The Schmidt Tax Report

Tax, Money & Property

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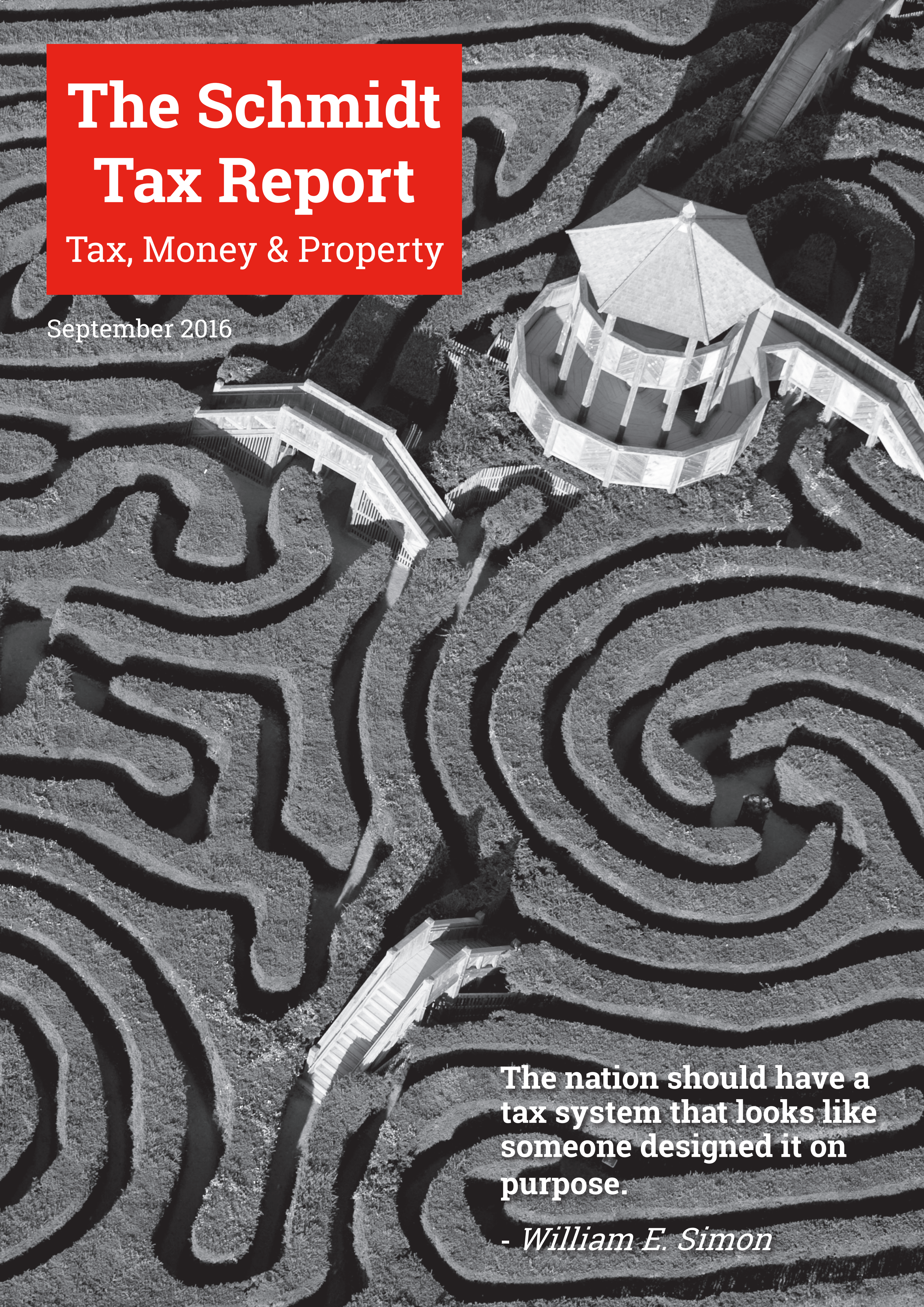

The nation should have a tax system that looks like someone designed it on purpose.

- *William E. Simon*

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Tax

News

Apple rejects £11bn tax bill

The European Commission (EC) has ruled that Apple must pay a record €13bn (£11bn) in back taxes. The EC decided that the tax arrangements between Apple – which enabled it to pay a maximum tax rate of just 1%, compared to the usual rate of corporation tax in Ireland of 12.5% – and the Irish tax authorities amounted to illegal state aid. Writing to Apple customers, Tim Cook, CEO, said: "The European Commission has launched an effort to rewrite Apple's history in Europe, ignore Ireland's tax laws and upend the international tax system in the process. The opinion issued on August 30th alleges that Ireland gave Apple a special deal on our taxes. This claim has no basis in fact or in law. We never asked for, nor did we receive, any special deals. We now find ourselves in the unusual position of being ordered to retroactively pay additional taxes to a government that says we don't owe them any more than we've already paid. The Commission's move is unprecedented and it has serious, wide-reaching implications. It is effectively proposing to replace Irish tax laws with a view of what the Commission thinks the law should have been." Apple and the Irish Government are expected to appeal the decision.

Black news for the black economy

HMRC has announced three separate consultations on proposals designed to reduce the size of the black economy and generate additional revenue for the Exchequer. The proposals include extending HMRC's data-gathering powers, forcing more business to register for tax purposes in order to access business services and licences, and new penalties for compliance failings. In particular, HMRC wants permission to extend its bulk data-gathering powers to include customer data held by money service businesses (such as money transfer). It also wants to introduce 'conditionality', which would mean that access to certain business services or licences should be dependent on businesses being registered for tax.

HMRC survey results

Every year, HMRC questions around a thousand large businesses and then, in August, it issues the results of the most recent survey. This year, one in ten business decision makers stated they were 'confident' they knew what HMRC would challenge as tax avoidance – a reduction from the previous survey. Most tax chiefs and finance directors interviewed said they had a low-risk appetite to tax planning, suggesting a shift in mindset regarding tax avoidance, the survey found. Over the past few years, the UK Government has stepped up efforts to close tax loopholes that allow multinationals to pay little or no tax in certain jurisdictions.

300% penalties proposed

HMRC has unveiled proposals to introduce a penalty of up to three times the tax lost, as well as criminal charges for those who do not come forward and pay outstanding taxes from offshore investments and accounts. From October 2016, HMRC will start to receive an unprecedented amount of data on those with offshore accounts in the Crown

Dependencies and Overseas Territories – one year ahead of even more data coming in from across the globe, when the Common Reporting Standard comes into force. (See this month's 'Offshore Column'.)

Good news for developers

HMRC has softened its approach to developers when it comes to the 0% rate of VAT. In a policy paper, the tax authority said it now accepts that single dwellings can be formed from more than one building. A number of buildings may be combined to form a single dwelling as long as they are designed to function together for that purpose. Until now, HMRC had considered that, while a building could contain more than one dwelling, a dwelling could not be formed from more than one building. Those who have constructed or converted eligible buildings into new dwellings, consisting of more than one building that hasn't previously been treated as zero-rated (e.g. works of construction and eligible conversion services) may submit claims for overpaid VAT with retrospective effect up to four years from the date of the publication of this brief. (See this month's Property section for an article on property and VAT.)

Non-dom news

In the summer Budget 2015, George Osborne announced proposals that non-doms will have to pay UK tax on their worldwide income, while those born in the UK and who own a UK domicile of origin will no longer be able to claim non-dom status for tax purposes while they are living in the UK, even if they have subsequently left the UK and acquired a domicile of choice in another country. In a consultation document, the Government said that it plans to proceed with this legislation. Those who feel they may be affected, including those who are non-domiciled in the UK but hold property in the country through offshore structures, are advised to take specialist advice.

Inheritance tax hits record £4.7bn

The amount of revenue generated from inheritance tax hit a record £4.7bn in the last tax year. This was a 17% rise on the previous year.

Clamp down on benefits in kind

The Treasury has launched a consultation on benefits in kind because it believes that businesses may be incorrectly using them with a view to avoiding tax. Flexible remuneration packages have rapidly evolved in recent years and can now often include a mix of cash and benefits in kind, such as pension contributions or company cars. The effect of reducing an employee's pay often reduces the amount of income tax, employee and employer NICs. The Government is proposing to introduce legislation so that where a benefit in kind is provided through salary sacrifice it will be chargeable to income tax and Class 1A employer NICs, even if it is normally exempt from tax.

Ron Weasley loses appeal

Rupert Grint, the actor who plays Ron Weasley in the *Harry Potter* films, has lost his legal bid to claim a £1m tax refund. A tax tribunal judge rejected the actor's appeal against HMRC's decision to block his accountant's attempts to shield his earnings from the 50p tax rate. The judge ruled that Grint had failed to properly document a change in his accounting date, which meant that a total of 20 months of income would fall to be taxed in 2009–2010. This would have meant than an extra eight months of income would be taxed at 40% instead of the 50% rate.

Ingenious decision

HMRC has achieved a partial win in its attack on a tax scheme promoted by Ingenious Film Partners. The Ingenious Media Film partnerships were investment schemes designed to use specific accounting treatment for producing films to reduce investors' personal tax liability. A First Tribunal ruled that the partnerships were trading with a view to making a profit. However, it also found in the case of all three structures being considered (Inside Track Productions, Ingenious Film Partners 2 and Ingenious Games) that they were either not carrying on a trade, in the case of Ingenious Games, or not trading with a view to profit as determined on the Ingenious basis. However, in the case of Inside Track Productions and Ingenious Film Partners 2, the Tribunal found that if the expenditure was appropriately, in its view, restricted to 35 and 30% respectively then the structures could be treated as trading with a view to profit. Investors in one of these structures would have put in either 35 or 30% respectively of their own cash. The aim was to get back 40% of the claim. The investor was therefore meant to get most if not all of their cash contribution back through a tax claim. Both HMRC and Ingenious are believed to be considering onward appeals and the final decision may in fact still be years away.

Editor's Notes

Don't leave me now

Are you intending to sell some or all of the shares you own in a business and to walk away with 90% of the profits on the basis that you are entitled to entrepreneurs' relief? A word of caution. You must be an employee of the business when you make the claim. If you plan your sale and departure in good time, this is unlikely to be an issue. But there are many circumstances (such as illness, where the shareholders have fallen out when proper advice has not been taken) in which the sale of shares is only agreed after the vendor has left. The courts – most recently the First Tribunal – have dealt with several cases of taxpayers who feel they have been unfairly prevented from paying just 10% on their profit. The lesson: think ahead and talk to a professional tax expert before you do anything irrevocable. (As an aside, if you have a difference of opinion with your fellow shareholders you will always be in a stronger position if you are still a director/employee.)

£5,000 a year tax-free for each child...

If you receive dividends from your company and end up using some of the money to support children aged 18 or over then consider re-designating some of your own shares to your children or subscribing to a new class (e.g. dividend earning but non-voting) and passing them to your children. If you plan this correctly, you should be able to avoid any capital gains tax (CGT) liability and it will give the children an opportunity to receive £5,000 a year tax-free by way of a dividend. There must be no arrangement in place for you to take back the shares.

Winding things up properly

"This clause introduces a new targeted anti-avoidance rule (TAAR) that will apply to certain company distributions in respect of share capital in a winding-up. This TAAR will treat the distribution from a winding-up as if it were a distribution chargeable to income tax, where certain conditions are met. The TAAR applies to distributions made on or after 6 April 2016." Thus runs the introduction to

Clause 35 of the Finance Bill 2016 which carries the subhead: 'Distributions in a winding up'. Its purpose is to stop the owners of companies from winding up their business in such a way as to avoid income tax (especially the new dividends tax regime) and instead pay CGT. In particular, they have it in for people who wind up one business and then start another doing the same thing. In a nutshell, if you wish to wind up a company and pay capital gains rather than income tax you need to make sure there are commercial reasons to do so and there must be no question of you or someone close to you carrying on the same business via a new corporate vehicle. The conditions are not that onerous to meet, but failing to take account of them could be costly.

