

#### 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 2011 the threshold would be €332,084 (class (a) 2011). By contrast if a parent received a benefit from a child on the same date the threshold will only be €33,208 (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 5 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 25% on the excess if the value of the benefit over the available threshold. If a child received a gift of €100,000 from a parent in 2011 then this uses up €100,000 of the class (a) threshold of €332,084 and the available threshold to shelter future benefits will be €232,084.

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

An 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 2010 may result in a lower tax cost than a future inheritance of the same asset (if values or tax rates rise).
5. The current rate of CAT (25%) is relatively low and may rise in the future so benefits passing now may have less tax.

#### 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. A parent can buy a property for the benefit of a child. Ownership of the property remains with the parent for 3 years, after which it can be passed to the child. For relief to apply the dwelling must be occupied by the child as his or her principal residence for the 3 years.

No CAT arises on the gift if all the conditions of the relief are met. These include (for example) a condition that the child must not be entitled to an interest in any other residence, and must retain the dwelling as a principal residence for 6 years (subject to certain provisions for replacements).

In addition, if the house is also the donor's principal residence, he must be over 68 or have been dependant on the beneficiary for the 3 years up to the date of the gift, if relief is to apply.

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. However there is an Appeal Commissioner's case which indicates that if the second residential property was taken in the same inheritance as the principal dwelling house then relief may still be available.

*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.