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Loan vs. a Financial Gift to a Family Member

Q. What is the difference between a gift and an intrafamily loan?

A. The IRS defines an intrafamily loan as a formal creditor-debtor relationship involving an agreement, whereas gifts are given without obligations or expectations.

When money is transferred with the expectation of repayment, it's a loan. In this case, the person who loans the money can expect to be repaid (typically in interest payments), and they actually enforce the debt.[1] And, it usually involves a formal agreement signed by all parties.

Financial Gift to a Family Member

On the other hand, a gift is an amount given without any obligation or expectation that it will be paid back. For example, if a family member gives a relative a gift, whether in the form of cash, stock, business ownership or other types of assets, he or she doesn't expect to be repaid and there isn't any kind of consideration, meaning there's no money or promise to do something in exchange for the gifted amount. From an estate planning perspective, there is an annual amount you can give without paying taxes on it, up to the lifetime exclusion amount, which changes annually for inflation.

Q. What are the tax implications of loaning or gifting money to family?

A. The primary considerations are tax-related, but the reality is that family dynamics and personal opinions about family wealth can also come into play.

From a tax perspective, in 2024, a single individual can gift $18,000 per year to any other individual, including family members, without incurring gift tax implications. A married couple, for example, could gift their son or daughter $36,000 in one year ($18,000 per person) without triggering gift tax.[2] If individuals and couples make a gift in excess of that amount in a given year, then the amount above the $18,000 per-person exclusion will begin to cut into their lifetime gift tax exemption, set at $13.61 million per single individual (or $27.22 million per married couple) for 2024.[3] After those lifetime exemption amounts have been met, gifts made above those amounts will be subject to a 40% federal gift tax.[3] Given the tax implications of gifts, a loan may be a better option since it doesn't trigger any kind of gift tax exemption amount and, as a result, can be provided in larger amounts because there is no annual exclusion limit.

Family dynamics can be complex, so if you're the one giving a gift or a loan, think about how your family member might handle it and how you feel about it. If the money you are giving is a holiday gift or celebrates a major life event, a gift may be a better fit. If a family member is starting a business, you may choose to give him or her a loan. If you're thinking about making a loan to a relative, it's a good idea to document and structure the loan so everyone is on the same page. Either way, you know what works best for your family.

Q. What should I do to help make an intrafamily loan legitimate?

A. If you and a member of your family decide an intrafamily loan is the best way to achieve your mutual objectives, keep in mind the following points to help ensure the loan is legitimate both from a structural and administrative standpoint.

Document the Agreement

When creating a loan agreement, make sure you establish the repayment schedule, set an appropriate interest rate, identify the assets or services being exchanged in the transaction and have a section defining under what circumstances the loan must be repaid in full. Both of you should sign the document. It doesn't have to be overly complex, but it should set the terms for the lender and borrower. In addition, it should demonstrate to any outside parties, such as debtors or the IRS, that the loan is legitimate, especially in the event of litigation.

Keep Ongoing Records

In addition to having a written and signed document between parties, it's important to document and maintain ongoing records of the transaction. You should also make sure your family member makes the loan payments. Similar to a car loan or mortgage company that provides the borrower with a monthly statement and payment history, an intrafamily loan should also have a clear and regular paper trail. Statements should define the amount paid each period, how much goes toward the principal versus loan interest and the outstanding balance due. Should there ever be a question as to the legitimacy of the loan, these types of documents will be key in showing evidence that both you as the lender and the borrower entered into a legitimate contract and exhibited intent to be bound by the terms of the document.

For more information visit: **mariner.com**

[1] "Important Considerations in Intra-Family Loans" willamette.com.

[2] "Frequently Asked Questions on Gift Taxes" irs.gov.

[3] "What's New – Estate and Gift Tax" irs.gov.