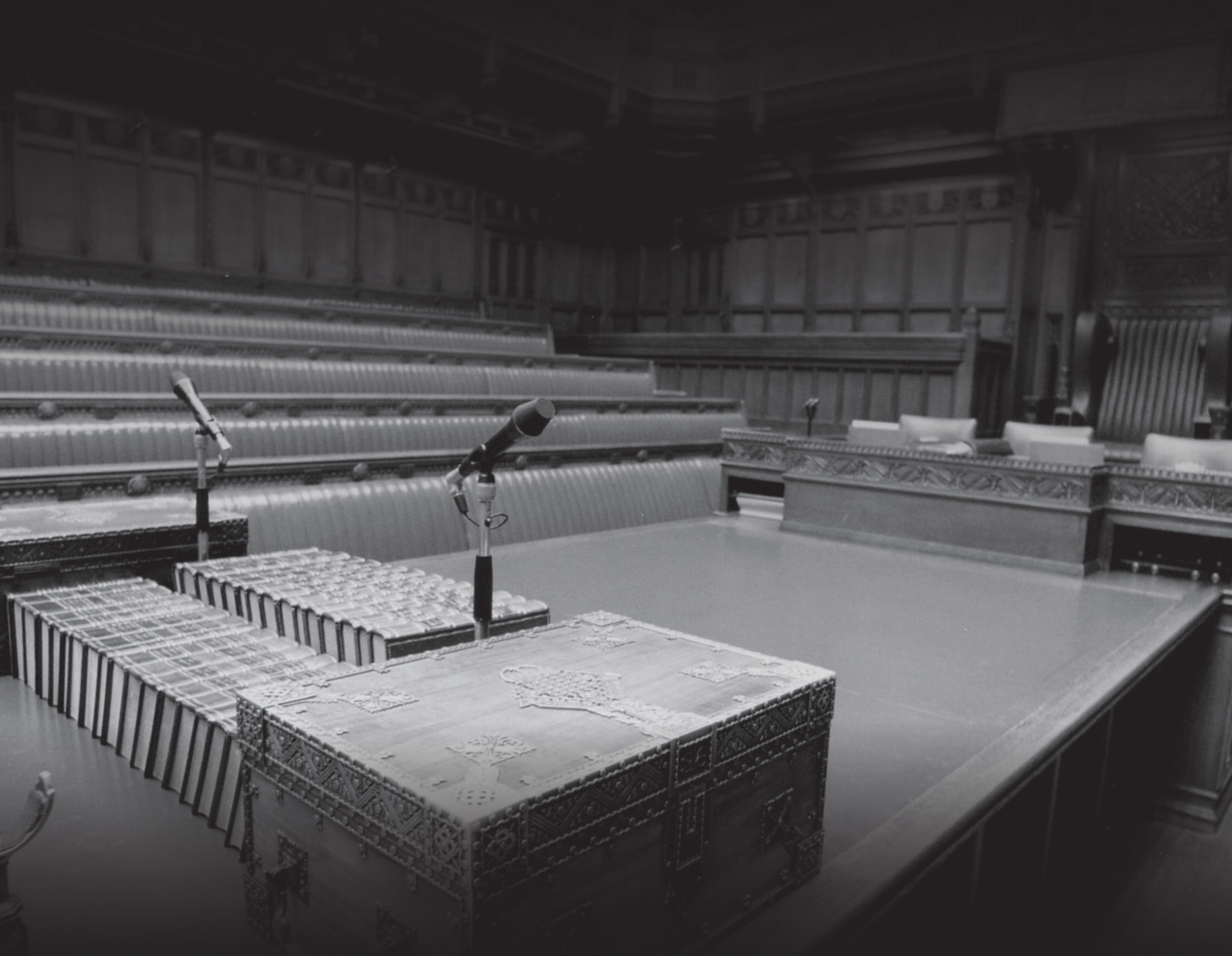
The Schmidt Tax Report

Tax, Money & Property

June 2017



There is no art which one government sooner learns of another than that of draining money from the pockets of the people - *Adam Smith*

The Schmidt Tax Report

Tax, Money & Property

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The password is all lower case: str

News

New corporate offence

The Criminal Finances Bill received royal assent on 27th April. It introduced a corporate offence of failure to prevent the facilitation of tax evasion. In essence, a business may face an unlimited fine and criminal conviction if any employee facilitates such a fraud. Employees do not have to be based in the UK to be found guilty. The legislation calls for the government to publish guidance for corporate bodies and partnerships. If a company can show it has reasonable prevention procedures in place this may serve as a defence.

Buying shares in a tax-efficient manner

A reminder that HMRC allows private companies to buy back shares in an affordable way via a process called 'multiple completion buybacks'. The idea is to allow a private company to buy back shares from, for example, a difficult shareholder or one who wishes to exit the business over a period of time. By phasing the payments in this way it makes the buyback affordable and ensures that the business doesn't suffer unnecessary strains on its cash flow. Providing the multiple share buyback is organised properly, the vendor should be able to claim entrepreneurs' relief and thus pay capital gains tax (CGT) at just 10%. However, HMRC does, from time to time, try to argue that entrepreneurs' relief is not eligible. For this reason, it is vital to take specialist advice before entering into such an arrangement.

Employment tax update

A reminder to readers who are taking advantage of salary sacrifice arrangements that since 5th April of this year some such schemes cease to offer the original tax benefits. The new rules mean that all sorts of benefits – such as workplace car parking and health screening, which would previously be exempt from income tax and National Insurance contributions (NIC) – will now be caught.

New ISA rules

As of 6th April, the amount that you can invest in an individual savings account (ISA) has risen to £20,000 for an individual and £40,000 for a couple.
As with pensions, investments held within an ISA do not incur CGT when sold, and no further tax is payable on any income or interest they yield. This means that investments held within an ISA wrapper can grow more than those held outside.
There are now six types of ISA allowing you to invest in a wide range of ways. On death, ISAs may be passed to a spouse without incurring inheritance tax.

HMRC to question work expenses

The professional tax media is full of reports that HMRC, annoyed by the growing expense of giving tax refunds for work expenses (such as travel, laundry and professional subscriptions), is planning a huge crackdown on employees' out-of-pocket expenses. HMRC has said that

while it has no intention of removing the relief on employee expenses the cost has become significant and that it is worried the relief is not being used in the way in which it was intended.

HMRC wins Swiss bank case

Karin Vrang, a Swedish banker, has lost her fight for a tax refund after her Swiss bank handed over more than eight times the amount she owed to HMRC. Payment resulted because of the tax arrangements between the UK and Switzerland aimed at collecting unpaid tax from undisclosed accounts while preserving bank secrecy. Account holders who did not opt to come forward were given the opportunity of maintaining their anonymity in return for their bank handing over a levy of between 21 and 41% of the value of the account. The judgment handed down by the UK High Court stated that: "It was Ms. Vrang's fault that the levy was taken because she failed to deal with perfectly clear correspondence." Ms Vrang said that she had not taken action when she received the letter from her bank because she thought the agreement was not aimed at those who, like herself, were not tax evaders, had no tax advisers, paid their taxes and expected to be treated fairly. The UK/Swiss agreement collected little more than a quarter of the £5.3 billion originally anticipated.

Littlewoods claims £1.2 billion from HMRC

The Barclay brothers, who own Littlewoods, the home shopping company, are taking their claim for £1.2 billion interest to the Supreme Court. Littlewoods has already received a full refund from HMRC on VAT that was wrongly charged on commissions paid to its agents who distributed mail-order catalogues. It has also received £250 million of simple interest on the VAT refund. However, the company contends it should have received £1.2 billion of compound interest charged on the interest already earned. The case will be closely watched as many other companies have similar cases either before the courts or waiting to go before the courts.

Single-property landlords suffer

The sales of buy-to-let property fell fairly dramatically in the first quarter of this year as amateur landlords left the market. The figures would be worse were it not for the fact that the number of valuations carried out for buy-to-let re-mortgages grew during the first quarter as landlords sought to take advantage of low interest rates and competitive mortgage deals to reduce their monthly payments.

Meanwhile, the National Landlords Association (NLA) has pointed out that many landlords with only one property are being pushed into a higher tax bracket after the introduction of the new taxation rules for buy-to-let. The NLA believes that as much as 20% of landlords may move up an income-tax bracket because landlords mortgage finance costs will, by 2021, count towards their taxable profit. The current average annual mortgage cost for a single-property landlord is £5,600. This means that those now earning just below the upper limit of the basic income tax threshold of £43,500 could be pushed into the 40% bracket, exposing them to significantly higher tax liabilities. As it currently stands, a fifth of landlords with just one property do not make any profit whatsoever and the new tax rules are likely to further worsen this situation.

Editor's Notes

Opportunity or chaos?

We had hoped to run an editorial about the new government's tax plans. However, as we go to press, it is unclear who is going to be running the country, how they are going to manage it or what they will be able to achieve. The only thing that is absolutely clear is that the country faces a number of worrying issues, all of which will have a strong impact on tax.

To begin with, we are a divided country. It is a case of inward looking v. outward looking, young v. old, cosmopolitan city dwellers v. everyone else, Unionists v. Nationalists and much more besides. Such political division can only make it harder than ever to create a fair, consistent and effective tax policy.

Then there is the economy, which has now shown very marked signs of being in decline. Last year, the UK economy defied all expectations and grew at the fastest pace within the G7. That ended after Christmas. In the first quarter of this year, economic growth was so slow that we became the worst performer within the G7. True, unemployment is low but inflation is at a three-year high and rising, and real wages are falling. Crucially, tax revenues are about to suffer. Without inward investment and a net migration of skilled Europeans, the Treasury is going to have less money to play with.

Finally, whether one is for or against Brexit, there is no denying that it involves dismantling an economic and political arrangement that has been in place for five decades. In the medium to long term Britain may well be better off. But in the short term we have to face the fact that there will be less trade, lower growth and fewer migrants. Whatever the deal, some of the costs will be unavoidable such as those relating to the expense of decommissioning nuclear power stations and storing spent fuel. Brexit is going to mean higher taxes and lower public spending.

So, what next? Assuming the Conservative party forms the next government – perhaps with the support of the Unionists – it is likely that all the existing Conservative policies are likely to stay in place. Moreover, those provisions in the Finance Bill that were deferred because of the election should now be enacted either in July or September. These include the corporate interest restriction rules, the substantial shareholding exemption reforms and the reformed inheritance tax (IHT) rules for non-doms owning indirect interests in UK residential property.

However, the Conservatives made it clear in their election manifesto that future tax rises – including increased NI and income tax – could not be ruled out. This is lucky, because it seems certain that the government is going to need the extra money.

The one silver lining is that where there is chaos there is also opportunity.

Crypto madness

In our 'Money' section this month we include a piece about the current cryptocurrency boom, which suggests it must be followed by a bust. While it is true that price increase of the type we have seen ($1,000 worth of bitcoins purchased in 2010 would now be worth $46 million) is exceptional, it doesn't automatically have to end in disaster.

It can't, for example, be compared to the tulip mania of the C17th. After all, unlike tulips, bitcoins and other cryptocurrencies have a real use. Nowadays, you can use them to purchase everything from an office chair to a building. Nor are cryptocurrencies likely to behave like gold. They aren't really a store of value. No one is pushing the price of cryptocurrencies up as a reaction to world events.

