3 April 2020

Global Tax Alert

Bank of Italy and CONSOB expand SSR market making exemption for OTC trades: impact for Italian FTT

Executive summary

The exemption from the Italian financial transaction tax (IFTT) is strictly linked to the concept of market maker as defined by the European Union (EU) Regulation no. 236/2012 on short selling (SSR) and as specified by the European Securities and Markets Authority (ESMA) in its Guidelines dated 2 April 2013 on *Exemption for market making activities and primary market operation under Regulation (EU) 236/2012 on short selling and certain aspects of CDS* (ESMA Guidelines).

At an Italian level, the Bank of Italy and CONSOB fully implemented the ESMA Guidelines through their joint statement dated 5 June 2013 (2013 Joint Statement).

On 4 November 2019, the Italian Regulators provided an update on this topic publishing a new joint statement (2019 Joint Statement) where they announced that they would expand the market making exemption (MME) activity to apply to over-the-counter (OTC) trades (which according to the ESMA Guidelines are excluded from the MME).

Such a new approach may entail relevant consequences for IFTT purposes. Indeed, in light of the 2019 Joint Statement, it seems that the MME may be applicable when the relevant financial instrument is traded OTC. For this

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purpose, taxpayers should submit an advanced ruling query with the Italian tax authorities in order to obtain a binding interpretation about the extension of the MME to OTC trades.

Detailed discussion

Background of the Italian market making exemption

ESMA, in order to ensure a level playing field, consistency of market practices and convergence of supervisory practices across the EU with respect to the MME prepared the Guidelines in 2013.

ESMA, in doing so, asked the national competent Authorities to notify whether they had decided to implement such Guidelines at a national level. In such respect, the Italian Authorities fully adopted them (*i.e.*, with no exemptions). Conversely, other national Authorities, like those of Germany and France implemented the Guidelines with certain restrictions. As reported above, the full implementation of the Guidelines in Italy occurred through the 2013 Joint Statement. Furthermore, in such document the Bank of Italy and CONSOB highlighted, specifically with respect to OTC trades, that, in line with the ESMA Guidelines, financial instruments not traded on a trading venue cannot benefit from such exemption.

Bank of Italy and CONSOB joint statement dated 4 November 2019

ESMA Guidelines require that the MME be applied only to market making activities carried out in financial instruments that are, jointly: (i) in-scope products; and (ii) traded on a trading venue, provided that the market maker is a direct member of that trading venue and carries out, at least in part, the market making activity on that trading venue.

The interpretation of the SSR provided by the ESMA Guidelines, specifies that the trading venue membership requirement under (ii) above, prevents entities which carry out market making activities entirely outside a trading venue from benefitting from such exemption.

In the 2019 Joint Statement, the Italian Regulators reversed their previous approach on OTC trades. In this respect, they reported, *inter alia*, that there is still no harmonization across Europe with regard to the MME activities, since national competent authorities of the main countries of the EU do not entirely comply with the ESMA Guidelines (*e.g.*, Germany, France and, recently, Spain) since they allow the use of MME for activities which do not comply with the abovementioned trading venue membership requirement.

Against this background, the Italian Regulators believe that their previous approach exposes Italian entities to an unlevel playing field compared with other European entities, and therefore decided to cease the application of the Guidelines specifically with respect to the so-called trading venue membership requirement.

Therefore, market makers subject the supervision of Bank of Italy and CONSOB will be able to benefit from the MME activities in shares, sovereign bonds and financial instruments linked to shares and sovereign bonds, even when such market making activities are carried out entirely outside a trading venue.

Consequently, as reported in the 2019 Joint Statement, market making activities in financial instruments traded OTC only, like sovereign credit default swaps and equity contracts for difference, will be able to benefit from the exemption.

IFTT consequences

The MME definition set out in the IFTT framework makes reference to the SSR and ESMA Guidelines. In particular, there is not a "tax definition" of MME for IFTT purposes. Therefore, IFTT is not applicable only to the extent that all the prerequisites of the MME as provided by the relevant regulatory provisions are deemed to be met.

In this context, the MME is applicable when the qualified financial intermediary deals as principal in financial instruments in the following capacities:

a) 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.
b) As part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade.
c) By hedging positions arising from the fulfilment of tasks under points (a) and (b).

The MME is an exemption given on an individual financial instrument basis. The assessment of the conditions required to qualify for the market making exemption must be done with respect to each individual financial instrument.

For SSR and ESMA Guidelines (and, as a consequence, for IFTT) purposes, MME may be applicable only to the extent that the relevant financial instrument is listed in a regulated market or in a multilateral trading facility.

Recently, for the reasons explained above, the Italian Regulators with the 2019 Joint Statement, extended the possibility to apply the MME with respect to financial instruments traded OTC. Therefore, the Italian regulatory definition of the MME now seems to be wider than that provided by SSR and ESMA Guidelines. In this context, even if the relevant provisions of the IFTT framework continue to make reference to the SSR and ESMA Guidelines, it may be possible to argue that, under a dynamic interpretation of such provisions in light of the 2019 Joint Statement, MME may apply also to financial instruments traded OTC also for IFTT purposes.

Therefore, in contrast to the past, the hedging of financial instruments not listed in regulated markets/MTFs may be included in the scope of the MME for IFTT purposes. However, lacking any official guidance, taxpayers should submit an advanced ruling query with the Italian tax authorities in order to obtain a binding interpretation about the extension of the MME also to OTC trades.

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EYG no. 001755-20Gbl

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