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Tax Robbery Incorporated: The transnational legal infrastructures of tax arbitrage

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Global Cooperation Research Papers 30

Philip Liste

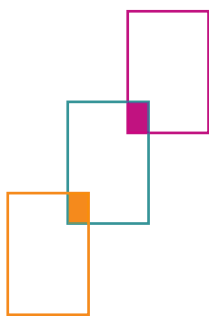
Tax Robbery Incorporated: The Transnational Legal Infrastructures of Tax Arbitrage



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Tax Robbery Incorporated: The Transnational Legal Infrastructures of Tax Arbitrage

Philip Liste

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Preface

Any mention of cooperation research in scholarly as well as general discourse tends to tilt towards the bright side of such collaboration efforts. Whether the discussions centre around themes such as climate change, nuclear disarmament or even global health, the focus remains on the success stories of global cooperation. However, this view fails to acknowledge that cooperation is not good per se. A substantial component of global cooperation in political issues sees actors operating in the dark side and out of public control – a facet that is often neglected by researchers. Prominent examples include cooperative practices between intelligence services in the war on terror as well as digital surveillance measures which are difficult to localize, as they work between the public and private sphere and across different scales. During his stay as a fellow and interim research group leader at the Centre, Philip Liste put in great effort to raise his fellow researchers' awareness of the need to pay closer attention to the dark sides of global cooperation as an important but often overlooked field of polycentric governance. His field of interest is a rather unusual case for scholars at the intersection of international relations and law: the transnational structures of tax arbitrage. While most people know about these (formerly hidden) practices through the leaking of the Panama Papers and other similar revelations, Philip's focus is on a special and highly complex case: the cum/ex industry and its underlying practices. As two British traders involved in the scandal were put on trial in Bonn, Germany during his fellowship at the Centre, Philip went to observe the trial and adopted ethnographic methods to gain an understanding of how these complex and normatively doubtful transactions were conducted by a network of equity traders, banks, super-rich investors, and lawyers. It is estimated that the scandal cost European treasuries over €50 billion. This research paper gives a micro-oriented perspective on how legal infrastructures make dark finance possible and how specific legal practices and practical knowledge reproduce a system of polycentric governance with harmful and immoral net effects for a global public.

Frank Gadinger (Editorial Board)

Tax Robbery Incorporated: The Transnational Legal Infrastructures of Tax Arbitrage

Philip Liste¹

1 Prologue: Law and finance

The courtroom S 0.11 of the Regional Court in Bonn (LG Bonn), Germany, is a modern wood-panelled meeting room with a wide window façade to an inner courtyard stretching across the whole length of the room. The TV cameras that have covered the scene throughout the week before are gone, but photographers and press representatives interested in a denser coverage of the scandal are still present. The atmosphere is busy. Some persons involved in the trial shake hands. A senior male attorney asks his younger female colleague for help with his bowtie. One of the accused equity traders talks to his attorney, a prominent lawyer in the field of white-collar crime. In the seat row behind the accused, the legal representatives of several banking houses get together. Amidst these protagonists, who apparently know each other quite well, two interpreters appear to be rather misplaced. From the other side of the room, two prosecutors observe the scene. The judges' bench is still vacant.

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In the meantime, the seats for the public are filling up – mainly press representatives, a few pensioner couples, and noticeably many young people, assumably students, who will later, during the proceedings, type every single spoken word into their notebooks. Perhaps they were sent by the finance industry, which would indeed be interested in a dense reporting of any single word said in this courtroom. In between, in the third row, a political scientist has taken a seat. Having started his 'observation', he seeks to do some type of court ethnography but will have to realize in the coming days that this is easier said than done. Suddenly, the noise of a doorhandle pressed down breaks into the various conversations. Three male judges enter the courtroom together with two female lay judges. Everybody stands up. The world of finance is about to be aligned to the law.

¹ For helpful comments on an earlier version of this paper, I am grateful to Andrea Binder, Frank Gadinger, Marieke de Goede, Oliver Kessler, Kai Koddenbrock, Friederike Kuntz, Simon Pratt, Thomas Rixen and a reviewer for the KHK/GCR21 Working Paper Series. I also thank Melissa Abreu, Saina Klein and Clemens Weggen for their comments and language editing.

2 Infrastructures

The trial against two British equity traders, Martin S. and Nicholas D., before the 12th criminal chamber of the LG Bonn deals with the so-called ‘cum/ex’ trades. Few people know what this exactly means. During the recent years, the media as well as a special committee by the German *Bundestag* have attempted to put a price tag on the phenomenon. Across Europe, cum/ex, a complex scheme of tax arbitrage to generate returns of capital income tax that has not been paid before, has caused an estimated loss of 150 billion euros to the state treasury (Correctiv 2021). Yet, the highly complex mechanics of such trades were modified numerous times during what has arguably been a ‘hare and tortoise’ race between protagonists in the cum/ex industry and state regulators (Balzli and Schießl 2009).

The challenge for the court in Bonn was to reconstruct the mechanics and to legally assess a financial phenomenon that not even all of the traders themselves had fully understood, while already operating it for about a year.² What helped was the fact that prior to the trial the two accused traders had extensively cooperated with the prosecutor and, in the courtroom, were willing to elaborate at length on the various elements and details of the transactions. Thus, this initial criminal court case on cum/ex also served a more far-reaching and future-oriented purpose. In the end, and because of their cooperative behaviour, the two accused traders got away with rather mild (suspended) sentences.³ In addition, one of the involved financial institutions, the Hamburg-based private bank M.M.Warburg & CO, which had been included in the trial as ‘*Einzugsbeteiligte*’ had to repay cum/ex related profits of 176 million euros.⁴ Yet, the meaning of the judgment transcends the case at hand. In establishing that cum/ex is a criminal phenomenon (a hard case of tax evasion), the judgment will likely serve as a blueprint for a mountain of future lawsuits against traders, CEOs of banks and accounting firms as well as legal experts serving the finance industry. At the time of writing, 105 cases against 1350 individuals are being investigated by the Cologne prosecutor’s office alone. In addition, investigations are under way in Frankfurt, Munich and Stuttgart (Iwersen and Votsmeier 2022: 30).

