
Consultation Response

Legislative reform of the Terminal Markets Order

12 September 2023

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the consultation on legislative reform of the Terminal Markets Order. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

We welcome the opportunity to respond to this Consultation on behalf of our members. The Terminal Markets Order (TMO) has historically and continues to be a valuable simplification legislative tool to aid the smooth operations of the commodities markets as well as combating VAT fraud. We are pleased that the TMO is being retained and the exploration to modernise the legislation and guidance to accommodate the digitalisation of how commodities are traded is long overdue.

We set out our responses to the questions in the consultation document below. We would be happy to provide further details or arrange a meeting to discuss our response, if that would be helpful.

We would suggest that once HMRC have had a chance to review all the responses to the consultation, a meeting is scheduled between HMRC and industry representatives to discuss next steps prior to the issue of a further consultation document or draft legislation.

Defining a recognised TMO commodity exchange or a recognised market association:

1. What are your views on removing the list of named markets which are in the current TMO legislation and replacing it with a definition of a recognised TMO commodity exchange or a recognised market association based on the suggested criteria?

A definition rather than a list of named markets and exchanges would be welcomed. However, the definition should be sufficiently wide to ensure there is symmetrical treatment of transactions between exchanges. Naming specific exchanges does mean that there will be a constant need to update the list. This does increase market uncertainty as there will be a natural time-lag in all markets participants becoming aware of any changes.

Although the TMO is unique to the UK and would have to be restricted, we assume territorially to exchanges established in the UK, due to reasons we outline further in our response. Consideration should be given to include TMO treatment to trades which may ultimately be executed and settled on a recognised exchange outside of the UK.

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We will be pleased to work with HMT/HMRC to produce a suggested criteria and definition of a qualifying exchange. Either way, we suggest that the territorial scope of the TMO be made explicit.

2. Are there any other criteria that could be used to define a recognised commodity exchange or a recognised market association for the purpose of the TMO?

As exchanges are the central counterparty with whom a member trades, executes, and settles there is considerable regulation which govern recognised exchanges. Consideration should be given to whether the FCA equivalent regulatory supervision could be built into any market criteria where relevant. It would be helpful to explicitly include foreign subsidiaries and branches of the exchange or association in the definition.

3. What are your views on the alternative approach, where the Government would maintain a list of exchanges/market associations in a VAT notice?

Our preference is for a principles-based approach. However, we think it would be helpful to have a non-exhaustive list of exchanges/market associations included in HMRC guidance. It would also be helpful to set out the criteria to determine which exchanges or market associations qualify for inclusion.

We understand that maintaining a list will have resource implications for HMRC and we would be happy to discuss how best the industry could support HMRC in this regard.

Defining a member of the market:

4. Do you agree that it would be helpful to define ‘persons ordinarily engaged with dealings on the market’?

Membership of recognised exchange/market associations do vary and thus it is important to contextualise any definition so that it is able to align and evolve as trading is increasingly technologically driven. The legislation therefore needs to ensure that a market member is broadly defined and encapsulates all categories of members.

A number of exchanges have members who are categorised. An exchange will typically have:

- Full Members – these are members who will have capability to clear and execute trades on the exchange.
- Associate Members – reduced entitlement and in some cases will not be able to clear trades on the exchange and will therefore have to use another Member who is able to do so.

For instance, London Metal Exchange has five categories of members and only some will have clearing rights. In practice this means that the trade when a client of a member who does not have clearing rights, the member will have to use the services of a clearing and execution member. In practice this means:

- There is a sale/buy between the Member and Clearing Member and simultaneously.
- There is a sale/buy between the Clearing Member and the Exchange

Since rights and obligations are created and transferred between members, what ordinarily on the outside looks like a single transaction can when viewed from a VAT lens be considered as a series of transactions. Thus, the definition should be sufficiently wide to ensure all transactions in the chain are covered otherwise VAT reporting obligations to account for VAT could arise.

5. Do you agree with the principles set out at paragraphs 2.15 and 2.16? If not are there any additional or different principles which the Government should consider?

