

Public Finance

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a.a. 2025/2026

The Italian Tax System I

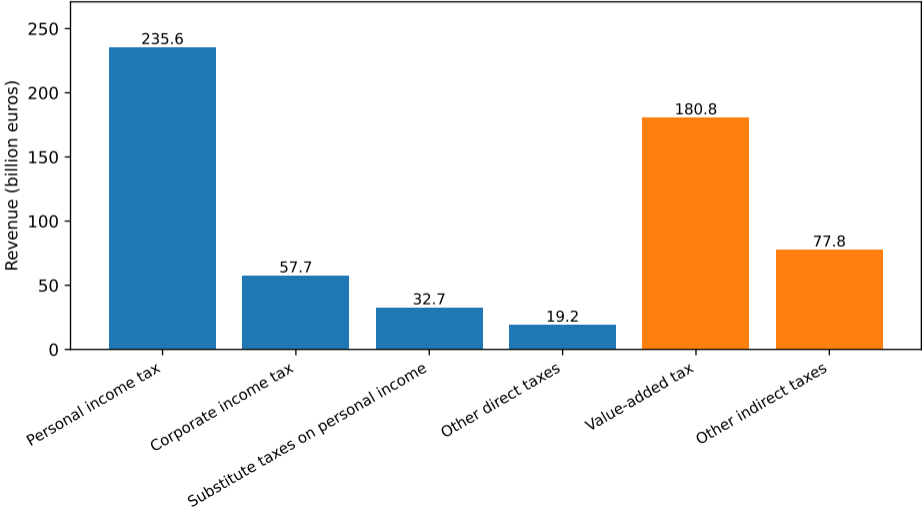
Introduction

- ▶ Articles 23 and 53 of the Constitution outline the general principles of the Italian tax system.
 - 23) No obligation of a personal or financial nature may be imposed on anyone **except by law**.
 - 53) **Every person** shall contribute to public expenditure in accordance with their **capabilities**. The tax system shall be **progressive**.

- ▶ The Constitution highlights four fundamental principles:
 1. Legality of taxation.
 2. Universality of taxation.
 3. Equity of the tax burden.
 4. Progressivity of the tax burden.

Introduction

Italian Central Government Tax Revenues - 2024
(Pre-final figures, accrual basis)



Introduction

- ▶ Almost 85 percent of the IT central government tax revenues comes from three sources
 - ▶ Personal Income Tax (IRPEF) and its substitute taxes
 - ▶ Corporate Income Tax (IRES)
 - ▶ Value-added Tax (IVA)
- ▶ These are also the taxes that offer the richest insights from an economic point of view
 - ▶ Efficiency vs. equity trade-off
 - ▶ Progressivity by brackets
 - ▶ Progressivity by deduction/rebate
 - ▶ Tax evasion and avoidance behavior

Personal Income Tax (IRPEF)

Taxable Income

- ▶ IRPEF is applied to incomes falling into certain categories identified by law:
 - ▶ Land incomes.
 - ▶ Capital incomes.
 - ▶ Employment incomes.
 - ▶ Self-employment incomes.
 - ▶ Business incomes.
 - ▶ Miscellaneous incomes.
- ▶ IRPEF is a progressive tax as it affects income with rates depending on income brackets.
- ▶ Taxable income and the tax to be paid are determined, respectively, net of **deductible charges** and **rebates for charges**.

Personal Income Tax (IRPEF)

Taxpayer

- ▶ Unlike other countries, such as France, Germany, USA, the taxpayer of IRPEF is the individual rather than the family unit.
- ▶ The choice of using a personal or family tax generates further distortions in individual choices.
 - ▶ In a single-income family, an additional hour of work by the already contributing individual is taxed more than the first hour of work by the second individual.

The EU Parliament resolution of 01/15/2019 encourages Member States using a family tax to replace it with a personal tax as the personal tax is neutral regarding the labor supply of the second income earner.

Personal Income Tax (IRPEF)

Gross Marginal Rates

- ▶ 3 income brackets with the following gross marginal rates:
 1. 23% up to 28,000 euros.
 2. 33% from 28,001 to 50,000 euros.
 3. 43% over 50,000 euros.
- ▶ Several reforms over the years
 - ▶ 2026: reduction of the intermediate tax rate from 35% to 33%
 - ▶ 2024: Reduction in the number of tax brackets from 4 to 3 (income between 15,001 and 28,000 euros)
 - ▶ 2022: Reduction in the number of tax brackets from 5 to 4 and revision of bracket thresholds
 - ▶ When IRPEF was first introduced in 1974, 32 income brackets

Personal Income Tax (IRPEF)

