The Offshore & International Taxation Review

MAJOR CHANGES TO IRISH GIFT AND INHERITANCE TAX

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Introduction

The Finance Act 2000 contains the detailed legislative provisions in relation to the gift and inheritance tax changes which had been announced in the Budget on 1st December 1999. This article outlines the significant amendments to the territoriality rules.

Prior to 1st December 1999 a charge to gift and inheritance tax arose where either:

- The person providing the gift or inheritance (the disponer) was domiciled in Ireland; or
- The asset was situated in Ireland

Tax was assessed on the recipient of the gift/inheritance at rates of tax ranging from 15% to 40%. There is an exempt threshold based on the relationship between the disponer and the recipient before tax is applied.

There was no definition of domicile contained in Irish Revenue Law and domicile was determined in accordance with general legal principles. An individual could have a domicile of origin, domicile of choice or domicile of dependency. Unlike the UK there was no deemed domicile based on the length of time an individual was resident in Ireland.

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The Changes in Summary

Effective from 1st December 1999, domicile will be of limited relevance in determining liability to gift and inheritance tax. Instead the tax residence or ordinary residence status of the disponer and the recipient are the key factors.

The rules to apply from 1st December 1999 are:

1. Gift and inheritance tax will be charged on worldwide gifts and inheritances where either the person providing or the person receiving the gift/inheritance is tax resident or ordinarily resident in Ireland.

2. Gift and inheritance tax will continue to be charged on assets situated in Ireland regardless of the tax residence of the person providing or receiving the gift/inheritance.

3. For individuals who are not domiciled in Ireland, there are two exceptions to the residence/ordinary residence requirement at 1 above:

    - Until 1st December 2004, a foreign domiciliary will not be considered tax resident or ordinarily resident.

    - On or after 1st December 2004, a foreign domiciliary will only be considered tax resident or ordinarily resident if they have been tax resident in Ireland for the previous five tax years.

4. The new residence rules will not apply to appointments from a trust if the trust was created and the assets were settled on the trust prior to 1st December 1999. Instead, the former domicile rules will apply.

There is also a "look through" rule in respect of shares in foreign companies which own Irish property such that in certain circumstances the foreign shares (or a proportion thereof) will constitute an asset situated in Ireland and gift tax or inheritance tax may arise. This will impact mainly on Irish domiciled individuals who are neither resident nor ordinarily resident if the underlying asset held by a company is situated in Ireland. For example, an Irish domiciled individual resident in the UK, gifting shares in a UK holding company which has an Irish subsidiary, would need to be aware of this rule.

Residence

An individual is regarded as tax resident in Ireland for a tax year where:

- The individual is present in Ireland for 183 days or more for the tax year commencing 6th April and ending the following 5th April; or

- The individual is present in Ireland for the tax year and the previous tax year for 280 days or more in aggregate. However in applying this test, if days of presence in Ireland are 30 days or fewer in a tax year, then the individual will not be resident in that year.

A day for this purpose is only counted where the individual is present in Ireland at midnight.

Ordinary Residence

An individual is ordinarily resident in Ireland for tax purposes if the individual has been resident in Ireland for 3 consecutive tax years. Once an individual is ordinarily resident, ordinary residence will only cease when the individual has been non resident for 3 consecutive tax years.

Implications of New Rules

The implications are best considered by looking at a number of examples.

Example 1

A US domiciled and resident individual, gifts shares in a US company to an Irish resident individual.

Pre 1st December 1999: no gift tax because disponer was not domiciled in Ireland.

Post December 1st: gift tax because recipient is resident in Ireland.

Apart from Irish resident individuals in receipt of gifts/inheritances from persons outside Ireland another category adversely affected by this change will be non domiciled individuals who are long term residents in Ireland. For such individuals their domicile status is ignored and is replaced by a "deemed domicile" status which is acquired after 5 continuous years of tax residence. However, the new rules only apply for this category of individuals after 1st December 2004.

Example 2

Non Irish domiciled individual long term resident in Ireland. Gift of non Irish asset to child who has also resided in Ireland for the past 6 years.

Pre 1st December 2004: no gift tax because disponer and recipient non Irish domiciled.

Post 1st December 2004:entire gift taxable because disponer now within the charge to tax.

In example 2, even if the disponer had broken the residence requirement of 5 consecutive tax years in Ireland e.g. assume that the individual is not resident in Ireland in the year to 5th April 2004, the gift would still be taxable in Ireland unless the recipient had also broken the residence requirement.

Irish domiciled individuals who are resident overseas could benefit from the changes. If such an individual has succeeded in ceasing to be both resident and ordinarily resident in Ireland, liability to gift tax or inheritance tax may no longer arise. Prior to the changes such an individual would always have been within the Irish tax net due to their Irish domicile. However, any potential recipient of the asset must now also be neither resident nor ordinarily resident.

Readers may find the decision chart set out at Appendix 1 helpful in determining the circumstances when a tax liability may arise under the new rules.

