

AN OUTLINE OF CREDITOR'S TOOLS AVAILABLE TO CHALLENGE ASSET PROTECTION PLANS

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1. Planning for the Sheltering Of Assets

The importance of having a will, and taking out adequate life and disability insurance is well understood by those planning for their future, even if planning for these things does involve thinking about the potential for problems that one wants to avoid. The literature that relates to how to shelter assets are not widely circulated or discussed in planning or legal literature. Perhaps the reason why such things are not widely discussed is not that their importance is not understood, but rather that planning in this area has risks for the planners and their advisors when the method followed is not well thought out and implemented.

This presentation will try to identify the risks involved and the thinking behind the rights of creditors. The purpose is to lay the groundwork for the presentation by my colleague Paul Jacobson which sets forth the building blocks of a structure devised to withstand successful attack afterwards.

From the words used by judges in cases where creditors have attacked transfers, it appears that the most important feature of a successful asset sheltering plan is proof that adequate provision has been made to pay known debts. Another principle referred to in the decided cases is that the plan must have been set up for a legitimate purpose, such as planning for one's retirement or the education and upbringing of one's children.

The laws that apply to attacking plans, and the views expressed by the courts on attacks on transfers of assets that have been challenged will be reviewed in this paper. The balance that the law is trying to create is to allow someone to plan for their retirement and family while allowing a creditor obtaining a judgment some reasonable prospect of recovering claims for debts. Planners must educate their clients on this balance, and ensure that their plans recognize the competing interests, and make adequate provisions for payment of debts at the time of creation of the plan.

For these reasons, a plan must be implemented in times when prospects for the planner are positive. When the creditor's axe is about to fall, then the client is not a candidate for asset protection. At those times, your concern as an adviser and a planner are to avoid liability and not to get involved.

2. Transfers – Conveyances, Preferences and Impeachable Transactions

The purpose of all of the remedies available to creditors is to prevent a debtor from putting assets beyond its reach. The tools available are varied. Their aim is directed at both conveyances, which are transfers for no consideration or inadequate consideration to related parties, and preferences, which are payments to one creditor where the choice is made to pay a creditor

one would like to pay over the others. The term transfers is used in this paper as a word that refers to a conveyance and a preference.

The word “settlement” is used in different ways in various statutes. When used in the Bankruptcy and Insolvency Act R.S.C. 1985, c. B-3, as amended, (the “BIA”) it refers to a legal finding that describes a conveyance that is not allowed. This is why the term conveyance is used to refer to a transfer for no money or less than market value to a related party. Some conveyances are allowed. Others may be attacked by a creditor and found to be settlements under the BIA. The word settlement is used differently under Alberta’s Fraudulent Preferences Act R.S.A. 2000, c. F-24 (the “FPA”), where it means the same as a conveyance. So that the terms are clear in this paper, the term conveyance will be used wherever possible, and the word settlement only to point out a transaction found to be illegal under the BIA.

The party transferring assets to a related party is known as the transferor. The party that received the assets is known as the transferee. Creditors’ remedies are to set aside a transaction, and legal proceedings are brought against both transferor and transferee in a lawsuit started by a Statement of Claim or by a motion in a bankruptcy.

As sheltering plans involve conveyances, and not preferences, this paper will not consider the possible attacks on preferences, which is a complex area in its own right.

Creditors have rights to set aside transactions. The setting aside of a transaction is known as “impeaching” a transaction as described by the courts. When a transaction is set aside, this means that the court orders that an asset is available to creditors generally. This means that the asset or its monetary value is sent back in the hands and name of the transferor, which results in the asset being shared by the creditors of the transferor. This often involves the asset itself, or its value being added to the amount available for the transferor’s creditors, such as a trustee in bankruptcy or a division amongst holders of judgments. When the term “attack” is used in this paper, it refers to legal proceedings brought by creditors under the BIA, the FPA, or the Statute of Elizabeth (1571), 13 Eliz. C. 5, which is a statute of England that forms part of the law of Alberta. All three have methods of setting aside or impeaching transactions, and will be reviewed in this paper.

