EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 17 December 2024

on a tax on the net interest and commission income of certain financial institutions

(CON/2024/41)

Introduction and legal basis

On 28 November 2024 the European Central Bank (ECB) received a request from the Banco de España, on behalf of the Spanish Parliament, for an opinion on a draft law establishing a tax on net interest and commission income of certain financial entities (hereinafter the 'draft law'). This draft law is part of a comprehensive draft law on a complementary tax to guarantee a minimum overall level of taxation for multinational groups and large-scale national groups, implementing into Spanish law Council Directive 2022/2523[1], a tax on the net interest and commission income of certain financial entities and a tax on liquids for electronic cigarettes and other tobacco-related products and other amendment of tax rules.

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and Article 2(1), sixth indent, of Council Decision 98/415/EC[2], as the draft law concerns the rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets, and the ECB's tasks concerning the prudential supervision of credit institutions pursuant to Article 127(6) of the Treaty. In accordance with Article 17.5, first sentence, of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 The draft law establishes a direct tax on the net interest and commission income obtained by credit institutions established in Spain, by specialised lending institutions, and by branches of foreign credit institutions established on Spanish territory (hereinafter 'financial institutions') arising from their activity in Spain. The taxable base of the tax is the positive margin of interest and fees income obtained in Spain after offsetting interest and commission expenses, and hence excludes those attributable to branches located abroad. The liquid base of the tax is the result of reducing the taxable base by EUR 100 million.

1.2 The draft law establishes a scale of five specific tax rates that are to be applied to the liquid base in order to obtain the gross tax charge: a tax rate of 1 % will be applied to a positive liquid base up to EUR 750 million; a tax rate of 3,5 % will be applied to the portion of the liquid base from EUR

1 Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (OJ L 328, 22.12.2022, p. 1).

2 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

750 million up to EUR 1500 million; a tax rate of 4,8 % will be applied to the portion of the liquid base from EUR 1500 million up to EUR 3000 million; a tax rate of 6 % will be applied to the portion of the liquid base from EUR 3000 million up to EUR 5000 million; and a tax rate of 7 % will be applied to the portion of the liquid base from EUR 5000 million upwards.

1.3 The gross tax charge is to be reduced by the amount resulting from applying 25 % of the liquid amount of the corporate tax that the financial institution is to pay in that same tax period, or the non-resident income tax in the case of branches of foreign credit institutions, in order to obtain the liquid amount of the tax payable by the financial institution.

1.4 Financial institutions are entitled to make an extraordinary deduction of the liquid amount of the tax in accordance with a formula established in the draft law if their return on assets (ROA) – calculated by dividing the net income of the financial institution without including the expenses from the payment of the proposed tax by the total assets of the financial institution – is less than 0,7 %.

1.5 Financial institutions must make a split payment equal to 40 % of the liquid amount of the tax (or of the liquid amount of the tax after the ROA-related extraordinary deduction) within the first 20 calendar days of the second month following the end of the tax period. The addressees must pay the rest of the tax liability within the first 20 days of the ninth month following the end of the tax period. The proceeds from the tax are to be paid to the State Treasury.

1.6 The tax period will coincide with the fiscal year of the financial institution and the tax is legally accrued the first day after the expiration of the fiscal year. Nevertheless, the tax period may end earlier, when a financial institution or a foreign branch ceases to operate as such. The tax will be applicable for the first three consecutive tax periods beginning on 1 January in 2024, 2025 and 2026, respectively. This means that the tax base is to be calculated based on the amounts recognised during 2024, 2025 and 2026, respectively, but that financial institutions are legally bound to pay in 2025, 2026 and 2027, respectively.

2. General observations

2.1 The ECB adopted an opinion in 2022 on a draft Spanish law on the imposition of temporary levies on operators in the energy sector, credit institutions and by specialised lending institutions[3]. Thereafter the ECB has adopted a series of opinions addressed to other Member States on draft laws introducing special, temporary or permanent taxes, levies, fees or solidarity contributions applicable to banks and/or financial institutions[4]. In these opinions, the ECB considered legislative initiatives introducing such taxes, levies, fees or contributions from the monetary policy, financial stability and prudential supervision perspectives.

