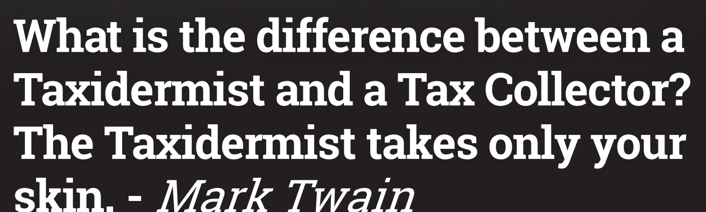
The Schmidt Tax Report

Tax, Money & Property

February 2017



The Schmidt Tax Report

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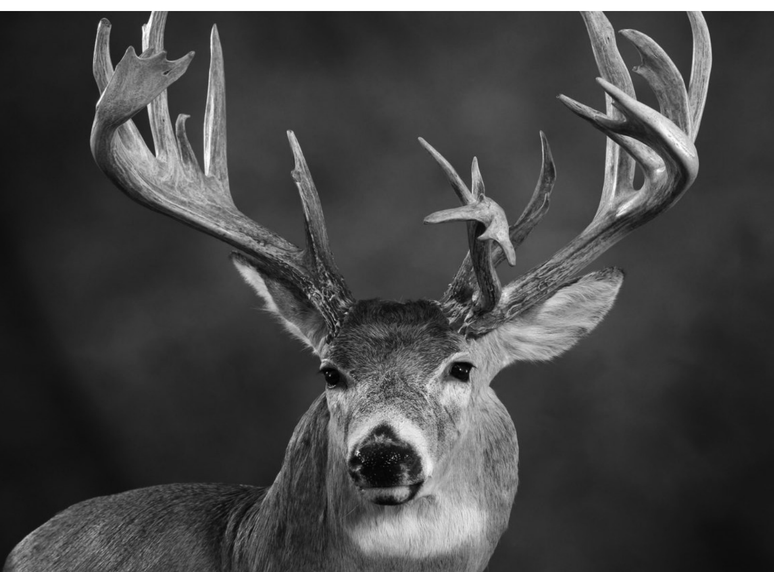

Tax

News

HMRC happy to pay for stolen data

Last year, HMRC paid nearly £0.5m to informants, some of which was for stolen – or, to use the taxman's preferred euphemism, leaked – data. Adam Craggs, tax partner at legal firm RPC, commented: "HMRC has demonstrated a willingness to use information it receives irrespective of its provenance so long as it will bring in additional tax revenue."

Apple appeal continues

Margrethe Vestager, EU competition commissioner, has accused the Irish government of not applying a uniform set of rules to the taxation of non-resident companies. The European Commission believes that Apple and other multinationals benefiting from favourable tax treatment in Ireland should pay back €13bn – little of which would be likely to end up in the Irish Exchequer.
Apple is appealing to the European Court of Justice and says that Ms Vestager is seeking to change tax rules retroactively. "The commission has shifted its theory in this case over time, in our view to make theory match what seems to have been a predetermined outcome," said Per Hellstrom, head of EU regulatory affairs at Apple.

Withdrawal symptoms

HMRC has withdrawn some 3,000 accelerated payment notices (APNs) since the system was launched. APNs were introduced in 2014 and they force taxpayers arguing with HMRC to pay the disputed tax within 90 days and not to wait until the case has worked its way through the courts or a settlement has been reached. HMRC says the main reason for the withdrawal of an APN is the reclassification of many programmes that had mistakenly been included in the Revenue's disclosure of tax avoidance schemes (DOTAS).

Sugar tax

An article in *The Lancet Public Health* journal has suggested that the UK's new sugar tax, which comes into force in April 2018, could reduce the number of obese children by up to 7% and lead to fewer people developing type 2 diabetes and tooth decay.

VCT cuts

The large venture capital trusts (VCTs) – listed funds that invest in early stage businesses and offer investors an opportunity to reduce their income tax bills by 30% (providing shares are held for five years) – have more money than they know what to do with and have, therefore, reduced their annual fundraising requirements. For example, Baronsmead Venture Trust and Baronsmead Second Venture Trust have announced that they are "unlikely to raise new funds" at this point in time.

New corporate reporting rules

The new Finance Bill (2017) contains measures that will require companies to report on their financial structures, including offshore accounts. One target of the new rules is the disguised remuneration scheme. The legislation will also introduce a new tax avoidance scheme penalty and create a new legal requirement to correct a failure on the payment of UK tax on

offshore accounts and investments. Dawn Register, tax partner at BDO, said: "HMRC are trying to ensure that there are no loopholes for people avoiding common reporting standards. There will be concerns on reporting structure as many people and companies will already be tax compliant, it creates another administrative burden on those already fully tax compliant. HMRC are trying to catch those avoiding tax but it makes you wonder if more layers of rules are really needed."

HMRC update

HMRC's investigations into payment of corporation tax by the UK's largest businesses generated an additional £2.6bn in revenue in the year 2015/16. However, the overall amount of additional corporate tax collected by HMRC fell by 25% from £3.5bn in the previous year.

HMRC's investigations into the tax affairs of small and medium-sized businesses generated an additional £468m in extra tax during the same period.

HMRC is to close 170 offices and move the work they did to one of 12 regional centres. Up to 5,000 staff are expected to leave as a result of the proposed move, which will affect 38,000 employees.

Editor's Notes

Destination-based cash flow taxation

Remember, you heard it here first. There is a new tax theory abroad in the world. Over the last couple of decades, governments have competed for business by offering lower corporate rates of tax. Thus we have a situation where 50% corporation tax has been replaced by rates, in Europe alone, from as low as 9%. While this has attracted real businesses, it has also attracted fake businesses with real profits. In plain English, companies such as Apple, Amazon and Starbucks have formed companies in low-tax jurisdictions solely to avail themselves of lower tax rates. The steps being taken to avoid this 'profit shifting' are proving only moderately successful and a number of academics and think-thanks have been trying to come up with a new way to stop it. The current favourite is being referred to as 'destination-based cash flow taxation' and the idea behind it is that taxes will be levied on profits not where the business is based but where the actual sale takes place. The location of a company's operations will no longer matter. The losers in this would be the tax havens that allow companies to set up head offices but aren't concerned about where the sales actually take place. Also countries with trade surpluses (such as Germany and Japan). The winners would, ironically, be the countries with trade deficits (i.e. where sales exceed production). Strangely enough, the one country that could probably impose such a solution on the world is the US and, even more strangely, it is not unfeasible that Donald Trump will decide to take action. There are Republicans in favour of the idea and he, of course, cares nothing for international opinion, after all.

Endangered 'specie'

Last year, the Indian government replaced its two largest bank notes (worth c. £5 and £12 each) with new versions in an attempt to reduce the size of the black economy – believed to account for at least 20% of the country's GDP. There is a rumour that England's largest banknote (the £50) is to be abolished. The idea stems from an announcement by the Bank of England that all the other banknotes (the £5, £10 and £20) will be replaced with new, plastic versions in the near future. Many governments hate cash – especially large-denomination notes (although the EU, interestingly, offers €50, €100, €200 and €500 notes) – because a cashless society makes it harder for criminals and tax evaders to operate. There is no doubt that HMRC would be delighted to see an end to the £50 note, and if you are holding a large supply you may like to consider your options!

Mental health *is* an excuse

Many years ago, I briefly had an American client in the insurance business who refused to file tax returns to the Internal Revenue Service (IRS) on the grounds that he suffered from severe mental health issues. Apparently, by means of occasional visits to private psychiatric hospitals, he managed to avoid ever having to sign a tax declaration, which would surely have meant perjuring himself. I mention him only because there was a recent tribunal case in which a UK taxpayer pleaded for, and was granted, anonymity on the basis that he or she was suffering from mental illness and didn't want it made public. I have seen statistics that suggest as many as one in four people suffer from some form of mental health issue during their lives. I have certainly experienced severe clinical depression myself. I was sorry to see that HMRC had objected to anonymity, as it indicates a lack of understanding for a very real and often very serious health issue. Hopefully, this ruling will serve as a reminder to the taxman to show a little more understanding and compassion.

Two important reminders

First, a quick reminder that, come 1st April, a new flat rate VAT scheme comes into force. It was introduced last autumn to stop apparent abuse by agency workers. The new rate is 16.5%. If you think you may be affected I would strongly advise you to take professional advice now.

Second, an equally quick reminder that if your beneficiaries are entitled to a lump sum death-in-service benefit from a life insurance policy this may become taxable if the amount of the benefit takes you over your pension lifetime allowance (LTA). There is a way around this, viz. excepted group life policies (EGLPs). If you are an employer who provides life cover to employees or if, as I say, your employer provides it for you then I would strongly recommend investigating a change to EGLP.

Ask The Experts

Q. Sole trader joiner/builder business and transfer in October 2015 to new company where he is sole director and shares are held 90% self and 10% wife.

Question 1: value of transfer of forward contracts with a retail value of £1,000,000 excl. VAT.

GP achieved as sole trader 20–24% calculated as net retail value less materials and subcontractor costs.

Would a goodwill valuation on transfer of the business of £100,000 be considered as excessive by HMRC?

Also, am I correct in thinking that entrepreneurs' relief will not be available and the company will not get relief on amortisation?

Question 2: Equipment and Motor Vehicles have a tax WDV of NIL and any value transfer would be chargeable at 40% on the sole trader.

Would an election under CAA 2001 ss 266 and 267 to transfer at tax WDV likely to be challenged by HMRC as tax avoidance?

Your comments would be greatly appreciated.

Name not supplied

A. A goodwill valuation of £100k does not appear to be excessive; indeed, it could be an undervalue, but you should carry out a proper valuation exercise so that you can justify the figures to HMRC.

You are correct that no entrepreneurs' relief or amortisation relief to the company will be available given that the transfer takes place after the changes to the rules in December 2014.

The use of s 266 and s 267 CAA 2001 would not be challenged as tax avoidance. The legislation is there precisely to prevent a tax liability arising in these situations.

Tame: Tax Abbreviations Made Easy

Tax disclosures

WDF *Worldwide Disclosure Facility:* This is a way by which UK taxpayers can disclose previous underpayment of income tax, capital gains tax (CGT), inheritance tax and corporation tax wholly or mainly relating to offshore income, assets or activities. It's an opportunity to get up to date before more serious penalties come into force.
CDF *Contractual Disclosure Facility:* If HMRC correctly suspects you of tax fraud, by owning up to at least one illegal act you can take advantage of the facility, which offers an opportunity to come clean without criminal prosecution.
VDO *Voluntary Disclosure Opportunity:* A chance for individuals and companies to disclose income tax, CGT and corporation tax liabilities that are not covered by WDF, CDF or HMRC campaigns.
DDS *Digital Disclosure Service:* HMRC's online portal through which WDF, VDO and campaigns disclosures can be made.
RTC *Requirement to Correct:* This is part of the Finance Bill 2017 and it forces taxpayers with offshore assets to correct errors before 30 September 2018 or face the consequences!
CRS *Common Reporting Standard:* Automatic international information-sharing agreement adopted by more than 100 countries that will result in HMRC receiving details each year of income arising in offshore accounts.
FATCA *Foreign Account Tax Compliance Act:* American legislation forcing banks to report annually to the IRS details of US taxpayers' income arising in worldwide bank accounts.
PSC *People with Significant Control:* A UK government requirement, administered through Companies House, whereby anyone with significant control of a UK company (or an offshore company that in turn holds a significant interest in a UK company) must declare their interest.
UBO *Ultimate Beneficial Ownership:* Exactly what it suggests.

