Taxation of Estates
Sensible tax planning will optimise the tax position of beneficiaries

By Dara Burke, ACA and John Ward, FCA

Intricate tax issues arise across a variety of tax heads in the course of the administration of a death estate. This article focuses on some of the fundamental aspects involved. It should be noted that space does not permit a discussion of trusts, which raise their own special complications.

Where the deceased individual dies testate, then the executors appointed under the will are responsible for the administration of the estate. If, on the other hand, a person dies intestate, administrators will be appointed. For the purpose of this article, both executors and administrators are referred to as personal representatives.

The estate beneficiaries will be primarily concerned with their Capital Acquisitions Tax (CAT) liability. Depending on the circumstances, a Capital Gains Tax (CGT) liability may also arise on the disposal of assets in the course of administration by the personal representatives. Income tax on the income accruing to the estate and on the beneficiaries' share of that income for the duration of the administration period will also need to be considered. As a general rule there is no exposure to stamp duty on the transfer of assets to beneficiaries; however, this is not invariably the case. Any outstanding tax liabilities of the deceased at the date of death will need to be ascertained and settled and all relevant claims for relief submitted. It cannot be over-emphasised that sensible, pro-active planning can ensure that the overall tax positions of the estate's beneficiaries are optimised.

Capital Acquisitions Tax

The beneficiaries fall within the scope of charge to CAT on taxable inheritances which they take from an estate. Broadly speaking, an inheritance is taxable if either the deceased or the beneficiary in question was resident or ordinarily resident in Ireland at the date of death. Otherwise, CAT is only chargeable to the extent that the deceased's assets were situated in the State. It should be borne in mind that the tests for residence and ordinary residence differ for CAT purposes in the case of non-domiciled individuals.

Where such individuals are domiciled in the United Kingdom, the UK Inheritance Tax position will also need to be ascertained.

The two dates which are salient for the purpose of computing a beneficiary's CAT liability are the date of the inheritance (generally the date of death) and the valuation date.

The beneficiaries' tax liabilities are computed by reference to the thresholds, aggregation rules and tax rates in force on the date of the inheritance. The CAT rates were increased from 22% to 25% and the tax exempt thresholds were reduced in relation to inheritances occurring on or after 8 April 2009. The principal relevance of the valuation date is that the beneficiaries' tax liabilities are based on the market value of the asset concerned on that date and that any associated CAT is payable within 4 months of that date. While the beneficiaries are primarily liable for the payment of the CAT liability, the personal representatives should be aware that they are secondarily liable where a beneficiary defaults; moreover, such liability is personal to them and is not restricted to the value of the assets remaining in the estate.

Depending on the terms of the will or consequences of an intestacy, and the manner in which the estate is administered, the valuation date may vary in relation to different assets. Generally, the valuation date will not occur before probate is granted, since the will (if one exists) may not be admitted or there may turn out to be insufficient assets to meet the deceased's debts.

In some cases, particularly those concerning residuary beneficiaries, the valuation date may occur some time after the grant. If, however, a beneficiary actually takes beneficial possession of an asset prior to the grant of probate then the valuation date will arise at that point. The judicious timing of the valuation date will often be critical in minimising the incidence of tax on the beneficiaries.

Example I

Mr. Long died testate on 25 January 2009. He left a small number of specific bequests and his residuary estate to his two adult children. Probate was granted on 15 May 2009 and the residue was ascertained on 18 July 2009. In this case, the date of the inheritance is 25 January 2009 and accordingly the thresholds and CAT rates in force prior to 8 April 2009 apply to this inheritance. The valuation date is 18 July 2009 with the result that the CAT liability charged on the children is based on the value of the residue at that date and falls due on 18 November 2009.

Reliefs / Exemptions

There are a number of important reliefs from CAT. Amongst these are the dwelling house exemption, agricultural relief and business property relief. It is necessary to ensure in so far as possible that the opportunity to avail of those reliefs is maximised. For example, in order to avail of agricultural relief, the beneficiary must be a farmer (as defined) on the valuation date and it may be feasible to organise matters so that this test is met. This might typically involve the beneficiary acquiring additional farming assets or divesting himself of non-farming assets (although in the latter instance there are anti-avoidance provisions to consider).

Capital Gains Tax

A deceased person's assets are deemed to be acquired by his personal representatives at their market value on the date of death ('Probate Value'). The assets are however not deemed to be disposed of by the deceased on his / her death. As a result, a CGT liability does not arise on any appreciation in value which has accrued during the deceased's ownership of the asset. Conversely, there is no relief for any depreciation in value. Where an asset forming part of the death estate passes under the will or intestacy to a beneficiary, then that individual is treated as acquiring the asset at probate value.

Example II

Mr. Short died on 15 January 2009. He bequeathed the residue of his estate to his adult daughter. Included in the estate is an investment property which he had acquired on 1 February 2008 at a cost of €750,000. The market value of the property on 15 January 2009 was €600,000. Mr. Short is not deemed to dispose of the property but his personal representatives are effectively treated as if they had acquired the property for €600,000 on 15 January 2009. The capital depreciation of €150,000 is disregarded. If the personal representatives sell the property in the course of administration of the estate then their base cost is €600,000. If the residual beneficiary takes the property under the will then her base cost is €600,000.

