Kids can't afford this inheritance

Tax could gobble up a third of your estate — despite all the taxes you paid while alive, writes **Louise McBride**

IRELAND'S tough inheritance tax regime has made parents afraid to support older children through college or to help them get on the property ladder.

This is because of a clamp down on inheritance tax announced by the government almost a year ago.

"There is now more awareness amongst people that passing on anything to their children and relatives could have tax consequences, whereas before there was a belief that if you were supporting your children, it was exempt from gift or inheritance tax," said Oonagh Casey Grehan, tax partner, with Fagan & Partners.

"There is a nervousness about doing anything in case it could inadvertently trigger a tax bill. Where we are seeing the most impact is on parents wishing to support children over the age of 25 who want to return to full-time education — or parents who want to help adult children with a deposit for a house."

In last December's Finance Bill, the government tightened up the rules on inheritance and gift tax.

Parents could previously pay for the support, maintenance or education of their children without triggering a tax bill for their child — regardless of how old that child was. However, since last December, only children under the age of 18 or those in full-time education under the age of 25 are now exempt from tax on such payments. So children could be liable for gift or inheritance tax if they are over 25 and their parents pay for their college bills, contribute towards a house deposit, or allow them to live rent-free in the family's second home.

That clampdown last December came on the back of successive cuts to the amount which children could inherit from their parents tax-free. In early 2009, a child could inherit €542,544 from a parent tax-free over their lifetime. By December 2012, that tax-free threshold had fallen to €225,000. Finance Minister Michael Noonan increased the limit to €280,000 in his Budget earlier this month. But as many family homes, particularly those in Dublin, are worth more than €280,000, it is still impossible for many children to inherit the family home — without getting hit with enormous tax bills.

The average asking price for a house in south Dublin city is €337,411; in south Dublin county, the average asking price is €520,451, according to the latest Daft report.

"The problem for children receiving such inheritances is that they often do not have the cash available to pay the tax," said Martin Kennedy, a financial planning consultant with Davy. "In some cases this can lead to the family home being sold."

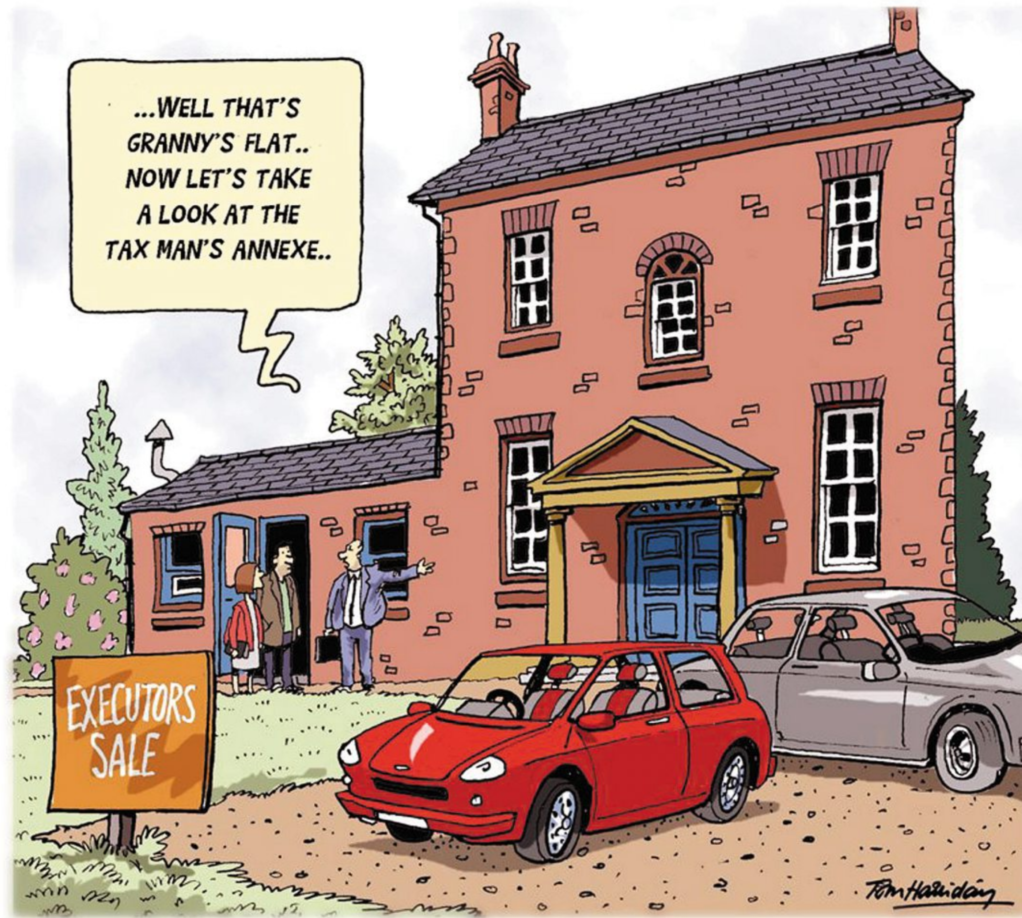
Even where a family home might not in itself be worth enough to trigger a tax-bill, savings held by a parent — when combined with the value of the home — could. These savings might have been squirrelled away to cover the cost of nursing home bills.

