The Schmidt Tax Report

Tax, Money & Property

July 2017

Bats have no bankers and they do not drink and cannot be arrested and pay no tax and, in general, bats have it made
- *John Berryman*

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The password is all lower case: str

Tax

News

Record IHT take

HMRC collected a record £5.1bn in inheritance tax (IHT) in the year June 2016 to May 2017 – a 9% rise when compared to the previous year's figure of £4.7bn. IHT relief claimed on charitable donations is predicted to reach £900m next year.

Making Tax Digital update

The Making Tax Digital (MTD) initiative is still expected to be rolled out in April 2018, despite the general election. In preparation, HMRC is considering what penalties will apply to late submission and late payments. It is proposing one of three different models: a points-based system, in which customers would receive a point each time they failed to make a submission on time; a regular review system, in which HMRC would carry out an automated regular review of customers' compliance; and a 'suspension of penalties' system, in which a customer would be given an extended period of time in which to complete the submission and avoid the penalty.

Sixty countries sign up to BEPS

During July, the multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting (BEPS) was signed by more than 60 jurisdictions. The convention is designed to implement a minimum standard to prevent against treaty abuse and strengthen mechanisms for dispute resolution.

Shell enjoys £112m tax windfall

Oil company Shell received a £112m tax rebate last year, despite making billions of pounds in profits. Most of the payment from HMRC was a contribution towards Shell's costs for decommissioning in the North Sea. The repayment highlights how the North Sea has transformed from being a cash cow for the government over four decades to being a cost. Oil companies are expected to spend £53bn from 2017 winding down North Sea fields but the Treasury will hand them back £24bn in tax relief.

Australian anti-fraud tax scandal

Deputy Commissioner Michael Cranston, one of Australia's leading anti-fraud tax officials, faces charges after his son and eight friends were arrested in raids that netted cash, luxury cars, two small planes, guns and vintage wine – the spoils of a A$165m tax fraud according to police. Cranston was, according to police, an unwitting participant in fraud after he accessed tax office systems at the request of his son, Adam.

Accounting software hid cyberattack

A worldwide cyberattack that affected companies in 64 different countries, including those in the United States, caused panic as security experts scrambled to find out how it happened. Microsoft now believes it can trace the origins of the cyberattack to a Ukrainian company's tax accounting software.

Gold tax boosts Indian black market

An increase in taxes on gold sales in India is increasing under-the-counter buying and increasing an appetite for precious metal smuggled into the country, where millions of people store big chunks of their wealth in bullion and jewellery. As part of a new nationwide sales tax regime that kicked in on 1st July, the Goods and Services Tax (GST) on gold has jumped to 3% from 1.2% previously, with traders and buyers saying the move will likely force more transactions into the black market.

UK cabinet split over tax

The British cabinet is rumoured to be split over the subject of whether taxes should be raised to pay for increased spending on public services.
Michael Gove said taxpayers would not foot the bill, amid signs the Tories will end the public sector pay cap and put more money into schools, hospitals and the Armed Forces. But his remarks put him at odds with Philip Hammond, who is understood to have privately warned ministers that unpopular tax rises will be required.

Editor's Notes

Patent relief

Even fewer British businesses bother to take advantage of the generous patent box regime than take advantage of the almost as generous research and development relief… which is really saying something. The patent box regime offers a 10% effective rate of tax on profits related to certain patents and other specified intellectual property (IP) rights (phased in fully this year) which can lower a business's UK and global effective tax rate.

Interestingly, the UK tax legislation does not just cover entirely patented products but also those with integrated patented components. For example, if a printer cartridge were patented, the relief would apply to the profits made on the sale of the printer as well as its spare parts. Not only that, but the relief is available to companies owning patents and those holding exclusivity rights and other forms of IP.

To be eligible for patents, any advance has to be new and more than an obvious extension of what preceded it. The technical hurdle is not as high as many people believe and obtaining patents and potentially securing a headline rate of 10% is practicable for tens of thousands of small to medium-sized businesses.

In practical terms relevant patents include those granted by the UK Intellectual Property Office (IPO), under the European Patents Convention, and by specified EEA states. Interestingly, patent box benefits can start to accrue as soon as a patent application is filed as pre-grant profits can be brought within the regime in the accounting period in which the patent is granted.

For a business's invention to be patentable, it must be new, involve an inventive step, solve a technical problem and be capable of being made or used in any kind of industry. It is worth bearing in mind that patents are not limited to tangible items. For example, an invention that solves a technical problem external to a computer or solves the technical issue within a computer may well be patentable. Moreover, it is not just product patents but also exclusive licences that may qualify.

What should you do if you wish to take advantage of this wonderful 10% tax rate? This is a specialist area and therefore it is recommended you employ a consultant with the relevant experience.

IHT planning

I recently read the summary of an interesting and informative talk given by Chris Whitehouse in which he highlighted some of the planning opportunities available to reduce potential IHT. In particular, I was struck by his suggestion that where property is of a certain value it may be worth using reversionary leases. He offered the example of a taxpayer granting a 199-year reversionary lease that takes effect in 20 years. This has the effect of reducing the current value of the property by around 50%, which would become a potentially exempt transfer (PET). As the years passed, the property's value would diminish progressively each year. This diminution would not be a PET. Thus, as the taxpayer approaches old age, the estate value of the property diminishes for tax purposes.

Another idea that Chris mentioned was a spouse gifting property to his or her dying spouse in the expectation the assets would benefit from tax-free uplift to market value when the person dies. This rather gruesome piece of tax planning is not, states the HMRC guidance, caught by the general anti-abuse rule (GAAR).

Another tax-planning tip suggested by Mr Whitehouse involves gifting surplus income to children. It is important that such gifts are made out of income and not capital, and there is no upper limit to how much can be given this way.

Mr Whitehouse is also in favour of an 'immediate post death in first' trust (IPDI) being created as soon as someone dies. Such an IPDI would be established for the surviving spouse. The trustees would have the power to terminate the IPDI and to advance capital to the children. In this way, Mr Whitehouse says, monies can pass down to the children tax-free.

Doing the splits

A recent First-tier Tribunal decision (*Graham and Christine Belcher*) will open up the possibility of business splitting for VAT purposes for many taxpayers who had previously given up hope of such a move.

Business splitting is carried out in order to avoid VAT registration. It generally involves claiming that one is running two separate trades, rather than a single trade. It is, of course, extremely popular amongst small businesses, which can benefit by keeping their prices down and also – bluntly – saving on all the bother of having to keep VAT records.

The interesting thing about the Belchers was that Graham traded as a barber and Christine traded as a hairdresser from the same premises. They traded together under the same name and they completed partnership tax returns for self-assessment. They produced one set of annual accounts for the partnership and they had one account with key suppliers. They also had joint insurance policies, a joint music licence for the premises and shared the same telephone line. There was one business bank account combining both activities.

So, how did they convince the tribunal they were trading as independent sole traders each trading below the VAT registration threshold?

The following was found to be in their favour:

- The businesses paid for cash expenses separately from their respective tills.
- Staff hiring and firing was done independently.
- There had been no conscious intention to run a single business in partnership.

Moreover, when the Belchers initially talked their situation through with the HMRC officer, both of them made it quite clear that they were operating two separate businesses.

The law is quite clear that one cannot create an artificial separation of business activities by two or more persons in order to avoid VAT. HMRC needs to prove that any two businesses have financial, organisational and economic links. The crucial thing is that inspectors have to prove all three links – one or two out of three is not good enough.

The importance of prevention

A recent YouGov survey found that three out of four senior decision-makers in British businesses were unaware of new legislation which makes their failure to prevent tax evasion a criminal offence. Basically, under the new law, a business will be guilty of a criminal offence if an employee or an associated person facilitates another person's tax evasion. Crucially, the offence will still be committed even if the directors and other senior management are not involved or even aware of what has taken place. The only practical defence is that a business may claim it has put in place 'reasonable prevention procedures'.

I mention this because, if you haven't yet put in place reasonable prevention procedures, now is the time to do so. All businesses will be affected – not just those involved in financial services or the law.

HMRC has published draft guidance on the criminal offences setting out the different principles that businesses should take into account in establishing reasonable prevention procedures. These include a risk assessment, proportionality of risk-based prevention procedures, top level commitment, due diligence, communication (including training), and monitoring and review. It is worth remembering that even small to medium- sized businesses may be affected. It is worth remembering that the offence is criminal and therefore may have wide-ranging implications. If you haven't taken action on this, I certainly recommend discussing it with your accountant.

Broken trust

At the beginning of July, new reporting rules came into force that will have a substantial effect on hundreds of thousands of trusts. From now on trustees need to give HMRC a detailed picture of the assets held in a trust, as well as the identity of trustees and beneficiaries. Why? It is part of the government's attempt to crack down on money laundering. As it currently stands, only law enforcement and tax agencies will receive the information, but the majority of EU states are pushing to make the registers public. The new rules catch almost all trusts – potentially those set up in wills – but, of course, only if they incur tax liabilities. Trustees will need to update the register for each year that the trust generates a UK tax consequence.

Feature: A Roof Over Your Head

Owning residential property, which used to be regarded by many as almost a guaranteed route to prosperity, has taken something of a battering from the tax authorities in recent years for anyone buying other than as their main home. Measures introduced include the higher rate of capital gains tax (CGT) applicable to residential property investments, the extension of CGT to UK property owned by non-residents, penal tax charges for owning higher-value (over £500,000) non-rental property via corporate structures and the phasing-in of the restriction of loan interest down to the basic rate of income tax.

In its 2016 response to a consultation on stamp duty land tax (SDLT) amendments, HM Treasury affirmed its commitment to helping people to own their own home although the focus was on "supporting those who want to work hard, save and buy their own home". It will surely not have escaped your notice that it is becoming increasingly hard for many people, particularly in London, to achieve this without help from their family. However, one of the measures introduced as part of the strategy was to increase the rate of stamp duty land tax on the purchase of additional residential properties by three percentage points, some of the funds raised being redirected to some of the areas in which the impact of second homes on the ability of local people to buy property have been particularly acute.

