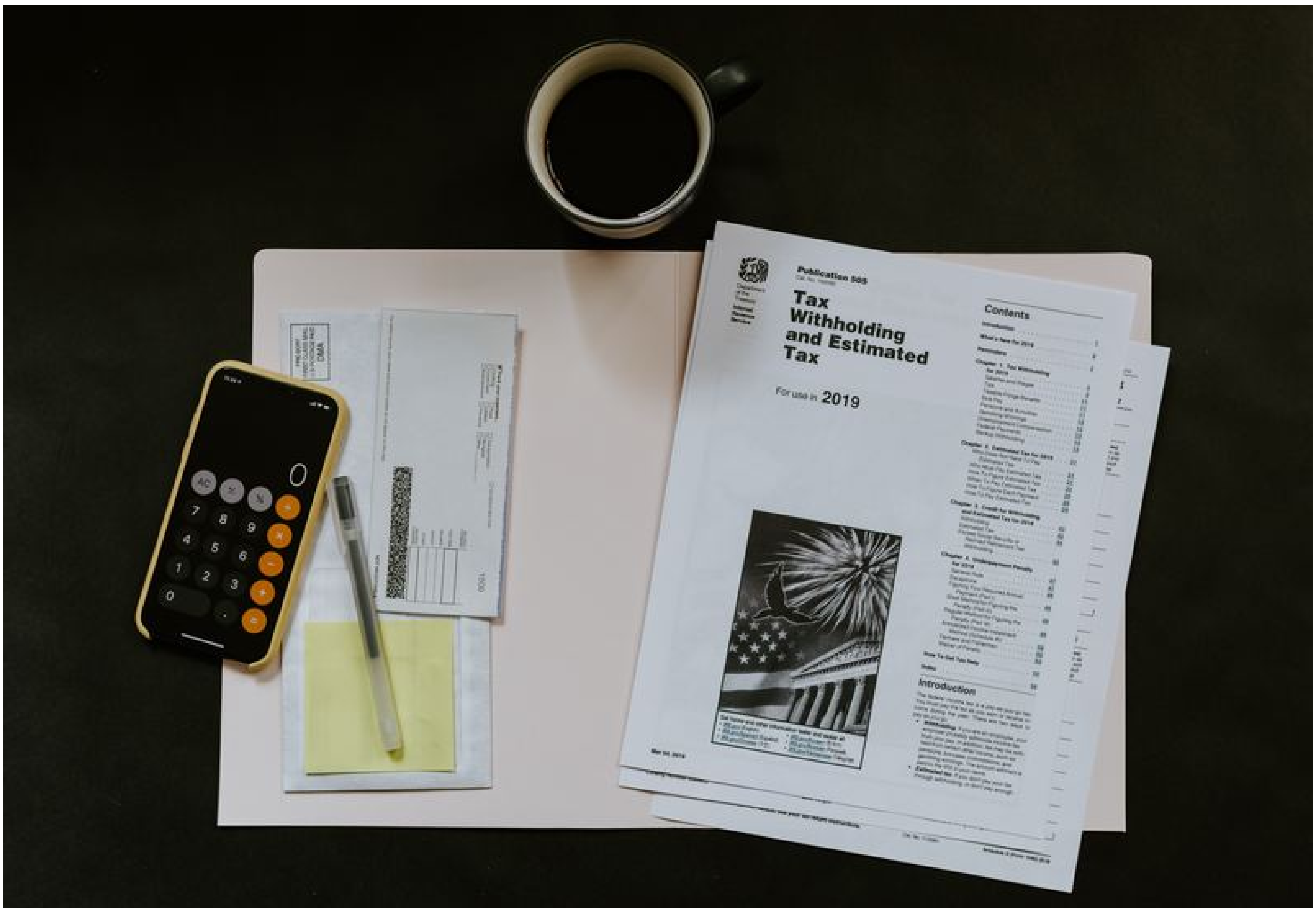
What Experts Say About Getting a Loan to Pay Taxes

Written by Ashley Lee | Last Updated February 24th, 2020

Ashley Lee is a Content Strategist for Best Company specializing in debt relief, tax relief, and student debt. She's been writing and editing professionally on topics such as finance and education for just under a decade. Ashley is enthusiastic about helping consumers get the information they need to make the best decisions possible.

Topics: DEALING WITH TAX DEBT TAX DEBT FACTS



It's tax preparation season: tax returns for 2019 are due on April 15. You might receive a refund after filing, but it's also possible you'll owe more taxes. But what happens if you can't afford to pay your income tax bill?

You might consider setting up an IRS payment plan or paying your taxes with a credit card. But what about taking out a loan?

Here's what the experts say about getting a loan to pay taxes.

When should you consider using a loan to pay taxes?

First, consider any options the IRS may offer for resolving your tax debt, such as an installment agreement or an offer in compromise, before turning to another lender.

