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Bahamas

BAHAMAS

THE BAHAMAS' ASSET PROTECTION TRUST

Malpractice or negligence suits are particularly worrisome for modern businesspersons or professionals who wish to protect their assets from claims of staggering proportions. Paying high insurance premiums has become an unsatisfactory way to protect wealth against litigation losses. A professional may instead now transfer assets to a trustee in the Bahamas to be held in trust for the professionals or others. If an offshore trust is properly structured, it can effectively remove assets from the settlor's balance sheet and protect them from lawsuits, without creating adverse tax consequences.

Trusts are a superior choice to high insurance premiums, which cut substantially into a professional's income. While a transfer to a trust may be subject to gift taxes, and a trust in favor of a spouse is subject to the risk of divorce, the other risks associated with a trust have now been practically eliminated by virtue of the recent enactment of financial laws in the Bahamas. Asset protection has attracted an increasing number of persons. The Bahamas' offshore asset protection trust is the state of the art financial vehicle in this field.

This article first discusses the primary legislation and second the case law which provides the background for the Bahamas' offshore protection trust. It is not a commentary on the specific terms of such a trust deed, which may vary depending on how it is drafted and the needs of the particular settlor.

I. LEGISLATION

The Fraudulent Dispositions Act of the Bahamas (Act No. 1 of 1991, An Act to Amend the Law Relating to Dispositions Made with an Intent to Defraud) (hereinafter "the Act"), assented to by the Governor-General on March 5, 1991, consists of only three pages and eight sections. Nevertheless, it is an important and integral part of a multi-faceted, new legislative program which aims to polish the Bahamas' image as one of the world's most competitive offshore financial centers.

Though a trust may be set aside if it is made to defraud creditors, challengers must show that the transfer of assets to the trustee was a fraudulent conveyance and, therefore, void.

The Act facilitates the formation of asset protection trusts in the following ways: 1) The burden of proof under Bahamian law rests with the creditors; 2) The assets of the trust are safe as long as the cause of action against the trust arose after the trust was formed; 3) A judgment in a U.S. or other foreign court against the settlor is not enforceable against a Bahamian trustee; 4) The creditor must institute independent proceedings in the Supreme Courts of the Bahamas; 5) The settlor is not protected against contingent creditors of whom he was aware, but from future claimants; 6) While the Act clearly invalidates a trust which was set up with the intent to defraud, it also designates a period of two years in which a creditor can challenge the trust. After that period the assets are safe.

Section 4(1) of the Act is the key section and states:

> Subject to the provisions of this Act, every disposition of property made with an intent to defraud and at an undervalue shall be voidable at the instance of a creditor thereby prejudiced.

Two central definitions are contained in section 2: "disposition" which means (tautologically) "any disposition or series thereof, however effected, and includes any transaction, gift, grant or transfer of property of any nature whatsoever;" and "undervalue," which "in relation to a disposition of property, means (a) the provision of no consideration for the disposition; or (b) a consideration for the disposition the value of which in money or money's worth is significantly less than the value of the property the subject of the disposition."

To be voidable, a disposition must have been made with the intent to defraud. The transferor must have wilfully intended to defraud a creditor. This is a complete departure from the 1570 Fraudulent Gifts Act, 13 Eliz. ch.5 (1570) (Eng.), which as applied in the case law, voided the settlement where it simply had the effect of disturbing, hindering, delaying, or defrauding creditors.

The obligation owed to a creditor must be in existence at the time of the formation of the trust. The disposition must have been made with an intention of defrauding an existing obligation to an existing creditor. Unlike the previous law, the transaction cannot be set aside simply because it may have had the effect of defeating a future creditor of the transferor. This is also a complete departure from the common law.

In the classic case of *Mackay v. Douglas*, 14 L.R.-Eq. 106 (1872), William Douglas, the settlor, had risen through the ranks from clerk to a partner of a firm of merchants heavily involved in jute and cotton trading, a very risky business because of wide price fluctuations in the market. Just before becoming a partner, Douglas settled his leasehold house on his wife and any children he might have. No debts existed at the date of the settlement.

Sir R. Malins, V.C., ultimately found that the probability of a partnership had induced Douglas to make the settlement. But, he also found that it was not necessary to show any fraudulent intent. The Statute of Elizabeth referred to cases where the creditors "are, shall, or might be in any wise disturbed, hindered, delayed, or defrauded," and he found that, if the settlement had that effect, the court would presume the intention and attribute it to the settlor. Accordingly, Douglas committed a fraudulent act because, on going into trade, he took away the only property available to creditors on his insolvency.

The Judge continued that if a person remained solvent, the settlement would be good. If Douglas had not contemplated going into trade at the time, his subsequent insolvency would have had no effect on invalidating the settlement.

In addition, the disposition can only be set aside by "a creditor thereby prejudiced." The burden of proof rests on the creditor. Therefore, it appears that the settlement or disposition cannot be set aside by the settlor's trustee in bankruptcy. He is not a creditor thereby prejudiced. Every creditor thereby prejudiced must institute his own action to set aside the settlement. Further, Section 6 provides that the disposition will be set aside only to the extent necessary to satisfy the obligation of the creditor by whom the action to set aside was brought. This contrasts with the position under the Statute of Elizabeth where the transaction was void *ab initio*, and consequently, beneficiaries and recipients of monies could be made to account for money had and received. Under the present law, the disposition is only voidable, and only to the extent necessary to satisfy the obligation to that particular creditor.

