

An Analysis of the Exemption from Income Tax of Canadian ‘Indians’ either as Individuals or ‘Bands’

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Introduction

Canadian law allows for the exemption from tax of the real and personal property of persons defined in the *Indian Act*, RSC 1985, c I-5 (the ‘*Indian Act*’) as ‘Indians’. Through the case law the concept of ‘personal property’ has been interpreted to include personal income, resulting in the advantage to Indians of enjoying tax free income in certain situations. The relevant provisions of the *Indian Act*, however, confine this exemption to income situated ‘on a reserve’. A further restriction is that the exemption is only available for individuals and Indian ‘bands’ (as defined in the *Indian Act*) so that the exemption is lost when a group of Indians incorporate. The results of these restrictions have serious financial consequences for many Indians and First Nations¹ groups of peoples.

This article examines the jurisprudence that surrounds the exemption from taxation provisions of personal property income under the *Indian Act*. It analyses the case law development and highlights how the exemption has been consistently read down in recent cases, to the detriment of the taxpayer Indian. It also analyses the income tax exemption available to Indians and bands when acting as a public body performing a function of government.

This article is aimed at informing Australian tax academics and policymakers of an approach to tax exemption that has been developed for Canadian Indians and which does not exist for Australian indigenous peoples. It concludes, for reasons which are discussed in the paper, that the Canadian approach has serious limitations as a means of overcoming the past disadvantages of indigenous peoples.

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¹ This term is often used to refer to Canadian Indians, for example section 87 *Indian Act*, RSC 1985, c I-5. Reference is sometimes made to First Nations because the word ‘Indian’ is viewed by many as colonialist and pejorative; however, there is no precise legal meaning for ‘First Nation’. In the United States of America the term used is ‘Native American’.

The *Indian Act* 1876 and onwards

The first *Indian Act* was enacted in 1876. This Act was passed after the majority of Indians living on the Prairies either signed or were in the process of signing treaties with the Federal Government. The Act amended and consolidated previous laws regarding the Indians.² The *Indian Act* was developed in accordance with the *Constitution Act* of 1867, which assigned to Parliament legislative authority over ‘Indians and Land reserved for Indians’.³ The *Indian Act* made Canadian Indians legal wards of the State⁴ and set out the conditions that needed to be met in order for them to be recognised as Indians and for the management of reserve land. There are strict requirements under the *Indian Act* for determination of whether or not a person is an Indian,⁵ the term ‘band’ is defined,⁶ a register of ‘Indians’ is required to be kept under the *Indian Act*,⁷ Indian reserves are defined⁸ and the Act establishes rules for the transfer of an Indian’s property on their death.⁹ The definition of Indians specifically excludes the Inuit people.¹⁰

² L James Dempsey, ‘Status Indian: Who Defines You?’ in Duan Champagne, Karen Jo Torjesen and Susan Steiner (eds), *Indigenous Peoples and the Modern State* (Altamira Press, 2005) 33, 34.

³ *Constitution Act*, RSC 1867, s 91(24).

⁴ Dempsey, above n 2, 33 and 34.

⁵ Section 2 of the *Indian Act*, RSC 1985, c I-5 defines an ‘Indian’ as a person who is registered as an Indian or is entitled to be registered as an Indian under the *Indian Act*. Scholars now argue that this definition and categorisation of ‘Indian’ for Canadian indigenous people negates their indigenous nationhood. Refer, for example Bonita Lawrence, “*Real*” *Indians and Others: Mixed-Blood Urban Native Peoples and Indigenous Nationhood* (University of British Columbia Press, 2004) 37.

⁶ Section 2 defines a ‘band’ as a body of Indians: (a) for whose use and benefit in common, lands, the legal title to which is vested in Her Majesty, have been set apart before, on or after September 4, 1951, (b) for whose use and benefit in common, moneys are held by Her Majesty, or (c) declared by the Governor in Council to be a band for the purposes of this Act.

⁷ *Indian Act* s 5.

⁸ *Indian Act* s 2.

⁹ *Indian Act* s 42.

¹⁰ *Indian Act* s 4.

The *Indian Act* has been amended many times over the years with the most recent consolidation occurring in 1985, although there have been amendments since that date.

