

TechTalk:

Options available to save for children: The assignment model versus putting a policy under trust.

Over the last few years, there has been a lot of interest in gifting cash to children and availing of the annual Small Gifts Exemption. In particular, grandparents want to pass some of their accumulated wealth to grandchildren and would like to do so in a tax efficient manner. It is interesting to note that this grouping accounted for €236,650,000 of the €522,000,000 Capital Acquisitions Tax take for 2018*.



| Group | Relationship to the donor | Group Threshold Amount |
|-------|---|------------------------|
| A | Son / Daughter | €335,000 |
| B | Parent/Brother/ Sister/Niece/ Nephew/ Grandchild | €32,500 |
| C | Relationship other than A and B | €16,250 |

Gift tax comes under the Capital Acquisitions Tax 'umbrella' and is payable on certain gifts made during the lifetime of the donor. The person making the gift is called the donor or disponent and the person receiving the gift is called the donee. A gift is taken when a donee becomes beneficially entitled in possession to some property or asset.

The tax, if any, is payable by the person receiving the gift. However, the thresholds for Capital Acquisitions Tax apply so if the value of the gift comes under the threshold amount, no tax is payable until such time as the value of all accumulated gifts exceed the relevant threshold.

These thresholds can be reached either by a single gift or by a series of gifts and inheritances over a period of years. Only prior gifts and inheritances to which the same group threshold applies are aggregated (added together) for the purposes of calculating tax.

However, there are a number of exemptions available for Gift Tax, one of which is the Small Gifts Exemption (SGE), amounting to the first €3,000 of all gifts taken by a donee from one disponent in any calendar year.

Section 5 of the Capital Acquisitions Tax Consolidation Act 2003 (CATCA 2003) sets out that a person becomes chargeable to CAT on a gift when a person becomes "beneficially entitled in possession, otherwise than on a death, to any benefit (whether or not the person becoming so entitled already has any interest in the property in which such person takes such benefit), otherwise than for full consideration in money or money's worth paid by such person."**

*Source: Revenue.ie

**Irish Statute book: <http://www.irishstatutebook.ie/eli/2003/act/1/section/5/enacted/en/html>

The above shows the current thresholds with effect from 9th October 2019.

Therefore, to become chargeable to CAT the following criteria must exist:

1. There must be a beneficial entitlement
2. It must be in possession

To fulfill these two criteria and to avail of the Small Gifts Exemption, a common question that regularly arises is regarding the differences between (a) Zurich's Child Savings Plan or (b) to set up a savings plan under Zurich's General Trust Form with a view to saving the Small Gifts Exemption (SGE) of €3,000 a year. There are many reasons behind being asked, an example of which is the need to have the children unaware that there is a savings policy in place.

The differences between both methods are outlined below.

A. Zurich Child Savings Plan:

For the purposes of the SGE, Zurich developed the Child Savings Plus Plan, which is a regular savings vehicle. By saving through this plan, a client builds up a fund and by assigning the plan to the child, the client can make full use of the small gift tax exemption of €3,000. The SGE counts from any one individual to another meaning a married couple could invest €6,000 a year for any one of their children.

By legally assigning the savings plan, the contributions to the savings plan count as gifts to the child. The child will be entitled to the proceeds of the policy because under the assignment, they are the owners of the policy as assignees. Provided the client stays within the annual gift tax exemption, the child will not incur any gift tax either when contributions are made or when the plan is encashed.

It is important to note the exact procedure in place to ensure the savings plan allows for the Small Gifts Exemption.

- The policy is issued in the name(s) of the donor(s)
- Immediately after issue and before any money is applied, the policy is assigned to the donee thereby passing full ownership to the donee. For this purpose the Assignment Form accompanies the proposal form so both can be completed simultaneously from outset.
- The premiums then payable to the savings plan count as gifts to the child.

The advantages and disadvantages of the Child Savings Plan are as follows:

Advantages

1. Through the Assignment of the policy to the child, the child is the full and beneficial owner of the assets within the Child Savings Plan.
2. All premiums/contributions made to the Child Savings Plan are deemed to be paid to the child, the child has beneficial entitlement and is in possession of those premiums.
3. By investing €3,000 a calendar year (or €6,000 for a couple) the child will not incur a gift tax liability nor will the relevant threshold for CAT purposes be impacted upon. Exit Tax will still apply.
4. The policy can still be encashed whilst the child is a minor by his/her parents/guardians however the money received must be for the full benefit of the child.

