David Sturrock, IFS and UCL
Drawing on work with Arun Advani

The economics of taxing wealth transfers

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Economic and Social Research Council

Context and motivation

- Perennial discussion of inheritance tax reform
  - Rumoured cut/abolition did not materialise in Autumn Statement
  - Will it be a Budget or election issue?

- There is a strong case to reform IHT (and wealth transfer taxation)
  - A range of exemptions, unequal treatments in the system
  - As inheritances grow, more important to get taxation right

Inheritance tax without reform

Inheritance tax basics

- Tax base:
  - Estate left at death (excluding that left to spouse or civil partner)
  - Gifts in the last 7 years before death
- Allowances:
  - ‘Nil rate band’ is £325,000
  - ‘Residence nil rate band’ is £175,000 (for house passed to ‘direct descendants’)
  - Unused portions of allowances can be passed to spouse or civil partner
- 40% tax rate above allowances

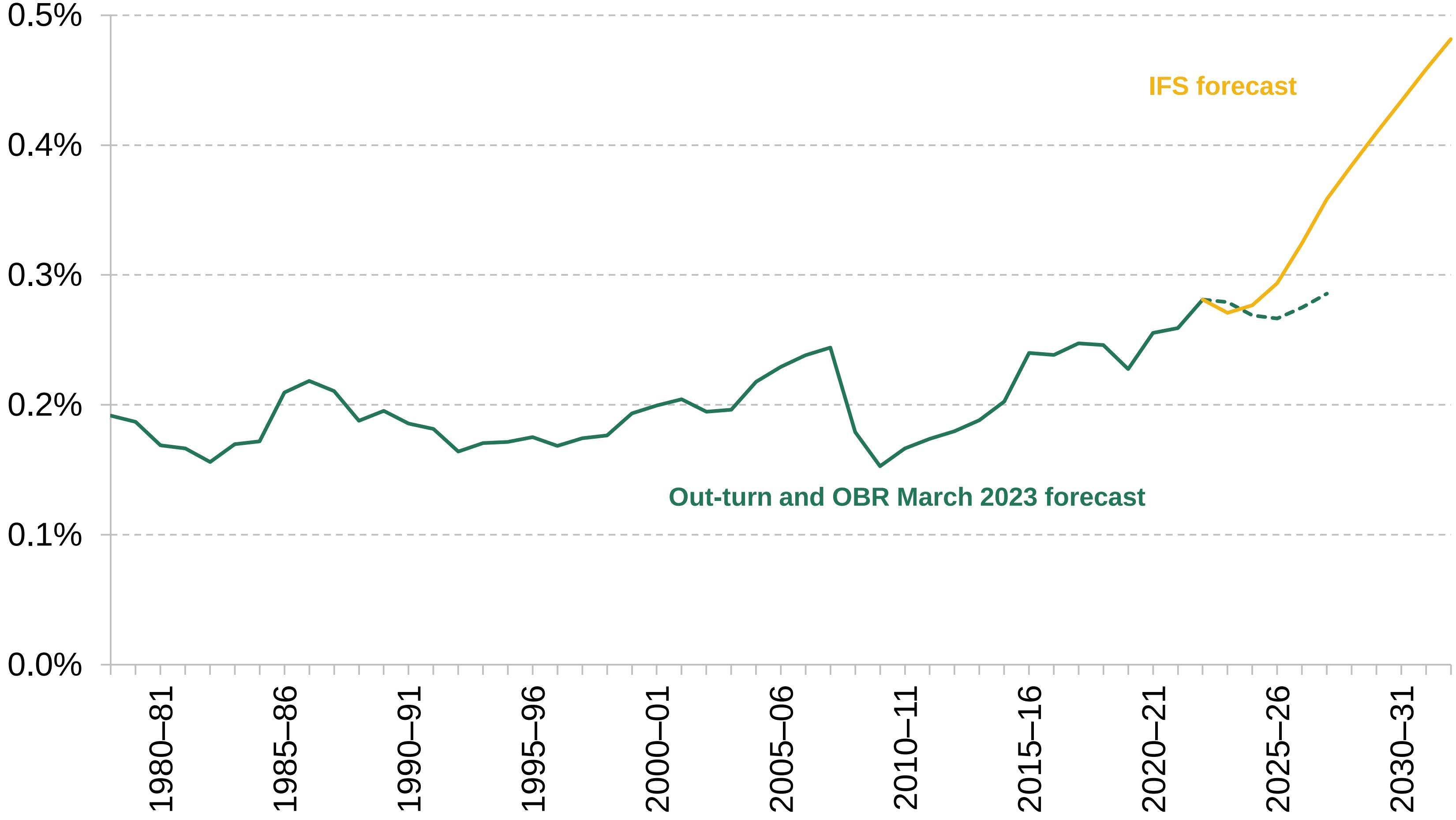
Currently inheritance tax is small

- Around 5½% of people have inheritance tax due on their death
  - Up from long run average of 4%
  - 9% of people have IHT due on their or their partner's death

- It is fiscally small, raising £7bn (0.3% GDP)
  - Though set to grow rapidly and double by 2032-33

Inheritance tax is set to grow rapidly

Inheritance tax revenues as a share of GDP over time



Over 80% of IHT revenues come from the wealthiest fifth at death

Average inheritance tax paid (LHS) and share of revenues paid (RHS) by wealth ventile of donor

Source: Figure 1, of Arun Advani and David Sturrock (2023b)

Problems and recommendations

Problems with the current design of IHT

1. **Special treatment of some assets:**
   - Business and agricultural reliefs
   - Pension pots outside of estates
   - Residence nil-rate band
2. **Special treatment given to some transfers:**
   - Giving that is ‘normal expenditure out of income’ is exempt
   - ‘Taper relief’ for gifts is oddly designed
   - Charity exemption and reduced rate if bequeath more than 10%
3. **Spousal exemption:**
   - May allow some wealthy individuals to avoid IHT

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

Related recommendations on taxation at death:

1. Don’t wipe out capital gains at death
2. Charge income tax on withdrawals from inherited pension pots (regardless of age of deceased)

