

## Discretionary Trust Tax

### Capital Acquisitions Tax Manual Part 5

This document should be read in conjunction with Part 3, Chapters 2 and 3 of the Capital Acquisitions Tax Consolidation Act 2003

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*Note: This manual is currently subject to review and may not reflect up-to-date position. Most recent version.*

## 5.1 Introduction

The term “discretionary trust” is defined in section 2 of the Capital Acquisitions Tax Consolidation Act 2003 (CATCA 2003) and means:

- a trust in which property is held on trust to accumulate the income or part of the income of the property, or
- a trust in which property, put into trust by a settlor (the person who provides the property) is held on trust by trustees for a certain class of beneficiaries (called the objects of the trust), but in which the trustees have an absolute discretion as to when, how and to which of the objects of the trust they may appoint the capital or the income of the trust property.

In general law, the distinguishing feature of a discretionary trust compared to a strict settlement is that none of the objects of the trust in whose favour the discretion might be exercised, or 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.

Notwithstanding the foregoing, it is important to note that the definition of a discretionary trust for CAT purposes differs from, and is broader than, its meaning in general law. It includes any trust where property is held on trust to accumulate all or part of the income of the property. Thus, a trust with one individual object (beneficiary) can be considered a discretionary trust for CAT purposes if the income of the trust property is to be accumulated.

The settlor of a discretionary trust must, within 4 months of setting up the trust, complete and file [Form DT1](#). (Section 46(15) CATCA 2003).

While the settlement/transfer of property on/to a discretionary trust constitutes a disposal of the property of the settlor, it is for CAT purposes a non-event in the sense that no person thereby becomes immediately entitled in possession to any benefit. Consequently, there is an indefinite postponement of CAT until such time as the trustees exercise their discretion in favour of some object of the trust. When that event occurs, the object(s) will take a gift or inheritance, as the case may be, from the disponent. The date of the appointment out of the trust funds to the object(s) will be the date of the gift or inheritance. Pending such an event, a separate discretionary trust tax (DTT) is levied on discretionary trusts.

## 5.2 The once-off 6% charge

A once-off 6% charge applies to any property that becomes subject to a discretionary trust. The tax is imposed on the latest of the following dates:

- (a) the date on which the property becomes subject to the discretionary trust;
- (b) the date of death of the disponent;

- (c) the date on which there are no “principal objects” under the age of 21 years. Principal objects are the spouse or children of the disponent or the children of a predeceased child of the disponent.

[Form IT 4](#) is the self-assessment return form for the 6% once-off charge. It must be filed within 4 months of the relevant [valuation date](#) by the accountable person, i.e. the trustees or the agent on their behalf. (Section 46(2C) CATCA 2003).

Where the entire trust property is appointed out of the trust to an object of the trust within 5 years of the date of the 6% charge arising, the 6% charge is reduced to 3%. (Section 18(3) CATCA 2003).

### 5.3 The annual 1% charge

An annual 1% charge arises on 31 December each year on the value of the trust assets. The annual 1% charge will not apply where the 6% charge applies to the trust on the same date, or within a year prior to that date. (Section 21(4) CATCA 2003).

[Form IT 32](#) is the self-assessment return form for the 1% charge. It must be filed within 4 months of the valuation date by the accountable person, i.e. the trustees or the agent on their behalf. (Section 46(2C) CATCA 2003).

Under section 24 CATCA 2003, the values of non-quoted shares and real property agreed for one chargeable date will also apply for the following two chargeable dates, subject to the conditions contained in the section.

### 5.4 Exemptions from Discretionary Trust Tax

Section 17 CATCA 2003 sets out various types of discretionary trusts that are exempt from discretionary trust tax (DTT). The following trusts are exempt where it can be shown to Revenue’s satisfaction that they have been created exclusively:

- For purposes that, in accordance with the law of the State, are public or charitable;  
[**Note:** Prior to the passing of Finance Act 2014 only trusts created for public or charitable purposes **in the State or in Northern Ireland** qualified for exemption. Finance Act 2014 removed this territorial limit of “the State or Northern Ireland” from section 17 for trusts created on or after 23 December 2014 and as respects inheritances taken on or after this date thus bringing the exemption into line with the exemption under section 76 in relation to gifts or inheritances taken for public or charitable purposes.

It should be noted that the location of the trust or the location of the trustees is not relevant to the exemption nor is the actual location where the purposes of the trust are carried out. However, the question of whether the purposes of the trust qualify to be treated as public or charitable has to be determined by reference to Irish law.

Finance Act 2014 also added a new anti-avoidance provision in relation to the exemption for these public or charitable trusts by providing that a

discretionary trust that is at any time a party to any arrangements the main purpose, or one of the main purposes, of which is to secure a tax advantage for any person shall be regarded as not having been created exclusively for purposes which, in accordance with the law of the State, are public or charitable].

