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Asset Protection Planning
Part I

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This is the first of two articles on asset protection planning. This article will review the various statutory and common law rights and remedies available to creditors and trustees in bankruptcy to attack unlawful payments and transfers of property, and what constitutes an unlawful payment or transfer of property for these purposes. The second article will discuss various planning alternatives available to solvent persons to protect their assets from the claims of creditors and trustees in bankruptcy.

Asset protection[1] is the protection of assets from creditors. Individuals and businesses engaged in risky enterprises or activities understandably wish to protect their assets and business operations from creditors and potential creditors.

A properly implemented and timed asset protection plan will protect assets from creditors and potential creditors and otherwise operate as an effective method of self-insurance.

Asset protection planning is often intertwined with tax and estate planning.

The best time to implement an asset protection plan is at the outset or significant expansion or financing of a business enterprise, and when an individual or business is solvent – that is able to meet liabilities as they become due – and there are no claims or foreseeable claims by

Inside

creditors or potential creditors which might render the individual or business insolvent.

An asset protection plan becomes more prone to attack by creditors (including taxation and other governmental authorities, lenders, guarantee holders, suppliers and other trade creditors, successful litigants, employees, and former spouses) as the individual or business approaches insolvency either as a result of the accumulation of excessive debts and other liabilities and/or as a result of successful claims by third party litigants.

There are numerous statutory and common law rights and remedies available to creditors and trustees in bankruptcy in the event an insolvent person or person who subsequently becomes insolvent makes a payment or transfer of property in a manner which is intended to or in fact unlawfully defeats or diminishes the claims of a creditor or trustee in bankruptcy against the person's assets. These rights and remedies generally afford creditors and trustees in bankruptcy the right to set aside unlawful transfers of property or payments of money or to seek compensation from property transferees or payees. And, in appropriate circumstances, these rights and remedies may be used by creditors and trustees in bankruptcy to attack estate and tax planning transactions which involve the transfer or payment of property, notwithstanding that the transfer or payment was carried out solely for estate or tax planning purposes, and not for asset protection purposes.

Most of the statutory remedies available to creditors or trustees in bankruptcy in Ontario are set out in the *Bankruptcy and Insolvency Act* (Canada), the *Assignments and Preferences Act* (Ontario), the *Fraudulent Conveyances Act* (Ontario), the *Bulk Sales Act* (Ontario), and specific creditor protection provisions in the *Business Corporations Act* (Ontario), the *Canada Business Corporations Act*, and the *Income Tax Act* (Canada). One should also keep in mind the fraud and related offence provisions of the *Bankruptcy and Insolvency Act* (Canada) and the *Criminal Code* (Canada).

The determination of whether a particular asset protection plan, whether tax motivated or not, will be successful or not will depend upon an analysis of, (i) the availability or not of creditor or trustee in bankruptcy rights to attack the plan, and (ii) the motivation of creditors or trustees in bankruptcy to spend the time and money required to attack the plan.

Rights of Creditors and Trustees in Bankruptcy to Attack Unlawful Property Transfers and Payments

Fraudulent Assignments and Conveyances Under the Fraudulent Conveyances Act (Ontario) and the Assignments and Preferences Act (Ontario)

The *Fraudulent Conveyances Act (Ontario)* ("FCA") and the *Assignments and Preferences Act* (Ontario) ("APA") contain parallel remedies regarding fraudulent assignments and conveyances. The general principle of the remedy is that a person has the primary obligation to pay creditors before conducting dispositions of property to the detriment of those same creditors. It should be noted that the word "fraudulent", to the extent that it is used to modify an assignment or conveyance under the FCA or APA, is used here in a civil sense – a "fraudulent" assignment or conveyance under the FCA or APA gives rise to a civil remedy (the voiding of a transaction) - rather than a quasi-criminal or criminal sense, as in the case of offences involving fraud under the *Criminal Code* (Canada) or the *Bankruptcy and Insolvency Act* (Canada). Transactions which are criminally fraudulent are addressed separately below.

Section 2 of the FCA provides that a conveyance of real or personal property with the intent to defeat, hinder, delay or defraud creditors or others (including potential creditors) is voidable at the instance of such persons and their assigns. There is a saving provision in Section 3 of the FCA, which provides that a conveyance of real or personal property is not voidable where it occurs for "good consideration and in good faith to a person not having at the time of the transfer to the person notice or knowledge of" the transferor's fraudulent intent.

Subsection 4(1) of the APA provides that a gift, conveyance, assignment or transfer, delivery over or payment of real or personal property made by a person when insolvent or unable to pay the person's debts in full or when the person knows that he, she or it is on the eve of insolvency, with intent to defeat, hinder, delay or prejudice creditors is voidable at the instance of such creditors who are injured, delayed or prejudiced as a result of the transfer or payment of property. Again, there is a saving provision in section 5 of the APA, which provides that a sale or payment of property is not voidable where it is made, "in good faith in consideration of a present actual payment in money, or by way of security for a present actual advance of money, or that is made in consideration of a present actual sale or delivery of goods or other property where the money paid or the goods or other property sold or delivered bear a fair and reasonable relative value to the consideration therefor".

Note that, in contrast to section 2 of the FCA, a creditor proceeding under subsection 4(1) of the APA must prove that, at the time of the transfer of the real or personal property, the transferor (i) was insolvent, (ii) was unable to pay the transferor's debts in full, or (iii) knew that the transferor was on the eve of insolvency.

