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RRSPs: The Exemption from Seizure Comes at a Price

By Odette Jobin-Laberge

On May 14, 2004, the Supreme Court of Canada rendered a judgment in the case *Bank of Nova Scotia* v. *Thibault*[1] thus putting an end to a controversy with respect to the exemption from seizure of RRSPs in situations when the settlor has control over the capital (mainly self-managed RRSPs). The Supreme Court of Canada ruled that these RRSPs do not benefit from the exemption from seizure because they cannot be qualified as an annuity or a trust. Moreover, the Court adds that other criteria must be satisfied in order for a contract to be qualified as an annuity contract and more specifically, the designation of a specific beneficiary who will benefit from an exemption of seizure by virtue of the law. Therefore, the designation of the settlor as a first recipient of the annuity is valid but cannot confer an exemption from seizure.

In Summary:

- a financial vehicle where the settlor maintains the control over the invested capital cannot be qualified as an annuity because there is no alienation of the funds;
- the December 2002 modification will enable the settlor of a valid annuity regime to make a withdrawal of capital. The Court assimilates such right of withdrawal to the right of a partial buy-back of a life insurance policy. This withdrawal does not affect the qualification of the annuity because the debtor keeps the balance of the capital;
- even in the event of the alienation of the capital, the other criteria of the annuity contract are not satisfied;
- the trust agreement does not foresee the possibility of periodic determined or determinable annuity instalments;
- lastly, even though all the conditions of validity of the annuity contract were met, the designation of the settlor as the annuitant does not make such a vehicle exempt from seizure; only the designation of privileged beneficiary (spouse, ascendant, descendant or irrevocable beneficiary) as the first annuitant provides the exemption from seizure.

Analysis of the Judgment

The Facts

Mr. Thibault subscribed to a self-directed registered retirement savings plan with Scotia McLeod, the terms of the contract being set-out in a document entitled “Declaration of Trust” and under said plan, the assets were applied to an annuity at maturity.
Mr. Thibault had the right to personally manage his investment and the only obligation of the trustee was to execute his instructions and to maintain the investment. The Supreme Court of Canada qualified Mr. Thibault’s position of “owner-annuitant”. Before the plan matured, the Bank of Nova Scotia, Thibault’s creditor, had a writ of seizure against the assets held on Thibault’s behalf. The latter presented a motion to quash the seizure which was dismissed by the Superior Court as well as the Court of Appeal because the Courts were of the opinion that there was no alienation of his capital and therefore one of the prerequisite for an exemption from seizure had not been met.

The Decision of the Supreme Court

Justice Deschamps, on behalf of the Court, must therefore determine if the assets invested in a self-directed registered retirement savings plan are exempt from seizure. The analysis is based primarily on the principle that the assets of the debtor Thibault are the common pledge of the creditors and that an exemption from seizure is exceptional. It is necessary to analyze the contract which intervened between Thibault and Scotia to determine if it respects the conditions of the Civil Code of Québec to constitute either an annuity or a trust, which the legislator has exempted from seizure under certain conditions.

[1] 2004 CSC 29.

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Is the Plan an Annuity?

Because the life or fixed-term annuity contracts transacted by insurers are assimilated to life insurance pursuant to article 2393 C.C.Q., Justice Deschamps refers to the judgment *Perron Malenfant* c. *Syndic de Malenfant*[2] where Justice Gonthier outlined the history of rights under life insurance policies and notes that Justice Gonthier declared that the exemption from seizure did not apply to any policy whose benefit reverted to and was held by the insured (par. 47). However, in the same *Malenfant* judgment, it was established that if the designated beneficiary of the insurance was the spouse or the civil union spouse, the descendant or the ascendant of the policy holder or of the participant, the rights under the contract were exempt from seizure and that an irrevocable designation of a third party would have had the same impact (articles 2457 and 2458 C.C.Q.). Therefore, she confirms:

> **"[13.] […] Insurers are not limited to insuring against a particular risk by promising to pay a lump sum. They may also offer life or fixed-term annuity contracts, and the rights conferred under such contracts are exempt from seizure if the annuitant is designated in accordance with the provisions governing the designation of life insurance beneficiaries (art. 2379 and 2457 C.C.Q.). The philosophy of protecting families remains apparent, despite the flexibility introduced into the rules governing protected contracts."**

