

GOING INTO BUSINESS? Borrowing, Asset Protection And The Family Trust

Are you considering buying a business?

Once you have identified a suitable business, Ellis Law recommends you sit down together with your solicitor and accountant to look at the figures and the proposed business. Is the business viable? What will you need to borrow to buy the business? What will be its ongoing working capital requirements, for example, what level of overdraft will it require? What structure will be used to purchase the business (company, trading trust partnership or sole trader)? What are the taxation ramifications of the structure and finance required to purchase the business?

Very early on in the process, you will need to negotiate an agreement for the purchase of the business. The agreement should be prepared in conjunction with Ellis Law. If there is an agent involved in the sale he or she will typically be getting paid by the vendor. The agent will want to get an agreement drawn up that is likely to be vendor friendly! Your solicitor will want to ensure a number of conditions are included in that agreement that protect your interests, such as a due diligence clause that meets your needs and a clause that makes the agreement conditional on you getting suitable finance for the purchase.

The typical first-time business purchaser will need to give their bank a mortgage over their family home as security for money being borrowed to buy the business and to provide its working capital requirements.

In such a case, Ellis Law recommends its clients split their banking. Borrow what is needed for the purchase of the business and its working capital from Bank No.1. However, the business banking activities should be run through Bank No.2.

Banks will often lend you more than you should prudentially put into that business, especially if you have good equity in your house i.e. your mortgage is relatively small in comparison to the value of your house.

By splitting your banking, this limits your exposure to both banks. If your business falters and ultimately fails, you have an inbuilt prudential handbrake. Bank No.1 has lent you the money to buy the business. It will want to be repaid. If you can find a job to keep up the payments the house should be protected. You will not have unlimited exposure to the one bank as you could otherwise have if you have both your business banking and all your borrowings with the one bank. Do you really want to risk the security of your family home?

Ellis Law also strongly advocates any person who puts money into their business to put in place a formal loan agreement between themselves and their company at the same time. You should take security from your company for that loan or for the money you have put into the company to purchase the business. This means that you then become a secured creditor. If your company is ever sued or gets into financial strife, you should get your money back before unsecured creditors get paid. This may seem harsh, but you do need to think of yourself in the first instance when going into business or putting money into the company to help it through what can be difficult business times.

There are many reasons why you may have your house owned by a family trust. They range from ensuring your child's inheritance is protected from avaricious partners in years to come, or keeping something aside if you ever need to go into state supported geriatric care, through to asset protection if you are in business.

As confident as you may be when you buy a business, you can never be certain about those unforeseen problems or issues that may arise. A large debtor may be unable to pay you; an employee could commit the company to something it cannot fulfil. The business could be put at risk as a result of circumstances beyond your control. And, chances are, you will have given a number of personal guarantees. It is very hard to avoid giving personal guarantees when you go into business. If your family home is owned by a family trust, if you have transferred your house to the family trust by way of an annual gifting programme, and if you have not used your house as security for that unlimited borrowing from the bank, there is every chance you could keep your house and your family together in the event that you should ever be sued by a disaffected creditor or client, or if your personal guarantee is called up.

The time to put all these steps into place is before you complete the purchase of the business. The sooner you put the various steps in place, the sooner you have the added protection of borrowing from the best sources, having security in place for any money you put into the company and having your house transferred into a family trust.

We have endeavoured to touch on a few key things that you should consider at a very early stage when going into business. However, there are many other factors that both Ellis Law and your accountant will want to discuss in the early stages of the business buying process.

COMPANIES WITH FOREIGN SHAREHOLDERS: Obligations to file financial statements at the companies office

The Financial Reporting Act 1993 sets out what documents companies are required to file each year at the Companies Office in addition to the annual return.

Until earlier this year, companies which had a 25% or more overseas shareholding were required to file audited financial statements for both the overseas company which held shares in the New Zealand company, and the New Zealand company. Once those accounts were filed, they immediately became public information and could be scrutinised through the Companies Office website.

