



Farm Taxation Brochure 2010

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KBG Chartered Accountants**

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INCOME TAX – Basics

A farmer needs to prepare farm accounts every year. These accounts must show all the income that was earned during the year (from cattle sales, subsidies etc) and all the related expenses. The net profit which the farmer makes during the year is subject to Income Tax.

Tax return

A farmer is obliged to submit an Income Tax (Form 11) each year. For example the Income Tax return for 2009 must be submitted before 31 October 2010

(if it is submitted online via the Revenue's Online Service "ROS", it doesn't have to be submitted until the 15 November 2010)

Payment of tax

A farmer or any other self-employed person has to make a preliminary tax payment for a given year or on before 31 October of that year. The amount to be paid is generally based on the farmer's tax liability for the prior year.

Example

A farmer's tax liability for 2008 was €4,000. The Income Tax return for 2008 had to be submitted by 31 October 2009. In addition, preliminary tax for 2009 has also to be paid before 31 Oct 2009. The amount of preliminary tax to be paid is based on the 2008 liability which was €4,000*. If, when the Income Tax Return for 2009 is prepared, it turns out that the actual tax liability is greater than €4,000, the additional tax will have to be paid by 31 Oct 2010. If it turns out that the actual tax liability was less than the €4,000 paid, then the Revenue Commissioners will refund the overpayment to the farmer.

(Note – if a farmer prepares accounts up to the 31 Dec each year, it would be very difficult for him to know what his tax liability would be for that year by 31 Oct which is when the preliminary tax is due. That is why he is allowed to base his preliminary tax payment on his prior year's tax liability. However, if he does have a good idea of what his income tax liability for the year will be, he can make a preliminary tax payment based on 90% of the actual tax liability for that year.*

Farming losses

If a farmer makes a farming loss in any given year (i.e. income is less than expenditure), he maybe able to offset that loss against his other income (in that year) and in certain cases may be able to claim a refund of tax (such as PAYE if he also has an employment)

Example

For 2009 a farmer had a farming loss of €20,000. He also had the following sources of income:

	€
Salary from part-time job	18,000
Rental income	<u>2,000</u>
Total	20,000

He can offset his farming loss of €20,000 against his other income of €20,000, resulting in his net taxable income being reduced to nil (and hence a nil tax liability). If he suffered PAYE on his salary, he should be able to claim a refund of this tax from the Revenue Commissioners.

Points to note

- A farmer can only set his farming losses against his other income if he is carrying out his farming trade “on a commercial basis with a view to the realization of profit”. This provision is to stop a “hobby farmer” using trading losses to shelter their other income.
- If a farmer makes a loss year after year, he won’t be able to keep offsetting his farming losses against his *other* income. The rule is:- if he has made a loss for 3 years in a row he can’t claim loss relief for the fourth and subsequent years. (*However if for example if he makes a profit in the 4th year and then goes back to making losses again, he will be able to claim losses for another three years*). Losses in this case means losses *before* capital allowances.
- Any farming loss which a farmer makes in a given year and which can’t be offset against other income can be carried forward and set off against any farming profits arising in future years.

Income averaging

In certain cases, a farmer can elect for Income Averaging – this means that instead of being taxed on the profits arising in the year of assessment, they are taxed instead on the average of the last three years profits.

(The profit that is subject to averaging is that after Stock Relief and before Capital Allowance).

Example

John makes up accounts annually to 31 December. His results are as follows:

	Farming income (<i>before capital allowance</i>)
	€
31 Dec 2007	2,000
31 Dec 2008	5,000
31 Dec 2009	23,000

If John elects for Income Averaging for 2009, he would be only subject to tax on the average profit for the last 3 years which is €10,000 (i.e. €2k + €5k + €23k) /3.

