Pensions Audit Sub Committee

2.00pm, Tuesday, 11 December 2018

EU Tax Claims and Other Income Tax Recoveries

Item number	5.2
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

This report summarises activity on EU and other special tax claims made on behalf of Lothian Pension Fund. During the period since the last report, no additional claims have been paid and the amount recovered to date remains at £1.3million. Progress on outstanding claims is discussed in detail within the report. The main developments are:

- Legal success on the Manninen and Manufactured Overseas Dividend claims;
- Appointment of a new provider to make additional tax recovery claims on a no win no fee basis;
- Appointment of Deloitte to recover withholding tax on Taiwanese dividends.

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Report

EU Tax Claims and Other Income Tax Recoveries

1. Recommendations

Committee is requested to:

1.1 Note the report and highlight any points it would like to raise at the Pensions Committee on 12 December 2018.

2. Background

2.1 EU tax claims relate to the recovery of tax deducted from dividend payments prior to receipt or payable tax credits thereon. 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 in a way that is likely to hinder the free movement of capital. The claims can be divided into three main types – Manninen / Foreign Income Dividends (FIDs), Manufactured Overseas Dividends (MODs) and Fokus.

2.2 Progress on a claim to recover tax on Taiwanese dividends is also covered in this report.

3. Main report

Claims - Manninen / Foreign Income Dividends (FIDs)

3.1 These claims are against the UK tax authorities. The FIDs claim is based on the UK providing for the repayment of tax credits on UK dividends but not on Foreign Income Dividends ("FIDs") 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 statutory claims on behalf of UK pension funds to claim a repayment of tax credits on FIDs and overseas dividend income in respect of periods 1990/91 to 1997/98. Pension funds have also pursued parallel claims in the High Court.

3.4 The claims are for tax credits and are based on the rate of advance corporation tax in place in respect of the overseas dividends. 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 by way of a test case brought with the BT Pension Scheme as the test claimant.

3.6 A chronology of events to date is provided in Appendix 1. The contents of which have been approved by Pinsent Mason.

3.7 The positive news is that as a result of the Court of Appeal's determination of the statutory claims in December 2017, the Court also made award of costs to the test claimant of £287k. As Lothian Pension Fund contributed to the legal cost of the case, it is entitled to a share of the award. We await news of the amount.

3.8 Fees incurred to date, by Lothian Pension Fund, on these claims amount to £63.4k (£63.4k as at the last update to Committee in December 2017). 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 – Manufactured Overseas Dividends (MODs)

3.9 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 manufactured overseas dividends suffered a UK withholding tax.

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

3.11 Claims in respect of manufactured dividends totalling £4,870.6k have been lodged with HMRC on behalf of Lothian Pension Fund.

3.12 KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery.

3.13 A chronology of events to date is provided in Appendix 2. The contents of which have been approved by Pinsent Mason. The positive news is that in May 2018 the Upper Tribunal (Tax and Chancery) decided in favour of the test claimant and against referring the judgement to the Court of Justice of the European Union.

3.14 Fees incurred to date on these claims amount to £175.7k (£162.3k as at the meeting of December 2017). Potential subsequent referrals are estimated to cost £20k for each legal stage.

Claims – Fokus Bank

3.15 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.

3.16 The Pensions Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £4.57m have been made. Progress on the claims is summarised in Appendix 3.

3.17 Fees incurred to date on these claims amount to £390.5k (£389.7k as at the meeting of December 2017). Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.

Claims – Taiwan

3.18 Last year's report on cross border withholding tax identified the opportunity to make additional claims to recover tax deducted on dividends from Taiwanese companies. It was reported to the Pensions Audit Sub Committee that a procurement activity would be carried out to appoint a firm of accountants to make the relevant claims.

3.19 After reviewing a number of quotations, Deloitte has been appointed to make claims for three calendar years (2016, 2017 and 2018). The potential amount to be recovered is in excess of £700k.

