The Schmidt Tax Report

Tax, Money & Property

December/January 2016/17

Mr. Dearly was rather unusually rich for a rather unusual reason. He had done the Government a great service...and, as a reward, had been let off his income tax for life.

\- *Dodie Smith, 101 Dalmations*

The Schmidt Tax Report

Tax, Money & Property

Tax

3 News
The month's roundup of tax-related news stories.

4 Editor's Notes
Investors' relief, visits from the taxman and our first review of Philip Hammond's Autumn Statement.

5 Ask the Experts
Our panel answers a question about transferring a property into a limited company.

6 Feature: Dumb Beats Smart
We bring Occam's razor to the fight between passive and aggressive investing.

7 Feature: Simple Inheritance Tax Planning
How to reduce your family's exposure to inheritance tax.

9 Feature: Capital Gains Tax: What's changing?
We look at recent changes to CGT and, more importantly, the tax opportunities these have thrown up.

10 The Business Column
How to take money out of your company tax-efficiently (with a twist).

11 Offshore News
A roundup of offshore news, including an update on Panama, several developments in Europe and how much US companies are keeping offshore for tax purposes.

12 The Offshore Column
The benefits of dual residency, choosing a new offshore structure and the pros and cons of setting up in the United Arab Emirates

Money

14 News
This month's money stories making the headlines.

15 Alternative Investment: Second-hand insurance policies
We take a long hard look at traded endowment policies and answer some FAQs about them.

16 Autumn Statement Summary
The key points of the new Chancellor of the Exchequer's first Autumn Statement.

Property

17 Property Tax Tips
Furnished holiday lettings, equity release, the business premises renovation allowance, full disclosure and how to make tax-efficient children.

20 Property Investment Notes
Valuing a building is fairly straightforward, so we thought we'd look at how to value the land to put it on, plus build-to-rent and retirement housing.

20 Buy-to-Let Landlords: A false alarm?
Is incorporating your property a good or bad idea?

22 Property Opportunities
Mexico, Gran Canaria and German *Schlösser*

Login details for our new site

Please note that back copies of The Schmidt Tax Report are now available online in PDF form via our website: www.schmidtreport.co.uk

The password is all lower case: str

News

Haven can wait

A survey of more than 1,000 professional tax advisers worldwide has found that the cost of anti-money-laundering and tax-information-exchange initiatives has forced many firms to increase their fees, with a result that some smaller offshore clients are closing down their structures. Respondents reported that clients were reviewing their structures in light of new requirements, cost and reputational concerns. Some clients are considering relocating to protect confidentiality or save cost. Clients cited 'reputation with the general public' as one of the most important issues when choosing an offshore location.

HMRC after big business

HMRC believes that transfer pricing is causing a shortfall in tax revenues of £3.8bn from larger businesses. This amount is up from the £2.4bn last year. HMRC is planning a number of new campaigns to try to close the gap.

Capital gains tax take-up

The capital gains tax (CGT) paid by individuals has jumped by nearly a quarter in the last year to £6.9bn. The equivalent amount in 2013/14 was £5bn. The higher tax rate of 28% was introduced in June 2010 in George Osborne's post-election Budget to increase the overall tax take; the basic CGT rate was previously 18%. It is believed that a high percentage of the increase is a result of buy-to-let investors selling properties.

HMRC complaints up

The number of complaints against HMRC are at their highest since 2008/9. HMRC handled a total of 81,066 complaints in the year 2015/16, 7,000 more than a year earlier and 16,000 more than 2013/14. Complaints were at their highest in 2008/09, at 83,917.

UK taxes rise as others fall

The global trend for reducing income tax over the past two decades has been ignored by successive UK governments. UK income tax rates for high earners have risen by 4% compared to the global average cut of 5.6%. The UK is one of the few global economies that have increased the income tax rate. Taxpayers on low incomes have, however, benefited from cuts, with their tax bills reduced by 9% since 1996, the global average is still less, at 11%. UK GDP has grown by 95% in the past three decades, compared to the global average of 135% GDP growth.

Innocent businesses to be fined

HMRC has proposed massive fines of up to 30% of lost VAT for companies that trade with other businesses involved in suspected VAT fraud – even if they are innocent. The First-tier Tax Tribunal has little power to sanction HMRC when it wrongly pursues innocent companies, or to award costs to businesses that win cases

against HMRC.

New guidance for professional advisers

New guidance has been issued regarding the standards expected of tax advisers and agents by the leading UK accountancy and tax bodies. The guidance has been endorsed by HMRC and sets out clear professional standards in relation to the facilitation and promotion of tax avoidance. The CIOT, ATT, AAT, ACCA, ICAEW, ICAS and the Society of Trust and Estate Practitioners have all circulated *Professional Conduct in Relation to Taxation* (PCRT) to their members. The seven bodies said in a joint statement: "We believe these new standards achieve an appropriate balance, making clear that tax avoidance schemes and bad behaviour is not acceptable, while enabling many advisers to continue undertaking responsible tax planning to make sure their clients pay the right amount of tax. We hope that those tax advisers and agents outside of the seven PCRT bodies will also commit themselves to following this code."

Editor's Notes

Great relief

My guess is that we mention entrepreneurs' relief (ER), which allows entrepreneurs to pay just 10% tax on their capital gains, in almost every issue of this publication. Inexplicably, however, we haven't given the same attention to its sister concession: investors' relief (IR).

IR applies to external investors in unlisted trading companies (or holding companies of trading groups), for newly issued ordinary shares acquired for new consideration on or after 17th March 2016. The investment must be held for at least three years from 6th April 2016. A £10 million lifetime IR cap will apply in *addition* to the lifetime ER allowance.

The conditions for ER on a disposal of shares require the individual to be an officer or employee, and hold at least 5% of the ordinary share capital of the company, with those shares giving the individual at least 5% of the voting rights.

The new rules for IR, which apply to investors who are neither officers nor employees, enable investors in unlisted trading companies to access the 10% rate as long as those shares are subscribed for on or after 17th March 2016, held continuously for three years, and disposed of on or after 6th April 2019.

There is no requirement to hold 5% of the shares or voting rights. As with ER, there will be a £10 million lifetime limit for the relief and this is in addition to the £10 million ER allowance for employees. The rules will also apply to qualifying beneficiaries of trusts.

Conditions are included to ensure that the relief only applies to new shares issued for genuine commercial purposes, and will also be restricted so that it will not apply to investors where those connected with the investor are officers or employees of the company.

Although the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) provide existing tax incentives for investors to invest in qualifying businesses, the introduction of IR allows companies to raise additional funds outside these schemes, as well as potentially being attractive to investors who have exceeded the limits for EIS and SEIS.

The relief is, of course, unfair to investors who put their money into unlisted trading companies prior to 17th March 2016. If you find yourself in this position and you hold a decent-sized stake in the company, it would not be unreasonable to see whether the equity could be reorganised in some way.

It has long been the case that capital gains are more attractive than income tax and this is even truer nowadays. Of course, if you can take advantage of the EIS or SEIS you may be able to avoid all tax, *but* the benefit of IR is that its conditions are considerably less onerous.

Please come back another time

When I wrote about unannounced HMRC visits as recently as five years ago I knew that there was almost no chance that any *Schmidt Tax Report* reader would ever experience one. It was, bluntly, good copy.

Things have, however, changed. HMRC is now adopting a much, much more aggressive approach towards taxpayers and the accountancy media is full of stories of clients who have been caught unawares. Moreover, HMRC has been setting up 'task forces' to visit a specific area and call upon, generally speaking, a certain type of business. So, for example, the task force may go to Norwich for a week and visit a number of, say, convenience stores, small manufacturing businesses or recruitment agencies. I am afraid that unannounced visits are going to become distressingly commonplace in the future.

I thought, therefore, it would be worth reminding you that unless HMRC has a warrant it cannot insist on being allowed to make an inspection, and nor can its officers insist that you answer any questions. If you are unlucky enough to be chosen for a visit, you will usually find up to four HMRC officers arrive together and that the most senior will hand you a letter and a factsheet. There are two types of letter. One is entitled: *Unannounced Visits for Inspections Approved by the Tribunal* and it is accompanied by factsheet *CC/FS5*. It warns you that you could be liable to penalties until you allow HMRC to carry out the inspection. The second is entitled: *Unannounced Visits for Inspections* and is accompanied by factsheet *CC/FS4*.

Neither letter entitles HMRC to insist on entry, and although there is a possibility of penalties with the first type of letter, in reality, providing you cooperate by offering a reasonable alternative date, it is unlikely they will be imposed.

On the whole, it is my belief that it is better to say to any HMRC team that calls on you that you would like to have your accountant or tax adviser with you when they ask you questions and ask them to wait while you telephone their office to get dates and times when they will be available.

The Autumn (under)Statement

The Autumn Statement was so dull and contained almost nothing – from a tax perspective – that hadn't been expected it hardly seems worth reporting on. However, it would seem irresponsible of us not to provide a summary of its contents. There follows, therefore, is the *Schmidt Tax Report's* Concise Version of the Autumn Statement.

The Chancellor of the Exchequer, Philip Hammond, announced that from 2017 there will be two Budgets a year – in the spring and autumn.

The 2017/18 personal allowance will be

£11,500. It will rise to £12,500 before the end of this parliament. The higher-rate threshold will be £45,000 and will rise to £50,000 over the same period. The National Living Wage will be £7.50/hr from April 2017. The income tax and CGT reliefs for employee shareholder shares (ESS) are to be stopped and there are plans to scrap the reliefs completely because they are being used primarily by wealthier employees for tax-planning purposes. The date by which employees must 'make good' (i.e. reimburse the employer) in relation to non-payrolled benefits in kind will be 6th July after the end of the tax year.

The chancellor confirmed that, from April 2017, salary sacrifice arrangements may be used to achieve tax and NIC savings only in the cases of: employer pension contributions and advice, employer-provided childcare, cycle-to-work schemes and ultra-low emission company cars. If taxable benefits are provided as part of a salary sacrifice arrangement, the employee will be taxed on the higher of the cash equivalent of the benefit as set out in the benefits code or any amount of salary sacrificed in exchange for the benefit.

Payments in lieu of notice of up to £30,000 will be slightly easier to claim. The 'disguised remuneration' rules are to be extended to tackle tax-avoidance schemes used by self-employed people. Draft legislation will be prepared regarding aspects of partnership taxation, especially in relation to profit allocations. Class 2 National Insurance contributions will be abolished from April 2018. There will be a reform of Class 4 contributions to build in entitlement to state benefits. It is proposed to do away with the tax benefits associated with incorporation for owner-managers.

It is proposed to change the rules as they relate to research and development relief including as it relates to the patent box regime.

From April 2017, the amount of losses that companies can use against their profits will be restricted. The deductibility of interest for UK corporation tax purposes will be restricted from April 2017.

Individuals will become deemed UK domiciled if they have been UK resident for 15 of the past 20 years. A person who was born in the UK but gave up UK domicile will become deemed domiciled for inheritance tax (IHT) purposes on returning to the UK after a year of tax residence. From April 2017, UK residential property held through an offshore company or trust will be liable to IHT.

It is planned that intermediaries arranging complex offshore structures for their clients will be forced to disclose full details to HMRC.

Taxpayers who owe income tax, CGT or IHT as a result of offshore income, gains or assets must correct their tax affairs by 30th September 2018 or face punitive higher 'failure to correct' penalties. From September 2018, revenue authorities in more than 100 jurisdictions will automatically exchange information with each other.

The definition of reasonable care will be legislated in tax-avoidance cases in which the arrangements have been defeated. The taxpayer will no longer be able to use the defence that he relied on non-independent advice (such as that commissioned by the scheme promoter) to show he took reasonable care.

