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Making Cash(less) King: Italian Lessons on Digital Payments and Tax Compliance

Raffaele Russo (Amsterdam Centre for Tax Law (ACTL) of the University of Amsterdam; Chiomenti) and Giorgio Beretta (Editor) (Amsterdam Centre for Tax Law (ACTL) of the University of Amsterdam; Lund University) · Tuesday, July 26th, 2022

The transition toward a cashless society is at the heart of many public policy discussions. The move is driven by several factors, such as the spread of debit and credit cards, the development of mobile and instant payment technologies favoured by FinTech and digital platforms, as well as the effects of the pandemic and the increasing time spent online.

Many governments and public institutions – among which, the European Central Bank (ECB) and the US Federal Reserve (FED) – are evaluating the design and implementation of a Central Bank Digital Currency (CBDC), while other countries like China have already started implementing it.

The transition toward a cashless society does not occur at the same pace in all countries. According to the ECB's Study on the Payment Attitudes of Consumers in the Euro area (SPACE), released in December 2020, the lowest cash-intensive countries in terms of the number of retail transactions settled by cash in the EURO area are the Netherlands (34%), Finland (35%) and Estonia (48%). Based on this study's estimates, the proportion of overall transactions settled by cash is much higher in a country like Italy (82%). The Bank of Italy, in a report published in March 2022, found that cash is mainly used for low-value transactions and mostly adopted in Italy's central and southern regions, by women and people with lower incomes and levels of education and self-employed workers.

The Court of Justice of the European Union (CJEU) also took a stance on the cash vs cashless contention in a landmark decision in January 2021. Notably, the EU Court ruled that a Member State can impose limits on cash payments for reasons of public interest, such as those relating to the security and fight against crime or the efficient organisation of payments in society **[1]**. Indeed, in his Opinion in the case, AG Pitruzzella specifically mentioned '*efficiency of tax collection*' (point 164) as a reason of public interest to limit cash payments.

Italians' love affair with cash might also have been impacted by various public and tax policy measures enacted by the country in recent years:

- Although through swinging policy decisions, Italian governments have been imposing stricter limits on cash payments (an upper ceiling of EUR 1,000 per cash payment is set to apply as of 1 January 2023).

- From the fiscal year 2020, individual taxpayers can deduct expenses from income tax due only if these expenses have been paid via electronic means (an exclusion applies for medical costs incurred through Italy's National Health Service).
- Since 1 July 2020, entrepreneurs and self-employed workers (having an annual turnover of less than EUR 400,000) receive a tax credit of 30% of the fees paid for transactions concluded with private consumers using cashless instruments (the tax credit amounted to 100% of the fees for the period between 1 July 2021 and 30 June 2022).
- From 30 June 2022, Italian merchants and professionals that do not allow their customers to pay with debit or credit cards face steep fines (EUR 30, plus 4% of the value of the refused transaction).
- Finally, businesses under the mandatory e-invoicing system (from 1 July 2022, based on an EU Council's authorization issued in December 2021, also extended to SMEs with an annual turnover of at least EUR 25,000 **[2]**), receiving payments over a certain amount (EUR 500) only via e-means, benefit from a two-year reduction of the ordinary notice period for income tax and VAT assessment.

However, Italy's most prominent initiatives favouring cashless payments relate to the so-called 'Cashback' and the Tax Receipts Lottery, which were the main pillars of the Italian government's initiative to accelerate the transition from cash to cashless ('Italia Cashless').

The Italian Cashback

The programme granted private consumers a 10% refund of the price of retail purchases made using cashless instruments (debit and credit cards but also payment apps) in the Italian territory.

To receive the 10% refund at the end of each semester, participants had to register via a public service app (called 'App IO') and conclude minimum 50 transactions per semester. Only on-shop transactions were valid: online sales were instead excluded. Moreover, a ceiling amount (EUR 150) was applied for each transaction, so the maximum refund for a single transaction was capped (EUR 15). There was also a total ceiling (EUR 1,500) per semester.

The initiative had a first trial stage between 8 and 31 December 2020 (so-called 'Christmas Cashback'), while the main phase was designed to last for three semesters, until 30 June 2022. The programme was first suspended on 30 June 2021 and finally abolished in 2022. Views differ regarding the initiative, being heavily criticised by some for its high costs whilst others praised it as supporting private consumption in COVID-19's dire times, helping Italians familiarise themselves with technologies (by accessing the government 'App IO'), and incentivising the use of cashless payments methods. According to the official data, nearly 9 million people registered on the programme, more than 820 million transactions were recorded, and 16 million payment instruments were used. In a document issued in December 2021, the Italian Ministry of Finance acknowledged the initiative for fostering the adoption of cashless payments but, at the same time, expressed doubts about its effectiveness, considering its high cost.

