Tax Matters

Brian Broderick gives helpful tax tips to probate practitioners concerning Legal Personal Representatives

Probate practitioners are getting to grips with the new Form SA.2, and an article in the DSBA Winter *Parchment* looked at some of the ways the Revenue may use the information now available electronically from this form.

Estates can have significant income levels (for example there can be a rental property or share portfolio) and Revenue can now check the Form SA.2 for income bearing assets, to ensure that the income is returned and any tax due is paid. The liability for tax on income arising in the course of administration rests with the Legal Personal Representative (LPR), and also with the beneficiary who is entitled to the income.

Income Arising to an Estate

An LPR who receives income when administering the estate is subject to income tax at the standard rate of 20%, but is not subject to PRSI or USC. Income tax returns should be prepared and filed, with a payment of tax, by the usual pay and file deadline of 31 October.

The beneficiaries of an estate, who receive income, are also subject to income tax (together with PRSI and USC) on that income, but can claim a credit for any tax paid by the LPR. In effect, the beneficiary "tops up" the tax paid by the LPR, to match the tax the beneficiary would have paid, had the income arisen directly to the beneficiary. The LPR should provide a Form R185 to the beneficiary to set out the income and tax credit.

Strictly speaking, the income tax should be calculated by reference to the year in which the income arose, but the liability to pay income tax on it does not arise until the distribution is received. If an estate received income in 2020, but it is not distributed to the beneficiary until 2021, the tax is calculated on the basis of the beneficiary's 2020 income, but the liability to file the tax return and pay any balance of tax due does not arise until 31 October 2021.

If the income level is small and the tax position is straightforward, Revenue may agree to treat the income as arising directly to the beneficiaries, from the date of death. This does not result in any income tax saving, as the beneficiary still pays tax at the marginal rate, but it simplifies the administration as the LPR does not need to file a return.

Extract from Revenue Guidance Note:
"It should be noted that, where an estate which is small and is a straightforward one (for example, only one or two residuary beneficiaries with no annuitants, life tenants or other persons with an entitlement to any of the income of the estate) the inspector may adapt an approach simpler to that provided for in this section and tax the residuary beneficiary directly on all the income of the estate received from death onwards. In such cases no assessments are made on the personal representative and the beneficiary is taxed each year as if he/she had received the estate income from its various sources directly himself or herself.

The position should be confirmed in writing each time as Revenue will not operate the concession in every case (for example if a beneficiary is non-resident).

Example:
The main assets in Liam's father's estate were two residential properties and the value of each was similar so Liam's father specifically devised property A to Liam and passed the residue of the estate (which included property B) to Jill.

The rental income on property A during the course of administration was €15,000 and the rental income on property B during the same period was €20,000 (after deducting letting expenses).

The total income for the estate was €35,000 and the estate was registered for income tax. Form 1 tax returns were filed and 20% income tax was paid(€7,000).

A Form R185 was provided to Liam setting out gross estate income of €15,000 on Property A and an income tax credit of €3,000. The income of €15,000 should be included in Liam's Form 11 income tax return together with a tax credit of €3,000.

Similarly, a Form R185 was provided to Jill setting out gross estate income of €20,000 on Property B and an income tax credit of €4,000. Jill should include €20,000 of income in her Form 11 income tax return together with a tax credit of €4,000.

Both Liam and Jill are resident in Ireland and if Liam, as LPR obtained agreement from Revenue to treat the income as arising directly to the beneficiaries there would have been no requirement to file a Form 1 income tax return for the estate. The overall income tax liability would have been the same but Liam and Jill would have accounted for the tax.

Brian Broderick is a tax practitioner at **O'Hanlon Tax Ltd**

Dealing with Income in the Estate Accounts

Where income arises to an estate, the income belongs to the individual who inherited the income bearing assets, unless the Will directs otherwise.

When the estate is being distributed, the income should be accounted for in an income distribution account (separate to the capital distribution account). Each beneficiary receiving a share in the income should be advised of the level of income being distributed and any tax credit available (using a Form R185). If the Revenue concession is obtained then there will be no tax credit available as the estate will not have paid any income tax, and the Form R185 is not required.

If a separate distribution account is not provided for income a beneficiary may not be conscious of the fact that income is being received, particularly if the income has been used to pay estate expenses.

The debts, funeral and testamentary expenses should be paid from the capital of an estate, in line with the provisions of the Succession Act 1965. However, if the estate does not have enough cash to cover expenses the LPR may opt to use income rather than selling an asset, in which case the income should be treated in the same way as a cash contribution from the relevant beneficiary. The use of the cash does not alter the nature of the funds received, or any tax liabilities that attach to the income.

If rental expenses are incurred (e.g. estate agent fees or routine maintenance costs) the expenses should be paid from the rent and allocated to the beneficiary who is entitled to that rent. They can be deducted from the Case V rental income in the income tax computation. In practice keeping separate cash accounts and distribution accounts for income and capital will make the process of accounting for tax much more straightforward.

Example:

Expanding on the previous example, there were cash assets in the residue of the estate amounting to circa €30,000 and the liabilities of the estate totalled €60,000.

The only other asset in the residue of the estate was Property B. The income on Property A was due to Liam so it could not be used to pay estate expenses. The income on Property B (after the payment of income tax by the estate) was €16,000 so Jill asked the estate to set this amount against the liabilities and she contributed a further €14,000 to meet the balance of the estate liabilities.

Estate liabilities	*€60,000*
Estate cash assets	*(€30,000)*
Net income contributed	*(€16,000) **
**€20,000 rent less €4,000 estate tax (20%)*	
Balance to meet liabilities	*€14,000 **
**contributed by Jill*	

In effect, the €16,000 of net rental income attributable to Jill and the €14,000 direct contribution of cash by Jill (a total of €30,000) was a contribution to cover the estate expenses.

Jill effectively provided funds of €30,000 so that she can take Property B in specie and prevent the property being sold.

The Income Account for the Estate could be set out as follows:

Income Account

	Property A
Rental Income	*€15,000.00*
Income Tax	*(€3,000.00)*
Net Income	*€12,000.00*
Distribution to Liam	*(€12,000.00)*
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	Property B
Rental Income	*€20,000.00*
Income Tax	*(€4,000.00)*
Net Income	*€16,000.00*
Contribution by Jill	*(€16,000.00)*

Conclusion

There can also be stamp duty and CGT implications to take into account where a capital contribution is made to an estate, as the payment is treated for tax purposes as a part purchase of the asset which is being distributed.

While the final liability to pay income tax rests with a beneficiary, the LPR should bear in mind that he will remain personally liable for the estate's income tax after distribution so he should satisfy himself that the income tax position has been dealt with, particularly if the level of income is significant. It is reasonable to assume that with more information at Revenue's fingertips they will take steps to prevent tax leakage in relation to estate income.

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