

First-tier Tribunal (Tax) Transcripts/2500-2999/TC02555: ROSS JAMES ANDERSON

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[2013] UKFTT 126 (TC)

**CASE REFERENCE NUMBER: TC/2012/03012**  
**FIRST-TIER TRIBUNAL (TAX CHAMBER)**

DECISION NUMBER: TC02555

APPELLANT: ROSS JAMES ANDERSON

RESPONDENTS: THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

**TRIBUNAL CHAIRMAN: JUDGE CHRISTOPHER STAKER**

**TRIBUNAL MEMBER: MR RICHARD THOMAS**

**LOCATION: SITTING IN PUBLIC IN LONDON**

**DATE: 10 DECEMBER 2012**

*Income tax — Appeal against amendment made by a closure notice — Whether Tribunal has the power to allow an appeal on grounds that the application of the law in the circumstances of the particular case would be manifestly unreasonable and unjust and would not achieve the purposes of the legislation — European Convention on Human Rights First Protocol Article 1 — Extra-statutory Concession A19 — Appeal dismissed*

FOR THE APPELLANTS: MR FACHERTY

FOR THE RESPONDENT: MS CARWARDINE

## **Decision**

### ***Introduction***

1.

This is an appeal by Mr Ross James Anderson (the “Appellant”) against closure notices issued under s.28A(1) and (2) of the Taxes Management Act 1970 (the “TMA”) in respect of the 2007-08 and 2008-09 tax years. The closure notices gave effect to a conclusion by HMRC that in the two years in question he had chargeable event gains from life insurance policies that had not been returned by him, resulting in a total additional income tax liability of £33,134.80.

### ***Background***

2.

During enquiries into the Appellant's 2007-08 and 2008-09 tax returns, HMRC found that the Appellant had failed to declare chargeable event gains that had arisen on offshore life insurance policies. There was correspondence between the parties, and with the Appellant's MP, in relation to the matter. The Appellant made offers of settlement which were not accepted by HMRC. HMRC issued closure notices in respect of the two tax years on 15 November 2011, against which the Appellant appealed on 21 November 2011. An HMRC review was completed on 13 January 2012, in which HMRC concluded that the closure notices should be upheld. The Appellant now appeals to the Tribunal.

3.

The Appellant has not sought to dispute that the additional tax liability is in accordance with the terms of the applicable legislation. Rather, his appeal seeks to attack the legislative provisions themselves, at least in their application to his particular circumstances. Alternatively, he argues that the legislative provisions lead to a result that is so unfair in his case that they should not be applied to him, and that the relevant tax should be written off.

4.

Because the Appellant has not sought to argue that the legislative provisions have not been correctly applied, it is unnecessary to deal in detail with the terms of the legislation. The relevant provisions are the Income Tax (Trading and Other Income) Act 2005 (“ITTOIA”), sections 461-468, 475, 515, 516, 522-525 and 528.

5.

Some explanation is necessary however to show why the Appellant feels so strongly about this case, and why the Tribunal has a great deal of sympathy with him. In the years concerned the Appellant was the holder of some life insurance policies issued by an Irish insurance company. He took out these policies at a time when he was not resident in the UK, but in the tax years concerned in this appeal he had become UK resident. Under the legislation mentioned above (as it applies to a UK resident), the policyholder of such offshore policies is liable to income tax on any “chargeable event gains” made. Where the event involves the policyholder ceasing to possess any rights in the policy, whether as a result of its maturity, total surrender or assignment, the calculation of the gain is simple and intuitive – the gain is the difference between what the policyholder gets from the insurance company as a result of the event and what was paid by way of premium.

## 6.

In the case of certain other events matters are far more complex. One of those events is the surrender of part only of the rights in the policy (“part surrender”), which is what the Appellant did. Where that happens, the policyholder may (in simple terms<sup>1</sup>) realise in a given tax year an amount equal to 5% of the total premium invested without any chargeable event gain arising in that year (s 507 ITTOIA especially subsection (5)). The amount withdrawn up to this limit is however brought into account, along with amounts withdrawn up that limit in other years, when the policy ends, by adding the various amounts paid on earlier part surrenders to the amount received on the final event (ss 491 and 492(1)(b) ITTOIA).

