ANALYSIS OF THE POSITIVE TAX LAW AFFECTING FIRST NATIONS IN THE CONTEXT OF CANADIAN TAX POLICY

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ABSTRACT:
TAX POLICY AND CANADA'S FIRST NATIONS

Section 87 of the *Indian Act*[1] contains a tax exemption for 'Indians' and 'bands' insofar as their property is located on a reserve. This thesis explores the historical origins, justification, and the scope of the *Indian Act* tax exemption, and considers its effect on Canadian tax policy.

For any tax system to operate fairly and efficiently, all citizens within the subject jurisdiction must be chargeable to tax at a *pro rata* rate. This idea is borne out within the Canadian tax system itself, which uses domicile to determine whether an individual should be required to bear a horizontally and vertically equitable tax burden.

Having said that, there is an historical and legal rationale for exempting reserve-based Indians from the tax structure, whereby reserved lands are treated as extra-territorial entities, separate from Canada for tax purposes. At present, band councils are not legally entitled to levy a tax on their reserve residents, and until such time as First Nations are in a position to 'self-govern', without relying solely upon federal transfer payments, Canada's tax system can never be truly equitable or efficient.

[1] The *Indian Act*, RSC 1985, c. I-5.

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INTRODUCTION

There is a common misapprehension that Aboriginal people are not required to pay tax. While the *Indian Act*[1] does contain a limited tax exemption, it is available only to 'Indians' and 'bands' insofar as their property is located on a reserve. At any rate, the term 'Indian' is used throughout this thesis to differentiate between 'Aboriginal people', meaning those people who have existed in Canada from time immemorial,[2] and 'Indians' as defined under Section 2(1) of the Act.[3] This is mentioned, in part, to explain why it is necessary to make use of the term 'Indian' and to indicate that no offence is intended.

This thesis consists of five chapters. Chapter One reviews the nature and historical origins of the tax exemption and inquires into its three possible sources: Aboriginal rights, treaties, and legislation. In identifying the source for the exemption, Chapter One describes why First Nations are afforded special treatment within the Canadian tax system. Chapter Two analyses the statutory source of the exemption contained in Section 87 of the *Indian Act* – the only source recognised by Parliament and the courts – and the technical requirements thereof. Chapter Three focuses on the jurisprudence interpreting the tax exemption, with an emphasis on the 'connecting factors' test conceived in *Williams v. The Queen*,[4] and discusses how it applies to employment, business and investment income. Chapter Four considers the

[1] The *Indian Act*, RSC 1985, c. I-5.
[2] Including Registered, or Status Indians and Non-Status Indians, Metis, Inuit, and Inuvialuit.
[3] Section 2(1) of the Indian Act defines an Indian person as "a person who pursuant to this Act is registered as an Indian or is entitled to be registered as an Indian." Section 6, a deeming provision, defines "persons entitled to be registered". Although Inuit are classified as Indians for the purposes of the *Constitution Act, 1867*, they do not so qualify under the *Indian Act*.
[4] *Williams v. The Queen*, [1992] 1 S.C.R. 877.

ill effects of the tax exemption in the context of tax policy, concentrating on the distorting effects, inequities, and inefficiencies produced by the exemption. And finally, Chapter Five discusses a range of possible solutions to the problems identified in Chapter Four, with a focus on self-government.

- CHAPTER ONE -
NATURE AND HISTORICAL ORIGINS OF TAX EXEMPTION FOR INDIANS

Canadian Indians[1] presently enjoy a tax exemption codified in Section 87 of the *Indian Act*.[2] At first glance, providing a tax exemption on the basis of racial designation might appear to be inequitable, but there are a number of reasons why Aboriginal people possess special consideration within Canada. There is an historical basis for this unique status.

The first issue we must consider is the nature of the right to go untaxed which, in turn, should help to explain whether this right exists as a tax exemption or tax immunity.[3] The legal basis for a tax exemption has at least one of three possible sources, which are examined in the pages to follow: (1) Aboriginal rights; (2) treaties; and, (3) legislation. The possibility that First Nations' are immune from tax is discussed in a following chapter, in relation to the so-called inherent right of self-government.

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[1] The term 'Indians' refers to those individuals registered or entitled to be registered as an Indian under the auspices of ss. 2 and 6 of the *Indian Act* R.S.C. 1985, c. I-5. The criteria used to determine whether an individual is entitled to be registered as an Indian is discussed in Chapter Two.

[2] R.S.C. 1985, c. I-5 – hereinafter, the *Indian Act*.

[3] The immunity/exemption distinction is of core importance because it indicates how entrenched the right for Indians not to be taxed is, within the Canadian constitutional and legal framework, and whether and under what circumstances the exemption might be withdrawn. The argument has been advanced that First Nations, insofar as they have not lost their Aboriginal rights, are possessed of an "inherent" right of self-government, which creates a form of sovereign immunity from taxation: Robert Strother, *Aboriginal Tax Exemption Outside the*

1-1 ABORIGINAL RIGHTS

Aboriginal rights are said to "inure to native peoples by virtue of their occupation upon certain lands from time immemorial."[4] Aboriginal people are thus distinguished from all other Canadians because,

> when Europeans arrived in North America, aboriginal peoples were already here, living in communities on the land, and participating in distinctive cultures, as they had done for centuries.[5]

As such, First Nations are accorded certain special treatment within Canada's legal and constitutional framework out of recognition that they conducted their affairs in a manner unique to their societies, prior to first contact with Europeans.

The notion of Aboriginal rights has for years caused difficulties within Canada's legal system, because such rights are not easily explicable under a western jurisprudential analysis.[6] Two recent decisions rendered by the Supreme Court of Canada have, however, gone a long way towards shaping the legal landscape of Aboriginal rights in Canada. Those decisions are *R. v. Van der Peet*[7] and *Delgamuukw v. British Columbia*.[8] In *Delgamuukw*, the Court established that Aboriginal rights fall into three basic categories:

> Aboriginal hunting, fishing and other sustenance rights over general tracts of land that were not sufficiently occupied to give rise to title; aboriginal hunting, fishing, and other rights exercised at a particular and specific site but in relation to which there was not sufficient occupation to give rise to title; and aboriginal title where the occupation was sufficient to establish title. In the first two categories, the right is the

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Indian Act (Report of Proceedings of the Forty-Fifth Tax Conference, 1993 Conference Report: Toronto, Canada) Canada Tax Foundation, 1993, p. 56:2.

[4] Peter Cumming and Neil Mickenberg, *Native Rights In Canada*, 2nd ed. (Toronto: Indian – Eskimo Association of Canada), 1980, p. 13.

[5] As *per* Lamer, C.J. in *R. v. Vander der Peet*, [1996] 2 S.C.R. 507, para 30.

[6] Note, for example, that Aboriginal rights have been described as being *sui generis*, or unique in law in *Guerin v. The Queen* [1984] 2 S.C.R. 335, per Dickson, C.J. at 342. The *sui generis* nature of Aboriginal rights portend to the difficulties that Canadian jurists have had in pinning down precisely what the term "Aboriginal rights" means, given the absence of any substantive recognition or definition by Parliament.

[7] [1996] 2 S.C.R. 507 – hereinafter *Van der Peet* cited to S.C.R..

[8] [1997] 3 S.C.R. 1010 – hereinafter *Delgamuukw* cited to S.C.R..

> right to carry on the same activity in a contemporary form. In the third category, namely aboriginal title, the occupation must be shown to have been exclusive and continuous. But once title is established, the land can be used for every purpose, including purposes which were not traditional.[9]

The possibility of a tax exemption flowing from Aboriginal rights will, therefore, be analysed in relation to these three categories.

1-2 CATEGORIES ONE & TWO: ABORIGINAL RIGHTS IN RELATION TO PRACTICE OR TRADITION – *R. v. Van der Peet*

R. v. Van der Peet was an appeal from the British Columbia Court of Appeal, which overturned a decision of the B.C. Supreme Court, which originally allowed the appellant's appeal from conviction. The appellant, a member of the Sto:lo band, was convicted of selling fish contrary to Subsection 27(5) of the Fishery Regulations. Counsel for the appellant argued that she was exercising her Aboriginal right to sell fish and that her conviction therefore violated Subsection 35(1) of the *Constitution Act, 1982*,[10] which gives constitutional protection to "existing aboriginal and treaty rights of the aboriginal peoples of Canada." The issue was whether Subsection 27(5) was of any force or effect with respect to the appellant. The question of a possible claim to Aboriginal title was not raised in *Van der Peet*.

Chief Justice Antonio Lamer, writing for the majority in a seven to two decision, took the momentous step of establishing a test to determine whether a practice or tradition constitutes an Aboriginal right and is thus "recognised and affirmed" by Subsection 35(1) of the *Constitution Act, 1982*.

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[9] The Honourable Mr. Justice Douglas Lambert, "Van der Peet and Delgamuukw: Ten Unresolved Issues"; 32 (1998) U.B.C. Law Review, para 19.

[10] Enacted under Schedule B of the *Canada Act, 1982*, c. 11 (U.K.), hereinafter the *Constitution Act, 1982*.

> [T]he following test should be used to identify whether an applicant has established an aboriginal right: **in order to be an aboriginal right an activity must be an element of a practice, custom or tradition integral to the distinctive culture of the aboriginal group claiming the right**.... A practical way of thinking about this problem is to ask whether, without this practice, custom or tradition, the culture in question would be fundamentally altered or other than what it is. One must ask, to put the question affirmatively, whether or not a practice, custom or tradition is a defining feature of the culture in question.... The time period that a court should consider in identifying whether the right claimed meets the standard of being integral to the aboriginal community claiming the right is the period prior to contact between aboriginal and European societies.[11] [emphasis added]

Hence, there are two critical elements in identifying Aboriginal rights when Aboriginal title has not been established: (1) the practice must be integral,[12] that is, of central significance to the Aboriginal society in question; and, (2) the practice must have continuity with practices that existed prior to first contact.[13]

It is now appropriate to analyse whether there exists an 'Aboriginal right' to a tax exemption in relation to the first two categories of Aboriginal rights, that is, in the absence of

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[11] As per Chief Justice Lamer in *Van der Peet*, *supra* note 7, at paras 55-60.

[12] To that end, Chief Justice Lamer added:

> To satisfy the integral to a distinctive culture test the aboriginal claimant must do more than demonstrate that a practice, custom or tradition was an aspect of, or took place in, the Aboriginal society of which he or she is a part. The claimant must demonstrate that the practice, custom or tradition was a central and significant part of the society's distinctive culture. He or she must demonstrate, in other words, that the practice, custom or tradition was one of the things which made the culture of the society distinctive – that it was one of the things that truly made the society what it was.... The court cannot look at those aspects of the aboriginal society that are true of every human society (e.g., eating to survive), nor can it look at those aspects of the aboriginal society that are only incidental or occasional to that society; the court must look instead to the defining and central attributes of the aboriginal society in question.

Ibid., at para 55. It should be noted that the "integral part" of an Aboriginal community's "distinctive culture" phraseology was first given effect by the Supreme Court of Canada in *R. v. Sparrow*, [1990] 1 S.C.R. 1075, at 1099. The fact scenario in *Sparrow* was similar to that in *Van der Peet*: at issue was the constitutionality of the federal fishing regulations which required fishing permits and prohibited certain methods of fishing. The Supreme Court of Canada held that fishing for salmon in the Fraser River estuary, known as Canoe Passage, was an integral part of the Musqueam First Nation's cultural identity and that the federal fishing regulations were invalid as the appellants' Aboriginal right to fish was protected by s. 35(1) of the *Constitution Act, 1982*.

[13] On this point, Chief Justice Lamer stated the following:

> This aspect of the integral to a distinctive culture test arises from the fact that Aboriginal rights have their basis [*sic*] in the prior occupation of Canada by distinctive Aboriginal societies. Conclusive evidence from pre-contact times about the practices, customs and traditions of the community in question need not be produced. The evidence simply needs to be directed at demonstrating which aspects of the Aboriginal community and society have their origins pre-contact.

Aboriginal title. Any such right would presumably find its roots in First Nations' pre-contact social structure. Hence, the argument that Indian peoples should be exempt from tax on the basis of respect for their traditional customs would run as follows: First Nations' ancestral social structures were communal, and tax is a mechanism that is foreign to a culture in which the materials necessary for survival are openly shared. Consequently, First Nations have a right not to be taxed because the absence of taxation is a defining feature of Aboriginal culture and that culture would be fundamentally altered if taxes were imposed.[14]

It is true that First Nations placed little if any value in material possession and property was 'owned' communally and shared amongst band members. In pre-colonial times, Aboriginal people were generous among themselves, and not attached to property as were their European counterparts. The Jesuit priest, Paul Le Jeune, reported in 1634 that:

> [The Aboriginal people] are contented with a mere living, not one gives himself to the Devil to acquire wealth.... Moreover, if it is a great blessing to be free from a great evil, our Savages are happy; for the two tyrants who provide hell and torture for many of our Europeans, do not reign in their great forests, - I mean ambition and avarice.[15]

First Nations were content to live without material possessions and "made a show of not being attached to the riches of the Earth". Such an existence was not conducive to political or tax structures as existed then throughout Western Europe. Simply stated, First Nations had no need for political institutions on a European scale since property was shared amongst members of the band.

We are thus led to inquire as to whether the absence of taxation is either (*a*) merely incidental to First Nations' social structure because forced distribution of wealth was unnecessary due to Aboriginal peoples' communal existence; or, (*b*) the result of a positive

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Ibid., at para 56.

[14] Robert Reiter, *Tax Manual for Canadian Indians* (Edmonton: First Nations Resource Council, 1990), p. 2.14.

decision not to compel band members to contribute because First Nations valued the right to exist in the absence of forced taxation? If pre-contact First Nations simply neglected to contemplate the imposition of taxes, it would be practically impossible to suggest that living tax free was integral or of central significance to their existence as First Nations. On the other hand, if establishing a tax system was taken under consideration and First Nations dismissed the idea of 'forced sharing' in favour of voluntary contributions, then an argument could be made that the right to go untaxed was a defining and central attribute of Aboriginal culture.

That there is an Aboriginal right to be exempt from tax based upon practice or custom alone seems unlikely. Even if First Nations could demonstrate that their culture in the past highly valued the practice of not being forced to contribute to society, Subsection 35(1) of the *Constitution Act, 1982* recognised and affirmed only the rights existing in 1982. By 1982, neither the absence of commercial transactions nor the absence of 'forced sharing' were integral to Aboriginal culture. This is borne out by the fact that the tax exemption would not be an issue if Aboriginal people were not engaged in commercial transactions involving income and profits, because tax only accrues on taxable income.[16]

Moreover, various statutes and declarations have contemplated the taxation of Indians "sufficiently intelligent to be capable of managing their own affairs"[17] and granted bands

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[15] Reuben Thwaites, 3rd ed., *The Jesuit Relations and Allied Documents – Travels and Explorations of Jesuit Missionaries in New France* (Cleveland: Burrows Bros. Company, 1896), Vol. VI, p. 231.

[16] Section 2(2) of the ITA defines taxable income as being s. 3 income minus Division C deductions. The calculation used to arrive at s. 3 income (revenue minus expenses) implies that for tax to have accrued, money must have changed hands, which further implies that Aboriginal people are no longer committed to the idea of a communal existence alone.

[17] For example, section 14 of the *Act to Encourage the Gradual Civilization of Indian Tribes*, S.C. 1857, c. 26 states:

> Lands allotted under this Act to an Indian enfranchised under it shall be liable to taxes and all other obligations and duties under the Municipal and School Laws of the section of the Province in which such land is situated, as he shall also be in respect of them and his other property.

limited powers of taxation.[18] Perhaps the most compelling evidence that the absence of taxation was not a defining feature of Aboriginal culture by 1982 is the Federation of Saskatchewan Indians 1977 declaration that:

> Indian tribes and subsequently Indian Bands are qualified to exercise powers of self-government because they are independent political groups. Among the inherent powers of Indian government are the powers to:
> (a) determine the form of government;
> (b) define the conditions of government;
> (c) regulate the domestic relations of its members;
> (d) **levy and collect taxes**.[19] [emphasis added]

It would appear that the right to be free from taxation was not a defining feature of Aboriginal culture by 1982 and cannot, therefore, be recognised and affirmed as such by Section 35 of the *Constitution Act*.

1-3 CATEGORY THREE: ABORIGINAL RIGHTS IN RELATION TO ABORIGINAL TITLE -- *Delgamuukw v. British Columbia*

The force of modern jurisprudence militates against the existence of an Aboriginal right to a tax exemption on the basis of practice, custom, or tradition. It is necessary, therefore, to assess whether such a right might exist, *vis-à-vis* Aboriginal title to the land.[20] There is an important distinction to note between 'lands to which First Nations have retained

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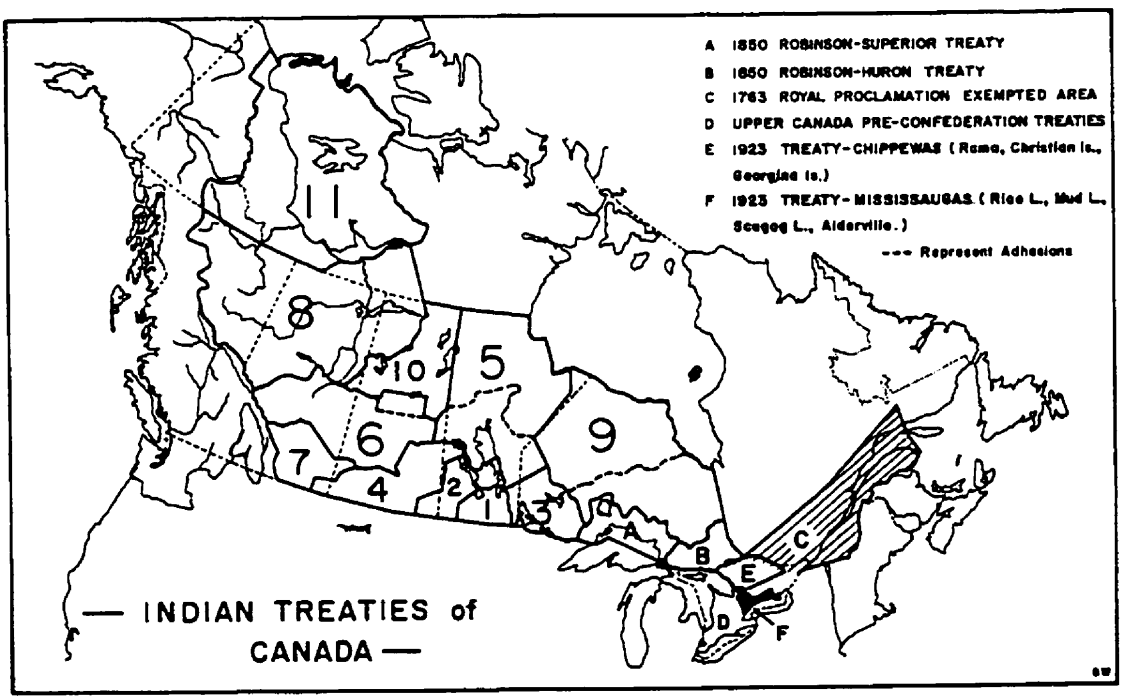
This section, arguably relates more to the extinguishment of the right to be tax exempt, but in any event it serves to illustrate the point that any such right has a questionable basis under the rules extant: Richard Bartlett, *Indians and Taxation in Canada*, 3rd ed. (Saskatoon: Native Law Centre, 1992) p. 2.

[18] Section 10(11) of the *Indian Advancement Act*, S.C. 1884, c. 28, conferred limited powers of taxation upon Indian bands. This section now appears in modified form in s. 83 of the *Indian Act* R.S.C. 1985 (4th Supp.), c. 17 which reads:

> 83.(1) Without prejudice to the powers conferred by section 81, the council of a band may, subject to the approval of the Minister, make by-laws for any or all of the following purposes, namely,
>
> (a) subject to subsections (2) and (3), **taxation for local purposes of land**, or interests in land, in the reserve, including rights to occupy, possess, or use land in the reserve....

[19] Federation of Saskatchewan Indians, "Indian Government" (Prince Albert, Saskatchewan: 1977), cited in Bartlett, *supra* note 17, at 19.

title' and 'Indian reserves'.[21] The latter refers to the lands defined under Subsection 2(1), and referred to under Section 18 of the *Indian Act*; whereas the former refers to the lands occupied by First Nations prior to the Crown's assertion of sovereignty, that have not been the subject of proclamations, statutory provisions, or treaties. As is evident in the illustration on the following page, a large part of British Columbia, North West Quebec, and Labrador has not been the subject of treaties or proclamations and is therefore open to claims based upon Aboriginal title.[22]



Source: Cumming & Mickenberg, *Native Rights in Canada.*

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[20] This is the third of the three categories of Aboriginal rights as enunciated in *Delgamuukw*; *supra* note 9.

[21] Brian Slattery observed:

> North American lands claimed by the Crown were initially of two types. First, there were the Indian Territories, where the Crown held the ultimate title and an exclusive right of purchase, and the native peoples held rights of possession.... Second, there were the lands that have been withdrawn from the Indian Territories and made available for settlement ("General Lands"). Such lands were governed by European style land systems under which title was in principle derived from Crown grant.... These two categories of lands, "Indian Territories" and "General Lands", were at an early stage supplemented by a third category: "Indian Reserves". An Indian Reserve [is] land that has become permanently attached to a particular group of native people. [A]n Indian Reserve cannot be lost by its title holders simply by non-occupation.

Brian Slattery, "Understanding Aboriginal Rights"; (1987) 66 Canadian Bar Review 741-742.

[22] Thomas Issac, *Aboriginal Law, Cases Materials and Commentary* (Saskatoon: Purich Publishing, 1990), p. 3.

The distinction between lands to which First Nations have retained title and Indian reserves is important in the context of taxation because the statutory tax exemption afforded under Section 87 applies only to reserves. The argument that there exists an Aboriginal right to go untaxed, *vis-à-vis* Aboriginal title, would thus geographically expand the exemption to cover lands to which First Nations have retained title. It is equally important to note, however, that the issue of Aboriginal title is limited to those areas where it has never been extinguished by treaties or other colonial instruments.

The idea that Aboriginal title comprises a legal right was placed beyond doubt in the leading case, *Calder v. Attorney-General of British Columbia*[23] and reaffirmed in *Guerin v. The Queen*.[24] In *Guerin*, Chief Justice Dickson, writing on behalf of Beetz, Chouinard and Lamer JJ., held that Aboriginal land title is a legal right derived from the Aboriginal peoples' historical occupation of their tribal lands and is not dependent upon legislative enactments or treaties.[25] The Supreme Court of Canada qualified its position, however, holding that Aboriginal title encompasses a beneficial interest in lands, as opposed to absolute dominion.[26] The beneficial interest arising out of Aboriginal title is said to give rise to a fiduciary duty upon surrender, whereby the Crown is obligated to deal with surrendered land

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[23] *Calder v. Attorney-General of British Columbia*, [1973] S.C.R. 313, concerned a claim by the Nisga'a people of British Columbia that they possessed Aboriginal title in respect of their traditional homeland in the Nass River Valley. Six of the seven Supreme Court of Canada judges held that the Nisga'a did have a right to the lands in question, but the same judges split evenly on the issue as to whether the rights had been validly extinguished.

[24] *Guerin v. The Queen*, [1984] 2 S.C.R. 335, involved the surrender, by the Musqueam Indian Band, of a portion of their reserve lands to the Crown so that the Crown could lease the lands to a golf club. The evidence showed that the lands could have commanded a much higher rent and the Supreme Court of Canada awarded the band $10,000,000.00 in damages.

[25] Aboriginal title was also recognised in the Royal Proclamation of 1763, but *Calder* and *Guerin* confirm that Aboriginal title has an independent basis in Canadian common law: Slattery, *supra* note 21, at 729.

[26] The notion that Aboriginal title comprises only a beneficial interest finds its roots in *St. Catherines Milling and Lumber Co. v. R.*, 2 C.N.L.C. 541 (J.C.P.C), where the Judicial Committee of the Privy Council held that Aboriginal land title comprised a "personal and usufructory right, dependent upon the good will of the Sovereign," at 549: Isaac, *supra* note 22, at 2.

for the benefit of the surrendering First Nations.[27] The fiduciary duty element is discussed in greater detail below, in relation to treaties and the obligations arising from them.

Since the *Guerin* decision pointed to the existence of Aboriginal rights arising *vis-à-vis* Aboriginal title, it is necessary to analyse how that title might be established. The question as to the proof required was central in *Delgamuukw v. British Columbia*, in which fifty-one Gitskan and Wet'suwet'en chiefs appealed a judgment by the B.C. Court of Appeal, upholding the dismissal of the appellants' action against the Province of British Columbia. The appellants sought damages and a declaration of ownership, jurisdiction, and Aboriginal rights over 58,000 square kilometres of land. In a controversial decision, Chief Justice Allan McEachern of the B.C. Supreme Court ruled that the appellants' Aboriginal rights were extinguished by colonial instruments by the time British Columbia joined the Confederation (1871). On appeal to the B.C. Court of Appeal, the appellants replaced ownership and jurisdiction claims with Aboriginal title and self-government claims. The Court of Appeal varied the trial court's judgment, stating that the appellants' Aboriginal rights were not extinguished prior to 1871 and that they did possess non-exclusive Aboriginal rights in certain lands, but that Aboriginal title had not been established. The appellants appealed and in ordering a new trial the Supreme Court of Canada took the opportunity to establish a test to determine whether a claim for Aboriginal title could succeed.

The Court asserted that there are three principle types of Aboriginal rights: the first two relate to tradition and custom, whereas the third relates to indigenous peoples' historic occupation of land. Moreover, Chief Justice Antonio Lamer ruled that Aboriginal rights fall along a spectrum with respect to their degree of connection with the land. He said:

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[27] As per Chief Justice Brian Dickson in *Guerin*, *supra* note 24, at 136.

> At the one end are those aboriginal rights which are practices, customs and traditions integral to the distinctive aboriginal culture of the group claiming the right but where the use and occupation of the land where the activity is taking place is not sufficient to support a claim of title to the land.... At the other end of the spectrum is aboriginal title itself **which confers more than the right to engage in site-specific *activities* which are aspects of the practices, customs and traditions of distinctive aboriginal cultures**.[28] [emphasis added]

The distinction between rights resulting from custom or practice and rights arising *vis-à-vis* title is important because, where Aboriginal title is established, there is no need to demonstrate that the activities or practices undertaken thereon are integral to the distinctive culture of the person charged.[29] Specifically, where Aboriginal title is proven, there would be no need to demonstrate that being free from tax, for example, was integral to the distinctive culture of the group asserting title.

Proof of title might, therefore, carry with it a tax exemption in the form of an Aboriginal right. The issue thus turns to how Aboriginal title may be established,[30] which Chief Justice Lamer confronted in *Delgamuukw*, stating:

> In order to make out a claim for aboriginal title, the aboriginal group asserting title must satisfy the following criteria: (i) the land must have been occupied prior to sovereignty, (ii) if present occupation is relied on as proof of occupation pre-

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[28] *Delgamuukw*, *supra* note 8, at 1019.

[29] This point was duly noted by Lamer, C.J., when he stated:

> Aboriginal title is a right in land and, as such, is more than the right to engage in specific activities which may be themselves aboriginal rights. **Rather, it confers the right to use land for a variety of activities, not all of which need be aspects of practices, customs and traditions which are integral to the distinctive cultures of aboriginal societies.** Those activities do not constitute the right *per se*; rather, they are parasitic on the underlying title. [emphasis added]

Ibid., at para 111.

[30] The leading case on proving aboriginal title is *Hamlet of Baker Lake v. Minister of Indian Affairs and Northern Development*, [1979] 3 C.N.L.R. 17 (F.C.T.D.), in which the Supreme Court of Canada established a stringent four-part test to prove the existence of Aboriginal title Under the *Baker Lake* test, to establish Aboriginal title an applicant was required to demonstrate:

(1) membership in an organised society;
(2) occupation by the organised society over the specific territory over which Aboriginal title is being claimed;
(3) occupation by the organised society was to the exclusion of other organised societies; and
(4) that the occupation was an established fact at the time English sovereignty was asserted.

It wasn't until the *Calder* decision that the test was relaxed and possession of the land in question was taken as proof of Aboriginal title: Isaac, *supra* note 22, at p. 5.

> sovereignty, there must be a continuity between present and pre-sovereignty occupation, and (iii) at sovereignty, that occupation must have been exclusive.[31]

Hence, where it can be shown that land was occupied exclusively, prior to the Crown's assertion of sovereignty, there will exist an Aboriginal right to that land in the form of Aboriginal title. When such title is established the claimants may engage in whatever activities[32] they desire, the only limitation being that "the values which made the site worth occupying, and continue to make it worth occupying, for the Aboriginal people should not be destroyed."[33] In other words, the land in question cannot be used in such a manner as to cause it irreparable harm, *e.g.*, for purposes of strip mining or nuclear waste disposal.

The law relating to Aboriginal rights is very much unsettled and to suggest that there exists an Aboriginal right to be exempted from tax, even where title can be established, would be imprudent and, in any event, the issue has yet to come before the courts. Moreover, the argument that First Nations have a right to go untaxed based upon Aboriginal title alone seems strained, and it is difficult to see how proof of title would automatically confer a tax exemption. A stronger argument for a tax exemption rooted in Aboriginal title arises out of the right of self-government that necessarily ensues. The argument runs as follows: since the Supreme Court of Canada acknowledged the existence of Aboriginal title and since Aboriginal title is a collective right,[34] there is an implied recognition that First Nations, not having surrendered their title, *must* have some degree of self-government.[35] How else, if not through a governing body, would the group asserting title allocate the use of

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[31] *Delgamuukw*, *supra* note 8, at para 143.
[32] The word 'activities' is problematic as it portends to positive acts, such as hunting, fishing, logging or whatever, whereas existing free from tax is not easily described as an activity.
[33] Lambert, *supra* note 9, at para 22.
[34] Aboriginal land rights attribute to groups of Aboriginal peoples a collective title. "The doctrine of aboriginal title attributes to a native group a sphere of autonomy, whereby it can determine freely how to use its lands." Slattery, *supra* note 21, at 746.
[35] Lambert, *supra* note 9, at para 58.

land; determine which resources should be harvested; thrash out compensation under infringement and justification arrangements; and finally, negotiate with the Crown should the community desire to surrender a portion of its land in exchange for compensation?

It follows that if a right of self-government exists then it too will be protected under Subsection 35(1). In turn, a tax immunity would exist as a corollary of the right of self-government whereby First Nations' self-government imputes a form of sovereignty that promulgates an immunity from taxation by other sovereign powers, including the Crown.[36] (The possibility of a tax immunity arising through the right of self-government is reserved for a following chapter.)

