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By PwC Deutschland | 31. März 2025

Economic ownership of shares assigned as collateral

In a most recent decision, the Supreme Tax Court held that the shares transferred by way of security are attributable to the purchaser (who is also the secured party) as of the date of transfer of ownership if the purchaser can legally and effectively exercise the material rights associated with the shares (in particular the sale and exercise of voting rights) and regardless whether the security event occurs.

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Background

In the case of dispute, the plaintiff (a stock corporation - AG) had concluded concurring securities repurchase agreements and securities lending transactions in the same amount. For the duration of the securities loans, the AG received listed British shares from its bank as collateral in return for a fee. It was able to dispose of these shares without restriction and exercise the voting rights associated with them. Upon termination of the securities loans, it had to return (identical) shares of the same type and quantity. The dividends received had to be transferred to its bank at the same time and in equal amounts. The transaction as a whole resulted in a tax loss because the dividends received were tax-free at the time and the forward of the dividends to the bank was deductible as business expense. The plaintiff optimized this loss by prematurely exchanging shares whose dividends it had already received for shares whose dividends were still due.

The tax office considered this to be an abuse of legal forms pursuant to Section 42 (1) Fiscal Code (Abgabenordnung - AO) and increased the plaintiff's profit for the tax year 2006 (year in dispute) by the amount of the dividends received. The appeal before **the Munich Tax Court** was rejected. As tax court of first instance, it confirmed the profit increases by stating that the British shares were not attributable to the plaintiff for tax purposes at the time the dividends were received, but rather to its bank. Bearing this in mind, the issue of an abuse was not considered by the court as relevant and had no effect on its decision.

Decision of the Supreme Tax Court

The Supreme Tax Court disagreed with the view of the tax court. The shares were attributable to the plaintiff for tax purposes in accordance with Section 39 Fiscal Code because - in contrast to traditional security ownership - the plaintiff was entitled to the essential rights associated with the shares. The mere intention or possibility to exercise existing rights are not relevant for the attribution. Such motives may nevertheless be relevant when examining the existence of abuse.

However, based on the findings of the lower tax court the Supreme Tax Court was not in the position to conclusively examine whether such an abuse existed and therefore **referred the case back to court of first instance.** The Supreme Tax Court has strong reservations as to the success

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of the appealfor the following reasons:

It cannot be inferred from the special anti-abuse provision introduced after the year in dispute (here: Section 8b (10) Corporation Tax Act in the version of the 2008 Corporate Tax Reform Act) that a scenario that was subject to this provision does not meet the requirements of the general anti-abuse provision of Section 42 Fiscal Code.

When determining whether an inappropriate arrangement exists it is essential to find out if there were also non-tax reasons for the securance (the securities loan) by transferring the UK shares. It will be a strong indication for an abusive scheme if the arrangement has no economic purpose of its own beyond obtaining a tax advantage.

In any case, the lack of a reason for the provision of collateral beyond the tax advantage is supported by the fact that also no recognizable risk as regards the repo-transaction existed because the securities lending transactions were concluded at the same time and in the same amount. Furthermore, the agreed amount of the “arrangement fee” to be paid by the plaintiff for the provision of collateral in the amount of 2.2% of the dividends received indicates that the provision of collateral was agreed solely for the purpose of obtaining a tax advantage.

Source:

Supreme Tax Court judgment of 13 November 2024 (I R 3/21) – published on 27 March 2025.

Schlagwörter

Collaterals / Sicherheiten, economic ownership, share transfer