

## CHAPTER 6

# Trusts

## IN THIS CHAPTER:

we consider the relationship between the PRA and trusts.

## INTRODUCTION

6.1 New Zealand has one of the highest rates of trusts in the world. Many New Zealand families use and enjoy property that is held on trust. Widespread use of trusts is an issue when relationships end because, as a general rule, trust property is not subject to division under the PRA.

## CURRENT LAW

6.2 The purpose of the PRA is to achieve a just division of property when relationships end. But the PRA only applies to property owned by the partners. When a person validly places property on trust, they pass legal ownership to the trustees. As a result, trust property only falls under the PRA to the extent each partner is said to have a beneficial interest under the trust, and that interest constitutes "property" within the meaning of the PRA.

6.3 Whether a beneficial interest under a trust constitutes property depends on the nature of that interest. In the Issues Paper we explained that a vested or contingent beneficial interest constitutes property, but a discretionary beneficial interest does not.<sup>349</sup>

6.4 Powers to control a trust may also constitute property under the PRA. In *Clayton v Clayton [Vaughan Road Property Trust]* the Supreme Court held that Mr Clayton's collection of powers under the trust deed amounted to property because they allowed him to give all the trust property to himself, even if that conflicted with the interests of the other beneficiaries.<sup>350</sup> Case law is still developing in this area. However, recent cases suggest that powers only constitute property under the PRA if they allow unfettered control of trust property, unconstrained by fiduciary duties.<sup>351</sup> Few trusts will grant a

<sup>349</sup> For a discussion on the different types of beneficial interests under a trust, see Law Commission *Dividing Relationship Property – Time for Change? Te mātatoha rawa tokorau – Kua eke te wā?* (NZLC IP41, 2017) at [20.31]–[20.34].

<sup>350</sup> *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551.

<sup>351</sup> See *Da Silva v Da Silva* [2016] NZHC 2064 at [53]; *Goldie v Campbell* [2017] NZHC 1692, [2017] NZFLR 529; and *Darlow v Raymond* [2017] NZHC 269, [2017] 3 NZLR 353 at [127].

partner such extensive powers, which means a partner's powers to control a trust will likely only be property in exceptional cases.

- 6.5 Most trusts will be structured so that beneficiaries only have a discretionary beneficial interest in the trust, and no person has unfettered powers to control a trust that would amount to property. Therefore, trust property will not usually be subject to division under the PRA.

### Existing remedies to access trust property at the end of a relationship

- 6.6 There are several remedies available to a partner to access trust property if the trust frustrates the just division of property at the end of a relationship. But each remedy has its own limitations. These remedies were discussed in detail in the Issues Paper, and are summarised below (Issues Paper at [20.41]–[20.71]).

#### Remedies under the PRA

- 6.7 There are two remedies under the PRA that apply to dispositions of property.<sup>352</sup>
- 6.8 Section 44 applies when a person has disposed of property, including to a trust, in order to defeat a partner's claim or rights under the PRA. If section 44 applies, section 44(2) gives a court the power to unwind the disposition and recover property from a trust, or order that compensation be paid to satisfy a partner's rights to relationship property. Section 44(4) provides that a court should not grant relief if the person from whom relief is sought received the property or interest in good faith, and has altered their position in reliance on having that interest in the property.
- 6.9 Section 44C applies specifically to dispositions of property to a trust that have 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 requires several elements to be met:
- (a) the property disposed of must have been relationship property;
  - (b) the disposition must have been made after the relationship began; and
  - (c) the disposition must defeat the claim or rights of one of the partners.
- 6.10 If these elements are satisfied, under section 44C(2) a court can order one partner to compensate the other from relationship property or separate property. As a last resort a court can require the trustees to pay the affected partner compensation from the income of the trust. There is, however, no power to order that property be recovered from the trust's capital.

#### Section 182 of the Family Proceedings Act

- 6.11 Section 182 of the Family Proceedings Act 1980 gives the court power to vary "nuptial settlements" following a couple's divorce or civil union dissolution. It does not apply to de facto relationships.

<sup>352</sup> The term "disposition" is given a wide meaning. It can sometimes include a transfer of property directly from a third party vendor to a trust, for example where the transfer is in accordance with a Deed of Nomination under which a partner nominates the trust as purchaser. See *Re Polkinghorne Trust, Kidd v Kidd* (1988) 4 NZFLR 756 (HC) (in the context of s 44); applied in relation to s 44C in *B v P* FC Rotorua FAM-2005-063-695, 7 October 2008 at [41]; affirmed on appeal in *P v B* [2009] NZFLR 773 (HC) at [13], although the Court overturned the Family Court's decision on the basis that the disposition was not one of relationship property. See also *O v S* (2006) 26 FRNZ 459 (FC) at [95].

6.12 The Supreme Court has described a nuptial settlement as a settlement that makes some form of continuing provision for one or both parties to a marriage in their capacity as spouses.<sup>353</sup> This means there must be some connection between the settlement and the marriage. A court will exercise its discretion under section 182 to address the failure of the spouses' expectation that the marriage would continue. To do this, the Supreme Court has said the first step is to examine what the spouses reasonably expected of the nuptial settlement when they assumed the marriage would continue. The second step is to compare those expectations to the spouses' expectations of the settlement in the circumstances after separation.<sup>354</sup> A court will also take into account other factors, such as the interests of children, the source and character of the assets, the length of the marriage and the suitability of the trust structure because of the changed circumstances.<sup>355</sup>

### Remedies in trust law

6.13 The law of trusts also provides remedies that can be used to access property held on trust at the end of a relationship, including:

- (a) Invoking the High Court's supervisory jurisdiction to ensure the trust is properly administered. This may result in the Court replacing the trustees,<sup>356</sup> reviewing trustee decisions,<sup>357</sup> or ordering that information be provided to the beneficiaries.<sup>358</sup> The Trusts Bill currently before Parliament contains provisions on these matters.<sup>359</sup>
- (b) A claim that the trust is invalid, either because the partner lacked an intention to create a trust, or that the trust purportedly created did not effectively alienate the settlor's beneficial interest in the property.<sup>360</sup>
- (c) A claim that the trust is a sham, because the settlor and trustee held a common intention to create different rights and obligations in respect of the trust property than those purportedly created through the trust instrument.<sup>361</sup>
- (d) A claim that the trust is subject to a constructive trust in the partner's favour, based on that partner satisfying the requirements in *Lankow v Rose*.<sup>362</sup> A constructive trust claim was the primary form of relief available to de facto partners prior to their inclusion in the PRA in 2001. Now it is generally only used in respect of property

<sup>353</sup> *Clayton v Clayton [Claymark Trust]* [2016] NZSC 30, [2016] 1 NZLR 590 at [34].

<sup>354</sup> At [53].

<sup>355</sup> At [59].

<sup>356</sup> Trustee Act 1956, s 51.

<sup>357</sup> Section 68. Note an application under this section cannot be initiated by a discretionary beneficiary.

<sup>358</sup> 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.

<sup>359</sup> Trusts Bill 2017 (290-1).

<sup>360</sup> In two recent cases (one from England and Wales and the other from the Cook Islands), claims that a trust is invalid were successful: *JSC Mezhdunarodniy Promyshlenniy Bank & Ors v Pugachev & Ors* [2017] EWHC 2426 (Ch); and *Webb v Webb* [2017] CA No. 7/17 (Court of Appeal of the Cook Islands) at [56] and [65].

