



[2019] UKFTT 0263 (TC)

**TC07103**

*INCOME TAX – chargeable event gain on sale of insurance bond – taxpayer not entitled to personal allowance due to chargeable event gain - calculation of top slicing relief – whether taxpayer entitled to personal allowance in hypothetical calculation undertaken to calculate relief – yes – Appeal substantially allowed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**Appeal number: TC/2018/1743**

**BETWEEN**

**MARINA SILVER**

**Appellant**

**-and-**

**THE COMMISSIONERS FOR  
HER MAJESTY'S REVENUE AND CUSTOMS**

**Respondents**

**TRIBUNAL: JUDGE BARBARA MOSEDALE  
HELEN MYERSCOUGH**

**Sitting in public at Taylor House, Rosebery Avenue, London on 18 February 2019**

**Mr N Silver, for the Appellant**

**Mr Corbett, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents**

## DECISION

### INTRODUCTION

1. Mrs Silver surrendered a life insurance bond in May 2015. Mr and Mrs Silver did not believe that Mrs Silver had any tax liability in respect of the surrender and so, Mr Silver acting on behalf of his wife, did not include it in Mrs Silver's tax return for year 15/16. In May 2017, HMRC wrote to Mrs Silver opening an enquiry into that return on the basis that they believed she owed additional tax of £21,391. HMRC closed the enquiry on 28 December 2017 amending Mrs Silver's return to show a tax liability of £26,818.33 (some £4,059.20 having been shown in the original return as owing in respect of declared income).

2. Mrs Silver asked for a review; the review upheld the amendment on 23 February 2018. Mrs Silver then appealed to the Tribunal.

### THE FACTS

3. The facts were not in dispute and no oral evidence was given. We find as follows.

4. Mrs Silver purchased a life insurance bond in October 1993 at a cost of £55,000. A total of £46,616 was withdrawn from the bond over the next 21 years (approximately £2,200 per year). Mrs Silver surrendered the bond in May 2015 for £119,105.92.

5. The insurance company issued Mrs Silver with a Chargeable Gain Certificate showing a gain of £110,721.93. The Silvers accepted that this was correctly calculated (surrender value plus amounts withdrawn minus purchase price).

6. In tax year 2015/16, Mrs Silver's other income amounted to £31,101. As we have said, her tax return showed a liability to tax of £4,059.20 on this sum. It was calculated on the basis that she had the benefit of a personal allowance.

### THE LAW

7. The relevant legislation in this appeal is the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA') s 461 onwards and the Income Tax Act 2007 (ITA) s 23 and onwards. In particular, s 23 ITA set out how income tax should be calculated in a series of steps, as follows:

#### Step 1

Identify the amounts of income on which the taxpayer is charged to income tax for the tax year.

The sum of those amounts is 'total income'.

Each of those amounts is a 'component' of total income.

#### Step 2

Deduct from the components the amount of any relief...to which the taxpayer is entitled for the tax year.

...

The sum of the amounts of the components left after this step is 'net income'.

#### Step 3

Deduct from the amounts of the components left after Step 2 any allowances to which the taxpayer is entitled for the tax year.....

#### Step 4

Calculate tax at each applicable rate on the amounts of the components left after Step 3.

....

#### Step 5

Add together the amounts of tax calculated at step 4.

#### Step 6

Deduct from the amount of tax calculated at Step 5 any tax reductions to which the taxpayer is entitled for the tax year under a provision listed in relation to the taxpayer in section 26.

#### Step 7

Add to the amount of tax left after step 6 any amounts of tax for which the taxpayer is liable for the tax year under any provision listed in relation to the taxpayer in s 30.

The result is the taxpayer's liability to income tax for the year.

### **Step 1: Mrs Silver's total income for 15/16**

8. The Silvers accepted that the policy they held fell within s 473 and s 474 ITTOIA; s 461 of ITTOIA provided that gains on such policies were chargeable to income tax. S 462 provided that a gain arose when a chargeable event occurred in relation to the policy.

9. The Silvers accepted that the surrender of the policy was a chargeable event; they did not accept that the withdrawals (approximately £2,200 per year) over the 21 years it was in existence were a part of the chargeable event.

