DEMOS

THE FUTURE OF INHERITANCE TAX

OPTIONS TO REPAIR INHERITANCE TAXATION IN BRITAIN

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Any errors remain the authors' responsibility.

Dan Goss

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ABOUT THE UNLOCKING INHERITANCE PROGRAMME

Inheritances are becoming increasingly important in our economy and society, while inheritance tax has become an important policy challenge. Demos is undertaking a new programme of work - supported by the abrdn Financial Fairness Trust - to explore what the UK's 'New Age of Inheritance' means for the country, and how we should adapt.

The first stage of our research showed that the public have more nuanced views about inheritance tax than often assumed. But it also showed that, if the public are to support it long-term, the tax has to be better designed.

The goal in our second stage is about pushing us towards that better system. We'll be working to advance the current inheritance tax debate with new research, and have engaged the public in a series of deliberative workshops to develop bold new reforms.

AN INCLUSIVE ECONOMY

This is part of Demos's wider work to help create an ***Inclusive Economy*** - one in which all people have security, opportunity, and respect. Our research shows that inheritances - people's increasing reliance on them, their inequalities, and an ill-equipped inheritance tax - plays a part in financial insecurity, inequality of opportunity, and underfunded public services. A new ambitious approach to inheritance policy is needed to address that.

At Demos we also put people at the heart of policy-making. In this project, all our recommendations are guided by what the public has told us in surveys and focus groups.

EXECUTIVE SUMMARY

After the recent election, the UK has a new Labour government and they are promising change for the country. Unfortunately, given the current fiscal environment, they have very little money available to deliver that.

Reports suggest the Labour government are looking at changes to inheritance tax as a way to unlock more public funds.[1] We at Demos think this is the right place to start. For one, the tax is poorly designed and ripe for reform. But also, with inheritances becoming increasingly important in our economy, and very few inheritances - only the most valuable - charged any tax, reforms could make a big difference for the country while bearing no cost on the vast majority of people.[2]

Alongside raising public funds, we also need to address the public's concerns about inheritance tax. To do so, we must make it fairer, simpler and more transparent.

To deliver these improvements, the UK can learn lessons from overseas, where the taxation of inheritances has been reformed and structured differently. This paper lays out those many lessons based on a review of UK and international evidence, and interviews with a series of policy experts.

KEY FINDINGS

Our analysis indicates that the UK could potentially increase revenue, progressivity, and public support simultaneously. In particular, on the economics, we should learn from the South Korean system:

- **We could raise more revenue.** While in the UK, around 4.2% of inheritance passed on in 2019-20 was paid in tax, the figure in South Korea was **9.7% in 2022** (after discounting the inheritance of Samsung, which incurred an anomalously large tax bill). If taxing the same proportion of inheritance in 2019-20, **the UK government would have raised around £11.6bn - an additional £6.5bn compared to what it actually raised.** If also taxing the same proportion of lifetime wealth transfers as South Korea (9.1%), we would have raised an additional £2.5bn on top.
- **We could make our system fairer.** In the UK, the wealthiest estates tend to pay lower effective rates (the percentage of all inheritance paid in tax). Those worth between £2m and £7.5m paid 25% in 2020-21, while those over £10m only paid 17%. **In South Korea, meanwhile, the effective rate reached 33% for estates between £6m and £30m, and 44% for those over £30m in 2022.**

On the political challenge, the UK should learn from Norway's reforms:

- **We could shift taxation away from inheritance per se, and towards 'inherited capital gains'** (the growth in an asset's value between being bought and being passed on as inheritance). Inherited capital gains are 'uplifted' in the UK (they are not taxed by capital gains tax), as they were in Norway until 2014. Yet, Norway then began taxing these, while simultaneously abolishing inheritance tax - a popular policy. While significant revenue would be lost if the UK did the same, we could begin taxing inherited capital gains while offering a smaller inheritance tax cut.

1 Isaac A. "Labour drafts options for wealth taxes to 'unlock' funds for public services". The Guardian. 21 June 2024. https://www.theguardian.com/politics/article/2024/jun/21/labour-drafts-options-for-wealth-taxes-to-unlock-funds-for-public-services
2 Goss D and Glover B. The inheritance tax puzzle: Challenging assumptions about public attitudes to inheritance. 14 June 2023. Demos. https://demos.co.uk/research/the-inheritance-tax-puzzle-challenging-assumptions-about-public-attitudes-to-inheritance

Given the experiences of other countries, we believe the most promising opportunities for inheritance tax reform are:

1. Reworking the exemption for business property to ensure it provides value for money.
2. Introducing progressive rates, increasing the rates for the most valuable estates.
3. Consulting on hypothecation (earmarking the tax to a specific spending commitment to improve public awareness of the impact of the tax revenues).
4. Removing the capital gains uplift and charging capital gains tax when the asset is sold.
5. Clamping down on remaining non-dom avoidance opportunities.

THE CURRENT INHERITANCE TAX LANDSCAPE

Inheritance tax is charged on the value of someone's estate passed on at death, plus gifts passed within seven years before death. Each estate gets a tax-free allowance of £325,000, and any inheritance over that is taxed at a flat rate of 40%. There is, however, an additional allowance of £175,000 for primary homes given to direct descendants (children and grandchildren), and couples can also combine their tax-free allowances. The available allowance therefore often totals £1m. There are also a broad range of exemptions for inheritance tax, including for business property, agricultural property, and charitable donations. Pension wealth also generally does not count towards inheritance tax.

Polling often finds inheritance tax is seen as the least fair tax. Yet, when presented with policy decisions - around which taxes to cut, whether to prioritise scrapping inheritance tax vs funding public services, and where to set the inheritance tax threshold - people express much less interest in cutting or scrapping it.

Despite this, it is clear that public concerns about the tax are widespread - as Demos explored these in 2023 through a series of 12 focus groups. Many people do not closely associate inheritance tax with public spending, and feel the money is generally wasted or not spent transparently. Many also see it as double taxation, and a cynical way for the government to stealthily get more money. There is also widespread concern that it is easy to avoid, doesn't do much to reduce inequality, and imposes burdens on families at times of grief. Reforms to inheritance tax should work to address these various concerns.

TABLE 1
COMPARISON OF UK SYSTEM TO REFORM PROPOSALS AND INTERNATIONAL SYSTEMS

KEY
Better than the UK
About the same as the UK
Worse than the UK

SYSTEM	REVENUE	PROGRESSIVITY FOR THE BOTTOM 99%	PROGRESSIVITY WITHIN THE TOP 1%	ADMINISTRATIVE EASE	DESIGN
Current UK system	0.7% of tax revenue	Effective rate increases almost consistently for taxpaying estates up to the 99th percentile by value, but some points of regression	Effective rate flatlines after estates reach the 99th percentile, then decreases for estates worth over £7.5m	Relatively easy to assess estate value, but a wide range of exemptions makes tax calculations hard	
PROPOSALS FOR THE UK SYSTEM					
IFS/UoW recommendations					Abolish business relief and agricultural relief. Bring 80% of the value of bequeathed pension pots into estates. Abolish the residence nil-rate band - and potentially raise the nil-rate band to £500,000. Tax capital gains at death
APPG recommendations	Unclear	Unclear			Shifting to a low flat rate tax (10%-20%) on both lifetime and death transfers, with all reliefs other than spouse and charity exemptions abolished, and capital gains uplift removd. Annual lifetime gifts allowance of £30,000, and death allowance around £350,000
OTS recommendations		Unclear		Unclear	Many reccomendations, including: Consider removing the capital benefitting from inheritance tax relief. Tighten requirements for business relief. Reduce the 7 year period on gifts to 5 years.

INTERNATIONAL SYSTEMS					
Japan	1.3% of tax revenue (2019)	Progressive consistently throughout the distribution	Progressive up the top 0.01%, but regressive after	Unclear	For inheritance, each estate gets a 30 million yen allowance (£156,200), with additions for statutory heirs and other criteria. Beyond this, rates range from 10% to 55%. A gift tax applies above an annual allowance of 1.1 million yen (£5,700), with rates from 10% to 55%.
South Korea	1.6% of tax revenue (2019)	Progressive consistently throughout the distribution	Progressive even at the top 0.2% of taxpayers	Unknown	An inheritance tax applies to estates at death and gifts in 10 years prior. A gift tax applies outside this. Generally, inheritors can choose between a threshold of KRW 500m (£295,000) or one determined by a range of factors. Beyond this, rates increase from 10% to 50%.
France	1.4% of tax revenue (2019)	Progressive consistently throughout the distribution	Progressive even at the top 0.05%	Unknown	There is a tax on inheritance and gifts given 15 years prior to the death, or a gift tax aggregating receipts within any 15 year period. There is a €100,000 allowance for direct descendents, and less for others. Beyond this, rates increase from 5% to 45%.
Germany	0.5% of tax revenue (2019)	Regressive for receipt between 100,000 and 500,000	Regressive for the top 0.1%	Unknown	An inheritance tax applies to all receipts. Each person has an allowance of €500,000 for receipts from spouses and €400,000 from parents - aggregating receipts within a 10-year period. Beyond this, rates range from 7% to 30%.
Spain	0.6% of tax revenue (2019)	Unknown	Unknown	Harder to calculate the tax because heirs' existing wealth needs to be valued	An inheritance tax is imposed on receipts, with a progressive rate. Notably, the rate increases for recipients with higher net wealth, prior to receiving the inheritance. At the top end, those with wealth over around €4m pay 1.2x the standard rate.
Ireland	0.7% of tax revenue (2019)	Unknown	Unknown	Hard to keep track of all lifetime receipts	A combined inheritance and gifts tax is imposed. Each person gets an allowance for all inheritance and gifts throughout life from certain donors; for example, €335,000 from parents or children. Beyond this, a flat rate of 33% is taxed.
Norway	Unknown	Unknown	Unknown	No inheritance tax, but capital gains tax upon the sale of inherited assets	The inheritance tax - which charged rates of 6% or 10% for receipt from parents - was abolished in 2014. At the same time, it stopped 'uplifting' capital gains at death, meaning inherited capital gains were still liable to capital gains tax at 22% or more.

The paper looks at three categories of reform: shifts to the parameters of the current system (e.g. rates, thresholds, exemptions), overhauling the tax base (e.g. taxing receipts rather than estates) and hypothecation. Below we consider how the UK compares to other countries, and key lessons we can learn.

Shifts to the parameters of the current system

In terms of the design of inheritance tax, we find the following:

- **Rates** - Of all OECD countries, the UK is one of seven to only apply a flat rate. The UK's 40% rate is the joint highest starting rate in the OECD, but the progressive rates in Japan, South Korea, France and Germany all go above 40% for the largest inheritances. While a progressive rate should, in theory, appeal to people with less inheritance, this benefit may be limited by the fact that knowledge of inheritance tax rates and thresholds is very low.
- **Exemptions** - The UK is unusual in offering 100% relief for owned businesses and agricultural property, and not counting most private pensions for inheritance tax purposes. For example, the UK is in a small minority of OECD countries who offers 100% uncapped relief for business assets, does not require any minimum time of ownership for the heir of business assets, and differentiates between listed and unlisted businesses (by offering additional exemptions for shares in unlisted businesses).
- **Administration** - Inheritance tax must be paid within six months of a death in the UK, and generally before inheritors can actually access the inheritance. This means people cannot generally use the inherited wealth to pay the tax bill. Extending the payment period could drive some increased support for inheritance tax, but would require a shift in how the government accounts for inheritance tax revenue.

In terms of the outcomes, we find the following:

- **Proportion of estates taxed** - the UK taxes a relatively low proportion of estates (4% in 2020/21). This is lower than Germany, Japan, and South Korea.
- **Proportion of wealth transfers taxed** - In the UK, around 3.4% of all inheritance and gifts passed on was paid in tax in 2019-20 - less than France, Japan and South Korea.
- **Progressiveness** - In the UK, the average effective tax rate is regressive for the most valuable inheritances. While overall it is less regressive than Germany's system, it is more regessive than France's, South Korea's or Japan's.
- **Revenues -** There is scope to increase inheritance taxation in the UK. The UK raised less from inheritance tax than most G7 countries, including the US, Japan, France, and Germany.

Overhauling the tax base

Looking at reforms to the tax base, we find the following:

- **Taxing receipts** - The UK is one of only four OECD countries to tax the estate, rather than receipt of inheritance. Most countries who tax receipt of inheritance also have a gift tax. While taxing gifts should, in theory, drive higher revenue (as more wealth transfers are captured by the tax), there may be responses that hinder this. Germany, for example, sees widespread gift-giving during life in order to minimise tax bills.
- **Taxing inherited capital gains** - Including inherited capital gains within capital gains tax could be less politically contentious than changes to inheritance tax itself. To avoid a significant loss in revenue, however, would likely require significant reform of capital gains tax, such as higher rates or fewer exemptions.

Hypothecation

We find that hypothecation has the potential to significantly expand political support. Yet, there are risks. First, if inheritance tax is hypothecated to a spending commitment but the amount spent is not primarily determined by the amount of tax revenue (as is the case with National Insurance), there is a risk that the hypothecation could face criticism of being misleading. However, attitudes to current and past hypothecated taxes do not provide evidence that this is a significant risk. Second, there is a risk that the public may not be widely aware that the hypothecation exists, undermining its ability to expand support. More needs to be done to test whether this is a risk, and if so, how the hypothecation can be designed to ensure a broad awareness, and broad support for the chosen spending commitment.

LOOKING FORWARD

To attract greater public support while taxing inheritance effectively, ambitious reform of inheritance tax is needed. Policymakers will have to make hard decisions - and we believe the public can help them by scrutinising and debating the various options. We are helping to facilitate this, having run an in-depth deliberative exercise with the public. Based on this, we will lay out a framework for a strategic but ambitious package of reforms - one to deliver a better future of inheritance tax.

INTRODUCTION

As wealth has surged in recent decades, the value of inheritance passed on is set to double by 2045. We at Demos call this the UK's "New Age of Inheritance".[3] Increasingly we will see the 'will-haves' - those inheriting the most - enjoying a deep financial safety net and the additional income and financial gains that wealth provides. The 'won't haves', meanwhile, will be left behind.

Yet, our tax system continues to ask for much greater contributions from the UK's wages and consumption than it does from its wealth and inheritance. To fix Britain's crumbling public services, the government will need to spend more money. But if it plans to fund this by asking the public to pay more taxes, the government will need public consent.[4] A reformed inheritance tax should be a part of this.

Instead of working to improve it, however, the debate on inheritance tax in parts of the media and politics is often reduced to 'cut or keep'. That debate often lacks ambition, disregards the trade-offs, and fails to engage with what the public actually want.

We want to break the deadlock and provide a vision for inheritance tax that better aligns with what people want. To do so, we worked with the public through an extensive deliberative process in Spring and Summer 2024. We set the participants a clear task: determine from a range of options how best to reform inheritance tax, while maintaining or raising revenue. Given the fiscal position of the UK, scrapping inheritance tax is unaffordable and would directly reduce revenue for public investment. We therefore used the deliberative process to understand how the public want to reform the current system, rather than continue the debate on whether to keep or scrap inheritance tax. Whilst this conditioned the deliberation, it ensured that the ideas developed are credible and implementable. This will lay the path for a more effective, popular and sustainable system.

Before we engaged the public, we needed to understand the full scope of opportunities available. This paper lays out those possibilities. For each, it assesses their economic outcomes (revenue, progressivity and behavioural impacts, such as on wealth transfers, saving, and business decisions) and political outcomes (public support and support among specific groups, such as businesses).

This paper also outlines a series of international case studies - on Japan, South Korea, France, Germany, Spain and Ireland - to explore potential reforms and some of their effects. These countries were chosen for having inheritance tax systems - and available data - that offer interesting and relevant alternatives for the UK. While every country has its unique circumstances, they help us learn about the possible risks and rewards of taxing inheritances differently.

While this paper does not make specific policy recommendations, it reveals the landscape of possible reforms, and identifies attractive routes the UK could take through.

Section 1 outlines the state of inheritance tax today. It looks at the current design of inheritance tax and its outcomes, how the UK system compares to those internationally - particularly OECD countries - and some of the sources of public concern about the tax.

Section 2 explores the possibilities for reform, divided into three types of reform: shifts to the parameters of the current regime (its thresholds, rates, exemptions and administration); overhauling the tax base (such as taxing inheritance receipt or inherited capital gains,); and hypothecation (looking at debates around soft vs hard hypothecation, and different potential spending commitments). Where relevant, it outlines country case studies, with a deep dive into the design of their system and some of the political and economic outcomes.

3 Goss D and Glover B. A New Age of Inheritance: What does it mean for the UK?. Demos. 23 January 2023. https://demos.co.uk/research/a-new-age-of-inheritance-what-does-it-mean-for-the-uk/

4 Goss D and Glover B. Winning the Argument: How to unlock public support for inheritance taxation. Demos. 26 September 2023. https://demos.co.uk/research/winning-the-argument/

SECTION 1
THE STATE OF INHERITANCE TAX TODAY

CURRENT DESIGN

Inheritance tax is an unusual, but relatively simple tax on the face of it. But once we get into the details, it seems much more complicated.

The tax base

Inheritance tax is the only tax that exists on private wealth transfers (e.g. transfers of property or cash between friends and family), and is charged on the 'estate' (the property and other assets held by individuals) of a dead person. It is charged on the value of the estate passed on at death, plus any gifts passed within seven years before death above an annual amount. This means the allowances are not affected by what people receive in inheritance - only what is passed on.

The tax also includes assets in some trusts, which may be charged the tax when transferred into the trust, taken out of the trust, or at 10-yearly intervals.[5]

Thresholds and rates

On the face of it, the inheritance tax rates and threshold seem relatively simple. Each estate gets a tax-free allowance of £325,000, and any wealth above that in the estate is taxed at a flat rate of 40%.

Importantly, however, transfers to spouses are completely exempt. There is also an additional allowance of an extra £175,000 for homes which the deceased lived in, if passed to direct descendants (primarily children or grandchildren). This can effectively increase the threshold to £500,000 per person giving an inheritance. Additionally, people who are married or in civil partnerships can also transfer tax-free allowances to their spouse after death. This means a surviving spouse can have a tax-free allowance of £1m.

5 Gov.uk. Trusts and taxes. (n.d). https://www.gov.uk/trusts-taxes/trusts-and-inheritance-tax

Given these additional thresholds, around just 3.7% of deaths resulted in inheritance tax in 2020-21, while just 15% of estates worth between £300,000 to £1m paid the tax (paying an average rate of 11%).[6,7] Meanwhile 86% of estates worth over £1m pay the tax (paying an average rate of 19%).

There are also thresholds for any gifts given within the seven years before death. Each person can give away £3,000 worth of gifts each tax year without these being included in the value of their inheritance. There are also additional thresholds for gifts given for weddings, for regular payments considered 'normal expenditure out of income', including birthday and Christmas presents, and for small gifts (up to £250 for each beneficiary annually).

A quirk of the system is that, when gifts given in the seven years before death exceed the £325,000 tax-free allowance, the recipient is liable for the tax, rather than the estate. This means that, if you give £325,000 away to your children three years before death, then give another £50,000 to a friend two years before your death, the friend is solely liable for any tax on that gift. If the £50,000 was instead given at death, any tax would instead be taken out of the estate as a whole.

For gifts given over the tax-free allowance, there is also 'taper relief', meaning the tax rate decreases the further away the gift is given from death. Gifts in excess of the nil-rate band given between six and seven years before death are charged at a rate of 8%, and this increases progressively, with those given between three and four years before death charged at 32%, and any given within three years before death charged at the full 40%.

Exemptions and treatment of inherited capital gains

There are a broad range of exemptions for inheritance tax; the Office for Tax Simplification counted 88 separate reliefs for the tax in 2013.[8] These include reliefs for business property, agricultural property, pension assets, and charitable donations.

RELIEF	DESIGN	REVENUES AND COSTS
Business Relief	Any wealth in a business you own or shares in an unlisted company can be completely exempt from inheritance tax. This includes shares sold in the Alternative Investment Market (AIM), a market for shares in smaller companies. To qualify, the deceased must have owned the business property for at least 2 years before they died. The relief does not apply to businesses that mainly deal with stocks and shares, real estate, or investments, or those that are being sold or wound down..	In 2020-21, £3.2bn of business assets benefitted from business relief.[9] Without this relief, these assets would have been subjected to a 40% rate for values over the relevant threshold. The value of assets benefitting from the relief tripled in real terms in the 15 years prior.[10] In 2019-20, 53% of assets benefiting from the relief were owned by just 4% of claimants (113 estates, with £8.7m of assets relieved per estate on average).[11]

6 This excludes estates which didn't submit probate, though these are normally either small estates (under £5,000) or those with joint property passed automatically to the surviving spouse
7 HM Revenue and Customs. Inheritance Tax liabilities statistics. 26 July 2023. https://www.gov.uk/government/collections/inheritance-tax-statistics
8 National Audit Office, Tax reliefs, 7 April 2014. https://www.nao.org.uk/wp-content/uploads/2014/03/Tax-reliefs.pdf
9 HM Revenue and Customs. Inheritance Tax liabilities statistics. 26 July 2023. https://www.gov.uk/government/collections/inheritance-tax-statistics.
10 Ibid.
11 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf

Business Relief	There is a 50% exemption for business property, under the same criteria as the 100% exemption, for certain other assets, like shares controlling more than 50% of the voting rights in a listed company, land, buildings or machinery owned by the deceased and used in a business they were a partner in or controlled. Currently, around 80% of the relief applies to shares in unlisted businesses, where the deceased did not likely exercise control.[12] This is up from 58% just 10 years ago. This is often through shares in the AIM.[13] The justification for extending the relief to such shares, when introduced in 1992, was that they are harder to sell than other shares, and so inheritance tax bills may create cash flow problems.[14]	The Institute for Fiscal Studies/University of Warwick (IFS/UoW) estimated that capping the relief at £500,000/person would raise £1.1bn in 2024-25.[15] The IFS estimates that removing business relief for AIM shares could raise around £1.1bn in 2024-25, or £1.6 billion in 2029–30.[16]
Agricultural Relief	Any land being used for farming purposes is entirely exempt from inheritance tax. This includes farm buildings and farmhouses, but not machinery, crops and livestock. Land farmed by the landowner is exempt after being farmed for two years. If it is farmed by someone else, it is only exempt after seven years.[17] This has also recently been extended to cover non-farming land which is environmentally managed, under the government's post-Brexit agricultural support regime.[18]	In 2020-21, £1.02bn of agricultural assets benefited from this relief.[19] In 2019-20, 35% of the assets benefiting from this relief was owned by just 6% of claimants (71 estates, with £4.6m of assets relieved per estate on average).[20] The IFS/UoW estimated that capping the relief at £500,000/person would raise several hundred thousand in 2024-25.[21] They estimate that capping both agricultural and business relief at £500,000 would raise £1.4 billion in 2024-25, rising to £1.8 billion in 2029–30.[22]

12 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
13 Ibid.
14 Lamont N. Ways And Means: Budget Statement. UK Parliament. Tuesday 10 March 1992. https://hansard.parliament.uk/Commons/1992-03-10/debates/dbdd3e68-d35a-4d01-94e1-6315b54a8701/WaysAndMeans
15 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
16 Advani A and Sturrock D. Raising revenue from closing inheritance tax loopholes. 18 April 2024. https://ifs.org.uk/articles/raising-revenue-closing-inheritance-tax-loopholes
17 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
18 Department for Environment, Food & Rural Affairs. Budget boost for farmers and environment with extension to Agricultural Property Relief. 7 March 2024. https://www.gov.uk/government/news/budget-boost-for-farmers-and-environment-with-extension-to-agricultural-property-relief
19 HM Revenue and Customs. Inheritance Tax liabilities statistics. 26 July 2023. https://www.gov.uk/government/collections/inheritance-tax-statistics
20 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf
21 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
22 Advani A and Sturrock D. Raising revenue from closing inheritance tax loopholes. 18 April 2024. https://ifs.org.uk/articles/raising-revenue-closing-inheritance-tax-loopholes

Pensions	A private pension is not counted for inheritance tax purposes if the pension provider can choose who to give the pension to. This is usually the case - and while the pension provider then has discretion over who to give it to, it is normally given to a person nominated by the deceased. Most pensions are therefore inherited according to the wishes of the deceased, but free of inheritance tax. On top of this, no income tax is placed on pension pots for those who die before age 75.	According to IFS estimates, applying IHT to 80% of the value of DC pension pots would likely raise £200m in 2024-25, rising to £400m by 2029-30.[23]
Charitable donations	All donations to charity within a will are exempt from inheritance tax. If 10% of the value of an estate is given to charity, the rate of inheritance tax reduces to 36%.	In 2022-23, the cost to HMRC of the charity exemption was £690m.[24]

Business relief in particular has become increasingly important in recent decades, as the value of property benefiting from the relief has grown significantly over time. While it was worth only £1.12m in 2005/06 (in 2022-23 prices), this increased to £3.38m by 2020/21 - over three times higher in real terms. In particular, the value of unlisted shares benefitting from the relief (which make up the majority of benefitting property) grew from £690,000 to £2.7m - a 290% real-term increase. This has not happened simply because the total value of unlisted shares in the UK has grown; they have only grown by 3.5% in real terms between 2006 and 2021.[25,26] Instead, this suggests that people have increasingly begun holding these shares in ways that utilise the inheritance tax relief (i.e. near death).

