Understanding Taxation

Marco Greggi, University of Ferrara

Summer School «Personal income Tax in the EU»

8 July 2023

Introducing the Class …

- Four topics under discussion:
    1. The interaction between PIT and VAT;
    2. Continued (VAT) reporting and E-invoice;
    3. Tax inspections data management (and *privacy*);
    4. Audits and Controls.

The interaction between PIT and VAT

Marco Greggi, University of Ferrara

Summer School «Personal income Tax in the EU»

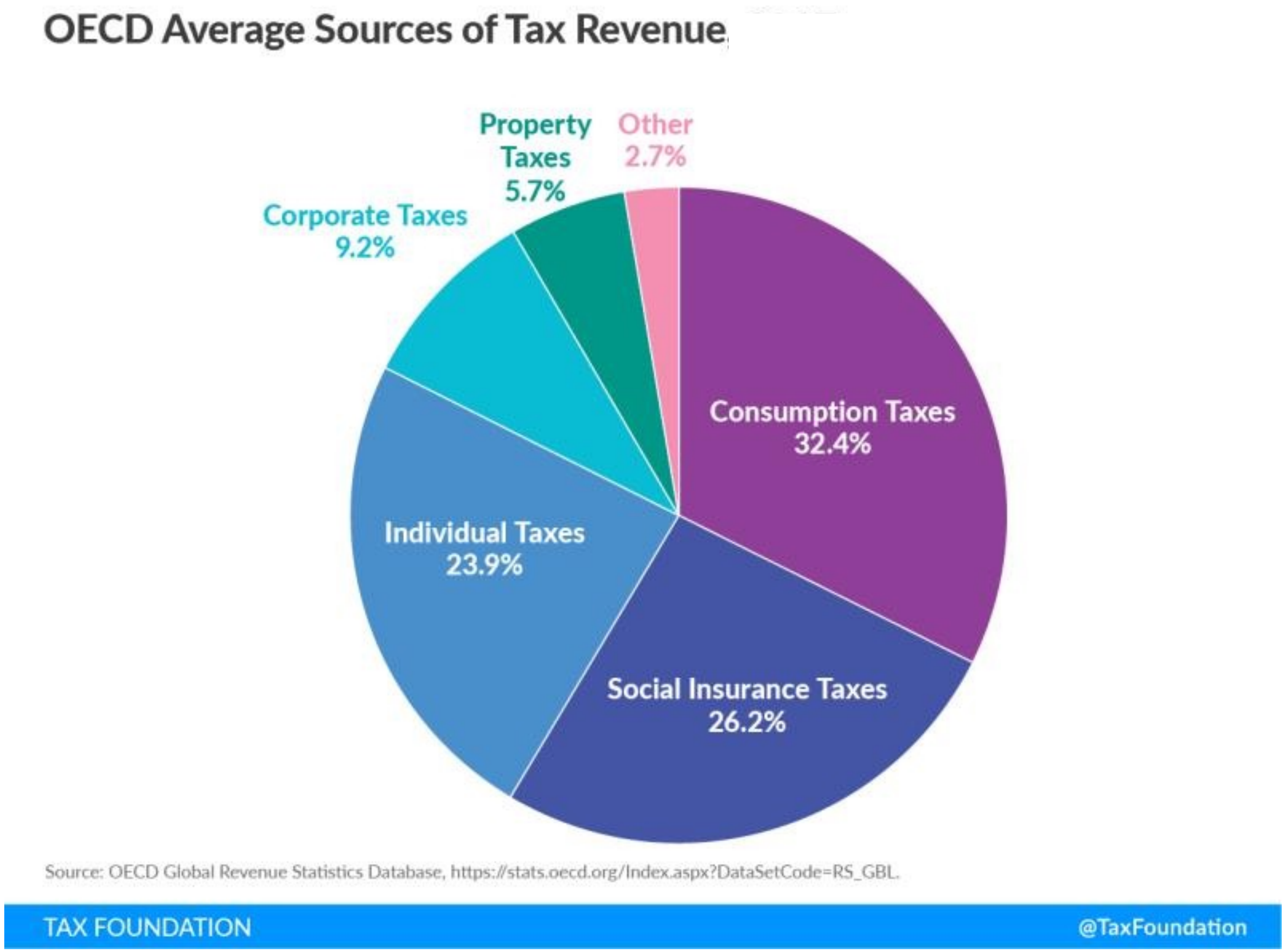
The rise of VAT

- Currently adopted by more than **150 countries**, worldwide;
- Accountable for around **20% of the world tax revenue**;
- Targeting **4 billion people** (70% of the world population);
- Constant support by the IMF, World Bank, OECD, …
  - VAT arguably incepted in 1918 as a way to overtake income taxation (C. F. Von Siemens);
- First European directive in **1967** (1967/227/EEC)
- First comprehensive European directive on VAT in **1977** (1977/388/EEC).

Continued …

- In terms of Revenue collected **equals Income tax** and Social Security contributions in 32 out of the 33 OECD members;
- Revenue share determined by VAT **climbed** from 1,8% (1965) to 19,2% of the total revenue (in 2009);
- 75% of the countries with VAT are low or middle income countries (World Bank Index);
- 2/3 of the least developed countries have VAT.

Some data


OECD Average Sources of Tax Revenue
Property Taxes 5.7%
Other 2.7%
Corporate Taxes 9.2%
Consumption Taxes 32.4%
Individual Taxes 23.9%
Social Insurance Taxes 26.2%
Source: OECD Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL.
TAX FOUNDATION
@TaxFoundation

An Academic Reading

- Crucial distinction:
- European Model of VAT;
- **Theoretical Model of VAT**, demanding this tax to be levied:
  1. On a broad consumption base, at a single rate;
     - Full and immediate deduction of VAT on inputs from the VAT on outputs
  2. Through the invoice-credit method;
  3. On a **destination basis principle**;
- The European Model **does not perfectly match** all the conditions set above (in particular, (1) and (3)).

Evidence from Europe

- Principles are confirmed by Article 1, § 2 of the current 2006/112/EC Directive (Recasted) in VAT;
  - **Proportional**, general tax on consumption;
  - Tax is charged on **every transaction**;
- VAT Design in the Directive:
  - Levied on consumption;
  - Collected **incrementally** throughout the value chain;
