DEMOS

PLUGGING THE BLACK HOLE

REFORMING INHERITANCE TAX TO UNLOCK REVENUE AND BUILD PUBLIC SUPPORT

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Any errors remain the authors' responsibility.

Dan Goss

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ABOUT THIS REPORT AND THE *UNLOCKING INHERITANCE* PROGRAMME

This report is part of Demos's multi-year *Unlocking Inheritance* programme, supported by abrdn Financial Fairness Trust.

With inheritances becoming increasingly important in our economy and society, Demos have explored what the 'new age of inheritance' means for the UK and how to respond. With invaluable support from our Advisory Group, we have published research on the socioeconomic impacts of the 'new age of inheritance', the nuances in public attitudes to inheritance taxation, the concerns people have about the system, the policy from both a Conservative and Labour perspective, and what we can learn from other countries about designing inheritance tax.

This report draws on all prior research alongside original research for this paper - including public deliberation, economic analysis and discussion with experts - to recommend a series of reforms that balances economical, political and administrative benefits.

We'd love to hear from you with any questions or thoughts about our work. If you would like to get in touch, please email Dan Goss at dan.goss@demos.co.uk.

EXECUTIVE SUMMARY

At the upcoming Budget, the government is expected to set out its plans to fill the £22bn 'fiscal hole'.[1] If widespread media reports are accurate, this is likely to include changes to the inheritance tax regime.[2] This paper outlines how the government could reform the taxation of inheritance to generate **£2.6bn in the current tax year - or around £16bn over this Parliament** - in a way that aligns with the values and priorities of the public.

As Demos has argued through our *Unlocking Inheritance* programme, the UK has entered a 'new age of inheritance', with the value of inheritance passed on annually doubling roughly every 20 years and reaching over £120bn.[3,4] The current regime for taxing these is out of date, with just 4% of inheritance paid in tax and the wealthiest estates paying lower rates than others.[5]

Well-designed reforms could raise revenue while making the tax fairer at the same time. As a tax that is paid by fewer than one in every 20 estates, and with almost half paid by the wealthiest 1% of estates, changes will also affect very few people and only those with significant wealth.[6] The challenge facing the government is how to unlock revenue from inheritance tax while minimising public backlash and avoiding harm to their wider objectives, such as economic growth or social mobility.

This paper sets out proposals to meet these objectives. It draws on findings from across Demos's *Unlocking Inheritance* programme, supported by the abrdn Financial Fairness Trust, including economic analysis, surveys, focus groups, and a reviews of inheritance tax systems internationally. It also draws on new analysis conducted for this report, including six two-hour deliberative workshops with a 27-person representative panel, original economic modelling, and discussion with experts. This deliberation offers unique insights into the public's values around different aspects of inheritance tax policy, and on how the public would likely react to a range of different reforms and the messages surrounding them.

1 Hooker L. 'Chancellor warns hard decisions ahead in Budget'. BBC. 11 September 2024. https://www.bbc.co.uk/news/articles/c2045wpddy2o
2 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
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/anew-age-of-inheritance-what-does-it-mean-for-the-uk
4 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
5 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
6 HM Revenue & Customs. Inheritance Tax statistics: commentary. 31 July 2024. https://www.gov.uk/government/statistics/inheritance-tax-liabilities-statistics/inheritance-tax-liabilities-statistics-commentary

RECOMMENDED INHERITANCE TAX REFORMS

Based on the findings of this analysis, the following package of reforms to inheritance tax has emerged, alongside a reform to capital gains tax on inherited assets:

RECOMMENDATION	CURRENT SYSTEM	PROPOSED REFORM	RATIONALE FOR REFORM
Introduce rate bands (-£410m)	Inheritance tax is charged at a flat rate of 40% above the tax-free allowance (which is at least £325,000 per estate, but can increase to £500,000 if the estate includes a house passed to children or grandchildren, and then up to £1m as married couple can combine their allowances).	Retain the current tax-free allowances, and introduce rate bands at: • 30% for any inheritance under £1m • 40% for inheritance between £1m and £2m • 45% for inheritance over £2m	**Fiscal:** Rate bands would make inheritance tax more progressive, and the loss in revenue due to the rate cut for inheritances under £1m would be partly offset by the gain due to the rate increase for inheritances over £2m. The rate cut for inheritance under £1m would also support the government objective to 'lower the tax burden for working people'.[7] **Public support:** The introduction of rate bands received strong support when it was tested with the public, with almost universal support across our panel. It would help mitigate concerns about the big jump in rates from 0% to 40%, and the sense of unfairness that all taxed estates pay the same marginal rate. It would also bring the UK more in line with most OECD countries.[8] These rates could be adapted by the government to meet their needs for revenue. For example, the government might instead want to cut the rate for inheritance under £1m to 35% to retain more revenue.

7 Forrest A. Starmer suggests no tax cuts for two years under Labour without economic growth. The Independent. 5 January 2024. https://www.independent.co.uk/news/uk/politics/starmer-labour-tax-cuts-tories-election-b2473717.html

8 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/

Reduce the tax-free allowance for the top 1% of estates (+£470m)	The residence nil-rate band (the additional allowance of up to £175,000 for people passing on homes to children or grandchildren) is tapered away by £1 for every £2 that an estate is worth over £2m. Yet, this does not happen for the nil-rate band (the minimum allowance for all estates).	Taper away the nil-rate band (minimum tax-free allowance) for estates over £2m, in the same way that is currently done for the residence nil-rate band. This would mean reducing the full allowance (the sum of the nil-rate band and residence nil-rate band) by £1 for every £2 above £2m.	**Fiscal:** Tapering away the nil-rate band would raise additional revenue from the most valuable estates. When taken with the introduction of rate bands, there would be a net revenue gain. Additionally, the top marginal rate - which is effectively at 60% under the current system due to the tapering of the residence nil-rate band - would remain the same.[9] **Public support:** The public generally feel that estates over £2m are particularly large, with some thinking they should face higher rates than 45%.
Reduce tax relief for estates with larger amounts of business assets (+£970m)	Business assets - excluding businesses that mainly deal with securities, stocks or shares, land or buildings, or investments - can benefit from tax relief. This includes 100% relief for a private business that someone fully or partly owns, or shares in an unlisted company (e.g. shares on markets for less developed companies like the Alternative Investment Market (AIM)), and 50% relief for shares controlling over half of a listed company.	Cap business relief, so that relief is only available on the first £500,000 of business assets in an estate.	Fiscal: Reducing tax reliefs for businesses over £500,000 would raise significant revenue, while only affecting the 22% of business relief claimants with over £500,000 in business assets (based on 2020-21 data).[10] The cost would be greatly skewed towards more valuable businesses, as the majority of business relief goes to a small number of very wealthy estates. In 2020-21, for example, just 68 estates - all with business assets worth over £5 million - collectively owned 57% of the assets benefitting from inheritance tax business relief (£1.8 billion of assets).[11]

9 Currently, the tapering of the residence nil-rate band effectively adds 20% to the marginal rate because, for every £2 above £2m, £1 becomes subject to the 40% rate. The rate effectively becomes 60%. Under our reform both tax-free allowances would be taxed at the 30% rate, because this wealth would be considered as part of the inheritance under £1m (which would be charged at 30% if rate bands were introduced). This would effectively add 15% to the marginal rate for estates over £2m and £4m. This additional 15% would be on top of the 45% rate for estates over £2m. Again, the rate would effectively be 60%.
10 Demos FOI request to HMRC, February 2024
11 Ibid.

			While there is a risk that people increasingly transfer business assets earlier in life to avoid the tax - which could lower the revenue gain - the extent to which this would happen is unclear. There are no suggestions it would wipe out the revenue gain. This is also an existing risk within the system among some businesses, as businesses that mainly deal with securities, stocks or shares, land or buildings, or in making or holding investments do not currently benefit from any business relief. There is also no clear evidence that the cap would lead to the breakup of many businesses, as estates generally have a significant portion of cash with which to pay inheritance tax bills, and measures are in place to allow payment over 10 years. Given that the UK's business relief is more generous than most other OECD countries, capping business relief would bring the UK more in line with international competitors.[12,13] **Public support:** The public feel that local community businesses and family-run businesses should be protected from inheritance tax, but that larger businesses should not receive the same relief. The public also feel that owning business assets should not be a way for wealthy estates to significantly reduce their inheritance tax bill. Capping business relief at £500,000 would protect most local businesses when passed on in inheritance.

12 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/
13 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

Tax all capital gains on inherited assets (+£1.6bn)	If someone buys an asset (like a second home or shares in a business) and later sells it for profit, they pay capital gains tax on the profit they make. However, if an asset is passed on in inheritance, the capital gains accrued up to that point do not count towards capital gains tax when the asset is sold. This is called the 'uplift' in capital gains at death.	Remove the 'uplift' in capital gains tax for inherited assets. When the asset is sold, apply capital gains tax to any gains since the asset was purchased - rather than only gains since the asset was inherited.	**Fiscal:** Removing the capital gains 'uplift' would raise significant revenue. It would also remove the distortive incentive that currently exists for people to hold onto assets until they die - which may be inefficient and undesirable - to avoid being charged capital gains tax. This policy would also bring us in line with many international competitors. Of the 29 OECD countries who have capital gains taxes,[14] 18 apply capital gains tax to the gains on inherited assets.[15,16] Ten of these - including Germany, Italy, and Japan - also have inheritance taxes Public support: The public have mixed opinions on the removal of the capital gains uplift. Some feel that the uplift mainly benefits the wealthy, and would particularly support its removal if offered alongside inheritance tax cuts. Others are concerned about creating additional taxation at death. Yet, if only applying the tax when assets are sold, removing the uplift will not necessarily add to the tax at death. Given the fiscal and economic benefits, removing the uplift is an important reform.

14 Excluding Poland and the Slovak Republic, because data is missing
15 Denmark and Hungary sometimes apply tax to the capital gains on inherited assets, but sometimes offer an uplift
16 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

It is important to note that, in order to protect the revenue gain from the recommended inheritance tax reforms, the government may need to introduce additional reforms that limit the remaining opportunities for the wealthy to reduce their tax bills. The additional taxation placed on businesses and high value estates may lead to an increase in migration, lifetime giving, and use of remaining tax reliefs among wealthy individuals. This could reduce the revenue gain.

The evidence is currently unclear on the extent to which these behavioural responses would occur and the impact on the revenue gain. Yet, if the government deems this to be a significant risk they should consider additional reforms, including:

- **Taxing lifetime gifts:** applying tax to lifetime gifts above, for example, an annual or lifetime allowance.
- **Restricting agricultural relief:** capping tax relief for farmland and buildings in the same way that is recommended for tax relief for business assets.
- **Taxing pensions:** bringing pensions into the scope of inheritance tax.

These reforms would deliver additional revenue in isolation, but would also help protect the revenue gain from wider inheritance tax reforms.

FISCAL IMPACTS

This package of reforms would collectively raise up to **£2.6 billion**, assuming no behavioural change. If we assume that the package consistently increases inheritance tax revenue by the same proportion in coming years, these reforms would lead to an increase in tax revenues of around **£16bn** over the five years of this parliament.[17]

These reforms would make inheritance tax much more progressive, as only estates **over £2m would pay more on average**, while estates **under £2m would pay less inheritance tax on average**, as shown in the table below.

ESTATE VALUE	CURRENT EFFECTIVE INHERITANCE TAX RATE[18]	PERCENTAGE CHANGE IN INHERITANCE TAX DUE TO REFORMS	EFFECTIVE TAX RATE AFTER REFORMS
£325,000-£500,000	0.9%	-23%	0.7%
£500,000-£1m	3.6%	-20%	2.9%
£1m-£2m	14.3%	-3%	13.8%
£2m-£5m	27.8%	+12%	31.0%
Over £5m	19.3%	+47%	28.5%

In terms of the distribution of capital gains tax due to the removal of the uplift, we look at modelling from Advani et al, which considers the removal of the uplift after the introduction of wider reforms to capital gains tax (the introduction of an 'investment allowance' and an

17 This is likely an underestimate as the rising value of inheritances is likely to mean more estates are in the higher rate bands.
18 The amount of inheritance tax paid as a proportion of the amount of inheritance passed on

increase in rates to match those on income).[19] This is reflective of the distribution of removing the capital gains uplift more generally. We see that, with the reformed capital gains tax, 86% of the additional revenue from removing the uplift would come from the wealthiest 10% of estates, while 46% would come from the top 0.1%. If averaging across all estates (including those who don't pay any capital gains) the policy increases the tax per estate by an average of £70 for those in the bottom 50%, but £4,900 for those from the 90th to 99th percentile and £261,440 for those in the top 0.1%.

To illustrate the effect of the recommendations, we can look at hypothetical estates:

ESTATE	WHAT DO THEY OWN?	WHAT DO THEY PAY NOW?	WHAT WOULD THEY PAY WITH THE PROPOSED REFORMS?
A typical estate	A married couple own a £300,000 estate, including an average priced house (£288,000), with no assets beyond a primary home, savings, and standard household items.	They pay no inheritance tax. They pay no capital gains tax.	They pay no inheritance tax. They pay no capital gains tax.
Single person owning average London house outright	Average London house - worth £706,200 - plus additional non-pension wealth of £43,800, taking their full estate to £750,000.	They pay £100,000 inheritance tax. They pay no capital gains tax.	They pay £75,000 inheritance tax. They pay no capital gains tax.
A £5m property-owning estate	A married couple own a £5m estate with a £2m main home, and three additional £1m homes that they rent out (that were each bought for £750,000) and are sold the day after inheritance.	They pay £1.74m in inheritance tax. They pay no capital gains tax.	They pay £2.05m in inheritance tax. They pay £180,000 in capital gains tax.

PUBLIC ATTITUDES: POLLING

To test the reforms with the wider public, we conducted polling with a representative sample of 2,029 people in September 2024, with the polling company Opinium. This showed broad support for all the recommended reforms, and for the package of reforms as a whole:

- **The public are much more in favour of the recommended inheritance tax system than the current system.** Respondents were almost twice as likely (1.8x) to support the recommended system over the current system (51% vs 28%) and were less than half as likely to oppose the recommended system. Preference for the recommended system was consistent across voters of different parties.
- **The public overwhelmingly think the government should prioritise inheritance tax reforms over cutting public spending.** Six in ten think the government should prioritise the reforms, compared to just one in ten thinking they should prioritise either spending cuts (9%) or borrowing (11%). This was highest for Labour voters (at 74%), and lowest for Conservative voters (53%).

19 Advani A, Lonsdale A, Summers A. Reforming Capital Gains Tax: Revenue and Distributional Effects. October 2024. Centre for the Analysis of Taxation. https://centax.org.uk/wp-content/uploads/2024/10/AdvaniLonsdaleSummers2024_CGTReform.pdf

- **The public overwhelmingly thought the reform package was 'fairer for working people'** - with 53% agreeing and just 12% disagreeing. Similar levels agreed that the reforms would show the government 'prioritising the concerns of people like me' (46% agreeing vs 16% disagreeing).
- **The public supported all of the individual policies.** All of the policies received net support (support higher than opposition), with the most popular being the cap business relief (51% support vs 15% oppose), tapering away the minimum allowance for estates over £2m (48% vs 19%), and removing the capital gains tax uplift (43% vs 21%). The introduction of rate bands received less support, but the public were still significantly more likely to support than oppose the policy (39% vs 24%).

PUBLIC ATTITUDES: HOW TO COMMUNICATE THE REFORMS

We ran a series of six two-hour deliberative workshops in May and June 2024 with 27 members of the public. Across the deliberative panel, the public generally felt that inheritance tax reforms should be framed mainly in terms of how they make the system fairer, while some also felt it was important to highlight the contribution of the revenue raised to specific public services. To confirm this, we ran an A/B test on this in polling. We found that framing inheritance tax reforms in the Budget around fairness ('the fairness frame') led to a **net increase in favorability towards the government of 4%.** In contrast, framing them around the contribution of additional revenue to public services ('the hypothecation frame') led to a 6% decrease in favorability. Even the hypothecation frame, however, led to a significantly lower loss in favorability than the 32% decrease from an announcement of public spending cuts.

TABLE 1
IMPACT OF THE RECOMMENDED INHERITANCE TAX REFORMS

POLICY	REVENUE EFFECT AND DYNAMIC EFFECTS (revenue loss due to behavioural changes)	DISTRIBUTIONAL EFFECT	IMPLICATIONS FOR INVESTMENT, PRODUCTIVITY AND BUSINESS BREAKUPS	POLLING
Introduce rate bands	-£410m 30% band: -£740m 45% band: +£330m Unlikely to drive significant dynamic effects.	All estates under £2m - and some estates over £2m - pay less tax.	N/A	39% support vs 24% oppose
Reduce tax-free allowances for the top 1% of estates	+£470m Unlikely to drive significant dynamic effects.	Only estates over £2m pay more, and generally only estates over £2.35m	N/A	48% support vs 19% oppose
Cap inheritance tax business relief	+£970m Potential for some dynamic effects, particularly if people begin gifing businesses earlier in life or making greater use of agricultural relief. Taxes on lifetime gifts and restricting agricultural relief could help mitigate this.	Affects only one in every 250 estates, and only those with business assets over £500,000.	No clear evidence that there will be a significant impact in terms of breaking up businesses.	51% support vs 15% oppose
Tax all capital gains on inherited assets	+£1.6bn Potential for some dynamic effects due to migration, if people leave the UK to realise gains on assets in a country with lower capital gains tax. This could be mitigated by applying capital gains tax to unrealised gains when people leave the country.	Additional revenue would largely be gained from the most valuable estates. If introduced alongside the introduction of an 'investment allowance' and an increase in rates to match those on income, 86% of the additional revenue would come from the wealthiest 10% of estates, and 46% would come from the top 0.1%.	Removes distortionary effects of the tax system whereby people are incentivised to hold on to assets until death and to acquire income as capital gains rather than other forms of income, both of which can be inefficient.	51% support vs 15% oppose

INTRODUCTION

POLICY CONTEXT

The new Labour government has its first budget on 30th October, widely expected to be a defining moment for this Parliament. Having identified a '£22bn fiscal hole' in the public finances, the Chancellor has signalled that there will be a mixture of spending cuts and tax rises to address it.[20] How exactly this is done will have critical economic and political impacts in the coming years.

The context for the Budget makes the challenge even harder. After a decade of stagnant real incomes and crumbling public services, the economy is in a poor state and the public want positive change. While the Budget will inevitably impose some short-term costs on parts of the public, the immediate challenge for the government is this: how to focus the costs on those who can afford it while also minimising long-term harm - particularly by further damaging public services or undermining efforts to grow the economy. In the long-term another challenge presents itself. Beyond filling the £22bn fiscal hole, the government must also find the funding needed to invest in Britain's future - in skills, infrastructure, and a reformed public service model.

In the face of this challenge, the government has already closed down many potential options. Its pledge not to raise taxes 'on working people', alongside specific promises to not increase income tax, National Insurance or VAT, means it is expected to instead look at taxes on wealth, income from wealth and business. The government will need to identify reforms to these taxes that will unlock significant public funds, minimise political backlash and potentially support the government's long-term objectives such as economic growth or social mobility.

Inheritance tax is fertile ground for such reforms. For one, inheritance tax is overly complex, poorly understood by the public, and the wealthiest estates pay lower rates than others. Well-designed reforms could therefore make it simpler, fairer and more transparent at the same time. But reform could also deliver significant public funds at little cost. As a tax that is paid by fewer than one in every 20 estates, and with almost half paid by the wealthiest 1% of estates, reforms will affect very few people, and only those with significant wealth.

THE *UNLOCKING INHERITANCE* PROGRAMME

This report is the culmination of Demos's multi-year *Unlocking Inheritance* programme looking at inheritance and its taxation. The first stage of this project highlighted the challenges that Britain will face as we enter what Demos call the UK's '*new age of inheritance*'.[21] With the value of inheritance passed on annually doubling roughly every 20 years - now reaching over £100bn - the UK will see a growing gap between the 'will-haves' (those inheriting a large amount of

20 Hooker L. 'Chancellor warns hard decisions ahead in Budget'. BBC. 11 September 2024. https://www.bbc.co.uk/news/articles/c2045wpddy2o
21 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/anew-age-of-inheritance-what-does-it-mean-for-the-uk

wealth) and the 'won't-haves' (those without large inheritances). This divide will closely align with existing economic and social divides across income, ethnicity, region, and educational background. The will-haves will benefit from greater upward social mobility, access to homeownership and financial security, while many of the won't-haves will face significant barriers in enjoying these benefits. Meanwhile, the UK's system for taxing inheritance is not designed to respond to these changes.

The first stage of our project also showed that attitudes to inheritance tax are more nuanced than suggested in widespread assumptions that inheritance tax is 'Britain's most hated tax'.[22] It's true there is significant opposition to inheritance tax when considered in the abstract. But 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.[23,24]

Despite having more support for inheritance tax upon considering the trade-offs, it is clear that public concerns about the tax are widespread - as Demos explored in 2023 through a series of 12 focus groups.[25] We found that the public 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.

