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I am an actuarial advisor to a group of disabled former Nortel employees who were, until recently, receiving their monthly income payments from Nortel's Health and Welfare Trust (the Nortel HWT). As far as we know, Nortel has always intended the Nortel HWT to comply with the *Income Tax Act (Canada)* (the ITA) and the published interpretations of the ITA by the Canada Revenue Agency (CRA). From the disclosed Nortel HWT tax filings for 2005 to 2009 and what we are told by the Nortel long term disability income recipients, it appears that benefits and investment income have been taxed in accordance with applicable CRA policy. We presume, but are unable to confirm, that Nortel has deducted all of its contributions to the Nortel HWT for tax purposes, as business expenses in the same year as they were paid into the fund.

As you may know, the Nortel HWT will be wound up in a deficit position and therefore the proper distribution of assets has become an issue. It is proposed to disburse assets in proportion to liabilities in respect of certain "participating" benefits. The liabilities being used for this purpose **include provision for future life insurance payments to pensioners**. That is, living pensioners are being allocated monies from the HWT to satisfy Nortel's promise to pay death benefits to employees who are said to have vested claims. It is our understanding, however, that HWTs may only consist of group term life insurance policies. This accords with Interpretation Bulletin IT-85R2, titled *Health and Welfare Trusts for Employees*, which provides that **HWTs are not permitted to comprise of permanent life insurance policies**. **In addition**, Nortel's Ruling Request Letter dated December 16, 1979 and the Revenue Canada Ruling dated December 28, 1979 specifically provided that the funding arrangement for the Group Life Insurance Plan (Part I – Basic)<sup>1</sup> would be for Nortel to make contributions to the HWT sufficient to pay **premiums**. The 1979 tax ruling makes clear that **only premiums** would be paid

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<sup>1</sup> The Pensioners and Active Employees were both covered by one Umbrella Group Term Life Insurance Policy, referred to as Group Life Insurance Plan – Part I.

from the HWT. Despite this, money is being allocated from the HWT to pay death benefits to living pensioners.

The now approved allocation is diverting a significant proportion of HWT assets away from benefits related to previously incurred disability claims to pay for benefits that have not as yet been incurred and which cannot comprise valid HWTs. It is our contention that only previously incurred claims for benefit plans permitted within HWTs should be considered liabilities on wind up of the Nortel HWT, as only these may be funded on a tax-deductible basis. In accordance with subparagraph 18(9)(a)(iii) of the ITA, **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.**

Notwithstanding this prohibition, Nortel has historically kept a notional account for these future life insurance premiums, known as the Pensioners' Insurance Fund (PIF), within the Nortel HWT. We believe that this accounting should not be relevant on wind up of the Nortel HWT, because it is not possible for a valid HWT to hold assets for this purpose. In any event, Nortel was **required** pursuant to the Nortel HWT Trust Agreement and CRA Information Bulletin IT-428 (*Wage Loss Replacement Plans*) to accumulate funds in respect of incurred disability claims. **Nortel was the insurer with respect to these disability income claims and provision should have been made for the orderly funding of disabled life reserves.** Despite the requirement for sound actuarial funding, the value of assets allocated to this purpose is woefully deficient.

We believe that the actual distribution of assets to the pensioners for death benefits may disqualify the Nortel HWT as a *bona fide* Health and Welfare Trust for tax purposes. The proposed HWT payments to pensioners as settlement for future death benefits represent neither legitimate HWT benefit payments, nor surplus. Clearly tax will have been improperly deferred on any lump sum distributions to pensioners at the HWT's wind-up.

As you may know, the Ontario Superior Court has not supported our interpretation that the pensioners are not appropriate beneficiaries of the Nortel HWT in respect of life insurance benefits or future life insurance premiums. Our group has also been denied leave to appeal to the Court of Appeal of Ontario. However, it would be appropriate, in my opinion, for the CRA to issue an opinion or ruling addressing the status of the proposed payments to pensioners and the consequences of making such payments.

I cannot stress enough the importance of this issue to the Nortel disabled group. The HWT distribution that the court has now condoned is not compliant with the ITA or CRA's interpretations thereof and it will needlessly leave these people in poverty.

Beyond the significance to the Nortel disabled, I believe clarity is required for the benefit of actuaries, tax advisors and other relevant professionals at large.

I have enclosed copies of the following documents:

1. [Request for Advanced Income Tax Rulings – Northern Telecom Benefit Plans  
December 16, 1979](#)
2. [Reply to Request for Advanced Income Tax Rulings from Revenue Canada  
December 28, 1979](#)
3. [Income Tax Act Amendment S. 18 \(9\) \(a\) \(iii\) Dec. 11, 1979](#)
4. [Trust Agreement as at January 1, 1980 between Northern Telecom Limited  
and Montreal Trust Company](#)
5. [Affidavit of Joann Williams – August 9, 2010](#)
6. [Affidavit of Joann Williams – September 24, 2010](#)
7. [Affidavit of Jeremy Bell – September 23, 2010](#)
8. [Valuation of Non-Pension Benefit Obligations at December 31, 2010 \(Mercer\)](#)
9. [Appendix UU - Mercers Analysis of the Funding Status of the Pensioners  
Life Insurance Fund as of Jan. 1, 2002](#)
10. [Supplement to Fifty-first Report of the Monitor dated September 17, 2010](#)
11. [HWT Allocation Order dated November 9, 2010](#)

The above documents and many more are available at monitor's website:  
<http://documentcentre.eycan.com/Pages/Overview.aspx?SID=89>

Please let me know if you require anything further. We appreciate your attention to this urgent matter.

Sincerely

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