

# Inheritance Tax reliefs: time for reform?

Arun Advani,<sup>1</sup> Franziska Disslbacher<sup>2</sup>, James Forrester<sup>3</sup>, and Andy Summers<sup>4</sup>

<sup>1</sup> Centre for the Analysis of Taxation (CenTax), University of Warwick Economics, and Institute for Fiscal Studies

<sup>2</sup> WU, Vienna University of Economics and Business

<sup>3</sup> CenTax

<sup>4</sup> CenTax and LSE Law

*Published by*

The Centre for the Analysis of Taxation

[centax.org.uk](http://centax.org.uk)

This research was funded by the Nuffield Foundation grant “Broad Shoulders” (WEL/FR-000023787). Funding for CenTax comes from the abrden Financial Fairness Trust and Thirty Percy. This work contains statistical data from HM Revenue and Customs (HMRC) which are Crown Copyright. The research data sets used may not exactly reproduce HMRC aggregates. The use of HMRC statistical data in this work does not imply the endorsement of HMRC in relation to the interpretation or analysis of the information. The authors thank Emma Chamberlain, Sebastian Gazmuri-Barker, and the entire HMRC Datalab team for insights and support. Correspondence to [a.advani.1@warwick.ac.uk](mailto:a.advani.1@warwick.ac.uk) and [a.d.summers@lse.ac.uk](mailto:a.d.summers@lse.ac.uk).

## Executive Summary

Inheritance Tax (IHT) applies at a flat rate of 40% to estates worth over £325,000. This **40% rate has extremely high salience** with the public and may be one of the reasons why IHT is regularly cited as the UK's most unpopular tax. And yet, **most estates do not actually pay 40% tax, or anywhere close to this**. The explanation lies in the proliferation of allowances, exemptions and reliefs for IHT (referred to as 'reliefs' for short), which mean that the statutory tax rate is not a good guide to the *effective* tax rates that estates actually pay.

Previous analyses (OTS, 2019 and HMRC, 2024) have shown that, on average, effective tax rates decline for the largest estates. However, there remains significant misunderstanding about which IHT reliefs are responsible for the low effective tax rates paid by (some) wealthy estates, and the policy justifications for them. Previous analyses have focused solely on differences between effective tax rates for lower and higher value estates, overlooking just how much variation there is *amongst* estates at similar levels of wealth: with some estates paying close to the 40% statutory rate, and others paying less than one tenth of this.

In this report, **we use de-identified tax data covering all estates filing for IHT between 2018-2020 to shed new light on IHT reliefs and their role in driving differences in effective tax rates across estates**. We also evaluate whether these apparent inequities can be justified in light of other policy objectives. Finally, we discuss options for reforming IHT reliefs and provide evidence on the revenues that could be raised.

## Effective Tax Rates

Previous analysis (OTS 2019, HMRC 2024) shows that the effective average IHT rate (EATR) declines for estates worth over £7m. It is often supposed that this regressivity is driven by reliefs for particular asset classes, particularly Business Relief and Agricultural Relief. We show that this is largely false: **the overall regressivity in IHT stems mainly from the uncapped nature of the spouse exemption**. It is only for estates valued at over £12.5 million (which have not been separated out in previous analyses), that Business Relief starts to result in regressivity.

However, Business Relief and Agricultural Relief are an important driver of '*horizontal*' inequity: differences in the effective tax rates paid by estates with the same amount of wealth. This inequity is substantial. Excluding estates eligible for the spouse exemption, **a quarter of estates above £10 million have EATRs above 37%, but another quarter pay less than 9%, and one in six pay less than 4%**. This implies that what matters for how much IHT an estate pays is not just how much wealth the estate has in total, but which types of asset are held.

A crucial caveat to **our analysis of effective tax rates does not account for 'missing wealth'**, such as lifetime gifts made more than seven years before death, pension wealth, assets transferred into trusts, or other assets that are exempt from IHT altogether (such as the foreign assets of 'non-doms'). In these cases, we will overestimate the 'true' EATR on the total wealth transferred to heirs. These forms of

missing wealth are in most cases not even required to be reported to HMRC, making it difficult to quantify their effects.

