

THE SPECIAL COMMISSIONERS

GREYCON LIMITED

Appellant

- and -

**MRS JOANNA KLAENTSCHI
(H M INSPECTOR OF TAXES)**

Respondent

Special Commissioner: DR JOHN F AVERY JONES CBE

Sitting in public in London on 24 and 25 June 2003

Barrie Akin, counsel, instructed by Baker Tilly, for the Appellant

Joanna Klaentschi, HM Inspector of Taxes, in person

DECISION

1. Greycon Limited appeals against an assessment in respect of its accounting period ended 30 April 1999. The issue is whether the proceeds of six key man insurance policies totalling £585,999 are receipts of the trade and taxable under Case I of Schedule D. The Appellant was represented by Mr Barry Akin; the Inspector, Mrs Joanna Klaentschi, appeared in person.

The Facts

2. There was an agreed statement of facts as follows into which I have inserted some minor changes agreed at the hearing or subsequently:

(1) The Appellant is a company registered in England under number 1861647 and has its registered office at 7 Calico House, Plantation Wharf, York Road, Battersea, London SW11 3UB.

(2) The Appellant was incorporated under the name Nullhigh Limited. On 7 November 1984 it changed its name to Greycon Limited, and on 1 February 1985 it changed its name to Greycon Consultants Limited. It has, since shortly after incorporation, carried on the business of the development and marketing of computer based systems for use in the paper industry. It changed its name to Greycon Limited on 23 August 1994. During the year to 30 April 1999 it incorporated a wholly owned subsidiary in the USA, Greycon North America Inc which now carries on a similar business in the USA.

(3) The original issued share capital of the Appellant was divided into £1 ordinary shares. Based on annual returns to Companies House, the shareholdings (including family held related shareholdings) are as follows:

	Nov 1988	Sep 1989	Mar 1990	Apr 1994	Dec 1994	Apr 1995	Apr 1999
A Ord voting shares							
CN Goulimis	350	350	350	350	400	400	545
G Bryant	350	350	350	350	350	350	0
AG Dimitriades and his executors					400	400	545
Non Voting Shares							
AG Dimitriades	200	200	200	400			
SR Duncan	100	100	200				
CN Goulimis				50			
Other	150	150	50				
B Ord voting shares							
Tullis Russell Limited		1	1				
Greycon (held for cancellation)				1	1		
Total	1,150	1,151	1,151	1,151	1,151	1,150	1,090

(4) The non voting shares ranked pari passu with the A voting shares in all respects (except as regards voting rights). The non voting shares were converted to A voting shares on 8 December 1994.

(5) During the year to 30 April 1998, Professor G Bryant sold 290 of his shares to Dr Goulimis and Mr AG Dimitriadis. In the following year the Appellant bought back Professor Bryant's remaining 60 shares in the company. Professor Bryant sold his shareholding interest in the company in 1998 and 1999 as he no longer was taking an active part in the company's business.

(6) Mr Dimitriadis acquired 200 non voting shares in 1986, increasing to 400 by 1993. His shares were converted to A voting shares in 1994. He was appointed as a director of the company on 23 January 1986. Mr Dimitriadis died on 18 April 1999 and since that date his shares have been held by his executors.

(7) The Appellant was incorporated to exploit the know-how of Messrs Goulimis and Bryant, who had met when the former had attended Imperial College as an undergraduate and subsequently a post-graduate student. Professor Bryant taught at Imperial.

Life Policy – C R Goulimis

(8) On 19 July 1989, Tullis Russell & Co Limited ("Tullis Russell") of Rothesfield, Markinch, Glenrothes, Fife KY7 6PD, a customer of the Appellant, entered into an agreement with the Appellant and its shareholders. Under the agreement, Tullis Russell was granted a two year option to subscribe for a 20% shareholding interest in the Appellant with a five year put option under which Tullis Russell could be required to acquire the balance of the issued share capital at its then market value, provided the two year option had been exercised by Tullis Russell. Under the agreement Tullis Russell also agreed to guarantee the Appellant's ordinary course of business indebtedness to the Royal Bank of Scotland plc up to a limit of £150,000 for a period of two years. Tullis Russell also agreed to subscribe £1 for 1 'B' voting share in the Appellant and did so subscribe on 31 July 1989. The holding of the B voting share entitled them to appoint a director to the board of the Appellant. The share certificate for the 1 B voting share was returned to the the Appellant on 10 February 1993 for cancellation.