More powers for HMRC

HMRC is seeking even more powers. In this instance, they want stiffer penalties for enablers (i.e. professional advisers) of tax avoidance that is defeated and stiffer penalties for those who use tax avoidance that is defeated. They also want stricter rules about what constitutes tax avoidance and further powers that will allow them to discourage avoidance. Their proposal is worrying because their definition of a tax avoidance scheme is so wide reaching, namely "any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)" and because there are very few safeguards for taxpayers. Moreover, they want the new rules to be applied retrospectively. The document outlining these proposals is entitled: *Strengthening Tax Avoidance Sanctions and Deterrents: A Discussion Document.* It was published on 17th August and if you have a moment you could write – quickly – to your MP to say that you object.

Go mid-shore

You don't want or need an offshore structure but you would (especially with the possibility of Brexit) like to move some or all of your business activity outside the UK. In particular, if the pound tumbles as anticipated (some economists say it hasn't fared worse because it has been the summer and trading volumes in general have been low), you want to start exporting. An increasing number of professional advisers talk now about what might best be called 'the mid-shore solution'. Mid-shore? A mid-shore jurisdiction imposes potentially high levels of tax, is signed up to all the various international tax treaties covering everything from transparency to information sharing and has a highly regulated financial and legal framework. A good example of a mid-shore option would be Malta. The corporate tax rate is 35% but if your company is owned by a non-resident individual or corporation then you get a refund of six-sevenths, meaning an effective corporate tax rate of just 5%. Malta is part of the EU and most definitely not on any blacklists. One compelling reason to move mid-shore, incidentally, is that increasingly banks, nervous of the consequences of dealing with offshore centres, are refusing business where jurisdictions such as Panama or the Cook Islands are involved and are also demanding that clients using such structures change them. It is not unusual for a bank to refuse to open accounts even where the ownership structure is completely transparent. For example, a British business recently had problems maintaining its British bank accounts because one of its shareholders was a Panamanian company owned by a British expat living in Cyprus.

Ask The Experts

Q. Are there any circumstances in which the members of an LLP [limited-liability partnership] are able to make tax deductible payments through the LLP for their own private medical insurance where there are no employees?

A. Private medical insurance is never a tax-free benefit. If the premiums are paid by the LLP (because, for example, a group policy is cheaper than individual ones) they should be added back when working out the LLP's taxable profits. Premiums paid for employees would be tax deductible for the LLP but would be a benefit in kind for the employees. Similarly premiums paid by a company are tax deductible in the company's hands but the directors/employees are taxed on the benefit in kind.

Q. Client has sold 100% of his limited company for consideration as follows:

£275,000 in cash upon completion of share purchase agreement, together with £50,000 worth of shares in the acquiring company. A further £225,000 payable in cash on the first anniversary of sale. A final payment of £100,000 in cash after the agreement of management accounts relating to the 2-year post-acquisition period adjusted in line with the difference between benchmark profits of £125,000 and actual annual profits. The final payment is subject to a guaranteed minimum value of £50,000 and a maximum value of £400,000.
My query is to do with the CGT calculation. Presumably the £275,000 initial consideration, plus the value of the shares in the acquiring company of £50,000 plus the first anniversary payment of £225,000 are unquestionably all part of the consideration received in the tax year of sale and will attract CGT at ER rate?
The main question is to do with the third payment which in part is contingent on results. As there is a guaranteed minimum payment of £50,000, is it allowable to include that element of consideration in the year of sale CGT calculation (in order to take advantage of ER rate of CGT)?
If it is, the next question is whether it is possible to include the £400,000 (if profits are anticipated to be that high) consideration in the year of sale calculation and pay the tax in advance at the lower ER rate and then claim it back if the consideration results in being lower?

A. Have you heard of the tax case *Marron vs. Ingles?* That case covered this issue. The deferred consideration is known as a 'chose in action' and is an asset in its own right. What you need to do is value the chose in action at the time of sale based on a realistic estimate of what the likely consideration payable in two years will be. So, for example, if the client felt there was a 10% chance of the ultimate amount payable being £50,000 and a 90% chance of it being £350,000, you would value the chose in action at £320,000. (Normally HMRC would then expect this value to be discounted to its net present value but given the current level of interest rates this would probably be unnecessary at the moment.)

So if the chose in action were valued at £320,000, you would bring this amount in as sale proceeds on the date of exchange. Then in two years' time when the actual amount payable is known there is a disposal of the chose in action for the cash amount received. The chose in action will have a base cost (in our example) of £320,000 so if the actual amount received is more than this you have a capital gain in the later year, and a loss if the amount received is less than this.

An election can be made under s 279A TCGA 1992 to carry back any loss arising in the later year to the earlier year.

This is only a brief overview of the rules for deferred consideration, which are very complex and we would advise you approach a tax specialist for assistance in dealing with this case.

Q. Under the 'old' system a company was incorporated on 1 Sep 2013 with Goodwill of £30k 'purchased' from the director and was to be written off in the company's accounts over 5 years. A claim against corporation tax for the amortised amount was made in the subsequent tax years that followed. Unfortunately the company has fallen on hard times and has had to cease trading. At this point there will be unamortised goodwill of £18k. Is CT relief available in the cessation accounts for the full £18k that is left thus creating a tax loss in the final period of trading enabling c/b for relief against Corp Tax paid in the previous year?
A. Yes – the 'old rules' continue for goodwill transferred prior to December 2014. So corporation tax relief is still available in accordance with the accounting write-down of the goodwill.

Q. I am considering purchasing a property for use as furnished holiday lettings. This will probably be a 50/50 joint venture with an acquaintance. He has cash available to fund his stake. I have a trading Ltd Co (that provides business consultancy services and which also operates an unrelated one-man-in-a-van franchise operation). The Ltd Co is also a partner in an LLP (along with myself and my spouse) that is purely an investment vehicle. There is cash in the bank of both the Ltd Co and the LLP, although some additional borrowing may be required to finance the property. The property has not yet been decided upon; it may be a property to be done up as an FHL or we may purchase a property (or business) that is already operating as an FHL.
A. We would advise against involving the company either in ownership or as a lender of funds to you. Borrowing from a company has adverse tax consequences and corporate ownership of property is less tax efficient than personal ownership and so is generally not advisable.

FHLs are privileged from income tax, CGT and IHT perspectives, which adds to the desirability of owning the property personally rather than through the company. So only if the company were the only source of funds would we say that corporate ownership would be desirable.

The LLP, on the other hand, can lend you funds without there being any adverse tax consequences, so given that the LLP has surplus funds available the answer would probably be for you to own the 50% share of the holiday property in your own name but to borrow funds from the LLP to enable you to fund the purchase.

The LLP could also acquire the 50% interest in its own name. As the LLP is transparent for tax purposes, the personal tax advantages associated with FHLs would flow through to you but this structure would seem unnecessarily complicated in terms of accounting and tax reporting.

So we would suggest keeping it simple: a 50:50 personal ownership with you borrowing from the LLP to fund your share.

Q. In recent issues you have touched on the use of farmland attached to one's primary residence to help with IHT planning. Do you feel this would include planting Christmas trees on a 6-year growing cycle? I do seem to remember something about forestry being exempt anyway, but this is very 'short term forestry'. Just in case it is relevant it is being carried out as a five-way partnership with my four children.

On a second point, there are quite a lot of initial VAT inputs – seedlings, machinery, fencing etc. – but we are not registered yet for this business (we are registered for others). We are planting enough to justify sales of over 82k per annum but I have no idea whether the business would turn over that amount or not. Obviously zero sales for 5 years but if the 6th year's sales are under 82k then can we de-register immediately or would they expect us to wait longer? The margin is extremely high and we are intending to sell direct to the public, so VAT registration would probably not be in the business's interest long term, would you say?

A. The growing of Christmas trees does not count as forestry or indeed farming but as a trade. Therefore, provided you can prove, if challenged, that you are carrying on the business with a view to a profit, any losses in the early years should be allowed as deductions from other income and the land on which the trees are grown should qualify as a trading asset for CGT and IHT purposes. Profits once made will be taxable in the same way as other trading profits.

It makes sense to register for VAT to reclaim all of your input tax, but if you were then to deregister before selling the trees you would be liable to account for VAT on the value of the tress if the output tax payable would be more than £1,000. So it is not possible to reclaim the input tax without paying any output tax. So you would need to assess whether it would be more advantageous to claim the input tax or not pay the output tax and the likelihood of annual sales not exceeding the registration threshold.

LEND ME YOUR EARS: SEVEN RULES FOR TAX-EFFICIENT LENDING

1. Lend from your company

Let's imagine that someone with whom you're not 'connected' in the technical sense approaches you for a loan. Whether this is a loan for private or business purposes on his side, there are at least three reasons why you should lend the money out of your limited company, if you have one, rather than loaning your own personal funds:

• The money in your company may be 'pre-tax', that is taking the money out of the company to make the loan would incur an income tax charge. Even if you've got the money available personally to lend, it may be the case that lending your personal funds will bring forward to an earlier date some future taxable extraction of funds from your company. So cut out the personal tax stage and loan the money direct from your company.

• If the loan bears interest, this will probably pay a lower rate of tax if received by your company than if you receive it personally and have to pay income tax (subject to the £1,000 tax exemption for interest that now applies).

• If you are unlucky, and the loan goes bad, this will be allowable against the company's profits in all circumstances, and won't depend on the use which the borrower made of the money, or be restricted only to capital gains of the company. Loan write-offs, in short, are treated much more favourably for tax purposes in limited companies than in the hands of individuals.

2. Finance your company by loan

Again, if you are involved in any way in a company, it usually makes sense, if you have to finance that company's business by way of cash injection, for the cash injection to be in the form of a loan rather than shares issued by the company.
First, if you are going to receive any kind of income on the money you've invested in the company, interest is very often a more

tax-efficient way of taking that income than dividends. Dividends would be what you got if you had invested the money in the company by way of share capital. The reason for this is that, unlike dividends, there is no effective 7.5% 'surcharge' on income taken out of the company in the form of interest. The whole tax regime is different and, instead of the company paying corporation tax and then paying you a dividend out of its post-tax profit, the interest payment will normally be allowable against corporation tax and chargeable on you at the normal income tax rates. Overall, between the investor and the company, the tax leakage is likely to be less with interest than with dividends.

The second reason why it usually makes more sense to loan money to a company than to buy shares in that company is because the loan can be repaid easily, and without incurring any kind of tax. A loan repayment is not 'income'. By contrast, getting the capital back on your shares can be a much more difficult and cumbersome process, at best.

3. Loans to shareholders

Always remember that there is an alternative to paying dividends to company shareholders, which is making them a loan of an equivalent amount. Don't try this if the individual concerned is also a director and the company is a public company, because with plc's there are criminal sanctions for loans to directors. For private companies, however, the theoretical law against making loans has no real teeth, and it can be a very tax-efficient alternative to paying the same individual a dividend.

It's not as simple as saying you save the income tax that the individual would have paid on receiving the dividend: there is a tax 'sanction' against making loans, or indeed there are actually two where the individual is also a director or employee. But the tax sanction may be much easier to bear than the income tax charge that you are avoiding.

Let's take an example. Snodgrass is a 45% income tax payer, who owns 100% of the shares in his trading company, Christmas Tree Decorations Limited (CTDL). He urgently needs £500,000 from the company to bridge a house transaction, because he wants to buy now while prices are purportedly lower thanks to Brexit, but for the same reason doesn't want to sell his current home. The money is just sitting there, doing nothing, in the company, and to Snodgrass it seems to be saying, "Spend me."

The company's accountant prepares the paperwork for taking enough money out of the company as a dividend to leave Snodgrass with the necessary £500,000 he needs to bridge. He works out that this comes to about £808,000, on which about £308,000 will need to be paid in higher rate income tax (including the new 7.5% dividend 'surcharge') leaving Snodgrass with the £500,000 net amount after tax.

At the eleventh hour, as his hand is poised, almost, over the company chequebook, Snodgrass thinks of consulting a tax adviser. The tax adviser points out that, if he takes the £500,000 out of the company by way of a loan, there will be no personal income tax: instead, there is a special 'loans to participators' tax charge, which is payable by the company, and is now at a rate of 32.5% (increased from 25% last year). So the company pays Snodgrass £500,000, and sets aside £162,500 to pay in 'loans to participators' tax.

