

Reforming the personal income tax schedule for self-employed and employees in Italy: pros and cons

ESPN Flash Report 2020/18

MARCELLO NATILI (UNIVERSITY OF MILAN) AND MICHELE RAITANO – EUROPEAN SOCIAL POLICY NETWORK

MARCH 2020

The Budget Law for 2020 modifies the tax system by making it more difficult to access the special regime for the self-employed, while reducing the tax burden on low- and middle-wage employees, although details of this reduction still have to be defined. These measures should reduce the inequality of the tax burden among different occupational categories, but the fragmentation of the personal income tax schedule calls for a comprehensive reform of this tax regime.



Description

The personal income tax schedule for the self-employed has been subject to major reforms in recent years. The Budget Law for 2019 (Law No. 145 of 30 December 2018) changed the tax system for the self-employed in order to significantly reduce the tax burden on these taxpayers. It introduced two main measures:

1) from 2019, self-employed people with an annual gross income lower than €65,000 could benefit from a favourable tax regime, the so-called special flat rate regime, with a 15% tax rate (reduced to 5% for the first 5 years of activity); for purposes of comparison, before 2019 the annual gross income threshold for the special regime was €30,000 for those aged less than 35 or a threshold between €25,000 and €50,000 depending on the economic sector; and

2) from 2020, in addition to the previous regime, a flat tax regime (with a 20% tax rate) for the self-employed with an annual gross income between €65,000 and €100,000.

According to these rules, almost all the self-employed (more than 80% according to some estimates; Dili 2019) would not be subject to the ordinary personal income tax regime (the Irpef, with progressive tax rates by income brackets), but instead would be subject to these much lower and proportional tax rates. By way of comparison, all employees are subject to the ordinary personal income tax regime with the following tax rates: 23% for annual gross incomes up to €15,000; 28% for

the share of gross income from €15,000 to €28,000; 38% for the share of gross income from €28,000 to €55,000; 41% for the share of gross income from €55,000 to €75,000; and 43% for the share of gross income above €75,000.

However, the 2020 Budget Law (Law No. 160 of 27 December 2019) reduces the scope of this special flat tax regime. First, it abolishes the originally planned introduction of the flat tax regime for the self-employed with an annual income of between €65,000 and €100,000 (see (2) above). Second, it establishes stricter eligibility requirements for the special flat rate regime for self-employed people earning less than €65,000. The following groups will now be excluded: i) individuals having a yearly employment income of more than €30,000 in addition to their self-employment income; and ii) those who have incurred more than €20,000 per year expenses related to their self-employment activity.

Importantly, in addition to measures concerning the self-employed, the 2020 Budget Law also allocates €3 billion for 2020 and €5 billion for 2021 to reduce the tax burden on labour in favour of employees.

Decree No. 3 of 5 February 2020 extends, from 1 July 2020, the generosity and coverage of the so called “€80 Bonus” (introduced by law No 190/2014). This bonus is a permanent deduction applied to employees’ personal income tax, consisting in a monthly bonus of €80 on earnings between €8,174 and €24,600 per year, with progressive reductions for earnings between €24,600 and €26,600. The new

LEGAL NOTICE

This document has been prepared for the European Commission. However, it reflects the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

measure increases the monthly bonus to €100 for those earning up to €28,000 per year. Furthermore, a new specific deduction from personal income tax was introduced for those earning between €28,000 and €35,000. This tax exemption increases by €80 net the monthly wage of those earning between €28,000 and €35,000, while the monthly tax exemption is gradually reduced to zero for those with annual earnings between €35,000 and €40,000.

It should be mentioned that the recent decrees adopted to tackle the consequences of the COVI-19 pandemic have not affected these measures.

Outlook and commentary

The 2019 Budget Law introduced a special tax regime for the self-employed with a view to reducing their overall tax burden and incentivising tax compliance. At the same time, it created some marked distortions, in particular:

- horizontal inequity between employees and most self-employed, who are subject to a different tax regime;
- horizontal inequity among the self-employed, between those who may or may not benefit from the special regimes (the ordinary personal income tax regime currently applies to the self-employed with an income above

€65,000, and this threshold was expected to increase to €100,000 as from 2020 according to the 2019 Budget Law);

- a reduction in the progressivity of the tax system, since the large majority of self-employed are subject to a proportional tax rate;
- serious distortions of choices to be made by individuals who, when working as employees, might decide to switch from employment to self-employment in order to pay fewer taxes and, when working as self-employed, may decide to have an income no higher than €65,000 (thus creating strong incentives not to expand their activity, or to underreport income); and
- an incentive for employers to hire employees through bogus self-employment arrangements to reduce labour costs;
- a drop in public revenues due to the lower tax rates on self-employed incomes (Dili 2019).

As pointed out, some of the new provisions included in the 2020 Budget Law softens the impact of the 2019 reform, without however eliminating in most cases the discrepancies in tax burdens between the self-employed and employees. Hence, several problems remain. First, pensioners are not covered by the measures aiming to reduce the tax burden, with the risk of creating unequal treatment between the active and non-active population. Second,

and possibly more importantly, the monthly bonus is not paid to those individuals whose annual earnings are below the “no tax area” threshold - i.e. those individuals with earnings below €8,174 (the so-called *incapienti*) - with, consequently, regressive effects. Third, because of the recent reforms, the personal income tax regime in Italy has become even more complex and fragmented, further increasing the need for a comprehensive reform of the entire personal income tax system.

Further reading

Dili, A. (2019), Tutti i limiti della nuova flat tax [*All the limitations of the new flat tax*], www.eticaeconomia.it

Pellegrino, S. (2020), Con il bonus rafforzato prove di riforma dell'Irpef [*With the "enhanced" bonus, attempts to reform the Irpef*], www.lavoce.info

Raitano, M. and Jessoula (2019), Riforma fiscale e “Flat tax”: i rischi per lo Stato e la coesione sociale [*Fiscal reform and the "Flat Tax": risks for the Italian State and for Social Cohesion*], *Altraeconomia*, July/August 2019.

Author

[Marcello Natili](#) (University of Milan) and [Michele Raitano](#) (Sapienza University of Rome)

The Flash Reports are produced by the European Social Policy Network (ESPN) established in 2014 to provide the European Commission with independent information, analysis and expertise on social policies in 35 European countries. The topics covered are identified by ESPN experts in the light of significant developments in their countries, or in some cases suggested by the Commission or the Flash Reports' editorial team (Eric Marlier and Slavina Spasova). The ESPN is managed by LISER (Luxembourg Institute of Socio-Economic Research), APPLICA and the OSE (European Social Observatory). More information on the ESPN: <http://ec.europa.eu/social/main.jsp?catId=1135&langId=en>.

Quoting this report: Natili, Marcello and Michele Raitano (2020). *Reforming the personal income tax schedule for self-employed and employees in Italy: pros and cons*, ESPN Flash Report 2020/18, European Social Policy Network (ESPN), Brussels: European Commission.