Policy Report

Inheritance Tax reliefs: Time for reform?

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Executive Summary

Inheritance Tax (IHT) applies at a flat rate of 40% to estates worth over £325,000. This **40% rate has extremely high salience** with the public and may be one of the reasons why IHT is regularly cited as the UK's most unpopular tax. And yet, **most estates do not actually pay 40% tax, or anywhere close to this**. The explanation lies in the proliferation of allowances, exemptions and reliefs for IHT (referred to as 'reliefs' for short), which mean that the statutory tax rate is not a good guide to the *effective* tax rates that estates actually pay.

Previous analyses (OTS, 2019 and HMRC, 2024) have shown that, on average, effective tax rates decline for the largest estates. However, there remains significant misunderstanding about which IHT reliefs are responsible for the low effective tax rates paid by (some) wealthy estates, and the policy justifications for them. Previous analyses have focused solely on differences between effective tax rates for lower and higher value estates, overlooking just how much variation there is *amongst* estates at similar levels of wealth: with some estates paying close to the 40% statutory rate, and others paying less than one tenth of this.

In this report, **we use de-identified tax data covering all estates filing for IHT between 2018-2020 to shed new light on IHT reliefs and their role in driving differences in effective tax rates across estates**. We also evaluate whether these apparent inequities can be justified in light of other policy objectives. Finally, we discuss options for reforming IHT reliefs and provide evidence on the revenues that could be raised.

Effective Tax Rates

Previous analysis (OTS 2019, HMRC 2024) shows that the effective average IHT rate (EATR) declines for estates worth over £7m. It is often supposed that this regressivity is driven by reliefs for particular asset classes, particularly Business Relief and Agricultural Relief. We show that this is largely false: **the overall regressivity in IHT stems mainly from the uncapped nature of the spouse exemption**. It is only for estates valued at over £12.5 million (which have not been separated out in previous analyses), that Business Relief starts to result in regressivity.

However, Business Relief and Agricultural Relief are an important driver of '*horizontal* inequity': differences in the effective tax rates paid by estates with the same amount of wealth. This inequity is substantial. Excluding estates eligible for the spouse exemption, **a quarter of estates above £10 million have EATRs above 37%, but another quarter pay less than 9%, and one in six pay less than 4%.** This implies that what matters for how much IHT an estate pays is not just how much wealth the estate has in total, but which types of asset are held.

A crucial caveat to **our analysis of effective tax rates does not account for 'missing wealth'**, such as lifetime gifts made more than seven years before death, pension wealth, assets transferred into trusts, or other assets that are exempt from IHT altogether (such as the foreign assets of 'non-doms'). In these cases, we will overestimate the 'true' EATR on the total wealth transferred to heirs. These forms of

missing wealth are in most cases not even required to be reported to HMRC, making it difficult to quantify their effects.

Around the world, countries adopt a variety of different models for taxing inheritances and lifetime transfers. The UK should look at these international examples and develop options for wholesale reform of Inheritance Tax. However, in the meantime, and even without major structural redesign, there are many options open to the government to **improve the fairness and efficiency of our existing IHT by reforming key reliefs and exemptions**.

Spouse exemption

Introduced in 1972, spouse exemption is **typically regarded as a deferral of tax** until both spouses have died. However, surviving spouses have the opportunity to engage in further tax planning, for example via gifts to heirs or into trust, meaning that the **spouse exemption can be used to circumvent IHT altogether**. Since accrued capital gains are also currently wiped out at death, spouse exemption can result in assets being passed to heirs completely tax-free.

Currently the spouse exemption significantly reduces the EATRs paid across all estates, by 4pp on average for estates valued above the Nil Rate Band. However, its effect is largest at the top: on average, the exemption **reduces EATRs by 12pp for estates valued at between £10 million and £12.5 million, but 2pp for estates valued between £1 million and £1.5 million**. This may be because those at the top are most able to benefit from the 'second chance' to engage in tax planning, which the spouse exemption provides.

The main aim of the spouse exemption is arguably to ensure that the surviving spouse does not face any material change in their standard of living as a result of IHT due on the first death. However, **capping the spouse exemption at £10 million** could support this goal whilst limiting the opportunity for very high value estates to use the exemption as a second chance for tax planning. This reform would **affect fewer than 0.1% of estates (100 deaths a year) and raise up to £350m in revenue**.

Business Relief

Business Relief provides 100% IHT relief on business assets and shares in unlisted and AIM-listed companies (where qualifying conditions are met), as well as 50% relief on controlling shareholdings in listed companies. The stated aim of the relief, according to the government (HMRC 2021), is to **'ensure businesses do not have to be sold or broken up following the death of the owner'**. However, the force of this policy justification depends on the size of the business (affecting its access to credit) and whether the deceased was an active or passive owner (affecting the degree of disruption that would result from sale of the owner's stake).

Between 2018 and 2020, an average of £2.2 billion per year in Business Relief went to around 3,400 estates per year. **83% of the relief went to estates claiming more than £500,000 in relief**, and more than two thirds (72%) went to around 400 estates per year (worth £7.6 million on average) that claimed more than £1 million in relief. **Business Relief is a major contributor to the regressivity of IHT at the very top**: amongst estates worth £30 million or more, the relief lowers the average EATR by

12pp (almost halving it from 23% to 12%), compared with less than 1pp for estates valued at less than £1.5 million.

We find that **only a quarter of those claiming Business Relief on shares had been involved in management of the business** as a company director at any point in the five tax years prior to death (19% as close company director). This suggests that most claims for Business Relief are by ‘passive’ investors rather than ‘active’ business owners. In these circumstances, it is less clear why the sale of the stake – if required where there are insufficient other funds to pay the tax – would be problematic for the business.

The concern about passive investors using Business Relief to reduce their IHT bill is most acute in the context of **AIM-listed shares**. Unfortunately, the way in which HMRC processes IHT returns for analytical purposes means that it is not possible to provide a reliable estimate of how much Business Relief goes on unquoted (AIM) shares specifically. Whereas justifications for Business Relief typically focus on liquidity concerns, the most common argument for giving relief on AIM shares is to incentivise investment in this market. However, if the aim is to incentivise investments in certain types of business, the **relief could be much better targeted** by restricting it to established schemes such as SEIS, EIS and VCTs.

Agricultural Relief

Agricultural Relief typically provides 100% IHT relief on the agricultural value of farmland, woodland and farm buildings (including farmhouses). The relief is available to landlords (i.e. those renting farms to tenant farmers) who have owned the land for at least seven years, as well as to active farmers provided that they have occupied the land for agricultural purposes for at least two years. Again, the stated aim of the relief is to **prevent the breakup of the farm** due to a lack of liquid assets available to pay the tax (HMRC 2021).

Between 2018 to 2020, an average of £900 million in Agricultural Relief (on UK property) went to around 1,300 estates per year. Although 64% of estates using the relief claimed less than £500,000 in relief, 83% of the value of the relief went to those claiming more than this amount. **Almost two thirds (64%) of all Agricultural Relief went to around 200 estates per year that each claimed more than £1 million in relief**, with an average estate value of £6 million.

Among estates that benefited from Agricultural Relief between 2018 and 2020, **less than half (44%) of individuals had received any trading income from agriculture** at any point in the five years prior to death. Income from agriculture made up less than a quarter of their income on average. Of the remainder, 51% received income from rent, which is consistent with them being landlords rather than active farmers, although we cannot rule out that they were actively farming via a company.

Abolishing or capping Agricultural Relief on its own would raise very little revenue, because a large proportion of existing claims would be displaced to Business Relief instead. Moreover, agricultural landowners may then be less willing to rent land to tenant farmers (rather than farming themselves and claiming Business Relief) because in doing so they would lose IHT relief. On the other hand, a key problem with Agricultural Relief in its current form is that it raises the price of farmland for tenant farmers who want to buy.

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Capping Agricultural Relief and Business Relief at a combined limit of £500,000 per estate could raise up to £900 million per year. Unlike previous revenue estimates (Advani & Sturrock 2023), our analysis accounts for optimisation across these two reliefs and increased use of the spouse exemption; however, we do not account for other behavioural responses that may erode revenues. Two-thirds of estates claiming Agricultural Relief, and three-quarters of those claiming Business Relief, would be completely unaffected, but would increase the effective tax rates paid by the very largest estates (above £30 million) by around 7pp on average.

Residence Nil Rate Band

Introduced in 2017, the Residence Nil-Rate Band (RNRB) exempts the first £175,000 of residential property passed to a 'direct descendant' (including children, grandchildren and their spouses). It is tapered away for estates worth more than £2 million and is completely withdrawn above £2.35 million. Compared with simply increasing the standard Nil Rate Band (currently £325,000), the **RNRB disadvantages estates with less valuable residential properties or where the deceased did not have children or grandchildren to inherit**. It is also extraordinarily complicated to apply, especially in relation to the 'downsizing' rules.

One option would be to **abolish the RNRB whilst increasing the standard Nil Rate Band (NRB) by an equivalent amount.** For estates valued at less than £2m, this would involve increasing the current NRB from £325,000 to £500,000. Overall, this reform would **cost around £1 billion per year, with all of the benefit going to estates valued at less than £2.7 million**. The largest proportional tax savings would go to estates worth £1 million and £1.5 million, who would see a reduction in EATR of 2pp on average, saving them £20,000-30,000.

Other reliefs

Our current IHT system incorporates many smaller reliefs, each of which individually costs relatively little, but where the benefits are highly concentrated. These include:

Funeral expenses seem relatively innocuous as something that can be claimed tax-free from an estate. But while the average value is £4,300, and 99% are less than £15,500, 0.1% of estates (270 estates) per year claim more than £154,000 tax free. Around 50 estates over 2018-20 had deductions in excess of £800,000. Capping the tax deductibility of funeral expenses at £50,000 would affect fewer than 700 estates a year, while raising up to £25 million.

Charity Relief is claimed on £2.1 billion in assets each year. More than half of this comes from fewer than 400 estates per year, with average estate size of £4.8 million, each benefitting from more than £1 million in IHT relief, at an implied revenue cost of up to £280 million per year. Whilst there may be some policy justifications for favouring charitable giving, it is important to note that the current system effectively redirects tax revenues towards the charitable preferences of a very small number of people.

Heritage Assets are conditionally exempt from IHT where the assets are deemed to be of 'national, scientific, historic or artistic, scenic, architectural interest', and the new owner undertakes to keep the assets in the UK and provide some access

(potentially at a charge) to the public. 96% of this relief (around £300 million) was claimed by just 44 estates over 2018-20. These estates benefited from an average of £7 million in relief on an average estate size of almost £20 million. There is a case for reviewing the effectiveness of this relief against its current objectives and considering whether alternative approaches might offer better value for money.

Revenue and distributional effects

We model a combined reform which includes all our proposed changes to the spouse exemption, Business and Agricultural Relief, and the RNRB and NRB. We estimate that, **together, these reforms could raise up to £500 million, whilst at the same time lowering effective tax rates (on average) for estates worth less than £2 million**. Only estates worth more than £8 million would see EATRs rise by more than 5pp on average.

The reform would also make IHT fairer by reducing horizontal inequality between estates of the same value. When comparing the interquartile range[1] for EATRs at each point in the wealth distribution, the **reduction in horizontal inequity is greatest for estates valued between £2-7 million**, where we see a reduction in variation of over 6pp. The change amongst estates below £2m or above £7m is relatively minor (ranging between -4pp to +2pp).

[1] This is a measure of the variation within the distribution, defined as the difference between the 25th and 75th percentiles of the distribution. Ranking estates of the same value by their EATR, this looks at the difference in EATR between an estate which pays more tax than 75% of estates at the same level of wealth, and an estate which pays more tax than only 25% of estates at that level of wealth (so must have a lower EATR).

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Introduction

Inheritance Tax (IHT) applies at a flat rate of 40% to estates worth over £325,000. This 40% rate has extremely high salience with the public and may be one of the reasons why IHT is regularly cited as the UK's most unpopular tax. And yet, most estates do not actually pay 40% tax, or anywhere close to this. The explanation lies in the proliferation of allowances, exemptions and reliefs for IHT (referred to as 'reliefs' for short), which mean that the statutory tax rate is not a good guide to the *effective* tax rates that estates actually pay.

Previous analyses (OTS, 2019 and HMRC, 2024) have shown that, on average, effective tax rates decline for the largest estates. However, there remains significant misunderstanding about which IHT reliefs are responsible for the low effective tax rates paid by (some) wealthy estates, and the policy justifications for them. Previous analyses have focused solely on differences between effective tax rates for lower and higher value estates, overlooking just how much variation there is *amongst* estates at similar levels of wealth: with some estates paying close to the 40% statutory rate, and others paying less than one tenth of this.

In this report, we use de-identified tax data covering all estates filing for IHT between 2018-2020 to shed new light on IHT reliefs and their role in driving differences in effective tax rates across estates. We also evaluate whether these apparent inequities can be justified in light of other policy objectives. Finally, we discuss options for reforming IHT reliefs and provide evidence on the revenues that could be raised.

How does Inheritance Tax work?

Inheritance Tax is mainly levied on the value of the net estate of the deceased.[2] The tax is a cumulative charge on assets transferred on death and over a seven-year period prior to death.[3] Thus, gifts made within the seven-year period will be added to the estate value on death for assessing the Inheritance Tax liability.[4] In addition, Inheritance Tax has several nil-rate bands, exemptions and reliefs for certain asset classes which reduce the chargeable value of the estate below its net value. On this chargeable value, Inheritance Tax is generally charged at a rate of 40%.[5]

Inheritance Tax includes two nil-rate bands that exempt certain amounts from the tax. Firstly, there is a general Nil-Rate Band (the NRB) which reduces the chargeable value of estates by £325,000, meaning that estates valued below this amount do not pay any Inheritance Tax. The NRB was introduced in 1986 at £71,000 and increased gradually to its current value in April 2009 (it is currently fixed at this level until 2028).

In addition, since 6 April 2017 there has been a Residence Nil-Rate Band (the RNRB) which exempts the first £175,000 of residential property passed to direct descendants. The RNRB was introduced starting at £100,000 and gradually increased to its current level for deaths occurring after 6 April 2020. The RNRB is tapered for estates worth more than £2 million and is completely withdrawn for those valued above £2.35 million.

In addition, any unused portion of the NRB and RNRB can be transferred to a surviving spouse or civil partner.[6] This means that on the death of the second spouse, up to £1 million (twice the amount of the NRB and RNRB) can be passed on tax-free to descendants.[7]

[2] Inheritance Tax can also be charged in circumstances other than death, mainly in relation to trusts (see the section “Missing Wealth” below).

[3] The value of transfers for Inheritance Tax purposes is based on the principle of the “loss to the donor’s estate”, which may differ from the value that the transferee receives (e.g. if the donor has a 51% shareholding in a company and gifts 2% of shares, the loss of value will be much higher to the donor than the value to the donee).

[4] Except for small gifts not exceeding £3,000 a year or gifts to a spouse or civil partner (unless the recipient is not domiciled or deemed domiciled in the UK), and some other exempt gifts (as mentioned below). Occasionally gifts made up to 14 years before death will be relevant, mainly to determine the tax applicable to lifetime gifts that fall within the 7-year window.

[5] Lower rates can apply to trusts and to gifts made between three and seven years prior to death.

[6] These are referred to as the Transferrable Nil-Rate Band (TNRB) and the Transferrable Residence Nil-Rate Band (TRNRB). Tapering of the TRNRB means that some benefit can accrue to estates worth up to £2.7 million.

[7] Assuming the first spouse leaves the entire estate to their surviving spouse, as this will be exempt under the spouse exemption (see next paragraph), and that the estate’s value does not exceed £2m (so the full RNRB is available).

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In addition to these exempt amounts, the Inheritance Tax system is characterised by a range of tax exemptions and reliefs. Quantitatively, the most important exemption is the spouse or civil partner exemption, which removes from the scope of Inheritance Tax any transfers between spouses or civil partners irrespective of the value of the estate.[8]

There are also several reliefs and exemptions for lifetime transfers made by the deceased. The main one is taper relief, which reduces the tax liability on gifts made between three and seven years prior to death (those made more than seven years before death are fully exempt).[9] Furthermore, Inheritance Tax includes an annual exemption allowing individuals to give a maximum of £3,000 each year tax free. There are also other smaller exemptions that can further reduce the Inheritance Tax base.[10] In general, HMRC collects very limited data on the use of these exemptions.

Further tax reliefs target specific asset types, driving the EATR below the statutory marginal rate and creating both horizontal and vertical inequity in effective tax rates. The main reliefs for specific asset types are Business Relief (BR)[11] and Agricultural Relief (AR).[12]

AR reduces the value of the estate for Inheritance Tax purposes by between 50% and 100% of the value of agricultural property that has been occupied for agricultural purposes for a minimum period. Agricultural property eligible for the relief includes land and pasture used for agricultural purposes[13] and farm buildings (including cottages and farmhouses).

BR similarly reduces the value of the estate by between 50% and 100% of the value of certain business property. 100% relief is given for interest in a business or shares in an unlisted company mainly carrying a non-investment business. 50% relief is given for controlling interests in listed companies, as well as for certain land, building and machinery owned by the deceased and used in a qualifying business they controlled or in which they were a partner.

There are also several less common reliefs that further reduce the tax liabilities on estates. For instance, there is relief on heritage assets wherein the tax rate on death is reduced if at least 10% of the value of the estate is left to registered charities, and a variety of other reliefs. We discuss these additional reliefs and deductions in the section “Other Reliefs”.

[8] Except if the receiving spouse or civil partner is not domiciled in the UK, in which case the exemption is restricted to the NRB available at the date of the transfer.

[9] The Inheritance Tax rate is reduced by 8% per year for gifts given between three and seven years prior to death (i.e. gifts in year 3-4 before death are taxed at 32%, in year 4-5 are taxed at 24%, etc.).

[10] Examples of tax exempt gifts include the small gifts allowance, gifts considered “normal expenditures out of income”, gifts in consideration of marriage or civil partnerships, and several gifts to charities, housing associations, political parties or for public benefit.

[11] Inheritance Tax Act 1984, Part V, Chapter I.

[12] Inheritance Tax Act 1984, Part V, Chapter II.

[13] Since 2024, land must be in the UK to qualify for the relief. This was previously the case until 2009.

Data

Our analysis is based on de-identified tax data accessed via HMRC (the UK tax authority), covering every estate that filed an Inheritance Tax return between 2012 and 2021. This includes all taxpaying estates and a (weighted) sample of non-taxpaying estates.[14] If not stated otherwise, our calculations are based on data from the tax years 2018 to 2020, which is after the introduction of the Residence Nil-Rate Band (RNRB) (6 April 2017) and before the outbreak of the Covid-19 pandemic.[15]

The data provides a detailed breakdown of asset categories and liabilities (including debt and funeral expenses). We observe most assets held on death, valued at their open market value. As noted above, we do not observe pension wealth, gifts made more than seven years prior to death, or other lifetime transfers below the relevant reporting threshold (for example, for small gifts). Furthermore, we do not observe foreign assets held by non-domiciled taxpayers (or former non-doms if these assets are held in a trust). While we generally do not observe assets held in trusts,[16] we have obtained some separate statistics on trusts liable to Inheritance Tax from a Freedom of Information (FOI) request to HMRC.

Throughout our analysis, we define the "net estate" or "size of estate" as the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death.

[14] An estate may be non-taxpaying either because it is "low value" (e.g. covered by the NRB) or "excepted" (e.g. covered by the spouse exemption).

[15] Note that the 2020 tax year ended on 5 April 2020, shortly after the introduction of lockdown restrictions in the UK relating to the Covid-19 pandemic (introduced on 23 March 2020).

[16] Unless the trust is settlor-interested.

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What drives variation in effective Inheritance Tax rates?

Previous work (including HMRC (2024), OTS (2019) and others) has demonstrated the vertical inequity within Inheritance Tax, i.e. that *on average* the highest value estates have a lower effective average tax rate (EATR) than estates of lower value. We explore the drivers of this inequity and show that – contrary to common supposition – it is driven by the spouse exemption. Business Relief (BR), and to a smaller extent Agricultural Relief (AR), substantially reduce the level of EATRs but do not create regressivity except at the highest estate sizes. However, they are an important driver of *horizontal* inequity: inequity in the EATRs paid by estates with the same amount of wealth. We also highlight forms of "missing" wealth that are not accounted for in our analysis and, in most cases, are not even required to be reported to HMRC.

