TAB 6

Asset Protection Using Trusts

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ASSET PROTECTION USING TRUSTS

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1. Introduction

For many years, clients have assumed that their personal assets were sheltered from business and professional liability by limited liability corporations and more recently for professionals by limited liability partnerships.

However with the expansion of directors' and officers' liability and increasing litigation against professionals such as lawyers and accountants, business people and professionals have increasing concern for personal liability and there is a corresponding search for guidance in formulating asset protection plans. The techniques range from freezing future growth, moving assets offshore, and gifting to others either outright or through a trust. In an early paper delivered on this topic[1] the following were listed as judgement profit teachings:

(a) Conveying assets to others by

  (i) gift;
  (ii) inadequate consideration; and
  (iii) conveyance at fair market value;

(b) Moving assets offshore;
(c) Cashing out;
(d) Moving assets into a form that is exempt from seizure;
(e) Making assets "ugly";
(f) Freezing future growth; and
(g) Closing business "A" and starting business "B".

This paper will explore one of these techniques, namely the use of a discretionary trust for asset protection objectives.

2. Asset Protection Trusts

The concept of a trust has been with us since the Middle Ages and over the centuries has been adapted to the demands and needs of society. This adaptability caused Maitland to declare the idea of the trust the "greatest and most distinctive achievement" of Equity.[2] In broad terms it might be said that the trust is a means of preserving and managing wealth for the benefit of one or a number of persons. Use of a trust for asset protection is but one example of this use of trusts.

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1. Judgement Profiting: Where are the lines, Daniel R. Dowdall and Alex A. Ilchenko January 27, 1994, CBA(O) Institute of Continuing Legal Education

2 Maitland, F.W., Selected Essays (1936).

A typical asset protection trust transaction is when an individual transfers or conveys assets to a trust where the interests of the beneficiaries are not fixed but are dependent on the exercise of discretion by the trustees. When a Settlor transfers legal ownership of assets to a trustee, a creditor cannot seize such assets to satisfy a judgement obtained against the Settlor as the Settlor no longer has legal control over the assets. A trust can achieve the above results provided that:

(a) The transfer of the assets to the trustee is absolutely;

(b) The trust is irrevocable; and

(c) The Settlor does not retain any vested interest in the trust property.

Asset protection trusts can be established by one or more persons for the benefit of him or herself and/or others, *inter vivos* or on death where there is a concern by the testator that if the assets were gifted outright to an intended beneficiary they might become subject to the claims of the creditors of that beneficiary or be dissipated by such beneficiary because such beneficiary is a spendthrift.

Generally speaking, a fully discretionary trust affords the greatest protection in that the right of a beneficiary is limited to what the trustee(s) determine to distribute to such beneficiary. Until such time as the trustee(s) exercises his or her discretion, the only right of a beneficiary is the right to be considered as a recipient of a distribution.

A creditor who obtains a judgment against a beneficiary of a fully discretionary trust has no better claim than the beneficiary. Thus defining and limiting the interest of a beneficiary is very important. The broader the trustee's discretion, in general, the greater the protection. This protection is magnified if there are multiple beneficiaries among whom a trustee may "sprinkle" distributions. Finally, a beneficiary's interest in a trust may change depending on his or her circumstances. For example, a trust providing for mandatory distributions might convert to a discretionary trust if the beneficiary becomes insolvent.

To maximize the protection against creditors, it is advisable that a beneficiary not be a trustee. If a settlor who has transferred assets to a trust for the objective of asset protection has control over the trust and has discretion over the distribution of the trust assets, the effectiveness of the trust's protection is reduced or eliminated, as an attacking creditor could assume the position of the settlor as trustee exercising control over the trust and could as a consequence exercise the settlor/trustee's discretionary power and distribute trust assets for the ultimate benefit of the creditor.

In spite of this consequence, the ability to have some control over the trust may be an important factor for a settlor contemplating an asset protection trust. If a settlor must also be trustee, and in particular if he/she is also a discretionary beneficiary, he/she should be a minority trustee, giving him/her some input into the trust decision-making process, without having complete control and thereby endangering the effectiveness of the asset protection trust.