Conditions

- An election for the averaging basis must be made in writing to the Revenue Commissioners.
- Farmer must have been taxed on a “normal” basis for each of the 2 years before the election is made
- Doesn't apply to a farmer who is carrying out another trade or who is a proprietary director of a company
- Doesn't apply to a farming company
- A farmer may revert back to the normal basis of assessment, but only after they have been assessed on the averaging basis for at least 3 years – special rules apply in this case to make sure tax hasn't been underpaid

Stock Relief

Farmers can claim a 25% deduction from their trading profits for any increase in the closing stock value over the opening stock value for the accounting period (*However the amount of stock relief claimed can't exceed the actual profits i.e. it can't turn a profit into a loss*)

<u>Example</u>	
	€
Closing Stock	60,000
Opening Stock	<u>40,000</u>
Increase	20,000
25% of increase	5,000
Case I profit	30,000
Less Stock Relief	<u>-5,000</u>
Case I Revised	25,000

Young trained farmers

There is enhanced Stock Relief available for Young Trained Farmers – such farmers can claim 100% Stock Relief. A young trained farmer is one who is under the age of 35 and who has met specific training requirements.

<u>Example</u>	
	€
Closing Stock	60,000
Opening Stock	<u>40,000</u>
Increase	20,000
Case I profit	30,000
Less Stock Relief	<u>-20,000</u>
Case I Revised	10,000

Point of caution (!)

Excess capital allowance or unused losses from a prior period cannot be carried forward from a period in which Stock Relief is claimed. So you need to be careful if this – if there are large losses/capital allowance coming forward, it may be better not to claim Stock Relief .

Other points

- A claim for Stock Relief must be made by the date the tax return for that year is due e.g. 31 Oct 2010 for 2009 tax return.
- This relief will only be available up to the end of 2010
- There is no provision to clawback the relief if the value of the stock declines

Valuation of Stock

Stock for resale is normally valued at cost but it is difficult in farming to establish the cost for animals either bred on the farm or bought-in when only a few months old. Generally cost may be taken as 60% of the market value of cattle, 75% of the market value of sheep and pigs and 75% of the market value of harvested crops.

Capital Allowances

When a farmer spends money on capital expenditure such as tractors, farm machinery, farm building etc, they are not allowed to deduct the cost against their profits all in the one year – instead they have to spread out the cost over a number of years in the form of capital allowances. Below are the main types of capital allowances that a farmer can claim:

1. Plant & Machinery
2. Farm Buildings
3. Pollution controls (under EU Nitrates Directive)
4. Milk Quotas

Plant & Machinery

If a farmer buys machinery such as tractors, trailers etc. for the purposes of their farm, they can claim capital allowances over 8 years at a rate of 12.5%.

Example

Farmer buys tractor for €40,000 in 2009. He will be able to claim an annual capital allowance of €5,000 for the 8 years from 2009 to 2016. So let's say his annual profit for 2009 is €20,000. He can deduct the €5,000 capital allowance from the €20,000, leaving him with a taxable profit of only €15,000.

Farm Buildings

If a farmer spends money in respect of farm buildings, fences, roadways, drains, yards, land reclamation etc. they can claim capital allowances over 7 years (15% for the first 6 years and 10% for the 7th year)

Example

A farmer spends €50,000 on the construction of a hay-barn in 2010. He will be able to annual capital allowance of €7,500 (15%) for the first 6 tax years from 2010 to 2015 and will be to claim capital allowances of €5,000 (10%) in the 7th year (2016)

Pollution controls

A farmer can claim *accelerated* capital allowances in respect of the construction of certain buildings and structure which are necessary for pollution controls The type of expenditure that qualifies would be on items such as like:-

- slurry tanks
- effluent tanks
- soiled water tanks
- tank fences and covers

- dunsteads and manure pits
- yard drains for storm and soiled water removal
- walled silos, silage bases and silo aprons
- certain housing for cattle and sheep, slatted sheds etc.

In order to be able to claim these accelerated capital allowances, the farmer has to submit a **farm nutrient plan** to the Department of Agriculture which has been drawn up by an approved agency/planner and certifies that the expenditure in question is necessary for the purposes of pollution control.

Tax relief for the expenditure can then be claimed over 3 years (*capital allowances at a rate of 33.33%*). For example, if a farmer spends €30,000 on these pollution controls in 2009, he can claim capital allowances of €10,000 against his trading profits for 2010, 2011 and 2012.

In some cases, the farmer can claim up to 50% of the expenditure in the first year (subject to a limit of €50,000).

This scheme of capital allowances only applies to expenditure incurred before 1 January 2011.

