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www.aileenkeogan.ie

Trusts for Vulnerable Clients

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Aileen Keogan
Solicitor & Tax Consultant
www.aileenkeogan.ie

The issues for discussion in this paper are

- Trusts for persons with special needs
- Provision for Improvident beneficiaries
- Provision for young children
- Advising the elderly client

1. Trusts for persons with special needs

Clients with dependants who have special needs require advice as to how best to provide financially for those dependants and protect them long term, especially after the death of the carer/parents where an inheritance is being left for them.

In certain cases the person with the disability has received an award for an injury caused and requires protection in respect of the management of that award.

In other cases there may be a local or national or general crowd funding type appeal to raise funds for the dependant which funds need to be managed.

A client very often is keen to ensure that whatever social welfare payments the dependant is in receipt of already will not be lost by the funds to be inherited or being fund raised for him/her. Often in cases of the disability not being so severe as to curtail the person's ability to engage in society yet where protection is still necessary, the client is hoping to protect a disability allowance paid to the dependant on the basis that the weekly allowance provides the person with special needs a sense of independence, for instance the free transport can enable a better integration of the dependant with society. Having 'pocket money' taken away from someone already used to such funds in their own right could affect the dignity of that person. In addition the person may already be settled in a sheltered community that suits his/her special needs and losing the eligibility for social welfare may disqualify the person from staying where they have settled. The medical card, heat and phone allowances and the possibility of obtaining funding for accommodation, sheltered or otherwise, that come with the package of benefits once the means test is passed are benefits that can be very valuable in the financial sense also as each reduces the costs that would otherwise have to be funded elsewhere even if of themselves these benefits may be unlikely to be sufficient to maintain the person long term where the dependant does not have the ability to earn his/her own income. Furthermore these benefits are also subject to State cutbacks and so will not of themselves be enough for the depenant. Therefore there is still a need to have a pool of funds set aside for the person's benefit.

The client is also keen to avoid the need for the dependant to be made a Ward of Court should s/he inherit a large sum. The procedures and restrictions of wardship are preferably avoided if possible, albeit the wardship procedures are being updated on foot of the Assisted Decision Making (Capacity) Act 2015 and its anticipated coming into force in due course.

In all cases the client is seeking to protect the dependant, minimise the tax, ensure social welfare benefits are maximised and minimise the procedures involved.

1.1. Succession Trusts – for inheritances

Where a client is seeking to provide for their child in succession terms and where the child is already eligible for means tested benefits, it is not prudent for the parent to leave an inheritance direct to the child. This is because that inheritance will be taken into account in the means testing and the child would have to be made a ward of court to allow for the management of the inheritance. Instead any available inheritance is best routed through a discretionary trust which is tailored specifically for the person with special needs as the sole beneficiary. In this way the trust is bequeathed the inheritance and the trustees manage for the lifetime of the person with special needs.

The advantages to this is that a potential benefit under a discretionary trust is not accounted for in means testing, the trustees can manage the investments in the trust to appoint income and capital as required for the benefit of the person with special needs and there is then no need to make that person a ward of court. The person is protected from inappropriate influences from others and can be given allowances as appropriate or assets, such as a house, can be held by the trustees and left for the person with needs to live in. Any money not spent on the person with special needs at his/her date of death can pass back to other family members.

Where there is a likelihood of extended family members also wanting to leave legacies for the person with special needs, it may be prudent to set up an inter vivos trust where each testator can then leave a legacy to that existing trust, albeit there would be more reporting/disclosure issues going this route. This avoids the situation where a 'kindly relative' might leave a legacy to the child resulting in the child having to be made a ward after all to deal with that legacy and losing State benefits. It also avoids each relative having to create a discretionary trust under their own Wills.

A trust set up for taking an inheritance is not exempt from all taxes; the usual trust taxes will arise for the trustees in so far as there is income earned by the trust and gains made on investments, also on any non-exempt appointments of benefits to the beneficiary where CAT will arise. However the advantage of a tailored discretionary trust for an inheritance earmarked for someone with special needs is that discretionary trust tax (levies) can be avoided and there are opportunities to make appointments to the beneficiary free of CAT in certain instances.

There are three tax exemptions to consider in terms of CAT, namely

- the exemption from mainstream gift/inheritance tax under section 84 Capital Acquisitions Tax (Consolidation) Act 2003 (CATCA03),
- the exemption from the levies for discretionary trusts and
- the exemption for a child (or dependant relative) from mainstream gift/inheritance tax under section 82(2) and (4) CATCA03.

1.1.1. Exemption for medical expenses

Section 84 Capital Acquisitions Tax (Consolidation) Act 2003 (CATCA03) provides that a benefit (gift or inheritance) taken exclusively to discharge qualifying expenses of a permanently incapacitated individual are exempt from CAT.

Qualifying expenses are expenses relating to medical care. Medical care includes cost of maintenance in connection with medical care, e.g. nursing home costs.

The criteria for needs is more stringent than many exemptions/reliefs as the beneficiary must be ***permanently*** incapacitated by reason of physical or mental infirmity.

Application must be made to Revenue who must be satisfied that the funds are actually being applied for medical care.

