

## **INVESTMENT TAXATION REVIEW**

**Report by Executive Director Finance & Regulatory**

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### **JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION FUND BOARD**

**11 December 2020**

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#### **1 PURPOSE AND SUMMARY**

- 1.1 **The purpose of this report is to update the Committee and Board on the findings of a review undertaken by KPMG on the reclaiming of taxation on the Fund's overseas investments.** This review was approved as part of the agreed business plan to ensure the Fund is as tax efficient as possible.
- 1.2 The income generated by these investments can be subject to Withholding Tax (WHT) in the country of origin. The WHT is deducted at different rates depending on the tax regime in the country where the investment is held. This withheld tax can be reclaimed under certain circumstances. To ensure the performance of investments is maximised the Fund needs to ensure it reclaims as much WHT as possible.
- 1.3 KPMG were commissioned to undertake the review which was broken down into 3 parts. Review of the performance of Northern Trust as the Fund's custodian for the segregated funds. Review of the infrastructure investments made in collaboration with Lothian Pension Fund and a review of investments in pooled funds.
- 1.4 The review of the performance of Northern Trust for the segregated funds highlighted a small number of differences in rates reclaimed, which have now been addressed.
- 1.5 The review of the infrastructure investments made in collaboration with Lothian Pension Fund highlighted one investment which has triggered a US filing obligation. The costs and requirements of this is currently under fuller investigation but may result in additional costs for the Fund.
- 1.6 The review of the pooled funds held confirmed all funds are tax efficient.

## **2 RECOMMENDATIONS**

### **2.1 It is recommend the Pension Fund Committee:**

- (a) note the outcome of the taxation review and**
- (b) approve the filing of any required USA tax documents with the assistance of KPMG.**

### **3 BACKGROUND**

- 3.1 The income generated by the Pension Fund's investments can be subject to Withholding Tax (WHT) in the country of origin. This WHT is deducted at different rates per country and can sometimes be reclaimed. To ensure the Fund maximizes the performance of its investments and avoids unnecessary tax leakage the Fund needs to ensure it reclaims as much WHT as possible. The Fund reclaimed £179k of WHT for the year 2019/20 and registered as exempt for a number of its Funds.
- 3.2 As the Pension Fund has grown over the years, the value of investments and the complexity of the investments has increased. Investments are now held over a number of different structures and invested globally.
- 3.3 The investments for taxation purposes are categorised into 3 elements
- Segregated Funds – assets held in name of Scottish Borders Council Pension Fund. These are Baillie Gifford UK and Global equity Funds.
  - Pooled Funds – assets purchase by an Investment Manager, investors purchase units/shares in the fund rather than the direct assets. These include the funds held with Morgan Stanley, LGT, UBS, M&G, Blackrock, Partners and Permira.
  - Private Equity Investments – Investments via private vehicles which can be structured in a number of ways. These investments include the range of Infrastructure investments made in collaboration with Lothian Pension Fund.
- 3.4 To allow the Pension Fund to reclaim any WHT deducted at source requires the Fund to work with both Northern Trust as its custodian and the individual Fund Managers. There is a requirement to complete tax documentation for each country and for each individual manager. The requirement for countries vary greatly and many need renewed on an annual basis.
- 3.5 With the increasing levels of complexity of the investments held and the already complex requirements of ensure the Fund is as tax efficient as possible, the Committee approved a review within the Business Plan of the taxation position of the investments held and instructed a health check on the performance of Northern Trust in taxation reclaims be undertaken. KPMG were commissioned to undertake this work.

### **4 TAXATION REVIEW FINDINGS**

- 4.1 Due to the complexity of Fund the review was completed in 3 parts. The review was carried out by KMPG using data and information from both Northern Trust (NT) and legal documents held by the Fund.
- 4.2 The first part of the review was to ensure any WHT deducted on the segregated holdings held by Baillie Gifford where being reclaimed by Northern Trust correctly and in a timely manner.
- 4.3 The review found that generally Northern Trust had reclaimed the WHT correctly and in a timely manner. There was however nine source

countries identified with differences in rates expected to be used and those used by Northern Trust. Discussions have been held with Northern Trust to investigate and correct these issues.

- 4.4 The second part of the review was to undertake a review of the taxation position of the investments made in infrastructure in collaboration with Lothian Pension Fund. The fund at the time of the review had 16 individual investments with 9 different fund managers. These investments were also structured in a number of different ways and in different countries. The review looked at each individual investment to ensure maximum taxable benefit was obtained.
- 4.5 The review confirmed 15 of the investments are structured in a tax efficient way which ensures no tax leakage from the investments and no obligation for separate USA filing obligations. There is however one investment for £1.5m which may have a USA filing obligation and which WHT has been incurred.
- 4.6 If a USA filing obligation is triggered, it is recommended to do so irrelevant of the value, this is due to the risk of penalties and interest which may be incurred from non compliance. There are two possible options for filing, these are Federal or State filing and on occasion both may be required. Further investigation is currently underway to fully ascertain the filing requirements.
- 4.6 The final part of the exercise was to undertake a review of the Pension Fund's pooled investments. The Fund is currently invested in 13 pooled funds with 8 Fund Managers. The review has confirmed all distributions and payments to the Funds do not incur any WHT and are paid gross.
- 4.7 The overall findings of the review are positive demonstrating the Fund is tax efficient.

## **5 IMPLICATIONS**

### **5.1 Financial**

- (a) There are no additional costs identified from the review of the performance of the custodian or the review of the pooled funds.
- (b) If the Fund is confirmed to have a US Filing obligation for the Infrastructure investment which will incur additional costs. To file a US Federal return is around \$5,000 and a State return is \$750. To complete the process specialist taxation assistance would be required. It is estimated at £2,000 to £3,000 per return.

### **5.2 Risk and Mitigations**

To ensure the Fund maximizes the investment income it must ensure the Fund is managed in way which allows WHT to be reclaimed or be tax exempt at source. This is a highly specialist area which legislative requirements being different for each Country. If the Fund does not adhere to the requirements it could result in loss of WHT or penalties to be incurred. The review undertaken and the close working with the Custodian both provide mitigation to these risks.

### 5.3 **Integrated Impact Assessment**

There is no impact or relevance to Equality Duty or the Fairer Scotland Duty for this report. This is a routine good governance required under the Local Government Pension Scheme (Governance) (Scotland) Regulations 2014. Nevertheless, a light touch assessment has been conducted and this will be published on SBC's Equality and Diversity Pages of the website as in doing so, signifies that equality, diversity and socio-economic factors have duly been considered when preparing this report.

### 5.4 **Acting Sustainably**

There are no direct economic, social or environmental issues with this reports which would affect the Council's sustainability.

### 5.5 **Carbon Management**

There are no direct carbon emissions impacts as a result of this report.

### 5.6 **Rural Proofing**

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

### 5.7 **Changes to Scheme of Administration or Scheme of Delegation**

No changes are required as a result of this report.

## 6 **CONSULTATION**

6.1 The Monitoring Officer/Chief Legal Officer, the Chief Officer Audit and Risk, the Service Director HR & Communications, the Clerk to the Council and Corporate Communications have been consulted and any comments received have been incorporated into the final report.

### **Approved by**

**David Robertson** **Signature** .....

**Executive Director Finance and Regulatory**

### **Author(s)**

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**Background Papers:** Pension Fund Business Plan 2020/21 – 2022/23

**Previous Minute Reference:** Joint meeting Pension Fund Committee and Pension Fund Board, 22 June 2020.

**Note** – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Pensions & Investment Team can also give information on other language translations as well as providing additional copies.

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