Moreover, bitcoins and other cryptocurrencies are linked to incredible technological innovation. For example, blockchains (essentially public databases without anybody looking after them) are now being put to other purposes. More than one government is using the technology to secure government records. Basically, cryptocurrencies are essentially private money that can be traded and used within other projects and innovations.

So, although it is certainly possible that investors could lose substantial amounts of money, each cryptocurrency must be viewed as a standalone investment. There is every reason to believe that at least some of these new cryptocurrencies will prove to be fantastic, long-term investments.

Credit where credit is due

I have written several times about the research and development (R & D) tax relief available to small and medium-sized enterprises (SMEs). I am raising it again because I worry that some *Schmidt* readers may not be taking advantage of what is – literally – free money! Moreover, several accountants I have spoken to say that more than 50% of their clients are failing to claim the relief even though they are entitled to it. Before I say another word let me put this into perspective.

R & D tax relief is worth 230% of allowable costs. In simple terms: for every £100 of qualifying costs your company could reduce its corporation tax by an additional £130 on top of the £100 spent.

For example, imagine that your company has made £26,000 profit and is able to claim R & D tax relief for expenditure of £20,000. You multiply the £20,000 by 130%, which comes to £26,000 and you can set this relief against your taxable profit, bringing your revised taxable profit down to zero.

To offer another example, imagine that your company has an allowable trading loss. This can also be increased by 130% of the qualifying R & D costs – so that is £130 for each £100 spent. Moreover, this loss can be carried forward in the normal way, but only if you choose not to convert it to tax credits. So if you are claiming R & D tax relief for expenditure of £20,000 and your company has made a loss of £10,000, the loss available to carry forward or back for corporation tax purposes is £36,000.

There is another option. You can turn your tax credit into a cash payment. Imagine again that you have expenditure allowable for R & D tax relief of £20,000 – you can claim a cash payment of £2,900 (the calculation is more complicated and I won't bore you with it here but you'll find it on HMRC's website).

The real thing to remember is that the R & D relief requirements are purposely broad. If your company is taking a risk by attempting to resolve scientific or technological uncertainties then you are almost certainly carrying out a qualifying activity. Creating new products, processes or services? Changing or modifying an existing product, process or service? You almost certainly will qualify.

One expert says you should be asking yourself the following questions:

- Has your business done something to differentiate itself within its sector?
- Has your business taken on something particularly challenging?
- Has your business taken on risk in trying to achieve something?
- Has your business invested time and effort into making efficiency gains?
- Does your business operate in a market that is specialist, niche or highly regulated?
- Does your business employ highly skilled or qualified technical staff?

Happily, the qualifying expenditure rules are so broad and include staff (including wages, salaries, NI and even pension contributions); sub-contractors; agency workers and freelancers; materials and consumables (including heat, light and power); and various types of software.

It is worth remembering, too, that you can make any claim for R & D tax relief on your corporation tax return or amended return. The normal time limit for making your claim is two years after the end of the relevant corporation tax accounting period.

There is no specific record keeping requirement for R & D tax relief claims. But, it makes it much easier to make the claim if you keep a note of relevant costs as they are incurred.

I make no apology for raising this topic again. This is, in my opinion, free money simply waiting to be collected.

Bad news for expats

There has been lots of publicity warning UK residents with offshore bank accounts, companies and trusts that their personal details are now in the hands of HMRC and that they can – if their affairs are not in order – expect trouble.

But there has been very little written about how the new automatic exchange of information rules will affect Britons living abroad. It is estimated that tens of thousands of expats may believe that because their UK tax affairs are in order they have nothing to fear from tax collectors in their new home. Nothing could be further from the truth! In most countries, residents are taxed on their worldwide income, gains and in some cases wealth.

So, if, for example, you have moved to Spain but still have a UK ISA, even though you comply with British tax rules, you could well owe money to the Spanish taxman. Spain is a particularly good case in point because the Spanish authorities are extremely hard on expats who fail to declare all their worldwide income and assets. In 2015, for instance, a retired British citizen living in Spain was ordered to pay more than €442,000 in interest, fines and other costs, following a late disclosure of €340,000 of stocks and cash in Switzerland. The European Commission believes that the Spanish fines for failure to comply with asset reporting are disproportionate.

Ask The Experts

Q. How best to utilise the new family home allowance for IHT?

Husband aged 85, wife aged 66, house value £2 million, 50% in wife's name, 50% in husband's name.

How should a will be worded to take best advantage of the new family home allowance for IHT?

I. B.-W., via email

A. The 'new family home allowance' is intended for those whose estate is worth less than £2m. The allowance is being introduced gradually over the next four years, from 2017/18 to 2020/21. By 2020/21, it will be worth £175,000 per person or £350,000 per couple. It tapers away at £1 for every £2 that one's estate exceeds £2m.

An allowance which is available but not used on the first death can be passed to the survivor.

If you were to die first after 2020/21 and your share of the house was left to your wife, the allowance would be unused and would in theory be passed on to your wife. But if your estate (before deducting assets left to your wife or qualifying for other reliefs) was more than £2.35m, you would not qualify for the 'family home allowance' and so would have nothing to pass on to your wife. In this case, if your wife died, after 2020/21 and after you, she would not be able to claim the 'family home allowance' if her estate was worth £2.35m.

Your estate therefore ideally needs to be worth less than £2m when you die. You would then qualify for the full allowance. If you then leave your share of the house to your wife, no IHT will arise on the transfer and your full £175,000 allowance will be unused and will be available to her estate when she dies. She would then be entitled to two times the allowance (i.e. £350,000) when she dies, provided her estate is worth no more than £2m in total, which doesn't seem very likely given that the house alone is worth £2m. She would be entitled to some of the allowance, to the extent that her estate is worth less than £2.7m (given that the allowance tapers away at £1 for every £2 of value, it takes value of £700,000 to lose £350,000).

If you could give other assets away to reduce the value of your estate to below £2m, the next thing would be to ensure that your wife's will left the property to your descendants, as this is the second condition necessary for the relief. You do not get the relief if the property is not left to, broadly, children, grandchildren or their spouses.

Q. I have read occasionally in the papers about flexible ISAs, but very little is said and I am unable to find much about them on the Internet. My understanding is that one can borrow from one's ISA as long as the money is paid back within the same financial year. I have a self select ISA held by my stockbroker. Would I be able to borrow up to the value of my ISA, pay it back within the financial year and it not count as a withdrawal? Are there any penalties for this? Does the wrapper need to be changed? Has this subject been covered in a previous issue of *The Schmidt Tax Report?*

C. S., via email

A. Your understanding about how flexible ISAs work is correct (i.e. you can borrow money from the ISA and, provided it is paid back within the same year, the paying back will not count as part of that year's ISA allowance). However, it only works with cash ISAs, or the cash element held within a stocks and shares ISA, and it only works if your provider operates flexible ISAs. It's up to the provider to sign up to this. There is no compulsion for them to provide flexible ISAs. So, if your self-select ISA is mainly invested in stocks and shares, you will not be able to borrow from it.

When paying the money back in, it usually needs to go back into the same ISA account from which it was withdrawn.

We found a good article on the Internet from Money Saving Expert.com at http://www.moneysavingexpert.com/savings/flexible-ISAs.

Feature: The Pay-As-You-Earn Menace

If you're involved in any way with a business or other situation where you are employing people, and paying them through a payroll, you may have the odd sleepless night when thinking about the possibility of the HMRC officers coming along to check your records.

You don't need to worry! The officers concerned are friendly, cuddly types whose only interest is in helping you understand your tax obligations.

All joking aside, what is it that the PAYE Gestapo are particularly looking for when they announce a payroll audit at your premises?

Perhaps surprisingly, their main focus doesn't tend to be on checking the basic arithmetic and logic of your calculations. This was never their main focus, we think, even before the days of spreadsheets. Although they'll obviously want to look at your payroll deduction sheets, and all the rest of the PAYE paraphernalia that you keep, their main interest is likely to be in looking through certain other records. Here's a list of some of their favourite target areas:

since a reasonably high proportion of inquiries are closed without any adjustment. We suggest that taxpayers who receive such letters direct from HMRC (bypassing their accountants) simply throw them in the bin.

1. The Minimum Wage

Given that we have a statutory requirement to pay human beings a minimum amount per hour of their time, even if that time isn't worth it to us, it's necessary for these statutory rules to be policed, and of course the police force chosen for this purpose is HMRC. So the visiting inspector is likely to ask you searching questions about your hourly rate paid to individuals, and their ages where you are near the threshold at which the minimum wage becomes less than that.

2. Gross Payments to Individuals

This is one of their favourite areas for enquiring; because it is a potentially rich field for raising assessments on you to further tax. If you are paying an individual for his or her personal services, rather than for goods, say, the question will always arise as to whether those services are provided to you by them in an employment situation or one of self-employment. The various considerations which determine what the relationship actually legally is are complex and multifarious, and we haven't got room for them here. But in general terms, you will need to be quite confident that the person concerned operates genuinely independently from your business, isn't subject to your control, and so on. If such can't be shown, the PAYE inspector is likely to raise assessments on you for back tax and NIC which in his view should have been paid, and these can go back for several years.

3. Petty Cash

OK, so petty cash is petty: but so is the mind of your average PAYE man. If you have business cash at all, do make sure that it's rigorously balanced on a regular basis, preferably every day. The inspector is quite likely to look at your petty cash account and pounce on any substantial differences or loose ends he finds. What he will cynically assume is that petty cash that has 'gone missing' is actually remuneration, taken through the back door, so to speak, by the company's directors.

4. Benefits in Kind

Although it's got nothing whatever to do with the payroll or PAYE deductions, the visiting PAYE inspector is also likely to be very interested in the question of whether non-business payments, such as benefits in kind provided to employees or directors of the company, can be discovered from a trawl through the company's cashbook records. He will be on the lookout for work on the directors' houses, holidays dressed up as business trips, purchase of the sort of items which cannot be appropriate to the company's business, accommodation provided to employees or directors of the company which may include a 'beneficial' element, and so on and so on. You need to make sure that all of your expenditure will stand up to this test, and preferably can be rigorously proved to do so.

5. Director's Loan and Current Accounts

As well as looking at the cashbook, the inspector is likely to want to see the loan accounts which the company holds with its directors, and what he will be particularly interested in finding out, here, is whether at any point in the year these loan accounts are overdrawn. Let's say, for example, that Stoat Limited has a practice of paying its single director, Mr Ferret, amounts which are debited to Mr Ferret's director's current account with the company (there's no significant difference between a director's current account and a director's loan account for these purposes). The company sees a cash-flow benefit in this, because the company's year end is 30th April, and in order to avoid tax problems with the 'loans to participators' rules relating to close companies, the practice is to write off these loans on 30th April each year as dividends to Mr Ferret, who's also the company's sole shareholder. So the dividend becomes his income for the following tax year, and effectively a one year's grace has been achieved. The problem with this is that there is a 'beneficial loan' outstanding from the company to Mr Ferret for the whole year, increasing steadily as the monthly payments are made to him. If these have not been put down on the company's annual form P11D, and taxed (and subjected to NI) as a benefit, the taxman rubs his hands in glee and raises the appropriate assessment – going back as many years as he can get away with.