  - Charged on a **destination basis principle**.

Income and Value Added

1. **Consumption** is the preferred tax base (*vis à vis* income);
2. Tax measures are optimal **when they do not interfere with market decisions** (they are consistent with the "Invisible hand");
3. Efficiency should prevail over Equity.

Why Consumption tax and not personal Income tax

- Towards a Consumer-centric **tax system**:
  1. Consumption is a less **mobile** tax base (if compared to income);
  2. Consumption is less **volatile** in case of fluctuations of the economic cycle;
  3. Consumption is a **more reliable benchmark** for the ability to pay of an individual (as indicator of his / her welfare);
  4. Consumption is **simple** to administer (in term of time of assessment);
  5. Consumption taxation is **neutral** to **savings/investment dichotomy**;
  6. Consumption taxation **does not affect investments decisions**.

VAT and Revenue generation

- This feature:
  - Derives from the multiple-stage system with the invoicing-credit mechanism;
  - … according to IMF an increase of 1% of VAT rate would increase revenue equivalent to 0,5% GDP;
  - … under the condition of broad base and extended invoice-credit collection system;
- VAT is also a low visible tax for taxpayer (no awareness of the tax, less incentives to evasion).

VAT, PIT and Neutrality

- Consumption, Labour and Investments decisions should be made on their merits and not on taxation;
- Tax neutrality should prevail because other goals (including equity) may be pursued using other instruments (spending / deficit spending), including non-tax mechanisms;
- **Neutrality is easy to measure if compared to Equity**;
- Neutrality:
  1. Of the **business structure**;
  2. Of the **goods / services provided**;
  3. In terms of **international trade**.

VAT and Equity

- **Horizontal equity:**
  - Same consumption tax rate irrespective of the goods sold / services delivered;
  - Neutral to business;
- **Vertical Equity:**
  - VAT not performing well, considering the different attitudes to consumption;
  - Poor people consume more of their taxable base while rich people consume more in absolute term (although a fraction of their taxable base);
  - No adjustment for individual circumstances;
  - Note: vertical equity justified according to:
    - Measure of the ability to pay;
    - Benefit principle.