Insurance premium tax is to rise by 20%, from 10 to 12%.

Mr Hammond still intends to launch the lifetime ISA in April despite criticism.

Ask The Experts

Q. I have a query concerning a client, husband and wife, who hold 25 properties between them, the rental income from which is their main source of income. Most of the properties are held jointly, some by each of the couple but in trust for each other. They have been running this activity since 2002 and feel they are entitled to treat it as a property business. The only reason any property has not been in joint names has been to assist with obtaining mortgages.

They wish to transfer the properties to a limited liability company and understand that although they ought to be able to obtain holdover relief, they are concerned about the question of stamp duty. They understand that stamp duty can be avoided if their property is accepted as being a partnership on transfer to the company, and they feel, to all intents and purposes, their property business has effectively been run as a partnership (and they have indeed always considered themselves in partnership in this business). They have more formally entered into a partnership as from April 2015 but wonder whether HMRC may consider this as a contrivance purely for the purpose of avoiding stamp duty, if in fact stamp duty can be so avoided. The transfer of ownership is mainly to assist with the forthcoming withdrawal of tax relief for mortgage interest.

In the foregoing circumstances, are my clients able to avoid stamp duty on transfer of the properties to the company?

If not, can you please advise me of a better approach to this problem to avoid stamp duty, or perhaps whether using an LLP would assist?

Thank you in anticipation of your response at your earliest convenience.

S. D., via email

A. 'Partnership' for stamp duty land tax (SDLT) is defined as a partnership under the Partnership Act 1890 (amongst others). So if the partnership they entered into in April 2015 fulfils these conditions and their interests in the partnership are the same as their shares in the company then they should qualify for the SDLT relief regardless of the fact that the partnership is relatively new. However, the Partnership Act also states that "jointly owned property … does not of itself create a partnership" (PA 1890 s 2(1)).

We would also draw your attention to HMRC manual PIM 1030, which talks a lot about jointly held property vs. partnership property and how the two are treated for tax purposes. It is clear from this that HMRC will presume there is not a partnership and the onus will be on you to prove otherwise. Certainly, if there is a partnership, we would expect partnership accounts, partnership tax returns, a partnership bank account into which all rents are paid and from which all expenses are met, and both the properties and the mortgages to be registered in the partnership's name.

Your question implies that at least some of the properties are not going to fulfil this criterion. Also, if the properties were mortgaged, we would query whether a transfer to corporate ownership would be a good idea. Have the clients discussed this with their lenders? In our experience, lenders will wish to renegotiate the terms on their loans on the change of ownership and the terms offered to a company will be significantly worse than the clients are enjoying personally.

Feature: Dumb Beats Smart

More than 75 years ago, Fred Schwed wrote a book entitled *Where Are the Customers' Yachts? or A Good Hard Look at Wall Street.*

The title refers to a story about a visitor to New York who was admiring the yachts of the bankers and brokers docked in the harbour. Naively, he asked where all the customers' yachts were. Of course, none of the customers could afford yachts, even though they dutifully followed the advice of their bankers and brokers.

Although written so long ago, Schwed's book is as relevant – and informative – today as it was when first published.

However, there are signs that the tide is turning and investors are, quite rightly, starting to question the fees that they are paying to both their portfolio manager and to the active fund management industry.

Active or passive?

The fund management industry is a highly competitive environment. This is perhaps not surprising since it is full of bright, talented, hard-working, highly ambitious and self-confident people. Basically, the industry breaks down into two camps. The first are 'active' managers, who believe that through their skill, insight and hard work they can beat the return of the market, by taking advantage when the market gets it wrong. Sounds like a nice promise.

The second group, 'passive' managers, believe that markets work pretty well and that the chance of picking up and exploiting any mispricing that is sufficiently large to outweigh the costs of doing so is slim, so they do not try. Their aim is to capture the market return as closely as possible for the investors in their funds, by buying every stock in the market (or specific index) in the same proportion as the index. For example, a FTSE 100 index fund may well own all 100 stocks in the same proportion as they appear in the index. How dull (and dumb in the eyes of active managers)!

The polarisation between these two camps is the source of much debate, some of it quite heated at times. Passively managed funds – sometimes known as 'index trackers' or 'index funds' – are often positioned as being in the 'dumb' part of the fund marketplace. Common arguments built against passive funds are often based on themes that seek to put them down and talk up the sophistication of an active manager's proposition. Here are a few you may have heard, and the underlying inferences:

- Why would you blindly want to own 'rubbish' stocks just because they are in the index (e.g. the FTSE 100) – the inference being that a skilled active manager would avoid the rubbish and pick only 'good' stocks.
- Why would you accept 'certain defeat' because index funds will always slightly underperform the return of the market owing to their costs – the inference is that if you invest with an active fund, you at least have the hope of beating the market, though no probability is ever attached to this implied promise.
- Why would you want to have an unthinking, rules-based, computer-driven approach to managing the fund – the inference being that what you really need is a skilled pilot to pick the right investments and be there when you need them, in order to avoid market falls by moving into cash?

In fact, the passively managed index fund has suffered a torrent of putdowns from the active industry from the day the first fund was launched in the US 40 years ago. One of the first was that, as an American, it was even deemed unpatriotic not to try to beat the market! At first glance, these criticisms may seem reasonable. However, if one digs a little deeper, it quickly becomes evident that they do not stick and the tables quickly turn on the active management promise.

Looking a little deeper

It is easy to think that a smart, well-educated fund manager should be able to beat all the other dumb investors in the marketplace. After all, if you ever need a barrister to defend you in court, you want to engage the brightest, sharpest QC you can find, who will fight your corner and deliver an outcome in your favour and thus justify the enormous fee you end up paying him or her. The value of doing so is quite straightforward. The situation is similar in other fields, such as medicine, engineering or, indeed, aviation. In the investment world, this is not the case, by any stretch of the imagination (or evidence). Here's why.

The perception of how markets work divides the two camps

The first thing to remember is that in aggregate all investors are the market. In the UK, around 80–90% of all money is managed by professional fund managers on behalf of individuals (via funds) and pension funds. So, when active managers claim that they are going to 'beat the market', what they are really claiming is that they are going to beat the majority of the other smart, well-educated and motivated professional investors, who are often backed by vast global research resources. Even if they are able to beat the other investors before costs, investing is never without cost because there are plenty of stages in the investment process at which various parties extract money for themselves. Some of these costs are explicit, such as management fees and other costs which together form the 'ongoing charges figure' (or OCF), but others are less evident, such as those arising when underlying investments are bought and sold (turnover).

The mathematical reality is that the average passive fund will beat a majority of active funds because of their cost advantage. The cost advantage of passive UK equity index funds (e.g. an index tracker following the FTSE All-Share Index) versus the average costs of an actively managed UK equity fund is in the region of 0.9% a year. The odds in favour of the dumb product already stack up well at this level.

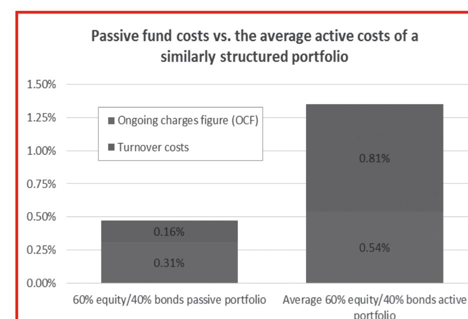

Figure 1 Passive vs. active average costs.
Source: Albion Consulting.

Active management is a zero-sum game: one investor's profits must come from another's losses.

The simple maths behind the zero-sum game (all investors are the market, so the average investor will receive the return of the market) needs to be extended to take into account the comparative costs of implementing the strategy of the two camps. Actively managed funds generally have significantly higher costs than passively managed funds, both in terms of the fees they charge and the costs of buying and selling securities between each other.

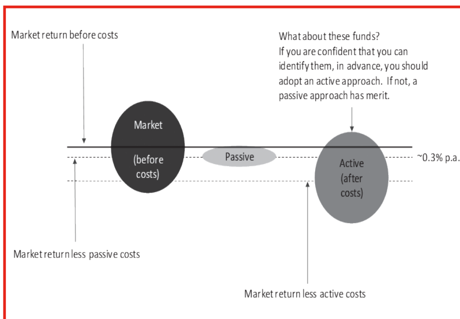

Figure 2 The mathematics of the less-than-zero-sum game.

Source: Albion Strategic Consulting.

How active managers can potentially win

One prominent theory (The Efficient Markets Hypothesis) suggests that market prices reflect all publicly known information about a company or security issuer. Thus the price of its shares, determined by the aggregate view of all market participants, is the best estimate of its true value. If that holds true then one should adopt a passive approach to investing.

If markets do not work well then skilled active managers should be able to take advantage of this. Paradoxically, the more skilled, talented and hard-working the profit-seeking 'active' market participants are – such as hedge fund managers, other fund managers and equity analysts – the less likely that any profitable opportunities that do exist will persist.

Crystal ball gazing – fun but ineffective

As active managers do not believe that markets work particularly well, they make short-term forecasts either about specific companies' earnings or the valuation levels of markets, to position their portfolios. The implication is that they (a) either use the available information better than others or (b) they have better information that others do not know, obtained via company visits and deeper industry insights. This often forms part of their marketing message such as, "We have 220 analysts on the ground in 58 countries…" or, "We make 500 company visits a year." As before, these types of claims all appear to be logical and likely to improve the chances of a better (market-beating) outcome, or so it would naively seem.

By and large, the track record of forecasting across all walks of life is pretty weak (whether by weather forecasters, politicians, economists, academics or fund managers – not to mention pollsters!) and has been subject to much research. All humans are suckers for a good, confidently told, forecasting story, as we can't bear uncertainty. That does not mean the story is right.

An elegant piece of research by Jack Bogle , who has been a pioneer of index fund investing and a true advocate for investors receiving a fair deal when they invest, reviewed all 355 actively managed US equity funds over the 36-year period from 1970 to 2005. This is one of the longest studies undertaken on how well active managers have fared and the odds investors face in trying to pick a winning manager, today, for the years ahead. This is what he found

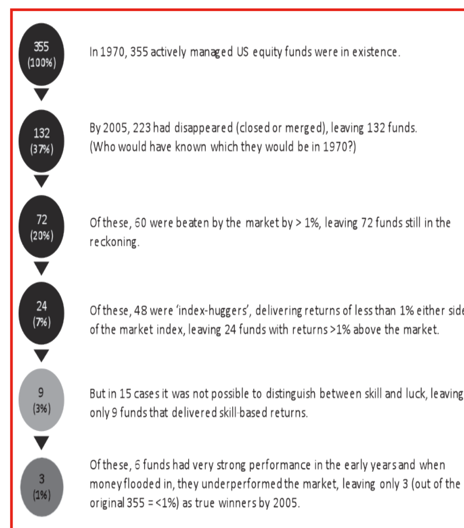

Figure 3 It is remarkably hard to deliver on the active promise.

Source: John C. Bogle, (2007), The Little Book of Common Sense Investing, John Wiley & Sons, Inc. Hoboken, NJ.

Are those the sort of odds you want to play with your money?

In summary

Most supporters of passive investing have become so as a consequence of looking at the evidence available. Most will admit to some sort of a Damascene moment when the realisation dawns on them that success in investing comes not from chasing long odds (hot markets and star fund managers) but from consistently making decisions that maximise the chances of a successful investment outcome. Most will also readily accept that a few truly skilled active fund managers do exist but they recognise that, despite much effort being expended in the endeavour, no one has yet defined any robust and consistent means of picking them ahead of time and they will not take the chance with their clients' money trying to do so.

