

OHT Guide

CAT Inheritance Planning



CAT – Inheritance Planning

Capital Acquisitions Tax (known as “CAT”) is a tax on gifts and inheritances, payable by the person receiving the asset.

CAT generally arises when a benefit is taken by (or from) a person living in Ireland, or consists of Irish assets, such as Irish land, cash in an Irish bank account, or shares in an Irish company.

There is provision for a tax free threshold below which no tax is paid, and there are 3 categories of threshold [class (a), class (b) and class (c)]. The tax free threshold depends on the relationship between the person giving the benefit and the person receiving it, and the closer the relationship the higher the threshold.

For example if a parent gave a benefit to a child in 2017 the threshold would be €310,000 (class (a) 2017). By contrast if a parent received a benefit from a child on the same date the threshold would only be €32,500 (assuming no exemptions apply) as a gift received from a child falls into the class (b) threshold.

Benefits are cumulative, so all gifts or inheritance received since 05 December 1991 (a cut off date set by legislation) which fall into the same class threshold, will be added together, and will use up part of the available threshold. CAT will be payable at a rate of 33% (since 06 December 2012) on the excess of the value of the benefit over the available threshold. If a child were to receive a gift of €100,000 from a parent in 2017 then this would use up €100,000 of the class (a) threshold of €310,000 and the available threshold to shelter future benefits would be €210,000.

There is no CAT between spouses so the focus of most CAT planning is passing wealth to the next generation.

A parent will generally want to plan the transfer of wealth so that children are given assets on a phased basis, so that they learn to deal with financial issues and manage properties and other assets before substantial wealth passes. In some cases planning may be required to ensure that the value of a business is protected in the

course of a transfer from a successful founder to the next generation.

Transferring Wealth by Gift

A gift allows a person to make provision for family members during his own lifetime, so he can benefit from a more structured and tax efficient transfer of wealth. However a gift may give rise to stamp duty and CGT costs (neither of which arise if an asset passes on death) so the potential tax costs of a transfer need to be established.

The advantages of gifts to children are:-

1. Any rise in value after the date of the gift accrues directly to the child, building up his wealth, and reducing the level of the estate the parent will eventually pass on.
2. The beneficiary will have assets which he can borrow against, or sell, to fund any gift/inheritance tax on future benefits.
3. Benefits received since the cut-off date (now 1991) are aggregated together to reduce the tax free threshold. If the cut-off date is brought forward again a gift made now may not affect future gifts or inheritances.
4. Most family transfers are taxed based on the market value of the asset. In the current climate values are depressed, so a taxable gift in 2017 may result in a lower tax cost than a future inheritance of the same asset (if values or tax rates rise).
5. The rate of CAT (33%) may rise in the future so benefits passing now may attract less tax than future benefits.

Reliefs

There are a number of measures available that can be used to facilitate the transfer of wealth without a prohibitive tax cost.

The following reliefs may be used to reduce CAT:-

Dwelling House Relief

This relief can be a useful mechanism for transferring value by way of inheritance but the relief is no longer available on gifts unless the beneficiary is an incapacitated relative or a relative aged 65 or over.

In general, the disponent needs to live in the property up until his date of death and the beneficiary must live in the property for at least 3 years prior to taking the inheritance.

If the disponent or beneficiary moves out of the dwelling as a result of mental or physical infirmity this is treated as occupation of the dwelling for the purposes of the relief.

The beneficiary must not be entitled to an interest in any other residence, and must retain the dwelling as a principal residence for 6 years unless the beneficiary was 65 or over on taking the inheritance (subject to certain provisions for replacements).

In general the ownership of any other residential property in Ireland or abroad (for own use or as an investment) will prevent the beneficiary from claiming the relief. If a second dwelling is taken in the same inheritance, the ownership of the second dwelling prevents the relief applying to the dwelling which may otherwise qualify for dwelling house relief.

Business Relief

The taxable value of qualifying business property may be reduced by up to 90% when it is passed on to a beneficiary. The value of the relief will be reduced if part of the value of the business comes from investments, and if the investments make up over half of the total value of the business relief will not be available.

