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Capital Acquisitions Tax Update: Finance Act 2016



Important Changes

Finance Act 2016 was signed into law by the President on 25 December 2016 and provided for two important changes to the current capital acquisitions tax (CAT) regime – welcome increases in the CAT tax-free thresholds and an entirely unwelcome but long-anticipated restriction on the availability to taxpayers of one of the three principal CAT reliefs, the dwelling house exemption.

Threshold Increases

CAT arises for beneficiaries when they receive a gift or inheritance in excess of their tax-free threshold amount. Under Finance Act 2016 the threshold amounts have been increased with effect from 12 October 2016 as follows:

- Group A threshold: from €280,000 to €310,000 in respect of gifts and inheritances received by children from their parents

(and extended to grandchildren and grandparents in certain circumstances).

- Group B threshold: from €30,150 to €32,500 in respect of gifts and inheritances received from certain other relatives.
- Group C threshold: from €15,075 to €16,250 in respect of gifts and inheritances received from all other individuals.

The thresholds apply to all lifetime gifts (in excess of €3,000) and inheritances received since 5 December 1991. CAT will continue to be levied at the unchanged rate of 33% on gifts and inheritances that exceed the tax-free threshold amounts.

The threshold increases are very welcome but modest, with the Group A threshold increasing by only €30,000 and remaining quite a way off the €500,000 to which the Government promised ultimately to increase it in the Programme for a Partnership Government. However, even such a modest threshold increase might have gone some way to alleviate the current prospective CAT burden for taxpayers passing on assets acquired during their lifetime from after-tax income had the other principal amendment to the CAT legislation brought into effect by Finance Act 2016 not put beyond the reach of many such taxpayers one of the three principal reliefs from CAT.

Restriction of Dwelling House Exemption

As many people are aware, there are three principal reliefs from CAT – agricultural relief, business relief and the dwelling house exemption. Agricultural and business relief, although extremely valuable for those in the farming and business-owner communities in passing on their assets to the next generation, are of little or no use to the broader taxpayer community: for example, the many lifelong PAYE employees whose main assets are a family home (paid for over a lifetime from after-tax income at a high mortgage interest cost) and some cash savings. Such assets were, in the recent turbulent property market, being

used more and more often to help the next generation access that property market, and in those cases the dwelling-house exemption became to members of the broader taxpayer community the much-needed CAT-alleviating mechanism that the agricultural and business reliefs are to those communities.

The dwelling house exemption from CAT was, until 24 December 2016, available in respect of a gift or inheritance of a dwelling house taken by a beneficiary who:

- had continuously occupied the dwelling house as his or her only or main residence either:
 - throughout the period of three years immediately preceding the date of the gift or inheritance or
 - where the dwelling house replaced another property, for a period of three years within the four years immediately preceding the date of the gift or inheritance; and
- was not at the date of the gift or inheritance beneficially entitled to any other dwelling house or an interest in any other dwelling house; and
- continued to occupy the dwelling house as his or her only or main residence for a period of six years starting on the date of the gift or inheritance.

To avail of the dwelling house exemption, there was no requirement that there be a relationship between the disponer (the person making the gift or inheritance) and the beneficiary and there was no limit in terms of the value of the dwelling house being gifted to or inherited by the beneficiary. The dwelling-house exemption was subject to clawback, and there were certain limitations on the use of the exemption in respect of a gift (introduced several years ago as anti-avoidance measures in response to initial reports of perceived misuse of the exemption). Generally, however, it was an extremely useful tool enabling parents and other family members to assist the next generation in acquiring a foothold in a property

market that has been anything but certain in recent years or merely enabling a family home to remain a family home for the next generation rather than being disposed of in an estate fire sale to realise liquid funds to pay CAT due (noting that the dwelling house exemption has also been and should continue to be of assistance to many co-habiting individuals in ensuring that a family home can pass free of CAT from one co-habitant to another).

However, the continued perceived misuse of the dwelling house exemption to pass on high-value properties free of CAT has resulted in a review of the exemption and ultimately its severe restriction by Finance Act 2016 with effect from 25 December 2016, so that under the repealed and replaced s86 of the Capital Acquisitions Tax Consolidation Act 2003:

- The dwelling house exemption will not be available for gifts, or gifts that convert to inheritances due to the death of the person making the gift within two years, except in the case of a gift made to a dependent relative, i.e. a relative of the donor or his or her spouse/civil partner who is over age 65 or who is permanently and totally incapacitated by reason of mental or physical infirmity from maintaining himself or herself.
- The dwelling house exemption will remain available for inheritances but will be severely restricted. It will in effect apply only to an inheritance by a beneficiary of the principal private residence of the donor (the person from whom the property is being inherited), as it must be occupied by the donor as his or her only or main residence at his or her date of death, and to qualify for the dwelling house exemption, the beneficiary must have occupied the property as his or her only or main residence for the three-year period immediately preceding the date of the inheritance (or, where the dwelling house replaced another property, for a period of three years within the four years immediately preceding the date of the inheritance).

The requirements that the beneficiary (1) must not be beneficially entitled to any other

dwelling house or an interest in any other dwelling house at the date of the inheritance of the dwelling house in respect of which the exemption is being claimed and (2) must continue to occupy the dwelling house as his or her only or main residence for a period of six years starting on the date of the inheritance remain necessary to avail of, and avoid a clawback of, the dwelling-house exemption.

Availing of Dwelling House Exemption Going Forward

It is difficult to see how the restricted dwelling house exemption might be availed of in the context of passing on a family home to the next generation other than occasionally, as to pass the family home to one child to the exclusion of siblings (even if the beneficiary residence requirements can be met, which is likely to prove difficult in many cases) where the family home is the only or primary asset is likely to be fraught with difficulties. In such circumstances, the passing on of the family home could potentially give rise to sibling arguments and family division, with possible s117 Succession Act 1965 applications by disappointed children necessitating the sale of that family home, a split of the net proceeds between the children and only the Group A threshold available to reduce the overall CAT bill.

An Alternative Restriction

The increases in the CAT tax-free thresholds effected by Finance Act 2016 are to be welcomed. However, the restriction of the dwelling house exemption has removed the only one of the three principal reliefs from CAT available to those who form a large majority of the taxpayer base and to whom the agricultural and business reliefs are and will continue to be unavailable because of the nature of the assets acquired by such taxpayers over their lifetime. Is it possible that this amendment to the availability of one of the three principal CAT reliefs could be perceived as an inequality in the treatment of taxpayers in respect of the nature of the assets acquired during their lifetimes? Investment in agricultural and business assets will attract relief from CAT, but investment in a

family home generally will not, as the conditions of the exemption make it too difficult to access for families with more than one child and, even in one-child families, the beneficiary occupation requirements are difficult to satisfy on a practical level.

Would the simple introduction of a cap on the value of a dwelling house (or an interest in a dwelling house) in respect of which dwelling house exemption could be claimed in the context of gifts and inheritances, coupled with an ability for a beneficiary to avail of dwelling house exemption only once during his or her

lifetime, not have been an extremely effective method of halting any perceived abuse while still maintaining the availability of the dwelling house exemption for the broader taxpayer community who relied on it to relieve a high CAT burden?

Read more on **taxfind** From Irish Tax Institute *Law of Capital Acquisitions Tax, Stamp Acts and LPT, Finance Act 2016; Part 24 - Capital Acquisitions Tax - Dwelling House Exemption, Revenue Guidance*



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