Pensions Audit Sub-Committee

10am, Monday, 16 December 2013

EU Tax Claims

Item number	5.6
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Executive summary

EU Tax Claims

Summary

This report summarises activity on EU tax claims made on behalf of the Lothian Pension Fund.

Recommendations

Pensions Audit Sub-Committee is asked to note the progress made in reclaiming EU taxes suffered on dividends.

Measures of success

Success is measured by the amount of tax recovered exceeding the cost of pursuing the claims.

Financial impact

EU tax claims totalling in excess of £10m have now been lodged with the relevant tax authorities. Professional fees amounting to £493.3k have been incurred to date. As previously agreed by Pensions Committee, it is likely that further legal costs will be incurred in pursuing the claims. However, any legal costs are shared across a pool of fellow claimants and Lothian Pension Fund has the right to cease participation without incurring further costs.

Currently, claims paid to date exceed the costs incurred by £561.6k. The financial position can be summarised as follows:

	Total Claims £'000	**Claims Settled £'000**	**Claims Outstanding £'000**	**Costs to Date £'000**
Claim Type				
Manninen	2,626.7	Nil	2,626.7	49.5
Fokus Bank	3,535.7	1,054.9	2,480.8	351.8
Manufactured Dividends	3,928.6	Nil	3,928.6	92.0
	10,091.0	**1,054.9**	**9,036.1**	**493.3**

Equalities impact

There are no equalities impacts arising from this report.

Sustainability impact

There are no sustainability impacts arising from this report.

Consultation and engagement

The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to governance

Background reading / external references

None

Report

EU Tax Claims

1. Background

1.1 EU tax claims relate to the recovery of tax deducted from dividend payments prior to receipt. They relate to a fundamental principle of EU law, that all member states should not discriminate in the application of national taxes between home tax payers and those in other member states.

1.2 The claims can be divided into three main types – Manninen, Fokus and Manufactured Dividends.

2. Main report

Claims for EU Tax Credits – Manninen

2.1 This claim is against the UK tax authorities and is based on HMRC permitting the repayment of tax credits deducted from UK dividends but not on Foreign Income Dividends paid by UK companies.

2.2 The European Court of Justice's ruling in the Manninen tax case in September 2004 opened an avenue for claims for tax credits on EU dividends. Pensions and Trusts Committee has previously agreed to pursue potential claims.

2.3 Based on the decision in the Manninen case, KPMG's EU Tax Group is undertaking claims on behalf of UK pension funds to claim a repayment of tax credits on dividend income for the period 6 April 1992 to 1 July 1997.

2.4 The claims are based on 20% of the gross dividends received. While the UK tax authorities are disputing the validity of such claims, the estimates show that the Lothian Pension Funds could benefit by up to £2.6m from a successful claim. A cost benefit analysis concluded that a claim should be lodged, and this was done on 9 February 2006.

2.5 HMRC has rejected all claims of this nature. As a result, KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery.

2.6 A brief chronology of events to date is provided in the table below:

Date	**Event**
March 2011	First-tier Tribunal (FTT) published its judgement on the test case: • Withholding of tax credits on foreign income dividends was a breach of EU law. • Claims were out of time because they were made more than six years after the end of the tax year in which the relevant dividends were received. The FTT rejected legal arguments that the statutory time limits should be extended.
July 2012	Appeal against the FTT judgement was heard by the Upper Tribunal.
February 2013	Upper Tribunal published its judgement on the appeal and supports judgement of the FTT.
May 2013	Upper Tribunal refuses HMRC's request for leave to appeal on the substantive issue and claimants' request on the out of time issue.
July 2013	Court of Appeal approves direct requests to appeal from HMRC and claimants.
September 2013	Court of Appeal advises that a preliminary hearing will be held in December 2013 to decide if any questions related to the case should be referred to the Court of Justice of the European Union.

