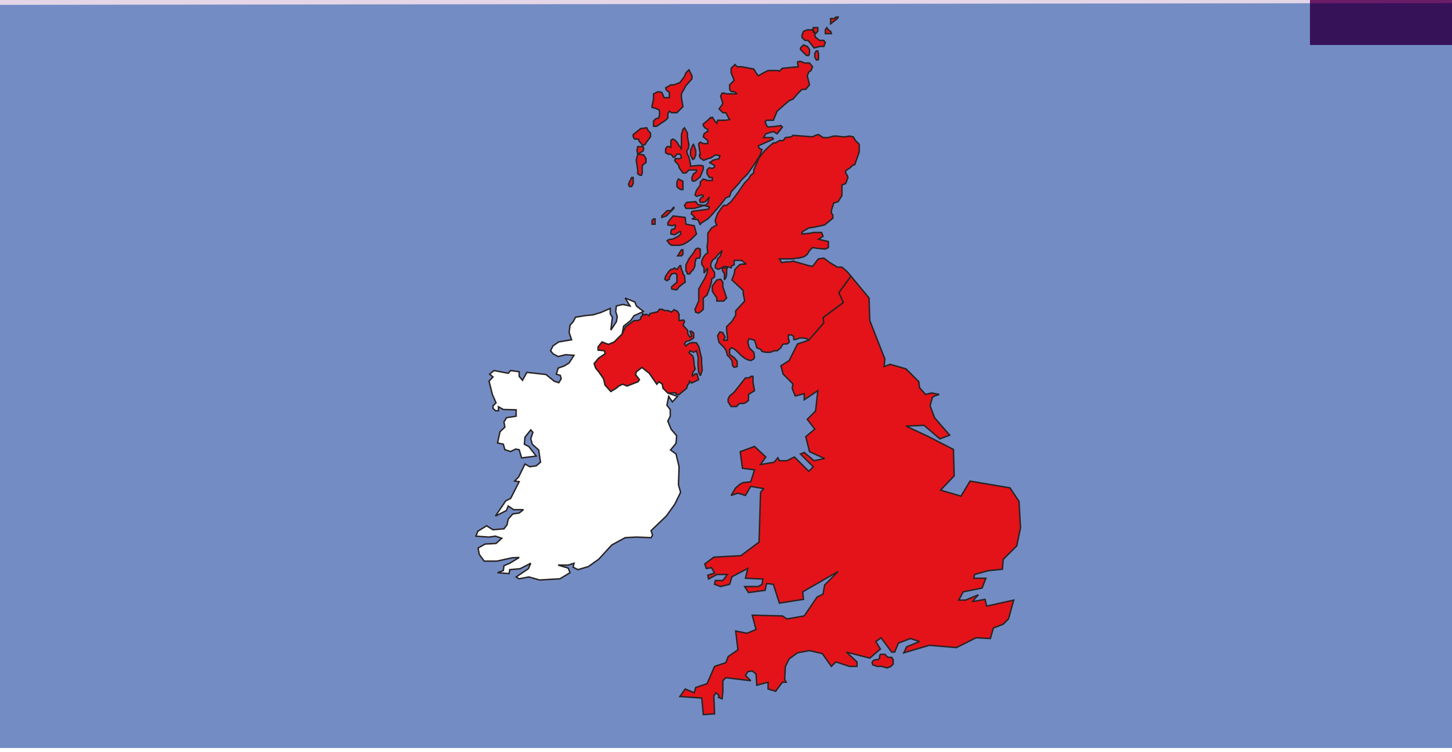

Cross-Border Inheritance Tax in Ireland

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Introduction

The recent review by the European Commission[1] has focused attention on the issues arising on cross-border inheritances, and in particular on the fact that double taxation can occur if more than one country claims taxing rights (in some cases included in the report, the effective tax rate was higher than 70%). The Commission pointed out that the trend in cross-border ownership of assets is also growing massively, and there is also a growth in the level of migration from one country to another. In 2010 more than 12 million EU citizens lived in a Member State other than their home country, which is an increase of three million since 2005.

