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PROTECTING THE BANK OF MUM AND DAD:

WHAT SHOULD BE IN A FAMILY LOAN AGREEMENT?

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1. Introduction

This paper is to accompany the power point presentation slides entitled "Protecting the bank of mum and dad: what should be in a family loan agreement?" to be presented at Television Education Network's Drafting for Maximum Impact in your Succession Law Practice – a live lunchtime online conference in February 2022.

This paper will consider the following:

1.1 Acting for one party – determining who your client is and obtaining appropriate instructions;

1.2 Gift or loan – considering intention and how to ensure document accurately reflects them;

1.3 Documenting the arrangement: tips for binding and enforceable agreements;

1.4 Taking security, charging interest and other protective strategies – eg in the context of relationship breakdown;

1.5 Appropriate conditions and restrictions;

1.6 Updating Wills to reflect loan agreements and forgiveness of loans on death;

1.7 Statute of limitation issues for loans "repayable on demand"; and

1.8 Conclusive remarks: drafting tips to withstand challenges.

2. Acting for one party – determining who your client is and obtaining appropriate instructions

2.1 It is increasingly common for parents to provide financial assistance to their children. There is a whole array of reasons why a parent may provide financial assistance to a child, but more common reasons include:

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(a) the payment of school fees and university tuition fees for children and/or grandchildren;

(b) purchase of property for the child, such as a family home, especially in a climate with rising property prices;

(c) start-up capital or additional cashflow into a child's business; and

(d) contribution of gifted sums into superannuation to take advantage of the generation of income in a concessionally taxed environment.

2.2 Legal practitioners must carefully consider who they are acting for and avoid conflicts as part of day to day practice. Parent to child loans are no exception to this and it is essential to make clear who the practitioner is acting for. If for instance, the practitioner is acting for the parents in a loan arrangement, the practitioner should recommend that the children obtain their own independent legal advice. The similar goes for practitioners acting for children in the loan arrangement and the parents ought to be independently represented.

2.3 This issue is particularly relevant given the significant take up in borrowings from the 'bank of mum and dad' with parents wishing to lend a helping hand to children who want to secure their first home.

2.4 The Victorian Legal Practitioners' Liability Committee (LPLC) has recommended that practitioners keep a record of advice and clients' instructions as a matter of risk management.[1] This is particularly the case in circumstances where there is a falling out between the parents and children, claims against the estate or 'he said she said banter' on the parents' death.

3. Gift or loan – considering intention and how to ensure document accurately reflects them

3.1 There are generally two ways in which parents can advance money to their children, which is by loan or by gift.

3.2 Where funds are advanced by way of gift, such funds leave the hands of the donor (and cease to be an asset in their personal estate) and are paid into donor's estate.

3.3 Where funds are advanced via loan, the individual retains control of those funds (ie the benefit of the loan). The benefit of the loan is still an asset of the individual lender's personal estate and:

(a) is subject to claim by creditors in the event of the individual's financial difficulty, insolvency or bankruptcy during their lifetime; and

(b) will form part of their estate on death and will devolve according to the terms of their Will or in accordance with the laws of intestacy. Where the loan account forms part of a lender's personal estate, it is available for division in the event one's Will is challenged[2] eg under Part IV of the *Administration and Probate Act 1958* (Vic) in Victoria, by one or more (disgruntled) beneficiaries.

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[1] See website: https://lplc.com.au/resources/lij-article/when-parents-lend-to-children

[2] See *Succession Act 2006* (NSW), Chapter 3; *Family Provision Act 1972* (WA); *Inheritance (Family Provision) Act 1972* (SA); *Succession Act 1981* (QLD), Part IV; *Testators Family Maintenance Act 1912* (Tas); *Family Provision Act 1969* (ACT); *Family Provision Act 1970* (NT).

3.4 Notably, parent to child gifts and/or loans can be made directly from personally held assets, or can be made from associated entities such as a private company or a family discretionary trust. This paper will focus on loans made directly from personally held assets.

3.5 A question that often arises is whether an advance of money from a parent to a child is a gift or a loan. The reason for this is that the arrangements surrounding the advance of money are often informal and undocumented due to the level of familiarity between the parties.