To summarise, Aboriginal rights exist out of recognition that First Nations were once independent, self-governing entities in possession of most of the land now comprising Canada. There are three principle types of Aboriginal rights, two of which flow from the practice of a traditional activity or custom integral to First Nations' distinctive culture. The third is derived from the occupation of lands where Aboriginal title was never extinguished by constitutional amendment, or voluntarily surrendered in exchange for other rights or compensation. One means of surrendering Aboriginal rights is through the process of treaty negotiation, which brings us to the second possible source of a tax exemption for First Nations.

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[36] Strother, *supra* note 3, at 56:3.

1-4 TREATIES

Like Aboriginal rights, the treaties negotiated between the Crown and First Nations have been described as *sui generis*.[37] They are not the same as international treaties in the sense of agreements between sovereign nations[38] and, as such, use of the term treaty should not be taken as conferring sovereign status upon First Nations.[39] Instead, treaties between the Crown and First Nations are properly regarded as agreements between those two parties with the following characteristics:

(1) Parties: The parties to the treaty must be the Crown, on the one side, and an aboriginal nation on the other side.
(2) Agency: The signatories of the treaty must have the authority to bind their principals, namely, the Crown and the aboriginal nation.
(3) Intention to create legal relations: The parties must intend to create legally binding obligations.
(4) Consideration: The obligations must be assumed by both sides, so that the agreement is a bargain.
(5) Formality: There must be a certain measure of formality.[40] [emphasis added]

The fourth characteristic portends to the *quid pro quo* element of First Nations' treaties which, as discussed below, is potentially the source of a tax exemption for Indians.

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[37] *R. v. Sioui*, [1990] 1 S.C.R. 1025, at 1043.

[38] In *R. v. White and Bob* (1965), 50 D.L.R. (2d) 613 at 617, Davey, J.A., held that,

> an Indian treaty is not an executive act establishing relationships between what are recognized as two or more independent states acting in sovereign capacities.

[39] Historically, the government did not regard First Nations as comprising sovereign states at the time the original treaties were negotiated. This is supported by the fact that, in the Commissioner's reports on the post-Confederation treaties, both the governmental representatives and the Aboriginal negotiators indicated that Aboriginal peoples were considered to be subjects of the Crown: Cumming and Mickenberg, *supra* note 4, at 54.

[40] Professor Hogg relied largely on *R. v. Sioui* [1990] 3 C.N.L.R. 127 (S.C.C.) and *R. v. Simon* [1986] 1 C.N.L.R. 153 (S.C.C.) in compiling the five characteristics: Hogg, *Constitutional Law of Canada* (Scarborough: Carswell Student Edition, 1998), p. 582.

1-5 THE TAX EXEMPTION CONTAINED IN THE WRITTEN BODY OF A TREATY

A useful starting point in determining whether the treaties negotiated between the Crown and First Nations contain a tax exemption is to examine the text of the treaties themselves. Unfortunately, with the exception of the more contemporary, post-*Calder* treaties,[41] there is no mention of a tax exemption contained in the written terms of any treaty. There is, however, evidence of oral assurances and promises relating to taxation not embodied in the treaties themselves. For example, the report of the treaty commissioner in respect of Treaty No. 8[42] reads as follows:

> There was expressed at every point the fear that the making of the Treaty would be followed by the curtailment of the hunting and fishing privileges, and many were impressed with the notion that the Treaty would not lead to taxation and forced military service.
>
> We assured them that the Treaty would not lead to any forced interference with their mode of life, that it did not open the way to the imposition of any tax, and that there was no fear of enforced military service.

Revenue Canada has interpreted the commissioner's report very narrowly to the effect that it represents only an assurance that Treaty No. 8 did not itself impose a tax, not that it promised a tax exemption.[43]

This narrow interpretation has met with criticism and is, in any event, probably inaccurate given Chief Justice Dickson's pronouncement in *Nowegijick v. The Queen* that:

> ...treaties and statutes relating to Indians should be liberally construed and doubtful expressions resolved in favour of the Indians. If the [treaty] contains language which can reasonably be construed to confer a tax exemption that construction, in my view, is to be favoured over a more technical construction which might be available to deny exemption.[44]

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[41] The James Bay (1975) and Northeastern Quebec (1978) agreements are but two examples. Those agreements are discussed in Chapters Three and Five.

[42] Treaty No. 8 (Ottawa: Queen's Printer, 1899).

[43] Robert C. Strother and Robert A. Brown, *Taxation of Aboriginal People in Canada* (Report of Proceedings of the Forty-Second Tax Conference, 1990 Conference Report) (Toronto: Canada Tax Foundation, 1990), p. 47:13.

[44] *Nowegijick v. The Queen*, [1983] 1 SCR 29 at 36.

The *Nowegijick* decision cited an earlier American case in which the U.S. Supreme Court held that "Indian treaties must be construed, not according to the technical meaning of their words, but in the sense in which they would naturally be understood by the Indians."[45] The notion that treaty language must be read in the sense that it would "naturally be understood by Indians" is significant; it implies that oral assurances and promises should be construed into the terms of the treaties. This is, perhaps, the only means of rendering what was otherwise an unfair and inequitable process into something that does not reek of undue influence.

It is instructive to note that the Crown possessed an unfair bargaining position in negotiating the numbered treaties. First Nations did not historically place any emphasis upon written documentation of their rules and regulations, but instead relied upon oral evidence.[46]

> Despite the insight and skill exhibited by their negotiators, it is clear that the Indians were not in an equal bargaining position with the Government. The Indians were a non-literate people and the concept of treaty was foreign to their culture.... The Indian culture followed the oral tradition and held verbal promises to be as binding as written promises. Their negotiators apparently relied upon the advice of missionaries and the North-West Mounted Police, neither of whom could be called disinterested parties.[47]

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[45] *Jones v. Meehan*, 175 US 1 (1899).

[46] Chief Justice Lamer provided an eloquent account of the importance placed by First Nations in oral history and record keeping in *Delgamuukw*:

> [T]he Aboriginal historical tradition is an oral one, involving legends, stories and accounts handed down through the generations in oral form. It is less focused on establishing objective truth and assumes that the teller of the story is so much a part of the event being described that it would be arrogant to presume to classify or categorize the event exactly or for all time. In the Aboriginal tradition the purpose of repeating oral accounts from the past is broader than the role of written history in western societies. It may be to educate the listener, to communicate aspects of culture, to socialize people into a cultural tradition, or to validate the claims of a particular family to authority and prestige.... Oral accounts of the past include a good deal of subjective experience. They are not simply a detached recounting of factual events but, rather, are "facts enmeshed in the stories of a lifetime". They are also likely to be rooted in particular locations, making reference to particular families and communities. This contributes to a sense that there are many histories, each characterized in part by how a people see themselves, how they define their identity in relation to their environment, and how they express their uniqueness as a people.

Delgamuukw, *supra* note 8, at para 85.

[47] Cumming and Mickenberg, *supra* note 4, at 122-123.

Simply stated, the First Nations participating in the treaty negotiations did not appreciate the importance of inserting terms into the written body of a treaty and might well have presumed that when oral assurances were made they automatically constituted a treaty provision.

Unfortunately, it might never be possible to know what the actual First Nations peoples participating in early treaty negotiations thought they would receive in exchange for surrendering title to their land. It is for this reason that such a wide berth must be given to the First Nations' perspective in construing such documents. This sentiment is borne out in *R. v. Badger*,[48] wherein the Supreme Court of Canada enumerated several guidelines bearing on treaty interpretation.

> First it must be remembered that a treaty represents an exchange of solemn promises between the Crown and the various Indian nations. It is an agreement whose nature is sacred....
>
> Second, the honour of the Crown is always at stake in its dealing with Indian people. Interpretations of treaties and statutory provisions which have an impact upon treaty or aboriginal rights must be approached in a manner which maintains the integrity of the Crown. It is always assumed that the Crown intends to fulfil its promises. No appearance of "sharp dealing" will be sanctioned....
>
> Third, any ambiguities or doubtful expressions in the wording of the treaty or document must be resolved in favour of the Indians. A corollary to this principle is that any limitations which restrict the rights of Indians under treaties must be narrowly construed....
>
> Fourth, the onus of proving that a treaty or aboriginal right has been extinguished lies upon the Crown. There must be "strict proof of the fact of extinguishment" and evidence of a clear and plain intention on the part of the government to extinguish treaty rights.[49]

The Court also indicated that oral assurances are an important information in treaty interpretation, and that such assurances, where appropriate, should be construed into the terms of a treaty.[50]

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[48] *R. v. Badger*, [1996] 1 S.C.R. 771. At issue in *Badger* was whether the treaty right to hunt provided a defence to a charge of hunting out of season and hunting without a license. The court ruled that the right to hunt was a treaty right within the meaning of s. 35(1) of the *Constitution Act* and that the right to hunt for food, not put to an incompatible use (e.g., used for commercial sale) was therefore protected.

[49] *Ibid.*, at 788-789.

[50] The Court stated:

To summarise, the Supreme Court of Canada established in *Nowegijick*, that a liberal approach is appropriate in interpreting treaties and in *Badger*, the Court confirmed that oral assurances made during treaty negotiations "are of great significance in their interpretation". Therefore, the oral assurances referred to in the commissioner's report concerning Treaty No. 8 should be read into the terms of that treaty. Moreover, the notion that the Aboriginal perspective should prevail in the face of vague or ambiguous language means that the assurances contained in the commissioner's report should confer a tax exemption, not merely a recognition that Treaty No. 8 did not itself impose a system of taxation. This very issue is set to come before the Federal Court of Canada, in the first case of its kind, on 26 June 2000.[51]

> [W]hen considering... a treaty, a court must take into account the context in which the treaties were negotiated, concluded and committed to writing. The treaties, as written documents recorded an agreement that had already been reached orally and they did not always record the full extent of the oral agreement.... As a result, it is well settled that the words in the treaty must not be interpreted in their strict technical sense nor subjected to rigid modern rules of construction. Rather, they must be interpreted in the sense that they would naturally have been understood by the Indians at the time of signing.
>
> The Indian people made their agreements orally and recorded their history orally. Thus, the verbal promises made on behalf of the federal government at the times the treaties were concluded are of great significance in their interpretation.

Ibid., at 792-793.

[51] Following an order dated 28 April 1994, by Jerome, A.C.J., approving an application by the plaintiffs' to be adjoined in the action, a statement of claim was filed at the Federal Court of Canada. The cause of action reads, "Charles John Gordon Benoit, Joan Elizabeth Benoit, and Gordon James Alfred Benoit" (Plaintiffs), and "Her Majesty The Queen" (Defendant) – File No. T-2288-92. The plaintiffs are Indians as defined under the *Indian Act* and reside in Fort McMurray, Alberta, which is within the area covered by Treaty No. 8. A portion of the statement of claim reads:

> 7. The Treaty Commissioners promised the First Nations that, *inter alia*, Treaty No. 8 did not open the way to the imposition of any tax (the "subject promise"). The subject promise is a term of Treaty No. 8 and provided a corresponding right to the members of First Nations who are entitled to the benefits of Treaty No. 8, not to have any tax imposed upon them at any time for any reason (the "subject right").
>
> 8. The subject right and the subject promise were not extinguished by Her Majesty the Queen or by Canada or by any other party prior to April 17, 1982, and are now protected from extinguishment by the *Constitution Act*, 1982.
>
> 9. Despite the subject promise, the Plaintiffs have been subjected to the payment of tax pursuant to the requirements of various acts and regulations enacted by Canada, and by the Province of Alberta, including, but not limited to, the Income Tax Act (Canada) and the Excise Tax Act (Canada).
>
> 10. The imposition of any tax on the Plaintiffs is an unjustified breach of the subject promise and an unjustified infringement of the subject right.

Finally, in light of the assurances and promises made by the Crown throughout treaty negotiations generally, First Nations are at least entitled to a 'reasonable expectation' that the Crown should not act contrary to their fundamental interests.[52] This reasonable expectation flows not from the written terms of any treaty *per se*, but from the course of conduct between the principal actors in negotiating the treaties. The Supreme Court of Canada has indicated that 'reasonable expectations' give rise to fiduciary obligations that bear upon the parties to a treaty or contract.[53]

1-6 FIDUCIARY DUTIES AS A PRODUCT OF TREATY NEGOTIATIONS

It would be grossly inequitable to expect that First Nations surrendered the lands to which they held title under the Royal Proclamation of 1763 for nothing more than what appears in the written embodiments of the early treaties.[54] First Nations did, after all, relinquish the rights to their land and resources in negotiating the treaties, which, prior to the 1850s, comprised almost all of what is now Canada.[55] This is mentioned to underscore the magnitude of what was involved for Aboriginal participants in early treaty negotiations.

> 11. The imposition of any tax on the Plaintiffs is an unjustified breach of Canada's fiduciary duty to the Plaintiffs, as members of the First Nations.

A trial date has been set for June 2000.

[52] Peter Hutchins, David Schulze and Carol Hilling, "When Do Fiduciary Obligations To Aboriginal People Arise?" (1995) 59 Sask. L. Rev. 97 at para 20.

[53] *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574 at 663. Mr Justice La Forest identified the reasonable expectation as being conclusive to the question of fiduciary obligations when he stated:

> As I indicated above, the issue should be whether, having regard to all the facts and circumstances, one party stands in relation to another such that it could reasonably be expected that that other would act or refrain from acting in a way contrary to the interests of that other.

[54] For example, under the terms of Treaty No. 1, the Indians were to receive, *inter alia*, 160 acres of land per family of five, an initial payment of $3.00 per person, and a yearly annuity of $15.00 per family. Treaties 2 through 11 proceeded along much the same lines. This is hardly ample consideration for the surrender of the land mass comprising areas the size an entire province: Cumming and Mickenberg, *supra* note 4, at 122.

[55] Brian Slattery captured that sentiment most eloquently when he wrote:

The Crown's primary goal in negotiating post-Confederation treaties was, in fact, to extinguish Aboriginal title, the existence of which was confirmed in the Royal Proclamation of 1763.[56]

> The need for such an extinguishment evolved from the recognition given to aboriginal rights by British colonial policy and subsequently confirmed by the Royal Proclamation of 1763. The language of real property law used in the treaties and the reports of the Government negotiators indicate that the purpose of the treaties was to extinguish Indian title in order that lands could be opened up to white settlement. The treaties, therefore, can be best understood as agreements of a very special nature in which the Indians gave up their land rights **in exchange for certain promises made by the Government.**[57] [emphasis added]

By the early nineteenth century, Britain's position in North America was much more settled than before and the need to procure a military alliance with the First Nations was subsumed by a drive to open frontiers to European settlers who were moving westward at a rapid pace.[58] As such, the Crown required the land to which First Nations retained title and made

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> Canada and the United States came into being, not simply through the activities of incoming European powers, but through a complex series of interactions among various settler groups and Aboriginal nations.

"Aboriginal Sovereignty and Imperial Claims: Reconstructing North American History", (1991) 29 Osgoode Hall L.J. 681 at 701.

[56] The Royal Proclamation states that, in the interests of security within the colonies, First Nations were not to be "molested or disturbed in the Possession of such Parts of [North America] as not having been ceded to or Purchased by [the Crown]...." The Royal Proclamation was drafted out of recognition of Britain's then precarious military position, and the need to establish peaceful relations with First Nations whose friendship was a source of military advantage. Such is evidenced in a series of correspondence preceding the Royal Proclamation between Lord Egremont and the Lords of Trade. The correspondence reveals the British Government's concern that Aboriginal title be respected, so as to avoid disturbances with First Nations:

> The Second Question which relates to the Security of North America, seems to include Two Objects to be provided for; The first is, the Security of the whole against any European Power; The next is the Preservation of the internal Peace and Tranquility of the Country against any Indian Disturbances. Of these Two Objects, the latter appears to call more immediately for such Regulations and Precautions as Your Lordships shall think proper to suggest.

The British Government was thus motivated in 1763 to preserve Aboriginal title so as to quell First Nations' concerns about the influx of British settlers: Cumming and Mickenberg, *supra* note 4, at 26.

[57] *Ibid.*, at 53.

[58] Hogg, *supra* note 40, at 580.

the acquisition of such lands its primary objective in negotiating treaties with First Nations from approximately 1850 onward.[59]

Therefore, additional consideration in the form of fiduciary duties should be read into the treaties, if for no other reason than to minimise the disparity between the value of the lands and the consideration given in exchange.

> The existence of fiduciary obligations by the Crown should be presumed whenever Aboriginal peoples are constrained in exercising rights to lands or resources, or in the exercise of their internal or external sovereignty. This is because those constraints were either conceded by them in return for promises, or else the Crown has imposed them unilaterally and without justification. On the strength of the Crown's promises, Aboriginal peoples granted access to or agreed to share their lands and resources, agreed to be faithful allies, or agreed to put themselves under the protection of the European sovereign.[60]

Even by adding fiduciary duties to the list of obligations vested in the Crown, the treaty provisions are still inequitable.

The Crown has long since acknowledged that First Nations deserve more than the treaties' written terms alone would suggest, for having surrendered their title. These additional entitlements may arise in the form of fiduciary duties, out of the promises made by the Crown in exchange for Aboriginal title. After all, the Crown had nothing more than promises to offer First Nations in return for their lands.

> The visitors brought with them various goods and services – trade goods, military support, agricultural implements – and the ubiquitous promises: promises of protection, promises of civilization, promises of riches, promises of security. It was these promises and their acceptance by the Aboriginal peoples that laid the foundation for the fiduciary relationship between the parties and the resulting fiduciary obligations on the Crown.
>
> From ocean to ocean to ocean, on the strength of these promises, Aboriginal peoples granted access to, or agreed to share, their lands and resources, or agreed to be faithful allies, or to put themselves and their lands under the protection of the European sovereign. Through this process, the Crown took on the privilege and

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[59] In 1850 the Robinson Treaties were signed, followed by the numbered treaties (eleven in number) between 1871 and 1921: *Ibid.*, at 580.

[60] Hutchins, Schulze and Hilling, *supra* note 52, at 121.

> burden of being the sole beneficiary of any surrender of Aboriginal rights, titles or sovereignty.[61]

From the time when Europeans set foot in North America, First Nations were expected to place their trust in the Crown and freely allow 'Canada' to engulf what was once their land.[62] It follows that the Crown should respect that trust by honouring its obligations to First Nations.

In *Guerin v. The Queen*,[63] the Supreme Court of Canada acknowledged the trust-like obligation assumed by the Crown when title is surrendered. In rendering its decision, the Court signalled that it was prepared to confront many of the basic unresolved issues concerning Aboriginal and treaty rights. Justice Dickson (as he was then) observed that

> ...Indians have a legal right to occupy and possess certain lands, the ultimate title to which is in the Crown.... It is true that the *sui generis* interest which the Indians have in the land is personal in the sense that it cannot be transferred to a grantee, **but it is also true..., that the interest gives rise upon surrender to a distinctive fiduciary duty obligation on the part of the Crown to deal with the land for the benefit of the surrendering Indians**.[64] [emphasis added]

It would appear that the fiduciary duty is rooted in two originating factors: first, the existence of Aboriginal title, and second, the principle dating back to the Royal Proclamation of 1763 that Aboriginal title is inalienable, excepting, of course, when surrendered to the Crown. These together are the source of the fiduciary obligation.

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[61] *Ibid.*, at 10.

[62] Harold Cardinal provides a good synopsis of the First Nations' perspective on the importance of the Crown honouring its treaty obligations:

> To the Indians of Canada, the treaties represent an Indian Magna Carta. The treaties are important to us because we entered into these negotiations with faith, with hope for a better life with honour.... The treaties were the way in which white people legitimized in the eyes of the world their presence in our country. It was an attempt to settle the terms of occupancy on a just basis, legally and morally to extinguish the legitimate claims of our people to title to the lands in our country.

Harold Cardinal, *The Unjust Society: The Tragedy of Canada's Indians* (Edmonton: Hurtig, 1969), pp. 28-29.

[63] *Guerin v. The Queen*, [1985] 1 C.N.L.R. 120.

[64] *Ibid.*, at 136.

The Supreme Court of Canada revisited its *Guerin* reasoning in *R. v. Sparrow*.[65] Although *Sparrow* concerned Aboriginal rights arising *vis-à-vis* custom or tradition, the Court took the opportunity to reaffirm the earlier decision.

> This court found that the Crown owed a fiduciary obligation to the Indians with respect to the lands. The *sui generis* nature of Indian title, and the historic powers and responsibility assumed by the Crown constituted the source of such a fiduciary obligation. In our opinion, *Guerin*, together with *Taylor and Williams* ground a general guiding principle for s. 35(1). That is, the government has the responsibility to act in a fiduciary capacity with respect to aboriginal peoples. The relationship between the government and aboriginal [peoples] is trust-like, rather than adversarial, and contemporary recognition and affirmation of aboriginal rights must be defined in light of this historic relationship.[66]

Having established that a fiduciary duty arises upon the surrender of Aboriginal title, one is inclined to inquire into the scope of the obligation and ask what First Nations received in return for surrendering their title. In addressing this question it is helpful to remind oneself of what the Crown gained from the treaty negotiations. As noted above, the Crown took ownership of the lands that now represent the prairie provinces, a portion of western Ontario, and a portion of the North West Territories for its part in the Treaties numbered 1 through 11.[67] The enormity of the land-mass comprising the subject matter of the Numbered Treaties is, perhaps, best depicted by a visual illustration, as reproduced on the following page.

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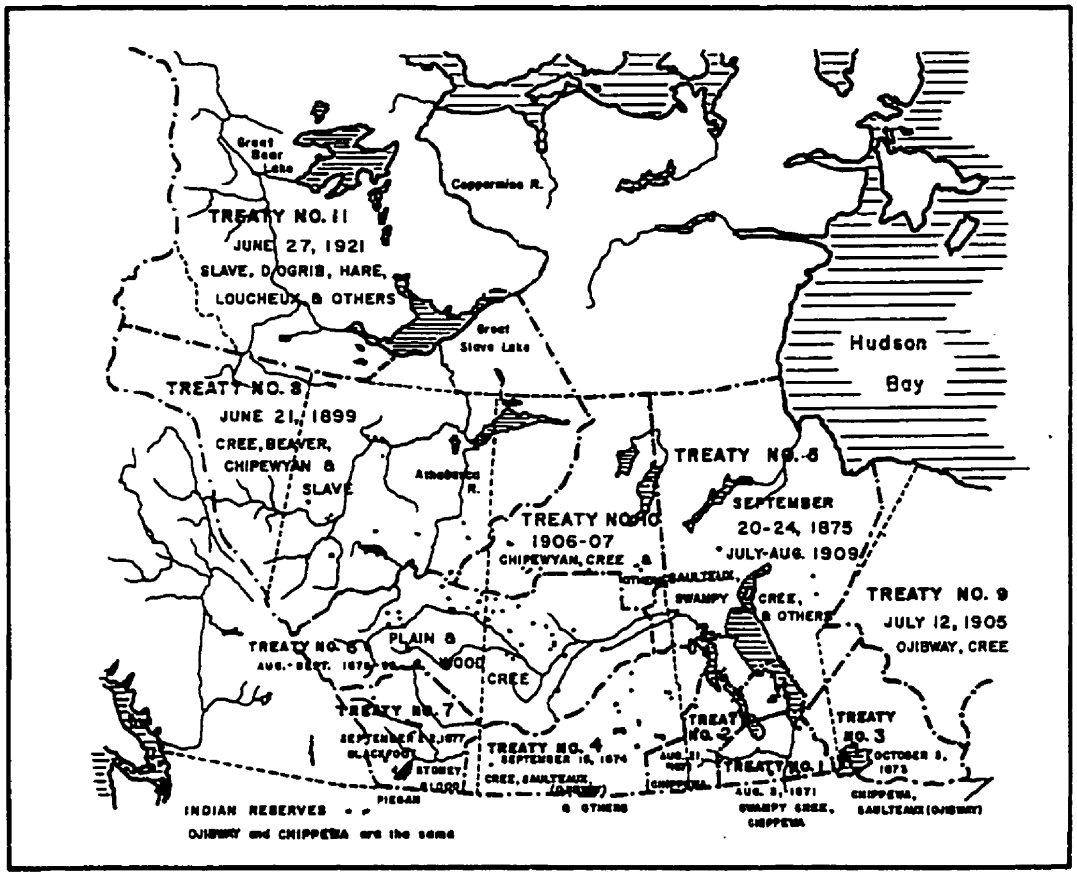
[65] *R. v. Sparrow*, [1990] S.C.R. 1075.
[66] *Ibid.*, at 1099.
[67] Cumming and Mickenberg, *supra* note 4, at 119.



Source: Cumming & Mickenberg, *Native Rights in Canada.*

Owing to the magnitude of what was at stake it would not be excessive to suggest that the Crown's fiduciary duty should at least consist of a duty to ensure that the lands reserved for First Nations in the treaties are not diminished in size. In his address at Lower Fort Garry in 1871, Lieutenant-Governor Archibald suggested as much when he explained the concept of the reserve system in the following terms:

> Your Great Mother wishes the good of all races under her sway. She wishes her red children to be happy and contented. She wishes them to live in comfort. She would like them to adopt the habits of the whites, to till the land and raise food, and store it up against a time for want. Your Great Mother, therefore will lay aside for you "lots" of land to be used by you and your children forever. She will not allow the white man to intrude upon these lots. **She will make rules to keep them for you, so that as long as the sun shall shine, there shall be no Indian who has not a place that he can call his home, where he can go and pitch his camp, or if he chooses, build his house and till his land.**[68] [emphasis added]

[68] *Ibid.*, at 121.

Since time immemorial the Crown has pointed to the duty to maintain reserve lands, in order to justify restrictions on Aboriginal title and to explain why the Crown acts as intermediary between First Nations and third parties.[69] In reality, the restriction on alienation actually served the Crown's interest because it prevented other European powers from usurping Aboriginal title and also helped to preserve peaceful relations between the colony and First Nations when the Crown's existence in North America was precarious at best.[70]

That the Crown owes First Nations a duty to shield them from being dispossessed of the lands reserved for them was expressed in *Mitchell v. Peguis Indian Band*[71] when Justice La Forest stated:

> [The] legislative restraints on the alienability of Indian lands are but the continuation of a policy that has shaped the dealings between the Indians and the European settlers since the time of the Royal Proclamation of 1763. The historical record leaves no doubt that native peoples acknowledged the ultimate sovereignty of the British Crown, and agreed to cede their traditional homelands on the understanding that the Crown would thereafter protect them in possession and use of such lands as were reserved for their use.[72]

Implicit in the duty to protect reserved lands, for "as long as the sun shall shine," is an obligation not to levy taxes upon First Nations, at least in respect of their property located on a reserve. This is a practical means of ensuring that the lands guaranteed to First Nations are never dwindled away, because it is not inconceivable that, if Indian property on the reserve were liable to tax, a confiscatory charge could be placed on that property if taxes were not

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[69] Dickson J., as he then was, drew attention to the restriction on alienation and its significance in *Guerin v. The Queen*, wherein he stated:

> The purpose of the surrender requirement is clearly to interpose the Crown between the Indians and prospective purchasers or lessees of their land, so as to prevent the Indians from being exploited. This is made clear in the Royal Proclamation itself, which prefaces the provision making the Crown an intermediary with a declaration that "great Frauds and Abuses have been committed in purchasing Lands of the Indians to the great Prejudice of our Interest and to the Dissatisfaction of said Indians."

[1984] 2 S.C.R. 335 at 392.

[70] Slattery, *supra* note 21, at 753.

[71] *Mitchell v. Peguis Indian Band*, [1990] 2 S.C.R. 85.

paid. This, in turn, could result in a forfeiture of that property under the garnishment provisions contained in the *Income Tax Act*,[73] thereby gradually chipping away at the 'Indian' entitlement. Justice La Forest acknowledged that the *Indian Act* tax exemption exists for the purpose of guarding against the diminishment of reserved lands,[74] but he declined to comment on whether there was a corresponding fiduciary duty upon the Crown not to levy taxes.

The *quid pro quo* element relating to treaties, whereby valuable consideration must be provided to render a treaty binding, resonates in the *Mitchell v. Peguis* decision. Justice La Forest identified the surrender of Aboriginal title, and the protections owed in return, as forming the primary elements of the bargain in Indian treaties, stating:

> 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 recognized that it is honour bound to shield Indians from any effort by non-natives to dispossess Indians of their property which they hold qua Indians**, i.e., their land base and the chattels on that land base.[75] [emphasis added]

Justice La Forest's choice of words is significant: the terminology "bears the impress of an obligation" and, "the Crown has always recognised that it is honour bound to shield Indians from any effort by non-natives" portends to the existence of a fiduciary duty. Moreover, because the provincial and federal governments qualify as 'non-natives', they too are prevented from dispossessing First Nations of their reserved lands. This implies that the

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[72] *Ibid.*, at 131.

[73] As contained in Part XV of the Act entitled "Administration and Enforcement", which include ss. 220 through 244.

[74] To that end Justice La Forest stated:

> In effect the 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.

[75] As *per* La Forest in *Mitchell v. Peguis* , *supra* note 71, at 132.

government must abstain from levying taxes in respect of property situated on a reserve, so as to negate the threat of dispossessing Indians of their reserved lands.

Unfortunately, Justice La Forest stopped short of saying that the Crown owes a fiduciary duty to provide a tax exemption, but his disposition was instructive nonetheless. He clearly implied that, in exchange for surrendering their title, the Crown owes First Nations a duty to protect their entitlements. This suggests that the statutory protections afforded in Sections 87, 89 and 90 of the *Indian Act* merely codify the fiduciary duty owed to First Nations to ensure that their lands are forever impervious to distraint.

In conclusion, by designating the tax exemption as a fiduciary duty arising out of treaty obligations, the rights flowing therefrom, like Aboriginal rights, are afforded constitutional protection under Subsection 35(1) of the *Constitution Act, 1982*. Hence, if the tax exemption is a treaty right it may only be withdrawn or infringed if that infringement is justifiable under the *R. v. Sparrow* doctrine.[76]

> The justification analysis would proceed as follows. First is there a valid objective? Here the court would inquire into whether the objective of Parliament in authorising the department to enact regulations regarding [the infringement] is valid. The objective of the department in setting out the particular regulations would also be scrutinised. An objective aimed at preserving s. 35(1) rights by conserving and managing a natural resource, for example would be valid.... If a valid legislative objective is found, the analysis proceeds to the second part of the justification issue. Here we refer back to the guiding interpretive principle derived from *Taylor and Williams* and *Guerin*. That is, the honour of the Crown is at stake in dealings with aboriginal peoples. The special trust relationship and the responsibility of the

[76] It is important to note that the provincial government could not, under any circumstances, infringe upon a treaty right to a tax exemption. Under the current tax regime, both the federal and provincial governments impose income tax, as provided for by the *Federal-Provincial Fiscal Arrangements Act*, R.S.C. 1985 c.F-8. Because the collection agreement establishes that income tax levied by the provinces respectively is imposed under provincial, not federal, jurisdiction, the levying of provincial income tax is subject to being barred by the terms of any treaty, such as Treaty No. 8. This is owing to s. 88 of the *Indian Act*, wherein it states:

> *Subject to the terms of any treaty...* 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 those laws are inconsistent with this Act. [emphasis added]

Hence, unless the federal government was to repeal s. 88 of the *Indian Act*, the existence of a treaty right to enjoy tax exempt status could not be infringed by the provincial Crown.

