Summary of Income Tax Act and CRA Ruling Documents Applicable to the Nortel HWT
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The **Nortel Health and Welfare Trust (HWT) Trustee Agreement** gives effect to the Nortel "Health and Welfare Plan" through a trust fund to be known as the "Health and Welfare Trust." This is an HWT as defined by the Canada Revenue Agency in **IT85R - Pre 1986 Health and Welfare Trusts for Employees Jan. 20, 1975** and **IT85R2 - Health and Welfare Trusts for Employees July 31, 1986** .

In a single HWT, there can be no surplus for one beneficiary group, while there is a deficit for another beneficiary group, as the HWT assets are commingled in a single trust account. The HWT is either in surplus, in balance, or deficit, as a whole. **The Nortel HWT assets estimated for Dec. 31, 2010 are $80 million. The HWT at Dec. 31, 2010 is in deficit relative to the HWT actuarial liabilities owed to the HWT's legal beneficiaries, who are the Long Term Disabled Income Plan and Survivors Income Plans' participants** (the $7.8 million being paid to the pensioners for life insurance premiums in 2010 under the March 31st settlement agreement were not an HWT liability otherwise.) There are estimated $80 million to $103 million of HWT actuarial liabilities for the Long Term Disabled Income Plan and $20 million for Survivors Income Plans. Final actuarial liabilities owed to sustain the Long Term Disability Income will not be determined until later in the Nortel CCAA Claims Process. Nortel's actuary, Mercers, estimates $80 million owed for disability income, while there are much higher actuarial liabilities owed as disclosed in the HWT's financial statements and Mercers Actuarial Reports for Accounting Purposes during 2005 to 2009.

Since there is no HWT liability for pensioners life insurance premiums after the end of the year, the Pensioners Life Insurance Plan participants are not beneficiaries of the HWT. Nortel's book-keeping of an HWT Pensioners Life Insurance Plan liability is not in compliance with the Income Tax Act and CRA Ruling Documents applicable to HWTs. The HWT reserve assets allocated to the Pensioner Life Insurance Plan in Nortel's book-keeping can only be considered surplus in respect to the Pensioner Life Insurance Plan, as there is no HWT Pensioners Life Insurance Plan liability beyond the end of the current year.

Nortel was not entitled to have an HWT permanent surplus, according to **CRA Ruling Document # 9412155 - HWT Surplus - July 26, 1994** . This CRA Ruling Document says that an HWT surplus does not automatically cause an HWT to lose its tax status, provided it is corrected by an employer contribution holiday. If an employer contribution holiday is not taken, and an HWT permanent surplus exists, then new employer contributions made into the HWT are not tax deductible.

Pre-funding of future pensioner life insurance premiums after the end of the year was not tax deductible under **Income Tax Act Amendment S. 18 (9) (a) (iii) Dec. 11, 1979.** The Nortel estate does have an obligation to pay the vested life benefits that Nortel promised its pensioners within their post-retirement benefit brochures**. But, the HWT has no liability for these post retirement benefits after the end of the year,** as confirmed by the **CRA Ruling Document #9477117 - Consideration for Insurance After End of Year - Nov. 22, 2004**. **Any pre-funding of the pensioners life insurance in the HWT, therefore, has to be considered surplus relative to the pensioners group within the HWT assets.**

CRA Ruling Document # 9433745 - Trust Wind-up - Nov. 30, 1994 says that **"Acceptable uses of trust funds upon windup include distribution to a registered charity as defined in section 149.1 of the Act and the provision of additional qualifying benefits as described in paragraph 1 of IT-85R2 to the employees covered by the plan.** Paragraph 1 of IT-85R2 defines the qualifying benefits as follows:

The purpose of this bulletin is to describe the tax treatment accorded to an employee health and welfare benefit program that is administered by an employer through a trust arrangement and that is restricted to
(a) a group sickness or accident insurance plan (see 2 below),
(b) a private health services plan,
(c) a group term life insurance policy, or
(d) any combination of (a) to (c).