Both the FCA and the APA require that the transferor have, at the time of the transfer of real or personal property, an intent to "defeat, hinder, delay or" [FCA and APA] "defraud" [FCA] or "prejudice" [APA] "creditors" [FCA and APA] or "others" [FCA].

In determining whether the requisite fraudulent intent exists in any particular case, the courts have developed a set of inferences, or "badges" of fraud, to infer a transferor's fraudulent intent in any particular case. If these factual indicia are present, a court will infer the necessary fraudulent intent on the part of the transferor without requiring that the creditor prove the transferor's actual state of mind at the time of the subject transfer or payment of property. The "badges of fraud" include the following circumstances, (1) the transferor is in a precarious financial situation; (2) the transfer is to a related party, (3) the transferor retains an ownership or other interest (e.g. use or enjoyment) in the transferred property following the transfer, (4) the effect of the transfer of property is to delay or defeat creditors by removing the transferred property from the pool of the transferor's assets which would have otherwise been available to satisfy creditors, (5) knowledge of the transferee that the transferred property is worth substantially more than the transferee is paying for it, (6) the transfer is carried out in secret, (7) the consideration paid by the transferee is inadequate or non-existent, (8) the transfer is carried out with unusual haste, (9) there is no coincident change in possession of the transferred property, and (10) the transfer documentation is falsified or non-existent.

The presence of one or all of the above "badges of fraud" may raise a presumption of fraudulent intent against one or both of the parties to the transfer of property. In such case, the transferor (or both the transferor and the transferee) will bear the onus of proving they had no intent to defeat, hinder, delay, or defraud creditors by leading cogent and affirmative evidence that the transferor had an honest purpose, and that the parties had no intention to defeat, hinder, delay or defraud creditors.[2]

Again, however, even if the requisite intent is inferred by virtue of the presence of one or more "badges of fraud", a transfer of property is not void as against the transferor's creditors if it was made, (1) for "good consideration" [FCA] or "in consideration of a present actual payment in money, or by way of security for a present actual advance of money, or that is made in consideration of a present actual sale or delivery of goods or other property where the money paid or the goods or other property sold or delivered bear a fair and reasonable relative value to the consideration therefor" [APA], and (ii) in "good faith to a person not having at the time of the conveyance to the person notice or knowledge of the [transferor's fraudulent] intent" [FCA] or "good faith" [APA]. Note the slightly different language used in the FCA and the APA. A transfer for natural love and affection would not satisfy the good consideration exception in either the FCA or the APA.

A transfer of property between husband and wife for lawful estate or tax planning purposes and on the advice of professional advisors is not, in and of itself, evidence of an intent to defeat creditors.[3] The transfer of a one-half interest in a matrimonial home to a wife was held to be made for good consideration, as she would have claimed the one-half interest under provincial family law legislation.[4] A transfer by a wife to her father-in-law who built a house on the lot that was used by the wife and her husband was set aside as a fraudulent conveyance.[5] A disclaimer of a beneficiary's interest under a will is not a conveyance and cannot be attacked.[6]

Fraudulent Preferences Under the Assignments and Preferences Act (Ontario) and the Bankruptcy and Insolvency Act (Canada)

The fraudulent preference remedy is based upon the principle that all ordinary creditors of a debtor should rank equally (subject to their rank amongst themselves), and no single creditor should receive preferential treatment over the other creditors (again subject to their rank amongst themselves). The remedy is available to creditors or trustees in bankruptcy under either the APA or the *Bankruptcy and Insolvency Act* ("Canada") ("BIA"). The remedy is against both the creditors of the insolvent person and the insolvent person itself.

This remedy is frequently used to attack the following types of transactions, (1) conveyances or transfers of property made in favour of a creditor, (2) charges/ mortgages on property of the debtor, (3) payments made to other equal ranking or subordinate creditors, (4) obligations incurred to creditors, including financial compromises, and (5) judicial proceedings taken by creditors, e.g. a landlord exercising self-help distress remedies against the assets of the debtor which give the landlord more than what would have been obtained in a bankruptcy.

Subsection 4(2) of the APA provides that every gift, conveyance, assignment or transfer, delivery over or payment made by a person being at the time in insolvent circumstances, or unable to pay his, her or its debts in full, or knowing himself, herself or itself to be on the eve of insolvency, to or for a creditor with the intent to give such creditor an unjust preference over one or more other creditors is voidable at the instance of such creditors injured, delayed, prejudiced or postponed by such preference.

Note that the debtor must at the time of the preference be in insolvent circumstances, or be unable to pay his, her or its debts in full, or must know himself, herself or itself to be on the eve of insolvency.

Unlike a fraudulent assignment or conveyance, which generally involves a transfer of property between a debtor and a non-creditor third party, a fraudulent preference generally involves a payment by a debtor to a creditor in whole or part satisfaction of the creditor's claim against the creditor and in "preference" to other creditors. Having said this, a fraudulent preference may also be a fraudulent conveyance.

Subsection 4(3) of the APA contains a presumption, in the absence of evidence to the contrary, that the fraudulent intent required by subsection 4(2) will have been present where the subject transaction ("whether it be made voluntarily or under pressure") with or for the benefit of the creditor has the effect of giving that creditor a preference over other creditors of the debtor and where the aggrieved creditor brings an action to set aside the transaction as an unjust preference within 60 days of the occurrence of the transaction.

The presumption can be rebutted, and the courts will usually look to the facts in each case to decide that point. For instance, the debtor company may be completely unaware that it is insolvent. This may not be a fact known to the creditor.