High rates of cross-border tax tend to arise where two jurisdictions tax an inheritance on a different basis and there is no effective provision for double taxation relief. Ireland has a double taxation agreement (DTA) with the UK covering inheritance taxes (IHT in the UK and CAT in Ireland), and s106 CATCA 2003 provides relief from CAT where a DTA is in place, so at first glance it may appear that there is a low risk of double taxation on cross-border inheritances involving UK IHT in Northern Ireland (NI) and CAT in Ireland (ROI).

However, the two systems of tax take a fundamentally different approach, as IHT is a capital transfer tax and CAT is an acquisitions tax. It follows that the two tax systems do not flow seamlessly beside each other and there are areas where the CAT and IHT treatment does not match, which can result in tax risks that were not anticipated by the taxpayer or his or her advisers.

1 http://ec.europa.eu/taxation_customs/taxation/personal_tax/inheritance/index_en.htm.

One of the major dangers in dealing with cross-border matters is that advisers may be influenced by the approach taken in their own jurisdiction and may not consider the tax position across the border until it is too late, so that opportunities are missed or interest and penalties arise. For example, in NI it is possible to execute a deed of variation relating to a will, which allows the beneficiaries to redistribute the assets of an estate, and after notification to HMRC, the beneficiaries can treat the redistributed assets as coming from the deceased for UK IHT purposes. However, there is no parallel provision in the ROI, so if the deed of variation involves property in the ROI, Revenue may tax it as an inheritance by the original beneficiary and a gift to the final owner (i.e., as a deed of family arrangement). An ROI adviser may not think of using a deed of variation for property in NI, and an NI adviser may not focus on the fact that a deed that is effective for IHT may have a tax cost in CAT terms.

Given the complexity of the two taxation systems, there is a good deal of scope for gaps or overlapping provisions, and this article identifies some (but by no means all) of the key areas where the two systems operate to give different results that may impact on the taxation advice to the client.

In a cross-border case an NI practitioner who is focusing on the IHT rules may miss the CAT deadline for a benefit with a valuation date of the date of death.

Basis for Tax

The two jurisdictions levy inheritance taxes on a different basis, so it is possible for a person to have both taxes arise on his or her worldwide estate. IHT arises on the worldwide assets of donors who are domiciled in the UK, and on all UK assets regardless of domicile. CAT arises on worldwide assets where the donor or beneficiary is resident or ordinarily resident in Ireland, and on all Irish assets regardless of residence. It follows that if a person who is domiciled in NI leaves an estate to a beneficiary resident in the ROI, the worldwide estate will be within the charge to both IHT and CAT.

In addition, IHT has a concept of deemed domicile, so that a person who is not domiciled in the UK shall nevertheless be considered as such if the person either had been resident in the UK for 17 of the previous 20 years or had been actually domiciled in the UK at any time in the previous three years (before adopting a new domicile). These rules apply for IHT (although not for other taxation purposes) even if the person is legally domiciled elsewhere.

Practitioners who are advising on the estate of a person who is domiciled and resident in the ROI, and leaving Irish property to ROI-resident beneficiaries, should bear in mind that if the testator moved from NI shortly before his or her death, the person may be deemed to be domiciled in NI, bringing the entire estate within the charge to IHT.

IHT is a capital transfer tax that is levied on the value of an estate at the date of the taxpayer's death, so the focus of IHT provisions is the date of death. CAT is a capital acquisitions tax that is levied by reference to the valuation date, which is the date on which a beneficiary becomes entitled to call for his or her benefit, or as it is passed to the beneficiary from the estate. In a single estate, there can be a range of CAT valuation dates, depending on each beneficiary's circumstances. A beneficiary who is living in (and therefore in possession of) the property that has been inherited will generally have a valuation date of the date of death, whereas a beneficiary who takes a share in the residue will generally have a valuation date of the date of grant. The date of death is important for CAT as it determines what rate of tax and thresholds apply, but the valuation date is also a key date in that the assets are valued on that date and it triggers the obligation to pay CAT and file the return.

