



Estate Planning – The Legal and Tax Issues

Susan O'Connell *McCann FitzGerald*

Aileen Keogan *McCann FitzGerald*

1. What is Estate Planning?

Estate Planning can be described as planning the transfer of assets to the next generation in as tax efficient way as possible while taking into account the legal obligations of the testator/donor. The purpose of this article is to outline the legal and tax issues that practitioners should account for when carrying out estate planning for their clients.

A major concern for any high net worth individual is to determine the most tax efficient method of passing assets on to future generations. In addition, the introduction of divorce and the increase in non-marital relationships and second marriages have given rise to complex family circumstances which require careful planning in relation to legal, tax and succession issues.

2. Making a Will

The first step in estate planning should be to make a will. In doing this, the testator should determine the trusted individuals whom they wish to act as their executors, trustees and guardians (where relevant) and choose the beneficiaries to whom the estate will pass. Most testators will be anxious to pass the estate in as tax efficient manner as possible. Depending on the size of the estate and the ages of the beneficiaries, a trust may be incorporated into the will. This is referred to in detail below.

2.1 Legal Issues for the Testator under Irish law

Under Irish law, there is a general presumption of testamentary freedom. However, there are certain legal issues that a testator must have regard to relating to marital status and children.

(a) Surviving Spouse

Where an individual has made a will and is survived by a spouse and no children the spouse "shall have a right to" one-half of the estate. If the testator is survived by a spouse and children, the spouse "shall have a right to" one-third of the estate. This is known as the Legal Right Share.

Where a spouse makes no provision in his or her will for his or her surviving spouse, the legal right share vests in the spouse automatically.

Where a surviving spouse is left a bequest or devise, the spouse is required to elect between the legacy under the will or the legal right share. This means that the testator cannot defeat his or her spouse's Legal Right Share by

leaving a small legacy. In certain circumstances it may be preferable to require the spouse to elect between a small legacy under a will and the Legal Right Share rather than having the automatic right to Legal Right Share.

If an individual dies intestate (without having made a will), the surviving spouse is entitled to the whole of the estate where there is no issue. Where the deceased is survived by a spouse and issue, the surviving spouse is entitled to two thirds of the estate while the remaining one third is distributed amongst the issue.

(b) Rights of Children

Unlike a spouse, a child of a testator does not have any automatic right to a share in the testator's estate. However, under Section 117 of the Succession Act if on application by a child, or on behalf of a child, a Court is satisfied that the testator has failed in his moral duty to make proper provision for the child in accordance with his means, whether by his Will or otherwise, the Court may order provision to be made.

Where a parent dies intestate leaving a spouse and issue, then as mentioned above, one third of the estate is distributed amongst the issue. If the deceased is survived only by issue, then the whole estate is divided between the issue equally.

Issue is the term for children, grandchildren and other lineal descendants. Children in this context includes marital children, non-marital children and adopted children. It does not include step-children, foster children or adopted issue (other than children). There is no legal obligation to provide for step-children or foster children. Such children are not entitled to make an application under

Section 117 of the Succession Act and are not entitled to a share on intestacy.

2.2 Who is the “Surviving Spouse”?

Issues surrounding the rights of a surviving spouse on death have become increasingly prevalent over the last number of years. It is important to examine the precise status of a surviving spouse and what (if any) rights might accrue to that spouse. There are a number of possible situations:

(a) Separation - by divorce *a mensa et thoro*

Prior to 1989 this was the only means to separate. It was quite limited and was available on a fault basis. A spouse who applied for the separation (the spouse not at ‘fault’) retains his or her right to the Legal

Right Share, share on intestacy and such other rights available to a spouse under the Succession Act in relation to the administration of the estate and extraction of the grant (the “Succession Act rights”) against the other spouse.

However, the spouse

against whom the Order of divorce *a mensa et thoro* is made (i.e., the spouse at ‘fault’) loses his or her Succession Act rights.

(b) Deed of Separation

Many older deeds of separation do not contain a renunciation of Succession Act rights. At the time these rights were almost the only rights that a dependant spouse had against the other - they were not waived lightly.

