the flaws of the former schedular approach and the proliferation of differentiated regimes.
The Commission charged with preparing the guidelines for the Tax Reform was well aware of this conceptual constraint, whereby it stated that, in order to achieve an equitable, efficient and transparent progressiveness, it was necessary to incorporate the various income taxes into a single personal and progressive tax on the overall income.\[26\]

The need to apply progressive rates to the comprehensive income was in fact enshrined in the principles of the Tax Reform: notably, according to the law of delegation, the personal and progressive character of the tax was to be implemented by means of the ‘application of the tax to the total net income, however obtained’ and to the ‘inclusion in the taxable base of all the incomes of the taxpayer’,\[27\] while the subject matter of exemptions and substitute tax regimes was to be ‘regulated on the basis of the general criterion of limiting, to the greatest possible extent, exceptions to the principles of generality and progressiveness of taxation’.\[28\]

The aim was to avoid the risk of distorting the overall design of the Tax Reform: the application of progressive rates to a subset of the taxpayer’s income would have infringed the principles of universality and personality of the tax, as well as those of horizontal and vertical equity. From the outset, however, the lawmaker has moved in the opposite direction and the actual implementation of the PIT started to diverge from what had originally been established.

Certainly, capital incomes are almost everywhere not included in the comprehensive income tax base; instead, they are subject to more favourable regimes, very often at proportional rates. In the Italian law, however, this trend has gone much further: land income are determined in a facilitated manner or completely exempted; rent location can be optionally taxed at a low proportional rate; realized gains on long-held immovable property are legally excluded from the taxable base; interest, dividends and capital gains are taxed at proportional rates; self-employed and professionals may opt for a flat-rate tax regime which is eligible below a certain threshold in terms of annual revenues (65,000 euro), and so on.

Further, the exemption of basic income, which at first was provided for on universal basis, has subsequently been abandoned and superseded by special tax deductions whose amount, if any, is dependent on the source of the taxpayer’s income.\[29\]

The Italian income taxation, thereby, has relentlessly come back to its starting point, given the resurgence of the schedular approach that was in force prior to the Tax Reform. Not surprisingly, the need of a new comprehensive tax reform has entered the Italian government agenda.

4 THE PRINCIPLE OF DIFFERENTIATION AND THE SUPPOSEDLY HIGHER ABILITY-TO-PAY OF CAPITAL INCOMES

Italian tax system, from its inception, has quite constantly pursued the principle of differentiation, according to which unearned (capital) income has a supposedly greater ability-to-pay than earned (labour) income. Different techniques have been used, to this purpose, in the Italian law. At first, the differentiation was put into effect by reducing the taxable base on labour income, as compared to capital income: namely, only a fraction of the income earned by employees was subject to tax. At a later time, differentiation was enforced by providing for different tax rates to be applied to the schedules corresponding to the various types of income, with higher rates on capital and business income.

The Tax Reform kept going in applying the differentiation, although the lawmaker changed, once again, the method for implementing such a principle. In this regard, the Commission of experts charged with studying the matter advocated that, in order to take into account that capital income entails a greater taxable capacity than labour income, a wealth tax could be a suitable means.\[30\] The legislator shared the need to differentiate between earned and unearned income, although it dismissed the idea of a wealth tax and opted instead for a kind of surtax imposed on all income categories, other than employment income.\[31\]
The principle of differentiation, in the subsequent years, was abandoned, or at least it was no longer intentionally pursued. Following to a reform which took place in 1997, the surtax on capital incomes Imposta Locale sui Redditi (ILOR) was abolished and superseded by a regional business tax,[32] thus ending Italy’s long experience in differentiating the tax treatment of incomes.

Having said that, the differentiation now works, if anything, in the opposite direction. The Italian legal system, as aforementioned (section 3), is roughly inspired to a kind of imperfect dual income taxation, with the application of progressive rates on labour income, and proportional rates on many capital income, such as interests, dividends, capital gains, rentals, small businesses earnings, and so forth. As a result, the principles of horizontal equity and progressivity are seriously jeopardized.

