



Intra-Family Loans

By Alan S. Kufeld, CPA, Partner and Edward Poreba, CPA, Senior Manager

As we await the details of the Trump Administration's tax plan, we are in a period of "transfer tax uncertainty." During this time, we generally encourage clients to avoid making taxable gifts or entering into complicated gifting strategies that could result in the payment of gift tax. If properly structured, intra-family loans can create an opportunity to shift wealth to the next generation with little to no transaction costs and without a gift tax.

With interest rates at their lows but threatening to increase, intra-family loans can also be an attractive way for individuals to lend funds to younger generations at rates lower than prevailing commercial rates.

This strategy is enabled by the low "safe harbor" rates set by the IRS, the Applicable Federal Rates ("AFR"), which represent the minimum interest rates that may be charged on an intra-family loan. These rates are published monthly and correspond to the yields and maturities of various Treasury bonds.

Interest Rate Factor

The interest rate used depends on the terms of the loan.

For September 2017, for term loans of three years or less, the short-term rate (1.29%) is used; the mid-term rate (1.94%) is used for more than three years but not more than nine year loans, and the long-term rate (2.60%) for loans longer than nine years.

For demand loans outstanding the entire year, the IRS provides a blended rate — currently 1.09% for calendar year 2017.

Examples of a few of the possible uses of intra-family loans include:

- Home mortgages for family members, including refinancing of existing mortgages;
- Loans to acquire investment assets generating a total return above the interest rate paid, achieving a transfer of wealth without gift tax implications;
- Loans as a means of making gifts over time by forgiveness of payments in some years; and,
- Loans to grantor trusts.

If loans are made with no stated interest rate or a rate below the AFR, the lender is deemed to have made a transfer (or gift) to the borrower of the foregone interest, followed by a deemed transfer by the borrower back to the lender as imputed income. Such "gift loans" may cause the lender to recognize imputed income and possible gift tax.

Be Alert

Despite the opportunities this strategy offers, taxpayers should be aware that there are possible pitfalls. It should be noted that the IRS presumes all intra-family loans are disguised gifts from the outset, with the burden on the taxpayer to prove otherwise.

Be Proactive

It is crucial that a bona fide debtor-creditor relationship be established at the inception of the loan and throughout its administration. Accordingly,

- a signed promissory note should designate a repayment schedule,
- collateral should be provided,
- repayments should actually be made (and demands made when they are not), and
- the borrower should be solvent and possess the ability to repay.

Any prearranged forgiveness of a loan could result in a gift of the entire loan amount.

Contact Us

For more information on intra-family loans or any other tax matters, please contact a member of your client service team or Alan S. Kufeld, CPA, Partner at akufeld@pkfod.com, Mary Parente, CPA, Partner at mparente@pkfod.com, or Edward Poreba, CPA, Senior Manager at eporeba@pkfod.com.

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