Based on our research on the problems facing inheritance tax in the first stage of this programme, we have explored how to fix inheritance tax in the second stage. Our first paper of the second stage, *The Future of Inheritance Tax*, laid out options for unlocking funds from inheritance tax, learning lessons from specific countries who do it better than the UK.[26] This analysis indicated that the UK could potentially increase revenue, progressivity, and public support simultaneously. It showed that countries such as France, South Korea, and Japan have systems that raise more as a percentage of all inheritance passed on, while ensuring the wealthiest inheritances are charged higher rates. Features of these countries that stood out were their progressive rates - with top rates rising higher than the UK's 40% - and more restricted tax reliefs for businesses. These lessons informed our subsequent research.

RESEARCH OBJECTIVE AND METHODOLOGY

In this paper, we offer the path to unlock needed revenue from inheritance tax, based on extensive public attitudes research, economic analysis, and discussion with experts. From 22nd May to 6th June 2024, we ran an deliberative exercise on inheritance reform, bringing together a representative sample of 27 members of the public in six two-hour sessions, to understand how they would choose to reform inheritance tax while maintaining or increasing revenue. The focus exclusively on reforms that collectively maintained or raised revenue was informed by the current political context, in which politicians are looking for ways to raise revenue and in which inheritance tax cut is not on the cards.

22 Poulter R. Inheritance tax poll finds 90% want 'Britain's Most Hated Levy' slashed in half. The Express. 13 March 2024. https://www.express.co.uk/finance/personalfinance/1877009/High-earners-want-inheritance-tax-halved
23 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
24 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/
25 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/
26 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/

The panel discussed their priorities for reform based on: (1) a neutral description of the current design of inheritance tax and possible reforms, (2) an outline of the impacts, where possible - particularly on the revenue, the number of taxpayers, and the distribution - based on government data or modelling by reliable sources, and (3) where relevant, the key arguments proposed for and against certain policies. A more detailed methodology can be found in Annex 3.

We used the priorities outlined in these sessions to inform a shortlist of policy packages. We ran economic modelling on a range of policy packages that aligned with the public's priorities, looking at the revenue raised and the distributional impact. We also discussed the policies with various experts to dig into the administrative issues surrounding each policy. We have designed a package of reforms that balances revenue gain, alignment with the public's priorities in the deliberation, and administrative feasibility.

Importantly, we are not claiming to have designed a holistic package of reforms that completely fixes inheritance tax and all of its problems. There are many technical challenges with inheritance tax, such as the exclusion of gifts 'out of normal expenditure', the tapering of inheritance tax for gifts further away from death, and the application of business relief for woodlands. These are issues that should be fixed, but they are neither a big concern for the public nor for the revenue of inheritance tax. Our focus is on how reforms can raise revenue while making inheritance tax more popular.

SECTION 1
THE INHERITANCE TAX REFORM PACKAGE

This section outlines four recommendations for reforming inheritance tax to unlock revenue in a fair way. For each, we explain the recommendation in terms of the economic rationale and the public support for the policy change.

INTRODUCE RATE BANDS

RECOMMENDATION	CURRENT SYSTEM	REFORM	REVENUE
Introduce rate bands	Inheritance tax is charged at a flat rate of 40% above the tax-free allowance (which is at least £325,000 per estate, but can increase to £500,000 if the estate includes a house passed to children or grandchildren, and then up to £1m as married couple can combine their allowances)	Introduce rate bands at: • 30% for any inheritance under £1m • 40% for inheritance between £1m and £2m • 45% for inheritance over £2m	-£410m

Introducing rate bands is critical for boosting the public support for inheritance - as this was one of the most broadly supported reforms in our public deliberation. It also supports key economic goals around making inheritance tax more progressive and Labour's stated objective to cut taxes for working people where possible.[27]

Public support

The introduction of rate bands was the top policy priority for most of our deliberative panel, and supported almost universally. While a small minority were more supportive of a flat rate on the basis of simplicity - because it could help the public understand the system better - most others felt that it was deeply unfair that everyone should pay the same rate, no matter how wealthy, and that the jump from paying 0% to 40% was too sudden.

> *It seems like the zero to 40% seems like a very big jump, whereas if it was smaller increases going up to 40 or a bigger percentage, whatever that may be, I feel like that would potentially be a fairer system.*
>
> **- Millennial homeowner, was undecided on 2024 vote[28]**
>
> *I think we all agree that 40% for every single person in the country is ridiculous. It makes no sense.*
>
> **- Gen Z living with parents, intended to vote Green in 2024**

On the top rate, many people felt it should be increased. Many felt that 45% was fair as a top rate, while some thought it could go even higher for the most valuable inheritances, for example to 50%. People felt that this was an important reform to make to raise revenue.

> *I think that anything like £2 million or above [should be] 45% to 50%.*
>
> **- Millennial homeowner, intended to vote Labour in 2024**
>
> *It's important you keep the revenue the same or more. I think if we get too many low rates, the overall take can go down…. There needs to be more bands higher than 40% than at the moment. You need to have some 50s and 55 in there to make it work out, or even 60s.*
>
> **- Boomer renter, intended to vote Labour in 2024**

27 Forrest A. Starmer suggests no tax cuts for two years under Labour without economic growth. The Independent. 5 January 2024. https://www.independent.co.uk/news/uk/politics/starmer-labour-tax-cuts-tories-election-b2473717.html
28 For each panellist we quote, we provide details on their generation, housing tensure, and voting intention as of May 2024.

On the starting rate, and when people should start paying it, there was disagreement about what approach should be taken. There were broadly two groups of thought:

1. Those who preferred a higher threshold (e.g. keep it the same) and a higher starting rate (e.g. 20%)
2. Those who preferred a lower threshold (e.g. at £100,000 or £200,000) and a lower starting rate (e.g. under 10%)

The first group generally favoured the simplicity of having fewer rates, often mirroring the three rates of income tax (20%, 40% and 45%). This group also felt that the threshold should therefore be higher to protect 'average people', such as those who just own a home rather than second properties or financial assets.

> *We agree about keeping it close to the income tax bands; say 20% for the minimum threshold, 40% above that, and then 45% for higher rate tax.*
>
> **- Boomer homeowner, was undecided on 2024 vote**

The second group - those preferring more bands and a lower threshold - generally were attracted to a very low starting rate (often below 5%) to ease people into the tax. They felt such small increments meant people would not feel hit by a significant jump in the tax, but that there would be the benefit of more people feeling they are contributing to public funds through inheritance tax, and in turn becoming more familiar with the tax.

> *I think everyone should pay their way. Everyone uses public service in some shape or form. If you are in the position where you do inherit, then it's money you didn't have before… So, the example of 3% of 100 grand seems fairly reasonable in that situation. If [inheritance tax] is paid by more people, it's probably understood by more people, because people talk about it more, and it would be more of a shared thing that people will want to know about.*
>
> **- Millennial homeowner, intended to vote Labour in 2024**

These different views have to be balanced against the strong desire among the public to ease the administrative burden from inheritance tax. Lowering the threshold to, for example, £100,000/£200,000 would mean a significantly higher number of people having to undertake thorough valuations of estates in order to understand if inheritance tax is liable, and how much.[29] The views of the first group - to retain the same allowances and simply introduce three rate bands - does not face the same problem, and therefore represents the more attractive option. Nevertheless, it is important to note where exactly the rate bands lie (both the rates and the amounts they kick in at) could be adapted by the government to meet their needs for revenue and administrative ease.

29 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/

Fiscal benefits

Rate bands would make inheritance tax more progressive, and the loss in revenue due to the rate cut for lower value inheritances could be partly offset by the gain due to the rate increase for higher value inheritances.

This would also bring the UK more in line to international systems. Most OECD countries have rate bands - with the UK being one of only seven to only apply flat rates.[30] France, Japan and South Korea - who all raise more than the UK in a more progressive way (i.e. the wealthiest estates pay the highest effective rates) - all have rate bands with top rates higher than 40%.[31] The high taxation on the most valuable estates provides large contributions to revenue in these countries.

The consideration of where to put the rate bands required consideration of the different costs and benefits. For example, doing a rate cut to 20% for inheritance under £1m - as opposed to a cut to 30% - would cost an additional £740m. We felt that the cut to 30% best balanced the public's priority for a rate cut with the need to retain revenue.

REDUCE TAX-FREE ALLOWANCES FOR THE TOP 1% OF ESTATES

RECOMMENDATION	CURRENT SYSTEM	REFORM	REVENUE
Reduce the tax-free allowance for the top 1% of estates[32,33]	The residence nil-rate band (the additional allowance of up to £175,000 for estates passing on homes to children or grandchildren) is tapered away by £1 for every £2 that an estate is worth over £2m. Yet, this does not happen for the nil-rate band (the minimum allowance for all estates).	Taper away the nil-rate band (minimum tax-free allowance) for estates over £2m, in the same way that is currently done for the residence nil-rate band. This would mean reducing the full allowance (the sum of the nil-rate band and residence nil-rate band) by £1 for every £2 above £2m.	+£470m

Tapering away the minimum allowance would more than recover the costs of the introduction of rate bands (with the two policies together delivering a £60m surplus), and only raise the tax on the most valuable estates. Meanwhile, the top marginal rate that estates effectively pay would not be increased, remaining at 60%. This policy also aligns with the public's priorities to increase tax on higher value inheritances, with much of the public supporting top rates above 45%.

30 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
31 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/
32 The top 1% of estates are estimated to be valued at £2.1m. The tapering of the nil-rate band may therefore affect some estates just below the 99th percentile. However, the vast majority of estates at the 99th percentile include homes worth over £50,000 given to children or grandchildren, meaning they benefit from at least £50,000 of the residence nil-rate band. This means the vast majority of estates at the 99th percentile are already paying the effective 60% marginal rate for all inheritance over £2m. Extending the tapering to the nil-rate band means this 60% marginal rate would be extended for inheritance up to £4m, but this change would not affect most estates worth between £2m and £2.1m.
33 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

Fiscal benefits

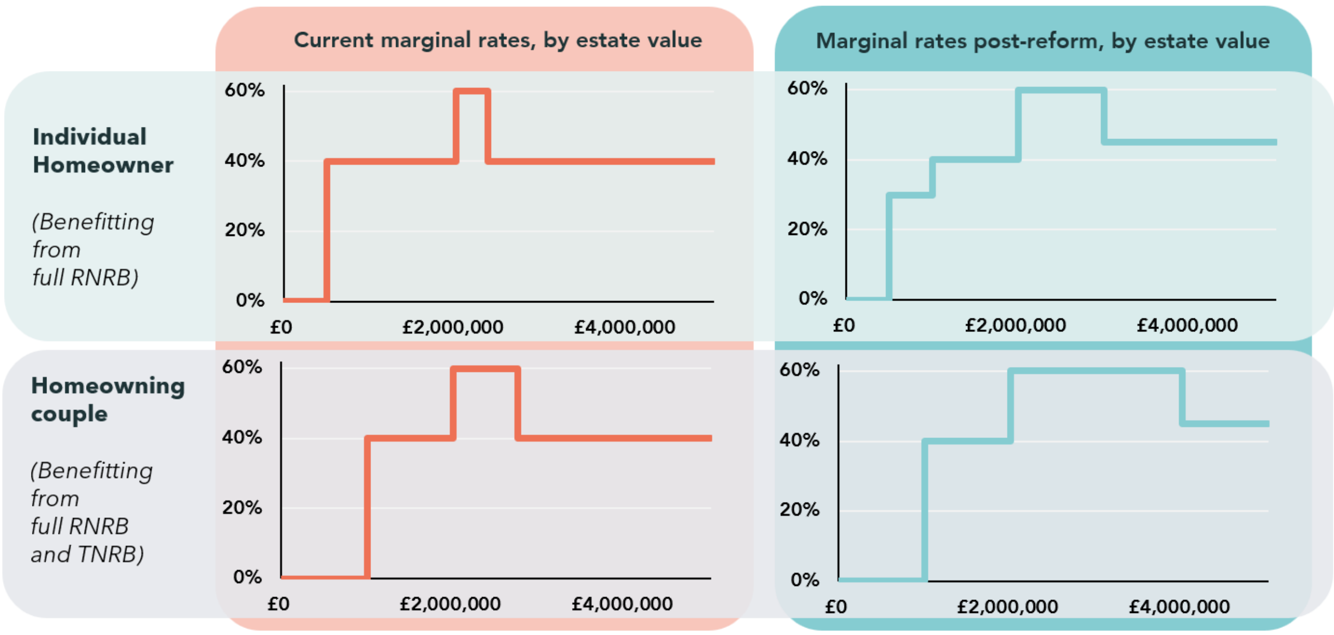
Tapering the nil-rate band away would replicate policies that already exist within inheritance tax and other taxes. The current inheritance tax regime sees the marginal rate increase from 0% to 40% as soon as the taxable value of an estate (excluding any exempt assets, for example) is higher than the tax-free allowances (the combination of nil-rate band, residence nil-rate band, and transferable nil-rate band). This 40% rate applies for all inheritance above this amount. On top of this, the tapering of the residence nil-rate band effectively adds 20% to the marginal rate because, for every £2 above £2m, £1 becomes subject to the 40% rate. As shown in Figure X below, the rate effectively becomes 60% for some inheritance over £2m. A similar policy exists for the personal allowance on income tax (for income between £100,000 and £125,140) and for the annual allowance for pension contributions.[34]

Our reforms would mean that, rather than just the £175,000 of residence nil-rate band being liable to inheritance tax, the £325,000 nil-rate band would also be tapered. This means single people may have up to £500,000 that could be tapered away, while married couples may have up to £1m that could be tapered away. This larger amount would be tapered away at the same rate as currently (£1 for every £2 over £2m).

The recommendation to introduce rate bands outlined above means all inheritance under £1m is charged a 30%. When tapering begins, the allowances would therefore begin being taxed at the 30% rate, because this wealth would be considered as part of the inheritance under £1m. As shown in Chart 1 - which illustrates the difference between the current system and the recommended system - this would effectively add 15% to the marginal rate for inheritance over £2m (and up to £4m, depending on the allowances). This additional 15% would be on top of the 45% rate for estates over £2m. Again, the rate would effectively be 60%.

CHART 1

Inheritance tax marginal rates for homeowning estates benefitting from the full residence nil-rate band



34 HM Revenue & Customs. Work out your reduced (tapered) annual allowance. Gov.UK. 27 September 2016. https://www.gov.uk/guidance/pension-schemes-work-out-your-tapered-annual-allowance

While it is not ideal to have a temporary jump in the marginal rate for a tax, removing the tapering would mean a loss of revenue, and it would be politically challenging to swap it with a rate increase to gain that revenue back. Moreover, a temporary rate increase for inheritance tax is much less harmful than for income tax, for example. While people may suppress their income to avoid higher marginal rates on income tax, they are likely to have less flexibility around the specific value of their estate, given much of the value may consist in illiquid assets (assets that are hard to sell) for which the current value is uncertain (like for homes). And importantly, the recommended reforms do not increase the top marginal rate, but instead extend it to cover more inheritance. The reform to increase the top rate to 45% also smooths the fall in the marginal rate after tapering ends (which falls from 60% to 45%, rather than from 60% to 40%).

Public support

Our panel generally felt that estates over £2m were particularly large, with some thinking they should face higher rates than 45%. Removing the allowance would be consistent with this view. While an increase in the marginal rate that estates over £2 effectively pay from 60% to 65% would have made some people feel uncomfortable, retaining the rate at 60% would mitigate these concerns.

CAP INHERITANCE TAX BUSINESS RELIEF

RECOMMENDATION	CURRENT SYSTEM	REFORM	REVENUE
Cap inheritance tax business relief	Business assets - excluding businesses that mainly deal with securities, stocks or shares, land or buildings, or investments - can benefit from tax relief. This includes 100% relief for an owned business or shares in an unlisted company (e.g. shares on the Alternative Investment Market), and 50% relief for shares controlling over half of a listed company.	Cap business relief, so that relief is only available on the first £500,000 of business assets in an estate.	+£970m

Capping business relief policy was decided equally based on the public's priorities for inheritance tax and the economic impacts, alongside consideration of the potential economic risks. This policy has also been recommended by the Institute for Fiscal Studies (IFS) and Resolution Foundation.[35,36] Given that the UK's business relief is more generous than most other OECD countries, it would also bring the UK more in line with international competitors.[37,38]

35 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
36 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
37 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/
38 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en

Fiscal benefits

Reducing tax reliefs for businesses over £500,000 would raise significant revenue, valued at £970m before accounting for behavioural changes. This cap would only affect the 22% of business relief claimants with over £500,000 in business assets (based on data from 2020-21) and because the majority of business relief goes to a small number of very wealthy estates, the cost would be greatly skewed towards more valuable businesses.[39] In 2020-21, for example, just 68 estates - all with business assets worth over £5 million - collectively owned 57% of the assets benefitted from business relief (£1.8 billion of assets).[40]

The cap would not bring many new estates into IHT. As noted by the IFS, capping business relief would only increase the proportion of people paying any inheritance tax by around 0.1% of deaths "because most business assets are held by those whose estates would already be large enough to attract inheritance tax".[41]

There is a risk that the cap would cause people to increase the transfer of business assets earlier in life in order to avoid the tax. This could potentially lower the revenue gain, but there is no clear quantitative evidence on the extent to which this would happen in this case. There are no suggestions it would wholly wipe out the revenue gain. We discuss this further in Section 1.1.

Another concern expressed about capping business relief regards the breakup of businesses.[42,43] If businesses do not have the cash to pay inheritance tax bills, they may be forced to sell off parts of the business to pay the bills. This may be a problem by creating three potential risks:

1. Families may lose sole control of a business (to the extent that we value family businesses)
2. UK businesses may sell their assets to investors abroad (reducing UK capital ownership)
3. Productive assets may be broken up (which is the reason given by the Chief Secretary to the Treasury Joel Barnett in 1976 when defending why business relief would be extended to unlisted shares), although it is unclear to what extent businesses are worth more if they are owned by one person rather than many people.[44]

Yet, it is not clear that people would be forced to sell off parts of their businesses. First, the current system already has measures in place to prevent this; people can pay inheritance tax bills for certain business assets (those that do not benefit from business relief but are deemed to be relatively illiquid (i.e. harder to sell) over a 10-year period, with interest.[45] This allows businesses to spread the costs of inheritance tax bills over time and potentially remove the need to sell off parts of the businesses to pay the bills. This same measure would apply to business assets which become liable to inheritance tax due to the cap at £500,000.

The evidence that inheritance tax bills would require people to sell off parts of their business is also unclear. On average, of estates worth over £500,000, 19% of their value is made up of cash.[46] Estates over £1m also contain 19% cash on average, while estates over £2m contain 11% cash. All of this cash, minus any debts to pay, can be directly used to pay the inheritance tax bill,

39 Demos FOI request to HMRC
40 Agyemang E. Fresh calls for action on IHT breaks after 68 estates shelter £1.8bn in assets. Financial Times. 2 Jun 2024. https://www.ft.com/content/637c1151-04c5-49d6-9d76-ed1f8cdf9435
41 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
42 Poulter R. Death tax raid on family businesses 'could force them to shut'. The Express. 25 July 2024. https://www.express.co.uk/finance/personalfinance/1927872/inheritance-tax-family-businesses
43 O'Dwyer M. UK family-owned businesses urge Labour to keep inheritance tax relief. Financial Times. 25 July 2024. https://www.ft.com/content/bdccec3b-b868-4137-b51d-28e0b02746b9
44 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
45 Gov.UK. Pay your Inheritance Tax bill. (no date). https://www.gov.uk/paying-inheritance-tax/yearly-instalments
46 HM Revenue and Customs. Inheritance Tax liabilities statistics. 31 July 2024. https://www.gov.uk/government/statistics/inheritance-tax-liabilities-statistics

as banks can provide cash from an estate directly to pay an inheritance tax bill.[47] If this does not cover the entire bill, any cash holdings of the recipient can be used to fund the remaining bill - the value of which would then be recovered after receiving the inherited assets. If this still did not cover the inheritance tax bill, the assets within the estate could be acquired through a 'grant on credit', and liquid assets (easy-to-sell assets like listed shares) could be sold to help cover remaining costs. Any remaining amount of inheritance tax to pay after this could then be paid over a 10 year period. Businesses could also borrow to pay the bill, and the tax only applies to larger businesses (worth over £500,000) which are expected to face lower barriers to accessing credit.[48] These various measures in place should reduce the need for people to sell off parts of their business.

