GUARANTEES, TRUST GIFTS AND A TIP

We see a lot of clients entering into guarantees and so it is timely to explain the basics of these.

Most guarantees are given by individuals involved in companies or trusts. That is a better situation than giving a guarantee for a family member or friend. If the guarantor (the person giving the guarantee) is involved in the borrowing entity, they should know of its ability to perform. For example, family shareholders of a small company should know how the company performs, so guaranteeing the company's bank obligations should not be difficult.

But there is significant danger when giving a guarantee for a party that you are not involved with. That includes parents giving guarantees of their children's borrowings. While parents might expect to trust and know their own children, it is not the character of the child that you are guaranteeing. Rather, it is their financial obligations. Linked to any guarantee might also be a mortgage over the parents' home. So if the child defaults, the parents' home is at risk.

Guarantees are usually all of the financial obligations of the borrower. This means, past and future borrowing. While a guarantor parent might be relaxed about giving a guarantee of a loan they know of, they might not know of past or future borrowings. A one-off guarantee of $20,000 can turn into $100,000 if the borrower increases the loan without the knowledge of the guarantor.

Lenders who enforce guarantees can treat the guarantor as the original borrower. The bank does not need to enforce the loan of the borrower before it asks for repayment from the guarantor. Also, if the bank releases the borrower from any part of its obligations, that release or indulgence may not necessarily carry over to the guarantor. Finally, if there is more than one guarantor, the bank can enforce the loan against either or both guarantors at its choice.

Trust gifts

We have covered previously the issue of the removal of gift duty which has allowed settlors of trusts to forgive all loans owed by trustees without any tax liability. However, although gift duty is now zero, diverting assets into family trusts has no impact on government residential care subsidies. That is because the law that administers social welfare payments, the Social Security Act, has not changed. Because of financial constraints, governments are increasingly looking behind family trusts and counting beneficial entitlements under a trust as a part of an aged person's assets. That part of the law is actually being enforced more strictly. Removing yourself from liability to pay a resthome subsidy should not be a reason for establishing a trust. The Government will usually win there.

Tip

Finally, we thought in each future article we would provide a small tip or useful piece of information. The first one relates to deposits on property purchases.

There is no legal obligation to pay a deposit. It is simply a custom. Agents will want one sufficient to cover their commission, but apart from that you do not need to pay a deposit. However, it is unlikely your offer will be looked at seriously without one.