However, the Financial Reporting Act has now been amended. Only "large companies" with a 25% or more overseas shareholding are required to file audited annual accounts.

To be considered "large", a company must have at least two of the following criteria:

- (i) As at the balance date of the accounting period for which the financial statements are required, the assets of the company and its subsidiaries (including intangible assets such as goodwill) exceeds \$10,000,000;
- (ii) In the accounting period for which financial statements are required, the total turnover of the company and subsidiaries exceeds \$20,000,000;
- (iii) As at the balance date for which financial statements are required, the company and its subsidiaries have fifty or more full time employees.

BUYING A PROPERTY - Paying The Deposit and the Penalties For Late Payment

Buying a property and concerned at the level of deposit you are committed to paying? Is the money for the deposit likely to be unavailable for some time? And what can happen if you are slow in paying a deposit?

When you buy a property you will generally be asked to pay a deposit. The deposit can be as little as you can negotiate through the agent or the vendor (seller) of the property (if you are dealing directly with the vendor). Typically, however, we find agents ask for a 10% deposit.

For an expensive property a 10% deposit can be a considerable amount of money. There is nothing wrong in paying a deposit of less than 10%. If that is difficult you can offer to pay a smaller sum on having your offer accepted and pay the balance of the agreed deposit on the agreement being declared unconditional. However, these points must be written into the agreement.

Often purchasers are dependent on paying the deposit for the purchase of a property out of the deposit they are getting on the sale of another property. You must ensure your agent is aware of this and ensure that point is covered in your agreement.

Don't forget to take into account that the real estate agent will deduct his or her commission from the deposit money on the sale of your property, leaving you with a somewhat smaller balance than was paid by your purchaser.

If you do not pay your deposit on time there are two important consequences. First of all, the vendor can give you notice

that you have failed to pay the deposit. Typically, the vendor's solicitor will give this notice to the purchaser's solicitor. If you do not pay the deposit within three working days of receipt of that notice the vendor can cancel the agreement. These sorts of notices are more frequently seen in a buoyant property market when there is hot demand for a property. However, there is no reason why a vendor would not invoke these provisions at any time especially if he feels the purchaser is delaying payment of the deposit unnecessarily. And he could possibly sue you if he suffers any losses once he has cancelled the agreement!

Secondly, you need to be particularly careful if your money is coming from the sale of another property or is coming from overseas and there is the possibility of delay in getting the money.

The vendor is entitled to charge you interest for late payment of the deposit. Interest is payable from the time the deposit was due to be paid until the date of payment. And interest will be payable at the penalty rate of interest as specified in the agreement. The penalty interest rate is normally several per cent more than the cost of borrowing money from a bank. On a deposit of \$75,000.00 at a penalty interest rate of 16% per annum you could be required to pay \$32.88 per day for every day you are late in paying the deposit. That equates to \$230.16 per week.

The key is to ensure that your agreement is worded in a way to provide for payment of the deposit when you confidently expect to have it available. If in doubt, check with Ellis Law before you sign that agreement.

TRUSTS AND ASSET PROTECTION – THE FULL MONTY? What Happens When You Take A Short Cut?

In a recent High Court case (Fisher & Ors v Official Assignee) the sale of shares by a bankrupt, Mr Fisher, to his family trust was overturned.

Mr Fisher had sold shares that he owned in a company to his family trust. He subsequently fell on hard times and was eventually bankrupted. The Official Assignee, the person who administers estates of bankrupt people, essentially claimed that the sale was a sham. He asked the High Court to overturn the sale of the shares. The High Court agreed and the sale was overturned. The Official Assignee was able to sell the shares and use the money for the benefit of Mr Fisher's creditors.

When Mr Fisher sold his shares, the resolutions he prepared were inadequate and that was enough to have the transaction overturned.

