

# Ten tips for lending money to your family



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SPECIAL TO THE GLOBE AND MAIL

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I met a gentleman a couple of weeks ago who had won money in a provincial lottery. “Tim, I won \$5-million in the lottery this year and I donated a quarter of it to charity. So, I’ve got \$4,999,999.75 left. What should I do with it?” he asked.

Okay, so that’s not the precise conversation I had with him. In fairness, he had given away more than that. After helping some charities, he decided to help his children, and his brother, by lending them some money. We had a good conversation about the tax and psychological issues around lending money to family. Here are 10 tips to consider.

## THE PSYCHOLOGY

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**1. Make sure you’re secure.** Don’t feel badly about saying “no” to lending money to family if it means jeopardizing your own financial security. If lending the money means you’ll have trouble meeting your own costs of living, or saving for retirement, you may be wise to say “no,” even if this is tough for you.

**2. Don’t expect to get it back.** There’s a good chance you may not see your money again, so only lend money that you’re sure you can live without.

**3. Talk to your partner.** I learned long ago that if I’m going to keep peace in my marriage, I should talk to my wife before committing our joint resources to a loan or gift. This way, if the money doesn’t come back, it won’t strain our marriage.

**4. Know your mental makeup.** If the loan you make isn’t repaid, how will you feel? Will you become resentful? Will it strain your relationship with the borrower? Maybe the hard feelings aren’t worth making a loan, even if you can afford it.

**5. Truly help the borrower.** Maybe lending your child or family member money isn’t helping them. Is this just one more in a series of bail-outs? Is your support becoming perpetual? Is lending the money enabling harmful behaviour? Perhaps your family member needs to learn to live within their means. You might help them more by introducing them to a good financial planner who can help them budget.

**6. Put it in writing.** Formalize any loan arrangement by preparing a promissory note. This will ensure there are no misunderstandings about the terms of the loan and establishes that this is an important commitment – just as though a bank was lending the money.

## THE TAXATION

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**7. Charge interest on the loan.** If you lend money and the loan turns sour, you won't generally be able to claim any tax relief if it's a personal loan. But if you charge interest on the loan, you may be able to claim a capital loss if you can't collect. This capital loss can be applied against any capital gains in the year of the loss, in one of the three prior years, or any future year.

**8. Lend to a corporation for business.** If you're making a loan for business, consider lending to a small business corporation set up by the borrower. Why? If the loan goes sour, and the business becomes bankrupt or insolvent, you may be able to claim an "allowable business investment loss" (ABIL). An ABIL is equal to one half of the money you've lost by making the loan (or investing in the shares of the small business corporation). Unlike a capital loss, an ABIL can be claimed against any type of income on your tax return, not just capital gains. The rules are complex, so speak to a tax pro before making the loan.

**9. Deduct your interest costs.** If you borrow money that you in turn lend to someone else, you'll be able to deduct your interest costs provided you charge interest on the loan you make. It's not critical that the interest collected be equal to or more than the interest you pay (unless you're in Quebec, in which case your interest deduction may be limited to the income you earn when you make the loan).

**10. Forgiving the debt has implications.** If you forgive the debt upon your death, there are no negative tax implications to the borrower. But if you forgive it during your lifetime, it's possible that the borrower might, in a worst case scenario, have to include the amount of the loan in his or her income. Speak to a tax pro before forgiving debt to find out the implications.

Some of the comments around the psychological aspects of lending money to family come courtesy of the Financial Planning Standards Council and their interviewees (see [financialplanningforcanadians.ca](http://financialplanningforcanadians.ca)).

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