A study on German businesses - where there is a very strong family business culture - corroborates this point, finding that estates facing inheritance tax bills generally had a significant amount of other wealth with which to pay the tax bills.[49] Similarly, the many countries that have much more restricted business relief are a testament that capping it does not create an unhealthy business environment. In South Korea, for example, inheritance tax relief is only available to small and medium-sized enterprises run by the deceased for at least 10 years.[50] These restrictions mean that, in 2020, the heirs to the country's top 25 companies faced a combined inheritance tax bill of $21 billion.[51] Nevertheless, South Korea's investment rate is significantly higher than the UK's (32% vs 18%), suggesting a healthy business environment.[52]

Public support

Following the deliberation, our panel generally felt it was good to offer exemptions for smaller businesses - to protect businesses that would struggle to pay and which may have to close down if facing large tax bills - but did not think the same protections should be offered for larger businesses. The panel felt larger businesses would be able to pay the tax and, given their high value and large profits, should be contributing more to the tax system already.

We explained that estates only benefited from 100% relief if they fully or partly owned a private business (not sold on a stock exchange) or if they owned shares in an 'unlisted company' (those sold on markets like the AIM), and could benefit from 50% relief if owning a majority share in a 'listed business' (sold on a main stock exchange). While there was some engagement with this distinction, people generally saw the key distinction as that between businesses that are local - e.g. 'a small business on the high street, like a hair salon or a shop' or 'someone who makes t-shirts from their own house and sells them online' - vs those that are national/multinationals (e.g. (e.g. 'Mcvities' or 'Amazon'). It is important to note that many national or multinational companies are listed companies without anyone owning over 50% of the voting rights - meaning the shares would not be liable to inheritance tax relief. Nevertheless, the general sentiment was that businesses in general should pay more, with protections for local businesses.

47 Gov.UK. Pay your Inheritance Tax bill. (no date). https://www.gov.uk/paying-inheritance-tax/deceaseds-bank-account
48 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
49 Houben H and Maiterth R. Endangering of Businesses by the German Inheritance Tax? An Empirical Analysis. German Academic Association of Business Research. 2011. https://www.econstor.eu/bitstream/10419/103696/1/2976.pdf
50 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/
51 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
52 World Bank Group. Gross fixed capital formation (% of GDP) - OECD members. 2022. https://data.worldbank.org/indicator/NE.GDI.FTOT.ZS?end=2022&locations=OE&start=2022&view=bar

I do think [business relief] is a bit too generous. But again, when we say businesses, you could be talking about someone who makes T-shirts from their own house and sells them online. That's not comparable to a business like Amazon, for example. They're not even in the same ballpark.

- Gen Z renter, intended to vote Labour in 2024

I think it needs to differentiate between the small businesses, like they can have their exemption, but big businesses don't need it.

- Millennial renter, intended to vote Labour in 2024

Many panellists also expressed concern about the business exemption being used by wealthy estates to reduce their tax bills.

I'd question why any of these business exemptions or pension exemptions even exist, because it's a way of legal tax avoidance for the extremely wealthy.

- Boomer homeowner, was undecided for 2024 vote

This has recently received attention in discussions of whether the relief should continue being applied to shares in the Alternative Investment Market (AIM) - a market in the London Stock Exchange for companies that are less developed.[53] While these companies are generally smaller than those on the main market, companies on the AIM were worth £86m on average in 2023 (by market capitalisation - a measure of a company's expected value by share price).[54] Some of our panellist were concerned about this use of business relief.

TAX ALL CAPITAL GAINS ON INHERITED ASSETS

RECOMMENDATION	CURRENT SYSTEM	REFORM	REVENUE
Tax all capital gains on inherited assets	If someone buys an asset (like a second home or shares in a business) and later sells it for profit, they pay capital gains tax on the profit they make. However, if an asset is passed on in inheritance, the capital gains accrued up to that point do not count towards capital gains tax when the asset is sold. This is called the 'uplift' in capital gains at death.	Remove the 'uplift' in capital gains tax for inherited assets. When the asset is sold, apply capital gains tax to any gains since the asset was purchased - rather than only gains since the asset was inherited.	+1.6bn

53 Advani A and Sturrock D. Raising revenue from closing inheritance tax loopholes. 18 April 2024. https://ifs.org.uk/articles/raising-revenueclosing-inheritance-tax-loopholes
54 Grimster R. The Alternative Investment Market (AIM). Price Bailey Chartered Accountants. (no date). https://www.pricebailey.co.uk/blog/alternative-investment-market/

Removing the capital gains uplift would provide a significant revenue boost of £1.6bn, while also removing distortive incentives which encourage people to hold on to assets until they die, even if that's longer than they otherwise want to or would be economically optimal. It appeals to the public's preferences for taxation on the profits of the wealthy, and has been recommended by the IFS, Resolution Foundation, the Office for Tax Simplification, and the APPG for Inheritance & Intergenerational Fairness.[55,56,57,58]

Of the 29 OECD countries who have capital gains taxes (excluding Poland and the Slovak Republic, because data is missing), only 11 always uplift capital gains at death (while Denmark and Hungary sometimes do and sometimes do not).[59] Of the 18 countries who apply tax to the capital gains on inherited assets, 15 treat capital gain as being passed over to inheritors (and the tax applies from when the asset was purchased).[60] Of these, eight - including Germany, Italy, and Japan - also tax inheritances, while seven do not. Three countries - Denmark, Canada, and Hungary apply capital gains at death, whether or not the asset is sold.

Fiscal benefits

Removing the capital gains 'uplift' would provide a significant boost to revenue, at £1.6bn, assuming no behavioural change. This is based on the assumption that the policy would apply to all assets sold after that point, including those that had already been passed on in inheritance but not yet sold. If only applying the policy to assets inherited after that point (and excluding those that had been inherited but not yet sold), the additional revenue would start lower than £1.6bn but increase to that figure over time (adjusted for increases in wealth). The additional revenue would primarily be paid by the wealthiest estates, as discussed in more detail in Section 2.3.

Removing the 'uplift' would help remove the distortion of people's decisions that it currently creates. The capital gains uplift currently incentivises people to hold onto assets until death if they have appreciated in value. If someone sells a business the day before death, they are liable to capital gains, but if they pass this asset on in inheritance and the recipient sells it the following day, the uplift means no capital gains tax is charged. This means people may hold onto assets for tax-reasons for longer than they may otherwise desire, and longer than may be economically optimal. For example, people may hold on to business assets which would be better owned by someone else, or hold on to a second home despite otherwise wanting to sell it and free it up to the market. The Office for Tax Simplification, in its review of inheritance tax, noted that it "has heard anecdotal evidence of businesses and farms suffering because the owner has remained in charge despite being too old to devote themselves to the business."[61]

The capital gains uplift also creates other dictionary effects. The more beneficial tax treatment of capital gains relative to other forms of income (e.g. the significantly lower rates than income tax) creates distortions whereby people are incentivised to work in a way that allows them to be paid in capital gains rather than normal income. For example, as Advani et al show, there is a widespread practice whereby people set up personal service companies - offering consultancy or professional support, for example - through which they get paid, and later extract the income

55 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
56 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
57 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
58 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
59 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
60 Some countries have different systems in place for different asset types and so are counted twice.
61 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

as capital gains by liquidating the company.[62] Yet, these companies "are typically not designed to ever grow", which "contributes to the regularly diagnosed 'long tail' of unproductive firms in the UK".[63] The capital gains uplift expands the incentive to work in this way. Removing the uplift could therefore help deliver a boost to productivity through reducing this distortive incentive.

If removing the capital gains uplift, there are two key things to consider: when will the capital gains tax be charged, and how will inflationary gains (gains that are lower than the rate of inflation in assets or across the economy) be treated. On the former question, there are broadly two options:

1. Apply tax when the asset is sold and the gain is realised (meaning the profit is made in cash terms).
2. Apply tax at death, whether or not the gain is realised.

There are economic and administrative risks with applying tax when the asset is sold, as outlined by Advani and Sturrock:[64]

- It is tricky to ensure that inheritance tax is not paid on the part of the accrued gain that will be paid in capital gains tax.
- It requires the inheritor to keep records of the original cost of the asset, potentially for many years.
- There is more scope for avoidance, as an inheritor could leave the UK for a few years and then realise the gain free of tax.

However, there is a critical risk to applying the tax at death. Given that people may not sell the asset around the time of death, they would not have the cash available to pay the capital gains tax charge at that time. Given the public's concern about people having to take out loans, sell family homes or break up businesses to pay inheritance tax bills, creating the same issue for capital gains tax bills at death would be challenging.[65]

If choosing this latter option, a mechanism should be developed to ensure that inheritance tax is not paid on the part of the accrued gain that will be paid in capital gains tax. The Office for Tax Simplification, when recommending this policy, outlines a way to address this: "the executors calculate notional capital gains on death as part of or alongside their Inheritance Tax calculations."[66] Effectively, estates would receive a discount on their inheritance tax bill, which would be equivalent to the amount of capital gains tax they would have paid if they had sold the asset just before. The full capital gains tax bill would then be paid when the asset is sold.

The second question to answer if removing the capital gains uplift is around the treatment of gains that just reflect either inflation or the 'risk free' rate of return on capital. The 'risk free' rate of return is the return that an investor could get without putting their capital at any risk (e.g. if putting their capital into government bonds). This is seen as equivalent to compensation for the opportunity cost (the foregone benefit) of saving wealth to spend later rather than spending it now. Currently capital gains tax takes neither inflation nor the 'risk free' rate of return into account.

62 Advani A et al. The productivity cost of low Capital Gains Tax rates. Centre for the Analysis of Taxation. October 2024. https://centax.org.uk/wp-content/uploads/2024/10/AdvaniHughsonInkleyLonsdaleSummers2024_ProductivityCostOfLowCapitalGainsTaxRates.pdf
63 Advani A et al. The productivity cost of low Capital Gains Tax rates. Centre for the Analysis of Taxation. October 2024. https://centax.org.uk/wp-content/uploads/2024/10/AdvaniHughsonInkleyLonsdaleSummers2024_ProductivityCostOfLowCapitalGainsTaxRates.pdf
64 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
65 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/
66 Office for Tax Simplification. Capital Gains Tax review – first report: Simplifying by design. November 2020. https://assets.publishing.service.gov.uk/media/5fae48d78fa8f50544c046a1/Capital_Gains_Tax_stage_1_report_-_Nov_2020_-_web_copy.pdf

On inflationary gains, up until 1998, capital gains tax was 'indexed' to inflation, meaning only real-terms gains were taxed.[67] 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'.[68] 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 - and capital gains tax may unfairly tax those who have acquired gains that have arisen from inflation, while undertaking those who have significant real terms gains (due to its low rates).

On the 'risk free' rate of return on capital, to the extent these are taxed, the compensation that people get for saving rather than spending wealth is taxed. People would therefore be better off spending rather than saving wealth.[69] Similarly, the 'risk free' rate of return aligns with the cost of borrowing. Because capital gains tax does not take this into account, if borrowing costs rise, people who have borrowed to fund their capital will see less profitable gains bu their tax charge will remain the same. This may provide an additional hindrance to investment when the cost of borrowing rises.

Advani et al recommend introducing an 'investment allowance' for capital gains tax, to ensure that people are not taxed on gains that just reflect either inflation or the 'risk free' rate of return.[70] While we would support this measure, if introduced in isolation, it would mean even lower effective rates of capital gains tax than currently exist, increasing the distortionary incentives that lower effective capital gains tax rates create. Given that the rates of capital gains tax were originally cut because the inflation indexation was cut, if reintroducing an allowance for either inflation or the 'risk free' rate of return, it would be appropriate to simultaneously increase the rates of capital gains tax, as has been recommended by the Resolution Foundation, Institute for Public Policy Research, IFS and Centre for the Analysis of Taxation.[71,72,73,74] A thorough evaluation of these broader reforms to capital gains tax rates is beyond the scope of this report, so while we recognise such reforms may be important, the modelling in this report is based on the retention of current capital gains tax rates and the lack of any investment allowance.

67 Thornley H. The downs and ups of capital gains tax. AccountingWEB. 16 February 2024. https://www.accountingweb.co.uk/tax/personaltax/the-downs-and-ups-of-capital-gains-tax
68 Steely A. Capital gains tax : background history. House of Commons Library. 2 June 2010. https://researchbriefings.files.parliament.uk/documents/SN00860/SN00860.pdf
69 Advani A, Lonsdale A, Summers A. Reforming Capital Gains Tax: Revenue and Distributional Effects. October 2024. Centre for the Analysis of Taxation. https://centax.org.uk/wp-content/uploads/2024/10/AdvaniLonsdaleSummers2024_CGTReform.pdf
70 Ibid.
71 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
72 Institute for Public Policy Research. The UK's tax system is a significant barrier to ending regional wealth inequality, new research argues. 29 Aug 2024. https://www.ippr.org/media-office/the-uks-tax-system-a-significant-barrier-to-ending-regional-wealth-inequality-new-research-argues
73 Delestre I. Options for increasing taxes. Institute for Fiscal Studies. 21 September 2024. https://ifs.org.uk/articles/options-increasing-taxes
74 Advani A, Lonsdale A, Summers A. Reforming Capital Gains Tax: Revenue and Distributional Effects. October 2024. Centre for the Analysis of Taxation. https://centax.org.uk/wp-content/uploads/2024/10/AdvaniLonsdaleSummers2024_CGTReform.pdf

Public priorities

The public have mixed opinions on the removal of the capital gains uplift. Some of our panellists expressed significant concern about creating additional taxation at death, feeling that this added to the current problem of double taxation that they felt inheritance created.

[Removing the capital gais uplift] seems to run the risk that you could end up being taxed twice, so once on the capital gains of it, and once on the inheritance tax.

- Gen X homeowner, intended to vote Labour in 2024

It could even be triple taxation, because you've saved your money from the income that you've earned… you've paid tax on the income that you pay the mortgage with, then you get capital gain tax on your profit, and then you get inheritance tax on the asset.

- Gen X homeowner, intended to vote Conservative in 2024

On the other hand, some in our panel felt that, given how capital gains are primarily skewed towards the wealthy, removing the uplift would mainly mean more taxes paid by the wealthiest. These panellists therefore felt less concerned about the policy.

[Removing the capital gains uplift] is going to increase the revenue for the country where it should be coming from: the people who've got the money.

- Boomer homeowner, intended to vote Labour 2024

It's only going to be the really rich that are going to end up paying it, so I don't mind too much.

- Gen X homeowner, intended to vote Labour 2024

Other panellists also felt that profits on assets should be taxed regardless of whether the assets were inherited, with some pointing out that taxing these profits could help reduce income inequality (given that capital gains are generally taxed at lower rates than other income).

I think [inherited capital gains] should be taxed the same as normal capital gains tax, and my reasoning behind that is it doesn't tax a main home… [and] if you bought something for £13,000 and you're passing it on, and it's now worth a million, you've never been taxed on that over the years, so I think you should have to pay tax.

- Gen X homeowner, intended to vote Labour in 2024

[Removing the capital gains uplift] kind of overcomes income inequality because it ensures that profits from investments are taxed.

- Gen Z renter, intended to vote Lib Dem in 2024

Some panellists also were supportive of the idea of removing the uplift to raise revenue and simultaneously offer cuts to inheritance tax. They felt that removing the capital gains uplift would receive minimal opposition, while an inheritance tax cut could gain more support.

You're cutting one tax and increasing another, and the one that you're increasing, you're removing an exemption for dead people. And that doesn't seem to me to be something that would be terribly unpopular.

- Gen X homeowner, intended to vote Lib Dem in 2024

Rather than just popping something up on top, [cutting inheritance tax while removing the capital gains uplift] would feel like we're going to cut this, but we're going to raise this.

- Millennial homeowner, intended to vote Labour in 2024

SECTION 2
FISCAL AND ECONOMIC IMPACTS

This section outlines the economic impacts of the recommendations outlined in Chapter 1, including on revenue, distribution, and wider government objectives. We also consider the dynamic effects of the reforms (how the effects of reforms may be shaped by people changing behaviour), including through increased migration, lifetime giving, and increased use of remaining tax reliefs.

2.1 REVENUE EFFECTS

Total revenue

The package of reforms we recommend is expected to raise £2.6 billion in 2024-25, assuming no behavioural change. This is double the amount raised through restrictions on winter fuel payments (£1.3bn).[75] It is also slightly higher than the cost of removing the two child benefit cap (worth £2.5bn, according to estimates by Resolution Foundation).[76]

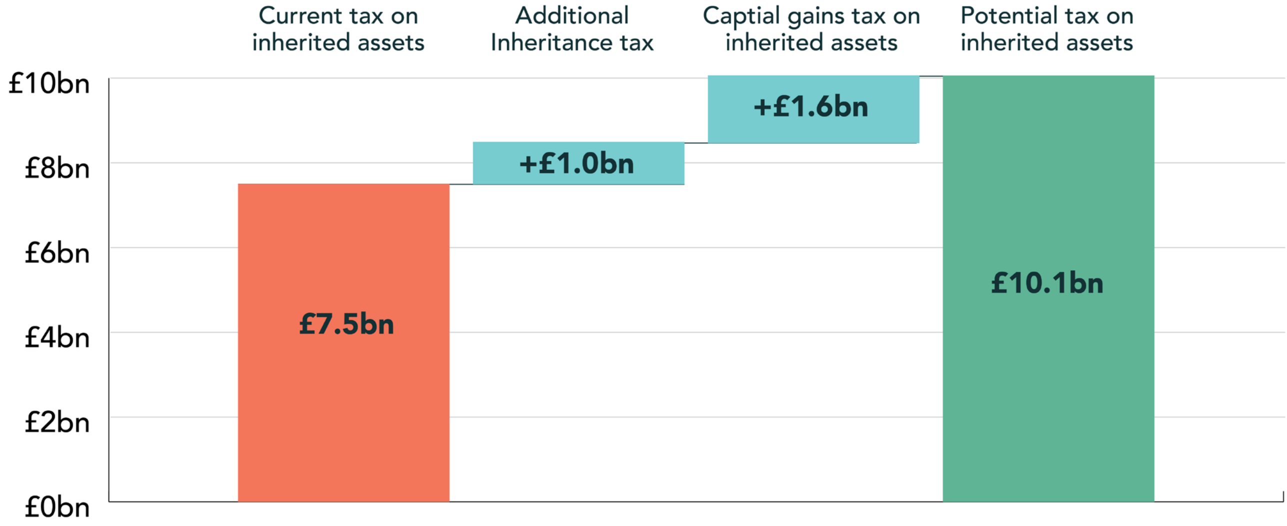
The revenue gain would include an additional £1.0bn from inheritance tax, and £1.6bn from capital gains tax on inherited assets. It would increase the value of tax on inherited assets from £7.5bn to £10.1bn in 2024-25.

75 Coleman C. Changes to winter fuel payments: The Social Fund Winter Fuel Payment Regulations 2024. House of Lords Library. 6 September, 2024. https://lordslibrary.parliament.uk/changes-to-winter-fuel-payments-the-social-fund-winter-fuel-payment-regulations-2024/
76 Try L. Catastrophic caps: An analysis of the impact of the two-child limit and the benefit cap. Resolution Foundation. 31 January 2024. https://www.resolutionfoundation.org/publications/catastophic-caps/

CHART 2

The recommended package of reforms would raise £1bn from inheritance tax and £1.6bn from capital gains tax

Additions to annual revenue based on Demos's recommended package of reforms



As the value of inheritance passed on is set to increase significantly in coming years, the additional revenue raised will also grow significantly. The IFS project that the value of inheritance tax will grow from £7.2bn in 2023–24 to £10.3bn by 2027–28 and £15.3bn by 2032-33. Assuming that the reform package consistently increases inheritance tax revenue by 34%, these reforms would lead to a £3.9bn increase in tax revenues by the end of the parliament (2028-29), or around £16bn over the whole five years of the parliament. Yet, this is likely to be an underestimate, because the value of estates across the distribution is likely to grow over this period, meaning an increasing number of estates would be pushed into higher rate brackets. This would drive an additional increase in revenue.

