



# ITALY

July 2016

## TECHNICAL ASSISTANCE REPORT—ENHANCING GOVERNANCE AND EFFECTIVENESS OF THE FISCAL AGENCIES

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Fiscal Affairs Department



## **ITALY**

**ENHANCING GOVERNANCE AND EFFECTIVENESS OF THE FISCAL AGENCIES**

**Juan Toro, Thomas Story, Dave Hartnett, Barrie Russell, and  
Frank Van-Driessche**

**December 2015**



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**GLOSSARY**

AdeE	<i>Agenzia delle Entrate</i> , Italian Tax Administration
AdeD	<i>Agenzia delle Dogane</i> , Italian Customs Administration
CASE	Center for Social and Economic Research
CIT	Corporate income tax
CPB	The Netherlands' Bureau for Economic Policy Analysis
EC	European Commission
FAD	Fiscal Affairs Department
GF	<i>Guardia di Finanza</i> , Financial Police
HIIs	High income individuals
HR	Human resources
HWI	High wealth individuals
INPS	<i>Istituto Nazionale Previdenza Sociale</i> , Social Security Contribution Agency
IT	Information technology
MEF	Ministry of Economy and Finance
MOF	Ministry of Finance
MOU	Memorandum of understanding
MTIC	Missing trader intra-community VAT fraud
LBT	Large Business Taxpayer
OECD	Organization for Economic Cooperation and Development
PD	Provincial directorates
PIT	Personal income tax
SOSE	<i>Soluzioni per il Sistema Economico S.p.A.</i>
SOGEI	<i>Società Generale d'Informatica S.p.A.</i>
SSC	Social Security Contributions
TA	Technical assistance
VAT	Value-added tax
VIES	VAT Information Exchange System

## PREFACE

In response to a request from Mr. Pier Carlo Padoan, Minister of Economy and Finance, a Fiscal Affairs Department (FAD) technical assistance mission visited Rome during the period October 14–28, 2015 to advise the Ministry of Economy and Finance (MEF) on selected areas of the revenue administration system. The mission was led by Mr. Juan Toro (Assistant Director, FAD) and comprised Messrs. Thomas Story (Deputy Division chief, FAD) and Dave Hartnett, Barrie Russell, and Frank Van-Driessche (FAD external experts).

The main purpose of the mission was to examine organization, governance and operational performance of the tax administration (*Agenzia delle Entrate*); as well as the tax administration functions of related agencies—collection of tax debts performed by Equitalia, and audit and tax investigation conducted by the *Guardia di Finanza* (Financial Police). The mission also examined governance issues in customs administration (*Agenzia delle Dogane*).

Meetings were held with the Minister of Economy and Finance, Mr. Pier Carlo Padoan; the Director General of Finance, Ms. Fabrizia Lapecorella; the Directors of the *Agenzia delle Entrate*, Ms. Rosella Orlandi, and *Agenzia delle Dogane*, Mr. Giuseppe Peleggi; the Vice President of the *Istituto Nazionale Previdenza Sociale*, Ms. Gabriella de Michele; Professor Tommaso Nannicini from the Presidency of the Council of Ministers; General Stefano Screpanti from the *Guardia di Finanza*; executives from *SOGEL (Società Generale d'Informatica S.p.A.)*, and executives and senior staff from the management team of the above entities. The mission also visited a provincial office in Rome and held meetings with associations from the private sector.

This report, which has been reviewed by IMF headquarters and incorporates comments from the authorities, represents the final version of the aide-mémoire that was submitted to the authorities at the end of the mission. It sets out the findings and recommendations of the mission and consists of an Executive Summary and the following three sections: (I) Reforms in Tax and Customs Administrations; (II) Autonomy of Tax And Customs Administrations; and (III) Improving the Performance of the Tax System.

The mission expresses its gratitude for the outstanding support and cooperation received from the staff of the MEF and the agencies during its stay in Rome.

## EXECUTIVE SUMMARY

**This report advises on priorities to enhance the governance and effectiveness of the fiscal agencies with a focus on the tax administration.** It addresses selected issues concerning (1) the tax and customs agencies' institutional arrangements, including their autonomy from and accountability to the MEF; and (2) the tax administration system with a focus on identifying opportunities to improve its effectiveness—the review of fiscal agencies' operations focused on the tax administration system.

**The tax administration system comprises multiple entities; this demands tight coordination and imposes additional costs.** The *Agenzia delle Entrate* (AdeE) is the tax administration agency and administers personal income tax (PIT), corporate income tax (CIT), and value-added tax (VAT). It also administers other indirect taxes, the regional business tax, and regional and municipal PITs. Other entities perform key tax administration functions—collection of tax debts by *Equitalia*, and audit and tax fraud investigation by *Guardia di Finanza* (GF, Financial Police). Excises are administered by the *Agenzia delle Dogane* (AdeD), the customs administration, and Social Security Contributions (SSC) by the *Istituto Nazionale Previdenza Sociale* (INPS, the SSC agency). *SOGEI*, an entity reporting to the MEF, provides the information technology (IT) support to all. *Solutions to the Economic System Spa* (SOSE), a company owned and control mainly by the MEF, supports fiscal intelligence work.

**Tax revenues are high but collection performance in the main taxes is mixed; effectiveness in collecting VAT is low.** There is a strong reliance on withholding from payments on labor. The VAT gap has decreased in the past few years; however, its 30 percent rate is among the highest in the EU, VAT efficiency is the lowest in the EU, and administration of VAT is weak.

### ***Improving autonomy and governance of the fiscal agencies***

**From 2001, tax and customs administrations were each granted agency status within the MEF; this enabled gains in modernization and effectiveness.** This change was part of a broad reorganization of the public administration (Law 300/1999), which established agencies within ministries. This new status provided greater administrative and operational autonomy to the tax and customs agencies; coupled with a stronger accountability to the MEF. In this new governance framework, the agencies have been modernizing in several areas: intensifying the use of IT to support compliance; broadening services provided; enhancing the focus on the largest taxpayers to safeguard tax revenues; and introducing risk analysis in their operations. See Section I.C.

**However, autonomy has since been weakened and needs to be restored.** Subsequent legal changes limited the autonomy of the fiscal agencies in several respects; Section I.B describes this trend. Section II assesses conditions for autonomy, concluding that the AdeE and AdeD do not meet recommended minimum requirements. In particular, the AdeE compared unfavorably against other tax agencies in Europe and in the Organization for Economic Cooperation and

Development (OECD), where sustained improvements in tax administration effectiveness are due in part to greater autonomy. Restoring it will be important if new approaches to taxpayer compliance that the government is pursuing (e.g., cooperative compliance), are to be well implemented. These approaches rely upon ex-ante actions to promote voluntary compliance, not just ex-post enforcement. Section II.D advises on measures to secure fiscal agencies' autonomy.

**The agencies' accountability framework to the MEF is very detailed and should be more strategic.** The process of defining the three-year agencies/MEF agreements (conventions) is characterized by a top-down and operational bias—the conventions have become the agencies' annual operational plans. The agencies have not been empowered to develop their own medium-term strategic plan. This delegation is needed in order to demand from the agencies the identification, planning, and implementation of medium-term major initiatives to improve effectiveness and collection performance. Section I.D briefly discusses reform priorities in tax administration and Section II and III provides detailed advice. Below is a summary of them.

***Opportunities for breakthrough improvements in performance of the tax system***

**A more comprehensive approach to manage compliance risks.** The input/output bias of operational planning leads to weak approaches to managing taxpayer compliance and risks. Major compliance risks—e.g., high-wealth individuals (HWI)—are not yet well addressed via effective compliance plans. A holistic approach to managing risks to the tax system is needed, including targeted compliance strategies. Section III.A advises on formulating this approach.

**A redesign of VAT management.** VAT return filing, payment, and reporting arrangements severely restrict the control of this tax—and indirectly other taxes. The absence of periodic VAT returns is a major flaw; VAT is a transactional tax, close monitoring of its self-assessment must be done in a timely manner. Relying only on payment information is insufficient. It makes the annual process more cumbersome, and delays detecting and addressing compliance problems. Section III.C advises on the approach to redesigning this system.

**A significant strengthening of debt collection.** The accumulation of tax debts is alarming; structural issues need to be addressed urgently. The lag in identifying VAT liabilities, due to a weak VAT return filing system, contributes to poor collection rates. The split and duplication of audit and investigations lead to uncollectable assessments. The overly generous installment schemes, limitations in power to recover tax debts, and the lack of effective write off arrangements continue to exacerbate the debt problem. Section III.D addresses these issues.

**A consolidation of audit and investigation functions into the AdeE.** Fragmentation of core tax administration functions across agencies hampers effectiveness. The most serious problem is the duplication of audit and tax investigation effort across the AdeE and GF; where there can be simultaneous actions. Section III.E recommends a reform strategy.

**Opportunities for more simplification should be investigated.** As an example, in declaring PIT and SSC withholding from employees, employers face parallel return filing and payment processes to the AdeE and INPS, despite the tax bases being harmonized. Section III.F discusses this issue.

**Sustained implementation of reform priorities will be essential to achieve improvements in the medium to long term.** These reforms have to be undertaken as a coherent package that will demand changes in legal frameworks as well as in administration practices, which will take time to materialize. Substantive gains in tax administration effectiveness would be enabled in the medium to long term, after a steady implementation of these reforms. Box 1 summarizes the mission's main recommendations.

### **Box 1. Summary of Report's Key Recommendations**

#### **Improving governance of the fiscal agencies**

- **Restore autonomy to fiscal agencies by:**
  - Amendments to law with respect to recruitment and promotion authority and the ability to provide a specific grading structure.
  - Adopting a fixed-term appointment for the director of AdeE and AdeD that is unrelated to the political cycle.
- **Enhance strategic management at the agencies by:**
  - Empowering the agencies in building their five-year institutional visions.
  - Revising the ministry supervision of the agencies, in particular the conventions, to achieve a more strategic approach; incorporate monitoring against strategic goals and apply higher level indicators appropriate to measurement of organizational outcomes.

#### **Opportunities for breakthrough improvements in performance of the tax system**

- **Strengthen management of compliance risks by:**
  - Adopting a more holistic approach to mitigating compliance risks.
  - Consolidating risk management and case selection function of the AdeE at the regional level.
- **Improve tax revenue performance of key segments by:**
  - Establishing a dedicated unit to manage compliance by HWI.
  - Undertaking industry-based compliance improvement projects in high risk sectors.
- **Redesign VAT compliance management by:**
  - Introducing monthly and quarterly returns and reducing information requirements.
  - Redesigning filing and payment arrangements with a view to early collection of taxes.
- **Take concrete actions to address the root causes of the accumulation of tax debts by:**
  - Bringing instalment arrangements in line with international trends
  - Adopting continuous write-off practices, and removing extended 'no-action' periods.
- **Increase the effectiveness of the audit and tax fraud investigation functions by:**
  - Implementing a staged approach to moving full responsibility for tax audit and investigation to the AdeE.
- **Simplify taxpayer obligations by:**
  - Adopting a common registration, filing and payment platform for SSC and PIT and common approaches to compliance management.

## I. REFORMS IN TAX AND CUSTOMS ADMINISTRATIONS

### A. Collection Performance and Revenue Administration Organization

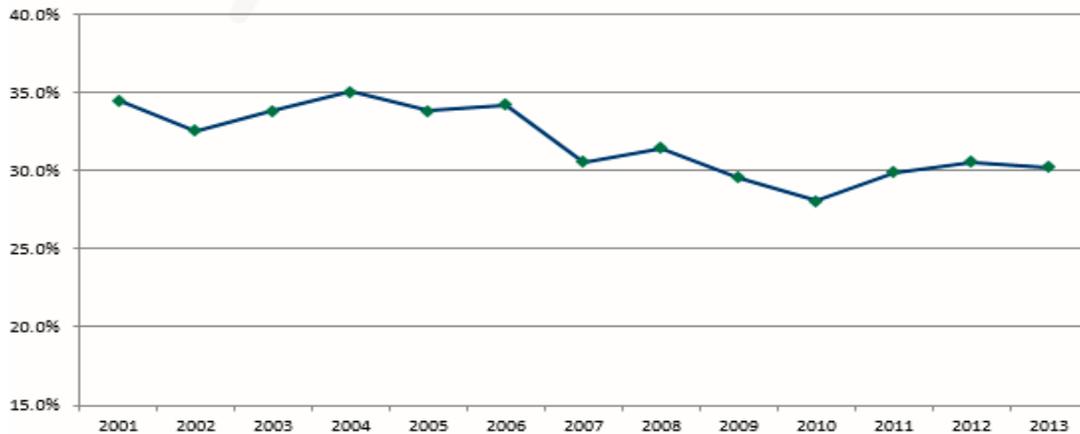
1. **Tax revenues in percentage of GDP are high and have been increasing in the past years** (Table 1). PIT and SSC are the more significant sources of revenue, accounting for 25 points of GDP in 2014, approximately 58 percent of total revenue. PIT is the main source of direct taxation—80 percent of the total. Thus, a significant part of total collection comes from the labor market via withholding on employees; while compliance by self-employed individuals is low. On indirect taxation, VAT is the main source, accounting for 40 percent of the total, excises represents the other important source of indirect taxation. As illustrated in Appendix 1 Figure 5, total revenue (with or without SSC) is well above the EU average.

**Table 1. Revenue in Percentage of GDP, 2005–14**

Row Labels	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Direct taxes	12.9	13.7	14.5	14.7	14.9	14.3	14.2	14.9	15.2	14.7
PIT	10.0	10.4	10.9	11.3	11.3	11.3	11.1	11.7	11.8	11.8
CIT	2.2	2.7	3.0	2.8	2.2	2.3	2.2	2.3	2.5	2.2
Capital gains and other income taxes	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.3
Property taxes	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5
Capital taxes	0.1	0.0	0.0	0.0	0.8	0.2	0.4	0.1	0.3	0.1
Indirect taxes	13.9	14.5	14.3	13.5	13.4	13.9	14.1	15.2	14.8	15.2
Taxes on production	3.3	3.4	3.5	3.1	2.9	2.9	2.9	3.8	3.5	3.4
VAT	5.7	6.0	5.9	5.7	5.5	6.1	6.0	5.9	5.8	6.0
Excise taxes	3.0	3.0	2.8	2.7	2.9	2.9	3.2	3.6	3.5	3.6
Stamp taxes	0.8	1.0	1.0	0.9	0.9	0.9	0.8	0.8	0.9	0.9
Other taxes on products and services	1.1	1.1	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.3
Customs duties	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social security contributions	12.2	11.9	12.6	13.0	13.4	13.3	13.2	13.3	13.3	13.3
<b>Grand Total</b>	<b>39.0</b>	<b>40.1</b>	<b>41.4</b>	<b>41.2</b>	<b>41.7</b>	<b>41.5</b>	<b>41.5</b>	<b>43.4</b>	<b>43.3</b>	<b>43.3</b>

Source: Prepared by the mission based on IMF data.

2. **Despite this high level of tax revenue, the performance in main taxes is mixed, and low in the case of VAT.** As illustrated in Appendix 1 Figure 3, VAT compared poorly with the revenue trends of EU average. VAT evasion and VAT efficiency also compared unfavorably, with Italy having the lowest VAT efficiency and one of the highest VAT evasion rates—see Appendix 1, Figures 5 and 6. According to the AdeE estimates, an important reduction in VAT gap was achieved before the financial crisis, from 35 to around 28 percent (Figure 1). However, during the crisis increased again to 30 percent that has persisted at that level. The AdeE VAT evasion rates are consistent with those published by the EC in the 2015 Center for Social and Economic Research (CASE) report; see Figure 6 in Appendix 1.

**Figure 1. Value-Added Tax Gap Estimate from Agenzia delle Entrate, 2001–13**

3. **Institutional arrangements to administer the revenue system are complex.** Seven entities have significant roles in administration functions, reflecting a highly inter-dependent revenue administration system. The AdeE is the tax administration agency and administers PIT, CIT, and VAT. But, other separate entities perform key tax administration functions—collection of tax debts by *Equitalia*, and audit and tax fraud investigation by the GF. Excises are administered by the AdeD, the customs administration, and SSC by the INPS. SOGEI, an entity reporting to the MEF, provides the IT support to all. SOSE, a company owned and control mainly by the MEF, supports fiscal intelligence work.

4. **The tax and customs administrations have faced significant institutional changes since early 2000.** The next subsections analyse this evolution, described key reforms introduced, and identified future reform priorities to enable greater effectiveness and enhance collection performance.

### B. Autonomy in the Fiscal Agencies

5. **Law 300 of 1999 established the AdeE and attributed to it most tax functions not already assigned to other agencies.** The AdeE also became responsible for central government taxes and some local taxes, which had previously been the responsibility of the Department of Revenue of the Ministry of Finance (MOF). In summary, this meant the agency was established as an autonomous body authorized to perform services in connection with administration, collection and determining liability of direct taxes and VAT. The AdeE's remit was described as pursuing the maximum level of fulfilment of tax obligations by taxpayers through the provision of assistance to them or through direct action to counter failures to pay or tax evasion. The AdeE came into operation on January 1, 2001. The AdeE took responsibility for the Land Registry, for cartographic services, and Real Estate Publicity in a merger that took place in 2012.

6. **Law 300 of 1999 also established the AdeD as an autonomous body to carry out services related to the administration, collection and litigation of customs and excise duties working in close cooperation with bodies of the EU.** The AdeD also began to operate from January 1, 2001. In late 2012 the Monopolies Agency was merged with the AdeD.

7. **A model of “principal-agent” was adopted.** This was to provide an organizational separation between the agencies and the MEF; the latter being responsible for policy-making and the agencies for delivering policy outcomes and managing tax and duties operations.