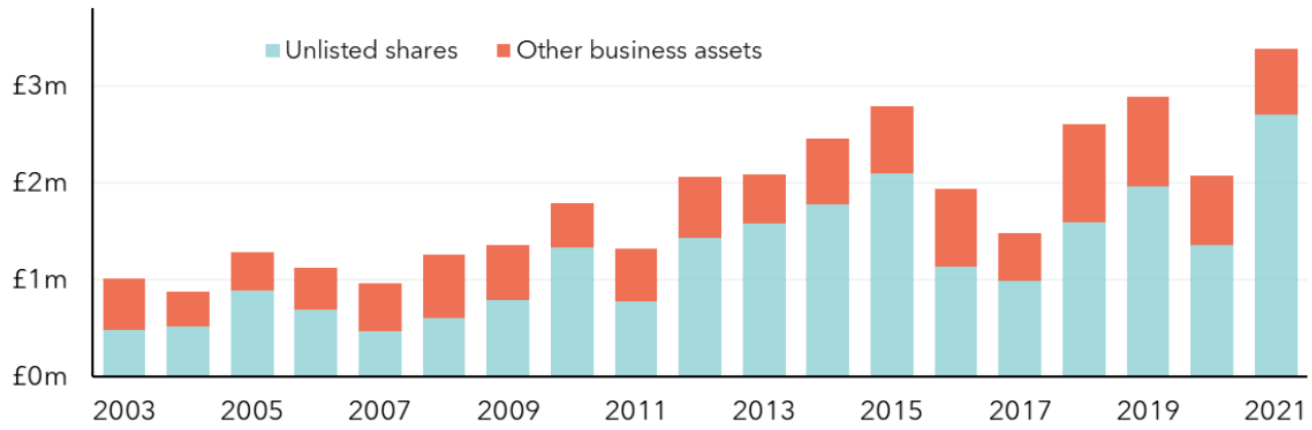
Breaking this data down, in 2002-03, just 1,514 estates claimed business relief, claiming the relief on £219,300 of property each on average (in 2020-21 prices). Fast forward to 2020-21 and 3,380 businesses claimed the relief, but claimed it on £946,700 of property on average. There have, however, been significant volatilities in this since 2015. This is partly a result of volatility in the AIM market. For example, in 2015-16, the value of business property relieved fell by 31%, likely because the AIM market (where BPR is likely to be used) in 2015-16 experienced a decline of around 25%.[27]

23 Ibid.
24 HM Revenue and Customs. Non-structural tax relief statistics (December 2023). 17 January 2024. https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-december-2023
25 ONS. UK sector (S.1): Unlisted UK shares (AF.512N1): Level: Asset: Current price: £million: Not seasonally adjusted. 28 March 2024. https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/nzal/ukea
26 Adjusted using GDP deflator
27 HM Revenue & Customs. Inheritance Tax statistics: commentary. 3 August 2018. https://webarchive.nationalarchives.gov.uk/ukgwa/20190318014648/https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary

FIGURE 1

Almost four times as much business relief was claimed on unlisted shares in 2020/21 than 15 years before

Value of property benefiting from business relief on inheritance tax, by type of property (2022-23 prices)



Source: HMRC Inheritance tax statistics

Separately, we can also look at the costs associated with the treatment of capital gains before death. For inherited assets, capital gains is not charged at the point of death (because inheritance is not deemed to be a disposal for capital gains purposes), and then any capital gains before the death are 'uplifted', meaning they are not taxed by capital gains tax. For example, if someone buys a second home in 1990 and sells it in 2010 at an increased value, they would normally pay capital gains tax on increase in value (the gain). If, however, the owner dies in 2010, when their child inherits the second home, they are deemed to have inherited it at the 2010 value. The gains between 1990 and 2010 are not considered for tax purposes, even if the child sells it immediately after inheriting.

The IFS/UoW estimate that charging capital gains tax at the point of death could raise £1.6 billion a year in 2024/25.[28,29] The Resolution Foundation estimates the revenue raised at £2bn in 2027/28.[30] The OTS, in contrast, model a situation whereby inherited assets are deemed to have been acquired at the original purchase price.[31] They estimated in 2019 that this policy would raise £1.3bn a year, or £2.8bn a year if the capital gains tax relief for main properties was not applied for inherited assets.[32]

Treatment of non-doms

Inheritance tax law becomes even more complex when we consider the case of non-doms. Inheritance tax is charged on all assets of people whose 'domicile' (a tax status reflecting where people have their long-term home) is in the UK. This is different from 'residency' (a tax status reflecting where people live in a particular year). Someone is deemed to be UK domiciled for inheritance tax purposes if they are either a UK resident for 15 out of the last 20 tax years, or if they were born in the UK to a British father, while being a current tax resident.[33]

Currently, if a person is UK domiciled, they are liable for inheritance tax on all their assets, whether in the UK or not. They also remain to be considered domiciled for inheritance tax purposes for three years after leaving

28 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
29 Office for Tax Simplification. Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax. July 2019. https://assets.publishing.service.gov.uk/media/5d274fad40f0b61158962af5/Final_Inheritance_Tax_2_report_-_web_copy.pdf
30 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf
31 Office for Tax Simplification. Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax. July 2019. https://assets.publishing.service.gov.uk/media/5d274fad40f0b61158962af5/Final_Inheritance_Tax_2_report_-_web_copy.pdf
32 Ibid.
33 HM Treasury. Technical note: Changes to the taxation of non-UK domiciled individuals. 7 March 2024. https://www.gov.uk/government/publications/changes-to-the-taxation-of-non-uk-domiciled-individuals/technical-note-changes-to-the-taxation-of-non-uk-domiciled-individuals

the UK. But if a person is not UK domiciled (a non-dom), they are liable for inheritance tax only on assets situated within the UK. For non-UK assets in non-UK trusts, a person is only liable for inheritance tax on those they were domiciled in the UK when the asset was put in the trust.

Changes to these laws were announced in the 2024 Spring Budget, as the chancellor Jeremy Hunt announced the ending of the non-dom regime. From 6 April 2025, all property owned by someone who has been a UK resident for 10 years will come into the scope of inheritance tax, whether or not they were previously domiciled in the UK.[34] This property will also remain in scope for 10 years after the person leaves the UK.

An exception to this change is non-UK property added into a trust by a non-dom prior to the April date. As we cover in Section 2, this property will remain out of scope, opening the potential for tax planning.

The new regime will also take some people out of the scope of inheritance tax. Currently, those who have left the UK, even for over 10 years, but have not acquired a domicile elsewhere (due to regularly moving around) are still liable. After the reforms, anyone who has left for 10 years will no longer be liable.

Administration

There are two key stages to the administration of inheritance tax: first, the valuation of estates and the calculation of tax due; and second, payment of the tax.

Firstly, how is the tax charge determined? All estates are first valued by the personal representative of the deceased (often the person chosen by the deceased to carry out their will - normally a friend or family member). If it seems likely that inheritance tax will be charged (because the estimated value is above the threshold), or if the estate fulfilled particular criteria (for example, if the decreased gave away over £250,000 in the 7 years before death, or had over £100,000 in foreign assets), the executor will have to provide a more thorough value of the estate. This includes getting an estate agent to value the property, and getting other assets over £1,500 professionally valued.

Second, how is the tax paid? An inheritance tax charge must generally be paid by the end of the sixth month after the person died. For some assets, however, (like a house the inheritor wants to live in or certain business assets), the bill can be paid in yearly instalments over 10 years, with interest charged. When being paid in the normal six month timeframe, inheritance tax must normally be paid before a probate (which allows the estate to be distributed according to the will) is issued.

To pay the tax, a bank can provide cash from the estate if it's directly paid towards an inheritance tax bill. But if there is not enough cash to pay the charge, until recently, recipients may have had to take out loans to pay it. Only if a recipient isn't able to raise the money or to take out a loan could they obtain a "grant on credit", which releases the assets in the estate before the tax is paid, in order to be sold and pay the charge. In the 2024 Spring budget, the policy was changed such that personal representatives of estates will no longer need to have sought commercial loans to pay inheritance tax before applying to obtain a "grant on credit" from HMRC.[35]

Economic impact

The key impacts of inheritance tax consist in the revenue it raises for the government, the number of estates who have to pay it, and how much different estates pay. We can also look at what would happen if we scrapped or cut the tax.

Revenue - IHT was worth £7bn in 2022-23 (0.28% of GDP or 0.9% of all tax revenues).[36] This is likely to increase, as the threshold is frozen until 2028 while estates increase in value. According to modelling by the Office for Budget Responsibility, this is set to rise to £8.4 billion by 2027-28 (0.29% of GDP). According to IFS modelling (which uses survey data rather than government administrative data) this is set to rise to £15bn by 2032-33 (in 2023 prices), or 0.48% of GDP.[37]

34 Ibid.
35 HM Treasury, Spring Budget. March 2024. https://assets.publishing.service.gov.uk/media/65e8578eb559930011ade2cb/E03057752_HMT_Spring_Budget_Mar_24_Web_Accessible__2_.pdf
36 Office for Budget Responsibility. (n.d.). Inheritance tax. https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/inheritance-tax/.
37 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf

Scope - One in 20 deaths (5.1%) led to an inheritance tax charge in 2022-23.[38] Yet, if we include in this people who initially pass their inheritance to a spouse tax-free, but the inheritance is later taxed when the spouse passes it on, the figure increases to around 9%.[39] To compare this to the volume of all deaths, we can see that in 2020-21, 27,000 estates paid the tax, out of 722,000 deaths.[40]

Rates - The average effective rate for taxpaying estates generally increases with estate value, peaking at 25% for those worth £2m-£7.5m. It then decreases, reaching 17% for estates worth over £10m.[41]

Impact of cutting the tax - According to IFS estimates in 2023, if scrapping the tax, around half (47%) of the benefit would go to estates worth over £2.1m (the top 1%) – getting an average tax cut of around £1.1m each.[42] The top 5% of estates (worth over £1m) would get 83% of the benefit (averaging £363,000 per estate). Nine out of every ten estates would see no benefit at all. If halving the rate, the top 5% of estates would get an average cut of £180,000.[43]

THE UK IN INTERNATIONAL CONTEXT

Inheritance and gift taxes are relatively common in developed countries. Of the 36 OECD countries, 24 levy wealth transfer taxes, while nine have abolished them since the 1970s.[44] The UK system is distinct from many of those levying such taxes on several grounds.

Most countries tax receipts, while the UK taxes estates

We have seen that the UK taxes a person's estate after they die. But of the 24 OECD countries with wealth taxes, only three others (Denmark, Korea, and the United States) tax the estate.[45] The other 20 tax the recipients of inheritance, and most of these also tax receipt of gifts. The UK is therefore in a minority of countries who have no tax on gifts during life.

The UK taxes a smaller proportion of estates than many countries

Comparing thresholds between countries is hard. Some countries apply thresholds to the estate, while others apply it to receipt. Some apply thresholds to receipt from specific groups of individuals (e.g. you can receive £100,000 collectively from siblings tax free), while others apply thresholds to receipts from a specific individual (e.g. you can receive £100,000 from any individual sibling tax free). Other countries calculate thresholds based on a wide range of factors.

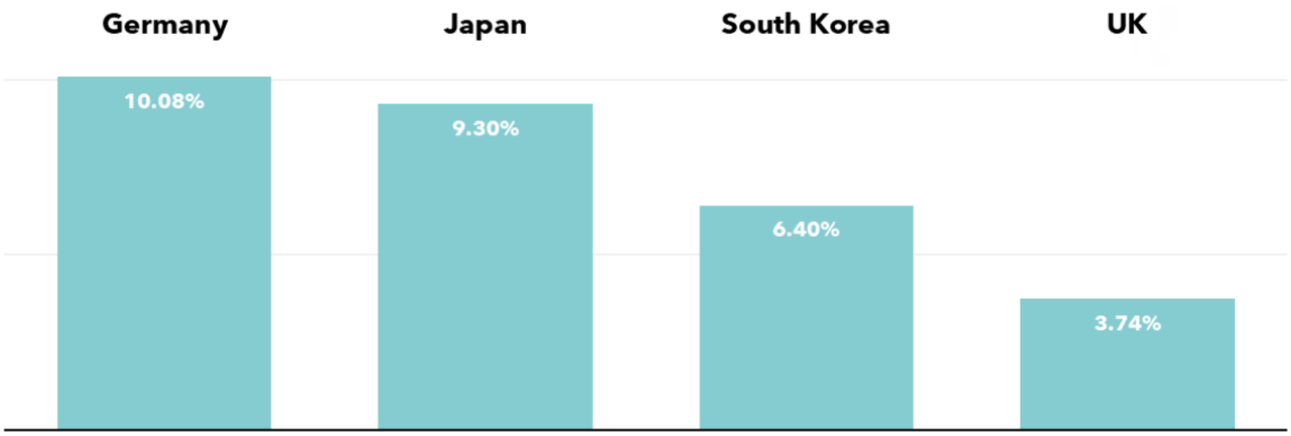
A similar, but more effective analysis is to compare what percentage of deaths results in inheritance tax being charged (which reflects how many go over the threshold). The UK has a relatively low number of estates subject to inheritance tax (3.74%). Compared to the selected comparison countries chosen in this report for 2021, the UK is lower than Germany (10.08%), Japan (9.30%), and South Korea (6.40%). In a separate analysis by the OECD based on the figures from 2017-19, the UK figure is the lowest among eight countries, higher only than the United States (0.19%).[46]

38 Office for Budget Responsibility. (n.d.). Inheritance tax. https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/inheritance-tax/.
39 Advani A. Tweet. 27 September 2023. https://twitter.com/arunadvaniecon/status/1706817780627218785
40 HM Revenue and Customs. Inheritance Tax liabilities statistics: commentary. 26 July 2023. https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary
41 HM Revenue and Customs. Inheritance Tax liabilities statistics: commentary. 26 July 2023. https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary
42 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
43 Ibid.
44 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
45 Ibid.
46 Ibid.

FIGURE 2

The UK taxes a much lower percentage of inheritances than selected comparison countries

Percentage of deaths resulting in inheritance tax payments, 2021 or latest year available



Japan and South Korea's data is from 2021. UK data is from 2020-21. Germany's data is from 2019.

Sources:
OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
Life Insurance Culture Center Public Interest Incorporated Foundation. "Life planning to stabilize the foundation of life". (n.d). https://www.jili.or.jp/lifeplan/houseeconomy/820.html
HM Revenue and Customs. Inheritance Tax liabilities statistics: commentary. 26 July 2023. https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary
H Lee. "6% of deceased people paid inheritance tax…".Kyunghyang Shinmun. 29 June 2023.
https://m.khan.co.kr/economy/economy-general/article/202306291321001.

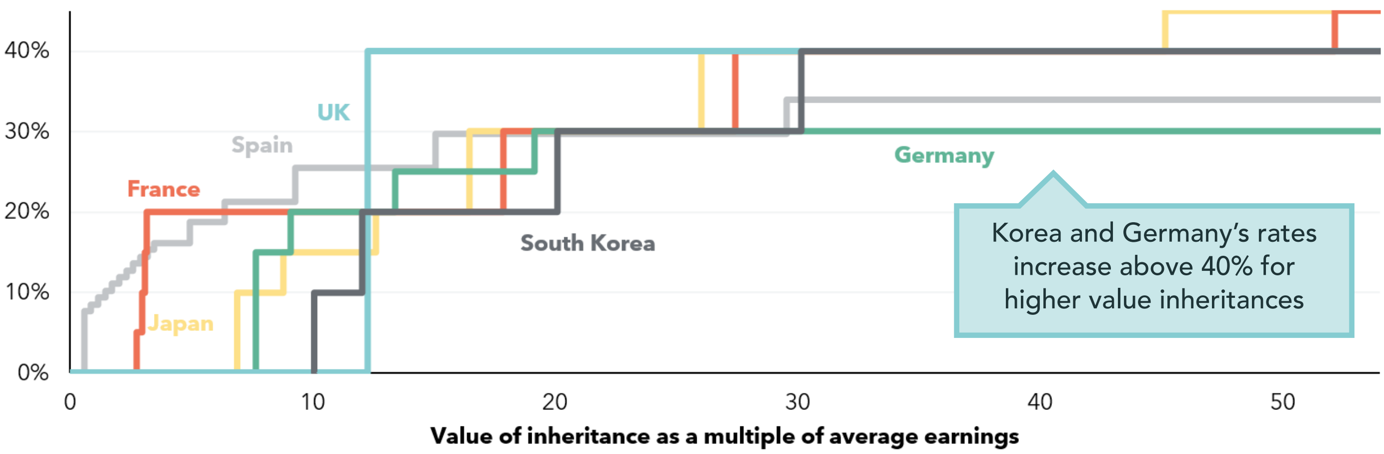
The UK applies a flat rate, while most OECD countries apply a progressive rate

In terms of the rate paid after any allowance, most OECD countries have progressive rates. The UK is one of only seven to only apply flat rates.[47] Many of those with progressive rates have a wide range of bands, as illustrated below.

FIGURE 3

Compared to other countries, the UK has a high threshold relative to average earnings, but also a high rate

Inheritance tax rates for different values of inheritances as a multiple of earnings



Source: EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide

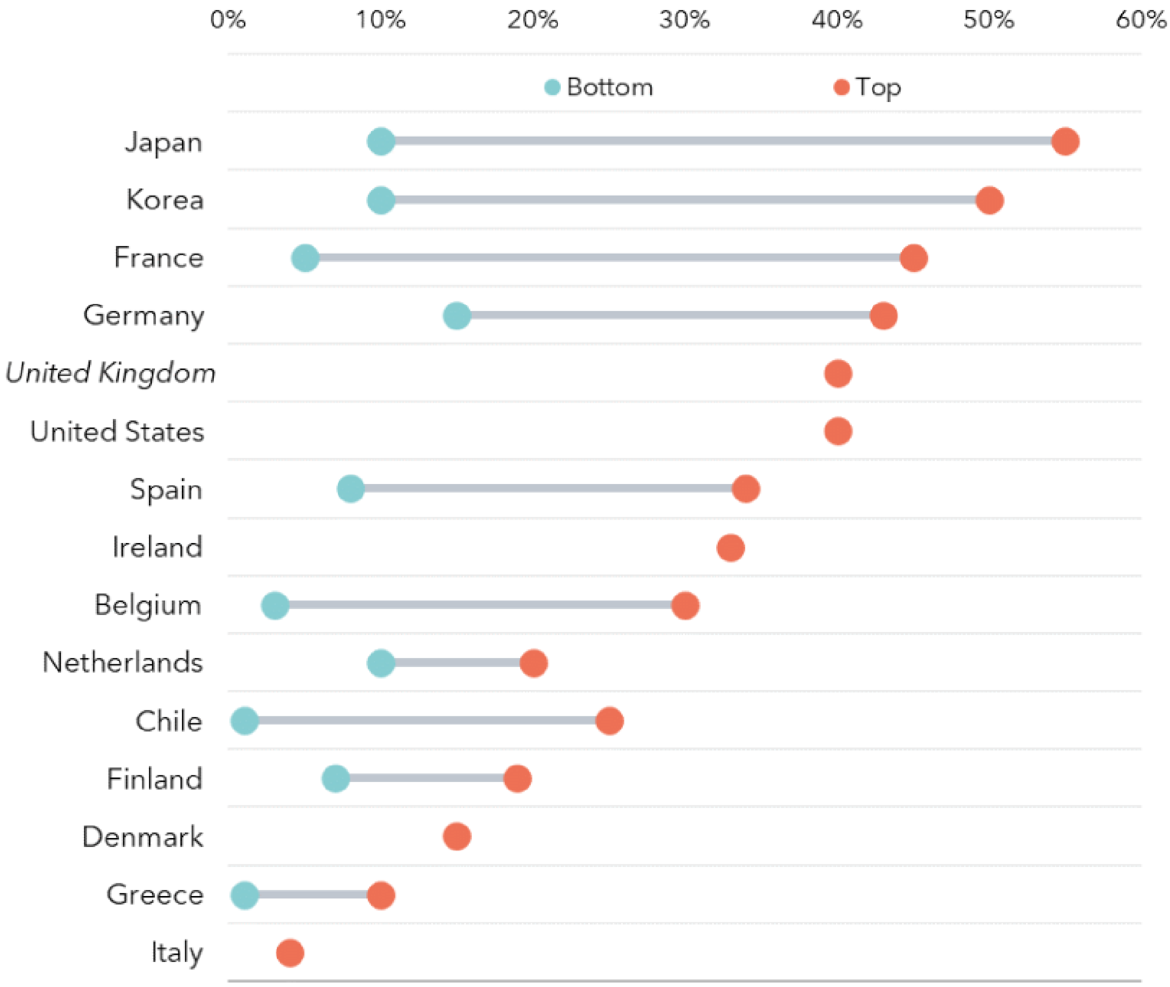
47 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

The UK also has a relatively high rate. It has the lowest minimum rate - equal with the United States - but Japan, Korea, France and Germany all have higher top rates.

FIGURE 4

The UK has a relatively high inheritance tax rate for children

Top and bottom marginal tax rates on inheritance given to children, as of 2021



Source: OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

The UK offers more generous exemptions than many peer countries

The UK is one of only three OECD countries to offer uncapped 100% inheritance tax relief for owned businesses, alongside Italy and Poland.[48] Germany and Korea also offer 100% exemptions, but the former begins tapering relief off beyond €26 million, and the latter caps relief at between KRW 20-50 (£11.9m-£29.6m) and only applied to small and medium-sized enterprises (SMEs).[49] Many other countries offer either partial exemptions (including Spain (95% exemption) and France (75%)), reduced rates or preferential valuations. The UK is also the only country we could find who, for exempted business property, does not require any minimum ownership time for the recipient, instead requiring two year minimum ownership by the giver, prior to their death.[50]

48 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
49 Ibid.
50 Ibid.

