

New Italian Rules for Joint and Several Liability in Contracts and Subcontracts

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In the modern economy, the growth of projects and business, in terms of complexity as well as size, requires works or services contractors to refer much more frequently to subcontractors to perform their obligations. Works or services are often carried out by smaller operators, who are usually able to perform these tasks for a lower consideration. However, practice has shown that such entrepreneurs are often undercapitalized and not always solvent. Therefore, their workers can be exposed to the risk of non-payment following performance of the subcontract.

To address this problem, the Italian legislator introduced and is still implementing several provisions to: a) ensure greater protection for the employees of the contractors and subcontractors, who are usually the weakest parties amidst the relationship between principal, contractor and subcontractors; and b) protect the State Treasury, the Inland Revenue and the Italian Institute for National Insurance for Casualties in the Workplace (*Istituto Nazionale per l'assicurazione contro gli infortuni sul lavoro*, "INAIL") against the failure of contractors and subcontractors to comply with tax, social security and social security obligations in respect of their workers.

With a view to granting protection to the workers of contractors and subcontractors as well as to the governmental entities mentioned above, the legislator is now reinforcing the principle of joint and several liability between the principal, the contractor and the subcontractors¹.

To this end, the Italian legislator started in 2003 by introducing joint and several liability of the principal and the contractor/subcontractor for the payment of the wages and social contributions to the employees of the contractors and subcontractors.

Recently, this principle was extended to cover tax law. Legislative Decree No. 83/2012, converted into Law No. 134/2012², which amended Article 35, paragraphs 28 and 29 of the Legislative Decree No. 223/2006 (the "New Rules"), provides for joint and several tax liability between the principal and contractor vis-à-vis the subcontractor in respect of the withholding tax on income from employment and VAT payments related to the services and works carried out by the subcontractors.

The implementation of the New Rules (and other similar provisions establishing the joint and several liability between the principal, the contractor and the subcontractors) exposes the principal to substantial risks and thus may affect the economic balance set out by the parties to a work or services contract. We will examine below the New Rules and the other provisions providing for joint and several liability with the aim of underlining the main points a principal should take into account while negotiating a contract for services.

I. Contract and Subcontract: A Brief Introduction

Pursuant to Article 1665 of the Italian Civil Code, a contract is an agreement that regulates the contractor's specific obligation to perform works or provide services at its own risk and with its own organization, in return for a negotiated consideration.

Subject to the principal's authorization, part of the works or services can be performed by the subcontractor, who, like the contractor, operates at its own risk and in its own interest, for a consideration payable by the contractor.

Generally, a contract operates to confer rights and impose duties only on the parties to the relevant contractual agreement and no other parties. Consequently, any liability arising from the agreement attaches only to the parties thereto. The principal, the contractor and the subcontractor bear only the liability arising from breach of the contract, which they are parties to, independent from the agreement entered into between the principal and the contractor (and the agreement between the contractor and its employees) and that entered into between the contractor and the subcontractor (and the agreement between the subcontractor and its employees). Despite these general principles, as anticipated, the Italian legislator provides in some cases for the joint and several liability of the principal for some of the contractor's and subcontractors' obligations towards their respective workers as well as towards the State Treasury, the Inland Revenue and the INPS.

II. Joint and Several Liability of the Principal in Civil Law

Article 1676 of the Italian Civil Code represents the oldest provision on joint and several liability of the principal and the contractor. It establishes that contractors have the right to sue the principal to obtain payment of their wages.

The principal's liability is limited to the consideration still due by the principal to the contractor pursuant to the contract at the time workers file their petition against the principal. Therefore, in cases where the total consideration due to the contractor has already been paid by the principal, the workers' actions are rejected.

Moreover, the provision is applicable only vis-à-vis the workers who performed the works or services provided for under the contract the principal is a party to. The principal is not liable for other contractors' workers, nor for the portion of the salary of the workers that is unrelated to the performance of the contract entered into between the principal and the contractor.

Subcontractors may rely upon this provision vis-à-vis the contractor, but they cannot bring direct actions against the principal.

More recently, the Italian legislator set forth a new provision to establish joint and several liability of the principal even for obligations other than the payment of salary.

Under Article 29 of the Legislative Decree No. 276/2003, as amended³, *"in the case of the contracting of works or services, the client or employer is jointly and severally obliged, together with the (principal) contractor and with each and every subcontractor, to pay the wages and social security contributions of the workers within two years of the date of termination of the contract"*⁴.

