



Pensions Audit Sub Committee

2.00pm, Monday, 4 December 2023

Investment Income Review Cross Border Withholding Tax and EU Tax Recoveries

Item number 6.4

1. Recommendations

The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the report and highlight any points it would like to raise at the Committee on 5 December 2023.
- 1.2 note that whilst the review by EY shows that Northern Trust is generally applying the correct withholding tax rates on investment income, several rates applied were queried as suggested by EY.
- 1.3 note the progress on French Fokus claims via KPMG and ongoing work on other Fokus claims via WTax.

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Investment Income Review Cross Border Withholding Tax and EU Tax Recoveries

2. Executive Summary

- 2.1 This report provides information on a benchmarking assurance review, prepared by EY, into the effectiveness of the procedures in place to manage the tax exposure on the investment income of the Lothian Pension Fund and the Scottish Homes Pension Fund.
- 2.2 The review shows that Northern Trust is applying the correct withholding tax rates on investment income and is pursuing reclaims where possible. A summary of the opportunities and issues identified is detailed in section 4. No significant claims have been settled in the period.
- 2.3 This report also provides an update on progress on Fokus bank reclaims as were previously covered the EU Tax Claims and Other Income Tax Recoveries paper. During the period covering the last two reports no additional claims have been paid.

3. Background

- 3.1 Lothian Pension Fund (LPF) and Scottish Homes Pension Fund (SHPF) invest directly in stock listed on markets across the globe. These investments generate income that is potentially liable to income tax in the country of tax domicile. During the 2022/23 financial year the funds earned income from companies in 34 different countries.
- 3.2 UK pension funds are usually able to benefit from beneficial tax rates. These rates are normally determined by separate tax treaties established between the UK Government and most foreign countries. Tax on dividends varies between 0% and 35%. In contrast, income on fixed interest stocks is usually free from tax.
- 3.3 In virtually all countries income is subject to taxation at source, so the owner of the investments receives the income net of the appropriate amount of tax. Taxation deducted in this way is called withholding tax (WHT).
- 3.4 In some countries, the preferential rate for UK pension funds is subject to providing the tax authorities with an application and supporting paperwork. The exact requirements vary from country to country and in some cases, can be quite onerous. Failure to have preferential rate approval in place means that income will be subject to a higher rate of tax than is necessary.
- 3.5 The preferential rate may be applied at source, meaning that there is no tax to reclaim from the foreign tax authority. Alternatively, the rules of the country may require tax to be deducted at the full rate with a subsequent claim having to be

made to the tax authority to get repayment of the difference between the full rate and the preferential rate.

- 3.6 The requirements to make a valid repayment claim and the time it takes for the claim to be paid vary considerably from country to country.

The Role of the Custodian

- 3.7 The custodian appointed for the two pension funds is Northern Trust (NT). In addition to the vital role of holding title to investments on behalf of the investor, the global investment custodian is responsible for the management of the procedures and processes that relate to the taxation of investment income.

The Scale of Activity

- 3.8 The tables below show the movement in the reclaimable tax balances during the 2022/23 and 2021/22 financial years for LPF and SHPF.

Lothian Pension Fund	2022/23 £	2021/22 £
Brought Forward 1 April	21,163,369.45	14,900,747.76
Recoverable tax accrued during year	8,041,452.20	7,042,029.31
Claims paid during year	(191,203.19)	(779,407.62)
Carried Forward 31 March	29,013,618.46	21,163,369.45

Scottish Homes Pension Fund	2022/23 £	2021/22 £
Brought Forward 1 April	11,686.58	11,780.50
Recoverable tax accrued during year	464.98	(93.92)
Claims paid during year	-	-
Carried Forward 31 March	12,151.56	11,686.58

- 3.9 The year-end recoverable tax balances at 31 March 2023 and 31 March 2022, broken-down by country, are provided for each of the Funds in Appendix 1.
- 3.10 For LPF, Switzerland accounts for 42% (41% at 31 March 2022) for the total amount receivable. The reason the Swiss total claim value is so large is that 35% tax is deducted on all dividends and the 0% rate relief is obtained by claiming the tax paid back. There are few other countries where the tax deducted at source is so high.
- 3.11 The Swiss, German, Belgian and Finnish claims are analysed in more detail later in this report.

4. Main Report

Benchmarking (Assurance) Review

- 4.1 Given the complexity and scale of the taxation of investment income, it is important that LPF's custodian, Northern Trust (NT), provides an efficient service. Failure to ensure that the correct tax rates are being applied would result in a direct loss of income. Poor management of the tax reclaim process could mean that recoverable tax is never recovered or delayed.
- 4.2 In order to assess the effectiveness of NT's work, EY has been commissioned to prepare a benchmarking assurance report. The remit was to carry out a review of the WHT suffered for the period 1 August 2022 to 31 July 2023.

