FINANCIAL TRANSACTION TAX
FAQ (HIGH-FREQUENCY TRADING)

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

Art. 12 (Scope of the tax)

1) Q: Please clarify whether only the orders generated by the algorithm shall be considered in the ratio, and not all the orders entered by the same taxable person which do not fall within the scope of the tax referred to in paragraph 495, as they are not generated by a computer algorithm.

A: Given that the tax is levied only on high-frequency trading and that these are the ones that, according to the Decree, are generated by a computer algorithm with the characteristics referred to in Article 12, paragraph 1, lett. a) of the above Decree, the orders entered by the same taxable person that are not generated by a computer algorithm shall not be considered in the calculation of the tax on high-frequency trading.

2) Q: Paragraph 1, lett. b): by comparing the text of paragraph 495 (this value may not exceed half a second) and that of the Decree, it is not clear how the transactions taking place at intervals exactly corresponding to half a second should be treated. An official clarification seems necessary.

A: The rule provides that the transactions relating to the sending, cancellation or modification of orders “made with a minimum interval” lower than that provided for by the Decree, in any case “not exceeding half a second”, fall within the scope of the tax referred to in paragraph 495. Further, the Decree provides that this interval “does not exceed half a second”. Based on the combination of the two provisions, the transactions relating to the sending, cancellation or modification of orders taking place in less than half a second are to be subjected to tax; those taking place at intervals of half a second or more are excluded.
3) Q: Please clarify the markets and securities which the tax on high-frequency trading referred to in paragraph 495 applies to.

A: As provided by Article 12 of the Decree, the tax on high-frequency trading referred to in paragraph 495 applies to the transactions in financial instruments referred to in paragraphs 491 and 492, although not issued by Italian resident companies, provided they take place on Italian regulated markets and multilateral trading facilities. Therefore, the transactions in securities of the companies referred to in Article 17 of the Decree (listed companies with average capitalization of less that 500 million) and the transactions in derivative financial instruments and securities referred to in paragraph 492, even if the underlying is not represented by securities issued by Italian resident companies, are subject to the tax on high-frequency trading.

4) Q: How to define the “specific desks devoted to market-making activities” for the purposes of the tax on HFT? Is it a requirement only for market makers carrying on also other transactions, or even the person carrying on only market-making activities must segregate desks solely devoted to its sole activity? How?

A: In view of the requirements of the ESMA Guidelines referred to in Article 16 of the Decree, in order to identify orders and transactions relating to market-making activities of a person who has complied with the rules for reporting such activities to the competent authority, it is considered that the compliance with the requirements set out in paragraph 43 of the above Guidelines incorporate the conditions needed to identify the specific desks devoted to market-making activities under Article 12, paragraph 1, lett. a).
Art. 13 (Application of the tax)

5) Q: Please clarify whether IOC (Immediate or Cancel) cancellations, FAK (Fill and Kill), FOK (Fill or Kill) cancellations and those due to the closure of existing orders at the end of the trading day, or to other causes attributable to the trading platform are to be considered for the calculation of the tax on high-frequency trading.

A: In general, the cancellations that are not automatically generated by an algorithm are not to be considered for the purposes of calculating the tax on high-frequency trading. Consequently, the cancellations due to IOC, FAK or FOK orders, being already provided at the time when the order was entered and not being required by the algorithm after the order was entered shall not be considered for the purposes of calculating the tax at issue. Similarly, the closures that take place automatically at the end of the trading day or for reasons other than a request generated by the algorithm shall not be considered in the calculation of the tax.

6) Q: Please clarify the methods of calculation for determining the tax.

A: Pursuant to Article 13 of the Decree, the tax is calculated by each taxable person for each trading day and for each financial instrument and is due where the ratio between the sum of cancelled and modified orders and the sum of entered and modified orders exceeds 60%, considering only the orders cancelled and/or modified in the interval of half a second. For these purposes it is specified that:

a) orders modified/cancelled within half a second mean those whose modification/cancellation is made within this timeframe to be calculated with reference to the previous entry/modification of the order; for example, if an order is entered at 10 o’clock, is modified after a second and cancelled after a quarter of a second, for the purposes of the above ratio the cancellation shall have to be considered in the numerator (because it took place within half a second from the previous step) and the order originally entered in the denominator; the transactions to be considered for calculating the interval of half a second do not include partial executions of orders;

b) any orders entered during the day as part of transactions with the features referred to in Article 12, paragraph 1, lett. a) must be considered in the denominator of the ratio, even if they have been not modified or cancelled within half a second. In the case of orders that are not executed or cancelled on the day of entry of the order (so-called good till date orders), these should not be counted, unless they are subject to modification within half a second.
7) Q: For the purposes of calculating the interval of half a second, should the time for placing the order and its subsequent modification or cancellation be taken (a) when originating from the server sending the entered, modified or cancelled orders, or (b) when terminating on the server of the market?
A: The intervals between entry, modification and cancellation of the order may be calculated with both procedures, as long as the criterion adopted is only one and is applied uniformly to all taxable persons.

