

Legislative reform of the Terminal Markets Order: Consultation

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Sent to: reformvatterterminalmarketsorder@hmrc.gov.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

General Comments

We welcome the opportunity to respond to the HM Treasury ('HMT') and HM Revenue & Customs ('HMRC') 'Legislative reform of the Terminal Markets Order: Consultation' ('the Consultation'). The Terminal Markets Order (the 'TMO') has continuously provided a historically valuable legislative simplification, which aids the smooth operation of the commodities markets and provides an important anti-VAT fraud measure. We are pleased that the TMO is being retained and regard this as an important opportunity to explore the modernisation of the present legislation and supporting guidance to accommodate the increasing globalisation and digitalisation of trading in commodities. Please see, in the section 'Specific Questions' below, UK Finance's direct responses to the 15 questions asked in the Consultation.

In summary, UK Finance broadly agrees with the aims of modernising the legislation to improve clarity and certainty. We consider, however, that this must be done in a way that is sensitive to the broader regulatory and competitive environment. We believe that the best outcome will be achieved through HMT, HMRC and representatives from industry working together to create a shared understanding of the types of transactions and scenarios that fall within the scope of the TMO, as well as those which display consistent features but are not explicitly covered by the existing (dated) legislation. Given the importance of the TMO as a simplification measure that has aided the UK's position as a centre for international commodities trading, UK Finance considers that a working group should be formed with representatives from industry alongside HMT and HMRC so that this work can be performed before proposals for revised legislation are developed.

The UK has traditionally been a strong base for international commodities markets and exchanges. At a time of increasing digitisation and globalisation, UK Finance would not want to see this compromised due to unintended consequences arising from this reform. Members will want to see that the impact of any proposed 'principles' are considered carefully at each step of the transaction supply chain and for each constituent party; for example, exchanges, markets, market makers, brokers, clearing members and houses. Overall, to prevent asymmetry, Members would value a set of principles that are defined sufficiently broadly to apply to the full range of activities necessary to transact on a relevant market or exchange. We consider that this can be achieved without materially altering the scope of the TMO, given the range of activities that market members may perform that fall within Article 3 of the existing legislation (and in particular under Article 3(1)(c)). Continued consultation between HMT / HMRC and Members as the proposals are developed will therefore be essential to ensure that the principles are sufficiently clear as to how they are to be applied to the

range of activities and participants involved, such that our Members can confidently and consistently apply them in practice.

Addressing the approach put forward in the Consultation:

- UK Finance does not object to a 'principles'-based approach on the whole; however, many key points need to be clarified (e.g. definition of 'market'; definition of 'member'; definitions of 'relevant commodities and transactions') in order to establish how the relevant principles should be defined. HMT, HMRC and Industry should work together to build a shared understanding of the types of transactions in the international commodities markets that will involve UK members and use this to inform the design of the principles-based approach.
- From a future-proofing perspective, the legislative principles and definitions developed should be broad enough to accommodate future changes in the commodities markets, for example new qualifying markets and the trading of new commodity products.
- If principles cannot be defined clearly enough to prevent differences in interpretation and consequent legal uncertainty, UK Finance Members would then prefer the clarity and certainty of updated lists within the legislation (alongside appropriate governance processes to ensure that these lists remain accurate and up to date).
- From a practical perspective, we consider that any new principles based legislative definitions should be accompanied by revised guidance, published by HMRC, to aid interpretation and this should include non-exhaustive examples and lists (for example, illustrating the definition of a 'TMO qualifying market or exchange').

Continued engagement with industry should also assist HMT / HMRC in understanding the broader competitive and regulatory environment in which the commodities markets operate – this will be essential to guard against any unintended consequences that could have a detrimental impact on the commodities markets and those that rely upon them.

Specific Questions

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

Q1: 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?

A1: UK Finance considers that the current approach of listing named markets within the current legislation does require modernisation. The list-based approach creates a time-bound legislative framework that, without a clear governance structure, can quickly become out of date leading to uncertainty for markets, members and those who use them.

On the whole, UK Finance is supportive of a legislative definition of a recognised commodity exchange or market association. A successful definition will need to appropriately capture those features of a recognised commodity exchange or market association manner that are consistent across the various exchanges and markets covered today by the TMO, but also to be drawn broadly enough that the definition can accommodate future developments in the structure and operation of these markets. This will be essential for the definition to function properly such as not to create asymmetrical treatment for equivalent transaction in the future.

