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This month we report on three interesting real-estate related court decisions involving adverse possession, the statute of limitations on a lien of deed of trust, and a bankrupt couple's homestead claim on a home under construction. We also provide a section titled "Information Brokers Should Know" regarding the extension and expansion of the homebuyers tax credit, independent contractor reporting requirements, and C.A.R.'s Legal Hotline Service.

Adverse Possession by Constructive Notice to Absent Incompetent Owner

In the case of Nielsen v. Gibson, Lyman and Mary Bender owned three lots, one with a residence. In 1993, they deeded one vacant lot to their daughter Gayl (the "Lot"). Gayl built a cabin on the Lot and shortly afterward permanently moved to Ireland. In 1997, an attorney in Ireland was appointed by the Irish court to act for Gayl in a role similar to a conservator. The Benders believed Gayl was competent and was being taken advantage of. Mary Bender went to Ireland to be with Gayl. Lyman stayed to negotiate the sale of the three lots, including Gayl's Lot, to David and Tricia Nielsen. Lyman told the Nielsen's that he and Mary believed Gayl was competent and was being taken advantage of. The Niensens moved into the residence on the Bender property in December 1997 and immediately began using, improving, and maintaining the Lot. Their improvements included blocking road access, posting "no trespassing" signs, denying permission to access the Lot, irrigating, planting gardens, trimming trees and shrubs, and building a go-cart track. The Niensens paid for homeowner's insurance, utility services and property taxes on the Lot starting in 1997.

The sale transaction was delayed in closing, because the Benders had no interest in Gayl's property and no power of attorney. The Irish attorney told Lyman that the Irish courts had determined Gayl was incapable of managing her affairs and did not have the capacity to make decisions with legal consequences. In September 1988, to get the sale to the Niensens closed and move to Ireland, Lyman executed a grant deed to the Niensens for the Benders' two lots and a quitclaim deed for Gayl's property. Gayl died in 2003.

In 2006, about nine years after they took possession of the Lot, the Niensens brought a quiet title action against Gibson, the executor of Gayl's estate. The Nielsen's claimed they owned the Lot under the legal theory of adverse possession under Civil Code section 1007. To establish title by adverse possession, the claimant must establish all five of the following elements:

1. Possession by actual occupation under such circumstances as to constitute reasonable notice to the owner (“open and notorious”);
2. Possession must be hostile to the owner’s title
3. The holder must claim the property as his own, either under color of title, or claim of right;
4. Possession must be continuous and uninterrupted for five years;
5. The possessor must pay all of the taxes levied and assessed upon the property during the period.

Gibson claimed that Gayl’s incompetence tolled the running of the five-year period required to establish adverse possession. Code of Civil Procedure section 328 prevents a claim for adverse possession from accruing during the period of a landowner’s “insanity.”

The Placer County Superior Court found that Gibson failed to establish that Gayl was “insane” within the meaning of the Code and that there was inadequate evidence to establish the time period she was considered incapable of taking care of her affairs. Gibson appealed.

The appeal court upheld the trial court’s decision. It found that Section 328 was inapplicable and Gibson had not proved that Gayl’s incompetency was “insanity” within the meaning of the Code. The court also found that Gayl had constructive notice that the Niensens possessed the Lot. The courts have held that “open and notorious” means visible to the true owner and others, and may be “actual or constructive notice” of the adverse use. Further, even a property owner who has no actual notice of the claim or occupancy may be presumed to have notice of an adverse claim that is sufficiently open and notorious. The court explained that when an adverse claimant is in open possession and the true owner fails to look after his interests and remains in ignorance of the claim, it is his own fault.

Statute of Limitations of a Lien of Deed of Trust

In the case of Schmidli v. Pearce, the heirs of the original creditor and debtor disputed whether a lien of deed of trust on the debtors’ property expired 10 years after a notice of default was recorded, or whether a 60 year statute of limitations applied. There were two appellate court decisions addressing the issues with different results.

Mary Pearce loaned \$40,000 to her brother Robert Maple in April 1986. Four years later in January 1990, she recorded a deed of trust against real property owned by Robert and his wife, Stella, securing the debt. The deed of trust did not indicate the due date or include a copy of the note. Four years later in January 1994, Mary recorded a notice of default stating \$65,760 was due as of December 22, 1993 and she intended to cause the property to be sold to satisfy the debt. Mary took no further action. Stella died in 1999. Mary died in 2000, and her interest in the note and deed of trust passed to her children, Rodney, Mary and John (“Mary’s Heirs”). Robert died in 2003, and his interest in the real property passed to his children Nancy and Patrick and their spouses (“Robert’s Heirs”).

