



the **ADVISOR**

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FINANCIAL ADVISORY SUPPORT

Creditor Protection of RRSPs and RRIFs

The federal Bankruptcy and Insolvency Act (BIA) provides creditor protection to registered retirement investment products (e.g., RRSPs, RRIFs and deferred profit sharing plans or DPSPs), but only in the event of bankruptcy.

This article explains the circumstances under which RRSPs and RRIFs are protected, their limitations and strategies for your consideration. Although DPSPs are also protected, this article focuses exclusively on RRSPs and RRIFs for ease of reference.

Overview

The federal BIA was amended to provide creditor protection to RRSP, RRIF and DPSP annuitants in the event of bankruptcy, effective July 7, 2008. This means that the BIA does not protect you in the case of a creditor claim arising outside of bankruptcy. There is no cap or ceiling on the amount of assets that are protected, subject to certain exceptions and limitations such as the 12-month clawback period (discussed later on) and any withdrawals from these plans.

Another type of registered plan, the Registered Education Savings Plan (RESP), is not included in this new legislation. However, locked-in RRSP and RRIF assets continue to be exempt from bankruptcy claims.

Protection under federal BIA and provincial bankruptcy legislation

In addition to the protection provided under the federal BIA, each province also has its own legislation. Since the federal BIA only protects you in the event of bankruptcy, it's worth consulting your provincial bankruptcy and creditor protection legislation as it may extend your protection outside of bankruptcy (e.g., to a professional liability lawsuit) or at death. In the event of a dispute with respect to the federal BIA and provincial bankruptcy laws, the federal BIA takes precedence. Notwithstanding the federal and provincial protection, it's important to note that children and ex-spouses continue to have special rights with respect to making a claim against you to enforce support and maintenance orders.

Provinces that have provincial legislation that provides creditor protection outside of bankruptcy:

- Prince Edward Island — during your lifetime and at death
- Saskatchewan — only during your lifetime
- Manitoba — only during your lifetime
- Newfoundland and Labrador — only during your lifetime
- British Columbia — only at death
- Ontario — only at death¹
- Alberta — only at death

What happens if you do not declare bankruptcy?

If you do not declare personal bankruptcy, your RRSPs or RRIFs will not be protected under the BIA in the event of a general creditor claim or a personal or professional liability lawsuit for negligence. Unless you live in a province that protects you from non-bankruptcy-related creditor claims, it is important your creditor protection plan considers both bankruptcy and non-bankruptcy-related risks.

12-month clawback period

It is important to note that under federal BIA legislation, the entire value of your RRSPs and RRIFs may not be shielded from your creditors. This is due to a 12-month clawback provision that allows your trustee in bankruptcy to “claw back” any contributions you made to your RRSPs and RRIFs during the 12 months preceding the date you declared bankruptcy.

For example, if you declared bankruptcy on October 10, 2009, the clawback period would commence October 10, 2008 and end on October 10, 2009. If the value of your registered plan was \$200,000 and you contributed \$10,000 to your plan during this clawback period, then \$10,000 would be paid out to the trustee in bankruptcy, subject to withholding tax. In this example, this means that the trustee in bankruptcy would receive \$8,000 (the net after-tax amount) or \$7,400 if you were living in Quebec.

Although contributions may not be made directly to a RRIF, the clawback period may still apply in the case of a RRIF as a RRIF can hold funds transferred from an RRSP that has received contributions during the 12-month clawback period. Amounts transferred from other financial institutions during the 12-month period, however, are not considered contributions for the purpose of this clawback.

In addition to the 12-month clawback period, your trustee can seize amounts you transferred or contributed to your registered plans during the five years preceding bankruptcy while you were insolvent if the trustee believes that the amounts you transferred or contributed to your RRSP were made in an effort to defeat creditors.

¹ Though there is no specific legislation in Ontario, this protection is available thanks to a 2004 Ontario Court of Appeal decision that granted protection in the case where the RRSP or RRIF was payable to a designated beneficiary on death. Although it is possible that other Canadian provinces and territories will adopt a similar stance, this is not guaranteed as there are known cases in provinces like Quebec and Manitoba where a contrary judgment was applied.

How is the clawback amount determined?

In bankruptcy, the trustee in bankruptcy steps into your shoes as the RRSP or RRIF annuitant. They have the right to request information from the financial institutions concerning your contributions to your RRSP during the 12-month clawback period in order to determine the amount that they are entitled to receive from your RRSPs and RRIFs. In response, your financial institution is obligated to provide such details once they receive documentation evidencing the trustee in bankruptcy's authority to act.

As administrative procedures may differ among financial institutions receiving a notice of the bankruptcy of an RRSP or RRIF annuitant, if you declare bankruptcy, you should contact all financial institutions concerned to inquire about their process for handling bankruptcy situations. Your financial institutions will likely put your RRSP or RRIF account under restraint at the time of receiving the notice of bankruptcy until such time that the clawback matter is fully resolved with the trustee in bankruptcy, who will need to gather details from all financial institutions concerned, until you are discharged from bankruptcy.