Taxation issues: the impact of the *Indian Act* and the treaty rights on taxation

Under the Canadian Constitution the Federal Government is the only entity with the power to enact legislation in respect of Canadian Indians and lands reserved for Indians.¹¹ The Federal Parliament enacted the provisions of s 87 of the *Indian Act*, which exempts real and personal property situated on reserve land from taxation where the owners of the property are either individual Indians or the collective First Nation.¹² This provision predates the first Federal income tax which was not enacted until 1917.¹³

In his book *Indians and Taxation in Canada*,¹⁴ Professor Richard Bartlett traces the origins of statutory tax exemptions for native Indians to an Act of the Province of Canada passed in 1850.¹⁵ Professor Bartlett notes this exemption from taxation remained unchanged until the

¹¹ *Constitution Act*, RSC 1867, s 91(24).

¹² Section 87 states that (1) Notwithstanding any other Act of Parliament or any Act of the legislature of a province, but subject to section 83 and section 5 of the *First Nations Fiscal and Statistical Management Act*, the following property is exempt from taxation: (a) the interest of an Indian or a band in reserve lands or surrendered lands; and (b) the personal property of an Indian or a band situated on a reserve. (2) No Indian or band is subject to taxation in respect of the ownership, occupation, possession or use of any property mentioned in paragraph (1)(a) or (b) or is otherwise subject to taxation in respect of any such property. (3) No succession duty, inheritance tax or estate duty is payable on the death of any Indian in respect of any property mentioned in paragraphs (1)(a) or (b) or the succession thereto if the property passes to an Indian, nor shall any such property be taken into account in determining the duty payable under the *Dominion Succession Duty Act*, chapter 89 of the Revised Statutes of Canada, 1952, or the tax payable under the *Estate Tax Act*, chapter E-9 of the Revised Statutes of Canada, 1970, on or in respect of other property passing to an Indian.

¹³ The *Income Tax War Act 1917* (Ca) 7-8 Geo, c 28.

¹⁴ Richard H Bartlett, *Indians and Taxation in Canada* (University of Saskatchewan, Native Law Centre, 3rd ed, 1992) 1.

¹⁵ Section 4 of this statute, entitled *An Act for the protection of the Indians in Upper Canada from imposition, and the property occupied or enjoyed by them from trespass and injury*, SC 1850, c 74.

passage of Canada's first post-Confederation *Indian Act* in 1876,¹⁶ which effected a comprehensive consolidation of laws respecting Indians.

In order to ensure that s 87 is effective for Federal income tax purposes,¹⁷ there is express provision in the *Income Tax Act* (the ITA) that a party exempt from taxation by an application of another statute is accordingly not subject to taxation under the ITA.¹⁸ Provinces and municipal governments are precluded from imposing taxes on property located on reserves by s 88 of the *Indian Act*.¹⁹

As part of the legislative suite of sections aimed at protecting Indian income and property, the legislature also enacted s 89 of the *Indian Act*, which prevents Indian property from being

¹⁶ Bartlett, above n 14, 128.

¹⁷ In Canada there is also provincial income tax legislation and sales tax.

¹⁸ ITA s 81 (1)(a).

¹⁹ Section 88 of the *Indian Act*: Subject to the terms of any treaty and any other Act of the Parliament of Canada, all laws of general application from time to time in force in any province are applicable to and in respect of Indians in the province, except to the extent that such laws are inconsistent with this Act or any order, rule, regulation or by-law made thereunder, and except to the extent that such laws make provision for any matter for which provision is made by or under the Act.

mortgaged to or charged by non-Indians.²⁰ Section 90 provides that property acquired under treaty is deemed situated on a reserve and is consequently exempt under s 87.²¹

Indian reserves

In order to understand the operation of the exemption under s 87 it is important to be clear on the meaning of the terms ‘reserve’ and ‘band’, which are defined in the *Indian Act*.

A reserve is an area of land set aside for the use of Canadian Indians. Section 2 of the *Indian Act* defines ‘reserve’ as ‘(a) ... a tract of land, the legal title to which is vested in Her Majesty, that has been set apart by Her Majesty for the use and benefit of a band, and ... includes designated lands’. A ‘band’ is also defined in this section and is essentially a body of Indians for whose use

²⁰ Section 89(1):

Subject to this Act, the real and personal property of an Indian or a band situated on a reserve is not subject to charge, pledge, mortgage, attachment, levy, seizure, distress or execution in favour or at the instance of any person other than an Indian or a band.