8. **The model was intended to give significant responsibility and accountability to the director of each agency.** This was in order to counter a slow pace of change in the previous Department of Revenue in the MOF, bring clarity to roles and responsibilities, remove some of the constraints of rigid public accountancy rules, and promote organizational performance. The agencies were also intended to:

- have more autonomy in the organization of their offices and be able to take strategic and operational decisions based on the results they achieved;
- have more autonomy in the management of human resources (HR) processes and personnel issues aimed at changing selection criteria and improving skills in the fight against tax evasion;
- modernise administrative machinery by reorganizing tax collection to reduce operating costs and improve voluntary compliance; and
- increase momentum in tax collection by making it transparent and helping taxpayers thereby ensuring the fairness of the tax system.

9. **The design of the agencies also gave the Minister of Finance a significant role in relation to their governance.** The key activities of the Minister and MEF involve:

- the preparation of an annual Guidance Act setting out the key fiscal policies that the agencies have to deliver each year;
- negotiation with the agencies of the three-year Convention (updated annually) that amounts to a principal-agent contract between the MEF and each of the agencies setting out the activities to be delivered and the relationship with the MEF;
- monitoring and verification of the outcomes achieved by the agencies as against those planned; and
- a supervisory function to ensure that the agencies are delivering transparency, impartiality, and fairness in their application of tax rules.

10. **The Convention between the Minister and the agencies is the way in which strategies to implement the government’s fiscal policies are translated into operational objectives.** This contractual document of more than 60 pages for each agency is the subject of top down negotiation by the MEF and bottom up negotiation by the agencies. It is very different from the sort of annual “remit” letter that finance ministers in some countries send to heads of tax administrations. Those letters, which may be published, usually identify four–six significant issues of wide importance and the progress on them expected to be achieved over the coming 12 months. The Convention is described at Box 2.

#### **Box 2. Features of the Convention**

The Convention sets out the following:

- The services and objectives to be achieved.
- General guidelines on the management and policy constraints to be respected.
- Strategies for improvement.
- Available resources.
- Indicators and benchmarks by which the performance of the Agencies is to be measured.
- Procedures for verifying performance results.
- Steps to ensure that the MEF has access to internal management information of the agencies.
- The approaches needed to oversee the agencies in terms of transparency, impartiality, and fairness.

11. **Within three years of the new agencies commencing, the first steps to weaken the new governance framework were taken.** A series of measures have followed over the next 12 years that are of a similar impact, and perhaps reflect uneven political support for autonomous fiscal agencies. Box 3 below sets out a chronology of the major challenges to fiscal agency autonomy.

### **C. Modernization and Reorganization**

12. **This section briefly outlines reform steps taken with respect to revenue administration over the past decade.** Management of Italy’s tax system has undertaken significant changes since the inception of the tax agencies in 2001, and many reforms are far-reaching. While there have been substantial reforms to both tax *and* customs administration, the mission’s terms of reference, have in the time available, obliged it to focus on the reforms to AdeE. Without diminishing the extent of substantial reform successes in the AdeD, the discussion below is primarily describing the tax administration.

### **Box 3. Challenges to Autonomy**

**2002:** Law 145 includes the fiscal agencies within the coverage of public administrations that are to be subject to law 165/2001. Budget law provides for restrictions on recruitment and partial replacement of separated staff.

**2003:** Legislative Decree 173 changed the approval mechanism for the most important decisions of the Agencies. These decisions had been made by the Management Committee but became subject to an approval mechanism operated by the Minister. The same Decree reduced the term of the Agency directors from five years to three years.

**2004:** Presidential Decree 272 establishes rules for the recruitment of directors in fiscal agencies.

**2006:** Legislative Decree 262 introduced the spoils system which had the effect of removing directors of the Agencies 90 days after a vote of confidence in the Government thus linking directors' tenure in office to the political cycle.

**2008:** Law 112 introduces detailed rules for human resource management, procurement, and energy consumption and cuts to head-counts within the fiscal agencies.

**2009:** Legislative Decree 150 introduced four areas of collective bargaining across the public sector thereby removing the independent collective bargaining power of AdeD and AdeE. Complex and rigid rules covering personnel evaluation, compensation incentives, training, and promotion in fiscal agencies are imposed.

**2015:**

- An adverse ruling by the Constitutional Court prohibits Agencies' from making provisional management appointments of functionaries pending the outcome of general competitions; this follows a series of complex rulings by lower courts to block application of rules specific to fiscal agencies on recruitment procedures.
- Law 157 (implementing enabling Law 24 of 2014) redefines the mission of the fiscal agencies to improve relations with taxpayers and reduce agencies' management headcounts by 10 percent.
- A draft law for 2016 proposes horizontal cuts to information technology expenditures in the fiscal agencies.
- A proposal for civil service reforms raises concerns that supervision of the fiscal agencies will be vested within the Presidential administration.

### **Office integration, reorganization, and merger**

13. **AdeE has undertaken continuous restructuring and consolidation.** Between 1997 and 2002, 384 local offices were established with a sub-provincial competence. These provided a country-wide presence and local offices, originally built around tax types, and were progressively integrated to provide functional support *across* the major taxes.

14. **AdeE moved to consolidate local offices into 108 provincial centers between 2009 and 2011.** This was in recognition that dispersal of technical skills and professionalism created problems of 'critical mass' in the more complex administrative areas. In the largest metropolitan

centers, there are multiple provincial directorates—three in Rome and two in each of Milan, Turin, and Naples.

15. **The provincial directorates (PDs) provide full support across all core functions of the tax administration.** PDs are divided into control and legal offices and territorial (satellite) offices. The PDs exercise a “provincial competence” for taxpayer assessment.<sup>1</sup> Regional directorates supervise the PDs. Together with local territorial offices, they provide registration, filing, tax audit and assessment, dispute resolution and advisory services. The AdeE office network now consists of 323 territorial offices, in addition to the 108 provincial directorates for all of Italy. This represents a substantial physical presence and with the continued roll-out of e-services for taxpayers (see below), further streamlining of the network looks feasible.

16. **Office mergers of the Land Registry with AdeE took place in 2012.** The Autonomous Administration of State Monopolies also merged with the customs administration as part of a government wide spending review. The mergers were difficult reforms—100 land offices were added to the network of the AdeE. Another three “operative centers” provide national automated processing facilities and there are seven multi-channel assistance centers (see below).

### **Taxpayer segmentation**

17. **Alongside the provincial reform, AdeE adopted national approaches for further segmentation of the taxpayer base.** The large business taxpayer segment (for businesses with total turnover greater than €100 million) was reorganized and attached to the regional directorates from 2009. The large taxpayer administration has developed advanced risk assessment and intelligence gathering platforms (see in Section III the discussion on compliance improvement opportunities). Control offices at provincial level were organized around three segments: (i) medium taxpayers (turnover between €5 Million and €100 million); (ii) the small business and professional sector; and (iii) individual taxpayers and the not-for-profit sector. Based upon OECD prescriptions, a cooperative compliance program for the largest businesses is to be phased in from 2016.

### **Multi-channel initiatives**

18. **AdeE adopted a charter of service in 2004.** The charter commits the AdeE to principles of confidence, cooperation and transparency and performance within specific service standards. The tax administration conducts customer satisfaction surveys and reports comprehensively each year on achievement of these standards. In general, levels of customer satisfaction with the new

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<sup>1</sup> Taxpayers, other than large businesses, are attached to the PD of their domicile and the assessment is issued from the office of competence. Regional directorates supervise the PDs.

suite of electronic services is high in 2014, complementing the positive perception of taxpayers with regards to services provided at operational offices.<sup>2</sup>

19. **A full range of modern taxpayer assistance facilities were rolled out.** The seven multi-channel assistance centers provide in-bound call center services to the general community, support to professionals and an electronic (Web mail, email, and short message service) advisory service. Extensive internet based services that include the capacity to file declarations, register deeds and access cadastral data, confirm VAT and taxpayer registry information, make payments, and receive statements of account, are available and well utilized. Italy requires 100 percent of tax declarations to be filed electronically for the four major taxes—PIT, CIT, VAT, and pay-as-you-earn withholding.

20. **Prefilled personal income tax returns were introduced from 2015.** This facility is incorporating information on 20 million individuals. Around 70 percent of taxpayers have made use, directly or indirectly, of the prefilled information in its first year and the data for prefilling is to be expanded next year

#### **D. Priorities of Tax Administration Reform**

21. **As previously highlighted, the AdeE has carried out several reforms; however, risks to collection performance are still widespread.** VAT evasion remains high and similar compliance behavior occurs in other domestic segments. Taxpayers operating in the global economy are also challenging the AdeE's ability to secure their taxation. Tax arrears have reached a worrying level, and administration systems contribute to an unmanageable accumulation. In the past, challenging situations have led to inappropriate responses—e.g., recurrent amnesties. These responses sent the wrong signals for developing a voluntary compliance culture, and seriously hamper the pursuit of greater tax administration effectiveness.

22. **Enhancing tax administration effectiveness to boost collection performance in the medium term requires a major reform effort; incremental improvements will have limited impact.** This is not the sole responsibility of the AdeE. Creating a fairer tax system and reducing the cost of compliance should be a national objective. However, the AdeE has to play a key role in identifying and leading the implementation of breakthrough improvements to promote voluntary compliance, deter noncompliance, and increase the performance of the tax system.

23. **This challenging environment demands a focus on key initiatives.** Tax administrations that have faced challenging scenarios have focused their strategic plans on a small number of critical major improvements. Clear strategic goals guide resource allocation and organizational effort. To give the appropriate priority and visibility, these key initiatives need to

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<sup>2</sup> See 2014 *Agenzia delle Entrate*: Annual Report, 2014.

be championed and monitored by senior managers.<sup>3</sup> Other initiatives are normally included in operational plans to strengthen continuity of operations and are monitored accordingly. Organizations making significant strategic shifts in the way they do business often establish a *change management capability* which ensures that the right level of resources and focus are applied to key reform initiatives.

24. **The mission identified structural reforms to address the major operational weaknesses and pursue the above goals.** Restoring the autonomy of fiscal agencies—discussed at length in Section II—is a key reform; solving the appointment of managers is also a must. Section III discusses in detail serious weaknesses in key operational areas and recommends major reform priorities, namely to:

- strengthen management of compliance risks;
- improve tax revenue performance of key segments;
- redesign VAT compliance management;
- take concrete actions to address the root causes of the accumulation of tax debts;
- increase the effectiveness of the audit and tax fraud investigation functions; and
- simplify taxpayer obligations.

25. **Major initiatives should form an integral part of a medium-term vision of the future tax administration, and should be implemented as a package.** As discussed in Section II.C, the strategic planning responsibilities have not been devolved to the fiscal agencies. The planning process has become more tactical and the agencies plans in the conventions have become annual operational plans. As recommended in that section, the need to empower the agencies in building their five-year institutional visions is crucial. The AdeE needs to develop its medium-term strategic plan. Sections II and III provide details on reform priorities to incorporate in such a strategic plan. These reforms would need to be undertaken as a coherent package but would take time to deliver noticeable changes in tax administration and would need to be supported by a sustained implementation effort. As these reforms will demand changes in legal frameworks, an early identification of the legal requirements is advisable to ensure timely adjustments and the political support that would be needed for the passage of the necessary legislation.

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<sup>3</sup> The AdeE faces a major challenge on this front; adverse court decisions on managerial appointments have weakened severely the AdeE management. As advised in Section II, this challenge requires urgent attention.

## II. AUTONOMY OF TAX AND CUSTOMS ADMINISTRATIONS

### A. Governance Reform Trends

26. **Governance structures have become increasingly important in the public sector over the last 20 years.** Governments are constantly searching for ways to improve results in service delivery and in general operational areas. Part of the focus is on public organizations having clearly defined legal authorities and powers, and flexibilities to address management problems. Responsibility, authority, accountability, and transparency for government agencies have become major themes.

27. **Governance refers to an overall legal framework and mandate in which the administrations operate.** Governance is assessed by looking at such features as independence and autonomy, reporting relationships, oversight mechanisms, levels of transparency, and frameworks for integrity and risk management. The basic rationale is that strengthening these areas leads to better performance by removing impediments to effective and efficient management while maintaining appropriate accountability. As described in Section I.B, Italy moved to adopt new governance standards for its tax and customs agencies from 2001. This change also reflected advice from FAD in the late 1990's. As described in Box 3, various modifications to the governance framework followed the 2001 reform.

28. **An effective governance framework for AdeE and AdeD requires a clear mandate for each body and an adequate level of autonomy.** Autonomy has a broad meaning but it is best described as the degree to which an agency or department is able to operate independently, in terms of legal form and status, funding and budget, management of financial and human resources, and administrative practices.

29. **The mandate for the fiscal agencies needs to be unequivocal.** In most countries, a single body is accountable for the administration and enforcement of the tax laws that apply to broad national taxes such as income taxes and VAT. Unifying the administration of these taxes provides synergies and efficiencies. A separate body for customs is also the more usual approach.<sup>4</sup> A single body having an "end-to-end" set of responsibilities for assistance, tax assessment, audit, and collection enforcement is also optimal to facilitate a full range of coordinated approaches to managing compliance with tax obligations. Italy is unusual in this respect because of the spread of tax administration responsibility across separate bodies (see below).

30. **Fiscal agencies require a degree of independence from the political level.** To achieve this, in many cases tax and customs administrations are headed by an apolitical appointee who

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<sup>4</sup> OECD: *Tax Administration 2015, Comparative information on OECD and Other Advanced and Emerging Economies*, May 2015. As at mid-2014, 13 countries in the OECD had aligned the tax and customs operations within a single organization.

has CEO-like responsibility for the entire organization. Individuals selected are qualified and experienced, and often appointed for a fixed period of time unrelated to the time horizon of any particular government. This aspect of governance provides a basis for independence, impartiality and consistency—all necessary characteristics of a modern tax administration.

31. **Under any governance model, the heads of the tax and customs bodies maintain a direct relationship with the government.** The Heads are accountable to the MOF for the overall effective administration of the revenue laws, and for managing within the rules and authorities that govern tax and customs administration operations. However, the political level does not normally become involved in specific cases nor in the day-to-day management of the administration.

32. **Increases in autonomy and independence are generally accompanied by increased accountability in terms of reporting, oversight and transparency.** Mechanisms to achieve this balance include the regular reporting of plans and results to government and to parliament, provisions for both internal and external audit, and high-level government control through budget allocation.

33. **There are different means and models to achieve the governance framework described above. The most common arrangements for fiscal agencies are the following:**

- a) **Multiple Directorates in the MOF:** Revenue administration functions are the responsibility of multiple organizational units (e.g., separate directorates for tax and customs, separate directorates for corporate support and information technology functions) that are located within the structure of the MOF (or its equivalent).
- b) **Unified semi-autonomous body:** Tax and customs functions carried out (usually separately) by unified and semi-autonomous bodies, responsible for all administrative functions, the head of each body reporting to a government minister.
- c) **Unified semi-autonomous body with board:** Tax and customs functions carried out by unified semi-autonomous bodies; the head of each body reports to a government minister as well as to an oversight body/board of management comprised of external officials. (This is commonly known as the Revenue Authority model).

34. **With few exceptions, tax administrations and customs bodies in the OECD and in EU countries adopt one of these institutional models.** Moving from (a) through to (c), these models are considered to provide increasing degrees of independence and autonomy. Of EU countries, the unified semi-autonomous body (b) makes up half of the most recently surveyed countries and is the most frequently reported institutional model for tax administration.<sup>5</sup> A

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<sup>5</sup> OECD: *Tax Administration 2015, Comparative information on OECD and Other Advanced and Emerging Economies*. May 2015.

unified semi-autonomous revenue administration with board (c), or revenue authority, is the least common (Box 4). Although AdeE is not reported within any of the categories in Box 4, the characteristics of Italy's tax administration organizations are broadly aligned to semi-autonomous bodies.<sup>6</sup>

<b>Box 4. Governance Models for Tax Administration</b>			
(In Percent)			
<b>Structural model</b>	<b>OECD</b>	<b>EU</b>	<b>Examples (OECD, EU, and Other)</b>
Single or multiple directorates in the MOF	30	37	Austria, Belgium, Czech Republic, Denmark, Estonia, France, Netherlands, Poland, Switzerland
Unified semi-autonomous body	44	48	Australia, Brazil, Chile, Finland, Greece, Hungary, Iceland, Ireland, Japan, Korea, Latvia, Norway, Romania, Russia, Slovak Republic, Slovenia, South Africa, Spain, Sweden.
Unified semi-autonomous body with board.	12	11	Argentina, Bulgaria, Canada, Colombia, Kenya, Mexico, Peru, Singapore, South Africa, Sweden, United Kingdom, United States.

Sources: OECD; and IMF.

35. **The degree of autonomy varies significantly and reflects the institutional context.** In the most recent OECD survey findings, where a tax administration is reported as a semi-autonomous body, over 80 percent of OECD survey respondents also report an authority to design internal structures, fix levels and mix of staff, reallocate budget, influence staff recruitment criteria, and hire and dismiss staff (Table 2). Across all institutional categories, the powers least frequently delegated are those related to the ability to negotiate pay levels and to determine levels and mix of staff.

36. **Evidence related to the impact of autonomy on tax revenue performance is not conclusive but it is reasonable to draw positive inferences for operational performance.** The prevalence of semi-autonomous tax administrations across countries known for their strong performance (e.g., Australia, Canada, Denmark, Norway, and the United Kingdom) reflect a broad consensus that in keeping with modern management principles, a certain level of autonomy for fiscal agencies has a positive impact on performance.

<sup>6</sup> Within the OECD categorization, Denmark, Germany and Italy are all categorized as 'other' administrative bodies. The classification for Italy reflects the spreading of tax administration functions across multiple organizations that have differing characteristics; they include publicly owned incorporated bodies (e.g., Equitalia for debt collection) and semi-autonomous government agencies for AdeE and GF.

