Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Creditor protection of RRSPs and RRIFs

Your RRSP or RRIF may be protected in the event of bankruptcy

The federal Bankruptcy and Insolvency Act (BIA) provides creditor protection to certain registered plans in the event of bankruptcy, including registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs). This article explains the circumstances under which RRSPs and RRIFs are protected, the limitations of this protection, and general creditor protection strategies for your consideration.

RRSP and RRIF protection under the BIA

The BIA provides specific creditor protection for assets held in RRSPs and RRIFs in all provinces and territories of Canada in the event of bankruptcy. There is no dollar limit to the amount of assets that are protected. However, the protection specified under the BIA is subject to certain exceptions discussed later in this article.

In addition to RRSPs and RRIFs, the BIA provides protection to deferred profit-sharing plans and registered disability savings plans in the event of bankruptcy. The BIA does not, however, provide protection for other registered plans such as registered education savings plans and tax-free savings accounts.

Locked-in RRSPs and other locked-in RRIF assets are exempt from many creditor claims (in and outside of bankruptcy) under provincial and territorial pension legislation.

12-month clawback period

The most notable exception to the BIA's creditor protection for RRSPs and RRIFs is the 12-month clawback period. The BIA may not protect the entire value of your RRSPs and RRIFs from your creditors because there's a 12-month clawback provision that allows your trustee in bankruptcy to recover any contributions you made during the 12 months prior to declaring bankruptcy.

For example, if you declared bankruptcy on October 10 of the current year, the clawback period would begin October 10 of the previous year. If the value of your registered plan is $200,000 and you contributed $10,000 to your plan during this clawback period, then the

$10,000 would be subject to clawback. The amount paid to the trustee is subject to withholding tax. The trustee in bankruptcy will receive $8,000 ($10,000 less 20% withholding tax) or $7,600 if you were living in Quebec ($10,000 less 24% withholding tax).

Although you can't make direct contributions to a RRIF, the clawback may still apply to a RRIF. A RRIF may be subject to clawback if it receives funds transferred from an RRSP where contributions were made during the 12-month clawback period.

Determining the clawback amount

In bankruptcy, the trustee in bankruptcy has the right to request information from financial institutions concerning your contributions to your RRSP during the 12-month clawback period. They can use the information they obtain to determine the amount they're entitled to receive from your RRSPs and RRIFs. Your financial institution is obligated to provide such details once they receive documentation evidencing the trustee in bankruptcy's authority to act.

Informing the RRSP or RRIF plan administrator

Procedures for handling bankruptcy differ among financial institutions, so when declaring bankruptcy, you should contact all financial institutions you deal with to determine their process. Your financial institutions may freeze your RRSP or RRIF account upon receiving the notice of bankruptcy until you and the trustee in bankruptcy are both discharged from bankruptcy. This is because the RRSP or RRIF technically vests with the trustee, who will now need to consent to withdrawal requests and may claim the withdrawal.

What happens if you don't declare bankruptcy?

If you don't 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. It's important that your creditor protection plan considers both bankruptcy and non-bankruptcy-related risks.

Protection under provincial and territorial legislation

Some provinces have their own legislation protecting some registered plans. Since the BIA only protects your RRSP or RRIF in the event of bankruptcy, it's worth consulting your provincial or territorial creditor protection legislation, as it may extend your protection outside of bankruptcy (e.g. to a professional liability lawsuit).

Notwithstanding the provincial and territorial statutory creditor protection, it's important to note that children and ex-spouses may have special rights with respect to making a claim against you to enforce support and maintenance orders. Similarly, the Canada Revenue Agency may have a priority regarding unpaid taxes. As always, it's important to obtain qualified legal advice about protection that may be available for any of your registered plans, including your RRSP or RRIF, in your province or territory of residence.

In bankruptcy, the trustee in bankruptcy has the right to request information from financial institutions concerning your contributions to your RRSP during the 12-month clawback period.

Creditor protection and segregated funds

Certain investment products, such as segregated funds, are structured as insurance contracts, which may offer creditor protection both in and outside of bankruptcy. In situations where your RRSP or RRIF may not otherwise be protected under the relevant legislation, a segregated fund registered as an RRSP or a RRIF may offer protection against creditor claims during your lifetime and on your death. You can also use segregated funds to protect your non-registered assets from creditors. It's important to keep in mind, however, that there's no guaranteed absolute protection from creditors.

