Court File No. 09-CL-7950

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. c-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AFFIDAVIT OF JOANN WILLIAMS

I, JOANN WILLIAMS, of the City of Ottawa, in the Province of Ontario, **SOLEMNLY SWEAR AS FOLLOWS:**

1. I submit this affidavit in support of a motion for an order appointing Rochon Genova LLP as counsel for Nortel employees on long-term disability ("LTD Beneficiaries"). As a result of my education and experience, as well as my review of the publicly available documents regarding Nortel's Health and Welfare Trust (the "Nortel HWT"), I have knowledge of the matters to which I hereinafter depose to, except where stated to be based upon information and belief.

2. For the reasons set out below, I believe that insurance and actuarial principles require that the LTD Beneficiaries' income replacement benefits be paid in priority to

Retiree Life Benefits (as defined below) from the proposed wind-up distribution of the Nortel HWT. This is because upon wind-up of the Nortel HWT, the liabilities should be calculated in respect of all claims for insured events occurring up to the date of the wind-up. In the case of LTD income benefits, the insurable events, namely the events of disability, have already occurred. On the other hand, future premiums payable to third party insurers for group term life insurance after the wind-up date are not incurred expenses; nor are they liabilities of the Nortel HWT on wind-up. As a result, the Nortel HWT assets should not be allocated to the cancelled insurance coverage that would have applied to future events, before and unless all existing claims for insurable events (such as those for LTD income benefits) have been satisfied.

3. I further believe that the LTD Beneficiaries are in a position of conflict with Nortel's pensioners and require separate representation as both of these employee groups have competing claims for entitlement against the finite assets of the Nortel HWT.

Education and Professional Experience

4. I graduated with a degree in mathematics from Dalhousie University in 1982. Thereafter, I took the qualifying examinations necessary to achieve the highest professional standing as an actuary. In 1988, I became a Fellow of the Society of Actuaries (FSA), and in 1989, I became a Fellow of the Canadian Institute of Actuaries (FCIA). Each of these designations requires the successful completion of extensive qualifying examinations, actuarial work experience, and ongoing professional development activity.

5. Immediately upon completing my actuarial studies, I was appointed to the position of Actuary, Group Life and Health at the (former) Mutual Life Assurance Co. of Canada. In this position I was responsible for all financial aspects of the Long Term Disability Insurance product line, including reserve reporting, profitability and setting premium rates.

6. From 1991 to 1997, I worked primarily in the area of pensions, including several years with the Pension Regulation Division of the Nova Scotia Department of Finance. In 1996, I was made Acting Superintendent of Pensions for the Province of Nova Scotia, where I acted as the provincial regulator ultimately responsible for the administration of the *Pension Benefits Act* and the regulation of all private pension plans in the province.

7. In 1997 I joined Welton Parent Inc., an Ottawa firm of actuaries, where I presently provide actuarial consulting services. Although I practice primarily in the pension area, I am frequently engaged to prepare actuarial valuations and recommend funding contributions for self-insured Health and Welfare Trusts established to comply with the requirements of the Canada Revenue Agency ("CRA").

8. I am also frequently engaged to prepare actuarial valuations for post-employment and post-retirement benefit plans. The results of these valuations are used in the annual financial statements of the plan sponsors. Accordingly, I am very familiar with the relevant generally accepted accounting and actuarial principles applicable to Canadian entities. I attach as exhibit "A" a copy of my curriculum vitae.

Health and Welfare Trusts – Background Principles

9. Non-pension employee benefits are frequently structured as Health and Welfare Trusts ("HWTs") in order to secure the favourable tax treatment afforded to such trust arrangements under Interpretation Bulletin IT-85R2, dated July 31, 1986, titled *Health and Welfare Trusts for Employees*, as published by the CRA.

10. In accordance with Interpretation Bulletin IT-85R2, the types of benefits that may be administered by an employer under an HWT arrangement are restricted to:

a) group sickness or accident insurance plans
b) private health services plans
c) group term life insurance policies, or
d) any combination of a) to c).

I attach as exhibit "B" a copy of *Interpretation Bulletin IT85R2 - Health and Welfare Trusts for Employees.*

11. Employers may deduct contributions to HWTs in the year the legal obligation to make the payment to the trust arises. The CRA's general position on funding is described in paragraph 6 of Interpretation Bulletin IT-85R2, which states that an employer's contributions must not exceed the amount required to provide the health and welfare benefits, and that the payments cannot be made on a voluntary or gratuitous basis. The nature of the employer's legal obligation to make contributions is governed by the terms of the trust agreement. The contribution requirements must be enforceable by the trustee(s) should the employer decide not to make the payments required.

12. In order to constitute a legitimate deduction, an employer contribution must not be made in respect of benefits that are "contingent" in nature, where the meaning of "contingent" in this context is described in the 1998 Court of Appeal for Ontario decision of *Canadian Pacific Limited v. The Minister of Revenue*. This case confirmed, among other things, that a lump sum contribution to an HWT is fully and immediately deductible to the extent that it represents the expected value of future income benefit payments to a disabled claimant. In the decision, Borins J. A. Wrote (at paragraph 43):

> *"To conclude this part of my reasons, where a taxpayer has incurred a liability in a taxation year, and has placed money into an account to enable it to fulfill the liability, uncertainties surrounding the amount which will ultimately be paid will not per se result in the liabilities being classed as contingent, nor the account being classed as a contingent account."*

13. CRA's position on the deductible amount of employer contributions to an HWT, since the *Canadian Pacific Limited* decision, is described in the publication titled: *CRA Technical News - Health and Welfare Trusts 10302002*, which I attach hereto as exhibit "C".

14. In accordance with subparagraph 18(9)(a)(iii) of the *Income Tax Act (Canada),* consideration for insurance in respect of a period after the end of a year is generally not deductible as a business expense for that year. Prior to *Canadian Pacific Limited*, CRA deemed the expected value of future payments owing to a disabled claimant as being consideration for insurance in respect of future years and, hence, not deductible. *Canadian Pacific Limited* confirms that the insurance coverage relates to the period in which the disability occurred such that the entire value of the income benefits expected to be paid to a disabled claimant is an expense incurred at the time of the insurable event

(i.e. the disability claim). As such, the present value of future disability income payments may be deducted in the year of disability.

15. On the other hand, future premiums paid to third party insurers for group term life insurance are not incurred expenses and, if group term life insurance is funded through an HWT, the premiums paid to the insurance company are only deductible at the time they are paid. Based on the analysis in *Canadian Pacific Limited*, the payment of premiums for future coverage periods would not be a deductible expense for an employer. As a result, there would be no accumulation of assets in an HWT to fund life insurance coverage into the future.

16. Similarly, claims made in respect of extended health care benefits are normally paid in the same period they are incurred, or shortly thereafter. Accordingly, it is fairly straightforward to relate the cost of extended health care to the proper taxation year. The deductible contribution can be described as the cost of actual claims incurred and reported during the year, plus an estimate of claims incurred during the year that had not been reported by the end of the year.

Nortel's HWT

17. In the case of Nortel, it has continuously offered various non-pension employee benefits through a Health and Welfare Trust (the "Nortel HWT") since January 1, 1980, with the original trustee agreement amended and transferred on a number of occasions. I attach as exhibits "D" to "H" the following trust related documents.

- Nortel - Montreal Trust H & WT Trustee Agreement dated January 1, 1980 (exhibit "D")
- Nortel - Montreal Trust Reorg H & WT Trustee Agreement Transfer dated September 24, 1984 (exhibit "E")
- Nortel - Montreal Trust H & WT Trustee Agreement Amendment dated June 1, 1994 (exhibit "F")
- Nortel - Northern Trust H & WT Trustee Agreement Transfer dated December 1, 2005 (exhibit "G")
- Letter From Nortel To Northern Trust dated December 1, 2005 (exhibit "H")

18. The trustee agreements show that the Nortel HWT is a formal trust arrangement under which assets are segregated for the purpose of providing various employee benefits. In its initial filing for court protection, Nortel's CEO, Mr. Doolittle, acknowledges in his affidavit dated January 14, 2009, that Nortel's pension and benefit plans, including the Nortel HWT, are formal trusts separate from the company's assets. He stated at paragraph 90 (c) (iii):

> iii) Benefit Trusts – As discussed above, employee benefits are funded in to accounts administered by a third party and trust accounts. The Applicants do not have any access to funds that are transferred into these accounts.

I attach as exhibit "I" excerpts from the affidavit of Mr. Doolittle.

19. In terms of Nortel's funding obligations, the original trust agreement (1980) provides as follows:

ARTICLE IV – EMPLOYER's CONTRIBUTIONS

1. The Corporation and its designated affiliated or subsidiary corporations agree to make Employer's contributions to the Trust Fund in amounts sufficient to pay any claims which may be asserted against the Trust Fund as a result of the administration of the Health and Welfare Plan, and as may otherwise be required from time to time by the Trust for the purposes of the Health and Welfare Plan, as determined by the Trustee on a sound actuarial basis.

2. The Trustee shall determine or cause to be determined, on a sound actuarial basis from time to time, and in any event, once every calendar year, the level of contributions to the Trust Fund necessary to fund adequately the Health and Welfare Plan.

3. Subject to paragraphs (1) and (2) hereof, the Corporation and its designated affiliated or subsidiary corporations shall be responsible for the adequacy of the Trust Fund to meet and discharge any and all payments and liabilities under the Health and Welfare Plan.

20. The amending Nortel HWT trust documents do not vary Nortel's funding obligations under the original trustee agreement.

21. The Nortel HWT trust agreement clearly provides that the adequacy of the fund is to be evaluated on an actuarial basis at least annually. Sound actuarial practice requires that HWTs maintain sufficient funds to pay the present value of future benefits in respect of all incurred long-term disability claims. With regard to the group term life insurance component of the Nortel HWT, the funding requirement would simply be the premiums that are payable to the insurance company for the year.

22. While the benefits, other than life insurance, provided through an HWT may be self-insured, in order to qualify as a "private health services plan" with reference to paragraph 10 of this affidavit, the self-insurance of extended health care benefits must

comply with *Information Bulletin IT339R2 - Meaning of Private Health Services Plan*, attached as exhibit "J".

Insurance Principles Apply to Nortel's Long-Term Disability Plan

23. Similarly, in order to comply as a "group sickness or accident insurance plan" with reference to paragraph 10 of this affidavit, self-insurance of the long-term disability ("LTD") benefits must comply with Information Bulletin IT-428 titled *Wage Loss Replacement Plans*, dated April 30, 1979.

24. The income replacement provisions of the Nortel HWT for employees on long-term disability ("LTD Beneficiaries") constitute a Wage Loss Replacement Plan under CRA Interpretation Bulletin IT-428. Accordingly, even if the benefits are not insured with a licensed insurer, the principles of insurance must be respected. From paragraph 7 of Interpretation Bulletin IT-428:

> *"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."*

I attach as exhibit "K" a copy of *Information Bulletin IT-428 - Wage Loss Replacement Plans*.

25. The Morneau Sobeco Handbook of Canadian Pension and Benefit Plans, a leading text on actuarial and insurance principles, further provides:

> *"Under an income-replacement benefit, Disabled Life Reserves (DLR) reflect the obligation of the insurance company for benefit continuation beyond policy termination. Once a claim is admitted and payments commence, the insurance company becomes liable for future benefit payments, usually through age 65, provided the individual continues to qualify under the terms of the benefit plan. The reserve reflects the present value of future benefit payments and claim-related expenses, adjusted for mortality and recovery assumptions, and discounted for projected interest earnings."*

I attach as exhibit "L" the above captioned excerpt from the Morneau Sobeco Handbook of Canadian Pension and Benefit Plans.

26. Although I do not have access to any actuarial reports containing funding recommendations for the Nortel HWT, it is clear that such reports should have been prepared annually in accordance with actuarial standards appropriate for insurance having the characteristics laid out by CRA for HWTs.

27. If all benefits within the Nortel HWT were fully insured, cancellation of the policy at a specific date would end coverage as at that date. This means no claims may be made in respect of insurable events happening after the cancellation date. However, claims for events that have already taken place must be paid in full. In accordance with the trust agreement, CRA's funding rules for HWTs and the principles of insurance previously discussed, the actuary's annual funding recommendation should have provided for full funding of the future benefits for all employees determined to be disabled under the LTD Benefits Plan each year. The liability of the Nortel HWT at any given time for each disabled life is equivalent to the Disabled Life Reserve discussed in paragraph 25 of this affidavit.

28. Upon wind-up of the HWT, liabilities would likewise be calculated in respect of all claims for insured events occurring up to the date of wind up. There is no basis for deviating from the existing terms of the Nortel HWT, or the applicable insurance principles on or before the wind-up of the plan, unless there are surplus assets remaining after existing claims have been settled. If there are insufficient assets in the Nortel HWT, then assets should be allocated in proportion to the liabilities in respect of incurred claims. Clearly the value of future benefits for the LTD Beneficiaries is the major liability of the Nortel HWT at any given time, including on plan termination.

29. In my opinion, therefore, the LTD Beneficiaries have a strong argument that the future income replacement benefits owing to LTD Beneficiaries should be settled in priority within the Nortel HWT. In other words, assets within the Nortel HWT should not be allocated to the cancelled insurance coverage that would have applied to future events, before and unless LTD income benefits, where the insurable events have already occurred, have been fully satisfied.

The Reserve for Retiree Life Benefits

30. Unaudited financial statements for the Nortel HWT for the year ended December 31, 2008 prepared on March 25, 2009 by Nortel (the "2008 HWT Financial Statements") identify $49.6 million of the $123.3 million in stated assets of the Nortel HWT as applicable to pensioners' life insurance ("Retiree Life Benefits"). Representative counsel for the LTD Beneficiaries and the former employees of Nortel, Koskie Minsky LLP, has identified this amount as a "contingency" reserve for Retiree Life Benefits. However, I am uncertain as to whether the meaning of contingency in this context is the same as that

discussed in paragraph 12 of this affidavit. If it is used in the manner discussed in paragraph 12, then an issue arises with respect to the deductibility of the corresponding contributions in accordance with the principles discussed at paragraph 13 of this affidavit. Whatever the nature of the so-called "contingency reserve" it must originate from employer contributions, as there are no employee contributions associated with Retiree Life Benefits. I attach as exhibit "M" a copy of an email dated February 26, 2010 from Andrea McKinnon of Koskie Minsky to Arlene Borenstein.

31. Furthermore, employer contributions to an HWT are not reported separately by benefit plan for tax purposes; rather, they are made on the basis of the total cost of benefits attributable to the current year for all the plans covered by the HWT. There is no provision in the Nortel HWT trustee agreements, or the applicable CRA requirements, for subdividing employer contributions. As such, the fact that $49.6 million is noted to be allocated on account of Retiree Life Benefits in the 2008 HWT Financial Statements is not determinative of how the Nortel HWT assets should be distributed on a wind-up.

32. According to the Thirty Ninth Report of the Monitor dated February 18, 2010 (the "39th Report"), Retiree Life Benefits, as well as life insurance benefits of the LTD Beneficiaries ("LTD Life Benefits") involved the payment of life insurance premiums to third party insurers. However, although the cost of LTD Life Benefits was noted in the 39th Report to have been historically paid on a pay-as-you go basis, the cost of Retiree Life Benefits was said to have been paid by the HWT from trust assets. However, since both the LTD Life Benefits and the Retiree Life Benefits involve the payment of life insurance premiums, the funding requirement for both life plans would simply be the

premiums that are payable to the insurance company for the year. Accumulating assets in an HWT to fund life insurance coverage into the future is not permissible.

33. In my opinion, the terms of the trust, as well as the actuarial funding reports/recommendations, in conjunction with federal tax legislation and guidelines, must be carefully examined to determine the appropriate allocation of trust assets. In particular, the actuarial valuation reports prepared for funding purposes, as required under the Trust Agreement, will show how the Nortel HWT actuaries intended Nortel to make contributions and to accumulate assets within this trust. Detailed HWT accounting records and the tax returns of the trust would give further insight. These documents are key to determining the proper disposition of HWT assets. In the absence of such information, I do not believe any significance should be attached to the unaudited HWT financial statement and the asset allocation for Retiree Life Benefits disclosed therein for the purpose of informing the ultimate distribution of assets.

34. Based on the income tax, actuarial and insurance principles and practices and the common law precedents that apply to HWTs discussed above and my review of the publicly available documentation related to the Nortel HWT, I believe that future income replacement benefits owing to LTD Beneficiaries, where the disability event has occurred prior to the termination of the plan, should be settled as a priority within the Nortel HWT before any payments are made in respect of Retiree Life Benefits. The liability for Retiree Life Benefits on termination of the Nortel HWT is limited to any premium payments owing to the third party insurer in respect of coverage up to the date of the HWT termination.

There is a Conflict of Interest between Pensioners and LTD Beneficiaries

35. Given the funding shortfall in the Nortel HWT (as evidenced by the disclosures in the 39th Report), I believe there is an inherent conflict of interest between pensioners and disabled employees over the disposition of the Nortel HWT assets. The conflict is particularly apparent in that a significant reserve for Retiree Life Benefits appears to have been allocated to pensioners based on the 2008 HWT Financial Statements. In addition, a progress report dated June 24, 2010 sent to LTD Beneficiaries by Koskie Minsky ("Progress Report") indicates (at page 6) that retirees would be entitled to a distribution from the HWT on account of Retiree Life Benefits. However, as noted herein, sound actuarial and insurance principles require that the LTD Beneficiaries' income replacement benefits be paid in priority to Retiree Life Benefits from the Nortel HWT wind-up. I attach as exhibit "N" a copy of the Progress Report.

36. As the Nortel HWT trust assets are not sufficient to both discharge the LTD income benefits liability and pay out the purported reserved assets for Retiree Life Benefits, the distribution involves a zero sum exercise – a dollar allocated to pensioners is effectively a dollar taken away from LTD Beneficiaries (and vice versa). As a result, I believe there is a very legitimate concern among LTD Beneficiaries that their interests may not be properly protected without having separate legal representation.

37. Given Koskie Minsky's representation of competing potential beneficiaries of the Nortel HWT, I believe that its ability to investigate competing claims of entitlement and to provide legal advice on the appropriate principles to apply to the disposition of trust assets has been impaired and compromised. In the circumstances, I fail to see how

Koskie Minsky can act in the best interests of LTD Beneficiaries with respect to the proposed distribution of the Nortel HWT assets while also advocating for pensioners.

38. I swear this affidavit in support of a motion appointing Rochon Genova LLP as representative counsel for the LTD Beneficiaries, and for no other purpose.

AFFIRMED BEFORE ME at the City of Ottawa, Province of Ontario this 9th day of August, 2010.

A COMMISSIONER, ETC.

William Johnston, LSUC.
613-730-8000
Barrister & Solicitor.

Joann Williams

JOANN WILLIAMS

This is Exhibit "A" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnston
613-730-8000
Barrister & Solicitor.

Joann Williams, F.C.I.A, F.S.A.

Qualifications:

B.Sc. (major in Mathematics), Dalhousie University, 1982
Fellow of the Society of Actuaries (FSA) 1988
Fellow of the Canadian Institute of Actuaries (FCIA) 1989

Current Experience:

Consulting Actuary at Welton Parent Inc. since 1997:

- Provides actuarial and consulting services for pension plans, including plan design and valuation of liabilities for funding, solvency and accounting purposes.
- Provides actuarial evidence on pension matters.
- Provides advice to individual pension plan members, and groups of plan members such as unions.
- Interpretation and research of the Canadian regulatory environment for pension plans.
- Provides actuarial and consulting services for employee disability benefit plans, including valuation of liabilities for funding purposes.