Not only is the tax only about half what would have been paid over to HMRC under the dividend route, but the 'loans to participators' tax charge is in fact only lending money to HMRC, not irrecoverably giving it the money. When, in due course, Snodgrass is able to pay the loan back when his old house sells, the £162,500 is refunded to the company.

Of course, in this example, the good sense of Snodgrass borrowing the money from CTDL rather than taking it as a dividend is very obvious. But it's still arguably the case even when there is unlikely to be any immediate prospect of paying the loan back. The actual dosh which has to be available is still very much less. The only drawback to a loan from the company as opposed to a dividend is that it gives rise to a 'beneficial loan' charge to income tax. However, at current interest rates, this is likely to be a comparatively trivial sum of tax to be paid as an annual benefit in kind.

4. Loan security

OK, this isn't a point about tax efficiency, but asset protection is obviously another consideration that should be taken into account, particularly if the loss of the amount of the loan, in the worst-case scenario, wouldn't attract tax relief. The point here is to remember that, just as banks and mortgage companies take out security, by way of fixed and/or floating charges against the borrower's assets, so can you, even though you may not be a professional moneylender. A floating charge is available where the borrower is a company or an LLP, and basically enables you to take first pickings, after those who have a fixed charge, in the event of the corporate entity being wound up, that is you rank ahead of unsecured creditors.

Remember also that this applies even if the loan in question is to your own company. You may have decided, following the advice in rule 2 above, to capitalise the company by way of loan rather than share capital. The fact that it may be your own company you're lending money to, though, doesn't affect your rights to take out fixed security – thus putting you to the front of the queue in the event that you have, regretfully, to wind up the company in the future with not all of its creditors being satisfied.

5. Choose your borrower wisely

From the point of view of asset protection, it's usually a good idea to lend to an individual rather than to his company. Companies have a nasty habit of going bust and leaving creditors high and dry, even where there are personal assets of that company's shareholders or directors which you, as the bilked lender, may feel you have a moral right to. So you may well want to lend to the individual, who then puts the money in his company, rather than lend to the company itself (lending to the company with a personal guarantee from the individual is a middle path).
There is just one tax-planning consideration that you may need to bear in mind here, though. This is that a loan to a director for him to then loan to his own company would not be eligible for capital gains tax (CGT) relief as a capital loss in the event that the loan went bad.
There is a relief available for bad loans where they are to 'traders', in this example loans to the trading company itself, which would not be available on loans simply to an individual. Of course, if you've made the loan from your own company, this doesn't matter because, as it says in rule 1, companies get relief for financing loans in any event (providing the borrower is not 'connected').

6. Consider the CGT entrepreneurs' relief implications

We're thinking, here, of the situation where you have money in your company that you are thinking of loaning to another entity whose activity is of an investment nature – perhaps buying an investment property portfolio. A direct investment in this sort of thing, whether as joint owner or as member of an LLP that is conducting the investment activity, may result in your company losing its trading status, and thereby your entitlement to entrepreneurs' relief if you ever sold or wound up the company. By contrast, a loan (preferably interest-free) to another company you own, which in its turn then puts the money into the investment activity, may well preserve entrepreneurs' relief, because your company is not directly participating in an investment activity itself.

7. Consider the inheritance tax implications

On the other hand, a loan by a trading company is unlikely to qualify for inheritance tax business property relief. This is a 100% relief, available against the value of trading companies, but it isn't available where there is what is known as an 'excepted asset' on the company's balance sheet.
The relief, which applies where shares in a trading company are held, would not apply to that part of the value of the shares that is represented by this non-trading loan. In this instance you may prefer the company to be a direct participant in whatever the outside activity is, if that activity is a trade.
So making your company a member of the LLP (its equity capital can be secured) will enhance your eligibility for inheritance tax business property relief as contrasted with the loan scenario described in rule 6 above.
To reduce rules 6 and 7 to a single sentence: consider both the CGT and inheritance tax implications of any loan you make: the form in which you hand over money can make a huge difference to your capital taxation.

CGT: A PORTRAIT

In the midst of all our learned disquisitions on the finer points of tax, it's important not to lose sight of the interests of those for whom the whole of taxation is a horrid mystery. There's always something to be said for going back to basics, and clearing up what may be elementary misunderstandings, so that we can make progress in our task of, shall we say, smoothing the rough edges of taxation for our readers.

So this month, we've decided to focus on one tax that is often very much misunderstood: capital gains tax, or CGT.

A common confusion

To start off with, let's make a clear distinction between two taxes whose effect is often confused: CGT and inheritance tax (IHT).

IHT is what you pay on death – referred to in old-fashioned novels as 'death duties'. It goes by the value of what you have on death, and how you arrived at that value is of no concern to the assessor of IHT.

CGT, by contrast, requires a detailed knowledge and memory of the history of assets, because it isn't (generally speaking) charged on death at all, but instead is charged when you dispose of an asset at a profit.

CGT and IHT are between them generally referred to as the 'capital taxes', although HMRC's Capital Taxes Office confusingly only deals with IHT.

What assets does CGT apply to?

So CGT only comes into play when you dispose of an asset. But, even then, it doesn't apply to all assets. With the exception of a very few unusual types of asset, CGT will only be payable where you sell or otherwise dispose of one of the following:
• investments like shares and unit trusts
•n property
•goodwill and other business intangible assets like trademarks etc.
• plant and machinery used for the purposes of a business.

So CGT won't be in point, generally speaking, when you dispose of assets like cars, stock (including property stock) of a trade, debts, non-business machinery & cash.

The basis of calculation

Nine times out of ten, the calculation of CGT is very simple. It's a straightforward question of comparing what you get from selling the asset, after deducting all associated costs like agents' and brokers' fees, with what you paid for the asset, again including all associated costs, when you first bought it – together with any money you've subsequently spent improving the asset. There used to be an allowance called 'indexation' that to some extent counteracted the effect of inflation on this calculation, but this is long gone for individuals (although it continues to apply for limited companies).

Two quirks

There are two oddities about CGT, in the context of the general rule that it's chargeable where you dispose of any asset of the specified classes:

• CGT applies to gifts of assets, as if they were sales of those assets for their market value.
• Although you, perforce, dispose of all of your assets on death, CGT doesn't apply on death.

The reasoning behind the second rule is no doubt that you will be chargeable to IHT when you die, and so a CGT charge in addition would be double taxation. However, this common-sense view has its limitations: if you give away an asset, say, within seven years of death, you'll be within the scope of the CGT charge, but also within a charge to IHT on the same asset, because IHT is chargeable on gifts made in the last seven years before death. So this could turn out to be a very bad piece of estate or tax planning!

The rates of tax

Generally speaking, CGT is going to be payable at one of three rates:

• 10% where you are selling a trading business
• 20% where you are selling any other asset except residential property
• 28% where you are selling residential property.

These rates apply to individuals who are higher-rate income tax payers, because there is a link between the rate of income tax that you are paying and the rate of CGT that you pay. In principle, someone who is only a basic-rate taxpayer has two possible rates, being 10% for all assets except residential property and 18% for residential property. However, one will very rarely come across these rates in practice, because, first, basic-rate taxpayers tend not to be the sort of investors who pay CGT and, second, the amount of the gain itself is likely to push what would otherwise have been basic-rate taxpayers into the higher bracket.

Tax is payable after deduction of an annual exemption, currently £11,100, which is offset against all of the gains that a given individual has made in a tax year.

Companies don't pay CGT. Instead, they pay corporation tax on chargeable gains at their corporation tax rate, and with the benefit of 'indexation allowance', which we mentioned above.

Basic CGT planning points

The following is a highly selective list of planning points that arise from the way the basic framework of CGT is constructed:
• The annual exemption applies to each person for each tax year (ended 5th April). If you don't use it, you lose it. So it can be good planning to make small disposals (e.g. out of a quoted share portfolio) to use up available annual exemption each year.

• Because of the availability of the annual exemption for each person, and also, where it applies, the lower tax brackets, it can make sense to spread ownership of assets liable to CGT amongst as many family members as possible. Unlike the position with income tax, it is possible to 'divert' capital gains to one's minor children without the gains concerned being treated as if they were those of the parents.

• Where there is the possibility of doing so, consider ways of 'turning income into capital'. One straightforward way of doing this (straightforward at least in principle) is retaining profits within a limited company, rather than paying them out as income in the form of dividends or remuneration. If you retain profits, and as a result the company becomes worth more, the reward will be on your ultimate disposal of the company, either by way of sale or on winding up. This sale, unlike the dividends, is subject to CGT, which is likely to be at a lower rate (10% if the company is a trading one that therefore qualifies for entrepreneurs' relief).

• While gifts are chargeable to CGT, as we've seen, there are ways of avoiding an immediate tax charge. If the asset concerned is a trading asset, you can 'hold over' the 'gain' by mutual agreement between the donor and the donee. If what you are giving away is not a trading asset (e.g. if it is a buy-to-let property), you can still achieve holdover relief if, instead of giving the asset to another individual absolutely, you give it to a trust for that individual. Watch out, though, for the £325,000 threshold over which gifts to trusts are liable to the other capital tax: IHT.

• Death is good CGT planning! It can make a lot of sense, therefore, not to give away or sell assets with big capital gains on them but retain them and leave them to your nearest and dearest in your will. While IHT is, of course, payable on assets held at death, there may be all kinds of reasons why IHT is not pushing you into making a forced disposal. For example, your estate may be below the IHT threshold; or you may be leaving everything to your surviving spouse, in which case that bequest will be exempt; or the asset may be a trading business, which is not liable to IHT. If you leave assets in your will, CGT treats the beneficiaries of your will as if they had bought the asset concerned for its value on the date of death. So a substantial capital gain, which may have accrued gradually over the years that you have owned the asset, can be completely washed out of CGT by this process.

HMRC: BEFORE AND AFTER

There's a line in a well-known hymn which runs "change and decay in all around I see". When applied to the UK's tax authorities, the first of these certainly applies big time: and, many would argue, so does the second. The really radical changes began with a bright idea of Gordon Brown's when he was Chancellor of the Exchequer: to merge the two taxing authorities which had existed until that time: HM Customs & Excise (who looked after VAT and excise duties) and the Inland Revenue, which dealt with most direct taxes. For years, the two departments coexisted under the same name of Her Majesty's Revenue & Customs without really merging. Old attitudes died hard. Only now are we beginning to see any real cross over between the VAT and direct tax sides of things.

The good old days

Some of us, who are not too long in the tooth, can remember when you had things called 'tax offices' and 'inspectors of taxes'. The latter were locally based, and highly trained, individuals whom you could talk to and even meet outside the purely tax arena. To us oldsters, there seemed to be a lot of advantages with this system.

For example, building up a relationship between individuals in the profession and in the Revenue meant that the system worked much more smoothly in many ways. Rather than trying to make contact with some unknown person who could be based at the other end of the country, you knew exactly how old Robertson was going to react to a tax issue, and you might have even go to the lengths of talking to him about a case over a pint at lunchtime.

Above all, the old inspectors of taxes knew what they were talking about technically. We're not at all convinced that their successors, these days, do. But more of this later.

The bad new days

HMRC has, indeed, suffered a sea change, but not, most of us think, "into something rich and strange". Strange, maybe, but the main impression given by today's HMRC is, on the contrary, one of poverty: poverty of resources, training and systems that work. Basically, Gordon Brown's bright idea was all about saving costs. The idea was, perhaps, that there would be some kind of economies of scale by having one organisation rather than two. Personally, we think only a politician could have got this idea, in the face of the obvious facts that the two departments were doing completely different jobs and that a human being needs as many cubic feet of space whether he's in one of two organisations or in a single unified organisation. But the merger went ahead, and, in order to make it look as though the merger was actually saving costs, it was accompanied by a swingeing programme of reducing numbers.

