



Withholding Tax: An Italian Case

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This paper aims to depict a synthetic description of a characteristic statute of Tax Law: the withholding of tax. The main reason for its peculiarity consists in the fact that the number of people obliged by law to pay tax, is increased by the presence of a subject, which has no links with the situation assumed by law as condition of the tax obligation, but is nevertheless obliged to pay tax.

The creation of this statute was in 1798, when English Prime Minister, William Pitt the Younger, imposed the *Income Tax*, a new tax to fund the wars against Napoleon. This decision by the government aroused such great opposition that it was abolished in 1803, but later reintroduced definitively in 1842. From the United Kingdom, withholding tax spread to many other countries, such as the United States, Germany, the Netherlands and Italy.

In the next part of the paper we will try to describe withholding tax and legal aspects related to it in each country.

The principal figure of withholding tax is the withholding agent, the employer in the case of people working on a contract basis, who takes the place of the taxpayer - the employee in the circumstances considered by our paper. He is bound by law to pay the entire amount of tax, because of details related to the employee specifically, the reception of a salary. Legal practitioners have tried to define withholding tax and place it within the context of Tax Law, with many different resulting propositions: some consider the withholding agent to be an atypical tax authority, others think of the withholding agent as a representative established by Employment Law. All of these theories concur in putting the figure under consideration into the scheme of civil obligations, with the disadvantage of deliberately extending the limits of application of the figure. Withholding tax has, in reality, peculiar aspects which make it impossible to be defined: it is a typical characteristic of Tax Law, created and developed precisely for the purposes of this area of law.

We may now start to analyze the statute of withholding tax in the most important Tax Laws that adopted it.

The first country to be considered is the United Kingdom, in which the present system, called PAYE (Pay As You Earn), was born during the Second World War, a period during which the war effort was rapidly consuming the State finances, necessitating the introduction of a new system of acquisition, characterized by certainty and speed. This origin continues to influence the statute even today.

The amount withheld comprises both the salary and any other earned wage paid to the employee (for instance, sick and maternity pay). The employer is completely responsible for the payment. The amount is determined partly by tax tables determined by the Government, based on salaries and wages, and partly by the employee's expected tax allowances, exemptions and reliefs.

A similar discipline is in force in the Republic of Ireland

In the United States of America, laws relating to the withholding tax were also born due to the costs of the Second World War¹, although a similar measure had also been adopted for the American Civil War.

The relevant rules are in the Internal Revenue Code, section 3401, where the amount is determined by the wage bracket method, which contains the amounts for single or married employees for different periods of time². If the amount exceeds the amount of the wage bracket method, there are different tables, determined by the United States Department of the Treasury, with the percentages to withhold. Taxable base is reduced for each employee based on his expectations about allowances and credits to the tax authorities.

The employer is responsible for the payment of an amount equivalent to the total of withholding taxes that he has to pay according to the federal laws. Payments aggregating \$200,000 or more per year must be made by electronic funds transfer. Smaller payments are made by depositing the amounts into the account of the U.S. government through almost any bank.

The structure of withholding tax takes into account a series of circumstances related to the employee:

- the taxpayer's marital status;
- the number of children or dependents the taxpayer has;
- if the taxpayer wants to claim child tax credits;
- if the taxpayer holds two or more jobs;
- if the taxpayer plans to itemize;
- any tax exemptions from withholding that the taxpayer wants to claim;
- any additional amount the taxpayer wants to withhold.

A taxpayer will get a tax refund if the withheld amount for the year was greater than the income tax actually required.

In Italy, withholding tax is very common in income taxes, and the details are contained in article 23 of D.P.R. 600 del 1973. The employer, who owes the employee the

¹ To be noticed also the description of the measure made by Department of Treasury: "This greatly eased the collection of the tax for both the taxpayer and the Bureau of Internal Revenue. However, it also greatly reduced the taxpayer's awareness of the amount of tax being collected, i.e. it reduced the transparency of the tax, which made it easier to raise taxes in the future".

² Daily, twice-weekly, partial-monthly, monthly.

salary, has to withhold a percentage of the salary and pay it to tax authorities in advance of the income tax owed by the employee.

The payment must be done with a form, form F24, adopted every year by the public company responsible for the collection of taxes, called Agenzia delle Entrate, in which the amount to withhold is established by the total of a series of points³, calculated specifically for different periods of time.

At the end of the year, the employer has to give to his employees a certificate, called CUD (Certificato unico Dipendente), showing the total withheld amount.

With regard to relations between the subjects of the statute, we can highlight these aspects: the employee is the tax authority's creditor for an amount equivalent to the total withheld, a credit which doesn't change if the employer withholds the money, but doesn't pay the tax. If the employer doesn't withhold the required amount, the employee has to inform tax authorities of the entire amount of his salary, without withholding tax. The employer can have the compensation only after the employee communicate this to the authorities.

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After this comparison of the statute, we can consider the enforcement of the law, a good example of which is represented by a recent case discussed at the Court of Pordenone.