The focus of this paper is neither a thick description of the cum/ex mechanics nor a legal assessment of the trades. Rather, the aim is to change the perspec-

² Testimony of Accused D. on September 25, 2019.

³ Moreover, the more senior accused S. had to pay back an estimated profit from cum/ex transactions of 14 million euros.

⁴ Landgericht Bonn, 62 KLS - 213 Js 41/19 - 1/19. Einzugsbeteiligte are third parties included by the court with the aim to confiscate illegally obtained property. In the Bonn trial, further Einzugsbeteiligte were Warburg Invest, Hansainvest, BNY Mellon, and the investment trusts of Société Générale (Iwersen and Votsmeier 2019: 33). In the meantime, the Bonn verdict has finally been confirmed by the Bundesgerichtshof (federal court). See Bundesgerichtshof, Nr. 146/2021, Urteil vom 28. Juli 2021 – 1 StR 519/20.

tive and study the role that law has played *for* the cum/ex industry. To this end, three main arguments are to be developed. First, law and legal practice are addressed not as a regulatory constraint to tax arbitrage, but as enabling it – that is, as a critical normative infrastructure that made cum/ex possible. This change in perspective implies that the nexus between cum/ex and law has not only been established in Bonn, i.e. in the moment in which – as I have called it in the prologue – the world of finance has aligned to the law. For practice in the global financial market, the relevance of law does not begin with the state’s attempt to prosecute equity traders as white-collar criminals. Rather, the law plays an active part in the everyday of finance, in that it serves as a critical normative infrastructure for establishing complex trading structures necessary for the cum/ex transactions.

Second, the cum/ex industry’s legal infrastructure is not fixed but depends on an ongoing and highly specialized legal practice through which the infrastructure is maintained despite various attempts by the state regulator to prevent tax-driven equity trading. And third, the legal infrastructure used for cum/ex is by no means limited to domestic law. As I will demonstrate in the remainder of this paper, the trading structures established (and permanently re-established) for making cum/ex trades possible involve a series of transactions, which are subject to various regulatory regimes, domestic and international, as well as public and private.

In elaborating on these three arguments, the paper seeks to contribute to (and integrate) debates in the fields of Law and Society Studies (Darian-Smith 2013), International Relations (IR) practice theory (Bueger and Gadinger 2018), polycentric governance (Gadinger and Scholte 2022) and transnational law (Zumbansen 2021).

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3 Foxes in the henhouse

In 2018, two investigative journalists, conducted a video interview with a whistleblower who had been one of the major orchestrators in the German cum/ex industry. After having left what he referred to as ‘the phalanx’, he collaborated with the Cologne prosecutor and, later, appeared as a key witness in the first criminal law cases (see below) (Wilmroth and Wischmeyer 2019: 18). As he stated at some point in the interview,

In all universities [...] the next generations are being cultivated. It will happen again [...] that investment bankers, lawyers, tax advisors, well-known individuals, and maybe even politicians, will find the next legal loophole and use it. As sure as day following night. Just because the door to the henhouse was nailed shut, doesn’t mean that investment bankers, especially the new generation, are now reformed, and have

changed their way of thinking. The next generation of bloodthirsty foxes is already growing up, possibly already working on finding the next entrance – maybe a window – to the henhouse. (Correctiv 2018, quote from the subtitles in the video)

The metaphor of the foxes in the henhouse becomes more obvious during the Bonn trial. Indeed, the whistleblower knew a lot about the function of the law since it was his and his senior colleague's legal service to orchestrate a complex interrelation of various actors in the world of finance and to arrange a critical legal infrastructure for German cum/ex trades. The description of 'finding loopholes' is thus an underestimation. More precisely, the lawyer's task has been to create and foster loopholes, to ensure legal certainty by way of providing legal opinions for various players in the cum/ex industry and even to lobby in a legislative process to avoid the state regulators closing the critical legal windows of opportunity. The lawyers, in other words, were the ones who set the stage and somewhat positioned (and re-positioned) the tortoises in their race against the hare.

In this sense, the legal knowledge practice offered to the financial players in the cum/ex industry comprises much more than just pointing the finger to the putative loopholes in German tax law. The major asset in the encounter of law and finance has rather been (and arguably still is) a severe knowledge of how processes are coded in the various stages of the relevant transactions – i.e. a broad knowledge of the domestic, international and transnational regulation of finance including the various rules of common law, international treaties on double tax avoidance (DTA), international regimes against base erosion and profit shifting (BEPS), private governance of global marketplaces, the private standardization of OTC (over-the-counter) trading, the internal compliance processes in the involved banks, etc. (Riles 2011; Teubner 2012; Dietsch and Rixen 2016; Picciotto 2016; Mattli 2019; Pistor 2019). The relevant knowledge practice, in other words, is transnational and it is practiced in hardly accessible places such as the 32nd floor of skyscrapers in Frankfurt, high-class restaurants in the City of London, luxury resorts in Mallorca or on a yacht in Monte Carlo. While these places are obviously not public, the relevant practice is not necessarily of an extraordinary nature. Rather, the legal infrastructure is provided through a sort of everyday type of transnational legal practice. Facing this transnational scale of the involved legal knowledge practice, we could of course ask whether it makes sense to observe a trial before a domestic court in which judges decide whether the accused actors have violated German law. In this paper, the answer will be 'Yes', for it is the domestic courtroom that provides a site in which the transnational mechanics of cum/ex as well as the corresponding transnational legal knowledge practice become (are made) publicly visible. With all its theatrical elements (Vismann 2011), the courtroom turns into a stage for the public encounter of polycentric and transnational law and finance.

4 An extended attempt to explain cum/ex

For the purpose of my argument, it makes sense to introduce an – at least rough – model of the cum/ex trades, even though this will hardly represent the practice in its full complexity and fluidity (Fig. 1). Moreover, the major aim is not a precise depiction of the cum/ex trades but to gather an idea of the necessary normative infrastructure and the corresponding transnational legal knowledge practice that made cum/ex possible.