6. Pool Cars

Another favourite of the visiting inspector. There persists, in some company circles, the view that the pool car rules are easy to manipulate to the advantage of the company and its directors. Just to recap briefly: where a car is provided to an employee or director of a company which is available for private use, a benefit-in-kind charge is levied on the individual and the company has to pay the appropriate NI charge. The exception to this rule is where the car is a 'pool car'. To be a pool car it needs to be genuinely available to several employees, and not normally left outside any individual employee's house at night. Tax inspectors are not above the practice of noting down the purported pool cars and then sneaking around the directors' personal homes under cover of darkness! Basically, they start with a presumption that a claim for pool car treatment is a false one, and then try to establish it. This may be a calumny on some inspectors, but we cynically think it is the general rule – the phrase 'pool car' is like a red rag to a bull as far as HMRC is concerned.

Feature: Extraction Of Profit From Limited Companies – An Update

This is the classic issue in tax planning for owner-managed businesses, and oceans of ink have been spilt dealing with this subject: both in this magazine and elsewhere. But, as with tax planning generally, this is very much a moving target, with HMRC and the government making changes to the basic framework of the rules on a regular basis.

So, even since the last article published here, and since my book, *The Entrepreneur's Tax Guide*, was published, there have been changes which alter the whole balance of planning between the various methods.

The root of the matter

Let's go back to first principles. A high proportion of owner-managed businesses in this country are operated through closely held limited companies, and there is an argument for many of them which are currently not in companies to be transferred

to companies, in order to save tax. Why is this?

Very simply, the rate of tax paid by limited companies on business profits tends to be very much lower, generally speaking, than the tax paid by sole traders and partnerships of individuals. The current rate of corporation tax, which applies regardless of how much your profits are, is 19%: compare this with the basic rate of income tax of 20%, which goes up to 40% on income just over £42,000 in total in a year, and 45% where a person's total income is more than £150,000 a year. In addition to this, there is NI on business profits if they are received by individuals or partners in a trading partnership. The rate of NI is 9% for self-employed earnings up to a figure roughly equivalent to the 20% tax band, and 2% above that. Above the personal allowance, then, you are looking at an effective 'tax' rate on individuals and partners of between 29 and 47%, taking the above NI rates into account.

So the 19% company tax rate looks very attractive, but the nub of the problem is: there is a fundamental issue with company earned profits. These cannot be transferred, in normal circumstances, to the owners and directors of the company without incurring further tax at the personal level, as income. Hence it is arguable that the advantage of the company is nonexistent in many circumstances.

There's not much use enjoying a lower rate of tax on your profits within the company, if you're then going to have to top this up with additional amounts on paying the income out of the company to you as the shareholder/director. Indeed, as we'll see, the interposition of the company between the business and the individual who 'owns' the business can actually significantly increase the overall tax/NI burden.

The four types of income

Before coming on to ways of taking money from companies in non-income form, it's appropriate, on the basis of the principle of 'walk before you can run', to consider the relative merits of the four basic types of income extraction from companies.

First, there is the ability to take money from your company by way of directors' remuneration. Generally speaking, it has to be said, this will tend to be the least favourite method of taking money from the company, even in the wake of the recent changes to the taxation of dividends. The problem with remuneration is that it is treated as earned income within the scope of the punitive 'class one NI' regime. Not only are employee deductions made from the remuneration concerned, at 12 or 2% according to the level of earnings, but there is also the even more punitive and arguably unjustifiable employer's contribution, amounting to 13.8%. NI, in fact, can add a further effective tax on money taken as salary/remuneration of up to 25.8%.

It's for this reason that, traditionally, dividends have been the preferred route of profit extraction. Until 6th April 2016, a basic-rate taxpayer, receiving dividends on his shareholding limited company, had no additional personal tax liability to pay at all. A higher-rate taxpayer (equivalent to the 40% taxpayer) had a tax liability equating to 25% of the net dividend received, and this percentage went up to just over 30% for anyone in the top income tax bracket (45% for most types of income).

You can see how the scheme worked, and, unlike the current rule, it had a reasonable logic to it. If, say, income was paid out to a 40% taxpayer from a company, derived from profits of, say, £100, the company would have paid corporation tax at the then standard rate of 20%, leaving £80 to be paid out as a dividend. The higher-rate taxpayer would then pay 25% of this as personal tax, that is another £20. The result was that, of the total £100 profits, £40 is paid to HMRC and the balance of £60 goes to the individual. This is equivalent to the situation where an individual higher-rate taxpayer receives that income direct, and pays 40% tax on it.

In a frankly underhand bid to increase government income whilst not apparently flouting the Conservatives' election manifesto promise not to put up income tax, a further 'dividend tax' (our words, not the government's) was introduced with effect from 6th April 2016. This was actually dressed up as 'the withdrawal of the tax credit', but to all intents and practical purposes it is an increase in the tax rate on dividends – and dividends alone.

The nil tax rate that previously applied to basic-rate taxpayers has been replaced by a 7.5% rate, and the rates for the two higher-income tax brackets have gone up to 32.5 and 38.1% respectively. A cynic may think that this (roughly) 7.5% uplift was set deliberately at the stage where it would not quite be worth a taxpayer's while to eliminate the company and take the income from the business directly as an individual, because the class four NI rate on basic rate income, at 9%, is still higher than the dividend rate. But who knows whether this was actually in the legislators' minds?

The alternative to dividends and remuneration

In many circumstances, and in the minds of many accountants, dividends and remuneration are the only possible ways of taking money from a company. But there are other ways, in fact, even without considering types of capital drawdown, which I will come on to look at.

One of these is interest payable. If the individual concerned has a loan outstanding, owing to him by the company, the customary way of dealing with this situation is to treat the loan as interest free – because the same individual will probably own shares in the company, and paying interest is normally therefore just an example of paying money to yourself. But it can be a tax-efficient method of profit extraction – or rather NI efficient. Because interest is treated as being a form of unearned income, NI deductions don't apply to it. Also, it is different from dividends because there is no 7.5% (or thereabouts) 'dividend tax' to pay, providing the interest is at a commercial rate.

So it may well be that many more companies will pay interest on their directors' loan account balances now than used to prior to the changes to dividend tax.

The other main alternative method of extracting personal income from the company is paying rent, where the company is occupying property owned by the individual director. Like interest, the payment is a deduction against the company's profits for corporation tax purposes, and is outside the scope of NI deductions and the dividend tax. Bear in mind that, if your company genuinely occupies part of your home, say, for the purposes of its business, there is no reason why it should not pay you a rent for doing so. (Watch out for exclusive occupation of any part of your home by the company, though, if it can be avoided: exclusive business use will have the effect of denying you CGT exemption, on that part of the home, if you sell it.)

Just a word of advice: in my personal view it's probably best to forget about the idea of claiming rent-a-room relief on interest paid to you by your company. The Revenue will kick and scream, and you will end up having your claim rejected as unsustainable for all practical purposes.

The practicalities

I've talked about interest and rent as viable alternative ways of taking income out of a company: but you have to bear in mind the practicalities of the situation, here. Interest can only be paid, effectively, at a fair commercial rate based on the actual loan you have with the company. Similarly, rent can only be paid up to a fair market rental for the property which you are making available to your company. So that is probably a good reason why, for most people, the contest tends to be between dividends and remuneration, and, for the reasons given above, dividends usually win except for a certain nominal sum paid as remuneration, in order to make each year count for NIC purposes, and therefore ensure that the state benefits based on keeping up a full NIC record.

Variable rewards

Looking at the practicalities of dividends and remuneration, though, it's also necessary to make the point that remuneration can be paid at different levels quite freely and without formality, based on the actual input of the individual to the company's business. Where the shares in the company are owned by unconnected individuals, it isn't so easy to pay shareholder A, say, £100,000 a year if shareholder B has the same number of shares and has not done enough work to justify being paid £100,000. The normal presumption with shares is that the same rate of dividend will be paid on all of the company's shares in issue.

To get round this practical problem, though, it is becoming increasingly popular to issue shares in different classes – or, if they are already issued in one class, making the necessary surgical changes to the company's share capital to create different classes. Even if the shares are otherwise identical, re-designating them as 'A' and 'B' (and so on) shares will enable you to declare different rates of dividend to different shareholders.

Let's sum up this particular point with an example.

Tom, Dick and Harry are equal shareholders in Everyman Limited. Everyman uses, for the purposes of its business, a property which the three shareholders also own equally. Whilst payment of rent by the company to Tom, Dick and Harry would seem like a good idea on basic principles (see above), they decide not to pay rent, because of the fact that this may reduce or eliminate their entitlement to CGT entrepreneurs' relief on any future sale of the property. Instead, they decide to take their income from the company in the most advantageous mix of dividends and remuneration.

On basic principles, the best mix would be to pay about £10,000 each to the three directors/shareholders as remuneration, with the balance being paid as dividends. This would be more advantageous than paying it all as remuneration, because dividends don't trigger the 13.8% employer's NI charge.

The problem with this simple solution is that Tom actually does most of the work, and Dick and Harry realise this and wish to continue to motivate him. So payment of equal dividends to all of them would not work, because Dick and Harry would then be receiving the same amount for far less work.

In many cases, taxpayers in Tom, Dick and Harry's situation would simply pay remuneration to Tom as a first charge on the company's profits, and then pay dividends to all three of them out of what was left. The level of remuneration can very freely and flexibly be set in order to reward the one individual who is working harder.

But the solution of paying extra remuneration still carries with it this 13.8% employer's NI penalty.

After some consideration, and advice from their accountant, the three resolve to change the share capital of the company such that Tom has 'A' shares, Dick has 'B' shares and Harry has 'C' shares. The shares otherwise rank equally, including rights to vote and rights to a share of the company's assets on a winding up. But what the new designation does enable the company to do is pay higher levels of dividend to Tom, who thus is rewarded for his additional work without that payment of income triggering the employer's NI penalty.

Income or capital?

You might say that the above discussion is doing no more than fiddling around at the margins of the problem. The basic problem is that income drawn out of a company as such triggers income tax and therefore will bring the overall rate of tax paid on the company's profits, between the company and its shareholders, to a figure which is similar to or more than the tax that would have been paid if the company hadn't existed, and the business concerned had been run by the individuals directly. Really all we're talking about, here, is ways of reducing or eliminating the NI charge and/or the 7.5% 'dividend tax'. But there is a more radical solution.

This is to take the money out of the company in capital form. Payments which are capital in nature are not subject to income tax, and therefore the worst-case scenario is that you are looking at paying CGT on the amounts received – or, in the best-case scenario, you may be paying no tax at all, as I'll come on to explain. CGT is charged, on most assets relevant to our purposes here, at rates of either 10 or 20%. Even with the most tax-efficient format of income extraction, these look like attractive rates… so how's it done?

The simplest answer to this conundrum, and still possibly the best, is to leave the funds in the company, if this fits in with your financial plan, until such time as the company is sold or its business discontinued and the company wound up. If you can claim entrepreneurs' relief on the sale or winding-up of the company, including these retained profits, your effective personal tax rate is 10%. Without entrepreneurs' relief, the rate is now 20%, but this, as I've already said, looks a lot better than some of the rates of tax (up to 38%) and NI that would apply to current extractions in the form of income.

