Valerio Forestieri and Raffaele Villa***

New Trend of Italian Tax Courts to Overrule IRAP Taxation of Dividends Received by Banks, Insurance Companies and Financial Holding Companies

In this note, the authors discuss two Italian cases wherein the lower courts, in response to a Constitutional Court decision finding that the EU Parent-Subsidiary Directive (2011/96) tax exemption for intra-group dividends extends to Italian regional tax on productive activities (IRAP), reversed IRAP taxation of dividends received by banks, insurance companies and financial holding companies.

1. Introduction

On 23 March 2022, for the first time in Italy, the Provincial Tax Court of Reggio Emilia (PTC),[1] in decision No. 53/1/2022,[2] ruled that IRAP (*Imposta Regionale sulle Attività Produttive*)[3] taxation of intra-group dividends[4] imposed under article 6(1)(a) of the IRAP Decree[5] was incorrect and had to be refunded. The PTC decision was issued on the basis of principles enunciated in the Constitutional Court decision in Case No. 12/2022 (20 January 2022),[6] and was recently confirmed in a Lazio Regional Tax Court (RTC) decision, No. 2303/13/2022, of 20 April 2022.[7] These decisions seem to have ushered in a new line of case law to the effect that the prohibition against double taxation of dividends[8] under the EU Parent-Subsidiary Directive (2011/96) should apply not only for IRES (Italian corporate income tax (*Imposta sul Reddito delle Società*)) purposes, but also for IRAP purposes. In contrast, in the past, several tax courts had dismissed appeals of administrative decisions denying an IRAP refund for tax paid by banks and financial holdings on dividends, arguing that the obligation for Italian law to comply with the EU Parent-Subsidiary Directive only extended to IRES.[9] In particular, these courts based their restrictive interpretation on the fact that the EU Parent-Subsidiary Directive (*see* Annex 1, Part B), which outlines the scope of the Directive, states that its provisions apply only to companies that are subject to IRES, without referring to IRAP. This approach, however, seems outdated now in light of the aforementioned recent case law developments, the scope of which is commented on in section 6., after outlining the courts findings in the decisions at issue.

2. The PTC Decision

PTC decision No. 53/1/2022 originated from the taxpayer's challenge of a decision by the Italian tax authorities (ITA) to deny a refund of the IRAP paid by a banking holding company on "domestic" dividends[10] in compliance with article 6(1)(a) of the IRAP Decree, which the taxpayer deemed to be unlawful. This regulation provides for IRAP taxation of 50% on dividends received by banks and financial holding companies.[11] According to the taxpayer, however, this conflicts both with the EU Parent-Subsidiary Directive (2011/96) and the principles of equality and ability to pay set forth in articles 3 and 53 of the Italian Constitution.

The PTC endorsed (only) one of the arguments of the taxpayer regarding the constitutional issue and therefore

* **Associate, Di Tanno Associati, Rome. The author can be contacted at v.forestieri@ditanno.it.**

** **LL.M. (Leiden), Partner, Di Tanno Associati, Milan. The author can be contacted at r.villa@ditanno.it.**

1. As of 16 Sept. 2022, Italian tax courts have changed their denomination due to the entry into force of IT: Law No. 130/2022. The provincial tax courts have been renamed as "Tax Courts of First Instance" and the regional tax courts as "Tax Courts of Second Instance". Since the decisions under discussion predate the entry into force of Law No. 130/2022, the former denomination will be used in this note.
2. IT: Reggio Emilia Provincial Tax Court, 23 Mar. 2022, Decision No. 53/1/2022.
3. IRAP (Italian regional tax on productive activities) was introduced and is regulated by IT: Legislative Decree No. 446/1997 [hereinafter IRAP Decree]. In particular, an IRAP taxable event is the regular conduct of an autonomously organized activity, aimed at either the manufacturing/trading of goods or the supply of services. IRAP is levied on the net value of production derived in each Italian region and its tax base is computed in different ways depending on the type of taxpayer and on the type of activity carried out. In particular, specific rules are provided in relation to banks and financial institutions, insurance companies and partnerships.
4. As clarified in sec. 2, the case specifically dealt with domestic dividends.
5. *See supra* n. 3.
6. IT: Constitutional Court, 20 Jan. 2022, Case No. 12/2022.
7. IT: Lazio Regional Tax Court, 20 Apr. 2022, Decision No. 2303/13/2022.
8. As is well known, art. 4(3) of the EU Parent-Subsidiary Directive (Council Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345/8 (2011), Primary Sources IBFD) sets forth, alternatively, that (i) no taxation is allowed on dividends distributed by the subsidiary in the state of the recipient where the country opted-in for the analytical non-deductibility of shareholding management costs or (ii) taxation is allowed up to a limit of 5% where the EU Member State of the recipient opted-in for flat-rate deductibility of shareholding management costs.
9. In this sense, *see*, for example, IT: Rome PTC, 29 Nov. 2019, Decision No. 16331; IT: Milan PTC, 10 Sept. 2019, Decision Nos. 3583 and 3584; and IT: Florence PTC, 12 Mar. 2019, Decision No. 265.
10. Specifically, the case law concerned relates to dividends distributed by an Italian tax resident bank to its Italian tax resident holding company.
11. The same provision is laid down in art. 7(1)(b) IRAP Decree in relation to dividends included in the life segment (*Ramo Vita*) of the financial statements of insurance companies.

