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### Webb Farry News

We are pleased to announce that Melanie Hayes has been promoted to Associate. Melanie is a member of our litigation team and works closely with John Farrow. She specialises in Civil Litigation and Dispute Resolution however also has significant experience in Employment and Relationship Property matters.

Blair Judd (Solicitor) has recently resigned from Webb Farry. Blair and his wife Steph intend to work overseas for a period of time and we wish them all the very best in that regard.

James Lovelock (Managing Partner) has recently been appointed as Selection Manager for the Otago Volts. Webb Farry is a proud supporter of Otago Cricket and James is looking forward to the challenges that this role will provide.

Together with nine other innovative New Zealand law firms, Webb Farry has recently established Law Plus Limited. We are pleased to be part of this strategic alliance which is made up of like thinking firms and offers knowledge sharing opportunities as well as group purchasing benefits.

### Christmas Close Down Period

Webb Farry will close for the Christmas break at 5pm on Friday, 23 December 2011. The Dunedin office will re-open at 8.30am on Monday, 9 January 2012. The Mosgiel office will re-open at 8.30am on Monday, 16 January 2012. For urgent enquiries during our close down period, please refer to our after hours contact details in the White Pages.

## Giftng

**"Never look a gift horse in the mouth":** An old proverb expressing the advice that when presented with a gift you should be grateful and not get caught up in assessing its value or potential issues before accepting.

However as can be seen below, in the context of gifting assets to a Family Trust it is vital to consider all consequences before proceeding.

### Removal of Gift Duty

As has been well publicised, gift duty was abolished as of 1 October this year. This change was effected by way of an amendment to the Estate and Gift Duties Act 1968.

Prior to 1 October 2011 any gifts exceeding \$27,000 in any 12 month period attracted a tiered gift duty tax starting at 5% of any excess above \$27,000. Following the recent law change, anyone can now gift more than \$27,000 in any 12 month period without incurring the potentially significant financial burden of gift duty. The practical effect of the change is that assets can be transferred or gifted much faster and with less red tape.

The abolishment of gift duty has implications on personal gifts and gifts to other entities, however it is particularly relevant for people who have Family Trusts.

Previously, gift duty has limited the speed at which assets could be transferred to a Family Trust. In order to avoid the imposition of gift duty it was necessary to carry out an annual gifting program to effectively transfer assets to a Trust in \$27,000 increments. This could be a time consuming process where assets of significant value were involved.

An initial response to the removal of gift duty is to consider the fast tracking of gifting programs to the extent of completely gifting all relevant assets in one transaction. However it is important to pause

and "look the gift horse in the mouth" as there are a number of issues that need to be carefully weighed up before completing significant gifts.

Setting up a Family Trust can achieve a number of advantages and protect assets from a wide range of risks that an individual faces. However, as detailed below, large scale and immediate gifting may detract from the reasons for setting up a Trust in the first place.

### • Asset Testing (Rest Home Subsidy)

The Residential Care Subsidy (RCS) is available to people over the age of 65 years who require long term rest home care. Eligibility for the subsidy is determined by a financial means test. The RCS is administered by the Ministry of Social Development (MSD) in accordance with the Social Security Act 1964 (SSA).

Based on current statistics, a relatively small proportion of the population requires long term rest home care. However, due to the high costs of such care, maximising the chance of qualifying for the RCS has been a driver for some clients when setting up a Family Trust.

A certain amount of gifting is allowable before it is considered to be direct or indirect deprivation of income or property and included in any financial means test. Essentially the following gifting is permissible:

- Up to \$6,000 in any 12 month period in the five years leading up to the date of an application; and
- Up to \$27,000 in any 12 month period for gifts made more than 5 years before the date of an application.

**These limits are not being affected by the removal of gift duty.**

*(article continues overleaf)*

## Gifting (continued)

The MSD has also recently clarified their position on the application of gifting limits where only one person in a relationship is applying for the RCS. Essentially, the MSD can take into account gifts made by the applicant's spouse/partner as well. If combined gifting exceeds the threshold for one person (i.e. the applicant), then the excess will be taken into account for the purposes of the test.

This development suggests that an even more conservative approach to gifting is now warranted to the effect that gifting by each spouse/partner is limited to:

- Up to \$3,000 (i.e. a combined total of \$6,000) in any 12 month period in the five years leading up to the date of an application; and
- Up to \$13,500 (i.e. a combined total of \$27,000) in any 12 month period for gifts made more than 5 years before the date of an application.

There are a number of aspects to take into account in this area and certainly if future eligibility for the RCS is an important factor then legal advice is recommended before making any significant gifts.

### • Preservation of Existing Debt

When settling a Family Trust, assets are transferred at current market value. However since the Trust has no funds there is typically a debt equivalent to the sale price left owing by the Trust back to the original owners.