Other Experience:

Over 20 years of experience in the pension industry:

- Acting Superintendent of Pensions for the Province of Nova Scotia in 1996, responsible for all aspects of provincial pension regulation.
- Actuary for the Pension Regulation Division, Nova Scotia Department of Finance, from 1993 to 1997, responsible for the regulation of actuarial work required under the Nova Scotia Pension Benefits Act.
- Pre-1993 experience includes working in the Group Pension Divisions of Mutual Life and Prudential Assurance.

Group long-term disability:

- Responsible for the pricing, profitability monitoring and financial reporting for this product line during 1988-1990 at Mutual Life Assurance.

This is Exhibit "B" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnston
613-730-5000
Barrister & Solicitor.

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Canada

Income Tax Interpretation Bulletin

Health and Welfare Trusts for Employees

NO.: **IT-85R2**

DATE: July 31, 1986

SUBJECT: INCOME TAX ACT
Health and Welfare Trusts for Employees

REFERENCE: Paragraph 6(1)(a) and section 104 (also subsections 6(4), 12.2(3), (4), and (7), paragraphs 6(1)(f), 56(1)(d), and (d.1), 60(a), 110(8)(a) and subparagraphs 148(9)(c)(vii) and (ix); also section 19 of the Income Tax Application Rules, 1971 (ITAR)).

This bulletin replaces and cancels IT-85R, dated January 20, 1975. Proposals contained in the Notice of Ways and Means Motion of June 11, 1986 are not considered in this release.

Notice to the reader:

- Bulletins do not have the force of law.
- This is an HTML version of the original document. It is also available in other formats, including PDF (which is an exact rendition of the original).

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1. The general thrust of paragraph 6(1)(a) is to include in employment income the value of all benefits received or enjoyed in respect of an employee's employment. However, there are a number of specific exceptions many of which can be described as benefits relating to the health and welfare of the employee. In some cases, the scope of the excepted benefits and applicable tax treatment are well established by other provisions of the Act, (e.g., registered pension funds or plans, deferred profit sharing plans, supplementary unemployment benefit plans, the standby charge for the use of an employer's automobile, employee benefit plans and employee trusts). The treatment to be accorded to the other exceptions can be less clear, particularly when the benefits form part of an omnibus health and welfare program administered by an employer. 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).

2. Paragraph 6(1)(f) sets out the treatment of periodic receipts related to loss of income from employment under three types of insurance plans to which the employer had made a contribution. These types of plans are sickness or accident, disability and income maintenance (also known as salary continuation). In the absence of any statutory definition, the Department generally accepts that an employer's contribution to any of the three types of plans will be a contribution to a "group sickness or accident insurance plan" as described in subparagraph 6(1)(a)(i), provided that the particular plan is a "group" plan and an insured plan. This is based on the assumption that a "disability" resulting in loss of employment income would almost invariably arise from sickness or an accident and that an "income maintenance" payment would likely arise from loss of employment income due to sickness or an accident if not lay off (the latter reason justifying an exception under subparagraph 6(1)(a)(i) as a supplementary unemployment benefit plan). There may be situations where these assumptions will prove invalid but, subject to this caveat, 1(a) above may also be read as a "group disability insurance plan" or "a group income maintenance insurance plan that is not a supplementary unemployment benefit plan".

Employee Benefit Plans and Employee Trusts

3. Employee benefit plans are broadly defined in subsection 248(1) and can encompass health and welfare arrangements. However, funds or plans described in 1(a) to (d) above are specifically excluded in the definition and are thus accorded the tax treatment outlined in this bulletin. Health and welfare arrangements not described in 1(a) to (d) above (e.g., those not based on insurance) may be employee benefit plans or, less likely, employee trusts subject to the tax consequences outlined in IT-502.

4. Where part of a single plan could be regarded as a plan described in 1(a) to (d) above and another part as an employee benefit plan or an employee trust, the combined plan will be given employee benefit plan or employee trust treatment in respect of the timing and amounts of both the employer's expense deductions and the employees' receipt of benefits under the plan. However, if contributions, income and disbursements of the part of the plan that is described in 1(a) to (d) above are separately identified and accounted for, the tax treatment outlined in this bulletin will apply to that part of the plan.

Meaning of Health and Welfare Trust

5. Health and welfare benefits for employees are sometimes provided through a trust arrangement under which the trustees (usually with equal representation from the employer or employers' group and the employees or their union) receive the contributions from the employer(s), and in some cases from employees, to provide such health and welfare benefits as have been agreed to between the employer and the employees. If the benefit programs adopted are limited to those described in 1(a) to (d) above and the arrangement meets the conditions set out in 6 and 7 below, the trust arrangement is referred to in this bulletin as a health and welfare trust.

6. To qualify for treatment as a health and welfare trust the funds of the trust cannot revert to the employer or be used for any purpose other than providing health and welfare benefits for which the contributions are made. In addition, the employer's contributions to the fund must not exceed the amounts required to provide these benefits. Furthermore, the payments by the employer cannot be made on a voluntary or gratuitous basis. They must be enforceable by the trustees should the employer decide not to make the payments required. The type of trust arrangement envisaged is one where the trustee or trustees act independently of the employer as opposed to the type of arrangement initiated unilaterally by an employer who has control over the use of the funds whether or not there are employee

contributions. Employer control over the use of funds of a trust (with or without an external trustee) would occur where the beneficiaries of the trust have no claim against the trustees or the fund except by or through the employer.

7. With the exception of a private health services plan, two or more employees must be covered by the plan. Where a partnership seeks to provide health and welfare benefits for both the employees and the partners by means of a trust, two distinctly separate health and welfare trusts (one for the partners and one for the employees) must be set up to ensure that the funds of each are at all times identifiable and that cross-subsidization between the plans will not occur. The exception in subparagraph 6(1)(a)(i) will of course not apply to such a trust established for the partners.

Tax Implications to Employer

8. To the extent that they are reasonable and laid out to earn income from business or property, contributions to a health and welfare trust by an employer using the accrual method of computing income are deductible in the taxation year in which the legal obligation to make the contributions arose.

Tax Implications to Employee

9. An employee does not receive or enjoy a benefit at the time the employer makes a contribution to a health and welfare trust. However, subject to 10 below, the tax consequences to an employee arising from benefits provided under such a trust are as follows:

Group Sickness or Accident Insurance Plans

(a) Where a group sickness or accident insurance plan provides that benefits are to be paid by the insurer directly to the employee, the premium paid by the trustees to the insurer for the employee's coverage will not result in a benefit to be included in the employee's income. (b) Where this type of group sickness or accident insurance plan existed before June 19, 1971 and the requirements of section 19 of the ITAR are met (see IT-54, "Wage Loss Replacement Plans"), the benefits paid to an employee by the trustees or the insurers under such a plan in consequence of an event happening before 1974 will not result in a taxable benefit to the employee. Where these requirements are not met and in all cases of payments for events happening after 1973, the wage loss replacement benefits will be taxable under paragraph 6(1)(f) (see IT-428, "Wage Loss Replacement Plans").

Private Health Services Plans (defined in paragraph 110(8)(a))

(c) Payment by the trustees of all or part of the employee's premium to a private health services plan does not give rise to a taxable benefit to the employee. Benefits provided to an employee under a private health services plan are also not subject to tax.

Group Term Life Insurance

(d) Payment by the trustees of a premium under a group term life insurance policy will not result in a taxable benefit to the employee unless the aggregate amount of the employee's coverage under one or more group term life insurance policies exceeds $25,000. (See IT-227R, "Group Term Life Insurance Premiums"). The provisions of section 12.2 which tax accrued amounts under a life insurance policy do not apply since a group term life insurance policy will be an exempt policy for that purpose.

(e) Where a group term life insurance policy provides for a lump sum payment to the employee's estate or a named beneficiary, the receipt of the payment directly from the insurer is not included in the recipient's income.

(f) Certain group term life insurance policies provide beneficiaries thereunder with an option to take periodic payments in lieu of the lump sum payment and others provide only for periodic payments to beneficiaries. Prior to the introduction of the accrual rules in section 12.2 for 1983 and subsequent taxation years, benefits thus paid by the insurer to a beneficiary, whether as a result of exercising the option or by the terms of the policy, were annuity payments that were income of the recipient (paragraph 56(1)(d)) who deducted the capital element of the annuity payment (paragraph 60(a) of the Act and Part III of the Regulations). (g) For the 1983 and subsequent taxation years, paragraphs 56(1)(d) and 60(a) continue to apply to a beneficiary who is a holder and annuitant under an annuity contract if subsection 12.2(3) does not apply because of the exceptions in paragraphs 12.2 (3)(c) to (e) or the application of subsection 12.2(7). Generally speaking, this will occur where the annuity contract

(i) is a prescribed annuity contract as defined in Regulation 304,

(ii) was acquired before December 2, 1982 under which annuity payments commenced before December 2, 1982,

(iii) is an annuity contract that was received as proceeds of a group term life insurance policy which was itself neither an annuity contract nor acquired after December 1, 1982, or (iv) was acquired before December 2, 1982, can never be surrendered and in respect of which the terms and conditions have not been changed and is not the subject of an election under subsection 12.2(4).

(h) For annuity contracts other than ones described in (g) above, the annuitant is required by subsection 12.2(3) for the 1983 and subsequent taxation years to include in income accrued amounts on every "third anniversary" of the contract. In addition, in any year that does not include a "third anniversary", paragraph 56(1)(d.1) requires the inclusion of amounts in respect of annuity payments received during the year under the contract. As an alternative to the application of subsection 12.2(3) and paragraph 56(1)(d.1), the annuitant may elect under subsection 12.2(4) (before annuity payments commence) to include accrued amounts on an annual basis. In each instance, the issuer will provide the annuitant with a T-5 information slip indicating the amount of income to be reported in respect of the annuity contract.

Shared Contributions

10. In 9 above the trustees are assumed to be receiving contributions only from the employer to pay for the cost of benefits under the trust plan. However, the trustees may also receive employee contributions to pay a part of the cost of the benefits being provided under the plan. If the plan does not clearly establish that the trustee must use the employee contributions to pay all or some part of the cost of a specific benefit, then it will be assumed that each benefit under the plan is being paid out of both the employer and the employee contributions. If the benefit in question is otherwise taxable to the employee, then in these circumstances a part of it is non-taxable. The non-taxable part is that proportion of the benefit received by the employee for the year that the total of employee contributions received by the trustees in the year is of the aggregate of the employer and employee contributions received by the trustees in the year. The above treatment will not apply if the benefit must be reported as income according to paragraph 6(1)(f) (see 9(b) above). However, the employee's contributions to plans referred to in 9(b) may be deductible for tax purposes from benefits received from the plan. See IT-428 for details.

Taxation of Trust

11. A trust which invests some of the contributions received and earns investment income, or has incidental income (other than contributions from employers and employees which are not included in computing income of the trust), is subject to tax under section 104 on the amount of such "trust income" remaining after the deductions discussed in 12 below. Where gross income (i.e., the aggregate of its income from all sources) exceeds $500 in the taxation year (and in certain other circumstances indicated on the form), the trustee is required to file form T3 (Trust Information Return and Income Tax Return).

12. In computing trust income subject to tax, the trust is allowed to deduct, to the extent of the gross trust income, the following expenses, premiums and benefits it paid, and in the following order:

(a) expenses incurred in earning the investment or other income of the trust,

(b) expenses related to the normal operation of the trust including those incurred in the collection of and accounting for contributions to the trust, in reviewing and acquiring insurance plans and other benefits and for fees paid to a management company to administer the trust, except to the extent that such expenses are expressly not allowed under the Act,

(c) premiums and benefits payable out of trust income of the current year pursuant to paragraph 104(6)(b).

Benefits that are paid out of proceeds of an insurance policy do not qualify. Other benefits paid are normally regarded as having been paid first out of trust income of the year. However, premiums and benefits that would not otherwise be taxable in the hands of the employee by virtue of paragraph 6(1)(a) may be treated at the trustee's discretion as having been paid out of prior year's funds or current year's employer's contributions, to the extent that they are available, to avoid the application of subsection 104(13). The remainder of the income of the trust is subject to income tax under section 122 of the Act. As an inter vivos trust, the taxation year of the trust coincides with the calendar year.

13. For administrative simplicity, payments of taxable benefits by the trustee to or on behalf of employees are to be reported on Form T4A by the trustee and not on the T3 Supplementary. Information on the completion of Form T4A is contained in the "Employer's and Trustee's Guide". Although the trustee is required to withhold income tax from taxable benefits paid to employees, these amounts will not be subject to either Canada Pension Plan contributions or unemployment insurance premiums when paid by the trustee.

14. Although actuarial studies of the trust may recommend the establishment of "contingency reserves" to meet its future obligations, transfers to such reserves are not deductible for tax purposes by the trust.

Setting up a Plan

15. There is no formal registration procedure for a health and welfare trust and no requirement that the trust agreement be submitted to the Department for approval prior to the implementation of the plan. However, the advice of the District Taxation Office may be requested where there is any doubt as to the acceptability of the trust agreement as a health and welfare trust. Full particulars of the arrangement including a copy of all pertinent documents should accompany the request.

Date Modified: 1995-01-01

This is Exhibit "C" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Jamieson
613-730-8000
Barrister + Solicitor.

Income Tax

Technical News

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In This Issue

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This issue contains issues of current interest that were discussed at a panel at the annual conference of the **Canadian Tax Foundation** on September 30, 2002, in Toronto by Roy Shultis, Deputy Assistant Commissioner, Income Tax Ruling Directorate, Policy and Legislation Branch, Mike Hiltz, Director, Reorganizations and Resources Division, Income Tax Rulings Directorate, Policy and Legislation Branch and Marc Vanasse, Director, Business and Partnerships Division, Income Tax Rulings Directorate, Policy and Legislation Branch, Canada Customs and Revenue Agency.

E-Commerce

In 1998, the Minister of National Revenue, in response to a report "*Electronic Commerce and Canada's Tax Administration*" prepared by the Minister's Advisory Committee on Electronic Commerce, established a framework for the study of electronic commerce.

The CCRA's study dealt with the effect of E-Commerce on all aspects of Canada's tax administration: goods and services tax, customs duties and tariffs and income tax. The income tax matters included compliance and collection concerns as well as interpretive issues. The latter issues related to non-residents carrying on business in Canada, residents carrying on business abroad, transfer pricing and the characterization of electronic transactions for withholding tax and treaty purposes. The income tax interpretive study benefited from the advice of a group of eminent Canadian income tax specialists and took into account the continuing work of the Organization for Economic Co-operation and Development (OECD) with respect to electronic commerce and permanent establishments, attribution of income to permanent establishments and characterization of payments made in an E-Commerce context.

The study considered the circumstances under which a non-resident who transacts with Canadians through a Web site may be considered to be carrying on business in Canada. The factors relating to this determination will be relevant not only to non-residents carrying on business in Canada but also to foreign affiliates of Canadian residents and residents of Canada carrying on business in other countries.

It was concluded that, in some circumstances, a Web site located on a server situated in Canada can constitute a permanent establishment of a non-resident. This conclusion is consistent with the recent amendments to Article 5 of the OECD Model Convention.

The attribution of income or loss to a permanent establishment in an E-Commerce context raises difficult issues. There is no consensus among the member countries of the OECD concerning the application of Article 7 to traditional forms of commerce. The current CCRA interpretation of Article 7 of the Model Convention does not always produce a result that is consistent with the arm's length principle as developed in the Transfer Pricing Guidelines. The working hypothesis developed by the OECD to apply the Transfer Pricing Guidelines by analogy to permanent establishments is under discussion at the OECD. Given this uncertainty on this difficult issue, the CCRA will continue its current interpretation of Article 7 and will apply its interpretation in the E-Commerce environment.

The characterization of E-Commerce payments is difficult because the distinction between the different "things" that may be purchased will be elusive in many situations. The general principles of characterization set out in the *Report to Working Party No. 1* of the OECD Committee on Fiscal Affairs are instructive and will be of benefit to the CCRA in the determination of the character of payments.

The most important aspect of the E-Commerce study concerns the purchase or licensing of digital products. The CCRA is of the opinion that the existing Canadian jurisprudence can be applied to the purchase or licensing of digital products. In the case of the purchase of a digital product, the CCRA considers that the customer makes the payment to acquire the ownership of data transmitted in the form of a digital signal. Any use of copyright involved in downloading the product is not an important part of the total consideration paid by the purchaser. For this reason, the payment for the product would not be considered a royalty as defined in Article 12 of Canada's treaties that follow the OECD Model Convention.

Similarly, a payment for the use of, or right to use, a digital property would not be for the use of copyright and would not be a royalty for the purposes of Article 12. Until recently, the CCRA considered a payment for the use of, or right to use, custom computer software to be a payment for a secret formula and within the definition of royalty in Article 12. Canada had an observation on this point in respect of Article 12 of the OECD Model Convention. The Department of Finance withdrew the observation on March 28, 2002. As a result, such a payment would now be considered to be within Article 7 of Canada's treaties that follow the OECD Model Convention.

It is important to appreciate that this conclusion would not apply to those of Canada's treaties that include in Article 12 a reference to a payment for the use of or right to use intangible property. In such cases, the payment for the use of or right to use a digital property would be a payment for the use of intangible property and therefore a royalty.

In summary, the CCRA should, in general, be able to apply the same principles of taxation to E-Commerce transactions that it has applied to conventional commerce. The CCRA's view of the law is generally consistent with the view of the OECD as expressed in the amended Commentary to the OECD Model Convention and the *Report to Working Party No. 1* referred to above.

Finally, the CCRA welcomes any queries you may have with respect to any interpretive aspect of E-Commerce. The CCRA is prepared to deal with them as interpretations or rulings, in the case of proposed transactions. In short order, the CCRA will include the results of its study in an Interpretation Bulletin.

Reasonable Expectation of Profit

This year the Supreme Court of Canada rendered its decision in two cases that concerned the application of the reasonable expectation of profit (REOP) test, *Brian J. Stewart v. The Queen*[1] and *The Queen v. Jack Walls and Robert Buyer*[2].

In the *Stewart* case:

- The taxpayer acquired four condominium units as part of a syndicated real estate development for $1,000 cash each. The balance of the purchase price was financed.
- Projections for rental income and expenses contemplated a negative cash flow. It turned out that actual rental losses were greater than projected.
- For the taxation years 1990 to 1992, the taxpayer claimed rental losses on the properties.

[1] 2002 DTC 6969; [2002] 3 CTC 421
[2] 2002 DTC 6960; [2002] 3 CTC 439

- These losses were disallowed on the basis that the taxpayer had no REOP and therefore, no source of income for the purpose of section 9 of the *Income Tax Act* (the "Act").
- Both the Tax Court of Canada and the Federal Court of Appeal upheld the reassessments.

