



HARD OR SOFT LOANS: BEWARE THE PITFALLS OF LENDING TO FRIENDS AND FAMILY

It is common for money to be loaned or gifted within families to help with property purchases or to meet other expenses. Very often, not enough thought is given at the point of payment to whether the payment is a gift or a loan, or indeed if it is a gift or loan to an individual, or that individual and their spouse. Even fewer people trouble to document the transaction to clearly characterise it for what it is. That ambiguity causes problems when a divorce occurs, and each party has a vested interest in interpreting the historical transaction differently.

Going through a divorce can be an expensive process. Often money is tied up in property such as the family home and there are insufficient available funds to pay for legal fees, whilst meeting other costs of living. With energy prices reaching an all-time high, it is a common time for clients to turn to family and friends for financial help. However, it is vital to have clarity about the terms on which that help is given.

HOW DOES THE FAMILY COURT TREAT BORROWING FROM FRIENDS AND FAMILY?

Where there is ambiguity and a lack of paperwork, the family courts often treat loans from family or friends as “soft” debts rather than “hard” debts, i.e. the view is taken that repayment is unlikely to be enforced and/or that there are unlikely to be repercussions for a delay or failure to repay.

Soft debts are less likely to be taken into account when considering the overall division of matrimonial assets, meaning that the borrower can be left with the “soft” debt at the end of the process, but not necessarily with the means to repay it. If there is an issue about whether a payment should be treated as a hard debt, the lender (often the parents of one spouse) may be forced to intervene in the court proceedings. They will need to make a claim for repayment to require that the liability is fully accounted for within a division of assets, and that funds are made available to repay the debt. Intervening in court proceedings adds more cost to an already expensive process and can require additional court hearings. This in turn causes delay. Becoming embroiled in someone else’s divorce is also highly stressful. This may all be avoided by taking the sensible steps at the point of payment.

HOW THEN DOES THE FAMILY COURT DETERMINE WHETHER MONEY ADVANCED BY A FAMILY MEMBER, FRIEND OR TRUST IS A SOFT LOAN OR HARD LOAN?

The recent case of *P v Q* [2022] listed the factors which may be indicative of the advance being a gift or loan and therefore considered a “hard” or “soft” debt.

Factors in support of a “hard” debt

- It is an obligation to finance company or bank
- There has been no delay in enforcing the repayment obligation
- The amount of the money is such that a creditor to be less likely to waive the obligation either wholly or in part
- The obligation arises out of a written agreement
- The terms of the obligation have the feel of a normal commercial arrangement
- There is a demand for payment, a threat of litigation or actual litigation or actual or consequent intervention in the financial remedy proceedings

Factors in support of a “soft” debt

- It is an obligation to a friend or family member with whom the debtor remains on good terms and who is unlikely to want the debtor to suffer hardship
- The amount of money is such that the creditor would be likely to waive the obligation either wholly or in part
- The obligation arose informally, and the terms of the obligation do not have the feel of a normal commercial arrangement
- There has been no written demand for payment despite the due date having passed
- There has been a delay in enforcing the obligation

Family judges have a very wide discretion when deciding how assets should be shared in a divorce. Following the guidance above gives the best chance of ensuring that monies lent by friends and family will be treated as a hard debt by the court.

If you want to financially help family and friends, or if you might be about to receive financial help from a parent or grandparent, it is sensible to seek legal advice so that the payment can be properly documented. A simple loan agreement reflecting the factors above is relatively inexpensive, and whilst it will incur a cost, it could shield you from a number of problems in the longer term.

KEY CONTACTS

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