That works, as I've said, if leaving the money in the company suits your personal financial plan. For example, it's OK to do this if you are happy just to see the money sitting on deposit in the company's name and you don't want to take the money out to use for personal, or other business, purposes.

But for many people this doesn't suit what they want to achieve with their hard-earned business profits. The more aggressive tax planners, over the years, have developed an arrangement known as 'serial liquidation'. I have actually seen it suggested (prior to the recent changes – of which more shortly) that a limited company could be formed and trade for one year, being then liquidated and the profits of that year's trading taken out all as a capital gain. Because the business is ongoing, a new company is immediately set up and takes over the trade, and in its turn is wound up 12 months later – and so on.

Personally, I think that this habit of serial liquidation is always sailing too close to the wind, because of specific anti-avoidance tax legislation. But the matter has now been basically put beyond doubt by some fairly vicious new rules introduced last year.

Under these new anti-avoidance rules, anyone winding up a company in order to avoid paying its money out as income, who then proceeds to carry on the same sort of business directly or through another company at any time in the next two years, will not have the benefit of capital gains treatment. Instead, the distribution in winding up will be taxed on him as income. Not only, therefore, would the favourable 10% entrepreneurs' relief rate not apply to this money but even the 20% rate for non-entrepreneurs' relief gains won't apply. Instead, the distributions will be treated as if they were dividends, and taxed at rates of up to 38% or so.

The limitations of the new rules

A lot of people seem to think that this new change to the treatment of company liquidations puts the kibosh on tax-favoured liquidations completely. Personally, though, I beg to differ. Winding up company is still going to be the best form of tax-efficient extraction in a wide range of circumstances.

First, and most obviously, where you are really retiring from the business in question, the rules won't apply even if you are deliberately extracting the company's money by way of liquidation rather than income to save paying income tax. The rules only apply where you are carrying on the same sort of business, in some way, after the liquidation: in other words, the rules are aimed at what is sometimes called 'phoenixism'.

Second, the rules don't apply automatically even if you are carrying on the same kind of business after the liquidation, as my next example illustrates.

The Canny Builders Group has always had a policy of forming a new limited company to carry on each new property development. The purpose of doing this is to ring-fence any financial difficulties or problems striking one of the developments from the other financial affairs of the group. In other words, there are a series of special purpose vehicles (SPV) set up in the ownership of the members of the family which own the business. Once a development is complete, and all of the units sold, the company is wound up as being surplus to requirements.

Providing the avoidance of tax on income forms no part of the motivation of the Canny Group in doing things in this way, the liquidations will continue to be treated under the more favourable CGT regime, even though the business of property development is ongoing.

Non-extraction

There is a bit of lateral thinking in this one, but so little as arguably to involve me in stating the obvious. If your plan is to invest company funds in assets which will provide income and/or grow in capital value, there's obviously a lot to be said for making those investments in the name of the company. Hence, you don't need to extract the funds into your personal hands and potentially pay a lot of income tax. If you don't pay the income tax, you've got that much more to invest, and therefore your income and capital growth benefits will compound at a far higher rate.

Nice and simple, really. But there are inevitably drawbacks.

One is the problem which would arise if you were ever to sell the company. Let's say you've invested surplus profits in the company in various shares or investment properties. The purchaser is not going to want to buy these, and therefore you are faced with a potentially expensive (in tax terms) process of extracting these assets at the point of sale.

What's more, if your company goes in too much for investment-type activities, it may lose the coveted trading status for entrepreneurs' relief, so the sale or winding-up of the company could be subject to 20% tax rather than 10% tax (using current rates).

The LLP alternative

Many of my readers will no doubt have been wondering how long it will be before I mention LLPs. Well, to avoid disappointing them, here is the LLP as an antidote to the problems I've just mentioned!

For those who don't hang on my words every month, a word of explanation of what I'm talking about here. The initials LLP stand for limited-liability partnership, a comparatively new form of body corporate which is treated for most purposes as equivalent to a company, but for tax purposes is treated as a partnership. OK. Let's consider how an LLP structure can enable profit extraction, along the lines of what I've described above, to take place without (it is hoped) causing tax headaches in the event of the sale or winding-up of the company.

Great Expectations Limited is a very profitable manufacturer and wholesaler of Christmas decorations. Its main shareholder, Mr Phillips, has comparatively modest income requirements and sees no reason why he should trigger a big tax bill each year by taking the profits out as a dividend. So the inevitable result is that a big cash deposit starts building up in the company.

Inevitably, as he gets older, Mr Phillips gets less satisfied with the idea of simply leaving the cash in a company bank deposit, where it earns interest rates that are, frankly, peanuts, and loses the fight against inflation. So he decides to diversify by investing some of his spare cash in an investment property portfolio.

Rather than buying the properties within Great Expectations Limited, though, Mr Phillips sets up, on the advice of his accountant, an investment LLP which has himself, other family members and Phillips Investments Limited as members. Great Expectations Limited loans its surplus cash to Phillips Investments Limited, which then invests it as equity capital into the LLP. The LLP then uses the funds to acquire the investment properties.

The terms of the LLP give Mr Phillips and his family the right to enjoy capital growth in the properties, in return for the personal effort they are putting in to running the LLP. The company member, Phillips Investments Limited, is entitled to a fair return, in the form of income profit share, on the capital it has introduced. This structure has a number of benefits quite apart from the ones I am highlighting here, but this article is already swelling to elephantine proportions, so I will concentrate just on the effect that this structure will probably have on the CGT treatment of a future sale or winding-up of Great Expectations Limited.

Any purchaser will have to be made aware of the fact that one of the assets in the balance sheet of the target company, Great Expectations Limited, is an intercompany loan to Phillips Investments Limited. If the company is worth, say, £10 million, and this intercompany balance asset is standing at £2 million, in theory the purchaser will have to pay £12 million for the shares, which is more than the value of the business he wants. However, this is a problem which is more apparent than real, because immediately on completion of the purchase, Phillips Investments Limited can be put in funds to repay the loan to Great Expectations Limited, meaning that it has 'really' only cost the purchaser £10 million to buy the business.

Unlike the position where investment properties are owned by the target company and have to be extracted at a tax cost, there is no tax cost of unwinding this situation other than the additional CGT on Mr Phillips on selling his shares in Great Expectations Limited. This is because capital gains on the investment assets don't belong to Great Expectations Limited but to the LLP members. Also, it is arguable (although I haven't seen the point tested) that a simple intercompany balance of the sort we are talking about here would not be treated as an investment asset endangering entrepreneurs' relief on the disposal of the Great Expectations Limited shares.

Quid pro quo

The other method of extracting money from a company that is not chargeable to tax as income, which I propose to talk about here, is the situation where you give the company something in return for the money it pays you. Here, again, there have been recent changes to the tax system that affect this.

In its most common form, accountants and tax advisers were suggesting to their clients that they take a business which had hitherto been run as a sole trader or partnership and sell it to a company, including an amount for the goodwill of the business, whatever can be justified on an arm's-length valuation of that goodwill. This was an amazingly tax-efficient thing to do. Not only were you likely to achieve entrepreneurs' relief on the sale of your business to the company, meaning that you only paid 10% tax on the goodwill value personally, but the company could then claim depreciation or 'amortisation' relief each year on writing down the goodwill it had acquired (in many circumstances).

This became so prevalent, in fact, that the killjoys at HMRC decided to put a stop to it. A couple of years ago now they introduced a rule to say, first, that the sale of goodwill in these circumstances would not qualify for entrepreneurs' relief and, second, they banned the tax relief for writing off goodwill.

So the party's over? Well, not quite.

First, this negative rate of tax (19% relief in the company versus perhaps only 10% CGT in the individual's computation) still applies to intangible assets other than goodwill.

Second, with the reduction in the rate of CGT to 20% on most assets (the main exception being residential property), this is still a very tax-efficient way to extract money from the company, even without entrepreneurs' relief and even without tax relief for the buying company. If the asset in question is real property situated in the UK, you also have to put into the equation the stamp duty land tax (SDLT) that may or may not be payable on the transfer of the property. However, the tax-planning possibilities of selling assets to your company, as a form of efficient profit extraction, can still be imagined.

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Feature: EMI

The initials EMI stand for a number of things, but we are not talking about the large company into which His Master's Voice morphed, or about those unfortunate elderly mentally infirm individuals who live in care homes. The particular bit of jargon we're concentrating on, as this is a tax magazine, is the Enterprise Management Incentive.

This is a particularly jargonesque phrase in this instance, because these words tell you little or nothing about what the scheme actually is. What it actually is is a tax-favoured share option scheme that can be granted to individuals by companies. The scheme is tax favoured in that the employees concerned can use shares in the company as basically a method of being paid for their work under CGT rates rather than income tax rates. Given that the CGT rate could be as low as 10%, whereas the comparable income tax and NI combined, if the same were paid as income, can be well over 50%, this is obviously a major advantage – and it goes against the general tenor of a telephone-directory-sized chunk of statutory rules whose principal aim is to prevent individuals avoiding income tax on share-related benefits.

In practice, and in the small companies' sphere, where shares aren't generally very marketable, the scheme tends to be that an individual can acquire shares and then immediately sell them in the event of the sale of the whole company. This very much suits those who want key employees of the company to be rewarded and incentivised to maximise the value of the company, but who don't actually want to give away shares now: or perhaps, just don't want the tax headaches that tend to accompany simple share transfers to employees.

Interested? Then here are the bare bones of the rules:

- Shares worth up to £250,000 can be granted per employee.
- The total value of shares with unexercised options over them can be up to £3 million.
- A company's gross assets must not exceed £30 million, and the company must have fewer than 250 full-time employees.
- The company must have 'permanent establishment' in the UK.
- The employee must work at least 25 hours a week for the company or, if less, at least 75% of his total working time.
- The option must be capable of being exercised in no more than ten years.
- The individual, together with any 'associates', must have no more than 30% of the company's ordinary shares.
- The company must carry on the trade on a commercial basis and with a view to making profit.
- It must also not take part to a substantial extent in any of the excluded and naughty activities listed in the rules, including dealing in land commodities, futures or shares, etc.; dealing in goods otherwise than in an ordinary trade of wholesale or retail distribution; banking, insurance, money lending, debt factoring, hire purchase financing or other financial activities; leasing; providing legal or accountancy services; property development; farming or market gardening; holding, managing or occupying woodlands, etc.; ship building; producing coal or steel; operating or managing hotels or comparable establishments; operating or managing nursing homes or care homes; or providing services or facilities for any of the above.

If you manage to negotiate the above pitfalls, the tax benefits of the scheme are that the individual can exercise his options without paying income tax, even if the effect of that exercise is that he is paying less for the shares than they are worth. To take an example, Herbert is granted over 100 shares in Gilbert Limited at a time when those shares are worth £10 each, and the exercise price is £10 per share. Because the option is to acquire the shares at no more than they are worth at the time the options are granted, there's no tax charge on grant. Ten years later, the company is sold for an amount equivalent to £30 per share, and because the company is being sold, this is a triggering event for the EMI option scheme. Herbert exercises his option and immediately sells the shares, thus making an immediate profit of £20 per share, or £2,000 in total. This gain is subject to CGT rather than income tax, even though, in exercising the option, he's acquiring shares worth £30 each for only £10 each.

