Vol 22, no 4 – May 2016

Schmidt *Tax* Report

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TAX NEWS

Exchange of information update

The Crown dependencies and overseas territories (with the exception of Anguilla and Guernsey) have agreed that they will provide information on the beneficial ownership of companies registered in their jurisdictions to UK law enforcement and tax agencies. This month, the EU's five largest economies have banded together to automatically share information on the ultimate owners of companies – the latest move by European powers to tackle offshore tax evasion. The news was announced at the annual International Monetary Fund spring meeting in Washington DC, bringing together key EU allies Germany, France, Italy, Spain and the UK to exchange data on company beneficial ownership registers. The announcement also extends to sharing data on new registers of trusts. A global move towards interlinking country registries will provide, for the first time, international real-time access to tax and law enforcement agencies on company ownership.

Not worth your weight in gold

HMRC has issued a warning to companies paying their staff in gold bars as a way of reducing their tax liability. Such schemes (referred to as 'disguised remuneration' schemes) depend on the employee paying the value of the gold to a trust at some point in the future and make the erroneous assumption that this obligation makes the initial receipt of the bullion tax-free. However, Tina Riches, head of tax at Smith & Williamson, was quoted in the *FT* as saying it may suit those in receipt of "large, one-off payments", such as bonuses, to take them in gold. The rate of capital gains tax chargeable on receipt of an asset, such as gold, is lower than the 45% rate of income tax applicable over the £150,000 annual threshold. "If a promoter was doing something like this, it would be an expensive scheme, which would only make sense for people who would otherwise have a very significant tax liability," she is reported as saying.

Balls beat taxman

Sportech has received good news from the Court of Appeal, which has ruled its famous *Spot the Ball* competitions are not games of skill but of chance and thus not subject to VAT. The ruling means the company is eligible for a £97m refund from HMRC for taxes paid between 1979 and 1996. The company had been awarded the money after a ruling in 2013, but had to pay it back after HMRC appealed.

At its peak, as many as 3m people a week played *Spot the Ball*, in which players try to guess the location of an imaginary football in a photograph. Sportech described the game as a "guessing game", because the original ball is removed before a team of judges marks the location for the competition.

Tax receipts at risk

The Institute for Fiscal Studies (IFS) has pointed out that while taxes are expected to recover to pre-recession levels by the end of the decade uncertainty about the strength of the UK's economic recovery, difficulties in forecasting receipts from new taxes and the chance that the Treasury will not stick to the assumptions used in the forecasts may all lead to lower than anticipated levels of revenue. According to the IFS, the UK is increasingly reliant on a range of small taxes, including five new ones that are forecast to raise a total of £7.3bn in 2020/21. The think-tank criticised the growing reliance on a small number of high

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earners, pointing out that as the tax base narrowed "the growth of receipts may be more unpredictable and risky". Since 2007, the number of adults paying British income tax shrank from 65.7 to 56.2%.

A total eclipse of the sum

The Eclipse Film Partners 35 scheme, accused by HMRC of using industry exemptions to help its members avoid paying tax, was refused permission to appeal to the Supreme Court on Wednesday. The scheme, whose 289 members included Sir Alex Ferguson and Sven Goran Eriksson, denies using distribution rights to Disney films *Enchanted* and *Underdog* to generate tax relief. The film partnership initially raised £50m that was topped up with loans from a Barclays subsidiary totalling £790m to buy the distribution rights mentioned above. On the same day, the Eclipse vehicle sub-leased the rights to another arm of Disney in a complex deal that generated income over 20 years, enabling it to claim tax relief intended to support the British film industry. HMRC refused Eclipse members tax relief to the tune of £117m in 2012, triggering a lengthy legal battle over whether the vehicle was genuinely trading, and therefore eligible for the tax breaks. Most of those who participated in this and other similar tax avoidance schemes promoted over the last 15 years – and it is believed that about 60,000 UK taxpayers are involved – did so on the recommendation of professional financial advisers, who have commonly pocketed their commissions and either escaped to warmer climes or wound up their practices. In other circumstances the taxpayers might be considered victims of mis-selling or – at worst – dupes, but the new political environment regarding tax means that this is not currently the case. The punishment – high penalties and fines – seems harsh compared to the actual crime. According to international law firm Pinsent Masons, HMRC collected £494m in income tax through an enhanced campaign against tax-avoidance schemes last year, as contrived tax structures continue to be a top priority for the government department. According to UHY Hacker Young, HMRC investigations into SMEs raised an additional £489m in corporation tax last year.

Staff tax evasion must be reported

UK and foreign companies will become criminally liable for failing to stop their staff facilitating tax evasion if new government proposals are adopted. "The criminal law currently renders corporations that refrain from implementing good corporate governance and strong reporting procedures hard to prosecute, and offers no incentive to invest in such procedures," the Government said in a consultation paper. The new legislation would criminalise the 'failure to prevent' the facilitation of evasion for the first time and will place obligations on corporates to monitor their employees, agents and subsidiaries.

Former PwC staff in court

Two former PwC employees have gone on trial in Luxembourg on charges of theft, revealing business secrets, violation of professional secrets and money laundering. In November 2014, some 28,000 documents describing tax deals struck by Luxembourg revealed that the tiny EU state was facilitating more than a thousand multinationals in tax-avoidance activities, all of which are entirely legal. The leaked documents primarily relate to clients of PwC.

Editor's Notes

Is incorporation worth it?

Traditionally it has been worthwhile for self-employed taxpayers to incorporate their businesses – dividends being taxed at a lower rate than other income. How has the situation changed now that corporation tax is set to fall and dividend tax is increasing? The answer is that in the short term taxpayers will still be marginally better off and that – if no further changes are made to the tax system before 2021 – they will then be better off, even though the employment allowance (worth £3,000) will not be available to sole employee shareholders from 2020. This is all best explained with an example. If you have a business that earned £100,000 profit in 2015/16, incorporation would have saved you around £4,700. Next year, your saving would fall to around £3,200. By 2020/21 the saving would have increased again to about £6,000. Of course, these figures do not allow for the extra cost of incorporation.

A very useful relief

On initial examination I was not that excited about investors' relief. In a nutshell, shareholders can benefit from the 10% capital gains tax rate on the disposal of ordinary shares in an unlisted company for which they have subscribed after 16th March 2016, as long as they have held the shares for at least three years. The three-year period cannot begin until 6th April 2016. Like so many reliefs there are innumerable conditions to be fulfilled, including the fact that the shares must be fully paid up in cash and issued on an arm's-length basis. Furthermore, any investor cannot work for (or be a director of) the investee company at any time during the three-year period, or connected to an employee or director. In fact, the relief is denied if the investor 'receives value' from the investee company. Also, dividends paid to any investor claiming the relief must not exceed a 'normal return' (whatever that is) on an equity investment in the company and any loans made by the investor to the company cannot exceed a 'reasonable commercial return'. Thinking it through, though, I can see some definite possibilities. The 10% rate is not as good as the 0% rate offered by schemes such as EIS but the rules are much more flexible and the onus is on the investor to claim the relief rather than the company to comply with lots of tedious regulations. There appears to be total flexibility in what business the company can be involved in, too. So far, HMRC's website has said nothing about trading in property, for example. I can also see situations where investors use shares as security against interest-free loans, taking their reward as an uplift on share value rather than as interest. As I say, investors' relief may have more to offer than I first thought.

Escaping IHT on family homes

In the first Budget speech of this parliament, George Osborne promised to "take the family home out of the inheritance tax net". If only it were true. In fact, what Osborne has introduced is something called the maximum residence nil rate band (RNRB) – an additional inheritance tax (IHT) allowance available if an individual passed their family home (with a value of no more than £1m) to their children, grandchildren or remoter descendants, including stepchildren, adopted children and foster children. Each beneficiary receives an allowance – starting with £100,000 in 2017/18 and rising to £175,000 by 2020/21 – which is hardly fair to those who die or become beneficiaries under a close relative's will before the new rules kick in. It is a particularly complex piece of legislation, anyway, with special rules that will (they are not yet enacted) apply to people who have downsized their home before their death. Nevertheless, if your estate would – including the value of your home – be liable to IHT then it is well worth seeking specialist advice. Incidentally, IHT receipts jumped to £4.6bn in the year to February 2016, up 21% from £3.8bn. Against this, the Government is planning to increase probate fees. Under the proposals, estates worth more than £2m would pay £20,000 for probate instead of the current £215.

Taxing the Rich

Taxing the Rich by Kenneth Scheve and David Stasavage is a study of 200 years of tax data from 20 different countries and references many other sources, not least the Bible: "The rich shall not give more and the poor shall not give less than half a shekel, when they give an offering unto the Lord, to make an atonement for their souls." Which comes, as you probably knew, from the *Book of Exodus*. It is packed with interesting stories and facts. For example, in France, prior to the Revolution, the aristocracy was exempt from the taille, the land tax imposed on the people. However, they had to pay *l'impôt du sang* (literally a "blood tax") in the form of military service to the king. In Renaissance Florence, the landed gentry had to pay tax but the mercantile classes were exempt. Before World War One, Britain's top rate of income tax was 9% but two years after the war ended in 1920, it had reached 60%. Across the Atlantic, in the US, income tax rose from 7% the day war broke out to 77% on Armistice Day. However, although it is entertaining to read how tax worked in different places and at different times, there is a serious purpose to the book, which is to explore whether progressive tax is both fair and effective. The authors include considerable evidence to support the idea that lower taxes stimulate the economy even if they are frequently politically unacceptable. When the UK's Conservative-led coalition cut the top rate from 50p to 45p in 2012, for example, tax revenues for the following year rose by £9bn. Soaking the rich may be popular with voters, but it may not be best for the Exchequer.