© IBFD

Exported / Printed on 6 Nov. 2022 by m.giardina@ditanno.it.

asked the Constitutional Court whether the IRAP regulation was in breach of the Constitution as a result of the IRAP's indiscriminate taxation of trading and non-trading dividends. Despite the fact that the Constitutional Court rejected the constitutional issue submitted by the PTC specifically, its decision is still important due to the position it assumed with regards to the relevance of the EU Parent-Subsidiary Directive for IRAP purposes.

In detail, the PTC assumed that the rationale for including 50% of bank and financial holding company dividends in the IRAP base was to approximate the amount that would have been included as "dividends from trading".[12] As is well known, IRAP aims to tax the net value of production derived from the ordinary course of a business activity carried out by taxpayers, which typically includes trading activities in respect of financial intermediaries. In accordance with this interpretation, in addition to approximating the amount of dividends to be taxed, the legislator wanted to (indirectly) exclude from taxation the residual 50% of the amount of the dividends (which should include, inter alia, intra-group dividends). According to the Emilian judges, however, since dividends from trading are reported separately in the bank's financial statements, the use of a flat-rate mechanism, which is very imprecise in nature, may be unreasonable and disproportionate relative to the aim of the provision. In other words, according to the Emilian PTC, the legislator should have established that the IRAP tax base was to be determined by directly (and exclusively) considering dividends derived from trading activities. As a result, IRAP taxation of the dividends of banks and financial holding companies, without a clear distinction between trading or other dividends,[13] conflicts with the constitutional principles of reasonableness and proportionality.

At the same time, the PTC, in referring the matter to the Constitutional Court, disregarded two other arguments raised by the taxpayer against the ITA's denial of a refund. In particular, the taxpayer had argued that article 6(1)(a) of the IRAP Decree conflicted:

– principally, with the prohibition against double taxation laid down in article 4(1) and (3) of the EU Parent-Subsidiary Directive (2011/96), as interpreted by the ECJ in *AFEP and others* (Case C-365/16)[14] and *X* (Case C-68/15),[15] which should be assumed to be directly applicable[16] to the Italian tax system (notwithstanding the fact that part of the Directive has not been transposed into Italian legislation), as well as potentially relevant also in relation to domestic dividends[17] (i.e. not only EU dividends); and
– secondly, if the relevant ECJ case law is assumed not to be applicable to domestic dividends, with article 49 (EU freedom of establishment) and 63 (EU free movement of capital) of the Treaty on the Functioning of the European Union (2017),[18] as well as articles 3 (principle of equality) and 53 (principle of ability to pay) of the Italian Constitution. Indeed, the non-application of flat-rate taxation (i.e., 50% of the total amount of the dividends) only in respect of EU dividends under the EU Parent-Subsidiary Directive (2011/96) would result in higher taxation of domestic dividends and, therefore, in "reverse" discrimination.[19]