Despite the legislation stating that the benefit ***taken*** exclusively for such expenses is treated as exempt, Revenue have interpreted this exemption as requiring evidence from the disponer that the benefit was ***provided*** in the first place exclusively for such purpose. Revenue eBrief 73/11 indicated that this meant that the intention of the disponer determines the availability of the relief. The writer is aware that there was an (unreported) Appeal Commissioners case of an intestate benefit taken by a person who was denied the exemption even though the inherited monies were solely used to pay the medical expenses of the sister. This was because no intention could be proved by virtue of the benefit being an intestacy. The matter was not appealed and Revenue are relying on this unreported case in their interpretation of the legislation.

There has been further clarity by Revenue very recently under eBrief 48/2018 in relation to the mixing of funds which is welcomed. Where there is a provision of funds generally for a person who is incapacitated but where the funds may be spent on other items other than medical care, the funds spent on the medical care will qualify for the exemption. In example 4 of the eBrief it is clear that the funds that are spent on medical care will qualify albeit the funds spent elsewhere will not qualify. Previous to this, bearing in mind the use of the term ‘exclusive’ in the legislation, there was a doubt as to whether the funds allocated to a trust to provide exclusively for the beneficiary to include provision of medical care costs of the beneficiary would not be allowed qualify as not all of the funds would be allocated to providing medical care.

As Revenue insist on intention being shown by the disponer to provide for the beneficiary’s medical care, it is prudent to state in the Will, or indeed more practically in a letter of wishes to the trustees, that the funds may be allocated to medical care. In this way any appointment of funds from the trust for the benefit of the beneficiary with special needs has the opportunity to be exempt under section 84 CATCA03 if the benefit is in fact used for the discharge of qualifying expenses.

1.1.2. Exemption from Discretionary Levies

Where a discretionary trust is set up under a Will or inter vivos, care must be taken to deal with the matter of if or when Discretionary Trust Tax (the 6% initial and the 1% annual levies) will arise under Sections 14 to 25 CATCA03.

A trust will be vulnerable to the levies once the child reaches age 21 (or once his/her younger siblings reach age 21 if they are included in the Will) unless the trust can be exempt from levies under Section 17(1)(d) CATCA03 for the initial levy (and section 22 for the annual levy).

The exemption from levies provides that if the discretionary trust is created exclusively

“ (i) *for the benefit of one or more named individuals, and*
(ii) for the reason that such individual, or all such individuals, is or are, because of age or improvidence, or of physical, mental or legal incapacity, incapable of managing that individual or those individual’s affairs”,

then the charge to levies will not arise.

While the matter of improvidence is dealt with later in this paper, note the exemption does not require permanent disability and is not limited to legal or mental incapacity but allows an incapacity because of age or improvidence also.

This means that the trust is capable of being free from the levies for the lifetime of the person with special needs if the trust is created exclusively for that person. A parent can therefore set up a special trust for their child with special needs without concerning themselves of the additional levies that such a trust would normally incur.

However the trust must be exclusive for the child with special needs. Revenue have accepted that trusts which also include charities as potential beneficiaries can be exempt as the charities themselves are exempt. This assumes however that the inclusion of the charities as beneficiaries is not for the purpose of securing a tax advantage which is then denied the charitable exemption under Section 17 (1A) CATCA03 – there is no tax advantage to their inclusion as the trust is already exempt from the levy where the child has special needs. Instead the rationale for including charities as potential beneficiaries is that the child may be availing of services from a charity and there may be a wish to provide funding for that charity.

On the other hand if the trust includes other siblings of the child with special needs and those children are principal objects under the age of 21, while the trust would not be chargeable to the levies until the youngest turns age 21, if at that stage the trust is not exclusive to the child with special needs, the trust would not be exempt.

If the trust is not structured to be fixed at the date of death of the child and remains discretionary, then levies will arise for those additional beneficiaries that would benefit then. This would be unusual as typically the discretionary trust is drafted so that the discretionary element automatically falls away to a fixed or absolute interest taken on the death of the person with special needs. Indeed family members alive at that point are the typical default beneficiaries then.

A concern arises however where parents have children with differing needs and need a discretionary trust for some for a limited period and for others for longer. For example in the case of a young family one child may have long term special needs, nevertheless his/her siblings also have need for protection simply for the time they are young. All should be provided for on a discretionary basis for all the children to benefit, albeit some will be able to take absolute benefits once they become adults. Sometimes the level of funding for each child cannot be determined until they each grow up so flexibility is required. As mentioned above, it is not possible to have all the children in the family as beneficiaries of a special needs trust until each becomes an adult as the exemption requires the exclusivity in relation to the exempt beneficiary (whereas a beneficiary from a class of beneficiaries being children in a family under age 21 is not an ‘exempt beneficiary’, rather that discretionary trust will just not be chargeable until the youngest is age 21). Separate trusts will therefore be required (a non-chargeable family trust and an exempt special needs trust) where possibly all funding can be kept in the non-chargeable family trust up until the youngest comes close to the age of 21 and then that trust can top up/fund the exempt special needs trust (just as the other siblings either receive absolute benefits or the family trust becomes subject to levies).

1.1.3. Exemption for Benefits for Children

The exemption for benefits taken by children for support, maintenance and education under Section 82 CATCA03 was originally a widely drafted exemption. It was somewhat controversial as it was perceived to be abused by wealthy parents and inequitable for those less fortunate. This was curtailed under Finance Act 2014 and eBrief 109/2014 updating Part 23 of the Revenue Manual which links to a useful guide to the Revenue's treatment of this exemption.