(9) As one of the conditions precedent to the agreement with Tullis Russell Greycon was required to effect "key man" life insurance policy approved by Tullis Russell for £499,999 for Dr Goulimis. A policy was effected on the life of Dr Goulimis on 27 January 1989. Greycon was intended to be the beneficiary of the policy, but the policy schedule shows Dr Goulimis as the grantee of the policy notwithstanding that the proposal forms show the Appellant as intended beneficiary.

(10) The policy on the life of Dr Goulimis was discontinued in April 1990 as Dr Goulimis had been informed that his military service in Greece from March 1990 would cause the policy to become invalid.

Life Policy – A G Dimitriadis

(11) Following the impending discontinuance of the policy on the life of Dr Goulimis an application was made on 6 April 1990 to Legal & General for life insurance cover of £499,999 on the life of Mr AG Dimitriadis . On 12 June 1990, five whole of life insurance policies with a guaranteed sum payable on death of £499,999, were issued by Legal & General on Mr A G Dimitriadis' life. The Appellant was the beneficiary under these policies. On 12 June 1993, a further whole of life policy with a guaranteed sum of £86,000 was taken out. Again, the Appellant was the beneficiary under the policy.

(12) The policies on Mr Dimitriadis were all whole of life policies, with a guaranteed sum payable on death. In the case of each policy, the specified percentage of the premiums was invested in fund units and the sum payable on death was expressed to be the greater of the guaranteed death sum assured and the bid value of the units then credited to the policy.

(13) Mr Dimitriadis was diagnosed with cancer in January 1997 and died on 18 April 1999. Legal & General paid the Appellant the guaranteed policy proceeds of £585,999 in May 1999.

(14) The aggregate bid value of the units credited to all of these policies at 18 April 1999 was notified by Legal & General as £5,973. The aggregate premiums paid to Legal & General by Greycon from the inception of the policies to 18 April 1999 amounted to £19,671.

Reporting of Premium payments and Policy proceeds in the accounts of Greycon

(15) The aggregate insurance proceeds of £585,999 on the six policies effected on the life of Mr Dimitriadis were received by the Appellant in May 1999 but were recognised in the profit and loss account of the statutory accounts for the period to 30 April 1999, as the proceeds were due and payable in that period.

Corporation Tax Returns

(16) In the corporation tax return for the year to 30 April 1997 for the Appellant an agreement was reached with the Inspector of Taxes to disallow an amount equivalent to the total premiums paid on the whole of life policies on Mr Dimitriadis' life from 1990 to 30 April 1997 of £14,324. It was accepted both by the Appellant and the Inland Revenue that a deduction for the premiums in the years to 30 April 1996 had previously been incorrectly claimed and that for convenience one adjustment should be made to correct the position for all accounting periods up to and including the accounting period ended 30 April 1996.

(17) The premiums paid in the two accounting periods ended 30 April 1999 were disallowed in the Schedule D Case I computations for those years so that in total the disallowed premiums of £19,671 equated to the total premiums paid in respect of the life policies on Mr Dimtriadis' life.

(18) The proceeds of £585,999 from the life policies were not treated as taxable in the Appellant's corporation tax return and computation for the year ended 30 April 1999.

Inland Revenue Assessment

(19) On 12 July 2001 the Respondent Inspector raised a corporation tax assessment in respect of the accounting period of the Appellant ended 30 April 1999, charging the life policy proceeds of £585,999 as part of the Schedule D Case I profits for the period. The Appellant company appealed against the assessment and requested postponement of tax of £195,781.14 charged, leaving corporation tax of £36,686.46 payable, which has been paid by the company.

