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COMPARATIVE ANALYSIS OF INHERITANCE TAX PROVISIONS: UK AND INDIA

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ABSTRACT

Inheritance tax (IHT) in the UK plays a crucial role in the tax system by addressing wealth distribution, generating government revenue, and influencing estate planning. Inheritance tax is important because it helps reduce wealth inequality by taxing large estates and redistributing wealth across society. It generates government revenue, which supports essential public services, and encourages estate planning and charitable giving. By discouraging the concentration of wealth in a few families, it promotes economic fairness and mobility, while also stimulating financial decisions that benefit the broader economy.

In this article, we will gain an understanding of what inheritance tax entails and the exceptions that apply to it. We will study the methodology for calculating inheritance tax. Additionally, we will delve into the concept of gifts, including what constitutes a gift, when gifts are subject to taxation, and which gifts are exempt from tax. We will also examine various other reliefs applicable to inheritance tax. We will determine whether inheritance tax pertains to the property itself or to the individual. Additionally, we will explore the concept of inheritance tax in India. Finally, we will review various case laws that enhance our understanding of inheritance tax.

WHAT IS INHERITANCE TAX?

Inheritance Tax (IHT) is a tax on the estate of someone who has died, including all property, possession and money. The inheritance tax to be paid if the value of the estate exceeds the £325,000 threshold known as the 'nil rate bond'

As per the UKHMRC, there's-normally no Inheritance Tax to pay if the value of your estate is below the £325,000 threshold and secondly if you leave everything above the £325,000 threshold to your spouse, civil partner, a charity or a community amateur sports club

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RESIDENCE NIL RATE BAND (RNRB)

The residence nil rate band (RNRB) is available where a death occurs on or after 6 April 2017. It is an additional nil rate amount available on top of the NRB where the deceased left a residence, or the sale proceeds of a residence, to his or her direct descendants. The maximum available amount of the RNRB (excluding any transferred amounts) for deaths in the following tax years are:

- £100,000 in 2017 to 2018
- £125,000 in 2018 to 2019
- £150,000 in 2019 to 2020
- £175,000 in 2020 to 2026

WHO IS A DIRECT DESCENDANT?

A direct descendant is a child, grandchild, great-grandchild or great-great grandchild of the deceased and for the purpose of RNRB a 'child' includes:

- a child who is, or was the deceased's step-child
- an adopted child is a child of the deceased
- a foster child is treated as a child of the deceased
- if the deceased was an appointed guardian or special guardian for a child who was under 18 at that time, the child is treated as a child of the deceased
- Including a spouse or civil partner of the child, grandchild or great-grandchild, (including their widow, widower or surviving civil partner, provided that the widow, widower or surviving civil partner had not remarried or entered into a new civil partnership before the deceased's date of death)

For RNRB purposes a 'child' does not have to be under 18 at the deceased's date of death, and a 'step-child' is limited to someone whose parent is, or was, the spouse or civil partner of the deceased.

Exceptions: Direct descendants do not include nephews, nieces, siblings or other relatives not included in the list above.

EXCEPTIONS TO PAY THE INHERITANCE TAX

1. The transfer of assets between spouses and civil partners (during life or at death) is entirely exempt from inheritance tax
2. If the main home is passed to a spouse or civil partner, the home is not included in the value of the net estate.
3. If it is passed to direct descendants i.e., children and grandchildren, the nil-rate band is increased to £500,000.
4. Owners or part-owners of a business or agricultural property may be eligible for 50% or 100% relief from inheritance tax on those assets.

CALCULATION OF THE INHERITANCE TAX

1. A person's net estate is the value of all the assets they own (including fixed assets such as houses), less the value of their debts, and after accounting for any exemption. An estate's assets include bank accounts**,** savings and pensions, property**,** household goods, personal items, certain gifts. An estate's debts include things such as bills, mortgages, money owed on credit cards and funeral expenses.

2. Before any reliefs are considered, if someone's net estate exceeds £325,000 (the nil-rate band, or NRB), an inheritance tax charge may be due. Inheritance tax is charged at 40% above the nil-rate band.

3. So, if your estate is worth £625,000 and your IHT threshold is £325,000, the tax charged will be on £300,000 (£625,000 - £325,000). The tax would be £120,000 (40% of £300,000).

WHAT ARE GIFTS?

Gifts are personal goods such as money, jewellery or furniture, certain stocks, or property, given by someone to someone else during their lifetime. Gifts are always made during someone's lifetime. If something (for instance, a necklace) is left to someone else in a will, it would not be treated as a 'gift' and will be part of the deceased's estate value.

WHEN GIFTS ARE TAXABLE?