3.6 For a gift to effective, three things must occur as outlined in the case of *Nolan v Nolan* (2003) 10 VR 626:[3]

(a) There must be an intention by of the donor to make a gift, usually expressed or accompanied by words of gift which evince the intention and delineate the object and extent of the intended benefaction.[4]

Notably, donative intention need not be manifested by words and there may be circumstances that evidence an intention to make a gift. However, such circumstances would be unusual.[5]

(b) Acceptance of a gift.

(c) Delivery of the gift (ie effecting of the gift).

The party that bears the burden of proof is the party that is trying to assert that the advance is a gift, namely the donee.

3.7 In order for an advance to be a loan, the following must occur:[6]

(a) There must be an intention of both parties to enter into legal relations in the creation of a loan in respect of the advance.

(b) A requirement to repay the loan.

The party that bears the burden of proof is the party that is trying to assert that the advance is a loan. Therefore, the evidentiary burden will usually be on the parent, where the amount advanced is meant to be a loan and not a gift.

3.8 Generally, in determining whether an advance of money is a loan or a gift, the intentions of both the party advancing and the recipient as noted in paragraphs 3.6(a) and 3.7(a) above, will be the most important consideration.

4. Documenting the arrangement: tips for binding and enforceable agreements

4.1 The clearest evidence of a loan or gift is the documentation setting out the terms of arrangement.

4.2 Where the advance is intended to be a gift, a deed of gift should be entered into by the parties to confirm the gift. The terms of the deed of gift should confirm the following:

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[3] See [131]-[132]
[4] Ibid.
[5] Ibid, [139]-[140].
[6] Ibid, [131]-[132].

(a) the amount of the gift;

(b) the purpose of the gift (if any);

(c) the donor's gifting of the gift; and

(d) the donee's receipt of the gift.

4.3 Where the advance is a loan, a loan agreement should be entered into by the parties to confirm the existence of the loan and the terms thereof. The terms of the loan agreement should set out the following:

(a) the date of the loan;

(b) details of the lender(s) and borrower(s);

(c) the principal sum amount loaned;

(d) the term of the loan (for example, whether the loan will be due and payable on a certain date, or on the occurrence of a certain event such the demand for repayment by the borrower or the date of death of the borrower);

(e) interest rate and how interest is to be calculated (eg. on a simple/compound basis);

(f) repayment terms (for example, whether the borrower shall make periodic payments, and whether repayments shall include principal and interest);

(g) events leading to a default of the loan agreement by the borrower (such as becoming a bankrupt, or failing to make repayments in according with the loan agreement); and

(h) security on the loan (if any).

4.4 In respect of loans, it is important for both parties to maintain ongoing records evidencing the continued existence of the loan until it is fully discharged or otherwise ends, such as:

(a) records of repayments including bank statements and amounts outstanding on the loan after each repayment; and

(b) correspondence in relation to the loan, such as any demands for repayment or the amendment of loan terms.

4.5 Where the loan is subsequently forgiven, there is a set-off of the loan, or the borrower defaults on the loan, this should also be documented in writing and records kept.

4.6 Fresh acknowledgement of the loans should also be executed by the parties annually or at least once every few years, to ensure that the loan does not become statute barred under the limitations legislation of each State and Territory (see section 8, below).

4.7 The gift or loan can be documented after the advance has occurred, usually by way of acknowledgement/confirmatory documentation. As noted above, due to the familiarity of the parties, gifts or loans are usually undocumented. Therefore, in some cases acknowledgement/confirmatory documentation acknowledging and confirming the existence of the gift or loan are prepared and executed by

the parties after the advance, usually on the advice of an independent third party such as a legal or financial advisor.

4.8 The nature and treatment of acknowledgement/confirmatory documentation of the gift or loan after the fact was dealt with in the case of *John Steiner v Kenneth Ross Strang and Jason Tang* [2014] NSWSC 1250 (***John v Kenneth and Jason***). The facts of this case are summarised as follows:

(a) Dorothy Steiner, the mother of John Steiner passed way and probate of her will was granted to Kenneth Strang and Jason Tang as her executors;

(b) Dorothy's Will provided that John was to receive a pecuniary legacy of $2m and shared the residual estate equally with his sister Robyn. In particular, the Will provided:

"I draw my Executor's attention to the Acknowledgement of Loan between myself and my son John dated 18 December 2007 and request that the provisions of that Acknowledgement be implemented and observed."

