



German administrative guidelines on cum/cum and securities transactions – A challenging revision of principles

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The Federal Finance Ministry (BMF) circulated revisited guidelines regarding the **allocation of economic ownership in cum/cum** and **securities transactions** on 15 July 2021. These guidelines include some fundamental changes compared to the previous administrative guidance¹ and shall apply to all open cases. There is now a much stronger focus on testing economic ownership, combined with anti-abuse considerations.

The following is a summary of the most important practical implications.

A. Cum/cum transactions

Regarding **cum/cum transactions**, which broadly include **stock lending, repo and spot transactions** with German securities **over dividend record date**, the new BMF circular provides for the following fundamental changes.

- 1. Allocation of economic ownership:** In contrast to previous administrative guidelines from 2017, cum/cum transactions no longer shall be primarily tested under general anti-abuse rules². Instead, transfer of economic ownership and the allocation of dividend income and entitlement to withholding tax benefits³ shall be challenged under the test criteria set out by the guidelines.

¹ See BMF circulars dated 11 November 2016 and 17 July 2017.

² Sec. 42 German Tax Code.

³ Germany levies 25% of withholding tax on dividends, plus solidarity surcharge of 5.5% thereon, totalling 26.375%.

Abuse of law considerations shall now apply as a second (rather than primary) layer of challenges.

The economic ownership **test criteria** are mainly based on non-exhaustive indicative facts and circumstances, inter alia:

- weak or low risk position of the transferee;
- no transfer of upside/downside risk attached to the securities (e.g. due to corresponding hedging transactions);
- pre-determined repurchase price for the underlying securities;
- sharing of tax benefits between the parties (e.g. by pricing arrangements);
- short term of duration of the transactions.

In addition, the new guidelines dealing with economic ownership allocation in securities lending transactions (as outlined under B. below) look at a minimum holding period of 45 days. We assume these guidelines shall also apply generally to cum/cum transactions. This would mean in case of a holding period of less than 45 days, the borrower/purchaser has the burden of proof for establishing economic ownership.

If a borrower/purchaser falls short of the test criteria, the guidelines provide that:

- Economic ownership does not transfer to the borrower/purchaser of shares but remains with the lender/seller. As a result, the borrower/purchaser is not entitled to claim a withholding tax benefit.
- The borrower/purchaser shall also be disallowed to deduct expenses incurred in connection with the cum/cum transaction.

This means that in all open cases the German tax authorities could (i) potentially reclaim withholding tax benefits granted and (ii) derecognize deductible expenses in respect of cum/cum transactions.

2. Non-deductibility of definitive withholding tax burden as business expenses: Compared to the previous guidelines, the BMF now rules out the possibility to partially deduct 3/5 of the full withholding tax as a business expense.

3. Grandfathering rules: Under the previous guidelines published in July 2017, dividends received prior to 1 March 2013 were explicitly carved out from the scope of the guidelines if the lender/seller was a EU/EEA counterparty. This exemption has now been completely removed.

4. Disclosure obligations: The guidelines explicitly point to the general rules on disclosure obligations⁴. Under these rules a taxpayer shall, without undue delay, notify the tax authorities in case the taxpayer realises prior to the lapse of the applicable limitation periods that (from an objective standpoint) incorrect or incomplete tax returns have been filed and result in a (potential) understatement of taxes. The taxpayer is obliged to prepare the necessary corrections.

- This means borrowers/purchasers are principally required to revisit their respective filing positions in case these include transactions captured by the guidelines.

B. Economic ownership in securities transactions

In respect of **securities lending transactions**, which over the last few years have been subject to a series of tax court decisions, the BMF guidelines provide for the following:

1. No transfer of economic ownership: In the case of so-called “structured lending” transactions, economic ownership does not transfer to the borrower if specific test criteria established by the Federal Tax Court in a landmark precedent on a structured lending case are met (decision dated 18 August 2015, case no. I R 88/13, developing the so-called “*empty shell doctrine*”).

⁴ Sec. 153 German Tax Code.

In this precedent the Federal Tax Court ruled that no economic ownership transfers from a lender to a borrower in circumstances where the transfer of legal title only appears as an “empty shell” in the hands of the borrower.

In an overall view test, the following facts and circumstances are particularly relevant under the “*empty shell doctrine*”:

- total remuneration received based on tax benefits;
- liquidity position the borrower;
- (possibility of) exercise of voting rights;
- legal position of the borrower under the contractual arrangements in place;
- a holding period of less than 45 days (in which case the burden of proof for establishing economic ownership shall be with the borrower).

2. Transactions in scope: The above principles shall equally apply to similar transactions such as repo or spot transactions.

3. Anti-abuse considerations: The guidelines provide that the application of Sec. 42 German Tax Code shall further ensure that any excess operating expenses achieved by an “engineered contractual framework” shall be reversed by way of an off-balance-sheet correction of any deduction.

4. Disclosure obligations: The circular does not contain an explicit reference to the disclosure rules. However, the same principles as for cum/cum transactions should apply (see A. 4. above).

C. What does this mean in practice?

Since the new guidelines fundamentally overturn principles applied in past practice, a number of **key questions** arises:

- How does the economic ownership test interact with anti-abuse rules?
- Do the new guidelines make the existing special anti-cum/cum rules⁵ redundant?

- How do taxpayers handle and meet the disclosure requirements in practice and which time periods need to be covered?
- Should parties revisit contractual frameworks and booking mechanisms commonly applied in practice?
- Should parties consider reflecting any tax risks on their balance sheet?
- What do custodian banks of parties involved or service providers assisting in tax refund procedures need to consider?

Since the **new guidelines apply to all open cases** and cover both German domestic taxpayers and non-German taxpayers, any tax benefits claimed in respect of transactions covered by the guidelines should be carefully reviewed. The exact time period under review depends on the status of the respective tax procedures.

Focal points in practice should include:

- **Economic ownership** test under the new administrative guidelines;
- **Analysis of potential challenges of tax positions**, in particular (partial) refunds granted in line with special anti-cum/cum rules (e.g. reversal of limited 2/5 tax credit positions) or the previous grandfathering rules, limitation or reversal of deductible expenses (e.g. payments associated with transactions or 3/5 definitive withholding tax burden previously treated as deductible business expenses). A review of existing provisions in the balance sheet for cum/cum risks might be necessary.
- **Preparation of disclosure notifications**, where required.
- **No clear position** of the guidelines **on the interaction with the special anti-cum/cum legislation** in place.

⁵ Secs. 36a and 50j German Income Tax Act.

1 minute read

Revised German administrative guidelines on the allocation of economic ownership in cum/cum and securities transactions:

1. reverse allocation principles applied in the past, with a strong focus on economic ownership;
2. provide for stricter application rules (abolishing grandfathering rules);
3. require taxpayers to consider disclosure notifications to the German tax authorities.

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