

Big CATs and new Acts

AILEEN KEOGAN PROVIDES AN OVERVIEW OF THE IRISH DISCRETIONARY TRUST TAX REGIME, INCLUDING THE *FINANCE ACT 2012*



Since the Irish *Finance Act 2012*, it is now more important than ever to carefully manage an Irish estate that provides for a discretionary will trust. Delays in the estate before the trust assets are transferred to the trustees can result in the accumulation of taxes that might otherwise have been avoided.

The *Finance Act 2012* has also extended the definition of discretionary trusts for Irish discretionary tax purposes to entities similar to discretionary trusts, e.g. Jersey foundations, Swiss *stiftungs* and Liechtensteiner *anstalts*.

Territoriality rules for discretionary trusts

Gifts or inheritances taken before 1 December 1999 were generally taxable based on the domicile of the donor at a particular time (for instance when a discretionary trust was set up, when a benefit was appointed from a discretionary trust or on the death of the donor). Where assets in the discretionary trust were set up by a non-Irish domiciliary and were Irish-situated, such assets were also taxable. These 'old rules' of domicile continue to apply to trusts set up before 1 December 1999.

Since 1 December 1999, a discretionary trust, whether an Irish trust or one based offshore, is within the charge to capital taxes in Ireland in the following instances:

- If the donor is resident or ordinarily resident in Ireland at the date of the disposition (both gifts and inheritances).
- If the donor is resident or ordinarily resident in Ireland at the date the benefit is taken (gifts only).
- If the donor is resident or ordinarily resident in Ireland at the date of death (where the benefit is taken after the donor dies) (gifts only).
- If the beneficiary is resident or ordinarily resident in Ireland at the date of the benefit (both gifts and inheritances).

Otherwise, whatever assets are situated in Ireland at the date of the benefit are subject to gift tax and whatever assets are situated in Ireland and appropriated to an inheritance are subject to inheritance tax.

Therefore the domicile of the donor is no longer relevant in most instances. Residence of either the donor or the beneficiary has been the crucial factor for trusts set up since 1999.

Gift tax and inheritance tax

The rate of gift and inheritance tax in Ireland is 30 per cent after thresholds are applied. The threshold applicable is determined by the relationship between the donor and the beneficiary. While lifetime transfers are possible, because both gifts and inheritances aggregate in calculating the thresholds, a gift does not always produce an Irish tax saving.

Ireland has formal double taxation treaties only with the UK (inheritances only) and the US, but there is some provision for unilateral relief from double taxation. Care must be taken in matching when the taxes are triggered in Ireland to avail a client of any double-taxation relief.

Gift tax and inheritance tax (together known as capital acquisitions tax – CAT) arise when a benefit is taken. Therefore, until an appointment is made or is deemed to have been made from a discretionary trust, no CAT arises.

Discretionary trust levies

Where a discretionary trust is created either during the donor's lifetime or under their will and the trust is within the Irish charge to tax, discretionary trust levies may arise in addition to the mainstream CAT.

Discretionary trusts are widely defined. A discretionary trust is created where income can accumulate or where discretion is retained over who is to benefit from the income or capital. The

“Where a discretionary trust is created by a will, the property becomes subject to the trust **at the date of death**”

definition of a discretionary trust has been extended under the *Finance Act 2012* to include entities similar in effect to a discretionary trust (irrespective of how such entities are described in the places where they are established). For instance foundations, *anstalts* and *établissements* in Liechtenstein and foundations, *stiftungs*, *anlagestiftungs* and *familienstiftungs* in Switzerland are all now to be treated as discretionary trusts under Irish capital-tax rules.

Discretionary trust levies arise by deeming the trustees to have taken a benefit for inheritance tax purposes on the death of the donor. Therefore the territoriality rules mentioned above apply in determining when a foreign discretionary trust may be subject to Irish discretionary trust levies by treating the trustees as a beneficiary.

An initial levy of 6 per cent of the capital value of the assets in the trust generally arises on the creation of a discretionary trust. An annual levy of 1 per cent arises on 31 December each year so long as that trust remains discretionary. The annual levies do not arise until after the initial levy has arisen. If the entire trust is wound up within five years of the death, the 6 per cent initial levy can be reduced to 3 per cent.

The levies do not arise until there are no principal objects (usually the children of the donor) under the age of 21 in the trust and, in the case of lifetime trusts, the settlor has died. There are exemptions to the levies under certain conditions.

The Finance Act 2012 and administration of estates with discretionary trusts

The *Finance Act 2012* has introduced a date-of-death trigger for the discretionary trust levies in respect of discretionary trusts created under a will or codicil of a deceased. The effect of this change is that any delay in administering the estate can result in additional annual levies accumulating and possibly also a denial of the refund of 50 per cent of the initial levy. This legislation reverses the effect of an Irish High Court decision from 2005 (*Revenue Commissioners v Executors and Trustees of Irvine, Christie and others (In re Irvine Deceased)* [2005] No 172R High Court, Laffoy J) that related to the point in time at which the discretionary trust levies are initially triggered.

The case of *In re Irvine Deceased* held that, as no assets were vested in the trustees until the ascertainment of the residue, there was no charge to the initial levy until that date. In accordance with s20 of the *Capital Acquisitions Tax Consolidation Act 2003* the property was therefore not subject to the discretionary trust until the extent of the residue was ascertained. The chargeable date for the initial levy was the date of the ascertainment of the residue. Only after that date would the annual levies arise.

This case was welcomed at the time as it reflected the practical reality that there is often a long administration period in an estate, e.g. where there was litigation in the estate or complicated assets to deal with. The

case ensured that levies would not accumulate for that administration period.

However, the *Finance Act 2012* has now reversed the effect of that decision for deaths on or after 8 February 2012. Now where a discretionary trust is created under a will (or codicil) of a deceased person, the property is deemed to become subject to the trust at the date of death of the deceased. The date of death is therefore the chargeable date for the initial levy and thus the annual levies arising after that.

The change applies to all discretionary trusts created under a will (or codicil). Therefore a specific legacy of assets into a discretionary trust will also be charged with the levy at the date of death.

The legislation as drafted appears to capture discretionary trusts that are created under wills, but that are not intended to come into effect until after a prior interest in possession has expired. However, Revenue has confirmed through the Tax Administration Liaison Committee, followed by a Revenue e-briefing, that no charges to discretionary trust tax arise while a person is beneficially entitled in possession to a limited interest in the trust property.

Reassuringly, although the charge arises at the date of death, the valuation date for the payment of the tax remains the same (for trusts of the residue that is usually the date of ascertainment of the residue). Therefore, although the levies may be accumulating, they will not be payable (and interest for late payment will not therefore arise) until after the trustees have retained assets from which they can pay the relevant charge.

Practical effect

The *Finance Act 2012* change will have an impact on the management of estates where discretionary trusts are involved. If it takes several years to administer an estate, annual levies will accumulate during those years.

When faced with an Irish estate that provides for a discretionary trust, practitioners should administer it in a timely manner, to minimise the accumulation of levies.

In addition, the executors may wish to inform the trustees that levies might accumulate so that the trustees can seek advice on how best to minimise such levies, in particular bearing in mind that the cut-off date for the refund of half of the initial levy remains five years from the date of death.

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