

# Relationship Property and Trusts

By: Gerald Nation

Published: 10/10/2010 |

The thinking behind the Property (Relationships) Act 1976 ("the Act") is that marriages and de facto relationships of more than three years are a partnership. Partners in the normal course of events contribute equally, often in different ways. Economic contributions are not to be valued higher than non-financial contributions. As a result it is the policy of this legislation that the wealth accumulated in the relationship should be shared equally when the relationship ends, whether it be through separation or through the death of one of the partners.

However, it is relationship property which is shared equally. Relationship property is defined in the Act but generally includes the home, chattels in the home, cars and boats and family chattels like that, and assets that have been acquired as a result of what the partners have been doing during the marriage or relationship<sup>[1]</sup>. Consistent with the policy of the Act assets that someone ends up with which were acquired independently of the relationship are classified as separate property and are not shared equally<sup>[2]</sup>. So assets that are owned by one party before the relationship begins or new assets acquired out of those original assets will be separate property. Assets which are inherited and which are kept separate, not intermingled with relationship property and not invested in the family home will remain as separate property<sup>[3]</sup>.

Property acquired as a beneficiary under a trust is separate property. So are the proceeds of the disposition of that property or property acquired out of a distribution from a trust unless, with the express or implied consent of the person who received it, that separate property becomes so intermingled with other relationship property that it is unreasonable or impracticable to regard that property or those proceeds as separate property<sup>[4]</sup>.

Since the Matrimonial Property Act was enacted in 1976 married couples have come to accept that legally this legislation will result in them having to share equally the wealth which they acquire as a result of their marriage. Since 2002 this has also become the expectation of de facto couples. Trusts can however be used and may have the effect of avoiding the sharing of wealth which accumulates during a marriage. That is because the Act does not provide for the automatic equal sharing of property owned by a trust.

We all know that trusts can be formed to provide protection against creditors. A trust can be used to facilitate succession planning and the transfer of assets from one generation to another. We know that accountants frequently recommend trusts because of some taxation advantage. Trusts are also used to protect assets from potential relationship property claims.

In advising our clients it is important to recognise that the transfer of assets from the personal ownership of say a husband and wife to their family trust may well affect their ultimate entitlements in respect of those assets, or future wealth which builds up within a trust based on what was initially transferred over to it. If a trust is created in a way which leaves just one party with the real control of the trust e.g. through being able to control the appointment and removal of trustees or through being able to decide as a trustee how trust assets are to be used this may well be to the disadvantage of the other partner.

For that reason it is important that if personally owned assets are to be transferred to a trust both parties are fully informed as to the relationship property implications of what they are doing and of the risks involved.

If the parties to a relationship are also to be fully and fairly informed as to what is happening during their relationship, they need to be aware of what the consequences might be if their business or financial affairs are organised in a way which means their wealth accumulates in a trust rather than in their personal names.

Take for example the situation where a company is set up to invest in property. The shares in the company are owned by a trust controlled by say the husband. The company borrows a significant amount from the bank, makes an initial property investment. The husband makes sure the investment is a success. The profit from it is invested in further property and so on until the company ends up with a valuable property portfolio. The shares in the company are all owned by the trust. That trust is largely controlled by the husband. We will assume that in building up that portfolio during the relationship he has worked hard with the support of his wife. After 30 years the marriage ends. The wealth has been accumulated during the marriage. Both parties have contributed to their marriage partnership in a normal way. It may come as a considerable shock to the wife in that situation to find that the wealth of that property portfolio is not relationship property. The shares in that property company are not owned by either her or her husband. They are not relationship property. The shares are owned by a trust. There is no legislation which requires the trust's wealth to be automatically shared equally or at all. Of course that may be just what the husband wanted.

Because trusts are so widely used in New Zealand, the accumulation of wealth within a trust frequently makes the settlement of relationship property claims on separation much more contentious, difficult and expensive than is the case when assets are owned by the parties personally. This is because the parties' entitlements are much less certain.