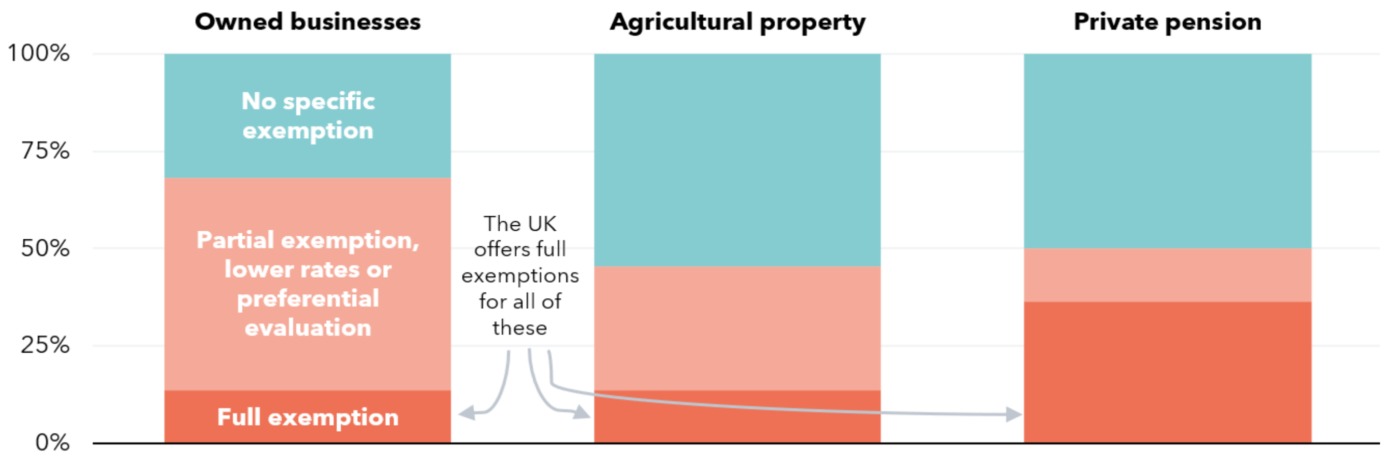
The UK is also one of only three OECD countries with a specific exemption for agricultural property, alongside Germany and Slovenia.[51] While some countries specifically exclude agricultural businesses from their business exemption (e.g. Switzerland), many of those offering business exemptions also apply these to agricultural businesses. However, this may not then apply to the land and farmhouse, which may be considered personal rather than business property.

The UK is also one of only nine OECD countries to offer full exemptions for most private pensions, alongside Denmark, Ireland, Italy, the Netherlands, Poland, Portugal, Spain, and Switzerland.[52] In Chile and Japan, pensions are taxed at a higher threshold.

FIGURE 5

A minority of OECD countries offer full inheritance tax exemptions for owned businesses, farms, private pensions, but the UK generally offers it for all

*Percentage of OECD countries offering exemptions for selected assets**



** Includes exemptions offered with conditions. E.g. owned businesses are taxed in the UK on the condition that they do not mainly deal with real estate, stocks and shares or investment*

Source: OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

The UK does not, however, exempt some assets which are exempt in other countries. These include buildings of historic value (which are taxed preferentially in three OECD countries and exempt in Germany and Italy, but only exempt in the UK if owners provide public access to them without prior appointments) and household goods (exempt in Finland, Germany, Portugal, and Slovenia).

Most countries with a capital gains tax apply this to inherited capital gains, but the UK does not

Of the 29 OECD countries who have capital gains taxes (excluding Poland and the Slovak Republic, for home data is missed), only 13 have capital gains uplifts at death, with only one also have no capital gains tax.[53,54] In 15 countries, capital gains are seen as being transferred over at death, and the tax applies from when the asset was purchased.[55] Of these, eight - including Germany, Italy, and Japan - also tax inheritances, while seven do not. In three countries, capital gains are taxed at the point of death, when the asset is transferred, with one of those (Canada) not taxing inheritances.

51 Ibid.
52 Ibid.
53 The OECD report does not have data for Poland and the Slovak Republic
54 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
55 Some countries have different systems in place for different asset types, so are counted twice

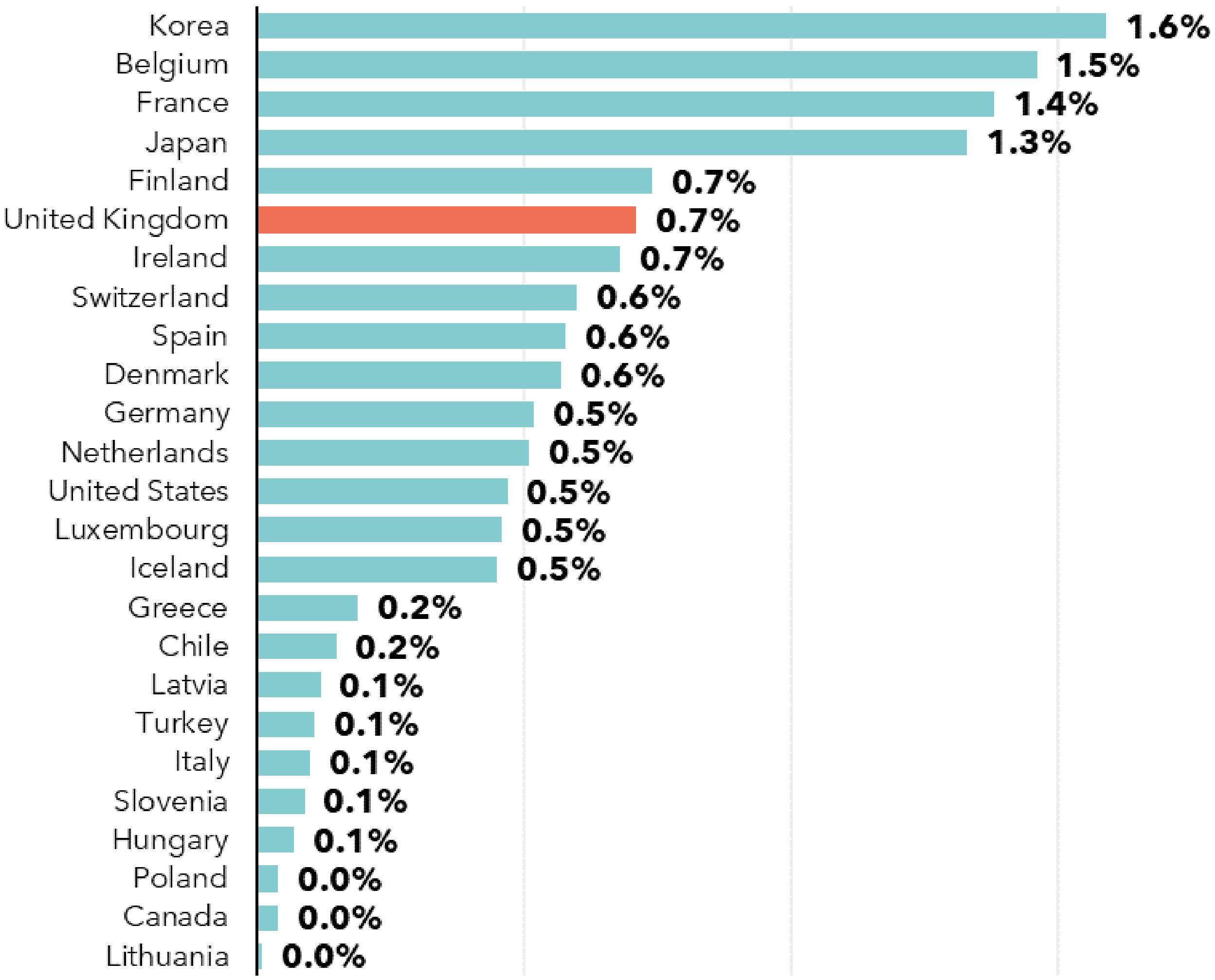
The UK raises more of its tax revenue from inheritance tax than many peers, but half as much as some

While the UK raises a small portion of its tax revenue from inheritance tax (0.7%), this is higher than many OECD countries. However, it remains significantly less than Korea (1.6%), Belgium (1.5%), France (1.4%), and Japan (1.3%), and about the same as Finland (0.7%) and Ireland (0.7%).

FIGURE 6

The UK's inheritance tax delivers just 0.7% of all tax revenue. While this is higher than most OECD countries, it is half as much as some

Inheritance and gift tax revenue as a percentage of total tax revenue, 2018 or 2019



Source: OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

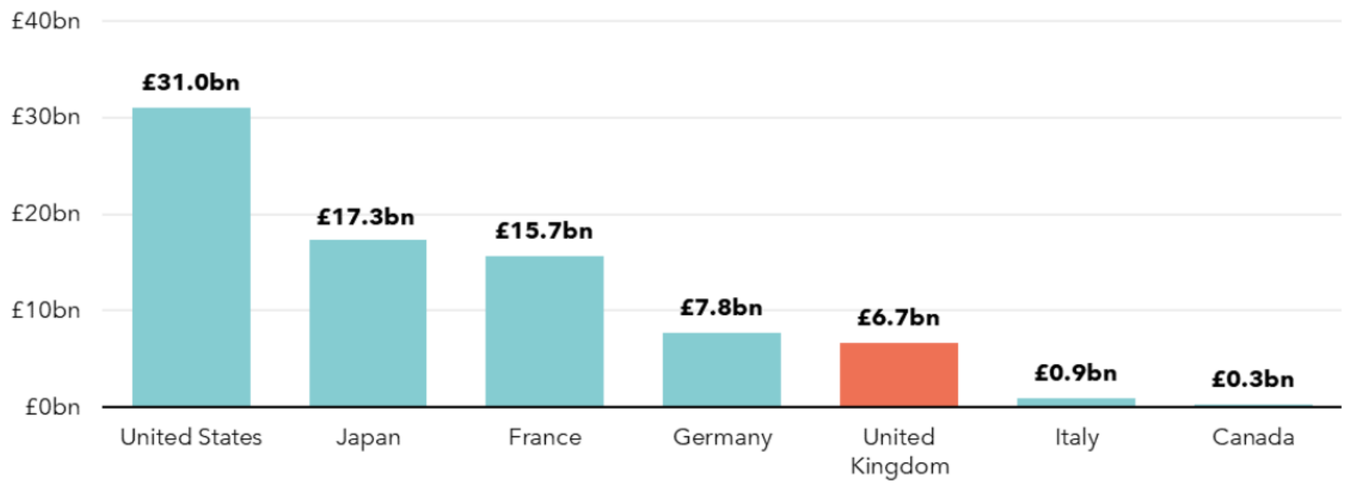
Looking instead at the actual amount of money brought in - rather than the amount as a proportion of all tax revenues - the UK's inheritance tax looks less of a revenue-raiser. Raising just £6.7bn in 2022, this is lower than most G7 countries including the US (£31.0bn), Japan (£17.3bn), France (£15.7bn), and Germany (£7.8bn).[56] Among G7 countries, the UK raised more only than Italy - whose inheritance tax is normally charged at just 3% - and Canada - who no longer have an inheritance tax.

56 OECD. Revenue Statistics - OECD countries: Comparative tables. (n.d). https://stats.oecd.org/Index.aspx?DataSetCode=REV

FIGURE 7

The UK raised less revenue from inheritance tax in 2022 than the US, Japan, France and Germany

Revenue raised from inheritance and gift taxes in 2022, G7 countries, OECD data



Source: OECD. Revenue Statistics - OECD countries: Comparative tables. (n.d). https://stats.oecd.org/Index.aspx?DataSetCode=REV
Figures converted from USD to GBP using 2022 average exchange rate.

The UK's system is less progressive than others

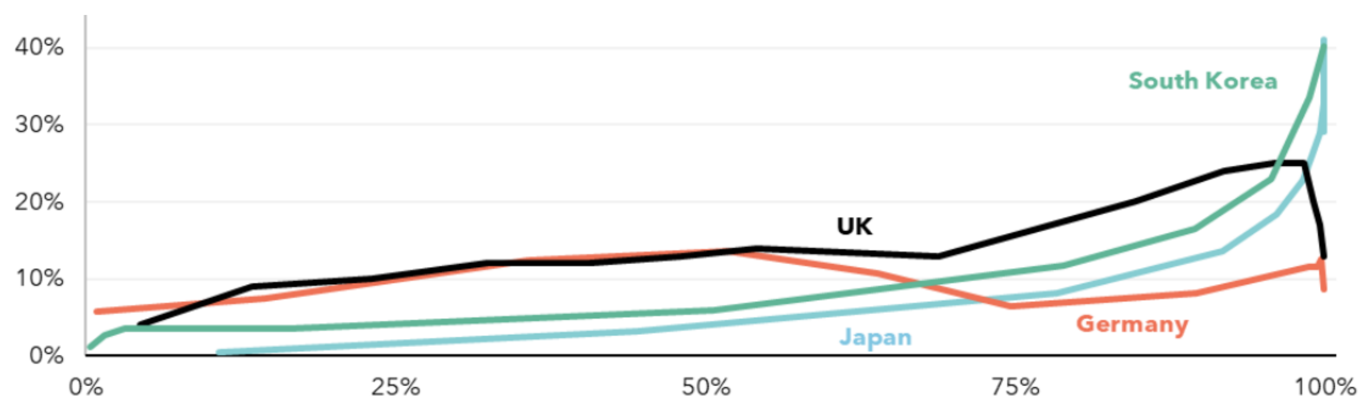
We've seen the marginal rates charged to taxpaying estates across different inheritance tax regimes, and how marginal rates tend to increase for more valuable inheritances. This is very different, however, from the effective rate (the percentage of the total value of inheritance paid in tax), and how this changes as inheritances become more valuable.

Figure 8 shows the average effective rate across the distribution of tax paying inheritances in 2021, for select countries analysed within this paper (on estates for the UK and South Korea and receipts for Germany and Japan). Untaxed inheritances (which constitute the vast majority of inheritance in all countries, as outlined in Figure 2) are excluded. We see that the UK's effective rate increases quite quickly in the first 20% of the distribution, and tends to gradually increase until around the 80th percentile. It then rapidly increases, before falling significantly for the top 1%. Given this is just the 4% of deaths resulting in tax, it actually represents just 0.04% of estates.

FIGURE 8

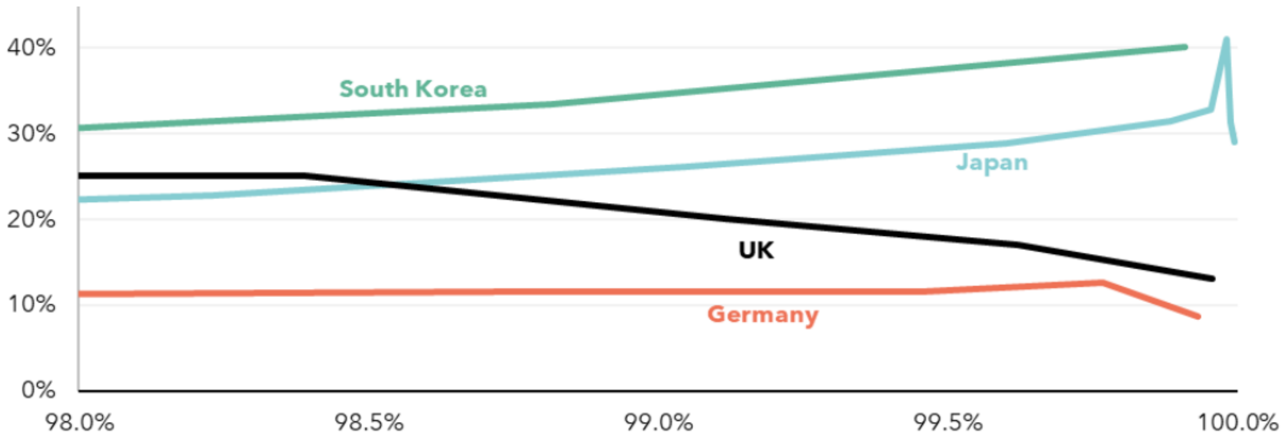
The UK has a higher effective inheritance tax rate than comparison countries across most of the distribution of taxpaying estates...

Estimated effective rates on inheritance tax for taxpaying estates/receipts, by percentile size of inheritance, 2021



...but the UK has a much lower rate then Japan or South Korea for the most valuable estates

Estimated effective rates on inheritance tax for the most valuable 2% of inheritances within taxpaying estates/receipts, 2021



Source: Demos analysis of various sources:

6.2.2 Inheritance tax decision status II. KOSIS Statistical List. 11 August 2023. https://kosis.kr/statHtml/statHtml.do?orgId=133&tblId=DT_133N_612&vw_cd=MT_ZTITLE&list_id=133_13301_200_60_10&scrId=&seqNo=&lang_mode=ko&obj_var_id=&itm_id=&conn_path=MT_ZTITLE&path=%252FstatisticsList%252FstatisticsListIndex.do&orderBy=ASC

Federal Statistics Office. Inheritance and Gift Tax Statistics - 2021 (Last edition - discontinued on a reporting basis). 20 July 2022. https://www.destatis.de/DE/Themen/Staat/Steuern/Weitere-Steuern/Publikationen/Downloads-weitere-Steuern/erbschaft-schenkungsteuer-5736101217004.html

HM Revenue and Customs. Inheritance Tax liabilities statistics. 26 July 2023. https://www.gov.uk/government/collections/inheritance-tax-statistics

e-Stat, Inheritance tax statistics, Table 0501, https://www.e-stat.go.jp/stat-search/files?page=1&layout=datalist&toukei=00351010&tstat=000001043366&cycle=8&year=20211&month=0&tclass1=000001043367&tclass2=000001043373&result_back=1&cycle_facet=tclass1%3Atclass2&tclass3val=0

Notes: No comparable data was available for Spain, France or Ireland. UK figures are for the 2020-21 financial year.

In government data tables, effective rates are provided for inheritances by certain value-brackets. This analysis calculates the bracket of percentiles that those inheritances make up on the distribution of tax paying inheritances, and uses the midpoint of that bracket.

In Germany, the effective rate is even more up and down. In contrast, in South Korea and Japan, there is a more straightforward progression of the rates. In both, the effective rate remains under 10% until around the 80th percentile, but increases exponentially within the top quarter of the distribution. In Japan, there is a slight decrease in the top 0.1%, but only from 31% to 29%. In South Korea, there is no decrease in the rates for any tax brackets for which data is provided, and the effective rate reaches 44% for the top 0.1% (representing around just 0.0064% of all deaths).

As we explore throughout the next section, much of the regressiveness is likely caused either by differences in the generosity of exemptions or the treatment of foreign assets. At the top end of the distribution particularly, business exemptions can play a big role in reducing the effective rate.

SOURCES OF PUBLIC CONCERN

Inheritance tax is widely seen as a particularly unpopular tax. When the public are asked how fair or unfair each tax is, inheritance tax often comes bottom of the list.[57,58] When asked about the tax in isolation, a majority of the public also say they support its abolishment.[59]

Many headlines interpret this as meaning inheritance tax is the 'most hated tax'. However, other polls suggest inheritance tax is not so unpopular. When asked to choose which taxes should be cut, only 14% of the public choose inheritance tax in the top three - lower than the basic rate of income tax, council tax, VAT, fuel duty, and national insurance.[60] Similarly, Demos polling showed that, when asked to choose between spending £7bn on scrapping inheritance tax or on funding public services like the NHS and schools or reducing borrowing, just 14% choose to scrap the tax.[61] When asked to set the threshold for inheritance tax, the median response is just around £300,000 - lower than the threshold most people experience.[62]

Collectively this suggests that while inheritance tax is viewed negatively in isolation, when presented with policy choices, the public tend to think we should keep the tax, and potentially with a lower threshold than the current one. The question remains, however, why does inheritance tax have such negative connotations when viewed in isolation?

Over the past year and a half, Demos have done extensive public engagement research, providing a range of insights into public concerns about the tax. In December 2022, we ran an extensive survey on attitudes to inheritance in the UK.[63] In April and May 2023, we ran 12 focus groups conversations about inheritance tax, collectively speaking with over 100 people.[64] We then identified key points of agreement across the groups - both those driving support for inheritance taxation, and those driving concern about it. A summary of the main points of agreement is given in the tables below.[65]

	ATTITUDES DRIVING SUPPORT FOR INHERITANCE TAXATION
Full agreement	'The ultra-wealthy are too wealthy'
	'It is important that the government has funds'
	'Scrapping inheritance tax could cause unacceptable trade-offs'
Agreement among three groups	'Inheritance of things like secondary homes should be taxed more'
	'It is right to tax inheritances as long as the threshold is at the right level'
	'The value of inheritance is the most important consideration for the tax'

57 Ipsos. Inheritance tax seen as an unfair tax but others are prioritised for cuts. 30 July 2023. https://www.ipsos.com/en-uk/inheritance-tax-seen-unfair-tax-others-are-prioritised-cuts
58 YouGov. How fair is inheritance tax?. 25 March 2024. https://yougov.co.uk/topics/politics/trackers/how-fair-is-inheritance-tax
59 Ward J. YouGov poll shows majority of public now supports scrapping IHT and even a majority of Labour voters oppose raising the current 40% IHT rate. Kingsley Napley. 29 September 2023. https://www.kingsleynapley.co.uk/our-news/press-releases/yougov-poll-shows-majority-of-public-now-supports-scrapping-iht-and-even-a-majority-of-labour-voters-oppose-raising-the-current-40-iht-rate
60 Ipsos. Inheritance tax seen as an unfair tax but others are prioritised for cuts. 30 July 2023. https://www.ipsos.com/en-uk/inheritance-tax-seen-unfair-tax-others-are-prioritised-cuts
61 Demos. "£7 billion electoral gamble' to abolish inheritance tax unlikely to pay off, according to new research". 11 December 2023. https://demos.co.uk/blogs/7-billion-electoral-gamble-to-abolish-inheritance-tax-unlikely-to-pay-off-according-to-new-research/
62 Goss D and Glover B. The inheritance tax puzzle: Challenging assumptions about public attitudes to inheritance. 14 June 2023. Demos. https://demos.co.uk/research/the-inheritance-tax-puzzle-challenging-assumptions-about-public-attitudes-to-inheritance/
63 Ibid.
64 Goss D and Glover B. Winning the Argument: How to unlock public support for inheritance taxation. Demos. 26 September 2023. https://demos.co.uk/research/winning-the-argument/
65 Ibid.

	ATTITUDES DRIVING CONCERN FOR INHERITANCE TAXATION
Full agreement	'Inheritance has a small impact on inequalities in the UK'
	'Inherited inequality is just a part of life'
	'Money from the tax system should be spent better'
	'Government spending isn't transparent enough'
	'We need to be given a better reason why inheritance taxation exists'
	'Inheritance taxation risks being the politics of envy'
	'Avoidance of inheritance tax is a problem'
Agreement among three groups	'Inheritance tax places too many burdens at a sad time'
	'Inheritance taxation is a problem because it's double taxation'
	'Inheritance taxation can be anti-aspiration'

Echoing the survey findings, there was widespread recognition that scrapping inheritance tax would either mean cuts to public services or tax rises elsewhere, and most people felt this was unacceptable. Most people felt like inheritance tax should play a role in the funding of public services, but that we had to set the right threshold - with wide disagreement about where that should be.

On the other hand, there were a wide range of concerns about the tax, including those listed below.

Detachment from the importance of the tax

A key driver of concern about inheritance tax arises because the public don't closely associate it with the funding it provides for public services.[66] Income tax is seen as the default funding for national services, council tax seen as providing council services. Inheritance tax, however, does not benefit from any such association. This is a problem with how the tax is communicated to the public.