Again, however, subsection 5(1) of the APA contains a good faith, good consideration exception to the unjust preference rules in subsection 4(2) and (3). Subsection 5(1) provides that any payment of money to a creditor that is made in good faith in consideration of a present actual payment in money or by way of security for a present actual advance of money shall not be an unjust preference under subsection 4(2) and (3) where the money paid bears a fair and reasonable relative value to the consideration therefor. Accordingly, payments made for transactions carried out in the "ordinary course of business" are protected. Such protected "ordinary course" transactions might include transactions undertaken by a debtor to take advantage of favourable payment terms or unique supply opportunities, or purchases of goods which are required by the debtor in order to remain in business. Further, transactions which are not in the ordinary course of business but which the debtor believed were necessary to ensure the survival of the debtor's business are protected.

Paragraph 95(1)(a) of the BIA provides, in a manner similar to subsection 4(2) of the APA, that every transfer of property, every provision of services made, every charge made on property, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors is, when it is made, given, incurred, taken or suffered within the period beginning on the day that is 3 months before the date of the "initial bankruptcy event" and ending on the date the insolvent person became "bankrupt", both dates included, deemed fraudulent and voidable on the initiative of the trustee in the bankruptcy. The 3-month period is extended under paragraph 95(1)(b) to one year if the transfer, charge, payment, obligation or judicial proceeding is in favour of a person who is not dealing at arm's length with the insolvent person. In addition, where the transfer occurs between non-arm's length parties, it is not necessary to prove that the transfer was made "with a view" to preferring one creditor over another, but merely that the transfer "had the effect" of preferring one creditor over another.

A person may become "bankrupt" in one of 4 ways:

1. The insolvent person makes an assignment in bankruptcy.[7] In this case, the "initial bankruptcy event" is the date which is 3 months prior to the date that the assignment is filed, and the preference period ends on the date that the assignment is filed (the date of bankruptcy).

2. A receiving order is made against the person following the issuance out of the Bankruptcy Court of a petition for a receiving order.[8] In this case, the "initial bankruptcy event" is the date which is 3 months before the date the petition is filed, and the preference period ends on the date the receiving order is granted against the person (the date of bankruptcy).

3. The insolvent person makes a proposal to its creditors pursuant to section 50 of the BIA. Prior to filing a proposal, an insolvent person may file a notice of intention to make a proposal in order to take advantage of the stay of proceedings contained in section 69 of the BIA. Where an insolvent person who has filed a notice of intention to make a proposal fails to comply with the requirements of the BIA, or where a proposal is made but is not approved by the requisite majority of creditors or, if so approved, is not approved by the Bankruptcy Court, the insolvent person will be deemed to have made an assignment in bankruptcy. In this case, the "initial bankruptcy event" is the date which is 3 months before the earliest of the date the notice of intention to make a proposal, if any, was filed and the date the proposal was filed. The preference period ends on the date of the event that caused the assignment by the person to be deemed to have occurred (the date of bankruptcy).

4. The Bankruptcy Court may annul a voluntary proposal under the BIA by an insolvent person where the proposal was otherwise approved by the requisite majority or majorities of creditors, and by the Bankruptcy Court, but where the insolvent person subsequently defaults in compliance with its terms. Where the Court annuls the proposal, the insolvent person will be deemed to have made an assignment in bankruptcy on the date the proposal was annulled. In this case, the "initial bankruptcy event" is the date which is 3 months before the earliest of the date the notice of intention to make a proposal, if any, was filed and the date the proposal was filed. The preference period ends on the date of the event that caused the assignment by the person to be deemed to have occurred, that is the date of the order annulling the proposal (the date of bankruptcy).

Where a transfer of property occurs between arm's length parties, subsection 95(2) of the BIA contains a rebuttable presumption similar to that in subsection 4(3) of the APA. Under subsection 95(2) of the BIA, if any conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in paragraph 95(1)(a) has the effect of giving any arm's length creditor a preference over other creditors, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure.

This rebuttable presumption does not apply to a non-arm's length transfer of property, which are impugned in the first instance under paragraph 95(1)(b) if it has the effect of preferring one non-arm's length creditor over another creditor.

The presumption may be rebutted, on a balance of probabilities, under a number of circumstances, including where the payment is made in the ordinary course of business, the payment is made pursuant to a prior agreement with a creditor, the payment is required to enable a debtor to carry on business, and security is given to secure a present advance by a creditor.

Outside of the 3-month and one-year periods set out in the BIA, a trustee in bankruptcy would have to look to the APA, which has been found to have a limitation period of 6 years[9]. However, it has otherwise been determined that an action based on a fraudulent conveyance may not be subject to any limitation period.[10]

The effect of a successful action under either the BIA or APA is that a judgement for the value of the preference will be assessed against the creditor who received the preference. If the preference involved the payment of money, then judgement will be made against the creditor for the payment of the amount of money paid. If goods are available, return of the goods may be ordered to the trustee in bankruptcy under the BIA, or otherwise the judgement will be made for the value of those goods at the time of their transfer. Costs will be assessed against the creditor, together with a set-off of any claim entered in the estate in bankruptcy by that creditor to the estate of the bankrupt, if the claim is otherwise valid.

An example of a preference might be, where an individual has advanced unsecured sums to a spouse, the individual subsequently takes back security after the spouse encounters financial difficulty.