This relief can be used to pass a business or shares in a trading company or group on to the next generation.

It could also be utilized to invest in a child's

business with a view to passing the shares or business interest on in due course.

It should be noted that to secure relief the parent must hold the business interest or shares for 2 years before an inheritance of 5 years before a gift.

There is a clawback provision so the beneficiary must retain the business for 6 years (10 years if the asset was development land), and must ensure that the business is run in such a way that it remains a qualifying asset for business relief during that 6 year period.

Agricultural Relief

The value of qualifying agricultural property may be reduced by 90% when it is passed to a "farmer", i.e. a person whose assets consist mainly (80% or more) of agricultural property.

If the asset passed consists of woodlands the beneficiary does not have to meet the 80% assets test to be a "farmer" and to get relief on the value of the woods.

Agricultural relief also has a clawback provision so the beneficiary must retain the agricultural property for 6 years (10 years if the asset was development land), In addition he must remain resident in Ireland for the 3 years following the year in which the benefit was received.

Annual Small Gift Exemption

A person can receive a gift of €3,000 per annum from any number of individuals. Two parents could give a combined gift of €6,000 per annum to a child, building up an investment of €30,000 over 5 years.

Asset Protection: Keep Control

Many parents want to transfer value without transferring total control to children, especially if children are young adults who may not have any experience of dealing with valuable assets.

In general it is difficult to provide absolute legal barriers to the realisation of assets as the beneficial interest (i.e. the real ownership) must transfer to





the child if a gift is to be effective for CAT purposes.

However a parent can install practical safeguards to minimise the likelihood of an ill-judged disposal of assets.

The following options may be of interest:-

Charges

To reduce the risk that the child will dispose of a benefit and dissipate the proceeds a parent can gift most of the value of a property, but require a payment left outstanding on the property as a charge in favour of the parent. Alternatively a parent with a strong banking relationship might look at a commercial mortgage on the property which can be paid by the child (possibly funded by renting a room) and which may be secured by a parent's guarantee (not a gift unless called by the bank).

If a parent gifts a property which is already owned by him, and charged to a bank, the child's gift is the value of the equity. It should be noted that if a commercial loan is involved the bank may have issues in relation to the security offered.

Co-ownership

A parent could acquire or retain a small interest in a property (say 5%) as a co-owner so that most of the value passes to the child. With the parent on title it will be difficult for the child to sell the property or charge it without co-operation from the parent (or a court order).

Private Company Shares

Control of a private company tends to vest in the person

who holds the voting rights and it is possible to carve the voting rights of a private company out into a separate class of voting shares; so that the children can be given value (in the form of ordinary shares) but the parent retains control via the voting shares.

Family Investment Partnership

A family investment partnership is a mechanism to increase overall family wealth while retaining control of decisions in the hands of the managing partner. The partnership agreement can be structured so that control of major decisions relating to the assets, and distributions is in the hands of one particular partner (generally the parent).

The structure allows the family members to participate in the returns from partnership assets, without passing on decision-making control to the children.

It also allows for economies of scale, and increased investment levels as family wealth is pooled for investment purposes.

The transfer of a share in the partnership from a parent to a child, or the "seed capital" to start the investments, would be subject to CAT at the date of transfer.

However the parent can use the tax free threshold to pass the investment "seed capital" to the child, without a tax cost, and the growth in the investment would accrue to the child.

Child Protection; Trusts

If it is clear that a child or other family member will need ongoing protection and should not be given outright control of assets a discretionary trust may be appropriate to secure the benefit (but not the burden) of assets for that child or family member.

There can be a tax cost associated with discretionary trust protection for adult children, but an exemption may be available if the trust is required to protect an incapacitated or improvident child.

Insurance

If it is clear that CAT will arise it is possible to insure against CAT using a "Section 60" life policy. The parent pays the premiums and the life company pay out the proceeds of the policy on death and they are exempt from CAT to the extent that they are used to pay CAT.

Caveat: *These notes are intended as a general guide to inheritance planning. OHT has endeavoured to provide an accurate commentary but the notes cannot cover all circumstances. OHT strongly recommends that formal tax advice be obtained before any steps are taken that may have a tax effect.*