VAT (and not PIT) as growth Facilitator

- Growth-friendly taxable bases:
  1. Immovable property;
  2. Consumption;
  3. Personal Income tax;
  4. Corporate Income tax;
- VAT is refundable under international tax rules, this create an advantage;
- **Suitable to be used in countercyclical policies**;
  - Disadvantage: expansion of the ***informal sector*** (the higher the VAT ...) ?

VAT Reporting and Invoice

Marco Greggi, University of Ferrara

Summer School «Personal income Tax in the EU»

VAT and Compliance

- Several compliance duties are in connection with VAT application, including:
  1. Invoicing;
  2. VAT identification (identification in other countries, appointment of a VAT representative, …);
  3. VAT annual tax return;
  4. **VAT periodical payments**;
  - …
- See for further reference: Articles 214 and sub. of the 2006/112 Directive.

In particular, invoicing

- Application of VAT is based on subtractive-indirect method;
- Role of the Invoice:
  1. Contains data pertinent to the VAT regime of the operation;
  2. Allows the control of the competent authority and
  3. Constitutes evidence in favour of the taxpayer;
- **Concept of invoice**: Articles 218 and 219;
- **Content and requirements** of the invoice: Article 226 and sub.

Cash Register and PoS

- Types and Software solutions:
  - Progressive **liberalization of the market**;
  - Competition of service providers with **authorization** of the revenue service as to their characteristics:
    - For instance NEXI solution costs € 29 (lump sum payment) pus fee of 1,89% on each transaction;
    - Average cost is between € 50 and € 100 (plus fees);
      Costs are tax deductible.
- **Preliminary distinction**:
  - Tax differences;
    - The law draw a distinction between business which do not reach € 65.000 revenue per year and the others;
    - Small business qualify for a reduced tax rate and limited compliance (essentially VAT-based)
  - Commercial differences;
    - Business solutions in terms of PoS and Cash register are **scalable** and independent from the size of the business.

Platform for Data Interchange

- As from January 1st 2021 the entire invoicing / receipt system migrated online (transition began in 2019)
  - Transactions are transferred via internet, *quasi* in real time to the Tax administration;
  - Platform has been developed by the Tax Administration with consultancy of state-owned company (SOGEI);
  - In 2019 with a decree the Government exempted qualified business:
    1. Public transport;
    2. Gas Stations;
    3. …

Data management

- The Italian System is *Tax agency-centric*;
- The Tax office operates the system via the **software services made available via state-owned company**;
  - **Private business** develop software and platforms consistently with the specifics delivered by the Tax office and under scrutiny;
  - Taxpayer is responsible for the transfer.
- Cash Register deliver one transfer at the end of the day, the Internet platform for each transaction;
  - Register malfunction: **12 days** time to send the file with the transactions (it can be downloaded on a *USB stick*);
  - **Occasional transactions malfunction**: necessity to have the connection always on, at the moment of the operations.

E-invoice Structure

- What is an invoice?
  - The Italian law depends on EU law and from the European legislation on the invoice (see for instance Directive EU 2014/55;
  - Italian Article 21 and sub. D.P.R. 633/72;
  - No remarkable changes in the content of the invoice as issued besides the format (XML and PDF).

Content of an (E)Invoice

- **Typical Content:**
  1. Date of emission;
  2. Unique ID number of the document;
  3. VAT number of the business issuing the invoice;
  4. Domicile of the business issuing the invoice;
  5. Details of the client;
  6. Description of the goods sold and services delivered;
  7. Date of the transaction and of the payment;
  8. VAT rate applied;
  9. VAT amount due;
  10. Total VAT (in case of multiple goods);
  11. Unitary cost of the goods sold.
  12. Unique SdI number of e-invoices

Simplified invoicing

- Art. 220-*bis* directive 2006/112/EU modified by directive 2010/45/EU 13 July 2010
    1. Date of emission and progressive number;
    2. Details of the business issuing the document;
    3. VAT number of the business;
    4. Details of the client;
    5. Description of the goods and services;
    6. Amount of the document and of the tax due;
- Simplified invoice may be used for amounts up to € 400.