And finally…

A note from the world's most successful active manager:

When the dumb investor realises how dumb he is and invests in an index fund, he becomes smarter than the smartest investor … most investors, both institutional and individual, will find the best way to own common stocks is through an index fund that charges minimal fees. Warren Buffett, Chairman, Berkshire Hathaway and legendary active investor (one of the few)

Carolyn Gowen is a Chartered Wealth Manager and Certified Financial Planner at award-winning City-based wealth management firm Bloomsbury. She has been advising successful individuals and their families on wealth management strategies for over 25 years. Carolyn can be contacted on email at truewealth@bloomsburywealth.co.uk or by calling 020 7965 4480.

Feature: Simple Inheritance Tax Planning

It's important, while thinking about the more sophisticated tax-planning situations that some people find themselves in, not to forget the basics. Inheritance tax (IHT) is a problem for an increasing proportion of families these days. Formerly the preserve of the super rich, IHT now could more fairly be described as the 'scourge of the middle class.' With a threshold of £325,000, which incidentally has stayed the same for nearly ten years now, the term 'stealth tax' applies equally well to IHT. In the period since the nil band was first set at this level, property prices have nearly doubled in some parts of the country, in particular London, of course.

So IHT is no longer a minority interest but something that can seriously damage the wealth of only moderately well off people.

As such, IHT planning is a big subject, and one which deserves at least a book to itself. However, we thought it would be useful just to set out a very brief summary of some of the more straightforward ways of reducing your family's exposure.

What follows doesn't claim to be a comprehensive list of all the planning techniques, but hopefully it will stimulate something in many of our readers.

1. Sensible will planning

Although opinions differ, in our view where a married couple are considering making their wills, they should always include a 'nil band discretionary trust'. What this does is provide that the maximum amount of a person's estate should go into trust rather than to their surviving spouse – widow or widower. The effect of this is that a taxable value of up to £325,000 (currently) can be taken outside the estates of any individual, and used either to benefit the surviving spouse at the trustee's discretion or to be applied in whatever way for the benefit of family beneficiaries seems appropriate at the time. This avoids burdening the surviving spouse with part of the estate that would then create an IHT-planning problem for them when the time came.

2. Skipping a generation (I)

Also when you are making your will, if you're in the increasingly common situation of having children who have already made their way in the world, and don't actually need a legacy from you, it makes sense to leave your estate to your grandchildren (or even great-grandchildren) instead. Since IHT is charged on each death, it's in principle a tax on each generation as the family wealth filters down. By missing a generation in your will, in this way, you avoid a 40% tax charge on the whole amount of wealth passing from generation to generation. As a variant to this, you could leave your estate to a family trust (on second death out of a married couple) so that the wealth doesn't form part of anyone's estate.

3. Skipping a generation (II)

Looking at this same situation from the other angle, you may be in the position of a reasonably elderly beneficiary of a parent's will. If your mother or father are on their last legs, or indeed have died within the last two years, having left all of their assets to you in their will, consider instead varying the will provisions (which can be done at any time in the two years after death) such that the estate passes down two or three generations instead. A variation of someone's will after their death, if done properly, is treated for IHT purposes as if it had been done by the deceased.

4. Lifetime gifts

There's a common misapprehension out there that there's a limit to the value of lifetime gifts you can make. Nonsense! You can give away as much money as you like to the next generation or generations, provided you take the simple precaution of living for seven years after doing so. A gift of any amount becomes exempt after seven years.

5. Use your exemptions

IHT exemptions come into play when you make gifts which are less than seven years prior to your death. The best known of these is the annual exemption, which is £3,000 per person. If you don't use this on lifetime gifts, you don't get it on death, and so those who may not live for another seven years should certainly be using this exemption. If you haven't used the exemption in the previous tax year (ended 5th April) you can carry it forward one year – and one year only. So a married couple, for example, who haven't made any substantial gifts in the last two tax years, can give away £12,000 (two years' annual exemption each) without that gift falling back into the charge if they die within seven years.

Less well known is the exemption for gifts in consideration of marriage. Parents can give up to £5,000 each to their children as wedding presents, with a similar exemption regardless of whether they live for seven years. More distant relations can also make exempt gifts in consideration of marriage, of lesser amounts.

6. Insurance policies

Another exemption which can be very good to use is what's known as the 'normal expenditure out of income' exemption. Typically, this is used by way of paying premiums into an endowment life policy. If the premiums are covered by your available income (which they normally are) they don't come back into play as gifts even if you die within seven years. The policy can be written in trust for your nearest and dearest, and the effect is that the payout, which happens on your death, is free of IHT, and you have managed to pass what can be a substantial amount of family wealth to the next generation tax-free.

7. Investment in 'business property'

Most 'business property', that is interests in trading businesses or the shares in trading companies, is 100% relieved from IHT. If there is a family business in point, it can therefore be a very good idea to make sure that the oldest generation of the family has a substantial stake in that trading business. That way, they can receive income from the business during their lives, thus ensuring financial security, without paying any IHT on the value when they die.

As a variant on this, some unquoted, in particular AIM (Alternative Investment Market), stocks are specifically marketed as being eligible for business property relief. Obviously, one needs to exercise a considerable amount of caution in investing in these smaller trading businesses, because the IHT relief is there on account of the risk the owner is taking. However, a wise investment is starting with a 40% 'head start' in terms of the return on capital you get, because of the absence of the 40% IHT charge on the death of the investor.

8. Make use of the 'loss to the estate' principle

IHT is charged on gifts to the extent that they reduce the value of a person's estate. So giving away a joint interest in an asset, for example, can more than rateably reduce the value of what the individual owns. Let's take an example. An investment property is owned wholly by an old man, who decides to give away a 10% interest in the property to his son. He can't afford to give away more than 10%, because he relies on the rental income to live. But a 10% gift reduces the old man's estate by more than 10% of the value of the property, because what he retains after the gift is only a joint interest in the property. This results in a major discount against the pro rata value of the property.

9. Equity release

If the main asset in your estate is your own home, IHT planning is very difficult and restricted by all kinds of practical and tax considerations. One idea that does still work, though, is taking out some kind of 'equity release' arrangement against the house. An equity release company will pay you a lump sum down, and in return will have security against your home which they will normally cash in on when you (or the last of you and your spouse) finally die. The 'loan' does not result in any requirement to make repayments or pay interest during your life, because that isn't the idea of the arrangements. However, the lump sum you receive can then, if you choose, fund either your living expenses or the making of substantial gifts to the next generation or generations.

Hopefully, at least one or two of the above ideas may be of interest. It's not an exhaustive list, as we say, but there are likely to be very few estates potentially within the scope of IHT that don't provide the scope for planning along the lines of at least one or two of these ideas.

Feature: Capital Gains Tax: What's Changing?

Capital gains tax, or CGT, is very much a politicians' tax. In the first place it wasn't introduced so much to raise revenue (it doesn't really raise much of that) but to punish the rich for having money, and to pander to the Inland Revenue's morbid fear of 'avoidance'. And being a politicians' favourite, it comes in for the sort of regular tinkering that we have come to know and hate in Budget after Budget.

So we thought it was high time, indeed long overdue, that we gave an update on important recent changes – and the planning opportunities which come from these.

CGT rates

Even in such a simple matter as the rate of tax, there's been endless change, with the rate going up and down like … let's say a yoyo. For many years, CGT was charged at a flat 30%. Then a rule was introduced that it was charged at a person's income tax marginal rate, either basic rate or 40% depending on how much income the individual had. Then we had 'taper relief', which reduced the rate depending on how long you'd held the asset – a relief which was changed radically several times in its ten-year life. Then we had a flat 18% rate, and then, up until 5th April of this year, a dual rate of 18% for basic-rate taxpayers and 28% for higher-rate taxpayers. Are you with us so far?

The rates have now been changed again, with the top rate being 20% for all assets except the hated residential property and 'carried interest' held by hedge fund managers.

Readers with a mathematical turn of mind will have noticed that this most recent change in rates, which applies from 6th April 2016, is actually a reduction for most sorts of asset. Interestingly, the political yoyo which is CGT rates is on its way down at exactly the same time (6th April 2016) that income tax rate on dividends from companies have gone up.

So let's start off our comments on tax planning by illustrating how this changes the tax-planning landscape – potentially very much in our favour.

Bod runs a company which trades successfully, and he also owns the office building and warehouse that the company trades from. This cost him £100,000 some years ago but is now worth £500,000. There is, as it happens, a similar amount sitting in the company in cash that he would like to get his hands on but is afraid of incurring too much tax in taking it out as a dividend.

So he sells the commercial property to the company. It's true that this triggers a gain, but the tax on this is only £80,000 (i.e. 20% of the £400,000 gain) where a dividend of £500,000 would have cost him nearly £200,000 in income tax. This is because the top rate of income tax on dividends is now about 38% – very substantially more than the top rate of CGT for commercial property.

Goodwill

The tendency of the accountancy profession to indulge in what might be called 'goodwill shenanigans' has given rise to a change to the entrepreneurs' relief rules. Accountants had worked out that selling goodwill to your own company was a very tax-efficient thing to do – to put it mildly, as it could even give rise to negative rates of tax. Because entrepreneurs' relief, which applies where you sell a trading business to your company, results in a 10% tax charge, and the goodwill (if it post dates April 2002) gave rise to a tax deduction in the company's hands at 20%, you actually ended up with HMRC effectively paying you the 10% difference in tax reductions, resulting from selling the goodwill, effectively 'to yourself'. Having let this go on for some years, HMRC finally got fed up with it last year and changed the rules so that you get neither the entrepreneurs' relief nor the corporation tax reduction in this situation.

So, a loophole well and truly closed? Not at all!

We refer our honourable readers to the example we gave just now: the example of Bod. Goodwill is now in the same position, effectively, as the commercial property we discussed there. If the individual has a business outside the company, and sells it to the company and realises a capital gain, the tax rate is now 20% and there is no relief for the writing-off of the goodwill in the company's books. But 20% is still a lot better than 32.5%, or 38%, that the individual would be paying if he took the money out as a dividend rather than as sale proceeds for the goodwill.

Moreover, stamping on tax planning using goodwill in this way has the (no doubt unintentional) effect of highlighting the fact that the planning still exists for all other kinds of intangible assets. Here's an example.

Gordon is a skilled computer software engineer. He runs a company which exploits the software that he writes, but he makes sure (on the advice of his accountant) that the ownership of that software rights remains very firmly with himself as an individual. When the software is fully written, he commissions an arm's-length valuation from a specialist valuer. Because of the capability of the software of earning profits for the company, the valuer sets the amount at £1 million. So Gordon sells the goodwill to his company for this fair market value, paying CGT at 20% (i.e. £200,000). The company then writes off the software over five years, which is its expected useful life, and over that period gains corporation tax relief, which we'll assess also in the same figure, £200,000. So in tax terms, what this equates to is £1 million of cash profits, over the period, which don't bear tax at company level and bear only 20% tax at the personal level. This is looking pretty good, is it not, in comparison with Gordon taking income from the company in the form of remuneration or dividends? Shall we pencil in something like £250,000 as the overall saving?

Non-residents

This is a blow below the belt. Ever since CGT was introduced by the rabidly socialist government of Harold Wilson in 1965, non-UK residents have been outside the scope of the tax, and this has hugely benefited the country by attracting inward investment. Now a purportedly Conservative government has reversed this – but only in respect of residential property, where they are presumably trying to prevent the market from overheating.

The new exposure to CGT of non-residents comes with a transitional relief: only gains over the 6th April 2015 value of the UK residence are subject to tax. So it may be a good idea for non-residential-property owners to secure valuations of their portfolio as at that date – it's still not too late to do this – as this could be good evidence to reduce tax on an ultimate disposal.

