TechTalk – Tax consequences on death of an ARF, AMRF or Vested PRSA holder.

In this issue of TechTalk, we look at the treatment of Approved Retirement Funds (ARFs), Approved Minimum Retirement Funds (AMRF's) and Vested PRSA's on death and in particular examine the tax consequences on payments made as a result.

The first thing to understand is that on death of an AMRF or Vested PRSA policyowner, the funds thereafter are treated as ARF funds. So in this TechTalk we will discuss taxation in the context of ARF Funds as this treatment will apply to ARF, AMRF and Vested PRSA funds on death.

The possible taxation of the funds on death depends on the recipient of the fund and their relationship to the deceased ARF/AMRF/Vested PRSA holder. We have examined each possible scenario in more detail opposite.

Recipient: Spouse/Registered Civil Partner

Where a spouse or registered civil partner inherits an ARF, AMRF or Vested PRSA they immediately have a choice as to whether or not they wish for the policy to be fully encashed or have the funds transferred into their own name. There are tax consequences for both scenarios.

Opting to fully encash the ARF:

- This payment would be considered a distribution from the ARF and subject to Income Tax, PRSI & USC at the deceased's marginal rate.
- No Capital Acquisitions Tax would be payable on the net fund received thereafter as the spouse/civil partner can avail of an exemption to CAT.

Opting to maintain as ARF for investment purposes:

- Availing of the exemption to Capital Acquisitions Tax, no Capital Acquisitions Tax is payable.
- No new proposal form is required for existing ARF/AMRF contracts as the spouse/civil partner takes on ownership of the existing contract. A new proposal form would be required where the existing contract was a Vested PRSA.
- Future withdrawals subject to Income Tax, PRSI & USC in the hands of the spouse/civil partner.

Recipient: Child under 21 inheriting the proceeds of an ARF*:

- The payment is potentially subject to Capital Acquisitions Tax at a rate of 33% for all amounts above the relevant Group A Threshold of €335,000.

Recipient: Child over 21 inheriting the proceeds of an ARF*:

- No Capital Acquisitions Tax liability applies as the Revenue allow an exemption for payments from an ARF to a child over 21, however the payment is subject to a flat rate of tax at 30%.

*Children do not inherit an ARF, it is the value/proceeds of the ARF that are received. The ARF must be encashed prior to value passing to the children.

Recipient: Other

- Through a Will, an ARF, AMRF or Vested PRSA Holder may leave their fund to their estate, less Income Tax, PRSI and USC.
- If the fund is left to another person other than those listed above in a Will, the ARF is payable first to the estate less the deceased's marginal rate of Income Tax, PRSI & USC.
- The recipient of the net fund would then potentially have a CAT liability on the net amount received, taking into account their relationship to the deceased and the Group Threshold available to them. The relevant thresholds would be either Group B or C.

Group B - Where the beneficiary is a lineal ancestor, descendant, brother, sister, or child of brother or sister of the disponer, they may receive up to a current maximum of €32,500 without incurring a tax liability.

Group C: In all other cases the exempt threshold is currently €16,250.

As ARF's, AMRF's and Vested PRSA's are contract based arrangements, it is not possible for clients to put a nomination form or letter of wishes on file with the QFM for the policy. On death the QFM will pay the fund in line with the instructions given by the executor of the client's estate. Therefore we would always recommend that clients ensure they have appropriate arrangements in place in terms of their Will and seek legal advice in this regard.

Case Study

Please note that for the purposes of these case studies we have illustrated the potential tax payable on an ARF fund assuming the deceased was a higher rate tax payer but excluding the potential liability for PRSI and USC which may apply but at variable rates dependent on the circumstances of the deceased.

Example

A deceased uncle who has left an ARF of €160,000 to a nephew.

What are the tax implications?

Firstly, the ARF is payable to the uncle's estate, less tax as it's a distribution

- €160,000 @ 40% tax = €64,000
- €160,000 - €64,000 = €96,000 payable to estate

Secondly, his nephew inherits the ARF and is assessed for Capital Acquisitions Tax under Group Threshold B with the available Threshold being €32,500 as he has not inherited anything previously under this Threshold

- €96,000 - €32,500 = €63,500
- €63,500 @ 33% tax = €20,955
- €96,000 - €20,955 = € 75,045

Net result for the nephew is €75,045, a loss of €84,955 to tax.

Example

A deceased co-habiting partner leaving a fund to his/her surviving partner.

What are the tax implications?

As the couple are not married yet co-habiting as a married couple would, they are treated as 'strangers' for the purposes of Capital Acquisitions Tax and can only avail of the Group C Threshold of €16,250.

With an ARF of €160,000, the situation would be as follows:

Firstly, the ARF is payable to the deceased partner's estate, less tax as it's a distribution

- €160,000 @ 40% tax = €64,000
- €160,000 - €64,000 = €96,000 payable to estate

Secondly, the surviving partner inherits the ARF and is assessed for CAT under Group Threshold C which is €16,250 assuming he/she has not inherited anything previously under this Threshold

€96,000 - €16,250 = €79,750

€79,750 @ 33% tax = €26,317.50

€96,000 - €26,317.50 = €69,682.50

Net result for the surviving partner is €69,682.50, a loss of €90,317.50 to tax.

Section 72 Insurance policies.

A possible solution to the above would be for the ARF holder to take out a Section 72 Life Insurance policy to pay off the relevant Inheritance Tax.

Section 72 policies were previously referred to as Section 60 however the Capital Acquisitions Tax Consolidation Act 2003 amended the rules so that the life insurance policy could pay the inheritance tax on an ARF, but also the 30% Income tax rate for children over 21.

Section 72 CAT provides for the exemption of the proceeds of certain qualifying policies in so far as the proceeds are used for the payment of inheritance tax arising on the insured person's death or within a year of his/her death.

The policies are further exempted from inheritance tax in so far as such proceeds are used to pay approved retirement fund tax, being tax which a qualifying assurance manager is obliged to deduct in accordance with the provisions of section 784A(4)(c) of the Taxes Consolidation Act 1997.

If a child over the age of 21 is due to inherit a parent's ARF, the 30% tax liability on the value of the ARF can be covered by the parents taking out a Section 72 Inheritance Tax policy.

In the first case above, the uncle leaving the ARF to a nephew would have the option to take out a Section 72 policy for the inheritance tax liability which his nephew would be liable for i.e. €20,955.

In the second case above, the partner leaving his ARF to his/her co-habiting partner would have the option to take out a Section 72 policy for the inheritance tax liability which his/her partner would be liable for i.e. €26,317.50.

In each of the cases above, these options would be exercised via Zurich Life's Guaranteed Whole of life policy written under Section 72 Trust. The sum insured on the policy would reflect the potential inheritance tax payable.

This reinforces the fact that clients who have potentially high worth estates, or intend to leave assets to family who will have a CAT liability, should plan earlier in their lives to cater for any potential CAT liability by setting up a CAT/Section 72 policy.

Need Further Information?

If you have further questions on any aspect of this briefing, please contact the **TechTalk Team** on **01 209 2020** or techsupport@zurich.com

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