

Brexit

Italian financial transaction tax implications: the market making exemption

This briefing note outlines the impact of Brexit for UK based market makers and their ability to take advantage of the Italian financial transaction tax exemption

I. Overview of the relevant provisions

I.1 The Treasury Decree

1. Based on Art. 16(3)(a) of the Treasury Decree¹, transactions in chargeable equities and chargeable derivatives executed in the exercise of market making activities, as defined in Art. 2(1)(k) of the Short Selling Regulation² (the **SSR**) and in the ESMA Guidelines³, are exempt from IFTT (the **IFTT MM Exemption**).
2. Under Art. 16(3)(a), first paragraph, of the Treasury Decree (the **General Rule**), the IFTT MM exemption applies provided that the person acting as market maker has been granted the exemption under Art. 17(1) of the SSR by the competent authority (the **SSR Exemption**)⁴. Subject to the remarks in 3 below, being entitled to the SSR Exemption is, therefore, a requirement for purposes of the IFTT MM Exemption.

¹ Decree 21 February 2013, as amended and restated from time to time.

² Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32012R0236>.

³ Guidelines on the exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps (ESMA/2013/74): <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-74.pdf>.

⁴ The wording of the Treasury Decree is not entirely accurate, since the competent authority in Art. 17(5,8) of the SSR is not formally granting the exemption under Art. 17(1) of the same regulation. Rather, that exemption is available to entities that have notified in writing the competent authority that they intend to make use of it, on condition that the competent authority has not prohibited the use of such exemption. Indeed, as stated in para. 58 of the ESMA Guidelines, “*the use of the exemption is based on the requirement for notification of the intent. It is not an authorization or a licensing process*”.

3. A specific procedure is contemplated for those countries to which the SSR is not directly applicable and, hence, the “authorization” under Art. 17(1) of the SSR is not available. Indeed, Art. 16(3)(a), second paragraph, of the Treasury Decree (the **Special Rule**) states that in these instances:

the person acting in the course of market-making activities is entitled to the exemption, provided that such person has submitted a specific application to CONSOB according to the procedures that will be set out in a regulation to be issued by this public authority; the applicant shall in any case prove to comply with the same requirements and conditions provided for in the above [Short-Selling] Regulation and [ESMA] Guidelines. CONSOB, on the basis of the information that it has received, confirms the satisfaction of the prescribed requisites [i.e. compliance with the requirements and conditions under the SSR and the ESMA Guidelines], within the deadline that will be set out in a forthcoming regulation issued by this same authority. CONSOB shall retain the right to request additional documentation; in this case, the statutory deadline period starts again from the reception of the above documentation

In this respect, the IFTT Decree includes a specific tax rule on the equivalence of third country venues, which addresses the fact the Commission has not yet issued any equivalence declarations for purposes of the SSR⁵. Indeed, the same Art. 16(3)(a), second paragraph, of the Treasury Decree, states that, pending the issuance by the European Commission of the above-mentioned equivalence declarations, for purposes of the IFTT MM exemption under the Special Rule:

regulated markets and multilateral trading facilities are deemed to be equivalent, provided that they are:

- authorized and supervised by a national public authority with which CONSOB has concluded a bilateral cooperation agreement, as identified in the specific section of the CONSOB website⁶; or*
- authorized and supervised by a national public authority with which CONSOB has concluded a multilateral cooperation agreement, as identified in the specific section of the IOSCO website⁷, provided that they are established in states and territories with an adequate exchange of information with Italy⁸; or*

⁵ See Section I.2 below.

⁶ See <http://www.consolb.it/web/area-pubblica/cooperazione-internazionale>.

⁷ See <https://www.iosco.org/about/?subSection=mmou&subSection1=signatories>.

⁸ The jurisdictions that allow an adequate exchange of information with Italy for tax purposes are listed in the Ministerial Decree of 4 Septembre 1996. The list was significantly broadened by the Ministerial Decree of 9 August 2016 which added 50 additional jurisdictions (including Bermuda, the Cayman Islands, Hong Kong, Liechtenstein, Saudi Arabia and Switzerland) and grants the Italian authorities the right to remove from the list those countries that repeatedly do not comply with their exchange of information obligations.

