

BRENDA WOOD – SEPTEMBER 14, 2018
CONSUMER PROPOSAL CASE STUDY

PART I

You meet with Jeff Smith. During the assessment you learn that Jeff is divorced, 45 years old and lives alone. He has one child who lives with his ex-wife full time. He is currently employed full time in a salaried position. He pays \$300 per month in child support.

Jeff has been involved in several businesses (sole proprietorships) over the years. His last two businesses failed. As a result of the first failed business, which was largely due to taxes owing, he filed an assignment in bankruptcy 7 years ago. He wants to know whether you, as his Trustee, will work for him or for his creditors. He also advises that he has already met with another Trustee. He wants to see if he could get a better deal on how much he has to pay – his friend made low payments for 9 months when he filed with your office last year. He suggests that you should reduce your fees so his payments could be reduced. He further suggests that should you agree to do so he will definitely “hire” your firm.

His second failed business ended 7 months ago. Jeff had no employees therefore, there are no source deductions owing. Jeff advised that he spoke to a CRA representative yesterday who told him that CRA is about to register a lien on his house because of a balance due for HST. There is also a balance due for personal income taxes. Jeff has not filed his personal income tax return for the prior year and he expects to owe taxes – the estimated amount owing to CRA is included in his list of liabilities. Jeff has not filed his HST returns in a year – the estimated amount owing to HST is included in his list of liabilities. Jeff advises he has never been very good at record keeping. He wants to know if he can “just guess” when he files his returns for last year. He has a supplier to whom he owes \$1000. He tells you he is not going to list this supplier because he knows the supplier will “tell everyone”. He is just going to pay him. He has a student loan for a business course which he believes he completed 6 or 7 years ago. He is unsure of when exactly when he finished.

During your assessment you ask Jeff if he has, in the past 5 years, transferred or disposed of any assets (real property or otherwise). He advises that he did own some property but since he never used it, he gave it to his brother who has always wanted it. Jeff tells you that the property was recently valued by a real estate appraiser at \$5,000. As the discussion continues, Jeff asks if you can ‘forget’ that he disclosed the transfer and erase it from your notes.

Jeff is very concerned that if his ex-wife finds out he is in financial trouble then she will be sure to post it on Facebook. He definitely does not want to file an assignment in bankruptcy and he wants to make sure you won’t “tell anyone”.

Address all of Jeff’s concerns and questions. Identify any other issues of concern that should be addressed with Jeff during your assessment.

Assets and Liabilities

Jeff Smith

Liabilities:

CRA: Personal Income Tax	\$20,000
CRA: HST	\$10,000
4 Credit cards	\$100,000
Bank A - Line of Credit	\$5,000
Student loan	\$20,000
Supplier	\$1,000
Bank A - Truck Loan	\$25,000
Bank B - Mortgage	<u>\$75,000</u>
Total	\$256,000

Assets:

TFSA (Cash)	\$500
Self-directed RSP (contributes \$50/week)	\$10,000
RESP (net cash value)	\$5,000
Truck - Financed with Bank A	\$25,000
House - Financed with Bank B	<u>\$100,000</u>
Total	\$140,500

Note: Each province has its own exemptions. For this assignment assume the equity in the home is \$5000. Assume the RESP is NOT exempt.

Income and Expenses

Jeff Smith

Employment Income	\$4,000
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Expenses

Mortgage Payment	\$950
Property taxes	\$100
Child Support	\$300
Phone	\$50
Electricity	\$50
Internet/Cable	\$100
Groceries	\$300
Dining Out	\$50
Smoking/Alcohol	\$100
Entertainment	\$50
Gas	\$400
Truck Payment	\$550
Car Insurance	\$75
Home Insurance	\$25
Clothing	\$50
Toiletries	\$50
Dog food	\$50
Trip fund	\$150
Gym	\$35
Gifts	\$50
Total	<hr/> \$3,485
Surplus	\$515