One of the side effects of increasing stamp duty is to make it more expensive for those parents fortunate enough to be able to help their children onto the property ladder by purchasing a property for them to occupy. While the property remains in the parents' name, it also falls within the scope of CGT as the parents' principal private residence exemption will no longer apply and it remains within their estate for IHT purposes. The applicable CGT rate for residential property is also higher than for most other assets, at 18–28% according to the owner's marginal income tax rate.

The simplest way to avoid these issues is just to give the child the money and allow them to buy the property themselves, either outright or with a mortgage that they raise based on their own income. While this avoids the higher rate of SDLT

if the children are first-time buyers or if they are replacing their only existing residential property on the same day, not everyone is comfortable with passing on what could be a substantial amount of money outright and consequently losing control of it, whether to potential bankruptcy or to other hostile creditors such as an unsuitable future spouse. Lending rather than gifting is an option, but the value of the loan remains in the parents' estate unless it is subsequently gifted and then it takes a further seven years to be excluded.

An alternative is to employ a life interest trust structure as a way of overcoming the various drawbacks of these routes. The parents can fund the trust by gift and/or loan, and as long as the gift does not exceed their remaining nil rate band of up to £650,000 for a couple (depending on previous transfers), it will not give rise to an immediate IHT liability as it will be a PET which will fall outside the estate after seven years. The life tenant(s) would be the child (or children) for whose benefit the property is being purchased.

Once the trust is funded, the trustees have two options as to how the property is acquired. The simplest is for the trust itself to purchase the property. However, this exposes any increase in the property's value to CGT and the trust's CGT exemption varies from £5,650 down to as low as £1,130 depending on the number of other trusts created by the same settlor.

A more efficient option is for the trust to lend capital to the child, who then purchases the property in their own name. Since they are purchasing personally and will be living in it, the child receives the benefit of the principal private residence exemption from CGT and so, assuming that it is their only residential property, the SDLT surcharge will not apply. The property will form part of the child's estate but if the trustees take a charge over it to the value of the loan, only the gain will be potentially liable for IHT.

From the parents' perspective, they have provided support for their child to acquire a property, avoided the SDLT surcharge, removed up to £650,000 from their estate if they live a further seven years and retained an element of control over the gifted capital so that it is not accessible to hostile creditors in the future. If the trust was funded partly via a loan, this can be written off in stages as each tranche passes the seven-year window, thus permitting a higher original purchase price.

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Feature: Slash Your Tax By Using The 'Main Residence' Exemption

Sometimes it's best, rather than pouring out a stream of words, to let the numbers speak for themselves. Tax planning isn't normally a complicated affair, despite the impression that some commentators may give. It's usually just a case of applying a few simple rules sensibly to a given situation. So let's look at the cases of Pat and Mick, respectively, who have bought what is effectively an identical house at the same time and sold it at the same time. Their physical circumstances may be identical as well; however, by following a few simple rules, Mick manages to pay only one-fifth of what Pat pays in CGT.

Pat buys the property in 2007 for £100,000, and sells it ten years later, in 2017, for £200,000. Those who are quick with a calculator will be able to work out speedily that the capital gain Pat has made is therefore £100,000. As with Mick (below), the property is in the nature of a second home, and Pat never lives in it as his 'actual' main residence. After two years, Pat (like Mick) buys a villa in Spain which he uses as an occasional residence. Again, his main residence remains the same, and it is neither of these properties. After the end of the fourth year, Pat decides to let the property out, as he no longer has any taste for spending weekends there (Mick does the same).

So far, so identical. However, the difference comes when we look at the tax planning that is done, particularly the use of the main residence election. This can be made to determine which of two or more residences is to be treated as your main residence for tax purposes – even where it isn't actually where you spend most of your time. So here's the computation Pat's accountant does as part of his tax return for the year of sale:

	£'000
Sale proceeds 2017	200
Costs 2007	100
Gain	100
Less annual exemption	11
Taxable gain	89
Tax at 28%	25

Now we move on to the much better informed Mick. On advice, he uses the opportunity given by the acquisition of the Spanish villa, at the beginning of year three, to elect for the property acquired in 2007 to be his deemed main residence. Note that he doesn't have to change any utility billing arrangements, or pretend to be actually living there full time. The result is that the 2007 property is treated as his main residence for tax purposes in years three and four, ceasing to be such, of course, when the tenants move in at the beginning of year five.

So here's Mick's CGT calculation:

	£'000
Gain – as Pat	100
Main residence relief for years three and four	(20)
Deemed main residence relief for the last 18 months (available where there is any period of main residence relief)	(15)
Letting relief for, say, years five, six, seven and half of eight (equals the amount exempt under the main residence rules above)	(35)
Annual exemption	(11)
	19
Tax at 28%	5

Negative Tax Rates: Battered, But Still There

Owing to various politically motivated bits of tax legislation, the reasonably well-known phenomenon of 'negative tax rates' came into being some years ago. Negative taxation is a strange concept, of course, and basically means that HMRC pays you money when you undertake a certain transaction, based on the value of that transaction, rather than the other way round.

Goodwill shenanigans

The classic, and surely easily most exploited, example of this was goodwill. Note we use the past tense here, because the Revenue has applied its customary carpet-bombing approach to shutting these arrangements down. But it's interesting, as well as relevant, to see how the arrangements worked because, as we say, negative tax rates are by no means dead yet.

Joe Soprano runs a highly successful and well-regarded 'consultancy' business. He has a lot of staff out in the field providing services to clients at all times, and the business turns over a lot of money and is highly profitable. Realistic projections, indeed, suggest that the bottom line profits of the business will be consistently over £1 million for quite a few years to come.

Until now, Joe has run the business as a sole trader, but the amount of tax his profits are bearing is getting too much for him to put up with. So, on the advice of his accountant, he transfers the business to a limited company.

A specialist valuer puts a report in, valuing the business goodwill at £6 million, based on a multiple of the sustainable future profits of the business. So, as well as all the other assets of the business – motor vehicles, equipment, working capital, etc. – Joe 'sells' the goodwill to the company for the sum of £6 million. The company therefore has this as its base cost in its own accounts, and, in accordance with accounting practice, writes off 20% of the £6 million figure, that is £1.2 million, as depreciation or 'amortisation', in each year's accounts.

This is where you get negative rates of tax. Joe pays CGT on the sale to the company, on a gain of £6 million (because, having built up the business from nothing, he has no base cost to offset against the £6 million 'proceeds' owed to him by the company). So he has about £600,000 CGT to pay on 31st January following the end of the tax year in which the business was transferred to the company. However, as against this he has the ability to draw down the £6 million that the company owes him tax-free, as the profits and therefore cash accrue year on year.

On the company's side, it was able to claim the £1.2 million as a deduction against its corporation tax under Gordon Brown's beloved 'intangible assets' tax regime. So the company was saving, assuming a 20% corporation tax rate, £240,000 a year. This saving continues, of course, for five years, meaning that the total saving in corporation tax over the whole period of the goodwill's accounting 'life' is £1.2 million.

QED: the Revenue has received £600,000 from Joe in the form of CGT, but has allowed £1.2 million relief on the same asset in the hands of the company: negative tax of £600,000.

Carpet bombing

This became so prevalent that HMRC decided to take action to prevent this 'abuse'. Typically for HMRC and its anti-avoidance crusade, it lashed out on all sides, hitting both the 'guilty' and the 'innocent'. It excluded sales of a business to a connected company, as in the Soprano example, from entrepreneurs' relief. So nowadays, the gain on the goodwill would be chargeable at the top 20% rate. On the other side of the coin, they excluded acquisitions of goodwill from the entitlement to amortisation relief under the intangible assets regime – even where the acquisition of the goodwill was nothing to do with any kind of dodgy tax 'planning'.

Negative tax is dead: Long live negative taxation!

What you'll notice about the Revenue legislative blitz, though, is that it only applies to goodwill. Other intangible assets are not affected. This may be because goodwill was undoubtedly by far the most common sort of asset to be used for the purpose of tax mitigation schemes. As a matter of tax policy, too, it is likely that what Gordon Brown most had in mind, when introducing the intangible assets regime, was encouraging innovative and intellectual-based businesses, rather than any business which happened to be making a profit. So intellectual property, as opposed to goodwill, is still eligible for relief, and this can include such things as computer software, trademarks, patents and knowhow.

So if, in the Soprano example, we had substituted as the asset which was enabling the business to make such high profits some clever computer app, just to take one example, the result would be exactly the same in tax terms as the now abolished goodwill arrangement.

Perhaps another reason why HMRC has left these other intangible assets alone is because things like software are on the whole less likely, in the real world, to be sold as part of a sale of the whole business attracting entrepreneurs' relief. Entrepreneurs' relief only applies where you sell a 'business', not individual business assets. In this it differs from the old business asset taper relief it replaced in 2008. So an individual's sale of personally owned software to the company, without an accompanying transfer of the whole business, would not qualify for the 10% CGT rate; and would therefore pay the full 20% rate.

In this case, of course, you don't have negative taxation, because the company, now, will only qualify for relief at 19%. However, even without the negative taxation which entrepreneurs' relief brings, it is still a pretty good deal if you think about it. To the extent of the value of the intellectual property concerned, you can basically make profits which are liable at a capped rate of 20% – even if those profits are all taken out of the company by you as an individual.

Indeed, even without tax relief for amortisation in the company's hands, the numbers are looking pretty good for the transfer of all kinds of intangible assets, including goodwill. To take the least favourable instance, which is, of course, that of goodwill, let's suppose you transfer goodwill to the company. Your CGT is 20% of the goodwill value. However, this value can then be drawn down by you out of the company tax-free, as we have already commented.

If the alternative to this would have been taking dividends out of the company, which are commonly taxed at 32.5 or even 38.1%, 20% is looking highly favourable. And of course, if you can get entrepreneurs' relief, because the asset concerned isn't goodwill, the differential in the personal tax rate is even higher.

