[2022] UKFTT 00077 (TC)

TC 08408/V

INCOME TAX – chargeable event gain – calculation of top slicing relief – whether beneficial ordering applied when calculating the relief – yes – whether other reliefs are to be taken account of – yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2020/04234

BETWEEN

SALLY JUDGES
(AS REPRESENTATIVE FOR THE LATE R YOUNG) **Appellant**

-and-

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

TRIBUNAL: JUDGE AMANDA BROWN QC

The hearing took place on 19 January 2022. With the consent of the hearing was a video hearing using the Tribunal video platform.

Mr T Good of Absolute Accounting Software Limited for the Appellant

Mr R Cook litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. The appeal concerns the mechanics of calculation of top slicing relief. The appeal was made in respect of a closure notice issued by HM Revenue and Customs (**HMRC**) amending the self assessment to income tax made on behalf of the late R Young for the tax year ended 5 April 2018. The amended assessment required the payment of £44,763 income tax for the year. The additional tax was considered due on the basis that the self assessment had incorrectly calculated the amount of top slicing relief to which Mr Young was entitled.

AGREED FACTS

2. There was no agreed statement of facts however, the facts were not in dispute between the parties.

3. Oral evidence was given by Mr George Smith, officer of HMRC. However, as noted by the Tribunal during the hearing, as useful as Mr Smith was in assisting the Tribunal to understand HMRC's views of the law, he gave no evidence of fact. He introduced and explained what HMRC considered to be the statutory purpose and effect of the top slicing relief provisions by reference to non statutory material annexed to his statement in the form of the Explanatory Notes to Income Tax (Trading and Other Income) Act 2005 (**ITOIA**) and Hansard debate concerning the 2002 Finance Bill amendment to age related allowances and to the 2020 Finance Bill amendments to top slicing relief effective from 11 March 2020. This was not "evidence" but submission. The relevance of this material is considered below.

4. Mr R Young passed away on 3 March 2018. Mrs Judges (**the Appellant**) acts in this appeal as his representative.

5. In the period from 6 April 2017 to his death Mr Young was in receipt of pension income (including his state pension) of £49,460, savings income of £185 and dividend income of £52. In the same year a single chargeable event gain of £232,275 arose in connection with three life insurance policies two of which were held for 23 years and one of which was held for 22 years.

6. The tax return and self assessment were completed using HMRC's self assessment calculator and the white space disclosure was used to make an appeal against the top slicing relief permitted by the calculator. The return was submitted on 30 April 2019. By letter dated 21 May 2019 the Appellant provided calculations which she considered reflected the statutory basis for calculation of top slicing relief. Pursuant to these calculations top slicing relief of £50,939 was claimed on the basis that when performing the calculation of top slicing relief Mr Young was:

> (1) entitled to allocate his personal allowance against his various sources of income in a way that achieved the lowest liability to income tax (i.e. apply what is known as beneficial ordering); and
>
> (2) not precluded from claiming the personal savings allowance by reference to the annual equivalent of the chargeable event gain.

7. Income tax due following the application of the Appellant's calculation of top slicing relief was £5,577.80.

8. HMRC treated the letter as the submission of an amended tax return on 23 May 2019. They opened an enquiry into the amended calculations by notice issued under section 9A Taxes Management Act 1970 (**TMA**) on 27 July 2020. On 8 September 2020 they issued a closure notice pursuant to section 28A(1B) and (2) TMA limiting the top slicing relief to £6,176 and amending the self assessment such that additional income tax became payable in the sum of £44,763.

9. The Appellant lodged and in time appeal to HMRC and, following the issue of HMRC's view of the matter letter, the appeal was notified to the Tribunal.

LEGISLATION

10. The applicable legislation in this appeal is contained in Income Tax (Trading and Other Income) Act 2005 (**ITTOIA**) chapter 9 Gains from Contracts of Life Insurance etc. and the Income Tax Act 2007 (**ITA**) chapter 3, Calculation of Income Tax Liability.

11. In summary the directly relevant provisions to this appeal, at the relevant time, were:

(1) Section 23 ITA: which provides the basis of calculation of income tax liability. The statutory provisions require a number of steps to be performed. The following steps are relevant in determining this appeal:

> Step 1 – Identify the amounts of income on which the taxpayer is charged to income tax for the tax year. This represents total income and each amount is a component of total income.
>
> Step 2 – Deduct from the components the amount of any relief to which the taxpayer is entitled in the tax year. Total income less deducted relief is net income.
>
> Step 3 – Deduct from the amounts of the components after step 2 any allowances to which the taxpayer is entitled for the tax year.
>
> Step 4 – Calculate the 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 (including top slicing relief).
>
> The result is the taxpayer's liability to income tax for the year.

(2) Section 25 ITA: which, at subsection (2), requires that the reliefs and allowances at steps 2 and 3 of the section 23 calculation be deducted "in the way which will result in the greatest reduction to the taxpayer's liability to income tax" (**beneficial ordering**).

(3) Section 461 ITTOIA: which represents the basic charging provision pursuant to which income tax is charged on gains arising on policies, including those held by Mr Young.

(4) Section 530 ITTOIA: which provides that an individual who is liable to tax on chargeable event gains is treated as having paid income tax at the basic rate on the amount of the gain. Such tax is not repayable. It also provides that the income tax treated as paid in respect of the chargeable event gain is to be reduced where "the individual's total income is reduced by any deductions which fall to be made at step 2 or 3 of the calculation in section 23 of ITA".

(5) Section 535 ITTOIA: which provides for top slicing relief. It requires a comparison of 1) the amount of the individual's total liability to income tax on the chargeable event gain (assuming that it is the highest part of the individual's total income for the tax year) (**TL**) less the amount of basic rate tax treated as having been paid on the gain (**BRL**) and 2) the individual's relieved liability under section 536.

