



April 6, 2011

The Honourable Keith Ashfield
Minister of the Canada Revenue Agency
Ashfield.K@parl.gc.ca
(613) 992-1067

Dear Minister:

Re: Nortel Health and Welfare Trust

Thank you for your correspondence of March 15, 2011 concerning payments to be made from the Nortel Health and Welfare Trust (HWT) on wind-up. Your prompt attention to this matter is much appreciated by all of us who are working toward a fair outcome for disabled employees whose disability insurance is provided through HWTs.

I understand that you and your staff are not permitted to comment on the tax issues of a taxpayer without written authorization; however, the actuaries, accountants and lawyers whose practices cover HWTs need clarification of the CRA's rules governing HWTs. The HWT is defined within the CRA administrative regime for interpretation of the ITA sections on employer contributions and employee benefits. At the Society of Trust and Estate Practitioners Roundtable with the CRA on June 8, 2010, the CRA announced it had no plans to withdraw IT-85R2 upon implementation of the ITA amendments for the new Employee Life and Health Trust (ELHT). Furthermore, at this important forum for practitioners, the CRA said it is remaining diligent in ensuring that HWTs fully comply with its administrative regime. I believe that further CRA guidance is not only warranted, but required due to the conflict between the November 9, 2010 decision of Justice Morawetz on the Nortel HWT wind up distribution, and the existing CRA rules for HWTs.

If I compare the HWT to a registered pension plan (RPP) constituted as a trust, there are a great many similarities. The obvious difference is that the law does not require the automatic filing of HWT documentation in order to maintain a tax-preferred status. However, CRA can and does from time to time request justification for the amounts of deductible employer contributions being claimed. CRA may also require even a third party to produce any and all documents related to a particular HWT. Furthermore, the CRA reviews actuarial reports and other material in order to determine the reasonableness of employer contribution levels. Just as in the case of an RPP, CRA may opine on whether or not a particular arrangement qualifies as a bona fide HWT for tax purposes. As you pointed out in your correspondence of March 15, the CRA may take enforcement actions to deny tax deductions for employer contributions. The CRA's

commentary carries a great deal of weight regarding the administration of such vehicles because taxation is the major issue driving the plan design. From your letter:

“The health and welfare trust developed as an industry response to situations in which employers did not want to purchase contracts of insurance, but employees (and/or their union representatives) wanted a somewhat higher degree of assurance than provided under a pay-as-you-go arrangement. The concept of the health and welfare trust was proposed to ensure that interposing a trust did not create any unintended tax results in terms of preserving the non-taxable status of employment benefits and employer deductions for contributions to the trust.”

If one consults the ITA in conjunction with related CRA publications, the HWT's primary function is to execute group life and health insurance contracts, either issued by third party insurers or self-insured by the employer. All benefits may be self-insured by the employer, with the notable exception being life insurance, which may only be provided using group term life insurance policies issued by third party insurers. The Nortel group term life insurance policies issued by Sun Life and held within the Nortel HWT have premiums that are pay-as-you-go expenses annually. These contracts terminate automatically upon Nortel's receivership or bankruptcy. Once insurance contracts lapse, it is well established that there is no further life insurance coverage for anyone. If all the benefits provided within the HWT were similarly insured with third party insurers, all insurance coverage would cease and there would be no further claims admissible of any kind. **The only remaining liability for the third party insurers would be for the future income payable within the disability claims that have already been incurred up to the date of the termination of the insurance policies. In accordance with the various publications of the CRA, it is clear that the situation on wind-up of the Nortel HWT should be no different.**

For example, the following excerpt from IT-428 dictates that Wage Loss Replacement Plans, such as disability income plans provided through HWTs, must be administered as true insurance plans:

“7. A plan for purposes of paragraph 6(1)(f) of the Act and section 19 of the ITAR must be an "insurance" plan. Those provisions are not applicable, therefore, to uninsured employee benefits such as continuing wage or salary payments based on sick leave debits, which payments are included in income under paragraph 6(1)(a). It is to be noted that, while a plan must involve insurance, it is not necessary that there be a contract of insurance with an insurance company. If, however, insurance is not provided by an insurance company, the plan must be one that is based on insurance principles, i.e., funds must be accumulated, normally in the hands of trustees or in a trust account, that are calculated to be sufficient to meet anticipated claims. If the arrangement merely consists of an unfunded contingency reserve on the part of the employer, it would not be an insurance plan.”

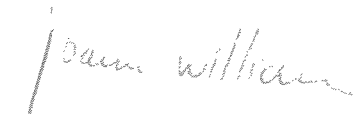


It is clear from the Nortel HWT wind-up reports that assets have been allocated to future life insurance considerations (for the benefit of pensioners and the disabled) for which the HWT has no further liability. Such assets should not have been accumulated using legally deductible employer contributions. At the same time, insufficient assets have been allocated to the liability for incurred disability claims, which is required to be funded under a bona fide HWT. These HWT issues are the jurisdiction of CRA and I suggest it is within the CRA's mandate to review a publicly available HWT wind-up report.

I believe you will find that Nortel should properly incur a tax liability for prior period employer contributions accumulated to fund the proposed distribution for future life insurance considerations. The ITA S. 18 (9) (iii) and CRA's Interpretation and Ruling Documents state that employer contributions in consideration for insurance in respect of a period after the end of the year are not tax deductible. Nortel should not be able to contravene the ITA and CRA administrative regime for HWTs over many years without consequences.

With the advent of the new legislation for ELHTs, there will be no new HWTs established; however wind-up issues pertaining to existing HWTs must still be addressed. Your intervention in the Nortel matter would provide the opportunity for CRA to present its interpretation, but your interpretation is required in any case. As a practitioner, I assure you that your guidance on these issues is essential, and I hope it will be forthcoming while the Nortel HWT is still in existence. Thank you again for your consideration.

Sincerely,



Joann Williams, BSc., FSA, FCIA
Welton Parent Inc.
(613) 842-7245
jwilliams@wpi.ca

CC:

Linda Lizotte-MacPherson
Commissioner and Chief Executive Officer
Canada Revenue Agency
Linda.LizotteMacPherson@cra-arc.gc.ca
Canada Revenue Agency



Wayne Adams
Director General, Income Tax Rulings
Canada Revenue Agency
Wayne.Adams@cra-arc.gc.ca
555 MacKenzie Avenue
Ottawa, Ontario K1A 0L5

Minister of Finance James Flaherty
Flaherty.J@parl.gc.ca
(613) 992-6344

Minister of Industry Tony Clement
Clement.T@parl.gc.ca
(613) 944-7740

Parliamentary Secretary to the Minister of Finance
Menzies.T@parl.gc.ca
(613) 995-8471

Parliamentary Secretary to the Minister of Industry
(613) 995-8695
Lake.M@parl.gc.ca

Joel P. Rochon
Rochon Genova LLP
jrochon@rochongenova.com
(416) 363-1867 ext. 222