People's desire to feel they get something out of the tax is perhaps even stronger for inheritance tax than most other taxes. People have a sentimental attachment to their inheritance, and want to feel as though they are leaving a legacy. Many feel that inheritance tax is counter to this, particularly because many feel that tax revenues are often wasted by the government.[67]

Many often see inheritance tax primarily as a more cynical way for the government to get more funds.[68] This is compounded by concerns about the tax being used as a 'stealth tax', with thresholds frozen while house prices increase.

Related to this is the fact that people feel like government spending in general is not transparent enough.[69] People would not just like assurance that their taxes are being spent well, but also knowledge of what the taxes are being spent on, so they can hold the government to account on this.

Concerns about taxing inheritance itself

Many of the public's concerns are about the idea of taxing inheritance itself. A common criticism is that inheritance tax is double taxation, because people have already paid income tax on the money.[70] While this

66 Ibid.
67 Ibid.
68 Ibid.
69 Ibid.
70 Ibid.

is the case for most taxes (council tax, VAT and fuel duty, for example, are all paid after income tax is paid), people feel more strongly about inheritance tax because it is wealth that people have put aside to save. Criticism around double taxation is also associated with the aforementioned sense that the public don't get anything out of inheritance tax; e.g. while VAT is seen as fair double taxation, inheritance tax is seen as arbitrary double taxation. The higher salience of inheritance tax as double taxation may also arise in part because taxpayers themselves have to administer the payments, while VAT payments (although included in the price of goods) are administered by businesses.

Some also see inheritance tax as inherently anti-aspirational. Inheritance is often seen as a noble effort to provide for one's family, and taxing this is seen to undermine those efforts.[71] This is primarily because inheritance is framed first and foremost as something *given* by someone, rather than something *received* by someone.

People often feel that inheritance taxation also risks becoming the 'politics of envy', whereby the tax policy is driven by animosity to the wealthy, rather than a more positive case.[72] People felt relatively averse to the idea that the tax system would make personal judgements about people and their wealth, and how much they deserve it.

A sense of unfairness

The public are aware that inheritance tax planning occurs - perhaps as a result of the regular articles in newspapers that offer advice on such tax planning. People are aware that this mainly benefits the wealthiest, and accordingly feel that the tax effectively targets people in the middle of the wealth distribution.[73] This damages the tax's credibility.

This concern is mainly unfounded; inheritance tax doesn't affect any estates at all in the bottom 65% of the wealth distribution, and 98% of the tax is paid by the wealthiest 20% of estates. However, the concerns have some basis. Among those who do pay the tax, the wealthiest estates are known to engage in tax planning, particularly making use of the various exemptions.[74] This contributes to the fall in tax rates we see for the top 1% of taxpaying estates (around 0.04% of all estates).[75] This is therefore both a problem of communication (informing people that inheritance tax does only affect the wealthiest), but also of tax design (to address concerns about tax planning).

Scepticism about its effectiveness

Another reason people do not perceive a positive case for inheritance tax is because many are sceptical about the impact it can have on inequality.[76] There is general agreement that inheritance plays a relatively minor role in today's inequalities, and that it would be better to focus on levelling up and fixing the housing market. There is also a sense of fatalism about inherited inequalities - a sense that some families have always been, and will always be, wealthier, and that this is not something that the government can change.

Issues with the administration

Many feel that inheritance tax imposed too many burdens on families at a time of grief.[77] This included the burden of filling in form and possibly having to take out loans or face debts in paying the tax. As mentioned earlier, changes announced in the Spring Budget should help remove the need for people to take out loans. It is unclear whether or not this will have any impact on these perceptions.

71 Ibid.
72 Ibid.
73 Ibid.
74 Dunsten T. Advisers turn to Aim-listed companies for IHT relief. FT Adviser. 15 February 2024. https://www.ftadviser.com/companies/2024/02/15/advisers-turn-to-aim-listed-companies-for-iht-relief/
75 HM Revenue and Customs. Inheritance Tax liabilities statistics: commentary. 26 July 2023. https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary
76 Goss D and Glover B. Winning the Argument: How to unlock public support for inheritance taxation. Demos. 26 September 2023. https://demos.co.uk/research/winning-the-argument/
77 Ibid.

CONCLUSION

We have seen that the UK's inheritance tax may seem simple on the face of it, but ends up highly complex once we get into the detail of its different thresholds, exemptions, treatment of gifts, payment conditions and treatment of non-doms. Within these complexities, problems arise, such as a regressive effective rate at the top of the distribution, avoidance opportunities for non-doms and administrative burdens.

There are additional and related problems with inheritance tax in terms of public concerns about it. Many of these concerns are, in large part, independent from the design of the tax. Many people don't like the idea of taxing inheritance at all, as many feel they have earned their wealth and already paid tax on it. Yet, issues with the design of the tax aggravate and add to these concerns. Many people feel inheritance tax unfairly taxes those in the middle of the distribution and is avoided by the wealthiest, that (perhaps relatedly) it isn't effective at tackling inequality, and that it imposes excessive burdens on people during sad times. People are also detached from its importance to public funds, which, as we discuss later in the report, could be addressed by hypothecating the tax.

The various complexities around inheritance tax, and associated problems, present opportunities for a wide range of reforms and improvements.

In exploring those reforms, we may also choose to reform by aligning more closely to other developed countries. The UK is in a minority whose inheritance tax only varies depending on how much is given (regardless of how much each person receives), who don't tax lifetime transfers (only those near or after death), with a flat rather than progressive rate, who don't tax most private pensions, who offer a full exemption for owned businesses, and who differentiate between listed and unlisted shares.. Of those with capital gains taxes, we are in a minority who 'uplift' gains for inherited assets (meaning gains before the death go untaxed). These differences present useful opportunities for change.

We should assess these opportunities for reform against problems with our current system of inheritance taxation. Demos's previous research has examined problems with the system from the public's perspective - highlighting their concerns and priorities. The next section will look at how the reform options might address those concerns, while meeting their priorities for a fair, revenue-raising tax.

SECTION 2
OPTIONS FOR REFORM

We've seen how the design of inheritance tax has many facets - providing many levers that the government can shift to improve the tax. In this section, we look at three categories of reform available to the government:

- **Shifts to the parameters of the current regime** - including introducing a package of different thresholds and exemptions, a progressive rate, taxing inherited capital gains, and administrative reforms.
- **Overhauling the tax base** - including taxing inheritance receipt rather than bequests, a lifetime receipts tax, and linking rates to the recipient's wealth.
- **Hypothecation** - including soft or hard hypothecation, and hypothecation to different spending areas such as social care, or homes for the next generation.

We evaluate these reforms against both their economic outcomes (revenue, progressivity and market incentives) and political outcomes (public support and support among specific groups, such as businesses).

1. SHIFTS TO THE PARAMETERS OF THE CURRENT REGIME

Shifting the thresholds, rates and exemptions

There are a range of ways that the inheritance tax thresholds, rates and exemptions could be shifted. Given these different features of the tax affect one another, reforms are usually recommended in packages - shifts to the thresholds, rates and exemptions are recommended in conjunction with one another. Four key packages of reform are those recommended by the Institute for Fiscal Studies (IFS) and University of Warwick (UoW), the Resolution Foundation, the APPG on Inheritance and Intergenerational Fairness, and the Office for Tax Simplification (OTS). The Resolution Foundation proposes similar changes to the IFS, but with the addition of two new tax bands.[78] This progressive rate is considered in the next subsection.

78 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf

Institute for Fiscal Studies & University of Warwick's proposals

In 2023, the IFS/UoW suggested the following changes to the thresholds and exemptions:

- Abolish business relief and agricultural relief (or potentially cap these at a level of £500,000 per person (transferable between spouses)).
- Bring 80% of the value of bequeathed pension pots into estates
- Abolish the residence nil-rate band - with the option to raise the threshold to £500,000

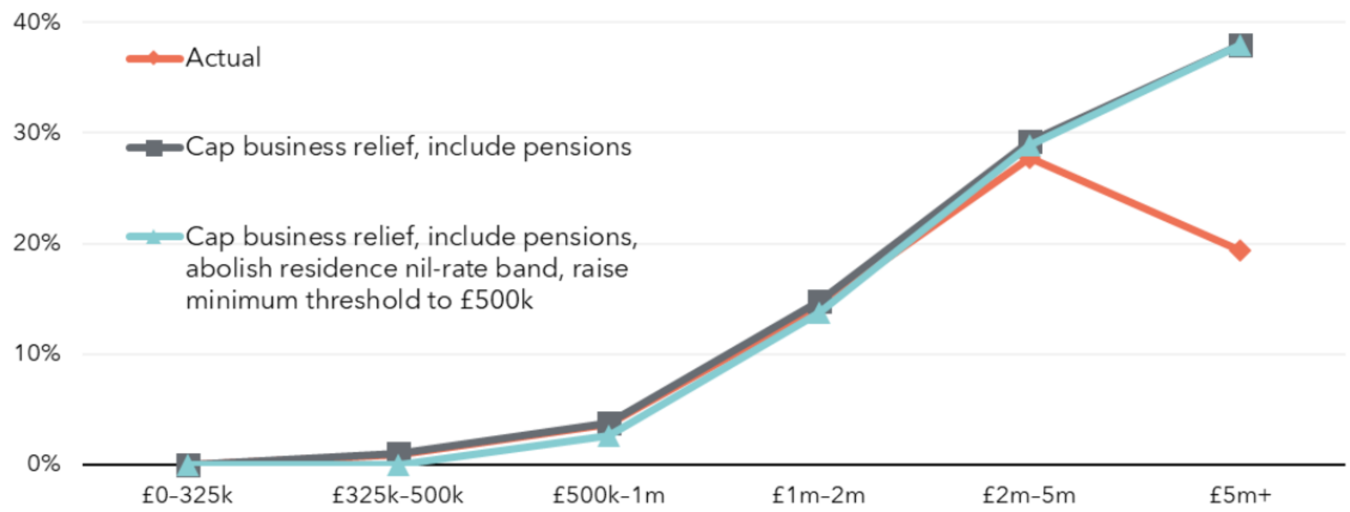
The Resolution Foundation proposals in 2023 recommend similar policies, but they suggest bringing the total value of pensions into the scope of inheritance tax, and do not explicitly suggest a cap on the reliefs. Given the similarities, we assess these together.[79] Beyond the exemptions, the Resolution Foundation suggests implementing a progressive rate, which is assessed in the next subsection. Both also recommend removing the capital gains uplift, but we address this later in the report.

Removing the exemptions would lead to a significant increase in the average rate paid by estates worth over £5m. According to the IFS/UoW's modelling, capping business relief at £500,000 and including 80% of the value of pensions would increase the rate for these estates from 19% to 38%. For lower value estates, the average rates remain almost unchanged. If, on top of this, the government also abolishes the residence nil rate band and raises the threshold to £500,000, this would lead to no significant changes in the average rate for estates worth over £2m, but a 1 point reduction in the rate for estates worth between £500,000 and £2m.

FIGURE 9

Capping business relief and including pensions in inheritance tax would double the average rate for estates over £5m, but leave rates for other estates almost level

IFS modelling of inheritance tax effective rates under different reform scenarios



Source: Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf

Alongside making the system more progressive and revenue-raising, these reforms could also expand support for inheritance tax among sections of the public. If the reforms reduced tax planning and led to the most valuable inheritances paying a higher effective rate - while being framed politically as making the tax simpler and harder to avoid - this could ease key public concerns about the tax.

79 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf

Yet, there are risks. In particular, the public is concerned about taxing pensions. Taxing inherited pension wealth makes economic sense - because pensions are currently treated more favourably by the tax system if given as bequests than if used for retirement income, which is what they are meant for.[80] Yet, in Demos' 2022 survey, 41% of respondents said pensions, when inherited, should always be tax-free and a further 19% said they should generally be tax-free.[81] Still, 51% of the public said they should be taxed in some instances, which is slightly higher than the number for main residences (which are currently taxed in inheritance). Similarly, while capping business exemption would be more popular among the public (63% of survey respondents said owned businesses should be taxed in some instances), it would likely cause backlash from larger businesses, particularly if there were concerns about liquidity issues (a lack of cash to pay the charge) and having to sell off parts of their business. Importantly, however, 77% of those claiming business relief in 2020-21 had business property worth under £500,000, and so would have been unaffected.[82]

In contrast, raising the threshold to £500,000 would prove especially popular, in particular with the transferable allowance meaning a threshold of £1m. Our focus groups showed how a top concern for people is where the threshold lies, and many of those who are more sceptical about the tax felt they would be satisfied if the threshold was increased to £1m.[83]

Another factor to consider is the economic impact of removing exemptions for particular assets. While the business and agricultural exemptions were not introduced to incentivise investment in these assets, this has likely manifested. In particular, business relief may have driven investment - and therefore price increases - in AIM shares, with agricultural relief doing the same for land values. Removing the exemptions could significantly reduce these prices, which could drive instability for those owning such assets. For example, if such a business or farm was intending to raise capital around this time, they may have to sell off more AIM shares or land. The extent of this impact requires further analysis.

More recently, the IFS specifically recommended removing the exemption for AIM shares.[84] They argue the relief lacks rationale and distorts investment choices towards such shares.

APPG's proposals

In 2020, the proposals of the final report from the APPG on Inheritance and Intergenerational Fairness most notably recommended:[85]

- Shifting to a low flat rate tax (likely between 10% and 20%) on both lifetime and death wealth transfers.
- Abolishing all reliefs other than spouse and charity exemptions, and abolishing the capital gains tax (CGT) uplift.
- An annual lifetime gifts allowance of £30,000 and a death allowance around £350,000 (without the residence nil-rate band), with 10% paid after this.
- The possibility of also having a 20% rate paid after £2m.

In justifying the lower rate, the APPG argues that rates above 20% start to incentivise planning. If correct, this would likely enhance the tax's credibility long-term - but further research needs to be done to test to what extent this holds, as wealthiest may still face incentives to engage in tax planning if facing a 20% rate or lower. Planning options would of course be reduced given the ending of business and agricultural exemptions, but this could occur without the rate change. It is unclear to what extent the combination of rate changes and reduced exemptions would reduce tax planning.

80 Adam S, Delestre I, Emmerson C, and Sturrock D. Death and taxes and pensions. Institute for Fiscal Studies, December 2022, https://ifs.org.uk/sites/default/files/2022-12/Death-and-taxes-and-pensions-Institue-for-Fiscal-Studies.pdf
81 Goss D and Glover B. The inheritance tax puzzle: Challenging assumptions about public attitudes to inheritance. 14 June 2023. Demos. https://demos.co.uk/research/the-inheritance-tax-puzzle-challenging-assumptions-about-public-attitudes-to-inheritance/
82 Demos FOI request to HMRC
83 Goss D and Glover B. Winning the Argument: How to unlock public support for inheritance taxation. Demos. 26 September 2023. https://demos.co.uk/research/winning-the-argument/
84 Advani A and Sturrock D. Raising revenue from closing inheritance tax loopholes. 18 April 2024. https://ifs.org.uk/articles/raising-revenue-closing-inheritance-tax-loopholes
85 APPG for Inheritance & Intergenerational Fairness. Reform of inheritance tax. January 2020. https://files.pumptax.com/wp-content/uploads/2020/01/30174440/Reform-of-inheritance-tax-report-Jan-2020-final-ALT.pdf

The rate reduction would also have a significant impact on the revenue, which the APPG itself does not model. Increases in revenue due to reduced tax planning and exemptions are unlikely to compensate for the loss due to the rate cut. For example, adjusting the IFS's estimates of the revenue gained from ending exemptions (by halving them, assuming a 20% flat rate in the same system and a static response), this would raise just £1.55 billion. Revenues would also be increased by the removal of the residence nil-rate band, and the taxation of lifetime gifts. More research needs to be done to understand the overall impact.

In regard to the removal of the residence nil-rate band (and raising the minimum threshold up to £350,0000), this would bring a significant number of people into inheritance tax. In 2020-21, 5,000 paid no inheritance tax because of the residence nil-rate band, and an additional 20,200 estates used the band but still paid the tax.[86] £6.2 billion of wealth was sheltered from inheritance tax as a result.[87] For those estates facing increased inheritance tax payments as a result, their concerns may be mitigated by the APPG's recommended rate reduction. However, there will also be estates who faced no charges as a result of the residence nil-rate band, but subsequently do face charges. This would be controversial among those at risk of paying it.

The annual lifetime gifts allowance of £30,000 could also be contentious, despite impacting very few people. Currently only around 5% of adults receive a gift worth over £500 in a two year period, and even the largest 10% of transfers between 2008–09 to 2019–20 were only worth over £20,500 - significantly below the £30,000 threshold.[88] Of the small minority who would be affected by the tax, those with liquidity (available cash) could plan around the tax quite easily, by spreading gifts over multiple years. However, we know that people overestimate their chances of being charged by inheritance tax, and the same would likely apply to a lifetime gift tax.[89] A gift tax may also attract more concern because people are liable to pay it at any time in their life, rather than just near death. As discussed later, the lifetime gifts tax in Germany encourages significant tax planning by timing gifts intermittently. Adding such pressure on houses to plan taxes would be controversial.

As with the IFS proposals, there would likely be similar complaints from businesses and landowners around the removal of the business and agricultural exemptions. The proposal to remove the capital gains uplift will be assessed in the next subsection.

OTS's proposals

In 2019, the OTS recommend a range of measures to simplify the tax, making it easier to administer and harder to avoid.[90] This includes recommendations to:

- Consider removing the capital gains uplift for assets that have benefited from inheritance tax relief and carry over any gains
- Review whether the level of trading activity required for business relief (such that a business is not 'wholly or mainly' involved in investment, i.e. over 50%) should continue to be set at a lower level than that for gift holdover relief or entrepreneurs' relief (which requires a business has 'substantial' trading activity, i.e. over 80%).
- Consider whether to align the Inheritance Tax treatment of furnished holiday lets with that of Income Tax and Capital Gains Tax
- Replace annual gift exemption and exemptions for gifts for weddings with an overall personal gifts allowance, and abolish taper relief
- Reduce the 7 year period to 5 years, so that gifts to individuals made more than 5 years before death are exempt from Inheritance Tax

86 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
87 HM Revenue and Customs. Inheritance Tax liabilities statistics: commentary. 26 July 2023. https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary
88 Boileau B and Sturrock D. Who gives and receives substantial financial transfers in Britain?. Institute for Fiscal Studies. 3 February 2023. https://ifs.org.uk/sites/default/files/2023-03/WP202308-Who-gives-and-receives-substantial-financial-transfers.pdf
89 Goss D and Glover B. The inheritance tax puzzle: Challenging assumptions about public attitudes to inheritance. 14 June 2023. Demos. https://demos.co.uk/research/the-inheritance-tax-puzzle-challenging-assumptions-about-public-attitudes-to-inheritance/
90 Office for Tax Simplification. Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax. July 2019. https://assets.publishing.service.gov.uk/media/5d274fad40f0b61158962af5/Final_Inheritance_Tax_2_report_-_web_copy.pdf

Our focus groups suggested that people were aware that inheritance tax is complex, but were mainly concerned to the extent it made the tax hard for them to understand, and easy for the wealthy to avoid.[91] Some of these reforms would help in that regard; a single personal gift allowance without taper relief would make the tax easier to understand, while tightening the rules on business relief may make the tax harder for businesses to avoid.

Primarily, however, these reforms are unlikely to tackle the key drivers of perceived complexity and unfairness among the public, such as the complexity around the residence nil-rate band (which the OTS suggest needs to be given more time before a comprehensive evaluation can be made) or the ease of avoidance due to various generous reliefs.

There is also a risk that the government may not want to deliver these reforms in isolation. While the benefit would be relatively small, the political cost of raising any debate on inheritance tax could be high if it pushes others to call for abolishment. Such reforms may therefore have to be part of a wider reform of inheritance tax, one which addresses its more fundamental problems.

Business relief

Given the prevalence of recommended changes to inheritance tax business relief, it is worth focussing on this specifically. Given questions around whether the relief still serves its intended purpose, rather than mainly providing opportunities for the wealthy to reduce inheritance tax bills, there is a need to assess whether business relief still provides value for money.

When introduced in 1976, business relief was meant to prevent the break-up or sale of businesses due to inheritance tax (who may not have the cash available to pay the bill).[92] Since then, it has been extended to different kinds of business property. In 1992, it was extended by the Chancellor to shares on the unlisted securities market (which was replaced by the AIM in 1995) on the basis that such shares are "less liquid than shares with a full stock market quotation".[93] This means people may incur an inheritance tax bill for unlisted shares, but then struggle to sell the shares to help pay it. Similarly, the market for those shares may be harmed if people are then put off from investing in. While full relief was initially only available for shares worth over 25% of the company, it was extended to all shares in 1996. This is significant, because shares in unlisted traded businesses made up 80% of the value of business property benefiting from the relief in 2020/21.[94] Other types of business property - including non-traded businesses - made up the other 20%.

However, the liquidity of unlisted shares may be dramatically different to when the relief was extended. For example, while the AIM included just ten companies in 1995, it had 738 by the end of March 2024.[95] The value of trade on the market has also increased dramatically since its formation.[96] This suggests the shares would be more liquid, and the basis for the relief may no longer hold.

Many of the businesses on AIM are also overseas businesses (101 were as of February 2024).[97,98] Some benefits of the tax relief - in protecting businesses who sell unlisted shares - are therefore not enjoyed by British businesses. This again raises questions around value for money for the British taxpayer.

While it is not clear whether the relief still serves its intended purpose, it does clearly allow the wealthiest estates to reduce their inheritance tax bill. The majority of business relief in 2020-21 (57%) was claimed by just 68 estates, each with an average of £27 million of business wealth benefitting from the relief.[99] This plays a part in reducing tax rates paid by the wealthiest estates, particularly those estates worth over £10m for whom the effective rate falls to 17%.

91 Goss D and Glover B. Winning the Argument: How to unlock public support for inheritance taxation. Demos. 26 September 2023. https://demos.co.uk/research/winning-the-argument/
92 Hansard, UK Parliament. Relief From Tax On Chargeable Gains In Respect Of Business Property. 17 May 1976. https://hansard.parliament.uk/Commons/1976-05-17/debates/d3143b4c-9829-4625-8ad3-dccad92535d3/ReliefFromTaxOnChargeableGainsInRespectOfBusinessProperty
93 Lamont N. Ways And Means: Budget Statement. UK Parliament. Tuesday 10 March 1992. https://hansard.parliament.uk/Commons/1992-03-10/debates/dbdd3e68-d35a-4d01-94e1-6315b54a8701/WaysAndMeans
94 HM Revenue and Customs. Inheritance Tax liabilities statistics. 26 July 2023. https://www.gov.uk/government/collections/inheritance-tax-statistics
95 Jolly J. Sharp rise in Aim delistings casts doubt over City of London's future. The Guardian. 22 April 2024. https://www.theguardian.com/business/2024/apr/22/sharp-rise-in-aim-delistings-casts-doubt-over-city-of-london-future
96 Long R. The Alternative Investment Market (AIM) 2023 – Worst Performance for Two Decades. Junior Mining Insights. 11 January 2024. https://www.linkedin.com/pulse/alternative-investment-market-aim-2023-worst-performance-ryan-d-long-pzcoe/
97 Hore A. How changes to ISAs could give AIM shares a welcome boost. Interactive Investor. 9th February 2024. https://www.ii.co.uk/analysis-commentary/how-changes-isas-could-give-aim-shares-welcome-boost-ii530704
98 London Stock Exchange Group. AIM. (n.d.). https://www2.lseg.com/AIMforgrowth/NorthAmerica
99 Agyemang E. Fresh calls for action on IHT breaks after 68 estates shelter £1.8bn in assets. Financial Times. 3 June 2024.

