

How Separate Is Your Separate Property?



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Most of you will be familiar with Public Trust's recent advertising campaign featuring a primary school photo and a theme along the lines of "You didn't plan on your daughter marrying him". While the ad is light-hearted, it has a serious and important message about the role of family trusts in protecting your family's assets. The following facts, based on a true case, are a reminder of just that.

HIM AND MRS JONES

A client whom we'll call Mrs Jones came from a loving, hard-working family – her parents believed in family, community and education. During their lifetimes her parents accumulated assets, including the family home, of more than \$1.5 million. Through the years when Mrs Jones and her sister were marrying, buying their first homes and starting families of their own, their parents gave each of their daughters \$25,000 a year, totalling \$150,000 each. The parents then died within a relatively short period of each other and left their assets to their daughters equally.

Mrs Jones had used the funds her parents had given her as a deposit on a house, and then to reduce the mortgage. When she received her inheritance she paid off the balance of the mortgage over the family home, and also paid off an investment rental property that she and her husband owned. The balance of the funds she invested in her and her husband's joint names. But within a very short time Mrs Jones and her husband separated, and Mrs Jones was left with the care of two pre-school children.

Under the Property (Relationships) Act 1976, the family home and the rental property were relationship property and Mr Jones was entitled to

half their value. Mrs Jones was shocked to realise that her husband could walk out of their marriage and claim half of what they had acquired, when the primary source of their assets had been funds that she had received from her parents by gift or by inheritance. Mrs Jones believed that her parents had intended to secure the futures of their daughter and grandchildren.

It is common for someone who receives an inheritance to pay off some or all of a mortgage. But, as this example shows, if the property is or becomes a family home and the relationship later ends, the equal-sharing provisions of the 1976 Act (which were strengthened in 2002) can be unfair.

INTERMINGLING OF INHERITED ASSETS

The significant amendments to the Property (Relationships) Act in 2002 have affected how inherited assets are divided on separation. If you are married or in a civil union or de facto relationship for more than three years, all relationship property will be divided equally unless the court considers there are extraordinary circumstances that make equal sharing "repugnant to justice". Under the Act, property acquired by way of inheritance is separate property. But for it to remain separate it must retain its separate character.

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It can become relationship property if it is used for the benefit of both parties or if it becomes so intermingled with other relationship property that it loses its separate character.

In Mrs Jones's case, money that she inherited was applied to the payment of a mortgage for joint property. It lost its separate character because the family home, and property held in joint names, is relationship property. When they separated, her husband was therefore entitled to an equal share of the property, and in effect received a portion of the wife's inheritance.

HOW YOU CAN PROTECT SEPARATE PROPERTY

Your separate property can be protected in various ways:

Prevent intermingling with relationship property

Separate property, or proceeds from it, that are used for relationship purposes, or applied to relationship property, will lose its separate character.

Establishing a trust

By settling your separate property into a trust that does not contain relationship property, you minimise risk of intermingling. As the trust's assets are no longer your property, they are not available to be divided as relationship property if your relationship ends. However, this is not true of relationship property that is settled into a trust during a relationship. We recommend that you seek advice about these issues. Protection of property from claims under the Property (Relationships) Act is only one of the potential benefits of creating a trust, but a trust may not best suit your needs.

A "contracting out" agreement

The Property (Relationships) Act provides for couples to agree in writing that some or all of the Act's provisions will not apply in their case. These "contracting out" agreements allow couples to make their own decisions about the ownership of property and how it is to be

divided if their relationship ends. A contracting out agreement can specify the property you want protected as separate property. Mrs Jones could have entered into such an agreement with her husband before she used her inheritance to pay off the family home and investment property, specifying that on separation Mrs Jones would be paid out the amount of inheritance she contributed to those properties before relationship property is divided. Depending on your circumstances, it may be that your assets are best protected by combining a contracting out agreement with a trust.

Loans

In some cases the best protection is to lend money to family members, rather than gifting it to them. If parents have lent one partner money and the relationship fails, the loan remains the asset of the lenders, the parents. The other partner cannot claim a share of the funds, as those funds did not become relationship property. Indeed the loan would likely be classified as a relationship debt that the partners are both responsible for repaying.

PLAN AHEAD AND SEEK PROFESSIONAL ADVICE

If you are in a relationship and have separate property, or if you intend to give money to family members or to leave an inheritance, perhaps the most important thing you can do is plan ahead on the basis of professional advice.

You may also wish to discuss estate planning with your children. It can be important that they are aware of the ways in which inheritances can become relationship property and that they understand they have the ability to protect their assets.

If you would like more information, please contact Jane Forrest, Partner in our Wellington Office, (04) 495 9940 or Simon Weil, Partner in our Auckland office, (09) 306 1465.