Findings – WHT Rates Applied

- 4.3 The EY study found that the correct WHT rates have been achieved by the Fund for the majority of dividend distributions received. EY highlighted £29k WHT suffered on Canadian dividends identified by NT as cross-border payments. NT has provided evidence of the cross-border nature of these payments. WHT of £238k suffered on Dutch dividend payments was also noted by EY. NT has confirmed they are pursuing a full reclaim of this amount.
- 4.4 The reclaim process consists of the custodian preparing an application in the required format for the country concerned. Once the application has been lodged with the tax authorities of the country, it will take the authority an amount of time to process the claim and pay the refund. This processing time varies from country to country – some take a matter of months and others will take a number of years.
- 4.5 Swiss claims accounted for 42% (£12,231k) of the value of Lothian Pension Fund claims. The amounts due can be summarised as follows:

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
	30/9/23 £	31/3/23 £	31/3/22 £	
2019	2,532k	2,503k	2,333k	NT status at 30 September 2023: "Reclaim Submitted to Tax Authority"
2020	3,187k	3,150k	2,937k	NT status at 30 September 2023: "Reclaim Submitted to Tax Authority"
2021	2,360k	2,333k	2,175k	NT status at 30 September 2023: "Claim under preparation"
2022	2,616k	2,587k	1,304k	NT status at 30 September 2023: "Certification Requested"

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
2023	2,855k	1,657k	-	Claim cannot be made until the end of the calendar year.
Total	13,550k	12,231k	8,749k	

4.6 During the pandemic the Swiss Tax Authorities had agreed to process claims submitted without HMRC certification. This has since been rescinded and all claims now require this certification before submission. This decision has led to a backlog in addition to that built up over the pandemic. Claims are now beginning to settle with LPF receiving (based on unaudited October 2023 data) £2.8m in Swiss claims in October 2023.

4.7 For Germany, the position for the LPF claims can be summarised as follows:

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
	30/9/23 £	31/3/23 £	31/3/22 £	
2016	589k	716k	688k	NT status at 30 September 2023: "Documentation Required From Client"
2017	961k	973k	936k	NT status at 30 September 2023: "Reclaim Submitted to Tax Authority"
2018	1,133k	1,147k	1,103k	NT status at 30 September 2023: "Reclaim Submitted to Tax Authority"
2019	1,427k	1,445k	1,390k	NT status at 30 September 2023: "Reclaim Submitted to Tax Authority"
2020	1,290k	1,306k	1,256k	NT status at 30 September 2023: "Reclaim Submitted to Tax Authority"
2021	1,002k	1,015k	976k	NT status at 30 September 2023: "Market Issue"
2022	1,641k	1,663k	169k	NT status at 30 September 2023: "Documentation Required From Client"
2023	1,800k	167k	-	Claim cannot be made until the end of the calendar year.
Total	9,843k	8,433k	6,520k	

4.8 The Germany Tax Authorities introduced a holding period requirement where the reclaim rate is greater than 15% in rate terms. Claimants must not have traded 45 days prior to and after the dividend ex-date UK pension funds fall into scope of this

new requirement. NT now has a procedure in place to capture this and has submitted reclaims for 2016-2020 which the Fund now awaits payment.

- 4.9 NT has confirmed that no other LGPS clients have received German reclaims and therefore LPF's long dated claims are not an outlier. An electronic submission process was introduced for these claims in 2023 and NT expects that this should speed up the reclaim process in future.

- 4.10 For Belgium, the position for the LPF claims can be summarised as follows:

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
	30/9/23 £	31/3/23 £	31/3/22 £	
2019	465k	547k	526k	NT status at 30 September 2023: "Reclaim Submitted to Tax Authority"
2020	443k	450k	432k	NT status at 30 September 2023: "Claim Under Preparation"
2021	183k	185k	179k	NT status at 30 September 2023: "Certification Requested"
2022	180k	182k	-	NT status at 30 September 2023: "Certification Requested"
2023	143k	7k	-	NT status at 30 September 2023: "Claim under preparation"
Total	1,415k	1,371k	1,137k	

- 4.11 Like Germany, the Belgian tax authorities have introduced a holding period requirement for foreign pension funds. NT has implemented a procedure to automate the process for collecting this data and they have noted that claims from 2019 are now beginning to be repaid.

