

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 23/07/2008

Before :

MR JUSTICE NORRIS

Between :

JASON DRUMMOND

Appellant

- and -

**COMMISSIONERS FOR H M REVENUE AND
CUSTOMS**

Respondent

Patrick Way and Hui Ling McCarthy (instructed by **Penningtons Solicitors LLP**) for the
Appellant

Timothy Brennan QC and Nicola Shaw (instructed by **Solicitor for HMRC**) for the
Respondent

Hearing dates: 20th February 2008

Judgment

Mr Justice Norris:

1. The expenses of effecting policies of insurance and of assurance and the realisation proceeds of such policies raise questions about income and capital in various contexts. In the context of taxation the realisation of such policies by surrender is both a disposal for capital gains tax purposes and an event giving rise to a charge to income tax. This case concerns the interrelationship between these two sets of provisions. In order to impose the charges to tax the provisions operate by the creation of various hypotheses. The appellant says that the interrelationship of these various hypotheses is such that, in the space of a few days and at a cost of £210,000, he has been able to create a capital loss of £1.962 million which is available for off-setting against other real gains that he has made. Whilst not asserting that such a consequence was intended by the legislature, the appellant submits that it is the inevitable consequence of entering the complicated hypothetical world which this legislation inhabits.
2. The essential facts are not in dispute and are set out in paragraphs 21 to 60 inclusive of the decision of Sir Stephen Oliver QC dated 5 July 2007 (“the Decision”) against which this present appeal is brought. The following is a sufficient summary to determine the issues arising on the Appeal. London & Oxford Capital Markets (“London & Oxford”), a small corporate finance and investment company, operated as a market maker in second hand life assurance policies. It created a stock of such policies by procuring an interest free loan to be made to one of its employees (Ms Sedgley) who used the loan to effect non-qualifying policies on her life with American Life Insurance Company (“AIG”) on 23 February 2001. The policies were in every respect real. The insurance company was a major institution. The underlying investments were genuine and potentially long term. The rights of the policyholder were in all respects of an arm’s length nature. On 26 March 2001 Ms Sedgley assigned the AIG policies to London & Oxford for a small profit. The Special Commissioner found that this had been intended from the outset, and that Ms Sedgley’s taking of independent financial advice in respect of apparently personal investments by her had been “a charade”. On 28 March 2001 London & Oxford charged the AIG policies as security for an overdraft from its bankers. On 30 March 2001 London & Oxford then drew down on this overdraft facility and used the advance to pay substantial additional premiums on the AIG policies. On 4 April 2001 Mr Drummond agreed to buy five of the AIG policies from London & Oxford for £1.962 million, £1 million being payable that day and the balance of the consideration the following day. The five policies had a surrender value of £1.751 million (equivalent to the premiums paid). The difference between the cost to Mr Drummond of the five AIG policies (£1.962 million) and the surrender value of the five AIG policies (£1.751 million) represented the scheme costs (consisting of London & Oxford’s profit, an introductory commission, fees for “independent financial advice”, a contribution to a fighting fund, and a contingency fund of about £98,000). On 5 April 2001 (as had been intended from the outset) Mr Drummond surrendered the five policies to AIG, part of the surrender money being used to discharge the obligation to pay the outstanding consideration payable that day. Thus the five policies acquired by Mr Drummond on 4 April were turned into cash on 5 April 2001. The process had cost Mr Drummond about £210,000. The object of the process had been to create an allowable capital gains tax loss of £1.962 million to off set against a capital gain of

£4.875 million which Mr Drummond had made on the sale of his shares in Virtual Internet Plc.

3. An insurance policy may conventionally be thought of as an asset and its surrender as amounting to a disposal from which a capital sum is derived. The Taxation of Chargeable Gains Act 1992 (“TCGA 1992”) indeed so provides. Section 210(3) states in relation to policies of assurance of the kind relevant to this case :-

“Subject to subsection (2)...the occasion of the surrender of a policy of assurance, shall be the occasion of a disposal of the rights under the policy of assurance.”

Section 210 (2) then provides:-

“No chargeable gain shall accrue on the disposal of...the rights under any such policy of assurance...except where the person making the disposal is not the original beneficial owner and acquired the rights...for a consideration in money or money’s worth.”

There is thus only both a disposal and a chargeable gain in relation to second hand policies. But in this way, the donor of a relevant second hand policy is brought within the capital gains tax regime.