Vertical Inequity

As highlighted above, UK estates are liable to pay a flat rate of 40% on the net wealth of the deceased above a tax-free Nil-Rate Band (NRB) of £325,000. However, while the headline 40% rate is highly salient, estates only pay close to this rate *on average* if the estate's net wealth is well above the NRB. Without reliefs, it would take an estate of £5.2 million to reach an EATR of 35%, or an estate of £26 million to reach an EATR of 39%, for the second death within a married couple.[17]

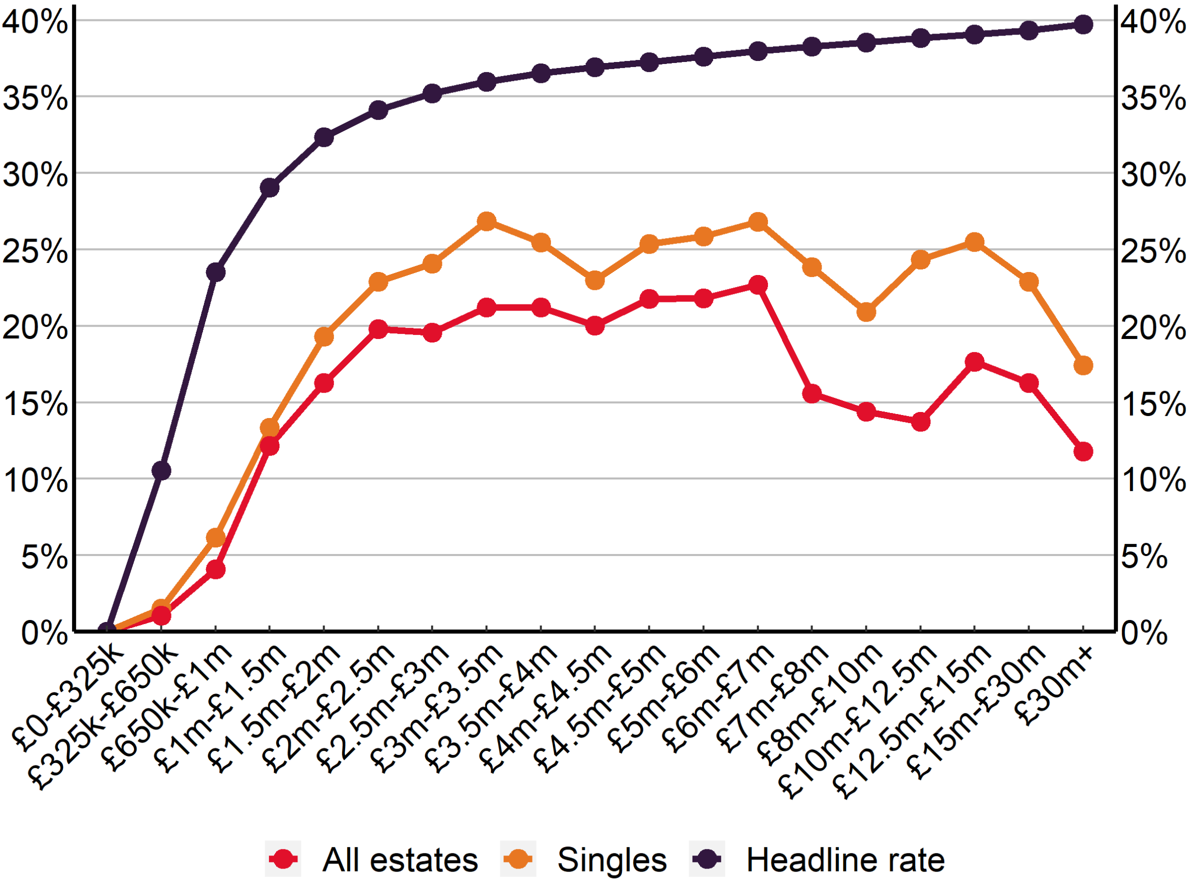
In practice estates pay far lower EATRs than the 40% marginal rate. In part this is because of the treatment of transfers between spouses. However, it also arises through the varying composition of assets held by estates and the treatment of residential property, agricultural land, business property, and certain classes of shares, as well as a range of reliefs given for charitable giving, "national heritage assets" and others.

In the first instance we examine how much these striking findings are merely driven by the spouse exemption, which provides a complete exemption on transfers made between spouses or civil partners. This exemption can potentially reduce the effective Inheritance Tax rate to zero on the estate of the "first deceased" from a couple. This factor will tend to reduce average EATRs across the board but could also affect measured vertical inequity if (for example) it was the case that higher value estates were more likely to be first deaths.

In Figure 1 we show the EATR at different levels of net estate value, for all deaths and separately only for those without access to the spouse exemption (denoted as "singles"). By pooling across multiple years we can show results for finer categories of estate size than have previously been reported. Among those without access to

[17] These calculations assume full use of the Transferrable Nil-Rate Band (TNRB). The Residence Nil-Rate Band (RNRB) is gradually withdrawn once the value of an estate reaches £2m, and no benefit is given to estates valued at more than £2.35 million (£2.7 million in the case of the Transferrable Residence Nil-Rate Band (TRNRB)).

Figure 1: EATR among the estates of "singles" and among all estates, by size of estate (2018-2020)



Notes: EATR denotes the effective average tax rate, where the average is the democratic mean within each band of the net wealth distribution shown. The "size of estate" here is defined as the individual's net wealth on death, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata. "Singles" refers to those who do not have access to the spouse exemption, i.e. estates for which no spouse exemption is observed, and which are not classified as "Married" in the HMRC microdata. Data is pooled across tax years 2018 to 2020.

Source: Authors' calculations based on HMRC administrative datasets.

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the exemption, the EATR paid is lower by between 3 and 7 percentage points on average between £2 million and £7 million. The spouse exemption also explains much of the regressivity seen above £7 million, as EATRs decline beyond this point. This average will mask considerable heterogeneity: some estates will have no access to the spouse exemption, while others will be fully relieved of Inheritance Tax because of it.

In the context of the widespread perception that Inheritance Tax is borne most heavily by the "modestly wealthy", rather than by the very well-off, it is important to note that on average, the highest effective Inheritance Tax rates are paid by estates valued at between £2m and £7m, which places them all within the top 0.5% of the wealth distribution on death. Nevertheless, it is indeed the case that – even after accounting for the spouse exemption – these estates do (on average) pay a higher EATR than estates above £7m, i.e. the top 0.05%.

Looking across all estates (whether the deceased has a surviving spouse or not), Figure 1 illustrates how the EATR initially increases as the size of the estate increases. Estates with net wealth of less than £325,000 paid zero tax. The EATR then rises smoothly to 20% for estates valued between £2 million and £2.5 million. The EATR is then relatively constant, rising slightly to 23% for estates worth between £6 million and £7 million. Above this value, the EATR decreases as the size of the estate increases, meaning that it is regressive above this level. For the largest estates valued at more than £30 million, the EATR was 11.8%, lower than the EATR paid by estates with wealth between £1 million and £1.5 million who paid 12.2% on average.

When excluding those eligible for the spouse exemption, we observe higher EATRs paid at every level of the wealth distribution, as one might expect. Comparing the distribution of EATRs for those without access to the spouse exemption with the distribution among all estates (whether the deceased has a surviving spouse or not) highlights that the spouse exemption contributes towards the regressivity of the distribution for estates at the top of the wealth distribution.

However, even among estates without access to the spouse exemption, we still observe local regressivity in EATRs for estates valued at more than £7 million. Among estates not eligible for the spouse exemption, estates valued at more than £30 million paid an EATR of 17%, a lower rate than estates valued at £1.5 million to £2 million who paid 19% on average. It is important to note that this analysis does not consider pension wealth, wealth held in trusts, lifetime transfers more than seven years prior to death, or the foreign wealth of non-domiciled individuals because we do not observe this information in the HMRC microdata. If these other forms of wealth were taken into account, the effective tax rates paid by many of these estates would be even lower than the figures indicated above. It would also shift these estates further up the wealth distribution.

Below we examine what impact different reliefs have in lowering the EATRs paid across the wealth distribution, relative to the headline rate we would expect in the absence of any reliefs.

Impact of Reliefs

From a policy perspective it is crucial to understand what is driving this variation in effective Inheritance Tax rates. In terms of the variation that we observe, by far the main driver is tax reliefs (including allowances and exemptions).

Below we outline how the spouse exemption and these other reliefs account for the observed variation in EATRs, especially for estates valued at more than £7 million. Figure 2 highlights the extent to which each individual relief contributes to reducing the average EATRs across the wealth distribution.[18] Each line represents the average EATR that would be paid at each level of wealth if the indicated reliefs were iteratively removed, assuming no behavioural response.[19] The "EATR after all reliefs" is the average observed EATR paid by all estates within the given wealth band in tax years 2018 to 2020. The order of removal is as follows: spouse exemption; the TNRB; BR; AR; the RNRB[20]; Charity Relief; and finally all other reliefs. The black line indicating the "headline rate" denotes the theoretical Inheritance Tax rate that would be paid by an estate with the given amount of wealth in the absence of all reliefs other than a NRB of £325,000. Figure 3 shows the same breakdown but as a proportion of the difference between the headline rate and the EATR paid at each level of the wealth distribution.

Some reliefs figure more prominently in different parts of the wealth distribution than others. The proportion of the overall reduction in average EATR caused by the spouse exemption broadly increases as the size of estates increases to £3.5 million. The impact of the spouse exemption declines beyond this level before becoming particularly large for estates valued at more than £7 million. BR and AR make up a very small proportion of the impact of overall reliefs for estates valued at less than £1.5 million, but a larger proportion for estates valued at more than £4 million (see Figure 3).

Addressing the source of this vertical inequity between individuals at different levels of wealth is therefore important for maintaining public confidence in the tax system. Subsequent sections in this policy brief consider the impact of the spouse exemption, BR, AR, and other reliefs in more detail, including characterising the estates claiming them. However, as we show below, it is in fact the variation in effective tax rates paid by estates of similar value (i.e. "horizontal inequity") that is most striking. In the next section, we look at the issue of horizontal inequity and its causes.

[18] To include the impact of the spouse exemption in our analysis, we now consider the effective tax rates of all estates (not just those of people who were not married at the time of death).

[19] Note that this means that the distribution indicated by "spouse exemption" in Figure 2 does not replicate the distribution of "singles" in Figure 1. Figure 2 shows the distribution of EATRs under the iterative removal of reliefs from all estates (assuming a static behavioural response), whereas Figure 1 shows the distribution of EATRs paid by estates without access to the spouse exemption.

[20] In the HMRC microdata, we observe the combined total of the RNRB and the TRNRB.

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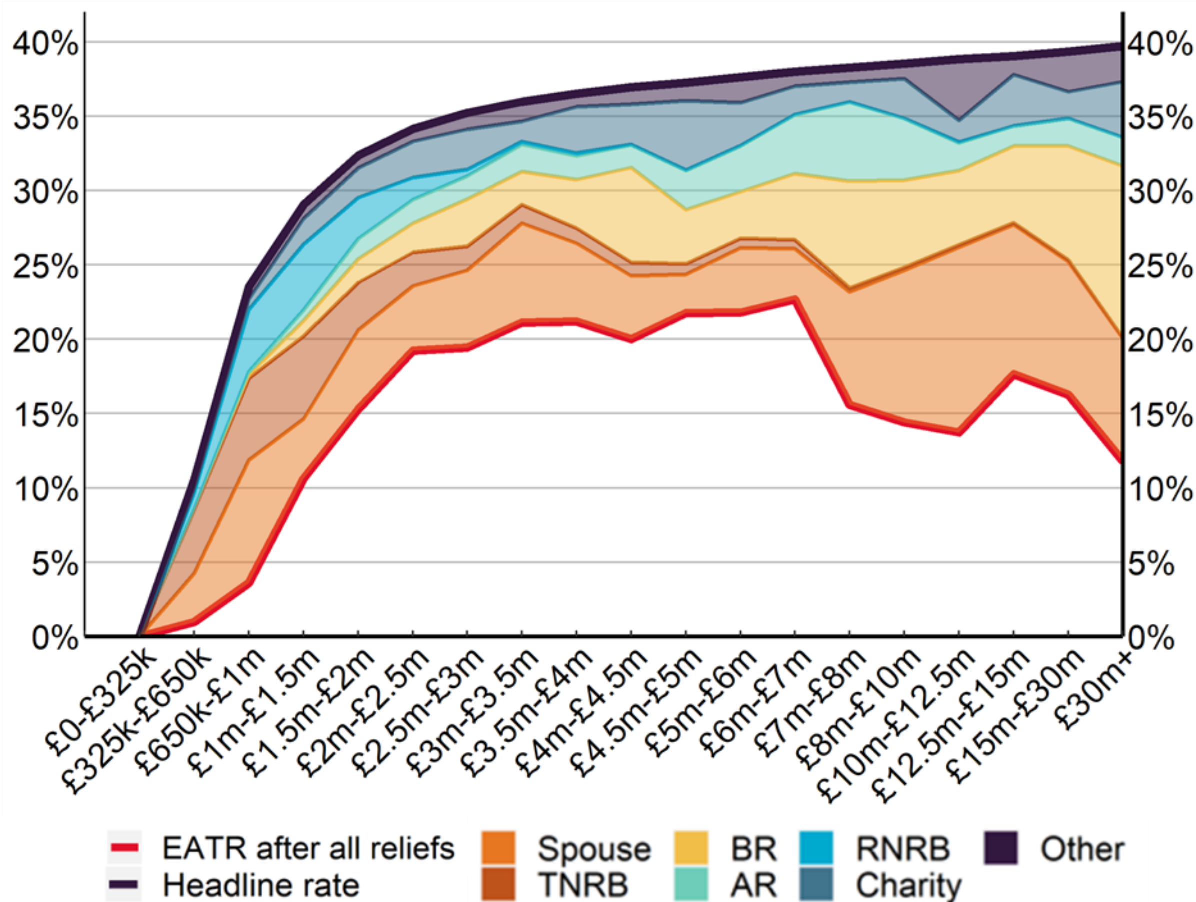
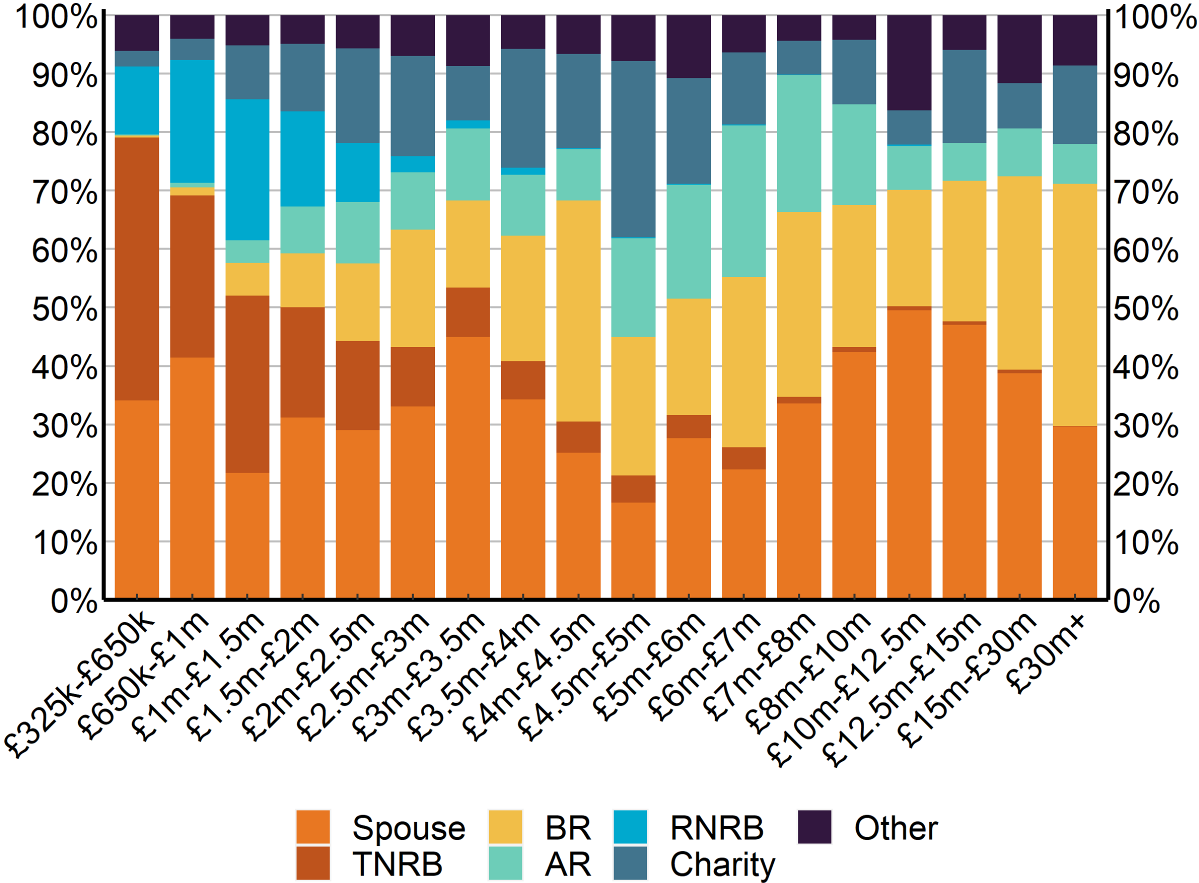
Figure 2: Impact on EATR of different reliefs by size of estate, 2018-2020



Notes: EATR denotes the effective average tax rate, where the average is the democratic mean within each band of the net wealth distribution shown. The "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata. "Spouse" denoted the spouse exemption. "TNRB" denotes the Transferrable Nil-Rate Band. "BR" denotes Business Relief. "AR" denotes Agricultural Relief. "RNRB" denotes the Residence Nil-Rate Band (including the Transferrable Residence Nil-Rate Band). "Charity" denotes charity relief. "Other" denotes the total of all other reliefs not listed.

Source: Authors' calculations based on HMRC administrative datasets.

Figure 3: Proportion of difference between headline rate and EATR accounted for by different reliefs by size of estate, 2018-2020



Notes: The "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trust, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata. "Spouse" denoted the spouse exemption. "TNRB" denotes the Transferrable Nil-Rate Band. "BR" denotes Business Relief. "AR" denotes Agricultural Relief. "RNRB" denotes the Residence Nil-Rate Band (including the Transferrable Residence Nil-Rate Band). "Charity" denotes charity relief. "Other" denotes the total of all other reliefs not listed. Estates smaller than £325,000 are not shown since the headline rate and EATR paid are both 0.

Source: Authors' calculations based on HMRC administrative datasets.

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Horizontal Inequity

The extent of horizontal inequity in the Inheritance Tax system has not previously been apparent because existing statistics (such as HMRC, 2024) have focused exclusively on *average* EATRs. We find that the average EATR paid at each level of the net wealth distribution masks a wide variation in the EATRs paid by estates *within* each level of net wealth.

Figure 4 below shows the distribution of EATRs paid by the estates not eligible for the spouse exemption within each level of the wealth distribution.[21] We focus on these estates in particular to highlight the extent to which the variation in EATRs exists even for those who do not have access to the spouse exemption.

In contrast, the impact of the TNRB makes up a substantial proportion of the reduction in EATR for the smallest estates, declining in its impact as the size of estates increases. Similarly, the RNRB makes up a substantial proportion of the reduction in EATR for many estates valued at less than £2.7 million, but has no impact for the highest value estates since it is fully tapered away above £2.7 million.[22] In proportional terms, the impact of charity relief varies across the wealth distribution, but is small for estates valued at less than £1.5 million and particularly large (in proportional terms) for estates valued at between £4.5 million and £5 million.

Figure 4 shows the huge range in the tax rates paid by estates with the same amount of wealth. Wide variation can be seen at all levels of wealth above £650,000, but the variation is starkest for the largest estates valued at more than £4 million.

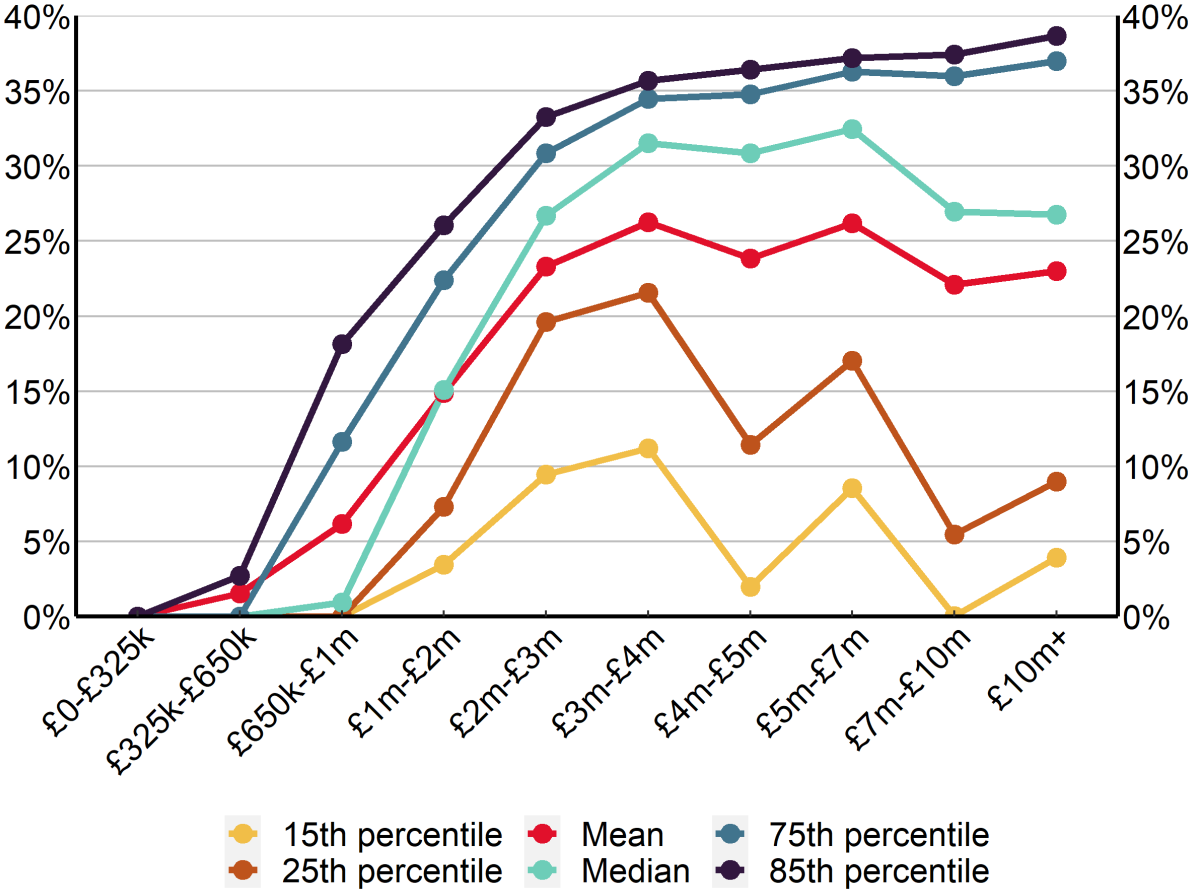
Among estates worth £10m or more, the *average* EATR was 23%. However, while a quarter of these estates paid an EATR of over 37%, more than a quarter of estates worth £10m or more paid less than 9%. One in six paid an EATR of less than 4%.

