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Money

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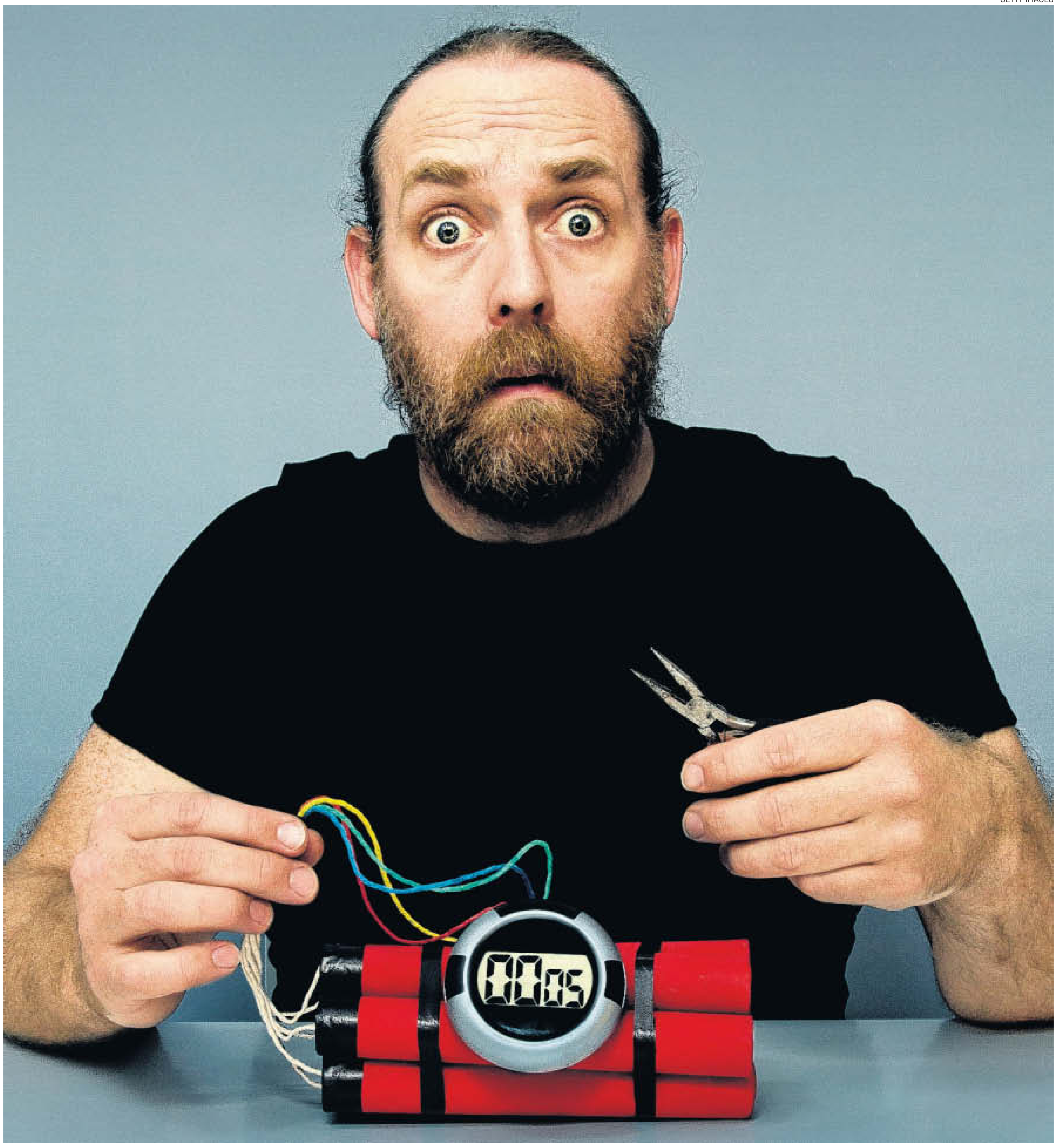

Missing the cut-off point for your tax return may result in an explosive situation costing you tens of thousands of euros. Steering clear of filing it will not defuse the problem

THE CLOCK'S TICKING

Time is running out to meet those important end-of-year tax deadlines but hitting them could provide you with an early Christmas present, writes **Mark Channing**

ONLY weeks remain to take advantage of a host of important year-end tax deadlines. Investors can pocket generous tax relief by investing in small firms before December 31. That is also the last date to take advantage of the annual small-gift exemption, which allows you to give up to €3,000 to friends or family tax-free.