Use of Discretionary Trusts

Discretionary Trusts have been used in Ireland as a means of deferring the tax charge and for ensuring that any reliefs from gift tax and inheritance tax are availed of. The gift tax or inheritance tax only arises where an appointment is made from the discretionary trust to the beneficiary.

Appointments from Discretionary Trust

As mentioned there is a difference between an appointment from a discretionary trust which was established before 1st December 1999 and one established on or after 1st December 1999.

Discretionary Trust – in existence on 1st December 1999

For appointments after 1st December 1999 there will be a charge to Irish gift/inheritance tax on the beneficiary where:

The settlor was domiciled in Ireland at the date the trust was created; or

The settlor is domiciled in Ireland at the date the appointment is made; or

The settlor was domiciled in Ireland at the date of his death; or

The appointment is of an asset situated in Ireland.

The residence or ordinary residence status of the settlor or beneficiary is not relevant in the above case. Thus any foreign domiciliary resident in Ireland whose assets have been settled on trust before 1st December 1999 is less concerned with the new rules.

Discretionary Trust – Post 1st December 1999

Where discretionary trusts have been created after 1st December 1999 the rules are set out in summary format in Appendix II.

Double Taxation Relief

The question of double taxation is likely to increasingly arise given the extended territorial charge.

Ireland has taxation treaties with both the US (which dates from 1951 and applies only to inheritance tax) and the UK (which covers both gift and inheritance tax). Due to the changes introduced in the Finance Act care will be required in interpreting these treaties in particular those provisions relating to the domicile of the taxpayer.

Ireland also has provisions for granting unilateral credit relief. This is restricted to tax which is imposed by a Foreign State on foreign property located therein. Unfortunately the unilateral relief is unlikely to deal with a situation where Ireland and another jurisdiction seek to claim worldwide taxation for the reason that the recipient is resident or ordinarily resident in Ireland while the disponer is domiciled or resident in the other jurisdiction.

It is questionable in any event if a unilateral credit relief on a broader basis could deal with the various permutations which are likely to arise. In this regard the December 1999 edition of European Taxation 486 (IBFD) has an illuminating article on the inheritance tax unilateral credit provisions contained in Austrian tax legislation.

Conclusion

The provisions introduced in Finance Act 2000 are radical and undoubtedly many individuals will need to review their planning for gift and inheritance tax. Foreign domiciliaries who are long term residents in Ireland in particular will need to monitor their potential liability to tax over the coming years.

It should also be noted that Ireland has introduced a single rate of charge for gift and inheritance tax of 20%, effective from 1st December 1999. This combined with significantly increased thresholds in respect of gifts/inheritances from parents to children (a child can now receive IEP300,000 from a parent before tax arises) should greatly diminish the burden of this tax in many situations.

Domicile will also continue to be relevant in the application of certain reliefs from gift and inheritance tax including agricultural property relief and exemption for transfers of government gilts.

Appendix I

Decision Chart - Gift and Inheritance Tax (other than appointments from a Discretionary Trust - See Appendix II)		
Is the asset comprised in the gift/inheritance situated in Ireland? No ↓	Yes →	Recipient Liable
Is disponer domiciled in Ireland and either resident or ordinarily resident? No ↓	Yes →	Recipient Liable
Is disponer non domiciled but resident for 5 consecutive tax years prior to that in tax year which the gift/inheritance arises(Note 1)? No ↓	Yes →	Recipient Liable
Is recipient domiciled in Ireland and either resident or ordinarily resident? No ↓	Yes →	Recipient Liable
Is recipient non domiciled but resident for 5 consecutive tax years prior to that tax year in which the gift/inheritance arises (Note 1)? No ↓	Yes →	Recipient Liable
Recipient not liable to gift/inheritance tax		

Note I: This only applies for gifts/inheritances taken on or after 1st December 2004

Appendix II

Decision Chart – Gift and Inheritance Tax Appointments from a Discretionary Trust created after 1st December 1999		
Is the asset appointed situated in Ireland ? No ↓	Yes →	Beneficiary Liable
Was the settlor resident or ordinarily resident in Ireland when the trust was created ? No ↓	Yes →	Beneficiary Liable
Is the settlor resident or ordinarily resident in Ireland when appointment made from the trust ? No ↓	Yes →	Beneficiary Liable
Was the settlor resident or ordinarily resident in Ireland on death (in the case of appointments taken after death) ? No ↓	Yes →	Beneficiary Liable
Is the beneficiary resident or ordinarily resident in the State when appointment made ? No ↓	Yes →	Beneficiary Liable
Beneficiary not liable to gift/inheritance tax		

Note: ***The above will only apply to the foreign domiciliary resident or ordinarily resident in Ireland where the event takes place on or after 1st December 2004 and the foreign domiciliary has been resident in Ireland for the 5 consecutive tax years prior to the tax year in which the event happens.***