Similarly, the exemption for AIM shares primarily benefits the wealthiest estates. This relief is most accessible to those whose wealth is not locked up in houses, pensions or physical belongings - which tend to be the wealthiest estates. For the median household in terms of wealth, 97% of their wealth is locked up in houses, pensions or physical belongings, but for the top 1%, just 72% of their wealth is.[100]

Case studies

As a comparison for different thresholds, rates and exemptions, both Japan and South Korea offer useful case studies. Both have a relatively high inheritance tax threshold - and therefore not a particularly large proportion of people paying the tax - but achieve significantly more revenue than the UK.

SOUTH KOREA'S HIGH REVENUE WITH A HIGH THRESHOLD

The South Korea system raises more revenue, more progressively than the UK for four key reasons:

- More inheritances face the tax in South Korea than the UK - 6.4% vs 3.7% respectively. Importantly, however, the UK figure is already expected to rise to 6.3% by 2028-29.
- South Korea taxes the most valuable inheritances at higher rates (50% for taxable inheritance over £1.77m, compared to the UK's 40% flat rate).
- While the UK exempts most owned businesses from the tax regardless of size, South Korea only exempts small and medium-sized enterprises run by the deceased for 10 years.
- The South Korean tax applies to any property given by a resident, while the UK's non-dom regime (which will continue until 2025) allows some residents to bypass the tax.

THE DESIGN

Like the UK, South Korea is one of the few countries to tax estates rather than receipts. For inheritance tax, the estate includes any gifts given to heirs in the 10 years prior to death, and any gifts given to non-heirs in the 5 years prior to death. South Korea also imposes a gift tax for gifts outside this period.

For inheritance tax, a choice is given to the executor on the estate either to take a flat threshold of KRW 500m (£295,000) or to take a threshold determined by who the inheritance is given to.[101] For the latter option, various allowances are added together depending on certain features of the recipient, including a basic allowance plus an allowance for each child of the deceased. There are additional allowances if recipients or family members are under 19, over 65 or have a disability. There are also

100 ONS. Household total wealth in Great Britain: April 2018 to March 2020. 7 January 2022. https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/april2018tomarch2020
101 EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide

allowances for things like funeral costs. Alongside this, there is an exemption for main residences up to KRW 600m (£354,000), if the donor lived in it for at least 10 years prior to death.[102] For gifts - with gifts in any 10-year period added together - the thresholds are KRW 600m (£354,000) for spouses, KRW 50m (£29,500) for parents, children, or grandchildren, and KRW 10m (£5,900) for others.

For amounts above this, for both inheritance and gifts, a 10% marginal rate is applied up to KRW 100m (£59,000), increasing in 10% intervals until racing 50% for estates worth over KRW 3 billion (£1.77m).[103]

THE ECONOMICS

6.4% of deaths in South Korea resulted in inheritance tax being due in 2021.[104] This is higher than the UK's 3.7% in 2020-21, but the UK figure is expected to be around 5% in 2022-23, and to rise to 6.3% by 2028-29.[105,106]

South Korea's tax, having made up a higher percentage of tax revenues than in the most of any OECD country in 2019 (1.6%), raised a significantly higher percentage in 2022 (3.4%) - worth KRW 19.3 trillion (£11.6 billion in 2022).[107,108,109,110,111,112,113] This represented 20.1% of all inheritance passed on - significantly higher than the UK figure (which was around 4.2% in 2019-20 -the most recent year for which accurate estimates can be made).[114,115,116,117,118]

2022 was anomalous, however, because the inheritance tax bill of Samsung - whose owner passed away in 2020 - was processed in 2022, with a charge of around KRW 12 trillion (£7.2 bn).[119] Even taking Samsung out of the equation, the inheritance tax revenue (around KRW 7.2 trillion (£4.5 billion)) was worth around 1.3% of all tax revenue in South Korea, or around 9.7% of all inheritance passed on.[120,121,122] If the UK taxed the same proportion of inheritances in 2020-21, it would have raised around £10.6bn - almost double what it actually raised. In 2021, a slightly lower percentage of all

102 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
103 EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide
104 H Lee. "6% of deceased people paid inheritance tax…".Kyunghyang Shinmun. 29 June 2023. https://m.khan.co.kr/economy/economy-general/article/202306291321001.
105 Office for Budget Responsibility. (n.d.). Inheritance tax. https://obr.uk/forecasts-in-depth/tax-by-tax-spend-by-spend/inheritance-tax/.
106 Institute for Fiscal Studies. Inheritance tax explained. 5 March 2024. https://ifs.org.uk/taxlab/taxlab-taxes-explained/inheritance-tax-explained
107 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
108 Based on inheritance tax decision status (the year the government decision on inheritance tax was made)
109 6.2.2 Inheritance tax decision status II. KOSIS Statistical List. 11 August 2023. https://kosis.kr/statHtml/statHtml.do?orgId=133&tblId=DT_133N_612&vw_cd=MT_ZTITLE&list_id=133_13301_200_60_10&scrId=&seqNo=&lang_mode=ko&obj_var_id=&itm_id=&conn_path=MT_ZTITLE&path=%252FstatisticsList%252FstatisticsListIndex.do&orderBy=ASC
110 South Korea's government revenue in 2022 was KRW 573.9 trillion.
111 Ministry of economy and finance. 2022 Government Financial Statement. 4 April 2023, Ministry of Economy and Finance. https://english.moef.go.kr/pc/selectTbPressCenterDtl.do?boardCd=N0001&seq=5532
112 Exchange Rates UK. South Korean Won to British Pound Spot Exchange Rates for 2022. (n.d). https://www.exchangerates.org.uk/KRW-GBP-spot-exchange-rates-history-2022.html
113 Using the average KRW to GBP conversion rate in 2022
114 This takes the £5.1bn of inheritance tax liabilities in 2019-20. It compares this to the £121.1bn worth of inheritance that the Resolution Foundation estimate was passed on in 2019-20.
115 Young-tak W, Three-fold increase in 4 years... Inheritance tax with effective tax rate exceeding 20%. Seoul Economic Daily. 22 January 2024. https://www.sedaily.com/NewsView/2D46L6WMEP
116 Dae-cheol K. The average inheritance amount of the top 1% of wealthy individuals was KRW 233.3 billion, and the size of inherited and gifted assets last year was KRW 188 trillion. Business Post. 21 August 2023. https://www.businesspost.co.kr/BP?command=article_view&num=324882
117 In South Korea, the total value of inheritance stood at KRW 96.5 trillion in 2022
118 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf
119 Kang Jin-gyu. "Korea's inheritance tax burden is four times higher than that of developed countries". Hankyung. 30 January 2024. https://www.hankyung.com/article/2024013019541
120 Young-tak W, Three-fold increase in 4 years... Inheritance tax with effective tax rate exceeding 20%. Seoul Economic Daily. 22 January 2024. https://www.sedaily.com/NewsView/2D46L6WMEP
121 The Samsung estate was worth around KRW 22 trillion
122 Dobberstein L. Samsung family sells $2B worth of shares to pay inheritance tax bill. The Register. 6 November 2023. https://www.theregister.com/2023/11/06/samsung_family_sells_2_billion_shares/

inheritance was paid in tax in South Korea, at 8.7% - but this remains at least 3.5 percentage points higher than the UK's.[123,124]

On top of this, South Korea has a tax on lifetime gifts (those given outside the 10 years prior to death). This raised KRW 8.4 trillion (£5.0bn) - equivalent to 9.1% of the value of all gifts passed on.[125,126] This compares to the UK, where gifts given outside the seven years prior to death face no tax at all. If the UK taxed the same proportion of gifts in 2019-20, we would have raised around £2.5 billion.[127,128]

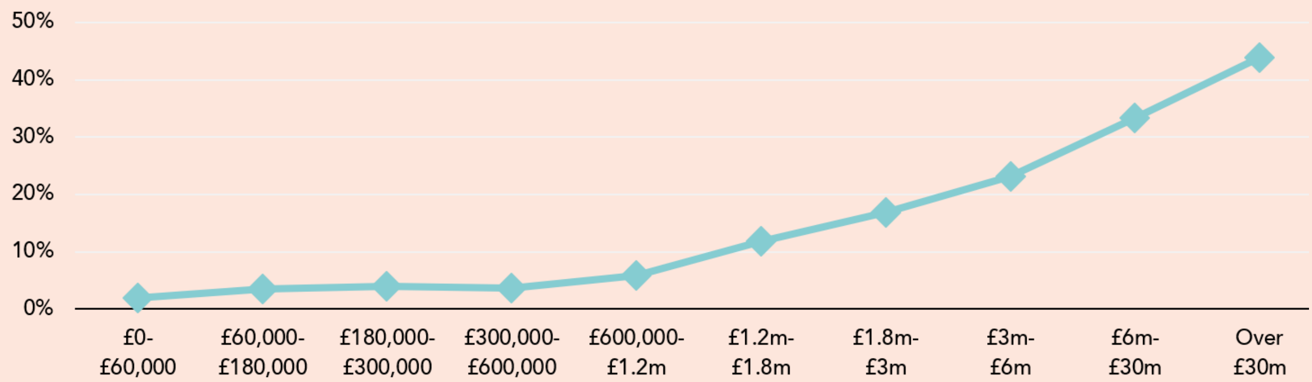
In terms of progressivity, Figure 10 looks at average effective tax rates paid on all inheritance (pre-deductions) across the distribution of taxable estates, by taxable estate value, 2022. The South Korean inheritance tax is progressive across the distribution, even increasing from 33% for the top 2.1%-0.16% of the distribution, to 44% for the top 0.16% of the distribution (estates worth over £30m).[129,130] This compares to the UK, where in 2020-21, the 278 taxpaying estates worth between £5m and £7.5m were taxed at 25%, while the 158 taxpaying estates worth over £10m were taxed at just 17%.

Given this, in South Korea, 77% of all inheritance tax revenue in 2022 was paid by just 26 estates worth over £30m (0.2% of all taxable estates).[131] And even if subtracting Samsung, around 40% of inheritance tax was paid by the remaining 25 estates.

FIGURE 10

Effective inheritance tax rates are higher and more progressive in South Korea than the UK for the most valuable estates

Average effective inheritance tax rates for all taxpaying estates in South Korea, 2022



Notes: taxable value brackets converted into GBP using 2022 average exchange rate
Table 6.2.2 Inheritance tax decision status. https://kosis.kr/statHtml/statHtml.do?orgId=133&tblId=DT_133N_612&vw_cd=MT_ZTITLE&list_id=133_13301_200_60_10&scrId=&seqNo=&lang_mode=ko&obj_var_id=&itm_id=&conn_path=MT_ZTITLE&path=%252FstatisticsList%252FstatisticsListIndex.do&orderBy=ASC

123 Dae-cheol K. The average inheritance amount of the top 1% of wealthy individuals was KRW 233.3 billion, and the size of inherited and gifted assets last year was KRW 188 trillion. Business Post. 21 August 2023. https://www.businesspost.co.kr/BP?command=article_view&num=324882
124 6.2.2 Inheritance tax decision status II. KOSIS Statistical List. 11 August 2023. https://kosis.kr/statHtml/statHtml.do?orgId=133&tblId=DT_133N_612&vw_cd=MT_ZTITLE&list_id=133_13301_200_60_10&scrId=&seqNo=&lang_mode=ko&obj_var_id=&itm_id=&conn_path=MT_ZTITLE&path=%252FstatisticsList%252FstatisticsListIndex.do&orderBy=ASC
125 Dae-cheol K. The average inheritance amount of the top 1% of wealthy individuals was KRW 233.3 billion, and the size of inherited and gifted assets last year was KRW 188 trillion. Business Post. 21 August 2023. https://www.businesspost.co.kr/BP?command=article_view&num=324882
126 6.3.2 Gift tax decision status II. KOSIS Statistical List. 11 August 2023. https://kosis.kr/statHtml/statHtml.do?orgId=133&tblId=DT_133N_612&vw_cd=MT_ZTITLE&list_id=133_13301_200_60_10&scrId=&seqNo=&lang_mode=ko&obj_var_id=&itm_id=&conn_path=MT_ZTITLE&path=%252FstatisticsList%252FstatisticsListIndex.do&orderBy=ASC
127 This takes the £28bn worth of gifts that the Resolution Foundation estimate was passed on in 2019-20, and applies the 9.1% effective gift tax rate in South Korea.
128 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf
129 6.3.2 Gift tax decision status II. KOSIS Statistical List. 11 August 2023. https://kosis.kr/statHtml/statHtml.do?orgId=133&tblId=DT_133N_612&vw_cd=MT_ZTITLE&list_id=133_13301_200_60_10&scrId=&seqNo=&lang_mode=ko&obj_var_id=&itm_id=&conn_path=MT_ZTITLE&path=%252FstatisticsList%252FstatisticsListIndex.do&orderBy=ASC
130 Ibid.
131 Ibid.

The highly progressive rate in South Korea comes in spite of a 100% business exemption offered. However, the business exemption has quite demanding requirements.[132] It is only available to SMEs, as defined by a set of criteria, such as employing less than 1,000 people, while having less than KRW 150 billion (£8.8m) in sales in the preceding three years, and less than KRW 100 billion (£5.9m) in equity capital.[133] It is also only available if the deceased ran the business for 10 years, with a cap of KRW 30bn (£11.8m) if run for 10-20 years, increased to KRW 60bn (£23.6m) if run for longer than 30 years.[134] These restrictions mean that, in 2020, the heirs to the country's top 25 companies faced a combined inheritance tax bill of $21 billion.[135]

Alongside this, different rules on the treatment of non-residents and foreign assets to the effective rates, particularly at the top. Yet, in South Korea, inheritance tax is assessed on all property given by a resident, and all property within the Korean territory given by a non-resident.[136,137] This compares with the domicile rules in the UK up until 2025, which have allowed many residents to bypass the tax.

132 EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide
133 Ministry of Startups and SMEs. Scope of SME. (n.d). https://www.mss.go.kr/site/eng/02/20201000000002019110604.jsp
134 EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide
135 Jung-a S and White E. South Korean inheritance tax threatens family business. Financial Times. 13 January 2020, https://www.ft.com/content/d9d664fa-0518-11ea-a984-fbbacad9e7dd
136 EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide
137 Lee AK. Korean Inheritance Laws and Tax: Managing Estates, Wills for Foreigners and Overseas Koreans. Lee and Lee. 7 March 2024. https://lawfirmleeandlee.com/korean-inheritance-laws

JAPAN'S HIGH REVENUE WITH A HIGH THRESHOLD

The Japanese taxes a slightly higher percentage of all inheritance than the UK. Its tax is also more progressive than the UK's, with particularly high tax rates for the most valuable inheritances, likely in part because the business exemption is stricter.

THE DESIGN

In Japan, inheritance tax is charged on the receipt of inheritance - and Japan has mandatory heirship rules, guaranteeing certain family members a share of the inheritance. There are allowances both for the estate, and for each statutory recipient.[138]

Beyond the allowance, there is an 8-bracket progressive rate ranging from 10% for taxable inheritance up to 10 million yen (£52,100), to 55% for inheritance over 600 million yen (£3,123,262). Separately, a gift tax taxes gifts above an annual allowance of 1.1 million yen (£5,700), with rates also from 10% to 55%.

THE ECONOMICS

Japan gets significantly more of its tax revenue from inheritance tax revenue than the UK (1.3% vs 0.7% in 2019). This in part results from the relatively high proportion of estates being taxed (9.6% in 2022, vs 4% in the UK in 2020-21), and partly because more inheritance is passed on in Japan.[139,140,141,142,143]

Looking at all inheritance passed on in Japan - estimated at around 46 million yen (£232bn) in 2022 - around 6% was paid in tax.[144,145] This is higher than the UK figure for 2019-20, which was around 4.2%.[146,147] If the UK taxed the same percentage of inheritance in 2019-20, it would have raised an additional £2.1bn.

Japan also has relatively high effective tax rates, which are progressive until very high amounts. Figure 11 shows the average effective tax rates paid on taxable receipts (receipts over the threshold), by the value

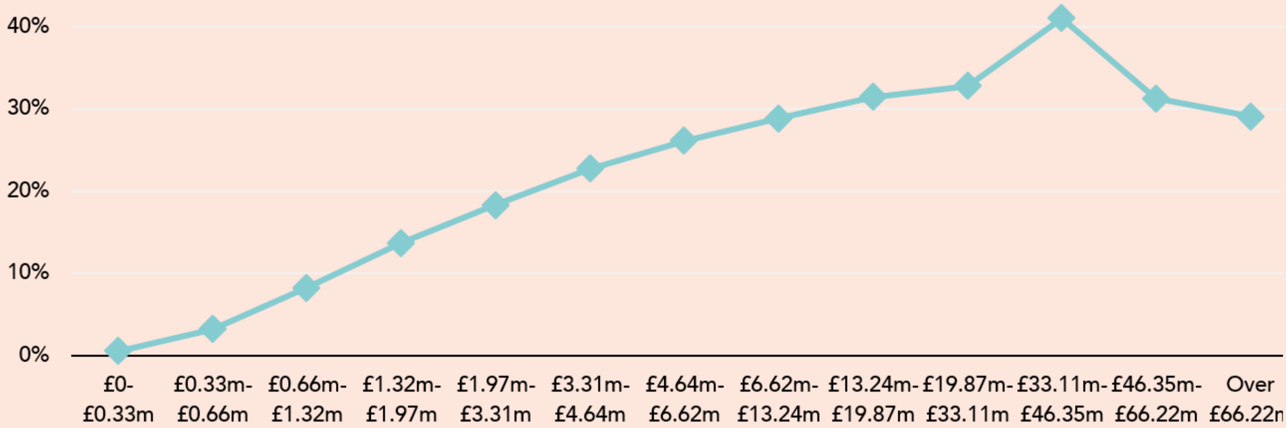
138 e-Stat, Inheritance tax statistics, Table 0501, https://www.e-stat.go.jp/stat-search/files?page=1&layout=datalist&toukei=00351010&tstat=000001043366&cycle=8&year=20211&month=0&tclass1=000001043367&tclass2=000001043373&result_back=1&cycle_facet=tclass1%3Atclass2&tclass3val=0
139 Life Insurance Culture Center Public Interest Incorporated Foundation. "Life planning to stabilize the foundation of life". (n.d). https://www.jili.or.jp/lifeplan/houseeconomy/820.html
140 HM Revenue and Customs. Inheritance Tax liabilities statistics: commentary. 26 July 2023. https://www.gov.uk/government/statistics/inheritance-tax-statistics-commentary/inheritance-tax-statistics-commentary
141 Japan Research Institute. Policy Observation. 20 August 2012. https://www.jri.co.jp/MediaLibrary/file/report/policy/pdf/6266.pdf
142 Statista. Number of deaths in the United Kingdom from 1887 to 2021. 22 March 2024. https://www.statista.com/statistics/281488/number-of-deaths-in-the-united-kingdom-uk/
143 Statista. Number of deaths in Japan from 2013 to 2022. 1 February 2024. https://www.statista.com/statistics/612183/japan-fatality-number/
144 The Japanese Research Institute. Increasing issues surrounding inheritance in a society with high death rates. 25 March 2024. https://www.jri.co.jp/MediaLibrary/file/report/researchfocus/pdf/14893.pdf
145 Life Insurance Culture Center Public Interest Incorporated Foundation. "Life planning to stabilize the foundation of life". (n.d). https://www.jili.or.jp/lifeplan/houseeconomy/820.html
146 This excludes the value of gifts passed on, although these make up a small proportion of the value of estates that is taxed in the UK.
147 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf

of taxable receipt.[148,149,150] The average effective rate for taxable receipts worth under 50m yen (£330,000) is just 1%. The rate increases gradually, peaking at 41% for those worth between 5bn and 7bn yen (£33.11m-£46.35m). It then decreases, reaching 29% for taxable receipts worth over 10bn yen (£66.22m). This is, however, more progressive than the UK, where the rate begins to drop after estates are worth £7.5 million.

FIGURE 11

Effective inheritance tax rates rise much higher in Japan than the UK, and don't fall until inheritances are over £46m

Average effective inheritance tax rates (tax due as a percentage of all inheritance passed on) for all taxpaying estates



Source: e-Stat, Inheritance tax statistics, Table 0501, https://www.e-stat.go.jp/stat-search/files?page=1&layout=datalist&toukei=00351010&tstat=000001043366&cycle=8&year=20211&month=0&tclass1=000001043367&tclass2=000001043373&result_back=1&cycle_facet=tclass1%3Atclass2&tclass3val=0

Japan's more progressive rate may in part result from Japan's relatively limited benefits for inheritance of business, despite this being expanded in recent years. Japan only offers a deferral of the inheritance tax payment for certain SMEs, and only if unlisted, if the inheriting family holds over 50% of the shares, and if the successor is a representative of the company.[151] As part of a temporary policy, however, it is possible to defer the payment indefinitely if the business is kept within the family across generations.

148 "Taxable value" is the value of the inherited property plus the taxable property value settled at the time of inheritance, deducting the decedent's debts and funeral expenses, and the value within 3 years before the start of inheritance.

149 National Tax Agency, Summary of inheritance tax return results for 2021. December 2022. https://www.nta.go.jp/information/release/kokuzeicho/2022/sozoku_shinkoku/pdf/sozoku_shinkoku.pdf

150 e-Stat, Inheritance tax statistics, Table 0501, https://www.e-stat.go.jp/stat-search/files?page=1&layout=datalist&toukei=00351010&tstat=000001043366&cycle=8&year=20211&month=0&tclass1=000001043367&tclass2=000001043373&result_back=1&cycle_facet=tclass1%3Atclass2&tclass3val=0

151 Landmark Licensed Tax Accountant. "Easy-to-understand explanation of how to reduce gift tax and inheritance tax on company stock to zero under business succession tax system". (n.d). https://www.zeirisi.co.jp/souzokuzei_jigyouyoushisan/business-succession-taxation-scheme/

A progressive rate

One option proposed by the Resolution Foundation - but only lightly touched on in the IFS, APPG, or OTS reports - is to introduce a progressive rate.[152] The UK is in a minority of countries that uses a flat rate for inheritance tax. The Resolution Foundation suggests, after removing the exemptions and residence nil-rate band, introducing a 20% rate for inheritance between £325,000 and £500,000 (assuming no further reliefs) and a 30% band for inheritance up to £750,000, before then charging 40%.[153] Like the APPG, they suggest these lower rates weaken the argument for business and agricultural exemptions, given they reduce the risk of liquidity problems.

We've seen that, in Japan and South Korea, progressive rates correspond with more progressive distributions of inheritance than in the UK. Alongside this, one might also presume that a progressive rate could expand support for the tax among those with less wealth or income, who would be more likely to face the minimum rate than, for example, the UK's 40% rate. A progressive rate might also associate inheritance tax more closely with income tax, which has a well-known progressive rate.

FRANCE'S PROGRESSIVE TAX

France has increased the revenue of its inheritance tax over time, partly through increasing the top rates of the tax, and partly through decreasing the threshold. Its tax is progressive across the distribution, even until the top 0.1% of estates.

While France has a highly progressive rate structure, starting at just 5% for the lowest inheritances, many people are not aware of this, and overestimate the minimum rate.

THE DESIGN

France has an inheritance and gift tax. The inheritance tax applies to net inheritance received by each beneficiary after a death, as well as any gifts given less than 15 years prior to the death.[154] The gifts tax applies to all gifts given within any other 15 year period.

