Part G – What should happen to property held on trust?

Chapter 20 – Trusts

Introduction

20.1 Part G addresses the intersection between the PRA and the laws governing trusts. Parliament has sought a balance between the division of relationship property under the PRA and the rules that apply to property held on trusts. This part considers whether the right balance has been struck between enabling a just division of property and the preservation of trusts.

20.2 In this chapter we describe what a trust is and why New Zealanders use trusts to hold property. We then examine how the PRA and the wider law apply when property is held on trust. In particular, we look at the legal remedies available to a partner to seek an interest in the trust property at the end of a relationship. The rest of Part G is arranged as follows:

(a) In Chapter 21 we discuss how problems may arise when partners come to divide their property at the end of a relationship and a trust is involved. We look at how a trust can frustrate the just division of property under the PRA. We also examine the interplay between the PRA and the other remedies outside the PRA in respect of trusts.

(b) In Chapter 22 we suggest some possible options for reform.

20.3 This part focuses mainly on the ways trusts can interfere with the division of the partners' property when a relationship ends on separation. If one partner to a relationship dies, the surviving partner may elect to divide the couple's property under the PRA rather than accept whatever provision is made in the will. The rules that apply to relationships ending on death are discussed in Part M. Many of the same issues discussed in this part may, however, arise if a surviving partner elects to divide property under the PRA.

The use of trusts in New Zealand

20.4 New Zealand has one of the highest numbers of trusts in the world as a proportion of its population. The Law Commission has previously estimated there may be anything between 300,000 to 500,000 trusts in New Zealand.[1] In the 2013 Census, 14.8 per cent of households reported that their home was held on trust.[2] In 2015, Statistics New Zealand found that 19 per cent of households had involvement with a trust, meaning at least one member of the household was involved as a settlor, beneficiary or trustee.[3] Cron described New Zealand's use of trusts in these words:[4]

> *The growth of trusts in New Zealand over the past two decades has been nothing short of phenomenal. Trusts seem to be on par with motor vehicles – every family has one and in some cases two.*

20.5 Widespread use of trusts is potentially a big issue because as a general rule, property held on trust is not divided equally between the partners when the relationship ends. Instead, when someone places his or her property on trust (sometimes referred to as "settling" the property on trust), he or she passes legal ownership of the trust property to the trustees. As a result, the trust property is only divisible to the extent each partner is said to be the beneficial owner of the property. The effect of these rules is that the PRA has no application to a lot of the property used and enjoyed by New Zealand families.

20.6 Many people argue that the PRA should deal with trusts more effectively. Apart from some limited changes made by the 2001 amendments, the PRA's application to trusts has remained largely unchanged. The debate has intensified in recent years as disputes over trust property have gone to court, resulting in several significant developments in the law.[5]

20.7 In 2013, the Law Commission released its final Report in a project reviewing the law of trusts, including the relationship between

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1 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [2.3].

2 Statistics New Zealand *2013 Census QuickStats About Housing* (March 2014) at 12.

3 Statistics New Zealand *Household Net Worth Statistics: Year ended July 2015* (June 2016). The survey excluded independent trustees.

4 J Cron *Family Trusts in New Zealand* (Penguin Books, North Shore, 2010) at 9.

5 See for example *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551; *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590; and *Vervoort v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807.

the PRA and trusts.[6] During the project the Commission invited submissions on that issue and the majority of submitters believed that the PRA is ineffective at dealing with trusts.[7] Some submitters said that the PRA did not produce a just division of property. They said that the courts needed greater powers to deal with property held on trust.[8] In spite of these responses, the Commission was cautious about proposing changes to the PRA because relationship property law was broader and involved different considerations to trust law, which was then the Commission's focus.[9] A comprehensive review of the PRA's relationship with trusts was left for another day.

What is a trust?

20.8 At a basic level a trust is a legal relationship in which the owner of property holds and deals with that property for the benefit of certain persons or for a particular purpose.[10] The person who establishes the trust and provides the initial property is called the settlor. The person who receives the property from the settlor to hold on trust is called a trustee.[11] The individuals who will receive the benefit of the property are beneficiaries.[12] The property held on trust is called trust property. Trust property can be most forms of property provided there is enough certainty about what property is the trust property. Trust property may therefore be land, a sum of money or shares in a company.

20.9 The law that applies to trusts distinguishes between the *legal* owner of the trust property and the *equitable* owner of the trust property. The legal owner is the trustee. For instance, if the trust property comprises land, the trustee will be recorded as the registered proprietor of the land in the land register. As the trustee must hold the trust property for the benefit of the

6 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013).

7 Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [17.2].

8 Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [17.2].

9 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.2].

10 This definition is taken from the Law Commission's formulation of the essential characteristics of a trust as set out in our final report: Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at R1 p 86. We based the formulation on the widely accepted definition in David J Hayton, Paul Matthews and Charles Mitchell *Underhill and Hayton Law of Trusts and Trustees* (17th ed, LexisNexis, London, 2007) at [1.1]. The Trusts Bill currently before Parliament provides that a trust has the characteristic of being a fiduciary relationship in which the trustee holds or deals with property for the benefit of the beneficiary or for a permitted purpose: Trusts Bill 2017 (290-1), cl 13(a).

11 It is possible for a settlor to also be the trustee. The settlor can declare that he or she holds the property on trust without transferring the property to a third party.

12 It is possible for a settlor and/or a trustee to be a beneficiary. But he or she cannot be the only beneficiary.

beneficiaries, the trustee is not the equitable owner. Instead, the equitable owners (or beneficial owners) of the trust property are usually the beneficiaries.[13] A beneficiary's entitlement to the trust property will depend on the nature of his or her interest under the trust.

20.10 The law imposes duties on trustees to act in the best interests of the beneficiaries. Trustees are required, among other things, to act in accordance with the terms of the trust, to avoid conflicts of interest, and to act honestly and in good faith.[14]

20.11 The most common form of trust is an express trust. This is a trust which has been expressly established by the settlor. The trust instrument identifies or explains the method for identifying the trustees, the trust property and the beneficiaries.[15] Most trusts used by families in New Zealand are express trusts. There are different types of interest that a beneficiary can have in a trust.[16] The most common are summarised below.

Discretionary interests

20.12 Often the trust deed gives the trustees or other specific individuals a power to decide how to distribute the trust's property to the beneficiaries.[17] The trustee may then determine when and to who (amongst the beneficiaries) to give the trust property. In such cases the beneficiaries have a discretionary interest and the trust is usually known as a "discretionary trust."

Vested interests

20.13 A vested interest gives the beneficiary an absolute right to the use and enjoyment of the trust property and does not depend on the

13 It is possible that the equitable estate of the trust property will not be held by the beneficiaries. This may be the case in a purpose trust or charitable trust. There is also debate on where the equitable estate of the trust property is to be found when the trustee has discretion to appoint the property to any beneficiary.

14 There has been some debate regarding a trustee's duties and to what extent they can be excluded by the trust instrument. The Trusts Bill currently before Parliament sets out mandatory trustee duties that cannot be excluded by the trust instrument: Trusts Bill 2017 290-1, cls 22–26.

15 See Andrew Butler "The Trust Concept, Classification and Interpretation" in Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 43 at 69–84. Not all trusts have a document that records the terms of the trust. An express trust can arise by virtue of the settlor declaring that he or she holds the property on trust for the beneficiaries. See for example *S v S* [2012] NZFC 2685 where the settlor declared that he held some paintings hanging in his house on trust for his children. Some trusts, like constructive trusts, will arise by operation of the law and so will not have documents which set out the term of the trust.

16 The complexities are illustrated by Tipping J's decision in *Johns v Johns* [2004] 3 NZLR 202 (CA) at [46].

17 Such a power is called a power of appointment. If the holder of the power has discretion to appoint the trust property to any person, including himself or herself, it is known as a general power of appointment.

trustee's discretion. For example, if money is held on trust and the beneficiary has an interest vested in both interest and possession, then the beneficiary can ask the trustee to transfer the money to him or her.[18]

Contingent interests

20.14 A contingent interest arises where the vesting and possession of the interest depend on the satisfaction of a condition.[19] For example, a trust deed may state that the trustees are to hold the trust property for 20 years. During that 20 year period, the trustees may distribute the trust income to the discretionary beneficiaries. At the end of the 20 year period, the deed may require the trustees to distribute any residual trust property to certain named beneficiaries. These beneficiaries[20] have a contingent interest because their interest depends on them being alive at the end of the 20 year period and trust property being available for distribution.

Trusts used by New Zealand families

20.15 There is very little official information on how trusts are typically structured in New Zealand. There is no official register that lists all trusts,[21] unlike companies or other incorporated entities which must register their formation documents.[22] In any event, the structure of trusts used by families in New Zealand is likely to vary according to the needs of the family and the professional

18 There is a distinction between interests that are vested in interest and interests that are vested in possession. If a beneficiary's interest is vested in interest but not possession, the extent of the beneficiary's interest is determined, but he or she is not yet entitled to possession of the interest. For example, a trust deed might provide that a beneficiary is entitled to $1,000 when he or she reaches the age of 21. In that scenario, the extent of the beneficiary's interest is determined as $1,000 so it is vested in interest. It cannot, however, be enjoyed until the beneficiary reaches the age of 21 so the beneficiary's interest is yet to vest in possession.

19 *Johns v Johns* [2004] 3 NZLR 202 (CA) at [47]; and Jeff Kenny & Jared Ormsby "Powers of Appointment and Powers of Advancement: What Every Lawyer Needs to Know" (paper presented to New Zealand Law Society Trusts Conference, June 2011) at 177.

20 These beneficiaries are often called by different names, such as "final beneficiaries", "residual beneficiaries" or "capital beneficiaries".

21 Law Commission *Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts Fifth Issues Paper* (NZLC IP28, 2011) at [9.6]–[9.7]. The trustees are only required to file tax returns in respect of the trust if the trust is engaged in taxable activity. It is thought that a significant number of trusts are used simply to hold assets such as houses and farm property. Those trusts would not need to register with the Inland Revenue Department. Recently, however, the Land Transfer Amendment Act 2015 has introduced a requirement for trusts to obtain an IRD number and file a tax statement when completing a transfer of land: Land Transfer Act 1952, ss 156B and 156C. These measures only apply to transactions where the contract for the sale and purchase of land was entered after 1 October 2015.

22 This is one of the central attractions of trusts: to keep financial affairs confidential.

advice given to them.[23] The structure will also differ from trusts used in other areas. For example, a charitable trust is different to a trust used to hold the family home.

20.16 Nevertheless, we have observed some recurring characteristics from our review of cases and literature, and our consultations with trust experts.

20.17 Before describing these characteristics, we wish to address terminology. In this part we will sometimes use the term "family trust" to refer to an express trust that families in New Zealand commonly use. Several other commentators use this description.[24] We use the phrase purely for convenience. By terming a trust a family trust, we are not implying any particular legal categorisation. Rather a family trust will usually bear the legal characteristics we discuss in the following paragraphs.

20.18 Family trusts are usually discretionary trusts. The deed will then state what happens when the trust comes to an end. A common provision requires all remaining trust property to be distributed to the named beneficiaries.[25] The trust therefore has beneficiaries with discretionary interests and beneficiaries with contingent interests.

20.19 We have also seen that some trust deeds contain provisions that allow the settlor(s) to retain control over the trust.[26] For example, the trust deed may give the settlor the power to appoint or remove trustees. The trust deed might also give the settlor the power to add or remove any of the beneficiaries, producing even greater control over the trust.

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23 Over the years there have also been trends in the way trust deeds have been drafted. Often the trends reflect the tax and legal context in which the trust is designed to operate. A good example is the phenomenon of mirror trusts. Mirror trusts were used by partners as a means of avoiding gift duty. In 1983 the Estate and Gift Duties Act 1968 was amended to allow partners to transfer up to 50 percent of their property to each other pursuant to a contracting out agreement under the then Matrimonial Property Act 1967 without incurring gift duty. The practice emerged of partners receiving a transfer of the property and then each partner would settle the property on trust. Under the trust the other partner would be named as beneficiary along with the partners' children. These types of trusts were known as mirror trusts as the trust each partner settled would be in exactly the same terms for the benefit of the other partner. The ultimate goal of the mirror trust structure was to allow both partners to use and enjoy the whole of their assets through the trusts without attracting gift duty. See WM Patterson "When is a Trust a Trust?" (paper presented to Legal Research Foundation Seminar "A Modern Law of Trusts", Auckland, 28 August 2009) at 4.

24 See for example Andrew Butler "The Trust Concept, Classification and Interpretation" in Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 43 at 62.

25 The law provides that an interest must vest within 80 years or the lifetime of a relevant person plus 21 years. In other words, a trust cannot operate beyond this period. This is known as the rule against perpetuities. It is common for a trust deed to prescribe the lifespan of a trust by specifying a date at which all residual trust property must vest in the beneficiaries. This is sometimes termed the "vesting date" or "date of distribution" in trust deeds.

26 Butler explains that a major attraction of trusts is that the settlor can retain considerable de facto control over, and benefit from, the trust property: Andrew Butler "The Trust Concept, Classification and Interpretation" in Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 43 at 62.

20.20 To explain how a typical family trust might look, we have used the example of Kim.

Case study: The K Family Trust[27]

In 1998 Kim bought a house. Kim's lawyer advised her to set up a trust to hold the house. In July 1999 Kim executed a deed and established the K Family Trust. The trust deed provides that:

a. The trustees of the K Family Trust are Kim and her accountant.

b. Kim has the power to appoint or remove trustees.

c. The beneficiaries of the K Family Trust are Kim, her spouse, and her children.

d. Kim has the power to appoint new beneficiaries and remove existing beneficiaries.

e. The K Family Trust runs until 27 July 2079.

f. Before 27 July 2079, the trustees can distribute the trust property to any of the beneficiaries as the trustees shall decide.

g. On 27 July 2079, the trustees must distribute any remaining trust property equally between Kim's children.

Shortly after the trust deed is executed, Kim transfers the house to the trustees to be held on the K Family Trust.

In this scenario, Kim, her husband and her children have a **discretionary beneficial interest** under the K Family Trust.

Kim's children also have a **contingent beneficial interest** under the K Family Trust.

27 The following example is based loosely on the trust that was the subject of the Court of Appeal case *N v N* [2005] 3 NZLR 46 (CA). The terms of the trust deed are set out in the High Court judgment *N v N* [2003] NZFLR 740 (HC) at [19].

Kim has control over the trust property (the house) as she is a trustee with discretion to distribute property to the beneficiaries. She also has power to appoint and remove beneficiaries.

Why do New Zealand families use trusts?

20.21 The proportion of New Zealand families that use trusts exceeds that of comparable jurisdictions, such as the United Kingdom, Australia and Canada.[28] The reason New Zealanders rely so heavily on trusts is mainly due to New Zealand's tax and legal landscape from the 1950s onwards.[29]

20.22 We think that one reason New Zealand families use trusts is to protect assets from a claim under the PRA. This is because property held on a discretionary trust is largely excluded from the PRA's equal sharing regime. Trusts have therefore emerged as a way for partners to keep property separate when they enter relationships. We have been told that it is common for people entering second or subsequent relationships to want to protect property from potential claims of their new partner, particularly if they want to preserve the assets for the benefit of the children of a former relationship. We have also been told that trusts are often perceived as a more suitable way of excluding assets from the PRA rather than contracting out agreements.[30]

20.23 There are other reasons New Zealanders have set up trusts, including to:[31]

(a) shield assets from creditors;[32]

28 Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010) at [1.13].

29 Some of this history was traced by the Law Commission in Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010); and Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts Second Issues Paper* (NZLC IP20, 2010).

30 Consultees have told us that trusts are often preferred to contracting out agreements for a number of reasons. First, a trust may be settled before a subsequent relationship is contemplated. A contracting out agreement may only be entered with a prospective or current partner. Second, a partner may unilaterally settle a trust. A contracting out agreement, on the other hand, is more likely to prompt awkward conversations between the partners. Third, contracting out agreements are perceived to be more vulnerable to challenge as the court may set them aside under s 21J of the Property (Relationships) Act 1976 on the grounds they cause a serious injustice. Nicola Peart has discussed the reasons why partners prefer trusts over contracting out. See Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2016) 47 VUWLR 443 at 460.

31 To research the motivations behind the use of trusts in New Zealand, we have relied on WM Patterson "When is a Trust a Trust?" (paper presented to Legal Research Foundation Seminar "A Modern Law of Trusts", Auckland, 28 August 2009). We have also searched the websites of over 40 professional trustee companies, law firms, accountancy practices and community advice bodies for the reasons they give for establishing trusts. The reasons summarised in this paragraph are consistently identified on these websites.

32 A person may settle assets on trust yet retain considerable control and benefit from those assets. If the settlor has only a discretionary beneficial interest in the trust, he or she is deemed to have no property interest in the assets. Only in exceptional cases, such as fraud, can the trust assets be claimed by the settlor's creditors. Professional advisers have therefore recommended that families establish trusts to protect key family assets from liability to creditors.

(b) provide a means of intergenerational transfers of wealth;[33]

(c) manage property for someone who is unable to manage his or her own affairs (for example a minor or person suffering mental incapacity);

(d) put property aside for specific purposes (for example, for a child's education);

(e) avoid estate duty and gift duty;

(f) minimise taxable income;[34] and

(g) qualify for residential care home subsidies.[35]

20.24 Many of these reasons no longer apply. Estate duty and gift duty have now been abolished.[36] Likewise, tax laws have been tightened to prevent tax payers from redirecting income through a trust to take advantage of more favourable tax rates.[37] A person's ability to use a trust as a means of qualifying for residential care subsidies has also been largely limited by a change in the Ministry of Social Development's policy towards trusts.[38] Nevertheless, because the life of a trust can span several decades,[39] many trusts will continue to exist even though they were established for reasons that are now irrelevant.

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33 Unlike a deceased's estate, claims cannot be made against a trust under the Family Protection Act 1955 and the Law Reform (Testamentary Promises Act) 1949. Historically, many families in New Zealand have chosen to settle a farm property on trust. The aim of the trust is, among other things, to ensure the farm assets pass intact to the next generation. We discuss the use of trusts to pass key items of family property to the next generation further below at [21.19].

34 Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts Second Issues Paper* (NZLC IP20, 2010) at [2.12].

35 See Bill Paterson "Residential Care Subsidies – Problems and Puzzles" (paper presented to New Zealand Law Society Seminar, 2013) at 134; Theresa Donnelly "Residential Care Subsidies – Problems and Puzzles: Commentary" (New Zealand Law Society Seminar, 2013) 159 at 161–162.

36 Estate duty was abolished through the Estate Duties Abolition Act 1993. Gift duty was later abolished through the Taxation (Tax Administration and Remedial Matters) Act 2011, s 245.

37 The practice of using trusts to redirect income through a trust to minor beneficiaries in order to be taxed at the beneficiaries' lower marginal tax rate was restricted by the Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Act 2001.

38 Previously the Ministry of Social Development would only assess whether an applicant had settled property on trust in the five year period leading up to an application in order to determine whether an applicant had deprived himself or herself of property in order to qualify for the subsidy. See Bill Paterson "Residential Care Subsidies – Problems and Puzzles" (paper presented to New Zealand Law Society Seminar, 2013) 133 at 134; Theresa Donnelly "Residential Care Subsidies – Problems and Puzzles: Commentary" (New Zealand Law Society Seminar, 2013) 159 at 161-162.

39 The law provides that an interest must vest within 80 years or the lifetime of a relevant person plus 21 years.

20.25 We also recognise that the use of trusts has been heavily promoted by professional advisers. The Law Commission has previously noted a "commodification" and "marketing" of trusts.[40]

20.26 There have, however, been no comprehensive studies on why contemporary New Zealand families settle trusts. There are likely to be different reasons for each family. It is nevertheless important to understand the role that trusts play in contemporary New Zealand so that the right balance between relationship property rights and the preservation of trusts can be found.

CONSULTATION QUESTION

G1 Why do families in New Zealand set up trusts? Are there major reasons other than those we have identified?

The PRA and property held on trust

The definition of property under the PRA

20.27 The PRA only applies to property owned by the partners to the relationship. To understand how the PRA deals with property held on trust, the starting point is to look at the PRA's definitions of "property" and "owner". The PRA provides:[41]

> owner, in respect of any property, means the person who, apart from this Act, is the beneficial owner of the property under any enactment or rule of common law or equity
>
> …
>
> property includes—
>
> (a) real property:
>
> (b) personal property:
>
> (c) any estate or interest in any real property or personal property:

40 Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [1.26]. Tappenden describes the promotion of trusts to families as "big business": Sue Tappenden "The Family Trust in New Zealand and the Claims of 'Unwelcome Beneficiaries'" (2009) 2 Journal of Politics and Law 17 at 17. The Law Commission's 2012 review of trusts received submissions that legal and accounting professionals recommend that clients establish trusts as part of a package of work being done. Other submitters commented that trusts are sometimes seen as status symbol which people set up to keep up with the neighbours: Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [1.26]. Sometimes, an adviser may have recommended that a client establish a trust even if the client did not fully appreciate whether they needed the trust, or the implications of the trust.

41 Property (Relationships) Act 1976, s 2.

(d) any debt or any thing in action:

(e) any other right or interest

20.28 The PRA's definition of owner means the "beneficial owner" of the property. A trustee, however, is not the beneficial owner of the property. Consequently, the property a partner owns in his or her role as trustee will be excluded from division under the PRA.[42] Neither will the settlor of the trust be considered the owner of the trust property under the PRA. Like trustees, settlors have no beneficial ownership of the property they settle on trust.[43]

20.29 The PRA's definition of property does, however, include any "estate or interest" in property or "any other right or interest." Therefore, a beneficial interest under a trust may constitute property under this definition and that interest may be eligible for division under the PRA.

20.30 Not all types of beneficial interests under a trust, however, will constitute property. The courts have looked to the general law of property and trusts in order to determine which types of beneficial interests are property for the purposes of the PRA.[44] The courts have said that the PRA's use of a standard definition of property strongly indicates that the PRA was intended to draw on a conventional understanding of property law principles.[45] We now turn to look at which types of beneficial interests the courts have said amount to property under the PRA.

Vested interests

20.31 The courts have held that if a beneficiary has a vested interest in a trust, that interest constitutes property under the PRA and the beneficiary is an owner to the extent of his or her beneficial interest. This is because a beneficiary with a vested interest can

42 This position is also reinforced by s 4B of the Property (Relationships) Act 1976 which provides that the normal rules of common law and equity will apply if a partner is acting as trustee.

