Appeal number: FTC/26/2009

CORPORATION TAX – insurance company – with-profits policyholders sharing in profits of with-profits policies only – meaning of "separate revenue account required to be prepared" in FA 1989 s 83A(2)(b)

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

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

- and -

LEGAL & GENERAL ASSURANCE SOCIETY LIMITED

Respondent

Tribunal: Mr Justice Newey
Judge Colin Bishopp

Sitting in public in London on 13 July 2010

Mr David Ewart QC and Mr David Yates, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Mr Malcolm Gammie QC and Mr Ben Jaffey, instructed by McGrigors LLP, for the Respondent

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DECISION

Introduction

1. This is an appeal by the Commissioners for Her Majesty's Revenue and Customs ("HMRC") from a decision of the First-tier Tribunal (Judge Dr Avery Jones CBE) ("the Tribunal") dated 6 August 2009. HMRC and Legal & General Assurance Society Limited ("L & G" or "the Society"), the respondent to this appeal, made a joint reference to the Tribunal, pursuant to paragraph 31A of schedule 18 to the Finance Act 1998, of two issues. The Tribunal determined the first in favour of L & G and did not determine the second since its conclusion in respect of the first, if correct, made it unnecessary to do so. The appeal before us is in respect only of the first issue; it is agreed that if we allow the appeal the reference must be remitted to the Tribunal for determination of the second.

2. The appeal relates to the taxation of L & G's life assurance business which, as is common ground, is structured in an unusual manner. The essence of the dispute is the interpretation and application of, in particular, sections 83 and 83A of the Finance Act 1989. Section 83 introduced a new approach to identifying certain parts of an insurance company's income and gains for tax purposes. As Mr Malcolm Gammie QC, who appeared with Mr Ben Jaffey for L & G, explained to us, the section shifted the basis of taxation from realisation to recognition, and did so by identifying the income and gains by reference to "revenue accounts" which insurance companies had to prepare for regulatory purposes. Over the relevant years, 1999 to 2004 inclusive, the regulatory accounting and actuarial reporting obligations to which insurance companies were subject were laid down by (i) until 30 November 2001, the Insurance Companies Act 1982 ("ICA 1982") and regulations made under it, particularly the Insurance Companies (Accounts and Statements) Regulations 1996 ("the 1996 Regulations"); and (ii) from 1 December 2001, the Interim Prudential Sourcebook for Insurers (known as "IPRU (INS)" or, as we shall refer to it, "the Sourcebook"), published by the Financial Services Authority in accordance with the powers and duties conferred on it by the Financial Services and Markets Act 2000 ("FSMA").

L & G and its structure

3. The following description is a summary, so far as now relevant, of the agreed statement of facts produced for the hearing before the Tribunal, supplemented by the Tribunal's findings of fact. Overall, the agreed and found facts are extensive and detailed, but we have found it necessary for the purposes of this appeal to focus on only some of them.

4. L & G is a member of the Legal & General group of companies. It is principally engaged in life assurance and pensions business, but also has a small portfolio of general insurance business which is essentially in run-off. Its life assurance and pensions business gives rise to long-term liabilities. A life insurer's fund in respect of such business is generally known as the long-term insurance fund. That fund can be composed of separate funds (which may themselves be broken down into parts) representing sub-sets of the overall business. Each such fund is itself identified as a separate long-term business fund under regulation 8(b)(i) of the 1996 Regulations or long-term insurance fund under rule 9.14(b)(i) of the Sourcebook.

5. In L & G's case, the long-term insurance fund was divided into the following discrete funds:

(a) the life and annuity fund ("the L&A Fund");

(b) the permanent health insurance fund;

5 (c) the capital redemption fund; and

(d) the pensions fund management fund.

6. The L&A Fund was much the largest of the individual funds. It related to (i) basic life insurance and general annuity business and (ii) pension business. Further, it contained both "with-profits" and "non-profit" elements.

10 7. Mr Gammie made the important point that there were no physically separate funds for non-profit and with-profits business. That was accepted by the Tribunal, which recorded at paragraph 3(6) that:

> "Individual assets were not segregated between the with-profits or non-profits part of the L&A Fund. A proportion of each pool of assets would
> 15 have been referable to each."