<sup>1</sup> In fact the 5% of the premium is a cumulative amount, so that if in the first year of the policy there is no part surrender, the next year’s allowance is 10%, and so on (s 507(5) ITTOIA)

## 7.

However, if the amount obtained on a part surrender in any year exceeds the 5% allowance for that year (plus any unused allowance from previous years), then the whole of the excess is a chargeable event gain and is taxed in the year that the part surrender is made. Where a substantial part surrender is made in the early years of a policy, it is likely that the part surrender will in economic terms represent in large part a realisation of capital invested rather than of the income earned from the investment of the premiums by the insurer, but nevertheless the whole of the amount realised in excess of the 5% allowances available is taxed as income.<sup>2</sup> In the case of a UK policy,<sup>3</sup> the policyholder is liable to income tax only at the excess of the higher rate over the basic rate (s 530(1) ITTOIA), but in the case of an offshore policy, the policyholder is liable at the basic rate as well (s 530(4)(b)). This reflects the fact that under the UK system of taxing life assurance, the insurer pays corporation tax at a rate equal to the basic rate of income tax on the income accruing for the benefit of policyholders.<sup>4</sup>

<sup>2</sup> If the premium paid is £1000, and at the end of year 1 the policy value is £1100 (i.e. 10% return has been earned by the insurer) and the policyholder withdraws £1000, the “income” included in that withdrawal cannot exceed £100, but the chargeable event gain will be £1000 - £50 (5% of premium) which is £950. If the policy had been surrendered in full at the end of the year, the gain would have been £100 (£1100 less (£1000)).

<sup>3</sup> With very minor exceptions.

<sup>4</sup> There is a relief at the basic rate for certain EEA policies (section 532 ITTOIA) but that only covers policies which have been subject to a “comparable EEA tax charge” (section 533). That section does cover certain Irish policies issued before 2001 to Irish residents, but the Appellant does not appear to have been an Irish resident at any relevant time.

8.

A further complicating aspect of the Appellant's tax situation is that the largest policy he held has been classified by the insurer as a personal portfolio bond ("PPB"). It therefore falls within the regime given by ss 515 to 526 ITTOIA. Under that regime, in addition to any actual chargeable event gains that arise on the policy, the policyholder is charged to tax each year as if there were an actual gain on an amount equal to 15% compounded of the premiums paid ("PPB gain") less the aggregate amount of any previous part surrender gains, irrespective of whether the policy gives an actual return of that amount, or indeed any return at all. These PPB gains are also deducted, in addition to the part surrender amounts, in computing the final gain in the year the policyholder ceases to have any rights in the policy (s. 491(2) (4) ITTOIA).

9.

The effect of the rules for taxing part surrenders of life insurance policies in excess of the 5% allowances may be mitigated or completely nullified (except for a cash flow disadvantage) by certain reliefs that are available in certain circumstances. One such relief, known as "corresponding deficiency relief" (ss 539 to 541 ITTOIA), applies where the policy ends, the final chargeable event calculation does not give rise to a gain, and there has been at least one previous part surrender giving rise to a gain (s 540). The amount of the "deficiency" will be equal to the amount of the previous gains, because of the exclusion in the computation of earlier chargeable event gains on part surrenders. However annual gains on PPBs are not included in the amount of previous gains (s 541(4)(a)).

10.

Where there is a deficiency, the policyholder may be entitled to a reduction in liability to tax on their other income in the year in which the policy comes to an end. However, deficiency relief is only applied to income taxed at the higher rate of income tax, and of course can only be given if the policyholder has income from other sources taxed at that rate. Furthermore, deficiency relief is calculated as a tax reduction based on the difference between the basic rate and higher rate of tax, even if as in the Appellant's case, the previous gains have been taxed at the basic rate as well as the higher rates because they were from an offshore policy. The Appellant says that the effect of this was that he was taxed at the higher rate of 40% on the amount of some £97,000 that he withdrew from the policies in the years in question, while he received deficiency relief of only 20% on some £15,000, the amount of his expected income at the higher rate in the year of full surrender.