It's Never Too Late

If you'll excuse me reminding you of this, we're all going to die some day. And, of course, death and taxes aren't the only inescapable realities of life but they do tend to come together. So because we never know when that bus will be coming round the corner to run us over, there's always a certain urgency about planning against death taxes, even for those who are still hale and hearty.

The principal death tax in the UK, of course, is IHT. Subject to the deduction of a comparatively small 'threshold' amount (currently £325,000 per person), HMRC and the government will help themselves to a massive 40% of the value of your estate when you go. This can be deferred by leaving your estate to your surviving spouse if you have one, but of course a legacy to them simply defers the problem, because their estate is then correspondingly greater as a result of what they have inherited from you.

All that's sufficiently gloomy, no doubt, and may appear to go against the optimistic tone of the title I've chosen for this article. However, while it's perhaps going too far to say that it's never too late to do IHT planning, it is certainly true to say that it's not necessarily too late to reduce your IHT liabilities after death.

One powerful tool of post-death IHT planning is the deed of variation of a person's will (or intestacy). If this is done within the two-year window following death, the varied arrangements are treated as if they had been made by the deceased in his will. Let's have a look at an example, which is based on a real-life situation.

It's not too late

Alf Garnett is an ordinary sort of bloke, living in a fairly humble terraced house in what was originally a highly unfashionable suburb of London. This overall area has since been christened 'Docklands', and of course has come up in the world beyond all recognition. Alf's house, unlike an awful lot of the surrounding area, hasn't been flattened to make way for gleaming blocks of flats with balconies overlooking the river, but it certainly has been gentrified.

Alf made his will many years ago, when the house had a very low value; and apart from the house, he hasn't got a lot of other valuable assets to bequeath. In his rough-and-ready way, he's drawn up a will, using a basic template supplied by a well-known bookshop and stationer, leaving half of the house to his wife and half to his only child, Una. He sees this as a sort of rough compromise between his fear of his wife remarrying and taking the house away from the family, and giving too much too soon to his daughter, who is involved with a highly undesirable (in Alf's eyes) young man.

In a way you can see the sense of this: for a small amount of value, you can get too complicated in the way of trusts, etc., trying to control the destiny of your wealth after your death.

The problem is that by the time Alf dies, we aren't talking about a small amount of money. Bijou terraced houses with three bedrooms and a bit of garden, near the river, are now fetching upwards of £1 million. This is before the time when the enhanced relief for homes, currently being introduced by the Conservative government, has come in, and in consequence Mrs Garnett and Una are shocked to find that there is a tax liability, on the legacy to Una, of £500,000 – £325,000 at 40%, that is £70,000. Alf hasn't left any cash to speak of to pay such a liability, and Mrs Garnett doesn't want to move out of the home she's lived in all her life. So what can they do?

Following advice from an accountant, they go to the solicitor and arrange for the will to be varied. Taking a charitable view of what Alf's intentions would have been, the will is changed so as to leave the whole estate in trust for Mrs Garnett during her lifetime, with the remainder to her daughter when she dies. This deed, varying the will and creating the trust, is signed, sealed and delivered within the two-year period following Alf's death, and therefore the taxable legacy doesn't take effect: instead, the whole estate is exempt, because a life interest is treated as if it were absolute ownership in these circumstances. Thus, the legacy becomes an exempt gift to Alf's surviving spouse.

In this way, the family is given breathing space and Mrs Garnett ultimately decides, on advice, to take out an equity release arrangement on the house. The way this works is to give a finance company an effective interest in the property in return for a cash lump sum. Whilst in commercial substance it's a kind of loan, the loan isn't repayable until Mrs Garnett's death, at which time the house will inevitably be sold in any event, and the proceeds will become available.

Mrs Garnett uses the cash she gets from the equity release company to make a gift to Una, which comes in very handy as a deposit for the girl's house, into which she moves with the long-haired Liverpudlian. Provided Mrs Garnett survives seven years after making this gift, she will have successfully reduced her estate and this, together with the increase in the nil band, should take her estate out of tax when she eventually joins her husband in the local churchyard.

What principles arise from this example? Well, first of all, I think it's sound policy to avoid paying tax sooner than you need to, because there's always the possibility that the tax may turn out not to have been just deferred but actually permanently saved, as in the example here. The deed of variation has given the widow time to take more considered action (in the light of the stratospheric increase in the value of the estate) to avoid paying tax on that estate.

The second moral is that you need to think about these things and act quickly. Many estates, for reasons best known to the executors, take a great deal more than two years to administer in practice, and, whilst this may seem a long time, it's easy to miss the deadline if you're not alert to the possibility of tax planning.

Retrospective relief

The other type of post-death IHT planning I'd like to have a look at here is the relief for sales of assets after death at a loss. Again, I think this brilliant tax-saving opportunity can be best highlighted by way of an example.

Cuthbert's calculation

Cuthbert, whose estate is well into 40% IHT because of his substantial property holdings, dies, leaving to his children not just the property portfolio but also a quoted share portfolio with a value of £500,000. This is made up of five substantial shareholdings in A plc, B plc, C plc, D plc, and – you guessed it – E plc. His portfolio was 'balanced' recently on the advice of his stockbroker, and it just so happens that each of these holdings is worth exactly £100,000 at the date of his death. This is therefore the figure which goes down on the IHT account prepared by the solicitors.

A period of global economic turbulence succeeds Cuthbert's death (although the two events are probably not connected). Oil prices dive through the floor, as does the pound. As is the way with economic turbulence, though, this is both good news and bad news at the same time. A plc makes its money largely from exporting goods, and therefore the weak pound encourages its turnover massively. The shares in A plc have doubled in value, in fact, within the eleven-month period following Cuthbert's death, and this holding is now worth £200,000. B plc uses a lot of oil in its manufacturing process, and of course the directors forget to put the price of their finished goods down in consequence of the massive reduction in their manufacturing costs. Again, B plc's shares rocket on massively enhanced profit estimates, and these shares go up to £200,000 as well. C plc is in a pretty bulletproof and recession-proof industry, and its shares just jog along the same, being still worth about £100,000 at this eleven-month mark. Unfortunately, the gains on A and B are balanced by the bottom dropping out of the market for shares in D and E plc. They were always fairly speculative investments on Cuthbert's part, and economic turbulence is just what these companies could have done without. Both companies are in imminent danger of receivership, and their shares are effectively worthless because they rank behind some pretty substantial loan finance taken out by those companies.

The executors, on advice, decide to sell the shares, because holding quoted shares doesn't form part of Cuthbert's beneficiaries' investment plans. However, following specific tax advice, and securing indemnities from the beneficiaries accordingly, they elect to sell the shares in D plc and E plc first. The sales of A, B and C plc are postponed until a couple of months later.

Result: the executors can claim relief for shares sold within twelve months after the death at less than probate value. A £200,000 'loss' has been incurred, and this results in a reduction of £80,000 on the IHT due on Cuthbert's estate.

Note that, if they had sold the shares in the profit-making companies at the same time, there would have been no overall loss and no availability of relief. This is because all the sales of quoted shares in the twelve months following death are 'pooled', and it is only the net loss, after offsetting any gains, which is eligible for the claim.

The other sort of asset we can claim post-death relief for is land and buildings. Because these tend to be less liquid and easy to realise, though, the period you are allowed to make the loss-producing sale is three years rather than one year.

Looking further forward

In my example of the deed of variation of Alf Garnett's will, I have shown a situation where the variation gives rise to an immediate reduction in the amount of IHT payable. But it can be worthwhile considering variations even where the variation itself doesn't trigger an immediate IHT repayment. Take, for example, the case of Adam and Eve, who have left the normal sort of 'mirror' wills under which their whole estate passes to the survivor, with the estate then passing, on death of the second of the couple to die, to their son Seth. As is the way of things, Eve is the one who survives the longest (even though Adam lives to a ripe old age). So on her death the whole estate, subject only to the deduction of two nil bands, is chargeable to IHT at 40%. The issue is, though, that Seth has already managed to amass a substantial fortune himself, and by the time his mother dies he is already concerned about his own future tax exposure. Frankly, he doesn't need the money Eve has left him, whereas his children and grandchildren do. So he arranges for a variation of Eve's will, such that the estate goes instead to a family trust for the benefit of all Seth's children and 'remoter issue'.

There's no difference to the tax on Eve's bequest: it's still 40% on the whole value over the nil band. But varying the will has meant that Seth's own estate is not increased, giving him an IHT headache. On the contrary, the effect of the trust is to move the wealth down two or even more generations – which is excellent IHT planning. No doubt Seth could have taken the bequest and then made gifts of it to the children and grandchildren, but there may be reasons why this is not seen by him as being a very good idea. For example, putting a lot of wealth in the hands of the young and very young is very often not practicable – you'd rather take a risk of tax than risk the money spoiling the children or being lost by them. Seth would not favour the option of setting up a family trust himself, because lifetime gifts into trust are chargeable to IHT at 20%. This doesn't matter if the money is treated under the variation as going direct from Eve to the trust: there's 40% tax anyway on Eve's bequest, whatever she does.

A final word...

Finally, of course, remember that these post-death tax actions don't relieve you of the need to keep your IHT planning up to date for changes in your estate and in the law. I would always recommend a regular review of wills and IHT planning as time passes: prevention is better than cure.

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Have You Done Your Homework?

There are very few self-employed people who don't do some of their work at home. Even if it is only thinking about what you're going to do tomorrow, and even if you have a large and well-staffed office, the person in business on his own account can't just switch off like the wage slaves can. And often, of course, home is a centre or even the main centre of where the business activities are carried on. So one of the commonest questions that accountants get asked, by clients setting up new businesses, is: "What can I claim against tax for the use of my home as an office etc.?"