(1.1) Exception — Notwithstanding subsection (1), a leasehold interest in designated lands is subject to charge, pledge, mortgage, attachment, levy, seizure, distress and execution.

(2) Conditional sales — A person who sells to a band or a member of a band a chattel under an agreement whereby the right of property or right of possession thereto remains wholly or in part in the seller, may exercise his rights under the agreement notwithstanding that the chattel is situated on a reserve.

²¹ Section 90(1):

For the purposes of sections 87 and 89, personal property that was (a) purchased by Her Majesty with Indian moneys or moneys appropriated by Parliament for the use and benefit of Indians or bands, or (b) given to Indians or to a band under a treaty or agreement between a band and Her Majesty, shall be deemed always to be situated on a reserve.

(2) Every transaction purporting to pass title to any property that is by this section deemed to be situated on a reserve, or any interest in such property, is void unless the transaction is entered into with the consent of the Minister or is entered into between members of a band or between the band and a member thereof.

(3) Every person who enters into any transaction that is void by virtue of subsection (2) is guilty of an offence, and every person who, without the written consent of the Minister, destroys personal property that is by this section deemed to be situated on a reserve is guilty of an offence.

and benefit in common, lands have been set apart or for whose use and benefit in common moneys are held by Her Majesty the Queen.

Reserve lands are therefore Federal Crown lands held by Her Majesty the Queen in Right of Canada for the use and benefit of the Native Indian bands for which they have been set apart. There are more than 600 reserves across Canada.²² Although the *Indian Act* defines reserve, it is silent with respect to the procedures required to create reserves. Because of this, Federal policy has been developed with respect to the creation of new reserves.²³

The *Indian Act* imposes certain limitations on the rights of non-Indians to occupy reserve lands. Where it is intended that the reserve property will be occupied by a corporation or other non-First Nation entity, provision is made for a process under which the First Nation band surrenders its rights in the land to the Federal Crown, subject to the terms and conditions set out in the surrender. The result is that the land is determined as ‘designated’ land and may then be leased by the Crown to the non-First Nation entity.²⁴ These designated lands continue to hold the status of reserve lands for the purposes of the *Indian Act*.²⁵ As a result income sourced from this land may also be exempt from income tax under s 87.

The term ‘Urban Reserve’ is typically applied to lands acquired by First Nations which subsequently achieve reserve status. There is nothing inherently different about the legal status of an ‘Urban Reserve’ from that of other reserve lands located elsewhere in Canada.²⁶

²² Richard M Bird ‘The GST in Canada: *Plus Ca Change, Plus C’est La Meme Chose?*’ (2009) 63 *Bulletin for International Taxation* 414, 415.

²³ Department of Indian and Northern Affairs Canada, ‘Additions to Reserves Policy’, <<http://www.ainc-inac.gc.ca/ai/mr/is/urs-eng.asp>> 22 September 2009.

²⁴ Barbara M Shields, ‘Aboriginal Tax Issues/Urban Reserves’ (Paper presented at Prairie Provinces Tax Conference, 2004) 1–12.

²⁵ ‘Designated lands’ is defined in s 2 of the *Indian Act* as ‘a tract of land or any interest therein the legal title to which remains vested in Her Majesty and in which the band for whose use and benefit it was set apart as a reserve has, otherwise than absolutely, released or surrendered its rights or interests, whether before or after the coming into force of this definition’.

²⁶ Shields, above n 24.

Taxation of income of Canadian Indians

Section 87 of the *Indian Act* has been interpreted by the courts to mean that all income of an Indian²⁷ from the use of their property, both real and personal will be exempt from income tax provided that it has the necessary connection with a reserve. Personal property of a First Nation individual has been held to include income from personal services for the purposes of this exemption. The result is that the exemption can apply to salary and other income from personal services such as business income where the business is operated as a sole trader or in a partnership of Indians.²⁸ In the case of *Nowegijick v R*²⁹ the Court held that wages, salary or other income constitute personal property thereby ensuring that this type of income could be exempt from tax under the *Indian Act* and this exemption remains.³⁰ In coming to this conclusion Dickson J took the broad view that ‘treaties and statutes relating to Indians should be liberally construed and doubtful expressions resolved in favour of the Indian’.³¹

In order to gain the exemption from income tax, however, the income must be ‘situated on a reserve’. This is straightforward where the income is from real property or other tangible personal property physically situated on reserve land.³² However, it is more problematic where the income is from an individual’s personal exertion either as an employee or as a business (sole trader or partnership of Indians).

