Case Study: Creditor Protection

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

The Facts

Geraldo's wife died of cancer two years ago when he was 56 and she was 52. Geraldo has not yet updated his will, since his spouse's death. He is currently relying on the provision that names his two adult children as equal beneficiaries and provides for an outright distribution of the assets (in the event of his spouse passing first). The current inventory of Geraldo's estate is as follows:

Asset	Fair Market Value	Additional Details
House	$425,000	Principal residence
Universal Life Policy on Geraldo's life	$27,000 CSV	
Stock Portfolio	$225,000	
RRSP – Mutual Funds	$160,000	
Employer's Pension	$135,000 Estimated commuted value	No residual value

Prior to her death, Geraldo's wife was the beneficiary of the universal life insurance policy and the RRSP, as well as the survivor under his pension plan. There were no contingent beneficiaries named on any of the plans and he has not yet made any changes.

Geraldo is self-employed and is concerned that the ultimate transfer of his assets to his children could be interfered with by a possible lawsuit. A concerned Geraldo has asked for advice regarding the current status of his assets vis-à-vis creditors as well as any suggestions as to how he might "creditor protect" those assets.

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.

Reference

- *257 Advanced Estate Planning Study Guide (Section 2.3)*
- *Estate Planning with Life Insurance, 6th Edition (Chapter 11)*

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. 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. 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.

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.

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). 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.

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.