43 See for example *S v S* [2012] NZFC 2685 in which one partner declared that he held some of the paintings that he owned on trust for the benefit of his children even though the paintings continued to hang in the partners' family home. The partner was both settlor and trustee. The Family Court accepted that a valid trust had been created and therefore the paintings were not items of property that were owned by the partner.

44 This is because the definition of property in the Property (Relationships) Act 1976 is also found in many other statutes that deal with property generally. In *Z v Z (No 2)* [1997] 2 NZLR 258 (CA) at 279 the Court of Appeal listed the statutes that, at the time, had the same "standard" definition of property (albeit sometimes with adaptations): Property Law Act 1905, Child Support Act 1991, Crimes Act 1961, Domestic Actions Act 1975, Family Proceedings Act 1980, Forest and Rural Fires Act 1977, Housing Corporation Act 1974, Legal Services Act 1991, Mortgagors and Lessees Rehabilitation Act 1936, New Zealand Government Property Corporation Act 1953, Property Law Act 1952, Public Trust Office Act 1957, Receivership Act 1993, Simultaneous Deaths Act 1958, Trustee Act 1956 and Wills Amendment Act 1955.

45 *Z v Z (No 2)* [1997] 2 NZLR 258 (CA) at 279. See Chapter 8 for more discussion on the definitions of "property" and "owner" in s 2 of the Property (Relationships) Act 1976.

force a trustee to let him or her enjoy his or her beneficial share of the trust property.[46]

Case Study: The AB Family Trust[47]

Atamai and Brenda wish to help their daughter, Caroline, by providing her with a house. Atamai and Brenda buy a house. They then execute a deed of trust to set up the AB Family Trust. Under the deed, Atamai and Brenda are the trustees. Caroline is named as the sole beneficiary. The deed states that:

"The trustees will hold the house in trust for Caroline".

Atamai and Brenda let Caroline live in the house.

Caroline has a vested interest under the trust. The trust deed provides without limitation that she is beneficially entitled to the house. Under the PRA's definitions, Caroline's interest under the trust is property.

Discretionary interests

20.32 A discretionary interest in a trust is not considered property.[48] The reasoning is that a discretionary beneficiary will only obtain the benefit of the trust property if the trustee distributes the property to the beneficiary.[49] The most a beneficiary can have is an expectation or a hope that the trustee will distribute the property to him or her.[50] The trustee may decide never to exercise their discretionary power in favour of the beneficiary.[51]

46 If, however, the interest has not yet vested in possession, the beneficiary will not be entitled to immediate use and enjoyment of the property. Nevertheless, his or her interest will be fixed and will vest in possession eventually, so the courts have viewed the interest as property albeit one that is to be enjoyed at a later stage.

47 The facts of this example are based on the case *Yu Ping Gao v Elledge* [2003] DCR 145 (DC).

48 *N v N* [2005] 3 NZLR 46 (CA) at [74]; and *Q v Q* (2005) 24 FRNZ 232 (FC) at [120]. The point was first stated in *N v N* without discussion. However, in *Q v Q*, the Family Court said that *N v N* had laid down an expectation that the principle would be applied to cases under the Property (Relationships) Act 1976 (PRA). See too *Clayton v Clayton* [2015] 3 NZLR 293 (CA) at [54]. Compare *B v M* [2005] NZFLR 730 (HC) at [98] in which the High Court said it was "certainly arguable" that the definition of "property" in s 2 of the PRA was sufficiently wide to cover the rights and interests of a spouse as a beneficiary under a discretionary trust.

49 The beneficiary does, however, have a number of other rights which are enforceable against the trustee. For example, a discretionary beneficiary has a right to be considered when the trustees decide whether to distribute trust property. Likewise, the trustees have a duty to perform the trust honestly and in good faith.

50 *Hunt v Muollo* [2003] 2 NZLR 322 (CA) at [11].

51 *Johns v Johns* [2004] 3 NZLR 202 (CA) at [32] per Tipping J citing *Armitage v Nurse* [1998] Ch 24 (CA) at 44. See too *Gartside v Inland Revenue Commissioners* [1967] 3 All ER 173 (CA and HL) at 128 per Lord Reid, "… a right to require trustees to consider whether they will pay you something does not enable you to claim anything. If the trustees do decide to pay you something, you do not get it by reason of having the right to have your case considered; you get it only because the trustees have decided to give it to you."

Case Study: The DW Family Trust

Doris and Warren have run a successful furniture making business for many years. They employ many staff and the business has a bright future. Doris and Warren operate the business through a company in which they are the only shareholders. Doris and Warren are about to retire. They want their two adult children to continue to benefit from the business. They do this by creating the DW Family Trust. Under the trust deed, Doris and Warren's lawyer and accountant are named as the trustees. Doris and Warren transfer their shareholding in the company for the trustees to hold on trust for their children.

Doris and Warren think that their children would not be prudent shareholders if they held the shares personally. They also expect that the children will ask the trustees to distribute money to them regularly. Instead, Doris and Warren want the trustees to manage the shares to ensure the future profitability of the company rather than respond to the children's requests.

Doris and Warren ensure the trust deed gives the trustees discretion on when and how they distribute the company's profits to their children. The children are therefore beneficiaries with a discretionary interest. Under the PRA, the children's discretionary interest under the trust would not constitute property.

Contingent interests

20.33 Whether a contingent interest constitutes property under the PRA is more difficult. It is common for trust deeds to provide that when the trust comes to an end, the residual trust property is to be divided in equal shares between several beneficiaries, sometimes referred to as residual or final beneficiaries. The interest of these beneficiaries is contingent on them surviving until the date the trust is wound up and there being property available for distribution.

20.34 Some courts have said that a contingent interest constitutes property under the PRA.[52] In the case of a discretionary interest, the interest cannot be property because enjoyment of the property is always subject to the discretion of the trustees. A contingent interest is enjoyed as of right under the trust deed provided the condition is satisfied.[53] As we explain further below, some commentators have reservations about this position.

52 *Q v Q* (2005) 24 FRNZ 232 at [125]; *B v M* (2004) 24 FRNZ 610 (HC) at [101]; *O v S* (2006) 26 FRNZ 459 (FC) at ([82]–[88]); *Prasad v Prasad* [2014] NZFC 8298 at [39]; and *H v R* [2017] NZFC 761 at [30]–[31] (involving a determination of whether children's interests as contingent beneficiaries under a trust provided them with a property interest for the purpose of a joinder application under s 37 of the Property (Relationships) Act 1976).

53 This reasoning was articulated by Tipping J in *Johns v Johns* [2004] 3 NZLR 202 (CA) at [49]. His Honour was, however, determining what interest constituted a "future interest" under s 21(2) of the Limitation Act 1950 for the purposes

Case study: The R Family Trust

Raewyn has unexpectedly come into some money. She has no present need for the money and she would like her children and grandchildren to receive the benefit of it. Raewyn sets up the R Family Trust on which to hold the money. Raewyn's accountant is the trustee. The accountant recommends that the money be invested in several funds that will provide a good return over the coming years. To maintain a good rate of return, Raewyn's accountant says it is important to preserve the capital as a whole.

The R Family Trust deed provides there are two types of beneficiaries: discretionary beneficiaries and final beneficiaries. The discretionary beneficiaries are Raewyn's children. The final beneficiaries are Raewyn's grandchildren. The trust deed states that during the lifespan of the trust the trustee may distribute any of the income to the discretionary beneficiaries as the trustee decides. At the end of the trust, which will be in 2097, the trustee is to take the capital out of the investments and divide it equally between any of the final beneficiaries who are still alive. The idea is to maintain the capital in the investments during the life of the trust to ensure a steady stream of income.

The final beneficiaries have a contingent interest under the R Family Trust. Their interest is conditional on them surviving until 2079 and there being capital in the investments left to distribute. A court may consider that the final beneficiaries' interest in the trust is property under the PRA. The discretionary beneficiaries' interest, on the other hand, will not be considered property under the PRA.

Classification of an interest in a trust as relationship property or separate property

20.35 If a partner's beneficial interest in a trust amounts to property, the next step is to consider whether it is relationship property or separate property. Section 10 of the PRA provides that if a partner acquires property because he or she is a beneficiary under a trust settled by a third person, the property will be separate property. The PRA is silent on the classification of the interest if the trust has been settled by one of the partners.

of ascertaining the applicable limitation period for an action for breach of trust. At [49] Tipping J emphasised that the question of whether a future interest constituted an interest must recognise the vital importance of the statutory context and the purpose of the legislation. Notably, his Honour was not determining whether a contingent interest should be deemed property for the purposes of the Property (Relationships) Act 1976 (PRA). Nevertheless, the Court of Appeal's finding that a contingent interest constitutes an interest (albeit for the purposes of the limitation legislation) was applied by the Family Court in *Q v Q* (2005) 24 FRNZ 232 (FC). The Court relied on Tipping J's distinction between a discretionary interest and a contingent interest. It said that Mrs Q's future contingent interest was property for the purposes of the PRA even though the interest in the trust was contingent on Mrs Q's survival to the date of distribution (in 2028) and on there being trust property available for distribution. The reasoning has been questioned. See RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [4.47]; and Kate Davenport and Stephanie Thompson "Piercing the trust structure at a relationship's end: interesting developments in trust law from the New Zealand Supreme Court" (2016) 22(8) Trusts & Trustees 864 at 871–872.

Powers as property – *Clayton v Clayton [Vaughan Road Property Trust]*

20.36 The Supreme Court has recently decided that a person's powers to control a trust can constitute "property" in their own right under the PRA. As explained above, it is common for the people who establish trusts to retain control over the trust property.[54] The Supreme Court case of *Clayton v Clayton [Vaughan Road Property Trust]*[55] is an extreme example. Mr Clayton had settled a trust called the Vaughan Road Property Trust. Mr Clayton was the trustee. He was also a discretionary beneficiary along with his children. The trust deed gave Mr Clayton the role of "Principal Family Member". In this capacity, the trust deed empowered Mr Clayton to appoint and remove discretionary beneficiaries, distribute any of the trust property to any beneficiary, and effectively bring the trust to an end. The Supreme Court described the combination of these powers as amounting to a general power of appointment. That is, Mr Clayton had the power to distribute all the trust property to himself for his personal benefit rather than for the benefit of the other beneficiaries.[56] Importantly, the trust deed specifically stated that, in exercising these powers, Mr Clayton was not constrained by the normal duties that dictate the standards of behaviour expected of a trustee. He could therefore disregard the interests of the other beneficiaries and effectively treat the trust property as his own.[57]

20.37 The Supreme Court held that the powers afforded to Mr Clayton under the trust deed amounted to "property" within the meaning of section 2 of the PRA. The Court noted that although the law traditionally distinguished between powers and property, strict concepts of property may not be appropriate in a relationship property context.[58] The Court felt that "worldly realism" is needed (although this must be balanced with respect for the legal affairs

54 The courts have generally permitted high levels of control. A leading example is *Kain v Hutton* [2008] 3 NZLR 589 (SC). In that case Mrs Couper had settled a trust. The beneficiaries of the trust, who were discretionary beneficiaries, were Mrs Couper and her other family members. Under the trust deed, Mrs Couper had the power to both appoint and remove trustees and also appoint and remove any person from the class of discretionary beneficiaries. The Supreme Court recognised that these powers meant the trust was very much for Mrs Couper's own benefit as Mrs Couper could ensure that the trust property reverted to her: at [22]. The Court described Mrs Couper has exercising "effective control" over the trust property: at [23]. Yet, the Supreme Court did not criticise the degree of control Mrs Couper exercised over the trust.

55 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551.

56 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [54].

57 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [57]–[58].

58 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [79].

of trusts).[59] The Court concluded that Mr Clayton's powers were rights that gave him an interest in the trust and its assets.[60] Because the powers were "acquired" after the relationship began they were relationship property and their value should be divided equally between Mr and Mrs Clayton.[61]

20.38 On the question of how Mr Clayton's powers were to be valued, the Court noted that Mr Clayton could appoint the assets of the trust to himself at any time. The Court saw no reason to differentiate the value of this power from the value of the trust property.[62] Therefore the value of Mr Clayton's powers was equal to the value of the net assets of the trust.

20.39 The Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]* confirmed a new way of looking at a partner's interest in a trust when dividing property under the PRA. Besides looking at a partner's beneficial interest in a trust, the courts may now inquire into whether a partner's powers to control the trust can also be considered property for the purposes of the PRA. As we explain further below, the Supreme Court stressed that the trust and the powers it gave to Mr Clayton were unusual.[63] It is therefore doubtful that the *Clayton* decision will apply to many trusts.

Summary of the PRA's treatment of property held on trust

20.40 It is helpful at this point to recap how the PRA treats property held on trust. First, the property a partner holds as trustee will not be eligible for division under the PRA because the partner is not the beneficial owner of the property and therefore the PRA does not see the trust property as his or her property. Second, the courts have said that a partner's interest as a beneficiary under a trust may be property under the PRA, but only if the beneficiary has a vested or contingent interest. A discretionary interest does not constitute property. Third, following the Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]*, a

59 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [79].

60 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [80].

61 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [86]. At the time the Supreme Court released its judgment, Mr and Mrs Clayton had reached a settlement. It was therefore unnecessary for the Supreme Court to make formal orders dividing the property.

62 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [104].

63 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [14].

partner's extensive powers to control a trust may amount to property within the meaning of the PRA.

Ways in which property held on trust can be shared between the partners

20.41 The PRA will generally not apply to property held on discretionary trusts. When property is settled on a discretionary trust, the partners may lose rights to an equal share in that property under the PRA. There are, however, a number of legal avenues available to address injustice that might arise from the use of trusts. The main avenues are:

(a) section 44 of the PRA;

(b) section 44C of the PRA;

(c) section 182 of the Family Proceedings Act 1980;

(d) the High Court's power to ensure a trust operates properly;

(e) a claim that the trust is invalid or is a sham; and

(f) a constructive trust over property held on an express trust.

20.42 As can be seen, some of these avenues are provided in the PRA. Many, however, are found outside the PRA. These avenues have various limitations. We look at each of them in turn.

Powers within the PRA to recover property – section 44 and section 44C

20.43 Section 44 applies when a person has disposed of property to a trust in order to defeat a partner's claim or rights under the PRA. In these circumstances, section 44(2) gives a court the power to unwind the disposition and recover property from a trust, or order that compensation be paid in order to satisfy a partner's rights to relationship property.

20.44 The key element of section 44 is that the person who disposed of the property to the trust must have intended to defeat the other partner's rights. The courts have clarified that this requirement will be met if a person disposes of property to a trust knowing that as a consequence his or her partner risks losing rights to that

property. There will be an intention to defeat the partner's rights, even if the person transferring the property did not wish to cause the partner loss.[64] Although equating knowledge of consequences with an intention to bring about those consequences is a lower threshold than proving an actual intention, the test is still described by commentators as a "significant hurdle".[65] The Court of Appeal has said that the task is to assess the intention or purpose of the person disposing of the property at the time the disposition is made. That requires an assessment of all the relevant evidence.[66]

20.45 Consequently, the court's powers under section 44 are not used often. In very few cases can a partner show that a disposition of property to the trust was made with the knowledge that his or her rights under the PRA would be defeated.[67]

Case study: The D Family Trust[68]

Desmond has been seeing Malosi for several months now. They decide to start living together. The partners plan that Desmond will sell his apartment and use the sale proceeds to buy a larger house which will be their family home. Desmond and Malosi agree that Desmond will take out a mortgage to cover any shortfall between the price of the new house and the sale proceeds from Desmond's apartment. Both Desmond and Malosi will pay the mortgage payments equally even though Desmond is the only borrower under the mortgage.

A few years ago Desmond went through a painful separation from his former partner. There was a long dispute over relationship property. Desmond knows that if he and Malosi separate, he might be forced to share the equity in their new

64 *R v U* [2010] 1 NZLR 434 (HC) at [33] per French J applying *Regal Castings Ltd v Lightbody* [2009] NZSC 87, [2009] 2 NZLR 433 at [53] per Blanchard J. See for example *Clayton v Clayton* [2015] NZCA 30, [2015] 3 NZLR 293. Mr Clayton had established two "education" trusts purportedly for the education of the children of the marriage. Mrs Clayton was not named as a beneficiary under the trusts. The trusts were, however, used within Mr Clayton's group of companies for the purpose of minimising business risk. Mr Clayton had funded the purchase of the trust property from, among other sources, the proceeds of a family holiday home. Mr Clayton's fellow trustee gave evidence that Mr Clayton was concerned about the risks identified to his company and banking arrangements if his marriage broke down. The Court of Appeal concluded that exclusion of Mrs Clayton as a beneficiary was "uppermost in Mr Clayton's mind". It was therefore a disposition made to defeat Mrs Clayton's rights for the purposes of s 44 of the Property (Relationships) Act 1976. See too *P v D* [2012] NZHC 2757; *G v G* [2013] NZHC 2890; *W v C* [2013] NZHC 396, [2014] NZFLR 71; and *P v H* [2016] NZCA 514, [2016] NZFLR 974.

65 N Peart, M Henaghan and G Kelly "Trusts and relationship property in New Zealand" (2011) 17 Trusts & Trustees 866 at 869.

66 *M v ASB Bank Ltd* [2012] NZCA 103, [2012] NZFLR 641 at [53]; and *Clayton v Clayton* [2015] NZCA 30, [2015] 3 NZLR 293 at [134].

67 This observation is repeatedly made by commentators. See Nicola Peart "Can Your Trust Be Trusted: Inaugural Professorial Lectures" (2009) 12 Otago LR 59 at 69. See also Mark O'Regan and Andrew Butler "Equity and trusts in a family law context" (paper presented to New Zealand Law Society Family Law Conference, November 2011) 269 at 271; and Bruce Corkill and Vanessa Bruton "Trustee Litigation in the Family Context: Tools in the Family Court, and Tools in the High Court" (paper presented to New Zealand Law Society Trusts Conference, 2011) 103 at 116.

68 The facts of this example are based on the cases *R v U* [2010] 1 NZLR 434 (HC); and *O v S* (2006) 26 FRNZ 459 (FC).

house, even if he contributes the majority of the purchase funds. To avoid this Desmond arranges with his lawyer to establish the D Family Trust. Desmond is the trustee. The beneficiaries of the trust are Desmond and his children. When Desmond and Malosi find a house they like, Desmond signs the sale and purchase agreement. The purchaser in the agreement is named as Desmond or "his nominee." Desmond then arranges for the trustees of the D Family Trust to purchase the house.[69] The result is that Desmond's and Malosi's home is held on the D Family Trust in which Malosi has no interest even though he contributed to the mortgage.

Malosi may have a claim under section 44 of the PRA. Desmond appears to have intentionally structured the acquisition of their family home so Malosi can claim no rights in the property under the PRA.

Case study: The E Family Trust

Emily has worked as an engineer for nearly 15 years. About five years ago Emily bought a house. Emily's lawyer advised her to set up a trust through which to buy the house. Emily did not understand what a trust was, but followed the advice of her lawyer because the lawyer said the trust would protect her assets. Consequently, Emily set up the E Family Trust and the house was bought in the names of the trustees (Emily and her lawyer). About a year ago, Emily started seeing Felicity. They recently got engaged. They intend to make the house their family home once they are married.

If Emily and Felicity later separate, it would be difficult for Felicity to claim under section 44. She may not be able to show Emily intended to defeat her rights. Emily established the trust before she met Felicity. Emily does not appear to have understood the nature of a trust and how that might affect any rights her future partner would have under the PRA.

20.46 To overcome the limited application of section 44, the 2001 amendments introduced a new provision: section 44C. Section 44C applies when a disposition of property to a trust has the *effect* of defeating one partner's claim or rights under the PRA. There is no need to prove an intention behind the disposition. However, section 44C has several conditions. The property disposed of must have been relationship property. The disposition must have been made after the relationship began. It is also implicit that the disposition of property must only defeat the rights of one partner, not both of them. This is made clear in the wording of section 44C(1)(b) and it is captured in the notion of compensation. The courts have said the section is aimed at ensuring equality

69 In both *R v U* [2010] 1 NZLR 434 (HC); and *O v S* (2006) 26 FRNZ 459 (FC) the courts said that procuring the trustees to purchase the property rather than the partner in his or her personal capacity constituted a "disposition of property" for the purposes of s 44 of the Property (Relationships) Act 1976.

between the parties when a disposition of property has the effect of defeating one partner's rights, but leaving the other partner's rights intact.[70] Even if section 44C applies, the court's power to recover the property disposed of to the trust is limited. Under section 44C(2), the court can only order one partner to compensate the other from relationship property or separate property. As a last resort the court can require the trustees of the trust to pay the affected partner compensation from the income of the trust. However, the court has no power to order that the property be recovered from the trust's capital.

Case study: The E Family Trust continued

In the case of Emily and Felicity, Felicity probably could not make a successful claim under section 44C of the PRA against the E Family Trust. The trust property is a key family asset; the family home that would usually be classified as relationship property. Nevertheless, because the property was acquired by the trustees before Emily and Felicity used the house as their home, it would not have been relationship property when it was acquired by the E Family Trust. Consequently, section 44C would not apply. Even if the home was relationship property when it was acquired by the E Family Trust, the court would have no power under section 44C to order that the home be recovered from the trust and shared equally between Emily and Felicity.

Case study: The I Farming Trust[71]

Ida is a farmer. She has been married to John for about 15 years. During the relationship Ida inherited a farm from her grandparents. Since acquiring it, Ida and John have lived on the property and farmed it as a partnership.[72] About ten years ago Ida's accountant came up with a plan to restructure her financial affairs. First, Ida set up the I Farming Trust. Ida is trustee. Ida, John and their children are all discretionary beneficiaries. Ida then transferred the farm assets to the trust.

Ida's accountant said that the transfer could be structured in a way that meant the trustees did not have to pay the purchase price for the farm assets. Instead, the transfer would be for an interest free loan. The accountant then planned a gifting programme under which Ida would forgive the debt owed to her by the trustees.

70 See for example *N v N* [2005] 3 NZLR 46 (CA) in which the husband had disposed of property to a trust over which the Court of Appeal noted the husband exercised considerable control. The inference was that the husband continued to enjoy the benefits of the property whereas the wife's rights had been compromised.

