

Who Needs A Lawyer?

vol.1 edition 8



kmb notes

Picture this – The phone rings, the panicked voice at the other end shouts, “Brian, I just got a demand letter from some creditor and they want everything including the kitchen sink! Quick, we gotta protect my stuff.”

■ The law is a step ahead of you

And then suddenly the voice takes on a smug tone. “Never mind, I have the answer. I’ll transfer ownership of everything to my wife and my brothers, no money will change hands, no-one will know and I am free and clear. Let them demand, I own nothing! Who needs a lawyer for simple business solutions like this?”

It is at this moment that I share with the client a concise summary of the various pieces of legislation designed to restrict the circumstances under which people can conveniently dispose of their assets in times of trouble and then “reclaim them” when the sun comes back out. The essence of this legislation is that if you wish to maximize the differential between your ability to control an asset and the ability of creditors to seize the asset those steps must be put into place well before the issuance of a Statement of Claim or the attendance at your premises of a couple of “gentlemen” designed to point out to you the close connection between your payment of this particular obligation and your continued health.

■ Basic idea, levels of complexity

The most obvious and simple technique is to incorporate a business or limited partnership which ensures that (with a few exceptions) only the incorporated entity or the limited partner will be liable for debts incurred by the incorporated entity in the normal course of business.

This basic model can be used in a variety of ways involving many different levels of complexity. A simple example involves the creation of a

two-tiered corporate structure. I recall the story of a sports bar, where the entire décor consisted of very expensive sports memorabilia. The bar was unable to make a successful go of it and eventually went out of business. Only at that time did the numerous creditors become aware of the fact that every piece of sports memorabilia situated in the sports bar was in fact leased to the sports bar by a separate and distinct corporate entity, owned, of course, by the same individual who owned the bar. This had been set up prior to the opening of the bar and therefore the creditors were left with only a bit of inventory and used furniture. A slightly different variation is to sell all major assets to your corporation and to take back an appropriate security interest, so that should the business fail, you will have priority over all other creditors with respect to whatever value remains in the assets secured. This can be done personally or even more effectively from a holding company set up to control the shares of the operating company.

Applying the same principal in a family setting, each spouse takes on a separate and distinct role. One spouse only is actively involved in the business and the passive spouse controls all of the shares of the business and other family assets.

■ Secure your sale

I once acted for an American corporation that sold large discreet pieces of machinery valued at anywhere between \$50,000 and \$200,000.00. I was astonished at the time I was first retained by the fact that the company’s only security for payment was the contractual obligation of the corporate entity.

Though not applicable, in situations where the value of an individual item sold is relatively modest, in a scenario such as described above, the company created a totally unnecessary

and unwarranted business risk by not taking the time to ascertain what tools may have been available to protect them. In this particular case, a PMSI (purchase money security interest) under the PPSA (Personal Property Search Act) would have been a simple and effective way of using the very item they were selling as security for payment of the item itself.

■ Debts are not all created equal

Though a corporation provides much protection, clients are not always aware that not all debts are created equal and there are certain debts where the officers and directors of the corporation can be held personally liable. As much as it pains me to explain this to clients, if you have a choice between paying the salaries of your employees or any remittances, such as GST or PST or your lawyer, only the former debts are likely to attract the personal liability of directors and officers.

■ Consider a trust

There are also long-range approaches, the primary technique being the creation of trusts. A trust consists of the following components – a settler or grantor which is the entity that actually initially owns the assets and transfers it to the trust. The trustees who administer or manage the trust property over time and finally the beneficiaries or the entities named by the settler to benefit in some way from the assets that have been placed in the trust.

Trusts have the potential to alleviate problems with probate and inheritance law, may render administration of assets simpler and create the greater likelihood that any potential beneficiaries will in fact receive the specific

assets or monies in a manner completely consistent with the intentions of the grantor / settler. They can minimize taxes and the necessity of probate.

All of the above represents various ways of arranging the ownership of your assets and your property in such a way that you retain maximum control without any or minimal direct ownership.

■ Avoid the problems of Do It Yourself

There may be a dozen ways to protect your assets that sound really simple to implement. But you are talking about your livelihood, maybe your house and the security of your family. I can be a good sounding board for you. Please take a moment before you go ahead, let's clarify the nature of the risks associated with each asset and develop a plan that will allow you a peaceful night's sleep, just in case the sky does happen to fall in.

■ Questions?

If you have any questions or comments regarding matters discussed in this newsletter, please contact,

Brian Jenkins Jenkins@kmbllaw.com
or call (905) 276-0409

Brian Jenkins practice is centred on commercial litigation including shareholders' disputes, estate litigation, insurance defence and construction liens. He also acts as general counsel to a number of condominium corporations and is presently a member of the Ontario Insurance Adjusters Association.

kmb notes

The comments in this newsletter are of a general nature and are not designed to replace professional advice in specific situations. If you would like extra copies of this newsletter, or you know of anyone who would be interested in joining our mailing list, please contact Giselle Ladesic at (905) 276-9111.

