

## Legal Brief

Attention: Credit Union Managers

99-039

March 25, 1999

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### Security Interests in RRSPs: New Developments

At one time it was possible for lenders to take a security interest in an RRSP, if the lender and the Trustee of the RRSP were the same institution and the security interest extended only to funds in the RRSP borrowed from that lending institution. In December 1980, amendments were made to Section 146 of the *Income Tax Act* (which required, as a condition of registration, that an RRSP plan include provisions that the property held in the plan could not be given as security). Following those amendments, a number of court decisions held that such a security interest was prohibited and unenforceable, at least in cases where the security interest was granted after December 1980.

However, in December 1998, the Ontario Court of Appeal effectively overruled these decisions. The court decided that the effect of the restriction in the *Income Tax Act* was not to prohibit, nor to render unenforceable, a security interest in the property in an RRSP, but merely to disqualify the plan as an RRSP if and when such a security interest is given.

The result of such disqualification, of course, will be that the value of all of the property in the plan will become taxable income to the annuitant in the year in which the security interest is given. This is not a result that most borrowers will want to face as a condition of borrowing. Lenders would, we suggest, be under a duty to explain the taxation consequences of such a transaction to a prospective borrower and to issue a T4RSP for the taxation year in which the security interest was given. If such consequences are acceptable to the borrower, the security interest granted in the RRSP will be valid.

The case may be of greatest practical interest in cases where a credit union finds itself in a dispute with a Trustee in Bankruptcy over existing security interests granted in RRSP property by borrowers who were probably unaware of the taxation consequences that (it has now been determined) would follow. In such a case, it is our view that the security interest will be valid and will have priority over the claim of a Trustee in Bankruptcy. Although Revenue Canada will have a claim for the unpaid taxes, it appears that that claim will simply be an ordinary unsecured claim in the bankruptcy.

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