In some cases it is advisable from both a legal and tax perspective to preserve such debt. Examples include:

- Where the creditor does not have complete control over the Trust (i.e. the creditor is not an appointer and trustee of the Trust). Since any gift of assets is final there is no recourse if repayment is later required. Further there may be no guarantee that the creditor will receive any form of distributions from the Trust in the future. This may be an issue later down the track if for any reason the creditor does require funds back from the Trust.
- If an income producing asset is transferred to a Trust then the income that the Trust receives can

be used by the Trust to repay the debt over time without resulting in gifting implications.

- If a Trust has income producing assets in furtherance of a taxable activity then the existence of related debt can be advantageous as any interest paid by the Trust on such debt can constitute a tax deductible expense for the benefit of the Trust.

It is important to consider the Trust and its business structure before making any large scale gifts that may actually result in a disadvantage.

### • Creditors

Trusts can provide protection for assets which a person does not want exposed to business risks. With the abolishment of gift duty it will now be possible to quickly transfer assets to a Trust for the purpose of protecting those assets from creditors.

However, existing legislation remains in place which will continue to provide safeguards to creditors. Briefly such legislation includes:

- The Insolvency Act 2005: Which provides that any gifts made within 5 years prior to bankruptcy can, if the person making the gift was insolvent at the time, be reversed.
- The Property Law Act 2007: Which provides that any gift made (at any time) with the intention of defeating creditors can be reversed.

Asset protection can be a significant consideration when forming a Family Trust. However a considered approach needs to be taken to ensure that assets are transferred to the Family Trust in an effective manner.

### • Relationship Property

Family Trusts can effectively separate certain assets from 'relationship property'. This can be desirable if the relationship fails as the assets in the Trust may be protected from the presumption of equal sharing.

For single people, assets that could potentially become relationship property can be transferred into a Trust prior to a relationship. Timing is essential because certain assets that have been

used as part of a relationship or acquired during a relationship that exists for over three years are likely to be split if the relationship ends.

Regardless of the change in gifting law, a considered approach needs to be taken if any assets are gifted to a Trust or any debt forgiven which has the effect of excluding such assets from relationship property. This is because if such gifts are not carried out correctly they can be set aside under the Property (Relationships) Act 1976.

Overall this is a complex legal area and specific legal advice regarding relationship property needs to be obtained before completing any gifting which may have an effect for relationship property purposes.

### • Income Tax

As has been the case and will continue to be the case, forgiveness of debt to any person or entity that does not fall within the "natural love and affection" test under the Income Tax Act 2007 may lead to the forgiven debt becoming income in the hands of the Trustees and subject to income tax.

Such income tax liability may negate any advantage in transferring the relevant asset to the Trust in the first place.

It is important to carefully consider income tax issues to ensure that any gifting does not trigger an unanticipated income tax liability.

### Conclusion

The abolishment of gift duty at first glance appears to provide a quick and cost effective avenue for transferring assets to a Trust. To some extent this is true, however as can be seen from the above points, there are a number of issues that need to be considered before proceeding to carry out any large scale gifting.

Webb Farry has expertise in all aspects of Trust formation, administration and asset protection and can guide you through the current gifting landscape in order to avoid the potential pitfalls along the way. Please contact us if you would like assistance in this area.

## ..... Protecting Your Intellectual Property From Trading Risks .....

Running a business has its risks – the ultimate being the entity going out of business and having to shut up shop. The recent recession increased such a risk for many businesses with some being unable to cope with the economic pressures and consequently becoming insolvent.

When a business becomes insolvent and is subsequently liquidated, the assets of the entity are seized and sold with the view to pay creditors. Intellectual property assets are no exception and assets such as domain names, trademarks and copyrights as well as concepts relating to branding are often lost in the process as well. More often than not, such intellectual property assets are irreplaceable. It is therefore important that time and effort is invested in protecting such assets in the event that a company is put into liquidation.

Separating assets into two or more legal entities as a means of protection has been common practice for some time, with business owners transferring their houses and other personal assets into trusts.

However with intellectual property, while it is possible to register legal ownership rights in a trust (provided that ownership is recorded in the joint names of the trustees and not in the name of the trust itself) problems can arise relating to sub-licensing due to consent issues from co-owners. Additionally, the Intellectual Property Office of New Zealand is adopting a stricter interpretation of intellectual property laws that prohibits trusts from owning intellectual property.

The separation of assets through the use of limited liability companies is therefore a more suitable vehicle for the purposes of intellectual property asset protection. Separate ownership using companies requires the establishment of two or more registered companies where one company, Company A, owns the intellectual property and the other company, Company B, acquires a licence from Company A to sub-licence the intellectual property to clients.

