

REPORT ON RECENT DEVELOPMENTS

I. Jurisprudence Update - How Secure Are You?

RRSPs not safe from seizure

The myth that RRSPs are safe from seizure was shattered earlier this year by the decision of the Supreme Court of Canada (“SCC”) in *Bank of Nova Scotia v. Thibault*,¹ which held that a self-directed RRSP held by a Quebec resident was not exempt from seizure by creditors.

The case involved Mr. Thibault who invested in a self-directed RRSP with ScotiaMcLeod. The terms of the agreement described the plan as a trust and stated that the funds invested in the plan would be exempt from seizure. The plan further provided that until maturity Thibault was free to make withdrawals, and that upon maturity, the funds would be used to purchase an annuity.

Prior to the maturity date, one of Thibault’s creditors, the Bank of Nova Scotia, tried to seize the funds invested in the plan. Thibault contested on the basis that the funds were exempt from seizure as provided for in his agreement with ScotiaMcLeod. The Superior Court dismissed Thibault’s application, finding that the funds invested in the RRSP were not exempt from seizure. ScotiaMcLeod appealed to the Quebec Court of Appeal, which also found that the funds were not exempt from seizure. The matter was then brought before the SCC.

In rendering the decision of the Court, Madam Justice Deschamps begins with a reminder that “[e]xemption from seizure does not result from the mere intent of the parties. The law alone can grant that protection.”² To establish non-seizability, it was necessary to show that the particular RRSP was a qualifying annuity or

trust, vehicles in respect of which declarations of exemption from seizure may be valid under the Civil Code of Quebec (“CCQ”).

In order for the RRSP to be considered an annuity, Madame Justice Deschamps stated that, among other requirements, there must have been an alienation of capital. She noted that, under the plan in question, an annuity was to be purchased with the funds in the RRSP only upon maturity of the plan and that, until maturity, Thibault remained the absolute owner of the funds with full power and authority to withdraw the funds at any time. She concluded that there was no alienation and, therefore, no annuity.

The Court then reviewed the three requirements for a trust to be constituted under the CCQ: property must be transferred to a patrimony by appropriation, appropriated to a particular purpose and accepted by a trustee. These were all found to be lacking.

While it is possible to acquire life insurance policies and annuities that are exempt from seizure, the *Thibault* case illustrates that it is not sufficient to simply put one of those labels on an RRSP to render it unseizable.

It should also serve as a reminder that, in Quebec, beneficiary designations in an RRSP are generally invalid. Individuals would be well advised to have their RRSPs and their wills reviewed with this in mind.

¹ [2004] 1 S.C.R. 758; 2004 SCC 29

² *Ibid.*, at para. 2.

Does your security protect you?

Many lenders insist on obtaining security in the form of a lien or movable hypothec on assets before agreeing to a loan. Recent decisions of the Federal Court of Appeal (“FCA”) have put the effectiveness of such security into question.³

The cases involve attempts by the Attorney General for Canada to recover, from secured creditors, source deductions that had been deducted but not remitted by their defaulting borrowers. After the financial institutions had realized their security interests against their borrowers, the Attorney General served “requirements to pay” on the financial institutions for the unremitted source deductions, invoking the Crown’s absolute priority over amounts held in trust for Her Majesty. The financial institutions’ refusal to pay was upheld by the Federal Court, Trial Division (as it then was). The FCA disagreed, holding that the language of the legislative provisions was clear, that the deemed trust extended to the assets seized, and that the procedural requirements contained in the *Income Tax Act* (Canada) had been followed by the Attorney General.

Both the *Income Tax Act* (Canada) and the *Employment Insurance Act* stipulate that amounts deducted or withheld under these statutes are deemed to be held in trust for Her Majesty. When such amounts are not remitted, the deemed trust extends to the property of the person, including property held by a secured creditor (the financial institutions, in these cases) and the Receiver General must be paid in priority out of the proceeds of such property.

In rendering its decision, the FCA reviewed the case *First Vancouver Finance v. M.N.R.*⁴ In that case, the SCC held that property of the tax debtor was part of the deemed trust, but that its sale to a *bona fide* third party removed such

property from the deemed trust. Instead, the deemed trust applied to the proceeds received from such sale. The FCA distinguished secured creditors from third party purchasers noting that for secured creditors, the situation is specifically legislated to be different. Since the property over which the secured creditors asserted their security continued to be subject to the deemed trust and remained so at the time of its sale, the proceeds from the sale had to be paid to the Receiver General in priority to the secured creditors. The FCA also said that a secured creditor that does not comply with the obligation to pay the proceeds becomes personally liable. The financial institutions have sought leave to appeal to the SCC.

