CURTIS BANKS

# Case study

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# Purchasing commercial property: pension or personal?


### Summary

An investor wants to access his pension in order to purchase a commercial property. He had not considered that he may be able to purchase the property without accessing his pension.


## The Challenges

Horace recently turned 55. He is considering exhausting his £400,000 pension in order to purchase a commercial property, which he feels is a suitable investment for his circumstances and attitude to risk. Horace has seen a shop on the market for £250,000: he thinks this is a good fit as it will leave him with cash left over for a few home improvements he has been considering. Horace is currently taking a year's unpaid leave from his job, but does not plan to retire for many years as yet. He approaches a financial adviser, Yuko, to discuss his plan further.

## The Actions

Yuko realises immediately that Horace hasn't considered holding a commercial property within a pension. Whilst Horace has always contributed to his workplace scheme, he's never really engaged with pensions. As such, he wasn't aware that there were schemes where he would have access to a wide range of investments and be able to make his own decisions.

Horace is intrigued enough to ask Yuko to outline some of the differences between the two options.

**Funding**

Firstly, Yuko addresses Horace's assumption that he will have plenty of funds left over if he exhausts his pension. She confirms that 25% of the pension would be tax-free, but the rest would be taxed as income. Although Horace will have no other earned income this year, a £300,000 payment is enough for Horace to lose his personal allowance and pay a significant amount of higher and additional rate tax.

| | Within a pension | Outside a pension |
|---|---|---|
| Fund value | £400,000 | £400,000 |
| Tax free cash | - | £100,000 |
| Taxable value | - | £300,000 |
| Total tax due (2017/18 rates) | - | £120,800 |
| Total net value | £400,000 | £279,200 |

By the time Horace has covered costs such as a solicitor's fees and Stamp Duty Land Tax (SDLT), there could be very little left over. If Horace leaves the funds within the pension, the money which he would pay in income tax will still be available to invest. Yuko points out that this will also allow Horace to diversify his investments.

**Rent**

Yuko then explains that rent paid into a pension is free of tax. It is treated as investment income, so it directly increases the value of Horace's pension. As Horace won't have taken any pension benefits, his plan will still be 'uncrystallised'. This means that any increase to the fund value also increases the amount of tax free cash he will eventually be able to take.

Yuko goes on to explain that the rent also provides additional liquidity in the pension. Horace can choose to invest any surplus rent in other assets. When he eventually decides to take benefits from the pension, the rent could also help provide the liquidity required to make income payments. Depending on the amount of rent and the income Horace requires, he won't necessarily need to sell the property when he wants to take benefits from his pension.

**Future contributions**

As Horace isn't intending to retire yet, Yuko also tells him about the money purchase annual allowance (MPAA). If Horace exhausts his pension to purchase the property, he will trigger the MPAA rules. This means that he will only be able to

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contribute £4,000 to money purchase pensions each year without paying a tax charge. Horace's employer offers generous pension contributions but doesn't generally offer alternative benefits, so this could cause problems for Horace when he returns to work next year. If Horace does not take income from his pension, he will keep the full £40,000 annual allowance.

Yuko also explains that if Horace still wants to consider the home improvements he had planned, he could withdraw a small amount of his tax-free cash. This would leave the remaining pension untouched, and would not trigger the MPAA rules.

**Capital Gains Tax (CGT)**

Yuko knows that Horace would like to hold the property as a long term investment, with the hope that its value will increase. Yuko explains that if Horace owns the property personally, he could face a CGT bill on the profit when he sells. However, if he sells a property held within a pension, there will be no CGT to pay.

**Inheritance tax (IHT)**

Finally, Yuko talks to Horace about IHT. She explains that once money is taken out of Horace's pension, it will form part of his estate for IHT purposes. This could lead to a significantly higher tax bill on Horace's death. On the other hand, his pension would not form part of his estate. Yuko also explains that under the current death benefits rules, any beneficiary Horace chooses could potentially 'inherit' his pension and continue to hold the property (and other assets) within a pension wrapper, with all the same tax advantages Yuko has outlined for Horace.

## The Results

Horace decides that he will transfer his pension into a SIPP and purchase the commercial property. He knows that there will be administration charges associated with the SIPP, but Yuko reassures him that the tax advantages will outweigh these. Leaving the money in a pension until it is needed will allow Horace to withdraw funds in a more tax efficient way.

Horace decides to go ahead with his home improvements during his year off. Yuko arranges for him to withdraw £15,000 as a tax-free cash payment, which leaves most of his plan uncrystallised, so his remaining tax-free cash entitlement can continue to grow as the fund value increases. He will also be able to take advantage of his employer's contributions when he returns to work, as he won't trigger the MPAA.

## Important points to consider

The value of pension funds may fall as well as rise. Your money is tied up until you take your benefits. Benefits can generally be taken any time after age 55. Always take financial advice to find out if a SIPP is suitable for you.

## Contact details

If you'd like to speak to us about anything on this fact sheet, please contact us on:

**T 0117 910 7910**
We may record and monitor calls. Call charges will vary.
**E** enquiries@curtisbanks.co.uk

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