2021: DEVELOPMENTS IN CUM-EX

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Syed Rahman, partner at financial crime specialists Rahman Ravelli, examines this year's significant events in the share-selling scandal

The past 12 months have seen matters come to a head on a number of issues in relation to Cum-Ex.

Putting it in the most straightforward of terms, Cum-Ex describes the trading strategies (also known as arbitrage) that were used to obtain dividend withholding tax refunds on dividend payments. Shares were traded rapidly with ("cum") and without ("ex") dividend rights, so that the identity of the actual owner was concealed. An agreement would be made to sell a company stock before the dividend was paid out, but it was not delivered until after the dividend had been paid. This enabled both parties to claim tax rebates, even though that tax had only been paid once, at most. Huge volumes of rapid trading between various parties gave the impression of numerous owners, creating large profits from tax rebate claims. Losses to European treasuries attributed to Cum-Ex are, according to the most recent research, estimated to be approximately €150 billion.

But while the use of Cum-Ex was uncovered by German authorities in 2012, investigations have only gathered pace in recent years. And 2021 has been, arguably, the most significant year in terms of those investigations.

Germany

German authorities believe Cum-Ex cost the country's treasury around €10 billion in lost revenue.

The country is one of the most active jurisdictions when it comes to Cum-Ex prosecutions and recovery of lost funds, with over 100 banks under investigation in Germany

This year saw the German Federal Court of Justice confirm the 2020 decision of the Bonn District Court that Cum-Ex transactions were criminal tax evasion and that the confiscation of €176 million as the proceeds of crime from Hamburg-based private bank M.M. Warburg was justified.

The Federal Court rejected the argument that the two British bankers convicted at the District Court were merely exploiting a tax loophole in German tax legislation. According to the Federal Court, the defendants "deliberately" asked the German authorities to reimburse allegedly-paid capital gains tax, by filing "untruthful" tax returns – which showed a criminal intent to commit tax fraud. The federal judges stated that there had been no such loophole in the legislation at the time.

It is now established in German case law that Cum-Ex is tax fraud – a development that will surely assist further prosecutions in the country. Just a month before this Federal Court ruling, Bonn District Court was also at the eye of the Cum-Ex storm when it jailed a former M.M. Warburg executive for five and a half years. He had been charged with 13 counts of aggravated tax fraud, committed between 2006 and 2013, in connection with Cum-Ex trading.

While this decision may yet be challenged in the Federal Court, the case is a clear sign of German authorities' intent to take a hard line regarding those it believes were to blame for Cum-Ex's financial consequences. February 2021 saw the German authorities ask INTERPOL to issue a Red Notice against New Zealand citizen Paul Mora for his involvement as a London-based banker in Cum-Ex. The following month, the trial began at Wiesbaden of German tax lawyer Hanno Berger, who has been called one of the architects of Cum-Ex. Germany had sought Berger's extradition from Switzerland in what was another sign of its determination to move decisively against those involved in Cum-Ex.

UK

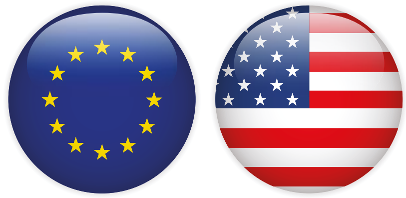
The UK does not have a withholding tax system relating to the payment of dividends. As a result, it has not lost money to Cum-Ex. But the UK legal system has already played a prominent role in investigations relating to Cum-Ex. A number of 2021 cases could prove pivotal in future Cum-Ex prosecutions.

In January 2021, the High Court upheld the validity of the European Arrest Warrant (EAW) after the UK's departure from European Union. It rejected an application by hedge fund worker Vijaya Sankar, who was challenging the EAW issued against him by German Cum-Ex investigators. The court ruled that extradition could not be halted due to Brexit, as the EAW was issued before Britain left the European Union and the UK and EU had agreed that the UK would honour EAWs issued during the Brexit transition period. It is a case that illustrates that although Britain is no longer an EU member, individuals based here that may be targeted by foreign authorities investigating Cum-Ex cannot expect to be immune to the possibility of being extradited.

In May 2021, the UK's Financial Conduct Authority (FCA) fined the broker Sapien Capital £178,000 – under Section 206(1) of the Financial Services and Markets Act 2000 and FCA Principles 2 and 3 - for money laundering failings connected to Cum-Ex trading.

Sapien was alleged to have acted as a broker for over-the-counter (OTC) trades worth £2.5 billion in Danish equities and £3.8 billion in Belgian equities The FCA claimed that these trades were conducted to improperly gain tax rebates via Cum-Ex. It was a significant case as it was the first Cum-Ex action taken by a regulator that is not based in a country affected by the share-selling scandal. The FCA's action was also notable as it did not directly address the legality of Cum-Ex. Instead, it focused on Sapien's failure to meet its procedural obligations. This tactical approach gave the FCA a more clear-cut opportunity to penalise the company than would have been possible if it had focused on the Cum-Ex trading itself.

May 2021 also saw the High Court dismiss a civil action for fraud damages brought by the Danish tax authority SKAT against approximately 100 defendants. In this case, SKAT v Solo Capital Partners LLP & Ors [2021] EWHC 974, the court found that the common law "revenue rule" prevents an English court enforcing a foreign public, revenue or penal law. It was the first case to determine that the revenue rule could apply in such circumstances and may restrict authorities' attempts to recoup cross-border Cum-Ex losses.



Europe and the United States

In 2020, the European Banking Authority stated that the identification and tackling of fraudulent tax schemes such as Cum-Ex was hampered by there being little coordination between EU member states' authorities and a lack of harmonised tax legislation.

But July 2021 saw the EU Commission announce that it was assessing whether to introduce a standardised withholding tax relief system to help prevent practices such as Cum-Ex.

It said it was also looking at how to improve cooperation and the exchange of information between tax administrations and regulators.

The announcement in itself is a sign that the Commission is prepared to take action. It should also be noted that 2021 has seen the creation of the European Public Prosecutor's Office (EPPO), which may lead to more coordinated enforcement action against those believed to have been involved in Cum-Ex or other trading schemes.

While 2021 has seen Germany and the UK taking significant action regarding Cum-Ex, other countries in Europe – notably Denmark and Austria – have also been putting time and resources into their own investigations this year. In the US, law enforcement agencies have brought multiple cases that touch upon Cum-Ex issues. There is a strong possibility that Cum-Ex cases will eventually be brought by the Department of Justice or Securities and Exchange Commission.

The results of such activities in these countries may well become apparent in the next 12 months.