

Transferring of tax related information via T2S

1. Background

As a follow-up to the discussion in the November 2020 HSG meeting on the ideas to enforce / incentivise compliance with AMI-SeCo standards, the AMI-SeCo mandated the HSG with finding ways to ensure achieving full compliance in all T2S markets with the T2S Harmonisation Standards. While the HSG recognises the usefulness of the current compliance framework, the recommendation to AMI-SeCo was to complement this with in-depth analysis of non-compliance cases; this approach was agreed in the December 2020 AMI-SeCo meeting. The aim of this note is to provide a summary of the Italian market case of non-compliance with T2S standard (4) related to the transferring of tax-related information via T2S and a summary of the discussions held in the HSG regarding the review of T2S standard 4 (transmission of tax information in T2S messages and of the implementation of a market practice (MP) handbook for portfolio transfer.

2. Italian market case of non-compliance: transmitting tax information in T2S settlement messages related to portfolio transfers.

According to T2S standard (4) on tax info requirement¹, tax-related information for domestic and cross-CSD transactions is not to be passed via T2S messages. The Italian market does not fully comply with the T2S standard since it has defined a market practice to manage portfolio transfers through T2S that includes in T2S messages some details regarding the portfolio to be transferred, which are tax-related and can be used for calculating future taxation.

For transactions not related to portfolio transfers, the Italian market fully complies with the standard and, a priori, the non-compliance does not have any impact on the rest of the T2S community other than putting forward specific requirements for transferring portfolios between Italian custodians. This highlights that there may be a way to formulate and interpret T2S standard (4) in a way which preserves the original objective of not forcing any T2S actors to transfer or process tax information via T2S messages.

In this regard, after the discussions on a proposal for the development of an AMI-SeCo Handbook on portfolio transfers, on June 2018 the AMI-SeCo mandated the HSG to continue working on the review of T2S standard (4) to potentially allow the transmission of tax information in T2S settlement messages, if such transmission does not affect T2S actors or force T2S actors to process such information. In May 2021,

¹ T2S standard (4) on Interaction with T2S (tax procedures): Tax-related information for domestic and cross-CSD transactions is not passed via T2S messages. For more details see Annex 1.

the HSG members confirmed their view that the text of the standard is outdated and that, for this reason, its revision does not need to be linked to the future publication of the Handbook on portfolio transfers.

Once the standard will be amended, the AMI-SeCo and the HSG took the view that the Italian non-compliance case will be resolved.

3. Summary of the discussion on the review of T2S standard on tax info requirements (Activity 4).

After having analysed the possibility of processing tax related information via T2S, in 2013 the Task Force on adoption to Cross-CSD settlement in T2S (TFAX) concluded that there were no technical and process-based solutions that would allow to avoid the inefficiencies generated by heterogeneous local tax requirements. A particular concern of the TFAX at the time was that including tax information in T2S messages may hinder cross-border settlement in T2S in case the recipients of such tax information were bound by law to process such information. According to the TFAX analysis and recommendation, the T2S AG endorsed the T2S standard (4), establishing that no tax info should be transferred via T2S messages.

However, in 2017 the European Working Group on Portfolio Transfer (EWGPT) of the European Banking federation (EBF) worked on a proposal for the definition of a market practice (MP) for portfolio transfers that could offer a higher degree of automation and would potentially imply greater efficiencies and back-office costs reductions in some T2S markets. Starting from the EWGPT MP, the HSG agreed to prepare a Handbook on portfolio transfers that would include the principles for cross border portfolio transfers and collect the existing market practices for domestic portfolio transfers across AMI-SeCo markets. In the event of a portfolio transfer, the MP and the Handbook create the possibility to transfer information from the delivering custodian to the receiving custodian via T2S messages, including tax related information; the review of T2S standard (4) is a pre-requisite for the establishment of the Handbook that triggered the discussion on changing the text of the standard.

3.1 EWGPT proposal for the new formulation of T2S standard (4)

The EWGPT submitted a first proposal (see Box 1) for an amendment of the text that aimed at offering the flexibility to T2S actors as whether to include or not to include tax information in their settlement messages. This would allow the transmission of tax information via T2S messages for portfolio transfers provided that the both parties to the transaction agree to such info to be transmitted.

