Gift and loan back strategy

View Legal

ONE COMMON ASSET PROTECTION STRATEGY IS KNOWN AS A 'GIFT AND LOAN BACK'.

THE APPROACH INVOLVES:

1. THE OWNER OF AN ASSET GIFTING AN AMOUNT EQUAL TO THEIR EQUITY IN THAT ASSET TO A FAMILY TRUST (OR LOW RISK SPOUSE).

2. THE FAMILY TRUST THEN LENDS AN AMOUNT OF MONEY TO THE OWNER AND TAKES A REGISTERED SECURITY INTEREST OVER THE ASSET.

The type of security interest taken will depend upon the nature of the asset – for instance:

a. If the asset is land, the security interest will be a mortgage registered with the Titles Office; and

b. For most other assets, the security interest will be a registered with the Personal Property Securities Register.

KEY ASPECTS

While there are a myriad of potential issues that always need to be considered, some of the key aspects to be considered when implementing this arrangement include:

a. care should always be taken to ensure that the trust which will make the secured loan does not itself conduct risky activities (for example, run a business).

b. while the arrangement can be entered into without registering a mortgage, if this step is not taken, the trust that has made the loan will simply be an unsecured creditor.

c. the impact of the arrangement in relation to potentially accessing the small business tax concessions should always be carefully considered, because while a family home will generally be excluded from the $6 million test, a secured loan will generally be included if the trust is an affiliate or 'connected entity' under the Tax Act (which will typically be the case).

d. to the extent that a third party financier already has a mortgage over the property, they will generally require a deed of priority securing their lendings (to whatever level they may be from time to time) as a first priority before the trust's second mortgage.

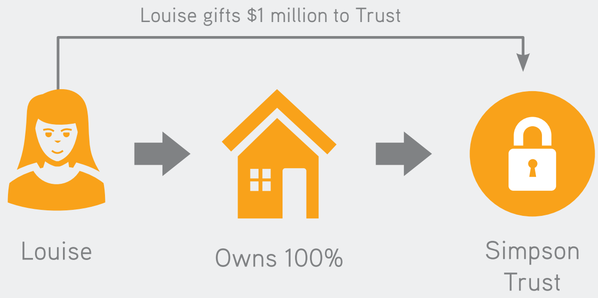
e. If no real property is available for registering security over, personal property can be used via the Personal Property Securities Register.

THE EXAMPLE BELOW ILLUSTRATES HOW THE STRATEGY CAN OPERATE.

Using property as an example, assume that Louise holds 100% of an investment property and the current value of the asset is $1,500,000. There is an existing mortgage of $500,000 owing to her current financier.

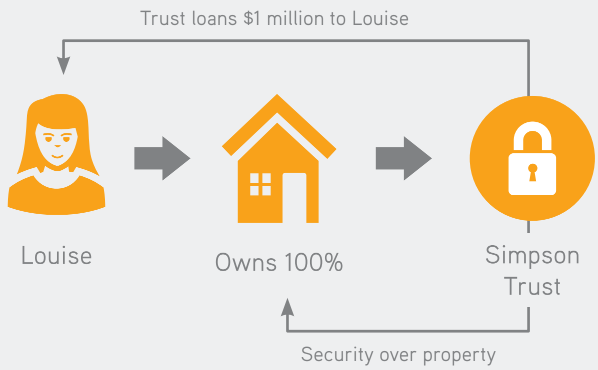
STEP ONE

Louise gifts the amount of her equity in the property to a trust



STEP TWO

The trust subsequently lends the amount back to Louise and takes security over property



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