Also in older deeds of separation where there has been a renunciation of Succession

Act rights, often there is no renunciation of the entitlement to extract a grant of probate or administration. This causes practical difficulties on a death.

(c) Judicial Separation

The Court in granting a Decree of Judicial Separation is entitled to make an Order pursuant to Section 14 of the Family Law Act, 1995 (the “Family Law Act”) extinguishing the Succession Act rights of the spouses if it is satisfied that adequate and reasonable financial provision exists or can be made by other ancillary financial relief orders of the Court.

Even in those cases where Succession Act rights have been extinguished by Court Order, Section 15(A)(10) of the Family Law Act gives a further residual entitlement to a spouse. In the event of a death of a spouse, the other spouse can make an application to the Court not later than six months after the grant of representation is issued seeking relief from the estate. The Court will make such provision to the applicant spouse out of the estate of the deceased spouse as it considers appropriate having regard to the rights of any other person having an interest in the matter if it is satisfied that proper provision in the circumstances was not made for the applicant during the lifetime of the deceased spouse. The Court will not make any Order under this Section if the applicant spouse has remarried.

It is often the case that the Decree of Judicial Separation where granted contains not only an extinguishment of Succession Act rights but also an Order blocking any application under Section 15(A)(10) of the Family Law Act.

(d) Divorce

On the granting of a divorce decree the parties are no longer each other's ‘spouse’ and are not entitled to Succession Act rights.

“A major concern for any high net worth individual is to determine the most tax efficient method of passing assets on to future generations.”

Unlike remarriage, divorce does not automatically revoke or cancel an existing will. Wills should therefore be reviewed following a divorce.

(e) Foreign Divorce

The client may have obtained a divorce in a foreign jurisdiction and may have remarried on foot of the divorce. It is frequently the case that the foreign divorce is not capable of recognition in this country and therefore the subsequent marriage will not be recognised. Prior to the introduction of divorce in Ireland in February 1997, in an effort to find a solution to their personal circumstances, many Irish people obtained divorces in foreign jurisdictions. In some cases they were resident in the jurisdiction for a period of time. In other cases, jurisdictions of convenience (such as the Dominican Republic, Haiti, Mexico) were used where quite clearly neither spouse was ever resident there, not to mention domiciled.

The recognition of foreign divorces is a complex area. The rules have not been relaxed even with the introduction of divorce in Ireland. The basis of recognition is that Ireland will recognise a foreign divorce if it is granted in a jurisdiction where either spouse is domiciled at the date of the commencement of the proceedings. Somewhat different rules apply within EU Member States (save Denmark) since 2 March 2001. However, the basic rule is as set out above. In many cases people have lived their lives on the basis that the divorce is recognised. Some people feel that, now we have divorce in Ireland, somehow this retrospectively fixes their own particular circumstances.

Very sad and difficult situations can present if people do not take active steps to regularise their affairs. For example, if the deceased has obtained a foreign divorce and subsequently

‘remarried’ without regularising his or her affairs, then it is the first spouse who may be regarded as the lawful spouse and therefore entitled to Succession Act rights.

2.3 Types of Assets

In advising clients in relation to estate planning, it is important to ascertain details of the nature, location and value of all assets in the individual’s worldwide estate. It is also important to clarify whether the assets are owned directly by the individual, jointly or through a company or trust structure.

In general, clients with assets abroad should obtain advice at the time of acquisition both in the foreign jurisdiction and in Ireland. Unfortunately, this is not always achieved.

Assets in other jurisdictions may be subject to the succession laws of that jurisdiction, for instance the forced heirship rules of many civil law jurisdictions, common in Europe.

In general, the devolution of moveable property is governed by the law of the place where the deceased was domiciled. Immovable property is governed by the law of the country where the property is situate. With increasing numbers of Irish investing in property and acquiring holiday homes overseas, it is particularly important to obtain good legal and tax advice. If directly held by an individual, succession to immovable property located overseas will be governed by the law of the jurisdiction in which the property is located.

