McKEAN & PARK LAWYERS

MATTERS

SEPTEMBER 2007

Superannuation Contributions

It's not too late, but the Rules are different

By MARK FLYNN

The end of the last financial year was possibly the busiest we have experienced in recent memory. One of the main drivers of activity was the interest of many of our clients in contributing to their Superannuation Fund ahead of the rule changes effective from 1 July 2007. For those that did not, or could not, make the most of the transitional non-concessional contribution limit of $1,000,000.00, there is no need to despair - the new Rules establish a very attractive (albeit more modest) contribution regime.

From 1 July 2007, eligible Members of a Fund can make non-concessional contributions of up to $150,000.00 a year, although if you are under 65 you can bring forward contributions and contribute up to $450,000.00 for a three year period. Contributions above these thresholds will be taxed at the highest marginal rate of 46.5% (including the Medicare levy).

While contributions can be derived from a range of sources, we found that most of our clients making contributions before 30 June 2007, elected to contribute part or all of a commercial property in specie into their Fund (up to the then contribution limit). Rather than selling the property and contributing the proceeds into Super, a contribution in specie means that the Fund acquires the property at its market value and holds it, and any income derived from the property (e.g. rental proceeds) for the benefit of its Members. In spite of rising property prices, we anticipate that many clients will have a commercial property the market value of which (or part of which) is below the current contribution limit, and which may potentially be transferred in specie into their Fund. Of course, the merits of that proposed contribution must be assessed in the context of ongoing financial, business and family succession planning objectives.

If you currently own commercial property, have received an inheritance, or otherwise have personal savings or the proceeds of a sale and are considering your investment options, you may also wish to consider the benefits of investing into Superannuation under the new contribution Rules.
We can assist you with assessment of your objectives and your Superannuation and personal succession planning.

For further advice or assistance, please contact Mark Flynn
mark.flynn@mckeanpark.com.au

STOP PRESS STOP PRESS STOP PRESS STOP PRESS

McKean & Park on the Move

McKean & Park will be relocating to new offices in March 2008.

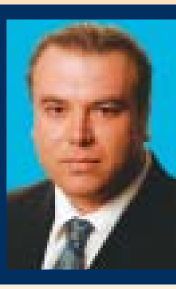
This will be only the third move for the Firm since 1916!

The move is required to accommodate recent and further expected growth of the Firm. Planning for the move is progressing. Further information will be included in future issues. Our aim is to create a new home that reflects the heritage of the Firm as well as offering a modern office.

contents

BUYING OFF-THE-PLAN TIPS FOR INVESTORS

By TIM GRAHAM



In the last decade buying property off-the-plan has become exponentially more popular in many major Australian cities. As the eponym suggests, buying "off-the-plan" means entering into a contract to purchase a property on the basis of design drawings before it has been built. For the investor there are many reasons to consider buying off-the-plan including a lower entry price into the property market, taxation benefits and stamp duty savings as well as capital growth and a fruitful return.

THE BENEFITS

A significant advantage to buying off-the-plan is the considerable saving you can make on stamp duty. In several Australian States stamp duty is assessed on the value of the property at the time the contract of sale is entered into. When buying off-the-plan stamp duty is assessed on the basis of the unimproved land where construction has not commenced.

As the property market continues to rise it is foreseeable that the value of your investment will increase between the period of signing the contract and taking possession. Buying off-the-plan may give you extra time to save money for future mortgage payments. It will also allow you time to sell your existing property and arrange finance. It may be possible to invest in off-the-plan property with as little as a 5% deposit or by bank guarantee.

Moreover, tax deductions may be available for investors via depreciation reducing your annual tax liability. Depreciation expenses may include the building, fittings and furniture. Ensure your contract contains a condition that the developer discloses the building costs to assist a depreciation claim. Specific advice should be sought.

The dearth of rental properties - and commensurate increases in rents - has received substantial press exposure in the eastern states in recent months. Higher rentals may mean an investment which is ultimately positively geared.