8) Q: What is meant by modification and cancellation of an order?
A: Modification of an order means a change in one or both components, price and/or quantity as compared to the order originally entered; the modification is characterized by the fact that the modified order keeps the reference number of the original order (the so-called order ID or PDN does not change), as the order is marked by the same reference number throughout its life, regardless of the effects of such modification on the time priorities. There is a cancellation when the number of securities included in the order is down to zero.

For the purposes of calculating the ratio referred to in Article 13 of the Decree, the following should be taken into account: a) the number of securities included in the single orders entered, modified or cancelled, for the instruments referred to in paragraph 491 and for the securities referred to in Article 7, paragraph 1, letter b); b) the number of standard contracts included in the single orders entered, modified or cancelled, for the derivative financial instruments referred to in Article 7, paragraph 1, lett. a).

For the purposes of applying Article 13 of the Decree, a distinction should be drawn between modifications of the order that do not involve a variation of the quantities with respect to the order entered (in other words, only modifications of the price, either upwards or downwards) and modifications of the order that involve a variation of the quantities.

In the first case (modification of the price without modifying the quantities) for calculation purposes, "modification" shall refer to the number of securities/standard contracts equal to that of the order whose price has been modified.

If, however, the modification concerns only (or also) the quantities, a distinction should be drawn between an upward modification and a downward modification. In the case of modifications of the order that increase the quantity previously entered, a number of securities/standard contracts equal to that existing before the modification shall be entered for the numerator and the denominator, whereas a number of securities equal the difference between the number of securities subject to the modification and the number of securities...
forming part of the order before the modification shall be added to the denominator as an entry: for example, if the original order is equal to 10 securities and is modified to 12 securities, 10 shall be entered for the numerator and 10 (modification) and 2 (new entry) shall be entered for the denominator.

In the case of modifications of the order that reduce the quantity previously entered, a value equal to the number of securities/standard contracts equal to that existing before the modification shall be added to both the numerator and the denominator, and a number of securities/standard contracts equal to the difference between the number of securities/standard contracts set in the past and those remaining after the modification shall be added to the numerator as a cancellation: for example, if the original order is equal to 10 securities and is modified to 8 titles, 10 (modification) and 2 (cancellation) shall be entered for the numerator and 10 (modification) for the denominator.

These modifications shall be considered only if made within half a second from the previous entry or modification: if there is a discontinuity in modifications, the variations shall be referred to the last modification made within half a second or, if there are none, to the order entered (for example, an entry of the order followed by modification no. 1 within half a second, modification no. 2 exceeding half a second, further modification no. 3 or cancellation within half a second from modification no.2: the modifications of the quantity and/or price recorded in modification no. 1 shall be compared with the number of securities forming part of the initial order, whereas those made with the modification no. 3 or cancellation, shall be compared with the number of securities existing after modification no. 1).

In the following examples, I indicates the entry, M the modification and C the cancellation.

1) Example of order modified within ½ second in the price:

<table>
<thead>
<tr>
<th></th>
<th>Quantity</th>
<th>Price (Case A)</th>
<th>Price (Case B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Order entered</td>
<td>10</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Order after modification within ½ sec</td>
<td>10</td>
<td>6</td>
<td>4</td>
</tr>
</tbody>
</table>

Case A: 10M/(10I+10M)  
Case B: 10M/(10I+10M)
2) Example of order modified in the quantity and cancelled within ½ second:

<table>
<thead>
<tr>
<th></th>
<th>Quantity (Case A)</th>
<th>Quantity (Case B)</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Order entered</td>
<td>10</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Order after modification within ½ sec</td>
<td>12</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>Order after modification within ½ sec</td>
<td>14</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Cancellation</td>
<td>14</td>
<td>6</td>
<td>5</td>
</tr>
</tbody>
</table>

Case A: \( \frac{10M+12M+14C}{10I+10M+2I+12M+2I} \)

Case B: \( \frac{10M+2C+8M+2C+6C}{10I+10M+8M} \)

3) Example of order modified in the quantity and cancelled with modifications made within and exceeding half a second:

<table>
<thead>
<tr>
<th></th>
<th>Quantity (Case A)</th>
<th>Quantity (Case B)</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Order entered</td>
<td>10</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Order after modification within ½ sec</td>
<td>12</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>Order after modification exceeding ½ sec</td>
<td>14</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Order after modification exceeding ½ sec</td>
<td>8</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Cancellation within ½ sec</td>
<td>8</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

Modifications and cancellations exceeding half a second shall be considered as “neutral”, *i.e.* for calculation purposes they are not considered either in the numerator or in the denominator.

