

Italian FTT - the draft Decree: do we now have all the answers?

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The Italian Minister of Economy and Finance (“MEF”) issued a draft Decree (the “Decree”) on 1 February 2013 relating to the implementation of the Italian Financial Transaction Tax (“FTT”) provisions included in the 2013 Stability Law. The Decree provides further guidance on the scope of the Italian FTT, the computational basis and the practicalities as to who will be responsible for collecting the tax and reporting to the Italian tax authorities.

Overview

The Decree provides further detail in connection with all three elements of the Italian FTT:

- a) The Securities Tax;
- b) The Derivatives Tax; and
- c) The High Frequency Trading (“HFT”) Tax.

The additional guidance contained in the Decree will help financial institutions in their implementation of the Italian FTT. However, there are still a number of areas (e.g. the detailed information on what financial institutions will need to report) on which further guidance will be required ahead of the 1 March 2013 start date for the Securities Tax and HFT Tax on securities, and 1 July 2013 for the Derivatives Tax and HFT Tax on derivatives.

Key issues

A detailed analysis of the Decree follows later in this Newflash. Some of the key points to note are as follows:

- The Decree confirms that the Securities Tax covers not only listed shares issued by companies with a market capitalisation in excess of €500m, but also any shares in Italian companies which are not listed. A list of securities has been issued by the Italian authorities, including those listed securities which are not within the

scope of the tax.

- The market-maker exemption appears to cover the same categories of transactions as those included within the market-maker exemption under the French FTT. However, for the Italian FTT there is an additional requirement for the institution to be approved by the relevant authority as a market-maker under the EU short-selling regulations (Regulation (EC) No 236/2012). Where the institution is not approved by the relevant authority, an application can be made directly to the Italian Securities Exchange Commission (“CONSOB”).
- The Securities Tax follows a similar model to the French FTT in that, for securities admitted to a central securities depository, the transfer of ownership occurs on the settlement date.
- The Italian FTT applies different rates of tax to those transactions executed on a regulated market or Multilateral Trading Facility and to those executed outside of such markets. The Decree provides more detailed guidance as to how the net buying position should be calculated for each taxpayer by the party responsible for paying of the tax.

- The liable party under the Italian FTT is the purchaser for the purposes of the Securities Tax, or both counterparties for the purposes of the Derivatives Tax. However, similarly to the French FTT, the obligations for collecting and reporting the tax have been placed primarily with the banks, nominees and investment companies involved in the execution of transactions.
- The netting provisions allow a purchaser to net positions across multiple financial intermediaries. However, in order to do this, the taxpayer must identify a single intermediary who will be responsible for accounting for and reporting the FTT and all intermediaries must agree to facilitate this.
- The Derivatives Tax includes within its scope derivative financial instruments to the extent that the underlying or reference value is comprised primarily (more than 50%) of taxable instruments as of the date of entry into the contract.

Next steps

A revised version of the Decree is expected to be issued by the MEF in the coming days. Further guidance will follow from the Italian Tax Authorities later this year regarding the reporting obligations.

What you should do now

The respective start dates are 1 March 2013 for the Securities Tax and HFT Tax on securities, and 1 July 2013 for the Derivatives Tax and HFT Tax on derivatives.

Given the short timeframe until the commencement date for the Securities Tax and the HFT Tax on securities, the current focus for brokers and custodians should be on developing the necessary systems and process changes required to identify

taxable and exempt transactions and to collect the tax where appropriate.

Many of the brokers and custodians who are impacted by the Italian FTT have already undertaken significant work in making the necessary IT systems and process changes required for the implementation of the French FTT.

Given there are many areas where the Italian regime for the Securities Tax mirrors that for the French FTT, the key to an efficient implementation will be to focus on the areas that are different between the regimes and to adapt the approach adopted for French FTT.

For the Derivatives Tax, it will be important to understand who will be responsible for collecting the tax and for fulfilling the reporting obligations once these are defined. For OTC derivatives it is likely that other financial institutions (e.g. asset managers) will also be required to meet some of these obligations. Further clarity is required from the Italian Tax Authorities in this regard before any implementation work can begin.

The following pages provide a more detailed analysis of the draft Italian rules on the FTT, for those with a specific interest in the implementation issues.

(a) The Securities Tax

1. Transfer of ownership

For shares, participating financial instruments and securities representing equity investments which are admitted to a central securities depository, the transfer of ownership takes place for the purposes of applying the FTT on the actual settlement date. The actual settlement date shall be interpreted as the date of actual registration of the transfer following the settlement of the transaction.

Alternatively, with the consent of the taxpayer, the liable party can assume the

contractual settlement date as the date of transfer of ownership.

In other cases, the transfer of ownership is to be determined by reference to the moment the transaction takes legal effect.