In the *Walls* case:

- The taxpayers were limited partners in a partnership that purchased a mini-warehouse for $2,200,000, payable in the form of $1 in cash and the balance in the form of an agreement for sale with interest payable at 24% per annum.
- In addition to the interest on the debt obligation, the partnership also paid the vendor management fees and 50% of the net operating profit of the venture under a management and services agreement.
- The taxpayers deducted their proportionate share of the partnership losses incurred in 1984 and 1985.
- These losses were disallowed on the basis that the taxpayer had no REOP and therefore, no source of income for the purpose of section 9 of the Act.
- It was also argued that the losses should be decreased by:
  - reducing the purchase price of the mini-warehouse to reflect a fair market value of $1,180,000; and
  - reducing the interest expense by decreasing the debt in excess of the fair market value and lowering the interest rate to 16%.
- The taxpayers filed notices of objection, but the Minister confirmed the reassessments.
- The Federal Court, Trial Division, dismissed the appeals and upheld the Minister's position with respect to REOP.
- The Federal Court of Appeal set aside the judgment, holding that the trial judge erred in applying REOP since the taxpayers did not have a personal motivation. It remitted the matter to the trial judge for a determination of the outstanding issues of whether the transaction was arm's length and at fair market value.
- The issue of whether the storage park operation constituted a source of income for the purpose of section 9 of the Act was appealed to the Supreme Court.

In both cases, the Court ruled in favor of the taxpayers. In its decision in *Stewart* (the analysis from which also formed the basis for the decision in *Walls*), the Court stated the REOP test is not supportable by law as a basis to determine if a taxpayer's activities constitute a source of income under the Act.

Question 1

Before getting into the impact of the decisions, could you briefly explain the basis for the CCRA's previous position that a business or property that had no REOP was not a source of income under the Act?

Response 1

The CCRA's previous position was based mainly upon the Supreme Court decision in *William Moldowan*[3]. While the *Moldowan* case involved the determination of whether a taxpayer's chief source of income was farming, the court noted that in order to have a source of income under the Act, the taxpayer must have a profit or a REOP. Further, in determining if a taxpayer has a REOP, the following criteria should be considered:

- the profit and loss experience in past years;
- the taxpayer's training;
- the taxpayer's intended course of action; and
- the capability of the venture, as capitalized, to show a profit after charging capital cost allowance.

Question 2

What impact will the Court's decision have on the CCRA's use of the REOP test?

Response 2

The Court has stated that the REOP test should not be accepted as a basis to determine if a taxpayer's activities constitute a source of income under the Act. The courts have suggested a two-stage approach:

- The first stage is to determine whether a taxpayer's activity is undertaken in pursuit of profit that results in a source of income under the Act, or is a personal endeavour. This first stage is only relevant where there is some personal or hobby element to the activity. The venture will be considered a source of income only if it is undertaken in a sufficiently commercial manner.
- In the second stage, pursuit of profit has been established and the taxpayer's activity is clearly commercial in nature. It then becomes a matter of determining whether the source of the income is from business or property for purposes of the Act.

[3] 77 DTC 5213; [1977] CTC 310

Question 3

Does this mean that the REOP test is no longer applicable in determining if a taxpayer has a source of income under the Act?

Response 3

- The REOP test, as it previously applied, will no longer be used to determine if there is a source of income under the Act.
- The CCRA will, however, question whether a taxpayer is operating in a sufficiently commercial manner when the activity has some personal or hobby element.
- At this point, a taxpayer's venture will be reviewed and criteria, including those set down in *Moldowan*, will be considered in determining if the taxpayer intends to carry on an activity for profit and the overall evidence supports that intention.

Question 4

Assuming a taxpayer's activity is commercially viable, but there is a personal element, how will the CCRA account for the expenses related to the personal element?

Response 4

- It is the CCRA's view that a calculation will have to be made using some reasonable basis, to determine the amount of the business expenses that may be deducted in calculating the income from the commercial activity.
- Thus, where there is both a personal and business element to the expenses incurred and they are not otherwise restricted under the Act, some reasonable basis of proration will have to be used to determine the portion that relates to the business activity.

Question 5

Could you comment on the part of the Court's decision in which it was stated that the realization of an eventual capital gain may be taken into account in determining whether a taxpayer's activity is commercial in nature?

Response 5

- The Court has stated that the motivation of capital gains accords with the ordinary businessperson's understanding of "pursuit of profit."
- Thus, the CCRA accepts that there may be situations where the realization of an eventual capital gain will be a factor in assessing the commerciality of the taxpayer's overall course of conduct.
- However, it is emphasized that the mere acquisition of a property in anticipation of a capital gain does not provide a source of income.

Question 6

Do you have any concerns that these comments seem to imply that a capital gain may be considered to be part of a source of income that is from a business or property?

Response 6

- As noted above, the acquisition of a property in anticipation of a capital gain does not provide a source of income under the Act.
- The proposition that a capital gain is now included in calculating income that is from a business or property source would be contrary to the overall scheme of the Act.

Question 7

If a taxpayer's loss is not from a source of income under the Act because the activity in question is not carried on in a sufficiently commercial manner, say for example in the case of a recreational property, will the expenses that generated the loss be deductible in calculating a capital gain from the disposition of a property?

Response 7

No.

- Pursuant to paragraph 40(1)(*a*) of the Act, only outlays and expenses incurred for the purpose of disposing of a property will be deductible in the calculation of the gain.
- The courts have stated that the phrase "for the purpose of" in subparagraph 40(1)(*a*)(i) means "for the immediate or initial purpose of" and not the eventual or final goal which the taxpayer may have in mind[4].
- Therefore, if a taxpayer's activity is not of a commercial nature, the annual expenses incurred in relation to that property may not be carried forward and deducted in the calculation of a capital gain or loss when it is disposed of.

Question 8

If a taxpayer's involvement in a venture is motivated by tax considerations, will this be viewed as a personal element such that it could affect the determination of whether the activity has a sufficient degree of

[4] See the Federal Court of Appeal decision in *Avis Immobilien G.M.B.H. v. The Queen* (1997 DTC 5002)

commerciality to be considered a source of income under the Act?

Response 8

If a taxpayer is motivated by tax considerations when he or she enters into a business or property venture, this will not detract from the venture's commercial nature or characterization as a source of income under the Act.

Health and Welfare Trusts

Background

For a number of years, the CCRA has been allowing employers to operate their health and welfare programs through a "trust" arrangement. The CCRA's position on the income tax implications for such arrangements, known as health and welfare trusts, is set out in Interpretation Bulletin IT-85R2, dated July 31, 1986, *Health and Welfare Trusts for Employees*.

The types of benefits administered by an employer through health and welfare trust arrangements are restricted to:

(a) group sickness or accident insurance plans

(b) private health services plans

(c) group term life insurance policies, or

(d) any combination of a) to c).

Essentially, the CCRA allows these trusts to be treated as conduits: an employee does not receive or enjoy a benefit at the time the employer makes a contribution to a health and welfare trust. Further, any income tax advantage that an employee would otherwise get is not affected because of the health and welfare trust. For example, payment by the trustees of health and welfare trusts of all or part of an employer's contribution to a private health services plan, does not give rise to a taxable employment benefit. The legislative exemption in subparagraph 6(1)(*a*)(i) flows through to the employees.

Employers can deduct contributions to health and welfare trusts in the year the legal obligation to make the payment to the trust arises, to the extent they are reasonable and laid out to earn business or property income.

The bulletin describes the tax implications for the trust. In general terms, none of the receipts from an employer are taxable, nor are the payments deductible in the trust. However, the trust is taxed as an inter vivos trust on any investment income generated because of investments made in the course of managing the employee benefit programs. The minimum tax rules must be considered as they could also have application.

In recent months, there has been a significant issue related to the funding of health and welfare trusts and the quantum of the deductions that an employer can claim when money is invested in the trust to fund the employees' benefits.

Question 1

What is the legal basis for a health and welfare trust under the *Income Tax Act*?

Response 1

Health and welfare trusts are not specifically defined or described in the Act. They became recognized administratively by the CCRA in the manner set out in IT-85R2, after extensive consultations with the tax community and employee benefits consultants in the 70s.

Question 2

Since the last version of the bulletin was issued in 1986, have there been any significant changes to the CCRA's position on health and welfare trusts?

Response 2

No, there have been no major changes to the CCRA's overall administrative positions set out in the bulletin. There have, however, been changes to the law that make some of the explanations of the income tax rules in the bulletin outdated. For example, the bulletin still has the discussion on the former $25,000 exemption for coverage under a *group term life insurance policy*. We will update the bulletin to reflect current law.

Question 3

Have any important issues arisen recently that would be of interest to administrators/trustees of health and welfare trusts?

Response 3

Yes, a significant issue has been considered over the last few months in connection with the funding of the cost of long-term disability benefits under "group sickness and accident plans" that are administered by employers through a health and welfare trust.

Question 4

Before getting into the issue on funding, could you briefly comment on the CCRA's general position in regard to the funding of a health and welfare trust?

Response 4

Yes, the CCRA's general position on funding is described in paragraph 6 of IT-85R2, which states that an employer's contributions must not exceed the amount required to provide the health and welfare benefits, and that the payments cannot be made on a voluntary or gratuitous basis. In this regard, we would like to emphasize that this means the "current" cost of paying out the benefits for a particular year. This is usually based on an actuarial determination where the employer has engaged a carrier to provide the health and welfare benefits.

Question 5

Could you now explain recent developments in regard to the cost of funding benefits in a health and welfare trust?

Response 5

The main issue has been with what we have referred to as the over-funding of benefits through lump sum payments by employers to a health and welfare trust. By this, we mean that employers were proposing to fund 100% of the estimated value of all future benefits payable with respect to insured claims under the long-term disability benefits provided under a health and welfare trust. That is, the employer would contribute a lump sum amount to a health and welfare trust that would finance not only the current benefits payable under the plan, but the estimated cost of the benefits that would be payable over a number of years.

Question 6

Could you describe the CCRA's position relating to the so-called over-funding of the benefits by the payment of a lump sum amount, including the effect on the deductions that may be claimed by the employer as well as any consequences for health and welfare trusts that otherwise meet the criteria outlined in IT-85R2?

Response 6

The CCRA's position is that, in those situations where an employer's contributions to a health and welfare trust are for future benefits, subparagraph 18(9)(*a*)(iii) of the Act applies to the deductibility of such contributions by employers. That is, the lump sum amount will be regarded as having been made or incurred as consideration for insurance for a period after the end of a taxation year. We have also concluded that contributions of lump sum amounts to fund future benefits would not, in and by itself, disqualify a trust as a health and welfare trust. However, the contributions must still be based on actuarial determinations of amounts needed to fund the future health and welfare obligations.

Question 7

In the course of considering the over-funding issue, there has been some discussion on the impact of the *Canadian Pacific Limited*[5] decision and whether it would support the full deduction in a taxation year, of the lump sum amounts paid to fund future benefit obligations in a health and welfare trust. This is based on the reasoning that, since the Court supported the position that the lump sum in question in that decision was held to be a legitimate business deduction and not prohibited by paragraph 18(1)(*e*) because it was contingent, the full amount should be a legitimate business deduction in a taxation year.

Could you outline the CCRA's position on the impact, if any, of the CP decision on the deduction by employers of lump sum amounts contributed to a health and welfare trust to fund current and future obligations?

Response 7

The CCRA has accepted the outcome in *Canadian Pacific* that the amounts set aside for the future payment of benefits were not "contingent" in nature. For health and welfare trusts, this means that contributions for actuarially required contributions by an employer to a health and welfare trust will not be denied as a deduction under paragraph 18(1)(*e*) as noted above. However, as also noted, subparagraph 18(9)(*a*)(iii) applies. In this regard, audit officials in the tax services office have already issued reassessments applying this rule.

Refreshing losses

An article in *Canadian Tax Highlights* in April of this year[6] raised the question of whether the opening summary statement attached to a published CCRA advance income tax ruling (doc. no. 2001-0090213) indicates a shift in the CCRA's administrative policy concerning "in-house" loss-consolidation transactions.

The article set out the concern as follows:

> "The ruling involves Lossco, with non-capital losses, lending at interest to its profitable sub (Profitco), which subscribes for preferred shares of a new Lossco sub, which on-lends the funds back to Lossco interest-free. Profitco reduces its taxable income via

[5] *Canadian Pacific Limited v. The Minister of Revenue (Ontario)*, (now the Minister of Finance), 99 DTC 5286; [2000] 2 CTC 331, (Ontario Court of Appeal).

[6] Dean Gresdal, "Loss Refreshing Abusive?" in *Canadian Tax Highlights*, vol. 10, no. 4, April 23, 2002.

the interest paid to Lossco, which uses its non-capital losses to shelter that interest income. The CCRA summary statement says that if an affiliated group undergoes a tax-loss consolidation and a group member (Profitco) deducts interest expense and thereby incurs a non-capital loss, the newly created loss is abusive: it 'effectively allow[s] the affiliated group to refresh one of its member's [sic] existing non-capital losses, which is beyond the scope of a tax loss consolidation.'"

1) Could the CCRA provide clarification as to when a loss-consolidation transaction that has the effect of "refreshing" losses might be considered to be abusive?

2) Can a loss-consolidation transaction be implemented for the purpose of using non-capital losses of Lossco from a **prior** taxation year (as opposed to non-capital losses that are anticipated to arise in Lossco in the **current** or **future** taxation years)?

CCRA Position

1) The summary statements attached to published CCRA rulings and interpretations are merely intended to provide a very brief synopsis as an aid to the reader in determining whether the main document is of relevance or interest. As the article indicates, it can be misleading to read the summary statement without a complete understanding of the document itself and the circumstances behind it.

   Loss-consolidation transactions involving a "Lossco" lending at interest to an affiliated "Profitco" that subscribes for preferred shares of Lossco (or a subsidiary of Lossco) will not necessarily be considered to result in an abuse, within the meaning of subsection 245(4), merely because the interest deduction results in a non-capital loss in Profitco. In particular, the CCRA would not ordinarily consider an abuse to result solely because the non-capital loss so created is carried back to a previous taxation year of Profitco in accordance with section 111. Futhermore, the CCRA would not ordinarily consider an abuse to result solely because the non-capital loss so created has a carryforward period that extends beyond the original carryforward period for Lossco's losses, provided that it is deducted within the original carryforward period.

   Losses may be considered to be "refreshed" in a loss-consolidation transaction in which Lossco transfers depreciable property, on which there is unrealized recapture, to affiliated Profitco, thereby allowing Lossco to deduct losses before they expire and Profitco to acquire the depreciables at an increased undepreciated capital cost. However, such a transaction would not ordinarily be considered to result in an abuse solely because it avoids the expiry of a non-capital loss, since the loss is deducted against income (the recapture) that arose in the original loss carryforward period.

   It should be noted, of course, that a loss-consolidation transaction that seeks to circumvent other loss-limitation rules, such as those in subsection 111(5), could be considered to result in a misuse or an abuse[7].

2) Yes.

Replacement Property Rules and Business Expansions

We understand that the CCRA has received a number of inquiries on how the replacement property rules are affected by business expansions. The inquiries have arisen because of the statement in ¶ 15 of Interpretation Bulletin IT-259R3, *Exchanges of Property*, that the replacement property rules are not intended to encompass business expansions.

Recently, you have been asked to consider whether a farmer could use the replacement property rules on the voluntary disposition of real property when the existing farmland is replaced with a substantially larger piece of land. Reasons for selling the existing farmland could include its proximity to an urban area where the land is very valuable compared to a more remote area. If existing farmland is replaced with a larger farm, the question arises as to whether the new farmland could be considered a replacement property, or be regarded as a business expansion and therefore, excluded by virtue of your position in the bulletin.

Question 1

Could you briefly explain the basis for the concern about the use of the replacement property rules in relation to business expansions?

[7] See the Department of Finance *Technical Notes* with respect to the introduction of subsection 245(4) in Bill C-139, June 30, 1988.

Response 1

In general terms, the replacement property rules in the *Income Tax Act* require that it be reasonable to conclude that a new property will be acquired to replace a former property. As such, there must be a correlation or causal relationship between the acquisition of the new property and the disposition of the former property.

Question 2

In light of this particular requirement in the Act, could you expand on the bulletin position as it relates to business expansions?

Response 2

The statement in ¶ 15, that the replacement property rules are not intended to encompass business expansions was made in the situation where it could not be readily determined whether one particular property is actually being replaced by another. Hence, it is important to consider the example given. The comments were made in the context of a taxpayer who was in the process of expanding a retail operation by opening and closing a number of locations. The new properties acquired during this type of "business expansion" were not considered replacement properties because there was no correlation or causal relationship between their acquisition and the disposition of the existing properties.

Question 3

Are there any other important considerations when a particular property is purchased under a business expansion?

Response 3

Transactions surrounding these cases are often not straightforward and have peculiarities that are specific to a taxpayer's business. A determination of whether a newly acquired property can reasonably be considered a replacement property under these rules can only be made after considering all the facts and circumstances surrounding a particular situation.

In conclusion, it is difficult to envision all situations where property purchased under a business expansion will not qualify as a replacement property. However, the example given in the bulletin can be a useful guide. I would therefore like to point out that the fact that a property is purchased under a business expansion will not, in and by itself, mean that the property cannot be considered a replacement property.

Question 4

Will Interpretation Bulletin IT-259R3 be changed to clarify the comments on business expansion?

Response 4

The bulletin will be amended to clarify that the emphasis will be placed on whether a correlation or causal relationship exists between the acquisition of the new property and the disposition of the existing property when determining if a particular property is a replacement property, and not simply on the fact that the new property is acquired because of a business expansion.

Question 5

Can a taxpayer get certainty on the tax implications when contemplating the purchase of a replacement property?

Response 5

As discussed in Information Circular 70-6R5, *Advance Income Tax Rulings*, the CCRA provides an advance income tax ruling service to promote voluntary compliance, uniformity and self-assessment by providing certainty with respect to the income tax implications of proposed transactions. In fact, the CCRA has issued rulings in the past involving the application of the replacement property rules to a business expansion. Therefore, provided all the facts are presented in the ruling request in accordance with the procedure outlined in the circular, the CCRA will consider a request for an advance income tax ruling on proposed transactions involving the replacement property rules in a business expansion.

Foreign Exchange Losses

The following issue has to do with the recharacterization of a foreign exchange loss to an amount deductible under Paragraph 20(1)(*f*) of the *Income Tax Act* (the "Act"). The corporate taxpayer incurred foreign exchange losses on the repayment of long-term debt denominated in US currency because the US dollar appreciated against the Canadian dollar over the period between the borrowing of the money and the repayment of the debt. The corporate taxpayer issued US dollar obligations but not at a discount. The borrowed money was used for capital purposes. The taxpayer has requested that the foreign exchange losses sustained on the repayment of debt may be claimed as a deduction from income under paragraph 20(1)(*f*) of the Act.

Legislative Context

Paragraph 18(1)(*f*) provides that "in computing the income of a taxpayer from a business or property no deduction shall be made in respect of an amount paid or payable as or on account of the principal amount of any obligation described in paragraph 20(1)(*f*) except as expressly permitted by that paragraph".

Paragraph 20(1)(*f*) reads in part as follows:

"(*f*) an amount paid in the year in satisfaction of the principal amount of any bond, debenture . . . or similar obligation . . . on which interest was stipulated to be payable, to the extent that the amount so paid does not exceed,

(i) in any case where the obligation was issued for an amount not less than 97% of its principal amount, and the yield from the obligation . . . does not exceed 4/3 of the interest stipulated to be payable on the obligation, expressed in terms of an annual rate on

(A) the principal amount of the obligation, if no amount is payable on account of the principal amount before the maturity of the obligation, or

(B) the amount outstanding from time to time as or on account of the principal amount of the obligation, in any other case,

the amount by which the lesser of the principal amount of the obligation and all amounts paid in the year or in any preceding year in satisfaction of its principal amount exceeds the amount for which the obligation was issued, and

(ii) in any other case, ½ of the lesser of the amount so paid and the amount by which the lesser of the principal amount of the obligation and all amounts paid in the year or in any preceding taxation year in satisfaction of its principal amount exceeds the amount for which obligation was issued:"

In subsection 248(1) of the Act, "principal amount", in relation to any obligation, means "the amount that under the terms of the obligation or any agreement relating thereto, is the maximum amount or maximum total amount, as the case may be, payable on account of the obligation by the issuer thereof [...]"