**Table 2. Authority Delegated to Tax Administrations**

Number of Institutions (by Institutional Category) and Areas of Delegated Authority

Nature of Authority Delegated	Single or Multiple Directorate(s) Within the MOF		Semi-Autonomous Body With or Without a Board		Other Bodies	
	Number	% of Total	Number	% of Total	Number	% of Total
To make tax rulings	20	100	31	100	5	83
To remit penalties/interest	18	90	28	90	5	83
To design internal structure	15	75	25	81	6	100
To reallocate budget as deemed appropriate	13	65	27	87	4	67
To fix levels and mix of staff	11	55	26	84	3	50
To set service standards	20	100	31	100	6	100
To influence staff recruitment criteria	17	85	30	97	6	100
To hire and dismiss staff	13	65	30	97	6	100
To negotiate pay levels	6	30	20	67	2	33

Source: Organization of Economic Cooperation and Development.

**B. Minimum Conditions for Autonomy**

37. **This section puts forward a set of minimum requirements that, taken together, can be considered the criteria for assessing the autonomy of a revenue agency.** Autonomy is not a rigid concept; there are different approaches that achieve this objective. And while there is not yet a single standard for gauging the autonomy of revenue agencies, the criteria described below reflect a wide body of evidence, including from Fund analysis and work with a broad swathe of other countries. Nonetheless, international trends towards increased autonomy show that the ability to manage resources and deliver tax and customs operations in a flexible manner, and free of external interference, are fundamental prerequisites.

38. **A proposed set of minimum requirements for gauging autonomy in tax and customs administrations are set out at Appendix 2.** In summary, the fiscal agencies should meet the following criteria:

- **Separate and dedicated administrative bodies.** An organization contains all functions related to the respective administration. A Director is in control of all aspects of the organization and reports to the Minister of Finance.
- **Headed by a nonpolitical appointee as Director who is appointed for a fixed term.** The term of appointment for the Director is unrelated to the time horizon of a government.

- **Empowered to administer and enforce the revenue laws, with all necessary and clearly defined powers and accountabilities.** Powers and authorities in revenue laws are assigned to the Director of the administration in legislation (or indirectly via the Minister). The Director is able to further delegate powers to officers at operational level.
- **Able to exercise strategic management and control of operations.** Performance measures are developed by the administration. There is full authority to produce and publish the administration’s strategic planning documents. The organization develops and submit an annual report to the Minister for publication. The Director can make organizational changes to respond to changing circumstances.
- **Provided with sufficient autonomy to manage the revenue administration’s resources—including human resources—based on delegated authority, accountability and transparency.** The Director may move funds between budget categories, within defined limits, to provide operational flexibility. The Director approves all appointments and promotions based upon merit, whether from outside recruitment or internal promotions. The tax administration has a position and grading structure that is competitive and ensures the skills and specialization needed is available in a timely way. The compensation levels are competitive with the private sector, especially for professional staff. There is sufficient human resource authority within the administration to promote integrity, investigate corruption, and take disciplinary actions including dismissal and prosecution as well as full authority for training and development.

### C. Assessment of Autonomy

39. **A summary of the progress in Italy on meeting minimum autonomy conditions for the fiscal agencies is at Box 5.** The analysis adopts a four level scale—fully, mostly, partially, or not adopted—to describe the extent to which an autonomy condition is fulfilled. A full description of adherence to the minimum autonomy conditions is at Appendix 2. It sets out, for each of the minimum requirements, the considerations that are pertinent to the assessment, and a description of the current status. Suggested enabling measures to give full effect to the condition are recommended in Section II.D.

40. **The autonomy of the fiscal agencies is well established in some key areas.** There is a high level of autonomy with respect to the powers provided in the revenue laws for the Directors of the tax and customs agencies to administer and enforce the revenue laws. The budget flexibility available to the Directors is generally appropriate (but note the caveats discussed in Section II, D) and the authority to make changes to internal structures does generally lie within the agencies and their management committees. These flexibilities and authorities represent good practice and are in line with those available in the most advanced administrations (see Section II.A, Table 2).

<b>Box 5. Assessment of Progress on Autonomy</b>	
Conditions	Adopted
1. Fiscal body is a separate and dedicated body with all functions	Partially
2. Director is empowered to administer the revenue laws	Fully
3. Director is a fixed-term appointment, not related to the political cycle	Partially
4. Authority to exercise strategic management	Partially
5. Authority for organizational change	Mostly
6. Budget flexibility	Partially
7. Recruitment and promotion authority	No
8. Determine grading, influence compensation	No
9. Integrity, discipline (including dismissal), and training	Mostly

41. **However, as illustrated in Box 5, there are several gaps that will potentially threaten collection performance.** The most immediate threat is represented by the absence of authorities for recruitment, and promotion; for the ability to provide specific grading structures that are relevant to fiscal bodies (condition 7 and 8).

#### **D. Enabling Measures for Securing Autonomy**

42. **This section describes the rationale for the assessment in Box 5 as well as the suggested remedial action for the identified gap in autonomy to be addressed.**

##### **Condition 1: A separate and dedicated body including all functions.**

43. **This condition is not met.** The most critical gap is in the duplication of audit and investigations between the fiscal agencies and GF. While tax collection enforcement functions are managed by *Equitalia*, these remain subject to control of the tax administration. Information technology functions in support of both fiscal agencies are delivered by SOGEI. Though this is also not consistent with the autonomy condition, the mission has not observed gaps in service delivery arising from these arrangements, although some issues may arise. The recent expansion of the mandate of SOGEI into a larger number of entities could impact the quality of IT services to the fiscal agencies. The government needs to take the necessary measures to ensure SOGEI will continue to provide high quality IT support to the fiscal agencies. This will be crucial for maintaining IT capabilities and enabling the implementation of the recommended reforms to improve the agencies' effectiveness. Achievement of the minimum autonomy condition would require the overlap in the tax audit functions to be addressed (see Section III.E).

**Condition 3: A fixed-term appointment for the Director unrelated to the political cycle.**

44. **Although tax and customs directors are under a fixed (three-year) term, the dependence of appointment upon the political cycle means that this condition is only partially met.** Originally, a term of appointment of five years applied to Directors. The enabling Law 300/1999 also provided adequate prescription on circumstances leading to removal of the Director. As discussed in Section I.B, the term for directors, management committee members and boards of auditors of the fiscal agencies was reduced to three years in 2003. Director positions were made subject to the “spoils system” in 2006. Under which Directors’ positions are vacated within 90 days of a new government formation. In the absence of a new appointee, the occupant will remain in place. Agencies note that during the period of possible reappointment by a new government, operational decisions are limited to more immediate concerns in order to not bind the incoming administration.

45. **It is likely that a focus on medium- or long-term strategies can be compromised while short term expedience is potentially encouraged under the current term arrangements.** Achievement of the autonomy condition requires that Directors’ tenure is not automatically subordinated to the political cycle and vote of confidence of the incoming government. It is also desirable to restore the term of appointment for the Directors to five years as an optimal period of service; and a more appropriate span for strategic management and medium-term institution building.

**Condition 4: Authority to exercise strategic management**

46. **The authority within the fiscal agencies to determine business strategies and exercise strategic management is not well demonstrated.** Agencies are subject to the “close supervision” of the MEF (article 60 of Law 300/1999). The most important decisions of the management committee of the agencies that relate to the statutes, regulations and documents of a “general nature” required the approval of the Minister. As outlined in Section I.B, Law 173/2003 curtailed management committee authority. It mandated an approval by MEF of the major decisions of the agency management committees and extended the timeline for ministerial approval of them—either explicitly or tacitly—to 45 days.<sup>7</sup>

47. **Supervision by the MEF can extend to detailed level considerations.** Article 59 of Law 300/1999 provides for supervision through a rolling three-year agreement (the convention), with annual adaptation. It provides for performance indicators (Appendix 3) to be measured as a means of verifying management results. These also inform the eligibility for the incentive scheme to determine a level of access to the bonus funding pool of each agency. The performance indicators are agreed between the MEF and the agencies. A certain level of negotiation is

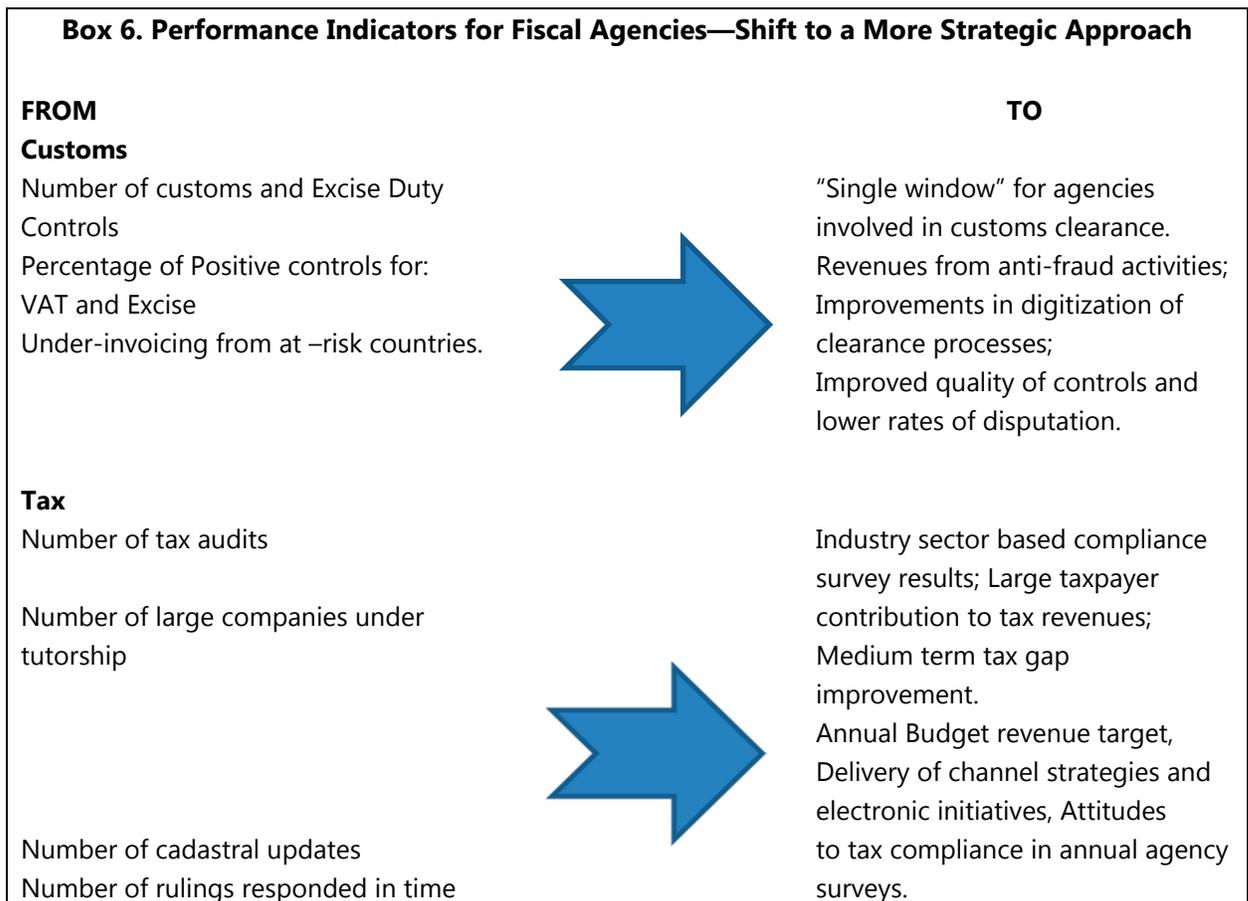
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<sup>7</sup> This is in contrast to the position under enabling Law 300/1999 providing for resolutions of the management committees for immediate effect unless a ministerial request for suspension of the decision was made within 10 days.

necessary between the parties when indicators are put forward to ensure they are sufficiently challenging yet realistic. Care is needed to maximize the extent to which the final nature and magnitude of indicators fairly reflect the views of both sides to the agreement. In effect, a “level playing field,” while difficult to secure, is important so that the convention remains credible, and balanced for the MEF and the fiscal agencies.

48. **Performance indicators and plans are operationally focused.** The indicators reflect business plans supplied by the agencies. The agreements incorporate many measures of volume and outputs; e.g., number of checks, customs controls and tax audits, processing times for cadastral updates, response times for enquiries, wait times for rulings etc.

49. **Both fiscal agencies and the MEF express a need to shift these indicators to a more strategic and outcome based focus.** The emphasis is on delivery of key reform initiatives and agency effectiveness. The movement is summarized at Box 6.



50. **Achievement of the minimum autonomy condition for strategic planning entails a progressive reset of roles within planning and monitoring processes.** Fulfillment of the

autonomy condition, as the agencies mature, allows a less “hands-on” approach to supervision and management of the fiscal agencies.

51. **The MEF and fiscal agencies should adopt a more strategic positioning with respect to their obligations under the convention.** Long term, transformative statements of intent need to be developed by the fiscal agencies. A set of strategies and major initiatives also need to be in place to give effect to these statements of intent (see Section I.D for further discussion). Annual business plans would be reshaped to reflect these strategies. A more systematic and wider consultation with a clear focus on external stakeholder needs must inform the assessment of progress against these strategies. The convention and MEF supervision would therefore reinforce an ongoing process of transformation for the fiscal agencies.

#### **Condition 6: Budget flexibility**

52. **The autonomy condition has features consistent with sound international practices but expenditure limits and constraints on allocations have arisen.** There is some flexibility in use and transfer of funds between spending categories within an approved budget cap. Both fiscal agencies have framework financing formulae, established in 2005. These produce some initial predictability in notional allocations from the State budget.<sup>8</sup> More recently, cuts were made specifically to earmarked items (e.g., amounts to be spent on consultants, numbers of management positions, motor vehicles, and training costs) which encroach on an agencies choice to find the necessary level of savings in the manner that it determines. It is entirely appropriate for the government to demand that economies in running costs be made; these are in keeping with the broader fiscal management objectives of the government. It would be more efficient and consistent with the autonomy principles, for the framework financing formulae to be revamped. The purpose is to incorporate in the cost of collection ratio the government’s recent initiatives on cost control, while leaving the decisions for determining the items for cost savings to the fiscal agencies.

#### **Condition 7: Recruitment and promotion authority**

53. **The absence of this authority represents the most serious gap in the autonomy framework of the fiscal agencies.** Section II.A has described that these powers are routinely adopted by semi-autonomous tax agencies within the OECD, the EU and internationally. The evolution of the autonomy provisions of fiscal agencies are described in Section I.B. Various rulings of administrative judges and ultimately a ruling of the Constitutional Court in March 2015 have rendered ineffective the provisions concerning the ability of the fiscal agencies to establish

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<sup>8</sup> For AdeD, the formula is 0.1668 percent of the average amount of collection recorded over three years on specific tax revenue chapters. For AdeE the figure is 0.8793 percent of revenues collected by AdeE, which includes amounts provided following the merger of the Land Agency.

their own rules for progression to management positions.<sup>9</sup> Decisions for temporary appointment to management positions were also annulled leading to vacating of over 900 managerial positions and large-scale disruptions.

54. **The result is that an essential lever for good governance in the fiscal agencies is missing.** There has been much litigation on rules for managers' recruitment. The most recent Constitutional Court ruling prohibits Agencies to continue to attribute managerial roles to functionaries on a provisional basis without competitive examinations. It appears clearly established that the power within law 300/1999 (and subsequent legislation) requires the fiscal agencies to ensure all management appointments are only accessed through competitive examination. This precludes promotion on merit to management positions that takes into account relative skills, expertise, and suitability for a role. The mission is firmly of the view that the current situation is clearly unviable.

55. **The government should restore the autonomy power with respect to promotion and recruitment rules.** It appears that the government has struggled to find a satisfactory pathway for reform. To fail to act, as noted previously, will put at risk the essential revenue protection functions within AdeE and AdeD. The mission is advised that there are precedents within the Italian public administration for the retention of the recruitment, promotion, and dismissal powers (e.g., the authorities granted to the State Property Agency<sup>10</sup>) and these should be urgently investigated with necessary amendments to Law 300/1999.

#### **Condition 8: Determine grading and influence compensation**

56. **The ability to provide a grading or job classification system that is specific to revenue administration was removed.** Internationally, this is also a widely held authority for semi-autonomous tax bodies. Fiscal agency specific collective agreements that defined the professional categories for staff were frozen. They were replaced by national labor contracts in 2009. As consequence, staff are classified generically whether they are employed in ministries, nonprofit bodies or universities. Though the effort to streamline this aspect of public administration is acknowledged, there is a strong concern that the professional classification system is too rigid and dated, for example in comparison to systems adopted by European customs and tax agencies,

57. **A related concern is that remuneration levels cannot be readily influenced in respect of highly specialized staff.** It is not expected that fiscal agencies can determine exclusively compensation levels of their officials. Rather a degree of flexibility is required. There is

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<sup>9</sup> These were within Article 71, 3. (d) of Law 300/1999.

<sup>10</sup> This relates to the legal status of "economic public body" that was granted to this agency.

some accommodation under the incentivizing quota scheme but the amounts of salary supplementation are modest.<sup>11</sup>

58. **A specialist classification scheme for the fiscal agencies is optimal.** Remuneration levels reflect a range of factors. Competitive market pressures for some specialist and “in-demand” skill sets are inevitable across many areas of complex government service delivery, with consequences for staff retention. Nevertheless, it is a practical step forward to attempt to better manage staff retention in the fiscal agencies.<sup>12</sup> A revamped scheme should have regard to the role complexity and market pressures within many roles such as large business and international tax compliance management, the management of high wealth individuals, fraud detection and post-clearance audit, intelligence and risk analysis, tax law interpretation as well as in senior management positions.

