

Law North Limited  
The Meridian, 93 Kerikeri Road • Private Bag 1001, Kerikeri 0245 • Ph: 09-407 7099 • Fax: 09-407 7095  
E-mail: info@lawnorth.co.nz • www.LawNorth.co.nz

Welcome to the 8<sup>th</sup> issue of *Trust eSpeaking*. We hope you find the articles of interest. If you would like to talk further about any of the articles in this newsletter, or about trusts in general, then please do not hesitate to contact us.

### Loans and Capital Distributions to Beneficiaries

- Care is required in funding arrangements

### Trust Busting

- Courts can overturn property transfers to trusts

### Keeping your Trust in Order

- Health check for trusts

**Warning:** 31 March 2009 is fast approaching. If your trust has a balance date of 31 March then we recommend supplying your trust's accountant with all the information required to enable preparation of financial accounts for your trust as soon as possible after 31 March. This is particularly helpful in the event that your trust intends distributing income to beneficiaries prior to 30 September 2009.

*If you do not want to receive this newsletter, please [unsubscribe](#).*

**Disclaimer:**

All the information published in *Trust eSpeaking* is true and accurate to the best of the publisher's knowledge and should not be a substitute for professional advice. No liability is assumed by this firm for any losses suffered by any person relying directly or indirectly on this newsletter. Articles appearing in *Trust eSpeaking* may not be reproduced without prior approval of the editor and credit being given to the source.  
©2009. Editor: Adrienne Olsen, email: [olsen@sorensengroup.co.nz](mailto:olsen@sorensengroup.co.nz)

## **Loans and Capital Distributions to Beneficiaries - Care is required in funding arrangements**

*In the last issue of Trust eSpeaking (September 2008), we discussed the scenario that often occurs when trustees provide funds to beneficiaries, for example, to help in the purchase of a house. This article further develops that theme, and considers how the funds made available to a beneficiary should be treated and, in particular, whether they should be provided by either a capital distribution or a loan.*

A capital distribution, by its very nature, represents the absolute transfer of capital from the trust to the beneficiary with the trust losing control of the funds once they have been distributed. As the ownership of the funds has changed the capital is at risk of being treated as relationship property (and ultimately lost).

We recommend that, in most instances, the trust should lend funds to a beneficiary and ensure appropriate documentation is completed. If the beneficiary and their partner do separate, then the trust can demand repayment of the loan. When the loan is repaid, the funds would be held once again by the trust and could be dealt with at that stage in any way that the trustees thought appropriate, including re-advancing the funds to the beneficiary.

### **Loan documentation**

If trust funds are lent to a beneficiary, trustees must decide on how the trust should document the loan. The most likely methods are either to obtain a mortgage which would normally be registered against the title to the property being purchased, or to execute a deed of acknowledgement of debt.

If the funds are secured by a mortgage, then there is more security provided to the trust, subject of course to the value of the property. If the funds are secured by a deed of acknowledgement of debt (which is frequently the option chosen), then there is very little or no security provided. It is important that trustees discuss with their lawyer the type of loan documentation and security required.

### **Lender's requirements**

If funds are lent, rather than the trustees agreeing to a capital distribution, there is an additional factor that may complicate matters. When a lender (most likely a bank) considers a loan application, it assesses the purchaser's equity being contributed to the purchase. Many lenders will not treat trust loans as comprising part of a purchaser's cash contribution, or equity, towards a purchase. In other words the lender will frequently treat trust advances as being further advances even if no interest is to be charged, and the lender may decline the loan application as the purchaser has contributed insufficient cash. In order to agree to the loan, a lender may require that the trust's transfer of funds to a beneficiary be an absolute transfer, that is a capital distribution rather than a loan. However, as stated above, a capital distribution has property relationship division consequences.

It is strongly recommended that any sale and purchase agreement for a property be conditional on finance, and the financial condition in the agreement not be confirmed as having been satisfied until the lender's loan offer has been carefully read and approved.

In summary, there are various options available for trustees to help beneficiaries purchase property. If you as a trustee want to help a beneficiary, then please consult us before doing anything.

## Trust Busting

### - Courts can overturn property transfers to trusts

*There is considerable power held by the courts to make orders under the Property (Relationships) Act 1976 (PRA) if relationship property has been transferred to trustees. Court orders can sometimes be made to set aside the transfer of property to the trustees (effectively reversing it), and/or compensation may be awarded to the 'other spouse' for loss of the property; or the terms of the trust itself may be altered. These powers are commonly referred to as "trust busting".*

Where a property owner both intends, and achieves, the transfer of relationship property to a trust in a way that defeats the claims of the other spouse the court can set that transfer aside. Let's look at a scenario with Sue and John who have recently separated.

