Submission on Income Tax Amendments for New Employee Life and Health Trusts

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Finance Canada's Tax Legislation Division has requested submissions before April 30, 2010 on the Government's February 26, 2010 plan to adopt Income Tax Act (ITA) Amendments governing new Employee Life and Health Trusts (ELHT).

I am very concerned about the Federal Government providing new tax incentives for ELHTs that reduce the taxes of corporations, while allowing them to provide unsafe Long Term Disability (LTD) Benefits to their employees. Under the proposed legislative amendments, the ELHTs may be used for both third party insured and **<u>self-insured LTD Benefits</u>, without providing any measures to ensure that self-insured LTD Benefits are fully funded and hence offer secure wage replacement income and medical benefits for the disabled.**

To understand the significance of my concern, you need only look at the missing over $100 million in the Nortel Health and Welfare Trust (HWT) due to Nortel's failure to make required employer contributions over many years. Plus, Nortel arranged a $37 million loan from its HWT that was not repaid prior to Nortel's bankruptcy filing. The alleged breach of trust in the Nortel HWT is putting 400 Nortel LTD employees into poverty after Dec. 31, 2010. Nortel's liquidation could not have been imagined over most of its 115 year history. No-one expects to become disabled either, but 0.35% of workers are dealt the disability cards. Self-insured benefits must be made secure for the small % of Canadians who become disabled, because these are the most vulnerable in society.

<u>I strongly recommend the ELHT ITA Amendments be delayed until the following changes occur:</u>

(1) <u>There is simultaneous adoption of amendments of the Companies' Creditors Arrangement Act (CCAA) and Bankruptcy and Insolvency Act (BIA) for the preferred status of long term disability claims.</u> The Federal Government needs to provide for the security of self-insured LTD Benefits within its own jurisdiction of Federal laws, in order to fulfil its part in the network of actors affecting the disabled and meet the principles of the United Nations Convention for the Rights of Persons with Disabilities signed by Canada on March 11, 2010.

(2) <u>Employers are required to make annual contributions into the ELHT's to fully fund their Long Term Disability Benefits Plan on a sound actuarial basis, covering both the current and future LTD wage replacement income and medical payments for the duration of the disability until age 65</u>. The event in respect of which the LTD self-insurance is provided is the onset of a long term disability. Full funding needs to be provided for in the year of the onset of the disability just like third party insurance companies are required to establish sufficient reserves to fully fund the current and future expected claims arising from the insured event. Contributions to fully fund self-insured LTD Benefits in the year of the onset of the disability should be tax deductible in the onset year and not be treated as a prepaid expense for LTD Benefits paid in the future.

ELHT ITA Amendments Without the Accompanying Bankruptcy Law Amendments Are Bad Social Policy

The ELHT ITA Amendments prescribe the rules for trusts used to fund employee life and health benefits within the Income Tax Act for the first time.

Employee Life and Health Trusts Income Tax Amendments Proposed on February 26, 2010

Federal Budget 2010 on March 22, 2010

The new ELHTs replace the old Health and Welfare Trusts (HWT). The old HWTs rules were only provided in CRA Interpretation Bulletins and Income Tax Technical News, shown in the following link.

Canada Revenue Agency H&WT and LTD Wage Loss Replacement Rules

The significance of the ELHT ITA Amendments is that they promote ELHT creation and broadened use of them to achieve the goal of active employees and retirees getting more life and health benefits, including wage replacement income for the disabled. If, however, the ELHT's are not properly designed and enforced, the ELHTs may end up being vehicles to save employers income taxes, while their employees are forced to live a life of poverty in the event that they become disabled and their employer also goes bankrupt. The draft legislation clearly says that the ELHTs may be used for both third party insured and self-insured LTD Benefits, without providing any new measures to ensure that self-insured LTD Benefits are fully funded and hence offer secure wage replacement income and medical benefits for the disabled.

In fact, the new ELHTs will explicitly permit employers to issue promissory notes from themselves to ELHTs. If such promissory notes are made, it will not be considered tax deductible employer contributions until the promissory notes are repaid in cash at a future time. Our Nortel experience tells us that promissory notes from employers should be not permitted within the EHLTs, but for carefully prescribed exceptions. In the exception situations, the promissory notes must certainly be required to be secured, so that they have super-priority in bankruptcy estates.

The extra tax incentive offered to employers using ELHTs are in two forms: (i) The ELHT will be permitted to treat employee benefit payments as expenses; and (ii) If the trust's expenses exceed its revenue for a particular year, the excess would be treated as a type of loss of the trust, with special rules allowing it to be deductible against income in any of the three preceding or three following taxation years, provided that the trust retained its status as an employee life and health trust for the year.

Promoting unsafe LTD Benefits, which adversely affect the life and quality of life of the disabled, is bad Federal Government social policy. Unsafe self-insured LTD Benefits provided by employers, without accompanying bankruptcy laws giving preferred status to LTD claims, is worse than no employer LTD Benefits. Employees who know they do not have employer LTD Benefits are apt to purchase their own personal LTD insurance.

The insurance industry has Assuris, which is a not for profit organization that protects Canadian policyholders in the event that their life insurance company should fail. Corporations that self-insure their LTD Benefits have no such bankruptcy protection provided. Amendment of the bankruptcy laws for the preferred status of LTD claims provides this backstop for the self-insured plan beneficiaries, to the extent there is money in the bankruptcy estate.