### Recommendations

- Restore, through amendments to Law 300/1999, the autonomy of the fiscal agencies with respect to recruitment and promotion authority and the ability to provide a specific grading structure.
- Revamp the financing formulae applicable to the allocation of the State Budget to AdeE and AdeD.
- Adopt a fixed-term appointment for the director of AdeE and AdeD that is unrelated to the political cycle.
- Revise the three year agreements between MEF and the fiscal agencies and the approach to ministry supervision; incorporate monitoring against strategic goals and apply higher level indicators appropriate to measurement of organizational outcomes.

### III. IMPROVING THE PERFORMANCE OF THE TAX SYSTEM

59. **The AdeE has made good progress in developing both its taxpayer service and enforcement capabilities.** Section I.C lists an impressive range of reforms implemented by the AdeE since its establishment in 1999. Many of these reforms have contributed to an improved capability to manage compliance risks including: achieving a 100 percent coverage for e-filing of for all core taxes; delivery of a wide range of service and assistance initiatives through multiple communication channels (in-person, telephone, email, Web site, etc.); prefilling of tax returns for individual taxpayers; large scale automated data matching; and the development of more than

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<sup>11</sup> The mission does not have data on the distribution of the incentivizing amounts but for example in AdeD, the pool of funds for this purpose was approximately €170 million for 2015.

<sup>12</sup> The mission is informed that staff separation rates escalated in 2015 following the adverse constitutional court decision.

200 industry sector benchmarks that enable the AdeE to identify taxpayers with a turnover below €5 million who declare revenue levels that are inconsistent with their level of business inputs and other economic indicators.

60. **However, more needs to be done.** The initiatives thus far have largely been developed in a piece-meal fashion and planned from a one dimensional viewpoint, i.e., they have been viewed as stand-alone service or enforcement initiatives. This section discusses the need to strengthen the management of compliance risks, including through development of a more strategic approach, and outlines opportunities for improving compliance across a range of key risk areas.

### A. Strengthening Management of Compliance Risks

#### Developing a more strategic approach

61. **The current approach to compliance improvement planning lacks a strategic focus and reflects a strong input/output bias.** Each of the two main directorates of the AdeE (Assessment and Taxpayer Services) separately develops operational plans to meet the objectives set out in the three year convention with the MEF. The focus of the planning is squarely on the volume of inputs and outputs that must be delivered rather than on achieving high level outcomes. For example, the informal economy has consistently featured as the biggest compliance risk over many years but, while many specific initiatives have been undertaken, there is no overarching strategy in place that would provide confidence to the government that this risk is being adequately addressed. Instead, the two central directorates of the AdeE, and the GF, all undertake independent responses with insufficient attention to the need to assess the overall cost and effectiveness of these activities in reducing informality, and no single point of accountability for outcomes.

62. **A more integrated approach to managing risks to the tax system is needed.** Compliance risk management should be considered in a more holistic way. Initiatives for improving service, reducing compliance costs and verifying compliance should not be developed independently within functional departments; piecemeal approaches can result in duplication of effort and poor sequencing of inter-related activities. The strategies must address the underlying causes of noncompliance in a rational way. For example, audits are not the best response to noncompliance caused by a lack of understanding of tax laws or unclear laws; taxpayer education and service is not the best response to deliberate evasion; and imposition of strong penalties may not be appropriate where voluntary compliance with obligations is made difficult by inadequate administrative policies and procedures. The VAT arrangements in place in Italy provide a clear example of how weak administrative design directly contributes to low compliance (see discussion in Section III.C).

63. **Effective tax administrations develop integrated strategies to improve compliance behaviors across entire taxpayer segments.** Application of this approach to managing

compliance has been shown to deliver, over time, sustainable increases in tax revenue through increased taxpayer compliance. Market segmentation principles are applied to divide the taxpayer population into smaller more manageable groupings based on common characteristics and potential risks. Compliance risks are then identified and prioritized from a corporate perspective to ensure that the major compliance problems contributing to the tax gap are being addressed. A planning approach is adopted which:

- recognizes that the factors underlying taxpayers' compliance behaviors in any specific risk area are quite complex and, as a result, are unlikely to be treated successfully with a single action strategy—particularly one based solely on enforcement actions;
- directs attention to understanding the factors that shape taxpayers' compliance behaviors, so that a potentially more effective set of responses—ones that deal with the underlying causes of noncompliant behavior rather than focusing on treating the symptoms—can be developed and implemented;
- promotes the development of integrated strategies which aim for an optimal mix of responses (e.g., education, assistance, amendment or clarification of the law, simplified procedures, audit, prosecution, and publicity) to achieve the widest possible impact on voluntary compliance across the entirety of the target taxpayer segment; and
- ensures that these responses are sequenced in a coherent manner to deliver the maximum compliance leverage from the overall treatment strategy.

A checklist of factors to be considered in developing and implementing effective integrated strategies is set out in Box 7.

64. **Structural integration of functions facilitates a more integrated planning approach for some key taxpayer segments.** Existing organizational arrangements for large business taxpayers (see Section III.B) and the proposed new organizational unit for managing compliance of very wealthy individuals (see Section III.B) will facilitate the development of balanced compliance improvement strategies for these two very significant taxpayer segments. The piloting of cooperative compliance arrangements for large business taxpayers (LBTs) is a good example of a compliance improvement strategy that reflects a genuine rebalancing of relationships, although care should be taken not to lose sight of the need for a strong enforcement capability to deal with recalcitrant taxpayers. A structural approach is only feasible, however, for taxpayer segments that feature a relatively small and manageable number of taxpayers who collectively account for a significant proportion of the tax base. For the broader population of individuals and small- and medium-sized businesses, integrated compliance strategies will need to be developed through close cooperation across functional departments.

### **Box 7. Factors to be Considered in Developing Integrated Strategies**

#### *Identify and analyze the compliance risk*

- What exactly is the risk and who is affected by it?
- What are the underlying causes of the noncompliant behavior?
- To what extent are the current law and/or administrative systems a causal factor in the noncompliance?
- What judgment has been made about how the compliance attitudes of the risk population have been formed (i.e., how have they been affected by business, industry, social, economic or psychological factors)?
- Has this judgment been validated through engagement with taxpayers and their advisors?

#### *Plan and implement the strategy*

- Has the desired outcome of the strategy been clearly articulated and have success criteria been identified?
- Is the tax agency's interpretation of the law understood and accepted? Does the revenue agency need to clarify and/or communicate its position?
- Can the tax agency improve the ease and/or cost of compliance for affected taxpayers by providing educational material or self-help tools such as industry benchmarks or online calculators?
- How can the tax agency identify and assist those taxpayers within the target risk population who are trying to comply? Can the tax agency provide them with the time they need to get their affairs in order?
- Are the tax agency's internal risk and intelligence capabilities adequate to detect instances of this type of noncompliance for case selection purposes?
- Does the tax agency staff have the skills and support tools to conduct effective audit and enforcement activities where necessary?
- Are there any underlying causes of the noncompliant behavior that are not addressed by the strategy?
- Are there any unintended consequences which are likely to arise as a result of the strategy?

#### *Evaluate the effectiveness of the strategy*

- What do the effectiveness indicators show about the impact the strategy has had?
- What has been learned from the implementation of the strategy and how will it influence future planning?

### **Moving to a more differentiated penalties regime**

65. **The current penalties regime does not promote taxpayer confidence in the fairness of the tax system.** The assessment penalties in Italy are relatively high and are applied in a coercive manner. It appears to be standard practice to apply a penalty of around 90 percent in the first instance with the penalty automatically reduced to 30 percent if the taxpayer accepts the assessment. If the taxpayer disputes the assessment, the full penalty is maintained. This approach

represents an inappropriate use of statutory penalty powers and is unlikely to contribute to a better relationship between taxpayers and the tax administration. Penalties should be proportionate to the issue and should be differentiated based on each taxpayer's individual circumstances. They should not be used as a negotiating tool to put pressure on taxpayers to accept assessments. The penalty regime should be modified to allow for remission of all or part of the penalty in the first instance based on objective and transparent criteria such as (a) the compliance history of the taxpayer; (b) whether the underpayment resulted from a genuine error or misunderstanding of the law; (c) whether the taxpayer has taken reasonable care in maintaining records and completing tax returns; and (d) whether the taxpayer has cooperated throughout the audit. The penalty regime should be applied uniformly across all taxes. The level of penalty applied in each case should be explained to the taxpayer and the taxpayer should have the right to appeal against the level of penalty.

### **Rationalizing the investment in risk analysis and case selection**

66. **Audit case selection is largely decentralized.** The AdeE has a large investment in risk management infrastructure. A total of 516 staff are allocated to compliance risk analysis and strategy development nationally, 292 of whom are spread thinly across 108 provincial offices. The central assessment directorate has also invested heavily in modern computer based risk analytics and produces priority audit case lists for distribution to regional and provincial offices. However, regions and provinces also have access to risk assessment tools and are relatively free to assign resources based on local knowledge. Guidelines require that the most productive cases be selected, but this is largely a matter of judgement for the provincial level offices.

67. **This is out of step with international trends, which have seen a strong move to centralized audit case selection.** There is little point in investing time and effort into creating sophisticated risk modelling processes at the central level unless they are used to drive the national audit case selection process. Risk assessment and case selection are complex processes in a modern tax administration and require high level of expertise. Advanced analytics have been proven to deliver better audit case selection and higher tax revenue yields. This level of expertise simply cannot be developed or maintained across a large number of very small distributed units. Centralizing the function also reduces the risk of inappropriate case selections.

68. **Significant savings and improvements in effectiveness could be achieved by consolidating the audit case selection function to at least the regional level, as a first step.** Consolidating the audit case selection function at the regional office level would increase the critical mass of the units, allow for greater specialization and more targeted training and development, simplify the line of command and improve communication with the central directorate, and tighten control over audit case selection. It is also highly likely that the overall number of staff allocated to the function could be rationalized as a result of the consolidation given that a total of 447 staff would be available for distribution across only 21 regional offices. Consolidation at central level should be considered after evaluating the results of this step.

## Recommendations

- Adopt a more strategic approach to managing key compliance risks.
- Move to a more differentiated penalties regime.
- Consolidate the risk management and case selection functions of the AdeE at the regional office level; over time consider further consolidation at the central level.

### B. Improving the Tax Revenue Performance of Key Segments

69. **The mission identified three key segments in which tax revenue performance could be improved: large business taxpayers; high wealth individuals; and the informal economy.** Potential improvements to compliance management in each of these segments are discussed below.

#### Managing large business taxpayers

70. **The AdeE has established a dedicated LBT department.** Since 2009, LBTs are managed by a central department with dedicated operational units located within the 21 regional offices. The LBT department manages taxpayers with an annual turnover of at least €100 million and banks and other insurance and financial institutions subject to thresholds based on interest income and premiums etc. There are on average around 3,200 LBTs across the country with more than half (in terms of both numbers and aggregate turnover) located in the regions of Lombardia and Lazio (Table 3). The LBT regional units are responsible for all administrative functions and all direct tax and VAT issues. The law that regulates the functioning of the LBT directorate provided for a new framework for tax compliance of LBTs involving a balance between enforcement and assistance measures. Under this law, all LBTs must be individually risk-assessed every year with high risk cases selected for interventions.

71. **The capability of the LBT department is maturing.** It uses advanced risk profiling methodologies and is actively engaged in a range of OECD forums and initiatives aimed at improving compliance by large businesses. In line with international trends, the LBT is now entering into settlements with taxpayers subject to a clear set of guidelines (Box 8). It reports significant success in resolving complex issues with taxpayers in a mutually satisfactory manner without the need to resort to litigation. Where a tax administration engages in out-of-court settlements it is important that it has in place an appropriate governance framework of checks and balances to ensure that the arrangements are not diverted for corrupt purposes. At the same time, it is also important that officers involved in negotiating settlements are adequately protected under the law against charges of corruption or maladministration etc. provided they comply fully with official guidelines.

**Table 3. Distribution of Large Business Taxpayers for Fiscal Year 2013**

<b>Region</b>	<b>Number of Taxpayers</b>	<b>Total Turnover (In € million)</b>
Lombardia	1,238	487,247.7
Lazio	377	472,836.1
Emilia Romagna	342	100,783.2
Veneto	294	87,551.6
Piedmont	252	95,917.6
Toscana	156	57,725.8
Campania	80	15,439.4
Other	477	186,194.8
Total	3,216	1,503,696.2

Source: Agenzia delle Entrate.

#### **Box 8. Criteria for Settling Complex Issues with Large Business Taxpayers**

The AdeE has piloted the following settlement criteria in the Lazio region to test the efficacy of this approach to resolving complex issues:

- Settlements are subject to a cost-benefit analysis.
- A fundamental principle is that (identified) taxes are not negotiable.
- Uncertain transactions may be waived (e.g., where insufficient factual evidence is available).
- Penalties may be reduced within set limits.
- Recognition is given to taxes actually paid.
- The cost and time involved in bringing the case to court is weighed against the chance of success in litigation (i.e., taking into account uncertainties under the law and the risk of the case failing due to formal procedural errors).

72. **The LBT population is unstable.** The qualifying criteria for categorization as an LBT are applied on a yearly basis with the result that there are a significant number of entries and exits each year. Table 4 demonstrates a turnover of 25 percent in the LBT population for the Lombardia region during the 2013 year. This is inefficient and creates the risk of a loss of focus on large businesses subject to regular movement in and out of the operational ambit of the LBT directorate. A better approach is to retain taxpayers in the LBT population for a period of at least three years before allowing exit (i.e., once a taxpayer meets the entry criteria for treatment as an LBT, it is retained in the LBT population unless it falls below the entry threshold for three

consecutive years). This approach allows for continuity in the management of LBTs in terms of both compliance monitoring and service delivery.

**Table 4. Turnover in Large Business Taxpayer Taxpayers for the Lombardi Region, 2011–13**

	2011	2012	2013
Total taxpayers	1,239	1,235	1,235
New entries	98	123	154
Exits	117	127	154

Source: Agenzia delle Entrate.

73. **The LBT department is currently piloting a cooperative compliance approach with a small number of the largest business taxpayers.** This scope of this initiative is in line with the practice of some advanced tax administrations in this area as described in Box 9 and is supported by the mission subject to a note of caution. The cost in terms of time and money of establishing sustainable cooperative compliance arrangements with large business taxpayers can be significant for both parties, especially during the initial set-up stage. There will also inevitably be missteps on both sides as the arrangements and mutual obligations are developed and clarified. For this reason, the pilot should be restricted to a very few taxpayers until such time as the AdeE has refined its approach and gained sufficient experience to properly gauge the cost-benefits of rolling out the arrangements to a wider audience.

#### **Box 9. Features of a Cooperative Compliance Arrangement**

Cooperative compliance arrangements are aimed at building collaborative and trust-based relationships with taxpayers (especially large taxpayers) and intermediaries to resolve tax issues and bring certainty to companies' tax positions in advance of a tax declaration being filed, or before a transaction is actually entered into. Typically, cooperative compliance arrangements are based on an agreed framework of behaviors as follows:

Taxpayers commit to demonstrating:

- good governance of their tax affairs, including an appropriate level of validation and review of their accounting systems; and
- a willingness to operate in an open and transparent manner and make full disclosure of their tax risks as they occur (i.e., in real time).

In return, the tax administration commits to providing enhanced service to the taxpayer through, for example:

- dedicated points of contact—including the use of client relationship management approaches;
- speedier resolution of technical and administrative issues;
- assignment of a reduced risk rating to the taxpayer for audit purposes; and
- remission of penalties where unintended errors occur.

74. **Interventions by the GF could adversely affect the success of a cooperative compliance arrangement.** The authorities advised that, even in the case of LBTs, a high proportion of field audits are currently conducted by the GF—totaling 241 field audits in the 2014 fiscal year. These audits range across a number of issues including technical issues such as permanent establishments and transfer pricing. The LBT department will need to ensure that the GF is aware of, and supports, the principles of the cooperative compliance arrangements and does not take a unilateral decision to approach an LBT engaged in such an arrangement. Building mutual trust takes time and effort, and relationships could be irreparably damaged if commitments given by the AdeE are ignored by another government regulator.

#### **Establishing a stronger focus on the wealthiest taxpayers**

75. **The AdeE advised that it is planning to establish a dedicated high wealth unit next year.** This initiative is strongly supported by the mission. Too little attention has been paid in the past to the tax affairs of wealthy Italians. Italy has a large number of resident HWIs and high income individuals (HIIs), but their tax affairs are presently assigned to tax offices by reference to their principal address and are managed by officials without any special skills or training. These officials encounter a range of complex tax issues but are not yet fully equipped to deal with them or search out issues that are not immediately apparent. The AdeE has been examining the case for setting up a high wealth unit for some time but is yet to make decisions on how the unit will operate and where it will be located. The deputy director responsible for the project recognizes the need for urgency.

76. **In all countries, HWIs represent a major risk to tax revenue.** The HWI segment consists of a relatively small number of individuals who control, directly or indirectly, a very significant amount of wealth.<sup>13</sup> They are internationally mobile and typically have substantial assets tied up in complex off-shore business arrangements. For example, numbers of Italian residents are known to hold assets through structures set up in low tax jurisdictions such as Switzerland, Luxemburg and Liechtenstein. While amnesties are said to have encouraged some citizens to return part of their wealth to Italy, many have not done so. HWIs represent a challenge for any tax administration because of (a) the complexity of their tax and private business affairs and the large numbers of entities many are likely to control; (b) the amounts of tax revenue at stake; (c) less transparency and regulation of the activities of privately owned entities; (d) their ability to pay for expert tax and legal advisors; (e) the opportunity to undertake aggressive tax planning; (f) their political influence; and (g) their impact on the overall integrity of the tax system.