One question which has arisen is the effects of the bankruptcy of a trustee of a trust on the trust's assets. The answer is that bankruptcy has no automatic effect on a trusteeship. The bankruptcy trustee is vested only with assets that the bankrupt does not hold in trust for others. The bankruptcy trustee in not vested with any status that the bankrupt might have (director; trustee; mayor). A trusteeship is not automatically terminated by the bankruptcy (absent the trust so stipulating). However, the bankruptcy trustee may be appointed to replace the bankrupt as trustee by application under the *Trustee Act*, if there is otherwise no mechanism for replacement, since bankruptcy is generally good grounds for the court to remove a trustee. If the trust has a mechanism for others (say, the other trustees, or beneficiaries) to remove and replace a trustee because of bankruptcy, that mechanism should govern.[3]

Once assets are transferred to a discretionary trust, provided the transferor is not the sole trustee or does not maintain control over the actions of the trustees, the assets are no longer considered the property of the transferor. Thus, such assets should not be subject to attachment by his/her judgment creditors or bankruptcy trustee.

The trustees of the trust could be authorized to make discretionary distributions of income or capital to or for the benefit of certain specified beneficiaries (usually family members). The individual contributing to the trust can, in certain circumstances, be a beneficiary. It is common in such a discretionary trust to provide that the trustees are prohibited from making any substantial distribution to any beneficiary who is insolvent although the trustees may make maintenance distributions for his/her benefit. The individual who establishes or contributes substantial assets to the trust should not be the sole trustee or in a position to control the actions of the trustees.

When assets are transferred to a discretionary trust, the transferor generally will lose "control" of those assets as the distribution of any trust capital or income would be dependent on the decision of the trustees, and the transferor should not be in a position to control the actions of the trustees.

There are a number of issues that must be considered in establishing a trust to hold assets, including the choice of current and future trustees and beneficiaries, the purposes for which the trust funds are to be used, tax issues and the loss of control over the trust assets.

3. Spendthrift Clauses

Before turning to a consideration of the tax and other issues, mention should be made of the use of "spendthrift clauses" in wills and trusts. These clauses provide that distributions of income and/or capital cease if certain conditions exist[4].

For example such a clause could provide that the right of a particular beneficiary to be considered for income and/or capital distribution ceases if he or she becomes bankrupt or assigns, charges or encumbers the income or does something whereby the income would, through the actions of the beneficiary or by process or operation of law, be vested in or become

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[3] In the case of *Newbank Group Inc. (Trustee of) Estate of Handelman* 4 OR (3d) 626 (1991); 6 CBR (3d) 240, the trust allowed a trustee to name a replacement for a bankrupt trustee and when that trustee became bankrupt the court held that this power was not intended to be exercisable by the very trustee who would be removed using that power because he/she was bankrupt. Thus the court removed the bankrupt and appointed in his place the firm that was also his bankruptcy trustee, using the *Trustee Act*.

[4] The "spendthrift clause" portion of this paper is based on a presentation by K. Thomas Grozinger, at STEP Conference 2009

payable to some other person. The clause might go on to provide that the interest of the beneficiary is restored once he/she is out of the difficult situation. In the meantime, the clause might provide for payment of income/capital to persons for the maintenance or welfare of the beneficiary.

Such a clause was considered in the case of Re Williams[5] where the court found that the condition was not void for uncertainty, the conduct of the beneficiary was not subject to review by the court and the conduct of the beneficiary was for the trustees to judge and not reviewable by the court so long as the trustees exercised their discretion in good faith.

In the later case of Re Thain[6] a will provided that after the death of the spouse, a trust was to be created for the son to provide him with $200 per month for life. The relevant clause in the will provided that the income would be received by the son "unless and until...any event happens....whereby....he would or might be deprived of the right to receive the same or any part thereof, and from and after the termination or failure of this trust…to pay or apply…".

The trustees received a demand and "direction to garnishee". The issue was whether the son was divested of his interest in the trust as a result. The court held that the direction to garnishee did not operate to determine the life interest in the trust. The direction to garnishee did not deprive the son of the right to receive the income but could apply to income to which the son became entitled in the future.

In the later case of Leir v. British Columbia (Public Trustee)[7] the court commented on a similar forfeiture clause and stated that the making of a voluntary assignment or bankruptcy would appear to be the type of event that could result in forfeiture under such a clause. One is left to speculate what the result would have been in the Re Thain case if the clause had gone on to include a condition that the income might become payable to another person or other persons...whether that would have resulted in depriving the beneficiary of further payments of income.

