TC02539

Appeal number: TC/2011/5621

INCOME TAX – partial surrender of life policies – taxable income arising under chapter 9 Pt 4 ITTOIA – outrageously unfair effect ton taxpayer – application of HRA 1998

FIRST-TIER TRIBUNAL
TAX CHAMBER

JOOST LOBLER **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE CHARLES HELLIER
KAMAL HOSSAIN FCA FCIB

Sitting in public at Bedford Square WC1B 3DN on 7 September 1012

The Appellant in person

Jack Lloyd for the Respondents

DECISION

1. In this appeal a remarkably unfair result arises as a result of a combination of prescriptive legislation and Mr. Lobler's ill-advised actions.

2. The legislation is that in Chapter 9 Part 4 ITTOIA 2005 which treats prescribed sums arising in relation to policies of life assurance as being liable to income tax.

3. In outline Mr. Lobler invested some US $1.4 million in a series of life assurance policies with Zurich Life on 1 March 2006 and within the next two years withdrew $1.4 million from the policies leaving the policies with comparatively negligible value. The form in which he made the withdrawal was by a partial surrender of each policy. As a result of the tax legislation in Chapter 9 Part 4 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") dealing with life insurance policies he is treated as having in those years realised taxable income of some $1.3 million. He becomes liable to pay some $560,000 in tax. He made no profit or gain as that term is commonly or commercially understood and yet he becomes liable to pay tax which exhausts his life savings and may bankrupt him. That is an outrageously unfair result.

4. The appeal takes place at a time when there is great media and political comment about a fair tax system. That interest focuses on the avoidance of tax by those who have substantial income, but to our minds it is more repugnant to common fairness to extract tax in Mr Lobler's circumstances than to permit other taxpayers to avoid tax on undoubted income.

The facts in more detail.

5. There was no dispute about the facts.

6. Mr. Lobler and his family are Dutch. Early in 2004 he moved with his family to England for work. In 2005 they sold their house in Holland and the proceeds - all Mr. Lobler's life savings, about £350,000 - were invested in a life insurance policy (or series of policies) with Zurich Life, a life insurance company in the Isle of Man

7. The investment was converted into roughly $700,000 and was supplemented by a loan from HSBC of another $700,000. His total investment in the policy was $1,406,000.

8. This insurance policy investment product had been arranged for Mr Lobler by HSBC Private banking. Mr. Lobler had told them about his situation and his future plans and assumed thereafter he did not need any further independent advice. He took no advice before withdrawing funds from the policies.

9. In 2006 Mr. Lobler bought a house in England. He started to withdraw funds from the policy. First he withdrew $746,485 on 28 February 2007. This he used to repay the loan from HSBC of $700,000 plus interest. Then on 29 February 2008 he

withdrew a further $690,171. This he used to pay for his house and works of renovation.

10. He withdrew the monies from the policies by completing a form provided by Zurich. The form contained four surrender options. Option A was for full surrender, option B was for partial surrender across all policies and funds, option C was for partial surrender across all policies from specific funds, and option D was for full surrender of individual policies. Mr. Lobler elected for option C: he put an "X" in the box opposite the words "partial surrender across all policies from specific funds"; he put the amount he wished to raise in the next box and indicated the funds from which the withdrawal should be made in the following section. He indicated that the reason for the withdrawal was that he was buying a property.

11. The monies were subsequently paid to him. Mr. Lobler assumed that because he had withdrawn no more than he had paid for the policies no taxable gain would arise. He made no mention of the monies in his tax returns. But in pursuance of its obligations under section 552 ITTOIA Zurich wrote to HMRC and Mr. Lobler following each withdrawal indicating the amounts which represented taxable income arising on each of the withdrawals. Those amounts were $676,184 in the case of 28 February 2007 withdrawal and $619,871 in the case of the 29 February 2008 withdrawal.

12. HMRC opened enquiries in relation to Mr. Lobler's self-assessment returns for the years ending on 5 April 2007 and 2008 and, on the closure of the enquiries, amended the assessments to include the amounts to be treated as income arising from the withdrawals from the policies.

13. Mr. Lobler says that he made a mistake in the way in which he withdrew funds from the policies. He did not realise that the effect of making a partial surrender was that almost all the amount he withdrew would be treated as taxable income.

The legislation

14. Section 461 ITTOIA provides that "[i]ncome tax is charged on gains treated as arising from policies and contracts to which this Chapter applies." There was no dispute that the Chapter applied to the Zurich life policies.

15. Section 462 provides that "a gain from a policy or contract arises when a chargeable event occurs in relation to the policy or contract.". Section 463 provides that "[t]ax is charged under this Chapter on the amount of the gain arising in the tax year.".

16. Section 507 provides for a calculation to determine whether a gain arises, and to calculate a gain if rights under a policy have been surrendered. The calculation requires that the gain is equal to the excess of the value of the any part of the policy surrendered over 5% of the premiums paid for the policy. The calculations are performed annually on a cumulative basis. Section 508 provides that if a share in the rights conferred by a policy is surrendered the value of that share for the purposes of section 507 is the amount or value payable because of the surrender

17. Section 509 provides that "[i]f the calculation in section 507 shows that a gain has arisen at the end of the insurance year, the gain is treated as arising on the occurrence of the chargeable event at the end of that year [unless certain conditions irrelevant to this appeal are met]".

