

FINANCIAL TRANSACTION TAX

(DERIVATIVE INSTRUMENTS AND OTHER SECURITIES)

Unless otherwise specified, legal references are made to the Decree of the Minister of Economy and Finance of 21 February 2013.

Article 7 - Objective scope

- 1) Do variance swaps, volatility swaps, correlation swaps, dividend swaps, index dividend futures and credit default swaps fall within the scope of application of the tax?**

Derivatives whose underlying assets are represented by indices, measures, returns on shares or indices to which the measures or returns refer fall within the objective scope of application of the tax. In this regard, it should be noted that dividend swaps, credit default swaps and index dividend futures are not subject to FTT, since the scope of the tax is considered to include the financial derivatives where the underlying is represented by measures or returns on shares or indices, when such measures are related to the value of the shares (which is their market price), so that the change in the said price results in a change of the underlying measure or return.

- 2) Please clarify whether the scope of the tax referred to in paragraph 492 also covers the transactions in derivative financial instruments and transferable securities referred to in Article 7(1) having shares of the "undercapitalized" companies in the list referred to in Article 17 as underlying assets.**

The law provides that the tax shall apply to derivative financial instruments having as their underlying primarily one or more financial instruments referred to in paragraph 491 or the value of which depends primarily on these financial instruments; the same is envisaged for securities that are subject to IFTT pursuant to paragraph 492. Therefore, the tax shall not apply to financial derivatives whose underlying assets are shares or other participating

financial instruments or securities representing equity investment issued by entities with average market capitalisation of less than EUR 500 million.

- 3) **With reference to the transferable securities referred to in Article 7(1)(b), please clarify if the tax is due in the following cases: a) repurchase of securities by the issuer; b) cash settlement when due, on predetermined exercise dates, or an early termination by the issuer.**

The repurchase of securities by the issuer, under the provision of Article 15(1)(c) is not subject to tax only if the repurchase is connected to the following cancellation of the securities purchased, otherwise the tax is applied to the repurchase of such securities. The cash settlement when due or on predetermined exercise dates, and the early termination by the issuer are not taxed. Such exclusion applies for both counterparties.

- 4) **Pursuant to Article 7(2), for financial derivative instruments traded on regulated markets or in multilateral trading facilities, a review to assess that they have as underlying primarily Italian shares (hereinafter referred to as “predominance test”) should be carried out at the time of issue. If the derivative instrument is not traded on such platforms, then predominance should be assessed each time a transaction is concluded. Please clarify whether this provision also applies to the transferable securities referred to in Article 7(1)(b) that are traded on a secondary market.**

The provision included in Article (7)(2) does not draw a distinction between the two categories of instruments indicated in paragraph 1 of the same Article. Thus, also for the transferable securities referred to in Article 7(1)(b), predominance should be assessed by the person obliged to pay with reference to the date of issuance if the transferable securities are traded on regulated markets and in multilateral trading facilities, or with reference to the date on which the transaction on these instruments was concluded in the other cases.

- 5) **Since the process for issuing transferable securities referred to in Article 7(1)(b) may involve persons other than the issuer before placement of such securities on the market, are these stages subject to tax?**

According to Article 15(1)(c), the issue of such transferable securities is excluded from FFT as for securities representing shares or participating financial instruments. Such exclusion

involves all stages needed for the placement of securities to the final investor. This exclusion applies also to any subsequent increase in the issue amount.

- 6) **Please clarify whether, regardless of the modalities governing the delivery (e.g. the so-called assignment), the purchase of shares, participating financial instruments and securities representing equity investment against physical delivery as a result of the exercise of derivative financial instruments and transferable securities falls within the scope of the tax.**

The tax is payable on the transfer of ownership of shares, participating financial instruments and securities representing equity investment, including those resulting from the settlement of the financial instruments referred to in paragraph 492. Therefore, any case of delivery of the securities referred to in paragraph 491 resulting from the settlement of the financial instruments referred to in paragraph 492 falls within the scope of the tax, regardless of the delivery modalities.

- 7) **In accordance with Article 7(2), for the financial instruments and transferable securities referred to in paragraph 492, not traded on regulated markets or multilateral trading facilities, a predominance test should be carried out each time a transaction is concluded. According to Article 8, the time of conclusion is to be understood as the time of subscription, negotiation or modification of the contract. Where the underlying value changes according to market trends, thus affecting the economic result of the financial instrument or transferable security, please clarify whether the predominance test should be carried out also in the absence of variations of its parties and of maturity.**

In the case above, no event requiring the test under Article 7(2) has occurred, since the counterparties have not modified any of the essential components of financial instruments and transferable securities referred to in Article 8. Contrariwise, when one of the variations under Article 8 occurs, the predominance test under Article 7(2) must be conducted. With reference to the variation of the notional value, and solely for the purposes of such test, the latter should not be carried out where the notional value is modified upwards or downwards, without changing the proportions, in terms of quantity, of the shares or securities making up the index or basket.

