

Report



meeting

PENSIONS INVESTMENT SUB-COMMITTEE

date

15 December 2006

agenda item number

REPORT OF THE STRATEGIC DIRECTOR OF RESOURCES

OVERSEAS DIVIDEND CLAIMS

1. Purpose

- 1.1 To present an update on the progress of the foreign income dividend (FID) and Manninen claims and to seek a decision on whether to pursue additional claims for recovery of withholding taxes on overseas dividends (referred to as Fokus Bank claims).

2. FID & Manninen Claims

- 2.1 The sub-committee, at its meeting on 24 March 2006, recommended joining the group litigation against HM Revenue & Customs (HMRC) to recover tax credits denied on overseas dividends. The funds formally joined this litigation on 3 April 2006 and served claims on HMRC in August.
- 2.2 The strategy of the litigation is to obtain a referral to the European Court of Justice (ECJ). HMRC are attempting to delay this by arguing that “domestic issues” should be resolved first. The main domestic issue is the application of the UK limitation legislation which may determine how far back claims are allowed.
- 2.3 HMRC’s view is that the limitation should run from the payment of the dividend. However, the recent *Deutsche Morgan Grenfell* judgement in the House of Lords is supportive of the time limit starting when the possibility of claiming arose (thus giving a potentially much longer claim period).

- 2.4 Following this decision, McGrigors, the firm of solicitors engaged on the case, are looking to go back to the High Court for a referral to the ECJ. Further updates from McGrigors are awaited but it is unlikely that there will be an early resolution to this case.

3. Fokus Bank Claim Background

- 3.1 The Fokus Bank case was heard in the European Free Trade Association (EFTA) court and established the principle that a country cannot levy withholding tax on other EU investors where domestic investors are not subject to the same tax.
- 3.2 In July 2006 the European Commission formally requested Belgium, Spain, Italy, Luxemburg, the Netherlands and Portugal to amend their tax legislation concerning outbound dividend payments to companies. The Commission considers that taxing payments to foreign companies more heavily than domestic ones is contrary to the EC Treaty by restricting free movement of capital.
- 3.3 KPMG are of the opinion that these rulings apply equally to pension funds and that precedent has been set for the ECJ. On this basis they are recommending that pension funds make claims for tax withheld on overseas dividends.

4. Claim Process

- 4.1 In the FID & Manninen case, the claim is against the UK tax authority for tax credits denied on overseas dividends. In the Fokus Bank case, claims would need to be made against the tax authorities of the relevant EU member state(s) for tax withheld on dividends. This makes the Fokus claims more complex. However, KPMG are offering, for a fee, to simplify the process as much as possible.
- 4.2 It is likely that litigation will be required in each claim territory, possibly to the level of the ECJ. Unlike the UK, other EU states do not have a formal test case mechanism although, in practice, agreement can be reached that only a sample of claims proceed with any judgement being binding on all claimants. Similarly there is no formal group litigation arrangement but claimants can separately agree to share costs.
- 4.3 KPMG have proposed separate fees for each element of claiming in each territory and have also set up a group funding arrangement. The total cost, therefore, will depend on the number of territories in which claims are lodged, whether test cases are required in those territories and the number of participating claimants.

5. Potential Claim Values

- 5.1 KPMG have advised in which territories claims are considered viable and over what period. Data from the Shareholder system has been analysed to assess the potential claim for withheld tax in each territory. The results, to 31 December 2005, are shown below.

Territory	Claim (Years)	Data From	Withheld Tax (£)
France	2	01/01/04	216,772
Germany	4	01/01/02	306,711
Italy	4	01/01/02	224,993
Netherlands	3	01/01/03	198,353
Spain	4	01/01/02	140,667
			1,087,496
Austria	5	01/01/01	7,024
Denmark	20	01/01/94	65,246
Finland	5	01/01/01	1,016
Luxembourg	1	01/01/05	600
Portugal	2	01/01/04	11,439
Sweden	5	01/01/01	52,558
			137,884

- 5.2 For territories other than Denmark, data is shown from the earliest allowed claim date. For Denmark, the above table shows 12 years' data (as this is held in electronic format) although earlier data may be held in physical form.
- 5.3 The majority of claims are by calendar year and KPMG recommend that claims be submitted before the end of December to maximise the allowable claim period. The case is rated as a good to high chance of success at the ECJ.
- 5.4 Attention has been drawn to Italy's poor record of payment in previous claims and so there may be a delay in receiving compensation from a successful claim in Italy. If the initial claims are successful subsequent claims would need to be submitted for year ending 31 December 2006 and beyond although these are expected to be simpler and quicker with a reduced cost.

6. Statutory and Policy Implications

- 6.1 This report has been compiled after consideration of implications in respect of finance, equal opportunities, personnel, Crime and Disorder, Human Rights and those using the relevant service. Where such implications are material, they have been described in the text of the report.

7. Recommendations

- 7.1 It is recommended that the sub-committee considers whether to submit claims for overseas withholding tax and if so, in which territories.

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Background Papers Available for Inspection
None