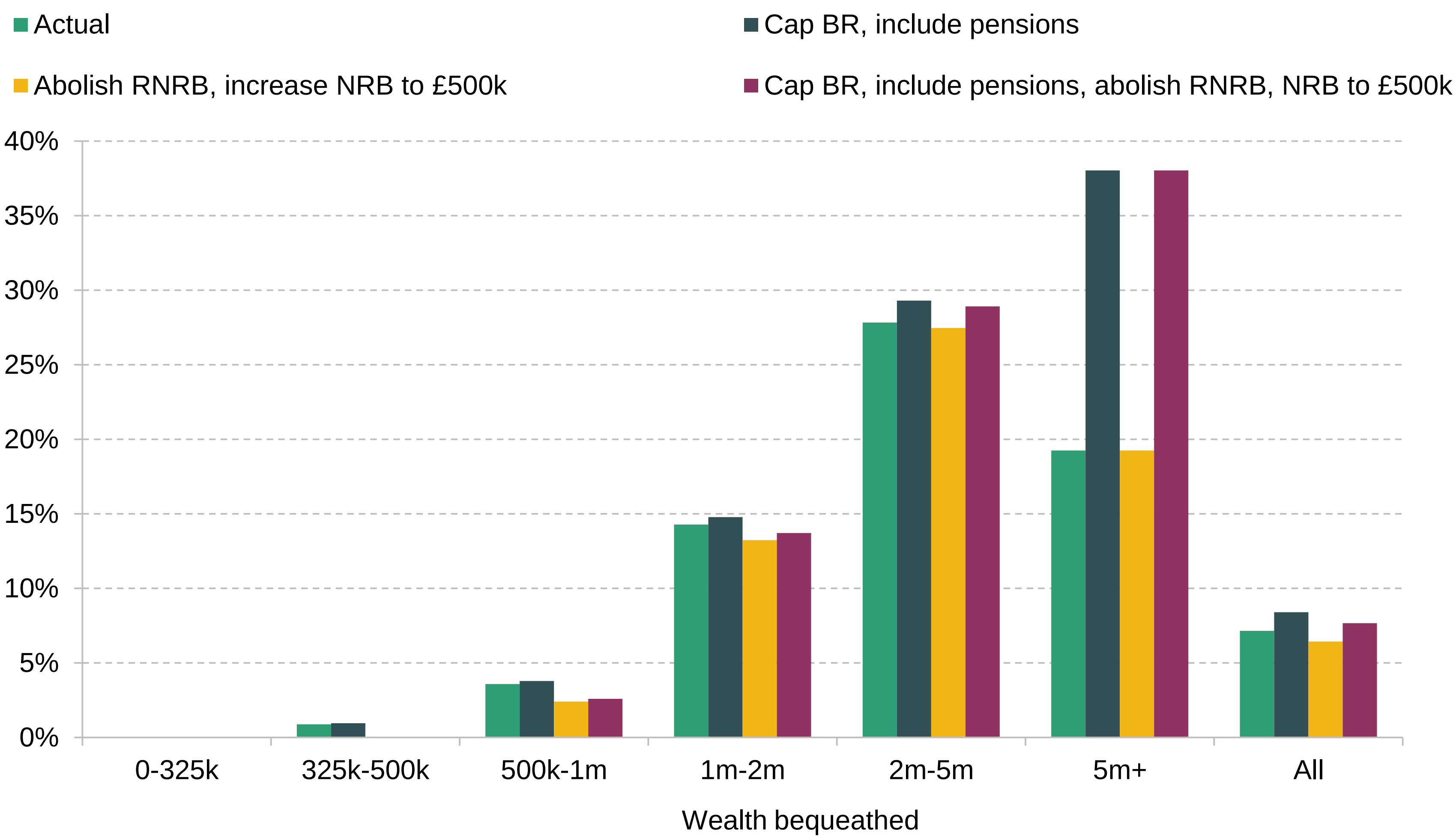
Revenue and distributional effects of reforms

Revenue effects of reforms

1. **Abolish business relief**
   - £1.4bn revenue (higher than HMRC estimate)
   - Funds cut in rate to ~34% or NRB of £415k
   - 80% of benefit achieved by capping at £500k per person
2. **Abolish agricultural relief**
   - £400m revenue
3. **Bring pension pots into inheritance tax**
   - £200m revenue now, rising over time
4. **Abolish residence nil rate band and raise nil rate band to £500k**
   - £700m cost

Combining 1+3+4 could fund NRB of £525k or rate of 25%

IHT paid as a percentage of wealth bequeathed (ex first deaths in couples)



Source: Figure 7.10, 'Reforming inheritance tax' from IFS Green Budget 2023, Arun Advani and David Sturrock, IFS Report R275

Summary

- Inheritances and IHT revenues are set to grow quickly over time
- Abolishing IHT would be £1m tax cut on average for wealthiest 1%
- Scrapping business and agricultural reliefs and bringing pensions into estates would raise taxes on the largest estates
  - Could fund public spending or raising tax-free threshold to £500k
- Treatment of gifts should be rationalised
- CGT step-up at death should be ended
- Wider questions about the structure of taxation of wealth transfers remain

Key questions in the design of wealth transfer taxes

1. **Which assets should be included?**
   - Strong fairness and efficiency case for treating all assets equally
2. **How should lifetime gifts be treated?**
   - Strong case from anti-avoidance for taxing gifts near to death
3. **Tax levied on giver or receiver?**
   - If inequalities among receivers is motivation, suggests receiver
4. **Transfers between whom?**
   - Room for principled disagreement on spousal exemption
   - Should cohabiting partners be treated the same as spouses?
5. **What should the rates and thresholds be?**
   - Depends on view on inequalities vs impact on saving/avoidance
   - Saving not very sensitive to tax rate but avoidance probably is

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