8. The unusual structure of the arrangement, which is of central importance in the case, was explained by the Tribunal at paragraph 3(7) of its decision:

> "The normal method used by insurance companies is that with-profit policyholders participate in the overall surplus of the fund in which the
> 20 policy is written so that they share in the surplus arising from any non-profit policies in that same fund. The Society used a different method with the with-profits policyholders participating in 90% of the profits from with-profits policies and until 1996, at the discretion of the directors, which was in practice exercised, participating in part of the profits referable to non-
> 25 profit policies. The articles were changed in 1996 to provide that with-profit policyholders in the L&A Fund were entitled to not less than 90% (and in the period concerned the figure was in fact 90%) of the profits arising from with-profit policies only. The other 10% and the profit arising from non-profit policies in the L&A Fund were transferred to the profit and loss
> 30 account for the benefit of shareholders. On the change to this method in 1996 a sub-fund ('the 1996 Subfund') with a then value of £200m was created within the non-profit part of the L&A Fund in which the with-profits policyholders could benefit. At the time the board indicated that it did not anticipate that profit distributions to with-profits policyholders would be
> 35 made out of the 1996 Subfund for the foreseeable future and no distributions were in fact made before the end of the Period of Dispute. The reason for the change was because under s 30 ICA 1982 the percentage of profits allocated to with-profits policyholders cannot be varied by more than 0.5% per annum. The effect was that prior to the 1996 changes, the rate of distribution of
> 40 profits from non-profit business was controlled by bonus distributions on with-profits business, which caused practical problems for the Society."

9. The single L&A fund which had been in existence before 1996 was retained, and the division into with-profits and non-profit parts was an accounting exercise only. With-profits policy holders remained entitled to a minimum of 90%
45 of the surplus attributable to the with-profits part of the L&A Fund and potentially, though as the decision records not in practice during the relevant period, to further distributions at the discretion of the directors of L & G.

10. Dr Avery Jones commented, at paragraph 4 of his decision:

> "The issues arise because of the Society's way of distributing surplus to with-profit policyholders described … above. The issues in this referral arise because the [tax] legislation does not appear to cater for the Society's situation."

5 11. Before coming to that legislation, it is necessary to describe the accounting requirements imposed on insurance companies by ICA 1982 and the 1996 Regulations and, latterly, by the Sourcebook.

The accounting requirements

12. L & G prepares its accounts to 31 December each year, and (as is 10 undisputed) does so in accordance with the regulatory requirements from time to time in effect. As we have indicated, until 30 November 2001 those requirements were to be found in ICA 1982 and the 1996 Regulations; from 1 December 2001 they are set out in the Sourcebook.

ICA 1982 and the 1996 Regulations

15 13. Part II of ICA 1982 contained a number of provisions which required insurers to comply with specified accounting and actuarial reporting obligations. Only sections 17 and 18 are relevant here.

14. Section 17 of the Act provided as follows:

> "(1) Every insurance company to which this Part of this Act applies shall, 20 with respect to each financial year of the company, prepare a revenue account for the year, a balance sheet as at the end of the year and a profit and loss account for the year or, in the case of a company not trading for profit, an income and expenditure account for the year.
>
> (2) The contents of the documents required by subsection (1) above to be 25 prepared shall be such as may be prescribed, but regulations may provide for enabling information required to be given by such documents to be given instead in a note thereon or statement or report annexed thereto or may require there to be given in such a note, statement or report such information in addition to that given in the documents as may be prescribed …."

30 15. The 1996 Regulations dealt with the contents of the documents which section 17(1) required to be prepared. Regulation 8 provided as follows:

> "The revenue account to be prepared by every company under section 17(1) of the Act— …
>
> (b) in the case of a company carrying on long term business, shall comply 35 with the requirements of Schedule 3 below and shall be in Form 40 so, however, that—
>
> (i) every such company shall prepare a separate account in Form 40 in respect of each long term business fund maintained by it; and
>
> 40 (ii) where there is more than one fund for ordinary long term insurance business or for industrial assurance business, the company shall also prepare a summary Form 40 for ordinary long term insurance business or for industrial assurance business, as the case may require."