Revenue breakdown

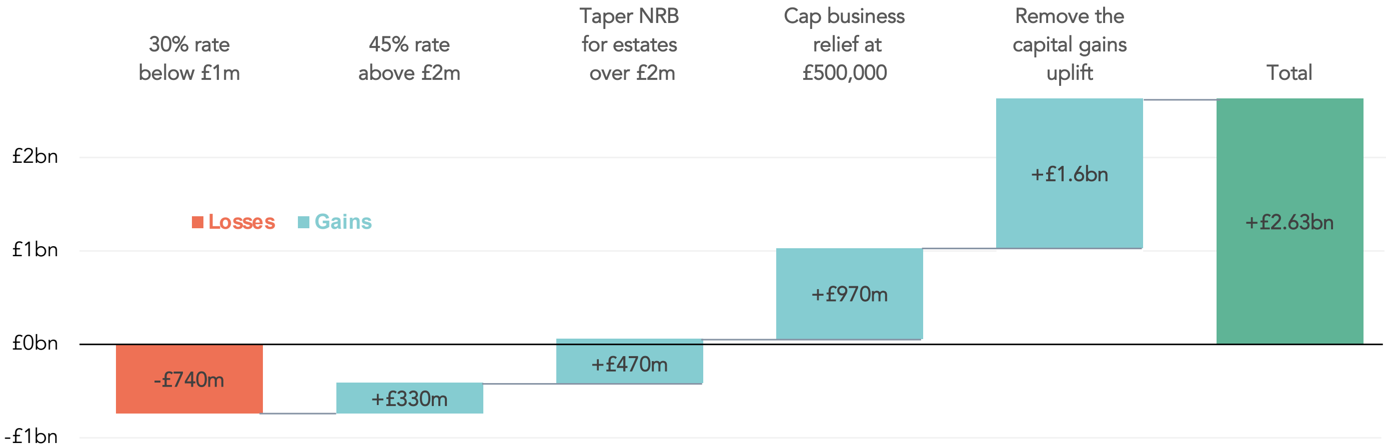
The expected revenue gained is the aggregate of:

- Loss of £410m from the introduction of rate bands (loss of £740m from the 30% band and gain of £330m from the 45% band)
- Gain of £470m from tapering away the nil-rate band for estates over £2m
- Gain of 970m from capping business relief at £500,000
- Gain of £1.6bn from removing the capital gains 'uplift'

CHART 3

£2.6bn is gained from the higher taxation on estates over £2m, the capping of business relief and the removal of the capital gains 'uplift'

Revenue impact of policies within package



Note, the modelling for the capital gains uplift is based on the current rates of capital gains tax. If these were increased in the Autumn Budget from their current rates (between 10% and 28%) - with various organisations calling for an increase in capital gains tax rates so to the same level as income tax rates (20%, 40% and 45%) - this could lead to significant larger increases in the revenue from this policy.[77,78]

2.2 DYNAMIC EFFECTS

The revenue estimates we report have assumed no behavoiural change in response to the tax reforms, as behavioural responses to relatively novel tax changes are challenging to model. Yet, three key behavioural changes could have an impact on the revenue: migration out of the country, increased lifetime gift giving, and shifting wealth into assets which face lower inheritance tax. While there is not sufficient data to incorporate these changes into the model, we consider here the effects that each change might have.

Migration

If inheritance tax reforms cause people to move out of the country, this could both reduce the revenue gain from inheritance tax, but also take potentially productive people and assets out of the UK, harming growth and reducing revenue from other taxes that migrants would have paid. This double effect means emigration could be a particularly harmful behavioural response.

The risk is that, because the recommended reforms increase inheritance tax for the most valuable estates, the wealthy will face a greater incentive to migrate. Similarly, the removal of the capital gains uplift may lead people to leave the UK to realise gains on assets in a country with lower capital gains tax. For this latter risk, the government could respond by applying capital gains tax when people leave the UK, taxing unrealised gains on assets moved abroad, as has been suggested by Advani et al and currently happens in Australia and Canada.[79]

77 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
78 Institute for Public Policy Research. The UK's tax system is a significant barrier to ending regional wealth inequality, new research argues. 29 Aug 2024. https://www.ippr.org/media-office/the-uks-tax-system-a-significant-barrier-to-ending-regional-wealth-inequality-new-research-argues
79 Advani A, Lonsdale A, Summers A. Reforming Capital Gains Tax: Revenue and Distributional Effects. October 2024. Centre for the Analysis of Taxation. https://centax.org.uk/wp-content/uploads/2024/10/AdvaniLonsdaleSummers2024_CGTReform.pdf

Yet, there is little evidence suggesting this is a significant risk in the case with inheritance tax. As Jakobsen et al. note, "While there is growing evidence on migration responses to labour income taxes at the top… there is virtually no evidence on [international] migration responses to capital or wealth taxes."[80] Similarly, in the UK context, Advani et al. look at the migration response to 2017 reforms of the non-dom regime, whereby those who had lived in the UK for 15 of the past 20 years were then considered domiciled in the UK and became liable to various taxes, including inheritance tax on non-UK assets.[81] The research shows that very few people left the UK in response - with just a 4.6 percentage point increase in non-doms migrating despite a 17.8% fall in the share of their income they could keep after tax. Overall, after accounting for the migration response, the group of people affected paid 150% more tax following the reforms.

Importantly, the government's suggested changes to the domicile regime would mean an individual's non-UK assets would remain in scope of UK inheritance tax for 10 years after leaving the UK.[82] This means people would have to move out of the UK for 10 years before death to avoid inheritance tax. This is a longer time than previous reforms; for example, the 2017 reforms meant people who thereafter ceased to have non-dom status would have to leave the UK for one to five years to gain it back.[83]

Lifetime gift giving

If people transfer their assets prior to the seven-year period before death, these assets would avoid inheritance taxation. The reforms recommended in this paper increase the incentive to do this for two reasons:

1. They increase rates on the wealthiest estates
2. They mean business assets over £500,000 are liable to inheritance tax, and businesses could be gifted to avoid this.

On the former, this risk already exists to a large extent, as estates with millions in assets face large incentives to transfer their liquid assets earlier in life to avoid inheritance tax. Yet, this often does not happen as much as it could. For example, of estates with a tax liability over £100,000, 16% was made up of cash.[84] If we assume a similar proportion of these people's estates were cash in the years leading up to death, then they faced a clear incentive to transfer more of this in the years before death to try to avoid inheritance tax. The same applies to many other assets which are easy to sell and transfer, and yet many such assets remain in estates and become liable to taxation. There is no evidence suggesting this trend should change dramatically due to the recommended policies, and no evidence modelling the scale of the change.

On the second shift to the incentive, while it is highly likely some businesses will be transferred in life in order to avoid inheritance tax - which would diminish the revenue to an extent - there is again no research modelling the scale for the UK context. Importantly, transferring business assets comes with a cost. People hold onto assets like cash later in life for the financial security, and the same applies to business assets.[85] And one cannot bypass inheritance tax by simply transferring ownership of business assets while continuing to benefit from them (e.g. through

80 Jakobsen, K, H Kleven, and G Zucman. "Wealth taxation and wealth accumulation: Theory and evidence from Denmark," The Quarterly Journal of Economics. February 2020. https://academic.oup.com/qje/article/135/1/329/5584349
81 Advani A, Burgherr D and Summers A. Taxation and Migration by the Super-rich. 15 June 2023. https://arunadvani.com/papers/AdvaniBurgherrSummers2023_TaxationAndMigrationByTheSuperRich.pdf
82 HM Treasury. Changes to the taxation of non-UK domiciled individuals. 8 August 2024. https://www.gov.uk/government/publications/2024-non-uk-domiciled-individuals-policy-summary/changes-to-the-taxation-of-non-uk-domiciled-individuals
83 Advani A, Burgherr D and Summers A. Taxation and Migration by the Super-rich. 15 June 2023. https://arunadvani.com/papers/AdvaniBurgherrSummers2023_TaxationAndMigrationByTheSuperRich.pdf
84 HM Revenue and Customs. Inheritance Tax liabilities statistics. 31 July 2024. https://www.gov.uk/government/statistics/inheritance-tax-liabilities-statistics
85 Personal Finance Research Centre (PFRC), University of Bristol. Financial wellbeing in later life: Evidence and policy. March 2014. https://www.bristol.ac.uk/media-library/sites/geography/migrated/documents/pfrc1402.pdf

receiving the profit, dividends or capital gains). If people still receive the benefits from a gift, it is considered a 'gift with reservation', and may still be liable to inheritance tax.[86] Similarly, the incentive to transfer busniess assets does exist for those assets which do not benefit from business relief (i.e. if the company mainly deals with investments, land or buildings). It is therefore not immediately clear that business assets would be gifted at a significantly higher rate than other non-residential assets in estates.

If the transfer of businesses during life is expected to seriously diminish the revenue from the recommended policies, the government should consider a tax on lifetime gifts to protect the taxation of inheritance. We discuss this option in Appendix 1.

Shifting wealth into assets which face lower inheritance tax

Beyond business relief, there are various other opportunities for people to reduce inheritance tax bills. There is relief for agricultural land and buildings. Assets put in trusts are taxed differently (charged 20% above the nil-rate band when they are put in and then up to 6% every 10 years and when the assets are taken out). Meanwhile, wealth in private pension pots is generally not counted for inheritance tax purposes. If people begin selling their business assets and instead buy farmland, for example, they would benefit from agricultural relief and this would reduce the revenue gain from capping business relief.

Again, it is unclear the extent to which this would reduce the revenue in the case of current inheritance tax reforms. It is important to note that many of those who would be affected by the cap on business relief will own their business assets based on their affiliation with the business (e.g. if it is a business they have invested in for many years). These people may specifically want to pass on those business assets in inheritance rather than selling them, even if that means additional tax bills.

To the extent that an expansion in the use of other opportunities to avoid inheritance tax bills is expected to significantly diminish revenue, the government should clamp down on these remaining opportunities. This could include capping agricultural relief, increasing the amount of time that someone has to own agricultural land before they can benefit from the relief (e.g. from two to five years), bringing pensions into the scope of inheritance tax, and increasing the 10-yearly charge on inheritance tax in trusts. We discuss these options in Appendix 1.

2.3 DISTRIBUTIONAL IMPACTS

All but one of the policy recommendations laid out in the paper relate specifically to inheritance tax. We focus first exclusively on the distributional impact from changes in inheritance tax, and then at the distributional impact from changes in capital gains tax.

Inheritance tax

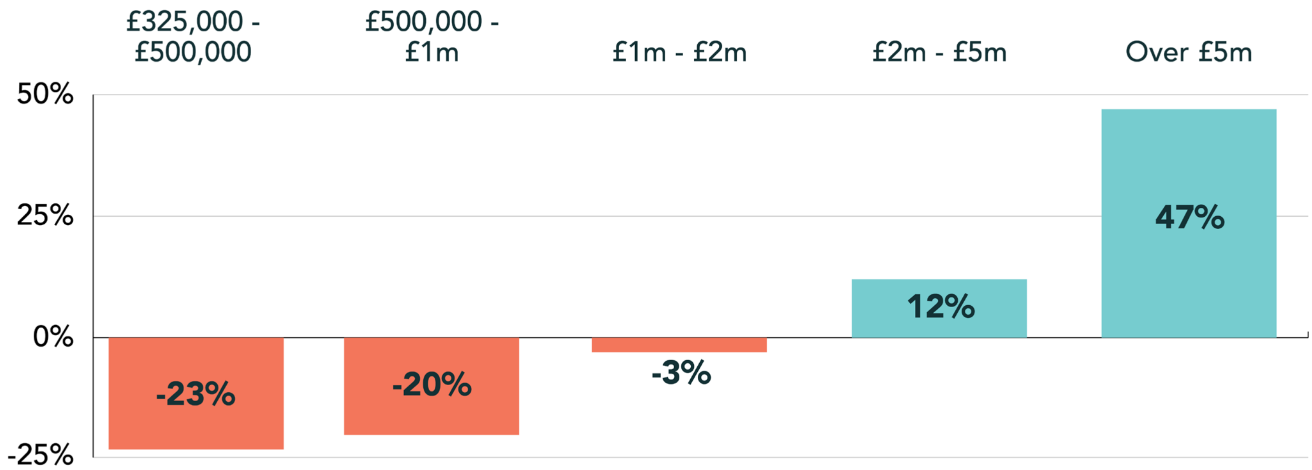
Currently, inheritance tax is regressive at the top of the distribution, but the recommended package of reforms would make it much more progressive. The effective rate currently peaks at 25% for estates worth between £3 and £5m. It then falls for esates over £5m, reaching 20% for those over £10m.[87] Under the reform package outlined in this paper, estates worth between £2m and £5m would pay 12% more on average, and those worth over £5m would pay 47% more. Meanwhile, estates under £2m would pay less inheritance tax on average. Those worth £1m-£2m would pay 3% less on average, while those worth under £1m get a much bigger cut, at 20% for estates worth £500,000-£1m, and 23% for estates worth £325,000-£500,000. There would be no effect on estates worth under £325,000.

86 Masala F. Inheritance tax: Current policy and debates. House of Commons Library. 18 March 2024. https://researchbriefings.files.parliament.uk/documents/SN00093/SN00093.pdf
87 HM Revenue and Customs. Inheritance Tax liabilities statistics commentary. 31 July 2024.https://www.gov.uk/government/statistics/inheritance-tax-liabilities-statistics/inheritance-tax-liabilities-statistics-commentary

CHART 4

Only estates over £2m would pay more inheritance tax on average, while estates under £2m would pay less inheritance tax on average

Percentage change to total inheritance tax payments, by value of estate

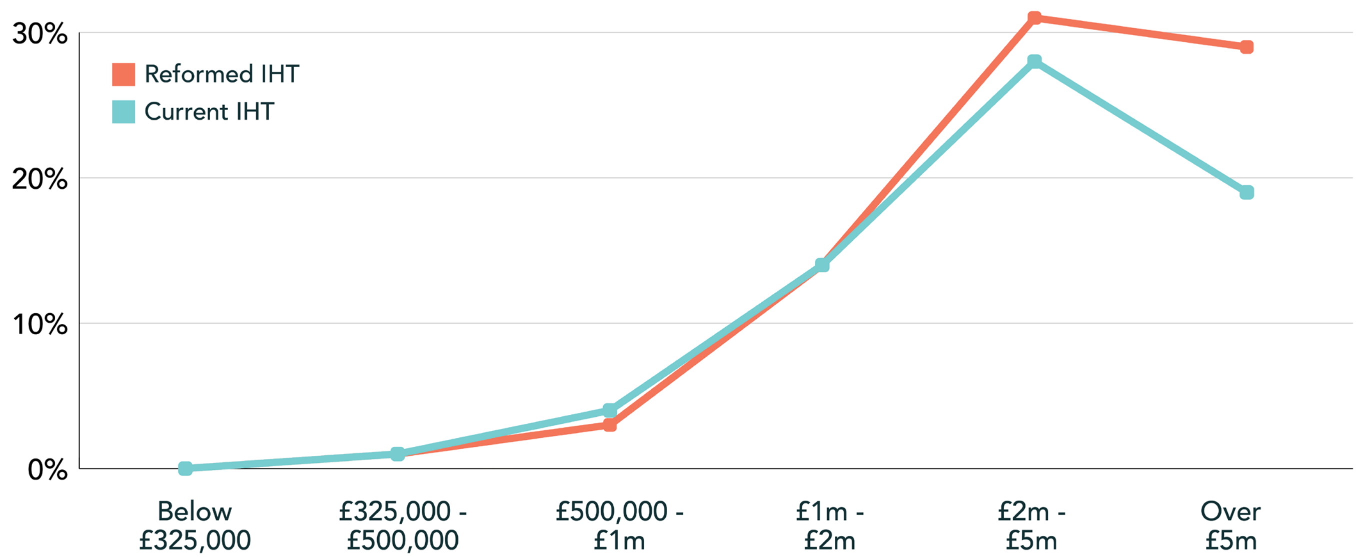


In looking at the impact of the reforms on the effective rate of inheritance tax across the distribution of estates, we see falls in the effective rates for estates under £2m. For estates worth between £325,000 and £500,000, the effective rate would drop slightly, from 0.9% to 0.7%. For estates worth between £500,000 and £1m, it would fall from 3.6% to 2.9%. And for those worth between £1m and £2m, the rate falls from 14.3% to 13.8%. For large estates, there are significant increases, with an increase from 27.8% to 31.0% for estates worth between £2m and £5m, and an increase from 19.3% to 28.5% for estates worth over £5m. Estates worth over £5m still pay a slightly lower rate than estates worth £2m to £5m due to their higher propensity to make use of the remaining reliefs, including business relief up to £500,000 and agricultural relief.

CHART 5

Our reforms would only increase the effective rate of inheritance tax for estates worth over £2m

Effective rate on inheritance tax, by estate value



Capital gains tax

Capital gains tax is largely paid by the very wealthiest. In 2022-23, over half of taxable capital gains (52%) went to just 6,000 people in 2022-23, each receiving £6.7m on average.[88] Similarly, over half of gains (52%) were received by people with taxable income (after deducting the personal allowance) over £100,000.

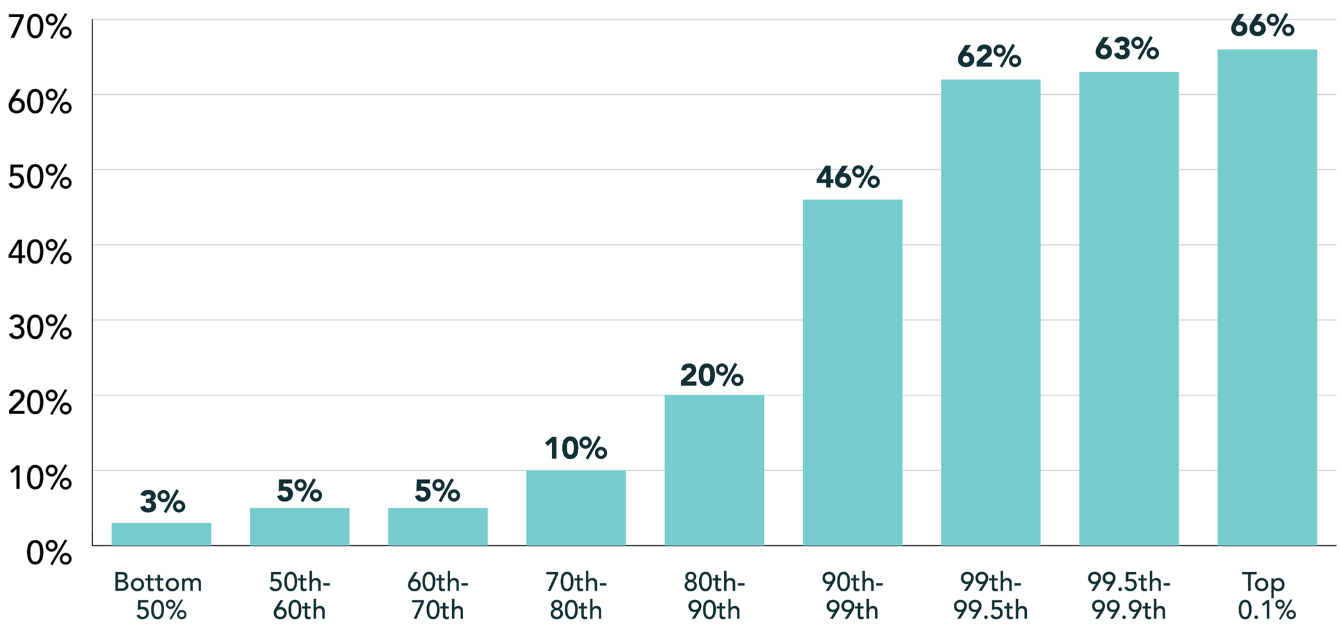
Advani et al estimate the cost of removing the uplift across the distribution of estates, with the addition of an allowance based on the 'risk-free' rate of return and an increase in rates to align with those of income tax, as discussed in Chapter 1.[89] While this differs from our core recommendation - as it means certain estates who make gains lower than the 'risk-free' rate of return would not be taxed, while they would under our system, and those who ar taxed would pay higher rates but with an additional tax-free allowance - it is reflective of the distribution across different estates. This wider set of reforms would also be sensible additions to the removal of the capital gains uplift, as we discuss in Chapter 1.

Advani et al first model the percentage of estates who would pay more due to the removal of the uplift, by estate value (using 2019-20 values).[90] They find that less than 5% of estates under the 70th percentile would pay additional capital gains tax due to the reform. Of those in the 90th to 99th percentile, 46% pay more, while over 60% of those in the top percentile would pay more. Note, the cost for estates will not be incurred at the point the estate is passed in inheritance, but when its assets are sold.

CHART 6

Removing the capital gains tax uplift will affect very few estates other than those with the most wealth

Advani et al estimates of the percentage of estates paying more capital gains tax due to the removal of the uplift with a risk-free rate of return allowance, by percentile of estate value, 2020



88 HM Revenue and Customs.Capital Gains Tax statistics. 1 August 2024. https://www.gov.uk/government/statistics/capital-gains-tax-statistics
89 Advani A, Lonsdale A, Summers A. Reforming Capital Gains Tax: Revenue and Distributional Effects. October 2024. Centre for the Analysis of Taxation. https://centax.org.uk/wp-content/uploads/2024/10/AdvaniLonsdaleSummers2024_CGTReform.pdf
90 Ibid.