> government *vis-à-vis* aboriginals must be the first consideration in determining whether the legislation or action in question can be justified.[77]

It might be possible to justify infringing upon a treaty-based tax exemption if levying a tax is necessary for purposes of preserving reserve infrastructures. For example, withdrawing the exemption under a revenue-raising objective required to provide reserve residents the services entitled to them as *per* the terms of the treaty, might be acceptable. In any event, the second part of the *Sparrow* analysis would surely require the tax be levied in such a way that would never put reserved lands at risk of distraint.

1-7 STATUTORY TAX EXEMPTION

The tax exemption enjoyed by Canadian Indians is a product of the commitment to shield the lands reserved for First Nations from erosion. The earliest statutory tax exemption appears in *An Act for the protection of Indians in Upper Canada from imposition, and the property occupied or enjoyed by them from trespass and injury*.[78] Section 4 provides:

> IV. That no taxes shall be levied or assessed upon any Indian or any person intermarried with any Indian for or in respect of any of the said Indian lands, nor shall any taxes or assessments whatsoever be levied or imposed upon any Indian or any person intermarried with any Indian **so long as he, she or they shall reside on Indian lands not ceded to the Crown**, or which having been so ceded may have been again set apart by the Crown for the occupation of Indians. [emphasis added]

From its inception, the tax exemption afforded to Indians attached to reserve lands, which exemplifies that the underlying policy rationale was singularly purposive. In devising the exemption, legislators were clearly unconcerned with the welfare of Aboriginal persons *per se*, intending only to shield reserved lands from erosion.

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[77] *R. v. Sparrow*, *supra* note 65, at 1103-1104.
[78] S.C., 1850, c. 74.

The 1850 exemption remained unchanged until the advent of the first *Indian Act* in 1876,[79] wherein Sections 64 and 65 provided:

> 64. No Indian or non-treaty Indian shall be liable to be taxed for any real or personal property, **unless he holds real estate under lease or in fee simple, or personal property, outside of the reserve or special reserve**, in which case he shall be liable to be taxed for such real or personal property at the same rate as other persons in the locality in which it is situated. [emphasis added]
>
> 65. All lands vested in the Crown, or in any person or body corporate, in trust for or for the use of any Indian or non-treaty Indian, or any band or irregular band of Indians or non-treaty Indians, shall be exempt from taxation.

The policy ideal was thus maintained. Once again, legislators were apt to attach the exemption to reserved lands, which explains Justice La Forest's remarks in *Mitchell v. Peguis* to the effect that:

> The fact that the modern-day legislation, like its counterparts, is so careful to underline that the exemptions from taxation and distraint apply only in respect of personal property situated on reserves demonstrates 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. 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 in the same basis as all other Canadians.[80]

The policy rationale for limiting the tax exemption to reserves is unmistakable. The exemption exists for no other reason than to protect reserved lands from distraint. The focus, therefore, in most litigation concerning the *Indian Act* tax exemption is location, location, location; with little if any regard for the litigant's personal circumstances, except insofar as they might denote a connection to a reserve.

Finally, in 1951 the statutory exemption was rewritten[81] and appears in much the same form as in Sections 87 and 90 of the present *Indian Act*.[82] In contemplating the origins of the statutory exemption we are able to account for the existing policy rationale, which

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[79] S.C., 1876, c. 18.
[80] *Mitchell v. Peguis*, *supra* note 71, at 132.
[81] S.C., 1951, c. 29.

must be understood if reforms are to be undertaken on the present system. It is clear that the Crown's original aim in providing the tax exemption was to shield Indians until such time as they were able to be included in Canada's commercial mainstream.[83] The very fact that the exemption still exists, largely unchanged since 1850, would suggest that the original policy was a failure and that it is time to rethink things for the future.

1-8 CONCLUSION

There are three possible sources of the tax exemption for Indians: Aboriginal rights, treaty entitlements, and legislation. The foregoing analysis demonstrates that there is no strong argument in support of an Aboriginal right to a general tax exemption, unless undertaken in conjunction with a self-government argument. There is, however, reason to believe that the treaties negotiated with First Nations have resulted in duties vested in the Crown to shield reserved lands reserved from distraint. As such, the Crown may be obliged to provide a tax exemption, because it is otherwise conceivable that the lands reserved for First Nations are at risk of being taxed out from under the inhabitants.

Presently, the tax exemption is regarded solely as a creature of statute, perhaps because the argument for an Aboriginal or treaty right to be tax exempt has yet to come before the courts. Whether the tax exemption exists as a codification of pre-existing Aboriginal or treaty rights, or is instead merely a policy oriented decree of Parliament, is of immense significance. This is because in the latter case the tax exemption could conceivably

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[82] R.S.C., 1985, c. I-5.
[83] Bartlett, *supra* note 17, at 1.

be withdrawn at Parliament's whim.[84] On the other hand, if the tax exemption exists as an Aboriginal or treaty right it would be more firmly entrenched by virtue of Section 35 of the *Constitution Act, 1982*. This would mean that to infringe upon the exemption would require that the infringement be justifiable under the *R. v. Sparrow*[85] doctrine discussed earlier.

If nothing else, the historical analysis serves to explain why First Nations warrant special consideration within Canada's tax structure. First Nations sacrificed a great deal to European settlers. The benefit of the use of reserved lands and the corresponding guarantees as to their continued existence is just one form of compensation for giving the Crown a monopoly on the alienation of Aboriginal title. In any event, the courts have recognised that the originating purpose of the tax exemption was to ensure that reserved lands are shielded from erosion, not to remedy subsequent Aboriginal peoples' economically disadvantaged position. One is left to wonder, however, if guaranteeing the existence of reserved lands was not the least the Crown could provide.

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[84] This notion is best understood as an expression of 'Parliamentary Sovereignty', which Albert Venn Dicey described as being Parliament's unreserved right to "make or unmake any law whatever." In essence, excepting constitutional constraints, each successive government has the untrammeled right to alter the law, which means, in theory, that Parliament cannot be bound by its predecessors: Richard Cosgrove, *The Rule of Law: Albert Venn Dicey, Victorian Jurist* (Chapel Hill: University of North Carolina Press, 1980), p. 71.

[85] *R. v. Sparrow*, *supra* note 65.

- CHAPTER TWO - ANALYSIS OF THE TAX LAW AFFECTING FIRST NATIONS IN SECTION 87 OF THE *INDIAN ACT*

Despite arguments supporting an Aboriginal or treaty right to be exempted from tax, Revenue Canada recognises only the statutory exemption contained in Section 87 of the *Indian Act*.[1] It is, therefore, appropriate at this stage to examine the all-important source of the exemption. Section 87 reads, in part:

> 87. (1) Notwithstanding any other Act of Parliament or any Act of the legislature of a province, but subject to section 83, the following property is exempt from taxation, namely:
>
> (*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.

Hence, we are able to distinguish four constituent parts: (1) the levy or charge in question must qualify as taxation; (2) the person claiming the exemption must be an Indian or band; (3) the property in question must be either an "interest in a reserve or surrendered lands", or

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[1] The *Indian Act*, R.S.C. 1985, c. I-5 (hereinafter, the *Indian Act*) tax exemption works in conjunction with paragraph 81(1)(*a*) of the *Income Tax Act*, which reads:

> 81.(1) Amounts not included in income – There shall not be included in computing the income of a taxpayer for a taxation year,
>
> (*a*) statutory exemptions – an amount that is declared to be exempt from income tax by any other enactment of Parliament, other than an amount received or receivable by an individual that is exempt by virtue of a provision contained in a tax convention or agreement with another country that has the force of law in Canada.

"the personal property of an Indian or band"; and last, (4) in the case of personal property, the subject matter must be "situated on a reserve".[2]

2-1 THE LEVY OR CHARGE IN QUESTION MUST QUALIFY AS 'TAXATION'

The Supreme Court of Canada addressed the issue of a charge being characterised as a tax in *Westbank First Nation v. British Columbia Hydro and Power Authority*.[3] The appellant, Westbank First Nation, sought to impose a "regulatory charge" on the respondent, B.C. Hydro Authority, in its capacity as agent for the provincial Crown. At issue was the ambit of Section 125 of the *Constitution Act, 1867*, which precludes the three levels of government from taxing one another. Justice Gonthier, writing for the majority, characterised the $124,527.25 "regulatory charge", imposed under the *Westbank Property Taxation By-law*,[4] as a tax and thus declared it inapplicable to the respondent B.C. Hydro Authority in its capacity as agent for the provincial Crown.

In rendering his decision Justice Gonthier followed *Lawson v. Interior Fruit and Vegetable Committee of Direction*[5] and *Re Eurig Estate*,[6] which outline the fundamental characteristics of taxes. In *Lawson*, Justice Duff identified the marketing levies in question as taxes because they were (1) enforceable by law, (2) imposed under the authority of the

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[2] Robert C. Strother and Robert A. Brown, *Taxation of Aboriginal People in Canada* (Report of Proceedings of the Forty-Second Tax Conference, 1990, Conference Report), (Toronto: Canada Tax Foundation, 1990), p. 47:15.

[3] *Westbank First Nation v. British Columbia Hydro and Power Authority*, [1999] 9 W.W.R. 517.

[4] The by-laws in question were passed pursuant to s. 83(1)(a) of the *Indian Act*, which authorises, *inter alia*, taxation for local purposes of land, or interests in land, in the reserve, including rights to occupy, possess or use land in the reserve.

[5] *Lawson v. Interior Fruit and Vegetable Committee of Direction*, [1930] S.C.R. 357.

[6] *Re Eurig Estate*, [1998] 2 S.C.R. 565.

legislature, (3) imposed by a public body, and (4) intended for a public purpose.[7] In *Re Eurig Estate*, Justice Major added a fifth factor to consider in determining whether a charge constitutes a tax, or instead, a type of user fee. He indicated that user fees and regulatory schemes are characterised by a "nexus" between the quantum charged and the cost of the service provided.[8] Further to Justice Major's fifth criteria, in delivering his *Westbank* ruling Justice Gonthier stated:

> As is evident from the fifth inquiry described above, the Court must identify the presence of a regulatory scheme in order to find a "regulatory charge". To find a regulatory scheme, a court should look for the presence of some or all the following indicia of a regulatory scheme: (1) a complete, complex and detailed code of regulation; (2) a regulatory purpose which seeks to affect some behaviour; (3) the presence of actual or properly estimated costs of the regulation; (4) a relationship between the person being regulated and the regulation, where the person being regulated either benefits from, or causes the need for the regulation. This list is not exhaustive. In order for a charge to be "connected" or "adhesive" to [a] regulatory scheme, the court must establish a relationship between the charge and the scheme itself.[9]

To summarise, the result of the decisions in *Lawson*, *Eurig* and *Westbank*, is that a levy or charge bearing the following characteristics is properly characterised as a tax:

- The charge is enforceable by law;
- The charge is imposed under the authority of the legislature;
- The charge is levied by a public body;
- The charge is intended for a general public purpose; and,
- The charge is unconnected to any form of regulatory scheme.

If a levy is deemed as a user fee, a licensing fee, or a regulatory charge, as opposed to a tax, Section 87 will not apply.

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[7] *Lawson v. Interior Fruit and Vegetable Committee of Direction*, *supra* note 6, at 362-363.
[8] *Re Eurig Estate*, *supra* note 5 at para 21.
[9] *Westbank First Nation*, *supra* note 3 at para 44.

2-2 THE PERSON CLAIMING THE EXEMPTION MUST BE AN INDIAN OR BAND

The *Indian Act* tax exemption applies only to 'Indians' and 'bands', both of which are defined in Section 2(1) of the *Indian Act*. We will deal first with bands, which Section 2(1) defines 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...,
> *(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.

Although a band can sue or be sued in its own name without a representation order,[10] a band is neither a natural person nor a corporation in its own right.[11]

The term 'Indian', also defined under Section 2(1) of the *Indian Act*, refers to "a person who pursuant to [the] Act is registered as an Indian or is *entitled* to be registered as an Indian"; in turn, Section 6(1) outlines who is *entitled* to be registered as an Indian. On 28 June 1985, substantial changes were announced in respect of membership provisions.[12] Previous reforms resulted in the loss of Indian status for various reasons, including the marriage by an Indian woman to a man of non-Indian ancestry, and the 1985 amendments restored Indian status lost due to the previous changes. However, in one case, three bands within the Treaties 6, 7, and 8 boundaries opposed the Bill C-31 amendments.[13] The plaintiffs claimed their bands employed a "woman follows man" custom, whereby women marrying non-band members were deemed to have left the band, and that the custom was protected by Section 35(1) of the *Constitution Act, 1982*. The court rejected the argument

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[10] *Clow Darling Ltd. v. Big Trout Lake Band of Indians*, [1990] 4 C.N.L.R. 7.
[11] *R. v. Cochrane* (1977), 9 C.N.L.C. 486.
[12] Strother and Brown, *supra* note 2, at 47:19.
[13] *Sawridge Band v. Canada*, [1995] 4 C.N.L.R. 121.

citing Section 35(4) of the *Constitution Act, 1982*, which guarantees that Aboriginal and treaty rights apply equally to male and female persons.

The leading case on the entitlement to be registered as an Indian, *Broadway v. The Minister of National Revenue*,[14] concerned an appellant who lost her status under the pre-1985 legislation when she married a non-Indian. Her name, however, remained on the band list and her argument advanced that she was eligible for the *Indian Act* tax exemption so long as her name appeared on the list. The Tax Review Board concluded that the crux of the issue was whether the appellant was 'entitled' to be registered as an Indian and that the pre-1985 legislation disentitled her to register, thereby depriving her of the Section 87 tax exemption.[15] In *Monias v. M.N.R.*[16] the Tax Court of Canada ruled that the "date of entitlement to be registered as an Indian" is the operative factor under Section 87, not the date at which registration actually took place, indicating that the onus of proving entitlement to registration rests with the individual.

Finally, it is noteworthy that corporations do not qualify as 'Indians' or 'bands' for purposes of the Act, even if all of their shareholders and directors are Status-Indians.[17] This sentiment is borne out in paragraph 6(d) of Interpretation Bulletin IT-62,[18] which reads:

> a corporation cannot meet the definition of "Indian" in the *Indian Act* and its income is not exempted from tax by these provisions, even where its only shareholders are Indians, its head office and physical assets are on a reserve and all of its business is carried out there.

The issue arose in the subsequent case, *Kinookimaw Beach Association v. Board of Review of Commissioners*,[19] where, at trial, Johnson, C.J. disregarded the IT-62 guidelines

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[14] *Broadway v. The Minister of National Revenue*, [1981] 2 C.N.L.R. 31 (TRB).
[15] The Section 87 exemption applies, however, to persons whose status was restored following the June 28th, 1985 amendment and is not dependent upon their names having been added to a band list or Indian register.
[16] *Monias v. M.N.R.*, [1999] 4 C.T.C. 2354 (TCC).
[17] Howard L. Morry, "Taxation of Aboriginals in Canada", (1992) 21 *Manitoba Law Journal* 426-452, at 429.
[18] Interpretation Bulletin IT-62, 18 August 1972.

and pierced the corporate veil.[20] On appeal, a unanimous Saskatchewan Court of Appeal reversed the trial court decision on the basis of the long-standing principle of separate corporate personality, established in *Salomon v. Salomon & Co. Ltd.*.[21] Chief Justice Culliton stated:

> Here the Indian bands decided that the most efficient manner of attaining their objectives was through a corporate structure.... To grant to the association the exemption from taxation provided for in s. 87 of the *Indian Act* would be to destroy the legal obligations of the association as an independent corporate entity and to determine its obligations by the character of its shareholders.[22]

That corporations do not qualify as 'Indians' and are therefore ineligible for the *Indian Act* tax exemption is not problematic in tax planning terms, because it is simple enough to use the corporate vehicle and still benefit from Section 87. Even in the instance of a 'personal service business',[23] subject to the strictest operation of the *Income Tax Act*,

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[19] *Kinookimaw Beach Association v. Board of Review of Commissioners*, (1978) 6 W.W.R. 749.

[20] Chief Justice Johnson had this to say:

> It seems that if the corporate veil can be lifted to prevent taxpayers from avoiding the payment of taxes... it may also be lifted to give the taxpayers the benefit of tax exemptions in a case such as this where such exemption is specially granted to a particular group or class of people for whose care and assistance the legislation is designed, as is the *Indian Act*.... It would be completely incongruous and anomalous for public funds to be expended by one government to assist Indian peoples if another government were permitted to assess taxes payable by Indians ultimately which would not be assessable if the corporate structure were not the vehicle for carrying out their project.

Ibid., at 754.

[21] *Salomon v. Salomon & Co. Ltd.*, [1897] A.C. 22.

[22] *Kinookimaw Beach Association v. Board of Review of Commissioners*, (1979) 6 W.W.R. 84 at 89. The Saskatchewan Court of Appeal's reasoning was approved by the Supreme Court of Canada in *Four B. Manufacturing Ltd. v. United Garment Workers of America* (1979) 102 D.L.R. (3d) 385.

[23] Defined under s. 127(7) ITA as being,

> a business [carried on by a corporation] of providing services where
>
> (a) an individual who performs the services on behalf of the corporation – [i.e. an 'incorporated employee'], or
>
> (b) any person related to the incorporated employee
>
> is a specified shareholder of the corporation and the incorporated employee would reasonably be regarded as an officer or employee of the person or partnership to whom or to which the services were provided but for the existence of the corporation....

salaries, wages and other remuneration paid to employees are tax deductible.[24] Hence, to make use of the corporate mechanism and still benefit from Section 87, a corporation need only distribute its earnings as salaries to Indian employees residing on a reserve, thereby nullifying its otherwise taxable income.

2-3 THE PROPERTY IN QUESTION MUST BE AN INTEREST IN A RESERVE, OR THE PERSONAL PROPERTY OF AN INDIAN OR BAND

Paragraph 87(1)(a) states that, "the following property is exempt from tax, namely: the interest of an Indian or a band in reserve lands or surrendered lands." At the risk of stating the obvious, it would be impossible for an Indian or band's interests in real property, located outside the reserve, to qualify for the exemption appearing in paragraph 87(1)(a) because interests in land are situated at the location of the land itself. It follows, therefore, that to have an interest in reserve lands requires that lands in question comprise a part of a reserve. And since the location of land is constant and immovable, interests in reserve or surrendered lands are easily determined for purposes of paragraph 87(1)(a).

A more vexing question arises in relation to paragraph 87(1)(b), which exempts from tax, "the personal property of an Indian or a band situated on a reserve." This leads one to inquire as to what constitutes personal property for purposes of the Act. A useful point of reference is that paragraph 87(1)(b), exempts both tangible and intangible property.[25]

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[24] As pursuant to paragraph 18(1)(p) of the *Income Tax Act*. the only proviso being that the salaries paid must be reasonable business expenditures, which inquires as to the extent that they were made "for the purposes of gaining or producing income from business," and not some ancillary purpose such as tax avoidance.

[25] There are, in law, only two primary forms of property: real property and personal property. Property that does not comprise real property, *i.e.*, real estate and the interests derived therefrom, is personal property. Personal property includes, *inter alia*, all forms of corporeal or tangible property, such as cars and boats.

By far the most significant form of personal property is employment income, if for no other reason than that it provides the most substantial tax base from which government revenues are derived. In the leading case, *Snow v. The Queen*,[26] the issue before the Federal Court of Appeal was whether employment income constitutes personal property for purposes of paragraph 87(1)(b). Justice Le Dain, for a unanimous court, wrote:

> We are all of the view that the appeal must be dismissed on the ground that the tax imposed on the appellant under the *Income Tax Act*, is not taxation in respect of personal property within the meaning of section 86 [now s. 87] of the *Indian Act*. In our opinion, section 86 [now s. 87] contemplates taxation in respect of specific personal property qua property and not taxation in respect of **taxable income** as defined by the *Income Tax Act*, which, while it may reflect items that are personal property, is not itself personal property but an amount to be determined as a matter of calculation by application of the provisions of the Act.[27] [emphasis added]

A sense of confusion and controversy prevailed in the late 1970s and early 1980s concerning the semantic distinction between 'income' and 'taxable income', as concerned the *Indian Act* tax exemption. In *Snow v. The Queen*, the court reasoned that 'taxable income' did not constitute 'personal property' *per se*, but was instead an amount reflected *vis-à-vis* a calculation performed in the *Income Tax Act*. The court added that the tax owing in respect of that amount is, in turn, levied on the 'taxpayer', not his or her 'income'. This was immensely significant in relation to paragraph 87(1)(b) because, as far as the court was concerned, the exemption afforded therein applied only to 'personal property', not the individual taxpayer. Simply stated, under the preferred late 1970s construction, Indians were required to pay income tax even when they worked and resided on a reserve.

Personal property also includes incorporeal or intangible property, such as income (from business, investment or employment), annuities, shares debts, and intellectual property: Morry, *supra* note 17 at 428.

[26] *Snow v. The Queen* (1979) C.T.C. 227 (FCA).

[27] *Ibid.*, at 227.

There is an historical explanation for this confusion on the legal status of taxable income. The *Indian Act, 1876*,[28] confined the tax exemption to 'personal property', thereby signalling a change from the 1850 *Act for the protection of Indians*,[29] which applied to the Indian 'person'. Coupled with the fact that federal income taxation was not introduced until 1917, there were simply no previous indicators as to whether the exemption for 'personal property' should apply to 'taxable income'.[30] A.J. Frost, for the Tax Review Board in *The Queen v. National Indian Brotherhood*,[31] recognised the cause for confusion and attempted to resolve the dilemma, stating:

> Statutory law exempting Indians from taxation preceded, by many years, the *Income Tax Act*, and established the broad principle that all property of an Indian situated on a reserve is exempt from taxation, thereby raising a presumption in law that the *Income Tax Act* cannot be taken to apply to the property of Indians on a reserve unless it is spelled out in clear unambiguous language and there is no conflict. Although the language of the *Indian Act* and the *Income Tax Act* appears to be repugnant in respect to taxation, it cannot be supposed that Parliament intended to contradict itself by exempting Indians under the earlier legislation and then tearing up the earlier statutes by imposing liabilities on them under the *Income Tax Act*.[32]

On appeal to the Federal Court, Trial Division, the issue was confined to the *situs* of the income and the court was able to assume that a salary or right of salary constituted personal property. This left the issue on the status of 'taxable income' for the Supreme Court of Canada to consider in *Nowegijick v. The Queen.*

Nowegijick afforded the Court a choice opportunity to dispel the confusion about the status of income for purposes of Section 87. In his landmark ruling, Justice Dickson (as he was then) declared

> ...it is legal lore that, to be valid, exemptions to tax laws should be clearly expressed. It seems to me, however, that treaties and *statutes* relating to Indians [*i.e.*, the *Indian Act*], should be liberally construed and doubtful expressions resolved in favour of the

[28] S.C., 1876, c.18 – *ante* Chapter One, note 77.
[29] S.C., 1850, c.74 – *ante* Chapter One, note 76.
[30] Richard Bartlett, *Indians and Taxation in Canada*, 3rd ed. (Saskatoon: Native Law Centre, 1992), at 56.
[31] *The Queen v. National Indian Brotherhood*, [1978] C.N.L.B. (No. 4) 99.
[32] *Ibid.*, at 104-105.

> Indians. If the statute contains language which can reasonably be construed to confer tax exemption that construction in my view is to be favoured over a more technical construction which might be available to deny exemption.[33]

Hence, the decision revealed that the confusion surrounding the classification of income was to be resolved "in favour of the Indians".

Justice Dickson continued, in any event, focussing more specifically on the semantic distinction between income and taxable income, and referred to an American case, *Bachrach v. Nelson*,[34] in establishing that income does constitute 'personal property'. Having gone that far, Justice Dickson directly confronted the question of whether 'taxable income', as defined under Section 2 of the *Income Tax Act*,[35] also constituted 'personal property'.

> A tax on income is in reality a tax on property itself. **If income can be said to be property I cannot think that taxable income is any less so**.... If wages are personal property it seems difficult to say that a person taxed "in respect of" wages is not being taxed on personal property.[36] [emphasis added]

Moreover, he concluded that, due to the liberal interpretation to be afforded statutes relating to Indians, Section 87 applied both to persons and property because of the phraseology "in respect of" contained in Subsection 87(2), which he felt conveyed a connection between the two.[37] It does not matter, therefore, "that the taxation of employment income may be characterised as a tax on persons as opposed to a tax on property..., section 87 creates an exemption for both persons and property."[38]

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[33] *Nowegijick v. The Queen*, [1983] 2 C.N.L.R. 89 at 94.
[34] *Bachrach v. Nelson*, 182 NE 909 (S.C. Ill., 1932).
[35] As noted above, the amount to be included in taxable income is arrived at through the calculation in section 3 of the *Income Tax Act*.
[36] *Nowegijick*, *supra* note 33 at 101.
[37] Note the wording to which Justice Dickson referred in subsection 87(2) of the Act which reads:

> No Indian or band is subject to taxation **in respect of** the ownership, occupation, possession or use of any property mentioned in paragraphs (1)(a) or (b) or is otherwise subject to taxation **in respect of** any such property. [emphasis added]

Strother and Brown, *supra* note 2 at 47:22.
[38] *Nowegijick*, *supra* note 33 at 101.

Subsequent decisions have recognised the following items as constituting 'personal property' eligible for the *Indian Act* tax exemption: electricity;[39] motor vehicles;[40] unemployment insurance benefits;[41] scholarship monies;[42] and, funds paid pursuant to the Northern Flood Agreements.[43] In the case *of Kahn-Tineta Horn v. MNR*,[44] the Court ruled, however, that the appellant's skills and expertise did not constitute personal property.[45] Finally, Justice Dickson stressed the limits of the s. 87 exemption.

> I conclude by saying that nothing in these reasons should be taken as implying that no Indian shall ever pay tax of any kind.... We are concerned here with personal property situated on a reserve and only with property situated on a reserve.[46]

This brings us to the final and arguably most significant of the four components of the *Indian Act* tax exemption: the *situs* requirement.

2-4 IN THE CASE OF PERSONAL PROPERTY, THE *SITUS* REQUIREMENT

The foregoing three components of Section 87 are for the most part settled; however, the issue of whether property is situated on a reserve for purposes of the *Indian Act* continues to present problems for Canada's First Nations and, in the case of intangible property,[47] remains a contentious issue. It is for this reason that most litigation relating to Section 87

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[39] *Brown v. British Columbia* (A.G.) (1979), 107 D.L.R. (3d) 705 (BCCA).
[40] *Danes v. British Columbia* (A.G.) (1985), 18 D.L.R. (4th) 254 (BCCA).
[41] *Williams v. The Queen*, [1992] 1 S.C.R. 877.
[42] *Greyeyes v. The Queen*, [1978] C.T.C. 91.
[43] *Webtech Controls v. Cross Lake Band*, [1991] 3 C.N.L.R. 182 (Man. Q.B.).
[44] *Kahn-Tineta Horn v. MNR*, 89 D.T.C. 147 (TCC).
[45] Strother and Brown, *supra* note 2 at 47:22.
[46] *Nowegijick*, *supra* note 33 at 97.
[47] In the case of tangible personal property, identifying the *situs* of such property has not proven overly difficult. In *Mitchell v. Peguis Indian Band*, the Supreme Court of Canada approved the 'paramount location' test established in *Leighton v. B.C.* (1989), 35 BCLR (2d) 216. The court there held that the 'paramount location' would be determined by the pattern of use of the property in question. Hence, in the case of a motor vehicle, for example, if that vehicle is to be stored on reserve lands, the 'paramount location' of such property is said to be

concerns locating the *situs* of property. The term *situs* is a Latin expression meaning simply "site",[48] and refers to the location of an item of property for legal purposes. In order for personal property to qualify for tax exemption, paragraph 87(1)(b) requires that such property be "situated on a reserve". This requirement is fundamental to the policy rationale behind the tax exemption which, as discussed earlier, remains practically unchanged since it first appeared in 1850.

According to the previous chapter, the underlying purpose of the tax exemption is to preserve Indian land entitlements. The Supreme Court of Canada addressed that point in *Mitchell v. Peguis Indian Band*,[49] and again, in the landmark decision, *Glenn Williams v. The Queen*,[50] when Justice Gonthier, writing for La Forest, L'Heureux-Dubé, Sopinka, McLachlin and Stevenson, JJ, expressed that

> ...the purpose of [s. 87] was to preserve the entitlements of Indians to their reserve lands and to ensure that the use of their reserve lands was not eroded by the ability of governments to tax, or creditors to seize. The corollary of this conclusion was that the purpose of [s. 87] was not to confer a general economic benefit upon the Indians.[51]

The law relating to Section 87 must, therefore, be analysed in light of its underlying purpose, which explains why the courts focus on determining whether property otherwise chargeable to tax is situated on a reserve.

Discourse on locating the *situs* of intangible personal property is framed around two Supreme Court of Canada decisions: *Nowegijick v. The Queen*[52] and *Glenn Williams v. The*

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the reserve and the vehicle is not, therefore, chargeable to retail sales tax. The issue of retail sales tax, generally, is discussed in greater detail below: Strother and Brown, *supra* note 2 at 47:29.

[48] The Concise Oxford Dictionary, 9th ed. (Oxford University Press, 1997), at 1298.

[49] *Mitchell v. Peguis Indian Band*, [1990] 2 S.C.R. 85.

[50] *Williams v. The Queen*, [1992] 1 S.C.R. 877.

[51] *Ibid.*, at 880.

[52] *Nowegijick*, *supra* note 33.

Queen.[53] In 1992 *Williams* superseded the *Nowegijick* approach when the courts developed the so-called 'connecting factors' test to determine whether property is situated on a reserve so as to qualify for the exemption. It would be imprudent, however, to proceed without reviewing *Nowegijick* because it stood for nearly a decade as the leading authority on locating the *situs* of intangible personal property, and it provides an invaluable background to the subsequently established *Williams* approach.

2-5 *Nowegijick v. The Queen* and the 'Residence of the Debtor' Test

Nowegijick concerned an employee of the band-owned and operated, 'Gull Bay Development Corporation', located on the Gull Bay Reserve in Ontario. The appellant, Mr. Gene Nowegijick, was employed as a logger and undertook his duties of employment primarily outside reserve boundaries. Revenue Canada assessed Mr. Nowegijick on his income earned as an employee of Gull Bay Development, relying on paragraph 6(2) of Interpretation Bulletin IT-62[54] that provides, *inter alia*:

> The key factor in determining whether or not a specific item of income is received by an Indian is taxable or exempt is the location where the income is earned. Income earned on a reserve by an Indian is considered exempt. Income earned away from the reserve is taxable. Different types of income have different criteria for establishing whether they are on or off the reserve.... Salary and wages are considered to be earned where the services are performed;... for a construction worker employed on a project it is the job site; for a teacher it is the school and so on.