(6) Section 536: which sets out a series of steps for determining the individual's relieved liability as follows:

> Step 1 – Find the annual equivalent of the amount of the gain by dividing the gain by the number of complete years for which the policy ran.

> Step 2 – Find the relievable liability on that annual equivalent on the basis that the gain is limited to that annual equivalent and that the gain represents the highest part of the individual's total income for the tax year and subtracting the income tax which was treated as having been paid under section 530(1).
>
> Step 3 – Multiply the outcome of step 2 by the number of complete years for which the policy ran.
>
> By reference to subsection (7) when performing the 3 step calculation gift aid relief is to be ignored.

12. Amendments were made to sections 535 and 536 with effect from 11 March 2020. With effect from that date, and so far as relevant to the facts of the present dispute, provisions were introduced:

> (1) as section 535(8) ITTOIA, the effect of which expressly provided that the beneficial ordering provisions of section 25(2) did not apply to the top slicing relief calculation and that as the chargeable event gain is to be treated as the highest part of the individual's income, reliefs and deductions are to be set against other amounts of income for which the reliefs or deductions are available in preference to the being set against the chargeable event gain, such that only those remaining after deduction against those other income amounts may be set against the chargeable gain.
>
> (2) By way of amendment to s536(1) to amend step 2 to include an assumption that in determining the amount of the individual's personal allowance under section 35 ITA (but not the amount of any other relief or allowance) the chargeable event gain is equal to the amount of the annual equivalent.

13. Although not necessary to summarise the provisions it is also relevant to note that section 35 ITA provides for an individual to be entitled to a personal allowance (in the relevant tax year the allowance was £11,500) however, in respect of individuals with an adjusted net income in excess of £100,000 the personal allowance is reduced by one half of the excess such that once and individual is in receipt of adjusted net income exceeding £123,000 they were entitled to no personal allowance.

14. Similar income-reducing provisions apply under section 12B to the personal savings allowance such that an additional rate taxpayer has no personal savings allowance, a higher rate taxpayer is entitled to £500 otherwise the allowance is £1000.

SILVER

15. In the case of *Marina Silver v HMRC* [20190 UKFTT 0263 Mrs Silver surrendered a life insurance bond triggering a chargeable event gain on a policy held for 21 complete years. The FTT determined that Mrs Silver's chargeable event gain was £110,721.93 which when added to her other income sources of £31,101 gave her total income at step 1 of the s23 calculation of £141,822. There were no reliefs available to Mrs Silver and as such her net income at the end of step 2 equalled her total income at step 1. By reference to the total chargeable event gain (and before top slicing relief) the FTT determined that Mrs Silver was not entitled to a personal allowance (as her net income exceeded the maximum permissible to be entitled to a personal allowance). As a result of steps 4 and 5 of the section 23 calculation Mrs Silver's tax liability was calculated to be £26,818.33.

16. Step 6 required a calculation and deduction of top slicing relief from the liability calculated at the end of step 5. The FTT applied the provisions of sections 535 and 536 to determine top slicing relief as follows:

> (1) As Mrs Silver had £31,101 employment income and applying the highest part assumption, the majority of her basic rate band had been used against her employment

income. She had £684 of her basic rate band to use in connection with the chargeable event gain. As such her TL – BRL calculation was (684 x 20% plus 110,037 x 40% = 44,150) minus (110,721 x 20% = 22,144) = £22,007.

(2) When performing the section 536 ITOIA calculation the FTT considered that it was required to determine an hypothetical liability on the assumption that the chargeable event gain was 1/21 of the total gain by reference to the section 23 ITA calculation such that:

(a) At step 1 of the section 536 ITOIA calculation the annual equivalent was calculated as £5,272.43 (£110,271 ÷ 21)

(b) At step 2 of the s536 ITOIA calculation and applying the required assumptions (as to: the annual equivalent representing the entire gain, the highest part assumption and applying a basic rate allowance against the chargeable event gain) the FTT considered that it was necessary to perform a full section 23 ITA calculation such that:

(i) (step 1 and 2 of the s23 ITA hypothetical calculation) total and net income was £31,101 + 5,272 = £36,373 (there being no relevant step 2 relief)

(ii) (step 3 of the hypothetical section 23 ITA calculation) Mrs Silver was entitled to deduct her personal allowance as, based on this hypothesised calculation total/net income for the year was £36,373. As such, at step 3 the then annual allowance of £11,000 was deducted from £36,373

(iii) (step 4 – 6 of the hypothetical section 23 ITA calculation) the full amount of the balance of the income was within the basic rate band such that all amounts of tax were treated as paid such that the section 23 ITA liability under the hypothetical calculation was £0.

(c) Step 3 of the section 536 ITOIA calculation required £0 to be multiplied by 21 resulting in £0.

(d) Top slicing relief was then calculated, in accordance with section 535 ITOIA as £22,007.00 - £0 = £22,007.00.

(e) The computed top slicing relief was then used in the actual section 23 ITA calculation at step 6 giving rise to a total liability for the year of £26,818.33 - £22,007.00 = £4,811.33.

17. That conclusion was predicated on a number of critical determinations:

(1) That section 536 ITOIA prescribed the assumptions on which the hypothetical section 23 ITA calculation was to be undertaken (see paragraph [30]).

(2) Parliament's intent for top slicing relief was "obviously" to provide that the tax charged in a single year in respect of income earned over a number of years was to approximate to the charges that would have arisen in each of the years in which the income was earned. "it mak[ing] every kind of sense that the taxpayer should be treated as entitled to the reliefs that that hypothetical income would have entitled her to" (see paragraph [31]).