5 THE TAXATION OF CORPORATE PROFITS: THE FIRST HYBRID TAX ON CAPITAL AND INCOME

For nearly a century, corporate profits were taxed under the income tax on moveable wealth, which was designed to affect all taxpayers, regardless of whether they were individuals or legal entities.

Compared to what happened in other countries, Italy was late in adopting a specific direct tax addressed to corporations. Approved by Law 6 August 1954, no. 603, the first corporate tax was meant mainly as a backstop, to prevent undistributed profits from avoiding the progressive surtax on individuals: in this case, indeed, an unequal treatment would have occurred between incorporated companies, on the one hand, and sole proprietors and partnerships, on the other hand.

According to the accompanying ministerial report to Law no. 603 of 1954, the rise in tax pressure and the growing progressivity have contributed to making it increasingly advantageous for economic operators to use the form of joint stock companies. Indeed, while sole proprietorships and partnerships were subject to the progressive surtax, the partners of joint stock companies were taxed at progressive rates only on dividends received, but not on retained earnings.[33]

The first Italian tax on corporations was a hybrid levy, being imposed on both wealth and income. The taxation on net wealth was meant as a substitute for those taxes that had affected, until then, stock tradings[34]; furthermore, the levy on net wealth worked as a sort of back-tax, to recover profits previously tax-exempt[35].

The taxation on profits above the threshold fixed at 6% of net book value, on the other hand, had the purpose of equalizing the regime of retained earnings with respect to individual entrepreneurs and partnerships, whose profits, as soon as produced, were (and still are) wholly subject to progressive rates. In addition, the combination of two taxable bases was intended to function as an anti-avoidance device: indeed, lowering the company’s net book value would have increased the share of taxable profits.

6 THE CIT PROVIDED FOR IN THE TAX REFORM. THE EVER-CHANGING APPROACH TO DOUBLE TAXATION OF DIVIDENDS

Faced with many criticisms raised by the hybrid corporate tax on capital and income,[36] the Italian lawmaker decided to modernize the system and introduced a CIT alongside the new PIT.

In the years leading up to the reform, a growing consensus was spreading on corporations as entities endowed with an autonomous ability to pay, distinct from their shareholders’ one. According to an even more radical view, some prominent scholars argued that corporations, to the extent that they enjoy special benefits from public services, have an increased taxable capacity and need to be additionally burdened: corporations, goes the argument, have an advantage over non-incorporated businesses, and should therefore be taxed more heavily. An autonomous tax on corporate income hinges, thereby, upon both the benefit principle and the ability to pay principle.[37]
Influenced by these opinions, and considering that corporations are legal entities distinct from their shareholders, the Italian lawmaker took a stance in favour of considering such entities as taxpayers with regard to business income they produce.

The introduction of the CIT, which was levied at a proportional rate, raised two intertwined issues. On the one side, in the light of the new PIT imposed at progressive rates, the taxation of business profits at corporate level had to be designed as a first layer, to be supplemented by the taxation of dividends in the hands of the shareholders. Otherwise, the corporation tax would turn into a device to circumvent progressivity.

On the other side, however, the taxation of dividends entails the issue of double taxation of corporate profits, which some influential academics straightforwardly dismissed on the basis of a supposedly higher ability to pay enshrined in corporate profits, that a reduced taxation of dividends would have undermined.[38]

Faced with such a problem, the Italian tax reformers chose, at first, to deny any relief to shareholders, thus considering income generated through corporations as deserving higher taxation. After a few years, however, the Italian law adopted the imputation system, providing shareholders with a tax credit on dividends cashed in, to be offset against PIT liability calculated including dividends in the taxable base.[39]

In this way, the two taxes were fully integrated, with the CIT playing the role of an advanced payment of the PIT. Thus, the idea of using the corporation tax as a discriminating tool, in order to target an increased ability to pay supposedly attributable to corporate profits (such a concept was backed, among others, by Prof. Cosciani), was abandoned.