From a practical perspective, as mentioned above, UK Finance considers that a principles based legislative definition should be accompanied by guidance published by HMRC. This should describe how the definition is to be applied in practice, for example, in the form of a non-exhaustive list.

UK Finance appreciates that the TMO is UK legislation, applied on a territorial basis within the UK. UK established businesses do, however, trade futures and options contracts on other international exchanges. These exchanges will have similar membership structures as UK established exchanges. UK Finance Members would advocate that HMT consider allowing the TMO remit to include trades between UK established business who enter into transactions, capable of physical delivery, where at least one stage of the trade takes place in the UK (for example, through a UK clearing member and / or UK clearing house). This could be considered the natural result of a principles-based definition of a relevant market. Our Members would be happy to work with HMT / HMRC on developing a clear set of principles to support this approach.

Alternatively, other approaches should be considered to prevent VAT from applying in the context of transactions involving UK members of non-UK exchanges to minimise any risk of fraud. For example, zero rating treatment could be afforded on the basis that the 'foreign' exchange transaction relates to an underlying product that is a commodity which is stored outside of the UK and would have qualified for TMO treatment if the product was warehoused in the UK. Essentially enabling an approach that would look through the transactions on the exchange (or market association) to the UK VAT treatment that would apply to the commodity transaction that is the subject of the contract.

In any case, our Members are keen to ensure that a broad range of scenarios are considered in developing the definition to ensure that the intended VAT treatment is fully understood prior to drafting the legislative definition; in particular, in the context of transactions involving UK parties to a transaction where the exchange (or market) is located overseas.

We will be happy to work with HMT and HMRC further to ensure that a full range of scenarios are considered and through this working to establish the criteria that would form the basis of the definition. If it is not possible to determine a definition that is sufficiently clear in its interpretation and application to minimise any legal uncertainty, UK Finance will be pleased to support HMT and HMRC in revising the list included in the current legislation and in developing a governance framework to ensure that the accuracy and completeness of the list can be maintained.

Q2: 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?

A2: Exchanges and market associations play a crucial role as the central counterparty through which members and non-members trade, execute and settle transactions. Accordingly, recognised exchanges are regulated by the FCA and are subject to MiFID II. The FCA is responsible for supervising recognised investment exchanges and clearing houses and their compliance with regulations formed under the Financial Services and Markets Act 2000 – this includes markets that fall within the scope of the TMO as it currently stands (i.e. the London Metal Exchange, ICE Futures Europe). Additionally, the FCA is responsible for supervising a number of overseas investment exchanges that are recognised in the UK – this includes commodities markets that UK members may also transact on.

UK Finance believes that HMT and HMRC should consider the extent to which the regulatory framework feed into the work to create a set of criteria to define a recognised exchange for the

purposes of the TMO. Care should be exercised in this however, to ensure that recognised market associations are also defined within the TMO with sufficient clarity.

Q3: What are your views on the alternative approach, where the Government would maintain a list of exchanges/market associations in a VAT notice?

A3: UK Finance Members have concerns over whether such an alternative approach could be successfully implemented; in particular, we consider that a list maintained in a VAT notice would be vulnerable to becoming outdated (for example, where exchanges merge or are renamed). Additionally, a risk exists that over time a list-based approach becomes disconnected from the initial objectives and principles on which the list was originally founded – this risk would be exacerbated by changes in personnel at HMRC alongside creating an administrative and record keeping burden which HMRC may not be resourced to meet. This could ultimately lead to the inclusion or exclusion of exchanges or market associations within the list appearing arbitrary and creating distortive treatment for transactions.

If a list-based approach is to be pursued, a strong governance framework will be essential. For example, the list should be reviewed annually by a group comprising HMT, HMRC and industry representatives. As noted in response to Q1 above, UK Finance would be happy to work with HMT and HMRC to develop an appropriate governance framework, as required.

That said, although UK Finance does not consider a list-based approach ideal to the *definition* of an exchange, there may be merit in HMRC maintaining in a VAT notice a list of those exchanges or market associations which it has recognized do meet the relevant principle-based definition (see our reference to a non-exhaustive list in our answer to Q1). This would have the benefit of providing a level of certainty to those markets and their members which will be important given the scale of activity that might otherwise be standard-rated. Such a list, while not being determinative could reduce risk within the functioning of the relevant market.