4. This is a specific application of the general rule set out in Section 22 TCGA 1992 that there is:-

“...for the purposes of [the] Act a disposal of assets by their owner where any capital sum is derived from assets notwithstanding that no asset is acquired by the person paying the capital sum...in particular...capital sums received in return for...surrender of rights...”.

For these purposes it is necessary to identify the “capital sum” derived. This is done by Section 22(3) which provides that in Section 22:-

“... “capital sum” means any money or money’s worth which is not excluded from the consideration taken into account in the computation of the gain...”.

This case concerns what is to be so “excluded”.

5. But the surrender of a policy of assurance is also an occasion for a charge to income tax under Chapter II of the Income and Corporation Taxes Act 1988 (“TA 1988”). Section 539 of that Chapter says that it:-

“...shall have effect for the purposes of imposing...charges to tax...in respect of gains to be treated...as arising in connection with policies of life insurance...”.

Section 540(1)(a)(iii) then identifies as one of the events which is a “chargeable event” the surrender in whole of the rights conferred by a non qualifying policy. Section 541(1)(b) is then in these terms:-

“On the happening of a chargeable event...there shall be treated as a gain arising in connection with the policy...(b) if the event is...the surrender in whole of the rights thereby conferred, the excess (if any) on the amount or value of the sum payable plus the amount or value of any relevant capital payments arising by reason of the event...over the sum of the following (i) the total amount previously paid under the policy by way of premiums; and (ii) the total amount treated as a gain...on the previous happening of chargeable events.”

It will be seen that what is being subjected to tax is a hypothetical or deemed “gain” (“...there shall be treated as a gain...the excess (if any)...”): and that the deemed gain incurred by the disponor is calculated by reference to matters which do not necessarily relate exclusively to him, but may relate in part to previous holders of the policy.

6. The charge on this hypothetical or deemed gain is then imposed on the disponor under Section 547(1)(a) by these words:-

“Where...a gain is to be treated as arising in connection with any policy...(a) if, immediately before the happening of the chargeable event in question, the rights conferred by the policy...were vested in an individual as beneficial owner...the amount of the gain shall be deemed to form part of that individual’s total income for the year in which the event happened...”.

The deemed gain is thus added directly to the individual’s total income for the purpose of assessing the income tax payable by him.

7. This charge is imposed in respect of all policies, whether or not originally effected by the disponor. But if the policy is a second hand policy the beneficial owner may not be able to calculate the gain which is to be treated as arising, because, whilst he will know the amount payable arising on the surrender (the chargeable event) he will not necessarily know the amount of previous relevant capital payments or the total amount previously paid under the policy by way of premiums (e.g. by previous owners) or the total amount treated as a gain on the happening of previous chargeable events (e.g. when the previous owner transferred to the disponor) so as to be able to calculate “the excess” which is to be treated as the gain arising in connection with the policy which forms part of his total income. Accordingly Section 552(1) TA 1988 imposes on the insurers an obligation, where a chargeable event has happened in relation to a policy, to deliver to the Inspector information including:-

“as may be required for computing the gain to be treated as arising...

- (i) the surrender value of the policy...
- (ii) the amount or value of any relevant capital payments...
- (iii) the amounts previously paid under the policy...by way of premiums...”.

8. Given that the surrender of the AIG policies was both a “disposal” for capital gains tax purposes (giving rise to a chargeable gain or allowable loss) and a “chargeable event” for income tax purposes (giving rise to a gain arising in connection with the policy which is deemed to form part of Mr Drummond’s total income) the system must make some provision for a relationship between those two taxes arising on that single event. This is achieved by means of an allowable deduction in the computation of the capital gain and is provided by Section 37 TCGA 1992, which lies at the heart of this appeal and is in these terms:-

“There shall be excluded from the consideration for a disposal of assets taken into account in the computation of the gain any money or money’s worth charged to income tax as income of, or taken into account as a receipt in computing income or profits or gains or losses of, the person making the disposal for the purposes of the Income Tax Acts.”