Understanding the extent of the variation in rates paid by estates with the same amount of wealth is an important step to understanding whether Inheritance Tax is a well-functioning tax. Apparent inequities could, in some cases, be justified when the underlying policy serves a specific purpose. However, the extent of the variation in EATRs paid by estates with similar amounts of wealth underlines the importance in articulating what that policy purpose is, whether the relief is achieving its purpose efficiently, and whether the policy can therefore be justified. Some of these issues are discussed in subsequent sections.

[21] For statistical disclosure purposes, Figure 4 uses a more aggregated breakdown of the net wealth distribution than Figures 1, 2 and 3.

[22] Note that the RNRB in Figures 2 and 3 includes the TRNRB. Some impact of the RNRB is observed above £2.7 million in Figures 2 and 3. This is due to a distinction between "size of estate" as defined in this policy paper and the definition used by HMRC. In particular, our definition of net wealth does not count funeral expenses as a liability. Relative to HMRC's definition, this lowers the calculated average EATR paid by estates with large funeral expenses and shifts these estates further up the wealth distribution. See Figures 19 and 20 in Appendix B for a breakdown of average liabilities across the wealth distribution.

Figure 4: Distribution of EATRs paid by the estates of single individuals by size of estate, 2018-2020



Notes: The "size of estate" here is defined as the individual's net wealth on death, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trust, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata. Data is pooled across tax years 2018 to 2020 and shows only the estates of those who do not have access to the spouse exemption, i.e. estates for which no spouse exemption is observed, and which are not classified as "Married" in the HMRC microdata. We refer to specific percentiles of the distribution of effective tax rates at a given level of wealth, where for example the 85th percentile (p85) indicates that 85% of the estates at a given level of wealth paid an EATR less than the indicated percentage. The median refers to the 50th percentile (p50), indicating that half of estates at a given level of wealth paid an EATR less than the indicated percentage, and half of such estates paid more.

Source: Authors' calculations based on HMRC administrative datasets.

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“Missing” Wealth

As noted above, this analysis does not take into account pension wealth, foreign wealth of non-doms, and wealth in trusts. It also does not consider gifts made more than seven years prior to death because we do not observe this information in the HMRC microdata. As a result, these forms of wealth are effectively “missing” from the measured value of the net estate, leading in many cases to an underestimate of the true value of the estates, and a corresponding *overestimate* of the EATR of (some) estates. If these other forms of wealth were taken into account, the effective tax rates paid by many of these estates would be even lower than the figures indicated above. It would also shift these estates further up the wealth distribution.

Since these sources of wealth are missing from the HMRC microdata to which the authors currently have access, it is generally not possible to include an estimate for them at the individual estate level. With the exception of trusts, which are taxable, HMRC is not even empowered to collect information about these sources of wealth, so neither HMRC nor other researchers are able to evaluate the impact of these exemptions in terms of foregone tax revenue or wider economic impacts using tax data.[23]

There is a strong case to be made for HMRC to require that information on pensions and gifts made more than seven years prior to death be provided to the tax authority, even if these wealth holdings remain exempt from Inheritance Tax. Specifically, new rules should be considered that require any lifetime transfer with a value over £10,000 to be reported to HMRC, as happens in countries such as the United States.[24]

Despite being unable to quantify their impact due to lack of data availability, we briefly consider each of these other forms of wealth. As well as reforms to the collection of data in relation to these wealth holdings, wider reforms to the taxation of these forms of wealth should be considered.

[23] However, this analysis can in many cases be done using other datasets. For example, Advani and Sturrock (2023) analyse the impact of the exemption of pension assets from Inheritance Tax using the Wealth and Assets Survey.

[24] In the United States, the annual exclusion per donee is $18,000 in 2024. For more information, see https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked-questions-on-gift-taxes

Trusts

Trusts have a special treatment under the Inheritance Tax regime, as the general framework is not appropriate for settled property. Although we do not currently have access to HMRC microdata on trusts, we are able to report statistics based on an HMRC response to a Freedom of Information (FOI) request made by the authors.

The Inheritance Tax regime for relevant property trusts currently applies to all discretionary trusts and most trusts set up after 2006, including interest in possession trusts.[25] Relevant property trusts are subject to a special Inheritance Tax structure.[26] When assets are transferred into the trust, an entry charge may apply if the value exceeds the available NRB, which is currently £325,000.[27] If the trust receives assets over this threshold, Inheritance Tax is charged at 20% of the excess amount (subject to reliefs, as discussed below).[28] There is an additional charge in the event that the transferor dies within seven years.

In addition to the entry charge, relevant property trusts are subject to periodic ten-year charges and exit charges. The ten-year charge is calculated at up to 6% of the value of trust assets exceeding the NRB. When assets are distributed out of the trust the exit charge due is proportionate to the time since the last ten-year charge (the maximum exit charge is 0.6% per annum). The rationale behind this regime is that over a roughly 30-year period, the 20% entry charge combined with repeated 6% ten-year charges and a proportionate exit charge should approximate a 40% rate.

More substantially, since trusts benefit from the same reliefs as individual estates, a trust which is settled with exempted assets has no entry charge, and would have no ten-year charge if still holding such assets at the ten-year anniversary or on exit. This is the case for qualifying assets including business assets, certain AIM shares[29], and farmland held in trusts, which may be entitled to BR and AR that could reduce each of these charges. Similarly, trusts can be used to maximise the benefit of the NRB, as it allows individuals to pass up to £325,000 Inheritance Tax-free every seven years.

[25] Trusts excluded from the relevant property regime include pre-2006 interest in possession trusts, bare trusts, trusts for bereaved minors, and trusts for the disabled.

[26] The situation is different for qualifying interest in possession trusts. These are, broadly, trusts giving a right to income to a beneficiary, where the right to income was given prior to 2006 or the trust was interest in possession and established by will, or is established during lifetime for a disabled beneficiary. In this case, the beneficiaries are treated for Inheritance Tax purposes as owning the settled property.

[27] Whether the NRB is exceeded is determined by including any transfers and any chargeable gifts made in the previous seven years by the settlor.

[28] If the transferor pays the Inheritance Tax entry charge then grossing up to account for the loss on their estate means the effective rate is 25%.

[29] AIM is the Alternative Investment Market, a sub-market of the London Stock Exchange.

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Table 1: Median entry, ten-year anniversary and exit charges paid by taxpaying trusts, 2018-2020

Tax year	Median entry charge	Median ten-year anniversary charge	Median exit charge
2018	6%	2%	1%
2019	11%	2%	1%
2020	11%	2%	1%

Notes: The table indicates the 50th percentile of the distribution of EATRs of Inheritance Tax paid by taxpaying trusts ranked by EATR within each charge type and tax year.

Source: HMRC response to an FOI made by the authors.

The response to the FOI request indicates that around 7,900 trusts paid Inheritance Tax over the tax years 2018 to 2020[30], an average of around 2,600 per year.[31] The majority of these tax liabilities arose as a result of paying exit charges but the majority of revenue accrued from ten-year anniversary charges (HMRC, 2024). Very few trusts received any amount of BR or AR, though the size of the tax relief provided through these channels was substantial and concentrated among a small number of trusts.

The total value of AR and BR received between 2018 and 2020 stood at £2.0 billion[32], an annual average of over £650 million. However, 97% of this combined total (£1.9 billion) went to 193 trusts over the three years, who claimed more than £1m in combined relief. On average these trusts each benefited from £10 million in Inheritance Tax relief. The application of AR and BR in the context of trusts is poorly targeted as most of the benefit is received by trusts holding very large wealth.

While we do not observe the full distributional impact of these reliefs on the effective tax rates paid by trusts, the FOI response indicates that, in the context of a headline rate of 20%, the median entry charge among trusts making this payment[33] was 6% in 2018, 11% in 2019 and 11% in 2020 (see Table 1). One in four trusts paid less

[30] Note that an individual settlor might have established multiple trusts, in which case the number of unique individuals using the trusts regime and paying Inheritance Tax may be fewer than this.

[31] The FOI response does not indicate the total number of trusts. For other statistics relating to trusts in the UK, see https://www.gov.uk/government/statistics/trust-statistics/statistics-on-trusts-in-the-uk-october-2022.

[32] 224 trusts received a total of £1.3 billion of relief on their business assets and 214 trusts received a total of almost £700m of relief on agricultural assets. The 214 trusts receiving AR are not necessarily distinct to the 224 trusts receiving BR. It is likely that many trusts claimed both forms of relief for different assets.

[33] We expect many trusts to pay no entry charge as the property settled is below the NRB.

than 2%, 5% and 4% in tax years 2018, 2019 and 2020 respectively.[34] This is perhaps not surprising given the Inheritance Tax rules for trusts, as there is an incentive for settlors to transfer amounts close to their NRB every seven-year period to reduce the entry charge. But it does highlight the distortive effects that trusts can have in this regime, as they effectively allow people with sufficient liquidity to "refresh" their NRB every seven years, further eroding the Inheritance Tax base.

The median ten-year charge among liable trusts[35] was 2% from 2018 to 2020, despite a headline rate of 6%. The median estate paying exit charges also paid 1% in each of those three tax years on a pro-rata basis. This is again strong evidence of the use of trusts for tax planning purposes to maximise the benefit of the NRB every seven years.

Pensions

The total exemption of pension pots from Inheritance Tax is costly in revenue terms and distorts economic decisions. Pension contributions are also relieved of Income Tax when made, and no Income Tax is due on withdrawals from inherited pension pots if the donor dies below the age of 75. As a result, defined contribution pension pots bequeathed by those who die under the age of 75 are not liable for either Inheritance Tax or Income Tax at any point.[36]

We do not observe pension assets in the HMRC microdata and are therefore unable to analyse (on the same basis as for other reliefs) the distributional or revenue impact of bringing pension pots within the scope of Inheritance Tax. However, Advani and Sturrock (2023) estimate that bringing pension pots into the scope of Inheritance Tax would raise around £200 million a year in additional revenue if immediately implemented in full.[37]

[34] There are a number of challenges in the interpretation of these statistics, primarily the existence of the NRB of £325,000. Given that we do not observe any data relating to the amount of wealth held across trusts, we are unable to interpret the contribution that the NRB makes in lowering the EATRs paid by these trusts.

[35] As with entry charges, we expect many trusts not to pay 10-year charges given the effect of the NRB.

[36] However, Income Tax is due if the pension is inherited from someone who died aged 75 or older.

[37] The revenue estimate in Advani and Sturrock (2023) assumes that within couples, wealth is always fully bequeathed to the surviving spouse so that those first to die in a couple have no taxable estate.

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Gifts

There are two types of exempt gifts. First, and most importantly, gifts and other transfers of wealth made more than seven years prior to death are not part of the giver's estate, regardless of their value.[38] For transfers that occur between three and seven years prior to death, "taper relief" is applied to reduce the tax liability.

Secondly, there is a range of other small exemptions for gifts: an annual exemption of £3,000, a small gifts allowance of £250, an exemption for regular gifts that are part of "normal expenditure" and made out of income,[39] and gifts for weddings and civil partnerships.

The exemption of these gifts means that those who can afford to give away substantial wealth during their lifetime without compromising their standard of living can pass on wealth to heirs at much lower effective tax rates than those who cannot afford to give away wealth during their lifetime. Those whose main residential property makes up the bulk of their assets are less likely to be able to give away substantial amounts of their wealth tax-free during their lifetime, whereas those at the top of the wealth distribution tend to have more liquid financial assets that are easier to give away.[40]

We do not observe exempt gifts in the HMRC microdata and are therefore unable to analyse the distributional or revenue impact of a "gift tax" on the same basis as our analysis for other reliefs.

Foreign assets of non-doms

Finally, we do not observe the foreign assets of non-doms (or former non-doms, if the assets are held in a trust). While we observe some UKassets of non-doms (typically a property in the UK), most other assets held by this group will be located abroad. People making use of this tax status are strongly concentrated at the top of the income distribution, and evidence from Advani, Burgherr and Summers (2023) suggests that they are also concentrated at the top of the wealth distribution. We do not observe these wealth holdings in the HMRC microdata and have not analysed the distributional or revenue impacts of this omission.[41]

[38] Except if the donor reserves a benefit in the asset. The rules on reservation of benefits are complex, but their effect is to prevent people from giving away illiquid assets (e.g. a house) from which they continue to benefit after the gift (e.g. living rent-free in the gifted house).

[39] OTS (2019) highlights that almost half of claims made under the "normal expenditure out of income" exemption are worth more than £25,000 annually. One in seven of such claims is worth more than £100,000 annually.

[40] See Appendix B for a breakdown of the composition of asset type by size of estate.

[41] In March 2024, the Conservative Government announced that it would be abolishing the exemption for foreign assets for individuals who had been resident in the UK for more than 10 years. The new government has adopted this reform and additionally pledged to bring foreign assets held in trusts within the scope of Inheritance Tax. Consequently, for deaths occurring after April 2025 this form of missing wealth should become visible in Inheritance Tax statistics, except where the deceased had been resident in the UK for less than ten years.

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Spouse exemption

Introduced in March 1972, the spouse exemption has provided a complete exemption from Inheritance Tax for assets transferred to a spouse or civil partner since November 1974 (unless non-UK domiciled).[42] As the largest relief by value, the total value of recorded assets transferred under this exemption between 2018 and 2020 averaged over £16 billion per year. In the section "Impact of Reliefs" above we discussed the effect that this exemption has in terms of the effective average tax rates (EATRs) paid by all estates with those paid by estates without access to the exemption.

Policy rationale and issues

Although the UK broadly treats individuals as the unit of taxation for Income Tax purposes, for "capital taxes" (Capital Gains Tax (CGT) and Inheritance Tax), transfers between spouses are given special status. The arguments made in favour of the spouse exemption for Inheritance Tax include that it prevents the surviving spouse from having to sell the family home or face further financial difficulties from an Inheritance Tax liability during a time of bereavement. It is also argued that the exemption simply defers the Inheritance Tax liability, as it is assumed that the estate will ultimately be taxed when the surviving spouse dies.

However, rather than just deferring the tax liability, the spouse exemption provides the surviving spouse with an opportunity for further tax planning. For example, Boileau and Sturrock (2023) show that surviving spouses often increase their level of lifetime giving after their partner's death. This increased giving can be the consequence of two tax incentives present in the current regime. Firstly, the Potentially Exempt Transfer (PET) regime means that the surviving partner will be able to reduce the Inheritance Tax liability if they outlive any lifetime gifts by three or more years, in a situation where the deceased partner would have paid Inheritance Tax at the 40% rate.[43]

Alternatively, as pointed out by Advani and Sturrock (2023), the increased giving can be explained by the fact that the assets are not only exempt from Inheritance Tax but also receive CGT uplift, thereby eliminating any potential CGT that would have been due if the gifts were made by the deceased spouse. Moreover, assets passed free of Inheritance Tax on death could be sold (realising no CGT, given uplift on death) and the proceeds from the disposal used to purchase AIM shares eligible for Business Relief (BR), which will be free of Inheritance Tax when later passed on.[44]

[42] Inheritance Tax Act 1984, s 18.

[43] Taper relief provides partial relief for gifts or lifetime transfers made between three and seven years prior to death. For transfers made more than seven years prior to death, no Inheritance Tax is due.

[44] This assumes the second spouse holds these at least for two years before death. See Advani and Sturrock (2023) for further discussion.

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This tax planning opportunity could be solved by removing CGT uplift on assets passed between spouses, but the former is more challenging as it reflects the distortive effects of the PET regime. This shows that the spouse exemption is not merely a deferral of the Inheritance Tax charge, as it can lead to a permanent loss of tax revenue.

Distribution of the spouse exemption

Across most of the wealth distribution, the spouse exemption is the relief that causes the single largest reduction in EATRs paid. It also contributes to regressivity at the top, given that the effect on EATRs is largest for estates valued at more than £7 million. Among estates above this level, the exemption lowers the EATR by more than 7 percentage points. The largest reduction occurs for estates valued between £10 million and £12.5 million, whose EATR falls by 12 percentage points (from 26% to 14%), compared to a reduction of 2 percentage points for estates valued between £1 million and £1.5 million.

Given its contribution to regressivity within the Inheritance Tax system and its potential to act as a further opportunity for tax planning (rather than simply acting as means for deferral), a set of reforms to the current Inheritance Tax regime could consider capping this exemption, which is currently generally unlimited. We consider one such cap in the section “Reforming Reliefs”.

Business Relief

While Inheritance Tax has existed in some form in the UK for over a century,[45] for much of its history there was no special relief for business assets. Business Relief (BR) was first introduced in April 1976 with the stated purpose of preventing businesses from being sold to cover large Capital Transfer Tax (CTT) bills after the death of the business owner when rates of CTT were much higher (Chamberlain, 2016; Fairpo, 2022).[46] In subsequent decades the scope of assets qualifying for BR has widened and the rates of relief applied to certain assets have increased. For example, in the 1977 tax year, only 30% relief was available for controlling shareholdings in unlisted companies, but this rose to 50% in 1978 and 100% from 1992 onwards.[47] From April 1996 the rate of BR has been 100% for transfers of unquoted shares (whether or not controlling holdings) such as AIM shares (subject to the relief conditions being satisfied).

Today BR reduces the value of businesses or its assets for Inheritance Tax purposes. To qualify for the relief the assets must be relevant business property,[48] held for at least two years preceding the transfer (i.e. death, in most cases),[49] and the business must not be mainly an investment business.[50] Its stated aim is “to ensure businesses do not have to be sold or broken up following the death of the owner” (HMRC, 2021).

The type of property determines the rate of relief, with a 100% relief given to interests in unincorporated businesses and shares in unquoted businesses.[51] Relief is restricted to 50% of the value of the assets if these are quoted shares or securities giving control to the deceased, and on land, building and machinery used in a business carried on by a company that the deceased controlled or by a partnership of which the deceased was a partner.

BR therefore fully removes the value of both private businesses and partnerships from Inheritance Tax where the deceased exercised control over the business, and shares of unlisted businesses where the deceased was merely an arm’s-length investor (provided they were not investment companies).

[45] An early form of what may be considered Inheritance Tax was introduced in 1694 as "Probate Duty”. In 1894 Estate Duty replace Probate Duty as the main form of taxation on death, which remained in place until 1974 when it was replaced by capital transfer tax (CTT). The CTT was gradually changed until it was renamed Inheritance Tax in 1986.

[46] See also HC Deb 17 May 1976 vol 911 cc1115-27.

[47] For further information on the historic rates of Business Relief, see https://www.gov.uk/hmrc-internal-manuals/shares-and-assets-valuation-manual/svm111290

[48] Inheritance Tax Act 1984, s 105(1).

[49] Inheritance Tax Act 1984, s 106.

[50] Inheritance Tax Act 1984, s 105(3).

[51] Other securities in unquoted business are also eligible for 100% relief if they give control of the company.

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Arguments for Business Relief

There are two main categories of argument made by proponents of BR.

Providing investment incentives

Although not directly aligned with the formal aim of BR, the first type of argument made in support of BR is that it acts as an investment incentive. By reducing the effective tax rate on inherited business wealth, including in arms-length unquoted shares (e.g. AIM shares), the government subsidises the allocation of capital towards these shares relative to a neutral regime that taxed all investments equally. This is sometimes defended on the basis that such businesses are particularly in need of capital, sometimes that they are particularly high-risk and individual investors would otherwise not invest, and sometimes that they benefit from 'patient' capital and individual investors might otherwise not be willing to hold these assets for long periods.

At the core of each of these arguments is the supposition that tax incentives should be used to encourage individuals to do something they otherwise would not do. The issues are slightly different for arms-length investments/passive ownership, but in both cases there are a number of reasons why the current regime is not well-designed if this were the aim.

Arms-length investments

The first case against using BR as an investment incentive, is that it is not at all clear why – if the aim is to increase investment in UK businesses – individual UK investors are the relevant investor-type to incentivise. There are many potential sources of capital for businesses, including institutions and international investors, neither of which are affected by UK Inheritance Tax reliefs. These groups typically have much more capital they could allocate. Smaller investors that only invest in these assets because of the incentive end up facing high risks than they could under a more diversified portfolio, which is potentially more appropriate.

The second problem is that BR is poorly targeted for supporting high-risk high-return firms. All unquoted shares are covered in the same way, whether the firm is innovative and likely to grow fast. Unlike other targeted tax reliefs (Enterprise Investment Scheme, Seed Enterprise Investment Scheme, Venture Capital Trusts), the current design of BR does not do anything to explicitly focus investment into companies which are expected to be high-return. If anything, for investors whose decision is being driven by the relief against Inheritance Tax – the wealth taxpayers intend to pass on – the focus will be investment in assets that are relatively stable, rather than risky high-return businesses.

A related problem is that BR comes with holding-length requirements. These are aimed at reducing tax avoidance through deathbed purchases of exempt assets. But the trade-off is that this makes it harder for older investors to exit, if a company is doing less well, because they know they may lose the relief if they do not live long enough after reallocating the money elsewhere.

There is also a conceptual problem in the discussion that often accompanies BR. It is important to remember that in the absence of the relief, the money would not

have been stored "under the mattress", but instead it will typically be held in the form of other financial assets. This still reduces the cost of borrowing for some companies, whether because the money is lent out through the banking system, or placed in a fund which then makes institutional investments.