Agreed issues on tax treatment of proceeds from life policies

(20) The proceeds from the whole of life policies on Mr Dimitriadis' life are not in the circumstances subject to any charge to tax under the provisions of Chapter II of Part XIII Income and Corporation Taxes Act 1988 ; and

(21) No chargeable gains accrued to the Appellant in respect of the six life Policies because of the provisions of Section 210(2) Taxation of Chargeable Gains Act 1992.

The position of the parties

(22) The Appellant's position is that the object of the first 5 policies of assurance effected by it on the life of Mr Dimitriadis was to satisfy the requirements of Tullis Russell (which required protection for its potential investment in the Appellant) to secure possible increases its capital and to provide a means for it to repurchase its shares in the event of Mr Dimitriadis' death. The policies for Mr Dimitriadis replaced the term life policy on the life of Dr CN Goulimis which was effected for the same reasons but was cancelled in view of his undertaking military service in Greece in March 1990. The the Appellant further takes the position that the final policy effected by it on the life of Mr Dimitriadis was regarded as an addition to the first 5 policies and should take as its object the object of the policies to which it is an adjunct.

(23) The Respondent Inspector's position is that the policies were effected to cover anticipated loss of trading profits in the Appellant in the event of Mr Dimitriadis' death, that the policies therefore have a trading purpose.

3. The issues for determination are agreed to be:

(1) whether the receipt by the Appellant in its accounting period ended 30 April 1999 of £585,999 being the aggregate proceeds of 6 policies of assurance effected by it on the life of Mr. Dimitriadis was a receipt of a revenue or a capital nature and whether it was a receipt of its trade; and

(2) whether the assessment to Corporation Tax for the period ended 30 April 1999 is excessive and ought to be reduced by £586,000, with profits chargeable to Corporation Tax determined in the sum of £165,889.

4. I heard evidence from Dr C N Goulimis (a director of the Appellant), and Mr D Erdil (formerly executive chairman of Tullis Russell) and Mr S Morrison (formerly

group finance director of Tullis Russell), and also had a witness statement from Mr S Duncan (a former director of the Appellant). There was also a bundle of documents. In spite of the policies in question being taken out in 1989 and 1990 the Appellant was able to provide remarkably good documentary evidence about them and I am grateful to them for their researches. I also had detailed skeleton arguments in advance from both Mr Akin and Mrs Klaentschi and I am grateful to both of them for their particularly clear presentation of the case.

5. In the light of the evidence I can make further findings of fact. By way of background, Dr Goulimis met Professor Bryant while doing an MSc computing course at Imperial College. He was invited to join Professor Bryant's Industrial Automation Group which was conducting research for the British Paper and Board Industry Federation while he was also working on his PhD on the "cutting-stock problem" of minimising waste when cutting small things out of big things, a problem with significant commercial applications in the paper industry. By 1984 his research had resulted in algorithms that were superior to those in use at the time. It was successfully tested at Purfleet Board mill, part of Unilever. Professor Bryant and Dr Goulimis set up the Appellant to exploit the algorithms commercially. Mr Dimitriadis was doing a MSc and MBA at Imperial and was also working on the same problem in the Industrial Automation Group. He joined the Appellant a few months after its formation. Originally the Appellant operated from Imperial College. Mr Dimitriadis was successful in obtaining contracts with Wiggins Teape (now Arjo Wiggins) for their Stoneywood mill in Aberdeen as a result of which the Appellant became too large to operate from Imperial's premises. Dr Goulimis also considered that the working atmosphere at Imperial College lacked the discipline required when supplying systems that were running round-the-clock scheduling in large paper mills, and secondly that they were not projecting the right image to prospective customers. Tullis Russell were competitors of the Stoneywood mill. Dr Goulimis had met Mr Erdal, the chairman, when travelling and the discussion eventually led to the Agreement with Tullis Russell described below.

