CHAPTER 16

DOUBLE CHARGES RELIEF

16.1 Introduction

In the chapter on Gifts with Reservation, we identified a couple of situations in which a potential double charge to IHT could arise. In this chapter, we shall look at the Regulations put in place in 1997 to **alleviate any such double charges.**

The Double Charges Regulations are contained in Statutory Instrument 1987/1130. This is worth looking at as it contains numerical examples showing how the Double Charges Regulations operate.

16.2 Operation of the relief

The Regulations are designed to prevent there being more than one Inheritance Tax charge on the same transfer. Having identified a Double Charge situation, HMRC will prepare two Inheritance Tax calculations and take whichever calculation, or set of calculations, produce the higher IHT liability. The Regulations apply automatically, and no formal election is required.

Illustration 1

David made a chargeable lifetime transfer of £121,000 in May 2002. In July 2005, David gave a house worth £220,000 to his daughter. David continued to live in the house, so he made a Gift with Reservation of benefit. David died on 30 April 2010 leaving an estate of £448,000.

At the date of his death, the house was worth £350,000. As David continued to occupy the property up until the date of his death, under the Gift with Reservation rules the house will form part of his estate for IHT purposes. The PET in July 2005 becomes a chargeable transfer as a result of David's death within 7 years. As there are potentially two charges to IHT on the same property, the Double Charges Regulations will take effect.

Under the Double Charges Regulations, HMRC will **prepare two computations and will then take whichever produces the most inheritance tax**. SI 1987/1130 reg 5

In the first calculation, we calculate tax on the potentially exempt transfer ignoring the Gift with Reservation. In the second computation we charge the house in David's death estate, ignoring the original PET.

We start by calculating tax on the PET in July 2005.

Gift to daughter (July 2005):		£
Gift		220,000
Less: AE 2005/06		(3,000)
Less: AE 2004/05		(3,000)
PET (no lifetime tax)		£214,000

Death tax:	£	£
PET		214,000
Nil band at death (2010/11)	325,000	
Less: chargeable transfer in 7 years before PET (May 2002)	(121,000)	
Nil band remaining		(204,000)
Taxable on death		10,000
IHT @ 40%		4,000
Less: taper relief (4-5 years = 40%)		(1,600)
Tax on PET		£2,400

We now calculate the tax on the death estate, ignoring the Gift with Reservation.

Tax on death estate:	£	£
Estate (without house)		448,000
Nil band at death	325,000	
Less: CT in 7 years before death (2002 transfer > 7 years)	(214,000)	
Nil band available		(111,000)
Taxable		337,000
IHT @ 40%		134,800
Total IHT on death (ignoring GWR) £(2,400 + 134,800)		137,200

Under the Double Charges Regulations, HMRC will prepare an alternative IHT calculation. The second calculation charges the house in David's death estate and ignores the original PET.

In effect, it pretends that the original gift to the daughter had never happened, and that David had retained the house until his death.

Tax on death estate:	£	£
Estate (with house)		798,000
Nil band at death	325,000	
Less: CT in 7 years before death (ignore PET)	(Nil)	
Nil band remaining		(325,000)
Taxable		473,000
IHT @ 40%		£189,200

No death tax on PET as ignored

HMRC will compare this figure with the tax liability previously calculated. Taxing the PET and ignoring the Gift with the Reservation produces a tax liability of £137,200. HMRC will use whichever set of calculations produces the most tax. In this instance, HMRC will collect the **most** tax by charging the house in the death estate and ignoring the potentially exempt transfer. The total IHT payable will therefore be £189,200. This, in simple terms, is how the Double Charges Regulations work.

Illustration 2

Beth made a chargeable lifetime transfer of £127,000 in June 1999. In May 2004, Beth made a gift of £250,000 to a discretionary trust. Beth agreed to pay any IHT on the transfer. Beth was a beneficiary of the discretionary trust she created, so this will be a Gift with Reservation of Benefit.

Beth died in October 2010. Her estate was valued at £350,000. The value of the assets in the discretionary trust created in May 2004 stood at £300,000 in October 2010. We will calculate the IHT payable as a result of Beth's death, taking into account any potential double charges. First we calculate the lifetime IHT on the gift to the trust in May 2004.

Gift to discretionary trust (May 2004):	£	£
Gift		250,000
Less: AE 2004/05		(3,000)
Less: AE 2003/04		(3,000)
CLT		244,000
Nil band 2004/05	263,000	
Less: CTs in 7 years before May 2004	(127,000)	(136,000)
Taxable		108,000
Tax @ $\frac{20}{80}$ (Beth pays tax)		£27,000
Gross CLT £(244,000 + 27,000)		£271,000

We now need to consider the IHT effects of Beth's death in October 2010.

When she set up the discretionary trust in 2004 Beth made a Gift with Reservation of Benefit. This will give rise to a potential double charge, because additional tax will be payable on the chargeable lifetime transfer and the value of the trust is treated as forming part of her death estate for IHT purposes. As usual, HMRC will prepare two IHT computations and take whichever produces the higher liability.

In the first calculation we will work out the tax payable on Beth's death, ignoring the Gift with Reservation. In effect we pretend that she was not a beneficiary of the discretionary trust set up in 2004.

Death tax on CLT:	£	£
Gross CLT		271,000
Nil band at death (2010/11)	325,000	
Less: CLTs in 7 years before May 2004	(127,000)	
Nil band remaining		(198,000)
Taxable		73,000
IHT @ 40%		29,200
Less: taper relief (6-7 years = 80%)		(23,360)
		5,840
Less: lifetime tax		(27,000)
Additional tax due		Nil

We also need to calculate the IHT due on Beth's death estate, **ignoring** the Gift with Reservation.