Defining a member of the market:

Q4: Do you agree that it would be helpful to define ‘persons ordinarily engaged with dealings on the market’?

A4: We believe that the extent to which there is value in defining ‘persons ordinarily engaged with dealings on the market’, will depend upon the approach that the revised TMO seeks to apply to the transaction supply chain as a whole and the various parties involved.

The functioning of the market associations and exchanges is often complex - what appears from the outside to be a single transaction can, when viewed through a VAT lens, be considered as a series of transactions. For example, for a trade to be completed it is subject to two steps which are facilitated by two separate parts of the market: the exchange (or market association) and the central clearing party. Therefore, for every trade on the relevant market or exchange there are two types of membership required for a market participant to complete the trade

For any such definition to be effective it must, as a minimum therefore, be capable of accommodating the wide variety of memberships and classes of memberships that exist across the exchanges and market associations. For example, markets often comprise both full and associate members or members may be otherwise categorised (e.g. in the case of the London Metal Exchange) – not all members will be clearing members.

Thus, the definition should be broad enough to ensure all steps in completing a trade are covered such that all UK supplies are subject to TMO treatment where they are intrinsic to trading, executing and settling transactions on the recognised exchanges and markets. We consider that such an approach would meet the stated objectives in terms of simplification and fraud prevention and would be consistent with the current operation of the TMO. To facilitate this, any definition of 'persons ordinarily engaged with dealings on the market' would need to be broad enough to recognise the differing roles performed and to encompass all of the relevant parties.

If a restrictive definition is used this could lead to some uncertainty in identifying those parties that meet the criteria. To manage any uncertainty if such an approach is pursued, we consider that supplementary lists of those meeting the definition would need to be maintained by the recognised exchanges and market associations. These lists should be publicly available to all or available on request for our Members.

Q5: 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?

A5: There appears to be an inconsistency between paragraph 2.15 and paragraph 2.9 (bullet point 5). Paragraph 2.9 refers to a contract being *capable* of physical delivery, but this wording has been omitted from paragraph 2.15. Assuming that this omission is not intentional, paragraph 2.15 should be read to be consistent with paragraph 2.9.

UK Finance considers that the principle set out in paragraph 2.16 should not be applied so as to arrive at an overly restrictive definition. As set out in our response to Question 4, there are many classes of membership and these can vary between the different exchanges and market associations, with some classes of membership not providing the ability to clear and execute transactions.

Understanding the roles that the different types of members play in the transactions that take place on the exchanges and markets will be crucial to creating a set of principles that can be consistently understood and applied. Formulating a set of principles or a definition without first understanding the types of trades that are transacted on the relevant markets, and the roles that different types of members play in this, could lead to VAT being imposed in the course of transactions that are currently covered by the TMO – this would create unnecessary complexity and potentially risk of VAT fraud.

An example of an area that should be specifically covered within any newly established principles is the role performed by clearing members of the LBMA and LPPM. In order for a trade capable of physical delivery to be cleared on either of these markets, the metal must be under the control of a clearing member in order for the interest in the metal to be transferred. In the context of trades that are between non-members of the exchange, the consequence of this requirement is that the clearing member will always be a party to the transaction as it will always face the market association.

In response to this question, in summary, we are not opposed to a principles-based approach in conjunction with supporting guidance; however, as mentioned above, we would welcome an open dialogue with HMT / HMRC on formalising and establishing any legislative principles.

Q6: 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?

A6: UK Finance Members are not in favour of this approach. We consider that this approach would be vulnerable to the same risks outlined in our response to Q3. Creating a static list of member classes entitled to apply TMO treatment will ultimately lead to greater uncertainty, as agreeing and making updates to published documents such as VAT Notices is frequently a lengthy process. In our view this approach would therefore not meet the stated objective of creating a framework for the TMO that is able to respond quickly and flexibly to developments in the market.

Defining qualifying transactions that fall under the scope of the TMO

Q7: What are your views on the proposal to define the qualifying transactions that would fall under the scope of the TMO?