6. The Agreement with Tullis Russell took some time to be completed. Tullis Russell's lawyers were instructed in about June 1988, negotiations were reported in board minutes of the Appellant with increasing concern being expressed about the time they were taking, in August 1988, September 1988, November 1988 when the requirement for key man policies is first mentioned in the minutes (then including insuring Professor Bryant, but this was regarded as too expensive having regard to his age and not necessary as he was not involved in the day-to-day running of the Appellant), and February 1989. The Agreement was finally signed on 19 July 1989. It was in the form of an offer letter from Tullis Russell beginning "Tullis Russell are pleased to outline to you the terms of our proposed acquisition of share capital in, and guarantee of certain banking liabilities of, [the Appellant]". The letter had annexed to it new articles of association providing for B shares, various warranties and undertakings to be given by the Appellant, Professor Bryant and Dr Goulimis (not Mr Dimitriadis, indicating that Dr Goulimis was thought by Tullis Russell to be the key player), and a list of the current shareholdings. It provided that Tullis Russell would subscribe for 1 B voting share entitling it to appoint a director, the first appointee being named in the Agreement. It provided that Tullis Russell would guarantee the

Appellant's "ordinary course of business indebtedness" with the Royal Bank of Scotland subject to a maximum of £150,000 for no longer than two years. A guarantee was entered into with the bank on 19 July 1991 for all the Appellant's indebtedness on any current account subject to the maximum of £150,000 together with interest and expenses. Commercially this provided the Appellant with funds for two years; one could expect the bank not to call in the overdraft within those two years while it was guaranteed. At the end of the period the guarantee ended and the bank could call in the overdraft, being paid by Tullis Russell who would be left with a right of subrogation against the Appellant, and so they would be in a similar position as if they had made a loan to the Appellant.

7. The Agreement also gave Tullis Russell the right to subscribe for such number of shares as would give it 20 per cent of each of the voting and non-voting shares within two years at a price of £150,000 within the first year and £200,000 in the second. It provided that the subscription money would be applied first in discharge of Tullis Russell's liability under the guarantee. Effectively therefore if Tullis Russell had subscribed for the shares, £150,000 (assuming that the overdraft has been used to the full amount guaranteed) would go to pay off the bank so that the guarantee would be cancelled by this means within its two year term. Commercially the Appellant would have Tullis Russell as a 20 per cent shareholder and no bank overdraft, so that Tullis Russell's investment of at least £150,000 would have been permanent funds, and Tullis Russell would be likely to support the future financing of the Appellant in their interest as shareholder and being a substantial company (Mr Goulimis estimated their turnover at the time to be £50m) they would be in a position to do so. Mr Morrison, the group finance director of Tullis Russell, thought that the price took into account an increase in profits resulting from the investment "a little bit." I deduce that Tullis Russell thought at the time of the Agreement that it was reasonably likely that they would take up this option.

8. The Agreement also provided that the shareholders had the option to require Tullis Russell to acquire all or part of the share capital within five years at market value determined by the auditors, but only if Tullis Russell had exercised their option to acquire 20 per cent of the capital and also if it then held more than 50 per cent of the voting shares. This second condition would have required either Tullis Russell to acquire further shares, or a purchase of own shares by the Appellant such as to leave Tullis Russell holding more than 50 per cent of the voting shares.

9. The option to acquire 20 per cent of the shares was never exercised. But a new guarantee to the bank was entered into by Tullis Russell on 18 July 1991 with the 1989 Agreement being discharged and the one voting B share being held to the Appellant's order, and the Tullis Russell director being removed. Tullis Russell received an assignment of the software by way of security for the guarantee and a floating charge on the remaining assets. Tullis Russell was then merely a secured lender to the Appellant without any shareholding interest. I assume that they did this in preference to finding the money to pay off the bank under the guarantee immediately. They had also decided not to continue investing in other companies. It is not clear that there was a requirement a requirement to continue the insurance on Mr Dimitriadis' life. The floating charge does contain a covenant not to do anything

to the assets that made void any insurance taken out by the Appellant. It seems doubtful to me that this was intended to refer to the key man insurance. The insurance on Mr Dimitriadis' life was in fact continued. The loan was eventually repaid in May 1995 and the security cancelled.