Trusts For Minors: Why and When?

Have trusts had their day? They are certainly looked at askance by HMRC, who sponsored a devastating attack on the creation of trusts in the 2006 Budget. However, that may be an indication that the rest of us are missing something by not considering their advantages!

This month, we'd like to focus specifically on the idea of trusts for young people: particularly those under 18.

Arguably, it's at this age trusts are most appropriate in any case. Even in these days of liberal and lax parenting, most of us feel that trusting children with the control of large sums of money or other assets would be a foolish thing to do. So a trust, which is an arrangement where you hold the value on their behalf but don't allow them unrestricted access to it, is a good compromise between keeping all the money yourself (and hence potentially exposing it to inheritance tax (IHT), apart from other considerations) and handing over complete control to the youngster.

And – surprise, surprise – trusts for minors can have income tax advantages too.

Let's consider the situation where the household income is more than about £85,000 gross a year. Even with two parents arranging things so that they are receiving this income evenly split, there will still be an element of tax chargeable to the 40% rate. Also, everyone has a personal allowance of over £10,000, which is the level at which one starts paying tax. If the personal allowances of the children in the household are not being used, they are being wasted: because you can't carry a personal allowance forward to the next year.

Presumably for this reason, parents used to set up trusts for their children within which they controlled the capital but could make payments of income that wouldn't be taxable because they would be within the children's allowances.

We say "presumably" because there are longstanding rules in the tax law to stop parents doing this, now. Any income receivable by a minor child as a result of arrangements made by their parents will be treated as the parent's income for tax purposes.

So where does this leave the idea of trusts for minors? Their IHT advantages can be taken as read, because the amount held on trust, providing the person creating the trust can't benefit, is outside that person's estate once seven years have passed.

From the capital gains tax point of view, minors' trusts tend to be fairly neutral, with generally the same rate of tax and a fairly similar annual exemption being available.

Concentrating on income tax, though, consider the following two uses of trusts for minors:

1. Increasingly frequently, the person setting up the trust for the minor child is not the parent but one or both of the grandparents or, less frequently, other relations, such as uncles and aunts. The rules against diverting income to minors don't apply to grandparents, only parents. So this rule is most useful in situations where generation one, so to call it, was considering helping out generation two, but is conscious that giving generation two money will simply result in income on which they will pay higher-rate income tax. Instead, again parents can make a direct transfer to a trust for generation three. In this way, the extra income coming into the household of generations two and three can be tax-free up to the amount of each relevant child's personal allowance. Even above this, there is quite likely to be an advantage in that the child could be taxable at the basic rate of 20%, if the alternative was their parents paying 40 or 45%.

2. The other situation where a trust for minors can be advantageous is where the income is not distributed but rolls up within the trust. Providing the income isn't added to capital, it may be possible to pay it out to the children once they have passed the magic age of 18. This sort of arrangement has the disadvantage, if the trustees are UK resident, of giving rise to a 45% tax charge on the trust's income each year. However, this tax can be reclaimed as and when the income is paid out to the beneficiaries, and the repayment may be the whole 45% that the trustees have previously paid, if the beneficiary's applicable tax rate is zero. If their tax rate is 20% at the time, 25% will be refunded, and so on.

Where the sums in question are big enough, then, there may be something to be said for an offshore trust in situation 2. If the types of income receivable are types which are not already subjected to income tax at UK rates, the benefit of this arrangement is often that the income can be rolled up within the offshore trust tax-free. Always bear in mind, though, the countervailing costs of running a trust offshore.

All Aboard The Gravy Train

One effect of our system of government, under which our rulers come and go on quite a frequent basis, is that governments never learn.

Arguably, one example of this is the new £5,000 tax-free band for dividends, and the £1,000 tax-free band for interest.

Let's go back a little way in time. Back in the days of New Labour, Gordon Brown had the bright idea (or someone else in his government) of 'encouraging' small businesses by introducing a £10,000 0% rate of corporation tax. It took accountants approximately 10 seconds to work out the advantages of running limited companies, for businesses which would otherwise have been too small to be worth incorporating. Effectively there was an extra £10,000 tax-free allowance, if you got the arrangements right.

It is to be assumed that this wasn't what the Government had been intending at all. They presumably had had some vague idea of giving the small business sector a shot in the arm. What they actually did was provide a (in the context) huge incentive to changing from an unincorporated business format to an incorporated one.

Readers may remember the sequel. With much fulmination against 'abuse' of the rules, the 0% band of corporation tax was summarily withdrawn. How dare taxpayers take advantage of tax reliefs in order to pay less tax?

On perhaps a smaller scale, we can see a possibility of a similar outcome with the £5,000 tax-free dividend route.

These arrangements are actually crying out to everyone who has a company under their control or influence to rearrange things to qualify for nil tax income.

The way the rules are written is rather odd. The dividend or interest income concerned doesn't get eliminated by the offset of any kind of allowance. Instead, it sits exactly where it would have sat in the hierarchy of your different types of income, and there is a notional tax rate therefore applying to that income, which may be nil, 20, 40 or 45%. But the effect of the rules is that instead of paying this rate of tax (whatever it is in your circumstances) you simply pay nil on that slice. So the allowance benefits higher- and top-rate taxpayers just as much, in fact far more, than it benefits basic-rate taxpayers.

Take the example of somebody who is in the very top rate of income tax. Using the new dividend tax rates that apply from 2016/17 onwards, they would otherwise be paying 38.1% on the net dividends received. The £5,000 nil rate is therefore worth a tax saving of over £1,900 to them.

The interest allowance, although much smaller, still has the capability of changing people's behaviour. How about the director who has a director's loan owed to him by his company, for example? In what is probably the vast majority of cases, directors don't bother charging their own companies interest. However, if the first £1,000 of your interest were tax-free, you would presumably charge this, since the company would still get tax relief. (We have to bear in mind that, as we write this, the rules aren't yet in their final form, but this seems to be the inevitable inference of the way the changes have been initially presented.)

Things start getting a little bit more complicated when you're talking about arrangements to enable dividends to be paid.

Let's consider a situation which is hypothetical but will probably be applicable in a great many cases. Mrs A owns all of the shares in her trading company, and hitherto has taken a mixture of remuneration and dividends. Her husband, Mr A, has his own highly paid PAYE job elsewhere. The income from the company is great enough, though, to put Mrs A into higher rates of income tax, if she takes it all out in the form of dividends. So it seems obvious to create new shares in the company, perhaps a small number, and issue them to Mr A. Mrs A will make sure, in most real-life situations, that she keeps complete control over the company!

The new shares issued to Mr A then pay him, by coincidence, exactly £5,000 dividends a year (we assume he has no other dividend income from elsewhere). The result is this amount of income extracted from the company tax-free.

In that hypothetical example, we can suppose that the new shares issued are exactly the same type and class of shares as the ones already owned by Mrs A. But this may be awkward, in that a company which has shares of all the same class has to pay dividends on all those shares of the same amount – unless any of the shareholders go through the rather fussy and difficult process of waiving their dividend entitlement. This can be quite awkward, especially where you are trying to fit in with this structure the payment of something like exactly £5,000 of dividends to the minority shareholder.

So the answer may well be to create a different class of shares for Mr A in this situation. If Mrs A has all the ordinary shares, and Mr A has 'B' ordinary shares, it seems likely (but note what follows) that it will be possible to pay over simply £5,000 a year to Mr A on his special shares, while retaining complete freedom to pay whatever is appropriate on the ordinary shares.

I think the temptation should be firmly resisted, though, of going any further than this, and limiting the rights of the 'Mr A' type shares. It would be possible, in principle, to issue him with shares which have no voting rights and even no rights to the assets of the company on a winding up. But this would probably bring the situation firmly within the 'settlements' income tax rules. These state that, where one spouse gives the other spouse something which is substantially just a right to income, then the transfer doesn't work for income tax purposes. So if the new shares that Mr A received were non-voting, non-participating shares, it's likely that we wouldn't be using his £5,000 allowance after all – because HMRC would be taxing the dividends on Mrs A under these settlements rules.

It's even questionable whether too 'automatic' an arrangement, under which there is an assumption the recipient's spouse will get £5,000 a year, may not be stigmatised by the Revenue as substantially a right to income, and therefore ineffective.

Where you're talking about other family members, for example the children of the company owners, you haven't got quite the same issue with the settlements rules. Instead, you've got a different issue.

If the children concerned are under 18, of course, you haven't achieved anything. The £5,000 dividends will simply be added to your income for tax purposes, under long-lasting 'settlements on minors' provisions (see article on children's trusts elsewhere this month).

If the children are over 18, however, and, preferably again, the shares are 'real' shares and not just a mechanism for paying dividends, then there is certainly scope to cash in on their available £5,000 nil bands.

What about employees? It's always been a sought-after result in tax planning to pay your staff without incurring employer's and employee's National Insurance contributions (NICs), and for this reason the idea of giving staff shares, and paying them dividends, has been very popular in the past. Inevitably, we think, there is likely to be a further surge in popularity of paying employees by dividends, where the first £5,000 of those dividends is going to be not just NI-free but tax-free as well.

But here we are straying into, if possible, even more provocative territory. We are even, perhaps, straying into the area of the hated 'marketed tax avoidance scheme' that HMRC reserves so much venom for. One way to get this new relief shut down even quicker than it is likely to be anyway is to start an industrial-scale production of employee shareholdings for this purpose.

