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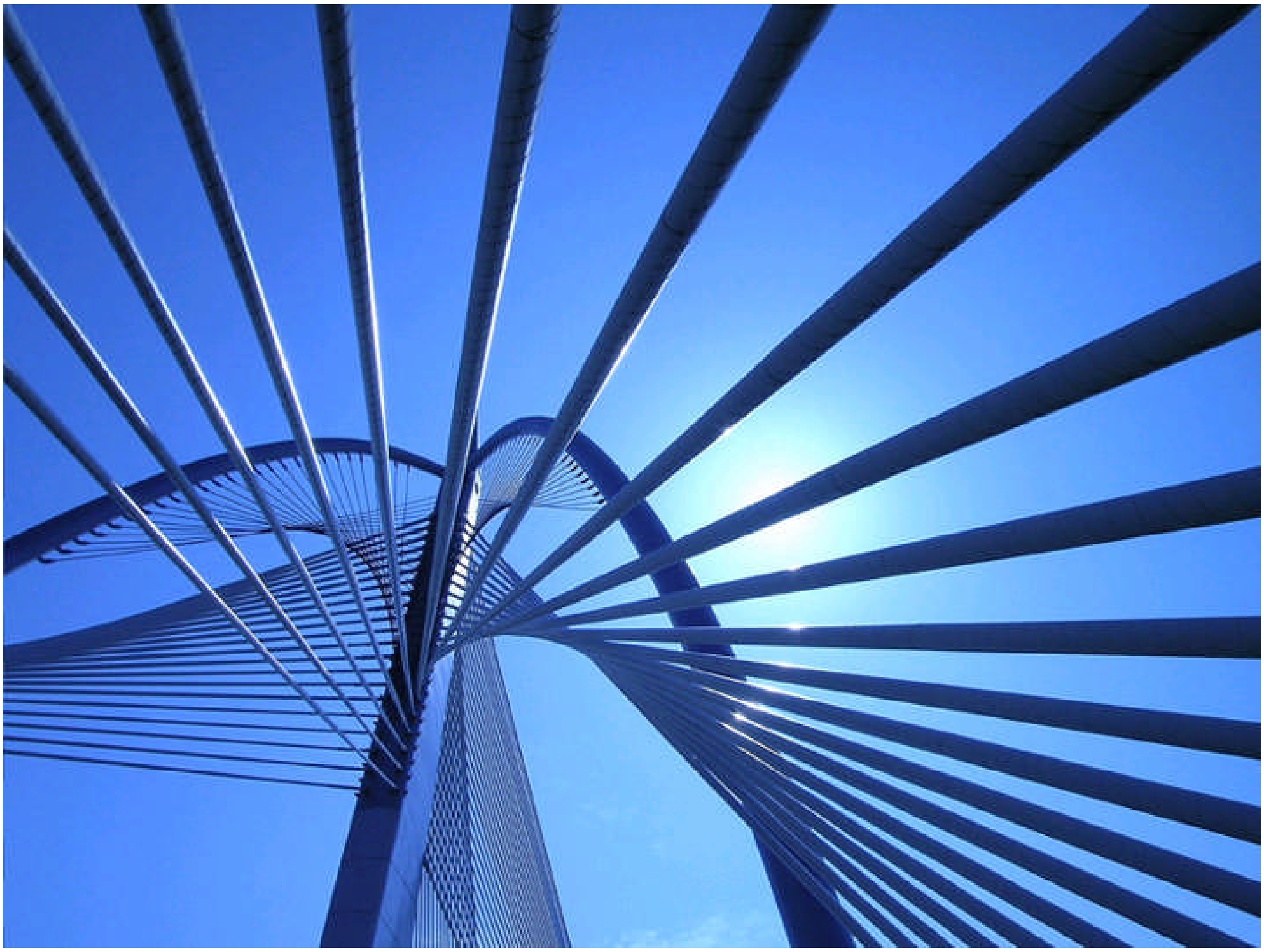


Implementing MiFID in your organisation - Managing your VAT exposure*

*connectedthinking

PricewaterhouseCoopers

Financial Services MiFID VAT Review

The Markets in Financial Instruments Directive (MiFID) comes into effect on 1 November 2007. MiFID is likely to have a far-reaching effect on trade in financial instruments, as it allows firms to provide services throughout the EU on a “home-country supervision” basis and does away with the idea that all share trading has to be done through exchanges.

