Pensions Audit Sub Committee

10.00 a.m., Tuesday, 15 December 2015

EU and Other Tax Claims

Item number	5.5
Report number	
Executive/routine	
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Executive summary

This report summarises activity on EU and other 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 £108.0k to a total of £1,370.1k. Progress continues on the various outstanding claims.

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Report

EU Tax Claims and Income Recovery

Recommendations

1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.

1.2 Note the report and highlight any points it would like to raise at the Pensions Committee on 16 December 2015.

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.

2.3 In addition, the report covers a claim made in the USA in respect of Master Limited Partnerships.

Main report

Claims - Manninen / Foreign Income Dividends

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 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 Lothian Pension Fund 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 – the substantive issue. • 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 out of time issue.
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 (CJEU).
December 2013	Court of Appeal rejects the claimants' appeal on the out of time issue (based on UK domestic law). A further hearing by the Court of Appeal has been set for February 2015 to consider HMRC's appeal on the substantive issue and the out of time issue (based on European law). It is possible that the Court of Appeal will refer certain issues to the CJEU at this hearing.
June 2015	The second Court of Appeal hearing took place in June 2015 concerning EU law based "out of time" arguments and the substantive issue.

July 2015	The Court of Appeal hands down its judgement: 1. The original decision on the out of time issue is upheld and the Court has refused to allow an appeal to the CJEU on this issue. 2. On the substantive issue the Court has decided to refer matters to the CJEU.
November 2015	On the out of time issue an application for permission to appeal has been submitted to the Supreme Court directly. The outcome of this application is awaited. On the substantive issue the Court of Appeal has agreed the specific questions that will be referred to the CJEU. It is expected that the CJEU will take up to 2 years to issue a judgement.

3.7 Fees incurred to date, by Lothian Pension Fund, on these claims amount to £58.2k (£54.5k as at the last update to Committee in December 2014). 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 - 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 Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £3.2m 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	278.9	278.9	All claims paid - final instalment received in February 2013 (£73k)
Spain	2004 2009	568.2	568.2	All claims paid - final instalment received in March 2015 (£102k)

Country	Claim Period From / To	Estimated Amount Claimed £'000	Amount Received £'000	Notes
Active Claims				
France	2005 2009	551.4	-	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. KPMG will complete a comparability analysis in conjunction with Lothian in Q4 2015 to demonstrate the pension scheme is in a similar situation to the test claimant. The French Tax Authority has indicated informally that they are keen to resolve pension fund claims and KMPG have agreed an approach with them to do so.
Germany	2003 2010 2011 2014	764.0 95.9	-	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. There have been delays in KPMG appointing a test claimant. However it is hoped that one will be agreed in the next few months. At which point the issue of repayment will be tested in the German Courts. In August 2015, following a competitive tender, Deloitte LLP was appointed to make additional claims in respect of the calendar years 2011 to 2014 inclusive.
Italy	2004 2010	426.3	-	The Italian Tax Authority has taken no action in respect of claims and it seems litigation will be required for a resolution. There has been little appetite amongst claimants to date to fund a test case although KPMG are keen to do so.

Country	Claim Period From / To	Estimated Amount Claimed £'000	Amount Received £'000	Notes
				KPMG believe claimants prefer to concentrate efforts on France and Germany before considering Italy.
TOTAL		**3,207.7**	**1,370.1**	

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 £369.4k (£367.7k as at the meeting of December 2014). Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.

Claims - 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 £3,928.6k on behalf of Lothian Pension Fund have been lodged with HMRC. Following a competitive tender in the summer of 2015, Deloitte LLP has been appointed to make an additional claim for around £942k, covering the 2013 calendar year. This increases the total claimed to of £4,870.6k.

3.15 KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery. A brief chronology of events to date is provided in the table below:

Date	Event
March 2013	An initial hearing of the First-tier Tribunal (FTT) took place.
During 2014	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.
November 2015	The case was heard by the FTT (sitting in London between 2 and 5 November 2015). A decision was reserved by the Tribunal and will be handed down at a later date.

3.16 Fees incurred to date on these claims amount to £116.3k (£100.4k as at the meeting of December 2014). Potential subsequent referrals are estimated to cost £20k for each legal stage.

Claims – Master Limited Partnerships

3.17 This claim is against the US tax authorities. The withholding tax (WHT) audit reported to Committee in December 2014 noted that there were 21 income receipts in the USA that had suffered a tax deduction of 35%. The WHT rate for dividends in the USA is 0%. However, the 35% deductions were in respect income distributions from Master Limited Partnerships.

3.18 Following a competitive tender in the summer of 2015, a firm of accountants has been appointed to make a tax claim in the USA. The value of the claim for the year ended 31 December 2014 is estimated to be around $576,000. Progress on this and the other claims will be reported on an annual basis.

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 Tax claims totalling in excess of £11m have now been lodged with the relevant tax authorities. Professional fees amounting to £543.9k have been paid 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 £826.2k. 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	58.2
Fokus Bank	3,207.7	1,370.1	1,837.6	369.4
Manufactured Dividends	4,870.6	Nil	4,870.6	116.3
Master Limited Partnerships	379.2	Nil	379.2	Nil
	11,084.2	**1,370.1**	**9,714.1**	**543.9**

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 Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

None

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Links

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