But there's another difficulty to watch out for, with staff shareholdings, in any case.

Let's imagine that you are running a very successful company, with a track record of profits going back many years, which has a large and loyal staff. Acting on advice from a tax avoidance scheme promoter, you issue a new class of special shares to your top 10 senior employees, so that you can pay them in dividends and hence save employer's NI. This is still going to be highly advantageous, incidentally, even with the new dividend tax of 7.5%, because employer's NI is 13.8%, and the marginal employee's rate for the sort of category of individuals we are talking about here will be 2% on top of that.

Having issued these shares, which may be classes A, B, C, D, etc. (hence giving this sort of arrangement the nickname of 'alphabet shares'), you can start paying these NI-efficient dividends straight away.

But the problem that we can see with this is the fact that the shares, when issued to the staff, may already effectively have a substantial value. In our imagined situation, they are shares in a very profitable company, even if they are shares of a new class in that company. There is an expectation, which is immediately fulfilled, that the shares will start paying copious amounts of dividend.

So how does one argue against a taxman claiming that the issue of shares to the senior employees constituted in itself a valuable benefit in kind, which should bear income tax? If such an argument were raised by HMRC and was successful, the arrangements could become the very reverse of tax efficient. And, wherever you are talking about mass-marketed avoidance, the likelihood of HMRC both challenging the scheme and being successful in front of a sympathetic judge become much greater.

The situation is different, no doubt, where you are talking about a newly formed company. Here there is no track record, and therefore arguably the shares are only worth their nominal value when they are issued. So there could be a significant advantage to be had here, where you already know that some of your staff members are crucial, and likely to be loyal, before the business has even really started.

Even in this case, though, we would counsel against starting to pay substantial dividends on the shares at too early a stage.

Pension Protection

This year has already seen more changes to the 'simplified' pension regime introduced back in 2006, one of which has been a further reduction in the standard lifetime allowance (LTA) from £1.25m to £1m. The maximum pension commencement lump sum (PCLS) of anyone without protection is therefore £250,000 (25% of £1m).

However, as before, two forms of transitional protection are available to protect those who have built up substantial values of pension benefit.

Fixed protection 2016

Individuals with fixed protection 2016 will have a LTA of £1.25m, with a PCLS of up to 25% of the value of their benefits, subject to a maximum of £312,500 (25% of £1.25m).

In order to qualify, it is necessary to cease all contributions and accrual of new benefits (as before, inflationary increases to defined benefits are permitted) from 6th April 2016.

However, unlike the previous forms of fixed protection, it was not necessary to apply for it before that date.

Individual protection 2016

In order to apply for individual protection 2016, total pension benefits as at 5th April 2016 must be at least £1m. Their personal LTA will then be that of the value of their benefits at that date, subject to a maximum of £1.25m, with PCLS entitlement of up to 25% of the value of those 5th April benefits. However, individual protection allows a member to continue to accrue benefits or make contributions.

Although benefits accrued by or for the member will not cause the loss of individual protection 2016, it can be reduced or lost if a pension debit is applied to those benefits as part of a divorce settlement.

Eligibility for those with existing protection

For those who already have an existing form of protection, there are restrictions as to eligibility for the new types:

Existing protection	Fixed protection 2016	Individual protection 2016
Enhanced protection	No	Yes2
Primary protection	No	No
Fixed protection (2012)	No	Yes2
Fixed protection 2014	No	Yes2
Individual protection 2014	Yes1	No
Fixed protection 2016	—	Yes2
Individual protection 2016	Yes	—

1 Dormant until individual protection 2014 is lost.
2 Dormant until the existing form of protection is given up or lost.

Valuing benefits

There are four components of pension benefits which need to be calculated and totalled to determine the value of benefits at 5th April 2016, as follows:

1. Revalued (to 5th April 2016) value of pensions in payment before 5th April 2006

To allow for the notional value of any lump sum which may have been paid at the time, these are valued by multiplying the value of the pension in payment by 25, so a £1,000 pension in 2016 would be valued at £25,000.

Income from capped drawdown

arrangements is valued at 80% of the maximum income available, whatever level of income is actually being drawn. If the capped drawdown has since been converted to flexi access drawdown, the income is valued at 80% of the maximum permitted under capped drawdown in the pension year in which the conversion was made.

Where benefits have been crystallised since 6th April 2006, benefits in payment at that date are valued according to the deemed amount of the LTA used by them at the first crystallisation event after 6th April 2006 but revalued in line with subsequent changes in the LTA.

2. Benefits crystallised between 6th April 2006 and 5th April 2016, revalued to 5th April 2016

The revaluation is to take account of changes to the standard LTA over the period, so the formula is:

Amount crystallised × (£1.25m/LTA at previous crystallisation event)

For example, if £500,000 were crystallised in 2012/13, when the LTA was £1.5m, the revalued figure would be:
£500,000 × (£1.25m/£1.5m) = £416,667

3. Benefits uncrystallised in UK-registered pension schemes at 5th April 2016

Benefits in defined benefit schemes are valued by multiplying the accrued pension by 20, plus the value of any additional lump sum rights.

Benefits in defined contribution schemes are valued using the fund value as at 5th April.

4. Benefits uncrystallised in relieved non-UK-registered schemes as at 5th April 2016

Overseas pension scheme benefits are tested against the LTA if they include contributions that have benefitted from UK tax relief, making them 'relieved overseas pension schemes'. If this applies, special rules apply which allow the member to include the value of the benefits tested against the LTA for the purposes of IP 2016.

How to apply

HMRC intends to create a facility for online applications for either of the new forms of protection from July 2016, upon which successful applicants will receive a reference number that needs to be provided to the scheme administrator when taking benefits subject to the protection. Unlike for the earlier protections, no certificates will be issued. No deadline for applications has yet been notified.

Those wishing to draw benefits and rely on either of the 2016 protections before that date need to submit a pro forma letter to HMRC's Pension Schemes Services office. They will then be issued a temporary reference number to give to their scheme administrator. They will still need to register using the online system once it is available.

Examples

On 5th April 2016, Brian is 61 and has a SIPP worth £550,000 and a defined benefit scheme worth £650,000, so his total benefits are £1.2m. He applies for both fixed protection 2016 and individual protection 2016.

He retires at age 65 in 2020, when his total benefits are now worth £1.3m. He takes his defined benefit pension and the PCLS from the SIPP, leaving the balance of the fund to be drawn in the future. Assuming that the standard LTA increases as scheduled at, for example, 2.5% a year (CPI) from 2018 onwards, it would now be £1,050,625.

Scenario A

Brian's total benefits are worth £1.3m, so, after using his fixed protection 2016 of £1.25m, he has excess funds of £50,000, which he leaves in the SIPP to provide income after the 25% excess tax charge has been paid.

Without fixed protection 2016, his excess would have been £249,375 and the tax charge (if he took the excess benefit as income) £62,343.75.

Scenario B

Some of the investments in Brian's SIPP performed less well than he anticipated and, as a consequence, his total pension benefits are now worth only £1m. In order to compensate for this, just before he retires he uses his current year and unused annual allowances from the previous three years to add £160,000, using a combination of personal and employer contributions (he is not subject to the tapered annual allowance). Although this invalidates his fixed protection 2016, which he contacts HMRC to revoke, he can still fall back on his individual protection 2016 figure of £1.2m, and this allows him to access all his benefits without any excess tax charge.

Had he not elected for individual protection 2016, his contribution would have been limited to that which would bring him up to the prevailing LTA (assumed here to be £1,050,625), i.e. £50,625 before an excess charge applied.

Individual protection 2014

Although it was introduced in 2014, applications for this protection may still be made online up to 5th April 2017. An email acknowledgement of the application will be sent but the certificate will then take up to three months to be received.

Eligibility requires that total pension benefits at 5th April 2014 were at least £1.25m, but further contributions and accrual are permitted.

The protected value will be that of the

benefits on 5th April 2014, up to a maximum of £1.5m, with PCLS entitlement of 25% of the benefits' value, up to £375,000.

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A Silver Bullet

This magazine is all about saving tax. Tax is a serious business, of course, that can seriously damage your financial health. See, for example, this month's 'Business Column', where the perils and opportunities associated with inheritance tax in a business context are considered.

But tax planning isn't all just about long-term strategies, involving major assets and income flows. There are also a number of silver bullets that you can shoot at the tax system, and we thought we'd give one or two of these here.

Let's start off with VAT on car accessories.

Most people are aware that you can't claim the VAT back when you buy a car, even if you're involved in a business which is VAT-registered. VAT on car purchases is just one of those random prohibitions.

But the same blanket ban on VAT reclaim doesn't apply to accessories added to cars. The accessory has to be added after the car has been purchased: if it is fitted when the car is bought, even if the invoice itemises it separately, there's no joy.

HMRC adopts a rather stern and school-masterish approach to accessories, even ones fitted after purchase, though. It says, menacingly, "HMRC will consider whether the accessory or modification was carried out primarily for personal indulgence rather than for business purposes."

Where considering the practice of 'souping up' a car's engine, HMRC states, primly, "An increase in top speed or faster acceleration is unlikely to assist the operation of the business."

A big issue is personalised number plates. These are 'generally' viewed as being purchased for private reasons. However, there may be times, HMRC kindly concedes, where the 'business purpose' test may be passed. One possible such situation would be when the purpose of the number plate was actually to mask the age of the vehicle, where that is an important potential consideration for customers of the business who see the vehicle.

