The Importance of Documenting Loans to Family Members for Estate and Medicaid Planning

With today's rising cost of living and uncertain economy, circumstances arise in which family members might need to rely on each other for financial assistance. Parents may decide to lend children money to help them buy a home, car or other large purchase, to get out of debt or to start a business or financial venture. Conversely, parents may need help from children in the event of a medical or other emergency. When providing a lending hand to a family member, it is important to document the loan. This can be done with promissory notes and other written agreements, mortgages, repayment schedules and records of repayments.

We frequently hear that people feel uncomfortable asking family members to document a loan. However, documenting the loan can be critical for estate planning and can provide protection for both the lender and borrower -- if a financial crisis arises or if, for instance, one of the parties to the transaction requires Medicaid benefits.

When preparing an estate plan, a parent who has loaned a child money may wish to forgive the loan, or the unpaid balance of the loan, at death. They may, instead, wish to make their other children "equal" by making a bequest to each of them of a sum equal to the loan or the unpaid balance of the loan that had been given to their sibling. Without evidence of the loan, and/or the remaining balance, it may be difficult or even impossible to comply with the Will's directions when administering the estate.

If a parent has borrowed money from a child with the expectation that it be repaid from their estate, documentation establishing the loan is required. The child is a "creditor" of the estate. Depending on the circumstances, it may be important to differentiate between the parent's estate assets and those assets that were loaned when valuing the estate.

If one of the parties to the loan requires Medicaid benefits, documentation supporting the existence of a loan is crucial. If the lender is applying for benefits, proof of the loan will avoid Medicaid's treating the transfer of money or other assets as a gift, resulting in a penalty to the applicant. On the other hand, if the applicant is the borrower, for instance, in circumstances where a child is paying parent's expenses, proof of the loan establishes that the child did not make a gift and pay those expenses out of "love and affection." Also, if the proceeds of the loan were deposited to the applicant's account, it will be important to demonstrate that the money is a loan and not part of the applicant's resources.

If you are planning to make or receive a loan from a family member, give us a call. We, at Berwitz & DiTata, will guide you regarding the documentation that will properly reflect the transaction.