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PART I	Identification of the issues
Objective	Teach candidate how to identify issues & address the issues once identified.
Issues and Discussion points: QUESTION 1	
❑ ROLE OF THE TRUSTEE	
<ul style="list-style-type: none"> - Trustee is independent and works for neither Jeff nor the creditors - Administer to provisions of BIA as they apply to the interests and rights of all parties - Must maintain high standard of ethics - Must comply with Code of Ethics - Must not assist, advise or encourage illegal or dishonest behavior - Must be honest and impartial and provide full and accurate information - Act as officer of the court 	
❑ FEES	
<ul style="list-style-type: none"> - Vary based on the complexity of the administration; <ul style="list-style-type: none"> o in summary administrations they are based on tariff as legislated; o in non-summary administrations, they are based on time involved and hourly rates. 	
❑ SURPLUS INCOME	
<ul style="list-style-type: none"> - Surplus income – duty of Trustee to determine and collect - Potential for mediation/court if there is a disagreement in amount to be paid. 	
❑ CRA	
<ul style="list-style-type: none"> - Has right to register lien on property for unpaid taxes which would give them a statutory secured position. - A filing under the BIA will prevent them from filing the lien 	
❑ TAX	
<ul style="list-style-type: none"> - The personal income tax and GST/HST returns need to be filed BEFORE a proposal is filed or CRA will vote against; - Trustee responsible for all unfiled GST/HST returns and for income tax returns due to be filed in the year prior to the beginning of the calendar year of the insolvency filing (in a bankruptcy) - Tax filings should not be based on “guessed” information - Must include disclaimer where info has not been verified - Must not assist, advise or encourage dishonesty - Must take possession of books and records – no person entitled to withhold 	
❑ STUDENT LOANS	
<ul style="list-style-type: none"> - How old is the student loan? Could survive a bankruptcy or a proposal filing if less than 7 years; - Jeff should confirm his Period Study End Date with the student loan provider; - Discussion of 5 year hardship rules; - Should a student loan clause be in the proposal stating debtor understands the debt is a 178 debt and will survive the proposal? 	

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❑ CONFIDENTIALITY
<ul style="list-style-type: none">- Trustee cannot disclose information to third parties until there is a formal filing and appointment- Confidentiality agreement to be signed by debtor- Must not disclose information to the public unless required by law or authorized by debtor- Must not associate with false or misleading information- Must not sign any document, including a report, that is misleading- Rights of all known unsecured creditors; cannot fail to disclose any known creditor- Must notify every known creditor- All property of the bankrupt must be seized – trustee must pursue transfer despite request not to indicate in report
❑ OMISSION OF CREDITORS
<ul style="list-style-type: none">- Trustee cannot be associated with a false statement;- Debtor has duty to complete and file a true statement of his affairs
❑ TRANSFER OF LAND (TUV)
<ul style="list-style-type: none">- Debtor has duty to disclose this transfer;- Trustee cannot be associated with a false statement- Cannot ignore that debtor told him about it- Must review the transaction with potential to overturn the transaction

PART II

1. **Compare alternatives available for this debtor, taking into consideration all aspects relevant to the decision for the debtor.**
2. **Provide a Quantitative Analysis for bankruptcy vs consumer proposal.**
3. **What would you recommend?**

(Assume OSB standard for 1 is \$2,152, the value of the transferred property is \$2000, and the net value of all other assets is as per the list of assets Jeff provided to you.)