Goods and Services ID

- European System **identifies subjects rather than goods**;
- Only exception: Customs duties (not pertinent in the case);
- As a consequence:
  1. VAT ID only for businesses;
  2. Goods and services described without a specific reference to their nature.

Failure to issue Invoice

- Italian system combines **administrative and criminal sanctions** (only for omission to file significant tax return);
- Theory of law: "*Ne bis in idem*" necessity to prevent cumulative application as it would contravene Human Rights Law (*European Court of Human Rights,* Grande Stevens case);
- **Most significant cases**:
  - Omitted invoice;
    - 90% - 180% of the amount due;
  - Omitted invoice with no impact on the outstanding tax liability;
    - From € 250 to € 2.500
  - Wrongful qualification of VAT (in case of VAT exempt operations, …):
    - From 5% to 10% of the amount.

Tax Agency and Private Companies

- Tax Office **admits and surveys** companies imposing standards;
- Requisite of **trustworthiness** and personal standing of the business;
- Currently only **big businesses** with reputation are active, including some foreigners.
  - One advantage: Tax office / Ministry of Finance have their own IT company (SOGEI) dealing with this.
- **Dual standard for electronic platform**;
  - No tariffs for the use of the basic platform granted by the Tax office on the portal (accessible via personal credentials);
  - Tariffs charged according to the private contract;
    - For instance “Invoices on Cloud” by *Teamsystem* spa vary from € 8 to € 22 plus VAT).

Implementation of the connected cash registers

- Strategy pursued in the period 2018 – 2021:
  - Phase I: electronic invoicing introduced for companies with a turnover of € 400.000 or higher;
    - In particular: supermarket and similar businesses;
  - In Phase II: 2019 – 2020 progressive extension slowed down due to Covid.
  - Phase III: now general system.

Tax inspections data management (and privacy)

Marco Greggi, University of Ferrara

Summer School «Personal income Tax in the EU»

A Italo – European Approach

1. A research "*Going against the Tide*": understanding the *hype* for AEoI (Automatic Exchange of Information);
2. What does "*Information*" mean: <u>Content</u>, <u>Use</u>, <u>Framework</u>;
3. The role of the Taxpayer: How much room for privacy in taxation ?
4. In search of evidence: Case law (EU, European, International) defending privacy;
5. Concluding the need for amore balanced framework (ways and means to get it).

And the Global Scenario

- **Europe and Taxation:**
- Recent developments: ATAD (I and II), Directives on Exchange of Information (2011/16/EU, …);
- Joint audit projects by Tax Administrations;
- Assistance in the collection of taxes (abroad …);
- **OECD and Taxation:**
- (Besides BEPS): setting standards for information exchanges or collection (CRS, CbC reporting, …);
- Data gathered *ex ante* a possible tax audit;
- **US and Taxation:**
- FATCA and FATCA-inspired agreements.

Information for Tax Purposes

- **Very comprehensive Concept;**
- Any data relevant for tax purposes (Tax profiling ?):
- Financial data;
- Ownership of assets;
- Personal status (residence / domicile) and evidence of it;
- Commercial practices and standard;
- Example: Italy – Liechtenstein TIEA agreement (in force since 2016 (signed on February 26th 2015):
- Group request;
- Clustering approach;
- …

Continued

- Dawn of the ***Revenue Rule***;
- Towards a "Push" model of data exchange, covering any aspect of taxpayer life *allegedly relevant* for tax purposes;
- *No room for privacy in taxation* (?);
- Privacy as "Avoidance in disguise";
- International taxation to cast light on taxpayers' position:
- Italian motto: *Too much light blinds you*.

External limits to data management in Taxation

- Statutory based:
- **European Regulation on privacy protection** 2016/679, art. 23, § 1 lett. (e);
- Reasonableness, foreseeability, proportionality, respect for a democratic life;
- **Article 8 ECHR** (respect for private life);
- Principle based:
- Principle of foreseeability relevance (in Directives and Treaties).

Addressing the “Foreseeably Relevance”

- Two possible interpretations:

1. Prevent redundant requests / queries (thus preserving the activity of the requested Tax Administration);
2. Protect the individual (this *is* protection of taxpayers’ privacy).

