

A family bank professionalizes intrafamily lending

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If you're interested in lending money to your children or other family members, consider establishing a "family bank." These entities enhance the benefits of intrafamily loans, while minimizing unintended consequences.

Upsides and downsides of intrafamily lending

Lending can be an effective way to provide your family financial assistance without triggering unwanted gift taxes. So long as a loan is structured in a manner similar to an arm's-length loan between unrelated parties, it won't be treated as a taxable gift. This means, among other things:

- Documenting the loan with a promissory note;
- Charging interest at or above the applicable federal rate;
- Establishing a fixed repayment schedule; and
- Ensuring that the borrower has a reasonable prospect of repaying the loan.

Even if taxes aren't a concern, intrafamily loans offer important benefits. For example, they allow you to help your family financially without depleting your wealth or creating a sense of entitlement. Done right, these loans can promote accountability and help cultivate the younger generation's entrepreneurial capabilities by providing financing to start a business.

Too often, however, people lend money to family members with little planning and regard for potential unintended consequences. Rash lending decisions can lead to misunderstandings, hurt feelings, conflicts among family members and false expectations. That's where the family bank comes into play.

Make loans through a family bank

A family bank is a family-owned, family-funded entity — such as a dynasty trust, a family limited partnership or a combination of the two — designed for the sole purpose of making intrafamily loans. Often, family banks are able to make financing available to family members who might have difficulty obtaining a loan from a bank or other traditional funding sources or to lend at more favorable terms.

By “professionalizing” family lending activities, a family bank can preserve the tax-saving power of intrafamily loans while minimizing negative consequences. The key to avoiding family conflicts and resentment is to build a strong family governance structure that promotes communication, group decision making and transparency.

Establishing clear guidelines regarding the types of loans the family bank is authorized to make — and allowing all family members to participate in the decision-making process — ensures that family members are treated fairly and avoids false expectations.

Please contact us to learn more about the ins and outs of intrafamily lending.

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