45 16. As Dr Avery Jones noted at paragraph 10 of his decision, the position was thus that a "separate account in Form 40 is … required for each part of the [long-

term insurance fund], plus a summary Form 40 with the totals". L & G was required to prepare, and in fact prepared, revenue accounts in Form 40 for the L&A, the permanent health insurance, the capital redemption and the pensions fund management funds. L&G also prepared, as required, a summary Form 40 in respect of the entire fund.

17. Section 18 of the 1982 Act provided as follows:

> "(1) Every insurance company to which this Part of this Act applies which carries on long term business—
>
> (a) shall, once in every period of twelve months, cause an investigation to be made into its financial condition in respect of that business by the person who for the time being is its actuary under section 19(1) below or any corresponding enactment previously in force; and
>
> (b) when such an investigation has been made, or when at any other time an investigation into the financial condition of the company in respect of its long term business has been made with a view to the distribution of profits, or the results of which are made public, shall cause an abstract of the actuary's report of the investigation to be made.
>
> (2) An investigation to which subsection (1)(b) above relates shall include—
>
> (a) a valuation of the liabilities of the company attributable to its long term business; and
>
> (b) a determination of any excess over those liabilities of the assets representing the fund or funds maintained by the company in respect of that business and, where any rights of any long term policy holders to participate in profits relate to particular parts of such a fund, a determination of any excess of assets over liabilities in respect of each of those parts.
>
> (4) For the purposes of any investigation to which this section applies the value of any assets and the amount of any liabilities shall be determined in accordance with any applicable valuation regulations.
>
> (5) The form and contents of any abstract … under this section shall be such as may be prescribed."

18. The 1996 Regulations elaborated on the report of the actuarial investigation under section 18 of the 1982 Act. Regulation 25 provided as follows:

> " … for the purposes of section 18 of the Act (periodic actuarial investigation of company with long term business) ordinary long term insurance business and industrial assurance business shall be treated separately and the abstract of the report of the actuary on long term business—
>
> (a) shall comply with the requirements of Schedule 4 below and shall contain the information (together with such of Forms 46 to 49 and 51 to 58 as may be appropriate) specified in that Schedule …."

19. Form 58, which was to be found in schedule 4 to the 1996 Regulations, was to set out, among other things, the "valuation result", the surplus arising and how that surplus had been distributed.

20. Schedule 4 also provided for the abstract of the actuary's report to contain other specified information. The information included, by paragraph 13 of the schedule, the following:

> "Where any rights of any policy holders to participate in profits relate to profits from particular parts of a long term business fund—
>
> (a) a revenue account in the format of Form 40 for each such part except where such information is provided elsewhere; and
>
> (b) the principles and methods applied in apportioning the investment income, increase or decrease in the value of assets brought into account, expenses and taxation between each part, where these particulars are not provided elsewhere."

21. The "revenue account in the format of Form 40" for which paragraph 13 of schedule 4 provided is commonly referred to as a "memorandum Form 40". Because of the structure of its L&A Fund, as it is described above, entitling with-profits policy holders to participate in "profits from particular parts of a long term business fund", this paragraph was engaged and L & G was required to, and did, prepare a memorandum Form 40 in respect of the with profits part of the L&A Fund. There were, accordingly, two overlapping accounts relating to that fund, one prepared for the purpose of section 17 "in Form 40" and relating to the entire fund, and the other prepared for the purpose of section 18 "in the format of Form 40", relating only to the with profits element.

FSMA and the Sourcebook

22. Although the replacement of ICA 1982 and the 1996 Regulations by the Sourcebook signalled a different regulatory regime, and the relevant requirements were worded differently, there was no significant change in their substance.