Case 1 – "*Sabou*"

- C-276/12 European Court of Justice (October 22nd 2013):
- No "Rights of the defence" of the taxpayer in the Exchange of information procedure consistent with EU law (if the limits are not in the domestic legislation):

1. No adversarial procedure;
2. No need for preliminary approval of the judiciary;
3. No right of cross examination of witnesses;
4. ....

Case 2 – *Berlioz Investment Funds SA*

- C-685/15 **European Court of Justice** (May 16th 2017):
- Request of information may be challenged in front of a Court by the requested individual in the other State (failing to abide by an information order issued by the authority);
- The request <u>may be challenged on the ground of reasonable relevance</u> by the requested individual (taxpayer);
- Article 47 of the Charter of Fundamental Rights grants a (restrained) access to the request of information to the requested individual;
- *Apparently*, *Berlioz* overrules *Sabou*.

Case 3 - *Sommer*

- N°73607/13 European Court of Human Rights (April 27th 2017):
- Article 8 (Respect of private ad family life) is a countervailing factor against the exchange of information;
- Tie break principle: reasonableness, proportionality, …
- Legal point: Human rights doctrine is limited in taxation only where the Convention admits such a limit (example: Article 1, first protocol);
- Privacy, eventually, protected.

Case 4 – A. and B.

- N° 2C_1000 2017 **Swiss Federal Court** (March 17th 2017):
- Information may be denied if a violation of the Bona fides principle occurred (Falciani Case);
- The Swiss legal system:
- Admits (restrained) judicial review on the exchange of information requested;
- Taxpayer must be informed of the request;
- Individual rights and General principles of International Public law (Good faith in the implementation of treaties) must be considered.

Concluding Remarks …

- Evidence collected:
- Privacy must be considered in the EOI procedures;
- Both statutory based legislation and general principles prevent an unrestrained flow of data between Tax administrations;
- … as they prevent disproportionate domestic tax profiling;
- Judiciary offers protection if qualified conditions are met.

… and the Road ahead

- The need to strike a (delicate) balance:
- Combat tax evasion;
- Respect taxpayers’ fundamental rights;
- Possible solutions:
- Judicial review of the requests of information (possibly with a fast tracking procedure);
- Reconsider the role of the Tax administration in this respect.

Audits and Controls

Marco Greggi, University of Ferrara

Summer School «Personal income Tax in the EU»

How to begin with ?

