CLEARY GOTTLIEB

ALERT MEMORANDUM

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Germany Proposes New Tax Rules against Dividend Stripping

On February 24, 2016 the German Federal Government approved a legislative proposal[1] explicitly targeting dividend stripping transactions (so-called “cum/cum transactions”). The proposal bemoans that non-resident taxpayers can avoid dividend taxation through the sale of equity securities to a German-resident taxpayer before the dividend record date and the simultaneous repurchase after the dividend record date (by way of forward transactions) or through securities lending. On the buy side, taxable dividend income is offset by losses from the subsequent sale of the equity securities or through the lending fee. This leads to a refund of the dividend withholding tax to the buyer. The tax saving is split amongst seller and buyer.

The anti-dividend stripping proposal introduces a specific holding requirement for taxpayers claiming the credit or refund in the form of a 45-day holding test during which the taxpayer must be economically at risk with respect to the underlying equities. The rule is modeled after precedents from the U.S. (Section 246(c) IRC) and Australia (Income Tax Assessment Act 1997 Section 160APHO and 160APHT) and is meant to deny the German-resident buyers in cum/cum transactions the credit or refund of the dividend withholding tax. A previously discussed new and more general anti-avoidance rule for abusive credit / refund claims modeled after a Swiss precedent (Article 21 sentence 2 of the Swiss *Verrechnungssteuergesetz*) is not included in the German Federal Government proposal.

The new holding requirement for German-resident taxpayers who wish to claim a credit or refund of dividend withholding tax is proposed by the German Federal Government as follows:

A credit or refund would no longer be granted if, during a 91-day period around the dividend record date, the taxpayer is not the legal and beneficial owner of the securities on at least 45 days (minimum holding period). Days, on which the risk of loss borne by the taxpayer is diminished to less than 30 percent of the fair value of the securities at the time of acquisition, would not count towards the minimum holding period. This is meant to prevent situations in which only legal ownership is transferred to a taxpayer but the economic risk remains with the former owner of the securities as a result of other transaction (*e.g.*, options or future contracts). Also, the borrower under a

[1] The legislative proposal predominantly addresses the reform of the German investment fund taxation. Gesetzesentwurf der Bundesregierung: Entwurf eines Gesetzes zur Reform der Investmentbesteuerung (Investmentsteuerreformgesetz, InvStRefG). Changes to the German investment fund taxation are not addressed in this Alert Memo.

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securities lending transaction would not be entitled to claim a credit or refund under this rule.

Special reporting and additional payment obligations are imposed on taxpayers on whose account tax was not withheld or on whose account tax withheld was subsequently refunded. This obligation would apply inter alia to investment funds and in particular to hedge funds as they are currently used specifically to avoid dividend taxation. These taxpayers would consequently have to put compliance procedures in place.

The German Federal Government proposal also introduces an exemption to the new rules for Contractual Trust Arrangements (CTAs) that are commonly used in the context of old age pension solutions. CTAs are not considered structures used to avoid dividend taxation by way of cum/cum transactions.

The new rules do not apply to non-German residents who claim a (partial) refund under an international tax treaty.

The new rules would apply retroactively to all dividends received after January 1, 2016.

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Should you or your colleagues have any questions in connection with this memorandum, please feel free to contact Dr. Daniel Weyde (jweyde@cgsh.com) or Jens Hafemann (jhafemann@cgsh.com) at the Frankfurt office of Cleary Gottlieb.

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