Tax investigations

COP8 *Code of Practice 8:* This is the HMRC procedure when it investigates cases where it thinks insufficient tax has been paid but which do not involve fraud or deliberate errors. It does not offer protection from prosecution.
COP9 *Code of Practice 9:* Another name for CDF, as defined above.
FIS *Fraud Investigation Service:* This is the division of HMRC that conducts criminal and civil investigations into tax fraud with a view to prosecutions and investigations into other tax issues (COP8).
CFD *Certificate of Full Disclosure:* HMRC demands that taxpayers sign a CFD to confirm that they made an accurate, full and complete disclosure of all tax irregularities. Lie on this certificate and HMRC could well launch a criminal investigation and even prosecute.
SOAL *Statement of Assets and Liabilities:* A statement of all your assets and liabilities on a particular date, including your business interests.
UWO *Unexplained Wealth Order:* Included in the Criminal Finances Bill, its purpose is to help HMRC find out where your money comes from. A sort of financial search warrant really.

Consequences of 'deliberate' behaviour penalties

PDDD *Publishing Deliberate Defaulters' Details:* If you have been found to deliberately underpay your tax HMRC will now publish your details using PDDD.
MSD *Managing Serious Defaulters:* If you are found to have under declared your tax liability, HMRC will watch you closely for two years using MSD.

Tax avoidance

CAD *Counter-Avoidance Directorate:* HMRC department responsible for seeking out and investigating tax avoidance planning.
DOTAS *Disclosure of Tax Avoidance Schemes:* All tax avoidance arrangements (TAAs) that fit within definitions issued by HMRC must be notified to the department after they are designed. HMRC then issues a DOTAS number. The promoter must give the user of the arrangement the number for inclusion on their tax return with entries regarding the TAA.
POTAS *Promoters of Tax Avoidance Schemes:* HMRC's legislation imposing consequences on some promoters of TAAs with the aim of deterring unacceptable planning.
GAAR *General Anti-Abuse Rule:* General principle introduced by HMRC to try to prevent artificial tax planning.
TAAR *Targeted Anti-Avoidance Rule:* The legislation contains TAARs to try to prevent pieces of legislation being exploited for tax avoidance purposes unintended by Parliament.
STAR *Serial Tax Avoidance Regime:* Supposing you start a tax avoidance scheme and get second thoughts and want to withdraw? You need to take part in this regime. It isn't pleasant but it may be better than the alternatives.
APN *Accelerated Payment Notice:* Issued by HMRC to taxpayers who participate in TAAs to collect the tax 'saved' before the inquiry or appeal is concluded.
FN *Follower Notice:* HMRC issues this to taxpayers to force them to remove entries relating to a TAA from a tax return after

a final court decision confirming that the arrangement, or a similar one, does not achieve the intended tax saving.

Governance, debt management and sundries

LSS *Litigation and Settlement Strategy:* Will HMRC sue you or reach a settlement? This sets out HMRC's strategy for handling inquiries and investigations.
TDRB *Tax Disputes Resolution Board:* Owe more than £20m in tax? Sensitive tax case? This is the board that will decide what to do with you.
ADR *Alternative Dispute Resolution:* Form of mediation to resolve inquiries and disputes between HMRC and taxpayers, as long as the proposed settlement is LSS-compliant.
HNWU *High Net Worth Unit:* HMRC unit that overseas compliance and inquiries into high-net-worth individuals (HNWIs).
CRM *Customer Relationship Manager:* An attempt to make the HMRC officer in charge of a tax case involving an HNWI or a large business sound friendly. He or she is responsible for bringing together all HMRC's other teams and will be your main point of contact.
LBS *Large Business Service*: HMRC section that oversees compliance for large businesses. Each business is allocated a CRM.
SAO *Senior Accounting Officer*: Large companies must allocate a senior accounting officer to take responsibility for tax compliance and be HMRC's main point of contact at the organisation.
TTP *Time to Pay*: Hard up? Reasonable excuse for being hard up? If you are facing hardship and cannot afford to pay the tax you owe, it is possible to negotiate time-to-pay arrangements with HMRC using TTP.

Top Tips For Tax Year-End Planning

With the end of the tax year rapidly approaching, now is a good time to carry out some financial housekeeping to make sure you have taken advantage of the various tax breaks available and organised your financial planning as tax-efficiently as possible. Here are some tips to set you on your way.

Pensions

The 'standard' annual allowance is £40,000 per annum, although this is reduced for those whose total income is in excess of £110,000, and where 'adjusted income' exceeds £150,000 the 'tapered annual allowance' will apply. If you have not maximised use of your annual allowance in previous years, there may be the opportunity for you to carry forward the unused relief to increase the amount you can pay in 2016/17.

Non-earners can make a 'threshold contribution' of £3,600 gross each year and, with the new flexibility surrounding how pension benefits can now be drawn, it may well make more sense than in previous years to take advantage of this tax break.

Employer contributions are also relievable for the employer as an expense against profits, assuming that the contributions qualify as being "incurred wholly and exclusively for the purposes of the employer's trade or profession" as defined by Her Majesty's Revenue & Customs (HMRC). This effectively means that the amount of contributions has to be reasonable given the individual's role within the organisation and their level of overall remuneration. However, there is no explicit requirement that they do not exceed the level of the member's relevant earnings.

The rules surrounding the annual allowance are fairly complex. A full explanation of the rules can be found in our 'Guide to Pensions', which can be downloaded free of charge by *TSTR* readers here: http://www.bloomsburywealth.co.uk/guide-to-pensions.

Individual savings accounts (ISAs)

The ISA subscription limit is £15,240 (rising to £20,000 on 6th April). As the ceiling remains relatively modest and there are no carry-forward provisions, maximising your contributions in each tax year whenever possible is generally the best practice.
With the pension lifetime allowance being reduced again, the tax shelter offered by ISAs has become relatively more significant.

As a reminder, the four main ISA tax benefits are:

- Interest is received free of UK tax in an ISA, other than from cash held in a stocks and shares ISA (when a flat 20% rate applies).
- There is no further UK tax to pay on dividends in a stocks and shares ISA.
- There is no capital gains tax on profits.
- ISA income and gains do not have to be reported on your tax return.

With short-term interest rates still at historically low levels, the tax benefits of a cash ISA are small. While the ISA season will no doubt see higher rates on offer for new savings, these rates almost invariably contain a large bonus element which falls away after a fixed period, typically 12 months. At the time of writing the best rate on offer is 1.25 % – significantly lower than the current rate of inflation, meaning that cash ISA savers are actually losing money in real terms.

If you arranged a cash ISA a year or more ago, it is worth checking what interest rate your account is now earning – it could be 0.5% or even less. If you rely on spending the interest income, you may want to consider a transfer to a stocks and shares ISA. You would lose the security of a capital deposit, but your income potential could increase significantly.

Inheritance tax (IHT)

The nil rate band remains frozen at the 2009/10 level of £325,000. There is a sliding timescale for implementation of an extra £175,000 of nil rate band for property owners; however, its full implementation has been deferred until April 2020.
It therefore makes sense to review the extent to which you use the three yearly IHT exemptions before 6th April:

- ***The annual exemption*** – Each tax year you can give away £3,000 free of IHT. If you do not use all of the exemption in one year, you can carry forward the unused element, but only to the following tax year, when it can only be used *after* that year's exemption has been exhausted.
- For instance, if you did not use the annual exemption in the last tax year, 2015/16, you can still do so by 5th April 2017 but only once you have fully used the 2016/17 exemption. Thus a gift of up to £6,000 (£12,000 for a couple) can escape IHT.
- ***The small gifts exemption*** – You can give £250 outright, per tax year, free of IHT to as many people as you wish, provided that none of the recipients is also a beneficiary of your £3,000 annual exemption. While the amount is small, if you have enough children and grandchildren the sum total of small gifts can easily exceed the annual exemption.
- ***The normal expenditure exemption*** – The normal expenditure exemption is the least understood, but arguably the most useful, of the yearly IHT exemptions. If you make a gift that is regular, out of income (*not* capital) and does not reduce your standard of living, it is exempt from IHT, regardless of its size. So if, for example, you decide to give away investment income which would otherwise be reinvested, that gift should be covered by the normal expenditure exemption.

Further information, and additional estate planning strategies, can be found in our 'Guide to Estate Planning' which can be downloaded free of charge by *TSTR* readers here: http://www.bloomsburywealth.co.uk/guide-to-estate-planning/.

Capital gains tax (CGT)

CGT rates have been 'de-coupled' from income tax rates for some years now, meaning that CGT is a relatively benign tax, particularly for those paying higher rates of income tax. The flat rate of 20% on non-property assets (28% on property assets for higher-rate taxpayers) applies to gains in excess of the annual CGT exemption, which is £11,100 (£5,500 for trusts) for 2016/17.

Thanks in no small part to the Brexit vote and the subsequent collapse in the value of sterling, 2016 was a pretty good year for stock market returns for sterling investors; therefore, it is well worth reviewing your investment holdings to decide whether to realise any gains and rebalance back to a mix that is consistent with your risk tolerance.
If you do crystallise some gains, be careful about also realising losses before 6th April. Capital losses made in a tax year must first be set off against gains made in the same tax year, with only any additional losses carried forward to future years. If your gains alone would have been within your annual exemption, the losses are effectively wasted.

Venture capital trusts (VCTs) and Enterprise Investment Schemes (EISs)

The continued attack on pension contribution tax relief means that attention is increasingly being focused on VCTs and EISs. Neither offers full income tax relief but the menu of tax breaks is attractive when compared with other types of investment.

Feature	VCT	EIS
Maximum income tax relief on initial investment	30% on investments up to £200,000 per tax year	30% on investments up to £1,000,000 per tax year
Minimum holding period to avoid tax relief clawback	5 years	3 years
Dividends	Tax-free (but no reclaim for tax credits) within £200,000 limit	Taxable (but profits usually retained, not distributed)
Capital gains on proceeds	Nil within £200,000 limit	Nil (except for reinvested gain)
CGT reinvestment relief	None	CGT entrepreneurs' relief will now be allowed where a qualifying gain, which has been deferred into investments qualifying for enterprise investment relief (EIR) and social investment tax relief (SITR), is subsequently realised
IHT business assets relief	None	Usually available after two years of ownership

VCTs and EISs are both high-risk investments in very small companies and, if considered at all, should only form a small part of a well-diversified investment portfolio. The high risk involved is the main reason why the government is prepared to offer such generous tax reliefs. Remember, there's no such thing as a free lunch and investors in such arrangements should understand that they could lose the entire value of their investment.

Dividend income

This tax year is the first to which a new dividend allowance of £5,000 for all individual taxpayers applies, although this was accompanied by additional tax rates on dividends above this figure of 7.5% for basic-rate taxpayers, 32.5% for higher-rate taxpayers and 38.1% for additional-rate taxpayers; a rise, therefore, in all effective rates of around 7.5%.

While it may be too late to alter your investment portfolios to benefit from this allowance (although if that is the case you should certainly look to do so to take advantage of it in future tax years), business owners who have the opportunity to distribute profits as dividends may be able to benefit (e.g. by paying a dividend up to this level to a non-working shareholder spouse).

Summary

You should, of course, always remember that old adage, 'Don't let the tax tail wag the investment dog', by which we mean don't make investment decisions based solely on tax considerations. That being said, it is certainly prudent to invest in a tax-efficient way, by maximising the tax breaks available to us all.

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Focus On...Capital Losses

If you're a tax adviser, you tend to get a weird, distorted view of life and finances. Your accountant's long face when he tells you that you've made a big profit is as comical as the way he brightens up when he's able to tell you you've made a loss. Incurring losses gives you access to all kinds of interesting tax reliefs and that Shangri-La of all tax consultants: the refund cheque from HMRC.