The other planning point arising from this most recent CGT change? Don't trust politicians, and don't invest in the UK if you are a non-UK resident!

The Business Column

Overdrawing for fun and profit

In this month's 'Business Column', I'll be looking at the age-old problem of how to draw money out of your company tax-efficiently – but with a new twist.

What follows is an example of what you might call lateral thinking. But I need first of all to set the scene, and explain what the straightforward thinking is. Let's put the discussion in the context of a simple example, as I always think it helps to have numbers in front of you.

Freddy Threapwood owns all of the shares in Emsworth Limited, which manufactures and sells dog biscuits. Freddy's an amazingly effective salesman, and in the first year of the company's business it has notched up profits of £1 million, which are now sitting in the company bank account. (OI, I know nothing in accountancy is as simple as that, but I'm just trying to isolate the tax-planning principles.)

Freddy's wife Aggie (short for Niagara) is insisting that they pay off their home mortgage, which is currently standing at £500,000, and she's well aware of the £1 million sitting on deposit in the company, which seems clearly earmarked for the purpose. As your starter for ten, what's the best way of taking this money out of the company?

Weapons in the accountant's armoury

For the purposes of our example, we'll assume that the money is taken out of the company to repay the mortgage, and has initially been debited to Freddy's director's loan account with the company. We'll also assume that he had no credit on that account before the drawing, so that the result is that he is £500,000 overdrawn.

The straightforward thinking, which applies in most accountants' offices, is that this overdraft should be eliminated by giving Freddy some kind of income. Assuming that there is no scope for paying him rent, for example, there are really only two weapons in the accountant's armoury:

- payment of remuneration
- payment of a dividend.

Let's take remuneration first. What HMRC will require, in the face of a £500,000 drawing, is a calculation known as 'grossing up'. The people who do the company's payroll will need to work out what gross salary is required in order to leave £500,000 in the employee's hands after all deductions have been made. Assuming the 45% rate of tax applies, we end up with a very big number indeed. Once you've taken 2% employee's National Insurance into account, you're talking about nearly doubling up the £500,000, to give the gross salary, that is your gross salary is more or less a million, in order to leave £500,000 after the deduction of tax and employee's National Insurance. You've then got to add to this the employer's National Insurance contribution, which is not far short of another £140,000. So it will actually cost the company somewhere in the region of £1.1 million to pay Freddy £500,000.

Hands up those who think this is likely to be the best way to do it. No hands? Well, let's move on to the dividend route.

The dividend route

The big plus point about dividends, which makes them traditionally the favoured method of profit extraction from private companies, is the fact that they don't normally bear National Insurance. Just recently, though, some of this benefit has been taken away by the introduction of George Osborne's new 'dividend tax'.

This is what accountants call the withdrawal of the tax credit (so called) and the introduction of new rates of tax on dividends. It's basically just a raid on companies and their owners by a government that came in on a pledge not to increase income tax. It means that, broadly speaking, dividends are now taxed at about 7.5% more than they were before 6th April 2016.

Again assuming that Freddy's in the top rate of tax, the payment of the £500,000 as a dividend gives rise to tax at approximately 38% in the new regime, that is you'll have a higher rate income tax liability, payable by him and not the company, of about £190,000.

This is where that fun situation called the 'tax spiral' begins. In our example, you'll remember that the £500,000 has gone straight to paying off the home mortgage. So Freddy, who hasn't got any personal savings, will need to take another £190,000 out of the company to pay the tax. This £190,000 drawing then gives rise to another tax charge at 38%, and so on and so on.

To short circuit the calculations, then, we need to 'gross up' the £190,000 at 38%, in order to calculate what he needs to take in addition, so that he has £190,000 after 38% tax. This comes, in fact, to just over £300,000.

So overall, the company's going to need to part with over £800,000 to leave Freddy with the £500,000 net figure that is wanted. An improvement on the remuneration route, but that's not saying much.

A third way?

Now we come to the lateral thinking bit. It's pretty much ingrained in accountants' minds, from the situation as it used to exist before the recent round of tax increases, that you can't allow a director's overdrawn loan account to continue. Somehow or other, either by dividends, remuneration or some other route, you need to bring the overdrawn loan account back to zero to keep the company and its director 'out of trouble'.

The third way we're talking about here isn't introducing an asset into the company to provide credit to offset against the cash debit. That can be an excellent way of extracting profit tax-efficiently, but we'll assume, in the case of Freddy and his business, that there is no suitable asset to put into the company.

But why not consider simply leaving the overdrawn loan account as it is? Is this, in fact, a brilliantly simple solution to the 'problem' of profit extraction from a private company?

The reason the accountants' orthodoxy is against this is that HMRC has anti-avoidance legislation in place to stop it. Where a company makes a loan to an individual who is also a shareholder, as in this case, there is a charge to what is called 'loans to participators' tax. Until recently, this was at 25%, such that a loan to a shareholder of £500,000 would give rise to a liability to HMRC of £125,000. Presumably this rate of tax was set to match the higher-rate tax that an individual used to pay on receiving a dividend (assuming he was a higher-rate taxpayer). The higher-rate tax equated to 25% of the net. With the increase in tax rates as a result of the new 'dividend tax', the loans to participators rate has also increased by 7.5%, to 32.5%.

But there are two very interesting things to note about this. First, the rate is 32.5% even where the individual concerned would be paying the top rate of about 38% (which applies where an individual's total income is more than £150,000) and, second, the loans to participators tax is payable by the company rather than by the individual.

So let's plug these numbers into the Emsworth Limited situation. The £500,000 loan to Freddy, assuming it's still outstanding on the trigger date of nine months following the company's year-end, will result in loans to participators tax being payable to HMRC of 32.5% times £500,000, which is £162,500 and… er… that's it. So the company's total outlay going down this road, in order to get £500,000 into Freddy's hands, is £662,500, instead of over £800,000 going down the dividend route and about £1.1 million going down the remuneration route. Tricky choice?

The downsides

You can't get such a brilliant deal as this without some disadvantages, though, and so let's consider precisely what these are.

First, of course, treating the amount paid as a loan means that, at some point, it will have to be repaid. However, this could be a long way in the future and all the time the individual concerned is in control of his company he can, of course, refrain from demanding the money back from himself, so to speak.

Second, as many accountants will be quick to point out, the 'loans to participators' tax charge isn't the only tax penalty for borrowing money from your own company. Freddy, as a director of Emsworth Limited, will be treated as receiving the £500,000 loan from the company by reason of his employment. This results in a taxable 'perk'. You don't want to exaggerate the effect of this particular downside, though. The way the tax is measured is by taking notional interest on the loan balance and charging that as if it were income of the individual. At an official rate of 3%, Freddy has tax to pay on £15,000, which, at the 45% tax rate, is about £7,000. There's also some National Insurance to pay, but all the same this is a pinprick in relation to the other amounts we've been talking about – and can even be got round by the company actually charging interest at the official rate.

Third, loaning money to a director of a company is illegal! Don't even think about this if you are a public company, where the loan can be treated as a criminal matter. With a private company, though, which the vast majority of companies in this situation will be, there are no real practical 'teeth' to the Companies Act rules which prohibit loans to directors.

Fourth, if the amount concerned is treated as a loan rather than as income, the individual becomes vulnerable if the company goes bust. One of the first things the liquidator is going to do is demand repayment of the loan account. If there is a regular tradition of paying income, by contrast, it's going to be much more difficult (although not always impossible) for the liquidator to get the amounts paid back by the director/shareholder. If this is likely to be a serious problem, this too can be got round, in most circumstances – by putting a holding company above the trading company and arranging things that the loan is from the holding company (which hopefully won't go bust) rather than from the trading company.

So there you have it. The numbers speak for themselves. Don't be steamrollered by your accountant into coughing up substantial amounts of tax on remuneration or dividends without looking at the third option of leaving the amount of your drawings outstanding as a loan from the company to you. Even if it were only a relatively short-term advantage (and it can be much more than that), a short-term advantage could nevertheless be important, particularly in a time when personal or company cash flow is under any kind of pressure.

Alan Pink FCA ATII is a specialist tax consultant who operates a bespoke tax practice, Alan Pink Tax, from offices situated in Tunbridge Wells. Alan advises on a wide range of tax issues and regularly writes for the professional press. Alan has experience in both major international plcs and small local businesses and is recognised for his proactive approach to taxation and solving tax problems. Alan can be contacted on (01892) 539000 or email: alan.pink@alanpinktax.com. His book, The Entrepreneur's Tax Guide, is on sale from Head of Zeus for £20 and from all good bookshops.

Offshore News

Italy to launch non-dom regime

The Italian government is to launch a non-dom regime for new residents requiring an annual payment of €100,000 and available for a 15-year period. Under this scheme foreign income and assets will be shielded from income tax and foreign assets from estate tax. The taxpayer may elect to pay tax on income from particular countries, so as to qualify for treaty relief. The regime is based on the UK's new approach to non-domiciled residents.

Offshore Shell Gains

Three US organisations – the PIRG Education Fund, Citizens for Tax Justice and the Institute on Taxation and Economic Policy – have published a report entitled *Offshore Shell Gains*. The report analyses how US Fortune 500 companies use low-tax jurisdictions to minimise US taxation. Some 367 (73%) of the companies investigated were using offshore structures and between them they had 10,366 subsidiaries in tax havens. It was estimated that some $2.5 trillion of profits were being kept offshore for tax purposes. Interestingly, just 30 companies accounted for two-thirds of the total amount being shielded.

Argentinian tax war

The Argentinian Tax Office, which believes that there is an estimated $400bn in Argentinian assets held in offshore locations, has offered tax evaders a generous amnesty program. Until 31st March 2017, Argentinian citizens and residents will have the opportunity to self-report undeclared domestic and foreign assets and income without facing prosecution and – crucially – without being required to pay tax liabilities owing on the assets. Instead, there is to be a special tax of between 0 and 15% on the total amount. At this stage, there is no requirement that they repatriate their wealth to Argentina.

EC proposes single corporate tax rate

The European Commission (EC) has made another attempt to move towards a single rate of corporate tax. The EC initially attempted a Common Consolidated Corporate Tax Base (CCCTB) in 2011. The proposal failed, however, to win the approval

of all member states. In 2015, the EC then proposed a new, two-stage approach towards an EU-wide corporate tax system. The first stage is a Common Consolidated Tax Base directive which sets out common rules by which the tax base for each member state will be calculated. The second stage, a revised CCCTB directive, would mean that the profits of multinational groups within the EU would have to be consolidated by means of a formulary appointment instead of the current transfer pricing rules. Finally, the EC has proposed a directive on double-taxation dispute resolution mechanisms in order to strengthen mandatory dispute resolution procedure, for double-taxation disputes concerning income from businesses in the EU.

HMRC loses Isle Of Man trust case

The First-tier Tribunal has ruled in relation to *ML Salinger and JL Kirby vs. HMRC*. In a nutshell, Mr Salinger had made transfer arrangements in order to reduce the amount of IHT that would be payable on his death. HMRC said that IHT was, indeed, due because of the transfer of the reversionary interest to the trust. The taxpayers disagreed because they said that no consideration had been paid for the reversionary interest and that there had been no transfer of value when it had been transferred to the trust. The First-tier Tribunal found that Mr Salinger had acquired the reversionary interest as part of a package for which he had paid £890,000. It held that there had been loss to his estate as a result of the transfer and therefore it had not been a transfer of value.

French Registry breaches law

The French courts have found that the publically accessible National Register of Trusts is unconstitutional because it breaches an individual's right to privacy. The Register makes available the names of individuals who are part of trust arrangements as well as information about their wealth management decisions. Some 16,000 entities have been identified as trusts and registered with the French tax administration. Information about these entities and their beneficiaries had been available online but the recent court decision means that it will no longer be publicly accessible. However, the ruling does not mean that trustees can escape the reporting requirements.