In the case of a conversion of bonds into portfolio shares, the transfer of ownership takes place when the conversion is effected.

The Decree also clarifies that an intermediary that buys in its own name but on behalf of another person shall not be treated as the purchaser.

PwC observation: The Italian model follows the approach adopted for French FTT purposes in treating the transfer of ownership as arising on the actual settlement date. The Decree provides an option to use the contractual settlement date. This also mirrors the French approach but can be invoked without the need for any election to be made.

2. Residence

The FTT applies to transfers of ownership of securities and other financial instruments that are issued by companies resident for tax purposes in Italy. The Decree clarifies that the residence shall be determined on the basis of the *registered office*.

3. Collective investment vehicles/SICAVs – carve-out

The transfer of ownership of units in collective investment vehicles (“OICR”), as well as of shares of open-ended investment companies (so defined “SICAVs”), shall not be subject to the FTT.

4. Value of the transaction

The value of the transaction shall be determined on the basis of the net daily balance. This must be calculated for each taxpayer by reference to the number of securities traded on the same day and relating to the same financial instrument. This calculation shall be made by the person liable for the payment of the tax as

defined under Article 19 of the Decree (i.e. the financial intermediary).

PwC observation: Following the comments received by various stakeholders, and also taking into account the provisions of the French FTT, intra-day transactions are only subject to the tax to the extent there is a net buying position at the end of the day.

5. Tax base

In order to determine the net daily balance, the financial intermediary must first calculate separately the number of purchases made on regulated markets or multilateral trading facilities (reduced FTT) and the number of purchases made outside of such markets (full FTT). These balances are added together and multiplied by the weighted average price of the purchases and total sales are deducted to determine the tax base.

PwC observation: Purchases and sales which are excluded or exempt from the FTT (see below) are not relevant for purposes of calculating the tax base.

Based on the Decree, the weighted average price to be applied to the net balances should be calculated based on all taxable purchases (both on regulated markets and OTC). This weighted average price is then applied to the total net balance for transactions carried out on both regulated markets and OTC.

6. Netting across intermediaries

The Decree provides the option for the taxpayer to request that the calculation of the net daily balance be performed on the basis of all intra-day purchases and sales involving the same security across all financial intermediaries. The benefit of this approach is that it enables the taxpayer to maximise the netting available in computing the tax base for the Securities Tax. However, in order to apply this approach, the taxpayer must appoint a single intermediary to collect and pay the

tax, and all intermediaries involved must agree to the request.

The single net balance may also be calculated by the Centralised Management Company (“CMC”) referred to in Art. 80 of the IFC upon request of the intermediaries liable for the payment of the tax. In this case, the CMC will report to the single intermediary liable for the payment of the tax the net balance of the taxpayer.

PwC observation: All the intermediaries involved must accept this option for netting transactions; further, the transmission of the information necessary for the calculation of the single tax base from each intermediary will be needed in order for this approach to be followed. Whether intermediaries will be willing to apply this approach in practice given the additional operational complexities remains to be seen.

7. Regulated market or multilateral trading facility

The tax rate is halved for transactions that take place on a regulated market or multilateral trading facility. The Decree clarifies that these markets also include those established in non-EU countries, to the extent they are in regular operation and authorised by a National Public Authority with State supervision, including those recognised by CONSOB (the public authority responsible for regulating the Italian securities market) under Art. 67, paragraph 2 of the IFC. Under any circumstances, for a market to be eligible, it needs to be established in countries with agreements allowing the exchange of information (the “white-list countries”).

PwC observation: In order to avoid potential violations of Art. 63 of the Treaty on the Functioning of the European Union (“TFEU”), which prohibits all restrictions on the movement of capital between Member States and third countries, the definition of regulated market and multilateral trading facility shall also include non-European markets to the extent they fulfil the prescribed

requirements and are established in countries with agreements allowing the exchange of information (i.e. included in the white list).

8. Tax rate for transactions undertaken on both regulated markets and OTC

Where the tax base is determined as the net balance between: (1) purchases and sales executed on regulated markets or multilateral trading facilities; and (2) purchases and sales OTC, the tax rate will be equal to the weighted average of the rates computed by reference to the number of securities purchased.

(b) The Derivatives Tax

1. Scope

The Decree confirms that derivatives are subject to the tax to the extent that the underlying or reference value consists of Italian securities which are within the scope of the Securities Tax (see above) and that those securities represent more than 50% of the market value of the taxable instruments as at the date of the entry into the contract.

Further, the Decree points out that structured bonds or bonds with embedded derivatives are out of scope.

2. Notional value

The Decree clearly defines the notional value of the contract on the basis of which the FTT is determined.

Guidance is provided in case the notional value is amplified due to the structure of the transaction.