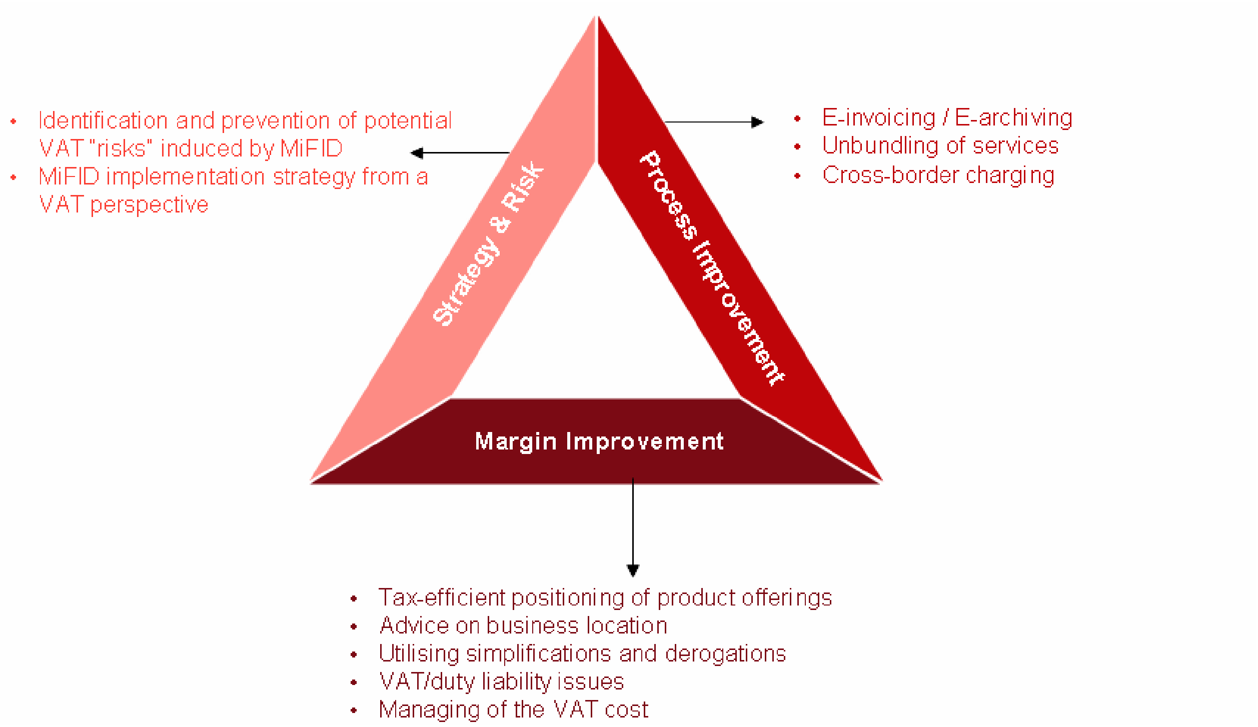
MiFID impacts companies involved in trading in financial instruments, businesses that deal in advisory services and companies that provide portfolio management. Have you also considered the VAT consequences of MiFID? Careful planning may minimise your VAT exposure.

The Investment Services Directive (ISD) has been the most significant EU legislation on investment intermediaries and financial markets since it was implemented in 1995. It is now being completely replaced by MiFID, which extends the coverage of the current ISD regime and introduces new and more extensive requirements to which firms will have to adapt, in particular in relation to their conduct of business and internal organisation.

The key objective of MiFID is to develop a single, transparent, European capital market that will benefit issuers and investors alike. It will affect all European regulated exchanges and investment firms, and the harmonised regulatory framework it prescribes should help promote the growth of EU cross-border trading, but will also have an impact across your clients’ businesses.

However, the impact will not be limited to how business is conducted and reporting lines; the restructuring of your business will also have VAT consequences.

MiFID Key Propositions



Key consequences of MiFID

- Companies that fall under MiFID will have to prove “best execution”
- Obligation to comply with requirements relating to the information that needs to be recorded and captured when accepting client orders, and to ensure that the firm is acting in a client’s best interests
- Establishment of clear procedures to categorise clients and assess their suitability for each type of investment product
- Obligation to prove transparency of pre- and post-trade pricing
- Certain companies such as insurance undertakings and/or pension funds will not fall under MiFID. Their products (such as insurance wrappers) will not have to comply with the MiFID Directive

VAT consequences of implementing MiFID

The implementation of MiFID will create various VAT issues, ranging from a possible increase in VAT costs associated with trading in financial products to the VAT implications of business restructuring.

Best execution and capture of information

A consequence of best execution may well be the centralisation of certain functions. Depending on the legal structure and the functions centralised, this could have adverse VAT consequences. For example, centralisation of administrative functions could result in the creation of VAT on cost charges to group members. Furthermore, companies are investing into IT architecture to facilitate the MiFID requirements for storage of client information. VAT on these additional costs will, in most instances, be irrecoverable, thereby adding to the cost in preparing for MiFID. On the other hand, when investments are made into IT architecture, they also bring potential savings opportunities for the billing process by implementing e-invoicing and e-archiving solutions, although the latter can be fraught with complications due to variable local VAT rules.

Outsourcing

Best execution, and other MiFID requirements, may promote the outsourcing of certain functions. When outsourcing certain activities to other parties you will have to ask yourself whether the outsourced service is collective portfolio management, discretionary portfolio management, trading or purely (fund) administration activities. Collective portfolio management will fall under the UCITS III Directive and be considered VAT-exempt in most cases. Discretionary portfolio management and trading activities, on the other hand, will fall under MiFID. In most EU countries, discretionary portfolio management is subject to VAT.

Transparent pricing, unbundling fees

It has often been the case that no fee is charged for investment advice. The cost of this “free” advice is included in the price of security transactions. With MiFID’s “inducement” requirements, a separate fee has to be charged; this will be subject to VAT and, as a consequence, the cost of undertaking securities transactions may increase because this VAT charge will not be recoverable.

Insurance wrappers

Currently, insurance wrappers are outside the scope of MiFID. However, supervisors are considering the implications of differing treatment for “substitutable” products. In some jurisdictions, regulators are already applying similar requirements. It is possible that, given the serious “unequal playing field” issues, insurance-wrapped products will be subject to MiFID rules or similar, sooner rather than later. If so, all the consequences outlined above will extend to insurance-wrapped products.

Contact us

For further information about implementing MiFID in your organisation with respect to managing your VAT exposure, please contact your local indirect tax specialist.

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