TRUSTS AND IRISH TAX IMPLICATIONS

FACTSHEET

Take the steps to protect your family wealth

Find out how UHY FDW can assist your business

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Overview

Family trusts can assist greatly in succession planning for the family business and protecting family wealth for future generations as well as offering a large degree of flexibility in providing for young children, beneficiaries with disabilities or vulnerable adult beneficiaries.

There are three broad categories of trusts for Irish tax purposes being Bare, Fixed or Discretionary trusts.

A bare trust (sometimes known as a simple trust or nomineeship), is one where the beneficiary(s) has an immediate and absolute right to both the capital and income of the trust and the Trustee(s) has no discretion over the assets held in trust. The trustee of a bare trust is a mere nominee in whose name the property is held and must follow the (lawful) instructions of the beneficiary(s) in relation to the assets held in trust.

In a fixed trust, each beneficiary has a fixed entitlement to a specific share or interest in the trust property. The entitlement may not necessarily be immediate but rather the beneficiary may be entitled to the property after a specific time period (known as "a period certain") has passed, on the death of a person who has an interest in the property for the duration of their lifetime or otherwise.

A discretionary trust is one where the trustees are responsible for the administration of a trust and its assets for the benefit of one or more of the trust's beneficiaries. Unlike other types of settlement, the trustees have the absolute discretion as to how to use the trust's income and to utilise, i.e. provide benefits, or distribute (appoint) the trust's capital and income to beneficiaries and the conditions, if any, they may impose on the recipients.

It is important to understand the concept and differences between each of the different types of trust as the tax treatment and the tax implications for all parties involved in a trust can vary depending on the type of trust involved.

Best Advice, Better Results

1. Irish Income Tax ("IT")

The Trustees

1.1 The IT position regarding a trust is determined by the tax residence of the Trustees, such that:

(a) If all of the Trustees are Irish resident, then any worldwide income of the trust will be liable to IT; or
(b) If all the Trustees are not resident in Ireland, then the Trustees will only be liable to IT on any Irish sourced income[1].

1.2 Trustees will pay IT at the Irish Standard Rate of 20%[2] and have no entitlement to credits, reliefs or allowances as apply to individuals. However, Trustees are not subject to USC or PRSI in relation to trust income.

1.3 In addition an IT surcharge of 20%[2] will apply to any income accumulated in certain trusts which has not been distributed within 18 months of the end of the tax year (calendar year) in which the income arose[3].

1.4 Income which has been treated as income of any person other than the trustees is excluded from the surcharge.

1.5 The usual income tax return deadlines and filing requirements that apply to individuals apply equally to trustees.

The Beneficiaries

1.6 If a beneficiary of a trust is absolutely entitled to the income[4] then the trustees are not assessable to IT and Irish Revenue will assess the beneficiary on the income directly.

1.7 Where a beneficiary is absolutely entitled to income as it arises, a trustee's expenses are not deductible against the income of the beneficiary.[5]

1 See Dawson V CIR [1989] STC 473
2 Section 805(3) Taxes Consoidation Ac 1997 ("TCA 1997") & Ssection 15(1) TCA 1997
3 Section 805(3) TCA 1997
4 Such a beneficiary (known as a life tenant) is deemed to have what is called an "interest in possession"
5 See Lady Miller v IRC (1930) 15 TC 25

2. Irish Capital Gains Tax ("CGT")

The Disponer

2.1 When a person creating a trust, known as a Disponer[6] in Ireland (a Settlor in the UK) creates a trust during his/her lifetime, he/she will transfer assets to the trust and these will form the basis of the trust's "Trust Fund".

2.2 Depending on the type of assets transferred to the trustees, CGT may arise[7]. CGT is assessed on the market value of the asset(s) transferred (gifted) to the trust[8].

2.3 If the market value of the asset gifted is greater than the original acquisition cost (value) to the Disponer, then CGT could arise. No CGT will arise, however, where cash (euro currency) is transferred to the trust by the Disponer.