Tax experts are urging anyone who missed last month's filing deadline to make their return before January or face crippling surcharges.

Barry Flanagan, senior tax manager at taxback.com, said: "Self-assessed taxpayers who have missed the year-end deadline need to take action now."

We round up the big December deadlines you need to know about.

LATE TAX RETURNS

Even though Revenue's "pay and file" deadline has passed, those who still have to make a return can save money by filing before 2017. The final filing deadline for self-assessed taxpayer was November 10.

Those who file late get hit with a 5% surcharge of the tax due, or €12,695, whichever is the lesser, provided they get their return in before December 31.

If you wait to file until January, or later, the surcharge rises to 10%, or €63,485, whichever is the lesser.

You will also become liable for interest on the tax owed, calculated at 0.0219% per day — the equivalent of 8% APR if you wait until 2017 to file.

"We see it every year," said Flanagan. "Hundreds, maybe even thousands, of people who fail to get their tax return in on time. People are not aware that the penalty and interest can increase if the taxpayer continues to delay filing their tax return."

If you are self-employed or a PAYE worker who made more than €3,174 in sideline income in 2015, you must make a return. This group includes homeowners who rented out spare rooms to paying guests through accommodation site Airbnb, which has handed over details of hosts to Revenue.

Flanagan warned not to take a "head in the sand" approach by hoping Revenue will overlook you.

"We have seen people steering clear of doing a tax return in the hope that Revenue will miss it. This is never the case," he said.

EII TAX RELIEF

Investors can back small firms and pocket a generous tax break by investing in an employment and investment incentive (EII) scheme before the end of the year.

Higher-rate taxpayers who make an EII investment before December 31 can deduct 30% of the investment from their 2016 income tax bill and claim the remaining 10% tax relief in 2021. The minimum investment for an EII is €5,000 and the maximum level is €150,000, over four years.

Suppose you make a €50,000 EII investment before the end of this year. After 30% tax relief and a 3% commission of €1,500, the net cost of the investment is €36,500.

Should the investment make a 10% return over the next four years, it would have grown to €53,900, after exit costs of 2%. The final 10% tranche of tax relief worth €5,000 bumps up your gross return to €58,900. This represents a net gain of €22,027 on your original investment of €36,500 — the equivalent of a 12.5% annual return.

An EII investment can be made two ways: directly in a qualifying business, or through a fund of investments offered by stockbrokers Davy and Goodbody.

Ross Curran, of Curran Financial Services, a fee-based adviser in Galway, said: "Funds have the advantage of spreading the investment risk over a number of different EII businesses, allowing you to take a diversified portfolio approach."

TAX REFUNDS

If you overpaid tax in 2012, you have until December 31 to claim a refund, or else you lose the cash. Revenue has a four-year limit for claiming tax refunds.

"The clock is ticking on 2012 refunds," said Flanagan. "If you don't get the claim in by December 31, you lose that refund for 2012. It's gone for ever."

Flanagan said medical expenses are one of the most claimed reliefs, available at 20% non-reimbursed expenses.

Thousands may be due a refund under "split-year relief", because they didn't claim their full tax credits, he added.

"You may be entitled to claim split-year relief either because you left the country or because you came back into the country during 2012," said Flanagan.

About 140,000 people emigrated from or returned to Ireland in 2012, according to the Central Statistics Office.