(3) Applying a literal interpretation and by reference to Parliament's presumed intent top slicing relief was to be calculated applying the section 23 ITA steps "in full" to the hypothetical situation postulated in section 536(1) ITOIA (see paragraph [33]).

18. HMRC appealed the *Silver* judgment but withdrew from it before the Upper Tribunal determined the case.

PARTIES SUBMISSIONS

The Appellant's submission

19. This appeal concerns the basis on which the hypothetical calculation is to be carried out is to be performed for the relevant tax year by reference to the provisions of section 536 ITTOIA (summarised in paragraph 11(6) above) and in particular 1) whether beneficial ordering applied in performing that calculation and 2) whether Mr Young was entitled to take account of the personal savings allowance.

20. The Appellant contends that consistently with the conclusions of the FTT in *Silver* the hypothetical calculation is a full section 23 ITA calculation to step 5. Their contention is rooted in the statutory language in section 536(1) ITTOIA which requires the calculation of the relieved liability to be determined "on the basis that" the gain from the chargeable event is limited to the annual equivalent. They contend that prior to the statutory amendments effective from 11 March 2020 there is no basis to exclude the provisions of section 25(2) ITA when performing the hypothetical calculation such that not only the beneficial ordering of allowances should apply but also that allowances other than the personal allowance should be given in the hypothetical calculation. They contend that doing so ensures that when calculating the amount of top slicing relief required to be deducted at step 6 of the actual section 23 ITA calculation full force and effect is given to section 25(2) to ensure that the calculation results in the greatest reduction in the individual's tax liability for the year.

21. The application of beneficial ordering is, in the Appellant's submission, of particular importance when performing the hypothetical s536 ITTOIA calculation in the context of the provisions of section 530 ITTOIA and the application of the notional tax credit. The Appellant contends that, in accordance with section 25(2) ITA allowances require to be allocated before application of the notional tax credit as doing so results in the greatest reduction in the taxpayers liability to income tax. The Appellant contends that as s530 ITTOIA does not reduce the taxpayer's liability to income tax under section 23 ITA and instead deems the taxpayer to have paid income tax at the basic rate, the amount to be minimised under s25(2) ITA is the section 23 ITA liability without reference to the amount treated as paid under section 530 ITTOIA. The Appellant draws a distinction between the tax liability and the amount of tax payable (which in a section 530 ITTOIA situation may be different).

22. The Appellant also contends that when performing a "full" section 23 ITA calculation it is appropriate to calculate the individual's entitlement to other income-reduced allowances, including the personal savings allowance, by reference to the annual entitlement and not by reference to the whole chargeable event gain.

23. In their submissions the Appellant accepts that HMRC's calculator has, throughout the period of self-assessment calculated top slicing relief in accordance with the view that they currently take of the legislation. However, the Appellant notes that prior to 6 April 2010, and the introduction of the income-based restriction on a taxpayers personal allowance, the difficulties identified in *Silver* and as present themselves now in respect of beneficial ordering and to more recently introduced allowances and focused rate bands did not arise.

24. The Appellant's calculation of Mr Young's tax liability pursuant to section 23 ITA is as follows:

(1) Mr Young has total income in the tax year of £49,460 pension/employment income, £185 interest, £52 dividends and £223,815 chargeable event gain

(2) He has no relevant relief under step 2

(3) He has no entitlement to personal allowance or to personal savings allowance as such beneficial ordering pursuant to section 25(2) ITA has no application.

(4) Tax due at each applicable rate:

Basic rate on £33,500 of his employment/pension income	£ 6,700.00
Higher rate on:	
£15,960 of his employment/pension income	£ 6,384.00
£185 bank interest	£ 74.00
£100,303 chargeable event gain	£ 40,121.20
Additional rate on £123,515 chargeable event gain	£ 55,580.40

(5) Add together amounts due at step 4 **£108,859.60**

(6) Deduct section 530 ITTOIA tax treated as paid (£223,815 x 20%) together with top slicing relief calculated as follows:

(a) Section 535(1) ITTOIA provides that top slicing relief shall be calculated by comparing the calculation required un section 535(3) with that at section 536(1).

(b) Section 535(3) calculation:

Mr Young is not entitled to personal allowance, personal savings allowance or dividend allowance on the basis total income for the year including the chargeable event exceeds the prescribed limit.

Total tax liability on income from all sources (£49,460 employment/pension, £185 interest, £52 dividend and £223,815 chargeable event gain) is calculated applying the basic, higher and additional rate bands is £108,859.60 calculated as above)

Thus total liability to tax on the chargeable event gain (£100,303 x 40% + £123,515 x 45%) = **£95,701.60**

TL – BRL (£95,701.60 – (£223,815 x 20%) = **£50,938.50**

(c) Section 536(1) calculation:

Three policies: two with gains of £66,989 and £102,651 respectively were held for 23 years and one with a gain of £54,174 was held for 22 years.

