CCH Tax Notes – November

The *Braydon* Asset-Protection Case – A Tax Drone's Perspective

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The Braydon case**[1]** - which involved a successful attack on a standard corporate spin-out by a creditor under BC fraudulent conveyances legislation - is a fascinating combination of insolvency, tax and corporate law issues. With its holding that "creditors and others" include future creditors, tax advisors may be tempted to conclude that asset protection is a thing of the past, and some of the commentary on the case gives out this sort of aura. But our insolvency lawyers keep reassuring me that we tax drones are overreacting. Even so, Braydon does raise some interesting issues.

Before I go too far, you should know that, on June 24th, the Supreme Court of Canada denied leave to appeal from the BC Court of Appeal decision. Thus, Braydon is, at least for the time being, settled law in British Columbia and has been called "persuasive law" in Ontario.**[2]** But persuasive of what?

Before offering further comments, here is a breakneck review of the facts:

"Bothham Holdings Ltd," ("BHL") had incurred capital gains tax;

- BHL also had valuable real estate;
- BHL's advisors suggested that it go into the leasing business, generate losses from CCA claims and carry them back to apply against the capital gains tax;
- The advisors also suggested to implement a standard spin-out transaction whereby BHL's real estate was transferred to Braydon;
- A stated rationale for the spin-out was so that the real estate would not be exposed to creditors of the leasing business. This was on the record, by virtue of a letter dated contemporaneously with the transaction**[3]**;
- Within seven months, the leasing business was $5M in debt; within 19 months, Braydon was assigned into bankruptcy and its debts exceeded $20M.

At issue was the propriety of the spin-out under BC fraudulent conveyance legislation. More precisely: is a transfer of property to protect against future [also present] creditors, if made without mala fides and with a legitimate business purpose, prohibited?

The case raised two points that I believe deserve clarification: the first was innocent versus dishonest intent as triggering fraudulent conveyance legislation; the second, which I will discuss later in the article, was whether good consideration was given for the spun-out real estate. Some other key points: First, the "creditors and others" terminology in fraudulent conveyance legislation includes future creditors. The fact that other business objectives in respect of the removal of assets are being pursued does not matter: "the question in every case is whether it was carried out to delay, hinder or defraud creditors and others. . ."**[4]**. It was argued that BHL could have incorporated a Newco for the leasing business, i.e., to insulate the real estate. The court's simple response? That's not what happened.**[5]**

The Mala Fides "Issue"

The BC Court of Appeal held that mala fides (improper intent) was not required. It literally struck-out words in the BC legislation pertaining to "collusion", "guile", "malice" and "fraud". However, the result of this rather unusual course of action is that the British Columbia legislation is essentially identical to Ontario, and other common-law provinces**[6]**.

For example, section 2 of the Ontario Fraudulent Conveyance Act (FCA) states:

"Every conveyance of property made with intent to defeat, hinder, delay or defraud creditors or others is void."

Section 3 of the FCA provides a defence to Section 2:

"Section 2 does not apply if property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance notice or knowledge of such intent."

So based on similar wording, Braydon held that the only intent necessary to void a transaction is the intent to put assets out of the reach of one's creditors.

"Issues" - That aren't really issues (In Ontario, anyway)

The commentary on Braydon has stressed a number of "issues" decided by the case. But in Ontario, at least, some of these aren't really issues.

The first is that "creditors and others" includes future creditors. Some BC cases have supported that "others" means future creditors**[7]**. In Ontario, "others" has included the concept of future creditors**[8]**. So there is nothing new in Ontario on this front.

Commentators have also stressed that the case indicates that putting assets out of reach of future creditors does not require mala fides.**[9]** As I said, this was a BC issue in view of the wording that was struck from the legislation (i.e., collusion, guile, etc.) - but is no longer. This is a non-issue in Ontario.

Points That I Find Interesting

Ok, so why do I find the Braydon case so interesting? First, because of the grief that the stated rationale for the transaction caused. To get the tax relief – i.e., losses from CCA, it was presumably necessary to take the real estate out of BHL: if BHL's "principal business" was not leasing, it could not create tax losses through CCA claims**[10]**. This was the "business reason" for the transaction. The advisor could have confined his remarks to this rationale, but he went on to say that the transaction's purpose was also to limit creditor claims.

As a tax practitioner, another point I find interesting is the analysis of a spin-out, especially in terms of the fraudulent conveyance defence that there was good consideration. The trial court used an intuitive "before and after" approach to find that the "good consideration" defence was not applicable: quite simply, before the spinout, BHL was a valuable company; after, it had little or no assets.**[11]** The BC Court of Appeal upheld this finding as it found there was no palpable error on this point. But neither judgment contained any detailed analysis of the spin-out.

Indeed, there seems to be a certain amount of confusion as to how a spin-out transaction translates into corporate law and solvency tests. At the risk of adding to it, I would like to put my two cents on the table. My contention is that, at the core of a spinout is a redemption of shares. (In Braydon, the spin-out was in substance a redemption made in consideration for real estate.**[12]** There are tax complications to doing this in one shot, so it was necessary to "temporarily" interpose other property for real estate.)**[13]**

So what was particularly problematic in Braydon? First and foremost, there was “hard evidence” that the transaction was to put property out of the reach of creditors. Also, Braydon obviously entered into a risky business with the intent to create losses. Finally, the time period before creditors materialized was short, although this was not specifically acknowledged in either judgment. The amount of debt run up within less than two years must have obviously been troublesome to the court. My insolvency colleagues tell me that these types of cases are largely fact driven.

So What’s New?

