The Cum-ex files - *information document*

Dividend arbitrage

- Dividend arbitrage is an often-used method by traders to hedge the difference in value between shares cum- (with) and ex- (without) dividend, making use of put options. Dividend arbitrage, which is also known as dividend stripping, is practiced throughout the world in many different forms.
- The *cum-ex* scheme gaining notoriety in recent years, concerns an aggressive form of dividend arbitrage employed in Germany and various other EU-countries. The cum-ex scandal allegedly started in 2001 and was first discovered in Germany in 2012. A collective of European media outlets, led by the German Correctiv group have worked together to investigate these so-called cum-ex files. The scope of the scandal has been biggest in Germany, but other European states have been involved as well, among which Denmark, Belgium, Austria, Switzerland and Norway.
- Besides the cum-ex scheme, a so-called *cum-cum* scheme has been deployed in Germany and throughout Europe for years as well.
- It has been estimated that the total costs to European taxpayers of the cum-ex and cum-cum schemes deployed between 2001 and 2012 amount to more than €55bn between 2001 and 2012.

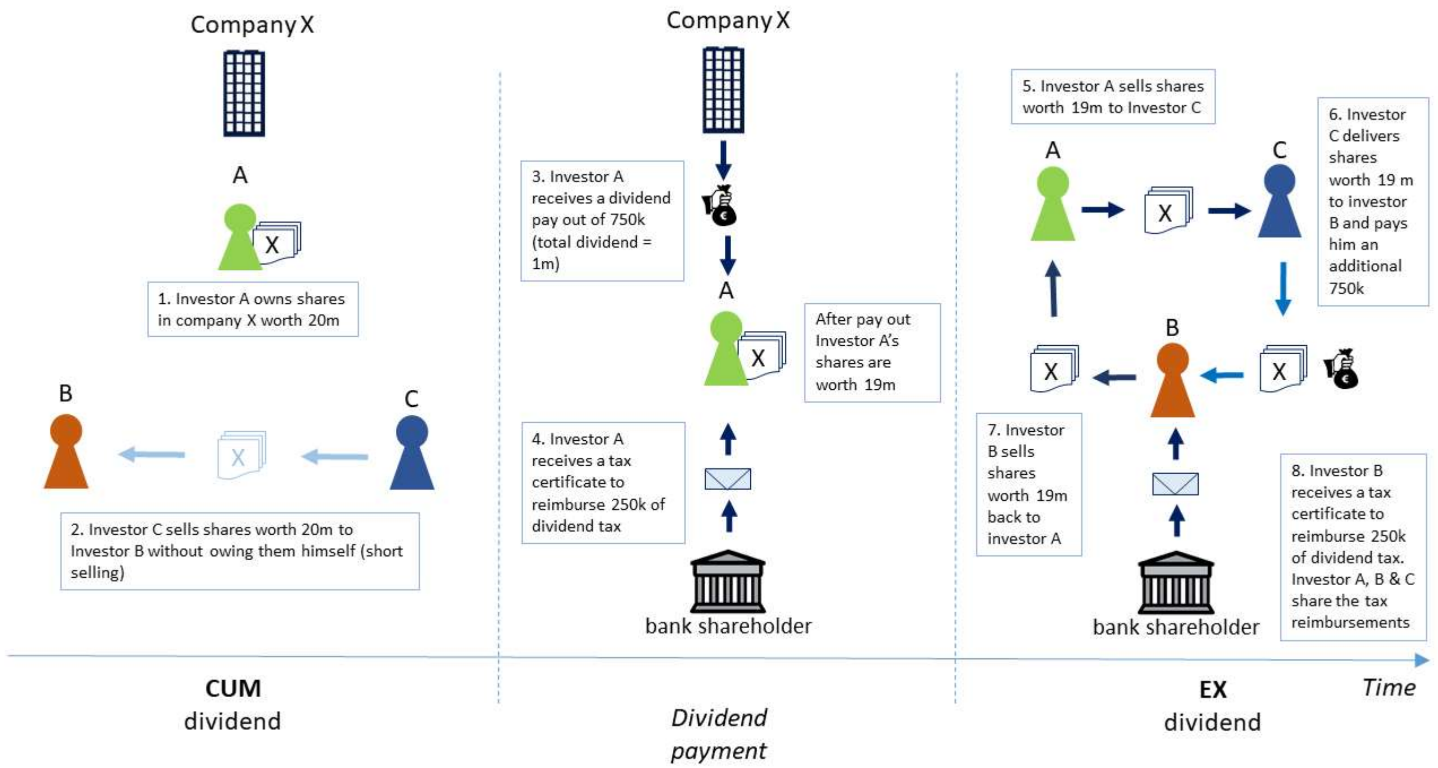
Cum-ex scandal Germany

- Institutional investors in Germany (as opposed to retail investors) may claim back dividend tax (in part) from the government. For years however, investors in Germany made use of a loophole in German tax law, enabling multiple parties to reimburse the same dividend tax.
- Until Germany changed its tax law in 2012, dividend tax (25% of the gross dividend) was collected by the corporation issuing shares, whereas the certificate for tax reimbursement (if applicable) was issued by the shareholder's bank.
- Depository banks did not (necessarily) know whether the transactions they handled were ordinary transactions or a cum-ex transactions, and consequently issued reimbursement-certificates for both. This system allowed multiple investors to claim back tax returns even though only one party actually paid the dividend tax.
- In 2012 Germany changed this system, and since then depository banks are responsible for both collecting the dividend tax and issuing reimbursement-certificates.

In general at least three parties are needed for a successful cum-ex scheme. Below a simplified example how the cum-ex scheme worked in Germany is shown.

Example:
- Investor A (e.g. an asset manager) owns shares worth 20m in listed company X.
- Investor B now buys shares worth 20m from company X as well, just a few days prior to company X paying out dividend to its shareholders. The shares bought by investor B are characterized as *cum*-dividend shares, because these shares will provide the buyer with dividend. Investor B buys these shares from investor C, who- critically- does not own these shares himself yet. Investor C is 'short-selling', and promises investor B to deliver the shares at an agreed time.
- Now company X pays out the dividend- worth 1m- to investor A, who receives €750.000,- directly from company X and a certificate from his own bank to reimburse €250.000,- worth of dividend tax which has been collected by the German tax authority. As a result, investor A's shares are now worth 19m (20m - 1m dividend).
- Investor A now sells these reduced-value shares, characterized as *ex-divided* shares, to investor C.

- As agreed before, investor C now delivers these shares to investor B. However, because they are worth 1m less, investor C pays investor B a dividend compensation worth €750.000,- and investor B's bank provides him with a certificate to reimburse €250.000,- of dividend tax.