The Interpretation Bulletin also provides that the employer's location is not usually relevant in determining the *situs* of income from an office or employment.

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[53] *Williams*, *supra* note 50.
[54] Dated 18 August 1972.

As mentioned earlier, the Trial Court and Court of Appeal decisions focussed on whether 'taxable income' constitutes personal property for *Indian Act* tax exemption purposes. At trial, on the *situs* issue, the court referred to *The Queen v. National Indian Brotherhood*,[55] where Justice Thurlow concluded that the salaries paid to Indians by a corporation located outside a reserve were not situated on a reserve for Section 87 purposes. To that end, Justice Mahoney stated:

> Wages, once received, lose the character of wages and become simply a negotiable instrument or money in their recipient's hands. Only up to the point of receipt are they wages. Wages are a contract debt, a chose in action, personal property which, strictly speaking, has no *situs*; however, **where the law has found it necessary to attribute a situs to a debt, that situs has been the debtor's residence**.[56] [emphasis added]

At the Supreme Court of Canada, the Crown conceded that the *situs* of Mr. Nowegijick's salary was attributable to the residence of the debtor, Gull Bay Development Corporation. In upholding the trial court ruling, Canada's highest Court indicated the only important factor in determining the *situs* of personal property, insofar as it relates to Section 87, was the residence of the debtor or employer. Subsequent decisions confirm, however, that the only reason for locating the *situs* of a debt at the residence of the debtor was that it was the rule utilised in the conflict of laws.[57]

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[55] *The Queen v. National Indian Brotherhood*, [1979] 1 F.C. 103 (T.D.) at 109, Justice Thurlow stated:

> A chose in action such as the right to a salary in fact has no *situs*. But where for some purpose the law has found it necessary to attribute a *situs*, in the absence of anything in the contract or elsewhere to indicate the contrary, the *situs* of a simple contract debt has been held to be the residence or place where the debtor is found. See Cheshire, *Private International Law*, 7th ed., at p. 420.

[56] *Nowegijick v. The Queen*, 79 D.T.C. 5115 at 5116 (FCTD).

[57] The notion that the residence of the debtor constitutes the *situs* of a salary or wage is based on the principles of conflicts of law. Lord Field addressed the issue of *situs* in relation to personalty and succession tax in *Commissioner of Stamps v. Hope*, [1891] A.C. 476, stating:

> Now a debt *per se*, although a chattel and part of the personal estate which the probate confers authority to administer, has, of course, no absolute local existence; but it has been long established.., that a debt does possess an attribute of locality, arising from and according to its nature, and the distinction drawn and well settled has been and is whether it is a debt by contract or a debt by specialty. In the former case, the debt being merely a chose in action...

Following *Nowegijick*, a debt owing in respect of an employment contract was regarded as situated at the location of the debtor/employer, the result being that when an Indian was employed by an on-reserve business, the wage received was 'situated on a reserve' and was thus tax exempt. It did not matter where the duties of employment were carried out, or whether the employee resided on-reserve.[58] Clearly, the 'residence of the debtor' *situs* requirement did not comport with the underlying purpose of the *Indian Act* tax exemption, that being: to shield property located on-reserve from distraint, in aid of preserving Indian entitlements.[59] Instead, the 'residence of the debtor' criteria provided a certain tax planning mechanism to enable Indians to effectively avoid paying income tax,[60] in abeyance with the object and spirit of the Act.

> *could have no other local existence than the personal residence of the debtor where the assets to satisfy it would presumably be....* [emphasis added]

Cited in Bartlett, *supra* note 30 at 60-61.

[58] In *Bank of Nova Scotia v. Blood*, [1990] 1 C.N.L.R. 16, the appellant, a status-Indian, who resided on a reserve, was employed as an RCMP constable. He sought an exemption from tax on his income based upon the fact that a majority of the duties of his employment were undertaken on a reserve. Applying the 'residence of the debtor test', the Alberta Court of Appeal ruled that his income was not exempt from tax because the place of enforcement of the debt was the detachment office located off the reserve.

[59] This is evidenced by the fact that given a fact scenario as arose in *Bank of Nova Scotia v. Blood*, where the exemption should rightly have been available, that under the residence of the debtor *situs* requirement, the appellant's income was not exempt from taxation. D.J. Purich recognised the cause for concern almost immediately following the *Nowegijick* decision, in an almost prophetic statement:

> Because the residence of the employer determines the situs of income, an Indian who works on the reserve for an employer whose residence is off the reserve might be subject to income tax. Such a result would certainly appear to be contrary to the object and spirit of the exemption in s. 87.

D.J. Purich, "Indians and Income Tax: A Case Comment on *Nowegijick*"; (1983-1984) 48 Sask. L. Rev. 122 at 127.

[60] Until 1992, *Indian Act* tax planning revolved around the formation of a reserve-based corporation. This could be established easily, bearing in mind the leading case, *De Beers Consolidated Mines Ltd. v. Howe*, [1906] A.C. 455, at 458 in which the House of Lords held that,

> a company resides for the purposes of income tax where its real business is carried on.... I regard that as a true rule, and the real business is carried on where the central management and control actually abides.

Hence, a corporation need only ensure that its Board of Directors maintain a residence and meet within reserve boundaries. That company could then contract out its services to businesses located off the reserve and, so long as the central management was carried in within a reserve, under the residence of the debtor rule, the wages paid to Indian employees were exempt from tax under s. 87.

Nearly a decade following the *Nowegijick* decision, the Supreme Court of Canada took to the task of bringing the *situs* requirements of Section 87 in line with the purpose of the tax exemption.[61] For example, *Mitchell v. Peguis*[62] gave rise to the 'commercial mainstream' concept[63] when Justice La Forest indicated that unless there exists a 'discernible nexus' between the property in question and an Indian reserve, such property is located in the 'commercial mainstream' and is ineligible for special treatment. The 'commercial mainstream' criterion is examined in greater detail below.

Even more dramatic inroads towards reform were undertaken in *Williams v. The Queen*, particularly the following expression by Justice Gonthier.

> In resolving this question, it is readily apparent that to simply adopt general conflicts principles in the present context would be entirely out of keeping with the scheme and purposes of the *Indian Act* and *Income Tax Act*. **The purposes of the conflict of laws have little or nothing in common with the purposes underlying the *Indian Act*. It is simply not apparent how the place where a debt may normally be enforced has any relevance to the question whether to tax the receipt of the payment of that debt would amount to the erosion of the entitlements of an Indian qua Indian on a reserve**. The test for situs under the *Indian Act* must be constructed according to its purposes, not the purposes of the conflict of laws. Therefore, the position that the residence of the debtor exclusively determines the situs of benefits such as those paid in this case must be closely reexamined in light of the purposes of the *Indian Act*. It may be that the residence of the debtor remains an important factor, or even the exclusive one. However, this conclusion cannot be

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[61] It is noteworthy that in 1985, Revenue Canada began to soften its approach on the application of the 'residence of the debtor' criteria, as evident in the Indian Remission Order, PC 1985-2446 (vol. 119, no. 17), 1985 *Canada Gazette Part II* 3610-3611. The order provided for remission of taxes for:

> Income earned by an Indian from an office or employment that is reasonably attributable to the duties of that office or employment performed by the Indian on a reserve....

The remission order was meant to apply to income earned between 1983-1987, but was then extended to the relevant taxation years.

[62] *Mitchell v. Peguis*, *supra* note 49.

[63] To this end, Justice La Forest stated,

> The fact that modern-day legislation, like its historical counterparts, is so careful to underline that exemptions from taxation and distraint apply only in respect to personal property situated on the reserves demonstrates 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. An examination of the decisions bearing on these sections confirms that Indians who acquire and deal with property outside lands reserved for their use, deal with it on the same basis as all other Canadians. [emphasis added]

Ibid., at 132.

> directly drawn from an analysis of how the conflict of laws deals with such an issue.[64] [emphasis added]

Since *Williams*, a preponderance of the litigation concerning the *Indian Act* tax exemption has focussed on whether the *situs* requirement there established – *i.e.*, the 'connecting factors test' – has been met.

2-6 *Glenn Williams v. The Queen* – The 'Connecting Factors' Test

Mr. Glenn Williams, a Status-Indian residing on the Penticton Indian Reserve, was employed by a reserve-based business as a logger. He performed his employment duties on-reserve and moreover, he was paid on the reserve; his income was thus exempted from tax pursuant to Section 87 of the *Indian Act*. In 1984, Williams lost his job, applied for and received unemployment insurance benefits.[65] The central issue at trial was whether the benefits received were also exempt from tax, as the residence of the debtor – the Employment and Immigration Commission – was in Ottawa. Applying the *Nowegijick* principle, Revenue Canada assessed Mr. Williams on his unemployment insurance benefits on the basis that his income arrived from a debtor located off-reserve.

Counsel for Mr. Williams argued that the 'residence of the debtor' test was inappropriate under the circumstances and that the court should apply a test that reviewed and applied all the factors relating to the circumstances at hand. At trial, Justice Cullen agreed, being of the view that the debtor's residence was but one of a number of 'connecting

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[64] *Williams*, *supra* note 41 at 882.

[65] In addition to regular benefits, the appellant also received 'enhanced' unemployment insurance benefits paid pursuant to a written agreement between the Band and the Commission under section 38 of the *Unemployment Insurance Act*, 1971, S.C. 1970-71-72, c. 48. Because the 'enhanced' benefits were given to the band under an

factors' to examine in determining the *situs* of intangible personal property. In reversing the decision the Federal Court of Appeal applied the *Nowegijick* principle to locate the *situs* of Mr. Williams' unemployment insurance benefits. Leave to appeal was granted to the Supreme Court of Canada and on 16 April 1992, the Court delivered a ruling that would irrevocably transform the test to determine the *situs* of intangible personal property, for purposes of the *Indian Act* tax exemption.

In developing the new test Justice Gonthier was mindful that an overly rigid one would possess the same weakness as the 'residence of the debtor' test, in that it would be unable to account for the underlying purpose of the *Indian Act* exemption. Moreover, he reasoned that a fixed test would be open to abuse in the form of well-contrived avoidance schemes, whereby skilled practitioners would emphasise certain factors of an individual case.[66] Hence, in keeping with the object and spirit of the Act, Justice Gonthier developed an adaptable test, intending that it be applied on a case-by-case basis. The so-called 'connecting factors' test is essentially two-pronged: Stage One takes inventory of the factors connecting property to a reserve; Stage Two inquires into the weight afforded to each factor listed in Stage One in light of the following three considerations.

> The first step is to identify the various connecting factors which are potentially relevant. These factors should then be analyzed to determine what weight they should be given in identifying the location of the property, **in light of three considerations**: (1) the purpose of the exemption under the *Indian Act*; (2) the type of property in question; and (3) the nature of the taxation of that property. The question with regard to each connecting factor is therefore what weight should be given that factor in answering the question whether to tax that form of property in that manner would

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agreement with the Crown, they were exempt from tax because those funds were deemed as being situated on the reserve *vis-à-vis* Section 90 of the *Indian Act*. Section 90 is discussed in greater detail below.

[66] To that end, Justice Gonthier stated:

> However, an overly rigid test which identified one or two factors as having controlling force has its own potential pitfalls. Such a test would be open to manipulation and abuse, and in focusing on too few factors could miss the purposes of the exemption in the *Indian Act* as easily as a test which indiscriminately focuses on too many.

Williams, *supra* note 41 at 882.

> amount to the erosion of the entitlement of the Indian qua Indian on a reserve.[67] [emphasis added]

Unfortunately, the Court gave no guidance as to how connecting factors might be identified; nor did it elucidate on how weight should be accorded to the factors once established. Justice Gonthier did, however, provide the following conceptual framework of potentially relevant connecting factors, specifying that the list was not exhaustive:

- the residence of the employer or debtor;
- the residence of the employee or person receiving the benefits;
- the location of the employment income which gave rise to the benefits; and,
- the location where the payment of wages or benefits took place.

Applying the framework to Mr. Williams' circumstances, Justice Gonthier ruled that since Mr. Williams' income was situated on the reserve, his unemployment insurance benefits were situated there also because all the potentially relevant factors pointed to a reserve.[68]

Unfortunately, Justice Gonthier did not provide a definitive answer as to whether the 'connecting factors' test was appropriate to determine the *situs* of intangible personal property other than unemployment insurance benefits. This was evident when he stated, "this would not be an appropriate case in which to develop a test for the *situs* of the receipt of employment income,"[69] and moreover:

> [A]s can be seen from our discussion of the test for the situs of unemployment insurance benefits, the creation of a test for the location of intangible property under

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[67] *Ibid.*, at 883.

[68] Justice Gonthier stated in his conclusion that,

> [w]ith regard to the unemployment insurance benefits received by the appellant, a particularly important factor is the location of the employment which gave rise to the qualification for the benefits. In this case, the location of the qualifying employment was on the reserve, therefore the benefits received by the appellant were also located on the reserve.

Ibid., at 886.

[69] *Ibid.*, at 885.

> the *Indian Act* is a complex endeavour. In the context of unemployment insurance we were able to focus on certain features of the scheme and its taxation implications in order to establish one factor as having particular importance. **It is not clear whether this would be possible in the context of employment income, or what features of employment income and its taxation should be examined to that end.... Therefore, for the purposes of the present appeal, we merely note that the employment of the appellant by which he qualified for unemployment insurance benefits was clearly located on the reserve, no matter what the proper test for the situs of employment income is determined to be**. [emphasis added]

In light of the question left open in *Williams* it is appropriate to review Revenue Canada's and the Assembly of First Nations' respective viewpoints on the impact of the decision.

2-7 REVENUE CANADA'S PERSPECTIVE ON THE IMPACT OF *WILLIAMS*

Following *Williams*, Revenue Canada moved quickly to alter its position on locating the *situs* of personal property for Section 87 purposes.[70] After discussions with various taxpayer groups, on 16 February 1993 Revenue Canada produced the following guidelines, describing the types of income that would be exempted from tax based on the 'connecting factors' test:

(i) employment income for duties performed entirely on a reserve;

(ii) employment income for duties performed entirely off a reserve, but both the employer and employee reside on the reserve;

(iii) employment income for duties that are substantially performed on a reserve, and either the employer is located on the reserve or the Indian lives on the

[70] For example, in a letter dated 29 December 1992, from the assistant deputy minister of the Legislative and Intergovernmental Affairs Branch, Revenue Canada, Customs, Excise and Taxation, the first signs of Revenue Canada's position on the *situs* issue were evident. The deputy minister confirmed that unemployment insurance benefits would, from that point on, be exempt from income tax when the employment income that gave rise to the eligibility was exempt from tax *vis-à-vis* section 87. He also indicated, however, that

> ...the principle factor connecting income to a reserve will now be where the duties are carried out. The location of the employer will continue to be a factor, but other factors connecting the income to the reserve will also have to be present for the income to be tax exempt.

As cited in Robert A. Brown, *The Impact of the Williams Decision* (Report of Proceedings of the Forty-Fifth Tax Conference, 1993 Conference Report), (Toronto: Canada Tax Foundation, 1993) at 53:10.

> reserve. If an Indian performs duties both on and off the reserve, we will prorate the exemption....
>
> (iv) [U]nemployment insurance benefits or pension benefits that an Indian receives, if these are based on non-taxable employment income.[71]

After further consultation and "with a view to assisting the Indian community in resolving any uncertainties", on 29 June 1994, Revenue Canada issued revised guidelines that provide, in essence, a thorough explanation of the 1993 guidelines. The 1994 guidelines contain numerous scenarios in which Revenue Canada considers income would be exempt, or otherwise chargeable to tax, and notes that there is always the possibility that there exist circumstances not accounted for within the guidelines.

It is noteworthy that, whilst many of the 1993 guidelines remain largely unchanged, the 1994 information sheet added a fifth, important area concerning employment duties performed off-reserve for the benefit of First Nations and their members. Equally important to note is that the guidelines open with the following statement:

> The guidelines are not intended to apply when it can reasonably be considered that one of the main purposes for the existence of an employment relationship is to establish a connecting factor between the income in question and a reserve.[72]

This rule is similar in many respects to the 'general anti-avoidance rule' contained in Section 245 of the *Income Tax Act*. As such, the 1994 guidelines, if followed, represent a serious impediment to First Nations' tax planning initiatives because they effectively bar the use of a corporate entity to act in place of an employer, if the 'main purpose' of the corporation's existence is to locate that employer on a reserve. It is the anti-avoidance phraseology employed by the guidelines that is problematic.

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[71] Revenue Canada, Customs, Excise and Taxation, "Information Sheet: Tax Exemption for Indians," 16 February 1993.

[72] This is in line with the sentiment expressed by Justice Gonthier in *Williams*, to the effect that the new test should have an element of flexibility so as to curtail manipulation and abuse: *Williams*, *supra* note 41 at 6325

The primary difficulty in developing an acceptable general anti-avoidance rule is establishing well-defined parameters for the taxpayer so that he knows where he stands before the law. A conflict thus arises between the need to curtail overall abuse and the need for clarity. Whilst general anti-avoidance measures provide blanket protection, they are notoriously ambiguous.[73]

> [General anti-avoidance provisions] violate perhaps the most important and fundamental principle of tax law: that the tax legislation must impose tax in clear and unambiguous terms and that a person must not be taxed unless he comes within the letter of the law.... Taxpayers have the right to expect that the tax laws are such that they are able to plan and conduct their legitimate business and financial affairs knowing in advance with a reasonable amount of certainty the likely tax consequences.[74]

The problem thus presents itself as such: how can a general anti-avoidance rule be drafted so as to maintain clarity and certainty for the taxpayer. One answer is found in an approach the English courts have been flirting with since *Ramsay v. I.R.C.*,[75] when the 'business purpose' test found favour with the House of Lords. The crux of the 'business purpose' test is to treat as a fiscal nullity any transaction having no commercial purpose other than tax avoidance.

Applying the 'business purpose' test is, however, fraught with its own unique difficulties: the courts must distinguish between legitimate and illegitimate business manoeuvres and it is often difficult to determine a taxpayer's motive or intention in

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[73] One of the more emphatic opponents of the GAAR contained in Section 245 is Mr. H. J. Kellough who stated:

> Its enactment will usher in a new era in Canadian tax law – **one of great uncertainty as to the application of our income tax laws**.... [T]his provision will only worsen a tax system that is over-encumbered with anti-avoidance rules.

H. J. Kellough, "A Review and Analysis of the Redrafted General Anti-Avoidance Rule", (1988) 36 Can. Tax J. 23 at 27.

[74] Colin Masters, "Is there a need for general anti-avoidance legislation in the United Kingdom? (Anti-avoidance provisions regarding excess profits tax and comparison of legislation in Australia, Canada and New Zealand)", B.T.R. 1994, 6, 647-673, at 671-672.

[75] *Ramsay v. I.R.C.*, [1981] STC 174.

conducting his affairs.[76] Justice Learned Hand, dissenting in *Gilbert v. Commissioner of Internal Revenue*,[77] confronted that very issue:

> I do not agree with the form of the test [to be put to the Court].... I am not clear as to what it is. To say it is whether the transaction has 'substantive economic reality' or 'is in reality what it appears to be in form' or is a 'sham' or a 'masquerade' or depends upon the substance of the transaction'; all of them appear to me to leave the test undefined because they do not state the facts which are to be determinative.[78]

The Judge recognised an inherent difficulty: that to suggest that transactions with no other purpose than to avoid tax constitute tax avoidance denotes circular reasoning and allots the courts too much discretion. Indeed, the courts should not be accorded unregulated latitude to determine whether a given transaction constitutes a sham, or is otherwise a legitimate business transaction. That the use of judicial anti-avoidance doctrines is undesirable finds its roots in a fundamental precept of Canada's constitutional arrangement: that the citizen be taxed by Parliament, not the courts.

> [J]udges are not legislators and if the result of a judicial decision is to contradict the express statutory consequences which have been declared by Parliament to attach to a particular transaction which has been found as a fact to have taken place, that can be justified only because, as a matter of construction of the statute, the court has ascertained that that which has taken place is not, within the meaning of the statute, the transaction to which those consequences attach.[79]

Hence, Revenue Canada's guidelines should either specifically identify offensive transactions, or establish exceptions to the rule for acceptable transactions if they are to withstand the appropriate measure of judicial scrutiny. It would seem that the Canadian

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[76] "The devil himself knoweth not the mind of man." Unless a taxpayer makes an admission as to the purpose of a transaction the courts are always relegated to determining the purpose by inference or assumption: *Report of the Royal Commission on Taxation* (Ottawa: Queen's Printer, 1966), hereinafter the 'Carter Report' named for Chairman Kenneth Carter, vol. 3 of 6 vols. at 538.

[77] *Gilbert v. Commissioner of Internal Revenue*, [1957] 248 F. 2d, 406 at 411.

[78] John Tiley, "Judicial Anti-avoidance Doctrines", (1987) 88 B.T.R., at 181.

[79] As *per* Lord Oliver in *Craven v. White*, [1988] STC 477 at 497.

courts are in agreement. In the post *Stubart Investments*[80] case, *Johns-Manville Canada Inc. v. The Queen*,[81] the Supreme Court of Canada established that the taxpayer should be given the benefit of the doubt when Parliament's intention is unclear.[82]

> If the interpretation of a taxing statute is unclear and one reasonable interpretation leads to a deduction to the credit of a taxpayer and the other leaves the taxpayer with no relief from clearly *bona fide* expenditures in the course of his business activities, the general rules of interpretation of taxing statutes would direct the tribunal to the former interpretation.[83]

As it presently stands, the anti-avoidance provision contained in the June 1994 guidelines is an affront to the potential taxpayer. It gives too much discretion to the courts in asking them to determine whether "the main purpose for the existence of an employment relationship is to establish a connecting factor between the income in question and a reserve," without providing any further guidance as to how that might be determined. It is submitted, therefore, that the courts should ignore the anti-avoidance, or apply it cautiously, erring in favour of the taxpayer.

At any rate, the "*INDIAN ACT* EXEMPTION FOR EMPLOYMENT INCOME GUIDELINES JUNE 1994 REVENUE CANADA" appear 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.[84]

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[80] *Stubart Investments Limited v. The Queen*, 84 D.T.C. 6305 (SCC).
[81] *Johns-Manville Canada Inc. v. The Queen* 85 D.T.C. 5373 (SCC).
[82] Moreover, Justice Muldoon writing for the Federal Court in *Vanguard Coatings and Chemicals v. M.N.R.*, 86 DTC 6552, suggested that vague and discretionary provisions contained in a taxing statute should be interpreted restrictively.
[83] *Johns-Manville, supra* note 81 at 5382.
[84] Included in Guideline 1 is a 'proration rule' which states:

> 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 in the reserve.

GUIDELINE 2
When:
the employer is resident on a reserve; and,
the Indian lives on a reserve;
all of the income of an Indian will usually be exempt from income tax.[85]

GUIDELINE 3
When:
more than 50% of the duties of an employment are performed on a reserve; and,
the employer is resident on a reserve or the Indian lives on a reserve;
all the income of an Indian from an employment will usually be exempt from income tax.[86]

GUIDELINE 4
When:
the employer is resident on a reserve; *and*,
the employer is:

(a) an Indian band which has a reserve, a tribal council representing one or more Indian Bands which have reserves, or an Indian organisation controlled by one or more such Bands or tribal councils and dedicated exclusively to the social, cultural or economic development of Indians who, for the most part, live on reserve; *and*,
(b) the duties of employment are in connection with the employer's part of the non-commercial activities carried on exclusively for the benefit of Indians who for the most part live on reserves;

all of the income of an Indian from an employment will usually be exempt from income tax.

Revenue Canada also indicated that the treatment of employment related benefits, including unemployment insurance benefits, retirement allowances and registered pension plan benefits would remain as under the 1993 guidelines.

Finally, an issue arises in relation to the 'proration' rule contained in Guideline No. 1,[87] which purports to give Revenue Canada the right to tax that portion of an Indian's income earned off the reserve. It would appear that in establishing the proration rule, Revenue Canada is essentially applying the formula found in Subsection 2(3) of the *Income*

[85] This is the guideline at which the aforementioned anti-avoidance proviso is aimed. Included in the "examples where not exempt" is an example in which an Indian employee is employed by an employment agency whose only meaningful purpose is to make it possible for employees to work for employers that are not situated on a reserve.
[86] However, as in Guideline 2, the residence of the employer will not be taken into account if one of the main purposes for the employment relationship is tax avoidance.
[87] *Supra* note 85.

Tax Act,[88] whereby persons residing outside Canada are taxed on the income they earn in Canada. Indeed, the proration rule bears a striking similarity to the provisions for taxing non-Canadian residents: Indian reserves, are treated as if foreign jurisdictions and the percentage of income earned by reserve residents, in 'Canada', is exigible to tax. The issue arises in relation to the introductory phrase contained in Section 87, which reads, "[n]otwithstanding any other Act of Parliament or any Act of the legislature of a province, the following property is exempt from taxation...."[89] This phrase has been taken to mean that the exemption afforded in Section 87 takes precedence over any other federal or provincial law, including the *Income Tax Act*.[90] Hence, subject to the untested argument that in applying the proration rules, Revenue Canada is essentially applying Subsection 2(3) of the *Income Tax Act*, the portion of income earned by an Indian off-reserve should not be taxable on a prorated, or any other basis.

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[88] Subsection 2(3) ITA reads as follows:

> Tax payable by non-resident persons – Where a person who is not taxable under subsection (1) for a taxation year
>
> (a) was employed in Canada,
>
> (b) carried on business in Canada, or
>
> (c) disposed of a taxable Canadian property,
>
> at any time in the year or a previous year, an income tax shall be paid, as required by this Act, on the person's taxable income earned in Canada for the year....

[89] With respect to the 'notwithstanding' clause, Section 87 underwent a semantic reorganisation between 1951 and 1985. In 1951, the introductory 'notwithstanding' phrase was formerly contained in a prologue to a single undivided section, which included what is now Subsection 87(2). There was some concern that this might result in the 'notwithstanding' criteria being inapplicable to what is now Subsection 87(2) of the *Indian Act*. The courts have, however, indicated that the revision to the 1985 legislation did not substantively alter the meaning of the section and that the phrase "notwithstanding any other Act of Parliament..." should be taken as applying to Subsection 87(2) as well as Subsection 87(1): *Sturgeon Lake Indian Band v. Minister of Indian Affairs and Northern Development*, [1995] 2 F.C. 389, noted in Robert C. Strother and Robert A. Brown, *Taxation and Financing of Aboriginal Businesses in Canada*; (Carswell: Thomas Professional Publishing, looseleaf service, 1998), at 3-20.

[90] Morry, *supra* note 17 at 428.

2-8 ASSEMBLY OF FIRST NATIONS' PERSPECTIVE ON THE IMPACT OF *WILLIAMS*

Following the issuance of the 1993 guidelines, and preceding those of 1994, representatives from Revenue Canada met with the Assembly of First Nations' Taxation Planning Committee. The Assembly prepared a proposal[91] indicating that First Nations and their members have an inherent immunity from all forms of taxation arising from their Aboriginal right of self-government.[92] Moreover, the Assembly put forward its view on the impact of the *Williams* decision, focussing on Justice Gonthier's comments that *Williams* was not "an appropriate case in which to develop a test for the *situs* of the receipt of employment income."[93] To that end, the Assembly's submission provides, *inter alia*:

> *Williams* has not in any way overruled the *Nowegijick* decision of the same court. On the contrary, it affirms the *Nowegijick* decision and extends the application of immunity to the very particular situation of unemployment insurance. We are of the view that the court in *Williams* stated specifically that it was not an appropriate case to establish rules of situs for employment income and that it was not doing so. It is therefore our view that *Williams* should be construed by Revenue Canada as expanding, without restricting, the categories of exempt income defined by section 87 of the *Indian Act*.

The Assembly went on to produce its own guidelines to determine whether an Indian's personal property should be exempted from tax under Section 87. Amongst other things, they proposed tax-exempt status for Indians employed by organisations "dedicated to the advancement of First Nations" causes, and re-adopting the *Nowegijick* principle to locate the *situs* of intangible property.

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[91] Assembly of First Nations, Tax Planning Committee, "Proposal for Mandate of Section 87/Williams," 16 March 1993.
[92] This notion is explored in greater detail in a following chapter.
[93] *Williams*, *supra* note 41 at 885.

Having explored the respective positions of Revenue Canada and the Assembly of First Nations concerning the tax exempt status of 'Indians', one must be mindful of the fact that the guidelines established by both camps merely represent a perspective and should not be confused as possessing legal effect *per se*.

> Administrative policy and interpretation **are not determinative** but are entitled to weight and can be an important factor **in case of doubt about the meaning of legislation**.[94] [emphasis added]

In short, the courts are free to disregard guidelines and Interpretation Bulletins and, in a number of cases discussed in Chapter Three, that is exactly what they have done. In the end, it is, of course, the courts' opinions that count. Accordingly, the post-*Williams* case law is discussed in the next chapter.

2-9 A WORD ON THE *SITUS* OF TANGIBLE PERSONAL PROPERTY

A comprehensive analysis on determining the *situs* of tangible personal property is not attempted here, because the tax treatment of tangible property varies between the provinces and with types of property. For example, tobacco, gasoline, liquor, motor vehicles, and goods intended for commercial use are all subject to different inter-provincial tax treatment. Suffice to say there is an over-riding test to determine the *situs* of tangible property for *Indian Act* tax exemption purposes.

In *Leighton v. The Queen*,[95] Justice Lambert for the B.C. Court of Appeal indicated that *situs* must be determined in relation to the type of property at issue. To that end he devised the 'paramount location' test which inquires into the "pattern of use and

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[94] As *per* Justice Dickson in *Nowegijick*, *supra* note 33 at 94.
[95] *Leighton v. The Queen*, [1989] 35 B.C.L.R. (2d) 216.

safekeeping" of the property in question. In rendering his *Mitchell v. Peguis* disposition, Justice La Forest cited the *Leighton* case with approval, stating:

> In what I take to be a sound approach, Lambert J.A. held that when considering whether tangible personal property owned by Indians can benefit from the exemption from taxation provided for in s.87, **it will be appropriate to examine the pattern of use and safekeeping of the property in order to determine if the paramount location of the property is indeed situated on the reserve**.... But I would reiterate that in the absence of a discernible nexus between the property concerned and the occupancy of reserve lands by the owner of that property, the protections and privileges of ss.87 and 89 have no application.[96]

Hence, the 'paramount location' of tangible property is the place where that property is primarily stored and put to use. For example, in the case of a motor vehicle, if it is stored and used primarily on-reserve, the paramount location of the vehicle is the reserve.