71 The facts of this example are based on the case *W v W* [2009] NZSC 125, [2010] 2 NZLR 31. Nicola Peart cites *W v* W as an example of the limitations of s 44C of the Property (Relationships) Act 1976: see Nicola Peart "Intervention to Prevent Abuse of Trust Structures" [2010] NZ L Rev 567 at 589.

72 Section 10 of the Property (Relationships) Act 1976 provides that the property a partner inherits is separate property. However, ss 10(2) and 10(4) provide that the property may become relationship property if it is intermingled with relationship property or used as the family home or family chattels. In this scenario it is possible that the farm has become relationship property.

Each year Ida forgave an amount of the debt up to the threshold at which gift duty was payable. When gift duty was abolished in 2010, Ida forgave the balance of the debt.

Ida and John have separated. Ida still lives on the farm and continues to operate the farm business. John has moved to the city. The farm is now valued at nearly $3 million. Ida and John look at what relationship property they have in order to divide it equally between them. It comprises some savings in a bank account, a vehicle and some furniture. John is dismayed to find he will receive about $60,000 in the relationship property settlement but Ida will continue to enjoy the value of the farm property.

John goes to see a lawyer. John's lawyer advises him that, although he may be able to make a claim under section 44C, the court probably will not be able to grant John any meaningful compensation. The court cannot recover the farm assets from the trust under section 44C; it can only make compensatory orders from Ida's share of the relationship property, her separate property, or the trust's income. None of these sources of property are sufficient to compensate John.

The lawyer also says that before gift duty was abolished, claims under section 44C were often more successful because there would be a debt owed by the trustees to the partner who disposed of the assets to the trust. Often a court could make compensatory orders from this debt. Here, however, Ida has forgiven the debt completely.

20.47 The limitations of section 44C are deliberate. In 1988, a Working Group was established to review the Matrimonial Property Act 1976.[73] The Working Group was dissatisfied with section 44. It said that the main problem was with dispositions to trusts where an intent to defeat the legislation does not arise or could not be proved.[74] The Working Group concluded that a court should have wider powers to intervene, and in particular, should have discretion to distribute the capital of the trust in order to make a just division under the PRA.[75] The 2001 amendments partly adopted the Working Group's recommendations. Section 44C was enacted as an alternative remedy to section 44. It differed from the Working Group's recommendation, however, because section 44C does not give the court the power to order compensation payments from trust capital. The reasons for limiting the court's powers under section 44C were to ensure minimal interference

73 The Working Group was convened by Geoffrey Palmer, then Minister of Justice, to review the "broad policy issues" with the Matrimonial Property Act 1976, the Family Protection Act 1955, the provision for matrimonial property on death and the provision for couples living in de facto relationships: Department of Justice *Report of the Working Group on Matrimonial Property and Family Protection* (October 1988).

74 Department of Justice *Report of the Working Group on Matrimonial Property and Family Protection* (October 1988) at 30.

75 Department of Justice *Report of the Working Group on Matrimonial Property and Family Protection* (October 1988) at 30.

with trusts. The Parliamentary select committee considering the Matrimonial Property Amendment Bill in 1998 received advice from the Ministry of Justice. In its report to the select committee, the Ministry explained:[76]

> *The proposed new sections do not, however, give the Court power to order that the capital of the trust be distributed to the affected spouse. This acknowledges that trusts are created for legitimate reasons (such as estate planning or protection from creditors) and should be permitted to fulfil that purpose, when there was no intention to defeat the spouse's claim when the trust was established. The power to claw property back from a trust could, effectively, result in the trust being unwound to the detriment of other beneficiaries who are likely to include the children of the marriage and the negation of the intended benefits.*

20.48 The select committee appears to have accepted the Ministry's advice. In its commentary on the Bill, the select committee explained that the reason the new section did not give the court power to make orders from the capital of a trust was that trusts are created for legitimate reasons. They should be allowed to fulfil those purposes where there was no intention to defeat a partner's claim when the trust was established.[77]

20.49 Despite its limitations, the courts have granted relief through section 44C in several cases. In many cases, however, section 44C has not been an effective remedy.[78] This was either because the section could not apply because the property in question was not relationship property prior to the transfer to the trust, or because the disposition had not occurred during the relationship. In some cases, there was insufficient property from which to order adequate compensation.

20.50 The final provision in the PRA relating to trusts is section 33(3)(m). This section gives a court the power to vary the terms of

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76 Ministry of Justice *Effect of Clause 47 Matrimonial Property Amendment Bill* (MPA/MJ/3, Ministry of Justice, 7 October 1998) at 3.

77 Matrimonial Property Amendment Bill 1998 (109-2) (select committee report) at xii.

78 In its final report in the Review of the Law of Trust project (Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.12]), the Law Commission reviewed judgments decided between 1 February 2008 and 1 February 2013 in which s 44C of the Property (Relationships) Act 1976 was discussed. The Commission found that often there was insufficient relationship property or separate property outside the trust from which the court could adequately compensate a spouse or partner whose interests were defeated by the disposition to the trust (although in some cases relief was available through s 182 of the Family Proceedings Act 1980). Likewise, Nicola Peart states: "…[section 44C's] ability to achieve a just division of assets produced or enhanced by the relationship is limited both by the section's requirements and by the remedies … it is easy to avoid being caught by section 44C. The section cannot be involved if the trustees acquired the assets directly from third parties, rather than from either of the parties to the relationship. Nor does it apply to trusts that affect both parties equally or that were settled by third parties": see Nicola Peart "Equity in Family Law" in Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 1161 at 1190–1191.

any trust when it is necessary or expedient to give effect to any other orders the court makes under the PRA. The effect of section 33(3)(m) is not to give a court unrestricted power to vary a trust when it considers it fair to do so. Rather, the power can only be used as a means of implementing other orders when a court has jurisdiction to make orders under the PRA affecting a trust. So if a court has the power to order payments from a trust under sections 44 or 44C, or if a partner has a beneficial interest in a trust that is relationship property, a court may be able to make orders under section 33(3)(m).[79] Unless any of these provisions apply, the court cannot use section 33(3)(m).

The power to vary a nuptial settlement - section 182 of the Family Proceedings Act 1980

20.51 Section 182 of the Family Proceedings Act 1980 (section 182) has become an important provision to deal with trusts after a marriage ends. Section 182 applies to what it terms "nuptial settlements" and consequently does not apply to settlements connected with de facto relationships.[80] The courts have held that property held on a discretionary trust can constitute a nuptial settlement provided there is a sufficient connection between the trust and the marriage.[81] Section 182 gives the court power to vary the nuptial settlement for the benefit of the children of the marriage or the spouses.

20.52 Section 182 is very different in approach and philosophy to the PRA. This is because it comes from a very different historical background. The wording of section 182 is similar to the first time the powers were introduced into legislation in England and Wales in 1859.[82] This accounts for the old fashioned language of "nuptial settlements."

79 *B v M* [2005] NZFLR 730 (HC) at [223]. See also discussion in Nicola Peart (ed) *Brookers Family Law — Family Property* (online looseleaf ed, Thomson Reuters) at [PR33.13].

80 Section 182 of the Family Proceedings Act 1980 also applies to civil unions.

81 *Re Polkinghorne Trust, Kidd v Kidd* (1988) 4 NZFLR 756 (HC); *Chrystall v Chrystall* [1993] NZFLR 772 (FC); *Kidd v van den Brink* HC Auckland, CIV-2009-404-4694, 21 December 2009; *X v X* [2009] NZCA 399, [2010] 1 NZLR 601; *W v W* [2009] NZSC 125, [2010] 2 NZLR 31;and *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590. There is, however, some debate as to whether the settlement refers to the trust itself or the disposition of property to a trust. In *W v* W at [33] the Supreme Court said obiter that the settlement is the trust itself and any trust property (whenever acquired) must be part of the settlement. On the other hand, in *Clayton v Clayton [Claymark Trust]* at [36] said obiter that it could be that each disposition of property to a trust could constitute a nuptial settlement.

82 Matrimonial Causes Act 1859 (UK) 22 & 23 Vict c 61, s 5. The power to vary nuptial settlements was brought into New Zealand law in 1867: Divorce and Matrimonial Causes Act 1867.

20.53 The nuptial settlements to which the legislation was originally intended to apply were marriage settlements. Marriage settlements were used extensively in England during the nineteenth century. They were usually a settlement of property on trust for the benefit of the spouses, the wife alone or their children.[83] The settlement was focused on the marriage. Often the legal instrument creating the settlement would describe it as being "in consideration of the marriage".[84] By the end of the nineteenth century, marriage settlements were less common in both the United Kingdom and New Zealand. Nevertheless, the power to vary nuptial settlements was applied to other forms of nuptial settlements beyond the traditional marriage settlement.[85] Today, section 182 is used almost entirely to address discretionary trusts.

20.54 The Supreme Court explained how the power in section 182 should be applied in *Clayton v Clayton [Claymark Trust]*.[86] Mr Clayton had settled a trust called the Claymark Trust just after the birth of the partners' second child. The beneficiaries of the trust were Mr and Mrs Clayton and their children.[87] Mr Clayton said the reason he established the Claymark Trust was to distance certain assets from creditors connected with his business interests. The trust assets comprised properties adjacent to Mr Clayton's sawmilling operations, the shares in a company which owned an avocado orchard, and a vehicle. The trust also held investments in other companies associated with Mr Clayton. When Mr and Mrs Clayton divorced, Mrs Clayton applied to the court to vary the Claymark Trust under section 182.

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83 For the reasons for marriage settlements see RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [1.17]. Importantly, a marriage settlement was a device through which a wife could retain separate property distinct from her husband: see *Bennet v Davis* (1725) 2 P Wms 316 (Ch); *Rollfe v Budder* (1724) Bunb 187 (Exch Ch) referred to in RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [1.17]. As the settlement was usually in the form of a trust, the early Divorce Court established under the Matrimonial Causes Act 1857 (UK) 20 & 21 Vict c 85 could not treat it as the property of the parties in order to apportion it after the divorce. In response, the legislation soon adopted a provision to allow the court to vary marriage settlements, namely s 5 of the Matrimonial Causes Act 1859 (UK) 22 & 23 Vict c 61 (see comments of Merivale P in *Bosworthick v Bosworthick* [1926] P 159 (Div & Mat) at 163 explaining the history of the legislation).

84 See the description of the "classic" marriage settlement in *W v W* [2009] NZSC 125, [2010] 2 NZLR 31 at [14] per Tipping J.

85 See for example: *Worsley v Worsley* (1869) 1 LR P&D 648 (Div & Mat) which concerned a trust established for the maintenance of a wife after she and her husband had separated; *Bosworthick v Bosworthick* [1927] P 64 (CA) where a wife executed a bond which provided her husband an annuity; and *Lort-Williams v Lort-Williams* [1951] P 395 (CA) where a husband took out an insurance policy on his own life.

86 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590.

87 Mr and Mrs Clayton and their children were described by the court as discretionary beneficiaries. Mr and Mrs Clayton's children were final beneficiaries and held contingent interests in the trust's capital and income when the trust was to come to an end.

20.55 The Supreme Court said that section 182 should be applied in two stages:

(a) Is the settlement a nuptial settlement?

(b) If it is, should the court use its discretion to vary the settlement?

20.56 To determine whether the settlement is a nuptial settlement, the Supreme Court said that the settlement must make some form of continuing provision for one or both of the parties to a marriage in their capacity as spouses. This means there must be some connection between the settlement and the marriage.[88] The Court observed that where a trust is set up during a marriage with one or both spouses as beneficiaries, there will almost inevitably be that connection.[89] The Court raised the possibility, but did not ultimately decide, that where a future spouse is named as a beneficiary but no marriage has taken place, the trust might be a nuptial settlement.[90] Similarly, the Court raised the possibility that a trust may still be a nuptial settlement even though other beneficiaries may obtain considerable benefits from the trust.[91]

20.57 On the question of whether the court should exercise its discretion, the Supreme Court explained that the purpose of the court's discretion was to address the failure of the spouses' expectations that the marriage would continue. To do this, the Supreme Court said the first step is to examine what the husband or wife reasonably expected of the nuptial settlement when they assumed the marriage would continue. The second step is to compare those expectations to the husband or wife's expectations of the settlement in the circumstances after separation.[92] The Court said it was unnecessary to fix a specific point in time to assess the expectations, but rather it is a general comparison between the position under the settlement had the marriage continued and the post-separation position.[93]

88 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [34].

89 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [34]. The court also rejected Mr Clayton's submission that, because the trust was set up for business reasons, namely the isolation of the trust assets from the bank guarantees, it did not have the character of a nuptial settlement. The court said that this separation of property was for the purpose of protecting family assets: at [39].

90 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [36].

91 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30 [2016] 1 NZLR 590 at [35]–[37].

92 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [53].

93 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [53]. In taking this approach, the Supreme Court departed from the approach taken in its earlier decision *W v W* [2009] NZSC 125, [2010] 2 NZLR 31. In *W v W* the

20.58 The Supreme Court then considered other factors which would influence how it exercised its discretion. The Supreme Court said there was no comprehensive list of relevant factors, but particular attention must be paid to the interests of children.[94] The Court identified other relevant factors: how the trustees would have exercised their discretion, assuming a continuing marriage, the source and character of the assets, the length of the marriage and the suitability of the trust structure because of the changed circumstances.[95]

20.59 In this case, the Court decided that, had the marriage continued, it was reasonable to assume that Mrs Clayton would have enjoyed the continued use of the vehicle, which was trust property, and the availability of other trust property for family purposes.[96] The Court recognised that in the current circumstances Mrs Clayton was unlikely to enjoy distributions as a discretionary beneficiary. As Mr and Mrs Clayton had settled their dispute before the Supreme Court issued its judgment, the Court did not state what specific orders it would have made.

Case study: The KM Family Trust

Kazamir and Mary have been married for about 15 years. They have two children. Five years ago Kazamir inherited a large sum of money under the will of his grandmother. Kazamir and Mary use this money to buy a holiday house for their family holidays. They bought the house jointly in their names. They then executed a deed of trust which established the KM Family Trust. Under the deed, Kazamir and Mary declared that they held the house on trust for the benefit of their family. Kazamir and Mary are named as discretionary beneficiaries with their children.

Two years ago Kazamir and Mary went through an acrimonious separation. They have just formally divorced. Mary no longer wishes to spend family holidays at the holiday house. She says she associates the place with the arguments she and Kazamir used to have in the later stages of their relationship. Kazamir likes the house and he wants to continue to spend holidays there. He does not want to change the trust. Kazamir also believes that because the house was bought with his inheritance from his grandmother's estate, Mary should not have a say in what happens to the property now that they have separated. Kazamir and Mary's teenage children say they do not like the house. Instead they would prefer to spend their holidays closer to home and closer to their friends. Mary asks Kazamir whether the house can be sold, and the sale proceeds resettled onto two separate trusts.

Court said it should compare the parties' expectations at the time the settlement was made and their expectations in the post-separation circumstances: at [25].

94 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [58].

95 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [59].

96 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [75]–[76].

Under one trust, she and the children would be beneficiaries. Under the other trust, Kazamir and the children would be beneficiaries. Kazamir refuses.

Mary may be able to obtain orders from the court that vary the KM Family Trust under section 182 of the FPA. The trust is probably a nuptial settlement as it is closely connected to the marriage. There is also a strong case that Mary's reasonable expectations of the KM Family Trust have been defeated because of the divorce. While the marriage continued, Mary expected to use the holiday house for family holidays. Now that the marriage has broken down and Mary no longer wants to use the holiday house, her expectations of the trust are very different. It is also important that the children no longer want to use the holiday house. These factors may well persuade the court to exercise its discretion to vary the KM Family Trust even if Kazamir does not want the trust to be varied.

20.60 The power in section 182 is much more far reaching and gives a court much more discretion than the powers under the PRA. This has led some people to say that section 182 is an anomaly and inconsistent with the PRA.[97]

High Court powers to ensure a trust operates properly

20.61 The law of trusts equips the High Court with powers to ensure that trusts are operated properly and efficiently. These powers may be useful if the partner seeking the court's intervention is a beneficiary under the trust and wishes to ensure the other partner does not interfere with or otherwise unfairly administer the trust. The High Court's powers arise under the Trustee Act 1956 and the High Court's inherent jurisdiction.[98]

20.62 For example, under section 51 of the Trustee Act 1956, the High Court has the power to appoint and replace trustees when it is inexpedient, difficult or impracticable to do so without the court's assistance. The power has been used in cases where, following a relationship break-up, the soured relationship between the parties has affected the administration of the trust. The High Court also

97 B Atkin and W Parker *Relationship Property in New Zealand* (LexisNexis, Wellington, 2009) at 208; N Peart, M Henaghan and G Kelly "Trusts and relationship property in New Zealand" (2011) 17 Trusts & Trustees 866 at 873. In *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 counsel for Mr Clayton argued that the restricted approach taken in ss 44 and 44C of the Property (Relationships) Act 1976 impliedly repealed s 182 of the Family Proceedings Act 1980, although the Supreme Court rejected the submission.

98 The Family Court's jurisdiction is founded in statute. Its jurisdiction is therefore limited to the extent of its statutory powers. The High Court, on the other hand, has an inherent jurisdiction to supervise trusts to ensure they are administered in accordance with the terms of the trust instrument and consistently with the wider law of trusts. We discuss the limits of the Family Court's jurisdiction in respect of trusts more fully in Part H of this Issues Paper.

has power to review decisions made by the trustees[99] or order that information be provided to the beneficiaries.[100]

The LM Family Trust[101]

Malu and Leigh have just been through a bitter break up. Malu and Leigh are both trustees of the LM Family Trust. They are both discretionary beneficiaries together with Leigh's children from her first marriage. The home in which the partners reside is held on the trust. Now that they have separated, Leigh wants them to sell the house and distribute the sale proceeds between them. Malu, still angry following their break up, refuses to talk to Leigh. He won't reply to her phone calls or messages. When Leigh goes around to the house Malu says there is no way he will sell the house and he slams the door on her.

Leigh applies to the High Court to have the Court replace both her and Malu as trustees with the Public Trust. The Court will probably order that Malu and Leigh are replaced by the independent trustee. The hostile breakdown of their relationship will impact on their ability to discharge their duties as trustees.

20.63 Although these powers can be very useful in ensuring that a trust is administered properly, their usefulness for partners who have separated may be limited. Notably, the High Court cannot divide and distribute the trust property between the partners, which remains within the discretion of the trustees.

20.64 It should also be noted that if the Trusts Bill currently before Parliament is enacted, it will give wider powers to the Family Court to exercise in PRA proceedings.[102] The purpose of the Trusts Bill is to clarify and simplify core trust principles and trustees' essential obligations.[103] It will govern matters like when a trustee is obliged to provide information about a trust and when the court can remove a trustee. Clause 136 of the Bill provides that, if the Family Court has jurisdiction to hear and determine a proceeding, it may make any order or give any direction available under the Trusts Bill if it is necessary:

99 Trustee Act 1956, s 68. Note an application under this section cannot be initiated by a discretionary beneficiary.

100 The High Court's power to order that information be provided to the beneficiaries is part of its supervisory jurisdiction in respect of trusts. The Supreme Court has recently considered how the court should exercise this supervisory jurisdiction in *Erceg v Erceg* [2017] NZSC 28, [2017] 1 NZLR 320.

101 The facts of this example are based on the case *K v K* HC Wellington CIV-2010-485-2444, 8 March 2011.

102 Trusts Bill 2017 (290–1), cl 136.

103 Trusts Bill 2017 (290-1) (explanatory note).

(a) to protect or preserve any property or interest until the proceedings in the Family Court can be properly resolved; or

(b) to give proper effect to any determination of the proceeding.

Claim that a trust is invalid or a sham

20.65 There have been several cases where, following a relationship break up, one of the partners has argued that a trust was not a proper trust.[104] If the court declares that no trust exists, the property reverts back to the person who purported to settle the property on the trust and thus may be relationship property under the PRA.

20.66 The argument that no trust exists generally takes one of two forms in this context. The first is that the trust is invalid because the person who settled the trust did not intend to create a trust. This might be because the trust did not meet the essential elements required of a trust and so no intention to create a trust existed. There are very few cases where this argument has succeeded. In recent judgments, the courts have been reluctant to declare there was no trust. In *Clayton v Clayton [Vaughan Road Property Trust]* the Supreme Court considered whether the Vaughan Road Property Trust was actually a trust.[105] Mr Clayton had reserved for himself such broad powers to access the trust property it was arguable that he had not actually intended to dispose of the property settled under the trust deed in favour of another. The breadth of the powers also conflicted with what has sometimes been called the "irreducible core of trustee obligations", that is, the basic duties a trustee must observe in order for there to be a valid trust.[106] Ultimately the Supreme Court did not decide the issue. It said that the judges did not have a unanimous view and, as the case had settled, it did not need to decide that issue.[107]

20.67 The second argument that no trust exists is that the instrument purporting to create the trust is a sham. The instrument gives the

104 See for example: *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551; *Vervoort v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807; *O v S* (2006) 26 FRNZ 459 (FC); *Glass v Hughey* [2003] NZFLR 865 (HC); and *Begum v Ali* FC Auckland FP004/128/00, 10 December 2004.

105 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551.

106 The phrase "irreducible core of trustee obligations" comes from the English case *Armitage v Nurse* [1998] Ch 241 (CA).

107 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [207].

appearance that a trust has been created but the parties intended to create different rights and obligations regarding the trust property. The legal test for establishing a sham is whether both the settlor and the trustee held a common intention that the trust instrument was a sham.[108] Poor administration of the trust or even breaches of trust do not of themselves establish a sham.[109] A sham can be difficult to prove and therefore the claim is of limited use to a partner at the end of a relationship.[110]

Case Study: The N Family Trust[111]

Nigel and Chloe have been in a de facto relationship for about five years. Over the past six months they have been drifting apart. The house in which Nigel and Chloe live is held on the N Family Trust. The trustees are Nigel's lawyer and accountant. Nigel makes all the decisions about the house and treats the property as his own. Once Nigel requested that the trustees borrow money so Nigel could build an extension to the house. The trustees refused as they were concerned about the trust's finances, but at all other times, the trustees have carried out Nigel's instructions without question.

It is unlikely that Chloe can prove the trust is invalid even though Nigel treats the property like his own. There is no evidence to suggest that Nigel did not intend to create a trust. The trustees also appear to be independent third parties and do not appear to have had a common intention with Nigel that there was a sham.