But there are losses and there are losses. It's undoubtedly true to say that one sort of loss, the capital loss, is much less useful than the other sort. Whereas if you make a loss in some kind of trading business you can (subject to certain criteria) claim to offset this against your other income and your capital gains, capital losses (i.e. losses on fixed assets within the scope of capital gains tax) generally don't work the other way round. That is, you

can't, generally, offset them against income.

We'll come on to an example of where this doesn't apply shortly, but the main aim of this piece is to raise awareness, as they say, of some generally little-known advantages of the way the tax system works in the face of loss of capital.

No time limit

Consider the case of Mr Hopeful, who invested money some years ago in a company set up to extract gold from seawater. The shares were duly issued to him, but he waited in vain, year after year, for those dividends which were so confidently predicted by the promoters of the company. Then the principal promoter, who was also the managing director, Mr Devious, mysteriously disappeared, and after a period an administrator, and then a liquidator of the company, was appointed.

The liquidator (played by Michael Palin in the film version) writes to all the shareholders saying that, unfortunately, it seems the scheme for extracting gold from seawater isn't commercially viable, and all the money they have subscribed has already disappeared in paying Mr Devious a substantial annual salary for the purpose of establishing this fact.

So Mr Hopeful's shares have become worthless, and he will never see again the £100,000 he originally put into this venture. Having gone through the motions, the liquidator duly applies to Companies House, and the company is struck off the register with no assets. Mr Hopeful has a capital loss of £100,000. What can he do with it?

Well, the first bit of good news in this story is that there's no time limit for the carry forward of this loss. Assuming (as is most often the case in practice) the person making the loss has no capital gains, which would otherwise have been subject to capital gains tax (CGT) in the same tax year ended 5th April, the loss can go forward indefinitely and be offset against any capital gain he makes in any future tax year. (Unlike income type losses, there's no facility in normal circumstances for a capital loss to be carried back and offset against earlier years.)

Claiming your loss

Is it sufficient, then, if Mr Hopeful just puts his worthless share certificate in a file and notes down that he can use the loss in the future if he sells, say, one of his buy-to-let properties at a capital gain? Not quite.

If the loss has been sustained in the period following the introduction of self assessment in 1996, you do have to quantify it and place it as a specific claim on your self assessment tax return. The loss can then be carried forward year after year. If you've forgotten about the loss in your hurry to meet the 31st January deadline, it's not necessarily time to start panicking. A loss can be established and claimed, in the self assessment period, within a set period of, broadly, four years.

The flipside to what we've just said is that, if losses have been incurred prior to 1996, there's no requirement to have put in a formal claim and, if you still have the records, you can establish a loss for this pre-1996 period even now.

'Negligible value' claims

In our example of Mr Hopeful, the asset whose value has disappeared has also ceased to exist as an asset – the company has been struck off. But you don't necessarily need to wait for the complete destruction or extinction of the asset (or its sale) in order to claim a loss. There's also the situation where the asset has lost all of its value but still exists. You can claim that the asset has become of negligible value and that you should be treated, for CGT purposes, as if you had sold that asset for its negligible value, crystallising the loss for use against other gains.

And there are some interesting tax-planning wrinkles arising from negligible value claims, which relate to the timing of when the loss is established.

It's probably time we had another example. Some years ago, Stephen bought a very thin plot of land (little more than a hedge, really) for £50,000, and he paid this large amount on the basis of its being a 'ransom strip'. A ransom strip is a bit of land which someone else who owns adjoining land needs to own, or has some kind of rights over, to get access to his land. In Stephen's case, there was a large field next to his ransom strip that he was pretty sure would get planning permission for development.

There was good reason for him to anticipate this, because he was aware that the land had been acquired by a large national developer, Greenfield Developments plc. A quick look at the Land Registry revealed to him that they'd paid over £1 million an acre for this land – and these boys don't spend that sort of money unless they know they're going to be able to turn it to good account. And the only way into this field, Stephen thinks, is via his pocket-handkerchief-sized plot.

In the event, one part of Stephen's expectation is met, but the other isn't. That is, Greenfield get the planning permission to build. But on the other, they manage to 'persuade' the local council to build a big new road across the other side of the land, thus 'opening it up' for development on that side. So Stephen's ransom strip is no longer such, and becomes worthless overnight.

The news of the new road broke at the end of 2013. So Stephen's land has become of negligible value in the tax year 2013/14, ended 5th April 2014, and he has a capital loss of £50,000.

As it happens, in that tax year he had made a modest capital gain on selling some quoted shares, amounting to £10,000, or just within the available capital gains tax annual exemption. In the following year, on the other hand, he had made no capital gains at all. So he times his claim to give it effect in the 2014/15 year, resulting in his being able to carry forward to future tax years the full £50,000, rather than £10,000 of it being uselessly offset against capital gains which were within his annual exemption.

Timing of losses

This really just illustrates a basic principle about when you should time losses. In the case of negligible value claims, you can make the claim at any time after the asset has lost its value. In the case of other assets, it becomes a question of when you should best time the disposal of the asset and the crystallisation of the loss. So bear in mind, if you have flexibility on the timing, the all-important principles that losses cannot be carried back; <i>must<i/> be offset against other gains in the tax year, even if those gains are less than the annual exemption; and, once they have been carried forward, do not get offset against gains which are merely within the annual exemption.

Remember, too, that CGT is a 'progressive' tax: that is it is at a lower rate for those with small amounts of income plus gains than it is for those with large amounts. So crystallising your capital loss claim in one year can result in relief being enjoyed at a higher or lower rate than crystallising it in another tax year. Worth talking to your accountant if you're in doubt.

What assets?

CGT losses can generally be claimed on all assets where the gain would have been taxable if one had been made. For most people's purposes, these assets comprise the following:

- shares in companies
- property (other than property held as the stock in trade of a development business)
- intangible assets like goodwill, trademarks, computer software rights and other contractual rights
- chattels used for a trade (over a certain value)
- agricultural quotas (if these still exist).

What are definitely excluded from the above list are debts owed by another person. No doubt, those making up CGT reasoned that you were unlikely ever to make a profit on a debt, whereas people are making losses all the time from lending money to other people who don't pay them back. So there was no way they wanted to give people relief for such losses, however real and substantial they are.

But there is an exception to this. If you make a loss on a loan to someone carrying on a trade, then, providing the money you've lent was actually used for the purposes of that trade, and you haven't done anything yourself to make the loan irrecoverable, you can claim this as a capital loss.

Interestingly, this even applies to the common situation where a director has made a loan to his own company. And remember that it only needs to be of 'negligible value' – it doesn't have to have been completely written off.

'Clogged losses'

This is the term used for losses made on disposals of assets to connected persons. For some reason, those framing the CGT legislation felt the need for extra protection for the Inland Revenue against people being able to claim for losses they had incurred. They already had the rule that any disposal of an asset to a connected person needed to be at market value for CGT purposes. But they added to this a further requirement that such losses were 'clogged', that is they could only be used against future gains on disposals to the same connected person. This rule has caught out many a tax planner in the past.

Fortunately, this being such a perverse and apparently unnecessary rule, it's also relatively straightforward (with the emphasis on the word 'relatively') to get round the problem. This is by ensuring that any future disposal you make is routed via the same connected person.

Let's say that Stephen didn't claim negligible value for the ransom strip in our example but instead transferred it to a family trust that he had set up. This turns the £50,000 into a 'clogged loss'. Five years later, he's looking to sell a buy-to-let property he owns, and this will realise a £100,000 gain. As the purchaser is not the same person, the £50,000 loss would not normally be able to be offset against the subsequent £100,000 gain. Aware of this rule, Stephen transfers the buy-to-let property to the trust as an intermediate stage of the sale, and thereby crystallises the £100,000 gain, because the gift to the trust is treated as if it were made at the market value of the property. Hence the loss and the gain are both on disposals to the same connected person, and the loss is relievable. The trust then sells the property on to the third party, and doesn't make a gain, because it's treated as if it had paid the full market value of the property at the time it received the gift from Stephen.

Losses against income

Finally, there's the exception to the rule about capital losses only being offsetable against capital gains.

This is where the loss arises on shares that you have subscribed for in an unquoted trading company. If you have a loss worked out on CGT principles (including the possibility of a negligible value claim), you can offset this against your income for the year of loss or the preceding year. The company has to be carrying on a qualifying trade, and if EIS relief was available when you subscribe for the shares, the income tax relief you've received is taken off the amount of your loss. However, an EIS investment that goes wrong, and where the loss is fully claimable against other income, will actually have cost you far less than half of the actual amount you subscribed, when you take into account both the income tax relief on subscription and the loss relief on the company turning turtle.

Of course, no one plans to make a loss, but it is still very relevant to bear in mind the availability of this potential loss, when you're deciding how to structure your investment in an unquoted trading company. If you do this by way of a loan, you have the advantage that the loan can be repaid to you, tax-free (because it's only a return of your capital) without the formality that would be associated with your shares being cancelled or bought back. Small companies are generally financed mainly by way of loan rather than share capital for this very reason. However, if you do choose to capitalise the company by way of subscription for shares (note that those who acquire shares from others, rather than subscribing for them, can't claim this relief), you do have the potential of an unexpected tax-planning bonus in being able to offset your loss against income rather than just against gains.

The Young Of Today

Anyone who is a parent will know the mixture of joy and anguish that children bring. Whether the former or the latter predominates in a particular case, the one thing that is certain is that bringing up children is an extremely expensive exercise. So it's only fair, we would have thought, for you to try to cash in, in any way, on this expense in order to save tax. (At least, that's the way our minds work!)

Presumably at some time in the dim and distant past, parents were in the habit of arranging things so that a portion of 'their' income got paid to their children instead. The obvious benefit of this was the fact that every man, woman and child in this country had personal tax allowances, lower rate bands, etc. that could only be used if they had income to offset them against. So a parent who was a higher-rate taxpayer could change the rate of tax on some of their income to nil or the basic rate by transferring that income to their children.

So the 'settlements on children' legislation was introduced. Forget the word 'settlements': this actually refers to any arrangement a parent makes, however deviously and indirectly, as a result of which a child who is under eighteen receives income. The blanket rule, which it's almost impossible to argue against, is that the income in this situation is taxed instead on the parent, as if it had never been diverted.

Grandparents

These rules don't apply to gifts made by

grandparents or other relations, on the other hand. So, let's take a simple example of how this gap in the rules can be exploited.

Grandmother and grandfather are considering making a gift to their children following 'downsizing'. At the suggestion of a tax adviser, they actually make the transfer to a family trust in which not only their children but also their grandchildren are beneficiaries. So money that would have had to be found somehow by generation two to support the financial needs of generation three instead comes out of this trust. Because it is a trust made by the grandparents in favour of their grandchildren, the anti-diversion rules don't apply even if the grandchildren are under eighteen.

The same principle applies to absolute gifts, and not just to gifts into family trusts.

Children in tertiary education

Arguably, the rule which sets the age at eighteen, above which these 'settlements on children' rules don't apply, is a survival of the old days, when children of eighteen were more often than not in jobs. There has undoubtedly been a huge increase in the number of people going on to tertiary education, that is education in universities and higher education colleges, since our grandparents' day. So there is now quite a lot of scope, in fact, for parents to divert income to their children, who are still entirely dependent on those parents, without this diversion being neutralised as tax planning by the rules.

As example two, let's consider a large property portfolio owned by Mother and Father. Mother and Father decide to introduce this portfolio into an LLP in which their two children, who are aged eighteen and twenty, are also members. Some of the rents from the portfolio, which make up the total profit of the LLP year on year, can be allocated to the two children in the accounts and for tax purposes. In practice, the amounts allocated to them may just be amounts actually paid to them or on their behalf to support them while they are at university. Nevertheless, the effect of this arrangement is to use their personal allowances etc. and reduce the overall tax charge on the rental portfolio substantially.

