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residential property

As a rule, registered pension schemes cannot own residential property. It is classed by HMRC as 'taxable' property and can lead to the imposition of heavy tax penalties. This penalty applies whether the pension scheme owns the property, or an interest in the property, either directly or indirectly. There are very limited circumstances in which a pension scheme can own residential property, and the mechanisms can be extremely complex.

Where to start

The means by which the registered pension scheme will be exposed to residential property needs to be determined initially. There are various transactions which could result in potential exposure, relating from a direct ownership of a property that has some form of residential accommodation, to a development project that could result in significant capital gains, to a type of indirect ownership via an investment 'scheme'. Each scenario will have differing requirements that must be followed in order for a pension scheme to remain compliant, so background information is vital.

Definition of residential property

HMRC broadly defines residential property as a building or structure that is used, or is suitable for use, as a dwelling. This definition also extends to related land used as a garden of, or for the enjoyment of, a residential property.

HMRC excludes certain categories of property from being classed as residential. These include residential homes or institutions designed for children's welfare, or the welfare of those such as the elderly or disabled (whether physical or mental). It also extends to other specific examples, such as hospitals, hospices, and halls of residence.

Hotels are also specifically excluded from the definition of residential property. HMRC clarifies that hotels, inns and similar accommodation are only classed as residential property where the pension scheme only owns part of the property and as a consequence the member (or any connected party) has a right to use any part of the property or use any of the facilities that are available there. Examples might be staying in an hotel for reduced or nil rate or using any of the facilities offered at the hotel.

Parts of buildings need to be considered carefully. If a property contains integrated commercial and residential elements, such as a shop with an inter-connected residential area, HMRC will treat the entire property as residential. Where the parts of the building are separate, meaning that there are separate entrances and no inter-connected areas, then the two elements will be treated separately: commercial and residential. A communal hallway would not, in this instance, be treated as inter-connection.

Direct ownership

There are very limited instances where residential property can be held directly by a pension scheme. These relate to permitted 'job related' residential property and cover two specific examples.

Firstly, where the property is occupied (or will be) by an individual not connected with a scheme member or employer and who is required to occupy the property as a condition of employment. An example is a caretaker's flat.

Secondly, where the property is occupied (or will be) by an individual not connected with a scheme member or employer and is used in connection with business premises held as an investment of the pension scheme. An example is a flat above a shop where the flat is occupied by the trader in connection with them operating their trade from the shop.

It is important that any documentation relating to the tenancy in these situations, such as the lease, ensures compliance with the requirements of legislation.

Property development

Land, when acquired by a pension scheme, would not be classed as residential property when bought (unless it falls into the definition of a garden, etc, as mentioned above). It is therefore possible to acquire land for the purpose of considering residential development.

In considering a residential development, the Trustees must be aware of a significant number of challenges. As HMRC does not provide specific guidance as to when a property becomes habitable, it is up to the Trustees to determine when this might occur. The expectation would be that professional contractors working on the property would be experienced in the process and can therefore help identify the stage at which this would occur. The Trustees must then plan to sell the property prior to this point being reached – ideally, well before. HMRC confirms that a property sold before the development or conversion is substantially completed never becomes residential property. The challenge is in determining this point.

Trustees may also be challenged to ensure that the property can be sold. As the development will only be part completed, they ideally need to ensure that they have a potential purchaser before embarking upon the project. This could be a scheme member, employer or other connected party, or another developer, who will take the project on to completion.

Indirect ownership

Indirect ownership of residential property is also caught by HMRC's rules. This applies where the pension scheme owns, or has an interest in, another 'vehicle', such as a limited company, and that vehicle then owns the property. There are some exemptions for certain types of indirect interest vehicles, but the rules concerning these are extremely complex.