A comparison with 1974

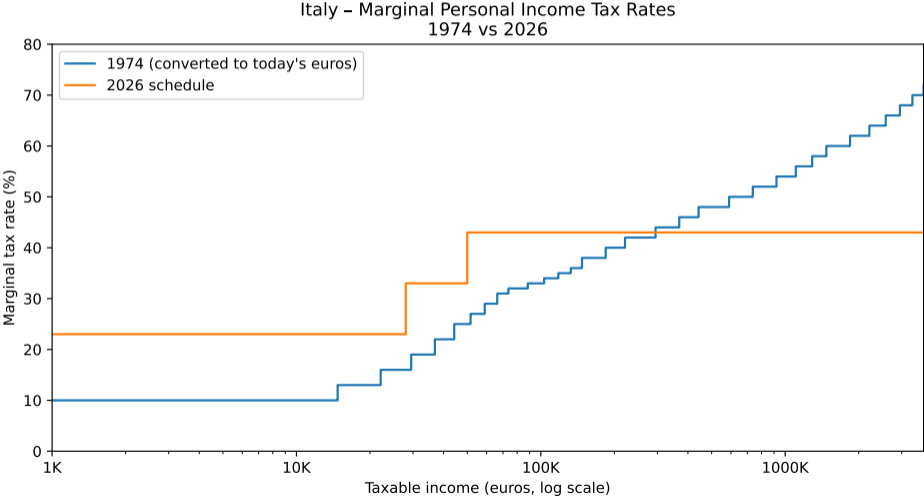
Aliquote marginali IRPEF in vigore nel 1974

Da Euro	A Euro	Aliquota
0,00 €	1.032,91 €	10,00%
1.032,91 €	1.549,37 €	13,00%
1.549,37 €	2.065,83 €	16,00%
2.065,83 €	2.582,28 €	19,00%
2.582,29 €	3.098,74 €	22,00%
3.098,74 €	3.615,20 €	25,00%
3.615,20 €	4.131,66 €	27,00%
4.131,66 €	4.648,11 €	29,00%
4.648,11 €	5.164,57 €	31,00%
5.164,57 €	6.197,48 €	32,00%
6.197,48 €	7.230,40 €	33,00%
7.230,40 €	8.263,31 €	34,00%
8.263,31 €	9.296,22 €	35,00%
9.296,22 €	10.329,14 €	36,00%
10.329,14 €	12.911,42 €	38,00%
12.911,42 €	15.493,71 €	40,00%

Da Euro	A Euro	Aliquota
15.493,71 €	20.658,28 €	42,00%
20.658,28 €	25.822,84 €	44,00%
25.822,85 €	30.987,41 €	46,00%
30.987,41 €	41.316,55 €	48,00%
41.316,55 €	51.645,69 €	50,00%
51.645,69 €	64.557,11 €	52,00%
64.557,11 €	77.468,53 €	54,00%
77.468,54 €	90.379,96 €	56,00%
90.379,96 €	103.291,38 €	58,00%
103.291,38 €	129.114,22 €	60,00%
129.114,23 €	154.937,07 €	62,00%
154.937,07 €	180.759,91 €	64,00%
180.759,92 €	206.582,76 €	66,00%
206.582,76 €	232.405,60 €	68,00%
232.405,61 €	258.228,45 €	70,00%
258.228,45 €	In su	72,00%

Personal Income Tax (IRPEF)

A comparison with 1974



Personal Income Tax (IRPEF)

A comparison with 1974

- ▶ Legal tax rates for low income levels are (much) higher now than in 1974 while top marginal tax rates are much lower than in the past
- ▶ Recall the discussion about the Laffer Curve and the reduction of top marginal income tax rates pursued in several countries since the eighties
- ▶ **Less progressive tax system now?** Not so obvious to answer
 - ▶ Need to take into account the distribution of taxable income
 - ▶ $\bar{y} = 24K$; $y^m = 20K$; $y^{90} = 43K$
 - ▶ Today's IRPEF relies heavily on tax rebates to achieve progressivity (next slide)
 - ▶ Baldini (2020) based on surveys about the income distribution argues that modern-years IRPEF redistributes more than 1974 IRPEF (mostly due to its higher incidence) and is overall slightly more progressive

Personal Income Tax (IRPEF)

Rebates for source of income and rebates for dependent family members

- ▶ To incentivize incomes predominantly from employment, the legislator has provided for a progressive IRPEF deduction for income from self-employment, employment, and pension incomes.
- ▶ To take into account that the fiscal capability of each individual also depends on their family dependants, the legislator has introduced tax rebates for spouses and children that are not earning income or earn very low income.
- ▶ The combination of the basic rebate for source of income and the rebate for family dependants implies that the net tax liability for most taxpayers is significantly lower than the gross tax liability
- ▶ A "no-tax area" exists because of the combination of the brackets regime and the rebates regime although the statutory tax rates are positive for any income

