

Life insurance policies: recalculating gains on part surrenders
Consultation on draft clauses for Finance Bill 2017
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

- 1.1 While this measure introduces a fair and coherent solution to a legislative problem that has caused gross unfairness to some taxpayers, we have some serious concerns over the draft legislation itself and practicability of its application.
- 1.2 It is noteworthy and worrying that HM Revenue & Customs (HMRC) did not consult publicly on this chosen solution, hence those with an interest in the changes may not have had the opportunity to comment on it before publication of the draft legislation. It is therefore to be hoped that comments made on the draft legislation will be taken seriously and dealt with before the Finance Bill 2017 commences its passage through Parliament.
- 1.3 On the legislation itself, we recommend the following:
- 1.3.1 The draft clause be amended to include a crucial right of appeal on all aspects of the proposals – that is: whether or not a gain is considered disproportionate; how the ‘just and reasonable’ recalculation is arrived at; and to appeal HMRC’s denial of a longer period for recalculation to be applied for (if the two years proposed is not extended).
- 1.3.2 The period for application for a recalculation to be extended to four years from the end of the tax year in which the gain arose (rather than two years from the end of the insurance year, as currently proposed).
- 1.4 Finally, given that the success of this proposal depends very much on how it is to be operated in practice, it is hugely disappointing that draft HMRC guidance material was not published during the consultation period on the draft legislation. We strongly recommend that this is published as soon as possible and at any rate before the clauses are debated in

Committee, along with draft guidance for the general public. Further, consultation is without doubt needed as to how taxpayers may be made aware of the possibility of a recalculation – for example, HMRC need to engage with interested stakeholders on how digital and other systems can be used to prompt/nudge those potentially affected.

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 General comments

- 3.1 As announced at Budget 2016 and following consultation, the government will legislate in Finance Bill 2017 regarding the very large and hugely unfair tax charges that arise in certain circumstances from life insurance policy part-surrenders and part-assignments. With effect from 6 April 2017, this will allow taxpayers to ask HMRC to recalculate the gain on a 'just and reasonable' basis. We would note that the measure to be finally adopted here was not one of the options formally consulted on by HMRC,¹ thus potentially limiting the opportunity for interested parties to comment on it.
- 3.2 We welcome this change, although we would have preferred a more clear-cut measure to tackle the problem. As it stands, much depends on how the new rules proposed in draft clause 13 of the Finance Bill will be communicated to people. Many unanswered questions remain, such as: If someone is unrepresented and fills in their return with gain details and

¹ See consultation document published 20 April 2016:

<https://www.gov.uk/government/consultations/part-surrenders-and-part-assignments-of-life-insurance-policies>

then notes the resulting large tax bill, what will prompt them to ask for it to be recalculated on a just and reasonable basis? Furthermore – assuming they get that far – how will they know if the revised calculation is actually just and reasonable? Will gains in fact be prepopulated into individuals’ digital tax accounts under the Making Tax Digital proposals? If so, will the online system prompt people very clearly to there being a possible alternative means of calculation?

- 3.3 Given that the answers to all of the above are fundamental to us understanding how this clause will operate in practice, it is disappointing that HMRC draft guidance material on its application has not been made available during the consultation period.

4 Right of appeal

- 4.1 Our support for these changes is predicated on there being a full right of appeal to the tax tribunal. No such right currently appears in the draft legislation, and this must be rectified prior to the changes becoming law. Otherwise, we understand that the only avenue open to the taxpayer in the event of disagreement with HMRC would be judicial review – a solution which is out of the reach of practically all ordinary taxpayers, particularly those on low incomes.
- 4.2 It is clearly unacceptable that an HMRC officer should be the sole judge of whether the gain is disproportionate, how a just and reasonable substitute is to be calculated (given that this is not specified in the legislation), and whether or not an application to recalculate the gain more than two years after the end of the ‘insurance year in which the gain arose’ should be accepted.

5 Timescale for application for recalculation

- 5.1 We are confused as to the choice of timescale for a recalculation application to be made:
- 5.1.1 First, the two-year period does not appear to tie in with other ‘claims’ under tax law. Why would this not be a four-year period, for example, to mirror other reclaims for a tax refund?
- 5.1.2 Second, why ‘two years after the end of the **insurance year** in which the gain arose’?¹ It would surely be more comprehensible to the taxpayer to have a deadline by reference to the **tax year**, especially given that it is likely to be on completion of a tax return (or other filing under the proposed ‘digital’ tax system) that the taxpayer becomes aware of a disproportionate gain arising.

¹ Draft Section 512A(2)(b)(i) ITTOIA 2005

6 Guidance to taxpayers

- 6.1 HMRC will need to issue very clear guidance to the public. This in itself raises a serious and legitimate concern that in fact HMRC do not now have full control over tax guidance made available to the public, given that the Government Digital Service has editorial oversight of GOV.UK. We have seen instances where the ethos of that website (which we understand to be to meet the needs of the majority) means that points such as this are not covered at all as they are likely to be viewed as esoteric, thus depriving those who do need to know of essential guidance. Considerable effort therefore needs to be invested in making this new legislation work, and we are willing to work with HMRC so we hope they will consult on these matters in due course.

LITRG

27 January 2017