TC01627

Appeal number: TC/2010/08880

Income tax – insurance policy chargeable events – bond issued comprised of 20 individual life insurance policies or "segments" – partial surrenders of bond – unclear whether surrenders effected as equal partial surrender of each segment or as total surrender of a number of segments – policy documents ambiguous on the point – requests for withdrawals by the Appellant did not address the point – insurance company certificates unreliable and demonstrating underlying administrative chaos – held that contractual documents provided the framework – if on a true construction they also answered the question, then that answer was definitive – otherwise, other evidence of how the surrender was structured, if consistent with the legal framework of the policy, could provide the answer – otherwise, general legal principles would apply. Held – contractual documents, on their true interpretation, showed that the partial surrenders were effected equally across all policies. If this was wrong, held no cogent evidence provided as to the basis actually applied, therefore general principles would apply – equitable maxim "equality is equity" applied – default position would therefore also be equal partial surrender across all policies – appeal dismissed in principle

FIRST-TIER TRIBUNAL

TAX

MARTIN HEDLEY ROGERS **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS (income tax) **Respondents**

TRIBUNAL: **KEVIN POOLE (TRIBUNAL JUDGE)**
GORDON MARJORAM FCA

Sitting in public in Birmingham on 30 September 2011

Gary Rooney of RTS Investigations Limited (trading as Rooney Tax Services) for the Appellant

Alan Hall, Presenting Officer of HMRC for the Respondents

DECISION

Introduction

1. This appeal arises out of the complex "chargeable events" provisions contained in Chapter 9 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA").

2. Chapter 9 is headed "gains from contracts for life insurance etc." and sets out a number of charges to income tax that can arise from such contracts.

3. The Appellant invested in an offshore life assurance bond which was subdivided into 20 individual policies or "segments". Generally it is possible to withdraw up to 5% of the original sum invested each year without triggering a tax liability under the "chargeable events" provisions, but the Appellant's circumstances changed and he withdrew far more than that during the relevant year. HMRC therefore seek to make him liable for income tax on the excess, on the basis that he has effected partial surrenders of all 20 of the segments in the bond.

4. The Appellant disputes his liability, arguing that in fact he has totally surrendered a number of segments, and partially surrendered just one segment. The effect of this would be to substantially reduce his tax liability, as the amount received on the total surrender of a segment would give rise to little or no tax liability (due to the fact that there had been little or no increase in value of the segment since inception) and the amount received on the partial surrender of just one segment would be far smaller (thus triggering a much smaller overall tax liability).

5. The dispute arises because the basis of the withdrawals made by the Appellant is unclear. HMRC argue that partial surrender of each segment or policy within the bond took place on each withdrawal – "horizontal" surrender as the parties called it; the Appellant argues that on each withdrawal, a total surrender took place of a number of segments or policies plus partial surrender of one – "vertical" surrender, as the parties called it.

6. At this stage, we are asked to decide simply whether "horizontal" or "vertical" surrender is the correct treatment of the withdrawals that were made. The parties are confident that once this has been established, there will be no dispute between them as to the tax liabilities arising as a result.

7. A number of copy documents were submitted in evidence. We also heard oral testimony from the Appellant.

The Facts

Events leading up to the Appellant's investment

8. The Appellant, for personal reasons which are not relevant to this appeal, found himself with a large capital sum which he wished to invest to provide himself with a tax efficient income.

9. Having taken advice from an independent financial adviser, in November 2004 he invested £85,000 in a "Transact Offshore Bond" ("the Bond") issued by Isle of Man Assurance Limited (incorporated in the Isle of Man) ("IOMA"). We should mention at the outset that the Appellant accepted that IOMA had not been responsible for providing any tax advice to him at any stage, indeed it knew nothing of his tax position. All tax advice was provided by his independent financial adviser.

10. The Appellant's investment was made through a "Transact" portfolio, which appears to have been a management service offered by a UK company called Integrated Financial Arrangements plc ("IFAplc"). There was no suggestion before us that the investment through the "Transact" portfolio had any implications for the correct tax treatment of the Bond. The "Transact Key Features Document & Terms and Conditions" governing the terms of the "Transact" portfolio which were provided to us were dated July 2005 and clearly therefore could not have applied at the time the Appellant made his investment, but we see nothing in those terms to suggest that they reflected a major change from the previous arrangements or that the Transact portfolio was anything other than a portfolio management service for assets (and in particular, various structured investment products, including the Transact Offshore Bond and other products carrying the "Transact" name) intended to be beneficially owned by the Appellant. No argument to the contrary was raised by either party. We were not informed of any other assets comprised in the Appellant's Transact Portfolio apart from the Bond.

11. We therefore find that whatever terms applied to the "Transact" portfolio in November 2004 when the Appellant invested, they do not directly affect the correct tax treatment of the Bond, which was the Appellant's sole underlying investment; we find the Appellant to be the beneficial owner of the Bond.

12. Mr Rooney also sought to persuade us that we should have regard to a particular provision in the portfolio terms and conditions to assist us in unravelling the detail surrounding the surrender, and we consider that point later in this decision. For these purposes, we should record that the document headed "Key Features of Transact & The General Investment Account" which was provided to the Appellant at some time in or after July 2005, contained the following wording under the heading "**What is my tax position?**":

> "Your General Investment Account is itself "tax neutral" – which means that buying, holding and selling your investments through it will not increase or reduce any resulting tax liabilities."

The contractual documents

13. We were provided with a copy of the application form signed by the Appellant when he applied for the Bond. It is dated 2 November 2004. In it, he requested regular monthly withdrawals of £293 per month, to be paid direct to his bank. He also specified that his investment should be split equally into 20 different segments. A note in the relevant section of the form said:

> "Any regular withdrawal payments will be provided by equal partial surrender of each policy within your Transact Offshore Bond."

14. We note that the regular monthly withdrawals of £293 would amount to £3,516 per year, well below the 5% limit of £4,250 for tax-free withdrawals if applied equally across the 20 policies comprised in the Bond.

15. We were also provided with copies of the standard terms and conditions applying to the Bond at the time it was taken out, and of a "Schedule" to those terms and conditions which recorded an initial premium of £85,000 and a commencement date for the policy of 25 January 2005. The proposer and life assured were both given as the Appellant.

16. In the "Glossary of Terms" at the start of those standard terms and conditions ("the 2004 Terms"), the following terms (amongst others) were defined as having the meanings respectively ascribed to them:

> "Bond or 'Transact Offshore Bond' – The Transact Offshore Bond underwritten by IOMA and consisting of the Policies."
>
> "Instruction – An instruction received by IOMA in connection with the Bond, any Policy or the Portfolio in accordance with the Policy Provisions."
>
> "Policies – All single premium unit-linked whole of life assurance policies issued by IOMA, comprising the Bond and in force at any time, the numbers of which appear in the Policy Schedules."
>
> "Policy Provisions – The standard policy terms and conditions and any special policy terms and conditions included in the Policy Schedule, any Supplementary Policy Schedule and any endorsement(s) on any of them all as amended from time to time."
>
> "Policy Schedule – The policy schedule issued by IOMA which includes details of the Policyholder(s) of the single premium unit-linked whole of life assurance policy issued following acceptance by IOMA of an application for the Transact Offshore Bond and the number identifying such policy."