A final important concern, when examining the effects of any policy is to think about the alternatives. As we show below, BR is costly. Even if it has some positive effects, this does not in itself indicate that this is the best way to spend this money to support growth. Effectiveness depends both on leading to positive outcomes, but also on *additionality*: how much extra investment is there that would not have happened in the absence of policy. As the National Audit Office highlighted, there has not been an evaluation looking at the impact of this tax relief (NAO, 2020).

Owner-managed businesses

The above arguments largely apply also to owner-managed businesses: relief against Inheritance Tax applies to a wide range of businesses, whether or not they are likely to be high growth; along with uplift at death against Capital Gains Tax, it encourages some people to hold on to businesses for longer than is productive; and there remains the question of additionality.

A different argument made around investment incentives specifically in the context of owner-managed businesses is that the owner can choose how much cash to pay out of the business. If the tax rate is high, then owner-managers may pay out of the business to pay the tax, and this would reduce investment in the business. We turn to this set of arguments next.

Tackling liquidity constraints

A second set of arguments made in favour of BR is that it reduces **liquidity problems**. The concern here is that an estate may not have enough cash or liquid assets to be able to pay Inheritance Tax, and so some business assets would need to be sold.

Arms-length investments

In the context of arms-length investments this is unlikely to be a serious concern. In the absence of reliefs, individuals do not choose to tie up assets they need access to in highly illiquid forms. At very high levels of wealth, illiquid investments become a larger part of an individual's portfolio, but there are typically sufficient liquid assets also in the portfolio (Loutzenhiser and Mann, 2021). For those few cases where liquidity is a problem, there already exist solutions, both private – individuals can choose to purchase life insurance to provide a lump sum on death – and public – the tax authority can allow a staggered payment schedule (with interest). Finally, if a small number of passive investors nevertheless need to sell some arms-length investments, and these are purchased by some other passive investors, there are no impacts on business performance to be concerned about.

Owner-managed businesses

In the context of owner-managed businesses, there may be a concern for the impact on the business itself if the estate does not have enough available liquid assets. Where the private business makes up a large share of the estate, individuals

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may need to find cash to pay the Inheritance Tax. This presents the owners with three options in principle: they could pay using income from the business, borrow against the business, or sell part of the business.

The first two options are similar. In the first, profits from the business can be used to buy life insurance prior to death or can be used to pay the staggered Inheritance Tax bill in the subsequent years. In the second, borrowing privately against the company can allow repayment over a longer horizon than HMRC might allow if desired. If the business is profitable enough, then this will be possible. For a (persistently) unprofitable business, this will not work, but we would not want the tax system to sustain unprofitable businesses which tie up resources from being more productively used.

The case which is most problematic is where a business is profitable but is highly credit constrained. The business may then be relying on retained earnings to invest, and paying these out could reduce its productivity. It is important both to recognise that this case does not apply to all businesses that are currently covered by Inheritance Tax, but also to think carefully how best to target support for those businesses which need it, since constraints on access to credit will also be a problem for the growth of businesses which are not yet being bequeathed – a point to which we return below.

A third option is to sell a share of the company. This reduces the family's control over the business. From an individual perspective this clearly reduces the value of what can be passed on, as Inheritance Tax does for everyone else. From a business perspective, the main difficulty is finding a buyer (Family Business UK, 2024), since it may be difficult to find a route for smaller businesses without much track-record to find external investment.

Achieving this would be a larger prize, since it would more generally expand the company's access to capital beyond what can be sustained by the founders, and again improvements could benefit other businesses. Wider ownership may also lead to change in management that improve the company's productivity. There will already be some change since the business is being transferred on death, but it is often kept within the family. The academic evidence suggests that on average this is worse for performance: firms with dispersed shareholders and family-owned firms with non-family management perform similarly, and both perform better than businesses that are both owned and managed by a family (Bloom, Sadun and Van Reenen, 2010)

In summary, the liquidity constraint argument is an important one for some owner-managed businesses. However, for these cases, there are multiple better solutions than a blanket exemption from Inheritance Tax for all owners of these businesses. Directly solving the problem of access to capital would obviously be the best solution, since it benefits all business. Government supported investment incentives already attempt to do this, but revenue would be potentially better spent on expanding these in appropriate cases if desired rather than exempting all business assets from Inheritance Tax.

If focusing relief on Inheritance Tax specifically, HMRC offering a longer payment period – potentially longer than the current 10 years – is equivalent to HMRC lending

money to the company. An alternative would be for the state to be willing to take an ownership stake. In both cases HMRC is taking more risk that the tax is never paid, or that the value of the business declines, than if it insisted on being paid in cash. On the other hand, it receives more tax than the status quo, where it gives up all revenue from these private businesses.

Finally, the imposition of a cap on the value of relief can be used to protect the smallest businesses if this is desired. A cap of £1 million per couple, on top of £650,000 from nil rate bands, means business wealth would need to be above £3.3 million to reach a tax rate of 2% p.a. over 10 years. For a family paying the IHT bill out of profits from the company, this requires the company meet only a relatively low level of profitability. The effective rate rises for more valuable companies, but these larger businesses are also less likely to be liquidity constrained, and so can choose to raise capital privately to ensure they can still invest efficiently.

Distribution of Business Relief

Between 2018 and 2020, an average of £2.2 billion per year was provided in BR to around 3,400 estates per year, with the vast majority of this relief (£1.9 billion annually, 83% of the total) provided to fewer than 800 estates per year that each claimed more than £500,000. Indeed, more than two thirds of the BR claimed (72%, or £1.6 billion annually) was claimed by around 400 estates per year that each claimed more than £1 million in relief. The average wealth of these estates was around £7.6 million.

Figures 2 and 3 above highlight how BR has a larger effect in reducing the EATR paid by estates close to the top of the wealth distribution than any other Inheritance Tax relief except the spouse exemption. Indeed, for estates worth £30 million or more, the effect of BR in reducing the EATR is larger than the effect of even the spouse exemption, lowering the EATR of estates valued at more than £30 million by 12 percentage points on average (from 23% to 12%). However, this relief provides very little benefit for those further down the wealth distribution, lowering the EATR of estates valued at less than £1.5 million by less than 1 percentage point.

The HMRC microdata does not allow us to determine the distribution among estates of all business assets that qualify for BR, but we are able to identify share assets recorded in Inheritance Tax returns that qualified for BR between 2018 and 2020. More than two thirds (68%) of these assets were held by estates valued at more than £2m; and more than one third of all such assets (35%) were held by estates valued at more than £10m, although this group represents less than 0.1% of the population.

While an annual average of around 2,300 estates claimed some form of BR on share assets, over £1 billion (72%) of the total BR claimed on shares went to around 250 estates per year, each claiming more than £1 million in relief. The average wealth of these estates was around £8.2 million.

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Does Business Relief go to active business owners?

Since the stated aim of BR is to prevent the need for the breakup of businesses following the death of the owner, we next examine how often these shareholdings relate to someone who was actively involved in the management of the business.

Using directorship of a company or a close company as a proxy for an "active" business owner, we link Inheritance Tax returns data to self-assessment data to understand the population of those claiming this relief.[52] Considering those recorded as directors, we examine the five tax years prior to the tax year of death. 25% of those claiming BR on shares between 2018 and 2020 were identifiably a company director at any point in the five tax years prior to their tax year of death. A smaller group (19% of those claiming BR on shares) were directors of a close company[53] at any point over the same period. This suggests that a minority of those claiming this relief were actively involved in the running of the business under this definition.

Relief on AIM Shares

As noted above, in the years following its introduction, the scope of BR was expanded to include AIM shares, and much of the commentary in this policy space has focused on the value of BR provided to estates holding these types of shares specifically.

The stated purpose of the expansion of the relief to these assets included addressing illiquidity issues when these assets are sold to pay an Inheritance Tax bill,[54] but it is unclear the extent to which providing relief to passive investors who hold these assets aligns with the original stated intent of BR to prevent genuine trading businesses from being broken up or sold on at the death of their owner. If the intent of providing BR to AIM shares is to promote business investment, it is not well targeted.

Without access to the HMRC microdata, previous work (such as Advani and Sturrock, 2023) has been based on datasets such as the Wealth and Assets Survey

[52] In 90% of cases, we obtain a successful match between the Inheritance Tax return of an estate claiming Business Relief between 2018 and 2020 and the individual's income data in the five tax years preceding death.

[53] Broadly speaking, a close company is a company under the control of five or fewer participators, or where more than half of the company's assets would be distributed to five or fewer participators (or to participators who are directors in the event of the company winding up). If the participators are directors, there may be any number of participators. For further information, see https://www.gov.uk/hmrc-internal-manuals/company-taxation-manual/ctm60060

[54] See Nigel Lawson's statement in the Hansard entry for the House of Commons, Inheritance Tax, Volume 205: debated on Tuesday 10 March 1992, available at https://hansard.parliament.uk/Commons/1992-03-10/debates/fdd28bd9-9f6e-4d8b-9d13-e3ddb5ba458a/InheritanceTax

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(WAS) and official statistics published by HMRC (HMRC, 2024). The HMRC Inheritance Tax liabilities statistics show the value and number of estates claiming BR by tax year, broken down by “relief on unquoted shares” and “other business property reliefs”. A more granular breakdown is available in the HMRC microdata, but the manual entry of IHT400 returns onto HMRC’s systems results in it not being possible to reliably distinguish between relief on unquoted and unlisted shares (whether control or non-control holding).

While the information in terms of the value of share assets held and relief provided is correct, it is not possible to reliably distinguish the breakdown of AIM shares from other shares that qualify for BR. As a result, neither HMRC official statistics nor the HMRC microdata provide a reliable breakdown of the relief provided to AIM shares specifically. To our knowledge, there is no reliable estimate available. The provision of data by HMRC that allowed this distinction to be made would be a useful and prudent step in understanding the breakdown of BR. Collecting this data would aid public understanding of the cost to the Exchequer of BR on AIM shares.

Nevertheless, our analysis indicates that of £2.2 billion in annual Inheritance Tax BR provided between 2018 and 2020, £1.4 billion (65%) went to providing BR on all forms of share assets that qualify for BR. From an economic efficiency perspective, the government could consider the abolition of BR on AIM shares and, if desired, use the money from such a reform on a targeted business investment support scheme, rather than the current tax relief for those who own AIM shares. For example, the government could consider the established sets of criteria for schemes such as the Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS), or Venture Capital Trusts (VCT).

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Agricultural Relief

Alongside Business Relief (BR), Agricultural Relief (AR) on Inheritance Tax in the UK was also introduced in 1976 with a similar policy intent of preventing businesses from being sold to cover Inheritance Tax liabilities. This relief reduces the transfer value of qualifying agricultural property that has been held for a minimum period,[55] and the reduction is usually for 100% of the value of the assets.[56] AR is given to land that is farmed by the owner, if the owner has occupied the property for agricultural purposes for at least two years before the transfer. If the owner does not occupy the land, they must have owned it for at least seven years before the transfer provided it has been occupied throughout that period for agricultural purposes.

Qualifying agricultural property for the purpose of AR include agricultural land or pasture, woodland and buildings,[57] and cottages and farmhouses.[58] On the other hand, AR is not available on farm equipment and machinery, harvested crops and livestock (although these can be covered by BR if they meet all of the relevant conditions). AR will also be available if the qualifying agricultural property is held by a company controlled by the transferor.

Where there is potential overlap between AR and BR (for example, farms that qualify both as agricultural businesses and as general trading businesses), AR should apply in priority to BR.[59] Even in cases where BR would exempt the entire business, AR should apply first to the assets meeting the agricultural requirements, and BR applies to the rest of the business's assets (if any). For example, where agricultural land also has development value, the agricultural value of the land is typically less than the market value. In that case, AR provides relief up to the agricultural value of the property, and, in certain cases, BR for the excess of the market value over its agricultural value (sometimes referred to as the "hope value"). Indeed, our analysis indicates that 40% of the almost 3,900 estates that claimed AR between 2018 and 2020 also claimed some form of BR.[60]

[55] The reduction only applies to the agricultural value of land, so there could be part of the land value subject to Inheritance Tax even if 100% AR is given (e.g. if the land has development value).

[56] Agricultural Relief is due at 100% if the person who owned the land farmed it themselves; the land was used by someone else on a short-term grazing license; it was let on a tenancy that began on or after 1 September 1995. AR will be given at a 50% on other cases (e.g. when transferor if landlord of tenanted farm under a tenancy that begun before September 1995).

[57] Provided they are occupied as ancillary to the land in connection with intensive farming.

[58] Provided they are of a character appropriate to that property.

[59] Inheritance Tax Act 1984, s 114(1). Except for transfers made on or before 10 March 1982, where the taxpayer had a choice between BR and AR.

[60] Here and throughout our analysis, we consider only estates that we determine to have received Agricultural Relief on UK farmland and UK farm assets. During the period of analysis (2018-2020), Agricultural Relief was also available to estates holding agricultural property in the EEA. Since 2024 this has subsequently been restricted to only the UK, Channel Islands, and Isle of Man.

However, broadly speaking, the additional relief provided by AR relative to BR is two-fold. AR provides for:

- the agricultural value of qualifying farmhouses and cottages to be exempt from Inheritance Tax (subject to certain conditions)
- the landlords of wholly tenanted and mixed-tenure farms to reduce the agricultural value of the land for the purposes of Inheritance Tax.[61]

Arguments for Agricultural Relief

Some of the key arguments for AR mirror those used for BR: we do not repeat those here. There are three specific issues for agriculture which do not come up for general businesses: the importance of relief for encouraging tenanted farming, the indivisibility of land holdings, and security in food production.

The tenanted farming sector

There are different business models for farming, including contract and share farming - where the landowner receives some of the return from the farm business - and tenant farming - where the landowner receives only rent, and the farmer receives any profit from the farm. It is sometimes argued that tenant farms are more productive than contract farms: having more control and receiving all of the reward, they may be more innovative (Northfield Committee, 1979).

In the presence of BR, AR is then needed to prevent landowners from allowing only contract farming so that they can benefit from BR (Tenant Farmers Association, 2024). If BR were abolished or scaled back, this case for AR would be irrelevant.

A separate argument that is sometimes made is that, in the absence of the relief, landowners would not have enough incentive to let out the land, since the returns are relatively low. In part this is perversely because AR drives up the value of farmland above its farm value, driving down the yield. Removing the relief would bring down the value of land, which would benefit the farming sector by making it easier for new farmers to buy land. By attempting to preserve current landownership, the status quo makes entry harder.

More broadly, and as discussed further below, if there is a desire to support the tenant farmer sector, better targeted expenditure aimed at this group would be preferable. Targeting reliefs to landowners, only some of whom let out their land, is unlikely to be the most effective way to support the tenants.

[61] HMRC consider that letting out property is an investment activity rather than an active trade, which (in the absence of Agricultural Relief) would disqualify the agricultural assets of a let-farm from qualifying for Business Relief.

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Indivisibility of land holdings

A key input for farmers is land, and for a farm to be productive it needs the land to not be fragmented into disconnected small parcels. This sometimes motivates discussions about the need for relief. At its core, the argument here actually mirrors the "liquidity constraints" argument for owner-managed businesses – how to ensure the assets remain together– and the same solutions are available.

Longer payment periods would allow the effective tax rate to be lower, as would the state taking part-ownership of land and becoming the landlord to tenant farmers. As above, removal of the AR would also lower the cost of land, reducing the Inheritance Tax actually due.[62]

Security in food production

A final concern is that food production is a matter of national security, and is therefore different to other businesses (Country Landowners Association, 2024). If this is the rationale, then there may again be a case for some targeted expenditures, but AR is poorly designed for this purpose. Instead payments for the specific activities desired e.g. farming particular produce, would be a more appropriate way to ensure that the desired goals were being delivered. Farmers in the UK have historically received such direct payments, including via the EU Common Agricultural Policy and more recently the Basic Payment Scheme, which have specified activities needed to receive the money, so reform here would be a better way to achieve the desired goals.

Distribution of Agricultural Relief

Around 1,300 estates per year benefit from almost £900 million in AR on identifiably UK-based farmland and farm assets.[63] Figures 2 and 3 show the distributional impact effect of this relief in reducing the EATRs across the wealth distribution. While this relief has minimal impact in reducing the EATRs of estates towards the bottom end of the wealth distribution, AR has a particularly large impact in reducing the tax burden of estates valued at more than £5 million.

While 64% of estates claiming AR between 2018 and 2020 claimed less than £500,000 in relief, 83% of the value of the relief went to those claiming more than this amount. Indeed, almost two thirds (64%) of all AR benefited just over 200 estates per year that claimed more than £1m. The average wealth of these estates was £6.0 million.

[62] Agricultural Relief is only part of the reason agricultural land is so expensive relative to the returns received from it. Another important issue is "hope value", the value that comes from the possibility that the land will receive permission for alternative higher value uses. If more of this hope value were captured by the state, it would not only raise revenue for government, but also make the land more affordable for farmers while it does not have planning permission.

[63] Based on annual averages between 2018 and 2020.

Does Agricultural Relief go to active farmers?

As noted above, AR is designed to benefit owners of farmland whether or not they are involved in the farm business. Nevertheless, since there may be more targeted ways to help tenants than through tax breaks for their landlords, it is useful to understand what share of AR claims are by estates where the deceased was actively involved in the farm business. To determine this, we again use Inheritance Tax returns linked to the lifetime self-assessment returns of the deceased, to understand the population of those claiming this relief.[64]

Among estates that benefited from AR between 2018 and 2020, only 44% of those individuals had received any identifiable trading income from agriculture[65] at any point in the five tax years prior to their tax year of death. Under this definition of "active" farming, we therefore observe only a minority of beneficiaries of AR as "active".

Among this group identified as "active" working farmers, in the majority of cases trading income from agriculture constituted a minority of the individual's income. This agricultural income represented an average of 23% of the total income of individuals in this group over that five-year period. Indeed, only 24% of this group (i.e. 10% of all beneficiaries of AR) received an average of more than £10,000 per year in agricultural income over the five tax years prior to their death. These findings suggest that in a minority of cases did agricultural income make up a substantial proportion of these individuals' income.[66]

Among those for whom we observe no trading income from agriculture at any point in the five tax years prior to death, in 51% of cases the individuals had received income from rent, which is consistent with them being landlords rather than active farmers, although we cannot rule out that they were actively farming. These findings suggest that the majority of estates benefitting from AR may be those of individuals who were passive in their ownership of agricultural property.

However, we note Defra statistics that show that, in England in 2021, 54% of farms were owner-occupied, with 31% of mixed tenure and 14% wholly tenanted (i.e.

[64] In 87% of cases, we obtain a successful match between the Inheritance Tax return of an estate claiming Agricultural Relief for UK farmland or UK farm assets between 2018 and 2020 and the individual's income data in the five tax years preceding death.

[65] Here we define "trading income from agriculture" as income received through self-employment or a partnership in an industry within the SIC classification "Agriculture, Forestry and Fishing (Category A)". For each individual we observe the amount of income and the industry associated with the two highest sources of both self-employment and partnership income.

[66] Considering a narrower timeframe, 26% of the beneficiaries of Agricultural Relief had received trading income from agriculture in the year prior to their tax year of death, representing an average of 31% of the total income of individuals in this group. 35% of this group (9% of all beneficiaries of the relief) received more than £10,000 in trading income from agriculture in that tax year.

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owned by a landlord but worked exclusively by a tenant farmer).[67] This would suggest that, by number of farms, 85% of farms in England are (at least in part) farmed by their owner. In contrast, we observe only 44% of the beneficiaries of AR as “active”.

The disparity between these statistics and those we find in the HMRC microdata could reflect a number of factors. Among them is the possibility that AR only provides benefit for those who cannot pass on their farm using the standard NRB and TNRB allowances, which amount to £650,000 per couple (for assets other than the main residential property). Even among those claiming AR, the median value of farmland and farm assets held by an estate was around £414,000, suggesting that many small farms may fall within standard allowances.

[67] For the remaining 1%, tenancy was undeclared. See https://assets.publishing.service.gov.uk/media/6331b071e90e0711d5d595df/AUK_Evidence_Pack_2021_Sept22.pdf

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Other Reliefs

A range of other reliefs exist within the Inheritance Tax regime that contribute to lowering the EATRs paid across the wealth distribution while increasing the variation in rates paid by those with the same amount of wealth. We consider a number of these in turn.

Residence Nil-Rate Band

As highlighted in the section "How does Inheritance Tax work?" above, the Residence Nil-Rate Band (RNRB) gives special treatment to residential property passed to direct descendants. The application of this additional exemption to residential property disadvantages the small share of estates that hold more than £325,000 in net assets but less than £175,000 in residential property assets, as well as those without children or grandchildren. It also contributes to lowering the EATRs paid by estates valued at less than £2.7 million, with no impact for those at the top end of the distribution.[68]

Although abolishing the RNRB may address the distortions created by giving a special treatment to residential property, it would have no impact on the tax paid by estates valued at more than £2.7 million. Instead, it would only raise tax for some estates under this threshold. The section "Reforming Reliefs" below includes discussion of the potential reform of this band, including removing this form of special treatment by abolishing the RNRB but simultaneously extending the Nil-Rate Band (NRB) from £325,000 to £500,000.

Funeral Expenses

The legislation allows the deduction of "reasonable" funeral expenses from the value of an estate for the purposes of Inheritance Tax.[69] Over the period 2018 to 2020, the average deduction for funeral expenses was around £4,300, with 99% of such deductions less than £15,500.

However, a small number of estates made very large deductions for funeral expenses, with 0.1% of estates (an average of around 270 estates per year) deducting more than £154,000 tax free. We also observe deductions much larger than this – over the three years from 2018 to 2020, around 50 estates made very large deductions in excess of £800,000. Since these expenses are deducted pre-tax, this acts as an effective tax relief on large funerals for a very small number of estates.