For direct descendants, there is a €100,000 allowance for either inheritances or gifts, with progressive rates applied after this from 5% up to €8,072, to 45% for €1,805,678 and above.[155] Notably, for transfers beyond direct family, the system is very different. The allowances for nieces and nephews are just €7,967 nil, with a 55% flat rate beyond that. For non-relatives, it's €1,594 with a 60% rate beyond that.[156]

THE ECONOMICS

France's inheritance tax raises a relatively high amount of revenue. In 2022, it raised €18.6 billion (£15.9 billion). This is more than double the amount raised in the UK. This is in part because around 20% of inheritances are subject to the tax.[157]

152 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf
153 Inheritance tax is charged on the taxable value of an estate, after the exemptions, reliefs and nil-rate bands. Under the current system, progressive rates would in fact apply to the taxable value of an estate after these deductions. E.g. a 20% rate for inheritance between £325,000 and £500,000 would technically be a 20% rate for inheritance up to £175,000 after the deduction of exemptions, reliefs and nil-rate bands.
154 EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide
155 Ibid.
156 Axis. French inheritance tax and succession planning. (n.d). https://axis-finance.com/tax/french-inheritance-tax/
157 Tordjman J. Do "99%" of French people pay inheritance tax? The erroneous diagnosis of Christiane Taubira. AFP Factual. 2 February 2022. https://factuel-afp-com.translate.goog/doc.afp.com.9XR2ZJ?_x_tr_sl=fr&_x_tr_tl=en&_x_tr_hl=en&_x_tr_pto=sc

France's inheritance and gift tax revenue has increased over time. The top marginal tax rates for receipts from parents were increased from 20% to 40% in 1984.[158] Accordingly, inheritance tax revenue increased from an average of 0.63% of all tax revenues between 1980-83, to 0.73% from 1985-88.[159] The top rate was then increased to 45% in 2011, followed by a significant reduction in the threshold in 2013 from €166,700 to €100,000 (after new president Hollande took office). Correspondingly, inheritance tax revenue increased from 0.96% of total tax revenue from 2007-10, to 1.21% from 2014-17.

Taking all inheritance and gifts passed on in the UK, around 3.4% were paid in tax in 2019-20, compared to an estimated 3.9% in France in 2019.[160,161,162,163,164] Taxing the same percentage of France would have netted the UK government an extra £680m.

Inheritance tax in France is also progressive across the distribution. Modelling by the Economic Analysis Council in France (CAE) finds that the average effective inheritance tax rate increases across the distribution, even within the top 0.5%.[165] Inheritance tax starts being paid once people reach the 60th to 70th percentile of inheritors. It then increases relatively consistently, including for inheritors in the top 0.5%.[166] Between the 99.5th and 99.9th percentile, the effective rate is 8.5%, and at the top 0.1 percentile, it's 10%. While the effective rate may decrease for even higher percentiles, the data is not available to check this.

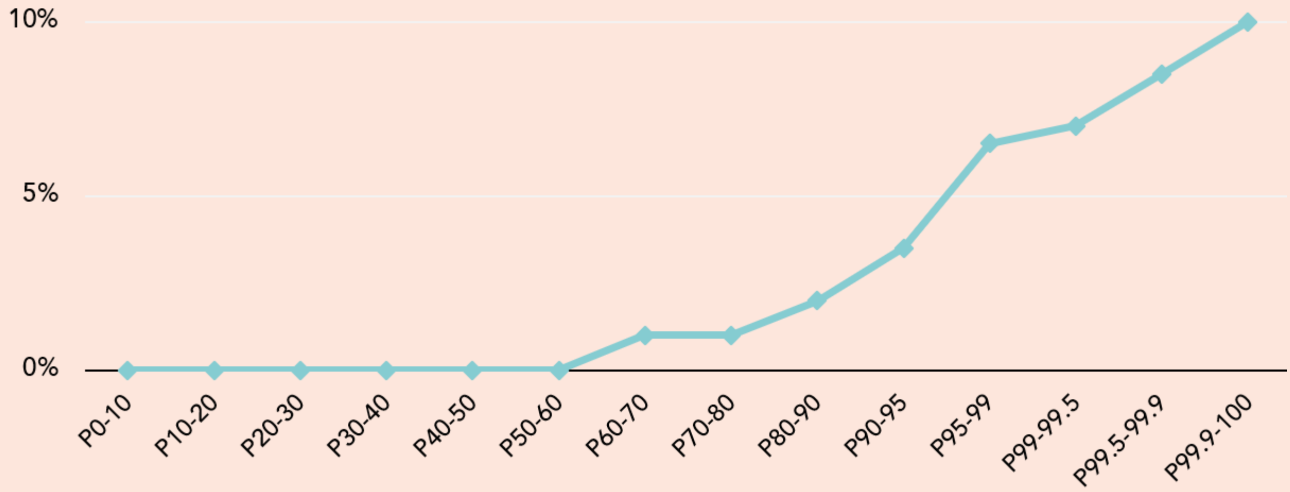
We see that once we reach the top 1% of all estates in the UK (worth over £2.1m), the effective rate flattens out at around 25%.[167,168] The effective rate then drops for the top 0.1% of estates (those worth over £5m).[169] In France, however, the effective rate continues to increase, even up to the top 0.1% of estates, suggesting it's tax is less regressive than the UK's.

158 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
159 OECD. Revenue Statistics - OECD countries: Comparative tables. (n.d). https://stats.oecd.org/Index.aspx?DataSetCode=REV
160 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf
161 The figures for France take Pikkety and Zuchman's estimate that France's inheritance and gift flow in 2019 will be worth 15.2% of national income, using their model which assumes slower economic growth post-2010. With France's national income in 2019 being $2,861.6bn (worth €2,555.7 using 2019's average exchange rate), this puts the flow of inheritance and gifts at €388.5bn. With France's inheritance and gift tax raising €15.2bn in 2019, that puts the overall effective tax rate at 3.91%.
162 Pikkety T and Zuchman G. Wealth and Inheritance in the Long Run. 2015. https://gabriel-zucman.eu/files/PikettyZucman2015.pdf
163 Macrotrends. France GNI 1960-2024. Using World Bank data. (n.d). https://www.macrotrends.net/global-metrics/countries/FRA/france/gni-gross-national-income
164 OECD. Revenue Statistics - OECD countries: Comparative tables. (n.d). https://stats.oecd.org/Index.aspx?DataSetCode=REV
165 C Biernat et al, Rethinking legacy: additional analysis, Economic Analysis Council, https://www.cae-eco.fr/staticfiles/pdf/cae-focus077.pdf.
166 Ibid.
167 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
168 HM Revenue and Customs. Inheritance Tax liabilities statistics. 26 July 2023. https://www.gov.uk/government/collections/inheritance-tax-statistics
169 Note, this data is different from that on 'taxpaying estates', who only make up a small percentage of all estates

FIGURE 12

France's inheritance tax is progressive even within the top 0.5%

CAE modelling of average effective inheritance tax rates in France, by percentile of inheritance



Source: C Biernat et al, Rethinking legacy: additional analysis, Economic Analysis Council, https://www.cae-eco.fr/staticfiles/pdf/cae-focus077.pdf

THE POLITICS

Despite France's inheritance tax applying seven different marginal rates, many are unaware there is a progressive rate at all. A 2021 survey found that 43% of French respondents thought that France has a flat tax rate on inheritances, and people tended to overestimate the minimum tax rate (with an average response of 23%, despite the reality of 5%).[170] This likely arises, in part, because of how few people pay with the tax, and how rarely those who do pay it actually engage with it.

Correspondingly, it is not clear that a progressive rate eases concerns among those with less wealth or income, who could feel that even if they fall above the inheritance tax threshold, they will pay a lower rate. Like in the UK, in polling of those aged over 45, those on lower incomes (under €2,000 a month) are about the same or slightly more opposed to the tax than those on higher incomes (over €2,000 a month).[171]

This casts doubt on whether a progressive rate would necessarily shift UK public attitudes, given a similarly poor understanding of inheritance tax in the UK.[172] It highlights the importance of effectively communicating such a policy shift, and potentially the need for the government to highlight the benefits of inheritance tax - e.g. through hypothecation - rather than just reducing the costs for some people.

170 C Biernat et al, Rethinking legacy: additional analysis, Economic Analysis Council, https://www.cae-eco.fr/staticfiles/pdf/cae-focus077.pdf

171 Therese. "Why are 80% of French people against inheritance taxes?". Blog Masuccession. 24 May 2018. https://blog.masuccession.fr/pourquoi-80-des-francais-sont-contre-les-droits-de-succession/

172 Goss D and Glover B. The inheritance tax puzzle: Challenging assumptions about public attitudes to inheritance. 14 June 2023. Demos. https://demos.co.uk/research/the-inheritance-tax-puzzle-challenging-assumptions-about-public-attitudes-to-inheritance/

Treatment of non-doms

The ending of the non-dom regime in the 2024 Spring Budget was welcome. It will bring many long-term UK residents, who are nevertheless not UK domiciled, into the scope of inheritance tax. These are more likely to be wealthy individuals, and thus to make higher contributions to inheritance tax revenues.

The concern about these changes primarily centres around the risk of migration. Will many of the super rich leave the UK as a result? This question has been analysed in relation to reforms to the non-dom regime in 2017, which brought long-term residents, who had been in the UK for at least 15 of the last 20 years, into the standard tax system.[173] This analysis finds a small migration response: while around 4% of long-term resident non-doms migrate each year, the reforms increased this to 8.6%, while all others remained and paid the standard taxes. The authors suggest that, given the higher earnings available in the UK for most non-doms, emigration was not worthwhile.

The reforms announced in the Spring Budget, however, won't be implemented until April 2025.[174] As part of the rules, any wealth in trusts before this date can remain outside the scope of the UK inheritance tax. This means wealthy non-doms who are currently in the UK have over a year to put their wealth into a trust to avoid the tax. This could be changed, either by reforming the inheritance tax treatment of such trusts, or bringing the date forward.

In April 2024, Labour announced plans to include all foreign assets held in trusts into the scope of inheritance tax, if forming the next government.[175] This would apply even to assets put in trusts prior to April 2025. They suggested this would raise £2.6 billion over the next parliament.

Administration

Each country sets a deadline for when inheritance taxes must be paid, generally ranging from a few 6 to 48 months in OECD countries.[176] The UK is on the lower end of this, at 6 months. In our focus groups, people felt that inheritance is highly burdensome for people in a time of grief, continuing to their sense that it is a 'death tax'. A policy to allow people more time to pay the tax would signal that the government recognises and is responding to this concern.

On top of this, the UK's system requires that any inheritance tax is paid on the estate before probate is granted (which then releases the estate to the heirs). It means executors of the estate have to pay the tax out of their own pocket, and until recently, may have needed commercial loans to do so. This can compound the sense of burden.

However, a barrier to changing this arises due to how inheritance tax revenue is accounted for in the National Accounts by the ONS. Inheritance tax is counted as being received when the cash is paid, not when the taxable event occurs (i.e. the death). Shifting the payment period in one go, say by six months, could mean six months of inheritance tax payments (around £3.5 billion) being pushed back by six months. This would appear on Treasury books as a loss in revenue, even though the same amount of revenue would be received in the end. To address this, the National Accounts would need to shift to count inheritance tax as being received when the taxable event occurs (as is the case for some elements income tax, for example).

2. OVERHAULING THE TAX BASE

If a government is seeking to drive more ambitious change to inheritance tax, they may look to overhaul the tax base. This could include taxing receipts rather than bequests, taxing lifetime gifts, linking rates to the recipient's wealth, taxing inherited capital gains.

173 Advani A, Burgherr D and Summers A. Taxation and Migration by the Super-rich. 15 June 2023. https://arunadvani.com/papers/AdvaniBurgherrSummers2023_TaxationAndMigrationByTheSuperRich.pdf
174 HM Treasury. Technical note: Changes to the taxation of non-UK domiciled individuals. 7 March 2024. https://www.gov.uk/government/publications/changes-to-the-taxation-of-non-uk-domiciled-individuals/technical-note-changes-to-the-taxation-of-non-uk-domiciled-individuals
175 Inman P. 'Labour plans £5bn crackdown on tax avoiders to close non-dom spending gap'.The Guardian. 8 April 2024. https://www.theguardian.com/business/2024/apr/08/labour-to-launch-5bn-crackdown-on-tax-avoiders-to-close-gap-in-spending-plans?CMP=share_btn_url
176 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

Taxing receipts vs bequests

We have seen that the UK is in a minority of countries who tax the estate rather than the receipt of inheritance. Most countries that tax receipt of inheritance also tax receipt of gifts provided during life, and the two shall be considered together here.[177]

In theory, taxing the receipt could have multiple benefits. Taxing gift receipts could potentially raise revenue (as it brings a greater proportion of wealth transfers into scope of the tax) and increase progressivity (as gifts are more unequally distributed than inheritance according to most measures).[178] Taxing receipts generally could also help shift the perceptions of the tax to be more a cost to the recipient rather than the giver. This could, in turn, alleviate concerns about penalising the aspiration of the giver and double taxing their earned income. In theory it should also encourage a more even distribution of inheritance among different recipients, as people are incentivised to transfer to those who have received less in the past. The OECD also recommends moving to such a system. They note how taxing receipts better promotes equality of opportunity - as wealth received is more important for opportunity than the overall amount left by the donor.[179]

For many of these theoretical arguments, more research needs to be done to test whether they hold up in reality. On whether taxing receipts promotes a more even distribution of inheritance, evidence is scarce. On whether such a system expands support for inheritance tax, causal links are hard to establish (although Demos's deliberative exercise aimed to test this hypothesis). We can, however, better assess the impact on the revenue and progressivity of inheritance tax. In particular, by looking to Germany, we can see that taxing receipts does not necessarily lead to a high-revenue, progressive system.

GERMANY'S TAX ON RECEIPTS

The German system raises less revenue and is less progressive than the UK for two key reasons:

1. The exemption for businesses is highly costly (particularly because Germany has many family-owned businesses) and benefits the wealthiest estates most.
2. The gift tax threshold only applies to gifts within a 10-year period, meaning those who can transfer their wealth flexibly can strategically time gifts to avoid the tax.

THE DESIGN

Germany taxes the receipt of both inheritance and gifts. Each person has a personal allowance for receipt of or inheritance, determined by the relation to the giver. This is €500,000 for spouses (although this can be higher), €400,000 for children, and decreasing amounts for others. There are also additions to the thresholds for certain assets, like personal items or family homes.

The threshold applied to the total value of inheritance and gifts received within any 10 year period. This means children can, for example, receive at least €400,000 from their parents tax-free every 10 years. The rates then increase with the taxable value of the receipt, from 7% (for taxable receipt between 0 and €75,000) to 30% (for taxable receipt over €26 million).

177 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
178 Boileau B and Sturrock D. Who gives and receives substantial financial transfers in Britain?. Institute for Fiscal Studies. 3 February 2023. https://ifs.org.uk/sites/default/files/2023-03/WP202308-Who-gives-and-receives-substantial-financial-transfers.pdf
179 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

THE ECONOMICS

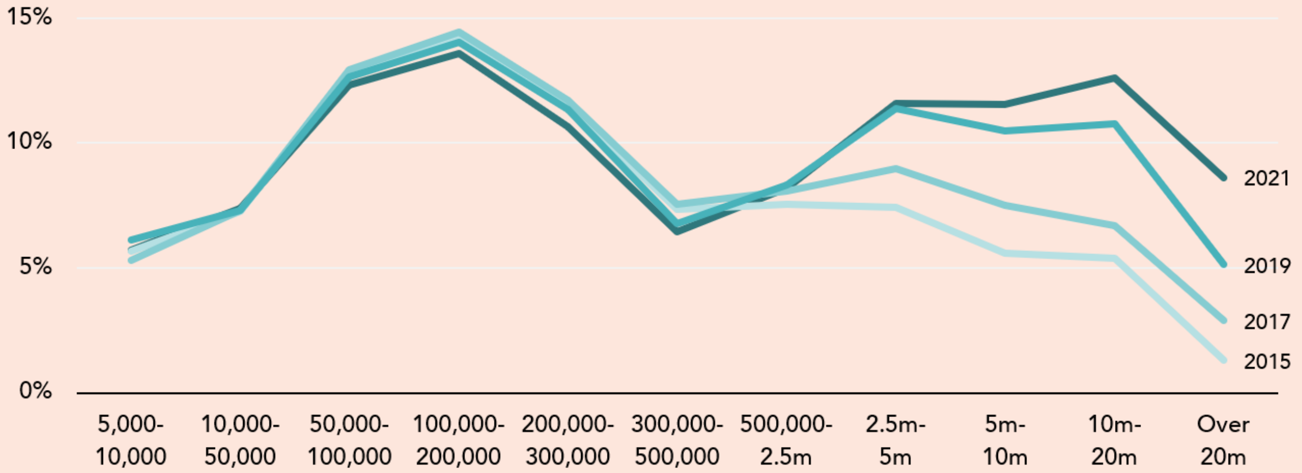
Germany's inheritance tax raises a slightly higher amount than the UK's (€11.4 billion (£9.7bn) in 2022, vs £7bn in the UK in 2022-23), but this makes up a smaller percentage of its total tax revenue (0.5% in Germany vs 0.7% in the UK). [180,181] This is despite the fact that much more inheritance and gifts are passed on in Germany (between £215bn to £344bn in 2021, compared to around £148bn in the UK in 2019-20) and more inheritances are taxed (10% of deaths in Germany result in inheritance tax, compared to 4-5.5% in the UK).[182,183]

Germany's lower revenue primarily results from lower effective tax rates, particularly for the most valuable inheritances - although these have improved in recent years. Currently, taxable receipts worth over €20m paid an average effective rate of 9% in 2021, which is lower than for taxable receipts of €100,000-€200,000.[184] In 2015, however, while those with a taxable receipt of €100,000-€200,000 paid 14%, those receiving €300,000-€500,000 paid just 7%.[185] After decreasing slightly for higher value receipts, the rate then decreased significantly, reaching just 1% for receipts worth over €20m.

FIGURE 13

The German inheritance tax system is regressive, but has become more progressive for high-value estates over time

Effective inheritance tax rate in different years, by taxable value of receipt



Federal Statistics Office. Inheritance and Gift Tax Statistics - 2021 (Last edition - discontinued on a reporting basis). 20 July 2022. https://www.destatis.de/DE/Themen/Staat/Steuern/Weitere-Steuern/Publikationen/Downloads-weitere-Steuern/erbschaft-schenkungsteuer-5736101217004.html

180 Federal Statistics Office. Inherited and gifted assets fell by 14% in 2022 after a record year in 2021. 18 July 2023. https://www.destatis.de/DE/Presse/Pressemitteilungen/2023/07/PD23_281_736.html
181 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
182 Thiemann, A. Shifting the Tax Burden away from Labour towards Inheritances and Gifts – Simulation results for Germany. European Commission. 2021. https://joint-research-centre.ec.europa.eu/system/files/2022-01/jrc127424.pdf
183 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf
184 Federal Statistics Office. Inheritance and Gift Tax Statistics - 2021 (Last edition - discontinued on a reporting basis). 20 July 2022. https://www.destatis.de/DE/Themen/Staat/Steuern/Weitere-Steuern/Publikationen/Downloads-weitere-Steuern/erbschaft-schenkungsteuer-5736101217004.html
185 Federal Statistics Office. Inheritance and Gift Tax Statistics - 2021 (Last edition - discontinued on a reporting basis). 20 July 2022. https://www.destatis.de/DE/Themen/Staat/Steuern/Weitere-Steuern/Publikationen/Downloads-weitere-Steuern/erbschaft-schenkungsteuer-5736101217004.html

The changing effective rates results partly from the exemption for business assets, and partly from tax planning.

BUSINESS EXEMPTION

Currently, the revenue shortfall for Germany's business exemption was estimated to be €5.1bn (£4.3bn) in 2022, compared to £1bn in the UK in 2021-22.[186] Before 2016, however, the cost was even higher, at €9.7bn in 2014, decreasing to €8.8bn in 2015.[187] The benefits of this mainly go to the wealthiest - with business transfers worth over €30m, accounting for just 0.8% of transfers from 2009 to 2014, but 61% of the total value.[188]

The reducing size of the business exemption follows a ruling by Germany's constitutional court that the exemption provided unfair privileges to business owners over other taxpayers.[189] Subsequently, a series of reforms were introduced in 2016, including tapering off business relief for companies worth over €26m (with no relief beyond €90m unless the business can prove it is unable to cover the tax through private wealth) and abolishing the relief for non-operational business assets.[190]

The business exemption in Germany is particularly impactful because family businesses are very important in Germany's economy - they account for 90% of non-public businesses in Germany, and 55% of business employees.[191] However, research suggests that family-businesses tend not to face significant challenges without the exemption - businesses faced minimal impacts from inheritance tax before 2009 - when only 65% exemption was offered - because inheritors tended to inherit other wealth that could be used to pay the tax.[192]

The inequalities created by this exemption may also harm public support for the tax. Analysis of online debates about inheritance tax finds that the most common reason people oppose inheritance tax is its design, particularly its ineffectiveness in taxing the highest value inheritances.[193]

While the German gift and inheritance tax law provides a progressive tax schedule, generous exemptions for business assets and a means test for recipients of transfers above 26 million € lead to little taxes actually paid at the very top. Thus, the law is commonly referred to as „fool's tax", since only recipients that are not able to make use of the exemptions carry the full tax burden."

- Policy expert

186 Federal Ministry of Finance. 28th Subsidy Report 2019–2022. 14 December 2021. https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Press_Room/Publications/Brochures/28-subsidy-report.pdf?__blob=publicationFile&v=3
187 Federal Ministry of Finance. 28th Subsidy Report 2019–2022. 14 December 2021. https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Press_Room/Publications/Brochures/28-subsidy-report.pdf?__blob=publicationFile&v=3
188 Tax Myths. "The inheritance tax on business assets endanger jobs". (n.d.). https://steuermythen.de/wp-content/uploads/Mythos161.pdf
189 Shotter J. Germany changes inheritance tax to protect family business. Financial Times. 22 September 2016. https://www.ft.com/content/cd1ec712-80c7-11e6-8e50-8ec15fb462f4
190 Thiemann A. Shifting the Tax Burden away from Labour towards Inheritances and Gifts – Simulation results for Germany. European Commission. 2021. https://joint-research-centre.ec.europa.eu/system/files/2022-01/jrc127424.pdf
191 BDI. Family businesses – their defining characteristics. 24 April 2020. https://english.bdi.eu/article/news/family-businesses-their-defining-characteristics
192 Houben H and Maiterth R. Inheritance tax-exempt transfer of German businesses: Imperative or unjustified subsidy? An empirical analysis. Arbeitskreis Quantitative Steuerlehre. 2009. https://www.econstor.eu/bitstream/10419/39066/1/622866672.pdf
193 Beckert J and Arndt L. Deserved – Undeserved. The public discourse around the Inheritance tax in Germany and Austria. Berlin Journal of Sociology. 2017. https://pure.mpg.de/rest/items/item_2531368_4/component/file_2609191/content

TAX PLANNING

One might presume the German system provides less incentive to give gifts during life in order to avoid inheritance tax. In the UK, people can pay much less tax if they give a gift during life than if they give it at death or in the 7 years prior. Intuitively, this should mean people give more gifts earlier in their life - and in Germany, where gifts are taxed the same whether or not they are given during life or at death, this would not apply.

However, while inheritances are worth about 10 times more than lifetime gifts in the UK, they are only worth around twice as much as in Germany (€39.1 billion vs €18.5 billion). It seems, counterintuitively, that taxing receipts as Germany do (whereby it matters how much people receive at any point in their life) encourages more tax planning during people's lives - rather than just near to death like in the UK - even if there are less opportunities to avoid the tax from doing so. and therefore encourages more lifetime wealth transfers. So even though the UK tax system is more generous on lifetime transfers, it seems to encourage less of them, because people are thinking about the tax less.