To the extent benefits are taken by a child with special needs from a discretionary trust, this benefit may be exempt under Section 82.

The restrictions introduced by Finance Act 2016 to age 18 for children generally or age 25 for those in full time education do not apply to children with special needs. Through a successful submission by the writer at the Bill stage of the Finance legislation in 2014 the exemption was extended to any child who, regardless of age, is permanently incapacitated by reason on physical or mental infirmity from maintaining himself or herself.

Once again however the more restrictive requirement of permanent incapacity (physical or mental) applies, unlike in the case of the exemption for the levies.

The difficulty however is that, where an inheritance (rather than a gift) is being taken, the parents of the child must both have died for the benefit to be exempt. This means for instance that a dependant pension that may be paid out for the benefit of that child on a first death will not be exempt. Also any monies routed through a trust created by a parent who may have divorced from the other parent will not be exempt until both parents have died. Submissions are made annually on this to the Minister for Finance to seek a more equitable treatment of gifts and inheritances. Given that gifts are exempt whether or not one parent has died, there seems no logic to why there is a requirement for both parents to have died for the inheritance exemption to apply.

The benefits are only exempt if the payments would be regarded as part of the normal expenditure of a person in the circumstances of the disponer and are reasonable having regard to the financial circumstances of the disponer.

It is likely that the benefits passing to a child who has a permanent disability from a special needs trust created after the death of both parents would be able to qualify in general for this exemption as it is unlikely that provision would be made in an extravagant fashion from the trust to the child bearing in mind the duties of the trustees to make proper long term provision for the child. This would mean the provision of accommodation (free use of a house held by the trust, paying rent for the child, paying for sheltered accommodation) would appear to be exempt. It is unlikely that capital amounts other than medical costs that might already be exempt under section

84 CATCA03 mentioned above would be paid from the trust if the child is unable to manage such benefits financially himself or herself and in any event as such capital amounts would affect the means test for social welfare purposes.

1.1.4. Exemption for LPT

There are other exemptions available for certain trusts such as an exemption from Local Property Tax (LPT) albeit this relates to a residential property acquired or adapted to make suitable for occupation as a residence by individuals who are permanently incapacitated so that they cannot earn an income from working and whose condition is so severe as to require a particular special type of property to suit them. Age alone is specifically stated not to be an incapacity even if the person no longer is able to work because of age.

While properties held out of funds under section 189 and 189A TCA97 discussed next, it is not necessary for such trusts to be established for the LPT exemption to apply to a trust held property if there is a claim made with medical certification that the property is required for the individual's needs.

1.2. Awards Trusts – litigation receipts

Where monies have been received by an individual who is permanently and totally incapacitated from maintaining himself or herself by way of personal injuries compensation (a court award or an out of court settlement or a tribunal payment) where the injury caused the permanent and total incapacity, the funds can be exempt. This includes Hepatitis C compensation awards where the condition is degenerative.

This money is not tied up into a trust. It is paid to the individual. If the individual has sufficient legal capacity however to settle the funds into trust for his/her own benefit, the funds would then be exempt within the trust. If the individual does not have capacity, s/he may need to be made a ward of court to manage the funds.

Total incapacity is indicated by Revenue to be where the individual is not capable of earning a living from any kind of work. Revenue have pointed out that this is a high threshold of incapacity but rehabilitative work in sheltered workshops does not disqualify the individual. A medical certificate will be required for this relief. **Permenent** means that there must be no prospect of the individual recovering or of the condition improving to the extent the individual could maintain him/herself.

There are conditions in relation to the nature of the compensation, if there was a previous injury etc. The income and gains that are exempt from income tax and CGT must come from the award or the investment of the award. If the investment is part funded by borrowing then there is an apportionment made of the amount exempted.

However the exemption only applies where aggregate of the income and gains do not exceed 50% of the total income and total gains of the individual in a year of assessment. This excludes disability pension/benefits from the State in applying the 50% rule where such payments from the State relate to the same injury/disability for which the compensation was made (albeit that pension/benefit is taxable itself).

If an award is accepted by Revenue as applicable to be exempt under section 189 TCA97, then the LPT exemption is likely to be available for property held in that trust and adapted for use for the beneficiary with the disability.

1.3. Public Subscription Trusts

Where a trust is established with funds raised by public subscriptions for the benefit of one or more than one permanently and totally incapacitated persons, the trust obtains certain exemptions from tax.

The trust must be one exclusive for the benefit of an individual(s) who is/are incapacitated permanently and totally by reason of physical or mental infirmity. This is again the more exacting standard where it must be both permanent and total incapacity. Therefore seeking public funding for someone to be ‘cured’ or to reduce their incapacity would not qualify.

What is total incapacity is however not at first sight clear and, given the new functional test coming into play under the Assisted Decision Making (Capacity) Act 2015, possibly someone who can function on some levels but not on others would be denied this relief. Nevertheless the Revenue guidance on what is total incapacity for section 189 relief outlined above should be followed where it focuses on the question of capability of earning a living.

Differing from the family / succession trusts mentioned above, the trust must be established to provide that on the death of the qualifying individual (or last qualifying individual) the remaining funds must pass either

- to that individual’s spouse, civil partner or child; or
- to charity.

The trustees must not be connected with the individuals.