17. The following paragraphs also appeared in the 2004 Terms, under the heading "**2.3 Partial and Full Encashment**":

> "Partial Encashment
>
> (1) The Policy holder(s) may request IOMA to encash part of the Bond by encashing a portion of each Policy, subject to any minimum or maximum levels of payment permitted by IOMA from time to time and the request being made in accordance with paragraph 3.1(3). Where such a request is made, the amount of the payment requested shall be applied equally to each of the Policies remaining at the date of withdrawal. For the avoidance of doubt, this means that the affect *[sic]*

> on each Policy will be the value of the payment divided by the existing number of Policies remaining in the Bond.
>
> Full Encashment
>
> (2) The Policy holder(s) may request IOMA to encash part of the Bond by terminating one or more, but not all of, the Policies, subject to any minimum or maximum levels of payment permitted by IOMA from time to time and the request being made in accordance with paragraph 3.1(3). IOMA will terminate each Policy which is subject to a request from the Policyholder(s) for an encashment of the Bond under this paragraph 2.3(2) on receipt of any such request."

18. Paragraph 3.1(3) dealt only with the method of making requests or giving Instructions, and nothing turns on its terms in this appeal. There was also a section dealing with "Total encashment", which covered the situation when the policyholder wanted to encash his total investment. This distinguished it from the "Full Encashment" referred to in paragraph 2.3(2), which at first sight of its title conveys the slightly misleading impression that it is concerned with such total encashment.

19. The following paragraph appeared at 3.1(2), below the heading "**3 General**" and the subheading "**3.1 Administration of Policies**":

> "(2) All requests and Instructions received will be applied identically to each of the Policies, save where the Policyholder(s) have requested a partial encashment of the Bond in accordance with paragraph 2.3."

We consider this to be the crucial provision for the determination of this appeal, for the reasons set out below.

20. The following paragraph appeared under the heading "**3.8 Governing Law**":

> "The Policies shall be governed by and construed in accordance with Isle of Man law and the Isle of Man courts will have exclusive jurisdiction in relation to all disputes concerning the Policies."

21. This paragraph was not raised at the hearing of the appeal, we assume on the basis that both sides accepted that English law was indistinguishable from Manx law so far as it related to the issues relevant to the appeal. We have proceeded on this basis.

22. In passing, we observe that the policy schedule issued by IOMA did not comply with its own terms and conditions, as it only gave one policy number in respect of the full £85,000 premium invested when it should have given one number for each policy comprised in the Bond. This administrative inaccuracy was the forerunner of much worse to come.

23. Paragraph 3.7 of the 2004 Terms, headed "**Entire Contract**", contained the following text:

"The Policies, as constituted by –

(i) the application form for the Transact Offshore Bond;

(ii) the Policy Schedule;

(iii) any Supplementary Policy Schedule(s)

(iv) any endorsement(s) on the Policy Schedule or any Supplementary Policy Schedule(s); and

(v) the Policy Provisions;

contain all the terms of the contract between the Policyholder(s) and IOMA and IOMA accepts liability solely in accordance with its terms...."

24. We were not informed of any Supplementary Policy Schedules and there were no relevant endorsements on the policy schedule which was produced to us.

25. We therefore find that the provisions set out above comprised all relevant contractual terms in the Bond as it was originally set up, and we further find that those terms continued to apply at least until 21 November 2006 (which is the relevant date for the purposes of this appeal, being the end of the "insurance year" in which the relevant partial surrenders took place). There appears to have been a change in identity of the insurer under the Bond at some point (possibly July 2005), from IOMA to IntegraLife International Limited (a company also incorporated in the Isle of Man) ("IntegraLife"). We were provided with no detail of that change, but neither party argued that it made any difference to the issues we were asked to determine. We accordingly use whichever of those names seems appropriate to any relevant time, whilst observing that they are in effect interchangeable and are both used to refer to the insurer under the Bond at the relevant time.

Investment in, and payments from, the Bond

26. The Appellant paid his single premium of £85,000 on 22 November 2004.

27. IOMA appear to have treated this as the date on which the Bond was made, as subsequent "chargeable event certificates" have recited that as the commencement date, notwithstanding the 25 January 2005 commencement date stated on the Bond schedule that was provided to us. Both the Appellant and HMRC appear to have accepted 22 November 2004 as the correct date for the purposes of this appeal, so we make no finding to the contrary and we accept that the "insurance year" of the Bond ran from 22 November in each year. This would appear however to be another pointer towards administrative disarray at IOMA.

28. The regular withdrawals requested by the Appellant took place for a year (though the first withdrawal did not happen until 17 February 2005, compared with the instruction given by the Appellant in his application form for regular withdrawals

to commence on 15 December 2004). There were 12 regular monthly withdrawals of £293 each, the last taking place on 17 January 2006.

29. On 10 August 2005, the Appellant required extra funds and sent an email to info@Transact-Online.co.uk in the following terms:

> "I wish to withdraw £10,000 from my Transact account, to be transferred to my nominated Barclays account M. Rogers *[account details given]*
>
> I cannot seem to actuate this through the 'Withdrawal request' feature on the website. Please advise"

30. In response to this email it appears the requested transfer was made. We infer (and neither party suggested otherwise) that this transfer was made by way of withdrawal from the Bond through the Transact portfolio structure.

31. On 14 October 2005, a further £10,000 was transferred in response to a similar request (this time by letter dated 10 October 2005).

32. On 30 November 2005, a further £30,000 was transferred. No copy was provided to us of the request for this transfer, but no suggestion was made that it would have been in materially different terms from the earlier requests. We find that it did not make any mention of whether the transfer should be funded by "horizontal" or "vertical" surrender of policies.

33. On 3 February 2006, a further £25,000 was transferred, in response to a letter dated 1 February 2006. This request was in similar terms to the previous requests (making no reference to the mechanism for withdrawal) but also gave instructions for the cessation of the regular monthly payments of £293. The regular monthly payment that had been made on 17 January 2006 therefore proved to be the last such payment.

34. Finally, on 26 April 2006 a further £8,000 was transferred in response to a request by letter dated 24 April 2006 in similar terms to the previous requests.

35. The total withdrawals in the "insurance year" ended 21 November 2005 were therefore £22,930 (10 regular monthly withdrawals of £293 each plus two withdrawals of £10,000 each on 10 August and 14 October 2005).