Personal Income Tax (IRPEF)

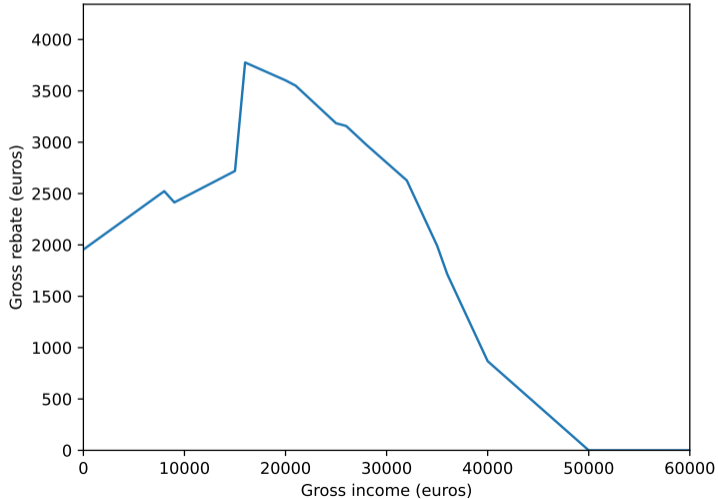
Rebates for source of income and rebates for dependent family members

- ▶ The system of rebates has been amended several times over the recent years and perhaps not in the most elegant and user-friendly way
- ▶ Example for a salary worker, single with no dependent children
 - ▶ **Basic tax rebate (“detrazione”):**
 - ▶ If $y \leq 15,000$: $f = 1,955$.
 - ▶ If $15,000 < y \leq 28,000$: $f = 1,910 + 1,190 \cdot \frac{28,000 - y}{13,000}$.
 - ▶ If $28,000 < y \leq 50,000$: $f = 1,910 \cdot \frac{50,000 - y}{22,000}$.
 - ▶ If $y > 50,000$: $f = 0$.
 - ▶ **Extra fixed rebate:** add +65 if $25,000 < y \leq 35,000$.
 - ▶ **Additional income-related credit (“ulteriore detrazione”):**
 - ▶ If $y \leq 8,500$: add $+0.071 \cdot y$.
 - ▶ If $8,500 < y \leq 15,000$: add $+0.051 \cdot y$.
 - ▶ If $15,000 < y \leq 20,000$: add $+0.048 \cdot y$.
 - ▶ If $20,000 < y \leq 32,000$: add +1,000.
 - ▶ If $32,000 < y \leq 40,000$: add $+1,000 \cdot \frac{40,000 - y}{8,000}$.

Personal Income Tax (IRPEF)

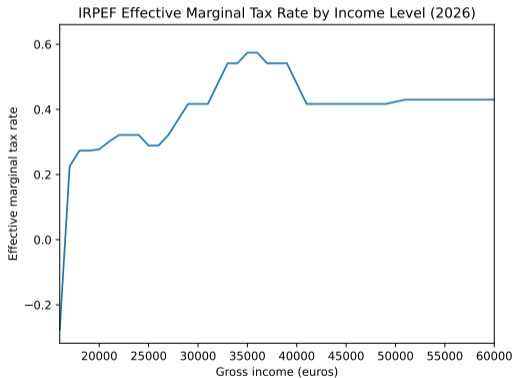
Rebates for source of income and rebates for dependent family members

IRPEF Gross Rebate by Income Level (2026)



Personal Income Tax (IRPEF)