9. The Section operates in this way:-

- (a) It is first necessary to identify “the consideration for a disposal of assets.” Section 22 TCGA 1992 identifies this “consideration” as the surrender proceeds of £1.751 million.
- (b) It must then be confirmed that this consideration will be taken into account in the computation of the gain. Section 210(2) TCGA 1992 confirms that the surrender of the AIG policies is a disposal that will give rise to a chargeable gain which must be computed. Mr Drummond in fact paid £1.962 million to acquire the right to the surrender proceeds of £1.751 million, so that he did not make “a gain” but rather incurred a loss. However, Section 16 TCGA 1992 provides that the amount of a loss accruing on a disposal shall be computed in the same way as the amount of a gain accruing on a disposal is computed. So the surrender proceeds will be taken into account in the computation of the gain.
- (c) There is then to be excluded from the surrender proceeds taken into account for the purposes of that computation (1) any money or money’s worth which is (2) either (a) charged to income tax as income of the person making the disposal or (b) taken into account as a receipt in computing any income or profits or gains of the person making the disposal. This brings me to the heart of the appeal.

10. For income tax purposes the surrender of the five AIG policies had given rise to a “chargeable event gain” of £1,351. This was the excess of the surrender proceeds over (a) the initial premiums paid by Ms Sedgley (£1,250) (b) the additional premiums paid by London & Oxford (£1,748,750) and (c) a chargeable event gain of £25 which had occurred when Ms Sedgley assigned the five AIG policies to London & Oxford. When Mr Drummond did his computation of the capital gain arising on the disposal by surrender of the five AIG policies he did not deduct from the policy proceeds the sum of £1,351 as

“money...charged to income tax as income of...the person making the disposal” under Sections 541(1)(b) and 547(1) TA 1998. Instead he deducted £1,751,376 (i.e. the entirety of the surrender proceeds) (thereby reducing the consideration for the disposal by way of surrender to nil). His argument was that the £1.751 million was “money...taken into account as a receipt in computing income or profits or gains or losses...for the purposes of the Income Tax Acts.” The relevant “gain” was the “chargeable event gain” treated as arising in connection with the life policy under Section 539, the relevant computation of the gain was that undertaken pursuant to Section 541 TA 1988, and the “taking into account” arose because Section 541(1)(b) charged to tax the excess of the surrender proceeds over the aggregate of the premiums paid and any previous chargeable event gains. So the surrender proceeds were “taken into account” as a receipt in the computation of the chargeable event gain, and they must therefore be excluded from the calculation of the gain/loss on the disposal of the policy: so Mr Drummond is to be treated as having paid £1.962 million and got nothing in return. Hence the loss which he can offset.

11. Sir Stephen Oliver QC rejected this argument. In paragraph 16 of the Decision he held:-

“In common with the Revenue, I disagree with Mr Drummond’s construction. The calculation required by Section 541(1)(b) brings into the reckoning amounts that may have had nothing to do with the surrendering policyholder. Neither the premiums paid by, nor the chargeable event gain of Ms Sedgley, nor the topping-up premium paid by London & Oxford nor the surrender proceeds of £1,751,376.00 were, in terms of Section 37 (1), moneys taken into account as receipts in computing Mr Drummond’s income or profits or gains or losses for income tax purposes. The only amount so taken into account is the actual chargeable event gain ie £1,351.35. That is a discreet (*sic*) amount produced from the calculation of gain “treated as arising in connection with” the policy; and that amount, as a stand-alone figure of income, is deemed by Section 547(1)(a) to form part of Mr Drummond’s total income.”

The Special Commissioner went on to amplify the distinction he was drawing between amounts taken into account for the purposes of prior calculations affecting a tax payer and amounts taken into account as receipts in computing the tax payer’s income by reference to the decision of Mr Justice Vinelott in Hirsch v Crowthers Cloth Ltd (1989) 62 TC 759.

12. Mr Way and Miss McCarthy submit that the Special Commissioner erred in law in so holding. Their argument proceeds as follows:-

- (a) The surrender of a life policy is an occasion to charge both capital gains tax and income tax.
- (b) The methods of calculating the gain chargeable to capital gains and that chargeable to income tax are entirely different, the former being concerned with the actual expenditure incurred by the tax payer in acquiring the policy which is surrendered, and the latter being a calculated

figure assessed by reference also to expenditure laid out and to sums received by previous holders of the policy.