²⁷ As determined in accordance with the definition of Indian under s 2 of the *Indian Act* and the consequent provisions of the *Indian Act*.

²⁸ *Nowegijick v R* [1983] CarswellNat 123 [29].

²⁹ [1983] CarswellNat 123.

³⁰ Although there is judicial comment to suggest that it is no longer good law; refer *Southwind v R* [1998] CanLII 7300 [16].

³¹ *Nowegijick v R* [1983] CarswellNat 123 [25].

³² As the income producing property is physically located on the reserve. Also refer Barbara M Shields, ‘Current Trends in Aboriginal Taxation’ (Paper presented at Prairie Provinces Tax Conference, 2008) 15.

Originally, court decisions on this issue applied the principles of conflicts of laws to determine this question based on the *situs* of the obligation to pay the income.³³

As a result the salary of Indians was held to be from the reserve and exempt where payment was made by an entity located on a reserve even where the employment activity took place outside the reserve.³⁴ In the 1992 decision of *Williams v R*³⁵ this test was replaced by the ‘connecting factors’ test.

The issue in the *Williams Case* was whether employment insurance benefits were taxable where the employment giving rise to the insurance benefits had occurred on a reserve. The Court was of the view that the complexities of determining the location of income were strong arguments against the use of the *situs* test relied upon in *Nowegijick v R*³⁶ and earlier decisions. In addition the Court had considered similar issues in their earlier decision of *Mitchell v Peguis Indian Band*,³⁷ which involved the potential garnishment of First Nation funds. In this case the Court came to the conclusion that a *situs* test was inappropriate and that a test relying on connecting factors was more appropriate given the rationale behind the legislative protections of Indian property.

The connecting factors test arises out of the commentary of La Forest J in *Mitchell v Peguis Indian Band*³⁸ with respect to the purpose of the statutory exemption. In this case La Forest J stated:

The exemptions from taxation and distraint have historically protected the ability of Indians to benefit from this property in two ways. First, they guard against the possibility that one branch of government, through the imposition of taxes, could erode the full measure of the benefits given

³³ *Nowegijick v R* [1983] CarswellNat 123 [17].

³⁴ *Nowegijick v R* [1983] CarswellNat 123.

³⁵ *Williams v R* [1992] CarswellNat 232.

³⁶ *Nowegijick v R* [1983] CarswellNat 123 [17].

³⁷ *Mitchell v Peguis Indian Band* [1990] CarswellMan 209.

³⁸ [1990] CarswellMan 209.

by that branch of government entrusted with the supervision of Indian affairs. Secondly, the protection against attachment ensures that the enforcement of civil judgments by non-natives will not be allowed to hinder Indians in the untrammelled enjoyment of such advantages as they had retained or might acquire pursuant to the fulfilment by the Crown of its treaty obligations. In effect, these sections shield Indians from the imposition of the civil liabilities that could lead, albeit through an indirect route, to the alienation of the Indian land base through the medium of foreclosure sales and the like ...³⁹

In the *Williams Case* the Court stated that in order to determine whether or not the income was situated on a reserve, the first step was to identify the various connecting factors which are potentially relevant to either connect the property at issue to a reserve location or away from the reserve. The weight to be attached to the individual factors will then depend on the nature of the property itself, in the context of the purpose of the exemption, as well as the nature of the taxation from which the exemption is sought.⁴⁰

Examples of the factors which may play a role in the determination include the residence of the employee, location of the employer, nature of the services provided, business activity, where the services giving rise to the wages/business income are performed and where the transactions giving rise to the income occur.⁴¹

Although the results in both the *Williams* and *Mitchell Cases* were in favour of the Indians, by applying a connecting factors test the outcome is that the exemption is confined to activities closely connected with reserve life. The Courts specifically stated that the exemption is only available to Indians in respect of Indian property,⁴² a clear indication that the exemption does not apply to income producing activities that cross the reserve boundaries.

³⁹ [1990] CarswellMan 209 [85].