36. The total withdrawals in the "insurance year" ended 21 November 2006 were therefore £63,586 (two regular monthly withdrawals of £293 each plus the three withdrawals totalling £63,000 on 30 November 2005, 3 February and 26 April 2006).

Subsequent events

37. Included in the documents provided to us was a copy of a letter dated 28 February 2006 from IntegraLife (which appeared, from its notepaper, to share an office there with IOMA) to the Appellant. That letter read as follows:

> "Dear Mr Rogers

Re: *Transact* Offshore Bond – Chargeable Event Certificate

We have noted from our records that you have made a withdrawal (or a series of regular withdrawals) from your Transact Offshore Bond that exceeds 5% of your capital investment. One of the attractions of investing offshore is that you can defer any tax liability of a withdrawal for a number of years. However, in broad terms, should you withdraw more than 5% of the capital invested in any one policy year, a "chargeable event" will occur and the excess over 5% is liable to income tax and should be declared on your annual tax return.

To help policyholders identify when these events have occurred, life companies are required to send a Chargeable Event Certificate. Regrettably, following the transfer of business from Isle of Man Assurance Limited (the previous provider of the Transact Offshore Bond) and IntegraLife International Limited (the current provider), it has become apparent that a number of Chargeable Event Certificates were not sent to policyholders. We have, therefore, enclosed with this letter a certificate(s) in relation to your particular chargeable event(s).

We offer our sincere apologies for any inconvenience caused.

Should you require advice regarding this letter we encourage you to approach your financial adviser or accountant.

Yours sincerely."

38. We were not provided with any copies of the certificate(s) which were supposedly enclosed with that letter; it is not even clear whether any certificates were in fact enclosed with it. Nor were we provided with any documentation dealing with the transfer of business referred to in it. We infer that the terms of the contract governing the Bond remained unchanged as a result of that transfer, whenever it occurred.

39. We were also provided with a copy of another letter, this time dated 31 August 2006, from IntegraLife to the Appellant. This letter was in exactly the same terms as its earlier letter dated 28 February 2006, except that the second paragraph was a little shorter and did not refer to the transfer of business from IOMA to IntegraLife. The revised second paragraph read as follows:

> "To help policyholders identify when these events have occurred, life companies are required to send a Chargeable Event Certificate. Regrettably, it has become apparent that a number of Chargeable Event Certificates were not sent to policyholders. We have, therefore, enclosed with this letter a certificate(s) in relation to your particular relevant chargeable event(s)."

40. According to the Appellant (whose evidence we accept), attached to this letter were three certificates, each headed "**Chargeable Event Certificate Insurer's report under s 552 ICTA 1988**". All three were addressed to the Appellant, quoted

his policy number (as set out on the schedule to his Bond) and named IntegraLife as the insurer.

(1) The first certificate purported to relate to a "withdrawal" on 3 February 2006. It quoted the policy year as ending on 14 November 2006, gave the "Number of years" (presumably since inception of the policy) as 2 and reported an "Amount of Gain rounded down" of £25,750.

(2) The second certificate purported to relate to a "withdrawal" on 3 May 2006, quoted the same policy year end date and number of years, and reported an "Amount of Gain rounded down" of £25,000.

(3) The third certificate purported to relate to a "surrender" on 26 July 2006, quoted the same policy year end date and number of years, and reported an "Amount of Gain rounded down" of "–£68,500".

41. Neither the Appellant, his advisers nor HMRC are able to relate these reported gain figures and event dates in any meaningful way to the known history of investment and withdrawal by the Appellant. In short, they are nonsense.

42. The Appellant filed his income tax self-assessment return for the year 2006-07 on 30 January 2008. He did not include any entry in it in relation to the withdrawals made by him during the policy year 22 November 2005 to 21 November 2006 (as he ought to have done). He was not specifically asked why he had failed to do so, but we infer it was because he was either unaware of any such obligation or he considered that since all he had done in financial terms was withdraw the bulk of an investment which he had made (without making any gain), he did not need to report any chargeable income (though he had reported gains on UK life policies in that return, with an associated tax credit).

43. On 15 January 2009, HMRC wrote to the Appellant opening an enquiry into his 2006-07 tax return. When he referred the matter to his accountants, they wrote to HMRC saying that withdrawals from the Bond (and another investment) did not appear on the return. They sent copies of the chargeable event certificates, but noted that "there is a Transact one with a minus figure on it and we are trying to find out why".

44. HMRC were provided with basic information about the Appellant's investment in the Bond and the lump sum withdrawals he had made, from which they calculated a taxable gain of £58,750 for the tax year 2006-07. The accountants obtained a copy of the July 2005 terms and conditions referred to above, and referred HMRC to a provision in it which stated "Each policy will be comprised of 20 segments. In the case of larger contributions, you may choose to divide your Transact Offshore Bond into a maximum of 100 segments." HMRC did not accept that sub-policies were sold (i.e surrendered), and therefore maintained their stance that a large tax liability had arisen as a result of a series of partial surrenders of the whole Bond (i.e., "horizontal" surrenders of all 20 of the sub-policies or segments comprised in it). This view was communicated in a letter dated 26 August 2009.

45. There was clearly then some contact between the Appellant's advisers and IntegraLife. This resulted in a further letter to the Appellant from IntegraLife dated 1 October 2009. That letter read as follows:

> "Dear Mr Rogers,
>
> **Re: *Transact* Offshore Bond Policy Number TRAN000256**
>
> Please find enclosed three Chargeable Event Certificates which are being sent to you following the withdrawals from your Transact Offshore Bond in 2005 and 2006.
>
> These certificates are correct and supercede the previous certificates issued in 2006. The previous certificates should be ignored and/or destroyed. Please accept my sincere apologies for any inconvenience this may have caused you.
>
> You must provide details of any chargeable gains on your annual tax return to Her Majesty's Revenue and Customs (HMRC) and the required information is shown in the certificate.
>
> We are also required to send a copy of the Chargeable Event Certificate to HMRC.
>
> Should you require further advice regarding this certificate then please contact your financial adviser *[Name]* on *[phone number]* or your accountant.
>
> Yours sincerely"

46. The three certificates attached to the letter were all dated 1 October 2009, addressed to the Appellant and expressed to relate to the Bond (giving the policy number). The rest of the content was different between the three certificates:

(1) The first certificate was expressed to relate to the policy year 22 November 2004 to 21 November 2005. It stated that a "Surrender of Segments" had taken place on 10 August 2005 in year one, giving rise to a chargeable gain of £98.82 (with no associated basic rate income tax paid). This certificate, as far as we are aware, still stands (though it relates to the policy year 2004-05, and therefore to the tax year 2005-06, to which this appeal does not relate).

