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Dwelling House Exemption

Section 86 CATCA 2003

Section 86 of CATCA 2003 provides for an exemption from gift/inheritance tax in the case of dwelling houses, provided certain conditions are met. A dwelling is defined as 'any building or part of a building used or was suitable for use as a dwelling', and includes grounds of up to one acre occupied and enjoyed with the dwelling.

The exemption is available to any beneficiary who meets the conditions for the exemption, irrespective of whether or not they are related to the disponer, and irrespective of the value of the property being acquired. The dwelling house exemption is also separate to the Group tax-free thresholds which would also be available to apply to other assets received by a beneficiary.

Conditions for the Exemption

The main conditions attaching to the dwelling house exemption are that the beneficiary of the dwelling house must

- have continuously occupied the house as his or her only or main residence throughout the period of 3 years immediately prior to and 6 years after the date of the gift or inheritance .
- not be beneficially entitled, at the date of the gift or inheritance, to any other dwelling house (this includes property outside of the State).

Also, the recipient must continue, except where he/she is aged 55 years at the date of the gift/inheritance, to retain ownership of and occupy that dwelling house as their only or main residence for six years commencing on the date of the gift/inheritance. If the dwelling has been replaced during this three-year period, then the beneficiary must have occupied the original dwelling and the replacement property for at least three out of the four years up to the date of gift or inheritance.

Clawback

The exemption will be clawed back if the dwelling is sold within the required six-year period of occupancy and ownership. However, a beneficiary can replace the property during the six-year retention period without losing the exemption. The original and replacement properties must be occupied as the beneficiary's only or main residence for at least six out of seven years commencing on the date of the gift or inheritance.

If the full sales proceeds are not reinvested there will be a clawback of part of the original relief granted, in proportion to the amount of the sales proceeds that is not re-invested.

The clawback condition does not apply if:

- The beneficiary was over the age of 55 at the date of the gift or inheritance.
- The sale or disposal, or non-occupation of the house occurs because the beneficiary needs long-term medical care in a hospital or nursing home.
- The house is not occupied because an employer requires him to live somewhere else or because he is working abroad.

Anti-Avoidance measures for gifts from Feb 2007

Some anti-avoidance measures specifically relating to gifts were brought in from February 2007 to add additional conditions to avail of the exemption i.e.

- If the disponer also lives in the dwelling and it is the only or main residence of the disponer then the period of occupation by the beneficiary will not be counted towards the 3 years needed to qualify for relief unless the disponer is elderly and/or infirm and dependant on the beneficiaries services, and

- The dwelling house must be owned by the disponer during the three-year period immediately preceding the date of the gift.

Cost of the Dwelling House Exemption

The latest available information in respect of Dwelling House exemption from Capital Acquisitions Tax is as shown in the following table. The estimated cost for the Dwelling House exemption does not take account of the availability or otherwise of the relevant thresholds if the exemption did not apply.

Table 1 – Cost of the Dwelling House Exemption 2008-2015

Year	Numbers	Cost €m
2008	460	43
2009	574	36
2010	440	26
2011	565	45
2012	499	38
2013	538	35
2014	614	41
2015	741	52

Development of the Dwelling House Exemption

Finance Act 1991

A relief was introduced in the Finance Act 1991 in respect of inheritance of a dwelling-house taken by elderly brothers and sisters of the deceased. The conditions for the relief were:

- the brother/sister must have been 55 or over;
- he/she must have lived with the deceased for a minimum period of 5 years prior to the date of the inheritance; and
- he/she must have had no interest in any other house on the date of the inheritance.

The relief was capped at the lesser of £50,000 or 50% of the value of the house. Subsequent amendments (up until FA 1998) to this relief extended it to include siblings under the age of 55, nephews, nieces, parents and grandparents. The amount of the relief was extended to the lesser of 80% of the value of the house or £150,000. The period for which both the disponer and the successor were required to be resident in the house, prior to the date of the inheritance, was increased from 5 years to 10 years.

Finance Act 2000

The relief was radically altered in the Finance Act 2000. The underlying reason for this appears to have been the acknowledgement that other categories of persons could face hardship in paying a CAT liability when inheriting a house. This could happen in particular, where the survivor of an unmarried couple inherited the house they had both lived in. The survivor, in such circumstances, would only have been entitled to the Group C threshold. It could also happen where a child, who lived in a house with a parent, perhaps into their old age and very often to care for the parents, inherited the house on the death of the parent.

