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**TAX TREATMENT OF ADDITIONAL TIER 1  
RESTRICTED TIER 1 & CORPORATE HYBRIDS  
IN CERTAIN EUROPEAN JURISDICTIONS**

## **INTRODUCTION TO TAX TREATMENT OF AT1, RT1 AND CORPORATE HYBRID INSTRUMENTS**

The summary table is intended to provide an overview of the tax treatment of Additional Tier 1 (AT1) issued by banks, Restricted Tier 1 (RT1) issued by insurers and corporate hybrids by corporates in certain European jurisdictions.

In this technical briefing we discuss the classification, corporate tax deductibility, withholding tax treatment and other important topics of AT1, RT1 and corporate hybrid instruments.

**IMPORTANT:** The following overview is based on the laws and practice in force as of July 2022 and is subject to any changes in law and the interpretation and application thereof, which changes could have retroactive effect. The following summary does not purport to be a comprehensive description of all the tax considerations of AT1, RT1 and corporate hybrid instruments that may be relevant, and it does not purport to deal with the tax consequences applicable to all categories of instruments or investors, some of which may be subject to special rules.

### **European jurisdictions covered are:**

- Belgium
- France
- Germany
- Italy
- Luxembourg
- Netherlands
- United Kingdom
- Spain

Jurisdiction	Instrument	Classification	Tax deductibility	Withholding tax	Comments
Belgium	AT1/RT1	No general rules. AT1/RT1 classification follows the Belgian civil law conditions that are attached to either debt or equity (see below in that regard). The Belgian federal ruling administration has however established the following test to classify AT1/RT1 instruments as debt: (i) the return is determined in advance (fixed rate or floating rate), and is not linked to the profitability of the issuer; (ii) on redemption, the investors are only entitled to the principal amount; (iii) the investors have no voting rights as shareholders; (iv) the instrument is recorded as debt for Belgian GAAP purposes; and (v) there is a maturity date (which may be implied by underlying features).	Yes, provided the terms of the instrument comply with the conditions for debt classification and provided that the ordinary conditions for tax deduction are met.	In principle yes (30%), but Belgian tax law provides for a withholding tax exemption on interest paid under financial instruments that are cleared in the so-called 'X/N system' operated by the National Bank of Belgium as well as, in relation to non-residents, for financial instruments that qualify as 'registered bonds' (subject to formalities). In addition, interest payments made by Belgian professional investors to qualifying credit institutions are not subject to withholding tax.	Qualification as debt is generally crucial as withholding tax exemption are less broad in relation to dividend distributions and because of the tax deductibility of the interest for the borrower (subject to conditions and limitations).  In relation to withholding tax, Belgian natural persons may not have access to a withholding tax exemption on AT1/RT1 instruments but the withholding tax levied (at the rate of 30%) constitutes the final tax they would pay.
	Corporate hybrid	No general rules. Classification as debt or equity for hybrid must therefore be determined on the basis of the civil law characteristics of debt and equity (similar as to AT1/RT1 instruments), taking into account the essential features of the contract and the real intention of the parties. Equity is defined as funds that are subject to the corporate risk, which is the case if three conditions are met: (i) there is no entitlement to repayment of the principal amount, (ii) there is no fixed repayment date, and (iii) the repayment is due only to the extent that the debtor has "distributable reserves". If one of these conditions is not met, the funds may classify as debt and payment thereto as interest.		Same as above. Loans usually benefits from stricter withholding tax exemptions than bonds and similar instruments (except when the lender is a qualifying credit institution).	Same as above. In addition, the Belgian federal ruling administration has established the following criteria to distinguish between debt and equity: (i) term/maturity; (ii) early repayment possibilities for the principal; (iii) no conversion features; (iv) subordination to other debts; (v) stapling/transferability of the instrument; and (vi) profit participation features.  These criteria are broader than these used for AT1/RT1 instruments. Compliance with all criteria is not required.  Belgian tax law also includes a General Anti-avoidance Rule (GAAR) that allows the Belgian tax administration to reclassify a debt instrument as an equity instrument, provided that it is able to demonstrate that the initial classification as a debt instrument constitutes a tax abuse and provided that the taxpayer has no sufficient non-tax motives.

