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Ken Berry, JD • Apr. 12, 2023



One of your children may be struggling in this challenging economic environment. Or maybe they need money to buy a home or launch a new business venture. Possible solution: You might arrange a no-interest (or low-interest) loan to help your child out.

What are the tax consequences? As long as you stay within the tax law boundaries, your family should be in the clear. However, if you're not careful, you could get walloped by an unexpected tax bill.

Background: If you don't charge any interest, or you charge interest at a below-

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complete a home purchase, the imputed interest rules don't apply.

2. Loans of less than \$100,000. If loans total \$100,000 or less, the amount of interest you're treated as receiving annually for tax purposes is limited to the borrower's net investment income for the year. If the borrower's net investment income doesn't exceed \$1,000, there's no taxable interest income on the intra-family loan.

Note that this special exception doesn't apply if you did not charge any interest or you're using a below-market level interest rate for tax avoidance purposes.

The IRS is notoriously tough on loans reputedly made for business purposes. For instance, if you can't present clear and convincing evidence that the loan is tied to a business transaction, the transaction may be deemed to be a gift. Accordingly, you're not entitled to any tax benefits if the loan isn't repaid.

Sometimes you should just bite the bullet. Case in point: Instead of giving your child a no-interest loan, you might charge interest based on the Applicable Federal Rate (AFR) for the month of the loan. As an example, the AFR rate for March 2023 was 4.40%.

Be sure to spell out in writing the terms of the intra-family loan agreement, including the amount, the time for repayment and the designation of collateral. Finally, have the loan document witnessed and notarized. Thus, you'll have proof if the IRS ever comes calling.

If your child can't repay a personal loan, the subsequent loss is treated as a short-term capital loss when it becomes totally worthless (i.e., there's no reasonable prospect for repayment). You can use this loss to offset capital gains realized during the year plus up to \$3,000 of high-taxed ordinary income. For a loan made in

connection with your business, the full amount of the loss may offset ordinary

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