Transfers at Undervalue Under the Bankruptcy and Insolvency Act (Canada)

Until recently a trustee in bankruptcy may have attacked a transfer of property as a "settlement" or a "reviewable transaction" under the BIA. These rights and remedies were available only to trustees in bankruptcy, and only against persons who were bankrupt under the BIA. Further, they were only available as against transactions which occurred within certain time periods prior to bankruptcy. Transactions which occurred even a day outside of these time periods were not attackable under the BIA. This may have created some uncertainty when creating an asset protection plan, as it may have been difficult to predict if and when a bankruptcy might occur. If a trustee in bankruptcy wished to attack a transaction which occurred outside of these fixed time periods, the trustee must have attempted to avail itself of other remedies described elsewhere in this article, including under the FCA and the APA.

In September, 2009, the "settlement" and "reviewable transaction" provisions of the BIA were replaced with a single provision dealing with "transfers at undervalue" between both arm's length and non-arm's length parties. These amendments were introduced in an attempt to broaden the previous "settlement" and "reviewable transaction" rules and the persons from whom a trustee in bankruptcy might seek redress. Having said this, the following review of the now replaced "settlement" and "reviewable transaction" rules it is useful in identifying how the new "transfer at undervalue" rules will likely operate.

Settlements

Prior to September, 2009, a "settlement" of property was void as against a trustee in bankruptcy if it was:

(a) made during the period that was one year before the date of the "initial bankruptcy event" (see discussion above) in respect of the bankrupt settlor and which ended on the date that the settlor became "bankrupt" (see discussion above), both dates included,[11] regardless of whether the now bankrupt settlor was insolvent at the time of the making of the "settlement" of property; and

(b) made during the period that was 5 years before the date of the "initial bankruptcy event" in respect of the bankrupt settlor and which ended on the date that the settlor became "bankrupt", both dates included[12] if the trustee proved that the now bankrupt settlor was, at the time of making the "settlement" of property, unable to pay all the settlor's debts without the aid of the property that was the subject of the settlement or that the interest of the settlor in the property did not pass on the making of the settlement.

For this purpose, section 2 of the BIA contained a non-exhaustive definition of a "settlement" of property as including a contract, covenant, transfer, gift and designation of beneficiary in an insurance contract, to the extent that the contract, covenant, transfer, gift or designation was gratuitous or made for merely nominal consideration. This definition supplemented the common law definition of a "settlement". And although there appeared to be some differing views, a "settlement" at common law was generally considered to occur when "a disposition of property reduce[d] the bankrupt estate available to the trustee for distribution to creditors"[13]. Earlier cases had defined a settlement as requiring the contemplation by the settlor (at the time of the transfer of property and on an objective basis) that, in connection with a transfer of property, the transferred property be preserved in its present form or in such form as it could be traced.[14] In this regard, it appeared sufficient that the retention of the property or its proceeds be merely contemplated, since the transferee might be free to deal with the transferred property as he or she pleased. Moreover, the "contemplation" of the retention of the property or its proceeds might have been made manifest from the nature and circumstances of the transaction itself.[15]

A "settlement" of property was voidable only upon the settlor's bankruptcy and at the instance of a trustee in bankruptcy, with the effect that the settled property became the property of the trustee in bankruptcy. Accordingly, a settlement of property was not voidable without the appointment of a trustee in bankruptcy, and was void only then where the trustee acted to set aside the impugned transaction as a settlement.

"Debts" might have included a contingent liability under a guarantee where the guaranteed loan or debt was in default and where the guarantor had insufficient assets to satisfy its obligations under the guarantee.

Subsection 91(3) of the BIA contained an exception to the above rules for a "settlement" of property made in favour of a purchaser, incumbrancer or holder of a charge in "good faith and for valuable consideration". Such "settlements" were respected and were not be voidable at the instance of a trustee in bankruptcy.

Examples of a "settlement" of property which were void as against a trustee in bankruptcy if they occurred within the above one or 5 year periods of a bankruptcy included, (i) a gift or nominal consideration transfer of a residence to a spouse or other family member, (ii) the designation of a spouse as a beneficiary under a life insurance policy[16], (iii) the conversion of an RRSP to an annuity naming the spouse as a beneficiary on death[17] (although the purchase of an RRSP annuity in and of itself is not a settlement[18]), and (iv) the entering into of a shareholders' agreement which provides for the buyout of an insolvent shareholder at a discount.

However, a transfer of an interest in a home to a spouse in satisfaction of a matrimonial right under provincial family legislation or a valid marriage contract might not have been a void settlement.[19]

Reviewable Transactions

In addition and prior to September, 2009, a court may, on the application of a trustee in bankruptcy, have reviewed a sale, purchase, lease, hire, supply or receipt of property or services in a "reviewable transaction" which occurred within the period beginning on the day that was one year before the date of the "initial bankruptcy event" (see discussion above) and ending on the date of the bankruptcy (see discussion above), both dates included.[20] For this purpose, subsection 3(1) of the BIA deemed a "reviewable transaction" as one between persons who did not deal with each other at arm's length. Subsection 3(3) of the BIA stipulates that "related persons" (within the meaning of section 4 of the BIA) are deemed not to deal with each other at arm's length. Section 4 of the BIA sets out a list of relationships that, if found to exist, will constitute the parties to that relationship "related persons". Where in such review the court found that the consideration given or received by the bankrupt was conspicuously greater or less than the fair market value of the property or services concerned in the transaction, the court may have given judgment to the trustee in bankruptcy against the other party to the transaction, against any other person being privy to the transaction with the bankrupt or against all those persons, for the difference between the actual consideration given or received by the bankrupt and the fair market value, as determined by the court, of the property or services concerned in the transaction.[21]

Neither the intent nor the solvency or not of the now bankrupt debtor was considered. And the existence or not of the good faith or bad faith of the parties was not relevant in determining whether the consideration paid equalled fair market value at the time of the transaction.