(2) The second certificate was expressed also to relate to the policy year 22 November 2004 to 21 November 2005. It reported a chargeable event of "Policy Anniversary" as occurring on 21 November 2005 in year one, giving rise to a chargeable gain of £1,834.30 (with no associated basic rate tax credit). This certificate was subsequently replaced (see [50] below), but neither this certificate nor its replacement relates to the tax year currently under appeal.

(3) The third certificate was expressed to relate to the following policy year (22 November 2005 to 21 November 2006). It reported a chargeable event of "Policy Anniversary" as occurring on 21 November 2006 in year two, giving rise to a chargeable gain of £5,258.71. This certificate, which does relate to the tax year under appeal, was subsequently replaced (see [51] below).

47. When these certificates were forwarded to HMRC, they balked at them, observing that the figures in them were "totally different from the figures you originally sent to me." They asked for further information.

48. This clearly resulted in further contact with IntegraLife, who sent a further letter dated 13 January 2010 to the Appellant, which was forwarded to HMRC. The letter read as follows:

> "Dear Mr Rogers
>
> **Re: *Transact* Offshore Bond Policy Number TRAN000256**
>
> I am writing to you in connection with the chargeable event certificates that have previously been issued for your Transact Offshore Bond.
>
> I can confirm that the two certificates for the 2004/05 and 2005/06 policy years both quoted incorrect chargeable gain amounts in relation to the partial withdrawals made. The two old certificates should be ignored and/or destroyed and the enclosed certificates treated as replacements.
>
> Please accept my sincere apologies for this oversight and for any inconvenience it may have caused.
>
> Should you require further advice regarding this certificate then please contact your financial adviser *[name]* on *[telephone number]* or your accountant.
>
> Yours sincerely."

49. Enclosed with this letter were two further certificates, in similar form to those that had accompanied the previous letter dated 1 October 2009.

50. The first certificate was expressed to report a "Policy anniversary" chargeable event, occurring on 21 November 2005, giving the "number of years" as one. It gave a figure of £1,956.16 as the chargeable gain, with no associated tax credit. We are informed that this was a direct replacement for the certificate referred to at [46(2)] above. It does not relate to the year under appeal.

51. The second certificate was expressed to report a "Policy anniversary" chargeable event, occurring on 21 November 2006, giving the "number of years" as two. It gave a figure of £1,105.22 as the amount of the chargeable gain, with no associated tax credit. We are informed that this was a direct replacement for the

certificate referred to at [46(3)] above. This certificate does relate to the year under appeal, but was subsequently replaced yet again (see [52(1)] below).

52. The certificates were forwarded to HMRC and there was a delay of some months while they digested this information. The matter was referred internally for advice and there was clearly some contact between HMRC and IntegraLife. Finally, in June 2010, two things happened:

(1) On 21 June 2010, IntegraLife issued a further chargeable event certificate, to replace that referred to at [51] above. This time, the chargeable gain reported was £59,336. In the covering letter sending this certificate to the Appellant, IntegraLife said:

> "Please find attached a revised chargeable event certificate in respect of a chargeable gain that arose under your policy during the year ending 21st November 2006. We have been asked to issue this to you by HM Revenue and Customs to replace the original certificate."

(2) On 28 June 2010, HMRC wrote to the Appellant's accountants, saying they had "now been advised" that a revised certificate showing that figure of gain was to be issued, setting out their calculation of how the figure was arrived at and issuing a revised 2006-07 tax computation for the Appellant incorporating the figure.

53. We were provided with a copy of a letter dated 27 April 2010 from HMRC to IntegraLife which made it clear that there had been other detailed communications between them. This letter had apparently been copied to the Appellant's advisers, who had required that it be placed before the Tribunal. HMRC had made a decision not themselves to disclose this letter (or any of the other material referred to in it) in this appeal, taking the view that they were not required to do so by the Tribunal's directions (which only required disclosure of documents on which they wished to rely). At the hearing Mr Hall was either unwilling or unable to share the remainder of the correspondence with the Tribunal. We infer from HMRC's view on this issue that the missing correspondence contains material HMRC would not wish the Tribunal to see and we express our extreme dissatisfaction with this approach on HMRC's part. It conveys the distinct impression that HMRC are being less than fully open in their dealings with the Tribunal, a matter which we regard with extreme seriousness and which leads us to believe that there may be material which has not been disclosed which is adverse to HMRC's case.

54. In particular, we infer from HMRC's unwillingness to disclose the correspondence in full that they either pressurised IntegraLife into issuing the further revised certificate dated 21 June 2010 or deployed some incorrect argument or factual misrepresentation in persuading them to do so – this is the distinct impression we gained from a reading of the HMRC letter dated 27 April 2010 and if this is an incorrect impression HMRC have only themselves to blame for failing to disclose the full correspondence to clarify the position. In any event, HMRC's failure to produce the missing material has a prejudicial effect on our view of the worth and reliability of IntegraLife's latest certificate.

55. In the Appellant's witness statement, he refers to a letter dated 20 May 2011 from HMRC to his adviser Mr Rooney, in which HMRC sent to Mr Rooney a copy of the terms and conditions upon the basis of which HMRC asserted that all withdrawals must be treated as partial surrenders of all policies within the Bond. No copy of that letter was in our bundle, but it is clear that the letter refers to a set of terms and conditions issued by IntegraLife headed "transact Offshore Bond Standard Policy Terms and Conditions" dated November 2007 which were included in our bundle ("the 2007 Terms"). It was not made clear precisely how the 2007 terms came to be in the bundle, but they clearly postdate the Appellant's acquisition of the Bond and from his witness statement dated 1 July 2011 it is clear that they came as a surprise to him when he saw them attached to HMRC's letter dated 20 May 2011.

56. We find that the 2007 terms were in fact supplied to HMRC by IntegraLife in the course of the undisclosed correspondence between them, and presumably they were the documents which IntegraLife produced to HMRC as setting out their understanding of the contractual terms applying to the Bond. We have already observed the administrative chaos which appeared to prevail at IOMA and IntegraLife, which would provide an ample explanation of this error. We infer that it may well have been on the basis of this false assumption that HMRC prevailed upon IntegraLife to issue the revised certificate in June 2010.

57. For all these reasons we therefore treat the 21 June 2010 certificate from IntegraLife with a great deal of scepticism, indeed suspicion.

58. Associated with the 2007 Terms is a further document contained in our bundle, a document dated 1st October 2007 which is branded with the "transact" logo but which appears to have been issued by IFAplc in London. That document is headed "**IMPORTANT Notice of Changes to the Transact Terms and Conditions**". It goes on to say that the changes have been prompted by the Markets in Financial Instruments Directive, and will take effect from 1 November 2007. We shall refer to it as "the 2007 Change Notice". We infer from it that the 2007 Terms were introduced alongside the new "transact" terms and conditions as part of a general updating process which was prompted by the new Directive.

