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**TAXATION AND ECONOMIC DEVELOPMENT
IN THE ABORIGINAL CONTEXT**

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1. The *Indian Act* tax exemption

a. The text of the law

Under section 87 of the *Indian Act* “the personal property of an Indian or a band situated on a reserve” as well as any interest of an Indian or a band in reserve lands are exempt from taxation. The exemption applies whether the taxes are federal, provincial or municipal.

The *Cree-Naskapi (of Quebec) Act* contains an identical exemption for Category IA and IA-N lands. As Inuit are not considered Indians under either of these laws, they do not benefit from the exemption.

The key issues in determining the extent to which the exemption applies are:

- what is the personal property of an Indian?
- when is it situated on reserve?
- what is a tax?

b. “The personal property of an Indian”

i. The types of property included in the term “personal property”

The personal property exempted from taxation includes not just physical objects but also income (such as wages) and income replacement (such Employment Insurance).

In another example, the B.C. Court of Appeal decided that electricity delivered to Indians on a reserve was "personal property" as the term is used in section 87 of the *Indian Act*, even though it cannot be seen or felt.

ii. Property that is owned by an Indian

Nevertheless the tax exemption also does not apply to every form of property controlled by an Indian on reserve.

The GST/HST Administrative Policy states that “[b]usinesses owned by Indians, Indian bands or band-empowered entities whose annual taxable sales of property and services are more than \$30,000, are required to register for the GST/HST.” This policy applies whether the business is a sole proprietorship, a partnership or a corporation.

Moreover, a business on reserve must collect GST from its non-Indian clients, just as it must collect other types of sales taxes. The courts have found that in these circumstances, the Indian merchant is merely acting as an agent of the government for the purposes of tax collection and is not personally subject to any taxation.

In certain cases, notably the provincial tobacco tax, this principle allows the government to require retailers to pay the tobacco tax when purchasing the product from the wholesaler. The retailer then must request a refund from the government for the tobacco sold tax-free to Indians. While this mechanism may be awkward, it is not illegal.

c. “Situated on a reserve”

i. Sales taxes

(1) The law

The sale of property which takes place on reserve is tax exempt no matter where the property is later used.

For example, sales tax does not apply to sales of automobiles sold on reserve even if the automobiles are used off reserve. In the same way, the government of Quebec no longer collects sales tax on insurance policies for vehicles registered to Indians resident on reserve, even though it is clear that these vehicles can leave the reserve.

Whether the exemption applies can also depend upon the moment when property changes hands and becomes the property of an Indian. If this occurs outside the reserve, the transaction is normally subject to sales tax. On the other hand, if the transaction is “C.O.D.” (cash on delivery) with delivery to an Indian on a reserve, the goods will be on a reserve at the moment they become the Indian’s property and the transaction will therefore be tax exempt.

(2) The administrative policy

Parts of the GST Administrative Policy adopted by the Canada Revenue Agency go further than the *Indian Act* itself and waive GST on transactions which would not necessarily be exempt under section 87.

In addition, since Quebec's sales tax is harmonized with the federal government's GST, the same policy has applied to the provincial sales tax (PST or QST).¹

It is important to note that a policy is not law, as it can be changed at any time. Furthermore, the government is not bound by the policy and, if the matter goes to court, can choose to rely on the legal definition of the exemption.

The most important extensions to the law made by the policy are the following:

- While corporations do not usually benefit from the tax exemption given to Indians and Bands, non-profit "band-empowered entities" can purchase goods and services without paying GST or QST.
- While individuals must pay the GST and QST on services which are not performed entirely on a reserve, Bands and band-empowered entities can acquire services outside the reserve without paying tax, so long as these services are for band management activities.
- While under statute, the property must be purchased on reserve to be exempt, property purchased off reserve but delivered to the reserve by the vendor or his agent will be exempt from GST and QST (however, if the buyer uses his own vehicle to transport the property to the reserve, the purchase will be taxable).
- While under statute, the vendor must sell the property on reserve for the tax exemption to apply, property sold by vendors located off reserve but close to the reserve – particularly in remote areas – may be exempt from GST and QST if certain conditions are met.²

This will be the case where the vendor is within 10 kilometers of the reserve and where, during the previous 12-month period, all or most of the vendor's sales (generally 90% or more) were made to Indians, Indian bands or band-empowered entities.