It is of particular importance when an individual is making a will that advice is sought in relation to the succession issues in the relevant jurisdiction. It may be that the individual should

make a will in that jurisdiction and in that case, it will be important that the will in Ireland and the foreign will are confined to dealing with the assets in the relevant jurisdictions and do not accidentally revoke the other will.

3. Lifetime Gifts

Very often individuals wish to pass wealth to the next generation by making lifetime gifts. This is prevalent in cases where children or other relatives are involved in working in a family business. To ensure the smooth handover to the next generation, it is reasonably common for the main shareholder(s) to pass some or all of their shares to the next generation during his or her lifetime. In other cases, parents with significant wealth will pass assets to the next generation

during their lifetimes, perhaps to enable a child to purchase a house, set up in business, etc. Other parents are anxious to ensure that they provide a nest egg for their children. It is becoming increasingly popular for parents to purchase property in the name of minor children with the hope that the asset will increase in value. Where minor children are involved it is

“Under Irish law, there is a general presumption of testamentary freedom. However there are certain legal issues that a testator must have regard to relating to marital status and children.”

important to structure the investment through the mechanism of an *inter vivos* trust to ensure the effective management of the investment while the children are still minors.

In all cases, the donor should ensure that he/she retains sufficient assets to maintain himself/herself during his or her own lifetime (e.g., to cover the cost of future nursing home care, etc.).

3.1 When are the succession laws relevant?

In making lifetime gifts, the donor should have regard to the provisions of Section 121 of the Succession Act. This section recognises that an individual, being aware of the legal right share conferred on his or her spouse by the Succession Act and the implications of Section 117 in respect of children, might try to dispose of some of his or her property during his or her lifetime in order to defeat any claims that might be made by his or her family. Section 121 of the Succession Act was introduced to deal with any such dispositions, although it has limitations. The court must be satisfied that the disposition was made for the purpose of defeating or substantially diminishing the legal right share of the deceased's spouse or his or her share on intestacy, or the share of any of his or her children on intestacy or by will. The section therefore applies whether the deceased died testate or intestate. If the court is satisfied that the disposition was made with this purpose then it can nullify the transaction and treat the property in question as forming part of the deceased's estate. As a result it becomes available to satisfy the claims of the deceased's spouse and children.

The section only applies to a disposition of property made within three years of the death of the testator. Any disposition made by the deceased outside the period of three years prior to his or her death may not be challenged under Section 121 provided that the beneficial ownership of the property vests in possession in a donee. Thus, for example, if the deceased had established a discretionary trust and transferred property into that trust ten

years prior to his or her death, but the trustees had not made any appointment of the property, the beneficial ownership would not have vested in a donee and therefore that disposition would remain vulnerable to challenge under Section 121.

The time limit for an application under Section 121 is one year from the date of taking out of a grant of representation to the deceased's estate.

3.2 Marital breakdown

Clients are becoming increasingly concerned when passing assets to their children by way of lifetime gift or after their death that the assets may subsequently pass to a spouse of the child in the event of marital breakdown. Some clients

would prefer that the wealth of the family be preserved in a trust rather than be exposed to possible claims by estranged or former spouses notwithstanding that there may be a tax cost in terms of discretionary trust tax charges. It is important to be aware of the scope of the powers of the courts in relation to trusts which have been established with this purpose in mind.

The court has extensive powers under the family law

legislation to make orders for maintenance or a transfer of assets to a financially dependent spouse in the context of separation or divorce. The extent to which the court will take into account a beneficiary's interest in a trust will depend on the nature of that interest and the

circumstances in which it was created. The court is permitted to order "the variation for the benefit of either of the spouses and of any dependent member of the family or any or all of those persons of any ante-nuptial or post-nuptial settlement (including such a settlement made by will or codicil) made on the spouses". The court can also order "extinguishment or reduction of the interest of either of the spouses under any such settlement".

4. Common Types of Trusts

Whether created by will or during the lifetime of the donor, when creating a trust the donor should have regard to the legal considerations outlined above.