CCRA Position

The issue is whether the "principal amount" of a debt denominated in a foreign currency is based on the foreign currency rate on the date of issue of the obligation, the spot rate at the time the debt is paid or the average of fluctuating rates from time to time. This is also relevant for the application of the 97% test and the yield test in paragraph 20(1)(*f*). There is no indication either in paragraph 20(1)(*f*) or the definition of "principal amount" in subsection 248(1) **when** the "principal amount" is to be determined in respect of a foreign currency obligation. If the "principal amount" is to be determined at the time of issue, there is no discount since the amount of foreign currency exchange loss would not be ascertained at that time. Since the term "principal amount" in the Act does not specify the time at which the "principal amount" has to be determined, the time of determination is dependent on the context of the wording of a particular provision and the intent and purpose of that provision.

Other provisions of the Act contemplate foreign currency situations. For purposes of section 80 of the Act, paragraph 80(2)(*k*) states, "where an obligation is denominated in a currency (other than Canadian currency), the forgiven amount at any time in respect of an obligation shall be determined with reference to the relative value of that currency and Canadian currency **at the time the obligation was issued**". As such, foreign currency fluctuations after the time an obligation is issued are ignored for the purposes of section 80 of the Act. Also, paragraph 15.1(7)(*b*) refers to "the total of all amounts each of which is the principal amount outstanding immediately after that time".

The CCRA has stated in Interpretation Bulletin IT-361R3, dealing with subparagraph 212(1)(*b*)(vii), that where an obligation is in foreign currency, any fluctuation in the Canadian dollar relative to the foreign currency is not a factor in determining whether at a particular time the Canadian borrower is obliged to pay more than 25% of the principal amount of the loan.

It is the CCRA's position that for purposes of paragraph 20(1)(*f*) of the Act, the time at which the "principal amount" is to be determined should be at the time of issue and this is the relevant time at which the discount, if any, should also be ascertained. The "97% test" and the "yield test" should also be applied at the time of issue of the debt. Any loss should be governed by subsection 39(2) of the Act.

Dividend Reinvestment Plans

A "Dividend Reinvestment Plan" or "DRIP" is an arrangement under which the common shareholders of a public corporation are entitled to direct that cash otherwise receivable by them as regular dividends be used to purchase additional common shares of the corporation, usually at a discount from their market price. DRIPs sometimes also have an "Optional Purchase" component under which participants under the DRIP are entitled to purchase a limited number of common shares, in addition to those purchased with reinvested dividends, usually at market price.

Question

What is the CCRA's position with respect to whether participants under such reinvestment plans can be assessed taxable benefits?

Response

In our view, a corporation that permits a shareholder to use dividends to purchase additional shares of the corporation for an amount less than their fair market value confers a benefit on the shareholder in the amount of the discount at the time that the shares are purchased. Consequently, subsection 15(1) is potentially applicable to rights under DRIPs.

Paragraph 15(1)(*c*) provides that subsection 15(1) does not apply where the corporation confers on all owners of common shares identical rights to acquire additional shares of the corporation. However, the CCRA understands that the paragraph 15(1)(*c*) exception is not available with respect to most DRIPs, since foreign securities laws may prevent the corporation from permitting non-resident shareholders to participate under the plan.

Nevertheless, it is the longstanding administrative practice of the CCRA that a subsection 15(1) benefit will not be assessed in respect of a benefit arising from the reinvestment of dividends in additional shares under a DRIP, provided that the amount paid for the additional shares is not less than 95% of their fair market value. However, this administrative practice will not be applied in respect of a benefit arising from the acquisition by a shareholder of additional shares of the corporation for an amount that is less than their fair market value pursuant to an Optional Purchase component of a DRIP.

Silicon Graphics Ltd. v. The Queen, 2002 DTC 7112; [2002] 3 CTC 527 (FCA)

Alias Research Inc., a predecessor of the taxpayer, claimed enhanced SR&ED benefits under subsection 127(10.1) and section 127.1 in its 1992 and 1993 taxation years. During those years, the common shares of Alias were publicly traded on the NASDAQ exchange in the United States. The common shares were widely-held and more than 50% of those shares were owned by non-residents. Alias' principal place of business was in Toronto, and a majority of the board of directors and the entire management team were residents of Canada. The management team annually prepared a slate of people to be elected to the board, which was always accepted by the shareholders.

In December 1991, Silicon Graphics Ltd., a U.S. public corporation, agreed to advance up to $5 million to Alias in consideration of a security interest in Alias' assets and the issuance of warrants to acquire common shares of Alias. The loan was outstanding for seven weeks, during which time Silicon Graphics Ltd. approved daily cash forecasts and determined which creditors of Alias would be paid. Silicon Graphics Ltd. also made financial contributions to Alias for software development and marketing. Certain directors and officers of Alias were formerly associated with Silicon Graphics Ltd. and Alias software only operated on hardware of Silicon Graphics Ltd.

The issue before the Tax Court of Canada was whether Alias was "controlled, directly or indirectly in any manner whatever, by one or more non-resident persons" within the meaning of the "Canadian-controlled private corporation" (CCPC) definition in subsection 125(7) and the extended meaning of control in subsection 256(5.1). The Tax Court of Canada concluded that the non-resident shareholders had *de jure* control of Alias because they held the simple majority of voting shares, notwithstanding that there was no common connection between them. Because of this finding, the Tax Court of Canada found it was unnecessary to consider whether non-residents had *de facto* control of Alias.

Silicon Graphics Ltd. appealed to the Federal Court of Appeal. On the issue of *de jure* control, the Federal Court of Appeal equated the phrase "control by one or more persons" in the CCPC definition with the phrase "control by a person or group of persons", and, based on prior case law, agreed with Silicon Graphics Ltd. that in order for a group of persons to be in a position to exercise *de jure* control, a common connection must exist between the shareholders. As there was no evidence of a common connection, the Federal Court of Appeal overturned the Tax Court of Canada's decision. In reaching its conclusion, the Federal Court of Appeal referred to the 1998 legislative amendment to the CCPC

definition, adding paragraph (*b*) of the CCPC definition, prior positions taken by the CCRA on control by groups and the policy underlying tax advantages given to CCPCs.

With respect to the second issue, the Federal Court of Appeal stated that in order for there to be finding of *de facto* control, " . . . a person or group of persons must have a clear right and ability to effect a significant change in the board of directors or the powers of the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors." In the Federal Court of Appeal's view, there was no evidence to show that Silicon Graphics Ltd. satisfied those criteria. Instead, the Federal Court of Appeal found that *de facto* control remained in Canada.

Question 1

In the Revenue Canada Forum at the 1994 Canadian Tax Foundation conference, the CCRA expressed the view that since the CCPC definition in subsection 125(7) did not refer to control by a "group of persons", it was meant to mean ownership of that number of shares that would constitute control[8]. Contrary to this position, in *Silicon Graphics Ltd.*, the Federal Court of Appeal took the position that the reference to "one or more" in the CCPC definition essentially meant "group of persons", and therefore, there must be a common connection between the non-resident shareholders in order for them to have *de jure* control.

Does the CCRA accept the Federal Court of Appeal's findings, and if so, what are the implications?

Response 1

Yes. We accept the findings on this issue and have not sought leave to appeal to the Supreme Court of Canada. In the context of the CCPC definition, the findings are largely of historical interest given that paragraph (*b*) of the CCPC definition would apply, for years after 1995, to deny CCPC status in widely-held situations, such as that which existed in *Silicon Graphics Ltd.*

Question 2

Will the CCRA interpret control by "one or more persons", as used in other sections of the Act, to mean "group of persons" in accordance with *Silicon Graphics Ltd.*? For instance, this wording appears in paragraphs 83(2.2)(*c*) and (*d*) and paragraphs 83(2.4)(*c*) and (*d*), relating to capital dividends, and in the following definitions: "capital dividend account" and "private corporation" in subsection 89(1), "financial institution" in subsection 142.2(1), "restricted financial institution" and "term preferred share" in subsection 248(1) and "eligible corporation" in subsection 5100(1) of the *Income Tax Regulations*.

Response 2

Yes. There is no basis for limiting the findings in *Silicon Graphics Ltd.* on this issue to the CCPC definition.

Question 3

Have there been any other developments regarding the interpretation of the CCPC definition in subsection 125(7)?

Response 3

Yes. There is one new development regarding the application of paragraph (*b*) of the CCPC definition to multi-tiered corporate structures similar to that which existed in *Parthenon Investments Ltd.* v. *The Queen*[9]. Recall that in *Parthenon*, the Federal Court of Appeal held that control meant ultimate control, with the result that CCPC status was not denied to the corporation at the bottom of the corporate chain by reason of the interposition of a non-resident corporation in the middle of the corporate chain, when ultimate control lay with a Canadian resident at the top of the corporate chain. For taxation years that begin after November 1999, subsections 256(6.1) and (6.2) apply to override the position taken by the Federal Court of Appeal in *Parthenon*.

The *Parthenon* case only dealt with the application of what is now paragraph (*a*) of the CCPC definition. The CCRA is of the view, however, that paragraph (*b*) of the CCPC definition would apply to deny CCPC status in factual situations similar to that which existed in *Parthenon* for years after 1995. Paragraph (*b*) requires shares, not only of the corporation in question, but those of all corporations, owned by a non-resident person, a public corporation (other than a prescribed venture capital corporation), or a corporation described in paragraph (*c*) of the CCPC definition, to be attributed to a hypothetical person. If the hypothetical person would directly or indirectly control the corporation in question, the latter would not be a CCPC.

For illustrative purposes, consider the following scenario: Canco1 is a Canadian corporation that is

[8] See also Issue No. 3 of the *Income Tax Technical News*, dated January 30, 1995.

[9] 97 DTC 5343; [1997] 3 CTC 152 (FCA).

controlled by a Canadian resident. Canco1 owns more than 50% of the voting shares of Pubco, a Canadian public corporation, which in turn owns more than 50% of the voting shares of Canco2, a Canadian corporation. In determining Canco2's status as a CCPC, in the CCRA's view, paragraph (*b*) would apply to attribute the shares of Canco2 held by Pubco to a hypothetical person. Because this hypothetical person would then directly control Canco2, CCPC status would be denied notwithstanding the fact that ultimate control of Canco2 lay with a Canadian resident. As noted above, paragraph (*b*) will also apply if control by the hypothetical person is indirect. This would arise if, instead of owning the shares of Canco2 directly, Pubco owned 100% of the voting shares of Holdco, a Canadian corporation, which in turn owned more than 50% of the voting shares of Canco2. In this case, Canco2 would not be a CCPC because paragraph (*b*) would apply to attribute the shares of Holdco to the hypothetical person, who would then have indirect control of Canco2.

Question 4

The Federal Court of Appeal set out circumstances in which a person or group of persons would be considered to have *de facto* control. These circumstances are narrower in scope than those set out by the CCRA in ¶ 21 of Interpretation Bulletin IT-64R4, *Corporations: Association and Control*, dated August 14, 2001. How does this decision affect these views?

Response 4

The CCRA is not presently considering any change to the criteria contained in ¶ 21 of Interpretation Bulletin IT-64R4 as a result of the *Silicon Graphics* decision. There are two cases involving the application of subsection 256(5.1) that have been appealed to the Federal Court of Appeal: *Mimetix Pharmaceuticals Inc.* v. *The Queen* and *Rosario Poirier Inc.* v. *The Queen*[10]. The CCRA is of the view that the Tax Court of Canada decision in *Mimetix*[11] seems to suggest that the circumstances in which *de facto* control may arise may not be as narrow as those set out in *Silicon Graphics*. For instance, it is noted that the Tax Court of Canada in *Mimetix* found that a non-resident shareholder had *de facto* control of the appellant in part because the non-resident shareholder exercised the powers of the appellant's board of directors, which is not a situation cited by the Federal Court of Appeal in *Silicon Graphics*. Given the uncertainty surrounding the scope of *de facto* control, the CCRA intends to wait for the Federal Court of Appeal's decisions in *Mimetix* and *Rosario Poirier* prior to considering whether any change is necessary to our position on *de facto* control in Interpretation Bulletin IT-64R4.

[10] Court file No. A-63-02 and Court file No. A-378-02, respectively.
[11] 2001 DTC 1026; [2002] 1 CTC 2188 (TCC).

Partnership Issues

Background

In broad terms, the *Income Tax Act* (the "Act") is structured to tax the income of individuals, corporations and trusts. The Act provides for definitions for each of these terms.

Unlike the above-mentioned terms, a "partnership" is not defined in the Act. Moreover, in general, a partnership is not considered a "person" for purposes of the Act notwithstanding the fact that certain provisions in the Act refer to a "person" to include a partnership.

It is a question of fact and law as to whether a partnership exists. The Courts[12] have now established the following general criteria (which is based on the definition of partnership under the relevant provincial law) when determining whether a partnership exists:

- there must be a business;
- this business must be carried on by 2 or more persons;
- there must be a view to profit.

Once it is established that a partnership does exist, subsection 96(1) of the Act generally provides that a partnership is a "flow-through" entity, with income computed at the partnership level (as if the partnership is a separate person) and allocated to the members of the partnership. Each member of a partnership, in turn, reports and pays tax on their proportionate share of such income. The sources of income retain their character when flowed from the partnership to the members of the partnership.

Question 1

The CCRA's position provides that a partnership is a contractual relation between persons and therefore not a legal entity. In recent years, legislation has been established in the US [such as the *Delaware Revised*

[12] See the Supreme Court of Canada decisions in *Continental Bank Leasing Corporation v. The Queen* (98 DTC 6505; [1998]4 CTC 119), *Spire Freezers Ltd v. The Queen* (2001 DTC 5158; [2001] 2 CTC 40) and *Backman v. The Queen* (201 DTC 5149; [2001] 2 CTC 11). More recently, *Stanley Witkin v. The Queen* (2002 DTC 7044; [2002] 3 CTC 184) reinforced the criteria established in the foregoing cases.

Uniform Partnership Act (DRUPA)] to allow the creation of "partnerships" that are separate legal entities. This appears to contradict the CCRA's position. Can you provide any comments with respect to this matter?

Response 1

The CCRA announced in the June 14, 2001 *Income Tax Technical News* (No. 20) that it is its view that generally the attributes of an entity formed under the DRUPA and carrying on business in common with a view to a profit more closely resemble those of a Canadian general partnership under our common law. This approach has been followed by the Courts, in particular, *Backman, Spire Freezers,* and *Continental Bank.*

Question 2

Under provincial partnership laws, partnerships must have a "view to profit". Under DRUPA, legal entities may be created for non-profit purposes. Would these DRUPA entities be partnerships for Canadian purposes?

Response 2

No. It is the CCRA's view that entities governed by the DRUPA that are not created to carry on business with a view to a profit under common law principles would not resemble Canadian partnerships. Consequently, such entities would not be considered partnerships for the purposes of the Act.

We have received requests with respect to the determination of the Canadian tax status of foreign partnerships formed in other jurisdictions. The determination of whether a partnership exists for Canadian tax purposes is a matter of common or civil law and can only be made in the context of an advance tax ruling request.

Question 3

Similarly, legislation in the U.S. allows for the creation of Limited Liability Companies (LLCs), to operate as separate legal entities and allows business profits (or losses) to be allocated and taxed in the hands of the members.

What is the CCRA position with respect to these entities?

Response 3

The CCRA has reviewed the provisions of the legislation with respect to LLCs in some States. Based on the review, it is generally the CCRA's position that an LLC is considered a corporation for Canadian tax purposes.

Question 4

One of the criteria of a "partnership" is that the particular business is carried on with "a view to a profit". Does the CCRA consider this to mean a "reasonable expectation of profit" (REOP) as established in *Moldowan*?

Response 4

No. The "view to a profit" test that determines if a partnership exists is a common or civil law issue, while the REOP test is a determination of whether there is a business or source test under the *Income Tax Act.* The Courts have established that in order for a partnership to exist, there must be a "relation between persons carrying on a business in common with a view to a profit". The Courts have established that this test is different from the more difficult REOP test. Whether there exists a "view to a profit" requires an inquiry into the intentions of the parties entering into the alleged partnership. This determination is generally a finding of fact and law for each particular case.

Question 5

Now moving away from the issue of whether a partnership exists and to the computation of income for a partnership.

Interpretation Bulletin IT-138R provided an example with respect to a partnership agreement that provides for the allocation of an annual salary paid to one partner, after which the partners divide the income (or loss) of the partnership.

This position appears to contradict recent comments made in a recent CCRA technical interpretation.

Can you clarify the CCRA's position with respect to a "salary" paid to an individual partner?

Response 5

The CCRA is of the view that salaries paid to individual partners are not deductible in computing the partnership's income for income tax purposes. This concept is an extension of the general criteria established under the provincial Partnerships Acts. As an example, section 24, paragraph 6 of the *Partnership Act* of Ontario specifically states "no partner is entitled to remuneration for acting in the partnership business." Consequently, any amounts paid and deducted as such in the financial statements of the partnership as such must be added back when computing partnership income.

The CCRA wishes to clarify that Interpretation Bulletin IT-138R has been withdrawn in 2000 since much of the information it contained was out of date. Information

with respect to the computation of income for partnerships can be found in the *Guide for the Partnership Information Return* (T4068).

Question 6

The next question deals with the "partnership interest".

A limited partnership may issue different units of the partnership. Does the CCRA accept that the ACB of the different partnership units be computed separately, in the same manner that one computes the ACB of shares they hold in a corporation (preferred, common)?

Response 6

No. It is the CCRA position that a taxpayer's interest in a limited partnership is considered **one capital property**. Consequently, in a disposition one would compute the ACB of the partnership interest as the aggregate of the units. In a partial disposition, the ACB of the partial interest disposed would be determined pursuant to subsection 43(1) of the Act.

This is Exhibit "D" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnston.
613-730-8000
Barrister & Solicitor.

THIS AGREEMENT made as of the 1st day of January, 1980.

B E T W E E N:

NORTHERN TELECOM LIMITED,
a corporation incorporated under the laws of Canada, and having its Registered Office in the City of Montreal, Province of Quebec,

(hereinafter referred to as the "Corporation")

A N D:

MONTREAL TRUST COMPANY,
a company incorporated pursuant to the laws of Quebec and having its Head Office at the City of Montreal, therein,

(hereinafter referred to as the "Trustee")

WHEREAS:

1. The Corporation has established for the benefit of certain of its employees and the employees of such affiliated or subsidiary Corporations as the Corporation may designate, certain Health and Welfare plans, and such other similar plan or plans as the Corporation may from time to time place in effect, as follows:

a) a Health Care Plan;

b) a Management Long Term Disability Plan;

c) a Union Long Term Disability Plan;

d) a Management Survivor Income Benefit Plan;

e) a Management Short Term Disability Plan;

f). a Group Life Insurance Plan;

all of which are hereinafter collectively referred to as the "Health and Welfare Plan".