23. Rule 9.3(1)(a) of the Sourcebook required an insurer to prepare a "revenue account" for each financial year. Rule 9.14 provided as follows:

> "The revenue account to be prepared by every insurer under rule 9.3— …
>
> (b) in the case of an insurer carrying on long-term insurance business, must comply with the requirements of Appendix 9.3 and must be in Form 40 and –
>
> (i) separate accounts must be prepared in Form 40 in respect of each long-term insurance fund maintained by it; and
>
> (ii) where there is more than one fund for ordinary long-term insurance business or for industrial insurance business, the insurer must also prepare a summary Form 40 for ordinary long-term insurance business or for industrial assurance business, as the case may require."

Appendix 9.4 to the Sourcebook reflected the terms of schedule 4 to the 1996 Regulations. In particular, it required the preparation of a "revenue account in the format of Form 40" in the same circumstances as schedule 4 had done. L & G therefore continued to prepare the overlapping accounts we have described above.

The tax legislation

24. The taxation of insurance companies is addressed by Chapter I of Part XII of the Income and Corporation Taxes Act 1988 ("ICTA"). Under these provisions, basic life assurance and general annuity business is taxed on a different basis from

pension business. The profits of basic life assurance and general annuity business is charged to tax under the "I minus E basis", that is by taking actual income and gains less expenses. In contrast, the profits of an insurer's pension business are taxable under Schedule D Case VI, on profits computed in accordance with the provisions applicable to Schedule D Case I (see section 436(1) of ICTA, as it was in force throughout the material period).

25. Section 83(1) of the Finance Act 1989, introducing the change to which we have already referred, provided:

> "The following provisions of this section have effect where the profits of an insurance company in respect of its life assurance business are, for the purposes of [ICTA], computed in accordance with the provisions of that Act applicable to Case I of Schedule D."

26. The effect of the section is to modify, or adapt, the ordinary Case I rules as they are applied to those profits. For present purposes, the only relevant adaptation is that imported by sub-section (2) which, for the years 1999 to 2002 inclusive, provided as follows:

> "(2) So far as referable to that business, the following items, as brought into account for a period of account (and not otherwise), shall be taken into account as receipts of the period—
>
> (a) the company's investment income from the assets of its long term business fund, and
>
> (b) any increase in value (whether realised or not) of those assets.
>
> If for any period of account there is a reduction in the value referred to in paragraph (b) above (as brought into account for the period), that reduction shall be taken into account as an expense of that period."

27. From 2003, section 83(2) was amended to read as follows:

> "(2) There shall be taken into account as receipts of a period of account amounts (so far as referable to that business) brought into account for the period of account as—
>
> (a) investment income receivable before deduction of tax,
>
> (b) an increase in the value of non-linked assets,
>
> (c) an increase in the value of linked assets, or
>
> (d) other income;
>
> and if amounts (so far as so referable) are brought into account for a period of account as a decrease in the value of non-linked assets or a decrease in the value of linked assets they shall be taken into account as an expense of the period of account."

28. The differences between the two versions are not of immediate importance. The dispute centres on the phrase, used in both versions, "brought into account". The meaning of that expression is dealt with by section 83A. Until 30 November 2001, it provided as follows:

> "(1) In sections 83 to 83AB 'brought into account' means brought into account in an account which is recognised for the purposes of those sections.

(2) Subject to the following provisions of this section and to any regulations made by the Treasury, the accounts recognised for the purposes of those sections are—

(a) a revenue account prepared for the purposes of the Insurance Companies Act 1982 in respect of the whole of the company's long term business;

(b) any separate revenue account required to be prepared under that Act in respect of a part of that business.

Paragraph (b) above does not include accounts required in respect of internal linked funds.

(3) Where there are prepared any such separate accounts as are mentioned in subsection (2)(b) above, reference shall be made to those accounts rather than to the account for the whole of the business.

(4) If in any such case the total of the items brought into account in the separate accounts is not equal to the total amount brought into account in the account prepared for the whole business, there shall be treated as having been required and prepared a further separate revenue account covering the balance."

29. Following the passing of FSMA, section 83A(2) was amended, with effect from 1 December 2001, to read as follows:

"(2) Subject to the following provisions of this section and to any regulations made by the Treasury, the accounts recognised for the purposes of those sections are—

(a) a revenue account prepared for the purposes of Chapter 9 of the Prudential Sourcebook (Insurers) in respect of the whole of the company's long-term business;

(b) any separate revenue account required to be prepared under that Chapter in respect of a part of that business.