Statistics show that there were 91,167 staff members of HMRC on 31st March 2005, at which time the cost cutting had only recently begun; by 31st March 2014, a mere nine years later, numbers had reduced by about a third, to 61,370. Now, the recruitment literature on the HMRC website refers to a total staff number of 56,000.

The impact of the HMRC cuts

How have these cuts in staff numbers been achieved, and what has been the effect? (Don't worry: we're coming on to the practical effect of this on your tax planning in a moment!)

Well, first of all, and inevitably, a lot more of the onus has been put on the taxpayer. Particularly, there is now an expectation that everyone will be forced to do everything by computer: thus reducing the number of staff that HMRC needs to employ to transfer manual tax returns over on to its systems.

Second, tax offices in the local area are now a thing of the past. If you've got a problem with your tax, and can't afford an accountant or specialist tax adviser (or if you *are* an accountant or specialist tax adviser!) it's no good thinking you can go in to see someone locally to thrash the matter out. There isn't anyone there. So there's been a real decline in the service that HMRC supplies to those it insists on calling its 'customers'. Dealing with HMRC nowadays, most of those who have to would agree, is a pretty head banging experience. Instead of human beings who know what they were talking about, we now have the call centre mentality, manned largely by people who are unable to give you any answers even to the simplest questions – and in some cases, can't even access your records. So, to this extent, the Government cost saving has been achieved at the expense of turning our tax system into something dangerously approaching a complete shambles.

Third, though, the whole approach to policing the system has changed. For example, under the old arrangements, if you sent in business accounts, an inspector of taxes would look at them and mark them with one of three notes, which went 'examine', 'review' or 'accept'. Those who got the 'examine' note were the unlucky ones, because this basically meant opening up the accounts for a full inquiry. A 'review' was much more focused on particular figures, for example checking that all of the legal or entertaining expenses had been properly treated. If you got 'accept', you knew that HMRC had looked at your accounts and were happy with them.

This knowledge is no longer vouchsafed to anyone sending in their tax return.

A fourth effect of the cost cutting is, or seems to be, that HMRC staff no longer seem to receive the same quality of technical training. Those of us who deal with technical matters with HMRC find that we are more and more faced with an unthinking 'traffic warden'-type approach by those who blindly try to enforce rules that they don't really understand themselves. We've heard, anecdotally, of new recruits to the Revenue being put straight on to case work after a mere three weeks in the job.

Tax planning and today's HMRC

Now we come on to the practical implications, for those interested in tax planning, of the HMRC sea change.

Number one is: if you ever come into any kind of dispute with HMRC, perhaps in relation to the impact of some tax planning that you've done, not only can you not assume that HMRC is right but you can't even assume, these days, that the approach taken by the officer represents organisation-wide HMRC policy. We've had many examples recently of officers (the word 'inspector' doesn't seem to be used any more) arguing in direct contradiction of HMRC's own published practice. So the practical message here is: persevere in the event of any such technical disagreements arising, and don't feel that you are arguing against 'the law'.

Second, and conversely, don't assume that your planning has worked simply because you hear nothing from HMRC about it. This is partly a function of self assessment, of course, rather than the reduction in HMRC numbers, but the reduction in numbers does seem to have reduced the likelihood of a routine or random examination of the tax returns you've sent in. If HMRC does inquire at all, this is likely to be for some highly specific reason, and this brings us on to the third practical lesson from our consideration of HMRC history.

This is that inquiries, when they do occur, are much less likely to be of the benign technical kind and much more likely to be a vicious attack, where the Revenue basically pounces out of the blue. This attack is most likely to have been occasioned by malicious information from someone with whom the taxpayer has fallen out – often a disgruntled ex-spouse. But it could also arise from a computer algorithm throwing up a major change between one year and the next. This doesn't seem to apply, in fact, to sources of income which come and go, but to income or expenditure figures which are exceptional in some way. The moral here is: don't fall out with anyone and don't send in odd-looking tax returns, or, indeed, don't send them in late.

Finally, you should bear in mind that the pouncing-out-of-the-blue strategy HMRC now adopts makes the question of time limits, and finality in the self assessment system, much more important. One benefit we have derived in the UK from our membership of the EU is the reduction in the general six-year time limit for HMRC raising assessments to a four-year limit. In the absence of a careless or deliberate misstatement of your tax in a return, HMRC now has to accept that your tax affairs are final after four years – unless it has opened a formal inquiry into your return in the interim.

So HMRC officers very often find themselves in the position where they start inquiring into someone's tax affairs and find that the bird has flown. If your return was done in good faith in accordance with your understanding of the correct tax position, even if that view turns out to be wrong, there's nothing HMRC can do about it once the four-year limit has passed and no inquiry is open.

This doesn't mean they don't try, though – resist very strongly any attempt to go on a fishing expedition into periods more than four years old that are not subject to open inquiries. While HMRC can raise assessments going back up to twenty years where there has been deliberate misstatement of tax, the onus is on its officers to prove it, and of course they have very little effective machinery for finding out anything from you once the four-year limit has passed. Know your rights here, and stand by them! Don't let the highly unsatisfactory current strategy of HMRC, of leaving you alone and then suddenly coming down on you like a ton of bricks, act in HMRC's favour!

THE BUSINESS COLUMN: GOING THE EXTRA MILE

There's been a shift, recently, in the way most sensible people act to reduce their tax liabilities. This no doubt has come about as a result of a corresponding shift in public attitudes to tax planning, which has been promoted by the Press initially, and taken up eagerly by the Government and HMRC. Very much less popular, now, are the 'clever schemes' which used to be promoted so confidently. Like it or not, we are now in an environment where excessive cleverness is definitely disapproved of.

Indeed, doing anything at all to reduce your tax is disapproved of in some circles. If you're reading this, though (unless you're flying an HMRC reconnaissance plane) you probably don't subscribe to this fairly extreme view. You may think you're already shouldering an unfair burden in order to keep the non-productive members of society in comfort; or perhaps you're running a company partly or even wholly for the benefit of others, where the moral boot is on the other foot: you may actually have a fiduciary or moral duty to minimise tax sensibly, within the constraints of what is prudent and sensible.

So by going the extra mile, I'm talking about actions taken to reduce tax which aren't schemes but are more out of the way than the obvious claiming of tax deductions. You will also find a discussion of tax deductions, both obvious and not so obvious, in my book *The Entrepreneur's Tax Guide*.

Tax-efficient benefits

If you're running a business that employs staff, you should certainly be looking at ways of remunerating them tax efficiently. This is because a member of staff basically needs a certain amount of money to live on, and the tax deduction is arguably a charge against your profits, in reality, rather than against these individuals' income. And remember that the cost of remunerating staff members – even if those staff members are your and your family, as directors of your own company – are 100% allowable against the company's profits, assuming you are trading through a limited company.

One of my favourite examples of the tax-efficient benefit is the provision of cars which are comparatively environmentally friendly, but for which there is no business use element. This maximises the benefit of rewarding staff (including your own children) by way of company cars.

It does this because the company car regime takes no account of the proportion of business versus private expenditure, but just applies a fixed charge, based on the list price of the car when new, regardless of the circumstances. So where there is a lot of private use of a car, and little or no business use, the tax efficiency of the arrangement is at its maximum. It's even greater where the driver of the car is young and incurs very high insurance premiums. The cost of providing the car, including insuring it, is an allowable deduction for you… but doesn't find its way through to such a huge tax charge, often, in the hands of the individual.

This is just one example of tax-efficient benefits, of course. There are also a number of others, including staff entertaining at annual functions, staff parking, mobile phones and many others. All the time you should be looking at ways of minimising the amount the taxman creams off in between your payment of the amounts concerned for the benefit of your employees and the net value that the employee ends up actually getting.

Employee subsistence

Bear in mind, again, in what follows, that the employee in question can be your, if the business is run through a company that you own.

The phrase 'travel and subsistence' is one whose meaning is apparently obvious, but which does present certain points of interest (as Sherlock Holmes would have said). More precisely, what does the word 'subsistence' exactly mean?

Travel itself is fairly unambiguous. If an employee (including your) needs to travel, otherwise than in the way of ordinary commuting, for the purpose of working, the cost of the travel is clearly a deductible expense. You need to incur it to earn the profits of the business. Subsistence, on the other hand, means eating and drinking: but only eating and drinking of a certain type, or in a certain context. The basic point I'm wanting to make here, though, is that this sense of the word subsistence may be wider than a lot of people think. If you have to stay away on business, and you are doing so as an employee of someone else or of your own limited company, then the rules (which are typically vague) will generally allow you to claim the cost of eating and drinking. There's no particular bar on alcoholic drink (if you'll excuse the pun). A 'pie and a pint' at lunchtime, taken somewhere away from your ordinary place of work, can and should be claimed against tax.

As is typical of the way we make our law in this country, though, there is a dividing line that is difficult to define, but dangerous to cross. There's no logical difference between the pie and the pint at lunchtime, and the slap-up dinner in the five-star hotel with champagne and cognac to finish at £180 a shot. Logically, of course, the brandy may not be 'subsistence' in the sense of being absolutely necessary for your survival while staying away on business. Then neither is the pint that washes down the pie, or even the pie, which could have been foresworn in favour of a much cheaper takeaway sandwich from Marks & Spencer. So necessity isn't the logical distinction.

In fact, there isn't a logical distinction at all, but merely what HMRC is likely to swallow in the way of claims for what you have swallowed in another sense.

The advice could perhaps be usefully, but vaguely, summed up as: remember to claim everything you eat *and* drink when you're travelling on business, just don't take the micky!

Interest on directors' loans

I'm talking here about the situation where the company has been funded partly by way of money injected by its directors or other individuals or companies. In 95% of cases, in my experience, these cash injections are provided on an interest-free basis. But there's no reason at all why a reasonable commercial rate of interest shouldn't be paid, taking into account the fact that, usually, this is unsecured lending by the individuals concerned.

Of course, interest paid to an individual director, say, by his own company, while reducing the profits chargeable to corporation tax at 20% or lower rates may then end up paying income tax in the hands of the recipient individual. But there are still reasons why paying interest could be a good idea from the tax planning point of view, including:

- To use up the £1,000 per person allowance for interest received, which has been introduced with effect from the current tax year; this may lead you, in fact, to transfer the benefit of loans amongst your family so as to utilise a number of people's £1,000 allowance.
- As a way of taking income out of the company without suffering either National Insurance (which remuneration would incur) or the dividend tax (which you would incur if you took the same income as a dividend on your shareholding in the company rather than as interest on your loan to the company).

Capital payments to acquire property

This can be a good example of what I call an 'out of the way' tax deduction, because it's one that many people (and their accountants) miss.

First of all, and referring again to the *Entrepreneur's Tax Guide*, there is a whole chapter in that book on what I refer to as 'hidden treasure' – and I may have mentioned this in *Schmidt* from time to time! The hidden treasure is the fixed plant element, which exists in almost all buildings when they are acquired and is eligible for a tax deduction, providing it is correctly identified and valued. If the property was acquired before 6th April 2014, indeed, there is no need for the expenditure necessarily to have been identified, even, at the time the property was acquired. You may still be able to put in a back claim, and indeed a current claim, for allowances on the inherent fixtures in the property.

The other area where tax deductions are available but are often missed is where a premium has been paid for a short lease. Where a landlord grants a lease out of his interest (freehold or long leasehold) in a property, he's chargeable to tax as income on a proportion of the premium, worked out by reference to a formula. What the formula does is charge him to tax on income on a greater element of the premium he has received, the shorter the length of the lease. On the other side of the coin, looking at it (as I am here) from the tenant's point of view, the payer of the premium, if occupying the property for the purposes of a trade, can deduct a proportion of the same figure each year against tax.

Accounting provisions

Is accountancy boring? Well, there are obviously two views on this question, but the job of the tax adviser is certainly anything but, and from the point of view of tax planning what the accounts show can be very important. Let's focus on the use of accounting provisions, as an illustration of this.

What is a provision? Really all it is, is an accounting entry which, on the debit side, is an expense in the profit and loss account of the business, that is it reduces the profit for the period and on the other side sets up a kind of 'creditor' in the balance sheet.

Three particular types of provision can be very useful in reducing the business's taxable profit.

