

# **Part 7 – Break-up Of Settlements And Trusts And Payment For Future Interests - Section 33 of the CATCA 2003**

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## Capital Acquisitions Tax

### 7 Part 7 - Break-up Of Settlements And Trusts And Payment For Future Interests - Section 33 of the CATCA 2003

Break-up of Settlements and Trusts and the Advance Termination of limited interests.

#### 7.1 Examples

##### Example 1:

John Black settles property for life on his wife Marie with remainder to his brother George. During Marie's lifetime Marie transfers her life interest to George thus ending her life interest and enlarging George's interest into an absolute interest or, alternatively, George transfers his remainder interest to Marie thus ending his remainder interest and enlarging Marie's interest into an absolute interest.

This is shown diagrammatically as follows:

John Black > Marie (life) > George

Marie > George

or

George > Marie

Whether the transfer is from Marie to George or from George to Marie the effect of the break-up of the settlement is that inheritance tax is payable on the basis that George inherits the full value of the property from John. The life tenant Marie is deemed to die immediately prior to the transfer. Thus the inheritance tax claim that would have arisen on the death of Marie on the coming to an end of her life interest if the settlement had run its intended course is accelerated to the earlier date on which Marie's life interest actually has come to an end.

**Therefore the primary inheritance tax liability under the original settlement or will is always maintained in all respects as if the life tenant had died immediately prior to the break-up of the trust.**

If George pays consideration to Marie for the transfer or if Marie pays consideration to George for the transfer how does the consideration paid affect the tax situation?

##### Example 2:

John, in 2001, transfers his shop worth €500,000 to his wife Marie for her lifetime with remainder to his brother George. In 2007 the value of the property is €800,000 and Marie's life interest is valued at €180,000. Marie, in 2007, transfers her life interest to George in consideration of George paying her €100,000.

George is now full owner of the shop and under Section 33 of the CATCA 2003 he is liable to inheritance tax on the full market value of the shop taken by him from John. However, while George must pay tax on an inheritance of €800,000, he has paid €100,000 consideration to Marie.

**The €100,000 paid by George to Marie is not allowable as consideration against the value of George's inheritance from John.** It is allowable only as consideration against the value of the gift from Marie to George.

Likewise, if George, in 2007 transferred his remainder interest valued at €20,000 to Marie in consideration of Marie paying him €500,000, inheritance tax is payable on the basis that George inherits the full value of the property from John. Under Section 33 CATCA 2003 Marie is liable for the tax as transferee from George. The payment of €500,000 made by Marie to George is not allowable as a deduction against the taxable value of the inheritance. The €500,000 paid by Marie to George is allowable as consideration against the value of the gift from George to Marie.

Thus, consideration paid by a life tenant to a remainderman or vice versa for a release of his or her interest to the other is not allowed as a deduction against the market value of the property in respect of the primary inheritance tax claim. Such consideration is allowed only against the value of the secondary gift tax claims arising, if any.

Inheritance Tax arises on the full market value of the property, in all respects, as if the life tenant had died, and the property had passed to the remainder man.

In this type of settlement break- up two claims for tax – inheritance tax and gift tax- can therefore arise on the same property on the same event. Under Section 105 CATCA 2003 a credit is allowed for the inheritance tax, which is the first claim against the gift tax, which is the second claim.

### **Actuarial division**

The life tenant and remainderman may choose to divide the trust fund between them on an actuarial basis. This usually arises where it is in the interest of all parties to acquire liquid funds. However, the actuarial division again does not eliminate the primary inheritance tax liability arising under the original settlement. However, on an actuarial division between the life tenant and the remainderman, no separate gift tax claim would arise.

### **Example 3:**

Michael settles property on trust for John for life with remainder to Patrick. The trust fund is worth €500,000. The value of John's life interest is worth €100,000 and the value of Patrick's remainder interest is worth €400,000.

If the property is sold and the proceeds divided up as to €100,000 to John and as to €400,000 to Patrick neither John nor Patrick has received a benefit from the other and therefore no gift tax claims arise between John and Patrick.

**However, on the break-up of the trust, the primary inheritance tax liability under the original settlement or will is maintained under Section 33 CATCA 2003. The full value of the trust fund deemed to have been inherited by Patrick from Michael is charged to Inheritance Tax. The Inheritance Tax claim that would have arisen on the death of John is accelerated to the earlier date of when John's life interest in the trust fund has actually come to an end, which is the date on which the property has been sold, and the date on which the sale proceeds have been divided up between John and Patrick.**

## 7.2 General Rules

- ❖ A remainderman's benefit will not be taxed until it becomes an interest in possession.
- ❖ A life-tenant is deemed to die immediately before the release of his or her life interest to the remainderman.
- ❖ Deemed death of the life tenant applies only to the inheritance tax claim from the settlor.
- ❖ Two claims for tax arise on the release by the life-tenant of the life interest to the remainderman or on the transfer of the remainder interest by the remainderman to the life-tenant i.e. one claim for inheritance tax and one claim for gift tax.
- ❖ A credit is allowed for the inheritance tax against the gift tax.

## 7.3 Consideration Paid For Future Interests In Property

If a person makes a payment for the granting to him or her of an interest in property, which is not to take effect until a future date when he or she will eventually come into possession of the property, how is payment of this consideration dealt with?

### Example

In 2000 Liam makes a payment of €100,000 to Michael in consideration of Michael executing a deed under which Michael's public house will become the property of Liam on the death of Michael. At the date of the deed in 2000 the public house is valued at €500,000. Eight years later in 2008 Michael dies and the value of the public house at Michael's death is €1,000,000.

**Question: Is the taxable value of Liam's inheritance from Michael €900,000 (i.e. €1,000,000 minus €100,000 consideration)?**

**Answer: No.** Section 28(10) CATCA 2003 provides a formula for the deductible consideration.

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The formula is:

Encumbrance-free value at date of falling into possession  $\times$   $\frac{\text{Consideration Paid}}{\text{Market value of Expectant interest At date of payment}}$

On the basis that the market value of Liam's expectant interest at date of payment was say €200,000 the deductible consideration would be as follows:

$$€1,000,000 \times \frac{€100,000}{€200,000} = €500,000$$

The taxable value of Liam's inheritance is €1,000,000 minus €500,000 i.e. €500,000.