Example

A farmer spends €90,000 on slurry tanks in 2010 and has submitted a farm nutrient plan to the Department of Agricultural which was drawn up by an approved planner and certifies that this expenditure was necessary for the purposes of pollution control. He will be able to claim capital allowance of €30,000 (33.3%) for each of the 3 tax years from 2010 to 2012. Alternatively he can claim 50% of the expenditure in the first year (2010) which would be €45,000 and the rest of the expenditure over the following 2 years

Milk Quotas

Capital allowances can also be claimed on the cost of a Milk Quota – capital allowances are available over 7 years

Note:

- Capital allowances cannot be claimed on any expenditure that has been covered by grants
- Capital allowances cannot be claimed on that part of the expenditure which relates to VAT where that VAT has been refunded to the farmer

Compulsory Disposal of Livestock

Where a farmer had to de-stock due to an outbreak of certain diseases e.g. TB, Foot & Mouth and BSE, then the profits crystallized by the sudden sale of the entire herd may be spread over 4 years. The profit for the year is determined and the farmer has the choice of bringing in just ¼ of the profit in the year of disposal and in each of the 3 subsequent years. (*Alternatively they can bring in ¼ of the profit in the year after the disposal and the 3 subsequent years*)

Example

In 2008, a farmer made a profit of €12,000 as a result of the compulsory disposal of livestock. This profits can be spread as follows:

	<i>Option 1</i>	<i>Option 2</i>
	€	€
2008	0	3,000
2009	3,000	3,000
2010	3,000	3,000
2011	3,000	3,000
2012	3,000	0

However in practice, often the compensation/sales proceeds received will do little more than cover the value of the opening cost of the stock as per the accounts, so there may be no profit element in any case.

In a compulsory disposal case, the farmer can also get enhanced stock relief if he reinvests all the proceeds which he receives in new stock. The maximum amount of stock relief which is available is that which will match the taxable profit which is being spread over the 4 years - in the above example, this will be €3,000 a year for the 4 years (*which will bring his tax liability as a result of the compulsory purchase to nil*)

Farm Rental Income

Generally if land is rented out it will be fully subject to Income Tax.

Exemption

However in certain cases the rents received from the letting of **land can be exempt** from tax. In order to qualify for the exemption, the following conditions have to be met.

- The farmer must be over 40 years of age or must be permanently incapacitated from carrying on a trade of farming.
- The land must be let under a **formal lease**. This lease must be in writing and must be for a definite term of five years or more.
- The relief doesn't apply if the land is let to a spouse, brother, sister, child, grandchild or parent. It will apply though if it is let to niece/nephew or aunt/uncle.

The amount of rent that can be received tax free depends on:

- a. the duration of the lease; and
- b. when the lease was first entered into.

For example, if the lease was first entered into after 1 January 2007, then the following amounts of rent can be received annually tax-free:

- Term of lease is between 5 and 7 years - €12,000
- Term of lease is between 7 and 10 years - €15,000
- Term of lease is over 10 years - €20,000

Example

A farmer aged 45 rents out farmland under a formal written lease for 6 years which commenced in 2009. The annual rent which he receives under the lease is €10,000. As the lease is between 5 and 7 years in duration, he can receive up to €12,000 in rents tax free. So the annual rent of €10,000 will not be taxable

Farmers and VAT

The vast majority of farmers in the country are not registered for VAT, nor are they obliged to be registered for VAT.

As a non-VAT registered person, a farmer does not have the administration burden of collecting VAT from their customers and paying this over the Revenue Commissioners, which many other self-employed individuals are obliged to do. However the downside to this is that they cannot claim the VAT back on their expenses.

However, farmers are compensated for this in 2 ways:

1. flat-rate addition
2. refund of VAT on farm buildings

Flat-rate addition

When farmers are selling their goods, they are entitled to add on 5.2% to their price (this is called the “flat-rate addition”).

For example, if a farmer is selling cattle to a factory for €10,000, he is entitled to charge an extra €520. So the total amount that the factory pays to the farmer is €10,520. However if the factory is VAT-registered, it is entitled to reclaim this €520 from the Revenue Commissioners. So the cost to the factory is really only €10,000, while the farmer gets to keep the extra €520.

Refund of VAT on farm building work

An unregistered farmer is entitled to recover the VAT incurred by him on the construction of farm buildings, fencing, land drainage & reclamation.

The refund is obtained by completing and the appropriate form (Form VAT 58) and submitting it to the Revenue Commissioners along with the supporting invoices.