Portugal property tax to rise

The Portuguese government proposes to increase the tax on property. There will be a surcharge on homes valued at more than €600,000 and the tax on income from apartments let to tourists will be increased from 15 to 35%.me

Switzerland looks for more business

The Swiss Parliament has agreed to a referendum regarding the proposed Corporate Tax Reform III Legislation, which is designed to strengthen the attractiveness of Switzerland as a business location. In particular, the Swiss government wants the corporate tax system to be aligned with the latest international standards. This would mean the phasing out of all special corporate tax regimes (the mixed, domiciliary, holding and principal company regimes, for example) but federal and cantonal tax holidays would not be affected.

Panama Papers update

HMRC has announced that more than 30 individuals and companies are under active investigation for criminal or serious civil offences linked to tax fraud and financial wrongdoing as a result of information gleaned from the so-called Panama Papers. Apparently, several hundred more individuals and companies are under detailed review. To date, the task force has:

- opened civil and criminal investigations into 22 individuals for suspected tax evasion;
- led the international acquisition of high-quality, significant and credible data of offshore activity in Panama;
- identified a number of leads relevant to a major inside trader operation;
- identified nine professional enablers of economic crime;
- placed 43 high-net-worth individuals under special review;
- identified two new UK properties and a number of companies relevant to a national crime agency financial sanctions inquiry;
- identified 26 offshore companies whose beneficial ownership of UK property was previously concealed.

A number of individuals have come forward to settle their affairs in advance of task force partners taking action.

EC endorses exchange of information

At the moment EC member states currently have the choice of whether or not to give access to beneficial ownership information to other EC tax authorities. The EC has agreed to a proposal to give tax authorities access to this data. With access to this new information, tax authorities will be able to identify the person behind an opaque company, structure or entity.

Panama bows to OECD pressure

Panama has become the 105th signatory to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. As a result, it will exchange information on request, participate in spontaneous exchange, facilitate tax examinations and assist in tax collection. The Convention guarantees extensive safeguards for the protection of taxpayers' rights and allows automatic exchange of information on option.

The Offshore Column

A tale of two residences

If you are a British citizen and resident who has (or plans to have) an international business and/or is (or plans to become) non-resident at some point in the future, I want to remind you of the benefits that can accrue from having two residences.

To begin with, if Brexit proceeds (as seems likely) then by also becoming resident elsewhere in the EU you may be able to soften the practical disadvantages that may derive from the UK no longer being a member.

Moreover, being resident in two places can be a great aid to confidentiality.

Let me give you an example. If you apply for residency in Malta, to which you are still entitled, you will be able to use your Residency Card to travel freely within the Schengen Area, that is to say pretty much everywhere in Europe. You will also be able

to use your Maltese address when opening bank accounts and establishing businesses and holding shares. Other locations – such as Cyprus – are just as good for this, incidentally.

I have mentioned this concept before and I only do so again as I think the window to apply for residency elsewhere is going to close soon.

Offshore alternatives

Another subject I feel is important to raise again is whether it is advisable to still use any of the more controversial low-tax jurisdictions, such as Andorra, Belize, Panama and Vanuatu as a base for an offshore structure. Such countries may well be cooperating with the various anti-money-laundering, anti-tax-evasion initiatives being promoted by the OECD, EU, US and other bodies, but the reality is that they are still viewed with suspicion. I have written before about how difficult it can be for, say, a UK company to open a new bank account if any of its shareholders is located in a low-tax jurisdiction. Many British and European banks now seem to keep their own blacklists and refuse to be in any way flexible, even when something is perfectly legitimate and transparent.

The solution is, of course, to move your offshore structure to another, less controversial location. But where? Much depends, of course, on your priorities and overall situation. If you have no US connections then, strangely enough, America can be a very, very good choice. Certain of the states offer all the advantages of total confidentiality and zero tax. Ireland is good if you are looking for a residence as it is only tax non-doms on a remittance basis. Hong Kong, New Zealand, Cyprus and Gibraltar all have advantages, too. The key thing is not to dawdle. At the moment, it is relatively easy to migrate, say, a holding company or a trust. But it may become harder in the future.

Go east!

There was such a good deal on Emirates to Australia last month that I nipped Down Under for a short holiday and on the return broke my journey in Dubai. I have never visited the United Arab Emirates before and I suspect it would have suited me much better before it became so built up. Having spent a week trekking in the Sahara down by the Sudanese border, I have developed rather a taste for wildernesses and I would have enjoyed a visit to the desert but time did not allow. I did, however, have a couple of meetings with financial advisers and I must say I am sold on the idea of using the UAE as a base for an international business, a holding company and even more complicated offshore structures. My enthusiasm partly stems from the 'can do' attitude I encountered when talking to professionals. There was a real feeling that the UAE was open for business. It is a slightly complicated system, however. For example, if you plan to trade out of the UAE you will need the relevant licence and actual office space. However, for offshore-type structures the situation is much simpler.

The UAE is home to three authorities that register international or offshore companies. The three UAE authorities that register offshore companies are Ras Al Khaimah Investment Authority (RAKIA), Jebel Ali Free Zone (JAFZA) and Ras Al Khaimah Free Trade Zone (RAKFTZ). The benefits offered by a UAE offshore company are:

- complete exemption from tax;
- full foreign ownership;
- allowed corporate bank accounts across the UAE;
- to own real estate property across the UAE as well as trademarks, patents etc.;
- international company registry is kept confidential;
- become a limited-liability company, with the option of having Ltd. or Inc.;
- a company is allowed to choose the legislation/jurisdiction that best suits its needs, for instance civil law or common law.

The UAE is included in the OECD white list and so it is not considered a tax haven jurisdiction. Moreover, companies benefit from 47 different double-taxation treaties. There is a high degree of confidentiality and the company is not required to submit an annual report to the UAE authorities.

You can set up a UAE company without visiting the jurisdiction, although you will have to be present if you want a bank account. The costs are slightly higher than many other jurisdictions but still extremely reasonable at around €2,500 for formation costs and €1,500 annual running costs.

Money

News

House prices and wage gaps widen

The Home Track UK City's Index, which gathers data about house price growth in 20 major cities around the UK, has revealed that the gap between average earnings and house prices has hit a record high in certain parts of the UK. The worst affected areas are London and popular cities such as Oxford and Cambridge. In London, for example, the house price to earnings ratio is 14.2, meaning that you would need 14.2 times the average London salary of £33,720 to afford the average-priced property. The UK average is 6.5 times. Since 2009, London house prices have risen 86% and the current year-on-year rate of house price growth in the capital is 9%, its lowest level for three years. For homes to be more affordable, buyers need to look to the North. Glasgow has the lowest house price to earnings ratio (at 3.7 times), followed by Liverpool (4.4 times) and Newcastle (4.8 times).

FCA tightens annuity rules

The Financial Conduct Authority (FCA) has said that annuity providers will have to inform their customers how much they could gain from shopping around and switching providers before they purchase an annuity. The new rule, which the FCA plans to introduce from September 2017, is part of the regulator's retirement income market study. The FCA hopes that greater transparency and competition will lead to better rates and terms for people looking for a retirement deal.

UBS's choice for yield growth and safety

The Swiss bank UBS has picked its 35 favourite dividend plays designed to achieve yield growth and safety. It believes that its portfolio will produce annual yields of 4.8% and offers an estimated compound annual growth rate of 7% between now and 2019. Details of the proposed UBS income portfolio are to be found on the bank's website. European earnings are still 30% below their 2007 pre-financial-crisis peak, despite a decade of stimulus, and trail everybody else's on the global stage. When profits are tallied at the end of 2016, they are likely to be at the bottom of the pile, according to UBS.

Young people bail out

Savills, the estate agents, has analysed the Office for National Statistics' latest figures and arrived at the conclusion that an exodus of young people in their 30s from London has accelerated over the past five years. Because of factors such as births and international migration, London's population continues to grow but, if international migration is excluded, some 66,000 people in their 30s left London in 2015. For people aged 35 to 39, the number leaving has risen by 18% in the past two years.

UK retail sales surge

UK retail sales growth surged to a 14-year high in October as consumers kept spending and colder weather boosted clothing sales. Total volumes were 7.4% higher than the same month a year ago, the

fastest annual growth since April 2002.

Barrett cuts prices

The UK's largest house builder, Barrett Developments, is cutting prices at its top-end London developments by up to 10%. The company sold all the apartments in one development at a heavy discount to a private investor in the face of challenging market conditions. David Thomas, chief executive, said: "We have taken some price action on a limited number of sites, and have made one build-and-sale agreement on one site. We are taking some action to deal with particular requirements in the market. We like to tell it as it is… prices, particularly above a million, are tricky."

Gold prices tumbling

After Donald Trump's US presidential victory gold prices have started to fall. This was in direct contrast to what happened after the Brexit vote in June, when gold rose by $100 a troy ounce over a period of two weeks. Gold is still up by around 14% this year in dollar terms and around 34% when measured in pounds. This compares with a return of about 12% for the FTSE 100 index (with dividends reinvested) and about 4.6% for the FTSE or world index. It is felt by gold investment specialists that the outlook for the metal is likely to be heavily determined by the central banks – especially the Federal Reserve. For example, if the US increases interest rates this could hit gold prices as a stronger dollar usually brings about falling commodity prices. It is also to be noted that the World Gold Council has announced that the physical demand for gold remains weak in the two largest consuming nations: India and China. In both places, gold demand fell by roughly a quarter during the third quarter of 2016.

Self-employed numbers up, income down

The Resolution Foundation think tank has produced a report that shows typical weekly earnings for a self-employed worker in 2014/15 were around £240, which, after adjusting for inflation, is less than it was 20 years earlier. The number of people who work for themselves in the UK has increased by 45% to 4.8 million, or one in seven workers. However, self-employment has changed starkly in that time: fewer self-employed people work long hours, and they are less likely to be running small businesses that employ staff.

Alternative Investment: Second-Hand Insurance Policies

What sort of a mind reads a statistic such as "only one in three endowment policies ever reaches maturity" and sees in it an ingenious money-making opportunity? Some clever soul did, however, and the second-hand endowment policy market was born, a market offering private investors the twin benefits of relatively high returns and relatively low risk.

The concept is fiendishly simple. Two out of three people who start long-term savings plans (or endowments) with insurance companies stop them or cash them in well before the agreed term. As a result, they miss out on the best bit because these types of plan are designed with a single purpose: to provide the highest possible return on maturity.

How is it possible to profit from this? By buying up unwanted endowment policies – in other words, taking over a policy that someone else started a few years ago but no longer requires – paying the monthly premiums for the rest of the term and then scooping the lump sum that is due on maturity.

Second-hand endowments, known in the business as traded endowment policies, or TEPs, are an ideal way of building capital for future needs, such as university education or nursing-home fees, because you know when they will mature. As they offer exposure to the stock market without having to make a direct investment and without risking one's capital, canny investors also use them to achieve portfolio diversity. You should aim for a 5 to 8% return on investment.

(Note that for the first few years of any policy a high percentage of the premiums are being spent on paying the broker commission and other charges, which is why insurance companies offer such low surrender values when policyholders try to cash their policies in.)

When you buy a policy, you will be buying all the benefits, including the life cover. Therefore, if the original policyholder should die, the return you receive will be the basic sum assured.

For a TEP to be worth investing in, it should be at least five years old and should probably have a surrender value of at least £5,000. You will want to know:

- the name of the life company and the policy number;
- the name and other details of the life assured (the person who owns the policy now);
- the surrender value at a recent date;
- what locked-in bonuses there are;
- when the policy was started and when it matures;
- the basic 'sum assured';
- the gross monthly premiums.

