TC01215: CHANDRAPRAKASH SHANTHIRATNAM

[2011] UKFTT 360 (TC)

CASE REFERENCE NUMBER: TC/2009/14200
FIRST-TIER TRIBUNAL (TAX CHAMBERS)

DECISION NUMBER: TC01215

APPELLANT: CHANDRAPRAKASH SHANTHIRATNAM

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

TRIBUNAL CHAIRMAN: HOWARD M NOWLAN

TRIBUNAL MEMBER: HELEN MYERSCOUGH

LOCATION: SITTING IN PUBLIC IN LONDON

DATE: 8 SEPTEMBER 2010

Income Tax – Partial surrenders of overseas life policies – Method of calculating gains in respect of such policies – Appeal dismissed

FOR THE APPELLANTS: THE APPELLANT WAS NEITHER PRESENT, NOR REPRESENTED

FOR THE RESPONDENT: NICOLA PARSLOW OF THE APPEALS AND REVIEW UNIT OF HMRC

Decision

Introduction

1.

This was a case involving a partial surrender of approximately one third of the rights attaching to each of the 50 policies in a cluster of overseas life policies. On account of the rules concerning the calculation of gain (gain charged as income) on the occasion of partial surrenders, the Appellant suffered the extraordinary result that partly because the policies had subsisted only for one year, and regardless of the fact that the total policies were probably worth less at the time of the partial surrender than the premium paid, nevertheless 85% of the amount received on the surrender (i.e. £42,500 out of the £50,000) was treated as taxable income of the Appellant.

2.

The Appellant advanced three contentions as to why this result was incorrect. Regrettably, none of those three contentions is sustainable.

3.

In this decision, we will:

- confirm why the assessment made on the Appellant by HMRC is correct;
- seek to explain the structure of the legislation, and why the situation that the legislation essentially contemplates in relation to partial surrenders (i.e. only modest partial surrenders), results in the tax charge being fairer and more understandable than in the present case;
- comment on the different tax result that would have arisen had the partial surrenders been made in the form of total surrenders of one third of the 50 policies; and
- whilst it is not for us, or HMRC, to give tax advice to the Appellant, we will make suggestions as to the advice that the Appellant might seek with a view to reversing the frankly ludicrous tax result that has so far arisen..

The facts

4.

The Appellant apparently operated one or more Shell service stations and in that activity he was required to put up some collateral to secure various of his obligations to Shell. We do not know who suggested the form of the investment or collateral that was chosen, but in the event the Appellant paid in total £150,000, as a single premium, for overseas life policies issued by an Irish company in the HSBC banking group. In form, the policies were issued as a cluster of 50 policies, each with a separate policy number. The premium was paid on 22 March 2006.

5.

During the year following 22 March 2006, it emerged that Shell no longer required the Appellant to post the full collateral, and so the Appellant realised that without breaching his obligations to Shell, he could in fact surrender approximately one-third of the rights under the policies and withdraw £50,000. This he did, or at least was treated as having done for tax purposes, on the anniversary of the acquisition of the policies, i.e. on 22 March 2007.

6.

We were shown e-mails passing between two departments or companies within the HSBC group that indicated that it was important that someone gave the Appellant tax advice in relation to the proposed surrender. We saw, however, no actual tax advice or direct communication between any HSBC company and the Appellant in relation to the tax implications of the partial surrenders. Since the Appellant has brought this Appeal, and a 2009 Off-Short Life Policy Chargeable Event Certificate from HSBC Insurance indicates that HSBC effectively agree with HMRC's analysis that the partial surrenders of rights under the policies generated income (referred to correctly, but perhaps not all that clearly for an individual policyholder, as a “reckonable excess”) of £42,500, it emerges that the Appellant had not entirely understood the tax implications of making the partial surrenders. It is of course no concern of ours to enquire whether anyone was at fault for this result. The tax result for the Appellant was nevertheless that HMRC added £42,500 to his other income, in calculating his total tax liability, and since the policies were Non-Qualifying Off-Shore policies, no credit was given for tax at the basic rate since such tax had not been suffered in the hands of the insurance company.

The contentions on the part of the Appellant

7.

The Appellant contended in writing that:

- the policies were not insurance policies and that HMRC had thus levied an assessment under the wrong statutory provisions;
- the assessment should be withdrawn because the Appellant had made his investment in the policies entirely from a taxed fund such that taxation in accordance with the assessment involved double taxation, which was obviously wrong; and that
- the calculation had to be wrong, not least because the total value of the policies was about £10,000 less on the occasion of the partial surrenders than the premium paid, such that in reality all that the Appellant was doing was recovering part of his capital, which capital that was indeed no longer “in tact”.

Our decision

8.

We were unable to consider the first of the Appellant's contentions because we were not given a copy of the

Policy documents or other Investment Certificates for the HSBC Policies, and we understood that the Appellant had refused to supply these documents to HMRC. We did however note that HSBC had classed the investments as Off-Shore Life Policies, and we also noted the wide non-statutory definition, adopted for taxation purposes, of what constitutes a life policy. We also note that in the Appellant's accountant's letter to HMRC of 6 May 2009, the very first sentence said that “The chargeable event which you refer to was in fact a partial surrender of an Off-Shore Life Policy with HSBC”. We have accordingly had to accept that the investment in this case was in Off-Shore Life Policies.

9.

We can understand why the Appellant contends that his income is being taxed twice. If £50,000 is withdrawn from policies taken out for £150,000 one year after the policies were taken out, and at a time when the value of the policies was said to be only £140,000, and the Appellant is treated as having taxable income of £42,000, this does very much look like double taxation.

10.

