

Thousands of buy-to-let families face tax shock



HMRC has confirmed it is not planning a tax crackdown however it is planning to take a concerted approach to helping landlords of all descriptions (not just in the buy to let market) to understand and comply with their tax obligations in what can be a complex area. In taking this approach the explicit presumption will be that the majority of landlords want to make a correct return but that many may need some help to understand exactly how to do so. The approach

will focus on giving landlords improved access to guidance and support so that they can understand how to calculate their own tax liabilities and, where there is tax to pay, using the lightest possible touch to ensure that the correct amount is paid.

Landlords can already obtain more detailed guidance to help them understand their own tax position from HMRC direct.

The New Rules of Pension Administration

All pension schemes must have at least one scheme administrator who has certain legal responsibilities

People who have set up their own pension scheme are being urged by HMRC to check who their pension scheme administrator is, and to make sure they are aware of their responsibilities. For those who have set up their own scheme rather than joining an existing scheme using an insurance company, bank or other provider, it is possible that the provider will not be the legal scheme administrator - it could be the individual themselves.

All pension schemes must have at least one scheme administrator who has certain legal responsibilities, for example:

- registering the pension scheme with HMRC;
- operating tax relief on contributions under the relief at source system;

- reporting events relating to the scheme and the Scheme Administrator to HMRC;
- making returns of information to HMRC;
- providing information to scheme members, and others, regarding the lifetime allowance, benefits and transfers;
- paying certain tax charges.

A Scheme Administrator can appoint a Practitioner to act on their behalf in relation to some of their duties.

Under the new simplified pensions tax regime there are three new reports and returns that the must be submitted to the HMRC by the Scheme Administrator of a registered pension scheme: the quarterly Accounting for Tax Return; the annual Event Report; and the annual Pension Schemes Return.

It is expected that less than 20% of all pension schemes will need to submit any of the above reports or returns in any tax year, and for most insured pension schemes they will never be required to submit a report or return to HMRC, except when the scheme winds up.

Reports and returns can be filed online either using HMRC's free software or third party software via HMRC's Pension Schemes Online service. (Visit <http://www.hmrc.gov.uk> and click on 'Pension Schemes' under the 'Do it Online' menu.)

Finally, if that doesn't provide the answers, contact HMRC's Pensions Helpline on 0115 974 1600.

Inside this issue:

Trusts Explained	2
What is the Efficient Market Hypothesis?	3
Trusts Explained (continued)	4
Kassius bio	4

Trusts Explained

Trusts have been around since medieval times, and are a way of giving assets away to others without giving them full control.

Putting assets into trust is a way to possibly exclude those assets in calculating the settlor's inheritance tax (IHT) liability on death. They are also helpful in protecting assets for both future generations and vulnerable beneficiaries. Life Assurance policies, pension policy proceeds on death and many other assets can be put in trust.

Setting up a trust involves various different people: the settlor, the trustees and the beneficiaries. The settlor is the person who gifts money or assets to the trust. In many trusts, they have the power to appoint and remove trustees, and in some trusts, the settlor may have the power to add additional beneficiaries to the trust, dependant on the trust. If the settlor doesn't set out in the trust what has to happen, he or she may indicate in a 'letter of wishes' what he or she would like the trustees to do with the trust funds.

The trustees are the people who will look after the trust assets, and will be the legal owners of the assets and will be responsible for carrying out the instructions in the trust. There will usually be at least two trustees (the settlor and an additional trustee) but there could be more. The settlor will normally be a trustee, but the other trustee should be chosen with care. In particular, where the asset in trust is a life assurance protection policy on the life of the settlor, the only time that trust assets will be worth a substantial amount of money is when the settlor has died and then the other trustees will be in sole control. In Scotland, trustees have to act by majority decision, and in the rest of the UK trustee decisions must be unanimous.

Many trustees holding life assurance policies will have to make the major decision of what do with the trust funds when the policy pays out possibly when the life assured dies. The trustees should consider all options available, including the possibility of making loans to beneficiaries

if the trust allows them to do so.

The beneficiaries are the people who may benefit from the assets put into the trust. If they are entitled to anything, what they are entitled to will depend on the wording of the trust.