Entrepreneurs' relief applies with no restriction for the fact that the shareholder has, in schemes such as this, held the shares for less than the usual one-year qualifying period.

The Tapered Annual Allowance: Confused? You Should Be!

One of several amendments to the 'simplified' pensions regime was the introduction from 6th April 2016 of the tapering of the annual allowance for individuals deemed to have high incomes.

Since that date, individuals with taxable incomes of greater than £150,000 in a tax year have had their pension annual allowance for the tax year restricted, potentially to as little as £10,000. As might be expected with the simplified regime, all is not wholly straightforward, given the evident concern that individuals may seek to avoid the new provisions by taking reduced remuneration in exchange for increased pension contributions. The extent of any tapering is therefore based on 'adjusted income'.

However, to provide some certainty for individuals with lower incomes who may periodically experience spikes in their employer's pension provision, a test is first made to see whether the individual's income exceeds the 'threshold income' figure. It is therefore first necessary to define the terms involved.

Adjusted income for the tax year is the individual's taxable income (i.e. after trading losses, share loss relief, charitable donations and various other allowances, as detailed in s 23 of the Income Tax Act 2007) from all sources ('net income'):

- plus the value of pension contributions made under a net pay arrangement;
- plus the value of any pension contributions using excess relief under net pay provisions;
- plus, for UK non-domiciled individuals making contributions to overseas pension schemes, any contributions attracting UK tax relief;
- plus the value of pension contributions using 'relief on making a claim' provisions;
- plus the value of any employer contributions to defined contribution schemes;
- plus the pension input amount (calculated using the annual allowance methodology) less the gross total of any pension contributions paid by the member to defined benefit and cash balance schemes;
- less any taxed lump sum death benefits received.

Threshold income for the tax year is the individual's taxable income as defined above:

- plus the amount of any employment income foregone via a salary sacrifice arrangement made on or after 9th July 2015;
- less the gross total of any pension contributions paid by the member;
- less any taxed lump sum death benefits received.

If threshold income is less than £110,000, no tapering applies. However, if it exceeds this figure, it is necessary to calculate 'adjusted income'.

Individuals whose income from all sources in a tax year exceeds the 'threshold income' of £110,000 and the 'adjusted income' of £150,000 will have their annual allowance tapered down from the normal level of £40,000 by £1 for every £2 of their 'adjusted income' over £150,000, down to a minimum of £10,000 for that tax year. The consequence is an annual allowance of £40,000 for those with adjusted income of up to £150,000, reducing to £10,000 for those with adjusted income of over £210,000. See Figure 1.

The situation for employees

The pages and pages of legislation on travelling and subsistence for employees are all based on one very simple principle: travelling for the purposes of your job is tax allowable, providing it isn't an expense of 'ordinary commuting'.

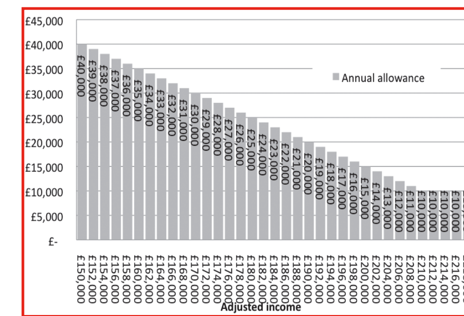

Figure 1 Tapering of annual allowance according to adjusted income. (Data source: Bloomsbury Wealth.)

Being subject to the tapered annual allowance does not affect one's ability to carry forward unused allowance from previous tax years, although the unused allowance being carried forward from a year in which the taper applied will be the balance of the tapered allowance for that year.

Since individuals who have elected for access to their defined contribution pension benefits via flexi access drawdown become subject to the money purchase annual allowance (MPAA) of £10,000 (it has already been announced that this will soon be reduced to £4,000, although the 2017 general election has delayed its implementation), there would normally be an 'alternative annual allowance' (the standard £40,000 less the MPAA of £10,000, so £30,000 – to become £36,000 when the legislation is passed) against which their defined benefit savings would be tested. However, individuals subject to the tapering provisions will have this restricted so that for adjusted income of more than £210,000 the alternative annual allowance is reduced to zero (although when the MPAA is reduced this will be £6,000).

Some examples may serve to highlight how the system operates in practice.

Example 1

Boris is a member of his employer's defined benefit scheme to which he pays 5% of his salary and he also pays gross contributions into a personal pension scheme of £6,000. In 2016/17, his position is:

Earned income	£	
Pensionable pay	£111,000	plus
Benefits in kind	£ 5,200	less
Deductible expenses (subscriptions)	£ 500	less
Less member's contributions under net pay	£ 5,500	
Taxable pay	£110,200	
Investment income		
Gross interest	£ 500	plus
Rents	£ 9,100	plus
Dividends	£ 6,800	
Taxable income	£126,600	
Pensions		
Total defined benefit increase	£ 32,000	less
Member's gross contributions (net pay)	£ 5,550	
Effective value of employer contributions	£ 26,450	
Member's gross contributions (relieved at source)	£ 6,000	
Annual allowance carried forward	£ 20,000	

The first step is to calculate the threshold income.

Taxable income	£126,600
Less gross contributions relieved at source	£ 6,000
Threshold income	**£120,600**

Since this exceeds the upper limit of £110,000, it is necessary to calculate the adjusted income.

Taxable income	£126,600
Member contributions under net pay	£ 5,550
Effective value of employer contributions	£ 26,450
Adjusted income	**£158,600**

Since Boris's threshold and adjusted income figures both exceed the relevant limits, his annual allowance will be tapered by £1 for every £2 that the latter exceeds £150,000 (i.e. by £8,600/2 = £4,300) to £35,700. However, since he has £20,000 of unused relief available, he avoids any annual allowance excess tax charge on this occasion.

Example 2

Teresa owns her own limited company and pays herself a modest salary but as she had an unused allowance of £41,000 at the start of the year, she decided to use this and the current year's allowance to extract profits in a tax-efficient way by making an employer contribution to her SIPP.

Earned income		
Pensionable pay	£ 17,000	plus
Benefits in kind	£ 6,100	less
Deductible expenses (subscriptions)	£ 250	
Taxable pay	£ 22,850	
Investment income		
Gross interest	£ 720	plus
Rents	£ 6,700	plus
Dividends	£ 80,000	
Taxable income	£110,270	
Pensions		
Employer contribution to defined contribution scheme	£ 81,000	
Annual allowance carried forward	£ 41,000	

Again, the first step is to calculate the threshold income.

Taxable income	£110,270
Threshold income	**£110,270**

Since this exceeds (albeit only slightly, owing to an increase in the premiums for her private medical insurance, something which may well be unknown at the time the contribution was paid) the upper limit of £110,000, it is necessary to calculate adjusted income.

Taxable income	£110,270	plus
Employer contribution to defined contribution scheme	£ 81,000	
Adjusted income	**£191,270**	

the contribution was paid) the upper limit of £110,000, it is necessary to calculate adjusted income.

Teresa's threshold and adjusted income figures both exceed the relevant limits, so her annual allowance will be tapered by £1 for every £2 that the latter exceeds £150,000 (i.e. by £41,270/2 = £20,635) down to £19,365 (what is left of the £40,000 annual allowance after the tapering £20,365 is deducted) and since the carried forward annual allowance had already been used, there would be an annual allowance excess tax charge.

This may be disconcerting to Teresa, who probably does not consider herself a high earner at all. However, there is a solution if she realises the situation before the end of the 2017/18 tax year. If she were to make a personal contribution of just £300 to her SIPP before 5th April, that would have the effect of bringing her threshold income down to £109,970 which, as it is below £110,000, would bring her income below the figure that triggers the adjusted income calculation. She still breaches the annual allowance but her annual allowance excess tax charge would now be based on £300 rather than £20,365.

In such circumstances, it may therefore be beneficial for those who could be caught by tapering to make personal contributions to a personal pension scheme rather than use employer contributions. Obviously, this requires that the personal contribution is also covered by earnings, which can be an issue where profits are extracted substantially in the form of dividends.

Quite how 'the man on the Clapham omnibus' can be expected to understand the intricacies of the tapered annual allowance is beyond me. Even advisers struggle to get to grips with it (in 2016, Prudential's adviser helpline fielded 14,000 calls from advisers, with the highest number relating to the tapered annual allowance). This could help to explain why, in the last five years, HMRC has collected £180m in annual allowance tax charges from defined benefit occupational pension schemes paid under 'scheme pays', a facility whereby the charge can be paid by the scheme rather than the member. This does not allow for those who did not choose the 'scheme pays' option.

The figures provided by HMRC show that a total of 9,257 scheme members

were affected during that five-year period. Interestingly – and somewhat tellingly – the number of cases varies significantly each year, which perhaps best illustrates the random nature of the policy and the likelihood that most charges arose as a result of people being caught out rather than knowingly breaching the limit.

What is clear is that if there is likely to be any chance that you will be affected by this tax charge paying for advice may well prove to be extremely cost-effective.

For more information please feel free to download our Guide to Pensions here:

http://www.bloomsburywealth.co.uk/guide-to-pensions-updated-may-2017-pdf/

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Offshore News

The Hong Kong pension loophole

As it currently stands (and many people feel that sooner or later the Hong Kong government is going to be forced to step in), it is possible to obtain complete financial privacy by starting a private pension plan in Hong Kong.

As readers will be aware, thanks to the Common Reporting Standard (CRS), over a hundred governments around the world are automatically exchanging tax information on their financial firms' clients, so that it is no longer possible to hide money anywhere apart from the less reputable offshore jurisdictions and (of course) America.

In Hong Kong, however, there is a type of pension known as an ORS, which stands for occupational retirement scheme. As the *Economist* points out: "The beauty of ORS from a tax evader's point of view is that anyone can get one and they are not caught in the Common Reporting Standard net."

The way it works is this. First, you set up a Hong Kong shell company and appoint yourself as its director with a local employment contract. Then you enrol with a trust company that provides an ORS. You can put cash, property or other assets into the pension fund and retire whenever you want. You can withdraw whatever you like, also whenever you want. An ORS, in other words, is a flexible bank account.

For reasons that are unclear, the arrangement falls outside both the common reporting standard and the Foreign Account Tax Compliance Act (FATCA). This is because the Hong Kong government considers ORS low risk and counts ORSs as "non-reporting financial institutions".

A number of law firms and tax specialists have started to sell the idea of ORSs to high-net-worth individuals in high-tax countries. As a result, the Hong Kong government may, shortly, find itself under pressure to close this particular loophole.

Brazil revives amnesty programme

Last year, the Brazilian government launched its Special Regime for Tax and Exchange Legislation (RERCT), which offered Brazilian taxpayers an opportunity to regularise their tax affairs without facing criminal prosecution. That regime ended in October 2016, having raised some $54 billion. In April this year, the government announced that it was going to revive the programme for four months this year. The cost has gone up from 30% (a one-off tax charge of 15% plus a 15% penalty) to 35.25%. In addition, taxpayers will have to use the less favourable Brazil real to US dollar exchange rate from 30th June 2016. Still, for any Brazilian taxpayer with money held offshore it offers an excellent and relatively inexpensive opportunity to regularise their affairs.