THE RISKS

There are, however, a number of countervailing forces you should be aware of when considering to make an off-the-plan investment.

These include the possibilities that the market price will stagnate or fall between the time you sign the purchase agreement and take possession of the property. There are no guarantees that the purchase price will reflect the market value when the construction is complete.

Also, it can be difficult to visualise how your apartment or townhouse is going to look once it is complete as there is generally nothing a developer can show potential purchasers except a floor plan, artists conceptions and other promotional material. Some alteration during construction is likely.

If the subdivision has not been registered it will be unclear what are the proposed levies to owners. Any estimates will be just that and may increase substantially by the time the building is completed.

A practical risk is that purchasers may be tempted to buy beyond their means because of the small size of the deposit required to be paid, with the substantial balance not due for a number of years.

TIPS FOR INVESTORS

The following tips may assist you in deciding whether or not to purchase off-the-plan:-

- **If possible, provide a deposit bond upon signing a purchase agreement rather than paying a deposit. If your deposit is released and the builder does not finish the project - for example, it may disappear** or become insolvent - it will be difficult to trace back your deposit. If the developer is unwilling to accept a deposit bond try to negotiate a minimal deposit.

- Endeavour to get in early as the best lots such as penthouses and lots with private courtyards are invariably sold first. The earlier you are the wider the selection. Be aware, however, that prime lots often have higher lot liabilities which means your levies will be proportionally higher.
- You may also be required to contribute to a sinking fund or maintenance fund for future repairs and maintenance required to the complex. This is seen as preferable to bodies corporate imposing large and sudden levies on lot owners when repairs or maintenance are required. Contributions are not refundable should the owner sell and move out even if the money has not yet been spent on the repair or maintenance works, though it is properly regarded as an asset of the building. A sinking fund is compulsory in New South Wales and a maintenance fund will be compulsory in Victoria after 31 December 2007[1].
- There may be lifestyle restrictions in the development of which you should be aware before entering into a purchase contract. These may include:-
  - (i) prohibition or restrictions on keeping animals.
  - (ii) parking restrictions
  - (iii) noise and the behaviour of invitees
  - (iv) activities of children
  - (v) there may be a rule prohibiting washing being left to dry on balconies which would be visible from the street or adjoining buildings
  - (vi) changing the appearance of your lot
- You should insist on the inclusion of sunrise and sunset clauses in your contract. A sunrise clause requires the builder to commence work by a specified date or within a specified period. This will guard against commencement being delayed until, say, a certain percentage of pre-sales has been achieved. Equally, a sunset clause provides that the project will be completed by a specific date or within a specific period.
- Contracts will invariably allow the developer to vary the total unit area from the original floor plan. Whilst a nominal variance is acceptable the contract should contain a condition that the variance will not exceed a prescribed maximum.
- Always read the schedule of fittings and fixtures in detail to ensure that you are satisfied with the quality and type of fittings and fixtures. These include appliances, lighting, door furniture, floor coverings, paint and the like. The contract must exhaustively set out all such items.
- Only after construction is 100% complete and you are satisfied after a final inspection of the work that you should pay the balance of purchase price should you do so. If there are outstanding issues these should be communicated to the builder via your solicitor in order that the issues may be rectified prior to settlement. In my view, an independent building consultant should be engaged to conduct the inspection and certify that the work undertaken is satisfactory.
- Ascertain whether there is a penalty for withdrawing from the contract. Also, if construction finishes ahead of time ensure that your finance will be available.
- Check whether there is scope to customise your apartment design and whether you can change the fittings and fixtures. If so, inquire how the contract price will be affected.
- GST will be payable on the sale price and should be paid by the developer. Ensure that your contract contains a term to this effect or GST liability may be passed on to you.
- When purchasing you may not know what contractual arrangements have been made by the developer for management, caretaking and the like. Full inquiries should be made.
- Finally, previous examples of the builder's work should be inspected. Testimonials of people who have employed the builder and/or purchased from the developer should be sought.