However, the terms of the new relief made it significantly more generous and more widely available because of the following features:

- it applies to gifts as well as inheritances;
- it applies to all beneficiaries regardless of their relationship to the disponer;
- the requirement that the disponer resided in the house along with the beneficiary was abolished and the period of residence of the beneficiary was reduced to 3 years ; and
- there is no limit to the value of the house – i.e. the relief became an exemption.

Finance Act 2007

Finance Act 2007 introduced additional anti-avoidance conditions specifically relating to the exemption as it applied to gifts i.e. the disponer must own the relevant dwelling for the 3 years prior to the gift and any periods in which the disponer was also living

there do not count towards the required 3 year period of residence of the beneficiary in the dwelling. These measures effectively removed the ability to gift the family home.

These amendments were introduced to deal with certain situations. Because of the provision in section 86(3)(a)(ii) of CATCA 2003 which allows the replacement of one property with another, a child living in the family home could argue that the house that is gifted to him or her replaced his or her family home and that, even if he or she was living in the house that is gifted to him or her for a short time only, the period of occupation in the family home could be combined with the period of occupation in the gifted house for the purposes of the 3-year occupancy test.

The amendment also deals with the following situation. A parent, for example, wishes to make a substantial cash gift to a child without the child incurring a gift tax liability. The child owns a house in which he or she has lived for over 3 years. The parent buys the house from the child for full market value. The parent then gifts the house to the child, who claims exemption under section 86 of the Act in respect of the gift of the house on the basis that he or she has occupied the house for a period of over 3 years. In effect, the child has received a tax-free cash gift equal to the market value of the house. The amendment also counters the purchase of a house for a child by a family trust. The child will no longer qualify for exemption under section 86 of the Act because the house will not have been owned by the disponer for the relevant period.

Unintended Use of the Dwelling House Exemption

While the exemption was originally designed to prevent the hardship of the forced sale of inherited property to pay inheritance tax where the beneficiary of that property had resided in the property and had no interest in another property, it has been found in the Districts and highlighted in the media that this exemption is being employed in some instances to pass on significant wealth within families CAT free via the gifting of property.

Cases are coming to attention where wealthy parents are using this exemption to buy and gift houses to their children. There is nothing in the exemption as currently drafted to prevent a parent with (say) four children from purchasing a dwelling house for each of them and gifting/ bequeathing them, subject to the conditions being satisfied – in practice, it can be difficult for Revenue to determine whether or not the conditions are satisfied.

Additionally, the gifting of dwelling houses in this way has no impact on the CAT Thresholds – as this exemption is additional to the CAT Thresholds, i.e. each child retains their full Group A Threshold for any further gifts/inheritances they may get.

Furthermore, the relief does not confine the gifting /inheritance of a dwelling-house to children. As enacted, the relief can apply to anyone to whom a house is gifted / bequeathed.

It is considered that such gifts are outside the scope of the intended exemption provided by Section 86 Capital Acquisitions Tax Consolidation Act 2003.

Various proposals to address this issue were put forward for the Finance Bill 2014 but the Minister was reluctant to pursue at the time due to lack of specific examples. Similarly, this issue was on the Finance Bill list for 2015 but it was ultimately removed due to the lead up to an election but also the view that the collection of data and evidence necessary in order to take a view on the need for and scale of any changes to the existing provisions might not be available in the truncated timespan available for consideration of FB issues.

Revenue Data Gathering Exercise

Tightening up of the dwelling house exemption was proposed as a priority item for Finance Bill 2016 and a data gathering exercise was conducted in Revenue to try to ascertain the extent of the use of the dwelling house exemption to pass on wealth within families tax free. Revenue examined the following data sources to determine the extent of this unintended use of the exemption:

- CAT Returns (IT38)
  The IT38 has a tick box to indicate that the dwelling house exemption is being claimed. Data from 2011 to 2015 inclusive where the tick box was checked was available and analysed to identify the passing on of properties which were not the family home by way of gift.

- Stamp Duty Returns (STR1)
  Stamp Duty returns were examined to identify cases where there was a purchase of a property which was subsequently transferred by gift at least three years and where the return indicated that the beneficiary of that gift was a 'lineal descendant' were identified and extracted. Cases where there was no contract and/or the consideration did not represent the market value of the property were also extracted.