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PART II	Options available for debtor to deal with his debts	
Objective	Understanding the differences between the options available to deal with the debt and how the debtor, his assets and other stakeholders would be affected.	
Issues and Discussion Points: QUESTION 2		
ISSUE	BANKRUPTCY	PROPOSAL
ASSETS	<ul style="list-style-type: none">- Vest with trustee- Debtor unable to deal with them- Trustee realizes on them for the benefit of creditors	<ul style="list-style-type: none">- No vesting with the administrator- Debtor free to deal with the assets unless included as term of proposal;- Value of assets to be considered in a proposal payment
TFSA/RESP/RSP	<ul style="list-style-type: none">- Trustee will cash out of sell back to debtor- Except assets which are exempt pursuant to BIA or Federal or Provincial Statute	<ul style="list-style-type: none">- Debtor can keep or include as term in proposal- If keeping the value must be considered in formulation of proposal
EQUITY IN HOUSE	<ul style="list-style-type: none">- Trustee to realize on or make sell-back agreement with debtor	<ul style="list-style-type: none">- Value must be considered in formulation of proposal
EQUITY IN TRUCK	<ul style="list-style-type: none">- No issue	<ul style="list-style-type: none">- No Issue
INCOME TAX RETURNS	<ul style="list-style-type: none">- Deemed year-end at the date of bankruptcy- Trustee to file pre-bankruptcy return and others due in year prior to calendar year of date of filing;- Debtor responsible for previous years	<ul style="list-style-type: none">- Debtor responsible to file outstanding returns;- No deemed year end at date of proposal but can file provisional pre-proposal return and include amount owing in proposal- CRA requires specific terms in the proposal for provisional returns – See Standards of Professional Practice- CRA requires specific terms regarding filing/payment of future returns – See Standards of Professional Practice
GST/HST RETURNS	<ul style="list-style-type: none">- Trustee responsible to file outstanding returns	<ul style="list-style-type: none">- Debtor to file outstanding returns
CRA POTENTIAL LIEN	<ul style="list-style-type: none">- Stayed by filing of assignment in bankruptcy;- If filed prior to assignment, it forms a secured charge against the equity in the property	<ul style="list-style-type: none">- Stayed by filing of proposal;- If filed prior to filing of proposal, it may be compromised to extent of equity in property (equity would be secured – remainder unsecured)
VOTING	<ul style="list-style-type: none">- No voting by creditors as debtor has legal right to file assignment	<ul style="list-style-type: none">- Creditors to vote on acceptance or rejection of proposal;

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STUDENT LOANS	<ul style="list-style-type: none"> - Has he confirmed period study end date? - If more than 7 years old then not dischargeable in a bankruptcy - If more than 5 years old but less than 7 years then he may apply to court under hardship clauses 	<ul style="list-style-type: none"> - Has he confirmed PSED? - If more than 7 years old then no special provisions required - If less than 7 years old then a provision should be in the proposal that debtor acknowledges it is a 178 debt - Case law supports that the debtor could make use of the hardship provisions (5 year rule)
INCOME TAX REFUNDS	<ul style="list-style-type: none"> - CRA will offset against pre and prior years - Post-bankruptcy return vests in trustee/Any debt owing debtor must pay - Subsequent years belong to debtor but will be included in income during the period of surplus income payments 	<ul style="list-style-type: none"> - No vesting in trustee - CRA will offset against pre and prior years
AFTER-AQUIRED ASSETS	<ul style="list-style-type: none"> - Vest in trustee and could be seized 	<ul style="list-style-type: none"> - No vesting of after-acquired assets
TRANSFER OF LAND (TUV)	<ul style="list-style-type: none"> - Trustee to investigate; - If TUV, trustee to realize on as asset of estate; - CRA could take action under ITA s. 160 	<ul style="list-style-type: none"> - Investigation only if requested by creditors; - Consider including value in formulation of proposal terms to enhance value of proposal
❑ QUANTITATIVE ANALYSIS: SEE SCHEDULE A		
❑ SUGGESTED COURSE OF ACTION FOR JEFF		
<ul style="list-style-type: none"> - Must consider potential receipts in a bankruptcy versus cash-flow and ability to make payments in a proposal to make it more acceptable for the creditors - Estimated total receipts in a bankruptcy are \$42,964 (surplus x 36 + house equity + TFSA + TUV+RESP+RSP claw back) - Available cash-flow based on current income and expense statement is \$515, which is insufficient to provide total payments in proposal to exceed receipts in bankruptcy; - Expenses need to be adjusted to improve cash-flow; - Also consider cashing in TFSA, RSP and/or RESP as a term in proposal; - Consider tax consequences of cashing out RSP; - In addition to providing a return greater than bankruptcy must consider the likelihood of creditor acceptance (i.e. will a dividend of x% be enough) - Proposal will provide better return to creditors and allow Jeff to budget a fixed payment each month. 		