However, granting shareholders a tax credit raised, in turn, the issue of a possible mismatch between the tax paid by corporations, and the amount of tax credit inherent to dividends distributed to the shareholders. In particular, when corporate taxable base is reduced by preferential or exemption rules, the tax credit on dividends exceeds the amount of corporate tax that has been (or will be) paid.

Now, such a situation might be framed in two different ways. According to a certain opinion, the mismatch triggers a distortion: since the tax credit on dividends has the aim of relieving double taxation, there would be no reason to consent a refund against taxes never paid by the corporation. From a different perspective, however, even in such event the tax credit would make it possible to pass on to the shareholders the exemptions attached to corporate income.[40]

This latter position initially prevailed, but was later overturned by the enactment of an equalization tax:[41] the distribution of exempted or subject to preferential rates profits triggered the equalization tax; as a result, the profits out of which dividends were paid would bear taxation at corporate level. Hence, the equalization tax had the effect of doing away with any corporate preferential treatment as soon as profits were distributed.

Such a system was restated in 1997.[42] Thereafter, the equivalence between the tax credit on dividends and the tax actually paid by the corporation was pursued in a different way: instead of through additional taxation upon dividends distribution, the tax credit was made dependent on the amount of corporate taxes recorded in special so-called ‘baskets’, which the distribution had the effect of depleting.

After some years, following to a reform that took place in 2003, Italy replaced the imputation system with a twofold method of taxing dividends cashed in by individuals: on the one hand, dividends referring to non-qualified shareholdings (namely, those representing up to 20% of the share capital) were imposed at source through a final withholding tax,[44] on the other hand, dividends inherent to qualified shareholdings (id est, those representing more than 20% of the share capital) were partially tax-exempt, with the taxable portion to be included in the shareholder’s tax return. Finally, the double regime of taxation of dividends was abandoned in favour of a unique final withholding tax of 26%, applied regardless of the size of the shareholding and the taxpayer’s total income.[45]

Now, considering that corporate rate is currently fixed at 24%, the overall burden faced by any shareholder is slightly higher than the highest PIT tax rate, which is currently set at 43%. This way Italy, although covertly and
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without a clear idea of tax design, has done away with the progressivity as regards dividends, and has reverted to the original intent of the 1970s Tax Reform (which for some years, as abovementioned, provided for a full double taxation of dividends). Nowadays, since Italian tax law has so far supposedly dismissed any endeavour of pursuing an integrated approach with regard to the taxation of corporate profits, the current taxation of dividends carries out a de facto discrimination. As far as low- or medium-income earners are concerned, indeed, they face a lighter tax burden when they cash in profits in the capacity of sole proprietors or members of a partnership, rather than in the guise of shareholders of a corporation.

7 INDIRECT TAXATION AND THE SWITCH-OVER FROM THE MULTI-STAGE CUMULATIVE TAX ON SALES TO THE VAT

As most of the Members States of European Community and with the exceptions of France, Italy applied, up to the 1960s, a cumulative multi-stage sales tax, which brought about cascading effects. Such a tax affected, with low tax rates, the full value of each transaction in any stage of the productive process, which made it impossible to gauge the amount of taxes embedded in the final price of goods.

Back then, such features were appreciated by many scholars. The tax was grafted on the price of the products, while its cumulative character rendered non-transparent the tax burden: its amount was higher than the nominal tax rate, thus resulting in a financial illusion, which at that time was regarded favourably.

Some scholars prioritized the cumulative multi-stage sales tax on the ground of the benefit principle: according to such opinion, the gross output represents a reliable measure of the public services received by the businesses, and therefore a suitable ground for taxation. Others opposed the need to move beyond the benefit principle as an equitable basis for taxation, to be replaced by the ability to pay principle, and the lack of a proportional relationship between gross product and the amount of public services enjoyed by the undertaking. Therefore, they privileged a single-stage tax, to be applied to sales to final consumers.