77. **HIIs also represent a significant tax revenue risk.** Across the globe there has been a growing trend to structure the remuneration packages of senior executives of both domestic and

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<sup>13</sup> Recent studies have estimated that as few as 128,000 individuals control around one-third of the world's total wealth.

international companies around substantial bonus payments, varying parts of which may be paid in shares involving options, other rights, deferral periods and payment into trusts. Remuneration packages are sometimes put in place with split contracts intended to ensure part of the package is taxed in one or more low tax jurisdictions. The pension arrangements of these executives can be equally complex. HIIs tend to be highly visible in the community which increases the imperative to ensure that they are, and are seen to be, properly monitored by the tax administration.

78. **The establishment of dedicated organizational units to manage the tax affairs of HWIs and HIIs has proven successful in many countries.** These units have been shown to make a big contribution to preventing structured tax avoidance. The mere act of segmenting this group and paying special attention to them sends a clear signal to the community that the tax administration is determined to tackle tax avoidance at all levels of society. The units require skilled staff and access to sophisticated analytics to research and understand complex financial arrangements, and advanced software mapping programs to identify the full network of entities controlled by target HWIs. It should always be kept in mind, however, that “high risk” does not equate to “high tax avoidance.” Where noncompliance is detected, verification activities must be conducted in a measured and professional manner as every action can be expected to be challenged. Good communication with the taxpayers’ accountants and tax advisors is of paramount importance.

79. **A well-articulated and balanced strategy of assistance and verification is required.** The new units have to deploy a balanced program of service and enforcement actions to better manage the needs of an important group of taxpayers who collectively can make a major contribution to the tax revenue of the nation. The need to be promoting voluntary compliance of this segment of taxpayers means that priority attention should be paid to ex-ante services, timely clarification and information, as well as ex-post enforcement. Emphasis should be placed on the benefits that will flow in terms of quality of service, support with complex tax issues and speed of resolution of disagreements. Ideally, the strategy should be made public so that the broader community can see the value in the approach taken. For this reason, individuals whose tax affairs are managed in dedicated high wealth units also receive a personalized taxpayer service with the tax authorities often providing them with a relationship manager. The relationship managers typically establish a framework for dialogue between these taxpayers, their advisers and senior tax officials.<sup>14</sup> The purpose of this dialogue is to improve customer experience by ensuring that the tax authority has a complete overview of the individual’s tax affairs and so can help them meet their compliance obligations. At the same time the tax authority can better assess the level of tax risk. Close engagement with these individuals can also lead to early detection of avoidance schemes enabling more timely responses including closing potential loopholes in the tax laws.

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<sup>14</sup> HWI relationship managers are generally moved every two–three years to ensure the integrity of their dealings with wealthy taxpayers.

80. **International experience has shown that it is prudent to start small and gradually build a capability for this segment.** The initial size and scope of the unit should be restricted until such time as the AdeE has developed the necessary expertise and capability to manage a broader population. For this reason, the criteria for selecting the initial target population of wealthy persons (i.e., thresholds of income and wealth) should be set at the higher end of the scale. Staffing of the unit should be weighted heavily to take account of the complexity of the financial and business arrangements to be controlled, the level of the tax revenue risk, and the sensitivities involved in dealing with high profile citizens.<sup>15</sup> The staff of the unit should have competence across a range of skills and qualifications including audit, law, accounting and analytics.

### **Reducing informality**

81. **More specific action is required in the short term to promote compliance.** This could include undertaking industry based projects and making broader use of the industry sector benchmarks.

82. **Industry-based projects represent an ideal vehicle for gaining experience in developing integrated treatment strategies.** Structured industry-based compliance improvement projects have been found to be very effective in lifting levels of compliance, especially in industries which exhibit a significant level of informality. These projects require a cooperative planning approach across functional directorates and strong coordination of activities during the implementation stage. A senior officer should be appointed as the project manager (or “risk owner”) to develop the plan, secure resources, establish appropriate coordination and communication arrangements, and oversee implementation. Key steps in a typical industry-based compliance improvement plan are set out in Box 10.

83. **Better leverage can be gained from use of industry sector benchmarks.** The industry sector benchmarks developed by AdeE were originally used as both self-help tools for taxpayers and for issue of automated assessments. As a result of adverse court rulings, the AdeE now uses the tool as a risk indicator for audit case selection. Audits are resource intensive and can only cover a small fraction of cases in the small business segment. Consideration should be given to issuing letters to taxpayers identified as outliers indicating that an under-declaration has been made and inviting them to review their tax returns and file amended returns. Taxpayers who fail to respond should receive a second letter indicating possible audit action. At least a proportion of those who fail to respond a second time should be selected for audit. This approach will gain a much greater coverage of small businesses and better compliance leverage.

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<sup>15</sup> See OECD (2015), *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies*, OECD Publishing, Paris. [http://dx.doi.org/10.1787/tax\\_admin-2015-en](http://dx.doi.org/10.1787/tax_admin-2015-en) for a summary of the selection criteria applied, the numbers of taxpayers controlled, and staff allocations in countries which have a dedicated high wealth unit.

### Box 10. Key Steps in a Typical Industry-Based Compliance Improvement Plan

Where an industry or trade is identified as high-risk, the tax agency should:

- **Engage with the relevant industry or business associations** to explain why the industry is seen as high-risk and to ensure that the tax agency has an accurate understanding of how the industry operates.
- **Publicize the tax agency's intention to conduct a verification program of the industry** and seek the support of the associations in informing their members.
- **Identify tax practitioners who have a significant client base in the targeted industry**, alert them to the issues and request that they inform their clients of the intention to conduct a verification program.
- **Conduct a sample audit program** to confirm the most serious areas of noncompliance and to quantify the amount of tax at risk across the industry.
- **Engage with the relevant associations and tax practitioners** to prepare advice to industry participants on the areas of noncompliance identified through the sample audit program.
- **Communicate directly with taxpayers in the industry and/or indirectly through the relevant associations and tax practitioners** advising them of the specific areas of noncompliance and requesting that they review their tax returns and make any necessary self-corrections. Highlight that voluntary disclosures will attract reduced penalties, and that further audits are planned under which taxpayers who have not self-corrected will be subject to full penalties.
- **Offer free seminars and advisory visits to taxpayers** who are unsure of their obligations (seminars should ideally be conducted jointly with the industry association to engender greater acceptance of the views expressed).
- **Ensure that the tax agency's enquiry staff is aware of the compliance improvement program** and has scripted answers for enquiries received from taxpayers about the compliance improvement program, including how to make a voluntary disclosure, attend a seminar or request an advisory visit.
- **Ensure that the collection enforcement staff is aware of the program** and applies the reduced penalties and more flexible payment arrangements to taxpayers who voluntarily self-correct.
- **Conduct a follow-up audit program** of the industry targeting taxpayers who have failed to self-correct and are assessed as high risk; and prosecute the worst offenders.
- **Publicize results of audits and prosecutions** highlighting how data matching and other new approaches facilitated detection of high risk taxpayers, and using representative case studies to show how noncompliers were identified and dealt with.
- **Measure the effectiveness of the compliance improvement project**, e.g., by tracking the number of voluntary disclosures received and the overall change in tax paid by taxpayers in the target industry, and surveying the industry and practitioners to test for observed changes in compliance behavior.

## Recommendations

- Stabilize the LBT population by retaining taxpayers for a minimum of three years.
- Carefully assess the capability of the LBT department to effectively manage cooperative compliance arrangements before offering them more broadly.
- Ensure that appropriate checks and balances are in place for settlement procedures.
- Establish a dedicated HWI/HII unit as soon as possible—starting with a relatively small target taxpayer population and building over time.
- Establish a joint task force to take stock of current initiatives to reduce informality and, in time, develop a more coherent strategy.
- Undertake industry-based compliance improvement projects in high risk sectors.

### C. Revamping Value-Added Tax Management

#### Background

84. **This subsection examines critical issues in VAT administration.** It embraces approaches to improve payment and filing compliance and tackle VAT fraud.

85. **VAT is a major revenue source for Italy.** VAT is collected at the State level by the AdeE, the AdeD and Equitalia. In 2014 total VAT collections amounted to 115 billion Euros and account for 40 percent of indirect taxes—as mentioned in Section I.A.

#### Value-added tax filing and payment compliance

86. **Filing periods are not in line with widespread current practice.** Italy is the only EU member state that has no monthly or quarterly VAT reporting obligations (see Appendix 3, VAT reporting obligations in EU member states). The VAT annual filing deadline is September year  $n+1$ . This is late according to international standards. Given the nature of the VAT, businesses act as tax collectors and therefore should be subject to regular and timely reporting obligations. Most countries have monthly and quarterly returns depending on the turnover of the taxable person, and filing deadlines between one and three months after the end of the tax period.

87. **Multiple and complex advance payment obligations complicate consolidation of payments and liabilities.** Taxable persons in Italy that are in a VAT payable position are required to make monthly or quarterly advance payments, depending on their turnover. Payments are due on the 16<sup>th</sup> day of the month following the end of the tax period. Quarterly payments are subject to interest. Moreover, an additional advance payment is required on December 27 against liabilities arising in the final tax period of the calendar year. The final payment, after reconciliation by the taxpayer of his advance payments and liabilities, is due on March 16 of the following year

(see Appendix 4, filing and payment obligations in Italy). Payments are made with reference to the nature of the tax. Moreover, payments can be off-set against credits without intermediate reporting to the tax authorities. Problems were reported in achieving a timely reconciliation of monthly, quarterly and December advance payments with liabilities.

88. **The processing of returns and payments may be delayed by up to one and a half year after the taxable period.** Because of the multiple advance payment arrangements, the absence of periodical reporting, the late submission deadline for the annual return, and the time needed for the processing of over 5 million of complex annual VAT returns, officials reported that the tax administration only has a full picture of the taxpayer's payment compliance in year n+2.

89. **The filing and payment arrangements are a significant impediment to effective compliance management and debt collection and early detection of VAT fraud.** Modern compliance management aims at prevention and changing taxpayer behavior and relies heavily on the availability of current compliance data. The likelihood of the collection of arrears deteriorates exponentially after six months. Moreover, the collection of VAT arrears related to assessments for missing trader fraud are negligible, hence efforts should focus on stopping the fraud at an early stage to prevent further loss of revenue. Given that a full picture of a taxpayer's compliance is only available one and a half years after the tax period, the administration is in a very weak position to:

- monitor current compliance of the taxpayer;
- detect fraud and evasion at an early stage;
- launch timely corrective actions; and
- recover arrears in a timely manner.

90. **An excessive amount of information is required in the annual VAT return.** To reduce both taxpayer and the administration costs, the amount of information required to be filed with returns should be minimized. The annual return contains more than 500 information boxes and has a user guide of 100 pages. It requires very extensive information. Sections of the VAT return are dedicated to the provision of detailed information on specific transactions, e.g., purchases of goods coming from San Marino, withdrawals of goods from VAT warehouses, consignment stock, and purchases of investment gold. Until recently the return had to be accompanied by listings of customers, suppliers, and exporters. The total compliance cost to businesses for preparing and filing VAT returns is estimated at EUR 8.8 billion,<sup>16</sup> which is the highest in the EU both as an absolute amount and per tax return. While the mission was not able to conduct a full review of the data required in the return, the following is noted:

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<sup>16</sup> Study on the feasibility and impact of a common EU standard VAT return, PwC 2013, commissioned by the European Commission (EC).

- Extensive information is required on advance payments of VAT and interest and on off-sets of credits against debits which would be unnecessary in the case of monthly and quarterly tax returns.
- Much of the data required is not directly relevant to the calculation of the VAT liability or to overall risk analysis and therefore should only be requested where an audit or investigation is being conducted.
- Detailed data requirements for special regimes add complexity to the return and may need to be reconsidered from a tax policy and administration perspective.

91. **The annual VAT return should be abolished and replaced by monthly and quarterly returns.** An annual VAT return is permitted but not required by EU law, and exists in only eight other EU member states. Its usual function is to allow taxpayers to make adjustments and/or to collect aggregated information. Given that adjustments can be made in, and information can be aggregated from, periodic VAT returns submitted by business, the annual VAT return could be abolished. Additional information which is currently included in the annual VAT return could be requested from relevant individual businesses by the tax authorities on the basis of risk assessment.

### **Recommendations**

- Introduce monthly and quarterly VAT returns.
- Review and reduce significantly the amount of information required to be provided in these periodic VAT returns.
- Abolish the yearly VAT return.

### **Value-added tax fraud**

92. **There is widespread VAT evasion and fraud across all business segments.** A report on tax evasion published by the Italian government in October 2014 estimated an average total tax gap of €91 billion (5.6 percent of GDP) over the period 2007–12, of which around €40 billion represented unpaid VAT (2.5 percent of GDP).<sup>17</sup> Italy's VAT compliance gap was estimated to be among the highest in the EU (31 percent) in 2013.<sup>18</sup> Moreover, VAT

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<sup>17</sup> MEF, Rapporto sulla realizzazione delle strategie di contrasto all'evasione fiscale 89.

<sup>18</sup> The Netherlands' Bureau for Economic Policy Analysis (CPB)/CASE, Study to quantify and analyze the VAT gap in the EU27 member states, commissioned by the EC, 2015, see figure 6 in Appendix 1.

arrears are a significant share (around 35 percent) of the stock of arrears held by Equitalia in 2014, amounting to €188 billion.<sup>19</sup>

93. **Officials expressed concern of significant so-called "missing trader intra-community VAT fraud" (MTIC).** Missing traders are bogus companies with a post box or agent address, no commercial activity, no assets and no facilities. They can either be a recently established or a reactivated dormant companies. Missing traders may, by increasing their "life span" (or the period before detection), file no returns, file nil returns, or file regularly but not pay the VAT. Whatever the mode, the fraudulent intention is to not pay VAT, and allow other links in the fraud chain to deduct VAT and obtain a refund or reduce a liability. The other links in the chain may include interposed companies aimed at disrupting possible VAT investigations. The fraud will, in almost all cases, involve intra-community acquisitions or supplies within the EU. On the surface, these fears of significant fraud may be justified. This section will discuss some areas that appear to warrant detailed analysis and corrective measures.

94. **There is a need to develop or acquire specific intelligence and risk assessment for MTIC fraud.** Although modern risk analysis systems are in place, MTIC fraud mechanisms are difficult to detect. The major difficulty is in finding the fraudulent transactions quickly among hundreds of millions of transactions within the EU annually. New and more effective means of early detection of missing trader fraud—as from the first suspect VAT return or other suspicious behavior—use multiple analytical techniques, combining social network analysis, business rules, predictive modeling and anomaly detection. This requires, inter alia, input from the VAT Information Exchange System (VIES), preferably monthly VAT returns, and Eurofisc data. In the case of Italy, which has only annual VAT returns, the analysis would have to use periodical payment data instead, which will impede the analysis and early detection.

95. **Deregistration procedures are too slow to stop VAT fraud at an early stage and do not succeed in quickly deregistering missing traders from the VIES system.** It is important to react quickly on detected frauds associated with fictitious businesses in order to prevent further loss of revenue. Deregistration has proven to be very effective in stopping frauds. Therefore a short and rapid procedure should be in place to deregister the VAT number in VIES. Many administrations have a central fast-track deregistration procedure as well as the necessary legal competence to cancel a VAT registration in case of suspicion of MTIC fraud. Currently, deregistration requires a decision by the Director of the provincial tax office of the AdeE based on an audit report and an on-the-spot check. Requests for deregistration by the AdeD and the GF have to be addressed to the AdeE. The completion of this procedure takes too long to be effective.

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<sup>19</sup> Estimates by Equitalia.

96. **The specific and complex nature of the MTIC fraud requires coordination of preventative and enforcement measures in order to ensure fast and effective action.** VAT audit, assessments and collection is fragmented across multiple agencies and, within the AdeE, across local and regional offices. Pockets of good practice have been implemented. Coordination of repressive action between the headquarters of the Agencies is done in the so-called "control room." The control room agrees on division of work between the agencies for detected fraud cases and occasionally coordinates joint-actions. However, a systematic coordination of preventive action and efforts for early detection is missing. There should be one central unit to coordinate risk analysis and take action nationally. Many administrations in the EU have created central VAT anti-fraud units with the competence to coordinate detection, preventive, and repressive actions. These units:

- are able to carry out, or coordinate, the registration control or visiting programs for potential buffers and brokers;
- run the detection software and have access to VIES, VAT returns, payments, and Eurofisc data;
- have the competence to cancel directly the VAT registration numbers;
- are the competent authority for the exchange of information with EU member states;
- may coordinate investigations and referrals for prosecutions.

Ideally, such a unit should be in the AdeE as the agency responsible for VAT operations.

97. **The VAT audit system is not sufficiently supported by preventive measures to avoid or facilitate early detection of VAT fraud.** The measures described hereunder represent a set of possible additional actions in order to prevent VAT fraud. It should not be considered as an exhaustive list of actions but as some examples of good practice.

98. **The registration process is crucial.** Where fraudulent intention is suspected, many countries take precautionary measures and require monthly returns or securities as precondition for registration. Italy has opted for a fast, business-friendly VAT registration policy. Risk assessment can, however, be done in two steps. First, a quick assessment of all applications based on minimum data requirements. And secondly, an in-depth assessment for a minor group of risky applications.

99. **Keeping the VAT register free of inactive taxpayers reduces the possibilities of reactivating or replacing a deregistered missing trader.** Although deregistration procedures are in place, it takes more than three years for physical persons and more than five years for companies that have ceased their activities to be de-registered. There is no systematic clean-up of the register, resulting in around 618,000 nil returns.

100. **Monthly returns facilitate early detection of VAT fraud.** Many countries require monthly returns for VAT operations in risky sectors or even for all taxpayers involved in intra-community operations.

### Recommendations

- Develop or acquire specific risk assessment tools for missing trader VAT fraud using multiple analytical techniques, combining network analysis, predictive modeling and anomaly detection.
- Introduce a short and rapid procedure to de-register or to cancel the VAT number in VIES in cases of suspected VAT fraud.
- Create one central unit to co-ordinate the risk analysis, preventive and repressive actions nationally for all the agencies, and locate this unit in the AdeE.