10. However, we find that ss 491-492 provided that the chargeable gain included capital sums paid under the contract before the chargeable event (being the surrender).

11. We find that HMRC are right to say that the full amount of the gain, calculated to include the withdrawals over the time Mrs Silver held the policy, fell to be charged in 2015/16. So at Step 1 of the calculation, the figure to be added to Mrs Silver's other income (some £31,101) was £110,721.93. Therefore, her total income for 15/16 was £141,822, as HMRC had said.

### **Step 3 - entitlement to personal allowance?**

12. Both parties were agreed that there were no applicable reliefs at Step 2. So 'net income' at the end of Step 2 was the same as 'total income' at the end of Step 1 (£141,822.) HMRC accepted that Step 3 entitled Mrs Silver to deduct her personal allowance, if she had any. It was their case that she did not. The Silvers did not accept that.

13. However, S 35 ITA provided:

#### **35 Personal allowance**

(1) An individual who makes a claim is entitled to a personal allowance of £11,000 for a tax year if the individual meets the requirements of section 56 (residence etc).

(2) For an individual whose adjusted net income exceeds £100,000, the allowance under subsection (1) is reduced by one-half of the excess.

(3) If the amount of any allowance that remains after the operation of subsection (2) would otherwise not be a multiple of £1, it is to be rounded up to the nearest amount which is a multiple of £1.

(4) For the meaning of “adjusted net income” see section 58.

14. HMRC’s case was that Mrs Silver’s adjusted net income for 15/16 exceeded £122,000 so that under s 35(2) she had no personal allowance. They considered her adjusted net income to be £31,101 (her other income) plus £110,721.93 (the chargeable event gain), making £141,822 in total. We agree for the reasons given above. Therefore, we agree with HMRC that Mrs Silver was not entitled to a personal allowance in 2015/16.

#### **Step 6: Top slicing relief**

15. HMRC’s case was that steps 4 and 5 would then generate a tax liability of £26,818.33. We understand that the *mathematics* in the calculation was not in dispute. In any event, we were not given the necessary information to calculate whether this was correct. If it is not correct, the parties have liberty to apply: see below at §39.

16. Moving on to Step 6, this allows the taxpayer to make further deductions if entitled to any. The deductions are those listed in s 26 ITA. S 26 ITA lists top slicing relief (s 535 ITTOIA). The Silvers claimed Mrs Silver was entitled to top slicing relief; HMRC said that Mrs Silver was not. Mr Corbett’s position was that HMRC’s manual was quite clear that top slicing relief could not be used where the taxpayer was not entitled to a personal allowance. And, he pointed out, Mrs Silver was not entitled to a personal allowance in year 15/16.

17. So we have to consider s 535 ITTOIA to decide whether or not Mrs Silver was entitled to top slicing relief; we accept for the reasons given at §§12-14 above that she was not entitled to a personal allowance in 2015/16.

#### **535 Top slicing relief**

(1) An individual is entitled to relief under this section for a tax year if—

(a) the individual's liability for the tax year, as calculated under subsection (3), exceeds

(b) the individual's relieved liability for the tax year, as calculated under—  
section 536 (top slicing relieved liability: one chargeable event), or  
section 537 (top slicing relieved liability: two or more chargeable events).

(2) The relief is given by a reduction in or repayment of income tax equal to the excess.

(2A) If the relief is given by a reduction in income tax, it is given effect at Step 6 of the calculation in section 23 of ITA 2007.

(3) An individual's liability for a tax year for the purposes of subsection (1)(a) equals  $TL - BRL$ , where—

TL is the amount of the individual's total liability to income tax on income charged to tax under this Chapter for the tax year, calculated on the basis that no relief is available under this section and the highest part assumptions apply, and

BRL is the amount of income tax at the basic rate that the individual is treated as having paid under section 530(1) for the tax year.

(4) For the purposes of subsection (3) and sections 536 and 537, the highest part assumptions, in calculating liability to income tax on an amount, are that—

(a) the amount is the highest part of the individual's total income for the tax year, and

(b) any provision directing any other amount to be treated as the highest part is ignored.