Example

An farmer incurs €2,700 (inclusive of VAT at 13.5%) on the construction of a farm building. He is entitled to receive a refund of the VAT of €2,700

VAT-registered farmers

If a farmer is engaged in another trade and is obliged to be registered for VAT in respect of that trade, he will also be considered to be registered for VAT in respect of his farming activities. A VAT registered farmer:-

- has to file regular VAT returns (normally every 2 months)
- has to charge VAT to his customers (*the rate of VAT which applies to livestock is 4.8%*)
- has to issue VAT invoices to his customers
- is *not* entitled to claim the flat-rate addition

A farmer who is not obliged to register for VAT can still register for VAT if he so wishes. However, there may not be much advantage to doing this, as

- a. a unregistered farmer can still re-claim the VAT on farm buildings
- b. a VAT-registered farmer has an increased administration burden in that he has to issue VAT invoices and submit VAT returns etc.
- c. a VAT-registered farmer is not entitled to the 5.2% flat-rate addition

Disposal of a farm – CGT

If a farmer sells land, he will be subject to Capital Gains Tax at a rate of 25% on the difference between the sales price and what he originally paid for the land.

Example

A farmer sells 20 acres of land for €200,000 which he originally acquired for €50,000, hence making a gain of €150,000. He will be subject to CGT at a rate of 25% on the gain of €150,000 resulting in a tax liability of €37,500.

If the farmer has held the land for a number of years, then he will be allowed some measure of relief for inflation, depending on the year in which he purchased the land. Let's say that in the above example, the land was purchased in 1980. The farmer is allowed to multiply the original cost of the land by 3.24 to account for inflation. So the indexed cost would then be €62,000, reducing the taxable gain to €88,000 and the tax liability to €22,000.

If the farmer held the land before 1974, then the market value of the land as at 5 April 1974 is used as the "cost" of the land in the calculation of the capital gain.

The farmer will also be able to claim a deduction for the costs of buying and selling the land such as Stamp Duty and solicitor's fees etc. and for any enhancement expenditure on the property such as building sheds etc.

Point of caution (!) - gifts

If a farmer gifts property to a child or other connected person, then for CGT purposes they will be treated as if they received market value for the gift even though they actually received nothing! This is something that many people are not aware of.

Example

In 2010, a farmer gives 20 acres of farmland to his son. The market value of the land at the date of the gift is €200,000. The farmer purchased this land for €100,000 in 1999. Although the farmer received nothing from his son in payment for the land, for CGT purposes he will be treated as if he received the market value of €200,000 resulting in a taxable capital gain of €100,000 with a corresponding tax liability of €25,000

Note: CGT does not apply to the transfer of assets between spouses

Reliefs from CGT

There are however a number of reliefs from CGT which a farmer may be able to avail of:

1. **Transfer of a site to a child**
2. **Retirement Relief**

Transfer of a site to a child

If a farmer transfers a site to a child to enable them to build a house, then the disposal will be exempt from CGT provided the following conditions are met:

- The size of the site cannot be more than 1 acre and its value cannot be more than €500,000
- The child must build a house on the site and occupy that house as their main residence for a period of at least 3 years. If the child either
 - sells the site without ever having built on it; or
 - sells the house without having lived in it for at least 3 years

then there will be a clawback of the relief, and the CGT which the parent would have had to pay, had the relief not applied, will then become payable, but it will be the *child* and not the parent who will have to pay the tax to the Revenue Commissioners

[There is a complementary relief from Stamp Duty on the acquisition by a child of a site from their parents]

Retirement relief

Retirement Relief from Capital Gains Tax is a very important relief which farmers should be aware of if they are considering selling some of their land. In order to qualify for the relief, the farmer must be over 55 years of age and must have owned and *farmed* the land for the last 10 years. There are 2 different types of Retirement Relief

- one which applies if the farmer is transferring property to his children; and
- one which applies if the farmer is selling the property to anyone else

Transferring to a child

If a farmer is transferring property to a child, there is no limit on the value of the property which you can be transferred. However, the child can't sell that land for at least 6 years or the relief will be clawed back, and the CGT which the parent would have had to pay had the relief not applied will then become payable, but it will be the *child* and not the parent who will have to pay this tax to the Revenue Commissioners

Sale to anyone else

In this case, in order to qualify for Retirement Relief, the proceeds of the sale cannot exceed €750,000. This limit applies to all sales of farming assets after the individual reaches 55.

