PENSION FUND COMMITTEE – 8 MARCH 2013

PENSION FUND TAXATION REVIEW

Report by Assistant Chief Executive & Chief Finance Officer

Introduction

1. This report summarises a recent taxation review for the Oxfordshire County Council Pension Fund, provides an update on the progress of existing claims for the recovery of tax, and considers new claim opportunities for the Fund.

2. The potential for the Oxfordshire Pension Fund to receive additional tax repayments via new tax reclaim applications was discussed in a meeting between officers and KPMG in January 2013. KPMG indicated that the timeframe to initiate the claims procedure may, in some instances, require a decision to be taken before the next Pension Fund Committee meeting. The recommendations at the end of this report are intended to address this issue.

General Tax Review

3. The Pension Fund Investment team have recently conducted a taxation review to ensure that the fund's investment activities operate in a tax efficient manner. The review sought to ensure that the fund receives all available relief for witholding tax suffered on overseas dividends, where it is cost effective to do so.

4. A number of areas for further investigation were identified and are being explored with the relevant parties.

FIDS/Manninen Claims Update

5. At the 26 May 2006 Pension Fund Committee meeting, it was agreed that the fund would pursue claims for the repayment of excess UK tax credits on Foreign Income Dividends (FIDs) and foreign dividends against HMRC, on the basis of breach of EU Community Law. The OCC Pension Fund filed FIDs/Manninen claims amounting to £1.2m.

6. In June 2011 the ruling from the First-Tier Tribunal (Tax) was released in a test case brought by the BT Pension Scheme Trustees. The OCC Pension Fund was part of the group funding arrangement (GFA) to bring this case. The Tribunal found largely in favour of the claimant on the principles involved in the tax issues, but found that the majority of the claims were made out of time. The OCC Pension Fund claims related to the tax years 1993/94 – 1997/98 and were made in the 2005/06 tax year. Under the current ruling all of the claims are deemed to be out of time, as they are outside the six year time limit imposed under UK legislation.

7. The case is now being appealed in the Upper Tribunal (Tax and Chancery); the case was heard in July 2012 with a decision expected in early 2013. Depending on the granting of permissions to appeal, the case could continue

up to the Supreme Court. If this were the case a final ruling would be expected around 2015.

8. McGrigors (who have subsequently merged with Pinsent Mason) were engaged to pursue the case on behalf of the pension fund. The pension fund agreed a legal fee cap of £36k which has now been reached. Individual costs of £27k have been incurred to date and are not capped.

Fokus Claims Update

9. These claims relate to witholding tax suffered on dividends on stocks held in certain EU territories, under domestic law in those territories. Where the domestic law treats domestic pension funds more favourably than other EU based pension funds, it is argued that this is in breach of the EU principal of the free movement of capital.

10. The pension fund successfully filed a claim in the Netherlands through KPMG, for witholding tax levied on dividends between 2004 and 2006. The pension fund subsequently received a repayment of €162,000 from the Dutch Tax Authorities. When this claim was made, this committee decided not to pursue claims in any other EU territories as the estimated cost versus the chance of a successful claim was deemed to be inappropriate.

11. There have been a number of recent rulings in the EU that support the principle behind these claims, and change the likelihood of a successful claim. Based on initial analysis, the table below details the amounts of witholding tax potentially reclaimable in a number of EU countries in which the pension fund has held stocks. These results suggest it would be worth investigating the potential benefits of filing a claim in Germany and France. Due to the small amount of the potential claims in Spain and Italy relative to the costs, officers believe that claims in these territories would not be cost effective for the pension fund.

12. In Germany a positive decision was made in October 2011 in ‘Commission v Germany’, in respect of a corporate. A separate case was brought against Germany by the EU Commission in respect of EU pension funds. The ruling was made in November 2012 in favour of Germany. However, this latter case only addressed a limited element of the German tax regime and it is still argued that the German rules are contrary to EU law.

13. KPMG has agreed a test claimant for the German claim with its GFA clients. The test case work is intended to commence within the next couple of months.

14. There have been a number of court rulings confirming French taxation rules to be in breach of EU rules. As a result the French tax authorities have amended their rules going forward so that domestic and foreign investors are treated equally. Retrospective claims are being filed covering the period when the rules were still viewed as discriminatory. A test case is intended to be taken forward in France. It is likely that the pension fund would have to demonstrate comparability to French pension funds in order to be successful.

15. The table below shows the tax amounts Oxfordshire County Council Pension Fund could potentially reclaim.

Country	Local Reclaim Amount (€'000)	GBP Reclaim Amount (£'000)
Germany	155	133
France	155	133
Spain	47	40
Italy	63	54

16. Based on KPMG's proposed fee structure the cost of filing a claim is likely to be around £15,000 per territory.

Manufactured Overseas Dividends Claims

17. Manufactured overseas dividends (MOD) are created when a stock is out on loan as part of the securities lending programme and a dividend is paid. The ownership of a stock on loan temporarily transfers to the borrower. If the dividend record date occurs whilst the stock is on loan, the borrower will receive any dividend due. A payment is then typically made from the borrower to the lender, representing the dividend payment. If it relates to a non-UK stock it is referred to as a MOD.

18. UK witholding tax is suffered on MODs at a rate broadly equal to 15%. Whereas manufactured dividend receipts relating to domestic stocks are not subject to any witholding tax. The claim asserts that this is contrary to the free movement of capital provisions of the EC Treaty.

19. At its meeting on 25 June 2010, the Pension Fund Committee decided not to pursue a claim in respect of MODs due to potential costs and concerns around the chances of success. As it is intended that a test case will be brought soon, the pension fund has the opportunity to review the potential benefit of joining, taking in to account changes since the last review.

20. A test case is expected to be brought against HMRC. There is an opportunity to join the GFA for this claim. HMRC have agreed in principle that the ruling in the test claimant's case should be binding on GFA participants subject to any materially distinguishing factors. Pinsent Mason believe there are no distinguishing factors regarding other MOD claims filed by GFA members, which includes other LGPS funds. There are currently about 30-40 claimants in the GFA and direct costs for joining the claim are estimated to be £30k.

21. Officers are waiting for the Pension Fund's Global Custodian to provide details of MODs that the fund has received, so that the potential claim value can be established. In 2009 the estimated potential claim was £1.5m. However, since then the period over which a claim can be made has been reduced and the claim period will now cover the period during which the pension fund had no segregated overseas equities, due to the transition to a new fund manager, so the claim value is likely to be lower.

RECOMMENDATIONS

22. The Committee is RECOMMENDED to:

(a) note the outcome of the review of taxation undertaken for the Pension Fund;

(b) delegate to the Service Manager (Pensions, Insurance & Money Management) following consultation with the Chairman, the decision as to whether to pursue withholding tax reclaims in any EU territories, following the completion of a detailed cost benefit analysis; and

(c) delegate to the Service Manager (Pensions, Insurance & Money Management) following consultation with the Chairman, the decision as to whether to pursue a tax reclaim for MODs, following the completion of a detailed cost benefit analysis.

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Background Papers: **None**

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