A more straightforward (in some ways) way of doing the same thing, but also a more irrevocable one, is to give the children a share in one or more properties or other income-producing assets.

Dividend and interest allowances

One cheer for the current government, in introducing a new tax allowance, or perhaps we should say two new tax allowances. From the current year, every individual can receive up to £5,000 of dividends, and £1,000 of interest, tax-free.

The most simple and straightforward way of reacting to this in order to save tax is to rearrange your affairs so that dividends and/or interest are received not by the parents but by the adult children. The key to doing this may be finding a way of channelling the income to them in this way without giving them an undesirable element of control over any assets. There are ways of doing this, but this article would swell out of all proportions if we went into all the permutations!

Settling gains on minors

Interestingly, for those who have children under 18, there's no capital gains tax (CGT) equivalent to the income tax rule against diverting income to children under 18.

If you hold assets (properties, shares or unit trust holdings etc.) in the joint ownership of yourself and your young children, any capital gains made on disposing of those assets will be allocated for tax purposes in the same way they are allocated in reality, resulting in the availability of the children's CGT annual exemptions (currently about £11,000 each).

Fun with car benefits

We've mentioned this fun bit of planning before, but no harm repeating it here for those who haven't come across the idea. If you are running a business, any cars provided to employees of the business (which could be you if you are running it through a company, and could in any event be your children) are taxed on the relevant employee on the basis of a fairly rough-and-ready set of rules. The list price of the car when new is multiplied by a percentage based on the CO_2 emissions of the car (normally) and the resultant figure is then treated as income of the relevant person.

If you have a child who is old enough to drive, and for whom you propose to provide a car, consider doing this through the business structure. To take the simple situation of where you are running your business through a limited company: the company acquires the car and provides it to your eighteen-year-old son or daughter. The tax rules would apply to treat this as a benefit in kind on you personally, because HMRC would definitely conclude that your child was receiving the benefit of the car because of your employment, rather than theirs.

However, if the car (as is likely in these circumstances) is a small and environmentally friendly one, the benefit in kind calculated under the above rules may well be less, even significantly less, than the actual cost of running the car. With a young driver, the insurance premium alone may be sufficient to result in tax efficiency here, to say nothing of the annual depreciation and running costs. So, instead of having to take income out of the company, which may be bearing a heavy burden of tax and National Insurance, and using the net amount you have left to provide the car for your child, bypass all of this and have the company provide the car itself. It gets tax relief for all the running costs – including the insurance – against its corporation tax, and the chances are that your personal income tax charge on the benefit will be a very much lower amount.

Flying the nest

Our final fun planning point relates to the common situation (these days) where Bank of Mum and Dad provides the funds for a child to buy their first home, sometimes as somewhere to live while at university.

Very often, in this situation, the parents aren't ready, financially, to simply make a gift of the deposit or purchase price of the property to their child. They also may have fears, increasingly justifiable in today's world, that anything given to the child may end up being diverted elsewhere in the event of a failed marriage or other relationship.

On the other hand, if they simply buy the property in their own (the parents') name, any gain they make when they ultimately sell the property will be fully chargeable to tax: even though their child has lived there.

So the answer, in many such situations, will be for the parents to put the money into a trust in which both they and their children are beneficiaries. Providing one of the beneficiaries (it doesn't have to be all of them) lives in the trust-owned property as their main residence, CGT relief against the gain will be available in exactly the same way as it is for an owner-occupier.

The Business Column

Property businesses: What can I claim against tax?

If you receive an income from letting property, you're probably familiar with the basic rules for claiming expenses: most of which are pretty obvious anyway. Unless you're an expert, though, there are some wrinkles you may not know about. So we thought it might be useful to dwell on some of these wrinkles for a bit, moving from the more straightforward to the less straightforward.

And, as always in this sort of article, we're looking specifically at things you can actually do to make your tax position better. That is, this isn't just a lecture on the rules, which you might say is all very interesting for accountants but doesn't cut much ice with the people who actually have to pay the tax.

1. Repair or capital?

Hands up all those who think that the UK tax system, left alone and unsullied by 'planning', ends up with you paying your 'fair share' of tax?

Not many hands going up from our regular readers, I see. Consider the following far-from-hypothetical scenario, which is just one example of the way the rules work against the taxpayer.

George has bought a property, a rundown house on four floors, which he proceeds to convert into four flats. He does a spanking good job of it, with everything decorated and fitted out to the highest standards. His accountant tells him (correctly, as a matter of law) that he can't claim any of the payments to the building contractor against tax, because the conversion of the flats is 'capital'. George holds on to the property for a great many years, and in the course of that period the market changes. In the area the property is, it has now become much more desirable to have a large family house, and so, in order to sell the property, he reconverts it back into a single house.

The original expenditure he incurred on converting the property into flats is what's called a 'nothing' for tax purposes, that is it is business expenditure, wholly and exclusively incurred for the purposes of that letting business, which receives no tax relief at all. The technical reason for it in this particular case is that the conversion expenditure is not reflected in the state or nature of the property when it is sold, and therefore it can't even be claimed for capital gains tax purposes against the profit George makes on selling the reconverted house.

It's not the first time I've raised the question in these pages about how anyone can think it 'fair' to pay tax on more profits than you've received. But no one seems to be answering it, so here the question is again.

The point of principle which is at the core of this scenario is (God knows where it came from) that expenditure which is 'capital' in nature can't be claimed against income. If you're lucky, it can ultimately be claimed against the capital gain on disposing of the property, but if you're unlucky, like George, you can't. So the name of the game is to avoid incurring capital expenditure to the maximum extent possible.

You might say that there is actually no room for manoeuvre on this point at all, because if you're going to be converting or incurring other major improvement expenditure on a property, you're going to do it regardless of the tax consequences.

But this isn't quite an accurate picture of the choices facing a landlord. Sometimes, there is the choice between a philosophy of gutting a property completely and virtually rebuilding the interior or patching up the property piecemeal over a longer period. The latter is much more likely to get tax relief because it is categorised as 'repair and redecoration' rather than being a capital improvement.

2. VAT

I raise the point of VAT because I have seen some confusion on the part of landlords in this area. If you are letting residential property, your rents will be exempt from VAT, and therefore you won't be able to claim any of the VAT on expenses (e.g. legal charges or the charges of builders doing repairs). The point is, though, that it is the VAT-inclusive amount you can claim against your income tax in this situation. VAT, although it is actually a tax, becomes an expense like any other, which you can offset against your rental profits.

If you're letting commercial property, you have the option to apply VAT to your rents, in pursuance of a special claim sent to HMRC to that effect. If you do charge VAT on your rents, you can reclaim the VAT and therefore it doesn't form part of the expenditure that you can offset against your rents.

3. Management charges/wages

Most property, particularly residential property held by buy-to-let landlords, is very much in the position of an investment that doesn't look after itself. Many people, indeed, are put off the idea of having a buy-to-let residential property portfolio by the hassle of being rung up in the middle of the night when the boiler has broken down or water is pouring through the ceiling. Letting agents commonly charge anywhere between about 8 and 15% plus VAT for looking after a property. They can get away with this because of the 24/7 nature of property letting as an activity.

If you don't have a letting agent (or, depending on the contract, even if you do), you can probably also justify charges against your rents from connected persons. This may reduce the amount you are paying tax on without necessarily increasing the tax paid by the connected person in question by the same amount.

Again, an example is probably the best way of illustrating what can be done. Peter owns the freehold of a block of flats, all of which are let on short-term lets, so that the income is Peter's. His son, Andrew, is currently between school and university, and being (arguably unlike most eighteen-year-old boys) endowed with reasonable common sense and practicality, offers Peter the service of looking after the property in return for a commercial charge. If the rents from all the flats together are £100,000 a year, Andrew agrees that he will look after the property for 10% of this, that is £10,000.

Result: £10,000 of the rents doesn't get taxed, because Andrew has no other income and the £10,000 he receives is within his personal income tax allowance. Bear in mind that Peter might actually be helping Andrew financially in any event, and by making this a payment in return for services, rather than just an annual gift by Peter, secures a valuable tax advantage worth in this case (let's say) £4,500 off Peter's tax bill.

A similar principle applies if you set up a limited company to look after your

portfolio. Even if you own all the shares in this company, there's nothing in principle stopping it charging you for its services in managing the property. If the company is paying corporation tax at 20% and you would otherwise be paying income tax on the rents at 40 or 45%, this obviously could represent a fairly chunky reduction in your annual tax.

What happens to the money that is paid to the company, though? If you then just take it all out as dividends, you haven't gained any tax advantage, because the dividends are chargeable on you to higher-rate tax. So what about considering two alternatives to this?

1. The shares in the company could be partly held by your spouse or other family members, and pay dividends to them (perhaps using their new £5,000 tax-free allowance against dividends); or

2. The company could become a partner in the property-letting business, held via an limited-liability partnership (LLP), and leave the amounts it charges in as equity capital.

If you are looking at more substantial charges from connected persons, to reduce your rental tax bill, do watch out for the danger of running over the £83,000 VAT threshold. If the connected person has to charge you VAT on top of his, her or its charge, this is likely to take away most or all of the benefit of the arrangement: because you can't reclaim the VAT if you are letting residential property.

4. RIP the wear-and-tear allowance

From the current tax year onwards, those who let furnished residential property can no longer knock off an automatic 10% for 'wear and tear'. (If you haven't done this in the past, do go back and claim some tax back for up to four years accordingly.) The wear-and-tear allowance was intended to be a rough-and-ready substitute for claiming the cost of maintaining the furnishings in the property.

Instead of this broad-brush approach, we now have specific rules under which you claim the cost of replacing furniture items. Therefore, for the first time, it's quite important to make sure you keep proper evidence of all those times you've bought, a new bed, or fridge, etc.

5. Loan interest

As you will no doubt have seen from one or many other articles on the subject, this is the hot topic at the moment. Those letting residential property will gradually lose the ability to offset loan interest paid on mortgages to acquire that property, starting from 6th April 2017, for the purposes of higher-rate income tax.

I'll save you my customary rant on this subject, as anybody who isn't *parti pris* will by now have already formed their own views on the fairness of landlords paying tax on profits they haven't made. But the important question is, is there anything landlords can do about it?

Apart from the obvious ideas of downsizing the portfolio by making sales of properties, and pay off the offending loans, most solutions involve the idea of rearranging the holding of the portfolio so that persons who aren't higher rate income taxpayers receive all or a share in the rents.

In the simplest example, a spouse who owns a property portfolio may transfer an interest in that portfolio to the other spouse. If the other spouse is not a higher-rate taxpayer (even with the gross rents being slapped on top of his or her income) then you save the impact of the new rules to that extent.

More sophisticated planning involves the use of limited companies. I've written elsewhere about the extremely risky (in my view) practice of transferring buy-to-let property portfolios to limited companies root and branch. The risk here involves the very real danger, in most cases, of incurring both stamp duty land tax and capital gains tax on the transfer.

But there are other ways of bringing about the position whereby the company can legitimately receive an effective share of the rental income. One way, which I've already mentioned, is the idea of the company making a justifiable charge for looking after the portfolio. To the extent that income ends up in the company (even, in fact, in the situation that it is then paid out as a dividend to the same person), this element of income is not subject to the disallowance of loan interest.

More ambitiously, the company can be brought in as a partner in the letting business, perhaps one of the members of an LLP into which the property portfolio is introduced. This idea, which is likely to be the only one providing meaningful savings for portfolios over a certain size, deserves an article to itself!

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Offshore News

Non-resident taxpayer granted judicial review

An unnamed (as yet) non-resident taxpayer who has been subject to an Information Notice has been granted judicial review in respect of HMRC's right to demand information even though he (or she) no longer lives in the UK.