Example

A farmer sells half of his farm for €500,000 when he is 56 years old. Provided that he has owned and farmed the land for the previous 10 years, he should qualify for Retirement Relief as the proceeds of the sale are less than the €750,000 limit. However if after another 2 years, the farmer sells the second half of his farm for another €500,000, he will have breached the €750,000 limit and will then he will become fully subject to Capital Gains Tax on *both* sales.

Point to note

One of the main conditions, to qualify for Retirement Relief is that the farmer must have owned and farmed the land for the 10 years prior to its disposal.

So in general, if a farmer rents out land before he disposes it, he would be disqualified from the relief. However, an important exception to this provision was introduced in 2007. Under the new rules, if a farmer rents out his land, and within 15 years of first renting it, he transfers it to a child, then he will still qualify for the relief, provided he farmed the land in question for at least 10 years before he first rented it out. Relief is also still available in the case where the land is leased out under the Scheme of Early Retirement for Farming run by the Department of Agriculture and Food.

NAMA and new 80% “Windfall tax”

The NAMA legislation was brought in before Christmas. Hidden within this legislation were some extremely penal taxation measures which aim to apply tax at a rate of **80%** on what is called a “windfall gain”.

A windfall gains is defined as gain that arose due to a rezoning decision which occurred *after 30 October 2009*.

So if a farmer has land which is rezoned from “greenfield” to residential, commercial or industrial *after the 30 October 2009*, and the farmer later sells the land in question, then any gain made as a result of the re-zoning will be subject to tax at the horrific rate of 80%. For example if the value of the land before the re-zoning was €100,000 and if the valued of the land after the re-zoning was €500,000, they will be subject to the 80% windfall tax on the gain of €400,000

It is important to note however, that this windfall tax only applies where the re-zoning occurred after the 30 October 2009. So if a farmer has land which was rezoned *before* this date, and he later sells this land, he won’t be caught with the 80% rate.

The recent Finance Bill proposes that there should be an exemption from the windfall tax where a small site (less than 1 acre) is sold with a market value of less than €250,000.

Passing on a farm to the next generation – CAT

Capital Acquisitions Tax (“CAT”) is a tax that applies to gifts and inheritances.

- **A child can receive total gifts and inheritance from their *parents* up to a value of €14,799 before they have to pay any CAT.** Any gift or inheritance in excess of this limit is subject to CAT at rate of 25%. This threshold of €14,799 is a lifetime limit.

Example

A farmer wills his farm to his son. When the farmer dies, the value of the farm is €600,000. The son received no previous gifts or inheritances from his parents. As the son can receive €14,799 worth of gifts/inheritances tax free, he will only be subject to CAT on €552,201 (i.e. €600,000 minus the €14,799 threshold) resulting in a tax liability of €138,050.

Example

Take the above example, but this time assume that the son previously received gifts from his parents with a value of €14,799. As these previous gifts would have used up all off his tax-free threshold of €14,799, he will be fully subject to CAT on the inheritance of €600,000 and will have a tax liability of €150,000

- A person can receive total gifts and inheritances from brothers, sisters, aunts, uncles, grandparents and children up to a value of €11,481 before they have to pay any CAT. Again this is a lifetime limit.

Example

A farmer left his farm to his nephew. The value of the farm was €200,000. The nephew had previously received an inheritance from his grandfather worth €11,481. As this first inheritance used up all of the nephew’s tax-free threshold of €11,481, he will be subject to CAT on the full value of the farm i.e. he will have a tax liability of €50,000 (€200,000 x 25%)

- A person can only receive total gifts and inheritances from “strangers” and more distant relatives such as cousins up to a value of €20,274 before they have to pay any CAT.

Favorite niece/nephew relief

As previously discussed, a person can receive gifts and inheritance up to €14,799 tax-free from their parents but can only receive €1,481 from uncles/aunts.

However, in certain cases a niece or nephew can be treated as if they were a child of the individual for CAT purposes – i.e. they can utilize the €14,799 threshold instead of the €1,481 threshold in respect of the gift or inheritance of a farm.

