

Pensions Audit Sub Committee

2.00pm, Tuesday, 10 December 2019

EU Tax Claims and Other Income Tax Recoveries

Item number	5. 2
Executive/routine	
Wards	All
Council Commitments	

1. Recommendations

The Pensions Audit Sub Committee is requested to:

- 1.1 note the report and highlight any points it would like to raise at the Pensions Committee on 11 December 2019.

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

EU Tax Claims and Other Income Tax Recoveries

2. Executive Summary

- 2.1 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 £1.37m. Progress on outstanding claims is discussed in detail within the report. The main developments are:
- further legal progress with the Manninen and Manufactured Overseas Dividend claims; and
 - wtax has made additional Fokus claims in Germany and Denmark on a no win no fee basis.

3. Background

- 3.1 EU tax claims relate to the recovery of tax deducted from dividend payments prior to receipt. The claims are based on a fundamental principle of EU law, that 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.
- 3.2 Progress on claims to recover tax on Taiwanese dividends is now covered in the separate report on cross-border withholding tax.

4. Main report

Claims - Manninen / Foreign Income Dividends (FIDs)

- 4.1 These claims are against the UK tax authorities. The FIDs claims are 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. Manninen claims concern whether the UK breached EU law in denying claims for tax credits on overseas dividend receipts.

- 4.2 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.
- 4.3 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.
- 4.4 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 Manninen claim. A cost benefit analysis concluded that a claim should be lodged, and this was done on 9 February 2006.
- 4.5 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.
- 4.6 A chronology of events to date is provided in Appendix 1. The contents of which have been approved by Pinsent Mason.
- 4.7 Since the last report to Committee in December 2018, work has continued towards litigation against HMRC in the High Court.
- 4.8 Fees incurred to date, by Lothian Pension Fund, on these claims amount to £67.5k (£63.4k as at the last update to Committee in December 2018). 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)

- 4.9 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.
- 4.10 Note that manufactured dividends are dividends created when a security is out on loan at the time the company pays a dividend.
- 4.11 Claims in respect of manufactured dividends totalling £4,870.6k have been lodged with HMRC on behalf of Lothian Pension Fund.
- 4.12 KPMG has appointed a firm of solicitors (Pinsent Masons) to pursue recovery.
- 4.13 A chronology of events to date is provided in Appendix 2. The contents of which have been approved by Pinsent Mason.
- 4.14 Since the last report to Committee in December 2018, the Court of Appeal decided in favour of the test claimant and refused HMRC permission to appeal to the Supreme Court. HMRC has indicated that it intends to apply for permission to

appeal this decision. Pinsent Masons plan to file a notice of objection to such a move by HMRC.

- 4.15 Fees incurred to date on these claims amount to £187.7k (£175.7k as at the meeting of December 2018). Potential subsequent referrals are estimated to cost £20k for each legal stage.

Claims – Fokus Bank

- 4.16 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.
- 4.17 The Pensions Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £5.5m (£4.57m as at the meeting of December 2018) have been made. Progress on the claims is summarised in Appendix 3.
- 4.18 Since the last report in December 2018, Wtax have made additional claims of €1,192.6k in Germany and €34.4k in Denmark. Wtax operate on a no win no fee basis, so Lothian Pension Fund has not incurred any costs in making these additional claims. Since the initial success with claims in four EU countries there has been little apparent progress to the remaining substantial claims in France and Germany.
- 4.19 Fees incurred to date on these claims amount to £390.5k (£390.5k as at the meeting of December 2018). Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.

Claims – Taiwan

- 4.20 Note that the financial impact of the Taiwan claims is now included in the separate report on cross-border withholding tax.

5. Next Steps

- 5.1 Officers will continue to monitor progress with the remaining claims with the assistance of the appointed professional advisers.

6. Financial impact

- 6.1 Tax claims totalling of £13.0m (£12.8m as at the meeting of December 2018) have now been lodged with the relevant tax authorities. Professional fees amounting to £645.7k (£629.6k as at the meeting of December 2018) 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.

- 6.2 Currently, claims paid to date exceed the costs incurred by £724.4k (£740.5k as at the meeting of December 2018). So irrespective of the outcome of the remaining claims, Lothian Pension Fund will accrue 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	67.5
Manufactured Dividends	4,870.6	Nil	4,870.6	187.7
Fokus Bank	5,498.0	1,370.1	4,127.9	390.5
	12,995.3	1,370.1	11,625.2	645.7

- 6.3 Because of the uncertainty associated with the tax claims, amounts are only recognised in Lothian Pension Fund's accounts when funds are received.
- 6.4 Note that the financial impact of the Taiwan claims is now included in the separate report on cross-border withholding tax.

7. Stakeholder/Community Impact

- 7.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the pension funds and they are invited to comment on the relevant matters at Committee meetings.
- 7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.
- 7.3 There are no adverse sustainability impacts arising from this report.

8. Background reading/external references

- 8.1 None.