A7: UK Finance Members would wish to see a broad approach taken to defining qualifying transactions for the purposes of the TMO, taking a more streamlined and holistic view of the various activities performed to effect a commodities transaction. We consider that this type of forward-looking approach would help to maintain the role of London as a primary centre for commodities trading.

We are broadly in favour of the approach of creating a definition of ‘qualifying transactions’ by reference to a set of principles, as opposed to a finite and static list. Care will be required in formulating these principles however, to ensure that the definition created is sufficiently clear and can be applied to transactions and business processes in a straightforward manner. Engagement between HMT, HMRC and industry in designing the principles will be essential to manage any risk of differing interpretations that could create legal uncertainty and increase the risk of disputes.

We consider that alongside any legislative definition, guidance should be published by HMRC to aid interpretation, and this should include non-exhaustive examples of the types of transactions that fall within the qualifying definition. A process should be established to allow for this guidance to be reviewed and updated periodically in collaboration with industry.

Q8: 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?

A8: Growing globalisation and digitisation of commodities trading means that a range of scenarios for executing and clearing commodities transactions are increasingly available. For example, members may:

- Execute and clear transactions in the UK;
- Execute transactions on overseas exchanges but clear their trades in the UK; or
- Execute transactions on UK exchanges / markets but clear their trades outside the UK.

The future regulatory environment will be a factor in determining the approaches that members take to clearing location, with the June 2025 expiry of the temporary equivalence granted by the EU to UK clearing houses particularly relevant. Further, although ‘Over the Counter’ (‘OTC’) or bilateral trades are treated as falling within the scope of the TMO in some cases, most notably within the precious metals markets, we believe that consideration should be given to putting these types of transaction on a clearer and more consistent footing within the scope of the TMO. Increasingly, to

reduce risk, regulatory drivers are leading to a greater proportion of OTC contracts being centrally cleared with OTC trades being increasingly standardised and often mirroring exchange contracts. We believe that consideration should be given to creating a set of criteria, potentially linked to the market associations and the standardised contractual terms used, that would provide a clearer and more certain legal position for the VAT treatment of these types of contracts without materially changing the nature of the TMO. We consider that failing to do this by adopting a too restrictive approach is likely to create confusion and be detrimental to the operation of some markets in particular. Moreover, services which are ancillary to the transaction itself but are provided by members acting as agents (e.g. brokerage services), under Article 3(1)(c), should equally be given this clarity of treatment under any revision of the TMO. Any definition of a 'qualifying transaction' must therefore be developed with the changing commercial and regulatory environments in mind.

To promote London as the primary global centre for commodities trading, UK Finance Members would wish to see a broad approach taken to defining qualifying transactions for the purposes of the TMO. As highlighted above, any distinction between execution and clearing that resulted in differing VAT treatment would lead to unnecessary legislative complexity and uncertainty. In line with the current position, Members would be keen to see all elements that are integral to a commodities trade covered by the TMO treatment, as well as all transactions where a member of the recognised commodities exchange or market association is involved.

In our view, an update to the TMO of this nature should be revenue neutral in any case as, even if these trades were subject to VAT, the direct link aspects of the transaction would mean any VAT charged is fully recoverable. This approach should therefore reduce fraud risk by reducing the numbers and types of commodities transactions on which VAT must be charged and paid across to HMRC. The reduced complexity should also reduce the pressure on resources for both HMRC and taxpayers.

Addressing some specific points raised in this section of the Consultation, we would like to raise the following points:

- In 2.21, the Consultation refers to "wholesale trades between businesses". This should be broadened as we would currently expect the TMO to cover certain transactions between members and non-members which in some cases may involve a party that is not a business.
- Further, 2.21 also seeks to apply the following criteria: "Futures, forwards, options and spot contracts which are exercisable at a date later than that on which it is granted". This would appear to provide a narrower scope to the existing TMO which, in Article 3(3), currently covers the "grant of a right by virtue of paragraph (1)(b)". We consider that the current scope of the TMO should be retained.
- 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 on what is meant in 2.22 where it states that the government does not intend to include transactions that are exclusively cash settled.

We would be happy to engage with HMT and HMRC further on the development of a principles-based approach to defining qualifying transactions, as well as feeding into the creation of appropriate HMRC guidance and examples to support interpretation.

