



Government-Approved Inter-Family

Logic might tell you that any loans you make to family members would be a personal matter, without requiring the government to get involved. But whenever has the tax code followed logic?

The key issue to remember, with the Internal Revenue Service involvement in family loans, is that the IRS wants to be able to calculate gift taxes against the amount you would ultimately owe in estate taxes when you pass on assets to your heirs. If you were to make a no-interest loan to a son or daughter, the IRS would count the amount of interest you would be foregoing as a gift. If you DO charge interest, the amount of interest would need to be reasonable in the eyes of the government.

What's reasonable? The government monitors interest rate movements in the marketplace and calculates minimum applicable federal rates (AFR) for loans covering different time periods, posting them on its website. (You can find this month's rates here: <https://www.irs.gov/pub/irs-drop/rr-21-16.pdf>). If you charge family members or heirs less than this rate, then the government would calculate the difference, and that would be counted as a gift to the family member to whom you made the loan.

These rates are pretty low: a short-term AFR (up to 3 years) in September 2021 is 0.17%; the AFR on loans of 3-9 years is 0.86%, and anything over 9 years would have a rate of 1.71% to 1.73%, depending on whether the interest is being paid back yearly, quarterly, or monthly.

Note that these rules don't apply to loans of less than \$10,000 that are not used to purchase income-producing property. And if you don't want to go through the hassle of charging interest, you could always calculate (or have a professional calculate) the implied interest payments, and then offset that amount with your \$15,000 annual gift exemption to the borrower. But even then, it's a good idea to document the terms and stated interest rate in case the IRS ever decides to come back and do an audit.

Sources:

<https://tips.resourcesforclients.com/T74ctGwcsp3d/5749>

If you have any questions about this article or want to discuss your family finances, investment portfolio, or financial planning advice, please call on me anytime at my number [\(215\) 325-1595](tel:2153251595) or you can [click here to schedule a meeting](#).

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