WHAT TO DO WHEN FRIENDS OR FAMILY ASK FOR MONEY

More than half—60%—of U.S. adults have lent money to a friend or family member, according to the 2019 Bankrate Lending Money Survey. However, 35% of Americans who did offer financial assistance were negatively impacted, whether they lost money, damaged their credit score or harmed their relationships.

While it's natural to want to help a friend or family member when they need financial assistance, but be careful. Money can drive a wedge into friendships and family relationships. Plus, there are tax-related considerations.

Review this advice before you commit to lending money, not only to ensure everyone understands the details of the loan, but also to reduce the likelihood of breaking a tax law.

Think it through completely.

- **Lend only what you can.** Before you lend someone money, you need to evaluate your own situation. Can you afford it? Do not lend more than you can afford to lose.
- **Don't take from your future.** If you do not have cash on hand to make the loan, do not take the funds from your own retirement accounts.
- **Communicate.** Who else will be impacted by your decision? If you have a significant other, discuss the request with him or her.
- **Ask questions.** What is the money for? Money to cover an emergency car repair may impact your decision-making process differently than money for a risky investment scheme or a beach vacation.
- **Be detail oriented.** Your loan may be to a friend or family member, but treat it like a business arrangement. Agree on the loan amount, terms, interest rate, payment schedule and any penalties for late or missed payments. Determine what will happen if the borrower defaults.
- **Write it down.** Perhaps the most important step of all is creating a formal contract. Writing it down will help make everyone more accountable in the long run.
- **Have a witness to the loan.** Have the document signed and dated by you and the person you are lending the money to. Have the document notarized or at least have a third person sign off on it.
- **Don't be afraid to say no.** While helping your family and friends is a lovely idea in theory, someone who repeatedly needs money because of bad decisions and poor money management will not be further helped if you throw good money after bad. The greatest gift may be the gift of financial planning services. Keep in mind there is a reason the person is asking you for a loan instead of a lending institution or someone else.
- **Let go.** Once you have given the loan, acknowledge that you have no control. Don't obsess over how the money is spent. Just follow the terms of the loan, or you may find yourself angry and resentful.

Be cautious of co-signer requests.

Co-signing on a loan as opposed to handing over your own money may sound like a less risky way to help someone, but attaching your name to someone else's loan comes with potential pitfalls.

Be aware the loan would appear on the credit reports for both the borrower and the co-signer. That may reduce the amount of money you might otherwise be able to borrow and, if there are late payments, it would impact the co-signer. In the worst-case scenario, if the primary borrower defaults on the loan, you would be the one responsible for repaying the loan and the negative information would appear on your credit report.

Understand the tax implications.

If you loan money and the loan is not repaid, you can usually deduct the money not repaid as a bad debt. To deduct bad debt, you must have documented the loan with a promissory note or other similar documentation of the terms of repayment, or the loan will be indistinguishable from a gift. There are several rules to qualify as nonbusiness bad debt and be deductible for tax purposes, so you should contact your CPA.

Be aware of any taxes you may be assessed if you decide to loan money. You may be subject to a gift tax if you lend someone more than $15,000, which is the amount set by the IRS for 2020. Spouses can combine their annual exclusions to double the amount of the gift. Consult a CPA to determine how you will be impacted by the loan. If your borrower defaults, be sure to document your attempts to collect the funds. You will need this information to write off the loan down the road.

If you don't charge interest on the loan, the IRS may get curious. And if the interest rate you do decide to charge is less than the most recent applicable federal interest rates, the loan can be considered a gift and trigger a taxable event on a federal income tax return. In addition, interest received by a lender of a loan is generally taxable. While the amount of interest payments on a personal loan may not be large, it is important to know interest payments on unsecured personal loans are not tax deductible.

Trust your judgment.

If you're feeling uncomfortable with the process of lending to a friend or family member, you may want to step back and reconsider. Maybe there are other ways you can help. Offering to buy groceries, donating a gift card, helping with a job hunt or connecting someone with a personal financial planner may help someone restart their financial journey on a positive note.