Rather than removing the deduction for funeral expenses, limiting such tax-free deductions by explicitly quantifying the level of maximum "reasonable" tax-free funeral expenses could be considered as part of a package of reforms. Our

[68] See Figure 4 for the effect of the RNRB (combined with the Transferrable Residence Nil Rate Band (TRNRB)) on EATRs across the wealth distribution.

[69] Inheritance Tax Act 1984, s 172

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estimates indicate that a cap of £50,000, affecting fewer than 700 estates per year (around 0.2% of estates), could raise up to £25 million annually.[70]

Charity Relief

Assets left to a registered charity or club and gifts to political parties in a will are exempt from Inheritance Tax. In addition, since 6 April 2012, if at least 10% of the value of the estate over the NRB is left to registered charities the headline tax rate applying to the remaining net estate is reduced from 40% to 36%. This provides a subsidy or incentive for charitable giving targeted at those with estates over the Inheritance Tax threshold.

Between 2018 and 2020, around 11,000 estates per year made use of a combined annual £2.1 billion of this relief, an average of £183,000 of relief per estate.[71] However, more than half (£1.1 billion, 53%) of the value of Charity Relief was claimed by fewer than 400 estates per year on average, each benefitting from more than £1 million in relief. This suggests an implied revenue cost of up to £280 million per year versus a scenario that limited Charity Relief to £1 million of assets per estate. These estates had an average wealth of £4.8 million. Whilst there are sound policy justifications for favouring charitable giving to some extent, it is important to note that the current system effectively redirects tax revenues towards the charitable preferences of a very small number of people.

Relief for Heritage Assets

Heritage assets[72] are granted a conditional exemption from Inheritance Tax when transferred to new owners that agree to properly preserve the heritage assets, secure reasonable access to the public and to maintain them in the UK.[73] Charges may be made to the public to access these heritage assets, although those charges must be reasonable, and access needs not be permanent.[74] The conditional

[70] These revenue estimate figures assume a static behavioural response, apart from in the case of estates with access to the spouse exemption who are assumed to reduce their funeral expenditure to the level of the cap. The difference between the initial spending on the funeral and the new cap is passed to their spouse tax free. See Appendix C for further information and details on the calculation of revenue estimates.

[71] The value of relief is the value of relieved assets among estates meeting the threshold to access the 36% reduced rate of Inheritance Tax, not the Exchequer (i.e. tax) cost of the relief.

[72] Designated by the Treasury due to its national, scientific, historic or artistic, scenic, architectural interest.

[73] Inheritance Tax Act 1984, Part II, Chapter II.

[74] Public access can be quite limited. For instance, some paintings benefitting from the relief were available for public access 28 days a year at a charge of £10 per person in 2023. Another collection is only in display for 3 months every 3 years. HMRC maintains a website indicating when the public may visit land and buildings, although when and where the public can see works of art depends on the terms agreed with the owner (see https://www.hmrc.gov.uk/gds/heritage/lbsearch.htm).

exemption is withdrawn and Inheritance Tax is charged if the new owner breaches the conditions of the agreement or sells the asset.[75]

The policy intent of these reliefs seems clear: to preserve heritage assets in the UK and facilitate public access, and these seem to be valuable goals. But it is unclear whether this relief is the most effective way of achieving these goals. A similar aim is pursued by granting an exemption from Inheritance Tax to heritage property transferred to cultural bodies defined in the legislation,[76] but the benefit to the public in this case seems much greater. There are also non-tax policies that could achieve similar objectives without the Inheritance Tax base erosion, such as imposing an export ban on heritage assets.

Over the period 2018 to 2020, a total of 180 estates benefited from a conditional exemption on £313 million of assets under this scheme (£104 million per year). Almost all of the value of this conditional exemption (£300 million, 96%) was claimed by a total of 44 estates across the three years that benefited from an average of £6.7 million in effective relief. These estates were worth £19.3 million on average. There is substantial revenue forgone through this relief, so the government should consider reviewing this conditional exemption to assess whether the benefit to the public justifies the tax deferral, whether more stringent requirements should be established, or whether the relief should be simply abolished and the policy goals pursued through other (tax or non-tax) policies.

Timber Relief

When a landowner dies, Agricultural Relief is not available for woodlands that are used for the production of commercial timber, although Business Relief may be available if the woodlands are being actively used in a business (assuming that the business is not engaged in wholly or mainly holding investments). However, if the woodland does not qualify for Agricultural or Business Relief, but the trees or underwood are growing, woodlands relief may be available on the value of the trees or underwood (although not the land itself). Inheritance Tax should, however, be paid when the trees are sold, given away, or otherwise disposed of.

Over the period 2018 to 2020, statistical disclosure rules do not permit us to report the value of this relief or the number of estates benefitting, since they are too few in number. However, over the decade from 2012 to 2021, our analysis indicates that on average 20 estates per year made use of an annual total of around £5 million of this relief, an average of around £240,000 per estate.

[75] The assets given a conditional exemption under Inheritance Tax are also given an additional tax break when sold to heritage bodies through 'private treaty sale' in the form of an Inheritance Tax (Inheritance Tax 1984, s 32A(5)(a)) and CGT exemption (TCGA 1992, s 258(2)(a). The tax benefit in these 'private treaty sales' is usually shared 75/25 between the heritage body and the vendor in the case of chattels and 90/10 in the case of land.

[76] Exemption is granted in Inheritance Tax Act 1984, s 25, and the list of bodies is contained in Schedule 3 of Inheritance Tax Act 1984.

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Loss Relief

An Inheritance Tax liability is calculated on an asset's valuation on the date of its owner's death, but the actual value achieved on the sale of the asset may ultimately be less than the valuation.[77] Loss Relief allows for the estate of the deceased to apply for a refund of the overpaid tax if certain assets are sold at a loss after death (e.g. at a lower value than the valuation used for Inheritance Tax purposes). Loss relief is only available for land (provided the sale occurs within four years of the date of death) and for qualifying securities[78] (provided they are sold 12 months after the date of death). Around 26,000 estates made use of a total of £1.2 billion of this relief over the period 2018 to 2020, an average of around £48,000 per estate.

Other Reliefs

A range of other reliefs exist within the Inheritance Tax system. These include exemptions for medals and decorations awarded by the Crown to armed forces and emergency services personnel; armed forces relief for those who die in active service; and exemptions specifically named in primary legislation for the Chevening Estate and Apsley House,[79] located on Hyde Park Corner and reportedly the "grandest address in the capital".[80]

Over the period 2018 to 2020, just over 2,000 estates made use of £714 million in other reliefs for which the HMRC microdata does not provide a more granular breakdown. Almost two thirds of the total amount of these other reliefs (£455 million) benefited 147 estates, at an average tax relief of £3.1 million each. These estates were worth £4.3 million on average, suggesting that these other reliefs, providing over £200 million of relief per year, are benefiting a small number of high-value estates.

[77] For example, a business may be worth less once the founder has died.

[78] Qualifying securities are listed shares or securities or holdings in authorised unit trusts.

[79] See Inheritance Tax Act 1984, s 156.

[80] See https://www.english-heritage.org.uk/visit/places/apsley-house/.

Reforming Reliefs

As we have seen, the current Inheritance Tax system results in substantial vertical and horizontal inequity in the effective average tax rates (EATRs) paid. While there may be a legitimate debate surrounding the justification for some of the reliefs within the Inheritance Tax system, in many cases these reliefs provide incentives that can lead to inefficient resource allocation through distortions in investment decisions. The importance of reform is only further underlined by the substantial projected increase in inheritances over the next decade (see Advani and Sturrock, 2023).

The "first-best" policy would likely encompass wholesale reform of the Inheritance Tax system, potentially moving from a tax on estates to a tax on inheritors. Even within the current tax on estates, a comprehensive reform should address the treatment of lifetime transfers, wealth held in trusts, reform of reliefs, and the question of the tax rate. Against this background, the All-Party Parliamentary Group for Inheritance and Intergenerational Fairness (2020) suggested a flat tax rate of 10% on all lifetime gifts and intergenerational transfers and a higher rate for death transfers.

However, in the absence of data regarding pension assets, trusts and (in particular) lifetime gifts, this section outlines a number "second-best" reforms. These include reform options targeting the current differentiation across asset types (for instance, via the Residence Nil-Rate Band (RNRB)), the additional (partial) relief for specific asset classes, and reforms addressing the largely unlimited exemption for transfers made to spouses. We present several potential reform options and estimate both their effects on Inheritance Tax revenues in the next full tax year (2026), as well as the distributional impact across different levels of the wealth distribution. For further details on methodology and additional revenue estimates, see Appendix C.

Whereas estimates produced in Advani and Sturrock (2023) used data from the Wealth and Asset Survey (WAS), the Inheritance Tax data as provided by HMRC provides us with the (weighted) population of Inheritance Tax taxpayers and more granular asset categories for analysis. The WAS data does not include information on the type and value of tax reliefs used, which are crucial to our analysis. A disadvantage of the Inheritance Tax data, by contrast, is that it does not allow us to explore cohort effects – how Inheritance Tax receipts are likely to change in the future because of the relative wealth of different cohorts – as we observe only wealth on death. We use statistics on the evolution of inheritances up to 2026 from Advani and Sturrock (2023) to project the 2026 revenue potential of the reform scenarios we analyse using data from 2018 – 2020. We do this by applying a multiplier of 1.736 to annual averages, which reflects the ratio of UK Inheritance Tax revenue projected for 2026 to the observed average for 2018–2020. This multiplier also accounts for projected changes in asset values due to price increases from 2018–2020 to 2026.

We acknowledge that the reforms considered here are imperfect, but, short of total reform of the entire Inheritance Tax system, there is a strong rationale for these reforms in terms of economic efficiency and equitable treatment of those holding different types of assets. Even piecemeal reform scenarios could lead to substantial increases in tax revenue while simultaneously reducing vertical and horizontal

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variation in EATRs. Capping certain reliefs could fund an increase in the Nil-Rate Band (NRB), thereby reducing the number of estates incurring any Inheritance Tax liability while maintaining revenue neutrality.

It is important to emphasise that all of our estimates in this section are 'semi-static' meaning that they do not fully account for behavioural responses. In particular, in the case of estates with access to the spouse exemption, we assume that the deceased would have chosen to pass more assets to their spouse rather than incurring an (additional) Inheritance Tax charge. However, we do not account for any other types of response, such as shifting across asset types, increased lifetime giving, and others. Our estimates should therefore *not* be interpreted as the actual amount of revenue that would be raised from the reform (after all behavioural responses) but instead an upper bound on the tax that could be "at stake" from the reform. We intend to provide further evidence on behavioural responses (allowing full post-behavioural revenue estimates) in future work.

Abolish the RNRB and raise the NRB by £175,000 per estate

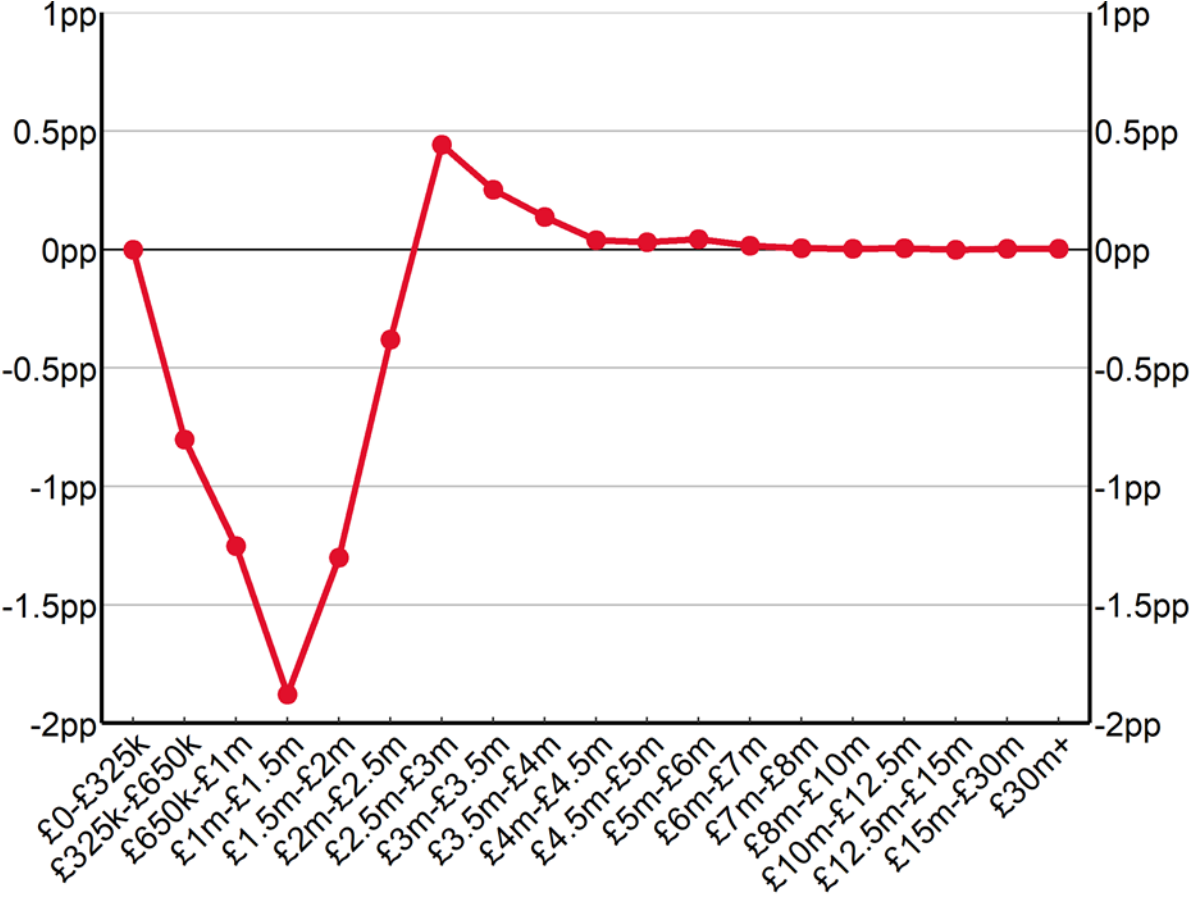
While abolishing the RNRB would address issues around the preferential treatment of residential property, it would raise taxes for many estates valued at less than £2.7 million without (generally) raising the tax liability of estates valued at more than £2.7 million. An alternative approach, as modelled here, would be to abolish the RNRB while simultaneously increasing the NRB by £175,000, bringing it to £500,000 (the current combined value of the NRB and RNRB). This adjustment would ensure more equitable treatment of estates across different asset holdings. However, rather than raising the NRB for all estates, our reform includes that £175,000 of the new NRB is tapered away at a rate of 50p per additional £1 for estates valued at more than £2 million, so that estates valued above £2.7 million do not benefit from a reduction in the EATR.

We estimate that this reform could cost approximately £1 billion per year. The reform's impact on effective tax rates would be relatively modest, with the largest percentage point reduction — just under 2 percentage points — affecting estates valued between £1 million and £1.5 million (see Figure 5), who would save £20,000 to £30,000 each on average.

As highlighted above, the inclusion of a taper for £175,000 of the value of the higher NRB would mean that higher-value estates do not benefit from lower EATRs. In fact, the average EATR of estates valued at more than this amount actually increases, with the largest percentage point increase (0.4 percentage points) experienced by estates valued at between £2.5 million and £3 million. This is because of the different way that the RNRB and NRB are treated when an estate's Inheritance Tax liability is calculated.

For example, consider an estate worth £2 million, made up of £1 million in cash and £1 million in residential property. Three years before the individual's death, they give away £400,000 in gifts. The £400,000 gift would completely use up the £325,000 NRB, leaving no NRB available for the remainder of the estate. However, the RNRB of £175,000, which is not affected by lifetime gifts, can still be applied to reduce the taxable value of the estate if the property is passed to a direct descendent. This would allow £175,000 of the residential property to be passed on tax-free.

Figure 5: Estimated percentage points change in average EATRs of abolishing the RNRB and raising the NRB by £175,000 compared to the current Inheritance Tax system, by size of estate



Notes: RNRB refers to the Residence Nil-Rate Band, initially set at £100,000, rising by £25,000 per financial year until 2021 when the threshold level reached £175,000. This reform scenario models the abolishment of the RNRB while increasing the NRB to £500,000.

Source: Authors' calculations based on HMRC administrative datasets.

If the RNRB were abolished and replaced with an increased NRB of £500,000 (including a £175,000 taper), the £400,000 gift would reduce this new NRB first, leaving only £100,000 of NRB available for the estate. As a result, only £100,000 of the remaining estate could be passed on free of Inheritance Tax, incurring an Inheritance Tax liability on an additional £75,000 of the estate's value relative to the current system.

This can affect estates valued at up to £2.7 million because of the effect of the TRNRB. However, we observe small impacts of this change on estates valued at more than this amount in Figure 5 because HMRC's definition of net wealth counts funeral expenses as a liability, whereas we include these expenses in the value of the net estate. Relative to HMRC's definition, this shifts these estates further up the wealth distribution.

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Cap Agricultural Relief and Business Relief at a combined £500,000 per estate

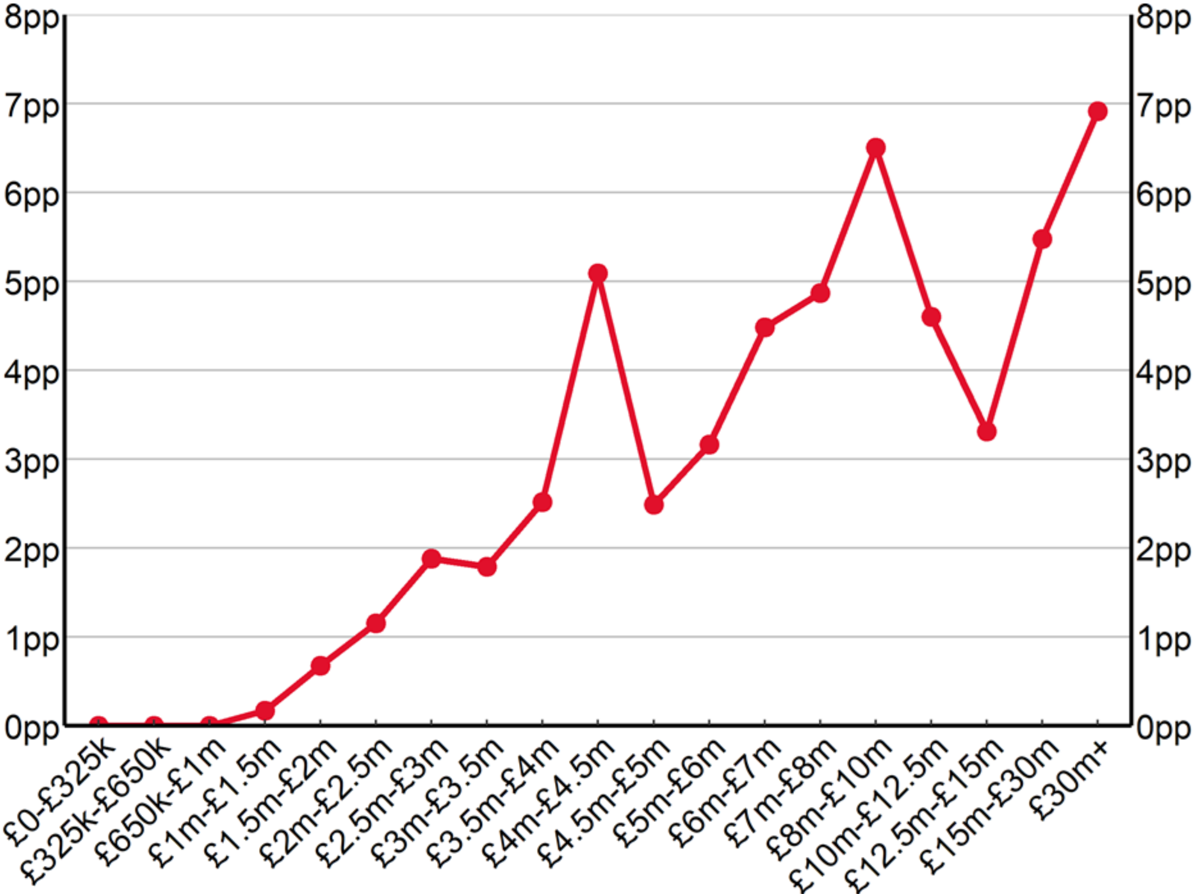
As highlighted in the section "Agricultural Relief", given that there is potential overlap between Agricultural Relief (AR) and Business Relief (BR) (for example, farms that qualify both as agricultural businesses and as general trading businesses), the capping or abolition of one of these reliefs could lead some estates to simply claim tax relief using the other relief. A combined cap that treats the two reliefs together would also reduce incentives for estates to shift their asset holdings between agricultural and business property.

In light of this, short of complete abolition[81], we model a reform that proposes a *combined* cap on AR and BR at £500,000 per estate. The precise level of such a cap (or whether it should exist at all) would be a matter for debate, but this level is chosen because the majority of estates claiming either one of AR or BR claim less than this amount. Between 2018 and 2020, 64% of estates claiming AR claimed less than £500,000, while 77% of estates claiming BR claimed less than £500,000.

We estimate that this reform could raise up to £900 million per year. The reform would raise average EATRs, particularly for higher-value estates, but would have close to no impact on estates valued at less than £1 million, thereby reducing vertical variation in the Inheritance Tax system (see Figure 6). For estates valued at less than £3.5 million, EATRs would increase by no more than 2 percentage points on average. For those larger than this, EATRs would rise by at least 2.5 percentage points on average, with the largest increase experienced by estates valued at more than £30 million – these estates would experience an increase in their average EATR of 6.9 percentage points.

[81] We provide revenue estimates for the abolition of AR and BR in Appendix C.