- (c) The deemed gain is not “money or money’s’ worth” but an entirely notional figure, the product of a statutory calculation. Thus Mr Drummond has been taxed on the footing that he made a chargeable event gain of £1351 although in truth he made an economic loss of £210,000.
- (d) In order to calculate the deemed “gain” which is to be charged to income tax the starting point is to take the actual surrender proceeds (in order to deduct from that sum the premiums paid and earlier gains realised) so that the surrender proceeds are “money...taken into account as a receipt in computing income...or gains...”;
- (e) Because the surrender proceeds have been so “taken into account” for income tax purposes they must for capital gains tax purposes “be excluded from the consideration...taken into account in the computation of the gain”, because that is what Section 37 TCGA 1992 explicitly provides;
- (f) In the resulting computation of the capital gain the entirety of the consideration received on the disposal of the asset is excluded, leaving only the acquisition costs of the asset which accordingly constitutes an allowable loss;
- (g) Whilst this may appear a surprising result it is the result required by the prescriptive code established in relation to the taxation of life policies, which legislation is entirely without ambiguity, and tells the reader precisely how to compute the deemed gain charged to income tax on the surrender of a second hand policy and then tells the reader precisely how to compute the CGT. The surrender proceeds must be ignored but the acquisition costs must be included. There is no room for doubt;
- (h) This was simply another instance of that to which Henderson J referred in Revenue and Customs Commissioners v D’Arcy [2007] EWHC (Ch) 163 (at para. 47), [2008] STC 1329:-
 - “..... one of those cases, which will inevitably occur from time to time a tax system as complicated as ours, where a well advised taxpayer has been able to take advantage of an unintended gap left by the interaction between two different sets of statutory provisions”.
- (j) HMRC itself has recognised that this is the case because on 9 April 2003 it issued a Budget Note (REV BN 30 Capital Gains: Second Hand Life Insurance Policies) in which it acknowledged that on the disposal of second hand policies “the computational rules may result in a loss for capital gains tax purposes which exceeds the amount of an economic loss incurred” and it promoted new provisions to “correct two defects in the current tax rule”, eventually achieved in the Finance Act 2003 by the substitution of a new Section 210 (in the course of which explanatory Treasury Notes issued in connection with what was then clause 156 of the

Bill confirmed that the object was to counter tax-avoidance measures exploiting defects in the current rules ;

(k) Far from supporting the conclusion of the Special Commissioner the decision of Vinelott J in Hirsch demonstrates that the reasoning in the decision under Appeal is erroneous.

13. It is at this point convenient to consider Hirsch. Crowthers acquired plant on which it received capital allowances. In 1980 the plant was sold for more than its acquisition cost. Section 44(3) Finance Act 1971 provided that for any chargeable period in which the company's qualifying expenditure was less than the disposal value which it brought into account there was to be made on the company "a balancing charge". The disposal value of Crowther's pooled assets exceeded its allowable expenditure, so Crowther's accounts included such a balancing charge. However the Revenue raised an assessment to capital gains tax on the difference between the cost of the plant to Crowthers and its sale proceeds. The company relied on Section 31(1) Capital Gains Tax Act 1979 which provided:-

"There shall be excluded from the consideration for a disposal of assets...any money or money's worth charged to income tax as income of, or taken into account as a receipt in computing income or profits or gains or losses of, the person making the disposal for the purposes of the Income Tax Acts...".

The acquisition cost of the plant had been an element in the computation of the balancing charge. Vinelott J held (at p771 D):-

"The words "taken into account" are no doubt capable of being given a very wide construction and as comprehending a sum which is an ingredient in a calculation which gives rise to a further sum which then has to be brought into a corporation tax computation and which may accordingly be said to have been indirectly "taken into account". But these words are capable of being read, and in this context are I think most naturally read, as referring to sums which have to be brought directly into the computation."

As examples of sums being brought "directly" into the computation of profits and losses for the purposes of income tax (and which therefore had to be excluded in ascertaining the consideration for a disposal) Vinelott J cited (1) the deemed annual rent which is brought into the charge to income tax on the disposal of a lease for less than fifty years at a premium and (2) the proportion of the market value of shares acquired by a director or employee under a share incentive scheme. By contrast, the judge considered the value of the plant disposed of was one element of the total disposal value of all machinery during the relevant accounting period, and it was brought into account against a pool of qualifying expenditure. In argument before me Mr Way demonstrated that there were eight steps between the "taking into account" of the proceeds of sale of the plant and the computation of Crowther's profits chargeable to corporation tax: and he submitted that it was unsurprising that Vinelott J should regard the proceeds of sale as having been only "indirectly" taken into account. In the instant case he submitted there were but two steps

(the identification of the policy proceeds, the deduction therefrom of the aggregate of the premiums paid and any previous gains, and the carrying of the resulting excess into the computation of Mr Drummond's total income).