The Revenue is a notoriously slow man with a dollar, and its own guidance, available on the Internet, includes flat-rate allowances for use of the home which are frankly miserly, especially with the cost of living these days. If you work at home less than 25 hours a month, inspectors won't allow you any flat-rate deduction. Between 25 and 50 hours a month, you can claim the princely sum of £10. This goes up to £18 between 51 and 100 hours, and reaches a maximum of £26 a month if you work more than a 100 hours a month at home.

The stated objective of having these fixed rates is to relieve you of the hassle of totting up your actual expenses and claiming them. This isn't such a simple matter, true: you can't simply take all the costs of maintaining your home and deduct them against tax. Not only do you have to take into account the fact that not all of your occupation of the home is for the purposes of the business but you also have to do some quite detailed thinking about how much the various expenses relate to the business. Again, this is an area where quite a lot of initiative and imagination can be employed, resulting in a significantly higher claim. Even though the above Revenue flat rates don't include telephone and Internet, which you have to work out on a usage basis in any event, the following example shows how the actual cost of using your home for business can be stratospherically higher than anything the bureaucrat who wrote the HMRC rules can have imagined.

Home expense claiming: The scientific way

Herbert is one of those individuals who keeps every receipt and likes to balance even his household accounts to the penny. He's also a self-employed consultant, working almost all of his time from home. He's fitted up a room at the back of the house, originally built as an extension some years ago, as an office. He uses this, broadly speaking, five days a week for business and for other non-business-related but office type activities at the weekend. This extension wasn't particularly well built, as it happens, and he has had to have the flat roof, which was leaking profusely, completely renewed at a cost of £3,000. It's particularly important that water doesn't get in to this part of the house, because Herbert's consultancy is in the area of IT, and he has a lot of expensive technology stashed away in this room.

The whole house is heated by electricity, and Herbert's electricity bill comes to an average of £400 a quarter. In terms of actual occupation of this room, Herbert estimates that 90% of the time he spends there, when the lights and heater are on, is when he is working for the business.

Moving on to the telephone, his bill from BT is again an average of £400 a quarter, and he pays £15 a month for broadband. Although his wife also uses the phone quite profusely, it's fair to estimate that 75% of the telephone (and Internet) use relates to the business.

The contents of the house are skewed, in value terms, towards the expensive computer equipment in the office, so that 20% of the £800 contents insurance premium is correctly attributable to the assets used for the business. The buildings insurance premium is £1,000, and unusable floor space terms, Herbert reckons that the study/office is about one-tenth of the total.

Finally, the water rates are £1,200 a year, and two-thirds of the use of water is, in Herbert's fair estimation, referable to the time when he is using the property as an office.

Using the HMRC scale, Herbert would be able to claim £1,335 for the telephone and broadband, worked out as 75% of the £1,600 total BT bills for the year, and the £180 broadband cost. Other than this, he would be looking at claiming a flat £26 per month under the fixed scale, which comes to £312 in the year. The result is a claim on HMRC's basis, so to call it, of £1,647.

Now consider the claim which Herbert is actually able to make using the scientific basis which he so enjoys:

Flat roof repairs, say, 90% × £3,000	2,700
Heat and light, say, 90% × 5 days/7 days × 2/3 × £1,600	686
Telephone and broadband – as above	1,335
Contents insurance 20% of £800	160
Buildings insurance 10% of £1,000	100
Water rates 5 days/7 days × (say) 2/3 × £1,200	571
	5,552

So, by being a little bit careful about his record keeping, and making reasonable approximations and assumptions, this taxpayer is able to claim over three times as much expenditure – which he's genuinely incurred – to reduce his tax bill.

In addition to the basic house-running expenses, don't forget also that computer equipment used at home for the purposes of your business can give rise to a capital allowances claim. Even if you bought the computer, printer, etc. before you began the business, you can bring it in at its value at the commencement of the business and claim 'writing down allowances' each year on the basis of that number. The resultant allowances have to be abated for a proportion relating to private use, of course, and the proportion of private use is normally a matter that you can only estimate on a reasonable basis as there are no firm records available in most situations.

What about CGT?

All the above might be giving rise to a worrying thought, though. Are we trying to have our cake and eat it? On the one hand, if you sell a property which has been your main residence throughout your period of ownership, you're exempt from CGT on it. If you sell an office used for the purposes of your business, in contrast, there is no CGT exemption. So, by muddying the waters of the distinction between business and private, are we risking some of the sale proceeds, when you come to move, being subject to CGT?

Well, this is a real danger depending on the circumstances, but in most cases of working at home the threat of a CGT charge can be quite easily circumvented.

What the rules actually say is that, if any of the building in which you have your home is used *exclusively* for the purposes of a business, that part of the home is not covered by the main residence CGT exemption. But what this rule is really aimed at is the sort of 'flat over the shop' scenario where there is a clear distinction between the part of the building which is commercial and the part which is residential. In theory, if in Herbert's case he had never set foot in the study/office except to do work relating to his business, HMRC could have had an argument for tax being chargeable on, say, 10% of the gain made on selling the house.

But of course, that's not what actually happened in the above example. In Herbert's case, the study/office was used not just for business purposes but also for doing private office type activities, like sorting out Herbert's personal finances, paying personal bills, and so on. Any non-business use at all, even if it is minimal, gives rise to the very satisfactory situation that the whole property is eligible for exemption, because of the way the above provision is worded. It is only exclusive business use which gets you into trouble from the tax point of view. This is surely a case of forewarned is forearmed.

Mortgage interest

You'll have noticed that we haven't included the loan interest paid on Herbert's mortgage amongst the above category of claimable expenses. This isn't an accidental omission, because Herbert does have a mortgage and pays quite a lot of interest on it which, of course, being for his home doesn't prima facie qualify for tax relief. But, whether rightly or not, advisers are chary of suggesting that their clients claim a proportion of the mortgage interest, because there is an understandable concern that the logical implication of claiming mortgage interest is that that part of the house is exclusively used for business purposes. Either claim the interest and put up with a CGT charge, then, or refrain from claiming the interest: on the much more realistic view of the facts, which is that the part of the house in question is not absolutely 100% in business use. This is one of those myriad instances of the actual legal principles being unclear, and in this instance we feel that the motto is 'safety first'.

Far From The Madding Crowd

The British are a country-loving race. This undoubted fact is reflected, for example, in the fact that aristocrats' main homes are usually their places in the country rather than their houses in London. And it's also reflected in the very generous tax reliefs given to agricultural property.

As we'll come on to see, agricultural property is a unique example of an asset, which can be purely investment in nature, rather than relating to a trading business, which is nevertheless favoured from a number of IHT and CGT points of view. So let's have a look, first of all, at what exactly is defined as 'agricultural property'.

The most obvious example is pasture and arable land used for active farming. The fields with cows and sheep grazing, and the fields of waving golden corn, are all tax-favoured assets. Along with the land, you have working farm buildings like barns, storage, sheds for plant, cottages occupied by labourers and even the farmhouse itself.

In fact, it is probably easiest to look at a typical country land holding and consider the parts that don't qualify.

1. Unless your house qualifies as a farmhouse (of which more below), the garden and grounds of that house, even if they look like fields which are part of the 'country', won't qualify as agricultural property. The paddock in which you let the horses run around, for example, won't qualify under this heading.

2. Equine businesses generally don't count for these purposes as 'farming' in most cases, and therefore equestrian property will not normally be agricultural property as well.

3. Farm cottages not occupied by labourers (which, it has to be said, seems to be the almost universal rule these days) will be investment assets that are not part of the agricultural property for the purposes of the tax relief.

4. Woodland, even if occupied commercially, doesn't tend to qualify as farming, and therefore agricultural property, unless the commercial occupation is in the nature of short rotation coppicing.

5. Finally, if the house is too big and grand for the holding of land, or as a question of fact isn't really the centre of a farming business, then this won't come under the favoured heading either. This is an area which has caused probably more dissension between the taxpayer and the Revenue than any other part of the definition of agricultural property. A stately home amongst 30 acres of farmed land will not qualify. At the other end of the scale, a dirty little cottage, with muddy boots in the front porch, which is the actual base of a 500-acre farming operation, will clearly qualify. The problem is that the case law we have in this area, which is the only real authority for interpreting the supremely vague rules, unfortunately tends to be on the first mentioned end of the spectrum, and HMRC, perhaps deliberately, has apparently chosen not to take any more marginal cases to court. No doubt the Revenue is concerned to not create a precedent in the taxpayer's favour, and it is always able, if it so chooses, to concede a point rather than create a precedent.

IHT relief

The relief for agricultural property is very generous, as we have said, and no doubt springs from a wish not to destroy the

farming industry, which par excellence is an industry in which very substantial capital assets are employed, to make a comparatively very small income return. If agricultural property relief applies, 100% of the value of the property concerned is excluded from taxation.

In order to qualify for agricultural property relief, the owner needs to pass either one of two tests. First, he should be entitled to vacant possession of the land within 24 months (or, of course, have vacant possession at the time) or he must have owned the property for at least seven years and the relief is available in this case even if it is let to someone else on an appropriate form of tenancy.

So, as we say, agricultural property is a rare example of an asset which can be in the nature of 'pure' investment, where the owner sits back and receives rent, but nevertheless qualifies for 100% relief from IHT.

The relief is also unique in another way. When the farmhouse qualifies, because it is of a size or nature appropriate to the farm holding, and is a genuine working farmhouse, this is a unique example of where you can secure 100% IHT relief for your main residence. We are accustomed, of course, to the idea that your home is exempt from CGT, so that you don't pay tax when you sell it: but if it's a farmhouse, you don't even pay IHT on it when you die.

This is an area where sometimes the planning can go badly wrong, it has to be said. A very common instance is the case where mother and father are now past the age where they want to get up at 5 o'clock every morning and milk the cows, so they have given the farm to their sons to carry on the family farming business. This gift hasn't, however, typically included the agreeable old house in which father and mother live. While, until the retirement of the older generation, this house would no doubt have qualified as a farmhouse fully eligible for relief, following the divorce of the house from the surrounding land, which they have brought about by making the gift, it no longer qualifies as a farmhouse because it isn't under the same occupation.

