



Pensions Audit Sub Committee

2.00pm, Tuesday, 3 December 2024

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 2024;
- 1.2 note that whilst the review by EY is ongoing nothing has been noted to date to give concern that Northern Trust is not generally applying the correct withholding tax rates on investment income; and
- 1.3 note the progress on Fokus claims via KPMG and ongoing work on other Fokus claims via WTax.

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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 is ongoing, no adverse findings have been noted to date. The expectation is that the review will show 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.
- 2.3 This report also provides an update on progress on Fokus bank reclaims. During the 2023/24 financial year the outstanding French claims of €777k were 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 2023/24 financial year the funds earned income from companies in 32 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 2023/24 and 2022/23 financial years for LPF and SHPF. These balances are not recognised in the accounts of the Fund until claims are settled.

Lothian Pension Fund	2023/24 £	2022/23 £
Brought Forward 1 April	29,013,618.46	21,163,369.45
Recoverable tax accrued during year	7,004,797.22	8,041,452.20
Claims paid during year	(4,951,373.63)	(191,203.19)
Carried Forward 31 March	31,067,042.05	29,013,618.46

Scottish Homes Pension Fund	2023/24 £	2022/23 £
Brought Forward 1 April	12,151.56	11,686.58
Recoverable tax accrued during year	-	464.98
Claims paid during year	(328.39)	-
Carried Forward 31 March	11,823.17	12,151.56

- 3.9 The year-end recoverable tax balances at 31 March 2024 and 31 March 2023, broken-down by country, are provided for each of the Funds in Appendix 1.
- 3.10 For LPF, Switzerland accounts for 41% (42% at 31 March 2023) 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.

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 and effective 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 2023 to 31 July 2024.

Findings – WHT Rates Applied

- 4.3 The EY study is ongoing. Previously reviews have found that the correct WHT rates have been achieved by the Fund for the majority of dividend distributions received. We will provide an update on any areas where any unclaimed WHT is significant.
- 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 The Canadian position (£117k at 31 March 2024, £976k: 2023) is 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 are now in the process of settlement and only 9 claims were outstanding at 31 March 2024 (103: 2023).
- 4.6 Previously, 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 is gathering quotes from providers to appoint a consultant to do this work.

Fokus Bank reclaims update

- 4.7 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.
- 4.8 The Pensions Committee of October 2007 approved making claims under the principle established in the Fokus Bank case. Claims currently estimated at around £6.5m (£6.7m as at the meeting of December 2023) have been made of which £2m have been settled. Claims are outstanding with the German Tax authorities.
- 4.9 The French Tax Authorities (FTA) have now resolved the outstanding claims via KPMG and the Fund received £1.1m in settlement (£677k in claim value and £423k in

interest) in January 2024. There are no further claims outstanding with the FTA. No other claims have been paid since the last report in December 2023.

- 4.10 There has been no update regarding the German claims of £4.4m and no further German claims have been made through KPMG or WTax.
- 4.11 Fees incurred to date on these claims amount to £411.1k (£390.5k as at the meeting of December 2023). 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

- 4.12 Tax claims outstanding totalling £4.4m (£5.3m as at the meeting of December 2022) are currently lodged with the relevant tax authorities. A full breakdown is provided in Appendix 2.
- 4.13 Currently, claims paid to date exceed the costs incurred by £1,636k (£979.6k as at the meeting of December 2023) therefore, irrespective of the outcome of the remaining claims, the Fund will accrue a financial benefit. The financial position can be summarised as follows:
- 4.13.1 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 31/03/2024 £	Number of Dividends 31/03/2024	Reclaim Amount 31/03/2023 £	Number of Dividends 31/03/2023
Austria	-	-	13,877.73	2
Belgium	1,425,443.17	31	1,371,284.13	30
Canada	117,550.55	9	976,061.31	103
Denmark	621,741.57	55	573,895.20	59
Finland	4,675,976.94	23	3,402,191.02	16
France	-	-	5,664.67	2
Germany	9,299,491.06	179	8,432,793.11	178
Ireland	7,393.32	2	25,801.40	2
Netherlands	591,509.28	32	720,136.10	37
Spain	864,041.63	32	284,677.44	18
Switzerland	12,594,932.82	112	12,230,863.62	113
United Kingdom*	858,821.52	18	966,012.75	22
United States	10,140.19	2	10,359.98	2
Grand Total	31,067,042.05	495	29,013,618.46	584

* Relates to UK listed overseas companies' dividends.

Scottish Homes Pension Fund	Reclaim Amount 31/03/2024 £	Number of Dividends 31/03/2024	Reclaim Amount 31/03/2023 £	Number of Dividends 31/03/2023
Germany	11,823.17	4	12,151.56	4
Grand Total	11,823.17	4	12,151.56	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 2024 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	4,420	-	4,420	
France	677	677	-	
Netherlands	440	440	-	
Norway	279	279	-	
Spain	568	568	-	
Total	6,467	2,047	4,420	411