Example III

Same facts as in Example II, but assume that the property falls in value to €500,000 by 30 August 2009, which is accepted to be the valuation date for that property. If the personal representatives sell the property at that date as part of the winding up of the estate and pass on the cash proceeds of €500,000 (ignoring transaction costs) to the residual beneficiary, they will incur a capital loss of €100,000. Assuming that they do not realise any capital gains on the disposal of other assets in the course of the administration, that loss will go to waste. If the property instead passed under the will at that date to the residuary beneficiary, she would be deemed to acquire it at its probate value of €600,000. If she were to sell the property immediately for its market value of €500,000, she could claim a capital loss of €100,000 (again ignoring transaction costs). Alternatively, if she was to retain the asset, she would be able to set off the probate value of €600,000 against any future sale proceeds. Under both scenarios, the CAT liability would continue to be based on the lower amount of €500,000.

The personal representatives should also bear in mind that capital losses arising in the year of death can be deducted from chargeable gains that accrued to the deceased in the three years of assessment preceding the year of death.

This is particularly relevant in the current environment, where investors may have realised significant capital losses over the previous 12 months. To the extent that the capital losses in the year of death could be offset against prior year gains, the estate would receive a refund of CGT. This would of course increase the taxable value of the estate correspondingly for CAT purposes!

Income Tax

The personal representatives of a deceased person are responsible for agreeing his liabilities to income tax and any relevant levies on all income received by him up to the date of his death. Any liabilities which arose before the person died are a debt due and payable out of the estate and will reduce its taxable value. The personal representatives are liable for the tax charged on a deceased person and they can generally be proceeded against in the same manner as any other defaulter.

In e-briefing 15/2008, the Revenue Commissioners stated that, in accordance with the jurisprudence of the European Court of Human Rights, they would not seek to exact penalties in respect of settlements or proceedings which were not finalised at the date of death. This practice has effectively been given statutory force following the passing of the *Finance (No 2) Act 2008*.

The personal representatives must be alive to the strict time limits within which the Revenue Commissioners can raise assessments on the income

and gains of the deceased or initiate proceedings for the recovery of agreed penalties (usually within two years from the end of the tax year in which the grant of probate issues, but never less than within three years from the end of the tax year in which the death occurred). However, if an additional affidavit has to be submitted for CAT purposes, an assessment may be raised within the two years from the end of the tax year in which the submission was made. Personal representatives need to be aware therefore that the belated discovery of undeclared assets could trigger off a corrective affidavit and additional income tax and/or CGT liabilities.

Again, in the current climate, particular care should be taken to ensure that full relief is claimed for all eligible trading losses, bearing in mind the potential for terminal loss relief claims in this context. Again, any consequent repayments of income tax, etc. for past years would increase the taxable value of the estate for CAT purposes.

Consideration also needs to be given to the income tax implications of the administration itself. The personal representatives of a deceased person are taxable in their representative capacity on the estate's income during their administration. Assessments on the personal representatives are made at the standard rate, without any deduction for personal tax credits. Once the administration is complete and the income is paid to the beneficiaries, they will be liable to income tax on the income with a credit for the tax paid by the personal representative. In certain cases, the Inspector of Taxes may tax the residuary beneficiary directly in respect of the income from the estate from the date of death onwards. In these circumstances, no assessments will be raised on the personal representatives.

Stamp Duty

A transfer of property under the terms of a will or intestacy does not attract stamp duty. A transfer to a person who does not have an entitlement under the will or intestacy is of course liable to stamp duty in the normal way. If the value of an asset appropriated to a beneficiary exceeds the value of the beneficiary's share of the estate then the assent will be liable to stamp duty to the extent that the beneficiary pays for the asset, i.e. the amount in excess of the value of his / her entitlement under the will or intestacy. This type of transaction also carries CGT implications which will require careful review.

Conclusion

This article only deals with some of the key tax issues which arise in the course of the administration of an estate. Once appointed, it is vital that the personal representatives take all necessary steps to ensure that the estate is administered as tax-efficiently as possible.

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for any form of registration for tax agents in the UK. It is felt that any potential benefits of agent registration would be eroded by an increase in compliance costs and would fall foul of European and Competition Law.

Chartered Accountants Ireland does not support the suggestion that a 'tax agent' should be defined, as the benefits of such definition are not apparent.

Summary

While Chartered Accountants Ireland recognises that the consultation process is the most appropriate means of discussing the efficient administration of the tax system, it does not agree with a number of suggestions put forward in the paper. These can be summarised as follows:

- Chartered Accountants Ireland rejects HMRC suggestions that it would either regulate the profession in some shape or form by having a register of tax agents, or engage with the disciplinary processes of professional bodies or directly penalise firms for sloppy work.
- A tax agent registration regime would impose additional compliance costs and would potentially fall foul of the European and Competition law consequences of state interference with the market.
- Members of Chartered Accountants Ireland are already regulated by an independent body – Chartered Accountants Regulatory Body (CARB). Much of what the HMRC proposes in the form of direct regulation is already provided for and implemented by CARB through practice review and through its rigorous complaints and disciplinary procedures.

HMRC has stated that responses to the consultation will be published around the 2009 Pre-Budget Report.

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Business leaders surveyed on Commission on Taxation

A survey of business leaders conducted by PricewaterhouseCoopers shortly after the publication of the Commission on Taxation report found that a significant majority of business leaders (87%) do not believe that the tax-raising measures recommended by the Commission will be balanced by tax reductions to give an overall tax neutral result. The area of greatest concern relates to taxes on labour, with 92% of participants believing that the recommendations would have a broadly negative impact in the personal tax area, and as a consequence a further significant majority of 84% believe that Ireland will be a less competitive location to do business.

An overwhelming majority (87%) believe that the tax-raising measures recommended will not be balanced with tax-reducing measures to preserve the revenue-neutral ethos of the Report and over three quarters (84%) said that Ireland will be viewed as less competitive as a place to do business.