2. To give effect to the Health and Welfare Plan it is necessary to establish a trust fund to be known as the "Health and Welfare Trust".

Now therefore in consideration of the premises and the mutual covenants herein contained the Corporation and the Trustee, hereby covenant and agree as follows:

ARTICLE I - DEFINITIONS

1. The term "Trustee" shall mean the Trustee herein named its successors and assigns and shall include the person, legal entity or corporation to whom the Trustee may delegate such powers as are necessary for the sound and efficient administration of the Trust Fund.

2. The term "Benefits" as used herein shall mean payment benefits as determined under the Health and Welfare Plan.

3. The term "Eligibility Requirements" as used herein shall mean the rules, regulations and procedures established from time to time by the Corporation for determining the eligibility of Employees for Benefits.

4. The term "Employees" shall mean those active and retired employees of the Corporation and

designated affiliated or subsidiary corporations which have adopted the Health and Welfare Plan, including dependents as defined in Schedule A, on whose behalf contributions are or have been made to the Trust Fund and who are eligible for benefits under the Health and Welfare Plan.

5. The term "Employer's Contribution" as used herein shall mean payments required to be made by the Corporation and by designated affiliated or subsidiary corporations to the Trust Fund to enable the Trustee to discharge the obligations arising under the Health and Welfare Plan.

6. The term "Trust Fund" as used herein shall mean all of the assets of the "Health and Welfare Trust" including all funds received by way of contributions from the Corporation and those of its designated affiliated or subsidiary corporations in accordance with the provisions of the Health and Welfare Plan and of this Trust Agreement, and all employees' contributions together with all profits, increments, and earnings thereon.

ARTICLE II - TRUST FUND

1. The Trust Fund is created for the purpose of providing the Health and Welfare Plan benefits for the benefit of the Employees.

2. All payments made to the Trustee from time to time by the Corporation and designated affiliated or subsidiary corporations and by the employees, together with all profits, increments and

earnings thereon, shall be irrevocable and constitute upon receipt by the Trustee, the Trust Fund to be administered by the Trustee in accordance with the terms of this Trust Agreement, the Health and Welfare Benefit Plan and the Eligibility Requirements.

3. The Trustee shall from time to time on the written directions of an officer of the Corporation so designated by its Board of Directors, or failing such designation, by the Secretary, of the Employees' Benefit Committee of the Corporation, or a Plan Administrator appointed by the Corporation, make payments out of the Fund to such persons, in such manner and in such amounts as may be specified in such directions to the Trustee. In each instance, the written directions shall be deemed to include a certification to the Trustee that such directions and the payments to be made pursuant thereto are in accordance with the terms of the Health and Welfare Plan, which certification shall constitute full and complete protection to the Trustee in complying with such directions.

ARTICLE III - TRUSTEE

1. The Trustee, who shall also be known as the "Trustee of the Health and Welfare Trust", hereby accepts the trust created by the Trust Agreement and agrees to hold, invest, distribute and administer the Trust Fund in accordance with the

terms and conditions of the Health and Welfare Plan and this Trust Agreement.

2. The Trustee is authorized and empowered:

a) To sell or otherwise dispose of any property held by it;

b) To exercise all voting and other rights in respect of any stocks, bonds, properties or other investments held in the Trust Fund;

c) To execute all documents of transfer and conveyance that may be necessary or appropriate to carry out the powers herein granted;

d) To make payments out of the Trust Fund and to reimburse itself for disbursements incurred pursuant to the exercise of the authorities and powers herein set forth, unless paid by the Corporation;

e) All monies, securities for money and other assets from time to time held by the Trustee may be in negotiable form or recorded or registered in the name of the Trustee or in the name of its nominee;

f) When instructed to do so by the Corporation, to commence, maintain, defend, adjust and settle suits and legal proceedings and to represent the Trust Fund at any such suits or proceedings at law or otherwise for the enforcement or realization of any investment;

provided that the Trustee shall not be obliged or required to do so unless it has been first indemnified to its satisfaction against all expenses and liabilities sustained or anticipated by it, and the Corporation hereby agrees so to indemnify the Trustee.

g) In general, in the carrying out of its duties and responsibilities under the Trust Agreement to exercise the general powers accorded by law to trustees.

h) The Trustee shall hold, invest and reinvest the principal and income. The Trustee may keep the investments of the Trust fund wholly or partly, in its principal office or in any one or more of its branches in any Province of Canada. Unless otherwise directed by the Corporation, the Trustee shall make only such investments as comply with the limitations and restrictions imposed by applicable federal and Provincial laws and regulations respecting the investments of trust funds.

Notwithstanding the foregoing, the Corporation may, at any time, or from time to time, direct the Trustee as to specific or general investment of the Trust Fund, and the Trustee shall comply with such directions.

Whenever the Trustee is required or authorized to take any action pursuant to the provisions of this paragraph upon the request, direction or authorization of the

Corporation, such request, direction or authorization shall be a sufficient protection to the Trustee if contained in a writing signed by any person authorized by resolution of the Corporation's Board of Directors to sign such a writing. The Corporation will indemnify and hold harmless the Trustee of and from any liability or expense incurred by it arising out of any payment out of or disposition of the Trust Fund made by the Trustee pursuant to any such request, direction or authorization of the Corporation.

i) The Trustee may hold such part of the Trust Fund uninvested as the Trustee may deem advisable in the best interests of the Trust Fund for the proper administration thereof.

j) The Trustee may keep such portion of the Trust Fund, as may from time to time be deemed by it to be in the best interests of the Trust Fund, on deposit in a chartered bank or Government Savings Bank in Canada at such rate of interest, if any, as may be allowed thereon, or on demand deposit at an agreed interest rate with any Trust Company (including the Trustee) then licensed under the laws of Canada or of any Province thereof to carry on business as such.

k) Notwithstanding any other provision of this Agreement and subject to clause 2 (h) hereof, the Trustee will invest and reinvest all or such portion of the Trust Fund as the

Corporation may from time to time direct in writing in the Northern Telecom Group Trust Fund established by the Company and the Trustee pursuant to an Agreement made and entered into as of the 1st day of January, 1980.

1) (i) the Trustee shall, in accordance with the written direction of the Corporation from time to time invest all or any part of the Trust Fund jointly with assets belonging to any other trust funds maintained under a pension plan maintained with the Trustee by the Corporation or by any corporation associated, subsidiary to or affiliated with the Corporation, and may jointly invest and reinvest on behalf of the Trust Fund and such other trust or trusts, allocating undivided shares or interests in such investments or reinvestments to the two or more trusts in accordance with their respective interests. To facilitate the administration of such joint investments or reinvestments, the Trustee shall identify the undivided shares or interests by way of "units" which shall represent the undivided ownership interest of each participating trust fund in the jointly owned investments;

(ii) the Trustee shall invest and reinvest all or any portion of the Trust Fund in accordance with the written direction of

the Company in any "Pooled Fund" which phrase shall mean in this Agreement any pooled trust fund maintained by the the Trustee or one of its associated or affiliated Corporations licensed to do business in Canada as a Trustee. Such written direction shall specify that such portion of the Trust Fund to be invested in such Pooled Fund shall be invested as part of one particular section of the Pooled Fund or as parts of two or more sections of the Pooled Fund in such proportions as is set out in such direction, failing which specification the same shall be invested as part of one particular section of the Pooled Fund in such proportion as the Trustee deems advisable.

m) The Trustee may, with the consent of the Corporation, borrow money in such amounts and upon such terms and conditions as it shall deem advisable and pledge any securities or other property for the repayment of any such loan.

n) The expenses incurred by the Trustee in the performance of its duties, and such compensation to the Trustee as may be agreed upon in writing from time to time between the Corporation and the Trustee, shall be paid by the Corporation. All taxes of any and all kinds whatsoever that may be levied upon or in respect of the Trust Fund shall be paid

from or be the responsibility of the Trust Fund.

o) The Trustee shall not be liable for the making, retention, or sale, in good faith, of any investment or reinvestment made by it as herein provided, nor for any loss to or diminution of the Trust Fund, except due to the negligence, wilful misconduct or lack of good faith of the Trustee, its servants, agents or employees.

p) The Trustee shall keep accurate and detailed accounts of all investments and transactions made by it pursuant to this Agreement and shall keep separate records for each of the separate Plans. The accounts and records relating thereto shall be open to inspection at all reasonable times by any person designated by the Corporation. Within ninety (90) days following the close of each fiscal year of the Trust Fund, or within ninety (90) days after the removal or resignation of the Trustee as provided for in paragraph (q) hereof, the Trustee shall file with the Corporation a statement setting forth all investments and cash transactions effected by it during such fiscal year or during the period from the close of the last fiscal year to the date of such removal or resignation. Upon the expiration of ninety (90) days after the date of filing such annual or other statement, but subject to the provisions of paragraph (o) hereof, the Trustee shall be released and discharged from all liability

and accountability to anyone with respect to its acts and transactions during the period covered by the statement. The Trustee shall from time to time make such reports and furnish such information concerning the trust to the Corporation as the Corporation may in writing request.

g) The Trustee may be removed by the Corporation at any time upon ninety (90) days notice in writing to the Trustee. The Trustee may resign at any time upon ninety (90) days notice in writing to the Corporation. Upon such removal or resignation of the Trustee, the Corporation shall, within said ninety (90) day period, appoint a successor trustee or trustees who shall have the same powers and duties as those conferred upon the Trustee hereunder and, upon acceptance of such appointment by the successor trustee or trustees, the Trustee shall assign, transfer and pay over to such successor trustee or trustees the funds and properties and accounts then constituting the Trust Fund. The Trustee is authorized however, to reserve such sum of money, as may at such time be reasonably owing to it for payment of its fees and expenses and any balance of such reserve remaining after the payment of such fees and expenses shall be paid over to the successor trustee or trustees within thirty (30) days after the date of such removal or resignation.

x) The Trustee shall not be bound to act in

accordance with any direction or request of the Corporation or of its Board of Directors until a duly authenticated copy of the instrument or resolution containing such direction or request shall have been delivered to the Trustee, and the Trustee shall be empowered to act upon and shall be fully protected by the Corporation in acting in accordance with any direction or request of the Corporation upon receipt of any such copy purporting to be authenticated and believed by the Trustee to be genuine. Any direction, request, certificate or other instrument to be made or given by the Corporation under any of the provisions hereof shall, unless otherwise provided herein, be deemed sufficiently authenticated if certified by the Secretary or an Assistant Secretary of the Corporation.

s) The Trustee may appoint a qualified person, firm or corporation to act as administrator of the Trust Fund to determine on a sound actuarial basis the amounts of Employer's contributions required in order to fund adequately the Health and Welfare Plan and to advise and carry out administrative procedures in accordance with the Health and Welfare Plan and the Eligibility Requirements.

ARTICLE IV - EMPLOYER'S CONTRIBUTIONS

1. The Corporation and its designated affiliated or subsidiary corporations agree to make Employer's

contributions to the Trust Fund in amounts sufficient to pay any claims which may be asserted against the Trust Fund as a result of the administration of the Health and Welfare Plan, and as may otherwise be required from time to time by the Trust for the purposes of the Health and Welfare Plan, as determined by the Trustee on a sound actuarial basis.

2. The Trustee shall determine or cause to be determined, on a sound actuarial basis from time to time, and in any event, once every calendar year, the level of contributions to the Trust Fund necessary to fund adequately the Health and Welfare Plan.

3. Subject to paragraphs (1) and (2) hereof, the Corporation and its designated affiliated or subsidiary corporations shall be responsible for the adequacy of the Trust Fund to meet and discharge any and all payments and liabilities under the Health and Welfare Plan.

ARTICLE V - NOTICES

1. Any notice provided for herein to be given by one party to another shall be in writing and shall be effectively given if delivered personally or by telegram or prepaid registered mail addressed to the Trustee at:

Montreal Trust Company
Pension Trust Administration
Place Ville Marie
Montreal, Quebec H3B 3L6

and if to the Corporation at:

Northern Telecom Limited
Box 458, Station A
Mississauga, Ontario L5A 3A2

Attention: Director, Corporate Compensations

Any notice so given shall be deemed to have been given if delivered personally or given by prepaid registered mail on the third business day immediately following the date of mailing of such notice.

ARTICLE VI - AMENDMENT AND TERMINATION

1. This Trust Agreement may be amended in any respect from time to time by mutual agreement of the Corporation and the Trustee except that no amendment shall divert the Trust Fund or any part thereof as constituted immediately prior to such amendment to a purpose other than the provision of benefits as herein defined.

2. Upon sixty (60) days prior written notice to the Trustee, the Corporation may terminate its obligation to make Employer's contributions in respect of benefits after the date of written notice to the Trustee (hereinafter called the "Notice of Termination"). Upon receipt of the Notice of Termination the Trustee shall within one hundred twenty (120) days determine and satisfy all expenses, claims and obligations arising under the terms of the Trust Agreement and Health and Welfare Plan up to the date of the Notice of Termination. 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 to benefits and claims up to the date of the Notice of Termination. The Corporation and the designated affiliated or subsidiary corporations shall be responsible to pay to the Trustee sufficient funds to satisfy all such expenses, claims and obligations, and such future benefits and claims. The final accounts of the Trustee shall be examined and the correctness thereof ascertained and certified by the auditors appointed by the Trustee. Any funds remaining in the Trust Fund after the satisfaction of all expenses, claims and obligations and future benefits and claims, arising under the terms of the Trust Agreement and the Health and Welfare Plan shall revert to the Corporation.

ARTICLE VII - GOVERNING LAW AND SEVERABILITY

1. This Trust Agreement and all amendments thereto shall be administered, construed and enforced in accordance with the laws of the Province of Ontario.

2. If any provision of this Trust Agreement, the Health and Welfare Plan, the Eligibility Requirements or the rules and regulations made pursuant thereto, or any action taken in the administration of the funds of the Trust Fund or the Health and Welfare Plan are held to be illegal or invalid for any reason, such illegality or invalidity shall not affect the remaining portions of this Trust Agreement, the

Health and Welfare Plan, the Eligibility Requirements, or the rules and regulations made pursuant thereto unless such illegality or invalidity prevents accomplishment of the purposes of the trust hereby created. In the event of any such holding, the parties will immediately commence negotiations to remedy any such defect.

ARTICLE VIII - CLAIMS BY BENEFICIARIES

1. No person entitled to benefits under the Plan shall have any claim against the Trustee or the Trust fund except by or through the Corporation, and the Corporation shall indemnify and save the Trustee harmless from any such claim including the costs of defense.

ARTICLE IX - MISCELLANEOUS

1. Wherever in this Agreement the word "Corporation" is used, it shall be deemed to mean and shall include the Corporation's successor and any other Corporation with which the Corporation may have amalgamated, whether under its present name or any other name.

To the extent required by any Federal or Provincial law or regulation that are or might be promulgated from time to time, the Corporation shall be the administrator of the Plan and the duties of the Corporation as such administrator hereby are delegated to the Trustee to the extent provided in this Agreement.

A copy of the Health and Welfare Plan initialled by the Parties may be annexed to this Agreement and may be amended from time to time and when so annexed shall form part hereof, but no terms or provisions of this Agreement shall be construed or interpreted as imposing upon the Trustee any obligation to see to the administration of or the carrying out of any of the terms or provisions of the Plan.

Any corporation resulting from any merger or consolidation to which the Trustee may be a party or succeeding to the trust business of the Trustee, or to which substantially all the trust assets of the Trustee may be transferred while the Trustee continues to act as Trustee hereunder shall be the successor to the Trustee hereunder without any further act or formality with like effect as if such successor trustee had originally been named trustee herein.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed by their respective officers thereto duly authorized and their corporate seals to be hereunto affixed and attested as of this 1st day of January, 1980.

Legal Dept. APPROVED DEC 18 1980 DATE

NORTHERN TELECOM LIMITED

Per: _____
Vice President

Per: _____
Secretary

MONTREAL TRUST COMPANY

Per: _____
M. C. WHITELOCK, SENIOR CONSULTANT, HEAD OFFICE PENSION SERVICES

Per: _____

This is Exhibit "E" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.
William Johnston
613-730-8090
Barrister + Solicitor

THIS AGREEMENT made as of the 24th day of September, 1984.

A M O N G

NORTHERN TELECOM LIMITED, a body corporate, duly incorporated under the laws of Canada, and having its registered office in the City of Montreal, Province of Quebec, Canada

(hereinafter called the "Corporation")

PARTY OF THE FIRST PART,

- and -

MONTREAL TRUST COMPANY, a body corporate, duly incorporated under the laws of the Province of Quebec, and having its head office in the City of Montreal, Province of Quebec, Canada

(hereinafter called the "MTC")

PARTY OF THE SECOND PART,

- and -

MONTREAL TRUST COMPANY OF CANADA, a body corporate, duly incorporated under the laws of Canada, and having its principal office in the City of Toronto, Province of Ontario, Canada

(hereinafter called the "Montreal Trust")

PARTY OF THE THIRD PART.

WHEREAS the Corporation has established and is maintaining certain Health and Welfare Plans, as amended from time to time (collectively the "Health and Welfare Plan");

AND WHEREAS the Corporation and MTC entered into an agreement dated as of and with effect from the 1st day of January, 1980, (the "Trust Agreement"), respecting trust arrangements pertaining to the Health and Welfare Plan;

AND WHEREAS the parties hereto wish to evidence the transfer and assignment of the rights and obligations of MTC under the Trust Agreement to Montreal Trust and certain other amendments, all as specified herein;

NOW THEREFORE this Agreement witnesseth as follows:

1. MTC hereby assigns, transfers and sets over unto Montreal Trust, with effect from and after the date hereof, all of its right, title and interest, as trustee, in the Trust Agreement and the trust fund established thereunder (the "Trust Fund").

2. The Corporation hereby consents to the assignment to Montreal Trust from MTC of the trusteeship of the Trust Fund under the Trust Agreement and hereby confirms the appointment of Montreal Trust as the trustee under the Health and Welfare Plan.

3. Montreal Trust hereby accepts all right, title and interest in and to the trust herein and contributed under the Trust Agreement, assumes all duties and obligations thereunder, and agrees to act as trustee to hold all property now or hereafter constituting the Trust Fund in accordance with the provisions thereof.

4. MTC covenants and agrees that it shall execute all such further assurances as may be necessary or desirable from time to time to give full effect to the transfer of the trusteeship provided for herein.

5. The Trust Agreement governing the said trust shall be amended by deleting the Trustee's address referred to in ARTICLE V and substituting the following address therefor:

Montreal Trust Company of Canada
Pension Trust Administration
15 King Street West
Toronto, Ontario
M5H 1B4

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be executed by their authorized officers and their respective corporate seals to be affixed and attested as of the day and year first above written.

NORTHERN TELECOM LIMITED

C/S

MONTREAL TRUST COMPANY

C/S

W. B. DAWE, Asst. Manager
PENSION SYSTEMS

MONTREAL TRUST COMPANY OF CANADA

C/S

W. B. DAWE, Asst. Manager
PENSION SYSTEMS

This is Exhibit "F" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnson,
613-730-8000
Barrister & Solicitor.

AMENDING AGREEMENT made as of the 1st day of June, 1994.