⁴⁰ *Williams v R* [1992] CarswellNat 232.

⁴¹ *Williams v R* [1992] CarswellNat 232.

⁴² *Williams v R* [1992] CarswellNat 232; *Mitchell v Peguis Indian Band* [1990] CarswellMan 209.

The substitution of a ‘connecting factor’ test for the *situs* test has made it more difficult for an Indian to gain the tax exemption.⁴³ In coming to his conclusion in *Mitchell’s Case*, La Forest J strongly argued that Parliament did not intend to ‘remedy the economically disadvantaged position of Indians’ through the income tax exemption in the *Indian Act*.⁴⁴

Business income of Indians

In *Southwind v R*⁴⁵ the Court held that the taxpayer Indian’s business income was not from ‘on the reserve’ and therefore was not exempt from income tax. In coming to its conclusion the Court applied the connecting factors test outlined in the *Mitchell* and *Williams Cases*. Although the taxpayer lived on the reserve and the business had its office there, the only customer was off-reserve and the business activity (logging) was performed off-reserve. The Court therefore concluded that the resulting business income was off-reserve and not subject to the exemption.

The Canadian Federal Court warned in *Southwind* that s 87 does not exempt all Indians resident on a reserve from income taxation. The Court clearly distinguished between business and employment income that is situated on the reserve and which is integral to community life and which should therefore be tax exempt and ‘income that is primarily derived in the commercial mainstream, working for and dealing with off-reserve people’ which is not tax exempt.⁴⁶

Investment income of Indians

The connecting factors approach established in *Mitchell’s Case* and leading to a narrow application of s 87 was confirmed in the recent decision of *Dube v Canada*⁴⁷ in the context of income from investments.

⁴³ Shields, above n 32.

⁴⁴ *Mitchell v Peguis Indian Band* [1990] CarswellMan 209 [87].

⁴⁵ [1998] CanLII 7300.

⁴⁶ [1998] CanLII 7300 [17].

⁴⁷ [2009] FCA 109.

In this case the taxpayer was a member of the Obedjiwan First Nation. He used the services of the financial institution, the Caisse populaire Desjardins de Pointe-Bleue (the Caisse) situated on the Mashteuiatsh Reserve. There is no financial institution on the Obedjiwan Reserve, which is located approximately 300 kilometres from the Mashteuiatsh Reserve.

The Caisse has three main sources of revenue. Twenty-five per cent of the Caisse members' deposits are invested with the Fédération des caisses populaires Desjardins (the Federation), which makes investments in investment funds and liquidity funds that, in turn, are invested in the economic mainstream off the reserve. The remainder of the deposits, namely 75 per cent of the total, is lent to members of the Caisse residing on or off the reserve. Lastly, the Caisse receives income from other revenue sources, such as administrative fees, brokerage fees and so on.

The Court found that the majority of the Caisse members were Indians. The taxpayer also considered himself to be a resident of the Obedjiwan Reserve, even though, for a few years, he owned a residence in St-Félicien and then in Roberval.

Mr Dube used the services of the Caisse for personal purposes and for the purposes of his business. This business involved transportation services, including transportation from the Obedjiwan Reserve to Roberval, for reserve residents in need of medical care.

The taxpayer argued that the investment income, in other words the profit generated from the capital invested with the Caisse, was exempt from income tax under s 87. The case came down to a debate of whether or not this income was sourced from on the reserve.

In concluding that the investment income was not exempt, the Court stated that the mere fact that the financial institution is situated on the reserve merited little weight. What mattered to the Court was whether the investment income was produced on or off the territory of the reserve.

The Court concluded that, since part of the funds were invested in the general mainstream of the economy, the exemption from taxation provided by s 87(1)(b) of the *Indian Act* could not apply.

In a concurring judgment Pelletier J pointed out that the capital market is a global market. His Honour went on to say:

While the sources of the capital put on the market are local and the projects in which that capital is invested are local, the fact remains that the market itself is global. Investors can access that market from their own communities, but the point of entry does not, in itself, limit the market in which investors make profits and incur losses.

