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Are RRSPs Protected Against Creditors?

BY ELIZABETH CREATES

Meet Larry: Larry is 44 years old and is married to Joan. Larry is passionate about being a chef. He is also an entrepreneur. While Larry's restaurant had been successful in the past, it is currently in serious financial trouble and so is Larry. The restaurant will be closing its doors permanently and Larry is considering filing personal bankruptcy. Larry does not want to lose his life savings and is particularly concerned about his RRSPs. When Larry consulted Robins Appleby & Taub LLP, one of his questions was: "are my RRSPs protected against my creditors?".

Larry had always dreamed of becoming a chef. He would spend hours in the kitchen trying out different recipes. He enjoyed the creativity of the cooking process and the compliments he would receive from friends and family. It was no surprise to anyone when Larry opened his own restaurant.

Larry's restaurant received good reviews, and business was brisk for a few years. However, sales slowly declined and the restaurant eventually became another casualty of the bad economy. Although Larry had operated his restaurant through a corporation, he had provided substantial personal guarantees to the corporation's creditors as business declined. For this reason, the failure of the restaurant left Larry in dire financial straits at a personal level. His attempts to reach agreements with his creditors were unsuccessful and his personal savings were dwindling. Larry consulted Robins Appleby & Taub LLP to find out what his legal options were.

Among other things, Larry was concerned about his RRSPs. He had been diligent over the years in making contributions. In the months prior to the collapse of his business, Larry had continued to make contributions in the hopes that it would block his creditors from accessing even more of his personal funds. Larry's wife Joan is the designated beneficiary of all of his RRSPs. His RRSPs are not insurance products.

After much deliberation and legal advice, the corporation that operated Larry's restaurant declared bankruptcy and Larry declared personal bankruptcy. While the federal *Bankruptcy and Insolvency Act* protected most of his RRSPs against his creditors, it did not protect the RRSP contributions he had made in the year immediately preceding his bankruptcy.

Larry is currently working as a chef at a friend's restaurant and is developing a business plan for a theme restaurant that may have franchise possibilities.

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Many business owners fund their retirement using RRSPs and RRIFs. The following are some key points to know about these investment vehicles in the context of creditor protection:

1. In accordance with the Ontario *Succession Law Reform Act* and the Ontario *Insurance Act*, RRSP/RRIF beneficiary designations can be made within the plan contract, within a Will or both. Any validly made designation will revoke a previously made designation. In order to avoid any confusion, it is recommended that designations made within a plan contract and a Will be consistent.

Please note that legal advice should be obtained prior to designating a minor child or a disabled child as the beneficiary of an RRSP/RRIF.

2. RRSP/RRIF investments that are insurance annuities are considered to be insurance products. Pursuant to section 196 of the Ontario *Insurance Act*, such RRSPs/RRIFs are protected from creditors:

a. during the insured's lifetime if the designated beneficiary is a spouse, child, grandchild or parent of the insured, or any one or more of them; and

b. after the insured's death if the designated beneficiary is a person other than the insured's estate.

However, such products tend to be more expensive, and the contributions could still be considered "fraudulent" and open to creditor claims in certain situations. Under section 2 of the Ontario *Fraudulent Conveyances Act*, transfers made with the intent to defeat, hinder, delay or defraud creditors or others of their just and lawful claims are void. Also, as will be discussed below, the federal *Bankruptcy and Insolvency Act* provides relief to creditors if the RRSP contributions had been made during a particular time frame.

3. During the lifetime of the annuitant/debtor, any RRSPs/RRIFs that are not insurance products would not be protected from seizure by creditors outside of a bankruptcy situation. The Ontario *Execution Act* does not exempt RRSPs/RRIFs from a court-ordered seizure of assets.

On the other hand, RRSPs/RRIFs of a bankrupt individual are generally protected from seizure by creditors pursuant to paragraph 67(1)(b.3) of the federal *Bankruptcy and Insolvency Act*. This protection came into effect on July 7, 2008. However, the legislation does not protect any RRSP contributions made within 12 months of the date of bankruptcy or within any longer period that a court may specify.

4. After the death of the annuitant/debtor, RRSPs/RRIFs (whether insurance based or not) having a designated beneficiary (other than the estate) would generally be protected from seizure by creditors because, under provincial legislation, the proceeds would belong to the designated beneficiary and would not form part of the estate of the deceased annuitant/debtor. This protection is in subsection 196(1) of the Ontario *Insurance Act* for insurance based RRSPs/RRIFs and is in section 53 of the Ontario *Succession Law Reform Act* for non-insurance based RRSPs/RRIFs.

Debtors of an estate have first claim to the residue of an estate and then, if the residue is not sufficient, to specifically bequeathed assets. Therefore, if an asset can legitimately by-pass the estate and vest directly in a designated beneficiary, the estate's creditors will not be able to lay claim to it.

In *Amherst Crane Rentals Ltd.* v. *Perring*, 241 D.L.R. (4th) 176 (June 16, 2004), the deceased had been the director of a contractor corporation. His estate was sued by an unsecured creditor for breach of trust under the Ontario *Construction Lien Act*. The RRSP plan administrators paid the deceased's RRSP proceeds to his widow in her capacity as the designated beneficiary of the RRSPs. However, the creditor claimed that he was entitled to the RRSP proceeds rather than the widow. The Court of Appeal held that, due to section 53 of the Ontario *Succession Law Reform Act*, the RRSPs did not form part of the estate and the creditor was not entitled to claw-back the RRSP proceeds from the widow.

5. The general rule is that, upon death, the deceased annuitant is deemed to have received the fair market value of his or her RRSP/RRIF investments immediately prior to death as taxable income. However, there are situations in which the tax can be deferred. For example, RRSP/RRIF investments can be transferred on a tax-deferred basis to a surviving spouse.

Assuming no tax deferral opportunities are available and unless the Will provides otherwise, the tax will be funded out of the residue of the estate rather than paid by the designated beneficiary.

The following are some key points to keep in mind:

- For creditor protection purposes, it is generally recommended that your RRSPs/RRIFs have a designated beneficiary other than your estate. However, upon your death, any resulting taxes would be payable by your estate.
- While bankruptcy legislation offers some creditor protection for RRSPs/RRIFs, all factors should be analyzed to determine whether bankruptcy is the appropriate solution to a creditor problem.
- Consider creditor-proofing your RRSPs/RRIFs prior to creditor problems arising so as to minimize the possibility of contributions being set aside as invalid or fraudulent.

The information contained in this article is for general informational purposes only and should not be relied upon as legal advice.

Elizabeth Creates is a tax and estate planning lawyer at Robins Appleby & Taub LLP. Elizabeth formulates and implements strategies that save tax for owners of closely-held Ontario businesses on both a business and a personal level. She believes in empowering her clients with the information and advice they need to make wealth-preserving decisions that benefit their businesses and their families.

For information on how we can assist you to protect your estate against creditors, please contact:

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