SMALL-GIFT EXEMPTION

The annual small-gift exemption allows you to give up to €3,000 a year tax-free to someone, but you must use it by December 31.

Eamon Dwyer, director of City Life wealth advisors in Cork, said: "The small-gift exemption is probably the easiest and most unknown financial planning tool out there. It's a great way for a family to transfer wealth through the generations.

"But it's a 'use it or lose it' exemption — you can't avail of it retrospectively."

When used over time, the exemption allows you to transfer a good chunk of your estate to the next generation completely tax-free, said Dwyer.

Take a couple with one child and an estate of €500,000. If the couple died leaving everything to their son or daughter, an inheritance tax bill of €62,700 would be triggered. This is calculated as 33% of the taxable portion of the estate after the tax-free threshold of €310,000 (€500,000 minus €310,000 is €190,000).

However, if the parents had gifted the child €6,000 annually (€3,000 from each parent) over 10 years using the annual small-gift exemption, the estate is reduced by €60,000, leaving only €130,000 liable for inheritance tax. This generates an inheritance tax bill of €42,900, or a saving of €19,800.

CAPITAL GAINS TAX

Profits from the sale of property and other assets such as shares are liable for 33% capital gains tax (CGT) on the difference between the cost paid and the price at which they are sold.

CGT due on gains made between January 1 and November 30 must be paid by December 15, and by January 31 on gains made between December 1 and December 31.

You can reduce a CGT bill by offsetting it against losses made on other assets in this year, or previous years. Suppose you have a CGT bill of €50,000 arising from the sale of a property, with no losses to carry forward. If you also own €20,000 worth of shares in a company that cost you €50,000 to buy, you could crystallise the loss of €30,000 and offset it against your CGT bill.

"If you know you're going to have to pay CGT, it could be a good idea to crystallise a loss now to reduce the bill," said Flanagan. "However, you need to be sure that you're comfortable crystallising that loss now."

Flanagan said there was nothing to stop you buying back the shares you took a loss on in 2017, provided you don't repurchase them within four weeks.

MARKET MOVERS
PHILIP DUGGAN

Philip Duggan, *pictured*, is a senior fund manager for fixed income and foreign exchange at Zurich Life, with €20bn of assets under management. His responsibilities include the Active Asset Allocation (AAA) fund, aimed at medium-risk investors.

The fund is open to those with a lump sum of at least €5,000, or those who agree to invest at least €75 a month.

Philosophy

The fund is actively managed and comprises a diverse portfolio of global equities, government bonds, property ETFs, cash and alternative assets.

"The great quest for investing now is diversification, so the fund invests in a diverse portfolio of equities bonds, property and alternatives, to give as broad a scope as possible," said Duggan.

The fund adopts a "top down" approach, focusing on broad economic themes to drive investment decisions.

"We look at the impact of secular themes such as monetary and fiscal policy measures. If you're on the right side of these themes, typically there's scope to outperform," said Duggan.

Performance

In the year to date, the AAA fund is up by 6%. It has risen by an average of 8% a year over the past three years, and its five-year average annual return is 8.4%. Since inception in 2010, the fund has returned 50.9% cumulatively.

"We have a consistent long-term track record, and since inception the fund has performed strongly on an outright basis and versus its peers," said Duggan.

Buying and selling

The fund invests in several existing Zurich Life actively managed and exchange traded funds. Duggan said it had been increasing its exposure to equities via Zurich's International Equity fund "pretty aggressively" since July and August.

"There has been a lot of scepticism about equities, but we feel there's still a relative value argument for holding them," he said.

"Equities don't look cheap, but in an environment of negative interest rates and negative yields on bonds, we think equities are attractive on a comparative basis."

In the alternatives space, the fund has added to its exposure to oil and copper, which Duggan expects to rise as commodities recover.

"There has been a large reduction in capital expenditure by oil companies, laying the foundation for an increase in oil prices," he said.

"Copper has benefited from an expectation that fiscal stimulus will cause infrastructure spending to rise around the globe."