11.

The Appellant says that he was the victim of bad advice from professional advisers. He says that the policies produced little or no gain overall. Therefore, if he had surrendered the whole of the policies in a single year, he would have paid little or no tax as a result. However, because he made large part surrenders, he paid 40% tax on the bulk of the amount withdrawn, and regained only a small portion of this by way of deficiency relief, and that only at 20%.

### ***The evidence and submissions***

12.

The Appellant's grounds of appeal, as set out in the notice of appeal, are in summary that:

- a) He has been helpful to HMRC in investigation and assessment.
- b) He initially relied on others to provide the correct tax advice and information, but his advisers proved unreliable and inaccurate.
- c) HMRC require insurance companies to provide the chargeable event certificates, and his insurance company was late in so doing. If his insurance company is regarded as an agent of HMRC in providing the certificates, Extra-Statutory Concession A19 ("ESC A19") should apply and the tax should be written off.
- d) The legislation for interim taxation relief of PBBs is "faulty" legislation is supposed to provide a reasonable estimate of tax chargeable during the life of the policy when actual figures are not available, and a correcting mechanism for overpayments. In this case, the interim tax was excessively high, and the correcting mechanism excessively low due to inequitable calculations and unfair restrictions.
- e) The legislation does not properly address the overseas nature of the PPB. Tax liabilities are calculated at both basic and higher rate, while deficiency relief is reduced.
- f) The legislation does not meet the standards required by English law in regard to fairness, equitability and the requirement to use the best evidence available. The legislation is unjust and does not produce the results intended by Parliament.
- g) The legislation breaches the requirements of the Unfair Contract Terms Act 1977.
- h) The legislation breaches the Appellant's human right to the peaceful enjoyment of his property as it amounts to "judicial theft".
- i) The tax calculation using the final state of the bond shows no tax due, and this final calculation should be used rather than the interim calculations.
- j) If the deficiency relief calculation used the same rate to calculate relief as was used to calculate the tax and the limit to higher rate tax removed, there would be no tax to pay.
- k) In all of the circumstances, it would be fair and equitable for HMRC to write off the relevant tax liability.

**13.**

The HMRC case as set out in the HMRC statement of case is as follows:

- a) The chargeable event gains have been correctly calculated in accordance with the legislation.
- b) No information has been received [within the meaning of ESC A19, we assume] by HMRC, so ESC A19 cannot be considered.
- c) Deficiency relief is available in the year the policy ends.

**14.**

At the hearing, the Appellant's arguments in the grounds of appeal were presented orally, and the following additional arguments were also advanced.

**15.**

No one with knowledge of the case could believe that HMRC would demand the full amount of money in this case. Applying the rules without regard to the particular circumstances of this case is wrong. The Appellant acted throughout in good faith, acting on professional advice which turned out to be incompetent.

**16.**

Over the life of the policy the Appellant made a loss, so there was no income from the policy. The rules relating to taxation of part surrenders are effectively based on estimated income over the life of the policy. The rules on deficiency relief when the policy is finally surrendered are intended to achieve a correction once the final net income from the policy is known, so that a fair amount of tax is paid over the life of the policy. In this case, an excess amount of interim tax was paid, and an insufficient correction was made at the end.

**17.**

HMRC simply rely on the terms of the legislation and refuse to consider the circumstances. The Appellant has made offers of settlement which HMRC have refused. His MP has intervened, to no avail. The Appellant has been treated inconsistently with large corporations where HMRC has been prepared to write off large amounts of tax.

**18.**

In effect, the Appellant has been unfairly taxed twice, as he was taxed on the capital when he earned it, and was then taxed on it again when he withdrew it from the policy. What happened in this case amounts to expropriation.