Unlike Article 1667, such provision does not limit the principal's liability to a specific amount. Moreover, subcontractors can sue the principal directly and the claim is not limited to the payment of their wages, but can be even extended to the payment of their social contributions.

The principal's liability expires within two years of the date of the end of the performance of the relevant works or services.

Finally, under Article 1, paragraphs 910–911 of Law No. 296/2006, the principal or the contractor is jointly and severally liable for injuries to the employees of the contractor or any subcontractor(s) not compensated by INAIL.

The Italian courts are not often applying this provision because INAIL is still compensating a large part of the injuries.

III. Legal Background of the New Rules on the Joint and Several Tax Liability

Pursuant to Article 35, paragraphs 28 and 29 of Legislative Decree No. 223/2006, the Italian legislator firstly introduced the joint and several tax liability: the contractor and the subcontractor were jointly and severally liable for the withholding tax on employment income, social security contributions and insurance contributions payments.

In 2012, a comprehensive tax reform was implemented with the aim of strengthening the enforcement of tax rules, by modifying paragraphs 28 and 29, Article 35 of Legislative Decree No. 223/2006 and establishing a new arrangement in the area of joint and several liability in contracts.

Legislative Decree No. 16/2012 firstly repealed paragraph 29 and amended paragraph 28, introducing joint and several liability for VAT payments (in addition to the existing liability for the withholding on employment income) that involved the principal, as well as the contractor and the subcontractor.

The last regulatory step was made through Legislative Decree No. 83/2012 (converted into Law No. 134/2012) whereby Article 13-*ter* once again modified paragraph 28 and set forth new paragraphs 28-*bis* and 28-*ter*, substantially changing the previous regulations.

Pursuant to the new paragraph 28, the contractor and the subcontractor are now jointly and severally liable for withholding tax on employment income and VAT payments related to the services or works carried out by the subcontractors.

Such liability is limited to the amount of the agreed consideration. There is no joint and several liability if the contractor procures the prompt and correct pursuit of the above-mentioned payments and verifies various certifying documents (the “**Documentation**”) produced by the subcontractor.

With respect to the obligations of the principal, paragraph 28-*bis* requires that the payment of amounts due to the contractor has to take place prior to the production of the Documentation. In the event of non-compliance, an administrative penalty is provided for, ranging from 5,000.00 to 200,000.00 euro.

Furthermore, pursuant to paragraph 28 and 28-*bis*, both the contractor and the principal have the right to suspend the payment of amounts due until the Documentation is provided.

Ultimately, pursuant to paragraph 28-*ter*, the new provisions apply to works and services contracts and subcontracts⁵. As for the definition of the type of services requiring the Documentation, the Inland Revenue clarified that Article 35 Legislative Decree No. 223/2006 only applies to contracts as defined by Article 1655 of the Italian Civil Code. Consequently, the New Rules do not apply to contracts for the supply of goods, to agreements to perform works or services (whereby the contractor acts primarily on his own initiative and without a relationship of subordination with respect to the principal), to transportation agreements and subcontracting agreements provided by Law No. 192/1998, and to services rendered in a consortium relationship.

A. Interpretation – Main Points

Several uncertainties have been caused by the implementation of the New Rules, in particular with reference to the effective date of the New Rules and the form of documentation certifying the legality of the tax payments. The Inland Revenue, by way of two different Circulars (Circular N. 40/E dated October 8, 2012, and Circular N. 2/E dated March 1, 2013), provided guidance concerning such aspects.

B. Effective Date

Circular N. 40/E dated October 8, 2012, provides that Article 13-ter of Legislative Decree No. 83/2012 applies to all contracts and subcontracts entered into from August 12, 2012.

Furthermore, the Inland Revenue stated that, in the event of a contract renewal, the renewed contract is considered as a new contract. Therefore, the new provisions also apply to contracts renewed after August 12, 2012.

It is instructive to note that since the provision establishes a tax obligation (which, according to the Taxpayer's Charter⁶, is due from the sixtieth day after the provision is enforced), the documentation can be requested only with regard to payments made from October 11, 2012.

C. Documentation Certifying the VAT Payment and the Withholding Tax on Employment Income Compliance

With respect to the documentation certifying the VAT payment and the withholding tax on employment income compliance, paragraph 28 of Article 35 specifically provides that the Documentation can also consist of a declaration on oath, released by the person in charge of Tax Assistance ("*Responsabile CAF*") or enrolled in the accountants, commercial experts and labor consultants registers ("*Soggetto Abilitato*").

