

Offshore Asset Protection Strategies & Structures

**A Presentation to the Estate Planning Council of Mississauga
By N. Gregory McNally, BA, LL.B, MBA, JD, LL.M (Int'l Tax), TEP**

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**N. Gregory McNally & Associates Ltd.
International Tax Strategies and Asset Protection Planning
1 First Canadian Place, Suite 350
Toronto, Ontario, M5X 1C1
416.259.1222
greg.mcnally@ngma.ca**

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Introduction

Offshore asset protection strategies follow similar concepts pertaining to domestic asset protection strategies. The difference is that offshore legislation is more geared towards asset protection and second, it is very difficult for a domestic court to exert jurisdiction.

The key to successful planning is to balance the advantages of offshore legislation with the remedies available to a domestic court should they seek to protect Canadian public policy.

Offshore Trusts

Asset protection trusts (“APT’s”) are the most common form of offshore asset protection. Typically, a domestic planner, like a lawyer or an accountant, has a connection with a certain offshore trustee service provider (like RBC, Scotiabank, Butterfield, etc.). The planner will be familiar with the standard trust indenture used by the trustee and the due diligence required by the trustee.

The planner gets specific information from the client, like whom it is who will be funding the trust (usually the client), as well as if there are to be named any specific beneficiaries. Many trust indentures leave the distribution of gifts from the trust to the discretion of the trustee, with the trustee designating who those beneficiaries are in the future. Many times a protector is named whose job it is to approve of any beneficiary designation and distribution and who also has the power to hire or fire the trustee. The client usually maintains the power to select and terminate the protector.

Once the indenture is finalized, the client wire transfers funds to the trustee. Often times the trustee will incorporate a holding company capitalizing it with the funds from the trust. A holding company is more efficient at opening up banking and investment accounts with which to manage the funds.

A list of specific recommendations regarding the formulation and operation of an APT are attached hereto as Appendix A and a list of often used jurisdictions is attached hereto as Appendix B.

Insurance Products

International insurance contracts are a little known strategy available to Canadians for asset protection. They are available for both life and general insurance and in respect of life contracts in both term and universal and in respect of universal, in both exempt and non-exempt formats.

For those of you not familiar with these terms, I attach a list of explanations as Appendix C.

In relation to asset protection, a client could purchase exempt universal life offshore, but that offers no more protection than is granted here in Canada. However, a client may consider non-exempt insurance, which in essence creates an asset protection wrapper without the cost of face coverage.

Non-exempt insurance is usually a combination of term insurance with a side account that is connected to some other aspect of insuring the client under general insurance such as critical illness or disability. International insurance underwriting is unique in that a company can legally segregate its premium payments and its various underwriting exposures. In other words, an underwriter can keep apart certain of its assets from certain of its liabilities under law, creating something similar to captive insurance on a private client basis.

Managing Domestic Courts

An offshore asset protection strategy is useless if the client is subject to domestic decisions that nullify the benefits of the planning. In the United States, where the courts are much more inclined to follow the doctrine of “Substance over Form”, they will simply order a client to unwind a plan or produce documentation, whether it is in the power of the client or not, and issue contempt orders if the client fails to comply.

With respect to Canadian jurisprudence, the courts seem less inclined towards the doctrine of “Substance over Form”, but keep in mind that offshore asset protection strategies have not been regularly litigated in Canada and very little reporting on the subject exists. Therefore, it is uncertain how Canadian courts would trend regarding Substance over Form, especially if the plaintiff was a spouse in a family law case.

If an asset protection strategy would be attacked, I believe that the legal arguments would be lead in respect of the following issues:

- 1) fraudulent conveyance (in some jurisdictions – fraudulent preference);
- 2) constructive trust; and
- 3) sham.

In respect of APT’s there is a fourth legal argument that would potentially apply – that of incomplete trust.

Fraudulent Conveyance

Fraudulent conveyance is going to be the number one legal principle that will be used by any plaintiff attempting to attack an asset protection strategy. It is most popular because there is domestic legislation (both federal and provincial) defining the concept and there is also ample case law in Canada dealing with it.