HMRC was seeking information in relation to the taxpayer's residence to determine when the taxpayer was resident during a particular period.

If you are a British expat who no longer has a UK address, the outcome of the judicial review, when it happens, is obviously going to be of some interest. We will report more when we hear more.

La Dolce Vita

In an attempt to attract HNWIs to Italy, its government has offered a special flat rate tax deal to anyone who hasn't been resident in the country for nine years or longer. The tax rate is €100,000 a year and covers all non-Italian income. The arrangement can be taken advantage of for up to 15 years.

Switzerland seeks new deal with the US

The Swiss government has announced that it wishes to update its tax agreement with the US. It is seeking automatic, reciprocal exchange of information. US authorities already receive information automatically about Swiss bank accounts held under the FATCA, but Switzerland wants a two-way exchange. If a new deal were struck with the US, it would have to be approved by the Swiss parliament, which could delay its implementation.

Wildenstein wins

Guy Wildenstein, the most senior member of the Wildenstein family, has been cleared of tax fraud charges in France after a six-year trial. It had been alleged by the French financial prosecutor that the Wildenstein family had concealed paintings and properties using trusts and holding companies in tax havens. The court said that while there had been a definite attempt at concealment the illegality of the schemes had not been proved by the French prosecutors. It is believed that the family owns some 2,500 works. Over the last few years the family has sold more than 600 artworks and generated roughly £250 million to fund other investments and lifestyle.

HMRC demands more information

HMRC is expected to write shortly to around 50 UK-based firms that are known to set up trusts and companies offshore. The letters will demand details about the offshore entities and their beneficial owners, including names and addresses. If the information isn't forthcoming, it is believed that formal notices will be served. HMRC claims that the data it is requesting is not protected by legal professional privilege. However, the Law Society does not share HMRC's opinion. It believes that legal privilege was very likely to be engaged when the client sought advice on matters such as establishing an offshore company or trust. The campaign is most likely to affect non-doms.

Mossack Fonseca fined by the BVI

The local subsidiary of Panamanian law firm Mossack Fonseca has been fined $440,000 by the British Virgin Islands financial services commission. The subsidiary was fined for eight contraventions of the anti-money-laundering and terrorist financing code of practice in respect of record keeping and risk assessment failures and inadequate updating of customer due diligence. The enforcement action followed a six-month onsite compliance inspection.

Beneficial ownership to become public

The European Council has passed a proposal which will give tax authorities access to information on the beneficial ownership of companies as of 1st January 2018. The new legislation will also allow tax authorities to gain access to information about the beneficial ownership of intermediary entities and other relevant customer due diligence information. Its effect will be to allow tax authorities to look through intermediary structures.

Germany to close tax loopholes

The German government is planning to introduce legislation designed to make it much harder for German businesses and individuals to hide offshore holdings, by forcing them to declare all business relationships involving beneficial ownership of 10% or more. The law will also cover partnerships, estates and associations. Financial institutions will be forced to report on their clients.

97% of jurisdictions ready

The Global Forum on Transparency and Exchange of Information for Tax Purposes has found that 97% of jurisdictions committed to exchanging information in 2017 were ready for these exchanges. The Forum criticised a large number of jurisdictions – not least the Marshall Islands and Panama – for not making sufficient progress.

Hungary cuts corporate tax rate

The Hungarian government has announced that it will be introducing a new single 9% corporation tax rate in 2017, the lowest level in the EU. The current rate of corporation tax is 10% for profits up to $1.74 million and 19% above that level. The new band will apply to all businesses. This development places Cyprus and Ireland – which offer 12.5% corporate rates – in joint second place.

US taxpayer fined $100 million and faces jail

A professor of business administration in an American university, Dan Horsky, has pleaded guilty to his role in a financial fraud involving a Swiss bank account containing more than $200 million. In 1995, Horsky started to invest in start-up businesses through financial accounts held in various offshore banks. One of these companies was sold for $1.8 billion and Horsky's share of the purchase price was around $200 million. Horsky is a citizen of the US, Israel and the UK but he was being tried as an American. In addition to a fine of $100 million, he faces a maximum penalty of five years in prison. The Swiss bank involved was Credit Suisse.

The Offshore Column

This month's 'Offshore Column' is mostly concerned with news and, in particular, the considerable success that the OECD and other national and international government bodies have had in increasing financial transparency. Before many more years have passed, most of the world's governments are going to be in a position to identify and punish those they consider to be engaged in tax evasion. For anyone who believes in high levels of taxation and zero-tax competition – this is good news. The wealthiest governments in the world are about to get wealthier (their coffers swelled with previously undeclared funds). Those found guilty of criminal tax evasion will be fined and may end up behind bars. The world's low-tax jurisdictions are about to be dealt a knockout blow.

I am not convinced, however, that everything will proceed as anticipated by the OECD and its allies.

To begin with, I strongly suspect that the number of people using offshore centres to evade tax will prove to be much, much lower than anticipated and that the actual tax take will be disappointing. Those using low-tax jurisdictions have had a decade or more to plan for the coming storm and will have either made alternative offshore arrangements or repatriated funds already. We know from all the previous investigations and amnesties that revenue authorities are wildly optimistic by nature! We also know that those involved in crime will not be deterred by the new clampdown on offshore havens. They will simply find another way to hide and transfer their money.

Moreover, there is still a host of perfectly legitimate methods by which individuals and businesses can use offshore structures to reduce and avoid tax. As described below,

the US is, ironically, offering virtually 100% confidentiality, providing you are not an American citizen, and there are no signs of a change of policy in this regard. My guess is that it would be easier to pass anti-firearms legislation in the US than to pass a law changing the current tax arrangements.

Finally, nothing is ever over, as we all know, until the fat lady sings. Governments change, policies change. To offer just one example of what could happen: there is a strong chance that Trump will repeal FATCA (see below) and that the whole tax transparency movement may be set back by decades.

For those who believe, as I do, that the high-tax jurisdictions are hypocritical bullies, that low tax is good for everyone, that tax competition is healthy and, finally, that most governments grossly mismanage their country's finances (and should not be given any more money because they will only misspend it), all is not lost.

Finally, it is rumoured that the prices of tangible assets such as diamonds and art are being pushed up as those with offshore structures seek to convert their money into something untraceable before all the automatic exchange-of-information rules come into force. Personally, I doubt this. But, if I had sizeable wealth offshore I must admit it would be a tempting solution.

Nathaniel Litmann

The offshore year ahead

This year is likely to be remembered as the year in which the Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS) became reality.

FATCA is going to force foreign banks to start handing over their clients' data to the US or face a 30% tax on funds held.

The CRS is well on the way to forcing more than a 100 countries to automatically exchange financial information about non-resident bank account holders.

It is, more or less, an end to financial confidentiality and the estimated $10 trillion held offshore is now going to become more visible – although most of it is, of course, owned by corporations rather than individuals.

In recent years, many countries have offered tax amnesties as a method of raising money and it is estimated that some €55 billion have been brought onshore by this means.

How much more money will be repatriated or moved to high-tax jurisdictions is anyone's guess.

What does appear to be happening is a switch from cash and equities to other types of assets such as insurance policies, precious metals (gold, platinum &c.), diamonds, art and property – all of which are easier to hide. Holding an asset that doesn't offer any income is not seen as a disadvantage, since interest rates, inflation and even stock market returns are much reduced at the moment. Moreover, the loss of income may be nothing as compared to the fines, interest and penalties imposed by governments determined to come down on tax avoidance and tax evasion.

Another development anticipated this year is an increase in the number of HNWIs becoming non-resident or taking up dual residence. A number of jurisdictions – including Canada, the Netherlands, France, Japan and the US – are starting to impose exit taxes to stop their citizens from departing. Others refuse to accept that their citizens have really left, as many British expats know to their cost. Countries that will accept a taxpayer as resident even if they spend little or no time in the jurisdiction may come under pressure to change their residency rules.

Another interesting issue this year is going to be non-compliance with FATCA and CRS by certain countries. Many banks and banking systems, especially those in Africa and other poorer countries, are simply not in a position to comply with the new international regulations.

Incidentally, for those who aren't American citizens, the US is still able to offer complete fiscal confidentiality. By the simple expedient of appointing a local trustee and a foreign protector (an individual to direct the trustees) trusts can avoid scrutiny under both American and international rules.

Interestingly, while FATCA gives the US government lots of information about its own citizens' overseas holdings, the information provided by the US to other countries is strictly limited.

Finally, there could be another potential game changer in 2017. Donald Trump may decide to repeal FATCA, the introduction of which was strongly opposed by the Republican Party.

HMRC has a cunning plan

As a result of the CRS, up to 100 different jurisdictions around the world are going to begin supplying the British government with information about UK residents who hold bank accounts and other financial assets abroad.

Since HMRC staff numbers have fallen by around 10% over the last five years (although it has to be said that the compliance and enforcement team has seen a growth of roughly 5%), this has the potential to put a great deal of strain on the remaining staff.

Only, HMRC has come up with a cunning plan.

It is widely anticipated that the taxman will simply write to every individual about whom he has received information and ask them to (a) confirm or deny that they hold assets offshore, (b) explain what those assets are and how they came by them and (c) sign a declaration that there is no tax owing.

HMRC won't waste its time attempting to analyse all the data it receives. It will simply force the taxpayers concerned to prove their innocence.

Once a taxpayer receives a letter from HMRC, one can be fairly certain that most will come clean and cough up. After all, the longer a miscreant taxpayer delays, the more it is likely to cost them. At the moment, the WDF, which runs until 30th September 2018, offers no special treatment, but using it does mean that the future, draconian, proposed penalties will be avoided. HMRC has threatened that from 2019 the minimum penalty will be 100% and the potential maximum penalty will be 300% of the unpaid taxes. Moreover, offenders will be named and shamed.

Incidentally, as of 30th September 2016, financial advisers, solicitors and tax agents have been required by law to write to all their clients and tell them about CRS, WDF and the RTC – the term used to describe putting your tax affairs in order. If a professional firm fails to issue the required letters by 31st August 2017, it will be charged a penalty of £3,000. For UK residents the window of opportunity in which to make a tax disclosure is now considerably smaller.

Money

Alternative Investment Opportunities

Tracker funds

Generally speaking, this column focuses on tangible alternative investments, such as precious metals or sports cars, but there are many financial alternatives of which trackers are one of the simplest, least risky and potentially most lucrative.

The idea of a tracker fund is that it 'tracks' a market. The market could be something well known and obvious – such as the FTSE-100 – or it could be something less well known – a particular commodity, for example coffee.

The best way to 'track' is to buy an exchange-traded fund, or ETF. These will show virtually the same return as your chosen market, and the management charges are miniscule – often as low as 0.16% or less than 2p per £100 invested. When you compare this to the management fees charged by all the different types of managed funds, which often have an upfront fee, an annual management fee and an exit fee (as well as a spread), ETFs are bargains.

I love investing in tangible assets probably because my maternal grandparents were refugees and had they not had gold coins and jewellery would have started their new lives in America without a penny to their name. My paternal grandparents also had tangible assets – including a farm, a library and a wine cellar – that stood them in good stead during WWII.

But I recognise that, if I had to pick a single asset class in which to invest, the best option would be to achieve the same average return as the stock market. This is because over the medium to long term the stock market has outperformed everything, from bonds to property and from collectable stamps to art.

The problem of how to track the stock market – or some part of it – is solved by buying an ETF. What one should never do is either actively manage one's money or pass it to someone else to actively manage.

Up until around the 1970s or maybe even the 1980s, it was possible for investors and investment managers to consistently match and beat the market. When I took out a pension plan in my 20s I remember the predicted returns were 11% and – worst-case scenario – 9%! It wasn't impossible to achieve, either, because the markets were still quite small and it was possible for investors and investment managers to obtain an advantage. Bear in mind that insider trading only became illegal in 1980.