Step 1 - Annual equivalent of gain: (£66,989 + £102,651)/23 + £54,174/22 = £9,838

Step 2 – calculate individual's liability to income tax on the annual equivalent on the basis it is the top slice of income but otherwise undertaking a full section 23 ITA calculation (including the beneficial ordering required by s25(2) ITA):

- Mr Young's total income is £49,460 + £185 +£52 + £9,838 = £59,535
- Personal savings allowance allocated so as £185 to the interest and £315 to the chargeable event gain (maximum £500 as Mr Young, even on this hypothesised calculation, remains a higher rate taxpayer)
- Personal allowance allocated so far as possible to the chargeable event gain (£9,838 - £315 = £9,523) and remainder £1,977 to pension/employment income.
- Dividend allowance applies
- As there is no charge to tax on the annual equivalent of the chargeable event gain as it is fully relieved by his personal and personal savings allowance

- In accordance with section 530(3) – (5) ITTOIA the basic rate credit is reduced by reference to any deductions under steps 2 and 3 of section 23 ITA as such BRL too is nil (the calculations provided by the Appellant showed BRL as £63 – it is unclear how that figure was derived)

(d) As per the calculation in section 535(1) ITTOIA by reference to the above calculations top slicing relief is £50,939 - £0 = **£50,939**

Total tax liability for the year: £108,859.60 - £50,939 - £44,763 = **£13,157.60**

HMRC's submissions

25. HMRC contend that the intention of top slicing relief, since its introduction in 1968, has been to alleviate the impact of a higher tax charge in the year of receipt of the chargeable event gain the taxpayer would have otherwise been subject. As such it prevents a basic rate taxpayer from being taxed at the higher rate or a higher rate taxpayer becoming an additional rate taxpayer solely because of the chargeable event gain and effectively caps the ratew of tax payable on the gain.

26. In support of that contention they refer to the Explanatory Notes for section 535 ITTOIA 2005 which provides that top slicing relief is:

> 2102 … a relief where the gain charged … takes an individual's taxable income into the higher rate of tax.
>
> 2103 The relief is given by reducing the amount of tax charged on the gain …
>
> 2104 The relief reduces or eliminates the higher rate charge. …The relief is calculated by comparing the tax chargeable on the gain … with the tax that would be chargeable on a fraction of the gain, in both cases after setting off the appropriate income tax allowance under section 530. …The relief is the difference between the tax otherwise chargeable on the full gain and the tax that would be charged if the full gain were taxed at the rate of the tax chargeable on the fraction.

27. They further prey in aid the amendments introduced with effect from 11 March 2020 by the Finance Bill 2020. HMRC contend that the amendments summarised at paragraph [12] above were aimed at ensuring that top slicing relief was applied in a consistent and fair way.

28. They contended that the amendment to step 2 of section 536(1) specifically legislated to permit recalculation of the personal allowance where the individual lost their entitlement to it solely as a consequence of the chargeable event gain. They contend it addressed the inequity highlighted in *Silver* but did not amend the amount of personal allowance available to the taxpayer in the wider income tax calculation. They state *Silver* was given statutory effect by the amendment which has then been applied on a concessionary basis to any individual in the same position as Mrs Silver.

29. However, HMRC do not accept that the calculation to be performed is the section 23 ITA calculation. Rather, they contend that it is a self standing calculation to be undertaken on its own terms. The skeleton and argument on this point was, somewhat ambiguous (presumably given the clear statement in *Silver* to contrary effect) as HMRC submitted that "even if" they accepted that a section 23 ITA calculation was required, the effect of section 25(2) ITA was not as contended for by the Appellant. HMRC's interpretation of section 25(2) ITA is that beneficial ordering applies so as to secure the lowest amount of tax payable rather than the lowest charge to income tax.

30. As to the amendment introducing section 535(8) ITTOIA HMRC assert that its effect is to confirm that the personal allowance, whether recalculated or otherwise must be set against

all other sources of income in preference to the chargeable event gain when calculating the top slicing relief. It was repeatedly asserted that the amendment was a clarification. Support for the status of the amendment as a clarification was stated to be derived from the prior practice of HMRC's calculator, the Insurance Policholder Taxation Manual, the Explanatory Notes for the 2020 amendments and to the statements made by Jesse Norman MP (then Financial Secretary to the Treasury) in the Public Bill Committee debate on 9 June 2020.

31. Without the interpretation HMRC contend has now been clarified in statute, and by applying beneficial ordering they say there was a risk taxpayers would derive the benefit of the personal allowance twice in each of the tax years in respect of which the chargeable event gain accrued.

32. HMRC contend that the risk of a double personal allowance being taken was enhanced post 2007 when section 535(7) ITTOIA was introduced which explicitly excluded from the step 2 calculation only gift aid relief thereby potentially reintroducing personal allowances where no personal allowances were available in the main income tax calculations. They contend that the amendment thereby provided the necessary instruction on what to do with the reinstated personal allowance.

33. HMRC seek to illustrate that the Appellant's calculations are incorrect by a comparison to the tax calculation assuming no chargeable event gain had occurred at all. In that circumstance and by reference to all income sources Mr Young's total liability for the tax year would have been £8,484 (total income from employment/pensions, dividends and interest and allowing for the personal allowance, nil rate effect of personal savings allowance tax liability at basic and higher rate bands). And yet despite a gain of £223,815 total income tax liability for the year is on the Appellant's calculation £13,158 resulting in a tax charge on the gain of only £4,674 which, they say, arises only from the loss of the personal and personal savings allowance and not to the chargeable event gain itself. This, they contend, is contrary to the purpose of top slicing relief as described by Jesse Norman on 9 June 2020 at the Parliamentary Bill Committee. HMRC contend that the Appellant's calculation provides for excessive relief which goes significantly beyond the legislative intent of removing an additional rate tax charge.

34. On the question of the availability or otherwise of the personal savings allowance when undertaking section 536(1) ITTOIA calculation HMRC contend that the calculation (both pre and post the introduction of section 536(1) step 2 (a)(iii) amendment)cannot have included the reintroduction of the personal savings allowance at least on the grounds that by adjusting the annual equivalent of the chargeable event gain by reference to the personal savings allowance before multiplying the resultant tax liability by N it would have the effect of giving the personal savings allowance in years prior to its introduction in tax year 2016/17.

