

Giving the Gift of a Down Payment

If you're thinking big for junior's holiday gift – as in down-payment-on-a-home big – there's good news. Along with the warm and fuzzy feelings parents will get, there's also a tax advantage.

The *IRS*¹ allows parents to give up to \$13,000 annually to their child (or anyone else) without incurring a gift tax, says Troy Von Haefen, a certified financial planner and president of Von Haefen Financial Management in Nashville, Tenn. (In 2008, the cap was \$12,000 per year, per recipient.) Conceivably, a married couple could give four times that – up to \$52,000 to their child and their child's spouse, tax free. Giving more than \$13,000 to one person would eat into your lifetime gift-tax exclusion, which is \$1 million for individuals.

The newly extended and expanded *home buyer tax credit*² might be an additional incentive for parents to help their children buy a house now. The deadline – both for the first-time home buyer credit of up to \$8,000 and the existing homeowner credit of up to \$6,500 – is April 30, 2010. (The credit only applies to homes purchased for \$800,000 or less.)

Here are a few things to keep in mind with this kind of transaction.

Lender will require documentation

Make sure any transfer of funds to your child happens before they apply for a mortgage loan.

Mortgage lenders require documentation that the down payment money is, in fact, a gift and not a loan. The donor might also have to document the source of their funds – usually providing a bank or other account statement. If the donor isn't comfortable with this, they could get a letter from their financial institution verifying that the donor is an account holder there and they have the money to donate, says Bruce Brown, a certified mortgage planning specialist at Pulaski Bank Home Lending in Kansas City, Mo.

Chase Mortgage, for example, demands a letter that's signed by both the donor and mortgage applicant stating that the funds are a gift and no repayment is required, says Michael Fusco, a spokesman for JP Morgan Chase. The letter also has to specify the dollar amount that will be given, the donor's relationship to the applicant and assert that the funds are not coming from anyone who has an interest in the sale of the property, he says.

Borrower might still have to contribute to the down payment

The rules for gifting money for a down payment also depend on whether the mortgage is a conventional loan or an FHA loan. For a conventional mortgage, the buyer has to have a minimum down payment of 5% of their own funds in the transaction, says Neil Sullivan, president of Westfield Mortgage, a mortgage broker in Westfield, N.J. But if a parent gifts his or her child 20% or more of the home's purchase price, there's no need for borrower to put in their own money because the loan-to-value (LTV) ratio is low, Sullivan says. (The LTV ratio is the relationship between the amount of the mortgage loan and the appraised value of the property.)

For an FHA loan, however, the down payment can be 100% from a gift, says Pulaski bank's Brown.

Make sure retirement is secure

Before taking out that checkbook, parents should be absolutely sure they don't need that money. "Otherwise, the gift boomerangs if the child has to support the parents later," says Susan Brown, a certified financial planner and wealth manager at Back Bay Financial Group in Boston. Your retirement needs should be well taken care of before you think about giving away large amounts of money to the children.

Don't stretch it

Advice for the gift recipients: This is not the time to stretch for a minimal down payment, so if the gift isn't enough for a substantial down payment, reconsider the purchase or wait. Brown, of Back Bay Financial, advises buyers to have a 20% down payment or 10% at a minimum. With a smaller down payment, you're more exposed to further declines in home values while having little equity in the home, she says.

Read our story on 10 common mistakes first-time home buyers make *here*³.

¹<http://www.irs.gov/publications/p950/index.html>


²<http://www.smartmoney.com/personal-finance/taxes/10-Things-You-Should-Know-About-The-New-Homebuyer-Credit/>

³<http://www.smartmoney.com/personal-finance/real-estate/10-Mistakes-First-Time-Home-buyers-Make/>

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