(5) For the purposes of this section and sections 536 and 537, an individual's total income is treated as not including any amount which—

(a) is charged to tax under Chapter 4 of Part 3 (profits of property businesses: lease premiums etc.) as the profits of a UK property business, or

(b) counts as employment income under section 403 of ITEPA 2003 (payments and benefits on termination of employment etc.).

(6) For the purposes of this section and sections 536 and 537—

(a) any chargeable event under section 525(2) (chargeable events where annual personal portfolio bond calculations show gains),

(b) any gain treated as arising on the occurrence of such an event, and

(c) the amount of any liability to income tax arising on such a gain, are ignored.

(7) For the purposes of the calculations mentioned in subsection (1) any relief under Chapter 2 or 3 of Part 8 of ITA 2007 (which relate to gift aid and other gifts to charities) is ignored.

### ***Comparison of two tax liabilities – calculation of TL-BRL***

18. In other words, top slicing relief required a comparison between Mrs Silver's tax liability calculated as set out in s 535(3) and her 'relieved' tax liability calculated under s 536. (S 537 was not applicable as she only had one chargeable event in 2015/16).

19. Taking s 535(3) first, that required a calculation of

TL – BRL

20. TL was the amount of Mrs Silver's total liability to income tax on income charged to tax under that Chapter of ITTOIA for the tax year, calculated on the basis that no relief was available under this section and with the highest part assumptions applying. In other words, it was Mrs Silver's liability to tax on the chargeable event gain on the basis that her other income had been taxed first. BRL was the amount of income tax at the basic rate that Mrs Silver was treated as having paid under section 530(1) for the tax year.

21. As her other income was £31,101 and the higher rate band started at £31,785, only some £684 of the chargeable event gain could be taxed at basic rate (which was deemed paid). The rest of it (£110,037) was effectively taxed at 20% (It was taxable at 40% but the entire chargeable event gain was deemed to have paid tax at 20% under s 530(1)). This meant that TL-BRL was 20% x £110,037 = £22,007.

22. There did not appear to be any dispute between the parties over this figure and we consider that it was correct.

### ***Comparison of two tax liabilities – the relieved liability***

23. The next step was to calculate the relieved tax liability under s 536. S 536 provided as follows:

#### **S 536 Top slicing relieved liability: one chargeable event**

(1) To calculate an individual's relieved liability for the purposes of section 535(1) for a tax year for which the individual is only liable for tax on a gain from one chargeable event—

Step 1 Find the annual equivalent of the amount of that gain (“the annual equivalent”) by dividing that amount by the number of complete years for which the policy or contract has run before the chargeable event (“N”).

See subsections (2) to (8) for further provisions about calculating N.

Step 2 Find the relieved liability on the annual equivalent by—

(a) calculating the individual's liability (if any) to income tax on the annual equivalent, on the basis that—

(i) the gain from the chargeable event is limited to the amount of the annual equivalent, and

(ii) the highest part assumptions apply, and

(b) subtracting the amount of income tax at the basic rate on the annual equivalent which the individual is treated as having paid under section 530(1).

Step 3 Multiply the relieved liability on the annual equivalent by N.

....

We omit the rest of s 536 as it dealt with the calculation of N and there was no dispute between the parties over the calculation of N. They were agreed it was 21 (in other words, the policy was held for 21 complete years).

24. The relieved tax liability calculation in S 536 basically required the number of years of the policy (‘N’) to be multiplied by an amount called the ‘relieved liability on the annual equivalent’. As we have said, there was no dispute over the value of N. It was 21.

25. The first step was to calculate the ‘annual equivalent’ by dividing the chargeable event gain by N. In this case, the parties were agreed that the annual equivalent was £5,272.43 (ie £110,721 ÷ 21).

26. The second step was to calculate Mrs Silver’s (hypothetical) liability to income tax on the annual equivalent. This was done on the assumption that the single annual equivalent was the entire gain and that it was the last part of her income to be taxed. She was also to be given credit for basic rate tax.

27. This takes us back to s 23 ITA and the steps for calculating liability. Mrs Silver’s (hypothetical) income under this calculation was £31,101 plus £5,272.43 (the annual equivalent) making a total income of £36,373. (The full gain was excluded by s 536(1)(a)(i).)

