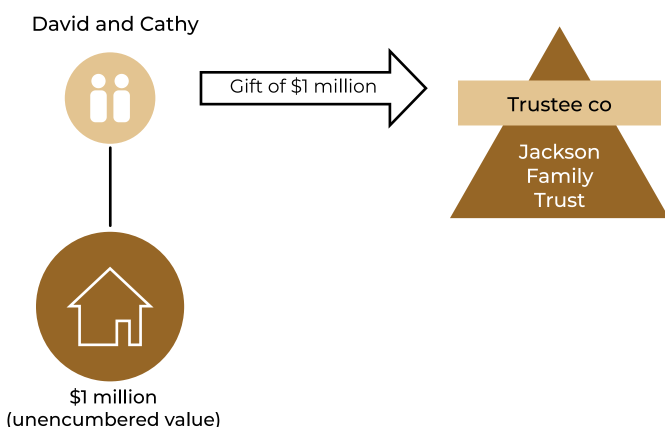
# Gift and Loan Back Strategy

The gift and loan back strategy is an effective method of increasing asset protection where a direct transfer of an asset is not desirable or appropriate, for instance, due to prohibitive tax and stamp duty costs. The strategy involves the gifting of an amount equal to the equity in property to the trustee of a discretionary trust without a transfer of the asset itself, so there is no income tax or stamp duty impact that arises. The trustee then lends an amount of money equal to the gift to the asset owner and takes a secured mortgage over the property.

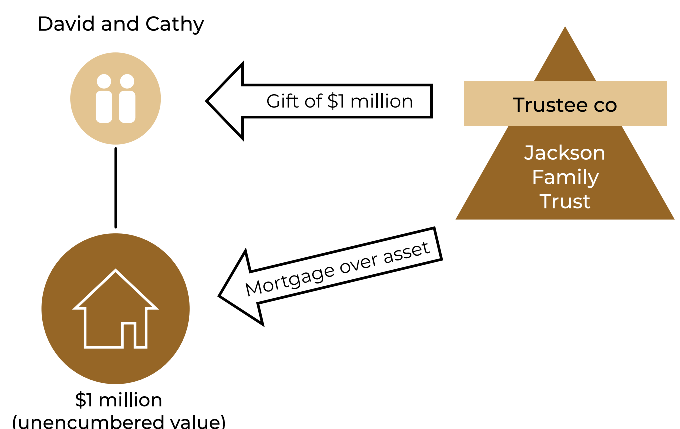
**Example:**

For this example, we assume that David and Cathy hold 100% of an interest in the property and the current value of the home is $2,000,000, with an existing mortgage of $1,000,000.

**Step 1:** David and Cathy gift the unencumbered value of the property to the trust




**Step 2:** The trust lends the gift amount back to David and Cathy and takes security over the property



## FREQUENTLY ASKED QUESTIONS

### How will this protect the equity in the property?

Using this strategy, the net equity in the property is protected by a registered mortgage. For example, if the property is currently mortgaged to a bank, the trustee will take a second registered mortgage (noting the bank still has priority under its first registered mortgage). If the property is not currently mortgaged, the trustee will take a first registered mortgage.

Either way, the full value of the property at the time the strategy is implemented is protected by registered mortgages.

### Does the gift and loan back strategy work for other assets?

Yes, this strategy can be implemented over other personally held assets such as, for example, shares in a private company or motor vehicles. In these circumstances, a security interest in favour of the trustee would be registered against the assets on the Personal Property Securities Register.

### Has this strategy ever been challenged in Court?

Given the popularity of the strategy, it is inevitable that there is some emerging and recent case law that has started to shine a light on internal debt strategies, mainly in the context of family law claims. Whilst it is too early to say what the likely impact of judicial consideration will be, it is worth noting that a particular result that is achieved in a family law context, is not necessarily transferrable to commercial law outcomes. The few cases to date that have considered its validity, would seem to show support for this view.

The only other decision of note was recently handed down in Queensland, concerning the removal of a conflicted executor of a deceased estate who stood to personally benefit - to the detriment of other beneficiaries - from a gift and loan back arrangement. He was removed on the basis he had "no intention" of challenging the validity of the arrangement. Its validity, in the context of being implemented to defeat a family provision application by other beneficiaries, was not tested in that decision.

What it is important to recognise is that this type of strategy is very unlikely to put marital assets, beyond the reach of a family law claim or to provide commercial protection against existing creditors or anticipated creditors that the strategy has been implemented to specifically avoid.

### How can the strategy be funded?

Given that this strategy is an internal arrangement, sufficient cash may not be available to fund the gift and loan back. In these cases, it is possible to arrange for the parties to use a form of non-cash consideration (e.g. a promissory note).

### What are the disadvantages vs the advantages of this approach?

#### Disadvantages include:

- the arrangement is subject to the bankruptcy clawback rules which generally have a lookback period of four years before bankruptcy. These provisions

target undervalue transactions and, for this reason, it is important to put these arrangements in place at the earliest opportunity to 'start the clock' so to speak.

- where the arrangement is used to reduce the value of personally owned assets for estate planning purposes and the asset owner is located in New South Wales, there is a three year look back period from the date of death of an asset owner that allows undervalue transactions to be 'added back' to the estate of an asset owner in the event that a claim is made against their estate. Again, it is important to put these arrangements in place at the earliest opportunity to 'start the clock' so to speak.

- the strategy only protects the amount of net equity in the asset at the time of the gifting and it will not automatically protect future increases in the asset value. However, the loan can easily be 'topped up' by (in the above example) David and Cathy gifting further amounts equal to the increased equity amount to the trust (though the gift of the increased equity will be considered a separate transaction for the purposes of the clawback periods already mentioned).

- by creating an asset in the trustee being the loan owed by the asset owner, also creates an asset that is required to be taken into account when determining a person's eligibility for small business CGT concessions under the Income Tax Assessment Act 1997 (Cth) in respect of an asset (the main residence) that is otherwise disregarded for that purpose.

## Advantages include:

- that the arrangement achieves broadly 'next best' protection for the asset compared with a straight transfer to a protected entity.

- unlike a straight transfer, as there is no change in the legal ownership of the property from the individual, transfer duty and capital gains tax will generally not apply to the arrangement.

- other drawbacks with trust ownership such as no access to the CGT main residence exemption and land tax threshold complications associated with acquiring property other than personally will not apply.

- the only transaction cost should be a mortgage and PPSR registration fees and professional establishment fees.

- **Source: John Iannou | Principal Lawyer Macpherson Kelley**

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