Tax on death estate:	£	£
Estate (ignoring trust)		350,000
Nil band at death (2010/11)	325,000	
Less: CTs in 7 years before death	(271,000)	
Nil band remaining		(54,000)
Taxable		296,000
IHT @ 40%		£118,400
Total IHT on death £(Nil + 118,400)		£118,400

In these calculations we have completely ignored the Gift with Reservation of Benefit. In the next set of calculations, we will **recalculate** the IHT assuming that the value of the trust forms part of Beth's death estate.

For the purposes of this calculation, we will not calculate additional tax on the chargeable lifetime transfer, and we will **ignore** this transfer for cumulation purposes.

Tax on death estate:	£	£
Estate (including trust)		650,000
Nil band at death (2010/11)	325,000	
Less: GCTs in 7 years before death (ignore trust)	(Nil)	
Nil band remaining		(325,000)
Taxable		325,000
IHT @ 40%		£130,000
Total IHT on death £(130,000 – 27,000)		£103,000

Note; Credit given for lifetime tax to avoid double taxation.

We compare this result with the tax payable from our initial set of computations.

You will see that the first set of calculations produce a higher liability (ie £118,400 as compared with £103,000), so these will be the ones adopted by HMRC. In this instance, keeping the chargeable lifetime transfer in charge and ignoring the effect of the Gift with Reservation produces a higher IHT charge.

16.2 Deduction of liabilities

Finally in this chapter, we will look at an **anti-avoidance rule** introduced in 1986 to **prevent the deduction of artificial liabilities in the death estate**. These rules are contained at Section 103 FA 1986. FA 1986, s.103

The effect of S.103 is to **disallow the deduction of a debt** in the death estate, **if that debt can be related back to property originally** derived from the donor.

Illustration 3

Mr X makes a gift of £500,000 in cash to a donee, Miss Y. This is obviously a PET and will only become chargeable if Mr X dies within 7 years of the gift. Shortly after the transfer, Miss Y lends £500,000 back to Mr X. This is not a transfer of value for IHT purposes as there has been no loss to Miss Y's estate.

The objective of this transaction is to try to avoid IHT on the transfer. For example, if Mr X survives 7 years from the gift, the original PET of £500,000 will be exempt. On the other hand, if Mr X dies within 7 years, the PET becomes chargeable, but the cash of £500,000 in Mr X's death estate is cancelled by the loan of £500,000 from Miss Y, this debt being a liability for IHT purposes.

In essence what Mr X is trying to do is to reduce the value of his estate for IHT purposes by making a lifetime gift, but at the same time still being able to **benefit** from the property given away. Not surprisingly there is anti-avoidance legislation to prevent this type of tax planning being successful.

The effect of S.103 is to **disallow** the debt of £500,000 in Mr X's death estate.

Assume in the previous illustration, that Mr X dies within 7 years of the gift to Miss Y. As a result the PET of £500,000 becomes chargeable. When considering Mr X's death estate, he has cash of £500,000. However under S.103, the debt of £500,000 owed by Mr X to Miss Y is disallowed because it is **directly relates to property originally derived by Miss Y from the donor**. Consequently the cash of £500,000 will be taxed in Mr X's death estate.

This in turn will give rise to another "double charges" situation because the same property – i.e. £500,000 in cash – is being charged to IHT twice, ie, once in respect of the PET and once within the donor's death estate. SI 1987/1130 reg 6

As usual, alternative calculations will be prepared and HMRC **will adopt whichever gives the highest liability.** In this scenario, if Mr X survived 7 years from the date of the gift, the PET would be exempt. However, the debt of £500,000 would not be allowed as a deduction in Mr X's death estate, so the cash of £500,000 would be charged to IHT at that point.

Example 1

Dominic made a gift of £202,000 to a discretionary trust in December 2001. He is not a beneficiary of the trust. In November 2004, Dominic gave a painting worth £285,000 to his girlfriend Louise. They separated in July 2007 and Louise returned the painting.

Dominic died in February 2011 and his estate was worth £900,000, including the painting worth £300,000.

Calculate the tax payable as a result of Dominic's death.

Answer 1

Dominic gave a painting to Louise (a PET). Louise returned the painting such that it forms part of Dominic's estate for IHT purposes. As Dominic died within 7 years, we need to consider the Double Charges Regulations.

The first calculation will be to charge tax on the PET whilst ignoring the painting in the death estate.

Gift to Louise (November 2004):		£
Gift		285,000
Less: AEs 2004/05 & 2003/04		(6,000)
PET (no lifetime tax)		279,000
Death tax on PET:	£	£
PET		279,000
Nil band at death	325,000	
Less: CLT in 7 years before PET (202,000 – 6,000 AEs)	(196,000)	(129,000)
Taxable on death		150,000
IHT @ 40%		60,000
Less: taper relief (6-7 years = 80%)		(48,000)
Tax on death		£12,000
Tax on death estate:	£	£
Estate (other than painting)		600,000
Nil band at death	325,000	
Less: CT in 7 years before death	(279,000)	(46,000)
Taxable		554,000
IHT @ 40%		£221,600
IHT on death £(12,000 + 221,600)		£233,600

The second calculation ignores the original PET and charges the painting in Dominic's death estate.

Tax on death estate:	£	£
Estate (including painting)		900,000
Nil band at death	325,000	
Less: CT in 7 years before death	(Nil)	(325,000)
Taxable		575,000
IHT @ 40%		£230,000

This is the tax on death as the PET is ignored.

The first calculation (£233,600) produces the higher liability and therefore will be adopted by HMRC.