- Finally, investor B sells his shares (worth 19m) back to investor A. As a result, both investor A and investor B now own a certificate to reimburse the dividend tax, even though the German tax authority collected the tax only once.
- The additional reimbursed dividend tax is shared between investors A, B and C.



1) Simplified figure representing the German cum-ex scheme

Cum-cum

During and after the cum-ex scandal was exposed, a so-called cum-cum scheme was used by investors in Germany and beyond as well. For a cum-cum scheme, a minimum of two parties is needed, although the traders cooperating in the scheme are often supported by a bank. Below a simplified example how the cum-cum scheme works in practice.

Example:
- Investor A owns 20m in shares in company X but has no legal right to reimburse dividend tax, e.g. because he is resident in a different country.
- Investor A temporarily sells his cum-dividend shares to investor B who does have the right to reimburse the dividend tax. Such a temporary sale is known as a 'loan'.
- Investor B then receives €750.000,- in dividend payments from company X and a certificate to reimburse €250.000,- worth of dividend tax.
- Investor B sells the shares ex-dividend, now worth 19m, back to investor A, who retained the contractual right to buy back his shares. Through this construction, investor A retains his shares, without suffering the negative consequence of losing €250.000,- on the total value of

his shares because he cannot reimburse the dividend tax. Investor A pays investor B a compensation for his help.

Response

After discovering the nature and scope of these dividend arbitrage (cum-ex/cum-cum) scandals, Germany in 2012 changed its law, from then on preventing cum-ex schemes, and in 2017 it ruled that cum-cum schemes would not be allowed any more either because these schemes have the sole aim of avoiding dividend tax. However, according to the media collective led by Correctiv, comparable schemes were deployed and are still being deployed in many other EU countries.

On Tuesday October 23 the cum-ex files were debated in the European Parliament. Although, according to the AT-presidency, there is no indication EU law has been breached, Members expressed their great concern with this scandal.

- Among Members, there was broad agreement that in response to this scandal the current framework for the exchange of tax information between tax authorities should be extended. One of the issues emphasised by Members was the fact that the German authorities prohibited cum-ex trades already in 2012, but did not communicate effectively about this scheme with other EU tax authorities.
- MEP Ferber argued to extend the mandatory exchange of information to capital gains tax and withholding tax (including dividend tax) besides the already existing exchange of information concerning corporation tax. This argument was supported by various other MEPs as well.
- Various MEPs suggested the EU should initiate an investigation into the matter. MEP Karas argued an independent and cross-border investigation should be initiated. MEP Giegold argued a special inquiry should be launched based on Article 22 of the ESA-regulations.
- Commissioner Moscovici argued the existing rules on information exchange and tax cooperation should be better enforced. According to him, the proper rules and means are already available, but the will to utilise these measures effectively often lacks. He did however comment that the idea to expand the rules on information exchange merits further exploration.