35. In their skeleton HMRC set out the steps that, by reference to their interpretation of the legislation applied and in Annex A applied the steps and calculated Mr Young's charge to tax (as assessed).

(1) Calculating total income for the tax year and identify how much of the gain falls within the starting rate for savings, personal allowance nil rate, basic, higher or additional rate bands.

Pension/employment income	£ 49,460
Interest	£ 185
Dividends	£ 52
Chargeable event gain	£ 223,815
Total	£ 273,152

Although Appendix A does not then show it (despite step 1 articulating it) the calculation which follows from their step 1 determines tax liability at this stage as **£108,859.60**.

This is on the basis that Mr Young was not entitled to the personal allowance or personal savings allowance and applying the highest part assumption, Mr Young's basic rate band was allocated to his pension/employment earnings, leaving £15,960 of his pension/employment earnings taxable at the higher rate. His interest income too was taxed at the higher rate. The dividend tax nil rate band was applied to his dividend income excluding it from the charge to income tax. The consequences that follow are that £100,303 of the chargeable event gain, without top slicing relief, would be taxable at the higher rate and £123,512 at the additional rate..

(2) Calculate the total tax due on the chargeable event gain across all tax bands and deduct the basic rate tax treated as paid under section 530 ITTOIA. The Tribunal notes that the skeleton refers to the output of this step as determining TL. By reference to the terms of section 535 ITTOIA that sum is not TL, somewhat obviously, it is the product of TL – BRL.

Tax on gain on policy at higher rate	£ 40,121.20
Tax on gain on policy at additional rate	£ 55,580.40
TL for section 535 purposes	£ 95,701.60
Less BRL (£223,815 x 20%)	£ 44,730.00
Individual's liability for the tax year	**£ 50,938.60**

(3) Calculate the "annual" equivalent for each gain dividing by N where N is there number of years that each policy has been held and add them together.

Mr Young had 3 policies each giving rise to a chargeable event gain; two of the policies (with gains of £66,989 and £102,651) had been held for had been held for 23 years and one (with a gain of £54,174) for 22.

The annual equivalent of the three policies was calculate as **£9,838.00**

(4) Calculate the individual's liability to tax on the annual equivalent by reference to a calculation which determines entitlement to personal allowance by reference to the annual equivalent of the chargeable event gain applying the highest part assumption and deduct the basic rate tax treated as paid on the annual equivalent (though not stated, in HMRC's skeleton this step is the consolidation of what are described as steps 2 and 3 un section 536(1) ITTOIA) and deduct the basic rate liability .

Total income for My Young by reference to the annual equivalent is **£59,535** (income from employment/pensions £49,460, interest £185, dividends £52, annual equivalent £9,838)

With income at that level Mr Young is entitled to his full personal allowance but remains a higher rate taxpayer.

As such the tax due on the chargeable event gain at this step is calculated as

Chargeable event gain	£ 9,838	
Taxed charge at higher rate		£ 3,935.00
Less basic rate		£ 1,967.60
Tax liability on annual equivalent		£ 1,967.60

(5) Multiply the result at (4) by the total chargeable event gain liable to tax in the year then divide the result by the total annual equivalent at (3) to give total relievable liability.

£1,967.20 x £223,815 ÷ £9,838 = **£44,763**

It is to be noted this is not the precise calculation prescribed in section 536(1) step 3, though it produces the same result. Step 3 references multiplying the annual equivalent by N. As Mr Young had 3 individual policies which represent the single gain and the policies ran for different periods the calculation prescribed requires the following calculations

Policy 1 - gain £66,989 N 23	
Tax liability on annual equivalent	
£2,912.57 x 40% = £1165.03 x 23	£ 26,795.69
Policy 2 – gain £102,651 N 23	
Tax liability on annual equivalent	
£4,463.09 x 40% = £1,785.24 x 23	£ 41,060.52
Policy 3 – gain £54,174 N 22	
Tax liability on annual equivalent	
£2,462.45 x 40% = £984.98 x 22	£ 21,669.56
	£ 89,525.77
Less basic rate	£ 44,762.89
Total relievable liability	**£ 44,762.89**

(6) Deduct the total relievable liability at (5) from total liability at (2) to give top slicing relief.

£50,938.60 - £44,763	**£ 6,165.60**

(7) Tax payable in the year:

Tax liability before top slicing relief	£108,859.60
Less top slicing relief	£ 6,175.60
Section 23 ITA liability	£102,684.00
Less section 530(1) ITTOIA credit	£ 44,763.00
Tax payable	**£ 57,921.00**

The Appellant's reply

36. In reply to HMRC's case the Appellant contends that the basis of calculation for which it advocates does not result in the personal allowance being given twice because tax liability is determined only by reference to the actual and not the hypothetical section 23 ITA calculation in which the personal allowances (and other allowances) are given only once.

37. The Appellant challenge's any attempt by HMRC to rely on the explanatory notes to the Finance Act 2020 and Hansard debate material as inappropriate on the basis that there is no ambiguity in the statutory provisions to be interpreted by the Tribunal. The Appellant refers to *Pepper v Hart* [1992] UKHL 3 (***Pepper v Hart***).

38. HMRC's assertion that the interpretation advocated for by the Appellant is administratively complex and costly to apply is both denied by the Appellant and considered, in any event, to be irrelevant.

39. The Appellant contends that the policy intent behind top slicing relief is not as asserted by HMRC, and is not limited to mitigating the impact of higher and additional rate tax charges, but rather, it is to mitigate tax liability of all elements of the tax calculation which might be impacted by the inclusion of a one off tax charge which accrued over several years.