IHT returns should be filed within 12 months after the end of the month in which the deceased died, but the tax should be paid within six months of that date. CAT returns should be filed and the tax should be paid by 31 October following the CAT year in which the valuation date falls. The CAT year runs from 1 September to 31 August, and this can give a very short pay-and-file timeline (as short as two months if the valuation date falls in late August) or a long timeline (up to 14 months if the valuation date falls in early September).

In a cross-border case an NI practitioner who is focusing on the IHT rules may miss the CAT deadline for a benefit with a valuation date of the date of death. If the valuation date occurs late in the CAT year (say, a death in August 2012), the CAT will fall due by 31 October, but the adviser may focus on tax only when the IHT payment deadline is approaching, in February 2013.

ROI practitioners who are focused on the CAT system may wait until the valuation date arises to consider the question of paying

IHT, which will in many cases be after it is due, giving rise to penalties and interest on the IHT.

Example

Tom was ROI domiciled and resident and had assets of €1.5m in the ROI and investments in NI valued at €750,000, which he left to his son David by will. Tom died on 1 September 2011, and the ROI grant of probate issued on 1 May 2012. The CAT will not fall due on the benefit until 31 October 2012. If Tom's executor leaves the process of extracting an NI grant until after the Irish grant issues in May 2012, it will be past the IHT payment deadline of 31 March before the IHT position is considered.

Thresholds and Tax Rates

Taxpayers who are likely to have both IHT and CAT on their estates will generally consider whether one regime is more favourable than the other and whether there is scope for determining which regime applies. It is easier to move in or out of the CAT regime than to move in or out of the IHT net, as it is more difficult to change domicile than to alter tax residence.

There is a single estate tax-free threshold for IHT, with provision that any unused threshold of a spouse can also be used, and the standard rate of IHT is 40%. In 2012/13 the IHT threshold is Stg£325,000 (*c.* €405,000), so the maximum tax-free amount if a spouse's unused tax-free threshold can also be claimed is Stg£650,000 (*c.* €811,000).

CAT is charged at 30%, and each beneficiary taking assets has a separate threshold for CAT purposes, depending on the relationship between the donor and beneficiary. There are three thresholds: Class (a), for benefits received by children of the donor (€250,000 in 2012); Class (b) for benefits received by other close family members of the donor (€33,500 in 2012); and Class (c) (€16,750 in 2012) for all other benefits.

At first glance, it appears that the level of CAT will generally be lower, as the rate is lower and multiple thresholds may be available. In the case of a large family with assets passing to children, the CAT regime gives a better tax position. If there are four children, a taxpayer can pass on €1m free of CAT, but would have an IHT threshold of only Stg£325,000 (*c.* €405,000), or Stg£650,000 (*c.* €811,000) if a spouse's unused tax-free threshold can also be claimed. However, if the benefit is passing to beneficiaries who are not children, the IHT thresholds may operate to give a better tax position. If the four beneficiaries are grandchildren, there will be a total of four Class (b) CAT thresholds (a total of €134,000, or *c.* Stg£107,000), so the UK IHT threshold is more generous.

Dependent Domicile

It is tempting to assume that where legal provisions are common to both jurisdictions, the law will be identical, but this is not always the case. Both the ROI and NI had a common law concept of dependent domicile for spouses, which has been abolished by legislation. In the ROI the relevant Act was the Domicile and Recognition of Foreign Divorces Act 1986, which provided that, after the passing of the Act, the domicile of spouses was to be determined independently. In the subsequent court case of *JW v JW*[2] it was held that the concept of dependent spousal domicile was repugnant to the ROI Constitution and therefore could not have survived the enactment of the Constitution. Therefore in the ROI, each spouse's domicile is determined independently. In the UK the relevant Act was the Domicile and Matrimonial Proceedings Act 1973, which provided that a spouse who had a dependent domicile in place at the date of passing of the Act would retain that dependent domicile until it was displaced by the acquisition of a new domicile.