### D. Addressing the Accumulation of Tax Debts and Enhancing Collection Enforcement

101. **The large stock of arrears managed by Equitalia is growing exponentially.** Total arrears were at €728 billion and tax arrears at €568 billion in June 30, 2015 (Table 5). Total arrears are growing rapidly—rose by €79 billion in 2014 compared to €55 billion in 2009 (Figure 2). Total arrears are at 93 percent of total tax revenue and tax arrears at 116 percent of tax revenue. The collection rate for tax arrears (6 percent) is lower than the overall collection rate (10 percent).

**Table 5. Equitalia—State of Arrears June 30, 2015**

(€ Billions)

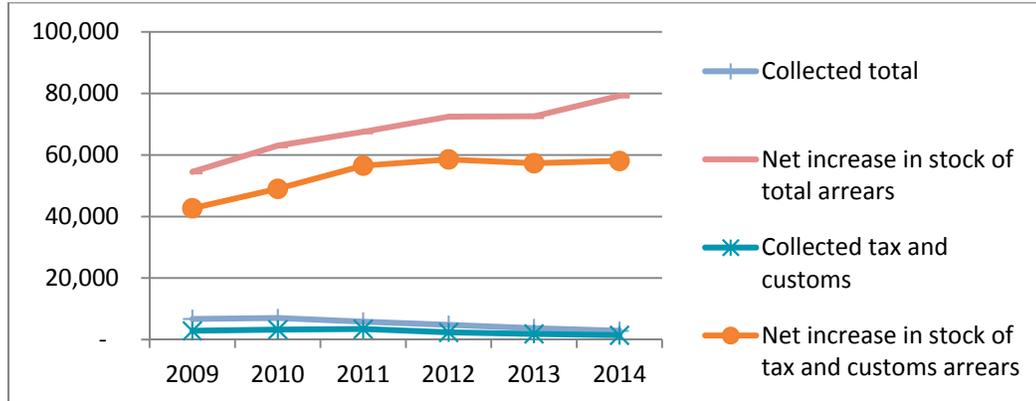
	<b>Total</b>	<b>Tax</b>	<b>Other</b>
<b>Arrears to be collected by Equitalia since 2000</b>	<b>805.8</b>	<b>602.6</b>	<b>203.2</b>
Collected	77.9	34.7	43.2
Collected in percentage of total arrears	10%	6%	21%
<b>Stock of arrears</b>	<b>727.9</b>	<b>567.9</b>	<b>160</b>
<b>Stock of arrears in percentage of yearly revenue<sup>1</sup></b>	<b>93%</b>	<b>116%</b>	<b>54%</b>
Suspended arrears (e.g., in dispute)	4%	3%	7%
Bankrupt, deceased, out of business	28%	31%	19%
Insolvent debtors	10%	11%	7%
Under instalments	3%	2%	5%
Enforced but not collected	36%	36%	36%
Under provisions protecting taxpayer's assets	8%	7%	12%
<b>Net residual stock of arrears</b>	<b>83.4</b>	<b>59.5</b>	<b>23.9</b>
<b>Net residual stock of arrears in percentage of total</b>	<b>11%</b>	<b>10%</b>	<b>15%</b>

Sources: Equitalia; and IMF staff calculations.

<sup>1</sup> Projections 2015—General Government (GDF 2001 Format), 2013–20.

**Figure 2. Equitalia: Net Increase of Stock of Arrears by Calendar Year**

(€ millions)



Sources: Equitalia; and IMF staff calculations.

102. **A significant amount of arrears is not collectable.** As shown in Table 5, 10 percent of tax arrears relate to insolvent debtors, 31 percent to debtors which are bankrupt, deceased or out of business, and 36 percent to cases in which enforcement actions have been taken but did not result in actual collection.

103. **Many factors contribute to the low rate of collectability.** The economic recession has undoubtedly led to an increase of insolvent debtors and uncollectable arrears. However tax policy choices and institutional arrangements also contributed to the high stock of arrears. Increased taxation is paired with high penalties for nonpayment compliance. Penalties are up to 30 percent for declared but not paid tax liabilities or 200 percent for nondeclared liabilities. Although significant reductions in penalties are foreseen by law in case of voluntary payment, the stock of arrears includes significant amounts related to penalties for noncompliance. International experience confirms that the collection rate for these penalties is very low. A recent proposal to reduce, inter alia, penalties from 200 to 180 percent is likely to have only a minor impact. Moreover, given that the GF is de facto the core field audit function in Italy, a significant amount of debt originates in audits or investigations conducted by this agency on cases for which there is little hope of collection.

104. **The absence of sufficient debt write-off results in an overstatement of tax debts that are truly collectible.** Between 2000 and 2015, only 21 percent of total arrears and 23 percent of tax arrears has been written off. As previously mentioned, 77 percent of the stock of arrears relates to insolvent, bankrupt, deceased or out of business debtors or to arrears for which enforcement actions have been taken but did not result in collection. The collectability of these arrears needs urgent further examination with a view to write-off.

105. **There are no effective write-off arrangements in place.** Classification of tax arrears as uncollectible is allowed by the AdeE following an audit of Equitalia's activity during the following three years of the request to write-off. AdeE may suggest additional enforcement measures or

deny write-off when the debt has not been recovered due to perceived shortcomings or irregularities on the part of Equitalia.<sup>20</sup> There is no legislative authority to write-off debts unless all possible recovery actions are taken. Good international practice suggests, however, that write-off should be an ongoing action and take place on a case-by-case basis once all reasonable steps to collect the debt are taken so that collection agencies do not waste valuable resources in following-up uncollectible debts. Debt write-off is an accounting action, not a mechanism for forgiveness of a debt. The mission was informed that, in future, the AdeE will examine write-offs on a yearly basis, which is a significant step forward. However, it is unlikely that this new procedure can accommodate the write-off demands on the scale associated with the huge stock of uncollectible tax debts. The key characteristics of an effective legislative write-off regime are set out in Box 12, see next page.

106. **Enforcement of collectible debt can be improved.** Around a €100 billion of tax arrears is deemed to be recoverable.<sup>21</sup> The measures described hereunder represent a set of possible actions to increase revenue collection.

107. **Collection enforcement starts too late, mainly because of the filing and payment arrangements.** Opportunities for collection deteriorate exponentially as time elapses. It is good practice to start work on collection immediately after the deadline for payment. However the filing and payment arrangements entail late reconciliation of payments and liabilities, e.g. for VAT, more than one and a half year after the taxable period. Subsequently, the AdeE has to notify a request for payment and only after 90 days can AdeE send a request for enforcement to Equitalia. Equitalia has to notify the taxpayer again and executory measures cannot commence for a further 180 days. Consequently, work on collections (e.g., notifications, reminders, early telephone contacts with new debtors) can only start after one and a half years and on enforced payment after more than two years. International experience suggests that successful collection should be done within three to six months, after which collection rates deteriorate exponentially. The absence of an early reconciliation of payments and liabilities, and the long legal time frames, are a major impediment to the enhancement of the collection processes.

108. **Equitalia has to enforce all debts and cannot prioritize collection work or apply nonsequential collection processes.** Although many functions can be automated, debt collection and in particular enforcement remains a labor intensive process. Therefore collection agencies have to prioritize limited resources to ensure the effectiveness of the overall process. In many administrations sophisticated debtor profiling tools assist in targeting the most effective means of collecting overdue payments. The collection processes will differ depending on the value and nature of the debt and the profile of the debtor. The legalistic approach to collection—exhausting all means for enforced recovery for all debts—is another impediment to the modernization of the collection processes.

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<sup>20</sup> In this case Equitalia shall reimburse one-eighth of the uncollectible amount.

<sup>21</sup> €60 billion net stock of arrears and €39 billion under protection of taxpayer's assets.

### Box 12. Writing-Off Uncollectible Tax Arrears

In the process of collecting tax arrears, situations arise where it is appropriate for the tax authority to discontinue collection activity because the amount is uncollectible. Generally, the decision not to pursue recovery of a tax debt is made when the amount is deemed a "bad debt" to be written-off under government accounting procedures. Before write-off takes place (which removes the tax debt from the books of account), the tax administration must be satisfied that it has taken all reasonable steps to collect the debt.

Write-off action is generally limited to three situations:

- The tax debt is not economical to pursue—typically, these cases involve small amounts or situations where the taxpayer cannot be located.
- The taxpayer has no funds or other assets (e.g., where a company has ceased operations and there are no assets or where a debtor has died and left no assets).
- The debt is not legally recoverable (e.g., where the amount represents the balance outstanding after a final dividend has been paid under bankruptcy or liquidation proceedings).

Most write-off systems have the following features:

- Legal authority to write-off tax debts is provided under a country's financial management and accountability laws (not tax laws), and write-off powers are given to a limited number, only, of senior tax officials.
- Write-off approvals (and supporting reasons) are fully documented, and reviewed—sometimes by a committee, in the case of large debts. The write-off system is also subject to audit by the government's external auditor, and the total value of debts written-off is published annually.
- Except where the amount is irrecoverable at law, the debtor is not absolved from ever having to pay the liability (i.e. the debt may be re-raised and action taken to collect it if, for example, the debtor's financial position improves).
- Tax debts are considered for write-off on a case-by-case basis.
- Uncollectible debts are written-off without the knowledge or involvement of the debtors concerned (i.e., write-off is an internal accounting function).
- Amounts withheld from employees' wages for personal income tax and SSC amounts may have seniority (as preferred creditor claims). Coherent joint processes to deal with both tax/SSC and private sector debt, including on an out-of-court basis, may be adopted, (on an exceptional basis), to assist private sector lenders and facilitate future credit access by tax/SSC debtors.

109. **Legal constraints to effective seizure of income and assets impede recovery of an estimated €39 billion of tax arrears and should be reconsidered.** These constraints were enhanced recently by Law Decree no. 69/2013 and led to a significant drop in collections. The restrictions relate to protection of balances on current accounts, impediments for executive procedure for nonprime residence real estate for debts under €120.000, or in general for mortgages for debts under €20.000.<sup>22</sup> There are restrictions for seizures of capital goods,

<sup>22</sup> According to Equitalia staff, this restriction resulted in a decrease from around 135.000 to 13.000 of yearly mortgages.

including passenger cars, as well as extensive notification requirements and 'no-action' period for any executory action.

110. **Some categories of income, inter alia wages and pensions, are overly protected.** For example the most recent salary cannot be seized on current bank accounts and third party seizure is limited to 5 to 10 percent depending on the salary level. This limitation is unusual. International practice commonly provides for garnishment of higher proportions or indeed all amounts exceeding a threshold (Box 13).

**Box 13. Seizure of Protected Income**

- a) Categories of income protected from enforced collection, include wages, pensions, family allowances, disability allowances, and other replacement income.
- b) The thresholds under which no seizure is possible are nominal amounts or a percentage set in relation to minimum wages or pensions.
- c) These amounts may be indexed annually.
- d) Above these thresholds 100 percent can commonly be seized.
- e) Rules may differ depending on whether the income is seized directly or indirectly from bank accounts. For direct seizures, the protective thresholds may take account of the family situation of the debtor and be increased for dependent spouse and children. For indirect seizures (bank accounts) threshold may be established as a fixed amount for each individual.
- f) Examples of monthly thresholds:
  - i. Belgium: between EUR 1,069 and EUR 1,386.
  - ii. Germany: EUR 930 increased by EUR 350 per dependent person.
  - iii. France: nonseizable credit balance on bank account (EUR 500).
  - iv. Portugal: 100 percent of the minimum wage (EUR 485).
  - v. Slovenia: 70 percent of the minimum wage.
  - vi. Denmark: single person: DKK 5,850 Married/cohabiting couples DKK 9,920.

111. **Equitalia does not have access to data on balances and transactions on bank accounts.** While the AdeE has full access for audit purposes, Equitalia does not have these powers for debt collection. Equitalia can only access information to confirm the existence of a bank account. Granting access could however significantly increase collection efficiency as it would allow for targeted automated e-garnishments.

112. **Instalment schemes are too lax and the excessive use of installment plans is not in line with international best practice.** Installment arrangements are allowed automatically in many circumstances without regard to the taxpayer's compliance history or the true capacity to

pay.<sup>23</sup> For example, all arrears under €75,000 are payable over two-to-five years regardless of the capacity of the taxpayer to pay the amount owing. In 2014 only 1.6 percent of requests for installment plans were denied by the administration, a trend which is decreasing (Table 6). Moreover, under certain circumstances installments can be granted for 10 years. There is no requirement for full and timely payment of all new tax obligations. And until recently new installment plans could be granted while previous plans were not complied with. Equitalia estimates the drop-out rate at around 30 percent and anecdotal evidence suggests that taxpayers often pay only the first installment under such arrangements. Although installments account for an increasing share of collection by Equitalia (close to 50 percent), these arrangements undermine general payment compliance and deviate from international best practice as outlined in Box 14.

**Table 6. Trends in Installments**

(€ millions)

	2010	2011	2012	2013	2014
Total amounts collected	8,876	8,623	7,531	7,134	7,411
Collected by instalments	3,213	3,409	3,066	3,334	3,405
Percentage on total	36%	40%	41%	47%	46%
Number of request for instalments	571,694	553,933	621,484	732,326	979,082
Percentage of requests denied	4.7%	4.2%	2.7%	2.0%	1.6%

Source: Equitalia.

## Recommendations

- Put effective write-off arrangements in place.
- Redesign filing and payment arrangements with a view to early collection of taxes.
- Review legal constraints to effective seizure of income and assets.
- Bring instalment arrangements in line with international trends.

## E. Increasing the Effectiveness of Audit and Investigations

113. **Responsibility for tax audits and investigations is fragmented across two separate agencies—the AdeE and the GF.** Appendix 5 outlines the scope of the tax audit and investigations activities of the two agencies and describes the coordination arrangements in place that are meant to ensure that taxpayers are not audited by more than one agency at any given time.

<sup>23</sup> Capacity to pay should be determined on the basis of an examination of a full statement of the taxpayer's financial position.

### **Box 14. Features of an Installment Payment System**

In times of economic crisis many taxpayers experience cash flow or other difficulties that prevent them from paying their tax debts on time. The tax administration should adopt a structured and transparent approach to considering requests from taxpayers to pay debts by installments, over as short as possible a period of time, and as an alternative to more formal recovery procedures.

**Eligibility**—In order to be eligible, taxpayers should:

- ✓ formally propose a realistic installment arrangement;
- ✓ demonstrate their financial viability;
- ✓ have a reasonable record of compliance;
- ✓ demonstrate that full and immediate payment would result in a genuine burden (rather than a mere inconvenience);
- ✓ show they are treating their tax debts with the same or greater priority as they are treating other payment obligations; and
- ✓ provide all necessary financial records and information.

**Conditions for approval**—the debt should be extinguished in as few installments as the taxpayer can reasonably manage, and taxpayers must adhere to the following conditions:

- ✓ payment of all penalties and interest as prescribed by law;
- ✓ subject to a sufficient interest rate that compensates the government for being denied the use of funds and ensures that the government maintains its status as a creditor to be paid ahead of other lenders;
- ✓ differentiation in payment terms between natural persons not carrying on a business and legal persons and individuals carrying on a business. For natural persons, the term of the installment scheme will generally not exceed 12 months. For any taxpayer, and regardless of the nature of the entity, the installment plan should not exceed three years duration.
- ✓ full and timely payment of all new tax obligations;
- ✓ provision of security (if required in certain cases); and
- ✓ cancellation of the arrangements and application of enforced collection procedures in the event of default.

114. **The coordination efforts are at a case management level only; there does not appear to be any joint strategy development across the agencies.** This represents a major weakness in the design of the overall enforcement program. Risk identification and audit planning is conducted independently. While agencies claim that good relationships and close cooperation is maintained to avoid multiple audits of the same taxpayers, feedback to the mission from taxpayer representatives suggested that this objective was often not achieved in practice. The mission assessed that effective coordination of audit activities across three separate organizational structures at several hundred local, provincial and regional offices would be problematic at best given the breadth of the cross-cutting mandate of the GF.

115. **The current approach is not efficient and represents a major constraint to realizing the vision of a more effective, transparent and trusted tax administration.** All of the risk management infrastructure is duplicated across the agencies and the massive overall investment in this and the audit function (around 34,000 staff in total) is not reflected in a proportional improvement in voluntary compliance.<sup>24</sup> The fragmentation of the audit function across separate agencies also means that:

- there is no single organizational unit that has a complete picture of the tax risk environment or is accountable for compliance outcomes;
- there can be no assurance that resources are properly directed to the highest risks;
- in the absence of any overarching strategy, compliance activities inevitably reflect a strong bias towards enforcement—especially given the size and specific focus of the GF; and
- taxpayers may be treated in an inconsistent manner and confused about the powers of the particular agency conducting an audit or investigation. This will represent a major constraint to building a trust-based relationship with taxpayers and promoting a stronger culture of voluntary compliance.

116. **Full responsibility for the tax audit function should be vested in the AdeE.** Audit is a core function of any tax administration; this includes responsibility for investigation of serious evasion and tax fraud. Police assistance may be requested in cases where the safety of the tax investigation staff is at risk, but the tax agency should retain the lead role. Cases should only be managed directly by an external financial police agency where the main focus of the investigation is on (nontax) criminal activity (e.g., activities of organized crime). In these cases, specialist tax agency staff should be seconded to the financial police agency to assist in resolving any tax issues that arise.

117. **Given the relative capabilities of the GF and the AdeE, transition to this tax administration model will need to be managed carefully.** It is clear that a culture of voluntary compliance has not yet taken root in Italy and that the AdeE is still building its field audit capability. In these circumstances, a continued substantial presence of the GF is required in the short-to-medium term. An indicative timeframe for a staged and manageable transition is indicated below:

*In the short term (within one–two years):*

- Maintain the arrangement under which all tax assessments are approved and issued by the AdeE—this reinforces the primacy of the agency in managing the overall tax system.

