

# Reforming inheritance tax

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 IFS



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# Reforming inheritance tax



# Inheritance tax needs reform

- In many surveys it is the UK's least popular tax.
  - Some say too easy to avoid, so should remove exemptions.
  - Others say it is unfair, so want to abolish.
- A lot of recent media speculation about whether some sort of reform is coming.

# What are the trade-offs inherent in reform choices?

1. What will happen to inheritance tax in the absence of reform?
2. What are the revenue implications of different reforms?
3. Who benefits from different reforms?



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# Inheritance tax without reform

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# Inheritance tax basics

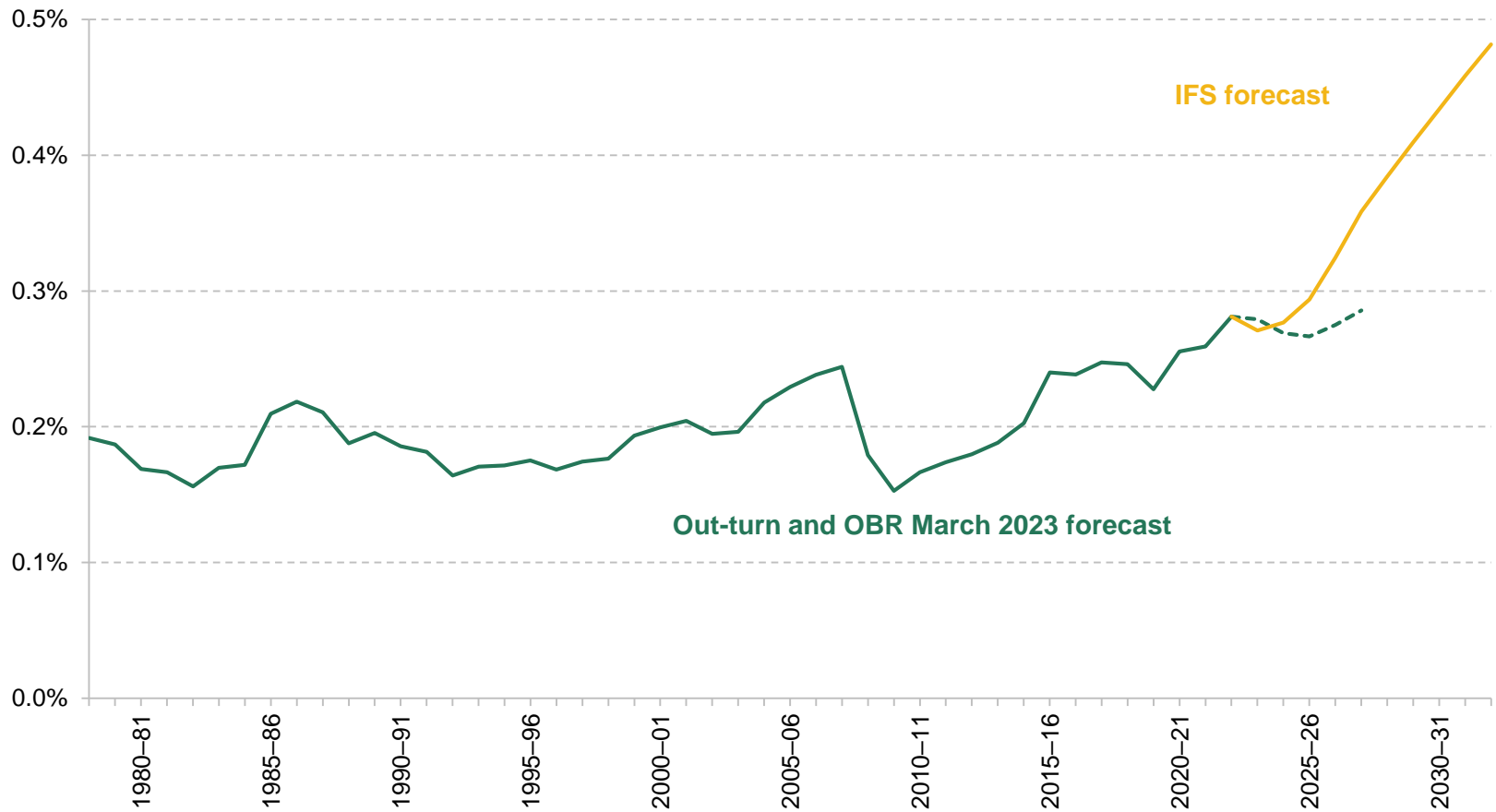
- Inheritance tax has a flat 40% rate on wealth passed at death (or passed in the years immediately before death) for wealth above a tax-free allowance.
- Basic allowance ('nil-rate band') is £325,000.
- Additional allowance if you have a house that you pass to kids/grandkids ('residence nil-rate band') of £175,000.
- If married or civil partnered, can pass these to your spouse on your death.
  - Combined with their own allowances, can be up to £1 million.

# Currently inheritance tax is small

- Around 5½% of people have inheritance tax due on their death.
  - Up from long run average of 4%.
  - But 9% of people have inheritance tax due on their death or their partner's death.
- It is concentrated in the (relatively wealthier) South of England.
- It is fiscally small, raising £7bn (0.3% GDP).



# Inheritance tax is set to grow rapidly







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# Reforms and their revenue effects

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## 0. Scale inheritance tax back to long-run average share of deaths

Reform	Change in annual revenue (£bn)	% of deaths taxed	Revenue-neutral NRB	% of deaths taxed under revenue-neutral NRB	Revenue-neutral inheritance tax rate
Raise NRB to £380k to target 4% paying inheritance tax					

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Abolish AR	0.4	N/A	N/A	N/A	N/A

## 2. Treat defined contribution pension pots as taxable

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Include 80% of DC pension pots in estates	0.2	5.4%	333,000	5.2%	39%

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Include 80% of DC pension pots in estates	0.2	5.4%	333,000	5.2%	39%
Include 80% of DC pension pots in estates (2032-33)	0.5	7.7%	375,000	7.3%	39%

## 3. Abolish the 'residence nil-rate band', and increase 'nil-rate band'

Reform	Change in annual revenue (£bn)	% of deaths taxed	Revenue-neutral NRB	% of deaths taxed under revenue-neutral NRB	Revenue-neutral inheritance tax rate
Eliminate RNRB, raise NRB to £500k, retain taper £175k above £2m	-0.7	4.3%	454,000	5.2%	44%

## 1+2+3. Combining these reforms

Reform	Change in annual revenue (£bn)	% of deaths taxed	Revenue-neutral NRB	% of deaths taxed under revenue-neutral NRB	Revenue-neutral inheritance tax rate
Cap BR, include pensions, eliminate RNRB	4.5	9.3%	525,000	3.8%	25%



# Recommendations

1. Abolish (or else cap) business relief and agricultural relief
2. Treat defined contribution pension pots as taxable
3. Abolish the 'residence nil-rate band', and increase 'nil-rate band'
4. Rationalise the treatment of gifts
5. Don't wipe out capital gains at death
6. Charge income tax on withdrawals from inherited pension pots (regardless of age of deceased)