Figure 6: **Estimated percentage points change in average EATRs of a combined cap on Agricultural Relief and Business Relief at £500,000 per estate compared to the current Inheritance Tax system, by size of estate**



Notes: Figure shows the percentage point change in EATRs of a combined cap on Agricultural and Business Relief at £500,000.

Source: Authors' calculations based on HMRC administrative datasets.

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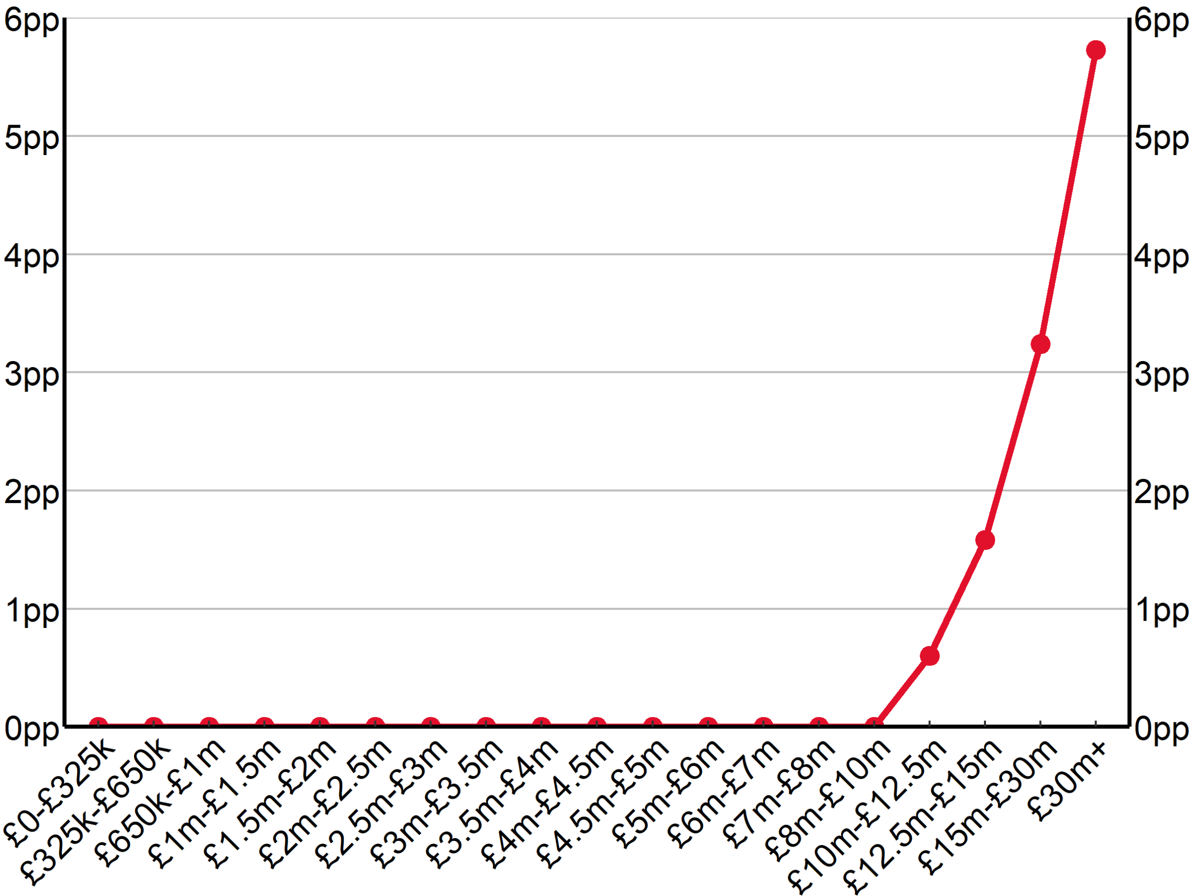
Cap the spouse exemption at £10 million per estate

Introducing a cap on the spouse exemption at £10 million per estate would affect fewer than 0.1% of estates (100 deaths a year) but could go some way towards addressing the fact that the exemption disproportionately benefits the largest estates, as shown in Figures 2 and 3 in the section "Impact of Relief". The precise level of such a cap would be a matter for debate, but this level is chosen as an example at which the vast majority of estates would not be affected by the cap.

This reform could raise up to £350 million in revenue, while reducing the regressivity in EATRs at the top of the wealth distribution. The increase in the average EATR is larger as the size of the estate increases above £10 million, with estates valued at more than £30 million experiencing an increase in the average EATR of 5.7 percentage points (see Figure 7). The EATRs paid by estates valued at less than £10 million are, of course, unchanged.

Figure 7: Estimated percentage points change in average EATRs of a cap on the spouse exemption at £10 million per estate compared to the current Inheritance Tax system, by size of estate



Notes: Figure shows the percentage point change in EATRs under a cap on the spouse exemption at £10 million per estate.

Source: Authors' calculations based on HMRC administrative datasets.

Combined reform

A cap on AR and BR, on the spouse exemption, and an increase in the NRB while abolishing the RNRB is a package of measures that we model together in this section. Capping AR, BR and the spouse exemption primarily increases average EATRs at the higher end of the wealth distribution, while the abolition of the RNRB alongside a corresponding increase in the NRB lowers the average EATRs of estates valued at less than £2.5 million.[82]

Our estimates suggest that a combined cap on AR and BR set at £500,000 per estate, introduced alongside a cap on the spouse exemption at £10 million per estate, could raise enough revenue to fund an increase in the NRB to £500,000 while abolishing the RNRB. In addition to paying for the abolition of the RNRB and a corresponding increase in the NRB, the reform could also raise up to £500 million per year.

The combination of these reforms would lower the average EATRs for estates valued at less than £2 million while raising average EATRs for estates valued at more than this amount. Only estates worth more than £8 million would see EATRs rise by more than 5 percentage points on average, with the largest percentage point increase in average EATRs – 18.3 percentage points –experienced by estates valued at more than £30 million (see Figure 8).

[82] Note that, as above, our reform to the NRB assumes that £175,000 of the new NRB is tapered away at a rate of 50p per additional £1 for estates valued at more than £2 million.

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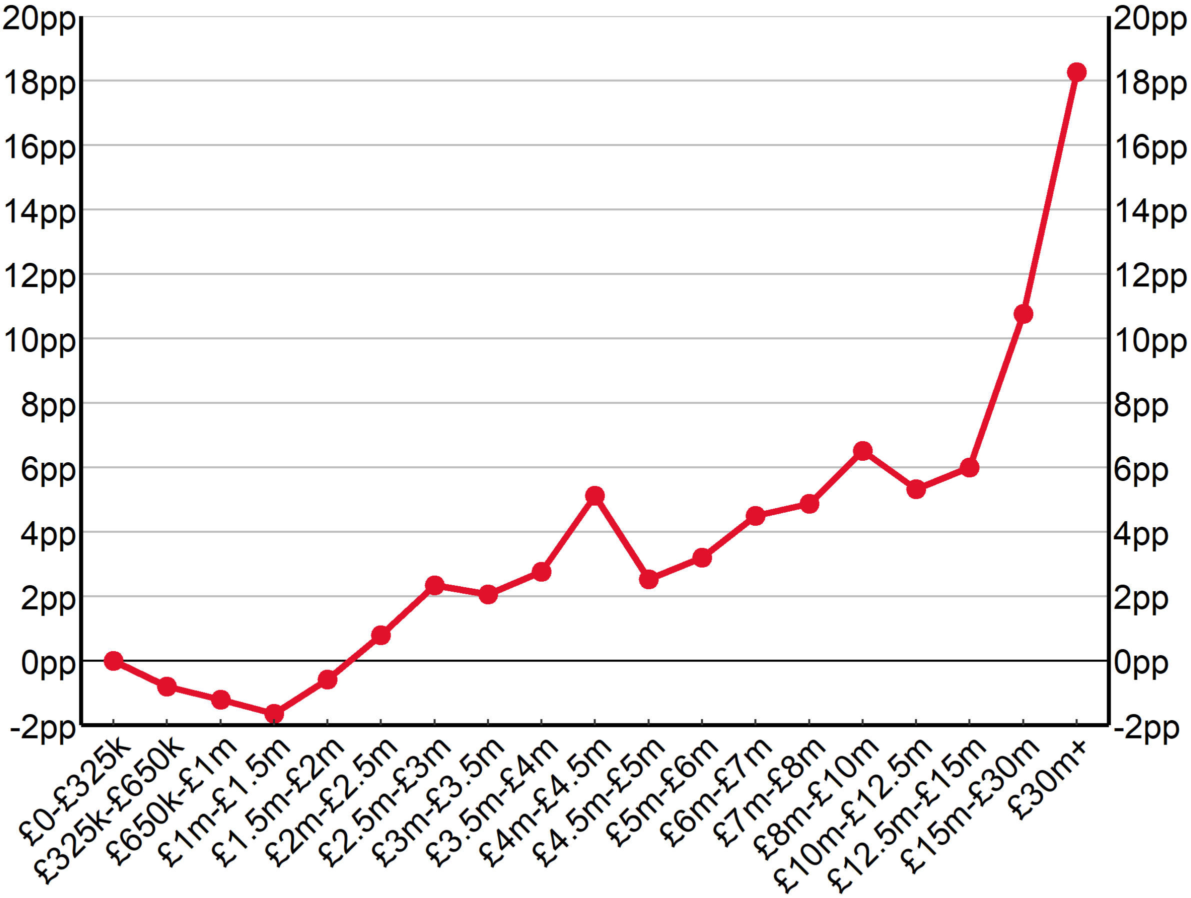
Figure 8: Estimated percentage points change in average EATRs of the combined reform compared to the current Inheritance Tax system, by size of estate



Notes: Figure shows the percentage point change in EATRs under a cap on the spouse exemption at £10 million, combined with a cap on Agricultural Relief and Business Relief (combined) at £500,000 per estate, and an increase in the NRB to £500,000 while abolishing the RNRB.

Source: Authors' calculations based on HMRC administrative datasets.

Figure 9 shows that this reform also reduces the horizontal variation in rates paid across parts of the wealth distribution. When comparing the interquartile range for EATRs at each point in the wealth distribution, the reduction in horizontal inequity is greatest for estates valued between £2 million and £7 million, where we see a reduction in variation of over 6 percentage points. The change amongst estates below £2 million or above £7 million is relatively minor (ranging between -4 percentage points and +2 percentage points).

This combined reform goes some way towards reducing both the vertical inequity in the EATRs paid across the wealth distribution (since it lowers the EATR for estates valued at less than £2 million while raising the EATR for estates valued at more than this amount), and the horizontal inequity (since it reduces some of the variation paid by estates with the same amount of wealth).

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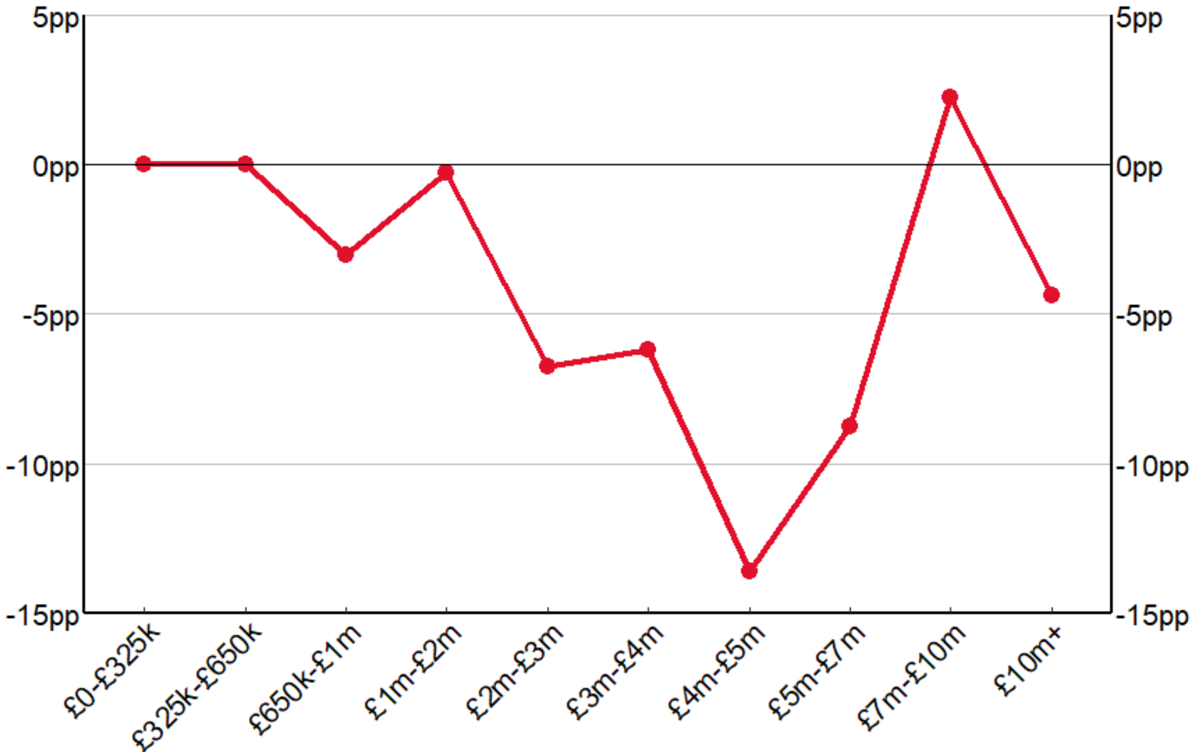
Figure 9: Estimated change in interquartile range of EATRs paid by estates compared to the current Inheritance Tax system (percentage points), by size of estate



Notes: Figure shows the percentage point change in the difference in the EATR paid by estates at the 75th percentile and 25th percentile of the wealth distribution under the relevant reform compared to the current EATRs paid. A negative value indicates that the EATR paid by those at the 75th and 25th percentiles of the EATR distribution are closer after the reform than before, i.e. that the reform has reduced the variation in rates paid between these percentiles of the EATR distribution. The relevant reform is a cap of the spouse exemption at £10 million, alongside a cap on Agricultural Relief and Business Relief (combined) at £500,000 per estate, and an increase in the NRB to £500,000 while abolishing the RNRB. For statistical disclosure purposes, Figure 9 uses a more aggregated breakdown of the net wealth distribution than Figures 5, 6, 7 and 8

Source: Authors' calculations based on HMRC administrative datasets.

Other reforms

We summarise the revenue implications of further reform options in Table C1 in Appendix C. Most of these options address the key drivers of horizontal and vertical variation in EATRs, including AR, BR, and the spouse exemption. The table also presents combinations of these reforms at different thresholds, along with various scenarios for reforming the NRB and the RNRB.

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Conclusion

Inheritance Tax is characterised by a wide variation in effective average tax rate (EATRs) paid by estates with different amounts of wealth (vertical variation) and by estates with the same amount of wealth (horizontal variation). Although there are many forms of wealth that we are not able to observe, we have outlined that the observable variation among estates is largely driven by reliefs such as the exemption for assets transferred directly to a spouse, as well as Business Relief (BR) and Agricultural Relief (AR), among others.

As well as being potentially iniquitous, the current Inheritance Tax is also economically inefficient. It creates incentives for tax planning that encourage individuals to purchase assets such as farmland or AIM shares, and to hold onto them until death to benefit from the tax relief even if the assets themselves are relatively unproductive. As well as raising revenue for the Exchequer, reforming these reliefs could encourage a more efficient allocation of resources within the economy, spurring on growth.

Short of abolishing the reliefs entirely, we highlight how capping the combined total of BR and AR at £500,000 per estate could raise up to £900 million annually. Alternatively, such a reform could be combined with a cap on the exemption for assets transferred to a spouse at £10 million per estate. The proceeds from restricting these reliefs could be used to pay for the abolition of the Residence Nil-Rate Band alongside a corresponding increase in the Nil-Rate Band (NRB) from £325,000 to £500,000,[83] while also raising up to £500 million per year in additional revenue. While we acknowledge the lack of a meaningful behavioural response in our estimates, we have incorporated one potential response among estates that have access to the spouse exemption. Nevertheless, this is an area where we intend to undertake further work in future.

Data availability has restricted our ability to provide an entirely comprehensive analysis of the EATRs paid on all forms of inherited wealth. While the HMRC microdata captures the universe of *taxpaying* estates, it only captures a sample of non-taxpaying estates, meaning that coverage of low-value estates (below the NRB) is incomplete. We have also been unable to analyse gifts or lifetime transfers made more than seven years prior to death[84], wealth held in defined contribution pensions, assets held in trusts where the deceased settlor is excluded from benefit, and the foreign assets of non-doms (or ex-non-doms, if the assets are held in a trust). However, among those estates included in the dataset, most types of assets held on death are included at their open market value.

[83] The increase in the NRB to £500,000 assumes that £175,000 of the new NRB is tapered away at a rate of 50p per additional £1 for estates valued at more than £2 million.

[84] We are also unable to observe other exempted gifts or wealth transfers that are below the reporting threshold. These include gifts of £3,000 or less in any tax year, small gifts of £250 or less, regular gifts that are part of “normal expenditure” and made out of income, and other gifts such as those for weddings and civil partnerships.

Nevertheless, further research in this area is required. Unfortunately, the way in which HMRC processes Inheritance Tax returns for analytical purposes means that it is not possible to provide a reliable estimate of how much Business Relief goes on unquoted (AIM) shares specifically. While the data as currently provided by HMRC allows us to distinguish between shares that qualify for BR from shares that do not qualify for such relief (such as listed shares), the microdata does not allow us to reliably distinguish between AIM shares and other unlisted and unquoted share assets (whether control-holding or non-control-holding). Provision of such data to researchers by HMRC in the future would prove useful in allowing greater clarity in this field of research.

More broadly, data in relation to defined contribution pensions and gifts or lifetime transfers made more than seven years prior to death is not held by HMRC.[85] There is a strong case to be made for HMRC to be empowered to require information in relation to these wealth holdings to be provided to the tax authority, even if these categories of wealth remain exempt from Inheritance Tax.

[85] In a limited number of cases, data may be held by HMRC on some gifts or wealth transfers made up to 14 years prior to death.

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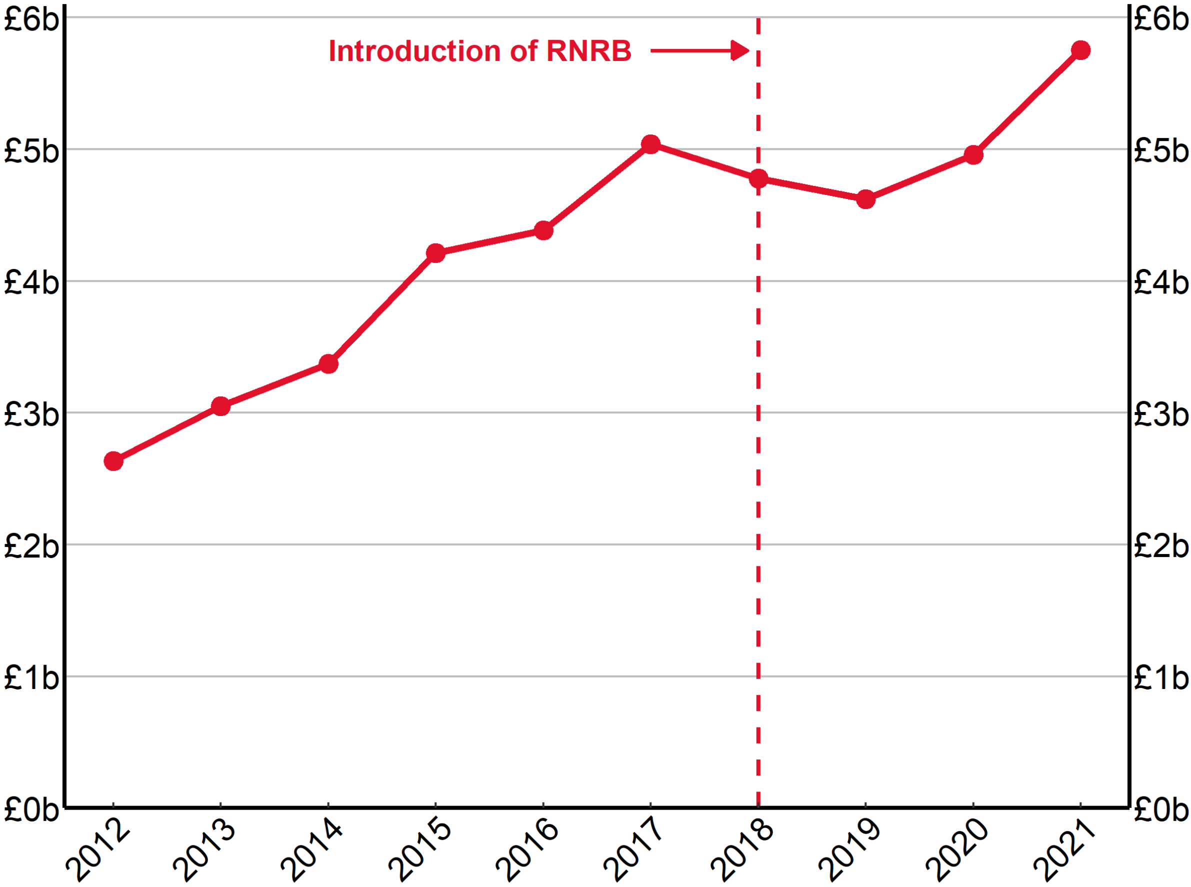
Appendix A: How much does Inheritance Tax raise and who is paying it?

Inheritance Tax raises a growing amount of revenue

The HMRC microdata allow us to determine the value of all Inheritance Tax liabilities that became due in each year from 2012 to 2021. In 2021 Inheritance Tax liabilities stood at almost £5.8 billion, having risen from £2.6 billion in 2012 (see Figure A1).[86] In 2022, HMRC (2024) indicates that liabilities rose further to £6.0 billion.