Establishing a constructive trust over property held on an express trust

20.68 Before the PRA was amended to apply to de facto partners, the main remedy non-married partners had for claiming an interest in each other's property was through a constructive trust. If the property was owned by one partner, but the other had made contributions with the reasonable expectation of obtaining a

108 *Official Assignee v W* [2008] NZCA 122, [2008] 3 NZLR 45; *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551; and *Vervoort v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807.

109 *Official Assignee v W* [2008] NZCA 122, [2008] 3 NZLR 45 at [94].

110 The courts have been reluctant to extend the grounds on which a trust can be said to be a sham. In *Official Assignee v W* [2008] NZCA 122, [2008] 3 NZLR 45 at [57] the Court of Appeal rejected the notion of an "emerging sham." That is a valid trust that is later said to be sham because the parties' intentions change. In the same decision, the Court dismissed the concept of an alter ego trust. That is a trust that is operated as the alter ego of the settlor. The Court explained at [70] that control over a trust alone does not justify the court piercing the trust. In *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 the Supreme Court rejected the concept of an illusory trust. That is a trust that is illusory in the sense that there is an illusion that the trust exists, but in reality the settlor never intended to part with the assets purportedly settled on the trust. The Supreme Court said at [124] there was no value in the "illusory" label. The trust is either valid or invalid.

111 The facts of this example are based on the case *Official Assignee v W* [2008] NZCA 122, [2008] 3 NZLR 45 (CA).

beneficial interest in the property, the courts would often decide that the non-owning partner's contributions gave him or her an interest in the property. The courts gave effect to this interest by declaring that the owner partner held the portion of the value of the property attributable to the partner's contributions on constructive trust for the non-owner partner.

20.69 As many de facto partners took their disputes through the courts, the requirements a partner needed to satisfy to claim a constructive trust have become fairly well settled. The requirements are that:[112]

(a) the person claiming the constructive trust made direct or indirect contributions to the property in question;

(b) he or she had an expectation of an interest in the property;

(c) the expectation was reasonable; and

(d) the property owner should reasonably expect to yield an interest in the property to the claimant.

20.70 The courts have often said that the same principles can apply when the property to which a partner has contributed is already held on an express trust, including in three recent Court of Appeal cases.[113] Each of the three cases concerned partners who lived in a house that was held on a trust. The trusts were closely associated with one of the partners. When the relationships broke down, the PRA did not apply to the houses because they were held on trust. Instead, the partner who did not stand to benefit under the trusts argued that, because of their contributions in maintaining or enhancing the houses, and their expectations in respect of the contributions, they had an interest in the property under a constructive trust. In all three cases the Court of Appeal allowed the claims. The Court reasoned that the cases were straightforward applications of the principles applying to constructive trusts as summarised above.[114] The Court further explained that if there was no constructive trust, the beneficiaries

112 The elements were summarised in the leading case of *Lankow v Rose* [1995] 1 NZLR 277 (CA) at 294 per Tipping J.

113 *Murrell v Hamilton* [2014] NZCA 377; *Vervoort v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807; and *Hawke's Bay Trustee Company Ltd v Judd* [2016] NZCA 397. See also *Prime v Hardie* [2003] NZFLR 481 (HC); and *Marshall v Bourneville* [2013] NZCA 271, [2013] 3 NZLR 766.

114 *Murrell v Hamilton* [2014] NZCA 377 at [63]-[64] and [70]; *Vervoort v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807 at [64]-[65]; and *Hawke's Bay Trustee Company Ltd v Judd* [2016] NZCA 397 at [44].

under the express trusts would receive a windfall from the partners' contributions and therefore be unjustly enriched.[115]

20.71 The potential for a constructive trust claim to be widely used as an alternative to claims under the PRA is explored at paragraph 21.73 to 21.75.

Case study: The P Inheritance Trust

Prudence and David have been in a de facto relationship for about two years. During that time they have lived together on a farm held on the P Inheritance Trust. The farm originally belonged to Prudence's grandparents. Prudence's grandfather settled the farm on the trust to avoid estate duty and to ensure that it stayed in the family. The beneficiaries of the trust are Prudence and her parents. The trustees are Prudence's parents. Since living on the farm, David has done a lot of work by fencing large parts and installing water storage tanks all by himself. David has never been paid for his efforts, but he has been encouraged to work on the farm by Prudence's father's assurances that "now he's part of the family, the farm belongs to him."

Prudence and David have recently separated. David feels like he should have some compensation for all the work he did on the farm.

David might claim a constructive trust over the farm. He has undoubtedly made contributions to the property. The comments made by Prudence's father also suggest there was a reasonable expectation that David would have an interest in the farm.

115 *Murrell v Hamilton* [2014] NZCA 377 at [30]; *Vervoort v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807 at [68]; and *Hawke's Bay Trustee Company Ltd v Judd* [2016] NZCA 397 at [47].

Chapter 21 – The issues

Issue 1: The priority trusts have over rights under the PRA may be causing problems

21.1 The PRA's approach is that, except in narrow circumstances, a partner's entitlement to relationship property does not justify interfering with property held on a trust.[116] The issue we address here is whether this approach is appropriate. In other words, should the purposes that trusts achieve and the interests of beneficiaries be given first priority? Or is a partner's right to the trust property that he or she would otherwise have had under the PRA more deserving?[117]

21.2 In this section, we focus on the following:

(a) First, we discuss the main problems arising from the PRA's limited provisions to deal with trusts.

(b) Second, we identify the main arguments that support the view that trusts should prevail. We also make observations about these views.

21.3 Our intention is to promote discussion and submissions that identify the merits of each position. This will assist us in assessing whether the current approach of the PRA in prioritising trusts needs reform.

116 The sentiment was captured by the Government Administration Select Committee in its report on the Matrimonial Property Amendment Bill 1998 which we discussed above at paragraphs [20.47] to [20.48]. The select committee explained that the Property (Relationships) Act 1976 (PRA) should have limited powers to interfere with the capital of a trust because trusts were created for legitimate purposes and the PRA ought to ensure trusts were respected so these purposes could be fulfilled: Matrimonial Property Amendment Bill 1998 (109-2) (select committee report) at xii.

117 The New Zealand Law Society neatly summarised the issue in its submission to the Law Commission during the Review of the Law of Trusts project (Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [16.5]): "A clear decision needs to be made about whether the equal sharing concept should be paramount. If it is to be paramount, the legislation should clearly say so and contain wider discretions giving the courts freedom to make appropriate orders in relation to trust assets that would otherwise have been relationship property or separate property subject to a court order."

The main problems arising from the PRA's limited provisions to deal with trusts

21.4 The PRA gives the courts limited powers to deal with property held on trust when a relationship ends. This gives rise to three main problems.

The PRA may be powerless to ensure a just division of significant amounts of property

21.5 We believe that a significant amount of what otherwise would be relationship property is held on trust in New Zealand. This removes that property from the application of the rules of the PRA. Given the PRA's limited powers to bring these assets within the pool of relationship property, we consider that the PRA often lacks effective mechanisms to achieve a just division of property.[118]

21.6 From our research, review of the court decisions and preliminary consultation, we can identify several areas of potential unfairness because the PRA does not apply:

(a) **Where the trust holds what would otherwise be key items of relationship property.** In some cases a partner may have a strong legal or moral claim to trust property, such as the family home. If the trust did not exist, a partner may have a claim to the property under the PRA but a trust prevents recognition of a partner's interest in the property held on the trust.

118 For instance, in its final report in the Review of the Law of Trusts project, the Law Commission reviewed judgments decided between 1 February 2008 and 1 February 2013 in which s 44C of the Property (Relationships) Act 1976 was discussed. The Commission found that often there was insufficient relationship property or separate property outside the trust from which the court could adequately compensate a spouse or partner whose interests were defeated by the disposition to the trust (although in some cases relief was available through s 182 of the Family Proceedings Act 1980). See Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.12].

Case study: The QR Family Trust[119]

Quinn and Rosaline have been in a de facto relationship for three years. They have just had their first child. Quinn is 32. He works as a builder. Rosaline is 27. She works as a carer at a rest home.

To date, they have been renting their home. They now decide to buy a house. Quinn and Rosaline have a little money they have saved from their respective incomes. Quinn insists that they buy a house through a trust because, he says, the trust will "protect their assets if anything goes wrong". Rosaline is unsure about the suggestion, but she agrees because she thinks that Quinn knows more about these things than her. Quinn and Rosaline set up the QR Family Trust. Quinn and his lawyer are the trustees. Quinn, Rosaline and their children are all discretionary beneficiaries.

Quinn and Rosaline advance their savings to the trustees to use as a deposit. The trustees then buy a house and fund the balance of the purchase price through a mortgage. Quinn and Rosaline pay the mortgage from the income they earn from their jobs.

A year later Quinn and Rosaline separate. Very little relationship property exists. Rosaline asks Quinn if they can sell the house so she can recoup her savings and start a new life. Rosaline argues that she should be entitled to half the home's equity because she helped finance the house purchase. Quinn says Rosaline can't recover money out of the house because the house "belongs to the trust" and the trustees don't want to sell it. Rosaline must make a claim under section 44 or section 44C of the PRA. Alternatively she could apply for a remedy outside the PRA. In either case, she bears the onus of making a claim which is more burdensome than using the general classification and division rules of the PRA. It is also uncertain whether her claims would be successful and actually meet her desired goal, which is to recover the property she has contributed to the relationship through the trust.

(b) **Where the trust is unsuitable for post-separation circumstances.** In some cases, a trust will be an inappropriate means through which a family holds and uses property after the relationship ends. Often, the partners may have set up a trust assuming that their relationship would continue. Many trusts may be structured to provide financial support for the partners on the premise they remain together. If the partners separate, the PRA provides no mechanism through which to revisit trust structures. Property may be locked in the trust and there may be difficulties in working

119 The facts of this example are based on the case *O v S* (2006) 26 FRNZ 459 (FC).

out how the trust is to be administered if the partners' ability to deal with each other has deteriorated.

(c) **Where trust assets are controlled by one partner.** As we have noted, it is quite common for a partner to exercise a high degree of control over a trust. The partner may be a trustee and have the power to distribute the trust property to the beneficiaries (including to himself or herself) at his or her discretion.[120] Yet, the PRA's conventional analysis of beneficial interests may often ignore who in reality enjoys or controls the trust property as if he or she were owner.[121] In light of the Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]*, the courts may be prepared to deem that powers expressly stated in the trust deed are property. That case was, however, unusual because of the extent of the powers Mr Clayton had under the trust. It is, therefore, uncertain (and probably unlikely) that in future cases the courts will consider lesser powers than those held by Mr Clayton to be property.[122]

Case study: The U Family Trust[123]

Umar and Ariana have been in a de facto relationship for nearly four years. Last year they moved into a house that was under construction. The house was held on the U Family Trust, of which Umar and his accountant are the trustees. Umar and his children from a former relationship are the discretionary beneficiaries. Ariana helped Umar finish the house. She helped landscape the garden and decorate the

120 In the recent cases *Vervoort v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807 and *Hawke's Bay Trustee Company Ltd v Judd* [2016] NZCA 397, the Court of Appeal said (at [70] and [44] respectively) that the reality of the New Zealand trust landscape was that "a good proportion of property is held in discretionary family trusts and trustees are more often than not the beneficiaries of those trusts and in control of them."

121 In its Review of the Law of Trusts project, the Law Commission identified the effective control of trusts as an increasing area of concern for the courts: see Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts Second Issues Paper* (NZLC IP20, 2010) at [5.34]. Similarly, many submitters reported the problem to the Commission: see Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [16.7]). Subsequent commentators have identified the control of a trust as an area where the law has inadequate remedies. See Anthony Grant "An important case on constructive trusts and settlor control" Law News (online ed, Auckland, 2 September 2016) at 4.

122 The Supreme Court emphasised that the terms of the Vaughan Road Property Trust deed were unusual: *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [14]. Consequently, it is unlikely that the judgment in *Clayton* will apply to many trusts. The Court expressly noted (at fn 81) that it left for another day what would be the position had the trust powers been less extensive – both whether the powers were property and, if so, how they would be valued. In the recent case *Da Silva v Da Silva* [2016] NZHC 2064 at [53] the High Court held that the trustee's powers could not amount to property because, unlike the trust in *Clayton*, there was no express provision in the trust deed that said the trustee did not have to observe the ordinary fiduciary duties. See too *Goldie v Campbell* [2017] NZHC 1692, [2017] NZFLR 529.

123 The facts of this example are based on the case *Murrell v Hamilton* [2014] NZCA 377.

interior. Ariana says she did all this work because she and Umar planned to live at the house as partners and she would enjoy the benefits.

Ariana knew the house was owned by the U Family Trust, but Umar treated the property like he was the owner. Umar had managed the construction of the house by himself. He would regularly contract tradespeople by himself without the involvement of his co-trustee. There are no trust records, financial statements or trustee resolutions. Umar seldom contacts his co-trustee.

Ariana and Umar have recently separated. Umar currently lives in the house. Ariana has moved out. Ariana feels she should have some compensation for all the work she put into the property. Ariana goes to see a lawyer and complains that it is unfair that Umar gets to keep the fruit of all her hard work. Ariana's lawyer says that even though it might look like the house belongs to Umar, it is actually held on a discretionary trust. The lawyer advises Ariana she probably cannot claim an interest in the house under the PRA.

In practice, partners may divide trust property as if the trust did not exist

21.7 The second reason the PRA's limited powers against trusts may be a problem is because the PRA does not authorise what appears to be common practice. During our preliminary consultations, we have received anecdotal evidence that often partners will agree to a division of the trust property as if the trust did not exist.[124] Although there is no way for the Commission to test whether the division of trust property is contrary to the terms of the trust in each individual situation, it is reasonable to assume that sometimes the division would constitute a breach of some principles of trust law. For instance, the partners' decision and the trustee's agreement may be an improper surrender of the discretion given to the trustees by the trust deed. Alternatively, the division between the parties may be contrary to the interests of other beneficiaries, such as the children of the relationship. The PRA gives the parties no mandate to divide the trust property in this way. Rather, its aim is to preserve trust structures. This may suggest that some New Zealanders want more flexibility to deal with trusts than the PRA currently gives.[125] In Part J we discuss

124 For example, in the recent Supreme Court case *Thompson v Thompson* [2015] NZSC 26, [2015] 1 NZLR 593 at [18] and [73] the partners had agreed to treat the assets held on a trust as in effect relationship property.

125 This problem also reveals that many New Zealanders who use trusts may not understand the consequences of settling property on trust. Through our research and consultation in this project so far, we have learned that many people who have settled property on a trust have a misconception that they remain the owner of that property. Frequently, people refer to a trust as "their" trust or as "having a trust." There is often little understanding that the property must now be administered in accordance with the terms of the trust and wider trust law.

whether the law should provide the partners and trustees with more flexibility to deal with trusts through a contracting out agreement under Part 6 of the PRA.

Inconsistencies within the PRA

21.8 The PRA's limited powers to affect trusts are arguably incongruous with its provisions regarding contracting out agreements (which allow partners to enter an agreement that determines how the parties will deal with their property if the relationship ends).[126] A trust can have a similar effect to a contracting out agreement because the creation of a trust can also exclude property from division under the PRA.

21.9 The major difference between using a contracting out agreement to exclude property from the PRA and using a trust is that contracting out agreements require the agreement of both partners and are subject to safeguards. The PRA requires that the contracting out agreements be in writing.[127] Each party to the agreement must have independent legal advice before signing the agreement.[128] The signature of each party must be witnessed by a lawyer.[129] The lawyer who witnesses the signature of the party must certify that, before the party signed the agreement, the lawyer explained to that party the effect and implications of the agreement.[130] If any of these requirements is not satisfied, the contracting out agreement is void.[131] While the PRA allows people to manage their financial affairs differently to the PRA, these safeguards ensure that partners do not give away their rights under the PRA without knowing what they are doing.[132]

21.10 In contrast, partners can settle property on trust during the course of their relationship without any safeguards to ensure they know what rights they are giving up under the PRA. If the property is held in the name of only one of the partners, that partner can unilaterally settle the property on trust without having to involve the other partner. There is therefore real scope for trusts, more

126 Property (Relationships) Act 1976, pt 6.

127 Property (Relationships) Act 1976, s 21F(2).

128 Property (Relationships) Act 1976, s21F(3).

129 Property (Relationships) Act 1976, s21F(4)

130 Property (Relationships) Act 1976, s 21F(5).

131 Property (Relationships) Act 1976, s 21F(1).

132 For further discussion see Part J of this Issues Paper.

than contracting out agreements, to be used to take property outside the PRA, in a potentially unfair way.

Why should the protection of trusts be more important than relationship property rights?

21.11 We have identified three main reasons to justify the PRA's limited application to trusts.

Trusts serve legitimate purposes and bestow interests on third party beneficiaries

21.12 Throughout our preliminary consultation, most people we spoke to supported measures to increase the PRA's powers to access property held on trust. Nevertheless, as we have explained, the PRA is founded on the view that the PRA should not interfere with trusts so that the legitimate purposes that trusts serve may be fulfilled, and the legitimate interests of beneficiaries may be protected.[133] We make the following observations in response.

21.13 First, we note that what is considered the "legitimate use of trusts" has changed over time. The abolition of estate duty and gift duty has removed a key motivation for New Zealanders to set up trusts. The Ministry of Social Development will now take into account any disposition of property made to a trust during the applicant's lifetime when deciding whether the applicant has deprived himself or herself of property in order to qualify for a residential care subsidy.[134] Also, the practice of using trusts to redirect income through a trust to beneficiaries in order to be taxed at the minor beneficiaries' lower marginal tax rate was restricted by legislative amendment in 2001.[135] These changes demonstrate that Parliament has been willing to prioritise other

133 Matrimonial Property Amendment Bill 1998 (109-2) (select committee report) at xii. As we have explained, the Parliamentary select committee that reviewed the draft s 44C during the 2001 amendments reasoned that the provision should not include a power to make orders in respect of trust capital because trusts should be allowed to fulfil the legitimate purposes they perform.

134 Previously the Ministry would only assess whether an applicant had settled property on trust in the five year period leading up to an application in order to determine whether an applicant had deprived himself or herself of property in order to qualify for the subsidy. See Bill Paterson "Residential Care Subsidies – Problems and Puzzles" (paper presented to New Zealand Law Society Seminar, 2013) 133 at 134; and Theresa Donnelly "Residential Care Subsidies – Problems and Puzzles: Commentary" (paper presented to New Zealand Law Society Seminar, 2013) 159 at 161–162.

135 Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Act 2001. In the commentary to the Taxation (Beneficiary Income of Minors, Services-Related Payment and Remedial Matters) Bill, the Finance and Expenditure Committee explained that the goal of the amendment was to prevent some families from gaining an advantage over others through the use of a trust: Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) 2000 (70-2) (select committee report) at 2–3.

considerations over what has traditionally been regarded as a permissible use of a trust.[136] There nevertheless remain many reasons why families in New Zealand choose to create trusts, such as to provide property for vulnerable persons or to pass assets to the next generation.

21.14 Second, a partner's freedom to remove assets from the relationship property pool by settling those assets on trust (subject to sections 44 and 44C of the PRA) is inconsistent with the PRA's provisions that apply when partners enter a contracting out agreement. Under those provisions, an agreement that affects a partner's relationship property entitlements but does not comply with the requisite formalities under section 21F is void. In contrast, there is relatively little preventing one partner altering the partners' respective entitlements under the PRA by using a trust.

21.15 Third, trusts are used to protect assets from claims by creditors or from a challenge to a person's will.[137] Even if a court could recover assets from trusts to meet relationship property entitlements, it does not mean that the remainder of the trust assets can then be claimed by third parties. Any third party claims would still be governed by a different part of the law.

21.16 Fourth, a focus on a trust's ability to protect property from creditors, or from tax liability, may overlook the fact that the preservation of the trust property is not the overall objective. Rather, the purpose of the trust is the protection of assets *for the benefit of the beneficiaries*. The view that trusts serve legitimate purposes should arguably focus on the nature of the beneficiaries' interests under the trust and how the trust deals with the property for their benefit. If, for example, a trust is used to protect assets for partners' use, there may be compelling reasons to distribute the trust property under the PRA's equal sharing regime when the partners separate. Conversely, if a trust has been established to ring fence assets for children's education costs or for charitable giving, there is arguably less fairness in redistributing those assets to meet relationship property claims.

136 We are mindful that none of the relevant law changes in the examples we have given had the effect of changing the law so that assets can be removed from trusts. Rather, the changes allow decision-makers to include or exclude assets a person has settled on trust when assessing that person's income or personal assets. In contrast, any amendment to the Property (Relationships) Act 1976 would probably provide greater powers so that trust property could be divided as relationship property.

137 In particular, a will can be challenged under the Law Reform (Testamentary Promises) Act 1949 and the Family Protection Act 1955 whereas a trust cannot.

In short, it is more helpful to analyse for whose benefit or for what purpose the trust assets are protected, rather than upholding protection of assets as an end in itself.

21.17 Fifth, in some circumstances it may not seem right that a beneficiary should have a greater interest than the partners to what would otherwise be relationship property. A beneficiary will not normally have provided valuable consideration in return for the interest he or she receives under the trust. The interest will usually be a gift. In contrast, a partner's interest in relationship property under the PRA is usually to recognise that a partner is entitled to the property because of his or her contributions to the relationship.[138] The PRA's priority of those entitlements is central to the PRA's concept of a just division of property.[139]

21.18 On the other hand, there may be cases where it would be unfair to deny beneficiaries their interest under the trust. In some cases, the partners may have jointly settled the trust expressly for the benefit of a third party knowing the consequences of the trust on their personal rights. For example, parents may have genuinely wished to gift property to their children to provide for their needs and chose to use a trust to do so. In those circumstances, it is arguably less fair to allow the partners to reclaim the trust property as relationship property.[140]

21.19 There may also be cases where the trust property is provided from an external source rather than through the joint and several efforts of the partners in the course of their relationship. For example, a partner may have settled the trust long before the relationship began. Alternatively, a third party may have settled the trust. In New Zealand, some families have created what can be described as "dynastic trusts". Dynastic trusts are established to hand down key family assets from parents to children and grandchildren.[141] Dynastic trusts have commonly been used to

138 See Part C – for disucssion of the definition of relationship property.

139 The Property (Relationships) Act 1976 gives priority to a partner's interest in relationship property in the sense that the rights to an equal share in relationship property displace the ordinary legal rules of ownership that would apply between the partners (s 4). In some circumstances, the partner's interest in relationship property will prevail over third parties, like unsecured creditors: see s 20B and the priority it gives to a partner's "protected interest", discussed further in Part K of this Issues Paper.