Another question that has arisen in this area is whether the trustees have the right to make inquiries as to the financial stability of a beneficiary before making distributions.

In the recent case of Barnes v. Barnes[8] it was held that where the terms of the trust do not refer to the financial resources of the beneficiary it is not appropriate for the trustees to make such inquiries. Does the presence of spendthrift provisions change this, one wonders?

In the Re Carley Estate case[9] the court questioned the meaning of the words "for the benefit of" The court held that while trustees could pay some debts of a beneficiary they would have to consider the even hand principle in so doing and the rights of the ultimate capital beneficiaries. Other cases have also focused on the fact that the trustees have to consider all of the

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[5] [1947] O.R. 1 (C.A.)

[6] [1970] 2 O.R. 432 (Ont. HCJ)

[7] 1 DLR (4th) 556 (BCSC)

[8] 2008 Can LII 36908 (Ont SC)

[9] (1994) 2 ETR (2d) 142 (Ont Ct General Division)

circumstances in determining in any one situation whether the elimination or reduction of a debt is for the benefit of a beneficiary See Re Esteem Settlement; Lowther v. Bentinck[10].

4. Tax Issues - Inter vivos trusts

(a) Transfers to a Trust – General Rule

Subject to a few exceptions discussed in more detail below, when there is a transfer of legal ownership of property to a discretionary trust, there is a disposition of the property at fair market value. This may result in a realization of accrued capital gains. Accordingly, the most appropriate assets to be the subject of such a conveyance should have no significant unrealized appreciation unless unutilized capital losses are available. Further, for tax purposes, trusts are deemed to dispose of their assets every 21 years at fair market value thus resulting in the realization of all accrued capital gains and the payment of income tax thereon.

(b) Spousal, Alter Ego and Joint Partner Trusts

An exception to this general rule is where property is transferred to a qualifying spousal, alter ego or joint partner trust. In such a case there will not be a disposition of the property at the time of the transfer to such a trust unless the transferor elects that the disposition occur at fair market value. These trusts are also not subject to the 21 year deemed disposition rule. However, on the death of the spouse, the individual or the individual and his/her partner, as the case may be, there will be a deemed disposition of the trust property at its then fair market value.

A qualifying spouse trust is one established by an individual for the benefit of his/her spouse. The terms must provide that the spouse is to receive all of the income of the trust which arises before the death of the spouse and no person except the spouse may, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust.

An alter ego trust is one which is established after 1999 by an individual who has attained the age of 65, the terms of which provide that the individual is entitled to receive all of the income of the trust that arises before the individual's death and no person except the individual may, before the individual's death, receive or otherwise obtain the use of any of the income or capital of the trust.

A joint partner trust is one which is established after 1999 by an individual who has attained the age of 65, the terms of which provide that the individual or the individual's spouse is, in combination with the other, entitled to receive all of the income of the trust, and no person may receive or otherwise obtain the use of the income or capital of the trust.

In all three types of trusts noted above it is contemplated that the trust will have contingent beneficiaries who will receive the income and/or the capital of the trust after the death of the spouse, the individual or the individual and his/her spouse in the case of the joint partner trust.

In addition, in all three types of trusts noted above, the transferor and the trust must be residents of Canada.

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[10] [2001] JLR 540 CA and (1874) LR 19 EQ 166

It is worth repeating that to ensure the transfer of property by an individual to an alter ego or joint partner trust does not constitute a taxable event to the individual, the individual must be 65 years of age at the time such trusts are created and property is transferred to such trusts.

These trusts, while tax effective in that a transfer of property to them does not generally trigger a taxable disposition, may not offer the same level of asset protection that a discretionary trust offers. Discretionary trusts offer the benefit of some protection of property from the claims of future creditors of the contributor and the beneficiaries. In the context of a spousal trust, provided the contributor of property to the spouse trust engaged in the transaction at an appropriate time, since the contributor is not a beneficiary of the spouse trust, the capital and income of the trust may be protected from the claims of the contributor's creditors. This same protection may not, however, be available to an alter ego trust or a joint partner trust.