More Credit Suisse raids

The Dutch government has coordinated a series of international raids on Credit Suisse offices in the Netherlands, the UK and France in a search for information about dozens of people who are suspected of tax fraud and money laundering.

Public access to beneficial ownership register

The upper house of Germany's parliament has given the go-ahead for changes to a bill that will allow the public to see Germany's beneficial ownership register. Similar legislation in France ended in disaster as wealthy citizens took the French government to court.

New UK online trusts register

This June, the UK's new Trusts Registration Service will be launched with responsibilities to coordinate the registration obligations of all trusts and estates. Any trust with a UK tax consequence will need to be registered. Moreover, trustees must ensure and confirm the trust register is accurate and up to date. Trustees will need to update the register each year that the trust generates a UK tax consequence. Registration does not apply to trusts that have closed where the trustee or their agents have received a letter from HMRC stating that the trust has ended.

The register, which will be accessible online, will demand details of the trust assets, including addresses and values, and the identity of the settlor, trustees' protector (if any) and all other persons exercising effective control over the trust (if any). It will also demand information about the beneficiaries or class of beneficiaries.

The information required will include: name, date of birth, NI number (if they are a UK resident) and an address and passport or ID number for non-UK residents, if there is no NI number.

Football clubs tackled

HMRC has raided football clubs in the UK and France to facilitate its investigations into multi-million-pound transfers and image rights arrangements.

The Netherlands plans beneficial ownership registry

The Dutch government is planning to introduce legislation that will result in a beneficial ownership register for Dutch companies. This is to comply with the Fourth EU Anti Money Laundering directive, which insists that EU member states ensure that entities incorporated within their territory obtain and hold adequate, accurate and current information on their beneficial ownership, in addition to basic information, such as the company name, address, proof of incorporation and legal ownership.

Mossack Fonseca founders given bail

The two founders of Mossack Fonseca, the legal firm at the centre of the Panama papers leaks, have been granted bail in a separate case involving a corruption investigation in Brazil. Jürgen Mossack and Ramón Fonseca each paid $500,000. The court found that they were not a flight risk because they had been cooperating with the investigation.

Tax spy accused

A 54-year-old Swiss man was arrested in Frankfurt, Germany on suspicion of spying, on the 28th April 2017. According to German Federal prosecutors he was working for the Swiss intelligence service with a view to identifying German tax investigators involved in the purchase of confidential Swiss Bank client data. The tax authorities in Germany have controversially bought information from whistle-blowers in Swiss banks to determine whether German residents with Swiss bank accounts have been evading tax. Meanwhile, the Swiss Supreme Court has confirmed an earlier ruling that the Swiss government cannot provide legal assistance to the French tax authorities in respect of two clients of a Swiss bank account because the request was based on information that had been obtained illegally. Basically, an unnamed, French couple whose bank account details were stolen by a former employee of HSBC want to ensure that Switzerland is not allowed to disclose their financial details to the French tax authorities. In a separate ruling last month, the Swiss Supreme Court made the legal distinction between data that had been stolen in Switzerland and that stolen abroad.

UK government U-turn on Overseas Territories

A move which would have required offshore financial centres in British Overseas Territories to establish a publically accessible register of beneficial ownership of companies no later than the 31st December 2019 has been stopped. The UK government is now taking the attitude that, although they would like publically accessible registers of beneficial ownership to become the global standard, for the time being they are going to leave it up to individual Overseas Territories and Crown dependencies to implement the standard.

US government after Amex records

The IRS, as a result of a demand from the Dutch government, has served a notice on American Express requesting it to provide information about Dutch residents who have debit or credit cards linked to bank accounts located outside the Netherlands and provided by American Express. The filing does not allege that American Express has violated any US or Dutch laws with respect to these accounts. It is unclear, at the time of going to press, as to whether American Express will resist this summons.

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America – the land of the free

The offshore financial services industry was, by and large, delighted to see Donald Trump elected President of the United States, because it means, at least for the time being, that there are unlikely to be any changes to the country's policy regarding exchange of information. This means, in practical terms, that the safest, most confidential home for your money and other assets is the US of A. Indeed, it is probably the only country in the world where you can start a company, set up a trust and establish a bank account without anyone – anywhere – knowing that you are the beneficial owner.

The Tax Justice Network explains the situation perfectly:

The United States, which has for decades hosted vast stocks of financial and other wealth under conditions of considerable secrecy, has moved up from sixth to third place in our index. It is more of a cause for concern than any other individual country – both because of the size of its offshore sector, and also because of its rather recalcitrant attitude to international cooperation and reform. Though the US has been a pioneer at defending itself from foreign secrecy jurisdictions, aggressively taking on the Swiss banking establishment and setting up its technically quite strong Foreign Account Tax Compliance Act (FATCA) – it provides little information in return to other countries, making it a formidable, harmful and irresponsible secrecy jurisdiction at both the federal and state levels.

Andrew Penny of Rothschild & Co puts it more succinctly: "The United States is

effectively the biggest tax haven in the world. It is the new Switzerland." Rothschild, incidentally, has opened a trust company in Reno, Nevada to cater to international families attracted to the stability of the US. Customers simply have to prove that they comply with their home country's tax laws.

Indeed, a 2012 study by various US universities showed that the US has the most lenient regulations for setting up a shell company anywhere in the world outside of Kenya. Tax havens such as the Cayman Islands, Jersey and the Bahamas were far less permissive, their research found, than states such as Nevada, Delaware, Montana, South Dakota, Wyoming and – interestingly – New York.

As Bloomberg puts it:

After years of lambasting other countries for helping rich Americans hide their money offshore, the US is emerging as a leading tax and secrecy haven for rich foreigners. By resisting new global disclosure standards, the US is creating a hot new market, becoming the go to place to stash foreign wealth. Everyone from London lawyers to Swiss trust companies is getting in on the act, helping the world's rich move accounts from places like the Bahamas and the British Virgin Islands to Nevada, Wyoming and South Dakota.

There is nothing illegal about banks luring foreigners to put money in the US with promises of confidentiality, as long as they are not intentionally helping to evade taxes abroad. Still, the US is one of the few places left where advisers are actively promoting accounts that will remain secret from overseas authorities. Moreover, holding your assets through, say, a Nevada LLC, which in turn is owned by a Nevada trust, would generate no US tax returns.

Can the situation last? The US government has been the loudest to condemn the offshore industry and to force other countries to provide it with information about its own citizens. It has pushed the OECD and others to crack down on low-tax jurisdictions, and it has enforced its right to information with dire threats. Elements within the country would like to see America reciprocate. However, attempts to change the status quo have, to date, stalled in the face of opposition from the Republican-controlled congress and the banking industry.

It seems likely that some governments may take action against US firms facilitating tax planning in the US with offices in other countries. For example, the UK government could decide to make it difficult for banks such as Rothschild & Co to keep their UK office if they also intend to run an office in Nevada. It is debatable how effective such an attack could be since any victory could be pyrrhic.

Meanwhile, if you are thinking of establishing a US holding company, a word of advice: arrange it locally (in other words visit the US to set it up) and bear in mind that one day the information may become public.

Money

News

A sporting gamble

This summer, a tech start-up called Stratagem aims to exploit advances in artificial intelligence to analyse football, basketball and tennis matches and to use algorithms to place bets before and during games. The company's goal is to establish betting on sports as an asset class. Part of the company's technology can map football pitches, especially in real time, tracking balls and players, and allows its computers to watch a football match. Stratagem hopes to raise £25 million for the fund, which will initially only be open to wealthy investors. The investments and risk will, undoubtedly, be high.

Supply chain finance bonds

Over the last few years a new financial product has been created to replace the old-style invoice factoring, whereby a small to medium-sized business could sell their invoices at a discount and/or borrow money against them at what was generally an above-market rate.

The new bond market was really started by Greensill Capital, which saw the opportunity to offer early payment all the way down the supply chain. For example, you can buy a 90-day senior claim on Vodafone for payment, in the form of a bond, at a slightly better spread than actual Vodafone bonds but with the same credit risk. Other available SME lending funds include TCA Global, targeting 8 to 12% yields; Beechbrook, 10 to 12%; and TLG Capital Credit Opportunities, 15%. One fund, Amundi, offers wealthy investors an opportunity to finance Italian ham production. The bonds it sells use the money to buy semi-finished raw hams, and hold them through the maturing phases of 8 to 24 months. Return is around 5% with the security of an asset that is increasing in value over time. These are relatively high-risk investments but they do offer worthwhile returns.

Feature: Divine Profits

You may remember the financial journalist Andreas Whittam Smith, a financial journalist who became one of the founders, and the first editor, of the *Independent* newspaper.

For the last 15 years, Sir Andreas – he was knighted for his services to the Church – has been the first Church Estates Commissioner, with responsibility for looking after the Church of England's assets. During his time at the helm, he has turned the Church of England endowment from a financial disaster into one of the most successful investments in the world. Last year, for example, the Church of England produced a 17.1% return on assets and if you look at the average annual return over the medium to long term it has been an impressive 9.6%.

When you consider the Church won't invest in some of the most profitable sectors, such as tobacco, arms and alcohol, on ethical grounds,

this is no mean achievement. How have they managed it? To begin with, they think very long term and invest a surprisingly high percentage of their asset base in alternative investments such as property, forestry and commodities, taking decisions that may not yield returns for many years. They avoid fixed-interest products, and keep 25% of the portfolio in property. They specialise in buying land with a view to obtaining planning consent for housing. Other asset categories include private equity. Overall, they take a contrarian position. At a time when most of the market is moving towards passive investment they have become active.

Every year, the Church Commissioners publish an annual report explaining their investment strategy in detail. For anyone who wishes to achieve the same sort of returns it makes fascinating reading. Indeed, I'd argue that for any UK investor it is considerably more valuable than anything produced by Warren Buffett.

Alternative Investment Opportunities

The numismatists' revenge

At school, children often made fun of the boys (for some reason girls are rarely bitten by the bug) who collected coins. It would appear, however, that the numismatists are going to get the last laugh. Every year, the Knight Frank Consultancy compiles an index of tangible alternative asset classes. For the ten years ending December 2016, rare coins were showing a 195% return, easily beating art, 139%; stamps, 133%; furniture, 31%; and the S&P 500 Index, 58%. Coins are, of course, considerably more portable than art or furniture and are viewed by collectors as aesthetic masterpieces rather than simply as investments.

For many years, numismatists were victims of disreputable dealers selling forgeries. Then, in 1986, the first independent coin certifier, the Professional Coin Grading Service (PCGS), based in California, established itself as an authority on authenticity and quality. Thanks to its grading system the market now has transparency, which in turn has boosted investor confidence and sales volumes. Interestingly, 85% of the market is in America and global sales are estimated at $8 billion a year. A rival to PCGS has now emerged, the Numismatic Guarantee Corporation (NGC), which is based in Florida and offers a very similar service.

These certifying bodies offer fantastic opportunities for profit since the difference in price between, say, a grade 63 and a grade 64 coin could be tens of thousands of dollars. A few astute collectors buy coins and keep sending them back for re-appraisal in the hope that the coin will be upgraded in the process and thus become more valuable overnight.