Effective Marginal Tax Rate

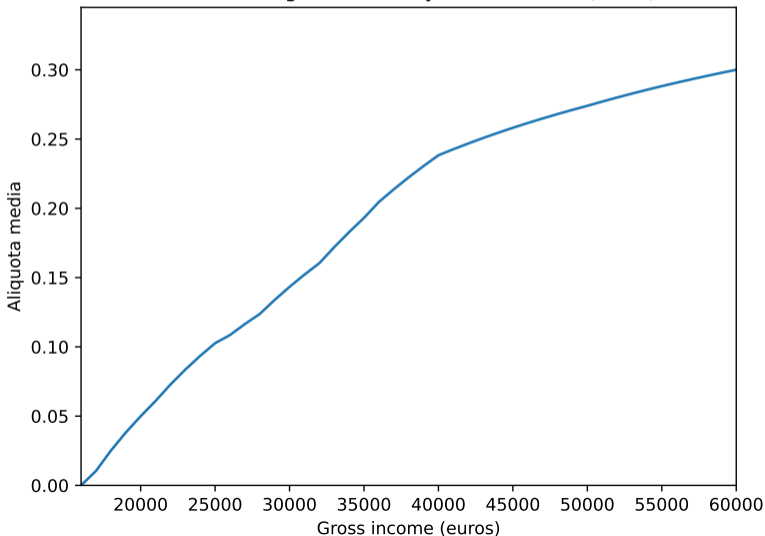


- ▶ Recall the formula $t^m = \frac{\partial T(Y)}{\partial Y}$
- ▶ Marginal rates not always increasing wrt income → **Violation of marginal rate progressivity definition**
- ▶ Marginal rates above the statutory max for $30K \geq y \geq 40K$
- ▶ Effective marginal rate $\approx 43\%$ starts earlier than 50K → **Potential efficiency losses**

Personal Income Tax (IRPEF)

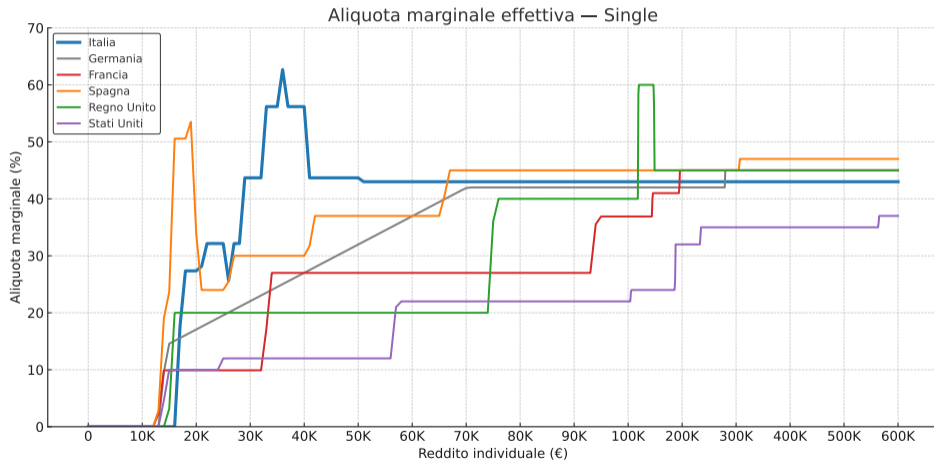
Effective Average Tax Rate

IRPEF Average Tax Rate by Income Level (2026)



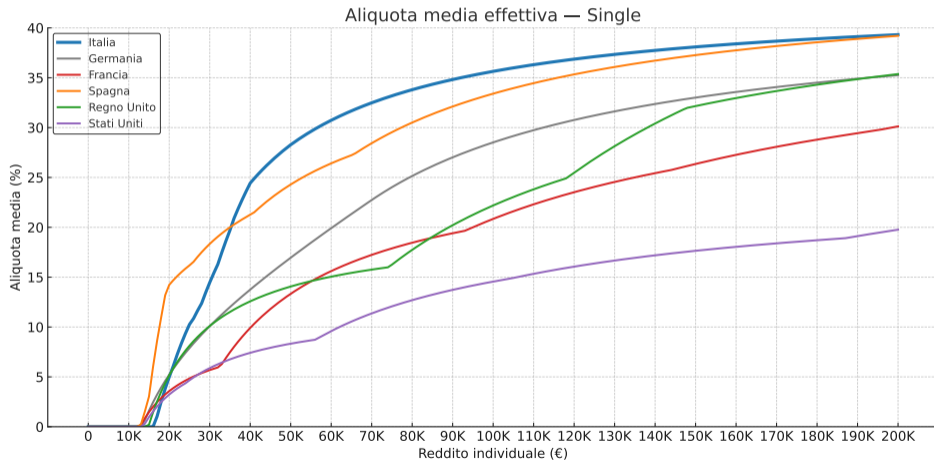
Personal Income Tax (IRPEF)

International comparison (2025)



Personal Income Tax (IRPEF)

International comparison (2025)