Trusts are commonly used in wills and are necessary when providing for minor children. A brief description of the main types of trusts is set out below.

4.1 Fixed Trust

In a fixed trust each beneficiary has a fixed entitlement to a specific share or interest in the trust property. For example, the trustees might hold property equally between children of the testator to be paid to them upon reaching 25 years of age.

4.2 Interest in Possession Trust

The most common form of an interest in possession trust is a life interest trust. A life interest gives the beneficiary (the "life tenant") a right to income of the trust fund for a certain period. A life interest in real property will entitle the life tenant to live there or receive the rental income (if any) from the property. The life interest can be for the duration of the life of the life tenant or some other individual. The interest of the life tenant is limited and not absolute. This type of trust may be appropriate in the context of a second relationship or marriage where the testator is anxious to protect the assets for the benefit of his or her children.

"... Under Section 117 of the Succession Act if on application by a child, or on behalf of a child, a Court is satisfied that the testator has failed in his moral duty to make proper provision for the child in accordance with his means, whether by his Will or otherwise, the Court may order provision to be made."

4.3 Discretionary Trust

A discretionary trust arises where the trust property is held by the trustees on trust for the benefit of the members of the class of beneficiaries which class is specified in the trust deed. Effectively the trustees have a discretion as to which beneficiary will receive trust assets and when. It is usual for the testator to write a letter of wishes to the trustees providing the trustees with guidelines as to how he or she would like the trust fund to be distributed. Unless there are particular reasons not to, the trustees will usually take into account these wishes.

Generally a testator wishes his or her children to be treated equally. Where children are very young and it is difficult to ascertain at the time of making a will what their individual needs might be in the future, a discretionary trust is often the solution. This will allow the trustees flexibility in making equal provision for the children and, if one child has greater needs than another, the trustees can make greater provision for that child.

4.4 Bare Trust

A bare trust arises where property is vested in trustees as nominees. A bare trust is commonly used where assets are being acquired during a parent's lifetime on behalf of minor children who, because of their minority, may not hold an interest directly in the trust property. The child is entitled to deal with assets on reaching eighteen years of age.

5. Tax Issues

The following are the principle tax issues that arise in the context of life time or post death estate planning.

5.1 Capital Gains Tax

As no capital gains tax arises where assets pass directly to a beneficiary under the provisions of a will, it is only relevant in the context of lifetime

gifts or where a beneficiary receives a gift or inheritance under a trust.

As a general rule, capital gains tax is payable on the increase in value from the date of acquisition by the donor or the trustee (as the case may be) to the date of disposal to the beneficiary by way of gift or inheritance. The current rate of capital gains tax is 20%.

5.2 Stamp Duty

In the normal course, stamp duty does not arise where assets pass to a beneficiary under a will. However, where assets are passed by way of lifetime gift to an individual, stamp duty may arise depending on the nature and value of the assets being transferred.

Stamp duty also arises on the transfer of certain assets into a trust (unless the trust is created by will). There is an exemption from stamp duty where trust assets are appointed by trustees to beneficiaries.

The rates of stamp duty vary depending on the types and values of the assets involved and range up to 9%. If the donor and beneficiary are blood relatives, consanguinity relief can be availed of to reduce the applicable rate by 50%.

5.3 Capital Acquisitions Tax (gift/inheritance tax)

Capital acquisitions tax is payable by a beneficiary on the receipt of a gift or inheritance.

The rate of capital acquisitions tax is 20%. The tax is payable by the beneficiary and is charged on the value of the gift/inheritance that exceeds the relevant tax free threshold. The tax free

threshold depends on the relationship between the donor and the beneficiary.

There is no capital acquisitions tax on gifts/inheritances between spouses.

For other relationships, there are three tax free thresholds, known as group thresholds. For the year 2007:

- › The group threshold applicable to gifts/inheritances from a parent to a child is €496,824. This threshold also applies to grandchildren where their parent (the child) is deceased. It is also available on inheritances of absolute (i.e., not limited) benefits by parents;
- › For other lineal descendants, lineal ancestors, brothers, sisters, nephews and nieces the group threshold is €49,682;
- › The group threshold is €24,841 in all other cases.