<sup>361</sup> *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 *Vervoot v Forrest* [2016] NZCA 375, [2016] 3 NZLR 807.

<sup>362</sup> *Lankow v Rose* [1995] 1 NZLR 277 (CA) at 294 per Tipping J. See *Murrell v Hamilton* [2014] NZCA 377; *Vervoot 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.

outside the jurisdiction of the PRA, such as trust property and Māori land (which is excluded under section 6 of the PRA).

## ISSUES

6.14 In Chapter 21 of the Issues Paper we identified several problems with the relationship between the PRA and trusts. These issues are summarised below.

### The PRA does not ensure the just division of property held on trust

6.15 Many people in New Zealand use trusts as a means of holding property. The Law Commission has previously estimated there may be anywhere between 300,000 to 500,000 trusts in New Zealand.<sup>363</sup> In the 2013 Census, 14.8 per cent of households reported that their home was held on trust.<sup>364</sup> 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.<sup>365</sup>

6.16 Because property held on trust generally falls outside the PRA, there is no requirement that trust property be divided at the end of a relationship. The remedies available under the PRA to access trust property at the end of a relationship are also of limited effect, either because they are hard to claim or give the court inadequate powers.

6.17 The result is that the PRA does not ensure the just division of significant amounts of property used and enjoyed by families in New Zealand. In the Issues Paper we identified a number of instances where the failure to divide trust property might be considered unfair, including where:

- (a) the trust holds what would otherwise be significant items of relationship property, such as the family home or other property acquired or maintained through the partners' income earned during the relationship;
- (b) the trust structure is inappropriate for post-separation circumstances, because it was originally settled during the relationship to hold assets central to family life; or
- (c) only one partner controls the trust, which means that in reality they may be able to treat the trust property as their own.

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

6.18 We understand that many couples will divide trust property upon separation as if the trust did not exist.<sup>366</sup> While this might present a pragmatic way to resolve property disputes, it is reasonable to assume that in some cases this way of dealing with trust property will be inconsistent with the terms of the trust or will breach some principles of trust law. This is undesirable. In principle, laws should be respected and trust deeds followed. People should not be able to take advantage of the legitimate benefits of a trust structure, but then ignore the trust structure when it becomes inconvenient. Further,

<sup>363</sup> Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [2.3].

<sup>364</sup> Statistics New Zealand *2013 Census QuickStats About Housing* (March 2014) at 12.

<sup>365</sup> Statistics New Zealand "Household Net Worth Statistics: Year ended July 2015" (28 June 2016) <www.stats.govt.nz>. The survey excluded independent trustees.

<sup>366</sup> For example see *Willis v Willis* [2017] NZHC 2586 at [26]. Some partners may have previously established mirror trusts, which may present fewer difficulties in terms of property division on separation. See for example *M v S* [2012] NZFLR 594 (HC).

there is a real concern that the rights and interests of other beneficiaries, particularly children, are not given appropriate attention when the trust property is simply treated as the partners' own property on separation.

### Inconsistencies with the contracting out regime under the PRA

6.19 The ability for one partner to unilaterally affect the division of property by settling property on a trust that would otherwise form part of the relationship property pool is inconsistent with the PRA's contracting out regime. When entering a contracting out agreement, the PRA requires compliance with a procedure designed to ensure both partners enter the agreement with informed consent and do not unwittingly compromise their rights under the PRA (section 21F). If this procedure is not complied with, the agreement is of no effect. There is no comparable procedure to govern how the partners settle property on trust during or in contemplation of a relationship.

### The law on what interests in a trust constitute property under the PRA is inaccessible and complex

6.20 The law governing whether a person's interest in a trust constitutes "property" is found in case law, which is likely to be inaccessible for many people. The nature of case law also means that the law is always subject to change, as in the developing area of whether powers to control a trust constitute property under the PRA.<sup>367</sup>

6.21 The approach a court takes to determining what interests in a trust constitute property under the PRA is complex and can also appear illogical, as it generally ignores the likelihood that the beneficiary will receive a distribution of the trust property. Even if a partner's interest in the trust does constitute property under the PRA, it is unclear whether that interest should be classified as separate property or relationship property.<sup>368</sup>

### The remedies in the PRA are limited

6.22 Section 44 of the PRA rarely applies because it is difficult to show the required subjective intention, namely, that a partner disposed of property in order to defeat the other partner's rights under the PRA.

6.23 Partners can also easily avoid being captured by section 44C. It only applies when a partner has disposed of relationship property to a trust after the relationship has

<sup>367</sup> The Supreme Court's decision in *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 leads to residual uncertainties. One area of uncertainty is whether, if a partner's powers are property, the partner holds an interest directly in the underlying trust assets. In *U v M* [2015] NZHC 742 and *B v B* [2017] NZHC 131 the courts accepted that the partners' powers under a trust gave them an interest in the trust property sufficient to support a notice of claim. In *H v JDVC* [2015] NZCA 213, (2015) 30 FRNZ 521, however, the Court of Appeal reached the opposite conclusion. In *B v S* [2017] NZFC 5741 the Family Court held that a partner's interest in a trust based on his powers to control the trust was sufficient to allow the Court to grant an occupation order to the other partner. This finding was not contested on appeal: *S v B* [2017] NZHC 2370, [2017] NZFLR 779.

<sup>368</sup> In *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29, [2016] 1 NZLR 551 the Supreme Court said at [85]–[90] that as Mr Clayton acquired powers under the trust during the relationship, and as those powers amounted to property, the powers should be classified as relationship property pursuant to s 8(1)(e) of the Property (Relationships) Act 1976. This suggests an interest under a trust arising during the relationship should also be relationship property. Some commentators disagree. They suggest that the interest under the trust should reflect the classification of the assets held on the trust. Thus, if separate property is held on the trust, a partner's beneficial interest under the trust should likewise be separate property: RL Fisher (ed) *Fisher on Matrimonial and Relationship Property* (online looseleaf ed, LexisNexis) at [4.47].

commenced.<sup>369</sup> This limitation was illustrated in *G v G*.<sup>370</sup> In that case the partners entered into a relationship shortly after meeting in 1994, but the Family Court found that a qualifying relationship did not commence until the end of 1998. In 1997 Mr G disposed of separate property to a trust, which was then used by the trust to acquire the family home. As the initial disposition of property to the trust occurred before the qualifying relationship began, and was a disposition of separate property, section 44C did not apply.<sup>371</sup>

- 6.24 It is also implicit that section 44C only applies where the disposition of property defeats the rights of one partner, not both of them. This means section 44C could be avoided if a partner disposed of property to a trust in which both partners only hold discretionary interests. Finally, even when the elements of section 44C can be satisfied, there may be insufficient relationship property or separate property available to adequately compensate a partner whose interests were defeated by the disposition to the trust.<sup>372</sup> The court has no power in that situation to order that the disposed property be recovered from the trust's capital.