It only relates to trust funds where the assets in the funds have been obtained through the form of public subscription for the benefit of one or more incapacitated individual whose identity is known to the person making the subscription. The total amount of the subscriptions is no longer limited but if the funds exceed €381,000 then no one person may donate more than 30% of the total amount of the subscriptions raised. It is therefore possible for one person to donate up to €381,000 provided no further subscriptions are raised.

The funds in the trust must consist of the funds raised by public subscription or money/property derived directly or indirectly from these monies, i.e. income, capital returns from investing the funds.

The benefit taken from the trust by the individual who is incapacitated is exempt from CAT under section 82(3) CATCA03. This applies to capital receipts, income receipts and indeed if the trust is wound up in favour of/for the absolute benefit of the incapacitated individual.

Income earned by the trustees or paid out to the incapacitated individual is exempt. Income from funds invested by the individual derived from the payment out to him/her from the trust is also exempt.

Capital gains accruing to the trustees in the trust funds and capital gains accruing out of funds invested by the individual derived from the payment out to him/her from the trust in income or capital form is also exempt.

However the exemption only applies where aggregate of the income payments made by the trustees to the individual and the income /gains of the individual from such payments /investments of such payments do not exceed 50% of the total income and total gains of the individual in a year of assessment. This excludes disability pension/benefits from the State in applying the 50% rule where such payments from the State relate to the same injury/disability for which the public appeal was made.

If a trust is accepted by Revenue as established under section 189A TCA97, then the LPT exemption is likely to be available for property held in that trust and adapted for use for the beneficiary with the disability.

2. The Improvident Beneficiary – Special Trust

Focusing on a particular vulnerable person, the improvident, a client is often particularly motivated to provide protection for the improvident dependant but tax benefits may not be available for that protection because of the restrictions of the exemptions available.

An improvident is not someone who is legally, physically or mentally incapable of earning a living. It is someone who does not necessarily have a medical diagnosis who is vulnerable for instance to

- Spending unwisely to an extreme
- Addiction of a sort that renders him/her financially incapable
- Might be susceptible to being preyed upon by others
- Cannot hold down an employment yet is on the surface capable of working.

This person is not likely to be in receipt of a disability allowance. This is not just someone who goes on a spree/binge every so often and spends more than is wise, rather someone that binges regularly so to their clear ongoing detriment. Possibly his/her family have already had to bail the person out of debt regularly, restrict the person from dealing with money, drip fee allowances to the person.

The discretionary trust is still suitable for this person if it is set up exclusively for their benefit as it allows the money allocated to them by way of inheritance to be drip fed to ensure it is not spent unwisely and is kept away from those who prey on the person, including creditors of that person.

The discretionary trust itself is exempt from the levies if it can be proven to Revenue that the trust is exclusively for an improvident person. After lengthy discussions with Revenue through TALC, eBrief 92/2017 issued to update part 5 of the Revenue Manual to confirm how the exemption from discretionary trust tax (levies) would be available to a trust created exclusively for the benefit of an improvident. This reaffirms that it is not necessary to prove legal, physical or mental incapacity - there is a stand-alone situation of improvidence where a person can still be incapable of managing his affairs.

A formal application must be made to the Revenue for this exemption.

It is important to have evidence available of a pattern of past improvident behaviour to ensure relief will be available.

If the person is ‘in remission’ (possibly because the funds are now restricted from him/her), the immediate improvidence is not visible, yet an inheritance could trigger the difficulty again. This is recognised by Revenue so long as there is evidence of ‘past wrongs’.

It is prudent when setting up Will trusts of this nature for the testator to set out his/her reasons for the establishment of the trust. Possibly a letter of wishes that would ultimately be disclosed to Revenue would be useful for this purpose. Also an affidavit of past behaviour and past remedies for dealing with this would allow the trustees claim the relief and indeed highlight to the trustees what they are dealing with in managing expectations / demands of an improvident beneficiary.

However bear in mind the GDPR data protection provisions now and how this might grant a right to the improvident as a beneficiary of the trust to seek his/her data from the trustee – could this now include the letter of wishes which mentions the improvident despite the Schmidt v Rosewood/re Londonderry Trustee cases which confirmed a letter of wishes could be held confidential as against a beneficiary?

Please note that the exemptions for benefits taken from the trust are less likely to be available as the improvident is not permanently incapable by reason of physical or mental infirmity from maintaining him/herself (section 82 CATCA03) nor are the day to day funding expenses for the improvident likely to relate to medical care (section 84 CATCA03). The trust will therefore need to factor in CAT on benefits taken over and above the threshold for the disponer to the beneficiary on appointments out. Nevertheless the trust is a sensible mechanism of drip feeding funds to the improvident without the levies as an additional cost to running that trust.

3. Young Children

Regularly clients seek advice as to how to provide for their children on their deaths where as parents they wish the inheritance to pass to their children in a tax efficient manner, yet they wish to protect their children from inheriting at an immature age. Typically the parents wish to provide that, after provision for the surviving spouse, the children should not inherit until each is aged 25 which had been perceived as the age a child ought to be mature!

It is rare for both parents to die when their children were young and so fortunately for the stereotypical Irish family of yesteryear this was not necessarily a difficulty where first the estate was left to the surviving spouse and the Will was reviewed after when the children were already mature. Not many trusts therefore came into effect for young children to consider the issue of the additional taxes that might arise.

However now with divorce, one parent will wish to provide for his/her children on his/her death alone with no provision for the surviving parent from those assets first.

In addition clients with significant wealth seek to provide that their spouse will only take part of their estate on death so that part will be available for the children whilst the spouse is still alive.