The proposal has been reviewed and discussed by the HSG in 2018 in light of a consultation with the National Stakeholders Groups (NSGs) regarding existing barriers in the national markets that would prevent market participants to include tax info in T2S messages.

HSG members' views differed as to the text of the proposal and highlighted the risk that the new text would provide room for different interpretations. The HSG members' views also differed as to the approach to review the T2S standard (4). Some of the members argued that in order to have a proper business case to change the standard the HSG and AMI-SeCo should first discuss the draft Handbook on Portfolio Transfers and only on that basis should the AMI-SeCo change the existing standard. Other members argued that the current wording of the standard is suboptimal and is too restrictive regardless of what will be in a future handbook on portfolio transfers as the Standard, as it stands, bans exchange of tax info even if it is legally allowed and agreed between the parties to the transaction in T2S.

Based on the outcome of the discussion, the HSG agreed on the principles for the review of T2S standard (4):

- a) The reviewed T2S standard (4) and the future market practice / handbook on portfolio transfers cannot be such that it would require any T2S actors – which is either not willing or not allowed to do it – to transmit tax information via T2S messages.
- b) Any proposal for a market practice or handbook for portfolio transfers drafted – inter alia – on the basis of a reviewed standard should be robust to potential future use of message fields in T2S according to the existing messaging standards.
- c) The changing of the standard for the purpose of portfolio transfers should be such that it does not imply change requests to T2S.
- d) To limit the risk of creating a dangerous precedent of revising a T2S standard in order to adapt it to existing legacy practices changing the standard should be done in parallel with / at the same time as with the adoption of a handbook or market practice on portfolio transfers in T2S markets.

The HSG then worked on a revised proposal for the reformulation of T2S standard (4) that was presented, together with the above principles, to AMI-SeCo:

Box 1

Current text of T2S standard (4):

Tax-related information for domestic and cross-CSD transactions is not passed via T2S messages.

EWGPT proposal:

T2S actors should not impose any mandatory requirement on their participants or on their counterparties to transmit tax-related information via T2S messages. It should be possible for all T2S actors to settle all types of transaction on T2S without providing tax-related information via T2S messages.

HSG revision:

Following a bilateral or a multilateral agreement, T2S actors may choose on a voluntary basis to include tax-related information in a T2S message; (in such a case, the content and/or format of such information may be subject to specific national legal requirements). T2S actors should not impose any mandatory obligation on their participants or on their counterparties to include tax-related information in T2S messages for settlement in T2S.

In June 2018 the AMI-SeCo endorsed the principles defined by the HSG to review T2S standard (4) and invited the HSG to submit a proposal for the new text of the standard in parallel with the finalisation of the work on the handbook of portfolio transfers.²

In May 2021, the discussion in the HSG on the Italian case of non-compliance confirmed the majority view among HSG members that the current text of T2S Standard (4) is suboptimal. Furthermore, in light of the delay in the finalisation of the handbook on portfolio transfers and the fact that the revision of the standard

² [Outcome of June 2018 AMI-SeCo meeting](#): "...As the current T2S harmonisation standard on tax info prohibits the transmission of tax information in T2S (settlement) messages it is considered suboptimal in light of the prevailing practices in some communities which use settlement messages to convey such info for portfolio transfers. A proposed reformulation is being worked on by the HSG which would allow the transmission without endangering the objective of harmonisation and without having an effect on any other parties in T2S. The revision to the standard would only be submitted for final approval by the AMI-SeCo once the Handbook on Portfolio Transfers is available for endorsement. AMI-SeCo endorsed the principles defined by the HSG to review standard 4 but noted the need for further work before finalising a new draft. ..."

is not restricted to portfolio transfers, the HSG agreed that a proposal for the review of the standard should be made to the AMI-SeCo now. The HSG members then agreed to put forward the previously agreed HSG proposal on the new text of the standard (see Box 1 above and in Annex 2) to the AMI-SeCo for its endorsement.

