Canada Revenue Agency

Taxpayer Alert

Owners of self-directed RRSPs should use caution with tax-free withdrawal schemes.

Taxpayers should use caution before taking part in any scheme that promises a tax-free withdrawal of Registered Retirement Savings Plan (RRSP) funds.

Some promoters of financial schemes promise RRSP owners that they can make tax-free withdrawals from their RRSPs. Typically, the arrangement involves using an individual's self-directed RRSP to purchase the shares of a private company or interest in mortgages (usually at highly inflated values). The funds used to make the purchase are then loaned back to the owner of the self-directed RRSP at low or no interest.

Marketers of these schemes promote them with claims such as "*Take advantage of your RRSP now – no tax to pay!!*," or "*I will loan you $5,000 to $250,000 over five years if your RRSP is locked in*."

Taxpayers who respond to these kinds of advertisements risk losing retirement savings AND the tax benefits of those claims. Why? If an RRSP is used as security for a loan, the value of the RRSP has to be added to the taxpayer's taxable income. Similarly, if an RRSP is used to purchase shares of a private corporation, and the shares are not a "qualified investment" under the rules, then the value of the shares will be added to the RRSP holder's taxable income.

In 2001, the Canada Revenue Agency re-assessed a taxpayer who had used such a scheme. Pursuant to the *Income Tax Act*, the Agency added the total value of the RRSP funds that were withdrawn through the scheme to the taxpayer's income. The taxpayer disagreed with the re-assessment and filed an appeal with the Tax Court of Canada.

In its decision ***(2004 TCC 164, Dubuc v The Queen),*** the Court stated: "the business with which the Appellant dealt was nothing more than an organization set up by unscrupulous individuals in order to cheat those least able to detect the swindle…individuals who had invested energy and resources in the creation of various corporate entities in such a way as to convince any non-believer or skeptic of the legality of the transactions."

The Court also went on to say, "although the Appellant is sympathetic and although she may possibly have been the innocent victim of an actual professional swindle, the appeal must be dismissed because the assessment is correct".

These RRSP schemes are very carefully planned and promoted to give the appearance of legitimacy. As a result, taxpayers should be reminded of the importance of exercising due diligence to protect themselves against schemes that will have a negative effect on their financial and/or tax situation.