On this basis, there are more instances of young children inheriting on the death of one parent only and so the question of protection of young children in contrast to the tax position needs to be addressed.

There is a perception that a discretionary trust is too costly in tax terms and so a fixed trust is instead put in place. The following is an outline of the legal and tax effects of various trust structures applied for young children to inherit under the Will of their parent.

3.1. Favouring tax efficiency over protection – The Bare Trust

The most tax efficient method of taking an inheritance is to give it to the child so that s/he takes it absolutely. This is held in a bare trust when the child is still under 18.

The legal effect of this for a child is that, as the child cannot give a valid receipt to the executor until s/he ‘comes of age’ at age 18, the inheritance is protected from the child in a bare trust until age 18. However once 18, the child is entitled to call on the bare trustee to hand over the inheritance. Most parents would be concerned that a child is not sufficiently mature at that age to receive an unrestricted inheritance.

The tax effect of this is that for CAT, CGT and income tax purposes, the child is deemed to inherit the asset at the date of death of his/her parent and taxed accordingly. For CAT purposes, the usual tax free threshold (€310,000 in 2018) is applied to the value received and the balance is subject to inheritance tax at 33%. At age 18 the inheritance is handed over to the child.

The principal advantage to this type of inheritance is the fact that the tax is paid immediately.

The principle disadvantage to this method of providing for a child is the fact that there is no restriction in legal terms on the child taking (and spending) his inheritance at age 18. Many young adults are not sufficiently mature at that age to handle an inheritance of significant value.

Another difficulty is that where there are more than one child in the family, it might not be best to have a straight division of the assets between all the children as the younger will have longer needs than the elder in terms of care and educational costs.

There is also a perception that investing only a net of tax amount for the child may result in a less than favourable return for the child in comparison to a gross amount invested and appointed out later. This is indeed the case, unless the returns on a particular investment are likely to be minimal in any event.

3.2. Favouring protection over tax efficiency – The Discretionary Trust

Despite the fact that discretionary trusts now appear to be globally perceived to be tax avoidance structures, particularly since the advent of Mandatory Disclosure Regime and the Anti Money Laundering Directives, they are in fact the best way of protecting children from taking an inheritance until each child is sufficiently mature to do so.

Under such trusts the parents select trustees whom they trust to make the judgement call on the level of maturity of each child. The trustees will appoint trust assets to the children at their absolute discretion.

The tax effect of this is that the child is deemed to inherit the asset at the date of the appointment of the trust assets to him on the exercise by the trustees of the discretion and the child is taxed accordingly. The usual tax free threshold (€310,000 in 2018) is applied to the value received by the child and the balance is subject to inheritance tax at 33% (in 2018), however note that the threshold and rate of the date of the appointment out is the one to be applied, not the one at the date of death of the parent setting up the trust. Until then, the money remains in the trust, tax free in CAT terms, and so the gross investment can result in a greater return for the child ultimately.

Once the youngest child who can benefit under the trust reaches his/her 21st birthday, if the trust is still in place or to the extent the trust still applies to certain assets, discretionary trust levies apply (6% initial and 1% per annum thereafter with a refund of 3% if the trust is wound up totally within five years).

The appointment from the trust to the child is a taxable event for CGT purposes in respect of chargeable assets that are not exempt being appointed out of the trust to the child. Usually there is a credit available for the CAT paid, provided the asset appointed out is retained for two years.

The inheritance is protected from the child in a discretionary trust until the trustees exercise their discretion. While the assets remain in the discretionary trust, the trustees can apply capital and income for the benefit of the child e.g. for living expenses, education etc.

While the parents can hope that older children in the family will have shown sufficient maturity by the time the youngest child has his/her 21st birthday so that the trustees will have appointed out their share of the inheritance, this is quite likely not to be the case for the youngest child. The difficulty is that the youngest child does not have the same chance as his older siblings to reach maturity without the additional tax cost of the levies. Therefore the trustees may decide to hold back some of the trust funds for the youngest to mature, but this will be at the cost of the levies.

3.3. A sensible balance or not? The Fixed Trust

Parents may take the view that there will come a time when their child should have enough maturity. Many Wills therefore provide that a child should take his/her inheritance at a particular age, the typical age being age 25. Where parents instruct that they would like their child to inherit at a particular age, it should be explained to them that reaching a particular age is not necessarily a guarantee of maturity. There are also ‘hidden’ taxes that make this form of trust quite inefficient for tax.

The legal effect of a fixed trust is that the inheritance is protected from the child until the selected age. Only at that stage is the child entitled to call on the trustees to hand over the inheritance to him/her.

Depending on how the Will is drafted, while the child is under the age of 18, the trustees can or must apply the income of the inheritance for the benefit of the child. If the trust does not allow the accumulation of income, the income not yet applied to the child at regular intervals from the date of death of the parent to age 18 must be paid out in lump sum at age 18 and all future annual income must be paid out to the child at regular intervals from age 18 on.

The tax effect depends on the version of the fixed trusts that applies. Assuming the selected age is 25, the following applies:

- Power to accumulate

Where the trustees have power to accumulate income, the trust is deemed to be a discretionary trust for CAT and income tax purposes (Section 2(1) CATCA03). On the child's 21st birthday, if there are no other principal objects in the trust, discretionary trust levies will arise (6% on the child's 21st birthday and 1% per annum thereafter, albeit that 50% of the 6% levy will be refunded on the 25th birthday). On the child's 25th birthday the child is deemed to inherit the asset at that date and is taxed accordingly. The usual tax free threshold is applied to the value received and the balance is subject to inheritance tax at 33% (rate at 2018) assuming the rate has not changed by then.

