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VIEWPOINT: The Case for Inheritance Tax

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Why keep Inheritance Tax (IHT)? This tax raises relatively small amounts for the government; is politically controversial; and seems unpopular with the public. In the UK, even its name is a misnomer. IHT is strictly a tax on the amount that a person inherits. In the UK, the tax is placed on the final estate and would, more properly, be called an estate tax. Nevertheless, the IHT label persists. Although abolishing IHT may seem tempting, there are strong reasons both to keep and strengthen it.

IHT taxes transfers of wealth at death. Wealth transfer taxes can include taxes on gifts a person receives during their lifetime as well as IHT. However, wealth transfer taxes play a small role in most tax systems. For example, according to the Mirlees Review, no G7 economy raised more than 1% of national income in any one year between 1970 and 2010 (see http://www.ifs.org.uk/mirrleesreview/dimensions/ch8.pdf). The current threshold for paying IHT in the UK is £325,000 and thereafter the IHT rate is 40%. In 2012-13, IHT raised about £33.1 billion, which was about 0.7% of total tax revenue (see HMRC Tax and NIC Receipts) http://www.hmrc.gov.uk/statistics/receipts/info-analysis.pdf). IHT applies to a minority of estates, with about 3% of all deaths in 2010-11 paying IHT (see http://www.hmrc.gov.uk/statistics/inheritance/commentary.pdf, HMRC Inheritance Tax Statistics, page 4).

Nevertheless, IHT provokes controversy that is disproportionate to the money it raises for the public purse. In 2007, the then Shadow Chancellor George Osborne seemed to revive the fortunes of the Conservative party with his promise to raise the threshold for paying IHT from £300,000 to £1 million. This prompted Labour to rush through its own proposals to weaken IHT. More broadly, The Daily Express and the Taxpayers' Alliance both ran national campaigns calling for the abolition of IHT. Polls regularly seem to show that IHT is a – if not the – most unpopular tax with the public.

So why keep IHT in spite of this? This means looking at the case for IHT. While there is no single case for IHT there are various arguments in its favour, which, while not always harmonious, add up to a strong case. Pragmatism provides one reason for IHT. According to the Treasury, the current period of fiscal austerity is set to stretch beyond the 2015 general election (see https://www.gov.uk/government/news/spending-round-2013-next-stage-in-governments-plan-to-move-from-rescue-to-recovery), and although many of the political discussions have centred on spending cuts, there is a need to raise taxes whichever government is in power. This means that government is seeking alternative sources of revenue for public spending and IHT is an obvious candidate for an untapped source of funding. Signs of this can be spotted in debates about payment for social care. Population ageing means that people are living longer beyond retirement. While this is a boon for life expectancy it raises the costs of providing social care which there is no adequate system to pay for. A Commission on Social Care, chaired by Andrew Dilnot, proposed that people should contribute up to £35,000 towards their social care needs through a levy on their estate, with the government guaranteeing to cover the remainder of the cost (see http://webarchive.nationalarchives.gov.uk/20130221130239/http://dilnotcommission.dh.gov.uk/files/2011/09/Technical-Briefing-Note.pdf).

Pragmatic arguments are not the only argument for IHT. Wealth is spread much more unequally than income in the UK. Sir John Hills chaired a National Equalities Panel that published a report in 2010 exploring economic inequality in the UK. This panel uses a '90% to 10%' ratio to measure inequality. This measures the ratio of someone 90% up along the income or wealth distribution to someone 10% along the distribution. The National Equalities Panel report notes that the 90:10 ratio for household wealth is around 100. 10% have wealth below £8,800 and 10% above £853,000. 1% has total wealth over £2.6 million. This compares to a 90:10 ratio of 3.7 for gross weekly full-time earnings. 10% have earnings below £240 a week and the top 10% above £893 (see http://sticerd.lse.ac.uk/dps/case/cr/CASEreport60.pdf). This report states that: 'For many readers, the sheer scale of the inequalities in outcomes which we present will be shocking. Whether or not people's position reflects some form of 'merit' or 'desert', the sheer degree of difference in wealth, for instance, may imply that it is impossible to create as cohesive a society as they would like' (at http://sticerd.lse.ac.uk/dps/case/cr/CASEreport60.pdf, page 2).

These levels of wealth inequality undermine equal opportunity. Equal opportunity is an important value in liberal and social democratic thought. Wealth provides people with a range of opportunities or advantages. It provides people with the resources to achieve their life plans. Lack of wealth means that people are denied the opportunities available to their wealthier peers. Transfers of wealth reproduce these unequal opportunities. Transfers from parents to children reproduce inequality of opportunity across the generations. Ideally, any tax would cover gifts as well as inheritances as both reproduce patterns of inequality. This means extending IHT to some form of wealth transfer tax.

Conservatives are often less worried than liberal or social democrats about wealth inequality. For example, conservatives see inequality as an important spur to enterprise or part of the natural order of society. This often makes conservatives less disposed to IHT, particularly as it conflicts with their other commitments, such as the view that the state should not interfere with transfers of wealth within the family. Nevertheless, recent conservative writing has also acknowledged concerns about current levels of wealth inequality in the UK. For example Conservative politician David Willetts says that baby-boomers born between 1945 and 1965 have unfairly 'pinched' the inheritance of later generations. Baby boomers have enjoyed historically generous state pensions and a boom in property prices that are unavailable to younger generations. He expresses concern about fairness between the generations and wants baby-boomers to transfers assets or wealth to the next generation. However, Willetts criticises IHT as he says that this encourages baby-boomers to spend their estate rather than transfer this to the next generation.

Willetts' proposals would allow wealth to be transferred across generations. He does not address wealth inequality within a particular generation, although he does recognise that wealth inequality raises an issue of fairness between generations, his aim is not to spread wealth more widely within a particular generation. However, other conservative arguments exist for spreading wealth more widely. Those conservatives who worry about the effect of benefit handouts to the 'idle poor' would presumably also be concerned about the 'idle rich'. An inheritance could also erode personal responsibility and a work ethic, as suggested by Irwin Stelzer. http://www.spectator.co.uk/features/269796/listen-to-adam-smith-inheritance-tax-is-good/

What this means is that there are a range of arguments for IHT across the political spectrum. Liberals and social democrats have traditionally backed IHT to support equality. However, even conservatives recognise that present levels of wealth inequality in the UK are too high. But, even if IHT is desirable, is it feasible? One objection to IHT is that the very wealthy can easily avoid IHT by exploiting various loopholes or shifting their wealth off-shore. The challenge of designing a practical policy is real and should not be ignored. Indeed, some commentators suggest that a public view that the very wealthy can avoid paying this tax might explain some of its unpopularity (as suggested in the conclusion to the Mirlees Review). http://www.ifs.org.uk/mirrleesreview/design/taxbydesign.pdf, p366).

One response to this would be to ditch IHT. But, this is not the only possible response. A different approach is to recognise the challenges but instead redesign IHT to reduce the scope for avoidance. Sir James Mirrlees chaired a recent review of the best tax system for the 21st century. This brought together an international panel of experts to consider issues of tax design. The Mirrlees review backed a lifetime wealth transfer tax as part of its ideas for an ideal tax system. Such a lifetime wealth transfer tax would replace IHT with a stronger tax on transfers of wealth. The Mirrlees review thus addresses the practical issues directly (see chapter 15) at http://www.ifs.org.uk/mirrleesreview/design/taxbydesign.pdf). Practical barriers then need not rule out IHT. The task rather is to see how it might be extended and strengthened.

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