Justice Deschamps then analyses the conditions of the formation of an annuity contract mentioned at article 2367 C.C.Q.:

> **"2367. A contract for the constitution of an annuity is a contract by which a person, the debtor, undertakes, gratuitously or in exchange for the alienation of capital for his benefit, to make periodical payments to another person, the annuitant, for a certain time.**
>
> **The capital may consist of immovable or movable property; if it is a sum of money, it may be paid in cash or by instalments."**

From this definition, Justice Deschamps concludes the following:

> **"[16] To form an onerous annuity contract, there must then be a debtor, an annuitant, an alienation of capital, an obligation to pay and a specification of a periodic amount for a fixed time."**

Alienation of Capital

Before all Courts, the primary issue was with respect to the alienation of capital and it is in the context of respecting said condition that Justice Deschamps carefully analyzes the Declaration of Trust to determine if this agreement constitutes an annuity contract. She is of the opinion that the structure of the contract is such that the condition of the alienation of capital was not met because, at all times prior to maturity, Thibault maintained the complete control over the capital and it was only on the maturity date that the trustee would liquidate the assets of the plan and would apply the proceeds therefrom so that the annuitant receives retirement income in the form of a fixed-term annuity[3]. She therefore concludes:

> **"[21] In other words, until the assets are liquidated by the Trust Company, they are treated as property of which Thibault is the owner, and in fact this how (sic) he is described in the application form. If an annuity is constituted, this juridical act can be carried out only in the second stage of the contract, that is, after the maturity date of the Plan. It is not until that point that the assets come under the Trust Company's control and are applied to a retirement income."**

She thus concludes that prior to the maturity date, the plan under scrutinity does not provide for the constitution of an annuity. In effect, from the date of the opening of the plan until the liquidation to eventually convert into an annuity, there is an absence of alienation of the funds in favor of the trustee and "*the fact that there was no alienation, combined with the fact that control remained with the owner, demonstrate that the relationship established is not the same as the relationship protected by the legislature.*"[4]

Other Prerequisites Including the Designation of the Beneficiary

Justice Deschamps also examines the other prerequisites for a declaration of exemption from seizure which are mentioned at paragraph 16 of the judgment: the existence of a debtor, an annuitant, an obligation to pay an annuity and a determined and periodic amount to which we must add to confirm the exemption from seizure, the designation of a privileged beneficiary as required by the Civil Code of Québec. She notes that under the terms of the plan, it is unclear that the trust company can be qualified as a debtor or is obliged to make periodic payments. She adds that even if the answer to that question was affirmative, there is no indication that the amount that the trust company would have undertaken to pay is determinable. However, what is most important concerning the privilege of the exemption from the seizure is the designation of the appropriate beneficiaries:

[2] [1999] 3 S.C.R. 375.

[3] (Par. 19 and 20).

[4] (Par. 26).

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"[28] […] Furthermore, in order to be protected and thus to be possible for him to get the seizure quashed, the annuitant would still have to have been designated in accordance with the rules respecting contracts of insurance which relate to beneficiaries and subrogated holders (…). In this case, Thibault is designated as the annuitant. He is not one of the persons referred to in art. 2457 C.C.Q. Can the designation of a "beneficiary" who is not a party to the annuity contract operate to designate a subrogated holder and trigger a protection mechanism? Is this an exception to the rules governing gifts *mortis causa* (art. 1819 C.C.Q.)? These arguments were not addressed, but should be discussed before concluding that a seizure should be quashed.

[29] As the foregoing analysis shows, even if there was an alienation of capital, a number of other issues would have to be decided in the appellant's favour in order for the argument based on the exemption of the Plan from seizure to succeed." (our emphasis)

The Court leads us to believe that the designation of the settlor as the annuitant, even if it is possible in an annuity contract, cannot confer an exemption from seizure.

Does the Plan Qualify as a Trust?

