New tax on financial institutions

Tax Alert

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21 December 2024 saw the publication in the Official State Gazette of Law 7/2024 of 20 December 2024, establishing a top-up tax to ensure global minimum taxation for multinational enterprise groups and large-scale domestic groups, a tax on the net interest and commission income of certain financial institutions and an excise duty on liquids for e-cigarettes and other tobacco-related products, and amending other tax laws (the "Law 7/2024").

The final provisions of the Law include a new tax to be levied on the net interest and commission income of financial institutions (the "Tax").

Despite its recent publication and entry into force, several aspects of the tax have been modified through Royal Decree-Law 9/2024, of 23 December, which adopts urgent measures in economic, tax, transport, and social security matters, and extends certain measures to address situations of social vulnerability (the "Royal Decree-Law 9/2024"), published in the Official State Gazette on 24 December 2024.

The new Tax is set to replace the temporary levy on credit institutions which, in 2023 and 2024, was applied, at a rate of 4.8%, to the total net interest and commission income and expenses arising from the activities pursued in Spain by credit institutions and financial credit establishments, provided such total was equal to or greater than Euros 800 million in 2019.

While the temporary levy on credit institutions was envisaged as a non-tax contribution for public purposes, raising considerable doubt as to its legality and constitutionality, the new Tax is conceived as a direct tax to be levied on the net interest and commission income obtained by financial institutions.

The Preamble of the Law merely includes a brief reference to the inclusion of this new Tax in Final Provision Nine thereof, without elaborating further on the justification or need for such a Tax (an aspect also highlighted by the European Central Bank in its opinion on the new Tax, which we will refer to later).

Despite its recent approval through Law 7/2024, Royal Decree-Law 9/2024 has modified several aspects of the Tax, according to its Preamble, motivated by the opinion issued by the European Central Bank on 17 December regarding the bill that led to Law 7/2024. The aim is to mitigate the adverse accounting effects on the solvency and competitiveness of credit institutions subject to the Tax, as mentioned in the Preamble, as these institutions would have had to account for both the temporary levy and the new Tax in the 2024 financial year if the original wording of Law 7/2024 had been maintained. However, as we will discuss later, Royal Decree-Law 9/2024 overlooks the implications highlighted by the European Central Bank regarding the impact on solvency, competitiveness, and the credit market that the new Tax may have.

Furthermore, it should be noted that the modifications made by Royal Decree-Law 9/2024 are not yet definitive and must be ratified by the Congress of Deputies before 24 January 2025.

Main features of the Tax

A summary of what we consider to be the relevant aspects of this new Tax is provided below.

- The **taxpayers** are credit institutions established in Spain, financial credit establishments and Spanish branches of foreign credit institutions. In this regard, note that the taxpayer is the individual institution and not the tax group, as had been the case with the temporary levy.

- The **taxable event** takes place when the net interest and commission income figure, i.e. the taxpayer's total interest income and expenses, plus commission income, obtained in Spain is positive. Income and expenses attributable to branches located abroad are expressly excluded.

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- The **tax period** is similar to that for corporate income tax purposes (i.e. it is in line with the institution's financial year). Initially, the Law stipulated that the Tax would **accrue** on the day following the last day of the tax period (1 January for tax periods that coincide with the calendar year). However, this is one of the main aspects modified by Royal Decree-Law 9/2024, which establishes that the Tax will be accrued on the last day of the calendar month following the end of the tax period (i.e., 31 January for taxpayers with a financial year coinciding with the calendar year) and the accrual is conditional upon having the status of taxpayer on that accrual date.

  Additionally, Royal Decree-Law 9/2024 removes the specifications made by Law 7/2024 regarding the scenarios of the conclusion of the tax period (e.g., when the entity is dissolved, ceases to be established in Spain, or in the case of branches that cease their activities in Spanish territory).

- The **tax base** is made up of the positive balance of the total interest and commission income and expenses arising from the activities pursued in Spain, as reflected in the institution's profit and loss statement, in accordance with the applicable accounting legislation.

  Meanwhile, the **net tax base** will be calculated by deducting Euros 100 million from the tax base, and in any case may it be negative. This is a relevant aspect, as even if the taxable event occurs, i.e. the taxpayer obtains positive net interest and commission income, the initial Euros 100 million of such figure would not be taxed.

- To calculate the **gross tax payable**, a **progressive tax scale** is established, ranging from 1% (for the first Euros 750 million of net taxable income) to 7% (from Euros 5,000 million of net taxable income).

  The **net tax quota** will be the result of reducing the gross tax quota by 25% of the net corporate income tax or non-resident income tax payable for the same period. Where the taxpayer is part of a tax consolidation group, the proportion of the group's net tax payable will be calculated on the basis of the taxpayer's individual tax base after performing the necessary eliminations and additions (prior to the offset of tax losses) in respect of the group's tax base prior to such offsetting. This possibility of reducing the gross tax payable in respect of the new Tax may make it advisable to consider whether to offset tax losses or use tax credits and other tax assets from 2024 to 2026, or to keep them for subsequent years.

