

BURROWES and Company

Barristers and Solicitors

Client Newsletter

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INSIDE THIS ISSUE:

<i>New Sale and Purchase of Real Estate Agreement Form</i>	1
<i>Structuring Trust Gifting</i>	1
<i>How to Secure your Debts</i>	2
<i>Change to District Courts Procedure</i>	3
<i>Giving Personal Guarantees</i>	4
<i>Cross-Lease Ownership</i>	5
<i>New Financial Limits for Disputes Tribunals</i>	5

NEW SALE AND PURCHASE OF REAL ESTATE AGREEMENT FORM

The Real Estate Institute of New Zealand has released a second form of agreement into the real estate market. The form aims to provide a 'plain English' alternative to the Auckland District Law Society / Real Estate Institute of New Zealand agreement. It makes significant changes to the form of agreement and the terms and conditions of sale that vendors and purchasers in the New Zealand market are familiar with.

For the past 20 years, the sale and purchase of real estate in New Zealand has predominantly been on the terms and conditions contained in the ADLS / REINZ standard form agreement for sale and purchase. The ADLS / REINZ agreement is now in its 8th edition. Because the form is so widely used, the meaning of many of its technical phrases is well understood, having been the subject of a significant body of case law and legal commentary.

The New Zealand Law Society has expressed concern about the new REINZ form of agreement and is recommending that practitioners caution clients about the risks of using the new form. The key concern of the NZLS and of practitioners is that the agreement is untested. The use of non-technical language is likely to result in disputes as to interpretation and to litigation in some cases.

We strongly recommend that our clients have any agreement for sale and purchase of real estate checked by us prior to signing. In the initial stages, we are likely to recommend that all clients insist upon the use of the ADLS / REINZ standard form agreement, rather than the new REINZ agreement. The costs to clients of becoming involved in a dispute about interpretation of a standard term of an agreement can be significant – particularly if the matter needs to be litigated.



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STRUCTURING TRUST GIFTING

Review: Begg v Commissioner of IRD

This case deals with trusts established for the purpose of reducing the value of elderly people's assets for asset-testing. The parties drafted a trust deed in which they promised to pay money upon their death and once their homes had been sold. In the first year after their death, the donors promised to give \$27,000 (just below the gifting tax threshold), with smaller amounts due every year after that. As trustees, they would hold their homes for themselves and their children "to the extent of their respective interests from time to time". The Commissioner argued that there were

no trusts made, and even if there were, no gifts at all would be made until all the payments were perfected. This would amount to one single gift which exceeded the \$27,000 threshold and thus would be liable for gift duty.

The first question to be addressed was whether a trust was established. This raised a statutory interpretation issue under section 2(2) of the Gift Duties Act definition of "disposition of property", which was:

any conveyance, transfer, assignment, settlement, delivery, payment, or other alienation of property, whether at law

Continued on page 2

STRUCTURING TRUST GIFTING

Continued from page 1
or in equity, and, without limiting the generality of the foregoing provisions of this definition, includes –

- (a) The issue of shares in a company;
- (b) The creation of a trust...

The Commissioner argued for a narrow interpretation – that the creation of a trust would only be included if it involved a “conveyance, transfer, assignment, settlement, delivery, or other alienation of property”, or fell within one of the listed specific circumstances. The Court of Appeal found that the standard approach to a “means and includes” definition like this was that it enlarged or extended the ordinary meaning of the defined term, rather than limiting it. Therefore there had been a disposition of property.

The Commissioner also argued that the 1913 case *Perry v Commissioner of Stamps* was wrongly decided. In that case, Mrs Perry entered into a deed with two others (“the beneficiaries”), which provided for £25,000 to be paid out of the proceeds of the sale of her land. She had a discretion to sell the land as she saw fit until her death. The Court held that Mrs Perry had created a trust and set herself up as trustee of the land, conferring rights to the beneficiaries.

Essentially, the Commissioner’s argument was that neither the donees in *Perry* nor the donees in *Begg* received a gift because the deeds did not convey to them a legal or an equitable interest in the donors’ property. However this was found to be based on the proposed narrow definition of ‘disposition of property’ discussed above. The Court of Appeal held that *Perry* was correctly decided and not distinguishable on the facts. The focus was not on the specific rights conferred but whether or not a trust had been created. A trust is created “when trustees accept the transfer of property to them to be held in trust”, and only in respect of “that property which is actually impressed with a trust at the time the deed is

executed. Later transfers of property to the trustees to be held on the terms of the deed create further trusts in respect of that property”. After execution of the deed, the trustees no longer had the full beneficial interest in their homes. The Court held that a trust was created in this case in respect of the parties’ property, and it did not matter that the settlor and trustee were the same person. Each separate transfer equated to a separate disposition of property, therefore none of the dispositions of property were sufficient to trigger gifting duty.