2.4 If the trust is created by a Will, becoming operational on death, then no CGT arises[9] on the initial creation of the trust as the trustees will inherit the assets at their open market value at the date of death of the Disponer[10]. This is the base cost for any future disposal of the trust asset(s) concerned.

The Trustees

2.5 Whether CGT arises on trust assets primarily depends on the residence and ordinary residence status of the Trustees.

2.6 Generally speaking, if the majority of the Trustees are resident and ordinary resident in Ireland and the general administration[11] of the trust is carried out in Ireland[12], then the Trustees will be liable to CGT on the trust's worldwide gains[13].

2.7 If the majority of the Trustees are not so resident or ordinarily resident in Ireland, then the Trustees will only be liable to Irish CGT on gains arising on the disposal of specified assets[14], namely:

(a) Land and buildings in Ireland;
(b) Minerals in Ireland including related rights such as exploration and exploitation; and
(c) Unquoted shares deriving their value or the greater part of their value from (a) and (b) above.

2.8 Apart from selling or disposing of assets[15], Trustees will be deemed to have disposed of assets for CGT purposes in the following situations:

(a) Where the Trustees cease to be resident or ordinary resident in Ireland (migration)[16]; or
(b) Where a beneficiary becomes absolutely entitled to trust assets save on cessation of a life interest as above, for example "to B on reaching 25", when B reaches 25, the trust may be liable to CGT on the rise in value of the trust assets during the intervening years[17].

If any of these events occur, then the trustees are deemed to have disposed of and reacquired the assets at their open market value.

2.9 Where a life interest ends and the trust fund continues to remain in the trust no CGT arises[18]. An example of which would be "to A for life remainder to B", then on A's death, the trust assets belong to B, and the Trustees must vest the assets in B, but this does not trigger a CGT event.

2.10 It is important to note that Trustees do not qualify for the annual CGT exemption of €1,270 that an individual may claim[19].

The Beneficiaries

2.11 If CGT arises, then it may be credited against any capital acquisitions tax which may be payable by the beneficiaries of the trust who

6 Section 2 Capital Acquisitions Tax Consilidation Act 2003 ("CATCA 2003")
7 Section 575 TCA 1997
8 Sections 549(1) & 10(1) TCA 1997
9 Section 573(2) TCA 1997
10 Section 573(2) TCA 1997 & Section 26 CATCA 2003
11 Not defined in legislation. Guidance available at paragraph 19.3.4.4 of Revenue CGT Manual
12 Section 574(1)(a) TCA 1997
13 Sections 574 & 29(2) TCA 1997

14 Section 29 TCA 1997
15 Section 568(1) TCA 1997
16 Section 579B TCA 1997
17 Section 579A TCA 1997
18 Section 577 TCA 1997
19 Section 568(2) TCA 1997

inherit the assets on cessation of the trust[20].

3. Irish Stamp Duty ("SD")

The Trustees

3.1 SD may be payable on the lifetime transfer by a Disponer of assets into a trust[21].

3.2 If the transfer comprises residential property then SD of 1% on the first €1 million consideration (2% on any balance) will be payable and this will rise to 6% if the transfer is of commercial property[22].

3.3 If cash is transferred (gifted), no SD duty applies.

3.4 If property can lawfully be vested in trustees without the need for written instrument (e.g. paintings, jewellery) no SD will arise.

3.5 No SD will apply to assets transferred to a trust created under a Will[23].

The Beneficiaries

3.6 Where correctly structured, appointments of assets to beneficiaries in accordance with the terms of the trust should not give rise to SD[24].

4. Irish Capital Acquisitions Tax ("CAT")

The Disponer

4.1 CAT applies to gifts and inheritances.

4.2 There is no CAT on the transfer of assets to a trust by the Disponer, as the legal title to the assets vested into the trust have not yet passed to the beneficiaries.

The Beneficiaries

4.3 Where a beneficiary receives assets/benefits from the Trustees, they are taxed as if the transfer/benefit had been given to them by the Disponer/ deceased.

