

HOW TO LEND MONEY TO FAMILY AND FRIENDS

Considering lending money to a relative or friend? Here are some strategies to get repaid and keep your relationship afloat.

By: Geoff Williams - September 27, 2021

It's a scenario many of us are familiar with: being hit up for a loan from someone you care about. And now you need to decide whether to lend that family member or friend money.

Of course, you already know the main reasons not to loan money to a friend or relative, especially a serious amount. You may not get paid back, and if you struggle to get your cash back, your relationship may crack under the pressure.

But if you plan to extend some credit anyway, before you write that check – or transfer money – here are some considerations to keep you and your borrower on speaking terms.

- Tell your friend or relative you'll think about it.
- Look at your finances before making a loan.
- Get everything in writing.
- Consider setting the debt payment plan on autopay.
- Understand the legal and tax consequences.
- Consider whether to charge interest.
- Learn to say no next time.

Tell Your Relative You'll Think About It

If a relative asks you for a loan, ideally, don't say yes right away. Tell the relative that you'll need to look at your budget first. In other words, don't loan money under pressure.

Telling your relative or friend that you'll think about it can also give you a chance to come up with a kind and creative way to say no. Of course, you may decide to make the loan. Still, whether this request is for \$50 request, \$500, \$5,000 or more, you deserve some space to think about this.

Also, don't be afraid to ask what the money will be used for. Chances are, your family member will volunteer the information. But if not, you're well within your rights to ask.

Look at it this way: While a bank isn't likely to ask what a customer intends to do with a personal loan, a bank will commonly ask how a business loan will be spent. Meanwhile, you are not a bank. Which means that you aren't obliged to give out a loan, and so it's reasonable to ask how the money will be spent.

Look at Your Finances Before Making a Loan

So somebody asked you for a loan, and you said you'd look at your budget first.

Take a look at your financial picture and see how lending money would affect you – especially if the friend or relative takes their time paying you back. If you can't afford to lose this money, you're taking an awful chance.

If you don't feel as if your own finances are sound, that's all the more reason to decline.

Get Everything in Writing

You and your borrower need to decide on a plan for repayment – and, yes, it should be in writing.

That's a suggestion from Timothy Wiedman, a retired management and human resources professor who lives in Grand Rapids, Michigan. He says that he once loaned money to his girlfriend, and they put everything in writing. And since they got married, we'll assume this is great advice.

Wiedman suggests putting everything involving the loan in your written agreement: "The date of the loan, loan amount, repayment terms, interest rate, payment due dates and so forth."

That said, putting everything in writing can make things awkward, Wiedman cautions. Signing a promissory note did not bother his soon-to-be fiancée, but when her older sister found out about the written loan agreement, she raised a bit of a fuss, according to Wiedman.

"That Thanksgiving, the dinner table seemed rather tense – at least to me," he says.

Consider Setting the Debt Payment Plan on Autopay

Maggie Germano, a financial coach for women who is based in Syracuse, New York, agrees that getting everything in writing is paramount when a family member loans money to another family member. But she has an idea you'll want to attach to the plan.

When Germano's father-in-law offered to pay off his son's student loans, "so that my husband wouldn't have to waste money on interest any more," they did something very smart.

"So they agreed to a payment plan," Germano says, "and my husband set up auto payments to his father through his bank account."

He never missed a payment, she says, and he eventually paid off the loan. Meanwhile, they never had arguments or even conversations about the loan because the payments were automatic and seamless.

While setting up automatic withdrawals to pay off a relative probably won't work for everyone (especially if the borrower has sporadic cash flow), it may work out well for a person with a steady paycheck.

Having a system like that also inoculates the borrower from being criticized for, say, how they're spending money while they still owe the family member.

Understand the Legal and Tax Consequences

Is it legal to lend money to family and friends? Yes. That said, there are some tricky legal loopholes senior citizen parents need to be aware of when lending money to an adult child.

Patrick Simasko, an elder law attorney and wealth preservation specialist at Simasko Law in Mount Clemens, Michigan, points out that "if you loan your child money and have to go into a nursing home and apply for Medicaid within the following five years, your child has to give you the money back. If they're unable and they never can give the money back, there is serious Medicaid divestment penalties that will apply. Medicaid will treat it as a gift."

You should also be thinking about the Internal Revenue Service, at least a little, according to Neel Shah, an estate planning attorney at Shah & Associates and a certified financial planner and the owner of Beacon Wealth Solutions in Monroe, New Jersey.

"As a general rule of thumb, the IRS believes that nobody gets something for nothing. When money or anything of value is transferred to a friend or family member, it's going to be either a gift, a loan or a sale. Each of these would have tax consequences associated with it," Shah says.

For instance, Shah says that if you lend enough that you wind up reporting the loan on your taxes, there would be the assumption by

the IRS that interest would be charged.

"Even if there is no interest actually charged, you may deal with imputed interest income – when the government assumes that the rate of interest has been charged and taxes you accordingly," he says.

Still, Shah deals with wealthy clients who sometimes lend large amounts of money to family members and friends. If you lend a few hundred bucks to your sister so she can pay her rent, you aren't likely to run afoul of the IRS.

Consider Whether to Charge Interest

Charging interest on your loan is certainly your right. How much that interest should be is up to you, but you'd probably want to charge no more than a bank. Typically, lenders will charge anywhere from a friendly 3% to an obscene 36%. If this is to a family member or friend, you should probably stay on the low side.

Still, don't spend that interest before you get it, and better yet, don't plan on getting it.

"I never make recommendations as to interest rates," Simasko says. "If you're preparing to loan money to a friend or family member, the only thing you should prepare for is never getting that money back."

In other words, he says, "only lend what you can afford to lose. If you go into the situation knowing you likely won't see the money again, then you won't be disappointed if you don't get it back."

Learn to Say No Next Time

If you feel like kind of a pushover, and family members and friends are always treating you like a bank (and in that case, asking for interest is probably a good idea), then you may need a strategy to start saying no.

Just be honest and firm and say that you're instituting a new policy – you can't loan a friend or family member money.

Some people have no problem with saying no. Others understandably have trouble turning down a loved one or friend for a loan. But saying no doesn't mean you don't care.

You may just not want to damage your relationship.

"I've seen relationships completely ravaged by money loans. Entire families have been destroyed," Simasko says. "If you're in the position where you cannot afford to lose the money, simply explain that to your family member or friend. Communication is key. If they truly understand that you're not in the position to lend the money, then all should be well-received."

Of course, it's when you are in the position to lend money – and your family member or friend knows that – that's when it can be really difficult to say no.

Still, you need to do what's right for you, and it's your money, and so you should feel free to make whatever decision you want, without guilt. Again, it's your money to do with what you want. That is, unless you do loan it out to a family member or friend. And then it's theirs.

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