All ownership of the intellectual property assets are vested in Company A, and Company B at no stage actually owns the intellectual property. In the event that Company B becomes insolvent, its creditors are not able to lay claim to the intellectual property assets by virtue of it being owned by a separate legal entity, Company A.

This model is particularly suited to software companies as they don't sell their products, but rather license them by granting a customer non-exclusive rights to use the software. The actual software remains the property of the original owner. The separate-ownership model can also be tailored to suit most business genres.

Although appropriate licences and insurance policies are worthy components of risk management, many policies do not guard against insolvency of a company or bankruptcy. As a consequence, while some effort may be required in setting up an appropriate structure, separating valuable intellectual property could be well worth the time and money.

## The Unit Titles Act 2010

The Unit Titles Act 2010 (the '2010 Act') came into force on 20 June 2011 and replaced the Unit Titles Act 1972. The 2010 Act contains material changes from its predecessor and is now the principal authority pertaining to the establishment and management of developments such as apartment blocks, multi-layered commercial spaces and flats.

The key changes included in the 2010 Act are discussed below.

All common property in an establishment is now owned by the Body Corporate. Previously, ownership of common property was jointly vested in all unit owners. The change now allows the Body Corporate to more effectively promote the benefit of the development as a whole by representing all unit owners in relation to the improvement and maintenance of common property.

Responsibility for the maintenance of building elements and infrastructure affecting more than one unit now lies with the Body Corporate. This means for example, that the Body Corporate will be responsible for repairing a leak from a top floor apartment to a unit below (provided the leak is not attributable to the recklessness or negligence of the unit owner and/or occupier.) Previously, the



obligation to remedy the leak would have fallen solely on the owner of the top floor apartment.

Minor alterations to individual units are now more feasible as the 2010 Act allows for increased flexibility relating to re-developments. Obtaining the consent of a body corporate is no longer required to carry out additions or structural alterations to units, provided the modifications do not materially affect the common property or the property of another owner.

The subdivision of principal units is also possible under the 2010 Act, allowing for the creation

of a separate unit title development within the principal title known as a subsidiary. This is known as a layered development and allows for multiple use of a building – such as where a building has car parking, shopping complexes and apartments all within its confines.

The 2010 Act also allows for the creation of separate Bodies Corporate that govern subsidiary units, which are also part of the Head Body Corporate responsible for overall management of the development.

Unanimous consent of the Body Corporate is no longer required under the 2010 Act and a 75% majority is sufficient for decisions to be made. This change has been welcomed by many as it means decisions will less likely be held up by difficult owners.

Bodies Corporate are also required to develop long term maintenance plans in advance, giving owners the opportunity to pay regular instalments over time. This is to avoid owners having to pay large one off special levies for work required on common property such as lifts.

The 2010 Act seems to attempt to be more flexible and pragmatic. To some extent the 2010 Act may give unit title owners more certainty and therefore promote unit titles as a form of land ownership.

## Christchurch Earthquake to Trigger Changes to Resource Management Act 1991

The Christchurch earthquakes have given cause for the Government to re-examine the requirements of the Resource Management Act 1991 ('RMA') with the damage caused to thousands of homes by liquefaction being a significant factor.

The purpose of the RMA is to "promote the sustainable management of natural and physical resources". The catastrophic effects of the earthquakes have highlighted the importance of the RMA as not only protecting the environment from the impact of people and land use, but also to consider the effect on people from nature.

To achieve its purpose, the RMA requires that decision makers consider matters of "national importance" in their determinations. However, natural hazards are not included as a matter of national importance. As a result it is becoming apparent that the zoning of areas for residential use in district plans, and the consideration of Resource Consent applications do not sufficiently consider natural hazard risks.

The recent Canterbury Fact Finding Project ('the Project') has investigated how much was known about liquefaction and lateral spreading risks in Christchurch, and the impact of such knowledge on zoning and development decisions. Since 1991 there have been reports available on the significant liquefaction risk in Christchurch,



including "clear maps that are uncannily accurate" on the locations where liquefaction would occur.

Hon. Dr Nick Smith, Minister for the Environment noted in a speech given recently that a significant number of resource consents, covering about 20% of the severely liquefied properties in Christchurch, were approved after the area specific reports funded by the Earthquake Commission (EQC) and GNS Science (GNS) were released in 1991 and 1992 respectively.

The Project has found that Resource Consents issued under the RMA for the development of land in some areas did not take into account identified liquefaction risks. Even post 2004, it is considered consents were being granted without any regard for this significant and by then well documented risk. Not only was the information regarding identified risks non-existent with the

zoning and consent decision making with the development of these areas, but the risk of liquefaction was not clearly identified on Land Information Memorandum Reports ('LIM Reports') for the affected properties.

The identification of liquefaction risk has now been incorporated into LIM Reports in Christchurch, and these risks will likely be considered with future residential development and zoning. The problems in Christchurch have however identified a shortcoming in the current consenting process, which must be readily addressed.