In order to claim this relief, the niece or nephew has to have worked substantially on a full-time basis on the farm for their aunt/uncle for a period of at least 5 years prior to the date of the gift/inheritance. “Substantially on a full time basis” generally means at least 24 hours a week but if all the farm work carried out just by the farmer, his spouse and the nephew/niece, then 15 hours a week would be sufficient.

Practically, it can be sometimes difficult to prove that the niece/nephew worked for all of the required hours and the burden of proof lies on the taxpayer.

Agricultural Relief

There is a very important relief from CAT which can sometimes apply to a gift or inheritance of agricultural property. This relief is called “Agricultural Relief” and when it applies it reduces the CAT liability significantly, very often to nil.

Whether or not a person can qualify for this relief depends on what assets they have. If more than 80% of their total assets (including the assets which were the subject of the gift or inheritance) are “agricultural assets”, then they will qualify for the relief. Agricultural assets for this purposes includes agricultural land, woodland, farm buildings, farm houses, farm machinery, livestock etc.

Example

John inherits a farm on the death of his father. The value of the farm is €600,000. John’s other assets are as follows:

Cash in bank	-	€20,000
Car	-	<u>€10,000</u>
		€30,000

Of John’s total assets of €630,000, €600,000 relates to agriculture assets which represents 95%. Hence as more than 80% of his total assets are agricultural assets, he will qualify for agricultural relief

Agricultural relief operates by reducing the value of the gift for CAT purposes to 10%. So in the above example, John will be taxed as if he received an inheritance of €60,000 instead of €600,000. As this deemed inheritance of only €60,000 will be well below the tax-free thresholds of €14,799, he will have a nil CAT liability.

Claw-back

There is one other important condition for Agricultural Relief. The person who received the gift or inheritance cannot sell the farm within 6 years (*unless they reinvest the sales proceeds into other agricultural property within 1 year*). If they do sell the land within this 6 year period, the relief will be clawed back and they will have to pay the CAT that would have applied had the relief not been claimed. This 6 year holding period is increased to 10 years in cases where the land has development value.

Note: There is never a CAT liability on a gift or inheritance from a spouse

Acquisition of farmland – Stamp Duty

If an individual wishes to buy land, the rate of Stamp Duty that generally applies is 6%. So for example, if the price of the land was €300,000, the Stamp Duty would be €18,000.

Young Trained Farmer's Relief

However, there is a relief for Stamp Duty for “Young Trained Farmers”. To qualify as a young trained farmer, a person must:

- be under the age of 35
- have an appropriate agricultural qualification; and
- must spend not less than 50% of his normal working time farming the land for the next 5 years.

If the land is sold within 5 years (and the proceeds are not invested in other agricultural land within 1 year of sale), the relief will be clawed back.

The availability of Young Trained Farmer's Relief has been extended to 31 December 2012.

Consanguinity Relief

When land is being transferred between relatives, a relief called “Consanguinity Relief” is available which reduces the Stamp Duty liability by 50%. So if for example, a father transfers land worth €300,000 to his son, the Stamp Duty liability will be only be €9,000 instead of €18,000 (i.e. 3% from 6%)

Other reliefs

There is another relief for farmers called “Farm Consolidation Relief” which provides relief from Stamp Duty on exchanges of farmland effected for the purposes of consolidation. There are a number of conditions attached to the relief which have to be satisfied.

Note: There is no Stamp Duty liability on the transfer of assets between spouses

Single Payment Scheme – some points

Income Tax

Any payments received under the Single Payment Scheme is subject to subject to Income Tax

The cost of purchasing a payment entitlement is not allowed as a deduction for Income Tax purposes as it is considered capital expenditure. Capital allowances are not available on the cost either.

Capital Gains Tax

If a payment entitlement is sold, gifted etc, any gain arising is subject to CGT. Unless it was purchased from another farmer, its base cost for CGT purposes will be nil. It is a qualifying asset for Retirement Relief however.

Capital Acquisitions Tax

The gift/inheritance of a payment entitlement is subject to CAT just like any other asset. Agricultural Relief may be available if all the relevant conditions are satisfied

Stamp Duty

The transfer of a payment entitlement is exempt from Stamp Duty.

This booklet has been prepared as a general guide for use in the Republic of Ireland and is based on our understanding of present law and practice. While every effort has been made to ensure accuracy, neither this firm nor the authors are liable for any errors or omissions.

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