A lifetime receipts tax

We have seen that, in Germany, significant tax planning occurs simply by strategically timing gifts. A system that would avoid this is a lifetime receipts tax, which counts all receipts over a lifetime, rather than within a specific time period. Such a system is proposed by both the Resolution Foundation and IPPR, and highlighted as desirable by the OECD.[194,195] This system would treat all gifts and inheritance more equally regardless of their timing, remove avoidance opportunities, and encourage greater distribution of inheritance and gifts to those who have received less throughout their life.

Demos's previous research also suggests that the public may support such a system. Survey respondents were significantly more supportive of taxing inheritances for people who have received them before, and when asked how much people should be allowed to receive in gifts throughout their life tax-free (with the option to say all gifts should be tax-free) the median response was just £50,000.[196]

This system may, however, come with additional administrative burdens - given the need for record keeping throughout a lifetime rather than just near death. As the APPG report highlights, there are also additional complications. For example, decisions would be needed on whether capital gains tax is paid on gifts (as it is in the UK now), how gifts to trusts are treated, and how to treat receipts by UK residents before they were in the UK. These questions would require careful review if such reforms were pursued.

194 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf
195 Roberts C, Blakeley G and Murphy L. A Wealth of Difference: Reforming the taxation of wealth. Institute for Public Policy Research. 9 October 2018, https://www.ippr.org/articles/a-wealth-of-difference
196 Goss D and Glover B. The inheritance tax puzzle: Challenging assumptions about public attitudes to inheritance. 14 June 2023. Demos. https://demos.co.uk/research/the-inheritance-tax-puzzle-challenging-assumptions-about-public-attitudes-to-inheritance/

IRELAND'S LIFETIME RECEIPTS TAX

THE DESIGN

A lifetime gifts tax is currently in place in Ireland, called the capital acquisitions tax. Each person can receive €335,000 collectively from their parents or children (Group A), €32,500 from siblings, nieces, nephews, grandchildren or grandparents (Group B) or €16,250 from anyone else (Group C) - including both gifts and inheritance. For any wealth received over and above this amount, a flat rate of 33% is charged in tax.

To avoid excessive admin requirements, individuals do not have to report receipt of inheritance or gifts until the value of their lifetime receipts exceeds 80% of the threshold, as determined by potential taxpayers.[197]

THE ECONOMICS

The inheritance and gift tax in Ireland raised €605m in 2022 (0.57% of all tax revenues). Given the much lower threshold for inheritance and gifts in Group B (less than 10% of the Group A threshold), this is the largest source of this revenue, making up 46% of the total.[198] While the UK does provide more tax advantages for inheritance given to children, it does so to a smaller extent than Ireland's system. If we were to adopt the Irish model, but not adopt such different treatment of these different inheritances, this would leave a gap in the revenue. We would have to compensate for this with lower tax-free allowances or higher rates.

Unlike in Germany, much more is given in inheritance than gifts in Ireland - with median inheritance receipt of €99,200, and median lifetime gift receipt of €15,900.[199] A lifetime allowance - rather than a 10-yearly allowance as in Germany - provides less opportunities for tax planning by strategically timing lifetime gifts. It may be that this is playing a part in driving less lifetime gifts.

There is no data on the distribution of inheritance tax payments for different values of receipt, so we are unable to assess the effective rate across that distribution.

Linking tax rates to the recipients wealth

In most countries, the only characteristics of the recipient that matters for inheritance tax are their residency or domicile, and their relation to the giver. However, inheritance tax could be linked to other features of the recipient. In particular, Spain links inheritance tax to the recipient's net wealth.

Such a system could further associate inheritance tax with being a tax on the recipient rather than the giver of inheritance, and help frame inheritance tax more directly as a tax on those with the most wealth, rather than those in the middle. It could also help address people's concern that inheritance tax harms people with low wealth, and for whom inheritance is the only way they could get wealth.

This would, of course, come with additional administrative work. Upon receipt of inheritance, not only would the inheritance have to be valued, but so would the recipient's net wealth. This would be burdensome both

197 Commission on Taxation and Welfare. Report of the Commission on Taxation and Welfare. 14 September 2022, https://www.gov.ie/en/publication/7fbeb-report-of-the-commission/#executive-summary
198 Capital Taxes and Stamp Duty Tax Strategy Group – 23/10. 10 July 2023 https://assets.gov.ie/263928/611689e3-f868-4a40-9afb-926e76104bfb.pdf
199 Revenue. Irish Tax and Customs. Breakdown of Capital Acquisitions Tax receipts. 15 May 2023. https://www.revenue.ie/en/corporate/information-about-revenue/statistics/receipts/receipts-capital-acquisitions-tax.aspx

for the government and the recipient. There is also a concern that this policy would open the tax up to avoidance. For example, people could temporarily reduce their wealth at the time of receiving inheritance by transferring it to others.

SPAIN'S MARGINAL RATES LINKED TO THE RECIPIENT'S WEALTH TAX

THE DESIGN

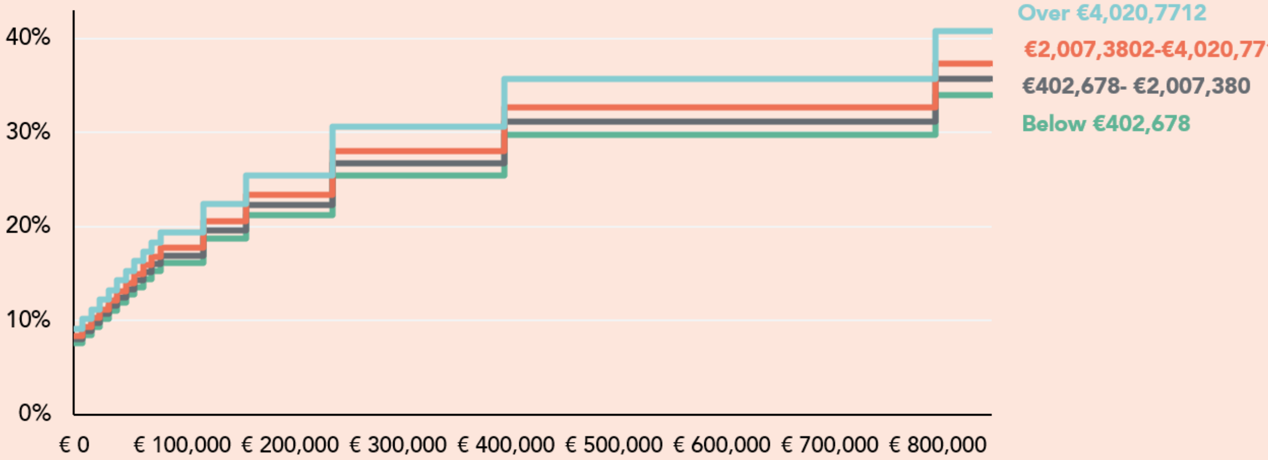
Spain's inheritance tax applies a progressive rate to any inheritance and gifts - and each descendant gets €15,956 tax-free. Importantly, however, the progressive rate applied in Spain varies not just according to the relationship between the giver and receiver, but also according to the receiver's net wealth (prior to receiving the inheritance).[200] For those with wealth below €402,678, they pay the standard rate. Then, those with wealth between €402,678 and around €2m pay 1.05x the standard rate, those with between around €2m and €4m pay 1.1x, and those with wealth over around €4m pay 1.2x. To enable this, a list of an heir's pre-existing assets must be submitted to the authorities as part of an inheritance tax assessment.[201]

This drives the rates illustrated in Figure 14 below. For example, for inheritance of €1m, someone with wealth under €402,678 pays a 34% marginal rate, while someone with wealth over €4m pays a 41% rate.

FIGURE 14

Spain has a progressive inheritance tax, with the rates increasing for wealthier recipients

Inheritance tax marginal rates for gifts and inheritance to children, by size of inheritance receipt and inheritor's net wealth pre-inheritance



Source: EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/world-wide-estate-and-inheritance-tax-guide

200 EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide
201 Santander. Inheritance tax: what is it and how is it calculated?. May 2023. https://www-bancosantander-es.translate.goog/blog/jubilacion/impuesto-sucesiones-que-es?_x_tr_sl=es&_x_tr_tl=en&_x_tr_hl=en&_x_tr_pto=sc

While this is the policy at the national level, since 1996, Spain's regional governments have had significant autonomy to apply deductions, and modify the marginal rates. Regions began making these modifications in the mid-2000s.[202] This means that, in practice, rates now vary considerably between regions.

THE ECONOMICS

According to 2023 estimates by Isabel Micó-Millán, in 2002 - before regional deductions began - the effective tax rate was high even for taxable receipts under €32,000, at 3.1% for inheritance and 6.9% for gifts.[203] This increased progressively up to 17.2% and 18.5% for inheritance and gift receipt over €160,000 respectively. However, between 2002 and 2019, the effective average inheritance and gift tax rates across all regions fell by 85% and 50%, respectively.[204] Now, there is almost no inheritance tax for receipt under €160,000.

Taxing inherited capital gains

The UK's system of uplifting capital gains at death creates various problems. First, capital gains disproportionately benefit the wealthiest - the top 5,000 taxpayers received 52% of all taxable gains in 2020, worth an average of £6,815,000 per person.[205] Almost half of taxable gains also went to those in London and the South East.[206] The benefit of capital gains uplifting is therefore largely confined to these groups. Second, it enables some to bypass capital gains tax entirely; for example, someone can pass inheritance to their spouse tax-free, and the spouse can sell that immediately after without paying any capital gains tax. Third, it can put people off passing on assets during their lifetime, because there is an incentive to wait until death to benefit from the uplift. This keeps people hanging on to, for example, businesses longer than they may otherwise desire, and longer than might be economically optimal.

Removing this uplift has broad support. The APPG and IFS recommend removing it, while the OECD say countries in the group should reconsider this change, and the OTS recommends that the government reconsiders the uplift in the case of assets which are exempt from inheritance tax. It may also get broader public support than increases on inheritance tax. In polling on the fairness of taxes, inheritance tax scores a net of -20%, while capital gains tax scores net -6%.[207] And when asked what areas of taxation should increase, 30% say capital gains taxes, while just 14% choose inheritance tax.[208]

Design choices

There are broadly two choices when removing this alternative. First, capital gains tax can be charged when the assets are inherited, regardless of whether or not the gains are realised. This is currently the case when assets are given as gifts, unless given to spouses.[209] Second, capital gains tax could be charged when the assets are sold, but counting both gains before and after a death. The concern with the former option is that it may cause liquidity issues (where people don't have enough cash to pay the tax charge, because they haven't yet

202 Mico Millan I, The Effects of Inheritance and Gift Taxation on Upward Wealth Mobility at the Bottom: Lessons from Spain. 16 May 2023. https://isabelmicomillan.github.io/isabelmicoweb/IMM_2023.pdf
203 Ibid.
204 Ibid.
205 Advani Arun, Lonsdale A and Summers A. Who would be affected by Capital Gains Tax reform?. CAGE Policy Briefing, https://warwick.ac.uk/fac/soc/economics/research/centres/cage/manage/publications/bn40.2024.pdf
206 Ibid.
207 Ipsos. Inheritance tax seen as an unfair tax but others are prioritised for cuts. 30 July 2023. https://www.ipsos.com/en-uk/inheritance-tax-seen-unfair-tax-others-are-prioritised-cuts
208 YouGov. Which areas of taxation should increase the most?. 25 March 2024. https://yougov.co.uk/topics/politics/trackers/which-areas-of-taxation-should-increase-the-most
209 Gov.uk. Capital Gains Tax: what you pay it on, rates and allowances. (n.d). https://www.gov.uk/capital-gains-tax/what-you-pay-it-on

sold the asset). With the latter option, people only have to pay the tax when they sell the asset, and therefore have the cash. The latter option also decouples the tax from associations with death and inheritance, given it is only paid upon the sale of the asset, while the former is paid upon death. A criticism of the latter option is that it may create administrative burdens, as the value of assets may have to be traced back several generations. However, digital record keeping helps alleviate this problem.

There would also be important questions to be answered on the policy on inflation indexing for capital gains tax. Up until 1998, capital gains tax was 'indexed' to inflation, meaning only real-terms gains (measured against the Retail Prices Index) were taxed.[210] In 1998, chancellor Gordon Brown removed the indexation and replaced it with 'tapering', which simply decreased the tax the longer the asset was held. He argued that 'in a low inflation environment, a complex system of indexation is no longer necessary'. Taper relief was then abolished in 2008, and replaced with a lower flat rate of capital gains tax which does not usually vary with the length of time an asset is owned. Given higher inflation in recent years, the logic that capital gains tax rates should not account for inflation may no longer hold in general. But in particular, removing the gains uplift would mean taxing some much longer-term gains across generations, meaning large inflationary gains. Without inflation indexing, removing the capital gains uplift could lead to taxes on inflationary gains - or real term losses - in a considerable number of cases. To address this problem, inflation indexing should be reintroduced if removing the capital gains uplift.

Political impacts

A political risk of removing the capital gains uplift also consists in the fact that many more people pay capital gains tax than inheritance tax. In 2020-21, just 27,000 estates paid inheritance tax, while 323,000 paid capital gains tax given its much lower threshold. This is particularly a risk if charging capital gains at death, whether or not those gains are realised, as this may be seen as effectively expanding the inheritance tax base considerably. If carrying capital gains over, this association should be less prevalent. Nevertheless, there will still be a significant number of additional people paying capital gains tax when selling their inherited assets, who may feel they are losing out.

In 2014, Norway abolished their inheritance tax, and simultaneously introduced the 'carry-over' principle for capital gains tax.

210 Thornley H. The downs and ups of capital gains tax. AccountingWEB. 16 February 2024. https://www.accountingweb.co.uk/tax/personal-tax/the-downs-and-ups-of-capital-gains-tax

NORWAY'S ABOLISHMENT OF INHERITANCE TAX AND INTRODUCTION OF TAX ON INHERITED CAPITAL GAINS

Norway's reforms appear to have been broadly popular, and potentially raised revenue. Yet, while Norway's capital gains tax rates were significantly higher than inheritance tax rates, the reverse is true in the UK.

THE REFORMS

Before 2014, Norway's inheritance tax applied to any inheritance and gifts received by the same person over NOK 470,000 (£51,100 in 2013), taxed progressively at either 6% or 10% for children and parents, or 8% and 15% for others. In 2014, Norway abolished its inheritance tax entirely.[211] At the same time, however, it began carrying over capital gains at death, rather than uplifting those gains. Capital gains are considered in the same way as income by the Norwegian tax system, for which there is a 22% flat rate.[212] There are some adjustments, however, with tax on dividends and gains from shares adjusted upwards by 1.72, meaning a tax rate of 37.84% - although the risk-free rate of return on shares (measured by the return on treasury bonds) can be deducted from this.[213]

For context, Norway does also have a wealth tax of 0.3% above wealth of NOK 1.7m (£125,200).[214] The wealth tax in Norway raised an estimated NOK 23.5 billion (£1.98 billion) in 2022, with an estimated 13% of taxpayers paying the levy.[215]

THE ECONOMICS

It is unclear exactly what impact the 2014 reforms had on overall revenue, because the tax received by capital gains income is not differentiated in the statistics from tax received by employment income. Prior to the reform, however, the government estimated that the removal of the inheritance tax in isolation would reduce revenue by NOK 2.2 billion.[216] In contrast, the changes in the basis for income tax were estimated to increase revenues by NOK 250 million.

For some, however, the changes likely meant tax increases. The reforms were announced in November 2013, to be implemented in 2014 - and we saw significant increases in gift giving in the period in between. 30% of all taxable gifts that year were given in December 2013, and the number of gifts worth

211 Pekala M. The future of personal wealth and inheritance taxation in Norway. University of Oslo. 2013. https://www.duo.uio.no/bitstream/handle/10852/35707/pekala.maciej.pdf..pdf?sequence=1&isAllowed=y
212 PwC. Norway: Individual - Income determination. 23 January 2024. https://taxsummaries.pwc.com/norway/individual/income-determination
213 eToro. Tax Report FAQ for Norwegian Residents. (n.d). https://www.etoro.com/customer-service/tax-report-norway/
214 PwC. Norway: Individual - Other taxes. 23 January 2024.https://taxsummaries.pwc.com/norway/individual/other-taxes
215 Ministry of Finance. NOU 2022: 20 A comprehensive tax system. (n.d). https://www-regjeringen-no.translate.goog/no/dokumenter/nou-2022-20/id2951826/?ch=11&_x_tr_sl=no&_x_tr_tl=en&_x_tr_hl=en&_x_tr_pto=sc
216 Ministry of Finance. Prop. 1 LS Supplement 1 (2013–2014). (n.d). https://www-regjeringen-no.translate.goog/no/dokumenter/prop-1-ls-tillegg-1-2013-2014/id745306/?ch=5&_x_tr_sl=no&_x_tr_tl=en&_x_tr_hl=en&_x_tr_pto=sc

over NOK 2 million (£217,329 in 2013) increased by 20% on the previous year.[217,218] It seems that many of those who had the option of paying inheritance tax in late 2013 vs paying capital gains tax under the new continuity principle later chose to pay the inheritance tax - suggesting many would have paid more tax in the new system.

This makes sense by simply looking at the difference in rates. Taking the 22% rate on capital gains and a 10% rate on inheritance (for most inheritance given by parents), any asset that is subject to both taxes whose gain is more than 45.46% of its current value (0.1/0.22) would definitely be better off paying inheritance tax. On top of this, inheritance benefitted from an additional threshold (NOK 470,000 (£51,100) in 2013) while capital gains are simply given income tax allowances.

In terms of progressiveness, an important shift came in the treatment of different assets. Under the inheritance tax, there were multiple policies allowing inherited businesses to reduce their valuations, and thus avoid the tax.[219] Such options are not available for capital gains tax. And while people's residences were subject to inheritance tax, they were exempt from capital gains tax. The government therefore felt that the 2014 reforms could have a positive distributional effect, as the new scheme to a greater extent affects the transfer of business activities - which are more often owned by those with high income and wealth - compared to residences - which are distributed more evenly.

THE POLITICS

Reports suggest that the government received "great support from the Norwegian people for the repeal of the inheritance tax law".[220] Similarly, news reporting on the reforms at the time often did not mention the reforms to capital gains.[221,222] This context - of support for the inheritance tax reforms and little concern for the capital gains tax reform - was also confirmed by a policy expert we spoke to. Even for businesses who might pay more tax, the expert told us that many seemed satisfied, as they were no longer worried about the liquidity problems associated with inheritance tax.

Lessons for the UK

While Norway's 2014 reforms may have raised more revenue, this is primarily because the capital gains rate is 22%, compared to a 6% and 10% inheritance tax rate for children. It is not clear this would apply to the UK, where the capital gains tax rates (10%, 18%, 20%, 24%, and 28%) are considerably lower than the inheritance tax rate (40%). Applying capital gains tax at the point of death currently - which would raise a similar amount as if gains were carried over - is estimated by the IFS to raise around £1.6bn a year in 2024/25.[223] The OTS instead model a situation whereby inherited assets are deemed to have been acquired at the original purchase price.[224] They estimated in 2019 that this policy would raise £1.3bn a year, or £2.8bn a year if the capital gains tax relief for main properties was not applied for inherited assets.[225] All of these estimates are considerably lower than the revenue of inheritance tax (£7bn).

217 Orange R. New Norway gov scraps inheritance tax in budget. The Local. 8 November 2012. https://www.thelocal.no/20131108/norway-scraps-inheritance-tax-in-first-centre-right-budget
218 Ibid.
219 Fasting M. Inheritance tax – before, now and in the future. Civita. 5 March 2020. https://civita.no/notat/arveavgiften-for-na-og-i-fremtiden/
220 Gjerjordet HF. Inheritance tax - A descriptive analysis of the consequences of the repeal of the inheritance tax act in Norway. 2016. https://openaccess.nhh.no/nhh-xmlui/bitstream/handle/11250/2404562/masterthesis.PDF?sequence=1
221 abc Nyheter . The government removes the inheritance tax. 7 November 2013. https://www-abcnyheter-no.translate.goog/penger/2013/11/07/186203/regjeringen-fjerner-arveavgiften?nr=1&_x_tr_sl=no&_x_tr_tl=en&_x_tr_hl=en&_x_tr_pto=sc
222 Dagsavisen. Piketty attacks blue-collar tax policies. 13 December 2014. https://www.dagsavisen.no/nyheter/innenriks/2014/12/13/piketty-angriper-blabla-skattepolitikk/
223 Advani A and Sturrock D. Reforming Inheritance Tax. Institute for Fiscal Studies. September 2023. https://ifs.org.uk/sites/default/files/2023-09/Reforming-inheritance-tax-1.pdf
224 Office for Tax Simplification. Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax. July 2019. https://assets.publishing.service.gov.uk/media/5d274fad40f0b61158962af5/Final_Inheritance_Tax_2_report_-_web_copy.pdf
225 Ibid.

To get a sense of this, we can apply the above calculations for Norway to the UK system. Let's take a property bought 30 years ago (Q2 1994) for the average house price (£51,362), which remained at the average house price until 2023, when it was passed on in inheritance and then immediately sold. When the average house price peaked in Q3 2022 (at £273,135), that property would have accrued capital gains of £221,800 (worth £180,600 after controlling for inflation). In today's system, inheritance tax might be charged, but no capital gains tax would be charged. This is because the gains would be uplifted at death and the sold property would have no further gains. We can then compare this to a situation whereby inheritance tax is scrapped, but capital gains tax is not uplifted.

Figure 15 compares these two situations for estates with a different number of properties. Note, these are not reflective of the wider or average composition of UK estates, but reflect how different value estates would be treated under each system. It takes 2023's rates and thresholds for capital gains tax, and assumes that the estate consists of the family's main residence, alongside different numbers of additional properties. It also compares married couples and single individuals (who don't benefit from a transferable nil-rate band. Given that the vast majority of older people either are or have been married or civil partnered, the 'married couple' scenarios are much more common.[226]

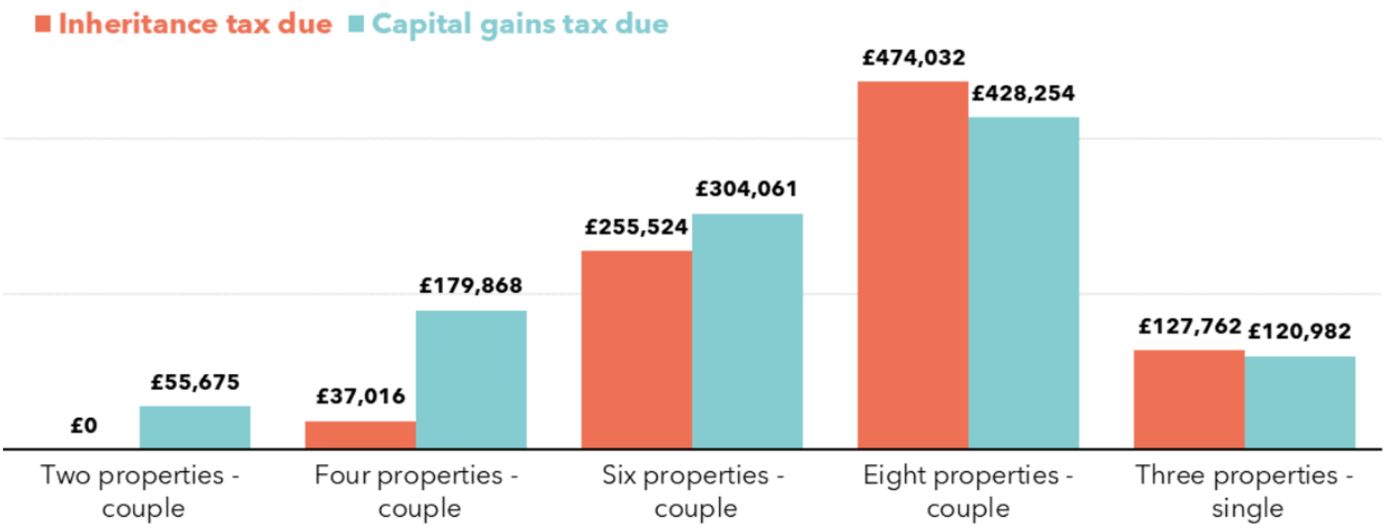
We see that, for the first scenario, no inheritance tax is paid, because even the main residence and the additional property do not meet the transferable nil rate band of £1m. However, £55,675 capital gains tax would be charged on the £221,800 gain on the additional property. For the second scenario, the estate is worth £1,092,540, meaning there is £37,016 of inheritance tax charged. However, there is a total gain of £665,319 on the three investment properties, meaning £179,868 of capital gains tax.