Indeed, the main problem of the Italian multi-stage tax on sales Imposta Generale sull’Entrata (IGE) was its failure in granting neutrality with regard to the undertaking’s organizational choice, since it put an extra burden on non-integrated businesses, fostering vertical integration. With regard to products having the same final price, the amount of tax paid depended on both the number of transactions and at what stage, within the production process, the value was created. Moreover, this raised problems with respect to the functioning of the destination principle in international transactions, given the lack of transparency and neutrality in the amount of tax to be refunded to exporters, as well as in the border adjustments for imported goods.

That being said, the Commission charged with studying the guidelines of a comprehensive tax reform was well aware of the many shortcomings of the Italian multi-stages tax on sales, which was reputed to be irreconcilable with the European Common Market. Therefore, the Commission proposed to move to a value added tax supplemented by a sales tax to be applied exclusively to sales made to final consumers.

With respect to the value added tax, the Commission had well perceived the benefits of the model, for instance in terms of equitable treatment of the different productive sectors or businesses, positive spillovers of bookkeeping, easiness in border adjustments, and so on.

At the same time, attention was drawn on critical issues and drawbacks of the French Taxe sur la Valeur Ajoutée (TVA), which in the 1960s was the benchmark in evaluating pros and cons of value added taxes, such as the treatment of instrumental goods, the distortions brought about by the many exemptions, the choice of the technical tool to operate the deduction.

The Commission’s proposal was peculiar. Notably, it suggested the enactment of a dual system: a value added tax to be applied up to the wholesale stage, which was expected to enhance the tax compliance, plus a retail sales tax on products and services supplied at final consumers, imposed at different tax rates in order to achieve redistributive goals.
Such a proposal was at first incorporated in the draft law of delegation, which provided for a value added tax to be applied up to the wholesale transactions, supplemented by a single-stage consumption tax, imposed with differentiated rates, on goods supplied to retailers or final consumers.\[^{52}\] In its final version, however, the law of delegation included in the scope of VAT any supply made by any undertaking, waiving the idea of a separate retail sales tax.\[^{53}\]

It is worth noting that the Commission chaired by Prof. Cosciani was fully aware of the risks of evasion entailed in a single-stage tax imposed on the final consumer, in light of the great number of retailers and the lack, for many of them, of reliable accounting records. As it will be seen in the next section, however, the Italian lawmaker neglected such a circumstance: it conceived an ill-designed system according to which the income had always to be ascertained on accounting basis, without taking into consideration that, for small businesses, keeping accounts does not grant truthfulness.

**8 THE ASSESSMENT OF BUSINESS PROFITS: EFFECTIVE VERSUS PRESumptIVE INCOME**

With regard to the taxation of business profits, Italy adopted, prior to the Tax Reform, a two-pronged approach. On the one hand, corporations were taxed on accounting basis, more precisely on the basis of the financial statement, the results of which were considered, in principle, to be reliable and true, unless the tax authority had provided qualified evidence of its falsity.

On the other hand, small businesses and self-employed were mainly taxed on a presumptive basis. Their tax returns had proved largely understated: to deal with such a lingering problem the Italian tax authority carried out assessments based on circumstantial evidence, with recourse to industry averages and outer signs of wealth, reminiscent of the old class taxes.\[^{54}\] On such premises tax assessments, unavoidably approximate, were settled through arrangements between taxpayers and tax officials; regrettably, such a situation would trigger a widespread corruption.

Faced with this problem, the Italian tax reformers made a choice that might be considered, with hindsight, a serious mistake.

Indeed, the truthfulness of accounting entries and financial statements depends, among other factors, on the size of the business, as had long been known.\[^{55}\] However, in order to cope with the widespread tax dodging carried out by micro-businesses, the Tax Reform extended the principle of ‘taxation on the basis of financial statements’ to any kind of undertaking, no matter how small.\[^{56}\] As a result, all businesses and professionals were obliged to keep accounting records and to determine their income on the basis of book entries to be shown to the tax authorities. Italian tax reformers neglected that financial statements and accounting records do not possess miraculous healing power, and that their truthfulness depends on elements like the size of the undertaking at stake, the sector in which it operates, the status of its customers, and so on.