BETWEEN

NORTHERN TELECOM LIMITED, a body corporate duly incorporated under the laws of Canada and having offices at 3 Robert Speck Parkway, Mississauga, Ontario, L4Z 3C8

(hereinafter called the "Corporation")

PARTY OF THE FIRST PART,

-and-

MONTREAL TRUST COMPANY OF CANADA, a body corporate duly incorporated under the laws of Canada and having its registered office at 15 King Street West, Toronto, Ontario, M5H 1B4

(hereinafter called the "Trustee")

PARTY OF THE SECOND PART.

WHEREAS the Corporation and the Trustee are parties to a certain Trust Agreement dated and with effect as of and from the 1st day of January 1980, as amended, (the "Trust Agreement") respecting trust arrangements relating to the Corporation's Health and Welfare plans; and

WHEREAS the parties hereto wish to amend the Trust Agreement to authorize and permit the Trustee to lend, from time to time, to approved brokers or banks, subject to the terms and conditions hereinafter set forth, securities that it holds as part of the trust fund established pursuant to the Trust Agreement.

NOW, THEREFORE, this Amending Agreement witnesseth as follows:

1. Article III of the Trust Agreement is hereby amended by adding a new clause 2 t) as follows:

"2 t) The Trustee may engage from time to time, subject to the prior written consent of the Corporation, in a program of lending to brokers or banks approved by the Corporation, securities that it holds as part of the Trust Fund, subject to complying with applicable laws and regulations, and subject to such other terms and

conditions, in addition to the terms and conditions of this Trust Agreement, as the Corporation and the Trustee may agree upon in writing from time to time."

2. The amendments to the Trust Agreement set forth herein shall be effective June 1, 1994.

3. Except as amended herein, the Trust Agreement remains in full force and effect.

IN WITNESS WHEREOF the parties hereto have caused this Amending Agreement to be executed by their proper officers and their respective corporate seals to be affixed hereto as attested by their proper officers, duly authorized on that behalf, as of the day and year first written above.

NORTHERN TELECOM LIMITED

Per: _____
Vice-President and Treasurer

Per: _____
Vice-President and
Associate General Counsel

MONTREAL TRUST COMPANY OF CANADA

Per: _____

Per: _____

This is Exhibit "G" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnston
613-730-8000
Barrister & Solicitor.

THIS APPOINTMENT OF SUCCESSOR TRUSTEE AND ACCEPTANCE OF APPOINTMENT OF SUCCESSOR TRUSTEE made as of the • day of •, 2005.

BETWEEN:

NORTEL NETWORKS LIMITED, a company duly incorporated under the laws of Canada (hereinafter referred to as the "Plan Sponsor")

OF THE FIRST PART,

and

THE NORTHERN TRUST COMPANY, CANADA, a trust company incorporated under the laws of Canada (hereinafter referred to as the "Trustee")

OF THE SECOND PART.

WHEREAS the Plan Sponsor has heretofore adopted certain health and welfare plans (collectively the "Plan") for the benefit of certain of its employees and their beneficiaries and the eligible employees and beneficiaries of any other corporation which may participate in the Plan;

AND WHEREAS the Plan Sponsor established a trust fund to give effect to the Plan effective as of January 1, 1980, as amended to the date hereof (the "Health and Welfare Trust") under which the current trustee is The Royal Trust Company of Canada (the "Prior Trustee");

AND WHEREAS the Plan Sponsor has removed the Prior Trustee and the Trustee is to be appointed as successor trustee by the Plan Sponsor pursuant to paragraph 2(q) of Article III of the Health and Welfare Trust;

NOW THEREFORE THIS DEED WITNESSES as follows:

1.01 The Plan Sponsor has removed the Prior Trustee and hereby appoints the Trustee as the successor trustee under the Health and Welfare Trust to assume all of the powers, rights, duties and responsibilities of the Prior Trustee under the Health and Welfare Trust effective as of the date hereof.

1.02 The Trustee hereby accepts the appointment by this deed as trustee under the Health and Welfare Trust in place of and as successor to the Prior Trustee effective as of the date hereof.

1.03 The Plan Sponsor and the Trustee hereby declare that every right, title or interest in any property subject to the Health and Welfare Trust shall vest in the Trustee subject to the terms of the Health and Welfare Trust with the intent and effect that the declaration hereby made shall, without any conveyance or assignment, operate to vest in the Trustee for the purposes of the said trust all such right, title and interest.

1.04 The Plan Sponsor and the Trustee shall use their best efforts to amend and restate the Health and Welfare Trust as soon as practicable in a manner that does not adversely affect the Plan or the Health and Welfare Trust for tax purposes and the Plan Sponsor further agrees to provide such further assurances, execute such instruments or take any such further steps as the Trustee may reasonably require in order to effect the succession contemplated herein.

IN WITNESS WHEREOF the parties hereto have caused this Appointment to be executed by their respective officers thereunto fully authorized and their corporate seals to be hereunto affixed and attested as of the day and year first above written.

NORTEL NETWORKS LIMITED

Per: William J. LaSalle
Signature
WILLIAM J. LASALLE
GENERAL COUNSEL - OPERATIONS
Name and Title

Per: K.B. Stevenson
Signature
K.B. Stevenson
Treasurer
Name and Title

THE NORTHERN TRUST COMPANY, CANADA

Per:
Signature
JEFFREY W. CONOVER
PRESIDENT & CEO
Name and Title

Per:
Signature
VEDA NANCOO
VICE PRESIDENT
Name and Title

This is Exhibit "H" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.
William Johnston.
613-730-8000
Barrister + Solicitor.

NORTEL

December 1, 2005

The Northern Trust Company, Canada,
Successor Trustee of the Nortel Health and Welfare Trust
161 Bay Street
Suite 4540, B.C.E. Place
Toronto, Ontario M5J 2S1

Attention: Veda Nancoo

Pursuant to that certain Appointment of Successor Trustee and Acceptance of Appointment of Successor Trustee dated as of December 1, 2005, you are currently acting as the Successor Trustee of the Nortel Health and Welfare Trust dated January 1, 1980 as amended on September 24, 1984 and June 1, 1994 (the "Health and Welfare Trust").

Notwithstanding anything to the contrary in the Health and Welfare Trust and for the avoidance of any doubt, we agree that you shall have no responsibility for determining, reviewing or monitoring the amounts of Nortel Networks Limited's contributions required in order to fund adequately the Health and Welfare Plan ("Contribution Amounts") nor to advise and carry out administrative procedures in accordance with the Health and Welfare Plan and the eligibility Requirements.

Nortel Networks Limited agrees that it shall be solely responsible for determining said Contribution Amounts on a sound actuarial basis and administering the Health and Welfare Plan and agrees to indemnify and hold you harmless from any and all costs, losses, damages, claims, actions, suits, liabilities, expenses or other charges (including attorneys' fees) that you incur directly or indirectly arising out of the contributions made (or not made) by Nortel to the Health and Welfare Trust or out of the administration of the Health and Welfare Plan.

This indemnification shall survive the termination of the Health and Welfare Trust. To the extent necessary, this letter shall constitute an amendment to the Health and Welfare Trust.

Nortel Networks Limited

By: _____
Name & Title William J. LaSalle
General Counsel - Operations

By: _____
Name & Title K.B. Stevenson
Treasurer

Accepted and Agreed:
The Northern Trust Company, Canada

By: _____
Name & Title JEFFREY W. CONOVER
PRESIDENT & CEO

By: _____
Name & Title VEDA NANCOO
VICE PRESIDENT

This is Exhibit "I" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnston
613-730-8000
Barrister & Solicitor

Court File No. 09-CL-7950

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AFFIDAVIT OF JOHN DOOLITTLE
(sworn January 14, 2009)

I, John Doolittle, of the City of Oakville, in the Province of Ontario, MAKE OATH AND SAY:

1. I am the Treasurer of Nortel Networks Corporation ("NNC") and Nortel Networks Limited ("NNL") and have held those positions since June 23, 2008. From October 14, 2002 to June 12, 2006, I was the Vice-President, Tax for NNL and NNC. As such, I have personal knowledge of the matters to which I hereinafter depose in this Affidavit. Where I do not possess personal knowledge, I have stated the source of my information and, in all such cases, believe it to be true.

2. NNC is a Canadian corporation and is the direct or indirect parent of 143 subsidiaries including the other Applicants, NNL, Nortel Networks International Corporation ("NNIC"), Nortel Networks Global Corporation ("NNGC") and Nortel Networks Technology Corporation ("NNTC"). NNC, NNL, NNIC, NNGC and NNTC are referred to herein as the "Applicants". In addition, NNC is a party to eight (8) joint ventures operating worldwide. References to "Nortel" or the "Nortel Companies" are references to the global enterprise as a whole. References to a "Nortel Company" are references to a

alignment of individual quota targets determined on an annual basis in the ordinary course of business.

37. The success of Nortel is directly dependent on the highly skilled and educated people who work for it, developing products and selling innovative ideas. Nortel's employees are a key component to achieving success through a restructuring process. As such, the Applicants intend to develop and seek Court approval of certain incentive programs appropriate for maintaining this valuable asset of the enterprise.

Pension and Benefit Plans

38. The Nortel Companies' employee benefits plans for eligible employees and retirees include health and dental benefits, life insurance and disability benefits, defined benefit and other retirement savings, and other ancillary benefits. The benefit plans differ by country in line with local market practices and legal requirements. These plans are sponsored on a regional basis by specific operating subsidiaries in the particular region.

39. The Applicants' primary current retirement program in Canada is its Capital Accumulation and Retirement Program ("CARP"), which consists of a combination of separate pension and other retirement savings plans, a Transitional Retirement Allowance Plan, retiree healthcare, life insurance and other ancillary benefits. All eligible Nortel employees and retirees participate in some combination of the various vehicles and plans that exist under CARP.

40. The Applicants also administer two defined benefit registered pension plans in Canada, namely the Nortel Networks Limited Managerial and Non-Negotiated Pension Plan and the Nortel Networks Negotiated Pension Plan (the "Cdn DB Plans") by way of which they provide pension benefits to more than 11,000 current pensioners. A small number of Canadian unionized employees and certain grandfathered non-union employees continue to accrue service under each of the plans.

41. The non-pension CARP benefits are administered by Sun Life Assurance Company of Canada through the Northern Telecom Health & Welfare Trust (the "HWT"). The HWT was originally settled in 1980 with the Montreal Trust Company. The HWT is used to

fund certain long term disability, life and other insurance and medical benefits for current and former employees.

42. Upon filing, it is anticipated that the Applicants will:

(a) continue to make current service payments to the Cdn DB Plans; and

(b) continue to make their current service payments under the other retirement savings programs included in CARP for active employees.

43. It is anticipated that benefits will continue to be provided for active employees going forward.

c. Boards of Directors

44. Each of the Boards of Directors of NNC and NNL is comprised of the same 10 directors and has the same non-executive chair. Meetings of the Boards of Directors of NNC and NNL are generally held together as joint meetings with limited exceptions. The following individuals sit on the Boards of Directors of NNC and NNL: Jalynn H. Bennett; Dr. Manfred Bischoff; The Honorable James Baxter Hunt, Jr.; Dr. Kristina M. Johnson; John A. MacNaughton; The Honourable John P. Manley; Richard D. McCormick; Claude Mongeau; Harry J. Pearce (Chair); and Mike S. Zafirovski. Mr. Zafirovski is also the President and Chief Executive Officer of NNC and NNL.

45. The Boards of Directors of the other Applicants are run separately from the Boards of Directors of NNL and NNC. The Boards of Directors of each of NNTC, NNGC and NNIC consist of Gordon Davies, Paul W. Karr and Paviter Binning, all of whom are members of management of NNC and NNL.

46. The members of all of the Applicants' Boards of Directors are collectively referred to as the "Directors".

(d) NN France acts as the purchaser for Global System for Mobile Communication products (CN) worldwide.

V. CASH MANAGEMENT AND INTER-COMPANY PAYMENTS

89. As a result of the interconnectivity of the Nortel Companies, Nortel employs a complex arrangement to deal with cash management and inter-company payments and the allocation of revenues, and costs among the Nortel Companies.

Account Structure

90. In Canada, the Applicants have a total of 39 Canadian dollar ("CAD") and U.S. dollar ("USD") bank accounts with Citibank and Royal Bank of Canada ("RBC"), which are maintained on an entity by entity basis. These accounts are subdivided into the following four account categories:

(a) *Treasury* – Each of NNC, NNL and NNTC maintains USD and CAD treasury accounts. Funds are transferred to the treasury accounts from their receipt accounts. Funds in the treasury account are then used to make inter-company payments, foreign exchange transactions, and certain specific payments such as pension funding.

(b) *Receipts* - NNL maintains dedicated bank accounts used exclusively for accounts receivable collections. Funds are then periodically transferred from the receipt accounts to NNL's treasury account.

(c) *Disbursements* - Dedicated bank accounts maintained for cash disbursements can generally be broken down into the following categories:

(i) *Trade Disbursements* - Trade disbursements are generally paid via electronic fund transfers on the 1st and 15th days of every month (excepting Flextronics, which as described earlier is paid every Wednesday).

(ii) *Payroll* - Canadian payroll accounts are all with RBC. Funds are physically transferred into these accounts from the treasury accounts to the payroll accounts.

(iii) *Benefit Trusts* – As discussed above, employee benefits are funded into accounts administered by a third party and are trust accounts. The Applicants do not have any access to funds that are transferred into these accounts.

(d) *Other* – The Applicants also maintain a number of "specific purpose" accounts that are accessible to them for financing and tax matters.

Transfer Pricing

91. As described above, the Nortel business is highly integrated with several key Nortel Companies acting as purchasing hubs for Nortel Companies around the world. This results in high levels of inter-company receivables and payables, which necessitate the complex transfer pricing and inter-company settling methods employed by Nortel.

92. Nortel's transfer pricing model (the "Transfer Pricing Model") in most instances can be broken down into two main components:

(a) *Inventory mark up* – when a TCC purchases inventory on behalf of a distributor Nortel Company, it invoices (the "Internal Invoice") that Nortel Company for the product with a mark up (the "Initial Mark Up") on cost from the supplier invoice. The mark up is the first component of Nortel's Transfer Pricing Model;

(b) *Residual Profit Sharing* – the second component of the Transfer Pricing Model is derived from Nortel's profit sharing adjustment model which is premised on the profit projections that Nortel forecasts for its global entities and its designated residual profit sharing entities - NNL, NNI, NN UK, NN France and Nortel Networks (Ireland) Limited (collectively the "RPS Entities"). On a quarterly, potentially moving to monthly, basis, operating profit is assessed and re-allocated based on the projections for these Nortel Companies. To the extent that any Nortel Company has enjoyed a profit that exceeds its profit entitlement (after

This is Exhibit "J" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnston
613-730-8000
Barrister + Solicitor.

Canada Revenue Agency | Agence du revenu du Canada

Canada

Income Tax Interpretation Bulletin

Meaning of private health services plan [1988 and subsequent taxation years]

NO: **IT-339R2**

DATE: AUGUST 8, 1989

SUBJECT: INCOME TAX ACT
Meaning of private health services plan [1988 and subsequent taxation years]

REFERENCE: Subsection 248(1) (also paragraphs 6(1)(a), 18(1)(a), 118.2(2)(q) and 118.2 (3)(b))

APPLICATION

The provisions discussed below are effective for the 1988 and subsequent taxation years. For taxation years prior to 1988, refer to Interpretation Bulletin IT-339R dated June 1, 1983.

SUMMARY

This bulletin discusses the meaning of a "private health services plan" and describes some of the arrangements for covering the cost of medical and hospital care under such a plan. It also discusses the tax status of contributions made to such a plan by an employer on behalf of an employee and the circumstances under which the premium costs incurred by an employee qualify as medical expenses for purposes of the medical expense tax credit.

DISCUSSION AND INTERPRETATION

1. Contributions made by an employer to or under a private health services plan on behalf of an employee are excluded from the employee's income from an office or employment by virtue of subparagraph 6(1)(a)(i). On the other hand, an amount paid by an employee as a premium, contribution or other consideration to a private health services plan qualifies as a medical expense for purposes of the medical expense tax credit by virtue of paragraph 118.2 (2)(q). The amounts so paid must be for one or more of

(a) the employee

(b) the employee's spouse and

(c) any member of the employee's household with whom the employee is connected by blood relationship, marriage or adoption.

For further comments on the medical expense tax credit see the current version of IT-519.

For purposes of the Act, a "private health services plan" is defined in subsection 248(1).

2. The contracts of insurance and medical or hospital care insurance plans referred to in paragraphs (a) and (b) of the definition in subsection 248(1) of "private health services plan" include contracts or plans that are either in whole or in part in respect of dental care and expenses.

3. A private health services plan qualifying under paragraphs (a) or (b) of the definition in subsection 248(1) is a plan in the nature of insurance. In this respect the plan must contain the following basic elements:

(a) an undertaking by one person,

(b) to indemnify another person,

(c) for an agreed consideration,

(d) from a loss or liability in respect of an event,

(e) the happening of which is uncertain.

4. Coverage under a plan must be in respect of hospital care or expense or medical care or expense which normally would otherwise have qualified as a medical expense under the provisions of subsection 118.2(2) in the determination of the medical expense tax credit (see IT-519).

5. If the agreed consideration is in the form of cash premiums, they usually relate closely to the coverage provided by the plan and are based on computations involving actuarial or similar studies. Plans involving contracts of insurance in an arm's length situation normally contain the basic elements outlined in 3 above.

6. In a "cost plus" plan an employer contracts with a trusteed plan or insurance company for the provision of indemnification of employees' claims on defined risks under the plan. The employer promises to reimburse the cost of such claims plus an administration fee to the plan or insurance company. The employee's contract of employment requires the employer to reimburse the plan or insurance company for proper claims (filed by the employee) paid, and a contract exists between the employee and the trusteed plan or insurance company in which the latter agrees to indemnify the employee for claims on the defined risks so long as the employment contract is in good standing. Provided that the risks to be indemnified are those described in paragraphs (a) and (b) of the definition of "private health services plan" in subsection 248(1), such a plan qualifies as a private health services plan.

7. An arrangement where an employer reimburses its employees for the cost of medical or hospital care may come within the definition of private health services plan. This occurs where the employer is obligated under the employment contract to reimburse such expenses incurred by the employees or their dependants. The consideration given by the employee is considered to be the employee's covenants as found in the collective agreement or in the contract of service.

8. Medical and hospital insurance plans offered by Blue Cross and various life insurers, for example, are considered private health services plans within the meaning of subsection 248 (1). In addition, the Group Surgical Medical Insurance Plan covering federal government employees qualifies as a private health services plan within the meaning of subsection 248 (1). Therefore, payments made by an individual under any such plan qualify as medical expenses by virtue of paragraph 118.2(2)(q).

9. Private health services plan premiums, contributions or other consideration paid for by the employer are not included as medical expenses of the employee under paragraph 118.2(2)(q) by virtue of paragraph 118.2(3)(b) and are not employee benefits (see 1 above). They are however, business outlays or expenses of the employer for purposes of paragraph 18(1)(a). On the other hand, contributions or premiums qualify as medical expenses under paragraph 118.2(2)(q) where they are paid directly by the employee, or are paid by the employer out of deductions from the employee's pay. The amounts so paid must be for one or more of

(a) the employee,

(b) the employee's spouse and

(c) any member of the employee's household with whom the employee is connected by blood relationship, marriage or adoption.

Date Modified: 2002-09-06

This is Exhibit "K" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnston
613-730-8000
Barrister & Solicitor.

