Budget

Treasury targeting inheritance tax reforms to help plug UK deficit

Exclusive: Chancellor also looking at tweaks to capital gains tax to try to bridge £40bn-plus spending gap before budget

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The Treasury is looking at ways to raise more money from inheritance tax amid growing pressure on the country's finances ahead of the autumn budget, sources have told the Guardian.

Officials have been tasked with examining whether tightening rules on the gifting of money and assets could be one way of addressing a gap between revenue and spending that is estimated to reach more than £40bn.

Although no decisions have been taken, the government has been careful not to rule out tax rises later this year amid slowing economic growth, higher-than-hoped inflation and unemployment at a four-year high.

Labour MPs have been pushing the idea of a wealth tax, but changes to inheritance tax (IHT) thresholds could be similarly controversial.

Rachel Reeves and Keir Starmer have already prepared the ground for tax rises in recent interviews, suggesting that the pressure on public finances is too great to rule them out.

However, the government's pledge not to increase taxes on "working people" in its election manifesto has left the chancellor with limited options for how to tackle a yawning deficit caused by factors including Donald Trump's tariffs, higher debt interest payments and a series of U-turns on welfare cuts.

Among the moves being considered are changes to how wealth or assets can be given away prior to death to reduce inheritance tax liabilities. This includes examining the possibility of a cap on lifetime gifting.

At present, gifts made seven years before someone dies are not subject to IHT, while those given three to seven years before death are taxed on a sliding scale known as "taper relief", with the rate reducing each year from 32% to 8%.

A lifetime cap could be introduced to limit the amount of money or value of assets an individual can donate as part of their IHT planning and the Treasury is also reviewing rules around the taper rate, people familiar with the matter said.

A source with knowledge of the work told the Guardian: "With so much wealth stored in assets like houses that have shot up in value, we have to find ways to better tap into the inheritances of those who can afford to contribute more.

"It's hard to make sure these taxes don't end up with loopholes that undermine their purpose. But we are trying to work out what revenue might be raised and how to ensure it's a fair approach."

The source added: "IHT can raise more, and even if we do nothing, it will raise more money as the threshold for paying it stays frozen. But we have to look at the levers for taxing wealth if the aim of the government is to avoid hitting earnings from work as much as possible."

IHT changes have provoked a strong public response in the past, even though fewer than one in 20 estates paid it in recent years.

In the late 2000s the Conservatives enjoyed a significant swing in opinion polls when they proposed raising the threshold at which IHT would kick in. As party leader David Cameron made it a hot-button issue, putting pressure on the Labour prime minister, Gordon Brown, with headlines about the "death tax".

Reeves has faced fierce criticism and protests over the past year in response to her decision in last autumn's budget to cut tax breaks for farmers passing on their businesses.

She defended her decision on Tuesday in an interview in Northern Ireland, saying she believed that those farmers with more than £3m to pass on "should make a contribution" and that they would still continue to pay a lower rate of IHT than others.

Only 4.6% of deaths resulted in IHT being paid in the tax year 2022-23, according to the latest figures from HMRC. The average effective tax rate was 13%, after accounting for all the different reliefs and exemptions that might apply depending on the individual circumstances. That compares with the headline rate of 40%.

The government is trying to work out how it can tap into the vast wave of wealth that will be transferred from baby boomers when they die, fuelled by large pension pots, as well as house prices that have risen sharply over their lifetimes.

It already took steps to bring these pensions into the scope of IHT late last year. From April 2027, most unused pension pots and death benefits will be subject to the tax. This leaves large loopholes, however, if sums are withdrawn and gifted instead, and officials are increasingly concerned about large cash sums being extracted from these pots.

Another possible revenue stream being looked at is whether to increase capital gains tax rates by a few percentage points.

However, this would be accompanied by some kind of CGT allowance for investors who put money into British businesses, as the Treasury tries to strike a balance between tapping into wealth to fund public services without deterring investment into the UK.

There is growing anecdotal evidence that some wealthy people and company directors may have already left the UK following recent tax changes, including the end of the "non-dom" status, though no official data is yet available.

The Guardian was first to reveal that the government was considering major changes to business property relief and agricultural land tax in 2024, a step later brought in by Reeves. These changes may have a significant impact on how much money is raised by IHT, but it is unclear how they might alter behaviour.

In 2024 CGT rates were not raised as high as many senior Labour party figures had hoped, with the government stepping back from bringing the levy closer to levels of income tax.

Still, some senior government figures believe that there is a political deal to be done to create a path towards equalising its levels with income tax. They believe there is room for a compromise after Reeves signalled that a flat-rate wealth tax - of the kind proposed by backbenchers last month, of 2% on assets over £10m - had more or less been ruled out.

In a recent interview, Reeves pointed to IHT and CGT as the UK alternatives to a headline wealth tax such as that in countries like Switzerland.

“We have inheritance tax. We have capital gains. We’ve just got rid of the non-dom tax status that doesn’t exist any more in our tax system. So we do have taxes that tax the wealthy,” she told LBC’s Iain Dale on 2 August. “I’m not keen to do what Switzerland has done and replace those with a wealth tax because I think there’s the risk of actually losing money by doing those things.”

A Treasury spokesperson said: “As set out in the plan for change, the best way to strengthen public finances is by growing the economy - which is our focus. Changes to tax and spend policy are not the only ways of doing this, as seen with our planning reforms, which are expected to grow the economy by £6.8bn and cut borrowing by £3.4bn.

“We are committed to keeping taxes for working people as low as possible, which is why at last autumn’s budget we protected working people’s payslips and kept our promise not to raise the basic, higher or additional rates of income tax, employee national insurance or VAT.”

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