The level of protection afforded by a transfer of property to an alter ego or a joint partner trust will be restricted in that the settlor/contributor (in the case of the alter ego trust) or the settler/contributor and/or his or her spouse or common law partner (in the case of a joint partner trust) must be entitled to receive all of the income of the trust in order for the tax rollover rules to apply. Further, if the contributor is the sole trustee and is entitled to encroach on all of the capital, there may be an argument that the assets still belong to the contributor.

Pursuant to subsection 67(1) of the *Bankruptcy and Insolvency Act (Canada)*[11] property of the settlor of an alter ego or joint partner trust may be considered to be "property of a bankrupt" which property vests in the bankruptcy trustee. Property is broadly defined in the *Bankruptcy and Insolvency Act* and property vesting in the bankruptcy trustee includes all property that may be acquired by or devolve to the settlor of an alter ego or joint partner trust before his or her discharge from bankruptcy. Such property also includes powers in, over or in respect of the property as might have been exercised by the bankrupt settlor for his or her own benefit. The latter provision raises concerns that might be addressed by not having the settlor be the sole trustee and ensuring he/she not have a veto power.

In the case of an alter ego or joint partner trust, consideration should be given to the best method of protecting the settlor's assets from being seized by the trustee in bankruptcy to satisfy the settlor's obligations to creditors. One method of safeguarding such an interest is to ensure that the distribution of capital to the settlor is either precluded or is entirely within the trustee's discretion.

These measures will not, however, offer any protection to the settlor where the initial transfer of property to the alter ego trust or joint partner trust is successfully challenged.

(c) Attribution Rules

In establishing a trust for asset protection purposes it is also necessary to be aware of the various income and capital gains attribution rules in the *Income Tax Act*.[12] As a result of these rules, the loan or transfer of property to a conventional trust for the benefit of a spouse, minor children or

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[11] *Bankruptcy and Insolvency Act (Canada)* R.S., 1985, c. B-3

[12] See Subsection 56 (4.1), 74.3, 74.5(7), 75(2), and 107 (4.1) of the *Income Tax Act* R.S.C. 1985, c. 1 (5th Supp.).

certain specified relatives may not succeed in removing such income from the hands of the settlor or transferor for income tax purposes. As a result, in many instances a trust arrangement may be neutral from an income tax perspective (i.e. the income and capital gains will continue to be taxed in the hands of the transferor). Where, however, the primary objective is asset preservation, the desired end has been achieved as the settlor's assets have been placed beyond the reach of potential creditors. The ultimate goal, however, will have been attained on the successful design of a plan which achieves income tax savings combined with the initial asset preservation goal. For example subsection 75(2), which taxes all of the income, gains and losses of the trust in the hands of the transferor, will apply if the transferor retains a certain measure of control or if he or she is a capital beneficiary or the property of the trust can otherwise revert to him or her.

5. Offshore Asset Protection Trusts

Asset protection trusts which are established in offshore jurisdictions operate on the same legal principles as domestic trusts. However, the protection from creditors is enhanced, as the attacking creditor must now overcome a foreign legal regime, in addition to Canadian proceedings, before gaining access to trust assets.

There are many jurisdictions which, due to favourable tax and secrecy laws, are attractive for establishing an offshore asset protection trust. Some of these jurisdictions have enacted legislation specifically designed to attract such trusts and the secrecy laws of such jurisdictions make finding the *situs* of such trust assets challenging for the creditor.

Another hurdle which faces creditors is that most of these jurisdictions have legislation which refuses to recognize foreign judgments, thus providing extremely effective asset protection. As a result, the attacking creditor is forced to commence an action in the jurisdiction where the trust is located, once the creditor succeeds in locating the trust jurisdiction. Additionally, under most asset protection trust legislation, creditors face another obstacle as their claims become statute-barred after a specified time period, ranging from one to six years.