Anyway, for the last few decades, active managers have consistently failed to produce higher returns than whatever market they were aiming to beat. Over the last 10 years, for example, 83% of managed funds failed to match their benchmark and 40% actually terminated within 10 years of launch because their performance was so bad.

Moreover, when one examines the long-term records of the few that do beat the market, usually there are extensive periods of loss (could be a decade) and periods of growth and then periods of loss again. So, to get the long-term gain from these winning managers one has to have the courage of one's convictions and sit through extensive loss-

making periods.

Having decided to invest in the stock market, the next question is, of course, which part of it to choose. You could do worse that the FTSE-100. Over the past 20 years, this has risen at a rate of around 5.4% per annum, excluding fees, dividends and inflation — dividends received are likely to cancel out fees and inflation anyway. During this period, the market has seen the dotcom bubble and the financial crisis: two events that have sent the FTSE-100 surging to a high of nearly 7,000 and crashing to a low of around 3,000. In comparison, over the same 20-year period, according to research conducted by a number of financial institutions, the average investor has only returned 2.5% per annum including dividends. This paltry return is, in a word, shocking. In fact, the average investor underperformed nearly every financial instrument bar one over the 20-year period studied. The only market that put in a worse performance than the average investor over this period was the Japanese stock market. Some of the instruments that performed better than the average investor over the past 20 years include: cash (3% p.a.), bonds (3–8% p.a.), hedge funds (8% p.a.), REITs, or real-estate investment trusts, (10% p.a.) and all emerging markets (6–10% p.a.).

So, an ETF that tracks the FTSE-100 certainly makes a lot of sense.

But maybe you want to diversify? As an ETF is nothing more than a basket of assets in a particular market or sector, you can use it to invest in pretty much anything. Its purpose is to reflect, as closely as possible, the behaviour of the index, asset class or sector that it represents.

So if you have an ETF that tracks the gold and the market goes up by, say, 8% in a year, then the ETF will go up by 8%. If the market falls by, say, 8%, then the ETF will fall by 8%.

A huge advantage of ETFs is that they are listed on major stock exchanges around the world. This allows you to buy and sell shares in an ETF in the same way that you would in an individual company. Also, the minimum investment is a single share, which could cost as little as a few pounds. Other benefits include:

- There is no stamp duty to pay.
- Many ETFs pay a regular dividend. This means they can be used by investors requiring an income.
- ETFs are highly liquid. That means you can sell them quickly whenever you want.

Name a sector or market and there is bound to be an ETF, or choice of ETFs, covering it. This ability to invest in an entire class of assets rather than having to select individual assets reduces risk and boosts returns. It also puts small, private investors on a level playing field with their wealthier counterparts because it allows them to develop and control a portfolio containing a broad mix of assets. Now, thanks to ETFs, it is feasible for someone with a few thousand pounds to invest in everything from Chinese shares to agricultural commodities and from the US dollar to international property. They are the ideal vehicle for all investors, large or small.

Finally, ETFs are the ideal way of creating a balanced portfolio. For example:

If you wanted to create a portfolio that provided you with a regular income and the opportunity for growth, you could divide your money 50/50 between an ETF that tracked the UK bond market (maybe government bonds to be safe) and the UK stock market.

If you want a little extra diversification, you could switch 10% of your total investments into an alternative ETF tracking, say, property or the Chinese stock market.

There simply isn't a simpler, easier, less expensive way to gain exposure to a whole asset class or index than through ETFs. You can buy ETFs via a stockbroker, independent financial adviser (IFA) or electronic trading platform. One of the largest managers of ETFs is iShares (http://uk.ishares.com).

(As an aside, every year thousands of investors in Berkshire Hathaway travel to Omaha, Nebraska to listen to Warren Buffett discuss the previous year's performance, his plans for the future and his personal investment philosophy. In 2014, Buffett explained that 90% of the money he was leaving to his wife would be invested, after his death, in an SNP-500 Index Tracker Fund. He pointed out that the vast majority of active managers never manage to outperform their benchmark once fees and other costs have been taken into account. If it is good enough for Warren Buffett, it is good enough for me!)

Contracts for difference

Sir Isaac Newton, widely recognised as one of the most influential scientists of all time, who laid the foundations of classical mechanics, lost a fortune by investing in the South Sea Company. "I can calculate the movement of stars," he is reputed to have said, "but not the madness of men."

Is it madness to buy contracts for difference (CfDs), aka spread betting? The answer is yes and no.

Let's begin with the downside. The Financial Conduct Authority (FCA) has raised significant conduct concerns regarding firms offering CfDs via online trading platforms. The FCA has calculated that eight out of ten people investing in CfDs end up making a loss. Moreover, the average loss was £2,200 per trade.

On the upside, spread betting is the perfect way to short shares, hedge risk in investment portfolios and – of interest to readers of *The Schmidt Tax Report* – to trade in a highly tax-efficient manner (your gains are tax-free because your losses are not tax deductible). Moreover, it is possible to make huge profits of 100, 200, 300% or more in a matter of days and it requires minimal capital investment.

So, how does it work? Spread betting was originally invented as a way of gambling on the outcome of sports events, but in the 1980s a number of financial service companies began to use it as a way of making money from market movements.

It allows you to bet on the rise or fall of an asset without actually owning it. You can get exposure to a market instantly with a relatively small sum of money when compared to, say, buying the actual asset. What's more, there is no commission to fork out, no stamp duty on dealing and no tax to pay on the winnings.

A spread betting firm will predict where an individual share or market will stand at a future date or period. They won't name a specific price but rather an upper and lower range. This range is referred to as 'the spread'. You can then bet on the spread in one of two ways: if you expect the share or market to be above the spread, you can buy at the high end; if you expect the share or market to be below the spread, you can opt for the low end.

This is best explained with an example.

Suppose a spread betting firm is quoting a spread of $40–$50 a barrel for crude oil during July 2017. If you feel this is a bit pessimistic, you may decide to bet at the high end, staking £100 for every dollar it goes above $50. Any time before the end of July, you can close your bet and take your gain or settle your losses. Let's say you are right and the index climbs $5 to $55 a barrel, at which point you close the bet. You will collect £500 (£100 for each $1 over $50). Let's say, on the other hand, you are wrong and the market falls $5 below the top end of the spread to $145 ($50 less $5). Your error of judgement is going to cost you £500.

Unlike fixed-odds betting, the amount won or lost can be unlimited as there is no single stake to limit any loss. However, it is usually possible to negotiate limits with the bookmaker. A 'stop loss' will automatically close the bet if the spread moves against the gambler by a specified amount. A 'stop win' will close the bet when the spread moves in a gambler's favour by a specified amount.

Spread betting has moved outside the ambit of sport and financial markets (i.e. those dealing solely with shares and futures) to cover a wide range of markets, such as house prices. In a falling stock market, financial spread betting can also be used by investors as a means of hedging against predicted losses in a portfolio of shares.

As the old investment adage goes, the only way to double your money safely is to fold it and put it in your pocket. You should never bet more money than you can afford to lose.

The Honda NSX

Just after Christmas, my next-door neighbour parked a Honda NSX – the letters stand for New Sports car eXperimental – in his driveway and subsequently persuaded me that not only would it be a lot of fun to own one… but it would also be a great investment.

I am old enough to remember the NSX when it came out. Honda was attempting to compete with cars such as Ferraris and Porsches. Indeed, when I bought a Porsche 911 in the early 1990s, I did, for a moment, consider the Honda. But there was no status to owning a Honda, whereas there was to owning a Porsche. What a young fool I was! The perceived inferiority is probably why only 18,000 NSXs sold worldwide over a 15-year production run, compared to over ten times as many 911s during the same period.

The Honda NSX, as I can now vouch, having just taken my neighbour's for a drive, is truly a supercar. Its looks are a little dated but its handling is superb and I risked taking his up to 135 miles an hour before fear of losing my licence brought me to my senses. Apparently, its top speed is 180 miles an hour in unrestricted form. Enthusiasts say that it has exactly the sort of reliability you would expect from a Honda.

Apparently, two years ago a good example was available for £25,000–£30,000 but that the booming modern classics market has caused values to move upwards. What should you look for? The earlier models had 3-litre engines with either a five-speed manual gearbox or a four-speed automatic gearbox. In 1997, the manual versions were given 3.2-litre engines and six gears, and in 2002 the body shape was changed slightly so that the original popup headlamps were replaced with fixed units.

The Financial Times recently quoted Graham Horgan, managing director of Plans Performance, which specialises in selling NSXs: "NSX have lagged behind those of comparable Ferraris and Porsches but they have started to rise – and I think they still have some way to go." He describes them as a dream to drive and said he sold a 1991 model in November last year for just £28,000 with 178,000 miles on the clock. Apparently, it was still in perfect running order. Most parts can be sourced off the shelf. At the top end, a really rare Honda NSX will go for between £140,000 and £170,000. However, at the bottom end there are still fantastic models around at about the same price of a comfortable family saloon.

If you are looking for a solid, classic car investment, the Honda NSX could be it.

Bank Interest Rate Compensation: Follow The Herd?

In Plato's *Republic*, Thrasymachus defines justice as "the interest of the stronger". If he's right, it is just if HMRC always wins its tax cases against the taxpayer: because HMRC, as a body representing the government, is incomparably stronger than the individual taxpayer.

But we suspect that most readers of these words side with Socrates on this question. HMRC isn't the law, and it doesn't always get the interpretation of the law right.

Anyone sticking their head above the parapet and questioning HMRC's divine right to tax everyone in whatever manner takes its fancy has to bear in mind that they are a David taking on a Goliath. And this is particularly the case where it seems that most people are just buckling under and accepting the Revenue's – actually highly questionable – views on a given point.

So the question is, if you're in this situation, should you follow the herd, or should you stick up for what you see as your rights?

To change the metaphor from the bovine to the ovine, anyone who has been for a walk in the country knows the tendency of sheep to follow in whatever direction the leader goes, and citizens of a virtually omnipotent bureaucracy, whose yoke we live under, share a lot of the characteristics of that flock of sheep. The situation we are specifically thinking about here is quite a topical one: the case of how you deal with large lump-sum compensation payments, by banks, for tax purposes.

Yet another mis-selling scandal

There have been so many of these over the years that it can be quite difficult to disentangle all the different sorts of compensation you could conceivably claim from your bank. One of these, which has given rise to some fairly chunky lump-sum compensation payments, is where you have been sold some kind of interest rate fixing product at the outset of a loan. It turns out that the poor old banks can't do anything right when selling such products to the public, and there's quite an industry of claiming these back, with a lot of reclaims having been received by business people in the last year or so. How should these payments be taxed?

The way they're calculated, in essence, is by looking at the interest you would have paid on your loan if you hadn't been 'mis-sold' this product with the amount of interest (higher) you actually did pay. It seems to us, who haven't received any such compensation, that this is looking a bit like a one-way bet, with the customer enjoying the reduction in interest paid if

things go the way they expected but being compensated for the extra interest if things go the other way. But that's not relevant to our question here.

Trading businesses and property businesses

There are two different situations where you may have taken out a large loan: one for the purposes of a trade (e.g. buying land or buildings for use in the trade) and loans simply to buy property which you then let to tenants in return for a rent. The tax treatment of these two different situations may conceivably be different, and we use the word 'may' because there isn't any decided case law as yet on the question at the core of this article.

The Revenue's own guidance, in its internal manuals (which are available on the Internet), is quite clear.