Disadvantages

1. Fund switching is not allowed on the Child Savings Plan, therefore careful consideration as to the initial fund(s) chosen must be made by the donor.
2. As the child will be a minor, it is not possible to receive instruction from a minor to make amendments to the policy.
3. Further to this, as the child is the owner of the policy through the assignment, it is not possible to have his/her parents switch the funds.

The key point is that under the assignment model of the Child Savings Plan, the child is beneficially entitled to and is in possession of the investment from outset, fulfilling the two criteria above. As the contributions are €3,000 or less under the Small Gifts Exemption, no gift tax arises on encashment. Please note Exit Tax is still payable.

For example, if a grandparent wishes to gift €3,000 a year to each grandchild, say 5 in total, this would require five Child Savings Plans assigned to each grandchild and the premium paid of €3,000 a year.

If, after 10 years the plans are encashed and assuming no growth achieved, the full €30,000 (€3,000 x 10yrs) is payable to each grandchild with no liability to gift tax.

B. Setting a Savings Policy under General Trust.

By setting a policy up under Zurich's General Trust Form, a donor can determine who will benefit from the sum insured on a policy, whether it be a savings or investment plan or a protection policy, on their death.

The General Trust Forms pays the benefit of a policy to the beneficiary on death so where it is paid to the beneficiary it is subject to inheritance tax.

The advantages and disadvantages of the General Trust Form are as follows:

Advantages

1. The trustee/initial policy owner retains full control of the policy and may switch funds throughout the lifetime of the policy.
2. There is no delay in distributing the proceeds of the policy in line with the policyholder's wishes. The benefit from the policy is paid directly to the Trustees, on receipt of the necessary proofs.
3. Setting a policy up under Trust removes the need for it to be included in the Will.
4. Setting a policy up under Trust protects the proceeds of the policy from creditors, unless the policy was specifically effected to defraud creditors.
5. The trustees must pay the proceeds of the policy to the beneficiaries named on the trust form. A trustee can be a beneficiary but, as this may present a conflict of interest, it is not recommended.

Disadvantages

1. The two criteria for Section 5 of the Capital Acquisitions Tax Consolidation Act 2003 (CATCA 2003) above are not met until such time that the savings plan is encashed and the money is paid to the beneficiary.
2. It is at this point that the beneficiary has an entitlement and is in possession to the accumulated fund of the savings plan, thereby triggering a Gift (Capital Acquisitions) Tax Liability.
3. On receipt of the value of the policy, the beneficiary may have a tax liability depending on the value received and the relevant threshold for CAT purposes.

If, for example, the same grandparent takes out a savings plan but puts it in trust for grandchildren, then when the value of the policy is payable to the grandchild it may give rise to a gift or inheritance tax liability.

Similar to the previous example if there is 10 years of contributions made with no investment growth i.e. €30,000 (10yrs x €3,000), on payment to the grandchild it reduces the Group B Threshold from to €32,500 to just €2,500 for future gifts and inheritances as the value of the savings plan comes off the Threshold.

Also, as the gift or inheritance received is within 80% of the Group B Threshold, there is a duty to inform Revenue of this by completing the relevant form, the IT38 form.

In conclusion:

The Zurich Child Savings Plan is primarily designed for wealth extraction for minor children who legally cannot take out a policy in their own name, hence the policy can be assigned to them. All contributions are treated as gifts to the child and do not impact on the threshold for CAT purposes, provided the contributions are kept within the SGE.

An adult child may take out any Savings Plan in their own name to which parents or grandparents can contribute the Small Gifts Exemption amount, the Child Savings Plan is primarily for minor children.

Using the General Trust Form ensures that the sum insured goes directly to those named as beneficiaries, without the assets of the policy becoming part of the deceased's estate. It is an ideal way of estate planning to specify who gets the value of a policy upon the life insured's death.

It is always a case however that any client should seek professional taxation advice on these matters to ensure that the policy they require meets their specific needs.

Further information

If you have further questions on any aspect of this TechTalk, please contact Technical Services on 01-209 2020 or techsupport@zurich.com

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The information contained herein is based on Zurich Life's understanding of current Revenue practice as at November 2019 and may change in the future.

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