

Taxable Property

The Finance Act 2006, now enacted, contains rules regarding taxable property and the associated charges for holding it within a pension. The taxable property rules in essence tax and therefore effectively prohibit investment in the two areas that created the most excitement pre A-Day, residential property and exotica.

The detailed legislation has created a minefield for advisers and scheme administrators alike, with administrators needing to exercise careful oversight not only in what they allow policyholders to invest in initially but also in monitoring investments on an ongoing basis.

What is taxable property?

Taxable property is split into two categories, residential property and tangible movable assets (TMAs).

Residential property is a building structure used or suitable for use as a dwelling. Buy-to-lets, holiday lets and time shares, even if they are run as a business, are therefore taxable property. There have been articles in the press regarding foreign property, namely French leaseholds that some people believe are not residential because in France they constitute commercial property. It should be noted that it is the UK legislation that applies and not how the investment is viewed under any other country's laws.

There are two exemptions to the restrictions on residential property. These are for 'job related' properties.

The first exemption is if the property is occupied by an employee who is neither a member of the scheme nor connected to a member of the scheme or the employer and is required as a condition of the employment to occupy the property. This for example, could be a caretaker's flat.

The second applies if the property is occupied by a person who is neither a member of the scheme nor connected to a member and the property is used in connection with a business premise held as an investment within the scheme. This is likely to apply to cases such as a shop with a flat above that is leased to a trader who is trading from the shop.

Any property that was exempt because of the above conditions becomes taxable immediately if these conditions cease to apply.

TMAs cover virtually everything you can touch and move. HMRC can make regulations to add to or remove things from the list of TMAs. The most recent exclusion is investment grade gold bullion. HMRC's intention with this legislation is to discourage investment in assets that could be capable of personal use such as, antiques, pictures, fine wine and classic cars etc. TMAs are not deemed taxable property if:

- » the asset is worth less than £6,000; and
- » indirectly held; and
- » held solely for the purposes of administration of management of the vehicle in which it is held; and
- » neither the scheme member, nor anyone connected with the scheme member personally occupies or has use of the asset.

Consequences of a SIPP investing in taxable property

Whenever a vehicle in which a SIPP invests owns taxable property then the SIPP is deemed to own that taxable property and will be taxed accordingly. If the SIPP does not own the whole taxable property then it will be taxed accordingly on a pro rata basis.

There is an initial tax charge of 40% on the policyholder and a 15% tax charge on the SIPP. If the taxable property forms more than 25% of the value of the SIPP then there is a further tax charge of 15% levied on the policyholder.

Ongoing tax charges will also apply. The SIPP will incur a charge of 40% on the income, or deemed income if there is none, and 40% on any gain on disposal



When are the taxable property provisions likely to apply?

The consequences of owning taxable property occur in a number of circumstances and in some cases when you might not expect it. For example, a SIPP owns 20% of an unquoted

company, which in turn buys a work of art worth £20,000. The SIPP is treated as acquiring £4,000 worth of taxable property. As the asset is worth more than £6,000

the asset will trigger an initial tax charge on the value of £4,000 and ongoing tax charges on the deemed income, as detailed in the previous section.

Vehicles which avoid taxable property consequences

If a SIPP holds taxable property directly it will always be taxed. Tax charges will also apply if taxable property is held indirectly unless it is held by one of the three following exempt vehicles. It should also be noted that in each case all of the conditions listed below must be met initially and continue to be met throughout the duration of the holding.

Real Estate Investment Trusts (REITs)

The Finance Act 2006 has introduced legislation regarding the criteria which a company must meet in order to be recognised as a REIT. The REITs legislation will bring REITs into force in January 2007.

A number of major property investment trusts have already declared their intention to convert to REIT status although we expect that it will take some time for the REITs market to become established.

Trading vehicles

Investments held in trading vehicles are exempt provided the following conditions are met:

- » the vehicle's main activity must be carrying out a trade, profession or vocation

- » the purpose of the investment must not be such that a policyholder or connected person can occupy or use the taxable property
- » the vehicle must not be controlled by a pension scheme, meaning that a SIPP and associated persons, jointly, must not hold more than 50% of the vehicle or, if the member is a controlling director or connected to a controlling director, then the vehicle can not be held by the SIPP.

Non trading vehicles

If a non trading vehicle such as a property syndicate holds taxable property then the following conditions must be met to exempt it from tax charges:

- » the gross value of the assets held by the vehicle must equal or exceed £1million; or the vehicle must hold at least three residential properties; and
- » no residential property can exceed more than 40% of the total value of the vehicle; and
- » the main purpose or one of the main purposes of the

- vehicle cannot be the direct or indirect holding of an animal or animals for sporting purposes; and if the vehicle is a company then it cannot be a close company; and
- » there cannot be any personal use of the taxable property by the SIPP investor/policyholder or a connected person; and
- » no arrangement under a SIPP can hold more than 10% of the vehicle, including associated persons.

It is likely that the non trading vehicle will be the route that SIPP syndicates opt for when looking to invest in residential property. The syndicates will need to be substantial in order to meet all the requirements and will need to invest in three or more properties so this will not be suitable for the small investor. It does however open the door to a new way to invest in residential property.

The definition of associated persons is more wide reaching than its predecessor the connected party and care should be taken as it also encompasses connected persons' pension scheme assets etc.

Our view

There are potentially many pitfalls associated with investing in taxable property, including investing in private company shares. For the moment we are continuing with our policy of not allowing such private company

shares although we may reconsider our position at a future date if there is demand. The flexibility associated with SIPP means that it is very easy for a SIPP policyholder to inadvertently invest in taxable property

Investment advice is therefore critical and advisers and investment managers should monitor investments regularly to avoid any potential adverse tax consequences.

This bulletin is based on our current interpretation of the changes under Pensions Simplification.