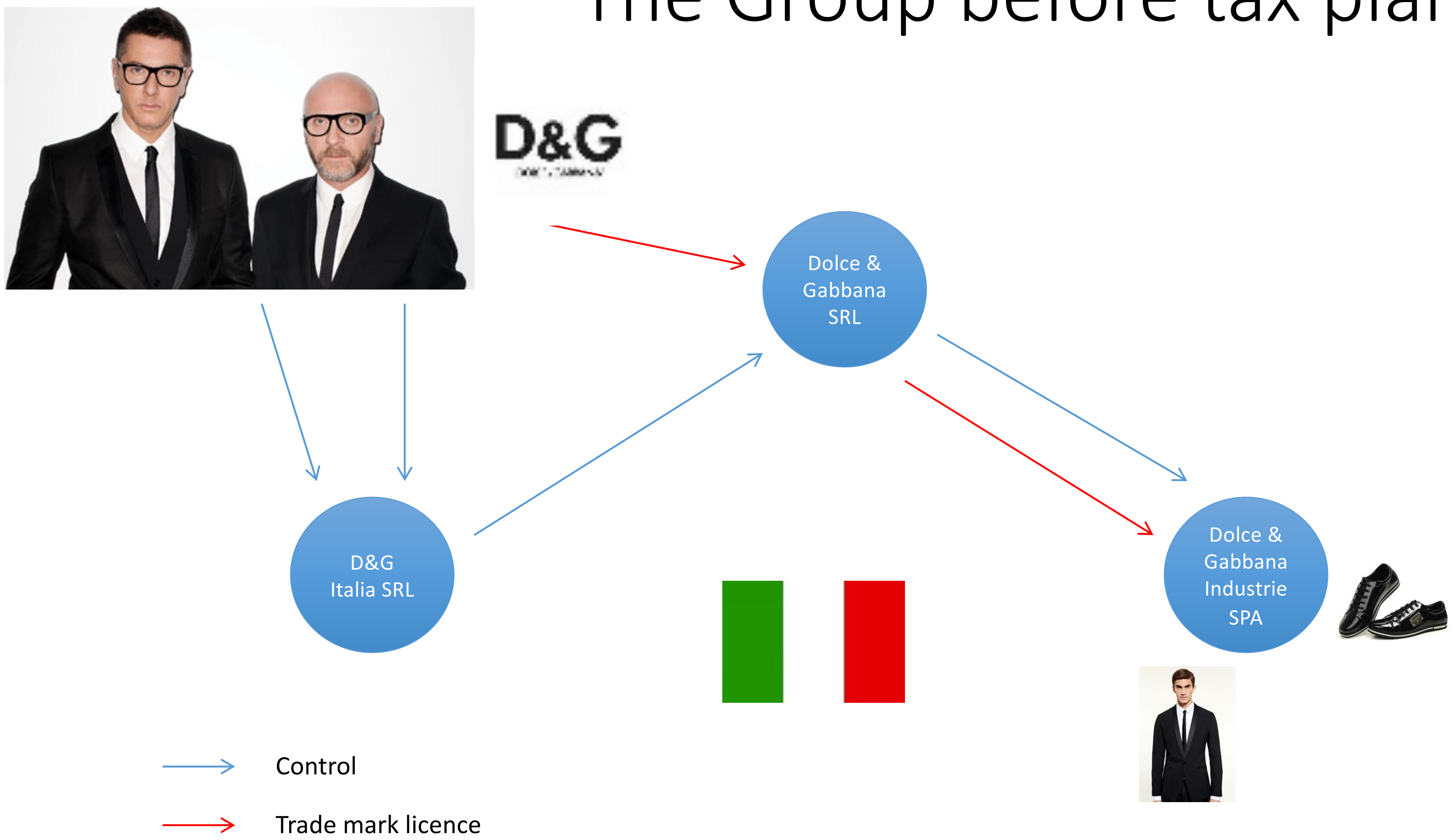
- Rather than theory, let’s discuss a case !