Although this case merely confirms the law as it has stood since 1913, it brings to light a significant loophole in legislation for asset testing for the elderly. Following this ruling, trusts may be created which allow the trustee to retain rights over their property until their death, while considerably reducing the value of their assets.

There may be an appeal to the Supreme Court, but the decision was based on law that has been relied on since so a Court may be reluctant to overturn it. However, this decision clearly contravenes Parliament’s intentions for gifting tax and asset testing law. There is a chance that there will be a legislation change to prevent people taking advantage of this decision. If the status quo is allowed to continue this process of creating trusts must be used sparingly and only for situations in which there is a very stable family dynamic, as power is transferred from the settlor (often the parent) to the beneficiaries (usually their children), potentially creating problems in the future if there is fallout within the family.

HOW TO SECURE YOUR DEBTS

The Personal Property Securities Register (“the Register”) is an electronic record of any debt security interests held against any personal property (except land) owned by an individual or organisation. In order to register a security interest over property a creditor needs to have ownership rights in the property.

Purpose of the Register

If someone owes you money (“the debtor”) for personal property that you have provided to them, then you are a secured party and have a security interest in that property. Your security interest attaches to that property for the purposes of the Personal Property Securities Act 1999, if you have given value to the debtor and the debtor has rights in that property. For example, an electrician installs lighting into a shop and the shop-owner fails to pay for it. The electrician has given “value” to the shop-owner (the lighting) and the shop-owner has “rights” in the lighting because they own it. Therefore, the electrician has a security interest in the lighting.

The purpose of the Register however, is to allow you to further protect your security interest by registering it. This enables you to enforce your security interest against a third party. For example, a debtor may sell property that you have a security interest in to a third party. If your security interest is registered then you are able to enforce your interest against that third party.

Priority of Secured Parties

The goods that you have a security interest in may also be subject to a security interest from another party. By registering a security interest on the Register, you are granted priority over other unregistered security interests. If all security interests are registered, then priority is given in order of the date of registration.

Continued on page 3

CHANGES TO DISTRICT COURTS PROCEDURE

The District Courts Rules have been the subject of a recent overhaul, and new Rules are set to come into force on 1 November 2009. The new Rules make significant changes to the way in which parties will bring an action in the District Court and the way that those matters will be resolved.

At the moment, the process for bringing an action in the District Court commences when the Plaintiff files a Notice of Claim at the Court and serves a copy of that Notice on the Defendant. This is followed by the Defendant filing and serving a Statement of Defence, assuming that the claim is not admitted. This is usually followed by interlocutory applications to the Court whereby the applicant seeks discovery from the other party.

From November, the process for commencing an action will be substantially similar, but the following steps will be quite different. The action will commence by filing of a Notice of Claim in a prescribed form. This will be filed with the Court and served on the Defendant in person as usual. Then, the Defendant will prepare a Response to the Claim, and will serve this on the Plaintiff. However, this will not be filed with the Court. Following this, the parties will exchange "Information Capsules" within a prescribed period of time. As with the Response of the Defendant, the Information Capsules will not be filed with the Court.

The rationale for the early exchange of Information Capsules without the involvement of the Court is that the parties need to see the information that the other party intends to rely on to make a realistic assessment of their legal position. If this can be done without the involvement of the Court and at the earliest possible opportunity, then the chances of the matter settling before significant Court costs are incurred increases.

The new Rules also introduce alternatives to the defended witness action that is the focal point of the current Rules. The reality is that only 3% of all proceedings filed in the District Court at present will end up at a defended hearing. The vast majority of matters settle. The new Rules are designed to acknowledge this fact and to encourage this process. There will also be Short Trials and Simplified Trials available for less complex matters.

