Standard Life

Technical Post

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For financial advisers only

The use of a Section 72 life assurance protection policy to provide for Inheritance Tax is well known.

Tony Gilhawley of Technical Guidance Ltd, highlights the less well known use of a unit linked savings plan to fund Gift Tax, with the benefit of Section 73 relief. It can be a useful option, particularly for those who can not get Section 72 life assurance cover on health grounds.

The benefits of a Section 73 savings plan

Gift Tax

When an individual during their lifetime gifts assets to a beneficiary, other than their spouse or civil partner, the gift eats into the beneficiary's available CAT Threshold. When the beneficiary's Threshold is used up, a Gift Tax liability of 33% will arise for the recipient of the gift.

Example

John gifts €500,000 to his son. This is a gift for CAT purposes. Assuming his son has already used up his full €335,000 Class A Threshold with a previous inheritance, his son will have to pay Gift Tax as follows:

Gift	€500,000
Less CAT small gift exemption	-€3,000
Taxable gift	€497,000
Gift Tax @ 33%	**€164,010**

So while John's son receives a gift of €500,000, he will have to use €164,010 of it to pay Gift Tax leaving him with a net €335,990.

The benefit of Section 73 relief

If John also paid his son's €164,010 Gift Tax liability for him, this would be another gift from John triggering another Gift Tax liability of 33% x €164,010, i.e. €54,123.30, for his son.

But if John had accumulated €164,010 in a unit linked saving plan arranged under Section 73 CAT Act, John could use these funds to pay his son's Gift Tax liability of €164,010 for him and **not** trigger another Gift Tax liability for his son. His son would then benefit from the full €500,000 gift with no Gift Tax to pay.

The benefits of gifting assets

Gifting assets, rather than holding onto them until death and leaving them as an inheritance, has two potential advantages:

- Assets are transferred earlier. For example, take a couple aged 60 with a 30 year old son. If they plan to leave assets to their son after both have died, on average this won't happen for another 34 years. Their son could therefore be well in his 60's before inheriting, i.e. older than his parents are today
- Any further growth in value of assets after transfer falls outside the CAT regime. If assets are expected to grow steadily in value, the sooner they are transferred to the next generation the better, from a CAT planning point of view

How is a savings plan effected under Section 73?

The client indicates on the plan application form that he or she wants the plan to be effected under Section 73 CAT Act 2003. The plan is **not** written in trust. The life company will endorse the policy schedule to say that it has been expressly effected under Section 73 Capital Acquisitions Tax Act 2003.

When can the savings plan be used to pay Gift Tax for a beneficiary?

The savings plan must be going for at least 8 years, and have received at least 8 annual contributions, before it can be drawn on to pay Gift Tax arising on a gift made by the policyholder. If contributions stop within the first 8 years, the plan loses the s73 relief.

The regular contributions must be broadly level; the amount paid into the plan in any one year can't be more than twice the amount paid in another year. Contributions can be paid monthly; they don't have to be paid annually.

For the relief to apply the gift giving rise to the Gift Tax must be made by the policyholder within one year **after** the plan is drawn on. So after 8 years the encashment (less any exit tax) is made from the plan first, the gift is made by the policyholder within one year of the encashment, and the policyholder can then use the encashment value to pay the beneficiary's Gift Tax, without triggering another Gift Tax liability for the beneficiary.

Must the savings plan carry life assurance cover?

No. It can therefore be useful for those who can not get Section 72 cover or can only get it at unacceptable terms.

Is the savings plan subject to exit tax?

Yes. It's a normal life assurance savings plan.

Must the plan proceeds be used to pay Gift Tax?

No. A savings plan, expressly effected under s73 CAT Act 2003, does not oblige the policyholder to make a gift or to use the plan proceeds to pay Gift Tax at any time in the future. It is simply an **option** after 8 years, assuming regular contributions have been paid for at least 8 years from inception of the plan.

The policyholder can make the s73 savings plan paid up after having paid regular contributions for 8 years from the plan's inception, and still retain an **option** of using the plan to pay Gift Tax on any asset transfers made by the policyholder thereafter.

The plan could be used to pay a number of different Gift Tax liabilities over time, after 8 years. To comply with the requirement (mentioned earlier) that the gift giving rise to the Gift Tax must be made within one year **after** the plan is drawn on, withdrawals from the plan could be staggered to occur no more than one year **before** each anticipated gift.

But the policyholder can encash the plan at any time and use the proceeds for his or her own benefit; he or she is not obliged to gift any assets or to pay Gift Tax just because the savings plan was effected under s73. Section 73 relief provides an option.

Capital conversion

While s73 savings plan regular contributions can be funded from income, a more likely scenario in many cases may be to drip feed existing capital into a s73 savings plan by way of annual encashments over 8 years, i.e. capital conversion.

Take, for example, these assumptions:

Example

Lump sum available for conversion into Section 73 Savings Plan	€100,000
Savings plan	
Allocation rate	100.00%
Fund charge	1.00% pa
Investment return before charges	4.00% pa
Capital sum	
Charges	1.00% pa
Investment return before charges	4.00% pa
No early encashment charges	

Based on these assumptions, the capital sum of €100,000 could be transferred into a s73 savings plan over 8 years at an annual contribution of €13,831, with the savings plan being made paid up after 8 years:

Year	Illustrated opening capital sum	Illustrated opening savings plan value	Illustrated encashment from capital sum to fund savings plan annual contribution	Illustrated closing capital sum	Illustrated closing savings plan value
1	€100,000	€0	€13,831	€88,754	€14,246
2	€88,754	€14,246	€13,831	€77,171	€28,919
3	€77,171	€28,919	€13,831	€65,241	€44,032
4	€65,241	€44,032	€13,831	€52,952	€59,598
5	€52,952	€59,598	€13,831	€40,295	€75,632
6	€40,295	€75,632	€13,831	€27,259	€92,147
7	€27,259	€92,147	€13,831	€13,831	€109,157
8	€13,831	€109,157	€13,831	€0	€126,677

Note: For ease of illustration, the illustrations above do not allow for exit tax on encashments from the capital sum.

So after 8 years based on these assumptions the €100,000 capital sum has been converted into a section 73 'bond' with a value of €126,677, which (less any exit tax due) can then be used at any time thereafter to pay Gift Tax arising for a beneficiary on a gift made by the plan holder.

Joint life plan

In the case of a married couple who have made Wills leaving everything to each other on first death, it would be better if a s73 savings plan were arranged on a joint life last survivor basis so that a first death within the first 8 years of the plan would not unintentionally end the plan before it has qualified to pay Gift Tax with the benefit of Section 73 relief.

