[2011] UKFTT 488 (TC)

TC01335

Appeal number TC/2010/04093

Appeals against two assessments and an amendment made by HMRC in respect of withdrawals made by the Appellant from an offshore insurance policy in excess of the permitted five per cent per annum of the premium – appeal dismissed

FIRST-TIER TRIBUNAL

TAX

CAPTAIN STEVEN CLEGHORN **Appellant**

- and -

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

TRIBUNAL: S.M.G.RADFORD(TRIBUNAL JUDGE)
R.WATTS DAVIES F.C.I.P.D M.I.H.

Sitting in public at 45 Bedford Square, London WC1 on 16 June 2011

Mr I Stedman for the Appellant

Mrs N Parslow for the Respondents

DECISION

1. There are three appeals They are against an assessment dated 9 January 2009 made by HMRC under Section 29 of the Taxes Management Act 1970 (“TMA”) for the tax year ending 5 April 2003; an amendment made by HMRC by closure notice under Section 28A of the TMA to the self assessment for the tax year ending 5 April 2004; and an assessment made by HMRC under Section 29 TMA for the tax year ending 5 April 2005.

2. In each case the assessments and amendmentwere made as a result of chargeable gains arising on the partial surrenders each year of an offshore insurance policy with Allied Dunbar International (now Zurich International Life Ltd) (“the insurance company”).

Background and Facts

3. On 1 March 2002 the Appellant effected an offshore investment bond with the insurance company based in the Isle of Man with £66,000 of the proceeds of the sale of his home.

4. At the time of the investment the Appellant did not intend to take any immediate withdrawals of capital or income from the bond. However soon after the investment was made the Appellant’s circumstances changed and he commenced training as a commercial airline pilot. At the time he was not working as he had taken a career break from his role as a police officer with Sussex police.

5. Due to his change in circumstances the Appellant needed to draw an income from the bond. Initially this was at the rate of £1,000 per month commencing in May 2002. Additional capital withdrawals were required from time to time to meet the costs of his training.

6. On 21 May 2002 the insurance company wrote to the Appellant and while confirming his instruction to make a withdrawal payment to him of £1,000 each month informed him that there was a five per cent withdrawal allowance for tax purposes.

7. Extra unexpected costs in connection with his training arose including for his residency in Florida which required the Appellant to withdraw further capital sums.

8. The Appellant’s income requirements were varied and from time to time the Appellant tried to stop the income payments entirely but despite repeated requests to the insurance company income payments were still made.

9. Eventually the insurance company realised their mistake and cancelled the income payments. By then they had paid out a sum greater than the assets of the bond so they sought repayment from the Appellant.

10. The Appellant complained and after investigation by the insurance company it was agreed that they would treat the overpayment as an ex-gratia payment to settle the dispute between them.

11. HMRC calculated that for the tax year ending 5 April 2003 the Appellant withdrew £24,300. This was more than the five percent limit of £3,200 allowed by legislation to be withdrawn from the bond each year and so there was a chargeable gain event in amount of £21,100 for the year.

12. HMRC calculated that for the tax year ending 5 April 2004 the Appellant withdrew £34,000. This was more than the five per cent limit of £3,200 allowed to be withdrawn and so there was a chargeable event gain of £30,800 for the year.

13. HMRC calculated that for the tax year ending 5 April 2005 the Appellant withdrew £10,000. Again this was more than the five per cent limit and so there was a chargeable gain event of £6,800 for the year.

14. On 26 February 2010 HMRC wrote to the Appellant informing him that the withdrawals from the policy in excess of five per cent of the premium paid had given rise to chargeable event gains under Section 498 of the Income Tax (Trading and Other Income Act 2005.

15. The Appellant requested a review of the decision and the reviewing officer upheld HMRC's conclusion.

The Law

16. The current method of taxing part surrenders of a life policy was introduced in legislation in 1975. It is commonly known as the five per cent rule as it allows the deferral of the tax consequences on withdrawals from the bond each year of up to five percent of the premium.

17. Under the legislation any withdrawals up to the five per cent allowance are disregarded for tax purposes although they are taken into account when the policy comes to an end. If more than five per cent is withdrawn in the year this will result in a chargeable event gain arising.

18. Section 540 of the Income and Corporation Taxes Act 1988 ("ICTA") provides that a chargeable event may arise in respect of a life insurance policy.

19. Section 541 of ICTA provides for the computation of the gain.

20. Section 546 of ICTA provides for the calculation of certain amounts in computation of the gain

21. Section 547 of ICTA provides the method for charging the gain to tax. The gain is deemed to form part of the taxpayer's income for the year in which the event occurred.

22. Section 533 of ICTA provides that if it is a non resident policy then the provision included at Section 547(5) that it is treated as if income tax at the basic rate has been paid is to be omitted.

Appellant's Submissions

23. Mr Stedman agreed that the assessments had been correctly calculated in accordance with the tax legislation.

24. He submitted however that the Appellant had issues regarding the unfair, unjust and illogical basis of the legislation.

25. The Appellant could not understand why he had a tax liability when he had made no profit on the investment and just withdrew the money to pay for his expenses while doing pilot training.

26. The sole intention of the investment was to finance his flying training whilst he was not working and he was led to believe that he would only pay tax on any amount received by him which was over and above the amount invested.

HMRC's Submissions

27. HMRC submitted that the policy was a life policy. The chargeable gain events arose when money was withdrawn from the policy in excess of the permitted five per cent per annum.

28. The chargeable event gains arose in all three of the relevant tax years because in those years part surrenders of the policy were made from the policy.

29. No basic rate tax was treated as paid on the chargeable event gains because the insurer was non UK resident.

Findings

30. We find that the assessments were correctly made by HMRC.

31. We find that despite the letter from the insurance company on 21 May 2002 the Appellant did not realise the implications of his monthly withdrawals.

32. The investment ceased to be suitable for him once he had decided to train as a pilot some two months after he invested the money.

33. Nevertheless the legislation on this type of investment is clear and if the five per cent permitted withdrawal is exceeded the balance falls to be taxed.

Decision

34. The appeal is dismissed and the assessments and amendment are hereby confirmed.

35. 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.

TRIBUNAL JUDGE
RELEASE DATE: 19 July 2011