Tax Lab

Tax Implications Financial Markets Regulation

Amsterdam, March 2015
Agenda

1. Drivers of new demands
2. Regulations with a Tax impact
3. Practical considerations
1. Drivers of new demands

The ever-increasing disclosure, transparency, accountability, and regulatory sanctions, and thus of an ever-increasing need for effective governance and proactive compliance risk management.
How did we get here?

The long journey from the financial crisis

In September 2009, G20 Leaders committed to a comprehensive programme of regulatory reform to tackle the problems laid bare by the worst financial crisis in decades.

“Systemically important financial firms should develop internationally-consistent firm-specific contingency and resolution plans.”

“All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties.”

“We have agreed to improve the regulation, functioning, and transparency of financial and commodity markets to address excessive commodity price volatility.”

“We commit to developing by end-2010 internationally agreed rules to improve both the quantity and quality of bank capital and to discourage excessive leverage.”

“We are committed to maintain the momentum in dealing with tax havens, money laundering, proceeds of corruption, terrorist financing, and prudential standards.”

“Reforming compensation practices to support financial stability”

G20 priority: “time for implementation”

Growth agenda
G20 is shaping the financial services industry

**Financial Stability Board**
- Global recommendations including Living wills (RRP) and SIFI and G-SIFI requirements

**Dodd-Frank**
- OTC derivatives
- Proprietary trading
- Living wills for ‘too big to fail’
- Basel III requirements
- Hedge funds
- Compensation
- Securitisation
- Consumer/investor protection

**FATCA**
- Disclosure of US persons and assets to IRS or 30% withholding tax

**Current US Requirements**
- Sarbanes Oxley
- SEC Acts
- CFTC

**Basel II en III/Solvency II**
- Core Tier 1 and Tier 2 requirements
- Capital and capital surcharges
- Liquidity and liquidity coverage ratio
- Conservation and countercyclical buffers
- Leverage ratio
- NSFR
- Stress testing

**Global Regulatory Reform**
The G20 commitments have led to a host of new regulatory requirements for financial institutions worldwide

**Dutch Regulation**
- Act on Financial Supervision
- Regulations on the Supervision of the Conduct of Financial Enterprise
- Anti-Money Laundering and Anti-Terrorist Financing Act
- Dutch Pension Act
- Dutch Data Protection Act
- Dutch Corporate Governance Code

**IFRS Convergence**
- FASB/IASB convergence
- IFRS 9 impairment
- IFRS 9 hedging
- Asset and liability offsetting
- Single control model

**EU Tax**
- Bank Levy (UK, France, Germany)
- Financial Transaction Tax

**EU Regulation**
- AIFMD
- MiFID/MiFIR
- UCITS
- CRD
- SLD
- MAD/MAR
- EMIR
- PRIIPs
- DGSD
- SSM/SRM
- CSD
- SEPA

**EU Tax**
- Bank Levy (UK, France, Germany)
- Financial Transaction Tax

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EU Financial Regulation: structural reform

- Risk Behavior
  - Remuneration
  - Governance, fit & proper test key personnel
  - Algorithmic trading requirements
  - Risk governance: obligatory key function

- Financial solidity
  - Enhanced own fund & buffer requirements
  - Enhanced capital quality requirements
  - Enhanced liquidity requirements
  - Leverage

- Systemic Stability
  - Central clearing OTC derivatives
  - SSM & SRM, structural reform Banks
  - Regulation AIF & MMF
  - Reporting requirements to CA/TR

- Investor protection
  - Depositary UCITS, AIF
  - Product intervention
  - Transparency (trading, product)
  - Inducements
# EU Financial Regulation: Impact

Regulatory overhaul of four different segments

## Banking
- CRD IV/CRR
- Bank Recovery and Resolution Directive
- Proposal on banking structural reform
- Revised Deposit Guarantee schemes
- Payment Services Directive

## Insurance & Pensions
- Solvency II
- IORP
- Insurance Mediation Directive (IMD)

## Markets, IP & Infrastructure
- MiFID II/ MiFIR
- MAD/MAR/Benchmarks
- CRA
- EMIR
- CSDR
- PRIIPS/KID

## Investment Management
- UCITS V
- AIFMD
- MMF
- European Venture Capital Funds
- European Long Term Investment Funds
- Social Entrepreneurship Funds
The next phase: growth agenda

1. **Securitisation**
   Develop proposals to encourage high quality securitisation and free up bank balance sheets to lend.

2. **Review Prospectus Directive**
   Review the Prospectus Directive to make it easier for firms, particularly smaller ones, to raise funding and reach investors cross border.

3. **Credit Information SME**
   Start work on improving the availability of credit information on SMEs so that it is easier for investors to invest in them.

4. **European Private Placement Regime**
   Work with the industry to put into place a pan European private placement regime to encourage direct investment into smaller businesses.

5. **European Long Term Investment Fund**
   Support the take up of new European long term investment funds to channel investment in infrastructure and other long term projects.