10. The Agreement entered into on 19 July 1989 with Tullis Russell provided as one of the conditions precedent that "Tullis Russell must have received "evidence that Greycon has effected a 'key man' life policy approved by [Tullis Russell] for £499,999 for [Dr Goulimis]". Mr Erdal explained that the suggestion for keyman insurance came from the Tullis Russell non-executive directors. The policy issued on 27 January 1989 (nearly six months before the Agreement, reflecting the delay in finalising the Agreement) was a five-year term policy on his life payable on his death for a premium of £71 per month without any surrender value; there was no accident or disablement cover. The proposal form stated that 50 per cent of the profits of the Appellant were attributable to Dr Goulimis. The answer to the question on the proposal form "why has this particular policy been chosen?" was "because of involvement of venture capital." Although the agreement does not contain any covenant by the Appellant to keep up the policy I accept Mr Akin's contention that this should be implied on the basis of the officious bystander test propounded by MacKinnon LJ in *Shirlaw v Southern Foundries (1926) Limited* [1939] 2 KB 206 that if the officious bystander had drawn attention to this, everyone would have said "Oh, of course!". Dr Goulimis's was then 31 years old and Mr Dimitriadis was 33 and they gave no thought to their deaths; the policies were taken out solely because this was a requirement of Tullis Russell, one that Dr Goulimis described as a bureaucratic hurdle they had to jump over. It had not occurred to him to insure at the earlier time the Appellant was set up. Mr Erdal, the chairman of Tullis Russell, regarded Dr Goulimis as the vital keyman because he had developed the software and the success of the Appellant depended on the further development of the software.

11. The combined effect of the Agreement and the policy is that if Dr Goulimis had died immediately after entering into the Agreement and Tullis Russell had paid off the bank guarantee it would receive from the Appellant out of the insurance proceeds by way of subrogation the £150,000 paid to the bank under the guarantee. The remaining insurance moneys would have been available to the Appellant. If he had died after the 20 per cent share subscription leaving the Appellant in a position that it could not continue to trade they would have potentially received £100,000 (20 per cent of the insurance moneys) on the liquidation of the Appellant, assuming it had no other net assets (the net assets in the balance sheet less than three months before the Agreement were only £6,492). If Dr Goulimis had died within the five years of the original policy after Tullis Russell had acquired the whole of the share capital, if one supposes that 20 per cent of the capital was worth the price to be paid in the second year of £200,000, the whole company would have a value of £1m. The original policy for £0.5m would have protected half of Tullis Russell's investment for the remainder of the 5 years of the original policy.

12. Following the termination of the policy on the life of Dr Goulimis on his starting national service in Greece in March 1990, the policies on the life of Mr Dimitriadis taken out in June 1990 (roughly half way through the two year period for Tullis

Russell's bank guarantee and period for its acquisition of 20 per cent of the share capital) were a series of five whole life policies (as with Dr Goulimis's policy with no accident or disablement cover) with a guaranteed sum assured and an alternative sum payable of the bid value of units credited to the policy (if higher) subject to monthly premiums of £148.30. The sixth policy with a guaranteed sum assured of £86,000 was taken out on 12 June 1993. Dr Goulimis suspected that it was taken out under an offer to index-link the policy. All the policies had a surrender value of the bid value of the units credited to the policy. The proposal form estimates that 33 per cent of the Appellant's profits were attributable to Mr Dimitriadis. The answer to the question "how has the benefit and/or loss to the firm been calculated?" was "company would not be able to trade"; and to the question "why has this particular policy been chosen?" was "Board decision." There is no evidence why there was a change from a term policy; one suspects that the insurance policy sold it as an alternative that was not much more expensive and which might have some investment benefits. Although Mrs Klaentschi correctly pointed out that there was no express legal obligation on the Appellant to provide a replacement policy when the policy on the life of Dr Goulimis lapsed on his starting military service in Greece in March 1990, I regard the policy on the life of Mr Dimitriadis as a replacement policy. This is how Lion Financial Services (presumably the Appellant's insurance broker) described it in a letter of 24 May 1990 to the insurance company, Legal & General. Mr Morrison said that the Tullis Russell board agreed to the transfer of the insurance to the life of Mr Dimitriadis. I accept Mr Akin's analysis that as there was an implied obligation to keep up the policy on Dr Goulimis's life taking out and keeping up the policy on Mr Dimitriadis' life is an agreed variation of that obligation. Mr Goulimis's policy was for a 5 year term; it is unclear whether the obligation to keep up Mr Dimitriadis's policy extended beyond this period. Commercially the substitution is what one would expect. Tullis Russell were even more exposed than before when Dr Goulimis, the primary person behind the Appellant, went to do his one year's national service in Greece, and would have been content to have insurance on the second key player rather than no insurance.