In general, you will pay about 10 to 15% over the surrender value offered by the company that issued the policy and you should aim to hold any policies until they reach maturity.

In planning your investment, you need to consider:

- the amount you wish to spend on your investment;
- how long you wish the investment for and when it will mature;
- the premium you will be paying each month;
- taxation: there are ways in which you can save money (e.g. by choosing certain types of policy or by buying multiple policies that mature each year).

On purchase, the policy is legally signed over to you via a sales agreement and absolute deed of assignment. The life assurance company who the policy is held with will then confirm you as the new owner. There are benefits from investing in endowment policies such as guaranteed return on investment and the fact that if you buy a policy in mid-term the set-up fees have been mostly paid.

First, determine your investment parameters: the lump sum you wish to invest, the future premium levels and the investment term. You may wish to purchase a series of policies to mature in different tax years or you may wish to concentrate on mutual life offices or those with large 'orphan assets', which may be distributed at some future point.

Incidentally, the history of TEPs is an interesting one and, apparently, started in the US in the early part of the 20th

century. A surgeon agreed to buy a life insurance policy belonging to one of his patients. John C. Burchard was in need of funds to pay for his surgery and offered to sell his insurance policy to Dr Grigsby in exchange for $100 and an agreement to pay all remaining premiums. Following Burchard's death a year later, the executor of his estate, R. L. Russel, challenged the transaction and Grigsby's claim to the benefits of the policy in court.

The case of Grigsby vs. Russell eventually reached the US Supreme Court in 1911, where it was established that a life insurance policy was considered an asset that the policy owner may transfer without limitation. In the landmark ruling, Justice Oliver Wendell Holmes noted that "life insurance has become in our days one of the best-recognised forms of investment and self-compelled saving". As a result of this decision, a policy could be transferred into the name of another person and a number of specific legal rights became attached to it. These included, among others, the ability to use the policy as collateral for a loan, change the name of the beneficiary and sell the policy to another party.

There are specialist brokers, or your independent financial adviser can guide you.

Frequently asked questions

Q. What is the security of a TEP?

A. As the policies are regulated contracts, security is provided by the Financial Services Compensation Scheme (FSCS), up to 90% of the policy value with no upper limit.

Q. What is the financial commitment of a TEP?

A. After payment of the purchase price, regular premium payments are required which can be paid by direct debit or standing order direct from the investor's bank account. Some policies may be acquired as paid up, so there will be no further premiums to pay but the policy's value will be adjusted accordingly. There are no other costs after acquisition and no further management is required.

Q. What happens to a TEP at maturity?

A. After the policy has been purchased, the policyholder signs a deed of assignment, transferring the policy to the purchaser and notice of this is sent to the insurance company. The insurance company will write to the assigned policy owner approximately one month prior to maturity and arrange for the investor's preferred methods of payment of the full matured policy proceeds.

Q. What happens if the life assured dies? How does the purchaser find out?

A. Members arrange for references to be taken out on 'lives assured' so that periodic checks can be made with bank managers etc. on the continuing life of the 'life assured'. Policies will not be invalidated if a life assured dies and this fact does not come to notice for some time, although some adjustment is likely to be made to maturity values to account for premiums paid in the meantime.

Q. Are maturity payouts subject to tax?

A. Maturity payouts are made without deduction of tax by the life office. This feature of TEPs enables the investors to choose the tax treatment that best suits their own circumstances, by either selecting a 'qualifying' policy that is subject to capital gains tax or by purchasing a 'non-qualifying' policy whose proceeds may be tax-free. If you are using policies to pay for, say, education fees you could make the beneficiary your child. You should take specialist tax advice before investing.

Autumn Statement Summary

Here is a brief summary of the key personal finance points contained in Chancellor Phillip Hammond's somewhat uneventful first Autumn Statement.

Pensions

No announcements were made regarding pensions tax relief, which led some experts to speculate that it could be dropped for higher earners. It is interesting to note that the relief cost the government some £48 billion in the 2015/2016 tax year. Around two-thirds of this relief goes to higher and additional-rate taxpayers. The one pensions announcement likely to be of interest to *Schmidt* readers was a proposal to cut the money purchase annual allowance from £10,000 to £4,000 in order to limit those over the age of 55 from recycling tax relief. Some commentators feel that this will have the effect of reducing a saver's ability to carry on working and contributing to a pension.

Property

The Chancellor of the Exchequer announced that there would be new legislation to stop letting agents from charging tenants administration and referencing fees. "Landlords appoint letting agents and landlords should pay their fees," said Mr Hammond. While tenants obviously welcomed the move, many landlords commented that it would probably not save them a great deal of money. One mortgage broker said: "I have no doubt the costs will be passed on directly to landlords, who will, in turn, pass them down to tenants."

Finally, at the same time as delivering his Autumn Statement, the Chancellor revealed that the help-to-buy ISA, a product supposed to help first-time buyers get onto the property ladder – had not been widely taken up.

Property Tax Tips

Better than buy-to-let

Slightly over a year ago, the *Daily Telegraph* predicted that "holiday homes will be the next buy-to-let boom". The main thrust of their argument was that the new tax applying to buy-to-let would not touch holiday homes where returns could be far higher and the tax breaks much better. When I read the article, I thought it made a lot of sense and I anticipated that a great number of buy-to-let investors would, indeed, switch to furnished holiday lettings (FHLs). Indeed, I have written many articles in this publication about the extraordinary profit and tax benefits offered by FHLs. Why, then, haven't we seen a huge increase in FHL landlords?

In a moment, I am going to summarise the key benefits offered by this investment category. There is, to my mind, only one disadvantage. It is extremely difficult to get a mortgage on a property you want to use as a holiday let. The fact is holiday home loans are problematic and if you need more than a moderate amount of finance you will really have to shop around, probably using some of the smaller building societies, to look for funds. Lenders to approach include the Leeds Building Society, The Newbury, Harpenden, Cumberland, Market Harbour and Penryth. Remember that while larger lenders are often willing to provide mortgages on second homes they generally stipulate that it must never be rented out. You could, of course, also take out a mortgage on your primary residence and use that.

It is always a mistake to allow the tax tail to wag the property investment dog. Nevertheless, it has to be said that FHLs offer unbelievable tax breaks. They will be treated as investment properties if this works best for you and as a trade when you want to take advantage of trading reliefs. They can also qualify as private residential accommodation while still obtaining the benefits normally reserved for commercial property. One expert said: "Getting one of your properties to qualify as a furnished holiday let is the property tax equivalent of winning the lottery!" This is because FHLs can qualify for:

- entrepreneurs' relief;
- rollover relief on replacement of business assets;
- holdover relief for gifts;
- capital allowances for furniture, fixtures, fittings and integral features;
- no restriction on tax relief for interest and finance costs;
- despite its 'trading style' advantages, National Insurance is not usually payable in respect of income;
- non-UK residents investing in UK FHLs will usually be exempt from capital gains tax (CGT).

It must also be pointed out that an FHL business can also be (in many circumstances) exempt from inheritance tax (IHT). In order to qualify for this IHT exemption the lettings must be short term and the owner and/or their employees must be involved with the holidaymakers' activities.

What about VAT? The letting of holiday accommodation is standard rated for VAT purposes and so therefore, assuming

that your income is over £83,000 a year, a landlord must register for VAT.

One final but crucial benefit. If you make losses in your FHL business, you can carry them forward to set off against future profits from that business. This is true providing all the properties are located within the European Economic Area (EEA).

Mention of the EEA brings me to the subject of what does and doesn't qualify as an FHL. In summary, the rules are as follows:

- The property must be located in the EEA.
- The property must be fully furnished.
- The property must be let out on a commercial basis with a view to making profits.
- The property must be available for letting on a commercial basis for at least seven months (210 days) of the year.
- It must actually be let for at least half that time (105 days).
- You mustn't let the property to the same tenant for more than 31 consecutive days at any time during a period of at least seven months out of the same 12-month period, as referred to above.

As mentioned in previous issues of *The Schmidt Tax Report*, the 105-day rule is not as strict as you might imagine. If you fail to meet the test, you can still stay within the FHL tax regime for up to two years. Moreover, if you have more than one property you can make an average figure across your whole portfolio.

If you are tempted to go into this area, one of the best things you can do when you begin to acquire property is to write up a credible business plan. Many tax advisers also suggest that you produce a written annual review of the plan as the need to at least expect profit is one of the conditions of relief. Bear in mind that a business plan is useless if it bears no resemblance to what you actually do.

If you are fed up with how small, private buy-to-let investors are being penalised by the government then FHLs offer a very real alternative. Yields can be much higher and the tax breaks much more worthwhile.

The tax advantages and disadvantages of equity release

Here is a strange but true story. Several years ago, I lived in a small village in Norfolk. One of my neighbours was a young farmer whose father had retired, passing the agricultural property over to his son but holding on to a number of rental properties. When the father died, it turned out that he had recently borrowed heavily against the rental properties which had previously had no mortgages on them. Let's say that the properties were worth, more or less, a million pounds and, at the time of his death, had a £750,000 debt against them. It appeared from papers found in the father's desk that he probably invested the money in a combination of tangible assets. Some appeared to have been put into stamps and some into gold bullion. The son, my neighbour, instigated a major search for these assets and I strongly suspect he found them – although he roundly denied it! He certainly denied it to HMRC.

I am not sure how the tax position resolved itself but I have a very good idea as to what the father had intended to do.

If you release equity from a rental property, you can put the cash in your pocket or reinvest it as you like with no immediate tax consequences. Let's imagine you buy a £100,000 flat in Brighton. Ten years later, it is worth £200,000. You had a £50,000 interest-only mortgage on the property when you bought it and this now represents just 25% of the total value. You approach a building society and are able to refinance the whole deal with a 75% loan giving you £100,000 cash. Providing you service that mortgage and never sell the property, you have nothing to worry about. The problems arise when you dispose of the flat. At this juncture you will have to pay CGT on the £100,000 profit, which, if you have no CGT allowance, will mean a £40,000 tax bill. What you have achieved by releasing the equity is delay. You are always going to have a 40% CGT bill unless you engage in some other form of tax mitigation. (It is my opinion that my neighbour's father was unaware of this. I think he thought that when the properties were sold they would look at the size of the mortgages and deduct the loans from the total value, bringing the total value down to just £250,000.) Is there any way round this?

Yes and no.

It may be possible that the interest on the borrowings is deductible for the purposes of income tax. However, of course, interest relief is only available if the funds are invested for business purposes and the total amount allowable is about to fall in net terms under the government's new rules. Also, tax relief for interest paid by residential landlords will begin to be restricted from 2017/18 onwards and will be restricted to basic rate only by 2020/21. It is important if you use equity release to fund the building of a property portfolio that you remember all you are doing is postponing potential CGT liabilities. You need to make sure you don't borrow and reinvest so much money that if you are forced to sell a property from your portfolio you end up with a bigger CGT liability than you can afford.

Business premises renovation allowance

The business premises renovation allowance (BPRA) was created in order to encourage the conversion and renovation of empty business properties in specified 'assisted areas'. BPRA offers an incredibly generous 100% tax relief to property owners on money spent on conversion or renovation works on a building. The relief is available to individuals, partnerships and companies. Crucially, and that's why I am raising it in this issue, BPRA was originally due to end in April 2012 but was extended to the 31st March 2017 for corporation tax purposes and the 5th April 2017 for income tax purposes.

As one would expect, given the generous relief being offered there are quite a lot of restrictions and only certain buildings qualify.