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France	AT1	No specific rule under French tax law.  It is generally considered that for an instrument to be treated as a debt security for French tax purposes (i) from a legal standpoint, it should qualify as a debt security and (ii) from an accounting standpoint, it should be booked as a liability in the issuer's accounts, although those conditions are not necessarily determinative.	Tax deductible, assuming the instrument qualifies as debt for French tax purposes and provided that no specific limitation applies (such as ATAD 2 anti-hybrid rules and ATAD 1 interest barrier rules).	Amounts paid on debt instruments which qualify as interest for French tax purposes are generally not subject to withholding tax in France, subject to certain exceptions.  Payment made on instruments qualifying as equity to foreign corporate beneficiaries are subject to a 25% withholding tax, which may be mitigated in certain circumstances based on the relevant double tax treaty provisions (if any), EU directives of domestic law.	To our knowledge, AT1 are generally treated as debt instruments for French tax purposes in the French market, based on prospectus published in relation to the issue of AT1/RT1 notes.  We are not aware of any concern or activity currently undertaken by the French government in relation to the qualification of these instruments for tax purposes.  Corporate hybrid qualification should be reviewed based on the specific features of the relevant instruments. The French tax authorities have challenged in the past certain schemes involving corporate hybrids which they found were tax driven.
	RT1	It is generally considered that for an instrument to be treated as a debt security for French tax purposes (i) from a legal standpoint, it should qualify as a debt security and (ii) from an accounting standpoint, it should be booked as a liability in the issuer's accounts, although those conditions are not necessarily determinative.			
	Corporate hybrid	The French tax authorities may review the term and conditions of the relevant instrument and challenge debt qualification as the case may be (including on the basis of GAAR/anti-abuse rules). Relevant factors can include modalities of remuneration on the instruments (i.e. fixed or variable), maturity date (if any), political shareholder rights, etc.			
Germany	AT1	AT1-Instruments complying with the standard terms as described in the tax decree issued by the Federal Ministry of Finance dated 4 November 2021 ("AT1 Tax Decree") with reference to the model terms and conditions for AT1 instruments as published by the Federal Association of German Banks qualify as debt.	Yes, provided the terms of the instrument comply with the conditions as laid down in the AT1 Tax Decree. Applying for a binding ruling is recommended.	In the case of German tax resident holders, German withholding tax is imposed on AT1/RT1 instruments if the instruments are maintained with a domestic branch credit or financial services institution, a domestic securities trading business or a domestic securities trading bank. However, this withholding tax of 26.375% is either equal to the final flat tax rate for German private investors or constitutes a prepayment that can be credited for German business investors.  In the case of coupon payments to non-German tax resident holders, no withholding tax should be levied provided the instruments are neither profit-linked nor convertible (confirmed in the AT1 Tax Decree and the RT1 Tax Decree). In the	Since the terms and conditions of AT1 / RT1 instruments actually issued generally deviate from the model terms and conditions, applying for a binding ruling is generally recommended despite the fact that tax decrees exist. In particular, the tax courts would only be bound by a binding ruling but not by the tax decrees.
	RT1	RT1-Instruments complying with the standard terms as described in the tax decree issued by the Federal Ministry of			

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		Finance dated 8 October 2020 (" <b>RT1 Tax Decree</b> ") with reference to the model terms and conditions for RT1 instruments dated 17 December 2019 qualify as debt.	Tax Decree. Applying for a binding ruling is recommended.	case of profit-linked or convertible instruments, German withholding tax applies.	
	<b>Corporate hybrid</b>	If properly structured, corporate hybrid bonds can be classified as debt.	Yes, provided certain requirements are met. Applying for a binding ruling is recommended.	The AT1 Tax Decree and the RT1 Tax Decree apply only to AT1 and RT1 instruments, respectively. However, the principles set out in these tax decrees should, in principle, also apply to corporate hybrid bonds.	
<b>Italy</b>	<b>AT1</b>	Debt, if it does not provide for a remuneration entirely represented by profits of the issuer or entities related to the issuer (based on article 2(22) of Decree 138/2011).	Yes, except for the portion of the remuneration represented by profits of the issuer or entities related to the issuer (based on article 2(22) of Decree 138/2011).	In principle yes, but subject to ordinary regime of listed bonds (Decree 239/1996) providing for an exemption regime in case of investors resident or established in countries allowing for an adequate exchange of information with Italy (based on article 2(22) of Decree 138/2011).	We are not aware of any concern or activity currently undertaken by the Italian government in relation to a potential requalification of these instruments as equity for tax purposes.
	<b>RT1</b>				
	<b>Corporate hybrid</b>	Debt, if it does provide for an unconditional obligation for the issuer to pay at maturity an amount not lower than its principal amount.	Not addressed by the law. However, the tax authority recently took the position corporate hybrid bonds having similar features to AT1 (e.g. perpetual and subordinated bonds) may be treated as "bonds" for tax purposes, thus allowing deduction of interest expenses under ordinary rules.	In principle yes, but the tax authority recently took the position that corporate hybrid bonds having similar features to AT1 (e.g. perpetual and subordinated bonds) would be subject to the ordinary regime of listed bonds (Decree 239/1996) providing for an exemption regime in case of white list investors (see above regime applicable to AT1/RT1).	
<b>Luxembourg</b>	<b>AT1</b>	Luxembourg tax law does not contain specific provisions on the qualification of an instrument as debt or equity. As a general principle, the Luxembourg tax treatment follows the accounting treatment. In this respect if the instrument is recorded as debt and the payments under the instrument as	Yes, provided that (i) the terms of the instrument comply with the conditions for debt classification, and (ii) the general conditions for the tax deductibility are complied with (e.g. interest deductibility limitation rules,	No, to the extent that the instruments qualify as debt for Luxembourg tax purposes and provided that the arm's length principle is complied with. Consequently, no withholding tax would be applicable unless the payment of interest is made or ascribed by a	We are not aware of any concerns or investigations currently undertaken by the Luxembourg government or tax authorities in relation to a potential requalification of these instruments as equity for tax purposes.
	<b>RT1</b>				
	<b>Corporate hybrid</b>				