ELHT ITA Amendments Without the Accompanying Bankruptcy Law Amendments Are Bad Tax Policy

<u>The EHLT ITA Amendments without accompanying CCAA/BIA amendments for the preferred status of LTD claims is bad tax policy.</u> With only the EHLT ITA Amendments adopted, taxpayers fund tax benefits for the employer providing self-insured LTD Benefits, without any assurance that employees will get their wage replacement and medical benefits once disabled. The disabled can end up being downloaded on Canada's social security programs, while employers reap the benefits of the tax incentives.

Let me explain how this can happen. With prior year tax benefits already earned, employers are able to commit breach of trust prior to filing for bankruptcy protection. This breach of trust may comprise: employers not making their required employer contributions as prescribed in the trustee agreement; making promissory notes representing plans to make required employer contributions in the future (even when not permitted in the trustee agreement); making loans to themselves from prior employer contributions made into the ELHTs; making other self-dealing investments, such as owning the employer's shares; negligent investment of the EHLT assets; and, other wrongdoings.

The consequences of breach of trust, by inference on how the Ontario Superior Court of Justice bankruptcy court interprets the Nortel March 31st settlement agreement, is that LTD employees may be pushed into poverty when their employers file for bankruptcy. Unless the lower court's interpretation of the March 31st Nortel settlement agreement is over-turned by the Court of Appeal of Ontario, the creditor claims of the disabled, even when they are caused by the wrongdoing of their employer's directors, ELHT governance committee members and third party trustees, are considered to be equal to the unsecured creditor claims.

When the debtors are not required to restore the missing assets in ELHTs before filing for bankruptcy or during the bankruptcy proceeding, the executives are able to pay themselves bonuses from the extra cash they achieve for the bankruptcy estate. Also, the junk bond owners make higher cash settlements from this extra cash achieved for the bankruptcy estate when assets are taken and not restored to the trusts for the disabled prior to the bankruptcy filing. The executives and junk bond owners should not be able to benefit from breach of trust wrongdoings in future ELHTs and today's

HWTs. The extra cash gained from breach of trust in a bankruptcy estate rightfully belongs to the disabled beneficiaries of these trusts.

Need to Fix CRA's Planned Restriction on Tax Deductibility for Contributions to Fund Long Term Disability Benefits Paid in Future Years

The ELHT ITA Amendments do not provide an adequate incentive for the full funding of self-insured LTD Benefits, since it allows tax deductibility for only the contributions in each year used to pay LTD Benefits in the same year. There should be tax deductibility for the full funding of the LTD benefits expected to age 65 in the year of the onset of the disability. This would be comparable tax treatment to third party insurance companies, who are required to establish actuarially determined reserves to fully fund the current and future expected claims arising from the insured event, and who can deduct their reserve additions for tax purposes in the year they are made.

The current draft legislation for ELHTs suggests a misunderstanding of how long term disability insurance works. The event in respect of which the LTD self-insurance is provided is the onset of a long term disability. This is the event that results in the obligation to make typical LTD wage replacement income and medical payments each year for the duration of the disability until age 65.

If there was an equivalent a group insurance policy, the insurer provides LTD insurance to the employer's employees. If an employee becomes disabled in the first policy year, the insurer will be obligated to have funds in reserve determined on an actuarial basis to pay for the current and future claims of the disabled employee for the duration of the disability to age 65, regardless of whether the employer renews the policy at the end of the first year.   The aggregate actuarially determined contributions for full funding may exceed the aggregate LTD Benefits being paid in the current year, depending on the number of disabled persons being added versus the number of disabled persons dying or reaching age 65 within the insured group.

Corporation Self-Policing is Not Working, So CRA Enforcement Procedures are Required

Once fully funding requirements are imposed on ELHTs providing LTD Benefits, there will need to be CRA enforcement procedures applied to the ELHTs in order to ensure that employers are not simply using their ELHTs for tax efficiency, while shirking their fiduciary duties to the ELHT beneficiaries. Employers, like Nortel, who do not make their required employer contributions into ELHTs and who manage the assets of ELHTs imprudently, should have harsh consequences, especially when they are taking advantage of the most vulnerable in Canadian society, the disabled.

The sought after CCAA/BIA amendments for the preferred status of LTD employees over unsecured creditors, including other employee groups, will remove the disabled from the stress of the bankruptcy process. These amendments will give the disabled the peace of mind that their LTD Benefits were there to accomplish in the first place.

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Related Documents

(1) Power and Politics - UN Convention on the Rights of Persons with Disabilities

(2) Senate Bill S-216 LTD Benefits in Bankruptcy

(3) Humanitarian Plea - BIA Amendment for Nortel LTD Employees

(4) CBC Gillian Finley Interview - Alice Campbell, Nortel LTD Employee November 26, 2009

(5) Finance Committee - Diane Urquhart, Bankruptcy March 25, 2010

(6) Finance Committee - Diane Urquhart, Bankruptcy French March 25, 2010

(7) Finance Committee - Josée Marin, Nortel LTD Employee April 20, 2010

(8) Finance Committee - Josée Marin, Nortel LTD Employee French April 20, 2010

(9) Finance Committee - Lee Lockwood, Nortel LTD Employee April 22, 2010

(10) Finance Committee - Sylvain de Margerie, Husband LTD Employee April 13, 2010