Where there is no agreement as to how trust assets should be dealt with, there are ways trust wealth can be accessed but they all have their limitations and uncertainties.

#### **The Act, Section 44**

Court can order the trustees to transfer property to someone or to pay compensation where property has been transferred to a trust "in order to defeat the claim or rights of any person under this Act" and the trustees received the property "otherwise than in good faith and for valuable or adequate consideration".

#### **The Act, Section 44C**

If, since the marriage or de facto relationship began either or both of the partners have disposed of relationship property to a trust, and that transfer "has the effect of defeating the claim or rights" of one of the partners the Court can:

- a. Order the other party to pay compensation or to transfer some other property to the party who has lost out;
- b. Order the trustees of the trust to pay compensation out of the income of the trust, provided that no third person has, in good faith, altered his or her position relying on the ability of the trustees to give them that income.

The right of the Court to make such an adjustment is discretionary both as to whether there is an adjustment and as to the extent of the adjustment.

#### **The Trust is a Sham**

If the trust's ownership of assets is a sham and the settlor of the trust (say, the husband) never intended to give up control of assets and in fact retained so much control and ownership of

the assets that the trust can be regarded as a fiction, the assets purportedly owned by that trust may legally be treated as still belonging to the husband so as to be relationship property.

"A sham will arise where a "trust" is created and is intended to appear to be a legitimate trust but is not intended to affect rights and obligations of the relevant parties in the way that a valid trust would..."[5]. In this sense, a sham trust is in fact no trust at all, merely the appearance of one used to disguise true ownership and control.

The absence of appropriate trustee minutes and other documents, lack of consultation between trustees, and failure to act properly as a trustee may be evidence a trust has always been a sham.

### **Bundle of Rights Argument**

Although it is a tentative and contentious potential development, it may be argued that one party's powers or rights in respect of a trust are themselves "property" or an asset which can be ascribed a real value which should be brought into account equally as relationship property and thus shared. For example, the rights of a settlor to convey his wishes to the trustees and have those wishes considered in the administration of the trust, the power to appoint or remove trustees or beneficiaries, the powers which one party may have as a trustee.

### **The Alter Ego Argument**

It may be argued that a trust is used and controlled by an individual to such an extent that the trust is regarded as an extension of that person and not as a separate person, eg as the alter ego of say the husband. In *Official Assignee v Wilson* [6] the Court of Appeal held the concept of the alter ego cannot be used to invalidate a trust so as to extinguish the rights of beneficiaries under a trust but the concept has been used in relationship property cases to justify a finding that trustees hold certain trust assets on a constructive trust for a claimant.

### **Constructive Trusts**

It may be argued that a husband or wife has a personal interest in an asset purportedly owned by the trust on the basis that, although that asset is owned by the trustees, they hold it under a constructive trust for the benefit of the claimant. A "constructive trust" is a trust which a Court will find exists based on the particular circumstances, case law, and equity.[7]

To establish a constructive trust in respect of property owned by someone else, the claimant must show:

- a. Contributions direct or indirect to the property in question.
- b. The expectation the claimant would thus have an interest in the property.
- c. Such expectation is a reasonable one.
- d. The owner of the property should reasonably expect to allow the claimant an interest.

"If the claimant can demonstrate each of the four points, equity will regard as unconscionable the defendant's denial of the claimant's interest and will impose a constructive trust accordingly".[8]

An allowable contribution to the property to establish a constructive trust will include any payment or service by the complainant which either (1) of itself assists in the acquisition, improvement or maintenance of the property or its value or (2) by its provision helps the other party acquire, improve or maintain the property or its value.

### **Section 182 Family Proceedings Act 1980**

The Family Proceedings Act deals with matters such as spousal maintenance and dissolution of marriage. It is not generally concerned with property rights.

Under section 182 of the Family Proceedings Act, within a reasonable time from the dissolution of a marriage a Family Court may enquire into any "ante-nuptial or post-nuptial

settlement" made on the parties and may make "such orders with reference to the application of the whole or any part of any property settled ... or the variation of the terms of any such settlement, either for the benefit of the children of the marriage or of the parties to the marriage or either of them as the court thinks fit".

