

UK Gifts and Inheritance Tax: When Is a Gift Not a Gift?

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By **Paul Webb**, 17th June 2026

Introduction

Grave goods are objects placed in burials to accompany the dead, and they offer important evidence of how past societies understood death, status, and the afterlife. In Neolithic cultures, such items often included pottery, tools, ornaments, and food offerings, suggesting both practical and symbolic concerns for the deceased. In ancient Egypt, the practice had become far more elaborate, with tombs containing jewellery, furniture, food, amulets, and ritual objects intended to sustain and protect the deceased in the afterlife.

Today, the prevailing view is simpler, you can't take it with you, but HMRC might still take a share up to 40%.

That makes one question critical, how do you pass on wealth efficiently and when is a "gift" not actually a gift for tax purposes?

The starting point is giving it away

One of the most effective ways to reduce an Inheritance Tax (IHT) bill is to gift assets during your lifetime. And beyond tax efficiency, there's something far more compelling the ability to see your wealth make an impact while you're still here.

This principle is well established. After all, Roy Jenkins once said: *"Inheritance Tax is, broadly speaking, a voluntary levy paid by those who distrust their heirs more than they dislike the Inland Revenue."*

The Joy of Giving

According to research, gifting activates the brain's reward centres. So the question is: why not give it away?

One answer could be concern about the person to whom you are gifting it. Any gift to W.

C. Fields may not have been wise, considering he said: *"I spent half my money on gambling, alcohol and wild women. The other half I wasted."*

However, assuming there are sufficient funds available (which is always an interesting calculation), we would encourage people to give with a warm hand rather than a cold one, so that they can see the fruits of their wealth in helping children purchase property, funding education for grandchildren, or providing financial security to loved ones. If you have decided to make the gifts, the next question is: what are the Inheritance Tax consequences? To which the answer, as ever, is "it depends". What are you giving, and where does it come from?

The Tax Position: Potentially Exempt Transfers

The most common form of gift is cash. In some circumstances, a deed of gift may be appropriate, but this is not essential.

A gift of capital is typically treated as a potentially exempt transfer. As the name suggests, the gift becomes exempt only if the donor survives for seven years from the date it is made.

Taper relief may apply after three years, but only to the tax, not the value transferred. The current Inheritance Tax rate is 40%, with the effective rate reducing on a sliding scale for qualifying gifts made between three and seven years before death.

Importantly, if the donor does not survive the full seven years, the position is no worse than if the gift had not been made. For this reason, starting the seven-year period is often a prudent step. In simple terms:

- No IHT if you survive 7 years after making the gift
- The gift may still be taxed if you die within 7 years
- Tax reduces after 3 years (via taper relief).

When a Gift is Not a Gift

Gifts can take many forms. After all, Secret Santa would be much less interesting if only cash could be gifted (and HR might have an easier job around the holidays). Like Secret Santa, not only cash can be gifted, but other assets as well. However, a key question arises in tax planning: when is a gift not treated as a gift?

The answer lies in the concept of a gift with reservation of benefit. If an individual makes a gift but continues to benefit from the asset, the gift may be disregarded for Inheritance Tax (IHT) purposes. A gift only works for IHT purposes if you genuinely give it away **in substance, not just on paper**.

One example is a parent gifting a house to children but continuing to live in it rent-free.

In such circumstances, the gift is not effective for Inheritance Tax purposes and remains subject to tax despite the legal transfer of ownership.

To avoid a reservation of benefit, the donor must either cease to benefit from the asset entirely or pay a full market rate for any ongoing use, such as market rent in the case of property. The potentially exempt transfer clock begins running only from the date the benefit ceases.

Closely linked to the Gift with Reservation of Benefit rules (GWR) is the pre-owned assets tax (POAT) regime. Even where the GWR rules do not apply, POAT can impose an annual income tax charge where an individual continues to enjoy the benefit of assets they previously owned.

This tends to apply only in relatively unusual circumstances, for example where a main residence is sold, the proceeds are gifted, and those funds are then used directly to acquire another property from which the donor continues to benefit.

When considering the gifting of assets, it is also important to consider the interaction between Inheritance Tax and Capital Gains Tax (CGT).

While IHT may be reduced through gifting, CGT may arise on the disposal of assets that stand at a gain. For CGT purposes, gifts are generally treated as disposals at market value.

By contrast, assets passing on death benefit from a CGT uplift to market value, effectively wiping out any gain.

This can create an interesting planning point: an asset that qualifies for relief, such as Business Property Relief, may be more tax-efficient to retain until death. In that case, it may indeed be better to give with the cold hand.

Gifts Exempt from Inheritance Tax

There are a few gifts that may be exempt for Inheritance Tax purposes. The first is the annual exemption of £3,000 in each tax year. Interestingly, this was introduced in 1981 and has remained frozen ever since. If it had increased in line with inflation, it would now be worth substantially more.

Separate from that is the small gifts exemption, which allows gifts of up to £250 to any one individual in a tax year, provided no other exemption is used for the same person.

Whilst some gifts may attract Inheritance Tax, there is at least some comfort in the fact that gifts can also be made out of income. It is not necessary to conduct a forensic review of every dinner bought for friends and family on death to determine whether the above limits have been breached.

Provided that the gift does not affect the donor's usual standard of living and forms part of a regular pattern of giving, gifts made out of surplus income can be exempt. This leads to the Micawber principle as applied to Inheritance Tax planning. As the Charles Dickens character *Wilkins Micawber* said: "*Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery.*" The same principle applies to Inheritance Tax gifts.

Where the gifts are in excess of income then, from an inheritance tax perspective, misery can result.

The importance of proper documentation in respect of gifts out of income should not be underestimated. If queried by HMRC, will your executors be able to demonstrate that the conditions are met? This typically includes maintaining records of income and expenditure, documenting the intention to make regular gifts, and retaining evidence of the payments themselves. Hopefully, much of this will already be evident from the bank statements.

Get in Touch

At [Dixcart UK](#), we work alongside clients to provide practical, well structured advice, as well as taking care of drafting of your will, helping to ensure that gifting strategies are both efficient and aligned with long term intentions. If you would like to review your position or discuss your options in more detail, please contact our team at advice.uk@dixcart.com.