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Stefano da Empoli, President, I-Com

Split payment: analysis and possible scenarios

Combating VAT evasion in Italy

Much Ado About Nothing? VAT Gap in Italy

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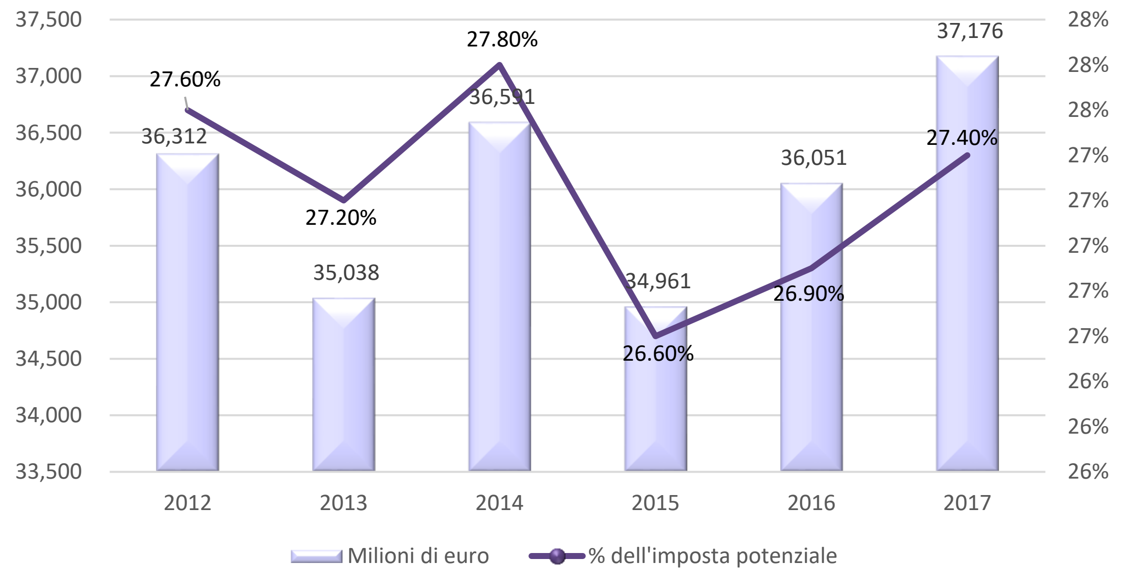
VAT Gap estimate (EUR in millions; % of potential tax)



According to the latest data published by the European Union on tax evasion, Italy is the leading EU country for VAT fraud in absolute value and fourth in terms of percentage of potential tax. In the five-year period 2012-2017, the average VAT gap in Italy was EUR 36 billion. The minimum value for the period was recorded in 2015 with EUR 34.9 billion, with an increase in subsequent years, which was back to its original value in 2017 (in fact, even larger in absolute terms).

Lost revenue resulting from VAT fraud is equivalent to an average value of 2.2% of GDP. After a slight decrease in 2015 and 2016, the ratio of VAT fraud to GDP began once again to increase slightly in 2017.

VAT Gap estimate (% of GDP)

Source: Report on the unobserved economy and tax and social security evasion - 2019

Much Ado About Nothing? VAT Gap in the EU

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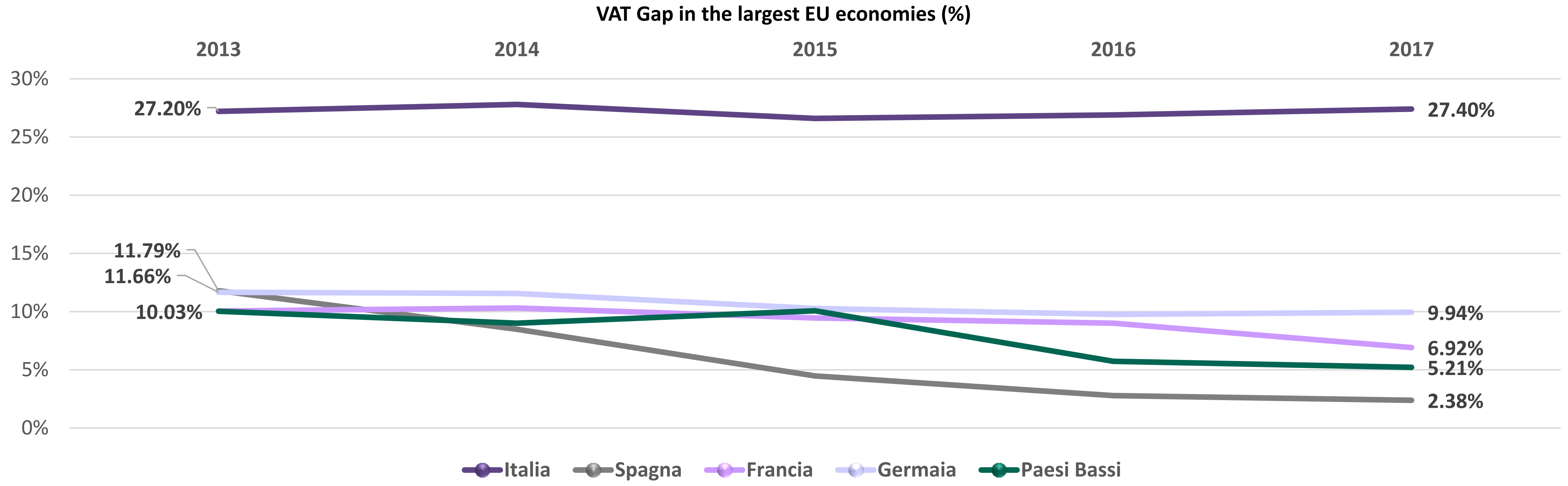
Looking at the information contained in the "*Study and Reports on the VAT Gap in the EU*", commissioned by the European Commission, it is clear that, **among the major economies of the European Union, Italy records the highest VAT Gap (27.4%)**. From the graph it can also be seen that Italy is the only one among the countries we analysed that did not reduce the gap between potential VAT and VAT collected in the five-year period 2013-2017, which instead increased by 0.2%.