In many cases, this is quite disastrous from an IHT point of view. Very often, the house can make up a substantial proportion of the overall value, particularly if it is old and beautiful. So ways need to be found of achieving what the family want to achieve in terms of practical utility, while not fouling up the availability of 100% IHT relief.

The answer is going to be different in different cases, of course, but sometimes the problem can be got round by the farmland not being given away as such, but the younger generation being brought into partnership in the business, with mother and father continuing, effectively, as sleeping partners. In other cases, no doubt it will be appropriate for the older generation to downsize and allow the younger generation to occupy the main house. It's horses for courses.

CGT

There is one particular respect in which agricultural property is favoured from the CGT point of view. Like the IHT rules, agricultural property which is in the nature of an investment can be accorded 'holdover relief' if someone makes a gift of it.

Holdover relief is a strange concept, if you think about it. First of all, the legislation starts with the quite bizarre fiction that a person who gives an asset away has made a 'gain' by reference to the market value of the asset. It then kindly gives you a 'relief' under which you can effectively pass the gain on to the recipient, such that the tax will not be paid until that recipient then goes on to sell the asset for cash.

Then, with your legislative hat on, you restrict the availability of holdover relief, so that, normally speaking, it's only available for gifts of 'business assets', that is assets which are being used for the purposes of a trade, profession or vocation.

So there is an insoluble problem, in the case of most 'investment' type assets, that you can't even give them away without paying tax (assuming that the value of the asset concerned is greater than the asset cost you).

Such is not the case with agricultural property, even if it has always been let to someone else, and you are just the bloated capitalist at the centre of the spider's web, watching the cheques coming in each quarter. The availability of business asset holdover relief is specifically extended by the rules to property which qualifies as agricultural.

Get away from it all

So, all the above gives a pretty strong incentive for choosing agricultural land etc. as an investment if you are looking around for anywhere to put your spare cash. One suspects that the actual price of farmland in the UK is actually higher than it would have been because of these tax reliefs, and realistically viable holdings of land can be difficult to come across. But this isn't impossible, and those who stand to lose a lot of their estate in due course to the taxman would do well to be persistent, if they are at all interested in land as an investment, in seeking out the ideal purchase.

Offshore News

Estonia voted world's most competitive tax system

The Tax Foundation, a Washington-based fiscal think tank, has voted Estonia the most competitive tax system in the world due largely to its 20% corporate tax rate and well-structured personal income tax system. The Foundation is largely concerned with how well a country's tax system promotes sustainable economic growth and investment. It looks at over 40 tax policy variables every year in five categories, including corporate income taxes, individual taxes, consumption taxes, property taxes and the treatment of foreign earnings.

According to the foundation, Estonia's position at the top of the 2016 index is predominantly the result of four factors, being its low-percentage corporate tax, a well-structured 20% tax on individual income, a property tax applied only to the value of land rather than the value of real property or capital, and a well-designed territorial system. Interestingly New Zealand and Latvia are number two and number three on the think tank's list. France, incidentally, is at the bottom.

A hundred extra staff for the Irish Revenue

The Irish Revenue has recruited more than 100 additional staff to undertake audit and compliance activities. The cost of employing this staff was around €5 million and the expected yield is around €80 million. Over the next five years, the Revenue intends to recruit around 150 more executive officers to carry on audit training.

EU to pursue VAT fraudsters

A new European Public Prosecutors Office is to be established responsible for investigating, prosecuting and bringing to justice crimes against the EU budget, such as fraud involving EU funds over €10,000, corruption and cross-border VAT fraud above €10 million. The EU believes that it loses some €50 billion of VAT revenues each year through cross-border fraud.

Tax Haven Update

Snow washing in Canada

According to a three-year-old internal memo circulated by Panamanian law firm Mossack Fonseca:

Canada is a good place to create tax planning structures to minimise taxes like interest, dividends, capital gains, retirement income and rental income.

Indeed, the practice of using Canada as a tax haven now has its own name: snow washing. Why?

- To begin with, federally and provincially incorporated companies don't have to register the names of their real owners and operators. Instead, they can list figurehead directors who often do nothing more than provide their names on paperwork. This is unheard of amongst high-tax jurisdictions and even amongst most tax havens. It offers, for the time being, total confidentiality.
- A certain type of company allowed in some provinces, known as a limited partnership, doesn't have to pay tax in Canada if its owners don't live there. This makes Canada the ideal location for an international holding company.
- Canada's clean reputation in the global financial world means that corporations registered there are less likely to attract attention from the prying eyes of governments, law enforcement and tax authorities abroad. It has a (well-earned) squeaky-clean reputation.
- Canada has a high number of double-tax agreements and exchange of information agreements, which further adds to its respectability.

As it currently stands there are no plans by the Canadian government to change the existing tax rules. However, since the Panama Papers were leaked, Canada has attracted a certain amount of media attention. Possibly, therefore, changes will be made in the future. In the meantime, international business is booming.

Wanted: Night manager

In John le Carré's thriller *The Night Manager*, Major 'Corky' Lance Corkoran is retained by master criminal Richard Onslow Roper to act as director and beneficial owner of all his criminal activities. It is Corkoran who signs all the documents, gives everything legitimacy and who would take the rap in the event of discovery. Roper, despite being the real criminal, thus hopes to avoid both detection and punishment. Later on in the book, Jonathan Pine, a hotel night manager turned spy, takes on Corkoran's role. Roper, not surprisingly, keeps Corkoran and then Pine by his side at all times. They are, effectively, prisoners – although prisoners in very luxurious surroundings.

The idea of employing a third party to act as the beneficial owner of an offshore structure is hardly a new one. Indeed, for several decades the idea of using nominees was perfectly acceptable. In the new totally transparent environment, however, there are only a few countries that allow beneficial ownership to remain confidential. Perhaps this is why a recent survey published by *Offshore Intelligence* suggests that there is a return to the 'night manager' type arrangement described by Le Carré.

For those employing nominees there must be total trust (perhaps a family member) or total control. On the other hand, this has always been the case with beneficial trust arrangements and so perhaps this doesn't represent much of a change either.

Hong Kong as a business base

Hong Kong has long been used by international businesses as a base for their operations. The main reason is that the tax climate can only be described as advantageous with no CGT, no withholding taxes, no sales taxes, no VAT, no annual net worth taxes and no accumulated earnings taxes on companies which retain earnings rather than distribute them. Corporate income tax (known as profits tax) is 16.5% but is still substantially lower than in most OECD countries. Moreover, businesses enjoy all sorts of extra tax concessions, such as:

- Trading profits and interest income derived from debt instruments issued in Hong Kong with an original maturity of up to seven years will be chargeable to tax at a concessionary rate, being 50% of the normal profits tax rate, while those with a maturity period of seven years and above qualify for 100% concession.
- Life insurance businesses are assessed at 5% of the value of the premiums arising in Hong Kong.
- An entity whose business is to grant rights to use a trademark, copyright, patents or know-how pays a flat profit tax of 30% of 16.5%, i.e. 4.95%.
- Income from international operations of shipping companies is exempt from tax unless the ships are operating in Hong Kong waters.
- Irrespective of whether or not the company is managed and controlled from Hong Kong, assessable profits of the proportion of income arising within Hong Kong to the proportion of worldwide income.
- The sale of goods on consignment from Hong Kong on behalf of the non-resident is subject to a tax of 1% of the turnover without any deductions unless the non-resident can produce accounts to show that he would have paid less profit tax than consignment tax, in

which case a normal rate of tax will apply.
• An entity whose business is to rent out a film, tape or sound recording for use in any cinema or television programme pays a profit tax of 30% of 16.5%, i.e. 4.95%.

In comparison to other jurisdictions, however, Hong Kong does not offer much in the way of tax incentive schemes. The attitude of the government has been that Hong Kong's low, simple territorial tax regime is incentive enough to establish business operations in Hong Kong.

What about personal tax? Personal taxation is also low by international comparison. Income tax, known in Hong Kong as salaries tax, is paid at either a flat rate of 15% or on a progressive scale between 2 and 17%. Taxpayers may elect to choose to pay tax under either of these systems, depending on which one gives them the lower tax liability. Interestingly, non-employment-source income such as share dividends and capital gains realised on the sale of shares are not taxable in the territory. In addition, the definition of 'income' does not include either a pension from a source outside Hong Kong or compensation for any loss of employment.

Hong Kong, like Canada, has been extremely slow to give up client confidentiality. Although the jurisdiction is coming under pressure to sign agreements with other jurisdictions, very few have been completed and ratified to date.

Money

News

Student loans: A warning and an opportunity

When student loans were introduced by the government, they incurred a relatively low rate of interest. Depending on which year the loan was taken out, students were either charged the same rate as the Retail Price Index (RPI) or the lower of that and the Bank of England base rate, plus 1%. However, students who began borrowing after 2012 have been charged interest at three percentage points above the RPI. So when the RPI reached 3.1% earlier this year it meant that student loans went up to the considerably higher rate of 6.1%. The only silver lining in this is that for low earners there is a lower rate of interest.

The total amount of student debt in the UK has now reached £100 billion, which is considerably higher than the amount of credit card debt (currently £68 billion). What about the repayment situation? Repayments are set at 9% of the graduate's annual earnings over £21,000. The outstanding balance is written off after 30 years. It is estimated that around seven out of ten students in the UK will never repay their loans. For this group, however, the loan serves more like a 9% income tax on their earnings above £21,000 until they reach their early 50s.

When one considers the fact that the current interest rate for a mortgage is around 1.5% this makes the student interest rate of 6.1% look incredibly high.

There can be no doubt that for graduates who do not end up earning a really high income taking out a student loan is extremely costly. Students should be warned before they undertake a degree what it may mean to them in real terms.