Judicial Settlement Conferences will continue to be a key part of the process. In the first instance, Judicial Settlement Conferences are to be scheduled for 90 minutes, which does not seem to be a very long time for dealing with a dispute. However, at a recent Law Society seminar, it was noted that often it is the allocation of the JSC fixture that encourages settlement to take place, rather than the JSC itself. A large number of cases in a Christchurch pilot of this 90 minute allocation approach settled before, at or within 10 days after the JSC. The allocation of the fixture is intended to focus the parties on the objective of settlement and the allocation of a short fixture only is intended to encourage the parties to spend a proper amount of time preparing for the JSC and distilling the matter down to its core issues.

HOW TO SECURE YOUR DEBTS

Continued from page 2

Therefore, when it comes to registering a security interest against goods, time is of the essence.

Registering Your Security Interest

In order for you to register an interest on the Register, you must register a financing statement. The cost for registering a financing statement is \$3.00 and the process for doing so is as follows: You must set up a Secured Party Group ID ("group ID") the first time you access the Register. All future registrations are made under this group ID.

Once you have set up your group ID then you are able to register a financing statement against your debtor.

The following details are necessary in order to register a financing statement:

In regards to a debtor that is an individual; full name, date of birth and address.

In regards to a debtor that is an organisation; type of organisation i.e. company, partnership or trust and organisation's contact address. It is imperative to retrieve this information from a debtor when entering into a security agreement with them as the fields are mandatory and a financing statement cannot be registered without it.

You must also enter information about the collateral (personal property) including the type (e.g. goods) and a description.

Searching the Register

The Register can also be searched by anyone at a fee of \$1.00. The following searches are all available on the Register:

- Debtor Person Search
- Debtor Organisation Search
- Motor Vehicle Search
- Aircraft Serial Number Search
- Financing Statement Number Search

It is advisable to search the Register before entering into an agreement to sell, supply or buy in order to avoid dealing with people that repeatedly do not pay their debts.

GIVING PERSONAL GUARANTEES

In recent months, and in response to the global economic situation, we have noticed a marked increase in the number of requests for personal guarantees as a means of securing both personal and business lending. The current economic conditions have also meant an increase in guarantees being called up, where the principal debtor (often a company over which the guarantor has a measure of control) is unable to fulfil its obligations in respect of the debt.

What is a Guarantee?

A guarantee is an enforceable promise to pay a creditor if the principal debtor fails to do so in accordance with its obligations. Guarantees generally impose on the guarantor the same obligations in respect of the debt as the principal debtor has assumed.

Guarantees can be limited to a certain maximum amount, and if this is the case the documents will say so. However, it is common for guarantors to be asked to sign an "all obligations" guarantee, which means that there is no upper limit to the sums that can be claimed from the guarantor. This can be convenient for borrowers if further lending is likely to be required, as the lending can be increased without executing new guarantees. However, in some cases, this approach can lead to greater obligations being imposed than were anticipated by the guarantor. This is especially so where the guarantor does not have a very close relationship with or a significant level of control over the principal debtor.

Does a Guarantee have to be in a Specific Form?

Guarantees are required to be in writing and must be signed by the guarantor in order to be enforceable against the guarantor. If the promise to pay is not in writing, it is likely to be an 'indemnity' rather than a guarantee, the obligations of which are potentially wider but perhaps more difficult to enforce where not recorded in writing.

Under the Credit Contracts and Consumer Finance Act 2003, certain disclosure is also required to be made to the guarantor upon signing a guarantee. Essentially, this involves the disclosure of the primary lending documentation as between the principal debtor and the creditor and of the guarantee documentation.

Should I Give a Guarantee?

Guarantees are a necessary means of securing debt in some cases or of securing significant levels of debt (often in addition to the giving of a mortgage). It will often be necessary for guarantees to be given in order to secure the type or level of lending that is sought.

However, there are some circumstances in which it would be unwise to give a guarantee. Guarantees effectively break down any barriers that may have been erected between an individual and their liabilities assumed through companies or trusts. It therefore needs to be assessed whether the giving of guarantees will have a particular unintended effect in your specific case.

In short, you should always obtain legal advice before signing a guarantee and it is likely that the lender will insist upon this.

Limiting the Risks

As noted above, a common situation in which personal guarantees will be sought is in securing lending to a company. In this case, the lender will often request personal guarantees from all directors.

In small companies with one or two directors, the risks associated with giving a personal guarantee can be limited by the actions of the director in controlling the debts of the company and managing the level of debt that the company takes on. This situation also limits the chance for debt to be increased without the knowledge of the director, or for the guarantee to be called up without advance warning.