The difference between this trust and the discretionary trust mentioned above is that the trustees here do not have the flexibility to amend the trust to avoid the levies and also must appoint out the fund to the child even if the child is not mature at age 25. Again the winding up of the trust on the 25th birthday is a taxable event for CGT purposes, albeit that usually there is a credit available for the CAT paid.

- No power to accumulate

Where the trustees do not have power to accumulate income, it is Revenue's view that the child is deemed to inherit an interest in possession for CAT purposes on the death of the parent. In such a case, assuming the child survives to age 25, this inheritance is ultimately taxed as a limited interest calculated by subtracting from 25 the age of the child at the parent's death to arrive at a calculation of a period certain (and then applying the rules in Schedule 1 Part 1 Paragraph 6 to arrive at the taxable value). The usual tax free threshold is applied to the value received and the balance is subject to inheritance tax at 33%. On the child's 25th birthday the child is deemed to inherit a further absolute interest in the trust fund at the value at that date of the trust fund for CAT purposes. The child's earlier fixed interest is aggregated with the absolute interest now taken. The usual tax free threshold is applied to the value received and the balance is subject to inheritance tax at 33%. In effect there is a double charge to CAT on the same assets in the trust. This tax treatment is however uncertain as it rests on the Revenue's interpretation of the legislation in light of the case of *Jacob (Brigid Kathleen) v Revenue Commissioners 1984 III ITR 104* which case was settled without fully determining the issue of value.

Again the winding up of the trust on the 25th birthday is a taxable event for CGT purposes, albeit that usually there is a credit available for the CAT paid.

The effect of this is that the typical fixed trust is

- tax inefficient either because of the discretionary trust levies or because of the risk of double taxation for CAT, and

- does not afford real protection for a child should that child still be immature at the selected age. Also income may need to be appointed out before the child is mature.

3.4. Comparison of returns

It is also noteworthy that if gross trust funds are invested by the discretionary trust rather than net of CAT funds invested, the bare trust and the discretionary trust (at least until age 21) are not far off each other in terms of net investment returns, see comparison in slides, assuming a 5% investment return and only a 2% increase in the tax free threshold.

Yet if returns were higher, this would make the bare trust the least efficient in net return terms where the discretionary trust (at least until age 21 would be the most efficient followed by the discretionary trust up to age 25.

3.5. Recommendation

While at first sight it may seem sensible to advise parents to take the 'balanced' view between protection and tax efficiency by adopting a fixed trust structure, such a structure does not afford the tax efficiency that one would assume.

Also, given the nature of a fixed trust, the protection is only available until a particular age, whether a child is in fact mature at that age or not.

It is therefore more appropriate to suggest to the parents that their assets be divided into certain asset types that would be suitable to put into a tax efficient bare trust and those that should be held back in a protective discretionary trust. This is particularly where the threshold can be maximised against the tax for the bare trust and in relation to assets that are likely to have a more restrained investment return.

Assets suitable for bare trusts could be those that are restricted in some other way, whether it be investment assets held in joint names with others where their consent is required to sell, or assets that are subject to mortgages which require bank's consent to sell.

Assets that are more liquid or that will be likely to give a greater investment return are best to be kept in discretionary trust at least until age 21 when the trustees can assess maturity and possibly appoint out assets absolutely to some, if not all, the children.

4. The Elderly Client

Our society is ageing. Today's 20 year olds are twice as likely as their parents to live to the age of 100. If you seek to fund a pension, an actuary can ignore the old tables such as in the CAT legislation that averages our living to age 80/82 and apply an industry standard for annuity funding where the assumption is that you will survive to age 100. This is on the basis that actuarily there is more chance that the very lifestyle today which allows you to fund a pension will keep you living for longer.

However it is becoming increasingly more difficult to fund this living. The Government is committed itself to increasing the age for paying State pensions to 68 by 2028; it is currently at 66. The Fair Deal Nursing Home Scheme allows everyone a place in a nursing home. Those in need of care are placed on about 7 week waiting lists to either enter nursing homes or have got in but must fund it themselves while on the waiting list. There is reluctance by many to fund the home and a risk of homes being undervalued. If you were prudent to have set aside funds in a private pension, you are now seeing these pension funds diminish through hidden administration costs, through cutbacks on the tax reliefs in the initial funding of the pensions, in annual pension levies and in surcharges where the pension is not drawn down annually after retirement. For those with disabilities, it is clear there is insufficient available for carers to care for their dependants through State funding.

So, if we are living longer, can we afford to do so? It is increasingly important to maintain what we have. We need to ensure your client is protected as future elderly people especially to the extent your client has further commitments to care for vulnerable children to ensure that what they have they hold as best they can so that they can afford to live.

The following is a checklist of issues that to consider to ensure that they are able to maintain their assets without unnecessary taxes and without making themselves financially vulnerable into the future.