4. Measures of success

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

5. Financial impact

5.1 Tax claims totalling of £12.8m have now been lodged with the relevant tax authorities. Professional fees amounting to £629.6k 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 £740.5k. So irrespective of the outcome of the remaining claims Lothian Pension will accrued a financial benefit. The financial position can be summarised as follows:

Claim Type	Total Claims £'000	Claims Settled £'000	Claims Outstanding £'000	Costs to Date £'000
Manninen	2,626.7	Nil	2,626.7	63.4
Manufactured Dividends	4,870.6	Nil	4,870.6	175.7
Fokus Bank	4,574.5	1,370.1	3,204.4	390.5
Taiwan	700.0	Nil	700.0	Nil
	12,771.8	**1,370.1**	**11,401.7**	**629.6**

6. Risk, policy, compliance and governance impact

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

7. Equalities impact

7.1 There are no equalities implications as a result of this report.

8. Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

Contact: Esmond Hamilton, Financial Controller, Lothian Pension Fund

E-mail: esmond.hamilton@edinburgh.gov.uk | Tel: 0131 469 3521

11. Appendices

Appendix 1 **Chronology - Manninen / Foreign Income Dividends (FIDs**

Appendix 2 **Chronology - Manufactured Overseas Dividends (MODs)**

Appendix 3 **Fokus Bank – Claims Summary**

Appendix 1

Chronology - Manninen / Foreign Income Dividends (FIDs)

Date	Event
March 2011	First-tier Tribunal (FTT) published its judgement on the test case: • Withholding of tax credits on foreign income dividends and overseas dividends (Manninen) was a breach of EU law – the substantive issues. • All but one of the 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.
April 2013	Upper Tribunal refuses HMRC's request for leave to appeal on the substantive issue and claimants' request on the out of time issue.
June 2013	Court of Appeal approves direct requests to appeal from HMRC and claimants.
November 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).
January 2014	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 was 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 issues.
July 2015	The Court of Appeal handed down its judgement: 1. The original decision on the out of time issue is upheld.

Date	Event
	2. On the substantive FIDs issue the Court has decided to refer this to the CJEU. 3. The Court did not determine the substantive Manninen issue because it was found not to be relevant as the claims were out of time. On the FIDs substantive issue the parties agreed the specific questions that will be referred to the CJEU.
August 2015	On the out of time issue an application for permission to appeal was submitted to the Supreme Court directly.
January 2016	The Supreme Court refuses to grant permission to appeal on out of time issue. CJEU acknowledge start of legal process on the substantive issue. Hearing should take place late in 2016 with the judgement likely to be issued within six months afterwards.
November 2016	CJEU hearing was held on 9 November 2016.
December 2016	The Opinion of the Advocate General was released, which recommended that the CJEU should conclude that the denial of payable tax credits on FIDs was an unjustifiable breach of EU law.
September 2017	CJEU full judgement released on 14 September 2017. This is a positive outcome with a clear finding of a breach of EU law in denying tax credits on FIDS.
December 2017	After delivery of the CJEU judgment the Court of Appeal made an order to determine the statutory claims reflecting the fact that the test claimant succeeded with the FIDs claim for the year 1997/98. However, the remainder of the test claimant's statutory claims were held to be out of time by the Court of Appeal and as such no recovery can be made for those periods at present via the statutory claims.
June 2018	Following the determination of the statutory appeals, the stay on the High Court proceedings was lifted. However, claimants should maintain their statutory claims as these may assist the High Court claims as the stay on these claims has now been lifted. As regards the High Court claims, a restitutionary Counsel has been appointed.

Date	Event
September 2018	A suitable timetable has been agreed with HMRC for exchanging updated pleadings and next steps. The test claimant's amended pleadings were served on HMRC on 31st August and then lodged at court on 7th September.
October 2018	Based on the current timetable, HMRC are likely to file their amended defences by 26 October 2018. The deadline for BTPS (the test claimant) to serve a reply, if this is considered necessary, is 17 December 2018. Once both parties have served their amended or fully pleaded statements of case, we expect the Court to list a case management conference in due course. The case management conference is therefore likely to take place in the early part of 2019. The full substantive hearing before the High Court should therefore be in the latter part of 2019.

Appendix 2

Chronology - Manufactured Overseas Dividends (MODs)

Date	Event
March 2013	An initial hearing of the First-tier Tribunal (FTT) took place.
During 2014	Pinsent Masons were in correspondence with HMRC through the course of 2014 and have 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 to be handed down at a later date.
July 2016	The FTT concluded that there was a movement of capital, but that the MODs rules applied by HMRC did not amount to a restriction on the movement of capital.
August 2016	The FTT granted the test claimant permission to appeal its decision to the Upper Tribunal.
October 2016	The Upper Tribunal (UT) stage commenced.
March 2017	UT rejected immediate reference to CJEU. Reference was requested as it was deemed beneficial to make the reference as early as possible in view of the UK's scheduled exit from the European Union.
July 2017	Substantive UT appeal has been listed for a hearing in February 2018.
May 2018	During May the UT issued a decision in favour of the test claimant and did not consider it necessary to refer its judgement to the Court of Justice of the European Union (CJEU).
June 2018	HMRC applied to the UT to appeal the decision. The UT granted HMRC's application for permission to appeal to the Court of Appeal.
July 2018	HMRC lodged their appeal at the Court of Appeal and commenced proceedings before the Court of Appeal.