140 Peart raises the valid point that when partners separate and a partner makes a claim in respect of trust property, the court's focus is on giving effect to the dominant social policy of equality between parties to a relationship. The interests of other trust beneficiaries, including children of the separated partners, are subordinated to the policy of equality between the parties: Nicola Peart "Protecting Children's Interests in Relationship Property Proceedings" (2013) 13 Otago LR 27 at 35.

141 Jessica Palmer "What to do about trusts?" (paper prepared for University of Otago Colloquium on '40 Years of the PRA: Reflection and Reform' 8-9 December 2016) at 3; and Nicola Peart "The Property (Relationships) Act 1976 and Trusts:

hold farm property.[142] If the trust property is not attributable to the relationship, the partners have a very weak claim to that property based on the principles of the PRA. The case of dynastic trusts raises the question of whether the wishes of a person (most likely from a previous generation) to pass assets to his or her descendants should stop a partner from making claims against that property under the PRA.[143]

21.20 It is important to note that a partner may be able to make claims in relation to property held on a trust settled by a third party. There may be cases where a partner has made significant contributions to the trust property. Those contributions may have maintained or enhanced its value.[144] For example, partners who have lived and worked for over twenty years on a farm held on trust will usually have had an impact on the farm's sustained or enhanced value. If those contributions were coupled with a reasonable expectation that the partner would gain an interest in the property, the partner could potentially claim a constructive trust over the trust property.[145] It may be preferable that all remedies that a partner may bring against a trust in respect of contributions made during a relationship are contained within the PRA. We discuss this point and constructive trusts claims further below.

21.21 It is difficult to weigh up the competing claims of the partners, settlors and the beneficiaries to trust property. In each case their interests, needs and expectations regarding the trust will differ. The following examples indicate some of these difficulties.

Case study: The TT Education Trust

Clarissa and Anuj have two daughters: Tabitha and Tessa. Tabitha and Tessa are aged 14 and 12. They are both doing very well at school. They both say that one day

Proposals for Reform" (2016) 47 VUWLR 433 at 456.

142 Jessica Palmer "What to do about Trusts?" in Jessica Palmer, Nicola Peart, Margaret Briggs and Mark Henaghan (eds) *Modern Family Finances – Legal Perspectives* (2017, Intersentia, Cambridge) (forthcoming); and Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2016) 47 VUWLR 443 at 456. There is, however, some indication that trusts may be less popular as a way of passing family farms to the next generation. Instead, more farmers may be relying on corporate structures to allow children to take a passive ownership over the farm asset. See Robin Martin "Dairy farmers struggle to pass on the family farm" (18 April 2017) Radio New Zealand <www.radionz.co.nz>.

143 See discussion in Chapter 10 in relation to whether gifts and inheritances from third parties should be treated as a special form of separate property.

144 When a partner's actions or contributions of relationship property enhance or maintain the separate property of the other partner, the contributing partner may be entitled to a relationship property interest in the enhanced value (s 9A) or compensation (s 17).

145 See discussion on constructive trusts above at [20.68]–[20.71].

they would like to study at university. Clarissa and Anuj recently subdivided the land on which their home sits. They then sold the new section. Clarissa and Anuj agree that they will settle the sale proceeds on a trust called the TT Education Trust. The purpose of the trust is to save money for Tabitha and Tessa to use in the future towards their university fees. Clarissa and Anuj are the trustees of the TT Education Trust. Tabitha and Tessa are discretionary beneficiaries.

A year later Clarissa and Anuj separate. As they divide their property they realise that the property and income they had collectively as a family will not stretch as far, once divided across two households. Clarissa and Anuj start to wonder whether they can unwind the TT Education Trust.

Case study: The H Trust

Vincent and Maia have recently decided to live together. They would like to buy their own house but cannot afford to do so. Vincent's parents purchase a house through the H Trust. The H Trust was created several years ago by Vincent's parents. Vincent is a discretionary beneficiary along with his parents and siblings. Vincent's parents allow Vincent and Maia to live in the house. Over the course of the relationship Vincent and Maia pay no rent to the trustees for living in the house. They do, however pay all other outgoings, such as rates, insurance and the costs of basic maintenance, from their incomes.

Their relationship lasts four years and then they decide to separate. Maia would like to claim an interest in the house. Vincent and his parents reject the claim. They say that the house was provided through the trust. Maia is not a beneficiary. Any contribution Maia made over the course the relationship was offset by the considerable benefits she received by living there rent free.

Case study: The Z Family Trust

Hao and Yu worked very hard over the course of a 30 year marriage to build up a successful pharmaceutical business. Hao was a skilled salesperson and was the public face of the business. Yu was a very good administrator and performed an invaluable role in keeping the company's accounts and records in order. Some years ago, the partners made plans to return to China for their retirement. They wanted to provide an income stream for their two children in New Zealand. Consequently, they set up the Z Family Trust. The trustee is their accountant. The discretionary beneficiaries of the trust are their two children and grandchildren. Hao and Yu then settled the shares they held in the pharmaceutical company on the Z Family Trust.

About six months ago Hao told Yu he was leaving her. He returned to China and took with him the majority of the partners' savings. Since the separation, Yu has also become estranged from her two children. She now wishes to unwind the trust.

She wants to regain control of the shares in the business she spent so many years building up.

Case study: The J Family Trust

Micah and Yvonne live in Hamilton. They have been married for 8 years. Micah's parents are farmers. They hold the farm on the J Family Trust. They created the trust to ensure the farm property could pass intact to any of their children who had an interest in continuing the farm. Micah is a discretionary beneficiary of the J Family Trust. Micah's parents decide it is time for them to retire, but they would like Micah to carry on the family farm. Micah and Yvonne agree. They sell their home in Hamilton and move onto the farm. They decide to invest the proceeds from the sale of their Hamilton home into the farm by funding the development of raceways and an irrigation system. Micah and Yvonne work long hours on the farm.

Some years later Micah and Yvonne separate. The partners own few assets. Yvonne would like to recover a portion of the farm's value which she says has been enhanced by the investment of the proceeds from the sale of their house in Hamilton and her labour. Micah does not accept Yvonne's claim to the farm. He thinks that the farm was provided by his parents and it is a key asset that he would like to remain in his family. If Yvonne is to be paid what she claims, part of the farm must be sold. Micah is reluctant for that to happen.

These scenarios are intended to show how partners' wishes regarding a trust can compete with the other interests in respect of the trust. It is often difficult to decide whose interests should take priority.

There is no proper basis to grant partners greater rights to recover trust property over other deserving parties

21.22 Just as trusts have the potential to defeat a partner's rights to property under the PRA, a trust may prevent other parties from claiming against the trust property. For example, a debtor's creditors will (subject to exceptions such as fraud) have no ability to claim against property that the debtor has on trust. Similarly, if a person owes money to the state, such as an unpaid tax liability, property cannot be recovered from the trust. If the PRA was amended to give a partner greater rights to recover property held on trust, the amendment might be seen as giving a partner superior rights regarding trusts than other deserving third parties.[146]

146 Peart has written about the Law Commission proposals to extend the ambit of s 44C: Nicola Peart "Protecting Children's Interests in Relationship Property Disputes on Separation" (paper presented to New Zealand Law Society CLE Ltd

21.23 In our view, there are two reasons why it might be appropriate for a partner to have greater rights. First, a partner's claim to property under the PRA is different to the claims of most creditors. A partner's claim to the property is not a debt or liability; it is an entitlement to the property that arises because of the equal contributions of the partners to the relationship.[147]

21.24 Second, partners should not be treated the same way as creditors because the nature of the relationship is different. Voluntary creditors enter an agreement balancing the benefit with the risk that the other party may fail to pay the debt and there may be no assets that the creditor can touch. Partners contribute directly and indirectly to accumulate relationship assets without undertaking the same risk analysis.[148] Given that partners do not approach each other "at arm's length" as creditors do, it is perhaps unreasonable to expect them to do so.

The law ought to allow people to hold and deal with property as they wish

21.25 A partner's freedom to deal with his or her property during the relationship as he or she wishes is a key feature of the PRA. Section 19 provides that nothing in the PRA prevents a partner from disposing or entering any legal transaction as if the PRA did not exist. Section 19 allows a partner to settle his or her property on trust even if that property is in fact relationship property and would therefore be divided equally if the partners were to separate.[149] The ability to unwind a partner's actions and take property out of a trust would arbitrarily interfere with the freedom to deal with his or her property. Indeed, the PRA would not usually restrict a partner's rights to gift his or her property outright to third parties. Why should there be an exception for trusts?

Conference "The PRA in the GFC – uncertainty in uncertain times", 22 February 2013). Among other things, Peart says it is not obvious why spouses or partners should have far reaching remedies to recover property from trusts, when other deserving groups, such as creditors and the taxpayer, do not enjoy these rights and protections: at 32.

147 See *S v S* [2001] NZFLR 367 (FC) at [37]–[51]. The Family Court applied this reasoning to hold that a wife's claim under the Property (Relationships) Act 1976 against her bankrupt husband did not require the leave of the High Court under the Insolvency Act 1967 because the wife's claim under the Insolvency Act was not a debt or liability for the purposes of the Act.

148 Nicola Peart "Intervention to Prevent the Abuse of Trust Structures" 2010 NZ L Rev 567 at 570.

149 The main exceptions to this are if one partner disposes of the property in order to defeat the rights or claims of the other partner under s 44 of the Property (Relationships) Act 1976, or, if the property in question is land, the non-owner partner has lodged a notice of claim on the title under s 42 of the Act.

21.26 The counterargument is that it has always been possible to unwind transactions under the PRA when there is a threat to relationship property rights. Sections 44 and 44C are examples of such provisions. The question is whether the right balance has been struck between a person's freedom to deal with property on the one hand and properly recognising a person's entitlements to relationship property on the other. The problems with the PRA's current provisions, particularly sections 44 and 44C, suggest the right balance may not have been struck and that greater protection of entitlements to relationship property is needed.

CONSULTATION QUESTIONS

G2 Are there any other reasons why people create trusts that we have not mentioned?

G3 Do you agree that the protection given to trusts over the rights of partners under the PRA is a problem?

G4 Do you agree with the reasons we have identified for and against the PRA's current position towards trusts? Do you have any other reasons to add?

G5 For what reasons and in what circumstances should a partner have rights under the PRA to recover property from a trust?

Issue 2: It is unclear whether an interest in a trust is property

21.27 The second issue we have identified is that the PRA struggles to analyse interests in a trust in a clear and consistent way. There are three particular areas of difficulty:

(a) interests under a trust and the PRA's definition of property;

(b) interests under a trust and section 44C of the PRA; and

(c) the classification of an interest in a trust.

Interests under a trust and the PRA's definition of property

21.28 Under general legal principles, some of the interests that arise under a trust are property interests and some are not. As we have

explained earlier in this part, the conventional position under the PRA is that:[150]

(a) a vested beneficial interest constitutes property;

(b) a contingent beneficial interest constitutes property; and

(c) a discretionary beneficial interest does **not** constitute property.

21.29 The courts' view that discretionary beneficial interests are not property is based on the conventional principle that a discretionary beneficiary has no more than a hope or expectation that the trustee will exercise his or her discretion in the beneficiary's favour.[151] The difficulty with this analysis is that it does not address the situation where it is highly likely that the trustees will in practice exercise their discretion in the beneficiary's favour.

21.30 It may appear contrary to common sense that the courts should ignore this likelihood, especially when the likelihood can be clearly discerned. Other laws go as far as to identify factors to assess whether a discretionary beneficiary will receive a benefit from the trust. For example, regulation 8(4) of the Legal Service Regulations 2011 provides that when an applicant's eligibility for legal aid is assessed, the Legal Services Commissioner will assess an applicant's discretionary beneficial interest in a trust with regard to:

(a) how the trust arose or was created;

(b) the terms and conditions of the trust;

(c) the person or persons who have power to appoint and remove trustees or beneficiaries;

(d) the history of the trust's transactions (for example, distributions);

(e) any change in the membership of trustees;

(f) any changes in the class of beneficiaries; and

(g) the source of income or capital that the trust receives.

150 See paragraphs 20.30–20.34. Note, the classification of beneficial interests into vested, contingent and discretionary interests is a general breakdown and there are many further subtleties in the legal analysis of these issues.

151 See paragraph 20.32 above; and *Hunt v Muollo* [2003] 2 NZLR 322 (CA) at [11].

21.31 Some expert valuers also suggest that a discretionary beneficial interest under a trust can be valued like any other item of property.[152] They list similar factors when assessing how the interest can be valued.[153]

21.32 Nevertheless, in cases under the PRA the courts have been reluctant to determine whether a discretionary beneficial interest amounts to property based on the likely benefit a beneficiary will receive from the trust.[154]

21.33 Although the courts have said that a final beneficiary's contingent interest constitutes property under the PRA, the courts' analysis has not taken into account the likelihood that the beneficiary will ultimately receive no property from the trust.[155] The courts appear to have based their view on the Court of Appeal's comments in *Johns v Johns* that a contingent interest is enjoyed "as of right" when the condition is satisfied.[156]

21.34 We understand that most family trusts in New Zealand are structured so that:

(a) the trustees have power to distribute trust property to discretionary beneficiaries; and

(b) at the date the trust comes to an end, the trustees are required to distribute any residual trust property to the "final" beneficiaries.

21.35 The final beneficiaries in this situation have a contingent interest. But their interest is reliant on:

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152 Tobias Barkley "Valuing Discretionary Interests and Accompanying Rights" (2013) 7 NZFLJ 223; and Brendan Lyne "Valuation and Expert Financial Evidence in PRA Cases" (paper presentedNew Zealand Law Society PRA Intensive, October 2016).

153 Barkley identifies nine factors to determine the value of a discretionary beneficial interest: (1) the intentions of the settlor; (2) the fiduciary duties of the trustees; (3) the number of beneficiaries; (4) the manner in which the power has been exercised in the past; (5) the size of the trust fund; (6) any criteria, including a letter of wishes, provided by the settlor in relation to the exercise of discretion by the trustees; (7) the number and identity of default beneficiaries; (8) the existence of any other powers such as a power to reduce or enlarge the class of discretionary beneficiaries; and (9) the relationship of the beneficiaries to the settlor and the trustees. See Tobias Barkley "Valuing Discretionary Interests and Accompanying Rights" (2013) 7 NZFLJ 223 at 225.

154 In some cases, however, the courts have referred to a partner's powers to control a trust as a "bundle of rights" that has value as property see *M v B* [2006] 3 NZLR 660 (CA) at [112]–[119]; and *Walker v Walker* [2007] NZFLR 772 (CA) at [97]–[98]. Despite these references, the bundle of rights argument has not been widely adopted: see Chris Kelly and Greg Kelly "Trusts Under Attack: The Legal Landscape Following the Clayton Litigation" (paper presented to Cradle to Grave Conference, Auckland, May 2016) at 14. The Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 is an instance where the Court looked beyond Mr Clayton's interest solely as a discretionary beneficiary. However, in that case, the Court found that Mr Clayton's powers as "Principal Family Member" were tantamount to a general power of appointment, which is beyond the interest of a discretionary beneficiary.

155 *Q v Q* (2005) 24 FRNZ 232 (FC) at [125]; *B v M* (2004) 24 FRNZ 610 (HC) at [101]; *O v S* (2006) 26 FRNZ 459 (FC) at ([82]–[88]); *Prasad v Prasad* [2014] NZFC 8298 at [39]; and *H v R* [2017] NZFC 761 at [30]–[32].

156 *Johns v Johns* [2004] 3 NZLR 202 (CA) at [49]. Followed in *Q v Q* (2005) 24 FRNZ 232 (FC) at [120]–[127].

(a) their survival to the date the trust is wound up; and

(b) there being residual trust property remaining for distribution.

21.36 Sometimes it may be very unlikely that the final beneficiary would receive a distribution of the residual trust property. The beneficiary may not survive until the date of distribution because that date extends beyond the expected lifespan of the beneficiary. Alternatively, it may be very likely that the trustees will distribute all the trust property to the discretionary beneficiaries before the date of distribution. These considerations have prompted some commentators to say that a contingent interest should not constitute property under the PRA until the contingency is satisfied and the beneficiary is entitled to the trust property.[157] Nevertheless, the courts have not relied on this analysis.

21.37 The courts' focus on conventional principles rather than the actual nature of a trust may also have a bearing on procedural matters. Section 37 of the PRA provides that any person "having an interest in the property" which would be affected by a court order under the PRA has a right to be heard in proceedings before the court. In one case, the Family Court said that beneficiaries with only a discretionary interest will not have an interest in the trust property that entitles them to be heard.[158] The Court relied on the cases that found a discretionary beneficial interest does not come within the PRA's meaning of property.[159] The Court said that beneficiaries with a contingent or vested interest, however, will have an interest in the property that will entitle them to be heard.[160] On this analysis, it is possible that a partner could have settled a trust with a clear and informed intention that the trust would provide irrevocable benefits to third party beneficiaries. The trust instrument may, however, only provide that the beneficiaries have a discretionary interest. In that situation, the beneficiaries would have no right under the PRA to defend their interest before the court if a partner challenged the trust. It may be fairer that all

157 RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [4.47]; and Kate Davenport and Stephanie Thompson "Piercing the trust structure at a relationship's end: interesting developments in trust law from the New Zealand Supreme Court" (2016) 22(8) Trusts & Trustees 864 at 873. See also *Ma v Ma* [2016] NZHC 1426. In that case the High Court held that a beneficiary's contingent interest in the trust as a final beneficiary did not constitute a caveatable interest. The Court reasoned that the beneficiary would only receive a vested interest on vesting date and therefore she had no present interest in the property on which to support a caveat.

158 *H v R* [2017] NZFC 761 at [26].

159 *H v R* [2017] NZFC 761 at [26].

160 *H v R* [2017] NZFC 761 at [30].

parties who have a realistic prospect of benefiting from the trust are entitled to be heard.

Interests under a trust and section 44C

21.38 In cases under section 44C of the PRA, the courts have not treated interests in a trust consistently. Section 44C offers a remedy in the situation where placing property on trust means that only one partner's interest in the property is lost. However, in several cases a partner has disposed of property to a trust in which both partners have only discretionary beneficial interests.[161] If a discretionary beneficial interest does not constitute property, section 44C could not apply because technically both partners' rights to the property under the PRA have been defeated.

21.39 The courts have been prepared to depart from this approach. In *R v R* partner A made a claim under section 44C.[162] The other partner (partner B) argued that he was also disadvantaged by the disposition because he was only a discretionary beneficiary under the trust. The High Court observed that partner B was a shareholder and director of the company that acted as trustee of the trust and that he had personally made all decisions as to drawings from the trust property. The Court said these factors gave the partner control over the trust even though he was a discretionary beneficiary.[163] The Court concluded that section 44C applied. It said that section 44C should be interpreted in a way that recognised the partner's control over the trust even if he only had a discretionary beneficial interest.

21.40 The High Court's approach in *R v R* is an unspoken acknowledgement that a partner who controls a trust *in fact* has a property interest. It seems odd however that on the same facts, the court would probably find that the partner had no property interest for the purpose of dividing relationship property under the PRA.[164]

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161 See for example *N v N* [2005] 3 NZLR 46 (CA); and *R v R* [2010] NZFLR 82 (HC).

162 *R v R* [2010] NZFLR 82 (HC).

163 *R v R* [2010] NZFLR 82 (HC) at [31]–[34]. The court drew on the reasoning of the Court of Appeal in the leading case *N v N* [2005] 3 NZLR 46 (CA). In that case Mr N made a transfer of relationship property to a trust under which he and Mrs N were both discretionary beneficiaries. The Court of Appeal noted at [149] that Mr N had considerable power over the trust and that this was a case in which Mr N could be required to compensate his wife under s 44C of the Property (Relationships) Act 1976. In the later case of *S v L* FC Taumarunui FAM-2007-068-78, 19 June 2009 at [72] the Family Court held that compensation orders under ss 44C(2)(a) and 44C(2) (b) of the Property (Relationships) Act 1976 should only be made against a partner who had effective control of the trust.

164 As we have already explained, the Supreme Court has recently accepted that in certain circumstances a partner's powers to control a trust can amount to property under the Property (Relationships) Act 1976: *Clayton v Clayton [Vaughan Road*

Classification of an interest under a trust as relationship property or separate property

21.41 The PRA classifies property acquired by a partner because he or she is a beneficiary under a trust settled by a third person as separate property.[165] The PRA is silent on the classification of the property if the trust has been settled by one of the partners. It is unclear how that property should be classified.

21.42 The Supreme Court has suggested that if the interest under the trust was acquired after the start of the relationship, it would be relationship property (because of section 8(1)(e) of the PRA). In *Clayton v Clayton [Vaughan Road Property Trust]*, the Supreme Court said that Mr Clayton's powers over the Vaughan Road Property Trust amounted to property. As those powers had been acquired after the relationship with Mrs Clayton began, the Court said they were relationship property.[166]

21.43 The Court also decided that the trust property would have been relationship property if it had not been settled on the trust.[167] The Court added that if the trust property had been separate property, it may have been appropriate to invoke the exception to equal sharing under section 13.[168]

21.44 Contrary to the Supreme Court's view, the authors of *Fisher on Matrimonial and Relationship Property* suggest that if, before the partner settled property on the trust, it was his or her separate property, the partner's powers or other interest in that trust should remain the partner's separate property.[169]

21.45 The classification of an interest in a trust settled by one of the partners therefore remains questionable, although the Supreme

Property Trust] [2016] NZSC 29, [2016] 1 NZLR 551. As we explain, at [21.46] to [21.52], the Supreme Court's reasoning is unlikely to apply widely because few trusts grant powers as extensive as those enjoyed by Mr Clayton. Consequently, it is probable that the courts will continue to accept a lower threshold when analysing a partner's interest in a trust for the purposes of s 44C than it would if analysing whether that partner's interest constitutes property.

165 Property (Relationships) Act 1976, s 10.

166 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [85]–[90].

167 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [80]. The Court's finding that the trust property would otherwise have constituted relationship property came from a concession made in the Family Court that the value of Mr Clayton's separate property before the relationship began was $500,000.