### The remedies outside the PRA are complex, inconsistent with the purpose of the PRA and create procedural problems

- 6.25 The alternative avenues to access trust property do not sit happily alongside the PRA or even with each other. They are based on different policy grounds or seek to protect different interests in the trust property. They sometimes require a partner to make claims under different statutes which, in some instances, must be filed in a different court and at a different time to an application under the PRA.
- 6.26 Section 182 of the Family Proceedings Act is based on a very old provision designed to deal with marriage settlements in the mid-nineteenth century. It is out of step with the PRA's principles and procedures. Section 182 gives the court a very wide discretion to vary a trust, in contrast to the much narrower jurisdiction under section 44C of the PRA, which prevents a court from interfering with the capital of a trust. But section 182 only applies to partners who were married or in a civil union. It does not apply to de facto relationships, as the PRA does. Further, a court can only make orders under section 182 after making an order dissolving the marriage or civil union. In contrast, a court can make orders under the PRA after the partners have separated but before formal dissolution.<sup>373</sup> There can therefore be an issue with timing as a partner is able to make an application under the PRA before they can make an application under section 182.
- 6.27 Remedies in trust law are also different in nature to those under the PRA. A partner's claim under the High Court's supervisory jurisdiction, a claim that the trust is invalid or a sham, or a claim for a constructive trust over an express trust all concern the legitimacy of the trust and its administration rather than a just division of property between two

<sup>369</sup> See Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2017) 47 VUWLR 443 at 451–452; and 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.

<sup>370</sup> *G v G* [2006] NZFLR 1119 (HC). See also *JEF v GJO* FC Hamilton FAM-2009-019-797, 3 October 2011, which was upheld on appeal in *JEF v GJO* [2012] NZHC 1021, (2012) 3 NZTR 22-010.

<sup>371</sup> *G v G* [2006] NZFLR 1119 (HC) at [73]–[75].

<sup>372</sup> Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [19.12].

<sup>373</sup> Property (Relationships) Act 1976, s 25(2)(a).

partners at the end of a relationship. Claims in trust law may require the partner to file separate proceedings in the High Court.

- 6.28 The different remedies create complexities for litigants. The procedural disharmonies can be costly and inefficient. People also struggle to understand the law as they cannot go to a single statute to determine how their property affairs should be resolved. This is contrary to the PRA's claim that it is a code.<sup>374</sup>

### Results of consultation

- 6.29 We received 59 submissions addressing the relationship between the PRA and trusts. There were 41 submissions from members of the public, nine submissions from law firms, trustee companies and other organisations, and nine submissions from individual practitioner and academic experts. Several clear themes emerged from these submissions.

#### *The protection given to trusts over the rights of partners under the PRA is problematic*

- 6.30 Most submitters, including the New Zealand Law Society (NZLS), agreed that the protection given to trusts over the rights of partners under the PRA, and the existing remedies to access trust property at the end of a relationship, are problematic.
- 6.31 Many submitters said that a trust can be used to disadvantage one partner at the end of a relationship. Business and Professional Women of New Zealand also argued that the partner in control of the trust will typically have the resources and experience to seek and retain stronger legal support on separation. NZLS submitted that the use of a trust can also create injustice when it has the effect of circumventing other provisions of the PRA that deal with occupation orders, deferring the sharing of relationship property, occupation rent, compensation for economic disparity and compensation for post-separation contributions. NZLS submitted that section 44C in particular needs a radical overhaul to avoid injustice.
- 6.32 Several submitters said that, in practice, most disputes over trust property arise when the family home is held on trust. Unless both partners agree to treat the family home as if it were relationship property and divide it accordingly, one partner typically feels they are not getting their fair share of property at the end of the relationship. Practitioners also noted that disputes can arise where relationship property (for example income) is used to pay the mortgage, rates, insurance and maintenance on a home that is held on trust. Rural Women New Zealand noted that many farms, agricultural contractors and agribusinesses are owned as partnerships, family trusts or companies, and when a relationship ends the complexities of these add to the grief and confusion often associated with relationship dissolution.
- 6.33 Some submitters also pointed to the lack of clarity as to when rights to trust property arise under different areas of law, which can result in expensive and lengthy disputes.
- 6.34 The few submitters who did not think that the current law is problematic (comprising mainly legal practitioners) thought it was appropriate that the law give priority to the preservation of trust structures. They considered the existing remedies available under the PRA were broadly achieving an adequate balance between upholding the trust structure and providing remedies for partners at the end of the relationship. Chapman

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<sup>374</sup> Section 4.

Tripp, while not agreeing with the general proposition that the protection given to trusts is problematic, did agree that the PRA was due for improvement in respect of its application to trusts. Chapman Tripp agreed that section 182 of the Family Proceedings Act is inconsistent with the PRA, and that this inconsistency leads to uncertainty when advising clients on whether a trust could be subject to a future section 182 claim.

### *Many people settle trusts without understanding the implications under the PRA*

- 6.35 Many submitters told us that people often do not understand the implications of settling property on a trust, including the implications under the PRA. Perpetual Guardian said that, in its experience, a number of trusts were set up because it was reasonably cheap and easy to do so following professional advice, and because it was a trend for a time to "have a trust". These settlors may now find it difficult to articulate exactly why the trust was established. Vicki Ammundsen Trust Law Ltd similarly submitted that a significant number of trusts are settled in circumstances where the settlor has little appreciation of what a trust is, and trustees are largely unaware of what that role entails. Some practitioners noted that the remedies available under the PRA are often used to remedy failings in professional advice at the time the trust was settled. These submitters questioned the extent to which the PRA should intervene to adjust for failings or shortcomings in legal advice, refusal to accept legal advice, or generally disadvantageous decisions made by capable adults.
- 6.36 Several submitters, including Jan McCartney QC, favoured more education for members of the public as well as lawyers about the implications of settling property on a trust. Chapman Tripp noted that the current review of the law of trusts aims to make trust law more accessible to New Zealanders, and hopes that this would avoid some of the problems that arise when partners settle property on a trust without understanding the consequences.

### *Trusts are used for a wide range of legitimate purposes*

- 6.37 Several submitters told us that many people use trusts for a wide range of legitimate purposes, including estate planning and protection against creditors. Chapman Tripp submitted that, in their experience, many New Zealand families see trusts as a protection mechanism for their key asset, usually the family home, from something "unanticipated but possible". It said that settling a trust is a sensible asset planning mechanism which aims to ensure the family home is not vulnerable due to a business-related liability of one member of the family. It submitted that any reform of the PRA must not prejudice the legitimate use of trusts for family asset management.
- 6.38 Protection of separate property from future claims under the PRA was often cited as a common and, many argued, legitimate reason for settling property on a trust. Several submitters said that many people decide to settle property on a trust after the dissolution of a previous relationship, because they want to protect their property from division in the event of a new or future relationship ending. This is driven by what many see as unfairness in the existing rules of classification, which, as we discussed in Chapter 2: Classification, means that the family home will be shared even if it was owned by one partner before the relationship began, or was received by one partner from a third party as a gift or inheritance. Jan McCartney also submitted that some people prefer using a trust structure over a contracting out agreement because the PRA "bites so viciously if

the court determines a contracting out agreement has become unjust". We discuss contracting out agreements in Chapter 8.