There is, however, reason to question whether the 'paramount location' of property should be the decisive factor in determining whether an Indian should be exempted from provincial sales tax. This is because provincial retail sales tax must be levied on the purchaser at the time of purchase, not on the commodity and not after a transaction has been negotiated. This invites an obvious question: how is the after purchase location and use of a commodity relevant to determining whether a purchaser, at the time of purchase, should be exempted from provincial retail sales tax?

To appreciate why provincial retail sales taxes are levied on a purchaser at the time of purchase, one must understand the distinction between direct and indirect taxation and that the provinces are confined to levying only direct taxes.[97] Simply stated, a direct tax is borne by the person who pays it, whereas an indirect tax is borne by someone other than the person

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[96] *Mitchell v. Peguis*, *supra* note 49 at 133.

[97] For example, Subsection 92(2) of the *Constitution Act, 1867* limits the power of the provinces to the imposition of direct taxation, stating:

> 92. In each Province the Legislature may exclusively make laws in relation to matters coming within the classes of subjects next herein-after enumerated; that is to say...,
>
> (2) direct taxation within the Province in order to the raising of a revenue for provincial, local, or municipal purposes....

who pays it.[98] For example, if a retailer is required to pay a tax when purchasing his goods from a wholesaler and, in turn, increases the cost of those goods to the consumer, the tax imposed is indirect because while it is paid by the retailer, it is borne by the consumer. Hence, to avoid challenges to their constitutionality, provincial retail sales taxes are deftly drafted so that they are imposed on the person who actually bears the tax, *i.e.*, the purchaser.[99]

Accepting that the 'paramount location' test is inappropriate to determine the availability of Section 87 leads one to inquire what the appropriate test for *situs* might be. One answer was provided by Madam Justice McLachlin (as she was then), writing for Lamer C.J., Cory, Iacobucci and Major JJ., in *Union of New Brunswick Indians v. New Brunswick*.[100] Justice McLachlin stated:

> The concept of "paramount location" finds no application to sales taxes on tangible goods. **Sales taxes attach at the moment of sale. At this point, the property has but one location – the place of sale. It cannot have its paramount location elsewhere because no pattern of use and safekeeping elsewhere is established**. The location of property after the sale and the imposition of tax is irrelevant. **This means that goods purchased off-reserve attract tax, while goods purchased on-reserve are exempt, regardless of where the purchaser may intend to use them**. To make taxation dependent on place of anticipated use of the article purchased would render the administration of the tax uncertain and unworkable.[101]

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[98] Brian J. Arnold, Tim Edgar, Jinyan Li and Daniel Sandler, *Materials on Canadian Income Tax* 11th ed., (Toronto: Carswell Publishing, 1996), at 2.

[99] A sample wording of provincial retail sales tax legislation is provided below from the *New Brunswick Social Services and Education Tax Act*, R.S.N.B. 1973, c. S-10, which states, *inter alia*:

> 4. Every consumer of goods consumed within the Province and every purchaser of services purchased within the Province shall pay to the Minister for the raising of revenue for Provincial purposes a tax in respect of the consumption of such goods or purchase of such services, computed at the rate of eleven per cent of the fair value of such goods or services....
>
> 5(1) In the case of a retail sale within the Province, the tax shall be payable by the purchaser at the time of purchase on the fair value of the goods or services.
>
> 5(2) Notwithstanding subsection (1), in the case of a retail sale within the Province of goods that are used or consumed within the Province and are used or consumed frequently or substantially outside the Province, the purchaser shall report the matter to the Commissioner in accordance with the regulations and shall pay the tax on such goods at such time and in such manner as the Commissioner requires

[100] *Union of New Brunswick Indians v. New Brunswick*, [1998] 1 S.C.R. 1161.

[101] *Ibid.*, at para 35.

In rendering the *Union of New Brunswick* decision, the Supreme Court essentially replaced the 'paramount location' test with the earlier established 'point of sale' test originating in *Danes v. The Queen*.[102] The question in *Danes* was whether an automobile purchased on-reserve, by an Indian living there, should be subject to retail sales tax. The court held that the *situs* of property for Section 87 purposes must be determined at the time and place that the tax is imposed, or in other words at the place of purchase. *Ergo*, an Indian purchasing property on a reserve is exempted from retail sales tax.

It does seem that the 'point of sale' test better conforms with the fact that the provincial sales tax is levied on the purchaser at the time of purchase, because it discards seemingly irrelevant questions about after-purchase use of property. Moreover, the 'point of sale' test is more administratively feasible because it does not require a potential taxpayer to prove that, after purchase, property was used primarily on-reserve.

There is nothing to suggest that the 'point of sale' test should not also apply to the incidence of tobacco, gasoline and alcohol taxes as well. In practice, however, various provincial retail sales tax statutes deal with the *Indian Act* tax exemption differently. For example, the *Manitoba Revenue Tax Act*[103] provides:

> 3(15) Notwithstanding section 2, no tax is payable under this Act in respect of tangible personal property
> (a) that is purchased by an Indian
> (i) on a reserve for consumption or use by an Indian on a reserve, or
> (ii) off a reserve for consumption or use by an Indian on a reserve if the tangible personal property is delivered by the seller to the reserve or shipped by the seller by common carrier for delivery to the reserve; and
> (b) that is not
> (i) a motor vehicle as that word is defined in The Highway Traffic Act, or
> (ii) tangible personal property which in the opinion of the Minister is for commercial use, or
> (iii) liquor as that word is defined in the Liquor Control Act.

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[102] *Danes v. The Queen*, [1985] 2 CNLR 18 (BC CA).
[103] *Revenue Tax Act*, RSM 1987, c. R-130.

While it is almost certain that the Province of Manitoba has no right to exclude motor vehicles, liquor and commercial use property from the exemption,[104] at least Manitoba's legislation gives effect to the 'point of sale' test.

Finally, Revenue Canada has taken a surprisingly liberal stance in applying the Goods and Services Tax to the tangible personal property of Indians. For example, Technical Information Bulletin B-039, which outlines the administrative policy on the application of GST to First Nations, states that "GST will not be exigible in respect of on-reserve purchases of goods by Indians or bands or to off-reserve purchases of goods delivered to the reserve by vendors or their agents." Revenue Canada could easily have applied the strict letter of the law to GST and exempted only properties actually purchased on-reserve and not those to be delivered there from an off-reserve retailer. GST is not subject to the same technical limitations as PST because GST may be levied as an indirect tax, on property, not merely on the purchaser. Under the current state of the law there is a great deal more clarity and certainty for the Indian taxpayer with respect to tangible personal property. He or she can know that anything purchased on a reserve is not rightly chargeable to tax and, in the case of off-reserve purchases in Manitoba at least, any goods purchased off the reserve but delivered there are exempted from tax, excepting, of course, cars, liquor and commercial materials.

[104] This is because of the 'notwithstanding' clause contained in the preamble to Section 87 of the *Indian Act*, and also because the legislation relating to Indians is a matter reserved to the exclusive jurisdiction of the federal Parliament as *per* Subsection 91(24) of the *Constitution Act, 1867*.

2-10 CONCLUSION

Indians living and working on a reserve are exempted from tax, as *per* a long-standing policy goal to shield reserved lands from distraint. The task of fully establishing the parameters of the exemption has, however, been left largely to the courts. In effecting the underlying purpose of the exemption, the courts ultimately settled on the 'connecting factors' approach to determine whether property is so located as to qualify for the exemption. The result is that the focal point in litigation concerning Section 87 is almost invariably an Indian's personal circumstances, such as location of domicile and place and manner of employment.

- CHAPTER THREE - LIFE AFTER *WILLIAMS*, APPLYING THE 'CONNECTING FACTORS' TEST

At the risk of stating the obvious, Section 87 of the *Indian Act*[1] affords reserve-based Indians an exemption from tax. Nevertheless, to suggest that Parliament intended to create a tax-avoidance mechanism in enacting the legislation would be disingenuous at best. The fact that Section 87 confers an exemption from tax is merely ancillary to its intended function: to prevent First Nations from becoming dispossessed of their treaty entitlements, a policy ideal originating in the Royal Proclamation of 1763. Once one comes to terms with the underlying purpose of the legislation, the importance of determining the *situs* of an Indian's property reveals itself: its location might demonstrate an inextricable link to a reserve, thereby indicating that such property warrants the protections contained in Section 87.

The 'connecting factors' test that Justice Gonthier devised in *Williams v. The Queen*[2] encapsulates both the policy rationale of protection and the necessary limits of the exemption, so as to render it null as a general tax avoidance mechanism. The two-stage test was conceived to determine whether property is sufficiently connected to a reserve to be 'situated' there for Section 87 purposes. Stage One inquires into the existence of any factors connecting the property in question to a reserve; Stage Two is directed at the weight afforded to those factors. Following *Williams*, the courts have built on the 'connecting factors'

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[1] R.S.C. 1985, c. I-5, hereinafter, the *Indian Act*.
[2] *Williams v. The Queen*, [1992] 1 S.C.R. 877.

approach, establishing that it should be used to locate the *situs* of all forms of income, from employment to investment income.

In essence, post-*Williams* litigation reduces the *situs* issue to whether income is earned in the 'commercial mainstream'.[3] Such an analysis is a result of the courts focussing on the first of the three considerations[4] applied to determine the weight a 'connecting factor' should receive. Justice Gonthier's first consideration was the purpose of the *Indian Act* exemption, which is, of course, "to prevent the erosion of an entitlement of [an] Indian *qua* Indian on a reserve."[5] Apparently, the reason for focussing on the first consideration is that the remaining two are virtually fixed; that is to say, the type of property in question is almost always 'income' and consequently, the nature of taxation is 'income tax'. However, the courts are flexible in their approach, exempting income in situations deemed appropriate, making it difficult to know exactly how the 'connecting factors' test should be applied. One thing is certain though: the courts are applying the test on a case-by-case basis and accordingly, the only way to discern their direction is to consider each individual case.

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[3] In applying the 'commercial mainstream' criteria, the courts are expanding upon the sentiment expressed by Justice La Forest in *Mitchell v. Peguis Indian Band*, [1990] 2 S.C.R. 85 at 131, to the effect that,

> [t]he fact that the modern-day legislation, like its historical counterparts, is so careful to underline that exemptions from taxation and distraint apply only in respect of personal property situated on reserves demonstrates 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. 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. [emphasis added]

[4] Justice Gonthier stated that the following three considerations should apply in determining what weight to ascribe a connecting factor: "(1) the purpose of the exemption under the *Indian Act*; (2) the type of property in question; and (3) the nature of the taxation of that property."

[5] As *per* Justice Gonthier in *Williams v. The Queen*, *supra* note 2 at 882.

3-1 THE 'CONNECTING FACTORS' CRITERION AND EMPLOYMENT INCOME

The oft-cited phraseology concerning the 'commercial mainstream' has appeared in numerous decisions[6] to support the proposition that when an Indian leaves the sanctuary and confines of reserved lands, he or she is subject to the same tax treatment as all other Canadians. Specifically, in *Clarke et al. v. M.N.R.*,[7] seven cases were heard together on the issue of whether the appellants' employment income should be exempted from income tax under the auspices of Section 87. *Clarke et al.* provided the courts an excellent opportunity to shape the 'connecting factors' criteria because it involved seven separately constituted cases with slightly varying fact scenarios. However, in only one of the seven cases were the duties of employment actually undertaken on a reserve, whereas the court deemed two of the appellants'[8] incomes to be situated on-reserve, pursuant to paragraph 90(1)(a) of the *Indian Act*.[9]

In the remaining four cases, the taxpayers were not entitled to the exemption because their employment duties were performed off reserve and the court ruled that their income was, therefore, earned in the 'commercial mainstream'. In the case of William Clarke, who was exempted from tax, Hamlyn T.C.J. stated:

> The property in question is employment earnings and the tax in question is income tax. The appellant has a choice. **He may choose to work off the reserve in which case he has entered the general commercial mainstream and must be treated as any other Canadian citizen.** Alternatively, he may choose to limit himself to the protective confines of the reserve and thereby protect his personal property from taxation and seizure. The appellant has chosen to accept employment which requires that a substantial amount of his duties are performed upon the reserve. Therefore, he

[6] See, for example, *Mitchell v. Peguis Indian Band*, [1990] 2 S.C.R. 85, *Poker v. Canada*, [1994] 1 C.N.L.R. 85, *Recalma v. Canada*, [1997] 4 C.N.L.R. 272, and *Kakfwi v. Canada*, [1999] F.C.J. No. 1407, to name but a few.
[7] *Clarke et al. v. M.N.R.*, [1992] 2 C.T.C. 2743 (TCC).
[8] The two appellants in question were Elizabeth Poker and Marianne Folster whose cases were subsequently appealed to the Federal Court, Trial Division and then, to the Federal Court of Appeal.
[9] Section 90 is discussed below.

> has chosen to remain within the protective confines of the reserve.[10] [emphasis added]

In applying the 'connecting factors' test as conceived in *Williams*, Judge Hamlyn found that the 'connecting factor' to be accorded the most weight was the location where employment duties were performed. In Mr. Clarke's case, Judge Hamlyn did not prorate the exemption, even though only 50% of his employment duties were performed on the reserve. The learned judge gave no indication as to whether the 'notwithstanding' clause, referred to above,[11] was a factor in exempting the income in entirety and not merely the portion earned on-reserve.

The *Clarke* decision was followed by *Brant v. M.N.R.*,[12] which involved a Status-Indian who resided on a reserve, but was employed off-reserve, ironically enough, by Revenue Canada. Sobier, T.C.C.J. stated:

> The relevant connecting factors in this appeal include the location of the employment which gave rise to the employment income, the source of that income and the residence of the Appellant at the time the Appellant earned and received the employment income. **The factors to be given the greatest weight in this circumstance are the source of the employment income earned by the Appellant and the location of the employment where the Appellant actually earned the income. The residence of the Appellant when he earned and received the employment income will be given weight albeit slightly less than the previous two factors.**
>
> The source of the Appellant's employment income is the government's general revenue and not property from a source situated on a reserve which requires protection from erosion. **The Appellant earned this income in the general commercial mainstream. In this way, the Appellant is no different from any other person working for the federal government. If an Indian chooses to work for an employer off a reserve, then income earned in the general commercial mainstream, in the day to day 'affairs of life' off the reserve lands, is not personal property exempt from taxation pursuant to section 87 of the *Indian Act*.** To allow the Appellant an exemption from taxation of this income would be an attempt to remedy the economically disadvantaged position of Indians who cannot find employment on the reserve. This is not the purpose of the exemption from taxation provided by section 87 of the *Indian Act*.[13]

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[10] *Clarke, supra* note 6, at 2749.
[11] *Ante*, Chapter Two, note 89.
[12] *Brant v. M.N.R.*, 92 DTC 2274 (TCC).
[13] *Ibid.*, at 2279.

The *Brant* decision seemed to indicate a trend whereby the courts were prepared to afford the most weight to two 'connecting factors' in particular: (1) the source of the employment income; and, (2) the location where employment duties are performed. This, Judge Sobier felt, was the best means of addressing whether a litigant's income was earned in the commercial mainstream, or alternatively on a reserve.

Finally, in *Bell et al. v. The Queen*,[14] Chief Judge Bowie added a new wrinkle. The *Bell* case involved fifteen Status-Indian fishermen who were registered with the Gwa'Sala-Nakwaxda'xw Band, located on a reserve near Port Hardy on Vancouver Island. The plaintiffs were employed by a successful commercial fishing enterprise and the issue was whether the income so derived was eligible for the *Indian Act* tax exemption. The judge observed:

> [T]he most important factors bearing upon the result in this case are **the nature of the employment, and the manner in which it is carried out**. Nothing about those factors suggests to me that any of the Appellants in this case, if taxed on the income, would tend to be deprived of property which they hold *qua* Indian.[15] [emphasis added]

It is not entirely clear why Chief Judge Bowie strayed from the *Clarke* and *Brant* decisions in according a preponderance of weight to the nature and the manner in which the taxpayers' employment was carried out.[16] He could have easily applied the test as in *Clarke* and *Brant*, focussing on the location where work was performed, and reached the same result. In any event, the fact that the plaintiffs were engaged in activities no different from other commercial fishermen, coupled with the fact that Indian persons resident on a reserve

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[14] *Bell et al. v. The Queen*, 98 DTC 1857 (TCC).
[15] *Ibid.*, at 1863.
[16] The question as to the nature of the work performed is aimed at determining whether that work is, in essence, equivalent to similar work undertaken by non-Indians in the 'commercial mainstream', or whether the work in question has a distinct 'Indianness' about it, or benefits Indians residing on reserves.

derived no meaningful benefit from the activities, compelled Chief Judge Bowie in rendering his decision.

Perhaps the most notable aspect of the *Bell* decision was Judge Bowie's concern that Mr. Walkus, the employer, relocated his corporation's head office onto the reserve based on advice provided by his accountant. Bowie felt that to allow an exemption under such circumstances would be an affront to the very purpose of the *Indian Act*.

> As Gonthier, J. said in *Williams*... '[a] connecting factor is only relevant in so much as it identifies the location of the property in question for the purposes of the *Indian Act*.' I am confirmed in this by the fact that the office in the Band Office building was clearly created, not for any purpose related to the operation of the *Indian Act*, or the identity of the Appellants as Indians, but, on the advice of [an accountant] for the purpose of providing a tax advantage to the company and its employees. Its purpose has nothing to do with the property of an Indian *qua* Indian, and everything to do with securing an economic advantage. To accept it as a significant connecting factor would be to permit the 'manipulation and abuse' against which the Supreme Court warns in *Williams*.[17]

Hence, if the *Bell* decision is to be followed, little deference will be given to either an employer's, or employee's residence as those factors can be easily manipulated for tax-avoidance purposes. This, in turn, calls into question Judge Sobier's focus in *Brant* on the source of the Appellant's employment income.

The foregoing cases suggest that in applying the commercial mainstream model, the courts will focus on two 'connecting factors' in particular, namely: (1) the location of the work being performed, and (2) the nature of the work being performed. *Ergo*, if an Indian performs his employment duties substantially outside reserve boundaries and the nature of his work is similar to that undertaken by non-Natives, the work will be deemed as having been performed in the 'commercial mainstream' and the income earned therefrom is ineligible for the tax exemption. The nature of the employment in question was the focus of

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[17] *Bell et al.*, *supra* note 14 at 1862.

two appeals arising out of the *Clarke* decision and as such, cannot be discounted as a factor of potentially vital significance in determining the *situs* of employment income.

3-2 A MORE RELAXED APPROACH – THE NATURE OF THE WORK PERFORMED

The courts seemed to be applying the 'connecting factors' test more and more stringently as litigation concerning the *Indian Act* tax exemption ensued, and then suddenly veered from that course in the *Canada v. Poker*,[18] and even more surprisingly, in *Folster v. The Queen*.[19] Both cases were appeals from the *Clarke* decision and both were rife with extenuating circumstances. *Canada v. Poker* involved the appeals by the Minister of National Revenue in respect of the Tax Court decisions on Elizabeth Poker and Marianne Folster. At the Federal Court of Canada, Trial Division, Justice Cullen followed *McNab v. Canada*[20] in applying the 'connecting factors' criterion and ruled that Ms. Poker's income was exempt from income tax based on Section 87, not on the deeming provision contained in Section 90 as the Tax Court found. Ms. Folster lost at the Federal Court, Trial Division, but was later successful at the Federal Court of Appeal, based upon a similar application of Section 87.

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[18] *Canada v. Poker*, [1995] 1 C.T.C. 84.

[19] *Folster v. The Queen*, 97 D.T.C. 5315.

[20] In *McNab v. Canada*, [1992] 2 C.T.C. 2547 (T.C.C.), the plaintiff was a Status-Indian who resided on a reserve. She was employed by the Saskatchewan Treaty Women's Council, whose mandate was to promote health care and protection for Aboriginal women and children in Saskatchewan. Beaubier, T.C.C.J., decided that because the Council was located on a reserve and the plaintiff was paid on the reserve, that although she performed most of her duties of employment off-reserve,

> ...the salary paid to her constituted personal property of an Indian situated on a reserve because all of her work was with Indians and all of her work was on the instructions of an employer whose sole purpose was to benefit Indians on reserves.

Dealing first with Ms. Poker, she resided on the Norway House Indian Band reserve and was employed by the Frontier School Division, whose administrative office was located on the reserve, and accordingly the residence of the debtor was on-reserve. Her duties were primarily performed at the school, adjacent to but slightly outside reserve boundaries. Applying a liberal interpretation of the *Indian Act* tax exemption, Justice Cullen found that

> ...[a]lthough the place of employment was not physically on the reserve, **the nature or purpose of the defendant's employment is *closely connected* to the reserve. The school in question and the schools on the reserve were seen as one system by the Frontier School Division and the Norway House Indian Band. The defendant's work was performed off the reserve on instructions from her employer. Most of the students attending the school were Indians. The circumstances surrounding the employment, and the income earned therefrom, overwhelmingly point to the reserve....** [I]n concluding that the defendant's income is situated on the reserve, I am taking into account the combined force of the connecting factors and the circumstances surrounding the employment.[21] [emphasis added]

His Honour stressed that he was by no means extending the definition of a 'reserve' or creating a 'notional reserve' outside the reserve boundaries.[22] Instead, he indicated that the exemption should apply because the nature and purpose of Ms. Poker's employment 'closely connected' it to the reserve. This, he based upon the fact that the school in question and the schools on the reserve were of the same system, and on the fact that most of the students attending the school were Status-Indians.

In *Folster v. The Queen*, the Minister of National Revenue first appealed to the Federal Court, Trial Division, where Justice Cullen ruled that the deeming provision, Section 90, did not apply and in administering the 'connecting factors' test found her income to be taxable because it was located outside the reserve. At the Federal Court of Appeal, Justice Linden, for a unanimous court, varied the lower court's judgment and ruled that under the

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[21] *Poker*, *supra* note 18, at paras 45-48.

circumstances Ms. Folster's income was sufficiently connected to a reserve to qualify for the tax exemption. Ms. Folster's employment duties were undertaken adjacent to the reserve, at a hospital that had a significant historical and cultural connection to the reserve and to the Band. Moreover, deference was given to the fact that the hospital was originally situated on the reserve and was rebuilt barely outside the reserve boundary after being destroyed by fire.

The Federal Court of Appeal found that the hospital's precise location was less important than the hospital's historic significance to the band. Moreover, Justice Linden reasoned that the trial court accorded too much weight to two 'connecting factors': (1) the location where the employment took place and (2) the employer's residence. He added that insufficient weight was accorded to the unique circumstances of Ms. Folster's employment, her residence on the reserve and the history of the hospital where she worked.

> In my view, having regard for the legislative purpose of the tax exemption and the type of personal property in question, **the analysis must focus on the nature of the appellant's employment and the circumstances surrounding it**. The type of personal property at issue, employment income, is such that its character cannot be appreciated without reference to the circumstances in which it was earned.[...] [W]hen the personal property at issue is employment income, it makes sense to consider the main purpose, duties and functions of the underlying employment; **specifically, with a view to determining whether that employment was aimed at providing benefits to Indians on reserves**. In this case, the appellant's employment was **intimately connected** with the Norway House Indian Reserve. Added to this is the fact that the appellant, as I have noted, lived on the Norway House Indian Reserve, the community which was served by the Hospital in which she worked.[23]

In the wake of *Poker* and *Folster*, it appears that the courts are willing to abandon strict application of the 'commercial mainstream' criterion in favour of a more liberal approach, when an appellant's employment is 'intimately connected' to life on a reserve, or

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[22] The 'notional reserve' concept was rejected in *Kirkness v. M.N.R.*, [1991] 2 C.T.C. 2028, in which, under a similar fact scenario as that in *Folster*, the appellants were denied the Section 87 exemption because their place of employment, a nursing station, was slightly outside the reserve boundary.

[23] As *per* Linden J.A. in *Folster*, supra note 19, at 5321-5323.

the well-being of the reserve's denizens. Hence, under the softer approach, if one's work location is geographically close to a reserve and the work benefits Indians residing on it, that employment might fall outside the commercial mainstream and be exempted from tax.

Folster and *Poker* must, however, be balanced against *Desnomie v. The Queen*,[24] a decision by Judge Archambault in the Tax Court of Canada. In *Desnomie*, the plaintiff resided in Winnipeg and performed his employment duties there for a company that, under a *De Beers Consolidated Mines Ltd. v. Howe*[25] analysis, resided in Winnipeg.[26] However, Mr. Desnomie's employer, the Manitoba Indian Education Association ("MIEA"), was a non-profit organisation whose purpose was to advance the education goals and otherwise to assist the social, cultural, and economic development of Indian people in Manitoba.[27] In essence, the job entailed providing services to Indian students whose main residences were situated throughout a variety of reserves, but who resided in Winnipeg whilst attending university or college.

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[24] *Desnomie v. The Queen*, [1998] 4 C.T.C. 2207.

[25] *De Beers Consolidated Mines Ltd. v. Howe*, [1906] A.C. 455. *De Beers* stands for the proposition that

> ...a company resides for the purposes of income tax where its real business is carried on.... I regard this as the true rule, and the real business is carried on where the central management and control actually abides.

As *per* Lord Loreburn at 458. In *De Beers*, the House of Lords ruled that the appellant company was located in England because that is where the Board of Directors resided and conducted business, even though the company was incorporated in South Africa and maintained its head office and management in South Africa.

[26] Moreover, the company's registered office was located in the City of Winnipeg.

[27] The MIEA's articles of incorporation read specifically:

> The undertaking of the corporation is restricted to the following:
> To promote, advance and protect the interests of the membership and to do all things that are lawful, incidental and conducive to the attainment of the undertaking of the corporation; and, in particular, to preserve and advance the education goals of Indian people in a manner consistent with the direction adopted from time to time by the Indian Chiefs of Manitoba; to provide leadership and organizational support to Indian Bands and Indian Associations in the field of education; to compile and disseminate information to the Indian community on developments in the field of education; to identify areas for study and conduct research on Indian education matters; to assist in the planning and coordination of local control of Indian education in a matter [*sic*] consistent with the direction established by individual Indian Bands or Indian School Board authorities; and to organize, coordinate and provide Indian student services as delegated from time to time by an individual Indian Band, Tribal Council or education authority in the Province of Manitoba.

Counsel for Mr. Desnomie drew the court's attention to the fact that his services were provided to Indian students and were aimed at improving Indian peoples' lives on reserves. An analogy was drawn between the case at bar and *Folster*, but Judge Archambault pointed out that the fact scenario in *Folster* was extraordinary.

> In *Folster*, the situation was quite different from the facts of this case. First, the taxpayer was residing on a reserve. Her services as an employee were being provided to a hospital which had been on a reserve, was relocated on land adjacent to the reserve after a fire, and was in the process of being annexed by the reserve.
>
> Furthermore, approximately 80% of the hospital's clients were status Indians who were presumably living on the reserve. As stated by Linden J.A. who wrote the decision in *Folster*, the employment of the taxpayer was **"intimately connected with the ... reserve". Here, we do not have this intimate connection.** The closest reserve, the Dakota Ojibway reserve, was 100 kilometres away from Winnipeg, while the furthest away, the Keewatin reserve, was located so far north that an overnight airplane trip was required to get to Winnipeg. Furthermore, unlike the clients of the hospital in *Folster*, the students of the MIEA were away from their reserve for 8 to 10 months. Finally, unlike Ms. Folster – and Mr. Williams in *Williams* – Mr. Desnomie was not living on the reserve that benefited from his work.[28] [emphasis added]

It is noteworthy that in the *Folster* case the court overlooked the fact that the appellant's employer resided outside reserve boundaries, but in *Desnomie*, no such exception was made. Perhaps, if the MIEA resided nearer to a reserve, as in *Folster*, the court might have ruled differently. Or perhaps, if the MIEA had relocated from a reserve, to an off- reserve location due to a fire, the courts might have been more sympathetic: this would certainly lead to some interesting tax planning schemes.

Judge Archambault was not persuaded by the fact that Mr. Desnomie's services were provided to enhance the social, cultural and educational development of Indians. It is nonetheless appropriate at this stage to address Guideline 4 of Revenue Canada's '*Indian Act* Exemption for Employment Income Guideline June 1994', which suggests that, under certain circumstances, income earned to that end shall be tax exempt. Guideline 4 reads as follows:

Desnomie, *supra* note 25 at para 10.

[28] *Ibid.*, at paras 28 and 29.

> When:
> - the employer is resident on a reserve; and
> - 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; and,
>
> ➢ the duties of 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;
>
> all of the income of an Indian from an employment will usually be exempt from income tax.

Examining Guideline 4 in its constituent parts, one finds that in order to qualify for the *Indian Act* tax exemption an individual's employment duties do not have to be performed on-reserve, if his employer is a band, a tribal council, or an organisation controlled by one or more bands and the employer resides on-reserve. Guideline 4 also requires, in the case of an 'organisation', that it be dedicated to the "social, cultural, educational, or economic development of Indians who for the most part live on reserves."[29] The guideline does not require that an individual be connected with a particular reserve or that he reside on-reserve, only that his employment be carried on exclusively for the benefit and welfare of Indians residing on reserves.

It is noteworthy that one of the example fact scenarios provided with Guideline 4 bears a striking similarity to the *Desnomie* fact scenario:

> Mr. R works for an Indian organization providing child and family related services to members of a large number of bands with reserves scattered over a large area within a province. Some of these services are provided in the provincial capital, where Mr. R works, and **the organization's administrative office is at an off-reserve location central to the bands served. However, the organization's directors, consisting of the band chiefs, meet at each reserve in rotation**. Mr. R is exempt from income tax on his employment income because the duties he performs for the Indian

[29] This includes the provision of social services such as health care or counselling.

> organization that employs him are connected to the reserves served by the Indian organization, **and the employer is resident on a reserve**. [emphasis added]

Perhaps if the MIEA board of directors had met on the reserves from which the students benefiting from Mr. Desnomie's services originated, rather than in Winnipeg, Judge Archambault would have ruled differently. In any event, when an Indian is employed by a non-commercial 'Indian organisation' whose purpose is to further the development of Indians residing on a reserve, Guideline 4 might indicate that the income earned therefrom is sufficiently connected to reserve life to qualify for the tax exemption.

The courts seem to have overlooked Guideline 4 in rendering the *Poker*, *Folster* and *Desnomie* decisions, although Justice Linden indicated in *Folster* that he was aware of the Guidelines but was "willing to ignore them" under the circumstances of the *Folster* case.[30] Although the judiciary has yet to make direct use of the Guideline to exempt the income of an Indian from tax, it does provide a foundation upon which judges might eventually base their decisions. Guidelines and Interpretation Bulletins are not legally authoritative and it is conceivable, therefore, that Guideline 4 might be applied more expansively than it presently appears, to exempt income earned whilst performing services off-reserve for the indirect benefit of Indians residing on-reserve. *Desnomie* was appealed to the Federal Court of Appeal, where a unanimous court affirmed Judge Archambault's. Tax Court decision.[31] One thing is certain: the location where an Indian's duties of employment are performed does not have to be the operative factor in determining the *situs* of the income earned whilst performing those duties.