**19.**

At the hearing, the following additional arguments were presented on behalf of HMRC. It appears that the PPBs were a kind of investment not suitable to the Appellant's circumstances. However, tax consequences must follow what actually happened, rather than what the Appellant wishes had happened. The legislation has been applied correctly to the facts of the case. HMRC accept that the Appellant cooperated in the course of the enquiry and acted in good faith. However, the law is the law. If the Appellant received bad advice, he should have recourse against his advisers.

**20.**

In reply, it was reiterated on behalf of the Appellant that the Appellant was charged to income tax when he has received no income, that HMRC has a discretion to not collect the tax, and that HMRC is intransigent and unfair in failing to exercise that discretion when the legislation produces such a flawed result. It is unfair to charge income tax when there has been no income, first because there is no income to tax, and secondly, because there is no income with which to pay the income tax.

### ***Findings***

**21.**

The Tribunal has a great deal of sympathy for the plight in which the Appellant presently finds himself. He is

certainly not the first Appellant to come before this Tribunal or its predecessors to complain of the workings of the chargeable event regime where large part surrenders are made—see for example *Shanthiratnam v Revenue & Customs* [2011] UKFTT 360 (TC), *Rogers v Revenue & Customs* [2011] UKFTT 791 (TC) and *Cleghorn v Revenue & Customs* [2011] UKFTT 488 (TC). He is almost certainly the first person to come before the Tribunal as someone who has fallen into the “large part surrender” trap, and been subject to the PPB regime and found that the corresponding deficiency relief has not only not given him relief on an amount of income equal to his deficiency but has only given him relief at lower rates than those he has suffered on the part surrenders. His advisers appear to have accepted that a PPB was not appropriate to his circumstances once he had decided to become UK resident, and that he should have surrendered the whole of a policy, rather than about 90%, in those circumstances. Unfortunately for the Appellant, as was submitted by HMRC, the fact that a person has been the victim of bad tax advice does not absolve them of their tax liability that results from following that advice. The Appellant may consider seeking some kind of redress against his adviser, but that is not a matter for the Tribunal.

**22.**

The fact that a taxpayer has been helpful to HMRC in investigation and assessment is not in principle relevant to the taxpayer's tax liability. In some cases it may be relevant to the level of penalty to be imposed for a failure to comply with obligations under tax legislation. The Tribunal is not persuaded that it could be relevant to the tax liability itself in the circumstances of the present case.

**23.**

The Appellant argues that the applicable legislative provisions are contrary to his human rights. Article 1 of the First Protocol to the European Convention on Human Rights provides as follows:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

**24.**

Article 1 of the First Protocol is a Convention right for purposes of the Human Rights Act 1998 (see s 1(1)(b) of that Act). However, as is clear from its terms, that provision does not impair the right of the State “to enforce such laws as it deems necessary ... to secure the payment of taxes”.

**25.**

The parties did not address detailed argument on the European Convention on Human Rights, or cite relevant case law on the issue. The burden of persuasion is on the Appellant to establish that there has been a breach of the Convention. The Tribunal finds that the Appellant has not discharged that burden.

26.

In *Burden and Burden v. United Kingdom* (2007) 44 EHRR 51, [2007] STC 252, the European Court of Human Rights said at [54] that:

It is for the national authorities to make the initial assessment, in the field of taxation, of the aims to be followed and the means to be used (*Lindsay*, cited above). The State enjoys a wide margin of appreciation in this field, as is usual when it comes to general measures of economic or social strategy (see, for example, *James and Others v. the United Kingdom*, judgment of 21 February 1986, Series A no. 98, § 46; *National and Provincial Building Society and Others v. the United Kingdom*, judgment of 23 October 1997, *Reports* 1997-VII, § 80). A government may often have to strike a balance between the need to raise revenue and the need to reflect other social objectives in its taxation policies. Because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is in the public interest on social or economic grounds. The Court will generally respect the legislature's policy choice in this field unless it is "manifestly without reasonable foundation" (*ibid.*; and see also *Lindsay*, cited above) and subject to the proviso that, in creating and implementing a scheme of taxation, the State must not discriminate between tax-payers in a manner which is inconsistent with Article 14 of the Convention (see, *mutatis mutandis*, *Stec and Others v. the United Kingdom* (dec.), [GC], nos. 65731/01 and 65900/01, §§ 54-55, ECHR 2005-...).