### *Not all trust property should be subject to PRA claims*

- 6.39 Submitters gave most attention to distinguishing between trust property that ought to be shared at the end of a relationship, and trust property that should be protected from claims under the PRA.
- 6.40 Several submitters, including NZLS and academic Professor Nicola Peart, submitted that any remedy should ensure that a court's powers extend to all trust property that would have been relationship property "but for" the trust. In other words, the remedy should mirror the underlying approach to classification in the PRA, which is discussed in Chapter 2.
- 6.41 Submitters were generally in agreement that, if the property held on trust represented the fruits of the relationship (that is, if it was acquired through the efforts of either partner during the relationship), the trust property ought to be subject to the PRA and divided at the end of the relationship.<sup>375</sup> However, submitters were less sympathetic where the partners had knowingly settled property on trust for the purpose of benefiting others.<sup>376</sup>
- 6.42 A few submitters, including the National Council of Women of New Zealand (NCWNZ), considered that the family home should always be shared, regardless of whether it is trust property or when or how it was acquired. However, many submitters felt that the PRA should not interfere with a trust simply because the trust property is used as the family home during the relationship. These submitters preferred to focus on how the property was acquired, rather than how it was used, to justify sharing. They thought that preserving the trust structure should be given more weight, as trusts are a legitimate tool and other beneficiaries may reasonably expect the trust structure to remain in place.
- 6.43 Some submitters pointed to different "types" of trusts, which they felt should be treated differently to trusts that represent the fruits of the relationship. In particular:
- (a) **Trusts settled by a third party.** Chapman Tripp noted that this typically includes trusts settled by parents, who intend that the trust property remains in the family. Their children's partners may be deliberately excluded from the beneficiary classes and from the possibility of becoming an office holder. Or the intention may be that partners benefit only to the extent they remain in a relationship with a beneficiary. Several submitters used the example of farms that have been in a family for years,

<sup>375</sup> This was also evident from submitter responses to scenario 1 on the consultation website. In scenario 1 (Hugh and Phil) the partners purchased a rental property during the relationship using their joint savings. The property was settled on trust by Hugh to protect it from creditors. Submitters were asked what should happen if the partners separated. We received 25 responses. Only one submitter responded that Phil should not get a share in the rental property because it was held on trust, but that submitter said that Phil should have been required to obtain legal advice beforehand. The most common response (17 submitters) was that the trust should not apply and the partners should be able to divide the rental property equally. Four submitters preferred that Phil receive compensation from Hugh, while three submitters preferred another way to recognise Phil's interest in the trust property.

<sup>376</sup> Submitter responses to a scenario on the consultation website which explored this issue were mixed. In scenario 3 (Talia and Sione) the partners settled a sum of money on trust for their children, having received advice at the time that the trust would mean the money could no longer be used as they like. The partners separate and Talia finds it hard to make ends meet and wants to unwind the trust. We received 15 responses. Six submitters said that Talia should not get the property held on trust, while six submitters said the court should be able to vary the trust to provide Talia with some or all of the property. Three submitters thought that Talia should get something else, such as a right of occupation over the family home and maintenance from Sione.

and that have been developed with the intention that they be enjoyed by future generations.

- (b) **Trusts settled before the relationship.** In this category are trusts settled by one partner well before the relationship began, perhaps for the benefit of their children from a previous relationship, and to protect important assets such as the family home from future claims under the PRA.

6.44 While many submitters thought that trust property should not be treated as relationship property if the trust was settled by a third party or settled before the relationship, submitters did generally agree that a partner should receive some form of compensation if they contributed to increasing or preserving the value of the trust property during the relationship.<sup>377</sup> NCWNZ submitted that people can invest in trust property in many ways, and they should be entitled to receive some benefit from that investment if the relationship ends. Rural Women New Zealand said that many women work on farms in an unpaid capacity due to the nature of seasonal peaks in work, because they tend to be the primary caregiver and because opportunities for work off-farm are limited by distance and/or infrastructure.

### *Other mechanisms used to avoid the PRA*

- 6.45 Some submitters, including Nicola Peart, were concerned that if trusts became a less effective device for avoiding claims under the PRA partners would attempt to use other avoidance mechanisms, such as company structures or third party ownership (for example, parents retaining legal title of a property they purchase for a child and their partner to live in). Nicola Peart argued that rather than looking at ways to "bust trusts", the question should be what sort of exemptions from the property sharing regime, other than contracting out, should be tolerated.
- 6.46 Two practitioners pointed to examples of how company structures can already be used to avoid the PRA. One practitioner gave an example of where the family home was held in a company, placing it outside the PRA. Another practitioner described a case where fees were paid to a company, which would otherwise have been received by a partner as income. However as neither partner held a shareholding in the company greater than 25 per cent, the full value of those fees could not be accessed through shareholding interests. Nor could the other partner make a claim under section 44F on the basis the disposition of fees to the company defeated their rights (section 44F only applies to companies in which a partner holds 50 per cent of voting rights).

## **OPTIONS FOR REFORM**

- 6.47 In Chapter 22 of the Issues Paper we presented four possible options for reform:

<sup>377</sup> This was also evident from submitter responses to scenario 2 on the consultation website. In scenario 2 (Ana and Brendon) the partners are married and live on Brendon's family farm, which is held on trust settled by Brendon's parents before the relationship began. Brendon and his parents and siblings are beneficiaries, but only Brendon and Ana live on the farm. Ana works on the farm and also does most of the child care for the partners' children. We asked what should happen when partners separate after 18 years of marriage. We received 18 responses to this scenario. Eight submitters thought that Ana should get half the increase in the farm's value during the relationship, because of the improvements the partners made on the farm during the relationship. Four submitters thought that Ana should get a half share of Brendon's interest in the farm. Three submitters thought that Ana should receive some other form of compensation. Only three submitters thought that Ana should not get any share in the farm because it was held on trust for Brendon's family.

- (a) **Option 1: Revise the PRA's definition of "property" to include all beneficial interests in a trust.** The focus of this option is on the partner's beneficial interest under the trust. Any interest through which it is both likely and permissible that the partner will receive a distribution of the trust property would be "property" for the purposes of the PRA, and would be classified as either relationship property or separate property like any other item of property.
- (b) **Option 2: Revise the PRA's definition of "relationship property" to include some property held on trust.** The focus of this option is on the character of the trust property. Trust property which is attributable to the relationship could be classified as relationship property if the court considers it just, having regard to a range of express considerations.
- (c) **Option 3: Broaden section 44C.** Under this option, section 44C 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 court's powers would also be broadened, so that it could have the power to make compensatory orders from the trust's capital.<sup>378</sup>
- (d) **Option 4: Create a new provision modelled on section 182 of the Family Proceedings Act.** This option would bring an equivalent of section 182 of the Family Proceedings Act into the PRA alongside section 44C. It would apply to de facto relationships as well as marriages and civil unions.

### Results of consultation

- 6.48 No clear preference for a particular option for reform emerged from consultation. This highlights the difficulty of devising a test for when property held on trust ought to be shared at the end of a relationship. Several submitters affirmed our comment in the Issues Paper that there is no "silver bullet" solution. Some submitters, including NZLS, Perpetual Guardian, Public Trust and Chapman Tripp, commented that they believed the Issues Paper canvassed all viable options, and agreed that the main avenues for redress should be found solely under the PRA.
- 6.49 No submitter indicated a preference for Option 1. Chapman Tripp commented that it did not support a definition of property for the purposes of the PRA that differs from long standing principles of property law as used and applied in trust law and practice. This was on the basis that a different definition of property would have far-reaching and possibly unintended consequences.
- 6.50 Several organisations and practitioner experts favoured Option 2, including Perpetual Guardian, Public Trust and Chapman Tripp. Chapman Tripp submitted that if Option 2 were favoured, trustees should be able to be parties to contracting out agreements. Public Trust preferred Option 2 over Option 1 because of the difficulty in practice of quantifying a beneficial interest and allocating a value to that interest.
- 6.51 NZLS favoured Option 3, on the basis that it respects the general structures of both the PRA and trusts. NZLS said a revised section 44C should enable a claim under sections 9A, 15 and 18B to be brought where the effect of the disposition has disentitled a partner to a claim under those sections. NZLS also submitted that a liberal interpretation of the

<sup>378</sup> This was the Law Commission's recommended reform of s 44C of the Property (Relationships) Act 1976 in its review of the law of trusts: *Law Commission Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at 232.

courts' powers should be favoured, and that recourse to the trust capital should be at the courts' discretion, rather than as a last resort. Chapman Tripp did not support Option 3, and strongly supported the jurisdictional criteria for section 44C remaining the same (that the disposition must have the effect of defeating the claim or rights of one of the partners, it must be of relationship property and it must occur after the relationship began).