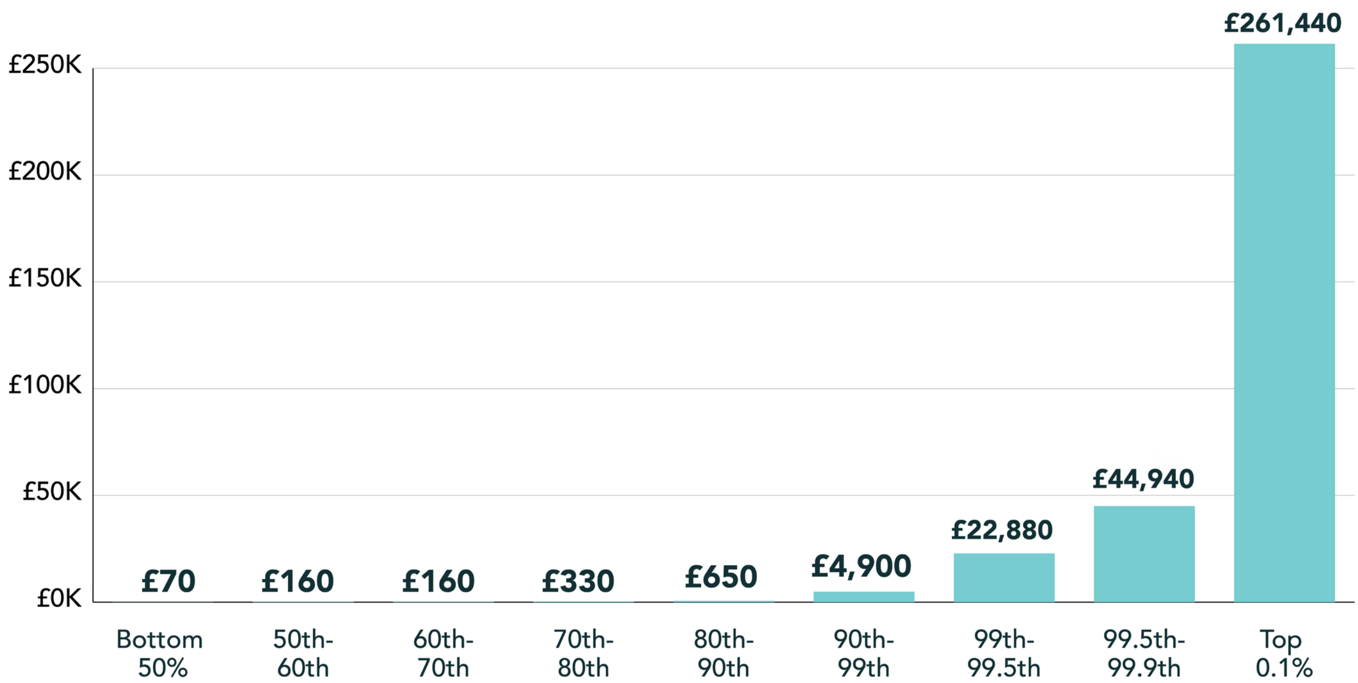
Advani et al also model the tax paid by estates at different parts of the distribution.[91,92] They find that 86% of the additional revenue would come from the wealthiest 10% of estates, while 46% would come from the top 0.1%.

By taking the total number of estates in 2019-20, we can estimate the average amount of additional tax paid per estate (across all estates, including those that didn't actually pay any additional tax). This shows that the removal of the uplift increases tax per estate by an average of £70 for those in the bottom 50% of the distribution (though the additional tax is shared among a small proportion of the estates in this group, meaning those taxpaying estates will pay much more on average).[93] Even estates between the 80th and 90th percentile will see an average increase of £650. This stands in contrast to the much larger increases for estates within the top 10%, at £4,900 for the 90th to 99th percentile, and increasing up to £261,440 for those in the top 0.1%.

CHART 7

Removing the capital gains uplift would lead to very small increases in the average amount of tax paid for most estates other than the very wealthiest

Average amount of additional capital gains tax paid per estate due to the removal of the uplift with a risk-free rate of return allowance, by percentile of estate value, 2020



This analysis demonstrates how the costs of removing the capital gains uplift are primarily borne by the wealthiest in society.

91 Again, this models the removal of the capital gains tax uplift alongside an allowance for the 'risk free' rate of return, and an increase in the rates.
92 Advani A, Lonsdale A, Summers A. Reforming Capital Gains Tax: Revenue and Distributional Effects. October 2024. Centre for the Analysis of Taxation. https://centax.org.uk/wp-content/uploads/2024/10/AdvaniLonsdaleSummers2024_CGTReform.pdf
93 Ibid.

TABLE 2
ILLUSTRATION OF THE IMPACT OF REFORMS[94]

WHAT IS THE ESTATE?	WHAT DO THEY OWN?	WHAT DO THEY PAY NOW?	WHAT WOULD THEY PAY WITH OUR REFORMS?	DIFFERENCE, CURRENT vs REFORMED SYSTEM
A typical estate	A married couple own a £300,000 estate, including an average priced house (£288,000), with no assets beyond a primary home, savings, and standard household items.	They pay **no inheritance tax**, because their assets are below the tax-free allowance. They pay **no capital gains tax**, because their assets are exempt from capital gains tax (standard household items are unlikely to appreciate in value beyond the capital gains tax allowance (£3,000)).	They pay **no inheritance tax**, because their assets are below the tax-free allowance. They pay **no capital gains tax**, because their assets are exempt from capital gains tax.	No difference in inheritance tax or capital gains tax.
A £750,000 estate	A single person owns a £750,000 estate, including a £500,000 house, £150,000 savings and £100,000 in shares in a private business (worth 20% of the total value, which were bought for £80,000).	They pay **£60,000 inheritance tax**, because the business assets benefit from relief and they pay 40% on the £150,000 above £500,000. They pay **no capital gains tax**, because the gains on their business (worth £20,000) are uplifted at the point of inheritance.	They pay **£45,000 inheritance tax**, because the business assets still benefit from 100% relief, and they pay 30% on the £150,000 above £500,000, which is a tax cut. They pay **£2,000 capital gains tax**, because the gains on their business assets are worth £20,000 and taxed at 10% (because the normal 20% rate is halved due to Business Asset Disposal Relief).	£13,000 less tax.

94 Pensions are excluded from this analysis.

A £1.2m, business-owning estate	A married couple own a £1.2m estate including a house worth £1m, savings worth £100,000, and a small business they set up which is now worth £100,000 (and is sold the day after inheritance).	They pay **£40,000 inheritance tax**, because the £100,000 business assets benefit from relief, and they pay 40% on the remaining £100,000 above their combined tax-free allowance of £1m (the combination of both their nil-rate bands and residence nil-rate bands). They pay **no capital gains tax**, because the gains on their business (worth £100,000) are uplifted at the point of inheritance.	They pay **£40,000 inheritance tax**, because the £100,000 of business assets still benefit from relief (because they are under £500,000), and they pay 40% on the remaining £100,000 above their combined tax-free allowance of £1m. They pay **£10,000 in capital gains tax** upon sale of the business, because gains of £100,000 are taxed at 10% (because the normal 20% rate is halved due to Business Asset Disposal Relief).	£5,820 more tax.
The 99th percentile estate (at the top 1%)	A married couple own a £2.1m estate with a £2m main home and £100,000 savings.	They pay **£460,000 inheritance tax**, because they pay 40% on the £1.1m above £1m, plus 40% on the £50,000 that is tapered off from the residence nil-rate band. They pay **no capital gains tax**, because their assets are not subject to capital gains tax.	They pay **£460,000 inheritance tax**, because they pay an extra 5% on the £100,000 above £2m (£5,000), but at the same time, they only pay 30% on the £50,000 that has been tapered, rather than 40%, so also pay £5,000 less. Because their combined tax-free allowances are £1m, they do not otherwise benefit from the 30% rate. They pay **no capital gains tax**, because their assets are not subject to capital gains tax.	No difference in inheritance tax or capital gains tax.

A £5m property-owning estate	A married couple own a £5m estate with a £2m main home, and three additional £1m homes that they rent out (that were each bought for £750,000), which are sold the day after inheritance.	They pay **£1.74m in inheritance tax**, because the additional homes do not benefit from business relief as this relief does not apply to businesses that mainly deal with land or buildings. They pay **no capital gains tax**, because the gains on their second properties (worth £750,000) are uplifted at the point of inheritance.	They pay **£2.05m in inheritance tax**. They pay 40% on the inheritance between £1m and £2m (£400,000), 45% on the inheritance above £2m (£1.35m) and 30% on the £1m in allowances that are tapered away (£300,000). They pay **£180,000 in capital gains tax** upon sale of the rental properties because the gains are worth £750,000 and taxed at 24% (the rate for residential properties).	£550,000 more tax.
A £5m business-owning estate	A married couple own a £5m estate with a £2m main home, a £2m business (that was bought for £1.75m), a second home worth £750,000 (that was bought for £500,000), and £250,000 in savings. Both the business and homes are sold the day after inheritance.	They pay **£940,000 in inheritance tax**, because the £2m business is tax-free, and they pay 40% on the remaining £2m above the tax-free allowances, and 40% on the combined residence nil-rate bands (£350,000) which are tapered away. They pay no capital gains tax, because the gains on their business (worth £250,000) are uplifted at the point of inheritance.	They pay **£1.825m in inheritance tax**, because £500,000 of the business benefits from relief, so the taxable estate is £4.5m. They pay 40% on the inheritance between £1m and £2m (£400,000), 45% on the inheritance above £2m (£1.125m) and 30% on the £1m in allowances that are tapered away (£300,000). They pay **£85,000 in capital gains tax** upon sale of the businesses and additional property because the gains on the business are worth £250,000 and taxed at 10% (because the normal 20% rate is halved due to Business Asset Disposal Relief), while the gains on the house are worth £250,000 and taxed at 24% (the rate for residential properties).	£970,000 more tax.

SECTION 3
PUBLIC ATTITUDES

3.1 POLLING

To test the reaction to the recommended policies among the British public at large and the response without prior deliberation on the issue, we ran polling with a representative sample of 2,029 people from the 13th to 17th September 2024, with the polling company Opinium. After providing the context of the upcoming Budget - explaining that the government has said there is a £22bn hole in the public finances and is expected to outline plans to fill the hole - we asked about attitudes towards the package of reforms as a whole, and to individual policies within the package. We also tested how the public would react to different framing of the reforms. This is indicative of the reaction that the public would have to the announcement of these policies in the October Budget.

All this data in this chapter is drawn from this polling.

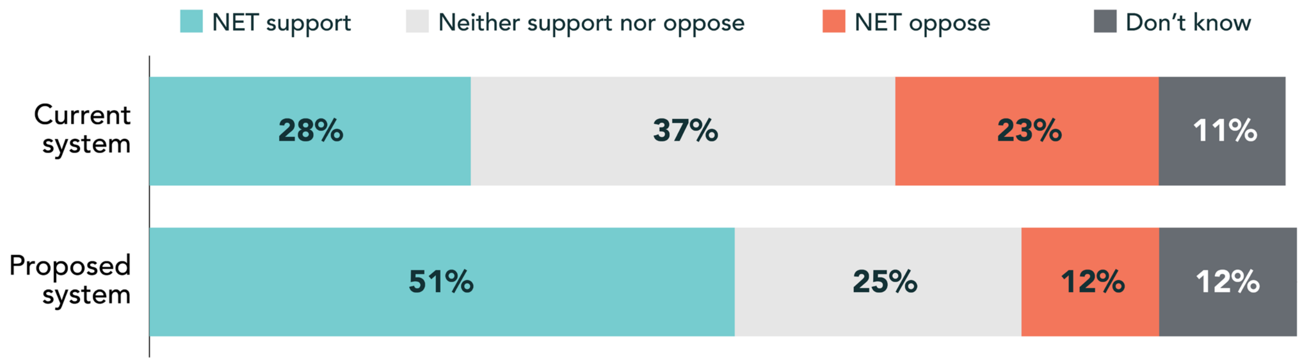
Public attitudes towards the package

The package of reforms - introducing rate bands, tapering away the minimum tax-free allowance, capping business relief and removing the capital gains 'uplift' - receives broad support across a range of measures. First, we can compare the recommended inheritance tax system to the current inheritance tax system. In our polling, we outlined both the design of the current system and the design of the recommended system and asked about the public's level of support or opposition to each. We found that the public are almost twice as likely (1.8x) to support the recommended system over the current system (51% vs 28%). Similarly the public are around half as likely to oppose the recommended system (12% vs 23%).

CHART 8

The proposed inheritance tax system receives significantly more support than the current system

To what extent do you support or oppose the following inheritance tax system? [Followed by summaries of each system]



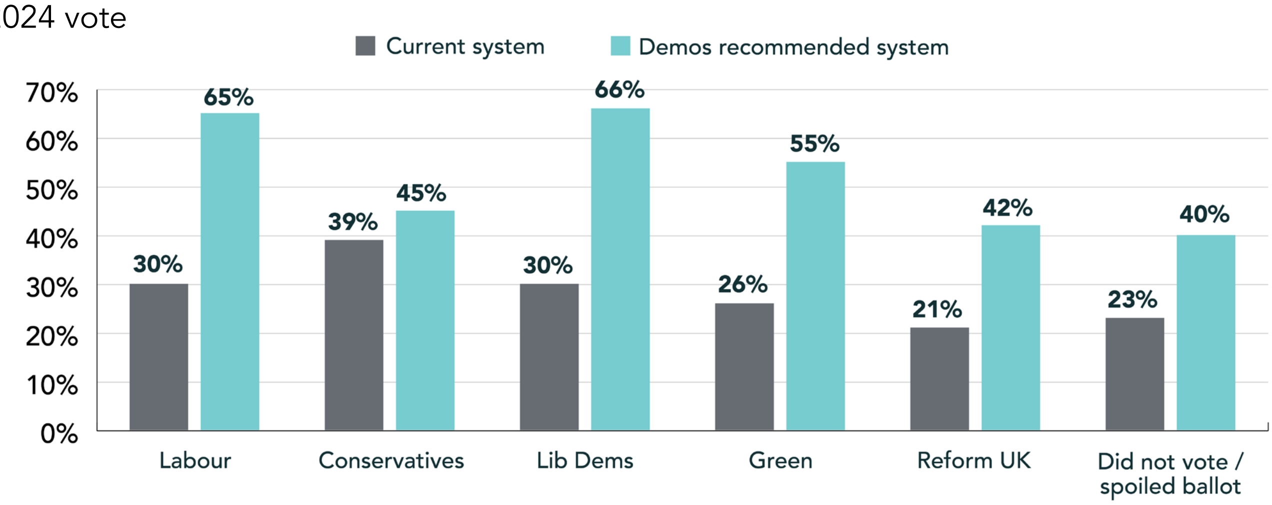
While support for the current system seems high (with support higher than opposition), this aligns with previous research which shows that, once digging into the details, the public are more supportive of inheritance tax than many people might anticipate. For example, when asked where the tax-free allowance for inheritance tax should be, the median response is just £300,000.[95] Given that we outlined that the tax-free allowance for inheritance tax is at least £325,000, but can increase up to £1m for couples who own their home, this may have underlied the level of support.

Preference for the recommended package is consistent across voters of different parties. In particular, voters of Labour, Lib Dem, and Green in 2024 are more than twice as likely to support Demos's recommended package over the current system, while Reform voters are exactly twice as likely to support the package. This suggests voters of these parties would have a much more positive attitude to inheritance tax if reformed along the lines proposed in this paper. Conservative voters, while still more likely to support the reformed system (45% to 39%), were more split.

CHART 9

The proposed inheritance tax system receives more support than the current system across all voters, but Conservatives are more split

Level of support for inheritance tax systems based on an explanation of key policies, by 2024 vote



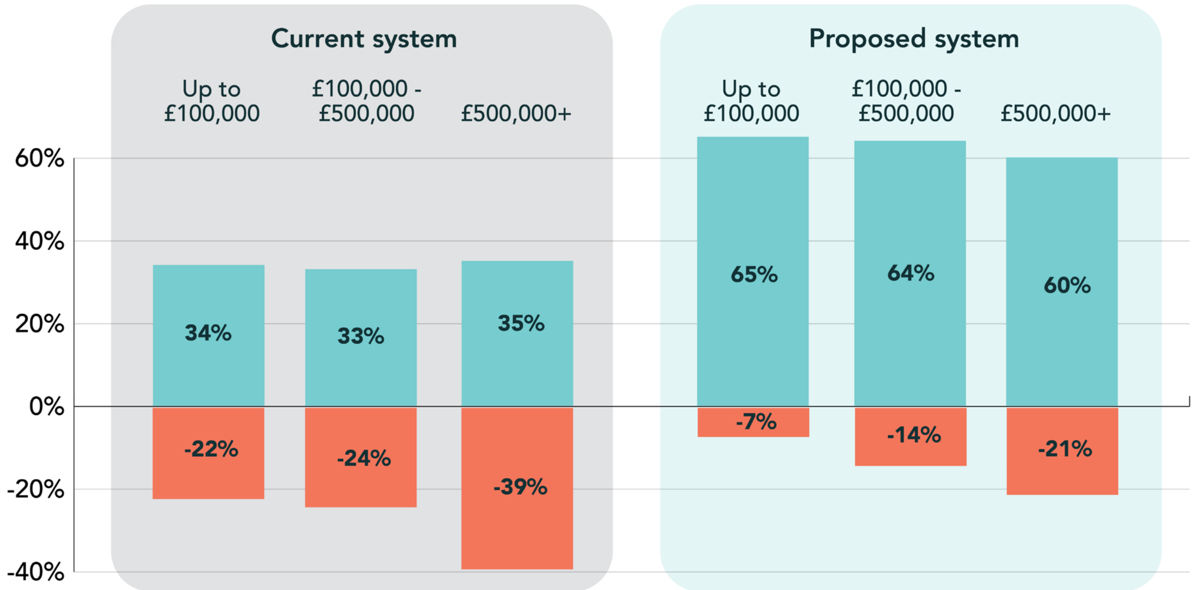
95 Goss D and Glover B. The inheritance tax puzzle: Challenging assumptions about public attitudes to inheritance. 14 June 2023. Demos. https://demos.co.uk/research/the-inheritance-tax-puzzle-challenging-assumptions-about-public-attitudes-to-inheritance

We looked at how support and opposition for the different systems breaks down by how much people expect to give in inheritance. For the current system, people who are more likely to pay inheritance tax (e.g. expecting to give inheritance over £500,000) are not less likely to be supportive, but they are more likely to be opposed. Levels of support remain steady - at between 33% and 35% - regardless of how much people expect to give in inheritance. Yet, opposition increases significantly from 22-24% for those expecting to give under £500,000, before spiking to 39% for those expecting to give over £500,000. A similar trend follows for the recommended system. While support drops slightly for those expecting to give over £500,000, opposition increases at a greater rate. Opposition starts at just 7% for those expecting to give under £100,000, before doubling to 14% for those expecting to give £100,000-£500,000, and then increasing to 21% for those expecting to give over £500,000. This similarly suggests that the expectation of giving more inheritance has a greater effect on increasing opposition than it does on decreasing support. Nevertheless, across all groups, support far outweighs opposition.

CHART 10

People expecting to pass on the most inheritance are more likely than not to oppose the current inheritance tax system, but are more likely to support the proposed system

Net level of support and opposition for inheritance tax systems, by expected bequest



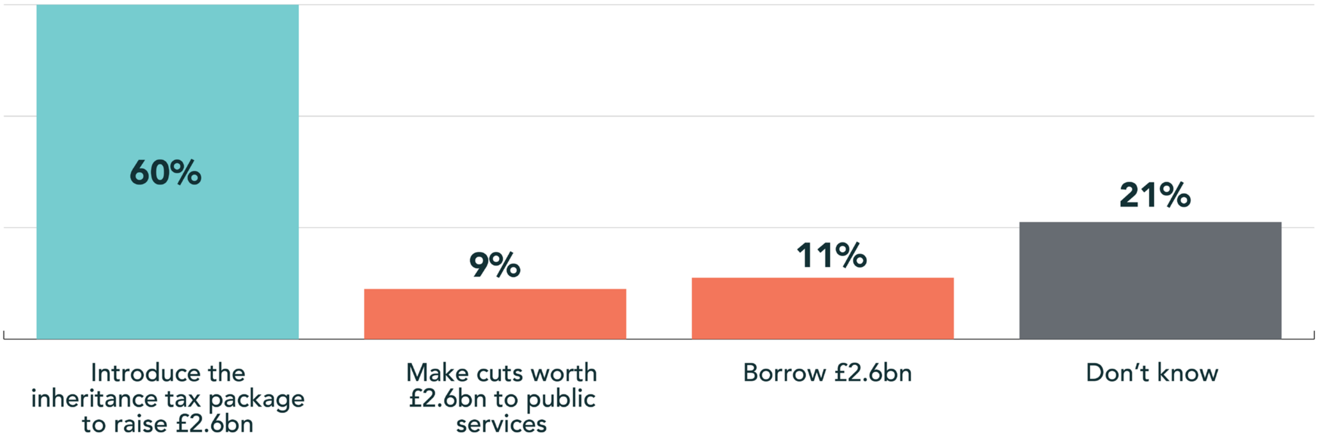
Alongside comparisons to the current system, we also compared the package of inheritance tax and capital gains tax reforms - raising £2.6bn - against public spending cuts or borrowing of the same amount. The Chancellor will face various choices in the Autumn budget, but it is likely that she will make some spending cuts and she may borrow some money. Each amount that is cut or borrowed will have to be weighed up against potential tax rises that could instead raise those funds, including the inheritance tax reforms in question. We therefore asked the public which they think the government should prioritise out of a package of inheritance tax reforms - as outlined in this paper - public service cuts worth £2.6bn, or borrowing £2.6bn.

