



Pensions Audit Sub Committee

2.00pm, Tuesday, 8 December 2020

EU Tax Claims and other Income Tax Recoveries

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 9 December 2020.

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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 covering the last two reports, 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.

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 since the last report 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 2019, 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 (£67.5k as at the last update to Committee in December 2019). If the case is pursued to a 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 since the last report 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 2019, HMRC has successfully appealed a decision by the Court of Appeal to refuse it leave to appeal to the Supreme Court against the decision in favour of the test claimant. We await news of the date when the case will be heard at the Supreme Court.
- 4.15 Fees incurred to date on these claims amount to £196.7k (£187.7k as at the meeting of December 2019).

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 £6.3m (£5.5m as at the meeting of December 2019) have been made. Progress on the claims is summarised in Appendix 3.

- 4.18 Since the last report in December 2019, WTax have made additional claims of €993.1k in Germany and DKK401.5k in Denmark. However, the claims in Sweden (€265.5k) have been withdrawn as there is no legal basis to support them. WTax is a company that aims to recover tax on dividends in cases where the custodian is not able/willing to do it. The company operates on a no win no fee basis, so Lothian Pension Fund has not incurred any costs in making these additional claims.
- 4.19 The remaining claims made by KPMG in Italy (€75.4k) are all now time expired. 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.
- 4.20 Fees incurred to date on these claims amount to £390.5k (£390.5k as at the meeting of December 2019). Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.

5. Financial impact

- 5.1 Tax claims totalling of £13.9m (£13.0m as at the meeting of December 2019) have now been lodged with the relevant tax authorities. Professional fees amounting to £654.7k (£645.7k as at the meeting of December 2019) 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 £715.4k (£724.4k as at the meeting of December 2019). 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 | 196.7 |
| Fokus Bank | 6,354.4 | 1,370.1 | 4,984.3 | 390.5 |
| | 13,851.7 | 1,370.1 | 12,481.6 | 654.7 |

- 5.3 Because of the uncertainty associated with the tax claims, amounts are only recognised in Lothian Pension Fund's accounts when funds are received.

6. Stakeholder/Regulatory Impact

- 6.1 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.
- 6.2 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.
- 6.3 There are no adverse sustainability impacts arising from this report.

7. Background reading/external references

- 7.1 None.

8. Appendices

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

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

| Date | Event |
|-------------------------------|--|
| October 2019 | HMRC provided further information in respect of their proposal to stay the High Court proceedings behind the case “Test Claimants in the Franked Investment Income Group Litigation v HMRC (FII)”. Pinsent Masons considered the implications of this on the High Court proceedings with Counsel and the test claimant. |
| December 2019 | Pinsent Masons agreed to HMRC’s request to stay the proceedings due to the potential relevance of the <i>FII</i> case on the FIDs and Manninen High Court proceedings. |
| February 2020 to October 2020 | <p>Pinsent Masons received the sealed orders approving the stay from the Court on 27 February 2020. These were served on HMRC.</p> <p>The <i>FII</i> hearing concluded on 20 February 2020. Pinsent Masons await the decision and will assess its impact on the FIDs and Manninen claims.</p> <p>The High Court proceedings are currently stayed pending the outcome in the <i>FII</i> case. We anticipate that the FIDs/ Manninen case will likely go live towards the end of this year or early next year following the release of the Supreme Court decision in <i>FII</i>.</p> |

Appendix 2

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

| Date | Event |
|---------------------------|---|
| October 2019 | <p>The Court of Appeal handed down its judgment on 3 October 2019 and the test claimant was successful again before the Court of Appeal.</p> <p>Further, the Court of Appeal refused HMRC permission to appeal to the Supreme Court.</p> <p>On 31 October 2019 HMRC filed and served an application for permission to appeal directly to the Supreme Court.</p> |
| November 2019 | On 14 November 2019 Pinsent Masons submitted a notice of objection to HMRC's application, setting out the reasons it should be refused. |
| May 2020 | On 20 May 2020 the Supreme Court granted HMRC's permission to appeal application. |
| June 2020 | On 1 June 2020 HMRC filed and served a notice of intention to proceed with their appeal to the Supreme Court. |
| July 2020 | On 13 July 2020 Pinsent Masons filed an acknowledgement of HMRC's appeal to the Supreme court. |
| July 2020 to October 2020 | In accordance with the Supreme Court timetable, during this period, the parties have been in discussions to agree a statement of the relevant facts and issues in respect of the test case and an appendix of documents. This was agreed and filed by HMRC with the Supreme Court on 12 October 2020. |

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 | £706.8 [€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>There have been no developments in the last two years. KPMG is not proposing any action and is waiting in the hope of some movement from the FTA.</p> |

| Country | Claim Period From / To | Estimated Amount Claimed | Amount Received | Notes |
|---------|---|--|-----------------|---|
| Germany | <p>KPMG 2003 2010</p> <p>Deloitte 2011 2014</p> <p>WTax 2016 2019</p> | <p>£979.2k [€1,076.0k]</p> <p>£123.3k [€135.5k]</p> <p>£3,031.7k [€3,331.5k]</p> | - | <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 2019 calendar year of €1,011.5k.</p> <p>The latest professional advice on the German claims is from Deloitte LLP:</p> <p>“On 13th November 2019, the Court of Justice of the European Union (“CJEU”) issued their ruling in <i>College Pension Plan of British Columbia v Finanzamt München III case (C-641/17)</i>. The claimant was a Canadian pension fund. The CJEU judgement stated that the application of the German withholding tax (“WHT”) regime constituted an unjustified restriction to the free movement of capital. The case has been remitted back to the Munich Fiscal Court to apply the CJEU ruling to the facts of the case.</p> <p>Separately, court decisions are pending for various investment funds test cases (which includes UK funds) in Germany.</p> <p>We expect, collectively, all the cases above should help improve guidance and comparability considerations for EU WHT reclaims in Germany (UK pension funds).”</p> |

| Country | Claim Period From / To | Estimated Amount Claimed | Amount Received | Notes |
|--------------|------------------------|--------------------------|------------------|---|
| Italy | | | - | <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. As a result, all the claims have now lapsed.</p> <p>An indication of the very low chance of the claims ever succeeding, WTax, which operates on a no win no fee basis, has decided not to pursue claims in Italy.</p> |
| Denmark | 2016 2019 | £143.3k [DKK1,194.4k] | | <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. An additional claim for 2019 has been made amounting to DKK401.5k.</p> <p>Previous providers did not consider it economic to make claims in this country.</p> |
| Sweden | | | | <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.</p> <p>Since the last report to Committee, WTax have advised that the claims have been withdrawn due to a lack legal basis.</p> |
| TOTAL | | £6,354.4k | £1,370.1k | |