Q9: Do you think any other criteria should be included in such a definition?

A9: Assuming HMT/HMRC are minded to accept our proposal for a broad definition of qualifying transactions, as outlined in our response to Question 8 above, our Members believe that this would be sufficiently broad to cover all eventualities. As markets and the regulatory environment continue to develop, however, any consequent changes should be reviewed on a regular basis to ensure that the definition and the principles that underpin it remain 'fit for purpose'.

Specifying the commodities traded on terminal markets

Q10: Do you foresee any issues with the intention to specify commodities within the legislative framework of the TMO?

A10: We consider that attempting to include a list of specified commodities within the legislation would be contrary to the stated objectives, as it would be inflexible and unable to accommodate future developments. Again, our Members would prefer a broad set of principles to underpin any definition which would ideally cover all types of commodities traded by the relevant parties on the recognised exchanges and markets. This could take as its starting point the principles in 2.26, subject to our answer to Question 11 below.

Such an approach would include commodities such as rhodium as well as voluntary carbon credits. We consider that this would provide parity for voluntary carbon credits, eliminating a potential area of confusion and risk of VAT fraud. This approach could also include commodities that may otherwise be regarded as standard rated services (e.g. guarantees of origin, gas storage contracts and similar products) when traded on, and subject to the rules of, the recognised exchanges and markets.

We note that the list of commodities included in section 2.25 does not include base or non-precious metals currently traded on the LME. We assume that this is an oversight but also provides an example of the problems associated with specifying the particular commodities covered. The current framework of the TMO by reference to specific markets does not include a specification of particular commodities and if this approach were adopted it would seem to narrow the scope of the current TMO.

Similar to our response to Question 6, if a list-based approach to specifying the commodities is to be adopted, we consider that appropriate governance processes will need to be established to allow HMT, HMRC and industry to work together to ensure that the list is maintained accurately.

Q11: 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?

A11: Of the three principles set out in 2.26 our Members were broadly in agreement that the commodities traded should ordinarily be treated as taxable supplies under the normal operation of VAT law.

The remaining two principles pose more of a challenge – in particular as they could lead to increased legal uncertainty if they were to be used to form the basis of a legal definition. Taking each of these principles in turn:

- The requirement to meet specific, recognised, international standards may make it harder to identify which commodities fall within the definition, and this could change over time as

international standards are updated or new standards are introduced (e.g. any future new UK standards).

- Introducing a definition that requires commodities to be traded in “sufficiently high value and volumes” is likely to be very difficult to apply in practice as, not only would it require a definition of ‘sufficient’ but depending upon demand and international markets, the value and volumes traded could fluctuate with affected commodities moving in and out of the scope of the TMO.

A broad approach of covering within the TMO all types of commodities traded by relevant parties on the recognised exchanges and markets would remove this uncertainty, creating a clearer legislative framework for taxpayers and reducing fraud risk and auditing time for HMRC.

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

Q12: 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.

A12: Our Members are generally of the view that these articles do not need to be revised. We consider that these Articles should continue to override the legislative exemption so that trading in investment gold under the TMO continues to be treated as taxable at the zero-rate.

Future changes to the TMO

Q13: Do you think the proposed principle-based approach meets the objective of flexible legislation to incorporate future changes?

A13: We believe that a well-constructed and sufficiently broad principles-based legislation (in conjunction with clear supporting HMRC guidance) would be capable of meeting the objective of flexible legislation able to accommodate future changes. That said, the principles and related definitions should be drafted with sufficient clarity to prevent differing interpretations and legal uncertainty.

We consider that application of new, principles based, legislation would be aided by the publication of HMRC guidance containing (non-exhaustive) illustrations and examples.

Q14: Do you think there is an alternative method to make these changes?

A15: If HMT/HMRC are of the view that a list should be maintained either in legislation or published guidance of exchanges, market associations, members and commodities, consideration should be given to establish a forum whereby regular exchanges can take place with industry representatives aimed at discussing and importantly informing HMT/HMRC of market trends and regulatory developments that will impact the existing commodities markets or lead to the trading of new commodities (both physical and intangible). Having such a forum, together with appropriate governance processes, 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.

Q15: 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.

Not applicable.

If you have any questions relating to this response, please contact Gabby Donald (gabby.donald@ukfinance.org.uk).

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