Case A: \( \frac{10M+4C+8C}{10I+10M+2I} \)

Case B: \( \frac{10M+2C+4C+4C}{10I+10M} \)
9) Q: Who is the person responsible for determining which operations are generated by an algorithm?
A: The distinction between transactions generated by an algorithm (or by separate algorithms) and other operations shall be made by the person responsible for paying the tax. The person responsible for paying the tax shall request from the taxable person the information needed to make the distinction.

10) Q: The ratio referred to in Article 13 should be calculated "with reference to the single financial instruments". In the case of options with the same underlying, please confirm that any combination of strike price and exercise date constitutes a separate financial instrument. Please also confirm that complex derivatives (resulting from the combination of two or more basic derivatives, e.g. collar) constitute separate financial instruments.
A: For the purposes of identifying the single financial instruments, in the case of options any combination of strike price (exercise price) and exercise date constitutes a separate financial instrument. In the case of complex derivatives, these constitute separate financial instruments only if they are traded as a unit and the order entered refers to the complex derivative as a whole.

11) Q: For the purposes of establishing the tax due in the case of high-frequency transactions in financial instruments referred to in paragraph 491, the number of securities exceeding the 60% threshold shall be multiplied by the weighted average price of the orders to buy, sell or modify for the specific financial instrument on the trading day. For the purposes of establishing that price, please confirm that: a) such value includes all orders entered (both modified/cancelled within half a second and exceeding that limit), b) it is the average price of the orders sent by the taxable person (which is known to the latter) and not the average price recorded on the market (still unknown to the taxable person at the end of the day).
A: For the purposes of calculating the weighted average price or the weighted average countervalue of the orders referred to in paragraphs 2 and 3 of Article 13 of the Decree, reference should be made to the price/equivalent value established for all orders entered that have contributed to the calculation of denominator of the ratio; also the prices/equivalent values entered in the case of modified orders contribute to this calculation, even in the case of modifications concerning only the quantity of the orders; therefore cancelled orders shall not be considered for these purposes. If the order does not specify a price/equivalent value (so-called market orders) or does not indicate a range of values within which the order can be executed,
for the calculation of the price/weighted average countervalue, the price/equivalent value at which the order has been executed shall be considered; if the order is not executed, for the calculation of the price/weighted average countervalue, the price/equivalent value at the closing of the trading day shall be considered, as recorded on the trading market where the algorithm of the taxable person is used.

For Combo or Flexco orders, which allow the combination of several derivative instruments in a single order (so-called compound orders), for the purposes of calculating the weighted average countervalue, for each order entered the average of the absolute values of the equivalent values of the single instruments that constitute the compound order shall be considered; even in this case, if they have not been specified in the order entered, for the calculation of the weighted average countervalue the average equivalent value at which the order has been executed shall be considered; if the order is not executed, for the calculation of the weighted average countervalue the equivalent value at the closing of the trading day shall be considered, again as recorded on the trading market where the algorithm of the taxable person is used.
Article 14 (Person liable to tax)

12) Q: The rule is not easy to interpret and may give rise to contradictory results depending on whether prevalence is given to the provisions either of paragraph 496, according to which the tax is due by the person on whose behalf the orders are executed, or of the Decree which attributes relevance to the person who enters the orders. It should be borne in mind that, in certain situations, there are brokers that allow access to the high-frequency trading systems to other brokers through their desk.

A: From a systematic reading of the measure and the decree, which has been complemented with the explanatory memorandum, the taxable person (i.e. the taxpayer) is the one that, if the orders entered were executed, would either acquire or divest of the ownership of the shares and other financial instruments or become counterparty to a derivative financial instrument. The person in charge of payment shall be identified in accordance with paragraph 494 of the Law and with Article 19 of the Decree. The explanatory memorandum has then clarified that the obligations of the person in charge of the payment remain the responsibility of the persons referred to in Article 19; more specifically, these are banks and other intermediaries involved in the HFT transactions even by simply placing their platforms at the disposal of the taxable person (so-called sponsor person).

13) Q: If the same person operates with multiple algorithms through the same intermediary, should the tax be calculated either according to the total orders sent through the intermediary, or distinguishing by single algorithm?

A: The tax shall be calculated by each person in charge of payment by single taxpayer, single financial instrument and single algorithm levels.

14) Q: If a person operates through various intermediaries on the same day, is the tax calculated at single intermediary level?

A: Yes.

15) Q: As we know, the performance of high-frequency transactions often implies the operational need to place a server as close as possible to the matching engine of the reference market, often renting a space in the same operational structure (co-location). Please clarify whether the obligation to pay the HFT tax is irrespective of (i) the presence in Italy of a server and (ii) the existence of a permanent establishment.
A: Article 14 of the Decree does not provide that the obligation to pay the tax requires the presence in Italy of a server or the existence of a permanent establishment; indeed, it is sufficient that such transactions are executed on the Italian financial market, regardless of the residence for tax purposes or operational methods chosen by the person that, through algorithms, enters the orders of purchase and sale, and the related modifications and cancellations.