THE VICTORIAN POSITION

In June 2004 the Victorian Legislature passed the Domestic Building Contracts (Amendment) Act 2004 to clarify the extent to which the Domestic Building Contracts Act 1995 applies to the construction of homes that are sold off-the-plan.

In March 2004 the Victorian Civil and Administrative Tribunal held that a contract of sale which contemplated the construction of a penthouse apartment in a residential development in the Docklands constituted a domestic building contract and so came within the ambit of the *Domestic Building Contracts Act* ("DBC Act"). It followed from the Tribunal's decision that purchasers under off-the-plan contracts were able to avoid their contracts where the contracts offended the DBC Act[2]. Within a matter of days the State Government published a press release advising of its intention to retrospectively amend the DBC Act as it was not intended to apply to off-the-plan contracts of sale. The hysteria the Philp decision generated in the development sector played no small part in effecting this legislative re-think.

Section 3 of the DBC Act provides as follows:-

A contract for the sale of land on which a home is being constructed or is to be constructed that provides or contemplates that the construction of the home will be completed before the completion of the contract is not…a domestic building contract within the meaning of the (DBC Act) if;

(a) the home is being constructed under a separate contract that is a major domestic building contract; or

(b) the contract of sale provides that the home is to be constructed under a separate contract that is a major domestic building contract.

Thus where developers engage or intend to engage a builder to construct the dwelling provided for in the contract of sale, the sale contract is not a "domestic building contract" as that term is meant and understood in the DBC Act. Accordingly, purchasers who enter into off-the-plan contracts do not benefit from the consumer protections set out in the DBC Act[3] so far as the developer is concerned.

That is not to say that a purchaser will not have the ability to pursue the builder for defective workmanship and/or materials. Section 9 of the DBC Act provides that an owner can pursue the builder for faulty workmanship or materials as if the owner was a party to the original building contract. Claims may be brought for up to 10 years from the date of the Occupancy Permit[4].

In circumstances where the builder has died, disappeared or is insolvent a claim may be submitted to the builder's warranty insurer for up to two years for non-structural defects and six years for structural defects from the date of the Occupancy Permit[5].

CONCLUSION

The location and aspect of many apartment buildings is congruous with the vibrant lifestyle enjoyed by many people. For reasons as diverse as proximity to your workplace, shopping facilities, cafés, theatres, beaches and parks more and more people are relocating into urban and inner suburban areas. Provided that you exercise some due diligence in selecting your apartment the prospects of procuring an investment as dynamic as your lifestyle are maximised.

tim.graham@mckeanpark.com.au

1 The Owners Corporation Act (Vic) 2006 comes into operation on 31 December 2007 unless proclaimed earlier

2 Philp v Mirvac [2004] VCAT 367 (10 March 2004)

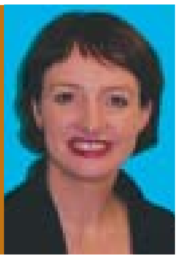
3 See, for example, Sections 8, 31-33

4 See Thurston v Campbell [2007] VCAT 340

5 s.135 Building Act (Vic) 1993; Domestic Building Insurance Ministerial Order No. 598, Friday 23 May 2003

RESTRAINTS OF TRADE

By SAMANTHA GIDLEY



Many employers have contracts of employment which contain a restraint of trade clause, preventing the employee from working for a competitor after the conclusion of the employment relationship with the employee.

Whether the restraint is enforceable will be dependant upon whether or not it is considered by a Court to be reasonable. There are various factors taken into account by a court to make this decision.

Set out below is the case of Otis Elevator Company v John Nolan. It is an interesting case in relation to restraint of trade clauses and their enforceability.

