Silver wins gold

Tim Good reviews the decision of the First-tier Tribunal in *Marina Silver*, which overturned HMRC's decision that top-slicing relief was not available.

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On 18 April 2019, judgment was delivered in the First-tier Tribunal case *Marina Silver* (TC7103 at tinyurl.com/y5apz6ju). Judge Barbara Mosedale (sitting with member Helen Myerscough) allowed the taxpayer's appeal against HMRC's calculation of top-slicing relief on a chargeable event gain.

The facts are simple enough. In May 2015, Mrs Silver surrendered a life insurance bond and the insurance company issued a chargeable event certificate showing a gain of £110,721.93. The bond term was 21 years and her other income in 2015-16 was £31,101. HMRC argued (but Mrs Silver disagreed) that because her adjusted net income was £141,822 she was not entitled to any personal allowance. This is because ITA 2007, s 35 reduces the allowance by £1 for every £2 of income over £110,000 threshold.

> "Section 536 clearly directed a hypothetical tax calculation to be carried out on certain assumptions."

Judge Mosedale agreed with HMRC (and so do I) that the chargeable event gain counts as income and, if the adjusted net income exceeds the threshold, the personal allowance is withdrawn. Every tax return software product does this.

However, Mrs Silver argued (and HMRC disagreed) that she was entitled to top-slicing relief of about £22,000 under ITTOIA 2005, s 535. According to HMRC, she was only entitled to about £2,000 of top slicing relief. (The actual figures may differ slightly – the judgment does not give me all the information required to calculate them accurately.)

Judge Mosedale agreed with Mrs Silver (as do I – see my article 'It's all gone Pete Tong' (*Taxation*, 28 September 2017, p14) so the net effect was that HMRC wanted to overcharge the taxpayer by about £20,000.

A hypothetical tax calculation

Although the calculations are complicated, the statutory provisions are not. As Judge Mosedale says in her judgment:

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

And she went on to say:

> 'Moreover, parliament's intent with top-slicing relief was obviously to allow a person who has taken income over a number of years to have relief when provisions taxed them to the entire income in a single year, as here. The relief was intended to make the tax liability approximate to what it would have been had the income been taxed in the year it was actually received. So when carrying out the

Key points

- Taxpayer's appeal against HMRC's top-slicing calculation is allowed.
- The chargeable event gain is taken into account in calculating the entitlement to personal allowances in ITA 2007, s 35.
- The tribunal's view was that HMRC's approach was not in accordance with parliament's intention.
- If tax has been overpaid in previous years consider a repayment claim and refer to ESC B41.
- The decision could affect many taxpayers.
- HMRC is expected to appeal the decision.

hypothetical tax calculation it made every kind of sense that the taxpayer should be treated as entitled to the reliefs that that hypothetical income would have entitled her to.'

She continued:

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

And finally:

'So applying the legislation, both literally and in accordance with parliament's presumed intent, results in the steps set out in s 23 being applied in full to the hypothetical situation postulated by s 536(1).'

The only argument put forward by HMRC is to be found at paragraph 16:

'Mr Corbett's [the HMRC litigator] position was that HMRC's manual was quite clear that top-slicing relief could not be used where the taxpayer was not entitled to a personal allowance. And, he pointed out, Mrs Silver was not entitled to a personal allowance in year 2015-16.'

The next stage

I understand that HMRC intend to appeal to the Upper Tribunal, so we can expect the department to continue to resist claims based on the interpretation of the legislation now endorsed by Judge Mosedale.

> "We can expect the department to continue to resist claims based on the interpretation of the legislation."

As it happens, just two hours before receiving the *Silver* judgment I was in the process of setting up a campaign through CrowdJustice.com to fund a similar case and a judicial review application. The clarity of Judge Mosedale's judgment makes me think that this will not now be necessary but, if need be, it remains an option.

In the meantime, agents and tax advisers should:

- identify clients who may have been overcharged tax (many of these will be deceased estates);
- calculate the top-slicing relief as directed by Judge Mosedale; and
- if the client has been overcharged, take the action suggested below.