The bankrupt's situation highlighted in this case is common enough. However, in the experience of Ellis Law it is the Inland Revenue Department who comes knocking on your door more often than the Official Assignee. If the IRD thinks that your records are inadequate you too could find yourself in a similar situation to the hapless Mr Fisher by being prosecuted and sued.

The message from Ellis Law is clear. In dealing with your trust, always ensure you use someone who is experienced in trusts to prepare the documentation. Do not just rely on your own intuition in an attempt to reduce costs. It may be a very expensive cost saving exercise.

RETIREMENT VILLAGES

Thinking of moving into a retirement village? Are Mum and Dad finding the house too much? Concerned about the costs of moving into a retirement village?

Ellis Law provided a considerable amount of input into an article published in the March 2007 edition of Consumer Magazine. If you would like a copy of that article contact Ellis Law or email info@ellislaw.co.nz and ask for a copy.

One of the biggest costs of going into a retirement village is your loss of capital if you want to leave after three or four years. And it does happen! If you do decide to leave, 20% or 24% is generally deducted from what you paid originally. Ellis Law has now come across instances where that 20% or 24% deduction is as high as 30%. You may also have to pay for the redecoration of the unit and the cost of selling it.

BEEN CAUGHT BY A FAILED COMPANY? Seen the Failed Company Rise from The Ashes?

Owed money by a company that has gone into liquidation? Upset to see that company start again with the same or similar name?

Until recently it was not against the law for the directors of a failed company to form what is known as a phoenix company. The directors would change the name of the company before it failed and then form a company using either the same or a similar name as the failed company. Or, sometimes the new company would be formed soon after the first company failed, with the same or similar name as the failed company.

From 1 November 2007 the Companies Act has been amended. Now, if a company has been placed in liquidation within the preceding five years, because it is unable to pay its debts, the directors are banned from forming a new company using the same or a similar name to the failed company. The person must have been a director of the failed company within twelve months of it failing and going into liquidation to be caught by this restriction.

A person breaking the new law faces imprisonment of up to five years or a fine of up to \$200,000.

This law now treats these actions as serious matters. If you think you have been the victim of a phoenix company, contact Ellis Law without delay.

BUYING A HOUSE OR APARTMENT - Building Inspection Reports and the Leaky Home Syndrome

Ellis Law advises all its clients buying a house or apartment to obtain a building inspection report irrespective of its age.

In recent months even clients who have purchased new houses have had building inspectors discover a multitude of problems. In one house built by a reputable building company a roof truss (supporting the roof) was left hanging without support in mid air! And the roof was made of concrete tiles.

In the same house a concrete block wall had been built as part of the house without proper internal support and no cap over the top. In yet another instance, daylight could be seen through the roof tiles. Even though

Ellis Law is not a building expert we thought this might give rise to water proofing problems! In these instances the local Council had issued a Code Compliance Certificate.

You need to be careful about how the clause covering the building inspection is worded. Many clauses are worded in such a way that make it very difficult to get out of the agreement even if you are genuinely unhappy with the problems or the work requirements to fix the problems.

If you are buying an apartment, unless the apartment is new, Ellis Law advises that you make the agreement conditional on inspection and approval of the previous

three years Body Corporate Minutes. If there are problems with the water tightness of the apartment or there are other building problems these should be mentioned in the Body Corporate Minutes. Body Corporate Minutes can also show up a multitude of other problems. Does the air-conditioning or lift need replacing? Does the building need repainting or re-roofing? How much will you have to contribute to the ongoing running costs?

Ellis Law recommends its clients allow it to check the wording of the building inspection and Body Corporate inspection clauses before the agreement is signed. After all, it is little comfort if you sign a document that does not protect you.

FRAUD IN THE WORKPLACE

In business? Employ staff? All 100% honest? Yeah right – how can you be completely certain?

A leading Auckland forensic accountant recently stated that the typical fraudster profile he sees in New Zealand is female, employed for a number of years, trusted by the organisation and in a position of control over accounts payable or payroll.