John Nolan, was a Sales Manager. He had extensive overseas experience in the lift industry. He applied for positions at Kone Elevators and Otis Elevators. The employee was successful in both applications, but decided to accept a position with Otis Elevators. He signed an employment agreement on his first day which contained a Restraint of Trade clause. The Restraint of Trade clause prevented him from working for any of the employer's major competitors including Kone for 6 months.

On his first day of his employment with Otis Elevators, the employee changed his mind. He tendered his resignation on the first day, after confirming that Kone Elevators were still prepared to offer him a position. Thereafter, the employee commenced employment with Kone Elevators.

A representative of Otis Elevators discovered that the employee was working for the competitor in contravention of the restraint of trade clause contained in his contract. The Company therefore issued proceedings in the Supreme Court of New South Wales to prevent the employee working for Kone on both an interim and a final basis. The Company had two main arguments. These were:

- **That the restraint of trade clause of 6 months was reasonable in protecting confidential information and or its customers.**
- **It was appropriate that the restraint should be granted on at least an interim basis. The reason for this was that it was improbable that there would be a final hearing within the 6 months period of the restraint. That is, if the restraint was not granted on an interim basis, a restraint on a final basis would be of no use or benefit as the confidential information would have already been imparted to its competitor.**

The employee agreed that the restraint of trade clause was reasonable. However, he also argued that this was not an appropriate case in which to enforce the restraint of trade as the employee had been employed by the employer for such a short period of time. During that period, the employee only had access to the confidential information for a short period of time.

Justice Brereton considered firstly whether the restraint was reasonable. He indicated that the period of time was reasonable. **It is also important to note that the length of time for which an employee had been employed could not affect the reasonableness of the restraint.**

However as to whether or not the restraint of trade should be enforced, was another issue. It was an exceptional case as the employee had been employed for a short period of time and it was highly unlikely that the employee would have had access to confidential information. The employee would suffer from financial prejudice if prevented from working in the industry for a 6 month period.

On these bases, His Honour did not grant the injunction. Instead, he made an order that the employee provide a written undertaking that he not disclose any confidential information that he might have obtained during his employment with the employer.

samantha.gidley@mckeanpark.com.au

DISCRETIONARY TRUSTS; Recent Developments in Beneficiaries Rights

Some years ago we wrote to our clients in our newsletter about the rights of beneficiaries in discretionary trusts, in relation to a trustee's obligation to supply such beneficiaries with information when requested. At that time our view of the law was that with the classic family discretionary trust, where the persons to benefit from either or both of income and capital was discretionary in the trustee, then where a beneficiary had never been allocated income or capital the trustee was under no obligation to provide information about the trust to that person voluntarily or if requested.

By GEOFF PARK

We also held the view that if at any time a beneficiary under a discretionary trust had been allocated some income or some capital then, depending on all the circumstances of the particular situation, such beneficiary would be entitled to a copy of the trust deed and the financial statement for the year or years in which any such allocation had been made. There have been recent developments generally, in family law, corporations law and tax law.

Generally

There have been developments, especially since 2003, which impact on the opening remarks above. The Privy Council in Schmidt's case in 2003 confirmed that the court had an inherent jurisdiction to supervise the administration of trusts and to require trustees to provide a beneficiary with trust documents and information about the affairs of the trust. This was an inherent jurisdiction which is not based on any alleged proprietary interest in a beneficiary; no beneficiary has an absolute right to information but has the right to ask the court to exercise its discretion to order disclosure.

That case was fully discussed in Foreman's case in New Zealand in 2003, and reinforced that beneficiaries had fundamental, though not absolute, rights to receive information enabling them to ensure the trustee's accountability, to have the trust property properly managed and to have the trustee's account for their management. The court stated that there was no category of core trust documents (for example, the trust deed and accounts) but instead left the whole matter of disclosure within the court's discretion.

As it is always in the court's discretion, then the trustees cannot be under a duty to make disclosure. This is also important in relation to payment of costs: if there were a duty then trustees who refused to comply with a request from a beneficiary would be at risk of being ordered to pay costs.