Anyway, if you are looking for a portable, confidential, reliable way of storing wealth, it is difficult to beat rare coins.

Cryptocurrency madness

If you are looking for a high-risk – by which we mean very high-risk – high-return – by which we mean astronomically high-return – way of making money, then dip a toe into the cryptocurrency market.

The sector has grown dramatically since the first virtual currency – Bitcoin – was invented by an unknown programmer, or a group of programmers, in 2009. Indeed, there are now more than 800 different cryptocurrencies from Artic Coin (an obscure Russian currency) to Zcoin (which boasts added security). If you would like to see a full list, visit CoinMarketCap.com.

Currently, there is a cryptocurrency boom. For example, had you invested just a few thousand dollars in April in a newly fashionably currency called Muse you would now find that your investment was worth nearly half a million dollars. In a single week recently the price rose by 278%.

The current speculative frenzy raging through the crypto market has been fuelled by a constant stream of initial coin offerings (ICOs). These mirror the actual world process of floating a company on a stock exchange in that the promoters publish a business plan, commonly known as a white paper, and then find speculators through Internet forums. The ICOs raise money in existing cryptocurrencies, generally Bitcoin and Ether.

In total, it is estimated that some $1.2 billion has been raised through ICOs, many of which are of dubious long-term value. One thinks, in particular, of cryptocurrencies such as ZRcoin, which bases its value on cubic zirconia, and Voise, a decentralised music platform.

If ever there was a speculation where one should only invest what one can afford to lose it is cryptocurrencies. In particular, one needs to pay particular attention to turning cryptocurrencies into more accepted currencies, such as dollars, euros and pounds.

Smoking hot returns

Would you pay $68,000 for a Kia Rio that is 3 years old? You might if you lived in Cuba. When the communists seized control in 1959 they banned the purchase of cars. Indeed, it wasn't until 2013 that private individuals have been able to buy and sell used cars without official permission. New cars, incidentally, can only be sold by government-owned dealerships.

With the recent economic liberation has come demand. As a result, cars that would be worth next to nothing in the United States or Europe have become incredibly valuable. What's more, second-hand car prices are going up, not coming down. A 25-year-old VW Golf has doubled in value from $5,000 to $10,000 over the last couple of years. If you have always fancied a holiday in Cuba and you like the idea of a high-risk investment, well, you know what to do!

Invaluable resource

Interested in alternative investment? Take a minute to visit and sign up to Invaluable.com. Invaluable is the world's leading online marketplace for buying fine art, antiques and collectibles. Working with more than 4,000 of the world's premier auction houses, dealers and galleries, Invaluable helps buyers from more than 180 countries connect with the things they love, with a best-in-class online bidding technology, along with a fixed price retail platform.

Property

Property Tax Tips

A capital tax-saving opportunity

In 2012, the *Guardian* newspaper, which is not known for being on the side of entrepreneurs, ran a headline that both surprised me and grabbed my attention: "UK firms losing billions on capital allowances".

The accompanying article, all about how British businesses, developers and investors were handing the government untold amounts of money unnecessarily, simply because they didn't understand capital allowances, was the wake-up call my family and I needed.

At that time, we owned a dozen small to medium-sized supermarkets in the north of England, many of which included office ancillary space that we let out, and we were paying next to no attention to our capital allowances. The subject had been raised a couple of times by our accountants, but my brothers and I had found it so dull that we had pretty much ignored everything we had been told.

The *Guardian* article, however, as I say, was something of a wake-up call. I simply hadn't realised quite how many things we could claim or how valuable the resulting relief could be.

Perhaps the first thing to explain is that there are several types of allowances, applicable to different asset categories. The two main forms are plant and machinery, and integral features. However, there are also capital allowances for short life assets, long life assets and energy efficient and water saving assets.

It is important to remember that capital allowances aren't automatic. It is up to you to make a claim at the appropriate rate.

The problem is that many property owners don't think that these allowances are worth claiming, even though they can run to a very substantial amount of money.

To be successful you basically have to separate the cost of the land, bricks and mortar (as it were) from the fixed plant and machinery that allow the business to function. It is the latter which is eligible for tax relief.

In 2014, new, and rather poorly worded, legislation was passed. It sets out the three requirements for a successful claim: the fixed-value requirement, the pooling requirement and the disposal value statement requirement.

The fixed value requirement

In plain English, the fixed value requirement means that if the purchaser of a commercial building wants to claim capital allowances on any plant and machinery forming part of the building, he must enter into a joint election with the vendor to agree an apportionment of the price. This election must be made within two years of the purchase. The parties can agree any value up to the original cost of the fixture; typically

the purchaser will want to agree a value as high as possible so as to maximise the availability of his capital allowances on the building, while the vendor will normally prefer a lower figure so as to avoid taxable clawback of allowances previously claimed (these are referred to as the 'balancing charge'). Where the purchaser and vendor are unable to agree a value, either party can apply to the tax tribunal to fix an apportionment of the price; but this, too, must be done within two years of the purchase.

The pooling requirement

The pooling requirement applies for sales made since April 2014 and normally will deny a purchaser any capital allowances at all in respect of fixtures in the building unless the vendor has previously made a claim for allowances in respect of those fixtures. If for any reason the vendor has failed to claim capital allowances, there is nothing the purchaser can do but be made aware that no allowance can ever be claimed on those assets within the property, whether by the purchaser or by any subsequent purchaser. This is, of course, very likely to affect the value of the property. However, if the vendor has no right to the allowances (e.g. if the vendor is a charity or pension fund) the rules may still allow the purchaser to make a claim. This will increase the building's value.

The disposal value statement requirement

The disposal value statement requirement comes into force where a seller who has made a claim is disposing of the property at a price below market value or where the sale involves different interests (such as freehold and leasehold) being merged together. In these circumstances the seller must make a written statement detailing the disposal value of the assets that are eligible for capital allowances, and also provide the purchaser with a copy of that statement within two years of the date of sale.

The importance of records

The complexity of the rules means that it is vitally important to keep good records of all types of expenditure during the period of ownership of a building. Unfortunately, many property investors, owners and landlords do not see this as a priority. However, in order to ensure that you optimise your available tax relief it is vital that your paperwork is in order. You have two years, incidentally, from the purchase of a property to make an election.

Pre-2014 rules

It is also crucial to remember that although the rules now prevent claiming capital allowances when no election has been made, and where the vendor had not claimed allowances, for properties acquired before the new rules came into force in 2014, allowances can be claimed without meeting all the requirements mentioned above.

Available reliefs

What exactly are the key reliefs that you will be eligible for? Whether you are involved in refurbishment or extension/new-build projects for non-residential property you can benefit from:

- 100% tax relief for expenditure on like-for-like repairs;
- 100% tax relief for expenditure with annual investment allowance (AIA), which may be as much as £200,000;
- 18% writing down allowances for plant and machinery (in excess of AIA);
- 8% writing-down allowances for integral features (in excess of AIA);
- tax relief for thermal insulation (8% writing-down allowance);
- potential for 100% tax relief on green technologies;
- additional valuable allowances for converting/renovating unused business premises;
- additional 50% deduction allowed for contaminated land remediation costs.

The first question to ask in a refurbishment project is whether any of the expenditure qualifies as a like-for-like repair of part of an asset (e.g. replacement windows). If this is the case, then it may be possible to secure 100% tax relief for the expenditure when it is incurred. However, substantial refurbishments, or those where there is an improvement to an asset, will often be treated as capital. Unless capital allowances are available then there will be no tax relief on this expenditure until the building is sold. This means that identifying all assets qualifying for allowances is an important exercise as it can achieve substantial tax relief and assist with cash flow.

What about the AIA at 100% relief? The AIA provides 100% deduction for the cost of plant and machinery or integral features up to an annual limit. That annual limit has risen and fallen over the years. From the 1st January 2016 it stood at £200,000.

Where a business has an accounting period that straddles the date of change the allowances have to be apportioned on a time basis.

For expenditure in excess of the AIA, writing-down allowances are available at 18% per annum on plant and machinery and 8% on integral features. It is therefore beneficial to consider the timing of the expenditure to fall within the AIA; otherwise, tax relief will be obtained over a number of years. One potential solution is to ensure that some of the expenditure qualifies for other enhanced capital allowances, which can be claimed in addition to the AIA (e.g. green technology). What exactly counts as plant and machinery? Well, machinery, it goes without saying. Also such things as manufacturing or process equipment, storage equipment (including cold rooms), sound insulation, refrigeration, fire alarm systems, burglar alarm systems and moveable partition walls. The list of integral features, incidentally, includes electrical systems, cold water systems, space or water heating systems, lifts, escalators and moving walkways, external solar shading, solar panels and so forth. Thermal insulation, incidentally, has an 8% writing-down allowance, but anything which counts as green technology (such as pipe insulation or radiant and warm air heaters) will give you a 100% enhanced initial allowance. This is, as you can well imagine, worth having. Other things to remember are that the business premises renovation allowance (BPRA) is worth 100% and that you can claim 50% of the cost of reclaiming contaminated land.

In conclusion

This area is so complex that it is, without doubt, worth getting specialist assistance. There are companies that promote themselves as only helping businesses claim their capital allowances. On the whole, unless the principles of those companies are professionally qualified, you should probably not consider using them.

Remember that if you are an owner of a commercial property you should be aware that a failure to claim all allowances will not only affect your own current tax bill but will affect your ability to pass allowances on to a purchaser and so is likely to impact on the valuation of the property on any future sale. As already explained, you should be aware that a detailed capital allowance history needs to be collated and form part of the property legal documents 'bundle' each time there is a transaction for that property and that a formal value fixing election should be negotiated as part of the purchase process.

Purchasers of property should speak to their professional advisers to ensure, first, that a complete capital allowance history is requested as part of the pre-contraction enquiries and, second, that where appropriate the purchase contract requires the vendor to claim capital allowances on relevant fixtures if they have not done so already.

If I had to offer one final piece of advice it would be to consult a specialist at an early stage as this will avoid future complications, stop delays when it comes to buying and selling and – best of all – could generate a very meaningful tax benefit.

Feature: VAT For The Non-VAT-Registered

For many who don't have to grapple with the value-added tax (VAT) rules as actual VAT-registered traders, the thought of an article talking about the tax is about as exciting as someone talking to you about their gluten-free diet. But VAT is a tax on you as the ultimate consumer, and it can be a very heavy tax, too. So here are some wrinkles for the otherwise non-VAT aware.

Small is beautiful

If you're having work done on your house, for example, it should be quite easy to ensure that the contractor you're using, even if he's doing lots of different things, is a non-VAT-registered trader. With the VAT registration threshold at over £80,000 per annum, a builder, or indeed other types of business, can be in a reasonable way of trade without needing to charge you VAT on the value of their services.

If you are having work done on your house by a number of different tradesmen, there is obviously a lot to be said for contracting with them separately rather than treating one of them as the main contractor who is thereby likely to exceed the VAT threshold and make his bill to you 20% more expensive.

The same principle applies to services like gardening and other domestic services: if you go for the big company, rather than the individual, you will be paying 20% to the government for the privilege of using their services.