"Getting a loan to pay taxes should be the absolute last resort, after going through the 'process' of options that taxing government agencies offer," says Anthony J. Viola, a CPA and senior partner at KVLSM.

If you don't have good credit, "the IRS might actually offer more affordable rates and terms," adds Anna Serio, loans writer for Finder. "Even if you have good credit, the longer terms that come with a personal loan can result in a higher overall cost, since it allows more time for interest to add up."

On the other hand, Serio continues, if you have good credit, you might pay less in interest on a personal loan than you would in fees for an IRS payment plan.

How does using a loan to pay taxes affect your credit score?

Ryan Guina, founder of The Military Wallet, warns that paying your tax debt by taking out a loan would have the same effect on your credit score as taking out any other unsecured loan.

Taking out the loan itself may not affect your credit score significantly, but other factors could.

"However, your credit score may take a hit if you have other underlying problems, such as not being able to make timely payments, or you have maxed out your line(s) of credit," Guina says.

If a potential lender uses a hard inquiry to check your credit score, that could hurt your credit at first, Serio confirms.

"But it can ultimately boost your credit by adding to your record of on-time repayments and diversifying the types of credit you have on file if you don't have any other loans in your name," Serio adds.

Furthermore, regularly making a monthly payment to the IRS "mostly just keeps your credit score from dropping," while making consistent payments on your loan will improve your credit score, explains Morgan Taylor, CMO for LetMeBank.

Sean Messier, a credit industry analyst with Credit Card Insider, agrees that consistently paying down your debt on time could improve your credit score.

"But, ultimately, the impact a loan has on your credit can vary based on your unique credit situation," Messier says.

What are the advantages and disadvantages of using a loan to pay taxes?

Taking out a loan to pay taxes is a good idea only if you know you'll be able to repay the loan quickly and if not paying your taxes on time would cause more financial trouble than the loan, according to Guina.

"This could come from IRS penalties, backup withholdings, or wage garnishments that could cause additional financial troubles for you," Guina says. "In general, it's best to avoid negative attention from the IRS."

Also be aware that taking out a loan to pay taxes might limit future debt you can accrue, such as for a student loan or home mortgage, Taylor warns.

If you do decide to use a loan to pay your unpaid taxes, Serio suggests prequalifying with more than one lender so you can compare the cost of both the monthly payment and other fees.

What options does the IRS offer for paying your taxes when you don't have the money to pay your tax debt?

If you owe less than $50,000, the IRS may agree to an installment agreement, according to Kathryn Dalli, a partner at Twomey, Latham, Shea, Kelley, Dubin & Quartararo.

"In most cases, a taxpayer would save money by choosing an IRS installment agreement over a personal loan," advises James Garvey, CEO of Self Financial, Inc.

And an IRS installment agreement comes with an additional advantage, says Dalli: "An installment agreement with the IRS would not appear on your credit report and would not affect your credit."

You can also apply for an offer in compromise, which allows you to settle your debt for a lower amount than you owe.

“Generally, you’ll need to prove that you owe more than you’re able to pay based on your income, assets, and living expenses,” Serio notes.

According to Serio, less than 50 percent of taxpayers who apply for an offer in compromise are accepted.

But no matter what, make sure you file your tax return on time.

“This will help you avoid penalties for failing to file your return,” Garvey says.

And taxing government agencies are less likely to work with taxpayers when there are open tax year filings and/or late tax filings, Viola adds.

“It’s never a good idea to borrow money you can’t afford to repay,” Garvey explains. “But defaulting on a personal loan will negatively impact your credit while defaulting on an IRS installment agreement can have more far-reaching consequences.”

What are other options for paying your tax debt?

The IRS doesn't accept direct credit card payments, but you can pay taxes with a credit card through an approved third-party payment processor.

"Those payment processors charge fees ranging up to a couple percent of the payment amount," Garvey says. "Plus, you’ll have to pay interest on the balance to your credit card company — usually at a higher rate than you’d pay with a personal loan or IRS installment agreement."

On the other hand, you might be able to find a credit card with an introductory 0 percent APR offer.

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"These credit cards allow you to carry a balance interest-fee for a set period of time," explains Messier. "As long as the full balance is paid by the time that period ends, you won’t have to pay a single cent in interest."

But also keep in mind that if you carry a high credit card balance for a long period of time, that could hurt your credit score.

Using the services of a tax relief company is another potential solution for dealing with your tax debt. Tax Defense Network, Optima Tax Relief, and Community Tax are currently some of the best tax relief companies on BestCompany.com.

What’s next?

The experts agree that using a loan to pay your tax debt isn’t a long-term fix.

"A loan is not a good solution if you aren't willing to change the underlying issues that caused you to owe the money to the IRS," Guina concludes.

Also keep in mind that tax debt often requires different solutions than other kinds of debt. If you’re looking for debt relief related to taxes, be sure to look for a specialized tax relief company rather than a more general debt relief company.

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