12. I.e. dividends that are the result of the typical trading activities of financial intermediaries.
13. I.e. dividends other than those deriving from stakes held in relation to trading activities.
14. FR: ECJ, 17 May 2017, Case C-365/16, *Association française des entreprises privées (AFEP) and Others v. Ministre des finances et des comptes publics*, ECLI:EU:C:2017:378, Case Law IBFD.
15. BE: ECJ, 17 May 2017, Case C-68/15, *X v. Ministerraad (Fairness tax)*, ECLI:EU:C:2017:379, Case Law IBFD. In *AFEP* (C-365/16), the ECJ addressed the compatibility, with the EU Parent-Subsidiary Directive (2011/96), of a surcharge of corporate tax (at a rate of 3%) provided for by the French tax system for resident parent companies even when profits are distributed by subsidiaries located in other EU Member States. In *X* (C-68/15), the Court dealt with the conflict between the EU Parent-Subsidiary Directive and the Belgian fairness tax, which is a tax other than corporate income tax (CIT) applicable to resident and non-resident companies receiving dividends excluded from the CIT tax base on the basis of certain benefits provided under Belgian law.
16. In this respect, it should be noted that EU directives that establish an unconditional and sufficiently clear regime are directly applicable in the domestic law of the EU Member States when the deadline for their implementation by the national legislator has expired. For the qualification of art. 4(1) of the EU Parent-Subsidiary Directive (2011/96) as a directly applicable regulation, *see* BE: ECJ, 12 Feb. 2009, Case C-138/07, Belgische Staat v. Cobelfret NV, para. 65, Case Law IBFD and M. Helminen, *EU Tax Law - Direct Taxation*, sec. 1.2.5. (IBFD 2021).
17. Indeed, the ECJ has pointed out (*see*, inter alia, IT: ECJ, 21 Dec. 2011, Case C-482/10, *Teresa Cicala v. Regione Siciliana* and RO: ECJ, 7 July 2011, Case C-310/10, *Ministerul Justiției și Libertăților Cetățenești v. Ștefan Agafiței and Others*) that where national law in purely domestic situations conforms to the solutions adopted under EU law, the provisions and notions taken from EU law must be interpreted in line with the meaning they assume in the EU context in order to avoid future discrepancies in their application. In this respect, the 95% CIT exemption regime for domestic dividends established by art. 89 TUIR (IT: Income Tax Consolidation Act, Presidential Decree no. 917/1986 (*Testo Unico delle Imposte sui Redditi*, TUIR), Primary Sources IBFD) mirrors the option Italy elected for under the EU Parent-Subsidiary Directive (2011/96) with regard to EU dividends. As result, the interpretative guidelines endorsed by the ECJ regarding EU dividends should also be observed with regard to domestic dividends.
18. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), Primary Sources IBFD [hereinafter TFEU].
19. Indeed, according to the taxpayer's arguments raised before the PTC, if art. 6 (1)(a) IRAP Decree were to be disapplied only in relation to EU dividends, there would be a:

    > violation of the principles of equality and ability to pay, as established in Articles 3 and 53 of the Constitution, insofar as, in the face of the same index of fiscal capacity, represented by the receipt of dividends by controlling shareholdings, two subjects are treated differently depending on the origin (domestic or foreign) of the dividends themselves, that is, on the basis of a criterion (the origin of the dividends) which is absolutely unsuitable for expressing a greater or lesser fiscal capacity of the recipient and, therefore, clearly unreasonable.

    It should be noted that the same argument, based on the constitutional principles of equality and ability to pay, should lead to the conclusion that it is also illegitimate to include non-EU dividends in the IRAP tax base (i.e. dividends distributed to the Italian parent companies by foreign subsidiaries resident in non-EU Member States). In any event, the IRAP exemption for domestic dividends should also lead to an exemption of non-EU dividends in light of art. 63 TFEU, according to which all restrictions on movements of capital between Member States, as well as between Member States and third countries, are prohibited. In fact, the free movement of capital is the sole EU fundamental freedom that applies not only between EU Member States but also with respect to non-EU Member States. Therefore, in the event that art. 6(1)(a) Decree No. 446/1997 is illegitimate with regard to domestic dividends, the taxation of non-EU dividends would also be discriminatory and equally illegitimate under art. 63.

Exported / Printed on 6 Nov. 2022 by m.giardina@ditanno.it.

3. The Constitutional Court Decision

In its Decision No. 12/2022, the Constitutional Court denied that article 6(1)(a) was unlawful due to the indiscriminate taxation of trading and non-trading dividends. Indeed, according to the Court, neither a systematic interpretation nor an historical one indicates a will of the legislator to exclusively tax dividends linked to trading activities. Thus, the Emilian PTC made a mistake when it adopted this argument as the sole reason for its referral of the case to the Constitutional Court.[20]

At the same time, the Constitutional Court endorsed the position that the EU Parent-Subsidiary Directive (2011/96)'s exclusion of the taxation of intra-group dividends applies to IRAP. Indeed, the Court emphasized that the Emilian PTC allegedly excluded the application of the EU Parent-Subsidiary Directive limits regarding dividend taxation for IRAP purposes "without even slightly dealing with the CJUE case law (in particular, case C-365/16, AFEP and others, and case C-68/15, X), evoked by the taxpayer's defence in the case at hand in order to infer the so-called 'reverse' discrimination".[21]

In fact, in the case law mentioned by the Constitutional Court, the ECJ clarified that the limits on the taxation of EU dividends established by the EU Parent-Subsidiary Directive are not only valid for taxes expressly characterized as corporate income tax by national law (i.e., IRES in Italy), but extend to all tax measures that potentially result in double taxation of dividends received by parent companies (including, therefore, IRAP).[22]