Home conversions

If you're looking at such substantial works, perhaps on a property you are looking to buy, that there's no way you can keep the amount below the VAT threshold, you'll find in most cases that the VAT is just an additional cost at 20%. But do be aware of the situations where work on a property is eligible for the reduced rate of VAT, at 5%.

The main instance of this is where you are converting a property so that there are a different number of dwellings in that property after the conversion from before. This is a surprisingly wide-ranging tax relief.

For example, it sometimes happens these days that someone with a large family wants to buy a property which is currently laid out as a number of flats. Their aim is to convert (often reconvert) the property into a single dwelling. The 5% VAT rate is available for the builder's services and the materials he uses.

Another situation is where you acquire and convert a property which is currently non-residential in nature, like a farm building or, increasingly these days, a commercial property in a town or city. Again, make sure the building contractor, if you use one, only charges you 5% VAT, rather than 20%: they often need to be fairly forcibly reminded of this rule.

The 'scorched earth' policy

Perversely, the VAT rules very much favour flattening a property rather than repairing it. Consider the following example.

John and Susan are moving to a new property which they have bought on the outskirts of their town. What attracts them to the property is not the frankly ramshackle house on the site, which will need fundamental refurbishment amounting to almost rebuilding, but the actual site itself: a nice substantial garden with pleasant views over the countryside.

There's not much in the current property which won't need significant renewal, though, and they've allowed for this in their costings. Almost all that the builder will leave of the original property are the walls, and even these will be demolished in some places in order to extend the footprint of the property.

Making sure that John and Susan are sitting down, the contractor reveals that his total project cost for the work on the house will be £100,000 plus VAT. John and Susan pale beneath their tan, and the builder, seeing their concern, adds a rider: "To be honest, it's not much more trouble for me to knock down the whole property and build afresh, exactly how you want it. There will be additional costs of putting up new walls, but I would have thought that you would get away with it for £110,000 plus VAT."

Susan, who is an accountant, sees the benefit of this straightaway. "That's actually cheaper!" she exclaims. "If you do a complete new build for us, there's no VAT because your bill will be zero rated." So £110,000 without VAT is obviously less than £100,000 with.

Do-it-yourself housebuilders

You may not be in a VATable business, but you can still reclaim VAT if you go in for the DIY housebuilder scheme. Again, subject to an exception which we will come on to, you have to be looking

at a complete new-build situation. But if you are doing the work yourself, those who make the rules can see no reason why you should be discriminated against as compared with the person who uses a builder. So you'll be able to apply for a pack and reclaim the VAT on all of the materials you buy, subject to the usual detailed and fussy bureaucratic rules.

In fact, this DIY VAT reclaim scheme applies not just to new-build, but also to DIY conversions of commercial premises into dwellings for individuals otherwise than by way of a business.

Listed places of worship

Finally, a strange little point for those of our readers who are treasurers of their local church, mosque, synagogue, etc. (Note the impeccable political correctness of this magazine!) If your place of worship is a listed building, what the government really wanted to do was provide VAT zero rating for repairs to that building. Unfortunately, the government is in the straitjacket of the EU Treaty rules, which are very specific on what you can favour in the VAT system and what you can't. So the government came up with a clever alternative: you have to pay the VAT on the repairs, sure, but you can fill in a fussy, bureaucratic, etc. set of forms to reclaim that VAT back under the 'listed places of worship grant scheme'.

Property Opportunities

Build Don't Buy

House hunting in the shires is not, according to one leading commentator, the walk in the country park it used to be. Ben Horne of Middleton Advisors, a buying agent who acts for wealthy investors looking for a country home, recently said: "Where a few years back it took three to four months for clients to find a new house, now we are saying between nine and twelve months." The cause is mostly shortage of supply. Country house sellers have seen prices falling and tax rising and, as a result, have been slow to list their properties. Country house buyers, on the other hand, are, according to Horne and his ilk, becoming harder and harder to please. An informal survey of buyers suggests that as many as half of them have started to consider building their own house. This makes excellent sense both in terms of making money and in terms of getting what you want. A £3 million investment can be turned into £4 million in a matter of 18 months if you know what you are doing. (As an aside, if you build your new home, don't forget to take advantage of the opportunities to avoid VAT – see this month's feature on VAT)

The first hurdle for anyone intending to build a rural retreat is to obtain a site with planning permission. There are two short cuts worth considering. The first is to acquire an old property in poor condition on a large plot of land and to apply for permission to knock it down and replace it. The other is to buy land a developer has already obtained outline planning permission for.

If time isn't of the essence you could also consider looking for a green field site. If your house is of architectural significance, many local authorities will allow it to be built on what would otherwise be considered sacred farmland thanks to a rule called PPS7 – which refers to a government paper called Sustainable Development in Rural Areas. Paragraph 11 of PPS7 states: "Very occasionally the exceptional quality and innovative nature of the design of a proposed, isolated new house may provide this special justification for granting planning permission. Such a design should be truly outstanding and ground-breaking, for example, in its use of materials, methods of construction or its contribution to protecting and enhancing the environment, so helping to raise standards of design more generally in rural areas."

The general rule of thumb is that you should be able to make a 25% profit when the house has been completed. It is the same effort, whether you build in Surrey or Shropshire, but the returns in the former will be much higher than in the latter. One developer who works in places such as Virginia Water and Chertsey told the *Financial Times* that he worked on the basis of £1 million for the site, £2 million for the build and £1 million profit. If, of course, you make it your primary residence, any gains will be tax-free.

Let there be light

Here is a strange, new opportunity for anyone interested in land or property. It is called Lightvert and, in plain English, it is a way of projecting an advertisement into the sky at night in such a way that it can only be seen from certain positions. So, you could be driving or walking along and the Lightvert will appear for a brief interval and then disappear. Think of it as a giant, virtual billboard in the sky up to 200 metres in height. A billboard that is projected by long but relatively thin strips mounted on buildings. How is this an opportunity? Well, if you have a suitable building you could contact Lightvert to see whether they are interested in paying you a fee to use it. Or, perhaps, you could create your own Lightvert. Either way, it is a good reminder of the value of buildings as advertising media.

Supermarket gains

In recent years, UK supermarket property investment has been falling. However, there are signs that the market is turning. James Watson, who is the head of retail capital markets at Colliers, recently said: "In an uncertain world, long-dated income from relatively sound covenants once again looks increasingly attractive to investors. The main structural concern about the current market is supply. Without substantial development programmes and an absence of sale and lease backs it will become increasingly difficult to source the best supermarket assets."

Sale and leasebacks by the big four operators (Tesco, Sainsbury's, Morrisons, and Asda) were for many years a major source of asset supply to the market. However, many supermarkets have changed their policy and are now net buyers of stores. This is, in most cases, because they are beginning to realise that the space above the supermarket could be redeveloped as either offices or homes. Indeed, airspace is rapidly becoming a tradeable commodity in the London property market. An urban planning firm called HTS Design believes that developments in London located in such airspace could deliver as many as 180,000 new homes worth £54 billion.

Incidentally, in New York, air space has been traded and transferred for years, with shorter buildings able to sell the airspace above them to property developers. However, to combat overdevelopment in historic areas of interest, the Department of City Planning in New York is now considering proposing a new tax on all air rights deals that take place in certain districts, including the famous theatre district. Such a move is unlikely in the near future here in London.

Cotton onto Egypt

Egypt may be a strange country to put forward as a suitable place for property investment. After years of political turmoil, it has recently suffered a number of terrorist attacks, most recently last April, when two bombs were set off in Coptic churches killing 47 and wounding over 100 more.

Despite this, investors have been pouring in since the end of last year. Why? Egypt is an enormous country with substantial resources, a relatively high level of education, a growing population and – by many standards – a stable government. Its current leader, General Abdul Fattah al-Sisi, has clamped down on political opposition and ended the country's brief experiment in democracy. Last November, he gave into the International Monetary Fund's demand that the Egyptian pound be floated, with the result that the government received the first tranche of a $12 billion three-year loan.

True, 28% live below the poverty line and millions more hover just above it. Youth unemployment is around 40% by some measures. Annual inflation is high. And food price inflation is particularly high. However, the recent devaluation has resulted in a fall in prices for all assets – both business and property. The economy is in a better position than it has been in the last five years and a new investment law offers investors greater protection.

What should you buy? Residential property offers real bargains.

Propertyfinder.eg has apartments with sea views in Alexandria for as little as £15,000 and a villa with a pool in one of the nicer areas of Cairo for just £200,000. You could buy a small shopping centre in Cairo, with tenants, for not much more. If you have the spare cash and you aren't risk averse then perhaps it is time to take a short buying holiday in Egypt.

London Property Update

As we currently face what by any standards must be described as a period of considerable uncertainty, we thought it would be useful to have a look at what is happening in the capital city.

Residential sales

House prices in London have slipped by 1.5% over the last year as a series of adverse political and economic factors have combined to cause an ongoing standoff between potential buyers and sellers. The effects of two increases in stamp duty over recent years has hit the higher value prime central London property market and sales have also been damaged by Brexit-inspired political uncertainty, domestic economic worries and a surplus of luxury new-build developments. Another problem is that London property prices stand at around 12 times average earnings, which, obviously, makes buying difficult for all but the wealthiest. Although foreign buyers, thanks to the lower value of sterling, have been lured into the market, thus propping prices up, future legislation may reduce foreigners' appetite for London's residential property. Further falls in property values are, therefore, expected in the short to medium term.

Retail

Although retail sales have been down in the suburban parts of London, central London and tourist areas have reported strong growth. Interestingly, Shaftsbury, the West End landlord, recently reported a 28% in first-half profits as its portfolio in central London defied both Brexit and concerns over the health of the retail sector. Shaftsbury owns property in Covent Garden, Soho and Chinatown and says that the West End has benefited dramatically from the weaker pound. Footfall, for example, was up nearly 3% year on year in April. Central London retail property prices, therefore, remain firm.

Office

Lower demand and a trend towards flexible working space appear to be affecting profitability for London office landlords. The average length of time before the first lease break – a moment at which tenants or landlords can terminate a contract – fell to a record low of 3.2 years across central London in 2016, according to Colliers International. Businesses are able to negotiate more favourable terms because there is less demand for new office space since the UK voted to leave the EU, adding to a broader trend of property owners being forced to offer greater flexibility. Should Britain face a hard Brexit and, in particular, should the financial services industry cease to flourish, then office property prices will be expected to fall even further. Flexibility is what tenants want at the moment.

Residential lettings

Interestingly, given the enormous demand for rental accommodation in London, tenants appear to be getting something of a break. Get Living, which owns the former athletes' village from the 2012 London Olympics, turned into some 1,500 homes that are all available for lease, has announced that it will no longer be asking new tenants for security deposits and intends to return existing residents' deposits to them from early July. To qualify tenants must give references or have a guarantor, and existing tenants must be up to date with their rent. The average deposit in London is nearly £1,900.

In another part of London, the Nine Elms district south of the Thames, where multiple developers are building more than 20,000 new homes, rents have been falling. On average, new properties in the SW8 postcode are being rented out for 7% below their asking price. Anecdotal evidence suggests that new homes are putting pressure on tired rental stock within the second-hand market. It is anticipated by many landlords that they will see further rent falls during the rest of this year. Again a hard Brexit, and the exit of any financial services companies from London, is expected to affect the rental market.

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