14. Tightly argued and attractively presented as this case was I reject it.
15. The key issue is what is the meaning of the words "money...charged to income tax as income of or taken into account as a receipt in computing income" in section 37. The exercise of construing Section 37 is not to be conducted in a vacuum. I must give the section a purposive construction in order to determine the nature of the transactions to which it was intended to apply, and then I must decide whether the actual transaction (involving as it does a number of elements intended to operate together) answers to the statutory description: see BMBF v Mawson (2004) 72 TC 446 at paragraph 32.
16. As I see it the purpose of section 37 was to avoid a taxpayer suffering double taxation in relation to a single event which occasioned both a charge to income tax and a charge to capital gains tax. It achieves that end by adjusting (for capital gains tax purposes) the consideration that is taken into account on the disposal of the asset by excluding amounts that have already been charged to income tax. Its purpose was not to create arithmetic losses which distort the economic effect of real transactions for the purposes of charging them to tax. There can, of course be provisions that do have such a purpose: section 541(1)(b) itself may be an example. It can also be the case that a provision having the former purpose by its language compels the latter consequence: and that is the essence of Mr Drummond's argument in this case.
17. I have summarised my view of the structure of section 37 in paragraph 9 above. I have no difficulty in holding that the chargeable event gain of £1,351 is "money". Both the appellant and HMRC agree that the proceeds received on surrender of the AIG policies were "money". In my judgment the £1351 is simply part of that "money" (being money from which other sums of money, such as the premiums paid, have been deducted). The fact that it is also the product of a calculation (to ascertain the relevant part) does not mean that it has ceased to be "money". This "money" was without doubt then charged to income tax as income of Mr Drummond. It was first treated as a gain arising in connection with the policy by virtue of section 541(1)(b) and that deemed "gain" was then deemed to form part of his total income by section 547(1)(a). Once the deemed gain was ascertained it was directly charged to tax as part of Mr Drummond's total income without any intervening calculation. So I would allow the whole of the £1,351 to be excluded from the consideration received on the surrender of the AIG policies. (In paragraph 19 of the Decision the Special Commissioner was inclined to allow only "his share of it"; but I see no warrant for that in section 37. The whole of the sum was charged to income tax as income of Mr Drummond and he is entitled to reduce his capital gain by the whole amount so taxed).
18. Since there is "money" which has been charged to income tax as income of Mr Drummond and on which section 37 bites, there is in my judgment no need to look for (and indeed no warrant in section 37 for seeking) some *other*

“money” which might additionally be used to create a second deduction from the consideration received for AIG policies for purposes of the computation of the gain on their disposal. In particular there is no need to look at the alternative method of identifying the “money” which is under section 37 to be excluded from the consideration for the disposal. The section contemplates that in relation to any given transaction there will only be one sum of money which falls to be deducted from the consideration received on disposal in the calculation of the capital gain: and that is why Mr Way had to submit that the chargeable event gain was not “money”.

19. If there had been no “money” charged to income tax as income of Mr Drummond it would have been necessary to see whether there was any “money” which had been “taken into account as a receipt in computing income”, that is to say, “money” which when identified, is then entered into a computation of income or profits or gains (in which allowable expenses incurred by the taxpayer are set off against the receipts of the taxpayer), which income or profits or gains when so computed are then charged to tax. Because the “money” has been treated as a receipt it will have inflated the total income charged to tax or will have reduced the loss (although not itself directly charged to income tax). So to avoid a double charge to tax the sum treated as a receipt for computing the profit liable to income tax is deducted from the consideration chargeable to capital gains tax. This explains why it is necessary for section 37 to contain alternative methods of identifying the “money” that is deducted from the disposal proceeds in the capital gains tax calculation.
20. In the instant case the proceeds of the AIG policy were not “taken into account as a receipt” for the purpose of computing income or profits or gains or losses within the meaning of section 37. Mr Drummond was not taxed as if he had received the policy proceeds as part of his income. He paid income tax assessed on the basis that he had received the chargeable event gain, a gain calculated and certified by the insurance company. Since the chargeable event gain itself represented part of the policy proceeds those policy proceeds inevitably constituted an element in the equation or an ingredient in the insurance company’s calculation: but they were not “taken into account as a receipt” for the purpose of computing income because they were not brought directly into the computation of Mr Drummond’s total income. They simply provided the starting point (the raw data) for a statutory process undertaken by the insurance company which involved the deduction of sums not expended by Mr Drummond and of which he had no knowledge, the result of which was a certificate specifying the deemed gain arising in connection with the policies that was then added to Mr Drummond’s total income. The policy proceeds were in this respect like the total premium payable on the 50 year lease which has to be brought into the income account rateably over its term: I would not regard the total premium as a sum “taken into account as a receipt”, but merely as the raw data for the apportionment process. “Taken into account as a receipt” is not the equivalent of “featuring in some prior calculation which results in a figure to be added to income”. The money must in some real sense be taken into account *as a receipt* and as such a receipt have a direct effect on the sum charged to income tax.

