



## Have you lent monies to someone? When is it not recoverable?

*It is quite common for many of us to make loans to family members or friends, or for loans to exist between us and our family company or family trust. For many of these loans, it is also quite common that the terms of these loans are not documented, that they are interest free and that there are no specific arrangements reached regarding repayment so that the loan is repayable when the lender wants it back. In other words, the loan is repayable on demand.*

### How does the law apply to loans repayable on demand?

The making of a loan between the lender and the borrower creates a contract between them. A loan which is repayable on demand (that is one where no time for repayment is specified, or it is expressed to be payable 'on demand') creates an immediate debt so that the lender can commence legal action for its recovery at any time. This means the lender's right to recover the loan commences as soon as the borrower receives the money.

Section 14 of the Limitation Act states that a legal action under a contract cannot be started after 6 years from when that right to take the legal action arose. Section 63 of the Limitation Act states that a right to recover a debt is extinguished at the end of that 6 year period. In other words, after 6 years from the making of the on demand loan, it is not only not recoverable by legal proceedings, it actually ceases to exist for all purposes.

### What are some unintended consequences of this law regarding loans repayable on demand?

The following are examples of the unintended consequences for the lender and others:

- Family Law:** 8 years ago a father lends his married son \$200,000.00 repayable on demand and the loan is not documented. The son's marriage breaks down. The son's wife contends that the money was a gift and not a loan. As the 6 year limitation period has expired, the loan is not recoverable by the father. The result is the total marital assets available in the son's property settlement has increased, the son's wife is potentially entitled to a larger share of those increased assets, the father potentially ends up with nothing, and perhaps the son morally may feel he has to compensate the father wholly himself.
- Wills and shares of an Estate:** An elderly mother of 3 daughters lends one daughter \$300,000.00 to buy a house. The mother dies 8 years later having made a Will giving her estate of \$900,000.00 inclusive of the \$300,000.00 equally to her 3 daughters. The other 2 daughters contend that the \$300,000.00 given to their sister was a loan, not a gift and should be part of their mother's estate. The loan was not documented. The estate has no right to recover the \$300,000.00 as the 6 year limitation period has expired making the estate assets \$600,000.00. The 2 sisters receive \$200,000.00 each from the estate instead of the expected \$300,000.00. Their sister has the benefit of \$500,000.00.



3. **Insolvency:** A father lends his son \$200,000.00 to assist his son's business. After 8 years the son's business fails and the son goes bankrupt. At the time the son has \$200,000.00 in assets but owes his bank \$400,000.00. The loan was not documented and is not recoverable by the father as it was made more than 6 years ago. As the loan is not recoverable the father cannot prove his debt in his son's bankruptcy so as to receive a share of the son's assets and the son's assets are distributed between the bank and his other creditors.
4. **Estate Planning:** A father set up a family trust for his children and lent that trust \$300,000.00 to invest without any documentation. After 10 years the trust's assets grew to a value of \$500,000.00 and the \$300,000.00 had not been repaid by the trust to the father. The father's personal assets were \$1,000,000.00 made up of \$700,000.00 plus the \$300,000.00 loan. His intention is to leave the \$1,000,000.00 to his wife. However, as the loan to the trust being made more than 6 years ago is not recoverable, the assets available to his wife are now \$700,000.00 and the trust assets are now worth \$500,000.00 which assets all go to the children instead of only the net trust assets of the trust being \$200,000.00 if the loan had been repayable.
5. At law, when monies have been paid by a husband to a wife, by a male fiancée to a female fiancée or by a parent to a child, a **presumption of advancement** can exist meaning the payment, in the absence of other evidence, is presumed to be a gift.

## How can these unintended consequences be avoided?

If you have not yet made the loan, you should ensure the loan is first documented, preferably by a deed, and clearly state in the document that the loan is repayable at some date after demand is made e.g. one month. This will make it clear that the 6 year limitation period does not start to run until demand is made.

If however, you have already made a loan that has not been documented, you need to obtain a 'confirmation' of the loan as soon as possible. Section 54 of the Limitation Act states that if a confirmation is made, the time that has elapsed between the making of the loan and the confirmation does not count in the 6 year limitation period and the 6 year period starts again. A confirmation can be obtained by:

- the borrower making a payment of interest
- the borrower making a part repayment of the loan
- obtaining a signed written acknowledgement from the borrower that the loan was made.

Alternatively, you can request the person to whom the money has been lent, enter into a loan agreement setting out the terms of the loan and providing for payment at some date after demand.

## Conclusion

*If you or anyone you know is proposing to make a loan, or has made a loan which has not been documented, and requires assistance to document the loan or if you would like further information about loans repayable on demand, please call [Michael Battersby](tel:0247315899) or [John Bateman](tel:0247315899) on 02 4731 5899 or email [commercial@batemanbattersby.com.au](mailto:commercial@batemanbattersby.com.au).*