The inheritance tax then begins to catch up both because it applies to the value of an estate - not just the gains - and has a higher rate of 40% (compared to 28% for capital gains tax on secondary properties (which was reduced to 24% in the Spring Budget)).[227] For couples, the capital gains tax continues to be worth more than the inheritance tax until the estate has eight properties, and is worth around £2.2 million. Alternatively, given the threshold for single people in this case is just £500,000, the inheritance tax becomes higher than the capital gains tax once the estate has just three properties (worth £819,000). This shows how capital gains tax paid is higher for lower value estates, but lower for higher value estates.

FIGURE 15

For additional properties, if CGT was applied at death rather than inheritance tax, more tax would be charged in most instances

Tax paid on an investment property, consistently worth the average house price, bought 30 years ago and sold in 2023, for people on 2023's median income, using 2023 CGT rates and thresholds and no inflation indexing



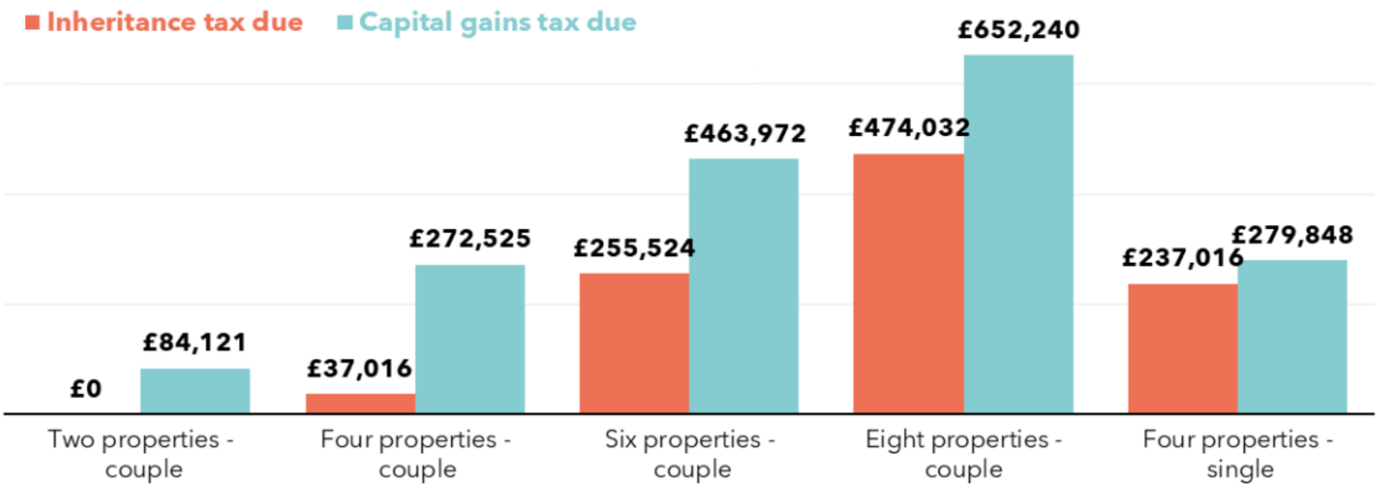
226 Office for National Statistics. Population estimates by marital status and living arrangements, England and Wales: 2019. 17 July 2020. https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/bulletins/populationestimatesbymaritalstatusandlivingarrangements/2019
227 HM Treasury, Spring Budget. March 2024. https://assets.publishing.service.gov.uk/media/65e8578eb559930011ade2cb/E03057752_HMT_Spring_Budget_Mar_24_Web_Accessible__2_.pdf

Yet, we can also imagine a scenario with significant reform of the capital gains regime. We take here the Resolution Foundation's suggestion to match capital gains tax with tax on income, with rates for residential properties of 40% for basic rate income taxpayers, 48% for additional rate taxpayers, and 53% for higher rate taxpayers.[228] In this scenario, even when the estate contains eight properties, the capital gains tax is worth 1.36 times as much as the inheritance tax. It is not until the estate has twenty properties - collectively worth £5.5 million - that the inheritance tax raises more than the capital gains tax. The capital gains tax therefore becomes more progressive in this case.

FIGURE 16

For additional properties, if adopting CGT rates proposed by the Resolution Foundation and applying it at death rather than inheritance tax, more tax would be charged in most instances

Tax paid on an investment property, consistently worth the average house price, bought 30 years ago and sold in 2023, for people on 2023's median income, using CGT rates of 40%, 48% and 53% proposed by RF and inflation indexing



It is important to note, again, that these calculations are not reflective of the wider or average composition of UK estates. Firstly, we would presume that people who own multiple properties are likely to have a primary residence worth significantly more than the UK's average house price. And while this primary residence could be taxed under inheritance tax, it would not be the current capital gains tax (because primary residences are exempt). People with higher value primary residences would therefore benefit more from the shift from inheritance tax to capital gains tax. Similarly, higher value estates are also likely to have large cash savings - but capital gains tax does not apply to cash, while inheritance tax does. Secondly, the estates within this model do not include non-residential assets. The asset structure of an inheritance, and how long the assets are held, would have a big influence on how the two taxes would land. Inheritors of self-made business wealth (which are likely to have accrued lots of real-terms gains) could be taxed much more, while inheritors of landed estates (which may not have accrued many real-terms gains) could be taxed less.

Beyond this, there are complications arising because, unlike inheritance, capital gains can be strategically timed. If a shift in capital gains policy is announced and some people stand to lose out as a result - particularly an increase in the capital gains tax rates - people may realise their gain before the policy is implemented, or hang on to the asset until in anticipation that it will later be reversed. The same does not apply to inheritance.

228 Broome M, Corlett A, and Thwaites G. Tax planning: How to match higher taxes with better taxes. Resolution Foundation. June 2023. https://economy2030.resolutionfoundation.org/wp-content/uploads/2023/06/Tax-planning.pdf

3. HYPOTHECATION

Hypothecation is when the revenues from a tax policy - be that a new tax, an existing tax or a tax increase - are committed to a particular spending commitment. An example of this is the Health and Social Care Levy, a tax change announced by Boris Johnson in 2021. This levy initially increased national insurance by 1.25% to fund for health and social care spending, with the intention that this increase would be replaced in 2023 by a separate tax functioning in a similar way.

Hypothecation is controversial, partly due to concerns about its effectiveness in raising public support, and partly due to concerns about it being misleading, or economically inefficient. This section addresses those various criticisms, and outlines options for the design of a hypothecated inheritance tax - something which the OECD recommended that governments consider.[229]

Does hypothecation work in theory?

Hypothecation is, in theory, effective in expanding support for policies. Perhaps unsurprisingly, polling shows that, in isolation, people dislike high taxes (just 16% support a high tax economy, compared to 59% wanting a low tax economy), but like high spending (54% prefer a high public spending economy, while just 25% want a low public spending economy).[230] Announcing higher taxes in isolation would generate only that opposition, while announcing them in conjunction with higher spending brings in the support.

The specificity of the spending also matters. If asking people what is more important, spending more on public services or reducing taxes - as More in Common do - 47% choose spending more, compared to 38% choosing tax cuts.[231] In contrast, if being explicit about spending commitments, asking people if they would prefer to see higher taxes and higher spending on health, education and social benefits, or lower taxes and lower spending on health education and social benefits, 55% say they want higher taxes and spending, while just 8% want lower taxes and spending. Beyond this, a survey by the Fabian Tax Commission in 2000 asking about a one percentage point increase in income tax, found 40% support when the tax was committed to unspecified areas, but 80% support when it was committed to the NHS.[232]

Demos have also tested this in relation to inheritance tax. While 55% support abolishing inheritance tax when asked in isolation, just 14% choose to do so when asked to prioritise between abolishing the tax, and spending on public services or reducing borrowing.[233,234]

Of course, polling is not a perfect reflection of the response to hypothetical policy announcements. We can, however, look at real-world examples of hypothecation. While we have not come across any prominent examples of hypothecated inheritance taxes internationally, there are forms of hypothecated tax in the UK - most notably income tax and national insurance. While these taxes work in similar ways - with national insurance more regressive for the top of the earnings distribution and harsher for those in employment than for others - just 19% choose national insurance as a top 3 priority tax cut, while 44% choose the basic rate of income tax.[235,236] Even when asked about whether it would be acceptable for different taxes to be increased to fund the NHS (which already provides a significant level of hypothecation), a net of 16% said it was acceptable for national insurance to be increased, compared to a net of -10% saying it was acceptable for income tax to be increased.[237]

The same can be seen for more recent tax changes. For Johnson's Health and Social Care Levy, polling in late 2021 - before the levy was introduced - showed that 58% supported this, while only 22% opposed

229 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
230 Tryl L. Tweet. 15 March 2024. https://twitter.com/LukeTryl/status/1768614948328882387
231 More in Common. Britons and the Economy: Election Battleground Series. November 2023. https://www.moreincommon.org.uk/media/dapb0ydq/britons-and-the-economy-election-battleground-series-1.pdf
232 le Grand J. Motivation, Agency, and Public Policy: Of Knights and Knaves, Pawns and Queens. OUP Oxford, 18 September 2003.
233 Ward J. YouGov poll shows majority of public now supports scrapping IHT and even a majority of Labour voters oppose raising the current 40% IHT rate. Kingsley Napley. 29 September 2023. https://www.kingsleynapley.co.uk/our-news/press-releases/yougov-poll-shows-majority-of-public-now-supports-scrapping-iht-and-even-a-majority-of-labour-voters-oppose-raising-the-current-40-iht-rate
234 Demos. "£7 billion electoral gamble' to abolish inheritance tax unlikely to pay off, according to new research". 11 December 2023. https://demos.co.uk/blogs/7-billion-electoral-gamble-to-abolish-inheritance-tax-unlikely-to-pay-off-according-to-new-research/
235 Institute for Fiscal Studies. Everything you need to know about National Insurance. 23 February 2022. https://ifs.org.uk/articles/everything-you-need-know-about-national-insurance
236 Ipsos. Inheritance tax seen as an unfair tax but others are prioritised for cuts. 30 July 2023. https://www.ipsos.com/en-uk/inheritance-tax-seen-unfair-tax-others-are-prioritised-cuts
237 Ipsos. Poll Conducted for the BBC: NHS Pressures Research. January 2017. https://www.ipsos.com/sites/default/files/migrations/en-uk/files/Assets/Docs/Polls/nhs-pressures-topline-2017.pdf

it.[238,239] Even once people started paying the levy, and there was backlash from many sides, including Tory MPs, Labour, and some in the health and social care sector - polling in May 2022 found that 52% supported it, compared to 23% opposed.[240] This is a high level of support, especially when considering that the Conservatives admitted it broke a 2019 manifesto commitment not to raise income tax, National Insurance or VAT.[241]

While this all suggests hypothecation can boost support for a tax reform, we have not yet seen a hypothecated inheritance tax. Inheritance tax is a unique tax, and it occupies a unique space in the public's mind. Hypothecation may work very differently in this case, and may vary considerably based on how it is designed. We therefore need to examine closer questions about design.

Soft vs hard hypothecation

Before discussing soft vs hard hypothecation, it is useful to first note that hypothecation is often criticised for being either inefficient or misleading. On the inefficiencies, IFS researchers note how the optimal amount of public spending on a particular service does not naturally align with the optimal amount of money raised from a particular tax.[242] Linking the tax and spending could therefore be inefficient. To avoid these inefficiencies, opponents suggest the tax therefore has to be delinked from the spending commitments.. This can be misleading if the hypothecated tax is framed to the public as if the spending does correspond with revenues.

This highlights the tension between 'hard' hypothecation (where, on the extreme end, the amount of spending is wholly determined by the revenue raised) and 'soft' hypothecation (where, on the extreme end, the spending is in no way determined by the revenue raised, but policymakers emphasise that the revenue supports the spending). The problem is that, the harder the hypothecation, the more inefficient it is. But the sofer the hypothecation, the more misleading it is - and hypothecation tends to become softer over time.

From the public's perspective, our research suggests that the public are not demanding a direct correspondence between revenues and spending. They are instead demanding a reason why taxes like inheritance tax are in place, and an indication that the money is being used for valuable purposes.[243] This would suggest a softer hypothecation is suitable.

It is true, however, that, if the spending is not determined by the tax revenue, this opens the hypothecation up to criticism of being misleading, for example by policy influencers and the media. Our focus groups showed that the public often see tax in general - and particularly inheritance tax - in quite cynical terms, as the government stealthily trying to raise extra revenue and spending it badly.[244] A hypothecation whose credibility is undermined through criticism by the media or politicians could exacerbate that feeling among the public.

Yet, real examples of hypothecation suggest this is not necessarily the case. The fact that National Insurance is much more popular than income tax - despite being a very soft hypothecation - suggests the public accept the link. Of course, national insurance was established over a century ago, while a newly hypothecated tax could cause a big media storm, and be a very different story.

A slightly closer example, however, is Johnson's Health and Social Care Levy. This was framed as a hard hypothecation - a new tax (starting as a National Insurance increase, with plans to transition to a new tax in 2023) with a specific £12bn spending commitment - but was actually a relatively soft hypothecation. For example, its abolishment in 2022 had no direct impact on the spending on health and social care.[245] And as would be the case if hypothecating inheritance tax, this was a newly introduced hypothecation coming under a significant deal of scrutiny. Yet, while this softness of hypothecation was recognised at the time, it played

238 Buzelli L, Cameron G and Gardner T. Public perceptions of the NHS and social care: performance, policy and expectations. 3 February 2022. https://www.health.org.uk/sites/default/files/pdf/2022-02/2022%20-%20Public%20polling.pdf
239 Ibid.
240 Booth R, Campbell D and Stewart H. Social care backlash grows after MPs vote through tax plan. The Guardian. 8 September 2021. https://www.theguardian.com/society/2021/sep/08/social-care-backlash-grows-after-mps-vote-through-tax-plan
241 Gibbon G, Johnson admits breaking manifesto promise on tax rises for health and social care. Channel 4. 7 September 2021. https://www.channel4.com/news/johnson-admits-breaking-manifesto-promise-on-tax-rises-for-health-and-social-care
242 Advani A, Leicester A and Levell P, Hyping hypothecation: should green tax revenues be earmarked?, Institute for Fiscal Studies, 7 July 2011, https://ifs.org.uk/articles/hyping-hypothecation-should-green-tax-revenues-be-earmarked
243 Goss D and Glover B. Winning the Argument: How to unlock public support for inheritance taxation. Demos. 26 September 2023. https://demos.co.uk/research/winning-the-argument/
244 Ibid.
245 European Observatory on Health Systems and Policies. Cancellation of the Health and Social Care Levy. 23 September 2022. https://eurohealthobservatory.who.int/monitors/health-systems-monitor/updates/hspm/united-kingdom-2015/cancellation-of-the-health-and-social-care-levy

only a minor role in criticism of the tax - including among the IFS (who have historically been sceptical of hypothecation) and various MPs.[246,247] This suggests media and political criticism may centre more on the level of taxation, rather than its hypothecation.

If we did seek to mitigate this risk, however, a middle ground between hard and soft hypothecation is to introduce a stabilisation fund, as proposed by Julian le Grand.[248] This could work by forecasting the long-term trend of inheritance tax revenue, and topping up a fund when revenues exceed the trend in a given year, and using the fund to top up spending when revenues fall below the trend. In this way, the spending is not wholly determined by revenues in a given year (avoiding the inefficiency), is still determined by the revenues long-term. While this reduces some flexibility, it would allow the government to design the hypothecation to match the long-term forecasted tax revenue with the forecasted spending requirements.

Other options to mitigate this risk include linking the tax to a spending commitment for a specific number of years - with a requirement to reassess the commitment by the end of the period - or handing over the revenue to an independent agency (e.g. a Citizens Wealth Fund) with a greater long term focus. More research is needed to test the extent of this risk, and these mitigation strategies.

Strong vs weak hypothecation

Another consideration is how strong or weak the hypothecation is. A strong hypothecation is when the tax is only used for one spending commitment, and is the sole source of funds for that commitment. The BBC licence fee is an example of this. A weak hypothecation, on the other hand, is when a tax is one of many funding sources for a spending commitment, or is split between multiple spending commitments. National Insurance (NI), for example, effectively fits both criteria in the modern era, as the healthcare system gets funding from multiple sources including NI, and NI goes to multiple sources of funding. A weak hypothecation is also a soft one, because the overall funding for the spending committing is not affected by changes in the tax revenue.

There is also a risk that weak hypothecation may not achieve the media coverage, and in turn public awareness, that is needed for hypothecation to be successful. There are examples from inheritance tax to illustrate this. In 2013, Jeremy Hunt emphasised that the inheritance tax threshold would continue to be frozen until 2019 in order to contribute to the costs of social care reform in the next Parliament.[249,250] This weak (and soft) hypothecation was mentioned in the media, but, for example, was not within the headline of the BBC's announcement on the issue (which instead read "Social care: Inheritance tax freeze expected").[251] It also seemingly gained very little traction with the public; while many in Demos' focus groups complained about the threshold being frozen, none mentioned the spending commitment. Reframing inheritance tax as a wholly hypothecated tax may achieve greater public awareness - but this remains to be seen.

Choice of spending commitment

In looking at what inheritance tax could be hypothecated to, it is useful to think about how people justify taxes. In the first place, people often feel they personally want to get something back from paying taxes. People thinking about paying inheritance tax are generally older people, and a key area of spending for older people (which is particularly salient at the moment) is social care.

On the other hand, inheritance is an unusual tax base. People strongly associate their inheritance with their legacy, which is generally about providing for future generations of their family. Perhaps this sentiment could also be felt if providing for future generations not just of one's family, but of the country more generally.

246 Verma H. MPs line up to criticise Health and Social Care Levy but it passes Commons. Chartered Institute of Taxation. 17 September 2021. https://www.tax.org.uk/mps-line-up-to-criticise-health-and-social-care-levy-but-it-passes-commons

247 Adam S et al. An initial response to the Prime Minister's announcement on health, social care and National Insurance. Institute for Fiscal Studies. 7 September 2021. https://ifs.org.uk/news/initial-response-prime-ministers-announcement-health-social-care-and-national-insurance

248 le Grand J. Motivation, Agency, and Public Policy: Of Knights and Knaves, Pawns and Queens. OUP Oxford, 18 September 2003.

249 Watt N. Inheritance tax freeze to fund social care cap of £75,000. The Guardian. 11 February 2023. https://www.theguardian.com/society/2013/feb/10/inheritance-tax-freeze-social-care

250 HM Treasury, Spring Budget. March 2024. https://assets.publishing.service.gov.uk/media/65e8578eb559930011ade2cb/E03057752_HMT_Spring_Budget_Mar_24_Web_Accessible__2_.pdf

251 BBC. Social care: Inheritance tax freeze expected. 10 February 2013. https://www.bbc.co.uk/news/uk-politics-21399751

On this basis, Demos have identified two areas of spending that could be particularly appealing for a hypothecated inheritance tax, which we tested in the deliberative exercise:

- **Old-age social care.** Many older people are forced to spend their wealth on old-age social care, which diminishes the amount they can give in inheritance.[252] If the money collected from inheritance taxation was directed towards investment in old-age social care, it would be used to help more people get more funding for their care needs. This would mean they could spend less of their own wealth and better maintain their inheritance. People could feel that the inheritance taxation system helps build stability around people's inheritances. There is also broad recognition that this policy area is underfunded.[253]
- **Funding for future generations.** Inheritance is often given to support the younger generation, with donor's feeling they want to leave a legacy. Iif some inheritance, via taxation, was directed towards a future generations fund investing in social infrastructure programmes (e.g. housing and education), it could too help support younger generations by removing barriers to prosperity. People could feel that their inheritance taxation contributes to a valuable social inheritance.

This also raises another criticism of hypothecation - that its use will cause excessive spending to be driven to popular, well-known spending commitments at the expense of other important - but often overlooked - commitments. Yet, while this may well be true if hypothecation applied across the tax system more broadly, it would not have a significant impact if inheritance tax (which is only 0.7% of tax revenue) was directed to an specially chosen area of spending that is both popular and needs more funding (as the two aforementioned spending commitments are).

It is also reasonable to hypothecate inheritance tax without a wider hypothecation of taxes, because it represents a special case. As we've seen, the unusual nature of the tax - in being the only tax on private wealth transfers, being very rarely engaged with, and taxing a pot of money with sentimental value - creates unique concerns. Given this, and the fact that people tend to recognise that inheritance tax is needed to fund public services, the public are keen (more than for most taxes) for a greater explanation of how this tax specifically is used. Hypothecation represents a potentially useful solution for this particular issue.

252 Age UK. 'Do I have to sell my home to pay for care?'. 7 July 2020. https://www.ageuk.org.uk/information-advice/care/paying-for-care/paying-for-a-care-home/do-i-have-to-sell-my-home-to-pay-for-care/

253 Booth R and Dugan E. 'Government has brought adult social care in England 'to its knees', MPs say'. The Guardian. 20 March 2024. https://www.theguardian.com/society/2024/mar/20/government-has-brought-adult-social-care-in-england-to-its-knees-mps-say

CONCLUSION

With a new government in power and a debate about inheritance tax reform rumbling, policymakers need to understand what reform is possible and what could best deliver for our country. Looking abroad shows us how the UK could have a more ambitious and hopeful vision for reforming inheritance tax - one that raises more revenue while also making it fairer. The findings in this report demonstrate that a variety of potential improvements exist - and a strategic collection of these could form a successful programme of reform for the UK.

Internationally, some countries raise more revenue from inheritance taxes than the UK, some do it without taxing a much larger proportion of inheritances, and some are more progressive as they do it, including for the highest value inheritances. Both Japan and South Korea do all three. If the UK could adopt the advantages of these systems, it could make really important steps towards a more effective inheritance tax. Understanding how exactly such changes would impact the UK system, and UK politics, requires more work.

Given the high emotions around inheritance tax, the politics of the tax is particularly important. Norway, despite abolishing inheritance tax, seems to have achieved more public support for their system of taxing inherited assets, while potentially not losing revenue, by taxing inherited capital gains at a higher rate than they taxed inheritance. The UK could also learn lessons from this. Alongside such changes to the tax structure, hypothecating inheritance tax also offers potential boosts to public support, as we have seen with other hypothecated taxes. The design, however, is key - again, more work is required.

Moving forward, it is critical we engage in a more nuanced dialogue. Policymakers must learn about the many opportunities for reforming inheritance tax, and consider the implications for revenues, progressivity, and public support for the system. The deliberative process run by Demos - which engaged the public on their views about how to reform inheritance tax while maintaining or raising the revenue - will enable the public to be at the heart of this policy making process. By focussing on how we can reform the current system - rather than continuing the debate around scrapping or keeping the tax - we worked to ensure the proposals are credible and implementable. And by involving citizens in informed discussions about the impacts and trade-offs of proposals, we have aimed to identify a more sustainable approach which better reflects the public's values. The results of this process will be published this Summer. Policymakers would be wise to listen.

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