(c) The deceased advanced sums totalling $881,000 to John to assist him in purchasing a property.

(d) John engaged a solicitor (Mr Ward) to act for him in respect of the purchase of the property. Following the settlement of the purchase, John instructed Mr Ward to prepare a document entitled "Acknowledgement of Loan" (**the Acknowledgement**) which acknowledged the following:

(i) the existence of the loan;

(ii) that John will repay the loan to Dorothy upon demand during her lifetime and to her deceased estate on her death; and

(iii) where Dorothy had not made demand for the repayment of the loan prior to her death and John is named in her Will as a residual beneficiary, as long as her liabilities at the date of her death are paid and discharged without her legal personal representatives being required to demand the repayment of the loan, then the loan can be repaid by John by offsetting the amount of the loan as part of his entitlement as a residual beneficiary of her estate.

The document was executed by both Dorothy and John, and duly witnessed.

4.9 One of the issues that was decided in the proceedings was whether there was a debt owed to Dorothy's estate by John and whether he was obliged to pay interest on the loan.

4.10 The Court held that the Acknowledgement was not intended to be the contract between the parties, but the acknowledgement of a loan *already* entered into. Therefore, it is properly to be regarded as an admission or admissible post-contractual conduct. Citing *Lym International Pty Ltd v Marcolongo* [2011] NSWCA 303, the Court emphasised that there is a difference between interpreting a wholly written contract, and finding out what has been agreed in a contract that is not wholly in writing. Post-contractual conduct is not relevant to

the former, but would be relevant to the latter in ascertaining what the parties have agreed upon.

4.11 Accordingly, the Acknowledgement should be properly regarded as post-contractual conduct, which should be treated as an admission by John, and was clear indication that a debt was owed to Dorothy's estate.

4.12 In light of the decision on John v Kenneth and Jason, while acknowledgment/confirmatory documentation would not constitute the agreement between the parties, it would be considered to be post-contractual conduct indicating what has been agreed upon between the parties. Where the terms of such documentation are clear as to the nature of the advance and the terms thereof, it would be clear indication of whether the advance was meant to be a gift or a loan.

5. Taking security, charging interest and other protective strategies – eg in context of relationship breakdown

5.1 One of the main issues in relation to parent to child loans is that the legitimacy of the loan is open to question, particularly where the terms of the loan are "friendly". In particular, it may be argued in the context of a dispute (for example a family law dispute) that terms of the loan are insufficiently commercial such that the loan is not legitimate and is in fact a disguised gift.

5.2 Notably, in the context of parent to child loans, the Family Court is unlikely to accept that advances were considered loans without proper documentation and commercial conduct of the parties such as the provision of a mortgage or other security, and likelihood of enforcement by the lender.[7] Therefore, it is crucial that records (of advances, repayment and security) be kept.

5.3 The factors to consider in determining the authenticity of a loan was discussed in in the case of *Bircher v Bircher* [2016] FamCAFC 123 (***Bircher***). *Bircher* was decided in the context of family law and dealt with financial orders. The relevant facts of Bircher are summarised as follows:

(a) *Bircher* involved the appeal against financial orders by Mrs Bircher (the wife), which was opposed by Mr Bircher (the husband) and Mr Bircher's father, namely Dr Bircher;

(b) Mr and Mrs Bircher separated in September 2012, and were not able to come to an agreement in relation to the division of their marital assets;

(c) the marital "pool" of assets consisted of non-superannuation assets of $74,947 and superannuation assets of $165,493. The liabilities of Mr and Mrs Bircher amounted to $55,269. Thus, the net pool as found comprised $185,171, of which $165,493 consisted of superannuation interests;

(d) however, the above assets excluded an amount of $64,467 standing to the credit of the parties in a solicitor's trust account. That sum represented part of the net proceeds of the sale of Mr and Mrs Bircher's former matrimonial home. The trial judge had held that Dr Bircher was

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[7] See for example, *Bauer & Bauer* [2013] FCCA 1125; *Carpenter & Carpenter* [2014] FAMCA 374; *Winston & Winston (No 2)* [2013] FAMCFC 147.

the sole and absolute owner of the $64,467, as that sum represented two loans (evidenced by mortgages) from Dr Bircher to Mr Bircher; and

(e) Mrs Bircher contended that the alleged loans, and the mortgages evidencing them, were shams, the product of a concoction between Mr Bircher and Dr Bircher to reduce the property pool for division.