There different types of trust that can be set up:

- An Absolute or Bare Trust is where there is a fixed list of named beneficiaries an absolute right to everything in the trust with no strings attached. This a a very inflexible type of trust and it is important to realise that this list of beneficiaries cannot be changed. Once beneficiaries of this type of trust reach the age of majority (16 in Scotland and 18 in the rest of the UK), they can demand that their share of the trust assets be passed over.
- A Flexible Interest in Possession Trust is where a list of beneficiaries have a right to any income arising in the trust but no right to any capital. Those beneficiaries entitled to income can be changed and the trustees can pay capital out to any of the beneficiaries at their discretion.
- A Discretionary Trust is where a range of beneficiaries have no right to either income or capital but the trustees can choose to pay either out at their discretion.

There are many other types of trust available, ranging from ones which give the trustees no flexibility as to who benefits and when, to ones which give the trustees full control. Possible beneficiaries of a trust can include the settlor's

spouse/partner which, with good advice, can have far-reaching IHT benefits.

The maximum period a trust can last is 80 years, but some trusts may have a shorter period written into the document. While this period lasts, the trustees may have a degree of flexibility including (in a Flexible or Discretionary Trust) the power to pay all the trust assets out to beneficiaries and bring the trust to an end. However, if there are still assets left in the trust at the end of the period, the trust will become an Absolute or Bare Trust.

The trustees have a duty to act in the best interests of the beneficiaries of the trust. Where the trust assets are investments rather than insurance or pension policies, this will include:

- obtaining advice on where the trust assets should be invested,
- ensuring that the trust assets are suitably diversified, and
- reviewing the trust investments on a regular basis.

With regards to income, the trustees will also need to ensure that the trust investments are suitable. For example, where an income should be paid out to beneficiaries, the trust assets should produce an income to payout.

As a general rule, where the asset in the trust is a pure protection life assurance policy, the trustees won't have to do anything until the policy pays out.

Continued on page 4



What is the Efficient Market Hypothesis?

Created in the 1970s by Eugene Fama, who first presented the, efficient market hypothesis in terms of the so-called fair game model.

For a market to be considered efficient, it needs to rapidly reflect all the information made available to its participants at any given time. The underlying implication of this is that all stocks are perfectly priced according to their inherent investment properties and no one can consistently out perform the stock market.

Three basic premises underpin the efficient market hypothesis:

1. There need to be large numbers of rational participants who each have the objective of profit maximisation.
2. Information is freely available to all market participants.
3. Prices adjust rapidly to new information, which arrives randomly and independent of previous information.

There are three forms of the efficient market hypothesis, each of which aims at reflecting different degrees of efficiency:

1. Strong-form efficient market hypothesis. This is the strongest version and states that all information in a market, whether public or private, is accounted for in a stock price. Not even insider information could give an investor an advantage in this form.
2. Semi-strong-form efficient market hypothesis. This implies that all public information is reflected in a

stock's current share price. Neither fundamental nor technical analysis can be used to achieve superior gains.

3. Weak-form efficient market hypothesis. This claims that all past prices of a stock are reflected in the current stock price. Therefore, technical analysis cannot be used to predict or beat the market.

These anomalies then provide an arbitrage opportunity for an investor to take advantage of

The vast majority of academics believe in at least the weak-form efficient market hypothesis and virtually all studies testing it have found that prices do not move in trends. However, there are still a number of academics who dispute the very basis of the efficient market hypothesis and there are also examples of investors, albeit few in number, who have consistently beaten the market, which would lend weight to the belief that markets are not always efficient.

Warren Buffett, for example, has developed an investment strategy focused on finding undervalued stocks and has made millions for himself and others from following this strategy. Buffett is a proponent of value investing, where investors look for securities with prices that are unjustifiably low.

Many value investors do not support the efficient market hypothesis but they do believe that the market will ultimately start to favour stocks that were previously undervalued. There are also a few fund managers that have better track records than others. For example, take Fidelity's Anthony Bolton. He is a 5 star rated fund manager by Morningstar.

Fidelity's Special Situations fund focuses on capital growth through investing in shares that were out of favour, unrecognised or undervalued and Bolton's success ultimately reflects this opportunistic approach to investment together with his clear view of value.

It is noticeable that both these examples are in markets where it could be argued that information is less readily available and consequently not reflected rapidly in stock prices. These anomalies then provide an arbitrage opportunity for an investor to take advantage of, suggesting that perhaps not all markets are as efficient as the efficient market hypothesis would have us believe.