4. The Final Decision of the PTC on the Merits of the Case

Once the case reverted back to the PTC,[23] it had to make a decision based on the merits of the case in light of the Constitutional Court's findings. The PTC preliminarily noted that it could not avoid taking into account the Constitutional Court observations that it had failed to examine ECJ case law on "reverse discrimination" and that a constitutionally-oriented reading of the EU Parent-Subsidiary Directive, inspired by the ECJ decisions, must be implemented by the national courts of EU Member States. Therefore, it concluded that article 6(1)(a) of the IRAP Decree conflicted with the EU Parent-Subsidiary Directive (2011/96) and no further taxation over dividends at the level of the parent company could be levied, even in respect of purely domestic dividends, on the grounds of the prohibition against "reverse" discrimination.

In particular, the PTC pointed out that (i) the EU Parent-Subsidiary Directive (2011/96) prohibits double taxation of EU dividends under domestic law, (ii) the prohibition against double taxation concerns not only IRES but also IRAP; and (iii) the tax regime applicable to purely domestic situations under Italian law cannot be worse than that applicable to similar EU situations under the EU Parent-Subsidiary Directive due to the prohibition against "reverse discrimination".

In light of the above, the PTC ordered the ITA to refund the IRAP paid by the taxpayer on 50% of the dividends it received.

5. The *Lazio* RTC Decision (Decision No. 2303/13/2022)

More recently, the incompatibility between IRAP taxation of dividends and the EU Parent-Subsidiary Directive was affirmed by a RTC in *Lazio* (Decision No. 2303/13/2022), in a case that involved EU dividends.[24]

In particular, the RTC first observed that the EU Parent-Subsidiary Directive's rules are directly applicable in EU Member States even if they were not specifically transposed into national regulation. In fact, as they are unconditional and sufficiently clear, the Directive's rules regarding dividend taxation may be invoked by an EU taxpayer without the need for an implementing provision. Second, the RTC acknowledged that the scope of the Directive extends to taxes other than corporate income taxes.[25] In particular, the RTC observed that the Constitutional Court, although in an *obiter dictum* (i.e. incidentally, as the topic was not an aspect of the Court's opinion on the question submitted), "unequivocally" found that the prohibition against double taxation of EU dividends established by the EU Parent-Subsidiary Directive was also applicable with regard to the IRAP tax base. Hence, the Court implied that, although the Directive's annex refers solely to IRES in defining its subjective scope (i.e. the entities to which it is applicable), this did not restrict its objective scope (i.e. exclude applicability to taxes other

20. In the opinion of the Constitutional Court, the flat-rate mechanism is aimed at avoiding excessive taxation of dividends as a result of the transition from the regime that applied before the 2008 Finance Law (Law No. 244/2007), which excluded dividends from taxation, to the new regime introduced by the 2008 Finance Law, which partially taxes them (with IRAP being relevant to dividends in the hands of both the payor and recipient). In addition, the Court emphasized that a further mistake inherent in the PTC's (and taxpayer's) arguments concerns its assertion that the sole trading activity was a "typical activity" of banks and other financial institutions. This assumption, which lacks any reasoning in the remission order, is also manifestly erroneous, both in fact and in law.
21. Case No. 12/2022 (20 Jan. 2022).
22. *See* the decision in *AFEP and others* (C-365/16), para. 33, wherein the ECJ states that:

    it is irrelevant whether or not the tax measure is classified as corporation tax. In that regard, it suffices to note that Article 4(1)(a) of Directive 2011/96 does not make its application subject to a tax in particular. That provision provides that the Member State of the parent company is to refrain from taxing the profits distributed by the non-resident subsidiary thereof. That provision thus seeks to avoid Member States adopting tax measures which lead to double taxation of parent companies in respect of those profits.
23. As is well known, in Italy, the Constitutional Court does not judge the merits of a case. In contrast, the Constitutional Court's decision is limited to the constitutional question submitted. It then reverts the case back to the court that raised the question.
24. In detail, the RTC dealt with a case concerning dividends distributed to an Italian parent company by associated companies incorporated in other EU Member States.
25. In this respect, the RTC referred to the ECJ decisions in cases *AFEP and others* (C-365/16) (*see supra* n. 14), also mentioned by the Emilian PTC, and PT: ECJ, 8 June 2000, Case C-375/98, *Ministério Público and Fazenda Pública v. Epson Europe BV*, Case Law IBFD, wherein the Court extended the scope of the EU Parent-Subsidiary Directive to inheritance taxes.