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[30] Justice Linden said:

> I am not unaware of Revenue Canada's guidelines for the application of section 87. Following the Supreme Court's decision in *Williams*, Revenue Canada issued four guidelines intended to assist in the interpretation of section 87 of the Act according to the connecting factors test.

3-3 THE WILDCARD APPROACH: *Shilling v. MNR*

There is one completely inexplicable decision in terms of the jurisprudence applying the 'connecting factors' test as established in *Williams* and applied in subsequent decisions. *Shilling v. M.N.R.*,[32] a Federal Court of Canada decision calls into question almost all the decisions on locating the *situs* of intangible property. The plaintiff, Rachel Shilling, was born and resided on the Rama Reserve for 20 years. In 1993, she entered into an employment relationship with Roger Obonsawin who operated the National Leasing Service ("NLS") as a sole proprietor; for all intents and purposes NLS was an employment agency.

Mr. Obonsawin was a Status-Indian who resided on and ran his business on the Six Nations of the Grand River Reserve in Ontario. In 1992, NLS contracted with Anishnawbe Health Toronto ("AHT"), a Native health centre located in Toronto, whereby NLS agreed to supply AHT with employees. Ms. Shilling was given the option of working directly for AHT, or contracting with NLS who would then contract out her services to AHT. Either way, she was required to reside and perform her employment duties in Toronto, which included "assisting native people in crisis to reconnect with their culture, and providing support in their healing process." AHT was a preventive health care provider, "committed to the recovery of native people through traditional healing." In any event, Ms. Shilling opted to contract with NLS, admittedly to take advantage of Section 87 of the *Indian Act*.

In rendering her decision, Madam Justice Sharlow focussed almost exclusively on the fact that Ms. Shilling's employer (NLS) resided on a reserve. To that end, the judge stated:

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[31] File No. A-533-98 – Application for Leave to the Appeal to the Supreme Court of Canada has been filed.
[32] *Shilling v. M.N.R.*, [1999] 3 C.T.C. 415.

> The most important factor to be taken into account in determining the location of Ms. Shilling's employment income is the location of her employer. Because the substantive legal and economic consequences of her employment relationship, that factor is entitled to considerable weight. Her employer is located on a reserve, which favours the conclusion that her employment is located on a reserve.... In my view, the determination of the location of the employment income for the purposes of section 87 **should not depend in any way upon the location of the employee's residence**, or the employee's personal and family connections to a reserve.[33] [emphasis added]

In so doing, Madam Justice Sharlow discounted the principle established in *Bell et al. v. The Queen*, that the weight afforded the easily manipulated 'connecting factors', for the purpose of tax avoidance, should be minimised. This was not, however, the most problematic result of the *Shilling* decision. It arises out of the fact that the location of Ms. Shilling's employer was the only factor connecting her income to a reserve. Even if Justice Sharlow's reasoning were meritorious, and *Bell* should be reconsidered on the issue that easily manipulated 'connecting factors' should not be accorded much weight, it does not follow that, if only one of these factors exists and is accorded full weight, it is enough to connect one's income to a reserve.

As such, the *Shilling* decision does not comport with the purpose of the *Indian Act* tax exemption because it confers an economic advantage – unavailable to non-Indians – to Indians ostensibly employed in the commercial mainstream. Justice Sharlow did not, however, see it that way:

> Counsel for the Crown argued in this case, the location for the employer should be considered to be only a weak connecting factor because of the manner in which the employment relationship arose. He points out that Ms. Shilling found employment with AHT but that instead of entering into an employment relationship with AHT, became an employee of NLS. He argues that, because she did so for the tax advantages, the location of NLS should be discounted.
>
> I do not accept this argument. I start with the premise that everyone is entitled to arrange their affairs to take advantage of statutory tax relief, and this may be done by creating legal rights and relationships that have no purpose but to obtain that relief.... **This principle should apply equally to Indians who seek the tax advantages of s. 87 of the *Indian Act***... [and] this is consistent with the comments of Gonthier J. in *Williams*, at page 887:

[33] *Ibid.*, at para 58.

> ...under the *Indian Act*, an Indian has a ***choice*** with regard to his personal property. The Indian may situate this property on the reserve, in which case it is within the protected area and free from seizure and taxation, or the Indian may situate this property off the reserve, in which case it is outside the protected area, and more fully available for ordinary commercial purposes in society. Whether the Indian wishes to remain within the protected reserve system or integrate more fully into the larger commercial world is a choice left to the Indian.
>
> In my view, the location of the employer as a connecting factor must be considered without regard to the fact that the location was dictated by a deliberate tax planning choice.... Ms. Shilling chose an employment relationship with NLS. That choice has substantive legal and commercial consequences that give her employment relationship an undeniable tie to a reserve.

It would appear that Madam Justice Sharlow confused two notions: that Indians and non-Indians alike should be free to exercise their full range of choices to lessen their tax liabilities, with the idea that Indians have the choice to either remain on a reserve or enter the commercial mainstream. She failed to recognise, however, that once the choice is made to enter the commercial mainstream, the *Indian Act* no longer applies and the tax-avoidance measures open to Indian persons are restricted to those available to all other citizens.

The tax exemption afforded in the *Indian Act* is not properly regarded as a tax-avoidance measure *per se*, as Madam Justice Sharlow's judgment would suggest. The exemption is only available under certain circumstances: when property is sufficiently connected to a reserve as to be 'located' there, so that taxing such property might result in dispossessing an Indian of property they hold as an Indian, *i.e.*, their land base or chattels on that land base.[34] In the present case, because the only 'connecting factor' is the employer's residence, even if that factor were accorded full weight, it is not enough to locate Ms. Shilling's income on a reserve for purposes of Section 87. Madam Justice Sharlow's decision amounts to a reversion to the 'residence of debtor' test, which the Supreme Court of Canada ruled in *Mitchell* and *Williams*, failed as a test to take into consideration the purpose

[34] As *per* Justice La Forest in *Mitchell*, *supra* note 3, at 132.

of the *Indian Act* exemption. Justice Gonthier explicitly stated that the reason for developing the 'connecting factors' test was to account for the purpose of Section 87, which was to preserve Indian land entitlements, not to confer a general economic benefit or tax planning mechanism.[35]

Finally, Madam Justice Sharlow seemed to indicate that the 'connecting factors' test entailed a sort of balancing act, whereby the factors connecting property to a reserve are weighed against factors connecting property to the commercial mainstream. This is evident when she stated that an employee's off-reserve residence should not work against her.[36] That idea has never been in issue; that an individual's residence is located outside a reserve simply means that it cannot be considered amongst the other factors potentially connecting the property in question to a reserve. The 'connecting factors' test is not a balancing act, but a formula used to determine a question of fact: whether an item of property is located on a reserve. If enough factors exist, then the income earned *vis-à-vis* the performance of a certain act is deemed sufficiently connected to a reserve as to be located there, and is accordingly tax exempt under Section 87.[37]

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[35] *Williams*, supra note 2 at 880.

[36] To this end, Justice Sharlow stated at paras 57-58:

> Counsel for Ms. Shilling argued that the residence on a reserve may serve to prove a connection to a reserve, **but residence off reserve cannot prove the contrary**.... In my view, the determination of the location of employment income for purposes of section 87 should not depend in any way upon the location of the employee's residence, or the employee's personal and family connections to a reserve.

[37] The Shilling case is currently under appeal at the Federal Court of Appeal: File No. A558-99.

3-4 THE 'CONNECTING FACTORS' CRITERION AND BUSINESS INCOME

The courts are content to determine the *situs* of business income, in much the same fashion as the *situs* of employment income. This makes good practical sense because it would be difficult to rationalise treating employment, business and investment income differently. All three forms of income are accounted for under Section 3 of the *Income Tax Act*[38] and the only meaningful way they are treated differently for tax purposes is in the manner in which deductions and losses are allowed. Simply stated, there is no reason to expect that determining the *situs* of income should vary between the three forms of income.

The location of business income for purposes of the *Indian Act* tax exemption was dealt with in the pre-*Williams* decision, *Charleson v. M.N.R.*,[39] which provided a useful starting point to illustrate the 'connecting factors' that might be relevant to business income. The facts in *Charleson* appear as follows: at all material times, the taxpayer, Mr. Charleson, a Status-Indian, was engaged in a commercial fishing enterprise, which involved chartering a boat from a Vancouver-based corporation. Mr. Charleson used the leased vessel throughout the fishing season, selling his entire catch on the open water to the corporation from which he leased the boat. Most of his records were maintained off-reserve and moreover, he resided on the Hesquiat reserve for only 30 to 40 days per year during the off-season.

The court had to determine the location of the business because the 'residence of the debtor' test was rendered ineffective because Mr. Charleson was the owner, not an employee

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[38] Section 3 reads as follows:

> The income of a taxpayer for a taxation year... [is] determined by the following rules:
>
> (a) determine the total of all amounts each of which is the taxpayer's income for the year from a source inside or outside Canada, including,... the taxpayer's income for the year from each **office, employment, business, and property**....

[39] *Charleson v. M.N.R.*, 91 D.T.C. 844 (T.C.C.).

of the company. Judge Rip identified the following potentially relevant factors in determining whether the business was sufficiently connected to a reserve to qualify for the tax exemption: (1) the location of the business's main office; (2) the location where the business's records were kept; (3) the location where contracts were negotiated, transacted and closed; (4) the location where payments were made on business contracts. Apart from preparing his nets for the season on the reserve, Mr. Charleson did not carry out business on-reserve, and moreover his only customer never set foot on the reserve. Hence, Judge Rip decided that Mr. Charleson's business was not located on a reserve and the income earned therefrom was ineligible for the *Indian Act* tax exemption.

In *Southwind v. The Queen*,[40] the Federal Court of Appeal dealt with the *situs* of business income and applied the 'connecting factors' test to determine whether the income in question was earned in the commercial mainstream, or alternatively on a reserve. Henry Southwind, who resided on the Sagamok Indian Reserve, was the sole proprietor of a logging business providing services exclusively to the non-Indian logging company, Morrell Logging Ltd. It is noteworthy that Mr. Southwind's business has the appearance of an employment agency.

Mr. Southwind spent approximately 40 weeks per year logging at various off-reserve locations, during which time he would remain on site, returning to his home on the reserve on weekends. Administrative work such as book-keeping and file storage was carried out at Mr. Southwind's home and when his equipment was not in use on site, it was stored at his home on the reserve. Finally, Mr. Southwind was paid by cheque drawn from Morrell Logging's off-reserve bank account. The Tax Court of Canada ruled that the business income did not constitute property situated on a reserve; and in coming to that decision, considered the

following potentially 'connecting factors': (1) the residence of the debtor Morrell Logging; (2) Mr. Southwind's residence on the reserve; (3) the location where Mr. Southwind's income was paid, *i.e.*, the bank used by Morrell Logging; and, (4) the locations where business was carried out, *i.e.*, where logging was done. Of these connecting factors, the Tax Court's judge accorded the most weight to the location where the work was performed and where the income was earned. Commenting on the other factors, he noted

> ...[t]he business activities which did occur on the reserve, such as the storage of equipment or the keeping of books or the negotiation of contracts, were merely incidental to the business of the Appellant and only occurred on the Appellant's residence thereon.

At the Federal Court of Appeal, Justice Linden, writing for a unanimous court, expressed some doubt as to Judge McArthur's evaluation of the factors at the Tax Court level. However, he felt that "the result reached by him is consistent with the wording and purpose of paragraph 87(1)(b), as well as with the jurisprudence interpreting it."[41] Justice Linden felt, however, that there were only three relevant potentially 'connecting factors':

- the location of the appellant's head office;
- the residence of the appellant as the business owner; and,
- the location where the work was performed.

Justice Linden accorded the most weight to the location where the actual work was performed, which he felt pointed to the fact that the appellant was engaged in business in the 'commercial mainstream' and was ineligible, therefore, for the *Indian Act* tax exemption:

> While it is significant that the appellant lives on a Reserve, engages in some administrative work out of his home on the Reserve, and stores the business records and the business assets which he owns on the Reserve when they are not in use, the

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[40] *Southwind v. The Queen*, 98 D.T.C. 6084 (F.C.A.).
[41] *Ibid.*, at para 10.

> appellant, in my view, **is engaged not in a business that is integral to the life of the Reserve, but in a business that is in the "commercial mainstream".**[42]

Justice Linden added that in *Mitchell*, the Supreme Court of Canada was clear that, "when an Indian enters the commercial mainstream, he must do so on the same terms as other Canadians with whom he competes."

Following *Southwind*, it would appear that when an Indian person engages in business activities carried out substantially outside reserve boundaries, the income derived therefrom is earned in the commercial mainstream and is thus chargeable to tax. It is interesting that the courts' direction mimics Revenue Canada's approach outlined in the 1972 Interpretation Bulletin, IT-62, which located the *situs* of a business at the place of its 'permanent establishment'. In turn, the principal factor determining 'permanent establishment' was said to be the location where business activities are carried out.[43] In any event, to tax an individual on income derived from activities undertaken outside reserve boundaries and ostensibly within the commercial mainstream is in keeping with the purpose of the *Indian Act* tax exemption.

3-5 THE 'CONNECTING FACTORS' CRITERION AND INVESTMENT INCOME

In determining the *situs* of investment income the courts, once again, make use of the 'connecting factors' test, only they have fixed a different primary factor than that used to determine the *situs* of employment and business income. In applying the test to investment

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[42] *Ibid.*, at paras 13-14.

[43] Robert C. Strother and Robert A. Brown, *Taxation and Financing of Aboriginal Businesses in Canada*; (Carswell: Thomas Professional Publishing), looseleaf service, 1998 at 5-33.

income the problem is not identifying the potential connecting factors, but assigning weight to those factors in light of the policy rationale behind the exemption.

The leading case on the eligibility of investment income for the Section 87 exemption is *Recalma v. The Queen*.[44] The appellants were members of a wealthy Indian family residing on the Qualicum Beach Indian Reserve on Vancouver Island. They had investments in mutual funds and bankers' acceptances at a Bank of Montreal branch located on designated lands in the Park Royal shopping centre in West Vancouver and claimed that the income earned on their investments was situated on a reserve and was, therefore, eligible for the tax exemption.

Writing for a unanimous court, Justice Linden of the Federal Court of Appeal upheld the Tax Court's decision and ruled that the investment was made in the commercial mainstream;[45] but locating the *situs* of investment income in light of the underlying purpose

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[44] *Recalma v. The Queen*, 98 DTC 6238.

[45] Revenue Canada was quick to indicate its position on the tax treatment of Indian investment income following the Tax Court's decision in the *Recalma* matter in "Income Tax Technical News – 9; 10 February 1997, entitled *TAXATION OF INDIANS – INVESTMENT INCOME*:

> Paragraph 81(1)(a) of the *Income Tax Act* and section 87 of the *Indian Act* establish the Indian exemption from taxation. Section 87 of the *Indian Act* exempts from taxation the personal property of an Indian situated on a reserve. In determining whether the income earned by an Indian is situated on a reserve and thus exempt from taxation, the approach taken by the Supreme Court of Canada in the 1992 case of *Glen Williams v. Her Majesty the Queen*, 92 DTC 6320, must be followed. The proper approach to determining the situs of intangible personal property is to evaluate the various connecting factors which tie the property to one location or another. The Court also stated that the ultimate question is to what extent each factor is relevant in determining whether to tax the particular kind of property in a particular manner would erode the entitlement of an Indian *qua* Indian to personal property situated on a reserve.
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> In 1996, the issue of the taxability of investment income was considered by the Tax Court of Canada in the combined cases of *Arnold, Laura and R. Mark Recalma v. Her Majesty the Queen*, 94-1971, 1972, 1973(IT)G. The taxpayers have appealed the decision.
>
> The taxpayers invested in bankers' acceptances and mutual funds, making their investments through a bank branch situated on a reserve. The taxpayers lived on a reserve and earned exempt income. At issue was whether the income earned from their investments was connected to an Indian reserve so as to be exempt from taxation under paragraph 87(b) of the *Indian Act*.
>
> The Court observed that the property in question was an income stream from securities. The Court identified several connecting factors that could be relevant to determining the situs of investment income, and it was pointed out that the source of the

of the exemption presented the court with a unique problem. Justice Linden was troubled by the "passive nature of investment income" which led him to determine that an investor's personal characteristics, such as place of residence, provide little assistance in determining the location of such income.[46] This, he reasoned, is because investment income is generated at a place potentially far removed from the individual to whom it is attributed, which helps to explain his cryptic remark that the Court must decide where it "makes the most sense" to locate the income, bearing in mind the purpose of the exemption. In any event, Justice Linden assigned a preponderance of weight to the following factors, each of which concerns the income stream of the issuer, not the appellants:

- the residence of the issuer of the security;

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capital used to buy the securities and the location of the bank branch where the securities were purchased are not as significant as other factors.

With respect to bankers' acceptances, the Court noted that these investments are relatively sophisticated financial instruments that are issued by a third party and guaranteed by a bank. The income stream from the bankers' acceptances and the managed funds was generated from companies that were located off reserve, and it was held that the investment income of the taxpayer was not personal property situated on a reserve. Rather, the income was earned in the economic mainstream. This follows the proposition stated by La Forest, J. in the case of *Mitchell v. Peguis Indian Band*, (1990) 2 S.C.R. 85, that the purpose of the *Indian Act* 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.

We have not identified all of the factors connecting investment income to a reserve; however, given the *Recalma* decision, if the investment income stream for a financial instrument involves an entity located off-reserve, that investment income will not qualify as personal property situated on a reserve. Rather, the income is considered to be earned in the economic mainstream.

In conclusion, it is our view that the decision supports the position that income earned in the economic mainstream is so strongly connected to a location off reserve that it will generally outweigh other factors that may indicate the income is connected to a location on reserve.

[46] To this end, the judge declared:

> Investment income, **being passive income**, is not generated by the individual work of the taxpayer.... The Tax Court Judge rightly placed great weight on factors such as the residence of the issuer of the security, the location of the issuer's income generating operations, and the location of the security issuer's property.... Less weight was properly accorded by the Tax Court Judge, in this case of investment income, to factors such as the residence of the taxpayer, the source of the capital with which the security was bought, the place where the security was purchased and the income received, the place where the security document was held and where the income was spent.

Recalma, *supra* note 43, at paras 11-12.

- the location of the issuer's income generating operations; and,
- the location of the security issuer's property.

None of these connected the Recalma's income to a reserve, as they were located in "the head offices of the corporations in cities far removed from any reserve"; and, although other factors were taken under consideration, such as the taxpayers' residence, the source of the capital, the place where securities were purchased, the place where the income was received, and the location where security documents were held, Justice Linden did not accord them much weight. He focussed instead on whether the investment vehicle's income stream was "intimately connected to a reserve" as in *Folster*, or alternatively located "in the mainstream of the economy."

Recalma thus raises questions as to whose income stream should be the focus of the 'connecting factors' test: that of the taxpayer or that of the security issuer. If, for example, the courts are to maintain consistency in fixing the primary 'connecting factor' used to determine the *situs* of the three types of income – the location where work is performed – then *Recalma* does not represent good law. This is because His Honour concentrated on the location of work done by the securities issuer, and discounted the investor's efforts in researching and choosing his investments, and indeed the business acumen one requires to succeed as an investor.

Is investment income anything but 'passive'? Just ask an investment broker or financial analyst about the rigours of their work. Archambault, T.C.C.J., acknowledged as much in *Elm Ridge Country Club Inc. v. The Queen*[47] when he stated:

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[47] *Elm Ridge Country Club Inc. v. The Queen*, 95 D.T.C. 715. Judge Archambault relied on the landmark case *Canadian Marconi Company v. The Queen*, 86 D.T.C. 6526 (S.C.C.) to provide an example as to when a taxpayer's conduct might convert what would otherwise be income from property into income from a business venture. In *Marconi* the taxpayer corporation was forced to sell its capital assets for $18 million and whilst searching for another suitable business to purchase it invested the proceeds in short-term interest bearing

> The term 'property' is defined very broadly in subsection 248(1) but this definition is not very helpful in defining income from property. Since the Act does not define this expression, it must therefore be given its ordinary meaning. This expression is generally regarded as signifying the return on invested capital where little or no time, labour or attention is devoted to producing the return. No one would dispute that income from property would normally include dividends, interest, rents and royalties. **However, such receipts *might* constitute income from business if sufficient time and effort is expended in earning them**.[48] [emphasis added]

The fact that the courts recognise circumstances when interest-bearing investments might give rise to business income is significant. It would suggest that the judiciary should not so easily discount an investor's skills and efforts in choosing his investments as the means of generating income. This, in turn, militates against the focus on the centre of an issuer's operations, to determine the *situs* of investment income, in favour of attaching more weight to an investor's residence and the location where research was conducted in the course of investing.

In any event, given the present treatment afforded Indians earning investment income, it is difficult to imagine a situation when an investment will not have been made in the commercial mainstream, unless the vehicle for the investment is itself 'intimately connected' with a reserve. The following examples come to mind:

- An investment is made in a business operated by and employing Indians who live on a reserve;
- An investment is made in a business resident on a reserve that contributes to the well-being of the reserve's Indian residents, *e.g.*, a gymnasium or activity centre; or,
- Investment is made in or through a reserve-based institution, such as the Peace Hills Trust, and the funds are to be used mainly for loans to Indians residing on a reserve.[49]

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securities. "Considerable energy and effort was expended to obtain a maximum return," as evidenced by the fact that over a four year time span, 1,041 transactions were made and there were as many as twelve employees involved in managing the investments. Madam Justice Wilson, writing for a unanimous court, ruled that the interest derived from the investments constituted Active Business Income, not Aggregate Investment Income.

[48] *Elm Ridge*, *supra* note 46, at 716.

[49] This example was actually provided by Justice Linden in *Recalma*.

Under such circumstances investment income might be regarded as intimately connected to a reserve so as to qualify for the tax exemption. To eliminate any incentive to invest in 'Indian' businesses might induce Indian investors to withdraw their capital and invest in the commercial mainstream where there is greater opportunity for investment. This, in turn, would erode the reserve infrastructure, thereby depriving Indians of services they might otherwise have received.

There is a strong sense of public policy considerations evident in Justice Linden's *Recalma* disposition and his approach was admittedly purposive. The court seemed reluctant to open the floodgates and allow investments by Indians to go untaxed altogether, which is evident when Justice Linden stated:

> [I]n our view, taking a purposive approach, the investment income earned by these taxpayers cannot be said to be personal property "situated on a reserve" and, hence, is not exempt from income taxation. To hold otherwise would open the door to wealthy Natives living on reserves across Canada to place their holdings into banks or other financial institutions situated on reserves and through these agencies invest in stocks, bonds and mortgages across Canada and the world without attracting any income tax on their profits. We cannot imagine that such a result was meant to be achieved by the drafters of s. 87.... When Natives, however worthy and committed to their traditions, choose to invest their funds in the general mainstream of the economy, they cannot shield themselves from tax merely by using a financial institution situated on a reserve to do so.[50]

While the court might have had the best intentions in reaching its desired conclusion, it does not mean the law was applied correctly. Indeed, *Recalma* is difficult to rationalise, considering that the income and capital interest of an investment are included in the same bundle of rights. Unfortunately, leave to the Supreme Court of Canada was denied, so it effectively agrees at present with Justice Linden.

3-6 SECTION 90 – THE DEEMING PROVISION

Under certain circumstances the *situs* of property is automatically located on a reserve, irrespective of its actual location. This occurs under the ambit of the so-called deeming provision contained in Section 90 of the *Indian Act*, which reads, in part:

> 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.

In *Mitchell v. Peguis*, Justice La Forest identified the policy rationale for affording the property given to Indians in treaties the full protection of the *Indian Act*, irrespective its actual *situs*. He stated:

> The reason why Parliament would have chosen to provide that personal property of this sort should be protected regardless of where that property is situated is obvious. **Simply put, if treaty promises are to be interpreted in the sense in which one may assume them to have been naturally understood by the Indians, one is led to conclude that the Indian signatories to the treaties will have taken for granted that property given to them by treaty would be protected regardless of situs**.... I am aware of no historical evidence that would suggest that Indians ever expected that their ability to derive the full benefit of this property could be placed in jeopardy because of the ability of non-natives to impose liens or taxes on it every time it was necessary to remove this property from the reserve.[51] [emphasis added]

Justice La Forest felt that to impose taxes on treaty entitlements, wherever located, would amount to a breach of the Crown's duty to shield Indian entitlements from distraint.

In any event, Section 90 is activated under two circumstances: (1) when personal property is purchased by the Crown with moneys appropriated by Parliament for the use and

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[50] *Recalma*, *supra* note 45 at paras 13-14.
[51] *Mitchell*, *supra* note 3 at 134.

benefit of Indians,[52] and (2) when personal property is given[53] to Indians or a band pursuant to a treaty or similar agreement. Dealing first with property purchased by the Crown for Indians' use and benefit, the jurisprudence suggests that an Indian's skill or expertise cannot constitute 'personal property' purchased by the Crown for the purposes of paragraph 90(1)(a). The leading case on point, *The Queen v. National Indian Brotherhood*,[54] was approved by the Tax Court in *Horn v. M.N.R.*,[55] where Judge Lamarre Proulx stated, at page 62:

> The appellant's skills, training and background cannot, were not and could not have been purchased by Her Majesty.... **I would say that Her Majesty cannot purchase the appellant's skills and training as the appellant cannot divest herself of such skills or training. Such a proposition appears to me as a contract for slavery**, something which is surely not meant by counsel for the appellant. In *Rapistan Canada Ltd. v. M.N.R.*, 48 D.L.R. (3d) 613 at page 616, Chief Justice Jackett stated that:
>
> > [A]s far as I know, under no system of law in Canada, does knowledge, skill or experience constitute 'property' that can be the subject matter of a gift, grant or assignment.... As I understand the law, knowledge or ideas, as such, do not constitute property.

That neither skills nor expertise constitute personal property was expressed as late as 1995 in *Canada v. Poker*,[56] when the Federal Court of Canada confirmed the *National Indian Brotherhood* decision. Moreover, in *Bank of Nova Scotia v. Blood*,[57] the court observed that, it was not the appellants' 'salary', but the 'services giving rise to the salary' that the Crown purchased and that those 'services' were not given to the band, but instead, to his employer as *per* the terms of his employment contract. Suffice to say, it would be practically impossible to contrive an argument that would withstand judicial scrutiny, using paragraph 90(1)(a) to situate employment income on a reserve.

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[52] Indian moneys are defined in Subsection 2(1) of the *Indian Act* as, "all moneys collected, received, or held by her majesty for the use and benefit of Indian bands."
[53] The term 'given' does not include loaned monies: *Pachanos v. M.N.R.*, 90 D.T.C. 1668 (T.C.C.).
[54] *The Queen v. National Indian Brotherhood*, [1978] C.N.L.B. (No.4) 107.
[55] *Horn v. M.N.R.*, [1989] 3 C.N.L.R. 59 (T.C.C.).
[56] *Poker*, *supra* note 19.

Section 90 was initially encumbered with semantic difficulties[58] similar to those arising in the late 1970s in relation to Section 87. Specifically, there was some confusion as to whether 'money' could constitute 'personal property' for purposes of Section 90. In *Kuhn v. Starr and Sandy Bay Reserve*,[59] Justice Ferg ruled that paragraph 90(1)(a) did not apply to 'money', because the language suggested otherwise. The judge observed:

> If the words 'personal property' are taken in the restrictive sense, rather than given their ordinary meaning, as referring to physical property then the section takes on a sensible meaning.[60]

The cause for confusion was a combined reading of Subsection 90(1) and paragraph 90(1)(b) and the following inapt wording that results when 'money' is the subject matter in question: "For the purposes of sections 87 and 89, *money* that was purchased by Her Majesty with Indian moneys or moneys appropriated by Parliament...." Moreover, Justice Ferg indicated that in the interests of consistency, 'money' should be also ineligible for paragraph 90(1)(b).

Then along came *Nowegijick*, in which Justice Dickson (as he then was) announced that, "treaties and statutes relating to Indians should be liberally construed and doubtful expressions resolved in favour of the Indians,"[61] which forced the courts to re-evaluate their approach to personal property as it applied to Section 90. Accordingly, in *Mitchell and Milton Management Ltd. v. Sandy Bay Indian Band*,[62] Justice Morse ruled that the money

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[57] *Bank of Nova Scotia v. Blood*, [1990] 1 C.N.L.R. 59.

[58] Reference is made to the confusion as to whether taxable income constituted personal property for the purposes of section 87.

[59] *Kuhn v. Starr and Sandy Bay Reserve* [1978] C.N.L.B. (No.4) 89 (Man.Q.B., 1976).

[60] *Ibid.*, at 96.

[61] The oft-cited passage reads in full:

> ...it is legal lore that, to be valid, exemptions to tax laws should be clearly expressed. It seems to me, however, that treaties and *statutes* relating to Indians [i.e. the *Indian Act*], should be liberally construed and doubtful expressions resolved in favour of the Indians. If the statute contains language which can reasonably construed to confer tax exemption that construction in my view is to be favoured over a more technical construction which might be available to deny exemption.

Nowegijick v. The Queen, [1983] 2 C.N.L.R. 89 at 94.

[62] *Mitchell and Milton Management Ltd. v. Sandy Bay Indian Band* [1983] 4 C.N.L.R. 50.

paid to a band by the provincial Crown under a settlement agreement did constitute 'personal property' within the meaning of paragraph 90(1)(b) and that its notional *situs* was therefore on-reserve. Following the *Nowegijick* ruling, any money given to Indians by the Government of Canada,[63] pursuant to a treaty or similar agreement, is deemed as situated on a reserve within the meaning of paragraph 90(1)(b).[64]

It is noteworthy that the question of whether 'money' can constitute personal property for the purposes of paragraph 90(1)(a) was left unanswered in *Mitchell and Milton Management*, and as late as 1999 it seems questions still remain, as evidenced in *Kakfwi v. Canada*,[65] a Federal Court of Appeal decision. Justice Marceau felt that 'money' did not fall within the rubric of 'personal property' for purposes of paragraph 90(1)(a) because, "money cannot be purchased by money."[66] In support of that proposition Justice Marceau cited the French Language version of the Act,[67] the construction of which precludes 'money' from being included under 'personal property'. Justice Noel, however, dissented on that point stating, "there is no bar in law or in principle to the purchase of money with money and hence no basis for the suggestion that by definition the term 'personal property' in paragraph 90(1)(a) excludes money."[68]

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[63] It is important to note that the expression "Her Majesty", for purposes of Section 90 no longer applies to the provincial Crown, only the federal Crown; as *per* La Forest in *Mitchell*, *supra* note 3, at 133.