4.1. Pressure to gift - Gifts to family members and others

In light of the increased rates of CGT and CAT (from the low of 20% to the current 33%) and reductions of tax free thresholds (from the high of €542,000 to a current €310,000 for children), families are concerned with the taxes that might arise on an inheritance in the future. Parents are themselves concerned with the taxes that their children will have to pay. Many are also conscious that their children have heavy mortgages and are under financial pressure to make ends meet. This can put a parent under moral pressure to use his/her own savings to put the child in funds to meet his debts and to do so in as tax efficient a manner as possible. This may be pressure of the parent's own doing or more dangerously could be pressure brought to bear on the parent by a child himself. Either way however it is important that the practitioner ensures that the parent reflects fully on the implications of what s/he is proposing to do in making a gift to his/her child out of savings.

- Can s/he afford to do without those savings now?
- Can s/he afford to do without those savings later if s/he gets less of a return on the pension and other income?
- Can s/he afford to do without those savings later if outgoings increase such as having to fund for care in the home or in a nursing home for self and spouse?
- If the parent is making the gift, conscious of borrowings made and thereby seeking to 'protect' savings by gifting them on, is the creditor protection legislation likely to apply to render the gift void? Is the parent solvent without recourse to the gift assets?
- If the parent is wanting to help his child pay his mortgage, is the mortgage likely to be paid off in full out of this gift or will that be just 'good money going after bad' where the bank will foreclose eventually?
- If the child is married, how stable is that relationship? Financial pressures can strain a marriage. Will the gift end up spent in divorce/ separation payments?
- Is the child generally under financial pressure in relation to other borrowings, not just the family home, where the parent is helping out? If so, should the payment be routed through a form of asset protection trust so that the family home is protected?
- Is the parent hoping to get back equity in the house when the child recovers financially - should it be a gift at all? Would a secured loan or a purchase of an interest be more appropriate?

These are matters that should be fully discussed with the elderly client before advising on the procedures in making a gift to ensure that it will be effective and a proper thing to do.

Assuming the client does wish to proceed to provide for the children then often an elderly client is asset rich but cash poor.

While this was more prevalent in the height of the Celtic Tiger as the assets felt more valuable, still where there is equity in a house and where there are ongoing costs (and indeed if the Fair Deal scheme taking 15% of your house over 3 years seems too much) clients may seek to release the equity in their homes. With house values increasing once again, the pressure on the 'asset rich cash poor' elderly parent will only increase again.

4.1.1. Equity Release Schemes

Equity release schemes promoted by the banks and other lending institutions are back being marketed again.

The Guidelines issued by the Law Society (Conveyancing Committee May 2008 "Equity Release Schemes Guidelines") suggest that, given the significant dangers identified by them in relation to these schemes, they should be treated with extreme caution.

A solicitor should have particular regard in the first instance to whether the money is really required, whether it is for the benefit of any other person, and whether safeguards are in place.

Indeed the solicitor should explore any other options available and consider whether this is truly a 'last resort' method of raising cash.

4.1.2. Rights of Residence

Rights of residence can pose considerable difficulties and are not recommended as a solution to release equity or pass on assets for the following reasons -

- Proper value may not be received for giving up a house where only a right of residence is maintained. If this is being done to pass on the house for tax saving purposes, then is this correct for the donor as he may need to use the house sale proceeds later to fund his living?

- It is not necessarily the most tax efficient structure to adopt. Where there is a gift element involved, it must be remembered that a further benefit is taken on the death of the holder of the right of residence on the value at date of death. Such a value may be significantly higher than the value when the right was created. The tax rates may also have increased to apply to that value. Also Stamp Duty is payable on the gift now which would not arise on a death.

- In the case of a joint right of residence, the tax arises on the both deaths

- It is important for tax reasons that the right of residence is not made exclusive. It may however be a huge worry for an elderly person that others would have the right to live in the house with him/her.

If going this route anyhow then the solicitor acting for the donee/purchaser should ensure that the donor as owner of the right of residence executes an Enduring Power of Attorney to ensure that the house can be sold in the future if required and where consent of the owner of a right of residence is required.

4.1.3. Sale of a Reversionary Interest

The sale of a reversionary interest is generally a more tax efficient way of releasing equity allowing protection for the elderly client by ensuring reasonable value being obtained, security of living in the house and tax efficiency for the purchaser of the reversionary interest.

Usually this is better done as a sale to whoever is likely to inherit the house so that the payment in advance of monies will be offset by the perceived reduction in CAT (as there would then be no CAT on the death of the life tenant). It is best confined to the house only to ensure that Principal Private Residence Relief is available for CGT purposes in the hands of the Reversioner on a later sale.

The method of the sale can appear to be complicated but is fundamentally a sale of a future interest. Nevertheless it can be a costly structure to implement in the first instance in setting up the sale and the relevant protections required and the stamp duty arising.

If it is necessary for the purchaser to borrow to fund the purchase, care should be taken to avoid the property itself being charged.

The purchaser's risk is that s/he does not know when s/he will get the house yet has paid for this upfront now.

4.1.4. Lending to child

If the client wishes to lend money rather than gift it and has cash already to loan then care must be taken to record the loan made and how it is to be repaid.

The child will have his/her own concern to deal with any CAT on any interest free element of the loan and any write off of the loan from time to time. If the parent charges interest, income tax should be paid by the parent on that income.

A loan that is not stated to be repayable at a certain date is due to be repaid at once and so the right to recover the loan is lost after six years under the Statute of Limitations unless the debt has been acknowledged by the debtor. It is therefore prudent to ensure the debt is acknowledged from time to time to ensure the loan is recoverable and not statute barred.

