Euro Tax Flash from KPMG's EU Tax Centre

CJEU rules that the Italian regional tax on productive activities is incompatible with the PSD

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On August 1, 2025, the Court of Justice of the European Union (CJEU or the Court) rendered its decision in the joined cases C-92/24 to C-94/24.

The cases concern the compatibility of the Italian regional tax on productive activities (IRAP) with the prohibition on taxing distributed profits in the hands of the recipient (i.e., the parent company) under Article 4 of the Parent-Subsidiary Directive (PSD or Directive).

The Court held that Article 4 of the PSD prohibits a Member State applying the exemption system from taxing more than 5 percent of dividends received from subsidiaries in other Member States, even where such taxation is imposed through a tax that is not corporate income tax but nevertheless includes those dividends (or a fraction thereof) in its assessment base.

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CJEU – Italy – Parent-Subsidiary Directive – Prohibition on taxing profits received by the parent company – Prevention of double taxation of dividends – Regional tax on production activities (IRAP)

Background

Under Italian law, companies are subject to a regional tax on productive activities (*imposta regionale sulle attività produttive* - IRAP), levied at a rate that can vary by region. The taxable base also depends on the taxpayer's business activity. Higher rates apply to banks and other financial intermediaries. For banks and financial intermediaries, the IRAP taxable base includes: i) intermediation margin reduced by 50 percent of the dividends; ii) 90 percent of depreciation costs related to fixed tangible and intangible assets; iii) 90 percent of other administrative expenses; iv) net value adjustments and write-backs for credit risk, under certain conditions.

The plaintiff in the joined cases at hand was an Italian bank, that received dividend income from subsidiaries based in Ireland, Luxembourg, and Spain. Since the conditions of Article 5 of the PSD were met, the subsidiaries did not withhold tax at source. In line with the Italian implementation of the PSD, the plaintiff exempted 95 percent of the dividend income for corporate income tax purposes, including only 5 percent in its taxable base[1]. However, due to its classification as a financial intermediary, the bank included 50 percent of the dividends in its IRAP taxable base, which was taxed at a rate of 5.57 percent. The plaintiff subsequently requested a refund of the IRAP paid, arguing that requiring 50 percent of dividends – otherwise meeting the criteria set out under the PSD, to be included in the IRAP taxable base was contrary to Article 4 of the PSD. The Italian tax authorities rejected the refund on the grounds that the Directive only covered corporate income taxes and was not applicable with respect to the IRAP. Following several legal proceedings initiated by the plaintiff, the case was referred to the CJEU.

The referring court questioned whether Article 4 of the PSD precludes national legislation that, under the exemption system, allows a Member State to tax more than 5 percent of dividends received by financial intermediaries (as parent companies) from subsidiaries in other Member States, particularly when such taxation occurs through a tax that is not corporate income tax (like IRAP) but nevertheless includes those dividends in its assessment base.

On March 27, 2025, Advocate General (AG) Juliane Kokott of the CJEU rendered her opinion in the joined cases at hand. The AG focused on the purpose of the PSD, which is to eliminate double taxation of the same income at the level of two different entities – specifically, parent companies and their subsidiaries. The AG took the view that the PSD is designed to prevent double taxation only where both taxes are of the same nature, meaning corporate income taxes or taxes that substitute for or supplement such taxes as defined in Article 2(a)(iii) of the Directive.

The AG also noted the pleas brought by the plaintiff and the European Commission (EC), which were primarily based on the cases C-365/16 (concerning the Belgian fairness tax) and C-68/15 (concerning the French surtax were dealing with taxes similar to a corporate tax). These cases also addressed the imposition of taxes in parallel, or in addition, to corporation taxes. According to the plaintiff and the EC, these cases established that Article 4 of the PSD prohibits EU Member States from subjecting more than 5 percent of dividends distributed by subsidiaries to parent companies to any form of taxation, and therefore the scope of the PSD is not only focused on corporation taxes (or other comparable taxes). However, the AG rejected this interpretation, arguing that the two decisions concerned taxes different from IRAP. Instead, they dealt with situations where local corporate income tax was supplemented by an additional levy on redistributed dividends.