[64] As noted in Richard Bartlett, *Indians and Taxation in Canada*, 3rd ed. (Saskatoon: Native Law Centre, 1992) at 73.

[65] *Kakfwi v. Canada*, [1999] FCJ No. 1407.

[66] *Ibid.*, at para 17.

[67] The French Languange version of Section 90 appears as follows:

90.(1) Pour l'application des articles 87 et 89, les biens meubles qui ont été:

(a) Soit achetés par Sa Majesté avec l'argent des Indiens ou des fonds votés par le Parlement à l'usage et au profit d'Indiens ou de bandes;

(b) Soit donnés aux Indiens ou à une bande en vertu d'un traité ou accord entre une bande et Sa Majesté,

sont toujours réputés situés sur une réserve.

[68] *Kakfwi*, *supra* note 66 at para 31.

At any event, there is a far more serious impediment to the use of Section 90 in employment scenarios than the almost capricious question as to whether money can be used to purchase money. The obstacle presents itself as such: the terms 'treaty' and 'agreement' as contained in paragraph 90(1)(b) are said to refer to the same form of arrangement. This is in line with Justice La Forest's comments in *Mitchell v. Peguis*, that the two terms "take colour from each other," and that the term "given" in paragraph 90(1)(b) "can be taken as a distinct and pointed reference to the process of cession of Indian lands."[69] This means that even when an 'agreement' for the provision of funding is made between an Indian band and the Federal Crown, the notional *situs* rules are not activated unless the agreement is akin to a land claims agreement or treaty.

This was the basis for the Federal Court of Appeal's decision in *Kakfwi v. The Queen*. In his capacity as Chief of the Fort Good Hope Band the respondent was paid an annual salary out of the 'Band Support Funding' program, funded by the Federal Crown to support band councils' core funding. A unanimous court ruled that it was not the type of arrangement to which paragraph 90(1)(b) applies, basing their decision on La Forest's remarks in *Mitchell*. To that end, Justice Marceau stated:

> I would say that the Band Support Funding program – if it can be said to be an agreement on the sole basis that the bands "consent" to take the funds and use them for certain basic programs for the benefit of their members, a view that strikes me as stretching the notion of a convention between the parties – is certainly not an agreement within the meaning of paragraph 90(1)(b) of the Act.... Justice La Forest's analysis makes clear that an application of the basic rules of legislative interpretation which require that the terms "treaty" and "agreement" in paragraph 90(1)(b) be linked together so as to limit the extent of the word "agreement" to that of "ancillary agreement" – that is to say an agreement in the nature of a treaty or attached to a treaty – is wholly supported by the history of the protective tax regime adopted by Parliament in furtherance of the duties of the Crown toward Indians.[70]

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[69] *Mitchell*, *supra* note 3 at 124.
[70] *Kakfwi*, *supra* note 66 at paras 4 and 9.

Hence, the role that Section 90 may play in assigning a notional *situs* to employment income earned *vis-à-vis* an agreement between the Crown and First Nations is very limited in nature. Section 90 does, however, play an enormous role when treaties, styled land claims agreements, are negotiated.

It is useful to restate that paragraph 90(1)(b) applies to money "given to Indians or to a band under a treaty or agreement between a band and Her Majesty." This means that money paid in respect of land claims settlements or treaty land entitlement agreements is situated on a reserve and is therefore tax exempt. It is less certain, however, whether the income earned on the capital investment will also be deemed as situated on a reserve. It is conceivable that term 'always' contained in Section 90 extends its scope to the income derived from the capital investment. Alternatively, as the Department of Indian Affairs and Northern Development suggests,[71] Section 90 might not apply to investment income earned on monies initially situated on-reserve by virtue of the deeming provision.

In practice, whether the investment income derived from settlement moneys is located on a reserve and exempted from tax depends largely on the actual terms of a treaty or agreement and the investment structure of the settlement.[72] Although an examination of the intricacies of negotiating land claims agreements is beyond the scope of this thesis, the issues should be at least summarily addressed.

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[71] For example, the Department of Indian Affairs and Northern Development, *Comprehensive Land Claims Policy* (Ottawa: Supply and Services, 1987), at 15 reads as follows:

> Cash compensation payable under a settlement will be regarded as a capital transfer and will be exempt from taxation. However, any income derived from such compensation will be subject to the provisions of the *Income Tax Act*. Other elements of compensation, such as a share of resource revenues, will be subject to prevailing taxation legislation and practices.

[72] In relation to the investment structure of a settlement, if the initial capital amount is held in a trust, much will depend on the terms of the trust itself. For an excellent discussion on the use of settlement trusts relating to First Nations treaty negotiations see: Biberdorf, Donald; "Aboriginal Income and the Economic Mainstream", in Report of Proceedings on the Forty-Sixth Tax Conference, 1994 (Toronto: Canadian Tax Foundation), pp. 25:16-25:23; Virginia Davies; "The Use of Inter Vivos Trusts to Preserve Treaty Entitlements"; Report of Proceedings on the Forty-Fifth Tax Conference, 1993 (Toronto: Canadian Tax Foundation), pp. 54:1-54:16.

Land claims fall into two basic categories: comprehensive land claims and specific land claims.[73] Most of the contemporary comprehensive land claims agreements include provisions for a 'settlement corporation', or contain an overall exemption from tax to expire in a term of years following the treaty.

3-7 THE SETTLEMENT CORPORATION

The *James Bay and Northern Quebec Agreement*[74] was the first of the contemporary treaties. It closely followed *Calder v. British Columbia*[75] which, as discussed in Chapter One, raised questions about the existence of Aboriginal title to lands not previously subject to treaties or proclamations. The Aboriginal participants received some $150 million as part of the basic compensation package.[76] The initial capital amount was exempted from tax under the auspices of paragraph 90(1)(b) and in order to ensure that the income earned from investing the capital amount was also exempt, a 'special Act' non-profit corporation – similar to a 'non-profit organisation' as defined under paragraph 149(1)(l) of the ITA – was established to deal with the funds.

Following the *James Bay and Northern Quebec Agreement*, Indian treaties have proceeded along much the same lines until the early 1990s when the *Dene/Metis Final*

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[73] "Comprehensive claims", such as the Nisga'a land claim, relate to lands which have not been the subject of any treaties or enactments extinguishing Aboriginal title. "Specific claims" are based upon the interpretation of treaties. Examples of specific claims are the Treaty Land Entitlement Agreements negotiated in Saskatchewan and Manitoba which relate to the settlement of outstanding obligations arising from non-fulfilment of the provisions of a treaty: Strother and Brown, *supra* note 44 at 10-2.

[74] Canada, Dept. of Indian Affairs and Northern Development, *James Bay and Northern Quebec Agreement* (Ottawa: Supply and Services, 1976).

[75] *Calder v. British Columbia*, [1973] SCR 313.

Agreement[77] was negotiated. In this agreement, the use of non-profit organisations expanded, giving rise to the 'settlement corporation' concept.[78] It is subject to essentially the same treatment as a charitable foundation and must make annual distributions in accord with a schedule of permitted activities.[79] Moreover, the corporation is restricted to investments which are either made in the course of carrying on permitted activities or are permitted for a trust governed by a registered retirement savings plan as defined in the *Income Tax Act*.[80] However, provided the 'settlement corporation' follows the prescribed rules, the income earned on its investments is exempt from tax for a term of fifteen years after the date of the initial transfer payment.

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[76] Strother and Brown, *supra* note 44 at 11-3.

[77] Canada, Department of Indian Affairs and Northern Development, *Comprehensive Land Claim Agreement Between Canada and the Dene Nation and the Metis Association of the Northwest Territories* (Ottawa: Supply and Services, 1990).

[78] For example, section 9 of the *Sahtu Dene and Metis Land Claim Settlement Act*, S-1.5 – (1994, c. 27) reads:

> 9. A charter may be granted under subsection 154(1) of the Canada Corporations Act establishing a settlement corporation within the meaning of the Agreement to carry on, with pecuniary gain to its members, the activities permitted by the Agreement.

[79] The list of permitted activities includes, *inter alia*:

> supplementing existing government funded programs;
> providing favourable financing for housing and residential repairs;
> providing funding for education and training;
> providing loans for economic development; and,
> providing loans for commercial fishing, harvesting and cultural activities.

Strother and Brown, *supra* note 44 at 11-23.

[80] Subsection 146(1) of the ITA defines a 'qualified investment' for a trust governed by a registered retirement savings plan as being:

> (a) an investment that would be described in any of paragraphs (a), (b), (c), (d), and (f) to (h) of the definition 'qualified investment' in section 204 if that definition to a trust were read as references to the trust governed by the registered retirement savings plan,
> (b) a bond, debenture, note or similar obligation of a corporation the shares of which are listed on a prescribed stock exchange in Canada....

3-8 ELIMINATING THE TAX EXEMPTION: THE B.C. MODEL

The land claims agreements negotiated in British Columbia, commencing with the Nisga'a agreement, have strayed from the use of settlement corporations. Instead, the agreements are predicated along the lines of eventually eliminating the tax exemption altogether, in aid of eliminating market distortions, achieving greater horizontal equity, and eliminating racial inequality. In turn, Nisga'a citizens will be chargeable to transaction taxes in eight years following the initial capital instalment, and twelve years with respect to all other taxes, including income taxes.[81]

There is no mention of the tax treatment in respect of investment income derived from the capital instalment. This might be because negotiators realised that such a stipulation would be superfluous, owing to the fact that the Nisga'a Lisims Central Government controls the funds and, as such, the income derived therefrom is exempt from tax under the auspices of section 149 of the ITA.[82] Paragraph 149(1)(c) of the ITA exempts from tax, "a municipality in Canada, or a municipal or public body performing a function of

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And in turn, Section 204 provides that a 'qualified investment' includes, *inter alia*, shares listed on a prescribed stock exchange in Canada, in addition to a number of other mainstream investments.

[81] Chapter 16 of the Nisga'a Final Agreement, entitled Taxation, reads, in part, as follows:

> SECTION 87 EXEMPTION:
>
> 5.Subject to paragraph 6, section 87 of the *Indian Act* applies to Nisga'a citizens only to the extent that an Indian other than a Nisga'a citizen, or the property of that Indian, would be exempt from taxation in similar circumstances by reason of the applicability of section 87 of the *Indian Act*.
>
> 6.Section 87 of the *Indian Act* will have no application to Nisga'a citizens:
>
> (a) in respect of transaction taxes, only as of the first day of the first month that starts after the eighth anniversary of the effective date; and
>
> (b) in respect of all other taxes, only as of the first day of the first calendar year that starts on or after the twelfth anniversary of the effective date.

[82] The provisions relating to self-government are contained within Chapter 11 of the Nisga'a final agreement.

government in Canada." Hence, as long as the Nisga'a Lisims Central Government functions as a government,[83] it will be exempt from tax under paragraph 149(1)(c).

3-9 CONCLUSION

Judges are clearly prepared to locate the *situs* of income, for Section 87 purposes, on a case-by-case basis. The courts seem satisfied that two particular 'connecting factors' should be accorded the most weight in determining whether employment income is earned in the commercial mainstream: (1) the location where the duties of employment are performed; and, (2) the nature of the work being performed. The second, more nebulous 'connecting factor' is, however, the cause of some confusion. To wit, the courts are more flexible when the nature of the employment is such that it benefits Indians residing on a reserve, and this has resulted in a somewhat arbitrary application of the 'connecting factors' test. At least Justice Gonthier's aim of establishing a flexible test has been achieved.

In locating the *situs* of business income, the courts seem to favour three potential connecting factors in particular: (1) the location of the appellant's head office; (2) the residence of the appellant; and, (3) the location where the work is performed. In turn, judges accord the most weight to the location where the work is performed, which renders the primary 'connecting factor' in determining the location of employment and business income practically identical.

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[83] In order to satisfy the requirements of performing the functions of government, the Nisga'a Lisims Government must pass at least one bylaw under Sections 81 and 83 of the *Indian Act*: Revenue Canada Views Document No. 9519925, 4 August 1994.

Finally, in relation to investment income, the present approach is to focus on the location of the head offices of the company or business in which an investment is made. While one may regard this approach as keeping with the object and spirit of the tax exemption, it raises serious questions about whose income stream should be in issue: that of the individual claiming the exemption from tax, or the vehicle for his or her investment. The courts appear to have approached the problem by asking: (1) when do the funds in question crystallise and become property or income? and, (2) at what stage in the transaction does that property or income, once crystallised, find its *situs*? In answer to the second question, the courts have determined that the point where the income crystallised is also its *situs*, which is determined by considering the location of both the issuer's income generating operations and the issuer's head offices, which generate the profits transformed into investment income.

In any event, if there is one thing the reader must be clear about, it is the unacceptable lack of clarity that has evolved out of the post-*Williams* litigation. The result is an almost incomprehensible mishmash of rules, exemplifying a desperate need for the legislature to enact clearer legislation to indicate when and under what circumstances an Indian should be exempted from tax. Parliament has done little if nothing at all to clarify the scope of Section 87 presumably to avoid the risk of alienating any segment of the voting public. This legislative apathy has resulted in considerable legal confusion and a wasting of public moneys which would be better spent on improving the quality of life on reserves. The cost of running test cases through the courts can be astronomical, which suggests that the only segment of society actually benefiting from the *Indian Act* tax exemption is the high-priced litigators representing Aboriginal taxpayers. The legislation could be amended to respond to

the questions coming before the courts; instead, Parliament hides behind Revenue Canada, which pretends to deal with the problem by issuing Guidelines and Interpretation Bulletins.

On that final note, the 'connecting factors' test is aimed at determining the *situs* of property in relation to the 'purpose' of Section 87. The Supreme Court of Canada determined the 'purpose' of the legislation not based on a legislative declaration *per se*, but instead on a policy conclusion derived from the earlier *Mitchell* decision emanating from the same Court. One is left to wonder, therefore, whether Justice La Forest in *Mitchell* might not have been mistaken in declaring the purpose of the *Indian Act* tax exemption without any indications from the legislators who remain actually responsible for enunciating policy.

- CHAPTER FOUR - ANALYSIS OF THE DISCERNIBLE TAX POLICY ARISING FROM THE 'CONNECTING FACTORS' TEST

The courts are guided by the originating purpose of the *Indian Act*[1] tax exemption in geographically confining it to reserve lands. Justice La Forest concluded that the tax exemption was conceived to

> ...shield Indians from any effort by non-natives to dispossess Indians of their property which they hold *qua* Indians, *i.e.*, their land base and the chattels on that land base..., 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.[2]

The underlying policy remains, as it was over a century ago, completely oblivious to the human element in the equation by making the preservation of Indian entitlements the focal point. As ever, there is dire need for reform. The outmoded arrangement purveys market irregularities, inequities and distortions, and has served to further entrench the destitution and despondency so prevalent on reserves.

In order to expose the deficiencies of the present arrangement it is necessary that the reader possess at least a cursory understanding of the components of an effective tax system. This is because in evaluating policy we need a point of reference; in this case, it is defining

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[1] R.S.C. 1985, c. I-5 – hereinafter, the *Indian Act*.
[2] As *per* Justice La Forest in *Mitchell v. Peguis Indian Band*, [1990] 2 S.C.R. 85 at 132.

what constitutes a 'good' tax structure.[3] While it is beyond the scope of this thesis to explore the depths of tax policy generally, some basic precepts are reviewed to gauge the effects of the 'connecting factors' test devised by the Supreme Court of Canada to confine the exemption to Indian reserves. Outlining the characteristics of a 'good' tax structure will thus allow the reader to hold the tax treatment of First Nations against the backdrop of the Canadian tax system and assess where and how improvements might be made.

EVALUATING TAX POLICY

Tax policy evinces itself in the technical rules, statutes and case law that combine to define the tax structure. In turn, the structure of a tax system impacts on every aspect of the economy and great care must be taken in devising a tax policy that creates an efficacious tax structure inclined to generate revenues for the provision of services. How are revenues best generated? Simply stated, government revenue derives from a strong tax base, which is, in turn, the product of a tax structure that inspires industry, the efficient use of resources and a robust economy.[4] Such a tax structure will have the following characteristics:[5] (1) systemic

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[3] "In order to evaluate the outcome for purposes of policy, we have to know first what the good tax structure *should* accomplish, and what it should look like.": Richard Musgrave, *Tax Reform or Tax Deform: Tax Policy Options in the 1980s*; Canadian Tax Foundation, No.66, (Toronto: Canadian Tax Foundation, 1982), at 20.

[4] Revenue generation does not necessarily increase with the imposition of higher marginal rates of tax. A leading theorist on the subject of disincentive effects, Arthur Laffer, is largely responsible for resurrecting the notion that, under appropriate circumstances, lower marginal tax rates will yield increased revenues, which he expressed in the following terms:

> If a tax is gradually increased from zero up to a point where it becomes prohibitive, its yield is at first nil, then increases by small stages until it reveals a maximum, after which it gradually declines until it becomes zero again.

C.V. Brown and P.M. Jackson, *Public Sector Economics, 4th ed.*, (Oxford: Blackwell Publishers Inc., 1996), at 453.

[5] In arriving at the characteristics of a good tax structure I took direction from two of the most comprehensive and influential works on the issue of tax reform: (1) *The Report of the Royal Commission on Taxation* (1966); and (2) *The Structure and Reform of Direct Taxation* (1978). Both were undertaken by highly esteemed

fairness and horizontal equity;[6] (2) clarity and certainty for the taxpayer; (3) incentives, neutrality and economic efficiency; and finally, (4) distributional effects and vertical equity.[7]

A competent government will be mindful of such considerations in devising tax policy and in failing to do so risks a fiscal collapse, because taxes affect patterns of consumption, the stability of prices and employment, and people's inclination to take risks and invest. In other words taxation affects the total supply of resources available to the economy,[8] which the 'Carter Commission' bore in mind in outlining its 1966 recommendations, summarising the characteristics of a good tax structure. To that end, the Commission stated:

> A tax system can be judged from different points of view. Is the system fair? Does it contribute as much as possible to the growth and stability of the economy? Are the rights and liberties of the individual protected? Does it help to strengthen the federation? These questions reflect not only the many facets of taxation but also what we believe to be the principle objectives that Canadians wish to realize through their tax system. They want equity, more goods and services, full employment without inflation, a free society and a strong, independent federation.[9]

Finally, it is useful to bear in mind the picture that emerged in previous chapters, of the post-*Williams*[10] tax treatment of First Nations, in order to assess how the 'connecting factors' approach comports with the principles of tax policy generally.

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committees. The commission that produced the *Report of the Royal Commission on Taxation* was chaired by Kenneth Carter, and the *Structure and Reform of Direct Taxation* was a report by a committee chaired by Professor J.E. Meade.

[6] Strictly speaking, horizontal equity refers to the equal treatment of persons with equivalent financial circumstances, *i.e.*, persons earning the same should pay equivalent tax.

[7] Vertical equity is achieved when taxpayers are subject to a desirable degree of unequal treatment based on their unequal income or wealth. It is achieved *vis-à-vis* the institution of progressive tax rates, *i.e.*, a tax system whose average rates rise as income increases.

[8] Vladimir Salyzyn, *Canadian Income Tax Policy – An Economic Evaluation* (Don Mills, Ontario: CCH Canadian Limited, 1976), at 3.

[9] *Report of the Royal Commission on Taxation* (Ottawa: Queen's Printer, 1966), hereinafter the 'Carter Report' named for Chairman Kenneth Carter, vol. 1 of 6 vols., at 3.

[10] *Williams v. The Queen*, [1992] 1 S.C.R. 877.

- When at least 90% of an Indian person's employment duties are performed on-reserve, the income earned is exempt from tax, even if he or she does not reside on a reserve.
- When at least 50% of an Indian person's employment duties are performed on-reserve, and he or she resides on a reserve, or the employer is resident on-reserve, the income earned is exempt from tax.
- When an Indian person's employment duties are performed off-reserve, but both the employer and the employee reside on-reserve, the income earned is exempt from tax.
- If there is a cultural connection between the employer's services and reserve residents, or the services performed directly benefit reserve residents, the income earned is exempt from tax.

To simplify things, let us assume that, following *Williams*, Indians living and working on a reserve are exempt from tax, whilst those living and working off the reserve are chargeable to tax as all other Canadians.

Hence, there is a marked disparity between the tax treatment of Indians living and working on-reserve and those in the commercial mainstream. The courts are adamant that once an Indian enters the commercial mainstream and severs his ties with reserve life, he is treated as any other Canadian and is thus chargeable to tax. Hamlyn, T.C.J. expressed the matter as follows:

> The appellant has a choice. He may choose to work off the reserve in which case he has entered the general commercial mainstream and must be treated as any other Canadian citizen. Alternatively, he may choose to limit himself to the protective confines of the reserve and thereby protect his personal property from taxation and seizure.[11]

[11] *Clarke et.al. v. M.N.R.*, [1992] 2 C.T.C. 2743 (TCC) at 2749.

We are told that the *Indian Act* tax exemption is necessary to preserve First Nations' treaty entitlements and ensure that the lands reserved for them cannot be subject to a confiscatory charge.[12] For as long as the federal government declines to revisit its outmoded policy rationale devised over a century ago, it will be impossible to reconcile the preservation of reserved lands with the ability-to-pay model of taxation. While the 'connecting factors' approach may be a judicious means of limiting the market distortions and inefficiencies caused by Section 87, the resulting disparate tax treatment of reserve-based Indians and those in the commercial mainstream also generates a myriad of inequities and distortions. Simply stated, the present state of affairs is a tax policy disaster.

At any rate, it is appropriate at this stage to review the aforementioned components of a good tax structure and analyse the shortcomings of the present system insofar as it relates to First Nations.

4-1 FAIRNESS AND EQUITY

Fairness may be assessed in two ways. First, taxpayers must feel that they are subject to equal treatment within the system and that people earning similar amounts bear roughly the same tax burden. Secondly, there must be a sense among taxpayers that they are not taxed inordinately in relation to people in other countries, otherwise international considerations might eventually prevail, causing taxpayers to migrate to warmer shores.[13]

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[12] As *per* Justice La Forest in *Mitchell v. Peguis*, *supra* note 9 at 132.

[13] This effect, colloquially branded the 'brain drain', is of particular relevance today, and was detected as far back as the early 1960s, as evidenced in the following passage from the 'Carter Report':

> [F]or many Canadian workers, the market for their services is continental... especially for highly skilled and professional employees and the Commission is anxious that the tax system should not contribute to a brain drain.

'Carter Report', *supra* note 9, vol. 3 of 6 vols., at 158 & 160.

This second consideration is discussed in greater detail below, in relation to incentives and economic efficiency.

The notion that persons with equivalent financial circumstances should be subject to equal tax treatment is by no means a novel idea. Adam Smith's seminal work delineated four fundamental canons of taxation. The first canon stated:

> The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate who are all obliged to contribute in proportion to their respective interest in the state.[14]

This maxim has come to be known as 'horizontal equity' and it stands for the proposition that those who generate similar amounts of wealth should bear comparable tax burdens.[15]

The objective of achieving a horizontally equitable tax system was high on the Carter Commission's mandate:

> We assign a higher priority to the objective of **equity** than to all the others.... We are convinced that unless this objective is achieved to a high degree all other achievements are of little account. **Thus the need for an equitable tax system has been our major concern and has guided us in all our deliberations**.... It is clear from the record of the past that a social and political system cannot be strong and enduring when a people becomes convinced that its tax structure does not distribute the tax burden fairly among all its citizens.[16] [emphasis added]

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[14] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Harmondsworth, Middlesex: Penguin Books, 1982; first published in 1776), vol. II of 3 vols., at 130.

[15] Admittedly, horizontal equity is not as simple a concept as it might first seem. In the case of a professional athlete who earns, say, $1,000,000.00/annum for six years and is then forced into retirement, compared with an accountant who earns, on average, $150,000.00/annum over forty years of work.

All things being equal, both individuals will enjoy lifetime earnings of $6,000,000.00, but under the ambit of horizontal equity they will bear quite different tax burdens due to the marginal rate structure. Under Manitoba's 1999 rate structure, the professional athlete would pay in the region of $2,960,000.00 on his lifetime earnings, whereas the accountant would pay approximately $2,360,000, a difference of $600,000 despite their total lifetime earnings being identical.

One possible solution might be to develop a different tax base, such as an expenditure tax, whereby individuals are taxed on consumption rather than income. For an excellent discussion on expenditure taxation see, J.E. Meade, *The Structure and Reform of Direct Taxation*, for the Institute for Fiscal Studies (London: William Clowes and Sons Ltd., 1978), pp. 150-173.

[16] 'Carter Report', *supra* note 9, vol. 2 at 17.

In any event, horizontal equity is achieved "when individuals and families with the same gains in discretionary economic power pay the same amount of tax." The laudability of horizontal equity is obvious. Every citizen is entitled to, and benefits from, the services provided *vis-à-vis* tax collection. Anyone benefiting from those services should bear a proportion of the tax burden in accord with their ability-to-pay.[17]

Although ensuring the existence of a just and impartial tax system is a commendable enough objective, horizontal equity is a matter of far greater consequence than that alone. Equal tax treatment of like individuals is necessary to evoke faith from those forced to part with their hard-earned dollars: "the tax system [must] not only be fair, it must be seen to be fair."[18] Deviations from horizontal equity inspire taxpayer resentment, causing them to seek means to reduce their tax burden to a level commensurate with that of their neighbour. The Carter Commission addressed that very issue, stating:

> The first and most essential purpose of taxation is to share the burden of the state fairly among all individuals and families. Unless the allocation of the burden of taxation is generally accepted as fair, the social and political fabric of a country is weakened and can be destroyed.... Should the burden be thought to be shared inequitably, taxpayers will seek means to evade their taxes.[19]

The phenomena of tax avoidance and tax evasion are of momentous importance as they affect the economy most adversely by obliterating a portion of the tax base. Generally, marginal rates can only be suppressed when it is possible to spread the tax burden over a

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[17] Under the 'ability-to-pay' principle it is assumed that one's ability to pay taxes or sacrifice a portion of one's income increases more rapidly than one's increases in income. This notion is at the heart of arguments favouring vertical equity and progressive taxation. – Salyzyn, *supra* note 8, at 185.

[18] As *per* the Hon. E.J. Benson, then Minister of Finance, in his Budget Speech delivered in the House of Commons, Friday, June 18th, 1971, p. 3: cited in Salyzyn, *supra* note 8, at 25.

[19] 'Carter Report', *supra* note 9, vol. 1 at 4.

relatively large tax base, which highlights the importance of curtailing its erosion if one favours, as he should, low marginal rates of tax.[20]

4-2 FAIRNESS/HORIZONTAL EQUITY, AND THE 'CONNECTING FACTORS' TEST

Under the post-*Williams* regime one of the hallmarks of an effective tax system, horizontal equity, is completely forsaken. There is not even the slightest pretense towards achieving horizontal equity between Indians and non-Indians, or within the Indian community. Indeed horizontal equity is mentioned nowhere in the jurisprudence concerning Section 87.

One of the main difficulties in measuring the fairness of the present arrangement is determining by whose standard fairness is to be assessed. Obviously, opinions may vary between Indians and non-Indians; non-Indians may find it objectionable that Indians living and working on reserve are exempt from tax, in spite of the fact that reserves are maintained by transfer payments from Ottawa, as opposed to local taxes.[21] Whether it is 'fair' to provide Canadian taxpayer's money to fund Aboriginal communities, without requiring their residents to similarly contribute, might depend on one's racial designation, but needless to

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[20] The virtues of maintaining low marginal rates are discussed below in relation to incentives and economic efficiency.

[21] Peter Russell, a University of Toronto political scientist made the following comment:

> The majority of the population have no sense of history, and they're saying, 'Who the hell are these people, and who said they have rights?'... [T]he strong feelings of native peoples about revindicating their rights has led, in some cases, to a reversal of perception of the reality that natives are by and large the victims of exploitation in Canadian history.

Steven Frank, "Getting Angry Over Native Rights" *Time Magazine*, Canadian ed., 15 May 2000 at 21.

say, there are arguments supporting both sides.[22] At any rate, it does not appear that the issue will be settled soon.

To accept that it is impossible to reconcile the horizontal inequities between Indians and non-Indians with the underlying purpose of the *Indian Act* exemption,[23] the 'connecting factors' approach subjects Indians living on-reserve and off-reserve to the same inequity. This is justified on the basis that Indians make a choice between entering the commercial mainstream or remaining within the protective confines of the reserve. Justice Gonthier expressed the matter as follows:

> [U]nder the Indian Act, **an Indian has a choice with regard to his personal property**. The Indian may situate this property on the reserve, in which case it is within the protected area and free from seizure and taxation, or the Indian may situate this property off the reserve, in which case it is outside the protected area, and more fully available for ordinary commercial purposes in society. **Whether the Indian wishes to remain within the protected reserve system or integrate more fully into the larger commercial world is a choice left to the Indian**.[24] [emphasis added]

The idea that Indians are able to choose whether to live and work on their reserve may be flawed. Indian people are often forced off their reserve and into the commercial mainstream by insufficient on-reserve employment opportunities.[25] Justice Gonthier might, therefore,

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[22] Arguments in support of continued financing are not completely without merit. They are based on the notion that entitlement to financial compensation provided by Parliament is a form of compensation for violations of Aboriginal rights and title.

> A popular way of explaining the fiscal implications of aboriginal rights is the landlord-tenant analogy. In this analogy the original Indian inhabitants owned Canada's lands and resources long before the coming of European colonists. In exchange for sharing the use of Canada's lands and resources, many First Nations assert that they should be paid rent, just as the tenant pays rent to a landlord.

Frank Cassidy and Robert Bish, *Indian Government Its Meaning in Practice* (Lantzville: Oolichan Books, 1989).

[23] As was enunciated by Justice La Forest in *Mitchell v. Peguis*, *supra* note 2 at 132.

[24] *Williams*, *supra* note 10 at 887.

[25] To wit, the United Nations Development Program has, for years, ranked Canada as the best country in the world to live. The calculation used to arrive at that conclusion is based on the so-called 'Human Development Index' that measures citizens' ability to exercise choices that would enable them to live longer, healthier lives, acquire knowledge, and earn income for a decent standard of living. When the Department of Indian Affairs and Northern Development applied the 'Human Development Index' to people living on reserves, the research revealed that the quality of life on reserves fell below Mexico, which ranked fifty-second in the world. Department of Indian Affairs and Northern Development, *Measuring the Well-Being of First Nations Peoples*, by D. Beavon and M. Cooke (Ottawa: Research and Analysis Directorate, 2 October 1998).

have been inaccurate in commenting that "an Indian has a choice with regard to his personal property", or at least underestimated the level of despondency that exists on reserves.