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

- In order to provide creditor protection, segregated funds must be purchased in good faith; if there's any suspicion that you purchased the funds as a shelter while you were facing financial difficulty, your funds may not be protected from creditors
- For the optimal structure supporting creditor protection, the segregated funds should be purchased in your own name and not in nominee name
- To ensure creditor protection, the segregated fund owner must make an irrevocable beneficiary designation, or the named beneficiary must be a family class beneficiary (e.g. a spouse, child, grandchild or parent); in Quebec, a family class beneficiary includes a married spouse, civilly unified spouse, ascendant or descendant of the contract owner
- Segregated funds can't be purchased by a corporation to protect corporate assets against a legal claim against the business
- Although segregated funds are creditor protected, they generally have fees that are higher than mutual funds and other investment products

Other creditor protection strategies

If you're concerned about protecting your assets in the event of non-bankruptcy-related claims, you may also want to consider the following strategies:

Purchasing life insurance: If you qualify medically, you may want to consider a life insurance strategy to accumulate wealth. Life insurance policies are generally afforded special protection from creditor claims under provincial and territorial legislation. The cash value of a life insurance policy may benefit from creditor protection if the policy owner makes an irrevocable beneficiary designation or the named beneficiary is an eligible family member specified in provincial or territorial legislation. Life insurance proceeds are generally protected from the policy owner's creditors on death if they have a designated beneficiary in place, as the proceeds don't form part of the policy owner's estate.

Sprinkling assets among family members: Transferring assets to family members (including making contributions to your spouse's spousal RRSP) may help protect these assets from your creditor claims and limit the assets that may be exposed to your creditor's claim. However, if you transfer assets to family members, you will lose both control and ownership of the assets and may expose these assets to the family members' creditor and marital claims. If you transfer assets to your spouse, family law matters may be complicated upon any future relationship breakdown. Additionally, transferring assets could complicate or derail your estate plan. Finally, a transfer could be set aside if it's found to be made with the intent to hinder or defeat a creditor's claim.

Settling living (inter vivos) and testamentary trusts: Similar to transferring assets directly to family members, bona fide irrevocable contributions made to a living trust during your lifetime may limit your personal exposure to creditor claims. Although the contributions must be irrevocable, the use of a trust can provide you with a measure of ongoing control over the assets as compared to direct transfers to family members. Discretionary trusts (either living or testamentary) may also provide protection against your beneficiaries' creditors' claims for any assets that have not yet vested in or been made payable to the beneficiary.

Business owner creditor protection strategies

If you operate your own business, you may want to consider the following strategies to protect your assets from business creditors:

Incorporating your business: Your corporation is a separate legal entity and the debts incurred by the corporation are not typically your responsibility. Therefore, your personal assets are generally protected in the case of corporate insolvency because creditors of the corporation can't sue you to satisfy the corporation's debts. However, there are situations where you may be liable for the corporate debt. These may include if you provide a personal guarantee for the debt, if you're also a director of the corporation and take certain actions while managing the corporation, or, in more limited situations, if you're a shareholder of the corporation, the corporate structure may be disregarded and you may be held personally liable for the debt. Please note that a personal creditor of yours may be able to seize company assets if you're personally insolvent.

Using multiple corporations: If you accumulated significant cash in your corporation, consider transferring the excess cash to another corporation to protect this cash from the creditors of your corporation. You may be able to make the transfer via a tax-free inter-corporate dividend to a connected holding company. You can also hold real estate and equipment in a leasing company to protect these assets from the creditors of your operating business.

Setting up an Individual Pension Plan (IPP) or Retirement Compensation Agreement (RCA): If you're an incorporated business owner or professional, retirement savings vehicles such as IPPs and RCAs may offer you creditor protection while helping you accumulate greater savings towards your retirement. Note that if you operate your business as a sole proprietor or through a partnership, you can't set up an IPP or RCA.

Purchasing professional liability insurance: Depending on your profession, you may be able to obtain insurance coverage to help protect your assets. Consider looking into what coverage or options are available to you.

Conclusion

In the event of bankruptcy, your RRSPs and RRIFs are generally protected against most creditors under the BIA. However, the protection may not apply to contributions or transfers made in the 12 months before bankruptcy. In the case your assets are not protected under the BIA, they still may be protected under provincial or territorial legislation.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.



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