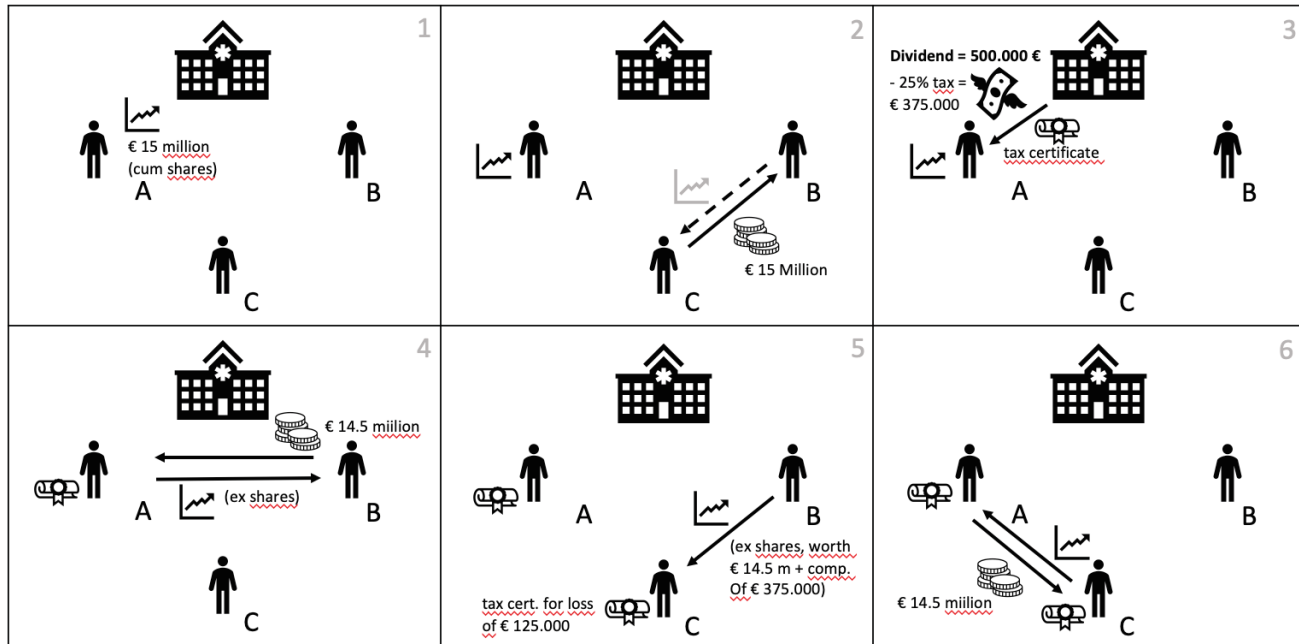


Figure 1

- The starting point is stage one. An investor A holds shares of a DAX company, say, worth 15 million euros. It is foreseeable that, very soon, the company will pay a dividend to all investors who ‘physically’ hold shares on the dividend record day. These shares are thus ‘cum’ shares, i.e. shares with dividend rights.
- In stage two, the day prior to the dividend record day, another investor C buys shares of the mentioned company, also worth 15 million euros, from investor B. However, B is a short seller and does not really have the shares at this point. That is, the sales contract provides for a future delivery of the shares.
- In stage three, the dividend record day, the company pays the dividend. For A, this means a dividend of 500.000 Euros. However, A does not receive the whole amount, because the company transfers 25 per cent capital income tax to the state. Thus, A only receives 375.000 euros, plus a tax voucher that certifies the tax paid. Under certain conditions, A can later get the tax refunded. Investor C receives no dividend. Al-

though having bought the shares, he does not hold them yet and this means: no dividend right.

- Stage four is the day after the dividend record day. Now, A sells the shares to B. The dividend has already been paid, implying that the shares no longer contain a dividend right. The shares are now ‘ex’-shares, i.e. shares without dividend right. Moreover, these ‘ex’-shares are less valuable because a certain share of the company’s capital has been paid to the shareholders. The value of the shares that B now receives from A is thus 15 million euros, minus the dividend. B pays A 14.5 million euros.
- In stage five, B can now deliver the shares to C as provided in the sales contract. Yet, the problem is that C had paid 15 million but only receives shares worth 14.5 million euros. Therefore, B pays C a compensation of 375.000 euros. This means that 125.000 euros are still missing. However, C can handle this gap because, in principle, dividend compensations are also subject to 25 per cent capital income tax, and the depositary bank thus issues the corresponding tax voucher worth the remaining 125.000 euros. Yet, the state has proven technically unable to track the process here, i.e. to reconstruct which actor had to pay the tax and if this tax has been paid altogether.
- Finally, in stage six, C sells the shares back to A for 14.5 million euros. Everything is as in the beginning – with the slight difference that now two investors have tax vouchers. As a result, the state returns tax twice, although it has only been paid once. The trick is of course a collusion of the involved participants who now happily share the prey.

Despite the complexity of the outlined course of action, the model is still a simplification. In the reality of cum/ex, more actors were involved (private investors, various funds, banks as custodian and/or for credit leverage, brokers, law firms, shell companies, etc.) and arguably, more consultations than depicted in the illustration were necessary among these actors. Moreover, some elements of the trades call for the payment of fees. As a result, the profit per individual share has been rather small. At the same time, it becomes obvious from our simplified model that cum/ex trades did not involve a remarkable speculative risk. During the proceedings in Bonn, one major orchestrator of the German cum/ex complex was even quoted as saying that ‘the only risk is: the state has no money’.⁵ Against the backdrop of a thus conceivable ‘risk,’ it was economically feasible to raise the profit through an excessive accumulation of traded shares, which of course requires a lot of capital (in some reported cases a single cum/ex transaction amounted to a billion euros).⁶

Against this backdrop, it is now possible to clarify the above argument. What

⁵ Witness ‘Frey’ in Bonn, October 29, 2019.

