

Demos review of IHT

Synopsis: The Demos review of IHT, which compares it with its OECD counterparts and proposes revenue-raising reforms.

Date published: 17.07.2024

In the words of *The Guardian*, Demos 'Quickly became seen as Tony Blair's favourite think-tank in 1995'. Its significance with the Labour party has waned since, with the Resolution Foundation arguably now more to the fore – its former head, Torsen Bell, is now an MP.

Nevertheless, the latest [report](#) from Demos, 'The Future of Inheritance Tax: Options to repair inheritance taxation in Britain' is likely to attract some attention in 11 Downing Street ahead of the Treasury's 'spending inheritance' review and the Autumn Budget.

The report compares the UK's inheritance tax system with other OECD countries' gift/estate taxes and makes the following points...

- *Proportion of estates taxed* - The UK taxes a relatively low proportion of estates (3.74% in 2020/21). This is lower than Germany (10.08%), Japan, (9.30%) and South Korea (6.4%). This comparison will change over time, thanks to the frozen nil rate band which the Office for Budget Responsibility (OBR) projects will mean 6.3% of estates will be taxed by 2028/29.
- *Proportion of wealth transfers taxed* - In the UK, around 3.4% of all inheritances and gifts passed on was paid in tax in 2019/20 - less than France, Japan and South Korea.
- *Progressiveness* - In the UK, the average *effective* tax rate is regressive for the most valuable inheritances. This was a point made by the Office of Tax Simplification (OTS), which highlighted in its first report that the effective rate of tax on estates between £2m and £7m was around 20%, but dropped to 10% once £10m was reached, primarily due to business and agricultural relief.

While overall inheritance tax (IHT) is less regressive than Germany's system (which also has business reliefs), it is more regressive than France's, South Korea's or Japan's.

- *Revenues* - The UK raised less from IHT in cash terms than most G7 countries, including the US, Japan, France, and Germany. However, as a proportion of total revenue raised in 2019 the UK was ahead of both the US and Germany. Again, this suffers from timing – the proportion is projected to rise from 0.7% to 0.8% by 2028/29.
- *Rates* - Of all OECD countries, the UK is one of seven to only apply a flat rate. The UK's 40% rate is the joint highest starting rate in the OECD, but the

- progressive rates in Japan, South Korea, France and Germany all go above 40% for the largest inheritances.
- *Exemptions* - The UK is unusual in offering 100% relief for owned businesses and agricultural property, and not counting most private pensions for IHT purposes.

The report does not set out a specific alternative framework for replacing IHT, but it does make a variety of suggestions, many of which have echo those of other think tanks, for example...

- *Taxing receipts* - The UK is one of only four OECD countries to tax the estate, rather than receipt of inheritance. The alternative of taxing recipients has been floated by the Resolution Foundation and the Institute for Public Policy Research, both of which have proposed (some while ago) a lifetime threshold of £100,000 above which income tax would apply.
- *Taxing inherited capital gains* - Demos thinks that including inherited capital gains within capital gains tax (CGT) could be less politically contentious than changes to IHT itself. Taxing gains on death is also a possibility but would mean many more estates would face tax on death. This was also on the OTS's proposal list, although its primary suggestion was that there should be no CGT uplift if business or agricultural relief applied.
- *Reforming reliefs* - The Demos report repeats the recent proposals on business, agricultural and pension reliefs made by the Institute for Fiscal Studies (IFS) – basically capping business and agricultural relief at £500,000 and taxing 80% of pension fund value.
- *Revising the rate structure* - This was an idea put forward by the [APPG](#) on Inheritance and Intergenerational Fairness which suggested a lifetime tax with no reliefs, but a rate of 10% rising to 20% above £2m, a death exemption of £350,000 and an annual gifts allowance of £30,000.

Comment

There is little new in the Demos report, but it does add further weight to the calls for reforming business, agricultural and pension IHT reliefs.

020 7183 3931
www.riskassured.co.uk