13. On Dr Goulimis's return from military service he took the lead in marketing while Mr Dimitriadis took the lead in the technical developments. Because of this it made sense to retain the insurance on Mr Dimitriadis' life. Owing to the recession, costs were being cut and insurance on Dr Goulimis's life was not taken out again.

14. During the negotiations for the Agreement, the board minutes of the Appellant refer to a possible purchase of premises in July 1988, saying that no progress could be made until the Tullis Russell agreement was finalised. In August 1988 this purchase had fallen through but Tullis Russell were in favour of a purchase through a separate company in which the Appellant had an interest. In September 1988 renting was stated to be unattractive option owing to interest rates. Later two possible properties for renting were found and an offer was made for one of them, but this was not the premises they finally rented. The agreement with Tullis Russell is addressed to the Appellant at premises in Wembley and so I presume they had already rented these premises. In January 1989 it was agreed to purchase an IBM 6150 computer for a list price of £45,000 with a software developer discount of 45 per cent. Because of Tullis Russell's guarantee the interest rate paid to the bank on the overdraft was reduced and

the possibility of purchase rather than renting of equipment was raised. The Appellant's accounts show a significant increase in fixed assets from £7,233 to £63,591 in the year to 30 April 1988, which is the year before the one that might be expected if purchased as a result of the move, and much smaller increases to £76,654 and £88,891 at the two following two year ends. It is therefore unclear how the funding provided by Tullis Russell was spent. Possibly Tullis Russell were guaranteeing the indebtedness to the bank for expenditure that had already been incurred without which the bank might have been unwilling to continue to support the Appellant. Creditors falling due within one year rose from £45,357 to £124,066 in the year to 30 April 1988, and to £162,053 in the following year. Net assets at 30 April 1989, shortly before the agreement with Tullis Russell were £6,492, and became net liabilities of £24,026 at 30 April 1989. One would expect expenses to be greater after they set up their own office. They were also adversely affected by the recession in the early 1990s. Because the parties are agreed that how the funding was actually spent was irrelevant it is not necessary to pursue this aspect.

The law

15. There was little dispute about the law. This is summarised by Diplock LJ in *London & Thames Haven Oil Wharves Ltd v Attwooll* 43 TC 491, 515:

“Where, pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of money which, if it had been received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation is so received, the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received instead of the compensation.

16. *Williams Executors v IRC* 26 TC 23 is an example of a small company insuring the life of a director who had special expertise in the bloodstock industry which was the company's business. The Special Commissioners had decided that the purpose of the policy was to protect the shareholders against loss of value of their shares. Lord Greene MR said at p.34:

“But the suggestion out of which the insurance materialised was that, in the event of Mr Crawford's death, the company's business would suffer and his family would not get much for his shares. The latter part of that sentence does not seem to alter the real character and object of this insurance, which was quite clearly to give the company some money to make up for the loss which it would suffer if it were deprived of the very valuable services of Mr Crawford.”

Lord Greene therefore accepted that there was a loss in value of the shares held by the shareholders who were also directors, but determined in the light of the circumstances that the real object of the insurance was to make up the trading loss to the company. This was also demonstrated by the fact that the policy covered temporary disablement. In other cases, such as *Keir & Cawder Ltd v IRC* 38 TC 28 and *Gray & Co Ltd v Murphy* 23 TC 225, the purpose of taking out the policies was analysed in the light of the surrounding circumstances to determine whether, as in the former case, it was to cover a loss of goodwill or a hole in the profits.