The Tax Receipts Lottery

The initiative started on 1 February 2021 and is still in operation. Participation in the Tax Receipts Lottery is open to all Italian residents that have obtained the tax lottery bar code and use cashless instruments to purchase goods or services from retail outlets. Each EUR spent entitled participants to 1 ticket, up to a maximum of 1,000 tickets for a receipt equal to or greater than EUR 1,000. Both consumers and merchants participate in the lottery draws, which take place on a weekly, monthly, and annual basis, with prizes of up to EUR 5 million for consumers and EUR 1 million for merchants.

In the context of the National Recovery and Resilience Plan (NRRP), the Italian lawmaker has recently amended the provisions regulating the scope of the receipt-based tax lottery, providing, inter alia, for the possibility of instant draws rather than only periodic ones.

Tax lotteries are a traditional instrument to enhance a cooperative relationship between citizens and tax authorities and have had different ranges of success/failure **[3].** This tax compliance instrument has received growing attention even among the EU Member States. Italy's Tax Receipts Lottery has so far encountered only scant attention by Italian residents, mainly due to the limitations imposed to safeguard the privacy of participants and the lack of a solid communication strategy which is crucial in these kinds of initiatives. In a document issued in December 2021, the Italian Ministry of Finance itself praised the programme as an effective measure to enhance compliance in high-risk tax evasion sectors but, at the same time, underlined difficulties for potential participants to access the programme and the lack of sufficient information on the initiative among the general public (pp. 13-16).

The 'cashless effect' on tax revenue

Tax compliance benefits associated with increased adoption of cashless payments are apparent, also in a country like Italy where cash is (still) king **[4]**.

Notably, a paper drafted by Bank of Italy's affiliated researchers and published in February 2022 shows that the decline in VAT revenue during the COVID-19 recession has been unexpectedly lower than the drop in household consumption (the difference has grown up to 9%-points). The paper notices that VAT bounced back to pre-crisis levels in the first half of 2021, even though aggregate consumption had still not recovered. It attributes (pp. 22-23) this lower-than-expected VAT revenue drop partially to a change in consumers' habits during the COVID-19 pandemic. Notably, consumption of services, characterised by lower VAT rates and a lower degree of compliance, dropped massively during the COVID-19 pandemic, while spending on durable goods fell briefly at the onset of the crisis and then rose quickly to pre-crisis level (based on a so-called 'substitution effect').

The paper also found that another element helped sustain VAT revenue during the COVID-19 pandemic: the increased adoption of cashless payments, an uprising trend possibly driven by the measures mentioned above. The paper concludes (pp. 23-24) that if the change in payment habits turned out to be permanent, this would lead to a structural reduction in the government deficit. The paper also provides preliminary evidence on the effect of electronic payments on reducing VAT evasion: a 1%-point increase in the share of cashless payments results in approximately 0.4% higher VAT revenue owing to increased compliance. Based on this evidence, the paper recommends electronic payments' adoption in sectors with a lower degree of tax compliance (p. 24). The study's results suggest that increased VAT revenues can pay off (part of) the costs of incentives for cashless payments, especially if these incentives are temporary but produce long-term effects in terms of consumer-spending behaviours.

Concluding remarks

The concrete instruments to incentivize cashless payments and support the transition toward a cashless society are a matter of policy choices. Anti-money laundering and tax measures can also be included among available public policy tools.

Notably, governments may introduce monetary benefits for using cashless instruments, such as in the case of Italy's Cashback and Tax Receipts Lottery. However, limitations on cash payments may also be conceived if justified and opportunely targeted, as shown by the CJEU's decision and AG Pitruzzella's Opinion mentioned above.

The use of CBDC for digital payments, like cash is used for physical payments, is yet to come. However, in a world increasingly marching toward cashless payment solutions, policymakers must consider how to leverage these developments to (i) make tax compliance more seamless, (ii) provide additional services to taxpayers, and (iii) ensure that legitimate privacy concerns are effectively addressed.

[1] The CJEU considered that Germany's '*obligation to pay the radio and television licence fee by cashless means of payment is intended to ensure the effective recovery of the licence fee and to avoid substantial additional costs*' (paragraph 72).

[2] The EU Commission's proposal on this implementing decision reports (p. 1) that, according to the Italian government, additional VAT revenue due to the implementation of mandatory e-invoicing can be estimated to around EUR 2 million.

[3] For a comparative perspective on tax lotteries, *see* L. Mattes, *VAT Lotteries – The Ultimate Road Towards Tax Compliance and Social Awareness?* (IBFD 2015), who reports that the first country to implement a receipt-based tax lottery was Taiwan in 1951. A successful tax lottery scheme is Portugal's '*Fatura da sorte*'.

[4] On the Italians' persistent propensity towards cash payments, *see* also The European House – Ambrosetti, *Verso un'Italia Cashless: Le Opportunità del PNRR e i Trend Innovativi nel Mondo dei Pagamenti* (2022).

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