I therefore conclude that in the case of the investment of capital through a financial institution, including a *caisse populaire*, the weightiest factor in determining the *situs* of the investment income is the nature of the capital market itself, which is not limited to a reserve, a province or even a country.⁴⁸

Dube's Case follows the leading case of *Recalma v Canada*⁴⁹ which points out that investment income, being passive income, is not generated by the individual work of the taxpayer and therefore different factors come into play in determining the source of this income.⁵⁰

The Court in *Recalma* stressed that the relevant factors to take into account in determining whether investment income is from on a reserve are the residence of the issuer of the security (the bank or other financial institution), the location of the issuer's income generating operations, and the location of the security issuer's property.⁵¹ However, the Court in *Dube* went one step further and clearly stated that in reality, where investment income is concerned it is really the location of the source of the investment income that is the most important factor and that the location of the financial institution on the reserve, as was the case here, has little importance.⁵² As the marketplace in modern banking situations is global, it is unlikely that there will be any situations where investment income is from inside the reserve.

⁴⁸ [2009] FCA 109 [36].

⁴⁹ *Recalma v Canada* (1998) 98 DTC 6238.

⁵⁰ (1998) 98 DTC 6238 [11].

⁵¹ (1998) 98 DTC 6238 [11].

⁵² *Dube v Canada* [2009] FCA 109 [36].

The *Dube Case* was handed down at the same time as the decision of *Estate of Rolland Bastien v R*⁵³. This case came to the same conclusion, placing little weight on where the investment bank is situated and making it clear that where the investments are made in the general economy the tax exemption will not apply.

Justice Nadon stated:

When an Indian invokes paragraph 87(1)(b) of the *Indian Act* to obtain a tax exemption on his or her investment income, and the income in question is generated off the reserve, the exemption cannot be granted. In such a context, the other connection factors are of little importance. In particular, the mere fact that the financial institution is situated on the reserve merits little weight. What matters is whether the investment income — that is, the profit generated from the capital invested in a financial institution — was produced on or off the territory of the reserve. In other words, if all or part of the funds were invested in the general mainstream of the economy, the taxation exemption provided at paragraph 87(1)(b) of the *Indian Act* cannot apply.⁵⁴

Both *Dube* and *Bastien* are on appeal to the Supreme Court, however at the time of writing this article neither decision had been handed down.

The taxation of the income of entities formed by Indians or bands

Because an Indian is defined as an individual who is either registered or entitled to be registered pursuant to the *Indian Act*,⁵⁵ a corporation is not entitled to the benefit of the income tax and other taxes exemption under s 87 even where all of its shareholders are members of a First Nation.⁵⁶ Accordingly, where a business enterprise or other organisation is incorporated by an individual or group of individuals who themselves would be entitled to the exemption from income tax its net income will, at first glance, be subject to taxation under the ITA. This is, however, subject to the following discussion.

⁵³ *Estate of Rolland Bastien v R* [2009] FCA 108.

⁵⁴ [2009] FCA 108 [36].

⁵⁵ *Indian Act* s 2.

⁵⁶ *Kinoosamin Beach Association v R in Right of Saskatchewan* [1979] 6 WWR 84 (CA); *Re Stony Plain Indian Reserve No 135* [1982] 1 WWR 302 (Alta CA).

The Canadian Revenue Agency (CRA) had originally considered, despite the lack of specific application of s 87 of the *Indian Act* to incorporated entities, that these entities were exempt from taxation as a ‘public body performing a function of government in Canada’ and therefore exempt from income tax under s 149(1)(c) of the ITA. The CRA also accepted the decision of *Otineka Development Corporation v R*⁵⁷ that a band is a public body performing a function of government, and that a corporation owned by a band that earns at least 90 per cent of income on reserve is therefore also exempt.

Although not binding on Federal income tax interpretation, the 2001 decision of *Tawich Development Corporation v Deputy Minister of Revenue of Quebec*⁵⁸ cast doubt on the correctness of this approach. In this case the Quebec Court held that the Cree Nation of Wemindji was not a Canadian municipality for the purposes of the Quebec taxation legislation which contained a similar provision to the previous s 149(1)(c) of the ITA. The Court considered that even though the Cree Nation exercised powers of local self-government, it was not a municipality because it had not been expressly constituted by provincial statute as a Canadian municipality.