Date	Event
October 2018	To date, the parties have exchanged skeleton arguments and the Court of Appeal has recently listed the substantive hearing for 25 – 27 June 2019.

Appendix 3

Fokus Bank – Claims Summary

Country	Claim Period From / To	Estimated Amount Claimed	Amount Received	Notes
Completed Claims				
Austria	2006 2010	£83.0k	£83.0k	Claim paid in September 2012.
Netherlands	2003 2006	£440.0k	£440.0k	Claim paid in 2009.
Norway	2004 2010	£278.9k	£278.9k	All claims paid - final instalment received in February 2013 (£73k)
Spain	2004 2009	£568.2k	£568.2k	All claims paid - final instalment received in March 2015 (£102k)
Active Claims				
France	2005 2009	£675.7 [€776.7k]	-	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. In February 2016 KPMG submitted a comparability analysis demonstrating that Lothian Pension Fund is in a similar situation to the test claimant. For efficiency purposes our claim is being included in a batch with similar claimants. This has delayed the filing of the documentation with the French Tax Authorities (FTA). To date KPMG have not received any response from the FTA. KPMG will contact the FTA in 2018 if they do not start to hear from them in respect of any clients and consider whether any other action should be taken. The FTA's willingness to resolve the cases is highly influenced by political influence in France.

Country	Claim Period From / To	Estimated Amount Claimed	Amount Received	Notes
				Significant interest accrues on any refunds from France and it is paid automatically. There have been no developments since the last report.
Germany	KPMG 2003 2010 Deloitte 2011 2014 WTax 2015 2017	£936.1k [€1,076.0k] £117.9k [€135.5k] £996.8 [€1,145.8k]	-	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. After appropriate due diligence, WTax was appointed in 2018, on a no win no fee basis, to recover any withholding tax not normally recovered by the custodian. WTax has decided to make additional claims in Germany To date, the German Tax Authorities (GTA) have ignored the claims filed by UK-resident pension schemes to date and litigation is likely to be required in this territory. Litigation has been pursued by a Canadian resident pension fund in Germany. The Fiscal Court of Munich issued a decision in October 2017, confirming that it considered the Canadian pension fund to be comparable to a pension fund under German law and that the Court did not see any reason why discrimination could be justified. The Court, at the same time, referred questions to the Court of Justice of the European Union (CJEU). Firstly, the Court queried whether the levying of withholding tax at 26.375% on dividend distributions to the pension fund is an infringement of Article 63 (Free Movement of Capital) of the Treaty on the Functioning of the European Union (TFEU) when a German pension fund is taxed on a net basis, with deductions allowable for technical reserves in respect of future pension liabilities.

Country	Claim Period From / To	Estimated Amount Claimed	Amount Received	Notes
				WTax is currently participating in friendly litigation with Germany using one of their clients as a test case and are hopeful that the results will be positive.
Italy	2007 2010	£181.5k [€208.6k]	-	The Italian Tax Authority (ITA) 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. KPMG believe claimants prefer to concentrate efforts on France and Germany before considering Italy. Under Italian law, claims must be renewed after a period of 10 years. In 2017, Officers considered the cost of refreshing the claim and the potential for the claims being paid and decided not to pursue this option. This means that €391.9k of the original claims have lapsed, reducing the value of the remaining claim to the £181.5k stated above. WTax, which operates on a no win no fee basis, has decided not to pursue claims in Italy.
Denmark	2016 2017	£65.4k [€75.1k]		After appropriate due diligence, WTax was appointed in 2018, on a no win no fee basis, to recover any withholding tax not normally recovered by the custodian. WTax has decided to make some claims in Denmark.

Country	Claim Period From / To	Estimated Amount Claimed	Amount Received	Notes
				Previous providers did not consider it economic to make claims in this country.
Sweden	2013 2017	£231.0k [€265.6k]		After appropriate due diligence, WTax was appointed in 2018, on a no win no fee basis, to recover any withholding tax not normally recovered by the custodian. WTax has decided to make some claims in Sweden. Previous providers did not consider it economic to make claims in this country.
TOTAL		**£4,574.5k**	**£1,370.1k**	