NAPIER'S NOTES:

A Couple Minutes Is All It Takes.

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MAKE LOANS, NOT WAR

"Money equals freedom."

— Kevin O'Leary

Was William Shakespeare foolish when he penned, "Neither a borrower nor a lender be"? Shakespeare's counsel was certainly sound in his day. But these times are not Shakespeare's times.

Instead, perhaps we should update an adage of another time, the 1960s. For our purpose, let's refresh a popular counterculture phrase of the '60s, "Make love, not war," and contradict Shakespeare's counsel. Yes, *Make loans, not war*.

So, why are these the days to make loans? Specifically, I am referring to intrafamily loans, like a mother making a loan to her adult child. This idea is currently compelling for many reasons.

Mom can make a loan to Daughter at historically low interest rates – even below 0.5%, with very favorable repayment terms. The modest interest Mom receives on the loan, if structured properly, is not even income taxable to Mom.

Furthermore, Mom's opportunity cost to make this loan to her daughter is quite low. Because interest rates are low, Mom is probably earning very little on her cash anyway. So, the cost to Mom to help the daughter is negligible.

To make this story more dramatic, let's place Mom in a low income tax state, like Florida, Wyoming or Texas, and let's place Daughter in a high income tax state, like Illinois, New York or California. For an unexpected plot twist, we will have Mom make the loan to a trust for Daughter, rather than directly to Daughter.

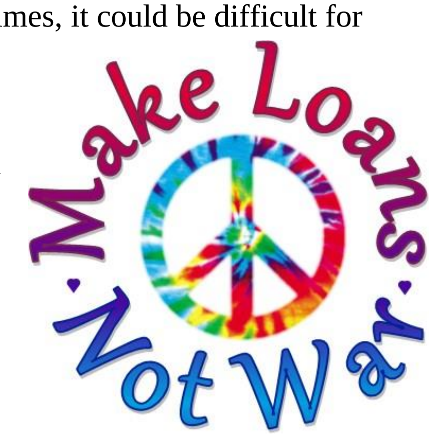
Imagine that Daughter prudently and successfully invests the loan proceeds. The taxes generated on the gains from those investments can actually be paid by Mom, if – and only if – Mom wants to pay those taxes for Daughter. For example, Mom can initially pay the income taxes generated by Daughter's trust, then change her mind in the future and have Daughter's trust pay any income taxes generated by the successful investments.

What have we accomplished? We have removed the earnings on the investments made with the loan from being taxable in Daughter's high tax state of residence. The income tax savings from this state tax arbitrage can be as high as 13% annually, and perhaps even more if warnings of state tax increases prove accurate.

Candidly, while maneuvers like these are wise, they probably do not warm the lender's heart. But every parent will glow with joy to be the cause for a child leading a better life. The loan idea can help the child live in a better home, in a better school district, in a safer neighborhood. The loan can reduce the economic hardships younger married couples face with health and education costs. The leading reason given for the dissolution of marriages is financial difficulties. It is impossible to quantify the benefits of helping maintain a marriage that might have otherwise unraveled over short-term financial stress.

Of course, we can take the mantra of "make loans" too far. Like Falstaff in Shakespeare's plays, or the counterculture kids of the 1960s, we cannot go overboard with the free – or nearly free – loan idea. In poor economic times, it could be difficult for Daughter's trust to fully repay Mom if the investments do not perform as well as planned.

For that reason, we must practice safe lending and lend responsibly.



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