In-time years

Returns already filed for the tax year 2017-18 can be amended by 31 January 2020.

Returns for the tax year 2019-20 should be filed using the correct basis of calculation. Since every single tax return software product (as far as I know) has simply used the same basis as the incorrect HMRC calculator, agents and taxpayers will have to file either a paper return or file online and then submit an amendment on paper.

Personally, I would pay the incorrect tax and then seek to recover it at a later date rather than have to deal with HMRC demands for penalties, surcharge or interest.

> "Taxpayers who have been overcharged for years earlier than 2015-16 should submit overpayment relief claims."

Overpayment relief claims

Overpayment relief claims may be made within four years from the end of the relevant tax year. So claims for 2015-16 and 2016-17 are still in time.

I would expect HMRC to resist overpayment relief claims on the grounds that the tax was calculated 'in accordance with the practice generally prevailing at the time'. However in *HMRC v Household Estate Agents Ltd* [2008] STC 2045, Henderson J considered the effect of similar words in FA 1998, Sch 18 para 45. On the meaning of 'practice generally prevailing' he said:

> 'Without attempting to give an exhaustive definition, it seems to me that a practice may be so described only if it is relatively long-established, readily ascertainable by interested parties, and accepted by HMRC and taxpayers' advisers alike.'

In *Boyer Alan Investment Services Ltd v HMRC* (TC2235), Judge Berner gave further consideration to the elements identified by Henderson J in *Household Estate Agents*. He made following points in paragraphs 34 to 40 of his judgment.

1) 'To be ascertainable required that the practice was not inchoate and that it be sufficiently precise and devoid of uncertainty in its application.'
2) 'Although a published statement of practice was the paradigm of an ascertainable practice, it was possible for a practice to be ascertainable if settled, defined and agreed between, or communicated between, taxpayers or otherwise sufficiently identified to the outside world.'
3) 'A published practice was likely to be capable of being regarded as having become generally prevailing over a shorter period than one merely established in practice.'
4) 'An internal practice of HMRC would not be generally prevailing until it could be identified with reasonable clarity and precision by taxpayers.'
5) 'That quality of clarity and precision must be present in the understanding of HMRC and taxpayers alike.'
6) 'In order for the practice to be "generally" prevailing it must have been adopted by HMRC and generally, but not universally, by the taxpayer community.'
7) 'The practice must be settled. This will not be the case if it is articulated or applied otherwise than in a consistent manner.'

I my view, I believe that HMRC's miscalculation of top-slicing relief fails to meet criteria (1) to (5), arguably fails to meet (6) and probably just about meets criterion (7).

Extra-statutory concession B41

The text of extra-statutory concession B41 ('Claims to repayment of tax' at tinyurl.com/ya4evoss) reads as follows:

> 'Under the Taxes Management Act, unless a longer or shorter period is prescribed, no statutory claim for relief is allowed unless it is made within four years from the end of the tax year to which it relates.
>
> 'However, repayments of tax will be made in respect of claims made outside the statutory time limit where an over-payment of tax has arisen because of an error by the Inland Revenue or another government department, and where there is no dispute or doubt as to the facts.'

In my view, taxpayers who have been overcharged for years earlier than 2015-16 should submit overpayment relief claims citing ESC B41 and (as explained above) rejecting HMRC's 'practice generally prevailing' defence.

The tapering of the personal allowance when income exceeds £100,000 was introduced by Alastair Darling from 2010-11. If I am right on the ESC B41 and 'practice generally prevailing' arguments, repayments should be requested for any of the tax years 2010-11 to 2016-17.

Calculating the correct relief

So how are we to calculate top-slicing relief correctly? My September 2017 article sets out several worked examples. The problem is that the HMRC calculator is used for top-slicing relief by (as far as I know) all of the tax return software developers. My company has a free top-slice checker at tinyurl.com/y4h7gk63 which can be used to identify whether the HMRC figure is right or wrong. At present, it covers the six years 2013-14 to 2018-19.

Planning point

Review client personal tax computations for previous in-date years to check whether a repayment claim could be made if the top-slicing relief was recalculated.

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