Source: I-Com analyses on data from the "Study and Reports on the VAT Gap in the EU"

The numerous tools to combat tax evasion

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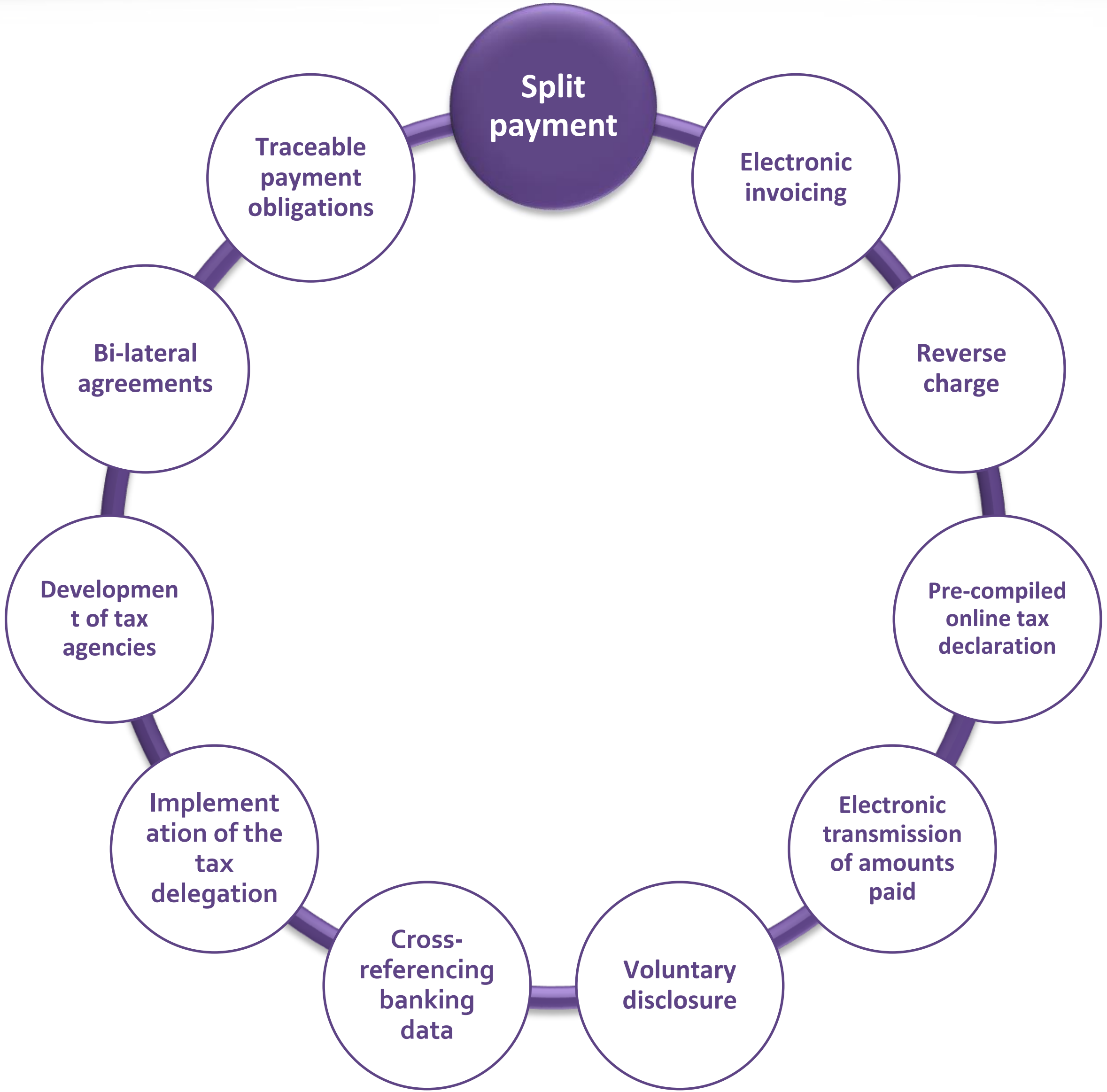
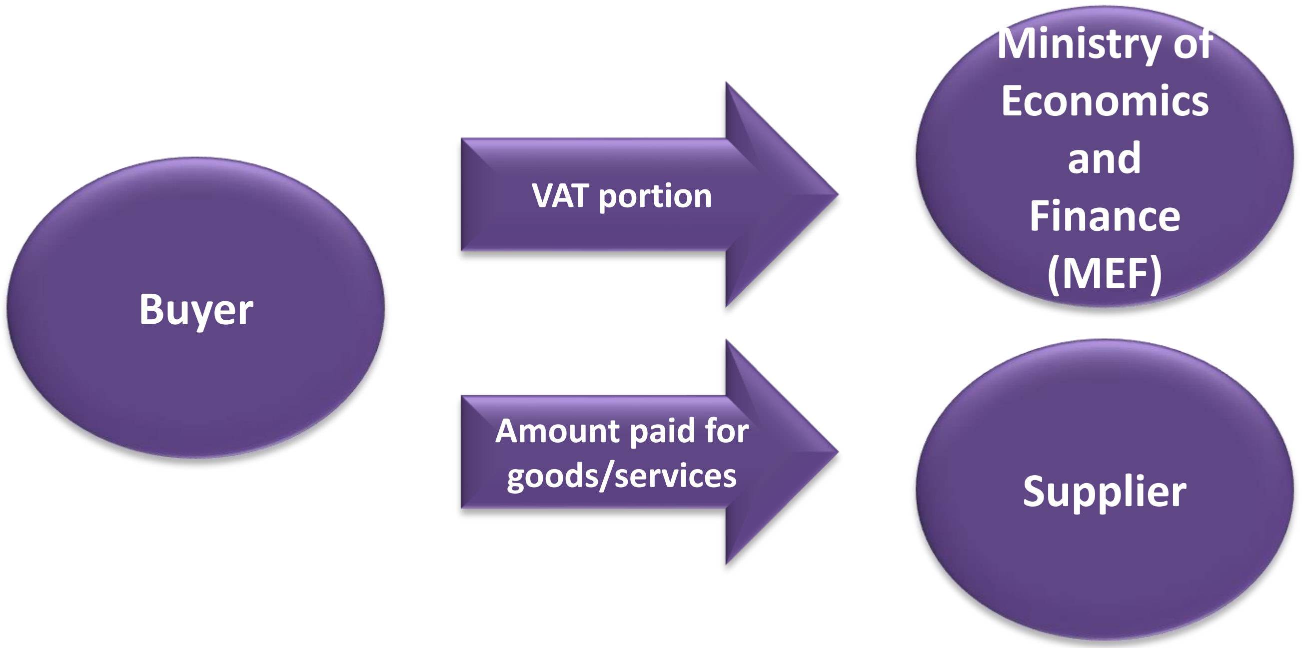