The Canadian Federal Government has proposed an amendment (although it has not been passed) that will apply retrospectively from 2000. This amendment will clarify that a corporation 90 per cent owned by a public body performing a function of government (and not just a corporation owned by a municipality) in Canada is exempt from tax. This exemption is, however, subject to the proviso that the corporation’s income from activities carried on outside the geographical boundaries of the entity (band) which owns it does not exceed 10 per cent of its income for the period. The proposed new provision, s 149(1)(d.5) of the ITA provides that, at least to the extent of the Federal income tax legislation, corporations with a minimum 90 per cent share ownership by a municipal or public body performing a function of government in Canada are treated as tax exempt.

⁵⁷ *Development Corporation v R* [1994] 2 CTC 2424.

⁵⁸ [2001] DTC 5144 (Que CA).

Corporations whose shares are owned by a First Nation may therefore qualify for the exemption provided that the CRA has agreed to treat the First Nation as ‘a public body performing a function of government in Canada’.

As a result, band owned corporations may be exempt from Federal income tax, but not because of s 87 of the *Indian Act*. The exemption flows from s 149(1)(d.5) provided the criteria set out in that section are met. Importantly, at least 90 per cent of this corporation’s income must be from within the reserve. This brings the situation back to a similar limitation to the tax exemption under the *Indian Act*.

Taxation of First Nations trusts established as part of reserve development

As part of their move towards economic development and self-determination, it is common for First Nation bands of Indians to enter into what are called Impact Benefit Agreements (IBAs). These agreements are often entered into where a development project of some form is to take place on reserve land. The contracting company will usually consider social and cultural issues, and agree to provide training, education, employment and business opportunities, environmental management and financial compensation in return for the First Nation supporting the relevant project.⁵⁹ As part of the IBA, and in order to receive and distribute the financial compensation, a trust is established. The trust money, which includes the compensation from the IBA as well as investment income from this money, may be used for a variety of purposes including band and community development and may also be distributed to individual band members.

The application of s 75(2) of the ITA to this trust income ensures that it is considered income of the members of the First Nation⁶⁰ and, as this is personal income of the individuals who make up the First Nation band, it is exempt from tax under s 87. The income is consequently exempt from Federal income tax because of the operation of s 81 ITA, which specifically states that a party

⁵⁹ Refer CRA Ruling 2005 – 0126261R3 ‘Taxation of Indian Trust’ 2006.

⁶⁰ Refer CRA Ruling 2005 – 0126261R3 ‘Taxation of Indian Trust’ 2006, A.

exempt from taxation by an application of another statute is not subject to taxation under the ITA.⁶¹

Furthermore, as stated earlier the CRA considers that the First Nation is a public body performing a function of government under s 149(1)(c) of the ITA and is therefore exempt from tax. It considers no tax is payable by the First Nation (as an entity in its own right) on the money received under the IBA.⁶²

The range of services that the First Nation undertakes and which demonstrate that it is a public body performing a function of government include band administration; management of existing fire protection services on the reserve; management of the reserve housing program; and medical and health services.⁶³

The variety and far-reaching benefits of these services demonstrate that these bands are operating at a significant administrative level. It certainly shows that they are performing many government and semi-government obligations and duties.

Conclusion

The tax exemptions under the *Indian Act* are significant financial and economic factors for many First Nation people. Without these exemptions there are potential negative impacts on their financial situation. This may pose immediate problems leading to a lack of funds to access services and infrastructure and could potentially harm their long-term financial future.

The discussion in this article indicates that there has been a consistent trend in the Canadian courts restricting the application of the s 87 exemption to income situations where there is a direct relationship between the earning of the income and a reserve community. Appeals to the CRA and ultimately to the courts seeking the application of the exemption from taxation to business, investment and employment income are being met with an increasingly narrow

⁶¹ ITA s 81 (1)(a).

⁶² Refer CRA Ruling 2005 – 0126261R3 ‘Taxation of Indian Trust’ 2006, C.

⁶³ CRA Ruling 2003 – 0035821R3 ‘Taxation of Indian Trust’ 2004.

interpretation of s 87. This results in a correspondingly greater exclusion from the benefit of the exemption to Indians. Given the reference to the ownership of the property ‘qua’ Indian found in the comments of La Forest J in *Mitchell’s Case*, there appears to be a growing intention that the exemption is limited to situations where the reserve community benefits from the property of the individual recipient of the income, or when the traditional aboriginal way of life is supported by the exemption.