168 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [89]. Section 13 of the Property (Relationships) Act 1976 allows the court to depart from equal sharing if there are "extraordinary circumstances that make equal sharing … repugnant to justice." Section 13 is, however, not aimed at injustices regarding the classification of property but rather when equal division is repugnant to justice.

169 RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [4.47].

Court's judgment suggests that the interest will be relationship property if acquired after the relationship began.

Issue 3: The Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]* did not resolve the tension between the PRA and trusts

21.46 The decision in *Clayton v Clayton [Vaughan Road Property Trust]*[170] is the first time the New Zealand Supreme Court has held that powers to control a trust can constitute property under the PRA. However, the decision does not resolve the underlying tension between relationship property rights and trusts.[171]

The Supreme Court's reasoning in *Clayton v Clayton [Vaughan Road Property Trust]* is fact specific

21.47 The Supreme Court found that Mr Clayton's powers over the Vaughan Road Property Trust amounted to property because they were so extensive. In particular, Mr Clayton had a collection of powers under the trust deed that allowed him to give all the trust property to himself without considering the interests of other beneficiaries. The trust deed modified the fiduciary duties that would ordinarily control Mr Clayton's actions as trustee. He was authorised to exercise his powers to benefit him even if it conflicted with the interests of the other beneficiaries.

21.48 The Supreme Court stressed that the terms of the Vaughan Road Property Trust deed were "unusual."[172] Evidently the Supreme Court did not think its decision in respect of the peculiar and far reaching terms of the Vaughan Road Property Trust deed would apply to many trusts. There have been a small number of subsequent cases in which one partner has argued the other partner's powers amount to property based on the Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]*.

170 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551.

171 The Supreme Court was not, of course, attempting a comprehensive reform of law in this area. It dealt with the facts before it and applied the law as it related to those facts.

172 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [14].

In each of those cases the courts distinguished the terms of the trust from the Vaughan Road Property Trust on the basis that the partner's powers in those cases were not as extensive as Mr Clayton's and therefore did not amount to property.[173]

The concept of trust powers as property is complex

21.49 We also think that partners will struggle to apply the *Clayton v Clayton [Vaughan Road Property Trust]* decision to their disputes regarding trusts.[174] The basis of the Supreme Court's approach in *Clayton v Clayton [Vaughan Road Property Trust]* was its view that because the PRA is social legislation, the definition of property should be interpreted more broadly than traditional concepts of property. The Court considered that property may include rights and interests that would not, in other contexts, be property rights or property interests.[175] To decide the case before it, the Supreme Court did not need to explain what other rights and powers to control a trust would amount to property, nor what the position would have been if Mr Clayton's powers been less extensive.[176]

21.50 Butler cautions that a departure from traditional property principles without firm legislative guidance undermines the certainty and predictability that the law requires.[177] Other commentators are concerned with what they see as considerable uncertainty as to what powers will amount to property and how those powers are to be valued.[178]

21.51 A further question arising from the *Clayton v Clayton [Vaughan Road Property Trust]* decision is whether a finding that powers

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173 *Da Silva v Da Silva* [2016] NZHC 2064; *B v B* [2017] NZHC 131; and *Goldie v Campbell* [2017] NZHC 1692, [2017] NZFLR 529.

174 Again, we emphasise that the Supreme Court was not attempting to propose a simple reform to the law that would resolve the underlying difficulties posed by trusts in the context of Property (Relationships) Act 1976 claims.

175 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [38]. The Supreme Court of the United Kingdom has taken a different approach to Clayton. Prior to the Clayton decision, it said that the same principles of property law applied in family law as in other areas of law. In *Prest v Petrodel Resources Ltd* it was argued that, owing to the high degree of control the other partner exercised over a number of companies, the property belonging to those companies could be equated as the partner's property. The Supreme Court of the United Kingdom rejected the submission that a special and wider principle applied when interpreting the concept of property under the legislation. Lord Sumption reasoned (*Prest v Petrodel Resources Ltd* [2013] UKSC 34, [2013] 2 AC 415 at [37]):

> *Courts exercising family jurisdiction do not occupy a desert island in which general legal concepts are suspended or mean something different. If a right of property exists, it exists in every division of the High Court and in every jurisdiction of the county courts. If it does not exist, it does not exist anywhere.*

176 *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [80].

177 Andrew Butler in Mark O'Regan and Andrew Butler "Equity and trusts in a family law context" (paper presented to New Zealand Law Society Family Law Conference, 21 November 2011) 269 at 292.

178 Chris Kelly and Greg Kelly "Trusts Under Attack: The Legal Landscape Following the Clayton Litigation" (paper presented to Cradle to Grave Conference, May 2016) at 14–15.

amount to property means that the person who holds the powers has a direct interest in the trust property.[179] This issue becomes particularly important in cases concerning a notice of claim over trust property.[180] Section 42 of the PRA enables a partner who claims an interest in land to lodge a notice of that interest on the title to the land. There have been three cases since *Clayton v Clayton [Vaughan Road Property Trust]* in which the courts have considered an application to remove a notice of claim one partner has lodged on the title to land held on trust.[181] In each case, the partner seeking to justify the notice of claim argued that the other partner's powers to control the trust gave an interest in the trust assets, being the land. The courts came to different decisions. In *U v M* the High Court held that the partner was able to support a notice of claim against land held on trust on the basis that the other partner had the power to appoint and remove the beneficiaries of the trust.[182] In contrast, in *H v JDVC* the Court of Appeal held that a partner's power to appoint trustees and beneficiaries could not give rise to an interest in land.[183] The Court held that until the husband exercised the power to appoint himself as a beneficiary, he did not have a present interest in the trust property.

21.52 The concept of powers as property is unlikely to prove a workable solution to resolve the many issues that trusts pose to relationship property rights.

179 At one point in the judgment, the Supreme Court said that Mr Clayton's powers gave him an interest in the Vaughan Road Property Trust and its assets: *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 at [80]. Later in the judgment, the Court questioned whether Mr Clayton did indeed have a direct interest in the underlying assets of the trust, and preferred to "leave that issue for argument in a future case": at [104], n 101.

180 The application of s 42 notices of claim to trust property is also discussed in Chapter 14.

181 *U v M* [2015] NZHC 742; *H v JDVC* [2015] NZCA 213, (2015) 30 FRNZ 521; and *B v B* [2017] NZHC 131.

182 *U v M* [2015] NZHC 742. See too *B v B* [2017] NZHC 131 in which a partner argued he had an interest in the land by virtue of the other partner's powers over the trust that held the land. The High Court dismissed the argument by distinguishing between the powers enjoyed by the partner in this case and the greater powers enjoyed by Mr Clayton in *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551. At no point in the judgment did the Court say the notice of claim could not be sustained because the partner's powers did not give an interest in the underlying trust assets. The High Court referred to *U v M* [2015] NZHC 742 but it did not refer to the later Court of Appeal judgment *H v JDVC* [2015] NZCA 213, (2015) 30 FRNZ 521.

183 *H v JDVC* [2015] NZCA 213, (2015) 30 FRNZ 521 at [53]. The Court of Appeal did not refer to the High Court's decision in *U v M* [2015] NZHC 742.

Issue 4: Remedies outside the PRA to recover property held on trust are inconsistent and create procedural difficulties

21.53 A partner whose relationship property entitlements have been frustrated by a trust may look to avenues outside the PRA to claim an interest in that property. We have set out above the main alternatives to the PRA. To summarise, they are:

(a) a claim under section 182 of the Family Proceedings Act 1980;

(b) a claim that the partner's contribution to the trust property has given rise to a constructive trust;

(c) a claim that the trust is invalid or a sham; and

(d) the court's intervention to ensure the proper administration of the trust.

21.54 Generally, the alternative avenues do not sit happily alongside the PRA regime or even with each other. They are based on different policy grounds or seek to protect interests in the trust property which are different in nature. The courts appear to have relied on these remedies because they are frustrated with discretionary trust structures and the limited powers under the PRA to deal with them.[184] The result is that the courts are developing remedies that create inroads into trusts that are far wider than the PRA would otherwise allow.

21.55 The most striking contrast is perhaps between section 44C of the PRA and section 182 of the Family Proceedings Act.[185] Section 44C is intended to protect a partner's rights to relationship property. It will apply when transferring property to a trust defeats a partner's

184 In *Vervoort v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807 at [70] the Court of Appeal justified the imposition of a constructive trust over property held on an express trust because the Court needed to recognise the "reality of the New Zealand trust landscape". In the Law Commission's Review of the Law of Trust's project, the Commission noted that the court's development of the "bundle of rights" concept (the idea that rights in a trust form property in their own right, similar to the principle developed in Cla*yton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551) appeared to have been adopted from frustration at the ability of the Property (Relationships) Act 1976's provisions to deal with discretionary trusts: see Law Commission *Some Issues with the Law of Trusts in New Zealand: Review of the Law of Trusts Second Paper* (NZLC IP20, 2010) at [4.33].

185 See discussion in N Peart, M Henaghan and G Kelly "Trusts and relationship property in New Zealand" (2011) 17 Trusts & Trustees 866 at 873 regarding the different policies underpinning the Property (Relationships) Act 1976 and s 182 of the Family Proceedings Act 1980.

rights under the PRA. This section has been purposefully limited so a court cannot make orders in respect of a trust's capital. Section 182 of the Family Proceedings Act seeks to protect a partner's reasonable expectations regarding a nuptial settlement. This section rests on the philosophy that when those expectations are frustrated owing to changed post-separation circumstances, a court may justifiably vary the settlement. The focus under section 182 is not an equal entitlement to relationship property but a partner's reasonable expectations of the benefits he or she would have received had the marriage continued.[186] A court has a largely unfettered discretion as to how it varies a trust under section 182. It can therefore make orders regarding a trust's capital.[187]

21.56 A partner may also invoke the High Court's supervisory jurisdiction under the Trustee Act 1956 or the Court's inherent jurisdiction to ensure a trust is being properly administered. Under this type of claim, the Court is primarily concerned that the trust is being administered in accordance with its trust deed and the law of trusts. The Court is not focused on extracting property from the trust to divide between partners. Rather, the court's aim is to ensure the trust structure is respected.

21.57 Likewise, a partner's claim of a constructive trust over the trust property has a different focus. The courts' approach has been to inquire into a partner's reasonable expectations of an interest in the property to which he or she has made contributions. The courts have also said they are keen to ensure the beneficiaries do not obtain a windfall at the contributing partner's expense. The focus is on the partner's contributions to the property rather than the PRA's primary focus on contributions to the relationship.

21.58 The inconsistencies between these remedies are a significant issue for the following reasons:

(a) The PRA claims to be a code which applies over other law.[188] Yet plainly it has not been drafted to provide comprehensive avenues of redress nor prevent the application of the wider law. Instead, the partners will often rely on external avenues of redress that are underpinned by differing, if not conflicting, principles.

186 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [51]–[54].

187 Also, the remedy under s 182 of the Family Proceedings Act 1980 is only available to married couples; unlike the Property (Relationships) Act 1976 it does not apply to de facto relationships.

188 Property (Relationships) Act 1976, s 4.

This undermines the PRA's intent to codify this area of law.[189]

(b) The various remedies create procedural disharmony. As we cover in detail in Chapter 26, the respective jurisdictions of the Family Court and the High Court to consider partners' claims regarding trusts are unclear. In some instances, the courts' respective jurisdictions overlap; sometimes they are distinct. This can create difficulties as to the appropriate court in which to start proceedings, particularly if the proceedings concern questions under the PRA and a claim against a trust under the wider law. There may also be an issue with timing. Section 182 provides that the Family Court has jurisdiction to make orders to vary a nuptial settlement only on or within a reasonable time of making orders dissolving a marriage. Disputes under the PRA may be brought to court even if neither partner has applied for a divorce. The discrepancy in timing may pose difficulties and contribute to delays if a partner is attempting to bring all claims in one proceeding at the same time.[190]

(c) Some commentators have said that the various remedies lead to inconsistent outcomes with inconsistent reasoning. This presents challenges for professional advisers who may struggle to draft effective documents and give clear advice.[191] The law is unpredictable given the evolving nature of the remedies.

21.59 While the inconsistencies between the various avenues of redress are a significant issue, the benefit is that the courts have a range of powers to use in different circumstances. It will be clear from the scenarios discussed in this Part that trusts are created for many different reasons and in many different circumstances. The different remedies at the courts' disposal provide flexibility to address the particular circumstances of each trust.

189 Nicola Peart "Intervention to Prevent the Abuse of Trust Structures New Zealand" [2010] NZ L Rev 567 at 599; and Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.4].

190 A dissolution of marriage or civil union is only available after the parties to the marriage or civil union have been living apart for a period of two years: see Family Proceedings Act 1980, s 39.

191 Greg Kelly "Recent Developments in Trusts" (paper presented to Legalwise Seminar, Wellington, 25 February 2016) at 18.

CONSULTATION QUESTIONS

G6 Do you agree that the remedies to be used for property held on trust give rise to the problems identified?

G7 Should the main avenues for redress be found solely under the PRA? Are there disadvantages in this approach?

Issue 5: Section 182 of the Family Proceedings Act 1980

21.60 In addition to the issues with section 182 of the Family Proceedings Act 1980 (section 182) discussed earlier, we note the following problems.

Section 182 is very broad and its ambit remains uncertain

21.61 Commentators believe that the Supreme Court's decision in *Clayton v Clayton [Claymark Trust]* will lead to more findings of a nuptial settlement and therefore increased application of section 182.[192] That is because the Court confirmed that a nuptial settlement simply requires some connection or proximity between the settlement and the marriage.[193] The Court observed that where there is a trust set up during a marriage with either or both parties to the marriage as beneficiaries, there will almost inevitably be that connection.[194]

21.62 Commentators also say it is uncertain how section 182 will apply to certain trusts.[195] In particular, they consider that in *Clayton v Clayton [Claymark Trust]* the Supreme Court left open the question of what would happen where:

(a) a trust is settled by a third party during the marriage and one spouse is included among a wider class of beneficiaries; or

192 Chris Kelly and Greg Kelly "Trusts Under Attack: The Legal Landscape Following the Clayton Litigation" (paper presented to Cradle to Grave Conference, May 2016) at 22.

193 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [34].

194 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [34]. See too Chris Kelly and Greg Kelly "Trusts Under Attack: The Legal Landscape Following the Clayton Litigation" (paper presented to Cradle to Grave Conference, May 2016) at 22.

195 Kate Davenport and Stephanie Thompson "Piercing the trust structure at a relationship's end: interesting developments in trust law from the New Zealand Supreme Court" (2016) 22(8) Trusts & Trustees 864.

(b) one party settles a trust with no particular marriage in mind.

21.63 The Supreme Court in *Clayton v Clayton [Claymark Trust]* commented that a trust and any subsequent settlement of property to that trust are distinct.[196] Peart likewise suggests that it is possible for a trust to continue in existence but any additional dispositions of property to that trust are to be seen as a fresh settlement.[197] In contrast, the Court of Appeal in *W v W* rejected the argument that a subsequent disposition of property to a trust after it is settled constitutes a new settlement.[198] The Court said, "[t]he settlement is the trust itself and any trust property (whenever acquired) must be part of the settlement."[199]

21.64 It is difficult for partners to ensure that a trust will not be subject to a section 182 claim. Sometimes partners can agree that they will not make a claim against a trust associated with the relationship. However, the courts have said that only in limited circumstances can the partners effectively make a contracting out agreement under Part 6 of the PRA that they will not make a section 182 claim. In *W v W*, the Supreme Court said that a contracting out agreement could only preclude a claim under section 182 if the trust was part of the contracting out agreement, such as by attaching the trust deed to the agreement or through some other way so that the precise terms of the trust formed part of the agreement.[200] This requires a high degree of formality which many partners may not observe.

21.65 Despite the uncertainties with section 182, there are advantages. First, the remedy gives the court flexibility to intervene in cases involving trusts to divide assets between the spouses. Second,

196 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [36]. The Court's comment was obiter, meaning it was not a ruling of law and therefore not binding on other courts. It is also the view expressed by Kiefel J in *Kennon v Spry* [2008] HCA 56, 238 CLR 366 at [228].

197 Nicola Peart "Relationship property and trusts: unfulfilled expectations" (paper presented to New Zealand Law Society Relationship Property Intensive, August 2010) 1 at 21.

198 *W v W* [2009] NZCA 139, [2009] 3 NZLR 336. Nevertheless, in *Kidd v Van den Brink* [2010] NZCA 169 the Court of Appeal granted leave to appeal on whether further property settled onto an existing trust could be considered a nuptial settlement.

199 *W v W* [2009] NZCA 139, [2009] 3 NZLR 336 at [33]. This view is also supported by the judgment of Heydon J in the High Court of Australia decision *Kennon v Spry* [2008] HCA 56, 238 CLR 366 at [183] in which the Judge rejected the "multi-trust" theory – that every separate disposition creates a new trust.

200 *W v W* [2009] NZSC 125, [2010] 2 NZLR 31 at [33]–[34]. The Court reasoned that, first, if a nuptial settlement is too easily regarded as part of the agreement, the remedial scope of s 182 would be narrowed. The Court noted that the criteria for setting aside a contracting out agreement ("serious injustice") is more onerous than those that apply to vary a trust under s 182. Secondly, in order to be binding, the parties to a contracting out agreement must have first received independent legal advice. The Court cautioned that if a deed of trust is not incorporated into the agreement, the parties may not have had independent legal advice before becoming bound by the terms of the trust. The Supreme Court approved this reasoning in *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [98].

some people say that section 182 respects trusts as the court may only intervene if the trust was first intended to provide for the spouses.[201] If that purpose fails, the court will only vary the trust to ensure the spouses' reasonable expectations of provision from the trust are not defeated.

Section 182 and its relationship with the PRA

21.66 Several commentators have said that Parliament's decision to retain section 182 alongside the PRA is strange.[202] As we have already noted, a court's power to vary a trust under section 182 is far wider than the limited powers the court has under the PRA. It is odd that the Family Proceedings Act and the PRA should take such different positions regarding trusts when both statutes are aimed at resolving partners' property affairs after their separation.

21.67 A possible explanation for Parliament's decision to leave section 182 untouched can be found in the legislative materials to the 2001 amendments to the PRA. The 2001 amendments were, in part, a response to calls to increase the courts' powers to make orders regarding trusts.[203] When reviewing the Matrimonial Property Bill in 1998, the Parliamentary Select Committee considered whether section 182 should be incorporated into the PRA. The Committee received advice from the Ministry of Justice on the point. The Ministry explained that, although the lower courts had permitted the variation of trusts in which a spouse was a discretionary beneficiary, the Court of Appeal had not yet considered the issue. The Ministry advised that it was unclear whether the application of section 182 to discretionary trusts would be upheld by the Court of Appeal.[204] Consequently, the terms of section 182 of the FPA were not brought into the PRA.

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201 Nicola Peart "The Property (Relationships) Act 1976 and Trusts; Proposals for Reform" (2016) 47 VUWLR 443 at 459.

202 Commentators have said that the inclusion of s 182 of the Family Proceedings Act 1980 alongside the relationship property regime is "curious", an "anomaly" and "without a clear rationale and purpose": see Nicola Peart "Relationship property and trusts: unfulfilled expectations" (paper presented to New Zealand Law Society Relationship Property Intensive, August 2010) 1 20; Kate Davenport and Stephanie Thompson "Piercing the trust structure at a relationship's end: interesting developments in trust law from the New Zealand Supreme Court" (2016) 22(8) Trusts & Trustees 864 at 873; and B Atkin and W Parker *Relationship Property in New Zealand* (LexisNexis, Wellington, 2009) at 208.

203 Department of Justice *Report of the Working Group on Matrimonial Property and Family Protection* (2nd ed, October 1988) at 30.

204 Ministry of Justice *Trusts – Effect of Clause 47 Matrimonial Property Amendment Bill* (MPA/MJ/3, Ministry of Justice, 7 October 1998 at 3; Ministry of Justice *Matrimonial Property Bill – Departmental Report – Clause by Clause Analysis* (MPA/MJ/4, Ministry of Justice, 2 March 1999) at 31. The Ministry of Justice also advised that the proposed amendments to the Property (Relationships) Act 1976 were based on an underlying policy position that dispositions of property to trusts should not be unwound so as to defeat the legitimate purposes for which the trust was created. Subsequent cases and commentators do not appear to have appreciated that the Government Administration Committee had considered the issue.

21.68 Since the 2001 amendments, the Supreme Court has confirmed that section 182 does indeed apply to discretionary trusts.[205] The power in section 182 has emerged as a useful provision to deal with property held on trusts that do not come under the PRA.[206] Consequently, section 182 has taken on greater significance than expected. This may be good cause to revisit whether the two regimes should be brought together.

Section 182 and de facto relationships

21.69 Section 182 applies to marriages and civil unions but not to partners in a de facto relationship. The Law Commission and some commentators believe section 182 should be changed so de facto partners are treated the same as married partners.[207] The partners' separation, rather than the married partners' divorce, would be the event which allows the court to exercise its powers under section 182.

Issue 6: Whether there are adequate remedies in the wider law to deal with trusts and rights under the PRA

Invalid trusts

21.70 Arguably many of the difficulties caused by trusts in the context of relationship property rights could be avoided if the courts more often found that a trust is invalid, either because the intended trust does not meet basic requirements of a trust, or because the trust is a sham.[208]

205 *W v W* [2009] NZSC 125, [2010] 2 NZLR 31; and *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590.

206 Several submitters made this point to the Law Commission during the Review of the Law of Trusts project: Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.41].

207 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.43]–[19.44].

208 See for example Anthony Grant "Effective Control and Sham Trusts" Law News (online ed, Auckland, 23 September 2016); Mark Henaghan "Family Law" [2016] NZ L Rev 356 at 379; Nicola Peart and Jessica Palmer "Double Trouble – The Power to Add and Remove Beneficiaries and the Power to Appoint and Remove Beneficiaries" (paper presented to New Zealand Law Society Trusts Conference, June 2015) 35 at 39; and Kate Davenport and Stephanie Thompson "Piercing the trust structure at a relationship's end: interesting developments in trust law from the New Zealand Supreme Court" (2016) 22(8) Trusts & Trustees 864. In recent years the courts have not developed other types of claims to challenge the validity of a trust. In particular, the courts have dismissed the concept of an "alter ego" trust: see *Official Assignee v W* [2008] NZCA 122, [2008] 3 NZLR 45. More recently the Supreme Court has dismissed the concept of an "illusory trust" see *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551.