In paragraph (a) above 'the Prudential Sourcebook (Insurers)' means the Interim Prudential Sourcebook for Insurers made by the Financial Services Authority under the Financial Services and Markets Act 2000. Paragraph (b) above does not include accounts required in respect of internal linked funds."

30. Section 83A was amended again by the Finance Act 2003, but not in ways that matter for present purposes.

31. Dr Avery Jones described the position, as we see it accurately, at paragraph 8 of his decision:

"In summary … , receipts of investment income and gains are Case I receipts only to the extent that they are 'brought into account' in … separate revenue accounts required to be prepared under ICA1982 (or from 2001, Chapter 9 of [the Sourcebook]) in respect of the part concerned, rather than the revenue account for the whole of the [long-term insurance fund]. However, by section 83A(4) if the total of the items brought into account in the separate accounts is not equal to the total amount brought into account in the account prepared for the whole business, a further separate revenue account covering the balance is treated as having been required and prepared."

Sections 432A to 432F of ICTA

32. Sections 432A to 432F of ICTA, which are included in Chapter I of Part XII of the Act, deal with the apportionment of income and gains between different categories or classes of insurance business for tax purposes. These provisions, too, were amended during the course of the period with which we are concerned, but the amendments do not affect the underlying principles. Section 432A, reflecting section 83 of the Finance Act 1989, provided that income, gains and expenses were required to be apportioned to basic life assurance and general annuity business (and taxed on the "I minus E basis"). The terms of the section are not important in the present context; what is important is that the section set the scene for the following sections, which dealt with the detail of the apportionment of the various categories of receipt brought into account in accordance with sections 83 and 83A of the 1989 Act. The first step was provided for by section 432B, entitled "Apportionment of receipts brought into account":

> "(1) This section and sections 432C to 432F have effect where it is necessary in accordance with section 83 of the Finance Act 1989 to determine what parts of any items brought into account, within the meaning of that section, are referable to life assurance business or any class of life assurance business.
>
> (2) Where for that purpose reference falls to be made to more than one account recognised for the purposes of that section, the provisions of sections 432C to 432F apply separately in relation to each account …."

The proceedings before the First-tier Tribunal

33. The reference asked that the following issues be determined:

> *Issue 1*
>
> "Which of the revenue accounts prepared by [L & G] in relevant years [*ie* 1999-2004] are 'recognised' for the purposes of section 83A(2) Finance Act 1989, and in particular which, if any, such accounts are 'required to be prepared' for the purposes of section 83A(2)(b) of that Act?"
>
> *Issue 2*
>
> "If the revenue account in respect of the with profits part of the Life and Annuity business is 'required to be prepared' and is therefore 'recognised' for the purposes of section 83A, how are subsections (3) and (4) of section 83A to be construed and applied in the circumstances of [L & G's] case?"

34. It was common ground that the revenue accounts prepared by L & G for the entirety of its long-term insurance fund fell within section 83A(2)(a), and that the separate accounts for the whole of the L&A Fund, the permanent health insurance fund, the capital redemption fund and the pensions fund management fund fell within section 83A(2)(b). The parties disagree about whether the memorandum Form 40 relating to the with-profits part of the L&A Fund also fell within section 83A(2)(b). The difference between the parties arises in part from the fact that while section 83A(4) of the 1989 Act clearly contemplates the possibility that the aggregate of the sums brought into account by the various revenue accounts will be less than the true aggregate, it does not cater (or appear to cater) for the possibility that, as in this case, where the regulatory requirements lead to double-counting, the aggregate of the individual accounts will exceed the true aggregate.

HMRC contend that this difficulty can be overcome by purposive construction; L & G that the difficulty does not arise because the memorandum Form 40 is not a revenue account, and therefore does not fall within the taxing provisions at all.