This will also be the case where the off-reserve vendor is located in a remote location and his regular trading zone (that is, the area in which 90% or more of a vendor's customers reside) includes a reserve, so long as more than 50% of his sales were to Indians, Indian bands and band-empowered entities during the previous 12-month period. A vendor will

¹ The federal policy is set out in GST/HST Technical Information Bulletin B-039R3, *GST/HST Administrative Policy – Application of the GST/HST to Indians* (August 2006) and is applied by Revenue Quebec by virtue of Interpretation bulletin TVQ.16-17/R2, *Rules Applicable to Indians* (April 28, 2000).

² See: GST/HST Policy Statement P-246, *Remote Stores and Other Off-reserve Stores with Significant Sales to Indians, Indian Bands and Band-empowered Entities* (October 24, 2005).

be considered to be in a remote location if located over 350 kilometers from the nearest community with a population of 5,000 inhabitants or if “surface transportation” is not available year round on paved or gravel roads linking the vendor with the nearest established community.

ii. Income tax

(1) The law

(a) Business and investment income

It will often be difficult to determine the location of property which is not a physical object, such as income from business or employment. For income in particular, the courts have devised the “connecting factors” test to decide whether it should be characterized as situated on a reserve.

In the *Southwind* case, the Federal Court of Appeal held that an Indian whose business consisted of providing logging services to a single client and who did all of the logging off reserve did not earn his income on reserve, even if he did some administrative work connected to the business at home on reserve and kept his tools there.

The Court of Appeal, drawing on previous case law, set out the following factors:

- (1) the location of the business activities;
- (2) the location of the customers (debtors) of the business;
- (3) where decisions affecting the business are made;
- (4) the type of business and the nature of the work;
- (5) the place where the payment is made;
- (6) the degree to which the business is in the commercial mainstream;
- (7) the location of a fixed place of business and the location of the books and records;
- (8) the residence of the business' owner.

With respect to the income earned by an Indian on his investments, the Federal Court of Appeal has found that it will generally be situated off reserve, even where the investments are made through a bank branch located on reserve.

In the *Recalma* case for instance, the Federal Court of Appeal decided that the interest earned from term deposits originated in the commercial mainstream off-reserve because the issuers of the term deposits earned their income throughout Canada.

In the more recent cases of *Bastien* and *Dubé*, the Federal Court of Appeal applied its reasoning in *Recalma* to investments made by a *caisse populaire* (credit union).

Mr. Bastien was a lifelong resident of the reserve until his death in 2003. He had run a moccasin business from the reserve. He used his business income to buy term deposits at the Caisse populaire Desjardins of the Huron Village located on the reserve. The Canadian Revenue Agency decided that the interest on his term deposits should be included in his taxable income and Mr. Bastien's heirs, his children, challenged the decision in court.

As for Mr. Dubé, he lived on another reserve but used the financial services of the Caisse populaire Desjardins of Pointe-Bleue on the Mashteuiatsh reserve. He invested the income from his local transport business, as well as his personal assets, and obtained a return on his investments. The Canada Revenue Agency decided that this income was taxable and Mr. Dubé challenged this decision.

The Federal Court of Appeal concluded that the other connecting factors – such as, in this case, the taxpayer's place of residence, the geographic location of the financial institution, and the location of the funds used for the investment – were of little importance if the return on the investment was produced outside the reserve. In short, even if the financial institutions were on reserve, the investment income from the term deposits was derived from investments made on the ordinary stock markets of the outside world.