Particularly in the trading situation, HMRC is in no doubt that any such receipt is a receipt of the trade and should be charged to tax as such (to income tax if you are a partnership or sole trader/ and corporation tax if you are a limited company). The guidance makes this impossible to misunderstand. This is on the basis that you will have claimed tax relief for the payments of interest in the first place, and therefore when these are reimbursed you should pay tax on the amount received.

The same applies, as far as HMRC is concerned, for property businesses. There should be symmetry between the treatment of the interest you've paid and the amount you get back from the bank.

Anecdotally, most accountants seem either to agree with HMRC or to be adopting a 'follow the herd' approach and tell their clients they should disclose the compensation payments as income and pay tax on them. But those few of us that actually read the legislation, and consider the legal precedent, can't quite see where this opinion comes from.

Tax 'fairness'

True, it seems to make intuitive sense and seems to be 'fair' that you should effectively have your tax relief withdrawn where you get expenses paid back to you. But since when was the tax law either intuitive or 'fair'? Where there's any unfairness against the taxpayer, the Revenue, judges and everyone else seem simply to shrug their shoulders and say, "Sorry it's not fair, but that's what the law says."

So let's look at what the law actually says with regard to these compensation payments.

To start with, we have a fundamental distinction, which is at the heart of a huge amount of case law (and some of the terms in the legislation itself), between receipts of money that are 'income' on the one hand or 'capital' on the other. Characteristics of income receipts are that they are normally recurring in nature, of a comparatively small amount and derived from exploiting some capital asset or carrying on some kind of activity which earns the money received.

By contrast, capital receipts tend to be large, one-off and representative of a substantial asset that the recipient owns.
For us, this is the main argument against the compensation payments paid by the bank being taxable as part of an individual's or company's income. Capital receipts are simply not within the scope of taxation of income by definition.

Symmetry

But what about the symmetry argument? Isn't it obvious that, if we've claimed tax relief against our income (trading profits or rents) for the interest we originally paid, we should be taxing amounts received, representing an effective repayment of this interest?

This would be a knockout argument in favour of HMRC if it were not for the fact that symmetry does not seem to be any kind of rule that applies for tax purposes.

Consider, for example, the case of a person who buys an office building from a developer. For the purchaser, there's no tax relief against his income for the purchase of the basic fabric of the building. But for the developer, the amount paid is income chargeable to income tax on him. So where is the symmetry here?

Even more pertinent to our argument here is the situation which applies with regard to insurance premiums. Let's say you pay regular insurance premiums against damage or destruction to your building. These premiums will be allowable against your income from the building (whether it's trading income from occupying the building or rental income from letting it). If the building is destroyed by fire, say, though, you will receive a payout from the insurance company that is capital. So there is no symmetry here either. Of course, this is a situation which is distinguishable from the interest rate compensation payments, because the amount you receive may be far more (or less) than the premiums you've historically paid to that insurance company. However, we're not looking for an exact parallel here, but merely for an illustration of the fact that there is no overriding principle of 'symmetry' in tax law that would lead us to ignore the fundamental distinction between income and capital receipts.

Rental businesses

There is another argument as well, on top of the capital/income argument (an argument which has formed the basis of countless decided cases in the courts); and this argument is possibly stronger in the case of a rental business than a trading business. It goes like this.

The profits of a rental or property business which are chargeable to tax as income are described quite specifically in tax law. These basically bring within the scope of income taxation receipts from the exploitation (in various kinds) of land and buildings. It seems to us absolutely clear that the receipt of compensation from the bank is not an example of money received for the exploitation of land and buildings.

In the case of trades, this argument is not quite so strong, because one could argue that the compensation payment arises, in some way, from carrying on the trade. All the same, it is an argument for the trading situation as well.

What do I do?

If you're in the position of having received such a compensation payment, or feel that you are going to get one, where does all of the above argument take us? Clearly, you've always got the option of trotting along behind the lead sheep and offering tax on the compensation payment when you do your self assessment tax return.

Alternatively, if you are that one sheep that always perversely runs the other way, consider what your strict legal position is. What the self assessment return requires you to assess tax on is amounts that you consider, as the taxpayer, chargeable to tax. If you have been convinced by this argument or, better still, have received an opinion from an adviser specifically related to your situation to the effect that an amount you have received is not taxable then your only logical course of action is to omit the receipt from the return.

'White space' disclosure

Now we come on to a trickier aspect of the problem. Let's suppose you have received professional advice, on which it's reasonable for you to rely, to the effect that the amount isn't taxable. Should you nevertheless put details of it on the 'other information' box of your return?

If you're afraid of HMRC, you probably will do. This is because you don't want it to think that you are trying to hide anything. But looked at objectively, what are the upsides and the downsides of alerting the Revenue to the existence of this issue? The upside is that you cannot be accused of trying to evade tax, which is a criminal offence. You have not tried to conceal anything or deceive HMRC, and this is the main distinction between legal and illegal tax saving: between avoidance and evasion, if you like to put it like that.

On the other hand, following proper professional advice in the way you complete your return can hardly be regarded as anything even approaching criminal activity and this is, logically speaking, therefore not an 'upside' at all.

You might think that putting details of the receipt in the white space would protect you against penalties, but we're not at all convinced of this. For a start, you shouldn't receive any penalties if you are following proper professional advice. After all, this is a difficult question, as the above argument and its disagreement with HMRC's published guidance shows, and what else can you do except follow professional advice if you're not a tax expert yourself? There's nothing culpable in doing so.

Another reason, though, why the prospect of penalties isn't really a reason for making a white space disclosure is that, if HMRC were inclined to try to penalise you even though you'd acted in accordance with professional advice, it is probably just as likely to do this even if you've put in a white space disclosure. The Revenue's main argument would be that you didn't self assess the tax on the amount when you should have.

Another 'upside' which is much less strong than it may appear at first sight is the protection from 'discovery'. Where HMRC decides that an amount that should have been charged to tax has not been, it has a certain period (normally four years) to raise an assessment. And it can do this even if your tax return for the year was not inquired into within the available one-year window. If, by contrast, it had all the information necessary to raise the assessment earlier, it can't raise a discovery assessment now. However, the scope of the word 'discovery' has been so widened beyond its natural meaning, by judges and others, that we don't put a lot of reliance on a white space disclosure preventing 'discovery'.

The downside of making the disclosure is obvious: someone from HMRC may spot it and inquire into the return, and ultimately raise assessments (as they have to) in accordance with their own guidance.

Stable doors and horses

Are you in the position of shutting the stable door after the horse has bolted if, before you realised there was any question about whether the Revenue were right or not, you actually have self assessed tax on such a receipt? Is there any scope for changing your mind now?

There is, if the year in question is less than four years ago, and within the scope of a repayment relief claim. Clearly such a claim will involve you in meeting stiff HMRC resistance, because it's one thing, from the Revenue's point of view, not receiving tax on an amount that wasn't self assessed and quite another writing out a cheque to you on the basis of an interpretation of the rules that they don't share. Not a chance, without some kind of litigation.

And this brings us on, finally, to the bigger picture with regard to HMRC versus the taxpayer on this point. We understand, from hearsay, that the Revenue's approach is being challenged formally by one taxpayer, or possibly a group of them. Therefore, if you do decide not to follow the main herd, at least you're not a sole lost sheep, but there are others who are adopting the same approach as you with whom it may be possible to get in touch to pool information, advice and resources.

Property

Property Notes

Take six homeowners

In early January this year, we ran a small advertisement using Google AdWords. Our ad read:

Is your home also an investment? Tell us your story.

We received around 50 responses, and below we have selected six typical stories. These highlight, perfectly, how home ownership can be used as a wealth-building asset.

1. Last year my wife and I decided that we needed to invest in an asset that would increase our retirement income when the time came. We are both currently in our early 50s and plan to work for another 15 to 20 years. We decided that we would purchase three shops in various Midlands towns. We spent £1.4 million. The gross yield on the three properties is 8% or some £112,000 a year. We funded the purchase with a combination of cash (£400,000) and a mortgage (£1,000,000) or, rather, to be more accurate we borrowed a million pounds secured against our home. Our £400,000 savings had been generating a pathetically small return of around £12,000 a year. So in income terms we are up, more or less, £40,000 after paying the loan costs. Without the equity in our main home we would not have been able to do this deal. While the loan and tax will eat up a large part of our profit in the short term, we are still considerably better off than we would otherwise have been. Plus, we feel that when we come to retire we should have a good, secure income, which we did not previously feel.

2. We managed to obtain planning permission to add a fire escape to the side of our semi-detached house. By adding an internal door in our upstairs hallway – which we keep locked – we have, therefore, been able to create two bedrooms, a small kitchen and bathroom for lodgers. The going rent in our area of North London for a single room in a flat share is a staggering £1,000 a month. My wife's personal allowance (£11,000) and the rent a room relief (£7,500) means that if we do decide to declare this income the tax bill will only be around £1,000 to £1,500 a year. Moreover, as we are, essentially, only taking in lodgers we know that it will have no effect on our ability to sell our home without having to pay any capital gains tax [CGT] in the future. We may not declare the income at all on the basis that it isn't worth the bother.

3. We have decided to turn our home into an HMO [house in multiple occupation] and then to sell it and buy another. We are in the process of converting it from a six-bedroom house into a nine-bedroom house with all the required facilities. However, as we are still living here during the conversion work – and as it is our principal private residence [PPR] – we will be able to sell it without having to pay any CGT. We estimate that after deducting the cost of the conversion work we will make an extra £200,000 over and above what the house would be worth if we sold it simply as a private dwelling. It won't, of course, have a council HMO licence, but in every other respect it will be ready for an investor to take over. We have been living here for four years and we now plan to do the same again so as to build up our net worth.

4. One of the reasons why we bought our current home in Brixton, London was the fact that there was a private lane to the back of the property. This lane is owned by ten different properties. After a long and sometimes fraught negotiation all ten owners have agreed that those of us who wish to, can now sell the ends of our gardens as building sites. We should make between £200,000 and £250,000, tax free, for the plot we are selling.

5. When my father died I inherited £300,000. I did consider purchasing a buy-to-let property but the hassle of looking after it plus the thought that I would be taxed on any income and its eventual sale put me off. In the end I sold my own house and invested all my capital into a property with a granny flat. I have decorated this and I now rent it on short-term lets – sometimes via online websites such as Airbnb – but more often to employees of one of a number of major local businesses. I am earning around £1,500 a month and it is the best financial decision I ever made.

6. You may be interested to hear that I have built a small amphitheatre on my land and I am now using it to hold music and theatre events. Our most successful event, a two-day folk music and poetry festival, brought in a gross income of £40,000 with around £20,000 worth of expenses. Not bad for two days' work. The amphitheatre cost me around £20,000 to build and I am in the process of adding a permanent lavatory and shower block to save on facility rental costs. Going forwards I am also planning to add glamping to my list of offerings. The hardest part of what we did was applying for the temporary event notice (TEN) which allows us to sell alcohol, provide entertainment and sell late night food and drink. The paperwork is long and tedious to complete. It has to be submitted to not only the licensing authorities but also the police and local environmental health office. We had to show that we were providing ample security and also that there would be no traffic issues. Each TEN, incidentally, allows for up to 500 people on the premises at any one time. After the application for each TEN, arranging adequate insurance has been the other main nuisance. For each event the ratio of credit card to cash sales has varied.

Gardeners' question time

In a property market where it is increasingly difficult to find relatively secure capital gains, one option is definitely to purchase residential properties with large gardens that can be sold off separately as building sites. Providing the site is part of your main residence any gain is completely tax-free. You must remember, if you decide to build wealth by this means, that:

- You must sell the development plot before selling your home (assuming you plan to sell your home).
- The area to be sold must at no time be separated or fenced off from the rest of your garden. It must be integral to the whole space.
- You should not use the land for anything other than normal domestic purposes such as gardening or maintaining a car garage.
- You must allow the area you plan to sell to fall into disuse.