These threshold amounts are indexed annually in line with inflation. In determining the amount of the group

threshold available, prior gifts and inheritances received from a donor in the same group since 5 December 1991 are aggregated with current gifts/inheritances for the purpose of assessing whether or not the relevant threshold amount has been exceeded. Therefore for a gift to a child you would look back to see what that child has

“With increasing numbers of Irish investing in property and acquiring holiday homes overseas, it is particularly important to obtain good legal and tax advice. If directly held by an individual, succession to immovable property located overseas will be governed by the law of the jurisdiction in which the property is located.”

received from either parent since 5 December 1991 to determine how much of the group threshold remains.

There are a number of reliefs/exemptions from capital acquisitions tax. The principal reliefs are as follows:

- › Spouse exemption;
- › Capital Gains Tax/Capital Acquisitions Tax Offset;
- › Dwellinghouse Relief;
- › Business Relief;
- › Agricultural Relief;
- › Small Gift Exemption;
- › Maintenance and Education;
- › Charitable Purposes.

5.4 Discretionary Trust Tax

Discretionary trust tax was introduced by the Finance Act, 1984 providing for a once off charge on the value of assets comprised in a discretionary trust. The charge as introduced was 3% and was increased in 1994 to 6%. However, the legislation provides for a refund of one half of the initial charge if the trust is wound up and all the trust assets are appointed absolutely to beneficiaries within a period of five years.

The definition of a discretionary trust for tax purposes brings within the charge to tax, trusts that are not strictly discretionary trusts. The definition includes certain trusts such as maintenance and accumulation trusts which would not normally be regarded by legal practitioners as discretionary trusts.

The initial charge arises on the later of:

- › 25 January 1984; or
- › The death of the settlor; or

- › Where there are no “principal objects” under the age of 21 years.

The term “principal objects” includes a spouse of the disponent, a child of the disponent or a child of a predeceased child of the disponent.

Finance Act, 1986 introduced a 1% annual charge on undistributed assets comprised in a discretionary trust. From 31 December 2006, this annual charge is taxed on the value of the assets comprised in the trust on 31 December in each year. However, the annual levy will not arise within the same 12-month period as the initial charge.

There are anti-avoidance provisions to counter short term appointments out of trusts which are designed to ensure that on the valuation date (31 December) there are no assets or diminished assets in the trust for the purposes of the 1% charge.

The rules of capital acquisitions tax apply in determining the territorial limits of discretionary trust tax. In all cases, where Irish situate property is comprised in the trust fund on the relevant date that property is within the charge to discretionary trust tax. For trusts created prior to 1 December 1999, the entire trust property is chargeable to discretionary trust tax if the settlor or testator was domiciled in the State at the date of establishment of the trust. For trusts created on or after 1 December 1999, all trust assets are chargeable to discretionary trust tax where the settlor or testator is resident or ordinarily resident in the State at the date of the establishment of the trust. The domicile or residence of the beneficiaries of the trust is not relevant for the purposes of assessing the charge to discretionary trust tax.

5.5 Foreign Taxes

As mentioned earlier, it is important to obtain details of assets held in other jurisdictions.

Where real property is located abroad and is

owned by an Irish domiciled and resident individual whose worldwide property is subject to Irish capital acquisitions tax, it is likely that the property will be subject to inheritance tax in Ireland and in the relevant jurisdiction. Usually the foreign tax will be allowed as a credit against Irish tax (subject to a ceiling of the amount of the Irish CAT on the property in question).

The only double

taxation treaties dealing with CAT are between Ireland and the UK and between Ireland and the USA.

In our experience, the inheritance tax payable abroad is nearly always higher than the Irish CAT and therefore usually the overall tax is computed at the higher rate(s) of the relevant jurisdiction.