59. It is not clear whether the 2007 Terms were (or were included as part of) the revised "Transact Terms and Conditions" referred to in the 2007 Change Notice, or whether they were simply introduced as part of the general updating process. For the purposes of this decision, however, it does not matter.

60. We would not normally consider 2007 contractual documents as having any particular bearing in construing a contract made in 2004 in connection with transactions occurring in 2005 and 2006. Indeed, at the hearing Mr Hall accepted that the 2007 Terms and the 2007 Change Notice did not apply directly to the Bond. However he made a submission to the effect that the 2007 Terms and the 2007 Change Notice are important aids in the interpretation of the 2004 Terms, and for that reason we set out the material passages from the 2007 Terms and the 2007 Change Notice below.

61. The 2007 Change Notice starts with the following text:

> "The implementation in the UK of the Markets in Financial Instruments Directive (2004/39/EC) (**MiFD**) on 1st November, 2007 has necessitated a review of the Transact Terms and Conditions. In undertaking this review we have also borne in mind the comments and queries raised in respect of the current Transact Terms and Conditions. As a result of this, a large number of the changes have been made to add clarity, set provisions out in more detail, and/or amend the style and phraseology of a number of clauses. We have also made changes to the Transact Terms and Conditions in anticipation of changes to the regulations in respect of ISAs and PEPs due on 6th April 2008.
>
> The Transact Terms and Conditions, in the form which will take effect on **1st November, 2007** are available on our website www.transact-online.co.uk or in hard copy from your Adviser or on request from us. You should ensure that you have read and understood the changes, and any implications which they may have for you, prior to **1st November, 2007**, as they will be binding on you from that date. In particular, we would draw your attention to the key changes mentioned in the summary that follows:"

62. That following summary ran to some three detailed pages and none of it has any bearing on the issues the subject of this appeal. Most of it dealt with changes to the rules and procedures surrounding execution of trades.

63. The 2007 Terms contained the following text under the heading "**3.3 Partial Encashment and Full Encashment of Individual Policies**":

> (1) Partial Encashment of Individual Policies
>
> The Policyholder(s) may, by Instruction to IlInt, request IlInt to encash an even portion of all Policies, subject to any minimum or maximum levels of payment permitted by IlInt from time to time. For the avoidance of doubt, this means that the effect on each Policy will be the value of the payment divided by the existing number of Policies.
>
> (2) Full Encashment of Individual Policies
>
> The Policyholder(s) may, by Instruction to IlInt, request IlInt to encash in full one or more, but not all of, the individual Policies, subject to any minimum or maximum levels of payment permitted by IlInt from time to time. Each Policy so encashed shall terminate on enchashment.
>
> (3) Applicable Conditions
>
> (1) Where an Instruction for an encashment, other than an instruction for Total Encashment, is received by IlInt which specifies the value of the encashment but does not specify whether this is to be a partial encashment of all individual policies or a full encashment of one or more individual policies, IlInt shall deem this to be a *[sic]* Instruction

> for the partial encashment of all individual policies as if it were made in the terms described in clause 3.3(1) above."

64. It is clear, therefore, that by the time the 2007 Terms were being prepared, the draftsman was fully alert to the problems being caused by the uncertainties in the partial withdrawal "chargeable event" calculations based on the 2004 Terms, and wished to clear the matter up.

65. Finally, to complete the factual picture, on 15 October 2010 HMRC wrote to the Appellant, setting out in a closure notice the amendments which they were making to the Appellant's 2006-07 tax return, which incorporated the extra £59,336 of income reflected in the latest certificate. It is against this amendment that the Appellant now appeals.

Identification of issues

66. There is no dispute as to the dates and amounts of the payments made by and to the Appellant in relation to the Bond. Nor were we made aware of any dispute as to the other amounts debited and credited to the Bond by IOMA or IntegraLife (by way of interest and fees). It is agreed that the Bond was made up of 20 individual policies (sometimes referred to as "segments" or "sub-policies") and that each of those policies should be considered separately and independently when applying the "chargeable events" rules. The sole dispute revolves around the appropriate treatment, for the purposes of the "chargeable events" legislation, of the payments made to the Appellant.

67. The legislation deals very differently with partial surrenders of rights under a policy and total surrenders of such rights. The detail of the differences does not matter for present purposes, as the parties have said they are agreed on how the two different sets of rules would apply in this case. What we are required to decide is the extent to which total (as opposed to partial) surrenders of the underlying policies resulted in the payments made to the Appellant.

68. The insurance policies in the present case are entirely legal constructs. They are bundles of rights and obligations whose creation, interpretation and termination are entirely matters of law. Therefore, while observation of the consequences of a surrender can provide clues as to the substance of that surrender, they can only do so insofar as they are consistent with the legal framework from which they arise.

69. A simple example illustrates this point. Let us assume for the moment that the Bond in the present appeal had been quite clearly constituted as a single policy with no segments or sub-policies. If IOMA or IntegraLife had issued a chargeable event certificate following a partial surrender which was drawn up on the basis that the Appellant had totally surrendered a number of sub-policies, that certificate would be entirely inconsistent with the legal framework of the policy. It would quite simply be wrong. It could not be regarded as evidence that the surrender had indeed been structured as the certificate suggested.

70. The situation becomes less clear when the legal framework (or a crucial part of it) is unclear or incomplete. It may be that it is possible to complete it by application of the normal rules of construction to the contractual documents. If not, it is necessary to "paint in" the missing detail, and the parties have suggested a number of ways they would like us to approach this task.

71. The task we face, therefore, is as follows. We must assess the legal framework of the Bond to establish whether it determines or leaves open the question of whether a partial surrender is to be effected on a "vertical" or a "horizontal" basis. If it leaves the question open, we must then determine the basis upon which the partial surrenders in question actually took effect. In considering that question, we need to assess the available evidence as to what was actually done. If that assessment provides insufficient basis for a decision, then we need to consider what answer will be supplied by general legal principles to fill the void.

Submissions

HMRC's submissions

72. Dealing first with the regular monthly payments, Mr Hall pointed out the provision in the application form filled in by the Appellant, in which it was expressly stated that "any regular withdrawal payments will be provided by equal partial surrender of each policy within your Transact Offshore Bond." Mr Rooney really had no answer to this and we find that this provision is determinative of the treatment of the regular withdrawal payments. We note, in passing, that it is worded very specifically in a way which requires allocation equally between all extant policies, taking no account of their respective values.

73. So far as the "lump sum" withdrawals were concerned, Mr Hall relied heavily on the original wording of paragraph 3.1(2) of the 2004 Terms:

> "All requests and Instructions received will be applied identically to each of the Policies, save where the Policyholder(s) have requested a partial encashment of the Bond in accordance with paragraph 2.3."