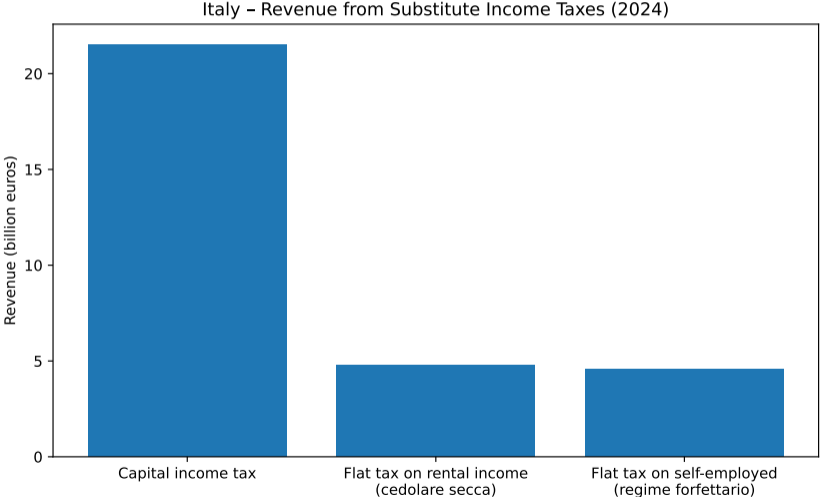
Personal Income Tax (IRPEF)

Substitute Taxes

- ▶ Some types of income are subject to substitute tax and therefore do not fall within the progressive IRPEF brackets.
- ▶ These are cases of proportional tax (so-called *flat tax*).
 1. *Regime forfettario* on income from self-employment;
 2. *Cedolare secca* on rental properties;
 3. Tax on financial income (capital gains and dividend income).

Personal Income Tax (IRPEF)

Substitute Taxes



Personal Income Tax (IRPEF)

Regime forfettario

- ▶ A regime reserved for individuals holding business incomes (sole proprietorship) or self-employment incomes who have **billed up to 85,000 euros** and have faced personnel costs below 20,000 euros.
 - ▶ The 2023 Budget Law raised the maximum billing threshold from 65,000 euros.
- ▶ Taxable income is determined favorably by a profitability coefficient established *by law*.
- ▶ Deduction of mandatory social security contributions.
- ▶ Application of a single tax equal to 15% on taxable income, replacing **all** taxes envisaged (income taxes, local surtaxes, IRAP).
- ▶ For the first five years of activity, the tax is reduced to 5%.

Personal Income Tax (IRPEF)

Regime forfettario

LAVORO DIPENDENTE	Elettricista		Consulente informatico	
	Uscite	Dal costo del lavoro al reddito netto	Uscite	Dal costo del lavoro al reddito netto
Costo azienda lavoratore (al netto di accantonamento TFR)		64.500 €		50.250 €
Contributi previdenziali (IVS) c/o azienda 23,81%	11.672 €		9.249 €	
Altri contributi c/o azienda (rispettivamente 7,77% e 5,55%)*****	3.809 €		2.156 €	
Imponibile previdenziale		49.020 €		38.845 €
Contributi previdenziali c/o lavoratore 9,19%*****	4.505 €		3.570 €	
Contributi CIGS c/o lavoratore 0,30%	147 €		117 €	
Reddito imponibile		44.368 €		35.159 €
Irpef lorda	12.429 €		9.206 €	
Detrazioni per lavoro dipendente		489 €		1.289 €
Irpef netta	11.940 €		7.917 €	
Addizionale Irpef regionale e comunale**	1.637 €		1.247 €	
Reddito netto		30.791 €		25.994 €
Totale imposte e contributi previdenziali	29.753 €		21.983 €	
Totale imposte e contributi	33.709 €		24.256 €	

Source: Bordignon et al., L'espansione del forfettario e i regimi fiscali di autonomi e dipendenti, OCPI, 2022

Personal Income Tax (IRPEF)

Regime forfettario

REGIME ORDINARIO (lavoro autonomo)	Elettricista		Consulente informatico	
	Uscite	Dal fatturato al reddito netto	Uscite	Dal fatturato al reddito netto
Fatturato		75.000 €		75.000 €
Costi (rispettivamente 14% e 33%)*	10.500 €		24.750 €	
Imponibile previdenziale		64.500 €		50.250 €
Contributi previdenziali 26,23%	16.918 €		13.181 €	
Reddito imponibile		47.582 €		37.069 €
Irpef lorda	13.554 €		9.874 €	
Detrazioni per lavoro autonomo		55 €		294 €
Irpef netta	13.499 €		9.580 €	
Addizionale Irpef regionale e comunale**	1.773 €		1.328 €	
Reddito netto		32.310 €		26.161 €
Totale imposte e contributi	32.190 €		24.089 €	

Source: Bordignon et al., L'espansione del forfettario e i regimi fiscali di autonomi e dipendenti, OCPI, 2022

Personal Income Tax (IRPEF)