#### Relationship property rights

The family home is in Sue's sole name, although her partner John has lived in it with Sue for a number of years. Sue has transferred the family home into a trust which excludes John as a beneficiary. John is livid and wants to get the transfer reversed, or at least equivalent compensation paid. John has to prove that he has relationship property rights over the home, which have been lost because of the transfer, and also that Sue intended him to lose those rights.

If compensation is ordered Sue may have to pay it from her own, otherwise separate, property. This separate property maybe money she inherited or had before the relationship began. Alternatively the court may order compensation to be paid from other relationship property, or for the trustees to pay income from the trust to John for a specific period or until he had been paid up to a specific threshold.

If the trustees had bought the family home from a third party, rather than acquiring it by transfer from Sue, they may have escaped these court powers because no actual transfer of property would have taken place and the court only has these powers where a transfer occurs.

If the purchase was of a property not used as the family home (eg: a rental investment) and if it was self-funding then no relationship property would have been put towards it. In that case the trustees would almost certainly succeed in avoiding John making a claim against it.

The courts have the power to insist that both spouses disclose all information about transfers to trusts, so any records showing Sue's intentions at the time of planning the transfer can put into evidence in court. These records might include her lawyer or accountant's file notes, or the bank manager's records relating to her mortgage application.

#### The PRA

As far as the PRA is concerned, it has retrospective effect and no end date. Therefore transfers made before the PRA was enacted are caught, as are transfers made after the end of a relationship.

Compensation is available to a 'spurned spouse' even if the family home had been in joint names and John co-operated in putting the house into the trust as long as Sue had the necessary intention and was successful in defeating his relationship property rights by way of the transfer. It seems odd, but couples do sometimes transfer their family homes to a trust that is effectively controlled by just one of them, and that can be enough to meet this criteria.

If John can't prove that Sue had the necessary intention to exclude him, he may still be able to bring a claim as long as only his rights were defeated by the transfer. If Sue's relationship property rights were also defeated he would have a much harder job bringing any claim for compensation. Technically Sue's relationship property rights would have been defeated if the family home was transferred to a trust effectively controlled by her as her rights have been converted from relationship property rights to beneficiary rights.

Unless the trust was established under a Will the courts have the power to vary the trust to give better effect to any order it has made under the PRA. So if the trust has no income to pay out to John the court may order the trustees to sell the house and repay any debt owed to the couple, so that a lump sum can be paid, or it may order the trustees to invest the trust fund in a way that produced income.

Trust busting techniques and provisions also exist outside of the PRA. It is a complex area of the law, so if you are unsure about any aspect of transferring assets into a trust, please give us a call.

## Keeping your Trust in Order - Health check for trusts

*Many people who have trusts blithely presume that once the trust is established, little more needs to be done. However, nothing could be further from the truth. A trust, as with any business enterprise, requires regular reviews, usually in consultation with your professional advisors.*

In these financially troubled times there is a greater chance your trust may come under scrutiny as we are seeing more business failures, bankruptcies, relationship break-ups, leaky building claims, and clients being pursued as guarantors of leases or supply contracts. It is therefore important to ensure your trust documentation is in order and robust enough to ensure it adequately protects your trust assets.

### Trust checklist

- Are you keeping good records by completing and filing trustees' resolutions detailing the decisions made by trustees?
- Do the trustees regularly review trust assets and liabilities?
- Where a trust has income, are the financial statements up to date and in order?
- Have all tax returns been filed and accounting matters completed?
- Is your gifting programme up to date?
- Do you have other assets you should be transferring to your trust?

### General Checklist

- Is your Will and the trust documentation aligned?
- Is it time to review your Memorandum of Wishes?
- Are the Deeds of Acknowledgement of Debt between you and your trust simple upon-demand documents, or are they more complex and contain the following:
  - The trust has a right to repay funds to you at any time without notice?
  - Does it have provisions which provide only you and your personal representatives can make demand? (You want to avoid the Official Assignee on bankruptcy having this right.)
  - Covers future advances, also which may or may not have been documented?
- Do you have an Enduring Power of Attorney that covers Personal Care and Welfare, and Property?

Most of us tend only to take action when we are forced to do so. In many cases this is too late with trusts.

We recommend that you arrange a review of your trust and other related documents to ensure that your trust affairs are current, and would survive any challenge.