35. Dr Avery Jones decided Issue 1 in favour of L & G and consequently declined to decide Issue 2 as it did not arise. On Issue 1, he held that the "memorandum Form 40" (the account "in the format of Form 40") was not "a separate revenue account required to be prepared" for the purposes of either ICA 1982 or, for the later periods, Chapter 9 of the Sourcebook, and that the amounts recorded in it accordingly did not fall within the provisions of section 83A of the 1989 Act nor, correspondingly, sections 432A to 432F of ICTA.

36. The core of Dr Avery Jones' reasoning is to be found in paragraph 27 of his decision:

> "The primary reason for my decision is that a memorandum Form 40 is not a 'separate revenue account required to be prepared under the [Insurance Companies] Act in respect of a part of that business' or a 'separate revenue account required to be prepared under that Chapter [Chapter 9 of [the Sourcebook]] in respect of a part of that business.' While a memorandum Form 40 is certainly something required to be prepared, it is not so required as a separate revenue account (meaning an account *in* Form 40) but is merely information to be provided in similar format in so far as it has not been provided elsewhere in answer to a list of information required to be provided by the appointed actuary and as support for the starting point for the separate with-profits Form 58 (which could have been prepared without a memorandum Form 40), so that the apportionment of part of the surplus to with-profits policies can be verified. Since the contents of the memorandum Form 40 are themselves an apportionment of the totals for the L&A fund, there seems no reason in principle why they should be brought into an apportionment of items brought into account for the whole L&A Fund to pension business. The separate revenue accounts that are required to be prepared under the Act (or Chapter 9 of [the Sourcebook]) are accordingly solely the real Form 40s."

37. Dr Avery Jones considered that support for this conclusion was to be found in the history of the provisions. He referred at paragraph 28 to an argument advanced on L & G's behalf to the effect that:

> "tax legislation adopted language from s 17 ICA 1982, which refers to the summary and separate revenue accounts but not to the memorandum Form 40 (which is required pursuant to regulations under s 18 ICA 1982, both the 1983 and the 1996 Regulations being in identical form in referring to 'a revenue account in the format of Form 40')."

38. We interpose that the 1983 Regulations, in full the Insurance Companies (Accounts and Statements) Regulations 1983, were the forerunners of the 1996 Regulations, and in similar terms. Dr Avery Jones then expressed agreement "with the linguistic argument that when s 83A(2) refers to 'any separate revenue account required to be prepared under the [ICA 1982]' it had in mind the separate accounts prepared under s 17 and not the memorandum Form 40 prepared pursuant to s 18".

39. Difficulties which would arise with Issue 2 also, in Dr Avery Jones' view, suggested that Issue 1 should be determined in favour of L & G. At paragraph 29 he said:

> "If Parliament says nothing about how to deal with both the Form 40 for the L&A Fund and the memorandum Form 40 for the with-profits part of it, which clearly creates double counting if they are both 'separate revenue accounts required to be prepared under the [ICA 1982],' this is a strong argument why Parliament did not intend the s 432 apportionment to use the memorandum Form 40. If Parliament had intended the memorandum Form 40 to be used in the s 432 apportionment it would surely have dealt with the excess total as well (I discount the possibility that Parliament would have intended double counting)."

The parties' cases in summary

HMRC's case

40. Mr David Ewart QC, who appeared with Mr David Yates for HMRC, argued that the First-tier Tribunal had erroneously equated the "separate revenue accounts" with "Form 40s". Mr Ewart pointed out that section 83A of the Finance Act 1989 did not refer to a "Form 40" or indeed to section 17 of ICA 1982 (or rule 9.3 of Chapter 9 of the Sourcebook). That section 83A extended to revenue accounts other than those in Form 40 is, Mr Ewart said, confirmed by the express disregard in section 83A(2) for "accounts required in respect of internal linked funds" which are not in Form 40 but rather in Form 44; this indicated (in the words of HMRC's skeleton argument) that "the draftsman anticipated all possible revenue accounts being brought within the meaning of section 83A(2)(b) and for this reason inserted an express disregard for Form 44".

41. With regard to the history of the provisions, Mr Ewart contended (to quote again from the skeleton argument) that "if the draftsman had wished to make express reference to section 17 of ICA 1982 etc he would have done so as opposed to (on [L & G's] case) leaving a trail of linguistic clues".