The Supreme Court of Canada heard the appeals in *Dubé* and *Bastien* on May 20, 2010, but has yet to render a judgment.

(b) Employees

The question of the tax exemption is as complicated with respect to employment income as it is for business income, whenever the employee or owner carries out a major part of his activities off reserve.

Courts apply the same connecting factors mentioned above. In practical terms, the further away from the reserve that the work is done or the service offered, the more reluctant courts are to allow the exemption.

In the *Shilling* case, the Federal Court of Appeal held that an Indian who lived and worked off reserve was not entitled to the exemption, even though her employer was an employment agency situated on reserve, which leased out her services. The Court held the fact that the employment contract was with an employer situated on reserve was of minor importance because all the important connecting factors indicated that the income was situated off reserve. The Supreme Court of Canada refused leave to appeal.

The Federal Court of Appeal has already decided, in the *Monias* case, that the fact that an employer locates itself *pro forma* on a reserve carries little weight in connecting employment income to a reserve.

The taxpayer in *Monias* was an Indian employed by the Awasis agency in northern Manitoba. The Awasis agency had been created by 25 Aboriginal communities to offer social services to children and families on the reserves of northern Manitoba. It was, however, impractical for Awasis to offer the majority of services on reserve and, as a result, Mr. Monias spent only 15% of his time on reserve. Revenue Canada recognized his right to the exemption for the portion of his income earned on reserve, but not for the time he spent at the agency's off-reserve office.

The Court acknowledged that it was not practical for the work to be done on reserve, but added that this fact could not have the effect of placing his work on the reserve. In short, necessity cannot not locate employment income on a reserve where the connecting factors indicate a different location.

According to the Court of Appeal, the *Indian Act* does not exempt from tax an Indian's employment income that is not clearly earned in circumstances that link it with the reserve as an economic unit. While *Monias* raised an interesting challenge to the existing jurisprudence, the Court still refused to find that the taxpayer earned his income on the reserves served by his employer where the employee neither worked nor lived on these reserves.

(2) The policy

The “*Indian Act* Exemption for Employment Income” guidelines were issued in 1994 and provide the criteria that the CRA will generally apply to determine if income is tax exempt. The guidelines can also go further than the law as interpreted by the courts.

These guidelines generally apply to employment income – business income is treated differently.

For example, the “Information for Indians” section of CRA’s website states that income earned by an Indian from his fishing business will only be tax exempt if the commercial fishing activities take place on an area of water within the boundaries of the reserve. CRA states that if the preparation of the fish takes place on a reserve, while harvesting takes place elsewhere, a portion of the business income may still be exempted from tax.

The CRA will, however, treat employment income earned from a commercial fishing business according to the employment income guidelines.

The guidelines are as follows:

Guideline 1

When at least 90% of the duties of an employment are performed on a reserve, all of the income of an Indian from that employment will usually be exempt from income tax.

Proration Rule

When less than 90% of the duties of an employment are performed on a reserve and the employment income is not exempted by another guideline, the exemption is to be prorated. The exemption will apply to the portion of the income related to the duties performed on the reserve.

Guideline 2

All the employment income will usually be exempt from income tax if the following conditions are fulfilled:

- the employer is resident on a reserve;
- the Indian employee lives on a reserve.

Guideline 3

All the employment income will usually be exempt from income tax if the following conditions are fulfilled:

- more than 50% of the duties of an employment are performed on reserve;
- the employer is resident on a reserve, or the Indian employee lives on a reserve.

Guideline 4

All the employment income will usually be exempt from income tax if the following conditions are fulfilled:

- the employer is resident on a reserve;
- the employer is,
 - an Indian band which has a reserve, or a tribal council representing one or more Indian bands which have reserves, or;
 - an Indian organization controlled by one or more such bands or tribal councils, if the organization is dedicated exclusively to the social, cultural, educational, or economic development of Indians who for the most part live on reserves;
- the duties of the employment are in connection with the employer's non-commercial activities carried on exclusively for the benefit of Indians who for the most part live on reserves.

d. What is a tax?