Lastly, once the foreign action is commenced, most jurisdictions allow a creditor to attack the conveyance to the trustee on the same principles as Canadian law, namely, a creditor must establish that it was defrauded or hindered by the transfer of the asset, that the settlor knew of the creditor's claim at the time of the transfer, or the settlor became insolvent by virtue of the transfer.[13]

6. Limits to Judgment Protection

In any discussion concerning asset protection, it is important to bear in mind that in Ontario, as in other jurisdictions, judgment creditors and bankruptcy trustees have various means by which to claim, and in fact regularly claim, that transfers of assets or settlements (whether to a family trust or otherwise) were done as an attempt to defeat or frustrate existing or potential claims against the individual's assets. Asset transfers will be particularly subject to attack:

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[13] For an interesting discussion of offshore jurisdictions see Norman Tobias, *Foreign Asset Protection Trusts,* 1993 Corporate Management Tax Conference

(a) where an individual has taken steps after a claim has been made or in anticipation of a claim and, without the assets which have been moved, the individual would be insolvent or otherwise facing bankruptcy;

(b) where transactions are between spouses or other related persons; or

(c) if an individual seeks to obtain benefit from or use of the asset notwithstanding its supposed transfer[14];

(d) conveyance is secretly made;

(e) deed gives grantor general power to revoke; and

(f) there is undue haste in making the transfer.

Vulnerability to such attacks will depend upon the particular circumstances and the assets in question, as well as the timing of the disposal of the assets. Where any such transaction could be characterized as dishonest by a reasonable person, or in substance is intended to defraud creditors of their proper remedies, it should not be undertaken.

A transfer of assets must be genuine to be successfully upheld against the claims of third parties. The transferor therefore must realize that he/she cannot later change his/her mind about the transfer. The transferee should be the owner of the asset.

In the recent case of *Botham Holdings Ltd. V Braden Investments Ltd*[15] the court reviewed the principles behind fraudulent conveyances legislation.

The Court quoted from an earlier decision of Baker J. in analyzing the meaning of a fraudulent conveyance.

> [62] A useful description of a fraudulent conveyance was provided by Baker J. in Ocean Construction Supplies Ltd. v. Creative Prosperity Capital Corp. (1995) 34 C.B.R. (3d) 241, 1995 CanLII 740 (B.C.S.C.) at paras. 25-28:
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> > 25. In essence, a fraudulent conveyance is a transfer of an interest in property which is made with the intention, and which has the effect, of hindering or impairing the right of a creditor or other person to satisfy a claim against the transferor. It is not necessary for the person seeking relief to show that the transferor was insolvent at the time the transfer was made, and the applicant need not establish that

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[14] Under such statutes as the *Fraudulent Conveyances Act* R.S.O. 1990 c F.29; *Bankruptcy & Insolvency Act* (*supra* note 5); *Assignments & Preferences Act* R.S.O. 1990, c. A.33; and *Criminal Code* R.S. 1985, c. C-46 (as amended).

[15] 2008 BCSC 1547[2009] B.C.W.L.D. 35, 48 CBR (5^{th}) 20

he or she was a creditor, or an unsecured creditor, at the time the transfer was made: Re Skinner (1960), 27 D.L.R. (2d) 74 (B.C.S.C.).

26. All that the applicant must show is that the transferor, in making the gift or transfer, did so with intent to delay, hinder or defraud creditors or others: Canadian Imperial Bank of Commerce v. Ash, (1964), 47 D.L.R. (2d) 620 (B.C.S.C.); Canadian Imperial Bank of Commerce. v. Boukalis (1987), 11 B.C.L.R. (2d) 190 (C.A.).

27. Fraudulent intent is essentially a matter of fact to be proved in the circumstances of each particular case. Proof that the transferor intended to defeat or delay its creditors usually involves drawing inferences from the circumstances surrounding the transaction. Where some consideration has flowed from the transferee to the transferor, the court may consider the adequacy of the consideration in relation to the issue of intent, since a transfer at an undervalue raises suspicions about motive. Inadequate consideration may be considered to be a badge of fraud.

28. Where a transaction renders the transferor insolvent, the circumstances may also be considered suspicious: Freeman v. Pope (1870), L.R. 5 Ch. App. 538. If a transferor with debts makes a transfer the effect of which is to render him unable to meet his then existing liabilities, that circumstance furnishes very strong evidence of an intent to defraud his creditors: Manryk v. Merko (1971), 19 D.L.R. (3d) 238, (Man. C.A.). This case is also authority for the proposition that where parties to a transaction are related to each other, and the circumstances are suspicious, the burden of explanation falls on the related parties. In such a case the testimony of the related parties must be scrutinized with care and suspicion, and a judge may reject the evidence absent corroboration. As Justice Duff said in Koop v. Smith (1915), 51 S.C.R. 55, 8 W.W.R. 1203, 25 D.L.R. 355, at page 1205 [W.W.R.]:

...it is very seldom that such evidence can safely be acted upon as in itself sufficient.