To begin with, the building, before it became vacant, must have been used for a trade, profession or vocation or as an office. Its last use must not have been as a residence or dwelling.

After renovation or conversion, the property must meet the definition of 'qualifying business premises'. In plain English, this means that it must be used by or be available and suitable for letting by a trade, profession or vocation or as an office and must not be used or available for use as a residence. A number of different relevant trades do not qualify for relief and these include:

- fishery and aquiculture
- agriculture
- coal
- steel
- ship building
- synthetic fibres
- transport and related infrastructure

- energy generation, distribution or infrastructure.

BPRA is actually a European state aid. Accordingly the building, or part of a building, must be in an area that qualifies for relief (i.e. an assisted area) when the expenditure is incurred. If you are interested in claiming this relief your first step should be to discover whether the building is in a relevant location. If you google "UK Assisted Areas Map 2014–2020", you will be able to see whether the relevant premises will qualify.

BPRA will not apply to any capital expenditure in buying the land, building extensions or developing adjoining land and will only apply to plant machinery if it is an integral feature for capital allowance purposes or contained on a list of specific fixtures (such as sanitary fittings, alarm systems and fitted cupboards). Qualifying expenditure is limited to the market value of costs, and the following project expenses qualify:

- building works
- architectural or design services
- surveying or engineering services
- planning applications
- statutory fees or statutory permissions.

Do remember that expenditure is excluded if the building was used at any time during the period of 12 months, ending with the day on which the expenditure is incurred. Moreover, works must be completed or services performed within three years (36 months) of the expenditure being incurred; otherwise, the related expenditure is treated as if it has never been incurred. BPRA projects often involve prepayment of expenditure to provide certainty but if the works are not completed then the tax relief will be withdrawn.

If you are in possession of a suitable property or interested in a highly tax efficient commercial property venture then now is the time to get your skates on. There is, to my mind, just time to take advantage of one of the best tax breaks available today.

Full disclosure, reduced bill

HMRC is a great one for voluntary tax disclosure schemes. There is the Credit Card Campaign (for people who have previously undeclared income from credit card sales), the Second Incomes Campaign (for employees who have undeclared second incomes), the National Minimum Wage Campaign (for employers or company directors who may not have complied with national minimum wage requirements in the past), the Worldwide Disclosure Facility (for people who have evaded really large amounts of tax and want to try an avoid prosecution if they are caught) and – last but by no means least – the Let Property Campaign.

The Let Property Campaign gives you an opportunity to bring your tax affairs up to date if you are an individual landlord letting out residential property in the UK or abroad and you want to get the best possible terms to pay the tax you owe.

The facility is available to individual landlords renting out residential property. You can't use the scheme to declare undisclosed income if you are a company or a trust or if you are renting out commercial property.

The Let Property Campaign promises, in principle, to offer you the best terms available to get your tax affairs in order. Unlike other campaigns, there is no window in which the disclosure must be made by a particular date. However, once you have made your disclosure, you have just 90 days to pay what is owing. Moreover, if you don't declare everything and cooperate fully with HMRC you are likely to be penalised further.

When you make your disclosure, you have the opportunity of telling HMRC how much penalty you believe you should pay. This doesn't mean that HMRC will necessarily agree. But, on the other hand, if you owe money as a result of a mistake rather than deliberate fraud HMRC is likely to be relatively lenient. Moreover, in the case of simple mistakes HMRC can only go back six years (even if the mistakes date back further), whereas, where fraud is suspected, the window is 20 years.

In order to take advantage of this scheme there are six different steps, being:

1. Notifying HMRC of your intention to make a disclosure.
2. Making the disclosure (which must be within 90 days of receiving confirmation from HMRC they acknowledge your request).
3. Declaration confirmation that everything you have told HMRC is true.
4. Acceptance; unless the position is complicated or HMRC suspects fraud it is likely to accept your disclosure and declaration within two weeks. An acceptance letter will be sent.
5. Payment: unless HMRC has granted additional time to pay, payment should be made within 90 days of the deadline given on the notification acknowledgement letter.

The Let Property Campaign does offer an opportunity to avoid prosecution and to keep interest and penalties to a minimum. If you are worried that your tax affairs are not in order we would definitely recommend getting professional advice before contacting HMRC. The situation may not be as bad as you think. Moreover, you should have a professional batting for you should HMRC turn nasty. Furthermore, although HMRC provides a useful tax, interest and penalty calculator on its website it is well worth getting a qualified accountant to check all your figures before you submit them.

Tax-efficient children

If you have a nothing ventured/nothing gained approach to life and are not afraid of an argument with HMRC then the following, somewhat controversial, tax mitigation plan may be of interest.

It is designed for someone (or a couple) who wishes to invest in buy-to-let property and wants to try to provide one or more of their adult, working children with somewhere to live.

The first step is to purchase the property in your own name(s) and to draw up a lease agreement with your child for a rent that is well below the market level.

Let's assume it is a two-bedroom property and your child lets out the other room and takes advantage of the generous rent-a-room relief.

Since the additional rental income is over and above normal income, in theory, he or she can remit it to you tax-free.

How beneficial a scheme this is likely to prove will depend, of course, on how many children you have and how expensive the property is. But, in theory, anyway, it is an opportunity to take fuller advantage of rent-a-room relief. The current tax-free allowance is £7,500, which is certainly worth having.

Property Investment Notes

According to the *Financial Times*, the hottest new property investment sector is build-to-rent.

Up until now, the UK's rented sector has been dominated by private landlords. To give you a feel for the market: some two million buy-to-let landlords own almost one in five of all residential properties. Many people who, in the past, would have bought their own homes can no longer afford to do so. As a result a large number of financial institutions have seen an opportunity to create a large-scale, corporate rented sector, as is found in the US and Germany.

In the UK, some £15 billion has already been invested into large-scale rented housing (much of it still to be built) and another £50 billion is expected to arrive by 2020, according to the property adviser Knight Frank.

Insurance companies and pension funds who are attracted by the steady income that rented apartment blocks offer, and many sovereign funds, are also aiming to get into the market. The British Property Federation believes that the number of professional rented units completed, under construction or with planning permission has risen to 57,000 of which half are in London.

Old news

JLL, a financial and professional services firm that specialises in real estate services and investment management, recently produced a report into the retirement housing market. It found that there was a chronic shortage of high-quality retirement property and that some three-quarters of a million of housing-with-care units will be desperately needed over the next decade.

JLL found that people aged 65 or over currently hold some £800 billion of housing equity in the UK and that as a result of this many retirees can afford to live in specialised housing. JLL actually estimates that the real undersupply is in the mid-and high-end areas of the market while the affordable markets have ten times the units per person in comparison. The report states:

There are too many retirement housing options in the UK, housing with support and housing with care. The former became popular in the 1980s, whilst the latter is now the fastest growing part of retirement housing and better suited to the long term care needs of retirees. This generation has benefited from unprecedented house price growth. To put it into context, if they bought their house in 1970, it has now risen in value by 4,300%. If we apply the equivalent value of growth to a loaf of bread that cost 9p in 1970, today it would cost almost £4. So, not only do they have the spending power, they also desire high-quality housing options making the need for investment stronger.

With the population growing around four times faster than the production of new homes, it is not surprising that the UK has a housing shortage.

Another property specialist, Savills, has forecast the market needs to build around 18,000 retirement homes per year just to maintain existing provision rates amongst older people.

Buy-To-Let Landlords: A False Alarm?

Last month, an article appeared in the *Daily Telegraph* which has caused some consternation amongst buy-to-let landlords: specifically, those who are looking at using an arrangement known as the 'beneficial interest trust' to transfer their property portfolios to a limited company.

The background to this is one which will be sickening familiar, by now, to those with mortgaged investment property portfolios. A leaving present from George Osborne, outgoing Chancellor of the Exchequer (as it turned out to be), was to announce the phased withdrawal, over four years, of higher-rate loan interest relief for buy-to-let properties. Landlords will no longer be entitled to claim relief for one-quarter of their interest in the tax year 2017/18, and this disallowable portion will increase to half in the following year, and so on. For higher-rate income tax purposes, then, landlords face paying tax on a greater profit than they are actually making.

It didn't take landlords and their advisers long to work out that if you could transfer your portfolio into a limited company you weren't affected by these changes. Companies don't pay higher rate tax in any event, and therefore the new rules have no application for them.

So the taxpaying community, with its notorious love of the 'quick fix', leapt at the idea of incorporating property portfolios that were previously held in individual names.

The tax problem with incorporation

We've already talked about this in earlier articles, but the issue certainly bears repetition. Even in terms of a 'quick fix', there are big potential problems in the areas of CGT and SDLT. If you aren't careful, you can end up being treated as triggering all of the inherent capital gains in your property.

To take an example, supposing you have a property portfolio that's worth £1.5 million but which only originally cost you £1 million, the £500,000 'gain' would normally crystallise when you transferred that portfolio to the company. So you'd have something like £140,000 CGT to pay, and quite likely no money to pay it with.

The SDLT charge could be even more vicious, with the 3% surcharge (contrary to the mythology) applying to all acquisitions of residential property by a company. Again, a massive six-figure SDLT charge (on the figures we have illustrated) would quite likely fall due even though you might have no money to pay it with.

Promoters of the limited company route say they have ways round both of these charges, but, as we've commented before, both of the 'escape routes' from these taxes involve difficult interpretation of vague words. Hence you need to be able to show that your property portfolio is a 'business' (probably in the teeth of HMRC opposition) in order to counter the CGT charge. And you have to show that your holding of the portfolio was a 'partnership' in order to counter the SDLT

charge.

And that's not all. What the devotees of the quick fix may be overlooking is the fact that, once you've got your property portfolio into the company, it's pretty much stuck there. And once your portfolio is in the company, future increases in value are very likely to be taxed at a greater overall rate when the gains on the properties are realised on sale, and the proceeds paid to you as the individual shareholder. So that's three tax problems with putting the portfolio into a company for starters. But what we're really talking about, in this article, is a practical or legal problem rather than a tax problem – but one which also brings a worrying sting in its tax tail.

The practical/legal problem

Basically, it's all very well airily advising a landlord to transfer his property portfolio to a limited company, but you have to remember that there's more often than not another party involved, who has to be consulted in any such transaction. This is the mortgage lender, who thinks he's lending to you as an individual and not to some company. As he will have a legal charge over the property, he can physically prevent you from changing the registered owner, unless you can persuade him to agree to it voluntarily.

In practical terms, of course, what this means is taking out what the mortgage company will treat as an entirely new loan. With the new loan comes all the hassle and expense of arranging a mortgage as if for the first time: arrangement fees, means tests, proof of income and almost certainly a substantial hike in the interest rate. That is if it is even possible to persuade the mortgage lender to lend to the company.

And that's where the so-called beneficial interest trust arrangements come in.

The solution?

What the group of lawyers who are reported in the *Daily Telegraph* have come up with is a way of transferring the properties to the company without changing the legal ownership, that is the name on the land registry.

It's not entirely clear, in fact, from the newspaper article whether the arrangement differs in any way from a simple 'bare trust'.

A bare trust, or nomineeship, is the situation where the legal ownership of an asset is in one name, but the 'real' or 'beneficial' ownership is with someone else. An example of this, outside the property sphere, is where you hold a quoted share portfolio at your bank. The actual registered owner of the portfolio will be X Bank Nominees Limited, but they are in no sense the true owner, and they have to hand over the income to you and, indeed, the shares themselves at any time you ask. They have no power or discretion not to do so. That's the essence of a bare trust.

It could therefore be that the solution which has caused so much rumpus in this article is neither more nor less than a bare trust: quite a simple idea, actually, and not a complicated tax-avoidance 'scheme' in our opinion.