40. In connection with HMRC's submission as to the effect of the highest part assumption, the Appellant emphasises the statutory language of section 535(4) ITTOIA as requiring only that the chargeable event gain be treated as the highest part of the individual's total income when calculating liability to income tax and not that it be subject to tax after all other sources of income have been taxed.

DISCUSSION

41. It is the task of this Tribunal to interpret the statutory provisions set out in outline above (and as annexed). The basic tenets of statutory interpretation apply such that the Tribunal is to look to achieve the purpose of the statutory provisions by reference to the language used in context.

42. The Appellant submits the exercise when calculating the amount of top slicing relief is plain from the clear language of the statute prior to amendment. Top slicing relief is calculated as the difference between the tax charge calculated pursuant to the section 23 ITA on the chargeable event gain assuming it to be the highest part of income and the same calculation undertaken "on the basis that" the gain is hypothesised as being limited to the annual equivalent. The sum calculated by reference to the hypothesised annual equivalent is then deducted from the actual section 23 ITA calculation to give the tax liability for the year.

43. As set out at [12] above with effect from 11 March 2020 the provisions of section 536(1) were amended to introduce the assumption that the chargeable event gain was to be limited to the annual equivalent when performing the section 536 ITOIA calculation only in connection with an assessment of entitlement to personal allowance; and section 535 ITOIA was amended to expressly provide that the beneficial ordering provisions were to be excluded and that reliefs and allowances were to be applied to the chargeable event gain to the extent not utilised against out components of total income.

44. HMRC contend that the amendments and certain extra statutory material should be used to confirm that their submission that the hypothesised calculation by which top slicing relief is determined is limited in scope.

45. HMRC's submissions give rise to some complex interpretive issues on which neither they nor the Appellant provided the Tribunal with much assistance in resolving. Though with respect to Mr Good he provided more assistance than HMRC, whose role it really should have been. HMRC essentially submit that the Tribunal should interpret the pre amended legislation as if the amendments had retrospective effect.

46. Dealing firstly with the submission that the amendments act as an aid to interpretation of the pre-amended legislation.

47. In *DSG Retail Ltd v Dixons Retail Group Ltd* [2020] EWCA 671 it has been stated:

> 57 … In the course of argument, a lengthy debate took place as to whether or not it was appropriate to use later primary and delegated legislation to interpret earlier legislation. Many authorities were cited, most of which were referred to in customarily erudite passages from Bennion on Statutory Interpretation at sections 24-19 and 26-10 under the respective headings: "Inferences from later Acts" and "Law should be coherent and self-consistent". The principle stated under section 24-19 is that "[w]here the legal meaning of an enactment is doubtful, subsequent legislation on the same subject may be relied on as

> persuasive authority as to its meaning". It is perhaps sufficient to record that Lord Sterndale MR in *Cape Brandy Syndicate v. Inland Revenue Commissioners* [1921] 2 KB 403 at page 414 emphasised the point that the legislation being construed had first to be shown to be ambiguous when he said:
>
> > "I think it is clearly established in *Attorney-General v Clarkson* [1900] 1 QB 156 that subsequent legislation on the same subject may be looked to in order to see what is the proper construction to be put upon an earlier Act where that earlier Act is ambiguous. I quite agree that subsequent legislation, if it proceed upon an erroneous construction of previous legislation, cannot alter that previous legislation; but if there be any ambiguity in the earlier legislation then the subsequent legislation may fix the proper interpretation which is to be put upon the earlier".

48. The section of Bennion referenced in *Dixons* goes on to state that "where one construction would render a later Act superfluous the presumption that the legislature does nothing in vain may be relevant."

49. It is plain that the interpretation to be applied by HMRC would render the amendments superfluous and in vain. As such unless it can be established that the pre-amendment legislation was sufficiently ambiguous that it required clarification and that clarification was the legislative purpose for the amendments the later amendments would indicate that the interpretation contended for my HMRC would be unlikely to succeed.

50. That therefore begs the question as to whether the terms of section 536(1) ITTOIA in context is ambiguous or unclear.

51. Judge Mosdale considered they were clear. In this regard she stated:

> "This takes us back to s 23 ITA and the steps for calculating liability".

52. The very premise of the judgment is that the calculation required to determine relieved liability (pursuant to in both *Silver* and here, section 536 ITOIA) for the purposes of determining top slicing relief under section 535 ITOIA is to replicate the section 23 tax liability calculation "in full" on the assumptions then prescribed i.e. that the chargeable event gain was the annual equivalent and that it represented the highest part.

53. It is accepted that she was not considering the question of beneficial ordering or whether other allowances were to be given effect in the calculation but a "full" section 23 ITA calculation would, it appears to this Tribunal, somewhat obviously import all provisions relevant to performing that calculation and involve all allowances and beneficial ordering.

54. *Silver* was an FTT judgment and, as such, it is not binding on this Tribunal. Consideration was given as to whether the fact that HMRC appealed *Silver* and subsequently withdrew from the appeal meant that the judgment itself could be given the status of that of having been given by the Upper Tribunal, but it was concluded that was not the case.

55. There is, however, significance in HMRC's appeal and withdrawal in the context of the principle of judicial comity. Judicial comity forms part of the principle of precedent. Both comity and precedent are rooted in the principle of *stare decisis* which requires courts to honour the findings of law made in earlier cases, in the case of precedent by a higher court and in the case of comity by co-ordinate courts. As set out in the case of *HMRC v Abdul Noor* [2013] UKUT 071 [82] it is the reasoning by reference to which a decision or judgment is reached that should be followed unless considered to be wrong.