3. The Criminal Code of Canada and Asset Sheltering

While most planners and advisers seldom consider that their advice can be challenged in criminal proceedings, there is a concern in the asset protection field.

A person who makes a conveyance of property with intent to defraud creditors is guilty of an indictable offence by virtue of Section 350 of the Criminal Code of Canada. Also, the Criminal Code of Canada has a provision where those who counsel participants or become a party to a fraud, assisting in either fraud or unlawful schemes, may carry potential professional liability. For lawyers, chapter 9, Rule 11 of the Code of Professional Conduct states that “A lawyer’s duty to uphold the law, and the high standards of conduct expected of lawyers generally, prohibit counseling, encouraging or assisting in conduct that is criminal or fraudulent” and “... a lawyer may not act in furtherance of a client’s improper objective”.

Fraud, when used in the criminal sense, has been defined to mean “dishonest deprivation” by the Supreme Court of Canada in **R v. Olan, Hudson and Malwett** (1928) 41 CCC (2d) 145 (SCC). This test is a strong one for the crown to prove. There are no cases that were found when preparing this paper that apply the criminal test to asset sheltering plans. In fraud cases generally, the reported cases that have led to criminal charges involve backdating transfers where false documents are used to suggest that transfers happened before they really did. Commentators, such as Nigel Howcroft, in article entitled **Scope of Fraudulent Conveyances and Fraudulent Preferences Legislation in Alberta**, (1986) Alberta Law Review, volume XXIV, page 496, have suggested that an accused will be acquitted if an honest ulterior objective might have existed. Certainly, the standard of proof of beyond a reasonable doubt would apply, which is higher than the civil standard of a balance of probability. The concept of “intent to defraud” used in Section 350 of the Criminal Code of Canada is much harder to establish than the concept of an “intent to injure, delay or prejudice” which are in the FPA. Similar words to the FPA are used in the Statute of Elizabeth.

While criminal charges under very rare, their potential should reinforce the need to document how and when a plan was set up, and to record its objectives. It also stresses the importance of avoiding transactions where the owner of the assets has too many debts, or leaves no assets for creditors.

4. The Fraudulent Preferences Act

Alberta’s FPA directs itself to both “conveyances and settlement” by Section 1 thereof. It states that such conveyances and settlements are “void as against creditors injured, delayed or prejudiced by them” by Section 3 of the FPA.

The other branch of the wording of Section 1 is that it applies only to attempts to injure, delay or prejudice creditors. Section 3 of the FPA assists a creditor greatly by providing that if a transaction is attacked within one year, then the intent to injure, delay or prejudice is deemed to have occurred.

The deeming of fraudulent intent is very useful to a creditor, as proving intent is the determining of what was in the mind of a transferor and transferee is difficult. To have the intent deemed to occur means that the creditor no longer has to establish what was in the mind of the transferor as expressed in Section 3 within the one-year period.

There are conflicting legal decisions about the effect of the deeming provision. One line of cases, which follows the English decision in **Freeman v. Pope** (1970), 5 Ch. App. 538 (English C.A.), holds that the deeming is conclusive. Recent cases, including **Rogers Realty Ltd. v. Prysiazry** (1996) 182 A.R. 118 (Alta Q.B.), have held that the deeming only occurs where, following a transfer, a transferor is both insolvent and has no property to satisfy its creditors. Other cases, such as **Faulhaber v. Ulseth** [1976] 4 WWR 48 (Alta T.D.) explain that the deeming provision means that the burden to disprove intent to injure, delay or prejudice shifts to the transferor.

Many other cases interpreting the FPA discuss the legal principles of whether a transfer was done with intent to defeat creditors, which will be dealt with in section seven of this presentation. These cases only apply one year after a transfer. For this reason, in the first year after a transfer is done for the best of purposes, any transfer is subject to possible attack under the FPA by a creditor.