Silver Bullet II

An employer can provide a tax-free benefit for its employees in the form of a 'staff canteen'. What this means is that you have a favourable tax asymmetry, because the business which is paying for the free or subsidised meals in the canteen gets tax relief for this expenditure as part of its employment costs. But there's no corresponding tax charge on the employee who benefits.

Of course, as with any Revenue concession, this is hedged around with qualifications. The canteen can't, for example, simply be a restaurant open to the public. The subsidy etc. must be on similar terms for all employees, that is you can't favour the directors. However, what about a business where the only employees of the company are its directors?

Silver Bullet III

It looks as though the Chancellor has inadvertently given a helping hand to tax planning by way of transfer of assets to one's own company. Let's just go back a little, and give some history, to explain the context of this new change.

It was very popular, until last year, for sole trader or partnership businesses to be transferred to a company, and for the 'goodwill' of the business to be valued for that purpose.

This had the benefit of setting up a credit in favour of the individuals transferring the goodwill to the company, which they could then draw down on tax-free, while only paying 10% capital gains tax (CGT; because of entrepreneurs' relief) on the value of the goodwill transferred. What's more, the company could claim relief for the cost of the goodwill (providing the business started after 1st April 2002) by way of annual writedown or amortisation.

So, if you work it out, under these old arrangements the *only* tax actually paid on the business profits was the 10% CGT, because the amortisation was offset against the profits for tax purposes (even though, arguably, not a 'real' expense) and the amount could then be drawn out subject only to paying the CGT up front.

This was so good that the Revenue decided to bring it to a crashing end. So, last year, it effectively banned both entrepreneurs' relief and amortisation relief in the company, where the asset transferred in was goodwill.

But all other sorts of intangible assets do still qualify for amortisation relief. For example, patents, trademarks, computer software rights and any other assets that are in the nature of intellectual property can still be transferred tax advantageously to the company. Prior to 6th April 2016, this was not such an attractive idea as it has since become: because it is likely that a simple transfer of an asset like this to a company would incur the full, 28%, rate of CGT. Even if the company could claim amortisation against this, the idea of paying 28% up front (when taking the equivalent amount out as a dividend may only have incurred 25%) must have put an awful lot of people off.

What's happened now, however, is that, first, dividend tax has gone up by 7.5% (broadly) so that the higher-rate taxpayer now has to pay 32.5% on dividends rather than 25%. And, second, the top rate of CGT for assets like this has come down to 20%.

Let's take an example. An individual runs a computer company but owns the software rights personally. These are valued at £1 million. By selling the software rights to the company for £1 million, he incurs tax of £200,000, say, since the software rights have no base cost for CGT purposes. However, the company can then write off the £1 million by regular annual instalments against its corporation tax. So £1 million of profits, effectively, that the company receives can be passed out to the individual with no further tax. Result: post-tax funds in the individual's personal bank account at no more than an effective 20% tax rate.

The Business Column

As the inheritance tax case may be…

There's a good case to be made for the proposition that all tax is actually tax on business. VAT, which is meant to be a tax on the final consumer, in practice comes out of a business's profits. PAYE and National Insurance are imposts on the employer, because the employee won't work unless he has sufficient net pay after all these deductions. Perhaps only inheritance tax (IHT) is outside this rule.

Nevertheless, IHT can have a profound, even ruinous, effect on a healthy business if you don't plan for it correctly. Looking at the other side of the coin, there are some generous reliefs available for IHT in the context of business that make the whole area a fruitful field for tax planners.

But I don't want to stand here, so to speak, delivering a yawn-worthy lecture on IHT and business. I thought it would be more fun – and possibly a lot closer to home for some readers – to tell you a series of very short stories, based on real-life situations, where the villain IHT is routed – or conquers.

1. Duckworth Investments

The company we're looking at here started off carrying on a trade, of building and property development. That was when the owners, Mr and Mrs Duckworth, were young and energetic. Now, they've built up a substantial portfolio of properties, most of which they have developed themselves and retained, rather than sold, to provide a long-term rental income.

Mr and Mrs Duckworth were well advised in the latter stages of their career. Their accountant, seeing the way the emphasis of the business was shifting from active building and developing towards holding an investment portfolio, suggested that they make a gift of a reasonably substantial slug of shares to the younger generation, before it was too late.

So, a few years ago now, the Duckworths gave 24.5% of the shares to each of their two children, Adam and Emma. Because, at that point, the company was still very arguably a trading company, rather than an investment company, the parents were able to 'hold over' the – purely imaginary – capital gain that they would otherwise have been treated as making on the gift. Gifts and other disposals of things like shares, on other than arm's-length terms, are treated as if they were a sale for the market value of those assets. But, if there's actually no consideration, or the shares are transferred at an under value, the gift element can be held over so as not to give rise to tax at that point.

Having given away 49% of the company in this way, Mr and Mrs Duckworth retained the 51%, which, during their children's comparative youth, they thought it prudent to keep, in order to continue to be able to control the affairs of the company. Every parent, especially one who has built up a valuable asset by the sweat of his brow, feels cautious about simply handing over control to children who may turn out to be a disaster financially.

That, as I say, was some years ago now. The children are now grown up, married and have children of their own. The Duckworths senior are beginning to face the inevitable fact of their own mortality.

As always when one is thinking about IHT, there is a potentially agonising choice between financial security and keeping the wealth in the family.

Let me explain. Whereas, during the first part of one's life, the aim of many people is to make themselves financially secure, by, to put it baldly, becoming as rich as possible: when you consider the possible IHT bill on death, holding a large and valuable asset portfolio begins to look like not such a good idea. So thoughts of making gifts to the next generation, to reduce that IHT exposure, become more and more urgent as time goes on and the likely lifespan of the individual nears its end.

With the aid of their accountant, Mr and Mrs Duckworth consider their own IHT position. Their house is worth £1 million, and the shares in the company – well, what are they worth? The portfolio of properties owned by the company is worth £1 million, so does that, therefore, mean that the Duckworth's 51% is worth £510,000?

Well, perhaps surprisingly, the view of HMRC is likely to be 'yes'. They do actually adopt this fairly simplistic way of valuing property companies. Forget about the fact that you'd be unlikely, in practice, to find somebody willing to pay £510,000 for an interest in an asset portfolio which is held jointly with others (the children).

Be that as it may, unless you're spoiling for a fight, you've got to assume that this shareholding, on the death of Mr and Mrs Duckworth, will be giving rise to IHT of 40% of half a million, that is £200,000.

So why don't Mr and Mrs Duckworth simply give away the rest of their shares of the company? Well, it's a point: if they've managed to build up pensions for themselves which are enough for them to live on, there's no doubt that giving away some or all of the shares in the company would reduce this IHT bill, providing Mr and Mrs Duckworth live the necessary seven years after the gift.

But this is where that dreaded ally of IHT, capital gains tax (CGT), comes in. Duckworth Limited is a £100 company, as it's sometimes called. That is, the original cost of issuing the shares and getting the business going was only £100, and the value of those shares at 31st March 1982 (the base date for CGT) was not much more. So, if the Duckworths gave away all of their shares, say, they would be looking down the barrel of a £510,000, or thereabouts, capital 'gain'. Unlike the position with the earlier gifts, there is no holdover relief available now, because the company is an investment company, not a trading company.

Also, if truth be known, the Duckworths don't actually feel entirely secure without the income that they derive from their shareholding in the company.

So, as a rather neat compromise, they decide to give away another 1% each to Adam and Emma. The result is that they move from 51% of the company to 49%, and this is quite a dramatic change in valuation terms.

While the shares themselves, which are given away, could be valued for CGT purposes at no more than about £10,000 each – giving deemed capital gains within the Duckworths' CGT annual exemptions – the loss of value to their estate is much more dramatic.

Even HMRC's share valuation division will accept that a 49% holding in a company, especially where the other 51% is controlled by a unified family 'bloc', gives rise to a major loss of control, which means a big discount on the pro rata asset value.

If one supposes that this loss of control results in a, say, 25% discount (and higher discounts could plausibly be argued for), the remaining value of their shareholding is 49% × £1 million × 75% = £367,500. So, by giving away shares valued for CGT purposes at less than £20,000, they have reduced their estate liable to IHT by £142,500. And, what's more, they've hardly reduced the amount of dividends that they will continue to be able to receive from the company.

2. Giving the oldsters a helping hand

Tom and Jane have been pretty successful, like the Duckworths. They have a personal fortune, mostly in cash and very liquid funds, of £1 million. They also have all of the shares in Timson Trading Limited, which are also valued at £1 million.

Tom and Jane have one child, a son called Boris. He went into the family business straight from school, and has now reached the point, 20 years later, where he's ready to take over the reins from Tom, who wants to step back and enjoy life a bit more in the autumn of his years.

It seems obvious, then, that Tom and Jane should consider giving a reasonably substantial shareholding, or even all of the shares in Timson Trading Limited, to Boris, so that he can take over the torch and bear it aloft for future generations of the family.

It makes financial sense for the old couple, too. What with the amounts they've managed to stash away in pensions (before the Government mounted its full-scale artillery attack), and the income from their liquid investments, they have quite enough to support their not particularly lavish lifestyle. Their nice £1 million house is free of mortgage, which they paid off years ago. Fortunately, it's a low-maintenance property, and they really don't need the income from the shares in the company.

Then Boris gets talking to a tax adviser in the pub. The tax adviser is also a friend, and Boris can't resist sharing the news that he is about to become the proud owner of a comparatively large, and very profitable, trading company.