- 6.52 Chapman Tripp and several practitioners favoured Option 4, but only on the basis that the new provision modelled on section 182 of the Family Proceedings Act underwent significant change. In particular, some said that the new provision should target trusts that contain property which ought to be shared based on the principles of the PRA, and provide more clarity on when the court should exercise its discretion. Vicki Amundsen Trust Law Ltd also favoured Option 4, but submitted this needed to be coupled with reforms targeted at clarifying the role of trustee and "provisions for a demonstrably transparent approach to situations where trust and relationship property assets (or expectations) intersect". NZLS did not favour Option 4, noting that section 182 is an anomalous provision that has been used (only for marriages) in the absence of an effective remedy in the PRA. It favoured repeal of section 182 of the Family Proceedings Act if section 44C of the PRA were broadened, under Option 3.
- 6.53 Nicola Peart submitted that, regardless of the preferred option, there may still be scope for a provision like section 182 of the Family Proceedings Act to remain. She argued that it could have a wider application than the proposed new section 44C in two respects. First, section 182 applies to all settlements, not only trusts. Second, it is possible that a section 182 claim could be brought by someone other than one of the spouses, such as a child of the relationship.<sup>379</sup>
- 6.54 Many submitters, including NZLS, favoured increasing the Family Court's powers in respect of trusts. Submitters generally accepted that the Family Court should have the power to make awards from the trust's capital, and in some circumstances vary or even resettle a trust.
- 6.55 Many submitters also said that partners should be able to contract out of any proposed remedy.

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<sup>379</sup> The possibility of a child bringing a claim under s 182 of the Family Proceedings Act 1980 was recognised by the High Court in the recent case of *Thakurdas v Wadsworth* [2018] NZHC 1106, [2018] NZFLR 451.

## PREFERRED APPROACH

**P27**

Section 44C of the PRA should be amended to provide a single, comprehensive remedy that will enable a court to grant relief when a trust holds property that was produced, preserved or enhanced by the relationship.

**P28**

An amended section 44C would apply in three different situations:

- a. where either or both partners have disposed of property to a trust, at a time when the qualifying relationship was reasonably contemplated or since the qualifying relationship began, and that disposition has had the effect of defeating the claim or rights of either or both of the partners under any other provision of the PRA; or
- b. where trust property has been sustained by the application of relationship property or the actions of either or both partners; or
- c. where any increase in the value of trust property, or any income or gains derived from the trust property, is attributable to the application of relationship property or the actions of either or both partners.

**P29**

The court should have broad powers that include ordering one partner to pay compensation to the other, ordering the trustees to distribute capital from the trust, varying the terms of the trust, and resettling some or all of the trust property on a new trust or trusts.

**P30**

A court must be satisfied that making an order is "just", having regard to a number of specified considerations. These considerations are designed to ensure the amended section 44C achieves an appropriate balance between protecting partners' entitlements under the PRA and the preservation of trusts.

**P31**

Partners should be able to agree not to make any claim under section 44C for the purposes of contracting out of the PRA under section 21, and to settle claims for the purposes of section 21A.

**P32**

Section 182 of the Family Proceedings Act 1980 should be repealed.

**P33**

Section 44 should remain unchanged and should continue to provide a remedy for other avoidance mechanisms.

6.56 Our preferred approach is to extend section 44C to provide a comprehensive remedy that will give a court broad powers to respond to the various ways in which a trust might hold property that is produced, preserved or enhanced by the relationship, in order to effect a just division of property under the PRA.

- 6.57 To facilitate consideration of our preferred approach to trusts we include at the end of this chapter a draft of new section 44C.<sup>380</sup>
- 6.58 The objective of this remedy (new section 44C) is to provide relief when a partner's entitlement under the PRA has been frustrated by the operation of a trust structure, or when the trust property was preserved or enhanced by the relationship. It aligns with the general scheme of entitlements under the PRA, subject to a court's overriding discretion to consider factors that might suggest that the trust should be preserved, or that compensation should be less than what a partner's full entitlement would have been, had the trust property been subject to the PRA.
- 6.59 This proposal adopts elements from both Option 2 and Option 3 presented in the Issues Paper. New section 44C will apply when some or all of the trust property is attributable to the relationship, which was the focus of Option 2. However rather than creating a new category of relationship property as Option 2 proposed, a court will instead have the discretion to grant relief. We consider that this strikes a better balance between protecting partners' entitlements under the PRA and the preservation of trusts. New section 44C will also apply to dispositions of property to a trust, similar to current section 44C, but its application will be broadened as proposed under Option 3.
- 6.60 By retaining much of the structure and wording of current section 44C, the established body of case law on the operation of section 44C (such as when a disposition has the effect of defeating a claim) will, subject to our proposed amendments, continue to provide some guidance on when and how new section 44C ought to apply.
- 6.61 We do not prefer Option 1, as we consider that the task of identifying the true nature and value of a partner's interest in a trust would be a complex inquiry, and there remains a significant risk that trust structures could be devised in a way that conceals a partner's real interest in a trust. Nor do we prefer Option 4, as it would not provide relief when the partners' actions have enhanced or sustained trust property when the trust is not a nuptial settlement.
- 6.62 In reaching our preferred approach, we have been guided by the following principles for reform:<sup>381</sup>
- (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 fall 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, while recognising that discretion may be required to minimise the risk of unintended consequences; and
  - (e) It is preferable that all remedies sit within the PRA.

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<sup>380</sup> These provisions have been prepared by Parliamentary Counsel Office for this limited purpose.

<sup>381</sup> See also Law Commission *Dividing Relationship Property – Time for Change? Te mātatoha rawa tokorau – Kua eke te wā?* (NZLC IP41, 2017) at [22.4].

## Dispositions to a trust

- 6.63 The application of new section 44C to dispositions to a trust shall be extended in three key respects. It will apply to dispositions:
- (a) of *all property*, whether separate property and relationship property;
  - (b) made *in contemplation of* entering into a qualifying relationship, as well as dispositions made since the qualifying relationship began; and
  - (c) that have the effect of defeating the claim or rights of either or both partners under any other provision of the PRA.
- 6.64 Third party dispositions to a trust will not be captured, even if the trust property is used by the partners during the relationship, for example as the family home. This aligns with our proposals in Chapter 2: Classification, and our recommendation that property one partner receives as a gift or inheritance from a third party should not be shared even if it is used as the family home. Compensation may, however, still be available under new section 44C to the extent that trust property settled by a third party was preserved or enhanced by the relationship (see below).

