OHT Guide

Discretionary Trust Tax

Discretionary Trust Tax ("DTT") is charged on discretionary trusts, which are essentially trusts which have beneficiaries who are not beneficially entitled in possession to the trust fund, but who are entitled to be considered as beneficiaries if the trustees decide to appoint assets from the trust.

The Revenue Manual indicates that:

> "*the distinguishing feature of a discretionary trust compared to a strict settlement is that, neither any one of the objects of the trust in whose favour the discretion might be exercised, nor the class of beneficiaries as a whole, is entitled, as of right, to any capital or income of the trust, except when the trustees appoint property out to them.*
>
> *Each object of the trust has merely a hope or expectation that the trustees may exercise their discretion in his or her favour*".

The definition of discretionary trust for tax purposes is wider than the legal definition as it includes trusts in which the income can be accumulated (if there is a discretion on paying the income out or not).

Finance Act 2012 extended the scope of Discretionary Trust Tax to cover "foundations" and similar entities (which are the European equivalent of trusts).

Revenue Manual Note re Foundations

Section 111 F.A. 2012 extends the 6% initial charge and the 1% annual charge to any entities, for example, foundations, which are similar to discretionary trusts irrespective of how such entities are described in the places where they are established. A foundation is any legal entity, wherever established, to which an individual transfers property. Examples of foundations are entities known as anstalts and etablissements in Liechtenstein and foundations, stiftungs, anlagestiftungs and familienstiftungs in Switzerland.

CAT arises when a beneficiary becomes entitled to a benefit, so if assets pass into a discretionary trust this has the effect of deferring the CAT payment until the asset is appointed from the trust to the beneficiary (S. 31 CATCA03).
While the asset is held in the trust the trustees may be liable to DTT on the capital value of the trust fund. In effect DTT is the price paid for deferring the CAT charge.

There is an initial charge which arises at a rate of 6% on the capital value of the trust fund, on the day the trust becomes subject to the tax. This can be reduced to 3% if the assets of the trust are absolutely appointed to beneficiaries within 5 years.

If some person is beneficially entitled in possession to an asset of the trust (for example if a life interest is created in part of the trust fund) the asset involved is not treated as being subject to a discretionary trust.

S.15 CATCA 03 deems the trustees to take an inheritance of the trust fund on the occurrence of the latest of 3 possible events. The tax is 6% (3% up to 11 April, 1994) of the taxable value of the trust fund.

The tax trigger is the latest of 3 dates:-

1. the date on which the property becomes subject to the discretionary trust,
2. the date of death of the disponer, or
3. the date on which there is no principal object of the trust who is under the age of 21 years (25 years up to 31 January 1993).

Principal objects are defined in S. 14 CATCA 03 as the spouse and children of the disponer, and the children of any predeceased child of the disponer.

This definition has been expanded to include families based on registered civil partnerships.

DTT is due for payment within four months of the valuation date, and interest starts to accrue on unpaid DTT from the following 01 November.

Exempt Protective Trusts

The legislation recognises the fact that in many cases discretionary trusts have no taxation motivation but are set up to protect a vulnerable beneficiary.

One common example of this is the practice of using a discretionary trust in a Will if the testator has a young child, as the trustees may need substantial discretion to deal with the changing needs of the child as he grows up. In addition if a parent has a child who is incapacitated a discretionary trust will normally be the preferred choice when making provision for that child.

S. 17 CATCA 03 lists certain types of exempt discretionary trusts which include:-

1. Trusts for public or charitable purposes, and

2. Trusts set up for one or more named individuals incapable of managing their own

affairs because of age, physical, mental or legal incapacity.

It is important to note that where a trust is exempt from discretionary trust tax because the named beneficiary is a minor the exemption will cease once the minor is 18. If there is more than one minor beneficiary the exemption ceases to apply when the oldest reaches 18.

This initial charge is followed by an annual charge of 1% arising every 31 December during the "life" of the trust (except in the 12 months following the initial charge). The annual 1% charge arises on the capital value in the trust fund on the 31 December liability date.

S. 24 provides the trustees with the option of agreeing a market value of certain trust assets (real property or private company shares) with the Revenue Commissioners for three years at a time, provided that meanwhile there is no change in the trust funds.

DTT paid by the trustees is not available as a credit against the CAT due by the beneficiaries on receipt of distributions from the trust.

Discretionary Trust Tax ("DTT") post FA12

The Finance Act 2012 provisions that affect discretionary trusts came into effect on 08 February 2012, and once these provisions apply a discretionary Will trust is to be treated for DTT purposes as constituted from the date of the disponer's death.

This effectively reverses the judgment in the Irvine case (Revenue Commissioners v Cedric Christie & Others) which pushed the trigger for discretionary trust tax back to the date on which the trust could be constituted, which was normally the date of Grant for a trust over the residue of an estate (on the basis that this was the date on which the assets passing to the trust could be identified).

Charges Triggered Earlier

The initial charge to DTT (6%) is paid on the valuation date, and this provision has not been amended. It follows that post FA12 the 6% charge will arise on the death, but will not fall due for payment until the level of the residue can be established and the trust is constituted.

The trigger date for the 1% annual charge has also been linked to the date of death, so the 1% charge will arise each year in the course of administration, but the valuation date provisions have not been amended so that the 1% annual charges should not be payable until the valuation date for the initial 6% charge occurs.

It follows that if the administration of the estate cannot be completed for some reason (e.g. the issue of S. 117 proceedings by a child of the deceased) the 1% charge can be accumulating while the administration is going on and if there is a delay of 4 - 5 years between the death and the constitution of the trust the DTT cost on constitution could be circa 10% consisting of the 6% initial charge and 4 x 1% annual charges.

Refund Period Starts Earlier

There is a 50% refund of the initial DTT paid, if the trust is fully distributed within 5 years of a relevant date. Prior to Finance Act 2012, this period ran from the date the trust was constituted in the case of a trust set up by a Will.

Post FA 12, this period runs from the date of death and if the period of administration is lengthy for some reason (for example if the administration is delayed by litigation) this could give rise to a scenario where the refund is not attainable as the relevant period has run out by the time the trust is constituted.

Starting Point for FA12 Legislation

The Finance Act 2012 provides that the changes to DTT came into effect on 08 February 2012. However the Revenue clarified in the CAT manual that the new provisions only apply where a person died on or after 08 February 2012.

Revenue CAT Manual Part 5 - When do the F.A. 2012 Amendments to Discretionary Trust Tax come into effect from?

The new discretionary trust taxes provisions apply in the case of discretionary trusts created by a person's Will where that person died on or after 8 February 2012.

If tax advice is required on any point raised in this article an email can be sent to info@ohanlontax.ie.