The adviser looks thoughtful. "Are you sure that's the best idea?" he asks.

So, after a lot of further discussion, and several pints, they come up with the following alternative.

Instead of giving the shares in Timson Trading Limited to Boris, Tom and Jane give their liquid funds instead (or all but a small 'buffer' amount). The income that they were looking to receive from these funds is instead effectively 'guaranteed' to them, by Boris agreeing to work in the company and continue to generate the profits, which will then be paid out to the old couple as dividends.

In reality, of course, it is likely, in situations such as this, that the return on value will be much greater from a close trading company than from bank deposits and the like.

But have you spotted the big difference from the IHT point of view? Tom and Jane's estate, as worked out for tax purposes, is now down to £1 million – the value of their home. This is because their other major asset, which also provides them with essential retirement income, is a shareholding in an unquoted trading company, which is available for 100% business property relief (BPR).

By contrast, if they'd kept the cash and given away the shares, they would have ended up with a taxable estate valued at £2 million, and would have paid £400,000 more IHT on their ultimate demise (assuming values remain constant).

In fact, you can carry this principle even further. Let's vary the facts in Tom and Jane's case a little, and imagine that Boris already had a shareholding in the company. In this situation, he could have sold his shareholding back to his parents, and hence increased their relievable estate at the expense of their non-relievable cash holdings.

And, as another major advantage of keeping the trading assets in the older generation's ownership, consider what happens with regard to CGT. On the death of the older generation, the shares will be passed down to the beneficiaries of their wills at probate value. This effectively washes out any gain in value that has arisen during their lifetimes. In a hypothetical sale of the company shortly after Tom and Jane's death, the CGT could be precisely nil.

3. The mixture is too rich

Party Mix Limited has been a successful trading company for many years. Gordon, who owns all of the shares, has no children of his own and is planning to leave the shares to his nephew, who isn't involved in the business.

Gordon is pretty canny as far as tax matters are concerned. He thinks it so imprudent as to be positively immoral to pay a penny more in tax than he needs to.

So the company, which has been turning in profits for year after year, has retained these profits in its own coffers, rather than paying them out to Gordon as a dividend. The income tax implications of paying dividends are something that Gordon is very conscious of.

But what to do with the money, within the company?

Well, Gordon is a great believer in property as an investment, and gradually, over the years, surplus profits have been invested in rental properties.

Going through his most recent year-end accounts with his accountant, the two of them note that the rental income from the company's property portfolio is £150,000 per annum, with very little in the way of expenses to offset. The net profit from the trade, on the other hand, is £200,000.

"What do you think the company's worth?" asks Gordon.

The accountant thinks a bit, and puts numbers into his calculator.

"Well, I reckon your property portfolio, being commercial, is probably worth somewhere in the £1 million region. The goodwill of the trade, which is the main other asset in the company, probably weighs in at a similar figure. So overall I'd say you're worth about £2 million here."

"So how much IHT would I have to pay on these shares if I died?"

This question gives both of them pause. Always, up to now, the accountant has assumed that there's no IHT problem, at least as far as the shares in Party Mix Limited are concerned. Companies are eligible for 100% BPR, aren't they?

Well, in this case, perhaps not. The availability of BPR depends, amongst other things, on the business of the company not being 'wholly or mainly' that of making your holding investments. HMRC interprets the phrase 'wholly or mainly', very helpfully, as meaning 'more than 50%'.

So has the company become wholly or mainly an investment one?

It's a moot point. The value of the assets, on a very back-of-an-envelope basis, is roughly equal between the trading asset (goodwill) and the investment portfolio. Probably, in this case, the company would just about scrape home as a trading company for IHT purposes, because the income from the trade is greater than the income from the investments.

But the danger is acute. If the process of making profits and reinvesting them goes on for only a very short time longer, the company will tip over the balance into investment status.

It's an 'all or nothing' situation. Once the investment element has become predominant even by a hair's breadth, you move from 100% tax relief to 0% tax relief – and an increased potential liability for Gordon's nephew of £800,000 suddenly appears out of nowhere.

The answer, painful though it is, is probably to extract more of the profits each year as dividends, so as to avoid the build-up of investment business within the company. Alternatively, keep surplus profits in the form of cash, which may not have the same tainting effect, or even consider interest-free loans to another company, which would arguably not be an investment, because it doesn't give rise to any income.

Finally, consider carefully making a gift of the shares in the company, say into a trust for the nearest and dearest, before it is too late. True, this trust will then be subject to IHT every 10 years if the company does cross over the borderline into investment status: but this is comparatively manageable in contrast to a sudden huge IHT bill.

4. The mixture isn't rich enough

The case of Stephen illustrates the converse to Gordon's problem. Stephen and his brother, who is much younger than him, are partners together in a farming partnership. So no worries about IHT there, because farming is a business, eligible for BPR, and you've also got agricultural property relief (APR) as belt and braces to make extra sure there will be no IHT.

That's all very well, of course, but the interest in the farm isn't Stephen's only asset. He also has quite a few let properties in a separate portfolio. Together, their value is probably £1 million, which is, by coincidence, also the value of Stephen's interest in the farm. When you add the value of the let property portfolio to the value of Stephen's house (which unfortunately doesn't qualify as a 'farmhouse' with consequent APR), there's the possibility of a reasonably chunky IHT bill when Stephen dies.

So what Stephen does, on his accountant's advice, is introduce the let properties into the partnership with his brother. The whole thing is done formally, with the paperwork making it absolutely clear that the let properties are partnership property from now on.

By careful rearrangement of the profit-sharing terms between Stephen and his brother, it is ensured that there is no CGT disposal on the introduction of the properties into the partnership.

What you end up with, looking at the partnership balance sheet, is therefore farmland and buildings worth, say, £2 million, and let properties worth £1 million. These are now held in common between Stephen and his brother, because they are both within the partnership.

But the partnership, looked at as a whole, while it is a 'business', is not wholly or mainly a business of making your holding investments. Farming, in fact, predominates quite comfortably, and therefore Stephen's capital interest in the partnership, which he has just enhanced significantly by putting in the let properties, should qualify in its entirety for BPR. Just like that.

5. A cautionary tale

So far all of these little stories have had a happy ending (although rather modified in Gordon's case). Now, in the spirit of the great Russian novelists, I am turning to a darker subject, where a family ends in ruin and grief. Mr and Mrs Pondersbury have long ago given away most of the shares in their family company to the children. Mr Pondersbury, though, does still put on a suit from time to time and go and sit in his huge and luxurious office, which remains empty for the rest of the time, when he isn't there.

Mr P was a great believer in gradually withdrawing and retiring from a business, rather than moving suddenly from 5 days a week to no days a week. So he spent some years working a partial week, 3 days, then 2 days, then 1 day. His £100,000 annual salary was scaled down, out of a regard to fairness for the younger generation, so that, by the time he reached the 1 day a week mark, he was receiving no more than £20,000.

Then Mr Pondersbury falls ill, a natural consequence of his advanced age. His son, Bertram, doesn't have the heart to cancel the salary, though, especially not now, at his father's hour of need.

So, for a period which turns out to be of some years, this fairly nominal salary (by this company's standard) continues to be credited month in month out to Mr and Mrs Pondersbury's joint account, and PAYE returns, forms P60 etc., duly completed.

Eventually, Mr P's illness proves fatal, and his remaining shareholding in the company passes over to his widow in his will. No one is expecting any IHT bill, of course, because a bequest to one's surviving spouse is exempt from IHT.

Somehow, though, an officious HMRC inspector becomes aware of the history of the case: how the majority of the shares in the company were given away many years ago.

Why was this a problem? Because, in the event, Mr Pondersbury had inadvertently 'reserved a benefit' in the shares. The inspector of taxes argues, unfortunately convincingly, that continuing to receive remuneration from the company when you actually weren't doing any work for it brought these 'gifts with reservation of benefit' rules into operation.

What the rules are designed to prevent, of course, is planning which involves giving away an asset but continuing to enjoy its use as if you hadn't given it away. But a particularly dangerous situation is the one where the older generation continues to receive an income from the business after it has been given away.

HMRC has stated explicitly, in correspondence, that you haven't got a problem with this sort of arrangement if the amount paid to the individual is a fair market return for their actual services to the business. But it's so easy to stray over the dividing line, and, as with BPR, the gifts with reservation of benefit rules are an 'all or nothing' measure. If you reserve a benefit, even a small one, in the assets you've given away, you're treated for IHT purposes as if you'd never given them away at all. Be warned!

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Ask the Experts

Q. Parents want to gift the whole of their home, continue to live in the lower ground rent-free, with the children renting the upstairs to unconnected persons (full rent). Even though there will be no giving away two separate leases and freehold reversion, there will be separate entrance to the upstairs and the parents will have no access and I cannot see any benefit deriving to them from the upstairs. I can see that the lower ground is GWR and it will be part of the estate on death. But, do you see any flaws with the upper ground falling out of the estate after 7 years? IHTM 14334 example 2 seems to be about the same facts. Many thanks.

D. S. via email

A. We would agree with you that there does not appear to be a reservation of benefit in the upper floor and that the situation appears analogous to that in example 2 in IHTM 14334.

Q. My son has started an Internet-based business that has surprised us all with its popularity, so much so that he has to VAT register in a hurry. With little experience in this area I am unsure how to treat Royal Mail zero-rated postage. For example, on a £100+ sale the website charges £5 on top for postage, but it may actually cost slightly more (£6.45) or less (£2.85) to send depending on size and weight of all the items.