74. Mr Hall also submitted that the 2007 Terms could be regarded as casting some interpretative light here. He pointed out that according to the 2007 Change Notice (see [61] above) the 2007 Terms were expressed to be "made to add clarity, set provisions out in more detail, and/or amend the style and phraseology of a number of clauses" in the previous terms and conditions. He argued therefore that paragraph 3.3(3)(1) of the 2007 Terms (see [63] above), which said that "no instruction" as to vertical or horizontal treatment of a partial surrender would be treated as a horizontal surrender instruction, was simply clarifying the correct interpretation of the 2004 Terms.

75. We do not agree that the 2007 Change Notice and the 2007 Terms can be treated as an aid to interpretation of the 2004 Terms in this way. Taken to its natural conclusion, this argument would mean that all of the 2007 Terms would effectively have to be interpreted in the light of the 2004 Terms and only given effect to the

extent that they could be regarded as adding clarity, setting out more detail or amending style/phraseology in the 2004 Terms. This would clearly be an unsustainable proposition. We consider the inclusion of paragraph 3.3(3)(1) in the 2007 Terms was a simple response to the awkward realisation that the 2004 Terms were deficient in lacking a clear crucial provision, and the wording in the 2007 Change Notice about "adding clarity" and so on was little more than a smokescreen to hide the insurer's embarrassment about this deficiency.

76. Mr Hall then referred to the actions of IntegraLife in issuing certificates. In his submission, the first set of certificates was quite clearly nonsense and should simply be disregarded. They then had two further attempts but finally "got it right" with their certificate dated 21 June 2010. That latest certificate, issued after the fullest consideration, was the most reliable. We should therefore accept it as the most compelling evidence of what actually happened at the times of the withdrawals.

77. We were referred by HMRC to three cases (though none of them was relied on to any material extent at the hearing).

78. In *Chandraprakash Shanthiratnam v HMRC* [2011] UKFTT 360 (TC), the First-tier Tribunal (Judge Nowlan) considered an appeal against what was said to be the highly unfair effect of the "chargeable events" provisions on a large withdrawal from a cluster of 50 offshore life policies which was structured as a "horizontal" surrender. Judge Nowlan explained why the "frankly ludicrous tax result that has so far arisen" could not be overturned on appeal, whilst commenting on the different tax result that would have arisen if the withdrawal in that case had been structured as a "vertical" surrender. It was not disputed in that case that the withdrawal had been structured as a "horizontal" surrender. Whilst that case is helpful in sketching in the background to the chargeable events legislation, it does not address the central issue in the current case, it merely confirms the "frankly ludicrous tax result" that ensues if a large withdrawal is indeed structured as a "horizontal" surrender.

79. In *Captain Steven Gleghorn v HMRC* [2011] UKFTT 488 (TC), the First-tier Tribunal (Judge Radford) reached a similar conclusion (though in less colourful language) where the initial investment was structured as a single policy (so that questions of "horizontal" or "vertical" surrender could not arise, as all withdrawals necessarily had to take effect as partial surrenders of the single policy). Again, that case did not address the key point which arises in the current appeal as there was only a single policy involved.

80. In *Spectros International Plc v Madden* [1997] STC 114, the High Court (Lightman J) considered the tax consequences arising from a company sale. The detail is not material for present purposes (it relates to corporation tax on chargeable gains and not to the "chargeable events" regime), but the general statement of principle by Lightman J most certainly is:

> "The parties to a proposed transaction frequently can achieve the same practical and economic result by different methods..... The law respects the freedom of the parties to a transaction to frame and formulate their agreement as they wish and to suit their own legitimate interests

> (taxation and otherwise) and, so long as the form adopted is genuine, and not a sham, honest, and not a fraud on someone else, and does not contravene some established principle of public policy, the Court will give effect to the method adopted. But as a corollary to this freedom, where the parties have chosen one method, it is not open to them to invite the Court to treat as adopted some other method because it is more advantageous to them, because it leads to the same practical and economic result and because it is the more obvious and sensible method to have adopted. If the question is raised what method has been adopted and the transaction is in writing, the answer must be found in the true construction of the document or documents read in the light of all the relevant circumstances. If the terms of the documents are clear, that is the end of the question. If however there is any doubt or ambiguity upon the language used read in its proper context, it may be possible to resolve that doubt or ambiguity by reference to the inherent probabilities of businessmen entering into the transaction in one form rather than another."

81. Mr Hall directed us mainly to the principle embodied in the first part of the above passage, which could be summarised as being "if the parties choose a particular form for their transaction, then in general the Courts will respect that choice and will not permit the parties to argue for a better tax result based on a different structure, achieving in practice the same result, that could have been (but was not) adopted".

82. Subject to possible arguments about rectification (which have not been raised in this case), we fully accept this principle, but find that it is not relevant in this appeal. We are not concerned here with whether the Appellant should be afforded the benefit of a more advantageous tax treatment than his transactions would normally attract; the dispute in this case is about the true nature of the underlying transactions themselves. Once that has been established, the tax consequences will follow naturally.

83. What we find more interesting, however, are Lightman J's comments in the latter part of the above passage. In broad terms, he is saying that if a transaction is "in writing", then its effect is a matter of construction of the relevant documents, in the light of all relevant circumstances. He also goes on to say that if that exercise of construction results in "doubt or ambiguity", then it may be possible to clarify matters by reference to the "inherent probabilities of businessmen entering into the transaction in one form rather than another".

84. In summary, therefore, we did not find any support for Mr Hall's submissions in the cases that had been put before us, as those cases were concerned with different issues. We rejected his submission that the 2004 Terms should be interpreted as if they contained the clarification that was subsequently added in the 2007 Terms, but we felt his submission on the actual wording of the 2004 Terms deserved further consideration. We consider this submission in more detail below, along with his submission about the June 2010 certificate.

The Appellant's submissions

85. Mr Rooney submitted first that paragraph 3.1(2) of the 2004 Terms was irrelevant. This was because that paragraph itself said that it did not apply "where the Policyholder(s) have requested a partial encashment of the Bond in accordance with paragraph 2.3" and, he said, that is precisely what the Appellant had done.

86. It was therefore necessary, he said, to consider paragraphs 2.3(1) and (2) as they stood, and neither of them applied because it was agreed that the Appellant had not made any request of the type referred to in them.

87. There was, he said, accordingly nothing in the 2004 Terms which determined whether the partial surrenders should be effected as "horizontal" or "vertical" surrenders.

88. He submitted that in determining the basis on which the partial surrenders were actually effected we should have regard to the assurance given by IntegraLife in their July 2005 "Key Features" document about "tax neutrality". In a situation where the insurance company would have known that processing the withdrawals on a "horizontal" basis would have generated a completely unnecessary, artificial and avoidable tax charge, he submitted that they would have been obliged, as a result of their "tax neutrality" commitment, to process them on a "vertical" basis.