Ellis Law now offers some tips to ensure opportunities for fraud and theft are minimised, including:

1. When making electronic payments have two people authorise the payments if you are not carrying out that function yourself. Get your payee (person you are paying) to fax or post you a copy of their bank account details. Emails can be altered! Always check the payee name against the payee account number when you make electronic payments. Banks only recognise numbers. They do not recognise names. Fraudsters are known to put in the correct name but their own account number.
2. When writing out cheques ensure there is no room to either alter the amounts in words and figures or add in additional words or figures, especially if the staff member has written out the cheque and you have been asked to simply sign it.

All cheques should have complete payee details. For example, if you are paying a cheque to ANZ Bank Limited for a client the cheque payee line should be completed "ANZ Bank Limited a/c Fred Smith" or "Auckland City Council rates Fred Smith".

Employees have been known to fraudulently bank cheques simply made payable to a particular bank into their own account at the same bank.

3. Check the payee details on the cheque against what is written on the cheque butt. In a recent case brought to the attention of Ellis Law, the fraudster was writing the cheque out to cash but the details of the cheque butt looked genuine.
4. Receive cash from time to time? If so, check the receipts issued, till tape or whatever system you may use to receipt cash against the bankings to your account. You should also check whatever form of receipting you use against your computerised accounting system. In a recent case a client of Ellis Law discovered a staff member was stamping the receipt to make it appear as if the money had been entered into the computer system and banked, but it was not entered into the computer nor banked!
5. Balance your petty cash regularly. Most frauds start with the milk money and other petty cash quietly disappearing.
6. Send statements to customers? Check statements for accuracy from time to time, as fraudsters are known to alter statements to suit their fraudulent actions.

Do you have fidelity insurance i.e. insurance to protect you if you do find yourself the victim of staff theft? If not, ring your insurance broker today. Fraudulent staff members have been known to bankrupt their employers!

If you have any doubts about your staff contact Ellis Law. We can assist and can arrange for the appropriate investigators to check your systems and see if you do have a problem.

PROPERTY RELATIONSHIP AGREEMENTS – Not Just for the Young At heart

The Property Relationship Act essentially provides for the equal sharing of property if you have lived together for three years or more, whether you are married, co-habiting or living in some form of de facto relationship.

But what is a de facto relationship in the eyes of the law? In a 2006 court case (Scragg v Scott) the High Court referred to a court case decided some years previously. In the earlier case neither parties lived together nor planned to live together; they did not have a sexual relationship, nor have any children. They simply regarded themselves as a close and devoted couple that were committed to each other financially and emotionally.

The High Court said that if that case were decided today it would qualify as a "de facto relationship." If the relationship had lasted for three years or more, what follows is the potential for equal sharing of property on death or relationship break up.

The message from Ellis Law – it doesn't take much to be caught in a relationship that may affect where your assets go on your death or if your relationship falls apart. Talk to us about a Relationship Property Agreement.

YOUR WILL – DOES IT SAY WHAT YOU WANT?

If you want your estate to be distributed amongst your nearest and dearest it is important you have a Will.

If you do not have a Will there will be no choice where your estate assets go. They will be principally shared amongst certain relatives whether you like it or not. If you do not have a Will, and if you do not have any parents or children alive on your death, there could be some real problems in distributing your assets to where you really wanted them to go.

On 1 November 2007 new legislation affecting Wills, the Wills Act 2007, came into force.

The law has always been very strict about the formalities of completing a Will. It must be signed by the Will maker in a particular place and must be properly witnessed to be valid. Under the new Wills Act, the High Court has the power to correct errors in Wills. The High Court has the right to approve changes to a Will if it is believed the Will does not accurately meet the intentions of the person making the Will.

However admirable it is to have this modern flexibility, there will be considerable cost involved in taking the matter to Court should one of those nearest and dearest to you decide to challenge your Will.