Canada Revenue Agency | Agence du revenu du Canada

Canada

Income Tax Interpretation Bulletin

Wage Loss Replacement Plans

NO: **IT-428**

DATE: April 30, 1979

SUBJECT: INCOME TAX ACT
Wage Loss Replacement Plans

REFERENCE: Paragraph 6(1)(f) (also paragraph 6(1)(a) and section 19 of the Income Tax Application Rules, 1971)

1. Paragraph 6(1)(f) provides that, for 1972 and subsequent taxation years, amounts received on a periodic basis by an employee or an ex-employee as compensation for loss of income from an office or employment, that were payable under a sickness, accident, disability or income maintenance insurance plan (in this bulletin referred to as a "wage loss replacement plan") to which the employer made a contribution, are to be included in income, but subject to a reduction as specified in that paragraph for contributions made by the employee to the plan after 1967. Before 1972, such amounts received by a taxpayer were not included in income.

2. Paragraph 6(1)(f) does not apply to a self-employed person inasmuch as any amount received by such person in the way of an income maintenance payment would not be compensation for loss of income from an office or employment. With regard to "overhead expense insurance" and "income insurance" of a self-employed person, see Interpretation Bulletin IT-223.

Exemption for Plans Established before June 19, 1971

3. Transitional provisions in section 19 of the Income Tax Application Rules, 1971 stipulate that amounts that would otherwise be included in income under paragraph 6(1)(f) are to be excluded if they were received pursuant to a plan that existed on June 18, 1971 and were in consequence of an event that occurred prior to 1974. Comments on these transitional provisions, particularly with regard to admissible and non-admissible changes in pre-June 19, 1971 plans, appear in IT-54. It is to be noted that, for 1974 and subsequent taxation years, the exemption in section 19 of the ITAR is applicable only if amounts received by a taxpayer are attributable to an event occurring before 1974. In this context, the word "event" has reference to the thing that caused the disability. In the case of an accident, for example, although the effect on the taxpayer's health may not have become noticeable or serious until 1974 or a later year, the "event" would have occurred before 1974 if the accident took place before 1974 and the later disability was directly attributable to the accident. Similarly, in the case of a degenerative disease such as muscular dystrophy, the "event" is the onset of the disease however much later the incapacity occurs. On the other hand, a recurring disease, such as a seasonal allergy or chronic tonsillitis, would qualify as an "event" only for the particular period of one attack.

4. For an illustration of the calculations involved where both paragraph 6(1)(f) of the Act and

section 19 of the ITAR apply to a particular taxpayer, in different taxation years, see 25 below.

Meaning of a "Wage Loss Replacement Plan"

5. In the Department's view, a plan to which paragraph 6(1)(f) applies is any arrangement, however it is styled, between an employer and employees, or between an employer and a group or association of employees, under which provision is made for indemnification of an employee, by means of benefits payable on a periodic basis, if an employee suffers a loss of employment income as a consequence of sickness, maternity or accident. This arrangement may be formal in nature, as evidenced by a contract negotiated between an employer and employees, or it may be informal, arising from an understanding on the part of the employees, that wage loss replacement benefits would be made available to them by the employer. Where the arrangement involves a contract of insurance with an insurance company, the insurance contract becomes part of the plan but does not constitute the plan itself.

6. Where it is apparent that a plan was instituted with the intention or for the purpose of providing wage loss replacement benefits, the assumption will be that it is a plan to which paragraph 6(1)(f) applies unless the contrary can be established. Such a plan will be considered to exist where, for example, payments under the plan are to commence only when sick leave credits are exhausted or where benefits are subject to reduction by the amount of any wages or wage loss replacement benefits payable under other plans. A supplementary unemployment benefit plan, as defined in subsection 145(1), is not considered to be a plan to which paragraph 6(1)(f) applies.

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.

8. An employer may contribute to separate plans for different classes or groups of employees. For example, there may be one plan for clerical staff and another plan for administrative staff. Each plan will be recognized as a separate plan. In other circumstances, an employer may have one plan that provides for short-term sickness benefits and another plan that provides for long-term disability benefits. Each such plan normally would be considered a separate plan for all purposes but, if desired, they may be treated as one plan provided they comply with the following conditions:

(a) the same classes of employees are entitled to participate in both plans, and

(b) the premiums or other cost of each plan is shared in the same ratio by the employer and the employees.

9. An association of employers, or a health and welfare trust that is organized and managed by or on behalf of both employers and employees in a certain industry, may establish a plan with an insurer that is available to all employer-members. In these circumstances, if there is one insurance contract between the insurer and the association of employers or the health and welfare trust and the contract was entered into after June 19, 1971, there is considered

to be one plan. Where employees contribute to the cost of benefits provided by a health and welfare trust, see paragraph 6 of IT-85R regarding the amount that may qualify as an employee's contribution for purposes of subparagraph 6(1)(f)(v). For plans that existed prior to June 19, 1971 see paragraph 7 of IT-54.

10. Where the nature of employment in a particular industry is such that it is usual for employees to change employers frequently (e.g. the construction industry) and the continuity of wage loss replacement benefits can be assured only if such benefits are provided under a plan administered by a union or a similar association of employees rather than directly by the various employers, the arrangement between the participating employers and the organization representing the employees is viewed as a single wage loss replacement plan.

Lump-sum Payments

11. If a lump-sum payment is made in lieu of periodic payments, that amount will be considered to be income under paragraph 6(1)(f).

12. Some contracts of employment may provide for payment of periodic benefits to employees in respect of loss of income due to disability and may also provide that employees will receive a lump-sum payment on retirement, resignation or death based on the value of unused sick leave credits accumulated under that plan. Even though these separate arrangements may be jointly funded by employer-employee contributions, it is the position of the Department that such lump-sum payments are not a periodic payment under a wage loss replacement plan to which paragraph 6(1)(f) applies but are taxable in the employee's hands by subsections 5(1) and 6(3) as remuneration received by them pursuant to their contract of employment. To the extent that a part of the lump sum payment has been funded by employee contributions not deducted by the employee under subparagraph 6(1)(f)(v) in computing the portion of amounts taxable under paragraph 6(1)(f), the accumulated employee contributions in respect thereof (but not any interest credited thereon) would represent a return of capital to employees and need not be included as part of the taxable lump sum payment.

Employee's Contribution

13. Employee contributions that are deductible under subparagraph 6(1)(f)(v), are restricted to those that were made to the particular plan from which the benefits were received. Thus, if an employee changes employment and becomes a beneficiary under the plans of the new employer, the employee may not deduct the contributions made during the previous employment from benefits received from the new employer's plan. For this purpose, a change in employment is not considered to take place where an unincorporated business is incorporated or where there has been a merger or amalgamation. Also, the continuity of an existing plan is generally not affected by internal alterations in the plan, such as a change in the insurer or an improvement in benefits. However, for purposes of section 19 of ITAR, an increase in benefits after June 18, 1971, in a pre-June 19, 1971 plan may be viewed as the creation of a new plan as indicated in paragraph 4 of IT-54. On the other hand, where an employee, because of a promotion or job reclassification, is moved from one of his employer's plans to another, such as a move from the "general" plan to the "executive" plan, contributions to the former plan would not be deductible in respect of benefits received from the latter plan.

Employer's Contributions

14. For benefits received by an employee under a wage loss replacement plan to be subject to tax in his hands under paragraph 6(1)(f), the plan must be one to which the employer has made a contribution out of his own funds. An employer does not make such a contribution to

a plan if he merely deducts an amount from an employee's gross salary or wages and remits the amount on the employee's behalf to an insurer. In these circumstances, the employee's remuneration for tax purposes is not reduced by the amount withheld and remitted by the employer to the insurer. Where the employer has made an actual contribution to a plan, paragraph 6(1)(a) provides that it is not to be included in the income of the employees if the plan is a "group sickness or accident insurance plan". It is considered that this exemption in paragraph 6(1)(a) applies to any of the three types of plans mentioned in paragraph 6(1)(f), provided that they are group plans.

15. If an employer should have a plan that is in part a wage loss replacement plan and in part a plan that provides for other types of benefits, the employer must be prepared to identify that part of any premiums paid by him, or other contribution by him to the plan, that relates to the other types of benefits included in the plan and, similarly, the part of the employees' contributions, if any, that relate to the wage loss replacement part of the plan. This information is required to determine whether the wage loss replacement plan is one to which the employer has contributed and the relevant amount of an employee's contribution for purposes of subparagraph 6(1)(f)(v).

Employee Pay-All Plans

16. An employee-pay-all plan is a plan the entire premium cost of which is paid by one or more employees. Except as indicated under 21 below, benefits out of such a plan are not taxable even if they are paid in consequence of an event occurring after 1973, because an employee-pay-all plan is not a plan within the meaning of paragraph 6(1)(f).

17. It is a question of fact whether or not an employee-pay-all plan exists and the onus is generally on the employer to prove the existence of such a plan. It should be emphasized that the Department will not accept a retroactive change to the tax status of a plan. For example, an employer cannot change the tax status of a plan by adding at year end to employees' income the employer contributions to a wage loss replacement plan that would normally be considered to be non-taxable benefits. On the other hand, where an employee-pay-all plan does, in fact, exist and it provides for the employer to pay the employee' s premiums to the plan and to account for them in the manner of wages or salary, the result is as though the premiums had been withheld from the employee's wages or salary. That is, the plan maintains its status as an employee-pay-all plan if the plan provided for such an arrangement at the time the payment was made.

18. If, under a wage loss replacement plan, the employer makes contributions for some employees, but not all, the plan will not be considered to be an employee-pay-all plan even for those employees who must make all contributions themselves. It is the Department's view that all payments out of a wage loss replacement plan to which the employer has contributed are subject to the provisions of paragraph 6(1)(f) regardless of the fact that the employer's contributions may be on account of specific employees only.

19. Where the terms of a plan clearly establish that it is intended to be an employee-pay-all plan, the plan will be recognized as such even though the employer makes a contribution to it on behalf of an employee during an elimination period (i.e. the period after the disability but before the first payment from the plan becomes due). During this period normally there would be no salary or wages from which the contribution could be deducted. Any amount so contributed by an employer should be reported as remuneration of the employee on whose behalf it was contributed in order to maintain the employee-pay-all character of the plan.

20. Where an employer pays, on behalf of an employee, the premium under a non-group plan that is

(a) a sickness or accident insurance plan,

(b) a disability insurance plan, or

(c) an income maintenance insurance plan,

the payment of the premium is regarded as a taxable benefit to the employee. The payment by the employer is not viewed as a "contribution" by the employer under the plan, and paragraph 6(1)(f) does not apply to subject to tax in the employee's hands any benefits received by him pursuant to the plan.

21. Whether or not the benefits an employee receives under a plan are required to be included in his income is governed both by the type of plan in effect at the time of the event that gave rise to them and any changes in the plan subsequent to that time. When a pre-June 19, 1971 plan, or an employee-pay-all plan, is changed and becomes a new taxable plan, an employee who was receiving benefits at the time of the change may continue to receive them tax-free thereafter but only in the amount and for the period specified in the plan as it was before the change. Where the new taxable plan provides any increase in benefits, whether by increases in amounts or through extension of the benefit period, the additional benefits must be included in income since they flow from the new taxable plan. Where an employee is receiving benefits under a taxable plan at a time when it is converted to a new employee-pay-all plan, the benefits he continues to receive subsequent to the date of conversion, to the extent that they were provided for in the old plan, will remain of an income nature because they continue to flow from the old taxable plan.

Claimant's Survivors

22. If the payment of wage loss replacement benefits should continue after the death of an employee who was receiving such benefits, paragraph 6(1)(f) is not applicable to such benefits paid to the widow or other dependent for the reason that the amounts received do not relate to a loss of income from an office or employment of the recipient. Such payments, however, may be viewed as being received in recognition of the deceased employee's service in an office or employment and be included in income as a death benefit if they exceed the exemption provided in subsection 248(1).

Information Returns

23. Paragraph 200(2)(f) of the Income Tax Regulations stipulates that every person who makes payments pursuant to a wage loss replacement plan is required to file Form T4A information return. The law does not require that income tax be deducted from such payments.

U.I.C. Employee Premium Rebate

24. A wage loss replacement plan may qualify the employer for a reduction in unemployment insurance premiums under subsection 64(4) of the Unemployment Insurance Act, 1971. This subsection also provides that five-twelfths of any such reduction must be used by the employer for the benefit of his employees. The benefit may be conferred directly by the employer, indirectly through an employees health and welfare trust or in any other manner, but it will only be tax-free in an employee's hands if it is conferred in the form of a benefit specifically exempt from taxation by paragraph 6(1)(a).

Computation of Benefit

25. The following is an example of the computation of the amount of payments received under a wage loss replacement plan that is included in income pursuant to paragraph 6(1)(f):

Assume:

(a) Employee's contributions (in addition to employer's contributions)

Year	Amounts	Cumulative Balance
1968-71	$ 110 per annum	$ 440
1972	120	560
1973	140	700
1974	140	840
1975	140	980
1976	140	1120
1977	160	1280
(b) Payments received		
1972	$ 200	$ 200
1973	300	500
1974	240	740
1975	1000	1740
1976	100	1840
1977	1000	2840

(c) The plan was in existence prior to June 19, 1971 and remains unchanged.

(d) The payments received out of the plan in 1974, 1975, 1976 and 1977 are as a result of events occurring after 1973.

Amount Included in Income:

1972 and 1973 -
none of the payments received are income because of section 19 of the ITAR

1974 - lesser of:

a) payments received in 1974			$ 240
b) aggregate of payments received after 1971	$ 740		
less:			
aggregate of contributions made after 1967	840	NIL	
amount to be included under paragraph 6(1)(f)			NIL

1975 - lesser of:

a) payments received in 1975			$1000
b) aggregate of payments received after 1971	$1740		
less:			
aggregate of contributions made after 1967	980	760	
amount to be included under paragraph 6(1)(f)			$ 760

1976 - lesser of:

a) payments received in 1976			$ 100
b) payments received in 1976	$ 100		
less:			
contributions made in 1976	140	NIL	

amount to be included under paragraph 6(1)(f)			NIL
1977 - lesser of:			
a) payments received in 1977		$1000	
b) payments received since the most recent year during which a benefit was taxable under this provision (1975)	$1100		
less:			
contributions made since 1975	300	800	
amount to be included under paragraph 6(1)(f)			$ 800

Date Modified: 2002-09-06

This is Exhibit "L" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Jamieson.
613-730-8000
Barrister + Solicitor.

tends to reflect a reporting lag of roughly one month between the date of death and the date the claim is filed with the insurance company. If the Group Life contract includes an insured disability premium waiver provision, the IBNR would tend to be much higher. By contrast, the IBNR under an LTD contract with a six-month elimination period would be in the order of 50% to 60% of premium. The insurance company may be willing to reduce the IBNR requirements or eliminate the reserve from the annual accounting if the plan sponsor is willing to delay the financial reconciliation to allow the late-reported claims to flow through the account.

Waiver of Premium Reserve

Waiver of premium reserves are held under Group Life insurance contracts in which the plan sponsor has insured the continuation of coverage for disabled lives without future payment of premium. Despite the term "waiver of premium", the reserve is not based on the future value of the premiums being waived on behalf of the disabled individual. Rather, the waiver of premium reserve is based on the discounted value of the death claim, taking into account the probability of recovery, termination, or death and discounting the face amount of the claim for projected interest earnings.

The insurance company remains liable for the death benefit for approved waiver of premium claims beyond the termination of the contract, usually through to age 65. The waiver of premium reserve allows the insurance company to reflect this obligation in the financial accounting before the death claim occurs.

The plan sponsor may choose not to insure the waiver of premium provision, in which case benefit continuation for disabled employees would be conditional on premium continuation. Self-insuring the waiver of premium provision renders the plan sponsor responsible for arranging continued coverage for the disabled individuals in the event the Group Life insurance contract is transferred to another insurance company.

Disabled Life Reserve (DLR)

Under an income-replacement benefit, Disabled Life Reserves (DLR) reflect the obligation of the insurance company for benefit continuation beyond policy termination. Once a claim is admitted and payments commence, the insurance company becomes liable for future benefit payments, usually through to age 65, provided the individual continues to qualify under the terms of the benefit plan. The reserve reflects the present value of future benefit payments and claim-related

expenses, adjusted for mortality and recovery assumptions, and discounted for projected interest earnings.

Pending Claim Reserve

The pending claim reserve reflects the present value of disability claims that were submitted before the end of the accounting period but have not yet been approved for payment. The insurer generally multiplies the DLR for these pending claims by a percentage factor to reflect the uncertainty around approval of the claim.

Claims Fluctuation Reserve (CFR)

Claims Fluctuation Reserves (CFR), also known as Rate Stabilization Reserves (RSF), reflect funds that are established typically from surpluses arising from the financial accounting of the plan and held by the insurance company. By withholding a portion of the surplus against future deficits, the insurance company is protecting itself against the contingency the plan sponsor will terminate the relationship while the account is in a deficit position. In consideration of a CFR, the plan sponsor should expect a reduction in any risk and cost of capital/return on equity charges levied by the insurance company. Amounts held may vary depending on the insurance company but are usually limited to 25% of annual premium for tax reasons.

Insurance Companies

Selecting an Insurance Company

Whether the role of the insurance company is to insure the benefit or to pay claims on an ASO basis, the selection of the right insurance company and the establishment of a good ongoing relationship is a factor in the success of the benefit plan. The same applies if retaining more than one insurance company, either for different benefits or for different employee groups. Similar principles apply in the selection of a third-party administrator other than an insurance company.

A plan sponsor may have one reason, or a combination of reasons, for inviting proposals from other insurance companies. Periodically marketing a benefit program allows the plan sponsor to determine whether the costs charged by the insurance company are competitive, and to confirm that the services offered by the insurance company meet with current needs and expectations. Reasons for marketing a benefit plan may include:

- Evidence of uncompetitive rates and/or expense costs;

This is Exhibit "M" to the Affidavit of Joann Williams

Sworn Before me this 9th day of August, 2010

A Commissioner, etc.

William Johnston.
613-730-8000
Barrister & Solicitor.

From: Andrea McKinnon <amckinnon@kmlaw.ca>
Date: February 26, 2010 3:13:35 PM EST (CA)
Cc: Susan Philpott <sphilpott@kmlaw.ca>, Mark Zigler <mzigler@kmlaw.ca>, Sue Kennedy <kennedy.robinson@rogers.com>
Subject: RE: CAW Health Care Trust?

Ms. Borenstein:

Ms. Philpott has asked me to forward to you the following response:

There is no agreement yet on the allocation of the assets in the Health and Welfare Trust. **There are assets in the Health and Welfare Trust that are in the nature of a contingency reserve, which were deposited by Nortel in respect of their obligation to provide life insurance to retirees. These amounts are qualitatively different from the payments for optional life premiums that were collected from individual active employees and used to buy insurance for them while they were employed at Nortel. We understand that at times those optional life remittances were in excess of the premiums required to purchase insurance but in any event, the insurance has been purchased and people who contributed are/were covered for the periods that they were employed. The obligation to provide those individuals with life insurance ends with their employment, while the obligation to provide a life benefit to pensioners does not end. The pensioners who are entitled to life insurance coverage are entitled to it for their lives (though the face value of the coverage depreciates over time). The contingency reserve in the Health and Welfare Trust is the money that was put aside to pay for that.**

As you know, one of the areas that your Representative and her advisors are exploring is the possibility of replacing medical coverage for both disabled employees and pensioners by using the dividend on those claims that are received through the claims process. The rationale behind including the disabled employees and the pensioners is the concern that disabled employees may not otherwise be in a position to replace their coverage due to their medical conditions. Placing them in a group with a large number of others dilutes the risk to the insurance company and makes the coverage viable. Ms. Kennedy's request for your input, and the input of her other constituents, was designed to elicit feedback on this concept. The concept, however, is far from a concrete formulation and will be discussed over the next few months. Your further input will be solicited as appropriate. There is no plan, however, as you say, to "recover retiree life insurance and LTD medical and dental from the assets in Nortel's Health and Welfare Trust and then [use them] to fund a new Health and Welfare trust with the NRPC, or the Canadian Auto Workers brand new Healthcare Trust (sic)"...