It is clear that section 87 of the *Indian Act* applies to income tax and to sales taxes such as the GST and the QST. However not every amount collected by the government is a tax and some amounts will therefore be payable by Indians or Bands even for property situated on reserve.

For instance, Indians are not exempt from paying duty on imported goods because the Supreme Court of Canada held in *Francis v. The Queen* in 1956 that "customs duties are not taxes imposed upon the personal property of an Indian situated on a Reserve but are imposed upon the importation of goods into Canada." (Currently, Indians must also pay GST on imported goods, which is collected by Canada Customs.)

In addition, fees such as business licenses fees are generally not considered to be taxes and must usually be paid by on-reserve businesses. The courts have also held that Employment Insurance and CSST or worker's compensation premiums are not taxes, even if all employers must pay them. Instead they are premiums owed under a mandatory and universal insurance scheme and Band Councils are obliged to pay them like all other employers.

An amount levied by government is a tax, rather than a fee, if no connection exists between the amount charged and the cost of the service provided.

For instance, Quebec charges employers a tax of between 2.7 and 4.26 per cent of total payroll as a contribution to the health services fund. This amount is not a fee because it bears no

relationship to the health services provided to the employees; it is therefore a payroll tax – not a premium – and does not apply to Indian employers on reserve.³

2. Business structures

a. Sole proprietorships

Any individual carrying on business alone and in his or her own name is automatically operating as a sole proprietor.

If an individual wishes to carry on business under a trade name rather than in his own name – but without incorporating – he must register that name with Quebec’s Inspector General of Financial Institutions. Such registration has no effect on the *Indian Act* exemption because the business remains a sole proprietorship: it merely acquires the legal right to do business under a name other than that of the individual who operates it.

For tax purposes, the sole proprietorship is by far the simplest means of taking advantage of the *Indian Act* exemption because the business is not distinguished from the Indian himself. To the extent that the income earned from the business can be defined as “situated on reserve”, it will be tax exempt.

For most people, the disadvantage of a sole proprietorship is that it leaves the individual fully responsible for all the debts and obligations of his business. This means that creditors could seize not just the business assets in payment of a business debt but could also seize the individual’s personal possessions.

However this issue is less of a concern for Indians on reserve because under section 89 of the *Indian Act*, the personal property of an Indian situated on a reserve is not subject to seizure by his creditors. (Note that this rule usually applies to money kept in savings or chequing accounts at financial institutions situated on reserve.)

The exemption from seizure always applies when the property of an Indian is actually on the reserve. It also applies to property whose “paramount location” is on reserve: that is, property for which the pattern of use and safekeeping indicates that it should be considered to be situated on reserve, even if it moves off the reserve temporarily. An example would be an automobile belonging to an Indian who lives on reserve, even when the vehicle is temporarily off the reserve. In addition, because an Indian’s property situated on reserve cannot be seized, it will not be lost even if he declares bankruptcy.

³ See: *Interpretation Bulletin*, RAMQ.34-5/R1, “Contribution to the Health Services Fund by Certain Indian Organizations”.

Under the circumstances, an Indian operating a business on reserve as a sole proprietorship faces far fewer risks than do other sole proprietorships.

b. Partnerships

A partnership is a business formed when two or more persons agree to combine their resources in a business. A partnership can be created by verbal agreement although it is preferable to use a written contract to settle issues such as who will manage the business, how control will be shared and how profits will be divided and debts paid.

Partnerships take two forms. The first is a general partnership, in which all members share the management of the business and each is personally liable for all the debts and obligations of the business.

