

College Tax Strategy



Gift or Sale and Leaseback



Basic Tax Strategy # 3

– Gift / Sale And Leaseback

Taxpayers who own a business can save taxes by shifting income to their children. One of the better income-shifting methods is to lease business property from them. The property can be an office building, a warehouse, a computer or telephone equipment, cars, trucks or any office equipment. There are two basic ways that you can provide your children with the resources to acquire the property that your business will lease.

1. Gift and leaseback – this arrangement works when you have direct (personal) ownership of some property that is being used by your business. By using a gift and leaseback arrangement, you can make a gift of the property to a child or to a trust (or limited partnership) for all of your children. Your business would then enter into a rental or lease agreement with the child (guardian) or trust.
2. Sale and leaseback – this is the more common arrangement when your corporation owns the property. Corporations can't make non taxable gifts, so a transfer of property by a corporation may be through a sale of the property. In order to make a gift to a child, your corporation would first have to make a taxable distribution of the property to you. In a sale and leaseback arrangement, the corporation would sell the property to a child (trust) and to then lease the property back from the child (trust).

Sales and leaseback transactions are not subject to gift taxes as long as the sale is a bone fide transaction and the sales price is equal to the fair market value of the related property. A gift and leaseback of the property would require a gift tax return if the amount is more than \$14,000 (\$28,000 for joint gifts).

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How To Qualify For The Gift / Sale And Leaseback Strategy

When setting up a gift-leaseback arrangement you need to first set up a trust. You name your kids as beneficiaries and then give business assets (computers, furniture, vehicles, etc.) to the trust. You and your spouse can give up to \$28,000 worth of assets per year to any number of recipients in the trust, free of gift tax. Thus, if you have two children the total gift each year would be \$56,000, before gift tax must be paid.

After you complete the gift arrangement, you then have the child (trust) lease the equipment back to your business. Then you simply make lease payments to the child (trust) and the income from the lease payments is reported by the lower tax bracket child or grandchild. The sale and leaseback arrangement is much easier and cleaner because you are selling the property to the child (trust) at its fair market value. The gift or sale and leaseback strategy works best with assets that have been expensed or fully depreciated.

For a gift-leaseback arrangement to meet IRS standards, you must relinquish complete control over the property. The trust must also have an independent trustee, such as a close friend or an adult member of your family. The leaseback must be in writing and the trustee must see to it that the lease is comparable to lease rates on similar equipment. There must also be a real business purpose for the leaseback, such as limiting the liability of a business.

Benefits Of The Gift / Sale And Leaseback Strategy

If you understand how to properly structure a gift/sale & leaseback strategy, you will be able to reap substantial tax benefits.

For example, assume that a very successful doctor with an extensive medical practice generates large patient fee income. The doctor's tax problem is due to the large income he generates that is taxed at a high income tax bracket. He may have a large investment portfolio and may own a building and other business assets, but he may not have sufficient income tax deductions to minimize his income tax because these assets have been fully depreciated.

However, if he could gift or sell those assets and then lease the assets back to the business, the tax deductions created from the rent or lease would be considerably greater. The lease payments, of course, would constitute taxable income to the new owner of the assets.

Tax Savings Involving The Gift / Sale And Leaseback Strategy

The basic tax benefit of the gift or sale and leaseback strategy comes from the gift or sale of non-deductible, fully depreciated assets and then leasing those assets back so that you can fully deduct the lease payments from your income. If you gift or sell those assets to your child(ren), you can also use this strategy to effectively shift the lease income to the child's lower tax bracket. This is a great way to reduce your family's total tax liability.

However, the money received from the lease payments is considered unearned income, so gift-leasebacks work best for kids 24 years of age, or over, due to the "kiddie tax" issue. For those under age 24, the first \$1,000 is considered unearned income and is tax free. The next \$1,000 is taxed at 15%, but higher amounts are taxed at the parents' rates, nullifying the tax benefit.

Example Of The Gift / Sale And Leaseback Strategy

Tom is a self-employed business owner and he and his wife gifted a \$28,000 car (within the IRS gift guidelines) to their 20 year old son, who is an employee of the business. The car was five years old and fully depreciated, so Tom was no longer able to take tax deductions for the vehicle. Tom then completed an agreement with his son to lease the car back to Tom's company for \$400 per month for 4 years.

Tom currently pays 25% in federal taxes, 6% in state taxes and 15.3% in self-employment taxes, for a total tax rate of 46.3%. Since the \$28,000 car was fully depreciated, Tom could no longer deduct the car from his business. However, using the gift and leaseback strategy, Tom can now deduct the lease payments of \$4,800 per year ($\400×12 months) from his business profit. As a result he will save \$2,222 in taxes ($\$400/\text{month} \times 12 = \$4,800 \times 46.3\%$) each year for the next 4 years.