2.7 Based on the above, it could be well into 2015 before a final decision is reached.

2.8 Fees incurred to date, by Lothian Pension Fund, on these claims amount to £49.5k. Assuming that the case is pursued to a final conclusion, total costs for the Fund are capped at £90k. This compares with the claim for £2.6m.

Claims for EU Tax Credits – Fokus Bank

2.9 These claims are against the tax authorities of the EU member states (and Norway) in which we have invested. The basis of the claims is that the tax authorities have applied favourable tax treatment to domestic pension funds that they have denied to pension funds in other member states.

2.10 The Pensions and Trusts Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £3.5m have been made. Progress on the claims is summarised in the table below.

Country	Claim Period From / To	Estimated Amount Claimed £'000	Amount Received £'000	Notes
Completed Claims				
Austria	2006 2010	83.0	83.0	Claim paid in September 2012.
Netherlands	2003 2006	440.0	440.0	Claim paid in 2009.
Norway	2004 2010	273.0	273.0	All claims paid - final instalment received in February 2013 (£73k)
Active Claims				
France	2005 2009	658.0	-	15% tax imposed on all pension funds from 1 January 2009 – so no further claims can be made after that date. In May 2012, the EU Court ruled in the Santander test case that refunds must be paid to investment funds. Since the last report to Pensions Committee in March 2013, the total claim has been reduced from €1,225m to €776k as result of claims for 2003 and 2004 being considered to be out of time as a result of case law. Work currently being done to comply with the detailed documentary requirements of the French authorities.
Germany	2003 2010	911.6	-	While the principles behind the claims seem to have been accepted by the German tax authorities, they are currently refusing to clarify the procedure that has to be followed to obtain payment of the claims. KPMG is still considering whether it would be appropriate to file a test to accelerate payment.

Country	Claim Period From / To	Estimated Amount Claimed £'000	Amount Received £'000	Notes
Italy	2004 2010	508.7	-	There is the possibility that a test case may start in approximately six months. It is reported that the Italian tax authorities have a poor record of responding to tax repayment claims.
Spain	2004 2009	661.4	258.9	In May 2013 the Courts decided that the claims for 3 quarters of 2004 should be refunded. Lothian received a refund of €93,704 (£78.9k) including interest. In early November 2013, we were advised that claims from final quarter of 2004 to the first quarter of 2006 have been paid to our Spanish agent. This amounts to €215,709 (£180.0k). This gives us some confidence that the remaining claims will be paid in due course.
TOTAL		**3,535.7**	**1,054.9**	

2.11 Exchange rate movements change the potential value of the claims in sterling terms.

2.12 Fees incurred to date on these claims amount to £351.7k. Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.

Claims for EU Tax Credits – Manufactured Dividends

2.13 This claim is against the UK tax authorities. It is based on the fact that manufactured dividend receipts relating to UK shares are not subject to any UK withholding tax but receipts relating to overseas dividends suffer a UK withholding tax of 15%.

2.14 Note that manufactured dividends are dividends created when a security is out on loan at the time the company pays a dividend.

2.15 Claims in respect of manufactured dividends totalling £3.9m has been lodged with HMRC.

2.16 KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery. Pinsent Masons have been working with HMRC to agree a test case process, the aim being to have the case heard by the First-tier Tribunal (FTT).

2.17 An initial hearing of the FTT took place in March 2013. HMRC are required to prepare a statement of their case by the end of November 2013. It is hoped that the FTT will hear the case during 2014.

2.18 Reference to the European Court of Justice would take a further two years. With potential subsequent referrals (maximum of three), a final decision may not be made until 2016/2017.

2.19 Fees incurred to date on these claims amount to £92.0k. Potential subsequent referrals are estimated to cost £20k for each stage.

3. Recommendations

3.1 Pensions Audit Sub-Committee is asked to note the progress made in reclaiming EU taxes suffered on dividends.

Alastair Maclean

Director of Corporate Governance

Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	
Appendices	None