The second form is a limited partnership, in which those referred to as “general partners” control and manage the business, while those referred to as “limited partners” contribute only capital, take no part in control or management and are liable for debts only to a specified extent. A limited partnership cannot be created without a written agreement.

For income tax purposes, each partner’s share of partnership income or losses is reported separately after calculating the total. This makes the partnership an attractive alternative to corporations where Indians on reserve wish to undertake business ventures together or with outside interests.

The profits from a partnership which were owed to the Indian partner would be tax exempt – provided that the profits could be considered property situated on a reserve – and even though a non-Indian partner would owe income tax on the same amounts.

The courts have not ruled on how the *Indian Act*’s exemption from seizure would apply to property of a partnership owned by both Indians and non-Indians. However if all the partners were Indians and the property is situated on reserve, the exemption of the partnership’s assets from seizure by creditors would clearly apply.

c. Corporations

i. Introduction

A corporation can be formed by one or more people who become its shareholders and elect the directors. A corporation is a legal entity that is separate from its owners, the shareholders.

ii. Disadvantages

As it is a distinct entity from its shareholders, a corporation must pay income tax and cannot benefit from the Indian status of its shareholders and their tax exemption under section 87 of the *Indian Act*.

On the other hand, in some cases special tax provisions can reduce or eliminate corporate income taxes, such as the Small Business Deduction.

Furthermore, any salary or dividends paid by a corporation to its Indian officers or shareholders will be tax-exempt for those individuals under section 87 of the *Indian Act*, provided the payments qualify as “property situated on a reserve” based on the same tests applied to other income.

The CRA is becoming more and more exacting on this point and will require that the income of the corporation has connecting factors which sufficiently link it with the reserve before it grants the exemption on the earnings of an officer or shareholder.

A corporation owned by Indians also cannot benefit from the protection against seizure under section 89 of the *Indian Act*. The property of a corporation will therefore be subject to seizure by its creditors whether or not it is situated on reserve.

This disadvantage can be overcome if an Indian shareholder owned property and lent it to his corporation: we believe that this property would be exempt from seizure so long as its paramount location was on reserve. There is, however, no jurisprudence on this issue.

iii. Advantages

The greatest advantage of incorporating is that no shareholder of a corporation is personally liable for its debts simply because he owns shares in it.

As long as a shareholder does not offer a personal guarantee, the debts of the company are not his. For an Indian whose principal assets are on reserve, however, this advantage is less pronounced as his non-Indian creditors would not be able to seize that property protected by section 89 of the *Indian Act*.

Finally, note that corporations are eligible for certain grants and subsidies which are not provided to individuals.

d. Band-empowered entities

i. Introduction

The term "band-empowered entities" is used in the federal policy on the application of the GST. However the variety of structures through which Bands and Band councils conduct their operations can also attract special treatment with respect to other taxes, especially income tax.

ii. GST rules

As discussed above, the tax exemption under section 87 of the *Indian Act* belongs only to individual Indians and to Bands: corporations have no right to the exemption, even if they are the property of Indians.

Nevertheless certain "band-empowered entities" will be exempted from the GST when purchasing property for "band management activities", under a policy adopted by the Canada Revenue Agency. As discussed above, this policy is not law and can be changed at any time; it also applies to the QST because Quebec's sales tax is harmonized with the GST.

For a corporation to be treated as a "band-empowered entity", it must be owned or controlled by a band, a tribal council, or a group of bands other than a tribal council. In addition, to be treated as "band management activities", the activities or programs it undertakes must be non-commercial.

In practice, therefore, only non-profit corporations owned by a Bands will be exempt from paying the GST.

iii. Income tax

(1) The municipally-owned corporation exemption

Corporations which are at least 90 per cent owned by municipalities are tax-exempt under both the federal *Income Tax Act* and Quebec's *Taxation Act*.