Ward v Ward Court of Appeal[\[9\]](#)

- a. For this section to apply, the settlement or trust should provide for the financial benefit of one or other or both of the spouses as spouses and with reference to their married state.
- b. A discretionary family trust can be covered by section 182.
- c. A Court should decide to exercise a section 182 discretion with caution and only where, taking into account all relevant circumstances, it is necessary in the interests of fairness and justice to do so.
- d. The rights of third parties, particularly interests of the children, will remain an important consideration.

Ward v Ward Supreme Court[\[10\]](#)

- a. At first if a Court decides it is appropriate to exercise its discretion, this will not automatically result in a 50/50 split. The Courts recognise that in 2002 when it amended the Matrimonial Property Act 1976, Parliament chose not to alter the law to require trust wealth to be shared equally between partners in the same way as relationship property.
- b. The Court's jurisdiction under section 182 is "designed to restore the applicant's expectations of deriving benefit from the settlement trust to what they were when the trust was established. Section 182 exists to allow the court to permit a husband or wife to receive her reasonable expectation of benefiting from a trust and to ensure that he or she is not denied this because of the dissolution of the marriage".

### **Concluding Thoughts**

The establishment of a trust, the creation of wealth within a trust, and the transfer of personally owned assets to a trust should be of considerable significance to both parties to either a de facto relationship or a marriage. Usually it will be fair to both parties if they are fully informed as to what is occurring and the implications of this.

The use of a trust will change the ownership of assets. Owning property as a trustee is not the same as owning it personally.

Our relationship property legislation provides for the almost automatic equal sharing of personally owned relationship property. It does not provide for the automatic equal sharing of property owned by a trust. The transfer of personally owned assets to a trust, or the retention of wealth within a trust can thus significantly and detrimentally impact on a parties property entitlements at the end of a marriage. People should be aware of this when they enter into a marriage and family assets are retained within a trust or if a trust is used or established during a relationship.

If a marriage ends and substantial family wealth is held within trusts, all trustees will have to exercise particular care in meeting their responsibilities as trustees, considering the interests of all beneficiaries and in not allowing the trust assets to be used or administered solely at the behest of the settlor or just one of the trustees.

If a trust is established in a way which leaves the settlor with the same control and rights he would have had if he continued to own the trust assets personally then the trust may well be treated as a sham and will not then provide the benefits or protection for which it may have been created.

If a trust's ownership of assets is not recognised by accountants and lawyers in the way they deal with property transactions in trust or company accounts, or in the way they proceed in handling transactions involving trust assets, this may affect how trust assets are dealt with

later on separation. If they do not deal with the assets as trust assets, they may make it easier for an aggrieved party to get a share of trust assets.

Often the more transparent, fair and effective way of protecting assets from relationship property claims when this is what people want to achieve will be to enter into a Prenuptial or Contracting Out Agreement which the Act provides for.

---

[1] Property (Relationships) Act 1976 ("the Act") S8

[2] S9 and S10

[3] S10(2). See also S9A which provides that the non owning partner may have an entitlement in respect of increases in the value of separate property where they have made a direct or indirect contribution to the increase in value, or the increase in value can be attributed to the application of relationship property. S17 stipulates the non owning spouse may also be entitled to compensation if separate property has been sustained by the application of relationship property or the actions of the other partner.

[4] S10

[5] Equity and Trusts in New Zealand para 15.2 at pg 395

[6] 2008 2 NZLR 45

[7] Lankow v Rose 1995 1 NZLR 277

[8] Lankow v Rose Tipping J at pg 294

[9] 2009 27 FRNZ 742

[10] November 2009 NZSC 125

## **Wealth and the Property (Relationships) Act 1976**

By: Gerald Nation

Published: 11/03/2012

Since 1976 with marriages, and since 2002 with de facto relationships, Parliament has tried to give effect to the philosophy that these relationships are a partnership. Both parties contribute in different ways. All contributions in the end should be treated as being of equal value. When a relationship ends, the wealth acquired through that relationship should be shared equally.