The Appellant's case is that the relevant provisions of ITTOIA are "manifestly without reasonable foundation", and apparently also that they do "discriminate between tax-payers in a manner which is inconsistent with Article 14 of the Convention". However, there is no suggestion that there was any obligation on the Appellant to invest in offshore life insurance policies or PPBs. Nor is there any suggestion, let alone evidence, that the tax regime for offshore life insurance policies or PPBs did not make them a suitable and attractive investment for certain persons with different personal circumstances to those of the Appellant, or that the tax laws deprived the Appellant of any suitable investment possibilities. The tax regime applicable to any kind of investment may make it suitable for one category of persons but unsuitable for another category of persons. This does not mean that the tax regime violates the rights under Article 1 of the First Protocol of the second category of persons. Persons in that latter category remain free to make alternative investments, more suited to their particular circumstances.

27.

The Tribunal finds that in reality the Appellant's complaint is not with the tax regime as such. Rather, his case is that the normal tax law should not be applied to him, on the ground that he has unintentionally put himself in a situation which has disadvantageous tax consequences as a result of bad advice and lack of knowledge of the applicable tax law. The Tribunal is not at all persuaded that it would be contrary to the European Convention on Human Rights to decline to exempt a person from the application of the normal tax laws in those circumstances. The Appellant has not cited any authority in support of his contention that it would be. It is also noted that in *Ferrazzini v. Italy* (2002) 34 EHRR 45, [2001] STC 1314, the European Court of Human Rights said at [29] that it "considers that tax disputes fall outside the scope of civil rights and obligations [for purposes of Article 6 of the Convention], despite the pecuniary effects which they necessarily produce for the taxpayer".

28.

The Tribunal therefore does not consider that it is required, pursuant to s 3(1) of the Human Rights Act, to seek to interpret the applicable legislation in a way that would avoid the Appellant having any tax liability.

**29.**

For similar reasons, the Tribunal does not consider, for purposes of s 6 of the Human Rights Act, that HMRC would act in a way which is incompatible with a Convention right in refusing to write off the tax owed, or that the Tribunal would act in a way which is incompatible with a Convention right in dismissing this appeal.

**30.**

The grounds of appeal based on the European Convention on Human Rights therefore fail.

**31.**

The grounds of appeal referred to at paragraph 12(d)-(g) above must fail, for the simple reason that the applicable legislative provisions are contained in an Act of Parliament. The Tribunal cannot review the provisions of primary legislation in the manner suggested. An Act of Parliament is not a contract for purposes of the Unfair Contract Terms Act 1977.

**32.**

The grounds of appeal referred to at paragraph 12(i)-(j) above must fail, because the tax liability in the closure notices has been determined in accordance with the applicable legislation.

**33.**

As to the argument referred to in paragraph 12(c) above, the Tribunal sees nothing at all in the argument that the insurance company was acting as an agent for HMRC in discharging its obligation to issue certificates, or in failing in that obligation, even assuming that the Tribunal had the jurisdiction to consider the possible application of ESC A19 (as to which, see for instance, *Prince & Ors v Revenue & Customs* [2012] UKFTT 157 (TC) at [33]-[34]; *Iretton v Revenue & Customs* [2011] UKFTT 639 (TC) at [53]; *Hudson v Revenue & Customs* [2012] UKFTT 661 (TC)). As to the argument referred to in paragraph 12(k) above, the Tribunal does not have a general power to order HMRC not to collect tax on the grounds that it would be inequitable in all of the circumstances.

