Mr. Tutty to see. 1/11

Minister from Donal McNally

Subject: Changes to the Capital Acquisition Tax regime in the next Budget/2000 Finance Bill.

Possible changes to CAT Code.

1. (a) You may wish to announce in the forthcoming Budget your intention to include provisions in the 2000 Finance Bill to exempt the family home completely from Capital Acquisition Tax (CAT) subject to a residential condition for the beneficiary. This would be done in a way that would cover relationships that are not based on marriage, including same sex unions, as well as nieces, nephews, siblings etc residing/have resided with the disponer of the property for a specified period. The change would apply to inheritances (and gifts) taken on or after Budget day.[1]

   Revenue tentatively estimate the cost of this measure at £3 million pa.

   (b) You may also wish to propose a widening of the bands for the charging of taxation as well as rationalising the rate structure. This would be on the following basis.

Existing Bands/Rates			Proposed Bands/Rates		
Threshold Amount	-	Nil	Threshold	-	Nil
Next £10,000	-	20%	Next £40,000	-	20%
Next £30,000	-	30%	Balance	-	40%
Balance	-	40%			

   The cost of this is tentatively estimated by Revenue at £10.5m pa.

   Therefore, the total cost involved in making the proposed changes would be £13m pa.

Background.

2. During the debate on the 1999 Finance Bill, and in answer to PQs, you have indicated that you intend to make considerable changes to the Capital Acquisition Tax (CAT) regime in the forthcoming Budget and Finance Bill. (The structure of the current CAT regime is set out in Appendix 1.)

   The expected yield for CAT in 1999 is £149 million of which £106 million comes from Inheritance Tax and £8 million from gift tax.

3. The major issues on CAT are:

   - CAT on the "family home". There are demands that the family home be exempted in full or substantially relieved from CAT arising on inheritance particularly in the case of certain classes of beneficiaries sharing a family home such as cohabiting couples; elderly brothers and sisters; aunts and nieces; and couples in same sex relationships,

[1] Revenue have suggested excluding gifts to counter possible avoidance. However, the CAT system incentivises inter-vivos transfers so excluding gifts would be contrary to the general approach. — abolished FB2000

where, in all cases, the amount of CAT payable on the shared domestic residence can be substantial.

- The low rate of increase (indexed to CPI since 1990) in CAT thresholds when compared to house price inflation, particularly in the Dublin area.
- The low level of thresholds in absolute terms in respect of particular gifts and inheritances taken by close relatives (other than children) and strangers i.e. £25,720 and £12,860 respectively.

Essentially the issue concerns (i) the low thresholds, relative to present day house values especially in Dublin, which is resulting in children (and other beneficiaries) having to pay substantial CAT when they inherit the family home and (ii) in the context of the family home, the need for the CAT law to take account of other non-marital traditional and contemporary relationship types. These factors warrant a review of the CAT arrangements. Significant numbers of representations have been made to you on the matter.

In addition there is also need to examine the bands for charging the tax (in excess of the thresholds) as well as the rates of the tax to take account of the recent inflation in property prices.

4. However, in examining the CAT issue it is important not to lose sight of the over arching goal of equity within the taxation system as a whole. While some updating of the CAT system is appropriate at this stage, significant concessions to those who have been gifted or inherit wealth may reduce the level of equity within the overall taxation system particularly for those paying 46% income tax on relatively low incomes.

5. The proposed exemption in respect of the family home would largely be on the same basis as the existing elderly sibling relief i.e.

   - Minimum period of 5 years during which the disponer and the beneficiary resided together in the house owned by the disponer,
   - The beneficiary not to have an interest in any other residence.

   In addition, it seems appropriate to require that the beneficiary in these circumstances should not dispose of the family home for 6 years after the inheritance or gift. Special arrangements would also be made to cover situations where the house is held in trust, discretionary or otherwise.

6. By exempting the family home from CAT much of the emotion that has built up on this particular issue should be largely reduced. The intention is that an individual could not become liable to CAT through inheritance of his principal private residence. Furthermore, a solution based around the disponer and the beneficiary residing/having resided together, should help to resolve the difficulties arising with non-marital or same sex relationships (as well as aunts/nieces etc residing together). It would also ensure that the tax code would be neutral in relation to certain types of relationships, which are not based on marriage, ahead of developments in the general law on marriage. This approach should help avoid problems which might arise with respect to the Income Tax code if the CAT code were to put such relationships on the same basis as married relationships.