In August 2006, 12 years after the maturity date stated in the Notice of Default, Robert's Heirs filed a lawsuit to quiet title and extinguish the deed of trust. They relied on Civil Code section 882.020(a)(1) (since revised), which provided that a lien of a deed of trust expires 10 years after the last date fixed for payment of the debt if that date "is ascertainable from *the record*"; and they claimed the "record" included any recorded document that disclosed the debt's maturity date, including a notice of default. The Notice of Default stated the maturity date and was recorded before the 10-year period expired. They claimed that the lien of deed of trust expired under a 10-year statute of limitations triggered by the recording of the Notice of Default.

Mary's Heirs claimed enforcement of the debt was not barred because under Civil Code section 882.020(a)(2) (since revised), if the last date fixed for payment of the debt "is not ascertainable from *the record*," a lien of a deed of trust expires 60 years after the date the deed of trust was recorded, and they claimed that the "record" was limited to the recorded deed of trust which did not contain the debt's maturity date.

The Superior Court of San Joaquin County agreed with Robert's Heirs and granted them summary judgment. The court relied on *Slintak v. Buckeye Retirement Co.*, (2006), which held that a notice of default triggered the 10-year statute. The court held that for purposes of Section 882.020, the debt's maturity date may appear in any recorded document, including a notice of default. Mary's Heirs appealed.

On appeal, Mary's Heirs claimed the *Slintak* case was wrongly decided and that "the record" interpreted correctly means a recorded document reflecting the actual debt obligation, such as a deed of trust or a promissory note, but not a notice of default. The Appellate Court agreed and reversed the trial court's ruling, explaining that interpreting "the record" to mean any recorded document would render the 60-year statute nugatory, which would be contrary to the rules of statutory construction. The Court concluded that the *Ung v. Koehler* case is the better reasoned authority applicable to the case. In *Ung*, the court determined that a notice of default did not trigger the 10-year statute where the notice was recorded after the 10-year period had expired, and the 60-year statute applied.

Section 882.0209 was amended effective in 2007 to clarify the meaning that the appeal court assigned to it. Although the amendment was not found to be retroactive and was not binding as to the *Schmildli v. Pearce* case, it was a factor the Court could consider. The Court stated that by codifying *Ung*, the Legislature clarified that a deed of trust was not part of the record for purposes of determining the applicable statute of limitations under section 882.020.

Automatic Exemption if Home Sale Proceeds Used to Build New Homestead

In the Chapter 7 bankruptcy case of In re: Guy Taylor Cerchione and Carla Marie Cerchione, the debtors ("Cerchiones") claimed a homestead exemption in a home under construction that they had never occupied and for which they had not recorded a declaration of homestead.

Mr. Cerchione was a home builder. He had to change jobs and move. In October 2007 the Cerchiones sold their home in Meridian for \$144,629.94 and moved to Idaho Falls. They were unable to find a home to purchase, so they lived with his mother while they built a new home. They bought a lot (the Property) in May 2008 and got a construction loan for \$163,500, after contributing \$100,000 as a down payment. On July 31, 2008, the Cerchiones filed for Chapter 7 bankruptcy protection. They claimed an exemption in the property of \$100,000, the maximum under Idaho law. The trustee objected to the exemption because they did not reside at the property and had not recorded a Declaration of Homestead regarding the property. Over the next five months, the Cerchiones amended their petition to claim exemption under Idaho Code section 5-108 as a voluntary sale of the homestead in good faith for the purpose of acquiring a new homestead. They also claimed exemption as to appliances purchased for the new home but not delivered. The Trustee objected to the amendments and also claimed (under the California case of *England v. Golden*) that the exemption in the Property expired a year after the sale of the Meridian residence. After additional briefing and multiple hearings, the bankruptcy court sustained the Trustee's objection to the exemption of the appliances and overruled the Trustee's objection to the homestead exemption in the Property. The Trustee appealed.

On appeal, the Bankruptcy Appellate Panel of the Ninth Circuit affirmed the bankruptcy court's decision after considering these issues:

1. Whether the court erred in determining that the Cerchiones could claim an Idaho homestead exemption in the Property when they had not occupied the Property and recorded a Declaration of Homestead on the Property.
2. Whether the court erred in determining that, if they were entitled to claim a homestead exemption when they filed their bankruptcy case, the exemption claim expired one year after the sale of their Meridian home.