So does anything change? While the Braydon case is not really new law in Ontario,**[14]** what may be significant is the notoriety of the case itself, i.e., in respect of perceptions as to the ability to successfully challenge asset protection manoeuvres.**[15]**

But a more recent development is the Bozzo case**[16]**, an Ontario decision that came down after the British Columbia Court of Appeal decision but before the Supreme Court of Canada denied the application for appeal. In that case, Cumming J. indicated:

“there is also [law] to suggest that an honest intent to remove assets from the reach of future creditors through a conveyance of property may be void under s.2 of the FCA. However . . ., in my view, the law allows a person to rearrange his affairs to isolate his personal assets from future creditors as opposed to present creditors.”**[17]**

Another wild card of Braydon and its notoriety could be the impact on a recently-enacted provision of the Bankruptcy and Insolvency Act**[18]** under which non-arm’s length transactions can be attacked within five years of bankruptcy**[19]** where the debtor intended to “defraud, defeat or delay a creditor” - note the similar wording to fraudulent conveyances legislation. (If the provision applies, the transferee must pay to the bankrupt estate the difference between the value of consideration received/given.)

The Braydon case and its possible aftermath could turn out to be reminiscent of the fallout from an older case, Trident v. Danand**[20]**. This case involved a creditor successfully piercing the corporate veil in respect of a bare trustee corporation; however, this did not stop the use of bare trustee vehicles. At the very least, they can provide negotiation room - to avoid expensive litigation.

My simple summary for professional advisors: be careful what you put “on the record”. It may come back and bite you.

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[1] *Abakhan & Associates Inc.* v. *Braydon Investments Ltd.*, 2008 BCSC 1547, 2009 BCCA 521 (leave to appeal to Supreme Court denied, June 24, 2010).

[2] See “The Honest Fraudster – aftermath of the Braydon decision”, Eleonore L. Morris, in Minden Gross’ summer 2010 newsletter, available on our website, www.mindengross.com.

[3] The letter described the objectives and purpose of transaction as follows:

1. Move the real property and other property of BHL to new company ("Newco") to ensure that BHL's real property and other assets are not exposed to its new leasing venture; and

2. Limit the activities and gross revenue of BHL to its interest in the JW Auto Group partnership.

This was confirmed in discovery [paragraphs 66 and 67 of BCSC judgment].

[4] See Court of Appeal decision (BCCA), paragraph 85.

[5] BCCA, paragraph 88.

[6] In some provinces, e.g., Alberta and Saskatchewan, there is a temporal component to the requirement for a fraudulent conveyance (so that the conveyance may be somewhat more difficult to set aside), generally being transfers made:

a) when the debtor is in insolvent circumstances;

b) when the debtor is unable to pay its debts in full; or

c) when the debtor in on the eve of insolvency.

[7] See BCCA paragraph 61, 64 and 78.

[8] In *Stone* v. *Stone,* (2001), 55 OR (3D) 491, Ontario Court of Appeal held that "others" included a spouse.

[9] This appears to include lying or deceit, e.g., misrepresenting the amount of a corporation's assets.

[10] See Regulations 1100(15) and (16) to the *Income Tax Act*.

[11] Also, the requirement of not having knowledge or notice of intent was not met.

[12] In isolation, BHL's shares were redeemed for a promissory note.

For further discussion of this issue, see 708 of Tax and Family Business Succession Planning, 3rd Edition, by the author, Michael Goldberg and Samantha Prasad. As stated, where shares are redeemable, solvency tests found in subsection 32(2) of the OBCA come into play. If the shares involved are not redeemable, there is a solvency test under subsection 30(2) of the OBCA relating to the acquisition of such shares by the corporation.

I also note that meeting the corporate solvency test for redemption was rejected by the lower court:

"I have also considered the defendant's argument that the plaintiff's position, if accepted, would place judge-made restrictions on . . . the right of a corporation to redeem shares under ss. 77 and 79 of the *Business Corporations Act*. I disagree. The statutory provisions do not provide a license to engage in transactions which are counter to the F*raudulent Conveyance Act".* [See Pars. 78 and 79]

[13] Whether the court's approach to the "good consideration" issue could apply to tax law remains to be seen.

Another thing I find interesting is that in order to access the tax losses of the leasing partnership, BHL was a general partner. The alternative would have been for BHL to be a limited partner, which would be the more usual approach. However, the "at-risk rules" would have then applied, so that in order to access the losses, it would be necessary to inject a corresponding amount of assets into the partnership - and therefore put them at risk vis-à-vis the partnership's creditors. Therefore, the structuring as a general partnership coupled with the spin-out of assets shows that there was effectively an intent to not to have to put assets at risk by complying with the at-risk rules. The inference of the general partnership structure is of intent to defeat creditors. However, this analysis was not necessary in view of explicit statements in this respect.

[14] Although perhaps the case "reinforces" that *mala fides* is not necessary.

[15] What is important is:

a) consideration given;

b) to whom the asset was conveyed;

c) what business the company which conveyed the asset is or will be carrying on following the conveyance;

d) timing of the conveyance where a bankruptcy or other creditor protection proceeding occurs; and

e) evidentiary threshold of showing that the conveyance was done for a legitimate business purpose *other* then to shelter assets.

[16] *Duca Financial Services Credit Union Ltd.* v. *Bozzo*, 2010 ONSC 3104.

[17] Paragraph 65.

[18] Section 96 of the *BIA*.

[19] One year if at arm's length.

[20] *Trident Holdings Ltd.* v. *Danand Investments Ltd.* (1988), 64 O.R. (2d) 65 (Ont. C.A.).