

# UK RESIDENTIAL PROPERTY: INVESTMENT

## BACKGROUND

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Property investment generally refers to property which is acquired in order to be let out. Gains made on sales of investment property are subject to the capital gains tax (CGT) regime whereas property development gains are subject to the income tax (IT) regime.

A barrage of anti-avoidance rules have affected the tax treatment of UK residential property since April 2012 which has limited planning options. However, it is still possible to use structures in appropriate cases to mitigate UK tax.

## QUALIFYING NON UK PENSION SCHEMES QNUPS PLANNING: KEY POINTS

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- Can be set up in Guernsey or in Malta, both can invest in residential property.
- Should be used by an investor who still needs to provide additional funding for their retirement but wishes to invest in residential property without the scheme incurring punitive tax charges that apply if a UK registered pension were used for this purpose.
- No tax in the country of establishment (Malta or Guernsey) on investment growth.
- Potential to mitigate UK tax on income and capital gains.
- Fund can be structured so that it does not form part of the member's chargeable estate for IHT purposes

## QUALIFYING NON UK PENSION SCHEMES QNUPS PLANNING: KEY POINTS

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Richard is 43 (UK resident and UK domiciled). He has a small pension with his UK employer. Most of his assets are held in UK residential property. He wishes to set up a personal pension scheme which can hold residential property. Ideally he would like to transfer some of his property portfolio into a pension but he is advised that this would trigger capital gains tax problems. His property portfolio (minus mortgages) is worth £2.5m and he has £500,000 of cash at bank from his grandfather's inheritance. He is advised that, although a UK pension scheme is able to invest in residential property, the scheme would be subject to punitive charges if such an investment were made. He is therefore advised to set up a Malta Qualifying Non UK Pension Scheme (QNUPS). He funds the pension with £500,000 from his inheritance and £350,000 by increasing the debt charged against his property portfolio. Total capital injection is £850,000.

The Malta QNUPS retains £250,000 which it holds in standard pension assets through an investment account and transfers £600,000 to an IoM company (£300,000 as share capital and £300,000 as a loan on commercial terms).

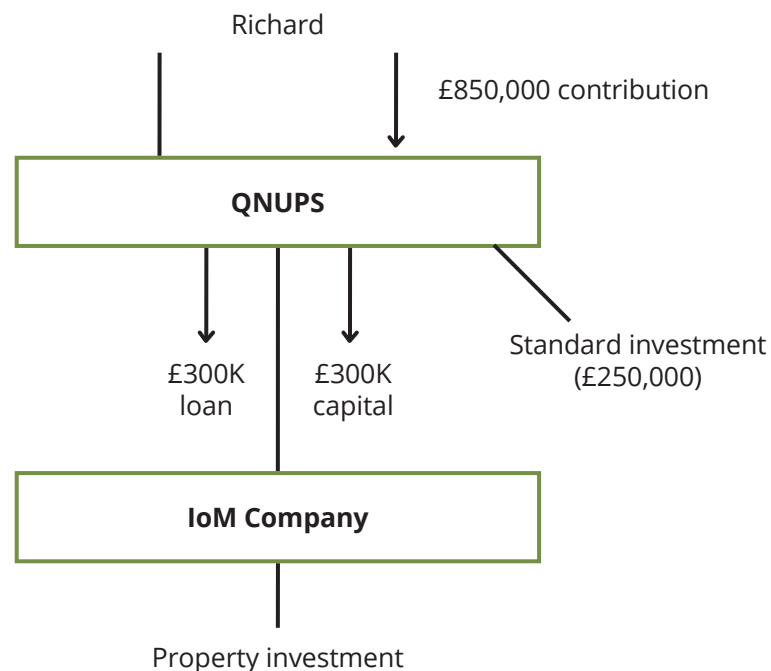
The IoM company uses the money to invest in UK residential property, purchasing three UK properties, each costing circa £200,000. The additional funding was provided with bank finance.

The tax treatment of the Isle of Man company is as follows:

- SDLT charged at the progressive rates on purchase. Plus 3% surcharge.
- Rental income taxed at 20% but interest paid on the bank and shareholder loans set against rental income together with standard expenses. Interest paid from the IoM company to the QNUPS is not taxed in the

UK, IOM or Malta.

- Gains reduced by indexation (for the time-being) and taxed at 20%.
- No IHT



Richard continues to contribute to the QNUPS by making regular contributions from his tax paid income from his employment. The further contributions are part invested into the IoM company to fund further property investment and part held in the investment account. Richard receives a lump sum from the QNUPS when he is 66. Under current rules he should be able to withdraw up to £250,000 as a lump sum without incurring a tax charge. The income he draws down is subject to income tax.

Richard nominates his three children as beneficiaries of the pension on his death but the pension trustee retains a discretion in relation death benefit rights. Any funds remaining on death should not be subject to IHT and can be used to provide the children with a pension, on which they will be taxed in the UK.

## **CASE STUDY 2: MR CHO (NON UK RESIDENT AND NON UK DOMICILED)**

Mr Cho, 57 (resident and domiciled in Thailand), holds 100% of the shares in a HK holding company which holds the shares in a network of companies that are registered in the Far East. The trading companies are involved in the manufacturing and distribution of clothing. The HK company holds £7m of profit which could be paid out to Mr Cho as a dividend.

Mr Cho is interested in using most of this income to invest in UK residential property. He is considering buying a number of apartments in the London area. He does not want to remit the £7m to Thailand as this would occasion a taxable remittance there. He is advised that the UK has recently introduced a number of provisions which make investing in UK real estate less attractive, most notably CGT for non-residents on a future sale and inheritance tax on UK property which is owned on the individual's death. Mr Cho is prepared to pay CGT on future gains but the prospect of IHT at 40% on death would deter him from investing, unless there were some tax planning that could be done. He is advised on various options including QNUPS: the QNUPS could be funded by a direct contribution from the Hong Kong company (Mr Cho's employer) or by a contribution by Mr Cho. Mr Cho is advised that no more than 75% of the pension could hold residential property which would mean that £2m of the contribution would need to be held in standard pension investments.

Mr Cho does not have a pension and, on balance, favours the second option. He accepts that the pension has restrictions re the form, size and timing of benefit provision. He establishes a QNUPS in Guernsey into which the £7m is transferred by the HK company. The QNUPS sets up an investment account which holds £2m in listed shares and funds. The QNUPS establishes an Isle of Man company into which £2.5m is transferred as share capital and £2.5m as a loan on commercial terms. The IoM company invests £7m (inclusive of the costs and taxes) in London property, with the £2m balance provided by bank finance.

## SUMMARY OF THE TAX TREATMENT

- SDLT at the progressive rates and SDLT surcharge of 3%.
- ATED letting exemption claimed by the Isle of Man company each year.
- 20% IT on rental income but rental income reduced by interest paid to the bank and the QNUPS. No UK WHT on the interest paid to the QNUPS. Isle of Man co applies to be a member of the Non-Resident Landlord Scheme.
- CGT taxed at 20% on future gains but gains reduced by indexation relief (for the time-being).
- Income that Mr Cho receives from the QNUPS is not taxed in Guernsey nor in the UK. It is not in Thailand provided Mr Cho does not remit it there.
- The new IHT provisions which would treat the value of the Isle of Man company shares as part of Mr Cho's estate should not apply as the shares are held in a QNUPS and thus there should be no IHT on his death.