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I believe we should complement the new European rules for banks with a **Capital Markets Union**. To improve the financing of our economy, we should further develop and integrate capital markets. This would cut the cost of raising capital, notably for SMEs, and help reduce our very high dependence on bank funding.” Jean-Claude Juncker

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2. Regulations Tax-impacting

Many upcoming regulations have an impact on your business activities or the way business activities are structured, hence impacting the Tax position.
Common Reporting Standards (CRS)

**Main Points**
- OECD Global Standard for automatic exchange of financial account information
- Automatic exchange of information with other jurisdictions on annual basis
- Financial information to be reported:
  - Investment income (including interest, dividends, income certain insurance contracts)
  - Account balances and sales proceeds from financial assets
- Reporting obligation financial institutions: banks, custodians, brokers, certain collective investment vehicles and certain insurance companies
- Reportable accounts: individuals and entities (including trusts and foundations)
- To be implemented in EU Directive

**Impact**
- CRS relies significantly on local AML/KYC requirements and self-certification. Validation?
- Continuous monitoring of tax residency (former as well as current)
- Reporting thresholds (FATCA vs CRS)?
- Do privacy issues justify a delay of providing information to local tax authorities?
- Process and system changes required to meet obligations under CRS
EMIR

European Market Infrastructure Regulation
EMIR

Main Points

• Clearing obligation for standard OTC derivatives through authorized Central Counterparties (CCP)
• Obligation of all European OTC derivative transactions to be reported to trade repositories (TR), accessible to supervisory authorities and ESMA (financial stability)
• Classes of OTC derivatives eligible for clearing, authorized by ESMA (published in register)
• Non-financial counterparties of OTC derivatives in scope of Regulation in case of non-hedging activity and exceeding clearing threshold
• Obligatory risk mitigation procedures for non-cleared OTC derivatives entered into by financial or non-financial counterparties
• Authorization requirements for CCP (e.g. capital requirements, conflicts of interest, continuity, client segregation, margin requirements, investment policies and default fund)

More stringent clearing and reporting obligations, but also steps that should be taken to mitigate risk

Key technique identified to mitigate risk is the compression of trades/portfolios

VAT treatment of this is not currently covered by VAT legislation or guidance Dutch tax authorities, this raises a number of questions regarding the exact nature of such supplies, the liability and the basis for valuation
CRD IV
CRD IV

Main Points

- Enhanced capital requirements and quality of capital
- Harmonized liquidity requirements:
  - liquidity coverage requirements (LCR): liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of thirty days
  - net stable funding requirement (NSFR): long term obligations are adequately met with a diversity of stable funding instruments under both normal and stressed conditions
- Publication of leverage ratio: capital divided by total exposure measure and shall be expressed as a percentage and possible maximum leverage ratio in future
- Remuneration policy consistent with effective risk management and does not encourage risk-taking (principles for variable remuneration)
- Country-by-country reporting: annual disclosure of (consolidated) financial information by Member State and by third country in which it has an establishment
- Diversity in Board composition


- CRD/CRR Published
- Application CRR/CRD
- Dutch implementation rules
- Stable funding requirements
- Phase in LCR
- Phase in capital buffer

Tax Impact

- Each credit institution and investment firm is required to disclose financial information on a country-by-country basis. OECD CBCR is a separate regime with different rules.
- The following (audited) information should be disclosed: Name(s), nature of activities and geographical location, Turnover, Number of employees on a full time equivalent basis, Profit or loss before tax, Tax on profit or loss, Public subsidies received.
- In the Netherlands "tax on profit or loss" is interpreted as accrued tax, corresponding with the tax on profit or loss as determined in the annual accounts.
- From 2015 tax disclosure is i.p. audited. Dry runs to test availability of information have already taken place.
PRIPS/KID

Packaged Retail Investment Products – enhanced retail investor protection
PRIPS/KID

Main Points

- Scope new regime: investment funds, insurance-based investment products, retail structured securities and structured term deposits, offered to retail investors
- Introduction of Key Investor Document (KID):
  - Short information document that will provide information about the features, risks, and costs of investment products, suitable for average retail investor
  - Standard structure to create cross-sector comparability of products
  - KID may replace UCITS Key Investor Information Document and the ‘financiële bijsluiter’ in the future

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<th>November 2010</th>
<th>July 2012</th>
<th>July 2014</th>
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<td>Consultation legislative steps for PRIPs initiative</td>
<td>Proposal regulation Key Information Document</td>
<td>Mandate EIOPA for delegated acts concerning KID</td>
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Tax Impact

- KIID (UCITS only) should not only include practical information such as name depository, statement liability manager but also information that affects the yield on the product. Therefore, if a product’s value depends on tax attributes this should be disclosed. If tax changes for existing products KID would probably have to be updated
- If providers of PRIPS are a target group for a certain investment product: are you facilitating PRIPS producers in their compliance obligations?
- Under PRIPS no need to disclose the ‘general’ tax treatment in the hands of investors. This is a MiFID II requirement.
MiFID II

Markets in Financial Instruments Directive: Investment services, trading platforms & Investor protection
MiFID II

