WIRRAL COUNCIL

PENSIONS COMMITTEE

14 JANUARY 2009

REPORT OF THE DIRECTOR OF FINANCE

RECLAMATION OF EUROPEAN WITHHOLDING TAX

1. EXECUTIVE SUMMARY

1.1 This paper informs Members of the engagement of KPMG to assist in the recovery of withholding taxes (WHT) suffered on EU sourced dividend income received in recent years, and non-recoverable under existing Double Tax Agreements. The claims are lodged with the tax authorities in EU Member States where such withholding taxes have been levied. The weight of past EU case law and current actions being taken by pension funds and the EU Commission across Europe provides support for the claims.

1.2 Members are requested to note that the engagement of KPMG is an exception to the procurement procedure. The reasons for this are two fold:

- There is only one viable supplier (5.1.1 Contract Procedure Rules)

- The supply is required so urgently that it is not possible to invite tenders (5.1.3 Contract Procedure Rules)

2. BACKGROUND

2.1 KPMG recently approached the MPF to advise that they are acting for a number of UK pension funds who are seeking to recover withholding tax on EU sourced dividend income received in recent years. KPMG consider that these claims have the potential to add significant value to pension funds and there have been a number of recent developments on these claims which are listed below.

a. As well as repayments received for some UK pension funds on their claims made in Norway, more recently a KPMG client has received repayments from the Polish Tax Authorities on their Fokus Bank claims in Poland. This is an important development as the Polish Tax Authorities did not challenge the claims made.

b. For claims made in 2008, there is a one off opportunity to extend claims made in France back to 1 January 2003. This opportunity ceased on 1 January 2009 when the time limits reverted to the normal domestic time limits (ie one to two years).

c. The EU Commission has now commenced infringement (of EU Law) proceedings against EU Member States whom it considers discriminate against non-resident investors, and particularly pension funds, by applying a higher level of taxation on outbound dividend payments. Such action has commenced against Austria, Czech Republic, Denmark, Estonia, Finland, Germany, Italy, Lithuania, The Netherlands, Poland, Portugal, Slovenia, Spain & Sweden. This action by the Commission is likely to drive forward changes to WHT rates across Europe and should eventually benefit MPF with lower tax rates. However this action will not enable MPF to recover WHT that has been suffered historically, up to any point where there is a change in law, and has remained unclaimed.

d. The Dutch reduced the withholding tax rate on dividend payments to pension funds to 0% with effect from 1 January 2007.

e. One UK local authority pension fund client of KPMG has now agreed to act as the test claimant for claims brought in the Netherlands and is party to a cost sharing agreement with other UK pension funds to reduce the costs to each fund for taking their claims forward. This agreement is open for MPF to share. This case will proceed in the next few months and will be representative for over 60 UK pension funds who have filed claims in the Netherlands. It is likely to take two to three years before the claims are settled due to the length of time litigation will take.

2.2 As MPF is involved in stock lending arrangements the dividend income calculated in appendix 1 excludes any manufactured overseas dividends (MODs) received throughout the claim period. However all MOD income received since April 2002 (in respect of any stocks out on loan, not just European Markets) should be included in a claim against the UK tax authorities who impose the WHT on MODs that MPF has received.

2.3 KPMG in the UK have now filed claims across Europe for over 60 UK pension funds, including 19 local authority funds.

3. ACTION TAKEN

3.1 In view of the need to file claims by 31 December, 2008 MPF has been urgently obtaining archive information from current and previous custodians in order to meet tax filing deadlines.

3.2 MPF has obtained a cost benefit analysis from KPMG to establish the potential quantum of any claims and the likely costs.

3.3 Based on a cost benefit analysis undertaken on MPF, KPMG estimate that claims are potentially worth in excess of £1.5m after costs with the value increasing year on year. The exact amount will depend on individual investment strategies. The detail of this is set out in appendix 1. Overall, numerous pension and investment funds have filed these claims on a Europe wide basis.

3.4 In view of the favourable cost benefit analysis, the tight filing deadlines, KPMG's expertise in this area and the opportunity to defray costs by joining with other institutions for whom KMPG are acting, I took the decision to engage them to undertake this work for MPF. The Chair of the Pensions Committee was consulted prior to this decision being taken.

4. FINANCIAL AND STAFFING IMPLICATIONS

4.1 The costs of filing the claims are approximately £15,000 per territory. Full details are in appendix 1. It should be emphasised that there is no certainty of success but, as explained in the report, KPMG believes that there is a growing body of case law which points to a successful outcome. There are already instances where tax authorities have rebated WHT to claimants.

4.2 Any additional work required will be on the basis of time cost at prevailing KPMG chargeout rates.

4.3 Whilst it is likely that litigation will be required in some territories, KPMG have already established cost sharing arrangements which will defray costs to MPF and liabilities will be capped should there be an unsuccessful outcome. Litigation costs are likely to be approximately £17,500 per territory.

4.4 There is no obligation for the MPF to proceed to litigation. This decision can be reassessed at the time in the light of future developments.

5. EQUAL OPPORTUNITY IMPLICATIONS

5.1. There are none arising from this report.

6. COMMUNITY SAFETY IMPLICATIONS

6.1. There are none arising from this report.

7. LOCAL MEMBER SUPPORT IMPLICATIONS

7.1. This report has no particular implications for any Members or wards.

8. LOCAL AGENDA 21 IMPLICATIONS

8.1. There are none arising from this report.

9. PLANNING IMPLICATIONS

9.1. There are none arising from this report.

10. BACKGROUND PAPERS

10.1 Technical reports from KPMG regarding the legal basis for claims.

11. RECOMMENDATION

11.1 That Members note the decision to engage KPMG to undertake the reclamation of European WHT.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/311/08

APPENDIX 1

Merseyside Pension Fund: cost benefit analysis

Territory	*Germany*	*France*	*Spain*	*Netherlands*	*Italy*	*Norway NOK*
Claim Value €	613,167	552,454	432,276	130,940	382,172	453,540
	£	£	£	£	£	£
GBP	**533,189**	**480,395**	**375,892**	**113,861**	**332,323**	**50,000**
Making claim						
Claim cost	11,000	12,000	10,500	10,000	10,000	9,000
French Domiciliation (address)		1,000				
Technical Report	5,000	5,000	4,500	3,000	3,000	0
Pursuing claims						
GFA joining Fee	5,000	2,500	2,500	2,500	2,500	0
	15,000	15,000	15,000	15,000	15,000	0
Claim value less costs	**497,189**	**444,895**	**343,392**	**83,361**	**301,823**	**41,000**

Notes

1. Figures exclude interest receivable (this will increase claims)
2. GFA fees for test case assume that the overseas tax authorities will agree a test case system that KPMG have 21 members in the syndicate (certainly the case for DE, FR, N).
3. There may be appeal costs to be incurred before a test case postion can be reached (eg Spain, here KPMG have reduced GFA case contribution fees to compensate)
4. For Italy an alternative claim value of £88,620 is provided in the event that only 4% rather than 15% were repaid (Italian pension funds are taxed at a maximum rate of 11%.
5. There is no technical report for Norway as claims are being made under domestic legislation. There is no syndicate in the GFA for Norway as no litigation is expected at present.
6. There may be legal costs to obtain the appropriate Power of Attorney for the Spanish claim and costs of obtaining vouchers.
7. An alternative to the GFA may be available in the Netherlands to benefit from the test case decision without joining the GFA, claimants who choose this alternative will not be kept up to date with the progress of the test case.
8. May be worthwhile deferring Norwegian claim until 2009 dividends are received and the Norwegian tax authorities have reached a decision on application of their tax rules to UK pension funds.