89. He then submitted that if we disregard the obviously nonsensical first chargeable event certificates issued in August 2006, the next such certificates (those issued on 1 October 2009) provided the best evidence that they had in fact done so. The detail of the calculations had been adjusted, resulting in an amended certificate dated 13 January 2010, but in either case it was clear that the basic approach assumed a "vertical" basis of surrender. The later certificate dated 21 June 2010 had, he said, clearly been issued as a result of pressure from HMRC, quite possibly on the basis of misinformation about the true policy terms applying; but in any event it should be disregarded as being obviously less reliable than the earlier certificates.

Discussion

Treatment of the regular withdrawals

90. We find there is no doubt about the appropriate treatment for the regular withdrawals. As set out in the original application form, these should all be dealt with "by equal partial surrender of each policy" within the Bond.

Treatment of the one-off withdrawals – establishing the contractual framework

91. In interpreting the 2004 Terms, we reject Mr Hall's submission that we should effectively import the extra provision from the 2007 Terms which would put the matter beyond doubt (see [75] and [84] above).

92. Considering the 2004 Terms themselves, paragraph 3.1(2) contains (see [19] above) a general statement that "all requests and Instructions received will be applied

identically to each of the Policies". On its face and without more, this would quite clearly require partial surrenders to be given "horizontal" treatment – it is clear from the various uses of the word "request" elsewhere in the 2004 Terms that it is apt to cover a request for a withdrawal.

93. Paragraph 3.1(2) however goes on to provide an exception to this general statement, where a policyholder has "requested a partial encashment of the Bond in accordance with paragraph 2.3".

94. Mr Rooney is clearly correct in his submission that the Appellant "requested a partial encashment of the Bond" on all relevant withdrawals. However, he must also establish that the request was made "in accordance with paragraph 2.3" if he is to succeed in his submission that paragraph 3.1(2) can be disregarded in relation to the various withdrawals.

95. As can be seen from [17] above, paragraph 2.3 offers two ways in which the policyholder can request less than total encashment. One way involves an express request to encash a portion of each policy (2.3(1)), the other involves an express request to terminate (and, by implication, encash) one or more whole policies (2.3(2)). It is common ground that the Appellant's requests in this case contained neither express instruction. It follows that the Appellant's requests were therefore not made "in accordance with paragraph 2.3". Therefore the provisions of paragraph 3.1(2) would operate so as to apply his encashment requests "identically to each of the Policies". We interpret this as meaning that surrender should be dealt with "horizontally", i.e. by equal partial surrender across all extant policies at the time.

96. We are reinforced in this view by standing back and looking at the general scheme of paragraphs 2.3 and 3.1(2). The general approach of paragraph 3.1(2) is that there should be equality of treatment across all the policies unless the policyholder requests otherwise; in paragraph 2.3 there are two ways envisaged of effecting a surrender, one involving equal treatment of all policies and one involving differential treatment. It is to be expected, therefore, that equal treatment should apply unless displaced by a specific request from the policyholder. We observe that the drafting of paragraph 3.1(2) could easily have been made consistent with this general scheme by one (or preferably both) of two small alterations:

> (1) altering the reference to " paragraph 2.3" so as to refer specifically to "paragraph 2.3(2)"; and/or
>
> (2) altering the reference to "partial encashment" so as to refer to "full encashment".

We note that if either or both of these alterations had in fact been made, the result (in terms of the effect of the Appellant's non-specific notices of withdrawal) would still be the same; therefore whether we consider the actual drafting or the drafting which we suspect the draftsman would have used if he had thought properly about the issue, our interpretation remains the same: in default of specific instructions to the contrary, any partial surrender would be contractually effected on a "horizontal" basis. We also

bear in mind that it is inherently improbable that the draftsman would have intended to leave this question purposely unanswered in the contractual documents.

97. There is a counter argument to this interpretation, which was not raised at the hearing. Paragraph 1.5 of the 2004 Terms is very prescriptive about how the cash in the policyholder's portfolio may be used. There is a list, which is expressed to be exhaustive, of just seven ways in which it may be used. Payments to the policyholder are mentioned in just one of those items, which states that cash will only be used "to pay all amounts due to the Policyholder(s) in terms of paragraph 2.2 (regular withdrawals), 2.3 (partial encashment) and 2.4 (total encashment) below". This implies that the only way in which a policyholder may obtain a one-off partial withdrawal is by making a request "in terms of paragraph 2.3". As we have already seen, the Appellant's requests were not made in the terms envisaged by that paragraph because they failed to specify whether they were to be satisfied by a "horizontal" or a "vertical" surrender of policies. Arguably, therefore, under paragraph 1.5 the insurance company should have refused to pay out the cash until it received a request which did comply with paragraph 2.3. This raises the possibility that there was never a valid partial surrender of the Bond at all (apart from the regular withdrawals). However the Appellant did of course receive his money and we therefore consider the better view is that the Appellant's requests were accepted in practice as falling within paragraph 2.3 in order to permit payment; if that was the case, then it might be arguable that the Appellant's requests should be treated as requests for "partial encashment of the Bond in accordance with paragraph 2.3", in which case the effect of those words in paragraph 3.1(2) would be to disapply the wording in that paragraph that "all requests and Instructions received will be applied identically to each of the Policies".

98. If this counter-argument were accepted (or if our interpretation of the 2004 terms is found to be wrong for some other reason), it would mean that the contractual documents contained no indication as to how a "non-specific" withdrawal should be effected, so that we would need to evaluate the available evidence of how the surrenders were in fact effected and, if unable to reach a conclusion on that basis, we would need to determine how the law would operate to fill the gap.

99. However we reject this counter-argument, not least because it relies on an apparent breach of the contractual terms to affect the interpretation of an entirely different clause in the contract. It also relies on a very close and detailed analysis of a written contract which in our view lacks the overall coherence and robustness to be meaningfully susceptible to such close and detailed analysis. As Lord Bridge of Harwich said in *Mitsui Construction Co Ltd v A-G of Hong Kong* [1986] 10 Con LR 1 at 41:

> "the poorer the quality of the drafting, the less willing any court should be to be driven by semantic niceties to attribute to the parties an improbable and unbusinesslike intention".

100. There is one other point we feel we should dispose of whilst considering the interpretation of the contractual documents. Mr Rooney asked us to find that no

sensible insurance company, knowing that "horizontal" partial surrender would trigger large, artificial and entirely avoidable tax liabilities, would have effected an "ambiguous" surrender on such a basis or, by extension, set up its contractual documents in a way that would make this happen. This could be interpreted as a reference to the point made by Lightman J in *Spectros* (see [80] above):

> "If however there is any doubt or ambiguity upon the language used read in its proper context, it may be possible to resolve that doubt or ambiguity by reference to the inherent probabilities of businessmen entering into the transaction in one form rather than another."