Example

Barbara, a widow, had an NI domicile of origin but acquired an ROI domicile of dependence on her marriage in 1970. She remained in the ROI for ten years after the death of her husband but then moved to NI because she wanted to be near her family as her health deteriorated. Five years after she moved to NI, she died. Her assets consisted of €750,000 of assets in NI and €500,000 of property in the ROI, all of which passed to nieces and nephews in NI.

An ROI adviser may take the view that the move back to NI revived the domicile of origin, and therefore the entire estate is within the charge to IHT. Revenue will not consider domicile, as CAT is charged on the basis of residence and the location of assets. However, HMRC will be open to the view that the retained ROI domicile of dependence survived the move back to NI, if it can be shown that it was motivated by a need for assistance from the family rather than a desire to return to live in the domicile of

2 [1993] 2 IR 476.

origin. On that basis, the only assets subject to IHT would be the NI assets (€750,000), which would be under the available estate threshold of Stg£650,000 (c. €811,000), as Barbara's husband's IHT threshold can be transferred.

Spouse and Civil Partner Reliefs

Married couples and registered civil partners are allowed to pass assets to each other during their lifetime or when they die without having to pay IHT, provided that both spouses are domiciled in the UK. However, the relief does not apply (apart from the first Stg£55,000 of value transferred) where the spouse/civil partner receiving the benefit is not domiciled in the UK and the spouse/civil partner providing the benefit was domiciled in the UK.

CAT spouse relief applies to all spouses, regardless of domicile, and there is a parallel relief for civil partners, which also applies regardless of the receiving civil partner's domicile.

ROI practitioners may assume that, once spouses are married, there is no need for tax planning regarding the transfer of assets from one to the other, as the spouse exemption will apply. This is a dangerous assumption if only one of the spouses is NI domiciled or if either may be deemed to be domiciled there.

Example

Paul and Sarah married in 2005; Paul is NI domiciled, and Sarah is ROI domiciled. If Paul dies and leaves his assets to Sarah, no CAT will arise because of spouse relief, but the inheritance will be subject to UK IHT.

The position is complicated by the UK deemed domicile rules, which can impose an artificial domicile over the legal domicile of one spouse. If a couple come from the ROI but live in NI for a few decades before retiring to the ROI again, they can acquire a deemed NI domicile. If they both do this at the same time, there is no IHT issue. They are both legally domiciled in the ROI, and both are deemed to be domiciled in NI for IHT purposes, so IHT spouse relief will apply. However, if one spouse moved to NI first, there can be a few years in which one spouse has a deemed NI domicile but the other does not. If the spouse who is deemed to be domiciled in NI dies in these years, the estate will be subject to IHT.

Example

Mary and John are ROI domiciled but lived in NI for many years. John moved there to work in 1990, and Mary moved there after she and John married in 1998. In 2012 John retired, and they followed their long-term plan of moving back to the ROI. Between 2012 and 2015 John will be deemed to be domiciled in NI (having been resident for 17 of the last 20 years) and will be legally domiciled in the ROI. However, Mary will not have acquired a deemed NI domicile as she has lived there for only 14 years. Legally, the spouses are domiciled in the same jurisdiction, but the deemed domicile rules result in a mismatch, so John's estate will be within the charge to IHT on any gift from John to Mary (in excess of Stg£55,000) if he dies between 2012 and 2015.

Looking Back to Prior Gifts

For IHT purposes, any gifts made to individuals will be exempt from IHT as long as the donor lives for seven years after making the gift, as it will be a "potentially exempt transfer" (PET). However, if the donor dies within seven years of making a gift and the gift is valued at more than the IHT threshold, IHT will need to be paid on its value, by the person receiving the gift or by the representatives of the estate. If the donor dies between three and seven years after making a gift and the total value of gifts made is over the threshold, any IHT due on the gift is reduced on a sliding scale by taper relief.