42. As for the difficulties with Issue 2 which the Tribunal had identified, Mr Ewart argued that Issue 1 was entirely discrete from Issue 2 and should be considered on its own merits. In any case, problems at the Issue 2 stage could be overcome by, as he put it, "applying a purposive construction" to section 83A. The First-tier Tribunal's approach to Issue 1 would produce problems of its own since the application of sections 432A to 432F to the revenue accounts, excluding the memorandum Form 40, would mean that a disproportionate amount of investment return would be allocated to basic life assurance and general annuity business. This point was put as follows in the skeleton argument:

> "Where … in [L & G's] case the rights of with-profits policyholders are restricted to a proportion of the profits arising from the with-profits business written in the L&A Fund (and, as a result, a memorandum Form 40 is required to be prepared for the [with-profits fund]), a distortion arises on the basis of [L & G's] interpretation on Issue 1 since such rights (and subsequent bonuses declared) are disproportionately weighted towards [basic life assurance and general annuity business] as opposed to [pension business]."

L & G's case

43. Mr Gammie contended that the First-tier Tribunal's decision was correct for the reasons it gave.

44. Amongst the specific points Mr Gammie made were these:

(a) In its references to revenue accounts "prepared for the purposes of the Insurance Companies Act 1982" and to "any separate revenue account required to be prepared under that Act", section 83A(2) of the Finance Act 1989 specifically adopted the language of section 17 of ICA 1982, which spoke explicitly of the preparation of a revenue account and referred to it as a document "required … to be prepared". In contrast, all that section 18 of the 1982 Act "provides for in terms of documents is an abstract of an actuary's report", the purpose of that report being "to investigate and report on the 'financial condition' of the company, for the protection of policyholders rather than the computation of profits, losses or tax liabilities".

(b) Were HMRC right on Issue 1, revenues would be "taken into account pursuant to the form 40 prepared for the whole of the L&A Fund and again under the memorandum Form 40 prepared for the with-profits part of the L&A Fund" (to quote from L & G's skeleton argument). The legislation should not be construed in such a way as to bring into account a figure (from the memorandum Form 40) which represents an apportionment of the L&A Fund Form 40 that has already been fully brought into account.

(c) There was no basis in the statute for the "purposive construction" of section 83A which HMRC advocated. "Rather than construing section 83A(4) beyond a meaning that its language can properly bear in order to avoid a result that parliament cannot have intended – namely, a double apportionment of investment income and gains, … the [First-tier Tribunal] was," L & G submitted in its skeleton argument, "correct in concluding that the draftsman did not intend that the memorandum Form 40 should count as a 'revenue account' under section 83A(2) …."

The construction of section 83A(2)

45. We have concluded that the memorandum Form 40 is not an account recognised for the purposes of section 83 of the Finance Act 1989.

46. We can summarise our reasons as follows:

(a) As mentioned above (paragraph 2), the enactment of section 83 of the Finance Act 1989 reflected a decision that documents which an insurance company had to prepare for regulatory purposes should be used to calculate its income and gains. That being the intention, Parliament can be expected to have had in mind documents which were intended to show the company's financial performance and balance sheet position. The revenue account and other documents mentioned in section 17 of ICA 1982 (and, later, rule 9.3 of the Sourcebook) self-evidently had that purpose. In contrast, Mr Ewart accepted L & G's description of the purpose of the actuary's report as "to investigate and report on the 'financial condition' of the company, for the protection of policyholders rather than the computation of profits, losses or tax liabilities". The apparent functions of sections 17 and 18 can be seen from their headings: section 17 was headed "Annual accounts and balance sheets" and section 18 "Periodic actuarial investigation of company with long term business". Similar headings are to be found in the Sourcebook.