5.4 In determining the authenticity of a loan, the Full Court in *Bircher* held that the following matters should be considered and determined:

(a) whether there were any agreements for loans and when those agreements were committed to writing;

(b) what the terms of the loans were, including but not limited to:

(i) the term (duration) of the loan;

(ii) the rate and calculation of interest if any; and

(iii) the required repayments; and

(c) whether mortgages were executed and when they were executed.[8]

5.5 The Full Court in *Bircher* allowed the appeal and remitted the proceedings inter alia for the following reasons:

(a) the trial judge did not fully consider the available evidence relevant to the matter;

(b) in reaching the conclusion that the loans from Dr Bircher to Mr Bircher were genuine, the trial judge only referred to a document entitled "Schedule of Mortgage debts and payments re [Mr Bircher] (Mortgagee) and [Mr Bircher] (Mortgagor)", and not the other evidence given by parties (which threw doubt on the Schedule of Mortgage debts and payments);

(c) In respect of the interest rate on the loans from Dr Bircher:[9]

(i) it was not to the point that the interest rate on the loans from Dr Bircher was "a reasonable amount", and Dr Bircher's entitlement to interest was entirely dependent upon the loan agreements entered into between the husband and the second respondent (if they be found to exist or to exist as claimed);

(ii) there were inconsistencies in the multiple versions of the loan agreement that were admitted as evidence in respect of the calculation of interest; and

(iii) there was an absence of evidence as to how expenses were purportedly included in the amount owing to Dr Bircher and how interest was chargeable on them; and

[8] See [29].
[9] See [59]-[61].

(iv) the trial judge did not consider the mortgages that were alleged to secure the loans from Dr Bircher to Mr Bircher.

5.6 To ensure that a parent to child loan is viewed as a genuine loan and protected as such, the terms of the loan should be as commercial as possible. The case of *Bircher* underscores the main protective strategies to ensure the commerciality of the loan terms, which are:

(a) the taking and registering of security; and

(b) charging interest.

5.7 Ideally, the loan would resemble the terms of a loan agreement between a borrower and a 3rd party financial institution (such as a bank) as the lender. Note though, where interest is charged, such interest will be taxable income in the lender's hands. In determining the efficacy of the loan and the intentions of the parties, regard would be had to whether the interest was appropriately returned by the lender in their income tax returns.

Taking and registering security

5.8 One of the main indications of the commerciality of a loan is the terms of the loan requiring security over a particular asset owned or controlled by the borrower, and for such security to be appropriately registered in favour of the lender. Two common types of security are as follows:

(a) security over real estate, and registered by way of a registered mortgage with the Land Titles Office of the relevant State or Territory; and

(b) security over other personal assets (such as shares in companies, intellectual property, motor vehicles, plant and equipment etc.), and registered by way of registration with the federal *Personal Property Securities Register* (**PPSR**) maintained by the Australian Financial Security Authority.

5.9 The most common form of security for loans is security over real estate by way of a registered mortgage, particularly where the purpose of the parent to child loan is to assist the child to purchase real estate. In particular, security for the loan could be taken in the form of a mortgage over the property purchased and/or other properties owned or controlled by the child. In respect of security over real estate:

(a) to ensure the effectiveness of the security, such security should be registered as a mortgage over the relevant property with the relevant authorities in each State and Territory;

(b) generally, once a mortgage is registered, further dealings in respect of the property will require the consent of the parents as the registered mortgagee(s), subject to the terms of the mortgage (eg memorandum of common provisions) and/or terms of the loan (under the loan agreement); and

(c) where the child experiences financial difficulty and is subject to a creditor claim or becomes bankrupt, the parents as the mortgagee(s) will be afforded the status of a secured creditor and rank ahead of all other unsecured creditors in recovering the debt owed, up to the value of the security.

5.10 There are instances where a mortgage has been executed by the parties in favour of the parents or grandparents as the lenders, but the mortgage is ultimately not registered. This may be where:

(a) there is duty payable on the registration of mortgages (noting that mortgage duty has since been abolished in all States and Territories); and/or

(b) there is an existing mortgage on the child's property, such as a mortgage in favour of a bank, and the first mortgagee does not consent to the registration of the second mortgage in favour of the parents, and/or the child will be in breach of the terms of the first mortgage.