Split payment

The 2015 Stability Law (Law 190/2014) introduced split payment, a mechanism that modifies the process of purchasing goods and services by Public Administrations (PA), foundations and investee companies in which not less than 70% of capital is owned, subsequently extended to other categories.

Under the split payment regime, suppliers continue to charge VAT on goods and services while buyers split the payment into two parts:



Impact of split payment on public accounts

Tax revenue before and after the introduction of split payment

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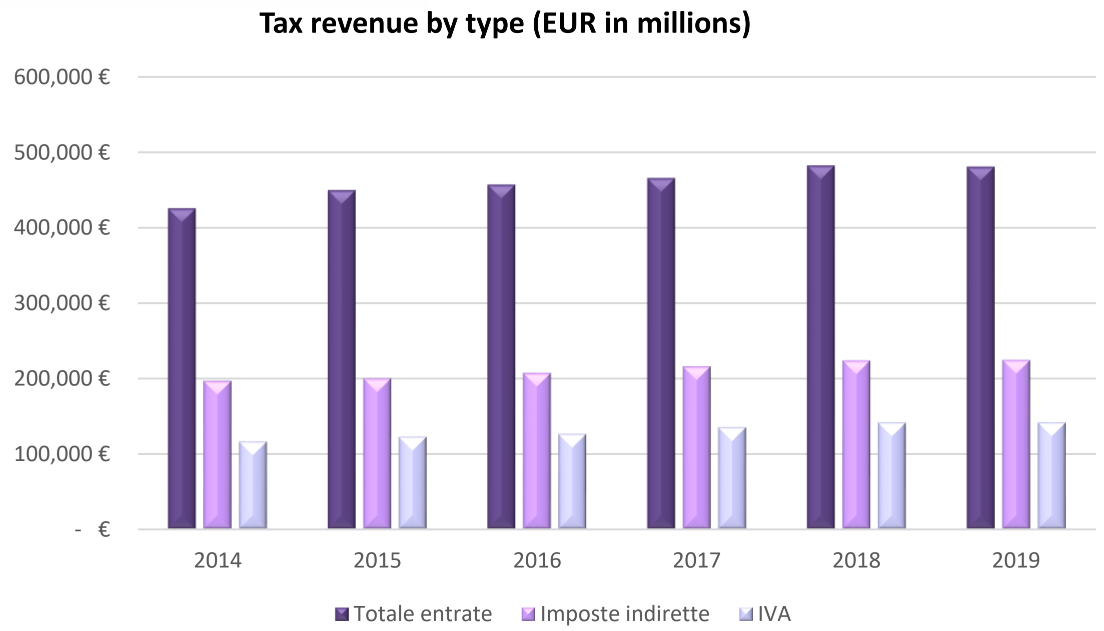
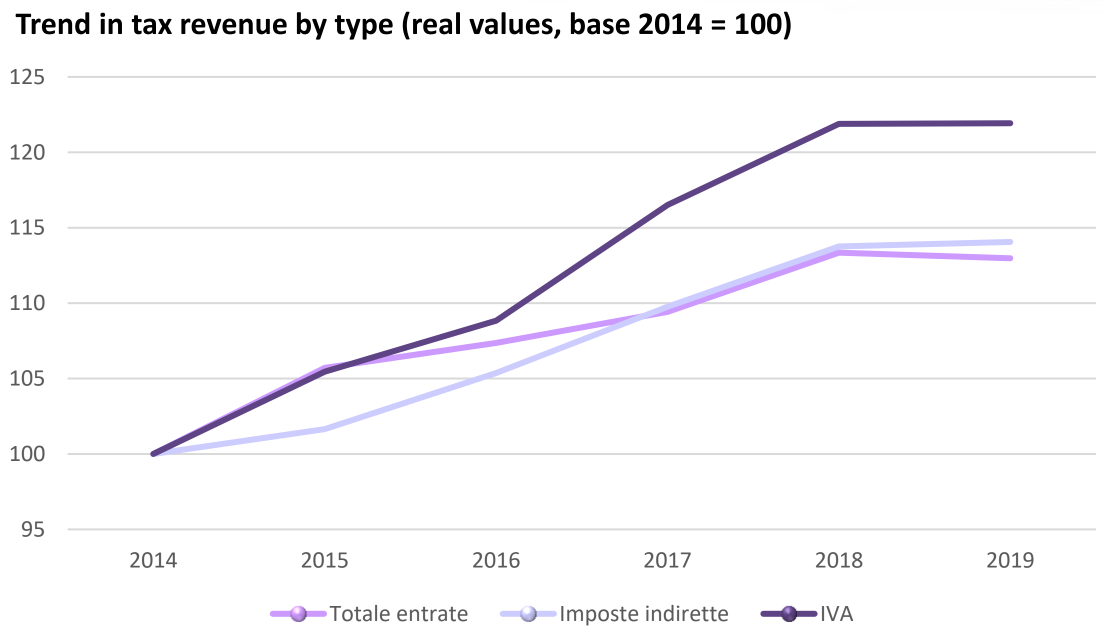


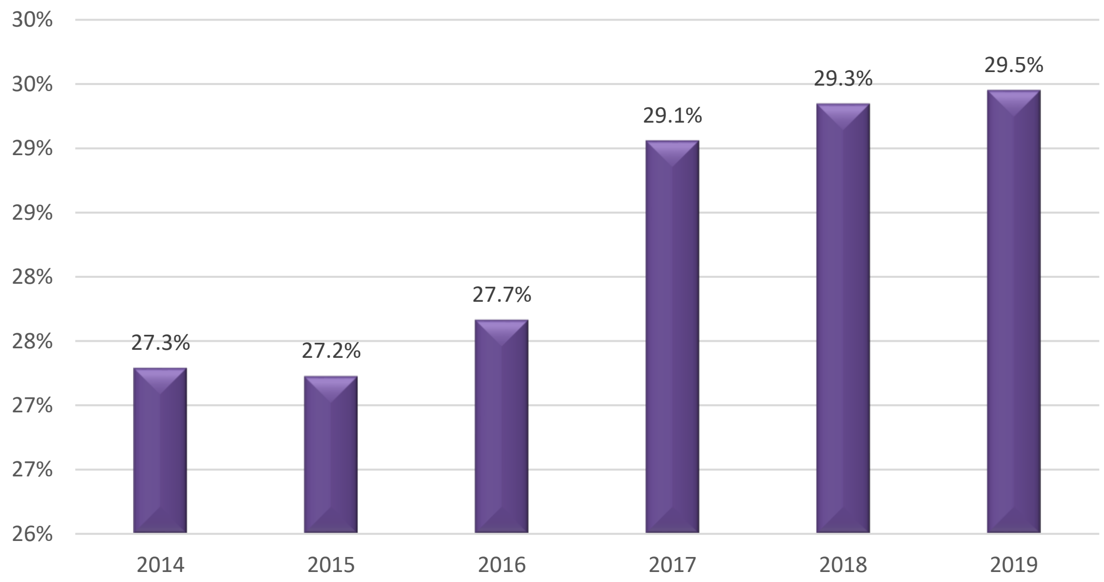


To assess the impact of the introduction of split payment on public accounts, it is useful to observe the trend in tax revenues both in the period prior to, and the one immediately following, its introduction. The current 22% ordinary VAT rate became effective on 1 October 2013, so to perform a standardised analysis, it was decided to start the observation from the following year. Analysing the growth trend in the five-year period 2014-2019, we can note that the **appropriated VAT grew at a faster rate than both total revenue and total indirect taxes**. **The increase becomes more significant in the two-year period 2017-2018** (coinciding with the greater use of other tools such as **electronic invoicing**, see slide 12).