## Dispositions of all property

- 6.65 New section 44C will apply when one partner makes a disposition of relationship property or separate property.
- 6.66 Currently section 44C is restricted to dispositions of relationship property only. This means that no remedy is available for dispositions of separate property that have the effect of defeating an entitlement under the PRA. The most common example is when one partner disposes of their separate property savings to a trust, so that the trust can then acquire a family home for the partners.<sup>382</sup> Had the family home been acquired in the partner's own name, rather than through a trust, it would have been classified as relationship property under the PRA. The disposition has therefore had the effect of defeating the other partner's entitlement to an equal share in the home.<sup>383</sup>
- 6.67 Extending new section 44C to dispositions of separate property aligns with our proposed approach to classification, under which separate property can become relationship property if it is used to acquire property for the common use or common benefit of the partners.
- 6.68 Whether a disposition of separate property to a trust has the effect of defeating a claim or rights under the PRA is a question of fact. The closer the connection between the disposition and the trust's acquisition of property for the partners' common use or

<sup>382</sup> See for example *P v B* [2009] NZFLR 773 (HC). In that case Mr P entered an agreement to purchase the family home during the relationship, but disposed of his interest in the home five days before taking possession by nominating the trust as the purchaser under a Deed of Nomination. The trust funded the purchase by way of loan from Mr P of his separate property. The High Court held at [21] that s 44C of the Property (Relationships) Act 1976 did not apply because, while the Deed of Nomination was a disposition of property to the trust, it was not a disposition of relationship property, because the property had not, at the time of disposition, become the family home.

<sup>383</sup> Under our proposals in Chapter 2: Classification, if the family home was owned by one partner prior to the relationship, then the original net value of the home will remain that partner's separate property. So if the owning partner disposed of the family home to a trust during the relationship, the entitlement that has been defeated by the disposition is the non-owning partner's right to any increase in the value of the family home that occurs during the relationship, rather than an entitlement to an equal share in the family home.

common benefit, the more likely it is that the disposition has had the effect of defeating a claim or rights under the PRA.<sup>384</sup>

### ***Dispositions made in contemplation of entering a qualifying relationship***

- 6.69 New section 44C should extend to capture dispositions made at a time when the qualifying relationship was reasonably contemplated. This might include, for example, dispositions made while the partners were dating, but not before the partners had met. This aligns with our proposed approach to classification, outlined in Chapter 2, and will help to minimise the risk of disputes over when the qualifying relationship began.
- 6.70 This proposal means that a partner can no longer use a trust structure as a means of unilaterally protecting their property from future PRA claims once the qualifying relationship in question is contemplated. Instead the partners will need to enter into a contracting out agreement under section 21 of the PRA.
- 6.71 In the Issues Paper we suggested that section 44C could be extended to capture all dispositions, including those made before the relationship was contemplated (Issues Paper at [22.46]). However, the effect of our proposals in Chapter 2: Classification will be that the PRA would no longer classify property owned by one partner before the relationship was contemplated as relationship property. There would be less need to extend the scope of section 44C further. This means that new section 44C would not apply to acquisitions made by the trust during the relationship, if they are the result of a disposition of property to the trust that was made before the relationship was contemplated. This preserves pre-relationship trust property but still provides a remedy if that trust property has been preserved or enhanced by the relationship (see below).

### ***Dispositions that defeat the entitlements of either or both partners under any other provision of the PRA***

- 6.72 New section 44C should apply to dispositions that have the effect of defeating the claim or rights of either or both of the partners, under any other provision of the PRA. This is intended to clarify two aspects of how new section 44C shall operate.
- 6.73 First, it will not be necessary to establish that the disposition has only defeated the claim or rights of one partner. Peart has argued that it is appropriate to limit section 44C to dispositions that only defeat the rights of one partner, given its aim is to redress the inequality in property rights between the partners resulting from the disposition.<sup>385</sup> But this limitation has created problems in practice. Often a disposition will be made to a trust where both partners have only discretionary interests in the trust. This enables one partner to argue that section 44C does not apply because the disposition had an equal effect on the partners. While the courts have taken a robust approach to considering the practical effect of the disposition on the partners, in some cases finding that one partner has been disadvantaged because the other has maintained effective control over the

<sup>384</sup> For example in *O v S* (2006) 26 FRNZ 459 (FC) the family home was acquired by a trust. The partners made dispositions of relationship property funds and separate property funds to the trust in order to meet the deposit on the home, and continued making dispositions of relationship property to meet the mortgage repayments throughout the relationship. The Court was satisfied (at [109]) that these dispositions had the effect of defeating the applicant's claim under the Property (Relationships) Act 1976, because it enabled the family home to be purchased in the name of the trust, when "[c]learly, had the family home not been purchased in the name of the Trust it would have been relationship property".

<sup>385</sup> Nicola Peart "Section 44C of the Property (Relationships) Act 1976: conflicting interpretations" (2003) 4 BFLJ 199.

trust,<sup>386</sup> this is a complex inquiry. It also seems at odds with the courts' reluctance to take a strict approach to determining whether a partner's interest in trust property amounts to "property" under the PRA (see paragraph 6.21 above). In any event, the problem remains that trust structures can be devised in a way that conceals a partner's real interest in a trust. We think disputes over whether one partner is more disadvantaged than the other are unnecessary, particularly given the court retains discretion as to the compensation awarded so that a just outcome is reached in the circumstances.

- 6.74 The second clarification we wish to make to the operation of new section 44C is that the claim or rights that are being defeated are not limited to a claim for an equal share in the property that was disposed of to the trust. As NZLS submitted, injustice can arise when the use of a trust has the effect of circumventing other provisions of the PRA, such as the provisions that deal with occupation orders, deferring the sharing of relationship property, occupation rent, compensation for economic disparity and compensation for post-separation contributions. While the courts have, in some cases, awarded compensation under section 44C on the basis that a disposition has frustrated a partner's claim under other provisions of the PRA,<sup>387</sup> a recent decision of the Court of Appeal has taken a different approach.
- 6.75 In *R v C* the appellant sought occupation rent in respect of the respondent's occupation of the family home after separation.<sup>388</sup> As the family home was held on trust, the appellant could not claim occupation rent under section 18B. The Court of Appeal upheld the High Court's decision that section 44C was equally unavailable because the trust itself had purchased the family home. While the partners had disposed of relationship property to the trust in order for it to acquire the family home, that did not mean that the family home "purchased by the trust somehow itself became relationship property".<sup>389</sup> The Court of Appeal also observed that section 44C(1) presented a further obstacle to the appellant's claim, because as the trust funds were eventually distributed equally between the partners, the disposition of relationship property had not defeated the partners' claims "to the relationship property disposed of".<sup>390</sup>
- 6.76 Our proposal is that the PRA should be capable of providing a remedy when *any* claim or rights under the PRA are frustrated by the use of a trust. By clarifying this in the legislation, we expect that new section 44C will be given a wider interpretation than is currently reflected in *R v C*. A court will still have discretion, when making an order under new section 44C, to consider whether or not compensation should mirror that which a partner would have been entitled to had the disposition of property not occurred.

### Trust property that is preserved or enhanced by the relationship

- 6.77 New section 44C should also apply when:
- (a) trust property has been sustained by the application of relationship property or the actions of either or both partners; or

<sup>386</sup> *R v R* [2010] NZFLR 82 (HC); and *N v N* [2005] 3 NZLR 46 (CA).

<sup>387</sup> See for example *Hodgkinson v Hodgkinson* [2003] NZFLR 780 (FC) at [95]–[96] where compensation was awarded under s 44C of the Property (Relationships) Act 1976 (PRA) on the basis that a disposition of relationship property to a trust had the effect of defeating a claim under s 17 of the PRA. See also *Cairns v Cairns* (2003) 23 FRNZ 168 (FC).

