EXPLANATORY MEMORANDUM RELATING TO

THE INHERITANCE TAX (DOUBLE CHARGES RELIEF) REGULATIONS 2005

2005 No. 3441

1. This explanatory memorandum has been prepared by the HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

   This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Description**

   2.1. As announced in the Paymaster General's written statement of 21 July 2005 these Regulations provide relief from double inheritance tax (IHT) charges in situations where arrangements caught by the pre-owned assets income tax provisions in Schedule 15 Finance Act 2004 are dismantled. (Existing Regulations (The Charge to Income Tax by Reference to Enjoyment of Property Previously Owned Regulations 2005 SI. No. 724) made on 16 March 2005 provide relief from double IHT charges where taxpayers elected to disapply the pre-owned income tax charge under paragraph 21 of Schedule 15.)

   2.2. The Regulations give relief in certain circumstances from a potential double IHT charge which can arise where taxpayers choose to dismantle their arrangements so that a pre-owned asset income tax charge is no longer due. The double charge can apply where the former owner of an asset disposes of it in circumstances such that Schedule 15 applies, and gifts the disposal proceeds (commonly an IOU) into a trust. If the former owner dismantles the arrangement, and dies within seven years of the gift into settlement, the value of the gift into trust will be aggregated with their estate at death for IHT purposes, and the value of the asset originally disposed of also forms part of their taxable estate. The Regulations provide relief so that, broadly, tax is due only on one of these components, whichever gives the larger tax liability.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

   3.1 A retrospection issue arises in that these Regulations come into force from 4th January 2006, but apply in a case where an individual dies on or after 6th April 2005. But since these Regulations are made under powers conferred by section 104 of the Finance Act 1986, a section which applies "with respect to transfers of value made, and other events occurring, on or after 18th March 1986", and since these Regulations make provision benefiting taxpayers, it is considered that the use made of the powers conferred is unobjectionable

4. **Legislative Background**

4.1 Schedule 15, Finance Act 2004 provides for income tax to be charged – from 6 April 2005 – on the benefit people gain, in certain circumstances, from the continuing enjoyment of assets they formerly owned. The taxable benefit is chargeable by reference to market rentals in the case of land, and by applying imputed yield to capital values in the case of chattels and intangible assets. The resulting amount so calculated will be treated as additional taxable income of the chargeable person, subject to a de minimis threshold of £5,000. There are numerous exclusions from the charge, for example, property which ceased to be owned before 18 March 1986, and property formerly owned which has been transferred to the former owner's spouse.

4.2 The IHT rules on lifetime gifts of property where the giver retains a benefit were introduced in the 1986 Finance Act. As a result of those rules, a potential double IHT charge on the same asset value on the same event could arise in certain circumstances. So section 104 of that Act contains an enabling power which provides for relief to be given by means of Regulations to ensure that only one IHT charge arises in these circumstances.

4.3 These Regulations use the enabling power mentioned above to provide relief from a potential double IHT charge as a result of taxpayers dismantling previous arrangements (described earlier in part 2) so that a pre-owned asset income tax charge is no longer due.

5. **Extent**

5.1 This instrument applies to all of the United Kingdom.

6. **European Commission on Human Rights**

6.1 No statement is required.

7. **Policy background**

7.1 The Chancellor of the Exchequer announced proposals in his Pre-Budget Report on 10 December 2003 to impose a free-standing income tax charge, starting on 6 April 2005, on the benefit people enjoy from free or low-cost use of assets they formerly owned (or provided the funds to purchase); known as "Pre-Owned Assets". These proposals were prompted by the Government's determination to counter contrived schemes to avoid IHT which had been widely marketed prior to the announcement, and to discourage comparable schemes in the future. These schemes involve artificial structures by which people circumvent the IHT "gift with reservation" rules by removing assets from their taxable estates while continuing to enjoy them.

7.2 Following the Chancellor's announcement, HMRC (formerly Inland Revenue) published a consultative document on 11 December 2003 seeking views on the detailed working of the income tax charge. The Chancellor subsequently confirmed his intention to proceed with the income tax charge in his 2004

Budget. Details were set out in BN40 dated 17 March 2004, which made clear that further consultation would follow to settle the rates of yield and other operational matters.

7.3 The legislation was brought forward in the Finance Bill 2004 and is now contained in Schedule 15 of the Finance Act 2004. Schedule 15 contains a number of exclusions and exemptions from the charge that would otherwise apply, and provides for operational matters and further exemptions from the charge to be made in secondary legislation.

8. Impact

8.1 These Regulations do not impose new costs on business or charities.

9. Contact

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