101. Whilst we accept that the language of the 2004 Terms creates some doubt and ambiguity, we do not consider that Lightman J's words assist the Appellant in this case. This is because the whole point of the 2004 Terms, however badly drafted, was to offer two alternative methods of structuring a partial surrender, leaving the choice open to the policyholder as to which method to adopt. There is therefore no "inherent probability" that the intention of the parties was to adopt one method in preference to the other in the event that the policyholder gave an ambiguous instruction. Nor is there any "doubt or ambiguity" about the language used by the Appellant in his various notices. In each case, he simply did not specify which method was to be used, because he simply had not applied his mind to the point. We cannot find, as a matter of legal interpretation, that the combined effect of the 2004 Terms and the notices of withdrawal should be interpreted as giving rise to a "vertical" surrender simply because that is the way the Appellant wishes it had been structured (and would, like every taxpayer in his position, have structured it if he had thought about it).

102. We therefore hold that the effect of the 2004 Terms, properly interpreted, is that in a case such as the present where no instruction is given at the time of a partial surrender to govern whether that surrender is to be effected on a "vertical" or a "horizontal" basis, the latter basis (i.e. equal partial surrender of each policy within the Bond) must be used.

103. This finding is sufficient to dispose of the appeal. However, in case we are wrong on this point, we go on to consider the remaining arguments before us.

Treatment of one-off withdrawals – the effect of other evidence

104. We deal first with the certificates. From the history of their issue and replacement as set out above, it is clear that (apart from the original certificates, which both parties agree to be nonsense) they have been issued by IntegraLife without any independent thought, merely falling in with the wishes of the parties in turn as to what they should say. We are invited to accept either the first (as nearest in time to the surrenders) or the last (as most reliable after mature consideration) as being the more authoritative.

105. We reject both invitations. Given the history behind the issue of the certificates and the general picture of administrative incompetence that has built up, we consider that none of the certificates has any probative value.

106. We turn next to Mr Rooney's "tax neutral" argument.

107. First, it is clear that the "tax neutral" comments in the "key features" document to which he referred were referable to the portfolio "wrapper" rather than to the Bond itself.

108. Second, on his more general point that an insurance company would be well aware that "horizontal" surrender would trigger an entirely artificial, unnecessary and easily avoidable tax liability and would therefore not proceed on that basis, we find his submission unconvincing. First, it was stated at a number of places in the documents that the insurance company was not providing tax advice, merely a financial product. The Appellant was directed squarely to his independent financial adviser for tax advice. In short, the insurance company was making it clear that all tax responsibility was left to the Appellant. Second, it is quite possible that it might have been to the Appellant's overall advantage to have triggered a large income tax liability by his withdrawals; he might have had other losses available to shelter that liability in the year in question and might find the corresponding relief for deficiencies extremely useful in later years.

109. In short, it was not for the insurance company to second guess the Appellant's tax position, they were quite justified in leaving that to his advisers. We therefore reject Mr Rooney's submissions based on the "tax neutral" wording in the documents.

110. As made clear above, the notices of withdrawal given by the Appellant provide no evidence as to the basis on which he wished the surrenders to be effected.

111. No evidence was before us as to the way in which the surrenders were recorded in the books of IntegraLife at the time they took place. If evidence, contemporaneous to the surrenders, had been available to demonstrate that they had in fact processed the surrenders on a "vertical" basis then we might have found that evidence persuasive; in evaluating it however we would have applied a critical eye, given the overall impression we have formed of the general level of administrative efficiency at IntegraLife. On the evidence before us, it is difficult to escape the conclusion that IntegraLife probably did not apply its mind to the question at all until it had to deal with the production of chargeable event certificates – and the quality of its thinking at that time is clearly evidenced by the standard of the certificates which it first produced.

112. No other evidence has been put before us which we consider will assist us in establishing the basis on which, as a matter of fact, the surrenders were effected. We are therefore forced to the conclusion that we simply cannot establish that basis by reference to the evidence before us.

113. We must therefore turn to general legal principles to provide an answer to the question.

The application of general legal principles

114. The key principle here appears to be that reflected in the equitable maxim "equality is equity". An early example of the application of this maxim is the case of *Kemp v Kemp* [1795] 13 ER 891. In that case, the court was considering a trust and was unable to ascertain from the terms of the trust which beneficiary was intended to take which interest; it therefore divided the property equally between them. This seems to bear many parallels to the present case.

115. Similarly, in *Jones v Maynard* [1951] 1 AER 802, Vaisey J considered the situation of a divorced husband and wife who disagreed about the sharing of jointly owned assets and he could find no other basis than equality:

> "Plato said that equality was a sort of justice, that is to say, if in such a matter as this one cannot find any other basis, equality is the proper basis. I think that is a principle which applies here."

116. We feel that principle also applies in the present case.

117. Therefore, if it is not possible to ascertain from the legal documents or the evidence of what actually transpired precisely how the withdrawals should be allocated across the outstanding policies, we consider that the default position should be that they should be shared equally between them.

Decision

118. In considering the question as to whether partial surrenders were effected on a "horizontal" or "vertical" basis, the contractual documents provide the legal framework. If that framework is sufficiently clear, it may provide the answer to the question without further enquiry; if it is not, it may be necessary to look beyond the framework so as to find what actually took place (consistent with that framework). If the evidence of what actually took place is still insufficient to provide the answer, then it must be provided by reference to general legal principles.

119. We find that the regular withdrawals were clearly made on the basis of equal partial surrender of all policies. This was specifically provided for in the contractual documents (see [72] and [90] above).

120. On the true interpretation of the 2004 Terms, we find they also specifically provided that lump-sum partial withdrawals where the policyholder specified no basis of surrender would be made on the basis of equal partial surrender of all policies (see [102] above).

121. If we are wrong in that view, we find that there is no cogent evidence as to the basis upon which the lump-sum withdrawals were actually effected, and accordingly that basis is to be determined by the application of general legal principles (see [112] and [113] above).

122. We find that the operation of general legal principles would result in the "horizontal" basis of surrender applying in any event (see [117] above).

123. With some regret, therefore, we must dismiss the appeal in principle. We echo the comments of Judge Nowlan in *Shanthiratnam* about the "frankly ludicrous" nature of the resulting tax liability, but when parties are advised to invest in complex financial products for tax planning purposes, the outcome illustrates all too clearly the fact that full advice needs to be given as to all the implications of that decision and where any associated traps and pitfalls may lie.

124. The parties are at liberty to apply for a final decision if they are unable to reach agreement on the basis of this decision in principle.

125. 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.

KEVIN POOLE
TRIBUNAL JUDGE
RELEASE DATE: 28 October 2011