(b) That the draftsman had in mind the revenue account which section 17 of ICA 1982 (and rule 9.3 of the Sourcebook) required is indicated by the fact

that echoes of section 17 and the regulations relating to the "revenue account" for which it provided are to be found in section 83A of the Finance Act 1989. Section 83A and section 17 both spoke explicitly of "revenue accounts"; in contrast, the memorandum Form 40 was not mentioned in either section 18 of the 1982 Act or the body of the 1996 Regulations, but only in a schedule to those regulations. The expression "required to be prepared", which section 83A(2)(b) used, was also found in regulation 8 of the Insurance Companies (Accounts and Statements) Regulations 1983 (in force at the time section 83A was enacted), and section 17(2) featured the word "required" too. Section 83A(2) referred to "any *separate* revenue account" and sub-sections (3) and (4) to "*separate* accounts"; regulation 8(b)(i) of the 1996 Regulations similarly referred to "a *separate* account" and regulation 17(a) to "each revenue account prepared *separately*".

(c) For a memorandum Form 40 to be recognised for the purposes of section 83 would be inconsistent with the scheme of the legislation. Were a memorandum Form 40 to be so recognised, the accounts to be brought into account for the purposes of section 83 and, hence, apportioned under sections 432B to 432E of ICTA would include both the account for the L&A Fund as a whole and the memorandum Form 40 for that fund's with-profits element. Mr Ewart argued that the double-counting that that would otherwise entail could be avoided through section 83A(4), which it may be helpful to quote once more:

> "If in any such case the total of the items brought into account in the separate accounts is not equal to the total amount brought into account in the account prepared for the whole business, there shall be treated as having been required and prepared a further separate account covering the balance."

This sub-section was most obviously directed at ensuring that the total amount brought into account for tax purposes was no *less* than that indicated by the account prepared for the whole business, but Mr Ewart argued that the sub-section was, according to its terms, also capable of applying where a total derived from individual accounts was *greater* than the total for the whole business. In such an eventuality, Mr Ewart said, a "further separate account" was (pursuant to section 83A(4)) to be treated as having been required and prepared of a *negative* nature. If that is right, a sensible result could be achieved only if that negative account were set in its entirety against the account for the L&A Fund and there were then apportioned (i) a net L&A Fund account after deduction of the notional negative account (in place of the actual account for the L&A Fund) and (ii) the memorandum Form 40. However, we agree with Mr Gammie that there is no basis in the statute for such an approach, and we do not consider that it could be justified. It follows, in our view, that Mr Ewart's submissions would lead to anomalous results that Parliament cannot have intended. This tends to suggest that Parliament (and the draftsman) did not contemplate a memorandum Form 40 being brought into account at all.

(d) The headings to sections 432C to 432E of ICTA imply that Parliament was envisaging that accounts apportioned under those provisions would relate to particular funds. Thus, the heading to section 432C is "Section 432B apportionment: income of non-participating *funds*", and those to sections

432D and 432E refer respectively to "value of non-participating *funds*" and "participating *funds*". Yet the memorandum Form 40 does not relate to any fund as such, but rather to the with-profits *element* of the L&A Fund, which is in any case itself the subject of a separate revenue account. The references to "funds" are, however, consistent with regulation 8(b)(i) of the 1996 Regulations (and rule 9.14(b)(i) of the Sourcebook), which called for a separate account "in respect of each long term business *fund*".

(e) It is implicit in what we have said in the previous sub-paragraphs that we do not consider that Issue 1 should be looked at in complete isolation from Issue 2 (compare paragraph 42 above). In our view, the problems which Issue 2 would present are of relevance to Issue 1;

(f) Notwithstanding Mr Ewart's argument to the contrary (see paragraph 40 above), it seems to us that the express disregard for "accounts required in respect of internal linked funds" (in section 83A(2)) does not assist HMRC. If anything, it indicates that the draftsman did not intend there to be double-counting and addressed the problem where he thought it could arise. The reason, as it seems to us, why he did not address the double-counting to which the memorandum Form 40 could give rise were it to be recognised for the purposes of section 83 was that he did not intend it to be so recognised.

Conclusion

47. The result is that, for reasons similar to those he gave, we agree with Dr Avery Jones' decision. We accordingly dismiss the appeal. We direct that HMRC pay L & G's costs of this appeal, to be the subject of detailed assessment by a costs judge of the High Court if they are not agreed.

Mr Justice Newey

Judge Colin Bishopp

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12 October 2010