Does he allow the actual cost of the postage or the £5 they have paid as the zero amount? If it is the actual cost of postage, I assume the price of the items will have to be accounted for slightly higher or lower accordingly.

J. W., via email

A. Postage is only exempt when supplied by the Post Office: your son must add VAT to his postage charges. So if the price paid by the customer is £105 including postage then your son has to account for VAT equal to 105 × 1/6 = £17.5.

Your son then pays postage, which is exempt from VAT.

So effectively your son is in exactly the same position as if he sold the goods for £105 and stated that postage was free.

Q. Will you kindly confirm that a Trinity Pension Scheme set up in the Isle of Man four years ago while being a non-resident is not classed as an asset, then subject to the personal wealth and liable for IHT because the person was a full resident of UK at the time of death?

C. L., via email

A. We are unable to comment specifically on the 'trinity' pension scheme. If you have a product-specific query we would recommend you refer to the promoters of the product.

What we can advise is that pension funds generally are not liable to IHT if one dies leaving undrawn funds to one's beneficiaries.

If death occurs before age 75, the funds are tax-free in the hands of the beneficiaries. If death occurs after age 75, the beneficiary is liable to income at their marginal tax rate on money withdrawn from the pension fund.

The Offshore Column

The Panama Papers

The biggest international tax story of recent years broke just as we went to press last month. Thanks to the efforts of hackers, some 11.5m documents belonging to the Panamanian law firm Mossack Fonseca were obtained by the German newspaper *Süddeutsche Zeitung* and shared with the International Consortium of Investigative Journalists (ICIJ). The ICIJ then worked with journalists from 107 media organisations in 76 countries, including UK newspaper *The Guardian*, to analyse the documents over a year. The documents show how Mossack Fonseca's clients were able to launder money, avoid sanctions and evade tax.

Although the law firm's main business is that of establishing offshore structures, it offered other services that allowed beneficial owners of companies and beneficiaries/settlors of trusts to remain anonymous. Its clients were often well-known international personalities, including 12 current or former heads of state and government (including dictators accused of looting their own countries). More than 60 relatives and associates of heads of state and other politicians have also been implicated. The files reveal a suspected billion-dollar money-laundering ring involving close associates of Russia's president, Vladimir Putin. Also mentioned are the brother-in-law of China's President Xi Jinping, Ukraine's President Petro Poroshenko, Argentina's President Mauricio Macri, the late father of the UK's Prime Minister David Cameron and three of the four children of Pakistan's Prime Minister Nawaz Sharif. The documents show that Iceland's Prime Minister, Sigmundur Gunnlaugsson, had an undeclared interest linked to his wife's wealth. He has now resigned.

There can be little doubt that in due course HMRC will receive full access to the 11.5m documents or, at a minimum, to those of interest to the UK tax authorities. A multi-agency task force has been announced and the Financial Conduct Authority has already contacted 20 firms with ties to Mossack Fonseca requiring them to carry out investigations and report back. There is now even greater pressure on politicians in Britain to be taking action to oppose offshore entities being used to avoid tax and launder money. This is embarrassing for the UK Government. The fact is many of the world's best-known (and best-regulated) offshore financial centres are British dependencies or overseas territories. The UK has long connived at or actively supported their activities as offshore financial centres, both to provide a source of revenue and to funnel business back to the City of London.

What information will HMRC end up receiving? Almost certainly the names and addresses of UK-resident beneficial owners or part-owners of offshore companies, UK-resident settlors of foreign trusts and UK-resident beneficiaries of foreign trusts and other offshore structures. Additionally, it looks as if they may receive all sorts of subsidiary information, such as details of offshore assets and bank accounts.

What HMRC will do with the data it obtains will to a large extent depend on the taxpayer's compliance history. Unfortunately, HMRC is likely to put the worst possible interpretation on any data it receives. In other words, even if there are innocent and legal explanations the existence of any sort of offshore structure may be considered suspicious regardless of its purpose or use.

The news is not all bad, however. It has to be remembered that in the past HMRC has not had that much success attempting to raise money and/or prosecute taxpayers with offshore connections. When the so-called Lagarde List, containing details of HSBC's Swiss private bank clients, was obtained almost no prosecutions followed and a mere £135m of additional revenue was raised. Of almost 9,000 UK tax residents whose details were shared with HMRC in 2010, only one has been convicted of tax evasion. It is also questionable whether leaked information will stand up in court. Even where tax fraud is suspected, HMRC can only pursue taxpayers for unpaid tax going back up to 20 years.

From 2017, HMRC will start to be sent details of UK taxpayers' assets, bank accounts, companies and trusts from more than 90 jurisdictions, including the likes of the Channel Islands, British Overseas Territories and Switzerland. In anticipation of this and given the availability of disclosure facilities, amnesties and other opportunities to regularize tax affairs, many of those mentioned in the Panama Papers may no longer have anything to fear. That said, if you have previously been the subject of a COP9 inquiry and not disclosed a Panama interest you should expect a fraud investigation (civil or criminal). The same is true if you used voluntary disclosure facilities such as the Liechtenstein Disclosure Facility (LDF) but failed to disclose all offshore assets.

One small advantage taxpayers have is that all of the information obtained by HMRC will be in the public domain. Taxpayers and their advisers will, at least, know what data the authorities have.

The man or woman who hacked into the Mossack Fonseca computer and downloaded the 11.5 million documents released a statement at the beginning of this month. Tellingly, a large part of the statement was to do not with the data he had stolen but with what happens to those who steal it:

I have watched as one after another, whistleblowers and activists in the United States and Europe have had their lives destroyed by the circumstances they find themselves in after shining a light on obvious wrongdoing. Edward Snowden is stranded in Moscow, exiled due to the Obama administration's decision to prosecute him under the Espionage Act. For his revelations about the NSA, he deserves a hero's welcome and a substantial prize, not banishment. Bradley Birkenfeld was awarded millions for his information concerning Swiss bank UBS—and was still given a prison sentence by the Justice Department. Antoine Deltour is presently on trial for providing journalists with information about how Luxembourg granted secret 'sweetheart' tax deals to multi-national corporations, effectively stealing billions in tax revenues from its neighbour countries. And there are plenty more examples.

The 1800-word statement (entitled *The Revolution Will Be Digitized*) gives justification for the leak, saying that "income inequality is one of the defining issues of our time" and claims that government authorities need to do more to address it. It also hints at more revelations to come…

A 10-year tax holiday and no IHT

Aliyah (from the Hebrew meaning 'ascent') is the immigration of Jews from the diaspora to the Land of Israel. Also defined as 'the act of going up' – that is towards Jerusalem – 'making Aliyah' by moving to the Land of

Israel is one of the most basic tenets of Zionism. The State of Israel's Law of Return gives Jews and their descendants automatic rights regarding residency and Israeli citizenship. For much of history most Jews have lived in the diaspora, where Aliyah was developed as a national aspiration for the Jewish people, although it was not usually fulfilled until the development of the Zionist movement in the late 19th century. Ever since 1970, the right of entry and settlement was extended to people with one Jewish grandparent or people married to a Jew, although they were not considered Jewish under Jewish law. Under certain circumstances, converts to Judaism may also manage to take advantage of Aliyah.

All very interesting, you may be saying, but what could this possibly have to do with tax? The answer is that if you take advantage of Aliyah there are some potential tax advantages, being:

- You will be able to claim a new domicile. This could be useful if you are living in a country where non-domiciled people are treated differently for tax purposes (say Ireland or Malta if you are British and the UK if you are from anywhere else in the world except Ireland).
- You will be able to take advantage of a 10-year tax holiday on all non-Israeli income: "new immigrants are entitled to tax breaks on passive and active income earned overseas for 10 years after immigrating."
- There is no inheritance tax in Israel (as of date) and so there obviously exists the opportunity to reduce or completely avoid IHT if you come from a country, such as the UK, that taxes its deceased citizens regardless of where they are resident.

The 10-year tax holiday sounds especially attractive, of course, since Israeli higher-rate income tax is charged at 52%. However, there are two potential catches. The first is that Israelis are taxed on their worldwide income. New citizens must declare all their overseas assets even if they don't have to pay tax on them. Second, if you manage an overseas business from Israel (for example by using the phone and email to instruct other managers or even to make trades) then the management of the business is considered, by the Israeli tax authorities, to be in Israel and, therefore, subject to Israeli tax. The Israeli tax authorities, incidentally, have been granted powers that other tax authorities around the world can only aspire to. For example, they demand a monthly tax and VAT return.

Is it possible to take advantage of Aliyah and still run a business from Israel? In principle, no. In practice, depending on the business, the answer is probably that many people do it using pay-as-you-go mobile phones and different computers. Providing you can show the Israeli tax authorities how you are supporting yourself, they may be disinclined to take any further interest in you. But you will be walking the very thin line between avoidance and evasion.

What about keeping assets outside your tax net in anticipation of the end of the 10-year tax holiday? In general, discretionary trusts and other similar vehicles are out, as the Israelis look straight through these. However, it may be possible to set up an offshore vehicle where the number of individual shareholders/beneficiaries is such as to ensure that it has almost no value.

Finally, there have been cases where new Israeli citizens have gone non-resident the moment they arrive. In other words, for the first 10 years they completely escape the Israeli tax net. This may, or may not, be effective depending on how well they plan during the 10 years.

For a very tiny number of people, Israel's Aliyah offers interesting tax-saving possibilities, but it needs to be approached with caution and expert advice should be sought.

