

Avoiding “Tax-Free” RRSP Withdrawal Scams

As the name implies, savings held within a registered retirement savings plan (RRSP) are intended to be held for the long term and used to finance, at least in part, a comfortable retirement. In most cases, Canadians who have money saved in an RRSP view withdrawing money from the plan as something to be avoided unless and until all other possible options have been exhausted. Generally speaking, taxpayers, especially older taxpayers, dip into an RRSP only where it's necessary to deal with a financial crisis, such as a pending foreclosure or a possible bankruptcy.

The fact that taxpayers contemplating a withdrawal of funds from their RRSPs are generally in some kind of financial distress makes them especially vulnerable to promoters of fraudulent schemes relating to such withdrawals. All withdrawals made from an RRSP, other than as part of government-sanctioned programs, such as a Home Buyer's Plan or a Lifelong Learning Plan, are subject to tax in the year in which the funds are received, regardless of the reason for the withdrawal or the purpose to which the funds will be put. Promoters of fraudulent RRSP withdrawal schemes usually promote those schemes on the basis that their plan will allow funds to be legally withdrawn free of income tax, thus maximizing the amount that the taxpayer will actually receive. Alternatively, they promise that the taxpayer can obtain, prior to retirement, access to a “locked-in” RRSP, something which is not generally permitted.

Consumer financial frauds flourish during difficult economic times, and RRSP withdrawal scams are no exception. The Canada Revenue Agency (CRA) recently issued a notice warning taxpayers that it was seeing an increasing number of “questionable” RRSP and registered retirement income fund (RRIF) withdrawal schemes. In the CRA's experience, promoters of such funds were seen to be operating in most Canadian provinces, and taxpayers who had been persuaded to participate in the schemes were located throughout the country.

The typical structure of such a scheme involves having the owner of a self-directed RRSP purchase a particular investment through a specified trustee. That investment usually takes the form of shares of a private company or an interest in mortgages, and the value attributed to the shares or the mortgage is usually inflated far beyond its actual worth. The taxpayer is then promised that he or she will be able to borrow back the invested funds through a low-interest or interest-free loan, and of course, there will be no income tax payable on the entire transaction.

The CRA's warning to taxpayers notes that the promotions used for many of these schemes appear entirely legitimate and professional, even to the extent of providing potential “investors” with opinion letters from professionals indicating that the promised tax benefits are indeed available. However, the more likely outcome of the scheme is a reassessment by the CRA of the taxpayer and the inclusion of the invested or withdrawn amount in the taxpayer's income for the year. In the worst-case scenario, which has unfortunately occurred many times, the outcome of the scheme is that both the promoter and the taxpayer's retirement savings disappear, leaving the taxpayer out of pocket and facing a tax assessment in relation to funds that he or she no longer possesses.

A few years ago, a taxpayer challenged a CRA assessment that had included in her income for the year an amount withdrawn and lost through an RRSP scam, and the challenge eventually went to court. The Tax Court held that, while it was sympathetic to the taxpayer's plight and believed that it was entirely possible that she had been the innocent victim of a professional

swindle, it could not overturn the CRA's assessment, which was correct in law. If a similar case were to come before the Court today, it would undoubtedly reach the same conclusion.

The CRA's most recent warning to taxpayers on the subject of RRSP withdrawal scams can be found on the Agency's Web site at <http://www.cra-arc.gc.ca/nwsrm/lrts/2009/1090317-eng.html>, and a more detailed outline of RRSP withdrawal scams generally is available at <http://www.cra-arc.gc.ca/tx/ndvdlis/tpcs/rrsp-reer/schms/menu-eng.html>.