

Gifts, Loans and Divorcing Children

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The current state of California real estate prices often begets loans by well-meaning parents to their adult children at either of two times: (1) When they marry; or (2) A short time into the marriage when the happy newlyweds decide to buy their first house together. But, are the loans really loans and does it matter? Aside from what a tax specialist might say about the difference, this divorce lawyer says that it does matter.

Debts in Dissolution

Divorces are never easy, tensions run high and distant family members often find themselves pulled into the fray where a lack of documentation leaves open to question the exact character of a particular marital asset, or in the case I am positing, a debt.

The general rule of thumb regarding debts in dissolution actions is as follows: Debts incurred by the happy couple before and during marriage are community debts. So, if you were a parent loaning your son/daughter and an in-law the funds for a down payment on a house, you probably would not give a second thought to an internal prompt from your conscience, a.k.a. your better business manager, that at the very least you should also prepare a rudimentary promissory note to be signed by the then very compliant and willing couple simultaneously with the transfer of the funds. Why should I, you might say to yourself. Sue and Dave are family, they are both gainfully employed, the technicalities (i.e. the Note) are

embarrassing, they are up-standing citizens of the community and they will do the right thing.

Don't Count on Others to Do the Right Thing

Or will they? Experience suggests very strongly that they will not when it counts most, and a dissolution action is at least one of those moments when it counts most. Yet once again this practicing divorce lawyer has seen a soon-to-be ex-spouse willing to state under oath that a loan was not a loan but a gift, and "I don't owe anybody anything!" Even before this outrageous assertion the afore quoted in-law had long since become an "outlaw." Nevertheless, such ribald conduct is not new and is occasionally accompanied by the following sentiment expressed *soto voce* to the opposing lawyer standing on the legitimacy of the loan: Why not, he'll take his chances and maybe he'll get lucky.

Financial Opportunities Missed

Let us assume for the moment the loan is legitimate. The lack of documentation becomes important in the dissolution context for at least two reasons which are largely unrelated to repayment of the debt but have significance in themselves. They are: (1) Proving the character of the transfer will then require considerably more time and effort, as well as possibly live testimony from the transferring party; and (2) The honest spouse acknowledging as a debt the transfer of the funds may very well be deprived of an opportunity to engage in some astute financial planning and assume the entire debt in exchange for a credit elsewhere, such as a release from some other liability (typically credit cards, credit cards and more credit cards), or receipt of a greater portion of some other community property item also being divided, such as equity in the family home.

Tax Consequences

Although the generous parent often does not consider repayment important other than as a matter of principle, the lack of documentation, if not convincingly surmounted at trial or before, also deprives the honest spouse, usually a blood

relation, of a financial planning opportunity at a time when financial opportunities are usually few and far between. The honest spouse with the promissory note in hand, either as a duplicate original or on loan from the principled parent, could assume the entire note, and divide the remaining assets such that additional other property is awarded to the honest spouse in an amount equal to the excess debt assumed via the promissory note. Remember, for the note herein contemplated as a community debt, each spouse is effectively obligated on only half the note for purposes of the division of the community estate in the dissolution proceeding. In addition, after judgment, should economic circumstances not improve and compliance with the note become too burdensome, the spouse assuming the debt could always apply to the creditor, a.k.a. mom/dad, to restructure the terms of the note. I strongly suspect such an application would not be rebuffed.

Of course, a note is still a note, and if the debt is forgiven other issues arise, including tax issues.

Put it in Writing

However, if contrary to the foregoing distribution the transfer of the funds is determined to be a gift-transfer, for whatever reason, the foregoing opportunities would be lost. I could well imagine a scenario in which the only objective evidence regarding the intent behind the transfer is the state of mind of the beneficent grandparent, who alas, is unavailable to attend the dissolution trial for any number of reasons, not the least of which is health, relocation, and/or stress. While it is true that actions such as partial repayment would support a request that the trial judge determine the transfer to be a loan, the repayments if not consistent and regular through the date of trial could also be characterized by the outlaw spouse as ability-based. By that is often meant that repayment is expected as long as the happy couple can, but when they cannot, the balance is a gift. This is not the time to discuss shifting burdens and probable outcomes, but suffice it to say, credible testimony of ability-based repayments is a problem.

In short, even in the familial setting, a loan of funds for whatever reason always should be formalized in writing and signed by all when each is in a willing and truth-obedient frame of mind. The effect thereof will be to greatly diminish the probability that an outlaw will successfully swindle her/his soon-to-be-former spouse and in-laws, will afford all the opportunity to rationally analyze the impact of the debt in the context of the asset division, and, afford all the opportunity to form a deliberate and considered plan for the debt's fair disposition.

I'm convinced, you say, I'll do it. But now I have to get a lawyer and, and ... Yes, yes I know, I've heard it all before. You could retain a lawyer to draft a note. You could also go to Staples or a number of other similar outfits and get pre-printed notes. I will not vouch for what you get in the form of pre-printed notes, but with a modicum of attention you will be able to select the appropriate form. Depending on circumstances a payable-on-demand note may be the appropriate vehicle. Last, nothing speaks to the authenticity of such a note as notarized signatures. Notarized signatures are typically not required on notes, but doing so in the instance contemplated here will yield intangible rewards well worth the extra effort.

Formalize Financial Transactions

In closing, let me remind you that the purpose of this article is not to help you collude with a loved one to develop a plan to defraud a ex-in-law, but to remind you of the importance of formalizing financial transactions with proper documentation, even in the familial setting. Avoiding such documentation could result in not only non-payment to you as a parent but also deprive a son or daughter of a fair and just distribution of marital assets should the unthinkable become the inevitable. *Pax.*