

The Taxing Wealth Report 2024

Every politician's guide to
"How to pay for it".

The reform of inheritance tax: Reforming rates and allowances to make the tax more progressive

Brief Summary

This note proposes that:

- The rates at which inheritance tax is charged should be subject to review.
- The existing flat charge rate of this tax is inappropriate and might be one reason for its lack of political acceptability.
- The current charge structure of this tax also fails to deliver sufficient vertical tax equity within this tax.
- At the same time, that flat rate also results in insufficient wealth being redistributed by this tax when that is one of the objectives for using it.
- If new tax rates from 10 per cent to 60 per cent of the value of chargeable estates were introduced on cumulatively increasingly wide bands of chargeable estate, then whilst no additional tax might necessarily be collected the distribution of that charge would change considerably, with much more being paid by higher value estates.
- The suggested revised structure would reduce the inheritance tax due on almost all chargeable estates of less than £1 million, often by significant amounts.

¹ This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See <https://www.financeforthefuture.com/taxing-wealth/>. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP. © Finance for the Future LLP 2023

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Finance for the Future

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- When this issue has been addressed, and when other recommendations in the Taxing Wealth Report 2024 relating to this tax have been considered, it may be appropriate to reconsider the size of the nil rate band for this tax.

<p>The proposal</p>	<p>To reform the rates and allowances at which inheritance tax is charged so that:</p> <ul style="list-style-type: none"> • The tax is more progressive. • Less tax is paid on smaller estates. • More tax is paid on larger estates (ignoring any other proposals made in the Taxing Wealth Report 2024).
<p>Reason for the proposal</p>	<ol style="list-style-type: none"> 1. To improve the public perception of inheritance tax by: <ul style="list-style-type: none"> ○ Making it more progressive. ○ Reducing its impact on smaller estates. ○ Increasing the overall yield to tackle increasing wealth inequality in the UK. 2. To increase vertical tax equity. 3. To reduce the incentive to avoid inheritance tax. 4. To reduce the tax spillover effect that existing inheritance tax rates create. 5. To potentially raise additional tax revenues but in a more progressive fashion.
<p>Estimated tax that might be raised as a result of the recommendation made</p>	<p>The behavioural responses to this recommendation cannot be known but are likely to be positive amongst most groups that currently view inheritance tax negatively. There will be negative reaction from those</p>

	<p>with significant wealth. Political capital will have to be expended to address this issue.</p> <p>An example calculation of additional tax that might be raised is included in this note. Whilst it suggests that no new tax might be raised by making inheritance tax significantly more progressive it does suggest that its redistributive qualities might be enhanced considerably.</p>
Ease of implementation	The changes proposed will be easy to implement. No technical difficulties should arise.
Likely difficulties that might result from implementation	As noted above, there is likely to be significant opposition to these changes but that is the only difficulty that should be anticipated.
Likely time required to implement the change	Capable of being delivered in any Finance Bill i.e. in a matter of months.
Consultation period required.	A few months, at most.

Introduction

It has long been the case that the structure of inheritance tax has been overdue for reform.

The nil rate band for this tax, which takes the vast majority of UK estates out of a charge to inheritance tax, has been set at £325,000 since 2009, although this sum can be increased in the case of the passing of former domestic residences. This sum is not expected to change until at least 2027.

The rate of tax has been subject to even less change. A few exceptions apart, once inheritance tax is charged it has been due at 40% for decades. It is stressed, that this rate only applies to the chargeable estate above the nil rate band, and not to the estate in its entirety.

For a tax that is so unpopular², according to public reports, the fact that there has been no serious review of its structure or rates for more than a decade is surprising. The changes

² <https://www.hl.co.uk/news/articles/archive/britains-most-hated-tax>

that have been made have all tinkered at the edges of the tax, but not addressed issues of principle.

Some of the unpopularity of this tax does, almost certainly, result from the apparent bluntness of the charging structure. In particular, the use of one tax rate that was (and is still, in the minds of many) associated with the higher rate of UK income tax most probably implies a penal rate that encourages an adverse reaction to inheritance tax.

The Taxing Wealth Report 2024 suggests a number of changes to this tax including:

- Taking domestic residences out of the charge to inheritance tax and subjecting them to capital gains tax on lifetime gains instead³.
- Removing the inheritance tax exemption for funds retained in pension funds at the time of death⁴.
- Removing business property relief and providing tax deferral arrangements in its place⁵.
- Removing agricultural property relief and providing tax deferral arrangements in its place⁶.

These proposals are likely to significantly increase the tax revenues owing by larger estates, which are the ones most likely to be impacted. Although business property relief and agricultural floor property relief are only claimed by fewer than 5,000 estates in the UK each year according to the latest statistics available, they reduce the tax paid by each of those estates by approximately £1 million. What this makes clear is how distorted liability to this tax is because of inappropriate reliefs and allowances. Any consideration of general reforms has to take this into account.