The Federal Court rendered a similar decision upholding the Crown priority in *M.N.R. v. HSBC Bank Canada*,⁵ and noted that the secured creditor might have made inquiries to determine whether its debtor owed any moneys for source deductions, and could also have insisted on personal guarantees to further protect its interests.

These cases have significant implications for secured creditors who may become involuntary debtors to the tax departments for not only unremitted source deductions, but also unremitted sales taxes of defaulting borrowers. Vendors who have recently sold their businesses and taken a security interest over the assets sold to secure a balance of sale, must consider that Crown claims for unremitted source deductions or sales taxes may impair their ability to enforce their security interests.

³ *Attorney General (Canada) v. National Bank of Canada, et al.*, 2004 FCA 92.

⁴ [2002] 2 S.C.R. 720.

⁵ 2004 FC 467.

II. Administrative Developments

Holding U.S. Vacation Property

The Canada Revenue Agency (“CRA”) announced, in its *Income Tax Technical News No. 31*, dated June 23, 2004, that it is revoking its long-standing administrative policy for single-purpose corporations.

The administrative policy accommodated taxpayers who held U.S. vacation property in a corporation as a means to avoid U.S. estate tax. The CRA policy was such that no shareholder benefit would be assessed provided certain conditions were met. The rationale for the revocation is that the 1995 amendments to the *Canada-U.S. Income Tax Convention* provide adequate relief to Canadians for U.S. estate tax liability arising on death.

Although it was initially announced that this change in policy would be effective as of June 2004, the CRA recently announced that implementation of the change will be postponed to January 1, 2005.⁶

Thus, the old administrative policy will no longer apply for:

- any property acquired after 2004 by a single-purpose corporation; or
- a person who acquires after 2004 shares of a single-purpose corporation other than as a result of the death of the individual’s spouse or common-law partner.

The administrative policy will continue to apply to those arrangements that are currently in

place until the earlier of:

- the disposition of the particular U.S.-based real estate by the single-purpose corporation; or
- a disposition of the shares of the single-purpose corporation, other than a transfer to the shareholder’s spouse or common-law partner as a result of the death of the shareholder.

The CRA is considering whether this grandfathering should have a limited duration and, also, how the change in policy will apply to certain situations, such as partially constructed residences.

Even in situations grandfathered for Canadian purposes, there is concern that the U.S. tax authorities may look through or ignore the single-purpose corporation thereby eliminating its effectiveness to avoid U.S. estate tax.

The change in CRA policy, coupled with the continued U.S. concerns, means alternative structures must be considered for holding U.S. vacation property. These may include Canadian trusts or Canadian partnerships. Other strategies involve insurance, non-recourse mortgages and joint ownership by different family members. Each situation must be examined to determine the most appropriate strategy.

⁶ CRA Round Table, Canadian Tax Foundation Annual Conference, Toronto, September 28, 2004.

III. Legislative Developments

Budget Implementation Act

The *Budget Implementation Act*, 2004 became law on May 14, 2004. Of special note is the new 10-year limitation period for the collection of taxes under the *Income Tax Act*, the *Excise Tax Act*, the *Excise Act*, and the *Air Travellers Security Charge Act*, among others. Essentially, the legislation has overturned the *Markevich v. Canada*⁷ decision by “restarting” the calculation of the limitation period for the

collection of all tax debts, whether previously prescribed or not, as of March 4, 2004. Therefore, all uncollected federal tax debts outstanding on March 4, 2004, whether or not collection action had been previously undertaken, will now be prescribed in 10 years. The Government of Quebec has announced that an identical limitation period will be introduced for the collection of provincial tax debts.⁸

⁷ [2003] 1 S.C.R. 94; 2003 SCC 9.

⁸ Quebec Budget, March 30, 2004.

Sweibel Novek News

October 1, 2004 marked the 10th anniversary of the founding of Sweibel Novek. In honour of this event and in appreciation of our clients and friends for their continuing support, Sweibel Novek will be making donations to the McGill University Health Centre and the Jewish Rehabilitation Hospital.

The material contained herein is necessarily of a general nature and cannot be regarded as legal advice. The members of our firm would be pleased to provide additional information. You may reach us at (514) 849-1188 or by e-mail as follows:

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