- Superannuation or Unit Trusts;
- Trusts providing for the upkeep of a heritage house or garden;
- Trusts for the benefit of one or more named individuals who are, because of age or improvidence (see section 5.4.1 below) or physical, mental or legal incapacity, incapable of managing their affairs.

#### 5.4.1 Improvidence

Discretionary trusts are exempt from DTT where it can be shown to Revenue's satisfaction that they have been created exclusively for the benefit of one or more named individuals who are incapable of managing their affairs because of improvidence. They may be established for the protection of individuals who exhibit various types of improvident behaviours, such as –

- individuals who have a compulsion such as gambling or substance addiction;
- individuals with special needs who are easily influenced and vulnerable to being financially exploited;
- individuals who are spendthrift to the point that they cannot manage their own money.

Depending on the nature of the improvidence, it may be difficult to show to Revenue's satisfaction that a trust has been established for this purpose. In the case of a spendthrift, the requirement for the exemption from DTT goes beyond being an individual who on occasion wastefully and extravagantly spends money. To qualify for the exemption, the trustees must satisfy Revenue that the object of the trust has demonstrated a pattern of reckless spending to such an extent that he or she is incapable of managing his or her own financial affairs. It is not necessary that the improvident behaviour be actively exhibited at the establishment of the trust provided that a pattern of improvident behaviour was previously evident and it is reasonable to assume that, based on past behaviours, the individual is likely to resume improvident behaviour if he or she were to receive an unrestricted benefit.

It is not possible to provide an exhaustive list of the types of evidence that will satisfy Revenue that the requirement for the exemption has been met. In arriving at its decision, Revenue needs to look at all the facts and circumstances of each individual case.

For example, an improvident individual, or his or her family, may have engaged with a registered medical professional in the area or a decision-making representative or assistant or a co-decision maker may have been appointed to the improvident individual for financial matters under the Assisted Decision Making (Capacity) Act 2015 (as amended). Where legal or mental incapacity of themselves may not have

been at issue in such engagement or appointment but concerns were raised in relation to improvidence, documentary evidence from the relevant practitioner or decision-making party in such situations would be considered strong evidence in support of the exemption.

It is recognised, however, that it will not always be possible to provide medical or legal evidence of improvidence. Where such evidence cannot be provided it is necessary to provide other evidence to establish that the conditions for the relief are satisfied. This may include documentary evidence of a pattern of improvident behaviour and/or of action taken to protect the individual or to deal with the consequences of the improvident behaviour. Such evidence may include, for example:

- a declaration made on the establishment of the trust confirming why the trust was established;
- inability of the individual to live independently as evidenced by repeated default on rent payments or utility bills;
- past financial supports required in relation to daily living expenses;
- discharge of an improvident individual's debts by other persons;
- protective financial arrangements already in place such as-
  - the use of cash up-front utility providers;
  - transfer of expenses such as utility bills into other persons' names;
  - payment for household essentials by way of pre-paid store credit and/or payment of on-line delivery subject to approval of another person;
  - the free use of the family home or other family property;
  - provision of an allowance for living expenses to the improvident person by family members on a regular, frequent and short-term basis, i.e. daily or weekly;
- inability of the individual to obtain credit from financial institutions;
- supporting affidavits from the settlor, other family members and associates attesting to improvident behaviour.

Along with such documentary evidence, it would be useful to include an affidavit from a settlor setting out the reason(s) and background for the establishment of a trust. It is appreciated that this would be more relevant in the case of proposed trusts but it may also be possible to do this in the case of existing trusts. Where a settlor is deceased, there may be other parties, such as family members, who may be in a position to provide relevant information.

## 5.5 Discretionary trusts created by wills - Finance Act 2012 amendments

### 5.5.1 Background

The initial once-off 6% charge to DTT arises by deeming the trustees to have taken an inheritance of the trust property at the **latest** of the three following dates:

- (a) the date on which the property becomes subject to the discretionary trust;
- (b) the date of death of the disponent; or
- (c) where there are principal objects of the trust, the date on which there ceases to be a principal object of the trust under the age of 21.

After the initial once-off 6% charge arises, annual 1% charges to DTT then arise in the following years while the property remains in the trust.

In the case of a discretionary trust set up by a disponent during his or her **lifetime**, the initial 6% charge arises on the death of the disponent or, if later, when all the principal objects have reached the age of 21.

In the case of a discretionary trust set up by the **will** of the disponent, the Revenue view was that the date on which the property passing under the will became subject to the discretionary trust was the date of death of the disponent and that the initial 6% charge arose at the date of the disponent's death or, if later, when all of the principal objects of the trust had reached the age of 21.