First, stock provisions, where the business holds stock. A stock provision is intended to reduce the carrying value of the stock at the year-end, which in its turn reduces the profit. The general rule is that stock has to be shown at the cost to the business, or the realisable value if this is lower. So trawling through all of your stock items seeing whether any of them will fetch less than you paid for them can have an immediate effect on the taxable profit. Similarly, looking through your debtor book, if you are a business which sells goods or services on credit, can have a sometimes major effect on your tax bill for the period. By identifying debtors who are unlikely to pay, and putting in a provision against those debtors, you will both be reflecting the profitability of the business more accurately and doing some very effective tax planning at the same time.

Finally, and least obviously, there is the provision which you ought to make, in order to be 'prudent' in accounting terms, for liabilities arising from past sales. The most obvious type of such provision is where you issue a warranty with goods, and there is a statistical likelihood that a certain value of these warranties will be called in by customers whose products have developed faults. But there is a less obvious element, too, for businesses which do not provide warranties: if you feel that remedial work of any type, which will cost the company money, is going to be needed, you should provide for this *now.* Don't wait, that is, until a claim comes in. Providing for it now, in the accounts, reduces your profits for this period, and at the very least defers an element of your annual tax charge.

Research and development

Some readers may feel I go on about this an awful lot, but the enhanced tax relief for R&D is clearly something which is still very little understood: witness the plethora of specialist firms that approach businesses out of the blue, offering to prepare special R&D tax claims. These firms, incidentally, tend to charge something like 30% of the enhanced tax saving, contingent on its being received, so there is a lot of money in it for them – and for the business which successfully puts in a claim.

The basic criterion is that the R&D must give rise to innovation, which is useful for the purposes of the company's trade (only limited companies can claim). But I have seen both restaurant chains and manufacturers of dog food approached by these agencies who promise that a claim is available!

Of course, the sensible and well-informed business doesn't wait for the specialist to approach them but is aware of the ability to claim, basically, 230% of the actual expense as if it were a trading deduction in the profit and loss account. In other words, if you spend £10,000 on R&D (staff costs, subcontract costs and consumables) in a period, you are given £23,000 tax relief for that expenditure, reducing your tax (at a 20% corporation tax rate) by £4,600.

Amortisation of intangible assets

If you've laid out any capital sums on acquiring intangible assets, including goodwill on buying a business (until recently), you may or may not be aware that the annual depreciation write-off (or amortisation) is an allowable deduction for corporation tax purposes.

The amount you can claim is basically whatever amount you have charged against profit and loss, and therefore there is an obvious incentive to writing off the intangible asset concerned in larger rather than smaller chunks.

There's even the view out there that the write-off of these amounts in partnerships is allowable, where one of the partners is a company: but the jury is still out on this one as far as HMRC's considered response is concerned!

A common thread

Perhaps the common thread behind all of these deductions that I've described as being 'out of the way' is that they won't necessarily just happen, but you, as the person in control of the business operation, may need to go out and get them, so to speak. But it certainly may be well worth taking the trouble: if you can reduce the amount you have to pay the taxman, that could be worth a huge multiple of the same amount in terms of the turnover your business would have had to make in order to yield the same result in terms of net profit after tax. So really it's an example of good business stewardship.

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The Offshore Column

Why the smart money is moving to Bulgaria

I make no apologies for my continued enthusiasm for Bulgaria as an international offshore centre. Technically, of course, it should be considered a mid-shore centre. This is because Bulgaria is part of the European Union, a member of NATO and the Council of Europe and a founding state of the Organization for Security and Co-operation in Europe (OSCE). It is a politically stable democracy, and not known for providing offshore financial services. Indeed, the economy basically depends on heavy industry, power engineering and agriculture – all of which rely on local natural resources. It is a staggeringly beautiful country, as anyone who has visited it will concur. It has a small, slightly primitive tourism industry and, because it isn't that popular, visitors are welcomed with open arms. It does not appear on any of the various offshore haven black or even grey lists. Announcing that you are setting up a business in Bulgaria may attract curious comments but it won't tell the world you have tax mitigation on your mind.

The Bulgarian tax system offers one of the lowest tax rates in Europe. It has three easy-to-understand components: (i) 10% on your corporate profits, (ii) 10% tax on your worldwide income and (iii) 0.25% tax on any dividends. This tax system has been in place since 2007 and can only be changed if there is an overwhelming majority (two-thirds) of the members of its Parliament. I should also point out that there is no inheritance tax and no gift tax. VAT is 20%. There are double tax treaties with more than 80 countries. Of course, as a member of the European Union, Bulgaria has been required to participate in the sharing of information agreements that the OECD has been forcing on virtually every country in the world (with the exception of America). However, Bulgaria's geography means that it is slightly apart from the rest of Europe. One has to remember that its neighbours are, basically, Macedonia, Serbia, Romania, Greece and Turkey. None of these countries (with the exception of Greece) is likely to sign up to the same level of information exchange anytime soon. So by using, say, a Bulgarian entity owned by, say, a Macedonian holding company, it should be possible to ensure relatively high levels of confidentiality.

Another thing to love about Bulgaria as a business location is that it offers something it refers to as joint stock companies. These can be more expensive to set up and run but offer a very interesting and almost unique benefit: bearer shares. You have to have more directors on the board as well as – possibly – a supervisory board, and a management board and the minimum capitalisation is, more or less, €30,000. Bearer shares are a rare thing nowadays and to find them on offer within the EU seems almost impossible. I am surprised that the option has not attracted more attention.

I should mention that if you use Bulgaria as part of a slightly larger corporate structure it is possible to reduce even the 10% tax further. Whether this is worth doing will, of course, depend on the total turnover and profits to be shielded. Bulgarian companies are being used for international trade, as service companies and as holding companies. It is worth noting that it takes just three days to set up a Bulgarian company and around ten days to obtain EU VAT registration. In short, Bulgaria could be a fantastic way to reduce your overall global tax burden.

How to avoid CRS and FATCA reporting

The Common Reporting Standard (CRS) developed by the G20 and approved by the OECD in July 2014 calls on jurisdictions to obtain information from their financial institutions and to automatically exchange that information with other jurisdictions on an annual basis. CRS sets out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered as well as common due diligence procedures to be followed by financial institutions.

The Foreign Account Tax Compliance Act (FATCA), on the other hand, is a 2010 US federal law to enforce the requirement for US citizens, including those who live away from the US, to file annual reports on their non-US financial accounts to a body with the rather ghastly name of: the Financial Crimes Enforcement Network (FINCEN). Moreover, the law requires all non-US (in other words foreign) financial institutions to search their records for US citizens with assets and to report such assets and identities to the IRS.

Between CRS and FATCA, it is now extremely difficult to maintain any degree of privacy with regard to one's banking and financial affairs.

Is it in any way possible to legally avoid CRS or FATCA?

Well, if you are actually a US citizen or hold a US Green Card, I think the answer has got to be a resounding: no. There is no way to legitimately avoid such reporting. But if you are not American and have no familial, tax or direct investment connections with the US then the answer is: maybe.

In a nutshell, there is one major economy in the world that refused to sign up to the high level of information exchange demanded by CRS and FATCA. A country that said, actually, we refuse to hand over the names of certain account holders or any other information about their business. A country so powerful that no other country dared argue. That country is – and this won't surprise you – the USA.

If you hold a bank account in America and it generates less than $10 a year in interest… your information will not automatically be offered to any other country in the world. Not surprisingly, lots of US banks are now offering what amounts to zero-interest facilities. What about if you want to invest in US securities? By interposing a company based in, say, an offshore location such as the British Virgin Islands, this should be possible.

Sometimes, the best way to hide something is in plain sight!

Expats give up

I was interested to see that a surprising number of US citizens/residents have been giving up either their passports or their Green Cards. Last year some 4,279 individuals took this action and it looks as if the same number or more will do so this year. It is believed that this is because of the increased actions by the US Treasury and the IRS to trace undeclared American assets and income held abroad. Incidentally, up until now any country who signed an intergovernmental agreement with the US – even if no information had changed hands – was viewed as being compliant. The US Treasury has announced that this is no longer the case. If foreign jurisdictions don't send the information demanded, they will be viewed as being in breach of the agreement.

UK threatens offshore evaders

The British Government is intending to bring in new, much tougher penalties for those who do not voluntarily come forward and pay outstanding taxes from offshore investments and accounts. The Government intends to introduce a requirement to correct (RTC) obligation which aims: "To compel those with offshore interests who have yet to put their UK tax affairs in order to do so by September 2018 ahead of the widespread adoption of the Common Reporting Standard." Failure to do so by the end of the RTC period will make such individuals liable to a new set of legal sanctions for failing to correct. HMRC said: "We believe the RTC proposal and the increased sanctions for failing to correct … will provide a strong incentive for taxpayers to review their offshore affairs and come forward to put them in order before HMRC receives the CRS data." In plain English, although the penalties currently in place are harsh, after 2018 the penalties are likely to be even harsher.

Panama update

Earlier this year the Consortium of Investigative Journalists (ICIJ) published 11.5 million documents relating to over 214,000 individuals in more than 200 countries. The data included a staggering 38 years' worth of information from 1977 onwards. All the data referred to financial transactions involving Panamanian companies.

In the past, the British tax authorities have taken the view that they did not have the resources to check into data received as a result of a leak or theft. Instead, they adopted a somewhat indiscriminate (one might even say scattergun) approach, writing to everyone and telling them to come clean but only investigating a few of the people who didn't. Things are going to be different. Faced with unimaginable volumes of data HMRC's new approach is going to be to look for key indicators in order to ascertain which bits of data could be worth further investigation. If you have any offshore skeletons in your fiscal closet the chances of their staying undiscovered are lessening all the time. Now really is the time to face HMRC and put your affairs in order.

Money

Jonathan Self presents a round-up of personal finance stories and alternative investment ideas.

Comment

All systems go for stocks and shares ISAs

Perhaps, considering how pathetic interest rates are at the moment, it isn't surprising that more and more British savers are putting their money into stocks and shares ISAs. In the tax year 2015/2016 some £21.4 billion went into investment ISAs, which offer savers the opportunity to buy stocks, bonds or managed funds without having to pay either income or capital gains tax (CGT) on any profits. At the moment everyone is allowed to put £15,240 into an ISA but the limit is going to be raised from next April to £20,000. There are, incidentally, around 13 million active ISAs at the moment. Of course, this means that millions of adults in the UK don't have one. One wonders how many people abuse the system. It would be so easy for someone to arrange with friends and family who don't have ISAs (and never plan to have ISAs) to pass on their entitlement. Illegal? Yes. But almost impossible to prove unless the conspirators fallout.

Why investment advice is rarely worth it

I was interested to see that accountants Grant Thornton have done some research into what it costs to give money to a UK financial adviser or investment manager. Using a figure of £100,000, they worked out that over a decade someone would pay, on average, 2.56% of their capital every year for financial planning and the cost of holding financial products. This is quite an interesting figure because in 2012 the UK's then regulator, the Financial Services Authority (now the Financial Conduct Authority), brought in new rules designed to reduce the cost of investment advice. At that point the average cost was 2.86% per year. In other words, the scrapping of commission payments to financial advisers by product providers on new business has done nothing to drop the cost to investors. When you consider the effect of inflation and the fact that any profits are going to be taxed in the current market, I would say on the first 5% of return that a saver is, more or less, maintaining the value of their investment. To see any sort of reasonable gain you need to make returns of 7 or 8% a year. Candidly, if I wanted to make a return of 7 or 8% on a lump sum of £100,000 the last thing I would ever do is hand it to a financial adviser. I would either go for a stock market tracker or put it into an alternative investment that I could control myself.