21. I consider that this approach is to be found also in sections 38 and 39 TCGA 1992. Section 37 deals with the consideration received on a disposal and what under the statute is to be “excluded from the consideration”. Section 38 deals with the other element in the computation of the gain, namely “the sums allowable as a deduction from the consideration”. Because some events will occasion both a charge to capital gains tax and a charge to income tax, once again the interrelationship of the two sets of provisions has to be addressed in the context of those deductions. Just as a receipt should not be taxed both as income and as part of a capital gain, so deductions should not be permitted both from the gain and from income. So section 39(1) provides:-

“There shall be excluded from the sums allowable....as a deduction in the computation of the gain any expenditure allowable as a deduction in computing the profits or losses of a trade.....or allowable as a deduction in computing any other income or profits or gains or losses for the purposes of the Income Tax Acts”

The principle is clear. If a sum has been allowed as a deduction from the income chargeable to tax it should not be allowed as deduction from the gain chargeable to tax. In my judgment the same principle is embodied in and governs the construction of section 37. If a sum of money has been directly treated as part of an individual’s total income or been treated as a receipt and thereby inflated the income charged to tax (or reduced the loss otherwise available), it should not also be charged to capital gains tax.

22. The purpose of section 37 is to avoid any part of the policy proceeds being subject to both income tax and capital gains tax. Mr Way’s construction has the effect that the policy proceeds (save for the chargeable event gain) escape both taxes entirely. I share the sentiment expressed by Vinelott J. in Hirsch at p772A

“ It would be paradoxical to find that the cost of acquisition is itself to be deducted from the consideration for the disposal of the asset thereby ensuring that the gain escapes the charge to corporation tax on capital gains. If the legislation were to compel that conclusion it would not simply have missed fire; it would have hit the wrong target.”

23. I agree with Mr Way’s submission that the question is whether simply upon its true construction the statute applies to the transaction (see MacNiven v Westmoreland Investments [2003] 1 AC 311, and that Mr Drummond’s purpose in utilising its provisions cannot inform that true construction. But in my judgement section 37 does not apply to the surrender proceeds in the manner for which he contends. The fact that HMRC might at one stage have thought that it did (and taken supposed remedial steps) is of no assistance in ascertaining the true legal meaning of the section: see Harding v HMRC [2008] EWHC 99 per Briggs J at paras 66-68.

24. This brings me to the second point on the appeal, which was argued independently of the first. The first point concerned what was to be excluded

from the consideration. This point concerns what may be deducted from the consideration. The policy proceeds were the consideration received on the disposal constituted by the surrender of the AIG policies. Section 38 TCGA 1992 permits deductions to be made from that for the purpose of calculating the gain to be subjected to tax. But it says that:-

“the sums allowable as a deduction from the consideration.....shall be restricted to ...the amount or value of the consideration, in money....givenwholly and exclusively for the acquisition of the asset.....”

Before the Special Commissioner, HMRC contended that in the computation of his capital gain none of the £1.962 million paid by Mr Drummond to London & Oxford for the AIG policies was to be allowed as a deduction since none of it was paid “wholly and exclusively” for the acquisition of the asset.

