

## KNOW THE TAX RULES BEFORE LENDING MONEY TO RELATIVES

There are many worthwhile reasons to lend money to a relative. For example, you may want to help your children or siblings continue their education or start their own business.

**The IRS says you must charge interest.** Lending money to relatives can have tax consequences. The IRS requires that a minimum rate of interest be charged on loans. The rates change every month, and can be found at [www.irs.gov](http://www.irs.gov). If you do not charge at least the minimum rate, the IRS will still require you to pay tax on the difference between the interest you should have charged and what you actually charged. If these excess amounts become large, or if the loan is forgiven, there may also be gift tax implications.

**There are some exceptions, though.** Loans of up to \$10,000 can be made at a lower (or zero) rate of interest, as long as the proceeds aren't invested. Loans between \$10,001 and \$100,000 are exempt from the minimum interest requirement as well, as long as the borrower's investment income is \$1,000 or less. If the investment income exceeds \$1,000, you'll be taxed on the lesser of this income or the minimum IRS interest.

**Do the paperwork.** For the IRS to treat the transaction as a loan and not a gift subject to the gift tax rules, the transaction must look like a loan. The borrower should have the ability to repay the principal and interest. A contract should be prepared which specifies the loan amount, interest rate, the payment dates and amounts, any security or collateral, as well as late fees and steps to be taken if the borrower doesn't pay. Have the document signed and dated by all the parties.

**Can you claim a deduction if you're not repaid?** If the borrower defaults, you may be eligible for a nonbusiness bad debt deduction. However, you must document your efforts to collect the unpaid balance. This may involve the unpleasant task of taking legal action against a family member. The preparation of a signed contract, though, may make the borrower think twice before attempting to evade his or her responsibilities.

For assistance in structuring a family loan that doesn't create tax concerns, give us a call. We're here to help.