Case Study: Residential Property Holding

OPTIMUS

Peter is the principal partner in a dental practice dentist aged 45 and in good health. His earnings have averaged approximately £275k per annum over the past 5 years. He has a SIPP invested in a range of mutual funds valued at £695k and into which he contributes the maximum annual allowance for his level of earnings of £10,000.

Peter is the beneficiary of an offshore trust which owns, amongst other assets, 5 residential properties in Cheshire with a combined market value of £1.85m and let on market terms. These were acquired in the run up to the financial crisis at a combined cost of £2.25m with borrowing from 3 different banks of £500k.

Peter recently acquired in his own name 2 residential properties in the same area with a combined value of £750k using borrowing of £500k. These too are let on market terms.

He also owns the building from which he runs his dental practice and that is valued, net of borrowing, at £1.2m and provides further income to Peter of £58k per annum.

He has 2 children from his first marriage aged 11 and 10, both privately educated, and 2 from his second marriage aged 2 and 4.

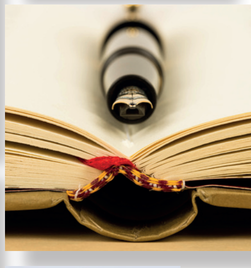
His current plan is to retire from the practice at 55.

Planning Considerations

Peter's existing pension may well reach the lifetime allowance before he retires and the maximum income will not provide him with anywhere near a replacement for his earnings in retirement. All four children will be still in full-time education which he will need to fund after retirement, as well as his own lifestyle which he wants to maintain. He is also justifiably concerned that if he dies either before or soon after his planned retirement that his children's education can continue uninterrupted his wife's standard of living is maintained. As a result he would like minimum exposure to IHT.

Peter believes the residential property market in his local area will pick up in the next 10 years which will increase his estate considerably from both within and outside of his trust. The introduction of the Non-Resident CGT charge has also increased Peter's exposure to CGT within the offshore trust to an improving residential property market.

> 'Provides a tax benign environment for pension savings"



Solution: The Offshore Enhanced Retirement Scheme ("OERS")

Following advice, Peter elects to move the 5 properties held by the trust and the 2 he owns personally into the Optimus Enhanced Retirement Scheme which meets all the requirements of UK tax regulations to be classified as a Qualifying Non-UK Pension Scheme ("QNUPS").

The total value of the combined property portfolio is £2.6m and the OERS trustees can easily refinance and consolidate the borrowing of £800k with a single lender on a loan-to-value of 31%.

In a financial planning context, Peter's adviser has identified a number of key advantages which match his planning objectives:

- Through his salary plus other investment and trust income, Peter has sufficient earnings to maintain his lifestyle without relying on the residential property income, allowing that to be transferred to the OERS.

- By investing in residential property, Peter is selecting an asset class for his supplemental savings that he is comfortable with and believes offers attractive investment returns over his medium-to-long term pension savings outlook.
- The lifetime allowance places a restriction on Peter's future pension income which will be significantly less than the earnings he currently enjoys but his financial commitments and lifestyle are unlikely to be reduced proportionately at his chosen retirement date. Through the OERS Peter is therefore able to provide for supplemental retirement income to redress the balance if he needs it.
- If Peter does not need the additional retirement benefits at age 55 he can defer it until age 75 and even then can take a minimal income in a manner similar to the minimum Government Actuary Department drawdown requirements.
- If Peter were to die prematurely, the value of the fund does not form part of his estate and therefore is not subject to IHT.

In addition to offering Peter what he needs in respect of his financial planning goals, the use of the OERS also provides him with a tax benign environment for his pension savings. In particular:

- The properties held in the offshore trust are standing at a loss and the personally held properties, being recently purchased were standing at little or no gain as a result of the flat market since purchase. As a result there will be no exposure to CGT on the transfer into the OERS.
- There will be no income tax relief on the contribution but the contribution is not limited in value by the lifetime or annual allowances.
- The initial charge for IHT purposes does not apply to the contribution of the properties into the OERS because there is no transfer of value from Peter or, until April 2017, from the trust.
- On the basis that the OERS has been established to provide bona fide pension benefits to Peter there is no element of bounty involved and so the OERS would not be classified as a settlor interested trust. Income arising to the OERS would not, therefore, be treated as Peter's income.
- There does not appear to be any practical way that the transfer of assets abroad provisions can be applied to the contribution.
- The properties under the current offshore trust arrangement are held via a special purpose company and as such the rental income is taxed at 20%. The amount of income that is taxed is reduced somewhat through the non-resident landlord scheme. Peter can simply transfer the company to the OERS and thereafter enjoy the same tax treatment as through the previous offshore trust ownership. The transfer of the non-resident company from the offshore trust to the OERS will not be subject to SDLT.
- Income from Peter's personally held properties is taxed at 45%. Once transferred into the OERS, they will also be held in the special purpose company with the rental income taxed at 20% and benefiting from the non-resident landlord scheme. The properties are let to unconnected parties on market terms and so relief from ATED can be applied for.
- If the OERS trustees were to sell the properties at a later date for a gain, CGT will not apply because an overseas pension scheme such as the OERS is exempt from the non-resident CGT charge.
- The value in the OERS will not fall within Peter's estate for IHT purposes. An interest in a QNUPS is not relevant property and, as such, is immune from the 10 year charge and exit charge.
- It is a widely considered view that for the above tax treatment to be effective in any particular case, a QNUPS arrangement must be established with a purpose to provide genuine pension benefits. With this in mind, it is worth noting that the OERS is approved in the Isle of Man under specific pension legislation and regulated as such. Furthermore, it is approved by the Isle of Man tax authorities under pension legislation. Peter is 45 and in good health and the contribution to the OERS is affordable within the context of his overall wealth and income. He can demonstrate a genuine desire to supplement his future retirement income and provide future financial protection for his family. The OERS is therefore genuine retirement planning.