Our polling shows that the public overwhelmingly think the government should prioritise inheritance tax reforms over cutting public spending. Six in ten think the government should prioritise the reforms, compared to just one in ten thinking they should prioritise either spending cuts (9%) or borrowing (11%) worth the equivalent amount.

CHART 11

Six in ten people think the government should prioritise the package of inheritance tax reforms over making cuts or borrowing the equivalent amount

Thinking about the inheritance tax 'package' you just read about... Imagine that the government has to choose one of the following. Which should the government prioritise?

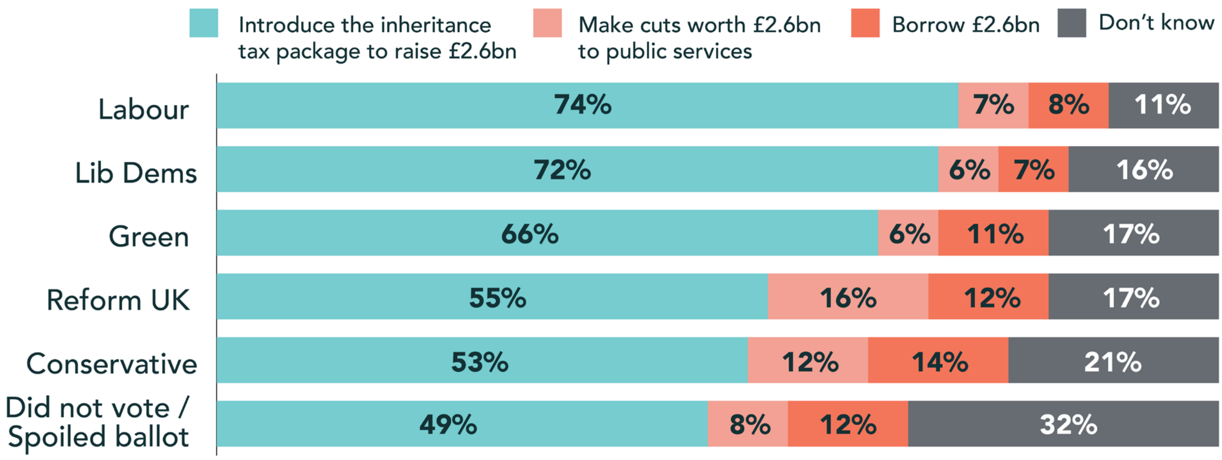


Among voters of all major parties, an absolute majority feel the government should prioritise the inheritance tax reforms over equivalent spending cuts or borrowing. This is highest for Labour voters (at 74%), and lowest for Conservative voters (53%). Those who did not vote are also in favour of the inheritance tax reforms, but to a lesser extent - although this is in large part related to the significant proportion of this group responding 'don't know' (32%).

CHART 12

Three quarters of Labour and just over half of Conservative voters think the government should prioritise the proposed inheritance tax reforms over spending cuts or borrowing

"...Imagine that the government has to choose one of the following options. Which do you think they should prioritise?

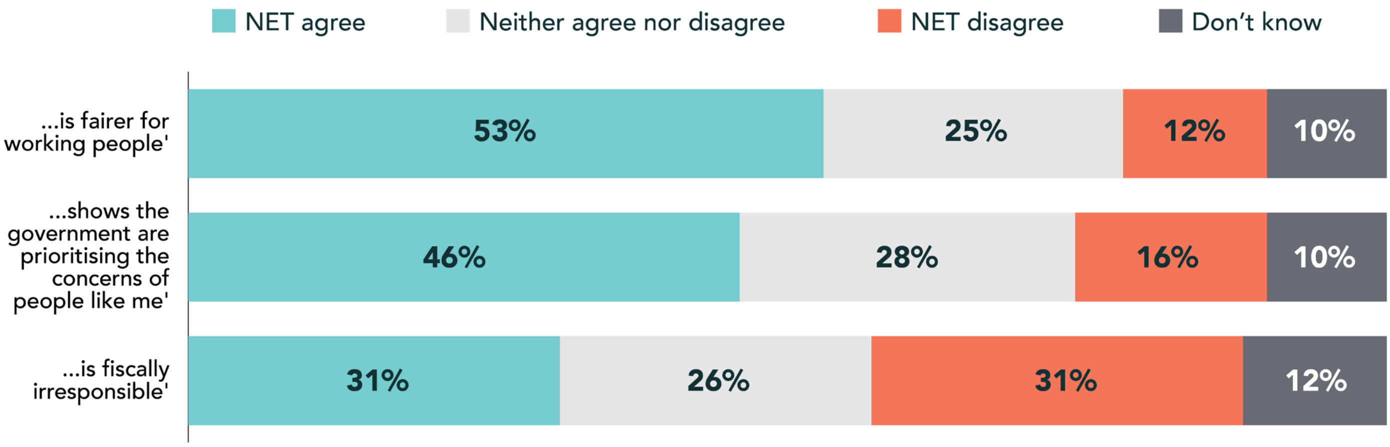


In our polling, we also examined the reasons that the public may support or oppose the package of inheritance tax reforms, asking about agreement with different statements about the package. The most broadly supported statement about the reform package is that it is 'fairer for working people' - with 53% agreeing and just 12% disagreeing. Similar levels agree that the reforms would show the government 'prioritising the concerns of people like me' (46% agreeing vs 16% disagreeing). We also asked about people's views on whether the package of reforms would be economically irresponsible, and got more mixed views. An even split are likely to agree or disagree that the reforms were economically irresponsible (31% either way), suggesting the public are more sold on the reforms being fair for working people and aligned with people's concerns than they were sold on their wider economic impacts.

CHART 13

People tend to think that prioritising the proposed reform package over cuts would be fairer for working people and prioritises their concerns, but are split on whether it would be fiscally responsible

Agreement with the statement "Prioritising the inheritance tax reforms...



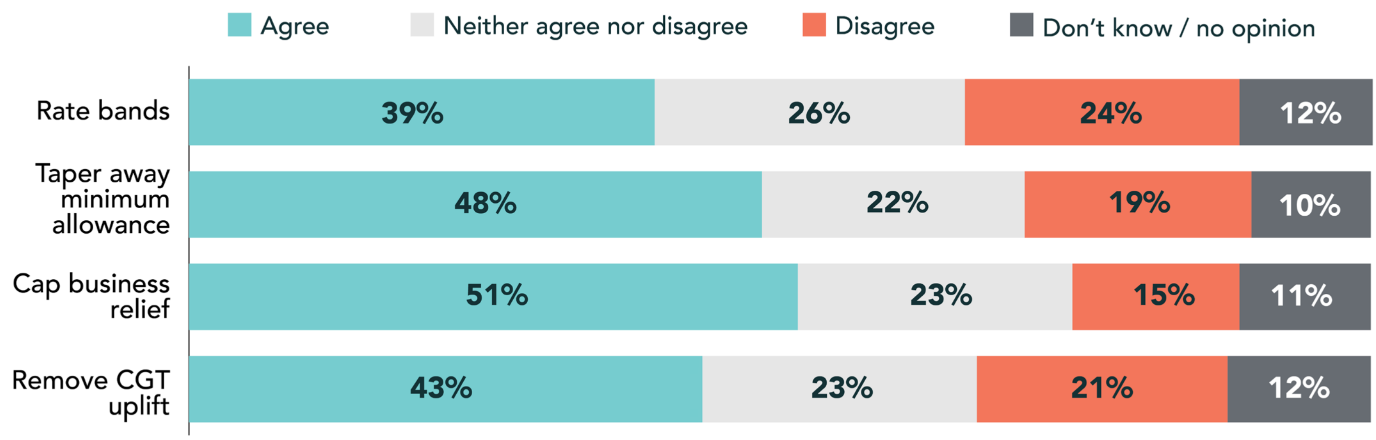
Public attitudes towards individual policies

We also polled on individual policies within the package. We found that all of the policies receive net support (support higher than opposition). The most popular policies are capping business relief (51% support vs 15% oppose), tapering away the minimum allowance for estates over £2m (48% vs 19%), and removing the capital gains tax uplift (43% vs 21%). The introduction of rate bands receives less support, but the public are still significantly more likely to support than oppose the policy (39% vs 24%).

CHART 14

Support for all policies in the package significantly outweighs the opposition

Agreement with the statement "I would support this proposal"



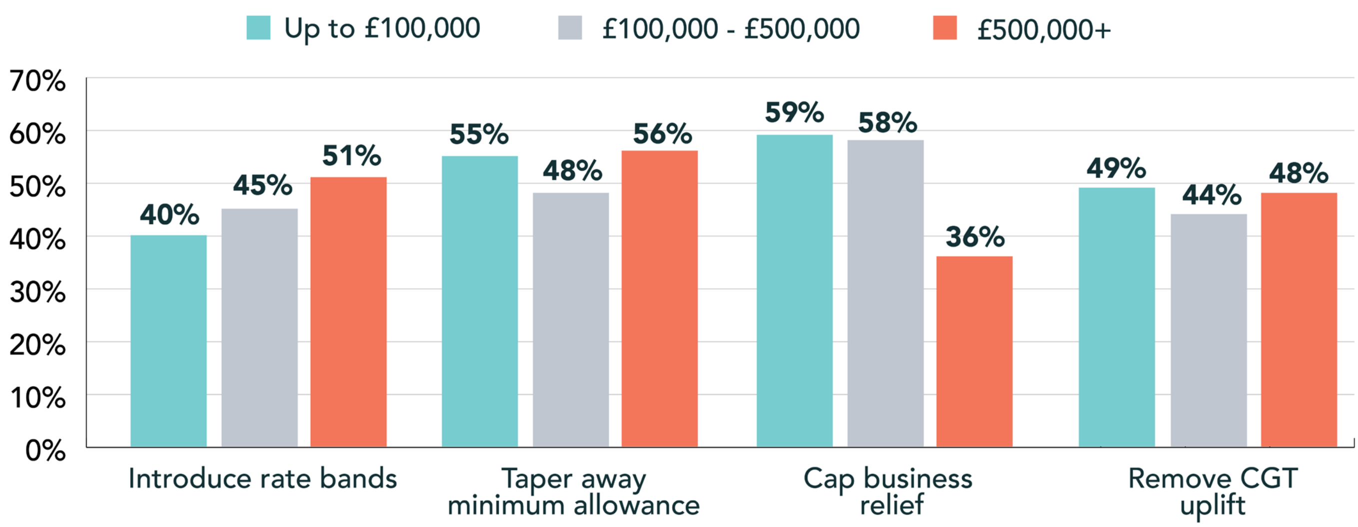
We also see that the amount people expect to inherit has different relationships with different policies. On rate bands, the more people expect to inherit, the more supportive they are of the policy - from 40% for those expecting to give under £100,000 to 51% for those expecting to give over £500,000. This may be because people expecting to give over £500,000 are more likely to pay the tax than others - and so more likely to benefit from the rate cut for inheritance under £1m - but also not that likely to have inheritance over £2m and pay the higher marginal rate of 45%.

In contrast, those expecting to give over £500,000 are significantly less supportive of the cap on business relief over £500,000, with 36% supporting this compared to 58%-59% of those expecting less inheritance. This may be because this former group, in owning over £500,000 of assets, more closely associate themselves with people owning over £500,000 of *business* assets - dampening support for increasing tax on these people.

CHART 15

People expecting to give more inheritance were more likely to support rate bands, but less likely to support the business relief cap

Agreement with the statement "I would support this policy", by expected bequest

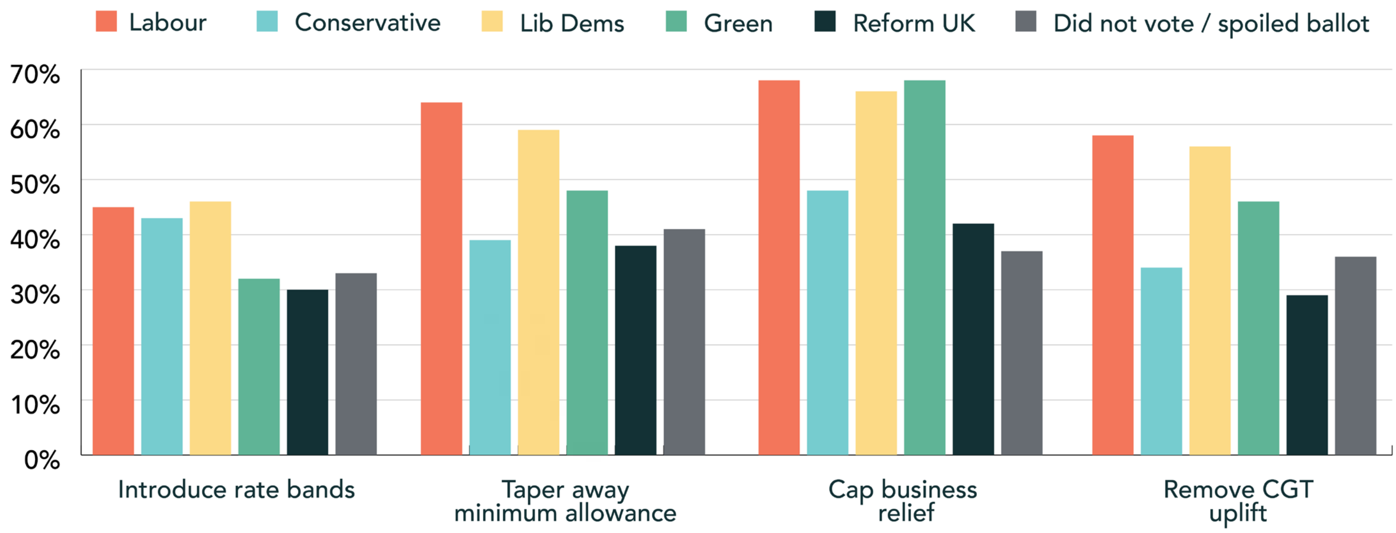


In looking at the breakdown of support for each policy by 2024 vote, we see that there is little difference in support for the introduction of rate bands between Labour voters (45%) and Conservative voters (43%). In contrast, there is a much greater divide on all other policies, including tapering away the minimum allowance (64% vs 39%), capping business relief (68% vs 48%) and removing the uplift in capital gains (58% vs 34%). Lib Dem voters follow similar patterns to Labour voters. Reform UK voters are generally less supportive of each policy, but nevertheless, all policies receive net support (support greater than opposition) from Reform voters other than removing the capital gains uplift.

CHART 16

There was little difference between Labour and Conservative voters' support for rate bands, but significant difference on other polices

Agreement with the statement "I would support this proposal", by policy and 2024 vote



The policies also receive particularly high support among Labour's 'hero' voters - currently defined as voters who switched from Conservative in 2019 to Labour in 2024.[96] Hero voters show large net support for rate bands (44% support vs 23% oppose), tapering away the minimum allowance (57% vs 16%), capping business relief (63% vs 11%) and removing the CGT uplift (58% vs 18%).

There may be a concern that increases to inheritance tax and capital gains tax would particularly frustrate older people and those in the South of England, who tend to be wealthier and generally more opposed to inheritance tax.[97] Yet, these groups show net support for all of the proposed policies:

- Introducing rate band received 17% net support (support minus opposition) among people in the South (excluding London), and 19% net support among Baby Boomers.
- Tapering away the minimum allowance received 21% net support among both Southerners and Baby Boomers.
- Capping business relief received 32% net support among Southerners and 36% among Baby Boomers.
- Removing the capital gains uplift received 17% support among Southerners and 27% among Baby Boomers.

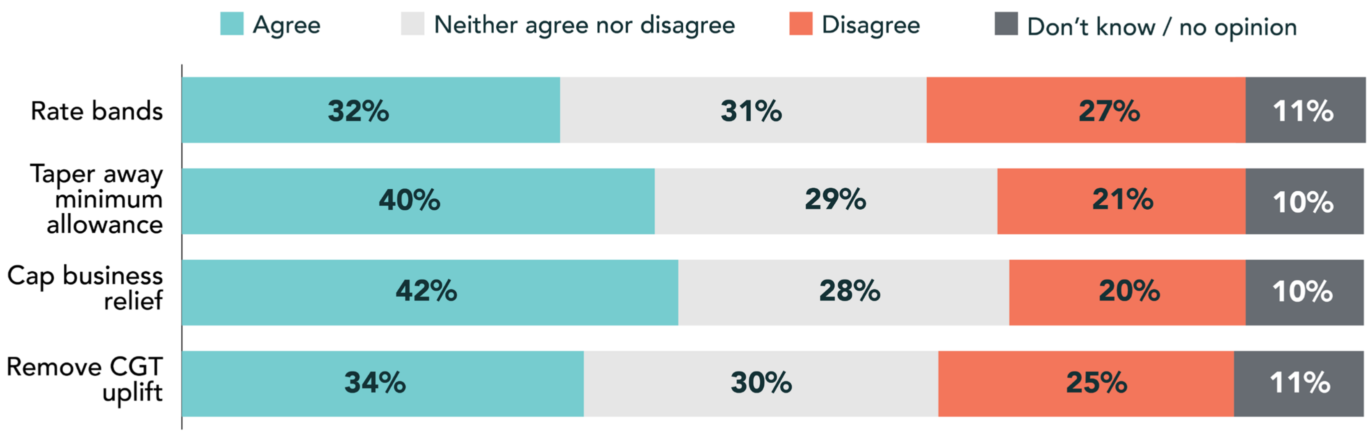
The public also suggested they would feel more positive towards the government if it implemented the recommended policies. The agreement with this statement correlates closely with support for the package. All policies we polled on would drive a net boost in positivity in the government if implemented (a larger proportion of people who would feel more positive about the government than those feeling less positive). Again this is particularly the case for tapering away the minimum allowance (40% more positive vs 21% less positive) and capping business relief (42% and 20% respectively).

96 Opinium's definition
97 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

CHART 17

All of the policies would tend to make the public feel more favourable about the government

Agreement with the statement "This would make me feel more positive about the government"



Summary of polling results

It is clear that both the recommended reform package, and the specific policies within them, receive significant support. The public overwhelmingly prefer the recommended reformed system to the current inheritance tax system, and think the package of reforms should be prioritised over spending cuts or borrowing of the equivalent amount in the Autumn Budget. Support is consistent across voters of different parties - with particular support among 2024 Labour voters - and people expecting to receive smaller or larger inheritances. Support is also consistent across individual policies, with particularly high support for policies to cap business relief and tapering away the minimum allowances.

This indicates that the package of recommended reforms, and the individual policies, could receive broad support if introduced in the Autumn Budget.

3.2 HOW TO COMMUNICATE THE REFORMS

Deliberation on framing

In the final session of our deliberation, after the public had decided on their priorities for inheritance tax reform, we presented them with various mock-up BBC headlines - presented as if news stories on the BBC app, each with a different framing - and asked them to explain how they felt about each one. These frames were:

- **Revenue frame** - focussing on the amount of money raised from reform
- **Hypothecation frame** - focussing on which public services the money would be used to fund
- **Fairness frame** - focussing on how the reforms would make inheritance tax fairer
- **Details frame** - focussing on the specific measures that were being implemented

The frames that the public were most drawn to were the hypothecation and fairness frame; people had very little to say about the other two. The fairness frame was the most widely supported of the two, with people feeling that it avoided putting the emphasis on needing more money, and shifted the emphasis to something everyone could support,

> *If you're saying you're 'overhauling to make it fair', that's a positive statement. But saying 'we're going to increase tax because we need more money', it sounds more negative.*
>
> **- Boomer renter, intended to vote Labour in 2024**

When asked to explain why their priorities were the right ones, panellists also often referred to fairness, for example that *"it's much fairer, and it reflects the modern society a lot better"*. Some people also felt that focussing on the money that inheritance tax reform could raise - rather than on how reform would make the tax fairer - might suggest that everyone will be chipping in some extra money, rather than the tiny percentage who actually do. Given the recommended reforms mean an inheritance tax cut for estates under £1m, some taxpaying estates would actually pay less.