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		<p>expenses for Luxembourg accounting purposes, such instrument would also be considered as debt from a tax perspective unless a tax provision imposes another specific treatment.</p> <p>However, when determining the classification of a hybrid instrument as either debt or equity, the substance over form principle generally prevails in Luxembourg. A comprehensive analysis of the following features is therefore performed to determine the nature of the instrument: maturity (and early redemption possibility), ranking for repayment purposes, remuneration (fixed/variable), conversion characteristics, rights attached to the instrument (e.g. voting rights, participation in the borrower's profits/loss or liquidation proceeds).</p>	anti-hybrid rules, expenses not economically linked to tax exempt participation).	paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner who is a Luxembourg resident.	
Netherlands	AT1	Debt, if the instruments qualify as debt for civil law purposes (not effectively functioning as equity) for tax purposes pursuant to the hybrid debt criteria as laid down in prevailing case law of the Dutch Supreme Court dated 15 May 2020 (" <b>Hybrid Debt Criteria</b> ").	Yes, based on article 8 of the 1969 Dutch Corporate Tax Act, if the instruments meet the Hybrid Debt Criteria and save for generic interest deduction limitations pursuant to the 1969 Dutch Corporate Tax Act.	No, if the instruments meet the Hybrid Debt Criteria	The Dutch Ministry of Finance confirmed in the Explanatory Memorandum to the Tax Plan 2021 that AT1-instruments (and corporate hybrid instruments) qualify as debt for tax purposes following case law of the Dutch Supreme Court dated 15 May 2020 on the classification of a corporate hybrid instrument issued in 2010. Although the Ministry of Finance have not confirmed the classification of RT1 instruments, we believe that this confirmation relating to AT1-instruments (and corporate hybrid instruments) should by analogy generally apply to fixed rate RT1-instruments.
	RT1				
	Corporate hybrid				
United Kingdom	AT1	Debt if Hybrid Capital Instruments Regime (" <b>HCI Regime</b> ") applies;	Yes, provided it falls under the HCI Regime, and	Yes by default, but other exemptions from the duty to	Due to state aid concerns, the HCI