The new Act reduces the limitation period within which an action can commence to set aside the settlement. By Section 4(3), no proceedings by a creditor can be brought after two years of the date of the disposition which is being set aside.

Further, by Section 5 of the Act, the transferee (i.e. trustee to whom the settlement was made) has a first charge over the assets in respect of its fees, costs, and other charges.

Section 8 prevents a creditor from bringing a claim which would be avoided or defeated by the Trusts (Choice of Governing Law) Act. In other words, a creditor cannot void a trust on the ground that the choice of the proper law of the trust was fraudulent, if the choice was made in accordance with the latter Act.

II. BACKGROUND

The Act supersedes prior applicable law in force in The Bahamas, in particular the 1570 Fraudulent Gifts Act. According to the Statute of Elizabeth, "feigned" or fraudulent conveyances are declared void as against creditors (§ 1), save conveyances to bona fide purchasers for value without notice of the fraud (§ 5).

For asset protection trusts which meet the above conditions of the Act, a number of English cases can no longer be used as good authorities in the Bahamian courts. *Mackay v. Douglas* held that a settlement where the settlor transfers the bulk of his property out of the reach of his creditors, shortly before engaging in trade of a hazardous character, may be set aside though there were no creditors before the date of the settlement.

In re Butterworth, 19 Ch. D. 588 (1882), held that although the settlor was solvent, the settlement was void as against the trustee in bankruptcy, on the ground that it was evidently executed with the view of putting the settlor's property out of the reach of his creditors.

Section 172 of the English Law of Property Act 1925 (hereinafter "the 1925 English Act") replaced the Statute of Elizabeth in England, but not in the Bahamas, and thus, it did not apply in the Bahamas. Now, however, the 1925 English Act is part of the pedigree of the new Act, from the drafting point of view. The provisions of § 172 are as follows:

> (1) Save as provided in this section, every conveyance of property made whether before or after the commencement of this Act, with intent to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced.
> (2) This section does not affect the operation of a disentailing

> assurance, or the law of bankruptcy for the time being in force. (3) This section does not extend to any estate or interest in property conveyed for valuable consideration and in good faith or upon good consideration and in good faith to any person not having, at the time of the conveyance, notice of the intent to defraud creditors.

"Conveyance" is defined by the 1925 English Act, section 205 (1)(ii), to include a mortgage, charge, lease, assent, vesting declaration, vesting instrument, disclaimer, release, and every other assurance of property or of an interest therein by any instrument, except a will. A conveyance is not confined to written instruments.

A number of English cases have added important glosses on the interpretation of § 172. In *In re Eicholz* [1959] 1 All E.R. 166, Harman, J., held that the trustees in bankruptcy could recover the house and some chattels from the widow of a deceased solicitor under § 172. The court found there was no consideration for the gift of the house and the chattels to the widow. Further, the claim could be maintained by either a trustee in bankruptcy or a representative creditor.

In *Lloyds Bank v. Marcan* [1973] 2 All E.R. 359, Pennycuick, V.C., held that the word "defraud" in § 172(1) was designed to reproduce the expression "hinder, delay or defraud" in that Statute of Elizabeth of 1570 and was not intended to be confined to cases of fraud in the ordinary modern sense of that word, as involving actual deceit or dishonesty. The word "defraud" in § 172 carried the meaning of depriving creditors of timely recourse to property which would otherwise be applicable for their benefit.

In addition, it was held that "notice" under § 172(3) included constructive notice. Therefore, a transferee under a conveyance who gave valuable consideration in good faith but had constructive notice of the transferor's intent to defraud creditors could not take the property. In this case, Mrs. Marcan had actual notice of that intent in that she knew the purpose was that she and her family should go on living on the property and that the bank should not obtain possession.

Cadogan v. Cadogan, [1977] 3 All E.R. 833, held that "a person thereby prejudiced" was not limited to creditors, but also included any person prejudiced by a fraudulent conveyance, such as a wife who had been deprived on her husband's death of the right to apply for reasonable provision for maintenance. The wife claimed she contributed almost half of the purchase price to purchase the matrimonial home and that the son, to whom the house had been conveyed by the husband, held it on resulting trust for her as to one half.

It would appear from *In re Eicholz* that a trustee in bankruptcy may bring an action as a creditor thereby prejudiced. Similarly, so may a wife, as in *Cadogan v. Cadogan*. *See, e.g.*, ROBERT MEGARRY AND P.V. BAKER, SHELL'S PRINCIPLES OF EQUITY 127(27th ed. 1973); DAVID J. HAYTON, UNDERHILL'S LAW OF TRUSTS AND TRUSTEES 20 (13th ed. 1979).

III. CONCLUSION

As Jessel, M.R., stated in the leading English case of *In re Butterworth*, 19 Ch. D. 588 (1882):

> A man is not entitled to go into a hazardous business, and immediately before doing so, settle all his property voluntarily, the object being this: "If I succeed in business, I make a fortune for myself. If I fail, I leave my creditors unpaid. They will bear the loss." That is the very thing which the Statute of Elizabeth was meant to prevent.

The position of the new Bahamian law is opposite that of the Statute of Elizabeth. A major feature of the Act is that subsequent creditors may not avoid the asset protection trust. The assets of the trust are safe as long as the cause of action against the trust arose after the trust was formed. The risks are virtually eliminated.

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