It may also, of course, open up opportunities for lenders to offer to refinance student loans at lower rates, perhaps backed by the security of their own or their parent's property. Certainly, it could be argued that one of the best things for a student would be to refinance their loan when they bought a home.

Amazon adventure

Amazon, the online retailer, has decided to ramp up its business lending. In particular, it intends to increase lending to small businesses in the US, UK and Japan. Amazon Lending was launched in 2011 as a pilot scheme. It offered to select sellers on its platform instant loans for up to 12 months at annual interest rates of between 6 and 17%. Since then it has lent around $3 billion and the experience has been so profitable that the company has now decided to roll Amazon Lending out to some two million businesses on its marketplace platform.

Better giving

It is easy for investors to evaluate their investments. All they have to do is look at their returns. Moreover, since that return is always represented in monetary or percentage terms, it is easy to compare like with like. How different it is when one gives

money away. As Warren Buffett, one of the biggest philanthropists in the world, points out about charitable donations: "You can keep doing something that doesn't make any sense and there is no playback from the market." In other words, it is very difficult to know whether one is giving effectively.

How can one get around this problem? The first thing to do is to discuss your donation with the recipient. What could you do to make the money you give more effective? It may be that they want a regular income more than they want a lump sum. Possibly, unrestricted funds would be more useful than restricted funds, or the other way round. Charities often feature emotional campaigns to raise money, which doesn't mean it is the most important work they are doing – just the work that is most likely to catch the public's attention.

Perhaps the second thing to do is to assess what effect your donation has had. If you are giving a small amount to a large organisation then you can track the organisation's performance and see whether it is aligned with your own desires and interests. If you are giving a significant amount to any size of organisation then you can ask them for detailed information about how they have spent it and whether it has been successful.

Finally, you could consider your transaction costs. How much of the money that you have given has gone on administration and how much has been devoted to the charity's actual work.

Happy birthday ATMs!

This year marks the fiftieth anniversary of the invention of the ATM. When the first ATM was opened by Barclays in Enfield, London it was groundbreaking. Before then it had been impossible to obtain cash outside banking hours. However, as we have moved away from cash towards credit, online and contactless cards so the role of the ATM has changed. In some countries you can buy everything from funeral plans to fishing licences and from cupcakes to pure gold. In Canada CIBC Bank offers a ski-through ATM and in Pakistan's Khunjerab Pass you can visit the world's highest ATM. In the UK, some £192 billion is taken out from ATMs every year – a figure that has remained steady for the last decade. The idea that we are moving to a completely cashless society is not borne out by this figure, which has remained unchanged for the last decade.

Cash ISA warning

Interest rates may be at record lows and stock markets may be moving back towards record highs, but for eight out of ten people who save money into ISAs cash remains their chosen investment.

The trouble with this policy is that, thanks to rising inflation, they are likely to see the underlying value of their savings fall year on year. Indeed, Royal London, an asset manager, has estimated that cash ISA savers have lost out on £100 billion of potential returns over the last 10 years, compared with potential returns on a diversified stocks and shares ISA. This is because the best instant access rate for a cash ISA is just 1.05% and to get that you have to pay in a full £20,000.

If you have a cash ISA it makes sense to switch it all across to something that will yield you a higher return. If you do decide to do this, remember to fill in a formal ISA transfer request or you will lose its tax-free status.

Buying a car? Go short

Over the last few years car manufacturers and lending institutions have, between them, come up with a number of new ways to finance one's driving. Many people still opt, of course, for the traditional car loan. This is particularly true for those buying a used car. One can lease, too. However, the most popular method is a personal car purchase (PCP) plan, which is a way of funding the depreciation of a new car over the term of the contract. It now transpires that PCPs are an extremely expensive way of driving away a new car. In fact, a growing number of financial experts believe that the most competitive way to drive a new car out of the showroom is to take advantage of personal contract hire (PCH), which is, effectively, a long-term rental agreement. Depending on your choice of car, this may prove to cost you even less than depreciation. For example, supposing you opt for a £30,000 VW Golf. Over the next three years you can expect depreciation to run at more or less £400 per month. However, you can lease the same car for roughly £300 a month, providing you pay a six-month deposit. Even if depreciation isn't quite as high as anticipated, leasing is still unlikely to lose you much money. Moreover, thanks to the growing popularity of PCP, the number of new car sales in recent years has risen rather than fallen. This supply is expected to weigh on the used car prices of popular models in the near future. By leasing instead of taking out a PCP or buying, you are, effectively, shorting the used car market. At worst, you will pay a small premium for a bother-free renting of a new car. At best you get your car for not much money. You will still have your warranty and you will have the certainty of fixed monthly payments.

Still time to claim PPI refund

Remember payment protection insurance (PPI)? It is estimated some 60 million PPI policies were sold over the last 30 years and so far there have been a staggering 18.4 million complaints. To date, £26 billion has been paid out in compensation. Many victims may feel they have left it too late to claim. However, this isn't true. The official deadline is August 2019, it costs nothing to make a claim and there are organisations that will help you. If you are able to make a claim you will receive back all your premiums plus 8% interest dating back to when the policy was sold. Over 10 to 20 years this could really add up. Bear in mind you may have been paying for PPI without realising it.

The first thing to do is to draw up the list of all the credit cards, store cards, mortgages and personal loans that you have taken out since the early 1990s. Next, try to gather together an address book of all the different lenders. If you have bank statements or other paperwork, better again. Third, consider contacting a company such as Resolver (resolver.co.uk) which operates free online claims tools in association with Money Savings Expert. It charges no commission and the oldest PPI case it has handled dated back 30 years. Interestingly, Resolver's online claim forms were devised in consultation with the sellers of PPI and are much more straightforward than the nine-page paper forms previously issued by the banks. It takes less than 15 minutes to make a claim, and there are absolutely no charges.

Remember just because you don't have paperwork to back up your claim doesn't mean that you won't succeed.

The London property gamble

Miles Johnson, the global investment editor of the *Financial Times*, has recently written an article in which he suggests young people think very hard before buying a London property. In Johnson's opinion buying London property is not a one-way financial bet. He points out that the gross rental yield on the average London property in 2016 was just 3.5% (he gets his figures from Deutsche Bank). That means that a landlord buyer would require some 200 years to pay off their mortgage after tax and interest are taken into account using only the cash flows from their property. This assumes a 65% loan-to-value ratio, a 35-year mortgage term and a constant rate of interest. Tax changes are estimated to lift this number to 1000 years to pay off the debt!

Johnson goes on to point out that the ratio of house prices in London to annual earnings in the capital has risen from 6.9 times in 2002 to 12.8 times in 2016. This compares with a rise from five times average salary to 7.7 times in the rest of England over the same timeframe. To justify making a big bet on London property at the starting valuations you must have a cast-iron belief in at least one of the following happening: that rents, and therefore wages, will rise significantly over the coming years (bringing down these high multiples); that interest rates will stay low for ever (eliminating refinancing risk); and that we will experience a sharp rise in inflation (eroding the real value of the debt). He suggests that a young person buying London property is, basically, placing a highly leveraged bet.

There are other factors to consider. Interest rates are currently extremely low and if they return to their historical average then it will take even longer to pay off one's mortgage.

Alternative Investment Opportunities

Emeralds and other coloured gemstones

A number of years ago I wrote a book for Thames & Hudson called, very simply, *Emeralds*.

I bought my first coloured gemstones – a pair of square-cut, one-carat emeralds – on impulse, as I was taking a shortcut through a Bangkok shopping mall. I was 22, had never before seen loose stones for sale and chose them because of their colour: a deep, vibrant green. I kept them in a jeweller's envelope made from thin card and lined with tissue paper and carried them around in my wallet, often communing with them when I was alone. I adored them. They were miniature works of art, my personal treasure trove, and I experienced a thrill every time I held them up to the light and gazed into their fiery green interiors. They quickly took on a talismanic quality and I fervently believed that they brought me luck. I can honestly say I have never loved any other physical object as much as I loved those emeralds.

That was how my fascination with coloured gemstones, and with emeralds in particular, began. A few years later I started working in Fleet Street and in my lunchbreak would sometimes walk over to Hatton Garden. I wasn't interested in the manufacturing jewellers and their brightly lit shops but in the gemstone dealers who operated from modest, upstairs offices and would only admit you by appointment. It must have been patently clear that I knew next to nothing about what I was being shown, and from time to time a dealer would take pity on me and give me a quick lesson on how to evaluate a gemstone. In this way I gained a rudimentary understanding of gemmology.

Gemstone trading is a secretive world. Jewellers and jewellery designers seek publicity, but coloured gemstone dealers prefer to work in the shadows. They carry on their trade behind closed doors. What they value above all else is privacy, tradition and trust. Nor are their suppliers much different. The majority of coloured gemstones are produced by small, artisanal mines located in extremely remote areas and managed by characters who would not be out of place in a Rider Haggard novel. Rough stones are likely to change hands several times before being cut and polished, and then several times again before being set and sold to the end consumer. Dealers make surprisingly modest margins: it's an industry driven more by passion than by profit.

I managed to keep my own passion for emeralds firmly in check until my first trip to India. There, to my infinite gratification, I discovered that gemstones are intricately woven into daily life. They are worn, employed and discussed in a way that is difficult for outsiders to comprehend. Different stones are ascribed different properties and it is believed that they can strongly influence one's health, wealth and fortune. They are so widely used in medicine that there are gemstone prescriptions on the government's health website. Gem healers and astrologers abound, offering detailed advice on which stones to wear and which to avoid. It is usual for Indians to speak of their family jeweller in the same way that people in other countries might speak of their family priest or doctor. Of all the coloured gemstones, emeralds are considered the most propitious. They represent paradise, the natural world, life, growth, hope, serenity, love and peace. To wear an emerald next to the skin is deemed to be highly beneficial. It would not be an exaggeration to say that Indian demand for emeralds is insatiable.