– recognized by CONSOB under Art. 70(1) of the Italian Finance Code, based on the list published on the CONSOB website⁹.

4. CONSOB adopted the regulation referred to in Art. 16(3)(a), second paragraph of the Treasury Decree, with Resolution 2 October 2013.n. 18663¹⁰ (the **Consob Regulation**), which replaces and supersedes the previous Resolution 13 March 2013, n. 18494:

- (i) the Consob Regulation governs the application for the purposes of the IFTT MM Exemption that needs to be made by market makers established in non-EU/EEA jurisdictions under the Special Rule, and also includes the form to be filed with CONSOB for that purpose (the **Form**);
- (ii) the Form shall be sent, together with all the required annexes, either by registered email to consob@pec.consolb.it or by registered letter to Consob , Markets Division, Post-Trading Office, Via G. B. Martini 3, 00198 Rome. The Form and the annexes must be anticipated by email to shortselling-service@consob.it;
- (iii) Consob shall reply to the applicant within 30 days from the receipt of the Form. In the event that Consob requires additional documentation, the 30-day period begins to run from the receipt of that documentation. In its response (which is also communicated to the Minister of Economy and Finance), Consob will indicate whether, on the basis of the information submitted by the applicant, the latter satisfies the requirements and is therefore eligible for the IFTT MM Exemption;
- (iv) it is clearly stated in the Consob Regulation that the application to Consob (a) is not deemed to be a notification for purposes of the SSR Exemption and (b) cannot be made by firms that carry out market making activities, as defined in the SSR, on an EU regulated market / MTF or on a trading venue of a third-country, the regulatory and supervisory framework of which has been declared to be equivalent by the European Commission based on Art. 17(2) of the SSR. These firms fall within the scope of the General Rule and, accordingly, can benefit from the IFTT MM Exemption provided that they have made a valid notification to the competent regulator for purposes of the SSR Exemption and are entitled to that exemption.

I.2 The SSR and the ESMA Guidelines

⁹ See <http://www.consolb.it/web/area-pubblica/mercati-esteri/#accordi>. The list only includes venues in Switzerland (SIX Swiss Exchange) and the United States (CBOT, CME-Globex, NYSE Liffe, ICE Futures U.S., NYMEX and COMEX). The Treasury Decree makes reference to Art. 67(2) of the Italian Finance Code. Due to subsequent changes, the reference is now Art. 70(1) of the same code.

¹⁰ See <http://www.consolb.it/documents/46180/46181/d18663.pdf/1d0c1fc7-3a61-4dc1-b854-5331e36d1f80>.

1. The SSR requires information on significant net short positions in shares to be notified to the competent authorities or disclosed to the market and imposes restrictions on naked short selling in shares. However, under Art. 17 of the SSR, the requirements concerning notification or disclosure of significant net short positions in shares and the restrictions on uncovered short sales in shares do not apply when these transactions are performed in the course of market making activities. The SSR Exemption in Art. 17 allows market makers to build net short positions, without having to notify the relevant competent authorities and disclose to the public, and to enter into short sales without having coverage for them. The SSR exemption applies only to those transactions that are essential in order to perform market making activities as defined in Art. 2(1)(k) of the SSR. All other trading activities conducted by a market maker (and, in particular, proprietary trading) are subject in their entirety to the prohibitions and transparency requirements of the SSR.