This is because, even if the trustee does not take possession of an exempt property, the property technically vests with them. This means, for example, that if you needed to withdraw an amount from your RRSP after filing for bankruptcy, you would need to inform your trustee, who would likely claim the withdrawal payment after taking the clawback amount, if any, into consideration.

Is there still a use for segregated funds?

As mentioned earlier, creditor protection of RRSPs and RRIFs under the federal BIA legislation is limited to bankruptcy situations, subject to the 12-month clawback period. While no one can guarantee absolute protection from creditors, an insured RRSP or RRIF using segregated funds will continue to offer you the most complete protection against all creditor claims during your lifetime and on your death — whether the claim arises from bankruptcy proceedings, a professional liability or a general creditor claim. You can also use segregated funds to protect your non-registered assets from creditors.

Segregated fund considerations

If you are exploring adding segregated funds to your portfolio, it's important to keep the following considerations in mind:

- In order to provide creditor protection, segregated funds must be purchased in good faith. If there is any suspicion that you purchased the funds as a shelter while you were facing financial difficulty, your funds will not be protected from creditors.
- You must appoint a family class beneficiary (e.g., a spouse, child, grandchild, parent) to your segregated funds in order to maintain the integrity of the creditor protection. A "spouse" beneficiary could include a common-law spouse or same sex spouse depending upon the provincial legislation. In Quebec, a family class beneficiary must be either a spouse or an ascendant or descendant.

- If you have an outstanding tax liability with Canada Revenue Agency (CRA), note that creditor protection offered under a relevant provincial legislation in a non-bankruptcy situation may not apply as CRA is considered a preferred creditor. CRA also has the right to pursue the estates of RRSP and RRIF holders and beneficiaries for unpaid taxes.
- Claims to provide for dependants under family law may take precedence over creditor protection in the court of law.
- Segregated funds cannot be purchased by a corporation to protect corporate assets against a legal claim against the business.

Additional creditor protection strategies

If you are concerned about protecting your assets in the event of non-bankruptcy-related claims or if you are an incorporated business owner, then you may also want to consider the following strategies:

- **Incorporating your business:** If you are sued personally, your operating company and any holding company assets will be protected. This will limit your exposure more than if you keep all your assets in your personal name.
- **Sprinkling assets among family members and trusts:** Assets transferred to family members (including contributions you make to your spouse's spousal RRSP) will limit your personal exposure to only those assets that are in your name, subject to any claims of fraudulent conveyance. However, this also entails a loss of ownership, which may not reflect your current intentions; and these assets will then be exposed to their creditors' claims and possible marriage breakdown.
- **Testamentary trusts:** If you are concerned about protecting your estate from potential claims of your beneficiaries' creditors, consider establishing a discretionary testamentary trust within your Will.
- **Professional liability insurance:** Investigate what coverage may be available in the case of a successful lawsuit against you.
- **Using multiple corporations:** If you accumulated significant cash in your corporation, consider transferring the excess via a tax-free inter-corporate dividend to a connected holding company to shelter these assets from your business creditors. You can also hold real estate and equipment assets in a leasing company that is either a sister or parent company of your operating company.
- **Securing funds you lend to your business:** Consider having your lawyer register a floating charge over the assets of your business. A floating charge is not specific to any particular asset, providing you greater protection. However the floating charge will be subject to any prior charges.
- **Setting up an Individual Pension Plan (IPP) or Retirement Compensation Agreement (RCA):** If you are an incorporated business owner or professional, or even an officer in a company, such retirement savings vehicles as the IPP and RCA may offer you creditor protection while helping you accumulate greater savings toward your retirement. Note that if you are a sole proprietor or a partner, it will not be possible for you to set up an IPP or RCA.

- **Life insurance:** If you have an insurable interest and are able to qualify medically, then you may want to investigate incorporating a life insurance strategy to accumulate wealth that could be protected from creditors. Life insurance policies are generally protected from creditors, provided they have a designated beneficiary in place. The cash value may also be protected if the beneficiary is irrevocable or is an eligible family member.

Summary

Although your RRSPs and RRIFs are generally protected against creditors, this is only in the event that you declare bankruptcy. Even then, there is a certain portion of your RRSP or RRIF that may be seized due to the 12-month clawback provision.

Since your RRSPs and RRIFs continue to be exposed to non-bankruptcy-related creditor claims, your creditor-protection plan is incomplete without traditional creditor-protection strategies such as insured RRSPs and RRIFs using segregated funds, incorporating your business, sprinkling assets among your family members, and using IPPs and RCAs. These strategies offer creditor protection against creditor claims during your lifetime and on your death, including those that arise outside of bankruptcy.



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