Pensions Committee

10am, Wednesday, 13 March 2013

EU Tax Claims

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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

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 £10.3m have now been lodged with the relevant tax authorities. Professional fees amounting to £463.1k have been incurred to date. As previously agreed by Committee, it is likely that further legal costs will be incurred in pursuing the claims. However, any costs are being 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 £332.9k. 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	3,814.2	796.0	3,018.2	293.0
Manufactured Dividends	3,928.6	Nil	3,928.6	120.6
	10,369.5	**796.0**	**9,573.5**	**463.1**

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. The Audit Sub-Committee, which shall consider future progress reports on the EU tax claims, should further strengthen financial and risk management assurance.

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.

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. Committee had 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 from EU companies 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 (McGrigors – now part of Pinsent Masons) to pursue recovery. In March 2011, the First-tier Tribunal (FTT) published its judgement on the test case.

2.6 The FTT held that the withholding of tax credits on foreign income dividends was a breach of EU law, as was the denial of tax credits on dividends received from a non-UK company. This is a very positive result as it is extremely unusual for a UK Tribunal to decide in favour of the tax payer with regards to a direct tax claim based on EU law without a reference to the European Court of Justice.

2.7 Unfortunately, the FTT also decided that 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. This issue was known at the time claims were lodged. Member States are allowed to impose time limits on EU claims but previous decisions of the European Court of Justice have suggested that it is possible to extend national limitation periods in circumstances where those time limits are discriminatory or make it impossible or excessively difficult to exercise EU rights.

2.8 An appeal against the FTT judgement was heard by the Upper Tribunal in July 2012, the legal arguments lasted six days. Final judgement was expected in February 2013 and we are awaiting news on the outcome.

2.9 If the Upper Tribunal judgement goes as anticipated, it is expected that HMRC will be given leave to appeal to the Court of Appeal on the substantive points and the claimants will be given leave to appeal on the time limit points. The Court of Appeal hearing would be likely to take place towards the end of this year.

2.10 With a further appeal possible to the Supreme Court, it could be well into 2015 before a final decision is reached.

2.11 Fees incurred to date, by Lothian Pension Fund, on these claims amount to £49.5k, compared to £44.6k reported at the December 2011 meeting of the Pensions and Trusts Committee. 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

2.12 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.

2.13 The Pensions and Trusts Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims estimated at around £3.8m 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
Austria	2006 2010	83.0	83.0	Claim paid in September 2012.
France	2003 2009	998.6	-	15% tax imposed on all pension funds from 1 January 2009. In May 2012, the EU Court ruled in the Santander test case that refunds must be paid to investment funds.
Germany	2003 2010	886.3	-	KPMG are currently preparing a test case in respect of the German claims.
Italy	2004 2010	489.3	-	The Italian tax authorities have not responded to the claims that KPMG has lodged for its clients. We await a decision from KPMG on its proposed course of action.
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)
Spain	2003 2009	644.0	-	In November 2012, the Spanish courts supported claims by a number of KPMG clients. News is awaited of any appeal from the Spanish tax authorities.
TOTAL		**3,814.2**	**796.0**	

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

2.15 Fees incurred to date on these claims amount to £293.0k, compared to £263.0k reported at the December 2011 meeting of Pensions and Trusts Committee.

Claims for EU Tax Credits – Manufactured Dividends

2.16 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%.

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

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

2.19 KPMG has appointed a firm of solicitors (McGrigors – now part of 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).

2.20 Due to inaction from HMRC, Pinsent Masons have made an application to the FTT for a direction that the test case should proceed. A response is awaited.

2.21 KPMG has discussed the case with independent Tax Counsel and has received a positive opinion on the chances of success.

2.22 The earliest expected date for receipt of a judgement from the FTT is in the second quarter of 2013. 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.

2.23 Fees incurred to date on these claims amount to £120.6k, compared to £77.4k reported at the December 2011 meeting. Potential subsequent referrals are estimated to cost £20k for each stage.

3. Recommendations

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

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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