**34.**

Unfortunately for the Appellant, it follows that all of his grounds of appeal must be dismissed. The Tribunal would however note that the system of taxation of part surrenders in excess of the 5% allowance is one which penalises the unwary or ill- advised, often with quite disproportionate consequences as in this case. HMRC, and for that matter the insurance industry, have been aware of this major fault in the system for many years but have done nothing to correct it. In correspondence with the Appellant's MP, the Director of

HMRC CT & VAT, Jim Harra, said "...the '5 per cent rule ... continues to be popular with many insurers and their investors. Proposals on a couple of occasions to abolish the 5 per cent rule have not been pursued." Quite apart from the odd notion that it is the rule's popularity with insurers that should allow the iniquitous effect of a large part surrender to be visited on taxpayers, the reply completely misses the point. The iniquitous effect of large part surrenders can clearly be removed without affecting the operation of the 5% rule in those cases in which it was intended to apply as a relief. What is more, the rules for corresponding deficiency relief are in most cases a wholly inadequate remedy for the disproportionate consequences of a large part surrender, even where they are not *prima facie* discriminatory (as to which see the next paragraph).

### 35.

There is, however, a further issue that appears to the Tribunal to be raised by the circumstances of this case, but on which no argument was advanced by the Appellant or by HMRC. As noted in paragraph 7 above, in the case of a UK policy, the policyholder is liable to income tax only at the excess of the higher rate over the basic rate (s 530(1) ITTOIA), but in the case of an offshore policy, the policyholder is liable at the basic rate as well (s 530(4)(b)). On the face of it this treatment discriminates against persons who take out policies with insurers in other Member States of the EU and against insurers in such Member States, such that the free movement of capital and the freedom to provide services might be in issue. The Tribunal assumes however that the differences between the UK system for taxing life assurance (the I minus E basis) and the systems in the rest of the European Union (where there is no current taxation of the income accruing for the benefit of the policyholder) explain why the only remedy for the apparent discrimination is s 532 ITTOIA. But such differences cannot explain why the corresponding deficiency relief rules similarly discriminate due to their failure to give relief at the basic rate where a gain on the policy has been charged to tax at that rate.

### 36.

The Tribunal expresses no view on this last issue, as it falls outside the scope of this appeal. The Appellant's notice of appeal states that the decision he is appealing against is the HMRC decision of 6 December 2011 (pages 242-243 of the bundle). The notice of appeal further states that the HMRC notice of conclusions of review of the decision appealed against was the decision dated 13 January 2012 (pages 244-245 of the bundle). The 13 January 2012 decision was in fact a review of the earlier 15 November 2011 decision (pages 229-230 of the bundle) explaining the additional assessments made in the closure notices for 2007-08 and 2008-09. An intermediate decision of HMRC dated 29 November 2011 (pages 237-239 of the bundle) noted that the Appellant was still appealing against the closure notices for 2007-08 and 2008-09, and advised him that he could either ask for a review by HMRC or notify the appeal to the Tribunal. In a letter dated 2 December 2011 (page 240 of the bundle) the Appellant requested a review, leading to the HMRC letter of 6 December 2011 and review decision of 13 January 2012. The Tribunal finds that the present appeal is an appeal against closure notices in respect of the 2007-08 and 2008-09 tax years, which were the years in which the Appellant had the taxable chargeable event gains (that is, the years in which he partially surrendered the policies). For the reasons above, the Tribunal must dismiss the appeal against those closure notices.

### 37.

Any argument as to the compatibility of the deficiency relief rules with EU law would arise in connection with the year that deficiency relief was claimed or claimable. It appears that this was in tax year 2010-11 (pages 216-218 of the bundle). Any argument relating to the deficiency relief rules would therefore have to be made by the Appellant in a claim to HMRC in respect of 2010-11. It does not fall to the Tribunal to consider in the present appeal whether or how such a claim could be made.

**Conclusion**

**38.**

For the reasons above, the Appellant's grounds of appeal are dismissed.

**39.**

This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**Release Date: 18 February 2013**