Contentions of the parties

17. Mr Akin for the Appellant contended that the only reason for the original policy on the life of Dr Goulimis was that it was a requirement of Tullis Russell in order to protect their investment in the form of the £150,000 bank guarantee for two years and possible investment in the shares, whether 20 per cent (which effectively replaced the finance obtained with the bank guarantee with permanent finance), or 100 per cent. The Appellant's purpose in taking out the original policy was to procure this capital for the Appellant from Tullis Russell and to procure a possible exit for the shareholders. The overdraft was to fund the capital purpose of setting up the Appellant in its own offices which was capital expenditure in principle, even though some of it may have been spent on rent or leasing of equipment. The original policy for about £0.5m had nothing to do with protecting the profits of the Appellant which were only £23,510 before tax in the year to 30 April 1989 at the time of the negotiations with Tullis Russell and similar figures for the two previous years. The sum originally assured was to be compared to the turnover of £224,855 in the same year which had more than doubled in the course of the previous two years. He pointed out that there was no accident cover in the policies, which helped to show that the policies were unconnected with the trading profits. He also contended, citing *Macaura v Northern Assurance Company* [1925] AC 619, that Tullis Russell as creditor and potential shareholder, would not have had an insurable interest to enable it to take out the policies itself. The policies on the life of Mr Dimitriadis were in replacement of the original policy and had the same object, being entered into roughly half way through the two year period of Tullis Russell's bank guarantee and option to acquire 20 per cent of the share capital. The sixth policy was taken out possibly to index-link the original amount and had the same object as the other policies on Mr Dimitriadis' life. Accordingly he contended that the object of taking out the policies was a capital one.

18. Mrs Klaentschi, the Inspector, contended that the expertise of Dr Goulimis and Mr Dimitriadis were essential to the Appellant's trade. The insurance proposals stated that 50 per cent and 33 per cent of the profits were attributable to Dr Goulimis and Mr Dimitriadis respectively, and the latter stated that without him the Appellant would not be able to trade, which seems likely in the context of Dr Goulimis being on military service in Greece at the time. She pointed out that the Agreement with Tullis Russell did not state the purpose for taking out the keyman insurance on Dr Goulimis's life. The primary effect of the Agreement was that Tullis Russell guaranteed the Appellant's "ordinary course of business indebtedness" and there was no evidence of the purchase of capital assets after the agreement had been entered into. There was no obligation in the Agreement with Tullis Russell to substitute the insurance on Mr Dimitriadis' life, and no documentary evidence to substantiate any agreement for doing so. Given the lack of evidence of the purpose of taking out even the original policy one must deduce this from the effect, which, as in *Williams's Executors*, was to fill the hole of the trading losses that would accrue on the death of Mr Dimitriadis, by providing funds with which equivalent expertise could be purchased in order to enable the Appellant's trade to continue, rather than any capital loss on the shares or loan.

Reasons for the decision

19. Both Mr Akin and Mrs Klaentschi agreed that one must look at the purpose of taking out the policies on Mr Dimitriadis' life at the time they were taken out. Mr Akin emphasised the capital expenditure approach and Mrs Klaentschi the hole in the profits approach. Both approaches seem to me to look at the same thing from different points of view.

20. Mrs Klaentschi's emphasis was that in any case where a company insures a key employee the effect is to protect against a hole in the profits caused by his death. On the death of either Dr Goulimis or Mr Dimitriadis there would undoubtedly have been a hole in the profits of the Appellant. Although she did not argue it in this way, one could also look at Tullis Russell's potential loss of its investment as the result of a hole in the profits, particularly a loss of the shares after it had exercised the option to acquire 20 per cent since the value of the shares is likely to represent the future profits. It is also the case that even if Tullis Russell had lost the amount paid on the guarantee of £150,000 there would still have been the rest of the insurance proceeds in the Appellant to enable it to purchase replacement expertise to the deceased keyman in order to continue the company's trade. Mrs Klaentschi contended that what one does with the policy money is irrelevant, as in the case of buying capital assets out of trading profits. However, she emphasised the revenue nature of the expenditure incurred using the bank overdraft, principally rent; there were no significant assets added in the balance sheet after the Agreement with Tullis Russell.