⁶ Landgericht Bonn, 62 KLs - 213 Js 41/19 - 1/19, para. 537.

is rather obvious, is that in regulatory terms cum/ex is not only subject to a domestic tax regime. In fact, the transactions indicated in the model imply different regulations and, to be sure, a transnational plurality of polycentric governance that, taken together, enable and structure these trades. The infrastructure has been transnational. In this sense, at least the following types of regulation were involved:

- The capital income tax is regulated through domestic tax law.
- The relation between the DAX company and the investors holding shares is subject to stock exchange regulation (which is of course regulated through domestic civil law but is in part also subject to private governance).
- Short sales are usually operated OTC (over the counter), that is, directly among banks, but are nevertheless regulated, e.g. through the International Swaps and Derivatives Association (ISDA), a private standards provider (Riles 2011).
- In some trading structures, investment funds appear as short sellers. Inasmuch as such funds are located in places like Malta, parts of the trade are subject to another domestic (and finance-friendlier) regulation.

Arguably, the closer we observe the trades, the more regulatory frameworks and agencies come into view – especially when accounting for the additional participants not yet addressed in the model. It is also important to bear in mind that trading structures imply a complex sequence – if not sequencing – of regulatory regimes. Turned into a productive enabling constellation, these regimes (or regime complexes) (Raustiala and Victor 2004) serve as legal infrastructure. Tax-driven equity trading is thus ill-conceived as an exploitation of given legal loopholes. Rather, a transnational constellation of regulatory regimes as well as their ongoing (re-)configuration enables and structures the practice that in the case at hand is called cum/ex.

5 Law in context

To understand law as infrastructure it is necessary to study law in its context or, to be sure, in the various contexts in which it may serve particular interests. In the case at hand, the prosecutor will use the law to bring a charge against the equity traders. In turn, the traders' attorneys will use the law to defend their clients. However, as argued before, the focus of the paper is not on how law is used in the courtroom. Outside the court, law may be used for multiple purposes. It is at work in various sites and contexts, including those we would not necessarily associate with law. In addition, we may broaden the picture by

addressing legal practice as legal knowledge practice, i.e. as a particular type of expertise in (1) what law can be put to work, (2) for what purposes and (3) how (Riles 2011). While it is arguably a truism that law is always embedded within a wider societal context, it is worth considering the meaning of context more in-depth, including both the law's macro and micro contexts. In legal studies, the contextualization of law is traditionally connected to legal realism (Frank 1930; Llewellyn 1930; Pound 1931).⁷ More recent strands of work that have been influenced by this tradition are the new legal realism in critical legal studies (Frankenberg 2011; Kennedy 1991), law and economy (Miles and Sunstein 2008), and law and society studies (Merry 2006; Mertz et al. 2016; Riles 2005).⁸ In this strand of scholarship, a distance to the subject of law is achieved through the insight into what is indeed a contradiction. On the one hand, legal norms are formulated in an abstract way, open to interpretation, which is necessary to apply the law to particular social situations. As a resource for legal practice that faces a contingent and, at times, quickly changing world, the law remains – and must remain – indeterminate. On the other hand, legal practice pretends to be consequential, i.e. the conclusions drawn from the law are presented as strictly following legal logic.

Legal realists have challenged this image by suggesting a shift in perspective. As Oliver Wendell Holmes, whose work inspired the realists, put it, we 'must look at it [the law] as a bad man, who cares only for the material consequences which such knowledge enables him to predict' (Holmes 1897: 459). Furthermore, a thus instrumentalist view allowed for questioning whether legal logic is really 'the only force at work in the development of law' (Holmes 1897: 465).

While this does not necessarily express a general scepticism towards law, it indeed shifts the attention to some of the conditions under which law is practiced (in context understood as the societal field of power) (Bourdieu 1987). Thus, the perspective diverges from a Marxist law scepticism in that it stresses contingency instead of determinism. For the realists, law is not a superstructure determined by the material relations of production but rather an indeterminate resource that structures relations between individuals or groups in society (Hale 1923). Hence, the core question is not how certain societal relations of power are inscribed in the 'law in the books' but rather how the ongoing application of such law, the 'law in action', reproduces relations of power.⁹

For Holmes, who also served as judge at the U.S. Supreme Court, the instrumentalist view was not of a purely academic interest. Dissenting to a landmark decision in *Lochner v. New York* (1905), he pointed to the problem that

⁷ For an insightful overview, see Horwitz 1992. Note that legal realism is not to be equated with realism in IR!

⁸ For a thorough engagement with legal realism, see Liste 2020.

⁹ For the distinction between the 'law in the books' and the 'law in action,' see Pound 1910.

‘general propositions do not decide concrete cases’.¹⁰ The judgment cannot be reduced to a logical deduction from the ‘law in the books’. Instead, law is practiced in context. It serves a purpose in context and, what is most important, will not remain unaffected by context. The conclusion that the legal realists drew from this insight is a call for empirical analysis, i.e. a call to take into account the extra-legal variables of legal decision-making.

New legal realists since the 1960s have extended this perspective to sites beyond the decision-making in the courtroom and turned to the workings of law in rather mundane settings such as police stations or sports stadiums (Macaulay 2005) and, more recently, legal technique in transnational banking practice (Riles 2011). Inasmuch law is put to work in different contexts, including contexts not at all related to courts; the corresponding legal knowledge practice is to be understood as contextualized as well.

In this analytical tradition, work on law needs to be sensitive to macro contexts like a capitalist market economy as well as to micro contexts such as a particular site in which legal knowledge is practiced (e.g. an interrogation room in a marginal police station or an office of an internationally operating law firm). At the same time, the focus on the micro perspective does not preclude the insight that legal practices in particular sites can be transnational, i.e. networked across various jurisdictional boundaries and also across the divide of public and private forms of legal regulation (Jessup 1956; Zumbansen 2021). Being a transnational knowledge practice, law serves as a tool to configure various kinds of infrastructures upon which, say, financial transactions can be networked. Transnational legal knowledge practice may give orientation on a transnational terrain but also works for structuring this very terrain. At the same time, law itself is a terrain on which ‘people with projects’ experience victories or defeats (Kennedy 2016: 56, 61–62). Legal knowledge practice, in other words, consists in an ongoing struggle for a transnational normative infrastructure that serves the purposes of certain economic actors – such as banks, traders, investors, etc.