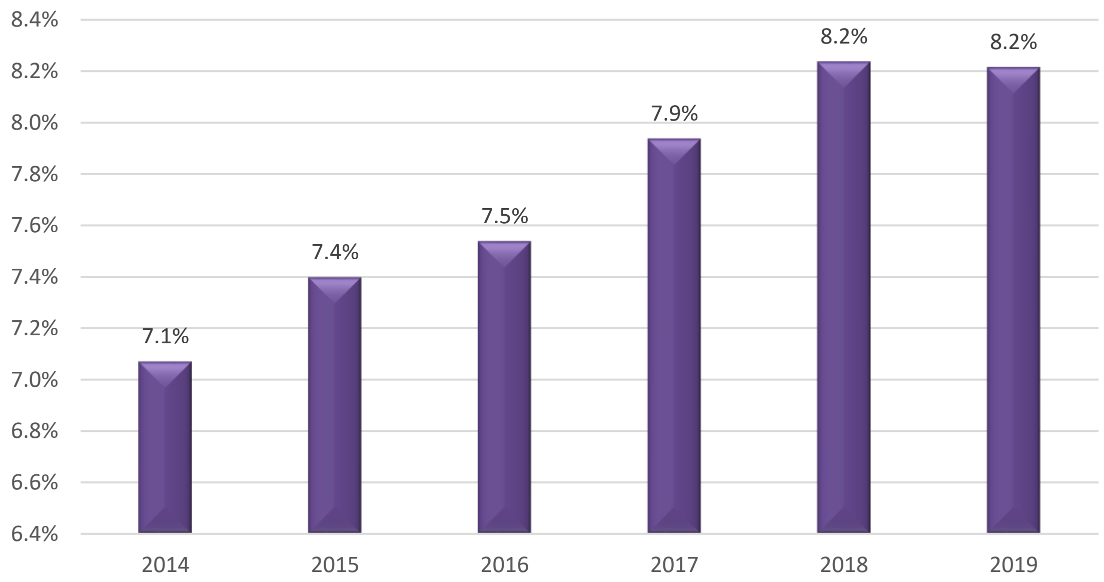
Source: I-Com analyses on MEF and ISTAT data

Increase in VAT collected

VAT collections compared to total tax revenues (%)



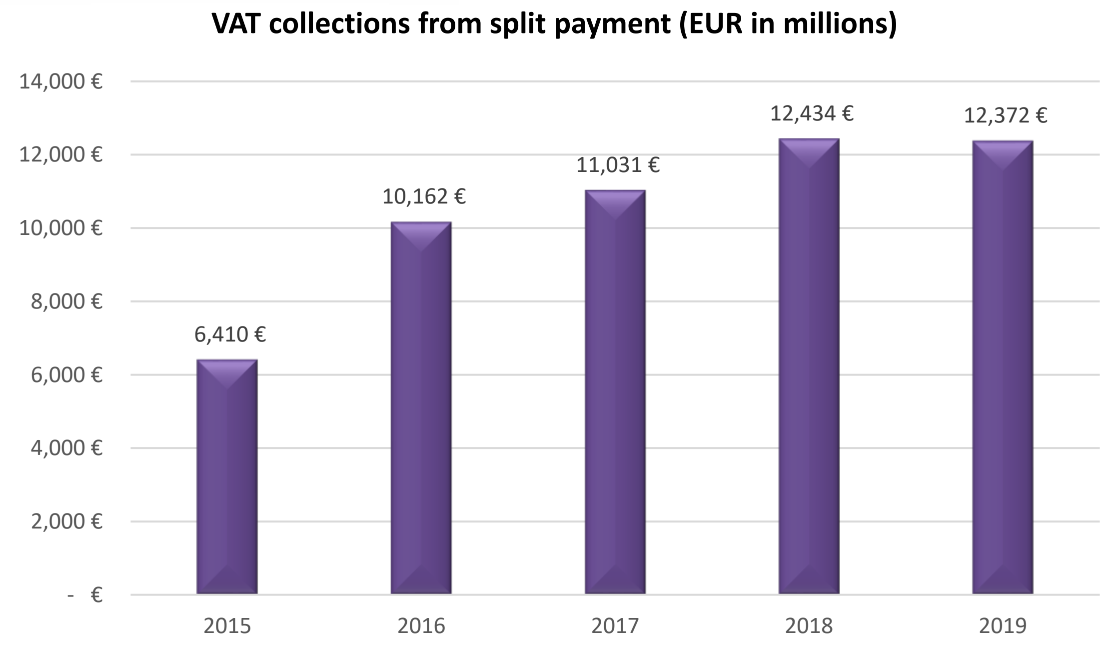
VAT collections compared to GDP (%)