4. Summary and conclusion

The case of non-compliance of the Italian market is strictly linked to the practice of including tax-related details for domestic portfolio transfers in T2S messages, while not having any impact on other T2S actors. The MP for portfolio transfers developed by the EWGPT, that would also rely on the transmission of tax information via T2S, has been proved to offer greater efficiencies via a process-based solution, while ensuring that the original objective of the T2S harmonisation activity is respected; i.e. tax info requirements should not be an obstacle for settlement in T2S. The HSG will continue its work on the 'Handbook' on portfolio transfers that will contain principles for cross-border portfolio transfers and will document existing practices for domestic portfolio transfers. It is understood that the T2S standards should evolve based on the emerging needs of the T2S community, especially if the standards prevent the implementation of MPs that might offer efficiencies to T2S actors while not challenging the spirit of harmonisation.

The HSG members agreed on a draft new text for T2S standard (4) in order to enable portfolio transfers in T2S as per some existing local practices, to be adopted and implemented independently from the Handbook on portfolio transfers. The proposed review to T2S standard (4) would achieve two objectives:

1. Solving the issue of irrelevancy of T2S standard (4) in some cases, and thus allowing the implementation of more efficient existing local MPs for portfolio transfers in T2S.
2. Accommodating the tax info requirements identified by some of the NSGs, without hindering cross-border settlement

Furthermore, with the introduction of the reviewed standard, the case of non-compliance of the Italian market would be resolved.

In light of the above, the AMI-SeCo is now invited to:

- **discuss the proposal of the HSG to revise T2S Standard (4) according to the formulation presented in Annex 4, i.e. not to wait for the publication of the AMI-SeCo Handbook on Portfolio Transfers.**
- **Consult and confirm with the T2S governing bodies (MIB, CSG) on whether the formulation proposed by the HSG is neutral to (has no impact on) the operation of T2S**
- **Based on the outcome of the above, agree to finally endorse changing T2S Harmonisation Standard 4 by the publication of the next T2S harmonisation progress report in December 2021**

Annex 1: T2S Activity no.4 Interaction with T2S (tax info requirements) – current text

Activity description

The objective of this activity is to establish a T2S standard for the management of transaction-related tax information across borders, in order to avoid inefficiencies generated by heterogeneous local tax requirements (transaction-related tax rules and tax information flow). Non-compliance would impose back-office costs on instructing counterparties and might discourage cross-CSD activity in T2S. The target date for T2S markets to fully comply with this standard is their migration date to T2S.

T2S STANDARD

Tax-related information for domestic and cross-CSD transactions is not passed via T2S messages.

Note: Tax-related information includes, but is not limited to, the tax status of the transaction, tax status or tax ID of the end investor, tax exemption identification number, alien registration number, passport number, corporate identification number, driving license number, foreign investment identity number, BIC, proprietary ID and name and address of the investor. ISO messages provide fields that can be used to pass information about a particular transaction tax type (withholding tax, payment levy tax, local tax, stock exchange tax, transfer tax, value-added tax, consumption tax), as well as the amount, debit/credit indicator, currency and other details. To fully comply with this standard, T2S markets/CSDs should not use these fields to pass on any kind of tax-related information.

Annex 2: Proposal for revision of T2S STANDARD (4)

Activity description

The objective of this activity is to establish a T2S standard for the management of transaction-related tax information across borders, in order to avoid inefficiencies generated by heterogeneous local tax requirements (transaction-related tax rules and tax information flow). Non-compliance would impose back-office costs on instructing counterparties and might discourage cross-CSD activity in T2S. The target date for T2S markets to fully comply with this standard is their migration date to T2S.

PROPOSED NEW TEXT OF STANDARD 4

~~Tax-related information for domestic and cross-CSD transactions is not passed via T2S messages.~~

Following a bilateral or a multilateral agreement, T2S actors may choose on a voluntary basis to include tax-related information in a T2S message; (in such a case, the content and/or format of such information may be subject to specific national legal requirements). T2S actors should not impose any mandatory obligation on their participants or on their counterparties to include tax-related information in T2S messages for settlement in T2S.

Note: Tax-related information includes, but is not limited to, the tax status of the transaction, tax status or tax ID of the end investor, tax exemption identification number, alien registration number, passport number, corporate identification number, driving license number, foreign investment identity number, BIC, proprietary ID and name and address of the investor. ISO messages provide fields that can be used to pass information about a particular transaction tax type (withholding tax, payment levy tax, local tax, stock exchange tax, transfer tax, value added tax, consumption tax), as well as the amount, debit/credit indicator, currency and other details. ~~To fully comply with this standard, T2S markets/CSDs should not use these fields to pass on any kind of tax-related information.~~