The Tax Court of Canada decided that Indians Bands are included within the definition of municipality for tax purposes in the *Otineka Development Corporation* case of 1994 and the Canada Customs and Revenue Agency has applied the same policy to Band-owned corporations since that time. (However this has not changed the fact that Indian Bands are a distinct form of government and are not municipalities.)

Unlike the definition of "band-empowered entity" under the GST policy, a Band-owned corporation treated as municipally-owned can be exempt from income tax even if it is engaged in commercial activities.

At the same time, the exemption for municipally-owned corporations has been narrowed since the *Otineka* case was decided. Now the corporation must ordinarily earn at least 90 per cent of its income within the municipal boundaries (or within the reserve for a Band-owned corporation) in order for the exemption to apply.

However certain joint ventures will benefit from the exemption even if their operations are carried on outside a municipality's boundaries or outside the Band's reserve:

- with another municipally- or Band-owned corporation, if carried on within that municipality's boundaries or the other Band's reserve;
- with the federal government or its Crown corporations, for operations carried anywhere in Canada;
- with a provincial government or one of its Crown corporations, for operations anywhere within that province.

In addition, a municipally- or Band-owned corporation will be exempt from tax for income it earns anywhere in Canada as a producer of electrical energy or natural gas, or as a distributor of electrical energy, heat, natural gas or water, provided that the operations are provincially-regulated.

(2) **The *Tawich* case**

Revenue Quebec refuses to treat Indian Bands as municipalities under the provincial income tax statute as it is currently written.

The Cree Nation of Wemindji challenged this approach with respect to its wholly-owned Tawich Development Corporation, which carried on the First Nation's economic development activities, including owning and operating several businesses, such as a hotel and restaurant, a small shopping centre, a bakery, a school bus, a canoe factory and a marine transport service.

The Quebec Court of Appeal upheld Revenue Quebec's restrictive interpretation and refused to "read in" the words Indian Band into the *Taxation Act's* definition of municipality, as the Tax Court of Canada had done under the federal *Income Tax Act*.

The Supreme Court of Canada agreed to hear an appeal of the *Tawich Development Corporation* case, but in September 2002 the case was dropped as part of a broader agreement between Quebec and the Cree.

The current legal situation in Quebec is therefore that a Band-owned corporation will be exempt from federal income tax if it operates predominantly on reserve or is involved in a joint venture as described above, but the same company remains taxable at the provincial level. Only the Quebec First Nations are subject to this unequal treatment as in other provinces there is not a distinct provincial income tax.

(3) The proposed amendments to the federal and provincial laws

The *Tawich* decision put in doubt whether a band can be considered a municipality for the purposes of taxation. As a result, the federal Minister of Finance has announced in every budget since 2002 that he would ensure equal treatment of First Nations by formally amending the *Income Tax Act*. This proposed amendment would apply to every taxation year and beginning after May 8, 2000.

The Quebec Finance Minister promised in the 2006-2007 budget to harmonize Quebec's *Tax Act* with the federal government's *Income Tax Act* as regards the tax treatment of corporations owned by First Nations, for the same period.

Quebec, however, has specified that such measures will only be adopted after the federal amendments have been adopted. Unfortunately, the bills in Parliament meant to bring about these changes have died on the order paper, year after year.

iv. Considerations regarding the type of business structure

The reasons why Bands create corporations are usually unrelated to tax: it can be to put certain operations at arm's length from the political process and the Band Council, or it can be to take advantage of certain programs and subsidies only available to corporations.

However if the operation is a business which is likely to generate profits and will be situated on reserve, the tax implications may outweigh other considerations.

In such a case, a Band should consider operating the business as a division of the Band Council and without separate incorporation. This would preserve the full tax exemption under section 87 of the *Indian Act* without needing to apply either the *Otineka* or *Tawich* decisions.

On the other hand, if the business is principally conducted off reserve, neither the tax exemption under the *Indian Act* nor the exemption from federal income tax for municipally-owned corporations will apply. In that case, incorporation should be considered based on its other advantages.

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