5.11 To provide the most protection from creditors and to ensure priority, as far as possible, security should be registered either by way of mortgage or registration with the PPSR (as the case may be). Doing so would ensure to the extent possible that:

(a) creditors will be on notice of the security, given that mortgages and the PPSR register are publicly searchable; and

(b) they will rank ahead of other unsecured creditors.

Charging interest

5.12 There are two aspects to charging interest under a loan, the first being the interest rate and the second being the interest calculation and payments made by the borrower.

5.13 Adequate rates of interest charged under a loan is an indication of the commerciality of the loan, and suggests a bona fide loan. The interest rate charged under a loan is generally at the agreement of the parties, but a conservative approach to ensure the commerciality of the loan is to charge interest with reference to a benchmark rate such as a residential home loan rate or a personal loan rate, depending on whether the loan in question is secured or unsecured, and what the purpose of the loan is.

5.14 As noted in the section above entitled "Documenting the arrangement – paper trails and loan agreement necessities" and underscored by the decision in *Bircher*,[10] the loan agreement should clearly state the interest rate and how it may be calculated. In addition, repayments made on the loan should be properly recorded, including details and calculations indicating whether the whether the payment comprises of principal only, interest only, or a combination of both.

6. Other appropriate conditions and restrictions

6.1 Other appropriate conditions and restrictions that may be included in the loan agreement to protect the loan include the following:

(a) the requirement for minimum periodic payments (eg. monthly or fortnightly) of principal and interest, which would ensure that the loan does not become statute barred (see section 8, below);

[10] At [60].

(b) setting out the purpose of the loan in the loan deed, and stipulating that any sums loaned can be utilised only for that purpose. For example, where a loan is made from a parent to a child to pay for the purchase of a property, a term may be included in the loan deed to restrict the child to using the moneys loaned for that purpose only.

6.2 The question that often comes up is whether an interest-free loan would be regarded as a bona fide loan, and how that would fare, if ever challenged.

6.3 In my opinion, an interest-free loan that is unsecured, may be viewed by Courts as a "disguised gift" rather than as an enforceable loan, depending on the context and factual scenario. In my view though, if lenders wish to avoid the interest-bearing loans (eg issues with the taxation of interest income), interest-free but secured loans, may carry more weight than interest-free and unsecured loans.

6.4 Obviously, the "gold standard" would be to have a commercial interest-bearing and secured loan, but if this is either not possible or preferable, the advisor should outline the available options and the "spectrum" of commerciality in enabling the client to make an informed decision. Also, the practitioner should consider the purpose of the loan, for instance is the purpose to:

(a) minimise the risk of assets being subject to division amongst creditors in a bankruptcy context;

(b) ensure that the advance does not form part of the assets in a family law property dispute;

(c) advance inheritance during the parent's lifetime, to be adjusted for under the terms of the Will.

6.5 The purpose may influence how "commercial" the terms of the loan should be; for instance, in a family law/bankruptcy setting, one would expect the loans to be more commercial. However, in an estate planning context where adjustments are to be made under Will, interest-free and unsecured loans are often used to keep things fair between the children as well as protect the borrower from creditors and predators on the lender's death.

7. Updating Wills to reflect loan agreements and forgiveness of loans on death

7.1 As noted earlier in this paper, where funds are advanced via loan, the individual retains control of those funds (ie the benefit of the loan). The benefit of the loan is still an asset of the individual's personal estate and will be dealt with on the lender's death under the terms of their Wills, or the laws of intestacy where there is no Will. After all, the lender's legal personal representative is bound to maximise the value of the estate, which includes calling in all debts owed to the deceased.

7.2 As part of the taking instructions for the preparation or update of a Will, full details should be obtained by the legal practitioner in relation to advances made by the testator to related and third parties. At this stage the legal practitioner should turn their mind to:

(a) whether the advance is likely to be viewed as a loan or gift;

(b) whether the loan has been sufficiently evidenced, including the review of loan agreements, correspondence (and other relative documents including bank statements showing the transfer of funds, etc); and

(c) where the loan has not been sufficiently documented and evidenced, whether acknowledgement/confirmatory documentation should be prepared.