Lawyers access judgments where Courts rule on property disputes that have arisen at the end of a relationship. These judgments show that often when a relationship ends, and significant wealth is held or controlled by just one of the parties, one side or the other will go to great lengths either to try and achieve a division of wealth that gives effect to that philosophy or to circumvent it. This can happen when a relationship ends with separation. It can also happen when a relationship ends with death. The dispute may then be between those who inherit from the person who has died and the spouse or partner who has survived.

Over recent years many of the most hard fought cases occur in situations where family wealth is not owned by the parties personally but by a family trust. It is common in New Zealand for major assets like a family farm, shares in companies owning investment properties or businesses, or other investments to be held by family trusts under the control of just one of the parties, often the husband. In such cases equal sharing of the wealth in that trust is not automatic but there are ways it can be achieved. There are also ways it can be resisted.

So there have been cases in which one party will claim property has been put into a trust to deliberately defeat entitlements under the Property (Relationships) Act. Claims can be made even when that may not have been the intention but assets have been put into trust so as to have that effect. There is certain legislation which allows the Court to dismantle trusts when a marriage has been dissolved. Claims may be made against trust assets when someone has worked on property or played their part in a long term relationship with the expectation and belief the couple would be benefiting equally from the wealth held by a trust.

There can also be significant wealth in the earning ability of one of the parties on separation. The highly paid company executive, medical specialist, accountant or other professional, may be part of a business, partnership or practice which assures them of a high income in future years. Is such an earning ability to be treated as an asset for division or should the future earnings be regarded as simply the reward which that person will get from his personal work and efforts after separation?

Judges have held there can be value in a husband's interest in a partnership which carries with it the right to share in significant profits even where the partnership agreement says no partner can sell his or her right to participate in those profits and where on retirement from the partnership that partner may receive nothing. There may be a capital value in a doctor's practice because of the way District Health Boards provide bulk funding for enrolled patients. Because of potential tax advantages, accountants have often encouraged professionals to set up companies so that some of their earnings can be paid to them as a salary from a company while other profits are retained within those companies. In doing so capital assets, e.g. shares, may be created and become an item of relationship property which on separation has to be shared equally.

Working out strict legal entitlements in these situations is not straightforward. When there is conflict over just what is the wealth to be shared, the financial stakes and costs of conflict can be high. When the potential for such conflict arises, constructive, well informed advice from the outset can make all the difference to both the ultimate outcome and the costs that might be incurred in getting there.

There are also situations where one or both parties to a relationship have never believed that the wealth associated with their relationship should be shared equally. It may be because a major part of the capital, say a farm, has been inherited. It may be because each has come to the relationship with substantial assets already and they want to keep those assets for separate families. There may be situations where people want to be in a relationship where they are upfront in saying that what he earns and owns will be his, what she owns and earns will be hers without any sharing. It may be that someone will want to ensure wealth is in a trust so that it will not have to be halved or diminished because of a major breakup. There may be situations where one party to a relationship honestly believes they have such extraordinary ability, energy and ambition that they should be able to keep for themselves the financial rewards that come from all these attributes and that providing support in running a home and caring for children leaving them free to build up wealth should not be treated as being of equal value. There are legitimate steps which can be taken to give effect to these different aspirations. Parliament recognised that people should have the freedom to make their own arrangements. The completion of a pre nuptial or contracting out agreement is a step which can be taken to implement expectations which do not fit with the ideals behind the Property (Relationships) Act.

The cases show that arrangements or agreements made to implement a different philosophy are more likely to stand the tests of time and challenge when they have been designed by lawyers who have a real knowledge of the different ways in which the law may require wealth to be shared when a relationship ends, whether it be because of separation or when one party dies. For those wanting to avoid equal sharing of family wealth, the investment in good advice right at the outset will be worthwhile. That advice will also be the more valuable when through knowledge and experience there can also be observations as to how such arrangements may impact on other longer term aspirations for a relationship. The issues are not straightforward.