Emeralds are at least 20 times rarer than diamonds. The best examples are more valuable than any of the other precious gemstones. Unlike other precious gemstones, the inclusions in emeralds do not necessarily depress their price and may actually enhance it. They were probably the first ever stone to be mined, some 5,500 years ago. It is possible to count on the fingers of one hand the mining areas producing first-class rough. In many societies they were revered and worshipped. They feature in some of the greatest religious texts and literature, and are the basis of innumerable legends and myths. Most intriguing of all, they were one of the earliest commodities to be traded over vast distances. Emeralds from North Africa travelled by ancient routes to Europe, India and China.

The more I uncovered while I was researching my book, the more I wanted to know. In the grip of emerald fever, I decided to visit all the locations of significance. What

followed was a series of long, engaging and occasionally hazardous journeys. I was nearly kidnapped twice: once by Bedouins in the southern Egyptian desert while searching for a lost 5,500-year-old emerald mine and once in Colombia while visiting a primitive artisanal mine near what *National Geographic* has described as the third most dangerous village in the world. After the second incident I began to understand why emerald and other coloured gemstone dealers prefer privacy to publicity and generally decline interview requests.

The lack of information about emeralds and other coloured gemstones is one of the reasons I believe they could be one of the best alternative investments of the future. As buyers begin to learn more about this investment class it will push prices up. This is what happened with diamonds. Thirty years ago, only experts understood the difference between one diamond and another. Now that knowledge is widespread. Even ordinary consumers have heard of the four C's – colour, cut, clarity, carat weight – and most know how to distinguish between high- and low-quality stones. For the first time ever, large public companies are interesting themselves in coloured gemstone mining and are investing in consumer education campaigns. The result of this education is going to be demand and demand is going to push up prices.

Another reason why I believe coloured gemstones offer a huge opportunity is to do with rarity value. They are rare – but not too rare. Strangely enough, there has to be sufficient supply to justify an investment in both mining and marketing. There are lots of very rare gemstones that never make big prices – tanzanite is a good example – because there isn't sufficient supply to attract investors.

Beauty comes into the equation, too. I have already spoken about my love of emeralds but I love many other stones, too, including some that are no longer that valuable (amethysts, for example, were almost priceless until substantial deposits were found in the late 18th and early 19th centuries). The fact is that owning precious gemstones, whether as jewellery or as loose stones, will bring great pleasure.

Nor must one ignore another benefit of coloured gemstone investment: portability. With the exception of stamps, I don't think there can be an easier asset class to carry around and store. Moreover, coloured gemstones are anonymous, unlike rare stamps, and are easily lab tested for authenticity. Their size alone makes coloured gemstones an excellent store of wealth.

What about the market? A quick Google search and you will quickly discover that there is very little accurate, reliable information about coloured gemstone prices. But there are clues! For example, the *Financial Times* ran a piece a year or two back in which it pointed out that emerald prices had been growing rapidly – in 2007 they shot up by 45% in the space of 15 months. To offer another example, Gemfields Plc, perhaps the largest of the coloured gemstone mining companies, reports that the carat price for rough (uncut precious stones) mined by the company has risen every quarter since it started its auctions in 2009. Christie's, Sotheby's and other auction houses all report that prices for coloured gemstones have been on the rise over the last few decades. There are also lots of newspaper articles talking about how coloured gemstones are now back in fashion. This is what one expert, Vivienne Becker, said on the subject in an article entitled: 'Marketing coloured stones: Resurgence of "big three" sees a return to tradition':

After decades of diamond domination, the monochrome minimalism of the 1990s, the celebratory sparkle of the millennium and the status stones hoovered up by new wealth, the jewellery world is embracing colour. It is reinvigorating the 'big three' coloured stones – emeralds, rubies and blue sapphires – edging away from the kaleidoscope of what used to be called semi-precious stones towards the intensity and saturation of traditional colour. Buoyed by the connoisseurship characteristic of the current market, and a growing appreciation among collectors of the subtleties, complexities, rarity and refinement of noble coloured stones, this resurgence has been focused on natural, untreated gems, wherever possible, and especially on the great heritage stones from celebrated, historic mines in Burma, Kashmir and Colombia.

What should you buy? My recommendation would be emeralds. You might think I would say this, given my personal interest in the stone. But my reasoning is not based on emotion but on fact. One of the most famous lapidarists in the world – Piat – recently did some very interesting research. They introduced the results of their findings thus:

While a broad documentation about diamonds can easily be found and is available on the Internet – sector-specific market studies, organized exchanges, prices index (thanks to the Rapaport list) – the colored gemstones market is blamed for being subjective and is often seen as a mystery for whoever isn't an insider or doesn't belong to the profession.

We believe this is wrong. There is an impartial and public source of information that provides a true transparency about the market prices of colored gemstones: auctions.

Their added value is high, mainly thanks to the advertising they bring on. They also contribute to improve the market performance, not only in terms of price fixing but also of liquidities.

However, one must be able to match a price with a quality. That's where the expertise and lots' evaluation come into play.

We studied the major sales organized by Christie's and Sotheby's auction houses since the beginning of 2017. Our analysis is based on the minimum eligibility criteria to our quality standards: natural and non-heated sapphires and rubies, emeralds without any treatment or with minor oiling. Bought lots only kept our attention.

What did they discover? In terms of average price, Burmese rubies (124,580 $/ct) are ahead of Ceylon sapphires (72,495 $/ct), while Colombian emeralds (47,742 $/ct) complete the trio. Burmese sapphires cost on average 2.1 times more than Ceylon sapphires. The greatest room for growth would, then, appear to be for Colombian emeralds.

At this juncture it is probably also worth pointing out that coloured gemstones generally command higher prices at auction than diamonds. This is because, rare as diamonds are, they aren't rare enough. Burmese rubies have actually made more than 1 million $/ct at auction!

So, how can you start investing?

If you are going to put serious money into coloured gemstones, you need to know as much as possible about them. There is a wealth of information out there. Subjects to cover include: geology, history, location, qualities (such as hardness) and how they are valued. Happily, there are plenty of books and other sources of reference. Various institutes also offer courses, which are well worth taking if you have the time.

Dealers may be secretive but if you show that you are going to be a serious buyer you will find that many will be happy to spend time teaching you about their stock. Nothing beats spending time with really high-quality gems. It is all about gaining experience. As with any alternative market, buyers depend on dealers to help and assist them. Yes, of course, there are unscrupulous dealers. But my experiences have – by and large – been nothing but positive. Oddly enough, I have done better in Hatton Garden, 47th Street in New York (the jewellery district) and Amsterdam than when buying close to mines in such places as Colombia, Zambia and Mozambique. I am not expert enough to buy rough, and someone selling a stone in, say, the open market at Coscuez, knows you are unlikely to be back and – therefore – may be less scrupulous. If you have the interest, I would also suggest visiting the biggest annual gem show in the world: The Tucson Gem and Mineral Show. Nowadays, this has as many as 45 separate mini-shows and there is no better opportunity to learn about gems.

In my opinion, the minimum investment grade coloured gemstone must be at least two carats and should have a wholesale price of at least $20,000. As with any alternative investment, buy the best you can afford. Quality always holds its price better.

I would also consider buying jewellery. You could buy antique and designer jewellery that has a value over and above its constituent parts such as that by Cartier. Or you could buy jewellery where the constituent parts are worth more than the retail price. I have picked up some fantastic bargains over the years where jewellery dealers have undervalued coloured gemstones in older, uglier pieces.

Of course, what every investor wants to know is what sort of returns can be expected? There is no easy answer to this. I am not exactly a dealer but I buy and sell on a regular basis and, in particular, over the years I have sold to a number of jewellers – so I have a ready market for anything I pick up. Therefore, I would always expect to make money on anything I purchased. However, if you are going to rely on a dealer to buy for you it could take five years for the market to catch up with you. On the other hand, over the medium to long term my prediction is that you will see solid returns equal to or better than the stock market. Coloured gemstones are not for the risk-averse. But for those with the interest and cash to buy well they offer a fantastic opportunity.

Jonathan Self

Property

News

How to save VAT on an HMO

One of the disadvantages of being involved in the residential rental market is that residential rental income is completely exempt from VAT. As a result of this, it isn't possible to register for VAT and thus reclaim expenditure. The situation is, of course, very different if you rent commercial property or even furnished holiday lets. The injustice of this position really comes home for investors who buy property and convert it into a house in multiple occupancy (HMO). Under normal circumstances the 20% VAT charged by suppliers and builders simply can't be claimed.

However, there are some loopholes. Under certain circumstances qualifying property conversions can qualify for a reduced rate of only 5% VAT. This rate applies both to materials and to services related to the conversion and any repairs or construction works within the immediate vicinity of the building site, such as a garage or shed.

A qualifying HMO is one where before the conversion the premises being converted did not contain any multiple occupancy dwellings and after the conversion those premises contain only a multiple occupancy dwelling or two or more dwellings. To qualify, it is important that the premises aren't used for anything except the relevant residential purpose. For example, you can't convert it for use as a hospice, residential home, school or some other type of use.

Many HMO developers fail to get the 5% VAT rate because they don't understand how it has to be claimed. It is for the registered contractor dealing with the refurbishment project to self-assess that the project itself is a qualifying conversion for the 5% rate to apply. Many contractors are worried about doing this, since if the project turns out not to be a qualifying project it is the contractor who would have to pay the extra tax and HMRC penalties and interest. In a nutshell, many contractors are cautious of assessing the VAT status as being at 5% and prefer to charge the 20%. After all, it's no skin off their noses.

How can you get around this problem? It is important, before you begin, to provide the main contractor with plenty of evidence that the renovation is of a qualifying nature. This can be done by gathering together before and after floor plans, planning permission documents, certificates of lawfulness, drawings and pictures.

Incidentally, since you can only really claim this 5% VAT through your main contractor, it is important that you put as many purchases as possible through that contractor in order to optimise your VAT saving. However, it must be for materials and services relating to the project. You cannot claim for such things as fixtures and fittings (furniture, carpets, etc.).