Regards,

Susan Philpott

This is exhibit "N" to the Affidavit of Joann Williams

Sworn before me this 9th August, 2010

w/a

Commissioner of Oaths.

William Johnston
613-730-8000.
Barrister Solicitor.

DISABLED EMPLOYEES PROGRESS REPORT

THIS REPORT HAS BEEN PREPARED BY KOSKIE MINSKY LLP IN THEIR CAPACITY AS REPRESENTATIVE COUNSEL TO THE NON-CAW DISABLED EMPLOYEES OF NORTEL AT THE REQUEST OF YOUR COURT-APPOINTED REPRESENTATIVE

JUNE 24, 2010

Please Note: A French translation of this document is in progress and will be sent when available.

COURT OF APPEAL UPHOLDS THE SETTLEMENT AGREEMENT

The Court of Appeal for Ontario released its decision on June 3, 2010, dismissing an application for leave to appeal the decision of the Ontario Superior Court of Justice upholding the Settlement Agreement that was executed on March 30, 2010. The Settlement Agreement secures the continuation of your medical and life insurance benefits, and long-term disability income benefits, through 2010.

Background: On March 31, Mr. Justice Morawetz of the Ontario Superior Court of Justice approved the Agreement, which was the product of lengthy negotiations among Nortel, the Monitor, Representative counsel, court-appointed Representatives, and other creditors, and was subject to two hearings before Justice Morawetz. The first court hearing was held March 3 - 5, and the second was held on March 31, 2010. Reasons for Decision were released on April 8. We have reported to you before about the Settlement Agreement, and you can view an executed copy of it in the Forty-Second Report of the Monitor, which is located on the Monitor's website at www.ey.com/ca/nortel.

Leave to Appeal: A small group of individuals receiving long term disability benefits sought leave to appeal the March 31 decision and the Court of Appeal denied leave on June 3, 2010. This means that there will be no appeal before the Ontario Court of Appeal and the Settlement Agreement and its approval are effectively final. In its decision, the Court noted that the objecting group failed to demonstrate that they had been subjected to procedural or substantive unfairness. The Court concluded that the motions judge exercised his discretion to carefully balance the interests at stake, and made no demonstrable error in doing so. Previously, the Court of Appeal also dismissed a motion by the same group of objectors who sought to consolidate the leave application with the proposed appeal (leave for which has now been denied).

The full text of the March 26 (Ontario Superior Court of Justice), April 8 (Ontario Superior Court of Justice) and June 3 (Ontario Court of Appeal) decisions are available at www.kmlaw.ca.

Please note: As a result of the Settlement Agreement, LTD income benefits, health & dental benefits and life insurance will continue to be paid in full until December 31, 2010. The Settlement Agreement also requires the wind up and distribution of the assets of the Nortel Health and Welfare Trust (HWT) by December 31, 2010. Disabled employees will receive a portion of those assets. Further information about this process is set out below.

NEXT AREAS OF FOCUS

Now that the Settlement Agreement has been approved, your Court-Appointed Representative and Representative Counsel, along with other parties, are focusing on the following important areas:

1. Finalization of a Compensation Claims Procedure;
2. Allocation and Distribution of Assets in the Health and Welfare Trust; and
3. Pension Plan issues.

1. COMPENSATION CLAIMS PROCEDURE

Discussions to finalize the Compensation Claims Procedure continue and the legal, actuarial and procedural details are the current focus. Your actuaries (Segal Company) and lawyers (Koskie Minsky) are advising the court-appointed Representative. All calculations and assumptions are subject to the approval of your actuaries. Koskie Minsky will also review and approve the actuarial approach, the determination of claims, and all of the related documentation and information. Although it was originally hoped that we would be before the court in June 2010 to obtain court approval of a Compensation Claims Procedure, there have been a number of unexpected events (including protracted proceedings about the Settlement Agreement) which have caused delays. We now anticipate being before the Court on this issue in September 2010.

The anticipated process: Before claims are finalized you will receive written notice of your individual claim amounts and will have an opportunity to review the data relevant to your claim, such as your date of employment, age and your salary prior to going on LTD. The package that you receive will explain the process, how your claim was calculated, and will detail each of your claims. You will not have to file your own claim - Koskie Minsky will do that for you. If something is missing from your claim, you will have an opportunity to provide information about it.

As a disabled employee, you will have a claim for all benefits to which you are entitled from Nortel and have lost (or will lose), including LTD income benefits, health, dental and life insurance benefits, future pension accruals, and severance pay. Depending on your circumstances, you may also have a claim for Transitional Retirement Benefits and Excess Pension Plan benefits. The contents of the notice, the calculation assumptions and methodologies, and the process will be subject to the court's approval before you receive your claims package.

Once all claims against the Canadian Nortel entities have been received, approved and tallied, and once the total assets available to the Canadian estate have been determined, there will be a distribution of assets. You will receive a percentage of your total entitlement on a pro rata basis with all other unsecured creditors of Nortel. All unsecured creditors will receive the same percentage recovery. The level of claims recovery from the Nortel estate is unknown at this time and no distribution is anticipated before 2011.

However, as we have explained in prior communications, as a beneficiary of the HWT, you will receive a portion of the assets of the HWT, and we expect that allocation to take place before the end of 2010. More information about that process can be found at Section 2 below. You should be aware, however, that if there is significant litigation among Trust Beneficiaries regarding the allocation of the money in the HWT,

this might delay the allocation, as well as decrease the amount of money in the trust, as the costs of the litigation come out of the Trust Assets.

Who has a claim for the shortfall in the pension plan?

Nortel's pension plans are underfunded and a "placeholder" claim has already been filed in the regular claims process by the pension plan administrator. Nortel, as the plan sponsor, is obligated under the applicable pension legislation to fully fund its pension plans if they are terminated, which is the basis for the claim. The claim will not be made by individuals because the deficit affects everyone in the plans, and individual losses depend entirely on the level of the deficit. Recoveries on this claim will be paid in to the pension plans.

The plans will eventually be terminated, but it is not yet known when, or what the value of the pension deficit claim is, and it may not be known for some time as the future of the pension plan is thus far uncertain. Your pension will not stop but may at some point be reduced. The deficit changes daily as it reflects the difference between the value of the liabilities (or total accrued benefit obligations) and the value of the assets at any given point in time. These amounts change with the markets and other factors.

2. UPDATE ON HEALTH AND WELFARE TRUST

Discussions to determine the proper allocation and achieve a distribution of the assets in the HWT are ongoing with the Company and the Monitor. All historical documents are being gathered and analyzed, and an application will be brought before the Court as soon as possible, with the goal of achieving a distribution of the HWT before the end of December 2010. Directions will be sought from the Court on the allocation of HWT assets, which were approximately $80 million at December 31, 2009. Your court-appointed Representative has requested and received access to historical documents and financial reports from the HWT (we are pressing for more public disclosure of them), and with actuarial and legal advice, is working towards a court-ordered distribution that protects disabled employees in accordance with the terms of the trust documents. The liabilities exceed the assets and accordingly, this distribution will replace only a portion of the lost future benefits that were historically paid from the HWT. (the present value of all future benefit obligations of Nortel under the HWT will be determined by mutual agreement of our actuaries and those retained by Nortel.) The balance of the present value of your lost future benefits that are not paid out of the HWT assets will form part of your claim against the Nortel Estate.

We hope to be before the Court on this issue by the end of September 2010. At a minimum, additional documentary disclosure about the HWT will be provided as part of any motion to determine its allocation and distribution, however we are pressing for earlier disclosure. All of the stakeholders are aware of the need to have this matter dealt with promptly so that there is a source of income for disabled employees after December 31, 2010.

Who has a claim for the shortfall in the Health and Welfare Trust?

The Trustee of the HWT has filed a "placeholder" claim against Nortel for the shortfall in the HWT because Nortel is ultimately responsible under the Trust Agreement to fund the benefits on termination of the HWT. A claim will also be made on behalf of individual beneficiaries for the loss of their benefits that

were historically provided from the HWT. These two claims are duplicative and will not be paid twice, but have been filed this way in order to ensure that no part of the claim is lost.

Are there ongoing discussions surrounding the possibility of medical coverage past December 31?

Yes. As you know, Nortel will cease to pay your health and dental benefits on December 31, 2010. Your Representative and her Steering Committee, the Nortel Retiree and Former Employee Protection Committee (the "NRPC"), Representative Counsel and their advisors are looking into options to provide some form of ongoing medical coverage post-December 31, 2010, but no decisions have been made at this point. Many people with disabilities have high medical expenses and would be unable to qualify for private health insurance plans because they are already disabled. Our hope is to try and secure some level of benefits from future recoveries against Nortel if it is possible and can be done at a reasonable cost. There may also be an option to convert current group coverage to individual coverage with Sun Life. We are still seeking concrete information from Sun Life in this regard. At some stage, your Representative and/or the CNELTD Steering Committee will be collecting information from the CNELTD membership. More information about this issue will be provided as it becomes available.

Are there ongoing discussions regarding the possibility of replacement life insurance and/or conversion of group life insurance after coverage ends on December 31?

Yes, we are determining what options are available to convert your life insurance to an individual policy after December 31, 2010. However, it should be noted that this option could be cost-prohibitive for many, and may be too expensive to pursue. If there is no replacement life insurance established, or if conversion options are too expensive, individuals will still have a claim against the Nortel Estate for lost life insurance coverage and will receive a pro rata cash distribution through the claims process.

3. UPDATE ON PENSION PLAN ISSUES

In accordance with the Settlement Agreement, Nortel will continue the current service funding of its Defined Benefit pension plans until the end of September 2010, and pension accruals for disabled employees will continue until then.

Defined Contribution pension plan members will benefit from the continuation of pension accruals until at least the end of September 2010. Nortel's Defined Contribution plans will change as of September 30, 2010 and the Monitor and company are currently examining options for the Defined Contribution pension plan after September 30, 2010. We will advise as to whether and how your pensions will accrue during the period between October 1 and December 31, 2010 as soon as we have the information.

If you have questions about your individual pension and/or retirement please contact the following:

Defined Benefit Plan Members
Mercer -1.866.667.8358

Defined Contribution Plan Members
Sun Life - 1.866.733.8612

For Defined Benefit plan members, it may be possible to obtain information from Mercer concerning your eligibility for early retirement with an unreduced or reduced pension. Further, annual pension statements, which will identify your accrued pension to date, will be mailed out to all employees by Mercer shortly.

What will happen to the Defined Benefit pension plan on September 30?

In accordance with the Settlement Agreement, Nortel will cease to administer its pension plans as of September 30, 2010. In the normal course, an administrator will be appointed by the Financial Services Commission of Ontario ("FSCO") on September 30, will become responsible for the administration of the Plans, and will determine and conduct the wind-up of the Plans.

However, you should be aware that the Representatives of the NRPC and their advisors are exploring alternatives to a conventional pension plan wind-up and are seeking support from the Government. In a normal wind-up scenario, the wind-up administrator takes over administration of the plan, determines whether reductions in pensions-in-pay to reflect the funded ratio are appropriate, sets a wind-up date, instructs the actuaries to prepare a wind-up report, makes an application for PBGF payments, and once the liabilities are all known, secures them through group annuity contracts obtained through a public RFP process. Pension-eligible members (including those eligible for reduced or unreduced early retirement) may start their pensions during wind-up with Regulator and administrator approval.

How long will a pension plan wind-up take?

Pension plan wind-ups can take years, even when straightforward. Nortel's pension plan wind-up, when it occurs, will be complicated. This will be a lengthy process. We will continue to provide progress updates in the future.

What happens to my pension if there is a plan wind-up?

Individuals who are retirement eligible will have the option to retire and to begin to collect a pension. Eligibility for retirement with a reduced or unreduced pension must be determined on an individual basis. If you wish to determine whether you are eligible to start receiving a pension under the Defined Benefit plan, please contact Mercer at 1.866.667.8358.

What happens if I am not yet pension eligible when there is a plan wind-up?

LTDs who are not entitled to an immediate pension will choose between:

- Lump sum commuted value transfer (to be transferred into a locked-in retirement vehicle); or
    - Please note: amounts in excess of *Income Tax Act* (Canada) limits must be taken in cash and will be subject to income tax.

- Annuitized pension / annuitized deferred pension (depending on your age and eligibility for retirement).

Retirement: When Should the Process Be Initiated?

In accordance with the Settlement Agreement, long-term disability income benefits will continue to be paid by Nortel until December 31, 2010. Provided you are still in receipt of long-term disability income benefits at the time of the valuation of your claim against Nortel, you will have a claim for the value of your future income benefits up until age 65 (among other claims). To ensure that you receive a distribution from the Health and Welfare Trust and from Nortel's estate for the future amounts to which you are entitled as a disabled employee, you may wish to consider waiting until after the valuation of your claim (the valuation date will be determined as part of the compensation claims process) and at the very least, until after December 31, 2010. If you reach age 65, you may have no choice but to take your pension because your disability payments are not payable after age 65. Others who are entitled to an unreduced pension should seek advice as to the optimum time to retire. We do not yet have information about the details concerning how to initiate the retirement process after December 31, 2010. You will be advised as more details become available.

How will the PBGF benefit me?

Nortel's Defined Benefit plans are underfunded. The last actuarial calculation, as at December 31, 2008, indicated that the plans were funded at a level of approximately 69%. A new actuarial valuation, with funding levels as at December 31, 2009, currently is being prepared. This document must be filed by September 30, 2010.

If you worked in Ontario, Ontario's Pension Benefit Guarantee Fund (the "PBGF") will top up the first $1,000 of monthly pension for service that accrued while employed in Ontario. For example, assume you are entitled to a monthly pension of $2,000 but that at the date of wind-up, the pension plan is funded at 70%. The first $1,000 of your pension will be topped up by the PBGF such that it will paid in full ($700 through the funds in the pension fund and $300 by the PBGF). The remaining $1,000 of your pension will be paid at the 70% value. Therefore, your total pension payment would be $1,700 as opposed to the $1,400 level you would receive if there was no PBGF, and the $2,000 level you would receive if there was no funding deficiency on plan wind-up. If you did not work in Ontario for your entire career, only the portion of your pension which was accrued in Ontario will be subject to the PBGF.

The key for the PBGF is in which province you accrued service. In preparation for this stage, please check your records to confirm how long you worked in each province. Please do not forward this information to KM or the CNELTD, simply keep it for your records for now, and we will ask for it if we need it.

STATUS UPDATES

HEALTH AND WELFARE TRUST CRA ADVANCE RULING SUBMISSIONS

Tax counsel for various parties have been involved in discussions for several months, and are now in the final stages of preparing written submissions, concerning an advance ruling as to the taxability of funds to be distributed to you from the Health and Welfare Trust. The CRA's decision on this issue will affect individuals who are entitled to a distribution from the Health and Welfare Trust, particularly with respect to disability and survivor income benefits and retiree life insurance. We anticipate that the final written

submissions will be filed with the CRA before the end of June. We are uncertain how long it will take the CRA to make its decision on the taxability of the various amounts to be distributed, however, we will advise on the KM website and through written correspondence as developments occur.

CANADA REVENUE AGENCY TAX ISSUES

Over the past several months, parties have been seeking to resolve a number of tax issues that have arisen during Nortel's CCAA proceedings, which has led to a dialogue with the Canada Revenue Agency (the "CRA"). The CRA has been provided with written submissions on the following three tax issues:

- Foreign Service Earnings issue, which concerns Nortel's historical practice of including foreign service earnings for the purpose of pension benefit calculations;
- Pension Adjustment Reversals ("PAR") which deals with restoring RRSP contribution room lost by terminated members who received a reduced CV transfer from Nortel's pension plans; and
- Tax on cash payments of the commuted value of registered pensions.

The CRA is now actively studying these issues and we expect a reply in the coming weeks. While the CRA continues to express a willingness to consider potential solutions, we cannot provide you with further information until such time as the CRA completes its analysis and provides us with its position. We will advise on these issues as soon as possible.

UPCOMING WEBCASTS

There have been no new webcast dates confirmed at this time. Please watch the KM website's "Latest Development" section for announcements concerning future webcasts.

SUN LIFE ANNUITY DECISION

On June 4, 2010 the Ontario Superior Court of Justice granted an order related to the Former Employee group, which requires Nortel to assign certain annuity contracts to retirees who are listed as annuitants on the documentation at issue. Subsequent to Nortel's CCAA filing, trust issues arose surrounding who was the legal owner/beneficiary of certain annuity contracts. These annuities were purchased by Nortel to benefit individuals at the date of their retirement with funds the individuals had accumulated towards various deferred compensation/retirement arrangements during their years of employment. A motion to address this issue was heard by the Honourable Mr. Justice Morawetz in November 2009. A decision in favour of the affected retirees was released on June 4, 2010 and we expect Reasons for Decision to be released shortly.

STAY OF PROCEEDINGS / HARDSHIP APPLICATION PROCESS

The Court granted an extension of Nortel's stay of proceedings in Canada until July 22, 2010. The Court also extended the Employee Hardship Process until July 22, 2010. Payments under this process are simply an advance on claims payments. Please note that Disabled Employees are not eligible for the Hardship Application Process. In the future, we may look at options to create a hardship process that would apply to Nortel's disabled employees. We will keep you apprised of developments.

ONGOING ASSET SALES / RESOLUTION OF INTELLECTUAL PROPERTY ISSUES

Many of the major asset sale transactions have been completed, however, there are still transactions to be effected in the future. Determination of intellectual property issues and valuation of patents are underway, however, this is a lengthy process and there has been no determination yet as to what form a recovery of the IP value will take, but maximization of the benefit to all creditors is the goal. KM and financial advisors, Richter, continue to represent the disabled employee constituency on these issues. The Monitor is aware of our interests and is negotiating, in consultation with our groups, to protect and promote the interests of all Canadian stakeholders. You will be advised of developments.

CONTACT INFORMATION

If you have an inquiry, or wish to speak to your Representative Counsel, please contact KM by email at nortel@kmlaw.ca or by calling our toll free hotline at 1.866.777.6344. For more information, please visit our website at http://www.koskieminsky.com/Case-Central.

Disabled Employees who have questions or wish to join the CNELTD group should send an email to SteeringCommittee@cneltd.info.

For access to a variety of information pertaining to Nortel's CCAA proceedings, including public Court documents and all Monitor's Reports, please visit the Monitor's website at www.ey.com/ca/nortel.

This Update has been sent to all Nortel LTD recipients, including those represented by the CAW-Canada, which has reviewed this Update. If you are a CAW member, you should direct any questions regarding this Update to the legal representative for the CAW – Barry Wadsworth, Associate Counsel, at (416) 495-3776 or by e-mail to michelle.bondy@caw.ca.

Court File No.: 09-CL-7950

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

PROCEEDING COMMENCED AT
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