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Renzi's Tax Cut Plans Hinge on Right-Wing Vote

William Hoke

Summary by taxanalysts®

Italian Prime Minister Matteo Renzi's July 19 announcement that his government plans to cut taxes by €50 billion over three years is a marked departure from the traditional philosophy of his Democratic Party, and his ability to turn the proposals into law might depend on defections from the center-right Forza Italia party, observers say.

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Italian Prime Minister Matteo Renzi's announcement on July 19 that his government plans to cut taxes by €50 billion over three years is a marked departure from the traditional philosophy of his Democratic Party (PD), which has its roots in the now-defunct Italian Communist Party. His ability to turn the proposals into law might depend on defections from the center-right Forza Italia party, observers say.

The Italian Parliament might not be the only obstacle Renzi has to clear. Although the prime minister told a PD congress on July 18 that Italy will be one of the few EU countries to lower both its national deficit and its public debt next year, it remains to be seen whether the budgetary watchdogs at the European Union will agree that Renzi's plans to cut taxes will have such a positive impact on Italy's financial situation.

Renzi spoke about his plans in various venues July 18-19, referring to them at one point as a "Copernican revolution in taxes." The prime minister said he wants to abolish local property taxes on primary residences in 2016, to lower the corporate income tax (IRES) and the regional tax on productivity (IRAP) in 2017, and to reduce the individual income tax (IRPEF) by modifying tax brackets for low- and middle-income taxpayers in 2018. "My pledge here, in front of you, is to achieve over five years a reduction in taxes with no comparisons in the republican history of the country," Renzi told the PD faithful at the party's meeting in Milan.

Whether he can accomplish all of that without violating EU budgetary guidelines is unclear, however. Under EU rules, Italy has committed to a general budget deficit no higher than 3 percent of GDP and a structural deficit, which ignores the effect of the business cycle, below 0.5 percent of GDP. While Italy's most recent general budget met those guidelines, the structural deficit ran afoul of the EU's "debt brake" requirement that countries with debt-to-GDP ratios above 60 percent reduce the excess by 0.5 percentage points each year. A country in breach of its budgetary commitments can be fined

0.2 percent of GDP, plus an additional penalty of up to 0.5 percent of GDP, for as long as the breach continues. Italy's public debt is close to 130 percent of GDP.

Concern over Italy's fiscal situation and budget deficit prompted the European Commission in November to postpone for three months a determination as to whether the country was in compliance with EU budget requirements. (Prior coverage.) The commission decided in February that it would not take any disciplinary actions against Italy over its rising government debt levels.

Renzi's plan to do away with the property tax on primary residences mimics a successful effort by Forza Italia's Silvio Berlusconi to drop an earlier version of the tax after he was elected prime minister in 2008. The deeply unpopular property tax was resurrected by another government in 2012 as part of a series of measures to shore up Italy's budget.

Renzi's latest plans are not his first stab at cutting taxes. The budget announced in October included a €5 billion reduction in IRAP and a personal income tax reduction of €80 a month for workers with annual salaries between €18,000 and €23,500. The tax reduction is gradually reduced for higher incomes until it is fully phased out for earnings in excess of €28,000 a year.

Political analyst Luca Ricolfi wrote in the *Il Sole 24* newspaper on July 21 that while the €80 monthly tax cut was "early Renzi," the prime minister's new focus on business tax cuts is a far cry not only from his own party's traditional focus on tax and spending but also from the right-wing model of Berlusconi and his political allies, which primarily concentrated on families. "This is a tax revolution in support of the business sector that nobody has achieved," Ricolfi said.

Gianluigi Bizioli of the University of Bergamo told Tax Analysts that Renzi is trying to definitively cut off his party's connections from its Communist antecedents. The PD was formed in 2007 through the merger of several parties, with much of its early support coming from the Democrats of the Left Party, which sprung out of the Italian Communist Party. "Like [the U.K.'s Tony] Blair, he would like to modernize the left-wing side of the Italian political scenario, and one of the steps in this direction is [its] relationship with taxes," Bizioli said.

Renzi will probably need political backing from current members of Forza Italia to achieve his tax-cutting goals, Bizioli said. "[Some] MPs will leave Forza Italia in September, and they'll start supporting the government," he said.

The decision to cut property taxes in a country where 80 percent of the people own their own homes will likely be the easiest of the tax measures to pass, Bizioli said. "The other measures proposed are only an illusion or . . . smoke and mirrors," he said.

Renzi's ability to sell the package to the European Commission could prove difficult. "The European stability regulation . . . allows tax cuts only if [they are] covered by reductions in government spending," Bizioli said. EU regulations call for member states to make steady reductions in expenditures and don't allow reductions of budgetary deficits based on projections of positive economic trends, he added.

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