Implementing The Gift / Sale And Leaseback Strategy

- Step 1: Identify the fully depreciated property you wish to gift or sell.
- Step 2: If donee/lessor is your child under the age of majority, you will need to have your attorney draft a trust to hold title (if the property has a title).

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- Step 3: Appraise (or otherwise determine) the value of the property to get the fair market value (if you have a copier, then ask a local copier distributor; if you have a farm combine, then ask a local farm implement dealer, etc.).
- Step 4: Execute the “Assignment of Interest” or “Lease Agreement”.
- Step 5: Re-title the property (if the property has a title, such as real estate, autos, etc.).
- Step 6: If you are implementing a gift and leaseback arrangement, then file IRS form 709 to report your yearly taxable gifts over \$14,000 (\$28,000 for joint gifts).
- Step 7: Make monthly lease payments under the lease agreement to the owner (lessor) of the property from your business checking account.
- Step 8: File Form 1099-MISC (if \$300 per year or more) to the owner (lessor) of the property (*the parent issues a 1099 to the child*).

Documents Used To Implement A Gift / Sale And Leaseback

These are the documents you will need to implement the Gift or Sale and Leaseback concept:

- Assignment of Equipment/Property Interest
- Equipment/Property Appraisal
- Equipment/Property Lease
- Form 709 to report taxable gifts over \$14,000
- Form 1099-MISC for lessor/child to record the lease payments (if more than \$600/year)

IRS Publications & Forms References

IRS Publications

Frequently Asked Questions On Gift Taxes

<http://www.irs.gov/businesses/small/article/0,,id=108139,00.html>

IRS Forms 709, 1099 MISC

<http://www.irs.gov/app/picklist/list/formsInstructions.html>

**GIFT/SALE AND LEASEBACK
IMPLEMENTATION PACKAGE**

**Sample Documents
Gift / Sale And Leaseback**

The following documents are needed in order to implement the “Gift/Sale and Leaseback” strategy and follow the IRS procedures and guidelines.

**GIFT/SALE AND LEASEBACK
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Assignment of Property (Gift and Leaseback)

THIS IS AN AGREEMENT TO ASSIGN PROPERTY, which is effective on the following date
_____/_____/_____ by and between:

Assignee

AND

Assignor

The above Assignor is the owner of the property listed in the Property Schedule, below:

Property Schedule:

Description	Value
_____	\$ _____
_____	\$ _____

And the Assignor wishes to transfer said property to the Assignee;

THEREFORE IT IS AGREED that the Assignor hereby transfers and assigns all rights, titles, and interests in said Property to the Assignee:

Assignee

Assignor

Signed and sealed in the presence of:

Notary Public

**GIFT/SALE AND LEASEBACK
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Equipment Lease Agreement (Sale and Leaseback)

THIS AGREEMENT TO LEASE EQUIPMENT, which is effective on the following date ____/____/____ by and between:

____ AND ____

Lessee Lessor

Lessor desires to lease to Lessee, and Lessee desires to lease from Lessor, certain tangible personal property. THEREFORE, in consideration of the mutual covenants and promises hereinafter set forth, the parties hereto agree as follows:

1) Lease

Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the following described equipment:

Equipment Schedule:

Description	Value
_____	\$ _____
_____	\$ _____

2) Term

The term of this Lease shall commence on _____ [Start Date] and shall expire _____ [Lease Length] months thereafter.

3) Shipping

Lessee shall be responsible for shipping the Equipment to Lessee's premises.

4) Rent and Deposit

A. Rent shall be \$ _____ per month, beginning ____/____/____ for _____ months.

B. Lessee shall pay a deposit in the following amount prior to taking possession of the Equipment: _____ [Deposit Amount]. The deposit will be refunded to Lessee promptly following Lessee's performance of all obligations in this Lease.

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5) Use

Lessee shall use the Equipment in a careful and proper manner and shall comply with and conform to all national, state, municipal, police and other laws, ordinances and regulations in any way relating to the possession, use or maintenance of the Equipment.

6) Right to Lease

Lessor warrants that lessor has the right to lease the equipment, as provided in this lease.

7) Repairs

Lessee, at its own cost and expense, shall keep the Equipment in good repair, condition and working order and shall furnish any and all parts, mechanisms and devices required to keep the Equipment in good mechanical working order.

8) Loss and Damage

A. Lessee hereby assumes and shall bear the entire risk of loss and damage to the Equipment from any and every cause whatsoever. No loss or damage to the Equipment or any part thereof shall impair any obligation of Lessee under this Lease which shall continue in full force and effect through the term of the Lease.