7.3 In addition to the above, legal practitioners and testators should also be aware of how loans are dealt with under the terms of a Will, namely:

(a) the loan can be forgiven at the date of the testator's death; or

(b) the loan can remain owing to the deceased estate.

Forgiveness of the loan

7.4 Where the loan is forgiven at the date of the testator's death, the borrower will no longer owe a debt to the testator's estate. The loan may be forgiven by a specific term in the Will, or may be forgiven at the discretion of the executor provided the executor has the power do so under the terms of the Will.

7.5 Where the loan is forgiven under the terms of the Will, the remaining terms of the Will should specify whether there will be an adjustment for the loan against any gift to the debtor beneficiary, and how such adjustment is to be calculated (for instance, should there be a deeming provision to value the principal sum to include a notional mark up of interest as part of the adjustment to account for the debtor beneficiary's use of the funds, even if the loan between the lender and the borrower was interest-free). In addition, the testator could prepare a separate letter of wishes detailing the reasons why the loan was forgiven, and the reasons for adjusting/not adjusting the amount of the loan.

7.6 We do not recommend that the executor exercise its discretion to forgive a loan even if empowered (but not expressly directed) to do so under the terms of a Will, as it may lead to disputes between the beneficiaries. Notably, the thought of exercising such power to forgive loans may be due to a conflict of interest, where the executor is also one of the beneficiaries under the Will who would benefit in their personal capacity if the loan was forgiven (as opposed to being called into the estate).

7.7 That being said, a situation where such an exercise of discretion would be appropriate is where all the beneficiaries of the estate are represented at the executor level (ie are all appointed as executors) and the decision to exercise discretion to forgive the loan is agreed to by the executors (and beneficiaries) jointly.

7.8 A detailed discussion and study of the commercial debt forgiveness rules under Division 245 of the *Income Tax Assessment Act 1997* (Cth) (**the ITAA97**) is beyond the scope of this paper, save to say that they should not be enlivened if the forgiveness is effected by Will[11] or for reason of natural love and affection.[12]

7.9 It is common for Wills to provide that the benefit of the loan (being an asset which still forms part of the testator's personal estate and should therefore feature part of the probate inventory) is gifted to the borrower, or to the trustee of a testamentary trust that the borrower has effective control of. While this may appear to effectively forgive the loan (as the borrower will now "owe" himself the

[11] See s 245-40(d) of the ITAA97.
[12] See s 245-40€ of the ITAA97.

amounts outstanding under the loan), this is not strictly considered to be a "forgiveness" of the loan, but the specific gift of the benefit of the loan.

7.10 For instance, if the benefit of a loan is appropriately gifted to a testamentary trust under the Will, the outstanding principal sum (and any interest) will be owing to the trustee of the testamentary trust. If the testamentary trust is earmarked for the borrower's benefit in lieu of an outright gift:

(a) there would be better asset protection for the borrower as they would be owing a trust with (for instance) a discretionary class of beneficiaries rather than themselves absolutely; and

(b) the principal sum owing would form part of the capital of the testamentary trust which can then be called in, subsequently invested for the beneficiaries to generate income. Given that the principal sum owing formed part of the assets of the deceased, income generated would be "excepted trust income" which can then be distributed amongst minor beneficiaries and taxed at adult marginal tax rates.

Loan remain owing to the deceased estate

7.11 A loan that is not forgiven by the testator during their lifetime or under the terms of their Will will remain owing to the testator's deceased estate on their death.

7.12 There are three main ways a loan owing to the deceased estate may be dealt with under the terms of a Will:

(a) be gifted to a particular beneficiary. For instance, the benefit of the loan may be gifted to the borrower, or the trustee of a testamentary trust the borrower has effective control of (see paragraph 50 above), or a third party;

(b) be adjusted against the borrower's share of the testator's estate; and/or

(c) form part of the residuary estate to be split in accordance with the terms of the Will.

7.13 In providing for the specific gift of a benefit of a loan to a beneficiary (including the borrower), the testator and legal practitioner will need to turn their mind to the following issues:

(a) drafting the terms of the Will to refer to the loan with certainty, to ensure that the gift does not fail for uncertainty;

(b) whether there will be a loan owing to the testator at the date of death and is recoverable at that time. Where there is no loan owing at the date of death or is unrecoverable, the benefit of the loan would no longer be held in the testator's residual estate and the gift will fail or be "adeemed". This will result in the Will being read as if the specific gift of the benefit of the loan was never made. This could give rise to the result that one or more beneficiaries receive more than was intended by the testator and disputes could arise;

(c) if the gift fails or is adeemed, whether there will be a substitute gift; and

(d) whether the specific gift is adjusted for against the beneficiary's share of the residual estate.