Another important element of new legal realism is its focus on the everyday. Rather than turning to the extraordinary moments of institutional design or prominent determinations of the law in form of, say, landmark decisions in high courts, this work focusses on the mundane, seemingly meaningless and thus usually invisible ‘technical’ decisions that, however, keep the system running. In this respect, Annelise Riles studies everyday regulation of global finance by revisiting the distinction between the public and the private, albeit as sites of divergent forms of legal knowledge practice – legal ‘technocracy’ of state bureaucracy and legal ‘technique’ of private business (Riles 2011). With regard to the different meanings of the term ‘collateral,’ Riles (2011: 49) carries out a remarkable analytical shift from norms to practice. As she observes,

¹⁰ *Lochner v. New York*, 198 U.S. 45 (1905), Justice Holmes, dissenting

In legal terms, collateral is a body of doctrines and theories, a special set of property rights. [...] But in the financial market, one encounters ‘collateral’ as a mountain of specific preprinted forms that must be completed and filed before trading can begin, and of confirmation documents that must be exchanged after each trade.

More important than norms is thus the seemingly banal technique of working with material artefacts such as forms or documents. Here, it is not the wording of legal norms but the gaps to be filled by legal experts that have practical relevance. The making of a legal contract receives its relevance not from the rather unlikely future scenario of a legal dispute to be solved in court but already in the everyday practice of making a financial trade happen. For Riles, it is here that we find something of a particular interest, which is the ‘technicalities of regulation’ as core element in the analysis of law in the world of global finance (Riles 2011: 223). The production and reproduction of business opportunities, and more than this, the normative infrastructure of these, happens right here, in the usually invisible private niches of a global financial market.

Yet, with regard to legal knowledge practice, the notion of infrastructure delineates a remarkable shift in the description of legal processes. This becomes particularly obvious when turning to the so-called use of ‘legal loopholes’, which is repeatedly invoked in the context of tax avoidance. Talking of loopholes implies that legislators in their attempts to regulate a certain practice have left something out and thus failed in creating a sufficiently dense web of regulation. In this logic, the result is a regulatory vacuum, which – when explored by legal experts – is used to act without legal constraints. However, by turning to the concept of normative infrastructure, I reject this notion of loopholes. What is neglected by this view is how legal practice itself contributes to the emergence of so-called loopholes or vacuums. As Fleur Johns argues, law is deeply involved in the processes of creating various forms of ‘non-legality’ and vacuums are indeed ‘structured by legal norms and normative practices’ (Johns 2013: 11).

In fact, this gives me the opportunity to clarify my analytical endeavour. When the cum/ex industry was put on trial at the LG Bonn in 2019, the purposes were rather conventional. The prosecutor aimed at a conviction of the accused traders and, with regard to future criminal procedures, an adjudication of cum/ex as a criminal practice (if not a complex of organized crime).¹¹ By contrast, the defence lawyers aimed at a lenient sentence for their clients. In addition, the legal representatives of the *Einzugsbeteiligten* (i.e. the involved banks) tried to avoid future confiscation of cum/ex-related profits. Yet, in this paper the aim is not to address these divergent legal purposes that in fact collide in court. Rather, the aim is to reverse a thus conventional legal perspec-

¹¹ See OLG Frankfurt a. M., Beschluss vom 06.05.2021 - 2 Ws 132/20, para. 11

tive. More importantly, this paper seeks to understand law not as a constraining but rather as an enabling devise, that is, as a normative infrastructure that allows for certain operations, circulations, accelerations or generations of certificates. Studying law in context thus means to ask for the multiple functions that law has played in the world of finance. It is this perspective that allows us to raise new questions: How did everyday legal knowledge practice enable and structure profit in the cum/ex industry? How has law served as a normative infrastructure even for apparently harmful and arguably illegal tax-driven trading structures? And how has this infrastructure been manufactured and maintained?

An important consequence of this research strategy is that the courtroom is no longer the site in which the relevant legal practice is to be analysed. Somewhat paradoxically, I have visited the courtroom to study the workings of law elsewhere. In other words, in this paper I use the courtroom as a window or, put differently, a theatre in which an industrial production of ‘non-legality’ is exhibited.

6 Infamous encounters

Before we turn to the courtroom, it is necessary to briefly visit the encounter between finance, law and politics that arguably set the stage for cum/ex. Before cum/ex was brought in court, several attempts to (re-)regulate finance, and thus to stop the unjustified extraction of tax returns, failed.¹² Perhaps, what was at some point called ‘the biggest tax robbery in history’ (Ackermann et al. 2017) was only enabled by way of an infamous encounter between courts, big banking houses, the German Banking Association, the German Ministry of Finance and legal experts, some of whom we will meet again in the courtroom below.

In 2016, a committee of inquiry by the German Bundestag was established, inter alia, to account for the measures taken by federal agencies to prevent cum/ex trading, to estimate the loss in tax revenue between 1999 and 2011, to assess whether state agencies knew or must have known about corresponding activities and whether the actions taken to prevent cum/ex are sufficient, also with regard to similar trading structures in the future (Deutscher Bundestag 2017: 21–22). In its final report, the committee located the first formally reported case of cum/ex as early as 1990 and, by the same token, points to the possibility that not even this incident is necessarily the original starting point

¹² Saskia Sassen productively uses the concept of ‘extractions’ in her critique of finance (Sassen 2014).

of cum/ex.¹³ And even when assuming that in the early years cum/ex was a niche product not likely to have caused huge damages to state treasuries, it turns out that state regulators still failed to prevent the unjustified extraction of tax returns when cum/ex structures gained steam during the 2000s. Moreover, it is in the latter time period that a relation between the cum/ex industry and state regulators – with lobbyism as a critical transmission belt – adds an interesting chapter to the history of the phenomenon (see Fig. 2).