Figure A1: Total Inheritance Tax due by financial year, 2012-2021 (nominal prices, £ billions)



Notes: RNRB refers to the Residence Nil-Rate Band in 2018, initially set at £100,000, rising by £25,000 per financial year until 2021 when the threshold level reached £175,000.

Source: Authors' calculations based on HMRC administrative datasets.

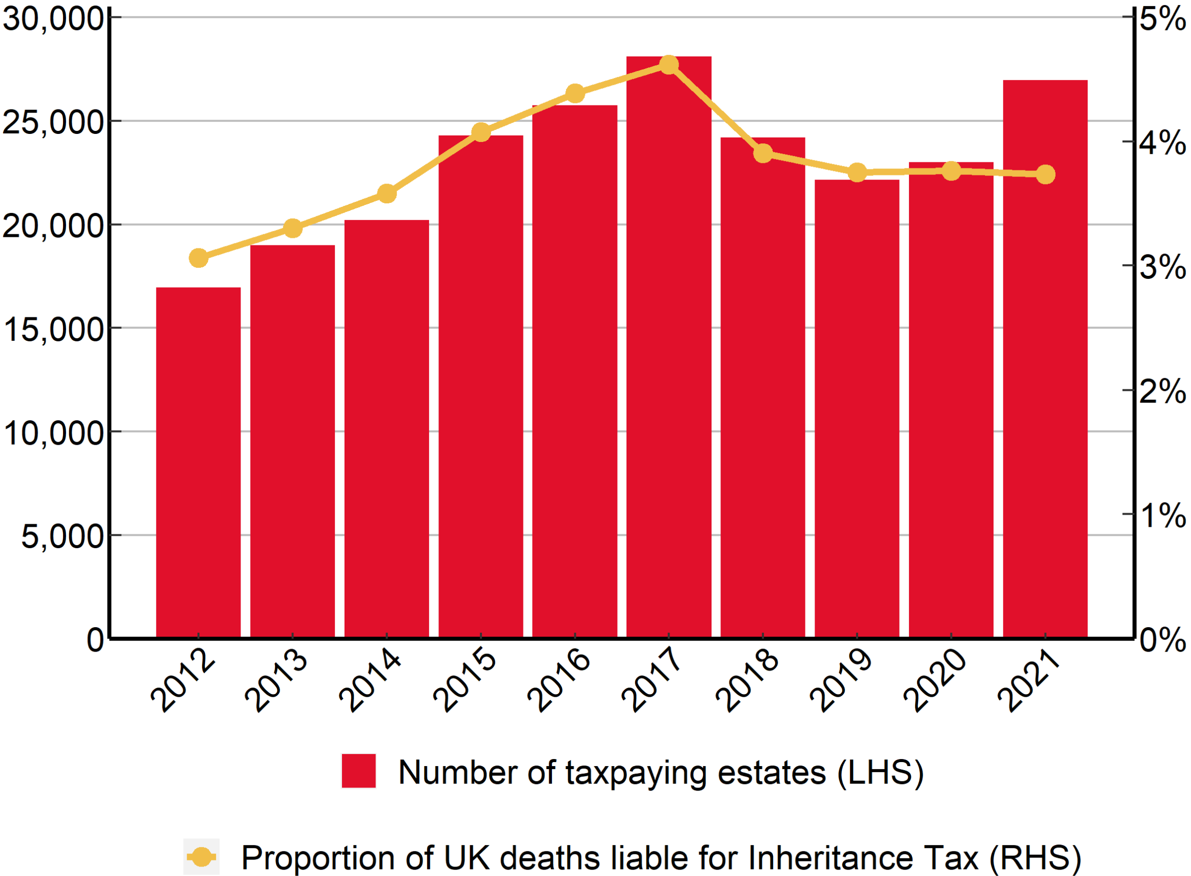
[86] Note that some publicly available statistics report the tax receipts *received* by HMRC in each financial year, irrespective of when the charge arose. In line with HMRC (2024), we report the tax that *becomes due* in each tax year. We do not observe Inheritance Tax liabilities on trusts – see Advani, Forrester, Gazmuri-Barker, and Summers (2024) for additional statistics on Inheritance Tax liabilities arising from trusts provided by HMRC in a response to an FOI request made by the authors.

Analysis in Advani and Sturrock (2023) highlights how liabilities from Inheritance Tax are expected to continue rising in future years, driven by increasing levels of wealth held by subsequent generations of retirees. This is despite the introduction of the Residence Nil-Rate Band (RNRB) in 2018, which tempered increases in revenue in the years following its introduction.

Fewer than 27,000 estates were liable for Inheritance Tax in 2021, representing 3.7% of all deaths in that year

The number of estates becoming liable for Inheritance Tax has important implications for the politics of reform. The HMRC microdata allow us to determine how many estates became liable for Inheritance Tax in each year from 2012 to 2021.

Figure A2: Total number of taxpaying estates – absolute number and as a percentage of all UK deaths, 2012-2021



Notes: The red bars indicate the total number of estates classified as "taxpaying" by HMRC (left axis). The orange line indicates the number of estates classified as "taxpaying" as a percentage of all UK deaths (right axis).

Source: Authors' calculations based on HMRC administrative datasets, and death statistics from the ONS, National Records of Scotland and Northern Ireland Statistics and Research Agency.

The number of estates liable for Inheritance Tax rose from just under 16,000 in 2012 (3.1% of all deaths) to over 28,000 in 2017 (4.6% of all deaths), before falling in 2018 and 2019 after the introduction of the RNRB (see Figure A2). Despite a fall

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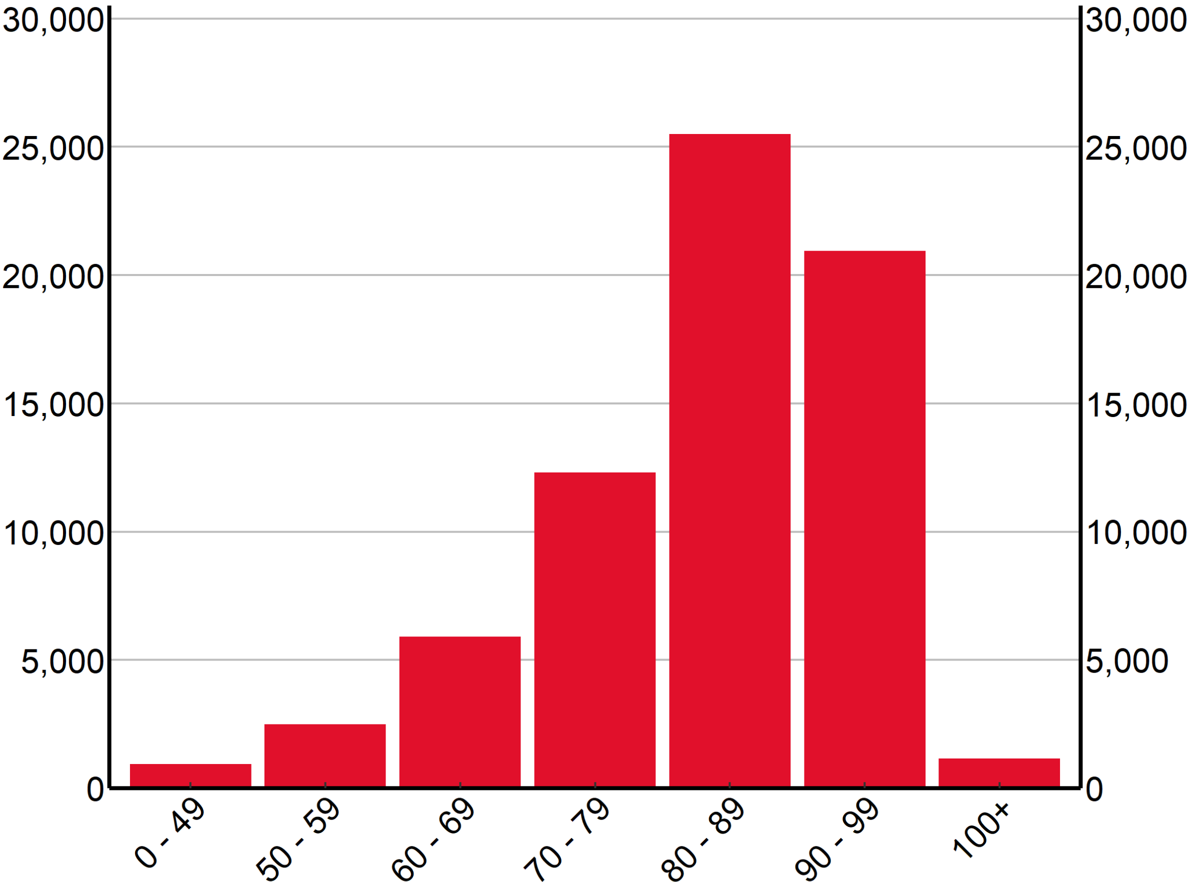
in the percentage of deaths liable for Inheritance Tax between 2017 and 2021, the higher number of overall deaths in the UK during the year of the Covid-19 pandemic meant that the number of estates liable for the tax in 2021 stood at just under 27,000, representing 3.7% of all deaths in that year. In 2022, HMRC (2024) indicates that there were 27,800 taxpaying estates, representing 4.4% of all UK deaths.

The vast majority of those liable for Inheritance Tax are aged over 70

Figure A3: Age distribution of taxpaying estates, 2018-2020



Notes: The bars indicate the number of estates classified as "taxpaying" by HMRC.

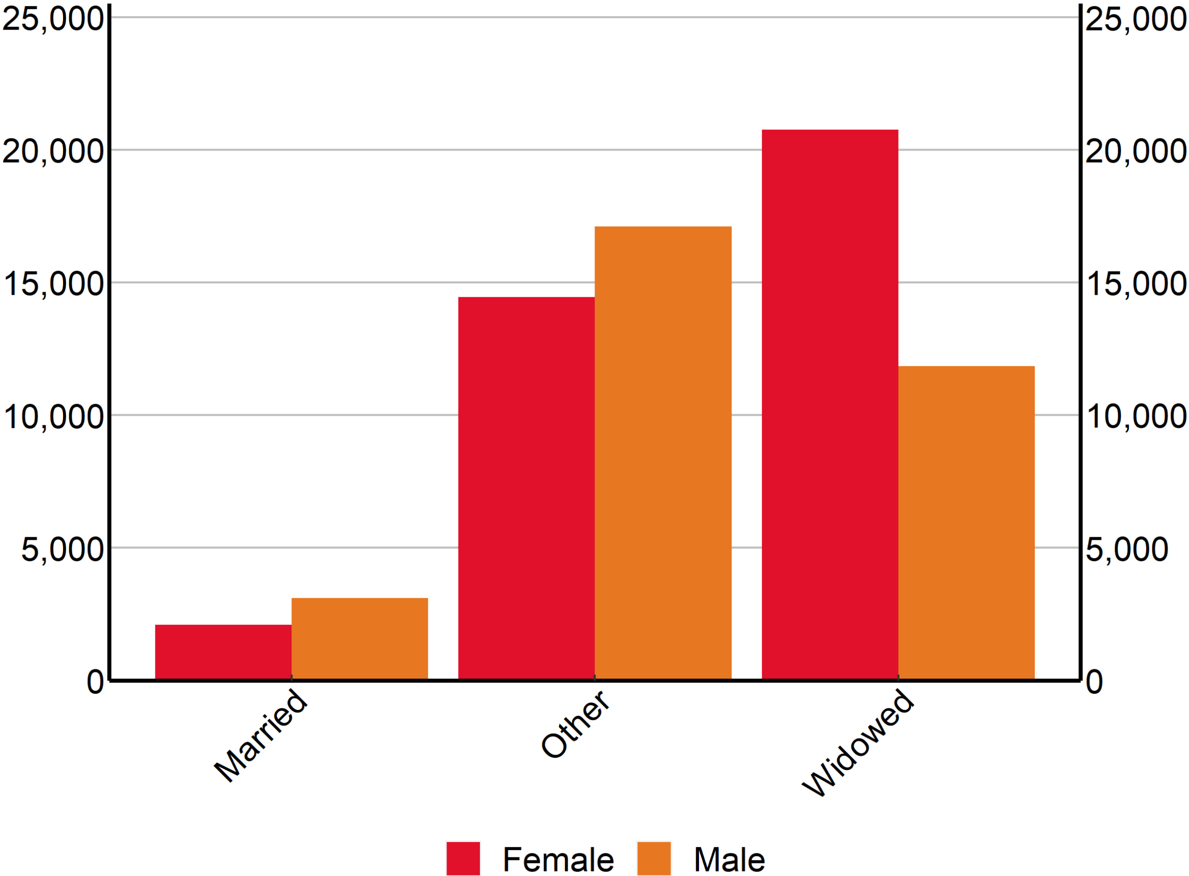
Source: Authors' calculations based on HMRC administrative datasets.

The remaining statistics in Appendix A focus on the tax years 2018 to 2020 inclusive, covering the period after the introduction of the RNRB but before the outbreak of the Covid-19 pandemic.

In terms of age distribution, 86% of those whose estates were liable for Inheritance Tax during this period were aged 70 or older, with more than two thirds (69%) aged 80 or older (see Figure A3). The age distribution reflects a combination of the overall age distribution of deaths among the UK population, but also the wealth distribution among different age cohorts. Older individuals are more likely to have accrued greater levels of wealth throughout their lifetime, and therefore more likely to be liable for Inheritance Tax.

Those liable for Inheritance Tax are largely widowed or otherwise single

Figure A4: Total number of taxpaying estates by gender and marital status, 2018-2020



Notes: The bars indicate the number of estates classified as "taxpaying" by HMRC.

Source: Authors' calculations based on HMRC administrative datasets.

Analysis of the gender and marital status of taxpaying estates suggests that relatively few married individuals become liable for Inheritance Tax (see Figure A4), with the estates of married individuals making up 8% of all estates liable for Inheritance Tax. This is as one might expect, given that the spouse exemption allows for the complete exemption of assets transferred to a spouse or civil partner.

47% of those liable for Inheritance Tax are widows or widowers, with almost two thirds (64%) of this group being widows (female), reflecting the fact that among opposite-sex couples the female spouse is more likely to outlive the male spouse. "Other" individuals (largely single people who have not been widowed), make up 46% of those liable for Inheritance Tax, of whom slightly more than half (54%) are male.

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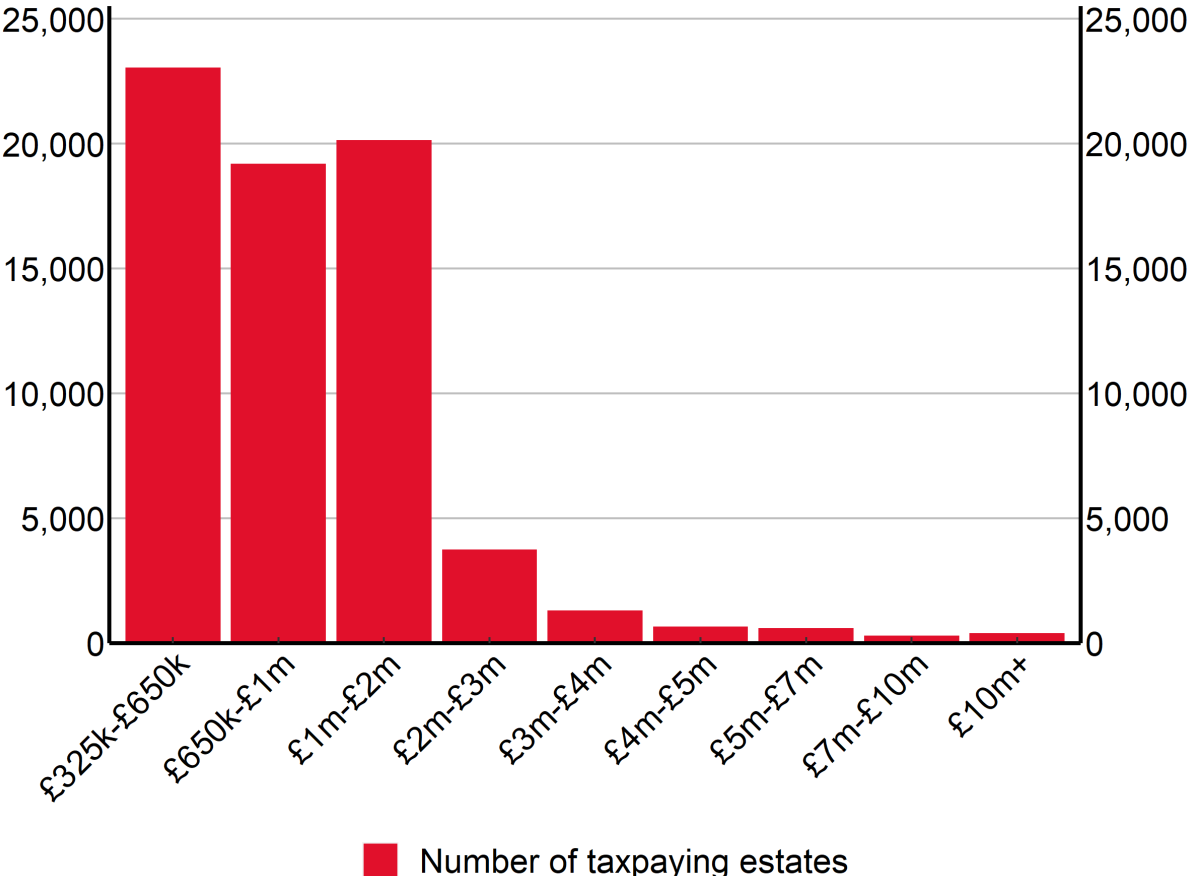
Appendix B: What is the current distribution of assets and liabilities across the wealth distribution?

Distribution of taxpayers by size of estate

Figure B1: Number of estates with an Inheritance Tax liability by size of estate, 2018-2020

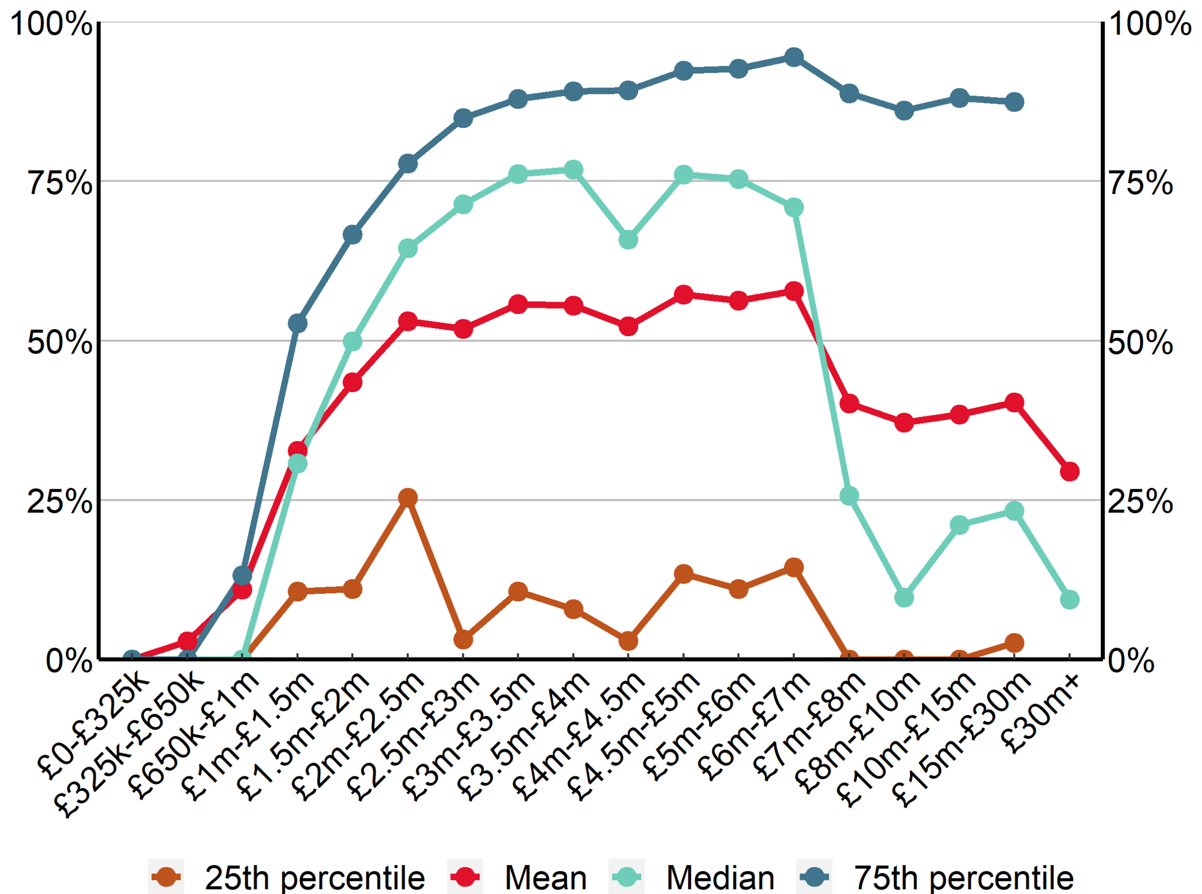


Notes: The number of taxpaying estates indicates those classified as "taxpaying" by HMRC. The "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata.

Source: Authors' calculations based on HMRC administrative datasets.

Chargeable Estate as a Proportion of the Value of Net Estate

Figure B2: Value of chargeable estate as a proportion of net estate (assets – liabilities) by size of estate, 2018-2020



Notes: This figure shows the share of the chargeable estate (after accounting for all reliefs), that is the effective tax base, in net wealth, which is the sum of assets (gifts excluded) minus liabilities. Values for the 25th and 75th percentile of the distribution among estates valued at more than £30 million are omitted for reasons of statistical disclosure. The "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata.