Section 1 of the FPA has been interpreted to mean that only a creditor who was a creditor at the time of the conveyance may advance a claim under the legislation. It is a complete defence to an attack under the FPA to show that a creditor was not owed money when the conveyance was done. The other defence available to an FPA attack is that the transferor was solvent at the time of the transfer, even though the transferor became insolvent before the proceedings under the FPA were brought. The reason this is a defence is that the issue of intent to injure, delay or prejudice is determined at the time of the transfer. Please refer to the cases discussed under the discussion of fraudulent intent in section seven of this paper. The cases that hold that the issue of whether other assets were available to satisfy creditors are the ones relied upon.

The FPA has no limitation period in it specifically, so that the two-year and ten-year time limits in the Limitations Act would apply. This is discussed in section ten of this paper. While the time limits are longer than one year, the creditor whose action is commenced more than one year after a transfer must then prove the additional required element, which is that the transferor had an intent to injure, delay, prejudice or postpone payment, which is a greater burden. Once again, the discussion of what is required is in section seven of this paper.

5. The Bankruptcy And Insolvency Act

The next method of attack available to a trustee or bankruptcy, or to a creditor, who applies for the power where a trustee will not (Section 38 of the *BIA*) is under Sections 91 to 96 thereof. The prohibition in Section 91 has two branches. The first is that any "settlement of property made within one period beginning on the day that is one year before the date of the initial bankruptcy event of in respect of the settlor and ending on the date that the settlor became bankrupt, both dates included, is void against the trustee." The second branch is that "Any settlement of property made within the period beginning on the date that is five years before the date of the initial bankruptcy event in respect of the settlor and ending on the date that the settlor became bankrupt is void against the trustee if the trustee can prove that the settlor was, at the time of making the settlement, unable to pay all the settlor's debts without the aid of the property comprised in the settlement ...". This means that a transfer that took place within the one-year period preceding bankruptcy will be considered a "settlement" and be subject to be declared void. The only issue is whether a settlement as defined in legal cases interpreting the *BIA* took place. Where you are within the prescribed time limits, this is the most efficient way to set aside a transaction, as intention is not relevant.

Settlement as used in the *BIA* has been recently defined in several court decisions. In **Amex Bank of Canada v. Grant Donovan Bank** (1997) 190 A.R. 307, 1460 DLR (4th) 55 (Alta C.A.), the Alberta Court of Appeal defined settlement as "... any disposition whereby the property is held or retained or preserved for the benefit of the donee". To establish a settlement, the trustee must show that property was to be preserved for the transferee. This applies to most asset protection plans. A classic case of a finding of settlement is where the property is transferred from one family member to another. While the previous cases, such as **Wilson v. Doane Raymond Ltd.** (1988), 69 C.B.R. (NS) 146 (Alta. C.A.), expanded the meaning of settlement to include any disposition which had the effect of reducing assets available from the bankrupt's estate for distribution among creditors, the amendments to the definition of settlement in the *BIA* and the **Amex** decision, have limited its application to dispositions of assets to family members. Note that transferring assets to a trust has been defined as a settlement in **First Canadian Land Corp v. First Canadian Plaza Ltd** (1991), 6 C.B.R. (3d) 308 (B.C.S.C.).

It is not a defence under the one-year attack under the *BIA* to establish that the transferor was solvent at the time of the transfer. Where a settlement occurs, the transaction is simply void. Planners of transfers of real property to spouses or family members or to trusts must recognize the potential for the transaction being a settlement under the *BIA*. This means a probable setting aside or impeachment of a transaction if the transferor should become bankrupt within one year of the transfer. No form of asset sheltering plan will avoid the setting aside of a transaction, so that the way to avoid it is not to go bankrupt within a year of settling assets on a spouse, relative or trust.