1. Gifts made less than seven years before the donor's death may be taxable. Hence, they are known as 'potentially exempt transfers.
2. If a person has gifted something, but has continued to benefit from it, then it is known as a 'gift with reservation'. For example, if someone has given away their house, but continued to live in it. HMRC explains that those gifts are not an "outright gift" and are not exempt from inheritance tax.
3. Not all gifts given within seven years of someone's death are liable for inheritance tax at 40%. However, not all such gifts are taxed at this rate. The closer the gift is given to the persons' death, the higher tax. This applies if the total value of all gifts given within those seven years is more than the nil-rate-bond. These rates taper off gradually as outlined below:

- Less than three years: 40%
- Three to four years: 32%
- Four to five years: 24%
- Five to six years: 16%
- Six to seven years: 8%
- More than seven years: 0%

EXEMPTED GIFTS FROM TAX

1. All gifts made more than seven years before the donor's death are exempt from inheritance tax.
2. Each tax year, someone can donate gifts totalling a maximum of £3,000, creating no liability for inheritance tax even if the donor's death happens within seven years of the gift. This means you can give away assets or cash up to a total of £3,000 in a tax year without it being added to the value of your estate for Inheritance Tax purposes. Any part of the annual exemption which isn't used in the tax year can be carried forward to the following tax year. It can only be used in the following tax year and can't be carried over any further.
3. Gifts made to a spouse or civil partner
4. Gifts made to charities
5. Gifts made to political parties
6. Gifts for national purposes (for instance, gifts made to the National Gallery or the British Museum), which capture institutions whose main purpose is to preserve "a collection of scientific, historic or artistic interest"

7. Gifts that are given regularly, out of income, and which do not decrease the donor's standard of living are exempt.
8. Any gifts up to £250 per recipient in each tax year, so long as another allowance had not been used on the same person
9. Any gift to someone getting married or starting a civil partnership, amounting to: – £5,000 to a child – £2,500 to a grandchild or great-grandchild – £1,000 to anyone else
10. Transfers for the maintenance of the donor's children (for instance, to help with living costs)15 – For example, this includes paying rent for a child.

OTHER RELIEFS

TRADING BUSINESS RELIEF

If, at death, someone owns a business or part of a business, it is an asset for purposes. A specific relief of 50% or 100% can apply to those assets. Shares in an unlisted company, or an interest in a business, may be eligible for 100% relief (and therefore effectively exempt).

Land, buildings or machinery owned by the deceased and that were used in the business may be eligible for 50% relief. The deceased had to own the business or asset for at least two years before their death in order for business relief to qualify.

AGRICULTURAL RELIEF

The HMRC definition of agricultural property also includes farm buildings, cottages, and farmhouses. It had to be occupied and in agricultural use for at least two years if it is occupied by the donor, a company controlled by them, or their spouse or civil partner. If it is occupied by someone else, the occupancy threshold is seven years.

Relief is worth 100% if the owner farmed the land themselves, if it was let on a tenancy began on or after 1 September 1995, or if the land was used by someone else on a short-term grazing licence. In any other case, relief is worth 50%.

REDUCED RATE AND CHARITY DONATIONS

An estate may be liable to a lower inheritance tax rate of 36% (instead of 40%) if the deceased has left at least 10% of their estate's net value to a charity.

USING LIFE INSURANCE TO PAY INHERITANCE TAX

Taking out a life insurance policy to pay some or all of an inheritance tax bill can make things easier on your family when it comes to sorting out your estate after your death. It can help protect your home and other assets from having to be sold to pay an IHT(inheritance tax) bill, which must usually be paid before probate is granted. This gives you the peace of mind that you're not leaving your family and friends with a hefty tax bill to pay when you die.

Most life insurance policies will count as part of the estate unless your policy is written 'in trust', which can often be done at no extra cost when taking out your policy. This means that any money is paid out to your beneficiaries and not to your legal estate. So, any payout won't count towards your threshold and won't be subject to IHT. This would avoid a lengthy probate process, so your beneficiaries will get their money much more quickly. A whole-of-life insurance policy is often used for this purpose, which remains in force until the policyholder's death, as long as you continue paying the premiums.

DOUBLE TAXATION RELIEF

Double taxation conventions are treaties (agreements) which help prevent you being taxed by 2 countries. This can happen if a person was domiciled in another country when they die. If the country where the person was living charges inheritance tax on the same property or gift the UK is taxing, you might be able to avoid or reclaim the tax through a double taxation convention. For instance, Double Taxation Avoidance Agreement between India and the UK was introduced back on 26th October 1993 when both parties agreed to abide by the articles included in the agreement. With this agreement, both India and the United Kingdom are responsible to avoid double taxation on income earned by residents of these countries in India or the UK.

WHETHER INHERITANCE TAX PERTAINS TO THE PROPERTY ITSELF OR TO THE INDIVIDUAL?

The inheritance tax in the UK is charged to the estate itself, not directly to the person receiving the inheritance. The estate must settle any IHT due before distributing the remaining assets to the beneficiaries. The beneficiaries are not directly liable for the IHT. They receive their inheritance after has been paid by the estate.

