Pensions Audit Sub Committee

2.30pm, Tuesday, 16 December 2014

EU Tax Claims

Item number	5.4
Report number	
Executive/routine	
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Executive summary

This report summarises activity on EU tax claims made on behalf of the Lothian Pension Fund. During the period since the last report, the amount of settled claims has increased by £207.2k to a total of £1,262.1k. Progress continues on the various outstanding claims.

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Report

EU Tax Claims

Recommendations

1.1 Committee is requested to:

- Note the progress made in reclaiming EU taxes suffered on dividends.
- Highlight any points that it would like to raise at the Pensions Committee on 17 December 2014.

Background

2.1 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.

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

Main report

Claims for EU Tax Credits – Manninen

3.1 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.

3.2 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.

3.3 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.

3.4 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.

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

3.6 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.
December 2013	Court of Appeal rejects our appeal on one specific time limit argument (based on the domestic law). A further hearing by the Court of Appeal has been set for February 2015 to consider HMRC's appeal on the substantive issues and our time limit arguments (based on European law). It is possible that the Court of Appeal will refer certain issues to the CJEU at this hearing.

3.7 Fees incurred to date, by Lothian Pension Fund, on these claims amount to £54.5k (£49.5k as at the last update to Committee in December 2013). 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

3.8 These claims are against the tax authorities of the EU member states (and Norway) in which the Fund has 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.

3.9 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. Legal action started in the Court of Appeal of Montreuil in 2013. Further legal arguments are due to be filed with the Court during the last quarter of 2014. KPMG are still positive about the ultimate payment of the claims but there is still uncertainty as to when.

Country	Claim Period From / To	Estimated Amount Claimed £'000	Amount Received £'000	Notes
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. With the continuing lack of clarity from the German tax authorities, KPMG are in the final stages of filing a complaint in the German Courts.
Italy	2004 2010	508.7	-	There have been few recent developments for pension funds in Italy. Furthermore, some Italian Court decisions announced recently have even shown reluctance on the part of the Italian Courts to recognise EU law jurisprudence over Italian law. It seems that litigation will be required in order to progress with claims in this territory. There are fewer claimants in Italy to fund litigation. KPMG feel that it is better to focus on France and Germany before considering to Italy.
Spain	2004 2009	661.4	466.1	The principle of paying the refunds was approved by the Spanish Courts in May 2013. By November 2013 we had received refunds for periods up to the first quarter of 2004. In May and July of 2014 we received refunds for quarters two to four of 2006, quarter four of 2008 and all four quarters of 2009. An additional £207.2k compared to the Committee report of December 2013. Quarter three of 2007 to quarter three of 2008 remain outstanding.
TOTAL		**3,535.7**	**1,262.1**	

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

3.11 Fees incurred to date on these claims amount to £367.7k (£351.7k as at the meeting of December 2013). 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

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

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

3.14 Claims in respect of manufactured dividends totalling £3.9m on behalf of Lothian Pension Fund has been lodged with HMRC.

3.15 KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery. An initial hearing of the First-tier Tribunal (FTT) took place in March 2013.

3.16 Due to continuing inaction, other than issuance of information requests from HMRC, Pinsent Masons made an application for the test case to proceed and the FTT granted this request. It is likely that the hearing will take place during the first quarter of 2015. Pinsent Masons have been in correspondence with HMRC through the course of 2014 and have now agreed a statement of facts in order to minimise the fact-finding undertaken by the Tax Tribunal at the hearing itself.

3.17 Fees incurred to date on these claims amount to £100.4k (£92.0k as at the meeting of December 2013). Potential subsequent referrals are estimated to cost £20k for each legal stage.

Measures of success

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

Financial impact

5.1 EU tax claims totalling in excess of £10m have now been lodged with the relevant tax authorities. Professional fees amounting to £522.6k 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.

5.2 Currently, claims paid to date exceed the costs incurred by £739.5k. 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	54.5
Fokus Bank	3,535.7	1,262.1	2,273.6	367.7
Manufactured Dividends	3,928.6	Nil	3,928.6	100.4
	10,091.0	**1,262.1**	**8,828.9**	**522.6**

Risk, policy, compliance and governance impact

6.1 There are no risk, policy, compliance and governance impacts arising from this report.

Equalities impact

7.1 There are no equalities impacts arising from this report.

Sustainability impact

8.1 There are no sustainability impacts arising from this report.

Consultation and engagement

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

Background reading/external references

None

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Links

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Single Outcome Agreement	
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