Further, if the notional value of the derivatives is also represented by instruments other than shares, participating financial instruments and securities representing equity investment, the notional value will be determined taking into consideration only such instruments.

(c) HFT Tax

1. Scope

The definition of HFT is consistent with that provided by the law: it includes transactions (i) generated by a computer algorithm that automatically determines the decisions relating to the sending, modification and cancellation of orders and of the relevant parameters and (ii) occurring at intervals not exceeding half a second.

PwC observation: The Decree makes a slight departure from the text of the law in providing a couple of exemptions to the HFT (all the other exemptions do not apply). First, transactions for the performance of the market-making activity are not considered HFT, provided that orders placed by such algorithms come from specific desks devoted to market-making activities. Second, no HFT is triggered by the fulfillment of clients' orders to comply with best execution requirements (for example, under the Mifid directive).

HFT tax is triggered when - in any trading day – the ratio of [cancelled and modified orders / overall orders] exceeds 60 per cent. The value of any cancelled and modified orders exceeding such 60 per cent threshold is subject to the 0.02% tax.

(d) General provisions

1. Exclusions

The Decree confirms that the FTT does not apply to transfers under death or gift deed, primary market transactions (including the conversion of bonds in newly issued shares), securities lending and transactions on “small caps”.

PwC observation: The Decree also provides that the issue of a convertible bond is not a taxable event; this was not so clear from the law text, as a convertible bond incorporates an option and as such could have been subjected to the derivatives FTT. Moreover, the decree also

highlights that, although “small caps” must be both listed and with a market capitalisation below half a billion €, the exclusion also applies when such stocks are traded OTC.

2. Exemptions

The decree confirms that the EU, central banks and supranational entities are not subject to the tax. As to the ethical and socially responsible exemption, it is actually twofold, applying to both (i) the trading of financial instruments which are objectively ethical and socially responsible and (ii) any transaction entered into by an ethical and socially responsible portfolio management (whose features will be fine-tuned by a future decree).

PwC observation: This exemption applies to both the eligible party that is exempted and the counterparty to the transaction. However, the Decree does not provide guidance for situations in which the counterparty for these purposes cannot be clearly identified.

Market makers and liquidity providers are exempted. In order to qualify as a market maker, a financial intermediary should either already qualify as such under the EU short-selling regulation, or have its status acknowledged by CONSOB (i.e. the Italian Securities Exchange Commission), which shall establish a procedure in this respect.

In order to qualify as such, liquidity providers must have a direct contract with the issuer.

PwC observation: The market making activity includes not only placing explicit bid / ask quotes, but also systematically fulfilling orders for bid / ask figures internal to the spread; moreover, also the hedging of any resulting imbalance is covered by the exemption.

The Decree provides for a wide reading of the exemption for pension funds, interpreting the law as extending this exemption not only to Italian pension funds, but also to European ones, to the

extent they are subject to supervision. This expansion of the exemption was necessary in order to avoid the Italian FTT being targeted by an EU infringement procedure, claiming that European pension funds were discriminated with respect to Italian ones.

PwC observation: Many foreign pension funds (especially Dutch ones) do not invest directly in Italian shares, but join forces with other similar entities in Pension Funds Pooling Vehicles; the decree acknowledges such situations and provides that indirect investments are also exempted, to the extent the subject matter vehicles are participated solely by eligible pension funds.

3. *Small caps*

CONSOB (i.e. the Italian Securities Exchange Commission) is appointed with the task of surveying the market capitalisation of Italian companies listed in an Italian market and to provide the Ministry of Finance with a list of eligible companies (i.e. those with a market capitalization of less than €500m, in the month of November of the previous year).

Italian companies listed (solely) in a foreign regulated market can also qualify as small caps, but the burden is upon them to establish their status, by providing the Ministry of Finance with the proper documentation in this respect (e.g. market certification).

PwC observation: The status of newly listed companies is somewhat unclear: it looks as if they should not be able to benefit from the exemption, until the time has passed to allow them to have established a suitable track record.

For the first year, the small cap list is provided as an annex to the Decree.

PwC observation: The list included as an annex to the Decree does not include any company which is not listed in Italy: either all Italian companies listed in foreign markets only have a market

capitalisation of more than half a billion euro, or those Italian companies listed in foreign markets with a capitalisation below such threshold are being discriminated against.

4. *Payment and reporting of the FTT*

The FTT payment and reporting obligations fall on the banks, custodians and other financial intermediaries who are involved in the execution of the transactions referred to above.

PwC observation: A procedure shall be established, under which it will be possible to centralise reporting requirements to the Centralised Management Company (i.e. Montetitolì). Foreign intermediaries can either route all compliance through their Italian permanent establishment, or appoint an Italian fiscal representative.

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