Duggan said the fund had greatly reduced the quantity and maturity of the bonds it holds, in anticipation of higher interest rates.

"There is limited upside to holding bonds at these yields, and in our view the risk reward of holding long-term bonds is not attractive. That's not to say bonds will sell off dramatically, but the reward for holding them is minimal, with yields close to zero in many regions."

Outlook

Duggan believes that the short-term direction of stock markets is up.

"This is a seasonally strong time for equities to push ahead, so in the next two months we see scope for upside," he said. "However, as always, we remain alert and open to changing our positions when we see fit."

Low volatility was a good plan until everyone decided it was

JOHN LOOBY

The global financial crisis had profound effects on the psychology of stock-market investors. The losses recorded in the period after the collapse of Lehman Brothers bank were shockingly painful. The S&P 500 Index, which tracks the largest US stocks, fell 46% between September 2008 and March 2009.

So painful were these losses, there has been a widespread, and understandable, desire since to mitigate the risk of suffering a similar fate. Many bruised investors simply walked away from stock markets entirely.

Those then tethered to deposit accounts with negative real returns had salt rubbed into their wounds as they watched the remarkable recovery in stock markets, since the spring of 2009. The S&P 500 has just recorded a new all-time high and has now risen more than 210% since its crisis low.

For other burnt investors, the response has been to embrace so-called "low-volatility" strategies. These strategies, which deliberately target an exposure to stocks with historically lower price volatility relative to the rest of the market, have gained a growing following. In the States alone, a recent research report from investment bank Jefferies notes that assets in low-volatility strategies grew from just \$1.7bn in 2011 to more than \$30bn today.

The overwhelming majority of this growth has taken place in index tracking exchange-traded funds (ETFs) where assets have grown from under \$1bn to \$26.2bn over the same period. Active low-volatility funds have seen scant inflows by comparison.

Companies with less volatile stock prices seem likely to have relatively more stable and therefore less risky businesses. With balance sheets and business models that seem likely to be safer and stronger, small wonder that chastened investors have been so keen to buy into such products. The tantalising prospect of combining higher return with lower risk has seen such low-volatility strategies become a growing favourite with wary investors everywhere.

Yet, in his 2009 book The Most Important Thing, renowned investor Howard Marks cautions that any investment "everyone believes to be a great idea — by definition simply cannot be so". In the context of the recent rush into low volatility strategies, he cites four reasons as particularly relevant.

Firstly, if everyone likes a particular investment, it's probably because it has being doing well. Most people seem to think outstanding performance to date presages outstanding future performance. It's more likely that outstanding performance to date has borrowed from future returns, increasing the likelihood of sub-par performance from here on out.

Secondly, an investment loved by the crowd is likely to have risen in price to reflect a level of adulation from which relatively little further upside is likely.

Third, universally liked investments are likely to be in an area that has been mined thoroughly — and has seen too much capital flow in — for many bargains to remain.

And finally there's significant risk that prices will fall if the crowd changes its collective mind and rushes for the exit.

Successful investing is possible but not easy. In the saltier words of Charlie Munger, the long-time business partner of Warren Buffett at Berkshire Hathaway: "It's not supposed to be easy. Anyone who thinks it's easy is stupid."

So, for every investor the perennial challenge is to try not to be stupid. Slavishly following investment trends based on some plausible, but ultimately transitory rationale has generally been a losing approach. There is nothing about low-volatility strategies to suggest that their current popularity won't result in similar disappointment.

In fact, while understandably alluring, the idea that the market can be sustainably beaten by simply owning stocks with relatively low historic price volatility is not just implausible, it may now be dangerous. The timeless insights of Howard Marks on the dangers of the "great investment idea" seem especially apt. It's time to consider leaving the over-loved comfort of low-volatility strategies.

John Looby is a Senior Portfolio Manager at KBI Global Investors, a global investment manager based in Dublin. The views expressed are his own