New Bankruptcy and Insolvency Act (Canada) Provisions

Effective September 19, 2009,[22] the new provisions of the BIA dealing with "transfers at undervalue" between both arm's length and non-arm's length parties replaced the above "settlement" and "reviewable transaction" provisions of the BIA. These amendments broaden the ability of the court to scrutinize transactions where a debtor receives consideration for a transfer that is "conspicuously less" than fair market value. Where such a transfer has occurred, the court is permitted to grant judgment against the parties to the transaction as well as parties "privy" to the transaction for the difference between the consideration received and the fair market value.

The word "conspicuous" is not defined in the BIA and courts have not ascribed to it particular mathematical parameters. Instead, courts have relied on its ordinary meaning, including "plainly evident, attracting notice and hence remarkable or noteworthy".[23] A court must make this determination in light of all the facts and from its own perspective, not from the perspective of the parties at the time the transaction was executed.[24]

If a transfer at undervalue occurs between parties not dealing at arm's length with each other, the court may grant judgment for the difference between the consideration received and fair market value if, (i) the transfer occurred during the period that is one year prior to the "initial bankruptcy event" (see discussion above) and ends on the date of "bankruptcy" (see discussion above), (ii) the transfer occurs between one and 5 years prior to the initial bankruptcy event and either the debtor was insolvent at the time of the transfer or was rendered insolvent by the transfer or the debtor intended to defeat the interests of a creditor.

The threshold is higher in respect of transfers between parties not dealing at arm's length with each other. In such a case, the court may grant judgment for the shortfall between the consideration received and the fair market value if: (i) the transfer occurred within one year prior to the initial bankruptcy event; (ii) the debtor was insolvent at the time or was rendered insolvent by the transfer; and (iii) the debtor intended to defeat the interests of a creditor.

Attacking Corporate Dividends and Redemptions and Purchases of Shares Under the Business Corporations Act (Ontario), the Canada Business Corporations Act and the Bankruptcy and Insolvency Act (Canada)

Subsections 30(1), 31(3), 32(2) and 38(3) of the *Business Corporations Act* (Ontario) ("OBCA") (subsections 34(2), 35(3), and 36(2) and section 42 of the *Canada Business Corporations Act* ("CBCA")) and section 101 of the BIA contain rules which prohibit the purchase of shares, the redemption of shares, or the declaration of dividends (other than stock dividends) by an insolvent corporation (or a corporation which would be rendered insolvent by virtue of the purchase, redemption or dividend) and subject directors and in some cases shareholders to liability.

An insolvent corporation for this purpose under the OBCA or the CBCA is one which cannot pay its liabilities as they become due, or one whose assets are less than the aggregate of its liabilities and the stated capital of its shares of all classes (in the case of a purchase of shares or dividend) or, in the case of a redemption, the redemption value of shares whose holders have a right to redeem their shares in priority to or rateably with the shares to be purchased or acquired.

Subsection 130(2) of the OBCA (subsection 118(2) of the CBCA) provides that directors of a corporation who vote for or consent to a resolution authorizing a purchase, redemption or other acquisition of shares contrary to section 30, 31, or 32 of the OBCA or the payment of a dividend contrary to section 38 of the OBCA are jointly and severally liable to restore to the corporation any amount so distributed or paid and not otherwise recovered by the corporation. Under subsection 130(4) of the OBCA (subsection 118(4) of the CBCA), a director liable under subsection 130(2) of the OBCA may in turn apply to court for an order compelling a shareholder or other recipient to pay or deliver to the director any money or property that was paid or distributed to the shareholder or other recipient contrary to section 30, 31, 32, or 38 of the OBCA.

Subsection 253(1) of the OBCA (section 247 of the CBCA) provides that where a corporation or any director does not comply with any provision of the OBCA, including the above provisions prohibiting the purchase or redemption of shares or the declaration of dividends under insolvent circumstances, a creditor of the corporation may apply to court for an order directing the corporation or any person (including the directors) to comply with, or restraining the corporation or any person (including the directors) from acting in breach of, such provision of the OBCA, and upon such application the court may so order and make any further order it sees fit.

Subsection 101(2) of the BIA provides that the directors of an insolvent corporation are jointly and severally liable to a trustee in bankruptcy for the amount of any dividend paid (other than a stock dividend) or the amount paid to redeem or purchase shares of a corporation (which amount has not been repaid to the corporation) within the period that is one year prior to the "initial bankruptcy event" (see discussion above) and which ends on the date of bankruptcy (see discussion above) where, (a) the transaction occurred at a time when the corporation was insolvent or the transaction rendered the corporation insolvent, and (b) the directors did not have reasonable grounds to believe that the transaction was occurring at a time when the corporation was not insolvent or the transaction would not render the corporation insolvent.

Under subsection 101(2.2) of the BIA, a shareholder of a corporation who receives a dividend or amount in respect of the redemption or purchase for cancellation of the shareholder's shares of the corporation within the period and under the circumstances described above may also be subject to this liability to a trustee in bankruptcy in circumstances where the shareholder is related to one or more directors or to the corporation or where the shareholder is a director who is not liable by reason of the solvency or reasonable grounds exceptions in subsection 101(2) or who otherwise protested against the dividend, redemption of purchase for cancellation of shares.