  It should also be borne in mind that taxpayers that have incurred net corporate income tax or non-resident income tax losses may be subject to the Tax without being able to apply the above reduction.

  Additionally, Royal Decree-Law 9/2024 includes a new section regarding the adjusted total tax liability in cases where taxpayers of the Tax become acquirers in structural modification transactions with credit institutions, financial credit establishments, or branches of foreign credit institutions. In such cases, the total tax liability will be increased by 15 percent of its amount in the financial year in which the structural modification transaction has accounting effects, provided that the interest and commission margin of the dissolved entity exceeds the amount resulting from prorating 100 million euros annually over the days elapsed in that financial year.

  Furthermore, a limit on this increase is established: 1% for amounts up to 750 million euros and 3% for amounts exceeding 750 million euros of the interest and commission margin of the dissolved entity that would not have been accounted for by the acquiring taxpayer.

  Subsequently, a 25% reduction of the Corporate Income Tax or Non-Resident Income Tax liability would be applied to the adjusted total tax liability to obtain the net tax quota.

- Lastly, the Law provides for an **extraordinary tax relief** where the return on the taxpayer's total assets falls below the 0.7% reference value. In such cases, a percentage will be deducted from the net tax quota payable relating to the proportion represented by the decrease in the profitability indicator, which in no case may exceed the net tax quota payable. Such tax relief may also be taken into account in respect of instalment payments.

- As regards **management of the Tax,** it will be settled by means of a self-assessment, to be filed within the first 20 days of the ninth month following that in which the tax period ends (normally within the first 20 days of September, where the tax period coincides with the calendar year). Taxpayers with a negative net tax base (i.e. a positive margin of less than Euros 100 million) will not be required to file a self-assessment.

  The Law also lays down the obligation to make an instalment payment within the first 20 calendar days of the second month after the end of the tax period (within the first 20 days of February when the tax period coincides with the calendar year). The amount due will be the result of multiplying the net tax payable for the tax period or, as the case may be, the net tax payable less the extraordinary tax credit, by 40%. However, with respect to the 2024 tax period, such instalment payment would be

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made within the first 20 days of the sixth month after the end of the tax period (within the first 20 days of June 2025 for institutions with an ordinary financial year).

Although Royal Decree-Law 9/2024 adapts the sections of the ninth final provision of Law 7/2024 relating to the management of the Tax to align them with the new accrual configuration, it does not practically modify the deadlines already established by Law 7/2024. Thus, the self-assessment must be carried out within the first 20 calendar days of the eighth month following the accrual, which coincides with the first 20 days of September for entities with a financial year coinciding with the calendar year. Additionally, regarding the instalment payment, this will be made within the first 20 calendar days of the month following the accrual of the tax (i.e., also coinciding with the first 20 days of February when the tax period coincides with the calendar year), except for the instalment payment related to the 2024 financial year, which will be made within the first 20 calendar days of the fifth month following the accrual (also coinciding with the first 20 days of June in cases where the tax period coincides with the calendar year).

- With regard to **collection of the Tax**, the Law provides that it will be distributed among the Autonomous Regions subject to the law generally applicable in Spain in the year following that in which the relevant self-assessment is filed, based on their regional gross domestic product at 1 January of that year.

- **Other relevant aspects** of the Tax are its **non-deductibility** for corporate income tax/non-resident income tax purposes, as applicable, and its **validity**. In this regard, it will only be in force for the three consecutive tax periods commencing on or after 1 January 2024, i.e., in principle, 2024, 2025 and 2026.

Impact and preliminary issues arising

The approval of this new Tax means that, for the next three years, the main financial institutions operating in Spain will have to pay an additional tax on their net interest and commission income. Although this is now inevitable, affected parties should be aware of the main issues and problems raised by this new Tax, and assess the steps that may be taken to mitigate its potential repercussions.

Uncertainty as to the alignment of the Tax with Spanish and EU law

The introduction of the new Tax on the eve of the end of the year, by means of an amendment to the Top-up Tax Draft Law to ensure global minimum taxation (commonly referred to as Pillar Two), together with the fact that the credit institution sector is already heavily taxed (not only due to the existence of an increased corporate income tax and non-resident income tax rate of 30%, but also due to other measures that have been approved in recent years, such as the State tax on deposits in credit institutions, stamp duty on the arrangement of mortgages and the charge for the conversion of deferred tax assets, as well as other charges derived from their activity, such as the limitation on the deductibility of input value added tax), raises considerable doubt in terms of legal certainty and alignment of the new Tax with the law, as well as its impact on the competitiveness of Spanish institutions.