If it is intended that the loan is to be repaid on the death of the client parent, the child will need to be aware of the issue of cash flow then to ensure it will be able to be recovered. Bear in mind that the child may have siblings who may have claims against the estate under section 117 Succession Act and the loan is an asset of the estate in that regard. It may be that the loan as an asset of the estate can be appropriated to the debtor child as part of the child's inheritance. The loan will be an asset of the estate so will be subject to CAT if it is left to the child /written off on death.

If the parent instead lends a house to the child and the child then uses it for his/her family home, the same issues arise as above. Insofar as the child may feel the need for protection against any claim from siblings later for the increase of the value of the house, also if the child wishes to fund work on the house, it may be that there would need to be a combination of a loan from the child to the parent for the work on the house and a put/call option for the child with the parent to have the right to buy the house on the death of the parent.

There is of course the risk for the parent that the loan may not be able to be paid back by the child if the child enters into financial difficulties.

4.1.5. Gifts of Chargeable Assets – CGT/CAT set off

Where a parent wishes to gift to a child an asset that will trigger a CGT charge on the parent, the application of the CAT /CGT credit should be used to reduce the overall tax bill to the amount that is greater (the CAT or the CGT). See slide on this. Care should be taken to ensure the relief is not clawed back by a sale of the asset within 2 years.

Furthermore bearing in mind the above results in the tax remaining as a cost to the parent and the tax for the child being reduced, if the parent wishes for the funding to be covered in full by the child then the child should be asked to pay for the amount that the parent has to pay in tax as consideration. This consideration should however not be stated to be 'the amount of CGT payable', rather it should be a stated as an actual figure in the contract for sale that in fact does equate to the amount of the CGT payable. In this way the child transfers funds to the parent to enable the parent to pay the CGT and the child gets a further reduction from the CAT payable as the consideration is a deduction with the CGT still available as a credit.

4.1.6. Dangers of Complications

Bear in mind that the more complicated the structure, the more risk associated with this, the risk of having the matter queried by Revenue and having to explain the position (mandatory disclosure or general audit), the risk of reliefs being clawed back if not held for the appropriate periods, the risks of children becoming bankrupt or divorcing.

Where acting for the elderly client, it is important to consider the risk profile of that client may be much different than that of their children and the worries associated with over complicating a structure to reduce the tax may not be worth it for your client.

4.2. Providing for the Elderly

Where the elderly client is not able to care for him/herself and the children are not seeking to receive benefits from their parent, rather wishing to provide for their parent, the following could be considered.

4.2.1. Deeds of Covenant

A covenant to one or more adults aged 65 or over is available to reduce the tax payable by the child on funding expenses of the parent. The relief is restricted to 5% of the child's total income.

The covenant must last for more than 6 years.

The child must deduct tax at the standard rate (20%) and pay it to Revenue and give the details of this to the parent on a form R185 each payment time.

The covenant only is of use for children on the higher rate of tax and relieves the amount covenanted by the difference between the marginal rate and the standard rate. The parent then is entitled to seek a refund of the 20% rate of tax if the parent's income with the covenant added to it does not reach the threshold of the standard rate.

Note covenants to persons who are permanently incapacitated are also available for tax relief. However a parent cannot covenant with his/her child under the age of 18.

4.2.2. Dependent Relative Tax Credit

A child who maintains a parent at the child's own expense can claim this credit if the parent is unable to maintain him/herself due to incapacity by old age or infirmity or for a widowed parent even if not incapacitated, also a spouse's or civil partner's parent. This is a tax credit of €70 provided the parent's income is less than €14,753.

4.2.3. Health and Medical Expenses

Where a child pays the health expenses of a parent, these can be included for relief from tax in the child's return.

The child can also claim tax relief on the cost of employing a person to take care of a parent who is totally incapacitated due to physical or mental infirmity. Indeed this is available for the parent employing the carer direct. This is also available for caring for other relatives as defined. If this is claimed the incapacitated child credit and /or dependent relative credit is not available.

The relief is limited to the cost of the carer or €75,000 per incapacitated person.

As mentioned above, these benefits would be exempt from CAT under section 84 CATCA03

4.2.4. Inheritance for parent

Where a child wishes to provide for his/her parent on the child's death, it is prudent to weigh up the question of whether the parent should receive a life interest in the legacy being provided or take an absolute interest or whether the amount to be set aside should pass into a discretionary trust for the parent.

If the parent takes an absolute interest, the tax free threshold is that of group (a) i.e. currently €310,000. However that would then be an asset affected by Fair Deal if that was to be applied for down the line.

Alternatively if the parent takes a limited interest, such as a life interest, the benefit for CAT purposes is reduced by reference to the age of the parent and the threshold is group (b) i.e. currently €32,500. If the parent then requires capital appointments to top up the benefit of the life interest, tax would arise on the top ups.

Of course if the parent is already showing signs of not being able to manage, the parent could also be provided for through a special discretionary trust which would be exempt the levies as mentioned above and would be able to appoint out absolute benefits.

It is therefore prudent to ascertain with the client the rationale for the legacy passing and consider if the Fair Deal scheme is likely to be availed of later. If it is not, an absolute benefit may be more useful for the parent. However if the amount is large and the Fair Deal scheme may become an issue, a discretionary trust may be a useful tool to manage that inheritance.

Aileen Keogan
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