It is likely that a court in Ontario will first look to legislation in Ontario. The applicable legislation is the *Fraudulent Conveyances Act*, R.S.O. 1990, c.F.29. The principal provisions are found at ss.2 & 3:

s. 2 Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns.

s. 3 Section 2 does not apply to an estate or interest in real property or personal property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance to the person notice or knowledge of the intent set forth in the section.

Also applicable in Ontario is the *Bankruptcy and Insolvency Act*. R.S.C, 1985, c. B-3, s. 1; 1992, c. 27, s. 2. A similar provision to s.2 of the FCA can be found at s.91 of the BIA. Section 91 provides that when the defendant has entered into bankruptcy, a settlement made by the bankrupt within one year of his or her bankruptcy, or within five years of his or her bankruptcy where a trustee can prove that he or she was insolvent, is void as against the trustee in bankruptcy.

There are exceptions to this general provision, the main one being where the settlement was made in good faith and for valuable consideration.

In any of these cases, counsel for the plaintiff is going to try to get the court to agree that a settlement of a trust or a purchase of an insurance policy is a fraudulent conveyance. In *Stone v. Stone*¹, the plaintiff successfully argued that a spouse is a “creditor” for the purposes of the FCA in Ontario by virtue of her rights to matrimonial property under under s. 5(3) *Family Law Act*².

The key for the plaintiff will be what remedy the court will order. If the defendant does everything within his or her ability to comply with a domestic court order, I think that it would be difficult for a court to order anything other than a monetary judgment. If the asset protection planning was complete, then a monetary judgment should be irrelevant to the defendant.

Constructive Trust

In *Waters’ Law of Trusts in Canada*, Professor Donovan Waters states that constructive trusts have been firmly recognized in the law of Canada.³ Constructive trusts are imposed

¹ *Stone v. Stone*, 203 D.L.R. (4th) 257, 18 R.F.L. (5th) 365, 39 E.T.R. (2d) 292, 55 O.R. (3d) 491, [2001] O.J. No. 3282, 156 O.A.C. 345.

² *Family Law Act*, R.S.O. 1990, c.F3.

³ *Waters’ Law of Trusts in Canada*, (3rd ed. Donovan W.M. Waters, Editor-in-Chief, Mark R. Gillen and Lionel D. Smith, Contributing Editors: Thomson Carswell, 2005), at p. 445.

by law to rectify an unjust enrichment. Theoretically, a Settlor in Canada could be deemed to be a constructive trustee in relation to an APT and ordered to distribute trust assets to the deemed beneficiaries. If those assets are based in Canada, then it would likely be easy to enforce that judgement. If the assets are outside of Canada, then the best that a Canadian court would likely do is order the defendant to sign a direction to the trustee to distribute those assets. If the defendant does not sign such a direction then he or she will most certainly be subject to contempt proceedings. However, if the direction is signed, but not acted upon, I doubt that a Canadian court would find contempt, unlike what has occurred in the United States.⁴

Sham

Sham means acts done or documents executed by parties involved in a certain transaction, which are intended to give to third parties (or to the court) the appearance of creating legal relations different from the actual rights and obligations (if any) which the parties in fact create.⁵ One of the main principles behind the concept of sham is that all parties to the transaction must be in on the deception, but it differs from fraud in that there is not an attempt to unlawfully take value from another.

The result of a finding of sham would be to “unwind” the transaction and trace all funds relating to non-arm’s length transactions. However, as with all remedies, if the assets are in a separate jurisdiction and there is no legal way for a party to the sham to retrieve the assets, it is unlikely that anything more than a money judgement would face a losing defendant.

Incomplete Trust

The concept of an incomplete trust is available for plaintiffs to argue in relation only to ATP’s. The idea is to defeat the trust based on the lack of one of the three main certainties that you need to create a trust. The certainty attacked is the certainty of subject. The argument follows along the lines that if the settlor used funds to settle the trust that were not legally his or hers in the first instance than no certainty of subject could exist.