- 4.12 For Finland, the position for the LPF claims can be summarised as follows:

Year	Lothian Pension Fund	Lothian Pension Fund	Lothian Pension Fund	Comment
	30/9/23 £	31/3/23 £	31/3/22 £	
2020	472k	478k	459k	NT status at 30 September 2023: "Reclaim Submitted to Sub Custodian"
2021	1,269k	1,286k	1,236k	NT status at 30 September 2023: "Claim under preparation"
2022	1,460k	1,479k	184k	NT status at 30 September 2023: "Certification Requested"

2023	825k	159k	-	NT status at 30 September 2023: "Certification Requested"
Total	4,026k	3,402k	561k	

- 4.13 Previously Finnish market offered tax relief at source, instead now full 35% tax rate suffered on investment income which can then be reclaimed. NT has commented that it is a complex manual process with additional steps required for claimants reclaiming below a 15% tax rate (LPF is entitled to 0%).
- 4.14 NT has recently been confirmed by the Finnish Tax Authority as an authorised source of client information. This could allow the provision of tax relief at source in future for LPF.
- 4.15 The Canadian position (£976k) is also of note. All withheld tax relates to the 2021 period where new requirements were put in place. NT has an automated process eliminating the need for retrospective reclaims. 2021 reclaims have been submitted to the Tax Authority.
- 4.16 EY have highlighted the opportunity to reclaim withheld tax in the Taiwanese market. WHT of £1,900k has been suffered in the period under review. Due to the complexity of the reclaim process this falls out of the scope of the claims the custodian would do on behalf of their clients. The Fund has participated in these reclaims in the past and plans to do a procurement exercise to appoint a consultant to do this work.

Fokus Bank reclaims update

- 4.17 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.
- 4.18 The Pensions Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £6.7m (£6.8m as at the meeting of December 2022) have been made of which £1.4m have been settled. Claims are outstanding with the French and German Tax authorities.
- 4.19 No further claims have been paid since the last report in December 2022 however the Fund has provided an earnings attestation to the French tax authorities (FTA) via KPMG following their request for information. KPMG believes that the FTA are now looking to resolve these claims and the Fund awaits a further update on the outstanding claims of £677k.
- 4.20 There has been no update regarding the German claims of £4.6m and no further German claims have been made through KPMG or WTax.

- 4.21 Fees incurred to date on these claims amount to £390.5k (£390.5k as at the meeting of December 2022). Costs are higher for the Fokus Bank type claims because of the need to file claims separately in individual EU countries.

Financial Impact of Fokus Bank reclaims

- 4.22 Tax claims outstanding totalling £5.3m (£5.4m as at the meeting of December 2022) are currently lodged with the relevant tax authorities. A full breakdown is provided in Appendix 2.
- 4.23 Currently, claims paid to date exceed the costs incurred by £979.6k (£979.6k as at the meeting of December 2022) therefore, irrespective of the outcome of the remaining claims, the Fund will accrue a financial benefit. The financial position can be summarised as follows:
- 4.23.1 Due to the uncertainty associated with the tax claims amounts are only recognised in the Funds' accounts when claims are settled.

5. Financial Impact

- 5.1 The financial impact of the withholding tax claims is described in section 3.8 of this report.

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.

7. Background reading/external references

- 7.1 None.

8. Appendices

- Appendix 1 – Tax reclaims by country
Appendix 2 – Fokus Bank reclaims

Appendix 1 – Tax reclaims by country

Lothian Pension Fund	Reclaim Amount 31/03/2023 £	Number of Dividends 31/03/2023	Reclaim Amount 31/03/2022 £	Number of Dividends 31/03/2022
Austria	13,877.73	2	13,346.69	2
Belgium	1,371,284.13	30	1,136,624.71	23
Canada	976,061.31	103	996,988.86	104
Denmark	573,895.20	59	434,170.34	49
Finland	3,402,191.02	16	1,879,923.50	11
France	5,664.67	2	5,447.90	2
Germany	8,432,793.11	178	6,519,623.14	151
Ireland	25,801.40	2	-	-
Netherlands	720,136.10	37	471,209.40	28
Spain	284,677.44	18	84,627.24	8
Switzerland	12,230,863.62	113	8,749,159.87	89
United Kingdom*	966,012.75	22	862,518.87	20
United States	10,359.98	2	9,728.93	2
Grand Total	29,013,618.46	584	21,163,369.45	489

* Relates to UK listed overseas companies' dividends.

Scottish Homes Pension Fund	Reclaim Amount 31/03/2023 £	Number of Dividends 31/03/2023	Reclaim Amount 31/03/2022 £	Number of Dividends 31/03/2022
Germany	12,151.56	4	11,686.58	4
Grand Total	12,151.56	4	11,686.58	4

SHPF had direct holdings in equity investments during the period March 2017 to March 2018. An Index Linked Gilts strategy was adopted in March 2018. As a result, SHPF had some outstanding withholding tax claims at 31 March 2023 relating to the period of equity investment.

Appendix 2 – Fokus Bank reclaims

Claim Country	Total Claims £'000	Claims Settled £'000	Claims Outstanding £'000	Costs to Date* £'000
Austria	83	83	-	
Germany	4,621.7	-	4,621.7	
France	676.8	-	676.8	
Netherlands	440	440	-	
Norway	278.9	278.9	-	
Spain	568.1	568.2	-	
Total	6,668.5	1,370.1	5,298.5	390.5