

Pensions Audit Sub Committee

2.00pm, Tuesday, 6 December 2022

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 7 December 2022.
- 1.2 note that the Fund has withdrawn from all Manninen and Foreign Income Dividend and also Manufactured Overseas Dividend reclaims. As the success of these reclaims was uncertain, they only appeared as a contingent asset note in the Fund's audited annual accounts. Withdrawal from these reclaims has no impact on the "bottom-line" figures reported.
- 1.3 note that, in future, progress on Fokus reclaims will be covered in the Investment Income Review Cross Border Withholding Tax paper

John Burns

Chief Finance Officer, Lothian Pension Fund

Contact: Jason Koumides, Financial Controller, Lothian Pension Fund

Laura Forsyth, Senior Finance Manager, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

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:
- 2.2 Lothian Pension Fund has withdrawn from the Manninen and Manufactured Overseas Dividend claims; and
- 2.3 WTax has made additional Fokus claims in Germany 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 taxpayers 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 were against the UK tax authorities. The FIDs claims were 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 claims are for tax credits and are based on the rate of advance corporation tax in place in respect of the overseas dividends. Estimates showed that Lothian Pension Fund could benefit by up to £2.6m from successful Manninen and FID claims. A cost benefit analysis concluded that a claim should be lodged, and this was done on 9 February 2006.

- 4.3 HMRC has rejected all claims of this nature. As a result of Counsel's opinion on the prospects of the claim and the estimated costs for High Court proceedings BT Pension Scheme withdrew as the test claimant for these claims. The request for a new test claimant was unsuccessful and Lothian Pension Fund withdrew the claims in July 2022.
- 4.4 Total fees incurred by Lothian Pension Fund on these claims amount to £69.5k (£67.5k as at the last update to Committee in December 2021).

Claims – Manufactured Overseas Dividends (MODs)

- 4.5 This claim was against the UK tax authorities. It was 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.
- 4.6 Claims in respect of manufactured dividends totalling £4,870.6k were lodged with HMRC on behalf of Lothian Pension Fund and KPMG appointed a firm of solicitors (Pinsent Masons) to pursue recovery.
- 4.7 Since the last report to Committee in December 2021, the Supreme Court released its decision on the MODs test case. The Court found in favour of Commissioners for Her Majesty's Revenue and Customs. As a result of this decision Lothian Pension Fund withdrew the claim in July 2022.
- 4.8 Following withdrawal from the claim there are no further contributions to costs for the claim, however, Lothian Pension Fund will be liable for a share of HMRC's adverse costs. An estimate for these is not yet available. Pinsent Masons expect that these costs will be unknown for at least a further 9 months from November 2022. On this basis, a contingent liability note would be included in the LPF financial statements 2022/23.
- 4.9 Fees incurred to date on these claims amount to £222.4k (£203.7k as at the meeting of December 2021).

Claims – Fokus Bank

- 4.10 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.
- 4.11 The Pensions Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £6.8m (£6.1m as at the meeting of December 2021) have been made.

- 4.12 Since the last report in December 2021, a specialist tax recovery company, WTax, acting on our behalf, has made additional claims of €688.5k in Germany. WTax operate on a no win no fee basis, so Lothian Pension Fund has not incurred any costs in making these additional claims.
- 4.13 No further claims have been paid since the last report in December 2021. KPMG has reported that the French Tax Authority (FTA) is now actively addressing claims and has started issuing information requests from claimants. KPMG therefore believes that the FTA are now looking to resolve the French claims. There has been no update regarding the German claims and KPMG still awaits the Munich court's ruling following the positive ruling from the CJEU in the Canadian pension fund case.
- 4.14 Fees incurred to date on these claims amount to £390.5k (£390.5k as at the meeting of December 2021). Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.
- 4.15 Future reporting of these claims will be included within the Investment Income Review Cross Border Withholding Tax report.

5. Financial impact

- 5.1 Tax claims outstanding totalling £5.4m (£13.6m as at the meeting of December 2021) are currently lodged with the relevant tax authorities. Professional fees amounting to £682.4k (£663.7k as at the meeting of December 2021) have been paid to date. As noted above, Lothian Pension Fund is liable for a share of HMRC's adverse costs in relation to the MODs test case. Any other fees will only be incurred following a successful claim by WTax.
- 5.2 Currently, claims paid to date exceed the costs incurred by £687.7k (£715.4k as at the meeting of December 2021). 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	Nil – Withdrawn	69.5
Manufactured Dividends	4,870.6	Nil	Nil - Withdrawn	222.4
Fokus Bank	6,786.1	1,370.1	5,416	390.5
	14,283.4	1,370.1	5,416	682.4

- 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

None.