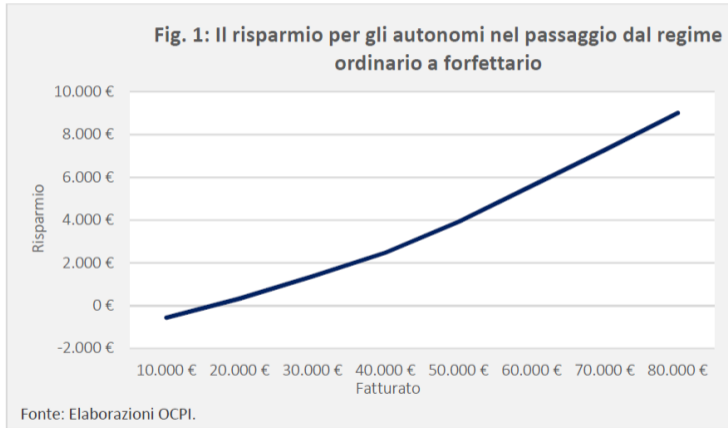
Regime forfettario

REGIME FORFETTARIO (lavoro autonomo)	Elettricista		Consulente informatico	
	Uscite	Dal fatturato al reddito netto	Uscite	Dal fatturato al reddito netto
Fatturato		75.000 €		75.000 €
Applicazione costi forfettari (rispettivamente 14% e 33%)***	10.500 €		24.750 €	
Imponibile previdenziale		64.500 €		50.250 €
Contributi previdenziali 26,23%	16.918 €		13.181 €	
Reddito imponibile		47.582 €		37.069 €
Aliquota flat 15%****	7.137 €		5.560 €	
Reddito netto		40.444 €		31.509 €
Totale imposte e contributi	24.056 €		18.741 €	

Source: Bordignon et al., L'espansione del forfettario e i regimi fiscali di autonomi e dipendenti, OCPI, 2022

Personal Income Tax (IRPEF)

Regime forfettario



Source: Bordignon et al., L'espansione del forfettario e i regimi fiscali di autonomi e dipendenti, OCPI, 2022

Personal Income Tax (IRPEF)

Regime forfettario

LAVORO DIPENDENTE	Elettricista		Elettricista		Elettricista	
	Uscite	Dal costo del lavoro al reddito netto	Uscite	Dal costo del lavoro al reddito netto	Uscite	Dal costo del lavoro al reddito netto
Costo azienda lavoratore (al netto di accantonamento TFR)		35.400 €		62.293 €		89.974 €
Contributi previdenziali (IVS) c/o azienda 23,81%	6.406 €		11.272 €		16.281 €	
Altri contributi c/o azienda 7,77%*****	2.090 €		3.678 €		5.313 €	
Imponibile previdenziale		26.904 €		47.342 €		68.380 €
Contributi previdenziali c/o lavoratore 9,19%*****	2.472 €		4.351 €		6.284 €	
Contributi CIGS c/o lavoratore 0,30%	81 €		142 €		205 €	
Reddito imponibile		24.351 €		42.849 €		61.891 €
Irpef lorda	5.788 €		11.897 €		19.513 €	
Detrazioni per lavoro dipendente		2.227 €		621 €		0 €
Irpef netta	3.561 €		11.276 €		19.513 €	
Addizionale Irpef regionale e comunale**	790 €		1.573 €		2.378 €	
Reddito netto		20.000 €		30.000 €		40.000 €
Totale imposte e contributi previdenziali	13.229 €		28.472 €		44.456 €	
Totale imposte e contributi	15.400 €		32.292 €		49.975 €	

Source: Bordignon et al., L'espansione del forfettario e i regimi fiscali di autonomi e dipendenti, OCPI, 2022

Personal Income Tax (IRPEF)

Regime forfettario

REGIME ORDINARIO (lavoro autonomo)	Elettricista		Elettricista		Elettricista	
	Uscite	Dal fatturato al reddito netto	Uscite	Dal fatturato al reddito netto	Uscite	Dal fatturato al reddito netto
Fatturato		42.165 €		68.774 €		97.554 €
Costi (rispettivamente 14% e 33%)*	5.903 €		9.628 €		13.658 €	
Imponibile previdenziale		36.262 €		59.146 €		83.896 €
Contributi previdenziali 26,23%	9.511 €		15.514 €		22.006 €	
Reddito imponibile		26.750 €		43.632 €		61.890 €
Irpef lorda	6.388 €		12.171 €		19.513 €	
Detrazioni per lavoro autonomo		528 €		145 €		0 €
Irpef netta	5.859 €		12.026 €		19.513 €	
Addizionale Irpef regionale e comunale**	892 €		1.606 €		2.378 €	
Reddito netto		20.000 €		30.000 €		40.000 €
Totale imposte e contributi	16.262 €		29.146 €		43896,9	