21. Mr Akin emphasised that the policy on the life of Dr Goulimis was a condition precedent for Tullis Russell entering into the agreement. That agreement enabled the Appellant to move out of Imperial College and establish itself as an independent commercial company trading from its own premises. Looked at from the point of view of Tullis Russell they were (a) guaranteeing the overdraft of £150,000, (b) possibly subscribing for shares giving them 20 per cent of the capital, and (c) possibly acquiring 100 per cent of the shares. At the time of the Agreement the Appellant had net assets of only £6,492 and so it was a risky investment leading Tullis Russell to protect their investment by the insurance. Without the policy if Dr Goulimis, as the key player, died they could lose the £150,000 guaranteed, or the 20 per cent of the share capital, the subscription for which would have gone to pay off the bank overdraft, or the value of the whole of the share capital, which could easily exceed the £500,000 cover. When Dr Goulimis went to do military service in Greece they were even more exposed. If Mr Dimitriadis had died during Dr Goulimis's absence it is probable that the Appellant's business would not have survived. Accordingly the purpose of the policies was to enable Tullis Russell to protect the value of their investment (some of which, like the guarantee was immediate, and some, the options over the shares, was a potential investment).

22. While therefore I do not disagree with Mrs Klaentschi that the effect of the policies on Dr Dimitriadis' life was to fill the hole in the profits that his death would have caused, and that this must have been at least *a* purpose, although perhaps an unconscious one, of taking out the policies, it seems to me that I should pay more regard to the Appellant's immediate and conscious purpose, which was to obtain the benefits of the Agreement with Tullis Russell. Mrs Klaentschi's arguments would

have much more force if the Appellant had itself decided to take out the policies. But Dr Goulimis at his then age of 31 did not give a thought to taking out policies covering what he regarded as the remote possibility of his death. Equally, he did not give a thought to the hole in the profits that his death would have caused. His, and the Board of the Appellant's, purpose in taking out the policies was solely to obtain the funding and other benefits of the Agreement with Tullis Russell. The immediate benefit to the Appellant from that agreement was the guarantee by Tullis Russell of an overdraft of £150,000. Some of the expenditure that this financed was no doubt of a revenue nature, such as rent, and some of a capital nature, such as the purchase of the computer and office equipment, but basically this was the capital funding for two years to enable the Appellant to move from Imperial College and set up as an independent commercial company operating from its own premises. Another benefit to the Appellant was the possibility that Tullis Russell would exercise their option to become a 20 per cent shareholder with the subscription money going to repay the bank overdraft previously guaranteed by them, so that the two-year funding would become permanent funding. In addition, Tullis Russell had funds to support the Appellant in the future and the interest as shareholder to do so. Finally, although more remotely, the shareholders might be in a position to force Tullis Russell to buy their shares at market value. The Appellant's (and its directors who were also shareholders) immediate purpose was to obtain these benefits, which are of a capital nature, unrelated to a hole in the profits caused by the death of the individual who was insured. Its purpose in taking out Dr Dimitriadis' policies was a continuation of that purpose relating to Dr Goulimis's policy. There was an implied obligation to continue paying the premiums on Dr Goulimis's policy and therefore if that became impossible because of his national service in Greece the Appellant needed to renegotiate the obligation with Tullis Russell (who must have been very willing to have continued insurance on the life of the second key player, rather than none) so as to become an obligation to pay the premiums on Dr Dimitriadis' policy as a substitution for the original policy and having the same purpose.

23. Accordingly, although I do not disagree with Mrs Klaentschi's approach, I give more weight to Mr Akin's approach because the policies were taken out as a requirement of Tullis Russell entering into the Agreement to provide funds, and find that the Appellant had a capital purpose in taking out the original and substituted policies. The policy moneys therefore were not part of the trading profits, and I allow the appeal. The assessment for the accounting period ended 30 April 1999 is determined in the agreed sum of £165,889.