Following to the Tax Reform, the two different methods of taxing big and small businesses, that had characterized the previous system, were overcome, since the law got rid of presumptive methods of assessment. The accounting records became, for all businesses, the basis of commensuration of taxes on income and value added, which could be disputed by the tax authorities only on the basis of direct evidence of specific concealments or violations. On the contrary, the use of presumptive evidence was limited and admitted only as an exception.\[^{57}\]

The Italian tax system resulting from the reform had been reshaped around the large undertaking, and under the illusion that by extending compulsory bookkeeping to the whole universe of businesses, no matter how small, the truthfulness of tax returns could be taken for granted. Unfortunately, the opposite occurred: a formally regular accounting ended up becoming an obstacle, to the advantage of ill-intentioned taxpayers, against presumptive assessments based on industry averages or other appraisals criteria.\[^{58}\]
It was only following to the enacting of turnover presumptions for each industry sector that the assessment of business profits on presumptive basis was founded on clear legal basis and made feasible. Later on, however, the Supreme Court laid down some strict rules concerning the taxpayer’s right to be heard, which had the effect of hindering income-tax assessment grounded on presumptive basis, until the legislator repealed the turnover presumptions, leaving unsolved an issue – the endemic mass-evasion of small businesses and self-employed taxpayers – which affects Italy since a long time.

9 CONCLUSION

What comes out from the above is that the principles of Italy’s 1970s Tax Reform have seemingly lost their appeal, as can be summarized in this final section:

— with regard to vertical equity, the Tax Reform had clearly opted for a personal staggered income tax with a steep nominal progressivity, under which the overall income (with some very limited exceptions) would be taxed. Things turned out otherwise: time and again, many exclusions have been introduced, with the result of eroding the taxable base subject to progressive rates. Thus, reverting to the schedular approach prior to the Tax Reform, the Italian legal system has departed from the guidelines laid down in Law of delegation no. 825 of 1971, whereby it provided for a progressive PIT on the taxpayer’s overall income, with as few exceptions as possible;

— as for horizontal equity, this should have been achieved by including any income in the single tax base, to be imposed at progressive rates. In addition, a selective surtax was meant to overburden only capital incomes, thus implementing the principle of differentiation. As a matter of fact, both of these provisions have been set apart, if not reversed. Many capital incomes are now imposed at proportional and relatively low withholding or substitute tax, while labour incomes are burdened with progressive rates. On the other hand, the surtax on capital income has long been repealed. The result is reverse discrimination, with labour income being taxed more heavily than many capital and business incomes;

— in the matter of taxation of corporate profits, since the inception of the Tax Reform the Italian legal system has changed many times. The original approach, namely the full double taxation of dividends according to the classical system, has been overturned in the subsequent years. At first, the classical system was superseded by the imputation system, later supplemented with an equalization tax at corporate level; then, Italy stuck to the exemption method; finally, the lawmaker has opted for a final withholding tax on any sort of dividends, on top of corporate tax, which brings about a discrimination of corporate profits. Hence, although in the absence of a clear tax design, the Italian legal system has seemingly reverted to the 1970s tax reformers’ original intent.

— as far as profits of small businesses and the self-employed are concerned, the Italian lawmaker leaned on a kind of presumption of truthfulness of bookkeeping, which was imposed on any undertaking, however small. As a consequence, tax assessments ceased to be conducted on a presumptive basis. However, the attempts to determine revenues on the basis of direct and analytical evidence failed, given that a formally regular accounting system hindered such determination. The lawmaker then changed direction, giving back to the tax administration the power of ascertaining small businesses’ gross receipts based on industry averages. Regrettably, even such endeavour turned out to be a failure, so that, at present, the long-lasting problem of how to ascertain self-employment income remains largely unsettled.