Based on the above, the AG concluded by recommending that the CJEU finds that Article 4 of the PSD precludes the taxation of received dividends by the Member State of the parent company through an additional tax, such as IRAP, insofar as that tax is considered either a corporation tax or a tax comparable to a corporation tax. It is for the referring court to determine whether IRAP is comparable to a corporation tax. For more details on the AG opinion, please refer to E-News Issue 209.

CJEU Decision

The CJEU recalled that Article 4(1) of the PSD gives Member States two options for the tax treatment of profits distributed by a subsidiary to its parent company (except in the case of liquidation):

[1] Article 4(1) of the PSD establishes a prohibition of taxing dividends received by a qualifying shareholder. Member States have the option to disallow the deductibility of charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary. Where the management costs relating to the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5 percent of the profits distributed by the subsidiary. Italy exercised this option, and therefore 95 percent of qualifying dividends distributed to Italian companies are exempt.

- to refrain from taxing such profits (the exemption system), or
- to tax them whilst allowing the parent company to deduct the underlying corporation tax already paid by the subsidiary (the imputation system).

Once a Member State has chosen one system, only that system is relevant for assessing compliance with the PSD.

In the Italian context, the Court noted that Italy applies the exemption system and has also implemented the option under which 5 percent of dividends received from subsidiaries is included in the corporate income tax (*imposta sul reddito delle società* - IRES) base, in line with the Directive. However, the Italian law also requires that 50 percent of such dividends be included in the tax base for the IRAP, regardless of whether the distributing subsidiary is established in Italy or in another Member State. As a result, in addition to the 5 percent inclusion permitted by the PSD for corporate income tax purposes, a substantially larger portion of dividends is subject to IRAP, leading to double taxation of cross-border profits distributed within the EU.

The CJEU recalled its settled case-law under which, when interpreting EU law, one must consider not only the wording of the provision, but also its context and objectives. Moreover, where the meaning of a provision of EU law is absolutely plain from its very wording, the Court cannot depart from that interpretation. In the CJEU's view, from a literal perspective, the exemption system applies to any tax that includes in its assessment base the dividends a parent company receives from subsidiaries resident in other Member States.

From a contextual perspective, the Court further clarified that the scope of the PSD with respect to the taxes covered is not limited by the list set out in Annex I, Part B[2]. In the Court's view, the fact that the IRAP is not listed does not exclude it from the material scope of the Directive, as the Directive's purpose is to eliminate double taxation of distributed profits at the level of the parent company, regardless of the formal classification of the tax.

Lastly, the CJEU noted that from a teleological perspective, the PSD aims to ensure tax neutrality and prevent double taxation of profits distributed by subsidiaries to parent companies across Member States. Therefore, in the Court's view, the exemption system must apply to any tax that, in the parent company's Member State, includes even a part of those profits in its assessment base.

Applying these principles to the Italian rules, the Court found that requiring 50 percent of dividends to be included in IRAP's base for financial intermediaries, in addition to the 5 percent inclusion for corporate tax, is incompatible with Article 4 of the PSD. According to the Court, the exemption system precludes any national measure that results in more than 5 percent of such cross-border dividends being taxed at the parent company level, regardless of the type of tax involved.

Finally, the Court addressed the Italian government's plea that this outcome could create reverse discrimination against Italian parent companies receiving dividends from Italian subsidiaries. The Court noted that such purely domestic situations fall outside the scope of EU law, and it is for the national court to address any potential discrimination under national law.

ETC Comment:

The CJEU's decision clarifies that the protection against double taxation under the PSD is broad and applies to all forms of taxation affecting distributed profits, not only corporate income tax.

The ruling also provides banks and other financial intermediaries with strong grounds to seek reimbursement of the IRAP paid on dividends received from qualifying subsidiaries, as well as to support any ongoing or future litigation concerning previously submitted claims.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre or, as appropriate, your local KPMG tax advisor.

[2] Annex I, Part B, lists the taxes referred to in Article 2(a)(iii) of the Directive, and includes corporate income taxes and their substitutes.

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