Act quickly on tax-free investment

If it is your intention to invest in either a venture capital trust (VCT) or an Enterprise Investment Scheme (EIS), I would urge you to get on with it. A variety of factors, not least low interest rates and changes to pension rules, mean that demand is expected to be at record levels this year. When the pension lifetime allowance was cut to just £1 million and annual allowance taper was introduced, pension investors who had used up their annual allowance began to think about investing in VCTs. These have full Government backing and provide 30% tax relief. However, there has been an enormous shortage of available schemes and as this is the time of year when new schemes are traditionally launched many investors have been waiting to see what would be available. It must also be said that new EU state aid rules, which came into effect in November 2015, have placed all sorts of restrictions on the type, size and stage of businesses that are eligible for funding. This means that VCT and EIS operators have to look to smaller and newer businesses. In particular, it is no longer possible to invest in management buyouts or in companies that are more than seven years old. Anyway, as I say, if you are interested in putting your money into a VCT or EIS, I would jolly well get on with it.

Is now the time to buy oil?

One of things I have been wondering about over the last few weeks is whether now is a good time to start speculating on the price of oil. In general, I avoid most commodities (gold is an exception), but it seems to me that oil holds an unusual place as an alternative investment, because it is so crucial to the world's economy.

About 20 years ago *The Times* sent me to interview Dr Colin Campbell, a geologist and one of the main proponents of what is referred to as the 'peak oil theory'. Basically, Dr Campbell felt, from his research, that oil discoveries have already peaked and that production was also in the process of peaking. If what he said then was true we could expect oil to fluctuate up and down in price, but – essentially – over the long term it would be a completely one-way bet.

Well, a lot has happened since then. In particular oil fell and fell in price until it was under $30 a barrel. Now it is trading in the mid- to high 40s. Could it have possibly bottomed out?

Despite the current slump, oil consumption is actually rising. According to the International Energy Agency (IEA), world oil demand has increased by 4.4% over the last three years – which translates into around 4 million extra barrels of oil per day. However, over the same period world oil supply has jumped by 6.7 million barrels per day. In other words, oil producers are creating a staggering 2.7 million barrels per day more supply than there is demand.

Perhaps, not surprisingly, once this position became clear and the oil price started to fall many producers slowed and even stopped production. What next?

Well, there is obviously plenty of oil sitting around not going anywhere. The price of oil tends to work in the opposite direction to the value of the dollar. I don't think it is any coincidence that as the US dollar has fallen the price of oil has begun to increase. On the other hand, it is clear that the fastest-growing economies of the world (in particular Brazil, Russia, India and China) are not in great shape. This points to lower oil demand going forward. Moreover, there are some other factors to be considered. Wind and solar power are growing rapidly. The wind power industry grew by 22% last year. It is also possible that the age of the petrol-driven car is likely to be coming to an end. Bloomberg New Energy Finance recently published an article in which it concluded that within 10 to 15 years electric cars will be the norm. The company says that, by 2040, 35% of all new cars worldwide will be electric. Bloomberg thinks that if electric cars continue to grow in popularity at the current pace by 2023 it could displace oil demand of 2 million barrels a day. Moreover, if driverless cars come in this could have an enormous effect on both domestic flights and the role of city centre hotels. Some people predict an era in which car interiors morph between driving mode and sleeping mode. Finally we have to consider that America itself has upped its own oil production and new technology is allowing extraction of oil from shale and in other ways that was never previously predicted.

Nevertheless, whatever is said about demand increasing and supply being finite, I still believe that oil will keep on rising in price. In fact, I have pretty much talked myself into a spread bet that oil will be between $60 and $70 a barrel two years from today. That is roughly a 30% increase on today's price.

The alternative investor: Classic cars (again!)

The Historic Automobile Group International (HAGI) has recently published research on the classic car market. The top three marques – Mercedes-Benz, Ferrari and Porsche – have risen between 60 and 85% over the last three years. To put this into some sort of perspective, the FTSE 100 fell by around 3% over the same period, while wine, often used for comparison purposes when it comes to alternative assets, was down by roughly 2%. I don't think it would be any exaggeration to say that classic car auction prices have gone crazy. Recent records include: a 1962 Ferrari 250 GTO for $38.1 million, a 1954 Mercedes-Benz W196R race car for $31 million and a 1967 Ferrari 275 Spider (identical to the one driven by the actor Steve McQueen in the *Thomas Crown Affair*) for $27.5 million.

Scarcity is, not surprisingly, the primary driver of the market. Other factors that make a difference to price include condition, documentation, accessories and how much of the original body work remains. It isn't just the cars themselves that are expensive. The *Financial Times* recently reported that collectors will pay up to £15,000 for the tool kit of a particularly rare model. Provenance is, perhaps not surprisingly, also important. If there are gaps where it is unclear who owned the car, this will reduce the value. Another factor that reduces value is poorly executed restoration work. Speaking of the *Financial Times,* they recently made a couple of suggestions as to which cars may become classics in the future. Top of their list was the Porsche 918 Spyder because just 918 were ever made. Brand-new Aston Martins and Lamborghinis with only delivery mileage on their clock, were, in their opinion, also likely to see massive increases in the future.

TRUSTS FOR VULNERABLE PERSONS

Trusts can be a very effective means of making provision for vulnerable people who are unable to look after their own affairs. This is recognised by tax legislation, most recently the Finance Act 2013, which affords various concessions to trusts for the vulnerable. The 2013 Act eliminated various prior inconsistencies and for taxation purposes vulnerable people now fall into two categories:

• people who are disabled, whether mentally or physically;
• children under the age of 18, at least one of whose parents has died.

Such a trust may be created expressly during the settlor's lifetime or on death (for the benefit of someone who is or is expected to become a vulnerable person) or may come into effect via the implementation of intestacy provisions for a minor beneficiary or for someone who is disabled or under the Criminal Injuries Compensation Scheme. Some are also established by disabled people in receipt of compensation awards for personal injury. Finally, trusts created since 2006 on the death of a parent for the absolute benefit of their minor children no later than age 18 also fall within the definition and thus the advantageous tax regime.

Since the tax treatment of the trust has a material impact on the relative suitability of different types of investments, it is essential for trustees to appreciate the various requirements.

To expand upon the categories above, a disabled person is defined as someone who is

• unable to administer their property or manage their affairs, owing to mental disorder within the meaning of the Mental Health Act 1983;
• in receipt of either attendance allowance or disability living allowance, by virtue of entitlement to the care component at the highest or middle rate;
• receiving disability living allowance based on entitlement to the mobility component at the higher rate, or;
• receiving personal independence payment (PIP).

The law relating to trusts for the benefit of vulnerable persons has changed over the years and the conditions for being regarded as a 'qualifying trust' (i.e. one which meets the requirements of the current tax regime) depend on the date when the trust was established.

For trusts created before 8th April 2013, there were limitations on how the income and capital of the trust could be applied, which varied according to the tax that was being considered. In order for income and gains to be taxed on the vulnerable beneficiary, the trust would need to ensure that the trust property can be applied for the benefit of the disabled person and that either the disabled person is entitled to all the income arising from it or, if they are not entitled to all of it, that none of the income can be applied for the benefit of any other beneficiary. To qualify for favourable inheritance tax (IHT) treatment, however, such a trust need only ensure that at least half of the settled property that is applied during the disabled person's lifetime is applied for that person's benefit. Although it is possible to include other beneficiaries under the terms of the trust, in practice these conditions mean that they would only be able to benefit after the death of the vulnerable beneficiary.

Trusts created on or after 8th April 2013 will be 'qualifying trusts' if the terms of the trust include provisions which ensure that during the vulnerable beneficiary's lifetime the trust income and capital can only be applied for the vulnerable person's benefit. However, trustees are able to apply small amounts (equivalent to the lower of either £3,000 or 3% of the trust fund each year) of income and capital without having to prove that it is for the benefit of the vulnerable beneficiary. Provided that these criteria are satisfied, the trust may be a discretionary trust, an interest-in-possession trust (as long as the vulnerable person has the interest in possession) or a bare trust. Where the vulnerable person is a bereaved minor, the trust will only be 'qualifying' if it is created on the death of a parent and the minor acquires an absolute interest in the trust fund no later than age 18.

The tax rules applicable to trusts for vulnerable persons

Income and capital gains tax

While the trustees normally pay tax at the rate applicable to trusts, they may make a claim for special treatment if, in the tax year, several conditions are satisfied:

• at least one of the trust's beneficiaries falls within the definition of a vulnerable person;
• the trustees hold property on 'qualifying trusts' for that beneficiary;
• a 'vulnerable person election' has been effected for all or part of that tax year.

The purpose of making the election is for the income (or capital gains) tax payable by the trustees being broadly equivalent to that which the beneficiary would have paid had it been attributed directly to them.

If no election has been made, it is the type of trust which determines how the income or CGT liability is calculated. For a bare trust, income and gains are assessed on the beneficiary in the normal way, provided that it is not subject to the parental settlement rules under which income can be assessed on the parent. For a discretionary trust, income and gains are taxable at the usual rates and terms applicable to trusts, subject to certain differences:

1. Trustees of qualifying disabled trusts are entitled to the full annual CGT exemption rather than the usual reduced exemption given to most trusts.
2. When a beneficiary of a trust for a bereaved minor becomes absolutely entitled to trust property, CGT holdover relief is available.

Inheritance tax

A gift during lifetime to a qualifying trust for a vulnerable person is treated as a potentially exempt transfer, even if the trust is a discretionary trust . This means that, whereas such a transfer would normally be a chargeable lifetime transfer, the transferor need only survive for a further seven years for the gift to fall outside their estate.

Transfers made out of a qualifying trust to a vulnerable beneficiary are not subject to an IHT exit charge and the trust itself is not subject to periodic 10-year charges. On the death of the vulnerable beneficiary, however, assets held in the trust on their behalf will form part of their estate and so will become liable to IHT.

Planning opportunities

The specific taxation provisions for such trusts afford various opportunities for both the trust beneficiaries and their carers, and a bespoke trust wording which satisfies the qualifying criteria can therefore be more appropriate than a standard equivalent, whether bare, interest in possession or discretionary. Several factors are worthy of consideration in the decision-making process:

- the extent to which the availability of means-tested welfare benefits are of significant importance;
- the extent to which transparency of income tax and CGT are important;
- for a trust which will come into effect on the death of the parent of a minor beneficiary, the relative importance given to maximum tax efficiency as against the beneficiary becoming absolutely entitled to the trust capital at a young age and their anticipated ability to manage this responsibility effectively;
- the extent to which the trustees envisage the need for payments to be made to other beneficiaries of the trust who do not meet the definition of 'vulnerable persons';
- the extent to which the vulnerable beneficiary's estate is already substantial, e.g. in excess of the IHT nil rate band, currently £325,000. Since their share of the trust property is treated as part of the vulnerable person's estate for IHT purposes, if they are already wealthy it may be more appropriate to opt for a normal discretionary trust, particularly if the trust property is worth less than the nil rate band and thus not subject to the relevant property charges within a discretionary trust.

The relative importance of these factors will determine whether the preferential tax treatment of qualifying trusts outweighs their potential disadvantages. If the qualifying trust option is appropriate, suitable professional advice is essential when drafting the trust documentation.

Personal injury trusts and other self-settlements

Personal injury trusts are established as vehicles to receive and then hold compensation awards for individuals who have suffered a personal injury and may take one of a number of forms. The most common are bare trusts or discretionary trusts. The normal approach is to treat them as self-settlements (i.e. as having been created by the claimant themselves).

Provided that the qualifying conditions are met, such trusts have been able, since 22nd March 2006, to count as disabled persons' trusts.

Since the claimant is the same person as the settlor of the trust, it is not normally necessary to make a vulnerable beneficiary election as any income arising will in any case be taxable on the claimant. However, where the claimant is a basic-rate taxpayer and/or does not use their CGT exemption, it can be worth making such an election for CGT purposes as the individual's exemption is higher than that of trustees of a discretionary trust (£11,100 in 2016/17 compared with £5,550 for trustees, assuming that no other trusts have been created by the settlor, in which case the exemption is divided equally between them down to a minimum of £1,110 per trust), while the rate of CGT is also lower (10% for other than chargeable gains on residential property, compared with 20% for trustees). Self-settlements for a disabled person are also an exception to the general rule that prevents holdover relief from applying on a transfer to a settlor-interested trust.