However Foreman's case now leans in favour of a beneficiary. The court effectively stated that the question is whether any reason exists for not ordering disclosure.

Furthermore, the court considered the situation of a person named or included by definition as one of the class of discretionary beneficiaries. Just because they had never been allocated any income or capital would not exclude the court from ordering disclosure of accounts and information to them, again depending on all the circumstances of the particular situation.

Other Situations

A number of other situations, relevant to the above, can be mentioned here. Whereas the above discussion is solely on the point as to whether a discretionary beneficiary can force a trustee to disclose information, these other situations raise a question of whether a person can wrest control of the trust (and accordingly decision making as to who will benefit from income and capital) from the party in control or alternatively seek court declarations that assets of the trust are in fact assets of a person. Accordingly the recent developments in these other situations are:

1. Family Law

The court will go behind a trust structure and may make a finding that the assets of the trust are the property of one of the parties to a marital relationship where that party had full control of the assets of the trust and the trust could be regarded as the "alter ego" of that party. In other words, if the husband has full control of the trust then the court may consider the trust assets to be assets of the husband and can be taken into account in the property settlement.

2. Receivership under the Corporations Act

Development in this area has come through a decision known as the "Richstar Case", 2006, which arose out of the collapse of the West Point property and finance group of companies. The case is particularly complex but for the purpose of this article the court found that where a potential beneficiary was the effective controller of the trust, then the court would extend the scope of the receivership to assets in those trusts.

3. The Bankruptcy Act

It is possible that in particular circumstances, the reasoning in the Richstar case might be applied to situations under the Bankruptcy Act.

4. Pensions

4.1 Generally

Where a trust has been set up to make provision for a person under a disability, then care needs to be taken. The Trust Deed may include a discretion as to payment of some or all of the income to the disabled person, and one reason for this may be to keep payments to a level which do not exclude the person from receipt of the pension. There may also be discretions as to advancing some or all of the capital to such disabled persons. In certain circumstances, under the Social Security Act, the Commissioner may consider that such beneficiary is "in effective control" of a "controlled private trust" and allocate 100% of the income and 100% of the capital of the trust to the beneficiary in relation to assessing his or her income and assets for pension purposes. This of course depends on the wording of the trust and there are many possible different wordings.

However, in a simple situation of a trust providing for all income to a life tenant and after that person's death, then the capital to other persons, then the Commissioner does not include either the income or the capital in the life tenant's income and asset test for social security purposes.

In a variety of situations where the beneficiary can request the further income or request capital to make up for any deficiency in income then the Commissioner is likely to allocate 100% of the income and 100% of the capital to the beneficiary for the assessment purposes. See "Cocks case", 2002, AAT.

4.2 Special Disability

After September 2006 parents and family members of a person with a severe disability, where such person is in receipt of a Disability Support Pension, can establish a private trust worth up to $500,000.00 for the future care of that person, without any existing pension of that person being affected by the income test. Furthermore, gifts to the trust by parents or immediate family members will not affect those persons' Age Pension or Department of Veterans Affairs Pension.

Should you require any further information on any of the matters raised in this article, please contact the writer, Geoff Park, an accredited specialist in Wills and Estates or his colleague at McKean & Park, Elisabeth Benfell who is also an accredited specialist in Wills and Estates.

geoff.park@mckeanpark.com.au

CHARACTERISTICS OF THE FRANCHISE RELATIONSHIP

Many franchisees enter into a franchise contract a bit starry-eyed, and without considering properly the legal, commercial and, no less importantly, the practical implications of the document they are signing. The reality is that there is an inherent power imbalance in the franchise relationship and in franchise contracts generally. *By* JOHN COGHLAN