- Survey of the Districts
  While the gifting of properties to children and claiming the DHE for this activity is provided for in CATCA 2003 and these incidences would not be triggering reap rules and leading to interventions in and of themselves, a survey was also

carried out across the Districts in each of the 4 operational Regions for any anecdotal evidence of such activity.

In all cases an estimate of the potential CAT which could have been collected had these transactions not been allowed by CATCA 2003 was generated.

Findings

Almost 3,000 IT38 returns were filed from 2011 to 2015 in which the DHE was claimed. An increasing trend in annual DHE claims since 2012 was evident with 2015 numbers up 19% on 2014. Almost a quarter of these related to gifts with gift DHE claims up annually since 2013; the number of these claims was up in 2015 by 13% over the previous years volume.

Table 2 – IT38 Returns where Dwelling House Exemption is claimed 2011 - 2015

	2011	2012	2013	2014	2015	Total
IT38s claiming DHE	555	498	535	611	728	2,927
DHE gifts	134	135	133	148	168	718
DHE gifts Parent to Child	68	80	76	95	121	440
DHE gifts Parent to Child over €400k	27	20	14	20	25	106

Of the total 718 DHE gift claims, 440 or 61% of them represented a gift of a dwelling house from a parent to a child with a quarter of these relating to dwelling houses with a market value of €400k or more. There is also a growing trend in the numbers of dwelling houses being gifted to children by parents across the 5-year period analysed although the proportion of 'high value' properties has remained relatively consistent albeit with a slump in the 2013 filing year.

The total market value of the 440 properties gifted by parents to children and claiming the DHE comes to €141.89m. Each return was examined and an appropriate full group A tax free threshold was applied in each case to allow an estimate of the minimum CAT which could have been collected were it not possible to gift a dwelling house and claim the DHE was produced; this amounted to some €18.7m over the 5 filing years examined.

When the 440 property transfers were examined for incidences of a parent gifting different properties to multiple children this was evident for 15 disponers accounting for 33 of the property transfers. Most commonly in these multiple gift cases two children within the same family were gifted properties but in 1 case 3 children benefitted from the DHE and in another case four children were each gifted a property. The total MV of the properties where the disponer had also gifted another property to at least one other child is €16.05m.

14 of the properties gifted to children over the five-year period exceeded €1m in value. One disponer gifted separate properties to four of their children which were valued at €1.7m, €1m, €800k and €700k respectively between 2011 and 2013; a total of €4.2m in wealth being passed on tax free.

Far fewer cases were discovered when examining the stamp duty data. Just 9 cases showed the types of transfers we expected to see over the five-year period studied. Interestingly just one of these cases overlapped with the IT38 returns i.e. only in one case was a return filed by the ultimate beneficiary and the use of the DHE exemption identified. The total market value of the 8 properties not previously identified in the examination of the IT38s was relatively small at €1.68m with just one case relating to a property with a market value of over €400k. The additional potential CAT yield from these 8 incidences assuming a full group A tax threshold is available in each case is €163,350.

Similarly, the survey of the Districts turned up small numbers. Anecdotal evidence from caseworkers identified 8 cases where properties were gifted to children by parents and the DHE claimed. All of these cases overlap with the IT38 returns data.

Why weren't more cases found?

There are a number of reasons why more cases weren't found during this exercise. Revenue advises in its guide to completing the IT38 return that a beneficiary is required to file an IT38 CAT Return where the total aggregable value of gifts / inheritances received on or after the 5th of December 1991 is in excess of 80% of the relevant tax free group threshold. It is highly likely that the public perception with many is that if no CAT is owed then they don't need to engage with Revenue at all.

In the context of the Stamp Duty data it is important to note that as data was only available over a 5-year time period and the STR data was being examined to identify both conveyances i.e. the initial purchase and the later transfer of the property after the minimum 3 year period, then there was a very small window within which cases could be tracked and identified. Only properties purchased in 2011 and 2012 and subsequently gifted in 2014 and 2015 could result in hits.

It isn't surprising that small numbers were turned up from the Districts survey either as the activity that this exercise tries to identify is not in contravention of CATCA 2003 as currently drafted and consequently this isn't something being examined from a compliance perspective.

Recent Media Attention

Recent media attention has highlighted this 'abuse' of the dwelling house exemption. The following are some examples:

Ken Foxe – Irish Journalist and Lecturer – February 2nd 2016 (also appeared in The Sunday Times)

...The Department of Finance decided last year they would not reform a rampantly abused exemption from inheritance tax despite knowing for close to a decade that it has been used for tax avoidance by the wealthy.