On a typical £200,000 project the VAT saved would amount to £30,000. A saving such as this is, obviously, worth having.

Five-year fixed mortgage rate of 1.69%

HSBC has launched the lowest five-year fixed rate deal available in the UK. It is now possible to obtain a five-year fixed rate of 1.69%, providing you have a deposit of 40% of the property value. The loan does carry a fee of £999; however, this is lower than many typically tied to such ultra-low rate deals.

Clearly, this rate is designed purely and simply for residential purchases and re-mortgaging. However, those with a small buy-to-let portfolio may consider it worth paying off any investment property loans by taking out a mortgage on their own homes. This is particularly true now that so little relief is available on buy-to-let mortgage interest.

It is difficult to imagine that mortgage rates could feasibly go any lower. If you can obtain this deal (there has been huge demand) my advice would be to take it. It is difficult to imagine how any reasonable investor couldn't beat a return of 1.69% on any such capital raised.

Government proposes tenancy deposit changes

One government proposal announced in the Queen's Speech is likely to leave many landlords and their letting agents substantially out of pocket. It is being suggested that the security deposit tenants leave will be capped at no more than one month's rent. Philip Hammond, the Chancellor of the Exchequer, stated that this is one of several measures designed to make the private rental market more affordable and competitive. Landlords and letting agents will be permitted to require no more than four types of payment from tenants: the rent, a refundable security deposit, a refundable holding deposit capital as one week's rent and fees in case the tenant defaults. The National Landlords Association estimates that around four in ten deposits are currently more than one month's rent. In particular, larger deposits are generally required by landlords who would otherwise be unwilling to take on higher-risk tenants. On the other hand, as reported in last month's *Schmidt Report*, a number of professional landlords have decided to end any requirements for a deposit. Get Living, which owns nearly 1,500 homes in East London, was the first of the professional landlords to make this move.

Note: the government is also proposing to ban letting agent fees. Letting agent fees account for around a fifth of their revenue and cover the cost of vital checks required to set up a tenancy agreement. Many letting agents believe that if they are banned outright agents will need to pass the costs on to landlords through higher agent fees. This in turn is likely to affect rent levels.

Knight Frank Predicts Student Property Woes

The head of student property at Knight Frank has recently highlighted risks to the market. In doing so, he reflects a recent report on purpose-built student accommodation published by Ernst & Young called *Testing Times Ahead?*, which also predicted falling demand and prices in this sector.

The potential threats to the purpose-built student accommodation market are:

- In the last decade the number of 18-year-olds leaving school each year has been falling. Between 2010 and 2020, some 200,000 fewer 18-year-olds will have left school. Since this group accounts for seven out of ten of first-year university entrants, this is a large drop in the number of potential students.
- Rising tuition fees, rising accommodation costs and the rising cost of student loans (see elsewhere in this issue of the *Schmidt Report*) are also likely to result in a drop in university applications.
- In fact, the number of applications to start a course at a UK university in the autumn of 2017 is down by 5% (some 30,000 students) compared to the same point in 2016.
- There has been a huge growth in apprenticeships and school leaver work programmes and many people are opting for degree apprenticeships that offer the chance to obtain a degree without incurring debt.
- In order to make up for the demographic reduction in the UK, an additional 60% extra foreign students would be required. This does not seem likely, particularly in light of Brexit.
- Increased supply. After a rush of investment in purpose-built student accommodation, many university towns have more supply than is required.
- Students are more likely to study close to home and live at home. Again, owing to the cost of student accommodation, many more parents are insisting that their children study close to home thus saving the cost of student accommodation.

Property Opportunities

Watch for restrictions

One area in which many new property developers get caught is that of restrictive covenants. A restrictive covenant affecting land involves an agreement that one party will restrict the use of its land in some way for the benefit of another's land. For example, that could be a restriction on the number or type of buildings that can be erected or the activities that can be carried out on the property. They are more common than you might imagine and, crucially, they are enforceable in law. On the other hand, it is possible to apply to the Upper Tribunal for the modification or discharge of a restrictive covenant as a comprehensive, long-term solution.

When planning any sort of development one of the first moves, whether you are a buyer or seller, could be to take out some sort of indemnity insurance policy. These are particularly effective where the restrictive covenants are historic and the benefiting land for the full extent of the burdened land cannot be identified. However, an indemnity insurance policy will be of no use if an approach has already been made to the beneficiary of the covenant or the beneficiary is on notice of a breach.

Better even than such insurance is to get a deed of release. This is where one negotiates with the owner of the benefiting land releasing the developer from the responsibilities attached to the covenant. However, even after a deed of release has been negotiated that is not to say that if the

affected land changes hands at some time in the future the next owners won't decide to reinforce it. To avoid such a scenario, the best thing is to apply to the Upper Tribunal for a release or modification of the restricted covenant.

It is interesting to look at the different reasons why the Upper Tribunal will consider such a course of action. To begin with, if they felt the covenant was obsolete because of, for example, changes in the character of the burdened land they would be open to action, if the covenant impedes some reasonable use of the burdened land or if the beneficiaries expressly or implicitly agreed to discharge the covenant by their acts or omissions. They will also want to know that no injury will be caused to those who benefit from the restriction.

It is important to address the issue of restrictive covenants before you purchase any property. Make sure when your solicitor arranges for the title to be searched that any such restrictions are highlighted.

Go modular

The property consultancy JLL has released a new research document: *Workspace, reworked*. Although the main thrust of the report is about how technology is shaping the workplace, its authors also looked hard at residential building development. They predict that over the next five years new homes are going to become increasingly prefabricated "like cars". The report points out that modular homes are generally quicker and cheaper to build, as well as smaller, more flexible and often of higher quality, bringing time and cost efficiencies that will make housebuilding more attractive to developers. It believes that the growth of on-site construction of modular housing will alleviate pressure on the housing market. One of the report's authors, Simon Peacock, points out that on-site construction in the UK is already growing by 25% per year and that it results in a 30% reduction in build time, a 75% reduction in workforce and 40% less vehicle use.

Homes manufactured like cars, in other words an off-site build in a factory, with the opportunity to pick and choose what goes into a basic structure, will bring car quality to the market. Clients and designers need to adapt to this evolving trend; indeed, this is an opportunity for innovation that could lead to a competitive advantage.

As evidence of the growing trend, JLL pointed out that the insurance and pension company L & G is investing in the largest housebuilding factory in Europe, near Leeds.

Incidentally, if you are interested in investing in this area, and you are not a developer yourself, then you may like to look at a company called Fruitful Homes. This company offers investors an opportunity to invest in modular housing developments from £1,000, with no maximum limit. Full retail and institutional investors can invest directly in residential property developments. The company says that the current estimated return for its investors is from 30 to 35% a year, stating: "the current estimated return after fees is what investors could earn from investing money in our property development projects. It is calculated by taking the gross development value (based on current market values) of available development projects, less fees in the original investment. The average return is given before tax."

The firm says that it only makes a profit when their investors receive a return, too, receiving a 25% share of the net profits each development project generates.

The latest property niche: Social housing

As one commentator explained: "Listed fund managers hunting for elusive income investments have taken to mining a new corner of the property market. Residential Secure Income, a new real estate investment trust (REIT), has announced that it is preparing for a London listing. It plans to raise £300 million to invest in social housing."

RSI is the second UK listed fund to invest wholly in social housing, the first being Civitas, which raised £350 million last year to acquire properties around London, the Midlands and the South of England to lease back to housing associations. Both companies target a dividend yield of 5%. Residential Securing Income believes that housing associations are excellent and reliable borrowers. They point out that not one housing association has ever defaulted.

Another niche that is proving popular among major investors is that of supported living accommodation homes that have been modified to aid people who require help to live independently.

Essentially what all such investors are doing is seeking to tap into public sector backed cash flows, as long dated as possible and, wherever possible, with inflation linkage.

Leasehold: Scam or opportunity?

Last year, some four out of ten new-build properties were sold leasehold rather than freehold. Generally speaking, those leases ran for the traditional 100-year period. According to the Land Registry, some £2 billion worth of new-build leasehold houses were sold in England and Wales in 2016.

What does this mean in practice? Depending on the terms of the lease, the purchaser may be liable for ground rent from year one. Certainly, most modern leases have the provision built into them that the ground rent increases as the lease shortens. So, for example, ground rent in year one might be a mere £250 but by year 10 it could have increased to £1,000 and by year 20 to £2,500. This, as you can imagine, is accompanied, of course, by a potential fall in value of the property. As the lease shortens it will have a depressive effect on the property's open market price. Leasehold tenants, of course, exercise their right to buy the freehold. This will cost them additional money.

How you feel about such arrangements will depend on your political views and whether you are a purchaser or a developer. Incidentally, many freehold owners will also make a service charge.

In recent years a number of charities have campaigned to see an end to the leasehold system. There have also been various court cases brought by leaseholders against the freehold owners, particularly in relation to the cost of purchasing the freehold.

If you are a developer, whether of a complete new-build or simply a converted property, you are certainly within your rights to sell leasehold rather than freehold. If you were a property buyer, on the whole, unless the property appears to have the expenses associated with the lease priced in you would be better off avoiding buying anything other than freehold.

Where there are jobs there are profits

The latest research from Lloyds Bank makes an extremely obvious point: those regions with the largest falls in unemployment over the last 10 years have seen their house prices soar by the highest amount. The bank found that the ten areas with the biggest unemployment declines have seen a house price rise of 53% on average between 2007 and 2017, while the ten areas with the highest unemployment rates recorded average house price growth of just 10%, less than half the national average, of 25%, during the same ten-year period. Moreover, the 20 areas that have recorded the sharpest falls in unemployment have, on average, seen house price gains of almost double the national average over the past decade. Interestingly, the best-performing area was that of Waltham Forrest, which has experienced a 92% house price increase from an average of £233,000 to £449,000. What does this tell us? Where there are jobs, there are opportunities. The canny investor snaps up properties in areas that are beginning to experience regeneration.

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