20 Section 104 CATCA 2003
21 Section 30 Stamp Duties Consolidation Act 1999 ("SDCA 1999")
22 Schedule 1 SDCA 1999
23 Section 113(c) SDCA 1999
24 Section 30(5) SDCA 1999

4.4 Where gifts and inheritances exceed the following CAT thresholds to any person (beneficiaries) falling within the following groups:

(a) Group A: children, minor children of predeceased child, parents inheriting absolute interest from child: €320,000;
(b) Group B: grandchildren, brothers, sisters, nieces and nephews: €32,500; and
(c) Group C: everyone else: €16,250,

a liability to CAT at a rate of 33% will be levied on the excess.

4.5 It should be noted that CAT is a lifetime tax, so any previous gifts or inheritances received since the 5th December 1991 may reduce or consume the entire tax-free threshold.

4.6 CAT will arise in the following situations[25]:

(a) If the beneficiary is resident or ordinarily resident in Ireland on the date the benefit is received;
(b) If the Disponer is resident/ordinarily resident either:
(i) at the date of setting up the trust; or
(ii) on the date the beneficiary receives the benefit;
(c) Where the Disponer is resident/ ordinarily resident at the date of death, CAT will arise on any benefit taken on his/her death; and
(d) Where assets are situated in Ireland.

4.7 A foreign domiciled person will not be deemed resident for CAT until they have been resident in Ireland for five continuous tax years[26].

4.8 Distributions from a trust can give rise to both an IT and CAT liability in some circumstances for beneficiaries. Distributions can be classed as capital or income in nature and the character of the payments in the hands of the beneficiary will determine the tax consequences[27]. The nature of distributions has been the subject of case law in the past. Regular or periodic distributions to a beneficiary are indicative of being income in nature and therefore can be both subject to IT and CAT (as opposed to capital in nature and subject to CAT only). A Revenue concession exists where CAT is chargeable on the net benefit received, i.e. the net after tax amount.

25 Section 6 & 11 CATCA 2003
26 Sections 6(4) & 11(4) CATCA 2003
27 In the case of the trustees of the Will of HK Brodie (deceased) v CIR it was determined that the payment of capital can be treated as income, if they come into the hands of beneficiary as income.

4.9 The income from the trust is broken down into the actual sources from which it has arisen. Thus, Irish rental income would be taxed in the individual's name under Schedule D Case V, foreign rental income under Schedule D Case III, etc[28].

4.10 If a beneficiary has a contingent interest in the income, i.e. no right to the income until a future event, or the Trustees have the power to accumulate income, the Trustees are subject to income tax while the income remains within the trust. The additional 20% surcharge may arise on such undistributed income.

4.11 If income is passed to a beneficiary upon which IT tax has already been assessed on the Trustees, the beneficiary can claim a credit for the tax already paid by the Trustees and the income is re-grossed up in the hands of the beneficiary and assessed in the normal manner[29]. The Trustees should provide the beneficiary with a form R185 (which shows the 20% tax paid by them) and the beneficiary will then receive a credit for the tax paid.

4.12 If the income is not paid to the beneficiary, but is applied for his or her benefit by the Trustees, e.g. for maintenance, education etc., this amount is treated as the beneficiary's income.

28 See Williams v Singer [1921] 1 AC 65
29 Section 59 TCA 1997

5. Discretionary Trusts

5.1 In a discretionary trust those persons able to benefit from the trust as prescribed by the Disponer (collectively known as the Class of Beneficiaries) are identified. However, it is the Trustees of the trust who have the discretion as to which beneficiary(s) should receive any income, capital or other benefits. For further information on the trust law aspects of discretionary trusts please refer to the Frequently Asked Questions section or Articles on UHY Trust and Corporate Services Limited website.