The framework

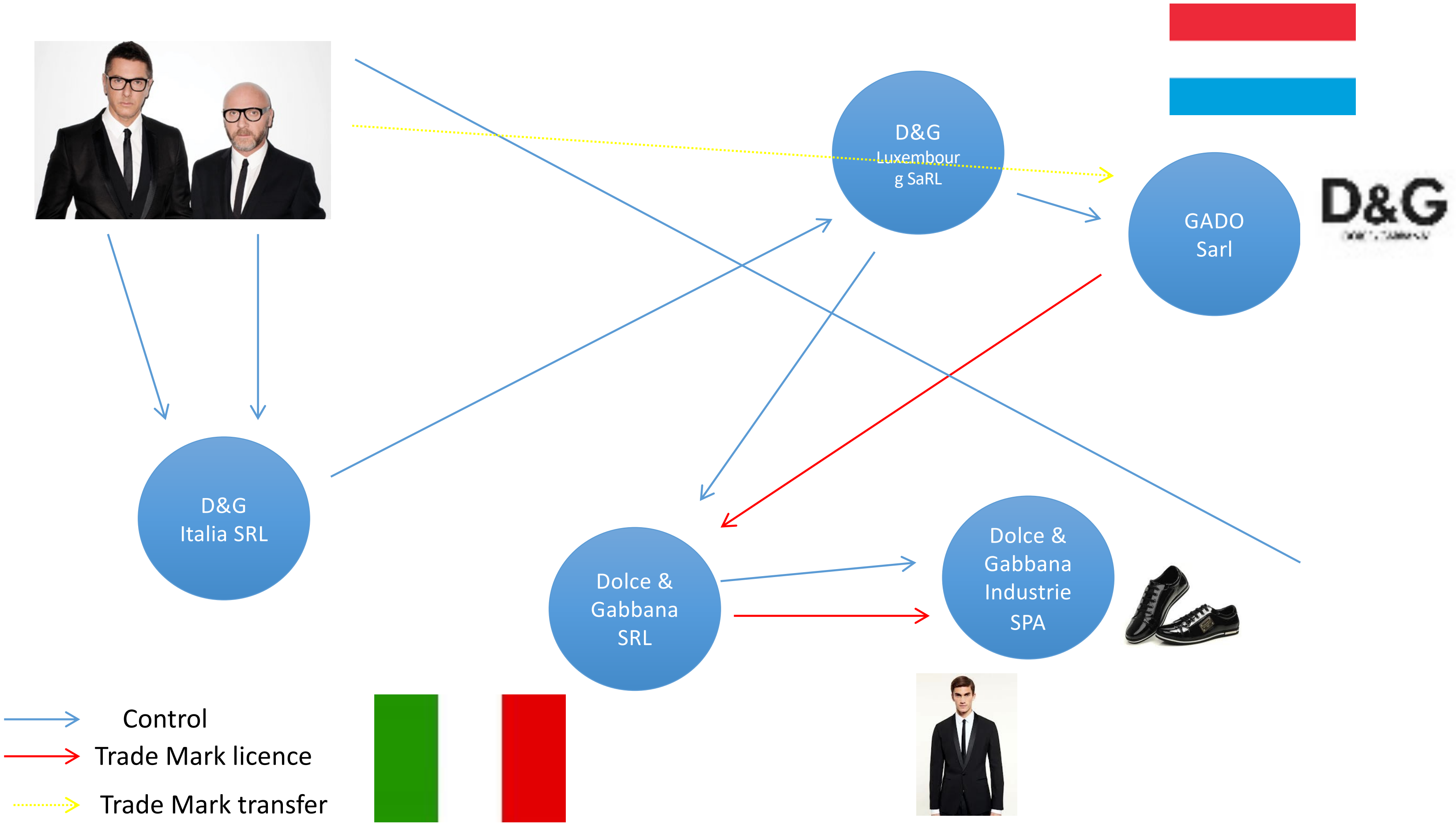
- Every Country has its own experience with tax avoidance and aggressive tax planning;
- Reaction depends:
  1. Attitude (policy decision) of the Tax Administration (Executive authority);
     - Stern vs relaxed approaches;
  2. Legal framework;
  3. Interpretive / cultural approach towards avoidance and tax planning;
     - Tax Court;
     - Academic literature;
- My country as an example …

The Dolce and Gabbana Case

The Group before tax planning



Group after Tax Planning



Assessing the Value

Interbrand Creating and managing brand value™

PRICEWATERHOUSECOOPERS

Guardia di Finanza

D&G DOLCE & GABBANA

€ 2.200.000.000

€ 360.000.000

€ 550.000.000

Allocating Profits from Intellectual Properties

- A problem of transfer pricing as well;
- Before the enactment of the operations:
- Royalties paid to Dolce and Gabbana for the right to use their logo:
  - Perfumes: 0,5%
  - Clothing and accessories: 2,5%
- After: between 7% and 8%

Different Tax Rates

- Royalties paid to GADO Sarl were charged with a 4% tax in Luxembourg instead of a 27,5% corporate tax (Italy);
- Significant tax savings *before* any TP scheme !
- The advantage was obtained simply transferring the IP Asset abroad.

  - Further References: *Data, facts and numbers are taken from and inspired by Court of Appeal of Milan – Italy – March 20th 2013, case n° 43*

Highlight of the Case

1. Making the most of different tax system and business environments:
2. ITALY:
    1. Good for:
        1. Manufacture facilities;
        2. Skilled workers (Como, Milan, …);
        3. IP and Brand development in qualified sectors;
    2. Bad for:
        1. Taxation in general and IP taxation in particular;
3. LUXEMBOURG:
    1. Good for:
        1. Taxation;
    2. Bad for:
        1. Working facilities (high quality textiles, logistics, …).

The Core of Tax Planning

1. Making the most of different tax system and business environments:
2. ITALY:
    1. Good for:
        a. Manufacture facilities;
        b. Skilled workers (Como, Milan, …);
        c. IP and Brand development in qualified sectors;
    2. Bad for:
        a. Taxation in general and IP taxation in particular;
3. LUXEMBOURG:
    1. Good for:
        a. Taxation;
    2. Bad for:
        a. Working facilities (high quality textiles, logistics, …).

TAX PLANNING

End of Day 2