5.6 Use of trusts in estate planning

Trusts continue to be effective structures for estate planning purposes. In addition, in the context of family estate planning, as it may not be appropriate to provide certain individuals with an absolute beneficial interest in property, a trust can be an appropriate method of providing such individuals with benefits while at the same time protecting the assets.

The following are circumstances where it might be appropriate to consider the use of a

“Some clients would prefer that the wealth of the family be preserved in a trust rather than be exposed to possible claims by estranged or former spouses notwithstanding that there may be a tax cost in terms of discretionary trust tax charges.”

trust structure in the context of tax and estate planning.

(a) Discretionary Will Trust for Minor Beneficiaries

Where children are very young and it is difficult to ascertain at the time of making a will what their individual needs might be in the future, a discretionary trust might often be the solution. This will allow the trustees flexibility in making provision for the children and if necessary, if one child has greater needs than another, the trustees can make greater provision for that child.

While discretionary trust tax may arise in the future, it will not arise until the youngest child reaches the age of 21 years of age. It may be possible to appoint the trust assets or change the terms of the trust in advance of the youngest child's 21st birthday to avoid the charge arising.

(b) Beneficiaries with Special Needs

A settlor or testator may have a child with special needs and may wish to set aside a proportion of his or her estate or certain assets for the benefit of that child. Due to the child's incapacity, he or she may not have capacity to hold assets directly in his or her own name. There is an exemption from discretionary trust tax where a discretionary trust is established for individuals who are because of age or improvidence, or physical or mental or legal incapacity incapable of managing their affairs. In order to qualify for this relief, the trust must be set up solely for the benefit of one or more incapacitated

persons who are unable to manage their affairs. The trust should set out provisions for distribution of any remaining trust funds after the death of the individual.

(c) Maximising Tax Planning Opportunities

In the case of most of the reliefs, certain criteria must be satisfied. The advantage of a discretionary trust is that it enables the trustees and the beneficiaries to plan their affairs so that they are in a position

to qualify for the relevant relief. For example, if one of the beneficiaries had an interest in farming, the trustees could acquire agricultural property and transfer the agricultural property to the beneficiary at such time when the beneficiary will qualify as a farmer and agricultural relief will apply. While in many circumstances where a discretionary trust is used discretionary trust tax may arise depending on the ages of the children of the testator/settlor,

depending on the values involved, the discretionary trust tax may be a worthwhile cost when compared with inheritance tax or gift tax saved.

The conditions attaching to business relief and agricultural relief are complex. However, in most trusts it will be possible to avail of the reliefs listed at paragraph 5.3 above if the

conditions attached to the specific relief are satisfied.

(d) Capital Gains Tax/Capital Acquisitions Tax Offset

Where an event gives rise to a charge to capital acquisitions tax in respect of any property and the same event constitutes a disposal for capital gains tax of the same property (or part of it) then insofar as the capital gains tax has been paid, it may be deducted as a credit against the net capital acquisitions tax due (up to the maximum amount of the capital acquisitions tax due). In other words, where the same event gives rise to a charge in respect of capital gains tax and capital acquisitions tax, the capital gains tax paid may be credited against any capital acquisitions tax due. It is important to ensure that it is the same event which gives rise to the charge to both taxes.

As both capital gains tax and capital acquisitions tax are currently charged at the rate of 20%, this can be a very valuable relief which if properly utilised can effectively eliminate a charge to capital acquisitions tax. In the event of trustees wishing to appoint assets which would give rise to capital gains tax, the overall charge to tax can be substantially reduced.

However, since Finance Act 2006 the relief will be clawed back if the donee disposes of the asset within two years of the date of the gift or inheritance.

6. Conclusion

The focus of tax and estate planning changes from case to case due to the relationships between the parties, the different types of assets involved and the personal dispositions of individuals.

Note:

This article was written prior to Finance Bill 2007.

“The basis of recognition is that Ireland will recognise a foreign divorce if it is granted in a jurisdiction where either spouse is domiciled at the date of the commencement of the proceedings. Somewhat different rules apply within EU Member States (save Denmark) since 2 March 2001.”