7.14 In deciding whether the loan should form part of the residuary estate to be divided under the Will, the testator and legal practitioner should consider the appropriateness of an equalisation clause that takes into account *inter vivos* gifts and loans, as well as assets of the testator that are not held personally (such as superannuation and assets held in family discretionary trusts). The equalisation clause should operate to ensure, to the extent possible, a global distribution of the testator's total wealth (not just the wealth held personally) that is in accordance with the intentions of the testator.

7.15 For instance, where a testator's residual estate is to be split equally between 2 beneficiaries and one beneficiary receives the benefit of a loan made to them as part of their share of the estate, the other beneficiary may receive other assets in the testator's total wealth (such as other estate assets or superannuation death benefits) to make up for the difference and to ensure that the overall distribution of the testator's wealth is equal between the beneficiaries. This would be a result of the executors exercising their power of appropriation.

8. Statute of limitation issues for loans 'repayable on demand':

8.1 A crucial consideration in respect of parent to child loans, before even being able to consider questions above such as of whether the advance is a gift or a loan or how the loan is to be dealt with under a Will, is whether the loan has been "statute barred", particularly if a loan is repayable at call/on demand. Where a loan is statute barred, it is no longer enforceable and has effectively become a gift.

8.2 Each Australian State and Territory has limitation laws in relation to the recovery of loans and the enforcement of Court judgments in respect of loans.[13] For example in Victoria, the limitation period for the enforcement of a loan agreement would be 6 years,[14] after which the loan will become statute barred and unenforceable, and will effectively become a gift.

8.3 For a loan agreement to remain enforceable, at least one of the following must have occurred in the limitation period set by the relevant State or Territory limitations legislation:

(a) a payment of interest;

(b) repayment of part of the principal; and

(c) acknowledgement by the borrower of the loan.

8.4 For this reason, it would be appropriate for the parties to the loan arrangement to acknowledge the existence or terms of the loan periodically, to prevent the loan from becoming "statute barred" and effective, eg under Will and adjusted between beneficiaries.

8.5 Alternatively, another way of ensuring that the loans are not statute barred may be to make them repayable upon a particular event – eg, the earliest of the sale of property, death of an individual (eg the borrower) or a period of time.

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[13] See *Limitation Act 1985* (ACT), *Limitation Act 1969* (NSW), *Limitation Act* (NT), *Limitations of Actions Act 1974* (Qld), *Limitations of Actions Act 1936* (SA), *Limitation Act 1974* (Tas), *Limitations of Actions Act 1958* (Vic), *Limitation Act 2005* (WA).
[14] *Limitation of Actions Act 1958* (Vic) s 5.

9. Conclusive remarks: drafting tips to withstand challenges

9.1 Advances made to children appear to be straightforward transactions. However, the esoteric distinctions between loans and gifts that may come up as issues in disputes, and ensuring that the loan is not "statute barred" highlights the need for careful attention to be paid to such arrangements.

9.2 Bringing the issues discussed above in this paper to the client's attention for their consideration would be the best way to ensure to the extent possible that their objectives in respect of any advances to their children are met.

9.3 Key drafting tips that practitioners should consider when drafting parent to child loans to uphold the enforceability of the loan arrangement include:

(a) Keeping it real – do the loan documents properly reflect the loan and what has taken place?

(b) Are the loan terms commercial? Consider the following:

(i) Interest;

(ii) Repayment terms;

(iii) Security; and

(iv) Is the risk to the lender appropriately reflected in the return?

9.4 Key drafting tips that practitioners should consider when taking into account parent to child loans in the estate and succession plan include:

(a) Asset protection for beneficiaries – gifting the benefit of loans to a testamentary trust rather than forgiving under Will; and

(b) Adjusting the benefit of the loan.

9.5 Where there are disputes as to the enforceability and/or existence of a loan, extrinsic evidence in addition to any loan documentation is necessary to shed light on the parties' intention.

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