9) Surrender

Upon the expiration or earlier termination of this Lease, Lessee shall return the Equipment to Lessor in good repair, condition and working order, ordinary wear and tear resulting from proper use thereof alone excepted, by delivering the Equipment at Lessee's cost and expense to such place as Lessor shall specify within the city or county in which the same was delivered to Lessee.

10) Insurance

Lessee shall procure and continuously maintain and pay for:

A. All risk insurance against loss of and damage to the Equipment for not less than the full replacement value of the Equipment, naming Lessor as loss payee, and;

B. Combined public liability and property damage insurance with limits as approved by Lessor, naming Lessor as additionally named insured and a loss payee.

The insurance shall be in such form and with such company or companies as shall be reasonably acceptable to Lessor, shall provide at least thirty (30) days advance written notice to Lessor of any cancellation, change or modification, and shall provide primary coverage for the protection of Lessee and Lessor without regard to any other coverage carried by Lessee or Lessor protecting against similar risks. Lessee shall provide Lessor with an original policy or certificate evidencing such insurance.

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11) Taxes

Lessee shall keep the Equipment free and clear of all levies, liens and encumbrances. Lessee, or Lessor at Lessee's expense, shall report, pay and discharge when due all license and registration fees, assessments, sales, use and property taxes, gross receipts, taxes arising out of receipts from use or operation of the Equipment, and other taxes, fees and governmental charges similar or dissimilar to the foregoing, together with any penalties or interest thereon, imposed by any state, federal or local government or any agency, or department thereof, upon the Equipment or the purchase, use, operation or leasing of the Equipment or otherwise in any manner with respect thereto and whether or not the same shall be assessed against or in the name of Lessor or Lessee.

12) Lessor's Payment

In case of failure of Lessee to procure or maintain said insurance or to pay fees, assessments, charges and taxes, all as specified in this Lease, Lessor shall have the right, but shall not be obligated, to effect such insurance, or pay said fees, assignments, charges and taxes, as the case may be. In that event, the cost thereof shall be repayable to Lessor with the next installment of rent, and failure to repay the same shall carry with it the same consequences, including interest at ten percent (10%) per annum, as failure to pay any installment of rent.

13) Indemnity

Lessee shall indemnify Lessor against, and hold Lessor harmless from, any and all claims, actions, suits, proceedings, costs, expenses, damages and liabilities, including reasonable attorney's fees and costs, arising out of, connected with, or resulting from Lessee's use of the Equipment, including without limitation the manufacture, selection, delivery, possession, use, operation, or return of the Equipment.

14) Default

If Lessee fails to pay any rent or other amount herein provided within ten (10) days after the same is due and payable, or if Lessee fails to observe, keep or perform any other provision of this Lease required to be observed, kept or performed by Lessee, Lessor shall have the right to exercise any one or more of the following remedies:

- A. To declare the entire amount of rent hereunder immediately due and payable without notice or demand to Lessee.
- B. To sue for and recover all rents, and other payments, then accrued or thereafter accruing.
- C. To take possession of the Equipment, without demand or notice, wherever same may be located, without any court order or other process of law. Lessee hereby waives any and all damages occasioned by such taking of possession.
- D. To terminate this Lease.
- E. To pursue any other remedy at law or in equity.

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Notwithstanding any repossession or any other action which Lessor may take, Lessee shall be and remain liable for the full performance of all obligations on the part of the Lessee to be performed under this Lease. All of Lessor's remedies are cumulative, and may be exercised concurrently or separately.

15) Ownership

The Equipment is, and shall at all times be and remain, the sole and exclusive property of Lessor; and the Lessee shall have no right, title or interest therein or thereto except as expressly set forth in this Lease.

16) Additional Documents

If Lessor shall so request, Lessee shall execute and deliver to Lessor such documents as Lessor shall deem necessary or desirable for purposes of recording or filing to protect the interest of Lessor in the Equipment including, but not limited to a UCC financing statement.

17) Entire Agreement

This instrument constitutes the entire agreement between the parties on the subject matter hereof and it shall not be amended, altered or changed except by a further writing signed by the parties hereto.

18) Assignment

Lessee shall not assign this Lease or its interest in the Equipment without the prior written consent of Lessor.

19) Headings

Headings used in this Lease are provided for convenience only and shall not be used to construe meaning or intent.

20) Governing Law

This Lease shall be construed and enforced according to laws of the State of _____.

LESSOR:

Sign: _____ Print: _____

Date: _____

LESSEE:

Sign: _____ Print: _____

Date: _____