56. HMRC litigated *Silver* on the basis that the hypothetical recalculation did not permit account to be taken of a personal allowance which had been reduced as a consequence of the

chargeable event gain and they lost. An appeal must have been lodged on the basis that Judge Mosedale had made an error of law. But it was subsequently withdrawn in close proximity to the making of a legislative amendment. Therefore there must be a strong indication that the judgment was not wrong but that ministers were concerned that the interpretation adopted would carry consequences which had not been addressed in *Silver*. Legislation was therefore introduced and ultimately enacted to address those consequences of which the facts of this case are an illustration. It is somewhat difficult to conclude that applying the legal principles determined by Judge Mosedale to the facts of this case the factual differences would impact her decision a full section 23 ITA calculation is required. A full calculation s23 ITA calculation is a full section 23 ITA calculation whether HMRC like the outcome or not.

57. However, the Tribunal agrees that the result contended for by the Appellant appears to be generous. As HMRC contend beneficial ordering appears to have the effect that the benefit of the personal and any other allowances could, in effect, be given twice for the years in respect of which chargeable event gain accrued.

58. For Mr Young personal allowance is only given once in the section 23 ITA calculation under either HMRC's or the Appellant's calculations as under the non-hypothetical section 23 ITA calculation he has no personal allowance. However, the Tribunal agrees that by reallocating the personal allowance to the chargeable event gain for the purposes of the hypothetical calculation an allowance that has (or at least may have) been actually given in previous years against other income has the effect of being given again at the last step of the section 536(1) ITTOIA calculation when the annual equivalent it multiplied by N and the result used by virtue of section 535(1) ITTOIA to calculate the sum deducted at step 6 from the actual section 23 ITA calculation for the tax year in question.

59. The same result will also arise, on HMRC's interpretation and by reference to the amended provisions, in a year in which there is a chargeable event gain and the individual has no other income against which the personal allowance has been set or which otherwise reduces the personal allowance. HMRC appeared to acknowledge this but considered that the circumstances in which this would arise were limited.

60. HMRC did not plead, or indeed actually argue, that there was any ambiguity in the statutory provisions however, as set out in paragraph [25] above they relied on the explanatory notes for section 535 ITTOIA, and the notes were included in the bundle.

61. Explanatory notes have accompanied most public general Acts since 1999. The text of such notes are prepared by the Government department responsible for the legislation. They do not form part of the Bill, are not endorsed by Parliament and cannot be amended by Parliament. They aim to explain the effect of the text and are not intended to justify it. They are updated in light of the changes made to a Bill through the parliamentary process.

62. It has been clear, at least since the judgment of the House of Lords in *Westminster City Council v National Asylum Support Service* [2002] 1WLR 2956 that explanatory notes may be used as a means of establishing the relevant statutory context in which to interpret the language used. In this context Lordy Slynn confirmed:

> 5. … The starting point is that language in all legal texts conveys meaning according to the circumstances in which it was used. It follows that the context must always be identified and considered before the process of construction or during it. … ambiguity need not be established before the surrounding circumstances may be taken into account. … Insofar as the Explanatory Notes cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are therefore always admissible ais to construction. They may be admitted for what logical value they have."

63. However, he also noted a caution:

> 6. …What is impermissible is to treat the wishes and desires of the Government about the scope of the statutory language as reflecting the will of Parliament. The aims of the Government in respect of the meaning of clauses as revealed in Explanatory notes cannot be attributed to Parliament. The object is to see what is the intention expressed by the words enacted."

64. This note of caution has been more recently reinforced by the Court of Appeal in *Flora v Wakom (Heathrow) Ltd* [2006] EWCA Civ 1103 in which Brooke LJ stated:

> 16 … The value of … Explanatory Notes as an aid to construction … is that it [sic] identifies the contextual scene … That is all. If, however, it is impossible to treat the wishes and desires of the Government about the scope of the statutory language as reflecting the will of Parliament, it is in my judgment equally impossible to treat the Government's expectations as reflecting the will of Parliament. We are all too familiar with statutes having a contrary result to that which the Government expected through no fault of the courts which interpreted them.

65. It is therefore entirely permissible and appropriate that this Tribunal to take account of the Explanatory Notes for ITTOIA 2005 at its introduction. HMRC included the note to section 535 as set out above in paragraph [26]. Taken alone the notes appeared to lend some support for their contention that the intent underpinning top slicing relief was only to provide relief in respect of the rate at which the chargeable event gain was to be taxed: "The relief is the difference between the tax otherwise chargeable on the full gain and the tax that would be charged if the full gain were taxed at the rate of the tax chargeable on the fraction" (emphasis added).

66. However, HMRC did not also reference the Explanatory Notes to section 536 ITTIOA. Those notes state:

> 2109 The method employed in subsection 1 takes three steps. … The second calculates the net tax charge that would apply to that fraction. The third step works out the tax on the whole gain (called "relieved liability") by multiplying the tax calculated under step 2 by the factor ("N" – see step 1) which was used to find the fraction. (emphasis added).

67. Section 536(1) ITTOIA step 2 states that the relievable liability on the annual equivalent is found by "calculating the individual's liability (if any) to income tax" on the annual equivalent. Section 23 ITA is headed "The calculation of income tax liability" and section 23(1) expressly provides "to find the liability of a person … to income tax…". It is thus clear, by reference to the statutory language used the step 2 section 536(1) ITTOIA calculation is that required under section 23 ITA to determine "the net tax charge" i.e. net of allowances and reliefs as provided for under Chapter 3 of Part 2 ITA (sections 22 – 32) and including prior to the enactment of section 535(8) ITOIA, section 25(2) ITA such that beneficial ordering applies.

68. The output of the section 536 ITTOIA calculation and the top slicing relief given then determines the rate of tax to be applied by reference to the net tax charge on the fraction.