Projected Funds Flow - Bankruptcy vs Proposal

Asset:	Bankruptcy:	vs Proposal:
Surplus Income Payment (est. \$774 x 36)	27864	
Cashing TFSA	500	
RESP (cash value)	5000	
Clawback (last 12mths RSP \$50 x 52)	2600	
House Equity	5000	
TUV ?	2000	
Proposal Payment (\$875 x 60)		52500
	42964	52500
Estimated Fees/Disbursements (assuming 15%HST):	9470	13631
Available for Distribution:	33494	38869
Less		
levy:	200	1943
Net Available for Distribution:	33294	36926
Total Unsecured Creditors:	156000	156000
Projected Dividend Percentage	21.34%	23.67%

PART III

Jeff attends your office to sign Division II proposal documents. The proposal provides for monthly payments of \$875 over a 60 month period plus cashing the TFSA of \$500 within 30 days of court approval (deemed or otherwise). The terms of the proposal include a distribution to creditors annually. He gives you a cheque for \$875 as an initial payment. The documents are e-filed.

On the 45th day you review all the proven claims and their voting letters as follows. Assume all the claims are properly proven.

Creditor:	Claim Proven:	Vote:
CRA – Personal Income Tax	\$ 20,000	Yes
CRA – HST	\$ 11,000	Yes
Credit Card A	\$ 25,000	No, with request for meeting
Student Loan	\$ 20,000	Yes
Supplier	\$ 1,500	No
Credit Card B	\$ 25,000	Abstained

As of the 45th day explain the process you would follow and all relevant points. Show your calculations.

Assume you did have to call a meeting of creditors. Using the votes noted above calculate if the proposal will pass. Show your calculations.

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PART III	Voting in a consumer proposal
Objective	Understanding the voting process in a consumer proposal.
Issues and Discussion Points:	
ISSUE	
DEEMED ACCEPTANCE OF A CONSUMER PROPOSAL	<ul style="list-style-type: none"> - At the expiration of 45 days following the filing of a consumer proposal, if no obligation has arisen to call a meeting of creditors, the proposal is deemed accepted by the creditors
DETERMINING IF A CREDITORS MEETING MUST BE CALLED	<ul style="list-style-type: none"> - Administrator shall call a meeting of creditors if requested by the OR; - Administrator shall call a meeting if at the expiration of the 45th day, creditors having in aggregate at least 25% in <u>value</u> of the <u>proven claims</u> have requested one. - See MEETING REQUEST RESULTS
IF A MEETING IS REQUIRED - VOTING	<ul style="list-style-type: none"> - Directive 22R - Creditors do not need to be present to have their votes counted as long as their claim is properly filed and their voting letter has been received prior to the meeting date; - Voting is by ordinary resolution – one vote for every dollar of claim of a creditors <u>voting</u> (abstained does not count in total votes) - Need 50% plus \$1 for proposal to be accepted - See VOTING RESULTS

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Meeting Request Results

	For	Against:	Against with Request for Meeting	Abstained
CRA - Personal Income Tax	20000			
CRA - HST	11000			
Credit Card A			25000	
Credit Card B				25000
Student Loan	20000			
Supplier		1500		
	51000	1500	25000	25000

Determining if a meeting is required:

Votes against & meeting request made	25000
Total	102500
% Requesting a meeting	24.39%

NO REQUIREMENT FOR A MEETING THEREFORE PROPOSAL DEEMED ACCEPTED

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Voting Results

	<u>For</u>	<u>Against</u>	<u>Against with Request for Meeting</u>	<u>Abstained</u>
CRA - Personal Income Tax	20000			
CRA - HST	11000			
Credit Card A			25000	
Credit Card B				25000
Student Loan	20000			
Supplier		1500		
	51000	1500	25000	25000

Votes in Favor	51000
Votes Against	26150
Total Voting	77500
% in favour = 65.8%	

PROPOSAL PASSES

PART IV – A

Assume that the proposal was approved on the 45th day and deemed court approval occurred on September 1st.

Jeff has been reminded that the TFSA must be cashed within 30 days of deemed court approval. On October 3rd your banking clerk comes to you and advises that the payment for the TFSA has not been made. You call and remind Jeff again. On December 4th Jeff arrives at the office to make the payment. He states that he had problems getting the bank to send him the funds but he finally has them.