The Court also noted that it is not necessary to find that the intent is to deceive or to be fraudulent. It is enough to show that a transfer was made with the intention of having the effect of hindering or impairing the rights of the creditor. The absence of lying or deceit does not absolve the defendant.

> "A transaction which is the result of an honest intent to defraud one's creditors is precisely one of the situations caught by the *Fraudulent Conveyances Act* (page 23).

The Court also notes that there are defences in respect of certain transactions. S. 2 of the *Fraudulent Conveyances Act* provides as follows:

> "This Act does not apply to a disposition of property for good consideration and in good faith lawfully transferred to a person who, at the time of the transfer, has no notice or knowledge of collusion or fraud."

In the case, it was found that with no valuable consideration partly because the transaction had been undertaken pursuant to the rollover provisions of S. 85(1) of the *Income Tax Act*.

The Court turned finally to a consideration of whether a person can legitimately take steps to limit the assets which are put at risk in a business venture.

> [81] I turn now to the defendant's argument that it is entirely legitimate to limit the assets which one puts at risk in a business venture. Otherwise, the defendant says, corporations would be illegal. It is true that the law permits a person embarking on a risky business to protect personal wealth from subsequent claims by incorporating the enterprise as a separate legal entity. However, in this particular situation, the defendant did not do that. BHL entered into the partnership with Mr. Welsh at a time when BHL had substantial assets. As a partner, BHL was responsible for all debts incurred by the partnership. BHL then acted to shelter its assets from the claims of present and future creditors of the partnership. BHL did this by transferring its assets to Braydon, a related company, for little to no consideration. By doing so, BHL engaged in a fraudulent conveyance.

This passage stresses the importance of the timing in which the creditor proofing occurs and the necessity of taking such steps prior to engaging in a risky venture.

It should not be forgotten that possible creditors include not only business creditors but spouses as well. In the context of family law, recent case law serves as a warning that transactions aimed at defeating the claims of spouses under the *Family Law Act* may be attached as a fraudulent conveyance.

There is case law in Ontario providing that a settlor's spouse may have creditor status to attack a transfer of assets as a fraudulent conveyance pursuant to the *Fraudulent Conveyances Act*. In

Stone v. Stone,[16] the plaintiff widow challenged an *inter vivos* transfer by her husband to his children of his considerable business assets (worth over $1,000,000), as well as the husband's transfer of the matrimonial home to his children without complying with the provisions of Section 21 of the *Family Law Act*. The transfer took place soon after the husband was advised he was terminally ill and took place without the knowledge of the plaintiff, his wife of 24 years. The motivation for the transfer was to ensure the husband's assets passed to his children from a previous marriage and not to the plaintiff's children. In addition, the husband prepared a Will giving the plaintiff $250,000 along with life interest in the matrimonial home. As a result of these transfers, there was very little in his estate upon his death. Rather than take under the Will, the plaintiff elected, pursuant to subsection 6(1) of the *Family Law Act*, to take an equalization payment and challenged the transfers as fraudulent conveyances.

At trial, it was determined that the plaintiff and her husband had been in a debtor-creditor relationship *vis a vis* their *Fraudulent Conveyances Act* entitlements and obligations. The transfer of property was set aside by the court as a fraudulent conveyance, and an equalization payment of over $861,000 was ordered in favour of the plaintiff out of the husband's estate. The court placed emphasis on Mr. Stone's knowledge of his impending death, the fact that the plaintiff's assets were significantly less than Mr. Stone's, the secretive nature of the transfers and Mr. Stone's acknowledgement prior to death that he anticipated litigation over the provision in his Will and the transfer of assets to his children.