Source: Authors' calculations based on HMRC administrative datasets.

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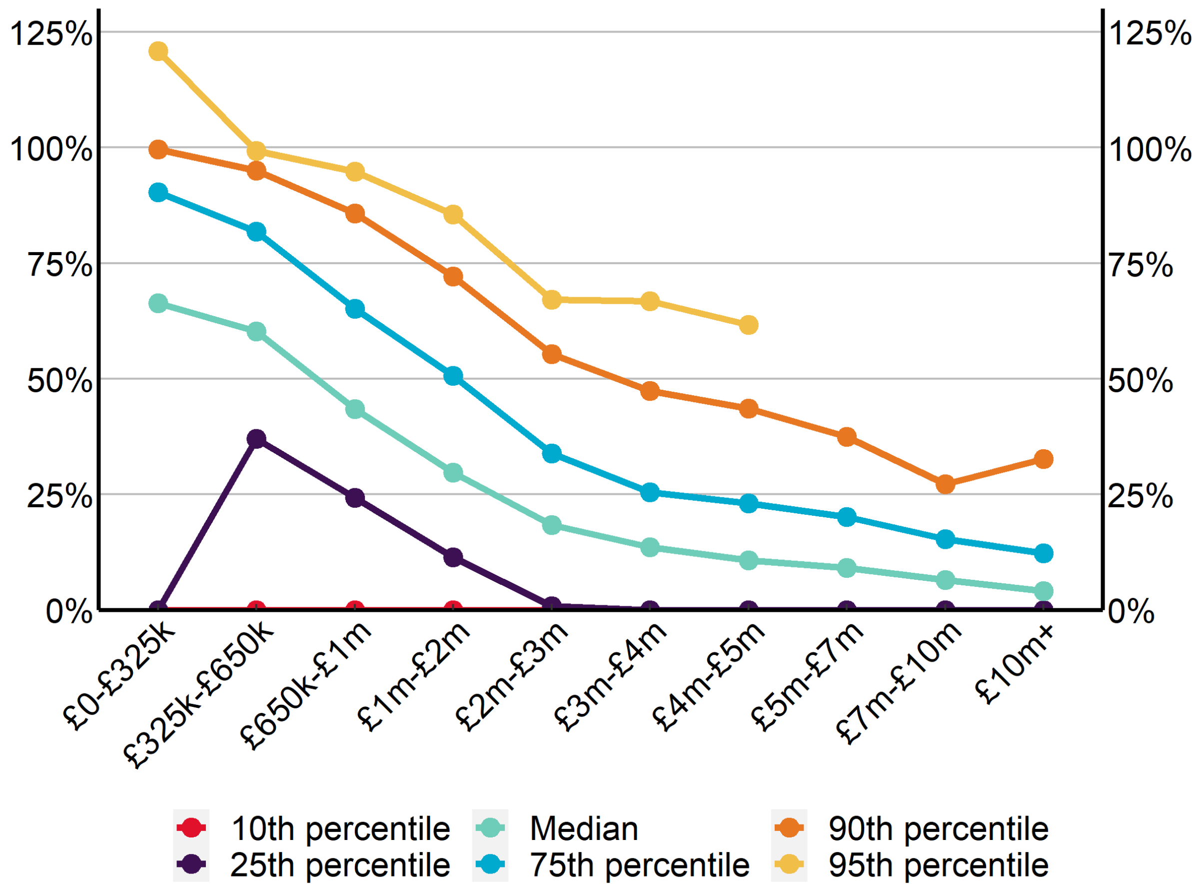
Distribution of assets by size of estate

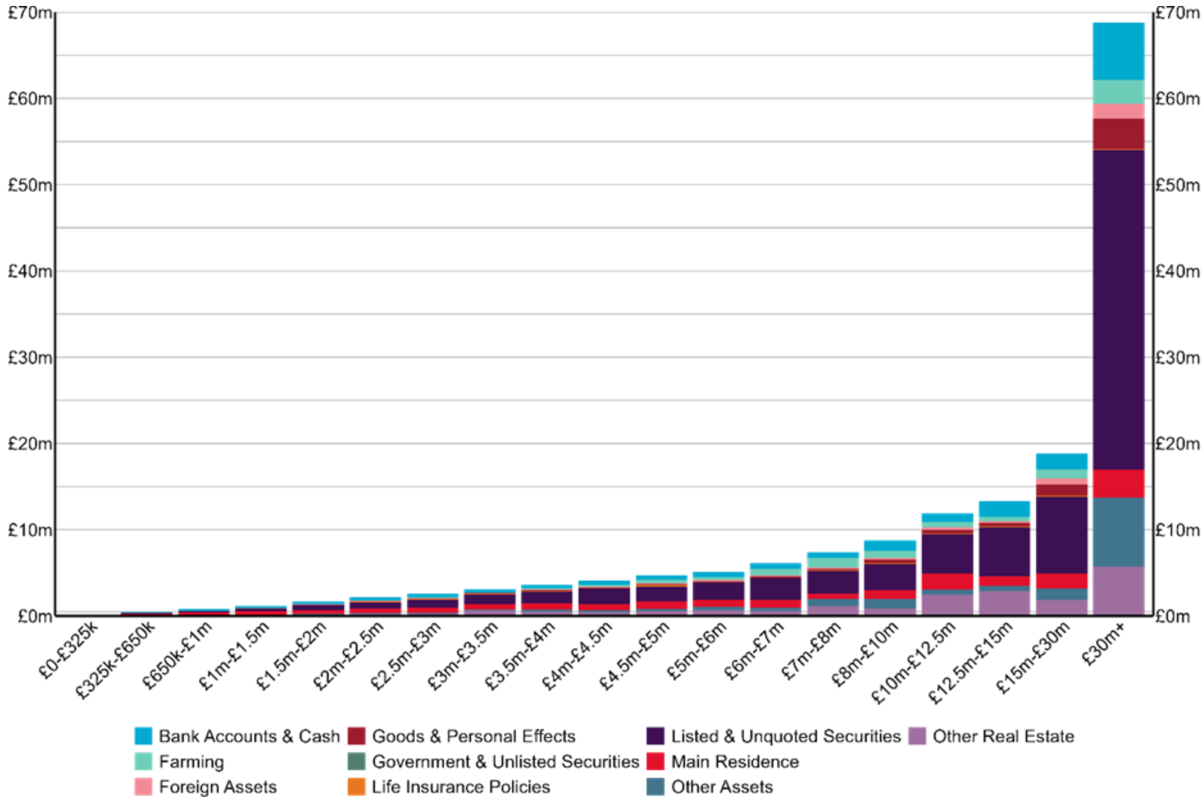
Figure B3: Value of main residence as a proportion of net estate by size of estate, 2018-2020



Notes: This figure shows the value of the main residence over the net estate across the estate distribution (vertical variation) and within brackets of the net estate (horizontal variation). Net estate is the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. Values for the 95th percentile of the distribution among estates valued at more than £5 million are omitted for reasons of statistical disclosure. The "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata.

Source: Authors' calculations based on HMRC administrative datasets.

Figure B4: Average composition of assets per estate, by size of estate in 2018-2020 (£ million)



Notes: This figure shows the mean values of asset types by size of estate, where "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata.

Source: Authors' calculations based on HMRC administrative datasets.

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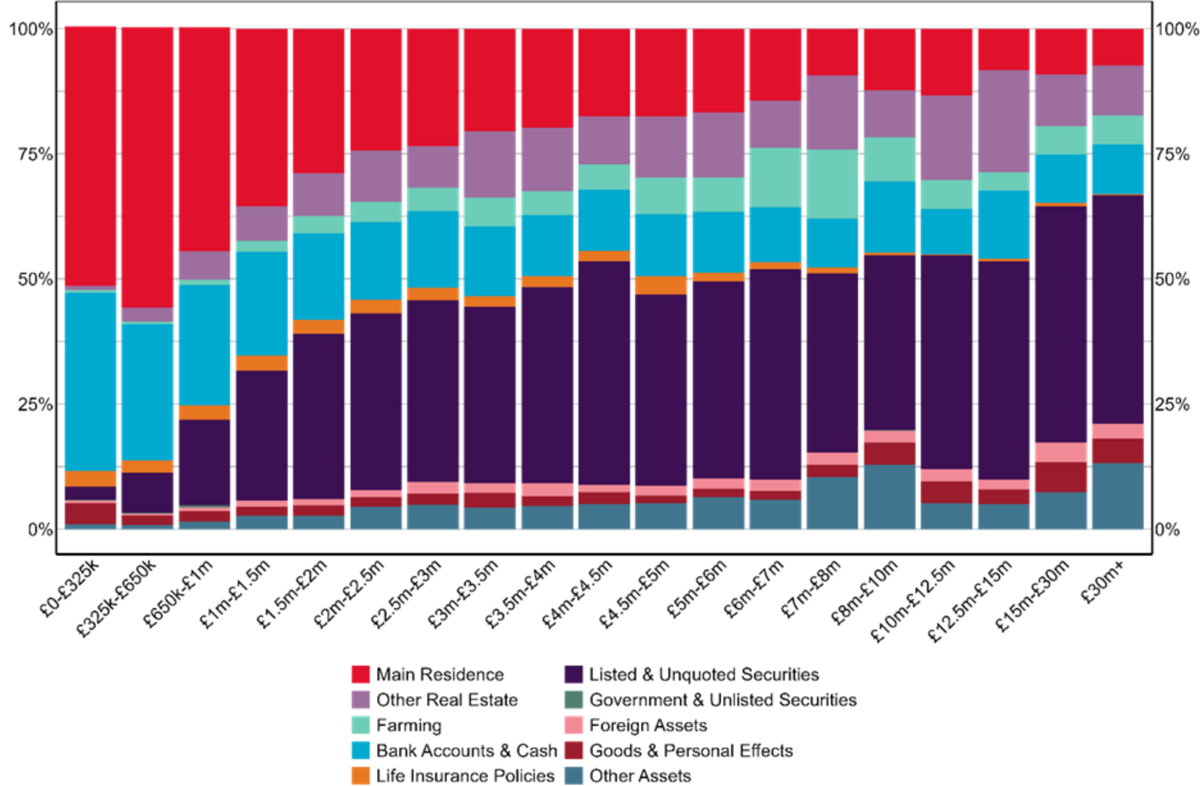
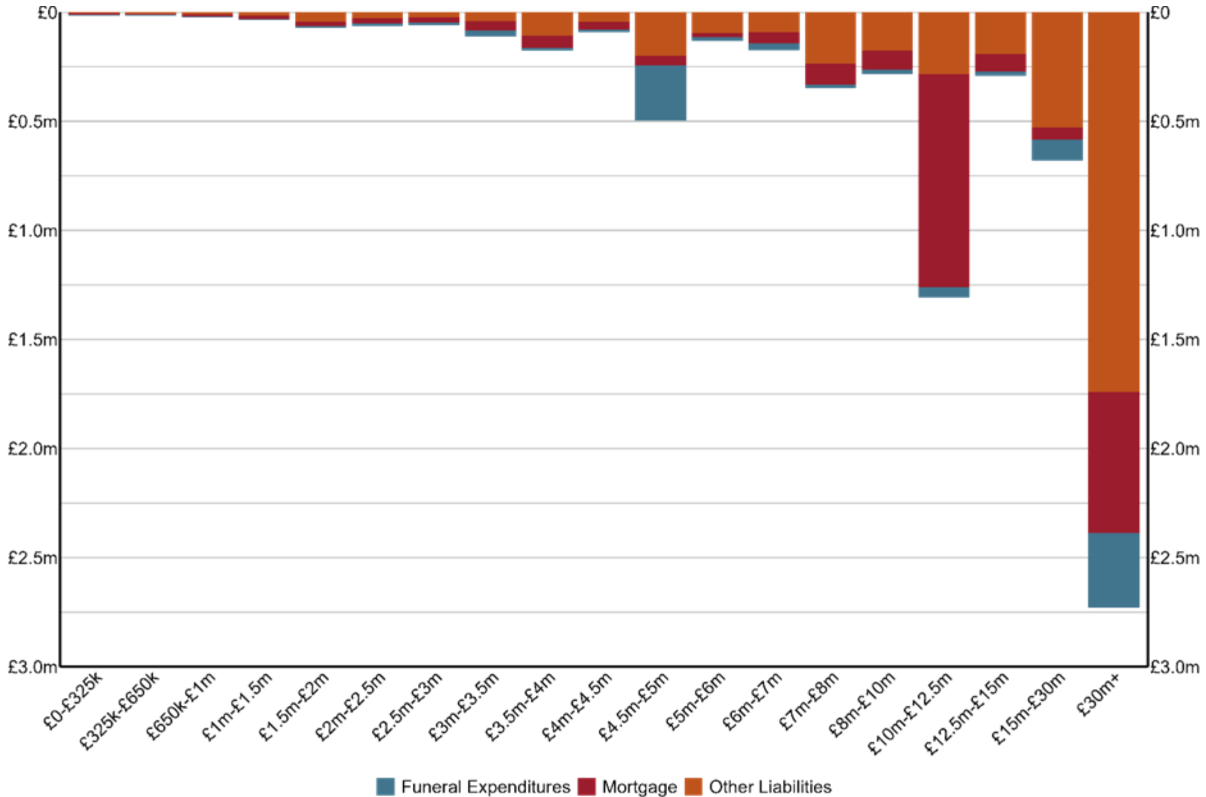
Figure B5: Average share of asset types per estate, by size of estate in 2018-2020



Notes: This figure shows the composition of assets by size of estate. The "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata.

Source: Authors' calculations based on HMRC administrative datasets.

Figure B6: Average composition of liabilities per estate, by size of estate in 2018-2020 (£ million)



Notes: This figure shows the mean values of types of liabilities by size of estate. The "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata.

Source: Authors' calculations based on HMRC administrative datasets.

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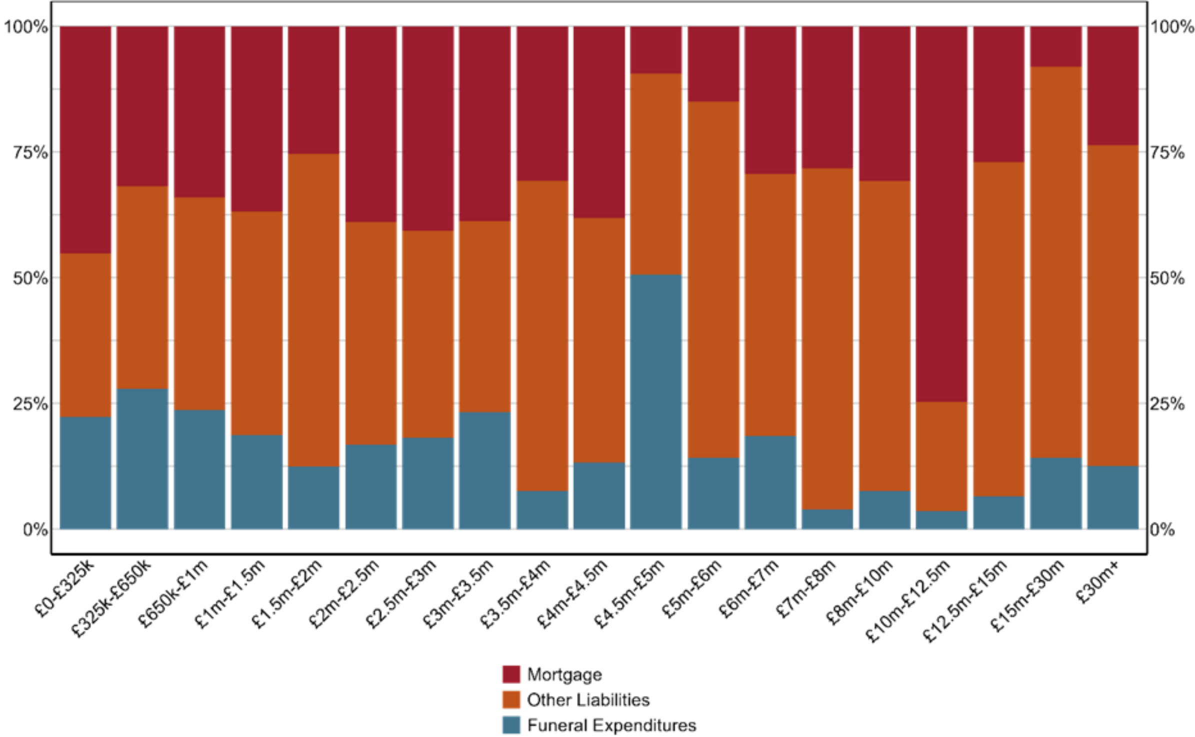
Figure B7: Average share of liability types per estate, by size of estate in 2018-2020



Notes: This figure shows the composition of liabilities in the estate by size of estate. The "size of estate" here is defined as net wealth, i.e. the sum of all chargeable assets on death minus all liabilities on death (where funeral expenses are not counted as a liability) plus all gifts given in the seven years prior to death. If liabilities on death are greater than assets on death, then the size of the estate is given by the total of all gifts given in the seven years prior to death. Pension wealth, wealth held in trusts, and lifetime transfers more than seven years prior to death are excluded, since none of these categories of wealth are observable in the HMRC microdata.

Source: Authors' calculations based on HMRC administrative datasets.

Appendix C: Additional Revenue Estimates

Table C1: Estimated 2026 revenue impacts of policy reform options (£m, 2026 prices)

Reform	Estimated change in 2026 revenue (£m, 2026 prices)
Cap tax-free funeral expenses at £20k	35
Cap tax-free funeral expenses at £50k	25
Cap the spouse exemption at £10m	350
Abolish AR	450
Cap AR at £500k per estate	300
Cap AR at £1m per estate	200
Abolish BR	900
Cap BR at £500k per estate	600
Cap BR at £1m per estate	500
Abolish RNRB and raise NRB to £500k	-1,000
Cap AR and BR at £500k combined	900
Cap AR and BR at £500k combined and abolish RNRB	3,200
Cap AR and BR at £500k combined, abolish RNRB, and raise NRB to £500k	-100
Cap AR and BR at £500k combined, abolish RNRB, raise NRB to £500k, cap spouse exemption at £10m	500
Cap AR and BR at £1m combined	700
Cap AR and BR at £1m combined and abolish RNRB	3,000
Cap AR and BR at £1m combined, abolish RNRB, and raise NRB to £500k	-300
Cap AR and BR at £1m combined, abolish RNRB, raise NRB to £500k, cap spouse exemption at £10m	300

Notes: "NRB" denotes the Nil-Rate Band. "RNRB" denotes the Residence Nil-Rate Band. "BR" denotes Business Relief. "AR" denotes Agricultural Relief. Changes show the estimated change in tax year 2026 (2026 prices). Policy reforms that include an increase in the NRB to £500,000 assume that £175,000 of the new NRB is tapered away at a rate of 50p per additional £1 for estates valued at more than £2 million.

Source: Authors' calculations based on HMRC administrative datasets.

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To calculate the additional revenue that could be generated by each reform, we use HMRC microdata to first re-calculate the baseline Inheritance Tax liability at the estate level, pooling the estates across tax years 2018 to 2020 and based on imputing an uprated entitlement to the Residence Nil-Rate Band for estates that already show an entitlement to the Residence Nil-Rate Band.[87] This ensures that our baseline estimate of revenue reflects the current policy environment, rather than the one that was in place at the time.[88] We sum the revised baseline Inheritance Tax revenue estimate across all estates pooled across tax years 2018 to 2020.

We then calculate how much tax would have been due at the estate level if a given reform had been in place by imputing a revised value of the given relief into the HMRC microdata and re-calculating the Inheritance Tax liability. Our approach assumes a static behavioural response for estates that do not have access to the spouse exemption, i.e. it does not take into account potential behavioural change or wealth planning in response to these reforms. However, in the case of estates with access to the spouse exemption, rather than allowing an (additional) Inheritance Tax liability to arise, these estates are assumed to pass on correspondingly more assets to their spouse tax free. For example, in the case of the abolition of Agricultural Relief, we assume that estates currently claiming Agricultural Relief and who have access to the spouse exemption pass any agricultural assets for which relief is currently being claimed to their spouse. Estates with access to the spouse exemption are therefore assumed not to become liable for new Inheritance Tax liabilities, except in the case of the £10 million cap to the spouse exemption, where estates at or close to the £10 million cap become liable for new Inheritance Tax liabilities.

We sum the revised Inheritance Tax liabilities due from all estates in the HMRC microdata across tax years 2018 to 2020 and deduct the baseline estimate, before dividing by 3 to give an average annual estimate.

Finally, we apply a multiplier of 1.736 to our average annual estimates. This is because we uprate the annual estimate by the ratio of the total Inheritance Tax revenue forecast for tax year 2026 in Advani and Sturrock (2023) to the average total Inheritance Tax liabilities due across years 2018 to 2020. This multiplier takes into account both the growth in the number of deaths and the cohort differences in wealth, i.e. that subsequent generations of retirees have larger wealth holdings than previous generations. The Advani and Sturrock (2023) estimates are given in 2024 prices, so the multiplier also takes into account the adjustment required to 2026 prices by uprating according to the CPI inflation estimates for 2024 and 2025 in the OBR's March 2024 Economic and fiscal outlook.[89]

[87] Our calculation also makes a corresponding imputation for the Transferrable Residence Nil-Rate Band. This approach is an estimate of the entitlements that would have existed in the case of the maximum Residence Nil-Rate Band being £175,000.

[88] The Residence Nil-Rate Band was introduced at £100,000 in 2018, rising to £125,000 in 2019, £150,000 in 2020 and £175,000 in 2021. It has remained frozen at £175,000 since 2021.

[89] See https://obr.uk/efo/economic-and-fiscal-outlook-march-2024/.