Justice Deschamps analyses the argument whereby this specific RRSP could be qualified as a trust. She rejects this argument because it is clear that the conditions of formation of a trust are not satisfied and she declares that the two juridical qualifications (annuity and trust) "*are incompatible because in an annuity contract, the debtor is personally obligated to pay whereas in a trust, the trustee has no personal obligation to the beneficiary as the periodic payments must be made out of the trust assets. Consequently, although the requirement that the capital be alienated is common to both contracts, the obligation created by each are dissimilar[5]"*. She adds that the argument based on the formation of a trust is, to a certain extent, a mirage because the trust patrimony cannot be seized to pay the debts of the settlor or of the beneficiary because the property does not belong to them[6].

The Legislative Modification of December 2002

Justice Deschamps then analyses the third question which is the impact of article 187 of the *Act to amend the Act respecting insurance and other legislative provisions* adopted in December 2002. This article aims to authorize withdrawals of capital without such withdrawals affecting the qualification of the annuity contract. She notes that a total withdrawal of capital had already been the subject of a judicial ruling in the case *Les Coopérants* v. *Raymond Chabot Fafard Gagnon*[7] and confirms that the termination of a contract does not change the nature of an annuity contract. She also compares the right of withdrawal according to article 187 to the case of life insurance when an insured receive an advance on the policy and that in those situations, the effect is to reduce the insurer's obligations.

She is of the opinion that article 187 clears away any ambiguity as to the effect of partial withdrawals of the already invested capital by stating that the annuities now benefit from the same flexibility as those authorized in the case of life insurance contracts. She however decides that this modification does not modify the rule requiring that capital be alienated, which is an essential element of the annuity contract.

Comparison with Other Plans

The parties having also invoked the protection awarded to other pension plans, Justice Deschamps analyses the impact of these protections and notes that in all the laws mentioned, "*the protection applies only as long as the assets remain locked in. None of those plans allows contributing employees to use the funds as they see fit during the life of the plan*[8]. Further, she notes that with respect to the financial vehicle that constitute real life insurance contracts and annuities, "*neither of those vehicles allows the policy holder or settlor to use the funds placed with the insurer or the annuity debtor as would an owner* [9]".

According to Justice Deschamps, although the Québec legislature clearly demonstrated its desire to protect the family and the retirement income of its employees under certain conditions and by specific juridical vehicles such as the annuity and insurance, it has not demonstrated an intention to have the RRSPs benefit from such a protection. The RRSPs have first and foremost a tax purpose[10],"*the Québec legislature however did not direct its attention to the legal status of RRSPs in civil law. While RRSPs are subject to both federal and provincial tax legislation, they are still governed by the rules of contract law that apply to the vehicle used. Thus, with respect to exemption from seizure, there was no statutory provision that operated to cover all RRSPs. To determine whether assets were seizable, the reference had to be made to the legal nature of the vehicle in which the assets were invested"*. Should the investors choose a protective financial vehicle such as insurance policies or

[5] (Par. 39).

[6] (Par. 40).

[7] [1994] R.L. 268 (C.A.).

[8] (Par. 49).

[9] (Par. 50).

[10] (Par. 53).

annuities, they will consequently obtain some protection against seizures[11] and the locking-in of the capital would not be so bad as the pension plans established by various statutes impose to the strict rules throughout the period when a participant is making contributions. Generally, these rules are no more favorable than those which that apply to self-employed workers.

She finally notes that the flexibility of self-managed plans is attractive for investors because they may dispose of their assets as they see fit, subject only to tax constraints. However, that flexibility "*comes at a price, because the assets held in such a plan are seizable*[12]".

Comments

From this decision, we should retain the fact that each plan must be analyzed in terms of these criterias because the variety of financial vehicles on the market does not allow for only one conclusion.

The exemption from seizure comes at a price: the renunciation to the control of the invested capital as well as the renunciation to be the beneficiary.

The investors should reexamine their objectives to choose the financial vehicle which is appropriate to their needs as well as to ensure that their wishes in terms of transmissibility in case of death may be respected.

The change to the legislation in 2002 now allows a partial withdrawal of the alienated capital to the debtor (insurer or trustee) but unfortunately does not settle the matter of the exemption from seizure.

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[11] (Par. 54)

[12] (Par. 56)

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