The Government is to continue with their changes to the Resource Management Act, and have indicated that further substantial changes will be proposed to ensure the risks of natural hazards are considered in planning decisions.

Perhaps these amendments will ensure all Councils look to address the risk of natural hazards beyond flooding when approving applications under the Resource Management Act, and be vigilant in protecting residents from real identified risks.

The inclusion of detailed information in LIM Reports will also assist in giving notice to property owners of the natural hazard risks to which the property may be subject, allowing them to account for such risks when building upon or otherwise developing their property.

# Frustrated Contracts



The common law 'doctrine of frustration' allows a contract to be discharged on the occurrence of certain events beyond the control of the parties which would make the performance of the contract impossible. As the doctrine is a departure from the traditional view that contractual promises are absolute, its application in law must satisfy strict legal tests in order to be successful. It requires an event to occur that is firstly unforeseen and one which significantly alters the relationship between the contracting parties.

## Categories of Frustration

Although not exhaustive, the following are five situations where the doctrine of frustration has been successfully applied.

1. Where the subject matter of the contract ceases to exist: In *Taylor v Caldwell (1863) 3 B & S 826*, a hall which was hired to host a series of concerts burnt down before the concerts could commence. Both parties were relieved of their obligations as the contract was held to be frustrated.
2. Non-occurrence of events - the purpose of the contract has become impossible to attain: In *Krell v Henry [1903] 2 KB 740* a flat was rented for the purposes of viewing the King's coronation procession. The procession was cancelled due to the King's illness and the contract was discharged as the sole purpose for which it was rented ceased to exist.

3. Death or incapacity of a party where the contract involves obligations of a personal nature: In *Robinson v Davison (1871) LR 6 Ex 269*, a contract by a pianist to perform on a specific day was held to be frustrated when the pianist became too ill to perform.
4. Delay and obstruction of performance: Where caused by external events, delay and/or obstruction may be held to be frustration if the delay is so long, or the obstruction so extreme that it would make the result of the contract fundamentally different from what had been contemplated.
5. Performance is rendered illegal by legislation: If a change in legislation that comes into effect after the creation of the contract renders its performance illegal, the contract is held to be discharged.

## Frustrated Contracts Act 1944 ('FCA')

The doctrine of frustration is supported in New Zealand by the FCA, which addresses the effect of the discharge of obligations on the areas of the contract already fulfilled. It confers three major benefits on parties that are supplementary to the common law doctrine.

1. It provides the right to a party to recover money paid in consideration of the contract despite payment being made before the date of frustration, and
2. It allows a party to claim compensation for work done and/or expenses incurred for the purposes of a contract up until the date of frustration, and
3. It permits the benefits received up to the date of frustration to be taken into account when determining the recovery of monies paid or expenses incurred.

The FCA can be contracted out of by including within the contract provisions addressing the event of frustration. In such instances, the provision will apply instead of the FCA.

The doctrine of frustration and FCA are examples of options or resolutions that may be available to a party following the breakdown of a contract. Legal advice may assist in identifying resolutions of a dispute or breakdown through remedies available outside the contract.

## Snippets

### Weddings and Wills

Death and Wills! This generally is not a typical topic of conversation when you are preparing for your wedding. But due consideration should be given to documents such as Wills and Contracting Out Agreements (i.e. Pre-Nuptial Agreements) as marriage imposes significant obligations in relation to property division and the allocation of assets.

If a person dies intestate (without leaving a Will), the allocation of their assets is determined by legislation such as the Property (Relationships) Act 1976 and may be divided differently to the way the person had envisioned it would be.

The advent of a new marriage also automatically invalidates all Wills that were made prior to the date of the marriage.

A review of a person's estate planning should also be undertaken prior to marriage as it too will be significantly affected. Consideration must be given to those who will benefit from a person's estate and legacy (a gift of personal property or money to a beneficiary of a Will). Failure to execute the requisite documents to reflect one's wishes can have negative consequences for all concerned.

### When is a Relationship Property valued following Separation?

The date upon which relationship property is valued for division of asset purposes varies depending on whether the parties or the Court decide the division of assets. The Property (Relationships) Act 1976 ('the Act') applies to de-facto relationships, civil unions and marriages. The Act provides rules for the division of property for relationships of over three years in duration.

Where the parties agree, they can document their agreement in a Separation and Relationship Property Agreement, and include the values as at the date of separation.

Where agreement cannot be reached, application can be made to the Family Court, where the value of relationship property is determined at the date of hearing, unless the Court exercises the overriding discretion it has to depart from a hearing date valuation.

Be aware of the impact timing can have when disputing the split of relationship property assets following separation. For some people, a quick resolution at the earlier asset value may be a better result than getting a greater share when asset values have fallen.

## Who's Who at Webb Farry

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