What do you tell Jeff?

PART IV – B

Assume the TFSA was paid in the required time period. Jeff is half way through the proposal. He has just missed his 2nd full payment. You ask Jeff to come to the office to discuss the delinquency. When you meet with Jeff he advises that two months ago his hours at work were reduced. The monthly payments were fine on his previous hours but now his income is not sufficient to cover all expenses. He is expecting to get another job which will pay him even more than the previous job. He does not want to default and does not want to file a bankruptcy. He wants to know if the proposal payments can be suspended until he begins the new job. He wants to know what happens if they cannot be suspended, as he cannot make his payment this month either. He is concerned that if the creditors find out about his income changes then they will “pull the plug” on the proposal. He also advises that in the last few years the value of his house has risen substantially.

Discuss various solutions for Jeff. What is required of the Administrator?

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PART IV - A&B	Implications of a Default
Objective	To provide Jeff with information regarding defaults and to allow him to make an informed decision regarding continuing the proposal or filing for bankruptcy
Issues and Discussion points:	
❑ RAMIFICATIONS OF MISSED PAYMENT, REVIVAL PROVISIONS	
<ul style="list-style-type: none"> - Missing a payment, which is not a monthly payment, results in a deemed annulment if not paid by the day which is three months after the day of the defaulted payment – no cure - The aggregate of 3 Missed payment results in a deemed annulment – no cure - Administrator can, within 30 days after the day on which the proposal was deemed annulled, send notice to the creditors and the Official Receiver, that proposal will be automatically revived 60 days after the day on which it was deemed annulled unless and objection to the revival is filed; - The Administrator can apply to the court at any time to revive a proposal 	
❑ CONTINUE WITH PRESENT PROPOSAL (ASSUMING NO DEEMED DEFAULT)	
<ul style="list-style-type: none"> - Increased value of house would not be taken into account as proposal did not provide for any adjustments due to change in asset values - Payments would remain the same should his income increase in the future - Only two and a half years remaining for proposal - Where proposal does not call for distributions every 3 months there is a requirement to notify creditors and the Official Receiver if the administrator, after consulting the debtor, concludes that a change in circumstance could jeopardize the proposal but does not result in a deemed annulment. 	
❑ AMENDMENT TO PROPOSAL	
<ul style="list-style-type: none"> - Amend the proposal to reduce payments which could be affordable to debtor given new income level; - Amendment must occur before the proposal is deemed annulled - Must still be better for creditors than a bankruptcy would be (consider new asset values and new income level) - Must send notices and follow same procedure as original proposal (45 days to request meeting etc.); - Advise debtor that should the amended proposal fail then the debtor will not be entitled to file another proposal (without court permission), the stay will be lifted, and the creditors rights revived 	

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□ FILE ASSIGNMENT IN BANKRUPTCY (CANDIDATE TO DISCUSS EFFECT OF BANKRUPTCY ON ASSET VALUES AT DATE OF BANKRUPTCY, SURPLUS PAYMENT, EFFECT OF INABILITY TO PAY SURPLUS, LENGTH OF BANKRUPTCY)

- Length of bankruptcy would be 24 or 36 months depending upon income level (only two and a half years left for proposal)
- Payments would vary monthly depending on the level of his income
- Inability to make required payments could result in length of bankruptcy exceeding 36 months (mediation or conditional discharge)
- Equity in assets would vest in the Trustee and be seized for the benefit of the creditors – or he would have to enter into “buy back” agreements.
- Given the increase in the value of his house, it would likely have to be sold
- Any income tax refunds for the year of bankruptcy would be seized by the trustee

□ OPINION REGARDING CONTINUING WITH THE PROPOSAL VS. FILING FOR BANKRUPTCY

- The cost to Jeff of filing for bankruptcy would likely exceed the cost of completing the proposal and the time frame is for completion of either may be the same if income increases. (balance due for proposal vs. assets in bankruptcy + potential surplus income + tax refund)
- A bankruptcy now would be more beneficial for the creditors, but creditors accepted proposal as filed
- Therefore, my opinion is that Jeff may want to rectify the default and continue with the proposal, if possible.