A specific loophole in Revenue rules allows parents gift valuable properties to sons and daughters without paying any tax – so long as their child has lived in the property for three years ... and remains there for another six years.

The loophole has in the past been used to transfer properties worth tens of millions of euros each year, and is being aggressively used by tax accountants as a mechanism for their wealthiest clients to help shelter money.

Documents obtained by the Sunday Times under FOI reveal that both the Department of Finance and Revenue Commissioners have known since at least 2007 that the scheme is the subject of systematic abuse.

http://www.kenfoxe.com/2016/02/why-did-fine-gael-government-postpone-decision-on-tax-loophole-used-as-vehicle-for-tax-avoidance-by-wealthy-individuals/

Personal Finance section on the Irish Independent – March 6th 2016

There is a valuable tax relief, known as the dwelling house exemption, which could allow your daughter to inherit the property you mention tax-free, as long as certain conditions are met. Your daughter may qualify for this relief, which is an exemption from Capital Acquisitions Tax (the tax paid on gifts or inheritances), if she continuously lived in the property you are considering passing onto her for the three years immediately preceding the date of the gift.

http://www.independent.ie/business/personal-finance/property-mortgages/can-i-buy-a-property-now-and-pass-it-on-to-my-daughter-taxfree-in-three-years-time-34514706.html

Dominic Coyle – Irish Times – August 28th 2016

...One of the things that has been brought into the mix is the relief you're talking about – dwelling house relief. I certainly did see some venting in certain media channels on the subject, much of it very exaggerated.

However, it is true to say that the number of families availing of the relief has jumped sharply, and there are concerns in Revenue circles that it is being abused – which it most likely is.

As usual, eagle-eyed tax specialists have been advising their often wealthy clients of the possibility of providing a home for children without any tax implications on. They have been surprisingly open on the subject of such "tax planning".

http://www.irishtimes.com/business/personal-finance/abuse-of-dwelling-house-relief-may-see-changes-to-inheritance-tax-code-1.2763509

Jill Kerby – Personal Finance Journalist – The Munster Express – September 15th 2015

This is an extraordinarily generous CAT/gift exemption, admit financial planners, since it means that anyone can leave a person (a relative or not) a second or multiple properties of any value tax-free so long as the beneficiary has lived in it for three continuous previous years and fulfils the other dwelling house exemption conditions.

It is also a hugely disproportionate tax break that only multiple property owners – people with existing means – will enjoy.

Should the Minister for Finance ease up on the CAT-free thresholds and the CAT rate in next month's Budget?

Many believe he should as property prices keep rising and CAT bills soar. Tightening up the anomalous dwelling house gift rule might help him justify such a contentious decision.

http://www.munster-express.ie/business/a-gift-tax-exemption-of-little-worth/

Industry Perception

The following are extracts from Industry websites which encourage the use of the DHE for the passing on of wealth.

Deloitte –

In summary, with a small amount of careful planning the dwelling house exemption can be utilised to protect the family home, as well as to offer parents an opportunity to support their adult children in acquiring a family home of their own.

http://www2.deloitte.com/ie/en/pages/tax/articles/capital-acquisitions-tax-dwelling-house-exemption.html

Davy Financial Life Planning –

In any case, the nature of parental assistance in Ireland remains largely property-related, with parents giving outright gifts, contributing towards deposits or simply agreeing to be guarantor for their children.

Following the economic turmoil that erupted in 2007 succession planning took a back seat as parents focussed on their own financial survival in the midst of falling property and other asset values. With renewed confidence now pushing asset prices back up, and with inheritance taxes having increased significantly, Irish parents are looking again at the area of succession planning and asking:

- *Have we sufficient assets to meet our needs?*
- *Should we transfer the asset(s) during our lifetime or as part of our estate and, if we do it now, how do we retain control?*
- *Can we avail of any tax reliefs?*
    - *Dwelling House relief for residential property assistance; and/or*
    - *Business Property Relief /Agricultural property relief for business assets*
- *Are we availing of the lifetime thresholds for Capital Acquisition Tax (CAT) of €225,000 for children and the annual exemption of €3,000 per parent and per individual?*

http://www.davy.ie/private-clients/insights/financial-planning-insights/transferring-assets-to-your-children.html