Joint and Several Tax Liability Under Section 160 of the Income Tax Act (Canada)

Subsection 160(1) of the *Income Tax Act* (Canada) ("ITA") makes a non-arm's length or minor transferee of property liable for the value of money or property transferred to him or her by a person who owes tax under the ITA. It is intended to prevent a tax debtor from transferring assets to a spouse or other relative and thereafter not having sufficient assets to pay the tax owing.

Subsection 160(1) provides that where a person has transferred property either directly or indirectly by means of a trust or otherwise, to a spouse or a future spouse, a person under the age of 18, or to a non-arm's length person, the transferee and transferor are jointly and severally liable for the amount by which the fair market value of the property transferred exceeds the value of the consideration, if any, given for the property, to maximum of the transferor's tax liability in respect of the taxation year of the transfer and any preceding taxation year.

The transferor remains taxable under the normal attribution rules in sections 74.1, 74.2 and 75.2 of the ITA on all income or capital gains arising from property transferred to a spouse and all income from property transferred to a child.

A typical application of subsection 160(1) is where a taxpayer transfers his or her interest in the family home to the taxpayer's spouse, leaving the taxpayer with insufficient assets to pay the taxpayer's outstanding tax liability. The spouse can be assessed under subsection 160(1) for the value of the interest transferred, and any of the spouse's assets (not just the transferred property) can be seized to satisfy this debt.

Other transfers which may be caught by subsection 160(1) include dividends (but not a stock dividend) paid by a corporation to a shareholder with which it does not deal at arm's length[25], mortgage payments on a family home[26], and contributions to a spouse's RRSP[27].

There is no time limit on a subsection 160(1) assessment.[28] The parties need not have an intention to defeat a tax debt, or even know of a tax debt, for the transferee to be liable, and there is no due diligence defence.[29] And it is not necessary that the tax liability of the transferor existed at the time of the transfer, as long as it arises in the taxation year in which the transfer occurs, or as a result of a reassessment issued after the transfer in respect of the transfer year or a prior taxation year. If the transferee is assessed under section 160, he or she may challenge the basis for the underlying assessment of the transferor even if the transferor does not.[30]

There is similar joint and several liability in respect of amounts received out of an RRSP[31], RRIF[32], RCA trust[33], and transfers from non arms-length insolvent corporations[34].

The payment by the transferee on account of his or her joint and several liability discharges the joint liability to the extent of the payment. The payment by the transferor on account of his or her liability discharges the transferee's liability only to the extent that the payment operates to reduce the transferor's liability to an amount less than the amount in respect of which there is joint and several liability.

The Canada Revenue Agency may also seek to void a transfer to a spouse or other family member as a fraudulent assignment or conveyance under the FCA or APA. In such case, the spouse or other family member would lose title to the property and would continue to be subject to a subsection 160(1) assessment.

Under subsection 160(4) of the ITA, if property is transferred to a spouse or common law partner pursuant to a decree, order, or judgment of a competent tribunal, or pursuant to a written separation agreement, and at the time the parties were separated and living apart as a result of the breakdown of their marriage or common–law partnership, the spouse or common law partner is relieved of joint and several liability in respect of the transferor's taxes or in respect of any income or capital gains derived from the property. Taxes paid by the transferor are deemed to be applied first against the liability that was not joint and several, and subsequently against the joint and several debt.

Bulk Sales Act (Ontario)

The primary objective of the *Bulk Sales Act* (Ontario) is to prevent businesses from consummating sales "in bulk" of their business assets to the detriment of their creditors. Section 1 of the *Bulk Sales Act* (Ontario) defines a "sale in bulk" as "a sale of stock in bulk out of the usual course of business or trade of the seller". "Stock" is defined in section 1 to mean, generally, inventory, equipment or fixtures. The Act imposes an obligation upon an intending buyer to comply with the requirements of the statute before completing a purchase of stock in trade from a seller. Such compliance requires that the buyer demand and obtain from the seller a sworn statement that lists the seller's creditors. The creditors must either furnish their consent to the sale, waive the protection of the statute, or be paid their claims. In the event the buyer and the seller do not comply with the requirements of the statute, a creditor of the seller or trustee in bankruptcy of the seller's estate may under subsection 17(1) bring an action to set aside or have declared void a sale in bulk. Further, the buyer is liable under subsection 16(2) to account to all creditors of the seller for the value of the stock in bulk received by the buyer (meaning that the buyer pays twice, once to the seller and once to the creditors of the seller).

Oppression Remedy Under the Business Corporations Act (Ontario) and the Canada Business Corporations Act

The oppression remedy in section 248 of the OBCA (section 241 of the CBCA) may be invoked by corporate creditors to attack transactions which could be generally characterized as fraudulent conveyances or preferences. This statutory oppression remedy may offer a number of advantages over federal and provincial legislation governing fraudulent conveyances, preferences, settlements and reviewable transactions. These advantages arise from the flexibility of the oppression remedy itself, and its ability to encompass a variety of debt, and that it avoids rules regarding standing, the necessity to prove bad faith or an intention to defeat, defraud, prejudice or delay creditors, and the requirement to prove formal insolvency at the date of the impugned conduct. Presumably, any form of activity by which a company's assets are diminished in value could be considered to be oppressive to the creditors of the company, and the actions of the board of directors that enter into the transaction accordingly called into question.