The second branch of the BIA attack relates to transfers done within a five-year period preceding bankruptcy of the transferor. It allows a settlement to be set aside where, at the time of the settlement, the transferor was unable to pay the transferor's debts without considering the value of the property transferred. There is still no factual issue of fraudulent intent. The factual issue for attacks under the BIA of conveyances done between one and five years preceding bankruptcy is really whether the transferor had other sufficient assets to pay creditors at the time of the conveyance. It is a defence to any attack under the BIA after one year for the transferor to prove that there were sufficient assets available to pay known creditors at the time of the conveyance.

6. The Statute of Elizabeth

The Statute of Elizabeth provides that grants, alienations and conveyances of lands or goods "for the purpose and intent to delay, hinder or defraude Creditors and others" shall be "utterly voyde frustrate and of none Effecte" against creditors and others whose suits "shall or mought be in any wyse dysturbed hyndered delayed or defrauded". It forms part of the laws of Alberta **Toronto-Dominion Bank v. Michael** [1973] WWR 656, 32 DLR (3d) 498 (Alta. C.A.). The factual issue is whether the disposition had the intention to delay, hinder and defraud one's creditors.

The Statute of Elizabeth is chosen by creditors who are too late under the one-year provision under the BIA, and where the transferor was solvent at the time of the transfer or where the party bringing the attack was not a creditor of the transferor. Either of these things would invalidate a claim under the FPA.

The issue as to whether the Statute of Elizabeth applies is whether a court is able to conclude that a transferor intended to "delay, hinder or defraud" creditors.

7. Intent to Injure, Delay or Prejudice Creditors

Under the Statute of Elizabeth, attacks are made against any conveyance done to delay, hinder or defraud a creditor (modernizing the precise language used). Under the FPA, the test of whether a transferor had fraudulent intent is whether the conveyance injured, delayed or prejudiced creditors. Fraudulent intent is measured using the factual test of intention to injure, delay or prejudice creditors. For practical purposes, the factual issue under both is virtually identical. Creditors often attack under both statutes in one proceeding. The FPA attack is not included where the creditor was not a creditor of the transferor at the time of the conveyance.

Courts have referred to, what they term, "badges of fraud" to assist in determining whether a transaction is impeachable based on intent where this is a

necessary element. Once again, this is a necessary element of all cases under the Statute of Elizabeth and all cases after one year from the date of transfer under the FPA.

Badges of fraud referred to in various legal cases include the following:

- (a) continued possession or occupation of the “transferred” property by the debtor;
- (b) non-arms'-length relationship between the debtor and the transferee;
- (c) attempts to keep the transfer secret or hidden;
- (d) a false declaration of valuable consideration being paid by the transferee;
- (e) a transfer at or near the time when serious demands for payment were being made against the debtor;
- (f) a lack of consideration by the transferee; and
- (g) a lack of remaining assets in the debtor.

A complete list of the badges of fraud is found in section 82(2) in the text authored by Holden & Morawetz entitled **Bankruptcy and Insolvency Law of Canada** 3rd edition. While these badges of fraud are often referred to in the cases, they are of assistance, none by themselves are conclusive evidence of fraud **Meeker Cedar Products Ltd v. Edge** (1968), 12 C.B.R. (N.S.) 49, 68 D.L.R. (2d) 294 (S.C.), affirmed (1967), 12 C.B.R. (N.S.) 60 (S.C.C.).

While there is no clearly enunciated test, there is a clear and emerging line of cases which state that the required intent will only be found where the transfer left the transferor with insufficient assets to pay known creditors. **Burton v. R&M Insurance Ltd. and Poole** (1977), 9 A.R., 589 (T.D.) and **Rogers Realty Ltd. v. Prysiazny** (1996), 182 A.R. 118 (Q.B.), **Mandryk v. Merko** [1971] 2 W.W.R. 542 (Man. C.A.) and **Faulhaber v. Ulseth** [1976] 4 W.W.R. 48 (Alta T.D.).

