

Pension and Benefits

This is a summary of Pension and Employee Benefits matters of interest.

Tax Court Releases Precedent Setting Decision on Taxability of Certain Benefit Claims in Nortel Insolvency Proceeding

On November 11, 2017, the Tax Court of Canada released *Scott v. The Queen*, 2017 TCC 224 (CanLII), a precedent setting decision regarding the taxation of payments made in relation to the termination of employment benefits in the context of the Nortel insolvency. The Tax Court “overruled”, in part, an Advanced Tax Ruling issued by the Canada Revenue Agency (“CRA”) relating to lump-sum payments made to former employees in respect of the termination of life insurance benefits. The Court confirmed the CRA’s Ruling with respect to the taxation of payments made for the termination of survivor income benefits. The time in which to appeal these decisions has now passed, with no parties appealing the decision.

The four cases before the Court served as test cases for four different groups of former Nortel employees and beneficiaries who received distributions from the underfunded health and welfare trust (the “HWT”) established by Nortel to provide various employment benefits. The payments at issue in the appeals related to the termination of life insurance coverage and monthly survivor income benefits. Koskie Minsky, serving as Representative Counsel to the pensioners, former employees and long-term disability beneficiaries of Nortel brought the test cases on behalf of approximately 10,000 former Nortel employees and beneficiaries.

The payments were made pursuant to a settlement agreement – approved by the Ontario Court in the insolvency proceeding – in order to compensate for the loss of life insurance coverage and monthly survivor income benefits. The CRA ruled that all of these payments were taxable. Koskie Minsky sought to challenge the CRA Ruling, primarily based on the principle affirmed by the SCC in *Tsiaprailis*, that a payment in settlement of a right to receive future benefits is in the nature of a capital payment and not taxable as income under the ITA. As capital payments, tax should only be payable if the beneficiaries

earned a capital gain.

Notwithstanding *Tsiaprailis* and other SCC decisions on which *Tsiaprailis* relied, the Tax Court held that it was not aware of any authority that would suggest that capital payments are not taxable.

However, the Tax Court held that the lump-sum payments to the former employees whose lives were insured under a group term life insurance policy were not taxable because they did not fall within the scope of subsection 6(4), which imposes tax on life insurance premiums for any time in the tax year when “a taxpayer’s life is insured under a group life insurance policy”. The Tax Court also rejected the Crown’s alternative argument that the payments should be taxed under section 6(1)(a), the catchall provision imposing tax on employment income and benefits. However, the Court confirmed the CRA Ruling with respect to the survivor income benefits, which were taxable as death benefits prior to their termination. The section of the ITA which taxes death benefits is worded much more broadly, and includes in taxation “any amount received . . . on account or in lieu of payment of, or in satisfaction of, . . . a death benefit.” The Court concluded that the language was broad enough to capture any payment in replacement of future survivor income benefits, even if the payment is properly characterized as a capital payment.

As none of the parties are appealing, the way is now clear for thousands of former Nortel employees to recover amounts that were improperly deducted from their claim amounts.

2018 Federal Budget: The Death of Health and Welfare Trusts and Other Items of Interest

The 2018 Federal Budget was released on February 27, 2018, and amongst other things, included a major and somewhat surprising announcement regarding the phase out of the CRA’s Health and Welfare Trust Policy, which has governed health and welfare trusts (HWTs) since 1966.

The announcement was included in the Tax Measures: Supplementary Information document released with the Budget ([see page 28](#)).

The Budget proposes that the CRA will no longer apply its administrative policy with respect to existing HWTs after the end of 2020 and will not apply the administrative policy with respect to any trusts established after Budget Day. The CRA will announce transitional administrative guidance relating to winding up of existing HWTs and the Ministry of Finance will provide transitional rules to facilitate the conversion of existing HWTs to ELHTs.

We knew that the CRA and the Ministry of Finance have been discussing concerns regarding the HWTs rules since the new HWT Income Tax Folio was released in 2015. Each recognized that there was a problem with applying two different sets of rules for what are essentially the same benefit plan vehicles.

While we expected them to address this, we did not think it would happen this quickly. The Ministry of Finance and the CRA teams that worked on this deserve a lot of credit for acting so quickly, particularly given the number of issues they have been dealing with.

We think for most in the benefits industry, particularly for multi-employer benefit plans, this announcement will be welcomed news. In general, the ELHT tax rules are more favourable than the health and welfare trust rules, including greater clarity on surplus, broader scope of tax deductions from the trusts' income, and the ability to carry forward and back non-capital losses.

The change also eliminates the legal limbo in which HWTs have operated since 1966. Apart from the ITA equivalent of a footnote, the Act does not include a single reference to health and welfare trusts. The CRA policy, which is not binding, became very disconnected from the reality of these employee benefit funds and has several gaps, particularly as it applied to multi-employer HWTs.

One of the frustrations with the HWT Folio is that it did not address mergers and transfers between HWTs. The CRA has been reluctant to confirm that such transfers are permissible and hinted that such a transfer may constitute a taxable disposition. In contrast, the ELHT rules include a rollover provision expressly permitting tax free transfers between ELHTs.

Trustees and unions will want to monitor the transitional rules that Finance and the CRA will be developing. The announcement includes an invitation to make submissions during the consultation period which ends June 29, 2018.

We expect to be involved in that consultation process and will be providing updates on the transitional rules.

Other Item of Interest

Other items of interest affecting employee pension and benefit plans included in the 2018 Budget include:

- The government announced the creation of an Advisory Council on the Implementation of National Pharmacare. The recently resigned Ontario Minister of Health, Dr. Eric Hoskins, is appointed as the Chair of the Council that will ultimately recommend options for the implementation of a National Pharmacare program.
- The government will initiate a consultation process to address concerns related to underfunded pension plans, particularly associated with insolvencies such as Sears Canada where “workers and pensioners, who have paid into pension plans over their careers, are faced with unexpected financial losses that impact their retirement security.” The announcement notes, however, that the government is mindful of the “challenges facing courts as they try to maximize recovery in bankruptcies that affect not just workers and pensioners, but also small business, lenders and other creditors which are owed money.” This announcement follows on two private members' bills which sought to address the same issue, which we have **previously written about**.

KOSKIE MINSKY

JUSTICE MATTERS

- The list of eligible Medical Expenses that can be provided by HWTs and ELHTs is expanded to include expenses incurred in respect of animals specially trained to perform tasks for a patient with a severe mental impairment. The coverage only applies to animals that are trained to assist in tasks to cope with their impairment, not for animals that provide “comfort or emotional support”.
 - Proposed amendments to deductions available for employee contributions made to the enhanced portion of the Quebec Pension Plan which are similar to the amendments made for contributions made under the CPP enhancement. This measure kicks in starting in 2019.
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This edition of Pension and Benefits was produced and edited by the following members of the Pension and Benefits Law Group at [Koskie Minsky LLP](#)

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