28. The dispute between the parties centres on Step 3. That provided as set out above. It meant that a personal allowance should be deducted if a taxpayer was entitled to one. HMRC’s point was that Mrs Silver was not entitled to a personal allowance in 15/16 and we have agreed with them on that point.

29. Mr Silver’s point was that this was a hypothetical calculation and as Mrs Silver’s hypothetical income was £36,373, s 35(2) was not applicable as the hypothetical income did not exceed £100,000. Therefore, in this hypothetical scenario, Mrs Silver was entitled to a personal allowance.

30. We prefer Mr Silver’s interpretation of the legislation. S 536 clearly directed a hypothetical tax calculation to be carried out on certain assumptions. It would be wrong to carry out the calculation without using those assumptions consistently. Consistently applying the assumption that Mrs Silver’s income was only £36,373.43 meant that she was (in this hypothetical scenario) entitled to a personal allowance in this calculation.

31. Moreover, Parliament's intent with top slicing relief was obviously to allow a person who has taken income over a number of years to have relief when provisions taxed them to the entire income in a single year, as here. The relief was intended to make the tax liability approximate to what it would have been had the income been taxed in the year it was actually received. So when carrying out the hypothetical tax calculation it made every kind of sense that the taxpayer should be treated as entitled to the reliefs that that hypothetical income would have entitled her to.

32. HMRC's interpretation, on the other hand, is clearly inconsistent with Parliament's presumed intent. HMRC's interpretation would result in someone who was a basic rate taxpayer in the year of realisation and who would not have had any higher rate tax to pay on the withdrawals from the bond had it been taxable year by year, nevertheless having to pay higher rate tax on the entire gain. Top slicing relief would be denied to those it was intended to help.

33. So applying the legislation, both literally and in accordance with Parliament's presumed intent, results in the steps set out in s 23 being applied in full to the hypothetical situation postulated by s 536(1). And that means that, at Step 3 Mrs Silver, hypothetically, was entitled to a personal allowance.

34. The result of that is that her liability to tax on the annual equivalent was nil. This is because deducting her hypothetical personal allowance of £11,000 resulted in her total hypothetical income at the end of Stage 3 being £26,373.43. That is well below the basic rate limit of £32,000 (for tax year 15/16). Therefore, the annual equivalent of £5,272.43 would have been taxable only at the basic rate; and as Mrs Silver was given credit for the basic rate, her relieved (ie hypothetical) liability would be £0.

#### ***The next step***

35. The next step under s 535 was to calculate the difference between TL-BRL (£22,007) and her relieved liability. As her relieved liability was £0, the difference was £22,007.

36. The top slicing relief is the amount of the difference and is given at Step 6. We have already said that her total tax liability at step 5 appeared to be £26,818.33, so deducting her top slicing relief of £22,007 gives a tax liability of £4,811.33.

37. It can be seen that this exceeds her declared liability but that will be because she had claimed a personal allowance, to which we have found she was not entitled.

38. The appeal is ALLOWED to a large extent, as explained above. That means that most of her payment in December 2017 must be refunded to Mrs Silver (with interest), because we find she was entitled to top slicing relief of £22,007.

39. If the parties cannot agree the final figure for Mrs Silver's tax liability for 15/16 calculated as explained above, they must revert to the Tribunal. We do not expect that will prove to be necessary.

#### **PENALTIES AND INTEREST**

40. HMRC assessed Mrs Silver to penalties and charged her to interest up to the date she paid the tax on 5 December 2017.

41. As HMRC agreed to suspend the penalties, there was no appeal against them. As the appeal is largely (but not entirely) allowed, the amount of the penalties suspended will now be significantly smaller.

42. Mrs Silver did seek to appeal the interest. The grounds for appealing the interest was that HMRC were (allegedly) slow to provide to Mrs Silver a calculation of the tax due on HMRC's view of the law; her case is that she would have paid the assessment earlier than she did had HMRC been more prompt in supplying the calculation.

43. The Tribunal has no jurisdiction over a taxpayer's liability to interest. Nevertheless, the interest charge will necessarily be substantially reduced owing to the appeal being substantially allowed.

**RIGHT TO APPLY FOR PERMISSION TO APPEAL**

44. 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.

**BARABARA MOSEDALE  
TRIBUNAL JUDGE**

**RELEASE DATE: 18 APRIL 2019**