On appeal, the trial judge's decision was upheld with the following clarification made regarding the use of *Fraudulent Conveyances Act* in the family law context:

(i) Spouses each own their separate property throughout the marriage; however, upon the happening of one of the five events triggering a valuation date, a spouse is entitled to equalization of net family property pursuant to subsection 5(1) or 5(2) of the *Family Law Act*;

(ii) The *Family Law Act* does not create a debtor-creditor relationship in the form of "an open running account which becomes a settled account on separation or death", but rather a debtor-creditor relationship is created between spouses only as of the valuation date;

(iii) In order for a spouse to qualify as a creditor intended to be protected from conveyances of property made with the intention of defeating the spouse's interest in the equalization of net family property, the spouse must have had an existing claim against the other spouse at the time the transfers were made. An example in the family law context where spouses are

[16] 46 O.R. (3d) 31 aff'd (2001) 55 O.R (3d) 491 [hereinafter referred to as *Stone*]. The concept of a spouse as "creditor or other" under the *Fraudulent Conveyances Act* was reiterated in *Jonas v. Jonas*, [2002] O.J. No. 3058 (online: QL (CJ)). In that case the husband, upon separation, orchestrated the transfer of his interest in his deceased mother's estate to his children from a previous marriage. This was done subsequent to the commencement of litigation by the wife with respect to child and spousal support, clearly establishing the wife's status as a creditor and was done despite a court order requiring the husband to provide his spouse with full financial disclosure, including disclosure of the above interest. The court noted that the "badges of fraud" in these circumstances more strongly supported a finding of fraudulent conveyance than in *Stone*.

cohabiting is a spouse's right under 5(3) of the *Family Law Act* to challenge a transfer of assets as an improvident depletion of net family property and seek an equalization of net family property as though the spouses were separated with no reasonable prospect of resuming cohabitation;

(iv) The *Family Law Act* does not exclude other applicable statutory or common law remedies that deal with the ownership of property, including the *Fraudulent Conveyances Act*. The *Family Law Act* does not specifically exclude the *Fraudulent Conveyances Act* as a means of determining the net family property of each spouse on the valuation date; and

(v) A spouse cannot, via deliberate non-disclosure of the transfer of assets, deprive the other spouse of his or her ability to establish himself/herself as a creditor.

7. Professional Conduct Issues – A Caveat

Lawyers who are asked to assist clients in judgment proofing often do not consider the professional conduct implications to themselves of complying with their clients' requests. A number of the Rules of Professional Conduct may cause serious professional conduct issues for lawyers.[17]

There is a debate that exists between what constitutes asset planning and what constitutes debt evasion. Although it seems clear that the legitimacy of any asset protection plan should depend on the solvency of the client, the *Fraudulent Conveyances Act* does not make insolvency the only precondition for setting aside a transaction, and thus, the line between what is an allowable transaction and what is not, is hard to define with clarity.

Difficult problems may arise when a lawyer is instructed by a client who wishes to arrange his or her affairs because the client is entering into a risky business. The facts may range from a situation where the transaction is entered into at a time when the client is solvent and there is no actual creditor or it may be a situation where the transaction is being contemplated by the client on the eve of a lawsuit. In both cases the lawyer must consider the possible application of the *Fraudulent Conveyances Act*[18] and must not only advise the client that the transaction may be voidable, but also consider whether he or she can even act, because in the particular

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[17] For example, Rule 2.02(1) states that when advising clients a lawyer shall be honest and candid. Rule 2.02(5) provides that when advising a client a lawyer shall not knowingly assist in or encourage any dishonesty, fraud, crime or illegal conduct or instruct the client how to violate the law and avoid punishment.

[18] In the case of *McGuire v. Ottawa Wine Vaults Co.* (1913), 48 SCR 44, the Supreme Court of Canada held that, while a husband who had conveyed assets to his wife at a time he was entering into a risky business was solvent at the time, the ensuing insolvency of the husband 15 months later was foreseeable thus the transfers were void as against his creditors.

circumstances the lawyer could be accused of participating in a fraudulent conveyance with the client.

Depending on the particular facts surrounding the reasons why a client wishes to enter into certain transactions and the timing of such transactions, the lawyer may be in breach of the Rules of Professional Conduct.[19]

In addition, there may be criminal law issues that may have application. While the general view is that the consequences of judgment proofing are civil only, the use of the word "fraudulent" in the *Fraudulent Conveyances Act* raises concerns about the possible scope of certain criminal code provisions that deal with behaviour that is characterized as fraudulent. An examination of the scope of these provisions is beyond the scope of this paper, but for a more detailed discussion

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[19] For a more detailed discussion of these issues see Burke Doran, *Ethical Duties of the Lawyer representing a client who is on the verge of insolvency or who is insolvent*, 1988 Special Lectures issue.