The HWT had group life insurance with payments of premiums to an insurance company from the beginning according to the **Nortel HWT CRA Interpretation Letter Dec. 28, 1979** . We see in existence at the HWT Termination pensioners' group one year term life insurance contracts that automatically terminate upon Nortel's receivership or bankruptcy. The Nortel HWT Trustee Agreement gives effect to the Nortel "Health and Welfare Plan" through an "HWT." Nortel's obligation to pay the vested life benefits to its retirees until death cannot be fused into an HWT, because doing so violates the terms and conditions of HWTs set out in the Income Tax Act and CRA Rulings Documents.

Furthermore, under accepted insurance and actuarial principles and practices, claims and future benefits arising only from incurred claims are liabilities of an insurance contract. Deaths for living pensioners are not incurred claims, because the insured event of death has not occurred prior to the termination of the HWT.
Accepted insurance and actuarial principles and practices must apply to the words in the HWT Trustee Agreement Termination Clause: "The Trustee shall also **determine upon a sound actuarial basis**, the amount of money necessary to pay and satisfy **all future benefits and claims to be made under the Plan in respect of benefits and claims up to the date of Notice of Termination**.

There are three key legal considerations that **support the fact that the long term disabled employees' current year's income and future years' income are liabilities of the HWT for incurred insured events.** **IT428 - Wage Loss Replacement Plans April 30, 1979** provides for the application of accepted insurance principles and practices within the required "insurance" plan, including claims and future benefits relating only to incurred claims. The HWT Trustee Agreement provides for determination on a "sound actuarial basis" in respect of benefits and claims up to the date of Notice of Termination. Under accepted actuarial practice, both the current year's income and future years' income for the disabled are part of the incurred claim, because the insured event is the onset of disability and this has occurred before termination of the HWT. The **Canadian Pacific Case on LTD Benefits Not a Contingency Reserve Sept. 10, 1998** clarifies that employer contributions to pay for future years' income for the disabled are not contingent pre-paid expenses, rather they are necessary to fund the actuarial liability of the incurred claim. The insured event of disability has occurred in the year the employer contribution is made and the Long Term Disability Income Plan sets out the obligation to pay income according to its provisions, which in Nortel's case is to do so until age 65, death or recovery.

HWT assets are irrevocable according to the HWT Trustee Agreement, which means that Nortel could not remove HWT assets for its own use once they were in the HWT. However, the CRA rules permitted HWT assets representing surplus to be used to pay employee benefits during an employer contribution holiday (**CRA Ruling Document # 9412155 - HWT Surplus - July 26, 1994** .) By corollary, the CRA does not permit employer contribution holidays when the HWT is in deficit.

The employer contribution holiday of $32 million that Nortel took from May 2005 until April 2006, resulted in HWT assets being used to pay for pay as you go medical costs and life insurance premiums.

This employer contribution holiday should not have occurred because the HWT had fallen into deficit starting in 2005. The Trustees should have recognized that if Nortel was not making its required employer contributions for these pay as you go benefits during 2005-2006, then the HWT loan to Nortel was likely impaired at this time too. The Trustees breached their fiduciary duties, in what known as a Breach of Trust, by allowing the HWT assets belonging to the Long Term Disabled and Survivors' Income Beneficiaries, to be used to pay for the pay as you go medical costs and life insurance premiums, which were the obligations of Nortel. This improper use of HWT assets is a form of misappropriation. The Trustees breached their fiduciary duties, when they accepted loans from Nortel rather than cash to fund the required employer contributions under the HWT Trustee Agreement. The write-off of the $27 million HWT loan to Nortel in 2009 should not have occurred, since it was an HWT asset within a trust account for the Long Term Disabled and Survivors' Income Beneficiaries. This HWT assets was irrevocable under the HWT Trustee Agreement and the HWT was clearly in deficit at the time the loan was written off to the benefit of the Nortel creditors.