> *Saying 'the government overhaul inheritance tax to raise funds for public services' is telling people that everybody is going to be paying more, where [the fairness frame] actually says it's going to be overhauled to make the system fairer. So some people will see no increase in inheritance tax, and still a lot of people won't be paying it. But the [hypothecation frame] could actually say that everybody will be paying it, rather than just the 5%.*
>
> **- Gen X homeowner, intended to vote Labour in 2024**

Within the fairness frames, we tested the panel's reaction to framing the reforms as 'ensuring the wealthiest pay their fair share'. Many supporters of the fairness framing were opposed to the idea of putting the focus on the wealthiest people to pay more, feeling this might come across as a personal attack. Instead, these people preferred a discussion of fairness that felt more neutral towards different people in the population, instead focussing on everyone paying what they can, and removing opportunities for the wealthy to avoid the tax.

> *I think [the frame of 'ensuring the wealthiest pay their fair share'] is just calling out people, and I don't particularly like that… Our thoughts are that people who earn more should pay more, and I think that's a fair enough thing to say, because that's where the tax system works. But trying to get an audience from calling out a certain group of people, I don't agree with that.*
>
> - **Gen X homeowner, intended to vote Conservative in 2024**

I think [the frame of 'ensuring the wealthiest pay their fair share'] makes it sound like the government's got a bit of a chip on its shoulder. It sounds a little bit too socialist.

- Millennial living with parents, intended to vote Reform in 2024

The hypothecation frame was supported by some. Some people felt the fairness frame was too vague - that it is not clear what fairness actually means in any specific context. Others felt that one person's gain is another's loss, and that no policy reform can be fair to everyone as some people will lose out.

The phrase 'make it fairer' is instantly going to create a debate on who is to judge what is fair and what is not. I think on the [hypothecation frame[, if something's going to be raising money for public services, that either is or isn't true. Money and maths are absolutely unforgivable arbiters. They're going to be measurable by the Treasury... So I think the [fairness frame] will create division and argument. I think the [hypothecation frame] will speak to everyone as a broad message, and it will be more palatable.

- Millennial homeowner, intended to vote Labour in 2024

Rachel Session 6 - I think nothing can ever be fair for everyone. So you're wondering who it's going to be fairer for.

- Gen Z renter, intended to vote Labour in 2024

Polling on framing

The findings of the deliberative exercise on framing the package - that the 'fairness' frame is most popular, with the 'hypothecation' frame also relatively popular - were confirmed in our polling. To understand the impacts that different framing approaches would have on favourability towards the government, we ran an A/B test in our polling. We ran this before any discussion of specific inheritance tax reforms, so as not to give people prior knowledge or influence their thinking on inheritance tax. We asked about four frames:

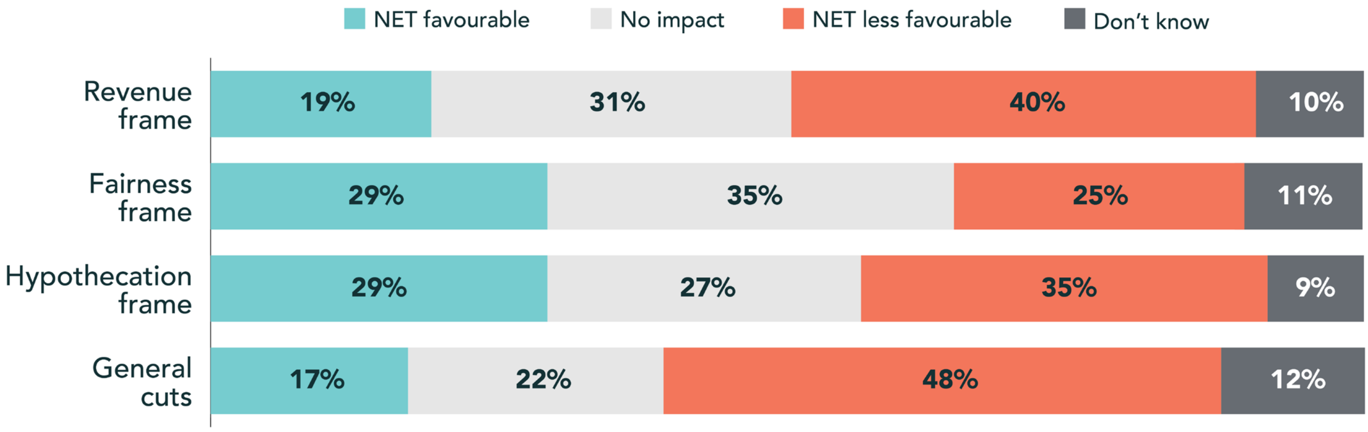
- **Revenue frame** - 'Government announces overhaul of inheritance tax in Autumn Budget to raise £2.6 billion'
- **Fairness frame** - 'Government announces overhaul of inheritance tax in Autumn Budget to "make it fairer for working households"
- **Hypothecation frame** - 'Government announces overhaul of inheritance tax in Autumn Budget to raise £2.6 billion to invest in the NHS and social care'
- **General cuts** - 'Government cut spending on public services by £2.6 billion in Autumn Budget'

Our polling shows that the 'fairness frame' led to a net increase in favourability towards the government of 4%. Alternatively, the 'hypothecation frame' led to a 6% decrease in favourability, while the revenue frame led to a 20% decrease. Both of these are significantly lower, however, than the 32% decrease in favourability from an announcement of cuts.

CHART 18

People would feel more favourable towards the government if they emphasise the fairness of inheritance tax reforms

A/B test on the impact of different Budget announcements on favourability towards the government

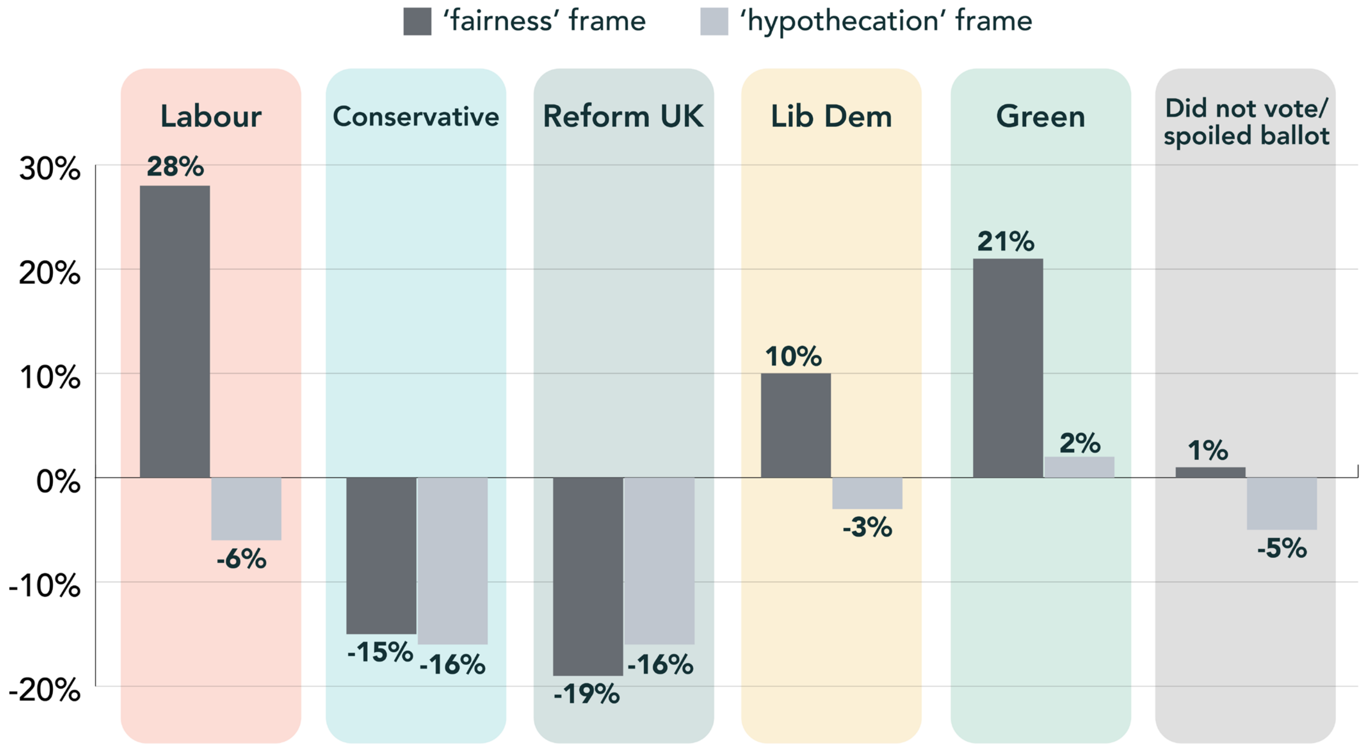


It is important to look at the split in framing preference by party vote, as the government may be looking to target its messaging towards specific voter groups. This positive response to the fairness frame is mainly driven by Labour voters, for whom the fairness frame drove a net favourability gain of 28%, compared to the 'hypothecation' frame driving a net favourability loss of 6%. We also saw significant boost in favourability for the fairness frame for Lib Dem voters (+10%) and Green voters (+21%).

CHART 19

Labour, Lib Dem and Green voters respond much more positively to the ‘fairness’ frame than the ‘hypothecation’ frame

Net change in favourability for the government in response to different framings of inheritance tax reform, by 2024 vote



While there were favourability losses among Conservative and Reform voters to all frames - as we might expect for polling on reforms by a Labour government - the losses for inheritance tax reforms were much lower than for equivalent spending cuts. While spending cuts would drive a net favourability loss of 35% among Reform voters and 28% among Conservative voters, the ‘fairness frame’ for inheritance tax reforms would drive a 19% loss for Reform voters and 15% loss for Conservative voters, while the ‘hypothecation frame’ would drive a 16% loss among both. This suggests that framing the inheritance tax overhaul as either making inheritance tax fairer or as raising funds for specific public services would lead to much better views of the government among Reform and Conservative voters than equivalent spending cuts.

CONCLUSION

This paper - laying out the case for an ambitious but pragmatic set of reforms to inheritance tax - is the culmination of nearly three years of research on the economic and public attitudes landscape around inheritance and its taxation. Having identified the growing value of inheritance in the UK as an under-explored trend, in 2022 we looked into the socioeconomic challenge; what problems might the *'new age of inheritance'* create?[98] In finding growing divides between the inheritance 'will-haves' and 'won't haves' and an inheritance tax system not suited to this changing landscape, it was clear that policy needed to adapt.[99]

We then explored the political challenge; how should the government respond, and what barriers will they face in doing so? We focussed on inheritance tax - a tool that many thought was too politically toxic for governments to use effectively. We found that attitudes to the tax are more nuanced than often assumed, and that reforms which engaged with and responded to the public's concerns about inheritance tax could build support.[100,101] We identified arguments for reform from both the Labour and Conservative perspective.[102,103] And we reviewed the options for reform of inheritance tax, looking at options outlined by researchers and the systems of countries who do it better than the UK.[104]

Drawing on all this, the recommended reforms have been designed to balance revenue gain, alignment with the public's priorities, and administrative feasibility. As the research shows, the reforms to inheritance taxation could play a key role in plugging the government's £22bn fiscal hole. With the proposed changes expected to raise up to around £16bn this Parliament, they could be critical in helping the Chancellor avoid harmful cuts to public services. Alongside raising revenue, the reforms would deliver needed improvements to the taxation of inheritance. By making inheritance tax fairer and helping limit the tax burden for working people, the changes could boost support for a tax which many Brits feel it is time to fix.

While the government faces many tough choices for the Budget on 30th October, **fixing inheritance tax while delivering additional revenue would be a bold and positive step to take.**

98 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/anew-age-of-inheritance-what-does-it-mean-for-the-uk
99 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
100 Ibid.
101 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/
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APPENDIX 1
REMOVING OPPORTUNITIES TO REDUCE INHERITANCE TAX BILLS

TAXING LIFETIME GIFTS

Currently, gifts given outside the seven years prior to death face no tax at all. This means people can avoid inheritance tax, if they are willing to transfer their assets earlier in life. This does happen to an extent, with gifts making up around 23% of the value of inheritance passed on each year.[105] The reforms recommended in this paper increase the incentive to do this for two reasons:

1. The reform increase the tax rates on the wealthiest estates
2. The reforms mean business assets over £500,000 are liable to inheritance tax, and businesses could be gifted to avoid this

If the transfer of businesses during life is expected to seriously diminish revenue, the government should consider a tax on lifetime gifts to protect the taxation of inheritance.

Most OECD countries who tax receipt of inheritance also have a gift tax.[106] Many of these have thresholds that apply to any gifts over a 10- or 15-year period (i.e. tax is paid to the extent that the aggregate of gifts in a 10/15 year period exceeds the threshold).[107] Ireland stands on its own in having a lifetime allowance that applies to all transfers during life and at death, with an allowance per person of €335,000 for all transfers collectively from their parents or children, of €32,500 for all transfers from their siblings, nieces, nephews, grandchildren or grandparents, or €16,250 for transfers from anyone else.[108]

For the UK context, the APPG on Inheritance and Intergenerational Fairness recommended a lifetime gift tax, suggesting we introduce an annual lifetime gifts allowance of £30,000 and a death allowance around £350,000, with a 10% rate after this.[109] The annual allowance could be bigger or smaller, or a lifetime allowance could be introduced, for example of £1m. Importantly, the UK did tax lifetime gifts under the Capital Transfer Tax. At its introduction in 1975, the Capital Transfer Tax applied a progressive tax rate (with rates from 5% to 75%), to lifetime gifts

105 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
106 OECD (2021). Inheritance Taxation in OECD Countries. OECD Tax Policy Studies. https://doi.org/10.1787/e2879a7d-en
107 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/
108 Goss D. The Future of Inheritance Tax: Options to Repair Inheritance Taxation in Britain. Demos. July 2024. https://demos.co.uk/research/the-future-of-inheritance-tax-options-to-repair-inheritance-taxation-in-britain/
109 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

over £15,000 (worth £113,000 in 2024 money), with an annual exemption of £1,000 (£7,5000 in 2024 money).[110] This was removed in 1986 by Nigel Lawson as it was seen as "a thorn in the side of those owning and running family businesses, and as such has had a damaging effect on risk taking and enterprise within a particularly important sector of the economy".[111]

A lifetime receipts tax was not included in the core recommendations of this paper given widespread public opposition to it, but we recognise that such a policy may be necessary to protect the revenue from inheritance tax.

Public attitudes

During our public deliberation, a lot of concern was expressed about taxing lifetime gifts, including an additional sense of double taxation and government overreach, concerns about the administrative burden, and the concerns about the ability to avoid or evade it.

On the additional sense of double taxation, people cited the fact that someone could earn a lot of money and have to pay tax on that, and immediately want to transfer that to their child - but with a gift tax, they may have to pay tax again. Some people felt this was unacceptable.

I've paid income tax, and I paid higher income tax on my earnings. So if I want to give a gift of any amount of money to my children or my grandchildren, I should be able to do that without being taxed again on it… It's so unfair… to say that you're giving a gift to your children or grandchildren, and you've got to declare it. Absolutely not. And I think that people will try and get around it.

- Gen X homeowner, intended to vote Conservative in 2024

Relatedly, some people felt that a tax on lifetime transfers would be immoral, representing 'a tax on generosity', or an imposition by the government into personal matters. While the same arguments could be applied to tax on inheritance, inheritance tax now has a long history and has been somewhat normalised within the tax system. The introduction of a new tax on similar transfers, however, could engender new and intensified opposition.

If we do it during life, this would feel like a tax on generosity, a tax on altruism.

- Millennial homeowner, intended to vote Labour in 2024

I don't think it's anybody's business what you give to your children. If you want to give them something, great, why not?

- Gen X Renter, intended to vote Reform in 2024

110 Finance Act 1975. https://www.legislation.gov.uk/ukpga/1975/7/pdfs/ukpga_19750007_en.pdf
111 Nigel Lawson, Chancellor of the Exchequer. "Business and Enterprise". Parliamentary Debates (Hansard). House of Commons. 18 March 1976. https://api.parliament.uk/historic-hansard/commons/1986/mar/18/business-and-enterprise

On the administration, members of our panel felt that the reporting requirements for the public would be too burdensome. People felt that asking members of the public to keep track of and report transfers would involve too much work.

Over the course of a person's life, that's such a massive body of work to track what every single citizen is receiving year on year, from their parents or from whoever it is. It feels horribly big.

- Millennial homeowner, intended to vote Labour in 2024

On the ability to avoid a gift tax, some felt that the reporting requirements for people would be too burdensome. One person raised the example of someone paying for their child's kitchen renovation, and the inability for HMRC to track that gift. Many in the group audibly agreed.

Taxing transfers during lifetime, it's just going to be a very very difficult piece. I think it'd be difficult for tax inspectors to check and people will avoid it in any way they can.

- Boomer homeowner, was undecided on 2024 vote

On the other hand, some in our panel identified the tax on gifts as something that would primarily tax the wealthiest, and as such tended to be more supportive. Others also noted how it would specifically help reduce the ability for the wealthy to avoid inheritance tax by transferring assets earlier in life. While people making these arguments were more supportive of taxing certain lifetime gifts, they did not manage to persuade many others.

The amounts that they're talking about aren't things like cars or gifts, like small gifts. I think this is something that would impact the really, really wealthy families, a gift in houses and hundreds of thousands of pounds. I don't think this is something that would massively impact the working class family. So I'm not massively against it, to be honest.

- Millennial renter, intended to vote Labour in 2024

I think if you don't have something in there on gifting, you're effectively just creating a complete back door that just completely goes around the entire point of inheritance tax. People would just give away.

- Millennial without permanent residence, intended to vote Labour in 2024

RESTRICTING AGRICULTURAL RELIEF

Currently, 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.[112] This has also recently been extended to cover non-farming land which is environmentally managed, under the government's post-Brexit agricultural support regime.[113]

In 2020-21, £1.02bn of agricultural assets benefited from this relief.[114] In 2019-20, 35% of the assets benefiting from this relief were owned by just 6% of claimants (71 estates, with £4.6m of assets relieved per estate on average).[115] HMRC estimates the cost of this relief to be £400m.[116]

Beyond this, restricting agricultural relief could also help protect the revenue gain from restricting business relief. If people owning business assets wanted to avoid inheritance tax, they could sell those business assets and instead buy farmland. If owned for two years, this would then benefit from inheritance tax relief. while the IFS/UoW estimate that capping both agricultural and business relief at £500,000 would raise £1.4 billion in 2024- 25.[117]

Restrictions on agricultural relief were not included in the core recommendations of this paper given broad public opposition to them, but we recognise that such a policy may be necessary to protect the revenue from inheritance tax. Restriction could include capping the relief available (e.g. at £500,000, as recommended by the IFS), or increasing the amount of time that someone has to own agricultural land before it can benefit from inheritance tax relief (e.g. from 2 years to 5 or 10 years).

Public attitudes

If introducing restrictions on agricultural relief, the government should be aware that many people were opposed to this for two key reasons: to protect farms from closing and farmers being put out of the job, and relatedly to reduce shocks to food prices.

First, the public felt particularly defensive about farms as a business and farmers as business owners. There was a general sense that farming is a particularly hard and unpredictable job, but one that we should value the continuity of. Many in our panel felt that applying inheritance taxes to farms would add unfair burdens onto farmers, and may force farmers to sell parts of their land and potentially close their farm.

112 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
113 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-propertyrelief
114 HM Revenue and Customs. Inheritance Tax liabilities statistics. 26 July 2023. https://www.gov.uk/government/collections/inheritance-taxstatistics
115 Demos FOI request to HMRC, February 2024
116 HM Revenue and Customs. Non-structural tax reliefs. 16 May 2024. https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs
117 Advani A and Sturrock D. Raising revenue from closing inheritance tax loopholes. 18 April 2024. https://ifs.org.uk/articles/raising-revenueclosing-inheritance-tax-loopholes

Farming is something that you can't predict the outcome of. So, making them pay taxes, I don't think it's proper, because sometimes you could have a bumper harvest. Sometimes anything can happen that's spamming for you. It's unpredictable. So I think [agricultural relief] is very fair.

- Gen X renter, intended to vote Labour in 2024

[Farming] is a very hard job, and I think it's only fair that they're not taxed to encourage future generations to keep going, because it's a dying industry. It's becoming harder and more expensive for them to run the farm. [Restricting agricultural relief] will just turn the farmers to sell the land for housing, which is a shame, when really we need to encourage the farming industry within the UK.

- Millennial homeowner, intended to vote Green in 2024

Our panel were told that many farms are rented, and that in these occasions it is the landowner's estate that directly benefits from the agricultural relief rather than the farmer's. Yet, people were concerned that applying inheritance tax to the land would have negative knock-on effects to the farmer, even if they didn't own the land.

That fact about 45% of the farms being rented, if the person inheriting it can't afford to pay the tax on it, they'll sell it, which will then put the person that's working the land out of business. So I think that's probably why that's there, to ensure they're protected.