Paragraph 2.15 does appear to contradict paragraph 2.9 and it may simply be a case of drafting. The words 'capable of physical delivery' seems to be omitted in 2.15. Assuming the wording has erroneously been omitted, the inclusion would be aligned.

The second principle referred in paragraph 2.16 should not be restrictive. All members and non-members are entitled to trade on the market. However only certain categories of members may clear and execute transactions on the market. For the reasons articulated in Q4 above, a restrictive interpretation would create an asymmetrical situation where there will be certain trades which are cleared on an exchange become subject to VAT. To ensure there is no confusion all transactions which involve a clearing and execution member should be covered by the TMO. To adopt a restrictive approach would create confusion and will be detrimental to the operation of the exchanges/markets. Moreover, services which are ancillary to the main commodities transaction (brokerage services as an example) should equally be covered and receive TMO treatment.

Although the TMO is territorially restrictive in that it is applicable to UK established exchanges/market associations, UK established businesses do trade futures and options contracts on other international exchanges. These exchanges will have similar membership structures as UK established exchanges. Members would advocate that HMT consider expanding the TMO remit to include trades between UK established business who enter and engage in transactions which are capable of physical delivery when they (the members/non-members) use a clearing and execution member of the requisite exchange is established in the UK.

The alternative would be to afford zero rating treatment to 'foreign' exchange transactions on the basis that the underlying product is a commodity which is stored outside of the UK and would have qualified for TMO treatment if the product was stored in a bonded warehouse in the UK. Underpinning all exchanged traded contracts, which are capable of physical delivery, is that the underlying commodities are stored in bonded warehouses or tax-free zones or equivalent regimes in the relevant jurisdiction. The imposition of indirect taxes other than when the commodities are taken out into free circulation would be disruptive to physical commodities trading.

6. What are your views on the alternative approach, where the Government would maintain a list of member classes entitled to trade under the TMO in a VAT Notice that would have the force of law?

This appears contrary to the principle-based approach that HMT/HMRC are advocating and would create issues and uncertainty. We are neutral to the proposal provided:

- There is consistency in the treatment between different exchanges.
- The list is updated on a regular basis.
- A broader definition encompassing more of what qualifies as a member is used which would negate the need to define specific member classes.

Defining qualifying transactions that fall under the scope of the TMO.

7. What are your views on the proposal to define the qualifying transactions that would fall under the scope of the TMO?

The globalisation of markets and trading of commodities means that UK established businesses will trade with both UK based market participants as well as overseas based counterparties. The TMO could be expanded and applied to trades between members and non-members established in the UK which are cleared and executed on recognised international exchanges.

In our view this expansion of the TMO would be revenue neutral as even if these trades were subject to VAT, the direct link aspects of the transaction would mean any VAT charged is fully recoverable. It would also reduce and eliminate fraud risk and importantly reduce the pressure on resources for both HMRC and taxpayers (e.g., aligning IT tax systems configuration and reduction of invoicing burden).

8. What are your thoughts on the proposed criteria that could be used as a basis for the definition of the qualifying transactions that would fall under the scope of the TMO?

We would welcome a very broad definition of qualifying transactions, including fundamentally going beyond exchange traded contracts and market associations to include bilateral Over the Counter (OTC) transactions between taxpayers. We recognise this may have an impact on other aspects of the VAT legislation including domestic reverse charge treatment of certain commodity asset classes but, as mentioned above it may reduce the burden for both HMRC and taxpayer alike.

We are concerned that principle 1 (bullet point one) of 2.21 as currently drafted, may restrict the application of the TMO as it currently stands. Currently the TMO legislation allows for the zero rating of a 'grant of a right,' and we would want to keep the legislation as currently drafted.

Given that 2.9 and 2.15 of this Consultation refer to contracts only being "capable of physical delivery" and "not going to actual physical delivery," clarification will be needed from HMRC on exactly what is meant in 2.22 where it states that the government does not intend to include transactions that are exclusively cash settled. HMRC need to also consider whether this includes those transactions scenarios that at the outset have the capability of delivery, with the intention of going to delivery, but that intention changes to cash settlement final position between the parties.