21.71 In *Review of the Law of Trusts: A New Trusts Act for New Zealand* the Law Commission expressed concern at the lack of remedies where trust property is in reality under the settlor's control.[209] The Law Commission recommended a new Trusts Act that sets out the essential characteristics of a trust and the limits of what settlors can do.[210] These recommendations have largely been taken up in the Trusts Bill which is currently before Parliament.[211]

21.72 A claim that a trust is invalid is unlikely to be a useful tool in PRA disputes. This is mainly because it is difficult to make a claim, both in terms of the evidence required and the complex legal argument needed, to persuade a court that a trust is invalid. If the proposed Trusts Bill is enacted, the claim that a trust does not meet the essential characteristics of a trust may be more straightforward. Nevertheless, it will continue to be difficult to determine whether some trusts are legitimate or not.[212]

Constructive trusts

21.73 The recent cases in which the courts have recognised a constructive trust over property held on an express trust have been criticised.[213] The main complaint about the remedy is that the trustees are not the beneficial owners of the trust property so there is no interest for them to pass on.[214] The remedy is therefore seen as taking the existing beneficiaries' rights in order to compensate a partner for his or her unpaid services in respect of trust property.[215]

21.74 A key aim of the 2001 amendments was to avoid the need for partners in de facto relationships to make constructive trust claims. Prior to 2001, this was the main avenue through which a de facto partner could claim an interest in his or her partner's

209 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [4.13].

210 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [3.23]–[3.41].

211 Trusts Bill 2017 (290-1).

212 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [3.29] in which the Law Commission made a similar observation.

213 Charles Rickett: "Instrumentalism in the Law of Trusts: the Disturbing Case of the Constructive Trust Upon an Express Trust" (2016) 47 VUWLR 463; and Nicola Peart (ed) *Brookers Family Law — Family Property* (online looseleaf ed, Thomson Reuters) at [TU12.02].

214 Nicola Peart (ed) *Brookers Family Law — Family Property* (online looseleaf ed, Thomson Reuters) at [TU12.02(c)].

215 Charles Rickett: "Instrumentalism in the Law of Trusts: the Disturbing Case of the Constructive Trust Upon an Express Trust" (2016) 47 VUWLR 463 at 473.

assets. It was a difficult process.[216] Court proceedings were often long and complex.[217] Parliament considered that it was preferable to extend the PRA to include de facto relationships as the PRA's rules of property division were seen as a better way to resolve disputes inexpensively, simply and speedily.[218]

21.75 We do not consider that constructive trust claims are a suitable remedy to address the problems caused by trusts in a relationship property context. To require partners to found their interests on constructive trust principles would, in our view, be a step backward given the policy and principles of the PRA.[219]

Ensuring proper administration of a trust

21.76 The remedies that are currently available to ensure the proper administration of a trust have a limited application to relationship property issues. The main remedies include reviewing trustee decisions,[220] replacement of trustees when the partner's separation has negatively affected the administration of the trust[221] and seeking information about the trust.[222] The key limitation is that none of these remedies provide a means of dividing trust property between the partners. A partner who is not a beneficiary has no standing to apply to the court to seek any of these remedies. These remedies therefore have insufficient impact to resolve relationship property disputes when trusts are involved.

CONSULTATION QUESTION

G8 Are there any further issues that trusts cause when a relationship ends?

216 The law culminated in the leading decision *Lankow v Rose* [1995] 1 NZLR 277 (CA). Prior to the inclusion of de facto relationships in the Property (Relationships) Act 1976 (PRA) regime, constructive trust claims under the principles articulated in *Lankow v Rose* were the main avenue of redress for partners who stood outside the PRA.

217 See for example Department of Justice *Report of the Working Group on Matrimonial Property and Family Protection* (October 1988) at 70.

218 There is also an issue of whether a partner's interest under a constructive trust in this context would constitute relationship property and therefore be subject to equal sharing between the partners. This question does not appear to have yet been considered by the courts. The question demonstrates the complexities that can arise when claims through other legal avenues are not harmonised with the scheme of the Property (Relationships) Act 1976.

219 See Chapter 3 for a discussion on the policy and principles of the Property (Relationships) Act 1976.

220 Trustee Act 1956, s 68.

221 Trustee Act 1956, s 52. See for example *Osborne v Wilson* HC Auckland CIV-2005-4054-1252, 8 September 2005; *K v K* HC Wellington CIV-2010-485-2444, 8 March 2011; and *Khanna v Khanna* [2014] NZHC 1715.

222 The High Court has an inherent jurisdiction to supervise the administration of trusts. The Court's supervisory jurisdiction encompasses trustees' decisions to provide information to beneficiaries. See *Erceg v Erceg* [2017] NZSC 28, [2017] 1 NZLR 320 at [50]-[62].

Chapter 22 – Options for Reform

Reform is necessary – what are the options?

22.1 The central question in this Part is whether the PRA strikes the right balance between enabling a just division of property at the end of a relationship and the preservation of trusts. We recognise that there are good reasons to preserve property on trust, particularly where a trust is legitimately created to provide for third party beneficiaries. On the other hand, we note the many problems that trusts can cause when the partners divide their property at the end of the relationship. Principally, a trust can prevent the partners from sharing in property attributable to the relationship. We have also observed that the effectiveness of sections 44 and 44C of the PRA is limited. Our preliminary view is that the PRA does not strike the right balance.

22.2 We also note that a partner can make several claims against a trust which are outside the PRA. For example, where trusts are involved, many partners will make claims under section 182 of the Family Proceedings Act 1980. It is also becoming more common for partners to claim that a trust is subject to a constructive trust in their favour. These claims are based on different principles. They may need to be brought in separate proceedings in a different court. The result is that the law is complex, unpredictable and procedurally inefficient.

22.3 Our preliminary view is that the PRA should be reformed so that partners' rights under the PRA more readily prevail against trusts. While we have considered the option of making no change to the law as it stands, we do not consider that this is a real alternative.[223]

22.4 Any option for reform in this area would ideally have several characteristics:

223 The Trusts Bill 2017 (290-1) currently before Parliament does not contemplate any substantive amendments to the provisions relating to trusts in the Property (Relationships) Act 1976 or the Family Proceedings Act 1980. The Bill proposes an expansion of the Family Court's jurisdictions to make orders under the legislation when determining proceedings under its own statutory jurisdiction (cl 136). Otherwise, the provisions of the Trusts Bill do not overlap with the options for reform presented in this Chapter.

(a) The reform should enhance the PRA's ability to provide a just division of property when property is held on trust.

(b) Not all trust property should be subject to the PRA. Any new provision needs to be able to distinguish between trust property that should and should not be classified or divided under the PRA. That is:

  (i) The treatment of trusts should be consistent with the wider scheme of the PRA. There are stronger reasons to subject trust property to division between the partners if the property has the character of relationship property. Conversely, trusts that contain what should be classified as the separate property of one of the partners, such as an inheritance from a parent, should not generally be subject to orders recovering that property for division between the partners.

  (ii) When one or both partners established a trust, or settled property on an existing trust, and both partners knew the effect of the trust or the settlement and consented to it, there is less cause to recover the property held on the trust.

  (iii) When one or both partners established a trust, or settled property on an existing trust, with the intention of irrevocably providing third party beneficiaries with the benefit of the property, there is greater cause to prioritise the interests of the beneficiaries over the interests of a partner under the PRA.

(c) Any provision that makes trust property available to meet relationship property entitlements should interfere with the trust to the least extent possible.

(d) Any provision that makes trust property available to meet relationship property entitlements should be simple and lead to predictable outcomes as far as possible.

(e) There are good reasons for the remedies (in whatever form they ultimately take) to be within the PRA. The PRA rests on the implicit principle we identified in Part A that a single, accessible and comprehensive statute should regulate the division of property when partners separate. It is preferable that the remedies within the

PRA be broad enough that partners do not need to seek relief outside the PRA.

22.5 We are conscious that there is no "silver bullet" solution. Given the competing interests at stake in this area, it is challenging to craft an option for reform that will perfectly balance all the issues at stake. There does not seem to be any consensus on how the law in this area should be reformed. We therefore expect that for all options we present below, there will be varying degrees of support and opposition. In short, there is no obvious answer as to how to find the right balance between enabling a just division of property and the preservation of trusts.

22.6 We present four options for reform:

(a) Option 1: revise the PRA's definition of property to include all beneficial interests in a trust;

(b) Option 2: revise the PRA's definition of relationship property to include trust property that is attributable to the relationship;

(c) Option 3: broaden section 44C;

(d) Option 4: introduce into the PRA a new provision modelled on section 182 of the Family Proceedings Act 1980.

22.7 The first two options are aimed at expanding the type of property to which the PRA's equal sharing regime applies. These options could be brought into the PRA to complement the existing remedies in sections 44 and 44C, although section 44C would apply in fewer cases. Option 3 is different. It is aimed at strengthening section 44C. If this option were to be implemented, it would replace the existing section 44C. Option 4 would introduce a power into the PRA to vary trusts. If implemented, it would probably exist alongside section 44C, either in its current or amended form.

22.8 It is possible to implement some of the options in combination with one another. However, options 1 and 2 would both increase the extent of property the PRA would classify as relationship property and potentially overlap. It is also likely that each option individually would significantly increase the property available for division between the partners. For that reason, it may be preferable that only one of the options be implemented.

22.9 Whichever option is preferred, we support the repeal of section 182 of the Family Proceedings Act. It is preferable to have all remedies within the PRA to ensure consistent principles and procedure. It would also improve the accessibility and clarity of the law to have all relevant provisions in the same statute.

22.10 Section 44 of the PRA should not be removed. Section 44's application is broader than dispositions of property to trusts. It applies generally to all dispositions intentionally aimed at defeating claims and rights under the PRA. The law regarding the application of section 44 is now fairly well settled and appears sound.

Option 1: Revise the PRA's definition of "property" to include all beneficial interests in a trust

22.11 The PRA's definition of property could be enlarged to include broader rights and interests than traditional concepts of property.[224] One way of doing this could be to include any interest under a trust through which it is both likely and permissible that the partner will receive a distribution of the trust property.[225] It may include a partner's power of appointment which is exercisable in favour of himself or herself.[226]

22.12 In determining whether a distribution of trust property is likely, the PRA could list several matters the court could take into account, such as the nature of the relationship between the partner and the trustees, the history to the establishment of the

224 Jessica Palmer "What to do about Trusts?" in Jessica Palmer, Nicola Peart, Margaret Briggs and Mark Henaghan (eds) *Modern Family Finances – Legal Perspectives* (2017, Intersentia, Cambridge) (forthcoming) in which Jessica Palmer discusses this option.

225 This amendment should expressly exclude trusts in which a partner holds a beneficial interest that falls within what is not commonly understood to be a "family trust". For example, a partner's beneficial interest may arise under a superannuation scheme or an investment scheme that are structured as trusts. In most cases, a partner's interest in such schemes is likely to come within the Property (Relationships) Act 1976 (PRA) because it is either a vested interest, and therefore come under the PRA's existing definition of property, or it is a superannuation scheme entitlement as defined separately by the PRA. Trusts in connection with Māori land within the meaning of Te Ture Whenua Māori Land Act 1993 would also be excluded, see Property (Relationships) Act 1976, s 6.

226 A general power of appointment would already be considered property under the current definition of property in the Property (Relationships) Act 1976 following the Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551. Powers of appointment have had legislative recognition as property in certain instances. See Estate and Gift Duties Act 1968, s 8 (now repealed, but provided that the extent of a dutiable estate included any property over or in respect of which the deceased had at the time of his or her death a general power of appointment); Family Property Act SM 2017, c F25, s 1(1); Family Law Act RSO 1990, c F3, s 4(1); and Family Law Act SBC 2011, ch 25, s 84(3)(b).

trust and the source of the trust property, whether the partner has the power to appoint and remove trustees and beneficiaries, whether any distributions from the trust have been made to the partner in the past, and any other relevant circumstances.[227]

22.13 A similar approach is adopted in many other statutory instruments. For example, in the Child Support Act 1991 and the Legal Service Regulations 2011 there are provisions that direct the court to look at the probable benefits related to a person's interest in a trust.

22.14 These pieces of legislation do not, however, lead to the recovery of property held on a trust, which would be the consequence under the PRA. Rather, they are a way of deeming an interest in a trust to be a person's personal property when undertaking a means testing exercise. These examples also operate in a different policy context. The objective of the relevant legislation is to ensure the State does not shoulder a financial burden which a person is capable of meeting from property at his or her disposal. Nevertheless, the provisions show that it is possible to adopt a definition of property that is focused on the actual benefits a person is likely to enjoy from a trust rather than pursuant to traditional legal concepts.[228]

22.15 The effect of including qualifying discretionary beneficial interests within the PRA's definition of property would be that the interest can be treated like any other item of property under the PRA. It will be classified as either relationship property or separate property. If the discretionary beneficial interest is relationship property, its value will be shared equally between the partners.

22.16 Consequential amendments may be needed to clarify two issues. First, although section 10 provides that property received under a trust settled by a third party is separate property, the classification of property received under a trust settled by one of the partners is not stated. The PRA may need to expressly provide that interests in a trust settled by one of the partners during the relationship are relationship property. Second, there is the argument that if the

227 The list of matters set out in reg 8(4) of the Legal Service Regulations 2011 could provide a useful model for some of the matters the court could take into account.

228 In England and Wales, s 25(2)(a) of the Matrimonial Causes Act 1973 (UK) requires a court to take into account the "financial resources" of the partners to a marriage when making orders dividing their property. In determining what constitutes a financial resource, the courts will attribute the assets of a trust in which a partner holds a beneficial interest to the partner if it is likely the trustees will advance the assets to that partner, even if that beneficial interest is only a discretionary interest: see *Thomas v Thomas* [1995] 2 FLR 668 (CA) at 670; *A v A* [2007] EWHC 99 (Fam), [2007] 2 FLR 467; and *Charman v Charman (No 4)* [2007] EWCA Civ 503, [2007] 1 FLR 1246.

underlying trust assets are separate property the partner's interest in that trust should be separate property.[229] Our preliminary view is that a discretionary beneficial interest in a trust that arose under a trust settled by a partner during the relationship should be classified as relationship property in accordance with general rule of classification in section 8(1)(e). If the interest arose under a trust settled by a third party, section 10 would apply and classify the interest as separate property.

22.17 An approach which seeks to quantify the benefit a person can receive under a trust may not take into account the legitimate interests of other beneficiaries, particularly child beneficiaries. We consider that when the court comes to determine a partner's interest in a trust it would need to ensure the legitimate interests and needs of children under a trust are not neglected.[230] This may require a court to preserve an element of the trust property on the same terms for the benefit of the children. Alternatively, a court may wish to settle a share of a partner's property interest on trust for the benefit of the children under section 26 of the PRA.[231]

22.18 As noted above, the courts have held that beneficiaries with only a discretionary interest in a trust do not have a sufficient interest which entitles them to be heard when a court considers whether to make orders in respect of a trust in PRA proceedings.[232] We suggest section 37 would need to be amended to entitle all beneficiaries to be heard in PRA proceedings concerning a trust, not just those beneficiaries with a conventional property interest under the trust.

Advantages and disadvantages of amending the PRA's definition of "property"

22.19 The main advantage of this option is that it addresses a partner's true interest in a trust. A partner could not hide from the PRA's equal sharing regime by settling property on a trust under which he or she holds only a discretionary beneficial interest. The

229 RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [4.47]. See discussion at paragraphs [21.41] to [21.45] above.

230 See the Supreme Court's comments in *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [58].

231 The Supreme Court in *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 observed in a footnote that s 26 of the Property (Relationships) Act 1976 gave the courts power to settle property for the benefit of children. A greater reliance on s 26 in this context may need to go hand in hand with reforms to s 26 to increase the section's effectiveness. We discuss potential reforms in Part I of this Issues Paper.

232 See the discussion above at paragraph 21.37. See also *H v R* [2017] NZFC 761 at [26].

focus on the likely distributions of property a partner would receive from a trust could then avoid many of the anomalies that currently arise under the PRA. The inconsistent way in which the PRA currently handles the types of interest in a trust would be less of a problem. If a partner wished to ensure his or her interest under a trust stood outside the PRA regime, he or she would need to enter a contracting out agreement with the other partner in accordance with Part 6 of the PRA. The interests of the other partner are better protected by the safeguards in the contracting out regime.

22.20 The primary disadvantage of this option is the risk that trust structures could be devised in a way that conceals a partner's real interest in the trust. For example, a trust deed might not name a partner as a beneficiary but may give the trustees, or even a third party, the power to add or remove beneficiaries at a later point in time. Under such a structure a partner could be added as a beneficiary and receive distributions of the trust property after a relationship has ended. It might be difficult for the PRA's definition of property to capture such arrangements.[233] Therefore the focus on a partner's interest in a trust as the basis for dividing property under the PRA may not be a reliable factor for determining the extent of property that ought to be shared between the partners. The appearance of the partner's interest in the trust can be easily manipulated.

22.21 Second, the extent or value of a partner's interest in a trust may not be as extensive as the interest the other partner feels he or she should have in the trust property. To take an extreme example, a trust holds significant property that, were it not for the trust, would be considered relationship property. A court may find, however, that it is only likely that the partner will receive a small distribution of property from the trust. Or the interest may have been granted before the relationship began, or from a third party, in which case the interest would not be relationship property. The result would be that the partner's limited interest, if any, would be subject to equal division, but the majority of the trust property, that would otherwise be shared equally, would be untouched.

233 Another example could be if a trust named a company or some other entity that was associated with a partner as a beneficiary. The trust would give the appearance that the partner held no direct beneficial interest in the trust, but in reality owing to his or her connection with the named beneficiary, he or she would be the de facto beneficiary.

22.22 Third, discerning the true nature of a partner's interest in a trust is not a simple exercise. The court would probably need to inquire into many matters to consider the likelihood that a partner would receive a distribution of the trust property, such as the terms of the trust deed, the relationship between a partner and a trustee, the history of the dealings between the trustees and the partner, and the nature of the other beneficiaries' interests. When all this evidence is before the court (which may be challenging in itself if third parties are unwilling to provide information), it may still be a difficult task to determine precisely what interest the partner holds. There is then the further issue of how that interest is to be valued. Although there is consensus that many interests in trusts are capable of valuation,[234] the methodology is not simple. It will require a valuer to take into account many factors.[235] The valuation exercise will involve predictions, namely how the trust is likely to be administered in the future. Such factual and valuation evidence may be expensive to obtain and the issues arising may make any court hearing complex.

Option 2: Revise the PRA's definition of "relationship property" to include some property held on trust

22.23 An alternative way of enlarging the range of property to which the PRA applies is to focus on the underlying trust property rather than a partner's interest in the trust. This option would involve three key changes to the PRA.

234 See Tobias Barkley "Valuing Discretionary Interests and Accompanying Rights" (2013) 7 NZFLJ 223; and Brendan Lyne "Valuation and Expert Financial Evidence in PRA Cases" (paper presented to New Zealand Law Society PRA Intensive, October 2016).

235 Tobias Barkley "Valuing Discretionary Interests and Accompanying Rights" (2013) 7 NZFLJ 223 at 225 and Brendan Lyne "Valuation and Expert Financial Evidence in PRA Cases" (paper presented to New Zealand Law Society PRA Intensive, October 2016) at 76-77, identify nine factors that a valuer should take into account. Barkley further says there will be considerable contingencies and uncertainties, although Lyne does not agree. Palmer and Peart say that the Supreme Court when valuing Mr Clayton's powers in *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 should have allowed a discount to reflect the possibility that Mr Clayton would have exercised his powers as trustee and Principal Family Member to distribute property to other family members: see Jessica Palmer and Nicola Peart "*Clayton v Clayton*: a step too far?" (2015) 8 NZFLJ 114. Kelly and Kelly, when commenting on the Clayton case, say that the valuation should also consider whether Mr Clayton would ever have removed the assets from the protection of the trust: see Chris Kelly and Greg Kelly "Trusts Under Attack: The Legal Landscape Following the Clayton Litigation" (paper presented to Cradle to Grave Conference, May 2016) at 15–16.

(a) Include a new definition of "trust property" in section 2 of the PRA

22.24 First, a new definition of "trust property" would be introduced to section 2 of the PRA. It would provide that trust property means any property (within the meaning of the PRA's existing definition of property) held on a trust, regardless of whether either or both partners settled the trust or hold a beneficial interest under the trust.[236]

(b) Include trust property attributable to the relationship within the PRA's definition of Relationship Property

22.25 The second change would be to amend the definition of relationship property. A proportion of the value of the trust property would be relationship property where two elements are satisfied:

(a) that proportion of the value of the trust property is "attributable to the relationship"; and

(b) the court is satisfied that it is just to treat that proportion of the value of trust property attributable to the relationship as relationship property having regard to –

(i) whether, with informed consent, the partners intended to irrevocably alienate the property for the benefit of third parties;

(ii) whether the trust was intended to meet the needs of minor or dependent beneficiaries;

(iii) whether the trust was intended to provide benefits to the partners on the basis that the relationship would continue;

(iv) whether either or both partners received consideration for any property disposed of to the trust and if so the amount of that consideration;

236 The definition would probably need to expressly state that trust property does not include any property in which a partner has a superannuation scheme entitlement or any trust in connection with Māori land within the meaning of Te Ture Whenua Māori Land Act 1993. That would prevent overlap with the Property (Relationships) Act 1976's separate treatment of superannuation scheme entitlements and its general exclusion of Māori land.

(v) whether the partners received any benefit from the trust during the relationship; and

(vi) any other relevant matter.

22.26 We discuss each of the two elements in greater depth below.

First element: A proportion of the value of the trust property is attributable to the relationship

22.27 The focus of this option is on the character of the underlying trust assets rather than Option 1's focus on the nature of the partner's beneficial interest in the trust.

22.28 The attribution test is used throughout the PRA where the property in which a partner claims an interest is held by a different person. For example, superannuation scheme entitlements, which are held by the superannuation scheme provider, are relationship property under section 8(1)(i) to the extent they are attributable to the relationship.[237] An increase in value of one partner's separate property is relationship property pursuant to section 9A if the increase was attributable to the application of relationship property or attributable to the actions of the non-owning partner.[238]

22.29 There is, however, some uncertainty about what "attributable" means. In interpreting the word as used in section 9A, the courts have relied on the Court of Appeal judgment in *Hartley v Hartley*.[239] In that case, Somers J explained that the word attributable meant "owing to or produced by."[240] Thus, in the context of section 9A, it is only the increase in value of separate property owing to or produced by the application of relationship property or the direct or indirect actions of the non-owning partner that becomes relationship property.[241] Some causative link is required.

