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Cum/Ex convictions- implications for financial institutions in the UK

German papers have called it the most complicated tax fraud trial in modern German history, but the “Cum-Ex” scandal could have implications for the entire financial services industry. Litigation & enforcement partners and attorneys [Judith Seddon](#), [Rosemarie Paul](#), [Paige Berges](#) and [Chris Stott](#), along with Tax partners [Kat Gregor](#) and [Andrew Howard](#) team up with Sarah Wrigley, Derek Patterson, Anant Modi, Rob Mason and Simon Taylor of Forensic Risk Alliance, to discuss a recent conviction in a German court in what is described as the “biggest tax swindle in the history of Europe”, and its implications for financial institutions in the UK. The authors describe the specifics of this case, the tax evasion offences at hand, and touch upon a potential ripple effect throughout the finance industry.

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On 19 March 2020, a German court found two former London-based bankers guilty of tax evasion offences in the first criminal trial related to “Cum Ex” trades.¹ They received suspended sentences totalling 34 months, in light of their extensive cooperation with prosecutors. They and a Hamburg-based bank involved with the transactions are also reported to have been required to repay over EUR 190 million in illegally obtained earnings.

What is a Cum Ex trade?

Described as the “biggest tax swindle in the history of Europe”, “Cum Ex” transactions involve multiple reclaims for a single payment of dividend withholding tax.² Transactions typically involve multiple counterparties with differing degrees of knowledge and can be very difficult to distinguish from less aggressive transactions involving equities taking place on or around the dividend record date.

What happened in this case?

The equity trading scheme orchestrated between 2006 and 2011 by the two individuals now convicted is believed to have resulted in a tax loss of approximately EUR 400 million (approximately USD 443 million).³ However, the scheme was part of a much broader pattern of trades which is said to have cost the German government as much as EUR 5.5 billion before the pattern was uncovered in 2017.

The case is notable for establishing for the first time that “Cum Ex” transactions were ineffective under prevailing German tax rules, and that this should have been so obvious to participants that the transactions in question amounted to criminal tax evasion.

What will happen next?

It has been reported that some of the participants affected by the verdict are considering an appeal.

¹ <https://www.ft.com/content/550121de-69b3-11ea-800d-da70cff6e4d3>

² For more detail see <https://www.ropesgray.com/en/newsroom/podcasts/2018/December/Podcast-Cum-Ex-Dividend-Trade-Investigations>

³ <https://www.cnbc.com/2019/10/14/cum-ex-german-tax-case-could-ripple-through-the-finance-industry.html>

Numerous banks, brokers and professional services firms have been mentioned in press related to the trades.⁴ German prosecutors have said they are continuing investigations into over 50 cum ex trades involving 400 suspects. This will be the first of many times when courts in Germany and across Europe pronounce on these issues. Criminal investigations have been ongoing for a number of years in numerous jurisdictions and continue to involve substantial amounts of cooperation and exchange of information between authorities. There is also already fairly extensive civil litigation, and there seems a good chance that this will increase. Authorities in many of the jurisdictions that are thought to have been affected have so far appeared to sit on the sidelines, but this verdict may prompt them to action.

Whether a wave of convictions will follow (as many predict) will depend upon courts' assessments of the level of knowledge and intent amongst the many parties involved in Cum Ex trades. Many cases will turn on fine factual judgments informed by highly technical forensic evidence.

What are the implications in the UK?

Although the UK tax authorities are not impacted by the transactions (unlike many European jurisdictions, the UK does not impose dividend withholding tax), it is not a coincidence that the individuals in this case were based in London. Many financial institutions had teams engaged in equities trading, including tax-related equities trading, based in London at the relevant time. Financial institutions may also have been involved in transactions in ancillary transactions, for example, acting as custodians or prime brokers and/ or providing liquidity or hedging for transactions.

As a result, UK financial institutions have been a focus for investigating European tax authorities, including various proceedings to obtain information through the English courts. The Danish tax authorities are also seeking to recoup lost tax through the New York courts.

The FCA has also confirmed that it is investigating. Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, said in a recent speech:

...The FCA has worked closely with European authorities for some time on a story that appeared this week about the seizure of a property in London as part of proceedings against a trader allegedly involved in dividend stripping tax avoidance schemes that have operated in Denmark, Germany, France and Italy.

The FCA has been investigating substantial and suspected abusive share trading in London's markets that has allegedly supported these schemes. These investigations are now very close to their conclusion and decisions about action are imminent.

What actions should financial institutions take?

Although, the transactions in question mainly took place at least seven years ago, it appears that the fall-out is only just beginning. The overall amount of tax at stake has been estimated at \$60 billion.

It seems likely that, as investigations proceed, financial institutions which have so far not been implicated may get pulled in. Those financial institutions that have been implicated already can expect further actions, some of which, such as FCA activity, may not have been anticipated in deliberations that have taken place to date. Institutions in both categories should monitor developments and may wish to consider conducting their own investigations if they are concerned that they could become implicated or further implicated.

⁴ <https://www.cnbc.com/2019/10/14/cum-ex-german-tax-case-could-ripple-through-the-finance-industry.html>