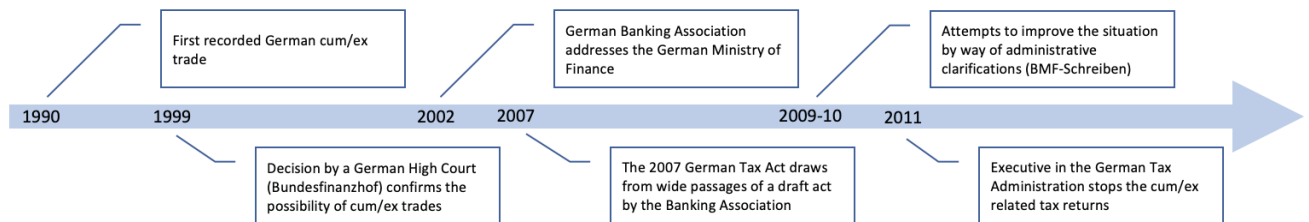


Figure 2: Timeline of major cum/ex related events

While the first recorded German cum/ex case already took place in 1990 and the *Bundesfinanzhof*, the federal fiscal court, had apparently confirmed the possibility of cum/ex trades in 1999, the German Banking Association addressed the German Ministry of Finance in 2002 to indicate that there may be a problem with the legality of certain financial trading structures (Deutscher Bundestag 2017: 112–140). But the hint given by the Banking Association, which is of course a major stakeholder in the finance industry, was initially ignored in the Ministry. Only years later, the legislators took action to prevent the obviously unjustified tax returns by way of certain revisions to German tax regulation, the *Jahressteuergesetz 2007*. While the added regulatory mechanism indeed addressed the deduction of tax through the operating banks – and, thus, a critical element in the cum/ex trading structures (see the above model) – this revision was not only ineffective but even turned out to be counterproductive. Since it provided for tax deduction through the ‘operating domestic banks or financial institutes,’ the legislative act in fact enabled – if not invited – an interpretation that the added tax mechanism would not be applicable to trading structures with foreign financial institutes.

Taken that the Banking Association represents the interest of the German finance industry, it is to be asked why it is exactly this actor that attempted to clarify the situation and warned the state regulators of a trading structure through which its client would make profits. Arguably, the purpose has not necessarily been to prevent the use of a product with a promising profit mar-

¹³ As the commission holds in its final report: ‘Cum/ex trades are a special form of the so-called dividend stripping [...] that appears in different variants since the 1970s.’ (Deutscher Bundestag 2017: 76, my translation).

gin – especially in the times right after the financial crisis with its globally spread policy of low interest rates. Rather, the industry would be interested in a management of the legal risk that cum/ex trading structures implied. And indeed, it has been reported that such legal issues have been discussed, e.g. at the Deutsche Bank, as early as 1992 (Deutscher Bundestag 2017: 117). In particular, the bankers may have been worried that some of the practiced variants of tax-driven trading (that were not called ‘cum/ex’ at the time) would constitute criminal offenses (i.e. tax evasion) and/or generate certain civil liabilities (Baumrucker cit. in Deutscher Bundestag 2017: 117). Against this backdrop, the aim must have been to create legal certainty, and it is here that the Banking Association comes into play as a transmission belt between the banking industry and the state. The final report by the parliamentary commission documents remarkable efforts to account for this episode of lobbyism, which indeed resulted in a legislative action that failed in its attempt to stop cum/ex. Moreover, the role of the Banking Association also played a certain role in Bonn since the court was interested in whether and how the new regulation after 2007 stimulated changes in the trading activities – what brings us back into the courtroom.

7 Back in the courtroom: Red lights turn on

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When asked by the chief judge to explain the workings of the trades, the accused S. starts his remarks by announcing that ‘this will be pretty technical’.¹⁴ And indeed, a few moments later, some highly complex charts are screened to large areas of two of the courtroom’s walls, above the judges as well as the accused and the representatives of finance. S. makes his remarks in English and, thus, has to stop every one or two sentences to allow for a German translation by one of the court’s translators placed in between the two accused traders and their legal defence teams. Difficulties emerge with some of the technical terms from the world of finance, so that attorneys and judges, time and again, find themselves entrapped in deliberations on a correct translation. Terms such as ‘trading level’, ‘all-in level’, ‘swaps’, ‘dividend arbitrage’, ‘double dib’, ‘gut spreads’, etc. indeed turn out to be challenging. How should the court reconstruct the complexity of all this, let alone come to a legal conclusion? Yet, the well-placed queries raised by the chief judge as well as the prosecutors are proof of a meticulous preparation.

At the same time, the accused S. acts as an expert who presents a rather exclusive knowledge, if not secret lore, from the world of finance. In a very self-confident way, he conveys the impression that only through his help would the court be able to decipher the matrix. In fact, the accused does not seem

¹⁴ Accused S. in court on September 19, 2019.

to be worried at all which is indeed noticeable since the legal action taken would, in principle, allow for a prison sentence of up to 10 years.