22.30 A difficulty is that the classification of property under the PRA generally does not depend on establishing direct causation. As we explained in Part A, the PRA treats a qualifying relationship as a

237 Property (Relationships) Act 1976, s 8(1)(i). See too s 8(1)(g), which refers to the proportion of value of any life insurance policy attributable to the relationship.

238 Property (Relationships) Act 1976, ss 9A(1) and (2).

239 *Hartley v Hartley* [1986] 2 NZLR 64 (CA) at 75 relied on by the Supreme Court in *Rose v Rose* [2009] NZSC 46, [2009] 3 NZLR 1 at [29].

240 *Hartley v Hartley* [1986] 2 NZLR 64 (CA) at 75 per Somers J.

241 *Rose v Rose* [2009] NZSC 46, [2009] 3 NZLR 1 at [29]–[30].

partnership or joint venture to which each partner contributes equally, although perhaps in different ways.[242] When the relationship ends, the PRA grants each partner an entitlement to an equal share of relationship property based on the equal contributions each partner has made to the relationship. It is only in exceptional cases that a partner is required to show that his or her specific contributions have led to the acquisition or enhancement of a specific item of property.[243]

22.31 Consequently, in order to maintain consistency with the general scheme of the PRA, the phrase "attributable to the relationship" should probably not be too strictly construed. It should be understood to encompass property that may have been produced indirectly by the partners' contributions to the relationship.[244] By way of example, in our view a proportion of the value of trust property is likely to be attributable to the relationship where:

(a) **The property was the partners' relationship property before it was settled on trust.** For example, the partners settle their joint savings accumulated during the relationship on trust.

(b) The trust property was acquired from the proceeds of relationship property. For example, the partners pool their savings acquired during the relationship and use them to fund the deposit for a house which is later settled on trust.

(c) **The trust property's value has been sustained or enhanced by the application of relationship property.** For example, the partners use their income to pay for maintenance or improvements to a family holiday home which is held on trust.

(d) **The trust property's value has been sustained or enhanced by the direct actions of either or both partners during the relationship.** For example,

242 This is reflected in the explicit and implicit principles of the Property (Relationships) Act 1976, discussed in Chapter 3.

243 Principally, s 9A(2) provides that where an increase in value of one partner's separate property is attributable to the actions of the non-owning partner, the increase in value is divided in accordance with each partner's contributions to that increased value. The courts have noted that this method of dividing property is not found anywhere else in the Property (Relationships) Act 1976; it is unique to section 9A. See *Rose v Rose* [2009] NZSC 46, [2009] 3 NZLR 1 at [46]. See Chapter 10 for further discussion of s 9A.

244 In discussing the meaning of "attributable to the relationship" in respect of superannuation scheme entitlements in s 8(1)(i), *Fisher on Matrimonial and Relationship Property* suggests that the test will be satisfied when the portion of the superannuation scheme entitlements can be linked to an activity which is recognised as a contribution under s 18 of the Property (Relationships) Act 1976: RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [10.27].

during the relationship either or both partners invest a significant amount of time into making a family business successful, and the shares of the company are held on trust.

(e) **The trust property's value has been sustained or enhanced by the indirect actions of a partner.** For example, during the relationship one partner cares for children and maintains the family household to provide the other partner the opportunity to develop an area of farmland which is held on trust.

22.32 Conversely, the following are examples of trust property that would not be attributable to the relationship:

(a) **The property was provided entirely by a third party.** For example, the parents of one partner settle land or company shares on a trust under which their children are beneficiaries.

(b) **The property was settled on trust before the relationship began and was kept separate from family life.** For example, a partner settles money on trust to provide for his or her children from a former relationship. The trust moneys are kept separate during the relationship and never used for the purposes of the new family.

22.33 Two specific matters are likely to require clarification. First, there is the situation where a third party has settled property on trust which is later used by the partners as the family home or family chattels. Our preliminary view is that this trust property should not be classified as relationship property. The property cannot be attributed to the relationship in the sense that it is produced by the relationship, even though it is used for relationship purposes. If, however, during the relationship the partners have sustained or enhanced the value of the trust property through their actions or through the application of relationship property, that enhanced value might be relationship property. If the enhanced value of the trust property was not considered relationship property, it is possible a partner would claim a constructive trust over the property in any event. It is preferable that these claims be brought into the PRA regime and harmonised with the principles underpinning the legislation.

22.34 Second, if the trust property has increased in value owing solely to increases in inflation, there is a question as to how the increases in value should be treated. The best approach may be to determine whether the underlying asset can be attributed to the relationship and, if so, then attribute any subsequent inflationary gains to the relationship. For example, if the partners purchase a house using relationship property funds and settle the property on trust, the house would probably be attributable to the relationship. If the house increases in value because of the growth in house prices generally, the increase in the trust property's value could also be attributable to the relationship. If, to take a different scenario, a partner's parents provided a house on trust for the partners to live in, and over the course of the relationship the house increases in value, the increase in value attributable to growth in the housing market would not be attributable to the relationship because the house itself is not attributable to the relationship. In Part C we discuss the rules under section 9A that apply when a partner's separate property increases in value because of the application of relationship property or the other partners' direct or indirect actions. We also suggest some options for reform. Our preliminary view is that increases in the value of trust property should be treated consistently with these rules in whatever form they ultimately take.

Second element: The court considers it just

22.35 The second element to option 2 is to provide the court with a residual discretion to treat the value of the trust property attributable to the relationship as relationship property. If the test in the first element is satisfied, the trust property will normally fall into the relationship property pool and defeat the effect of any trust. However, as we have recognised above at paragraph 21.12 to 21.21, trusts may be established for legitimate reasons for the benefit of third parties. The purpose of the court's residual discretion is to prevent trust property from forming part of the relationship property pool when it would be unjust to do so.

22.36 We have identified certain factors above at paragraph 22.4 which are relevant to when a partner's rights under the PRA should take priority over the preservation of a trust. In particular, there are grounds to preserve the trust if the partners genuinely intended to alienate the property by settling it on trust for the benefit

of third parties. The trust may also deserve protection if it was intended to meet the needs of minors or dependents.

22.37 On the other hand, if property has been settled on trust without the informed consent of both partners, there are good reasons to bring the property into the relationship property pool, particularly given the inconsistency with the PRA's contracting out provisions. Similarly, if the trust was intended to provide benefits to the partners on the basis they remained together, it may be preferable to bring the property into the relationship property pool if the partners' separation defeats the purpose of the trust.

22.38 In cases where one of the partners has disposed of property onto the trust, it may be relevant to inquire into whether the partner received consideration. The value of the trust property may be properly reflected in the consideration the partner received which could be divided as relationship property instead of the trust property itself.

22.39 Finally, it may be appropriate for the court to take into account any benefits the trust provided the partners during the relationship. The court could determine whether the benefits received exceeded the contributions the partners made to the trust property. For example, the parents of one partner create a trust in order to provide a house for their child and his or her partner to live in rent-free. During the relationship, the partners carry out renovation work on the house and enhance its value, meaning that the enhanced value is attributable to the relationship. The court could take into account the fact that the partners resided at the trust property rent-free. Such benefits may counterbalance any enhanced value the partners claim an interest in.[245]

22.40 Again, the beneficiaries of the trust should be entitled to be heard by the court, even if they hold only discretionary interests.

245 In claims for a constructive trust based on *Lankow v Rose* [1995] 1 NZLR 277 (CA) the claimant must show that the contributions he or she makes to the property "manifestly exceed" the benefits the claimant receives: *Lankow v Rose* [1995] 1 NZLR 277 (CA) at 282 per Hardie Boys J. In *Blumenthal v Stewart* [2017] NZCA 181, [2017] NZFLR 307 a stepson claimed, among other things, a constructive trust over his later stepfather's estate. The stepson's claim was based on his contributions to the deceased's rural property, such as spraying weeds and maintaining a water pump, and the alleged expectation of an interest in the property. On the other hand, the stepson received considerable benefits from the property. He used the property as a base for his business, and stored items there. He also fattened cattle on the property. At [40] the Court of Appeal rejected the claim on the basis that the contributions were cosmetic and did not add value to the property. Furthermore, at [42] the Court explained that it did not see the contributions as offsetting the overall benefits received by the stepson.

(c) Amend the orders the court can make in respect of trust property

22.41 The final change required under option 2 concerns the types of orders the court could make in respect of the trust property. The court would probably need to be better equipped with a range of orders to ensure the trust property is appropriately divided. The court should be able to make the same orders under the PRA in respect of trust property as it could in relation to other forms of property, such as vesting or sale orders.[246]

22.42 It may also be appropriate for a court to have the power to resettle part of the trust property in order to implement division orders. Although a resettlement might not look like a conventional division of relationship property, it may be an effective means of preserving the original intent of the trust, particularly if other beneficiaries have an interest in the trust property. Although the power to resettle a trust may be seen as providing the court with considerably greater powers under the PRA, we note that section 33(3)(m) already authorises the court to vary the terms of a trust. However, this power is rarely used. It is desirable for the scope of the court's powers and the circumstances in which they are to be used to be clarified.

Advantages and disadvantages of amending the PRA's definition of relationship property

22.43 The key advantage of this option is its consistency with the overall policy and principles of the PRA. The proposed provision draws on the underlying rationale for sharing relationship property and confirms that a partner's rights to the property should generally prevail against trusts. The focus on the relationship property component of the trust property and the court's residual discretion would also exclude many types of trusts that it might be inappropriate to subject to equal sharing. Also, partners can be assured that a trust will be preserved if there is clear evidence that it was established with the knowledge and informed consent of both partners. This will encourage partners to take proper advice and be transparent when settling property on trust. There would

246 Property (Relationships) Act 1976, s 33.

be greater consistency between the PRA's provisions regarding trusts and its provisions regarding contracting out agreements.

22.44 Other than the difficulties around the meaning of the test "attributable to the relationship" discussed above, the main objection to this option relates to the considerable consequences for trusts. In many cases trust property will be subject to equal division between the partners. This would represent a significant change in policy and some people may claim it gives insufficient priority to the preservation of trusts.

22.45 This option would also give the court a residual discretion when determining whether to classify trust property as relationship property and when making orders. This degree of flexibility will introduce some uncertainty to the law and may make it difficult for partners to resolve property matters out of court, at least until some case law has built up.

Option 3: Broaden section 44C

22.46 The third option is to amend section 44C to overcome its main limitations. This would include the following changes:

(a) Section 44C(1) would be amended so that any disposition of property that has the effect of defeating the claim or rights of one of the partners would be caught. The requirements that the disposition be of relationship property and that it must occur after the relationship began would be removed.

(b) Section 44C(2) would be expanded so the court may order the trustees to pay to one partner a sum of money from the trust property or transfer to a partner any property from the trust.[247] The instruction in section 44C(3)(a) that the court should only have recourse to the trust capital as a matter of last resort would be retained.

(c) The matters in section 44C(4) which the court must take into account when exercising its powers under section 44C(2) would be expanded. The court should

247 This proposal has previously been made by the Law Commission: Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at 232. There would also need to be a consequential amendment to subs 44C(3)(b)(i) of the Property (Relationships) Act 1976 to replace the reference in that subsection to "distribute the income of the trust" to something like "distribute a sum of money or property of the trust."

be required to have regard to whether the partners put the property on trust with informed mutual consent and with the intention of irrevocably settling the property for the benefit of third party beneficiaries. The court should also inquire into whether the trust has the purpose of providing for the needs of any minor or dependent beneficiary.

22.47 These changes would give section 44C much wider application. It would also be more consistent with anti-avoidance provisions in other areas of law, such as under section BG1 of the Income Tax Act 2007.[248]

Advantages and disadvantages of broadening section 44C

22.48 A major advantage of this option is that it would enhance the court's existing remedial powers while retaining the case law that has been decided under sections 44 and 44C in respect of dispositions of property with prejudicial effects.

22.49 Section 44C(3) allows a court to weigh the overall fairness of ordering compensation. This degree of flexibility is useful in responding to the variety of trusts and circumstances that come before the courts.

22.50 There are, however, several limitations to the approach in section 44C that would not be remedied by this option. First, section 44C focuses on dispositions of property that have the effect of defeating one partner's claim or rights under the PRA. However, a trust may have the effect of prejudicing a partner even though the other partner has made no disposition to that trust. For example, a partner may arrange for the trustees of an existing trust to purchase the property used by the family without either partner

248 Section BG1 of the Income Tax Act 2007 provides that a "tax avoidance arrangement" is void against the Commissioner of Inland Revenue for income tax purposes. A trust can come within the Act's definition of an "arrangement." The Act then defines "tax avoidance arrangement" as an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly (a) has tax avoidance as its purpose or effect or (b) has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental (see the leading Supreme Court decision on the interpretation of s BG1 of the Income Tax Act 2007 *Ben Nevis Forestry Ventures v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289). A trust may constitute a tax avoidance arrangement: *P and H v Commissioner of Inland Revenue* [2011] NZSC 95, [2012] 1 NZLR 433. Importantly, the reference in the definition of "tax avoidance arrangement" to "its purpose or effect" means the purpose or effect of the arrangement is determined objectively, not by the motive or subjective purpose of any party: *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* [2008] NZSC 116, [2009] 2 NZLR 359 at [36]–[39]. The proposed amendments to s 44C of the Property (Relationships) Act 1976 would enhance it into a more general anti-avoidance provision like s BG1 of the Income Tax Act 2007.

ever owning the property personally.[249] To take another example, parents may provide a house for their child to live in with his or her partner. During the course of the relationship, the partners may apply considerable effort and money to maintain or enhance the property's value. If the relationship has lasted several years, the value of these contributions may be high. Nevertheless, if the partners separate, it is questionable whether their contributions to the enhanced or sustained value of the house constitute a disposition of property within the meaning of section 44C.[250] Yet, if the house had not been held on trust, but instead was relationship or separate property, the partner may have had a valuable claim under the PRA.[251]

22.51 To compound this problem, it may be possible for the partner to claim a constructive trust over the house held on trust. The partner may still look to a remedy outside the PRA to claim property that is connected with the relationship.

22.52 Second, the notion of paying compensation to the affected partner is problematic. Section 44C is concerned with dispositions that defeat the interests of the other partner.[252] As noted above,[253] the courts have said that the partner who placed the property on trust must keep some benefit in the property, such as by controlling the trust. If putting the property on trust defeats both partners' interests then section 44C would not apply. In those circumstances, the court could not properly order compensation as the partner's loss does not mirror the other partner's gain. Arguably, the court should be able to make an order which addresses one partner's loss but is also fair to the other partner. For example, it may be better to recover the property disposed of to the trust in appropriate circumstances.

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249 If a partner arranges to purchase property but, prior to the transfer completing, the partner nominated the trustees of trust to be named as purchasers, the court will probably hold that there has been a "disposition of property" for the purposes of ss 44 and 44C of the Property (Relationships) Act 1976. See *R v U* [2010] 1 NZLR 434 (HC); and *O v S* (2006) 26 FRNZ 459 (FC).

250 There have been some cases with the same fact pattern as this example: *[LC] v S* [2012] NZFLR 939 (FC); and *Kidd v Van den Brink* (2008) 28 FRNZ 82 (HC). In these cases s 44C was not applicable.

251 If the house was relationship property, the value would be divided equally pursuant to s 11 of the Property (Relationships) Act 1976. If the house was separate property, the non-owning partner may have had a claim under ss 9A, 15A or 17 in respect to the enhanced or sustained value of the separate property. In contrast, the Family Court in *Q v Q* (2005) 24 FRNZ 232 (FC) at [149] accepted that the husband's financial and accounting services as well as labour on the trust property constituted dispositions of property for the purposes of s 44C. Few other cases have taken this approach. We also recognise that it may, however, be possible to expressly define "disposition of property to a trust" as including a partner's unpaid labour or services towards the trust property.

252 Section 44C(1)(b) of the Property (Relationships) Act 1976 provides that the disposition must have the effect of defeating the interests of one partner.

253 At [20.46] and [21.38]–[21.40].

Option 4: A new provision modelled on section 182 of the Family Proceedings Act 1980

22.53 This option is based on the Law Commission's recommendations in the *Review of the Law of Trusts: A Trusts Act for New Zealand*.[254] In that report, the Commission proposed that an amended section 182 be retained alongside an amended section 44C, and that it be enlarged to apply to de facto relationships as well as marriages and civil unions. The section would therefore apply to "relationship settlements" rather than "nuptial settlements." The basis for retaining section 182 was that it had proven to be a useful provision that gives effect to the original expectations of the parties that settle trusts and deals with injustice that could otherwise be caused by changed circumstances.[255] Although the recommended amendment would expand the potential class of applicants, the fundamentals of the provision would remain unaltered. The courts would continue to exercise jurisdiction under section 182, which since the Law Commissions report has been further explained by the *Clayton v Clayton [Claymark Trust]* decision.[256]

22.54 Several submitters on the *Review of the Law of Trusts: A Trusts Act for New Zealand* did not favour the retention of section 182. A common complaint was that section 182 was outdated and inconsistent with the PRA. Peart has said that section 182 should be kept as a separate provision, not as part of the PRA.[257] This is to acknowledge that the trust property is not beneficially owned by the partners and therefore different principles should apply than the PRA that only governs property that the partners do beneficially own.[258] Having undertaken research on the origins of section 182 and the way it was viewed in 2001,[259] we believe that the drafters of the 2001 amendments did not foresee the prominence section 182 has achieved in later years. There is a case

254 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at 239.

255 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.43].

256 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590.

257 Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2016) 47 VUWLR 433 at 461.

258 Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2016) 47 VUWLR 433 at 461.

259 See the discussion at [21.67] above.

for bringing the section 182 remedy within the PRA. As we have explained at paragraph 22.74, it is preferable that all relationship property matters be dealt with in the same proceedings, pursuant to the same principles found under the same statute. As we explain in Part A, it is an implicit principle of the PRA that a single, accessible and comprehensive statute should regulate the division of property when partners separate.

Advantages and disadvantages of a provision modelled on section 182 of the FPA

22.55 Peart says that section 182 is preferable to other options to recover property from a trust when a relationship ends, because section 182 does a better job of respecting the trust.[260] As section 182 applies to trusts that are intended to provide for the relationship, there should be no surprise if the court makes orders to ensure that happens, albeit in a different form.[261] Section 182 is therefore seen as attempting to preserve the intent of a trust while balancing that intention against property rights following the breakdown of a relationship.[262] It may, however, be an overstatement to say that section 182 preserves the intent of a trust. The Supreme Court in *Clayton v Clayton [Claymark Trust]* explained that the purpose of relief under the section was to ensure that a partner's *reasonable expectations* of the trust were not defeated, not the actual intention behind the trust itself.[263]

22.56 A further advantage of this option is that section 182 gives the court a great deal of flexibility to vary the terms of a trust. This

260 Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2016) 47 VUWLR 433 at 459. Palmer also favours an expanded variation discretion: Jessica Palmer "What to do about Trusts?" in Jessica Palmer, Nicola Peart, Margaret Briggs and Mark Henaghan (eds) *Modern Family Finances – Legal Perspectives* (2017, Intersentia, Cambridge) (forthcoming).

261 Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2016) 47 VUWLR 433 at 459.

262 Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.39]; and Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2016) 47 VUWLR 433 at 461.

263 In *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [51]–[52] the Supreme Court carefully pointed out that, when a court exercises its discretion under s 182 of the Property (Relationships) Act 1976, its aim is not to perpetuate the objects of the nuptial settlement per se. Rather, its aim is to remedy the failure of a partner's expectations because the marriage no longer continues. The focus is therefore not on the underlying premise of the trust, but rather on the partner's underlying expectations of a continuing marriage.

Indeed, this reasoning led the Supreme Court to depart from its previous judgment in *W v W* [2009] NZSC 125, [2010] 2 NZLR 31. In *W v W* the Court said that the parties' expectations were to be assessed at the time the settlement was made. In *Clayton* the Court said that a partner's expectations regarding the settlement are not to be assessed at any fixed point in time (perhaps allowing for the situation where the underlying intentions of a trust at the time it was made remain constant, but a partner's expectations change after the settlement but before the relationship break up): see *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [56].

Rather than say s 182 respects trusts, it is perhaps more correct to say that the court's approach under s 182 respects the partners' reasonable expectations of the benefits they would have received under a trust had the marriage continued.

flexibility can be very useful as it allows the court to tailor orders to meet the particular circumstances of each case. In addition, the case law decided under section 182 has now identified many matters the court is to consider when deciding whether to exercise its discretion. Among these matters, the interests of children are to be a primary consideration.[264] The remedy therefore allows the court to consider the overall fairness of a particular case for all concerned.

22.57 As already noted, a major disadvantage with this option is the disharmony between the principles underpinning the PRA regime and those on which the section 182 remedy is based. The court's focus is not on a just division of property in accordance with the principles of the PRA, but rather on a partner's reasonable expectations of the benefits he or she would receive if the relationship continued. Rather than reconcile those differences, maintaining section 182 will reinforce the different approaches to dealing with trust property at the end of a relationship.

22.58 The ambit of section 182 still remains unclear and we have discussed this in paragraphs 21.61 to 21.65

22.59 It is difficult to contract out of section 182. As discussed, the courts require a high degree of formal connection between the trust and a contracting out agreement in order for the agreement to shield the trust from a section 182 claim. The Supreme Court has said that, in order to be effective, the trust deed would need to refer to the relationship property agreement by some means.[265]

CONSULTATION QUESTIONS

G9 Which of the proposed options do you prefer? Why?

G10 Are there any other feasible options for reform we have not considered?

264 *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [56], [58], [64] and [67].

265 *W v W* [2009] NZSC 125, [2010] 2 NZLR 31 at [34]. The Court reasoned that, first, if a nuptial settlement is too easily regarded as part of the agreement, the remedial scope of s 182 would be narrowed. The Court noted that the criteria for setting aside a contracting out agreement ("serious injustice") is more onerous than those that apply to vary a trust under s 182. Secondly, in order to be binding the parties to a contracting out agreement must have first received independent legal advice. The Court cautioned that, if a deed of trust is incorporated into the agreement, the parties may not have had independent legal advice before becoming bound by the terms of the trust. The Supreme Court approved this reasoning in *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [98].