<sup>388</sup> *R v C* [2016] NZCA 393, [2016] NZFLR 672.

<sup>389</sup> At [14].

<sup>390</sup> At [17].

- (b) any increase in the value of trust property, or any income or gains derived from trust property, is attributable to the application of relationship property or the actions of either or both partners.
- 6.78 This aligns with the entitlements that arise under the PRA when one partner's separate property has been sustained by the relationship (section 17), or the increase in value, or income or gains derived from one partner's separate property is attributable to the relationship (section 9A). The effect of this proposal is that a partner has a claim regardless of whether the property that was preserved or enhanced was the other partner's separate property, or was trust property.
- 6.79 This will apply to trusts settled by third parties or trusts settled before the relationship was contemplated. For example, if the trust was settled well before the relationship, and the trust held the family home, then a partner would have a claim in respect of the increase in value of the home that is attributable to the relationship (see Chapter 2: Classification). Or if the trust property was a family farm, held on a trust that was settled by one partner's parents, the other partner would still have a claim if they can establish that the farm was preserved or enhanced by the relationship. Similarly, there should be a remedy in respect of trusts under a will or other testamentary disposition when the property held on those trusts has been sustained or enhanced in a way attributable to the relationship. We therefore propose the repeal of section 44A.
- 6.80 The expansion of new section 44C in this way is intended to provide a remedy within the PRA for those situations where the partners would otherwise need to make a separate claim based on a constructive trust.<sup>391</sup> Therefore it is not significantly expanding the remedies available to a partner on separation, rather simplifying and codifying the available remedies within the PRA.
- 6.81 It is possible that the application of relationship property to a trust may also be considered a disposition of property to the trust which defeats that partner's rights under the PRA. There may therefore be some overlap between the circumstances in which the new section 44C would apply. We anticipate that in these cases the court would be able to make the most appropriate orders that are just in the circumstances.

### Powers of the court

- 6.82 We propose giving the court broad powers under new section 44C to make one or more orders:
- (a) requiring one partner to pay the other partner a sum of money, or to transfer property to the other partner, whether the sum of money or property is relationship property or separate property;
  - (b) requiring the trustees of the trust to pay a sum of money, or to transfer trust property to either or both partners; or

<sup>391</sup> Cases in which a partner has attempted to claim an interest under the Property (Relationships) Act 1976 based on contributions made to trust property originally settled on the trust by a third party include *Q v Q* (2005) 24 FRNZ 232 (FC); and *Clark v Clark* [2012] NZHC 3159, [2013] NZFLR 534. Cases where a partner has relied on a claim of constructive trust over a trust arising from the contributions made to the trust property include *Murrell v Hamilton* [2014] NZCA 377; *Vevoort 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.

(c) varying the terms of the trust, or resettling some or all of the trust property on a new trust or trusts.

6.83 A court already has the power to order one partner to pay the other partner compensation under section 44C, and to vary the terms of a trust under section 33(3)(m) of the PRA. The extension of the court's powers to include ordering a distribution of the trust's capital is consistent with the original recommendations of the Working Group established in 1988 to review the Matrimonial Property Act 1976,<sup>392</sup> and with the previous recommendations of the Law Commission in its review of the law of trusts.<sup>393</sup> In the past Parliament has been reluctant to provide the court with such broad powers given that, unlike dispositions under section 44, there has been no intention to defeat a partner's claim.<sup>394</sup> However, as Peart points out, in the absence of legislative action the courts have been sympathetic to a range of arguments aimed at accessing trust assets that would have been subject to division between the partners, but for the trust.<sup>395</sup> In our view it is preferable that the PRA provides a more effective remedy that is more in line with partners' entitlements under the PRA, and that reflects what is occurring in practice.

### Matters the court must have regard to

6.84 While new section 44C will have a broader application, and will provide a court with wider remedial powers, a court must still be satisfied that making an order of compensation is "just", having regard to a number of specified considerations.

6.85 These considerations are designed to ensure new section 44C achieves an appropriate balance between protecting partners' entitlements under the PRA and the preservation of trusts. We also expect that they will promote consistency in the application of new section 44C and provide a guide to settling claims out of court.

6.86 The considerations are:

- (a) If the claim relates to a disposition of property, the extent to which the partner's claim or rights under any other provision of the PRA have been defeated by the disposition;
- (b) If the claim relates to the preservation or enhancement of trust property, the extent to which the trust property has been sustained or enhanced by the application of relationship property or the actions of either partner;
- (c) The date or dates on which property was disposed of to the trust, or the trust was preserved or enhanced by the application of relationship property or the actions of either partner;
- (d) Whether the partners disposed of property to the trust, or preserved or enhanced the trust property with informed consent of both partners;
- (e) Any benefits the partners received from the trust, including the value of any consideration given for any disposition of property to the trust or for the

<sup>392</sup> Department of Justice *Report of the Working Group on Matrimonial Property and Family Protection* (October 1988) at 30.

<sup>393</sup> Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at 232.

<sup>394</sup> Matrimonial Property Amendment Bill 1998 (109-2) (select committee report) at xii. See discussion in Law Commission *Dividing Relationship Property – Time for Change? Te mātatoha rawa tokorau – Kua eke te wā?* (NZLC IP41, 2017) at [20.47]–[20.48].

<sup>395</sup> Nicola Peart "The Property (Relationships) Act 1976 and Trusts: Proposals for Reform" (2017) 47 VUWLR 443 at 443.

preservation or enhancement of trust property by the application of relationship property or the actions of either partner;

- (f) Whether the trust is intended to meet the needs of any minor or dependent beneficiaries; and
- (g) Any other relevant matter.

- 6.87 Considerations (a) and (b) reflect the compensatory nature of the remedy, and require the court to look at what the applicant would have been entitled to, had the trust property been subject to the PRA. This should be the starting point for assessing the value of any compensation under new section 44C.
- 6.88 Considerations (c) to (g) recognise that the use of trusts is varied and can involve competing interests and considerations. Simply awarding compensation that mirrors what a partner would have received, had the trust property been subject to the PRA, may not always achieve the PRA's purpose of a just division of property. This might be the case, for example, where the partners genuinely intended to alienate property by settling it on trust for the benefit of third parties. This could include donations to charitable trusts, but also dispositions to trusts established to meet the future needs of their children. We therefore propose giving the courts a degree of flexibility, even though it is at the cost of greater certainty, in order to weigh the overall fairness of awarding compensation in the circumstances of each particular case.

### Contracting out of new section 44C

- 6.89 Partners should be able to agree not to make any claim under new section 44C for the purposes of contracting out of the PRA under section 21, or to agree not to pursue any existing claims against a trust under section 21A. This will provide the partners and trustees greater certainty, although any such agreement would be subject to the procedural safeguards and remedies in Part 6 of the PRA.
- 6.90 As we explain in Chapter 8: Contracting out and settlement agreements, partners cannot agree on the division of trust property under a contracting out agreement, because trust property is not owned by either partner. The partners can, however, identify trust property in a contracting out agreement and make that agreement conditional on other arrangements in relation to a trust being completed, which could include trustees agreeing to exercise their discretion in a manner consistent with the agreement.