Source: Bordignon et al., L'espansione del forfettario e i regimi fiscali di autonomi e dipendenti, OCPI, 2022

Personal Income Tax (IRPEF)

Regime forfettario

REGIME FORFETTARIO (lavoro autonomo)	Elettricista		Elettricista		Elettricista	
	Uscite	Dal fatturato al reddito netto	Uscite	Dal fatturato al reddito netto	Uscite	Dal fatturato al reddito netto
Fatturato		37.088 €		55.631 €		74.176 €
Applicazione costi forfettari 14%***	5.192 €		7.788 €		10.385 €	
Imponibile previdenziale		31.896 €		47.843 €		63.791 €
Contributi previdenziali 26,23%	8.366 €		12.549 €		16.732 €	
Reddito imponibile		23.529 €		35.294 €		47.059 €
Aliquota flat 15%****	3.529 €		5.294 €		7.059 €	
Reddito netto		20.000 €		30.000 €		40.000 €
Totale imposte e contributi	11.896 €		17.843 €		23.791 €	

Source: Bordignon et al., L'espansione del forfettario e i regimi fiscali di autonomi e dipendenti, OCPI, 2022

Personal Income Tax (IRPEF)

Cedolare secca

- ▶ The Cedolare secca is a substitute tax at a single rate on incomes derived from **real estate leases**.
- ▶ A **fixed rate of 10%, 21%, or 26%** replaces any other tax (income tax, registration tax, stamp duty) for leases made by private individuals – outside of commercial activity – of residential properties (cadastral categories from A1 to A9, A11).
- ▶ Since 2026, each taxpayer can only apply the 10 percent or the 21 percent rate to one rental property. If they have more than one rental properties, a flat tax rate of 26 percent applies to the second property. Subsequent properties are subject to standard progressive IRPEF

Personal Income Tax (IRPEF)

Tax on Financial Income

- ▶ Financial incomes are divided into two categories:
 1. Capital incomes (arising from capital investments, such as dividends and interest).
 2. Miscellaneous incomes (capital gains/losses arising from financial transactions).
- ▶ It is important to note that the two income categories are autonomous and distinct from each other.

They cannot be subject to tax offset.

- ▶ For example, any loss realized at the time of selling a stock **is not deductible** from the tax due on the stream of dividends received due to stock ownership.

Personal Income Tax (IRPEF)

Tax on Financial Income

- ▶ Financial incomes are, in general, taxed at a **fixed substitute rate of 26%**.
- ▶ An exception is represented by incomes generated by **government bonds or similar securities, subject to a 12.5% rate**.

Corporate Income Tax (IRES)

- ▶ In Italy, the type of direct tax that applies to business activities depends on the **nature of the taxpayers** (individuals vs. legal entities) and **their organization** (partnerships or corporations).
- ▶ Self-employed workers, sole proprietorships, and partnerships are subject to IRPEF while legal entities (corporations) are subject to IRES.
- ▶ **Flat-tax at 24%**, calculated on income, which in this case equates to **accounting profits**.

Corporate Income Tax (IRES)

Taxable Base

- ▶ Non-resident capital companies are also subject to IRES, limited to **income generated in the territory of the State**, provided that a **permanent establishment** is present in Italy.
- ▶ The concept of **permanent establishment** marks the boundary between foreign (or multinational) companies subject to IRES and companies whose income produced in Italy is not taxable in Italy.

Corporate Income Tax (IRES)

Taxable Base

- ▶ The 2018 Budget Law modified the permanent establishment regime, redefining the categories of material and personnel permanent establishments.
 - ▶ Idea: loosen the link between **physical presence in the territory of the State** and liability to tax legislation.
- ▶ In particular, the possibility of recognizing a permanent establishment in Italy has been introduced even in the case of **significant and continuous economic presence** in the territory of the State, structured so as not to result in its **physical presence** in the territory itself.

Corporate Income Tax (IRES)

Taxable Base

- ▶ The reform aimed to address the growing economic impact of e-commerce and the provision of telematic services without physical location.
- ▶ The lack of coordination of tax policies has globally led to intense **tax competition between countries** which has generated a progressive reduction in the last decades of **taxation levels on corporate profits**.
- ▶ This decrease in the level of taxation has caused revenue losses among countries far beyond those due to actual tax evasion.

Corporate Income Tax (IRES)

Taxable Base

- ▶ Supranational bodies, both at EU level and at G20 level, are moving to **reduce the harmful effects of tax competition.**
- ▶ There is currently a legislative initiative under discussion aimed at creating a **common corporate tax base in the EU.**
- ▶ G20 participants committed to introducing a *global minimum tax* on corporate profits of 15% to limit international tax competition.