"I have seen cases where older people have scrimped and saved specifically for nursing home care — but die suddenly," said Ms Casey Grehan. "If these savings are combined with a family home, this usually results in the hard-earned savings being used to pay a significant tax bill."

It is not just the family home which can trigger steep inheritance tax bills. So too could holiday homes, investment properties, and valuable stocks and shares.

Many high-net worth individuals are concerned that inheritance tax could take up to one-third of their estate — despite having paid a lot of other taxes on that estate over many years, according to Mr Kennedy.

"Other assets in a typical estate [of a high net-worth individual] which might pass the tax-free thresholds include investment portfolios, commercial property, art, business or farm assets," said Mr Kennedy. "There are tax reliefs in relation to business and farm assets but the conditions attaching to these are complex and not always workable in practice. Not all assets are immediately liquid [that is, easy to cash in] so there may not always be funds available to meet the tax bill."



Inheriting granny's cottage

The situation is stark when it comes to inheritances from friends or from a relative who is not your parent — because the tax-free thresholds are tiny.

A grandchild for example can only inherit €30,150 tax-free from a grandparent; an individual can only inherit up to €15,075 tax-free from a friend. Many people are struggling financially to hold onto anything they inherit as a result.

"We dealt with a case recently where a woman was left a house in Dublin by her grandmother," said Ms Casey Grehan.

"As this woman is commuting in from Portlaoise to work in Dublin, she would prefer to sell in Portlaoise and live in the house in Dublin. However, if she sold Portlaoise, it would not be sufficient (after she pays off her mortgage), to pay the inheritance tax bill on the Dublin house. If she can't get a mortgage on the Dublin property, she will have to sell her inheritance."

Can I pass a valuable family home onto my children tax-free?

Yes — but it's easier if you have a few children. Parents with more than one child could pass the family home on tax-free — if they leave it equally to their children.

Let's take a family home worth €600,000. Each child would be able to inherit an equal share of the home tax-free — if there are three children in the family. Were the same property to be passed on equally to two children, an inheritance tax bill would arise but at about €5,610 each (after the annual small gift exemption is accounted for), it might still be manageable.

A difficulty arises however if there is only one child in the family — the inheritance tax bill on the family home could be as high as €200,000, depending on whether or not the child has received other gifts or inheritances from his parents.

By thinking outside the box however, you could eliminate this tax bill for your child.

As long as your child has been living in the family home for at least three years before he inherits it — and so long as he meets certain other conditions — he should not have to pay any inheritance tax on the family home. This is because your child can claim an exemption known as the tax exemption for dwelling houses. For parents with a family home worth €600,000, this exemption is probably the only way the home would be able to be passed onto one child tax-free.