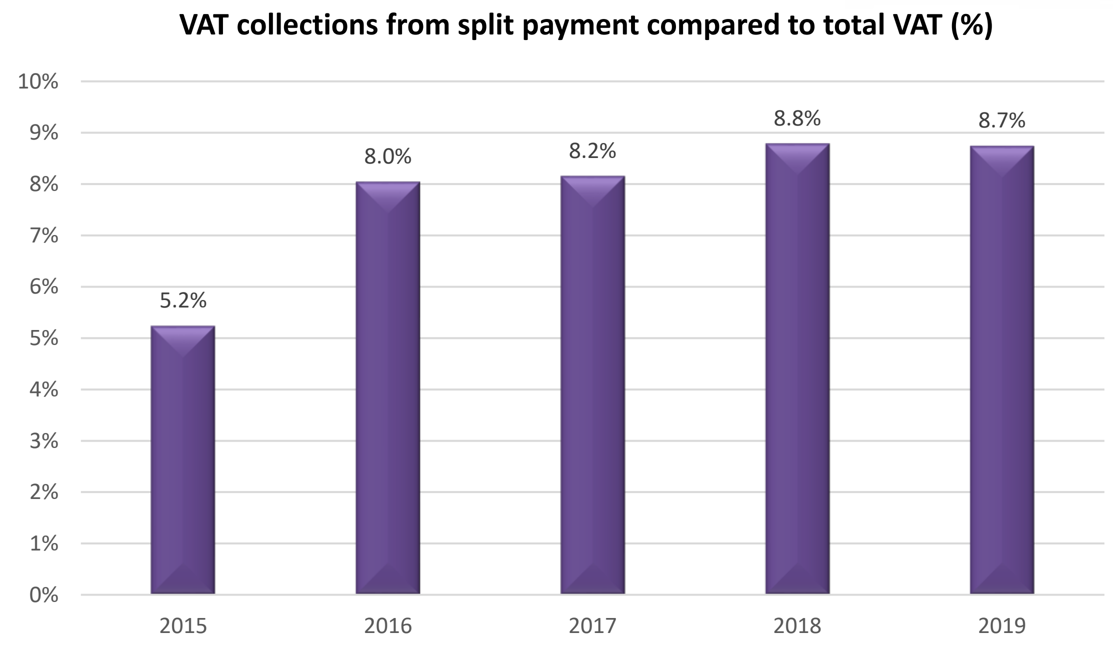


In 2014, VAT represented 27.3% of total tax revenue. In the years following 2015, this percentage has steadily increased, reaching 29.5% in 2019. The growth in VAT revenues is also evident when comparing the ratio of the tax to GDP. Between 2014 and 2018, the ratio of VAT to Gross Domestic Product grew by 1.1% and remained unchanged between 2018 and 2019. **This means that, in the observation period, tax revenues recorded a growth dynamic which cannot be attributed exclusively to economic growth and which therefore benefited from the contribution of other factors, such as the introduction of tools to combat tax evasion.**

Source: I-Com analyses on MEF and ISTAT data

Split payment collections: real or apparent effectiveness of the tool?



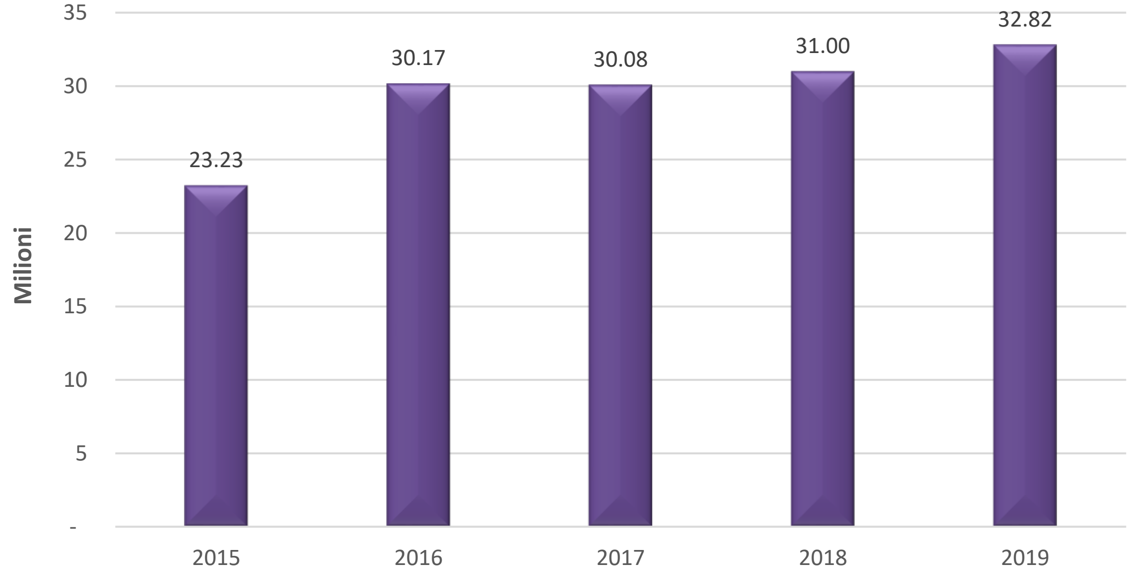


Analysing the split payment revenues in detail, we can see that, **after experiencing exponential growth between 2015 and 2016, the percentage of VAT collected through this tool stabilised in the subsequent three years, decreasing in 2019**. It is worth remembering that, as previously noted, the growth in the VAT revenue seen in the five-year period analysed must also be associated with other tools to combat tax evasion, such as the **electronic invoicing requirement**. Furthermore, the original regulation of the split payment mechanism has been amended by Legislative Decree 50/2017 (in force since 1 July 2017) and by Legislative Decree 148/2017 (in force since 1 January 2018), resulting in the extension of its scope of application to other economic entities.