The use of IBAs to fund economic and community development in a tax exempt manner is a clear example of a tax effective way that development can be funded; however, this is also clearly linked to the reserve and does not cross reserve boundaries. CRA approved IBAs cover such things as housing, service provision and medical centres, but they are all situated on a reserve.

Recent case law demonstrates the judicial view that the purpose of the *Indian Act* is not to overcome Indian disadvantage caused by previous colonial governments. The judicial narrative stresses that Indians and non-Indians must compete in the commercial world on a level playing field. An examination of the decisions bearing on these sections confirms that Indians who acquire and deal in property outside lands reserved for their use deal with it on the same basis as all other Canadians.⁶⁴ Justice La Forest in *Mitchell’s Case* warned that ‘... the purpose of the legislation is not to remedy the economically disadvantaged position of Indians by ensuring that Indians may acquire, hold, and deal with property in the commercial mainstream on different terms than their fellow citizens’.⁶⁵

The historical basis for this is explained by La Forest J:

In summary, the historical record makes it clear that ss. 87 and 89 of the Indian Act, the sections to which the deeming provision of s. 90 applies, constitute part of a legislative ‘package’ which bears the impress of an obligation to native peoples which the Crown has recognized at least since the signing of the Royal Proclamation of 1763. From that time on, the Crown has always acknowledged that it is honour-bound to shield Indians from any efforts by non-natives to

⁶⁴ *Mitchell v Peguis Indian Band* [1990] CarswellMan 209 [87].

⁶⁵ *Mitchell v Peguis Indian Band* [1990] CarswellMan 209 [87].

dispossess Indians of the property which they hold qua Indians, i.e., their land base and the chattels on that land base.⁶⁶

In arriving at his conclusion, La Forest J also points out that the specific wording of the sections as confirmed by modern legislatures indicates a current government approach of treating Indians on an equal footing with other Canadians when dealing in commercial matters.⁶⁷

Barbara Shields argues that, because of the narrowing of the application of the s 87 exemption and its restriction to 'on reserve' activity, economic development from both the business and employment contexts should be strategically linked to on reserve development opportunities.⁶⁸

On the other hand Chris Sprysak argues that, while the courts have on several occasions stated that it is both possible and acceptable for Indians and their tax advisors to structure their affairs in order to take advantage of the s 87 exemption, the reality is that such tax planning is very limited.⁶⁹ This is highlighted by the above discussion of the recent case law and the way the courts have determined and prioritised the connecting factors necessary to determine whether income is sourced from the reserve.

Chris Sprysak concludes that Indians and bands appear to be relying less on s 87 to exempt their income from taxation and more on other opportunities to raise monies for reserve life in a tax efficient manner.

A further significant hurdle for First Nations is that the tax exemption is lost once an individual or group incorporates. The corporate structure is commonly used in the commercial world as a vehicle for business operations. It has the advantages of perpetuity (being a legal entity as opposed to an individual) and it is flexible in that shareholding can be bought or sold so that

⁶⁶ *Mitchell v Peguis Indian Band* [1990] CarswellMan 209 [86].

⁶⁷ [1990] CarswellMan 209 [87].

⁶⁸ Shields, above n 32.

⁶⁹ Chris Sprysak, 'Aboriginal Taxation Update' (Paper presented at Prairie Provinces Tax Conference, 2007) 1.

ownership and income streams can vary depending on the future direction of the company and the decisions of the board of directors. Financing organisations are familiar with the corporate structure so that borrowing money for commercial endeavours is relatively easy. By not continuing the exemption when Indians wish to incorporate the advantages of the exemption in a commercial setting are significantly restricted.

When the First Nation is considered a public body carrying out functions of government within the provisions of s 149(1)(c) of the ITA then its income is exempt from income tax. The proposed new s 149(1)(d.5) will allow this exemption to flow through to a corporation, although it is again very restricted because 90 per cent of the income must be generated within the reserve. The alternative of a trust structure where the income is distributed to the band members ensures the continuation of the exemption, but again this structure is limited to activities on reserve land and does not apply to other economic development.

In conclusion, the discussion of the case law surrounding s 87 indicates that the exemption from income tax has little relevance to modern day economic activities of Indians once these activities cross reserve boundaries. It is therefore argued that if the Canadian Government wishes to encourage economic development by Indians it will need to investigate a broader range of approaches than the tax exemptions currently available under the *Indian Act*.