"To pass the property tax-free onto their child would necessitate the child living in the property both before and after the property is transferred to him, which may not be workable," said Ms Casey Grehan. "However, although the dwelling house exemption conditions can be onerous, with some forward planning I have seen it work, particularly if the parents are interested in downsizing or would consider renting an alternative property. The rent for that alternative property could be funded by the child who moves into the family home. People are inclined to write off the exemption because of the restrictive conditions that come with it, but with outside the box thinking, these conditions can be met. If it involves a house worth €600,000, this can mean a tax saving up to €200,000, so it's worth some serious consideration."

Use insurance to save kids from tax

Another way to save your children from the inheritance tax bill they could face on a family home is to take out Section 72 life assurance. These policies are specifically designed to cover inheritance tax bills. The proceeds of the policies are tax-free — as long as the proceeds are used to repay an inheritance tax bill. Be sure however to choose a Section 72 life assurance policy — any payout under a standard life assurance policy won't be tax-free.

It can make more sense to put your money into a Section 72 life assurance policy than to save up money specifically for your children to use to repay an inheritance tax bill. The reason for this is that the savings won't be tax-free — but the payout from the life assurance will be.

"A policy paying out €1.5m would be fully available to the children to pay an inheritance tax bill — as opposed to €1.5m cash in a savings account — of which only €1m would be available to the beneficiaries after tax," said Mr Kennedy.

Irish Life and Zurich Life are the main providers of these policies in Ireland. Should you decide to go for a Section 72 policy, choose one with guaranteed premiums. Otherwise, your insurer could increase your premiums over time — which could make the policy unaffordable.

"Anyone considering taking out a Section 72 policy should fully understand what the policy is designed to do and what happens under various scenarios — such as if you stop paying the premiums after a while," said Mr Kennedy. "Ensure too that you need the policy in the first place, that the level of cover is not excessive, and that you can afford the annual premiums. Where the proceeds of a Section 72 policy exceed the inheritance tax bill, the surplus becomes liable to inheritance tax."

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CHARLIE WESTON — THAT'S MY TWO CENTS...

GIVE up paying in cash, stop using that ATM machine and never mind those little coins.

That is the message that is being pushed out by the authorities.

The Central Bank's plan to have retailers round your change to the nearest 5c will be rolled out from this Wednesday.

The idea is to reduce the use of 1c and 2c coins.

The rounding will only apply to cash payments with the total amount of any bill being rounded up or down to the nearest 5c mark.

So if you are buying something for 81c or 82c, it will be rounded to 80pc.

If the product you are buying is 83c or 84c, it gets rounded to 85c. If the price of the item ends in 6 or 7 round to 5.

It is important to remember that rounding will be conducted on a voluntary basis, and 1c and 2c coins will remain legal tender. Customers will still be entitled to ask for exact change.

But the likelihood is that the small coins will eventually be withdrawn from circulation.

The move follows a two-month trial scheme in Wexford in 2013.

Some €37m worth of 1c and 2c coins have been issued in Ireland since the introduction of the euro.

The cost of producing small coins exceeds their face value — a 1c coin costs 1.65c to produce while a 2c coin costs 1.94c. That is why the Central Bank is anxious to get rid of them.

But the fear is that prices will be raised to accommodate the new rounded amounts, and shoppers will lose out. It is up to us to be vigilant to make sure this doesn't happen.

Another attempt to discourage the use of cash for small purchases was made in the Budget with the move to put a tax on ATM (automated teller machine) withdrawals.

A cap is being put on the charges banks can impose on retailers for debit card use, to encourage greater acceptance of card use.

From January, the annual stamp duty charge of €5 on debit cards will be replaced with a tax of 12c on each ATM withdrawal. This will be capped at €5 a year. There will be no charge when cards are used for purchases.

But the ATM charge is on top of bank imposed fees for using debit cards.

The limit for using a contactless card — one where you do not have to enter a personal identification number — is being raised from €15 per transaction to €30 from Saturday.

Most banks don't charge for contactless payments at the moment, but they are likely to from next year.

The attempt from all of this is to ensure cash is no longer king.

But we consumers need to be careful we do not end up paying for the move away from cash.

Charlie Weston tweets at @CWeston_Indo