Source: I-Com analyses on MEF and ISTAT data

Impact of electronic invoicing on tax revenues

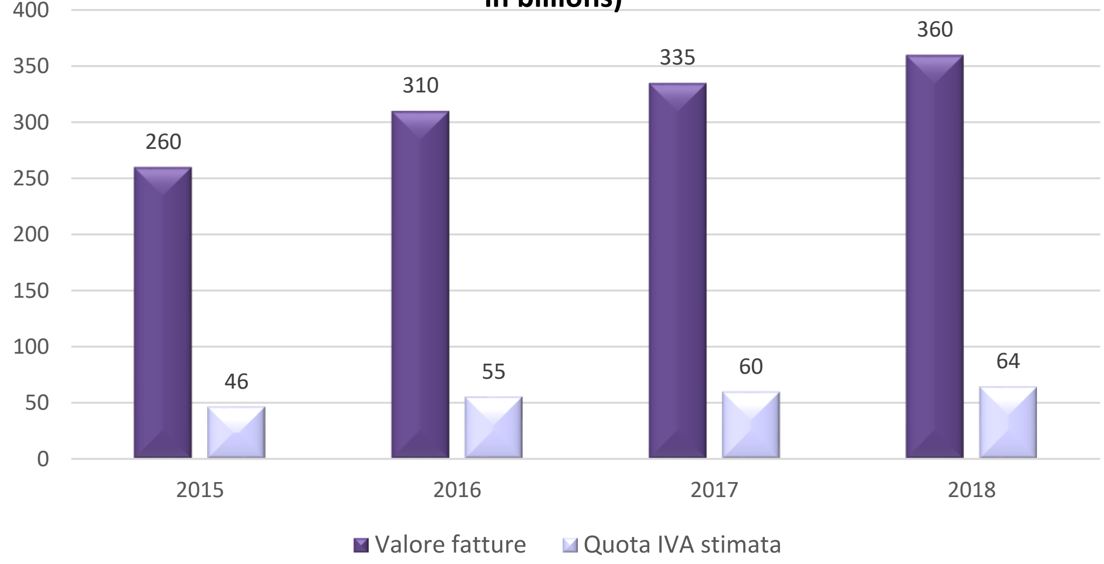
Millions of electronic invoices managed by the information exchange system (SDI) in the period 2015-2019



In 2014, the electronic invoicing requirement was introduced for all relations with the PA, public entities and listed companies. Since 2017, the information exchange system has also been made available, on a voluntary basis, to private operators such as companies and freelancers, while the 2018 budget law introduced the electronic invoicing requirement both between companies and freelancers, as well as with end consumers, effective 1 January 2019.

As noted in the previous slide, **electronic invoicing seems to have had a positive effect on tax revenues and, in particular, VAT**. In 2018, electronic invoicing was used for around EUR 360 billion of transactions between individuals, an increase of 7% compared to the previous year. By applying an average rate, **it can also be estimated that the VAT portion of these electronic invoices was EUR 64 billion, therefore a much higher value than that recorded for split payment** (2018 data).

Value of electronic invoicing between private individuals in Italy 2015-2018 (EUR in billions)



Notes: Estimate made by applying the average rate of 17.86%

Source: I-Com analyses on data from AGID, MEF and the B2B Digital Observatory (Politecnico di Milano)

Impact of split payment on companies

Main issues encountered by companies

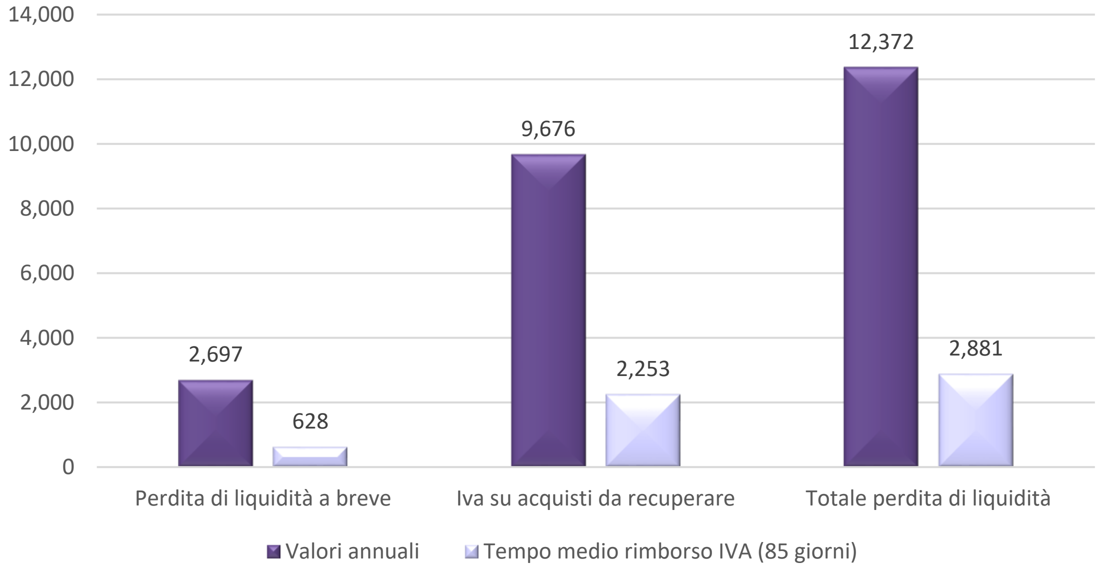
Companies that provide goods and services to parties to whom the split payment is applied have encountered mainly 2 types of issues:

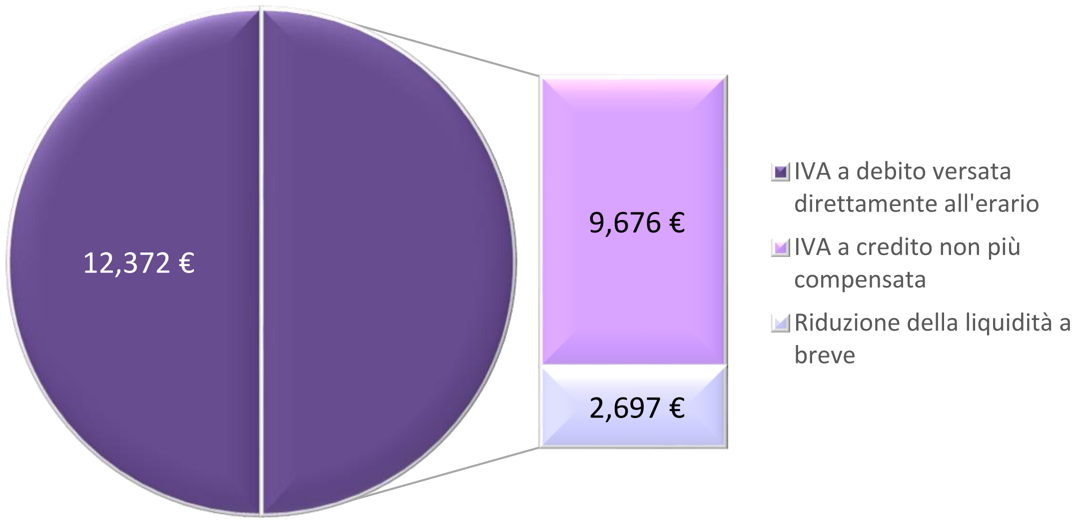
Permanent VAT credit position
With the application of split payment, the VAT offsetting mechanism is forfeited. In fact, each company must advance VAT to its suppliers (VAT credit) but is not compensated by buyers, since VAT on sales or services (VAT debit) is directly paid by the latter to the tax authorities.

Reduction of liquidity
The company that must apply split payment continues to provide short-terming financing to its suppliers but is no longer financed by its customers (PA), as they no longer pay the tax to them.

Estimated loss of liquidity due to split payment

Liquidity loss due to split payment in 2019 (EUR in millions)





The total loss in liquidity borne by Italian companies following the introduction of split payment is estimated at approx. EUR 12.3 billion for 2019. Considering only the 85-day average necessary to obtain the refund for the VAT credit from tax authorities, the loss equals EUR 2.8 billion. Starting from the VAT from split payment made during the year, it is also possible to estimate* a short-term loss of liquidity, due to the forfeiture of the offsetting mechanism, of EUR 2.69 billion on an annual basis and EUR 628 million for the 85 days.

* Starting from the VAT collected from split payment by tax authorities in 2019, it is possible to estimate the loss of liquidity of companies caused by the suspension of the offsetting mechanism. By applying an average rate of 17.86% (equivalent to the average rate of all VAT transactions carried out in Italy in 2018) to the split payment revenue of EUR 12.37 billion, the total expenditure to which the tax refers can be estimated as EUR 69.27 billion. Looking at the MEF data on the VAT tax of Italian companies, we can infer that the cost of the goods and services used has an average value that can be estimated at 78.2% of the value of the finished product. Following this logic, it is possible to estimate the short-term loss of liquidity as EUR 2.697 billion per year.

Source: I-Com analyses on MEF data

Scenario of suspending split payment

Conclusions

Tax authorities

According to the forecasts contained in the Economic Planning, tax revenues will decrease by 7.7% in 2020 and indirect taxes by 8.2%. However, tax authorities should not suffer excessively from a suspension of split payment, since collections deriving from this tool account for only 2.6% of total revenue and 5.5% of total indirect taxes (2019 data). The risk of tax evasion would also be mitigated by other tools such as electronic invoicing.

Companies

Companies would benefit considerably from the suspension of split payment, as they could, during a period of liquidity crisis such as the current one, take advantage of approximately **EUR 12 billion due to them**, which would then end up directly in the public accounts. The measure would also act in combination with other interventions to support the liquidity of companies that have been implemented by the government during this emergency (Decree no. 23/2020). On the other hand, the transition phase must be carefully managed to minimise costs and uncertainty.

Thank you!

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