A tax-efficient way to **purchase property**

Declan Gahan from MGM Financial Services, part of the Business Medical network, explores the idea of purchasing a property with your pension

The love affair with property continues

Irish people have always been very interested in property. As you can see by the coverage in the newspapers and the many property-related TV shows, this interest shows no sign of waning. With the Irish rental market for property currently very strong, many investors and their financial brokers feel that there is value to be found in the Irish property market at the moment.

Did you know that you could invest in a rental property without having to pay tax on any rental income? If you didn't, then perhaps you haven't considered your pension as a vehicle to achieve this. Some modern flexible pensions can offer this very option within their investment arena.

Why use a pension to buy property?

Let's look at why you'd consider buying within your pension rather than outside your pension fund. Firstly, we start with your pension fund, which will have ben built up in part because of the tax-relief applied to your contributions on the way in.

Once you've identified a property you'd like to buy, your pension fund buys it and pays all associated costs such as stamp duty, solicitors fees and estate agents fees. The rent then goes directly back into your pension fund and there are no tax deductions by Revenue.

You can direct this rent into another investment such as equities or bonds if you wanted to diversify within your pension fund.

If, at a later stage, you sell the property at a profit, again, Revenue doesn't get a part of the pie and the proceeds are reinvested back into your pension. You also have the option to keep the property right into retirement which may well work if you like the income part of the investment. In this case, the property would be transferred in-specie to your new post-retirement product an Approved Retirement Fund (ARF). No new stamp duty would apply, and all rental income will continue to be paid to the ARF. Only when you start taking income from this post-retirement pension fund will tax become applicable again.

Buying outside a pension

In contrast, if you did the same transactions outside of your pension and you pay a higher rate of tax, then almost half of your rental income may be taxed, while gains on the sale would be subject to tax at 33 per cent.

As you can see from above if you are interested in property investment it makes far more sense to purchase within your pension fund than externally.

What are the risks?

Naturally the risks that apply with property investments also apply when purchased within a pension as well. You'd need to consider potential risks such as not being able to rent the property for periods and for a fall in the value of the property itself. Also, we'd advise that you carefully consider your overall portfolio so that you achieve a mix of assets and are not dependent on one asset class – property in this case. In addition, you need to make sure you have sufficient liquidity within your pension to make all the transactions – you can't have every cent tied up in property and will need to be able to cover pension charges etc.

Identifying a property

One of the key features of the pension scheme is the ability to take control so you can identify and acquire various property investments. This means that you have the ability to use your own market knowledge to access opportunities and significantly enhance your retirement asset. These type of pension schemes have the ability to invest directly in residential and commercial property located in Ireland.

What are the rules?

Property purchases through pension schemes have set guidelines and restrictions issued by the Revenue governing what is permitted. Such restrictions include all purchases being on a totally arm's length basis from the beneficial owner of the pensions scheme. This means that you cannot purchase a property from any person or entity connected to you in any way. There are also rules prohibiting property purchases with the view to development and immediate disposal. The purchase of holiday homes and investment properties is permitted so long as neither the beneficial owner nor any connected party uses the property.

Who would this suit?

We'd recommend you talk to an impartial financial advisor before making any decisions like this but, in general, if you've built up a personal pension pot that you have control over then this could well be an option for you. Bear in mind that you will need significant funds to cover all the costs involved in the property purchase and to allow for a surplus to cover ongoing charges.

This could also be an option for someone about to retire or already retired who has an ARF in operation. In fact, rental income could be a great way of satisfying the obligatory 4% p.a. drawdown imposed by Revenue. Investors in this situation would need to have a higher level of liquidity within their pension to allow for this drawdown.

If you haven't built up your pension to a sufficient level it could be something to consider in the future and may give you a target fund to get to. In general, you'd need a pot of circa €250,000 to facilitate this option.

You could also consider buying a property jointly with another pension fund. Investors have previously combined their pension pot with that of their spouse and so increased their purchasing power. It's possible to form a syndicate with business partners or colleagues also. It would be very important that you were of like minds in terms of the investment itself and also in terms of when you'd be selling it – people at different stages of their career would not be ideal as different retirement dates would apply.

How do I find out the next steps?

There is an opportunity for you to use your pension fund to secure some long-term income and an asset that should provide tax-free capital appreciation, so you can enjoy the fruits of your labour in your retirement. However, these need to be looked at within your overall financial portfolio and your pension portfolio in particular. Contact MGM Financial Services directly to find out more about the options available to you. **Phone:** 01 293 9333 **Email:** info@mgmfs.ie

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