9. Appendices

- Appendix 1 Chronology - Manninen / Foreign Income Dividends (FIDs)
- Appendix 2 Chronology - Manufactured Overseas Dividends (MODs)
- Appendix 3 Fokus Bank – Claims Summary

Appendix 1

Events Since Last Report to Committee - Manninen / Foreign Income Dividends (FIDs)

Date	Event
October 2018	<p>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, was 17 December 2018.</p> <p>Once both parties have served their amended or fully pleaded statements of case, Pinsent Masons expect the Court to list a Case Management Conference in due course.</p>
December 2018	<p>HMRC filed their defences as expected on 26 October 2018 and BTPS (the test claimant) served their replies on 17 December 2018.</p>
January 2019	<p>On behalf of the test claimant, Pinsent Masons wrote to HMRC regarding the steps the parties needed to take in advance of the Case Management Conference (CMC). Pinsent Masons commenced work on these aspects. One of the steps was for the parties to attempt to agree the issues for disclosure in the case.</p>
February 2019	<p>HMRC wrote back to the test claimant with their comments on the issues for disclosure.</p> <p>BTPS (the test claimant) confirmed instructions to seek a short form prospects of success opinion from Counsel in respect of the High Court litigation in the early part of 2019.</p> <p>The Court notified the parties that the case had been allocated to Mrs Justice Falk and requested a short written summary of the issues for disclosure.</p>
March 2019	<p>Pinsent Masons wrote back to HMRC on behalf of BTPS regarding the issues for disclosure.</p>
April 2019	<p>Both parties agreed a short written summary and submitted this to the Court.</p>
July 2019	<p>On behalf of BTPS (the test claimant), Pinsent Masons wrote to HMRC regarding listing a Case Management Conference (CMC)</p>

Date	Event
	hearing.
August 2019	<p>A summary of Counsel's opinion on the prospects of success for the High Court action for both the FIDs and Manninen claims was sent to all group claimants. This update also set out the options claimants have in pursuing their FIDs and Manninen claims.</p> <p>The parties wrote a joint letter to the Court regarding listing a Case Management Conference.</p>
September 2019	<p>HMRC wrote to BTPS (the test claimant) seeking a stay of the High Court proceedings behind the case "Test Claimants in the Franked Investment Income Group Litigation v HMRC (FII)". In response Pinsent Masons wrote to HMRC to request further information and clarification of their stay proposal.</p>
October 2019	<p>HMRC have provided further information in respect of their stay proposal. Pinsent Masons are currently in the process of considering the implications of this on the High Court proceedings with Counsel and the test claimant.</p>

Appendix 2

Events Since Last Report to Committee - Manufactured Overseas Dividends (MODs)

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.
June 2019	The Court of Appeal hearing was heard on 25 – 27 June 2019 by Lord Justice Newey, Lady Justice Asplin and Lady Justice Rose at the Royal Courts of Justice. Judgement was reserved in the normal way at the end of the hearing.
October 2019	<p>The Court of Appeal handed down its judgment on 3 October 2019 and the test claimant was again successful before the Court of Appeal.</p> <p>Further, the Court of Appeal refused HMRC permission to appeal to the Supreme Court. HMRC have indicated that they intend to apply for permission to appeal the Court of Appeal's decision directly to the Supreme Court. If HMRC do apply for permission directly to the Supreme Court, Pinsent Masons will have an opportunity to file a notice of objection. The Supreme Court will review the notice of objection in deciding whether or not to grant HMRC permission to appeal.</p>

Fokus Bank – Claims Summary

Country	Claim Period From / To	Estimated Amount Claimed	Notes
France	2005 2009	£671.1k [€776.7k]	<p>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.</p> <p>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).</p> <p>KPMG’s update of July 2019 states:</p> <p>“A summary of the questionnaire has been filed with the FTA on behalf of UK pension funds to evidence their comparability. Meetings with the FTA are expected in the coming months to discuss next steps.”</p>
Germany	KPMG 2003 2010 Deloitte 2011 2014 WTax 2015 2018	£928.9k [€1,076.0k] £117.1k [€135.5k] £2,020.6k [€2,338.4k]	<p>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.</p> <p>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</p> <p>Since the last report to Committee WTax has made a further claim in respect of the 2018 calendar year of €1,192.6k.</p> <p>KPMG’s update of July 2019 states:</p>

Country	Claim Period From / To	Estimated Amount Claimed	Notes
			<p>“In KPMG’s view all claimants that have filed claims with local tax authorities [which LPF has done] should be in a good position to receive refunds.”</p> <p>“German Law has been amended so that all German portfolio dividends paid post 1 March 2013 are taxable income for German corporations. By this action Germany has reacted to the CJEU decision C-284/09 and abolished discriminatory treatment in the fact pattern underlying this decision. The amendment of the law only covers corporations; however it is a strong sign for other claimants (such as pension funds, investment funds and life companies) that discrimination existed.”</p>
Italy	2007 2010	£65.1k [€75.4k]	<p>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.</p> <p>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 €525.1k of the original claims have lapsed, reducing the value of the remaining claim to the £65.1k stated above.</p> <p>WTax, which operates on a no win no fee basis, has decided not to pursue claims in Italy.</p>
Denmark	2016 2017	£94.7k [€109.6k]	<p>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.</p> <p>Since the last report to Committee WTax has made a further claim in respect of the 2018 calendar year of €34.4k.</p>

Country	Claim Period From / To	Estimated Amount Claimed	Notes
			Previous providers did not consider it economic to make claims in this country.
Sweden	2013 2017	£229.5k [€265.6k]	<p>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.</p> <p>Previous providers did not consider it economic to make claims in this country.</p>
TOTAL		£5,498.0k	