INHERITANCE TAX IN INDIA

In India, the concept of levying tax on inheritance does not exist now. In fact, the inheritance or Estate Tax was abolished with effect from 1985. As per an article published at The Hindu- *"A debate has arisen in India over 'Inheritance tax' following Indian Overseas Congress chairman Sam Pitroda's remarks on April 24 advocating for a US-style tax policy for inherited family wealth. Responding to this, Prime Minister Narendra Modi alleged that Congress would impose such a tax on inherited wealth if voted to power."*

As per an article published at Livelaw - *"Despite India being one of the nations where the inheritance tax is not presently imposed, it is crucial to take into account that it was levied in the past as estate duty before it was scrapped in the year 1985 after the recommendation of the Economic Administration Commission. The then finance minister V.P. Singh scrapped it stating that the Estate Duty Act of 1953 had failed to achieve its goals of achieving social equality and reducing the wealth gap. Nevertheless, there were speculations that the Indian government might reintroduce the inheritance tax in the Union Budget for 2018–19. Although, this was never actually implemented, there are still persistent rumours in corporate circles regarding its imposition."*

But tax can be generated on the inherited property through following:

TAX ON INCOME FROM INHERITANCE

When there is any income generated from the inherited property, the tax is levied. For example- rent, interest etc.

TAX ON SUBSEQUENT SALE

Once you inherit a property, you become the owner and you can choose to sell it subsequently. This way, the capital gain or loss too will accrue to you as the legal heir.

Further, the holding period (period for which the property was held by you and the deceased) will determine if capital gains will come under long-term capital gains tax or short-term capital gains tax.

LANDMARK CASE OUTLINING INHERITANCE TAX LIABILITIES IN UK

WT RAMSAY LTD V. INLAND REVENUE COMMISSIONERS [1981] UKHL 1

The Ramsay case established the **Ramsay principle**, a significant doctrine in UK tax law. The principle allows HMRC to disregard artificial tax avoidance schemes that have no commercial purpose other than tax avoidance. In this landmark case, the House of Lords ruled that transactions designed purely for tax avoidance could be disregarded, emphasizing the importance of the substance-over-form approach in taxation. This principle has broad implications, including for inheritance tax, ensuring that tax liabilities reflect the economic reality of transactions.

MACNIVEN (HER MAJESTY'S INSPECTOR OF TAXES) V WESTMORELAND INVESTMENTS LTD [2001] UKHL 6

This House of Lords case further clarified the application of the Ramsay Principle. The court ruled that tax planning schemes lacking genuine commercial purpose could be disregarded for tax purposes. This decision reinforced the Ramsay Principle's relevance to Inheritance Tax (IHT), particularly in combating schemes designed to reduce IHT liability without any real economic substance.

ROUTIER AND ANOTHER V COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS [2019] UKSC 43

This case involved the application of the charity exemption under the Inheritance Tax Act 1984. The Supreme Court ruled that gifts to charities established in other EU member states could qualify for IHT relief. The case arose from the will of Mrs. Routier, who left a portion of her estate to a trust for constructing retirement homes on Jersey. HMRC argued that the gift did not qualify for charity exemption as the trust was not governed by UK law. The Supreme Court disagreed, stating that the free movement of capital within the EU meant that such gifts should qualify for the exemption.

CONCLUSION

Inheritance tax (IHT) in the UK serves as a crucial mechanism for taxing the transfer of wealth upon death, aimed primarily at estates exceeding the £325,000 threshold. It ensures that significant estates contribute to public revenue, while offering various exemptions and reliefs to reduce the tax burden in specific situations. For instance, transfers between spouses or civil partners are exempt, and passing a residence to direct descendants qualifies for additional relief under the Residence Nil Rate Band (RNRB). These provisions help protect family wealth in specific circumstances, while ensuring that larger estates contribute to society through taxation. The tax is designed not only to generate revenue but also to address wealth inequality by discouraging the accumulation of large fortunes across generations. Exemptions for business and agricultural property further ensure that family-run businesses and farms can continue without being unduly burdened by the tax.

A significant part of IHT is the taxation of gifts made in the years leading up to death. Gifts made within seven years of death may still be subject to tax, based on a sliding scale, with gifts made closer to death attracting higher rates. However, certain gifts, such as small gifts or gifts made to charity, are exempt, promoting philanthropy and allowing individuals to plan their estates efficiently. The importance of careful estate planning is further underscored by the availability of life insurance policies that can be structured to pay off IHT, relieving beneficiaries of the burden of settling the tax before inheriting the estate. Reliefs for agricultural and business assets also ensure that productive sectors are not disproportionately affected by IHT, and the reduced rate for charitable donations encourages social responsibility. While the inheritance tax system in the UK has been refined over the years, landmark cases such as **Ramsay v. IRC**, **MacNiven v. Westmoreland**, and **Routier v. HMRC** have helped shape its modern interpretation, especially around tax avoidance and the application of charitable exemptions.

The introduction of an inheritance tax in India could appeal to those advocating for its use to mitigate wealth inequality and prevent wealth concentration. By earmarking tax proceeds for public services and development projects, the government could enhance its efforts in addressing societal challenges and improve national well-being. The tax could foster a sense of social responsibility among the wealthy, promoting a culture of shared prosperity. The tax rate would likely be progressive, aiming to reduce wealth disparities and provide equal opportunities across economic backgrounds. While potentially profitable for the government, the tax could burden families, possibly forcing heirs to sell inherited assets to cover tax liabilities. Careful planning is necessary, alongside laws to address benami transactions and ensure a fair implementation of inheritance law.