Academics and investment managers have debated whether or not markets are efficient for many years and there are many experts who question this hypothesis. However, followers of the efficient market hypothesis do not claim that markets are always perfectly rational or that the information reflected in prices is always correct. They accept the fact that the consensus view of investors can temporarily result in

prices being well above or well below stocks' intrinsic value but believe that they will eventually resort back to their mean value. As such, because these deviations are in themselves random, they conclude that investment strategies that result in beating the market cannot be a consistent phenomenon.

Furthermore, they argue that an investor who outperforms the market does so by luck rather than skill and this is simply due to the laws of probability. In recent years, however, even Eugene Fama, the creator of the efficient market hypothesis, has cast doubt on the hypothesis.

In a series of papers, he says two factors could explain differences in stock returns - market capitalisation and value. In the real world, markets are probably not absolutely efficient or wholly inefficient but a mixture of both, wherein daily decisions and events are not always reflected immediately in a market.



kassius ltd

Independent Financial Planners

Clarity, focus, value

Finchley House
707 High Road
North Finchley
London

T: 020 8445 0246

F: 020 8445 0189

E: advice@kassius.co.uk



*Kassius Financial Planners was incorporated in 2002 by Chirag Shah and Andrew McGovren, who between them have over 40 years experience in the Financial Services industry. We are **totally independent, dealing with every provider in the market.** In 2003 Chirag Shah achieved Certified Financial Planner status, the highest and most respected qualification within the UK market, with only 600 practitioners in the country.*

*Our aim is to bring a common sense approach to financial planning, offering **clarity, focus and value**, whether it be advice on residential mortgages, protection and pensions or more complicated investment, inheritance tax and commercial loan issues.*

Please note: This bulletin is intended to be used as information only. Whilst we take every care to ensure that the content is accurate, we accept no liability in respect of any errors, inaccuracies and losses which may arise from its use.

Trusts Explained (cont.)

When it comes to paying out the trust capital to beneficiaries, the trustees must act in accordance with the trust instructions if it is a trust that gives them no flexibility. If, however, the trust allows them to choose when and to whom capital is paid, they should take into account the settlor's wishes (the settlor may have indicated them in a letter of wishes), however they are not bound to do so. It could be considered whether a loan to beneficiaries may be more appropriate than actually paying out capital. It is important to remember that capital may not have to be paid out immediately. The trustees may decide to delay payout if they have the power to do so.

A yearly tax return must be completed by trustees as they have to pay income tax on

any income or capital gains arising in the trust. If trust assets are invested in a Unit Trust/OEIC, directly in stocks and shares, or just placed in a deposit account, this yearly tax return will be necessary. This is why many trustees choose to invest money in a Single Premium Bond investment. This doesn't produce an income and, indeed, even allows limited withdrawals without the need to report anything to the Inland Revenue (HMRC).

The rules as regards IHT changed in March 2006, although some things remain constant. Setting up a trust means you have made a gift for IHT purposes. Some of that gift may be exempt as you can, for example, make exempt gifts totaling £3,000 in every tax year and, in addition, make regular exempt

gifts of your excess income. It is important to keep good records of these and surplus income may have to be proved. Any gifts over and above these exempt amounts will be either:

- Potentially Exempt Transfers (PETs) No IHT is payable when these gifts are made but they will be included in the calculation for IHT if the donor dies within seven years of the gift. After that, they fall out of account; or

- Chargeable gifts Lifetime IHT may be payable when the gift is made, but only if the total of chargeable gifts made in the last seven years amounts to more than the current nil rate band - £300,000 in 2007/08. In addition, if you die within seven years of the gift, more tax may be payable at IHT death rates. Gifts to

Discretionary Trusts are chargeable gifts. If a lifetime charge arises, it is primarily due to be paid by the trustees. It can be paid by the settlor, although, since any IHT paid by the settlor would also be regarded as a chargeable gift, IHT will then be payable on the IHT!

Most non-exempt gifts made into trusts before 22 March 2006 would have been PETs and most gifts to trusts made on or after 22 March 2006 will now be chargeable. The only gifts into trusts that are still PETs are gifts into absolute trusts and trusts for disabled persons.