It is doubtful that this argument would succeed where counsel is not able to use any of the three arguments noted above, but it still exists and should be counted in the discussion.

Family Law Considerations

There are special considerations where the creditor is a spouse. First, I think that the court will be more inclined to try to find for the plaintiff. Second, there are non-monetary

⁴ See *In re Lawrence*, 279 F.3d 1294 (11th Cir.2002) or *Federal Trade Commission v. Affordable Media, LLC.*, 179 F.3d 1228 (9th Cir. 1999).

⁵ *In Re Esteem Settlement* [2003] JLR 188

remedies available to the plaintiff under the *Family Responsibility and Support Arrears Enforcement Act*⁶, where the defendant is in arrears in spousal support, including jail sentences and confiscation of driver's license and passport.

Issues Relating to Planners

If you are a professional advisor counseling clients in relation to asset protection planning, there are a couple of issues that you want to be aware of.

Solicitor Client Privilege

Plaintiffs will seek to have all documentation related to the defendant revealed. If the motion includes lawyers providing advice to the defendant, the issue of solicitor client privilege will be raised. Generally speaking, solicitor client privilege attaches to all information requested by a client for the purpose of obtaining legal advice, or generated by counsel in the process of giving legal advice. However, two back doors to subverting privilege may exist.

The first is in relation to documents (like foreign bank statements or insurance contracts or trust indentures), in the possession of the defendant's lawyer which are not deemed to be information pertaining to the provision of legal advice⁷.

The second is where plaintiff's counsel argues that the lawyer was in fact involved in establishing the planning, which if fraudulent (which they will all try to argue), may subject the lawyer having to provide evidence to the court⁸.

Tort of Conspiracy to Defraud

One of the areas of concern to professionals working in asset protection planning is the concept of "conspiracy to defraud", which could result in the professional having to pay up for any damages awarded to the plaintiff by the court.

General Planning Recommendations

There are a few basic planning principles that make asset protection plans substantially less aggressive and more defensible than a number of asset protection strategies being marketed in Canada.

- 1) First and foremost, make sure that the client has written legal advice regarding the plan from competent counsel. If competent counsel helped orchestrate the plan it is less likely to be offside of the law and the client will appear to have acted reasonably in his or her planning efforts.

⁶ *Family Responsibility and Support Arrears Enforcement Act*, 1996, S.O. 1996, c. 31

⁷ *Canbook Distribution Corp. v. Borins*, 1999 CanLII 15082 (ON S.C.) — 1999-06-10

⁸ *Ken Peake, Trustee v. Dashney*, unreported, Ontario Superior Court of Justice in Bankruptcy, Court File No. 31/043764.

- 2) Use offshore jurisdictions to put the plan into place. There is no sense going to the expense and effort to establish a plan if a domestic court can simply order a seizure of the assets. Also, the defendant has a tremendous amount of bargaining power over a sensible plaintiff, if the plaintiff knows that it is virtually impossible for a plaintiff to collect on any domestic judgment ordered. This could stop litigation in its tracks before it starts.
- 3) Start the planning as early as possible; preferably before any clouds appear on the horizon. Early planning assists in relation to certain legislation like the BIA.
- 4) Incorporate ancillary purposes into the asset protection plan, such as estate, investment or tax planning. Ancillary purposes detract greatly from allegations of intent to defraud as the transactions formulated in terms of the ancillary purposes usually have nothing to do with the plaintiff.
- 5) All plans should be based on transactions incorporating commercially viable terms and replicate if possible mainstream domestic transactions. It is much more difficult for a judge to find that a certain transaction constituted a fraudulent conveyance in the case where an international service provider was used, if there are cases on point using domestic institutions.
- 6) Use a series of players to institute the plan and do not share all of the information with any one party, if possible. If each individual transaction is legitimate in and of itself, it is more difficult for a court to hold the collective players responsible for possible claims in conspiracy.

Summary

Asset protection planning is a unique area of practice. Professionals submit themselves to high degrees of professional risk and they carry with them responsibility that they may be procuring substantial financial harm to another individual. People working in this area need to select their clients with particular care, using thorough due diligence and weigh all of the factors at hand.