Value Added Tax (IVA)

- ▶ Value-added tax applies to **sales of goods and services made in the territory of the State** in the course of business or in the exercise of trades and professions, and on imports made by anyone.
- ▶ VAT is a **harmonized tax at the European level**, regulated by the directive that established the Common Value Added Tax System.
- ▶ Goods of different nature are subject to different tax rates. The standard rate is 22%, but there are goods, services, and supplies subject to reduced rates.

Value Added Tax (IVA)

Reduced Rates

- ▶ 10% on tourism products, some food products, building renovation works, residential and manufacturing electricity and gas.
- ▶ 5% on social, health, or educational services provided by social cooperatives.
- ▶ 4% on basic foodstuffs, printing and books, works to remove architectural barriers, seeds, and fertilizers.

Value Added Tax (IVA)

Calculation of Taxable Base

- ▶ The taxable base of VAT is the value added intrinsic to the provision of goods and services.
- ▶ Legally, **VAT is a tax on the final consumer.**
- ▶ To limit tax evasion, **each step of the production chain acts as a substitute taxpayer** for the immediately lower level.

Value Added Tax (IVA)

Calculation of Taxable Base

- ▶ The consumer of the final good or service does not pay the tax to the State, but **pays the full amount to the provider** of the good or service.
- ▶ The provider of the good or service is not required to remit the full tax to the State, but only the **difference between the tax amount and the tax that the provider originally paid to its supplier** at the time of payment for the raw material or intermediate good.
- ▶ And so on, up to the first sale of the good or service **at the beginning of the production chain**.

Value Added Tax (IVA)

Calculation of Taxable Base

- ▶ Consider the following example: a computer is sold to the final customer for 1220 euros.
- ▶ The computer is taxed at 22%, so the consumer owes the State 220 euros, which is paid to the retailer along with the net price of 1000 euros.
- ▶ Let's assume the retailer purchased the computer from a wholesaler for 500 euros + VAT.
- ▶ The retailer paid 610 euros to the wholesaler. Thus, they have a **VAT credit of 110 euros** and a **VAT debit of 220 euros received from the final consumer**.
 - ▶ The retailer remits to the State only 110 euros, equal to the difference between VAT debit and VAT credit.

Value Added Tax (IVA)

Calculation of Taxable Base

- ▶ Let's assume the wholesaler purchased the goods from the manufacturer for 250 euros + VAT.
- ▶ The wholesaler paid 305 euros to the manufacturer. Thus, they have a **VAT credit of 55 euros** and a **VAT debit of 110 euros** received from the retailer.
 - ▶ The wholesaler remits to the State only 55 euros, equal to the difference between VAT debit and VAT credit.

Value Added Tax (IVA)

Calculation of Taxable Base

- ▶ Let's assume the manufacturer purchased raw materials from three suppliers (for simplicity, let's assume they are at the end of the chain) for 50 euros + VAT; 50 euros + VAT; 25 euros + VAT, respectively.
- ▶ The manufacturer paid a total of 152.50 euros to their suppliers. Thus, they have a **VAT credit of 27.5 euros** and a **VAT debit of 55 euros** received from the wholesaler.
 - ▶ The manufacturer remits to the State only 27.5 euros, equal to the difference between VAT debit and VAT credit.

Value Added Tax (IVA)

Calculation of Taxable Base

- ▶ The suppliers have a VAT credit of 0 euros since they have not paid any amount as VAT to the upper level of the chain.
- ▶ The suppliers remit to the State 11 euros, 11 euros, and 5.50 euros, respectively.
- ▶ It can be verified that the total tax revenue is 220 euros, **equal to the consumer's total tax liability**:

$$110 + 55 + 27.5 + 11 + 11 + 5.50 = 220$$

Value Added Tax (IVA)

Calculation of Taxable Base

- ▶ There are two differences between the methods of collection that impact tax revenue.
 1. The individual incentive for final retailers to evade is reduced.
 - ▶ They can pocket 110 euros instead of 220.
 2. The risk of the State losing all 220 euros in revenue is reduced by spreading the risk.
 - ▶ All tax debt is evaded only in the case of total evasion by all levels of the chain.

Value Added Tax (IVA)

Tax Evasion

- ▶ VAT is the most evaded tax in Italy.
- ▶ The average between VAT due and VAT paid is about 35.5 billion euros per year.
- ▶ In absolute terms, Italy is the EU country with the highest absolute VAT evasion, followed by Germany (25 billion euros per year).
- ▶ The size of VAT evasion is largely underestimated by Italians.
- ▶ 7 out of 10 Italians underestimate the volumes of VAT evasion and are unaware that Italy has the highest absolute evasion in the Union.