MAYER • BROWN

Legal Update
August 2012

Fiscal court of Hamburg: Decision on securities lending in connection with cum/ex trades

In a recently published decision, dated Nov. 24, 2011 (6K22/10), the fiscal court of Hamburg had decided over a case of dividend stripping. In the trade structure at issue a German GmbH had purchased German stock shortly before the record date and entered into a securities lending agreement with a UK-based trading company. Under the securities lending agreement, the UK company was allowed to utilize the securities freely but had to return an equivalent number and kind stock upon the expiry date.

Along with the securities lending agreement, the parties entered into a total return swap, under which the German GmbH was obligated to transmit all of the dividends received throughout the distributions except for a fee of 5%. The German GmbH claimed the refund of the German withholding tax from the German competent tax authorities based on statutory tax law pursuant to which it is entitled to credit the dividend withholding tax against its own corporate tax liability or to claim a refund for withholding tax exceeding the tax credit, respectively.

The economic purpose of the transaction was to bring the UK entity which as a non-resident tax payer is unable to claim for a tax credit/refund but would have been limited to the applicable rate under the double taxation treaty into the same tax position as a resident corporate tax payer.

The fiscal court of Hamburg took the view that the securities lending has to be treated as a loan and not as a lease over the stocks because as typical for a loan, the borrower has to return not the specific stocks provided to him but stocks of the same kind and number. In addition to the legal ownership, the UK entity also took beneficial ownership as it assumed almost all risks and rewards out of the stocks based on the total return swap. As a consequence of the transfer of legal title and economic ownership, the German GmbH lost its ability to claim the withholding tax credit and tax refund, respectively.

An appeal against the decision was filed by the claimant and accepted by the Federal Fiscal Court (Doc. No. 1 R 2/12).

The ruling of the fiscal court of Hamburg is relevant for cum/ex structures which operate based on securities lendings. Transactions where the beneficiary had pledged the securities, hypothecated them even with the right to rehypothecate should not be affected. Of course, every structure has to be reviewed carefully in respect of any potential risk that arrangements are in place which cause beneficial ownership over the stock to forfeit.

The case at issue did not give the fiscal court of Hamburg the chance to provide guidance over the highly debated question whether in OTC transactions the buyer has obtained beneficial ownership same as for transactions on the regulated market for which the Federal Fiscal Court has confirmed that beneficial ownership has been acquired by the buyer already upon entering into the stock purchase agreement and not only on the settlement date.

The Federal Fiscal Court might also shed some light on this question when deciding over the case referred to it.

Dr. Ingo Kleutgens
Partner, Frankfurt
E: ikleutgens@mayerbrown.com
T: +49 69 79 41 1591

Heiko Penndorf
Partner, Franfurt
E: hpenndorf@mayerbrown.com
T: +49 69 79 41 1591

Mayer Brown is a global legal services organisation advising many of the world's largest companies, including a significant portion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest banks. Our legal services include banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory & enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

OFFICE LOCATIONS AMERICAS: Charlotte, Chicago, Houston, Los Angeles, New York, Palo Alto, Washington DC
ASIA: Bangkok, Beijing, Guangzhou, Hanoi, Ho Chi Minh City, Hong Kong, Shanghai, Singapore
EUROPE: Brussels, Düsseldorf, Frankfurt, London, Paris
TAUIL & CHEQUER ADVOGADOS in association with Mayer Brown LLP: São Paulo, Rio de Janeiro
ALLIANCE LAW FIRM: Spain (Ramón y Cajal Abogados)

Please visit our web site for comprehensive contact information for all Mayer Brown offices. www.mayerbrown.com

0440mrk
August 2012