Another common situation in which guarantees are sought is from trustees of a trust where the trust is the principal debtor. In this case, the lender will generally agree to a limitation of the guarantees sought in the case of independent trustees, but not for trustees who are also beneficiaries.

Discharging a Guarantee

A very common misconception is that a guarantee is automatically discharged upon the repayment of the principal debt. This is incorrect. A guarantee generally relates to the debts of a particular debtor not to a particular debt. This means that if some time in the future that debtor takes on new lending with the same creditor, the guarantor could be held liable for repayment of the new debt. This is not widely appreciated by guarantors and can have some unexpected consequences many years down the track.

If you wish to have your guarantee discharged, it is critical that you obtain the consent of the creditor in writing to the discharge of your obligations. The form of the consent is often important in cases where a creditor does seek to call up an old guarantee, and it is wise to obtain legal input on the form of discharge sought to ensure that your expectations are met.

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CROSS LEASE OWNERSHIP

Ownership of a cross lease property means you own a share of the underlying land and lease flats (or houses) to yourself and other owners for (normally) 999 years. A cross lease plan is annexed to the certificate of title and is commonly referred to as the 'Flats Plan'. This shows common areas, restricted areas and delineates the area of each flat.

The Common Areas

The common areas, for example a driveway, may be used by all owners by virtue of their joint ownership of the land if marked as a common area on their lease. There will be a covenant that the common area is not to be used for any purpose other than access for vehicles and pedestrians.

The Restricted Areas

The restricted areas are intended to provide each owner with a private area for their use such as a courtyard or garden. The rights that the owner enjoys over the restricted area depend on the actual terms of the lease itself. It is imperative that a prospective purchaser search all the leases of the property in order to ascertain the full extent of all restricted areas.

The Flats

The area of each flat should be clearly delineated on the plan. A prospective purchaser should take the opportunity to compare the Flats Plan with the actual buildings on the property to ensure that there have been no additions, alterations, or demolitions which are not shown or recorded on the Flats Plan. The alterations or additions may encroach either on to the common area or on to a restricted area and the owner has no leasehold title to them, and is in breach of the

lease if consent is not sought and the Flat Plans altered.

Objecting to Title

If you are purchasing a cross-leased property you can object to title if the Flats Plan is defective. You are able to object to title subsequent to signing an agreement for sale and purchase, provided you do so within the correct timeframe.

If alterations or additions have been made to the flats so the exterior dimensions have changed, the vendor will be unable to give you a leasehold title to the alterations/additions and the title is defective.

On receiving an objection notice from a purchaser, the vendor usually has one of three options. S/he can correct the title, cancel the agreement, or negotiate with the purchaser.

To correct the title, the vendor must have a cross-lease plan of the alterations or additions prepared and deposited in the Land Registry Office, and surrender the cross-lease and have a new cross-lease of the altered or enlarged building executed and registered. This process is costly and relies on the co-operation of all parties.

In summary, a cross-lease title should be checked carefully to ensure there are restricted areas, common areas and the Flats Plan is correct. If you want to purchase a cross leased property and there is a problem with the Flats Plan, you may be able to have the vendor rectify the issue and proceed accordingly.

NEW FINANCIAL LIMITS FOR DISPUTES TRIBUNALS

The New Limits

After some years of debate over the financial cap for disputes taken to the disputes tribunal, the government has recently announced that the limits are to be increased from \$7,500 or \$12,000 with consent of both parties to \$15,000 and \$20,000 respectively.

Why the Limits Have Increased

The current financial limits have been in place since 1998 and were well overdue for increase to keep pace with inflation and rising court costs. The gap between the upper financial limit for the Disputes Tribunal and the viable lower limit for taking an action in the District Court had become increasingly wide. The National party had stated its intention to raise the disputes tri-

bunal financial limits during the 2008 election. The proposal at that stage was to increase the limit to \$50,000, which would have brought the Disputes Tribunal into line with other tribunals, including the Motor Vehicle Disputes Tribunal.

When the Increase Will Take Effect

The increases to the jurisdictional limits cannot come into effect until the government passes legislation to amend the Disputes Tribunals Act 1998. The Ministry of Justice advises that, although this matter is understood to be a government priority, it is not yet known when the legislative changes will occur. We will continue to monitor this issue and provide an update in our next general newsletter.

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