69. The Tribunal considers that the Explanatory Note for section 536 ITTOIA provides some clarity that there was legislative intent that the section 536(1) ITTOIA calculation was intended to be a full section 23 ITA calculation. At that time it was unincumbered with the complexity later introduced by a reducing personal allowance and the addition of new allowances such as the personal savings allowance.

70. The Tribunal also finds no support for HMRC in the Explanatory Notes for the 2007 amendment introducing section 535(7) ITTOIA. Contrary to HMRC's submission that that

provision increased the risk of double counted relief the notes make clear that gift aid and gifts of shares to charities were always excluded from the top slicing relief calculation:

> This amendment addresses the provisions relating to chargeable event gains within Chapter 9 of Part 4 of ITTOIA. Relief under Chapters 2 (gift aid) and 3 (gifts of shares etc to charities) of Part 8 of this Act is not taken into account in computing top slicing relief. In the source legislation these provisions were in section 25(6) of FA 1990 (gift aid) and section 587B(2) of ICTA (gifts of assets etc). They are now located with the top slicing provisions themselves.

71. The Tribunal considers that had Parliament wished to exclude beneficial reordering and/or personal savings allowance in the same way as gifts were excluded the legislation would have so provided. As it now does, following the 2020 amendments.

72. HMRC did not include the Explanatory Notes for the Finance Act 2020. They provide:

> … 3. Subsection 2 inserts new subsection (8) in section 535 of ITTOIA to confirm that for the purposes of the TSR calculations:
>
> - The rules of reliefs and allowances at section 25(2) of ITA 2007, that require reliefs and allowances to set off income in a way that results in the greatest reduction in an individual's income tax liability, do not apply; and
> - an individual's reliefs and allowances must be deducted from other income before being deducted from the gain.
>
> 4. Subsections 3 and 4 confirms the calculation of the income tax liability on a proportion of the gain as required within the calculation of TSR in sections 536(1) and 537 of ITTOIA 2005. The clarifications allow the individual's personal allowance, but not any other relief or allowance, to be calculated as though the gain from the chargeable event is limited to the proportion of the gain.

73. The Tribunal has some concern at referencing Explanatory Notes which relate to later legislation when the terms of the legislation, as interpreted by the FTT in circumstances in which it is right to apply the principle of comity, are clear and for which no contrary view is evident in the Explanatory Notes to the legislation to be interpreted. It is acknowledged that these Explanatory Notes state that the provisions "confirm" the principles outlined. However, mindful of the warning of Brooke LJ as set out in paragraph [64] above the Tribunal considers that to interpret the pre amendment language by reference to this note is at risk of treating the "wishes and desires" of HMRC about the historic scope of the statutory language as reflecting the will of Parliament.

74. Judge Mosedale's judgment considered that section 536(1) ITTOIA had a contrary result to that which HMRC had argued, that result was wider than HMRC was prepared to accept and/or envisaged for the relief but this Tribunal agrees that it was the effect which the language used had. That now has been corrected.

75. Mr Young's estate has been taxed by reference to calculations which, on the basis that he had similar levels of pension/employment income in the years prior to his death, do have the effect of reducing the chargeable event gain by reference to allowances for which he has already had the benefit but that is as a consequence of the incorporation of section 23 ITA as the means by which section 536(1) step 2 calculates "the individual's liability … to income tax" on the basis only of the specified assumptions when performing the calculation at section 535 ITTOIA which, prior to 11 March 2020, did not exclude other allowances or beneficial ordering.

76. On the relevance of the material adduced by Mr Smith from Hansard in respect of the Parliamentary Bill Committee debates: since *Pepper v Hart* it has been permissible to use such material where three conditions are met: 1) the provision is ambiguous or obscure, or leads to an absurdity, 2) a statement as to the meaning of the provision is made by or on behalf of a minister or other promoter of the Bill; and 3) the statement is clear. That this is the approach to be adopted has been affirmed, in a tax appeal context, by the Upper Tribunal in *Christianuyi Limited and others v HMRC* [2018] UKUT 10 at paragraph [25] – [26].

77. This approach to the material adduced by HMRC was also confirmed by the Upper Tribunal in *HMRC v Inverclyde Property Renovation LLP and others* [2020] UKUT 161 (see [43]).

78. The Tribunal acknowledges that the result advocated by the Appellant is a very generous one however, the Tribunal considers that it is the only interpretation available on the language chosen by Parliament by reference to the pre amendment Explanatory Notes. For the reasons stated the Tribunal considers that the Finance Act 2020 amendment Explanatory Notes are insufficient to shed meaningful light on the intent of Parliament of as regards the relationship between section 23 and 25 ITA and sections 535 and 536 ITTOIA prior to the amendment.

79. In any event, the Hansard extracts certainly say no more than the Explanatory Note to assist HMRC. Mr Norman MP describes the clauses giving rise to the amendments as "changes" and reference changes to the personal allowance rules post 2010 which have added to complexity in the calculation of top slicing relief. He goes on to state explicitly that the amendment introducing section 536(1) step 2 (a)(iii) ITTOIA is a change. As such there can be little room for HMRC to contend that prior to 11 March 2020 the Appellant was entitled to include the personal savings allowance at step 2 of the section 536(1) ITTOIA calculation. Mr Norman also refers to the amendment introducing section 535(8) ITTOIA as a clause which will "put beyond doubt" that beneficial ordering should not apply thereby at least acknowledging that there was doubt as to the position prior to the amendment. The Tribunal considers there was in fact, no doubt, there was a difficulty in the operation of the provisions and that has now been remediated.

DISPOSITION

80. For the reasons stated the appeal is allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

81. 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.

AMANDA BROWN QC
TRIBUNAL JUDGE

Release date: 18 FEBRUARY 2022