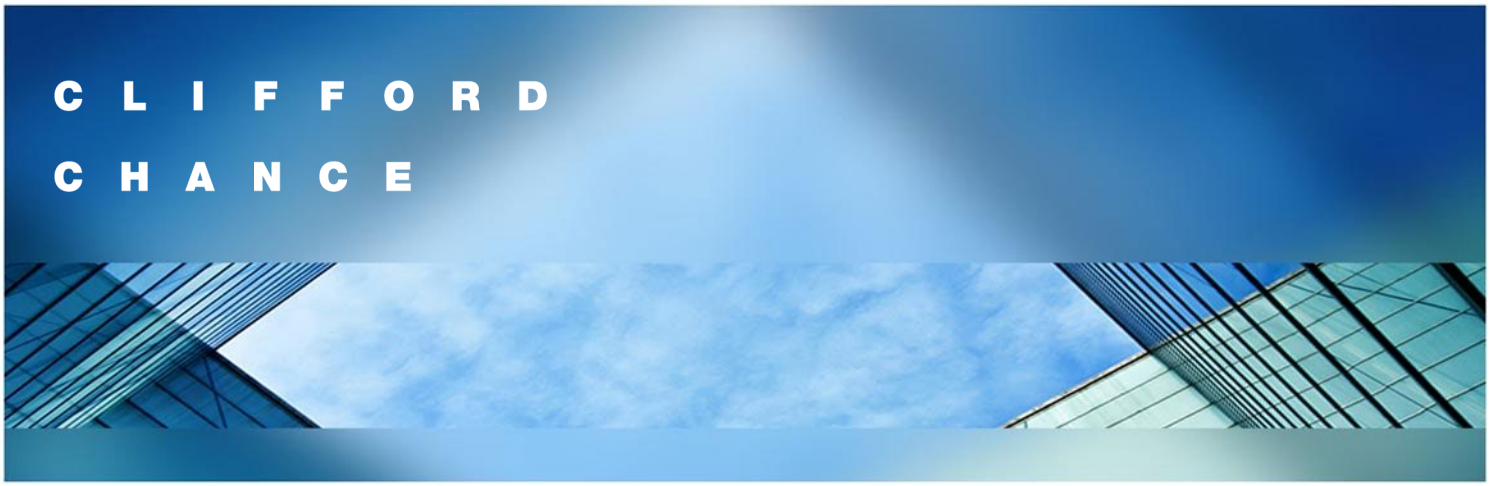

THE SPANISH DIRECTORATE GENERAL FOR TAXATION CONFIRMS THE TAX TREATMENT OF HYBRID INSTRUMENTS ISSUED BY SPANISH ENTITIES

The Spanish Directorate General for Taxation (*Dirección General de Tributos*, the "DGT") recently issued a binding ruling (V0143-21), confirming the tax deductibility of the remuneration of hybrid instruments issued by Spanish entities. The key development arising from the ruling is that it uncouples the accounting treatment of an instrument from the tax deductibility of the remuneration as an expense.

The existing tax framework for the various capital and debt instruments listed on a market and issued by Spanish companies can be summarised as follows:

- In the case of instruments classified as preferred securities under the provisions of Additional Provision One of Spanish Act 10/2014, of 26 June, on the regulation, supervision and solvency of credit institutions ("**Act 10/2014**"), the remuneration is tax deductible on the issuer's Spanish Corporate Income Tax (*Impuesto sobre Sociedades*), regardless of its accounting treatment.
- In relation to debt instruments issued by Spanish companies under that law (listed instruments that do not confer political rights or pre-emptive subscription rights), the remuneration is considered a tax-deductible expense insofar as the accounting treatment of such instruments is the treatment as a debt instrument that allows accounting for such remuneration as an expense in the profit or loss account.

Hybrid instruments, meanwhile, constituted an intermediate area, since they are not preferred securities (and therefore cannot use the tax regime established for such instruments), and only their potential consideration as debt instruments that meet the requirements established in Act 10/2014 would allow the same tax regime to be applied.

However, the fact that they are subordinated, along with their duration (long and sometimes indefinite), usually hinders their being considered debt instruments for accounting purposes and, therefore, the coupons being recognised as an expense and, ultimately, being tax deductible.

In light of this situation, issues of hybrid instruments have been carried out lately through subsidiaries located in other EU member states and thus are subject to the tax law of the state in question.

The binding ruling issued by the DGT is a significant development in that the accounting treatment of hybrid instruments will not have an effect on their being considered debt instruments.

The main argument in the recently published DGT ruling is that any financial instrument other than those that constitute a holding in an entity's capital must be considered a debt instrument for tax purposes, regardless of their form of return (explicit or implicit), their duration or any other characteristic (including their tax treatment).

In short, according to the text of the DGT ruling, insofar as hybrid instruments meet the requirements established in Act 10/2014 (essentially listing on a regulated market, a multilateral trading system or other organised market), they will be understood to constitute debt instruments as established in that law and, therefore, the tax regime established therein may be applied to them, including the tax deductibility of their remuneration.

The confirmation of their tax treatment by the DGT is therefore a significant incentive to issue hybrid instruments directly from Spain.

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