It must also be pointed out that if the total area of your house and garden exceeds half an acre then you will not be eligible for PPR.

Incidentally, you may be tempted to develop the property at the end of the garden and sell your house. You will still be able to claim your PPR exemption, providing you move into the new property within a year of starting the building work. You should always take specialist tax advice if you are planning to either sell off part of your property or develop it.

Airbnb warning

Propcision, the property data company, has found that rental income for Airbnb properties in central London is, on average, twice as high as the rent paid for long-term tenancies in the same areas. However, this is before costs. Still it explains why so many buy-to-let landlords are switching to short-term lettings. Indeed, according to Colliers, the estate agency, over 50% of Airbnb listings in London (some 42,600 homes) are now offered by hosts with more than one property, strongly suggesting that the owners are property investors.

Now there is a fly in the ointment. Under a new '90-day rule', properties may only be let on a short-term basis for 90 days a year or less. One result of this is that many landlords are now switching from very short lets (days or weeks) to a minimum of 91 days. By doing so they hope to fall outside the definition of a short let. This, if they are lucky, means they should be able to earn more from their properties than if they were forced to take on ordinary buy-to-let tenants. Other cities are watching to see what happens with the new 90-day rule in London before deciding whether to impose similar restrictions. This could be the end of Airbnb as we know it.

Property Tax Tips

Taking advantage of trusts

For many years now, it has been extremely difficult to find any way in which to utilise a trust so that it shields a British taxpayer from what he or she would otherwise pay. However, there is one interesting little wrinkle in relation to property.

What happens if a private residence is held by a trust? The normal PPR exemption stands. In other words, when a property is held by a trust, providing the property is the only or main residence of one or more of the trust's beneficiaries, there is no CGT to pay on its sale.

Having said this, the PPR exemption comes at a price. It isn't available on a property held by a trust if a holdover relief claim was made on the transfer of that property into the trust. So when you transfer a property into a trust you have to make a decision. Either you can pay some CGT immediately (in other words not make a holdover relief claim) or else you can make the holdover relief claim with the result that you will pay, probably, much more CGT when the property is eventually sold.

Interestingly, trusts also have their own annual exemption that is usually half the amount of an individual's annual exemption. Generally speaking, they will pay CGT at higher rates of 20 and 28%.

However, there is a way in which a trust can be used to obtain extra PPR relief. It doesn't work, sadly, where a capital gain on a property has been held over on a transfer into the trust. But it is available if you follow these four steps:

1. Establish the trust together with one or more other people as the beneficiary (however, this cannot be your spouse).
2. Purchase a residential property through the trust.
3. Have the beneficiary adopt the property as their main residence.
4. Retain the reversionary interest in the trust.

Because you have a reversionary interest in the trust it means that the trust's assets will

ultimately revert to you. When it is decided to sell the property (or simply to transfer it to you) any gain arising will be exempt from CGT and you can either retain the property or enjoy the tax-free sale proceeds.

This is, of course, a relatively simplified version of how to use trusts in this way. If you want further advice we strongly recommend contacting our editor, Alan Pink. Bear in mind that there may be inheritance tax implications to the above tax-saving system.

How EISs can help you defer CGT

If you want to earn a capital gain but wish to defer its taxation then one method is to do so using Enterprise Investment Scheme (EIS) shares. As you may be aware, you can't use the EIS in order to purchase, establish or operate any kind of property business. Thus, everything from hotels and guesthouses to lock-up garages and buy-to-let businesses are completely out. However, what you can do is find a simple, low-risk trading business such as a newsagent or sweet shop. Such a business requires business premises. You set up a company to run the shop and this company issues EIS shares to you in exchange for the cash proceeds of a property sale. The company then uses this cash to buy its retail premises. By following these simple steps you are rolling over any capital gain into the purchase of the business premises via the medium of the low-risk trading business.

How to earn buy-to-let income tax-free

Are you paying tax on buy-to-let income? Do you have any close relatives or friends who aren't using their personal allowances? By passing a nominal percentage of each property to someone who isn't paying tax (or who pays tax at a lower rate than you do) it is possible to shift the income without losing control of the property itself. This is probably best explained by an example. Imagine that you and your spouse own a single buy-to-let property worth £400,000 and that you have two children at university. The first thing to do is for you and your spouse to each give 1% of the property to one of your children. Assuming that neither of the children has made any capital gains during the year of the transfer they will be able to use up their annual exemption, which will mean no CGT will fall due. The position will now be: spouse 1: 49%, spouse 2: 49%, child 1: 1%, child 2: 1%. There will be no stamp duty land tax (SDLT) on the transaction, because it is a gift for no consideration.

As the second stage is to draw up two written agreements (the first between one parent and one child, and the second between the other parent and the other child) in which the spouses pass their taxable income to their other partners (i.e. one of the children). Now the first £22,000 income from the buy-to-let property goes to the two children without any tax liability whatsoever as they are able to use their personal allowances.

Highly Commercial

As a long-standing reader of *The Schmidt Tax Report* I have been particularly interested in the way the editorial policy has moved away from buy-to-let to other options such as furnished holiday lettings, agricultural land and HMOs. For my own part, I cashed in all my buy-to-let properties in 2015 and 2016 and have been reinvesting in retail. In particular, I have been purchasing small to medium-sized shops in busy locations with solid, national (or multinational) tenants. I've avoided any property that is being rented by a business which I feel may be affected by the consumer move from bricks-and-mortar to online shops. For example, I have been cautious about investing where the shop is tenanted by, for example, an electrical shop or a clothing shop. Instead, I've opted for businesses that can never be digital such as hairdressers, corner grocery shops, opticians and pharmacists. In general I've purchased in areas where I feel the local population is likely to increase. So, although higher yields are often available in less privileged areas I've preferred lower-risk locations. For instance, I have bought in Hertfordshire (Hitchin), Brighton, Reading, Birmingham, Bath and Bristol. When I first started buying, I was managing to obtain a yield of around 8–9%. However, as more investors have moved into this sector and as property prices in these areas have begun to rise, my yields have begun to dip. I now estimate that I am getting an average overall gross yield of 6.8%. This is hardly earth shattering but if I achieve some capital gain over time it should, of course, rise. Moreover, there are considerable advantages to being a commercial landlord versus a residential landlord. I would summarise these as being:

- Not having to find new residential tenants every six to 12 months. All my leases tend to be for a minimum of 10 years.
- All my leases are full repairing and insuring, unlike a residential tenant, who is likely to ring up all the time with repairs and other complaints. Commercial tenants have to cover the cost of any repairs and, of course, they have to insure the building, too.
- My commercial tenants pay me quarterly in advance instead of monthly, which improves cash flow and alerts me to any problems early on. If a business can't meet its quarterly rent on time I assume it has a problem and I get right after it.
- I have found that there is much less day-to-day management work required with a portfolio of commercial properties when compared to a similar portfolio of residential properties.

There are many other advantages to commercial versus residential investment. I can, of course, claim all my loan interest, which substantially improves my tax position. Moreover, there is much less regulation when dealing with commercial tenants as opposed to private renters. From a tax perspective I pay a much lower level of SDLT – less than half what I would pay on equivalent buy-to-let properties.

Incidentally, you may have wondered whether it is possible to borrow for the sort of property portfolio I am talking about. It is certainly true that a few years ago it was difficult to get a very high loan to value. Nowadays, I find that I can borrow about 60–70% of my portfolio value with no problem whatsoever.

Everyone has their own criteria when looking for retail commercial premises. For my own part I avoid secondary retail locations because, although they offer greater bargains and higher yields, I worry all the time that a secondary location is more likely to have a higher vacancy rate. I generally opt for units of between 500 and 2,000 square feet. Often I choose retail units that need a small amount of refurbishment as this generally makes it much easier to attract a tenant.

John Lowe

Property Opportunities

Irish house prices set to rise

The leading Irish stockbroker, Davy's, has predicted that Irish house prices will rise by 8% during 2017 thanks to the government's Help-to-Buy scheme and more generous mortgage lending rules. It anticipates that mortgage lending could triple to €15 billion by 2020. Another reason to anticipate a growth in demand is the fact that there has been a resumption of net inward migration. Davy's anticipates that the Irish GDP will expand by approximately 3.7% this year, a slight revision of its previous forecast of 4%, owing to Brexit.

Higher prices in Middle Earth

New Zealand, the chosen location of the three *Lord of the Rings* films, is experiencing an extraordinary price explosion. Knight Frank's global ranking of property price growth places New Zealand at the top of the list with an average annual growth rate of 11% in 2016. Indeed, prices across the country have risen by around half over the last five years. In Auckland, growth has been even higher: 80% since 2012.

Why? The primary reason is immigration. Last year, some 70,000 new immigrants arrived, of whom some 60% settled in Auckland. The majority of these immigrants come from the UK (5,000), but there are growing numbers from China, India and Australia. However, since sterling has fallen very dramatically against the New Zealand dollar, it is anticipated that the number of British buyers may drop.

Of course, many buyers are picking up one or two properties in New Zealand as an insurance policy against political, environmental and economic turbulence elsewhere. The country may be geographically isolated, but for those looking for a safe haven this is one of its advantages. Moreover, its bubbling hot springs, glaciers, fjords, wonderful sandy beaches and rain forests all in pristine condition and unspoiled by development add to the country's attraction.

If you are looking for a safe, medium- to long-term investment, the experts say that New Zealand is still a very good bet.

Small is beautiful: Minorca

It is between eight and nine times larger than Brighton with less than half of Brighton's population. It is located to the east of Spain, about an hour's flight from Barcelona. Unlike Ibiza and Majorca, it is a quiet, peaceful island that has never attracted wealthy holidaymakers or retirees, let alone the jet set. Its infrastructure is in need of improvement but, interestingly, thanks to its popularity with a select group of the international IT crowd, parts of the island have excellent Internet speeds.

Property prices have been relatively low ever since the banking crisis in 2008. Last year, for the first time, prices began to rise, especially for rural properties or newer apartments with sea views. Sotheby's is offering a 20-bedroom house in need of renovation in Mahon for €50,000 and Engle and Volkers has a large, rural estate with sea views for $3.5 million within commuting distance of the city. The average price of a Minorcan property in 2016 was under €300,000.

From a property investor's perspective, what makes this tiny, relaxed Balearic island interesting is the fact that for the last four years there has been an annual 20-day IT event held on the island, called Minorca Millennials. It brings in venture capitalists, IT experts and young entrepreneurs looking for investment and networking opportunities in the IT sector. Many of the visitors seem to be falling in love with the island while they are there, which, together with the relatively low prices, is one of the reasons many people expect prices to start rising.

Eastern promise

The *Financial Times* recently quoted the chairman of Knight Frank in India as saying that he believed property prices represented a major bargain at this particular moment. There are a various reasons for this. To begin with in the past two to three years investment buyers have deserted the market and too much has been built. Then there is the fact that the Indian government recently banned 500- and 1,000-rupee notes, which resulted in as much as $206 billion leaving the economy. Indeed, the government move seems to have invalidated around 86% of all cash in a single stroke. As many properties, even at the top end of the market, are sold for up to a third cash (the artificially low price is set in order to avoid tax) this has also had a major effect on prices. Finally, India is going through a period of inflation. One expert says the volume of sales in India has dropped by 40 to 60%. Whether this is true or not, Indian sellers are very open to deals at the moment. Now maybe is the time to look for a little Eastern promise.

It is worth noting that even in the better neighbourhoods of Mumbai, the most expensive part of the city, property costs around £740 per square foot compared to £2,500 for London. Moreover, the average cost of living and working in Mumbai is $29,000, about 25% of the cost of living in New York.

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