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	<b>RT1</b>	otherwise distribution treatment may apply.  The HCI Regime was introduced by Schedule 20 of the Finance Act 2019 and amended by the Taxation of Hybrid Capital Instruments (Amendment of section 475C of the CTA 2009) Regulations 2019 after significant consultation with stakeholders.	subject to other rules limiting the deductibility of interest (e.g. the corporate interest restriction rules, unallowable purpose rules and transfer pricing).	withhold income tax on interest (section 874 Income Tax Act 2007) as for other listed debt may apply (e.g. listed on a recognised stock exchange or issued by a bank acting in the ordinary course of its business).	Regime replaced the previous Regulatory Capital Securities (" <b>RCS</b> ") Regulations 2013/3209, which only applied to bank and insurance company hybrid securities.  Accordingly, the HCI Regime covers a wider range of hybrid capital instruments. However, the Regime has additional exclusions designed to restrict the HCI Regime to instruments with terms which HMRC considers to be market standard for AT1 securities.  Altogether, the HCI Regime has made determining the classification of hybrid capital much more technical from a tax perspective.
	<b>Corporate hybrid</b>	Debt if HCI Regime applies; otherwise distribution treatment may apply.	Yes, provided it falls under the HCI Regime, and subject to other rules limiting the deductibility of interest (e.g. the corporate interest restriction rules, unallowable purpose rules and transfer pricing).	Yes by default, but other exemptions from the duty to withhold income tax on interest (section 874 Income Tax Act 2007) for listed debt may apply (e.g. listed on a recognised stock exchange or issued by a bank acting in the ordinary course of its business).	
Spain	<b>AT1</b>	Debt/Equity (structured as preferred participations)	Yes, under Spanish Law 10/2014 (in conjunction with EU Regulation 575/2013).	No, under Spanish Law 10/2014 which requires that the instruments are listed in a qualifying stock market.	Spanish tax law does not make a classification on whether the instrument is considered debt or equity, nor if a coupon is tax deductible, except if the instruments are preferred participants under Law 10/2014 in which case, the remuneration would be tax deductible. Out of the scope of Law 10/2014, the tax treatment depends on the accounting treatment of the instrument.  The general rule is that any coupon on any instrument is tax deductible if it is accounted as an expense for Spanish GAAP purposes.  We are not aware of any concern or activity currently undertaken by the Spanish government in relation to a change in the tax deductibility status of these instruments.
	<b>RT1</b>				
	<b>Corporate hybrid</b>	Debt/Equity	Yes, under Spanish Law 10/2014.	No, under Spanish Law 10/2014 provided that the instruments are listed on a qualifying stock market.	Following the ruling issued by the Spanish Tax Authorities on 1 February 2021, the remuneration on hybrid instruments would be tax deductible irrespective of its accounting treatment provided that the instruments do not represent a participation in the equity of the issuer and they are listed on a

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Jurisdiction	Instrument	Classification	Tax deductibility	Withholding tax	Comments
					qualifying stock exchange as per Law 10/2014.



## CONTACTS



**Alexandre Ooms**  
Partner

**T** +32 2 533 5073  
**E** alexandre.ooms  
@cliffordchance.com



**Thomas Linard de  
Guertechin**  
Lawyer

**T** +32 2 533 5909  
**E** thomas.linarddeguertechin  
@cliffordchance.com



**Eric Davoudet**  
Partner

**T** +33 1 44055272  
**E** eric.davoudet  
@cliffordchance.com



**Pierre Goyat**  
Counsel

**T** +33 1 44055392  
**E** pierre.goyat  
@cliffordchance.com



**Olaf Mertgen**  
Partner

**T** +49 69 7199 1691  
**E** olaf.mertgen  
@cliffordchance.com



**Pablo Serrano de Haro**  
Global Practice Area Leader  
for TPE

**T** +34 91 590 9470  
**E** pablo.serrano  
@cliffordchance.com



**Roberto Grau**  
Counsel

**T** +34 91 590 7512  
**E** roberto.grau  
@cliffordchance.com



**Maxime Budzin**  
Counsel

**T** +352 48 5050456  
**E** maxime.budzin  
@cliffordchance.com



**Caroline Poiret**  
Senior Associate

**T** +352 (48) 5050429  
**E** caroline.poiret  
@cliffordchance.com

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Clifford Chance, Droogbak 1A, 1013 GE  
Amsterdam, PO Box 251, 1000 AG  
Amsterdam

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**Michiel Sunderman**  
Partner

**T** +31 20 711 9658  
**E** michiel.sunderman  
@cliffordchance.com



**Nolan Groenland**  
Counsel

**T** +31 20 711 9159  
**E** nolan.groenland  
@cliffordchance.com



**Carlo Galli**  
Partner

**T** +39 02 8063 4525  
**E** carlo.galli  
@cliffordchance.com



**Andrea Sgrilli**  
Senior Associate

**T** +39 02 8063 4239  
**E** andrea.sgrilli  
@cliffordchance.com



**Jemma Dick**  
Partner

**T** +44 207006 8383  
**E** jemma.dick  
@cliffordchance.com



**Cameron Dwyer**  
Senior Associate

**T** +44 207006 4595  
**E** cameron.dwyer  
@cliffordchance.com



**John Thomson**  
Lawyer

**T** +44 207006 4965  
**E** john.thomson  
@cliffordchance.com