Mareva Injunctions

A Mareva injunction is an equitable (common law) remedy available to a creditor or trustee in bankruptcy to prevent the dissipation of assets within a jurisdiction or the imminent removal of assets from the jurisdiction to the detriment of creditors. A creditor must generally overcome a high standard of proof in order to obtain a Mareva injunction. A Mareva injunction may be obtained ex parte on notice to the debtor.

Anton Pillar Orders

An Anton Pillar order is another equitable (common law) remedy available to creditors and trustees in bankruptcy to compel the production of information and documentation where improper or fraudulent acts have occurred and continue to occur, or are alleged to have occurred and continue to occur. This remedy is usually obtained ex parte.

Offences Under the Criminal Code (Canada) and the Bankruptcy and Insolvency Act (Canada)

Subsection 198(1) of the BIA provides that a fraudulent disposition, concealment, or removal of property can attract a fine of $5,000 or imprisonment of up to one year, or both, on summary conviction, or a fine of $10,000 or imprisonment of up to three years, or both, on conviction on indictment.

Section 392 of the *Criminal Code* (Canada) provides that any person who transfers, removes, conceals or disposes of property, or who receives any such transferred, removed, concealed or disposed property, in either case with intent to defraud creditors, is guilty of an indictable offence and is subject to imprisonment not exceeding two years. An offence under section 392 is not predicated on the person committing the offence being insolvent or on the eve of insolvency.

Note that, in contrast to section 392 of the *Criminal Code* (Canada), which requires "an intent to defraud creditors", the FCA and APA require that there be an intention to "defeat, hinder, delay" or "defraud" or "prejudice" creditors before a transaction is void under those statutes. Clearly, defeating, hindering, prejudicing or delaying creditors under these provincial statutes may be something considerably less than "defrauding" creditors in a criminal sense. The words "to defraud' in a criminal sense are generally used to mean to deprive a person dishonestly of something to which he is or might but for the perpetration of the fraud be entitled.[35]

A flagrant example of a criminally fraudulent act to defeat creditors can be found in *R. v. Ehresman*[36], where the accused husband was convicted under the predecessor of subparagraph 392(a)(i) of the *Criminal Code* (Canada) and fined $1,500 (and on default of payment sentenced to 4 months imprisonment). The accused husband had with his common law wife executed a third mortgage on the remaining equity in their home. The mortgagee never advanced funds under the mortgage, and no consideration for the mortgage otherwise flowed to the husband and his wife. The mortgagee was friend of the husband. Within two months of the accused husband executing and registering the mortgage, the accused husband and his company assigned themselves into bankruptcy. The Court found that the mortgage was a sham, and that the accused knew and intentionally promoted and entered into the fake mortgage as a device to keep his house equity and the equity of redemption on the first and second mortgages clear of any charges or judgements, and to deceive creditors into thinking that their claims would rank below that of the third mortgage.

It is suggested that, to avoid this result, there be no attempt to misrepresent or conceal the effect of a transfer or charge of property.

Additional offences under the *Criminal Code* (Canada) and relating to the defrauding of creditors include fraud (section 380), fraudulent concealment (section 341), conspiracy (section 465), aiding and abetting (section 21), and counselling (section 22).

Liability of Professional Advisors

The potential criminal liability of judgement proofing transactions could also be imputed to a lawyer or accountant for advising a client to act in a criminal manner. For instance, where counselling clients to convey assets, create documents, powers of attorney, and other devices necessary for the creation and implementation of a judgement proofing scheme, the above-mentioned provisions of the *Criminal Code* (Canada) may apply to the counselling lawyer or accountant where the scheme has the sole purpose and intent of defrauding creditors. Again, these offences are not predicated on the client committing the fraud being insolvent or on the cusp of insolvency.

Section 21 of the *Criminal Code* (Canada) provides that everyone is a party to an offence who actually commits it, or who aids and abets in (that is encourages) the commission of the offence, and where two or more persons form an intention in common to carry out an unlawful purpose and to assist each other to that end.

Section 366 of the *Criminal Code* (Canada) deals with forgeries and the making of false documents, Section 368 deals with the use of forged documents by any person, and section 462.31 deals with money laundering (as does the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (Canada)).

Section 159 of the *Income Tax Act* (Canada) creates joint and several tax liability for lawyers for the outstanding income tax liability of clients and in respect of whom the lawyer possesses or controls property. In order to avoid this joint and several liability, a lawyer who possesses or controls a client's property in his or her capacity as lawyer must obtain a certificate under subsection 159(2) of the ITA before distributing client property to a client.

Lawyers also need to be aware when advising clients of the relevant Rules of Practice governing their profession.[37]

Notes:

1 Sometimes called "creditor proofing", which term may incorrectly suggest an immunity from attack by creditors

2 See *Bank of Nova Scotia v. Bass* (1983), 47 C.B.R. (N.S.) 203.

3 See *Re Ross* (1983), 46 C.B.R. (N.S.) 43 (N.S.T.D.). In that case the transfer by husband to wife of a one-half interest in the matrimonial home left the husband with no assets to satisfy the claims of creditors in a bankruptcy proceeding which occurred 7 years later. The transfer was carried out in order to enter into a tax-sheltering arrangement pursuant to the provisions of the registered home ownership savings plan. The Court found that the husband did not know and should not have known that, at the time of the transfer of the interest in the matrimonial home, guarantees which had been given by him would probably be called. See also *Royal Bank of Canada v. Thiessen* (1981), 38 C.B.R. (N.S.) 284 (Man. Q.B.), where the Court found that a husband did not have the requisite fraudulent intent where he transferred his one-half interest in the matrimonial home (previously owned jointly with his wife) to his wife alone and where the transaction was affected on the advice of a professional advisor to avoid succession duties. The wife was found to have paid valuable consideration for the transferred property.