Furthermore, pursuant to the interpretation provided by Circular N. 40/E dated October 8, 2012, the use of alternative documents is considered valid. Hence, in order to avoid joint and several liability, it will be sufficient to provide a certified declaration⁷ (affidavit), whereby the contractor/subcontractor attests to the correct fulfillment of the required obligations.

In particular, the certified declaration should:

- State the VAT payment to which the invoice for works performed relates, specifying if such clearance resulted in a VAT payment or whether the VAT cash accounting⁸ or the reverse charge system applies.
- State the employment income withholding payment and indicate if such payment has been made through partial or total deduction.
- Specify the F24 Form details used for the VAT and withholding payments.
- State that the VAT and withholding payments include the ones referring to the contract/subcontract for which the certified declaration is made.

Pursuant to the above-mentioned Circular, the certified declaration can also be used in relation to the contractor-principal relationship.

In addition, in accordance with Circular No. 2/E dated March 1, 2013, in the event of several contracts/subcontracts pledged by the same parties, the documentation can be jointly displayed.

Please note that article 76 of Presidential Decree No. 445/2000 provides for specific penalties in the event of false certified declarations and equates such false statements to a misrepresentation.

IV. Key Points to Take into Account in Negotiating Contracts

In order to exclude any joint and several liability, the principal should negotiate works or services contracts taking into account the New Rules, as well as the other provisions mentioned above.

With reference to civil law and the provisions examined above:

With reference to the provisions concerning the liability of the principal for injuries to the employee, the principal should negotiate with the contractor a duty to enter into an insurance policy in respect of such injuries to contractors as well as for the workers of the subcontractors for the duration of the contract. In this respect, the principal may want to be shown the insurance policy, as well as the documentation proving the payment of any premium.

With reference to the rules concerning the payment of wages and social contributions, the exclusion of joint and several liability is based on the verification of the appropriate documentation confirming that the contractor and the subcontractor have correctly fulfilled their obligations in connection with their respective workers. Therefore, the contract should provide for a clause whereby payments are subject to the submission of the document proving the correct payment of wages and social security and insurance contributions.

Moreover, the contract should address a way to introduce a certain level of comfort at the subcontractor level, which is more complicated as the principal does not have a direct contractual relationship with the subcontractors and there is no duty, under the law, for the subcontractors to submit any document to the principal.

With reference to the tax issues, the New Rules already specify, together with the joint and several liability of the principal, the possibility for the principal to suspend the payment if the contractor does not provide the Documentation.

However, in order to avoid disputes⁹, even if the New Rules already envisage the possibility for the principal to avoid joint and several liability, the contract should envisage a clause whereby the contractor's duty to provide the Documentation is established, both for the contractors and the subcontractors, as well as the right of the principal to suspend any payment without such submission.

Conclusions

The aim of the Italian legislator in protecting contractors and subcontractors is to increase the risk attaching to the principal in entering into a works or services contract.

The principal should take note of the new risks arising from the new provisions when negotiating a contract. The principal should take particular care about the fulfillment of certain required obligations by the contractor and the subcontractors, as discussed above, to prevent, to the maximum extent possible, future contractual liability.

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- ¹ Under Article 2055 of the Italian Civil Code, joint and several liability refers to the claimant's ability to recover in full from any one defendant to the action.
- ² Entered into force on 12 August 2012.
- ³ By Article 4, paragraphs a) and b) of Law 92/2012.
- ⁴ Other workers' remunerative rights, such as the right to enjoy paid holidays, are already included in the system of joint and several liability established in this subsection of the decree. This is because they are related to the economic treatment of workers involved in an ongoing employment relationship.
- ⁵ Please note that, *inter alia*, New Rules are not applicable to contracting public administrations and other contracting entities regulated by Article 3, paragraph 8, Legislative Decree No. 97/2008.
- ⁶ As provided for by Article 3, paragraph 2, Law 212/2000.
- ⁷ As provided for by Article 46 Presidential Decree 445/2000.
- ⁸ As provided for by Article 7 Legislative Decree 185/2008.
- ⁹ In this respect, it is useful to note that, despite interventions from the Inland Revenue, the entry into force of the new joint liability arrangement caused uncertainties and doubts over its validity. In March 2013, the Italian Employer's Foundation (*Confindustria*) filed a complaint to the European Commission confirming the incompatibility of the New Rules with European Law. More specifically, *Confindustria* reported the existence of a ban imposed on Tax Authorities to transfer to taxpayers their control obligations; that joint liability is applicable only prior to the proof of the jointly responsible party being involved in a fraud offence; that there should be proportionality between the offences and the related sanctions; the applicability of the EU non-discrimination principle.