### Section 182 of the Family Proceedings Act to be repealed

- 6.91 We propose repealing section 182 of the Family Proceedings Act, for two reasons.
- (a) First, we are satisfied that new section 44C will eliminate the need for partners to rely on section 182 in order to achieve a just division of property at the end of a relationship. While section 182 could, in theory, have a wider application (see paragraph 6.53 above), in practice this is not how it is being used. Section 182 is a "relic from the past".<sup>396</sup> Its resurgence in recent times is due to the PRA's failure to provide an effective remedy for accessing trust property when relationships end. In the absence of any evidence of a need to provide a remedy with wider application than new section 44C, we are not convinced that section 182 needs to be retained.

<sup>396</sup> Bill Atkin *Relationship Property in New Zealand* (3rd ed, LexisNexis, Wellington, 2018) at 203; and Anthony Grant "A new problem for executors and a new risk for trusts" *Law News* (online ed, Auckland, 13 July 2018) at 4.

- (b) Second, the PRA is intended as a code and should therefore operate as a comprehensive regime to govern all property matters when relationships end. This will ensure property disputes are resolved applying the same purpose and principles.<sup>397</sup> It will also promote the inexpensive, simple and speedy resolution of property matters, by enabling disputes to be addressed at the same time, in one court and on a global rather than piecemeal basis.

### Section 44 to remain a remedy for other avoidance mechanisms

- 6.92 Our proposals do not affect section 44, which should remain unchanged. The law regarding the application of section 44 is now fairly well settled and appears sound.
- 6.93 Section 44 has wider application than new section 44C. It applies to all dispositions that are intentionally aimed at defeating claims or rights under the PRA. It therefore includes dispositions to third party ownership structures other than trusts. The requirement to prove intent to defeat a partner's claim or rights under the PRA is a significant hurdle,<sup>398</sup> but this is appropriate given that such a finding enables a court to set the disposition aside.
- 6.94 As Nicola Peart submitted, a possible risk of our preferred approach, which focuses only on the use of trusts, is that people may look to other ownership structures in order to avoid the PRA. We have, therefore, considered whether section 44 should be amended so that it applies to any disposition that has the *effect* of defeating the claim or rights of a partner under the PRA. This would eliminate the need for a specific provision in relation to dispositions to trusts, and would therefore avoid the possible risk of encouraging use of other avoidance mechanisms.
- 6.95 We do not prefer this as an option, however, for three reasons:
- (a) First, our research and submissions received have not revealed evidence of widespread avoidance problems with other ownership structures. Trusts are a unique avoidance mechanism, because interests in a trust are not usually "property" for the purposes of the PRA. But company shares, for example, are. This means that trusts can be used to maintain effective control or exclusive rights of use and enjoyment over property without subjecting it to the PRA. But companies are less easily manipulated, as demonstrated by the fact that the remedies for dispositions to companies in the PRA are seldom used.<sup>399</sup> As Atkin explains, this may in part be because shares held in family companies will often fall within the PRA's definition of relationship property in any event.<sup>400</sup> While other third party ownership structures may be more easily manipulated, without evidence it is difficult to effectively respond to any avoidance problems that may or may not arise in future.
- (b) Second, amending section 44 and making it an effects-based test would represent a significant limitation of the freedom of property owners to dispose of property as

<sup>397</sup> The policy of the Property (Relationships) Act 1976 is a just division of property when relationships end, whereas the focus of s 182 of the Family Proceedings Act 1980 is on a partner's reasonable expectations of the benefits they would have received under the trust had the relationship continued.

<sup>398</sup> N Peart, M Henaghan and G Kelly "Trusts and relationship property in New Zealand" (2011) 17 *Trusts & Trustees* 866 at 869.

<sup>399</sup> We have identified only two cases in which a substantive application under s 44F of the Property (Relationships) Act 1976 was decided: *P v P* [2003] NZFLR 925 (FC); and *RKR v TJH* [2012] NZFC 3779.

<sup>400</sup> Bill Atkin *Relationship Property in New Zealand* (3rd ed, LexisNexis, Wellington, 2018) at 215.

they so choose.<sup>401</sup> In the absence of evidence of a problem, such a limitation is difficult to justify. It was for this reason that section 44C, which already has a lower effects-based threshold, did not give the court more radical powers to unwind dispositions of property.<sup>402</sup>

(c) Third, we anticipate that our proposals to change the underpinning rules of classification set out in Chapter 2 will alleviate the sense of unfairness many people have with the way the PRA classifies and divides property, and will therefore reduce the incentives for avoiding the PRA in the first place.

6.96 While we are satisfied that there is a strong case for a more flexible remedy in relation to trusts, we are not satisfied that there is an equally compelling case for reform in respect of other dispositions.

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<sup>401</sup> Jessica Palmer "What to Do about Trusts?" in Jessica Palmer and others (eds) *Law and Policy in Modern Family Finance: Property Division in the 21st Century* (Intersentia, Cambridge (UK), 2017) 177 at 194.

<sup>402</sup> See discussion in *Simon v Wright* [2013] NZHC 1809 at [36].

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**44C Remedies when property held on trust**

- (1) This section applies if the court is satisfied that—
- (a) either or both of the partners to a relationship have, at any time when the relationship was reasonably contemplated, or at any subsequent time during or after the relationship, disposed of separate property or relationship property to a trust, and that disposition has the effect of defeating a claim or right of either or both of the partners under this Act; or
  - (b) trust property has been sustained by either or both of the following:
    - (i) the application of relationship property:
    - (ii) the actions of either or both of the partners during the relationship; or
  - (c) any enhancement of trust property (being an increase in the value of the property, or any income or gains derived from the property) is attributable to either or both of the following:
    - (i) the application of relationship property:
    - (ii) the actions of either or both of the partners during the relationship.
- (2) If the court considers it just in the circumstances, having regard to all relevant matters, including the matters in **subsection (3)**, the court may make 1 or more of the following orders:
- (a) an order requiring one of the partners to the relationship (**A**) to pay to the other partner (**B**) a sum of money out of relationship property or separate property:
  - (b) an order requiring A to transfer to B any relationship property or separate property:
  - (c) an order requiring the trustees of the trust to pay to A or B, or both A and B, a sum of money:
  - (d) an order requiring the trustees of the trust to transfer to A or B, or both A and B, any trust property:
  - (e) an order varying the terms of the trust:
  - (f) an order resettling some or all of the trust property on 1 or more new trusts.
- (3) The matters referred to in **subsection (2)** are,—
- (a) if this section applies because of **subsection (1)(a)**,—
    - (i) the extent to which a claim or right of either or both of the partners under this Act has been defeated by the disposition of the property to the trust; and
    - (ii) the date of the disposition of the property to the trust; and

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- (iii) any benefits the partners have received from the trust, including the value of any consideration given for the disposition of the property to the trust; and
  - (iv) whether the disposition of the property to the trust was made with the informed consent of both partners; and
  - (v) whether the trust is intended to meet the needs of any minor or dependent beneficiaries; or
- (b) if this section applies because of **subsection (1)(b) or (c)**,—
- (i) the extent to which the trust property has been sustained or enhanced by the application of relationship property or the actions of either or both of the partners; and
  - (ii) the date or dates on which the trust property was sustained or enhanced by the application of relationship property, or the actions of either or both of the partners; and
  - (iii) any benefits the partners have received from the trust property, including the value of any consideration given for sustaining or enhancing the trust property; and
  - (iv) whether the trust property was sustained or enhanced with the informed consent of both partners; and
  - (v) whether the trust property is intended to meet the needs of any minor or dependent beneficiaries.