APPENDIX A

Specific Recommendations Regarding the Formulation and Operation of APT's

- Pick a jurisdiction with a statute of limitations period. Although some jurisdictions claim not to need one, because of their reliance on a solvency test, it is still better to have a specific date past which no creditor claims can be brought.
- Specifically state in the trust indenture that the settlor is excluded from being a trustee. In addition, the settlor should not reserve as one of his or her powers the right to appoint the trustee. That power should be left to a separate party, such as a Protector.
- Make the trust settlement irrevocable and grant as much discretion to the trustee as possible in making distributions. Specific distributions can be seized.
- Limit powers reserved to the settlor as much as possible, but in any event, pick a jurisdiction that specifically states that the powers reserved to the settlor, at hand, are not excessive by their very nature. Keep in mind that a trustee in bankruptcy can exercise those same reserved powers, so the idea is to keep as much discretion in the trustee's hands as possible.
- Advisors in consultation with the client, may consider adding an "anti-duress" clause to the trust indenture, wherein the settlor would become specifically excluded as a beneficiary if he or she was subjected to court proceedings in his or her home jurisdiction.
- Do not dictate instructions to the trustee. Allow the trustee to consider any proposals and act independently. In framing proposals, the settlor should do so verbally. Email directions outside of powers reserved by the settlor are express proof of fettering the trustee's discretion. In fact, the opposite is also true. The written denial of a request by the trustee shows that the trustee is acting independently. It would be useful for the settlor to have evidence of such a consideration and denial on his file, so long as the settlor and trustee do not act in collusion to create such evidence as a deception.
- The assets settled to the trust should as much as possible be custodied in the trust jurisdiction, or if not in the trust jurisdiction, then in a jurisdiction that protects client confidentiality and is not biased towards creditor claims. Switzerland may be a good example. Real estate is almost always a bad asset to hold, from an APT standpoint, unless that property is located in the same jurisdiction as that governing the trust itself.
- Make sure that the trust has a flee-clause, especially if the original jurisdiction chosen has a long statute of limitation period, like Cayman. Some of the other jurisdictions, like Nevis and the Cook Islands will recognize the trust from inception and may have a statute of limitation period that has already passed.
- Choose a jurisdiction that has enacted confidentiality laws restricting the release of information and better yet, one that specifically legislates in favour of a trustee not divulging any information to beneficiaries or potential beneficiaries of a trust. Treaty countries in this regard, like Barbados, may not be preferable if the creditor is CRA.
- The settlor should swear an affidavit of solvency after the settlement and contribution to the trust and be able to prove same with a financial statement.

- Choose a jurisdiction that has specifically repealed the Statute of Elizabeth or one to which it, or anything similar, has not ever applied.
- If possible the trust should speak to other estate planning objectives other than simply protecting the assets against possible creditor claims. Perhaps the avoidance of probate taxes etc. may be referred to in the preamble. Giving the trust another intention weakens the argument that the Settlor specifically intended to defraud his or her creditors.

APPENDIX B

A Sampling of Certain APT Jurisdictions used by Canadian Planners

The Bahamas

A number of different Acts govern the establishment and validity of a trust in the Bahamas, the main ones being; the *Trustee Act, 1998*, the *Trusts (Choice of Governing Law) Act, 1989*, and its 1996 amending Act, the *Perpetuities Act, 1995*, and its 2004 amending Act, the *Fraudulent Dispositions Act, 1991* and the *Purpose Trust Act, 2004*.

The *Trustee Act, 1998*, lists certain powers that can be retained by the Settlor and provides for the role of a Protector. It also sanctions a “restriction against forceable alienation” under s.40, which may be provided in a trust indenture to keep any receiver in bankruptcy from claiming distributions to a bankrupt beneficiary. Information regarding Trustee deliberations is restricted and there are a number of provisions to protect and indemnify a Trustee, allowing it the ability to safely litigate the stated provisions of the trust indenture.