The profile of tax paid by size of estate in 2021, which is the last year for which reliable information is available with regard to this tax was as follows⁷:

³ <https://taxingwealth.uk/2023/09/28/charging-capital-gains-tax-on-the-final-disposal-of-a-persons-main-residence-might-raise-10-billion-of-tax-a-year/>

⁴ <https://taxingwealth.uk/2023/10/12/the-taxing-wealth-report-2024-abolishing-the-inheritance-tax-exemption-on-some-funds-retained-in-pension-arrangements-at-the-time-of-a-persons-death-might-raise-1-3-billion-a-year/>

⁵ <https://taxingwealth.uk/2023/10/16/taxing-wealth-report-2024-reforming-inheritance-tax-business-property-relief-might-raise-3-2-billion-of-tax-a-year/>

⁶ <https://taxingwealth.uk/2023/10/17/taxing-wealth-report-2024-reforming-inheritance-tax-agricultural-property-relief-might-raise-1-0-billion-of-tax-a-year/>

⁷ <https://www.gov.uk/government/statistics/table-121-estates-notified-to-hmrc-numbers-and-tax-due>

Net estate (lower limits)	2020 to 2021 number not taxed	2020 to 2021 number taxed	2020 to 2021 tax due (£ million)	2020 to 2021 average tax (£)	2020 to 2021 average effective tax rate of taxpaying estates (per cent)
Band limit					
0	9,750				
10,000	7,740				
25,000	5,890				
40,000	3,690				
50,000	3,790				
60,000	8,170				
80,000	10,000				
100,000	86,000				
200,000	63,900				
300,000	35,400	2,380	33	13,800	4%
400,000	20,600	2,460	105	42,800	9%
500,000	14,200	2,770	152	54,900	10%
600,000	7,080	2,300	178	77,600	12%
700,000	4,870	2,140	192	89,900	12%
800,000	3,320	1,800	201	111,000	13%
900,000	2,310	1,560	201	129,000	14%
1,000,000	1,110	6,330	1,020	161,000	13%
1,500,000	486	2,300	775	337,000	20%
2,000,000	145	1,560	888	570,000	24%
3,000,000	76	579	501	865,000	25%
4,000,000		248	271	1,100,000	25%
5,000,000		278	413	1,480,000	25%
7,500,000		114	197	1,720,000	20%
10,000,000		158	633	4,010,000	17%
Total estates notified	289,000	27,000	5,760	214,000	13%

The obvious reforms to consider are:

1. Changing the value of the nil rate band available within this tax.
2. Introducing tiered bands of tax payable as the size of estates increases.
3. Reducing the opening rate of inheritance tax to a level with which most taxpayers are more familiar.

- Increasing the rate at which inheritance tax is paid by the largest estates as a means of addressing the substantial wealth inequality that exists within the UK.

As example, it would be possible to change the rates at which inheritance tax is charged as follows:

Band of chargeable estate (£)	Size of band	Rate of tax (%)
0 - 325,000	325,000	0%
325,001 - 425,000	100,000	10%
425,001 - 525,000	100,000	20%
525,001 - 725,000	200,000	30%
725,001 - 1,025,000	300,000	40%
1,025,001 - 1,325,000	300,000	50%
Above 1,325,001	Unlimited	60%

If this were to be done then, assuming no other allowances and reliefs are claimed, liabilities by size of estate might change as follows (with numbers being approximations as the distribution of estates within bands is not known):

Net estate (lower limits)	2020 to 2021 number not taxed	2020 to 2021 number taxed	2020 to 2021 tax due (£ million)	2020 to 2021 average tax (£)	2020 to 2021 average effective tax rate of taxpaying estates (per cent)	Revised average tax due (£)	Change in tax due (£)	Total revenue in band (£ million)
Band limit								
0	9,750							
300,000	35,400	2,380	33	13,800	4%	3,450	-10,350	8
400,000	20,600	2,460	105	42,800	9%	11,400	-31,400	28
500,000	14,200	2,770	152	54,900	10%	17,450	-37,450	48
600,000	7,080	2,300	178	77,600	12%	28,800	-48,800	66
700,000	4,870	2,140	192	89,900	12%	37,425	-52,475	80
800,000	3,320	1,800	201	111,000	13%	53,250	-57,750	96
900,000	2,310	1,560	201	129,000	14%	66,750	-62,250	104
1,000,000	1,110	6,330	1,020	161,000	13%	90,000	-71,000	570
1,500,000	486	2,300	775	337,000	20%	281,250	-55,750	647
2,000,000	145	1,560	888	570,000	24%	665,000	95,000	1,037
3,000,000	76	579	501	865,000	25%	1,107,500	242,500	641
4,000,000		248	271	1,100,000	25%	1,460,000	360,000	362
5,000,000		278	413	1,480,000	25%	2,030,000	550,000	564
7,500,000		114	197	1,720,000	20%	2,390,000	670,000	272
10,000,000		158	633	4,010,000	17%	5,825,000	1,815,000	920
Total estates notified	289,000	27,000	5,760	214,000	13%			5,445

As will be noted, for many smaller estates, where the imposition of this tax is most keenly felt, liabilities would fall if these bands were adopted.

This would also be true for all estates where the overall net estate is less than £1.5 million.

However, on higher value estates the overall liability increases, as it would also do if other recommendations in the Taxing Wealth Report 2024, e.g. with regard to agricultural and business property relief are also taken into account, given that most of the estates claiming those relief will fall into this category.

It is suggested that this overall redistribution of liabilities is just and equitable whilst also achieving the goal of redistributing wealth within the UK without imposing tax charges at rates that are uncommon within the rest of the economy.

It will be noted that this change is broadly tax neutral. Bands could be altered to achieve an increase in revenue raised. Those chosen here were instead picked to increase the degree of redistribution that the tax might achieve.