The common settlor/beneficiary means that such trusts are also IHT neutral because the transferred property is treated as remaining in the settlor's estate, provided that the settlor is, or satisfies HMRC that they have a condition which could reasonably be expected to result in their becoming, disabled.

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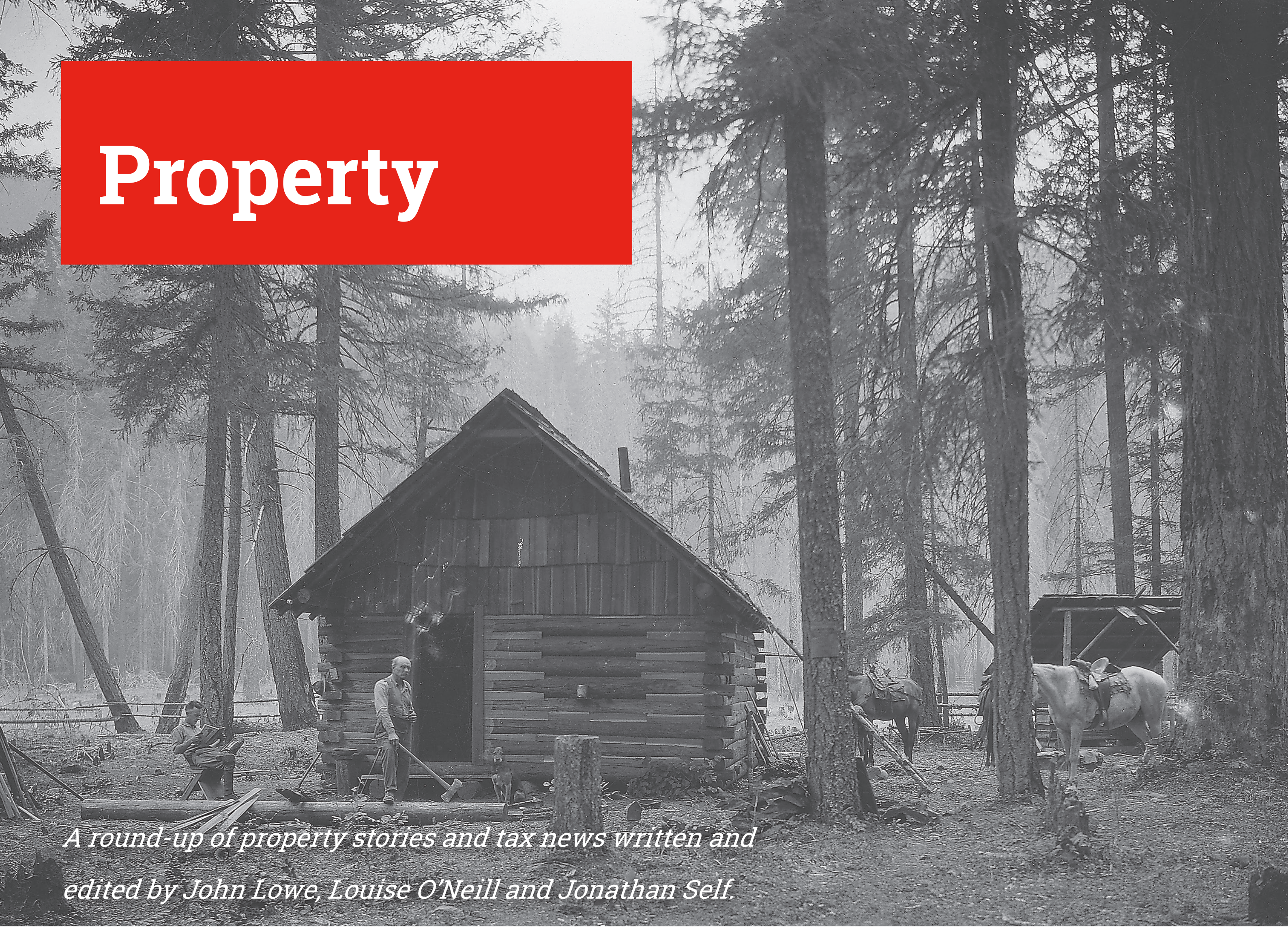
Property



A round-up of property stories and tax news written and edited by John Lowe, Louise O'Neill and Jonathan Self.

THE VAT BENEFITS OF INCORPORATION

We are used to hearing how, by transferring one's residential property holdings into a limited company, it is possible to reduce one's direct tax liability. What many investors do not realise is that there can also be VAT benefits arising from incorporation. VAT is a complex matter at the best of times but it becomes especially Byzantine when applied to property.

If I could offer a single piece of advice to anybody involved in property investment it would be to identify expenditure on which either no VAT or 5% VAT is chargeable rather than the standard 20% rate. While it is true that the correct liability of goods and services is the responsibility of the seller, in my experience a lot of property vendors, construction businesses and professional firms play safe and charge VAT at 20% on all their sales. If you have a sound knowledge of the VAT rate applicable to your costs, you are automatically in a stronger position.

The second general point I wish to make is that if you wish to claim input tax you must do so through a registered business. As one expert put it: "The challenge is to make sure that taxable sales are generated by the project owners and that the work qualifies as a business project or an 'economic activity'."

At risk of repeating myself I must stress that a business is not going to be able to claim incorrectly charged VAT on its returns. If you pay the wrong amount of VAT, you must go to the provider of the goods or services and request a VAT credit. True, this can be done up to four years after your purchase – but how much better (and less risky) to do so from day one? The professional accountancy and taxation media is full of cases of people who were unable to reclaim VAT on building projects because they failed to organise their work or invoicing correctly. Let's take a typical property development and see how we can minimise the VAT liability. I want to imagine that you have decided to purchase a commercial building and convert it into flats. The vendor of the commercial premises you are buying has opted to tax the property. This means that he has been able to reclaim VAT he has had to pay but that, in turn, he must charge VAT when he comes to sell the building. Your potential VAT liabilities are, therefore:

- the freehold cost of the commercial building;
- the building materials;
- labour from your self-employed contractors;
- professional fees required to arrange planning permission, monitor the project, etc.;
- other expenses such as equipment hire.

To give you a feel of how important it is to minimise your VAT liability, if you spend a total of £1 million on the project you could pay as much as £200,000 in VAT. However, with clever planning it may even be possible to get this down to zero.

There are two quick wins to get you started on your VAT-saving exercise. If it is your plan to turn non-residential property into residential dwellings you can advise the seller before the price of the deal is legally fixed (i.e. before exchange of contracts) and the sale will then be exempt rather than standard rated. In order to do this you have to give the seller form *VAT 1614D*. Incidentally, you don't have to have planning permission in place in order to hand over form *VAT 1614D*. The certificate requires only an intention to convert the property into residential dwellings.

So, no VAT on the purchase. What about VAT on the various building services required in order to do the conversion work? Again because you are turning a non-residential property into residential dwellings all the work qualifies for a 5% rate of VAT. This 5% rate also applies to work carried out on a property that results in the creation of a different number of dwellings, such as a detached house converted into two semi-detached houses (or vice versa) and work carried out on a dwelling that has not been lived in for at least two years.

You will notice that I keep making reference to the word 'dwelling'. HMRC has very strict rules regarding what is and isn't a dwelling. The following conditions must be satisfied:

- The dwelling must consist of self-contained living accommodation.
- There must be no provision for direct internal access from the dwelling to any other dwelling or part of a dwelling.
- Separate use of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision.
- The separate disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision.
- Statutory planning consent has been granted in respect of that dwelling and its construction or conversion has to be carried out in accordance with that consent.

The much-quoted example of a house that does not qualify as a new dwelling is when a cottage is built next to a farmhouse for the farmer's mother-in-law to live in but can only be sold as a single package with the farmhouse. Under these circumstances the farmhouse is simply being extended rather than a new dwelling being created. In this situation 20% VAT would have to be paid on all the building services. Incidentally, where conversion of commercial property is taking place it must have been empty for two years or the 5% VAT rate can be applied.

Incidentally, in order to benefit from the 5% rate it may be necessary for builders working on the property to receive a certificate from you to support the reduced charge. This is relevant if you are constructing a new building that you intend to use for a relevant residential purpose, such as a retirement home. Also if you are converting a commercial, non-residential building to one that will be used for a relevant residential purpose, bear in mind that the 5% rate applies not only to the work done by your main contractor but also to any subcontractors working for the main contractor. Sadly, the professional services of architects, engineers, quantity surveyors and other advisers must always be charged at 20%.

One tip that I discovered for myself the hard way is to make sure that you always buy your own building material. Why? By buying direct you can still take advantage of the 5% rate. If you buy through a contractor they will, of course, apply a mark-up to the materials, which will have the effect of reducing (if not completely removing) any VAT savings.

If it is your intention to rent the apartments that you are creating to tenants, you can't claim VAT as an input tax. Renting out residential property is not, annoyingly, considered a business or economic activity. However, if you wanted to sell the property since it was not residential property to begin with you could do so without having to charge VAT. Indeed, this rule is the key to further VAT savings. Basically my suggestion is to register as a business and claim the input tax and then to sell the properties to a connected business such as a limited company. The separate entity then rents out the properties but this has no VAT implications because this entity has no major VATable expenses.

Are there any pitfalls? Well, you must sell your properties to your company before rental income is earned.

Basically, with careful planning you should be able to substantially reduce your VAT liability and, best of all, to claim the rest as input tax.

IT ISN'T DEMAND, IT IS SUPPLY

In the three months following the UK's referendum to leave the EU the number of new sales listings coming to market has fallen at the fastest rate on record. As a result UK house prices have remained static. While the number of people looking to buy has fallen since the Brexit vote, the supply appears to be falling even faster. The Royal Institute of Chartered Surveyors regularly asks estate agents and surveyors what they think is happening to the market. Around one in five currently believe that prices will increase over the next 12 months. During July, the entire estate agency profession thought that house prices would fall over the next year. Prior to Brexit, it is to be noted, seven out of ten estate agents expected a rise.

Capital Economics, an independent property consultancy, believes that despite the initial shock of the referendum easing slightly a slowdown on house price growth and a fall in the number of transactions is still to be expected.

Brexit is not, of course, the only thing that can be blamed for falling house prices. New tax rules and other factors had already caused the market to falter from late 2015 onwards.

THE INCORPORATION DILEMMA

The question as to whether it is better to transfer one's personally owned buy-to-let property portfolio into a limited company is so important that we make no apologies for covering the subject again.

Before looking at the benefits I do think it is worth considering some of the drawbacks. First and foremost, it must be remembered that a limited company is a separate legal entity. Accountancy, tax and other advice prior to incorporation other than the actual cost of forming the company (usually only a few hundred pounds) can run to thousands of pounds. Companies also have to be audited and there will be various other fees and charges that have to be met. Although a company can shield you from certain tax, it has to be remembered that, even if you own it outright, the assets and income of the company are not yours. If you receive any benefit from the company you are going to have to pay tax on it. Extracting profits from a limited company in a tax-efficient manner is probably the most covered subject in this newsletter.

To my mind there are a number of situations where I would almost certainly advise against incorporation. These include:

• Where there are less expensive and less complicated alternatives. These could include selling off some of your properties, using a management or leasing company, sharing property ownership with a spouse or buying additional properties within a company but leaving current holdings personally owned.
• Where the amount of tax being saved doesn't justify the refinancing costs required to transfer a portfolio into a corporate structure.
• Where the property portfolio is too small and/or unprofitable, making avoiding capital gains tax and stamp duty difficult if not impossible.

It must also be remembered that, if your buy-to-let portfolio is funded with borrowings, switching from personally owning the property to a corporate structure could dramatically increase your banking charges. Typically, companies are charged more when they borrow than private borrowers.

So, what about the advantages? Well, the biggest tax benefit is that companies are not affected by the new mortgage interest relief restrictions. Starting from 2018, it will no longer be possible for private buy-to-let property holders to claim all their interest as an expense. From 2018, tax will be charged on pre-interest rental profits with a flat 20% credit for mortgage costs deducted from the tax bill arising. This will mean high rates (typically 60–80%) of income tax for mortgage portfolio landlords, which could make the entire rental business unviable, and if not unviable, certainly less profitable. If you move your buy-to-let properties into a company then all your mortgage interest will become tax deductible.