Franchising has appealed traditionally to individuals who want to own a business or 'be their own boss', but lack the experience or resources to establish an independent business enterprise.
In recent times, some commentators have observed the emergence of the 'Franchise Investor': a more sophisticated form of franchisee who enters into franchise agreements for investment purposes. 'Franchise Investors' generally have experience in upper management and use disposable income to finance the purchase of the franchise. This trend may be based, in part, on the rise of professional services franchise systems that require franchisees to hold mandatory professional qualifications (e.g. tax agents, psychologists).
However, while more and more franchisees may be professionals, outside of the professional services franchise systems it probably remains the case that the nature of the franchising industry continues to attract the individual of modest means and limited business experience. In any event, whether a franchisee enters into a retail, professional or other form of franchise, there is an inherent disparity in power between franchisor and franchisee reinforced by the franchise contract and the conduct of the business system.

The hallmarks of business format franchising are standardisation, consistency and uniformity across all aspects of the business enterprise. The franchisor is concerned to maintain these characteristics by imposing tight controls on its franchisees and regulating the quality of the services and products to be provided or sold by franchisees to consumers. Contracts are typically one-sided and offered to franchisees on a 'take-it-or-leave-it' basis, usually leaving little room for meaningful negotiation on the substantive terms of the agreement. The franchise contract covers the important features of the relationship, such as the licensing arrangements, intellectual property and franchise territory rights, the franchisor's powers in controlling franchise operations, and rights of termination and renewal. The contract generally imposes heavy obligations on franchisees while the franchisor's duties are relatively undefined. Whereas the contract will provide the franchisor with considerable discretion in performing its own obligations, the franchisee will be bound by explicit standards of conduct.

The franchise contract usually contemplates a long-term relationship between the parties, making it difficult, at the time of drafting, to anticipate and describe in detail all of the rights that may be required over the course of the relationship. Most of the day-to-day requirements of the franchise business are therefore left to an 'Operations Manual' that is incorporated, by reference, into the main franchise contract, and which is subject to change, from time to time, according to the requirements of the franchisor.
The franchisor's broadly expressed powers provide it with the flexibility to steer the direction of the franchise system and respond to changes in the market and contingencies as they arise.

Because of the inherent power imbalance in the franchise relationship and the incomplete nature of franchise contracts, regulators in Australia, as in other jurisdictions, have been concerned to protect the interests of franchisees by introducing into the industry 'fairness based' business regulation. The primary legislative instrument governing the franchise relationship is the Franchising Code of Conduct (the 'Code'), a mandatory industry code prescribed by the Trade Practices (Industry Codes - Franchising) Regulations 1998 (Cth). The Code regulates the conduct of participants in franchised businesses by setting out rights and obligations with respect to the negotiation and terms of franchise agreements, including pre-contractual disclosure requirements, provisions regulating transfer of the business, termination of the franchise contract and dispute resolution mechanisms. Outside of these limited areas of concern, the franchising relationship is governed by the common law and other relevant statutory provisions, including the Trade Practices Act 1974 (Cth).

The franchisee is uniquely vulnerable to the superior power of the franchisor, the interdependency of the relationship, and the incomplete nature of the franchise contract. The existence of the Code is recognition that franchisees need special protection under the law in the same way that other potentially 'vulnerable' commercial parties (e.g. retail tenants and consumer borrowers) are afforded special statutory protection. This article is not intended as a critique of franchising. Rather, it is intended to encourage franchisees to go into a franchise with their 'eyes open' having considered the legal, commercial and practical implications of the franchise relationship.

For advice on any aspect of franchising or contract law, please contact John Coghlan

john.coghlan@mckeanpark.com.au

Editor's Note: *The text of this article is derived, in part, from a research paper John prepared in the course of his studies towards the Master of Laws degree at the Australian National University. As part of those studies, he also recently completed a course in advanced contract law conducted at Cambridge University.*

McKEAN & PARK LAWYERS
405 Little Bourke Street
Melbourne VIC 3000 Australia
Phone 61 3 9670 8822 Fax 61 3 9602 5037
client.services@mckeanpark.com.au
www.mckeanpark.com.au