Footnotes

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1 IT: Imposta sui redditi della ricchezza mobile, Consolidated Act 24 Aug. 1877, no. 4021.

2 IT: Imposta complementare progressiva sul reddito, enacted with Royal Decree 30 Dec. 1923, no. 3062.

3 IT: Consolidated Local Finance Act, 14 Sept. 1931, no. 1175, Articles from 111 to 121.
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5 IT: *Imposta Generale sull’Entrata* (IGE), enacted with Law 19 June 1940, no. 762.

6 See G. Falsitta, *Lezioni sulla riforma tributaria* 12 et seq. (Cedam 1972): in the 1960s, Italy’s tax yield was mainly due to indirect taxes, as compared to the situation of other developed countries where direct taxes on income and wealth were predominant.

7 Whose findings were condensed in the report *Stato dei lavori della Commissione per lo studio della riforma tributaria* (Giuffrè 1964). For an appraisal of the elements of continuity and innovation of the proposals enshrined in such a report see G. Dallera, *Continuità e innovazioni nelle proposte di riforma tributaria*, in *Il progetto di riforma tributaria della Commissione Cosciani cinquant’anni dopo* 75 et seq. (B. Bises ed., Il Mulino 2014).


9 At first, the PIT was assessed at the household level, id est by pooling together the spouses’ income. The provision was struck down by the Constitutional Court (IT: Corte cost., 16 July 1976, no. 179), since the progressive rates had the effect of penalizing married individuals.

10 Falsitta, *supra* n. 6, at 9.


12 IT: Constitution, Art. 53, para. 2.


14 See A. Boidi, *Commento alla legge sulla imposta complementare progressiva sul reddito* 368 et seq. (Utet 1956).

15 See G. Copula, *L’imposta di famiglia* (Edizioni Agricole 1953). The accompanying report to the draft law of delegation, submitted to the Parliament the 1 July 1969, at 5 highlights the significant compliance costs and distortions brought about by the simultaneous application of the progressive surtax and the family tax on income.

16 See Botarelli, *supra* n. 13, at 8.

17 IT: Law no. 825 of 1971, Art. 2, and the subsequent IT: Presidential Decree 29 Sept. 1973, no. 597, enacting the PIT (*Imposta sul reddito delle persone fisiche*). The many goals of a personal progressive income tax had been underscored, among others, by Cosciani, *supra* n. 11, at 43 et seq.


19 The new Personal Income Tax (IRPEF) was enacted by Presidential Decree 29 Sept. 1973, no. 597.

20 Labour income was later split in two categories (employee and self-employment income).

21 This means, for instance, that inheritances, legacies and gifts, as well as accrued (non-realized) gains and imputed rental income, are outside the scope of PIT.

22 See on this point, the ministerial report accompanying the draft law of delegation presented to the Italian Chamber of Deputies on the 1 July 1969 (at 12).


See *Stato dei lavori*, supra n. 7, at 165 et seq. The deputy President of the Commission, in his academic findings, had previously neatly highlighted the point: according to Professor Cosciani’s opinion, progressive rates could be conceived only if applied to the taxpayer’s total income, whatever the sources of that income (Cosciani, *supra* n. 11, at 47).


On this issue see A. Fedele, *Ancora sulla nozione di capacità contributiva nella costituzione italiana e sui limiti costituzionali dell'imposizione*, in *L'evoluzione del sistema fiscale e il principio di capacità contributiva* 25 (C. Berliri & L. Perrone eds, Cedam 2014), who argues that the failure of the personality of the Italian PIT is confirmed by a substantial neutralization of the original, and already at that time very low, basic allowance, now replaced by a differentiated tax deduction aiming, rather, to the diversification of the incidence of the tax on income categories.

See *Stato dei lavori*, supra n. 7, at 203 et seq.

IT: *Imposta locale sui redditi* (ILOR), enacted with Presidential Decree 29 Sept. 1973, no. 599. In the subsequent years the Constitutional Court declared the unconstitutionality of the law whereby it included in the taxable base the self-employed income, despite not being capital-based (see IT: Constitutional Court, 26 Mar. 1980, no. 42).