2. Market making activities are defined in Art. 2(1)(k) of the Short Selling Regulation as:

the activities of an investment firm, a credit institution, a third-country entity, or a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC which is a member of a trading venue or of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2) where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:

(i) by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;

(ii) as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;

(iii) by hedging positions arising from the fulfilment of tasks under points (i) and (ii)

3. As clarified in para. 19 of the ESMA Guidelines, to qualify for the SSR Exemption, market making activities have to be undertaken, by dealing as principal in a financial instrument in any of the two capacities and related hedging activities specified in Art. 2(1)(k), whether on or outside a trading venue, by the following entities:

a. an investment firm which is a member of a trading venue; or

b. a credit institution which is a member of a trading venue; or

c. a third-country entity which is a member of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission under Art. 17(2)¹¹; or

d. a third country entity which is member of a trading venue in the European Union; or

iv. a firm as referred to in point (l) of art. 2(1) MiFID I¹², which is a member of a trading venue

4. Starting from an analysis of the definition of market making activities contained in Art. 2(1)(k) of the SSR conducted by the Commission Legal Services, ESMA clarified in its Guidelines that the market making activity is determined on a per-financial instrument basis and subject to various conditions, including being “*a member of the market on which [the entity] deals as a principal in one of the capacities defined in paragraph 11 above, in the financial instrument for which it notifies the exemption*”¹³ (the **Membership Requirement**)¹⁴. Five competent authorities (including the FCA and

¹¹ Based on Art.17(2) of the SSR the Commission may adopt decisions determining that the legal and supervisory framework of a third country ensures that a market authorised in that third country complies with legally binding requirements which are equivalent to those laid down by relevant EU provisions. In particular, the same Art. 17(2) states that “*the legal and supervisory framework of a third country may be considered equivalent where that third country's: (a) markets are subject to authorisation and to effective supervision and enforcement on an ongoing basis; (b) markets have clear and transparent rules regarding admission of securities to trading so that such securities are capable of being traded in a fair, orderly and efficient manner, and are freely negotiable; (c) security issuers are subject to periodic and ongoing information requirements ensuring a high level of investor protection; and (d) market transparency and integrity are ensured by preventing market abuse in the form of insider dealing and market manipulation*”. The equivalence assessment is designed to ensure that the third country trading venue of which the market maker is a member complies with legally binding requirements equivalent to the rules which apply to trading venues in the EU, including in relation to venue supervision and transparency, market abuse, issuer disclosure and transaction reporting. The Commission has not published any equivalency declarations so far (it published a few equivalence declarations in December 2017, but they should be relevant for MiFIDII purposes only).

¹² These are firms which provide investment services and/or perform investment activities consisting exclusively in dealing on own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets or which deal for the accounts of other members of those markets or make prices for them and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such firms is assumed by clearing members of the same markets.

¹³ See para. 20 of the ESMA Guidelines. In essence, the ESMA Guidelines list three preconditions for purposes of the SSR Exemption: (i) being a member of the market on which the firm (ii) deals as principal in one of the capacities listed under the definition of market making activities, (iii) in the financial instrument for which it notifies the exemption. According to ESMA's current interpretation, membership should be considered in relation to the trading venue on which the financial instrument subject to the SSR Exemption is traded; therefore, market making activities in relation to pure OTC instruments cannot benefit from the SSR Exemption.

¹⁴ For a detailed overview of the SSR Exemption and IFTT MM Exemption, see:

<http://www.klgates.com/files/Publication/c2e0cfa1-0a02-4034-b4d3->

BaFin) have reported that they were not complying with certain provisions of the ESMA Guidelines as they disagreed with the interpretations therein contained. This was the case in particular for the Membership Requirement. Differently from those disagreeing regulators, the Italian authorities (Consob and Bank of Italy) have stated their intention to comply in full with the ESMA Guidelines¹⁵.

II. Brexit - Availability of the SSR Exemption and of the IFTT MM Exemption

II.1 Introduction

1. On the assumption that the UK will no longer be a member of the EEA post-Brexit, the question that arises is whether it will continue to be possible for a UK based market maker (**UK-MM**), which may be a member of a UK venue (e.g., the LSE) and/or of an EU trading venue (e.g., the Italian MTA), to be entitled to the SSR Exemption and to the IFTT MM Exemption.
2. Based on the ESMA Guidelines (and pending possible amendments to the SSR Exemption and, in particular, to the “membership requirement”, as suggested by the same ESMA in its technical advice to the Commission¹⁶) the market maker must be a member of a trading venue (i.e. an EU regulated market or MTF) or of an “equivalent” market in a third country, where the (Italian) shares are admitted to trading or traded and where it conducts (at least part of) its market making activities.
3. Post Brexit, a UK-MM would become a third country entity.
4. If the UK-MM is a member of a UK market (e.g., the LSE) where the Italian shares are admitted to trading or traded and where it performs (at least part of) its market making activities:

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¹⁵ See Bank of Italy/CONSOB joint communication concerning the transposition of the Guidelines issued by AESFEM (ESMA), concerning the exemption for market making activities and primary market operations under Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swap: <https://www.bancaditalia.it/compiti/sispaga-mercati/short-selling/normativa/2013-06-Comunicazione-congiunta-BI-Consob.pdf> (the document is available in Italian only). The communication highlights some of the main issues in the ESMA Guidelines and provides operational guidance on the procedure to be followed for their application in Italy. CONSOB and Bank of Italy clearly make reference, in their joint communication, to para. 20 of the ESMA Guidelines, where it is stated that an entity can benefit from the SSR exemption provided that it is a member of the market on which it deals as principal in one of the relevant capacities (liquidity provision, client facilitation and related hedging) in the financial instrument for which it notifies the exemption.

¹⁶ See Final Report - Technical Advice on the evaluation of certain elements of the Short Selling Regulation (ESMA70-145-386): https://www.esma.europa.eu/sites/default/files/library/technical_advice_on_the_evaluation_of_certain_aspects_of_the_ssrr.pdf.

- (i) the SSR Exemption should remain available provided that the UK legal and supervisory framework is declared equivalent by the Commission pursuant to Art. 17(2)¹⁷ of the SSR or in the context of the Brexit arrangements¹⁸;
- (ii) the IFTT MM Exemption should remain available. Indeed:
 - (a) if the UK legal and supervisory framework is declared equivalent and, hence, the SSR Exemption remains available, the General Rule in Art. 16(3)(a), first paragraph, of the Treasury Decree applies;
 - (b) if the UK legal and supervisory framework is not declared equivalent and, hence, the SSR Exemption is no longer available, the Special Rule in Art. 16(3)(a), second paragraph, of the Treasury Decree should apply. Accordingly, the UK-MM should be entitled to make the application IFTT MM Exemption filing the Form with Consob.

4. If the UK-MM is a member of an EU trading venue (e.g., the Italian MTA) where the Italian shares are admitted to trading or traded and where it performs (at least part of) its market making activities, both the SSR Exemption and the IFTT MM Exemption should remain available. In this scenario, however, one would need to assess the existence of any MiFID II implications / restrictions on the UK-MM's ability to trade within the EU.

¹⁷ See footnote 11. above. As noted therein, the Commission has not published any equivalency declarations so far.

¹⁸ In the context of the Brexit arrangements, it may be agreed that the UK legal and supervisory framework is deemed to be equivalent for the purpose of the SSR.

Italian Financial Transaction Tax Exemption Application Form for Market Making/Liquidity Enhancement activities carried out on non-EU markets

Section I BENEFICIARY OF THE EXEMPTION	
<i>Status [1]</i>	<i>Full Company Name</i>
<input type="checkbox"/> credit institution <input type="checkbox"/> investment firm <input type="checkbox"/> other	<i>BIC code (if available)</i>
<i>Full Address</i>	<i>Postal Code</i>
<i>City</i>	<i>State</i>
Section II LEGAL REPRESENTATIVE	
<i>Full Name</i>	
<i>Telephone number</i>	<i>Fax number</i>
<i>Email address</i>	<i>Capacity in which acting</i>
Section III CONTACT PERSON (if different from the legal representative)	
<i>Full Name</i>	
<i>Telephone number</i>	<i>Fax number</i>
<i>Email address</i>	<i>Capacity in which acting</i>
Section IV DECLARATION-REQUEST OF THE BENEFICIARY OR LEGAL REPRESENTATIVE	

The undersigned (name of the declaring person)

DECLARERES:

A. That the person indicated as beneficiary of this application performs:

- market making activity on a non-EU market, complying with the requirements provided for by Regulation (EC) No 236/2012 of the European Parliament and of the Council of 14 March 2012 and by document ESMA/2013/158 "Final Report on Guidelines on the exemption of market-making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and of the Council on short selling and certain aspects of Credit Default Swaps" of 1 February 2013, with the exception of the requirement of being a member of and carrying out the activity on a market in a non-EU country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2) of the aforesaid Regulation 236/2012; and/or
- liquidity enhancing activity on the basis of an agreement directly entered into with the company issuing the share, complying with the requirements provided for by accepted market practice called "Liquidity Enhancement Agreements" approved by CONSOB, with the exception of the requirement of carrying out the activity on a EU regulated market or multilateral trading facility.

B. That the activity is performed/carried out on a non-EU market which is:

- authorized and supervised by a National Public Authority, with which CONSOB has entered into a bilateral cooperation agreement, as identified in the relevant section of the CONSOB website (http://www.consolb.it/main/consob/cosa_fa/impegni_internazionali/accordi.html); or
- authorized and supervised by a National Public Authority, with which Consob has entered into a multilateral cooperation agreement, as identified in the relevant section of the IOSCO website (http://www.iosco.org/library/index.cfm?section=mou_siglist), provided that they are established in States and territories included in the list referred to in the Ministerial Decree issued pursuant to Article 168-bis of TUIR [2]; or

recognized by CONSOB pursuant to Article 67, paragraph 2, of the TUF, as of the list published on the CONSOB website (http://www.consol.it/main/mercati/regolamenti/mercati_accordi.html).

C. That the person indicated as beneficiary of this application:

- is recognized as market maker by the market on which the activity takes place;
- is not recognized as market maker by the market on which the activity takes place;
- has entered into an agreement with the issuer for providing liquidity on the financial instruments;
- has not entered into an agreement with the issuer for providing liquidity on the financial instruments.

D. That the activity consists in (*only if the exemption for market making activities compliant with Regulation (EC) No 236/2012 is sought*) :

- posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
- as part of its usual business, fulfilling orders initiated by clients or in response to clients' requests to trade;
- hedging positions arising from the fulfilment of tasks under the previous points.

E. That the attached excel file contains the following information, for each financial instrument on which the market making/liquidity enhancing activity is carried out:

1. Type of exemption sought (market making/liquidity enhancement);
2. Name of the financial instrument;
3. Type of financial instrument (i.e. shares or a category between those listed in Part 1 of Annex I of the Commission Delegated Regulation (EU) No 918/2012);
4. Name of the underlying Italian share;
5. ISIN code of the underlying Italian share;
6. Name of the non-EU market on which the instrument is traded and the activity is carried out;
7. Name of the non-EU country where the market mentioned in the field before is located;
8. Contractual agreement with the issuer (yes/no);
9. Recognition by the market as market maker (yes/no);
10. Type of activity within the three typologies provided in article 2(1)(k) of EU Regulation no. 236/2012 (only if the exemption for market making activities compliant with Regulation (EC) No 236/2012 is sought).

F. That the information contained herein is true and that he commits himself to communicate any new circumstances that may impede the application of the tax exemption or that he is no longer willing to benefit from the tax exemption.

Signed

Date

(DD-MM-YYYY)

Capacity in which acting

Attachments:

1. Excel file with the list of financial instruments (see point E);
2. Copy of ID document;
3. Copy of the agreement with the issuer / recognition from the market (where available).

Footnotes

[1] "Credit institution" and "Investment firm" mean any undertaking whose head office is outside the Community and whose functions correspond to those of the Community credit institutions or investment firms as defined in the relevant EU legislation.

[2] "TUIR" means Testo Unico delle Imposte sui Redditi (Legge 22 dicembre 1986, n. 917). The list referred to in the Ministerial Decree issued pursuant to Article 168-bis is published on the website of Agenzia delle Entrate at the following webpage: <http://www.agenziaentrate.gov.it/wps/content/Nsilib/Nsi/Documentazione/Fiscalita+internazionale/White+list+e+Autocertificazione/Elenco>