Another day is reserved for the remarks by the other accused D., who had worked for S. He also cooperates with the court and willingly provides information on what he calls the ‘mechanics of the trades’.¹⁵ Yet, his appearance is less self-assured. Compared to the remarks by S., the descriptions do not come with the same air of objectivity. Rather, D. presents a more subjective narrative of his working environment, his role in it as well as some of his everyday working experiences. He even mentions party nights with a lot of drinks, in the City of London, Munich and then in Gibraltar. And even though he seems to portray this as if he would have felt uneasy about it, at one point his face shows a slight smile. Here, the judge interrupts the remarks and asks for a sense of wrongdoing, i.e. whether somebody put into question whether all of this were legal. But D. states that he – not being a lawyer himself – had never wondered about this. His boss and mentor has been the one having contact to lawyers and discussing legal opinions.¹⁶ But D. never saw these documents. It was just not part his job. The only thing he had to care about was whether a trade would happen or not.¹⁷

As the judge continues with queries on the awareness of legal regulation and explicitly suggests that a particular course of action in the shorting of shares could be due to the internal regulation of the bank, D. introduces an interesting distinction. He answers in the affirmative and explains that there were no ‘economic reasons’ for the practice. In other words, regulation, and even the bank’s internal compliance mechanisms, are perceived to remain on the *outside* of trading. Decisions on one or another trading variant are either of an economic or a regulatory nature. A few moments later, however, D. somewhat reintegrates the latter logic into the former by stating that trading rules (such as those of internal banking regulation) were just priced into the trades. Put differently, rules are but determinants in the pricing of investments and thus variables of profit. On the trading side, rules appear as obstacles while the practice of removing these obstacles generates costs and thus reduces the profit. In the knowledge of trading, normative distinctions between legal or illegal practice are seemingly not given much notice. Likewise, barely anyone attaches importance to the sanctions for irregular trading – except perhaps in cases where they would entail future costs.

When asked about the possibility of sanctions (e.g. by the stock exchange), S. also reveals a rather pragmatic notion of regulation by pointing to a ‘red light’ that may have at times appeared while entering a trade into the system. This stimulates a follow-up question by the judge who now wants to know

¹⁵ Accused D. in court on September 25, 2019.

¹⁶ Accused D. in court on September 25, 2019.

¹⁷ Accused D. in court on September 25, 2019.

about the meaning of the light and what the consequences were. ‘The red light,’ answers S., ‘meant that the trade cannot happen’. However, he did not see the light himself since it was not his job to enter the trades.¹⁸ One month later, an informant told me that the red light is not a metaphor but indeed a software mechanism that signals an irregular trade. Yet, whenever the light appears, the task is to turn it off by using certain tricks, e.g. by walking a different path through the software. This underscores the notion of a certain rule pragmatism. Coping with regulation turns more or less into a game. On the trading side, regulation does not have a normative function. What matters is not whether a practice is legal or illegal, right or wrong. What matters is profit, and whether more or less profit can be achieved. It is in this sense that the logic of finance differs from the normative logic of law.

8 Legal expertise

At the Bonn trial, the key witness enters the courtroom together with his attorneys. In addition to his criminal defence lawyers, the team also includes a media lawyer to prevent the press from mentioning his name. Instead, the journalists call him ‘Benjamin Frey’, an alias used in a previously given anonymized interview mentioned above (Bender et al. 2019: 32). The chief judge opens the questioning by acknowledging the comprehensive testimony with the prosecutor in Cologne, pointing to an impressively thick folder of about 1,000 pages. The style of the witness’ remarks is as melodramatic as in the interview. After some explanations on his career path, e.g. the time in law school and a professor’s role that put him in contact with the finance industry, he turns to an emerging ‘sense of uneasiness’ (*Störgefühl*) that had spread in the aftermath of 2007 and 2008. Before, as he explains, cum/ex appeared to the industry as a ‘normal phenomenon between banks’.¹⁹ The way Frey talks about cum/ex already indicates his role in what must have been the very centre of the German cum/ex industry. His mentor – and then partner – was not the originator of cum/ex but had accessed it as a product for super-rich private investors.²⁰

At one point, the witness claims he and his partner had actively contributed to the draft provided by the Banking Association and, moreover, that ‘not a single comma has been changed’ for the final version of the *Jahressteuergesetz 2007*.²¹ Against this backdrop, the narrative of an accidental regulatory loophole becomes less and less convincing. The cum/ex industry did not just

¹⁸ Accused S. in court on September 25, 2019.

¹⁹ Witness ‘Frey’ in court on October 29, 2019.

²⁰ Witness ‘Frey’ in Bonn, October 29, 2019.

²¹ Witness ‘Frey’ in Bonn, October 29, 2019.

exploit a vulnerability of the tax regime but actively participated in making it vulnerable. As the witness explains, the corresponding trades were running at full speed until 2009 when ad hoc changes became necessary because of the so-called *BMF-Schreiben*, i.e. official statements on the interpretation of the legal situation filed by the German Ministry of Finance. Facing the news about this executive legal opinion and thus administrative clarification of the legal situation ‘all lights turned red’ and the ‘trade stopped for several days or weeks’.²² Once again, the red lights are mentioned. Yet, for the lawyer in the cum/ex industry, the light may have a more metaphorical meaning, which becomes obvious with regard to the consequences drawn. Here, the problem was not easily done away with a trick. Rather, changes to the structure became necessary.

Taken together, the new regulatory situation did not bring an end to the cum/ex trades. Quite the opposite. As the witness explains, the creative readjustments of the trading structures in reaction to the new regulation did, in fact, work as ‘fire accelerant’²³ in that they continuously led to a fine-tuning of the machine. For example, since 2009 trading structures with equity funds were used to cope with the new regulation. These funds served the purpose of collecting capital from private investors and being included in the trading structure as short sellers. Yet, as the witness explains, this caused a follow-up problem. To establish an equity fund, it is necessary to obtain an approval by the *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin), the German financial services authority. Thus, one made use of another, but similar vehicle and established a so-called ‘special fund’, which calls for reporting to, but not for an approval by the BaFin. A special fund, in turn, comes with the disadvantage of not being accessible for private investors nor eligible to credit. For this reason, another corporation as a so-called ‘feeder fund’ was created in Malta, which is subject to a rather finance-friendly regulation, e.g. without strict requirements of transparency. With this trading structure, it would have been possible to collect private investment, to top up the capital by way of leverage credit, loop this capital through the special fund and use the latter for the short selling of shares on the financial market as in the cum/ex structure outlined above.