As discussed in earlier issues of *The Schmidt Tax Report,* the main problem when transferring properties from an individual or a partnership into a limited company is that CGT can be payable. In order to avoid this, incorporation relief must be claimed. This will allow the capital gain to be rolled over into the base cost of the company shares, thus avoiding CGT on the transfer. There is a catch, however. In order to claim incorporation relief, the management of the properties must amount to a business. Ideally the managers should have no other occupation or significant income source. The property business should be run to make a profit and should have a substantial turnover and a degree of scale. Business must be conducted using sound, recognised commercial principles. Finally, it is to be noted that if you wish to claim incorporation relief you must transfer all your property into a company and not just a percentage of the individual properties.

A further word of warning. If you are transferring your properties into a company you could easily become liable for stamp duty land tax (SDLT). However, SDLT can be avoided if the transfer is taking place from a partnership to a company. For a partnership to legally be a partnership there must be at least two partners who each own some property within the partnership, each file tax returns and each want to incorporate the portfolio eventually into the company. There needs to be a signed partnership agreement. The partnership must be a genuine business with a profit motive and with each partner actively involved on a day-to-day business. Mere joint ownership of buy-to-let property does not count as a business. Finally, it is important to establish the partnership at least two to three tax years before you decide to roll it into the company. This is in order to avoid something called general anti-avoidance rule (GAAR). However, given that mortgage interest relief is to be phased in, having to wait two or three years may not be a bad idea.

The different stages of the process are:

1. Form the partnership and run it with your partner on a day-to-day basis for at least two to three years.
2. Establish a new special purpose vehicle (SPV) prior to the incorporation so that the company's tax reference can be obtained, a bank account opened and so forth.
3. Have all the properties valued and sort out your new lending arrangements in the new limited company's name. Remember to let your tenants know.
4. Close the partnership and finalise its accounts. Prepare its last tax return.
5. Arrange for the properties to be acquired by the company.

I must stress that it is extremely unwise to move a buy-to-let portfolio into a company without taking professional advice. Do remember that our own editor, Alan Pink, is an expert in this whole area.

BEWARE OF THE GAAR

Do you own both property and a property management company? And, if you do, does your property management company charge a fee to manage your personally held portfolio? Or, to give you another scenario, do you rent your properties to a company that in turn rents them to tenants? Perhaps your spouse or one of your children works for you in some way? Possibly refurbishing property?

These and other situations may be viewed by HMRC as falling foul of the UK's general anti-avoidance rule (GAAR). The idea behind GAAR is to stop taxpayers from obtaining tax benefits arising from what the taxman considers abusive tax arrangements. Basically, the idea is to stop any sort of financial planning that has no genuine rationale or commercial reason behind it – other, of course, than to save tax. Although GAAR became law in 2013, HMRC did not seem overly concerned to apply it to property investors. This is because few property owners have complicated tax arrangements. More recently, however, accountants have reported cases where the taxman has questioned various arrangements on the grounds that they may not comply with the GAAR. Undoubtedly, this is because of recent changes to tax law and the added incentive that it gives landlords to be more proactive in their tax mitigation.

How can you avoid falling foul of GAAR? To begin with you must make sure that there is always a credible explanation for your overall business and tax set-up. Second, make sure that all your arrangements are strictly commercial. In other words, don't pay anyone, especially an individual or business connected to yourself, any more than you would have to pay a third party on an arm's-length basis. Don't set up payment plans, commercial contracts, schemes, rental agreements or anything else that isn't operating on normal commercial terms.

If some activity produces a tax benefit but no commercial benefit, you can be certain it is going to be in breach of GAAR. Incidentally, the penalties for any arrangements subject to GAAR can be anything up to 100% of the avoided tax.

DON'T LAND YOURSELF WITH AN UNNECESSARY TAX BILL

This article looks at a much-neglected area of property taxation: the avoidance of unnecessary tax on land sales. The term 'land' may be applied to an area a few feet square that is suitable for the erection of a garage, to a massive agricultural estate running to thousands of acres. In terms of value we may be considering something that is worth as little as £10,000 an acre (the average price for UK agricultural land) to millions, if not tens of millions, of pounds (a building site in London or some other desirable city location). The sale of any land can give rise to significant gains and land can change in value overnight. Consider, for example, the effect of planning permission on a green field site or access rights to a piece of otherwise land-locked property. On the other hand, there are lots of potential tax reliefs, including agricultural property relief, capital gains tax (CGT) entrepreneurs' relief, inheritance tax (IHT) business property relief and even main residence relief. If the land is owned personally it may be possible to reduce the tax bill through the process of incorporation and it may also be possible to make savings in other areas such as on VAT and stamp duty land tax (SDLT).

Perhaps the single most important tax to consider when it comes to the sale of land is CGT. Since April of this year the headline rate of CGT has been 20% but a higher rate of 28% is still in place for residential property. Interestingly if you run a commercial trade on a piece of land (e.g. if you farm it) then it may be possible to reduce your tax down to 10% so long as the land is disposed of a minimum of a year after you started the trading activity.

Incorporation has another benefit. The moment you are deemed to have ended an unincorporated business (i.e. the moment you incorporate) you trigger off a three-year period in which it is possible for you to claim entrepreneurs' relief on the sale of any assets. In this instance, of course, the asset would be your business premises or… the associated land. In other words, you can reduce a 20% rate of tax to 10% through the process of starting a commercial trade, transferring it to a business and then selling the assets from that business.

Sadly this rule does not apply to farming. It is very difficult for a farmer to sell land and claim entrepreneurs' relief unless the circumstances are exceptional. That is, unless the land being considered for sale has actually been held by a company. There is a risk to this because it can affect the IHT position, and while 10% is a better rate of tax to pay than 20% it is not as good as 0%! For the appropriate tenancy, 100% agricultural property relief can be obtained, although this only applies to actual farmland and not to development land.
I would just like to say a word here about VAT. If you are selling land to a developer or house builder it may often be worth your while to register for VAT. While this will mean that VAT has to be charged on the sale it does allow you to reclaim what may be high levels of VAT on your professional fees and any other costs associated with the sale. As house builders can normally recover VAT, there is little downside for the purchaser although there will be SDLT on the actual VAT element. It is worth discussing this with your potential purchaser before doing anything irrevocable.
What about IHT? Obviously, the ideal position is to be able to trigger business property relief but other action can be taken including gifting part or all of the land you own while it has low value. In the case of farmland, of course, you may also be able to obtain agricultural property relief on its agricultural value.

Finally, a few words of warning. If you are deemed by HMRC to be trading in land, there is always a slight risk that you could have to pay income tax on the profits. This, of course, would not arise if you were trading through a limited company. Nevertheless it is advisable if planning to engage in any sort of business activity surrounding land to take professional advice. Another area where land vendors get caught is where they sell part of their garden to a developer. It is vital that the land being sold is actually used as a garden and hasn't, for example, been separated away from the garden in anticipation of a sale. One adviser always recommends you photograph the garden being sold well in advance so that you have evidence regarding its status.

RATE UPDATE

Banks have started to charge their larger customers fees for holding cash. In other words, we have now moved into a world of negative interest rates. Interest on savings accounts has hit record lows. The average 12-month savings account pays around 1.15%. Unfortunately, the recent cut in interest rates has only been passed on to borrowers by about 50% of the UK's main lenders. But many property investors will have other worries on their minds, in particular the risk of higher retail prices. Some economists are warning that weak sterling, rate cuts and quantitative easing can only add up to one thing: higher inflation. Deutsche Bank has suggested that the pound could fall a further 10% against the dollar and that if this happens UK inflation is likely to break through its 25-year high of 5.2% within 36 months. Even if this doesn't happen, Deutsche Bank's economists believe that consumer price inflation is going to rise by at least 3% over the same period. The BBC reported that a panel of analysts actually believe that higher import prices are going to see inflation climb by 3% this year, too. What does this mean to private investors and, in particular, property investors? In a zero-rate environment it is likely that many investors will choose tangible assets – everything from infrastructure investment trusts to, of course, property. Better mortgage deals and rent rises may turn many investors back on to buy to let after the negative effect of recent tax rises. Apparently, commercial property prices have been holding steady since Brexit, which may also be interpreted as a good sign.

GO WEST!

I was interested to read that upcoming rail improvements in what is generally referred to as the M4 corridor are planned over the next decade. Apparently, electrification of the Great Western Mainline is on the cards with the result that there will be new, faster trains running from Maidenhead to Reading and Didcot by December 2017 with services on to Bristol (by the end of 2018) and Cardiff (by October 2019). It is also to be remembered that the trans-London Elizabeth Line (Cross Rail) service is scheduled to start running to Reading's newly developed station in December 2019 with intermediate stations in this part of the M4 corridor at Twyford, Maidenhead, Taplow, Burnham and Slough. Furthermore, there is every chance that there will be a new line from Reading and Slough to Heathrow Airport. If this is approved then Reading will be within 25 minutes of Heathrow and Slough within six minutes. The Government has suggested that the service could be operating by 2024 and it expects it to bring £2 billion in economic benefits and 42,000 new jobs. If Heathrow itself expands then there will be even better communications in the area and, of course, even more demand for new homes and business premises.

All of this suggests to me that, if you are looking for an area to invest in, the M4 corridor should not be overlooked. The area has long been known as Silicon Valley and Reading and Bracknell are home to the largest digital cluster outside of London. Indeed, the area has been so successful that the roads have, for many years, been highly congested and some companies have actually had to move back to London because they cannot find the staff they need.

Where would I look if I were thinking of investing in this area?

The first and most logical area is Reading. Reading has actually been growing faster than London (at around 3% per year), as well as offering local employment to people who live there they can still commute to London. The Berkshire Strategic Housing Market Assessment wrote a report that says 700 new properties need to be built in Reading each year to supply demand. There is also a large student presence in the town (14,000 students) and the university is growing at a rate of 400 students per year. Prior to Brexit, Reading home prices had actually been growing at a staggering 15% a year. If you would like to know about the rental market I suggest you look at a website called www.roomrental.co.uk.

Next on my list has to be Slough. Slough hasn't grown as quickly as Reading but it has still managed to achieve an average of 1.4% a year over the last decade. It is not a university town and it is not a digital hub. Rather the local economy is based on light manufacturing, logistics and services. It is obviously much closer to Heathrow and has a high immigrant population. Apparently, around four out of ten local residents were born outside of the UK. I don't think it would be any understatement to say that Slough is locked in the middle of a housing crisis. There is a great deal of social and public housing. Despite this, prices have grown by 22% in the last year. However, it has to be said that Slough is still one of the lowest property price locations in the area, surrounding London. Believe it or not, prices are actually expected to rise a further 33% between now and 2020.

Next up on the list is somewhere altogether prettier: Maidenhead. Maidenhead is extremely affluent and the average house price is around £440,000 compared to, say, £240,000 in Slough. Prices are rising more slowly – in the last year around 9.2%. However, they are expected to grow at approximately the same level as Slough as a result of the new Cross Rail link. To my mind this makes it a much more solid investment since, by preference, I would always rather own premium property. I am particularly keen, myself, in properties that are within walking distance of any train station as these are always much quicker to rent and sell.

Finally, I would urge you to take a look at two much neglected towns: Wokingham and Bracknell. Wokingham is, without mincing my words, hideously ugly. It underwent huge growth during the 1960s and 1970s and none of it was pretty. On the other hand, at its heart is a little market town and the whole area is currently being regenerated that may have the effect of turning it into a much nicer place to visit and live in. Bracknell, on the other hand, was a new town created in the 1960s. It has expanded and expanded well beyond its original borders. This also is in the middle of a long-term regeneration that will, hopefully, turn it into a much nicer place to visit and live. The interesting thing about both these towns is that unlike the areas I have mentioned above there is actually sufficient room to accommodate new housing. Prices have been rising more slowly and are not anticipated to rise at the rate of the towns I previously mentioned. Nevertheless, as more risky but potentially more profitable plays, Wokingham and Bracknell should be on your list.

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