Main Points

- Introduction of trading obligation ‘OTC’ derivatives eligible for clearing under EMIR and sufficiently liquid
- Introduction of Organised Trading Facility (OTF) for non-equity instruments
- Harmonised EU regime non-discriminatory access to trading venues and central counterparties (CCPs)
- Pre- and post-trade transparency regime to include non-equity instruments (but waivers)
- Position-limits for commodity derivatives
- Product monitoring & intervention
- Algorithmic trading: risk controls, business continuity and market making
- EU wide prohibition on inducements in case of independent investment advise
- Information on all costs investment services and financial instruments

Tax Impact

- Monitoring of tax attributes of offered products (changing tax laws and offered products). Avoid products from being banned
- Duty of care to ensure product is appropriate to the needs of the client. What about suiting his tax position?
- Third country providers may be forced to open a local branch, which should meet certain conditions as put forward by and subject to authorization by the Member State
FTT

Financial Transaction Tax
FTT

Main Points

- Proposal to introduce an FTT on the basis of a common set of rules by, at present, eleven EU Member States.
- Aim of proposal:
  - avoiding fragmentation of the EU’s internal market due to individual Member States adopting their own national FTTs
  - ensuring financial institutions making a fair contribution to the costs of the recent crisis and ensuring a level (tax) playing field with other sectors
  - discouraging certain types of economically inefficient transaction.

Market Impact

- The EC envisages a neutral treatment of savings and retirement products. However, it has not guaranteed a uniform treatment of these products, if they come from different EU Member States:
  - The proposal does for example not address any differences under national law of the Member States, like differences in the legal ownership of the assets held by way of UCITS and AIF
  - The proposal distorts the competition in the EU, because only 11 out of 28 Member States will be part of the FTT zone

Tax Impact

- If a transaction falls within the scope of the EU FTT, FTT is in principle payable by the financial institutions, such as banks, investment funds and stockbrokers, that are involved in the transaction. (whether this is carried out on their own behalf or on behalf of a client)
- The current proposal proposes two rates, one for derivatives transactions (0.01%) and one for other financial transactions (0.1%). These are minimum rates, participating Member States are allowed to impose higher rates
- Also financial institutions in a non-FTT country may be subject to FTT: how significant is this exposure for your firm? Will you be able to recharge additional costs of FTT to clients under existing contracts/products?
- Opportunity: structure investments via Dutch entities to stay outside FTT levy?
Solvency II
Solvency II

Introduction of enhanced risk based regulatory framework, applicable to direct life and non-life insurance undertakings, based on three “Pillars”:

- **Pillar 1**: requirements regarding technical provisions, valuation of asset & liabilities, solvency capital requirements (SCR) and quality of own funds (tier 1,2,3)
- **Pillar 2**: requirements for risk management, governance (e.g. fit & proper requirements key personnel), strict outsourcing requirements, introduction of “Own Risk and Solvency Assessment” (ORSA)
- **Pillar 3**: Obligatory publications (annual report of solvency and financial condition) and reporting to regulators

**Main Points**

- Deferred tax assets may be included for Pillar I purposes
- Stress testing and effects on deferred tax assets
- Process of measurement, valuation and stress testing
- Demonstrate that tax risks are adequately managed and understand how it affects Pillars I and II

**Tax Impact**

- November 2009: Framework directive
- December 2013: Postponement application
- April 2014: Publication Omnibus Directive (role EIOPA)
- January 2015: Publication delegated act
- July 2015: Publication Technical Standards
- January 2016: Application Dutch implementing rules
Recovery and Resolution Planning
Recovery and Resolution Planning

**Main Points**

- Obligatory recovery and resolution plans on how to deal with situations which might lead to financial stress or the failure of a bank
- Early intervention powers by supervisors
- Bank resolution tools to preserve critical banking functions, preserve value and minimize costs to State and taxpayer (e.g. bail-in)
- Enhanced cooperation between national authorities in case of cross-border banking group failure

**Tax Impact**

- Putting critical infrastructure (e.g. payment systems, retail functions and critical staff) in a separate legal entity from the bank. Avoid profit recognition for CIT purposes and need to create new intercompany transactions including adequate transfer pricing
- Effect if no VAT grouping
- Interaction with ring-fencing – possibility of ring-fenced banks being outside the VAT group due to the fact that, keeping them in, could create a tax exposure under the joint and several liability principle. Same is true for CIT fiscal unity

**Timeline**

- **November 2011**: FSB publishes 'Key Attributes' of resolution regime
- **June 2012**: EC proposal for Directive
- **February 2014**: Expected finalisation of RRD
- **January 2015**: Application BRRD in national Law
- **January 2018**: Bail-in’ to enter into force
3. Practical considerations
Practical considerations

Liaise with internal Risk and Compliance teams, as regulation can lead to:

• Unforeseen consequences
• Increased data management and reporting
• Legal structure changes

Manage tax related implications by engaging with tax authorities at an early stage by:

• Seeking clearance
• Lobbying via industry bodies
• Awaiting DTA guidance

Remember... regulation generally takes precedence over tax, so opportunities to manage risk
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