

**NOT A BED TIME STORY**

This is a good story, possibly not a bed time story ... but one with a moral.

Once upon a time there was a jeweller, Mr Lightbody. Mr Lightbody's jewellery company, Capro Three Limited ("Capro") owed a lot of money to its biggest supplier, Regal Castings Limited ("Regal").

To provide support to Mr Lightbody, Regal restructured Capro's debt into a term loan agreement repayable in monthly instalments. Mr Lightbody accepted personal liability for Capro's indebtedness to Regal. Even though Regal was aware that the home Mr Lightbody owned jointly with his wife was his only substantial asset, Regal did not request security over the home.

Some three years later, with \$220,000 owing under the Regal term loan and \$90,000 owing to Regal for further supplies, Mr Lightbody transferred his interest in the home to a trust. Mr Lightbody was a trustee of the trust, along with his wife and their lawyer. Mr Lightbody and his wife were beneficiaries and kept on living in the home, enjoying it just as they had before.

The transfer of the home was structured as follows:

- the trust bought the home from Mr Lightbody and his wife for current market value;
- if IRD questioned the purchase price, the price could be adjusted;
- the purchase price was not paid immediately by the trust but was recorded as a debt owed by the trustees to Mr Lightbody and his wife;
- the debt was to be repaid in seven years, Mr Lightbody could, and his wife could not, ask for early repayment;
- on the same day as they transferred their home Mr Lightbody and his wife each forgave \$27,000 of the debt.

Mr Lightbody did not advise Regal of the transfer of the home to the trust.

After the gifting programme had been completed the jewellery company Capro went into liquidation owing Regal \$15,358.57 under the term loan agreement and \$149,324.00 for further supplies. There were no funds in Capro to meet the debts.

Regal pursued Mr Lightbody for the debt and Mr Lightbody was adjudicated bankrupt.

Regal applied to the High Court for an order for the transfer of the property to be set aside. Regal did not challenge Mrs L's transfer to the trust as she had no liability to Regal, but requested that the 50% owned by Mr Lightbody be transferred to the Official Assignee in his bankruptcy.

The High Court and the Court of Appeal ruled that the transfer could not be challenged and the home was safe in the trust.

Regal appealed to the Supreme Court and was successful.

Referring to law and cases dating back to the Elizabethan era, the Supreme Court held that when property is alienated without proper payment by a person who is insolvent, the transfer will be voidable by the

disadvantaged creditor. The alienation amounts to, what is known in legal terms, as an alienation with 'intent to defraud'.

The Court acknowledged there had been no 'fraud' in the transaction. But the transaction exposed Regal to significant risk of non-payment and therefore Mr Lightbody must be taken to have intended to hinder, delay or defeat the claim of Regal.

The Supreme Court held that, following transfer of his interest in the home, Mr Lightbody was insolvent. He did not have enough money to pay the Regal debts. It did not matter that the Regal debts were debts of Capro. Mr Lightbody had guaranteed the debts and therefore the Regal debts must be taken into account when assessing if Mr Lightbody is solvent.

The Supreme Court held that there had not been proper payment for the home as the debt back was not repayable for seven years and there was a gift of \$27,000. Some members of the Court held that as Mr Lightbody intended to completely gift the purchase price, that meant the transfer was a transfer for insufficient payment.

The trustees argued that they had taken title to the home in good faith and therefore could not be forced to transfer half the home back to Mr Lightbody. The Supreme Court disagreed and said that as Mr Lightbody was one of these trustees then the trustees had the same knowledge as Mr Lightbody.

The statute law applying to gifts of property by an insolvent person has been clarified by the Property Law Act 2007. Gifts made by an insolvent person after 31 December 2007, will be set aside. The result under the new law would therefore be the same for Mr Lightbody. Regal can challenge and claw back the transferred asset into Mr Lightbody's personal property pool.

The moral of the story is that you should undertake structuring at the appropriate time. If Mr Lightbody had transferred the home to a trust before there were significant debts for which he was personally responsible, the transaction could not have been undone by the Supreme Court. A trust can sometimes seem an unnecessary expense when first establishing a business, but that may be the very best time to create one.

**Now is a great time to make sure your personal structuring is in order, our Private Client team are experts in this area and would be happy to field your queries:**

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