PERSONAL FINANCE

News

Less of a premium

Premium bonds have, traditionally, offered more or less the same return as an ordinary deposit account with the double benefit of zero tax on winnings and the chance of scooping one of the higher-value prizes. However, National Savings and Investment has announced that from June it is lengthening the odds of winning a prize from 26,000/1 to 30,000/1. This means an effective return of 1.25%. The monthly draw will retain its two £1m jackpot prizes, but the overall prize fund will be cut. Premium bonds are one of the UK's most popular savings products with 21 million Britons holding them. The maximum any individual can hold is £50,000. It should also be noted that at the time of going to press there are a number of current accounts paying between 3 and 5% (Nationwide, TSB and Tesco Bank). Whereas if you held £1,000 of premium bonds for five years you would expect to win no more than £60 in prizes.

Any oil profits?

J. Paul Getty famously said that his formula for success was to: "Rise early, work hard and strike oil." Over the last couple of years, we have seen oil prices fall and fall until they settled in the $30–$40 range. Now, some experts are predicting that prices are going to start rising again. Indeed, in the last few weeks oil has been hovering in the mid-$40 range. The Financial Times has suggested that the one-year average for 2016 will be around $51 a barrel. So, given that the world's economy is still in such trouble, why would oil prices be on the turn? The answer partly lies with the issue of oil storage. In the developed world oil supplies were allowed to run down over the winter, meaning no spring sell off. So, although there isn't a shortage, there isn't a glut, either. How should you invest? You could, of course, buy directly into an oil company (perhaps one with little or no gearing such as Royal Dutch Shell or the Wood Group). Alternatively, you could consider a resource-rich company in North America (such as Antero Resources or Pioneer Natural Resources). Finally there are, of course, plenty of funds and ETF options.

P2P lending opportunities

I have written on several occasions about the fast-growing world of alternative finance and, in particular, of peer-to-peer lending. Since the beginning of 2015, a number of funds have been launched on the London Stock Exchange designed to offer income from a diversified pool of consumer and small-business loans. The largest of these funds now appears to be trading at a discount of between 7 and 9%. Given that a fund like VPC is offering a yield of 8.9% a year, you may like to consider looking at this sector.

Opportunity: Classic Gains From Classic Cars

In 1996, you could have purchased an Aston Martin DB4 GT Zagato, of which only 19 were made, for £500,000. To put this into perspective, the same sort of money would have bought you a decent-sized flat or a small house in Chelsea. Two decades later, your Chelsea property would have been worth around £2.5m. Meanwhile, the FTSE 100 Index would have turned your £500,000 into £1.5m.

What of the Aston Martin Zagato? It would be worth more than £10 million! This equates to a twenty-fold (i.e. 2,000%) increase. Moreover, you wouldn't have to pay any tax on the profit as classic cars are exempt from UK capital gains tax (CGT).

Scarcity is, of course, one of the reasons why classic cars have proved to be such valuable investments. However, emotion also comes into it. As Matthieu Lamoure, the managing director of the Artcurial Motorcars Auction House recently said: "The market is a question of generation. You want to own the car that was a dream for you when you were a child." Obviously, if a car has appeared in a famous film (for example the Aston DB5 has long been associated with James Bond) this will help to boost its value. But even less famous classic cars can prove to be good investments. Suppose you had bought a VW Mark I Golf GTI from the 1980s a decade ago? You probably would have paid in the region of £1,500. The model has since become something of a cult car. Nowadays, one in good condition will trade for upwards of £15,000.

What of the future? The Historic Automobile Group International (HAGI) compiles an index of classic cars from the mid- to top end. It shows that, compared to other asset classes such as the stock market and London property, high-quality classic cars continue to perform incredibly well. Indeed, the last time the index in any way fell was nearly 30 years ago when speculators with borrowed money pushed up prices and then, when interest rates rose, brought about a collapse.

If you are tempted to buy, as with all alternative assets, it is important to focus on the very best that you can afford. In the case of cars this means those with full-service histories in exceptional condition that have either been completely restored or, at a bare minimum, have been well maintained with some age-related patina. Remember, too, that having acquired your car you will need to spend money maintaining and storing it.

What else do you need to know? There is a sense that at this particular juncture the auction houses may be slightly overambitious in their pricing policy. Incidentally, if you are tempted I recommend checking out a company called Bicester Heritage in Oxfordshire. It offers classic car storage maintenance and restoration.

The tax situation could not be better when it comes to classic cars. In the last Budget they were permanently exempted from UK road tax and are not (if bought from an EU country) subject to UK import duties or import VAT. Moreover, as I said at the beginning of this article, classic cars are free of UK CGT, a significant advantage for those owners now sitting on substantial gains.

Classic Car Investment Tips

Here are the key things to consider when making a classic car investment:

- The manufacturer: A Morris or an Austin – no matter how good – will never have the same allure to buyers as a Ferrari or a Bugatti.
- The model: A mass-produced, family car will never be worth as much as something with rarity value. Even low-production cars – such as Bentleys – will vary wildly in value. A 1980s saloon can be had for €15,000 but a 1920s racer might cost you over a million euros.
- Cultural zeitgeist: The cultural status of a car can have a major effect on its value. If the car wasn't highly desirable when it was launched it is unlikely to ever become highly desirable.
- Provenance: A car with a history – for instance, a car that has won an important race or been owned by someone famous – will always be more collectible.
- Condition: The more original and better the condition, the more likely it will appreciate.
- The price: Up to around £100,000 the market is dominated by enthusiasts

rather than collectors. That is not to say with a bit of careful research you won't be able to identify an undiscovered classic, but in some respects the more you invest, the lower the risk.

There are plenty of dealers, publications and auctioneers willing to provide help. Nor should you ignore the plethora of specialist clubs, which are an invaluable source of information.

PROPERTY

The FHL Tax Advantage

Traditionally, furnished holiday lettings (FHLs) were something of a niche investment. Typically, the sector consisted of flats and houses in popular seaside locations and major tourist destinations. Most offered pretty basic accommodation. Unless actively managed, moreover, the annual yields tended to be on the low side. Indeed, for many investors FHLs were a source of pin money and/or a way of defraying costs on a property that they did not wish to sell.

From a tax perspective FHLs offer various advantages:

- Investors can claim capital gains tax (CGT) reliefs (business asset rollover relief, entrepreneurs' relief, relief for gifts of business assets and relief for loans to traders).
- Investors are entitled to plant and machinery capital allowances for items such as furniture, equipment and fixtures.
- The profits count as earnings for pension purposes.

Depending on how the property has been managed and the services offered, it may also be possible to have the FHL qualify for business property relief (BPR). The key thing in this regard is to ensure that the business of the FHLs is not an investment but a trade. Where an owner provides a wide range of services more akin to a guesthouse or hotel, BPR/inheritance tax relief is much more likely to be granted. Obviously, the supply of such services will add to the owner's costs but these expenses can be passed on to the tenant. By providing clean linen and towels, housekeeping services, food or meals, concierge services and so forth – in short, being actively involved – it should certainly be possible to have your FHLs qualify for BPR/IHT relief. This will, in practical terms, mean you can:

- sell your business and potentially pay just 10% CGT
- pass your business on to a beneficiary with 50% or even 100% tax relief.

The rules regarding what does and doesn't qualify as an FHL are complicated. Your property must be in the UK or the European Economic Area (EEA) – the EEA includes Iceland, Liechtenstein and Norway. Moreover, it must be 'furnished', by which the rules mean there must be sufficient furniture provided for normal occupation and your visitors must be entitled to use the furniture. All your FHLs in the UK will be taxed as a single UK FHL business and all FHLs in other EEA states will be taxed as a single EEA FHL business. You will need to keep separate records for each FHL business because the losses from one FHL business cannot be used against the profits of the other.

Accommodation can only qualify as an FHL if it passes three occupancy conditions. The first of these is the 'pattern of occupation' condition. If the total of all lettings that exceed 31 continuous days is more than 155 days during the year, this condition is not met so your property will not be an FHL for that year.

The second condition refers to availability. Your property must be available for letting as furnished holiday accommodation letting for at least 210 days in the year. You cannot count any days when you are staying in the property yourself.

Third, there is the letting condition. You must let the property commercially as furnished holiday accommodation to the public for at least 105 days in the year. Do not count any days when you let the property to friends or relatives at zero or reduced rates as this is not a commercial let. Do not count longer-term lets of more than 31 days, unless the 31 days is exceeded because something unforeseen happens.

Incidentally, if you don't let your property for at least 105 days, you have two options (known as elections) that can help you reach the occupancy threshold. Basically, if you have more than one property you can average out over the period. Or, if your property reaches the occupancy threshold in some years but not in others, you can make a period of grace election.

At the beginning of this short article, I pointed out that up until relatively recently FHLs tended to be rather downmarket. They were the sort of places that holidaymakers went when they couldn't afford to stay in a hotel and didn't fancy a guest house. But, in the last few years the rise of Airbnb and other similar online services means that FHL businesses can now be extremely upmarket.

The *Financial Times* recently pointed out that holiday rental websites have seen a big rise in the number of superrich letting out their plush pads. This new sector of the market is referred to as 'prime home share'. To give you a feel for the way this market is changing, in June last year the number of one-bed listings charging more than £1,000 per night was nearly three times what it had been in 2014. During the same 12-month period, London listings grew by half and those in Paris by a third. There are many other premium home rental sites, such as Luxury Retreats, One Fine Stay and Villas.com. Online home rental sites typically feature interactive calendars allowing owners to switch availability on or off at a moment's notice, dodging the advance commitment typically required by property rental firms. As importantly, messaging apps and sophisticated review systems provide homeowners with the information they need to vet potential guests.