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<sup>24</sup> Italy continues to have one of the largest VAT gaps in Europe.

- Mobilize resources for the AdeE to boost its field audit capability (e.g., through permanent or temporary transfer of trained staff from the GF, targeted recruitment; and/or internal reallocation of AdeE staff).
- Develop and deliver an up-skilling program for existing and new AdeE audit staff.
- Narrow the mandate of the GF to ensure it focuses only on the most serious fraud and evasion cases. This could be done through the development of a formal memorandum of understanding (MOU) which outlines a narrower and more appropriate set of risk-based case selection and case referral guidelines. The MOU should also specify that all relevant intelligence is shared across the two agencies.

*In the medium term (within four years):*

- When the field audit capability of the AdeE is assessed as fully competent, further narrow the mandate of the GF to ensure that the AdeE has full responsibility for managing all aspects of compliance with domestic tax obligations, including investigation of serious evasion and tax fraud. Thus, within this medium term scenario, the GF will no longer have responsibility over tax audits and fraud investigations; full accountability for these core tax administrations functions will rest in the AdeE.

118. **Planning for a staged transition to the new tax administration model should commence now to set a clear reform agenda.** This project should represent one of the key reforms included in a three–five year agency level strategic plan for the AdeE. The heads of the AdeE and the GF should be made jointly accountable for implementing the reform and should be required to provide regular progress reports to the MEF.

### **Recommendations**

- Implement a staged approach to moving full responsibility for the tax audit and investigation functions to the AdeE.
- Include this initiative as a major reform objective in a three–five year agency-level strategic plan for the AdeE.

## **F. Filing and Payment of Social Security Contributions**

### **Background**

119. **SSC are a very important source of government revenues.** At 13 percent of GDP, or €216.4 billion (Table 1), they are the single largest category of collections and accounted for 28 percent of government revenues in 2014. SSC payers consist of (i) approximately 1.7 million employers (who pay 23.8 percent of employee earnings); (ii) amounts withheld from 20.2 million employees (paying 9.1 percent of earnings); and (iii) around 3.9 million self-employed persons (who must pay under a separate social security regime and the rate varies from 25 to 29 percent

of earnings).<sup>25</sup> Amounts are collected monthly from employers and quarterly from self-employed persons.

### **Social security contributions and the personal income tax**

**120. The bases for calculation of amounts payable for SSC and PIT are well harmonized.**

Both are based upon common definitions and any differences in the base are considered exceptional (though the mission in the time available could not confirm the extent of any deviations).

**121. Further harmonization of the registration, filing, and payment by payers of SSC and PIT provides distinct advantages for efficiency of administration and costs of compliance.**

Payers of each obligation would need to register once only and a unified register of payers can be established. A single payment and single declaration can be filed that provides the information necessary for calculation and validation of *both* amounts. Only minimal information is required by the tax administration to confirm the correct calculation of a payments. Pension funds require substantially different and complex information. This is for the purposes of validating and updating SSC entitlement data but this may be done either together or separately with the payment declaration.

**122. The unification of SSC and PIT registration, filing and payment has been completed in a number of European administrations.**<sup>26</sup>

The OECD observes that the marginal cost of expanding systems used for tax administration to include SSC appears low, and this is because the core processes for collection of tax and SSC are largely the same. They include identifying and registering employers and the self-employed (based on similar definitions of income), payment of both amounts through the banking system, follow-up of those who do not file and verification of the accuracy of the information in declaration using a risk based audit method.<sup>27</sup> The integration does not always extend to the institutional location of an “integrated” administration so that “one filing for two entities” remains an option, at least for the short term.<sup>28</sup>

**123. INPS are concerned for the extent of unregistered labor, “brown envelope” payments as well as for SSC payment compliance among self-employed persons.** Cash payments to evade SSC obligations are endemic to the system. Current year filing and payment

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<sup>25</sup> These are estimates based upon filers of n.770 in respect of PIT obligations.

<sup>26</sup> See for example, the research carried out by the European Institute of Social Security: *Case Studies in Merging the Administrations of Social Security Contribution and Taxation*, Bakirtzi, Schoukens, and Pieters, 2011. The reform experience in Estonia, Hungary, Italy, Netherlands, and the United Kingdom are discussed.

<sup>27</sup> OECD: *Tax Administration Comparative Information on OECD and Other Advanced and Emerging Countries*. (2015).

<sup>28</sup> See Enoff and Ruggia-Frick. *Innovations in contribution collection and compliance: Summary report 2011–13*.

compliance is estimated at about 70 percent of those self-employed who are expected to be regularly filing and paying their SSC obligations.

124. **There would be synergies and savings to government if common compliance programs were pursued.** INPS does attempt to focus on unregistered labor but their focus on detection of cash payments is minimal. There are no joint inspections at business premises between staff of INPS and AdeE. Information exchanges between INPS and AdeE are in place, but the cycle times for providing information from tax administration to INPS are extended. Consequently, the finalization of SSC obligations for self-employed is commonly delayed.

125. **INPS and AdeE should move to quickly adopt an integration of registration, payment and filing and joint approaches to compliance management within the PIT and SSC.** Better integration is both an opportunity for administrative simplification in filing and payment as well as a potential means for enhanced cooperation and better compliance on these major revenue items. The first step is to unify the register of payers across PIT and SSC and provide a single registration process for payers; the second is to finalize a common filing and payment platform; (a single payment is already available to cover PIT and SSC amounts but filing procedures differ); and the third step is to unify compliance approaches—joint payroll audits and single audits for self-employed—for detection of undeclared amounts for both obligations. Collection enforcement in respect of both obligations is conducted by Equitalia.

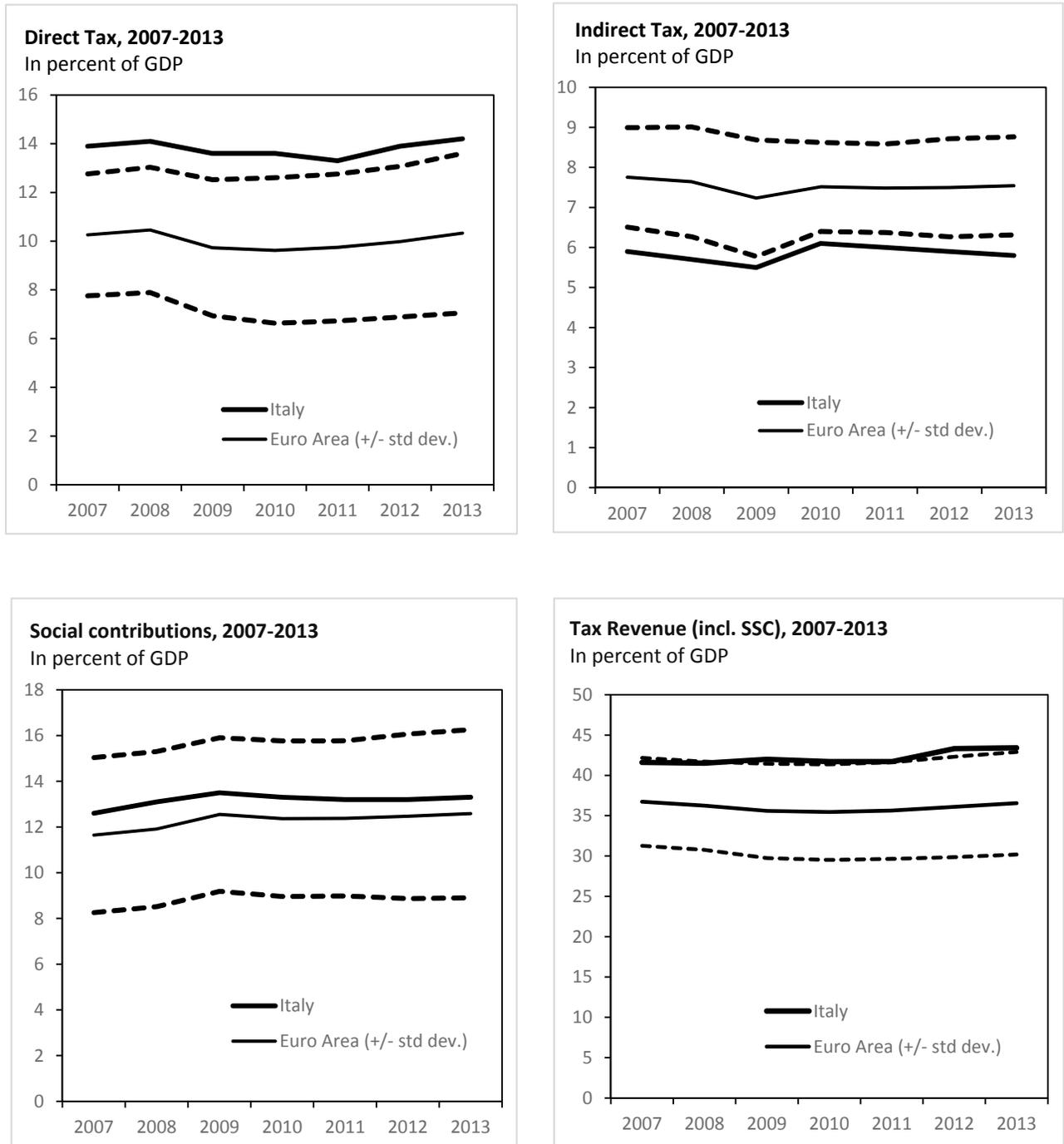
126. **Because of the dominance of SSC and PIT in the government's revenue base, the risks attached to an integration must be carefully managed.** It is beyond the mission scope to develop a detailed plan of actions for the integration project. Based on case studies where this reform is pursued, an integration of the core processes for registration, filing and payment of PIT and SSC within 24 months is envisaged. Reform to institutional arrangements that centralizes resources in the AdeE for the administration of registration, filing, payment, and compliance management of PIT and SSC obligations could be put in place concurrently or scheduled for a later time.

### **Recommendation**

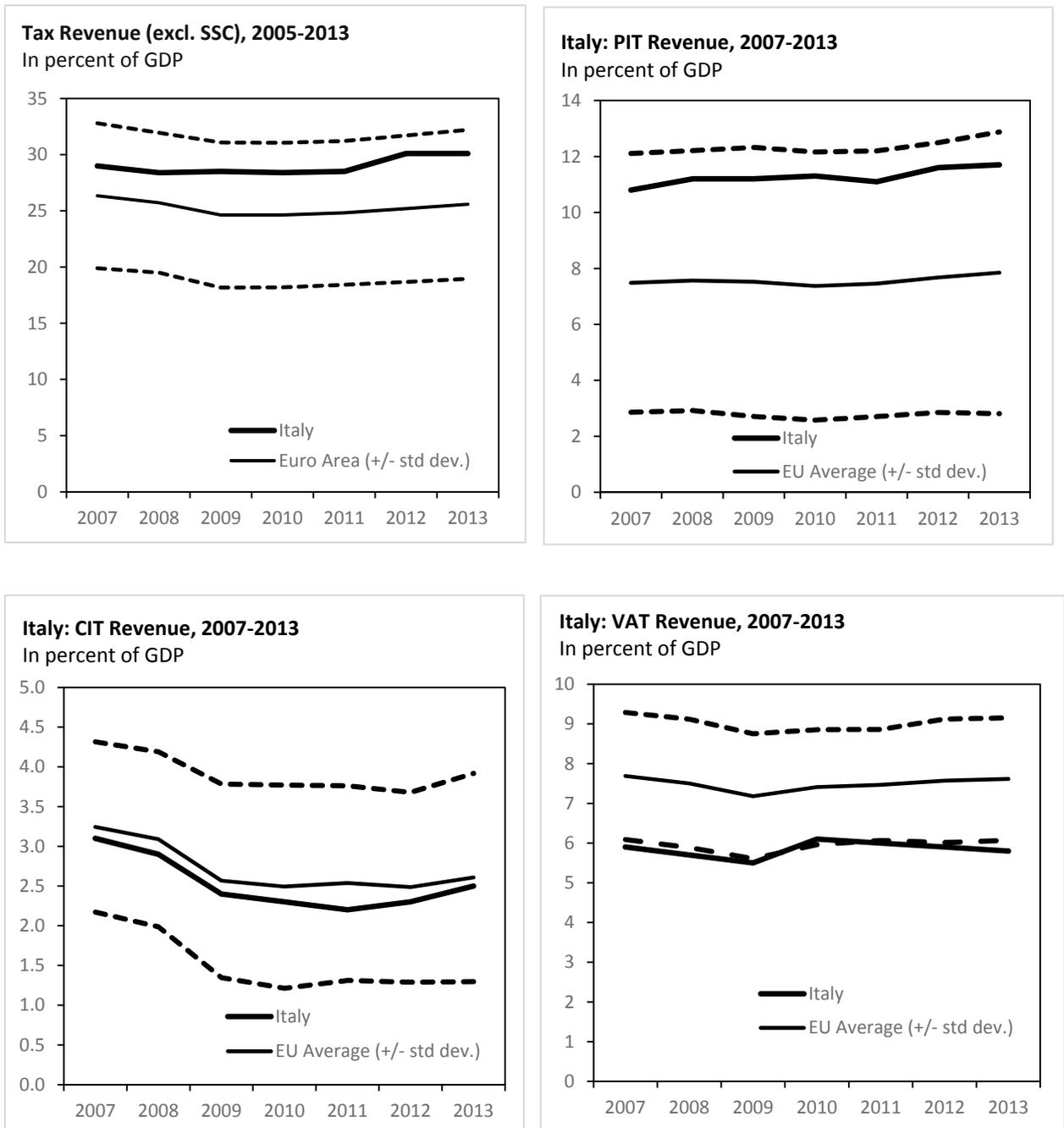
- Adopt a common registration, filing, and payment platform between SSC and PIT and common approaches to compliance management.

### Appendix 1. Trends in Collection Performance in Main Taxes and Social Security Contributions in Italy and European Countries

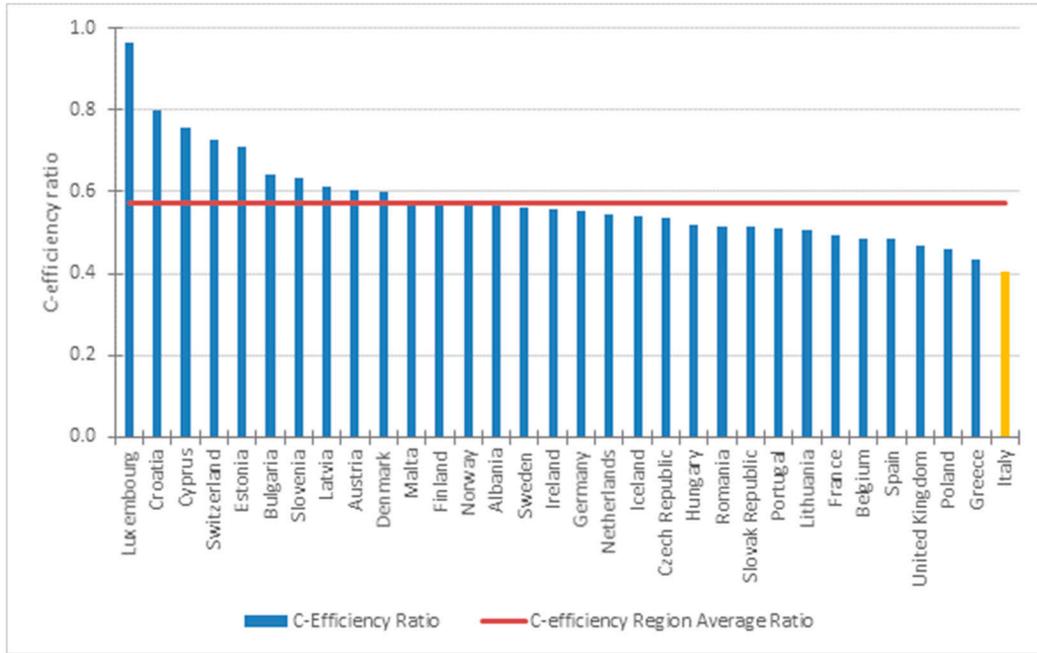
**Figure 3. Direct and Indirect Taxes and Social Security Contributions Collection in Italy and Euro Area, 2007–13**



**Figure 4. Main Taxes and Social Security Contributions Collection in Italy and Euro Area, 2007–13**

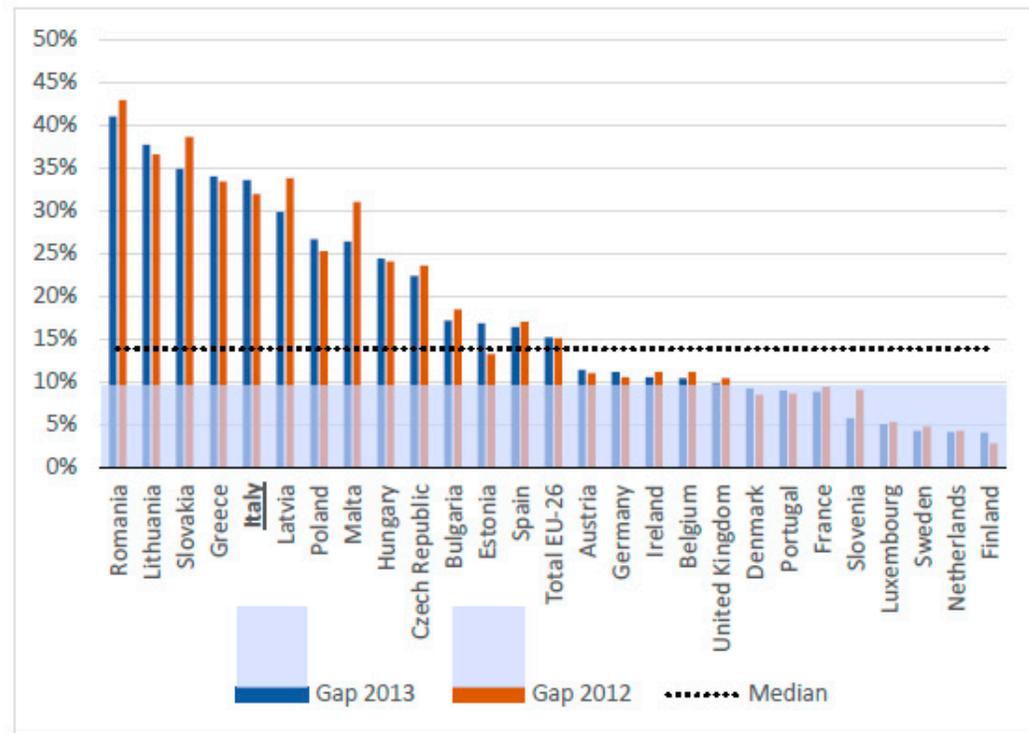


**Figure 5. C-Efficiency Ratio in Italy and European Countries**



Source: IMF estimates.