Prior to the new Wills Act a Will was automatically revoked on the marriage of a couple unless it had been specifically worded to cover the pending marriage. If your marriage fell apart and you divorced, your former spouse was automatically disinherited under your Will. That has now been turned on its head – neither a marriage nor a divorce automatically revokes a Will today.

The message from Ellis Law is clear: think very carefully about what you want to put into your Will. If you feel you may want to leave someone out, ensure your reasons are written down and kept in a safe place. Ellis Law also advises its clients to continue to keep up with those good old-fashioned formalities in completing, signing and witnessing your Will. If you are about to get married, are married or in a relationship, or that marriage or relationship is falling apart, talk to us so that you can be satisfied your wishes will not be overridden.

ELLIS LAW – Who is Ellis Law?

The principal of Ellis Law is Brian Ellis (LLB) has been a barrister & solicitor for 20 years, following a ten year career as a banker. Before setting up his practice, he previously worked for both large and small law firms and as a member of a small partnership. Brian's experience includes conveyancing (buying and selling properties and businesses), family trusts, financing, corporate and personal structuring, and the areas of general personal, company and commercial trusts. Brian has particular expertise advising small to medium sized businesses in a wide variety of legal matters.

Simon Thode is an associate with Ellis Law. Simon recently joined Ellis Law as an experienced lawyer with a conveyancing and background together with corporate and public sector experience.

Elaine St Leger has been with us for almost two years, as a personal assistant/legal executive. Elaine is qualified in Ireland as a legal executive and worked in various law firms for nine years before coming to New Zealand.

Ruth Kennett has recently joined Ellis Law as a trust accountant. Ruth has worked in both large and small law firms in Auckland for six years. Prior to that Ruth had experience in the District Courts and Land Surveyors.

Jessica Blake joined Ellis Law in July of this year as personal assistant and legal executive working with Brian Ellis. Prior to joining Ellis Law, Jessica worked as a legal secretary for a litigation firm.

Louanne King is our part-time in house accountant who looks after our debtors, creditors and carries out various other reporting and accounting functions for Ellis Law.

Victoria Ellis has recently joined the team at Ellis Law as law clerk/receptionist. Victoria has worked at Ellis Law in the past during university breaks and is looking forward to completing her law degree mid 2008.

IN BUSINESS – Do You Take American Express?

If you are in a business and accept American Express cards, Ellis Law warns you to take care, particularly for higher valued transactions.

In a recent situation that was brought to the attention of Ellis Law, a transaction for around \$10,000 was processed electronically on a customer's American Express card. The transaction came up with "approved". However, American Express subsequently enquired from the card owner whether or not the transaction was genuine. It took over seven days from the time the transaction was processed at the retailer for the money to hit his bank account when ordinarily it would be overnight.

If the card owner denied that the transaction was genuine the money would not have been credited to the retailer's bank account. And, too bad if the poor old retailer had given the customer that expensive Rolex watch!

OPERATE A COMPANY? Do Your Invoices, Letterhead, Cheques And Other Documents Have That Magical Word?

When your company sends out letters, invoices, statements, cheques or orders, by email or any other form of written communication, you must always use the full name of the company including that magical word "Limited".

The Companies Act is quite clear. You must use the word "Limited" on any written communication sent by or on behalf of the company or any document that may create a legal obligation on behalf of the company. If you fail to do so, the person who signed the document or ordered the goods or services could be personally liable for the obligation incurred.

Ellis Law was involved in a case some years ago where a flooring contractor failed to supply carpet and issued an invoice without the use of the word "Limited" on the invoice. We sued the carpet supplier personally. The carpet supplier argued that the case should have been taken against his company. The court case did not go very far because the lawyer for the carpet supplier advised his client that the person who had signed the invoice and was behind the failure to supply the carpet was personally liable. That defeated the benefit of operating through a company.

The message from Ellis Law is clear. Always ensure your letterhead, emails, invoices, statements, cheques and even your business cards include the word "Limited" after the name of your company.

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