Firstly, it should be considered whether this Tax may give rise to double taxation, notwithstanding the reduction in the gross tax quota payable of 25% of the net corporate income tax or non-resident income tax payable, insofar as it is set up as a direct tax, the taxable event of which overlaps with a portion of the income of credit institutions that is already taxed for corporate income tax or non-resident income tax purposes, i.e. the net interest margin of credit institutions.

It should also be borne in mind that the Tax is levied solely on net interest and commission income, and not on the final profit that financial institutions obtain therefrom (after considering credit risk provisions, among other items), which might not reflect their real economic capacity, without prejudice to the extraordinary profitability tax credit, in addition to the issues that may arise, also from an economic capacity standpoint, in cases where the new Tax gives rise to net tax payable but the taxpayer has nevertheless incurred a corporate income or non-resident income tax loss.

Also controversial is the decision to apply the Tax on a progressive scale, common in the taxation of individuals but difficult to justify in the case of legal entities, since such a system penalises larger financial institutions with a higher net interest margin, which may deter investment and growth in the credit market and encourage the transfer of operations to other jurisdictions.

From the standpoint of EU law, it should be noted that this Tax will potentially apply to a larger number of taxpayers than the previous levy did, due to the elimination of the threshold of Euros 800 million net interest and commission income in 2019 (a reduction is nonetheless included that exempts institutions with a

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net interest margin of less than Euros 100 million from taxation). A direct consequence of this is increased implementation among Spanish financial institutions, which could also affect their competitiveness in the credit market and raises the question of whether this new Tax may, in practice, infringe the principles of non-discrimination and free competition at EU level, by introducing an implicit tax benefit for non-resident institutions operating in Spain under the freedom to provide services.

Although the tax theoretically applies throughout Spain, the exercise of the Basque Country's and Navarre's foral tax powers, by virtue of the Agreement and the Convention, respectively, could give rise to situations of potential inequality or distortion of competition.

Lastly, the European Central Bank (at the request of Banco de España) issued an opinion on the Tax on 17 December 2024 (CON/2024/41). In the ECB's view, the new Tax could hamper the ability of banks, particularly less profitable ones, to maintain a solid capital position and to accumulate buffers against negative shocks. Moreover, the Tax could have adverse economic effects by limiting credit institutions' ability to provide credit and contributing to less favourable loan terms. The ECB also believes that the Tax may lead to greater fragmentation in the financial system and impair the level playing field, giving rise to asymmetries based on bank size (precisely due to application of the Tax on a progressive scale). Of note is the allusion made by the ECB to the lack of justification for the Tax, and its interpretation whereby it would need to be accounted for in 2024, giving rise to a double accounting effect for institutions, due to recognition of the temporary levy. It thus recommends that these accounting effects be analysed in order to avoid any undesired impact on the solvency and competitive position of the institutions involved.

Regarding these last two aspects mentioned, it seems that an attempt is made to address both through Royal Decree-Law 9/2024. However, concerning the first of these, as we anticipated, Law 9/2024 does not include any reference in the Preamble regarding the justification of the new Tax, and we understand that this absence is not compensated by the justifications included in the Preamble of Royal Decree-Law 9/2024.

Economic impact and increased financing cost

Further to the above, in addition to the increase in financial institutions' costs as a result of this new Tax, other adverse economic impacts that are likely to arise must be considered.

In particular, in the credit market, the Tax is likely to lead to an increase in the cost of financing and a possible impact on financing prices in the form of higher interest rates or additional fees, thus making access to credit more expensive for companies and individuals alike. It should also be noted that, unlike the temporary levy, there is no express legal prohibition on the direct or indirect economic shift of the new Tax to borrowers.

Adverse effects may also be generated within the financial institutions themselves, not only because of the little or no planning margin available to them due to the late approval of the Tax at the end of 2024, but also (in line with the ECB's comments) due to the impact on the solvency of the entities affected by the Tax. Although, as stated in its Preamble, Royal Decree-Law 9/2024 addresses the issue regarding the need to recognise both figures (the temporary levy applicable in 2024 and the new Tax) for 2024, as the ECB has already pointed out, the tax will limit the ability of entities to absorb potential risks from an economic slowdown (with the consequent drop in interest rates) that may occur in the future.

All these questions and doubts, although still preliminary and subject to reflection, will likely give rise to numerous actions on the part of the affected institutions, with a view to seeking clarification and possible modifications in the implementation of the new Tax, and potentially challenging it, where ultimately deemed necessary.

In any event, it is worth concluding by pointing out that, in our opinion, the manner in which the new Tax is set up provides additional reasons and arguments to refute the nature of the previous temporary levy as a non-tax contribution for public purposes, in view of the similarities between the two, this, moreover, despite the efforts that Royal Decree-Law 9/2024 dedicates in its Preamble to justify that these are non-coinciding legal figures.

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