CLU ADVANCED LEARNING SERIES

CASE STUDY: CREDITOR PROTECTION

Advocis

Case Study: Creditor Protection

Learning Objective

Identify any current or potential creditor issues and discuss alternative strategies for the preservation of assets.

Case Study: Creditor Protection

Question

Bearing in mind that you are not a tax/legal expert, offer Geraldo general advice as to the current creditor status of his assets and suggest ways he might improve his position vis-à-vis creditors during his lifetime and at death, including any issues that should be considered when evaluating the strategy.

References

257 Advanced Estate Planning Study Guide (Section 2.3)

Estate Planning with Life Insurance, 6th Edition (Chapter 11)

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Solution

In order to better protect the value of the universal life insurance policy, both now and in the event of Geraldo’s death, he could change the beneficiary designation from his estate to his children. To further strengthen the protection, he could name the children as irrevocable beneficiaries.

Case Study: Creditor Protection

Solution, continued

There are, however, several negatives associated with these changes: Estate liquidity would be reduced. If the suit was filed within 12 months of the change any protection afforded under the Bankruptcy and Insolvency Act (BIA) could be void.

Case Study: Creditor Protection

Solution, continued

Making the children irrevocable beneficiaries would tie Geraldo’s hands in dealing with the policy in the future. Also, multiple direct beneficiaries are generally not recommended, since there will be no gift over to the next generation if one of his children pre-deceases him.

Case Study: Creditor Protection

Solution, continued

Geraldo could name his children (rather than his estate) as direct beneficiaries of his RRSPs. To further enhance creditor protection, he could transfer the funds to a life insurance company plan (if they are not already invested with a life company) to add protection under the provincial Insurance Act. Either solution would be exposed to creditors for 12 months after the date of the change, under the BIA.

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Solution, continued

Re-registering either the house or the stock portfolio jointly with his children might protect the asset at Geraldo's death (as it would bypass his estate) but would offer no protection during his lifetime (at least as far as his remaining interest).

Case Study: Creditor Protection

Solution, continued

He would have to be able to establish that the re-registration constitutes a bona fide gift and protection would not take effect until 12 months had passed (under the terms of the BIA). Geraldo would, of course, also lose control of at least part of the asset in question.

Case Study: Creditor Protection

Solution, continued

It is also important to note that some provinces, like Ontario and BC, have Fraudulent Conveyance legislation that would void transfers executed for the purpose of evading creditors.

If the children become part owner of an asset during Geraldo's lifetime, it has the potential to create exposure to family law issues in respect of the children.

The same issues arise if Geraldo were to gift the assets to his children or to a trust on their behalf.