2.2 Unlike the draft Spanish law on the imposition of temporary levies on operators in the energy sector, credit institutions and by specialised lending institutions[5], the explanatory memorandum accompanying the draft law does not contain specific explanations on the rationale for the tax on the net interest and commission income of certain financial institutions.

3 See Opinion CON/2022/36. All ECB opinions are published on EUR-Lex.
4 See Opinions CON/2023/9, CON/2023/26, CON/2023/35, CON/2023/42, CON/2023/45 and CON/2024/35.
5 See paragraph 1.1 of Opinion CON/2022/36.

3. Monetary policy context

3.1 The euro area inflation rate reached record levels over the course of 2022 and posed significant challenges for the conduct of monetary policy. Guided by its primary objective of maintaining price stability, the ECB has taken determined action to ensure a timely return of inflation to the 2 % target over the medium term. Key ECB policy rates were raised by a cumulative 450 basis points between July 2022 and September 2023, with the intention of dampening demand and guarding against the risk of a persistent upward shift in inflation expectations. Following a period of rate stabilisation, key interest rates have now been reduced in view of the ongoing disinflationary process.

3.2 Credit institutions play a special role in ensuring the smooth transmission of monetary policy measures to the wider economy, and thus in respect of the impact of monetary policy on aggregate demand and ultimately on inflation rates. The ECB's observations as to the impact of the draft law on monetary policy are set out below.

3.3 It is important to keep in mind that monetary policy decisions always have some distributional implications. Changes in monetary policy have effects on incomes and on the profitability of credit institutions. In this context, maintaining an adequate capital position helps credit institutions to avoid abrupt adjustments in their supply of credit to the real economy[6].

3.4 Credit institutions’ net interest income tends to increase on impact as policy rates increase. Obviously, this effect occurs at a faster pace the greater the weight of short-term or variable interest rate loans within the balance sheets of credit institutions. At the same time, however, the tightening cycle also typically results in lower lending volumes, higher costs of funding, eventual losses recorded in the securities portfolio and an increase in provisions owing to a potential deterioration of the quality of banks’ credit portfolio. The realisation of downside risks in that environment may significantly reduce the repayment capacity of debtors and translate into lower profitability of credit institutions. The net effect of tighter monetary policy on bank profitability may therefore be less positive, or even negative, over a longer time horizon[7].

3.5 ECB interest rate reductions will generally affect bank profit and balance sheet items with signs opposite to those discussed in paragraph 3.4 in respect of monetary tightening. The net effects on bank profitability of these reductions can also be positive or negative over different horizons of the easing cycle and vary as a function of the financial situation of the banking sector and macro-financial conditions.

3.6 While credit institutions’ net interest income currently remains robust, and the latest reductions in past and expected key ECB interest rates have led to its stabilisation, care should be taken to ensure that any measures adopted do not hamper the ability of credit institutions to maintain solid capital bases and adequate provisions for impairments and ultimately transmit monetary policy decisions to firms and households.

6 See paragraph 2.2 of Opinion CON/2022/36 and paragraph 2.2 of Opinion CON/2023/9.

7 See paragraph 3.4 of Opinion CON/2023/26 and paragraph 3.4 of Opinion CON/2023/35.

4. Financial stability context

4.1 As indicated above, the ECB has previously opined on draft legislation introducing levies or taxes applicable to credit institutions in several Member States[8]. It has recommended that a clear separation is necessary between the extraordinary account created out of tax proceeds and the general budgetary resources of a government to avoid their use for general fiscal consolidation purposes. The ECB has also underscored that imposing a special tax on the banking sector could reduce credit institutions' ability to build additional capital buffers, as such measures reduce retained earnings, thereby weakening the banking sector's resilience to economic shocks. It is recognised, however, that concerns regarding the resilience of the banking sector could be partially alleviated by introducing or strengthening capital buffers. In parallel, these taxes could have adverse economic effects by limiting credit institutions' ability to provide credit, and potentially contributing to less favourable terms for customers on loans and other services[9]. Maintaining a sound capital base is essential for credit institutions to fulfil their role as credit intermediaries within the economy.

