

GIFT-BORROW BACK STRATEGY

In a gift-borrow back transaction a donor makes a gift of money to a lower-income family member, usually a child or parent, and the family member then loans the money back to the donor for his use.

Under federal gift tax laws, an individual may give up to \$10,000.00 and a couple may give up to \$20,000.00, to any individual or number of individuals each year, without incurring any gift tax liability, and without impairing the unified credit available to their estates upon death.

If the beneficiary of the gift is a minor, some type of irrevocable trust should be utilized and a close family friend should be appointed as trustee. The desired tax treatment is often disallowed because the trustee is related to, or subservient to, the grantor.

After the gift is completed, the donor may borrow the money back at an adequate rate of interest, with adequate security being provided for the loan. A promissory note should be executed that calls for interest payments at least annually, and providing for either periodic principal payments or for all principal to be due and payable upon demand. Successful use of the gift-borrow back strategy results in two income tax advantages. The first is income splitting. The interest income is taxed to the lower-income family member and the interest paid by the donor is deductible for tax purposes.

Another advantage of the gift-borrow back strategy is that it avoids the expense and delay of probate on a portion of your estate.

There are also some disadvantages. There is a reduction of the donor's net worth and periodic income for financial statement purposes and completed transfers of this nature reduce future planning flexibility. The donor may incur a gift tax on the initial transfer of the money. If the transfer exceeds the annual per donee limit of \$10,000.00 the amount of this transfer, if a taxable gift, for gift tax purposes, is then included in his estate at death and the corresponding increase in the grantor's estate taxes may offset, at least in part, the income tax saved through the gift.