- Gen X homeowner, intended to vote Labour in 2024

Secondly, and relatedly, the public felt that removing agricultural relief could disrupt food supply. People linked their concern about farm closure with a concern about harming UK food production, feeling this risked undermining our self-sustainability and driving up food prices. This likely plays into the current national mood, whereby many people are still feeling the effects of the rising cost of living.[118]

We want to make sure we keep food prices as low as possible, so that the people that earn the least in society can make sure that they still get their food at a reasonable price. If you start looking to heavily tax farmland, it will literally end up being sold off and going derelict, and food prices would become higher, or we'd look to import food from abroad, and then that would affect the taxation in the UK… It would be going overseas to other multinational companies.

- Millennial living with parents, intended to vote Reform in 2024

118 Johnson-Hunter M and Earwaker R. The scale of the challenge: JRF's pre-election cost of living tracker. Joseph Rowntree Foundation. https://www.jrf.org.uk/cost-of-living/jrfs-pre-election-cost-of-living-tracker

Taxing pensions

Currently, private pensions are 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.

Reforms to bring pensions into the scope of inheritance tax, or to place income tax on pension pots for those who die before age 75, were not included in the core recommendations of this paper given public concerns about this, but we recognise that such a policy may be necessary to protect the revenue from inheritance tax.

If the aim is to prevent pension pots being used to avoid inheritance tax, one option would be to reinstate the lifetime allowance on pensions (a higher rate of tax than normal for private pension wealth above a certain allowance when it is taken as either a lump-sum or income). The lifetime allowance on pensions - which was in place between 2006/07 to 2022/23 - acted as a barrier to people putting very significant amounts of wealth in their pensions in order to avoid inheritance tax, as people instead faced higher income tax rates above the allowance.[119] It was then removed. If reinstated, this would reduce the incentive to direct one's wealth into their pension pots to reduce taxation.

Alternatively, the government could introduce a cap on the amount of pension wealth that remains out of the scope of inheritance tax. According to IFS estimates, applying IHT to 80% of the value of DC pension pots (equivalent to applying inheritance tax to the value of the pension after basic-rate income tax has been deducted) would likely raise £200m in 2024-25, rising to £400m by 2029-30.[120] If income tax was applied to inherited pension pots for those who die before age 75, the IFS estimate this would raise tens of millions in revenue in the first year, but would grow over time.

Public attitudes

There are mixed opinions about taxing pensions in inheritance tax. Some of the public closely associate pensions pots with savings, seeing them as something very ordinary for people. Some argued that, unlike other assets, pensions are not investments that lead to large windfalls in the same way (though, of course, pensions can and do gain significant value through the investment of pension funds).[121]

119 Adam S et al. Should the pensions lifetime allowance be reintroduced and, if so, how?. Institute for Fiscal Studies. 4 June 2024. https://ifs.org.uk/articles/should-pensions-lifetime-allowance-be-reintroduced-and-if-so-how
120 Advani A and Sturrock D. Raising revenue from closing inheritance tax loopholes. 18 April 2024. https://ifs.org.uk/articles/raising-revenueclosing-inheritance-tax-loopholes
121 Broome R. Mulheirn I and Pittaway S. Peaked interest? What higher interest rates mean for the size and distribution of Britain's household wealth. Resolution Foundation. July 2023. https://www.resolutionfoundation.org/app/uploads/2023/07/Peaked-interest.pdf

Pensions feels really tangible to me, because it's something you pay into every month, and it's for your retirement and something that you've planned for yourself. So if you were to die young and not use your pension for your children to then be taxed on, that feels different for me than your house, because your property just goes up at a rate. You might have bought it for 200 grand, but living in it for 50 years, it's now worth a million pounds. That feels different, your pensions tied into what you've earned and so I feel differently about the pensions element of it.

- Gen X homeowner, intended to vote Labour in 2024

Others among our panel were, however, more supportive of bringing pensions into the scope of inheritance tax. In particular, some were concerned about the idea of pension pots being used as an inheritance tax loophole, and others felt the rule about no income tax on pension pots for those who die before age 75 did not make much sense.

People can then just put a massive lump sum in their pension, knowing that it's not going to be touched. So I don't really agree that there should be an exemption, to be honest.

- Millennial renter, intended to vote Labour in 2024

It may sound a cynical view, but as I said, it's, I think it's a way for pressure groups, for the extremely wealthy to pass on their wealth without paying inheritance tax.

- Boomer homeowner, was undecided for 2024

I think whatever the reason was [for having an income tax exemption for inherited pension pots of people dying before 75), it doesn't seem like it's necessarily justified to still have that exemption, particularly when you think of all the all the stresses that we've got in terms of that we're all likely to have to pay more tax in the future.

- Millennial without permanent residence, intended to vote Labour in 2024

Other members of the public made arguments about the wider economy, defending pensions on the basis that they support the wider economy, and arguing that taxation on these would deter investment in things like infrastructure.

People often forget that when pension money is actually paid into the pension fund, the government invests it, and they also make money. It's not just people benefiting. You're forgetting that more often than not, the government invests in other infrastructure in other countries to try and make a profit. It actually generates income. So if you then decide that you feel it's right to then deter people from wanting to put money in a pension because they're going to get heavily taxed afterwards, I think actually you're shooting yourself in the foot and not looking at the bigger picture.

- Millennial living with parents, intended to vote Reform in 2024

This aligns with other research showing that the public are highly opposed to pensions being included within the tax base for a wealth tax, even more so than for savings.[122] The context of the Budget - in following significant backlash about the reduction in winter fuel payments for pensioners - could also potentially inflate opposition to reforms to the inheritance tax treatment of pensions.

122 Rowlingson K, Sood A and Tu T. Public attitudes to a wealth tax. Wealth Tax Commission. 2020. https://www.wealthandpolicy.com/wp/EP2_PublicAttitudes.pdf

APPENDIX 2
REFORMS TO EXPLORE

TAXING RECEIPTS RATHER THAN ESTATES

The UK is one of only four OECD countries to tax the estate, rather than receipt of inheritance. This means that the tax is based on how much is given by a person in inheritance, not how much is received by each inheritor. If someone in the UK leaves an inheritance of £2m, it gets taxed exactly the same if they split that between 10 people or between two people. The allowances apply to the £2m estate. But in countries that tax the receipt of inheritance, the allowances apply to how much each person receives. If the £2m estate is split between two people, they receive £1m each, and this could be taxed completely differently to 10 people receiving £200,000 each.

In theory, taxing receipts should encourages 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 recommends moving to such a system on this basis.[123] This system could 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. However, our research suggests the public attitudes are more complex.

Public attitudes

There were mixed feelings across our panel about taxing receipts rather than estates. People were opposed to a receipts-based tax for a range of reasons:

1. Some were concerned that a receipts based tax punishes single children.

> *I only have one child myself. So if the limit [after introducing a receipts tax] ended up being lower - say about £200,000 or £250,000 - I'd end up getting penalised for it. Basically, I feel like it's not necessarily fair.*
>
> **- Millennial renter, intended to vote Labour in 2024**

2. Some also felt it shouldn't be the job of inheritance tax to encourage inheritance to be spread more widely between different people.

> *I don't think that's up to the policy to dictate what people do with their money. If they've got two children and they want to leave everything to their two children, that's up to them to do that.*
>
> **- Gen X Renter, intended to vote Reform in 2024**

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

3. Some felt that just taxing one amount (the estate) at death was better because it was simpler for both taxpayers and the government, potentially adding new burdens onto recipients

The problem about splitting the estate is its solicitors fees, isn't it? You pay £40 a letter, so it's more for the solicitor to actually do, which will take money away from the inheritance, which is why I think it should be done as a lump sum.

- Gen X homeowner, intended to vote Labour in 2024

Nevertheless, a receipts based tax did receive some support from those who thought it would be fairer for people who receive a small part of a large estate, and therefore may be affected by inheritance tax despite not receiving very much. Relatedly, most of those that were supportive were fond of the idea that a receipts-based tax could enable certain recipients to get additional tax benefits. For example, people with less wealth or with specific needs such as a disability could receive tax relief under a receipts-based system.

Fiscal context

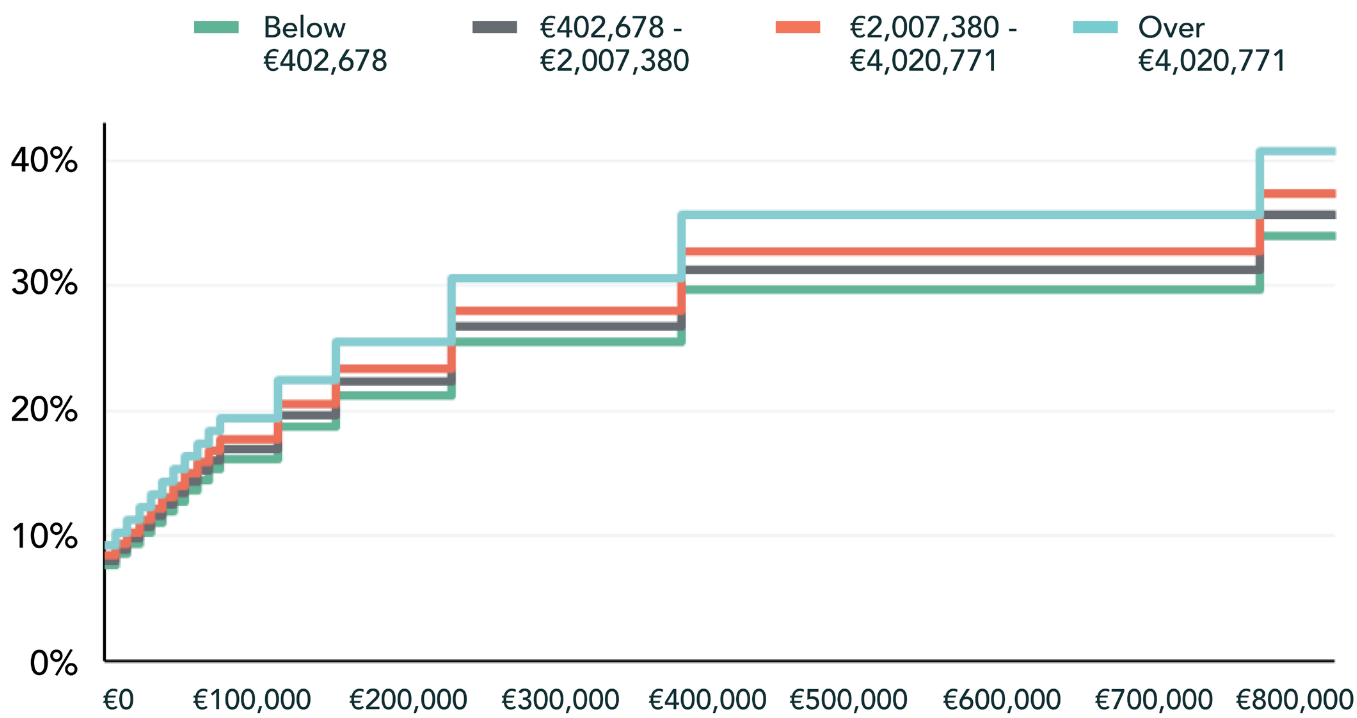
The preferred design of a receipts tax - whereby there is different treatment of recipients dependent on how wealthy they are prior to receiving inheritance - reflects the approach in Spain. Spain's inheritance tax applies a progressive rate to any inheritance and gifts - and each descendant gets €15,956 tax-free.[124,125] 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). 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.

124 EY. Worldwide Estate and Inheritance Tax Guide 2023. 20 July 2023. https://www.ey.com/en_gl/tax-guides/worldwide-estate-andinheritance-tax-guide
125 Importantly, regional governments can shape inheritance taxes in Spain and have generally cut inheritance taxes significant. The specific parameters of the tax outlined here, which are the parameters outlined by the national government, are rarely applied in practice.

CHART 20

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



We modelled the application of Spain's rate structure to the UK (whereby the thresholds for each rate band were adapted to the UK context by determining how much they were worth relative to Spain's average wages, and applying this to the UK's average wages). We found that applying Spain's rate structure to the UK would lead to a £10m revenue gain. While the revenue gain is small, there may be an impetus to move to such a system to help tackle issues of social immobility caused by inequalities in the receipt of inheritance.

The concern with the Spanish model is that it does not closely include tax reliefs for certain recipients - something which our panel were supportive of. To test a system that more closely aligns with the panel's preferences, we modelled the impacts of applying a more progressive rate structure, with an exemption for recipients with low wealth. In this, there would be no charge for recipients with pre-inheritance wealth below £100,000. The standard rate would then be applied for recipients with wealth up to £500,000, and there would be rate increases of 1.2x the standard rate for recipients with wealth up to £1m, and 1.5x for recipients with wealth above £1m. This model would lead to a net loss of £1.54bn. This could, however, be offset with other reforms, such as removing the capital gains uplift (+£1.6bn).

EXTENDING BENEFITS TO UNMARRIED COUPLES

Currently, people can pass on inheritance to their spouse or civil partner completely tax-free, and the 'transferable nil-rate band' means the surviving partner can take any of their spouses unused tax-free allowance. For example, if one spouse leaves their inheritance completely to their spouse, they would not use up any of their £325,000 tax free allowance. The surviving spouse can therefore add that to their own tax-free allowance, meaning a £750,000 minimum allowance. Yet, currently, these benefits are not available to unmarried couples who live in the same house.

Cohabiting couple families account for around 18% of all families in the UK, and the number of cohabiting couples in the UK has increased significantly over time.[126,127] The Office for Tax Simplification noted how organisations had suggested to them that the current system fails to take account of these couples, who make up an increasingly large portion of families.[128]

If seeking to change this, one option would be to allow unmarried couples who have lived together for a certain number of years both to transfer inheritance to each other tax-free, and to combine their tax-free allowances. Given that the spousal exemption costs a significant amount (£3.9bn in 2023-24), extending this to unmarried couples would also cost a significant amount. An option to align more with public preferences while reducing the revenue loss would be to extend just the transferable nil-rate band to unmarried couples. We modelled this latter option - whereby the transferable nil-rate band would be open to couples who had lived together for at least 5 years - and found that it would lead to a revenue loss of £40m.

There are three key issues with this. Firstly, multiple taxes offer greater benefits to married couples than unmarried couples.[129] It may be inconsistent to extend the benefits to unmarried couples for inheritance tax, but not for other tax and welfare benefits. As the OTS outline, "any change to the definition of spouse to include a cohabiting partner or sibling would be far reaching. This would most naturally form part of a wider response to social change considered across government rather than being driven primarily by Inheritance Tax considerations."[130] Secondly, extending the benefits to unmarried couples could open new routes for tax evasion, as people could, for example, falsely claim they are a couple. Lastly, extending the benefits to unmarried couples would add administrative complexity to the system, as HMRC would require couples to register and have to track their cohabitation in the time prior to death.

Given these issues, the extension of benefits for married couples to unmarried couples was not included in our core package, despite widespread public support for this measure. However, we note that this reform is something the government should explore to ensure the tax system remains in life with the public's values.

126 ONS. Families and households in the UK: 2023. 8 May 2024. https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/families/bulletins/familiesandhouseholds/2023
127 ONS. Families and households in the UK: 2027. 8 November 2017. https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/families/bulletins/familiesandhouseholds/2017
128 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
129 Garner and Hancock Solicitors. Taxes for Unmarried Couples. (no date). https://garner-hancock.co.uk/family-law/cohabitation/taxes-for-unmarried-couples
130 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

Public attitudes

Most people felt that the current system of giving more benefits to married couples than to unmarried couples was outdated, and that reforms were needed to reflect changes in relationship norms.

One thing we thought was quite important to take into account the fact that the way people live together has changed over the years, is to start allowing unmarried couples to combine their allowances.

- Millennial without permanent residence, intended to vote Labour in 2024

Nevertheless, our panel was concerned that this reform could be used as a way to evade taxation, and felt that any such reforms should come with reliable processes to prevent this.

We wanted to start allowing unmarried couples to combine their allowances as well, but we were very aware of it as a possible tax dodge….So we agreed that it should be done. There should be checks and balances to make sure that it's not a system that's gained in any way.

- Millennial homeowner, intended to vote Labour in 2024

APPENDIX 3
METHODOLOGY

Deliberation

In May and June 2024, Demos ran a deliberative exercise on inheritance reform. We first ran six two-hour sessions with 27 members of the public (sometimes split into three randomised groups of nine each, and sometimes together as a whole) on the question of "How to tax inheritances in a way people think is fair and effective, without losing revenue". Across these, the participants discussed three categories of reform:

- **Shifts within the current system:** rates, thresholds and exemptions
- **Shifting the tax base:** taxing receipts rather than estates, gifts, and inherited capital gains
- **Hypothecation:** to different kinds of spending commitment, and using different mechanisms

For each, we provided data - based on government guidelines, HMRC data, modelling from reliable sources - on aspects such as:

1. How the current policy works and the reason it exists
2. How the reformed policy would work and the reason it is proposed
3. The impact of reform on the amount and distribution of inheritance
4. The impact of reform on the amount and distribution of inheritance tax
5. Various arguments around the impact of different reforms on businesses, investment and growth from reliable sources - most notably the OECD, the IFS, Resolution Foundation.

In each session, the panel would discuss what they liked about the current system, what they did not like, and what kind of reforms they would like to see implemented. Based on this, we asked the panel to decide upon two things.

1. What aspects of inheritance tax should change, and what should stay the same?
2. For things that need to change, which direction should the changes go in (e.g. higher or lower rates, more or less restricted reliefs)?

Where relevant - and where we felt our public sample had enough evidence to make an informed decision - we also asked the public for a sense of the scale of change needed. For example, after the groups agreed that inheritance tax should have rate bands, we asked them how many bands they thought there should be, at what rates, and at what amounts.

In the fifth session, we asked the panel to think about all the previous sessions in the round and consider priorities for inheritance tax reform that would work together well. We ran the same decision-making process as outlined above and asked three randomised groups in the panel to outline packages of reform priorities. The reform priorities outlined in this briefing are informed by these three packages.

Economic modelling

The costings and distributional effects of the modelled reforms to IHT and CGT in this report are estimated by Landman Economics using data from the Wealth and Assets Survey (WAS). The WAS data used are from Round 7 (collected 2018-2020), which are the most recent wave available at the time of writing.

In the UK Inheritance Tax system, liability for IHT is assessed on the basis of the value of the deceased person's estate (taking into account eligibility for the Spouse Nil Rate Band and the Residence Nil Rate Band) rather than the amount of the estate received by each recipient and the number of recipients. Therefore, to estimate the cost of each IHT reform we model the size and distribution of estates becoming liable for IHT. For each household in WAS Round 7, the probability of the estate becoming assessed for inheritance tax in the next 12 months is modelled using probabilities of death based on the age and sex of each adult (or adults) in the household, using the Office for National Statistics' National Life Tables (ONS, 2024). The value of each estate is estimated using data from the WAS on the total value of each estate when the interview data was collected, and uprating to the 2024-25 tax year using house price indices (for property values) and nominal GDP (for other parts of the estate, e.g. financial assets).

The 'raw' yield from baseline IHT is then calculated by summing the estate value multiplied by the probability of the estate being passed on (i.e. the adults in the household dying) for each estate in the WAS, grossed up to GB population totals using household grossing factors. The predicted yield from the current IHT system is then calibrated to match Office for Budget Responsibility estimates for the yield from IHT in the current (2024-25) tax year (around £7.5 billion - OBR, 2024). This recalibrated dataset is then used to estimate the yield of the reforms to IHT featured in this report.

The simulated donor dataset is also used to estimate the distribution of IHT payments by estate size and the proportion of all estates paying IHT.

To model the distributional impact of the IHT reforms according to the wealth and income quintile of the recipients of inheritances, the data on actual inheritances received in the WAS is used and calibrated so that the yield of the baseline IHT system matches Office for Budget Responsibility forecasts (OBR 2024).

To model the removal of the uplift for capital gains on assets (except for business assets) when they are passed on after the death of the estate holder, we use data from WAS on the inheritances received by individuals in the 12 months prior to being interviewed for the survey and combine this with the income data on these individuals in the WAS to estimate liability for CGT on the inherited assets.

To model the extension of CGT liability to business assets when they are passed on after the death of the estate holder, we use data on the value of businesses held by individuals in the WAS. The original plan for modelling the extension of CGT to inherited businesses was to use information on the actual inheritances of individuals in the WAS where these contained business assets. However, the sample of inherited business assets in WAS is relatively small and this produced "lumpy" distributional results across household income quintiles. To smooth out the distribution analysis, we combined information from all individuals owning business assets in the WAS with the probability of receiving an inheritance in the last 12 months (by age group). This produced a much smoother distributional pattern of results for this CGT reform.

Synthesis

Alongside the deliberative research and economic modelling, Demos also discussed the policies with various experts to dig into the practical implications and ease of implementation of each policy. This led to the development of a package of reforms based on an evaluation of the revenue gain, alignment with the public's priorities in the deliberation, and practical implementability.

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