Any gift made is subject to CAT in the same way as an inheritance would be, with the beneficiary having the benefit of the relevant class threshold. However, there is a small-gift exemption of €3,000 that can be deducted from gifts, and taxpayers need to consider the aggregation rules. Prior benefits received since 5 December 1991 that are in the same class threshold need to be deducted from the tax-free threshold to ascertain the available threshold. Once the total of prior benefits exceeds the tax-free threshold, there is no available threshold, and the entire benefit will be subject to CAT at 30%.

Valuation of Assets

Assets are valued for IHT purposes on the date of death, and assets are valued for CAT purposes on the valuation date. However, in both jurisdictions, CGT is levied on the basis that the value at the date of death is the base cost, and any rise in value of the assets between that date and the date of sale will be subject to tax. It follows that in NI there cannot be any double taxation on the sale of an estate asset in the course of administration as the value up to the date of death will be subject to IHT and any increase in value after that date will be subject to CGT. However, CAT is charged on the value at the valuation date, so double taxation can arise in the ROI if an asset is disposed of after the valuation date and there is a rise in the value of the asset between the date of death and the valuation date, as that value will be subject to both CAT and CGT. As the taxes arise on different events, the CGT cannot be set against the CAT under s104 CATCA 2003.

In NI there is provision for adjusting the IHT paid if there is a fall in value, within four years for property and within one year for stocks and shares, after the date of death. However, if an application is made for this relief, so that the value on which IHT is charged is brought down, the lower value replaces the value at the date of death as the CGT base cost, so that both taxes remain synchronised. By contrast, the CAT legislation does not make any provision for relief reflecting a post-valuation date change in the value of the inherited assets.

Timeline for Instalment Arrangements

In NI an IHT instalment arrangement is provided for by statute in relation to certain property (land and buildings, certain shareholdings and business interests), allowing tax payments to be spread over ten years. There is also provision for paying CAT by an instalment arrangement, but this can be set up only by agreement with Revenue in the form of monthly payments that are allowed for a maximum of five years.

Variation of Estates

As mentioned above, in NI it is possible for the beneficiaries of a deceased to enter into a deed of variation and redistribute the estate of the deceased. If the deed complies with the conditions of the relief, the redistribution is treated, for IHT purposes, as a provision made by the deceased in place of his or her will.

There is no parallel relief from CAT. Beneficiaries who receive benefits within the charge to CAT and who want to redistribute the estate have to rely on the options of disclaimer (i.e., refusing to accept the benefit) or deed of family arrangement (treated from a taxation perspective as an inheritance followed by a gift, both of which may give rise to tax).

It is possible for a deed of variation to be executed for IHT purposes that affects assets that are subject to CAT. For an NI testator with assets passing through his or her estate that include a property in Dublin, there will be an asset within the charge to CAT. The beneficiaries may opt to enter into a deed of variation to redistribute the estate, which includes a change in the beneficiary taking the Dublin property. It is not clear how the Irish Revenue will approach a deed of variation, as there is no ROI equivalent. The deed of variation has an effect that is similar in many ways to a deed of family arrangement (as the beneficiary who took the asset is agreeing to redistribute it), and if Revenue follows this analysis, the transaction will be taxed as an inheritance followed by a gift. However, this will result in a mismatch in tax treatment between the two jurisdictions.

The authors understand that, in some cases, Revenue may be willing to consider following the UK treatment and treating the estate as if the provisions of the deed of variation were made by the deceased. In any case, where a deed of variation is contemplated involving assets that are within the charge to CAT, the tax position should be confirmed with Revenue.

Conclusion

Where a taxpayer is considering inheritance tax and there is a cross-border dimension due to movement of the taxpayer or family members from one country to another, or the acquisition of assets abroad, great care needs to be taken. There are some clear and fundamental differences between the tax laws of the two jurisdictions, but advisers should also bear in mind that some areas where the law looks similar at first glance may prove to have hidden pitfalls.