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By PwC Deutschland | 17 March 2022

Cum-ex deal rejected by Supreme Tax Court for want of beneficial ownership of shares

In a recently published decision, the Supreme Tax Court dealt with so-called cum-ex share transactions. In its judgment the court rejected a "business concept" that sought to "exploit" uncertainties in the clear economic allocation of shares in such a way that withholding tax once withheld might be credited or refunded by the tax authorities twice or even more times.

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Background

Cum-Ex (“Cum Ex”)- also known as so called dividend stripping - refers to a huge volume of transactions made prior to 2012 that involved the exploitation of an ostensible loophole vis-à-vis dividend payments that enabled several parties to claim the same tax refund. “Cum-Ex” trades involved the acquisition of shares with (cum) dividends due on or just before the dividend record date and delivery of these shares after the dividend record date without (ex) dividends, which made it possible to obtain multiple refunds of withholding tax that had only been paid to the German tax authorities once. In its landmark decision of 28 July 2021, the Federal Court of Justice held that claiming a refund or credit of withholding tax in the wake of cum-ex schemes is a criminal act of tax evasion. The proceeds obtained in these illegal transactions and the benefits derived therefrom may be collected (see **blog post** of 28 July 2021).

Supreme Tax Court judgment

In a specific case the Supreme Tax Court held that a U.S. pension fund is only entitled to a refund of withholding tax if it is the creditor of the investment income in accordance with national tax law and the withholding tax had been "withheld and remitted". It follows that the creditor of the investment income is the person who realizes the respective capital investment income and who is the economic owner of the shares at the time of the dividend resolution to distribute the profits or at the time of any compensation is paid out in lieu of a dividend. Where a person other than the owner exercises effective control over an asset in such a way that he can, as a rule, economically exclude the owner’s power of disposal over the asset during the normal period of its useful life, the asset shall be attributable to this person, Sec. 39(2) No. 1 Fiscal Code.

However, economic ownership in the case of so-called cum-ex transactions is not obtained if the acquisition of the shares is part of the overall concept of the model, according to which the acquirer can neither exercise the essential rights associated with the acquisition of shares nor should he do so according to the structural concept of the transaction; his role is rather to “contribute” his legal status and act merely as a "passive participant” or as a “transaction vehicle" in the course of business.

The plaintiff in the case of dispute, a US pension fund which was exempt from withholding tax according to tax treaty, sought a refund of the tax withheld following the acquisition of shares in German stock corporations; the acquisition via so-called futures occurred shortly before the respective dividend record date, whereby the transfer under civil law took place with a time delay only after the record date in accordance with the usual stock market practices. At the same time, the plaintiff received a so-called dividend compensation payment (i.e. the "net amount" corresponding to the dividend claim after deduction of the withholding tax). The establishment of the plaintiff pension fund (a legal entity with one beneficiary and a low level of funding), occurred in contemporaneous connection with the transactions.The plaintiff was part of a closely coordinated purchase and short-term sale transaction with several parties involving shares with a financial volume of several billion euros, whereby the risk of realizing the refund claim had in turn been transferred in full to a Luxembourg investment fund set up by a bank in return for the promise of a short-term yield of over 15 per cent.

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The position as beneficial owner of a share can only lie with someone who can at the same time exclude the stockholder from his essential rights (e.g. dividend receipts and voting rights). This position vis-à-vis the stockholder cannot be conveyed solely by a legally secured purchase expectation and (from an economic point of view) a receipt of dividends. Beneficial ownership could likewise not be considered where there was a participation in an "overall contractual concept" which virtually prevented that person from exerting his essential rights of ownership in the shares and precluded him from bearing the financial risk of the transactions.

Thus, the Supreme Tax Court confirmed the opinion held by the Federal Tax Office and subsequently the decision of the Regional Tax Court of Cologne by rejecting the refund claim of the plaintiff as unfounded.

Note: This current judgment of the Supreme Tax Court does not consider subsequent changes in tax law, as these did not apply in 2011 (i. e. the year in dispute).

Source:

Supreme Tax Court, decision of 20 February 2022 (I R 22/20), published on 15 March 2022.

Keywords

beneficial owner, cum-ex, dividend stripping