An alternative view was that, in the case of a discretionary trust set up by the will of the disponent, the property passing under the will only became subject to the discretionary trust when the administration of the estate was completed and that, accordingly, discretionary trust tax charges did not begin to arise until the administration was completed. This alternative view, that the property (normally the residue of the estate) was not subject to the discretionary trust under general law prior to the completion of the administration of an estate and was therefore not liable to discretionary trust tax charges until the administration of the estate was completed, had the effect of postponing the charges to DTT in trusts created by will.

In the **Revenue Commissioners v Christie** (2006) High Court case, the Court determined this issue and held that no charges to DTT could arise during the period when an estate was being administered. The Court determined that, during the period between the date of death of the disponent and the date when the administration of the estate was completed by the executors, the property passing under the will was not subject to the discretionary trust under general law and that charges to DTT could not begin to arise until the property became subject to the trust under general law on the completion of the administration of the estate.

Accordingly, charges to DTT were delayed in trusts created under wills until the administration of the estate was completed and until the property under general law became subject to the discretionary trust created by the will.

## 5.5.2 Effect of Finance Act 2012 amendments

The DTT provisions introduced by Finance Act 2012 (section 111<sup>1</sup>) apply in the case of discretionary trusts created by a person's will where the person dies on or after 8 February 2012.

### 5.5.2.1 The initial charge

Section 111 Finance Act 2012 provided that property is to be treated as being subject to a discretionary trust on the date of the disponer's death where such a discretionary trust is created by his or her will. The initial charge to DTT therefore arises on the date of the disponer's death or, if later, the date when all the principal objects of the trust have reached the age of 21. Section 111 set back the initial DTT charge to the date of the disponer's death by deeming the property in the estate to be subject to the discretionary trust at the date of death. The decision in the 'Christie' High Court case that DTT cannot arise before the property becomes subject to the discretionary trust under general law on the completion of the administration of the estate therefore no longer applies to DTT due to the deeming provisions in section 111. The initial 6% charge, accordingly, arises at the date of the disponer's death.

### 5.5.2.2 Extension of definition of 'Discretionary Trust'

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

### 5.5.2.3 Future trusts

The position remains unaltered in relation to discretionary trusts only coming into existence at a future date. An example would be a trust created by a will providing for a spouse or child of the deceased to hold the property for their lifetime and thereafter to hold the property on discretionary trust. No charges to DTT arise while a person, such as a life-tenant, is beneficially entitled in possession to a limited interest in the trust property. The initial 6% charge to DTT only arises on the coming to an end of the limited interest in possession and when the property then becomes subject to the discretionary trust. The trust is not required to pay either the initial charge or the annual charges during the lifetime of the life tenant as no such charges will have arisen.

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<sup>1</sup> Section 111 amended sections 2, 15, 18 and 21 CATCA 2003.

#### 5.5.2.4 Payment dates

The initial 6% charge arises on the disponent's death or, if later, when all of the principal objects of the trust have reached the age of 21. It is payable within four months of the valuation date of the inheritance deemed to be taken by the trustees. (Section 46(2C) CATCA 2003).

In the case of a residuary estate passing into a discretionary trust under a person's will, the valuation date will normally be the date of the ascertainment of the residue of the estate and the 6% initial charge is therefore payable within four months of that date.

The valuation date for the 1% annual charge is fixed at 31 December each year. (Section 21(b)(i) CATCA 2003). As noted in 5.3 the 1% charge will not apply where the 6% charge applies on the same date or within a year prior to that date. The 1% charge is payable within four months of the valuation date. (Section 46(2C) CATCA 2003).

In situations where the administration of an estate lasts for a number of years, a number of annual 1% charges may also have arisen before the valuation date for the initial 6% charge arises. In these situations, the valuation dates for any of the accrued annual 1% charges will be the valuation date for the initial 6% charge. (Section 21(b)(ii) CATCA 2003).

DTT is payable, for the initial 6% charge, and for any accrued 1% charges, on the value of the trust property at the valuation date for the initial 6% charge.

#### 5.5.2.5 Refunds of DTT

Any claims for refunds of DTT should be made within 4 years commencing on the later of the valuation date or the date of payment of the tax concerned where that tax has been paid within 4 months after the valuation date. (Section 57(3)(b) CATCA 2003).

### 5.6 Surcharge for late filing of DTT returns

An amendment to section 53A CATCA 2003 (made by Finance Act 2018) provides for a surcharge in the case of the late filing of DTT returns. Where returns are not filed within four months of the relevant valuation date, a surcharge is applied as provided for in section 53A(3).