

**Law Office of
DAVID M. HELLMAN**

851 Irwin St., Suite 205
San Rafael, CA 94901-3343
<http://www.davidhellman.com>

Telephone: (415) 457-4411
Facsimile: (415) 457-0356

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LOANS TO FAMILY MEMBERS

Many of you will find yourselves in a position where you want or need to loan money to a son, daughter, or other family member. Before you do, you need to carefully consider whether you can afford to lend the money and how the IRS will view the transaction. In addition, consider the effect on the relationship and the financial effect on yourself if the loan is not repaid or is not repaid in a timely manner. In other words, treat the decision to lend seriously.

Put it in writing: Make the deal as businesslike as possible. Be clear up front that for IRS purposes, a valid loan agreement is imperative, otherwise the IRS could argue that there was no loan at all – that the money you gave was really a gift.

Set an interest rate: If you set a rate that is lower than the Applicable Federal Rate (which is established by the Internal Revenue Service monthly), you may have to report income you never received and there could be gift tax consequences. If you charge a low interest rate, rather than no interest, the imputed interest is based on the difference between what you actually charge and the amount due, using the Applicable Federal Rate.

There are, however, two important exceptions to the “imputed-interest” rules. The first exception is for loans of \$10,000 or less. The second exception applies to loans up to \$100,000 and limits the imputed interest to the borrower’s “net investment income”. If that is \$1,000 or less, there is no imputed interest.. These exceptions are a bit confusing and you should contact a tax professional to explain how they might work in your situation.

Be careful -- *Loaning money to a family member is not something that should be done casually.* It can damage relationships between parents and children and between siblings. There are also income tax and estate planning problems. Given the complexity of the imputed interest rules and the related exceptions, it’s wise to work with a tax professional in structuring loans to family members.

DOCUMENT RETENTION

Clients frequently ask us how long they should keep documents. The following are basic guidelines for document retention.

Income tax returns should be kept indefinitely. Supporting documents such as cancelled checks, receipts and expense diaries should be kept for 4 years and then shredded. This would include correspondence from the IRS and state taxing agencies.

Real property – keep all documents until 4 years after you file the tax returns that report the sale of the property. This includes receipts for all improvements made to the property. It is easiest if you keep all

this material in one folder with a worksheet that contains a list beginning with the purchase cost and then lists each improvement. If it is rental property, keep all depreciation schedules for 4 years after you file the tax return that reports the sale of property.

Confirmations of stock, bond and mutual fund trades should be kept for 4 years after sale of the asset. This would include the annual record of reinvested dividends. Please also keep all stock option and employer stock purchase plan reports.

Deposit records for IRA and self employed retirement plan contributions should be kept until 4 years after all accounts have been depleted.

Paid bills (except tax related as indicated above) keep for 4 years.

Safeguard personal documents such as birth certificates, divorce and property settlement agreements, military discharge papers, pink slips for vehicles, bonds, estate tax returns of a deceased family member, organizational documents for business entities (partnership agreements, LLC Articles and Operating Agreements, Corporation Articles and Bylaws), deeds, insurance policies, and estate planning documents such as wills, powers of attorney and trust documents. These should be kept either in a safe deposit box or fireproof/burglar proof safe. Some documents are not valuable, but particularly hard to replace.

If you have a question about a specific document, get advice before shredding it.

SPECIFICALLY FOR SENIORS

If you “cruise the web” you might want to check out the website for the California State Bar Association, www.calbar.ca.gov and type in “Pamphlets” in the Search box. You may find something of interest which you can read on-line, print out or order for your own use, under several topic headings. This office has several copies of “Seniors and the Law” if you would like to drop by and pick up a copy, since it’s a 40 page download. We apologize that we cannot include the publication with our newsletter. You may also call (415) 538-2280 for information on ordering a copy.

TAX DUE ON INTERNET AND OUT-OF-STATE PURCHASES

If you purchase merchandise from a vendor located outside the state or the country, you may owe California use tax. This includes purchases you make over the Internet. When your income taxes are prepared, your tax preparer will be asking you if you made purchases outside of California because you can pay the use tax with your income tax return.

Use tax is like sales tax but you pay it directly to the state, rather than to the retailer. The rule of thumb is: You owe use tax if what you bought would have been subject to sales tax if you purchased it at a local store and you did not pay California sales tax. You generally owe California use tax when you use, store, or consume – in California – tangible personal property purchased from an out-of-state vendor. If the vendor does not collect the California tax on the purchase, the purchaser must pay the tax directly to the state. If you don’t report and pay your use tax in a timely manner, such as with your income tax return, the state will assess penalties and interest.

What is and is not subject to sales and use tax can be complicated. There are numerous exceptions to the rules, but here are some common ways that people make out-of-state purchases that are subject to use tax:

- Internet purchases
- Foreign purchases
- Shopping channel purchases
- Mail order purchases

These are some common examples of items subject to use tax:

- Clothing
- CDs and books
- Computers, cameras and other electronic equipment
- Toys
- Household items such as small appliances
- Makeup
- Over-the-counter medications
- Collectibles
- Jewelry
- Sports equipment
- Computer programs shipped on a disc

Items that are exempt from sales tax are also exempt from use tax. Here are a few examples:

- Music and other online media purchases for your iPod or MP3 player and transferred directly over the Internet.

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