4.2 As noted in paragraph 3.4, credit institutions may initially receive higher net interest income as interest rates increase but increasing interest rates can also contribute to a higher cost of funding and eventual losses on outstanding bank securities portfolios. Moreover, in a long-term perspective, higher interest rates may negatively impact borrowers' financial situations, thereby increasing credit risk and reducing bank profitability. When it comes to the draft law, the ECB notes, as set out in paragraph 1.4, that due to the extraordinary deduction mechanism based on financial institutions' profitability, financial institutions would not be affected by the tax if they record net losses. If profits are positive but lower than the 0,7 % ROA threshold, the extraordinary deduction decreases as financial institutions' profitability increases towards the prescribed ROA threshold. In these circumstances, the tax would still negatively affect the capacity of financial institutions to maintain a solid capital position or to rebuild buffers. Moreover, in periods of high profitability, the deduction would not operate, and thus the tax would limit the capacity to accumulate buffers against future negative shocks.

4.3 Due to the heterogeneous nature of such taxes in relation to the banking sector, the tax, similarly to other taxes of this kind across the Union, may lead to fragmentation in the European financial system and impair the level playing field across the banking union. Furthermore, the application of a progressive scale may give rise to competitive asymmetries based on bank size.

4.4 In the light of the above, and given that the draft law will apply over the next three years, the ECB reiterates the need for continued monitoring of its implications from a financial stability perspective, particularly regarding the potential long-term adverse effects on the resilience of the banking sector and the possibility of market distortions. As noted in previous opinions[10], the ECB recommends a thorough analysis detailing the specific impact of the tax on credit institutions' longer-term profitability and capital base, access to funding, potential impact on liquidity, the provision of new lending and

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8 See Opinions CON/2016/1, CON/2019/18, CON/2019/40, CON/2019/44, CON/2020/28, CON/2022/36, CON/2023/9, CON/2023/26, CON/2023/35, CON/2024/4 and CON/2024/35.

9 See paragraph 3.2.2 of Opinion CON/2010/62, paragraph 2.1 of Opinion CON/2011/29, paragraph 3.1 of Opinion CON/2022/36, paragraph 3.1 of Opinion CON/2023/9 and paragraph 4.1 of Opinion CON/2023/26.

10 See paragraph 3.4 of Opinion CON/2022/36, paragraph 3.7 of Opinion CON/2023/9 and paragraph 4.6 of Opinion CON/2023/26.

competition conditions in the market.

5. Considerations relating to the prudential supervision of credit institutions

5.1 The ECB understands that the tax would, as a practical matter, mostly apply to credit institutions directly supervised by the ECB within the framework of the Single Supervisory Mechanism.

5.2 Despite the extraordinary deduction on the amount of the liquid amount of the tax (based on net profitability), the basis on which the tax would be established does not take into consideration the full business cycle and does not include, inter alia, operational expenses and the cost of credit risk. As a result, the amount of the tax may not be fully commensurate with the profitability of a credit institution and its capital generation capacity. As a result of the general application of the tax, credit institutions that have lower solvency positions or challenging capital projections could become less able to absorb the potential downside risks of an economic downturn. This latter risk is further exacerbated by the progressive character of the applicable tax rate as the liquid base increases. This could lead to a situation where certain credit institutions with lower net profitability (or even a loss following the deduction of credit losses) end up paying tax at a higher effective rate, since the implicit assumption in the tax calculation that credit institutions with a higher liquid base have higher net profits is not necessarily always true.

5.3 The ECB understands that the draft law leads to the recognition of the expenses resulting from the tax in 2024 eroding the profitability and market profile of the relevant credit institutions, assuming the temporary levy on credit institutions' windfall profits is also recorded in 2024. The ECB recommends analysing the accounting effects of the tax in order to avoid unintended consequences for credit institutions' solvency and competitive positions.

This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 17 December 2024.

[signed]

The President of the ECB

Christine LAGARDE