A transfer done leaving sufficient remaining assets to pay creditors will most probably defeat a creditor's attack under any legislation, with the exception of the **BIA** challenge within one year of the transfer.

8. Trends in Exemptions and the *Civil Enforcement Act*

Exemptions allow a person against whom there is a judgment or bankruptcy to preserve some of their assets. These are assets that are exempt

from seizure and sale. For most persons, the most significant asset they own is their family home.

As of December 1, 1984, Alberta's Exemptions Act established an exemption of \$40,000 that could be claimed by each owner of an interest in land in an urban setting. Each city dweller could protect up to \$40,000 of their personal equity. If there were two owners of one property, the exemptions would shelter \$80,000 in equity.

In 1995, by virtue of the Civil Enforcement Act R.S.A. 2000, c. C-15, the change that took place was that city dwellers were left with one \$40,000 exemption for each principal residence. If you are one of two co-owners, the value of your exemption was effectively reduced to \$20,000.00.

While inflation and the relative buoyancy of the economy have driven up the values of assets generally, the exemptions available on the most significant asset people own have reduced in amount and in value over the last twenty years.

The decision in Re Sawatsky, (2001) 295 A.R. 282 (Alta Q.B.) supports the view that the transfer to a spouse of the home while in bankruptcy results in a fraudulent preference for the amount of equity in excess of one's personal exemption. It also confirms that while in bankruptcy, one can voluntarily sell exempt property, and retain only the exemption amount.

9. Converting Exempt Assets to Non-exempt Assets

Several legal cases have considered cases where a person in financial difficulty has exchanged non-exempt assets, such as ordinary Registered Retirement Savings Plans (RRSPs) into annuities or RRSPs sold by life insurers which are exempt from creditor's claims. In the landmark Supreme Court of Canada decision in Ramgotra (Trustee of) v. North American Life Insurance (1996), 37 C.B.R. 141 (S.C.C.), it was held that a transfer from a non-exempt RRSP assets to a RRIF was not a settlement within the meaning of the BIA. The Court concluded that persons cannot "settle" assets on themselves by transferring in this manner. While the designation of a beneficiary may have been a conveyance that injured, delayed or prejudiced creditors, the court found that this was not the transferor's intent, and thus the transaction was allowed.

This is a very significant planning consideration as far as establishing that transferring from non-exempt to exempt assets is allowed.

However, care must be shown, as the best defence to attacks on other planning tools is to establish that that other assets left available to satisfy creditors.

10. The Income Tax Act

The Minister of National Revenue has a power under Section 160 of the *Income Tax Act* R.S.C. 1985, c.1 (5th Supp.) to challenge transfers of property for the purposes of evading payment of taxes owed by the transferor. The section applies to transfers, which are defined very broadly. In **Wannan v. Minister of National Revenue** 2003 D.T.C. 76, a transfer was defined to mean any act of the parties by which title is conveyed from one person to another. The section applies “Where a person has transferred property, either directly or indirectly, by means of a trust or by any means whatsoever”. Thus, a transfer to a trust is reviewable under this section. Transfers to spouses, infants and persons with whom a person is not at arm’s length are all specifically defined as subject to this section.

Where you have such a transfer, specific rules apply. The transaction is not set aside, as is the case with attacks by other creditors reviewed in this paper. Rather, the transferor and the transferee are jointly and severally liable to pay the lesser of two sums. The first amount is the difference between the fair market value and the amount for which it is transferred. The second sum is the “Aggregate of all amounts each of which is an amount that the transferor is liable to pay under this Act or in respect of the taxation year in which the property was transferred or in any preceding tax year.” This allows the Minister to challenge any transfer where the transferor owed money in the year of the transfer and any preceding year.

The bankruptcy of the transferor will eliminate the tax liability of the transferor, but the transferee will still be bound by this section for the amount of money the transferor owed up to the value of the transfer **Heavyside v. R.** (1996) F.C.J. No 1608 (Fed C.A.).