5.2 From a tax perspective, discretionary trusts can potentially allow a situation to arise in which no beneficiary ever becomes "beneficially entitled in possession" to a trust asset thereby resulting in a potentially indefinite deferral of a CAT charge. To address this, discretionary trust tax in the form of a once off initial levy of 6%[30] and thereafter an annual levy of 1%[31] of the value of the assets in the trust, was introduced (see section 6 below for further details).

6. Discretionary Trust Tax ("DTT")

6.1 DTT only arises where the Disponer is deceased and the principal objects[32], i.e. the beneficiaries, of a trust, being children of the Disponer or children of a predeceased child of the Disponer, are aged 21 or over[33].

6.2 The initial DTT charge of 6% is therefore generally payable on the later of the death of the Disponer or on the date on which the last principal object of the trust (if any) reaches 21 years of age. The trustees are the persons primarily accountable for the payment of any DTT[34].

6.3 If the trust is wound up such that the trust fund of the trust is appointed out of the trust within five years of the payment of the initial 6% charge, a refund of 50% of the amount paid is available[35].

6.4 If the trust is created under a Will, and all of the beneficiaries are over 21, then the liability to DTT arises on the later of either the date of death or the date the property becomes subject to the terms of the trust. The executors of the estate of the deceased have four months to settle the DTT payable[36].

6.5 There is an annual DTT charge of 1% where the trust remains in being and this is calculated on the value of the trust on the 31st December each year[37]. The trustees are similarly the persons primarily accountable for the payment of this DTT charge.

6.6 There are a number of exemptions from the DTT tax[38]. These include trusts that are set up exclusively for:

(a) People with certain disabilities;
(b) Public or charitable purposes; and
(c) Approved superannuation schemes.

6.7 The initial and annual DTT charge will not arise if one or more of the beneficiaries of a trust are given a non-revocable life interest in the trust for a period of 5 years or more.

7. Fixed Trusts

7.1 In a fixed trust, the entitlement of the beneficiaries to the income or capital of the trust is fixed by the Disponer.

A Life Interest/Tenancy

7.2 A life tenant is a person who currently holds a life interest in trust property. In other words, he or she currently has a present right to the income or enjoyment of some or all of the trust assets (for example, the right to live in a house owned by the trust) but has no interest in the underlying asset).

7.3 CAT arises when a beneficiary becomes "beneficially entitled in possession" to trust property. This means in the case of a trust that present rights to the enjoyment of property to a life tenant are liable to CAT immediately. The liability to CAT is based on a multiplying factor related to the beneficiary's age and gender at the time they become beneficially entitled in possession to the property.

7.4 In contrast, a future interest to trust property is not liable to CAT until an event happens (such as the death of another person) whereby this future interest becomes a present interest.

7.5 As set out above, income that the beneficiaries of a trust are entitled to receive as it arises and which is mandated and paid directly to those beneficiaries (rather than accumulated within the trust) is not assessable on the Trustees; it is taxed in the beneficiaries' hands and can be subject to both IT and CAT (depending on the nature of the payment).

7.6 It is common, where a beneficiary has an interest in possession in a fixed interest trust, that the Trustees may have a discretionary power to appoint capital from the trust fund to the life tenant.

7.7 For CAT purposes, the power to appoint capital is treated as a contingency. Where there is a contingency, it should be ignored for CAT purposes unless or until the event happens and in such circumstances the life tenant is taxed on what he or she receives for life. Once the contingency happens, the CAT must be re-calculated.

Disclaimer

This overview of the Irish tax implications of trusts is for guidance purposes and given on the assumption that any interested party is fully aware of the classification of trust in which they are involved or contemplating establishing. Any definitive advice can be provided after review and due consideration of any trust deed and ancillary documents and any other pertinent documentation.

30 Section 20(1) CATCA 2003
31 Section 23(1) CATCA 2003
32 Section 14 CATCA 2003
33 Section 15 CATCA 2003
34 Section 16(c) CATCA 2003
35 Section 18 CATCA 2003
36 Section 18 CATCA 2003
37 Section 20 CATCA 2003
38 Section 17 CATCA 2003