Protect yourself while bailing out a relative in debt

by Craig Guillot on September 10, 2013

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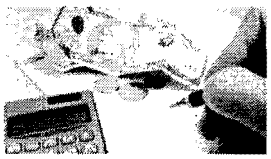

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You've taken the 4 steps to help a loved one in money trouble and now you want to offer financial support.

Before you start handing out cash, you need to set limits, establish a plan and ensure your money is going where it's supposed to go.

Follow our 5 smart moves and tread carefully.

Smart move 1. **Set your limit.**

Helping someone with money is saving someone from drowning. Don't think about doing it unless you can stay afloat yourself.

You'll want to examine your household income, expenses and cash flow to determine how much you can give. Then set a reasonable limit.

It can be a couple hundred bucks. It can be tens of thousands of dollars, depending on your financial situation. But any money you give should come from your discretionary income only.

Don't let emotion rule this decision. If you do, you risk helping your loved one at the expense of your own financial security, warns Bill Hammer, Jr., of Hammer Wealth Group in Melville, N.Y.

The last thing you want to do is go into debt or pull money from your retirement account.

Smart move 2. **Don't give cash.**

If your relative has financial problems, that's a sign they might not be able to manage money.

Blindly handing over cash or a check every month isn't going to help.

Larry Rosenthal, a certified financial planner with Rosenthal Wealth Management Group in Manassas, Va., says a better option is to offer to pay their creditors for them.

"It's better to pay bills directly," Rosenthal says. "Write the check not to them but to the utility company, credit card company or whoever it may be. People who are in these situations often don't put the money towards what they're supposed to."

If you want to help cover groceries, consider gift cards to grocery stores.

Smart move 3. **Consider a low-interest loan.**

Offering your loved one a loan may be another option.

If your relative pays 20% on a $10,000 credit card balance, you might be able to offer a personal loan at 5%.

That could save your loved one thousands in interest charges and would reduce minimum payments. You would also earn a return in the process.

But the big risk is you might not get paid back. If your relative got in trouble with debt once, it could happen again.

He may be more inclined to pay when you're the creditor, but you may also be more willing to cut some slack when payments are due.

Another risk is that while paying down what you're owed, your loved one could rack up debt. This is why it's important to maintain oversight over bills and account statements.

If you do offer a loan, there are government rules you must follow. Seek professional advice.

Smart move 4. **Don't put debts in your name.**

The debt is your relative's. Don't co-sign a loan or open a joint credit card.

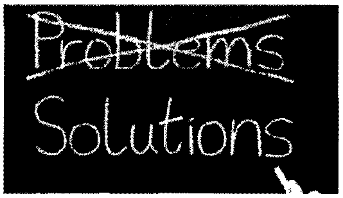
Doing so could damage your credit score and put you at risk financially.

A better option is to guide them to lower interest solutions.

Look toward home equity. Paying 6% on a home equity loan is a better option than paying 20% on credit card debt.

You'll have to maintain vigilance here. If your relative fails to repay the home equity loan, he or she risks losing the house to foreclosure.

If they don't own a home, have enough equity for a loan or have good enough credit to win a loan, other options could be to negotiate lower rates with credit card companies or seek the assistance of a debt counselor.



7 smart moves to boost your credit score:

- Correct any errors on your credit reports.
- Pay all your bills on time.
- Use every credit card you own.
- Pay down your credit card balances.
- Don't apply for credit on a whim.
- Have repaid debt removed from your credit history.
- Have someone add you to their card.

Smart move 5. **Bring in a professional.**

You should consider seeking the advice of a financial advisor, tax consultant or attorney.

There are many people who specialize in the transfer of assets and situations just like this.

If, for example, you give your relative more than $14,000 in a calendar year, you could trigger gift taxes. You'll want to consult an accountant so you can do it in a way to minimize the tax burden.

Document the transfers or donations you give and maintain records.

In some cases, an adult child or aging parent can also be claimed as a dependent on your tax return, assuming they meet the IRS criteria. This could net you some tax deductions and credits.

If the person having money problems is an aging parent, you'll also want to think about estate planning, says Michael Chadwick, a certified financial planner and CEO of Chadwick Financial Advisors in Unionville, Conn.

If there are assets to leave behind or you're the beneficiary of a life insurance policy, that could factor into your ability to offer financial assistance.

It may be helpful to know you might get something back when they're gone.

It sounds selfish, but you need to consider your own financial well-being. You, too, will get old someday and need to plan for your future.

You don't want to take money out of your retirement fund.

But if you're funding your own retirement, maybe you divert half of those savings to help your parent with the knowledge you'll be paid back through an inheritance.

Chadwick says it's a risky last resort.

He has seen cases where an adult child helps their parent expecting to inherit a house but they later end up having to drain the home of its equity.

You can minimize that risk by having the house or hard assets in your name.

"I think it's a fine thing to do but you have to build safeguards for yourself because it doesn't always play out with all the assets in place," Chadwick says.

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