25. The Special Commissioner upheld this contention taking as his starting point (para.63) the proposition that there was no purpose in London & Oxford’s sale and in Mr Drummond's purchase of the right to the five policies other than the facilitation of the tax avoidance strategy. He then proceeded to hold (para. 65) that the whole of the consideration must be for the acquisition of the asset, and that the acquisition of the particular asset must be the sole purpose for which the consideration is given. On the facts as he found them those conditions were not satisfied (see para. 73 of the Decision):-

“ The issue of whether the £1.96 million was incurred wholly and exclusively for the acquisition of the five policies can be expressed in terms of this question: were the consideration payments of £1 million on 4 April and £962,233 (which it was a term of the contract should be paid on the 5 April 2001) viewed realistically and taking an unblinkered BMBF approach to the facts, the consideration given wholly and exclusively for Mr Drummond's acquisition and London & Oxford's disposal of the five policies? The answer in my view is – No. The Offer to Sell does not stand alone. The scheme was designed to achieve the tax shelter, not Mr Drummond's acquisition of the five policies.”

26. Mr Brennan QC submitted that these were findings of fact against which no appeal could properly be brought. I disagree. The primary findings of fact made by the Special Commissioner must stand: but the secondary findings (the analysis of and inferences properly drawn from the primary findings) and the legal consequences are properly the subject of an appeal. It is my respectful view that the Special Commissioner started the analysis at the wrong point.
27. The transaction in question was the purchase and disposal of second-hand policies. There is no doubt that such a purchase really occurred and that Mr Drummond acquired an equitable title to the five AIG policies. Those policies had a history created by others: but that history does not deprive the policies of the characteristic of being assets acquired by Mr Drummond. The task in hand is to calculate the gain made when he disposed of them. He is allowed to deduct from what he received that which he expended upon acquisition. But

the deductions are restricted. He is not entitled to deduct everything he expended, but only “the consideration in money.... given by him... wholly and exclusively for the acquisition of the asset”. Mr Drummond paid a total of £1.962 million and in return he acquired the five AIG policies and some services and benefits. The total of £1.962 million can be broken down into a number of discrete sums and matched to the benefits or services. London & Oxford’s fee, the introductory commissions, the fees for “independent financial advice”, the contribution to the fighting fund, and the contingency payment of £98,000 into the escrow account were plainly not payments made wholly and exclusively for the acquisition of the five AIG policies. (Nobody argued they were “incidental costs”). So they are not amounts that can be deducted. It was only the remaining balance that constituted the consideration given by Mr Drummond wholly and exclusively for the acquisition of the five AIG policies: and that is the consideration given for the acquisition that is allowable as a deduction from the consideration received on disposal. This was an alternative view expressed by the Special Commissioner (in paragraph 74 of the Decision) and I agree with him.

28. The unblinkered approach to the facts which is required by BMBF (*supra*) does not require me to don the blinkers of “tax avoidance scheme” and with my vision so restricted then to view no part of the £1.962m as having been paid for the acquisition of an asset and the whole as paid for “participation in a tax avoidance scheme”. No-one suggested that Mr Drummond would have paid £1.962 million for participation in a tax avoidance scheme if the AIG policies had only had a surrender value of £10,000. Of course the amount of the policies he purchased was influenced by the amount of the loss which he hoped the scheme would produce: but he still purchased policies and did not merely pay a fee for a service.
29. It does not seem to me to be helpful to say (as Mr Brennan QC submits) that Mr Drummond “did not incur the expenditure because he wanted to acquire the policies” but for some other reason. As I see it, Mr Drummond wanted to acquire the policies precisely because by so doing he thought he would obtain a tax advantage on their surrender: and he still gave consideration wholly and exclusively to acquire them.
30. I therefore dismiss Mr Drummond’s appeal on the first ground (and hold that only the £1,351 chargeable event gain falls to be excluded from the consideration received on the surrender of the policies), and allow his appeal as to part of the second ground (and hold that the sum of £1.752 million may be deducted from the consideration received on the surrender but not the sum of £210,000, which latter sum was not wholly and exclusively expended in the acquisition of the policies). On this disposition of the appeal the matters raised in HMRC’s Respondent’s Notice do not arise, because no artificial loss has been generated by the transaction as part of a tax avoidance scheme.
31. I do not expect the attendance of legal representatives when I formally hand down this judgment (unless the appropriate arrangements have been made through the usual channels). If there is no attendance I will on that occasion

adjourn the question of costs and any applications arising out of this judgment to a further hearing to be arranged as soon as possible.