 © IBFD

Exported / Printed on 6 Nov. 2022 by m.giardina@ditanno.it.

than corporate income tax that nonetheless may result in double taxation of dividends).

6. Commentary

In conclusion, the decisions of the Emilian PTC and Lazio RTC likely represent a reversal of previous case law according to which the scope of the EU Parent-Subsidiary Directive, in Italy, is limited to IRES. It should be noted, however, that the Lazio RTC, in the final paragraphs of the decision, identifies the rationale regarding the tax neutrality regime provided for by the EU Parent-Subsidiary Directive, which is to facilitate the grouping together of companies operating in different EU Member States. As a result, the RTC stated that the exemption of EU dividends does not raise any questions regarding the constitutional legitimacy of the more burdensome tax regime applicable to domestic dividends, which are subject to both IRES and IRAP in the parent companies' hands. In other words, in the RTC's opinion, the more favourable regime applicable to EU dividends does not breach the principle of equality (article 3 of the Italian Constitution) since the difference in treatment in comparison to domestic dividends is reasonable and justified in light of the need to foster the EU internal market.

Moreover, despite the opening position assumed by the Emilian PTC, the ECJ decisions referred to by the taxpayer and the Constitutional Court actually concern cases with a cross-border element. In this respect, the principle of "non-discrimination" was invoked in relation to the worse treatment reserved for foreign entities in comparison to the tax regime applicable to resident persons.[26] In contrast, the ECJ, in other decisions,[27] has pointed out that it is not possible to derive, from the principle of "non-discrimination" established under EU law in respect of cross-border cases, a prohibition against "reverse discrimination". As such there is no general prohibition against EU Member States introducing beneficial tax regimes for non-residents in order to attract foreign goods and investments.[28] As noted by some authors,[29] according to the ECJ's interpretation, the scope of the EU principle of non-discrimination only extends "one-way", since it prohibits Member States from treating non-residents less favourably than nationals but does not preclude the application of a more burdensome tax treatment to residents in comparison with non-residents.[30]

Lastly, the IRAP exemption applicable to domestic and EU dividends received by banks and financial holding companies – as well as the refund for IRAP previously paid (where it is still possible, i.e. where it is applied for "on time") – would have a relevant impact on Italian tax revenue.

In light of the above, there is no certainty that the ITA and other tax courts will follow the interpretation adopted by the Emilian PTC and Roman RTC. In particular, on the basis of the EU Parent-Subsidiary Directive (2011/96) and the ECJ decisions mentioned, a new line of case law excluding EU dividends from the IRAP tax base is likely to be consolidated.

In addition, it is reasonable to assume that the same approach adopted in relation to dividends received by banks and financial holdings will be valid in respect of insurance entities (companies and holdings), due to the applicability of a similar IRAP regime to their dividends.[31]

In contrast, it is still unclear whether domestic dividends may benefit from the exemption provided for by the EU Parent-Subsidiary Directive (2011/96) on the basis of the principle of the prohibition against "reverse discrimination" or whether such an exemption may apply if it is grounded by the constitutional principles of equality and ability to pay. In this regard, however, the Lazio RTC, with decision No. 2303/13/2022, seems to rule out the constitutional illegitimacy of a different treatment of domestic and EU dividends. Therefore, it remains doubtful how this new approach regarding the IRAP tax base will be implemented in future decisions, especially with regard to purely domestic dividends.

26. *See X* (C-68/15), para. 40.
27. In this respect *see*, inter alia, the ECJ decision in FR: ECJ, 13 Mar. 1979, Case 86/78, *SA des grandes distilleries Peureux v. directeur des Services fiscaux de la Haute-Saône et du territoire de Belfort*.
28. In the ECJ's opinion, such differences are a consequence of "special features of national laws which have not been harmonized in spheres for which the Member States are responsible".
29. *See* N. Bammens, *The Principle of Non-Discrimination in International and European Tax Law – Part III: Non-discrimination in European tax law* in *General Overview of the Approach of the European Court of Justice to Non-discrimination* (IBFD 2012). Indeed, the author notes that, according to consistent ECJ case law, "the free movement provisions do not apply in purely internal situations and, therefore, do not offer a solution for issues of reverse discrimination".
30. The ECJ case law is also in line with this conclusion. For example, in the decision in *Peureux* (86/78), the ECJ noted that although the principle of non-discrimination "prohibits any Member State from imposing internal taxation on products imported from other Member States in excess of that on national products, it does not prohibit the imposition on national products of internal taxation in excess of that on imported products".
31. *See supra* n. 9.

Exported / Printed on 6 Nov. 2022 by m.giardina@ditanno.it.