The *Trusts (Choice of Governing Law) Act, 1989*, allows a Bahamian trust to provide for a flee clause to export itself to another jurisdiction and also specifically excludes the application of a foreign law in respect of forced heirship or matrimonial claims to defeat a disposition into a trust.

The *Statute of Elizabeth*, was repealed and replaced by the *Fraudulent Dispositions Act, 1991*. The primary purpose of the *Fraudulent Dispositions Act* is to protect transfers of assets into Bahamian trusts from unknown or contingent creditors. The creditor must prove that the Settlor had a fraudulent intent to wilfully defeat an obligation owed to it by making the disposition to the trust. Any action by a creditor must be commenced within two years from the date of transfer by the Settlor.

Foreign civil judgements, not otherwise statute barred, can be enforced in the Bahamas under the *Reciprocal Enforcement of Judgments Act*. However, that *Act* provides for a list of prescribed foreign jurisdictions from which a judgement may be reciprocally enforced and Canada is not one of the recognized jurisdictions.

Jersey

In Jersey, the main act governing the creation and validity of trusts is the *Trusts (Jersey) Law, 1984*. While this *Act* does not have specified reserved powers for the Settlor, it does expressly permit the Settlor to be a beneficiary and provide for a third party, which could potentially be a Settlor or Protector, to appoint a Trustee to the trust.

The *Act* does not specifically mention the term Protector, but sanctions the inclusion of a third party in the trust indenture to whom, the Trustee may need to seek consent from

before exercising a discretion. This could possibly be the Settlor or an appointed Protector.

The *Act* condones a “restriction against alienation” within the trust deed and there are provisions restricting the dissemination of information to Beneficiaries, as well as providing for the export of the trust to a different jurisdiction. Lastly, there are also provisions for the indemnification of the Trustee should it act in conjunction with a third party or attempt to enforce the terms of the trust indenture.

There is no equivalent of a statute against fraudulent dispositions in Jersey, as one has never been enacted and those under English law, such as the *Statute of Elizabeth*, were never incorporated into Jersey law. This means that while there may not be legislated rules assisting creditors in relation to setting aside a Jersey trust, or tracing proceeds in a Jersey trust, there aren’t any legislated qualifications or limitation periods either.

Although Jersey does not have as many legislative provisions clarifying its governance of trusts for asset protection purposes, the case *In Re Esteem Settlement*, certainly seems to evidence support for the business in the jurisdiction.

Barbados

Like Jersey, non-resident or international trusts in Barbados are regulated primarily by one act - the *International Trusts Act*, 1 LRO 1998, CAP.245.

However, this *Act* incorporates its own fraudulent dispositions provision that works similar to the Bahamian legislation. A creditor has the burden of proof to show that a Settlor wilfully intended to defeat an obligation owed to the creditor by making the transfer to the Barbadian trust. There is a limitation period of three years from the date of the transfer and local counsel has advised that the *Statute of Elizabeth* has no application to Barbados.

Section 18 of the *Act* states that the court shall not set aside a trust validly created under the laws of Barbados, in relation to the laws of another jurisdiction concerning, marriage, forced heirship or creditor protection in bankruptcy.

There are no specific powers reserved to a Settlor under the *Act*. However, s.26 provides for the recognition of a Protector to a trust governed by the *Act*, which appointment does not expressly exclude the Settlor. The *Act* expressly confers on the Protector the power to appoint the Trustee, change the governing law of the trust or to receive advance notice of specific actions of the Trustee. But keep in mind that notice is not consent.

The Barbados *Act*, like its predecessors above, provides for restricted information to Beneficiaries and for the ability of the trust to change its governing law. It also contains an interesting provision entitled the “presumption against avoidance”, wherein if a trust settlement is silent on being revocable or irrevocable, it shall be deemed irrevocable.

Cayman

The Trusts Law (1998 Revision) primarily governs trusts in Cayman, although most people are also familiar with the *Special Trusts (Alternative Regime) Law 1997*, which deals with non-charitable purpose trusts.