9. Do you think any other criteria should be included in such a definition?

Assuming HMT/HMRC accept our proposal outlined in our response to question 8 above, we consider that these are sufficiently broad to cover all eventualities. However, markets continue to develop and evolve and therefore any changes should be reviewed on a regular basis to ensure they remain 'fit for purpose.'

Additional considerations for HMRC may include:

- Issuing clear supportive guidance on common commodity transactions that do not qualify e.g., swaps, hedges other derivative transactions that fall outside the TMO in all cases, providing a clear rationale why they are transactions that do not qualify and their alternative tax treatment and VAT recovery treatments (i.e. not zero rated, but confirmation that these are exempt transactions).

We would advocate that the TMO should cover 'associated' commodities transactions. Examples of such transactions include clearing member fees, clearing exchange fees and brokerage fees.

- Qualifying and non-qualifying transactions should have a clear set of criteria as to who the 'transaction counterparties' are in the most common market traded transaction scenarios. This should reflect the use of clearing members and where the member themselves are regarded as a non-clearing member. This helps therefore define the transacting parties via market trades and assists the taxpayer meet invoicing requirements and determining the correct place of supply tax treatment when considering both taxable and exempt transactions.

Specifying the commodities traded on terminal markets

10. Do you foresee any issues with the intention to specify commodities within the legislative framework of the TMO?

We believe that all commodities which are traded on an exchange or by members of a market association should be automatically included. This approach would be consistent with the principle-based approach that HMT/HMRC are advocating, and it would remove and create a flexible trading environment for market participants to trade in the UK.

To have a list of qualifying products would mean HMT/HMRC having to establish governance on how to monitor new commodities which are being traded on exchanges or even in the OTC arena. To avoid uncertainty, HMT/HMRC would need to define in clear terms the criteria for a commodities inclusion into the TMO, which in turn could introduce the risk of judicial challenge.

A principles-based approach would eliminate the need for specifying commodities which should be covered by the TMO and remove the need to define the criteria for attaining TMO qualifications.

11. Do you agree with the principles that commodities should meet for the purposes of the TMO and that they are sufficient to prevent VAT fraud?

We have no objections to principle one in 2.26, and there is broad agreement that the commodities traded should be treated as taxable supplies.

Principles 2 and 3 introduce uncertainty as it is unclear what is meant by “standards that are recognised internationally” and “sufficiently high value and volumes” and it would be difficult to define this in practice. A broader approach to both principles should reduce fraud risk and auditing/inspection time by HMRC.

TMO and investment gold (Articles 4-7 of SI 1973/173)

12. Do you agree that Articles 4-7 of the TMO do not need revising? If you do not agree, please explain what changes may be required and why.

We agree that these articles do not need to be revised.

Future changes to the TMO

13. Do you think the proposed principle-based approach meets the objective of flexible legislation to incorporate future changes?

We would welcome a principle-based approach provided the definition is drafted widely. However, to supplement the approach with a defined list of exchanges, market associations and commodities covered by the TMO would be counter intuitive as it would bring into scope an element of uncertainty.

We consider that application of new, principles based legislation, aided by the publication of HMRC guidance containing (non-exhaustive) illustrations and examples (e.g., non-exhaustive lists of markets/example of commodities) would be welcome by the members.

14. Do you think there is an alternative method to make these changes?

If HMT/HMRC are of the view that there should be a list of exchanges, market associations and commodities, consideration should be given to establish a forum whereby regular exchanges can take place aimed at discussing and importantly informing HMT/HMRC of market trends and developments in the trading of new commodities (both physical and intangible). Having such a forum would increase the flow of information and enable HMT/HMRC to react more effectively to reduce risk of fraud but also ensure UK remains a competitive jurisdiction for commodity trading.

15. Does your business have any plans to change or consult on the operation of your commodity exchange or market association in the future? If so, can you provide an outline of these changes.

N/A

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