Around the world, countries adopt a variety of different models for taxing inheritances and lifetime transfers. The UK should look at these international examples and develop options for wholesale reform of Inheritance Tax. However, in the meantime, and even without major structural redesign, there are many options open to the government to **improve the fairness and efficiency of our existing IHT by reforming key reliefs and exemptions.**

## Spouse exemption

Introduced in 1972, spouse exemption is **typically regarded as a deferral of tax** until both spouses have died. However, surviving spouses have the opportunity to engage in further tax planning, for example via gifts to heirs or into trust, meaning that the **spouse exemption can be used to circumvent IHT altogether.** Since accrued capital gains are also currently wiped out at death, spouse exemption can result in assets being passed to heirs completely tax-free.

Currently the spouse exemption significantly reduces the EATRs paid across all estates, by 4pp on average for estates valued above the Nil Rate Band. However, its effect is largest at the top: on average, the exemption **reduces EATRs by 12pp for estates valued at between £10 million and £12.5 million, but 2pp for estates valued between £1 million and £1.5 million.** This may be because those at the top are most able to benefit from the ‘second chance’ to engage in tax planning, which the spouse exemption provides.

The main aim of the spouse exemption is arguably to ensure that the surviving spouse does not face any material change in their standard of living as a result of IHT due on the first death. However, **capping the spouse exemption at £10 million** could support this goal whilst limiting the opportunity for very high value estates to use the exemption as a second chance for tax planning. This reform would **affect fewer than 0.1% of estates (100 deaths a year) and raise up to £350m in revenue.**

## Business Relief

Business Relief provides 100% IHT relief on business assets and shares in unlisted and AIM-listed companies (where qualifying conditions are met), as well as 50% relief on controlling shareholdings in listed companies. The stated aim of the relief, according to the government (HMRC 2021), is to **‘ensure businesses do not have to be sold or broken up following the death of the owner’.** However, the force of this policy justification depends on the size of the business (affecting its access to credit) and whether the deceased was an active or passive owner (affecting the degree of disruption that would result from sale of the owner’s stake).

Between 2018 and 2020, an average of £2.2 billion per year in Business Relief went to around 3,400 estates per year. **83% of the relief went to estates claiming more than £500,000 in relief,** and more than two thirds (72%) went to around 400 estates per year (worth £7.6 million on average) that claimed more than £1 million in relief. **Business Relief is a major contributor to the regressivity of IHT at the very top:** amongst estates worth £30 million or more, the relief lowers the average EATR by

12pp (almost halving it from 23% to 12%), compared with less than 1pp for estates valued at less than £1.5 million.

We find that **only a quarter of those claiming Business Relief on shares had been involved in management of the business** as a company director at any point in the five tax years prior to death (19% as close company director). This suggests that most claims for Business Relief are by ‘passive’ investors rather than ‘active’ business owners. In these circumstances, it is less clear why the sale of the stake – if required where there are insufficient other funds to pay the tax – would be problematic for the business.

The concern about passive investors using Business Relief to reduce their IHT bill is most acute in the context of **AIM-listed shares**. Unfortunately, the way in which HMRC processes IHT returns for analytical purposes means that it is not possible to provide a reliable estimate of how much Business Relief goes on unquoted (AIM) shares specifically. Whereas justifications for Business Relief typically focus on liquidity concerns, the most common argument for giving relief on AIM shares is to incentivise investment in this market. However, if the aim is to incentivise investments in certain types of business, the **relief could be much better targeted** by restricting it to established schemes such as SEIS, EIS and VCTs.

## Agricultural Relief

Agricultural Relief typically provides 100% IHT relief on the agricultural value of farmland, woodland and farm buildings (including farmhouses). The relief is available to landlords (i.e. those renting farms to tenant farmers) who have owned the land for at least seven years, as well as to active farmers provided that they have occupied the land for agricultural purposes for at least two years. Again, the stated aim of the relief is to **prevent the breakup of the farm** due to a lack of liquid assets available to pay the tax (HMRC 2021).

Between 2018 to 2020, an average of £900 million in Agricultural Relief (on UK property) went to around 1,300 estates per year. Although 64% of estates using the relief claimed less than £500,000 in relief, 83% of the value of the relief went to those claiming more than this amount. **Almost two thirds (64%) of all Agricultural Relief went to around 200 estates per year that each claimed more than £1 million in relief**, with an average estate value of £6 million.

Among estates that benefited from Agricultural Relief between 2018 and 2020, **less than half (44%) of individuals had received any trading income from agriculture** at any point in the five years prior to death. Income from agriculture made up less than a quarter of their income on average. Of the remainder, 51% received income from rent, which is consistent with them being landlords rather than active farmers, although we cannot rule out that they were actively farming via a company.