Back to tax. When the current Government began to attack the buy-to-let sector by only allowing interest relief at the basic level of tax, many investors started to look for other options. If you are happy to be an active rather than a passive investor then FHLs provide an excellent, tax-efficient return on your money.

Incorporation Relief

If you hold investment property in your own name, you may be considering transferring it into a limited company. There are various tax advantages to doing this, such as the ability to claim interest relief, potential VAT advantages and the fact that retained profits will be taxed at a lower level. There is, however, a downside. The transfer of properties into a corporate structure can potentially lead to significant tax costs. In particular, if you are a higher-rate taxpayer, you could be hit with a 28% tax bill on the difference between what you paid for the property and its value at the point of transfer. The good news, however, is that it may be possible to claim incorporation relief. If you can do this then you will enjoy a tax-free uplift in the base cost of all your properties to current market value. Once your properties are within the corporate structure, they can generally be sold with a corporation tax exposure of just 18% increase in their value above the rate of inflation.

HMRC allows incorporation relief whenever any business is transferred to a company structure in exchange for shares. There are, however, exceptions. In particular, the business must trade in some way and not just hold assets. In particular, property-holding companies are specifically excluded. Happily, a recent court case – *Elizabeth Moyne Ramsey* versus *Revenue and Customs Commissioners* – has set a precedent that will make some property businesses eligible for incorporation relief.

Mrs Ramsey won her claim that she should be entitled to incorporation relief as a result of a number of factors, including:

- Business consisted of ten, self-contained flats. In other words, it was more than just one property.
- The block of flats included extensive communal areas as well as a garden, a car park and some garages.
- Mrs Ramsey carried out substantial repairs and maintenance work to the common parts and facilities. Moreover, she did it personally.
- She had one elderly tenant to whom she provided additional assistance.
- Neither Mrs Ramsey nor her husband had any other occupation during the relevant period.
- The fact that improvements had been made to increase the profits.

The judge ruled that: "The activity undertaken in respect of the property, again taken overall, was sufficient in nature and extent to amount to a business for the purposes of incorporation relief. Although each of the activities could equally well have been undertaken by someone who was a mere property investor, where the degree of activity outweighs what might normally be expected to be carried out by a mere passive investor, even a diligent and conscientious one, that will in my judgement amount to a business."

The net result of all of this is that anyone who can demonstrate that their business activities are equal in scope to Mrs Ramsey's (or greater) should now be in a position to claim this valuable relief. Here are some of the things you need to do, if you, too, would like to benefit from this valuable relief:

- Try to make sure your properties contain communal areas.
- Carry out repairs and maintenance personally.
- Try to ensure that running the property business is your only occupation.
- Actively look at ways to improve the capital value or rental yield of your property.
- Provide extra services.

One thing to watch out for, incidentally, is that as a limited company you may be expected to pay a higher rate of interest on your borrowing. You need to consider this prior to making any irrevocable decision.

Incidentally, there are other ways to use companies to save your property business tax. For example, you could set up a limited company and lease all your properties to it. Why? It will reduce your personal tax bill to nothing and will put all the profit into the company, which will be taxed at a lower level.

Another way of reducing your taxable profits is by paying management fees to a limited company that you could also own. Providing the management fees can be justified, this is an excellent way to reduce and/or postpone your tax bill.

Opportunity: Communal Living Spaces

Communal or co-living, whereby tenants accept smaller living/sleeping areas in exchange for much larger communal spaces and an emphasis on social interaction, is, possibly, the fastest-growing area of property investment. The reason why it is expanding so quickly is that it offers a solution to the shortage of affordable housing for young people in the world's major cities. Another benefit is that it removes the isolation that many people experience when they move to large conurbations. Plus, younger people are now much more mobile and they appreciate shorter rental contracts, serviced spaces and lower levels of financial commitment.

The first developer in the UK to appreciate the potential offered by co-living was a company called The Collective (www.thecollective.co.uk). It has recently created a purpose-built co-living space in Old Oak Common, north-west London. It is just next to a Bakerloo line Tube station and just 25 minutes from Oxford Circus. The typical rent for a one-person apartment is £1,000 a month. I say 'apartments' but really they are little more than bedsits. Why are people rushing to live there? Because of the shared spaces. Each floor contains a themed relaxation area catering to a range of moods and entertainment needs, from library, spa and private cinema to a Japanese tearoom. There is also something called a 'disco launderette', whose washing machines and tumble dryers will share the space with two disco balls, a sound system and a dance area. There is also a gym, restaurant and bar as well as a co-working space with up to 350 desks, available for non-residents to rent. Communal kitchens on every floor offer impressive dining spaces. The Collective promises that there will be lots of planned and impromptu events.

The monthly rent, by the way, includes all bills, electricity, cleaning, use of the gym, council tax and even Wi-Fi. Indeed, apart from food, everything is covered.

The UK is not the only place to embrace communal living. WeWork, the sixth-fastest-growing business in the world, and now worth a staggering $16 billion, is launching communal living like this in New York. In Hong Kong, Peter Pfister, a Swiss hotelier, runs the Camper's Hong Kong development, where he has just converted 48 one-bedroom apartments into 48 four-bedroom dormitories containing individual pods housing a desk and a wardrobe under an elevated bunkbed. All around the world other developers are launching similar spaces.

Finally, a thought. I believe that very similar projects could be managed on a much smaller scale and not just for young people. There is no reason why communal living for the middle aged shouldn't be popular.

Do You Have The Energy?

Another reminder (because it is so important) that since 1st April this year tenants of domestic private rented property can ask their landlord to give consent to their making prescribed energy-efficient improvements to the property. From 1st April 2018, a landlord will be unable to grant a new tenancy of such a property if its energy performance is below band E. And from 1st April 2020, the landlord will be unable to continue to do so if the property fails to meet the threshold. Non-domestic property will be subject to similar limitations from 2018 and 2023 respectively.

Perhaps the key point to make is that from 1st April 2018 it will be unlawful for landlords to grant a new lease on properties that have an Energy Performance Certificate (EPC) rating below E. Moreover, other regulations introduced in 2014 mean that properties currently rated as E could be downgraded to F.

Since roughly one in five non-domestic properties has been found to have an EPC of either an F or G rating, it is clear that a great deal of work is going to have to be done by both residential and commercial landlords. The sort of thing I am talking about include insulating buildings, replacing light bulbs or light units, secondary glazing and the upgrading of heating controls. Some expenditure will be chargeable to profit and loss. Unfortunately, any capitalised expenditure on repairs and maintenance cannot generally be relieved against the investment income for the period in which it is incurred. Nor will you usually be able to benefit from tax relief on deferred revenue expenditure.

Obviously, many landlords will want to ensure that any improvements they make are not classified as capital. HMRC's guidance in the *Business Income Manual* states: "The position is that the work is a repair and not an improvement if, after the work is carried out, the asset can just do the same job as before; and the work is an improvement and disallowable as capital if, as a result of the work, more can be done with the asset or the asset can be used to do something that it could not do before."

It is worth remembering that technology is not, automatically, an improvement but may be considered a repair. To offer an example, double-glazing used to be considered an improvement but now that it is the industry norm it is an allowable expenditure for tax purposes.

It is clear that the new legislation is going to have a significant impact. It is important to take action now in order to ensure you benefit from the available tax relief if and when you have to upgrade your properties.

Going Commercial

Knight Frank, the international property company, recently asked wealth advisers which asset class their clients had predominantly switched into over the period 2005 to 2015 and discovered that six out of 10 had opted for commercial real estate. In the same survey Knight Frank found that the West End of London's office investment market produced record sales of £7.4 billion during 2016 with two-thirds of the buyers being foreign, predominantly from the Far East and (of all places) Spain. Knight Frank also said that "compared to London, commercial property investment in regional cities offers a lower initial cost of capital and higher yields". Demand for commercial property is, in part, driven by the combined benefits of income generation and capital appreciation. Commercial property benefits, typically, from long leases but does carry risks associated with the security of the tenant and also market liquidity.

Investing in commercial property does not, necessarily, require a substantial amount of capital. Indeed, it is possible to purchase retail premises, small industrial units and storage space for a fraction of what it costs to buy residential property. Whereas, a residential flat in an inner London suburb might produce a yield of, roughly, 3 or 4%, excluding capital growth. The average yield on, say, a High Street shop in the same area is likely to be between 6 and 8%.

There are many differences between investing in residential buy-to-let property and commercial property. The first, and perhaps the most significant, is that whereas the value of a residential property resides in its vacant possession the opposite is true of any commercial investment. The value of commercial property is, bluntly, determined by the quality of the business tenant and the length of the lease they have signed. If you are looking for a reliable, long-term income stream then commercial leases make a lot of sense.

Within retail, convenience stores have, traditionally, provided the most stable form of rental income. Unlike other forms of retail (such as betting shops or banks), which can move online, convenience stores have to have a physical presence near where people live. Investors may also choose to focus on retail space in smaller towns (such as St Albans or Guilford), where lower retail capacity improves the reliability of tenancies and where there is less risk of a giant shopping centre putting smaller retail operations out of business.

Incidentally, the stamp tax on commercial property is much, much lower than that of residential property.

Finally, do remember that when you leverage any commercial property purchase your mortgage or loan interest will be fully tax deductible.

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