

# Too complicated?

*Ray Magill* provides an insight into some of the unexpected complexities in the tax system waiting to trap the unwary taxpayer

## KEY POINTS

- This example identifies a number of traps for the competent but inexpert taxpayer
- It is likely that unrepresented taxpayers will make frequent errors through lack of appreciation of the complexity of the tax system
- What is the future for a tax system overloaded with these complex areas?

**H**ow easy it is for a taxpayer to go wrong! This short case study illustrates some nasty traps for the unwary.

In 2001 Gordon, domiciled and resident in the Isle of Man, settled a substantial sum in trust for his grandchildren; the trustees being resident in the Isle of Man.

The trustees invested much of the cash settled in Microsoft shares but retained a substantial balance in the bank.

In 2004 the trustees appointed £100,000 cash absolutely to grandson Jack, who was not resident in the UK but is domiciled in England and Wales. The trustees had not sold any of the Microsoft shares yet.

In 2005 Jack gave his fiancée Jill £50,000 as a pre-marital gift. Jill, who has an eye for talent, splurged £25,000 of the £50,000 on a painting.

Later that year Jack and Jill got married. Late in 2007 Jack invested \$40,000 in a Chicago mutual fund, then the equivalent of £20,000.

On 6 April 2009 Jack and Jill moved to England and became resident in the UK.

In November 2009 Jack redeemed his holding in the Chicago mutual fund, fortuitously realising just \$40,000 (when the sterling equivalent is £30,000).

Meanwhile, the artist whose work Jill had bought in 2005 has zoomed in popularity; her painting was worth £150,000 by 6 April 2009 and holds a place of honour on the wall of Jack and Jill's living room.

Gordon's trust had stayed solely invested in Microsoft shares, but in May 2009, the trustees sold part of their shareholding, realising a gain of £150,000. They have made no further capital payments, nor did they make any more in 2009/10.

Jack had to complete his first UK tax return since his resumption of residence here, that for 2009/10. He reckoned that he had made no gain on his mutual fund, because the proceeds equalled the cost, in US dollars. Even if he realised he had made a gain, once the cost and sale proceeds were translated into sterling at the rates ruling at the relevant time, he would not readily have recognised that the gain to be taxable as income, and would have thought the gain covered by the exemption, and the proceeds to be less than the threshold mentioned in the Tax Return Guide.

In fact there was a gain subject to income tax [on the reasonable assumption that the Chicago mutual fund managers will not have obtained distributing status] of £10,000.

Jack does not even know about the gain realised by the trustees of his grandfather's trust.



## PROFILE



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**Profile** Ray Magill has had more than 40 years of tax experience, ranging from inheritance tax to VAT (particularly on property).

Following his retirement as a Tax Partner with chartered accountants Shipleys LLP in 2002, he has remained an active consultant to the firm. He is a member of the CIOT Succession Taxes Sub-Committee, the London Chamber of Commerce Tax Committee and the London Society of Chartered Accountants Tax Committee.

Yet he had a deemed gain in 2009/10 under TCGA 1992, s 87 of £100,000 [the lesser of his 2004 capital payment and the trust gain].

Jack certainly doesn't recognise that Jill's now valuable painting, whose possession he now shares, which Jill bought with money he gave her less than seven years earlier – before they were married – is a 'pre-owned' asset.

But Jack has an income tax liability for 2009/10 under FA 2004, Sch 15, para 7 on 4.75% of £150,000, £7,125. If £6,000 of Jack's gift to Jill in 2005 was covered by his annual exemption the amount chargeable would be reduced to 44/50ths of £7,125—£6,270 – still above the £5,000 *de minimis*.

Jack innocently completed his 2010 tax return referring only to his employment. Yet he has made three major omissions.

But what indications are there on the tax return which should signal to Jack that anything else should be mentioned?

As to Jack's much earlier capital payment, Question 5 on page 2 of the return asks if a capital payment has been received. It is natural to assume this refers only to the year under review; but should it be understood as covering capital payments received in the past, including when non-resident?

As regards the disposal of his mutual fund, TRG 5 in the *Tax Return Guide* says that one need only give details of capital gains if the proceeds exceeded £40,400 or the gains exceeded £10,100. There is nothing to remind a taxpayer to distinguish offshore funds.

Question 5 on page 2 of the return asks if the reader was entitled to 'foreign income, or income gains', referring to page 4 of the *Tax Return Guide*, but there's nothing on TRG4 about offshore income gains, although

they are referred to in box 41 on the Foreign pages SA 106 if one ever reaches that.

Only as regards the painting might a very careful reader of TRG15, which purports to explain pre-owned assets, have decided there was something to declare. But the chances of a layman recognising its relevance seems small.

One wonders what the Tribunal's attitude would be to any appeal against a penalty, if Jack fails to 'repair' his tax return before February 2012. Has Jack exercised 'reasonable care', thus excluding a penalty for the inaccuracies? Is it right that had Jack consulted a tax adviser his tax liability would have been higher as a result of these details being picked up? Or would he have failed (through lack of understanding) to provide the relevant information to the adviser, exposing him to a penalty for failure to take reasonable care?