**Abolishing or capping Agricultural Relief on its own would raise very little revenue**, because a large proportion of existing claims would be displaced to Business Relief instead. Moreover, agricultural landowners may then be less willing to rent land to tenant farmers (rather than farming themselves and claiming Business Relief) because in doing so they would lose IHT relief. On the other hand, a key problem with Agricultural Relief in its current form is that it raises the price of farmland for tenant farmers who want to buy.

**Capping Agricultural Relief and Business Relief at a combined limit of £500,000 per estate could raise up to £900 million per year.** Unlike previous revenue estimates (Advani & Sturrock 2023), our analysis accounts for optimisation across these two reliefs and increased use of the spouse exemption; however, we do not account for other behavioural responses that may erode revenues. Two-thirds of estates claiming Agricultural Relief, and three-quarters of those claiming Business Relief, would be completely unaffected, but would increase the effective tax rates paid by the very largest estates (above £30 million) by around 7pp on average.

## Residence Nil Rate Band

Introduced in 2017, the Residence Nil-Rate Band (RNRB) exempts the first £175,000 of residential property passed to a 'direct descendant' (including children, grandchildren and their spouses). It is tapered away for estates worth more than £2 million and is completely withdrawn above £2.35 million. Compared with simply increasing the standard Nil Rate Band (currently £325,000), the **RNRB disadvantages estates with less valuable residential properties or where the deceased did not have children or grandchildren to inherit.** It is also extraordinarily complicated to apply, especially in relation to the 'downsizing' rules.

One option would be to **abolish the RNRB whilst increasing the standard Nil Rate Band (NRB) by an equivalent amount.** For estates valued at less than £2m, this would involve increasing the current NRB from £325,000 to £500,000. Overall, this reform would **cost around £1 billion per year, with all of the benefit going to estates valued at less than £2.7 million.** The largest proportional tax savings would go to estates worth £1 million and £1.5 million, who would see a reduction in EATR of 2pp on average, saving them £20,000-30,000.

## Other reliefs

Our current IHT system incorporates many smaller reliefs, each of which individually costs relatively little, but where the benefits are highly concentrated. These include:

**Funeral expenses** seem relatively innocuous as something that can be claimed tax-free from an estate. But while the average value is £4,300, and 99% are less than £15,500, 0.1% of estates (270 estates) per year claim more than £154,000 tax free. Around 50 estates over 2018-20 had deductions in excess of £800,000. Capping the tax deductibility of funeral expenses at £50,000 would affect fewer than 700 estates a year, while raising up to £25 million.

**Charity Relief** is claimed on £2.1 billion in assets each year. More than half of this comes from fewer than 400 estates per year, with average estate size of £4.8 million, each benefitting from more than £1 million in IHT relief, at an implied revenue cost of up to £280 million per year. Whilst there may be some policy justifications for favouring charitable giving, it is important to note that the current system effectively redirects tax revenues towards the charitable preferences of a very small number of people.

**Heritage Assets** are conditionally exempt from IHT where the assets are deemed to be of 'national, scientific, historic or artistic, scenic, architectural interest', and the new owner undertakes to keep the assets in the UK and provide some access

(potentially at a charge) to the public. 96% of this relief (around £300 million) was claimed by just 44 estates over 2018-20. These estates benefited from an average of £7 million in relief on an average estate size of almost £20 million. There is a case for reviewing the effectiveness of this relief against its current objectives and considering whether alternative approaches might offer better value for money.

## Revenue and distributional effects

We model a combined reform which includes all our proposed changes to the spouse exemption, Business and Agricultural Relief, and the RNRB and NRB. We estimate that, **together, these reforms could raise up to £500 million, whilst at the same time lowering effective tax rates (on average) for estates worth less than £2 million.** Only estates worth more than £8 million would see EATRs rise by more than 5pp on average.

The reform would also make IHT fairer by reducing horizontal inequality between estates of the same value. When comparing the interquartile range<sup>1</sup> for EATRs at each point in the wealth distribution, the **reduction in horizontal inequity is greatest for estates valued between £2-7 million**, where we see a reduction in variation of over 6pp. The change amongst estates below £2m or above £7m is relatively minor (ranging between -4pp to +2pp).

---

<sup>1</sup> This is a measure of the variation within the distribution, defined as the difference between the 25th and 75th percentiles of the distribution. Ranking estates of the same value by their EATR, this looks at the difference in EATR between an estate which pays more tax than 75% of estates at the same level of wealth, and an estate which pays more tax than only 25% of estates at that level of wealth (so must have a lower EATR).