- 8) **Please clarify the rules for the application of the tax in the case of contracts that regulate exchange derivative financial instruments ("swaps") on a dynamic basket of shares or securities or indices and which, in other words, provide for the possibility to modify the notional value of the underlying and/or the basket composition (e.g. so-called "equity portfolio swap", "index basket swap" etc.).**

In such cases, the tax is applied separately to the positions of each share or security referred to in paragraph 491, considering each position as the underlying asset of a separate financial instrument. Accordingly, the tax base shall be calculated, at each trading date, for each counterparty and for each security making up the basket, distinguishing between positions involving "long" exposures and those involving "short" exposures; there shall be no compensation either between "long" and "short" positions, or between positions on different securities.

The tax base for each counterparty and for each security is therefore equal to the sum of the absolute value of the notional amount for each transaction .

Given that for the tax purposes there shall be a separate calculation of the tax base for each share underlying the derivative financial instrument, Article 7(2) shall not apply to the contracts in question; therefore, it is not necessary to carry out the predominance test on the basket of financial instruments referred to in paragraph 491.

The above explanations do not apply to the above transactions where they refer to a "static" basket, not providing for the possibility to modify the basket composition; the latter shall instead undergo the predominance test provided for in Article 7(2).

- 9) **The second part of Article 7(1)(a) - "financial derivative instruments the value of which depends primarily on one or more of these financial instruments" - and of Article 7(1)(b) - "securities giving rise to a cash settlement determined mainly by reference to one or more securities referred to in paragraph 491" - do not seem to exclude from the list of taxable financial derivative instruments those whose underlying assets are ETFs or, more generally, shares in CIUs, which primarily invest in shares subject to FTT. Please clarify whether the conclusion of such contracts shall be subject to FTT.**

Where financial derivative instruments or transferable securities whose underlying assets are ETFs or CIUs which invest primarily in one or more of the financial instruments referred to in paragraph 491, it is deemed that the value of the financial derivative instruments or transferable securities, as provided for by Article 7(2), depends primarily on one or more of

the financial instruments referred to in paragraph 491 in which the ETF or CIU invest; this is why the financial instruments or transferable securities in question are subject to the tax referred to in paragraph 492.

Article 9 - Notional value

- 10) Stock futures: pursuant to provisions in paragraph 1, No 2, the notional value is given by the number of standard contracts multiplied by the price of the futures by the standard contract size. Please clarify the definition of "standard contract size".**

The definition on the website of *Borsa Italiana* (Italian Stock Exchange) within the contractual specifications of the financial instrument, provides that the size of the contract is equal to the "product between the future price and the minimum unit of transaction". However, if such a definition would apply in the calculation of the notional value for the purposes of applying the tax, the effect would be to charge the price twice, amplifying erroneously the value of the tax base. Therefore, it is deemed that the proper procedure for calculating the tax base is that of considering for contract size only the "minimum unit of transaction of the securities underlying a single futures contract". Accordingly, for equity futures, the notional amount is given by the product between the number of standard contracts purchased/sold multiplied by the price of the future for the single standard contract multiplied by the number of shares ("minimum unit of transaction") underlying each single contract (standard contract size). The tax base so established (and the related tax) shall be calculated for each individual transaction concluded during the trading day; the conclusion occurs at the time of negotiation of each order to buy or sell.

- 11) Stock options (paragraph 1, No 4): a clarification similar to that relating to equity futures is also required for stock options for which the notional value for applying the tax is defined as the number of standard contracts multiplied by the contract price (premium) multiplied by the standard contract size.**

The explanatory memorandum states that *a choice was made to consider the premium as the notional value for financial instruments, whether derivative or not, which have an optional component (...) because that is always known (...)*. The premium alone does not constitute the notional value of the contract but must be multiplied by the minimum unit of transaction of the underlying as well as by the number of standard contracts purchased/sold.

As for futures, also for options the tax base so determined (and the related tax) shall be calculated for each individual transaction concluded during the trading day, the conclusion occurs at the time of negotiation of each order to buy or sell .

12) OTC Options: please clarify if in paragraph 1, No 5 this category encompasses all OTC options.

The answer is yes. The category "other options" includes all OTC options and other listed options not specifically classified in the categories of options referred to in paragraph 1, numbers 3 and 4.

13) Forward on an index (paragraph 1, No 6): please clarify the method of calculating the notional value. Since the forward is the OTC equivalent of the future, by analogy it is plausible to assume:

- **"forward unit value of the index": the monetary value of the numerical entity of the index at maturity;**
- **"number of units of the index under the contract": how many times the index is bought/sold in the contract.**

An official confirmation seems appropriate.

As regards forward contracts on indexes, it is deemed that the forward unit value of the contract is equivalent to the conventionally fixed multiplier (*e.g.* EUR 5 per index point for the FTSE MIB index) multiplied by the number of the forward index units to which the contract relates (as to the above example, if the September 2013 index value is equal to 17,280 points, the notional unit value of the contract is EUR 86,400).

14) Residual category of financial derivative instruments (paragraph 1, No 12): the reference to securities giving rise to cash settlement identifies a residual class of derivatives in relation to the others. The "securities" referred to here seem to be securitized derivatives, but it is difficult to identify specifically which are the derivatives that fall within that classification. Please provide therefore further examples besides that mentioned in the explanatory memorandum to the decree.