4 See *Millwork and Building Supplies Ltd. v. Marchione* (1984), 54 C.B.R. (N.S.) 47 (Ont. S.C.).

5 See *Re Garrett* (1979), 30 C.B.R (N.S.) 150 (Ont. S.C.).

6 See *Bank of Nova Scotia v. Chan* (1987), 68 C.B.R. (N.S.) 118 (Man. Q.B.).

7 Section 49 of the *Bankruptcy and Insolvency Act* (Canada).

8 Section 43 of the *Bankruptcy and Insolvency Act* (Canada).

9 See *Lakehead Newsprint (1990) Ltd. v. 893499 Ontario Ltd.*, [2001] O.J. No. 1 (S.C.J.).

10 See *Perry, Farley and Onyschuk v. Outerbridge Management Ltd.* (2001), 54 O.R. (3d) 131 (C.A.).

11 Subsection 91(1) of the *Bankruptcy and Insolvency Act* (Canada).

12 Subsection 91(2) of the *Bankruptcy and Insolvency Act* (Canada).

13 See *Wilson v. Doane Raymond Ltd.* (1988), 69 C.B.R. (N.S.) 156 (Alt. C.A.).

14 See *Re Bozanich* (1942), 23 C.B.R. 234 (S.C.C.), and *In re Tankard*, [1899] 2 Q.B. 57.

15 *In re Vansittart*, [1893] 1 Q.B. 181.

16 See *Re Geraci; Swallow v. Geraci and Geraci* (1971), 14 C.B.R. (N.S.) 253 (Ont. C.A.).

17 See *Alberta Treasury Branches v. Guimond* (1987), 70 C.B.R. (N.S.) 125 (Alta. Q.B.).

18 See *Re Jobin* (1986), 63 C.B.R. (N.S.) 277 (Que. C.A.).

19 In *CIBC v. Shapiro* (1985), 54 C.B.R. (N.S.) 134 (Ont. S.C.), the Ontario Supreme Court held that the transfer of a husband's interest in a home as part of divorce proceedings did not constitute a settlement because there was no intention that the home be retained or preserved for the benefit of the husband. Rather, the transfer was a resolution of claims asserted in the course of matrimonial litigation, and was arrived at in good faith and for substantial valuable consideration. The wife was a purchaser in good faith who had no intent to defeat or hinder her husband's creditors. The husband was secretive about his business, and the wife had no knowledge of her husband's intent. She was not a creditor.

20 See former subsection 100(1) of the *Bankruptcy and Insolvency Act* (Canada).

21 See former subsection 100(2) of the *Bankruptcy and Insolvency Act* (Canada).

22 *Order Fixing September 18, 2009 as the Date of the Coming into Force of Certain Sections of the Acts*, S.I./2009 68, C. Gaz. 2009.II.1711 online:<http://www.gazette.gc.ca/rp-pr/p2/2009/2009-08-19/html/si-tr68-eng.html>.

23 M. A. Springman et al., *Fraud on Creditors: Frdulent Conveyances and Prefernces*, Losseleaf (Toronto: Carswell, 2009) 22-13, and *Skalbania (Trustee of)* v. *Wedgewood Village Estates Ltd* (1989), 60 D.L.R. (4th) 43 (B.C.C.A.) aff'g (1988), 31 B.C.L.R. (2d) 184 (S.C.).

24 *Ibid.* at para. 50 affirming lower court's reasoning.

25 See *Algoa Trust and 116488 Canada Inc. v. The Queen*, 93 DTC 405 (TCC).

26 See *Medland v. The Queen*, 98 DTC 6358 (FCA).

27 See *Wannan v. The Queen*, 2003 DTC 5715 (FCA).

28 Subsection 160(2) of the *Income Tax Act* (Canada).

[29] See *Waugh v. The Queen*, 2000 DTC 1441 (TCC); aff'd 2008 DTC 6379 (FCA)

[30] See *Gaucher v. The Queen*, 2000 DTC 6678 (FCA).

[31] Subsection 160.2(1) of the *Income Tax Act* (Canada).

[32] Subsection 160.2(2) of the *Income Tax Act* (Canada).

[33] Subsection 160.3(1) of the *Income Tax Act* (Canada).

[34] Subsection 160.4(1) of the *Income Tax Act* (Canada).

[35] See *Scott v. Metropolitan Police Commissioner* (1974), 60 Cr. App. R. 124 (H.L.). The Ontario Court of Appeal held in *R. v. Renard* (1974), 17 C.C.C. (2d) 355, that a victim may be defrauded by begin deprived of something an he may be deprived of something either by being fraudulently induced to part with it or by having that to which he is entitled fraudulently diverted or withheld from him.

[36] (1979) 31 C.B.R. (N.S.) 209 (B.C. Co. Ct.); aff'd (1980), 58 C.C.C. (2d) 574 (B.C.C.A.).

[37] See, for example, the following *Rules of Professional Conduct* promulgated by the Law Society of Upper Canada: Rule 1: Integrity, Rule 3: Advising Clients, Rule 8: Withdrawal of Services, Rule 10: The Lawyer as Advocate, and Rule 11: The Lawyer and the Administration of Justice.

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