11. The Limitations Act

In the previous sections of this presentation, it was noted the deeming provisions of the FPA applied only in the first year after the conveyance. Also, it was noted that under the BIA, certain conveyances could be set aside if done within one year of the bankruptcy. These are not limitation periods, but laws that increase the chance of a successful attack on a conveyance.

Under Alberta law, there is a two-year limitation period that applies to all claims for “remedial orders” as defined in Section 1 of the Limitations Act R.S.A. 2000, c. L-12. Remedial orders are also defined to mean any judgment or order requiring or directing a legal person to perform a duty or pay damages for violation of a right also in accordance with Section 1 of the Limitations Act. The limitation period in relation to claims runs for two years beginning on the date that a “... claimant knew, or in the circumstances ought to have known, of a claim ...” by Subsection 2(2) of the Limitations Act.

The two-year limitation applies where a creditor knew or ought to have known that an asset was transferred. One can foresee cases where a creditor will be able to say that they just found out about a conveyance, and thus are able to extend the starting time of the two-year limitation period. If a claim is brought after the limitation period, then the person against whom it is brought is entitled to immunity from liability by Subsection 2(2) of the Limitations Act. The period is suspended for any time that a defendant fraudulently conceals the fact that the injury for which a remedial order is sought by Subsection 4(1) of the Limitations Act. The longest period within which an action can be brought is ten years from when the claim arose by Section 11 of the Limitations Act.

There is a five-year period under the BIA. There are no cases explaining that the five-year period in the BIA overrides Alberta's two and ten year limitation periods. In the Quebec decision of **Gingras v. General Motors of Canada Ltd**, (1976) 1 S.C.R. 4265 (S.C.C.), it was held that the five year period in the BIA was time that applied where this conflicted with the period under provincial law, as this was the wording of the federal legislation. It is highly probable that the five-year limitation would apply, but there are no Alberta cases on this point.

SUMMARY

As outlined above, legal proceedings can be brought by creditors under various Alberta laws in order to set aside a transaction by a transferor and make his or her assets available to creditors generally.

Under the FPA, if a transaction is attacked within one year, the intent to injure, delay or prejudice creditors, is deemed to have occurred. However, to successfully attack the transaction, a creditor must show that the transferor was insolvent at the time of the transfer and that he or she was a creditor at the time of the transaction. If the transaction is not attacked within one year of the transfer, then the proceedings must be commenced either within two years after the date on which the creditor first knew of the transaction, or within ten years after the action (transaction arose), whichever period expires first. In cases where a creditor commences the proceedings more than one year after a transaction has occurred, there is a much higher burden of proving the intent to injure, delay, prejudice or postpone payment.

The BIA provides a trustee in bankruptcy, or creditor with a means to attack a settlement of property. There are two time frames under the BIA that allow settlements to be set aside. Firstly, if the transferor makes a settlement within one year before the date of a bankruptcy event of the transferor, the settlement is void as against the trustee. Proving solvency at the time of the settlement will not prevent the settlement from being void.

The BIA five-year limitation period will apply to allow the settlement to be void as against the trustee, if the trustee can prove that the transferor was, at the time of making the settlement unable to pay all of the transferor's debts without the aid of the property comprised in the settlement. Intention of the transferor is not relevant in finding the settlement void, but it is a defence to any attack under the BIA after one year for the transferor to prove that there were sufficient assets available to pay known creditors at the time of the transfer.

Finally, the Statute of Elizabeth allows creditors to attack a transfer where proceedings are commenced too late under the one-year provision of the BIA, or where the transferor is solvent at the time of the transfer, or where the party bringing the attack is not the creditor of the transferor. These are the cases where a trustee or other creditors are using this statute, as these claims cannot be brought under the FPA.

Also, remember to ensure there is no tax liability left owing to the Minister at the time of a transfer to avoid a challenge under Section 160 of the *Income Tax Act*.