IT: *Imposta regionale sulle attività produttive* (IRAP), enacted with Legislative Decree 15 Dec. 1997, no. 446.

See L. Napolitano, *La imposta sulle società* 27 et seq. (Giuffrè 1955); O. Poli, *Imposta sulle società* 3 et seq. (Cedam 1955).

Stock tradings were not subject to the registration tax, which ensured a favourable treatment compared to the transfer of a business concern owned by an individual. Therefore, an annual tax on the comprehensive value of capital shares was provided for in lieu of a transfer tax; the latter was then absorbed by the new corporation tax enacted in 1954, which affected the capital book value at a rate of 0.75%.


For an illustration see Napolitano, *supra* n. 33, at 26 et seq.


As reported by Visco, *supra* n. 35, at 156 et seq., Prof. Cosciani believed that corporations have an autonomous ability to pay taxes, distinct from that of the shareholders, and that dividends should be taxed through a provisional tax collected through withholding, at a tax rate to be established keeping into account the income class in which, most likely, dividends accrue. On these basis he criticized the proposal envisaged by the Study Committee for the Implementation of the Tax Reform (Comitato di studio per l’attuazione delle riforma tributaria), which took office in 1964 and suggested to assign shareholders a tax credit on dividends received, according to the imputation system. Such a solution, at first set aside, was later adopted in 1977 (see *infra* n. 39).


For a summary of the debate and the opposing positions taken, respectively, by Cesare Cosciani and Bruno Visentini, see Visco, *supra* n. 35, at 159 et seq.; Botarelli, *supra* n. 13.


More precisely, two types of ‘baskets’ were foreseen: a first type (‘A’ Basket) corresponded to corporate taxes actually paid, while virtual corporate taxes were stored in ‘B’ Basket, in the cases provided for by the law. The tax credit of type ‘B’ could not be refunded, as opposed to type ‘A’, and was therefore ‘limited’ in its use.

The tax rate was fixed, regardless of the total income of the taxpayer, firstly at 12.5%, then at 20%, and finally at 26%, which is the current tax rate.

On the topic see G. Stammati, *L’imposta generale sull’entrata* (Utet 1956). Alongside the general multi-stage tax, some special single-stage taxes (excise duties) were also applied.

In favour of a gross receipts tax see e.g., M. Pugliese, *Un’imposta sul reddito lordo delle imprese speculative e suoi effetti*, 73(10) Giornale degli Economisti e Rivista di Statistica 677 et seq. (1933); P. Studenski, *Toward a Theory of Business Taxation*, 48 J. Pol. Econ. 621 et seq. (1940).


See D. Stevanato, *Forme del tributo nell’era industriale. Ascesa dell’imposta sul reddito e segni di un declino* 253 et seq. (Giappichelli 2021).

See e.g., E. Cossa, *La teoria dell’imposta* 120 (Hoepli 1902), who noted that even when law imposes bookkeeping duties to sole proprietors or family-based companies, these do not always report income accurately, as it is determined by the assets and liabilities that actually exist.

See on this point, the report of the VI Permanent Commission Finance and Treasury on the draft law of delegation concerning the tax reform, *supra* n. 52, at 24: ‘according to the law of delegation, indeed, all businesses are obliged to keep accounting records: as a consequence, those businesses become automatically taxable on the basis of financial statements. Therefore, in this respect, there is no chance to split undertakings in two groups: individuals and legal entities’.

See the report of the VI Permanent Commission Finance and Treasury on the draft law of delegation concerning the tax reform, *supra* n. 52, at 67: ‘the distinguished feature of presumptive tax assessment must be the exceptional nature of the tool; that means that tax officials will rely on it only after having tried all the ordinary ways provided for by the law (tax assessment on analytical basis) in order to determine the right taxable base’.


Although property incomes were determined on cadastral values not updated and not representative of the actual market values.