Corporate Tax or Not? The IRAP Puzzle and the Parent–Subsidiary Directive

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In March 2025, Advocate General Kokott of the Court of Justice of the European Union (ECJ) gave her opinion in the case of *Banca Mediolanum SpA and Others v. Agenzia delle Entrate – Direzione Regionale della Lombardia* (Joined Cases C-92/24, C-93/24 and C-94/24). This case examines the compatibility of the Italian regional tax on productive activities (*imposta regionale sulle attività produttive*, IRAP) with the Parent-Subsidiary Directive (2011/96). In anticipation of the ECJ's ruling sometime in 2025, this note walks the reader through the facts of the case, the issue at hand, the AG opinion and reflects upon the potential consequences that a decision in favour of the taxpayer (once available) would produce.

1. From a Domestic Conflict to the ECJ

Facts at hand

In 2014, Banca Mediolanum SpA (BM, tax resident in Italy) held shares in companies being tax residents in Ireland, Luxembourg and Spain. For completeness, the subsidiaries were also subject to tax therein. The subsidiaries paid dividends to BM in the same year and did not withhold any tax at source, according to article 2 of the Parent-Subsidiary Directive (2011/96) (PSD). The dividends were treated for accounting purposes as income from core financial activities at the level of BM.

Key domestic legislation

Generally, Italy has two layers of taxation: the ordinary corporate income tax (IRES) and the regional tax on productive activities (IRAP), with the latter applying on top of the IRES and having different rates depending on the nature of the company.

Only 5% of the total dividend income is to be included in the corporate income tax base for IRES purposes. This essentially means that 95% of the dividends are exempt. This first tax layer appears to be in line with article 4 of the PSD, which precludes dividends distributed by subsidiaries to parent companies from being taxed at more than 5% of their amount.

50% of the total dividend income is included in the taxable base for IRAP purposes. Additionally, due to the nature of its activities, BM qualifies as a financial intermediary and is therefore subject to specific IRAP rules. The specificity lies in the strictness of IRAP rules for bank and financial institutions that provide for a higher rate compared to the one applicable to any other non-banking entity.

Factually, BM obliged by the IRAP rules, paid IRAP and had accumulated IRAP tax surplus for prior years. In 2019, BM requested the tax authorities for a refund of the IRAP paid in excess, arguing that IRAP is in its core a violation of article 4 of the PSD due to it being equivalent to corporate income tax. In 2020, the tax authorities rejected BM's IRAP refund request claiming that IRAP falls outside the scope of article 4 of the PSD as the latter precludes income taxation of more than 5% and IRAP is not a corporate income tax. BM challenged the rejection of the refund at the Court of First Instance in Milan, which sided with the position of the tax authorities. BM yet again appealed against the position and the case reached the ECJ.

Legal Issue at hand – question referred to the ECJ

The main issue in this case is to understand whether Italy's IRAP on 50% of dividends received by Italian parent entities from their EU-based subsidiaries is compatible with article 4 of the PSD. The latter – broadly – aims to eliminate economic double taxation and practically requires Member States to refrain from taxing dividend income received by a parent company from its EU subsidiary, or to only tax up to 5%.

Naturally the question that arises is whether article 4 applies to all taxes (inclusive of the IRAP, and not solely corporate tax *strictu senso*) which may result in effective taxation of more than 5% threshold.

If the ECJ confirms that the type of tax is unimportant and what matters in this case is that the 5% total tax threshold is exceeded especially considering that banks and other financial intermediaries are not permitted to deduct from IRAP the fraction of (foreign) corporation tax paid by the subsidiaries in their Member State of residence, then IRAP will constitute a breach of EU law.

2. The Advocate General's Opinion

The AG structured her opinion as follows:

- At its outset, the PSD was conceived in order to eliminate double taxation of dividends (or similar distributions) at the level of the paying and the recipient company (i.e., two distinct entities), thereby suggesting that the two taxes levied at the level of the subsidiary and the level of the parent company are identical.

- The PSD contains a list of taxes (Annex I, part B) but makes no reference to a tax on productive activities, such as the IRAP, although it refers to *any other tax that may be substituted for any of those taxes*. So, when can one say that another tax supplements or substitutes the corporation tax by virtue of their comparability?

- The name of the tax and the moment of collection are unimportant in this case; the decisive factors are the object of taxation and the legal character. In other words, the comparability of IRAP with IRES is the pinnacle here.

- Historically, IRAP has been classified as a "hybrid tax" whose object of taxation is difficult to determine. The Italian Constitutional Court has stated that IRAP taxes a taxpayer's different ability to pay (as compared to what was taxed by previous taxes, which naturally include income and corporation tax).

- Based on its features, IRAP seems to combine a type of wealth tax, a specific-to-an-asset tax and an activity-dependent tax. If attention is drawn to those features, then IRAP is "probably" not an IRES substitute and therefore does not breach EU law. If, however (and inspired by the case of the *Belgian Fairness Tax*), IRAP is viewed as an additional corporation tax linked to income and thus taxes dividends comparably to IRES, then it is covered by the prohibition of article 4 of the PSD.

Unsurprisingly, the AG opined that the prohibition enshrined by article 4 of the PSD applies, provided that the additional tax is either a corporation tax or anything comparable to tax – in other words if IRAP is comparable to IRES. The tax comparability test should investigate the nature of IRAP and its object of taxation and should be answered by reference to the domestic law at hand. Who else – other than Italian legislators themselves – would be more appropriate to perform this comparability test? Nobody – this is precisely why the AG suggests referring the question to the national court.

3. Conclusion

While the ECJ has yet to have the (almost) final word on this case and it is not forced to abide by the AG's opinion, it is worth reflecting on the potential consequences a positive (for the taxpayer) decision would produce.

At national level: Italy would be requested to amend its IRAP legislation to bring it in line with article 4 of the PSD, entities similar to BM would be entitled to refunds of IRAP paid (exceeding the 5% threshold) and this "refund wave" could in turn create heavier administrative burden for domestic authorities.

At EU level: Member States would be advised to review their national legislation to mitigate situations where economically (and irrespective of the name of the tax and only for taxes which produce a similar effect to CIT) dividends are taxed more than what the PSD allows. In addition to that, the PSD's "big book of interpretational issues" would grow even larger as a positive decision would mean that the PSD applies not only to corporate income tax but actually to any tax that produces similar economic effect to CIT.

IBFD references:

- EU tax law developments are reported on the daily IBFD Tax News Service page.
- For IBFD summaries of ECJ judgments, *see* the ECJ Case Law IBFD collection.
- Italian tax legislation is described in IBFD Country Tax Guides.