What emerges is a highly complex coupling of financial vehicles, which in turn – and this brings me back to my major argument – involves a likewise complex constellation of regulatory regimes. In the example at hand, this regulatory constellation includes, but is arguably not limited to German tax law, securities trading law, investment law, as well as the supervision by the BaFin, the private governance regimes of the stock exchange, the private standardization of short sales (OTC), the internal compliance mechanisms of the involved creditor and depository banks, the local regulatory regimes in Malta,

²² Witness ‘Frey’ in Bonn, October 30, 2019

²³ Witness ‘Frey’ in Bonn, October 29, 2019

and further regulations relevant to the orchestrating players such as business run by the accused.

The establishment of such trading structures necessitates a highly specialized transnational legal expertise. What comes to the fore is a legal knowledge, which not only understands law as an instrument, but which strikes by combining such instruments transnationally. What we see unfolding are custom-made ‘regime complexes’ that serve as whole new normative infrastructures to make tremendous profits possible.²⁴ Even though public and private regulators may have established each of the mentioned regimes to prevent certain forms of misuse, it is their arrangement in which these regimes – in their combination – unfold a different effect. To be sure, the trick is not to circumvent undesirable regulations or to use loopholes (in the sense of niches of non-regulation) but to arrange fragments in order to mutually outplay the various regime’s normative force by putting them in a ‘productive’ constellation. Legal expertise, and transnational legal expertise at that, is thus a critical asset in the making of cum/ex trading structures.

9 Conclusion

Legal knowledge practice played a critical role for cum/ex. I have argued that it is not in the courtroom that a relation between law and finance has been initially established by attempting to bring white collar criminals to justice. A more complex role of law and legal practice comes to the fore when we overcome the usual narrative of a global financial system that outplays domestic legal regulation and, in the case at hand, domestic tax regulation. In fact, the whole narrative of (domestic) law versus (global) finance is highly misleading (Riles 2011). As I have demonstrated in this paper, the major role of law has not been to constrain certain financial practices but to serve as a normative infrastructure for such practice. At the same time, talk of a legal gap or legal grey zones tends to suggest a flawed understanding of finance as operating in a non-legal sphere. Quite to the contrary, it is legal practice that creates the corresponding spheres. Inasmuch as we are concerned with ‘non-legality,’ this is a paradoxical type of legal non-legality – a non-legality created through law (Johns 2013). Finance called for the management of legal risk, continuously reacted to shifting regulations and, most importantly, as I argue, evolved

²⁴ ‘Regime complexes are marked by the existence of several legal agreements that are created and maintained in distinct fora with participation of different sets of actors. The rules in these elemental regimes functionally overlap, yet there is no agreed upon hierarchy for resolving conflicts between rules. Disaggregated decision making in the international legal system means that agreements reached in one forum do not automatically extend to, or clearly trump, agreements developed in other forums. We contend that regime complexes evolve in ways that are distinct from decomposable single regimes.’ (Raustiala and Victor 2004: 279)

only against the complex backgrounds of transnational chains of regulatory regimes crafted through legal practice. Even though some of these regimes were arguably established to prevent harmful conduct, their knowledgeable assemblage resulted in an infrastructure that made an artful grab into the state treasury possible. This seemingly non-legal world, in other words, is obviously characterized by an excess of legal practice, even though its appearance (where visible at all) may often differ from the types of law that we know from courtrooms or pop cultural courtroom drama. The encounter of law and finance can be described by the fact that financial practice only operates in and through a normative infrastructure staged through a particular type of legal knowledge practice.

How to move on from here? First, the inter- or transnational quality of cum/ex (and similar trading structures) does not exhaust the fact that, as in the case observed here, British equity traders were brought to court in Germany or that cum/ex trading schemes were also used to ‘rob’ other countries. Since the regimes assembled as a normative infrastructure for tax arbitrage obviously transcend the domestic realm of regulation, cum/ex is to be studied as a phenomenon of transnational practice or, to be sure, practice in the transnational constellation. IR regime theories have indeed addressed phenomena of regime interaction, networks of governance, or regime complexes (Raustiala and Victor 2004) and, in doing so, have also included private governance and some of the complexities of private international law (Young 2012). What this discussion thus far lacks is the fine-grained type of analysis of the production and reproduction of knowledge as in the field of IR practice theory (Bueger and Gadinger 2018). While concepts such as ‘regime complexes’ provide important insights also for the study of tax evasion, the practical side (the everyday crafting of chains of regimes) is not accounted for in current regime theory.

In turn, practice theorists have, as far as I can see, widely neglected law, particularly the uses of law in legal practice,²⁵ let alone the transnational as a theatre for legal practice. What I suggest is not a focus on the practice of the interpretation of legal norms but rather on the more material aspects of legal practice in the transnational financial markets, such as the making and algorithmic processing of contract, the management of legal risk, the circulation of ‘legal opinion’ and the ongoing establishing of new and highly complex trading structures. Wouldn’t this be a promising empirical field for practice theorist? I hope so.

²⁵ But see Stappert 2020. The blind spot on the meaning of legal practice may stem from the early scepticism towards textuality as in Neumann 2002.

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Abstract

In the media, the so-called cum/ex trades were addressed as the biggest tax robbery in history. In a few years, the financial trading scheme caused an estimated damage to European state treasuries of ca. 50 billion euros. Through highly complex transactions, a network of equity traders, banks, super-rich investors, and lawyers generated returns of capital income tax that had never been paid before. In 2019, two involved British traders were put on trial in Bonn, Germany. Due to their cooperative behaviour, they received only mild sentences. Yet, this first cum/ex lawsuit has been a critical starting point for a wave of trials to follow. Observing the trial, the paper focuses on the role of law in the cum/ex industry. First, law is addressed not as constraining but enabling tax-driven equity – as an infrastructure that makes dark finance possible. Second, this legal infrastructure is not fixed but depends on an ongoing legal practice. And third, the infrastructure used for dark finance is not limited to domestic law. Rather, the relevant trading structures involve a series of transnational transactions, which are subject to various regulatory regimes, domestic and international, as well as public and private

Key words: *Cum/ex, global tax governance, legal infrastructure, transnational law, white-collar crime, finance, court ethnography, practice, expertise, law and society studies*

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