The Trusts Law (1998 Revision) expressly provides for Settlor reserved powers under ss.14(1) and the exclusion of marital claims under s.91. The *Act* sanctions the appointment of a third party in the trust indenture, which can be authorized to appoint and terminate the Trustee of the trust and to consent to investments made by the Trustee, but it does not expressly mention the role of a Protector to the trust.

The *Act* provides for “protective trusts” in the event that a beneficiary should be subject to forceable alienation of his or her trust disposition. It also sanctions the provision of a change of jurisdiction for the trust and offers wide protections for the Trustee in enforcing the terms of the trust.

Fraudulent conveyances to a Cayman trust are dealt with under the *Fraudulent Dispositions Law (1996 Revision)*. This law states that every disposition of property made with an intent to defraud, and at an undervalue, shall be voidable at the instance of the creditor prejudiced. Applications to set aside a disposition must be made within six years of the transfer.

However, Cayman trusts may also be subject to *The Bankruptcy Law (1997 Revision)*, which states that any disposition to a trust made within two years immediately prior to the bankruptcy will be void regardless of whether or not the bankrupt was solvent at the time of the disposition. Further, any disposition made between two and ten years prior to the act of bankruptcy will be void if the Settlor was not solvent at the time the disposition was made.

In order for *The Bankruptcy Law* to apply, the Settlor needs to have some *nexus* to Cayman. However, this *nexus* is achieved at a fairly modest standard. It includes a Settlor who is personally present in Cayman when the act of bankruptcy was committed (i.e. the transfer to the trust); a Settlor who is ordinarily resident in Cayman or has a place of residence in Cayman (perhaps a holiday condominium?); or who does business in Cayman, personally or by means of an agent.

The application of *The Bankruptcy Law* to a trust has already been successfully accomplished in the case of *Grupo Torras v. Butterfield Bank* [2000] CILR 441. So while the statute of limitation period under the *Fraudulent Dispositions Law* is six years, a Settlor could be faced with the prospect of dealing with a ten-year period under *The Bankruptcy Law*.

APPENDIX C

Insurance Definitions

“Exempt”, applies only to universal life contracts and means exempt from income tax on the income generated on the cash account in the policy. To qualify as “exempt” a universal life contract must comply with the Canadian MTAR (maximum tax actuarial reserve) rules. Simply put, these rules specify that in relation to a universal life contract, the policy must contain a certain multiple worth of face value death benefit relative to the amount of the premium payment. As an example, say an owner wanted to pay a premium of \$10,000 per year, depending on the particulars of the life insured, including age, the death benefit may have to be \$80,000 to \$100,000.

“General Insurance”, means anything other than life and usually refers to critical illness or disability insurance in the context of asset protection planning.

“Non-Exempt”, means simply that a particular universal life contract does not comply with the MTAR rules, but this does not necessarily mean that the cash account generates taxable income for the purposes of the *Income Tax Act* (Canada).

“Term Life”, means a life insurance contract that has only a face coverage component and no cash account or investment component.

“Universal Life”, means a life insurance contract that has both a face coverage component, plus a cash account or investment component.

APPENDIX D

N. Gregory McNally

BA, LL.B, MBA, JD, LL.M (Int'l Tax), TEP

Greg McNally is an international tax lawyer by training. He has earned various degrees, including law degrees in both Canada and the United States and a Masters of Law in International Tax. Greg was called to the Alberta Court of Queen's Bench in 1991 and to the Supreme Court of the Turks and Caicos Islands in 1992.

Greg practiced international tax law in TCI for 10 years, dealing primarily with high-net-worth Canadian clients. In 2002, Greg returned to Canada with his wife and three children and joined Royal Bank of Canada (Global Private Banking) as their Senior Manager of International Services in Toronto.

In 2004, Greg started an international tax consulting firm called N. Gregory McNally & Associates Ltd., where he now oversees the development and implementation of customized international wealth management solutions on behalf of high-net-worth and ultra high-net-worth clients.

N. Gregory McNally & Associates Ltd.

International Tax Strategies & Asset Protection Planning
1 First Canadian Place, Suite 350
Toronto, Ontario
Canada, M5X 1C1
416.259.1222
greg.mcnally@taxfreeliving.ca