The case concerns an employer, Giorgio Fidenato, who, from January 2009, decided to give his employee the entire salary, without withholding the request amount for tax and welfare. He also informed the authorities about his decisions. The facts continue into the next months in an absurd way: his employees went to the offices of tax authorities with the money to pay taxes, but the payment was refused on the base that it was illegal, because it is the employer that has to pay, rather than the employees.

The employer received a lot of claims of payment from the tax authorities, so he decided to go before the court and asked for an examination of the statute on withholding tax with the constitution.

This case forms a good basis from which to show how absurd and inefficient withholding tax law is in a system that forces the employer to become a tax collector.

The main reason to support withholding tax is that it allows tax collection at the point of earning income, therefore costs of tax collection are less than without withholding tax at then stage. It is an enforcement of the principle of efficiency of public administration and correct financial management.

This argument is completely incorrect: for example, consider a hypothetical system without withholding tax, in which tax payers only need to give information about their income to the tax authorities, who then only have to check the veracity of the informations. How is it possible to maintain that the present obligation to undertake difficult calculations to determine the amounts to pay, to apply an obscure and absurd method, is efficient?

³ Sections: "Erario", referred to taxes; "INPS", referred to National insurance contribution; "Altri enti previdenziali", referred to ather National insurance contribution; "Regioni", referred to local taxes; "ICI e altri tributi locali", referred to other local taxes.

Furthermore, one must also consider how much this wasted time collecting taxes may cost the employer? The difficulty to dispatch all the bureaucratic passages needs an employee only to do it, so who pay him? If withholding tax didn't exist, these costs would be eliminated.

Thus, finally, could the activity of the parliament and the government to create, change and correct the discipline of the tax, be considered efficient? Is the double work involved in tax authorities checking withheld amounts and then comparing the income declared to the real situation in line with the principle of efficiency of the administration? The answer, it would seem, is not.

Another argument used to defend withholding tax is its importance in reducing tax evasion. This point, very important for the Treasury, links withholding tax to one of the most important principles of Tax Law: the principle of the ability to pay taxes.

This principle imposes the duty that everyone must contribute to public expenditure by paying taxes on the grounds of their economic capacity, that is the benchmark to fix the amount of taxes that each taxpayer has to pay. This principle is the rule of division of the duty to pay taxes among taxpayers. Each taxpayer, therefore, has the right to expect that all other taxpayers pay taxes: consequently, the activity of tax authorities to fight against tax evasion is a way to enforce this right, and, within this structure, withholding tax is part of this enforcement.

This assertion, seemingly solid and precise, is actually not founded on a solid base, the risk being the creation of an authorization for public authorities to do everything for the purpose of the improvement of tax collection.

Before accepting this theory, we have to also examine the fact that the principle of the ability to pay taxes is a guarantee for taxpayers, rather than tax authorities. It established a strong link between the amount to pay and the economic capability of the taxpayer, in a strong personalization of the duty to pay taxes. The principle demands that the State pay attention to the situation of the taxpayer and not claim excessive taxes. This principle, therefore, means the opposite of the current interpretation, in that it should, rather, be in favour of taxpayers and against tax authorities.

What is at fault is the method of charging tax authorities with the task of enforcing taxpayers' rights, because, in Tax Law, public administration is the counterparty of the individual.

After having demonstrated the fault of common theories about withholding tax, we could say that this statute is opposed to constitutional principles, if the principle of the ability to pay taxes establishes a personal link between the taxpayer and his taxes, as it is illegal to extend the responsibility of payment to a subject that has no relation between tax and its foundations. The extreme individualization makes it absurd to claim money from someone, when the money must, in fact, be paid by another.

Finally, is it possible to deny the supposed effectiveness of withholding tax against tax evasion: it is enough to compare the data regarding of tax evasion as regards Gross Domestic Product of some countries with withholding tax laws, e.g. the United States - 16% of GDP, or in Italy - 18 % of GDP, with data from a country like France, 2,3 % of GDP,

which does not employ withholding tax⁴. It is very simple to frustrate aims of withholding tax: a mere agreement between the employer and the employee, the former declaring to give the latter a lower salary, but giving the employee some money without declaring its.

We are now at the conclusion of the paper, so the negative effects of withholding tax may be observed.

Firstly, the distortion of the perception that employees have of their salary. The automatism of withholding tax doesn't allow a complete comprehension of the high level of taxation (increasing from a minimum of one third to up). Employees tend to consider their salary "not satisfactory" due to market fluctuations, not because of taxes.

Another consequence is related to political choices and accountability of politicians, it is very simple to promise to reduce taxes, if taxpayers don't understand the exact amount they pay. They lack the means of assessing who may have respected the pledges made during electoral campaign, resulting in citizens making an irresponsible choice.

Having analysed the inefficiency of withholding tax, there remains just one question: who is interested in withholding tax? The answer, this paper suggests, is that only the state and politicians are concerned with this, who have, in doing so, deprived the individual of another space of liberty and forced him to act as the tax collector. They have just one opportunity: ask the state to act as the collector of their salary. In doing so, it could, for once, be the State performing the calculation for withholding taxes!

⁴ Data from Department of Treasury (US), Ministero dell'Economia (IT), Ministère du Budget, des Comptes publics, de la Fonction publique et de la Réforme de l'État (FR).

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