



NEITHER A LENDER

NOR A BORROWER BE

Shakespeare (and later Benjamin Franklin in *Poor Richard's Almanac*) warned: “Neither a lender nor a borrower be; for loan often loses both itself and friend.” At the Legal Hotline we get occasional questions about how to recover money that was loaned to a relative and not paid back. Folks should call **before** such a loan, asking for advice about if it is a good idea, and how to best handle such a loan. While most of us end up being borrowers ourselves at some point, few of us have the financial ability to be a lender. We feel we just don’t have enough to take a chance, the way a bank does, to loan out money. But because of affection for our friends and family members, sometimes in a moment of weakness, we agree to make a loan. Sadly, we talk to callers who have been viewed as an easy mark by their children for a loan—a loan that perhaps the son or daughter was not capable of securing elsewhere. Unless you can easily afford to lose the money you are lending, it’s probably best to not make such loans; as

Shakespeare counseled, in addition to the very real risk you may not be paid back, the loan itself often negatively affects the relationship, leaving you on poor terms with the borrower. If legal action to collect on the loan is required, the relationship will almost assuredly be ruined.

If friends or family members prevail on you to the point you just can't say no, or you are in a position to help and are enthusiastic about doing so, here are some things the Hotline suggests you should think about for your own protection:

- The old axiom to “Get It In Writing” is just as true with respect to a promissory note as it is with other types of promises and agreements.

Although a verbal contract for a loan may be enforceable in a court of law, without something in writing there is bound to be dispute about the terms of the agreement, e.g. when it will be repaid or the amount of the interest rate.

You have the best chance at enforcing the agreement when it is in writing.

Although a borrower (especially a family member) may balk at the whole idea of a promissory note, it is best to have it in all cases. If the borrower resists the idea of an agreement (a possible warning sign), suggesting that your attorney told you that you needed the agreement in writing may get you off the hook in terms of looking like the “bad guy” to the borrower. It is best to have such a note prepared by an attorney, but something you might

be able to prepare yourself is certainly better than nothing. Putting the agreement to writing has another important benefit—it clearly indicates this is a matter to be taken seriously by both parties, and that it is not intended to be a gift.

- Diligent recordkeeping is a must to keep the repayment on track and provide both parties with the proof they need should the matter end up in a collection lawsuit. If the loan carries interest, the lender and borrower should periodically reconcile their accountings so that both are on the same page.
- The amount of interest you can charge on a loan to an individual is controlled by the Michigan Usury Law. It is quite restrictive and prohibits an interest rate of more than 7% per year, between individual persons, if the agreement is in writing. If it is not in writing, then the interest rate may not exceed 5%. Thus, depending on what interest rate you agree upon, another good reason for having the agreement in writing is that it allows for the higher rate. When you take money from your interest bearing account to loan it, it's only reasonable that you be compensated for the interest you are losing. Remember too that the IRS requires an interest rate (interest on a loan is income and taxable) on loans, to prohibit taxpayers from claiming they loaned a relative funds at no interest. Once more, having the agreement

in writing can save you a possible headache in dealings with the IRS.

(Understand that gifts can cause other kinds of problems. Don't be pressured into a "gift" that you don't really want to give or can't afford to make.)

- We've had calls from folks who made a loan to a married son or daughter without including their spouses. When push came to shove and legal action for collection was required, the borrower was able to shield assets from collection simply because the assets were held jointly with the spouse and therefore, under the law, not reachable. If the borrower is married, and the loan will benefit the joint interests of the couple, it's smart to have both the husband and the wife sign the note. This ensures that both will be liable together and separately. In the event collection action needs to be commenced, a judgment against both can be directed towards the assets they own jointly.
- It is not uncommon with these kinds of loans for the parties to act differently than what the agreement provides, e.g. let payments or interest slide. A sound promissory note should contain language that any changes to the note must be in writing and agreed to by both parties.

- With respect to repayment of the loan, make sure that the timing, frequency and repayment terms are set out clearly in the promissory note, and also that these are set up to be practical for the borrower, taking into account the borrower's circumstances and possibly an uncertain future.
- Inserting a clause into the loan agreement to ensure confidentiality makes sense to keep others from knowing the terms and then being in a position to cause trouble or want to get in on the act.

Callers to the Legal Hotline also contact us about problems that have occurred after they have co-signed a car or bank loan, or an apartment or automobile lease. A few callers have reported they only went to the car dealer with their grandson to “help” pick out a car. Then they were prevailed upon to be a co-signer. They reluctantly agreed. After the paperwork was signed, they walked out of the dealership being the vehicle's sole owner and sole party on the loan. When you co-sign a legal obligation you are not only letting someone use your good credit, you are obligating yourself to pay the indebtedness when the other party defaults. Avoid being a co-signer under any circumstances.

Attorneys at the Legal Hotline can answer questions you may have about making loans or loans for which you are indebted. You can call the Hotline

weekdays from 9-5 to set an appointment to have an attorney call you back, usually the same day. The Hotline is a nonprofit organization and all of our services are free.