The simple idea is: since you're not changing the legal ownership of the property portfolio when you transfer it to the company, the mortgage company isn't bothered, and even don't need to know, some would say, about the change. For tax purposes, beneficial ownership is infinitely more important than legal ownership, and legal ownership is almost always looked through at the 'true' underlying position.

So doesn't this arrangement give the buy-to-let landlord what he wants, without giving him what he doesn't want, in the form of headaches from the mortgage company?

And this is where the scare story in the *Daily Telegraph* comes in.

Don't worry if you haven't seen the *Telegraph* article: we've read it, so you don't have to. Basically, the article sets two hares running:

- The dread words 'mortgage fraud' are referred to.
- Some obscure anti-tax-avoidance rules are also dragged up.

Let's look at these two nasties separately.

Mortgage fraud?

Unnamed commentators have apparently expressed the view that transferring the beneficial ownership without the legal ownership could be regarded as a fraud on the mortgage lender. This is, of course, a legal point and not a tax point on which we specialise here; however, from the point of view of the man in the street, it does seem odd that an arrangement publically promoted by a group of lawyers, and which on the face of it doesn't result in any loss to the mortgage lender, can have such a strong word as 'fraud' attached to it.

Is there any threat to the mortgage lender from arrangements like this? As non-lawyers, as we've said, we can't give any definitive view on this; however, it doesn't seem possible to get out of any of the obligations to the mortgage company, because these are indissolubly tied to the legal ownership, which still stays with the original owner.

The mortgage company only 'loses' in the sense of the owner not paying him a fat arrangement fee for a new loan, together, perhaps, with a higher rate of interest. But the owner may not have even considered doing this, because of this massive downside. Indeed, in many cases the mortgage company would probably refuse to lend to the new company, particularly if it's an old loan taken out when things were more relaxed in the buy-to-let finance industry.

When push comes to shove, if the mortgage terms aren't met, and the repayments made on the agreed basis, the mortgage company can repossess the property exactly as easily, we think, with a bare trust arrangement in place as it could if the legal and beneficial ownership were the same. So where, the man in the street may well ask, is the fraud?

It may be that the terms of the loan need checking, of course. Possibly there may be a clause making the transfer of the beneficial ownership a breach of the agreement – although we don't think this is at all common. But breaching the agreement technically is one thing, and gives rise to the theoretical ability of the mortgage company to seek immediate repayment – but surely fraud is another?

The anti-tax avoidance rules

A commentator from a medium-sized firm of accountants is quoted as threatening

the application of the 'transfer of income streams' rules in the Income Tax Act. With the greatest respect to the commentator, our view is that he's barking up the wrong tree.

The rules are aimed at a highly complex form of income tax avoidance scheme, and were not brought into play with bare trusts in mind. Of course, that doesn't mean they couldn't accidentally apply to the bare trust arrangement; however, the fundamental test of whether they do apply is quite a straightforward one.

In case you think this is a mere technicality, incidentally, bear in mind that the whole consideration for the transfer to the company could be charged to income tax in the year of transfer if the accountants are right. Certainly a shortcut to complete financial ruin! That's why the suggestion is so scary.

But do the rules apply? The straightforward criterion we mentioned was that the anti-avoidance kicks in where the right to an income stream from an asset is transferred from one person to another without the transfer of the asset itself. In other words, we're looking here at highly artificial arrangements designed to let taxpayers have their cake and eat it.

The accountant's reasoning is no doubt that transferring the beneficial interest in a property to a company, with the result that the company becomes entitled to the rents, is the transfer of the income stream without the transfer of the asset that gives rise to that income stream, that is the properties. But we beg to differ. It is the beneficial interest in an asset that gives rise to the right to income, not the legal interest: so those who transfer the beneficial interest to the property portfolio to a company are transferring the asset first and foremost, as a result of which the income becomes payable. This is a completely different situation from what the tax anti-avoidance rules seem to be aimed at.

Of course, though, never say never. Who knows whether some HMRC officer may not be found to argue this point, notwithstanding what seems to us to be the clear position? Tax, like all law, is a matter of interpretation.

A false alarm?

So where does all this leave us? In a sense, you might say, it leaves us between the devil and the deep blue sea. Either we've got to put up with the new rules, which could have the effect, in many cases, of charging more tax than we actually have net income, that is a more than 100% tax rate – or we take a measured view of the perceived risks. To sum up, these risks are:

- a CGT charge on transfer to the company;
- an SDLT charge on transfer to the company;
- less favourable CGT treatment of the portfolio going forward;
- an income tax charge on the whole value of the portfolio (however unlikely);
- an accusation of mortgage fraud.

Surely, our readers will be asking, there must be some way out of this dilemma?

Well, yes, as it happens we think there is – or at least out of the first three of the difficulties listed in bullet form above.

If, instead of transferring the portfolio to a limited company, you look at the option of introducing it into a limited-liability partnership, or LLP, the tax issues melt away, replaced by a much clearer system that doesn't depend so heavily on interpretation. The LLP structure enables you to share out income – including, with careful planning, to a limited company member – so as to mitigate or even remove the effect of the loan interest disallowance. It isn't easy, but we think it can be done.

What about the last two issues, though? Will we be looking down the barrel of a colossal income tax charge or will the police turn up and put on the handcuffs for mortgage fraud?

We can only say we don't think so. The income tax charge is based on what seems to us a completely perverse misinterpretation of rules which were introduced to counter an entirely different kind of 'mischief'.

And as for 'mortgage fraud', surely if you use a reputable solicitor to prepare the declarations of bare trust, you can assume that he would advise you PDQ if there were any kind of legal difficulties, especially difficulties of transgressing the criminal code. We think you can lay that particular spectre to rest, at the very least.

Property Opportunities

Down Mexico way

There are three very solid reasons to consider investing in Mexican property. First, and foremost, over the last five years the peso has lost half of its value against the US dollar, making property cheaper than ever for US buyers. Second, following Donald Trump's election as US president and his proposal to 'build a wall' on the southern US border (together with his threat to renegotiate or withdraw from the North America Free Trade Agreement) any Mexican investors are feeling nervous and this has pushed the peso even lower. At the time of going to press you can buy over 20 pesos for a dollar. Indeed, it looks as if it is going to be the worst-performing currency of all emerging markets in 2016. Three, despite the above, prices have risen by about 30% over the last five years for luxury property and properties in safer areas. In particular demand is going up for an area known as the Riviera Mya, which is basically the glorious coast along Mexico's Yucatan peninsula. The Riviera is a winter sun, year-round destination, with temperatures varying from an average low of 21 degrees centigrade in January to an average high of 34 degrees centigrade in August. One of the advantages of this climate is that homes can attract rental returns of up to 18% a year. The Riviera Mya can honestly be described as a dazzling stretch of coastline with long, golden, stunning, clean beaches and a near-perfect climate. Remember, too, that the cost of living in Mexico, always cheap is now even lower.

Time to have a Canary

Between 2007 and 2015, property prices in the Canaries fell by roughly 40%. But in the last 12 months the trend has changed.

In 2016, Gran Canaria had the highest demand of all the islands in the Canaries and Balearics with more than 10,000 sales, 28% of which were to foreigners. In the first six months of last year, house prices rose 1.8%, which suggests that the market may well be turning. Why is Gran Canaria, in particular, a good investment? The first reason is almost certainly that security concerns in rival winter sun destinations such as Turkey and Egypt have made many people plump for the considerably safer Spanish island. With typical winter temperatures of 20–25 degrees centigrade, the island is an inviting setting for a second home, retirement or as a location for a consultancy or online business. Believe it or not, there are just six days of rain on average every year.

The microclimate on the south side of the island makes this the most popular area with many investors. This, when compared to Mediterranean alternatives, represents excellent value. For example, if you were interested in a 23-bedroom town house restoration in Las Palmas it could be yours for just €1.75 million. Tax, by the way, is low. Property tax is calculated on land value rather than property value.

Fairy tale castles

According to Christof Von Schenck, who has the wonderful title 'castles expert' at Engel and Volkers, the upmarket estate agents, the price of castles and stately homes within 90 minutes' drive of Berlin has increased by a staggering 10–20% a year since 2013. He predicts further rises because: "Berlin is the capital of the strongest economy in Europe and attracting talent. Wealthy entrepreneurs are first buying an apartment in the city, then afterwards, they look for a country property." He considers, however, that former aristocratic homes in the region are "ridiculously cheap". Of the 1,000 castles, palaces and historic manor houses in the former German Democratic Republic, it is estimated that some 50 to 100 are currently up for sale. After the post-war communist land reforms all private stately homes in the GDR were confiscated and many were turned over to educational institutions and hospitals. When the Berlin Wall came down, many of these properties were sold off by the State and the market was flooded with cheap property. The current market is divided between derelict and uninhabited estates and properties that have already been renovated. To give you a feel for what's available, I spotted a 32-room neo-Renaissance castle with a lake for €435,000 and a medieval castle with keep for €200,000. Admittedly, the latter requires some €1 million to be spent on it but, still, it obviously represents extraordinary value. Given that Berlin is likely to benefit from Brexit, it is reasonable to assume that the current growth levels will remain.

- In practice, there are several ways in which passive investors capture market returns. The method used, e.g. full replication or partial replication with sampling, depends on the markets involved and the strategy employed by the manager. Synthetic replication using derivatives is best avoided for most investors, owing to counterparty risk.

- Eugene F. Fama (May, 1970), 'Efficient Capital Markets: A Review of Theory and Empirical Work,' Journal of Finance 25(2): 383–417.

- John C. Bogle (2007), The Little Book of Common Sense Investing, John Wiley & Sons, Inc. Hoboken, NJ. This is a great introduction to the active vs. passive debate, by one of the legends of the investment world. It is succinct, easy to read and, while most of the data is US-based, the same principles apply in the UK and elsewhere globally. Really well worth a read.

TWO FREE BOTTLES OF PORT

Introduce us to a new subscriber and we'll send you a bottle of port each

If you know of anyone who could be interested in subscribing to the Schmidt Tax Report now is a very good time to make the introduction.

In addition to all the benefits that come from subscribing to the UK's longest established, plain-English tax newsletter anyone you recommend will benefit from:

- A free trial issue
- Immediate free access to our 'Ask the Expert' service
- A 50% reduction for the first year – a saving of £99

Moreover, if your introduction results in a new subscriber to the Schmudt Tax Report we will be delighted to send you and our new subscriber a bottle of port each.

To take advantage of this offer please email us through the details of anyone you would like to introduce and we will send them a free copy of the newsletter. If they decide to proceed we will send you both your free bottle of port

Email: info@wentworth-publishing.co.uk

Please note that in order to claim your two free bottles of port whoever you recommend must take out and pay for a minimum, one-year, half-price subscription worth at least £99. Once the payment has gone through a bottle of port will be sent to you and a bottle to your friend. We reserve the right to withdraw this offer at any time. Offer limited to five new subscribers per existing subscriber. We will choose the port when the time comes. Offer ends 31.12.16.

The Schmidt Tax Report

Web: www. schmidtreport.co.uk Email: info@wentworth-publishing.co.uk

It is our intention to be as accurate in fact, detail, analysis and comment as possible. However, the publishers and their representatives cannot be held responsible for any error in detail, accuracy or judgement whatsoever. The Schmidt Tax Report is sold on this understanding. The STR is commissioned and published by Pink Consultants LLP, Unit 5, Hurricane Way, North Weald, Epping CM16 6AA © Wentworth Publishing Ltd 2016. All rights strictly reserved. This publication may not be lent, hired, reproduced (in any way whatsoever) or re-sold. This information is authorised for personal consumption only. Registered at The British Library - ISSN 2047-1785.