There is, however, no double taxation as we will seek to explain below, and the objective of the legislation in relation to Non-Qualifying Off-Shore Life Policies is only to charge income tax on true gains over the life of the policies. It is the feature that the rules concerning the calculation of gain on partial surrenders of the policies occasion extraordinary results, that should eventually be reversed and corrected, that has led the Appellant to consider that he is being taxed twice.

11.

We agree with HMRC's representative that the result of sections 461, 473, 498 and 507 of the Income Tax (Trading and Other Income) Act 2005 is that partial surrenders of off-shore life policies are taxed in the following way. We will deal below with the different situation that arises where the equivalent of a partial surrender is taken by wholly surrendering just some of the policies in a “cluster of policies”, but at this stage we will concentrate only on the rules where partial surrenders are made of the rights attaching to policies.

12.

In the event that a small partial surrender is made, the rules are almost favourable. Their method of operation is, broadly, to deduct 5% of the premium for each year during which the policy has subsisted (disregarding such amounts where they have already been deducted from earlier partial surrender receipts) from the amount received on a partial surrender, and to tax only the balance of the value received on the partial surrender as income. No regard whatsoever is given, at this point, to the value of the remaining rights attaching to the non-surrendered element of the policy.

13.

Accordingly, had the Appellant received only £7,500 on the partial surrender, the entire amount would have been received tax-free. This could indeed be beneficial, should the policy actually have increased in value and should the policyholder consider deferring taxation to be beneficial.

14.

Modifying the example, had the policyholder received £10,000 on the partial surrender on the first anniversary of the policy, there would have been the same deduction of 5% (i.e. the same £7,500), so that the taxable income would have been £2,500. Further modifying the example, had the partial surrender been made on the second anniversary of the policy, and had no earlier surrender been made, the policyholder would then have been able to deduct two 5% amounts (i.e. £15,000) from the cash receipt, such that only the excess over £15,000 would have been taxed.

15.

This blunt method of calculating gain and income can of course occasion very unrealistic results, and those results are at their most unrealistic on the facts of this case where:

- the surrender is made at an early date (i.e. when only one element of 5% can be deducted from the receipt);
- the cash received on the partial surrender is significantly in excess of the deductible amount; and
- the most objectionable feature of all, namely that the polices are in fact worth less at the point of the partial surrenders than the premiums paid.

16.

It is not for us to give tax advice to the Appellant, but we consider that we should draw to the Appellant's attention the broad nature of the rules that are intended to reverse the excessive taxation that has plainly occurred to date. These rules provide for a Relief for Deficiencies on the eventual Surrender of the various policies (or any of them), the result of which is that if during the life of the policies the policyholder has been treated as having income that exceeds the real total gain on the policies, then in the year when the final surrenders are made, there should be some form of tax relief for the excess taxation already suffered. Thus if the Appellant was now able to surrender the balance of the policies for £100,000, such that in total he had received £150,000 (i.e. making no real gain whatsoever), the feature that in year 1 he had been treated as receiving income of £42,000 should be broadly reversed, since in the year of final surrenders he should be entitled to tax relief for £42,000.

17.

It is of course for the Appellant to seek detailed tax advice, and doubtless to negotiate also with Shell, to determine what can now be done. Attention needs to be given to the rules for calculating Deficiency Relief, the issue of whether the Appellant will have sufficient income in the year of final surrender to recompense him for the excessive taxation suffered in year 1, and the issue of whether with an off-shore life policy the relief is available in respect of all rates of tax. Whilst this decision is one for the Appellant himself to take, with the benefit of proper advice, we merely suggest that it would seem prudent, at least in a tax year (or several tax years) when the full value of Deficiency Relief will be available, for the Appellant to consider surrendering these policies, and then agreeing with Shell that the released funds can be reinvested in some new, and possibly other, form of investment.

18.

We should mention two points on calculation. There was a suggestion in correspondence that we have seen that suggests that the Appellant considers that he did not receive £50,000, but that he actually only received £42,500 because there was a fee charged by HSBC Insurance for early partial surrenders. We are surprised by this suggestion because the Appellant must know what went into his bank account. The Chargeable Event Certificate unquestionably indicates that the figure in question was £50,000 and that the £7,500 figure was the product of the 5% calculation that we have explained above. Were our assumption to be wrong however, and were the Appellant only to have received £42,500 on the partial surrender, then it would of course follow that the assessment should be revised downwards to income of £35,000.

19.

The other point on calculation that we should mention is that a completely different result would have arisen had the partial surrenders of all of the 50 policies been effected by making total surrenders of roughly one-third of the 50 policies. In that situation, no income tax would have been chargeable because there would have been no gains on the total surrender of the surrendered policies, but also no relief would have been given for the feature that each of the surrendered policies would have had a surrender value that fell short of the premium paid for the surrendered policy.

20.

Whilst the Appellant would have avoided the tax charge on £42,500 that has in fact arisen, had the 2007 transaction taken the form of a total surrender of roughly one third of the policies, it appears to us that this feature is irrelevant to this appeal. We say this because the Appellant has not contended that the surrenders took the form of total surrenders of some of the policies, and more particularly because the HSBC Chargeable Event Certificate clearly records a tax liability on £42,500 and it also refers to the surrenders as being made in respect of each of the 50 numbered policies. We admit that we are at something of a loss to understand what tax advice was given to the Appellant prior to effecting the 2007 transaction, and whether it was made clear to the Appellant that the immediate tax liability would be considerably influenced by the precise form that the surrender transaction took.

21.

We add finally that we consider that the Appellant has been most unfortunate to have fallen into a trap, occasioned by what can perhaps be described as rather “broad-brush” legislation that does not always (at least until the final surrender) occasion very fair results, and we extend our sympathy to the Appellant.

Right of Appeal

22.

This document contains full findings of fact and the reasons for our 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: 19 October 2010