**Figure 6. Value-Added Tax Gaps in Italy and European Countries**



Source: CPB/CASE, Study to quantify and analyze the VAT gap in the EU member states, commissioned by the EC Taxation and Customs Union, 2015 report.

## Appendix 2. Requirements for Autonomy in Revenue (Tax and Customs) Agencies

The Autonomy Condition	The Minimum Requirements	Considerations	Assessment of the Agenzia Situation (met in full, in part, not met)
<b>1. A separate and dedicated administrative body</b>	A Director responsible for <i>all</i> functions related to the respective administration, and reporting to the Minister of Finance. The Director is in control of all aspects of the organization.	<p>a) There can be separate tax and customs agencies.</p> <p>b) Where revenue administration functions are across organization units, a single Director has ultimate control for administration, (i.e., there is a single Director with control of all tax administration functions and a single Director with control of all customs functions).</p> <p>c) Revenue administration functions are not replicated across entities.</p> <p>d) Heads of regional offices are only responsible to the Director of the respective administration.</p> <p>e) When a board or external body oversees the administration, they are not involved in decision making on operational matters.</p>	<p>a) The tax and customs agencies are separate.</p> <p>b) <i>Not met.</i> Directors of the agencies have ultimate control for some but not all aspects of administration. Information technology services are provided to each through SOGEI. AdeD works in close liaison with EU bodies as part of the process of harmonization and development of the European Union. A deD receives debt collection services from Equitalia but has limited control of debt enforcement within Equitalia. AdeE does not control the tax audit and tax investigation functions under the GF.</p> <p>c) <i>Not met.</i> Tax audit functions are duplicated between the GF and AdeE.</p> <p>d) <i>Met in full.</i></p> <p>e) <i>Met in part.</i> Management committees are not involved in decision-making processes on day-to-day tax and customs obligations and on operational matters. Management Committees review and monitor the results of management decisions and check on the compliance, consistency and legality of administrative operations (with regard to the obligations of the Court of Auditors). Staff appointment decisions may be reviewed by the Committees. The MEF has extensive supervisory powers over the agencies. The Minister must approve the Statutes, the Regulations, the budget and its revisions, the financial statements, the investment plan (including IT), and any other general measures concerning the operation of the Agency.</p>

The Autonomy Condition	The Minimum Requirements	Considerations	Assessment of the Agenzia Situation (met in full, in part, not met)
<b>2. Empowered to administer and enforce the revenue laws, with all necessary and clearly defined powers and accountabilities</b>	Powers and authorities in revenue laws assigned <u>directly</u> to the Director of the administration in legislation (or <u>indirectly</u> via the Minister). The Director is able to further delegate powers to officers at operational level.	<p>a) No powers or authorities provided in law will bypass the Director.</p> <p>b) Powers are not exercised by anyone outside the revenue administration (other than by the Minister, and this will be rare).</p>	<p>a) <i>Met in full.</i> No powers by-pass the Director</p> <p>b) <i>Met in full.</i> Powers are not exercised outside the administration or Minister.</p>
<b>3. Headed by a nonpolitical appointee as Director, appointed for a fixed term</b>	Terms of appointment are unrelated to the time horizon of a Government.	<p>a) Five-year terms for the Director and deputies may apply.</p> <p>b) The law fully describes the circumstances for early removal of the Director.</p> <p>c) The mechanisms for affecting removal are prescribed and transparent.</p>	<p>a) <i>Not met.</i> A three year term is in place for the Directors of AdeD and AdeE, but the term of office is linked to the duration of government regardless of the duration of contract. Directors are removed ninety days after the vote of confidence for the new government. Directors can be reappointed by means of a new contract signed by an incumbent government. The deputy directors and all other directors are appointed by the Director following the advice of the Management Committee.</p> <p>b) <i>Met in part.</i> Removal mechanisms are governed by the law. Early dismissal can occur in the event of nonachievement of targets. Targets are subject to MEF approval.</p> <p>c) <i>Met in full.</i> Early termination of the Director's employment contract results in the appointment of a special commissioner, pursuant to paragraph 1 of Article 69 of Legislative Decree no. 300/1999.</p>
<b>4. Sufficient autonomy to exercise strategic management and control of operations:</b>			
<i>i. Performance measures</i>	Performance measures are developed by the administration.	<p>a) The Minister of Economics and Finance approves key performance measures.</p> <p>b) Key measures are built upon performance outcomes.</p>	<p>a) <i>Met in part.</i> Approval processes are subject to final approval in the MEF. MEF involvement in development of indicators is possible.</p> <p>b) <i>Not met.</i> Key measures are a mix of operational inputs and outputs.</p>

The Autonomy Condition	The Minimum Requirements	Considerations	Assessment of the Agenzia Situation (met in full, in part, not met)
		c) The key performance measures are published.	c) <i>Met in full.</i> Measures are published in annual reports of the agencies.
ii. <i>Strategic planning</i>	There is full authority to produce and publish the administration's strategic planning documents.	MEF reviews strategic plans and business strategies prior to publication.	<i>Not met.</i> Ministry may request changes or additions to plans that can extend the scope of its oversight role. The strategic plan for the AdeE is only in respect of the period 2010 to 12. Plans accompanying the annual agreements are more operational in nature.
iii. <i>Reporting (to public and to Parliament)</i>	The organization would develop and submit an annual report to the Minister for publication.	The Minister approves the annual report.	<i>Met in part.</i> The plan, submitted to the Management Committee of the Agency, is approved by the Director of the Department of Finance of the MEF. There is also a role for MEF in drawing the annual report.
iv. <i>Authority to make organizational changes</i>	Director needs ability to make organizational changes to respond to changing circumstances.	a) The final approval for most organization changes is within the revenue administration. b) A central agency may be consulted in the design of major organization changes.	a) <i>Met in part.</i> Director can approve organization structures subject to review by the Management Committee and MEF. b) <i>Met in full.</i> MEF will be consulted.
<b>5. Sufficient autonomy to manage the revenue administration's resources—including human resources—based on delegated authority, accountability, and transparency:</b>			
i. <i>Budget flexibility and financing authority</i>	Director needs ability to move funds between budget categories, within defined limits, to provide operational flexibility.	a) A budget for the revenue administrations is approved each year by the Minister of Finance. b) Funds can be moved between operational budget items. c) No external controls on operational expenditures	a) <i>Met in full.</i> Financing formula is set for each agency as a fixed rate of collections on specific tax categories; the gross financing under the formula is adjusted for savings measures in accordance with government spending priorities. b) <i>Met in part.</i> There are limits on spending categories which are subject to caps. c) <i>Not met.</i> Limitations on specific categories of spending do apply.

The Autonomy Condition	The Minimum Requirements	Considerations	Assessment of the Agenzia Situation (met in full, in part, not met)
		<p>and assets (e.g. travel costs, motor vehicles).</p> <p>d) Government procurement rules may apply; restrictions on movement of funds to and from major capital items may apply (e.g. property and information technology acquisitions).</p>	<p>d) <i>Met in full.</i> Government procurement rules apply.</p>
<p>ii. <i>Authority to recruit, make appointments and promotions</i></p>	<p>Director approves all appointments and promotions based upon merit, whether from outside recruitment or internal promotions. Appointments of Deputy Directors may require central agency oversight.</p>	<p>a) The Director determines recruitment needs subject to the Budget.</p> <p>b) Rules for selection processes, including selection criteria, are determined by the Director of administration.</p> <p>c) Appointments are subject to objective and transparent processes with redress mechanisms and accountability.</p>	<p>a) <i>Not met.</i> Court rulings rendered ineffective the provisions concerning the ability of the fiscal agencies to establish their own rules for progression to management positions. Decisions for temporary appointment to management positions were also annulled leading to vacating of over 900 managerial positions and large-scale disruptions.</p> <p>b) <i>Not met.</i> See above.</p> <p>c) <i>Met in full.</i></p>
<p>iii. <i>Authority to classify positions</i></p>	<p>The tax administration needs to be assured of a position and grading structure that can be competitive and ensure the skills and specialization needed</p>	<p>A grading system specific to revenue administration is determined.</p>	<p>a) <i>Not met.</i> This authority is not available to the agencies. Fiscal agency specific collective agreements that defined the professional categories for agencies were replaced by national labor contracts in 2009. This has the consequence that staff are classified generically whether they are employed in ministries, nonprofit bodies and universities.</p>

The Autonomy Condition	The Minimum Requirements	Considerations	Assessment of the Agenzia Situation (met in full, in part, not met)
	is available in a timely way.		
iv. <i>Remuneration of officials</i>	Compensation levels need to be competitive with private sector, especially for professional staff.	<p>a) There will be government control on remuneration, through budget allocation or directly.</p> <p>b) The tax administration can influence key remuneration rates, especially for professional staff.</p>	<p>a) <i>Met in part.</i> Remuneration levels are competitive for entry and lower level positions.</p> <p>b) <i>Met in part.</i> There is some accommodation under the incentivizing quota scheme but the amounts of salary supplementation are modest</p>
v. <i>HR—integrity, performance evaluation, discipline, and separation</i>	Sufficient HR authority is needed within the administrations to promote integrity, investigate corruption, and take disciplinary action including dismissal and prosecution.	There may be government wide rules on discipline, evaluation and dismissal	<i>Met in part.</i> Agencies were vested with autonomy in matters relating to integrity, anti-corruption and disciplinary measures. Recent legal changes deprived collective bargaining of the exclusive competence over the types of infringement and the relative penalties (bargaining takes place only if not otherwise provided for by the law). The law has introduced new types of offences, penalties, including disciplinary dismissal, in many cases relating to the employment relationship.
vi. <i>HR—training and career development</i>	There is full authority for training and development.	<p>a) All training needs are determined by the administration.</p> <p>b) Measures to address training and development needs are developed and executed by the administration.</p>	<p>a) <i>Met in full.</i></p> <p>b) <i>Met in full.</i></p>

### Appendix 3. Periodicity of Value-Added Tax Return Filing in EU Member States

#### Periodicity of VAT Return

<b>EU Member State</b>	<b>Monthly</b>	<b>Bi-Monthly</b>	<b>Quarterly</b>	<b>Yearly</b>	<b>Summarizing Yearly Return</b>
Austria	X		X		X
Belgium	X		X		
Bulgaria	X				
Cyprus	X		X		
Czech Rep	X		X		
Estonia	X				
Finland	X		X	X	
France	X		X	X	
Germany	X		X	X	X
Greece	X		X		
Hungary	X		X	X	
Ireland	X	X		X	
<b>Italy</b>				<b>X</b>	
Latvia	X		X		
Lithuania	X				
Luxembourg	X		X	X	X
Malta			X		X
Netherlands	X		X	X	
Poland	X		X		
Portugal	X		X		X
Romania	X		X		
Slovak Rep	X		X		
Slovenia	X		X		
Spain	X		X		X
Sweden	X		X	X	
United Kingdom	X		X		

### Appendix 4. Return Filing and Payment Schedules

**Table 7. Schedule of Tax Return Filing and Annual Payments**

<b>Tax Return for Fiscal Year 2014</b>	<b>Presentation Period</b>		<b>Annual Payment</b>
	<b>From</b>	<b>To</b>	
Income—corporation tax	2015-05-01	2015-09-30	2015-06-16
IRAP	2015-05-01	2015-09-30	2015-06-16
VAT	2015-02-01	2015-09-30	2015-03-16
Substitute tax		2015-07-31	

**Table 8. Schedule Periodic Payments**

<b>Tax Return for Fiscal Year 2015</b>	<b>1<sup>^</sup> Advance Payment</b>	<b>2<sup>^</sup> Advance Payment</b>	<b>Single Advance Payment</b>
Income—corporation tax	2015-06-16	2015-11-30	
IRAP	2015-06-16	2015-11-30	
VAT			2015-12-27
VAT monthly payment	Day 16 of the next month		
VAT quarterly payment	Day 16 of the second month following the quarter		
Held on wages and salaries	Day 16 of the next month		

Note: The terms which expire on Saturday or Sunday are extended to Monday. The terms which expire from 1 to 20 august are deferred to august 20.

## Appendix 5. Organization of Audit and Tax Investigation Functions

**Responsibility for tax audits and investigations is fragmented across two separate agencies—the AdeE and the GF—both of which are under the authority of the MEF.** The AdeE is responsible for tax administration and has around 12,000 staff allocated to desk and field audit activities nationally, with a further 216 staff dedicated to tax fraud investigations. Audit and investigation work is supported by an extensive (if somewhat convoluted) network of central, regional, and provincial level risk analysis and case selection units with a total of around 516 staff. However, the majority of the audit activities undertaken by the agency involve desk audits and the issue of automated assessments based on the results of an extensive data matching program. Relatively few field audits are conducted by the AdeE (Table 9).

**Table 9. Mix of Audit Types Conducted by the AdeE, 2012–14**

	2012		2013		2014	
	Number of Taxpayers Audited	Percent of Total	Number of Taxpayers Audited	Percent of Total	Number of Taxpayers Audited	Percent of Total
Field audits	8,365	1.5	8,749	1.6	8,676	1.8
Desk audits	212,368	38.5	205,950	38.2	193,230	39.9
Electronic audits	330,492	60.0	324,970	60.2	283,102	58.3
Total	551,225	100.0	539,669	100.0	485,008	100.0

Source: Agenzia delle Entrate.

**The GF has a very wide mandate which includes authority to conduct its own investigations across all heads of revenue.** First established in 1774, the GF is a paramilitary police organization with a physical presence in 20 regional commands and 102 provincial commands across the country. It has around 60,000 staff who are, in the main, uniformed and armed. It conducts land, sea, and air based operations and is involved in a wide range of activities including the following:

- Fighting tax fraud and the underground economy.
- Anti-smuggling operations.
- Attacking the financial and economic interests of organized crime.
- Anti-money laundering operations.
- Overseeing public spending.
- Anti-corruption activities.
- Investigating corporate, bankruptcy, bank, and financial crimes.
- Protecting property rights (trademarks, branding etc.) and consumer rights.
- Countering illegal trafficking in drugs, waste, arms, and people.
- Intercepting unlawful cross-border movements of currency.

- Economic control of the territory and public utility line services.
- Cooperating with other Italian police forces in maintaining public order and safety.

The GF has a major focus on tax frauds and the underground economy and estimates that around 21,000 of its staff are involved directly, or indirectly, in tax enforcement activities.

**Each agency conducts its own intelligence gathering, risk assessment, and case selection functions.** A wide range of internal and external data is accessed and a suite of analytical software tools are deployed in identifying and analyzing compliance risks. Much of this data is readily accessible by both agencies via shared databases, and several of the analytical tools in use are also common across the agencies. The agencies separately select and rank audit cases based on their own risk criteria.

**The great majority of tax related field audits and investigations are conducted by the GF.**

Table 10 shows that around 77 percent of the total revenue related field audits and investigations each year are conducted by the GF. When these investigations are completed, the GF reports its findings to the AdeE for evaluation. The AdeE is the only agency with the authority to issue a tax assessment. In practice, few of the GF's findings are rejected or adjusted by the AdeE prior to assessment action. The mission was advised that much of the additional tax, penalties, and interest resulting from audits and investigations conducted by the GF is ultimately uncollectible (e.g., assessments raised in relation to VAT fraud cases) and simply adds to an already bloated stock of uncollectible tax arrears—see Section III.D. Where evidence is obtained of a criminal act, the findings of the GF are also forwarded to the public prosecutor who decides if criminal charges will be pursued.

**Table 10. Field Audits Conducted During 2012–14**

Agency	2012		2013		2014	
	Number of Audits	Percent of Total	Number of Audits	Percent of Total	Number of Audits	Percent of Total
GF	34,118	77.2	34,294	77.2	33,229	76.7
AdeE	8,365	18.9	8,749	19.7	8,676	20.0
AdeD	1,687	3.8	1,365	3.1	1,425	3.3
Total	44,170	100.0	44,408	100.0	43,330	100.0

Source: *Agenzia delle Entrate*.

**Arrangements are in place to coordinate tax related field audits and investigations.** This effort is aimed at ensuring that taxpayers are not subjected to multiple audits or investigations at the one time. It is conducted at the provincial level for individuals and small and medium sized entities, at the regional level for large business taxpayers, and at the national level for the most

serious cases of fraud or evasion. At the provincial and regional levels, each agency has online access to their respective lists of open cases and will defer or forego opening new cases which are already under active examination by the other (i.e., a "first-in" approach is generally applied). Regular liaison meetings are also held. At the national level, a special arrangement (known as the "control room") has been established under which representatives from the GF, the AdeE, and the AdeD meet on a regular basis to compare case pools. Where cases appear in more than one agency's case pool, a joint decision is taken on which agency should conduct the investigation based on the nature of the risks identified and the evidence available.