The securities referred to in paragraph 1, No 12 are the same as those mentioned in TUF in Article 1(1-bis)(d) that fall within the definition of financial derivative instruments provided for by TUF in Article 1(3).

- 15) **Please clarify whether the early termination of a derivative contract entered into outside of the regulated markets (*over the counter*), for the full amount of the notional value, or part thereof (so-called *full or partial early termination*), constitutes a modification of the contract and therefore is subject to tax.**

Where the early termination of the derivative contract (so-called *full or partial early termination*) is envisaged by the contract as a right of the parties, the exercise of this right does not imply a modification of the contract pursuant to Article 8 and, therefore, is not subject to tax. On the other hand, where the early termination of the contract, for the full amount of the notional value, or a part thereof, occurs for reasons not covered in the contract, such termination is a conclusion of the transaction pursuant to Article 8 of the Decree.

- 16) **Derivative contracts called "swaps" may provide that, during the life of the contract, at fixed intervals, the counterparties pay the sums based on the performance of the underlying asset, without making any changes to the underlying asset itself (so-called "reset" of the contract). Please clarify whether these payments imply a modification of the contract and, consequently, the application of the tax.**

A "reset" of the contract resulting from a mere advance of the exchange of flows between counterparties to avoid excessive exposure to counterparty risk is not a pre-requisite for the application of the tax. It is deemed that no tax event arises where the sum of the overall flows received/paid by each counterparty on the instrument (so-called swap overall "performance") does not change as a result of the reset, and where the dates and modalities of the reset are predetermined.

- 17) **Please clarify if the calculation of the notional value referred to in Article 9 is always applied to warrants, covered warrants and certificates regardless of their settlement method (cash settlement or assignment of the underlying).**

For the purposes of the application of Article 9 the settlement method of derivatives is irrelevant. The notional value of the transactions regarding transferable securities as of Article 9(9), (10) and (11), to be used to determine the tax to apply to such transactions, does not vary if the transactions on such transferable securities are settled by cash or with the assignment of the underlying.

- 18) Futures not traded on regulated markets or multilateral trading facilities: please clarify the relevant taxation methods according to the table annexed to the law provision.**

In the case in which futures are not traded on regulated markets and multilateral trading facilities, but have the same characteristics as to uniformity and predetermination of contract conditions regarding object, underlying, denomination, maturity and settlement method, as well as the impossibility for the parties to change them, the tax applicable is the one indicated in the first or second line of table 3 annexed to Law No 228 of 24 December 2012, depending on the fact the futures are on relative indexes, yields or measures or on shares. Such taxation method applies only if the above-mentioned instruments are offered by the intermediary to the majority of customers.

In all other cases, *i.e.* in case of over-the-counter forward contracts which are not standardised according to the requirements referred to above, the tax indicated in the third line of the above-mentioned table is applied.

Article 15 – Exclusions from the tax

- 19) Article 15(1)(g) envisages the exclusion from the tax for the transactions referred to in paragraph 492 performed between companies either linked by a control relationship as of Article 2359(1)(1) and (2), and under the Civil Code or controlled by the same company. Article 8 provides for the taxation of contract modifications deriving from contract variations by the parties. Please clarify if the exemption for such transactions involves or not the tax applicable to the counterparty of the transaction.**

The exclusion laid down for intra-group transactions applies to any transaction referred to in paragraph 492. Given that it is an objective transaction-related exclusion, the tax is not applicable to counterparties not belonging to the group.

Article 19 – Payment of the tax

- 20) In the case of derivative financial instruments traded on regulated markets, the functions of order execution (performed by a so-called executing broker) are distinct from those performed by the person in charge of the clearance of orders (so-called**

clearing broker). Please clarify which of the two parties is responsible for paying the tax.

In such cases, considering the particular functioning of the derivatives market, which entrusts the clearing broker with the final allocation to the customer of contracts in connection with settlement, it is deemed appropriate to attribute to the latter the responsibility of the payment, being the clearing broker at any rate involved in the execution of the transaction. Similarly, whenever the settlement implies physical delivery of the underlying asset, the clearing broker is also responsible for the payment of tax pursuant to paragraph 491.

- 21) In case of the exercise of derivative financial instruments or securities (as defined in Article 7 of the Decree) involving the delivery of shares, participating financial instruments or securities representing equity investment, where the buyer of the shares or securities is a person other than banks or investment firms and delivery is made by a bank, an investment firm or other person in charge of clearing not carrying out any intermediation activity in the performance of the transaction, please clarify which person is required to pay the tax.**

The person liable for payment of the tax, if no intermediaries "are involved in the execution of the transaction", coincides with the taxpayer. In the above cases, where the delivery of shares or securities is carried out directly by the clearing house (for listed instruments) or by persons referred to in Article 19(1) of the Decree, whenever they only deal with the delivery of shares or securities, the taxpayer is the person liable for payment of the tax.

If, however, the person making the delivery coincides with the person in charge of clearing of derivatives or transferable securities against which the securities are delivered (see question No 20.), the latter shall be liable for payment of the tax.