18. In *Mayes v HMRC* [2009] EWCA 2443 Proudman J considered the (more accessibly written) legislation in the Taxes Act 1988 which was a precursor of the present legislation. She noted that that legislation was "a code for identifying and quantifying gains on life policies and subjugating those gains to tax… the gains to be taxed are gains attributed by the statute rather than real ones because they are expressed by the statute to be "gains to be treated in accordance with this chapter as arising ..."." The same analysis applies to chapter 9: it is a prescriptive code which brings into tax amounts calculated under the provisions of the Chapter which bear little or no resemblance to "gains" in common or commercial parlance..

The Application of the Legislation.

19. Thus when Mr Lobler received monies from the policy in 2007 and 2008: (i) he made partial surrenders of his rights under the policy, (ii) the value surrendered for the purposes of the section 507 calculation was the amount received; (iii) for each year the section 507 calculation produced an amount (a "gain") equal to the amount received less 5% of the premium originally paid; (iv) because that amount arose from the section 507 calculation a chargeable event arose; (v) because there was a chargeable event there was for the purposes of section 462 "a gain from a policy" and (vi) as a result of section 463 tax was to be charged on "the amount of the gains arising in the tax year".

20. Mr Lobler does not really dispute this analysis, and, though we have struggled so to do, we can find no way to give a different interpretation to the legislation. As Proudman J said in *Mayes*, "This is legislation which does not seek to tax real or commercial gains. Thus it makes no sense to say that the legislation must be construed to apply to transactions by reference to their commercial substance….[the legislation] adopts a formulaic and prescriptive approach. No overriding principle can be extracted form the legislation…".

21. We should also note that in July 2008 Mr Lobler terminated the policies and received some $35,000. On the surrender of all rights under a policy, section 484(1)(a)(i) provides for a chargeable event, and section 539 ITTOIA provides for relief for "deficiencies", calculated, by section 541 (and 491), as the total amounts received under the policy, less the premium was paid for it and less any amount which had previously been treated as a "gain". The result of this calculation was that in 2008 Mr Lobler had a deficiency of some $1,230 (=($746k+$690k +$35k)-$1,406k-($676k+$619k)). That could be set against other taxable income of the year. But Mr Lobler did not have other income approaching that figure. The relief was of no use to him.

Other considerations

22. We considered whether the potential remedy of rectification affected the analysis. If a court would order rectification of the forms on which Mr Lobler made his application for funds so that they would take effect as the full surrender of some of the subsidiary policies, then relying on the maxim that equity treats what should have been done as done, we might treat the applications as total surrenders. Were that the case the calculation of the gain under Chapter 9 would be made after deducting the full amount of the related premium, and no taxable (or no material taxable) income would arise.

23. However the authorities in relation to rectification suggest that the "party seeking rectification must show that: (1)the parties had a common continuing intention, whether or not amounting to agreement, in respect of the particular matter in the instrument to be rectified; (2) there was an outward expression of accord; (3) the intention continued at the time of execution of the instrument sought to be rectified; and (4) by mistake, the instrument did not reflect that common intention."(Lord Hoffman in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] AC 1101; and see also the comments thereon in *Daventry* [2012] 1 WLR 1333). What is missing in Mr Lobler's case is the element of common intention. There was nothing before us to suggest that Zurich had any intention at all in relation to the withdrawals sought by Mr Lobler.

24. Section 3 of the Human Rights Act 1998 requires that "[so] far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with" relevant rights under the Convention for the Protection of Human Rights and Fundamental Freedoms. One of those rights is that in Article 1 of the First Protocol to that Convention, namely that every person is entitled to the peaceful enjoyment of his possessions save as a State deems necessary to secure the payment of taxes. It seems to us that the effect of the legislation as described above on Mr Lobler is so outrageously unfair that it may not fall within that exception for the collection of taxes. But even if that is the case, there is nothing we can do about it. That is for three reasons.

25. First, the duty to construe the legislation in accordance with the Convention is "so far as it is possible to do so". The legislation in Chapter 9 is so prescriptive that it does not seem possible to construe it any other way. Its object is to deprive Mr Lobler of these monies whatever their nature: there is no room for even robust interpretation.

26. Second, even if we were formally to conclude that the legislation produced a result which was not compliant with Convention rights we have no jurisdiction so to declare: section 4 of the Human Rights Act gives a jurisdiction in that respect to the High Court and the Courts above it, but not to this tribunal.

27. Third, although section 7 of the Act provides that Mr Lobler may rely on a Convention right before this tribunal if he claims that HMRC have acted in a way which, by virtue of section 6 is incompatible with a convention right, section 6(2) provides that section 6 does not apply if, as a result of one or more provisions of primary legislation, HMRC could not have acted differently. It seems to us to be clear that HMRC could not have acted differently in their interpretation of the

legislation, but it may be arguable that they could have decided not to make the changes to Mr Lobler's self assessments in reliance on their power of management of the tax system in section 1 Taxes Management Act 1970. But the jurisdiction given to this tribunal in a case such as this does not extend to making orders to overturn (or "review") the administrative process of HMRC. Section 31 TMA permits the bringing of an appeal against an amendment to a self assessment, but not against the decision which resulted in the amendment: that gives us power to adjudicate on the amount of the assessment and whether it was made under the powers given by the Act, but not on the decision to make it. The power to review HMRC's decision rests with the High Court (see eg paragraphs [39ff] *HMRC v Hok Ltd* [2012]UKUT 363 TCC).

28. Thus with heavy hearts we dismiss the appeal.

29. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 12 February 2013