The Panel looked at Idaho statutes regarding homesteads and found the Cerchiones exemption claim was proper because the debtor has an automatic homestead exemption and is not required to record a declaration of homestead if the owner intends to reside as a principal residence in the house intended to be placed on unimproved land owned by the debtor. The Panel found that under federal law, a debtor's entitlement to claimed exemptions is generally determined as of the date of the bankruptcy filing. When the Cerchiones filed their petition, they had paid \$100,000 from the sale proceeds of their Meridian residence to the bank for the construction of a new home where they intended to live. Idaho law provides two bases for claiming a homestead exemption for former homestead sale proceeds: (1) up to \$100,000 of cash proceeds are exempt for one year; and (2) up to \$100,000 is exempt in a new homestead acquired with the sale proceeds.

The Panel also looked at the California case of *England v. Golden*, relied upon by the Trustee to argue that the exemption, if any, had expired. In that case, the Ninth Circuit affirmed the decision of the bankruptcy court that if a debtor held exempt proceeds from the sale of a homestead property on his bankruptcy filing date, the proceeds lost their exempt status if not invested in a new homestead by the deadline set in the California exemption statute. The Panel

explained that the rationale for the *Golden* decision. Since the purpose of the homestead exemption in this context is to allow a debtor to substitute one home for another without a forced sale, and it is not intended to keep home sale proceeds beyond the reach of creditors indefinitely, states can make the decision appropriate to place a time limit on the investment of sale proceeds in a new homestead. California law requires reinvestment in order to prevent the debtor from squandering the homestead sale proceeds for nonexempt purposes. The Panel found *Golden* did not apply, because when they filed the bankruptcy petition, the Cerchiones had already invested the exempt proceeds from the sale of their Meridian home with the bank to pay for purchase of the new Property and to fund the construction of their new home. They had no sale proceeds left to “squander” for nonexempt purposes.

Information Brokers Should Know

Homebuyer Tax Credit Extension and Expansion Close to Approval

On October 28, 2009, US Senators reached a compromise on the proposed extension of the first-time homebuyers tax credit. The measure must still be approved by the full Senate and the House. The measure would extend the existing \$8,000 tax credit for first time homebuyers and offer an additional reduced credit of \$6,500 to repeat buyers who have owned their current homes for at least five years. The tax credit was scheduled to expire at the end of November. Some industry representatives blamed the uncertainty regarding extension of the credit for September’s 3.6% fall in home sales reported by the Commerce Department.

To qualify for the extended tax credits, homebuyers must meet the following conditions:

1. Earn up to \$125,000 for individuals or \$250,000 for couples (an increase from the prior \$75,000/\$150,000 requirements);
2. Sign sales agreements by April 30, 2010; and
3. Close escrow on the purchase by June 30, 2010.

It is expected that the extended and expanded tax credit will help home building and home sales and result in a boost to the California economy. Brokers and agents will need to move quickly so that their clients can meet the time requirements to get the tax credit.

Reporting Requirements for Independent Contractors

Under Internal Revenue Code Sections 6041 and 6041A, individuals and businesses who pay \$600 or more for services performed by independent contractors for services in the course of their trade or business must file an information return Form 1099-MISC. This includes a real estate broker who pays \$600 or more for services to a real estate sales agent or to a buyer’s broker. Escrow officers normally do not have to report under IRC Section 6041A, unless they operate outside their normal escrow functions and pay \$600 or more for services, exercise management or oversight functions, and receive a financial benefit or have a financial interest in the transaction.

To assist enforcement of child support orders, California legislation went into effect on January 1, 2001, requiring most federal Form 1099 fillers to also file Form DE 542 with the California Employment Development Department (EDD). This Report of Independent Contractor(s) must be made within 20 days of either making payments totaling \$600 or more or entering into a contract for \$600 or more with an independent contractor in any calendar year, whichever occurs first. Reports can be made on-line at the EDD's website at www.edd.ca.gov.

C.A.R. Legal Hotline Service

REALTORS® have a valuable member benefit through C.A.R. -- the Legal Hotline Service. Members can speak live with an attorney regarding their transaction-based questions by calling the C.A.R. Legal Hotline during normal business hours and also on Saturdays between 10:00 a.m. and 2:00 p.m. The Legal Hotline Service provides free and confidential legal advice over the telephone on real estate related issues, including contract formation and interpretation, dispute resolution (arbitration), litigation, taxes, commission disputes, disclosure requirements, homeowners association law, and fair housing issues. The number for the C.A.R. Legal Hotline Service is 213 / 739-8282.

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