In *Union of New Brunswick Indians v. New Brunswick*,[26] Justice Binnie, with whom Justice Gonthier concurred, provided an interesting comment in dissent.

> In the present case, we are dealing with personal property which, it is agreed, the Indians have chosen to locate and consume on the reserve. New Brunswick seeks to deny Indian people the tax benefit of that choice, not because the Indians have decided to "integrate more fully into the larger commercial world", but because the absence of appropriate retail stores on the reserve compels the Indians to shop off the reserve. The result of the majority decision to allow the appeal in this case is to defeat the assurance in *Williams*, *supra*, and in *Mitchell*, *supra*, that s. 87 is designed to give status Indian people a meaningful tax choice in the location of their personal property.[27]

Although *Union of New Brunswick* concerned a sales tax, and Justice Binnie's comments were directed at the absence of retail stores on reserves, they are instructive nonetheless. At best, they imply that the 'connecting factors' test should accord weight to the choice factor in determining whether the tax exemption should be available; and, they imply at least that the sentiment expressed by Justice Gonthier in *Williams* is no longer appropriate.

At any rate, application of the 'connecting factors' test results in a horizontal inequity between on-reserve and off-reserve Indians. Post-*Williams* jurisprudence effectively penalises Indian people for the absence of career opportunities available to them on reserves. As discussed below, this discourages people from venturing off reserves in search of employment, thus further entrenching the abject existence that is reality for many of Canada's First Nations.

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[26] [1998] 1 S.C.R. 1161. The majority view was represented by Madam Justice McLachlin (as she was then), writing for Lamer, C.J., Cory, Iacobucci and Major JJ..
[27] *Ibid.*, para 76.

4-3 CLARITY AND CERTAINTY FOR THE TAXPAYER

An effective tax system is coherent, straightforward and avoids complexities that might cause people uncertainty as to their tax liabilities. In short, the ideal tax system is within the average "Joe's" comprehension, and allows him to understand the nature of his tax liability, thereby engendering a sense of accountability by legislators to the electorate. Once again, a fundamental precept of the Carter Report was that

> ...all individuals or groups should have ample opportunity to make their views on tax laws known to the legislature [and] the public should have available all the information necessary to evaluate the adequacy of existing tax laws, and to formulate recommendations for improving the law.[28]

The virtues of a comprehensible tax system derive from the democratic process itself: those who enact laws are meant to represent the will of the electorate; and an inscrutable tax system makes it impossible for the public to make its views known because the system is beyond its comprehension. Simply stated, it's hard to say something isn't right if you can't understand when something's wrong.

More importantly, obscure or unclear legislation creates a sense of uncertainty that is intolerable under the ambit of the rule of law, which purports to strike down laws arbitrary or retroactive in their application.[29]

> Obscure law, and law that is not consistently enforced, creates uncertainty; when the law cannot readily be determined it is impossible for the individual to know in advance what he or she is free to do. In effect, uncertain law is retroactive law, because the effect of the law is known only after the event.[30]

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[28] 'Carter Report', *supra* note 9, vol. 2 at 13.

[29] The rule of law exists, we are told, to secure the public against arbitrary and retroactive acts by the legislature and provides that the law must be clear, fair and just in precisely defining peoples' rights: Trevor Allan, *Law, Liberty, and Justice: the Legal Foundations of British Constitutionalism* (Oxford: Clarendon Press, 1976), p. 34.

[30] 'Carter Report', *supra* note 9, vol. 2 at 14.

Indeed, a potential taxpayer should be able to understand the nature and extent of his tax obligation. It should be clear what is taxable, what is not taxable, and the amount of tax owing on all forms of income.

4-4 CLARITY/CERTAINTY AND THE 'CONNECTING FACTORS' TEST:

Tax law is undoubtedly a difficult and confounding subject, with clarity often sacrificed to curtail tax avoidance. It would be unrealistic to expect that taxpayers are able to grasp the finer points of the law and understand the nature of their liabilities.

> In a report to an annual meeting of the Canadian Tax Foundation, the director claimed, as a truism, that **the *Income Tax Act* is the most complex statute ever enacted in Canada**. He pointed out that the intricacies of the Act make comprehension difficult "even for seasoned practitioners"[31] [emphasis added]

This obviously flies in the face of what was expressed above respecting the importance of maintaining a coherent and understandable tax system about which the electorate can voice its opinions. The *Income Tax Act*'s inordinate complexity is not, however, the only difficulty faced by First Nations in assessing their tax obligations.

The previous chapters attest to a deep sense of confusion as to the scope of the *Indian Act* tax exemption. The 'connecting factors' test is far from clear in its application and, as a result, there exists a plethora of post-*Williams* litigation on the *situs* of personal property. This makes it difficult for Indians and non-Indians to comment on the status of the *Indian Act* exemption. While the courts have firmly established that the purpose of the exemption is to prevent the erosion of reserved lands, the jurisprudence seems to offer varying views as to what exactly that entails. Moreover, Parliament has done nothing to clarify things, thus

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[31] Salyzyn, *supra* note 8 at 41.

forcing the courts to assume a role reserved for legislators: determining who should bear the tax burden.

Finally, the indeterminate scope of Section 87 has resulted in needless litigation and expense by band councils and band members. Commenting on the virtues of unambiguous tax law, the Meade Committee's remarks exemplify yet another reason why the present situation warrants criticism.

> The costs of application of a given system of taxation must be judged not only by their official administrative costs, but also by the costs which the private taxpayers must incur in order to cope with their tax liabilities.... Such costs of compliance may be reduced by ensuring that the tax system is simple, straightforward and precise – qualities which are desirable in themselves in order to make the tax system easy to understand; for the more straightforward are the taxpayer's obligations, the less time and trouble need be spent on the preparation of tax returns and appeals.[32]

In short, litigating Aboriginal issues is costly to both those who directly benefit from the Department of Indian Affair's budgetary expenditure, and Canadian taxpayers who ultimately foot the bill. This is especially unacceptable given the ease with which Parliament could enact more precise legislation and clarify the circumstances under which an Indian's income is exigible to tax.

4-5 INCENTIVES, NEUTRALITY AND ECONOMIC EFFICIENCY:

To begin with a fairly straightforward proposition, 100% marginal tax rates effect an absolute disincentive against the generation of income. A person not allowed to keep any of his post-tax earnings is unlikely to go to the trouble of earning an income, except perhaps in a monastic community. As discussed below, near 100% effective marginal rates are a prospect faced by many Aboriginal people as a result of the ill-conceived tax treatment of First

Nations. Generally speaking, increasing marginal rates promulgates economic inefficiency because the disincentive effects of taxation depend upon marginal tax rates: as marginal rates increase, the incentive to earn decreases.[33]

An efficient tax structure is achieved by keeping marginal rates as low as possible, whilst maintaining viable average rates of tax. It is useful at this stage to distinguish between the two so that the reader may understand that the objectives of maintaining low marginal rates, whilst procuring viable average rates, are not necessarily mutually exclusive. The marginal tax rate affects one's next dollar earned and is expressed in terms of the tax rate to which any additional earnings are subjected. For example, in Canada, once a taxpayer has taxable income over $29,590, he shifts from a 17% to 26% marginal tax rate. The next dollar above that amount will be taxed at a 26% marginal rate. Alternatively, the average tax rate corresponds to the amount of tax owing within a time period, divided by the income earned within that period. For example, an individual earning $29,590, eligible for $10,000 in personal allowances, will pay approximately $3,330 in taxes and is therefore subject to an average rate of 11.25%, or $3,330/$29,590.

The disincentive effects of high marginal tax rates are readily apparent. Whilst our $29,590 earner is only taxed at an average rate of around 11%, the next dollar he earns will be taxed at 26%. And that accounts only for the federal tax. The point at which marginal rates discourage the taxpayer from earning an additional dollar in favour of leisure, or encourage him to seek out a more favourable tax climate, is the point at which the system becomes inefficient. Perhaps the main difficulty faced by legislators is being able to assess

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[32] Meade, *supra* note 16 at 20.
[33] J.A. Kay and M.A. King, *The British Tax System* (New York: Oxford University Press, 1997; 5th ed.), at 37.

precisely the point at which that occurs.[34] One thing is certain, however: high marginal rates are necessary only on distributional grounds and on incentive grounds they are to be avoided.[35]

The task of effecting sufficiently low marginal tax rates to minimise disincentives, whilst maintaining sufficiently high average tax rates to generate sufficient revenues, is a delicate one. The difficulty is heightened by the fact that average rates are affected by numerous considerations other than marginal rates alone. For example, increased progressivity may be achieved by introducing a more graduated rate structure, or by diminishing the tax threshold, *i.e.*, raising personal allowances. Striking a balance between distributional aims and economic efficiency is largely a matter of social predilection and political affiliation, and there are various rate structures available to effect either greater incentives or increased vertical equity.[36]

There are two competing influences which, in theory, are manifested by a given rate structure. Taxpayer behaviour is affected by what are known as the 'income effect' and the 'substitution effect' of taxation.

> [H]eavier [average rate] taxes on income reduce the taxpayer's spendable income, and this consideration alone would probably make it desirable for him to work harder to restore in part his post-tax income (the 'income effect'); but at the same time, a higher marginal tax rate will reduce the net spendable income which he can get from

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[34] The Carter Commission identified 50% marginal rates of tax as the point at which the system becomes inefficient:

> The personal income tax schedules we recommend do have one anchor point, however. The rate schedules have a top marginal rate of 50%. We think there is psychological merit in a rate structure that would limit the state's claim against a man's additional earnings to one half. In our opinion, it is essential that the marginal rates be kept low enough that the incentive to produce goods and perform services and invest funds is not destroyed.

'Carter Report', *supra* note 9,vol.1 at 20.

[35] Meade, *supra* note 5, at 316.

[36] For example, a high-low-high rate structure advocates high marginal rates at both the bottom and top end of the income scale, a low-high-low rate structure is achieved when marginal rates are low at the bottom and top ends of the income scale, and finally constant marginal tax rates exist under a flat or linear marginal rate structure. Obviously, whether one prefers one rate structure over another will depend largely on the policy he or she would aim to achieve through the tax structure: *Ibid.*, pp. 308-316.

> an extra hour's work, and this reduction in the extra goods which he can earn from an hour's work will tend to make him prefer leisure to work (the 'substitution effect').[37]

Substitution effects may take many forms: taxpayers might emigrate to countries where they are taxed less; the wage earner might substitute work with leisure; or a business executive may refuse a promotion because the low post-tax increase in earnings does not compensate for additional strain the promotion might entail.[38] Moreover, substitution effects lead to market distortions, whereby taxpayers prefer one option to another only because the tax implications make one option more preferable. Under the auspices of fiscal neutrality, governments seek to raise revenues in ways that avoid distorting effects.

The distorting effects of taxation are illustrated in the following example: assume that houses painted red attract more solar heat in the winter and that red paint weathered better. Now assume that people who live in red houses were required to pay a yearly 'red house' tax. People would flood to hardware stores in search of any other coloured paint, despite the fact that red houses were preferable. Distortions cause people to behave unnaturally and to exercise otherwise poor judgment. This, in turn, leads to economic inefficiency,[39] which is, of course, one of the hallmarks of an ineffective tax system.

4-6 INCENTIVES/NEUTRALITY/EFFICIENCY AND THE 'CONNECTING FACTORS' TEST

The level of efficiency and neutrality engendered by the 'connecting factors' regime must be assessed in two ways. First, we must consider how the post-*Williams* approach

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[37] *Ibid.*, p. 8.
[38] *Ibid.*
[39] J.A. Kay and M.A. King, *supra* note 33, at 19.

affects efficiency and neutrality within the Canadian tax system; then, we must contemplate its effects on the Aboriginal community itself.

Exempting on-reserve Indians from the tax base while simultaneously providing for them from that tax base necessarily requires that the tax burden be heavier on those in the commercial mainstream.[40] This is an undesirable result because it impinges on overall efficiency by necessitating higher marginal rates.

> Avoidance of economic inefficiencies would involve avoidance of high marginal rates of tax. One corollary of this need to keep marginal tax rates down is a general presumption in favour of tax systems which provide a broad basis for revenue-raising purposes. To raise a given revenue by means of low rates of tax spread over a large tax may be assumed to cause less marked substitution distortions than to raise the same revenue by concentrating high rates of tax on a few activities.... **For this reason it is of great importance to resist erosion of the tax base through exemptions**.[41] [emphasis added]

Marginal rates in Canada have already pushed workers to pay more in taxes and social security contributions than those in all other G7 nations: for example, the highest marginal income tax rates in Canada average 49.6%, whereas those in the U.S. average 26%.[42] While exempting First Nations from tax undoubtedly contributes to Canada's inordinate marginal rates, this is only a part of the problem. The 'connecting factors' approach is the source of serious, if unintended difficulties for the First Nations community as well.

Let us start by pointing put that the 'connecting factors' scheme is the product of a paternalistic and antiquated policy rationale, whereby Indians have been regarded from the beginning of Canadian policy (1876) as incapable of caring for themselves.

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[40] The Carter Commission recognised that in narrowing the tax base it is axiomatic that the tax burden be heavier on others.

> The narrow tax base [requires] that to raise required revenue, tax rates have to be higher than would otherwise be necessary and the tax burden on some is therefore correspondingly heavier.

'Carter Report', *supra* note 9, vol. 1, p. 24.

[41] Meade, *supra* note 5, pp. 9-10.

[42] Diane Francis, *Canada:* "The Battleground Between European and American Models", *Wealthy Boomer*, vol. 2, issue 1, p.14.

> Our Indian legislation generally rests on the principle that the aborigines are to be kept in a condition of tutelage and treated as wards or children of the State.... [T]he true interests of the aborigines and of the State alike require that every effort should be made to aid the Red man in lifting himself out of his condition of tutelage and dependence, and that is clearly our wisdom and our duty, through education and every other means, to prepare him for a higher civilization by encouraging him to assume the privileges and responsibilities of full citizenship.[43]

Hence, the purpose behind the tax exemption is evident: to keep our "Red brothers" as wards of the state until such time as they are "civilised" and capable of managing their affairs.[44] One may assume that the reason for legislatively narrowing the *Indian Act* tax exemption in 1850 and 1876, to apply only to Indians situated on a reserve, is because it was thought that those Indians were not sufficiently civilised or self-sufficient to bear a tax burden.

Outmoded policy objectives aside, the 'connecting factors' regime gives rise to a host of undesirable distortions between Indians living on and off reserve. Obviously, taxing Indians in the commercial mainstream whilst exempting those on reserves will discourage people from searching for employment off reserves, despite the fact that there might be better opportunities there. This, in effect, perpetuates reserve based Indians' dependence on the welfare system and fosters their continued existence as wards of the state.[45] The effect is one well known to tax policy, colloquially referred to as the 'poverty trap' and 'unemployment trap' respectively.

> The poverty trap, strictly defined, refers to a worker who becomes worse off following an increase in earnings. The looser definition of the poverty trap refers to the situation when a worker only becomes slightly better off after earnings go up. The poverty trap arises because, as income goes up, part of the extra income goes in higher [marginal] tax payments and some means-tested benefits are wholly or

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[43] Department of the Interior; *Annual Report for the Year Ended 30 June, 1876*; (Parliament, Sessional Papers, No.11, 1877), p. xiv.

[44] The federal government's policy toward Indians is said to have two historical components: (1) civilising the Indian population and achieving assimilation; and, (2) protection of First Nations from abuse and imposition until such time as they became civilised and such protection was superfluous: Richard Bartlett, "The Indian Act of Canada" (Summer 1978), 27 *Buffalo Law Review*, 581-615, at 583.

[45] Statistics show that unemployment rates are noticeably higher on reserves than off. Canadian Centre for Judicial Statistics; *An Overview of Data on Aboriginal Peoples*, May 1998.

> partially lost. The idea behind the unemployment trap is similar to the poverty trap except that it refers to people trapped in unemployment.[46]

In other words, reductions in social assistance, combined with the loss of tax exempt status by leaving the reserve, may result in near 100% 'implied' marginal rates.[47] It should come as no surprise that an individual faced with the prospect of inordinate marginal rates would choose to substitute labour for leisure.

At any rate, the 'connecting factors' test produces strong disincentives against leaving the reserve in search of employment. As such, Indians are induced to remain on reserves even though they might otherwise benefit from entering the commercial mainstream. There are many losers in this scenario: (1) the individual who decides to remain less productive and under challenged; (2) the taxpayer contributing to the welfare system; and finally, (3) society at large, which loses out on that individual's potential contribution to the community.

4-7 DISTRIBUTIONAL EFFECTS AND VERTICAL EQUITY

Vertical equity is a matter of distributing the tax burden fairly between the rich and poor so as to effect a desirable level of wealth redistribution.[48] There are numerous

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[46]The unemployment trap can be discussed using the concept of the 'replacement ratio'. Replacement ratio is expressed by dividing income when unemployed, by income when employed – that is RR = income when unemployed/income when employed. When the replacement ratio (RR) approaches or exceeds 1, there is no financial incentive to increase earnings through employment. Brown and Jackson, *supra* note 4, at 461-463.

[47] The Quebec White Paper on Personal Tax and Transfer Systems focused attention on the potential for the unemployed to be faced with inordinate marginal tax rates, stating the following:

> In the lower income brackets, benefits are reduced when work income increases – so much so that for the lowest income earners the implicit marginal tax rates generated by the combined effects of rates of taxation and reduction are very high, often above 70%. And when the cost of child care is added, the marginal rates can even exceed 100% when a household uses a non-subsidized day care service, as is usually the case; this means that low-income households have to pay for the privileges of working.

Quebec Ministeres des finances, *White Paper on the Personal Tax and Transfer Systems* (Quebec: Government du Quebec, 1984) at 179, quoted in Neil Brooks, *The Quest for Tax Reform* (Toronto: Carswell Company Ltd., 1988), p. 60.

[48] Meade, *supra* note 5 at 12.

justifications for vertical equity; the Carter Commission, for example, offered the following summation:

> Vertical equity requires that those in different circumstances bear appropriately different taxes.... We believe that vertical equity is achieved when individuals and families pay taxes that are a constant proportion of their discretionary economic power.... The tax base of each family and unattached individual should be subject to progressive rates of tax. Because we believe that non-discretionary expenses absorb a much larger proportion of the annual additions to the economic power of those with low income than of the wealthy, in order to attain the proportionate taxation of discretionary economic power, we recommend that a base that measures total economic power be taxed at progressive rates.[49]

In short, it costs the lower paid a roughly equivalent amount as the higher paid to acquire the necessities of life. Therefore, because the lower paid must contribute a higher proportion of income to household necessities than the higher paid, it is laudable that they contribute a lower proportion of their income to tax.[50]

Determining how progressive the tax structure should be, *i.e.*, the rate at which the incidence of tax should increase as income increases, involves basic value judgments. There is a caveat warranted here, however, as it is a common misapprehension that progressive taxation is achieved only when marginal tax rates are stepped. In fact, to achieve progressivity only requires that 'average' tax rates increase proportionately with income, which only requires that 'marginal' rates be maintained at a higher level than average rates.[51] For example, under a linear tax system with a 17% tax rate, progressivity is achieved simply by introducing a personal allowance. Three taxpayers earning $20,000, $30,000, and $50,000 respectively, under a 17% tax rate with a $6,000 personal allowance will bear different incidences of tax. The taxpayer earning $20,000 is subject to an 11.9% average

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[49] 'Carter Report', *supra* note 9, vol.1 at 4-5 & 21.

[50] Moreover, many of the taxes to which we are subject are regressive in effect. For example, sales taxes demand a higher proportion of a poor person's income in relation to the same amount of tax paid by a rich person. This is another justification for maintaining a progressive income tax structure.

[51] Kay and King, *supra* note 40 at 12-13.

rate,[52] the taxpayer earning $30,000 is subject to a 13.6% average rate,[53] whereas the taxpayer earning $50,000 is subject to a 14.96% average rate.[54] Hence, a linear tax system is not necessarily proportionate, nor regressive, so long as personal allowances exist and marginal rates always exceed average rates.

Finally, even the most non-interventional tax system is bound to have distributional effects because those with higher incomes will always bear a greater tax burden than the lower paid.[55] The corollary of this feature is that, in the absence of taxation, the state relinquishes its capacity to ensure that the impoverished are provided for and that those with a greater ability-to-pay bear any appropriate tax burden. In the absence of taxation there is simply no means to ensure that the poor will have the means with which to purchase basic necessities. To this, a cynic might add that providing the poor the means with which to purchase their necessities helps the economy because it provides a much broader market for retailers, as people on low incomes are known to spend a greater proportion of it on consumer goods.

4-8 VERTICAL EQUITY/DISTRIBUTIONAL EFFECTS AND THE 'CONNECTING FACTORS' TEST

Not much discussion is warranted on the vertical equity issue. Suffice it to say, the 'connecting factors' approach relinquishes the state's ability to disperse wealth between the opulent and needful reserve-based Indians. Taxpayers may find this offensive for a number of reasons. The Carter Commission expressed their views as such:

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[52] ($20,000 – $6,000) x .17 divided by $20,000.
[53] ($30,000 – $6,000) x .17 divided by $30,000.
[54] ($50,000 – $6,000) x .17 divided by $50,000.
[55] The only exception to this rule would arise if tax liabilities were capped once they reached a certain amount.

> In our opinion there is a consensus among Canadians that the tax-expenditure mechanism is equitable when it increases the flow of goods and services to those who, because they have little economic power relative to others, or because they have particularly heavy responsibilities or obligations, would not otherwise be able to maintain a decent standard of living.... It is also clear from the record of the past that a social and political system cannot be strong and enduring when a people becomes convinced that its tax structure does not distribute the tax burden fairly among all citizens.[56]

There is a definite Rawlsian[57] influence amongst proponents of vertical equity; those who favour a more progressive rate structure do so to develop a 'fairer' distribution amongst the rich and poor. Fairness, as we have already established, is a difficult concept to pin down. It largely depends upon who is judging the matter, but one thing is certain: exempting a segment of society from the tax system irrespective of their earning power is bound to inspire resentment among those required to pay tax. For example, an Indian person earning $50,000/annum in the commercial mainstream must wonder at the fairness of a system that permits someone earning $100,000/annum on a reserve to pay no tax. In any event, if one desires to appropriately distribute the burden for financing the provision of services between the rich and poor, then vertical equity cannot be left by the wayside. Accordingly, no one should be exempt from tax unless they are unable to contribute for financial reasons.

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[56] 'Carter Report', *supra* note 9, vol. 2 at 10 and 17.

[57] Philosopher John Rawls advocates an egalitarian criterion of social justice based on the concept of the 'difference principle'. According to this principle, inequality is justified only to the extent that it benefits the least advantaged. The Rawlsian theory of distributive justice is contractarian in the sense that rational individuals would agree to a particular income distribution in order to construct the ideal society. When deciding on how that ideal society is to be constructed, individuals are kept under a 'veil of ignorance', whereby they do not know where they will end up in the final distribution. Individuals not yet born thus create the society in which they would live as if life were a lottery with each individual facing an uncertain future. Presumably, no one would choose to be born into a state of poverty and with no distribution between the rich and poor. John Rawls, *A Theory of Justice* (Cambridge, Mass.: Harvard University Press, 1971).

4-9 CONCLUSION

The 'connecting factors' approach makes a mockery of the characteristics of a good tax structure because it discriminates on the basis of residence and racial designation rather than ability-to-pay. Systemic irregularities and distortions are rampant, thus signalling a need for immediate reform.

A possible solution would be to allow First Nations to levy their own form of income tax,[58] which could be facilitated alongside the self-government process. This would ultimately compel band councils to be more accountable to their members. Under the current financing arrangements band councils have little incentive to be responsible in providing services with the funds received from the federal government. This is because funding is provided for specified services and cannot be shifted to other activities or carried over to the following year, regardless of need.[59] Moreover, because funding derives from the federal government in the form of a lump sum, band members are frequently unaware of the costs of services provided and consequently, they have no means of scrutinising their band council's spending policies. In short, under the present funding arrangement, the federal government becomes a convenient scapegoat for band officials to blame for either insufficient funding or services available to their band members.

Finally, under the proposed model the federal government could more accurately assess each band council's financial needs and funding could be provided on an *ad hoc* basis.

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[58] Section 83 of the *Indian Act* currently permits band councils to levy real property taxes, which reads, *inter alia*:

> 83(1) Without prejudice to the powers conferred by section 81, the council of a band may, subject to the approval by the Minister, make by-laws for any or all of the following purposes, namely,
>
> (a) subject to subsections (2) and (3), taxation for local purposes of land, or interests in land, in the reserve, including rights to occupy, possess or use land in the reserve.

Each council's needs could be assessed according to requirements for funds over and above its ability to derive revenues from its inhabitants, along much the same lines as levels of federal/provincial transfer payments are determined.

The following chapter reviews the various models upon which First Nations' governments are predicated and the ways they might be utilised to solve the problems identified in this chapter.

[59] Cassidy and Bish, *supra* note 23 at 127.

- CHAPTER FIVE -
FILLING IN THE CRACKS

Tax inequities are known to cause market distortions, inefficiencies and resentment among taxpayers. The only means of procuring a tax system unencumbered by such inequities is to ensure that citizens bear an appropriate tax burden, which requires, in turn, that taxes be levied in accord with the principle of ability-to-pay. To effect a truly equitable tax system would entail either eliminating the *Indian Act*[1] tax exemption altogether,[2] or granting bands the power to levy taxes on income, whereby income earned on-reserve would be taxed at a rate roughly equivalent to that off-reserve.[3] Either approach could be facilitated in conjunction with self-government, which thus raises questions as to what self-government means in practice.

That First Nations are possessed of an "inherent" right of self-government is premised on the idea that, prior to First Contact, they constituted self-governing entities and that the right to self-govern can never be extinguished.[4] This, however, might be where the

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[1] R.S.C. 1985, c. I-5, hereinafter, the *Indian Act*.

[2] This approach is preferred by the province of British Columbia, which opposes "any taxation arrangement that provides for tax advantages to First Nations that could distort investment decisions or create unfair competition". Under the Nisga'a agreement, Nisga'a lands will no longer qualify as reserve lands and the *Indian Act* tax exemption will thus be faded out over a term of twelve years: R. Strother, and R. Brown, *Taxation and Financing of Aboriginal Businesses in Canada*, (Carswell: Thomas Professional Publishing), looseleaf service, 1998, at 11-21.

[3] Under such a model, tax could be levied under a residency model as currently operates in the *Income Tax Act*, whereby subsection 2(3) taxes non-residents on the portion of their income earned in Canada. Similarly, First Nations governments could tax Indians and non-Indians alike on the portion of their income earned on-reserve. Such a scheme could be predicated along the lines of the existing tax collection arrangement, and bands could be provided fiscal transfers akin to those received by provincial governments, based upon their needs.

[4] The very term "inherent" right of self-government derives from the notion that self-government is a right originating in the very act of creation.

> Many First Nation governments find their ultimate jurisdiction in terms of the power of the creator and the kindness and wisdom they believe this power showed to their forefathers. It

consensus ends because self-government is a perplexing concept and opinions vary markedly between band and tribal councils as to the preferred self-government model.[5] At the root of the divergence in views is the fact that there are over 600 bands interspersed throughout Canada, and between 130 and 140 tribal affiliations, each differing greatly in culture and heritage.[6]

> There are significant differences in both the heritage and history of these affiliations. Individual cultures differ depending on whether the Indian people come from a small community or from a large community.[7]

To expect that a consensus could be reached on an issue of such momentous importance as developing a framework for self-government, given the disparities between various Indian

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> [is] this power, they maintain, that originally determined the activities and subjects of their jurisdiction, empowered their citizens, and gave them a status equal to that of the governments of other nations.

Hence, the emphasis on spirituality within the Aboriginal models of government is self-evident: Frank Cassidy and Robert Bish, *Indian Government Its Meaning in Practice* (Lantzville: Oolichan Books, 1989), at 31-38.

[5] The following are but a few of the definitions available:

> Self government, for Natives, means that they, as first nations, will govern their own people and their affairs including land and its use. Self-government flows from Aboriginal rights which provide for the right of a peoples' cultural survival and self-determination. Specifically, this would exempt them from the application of laws of another jurisdiction. The Native proposals for self-government call for a third order of government with powers similar to those of a province. In fact, some proposals have suggested that the Indian first nations would have the right to sign international treaties and issue valid passports. These proposals have been summarily rejected by both levels of government.

James Frideres, *Native Peoples in Canada: Contemporary Conflicts*, 3rd ed. (Scarborough, Ont.: Prentice Hall, 1988), at 353.

> Self-government has always been a simple and straightforward concept for Aboriginal people. It is their right to govern themselves as they decide, sharing power with Ottawa and the provinces. In the Aboriginal view, Indian First Nations should become an integral part of the Canadian federal system, sharing revenues as equals with the provinces and Ottawa, and designing their own social, administrative, and economic institutions.

Pauline Comeau and Aldo Santin, *The First Canadians: A Profile of Canada's Native People Today*, 2nd ed. (Toronto: J. Lorimer, 1995), at 54.

> Self-government is a term which is often associated and sometimes used interchangably with the terms self-determination and sovereignty. Such a practice can be misleading, for a group of people can exercise self-government – that is, they can make quite significant choices concerning their own political, cultural, economic, and social affairs – without actually having sovereignty or experiencing self-determination. This might be the case because the form of self-government that has practiced in such in such circumstances is one that is ultimately defined and limited by external forces. Self-determination is the right and the ability of a people to choose their own destiny without external compulsion. It is the right to be sovereign, to be a supreme authority within a particular geographical territory.

Frank Cassidy, *Aboriginal Self-Determination* (Lantzville: Oolichan Books, 1991), at 1.

[6] Strother and Brown, *supra* note 2, at 21-2.

peoples, seems unrealistic. At any rate, there are three primary models for Aboriginal self-government in Canada: (1) a state-oriented, sovereignty model; (2) a quasi-provincial model; and, (3) a municipal government model.

5-1 FIRST NATIONS AS SOVEREIGN POWERS

The idea that First Nations might be immune from taxation by other sovereign authorities was raised in a previous chapter,[8] and rests on the assumption that they retained a form of sovereignty akin to statehood subsequent to first contact with Europeans. The Federation of Saskatchewan Indians observed:

> Indian governments traditionally exercised the powers of sovereign nations and the most fundamental right of a sovereign nation is the right to govern its people and territory under its own laws and customs.
>
> Inherent means that the right of self-government was not granted by Parliament or any other branch of any foreign government. Indians have always had that right and the Treaties reinforce this position.
>
> Indian tribes and subsequently Indian Bands are qualified to exercise powers of self-government because they are independent political groups. Among the inherent powers of Indian government are the powers to:
> (a) determine the form of government;
> (b) define the conditions of government;
> (c) regulate the domestic relations of its members;
> (d) levy and collect taxes.[9]

That First Nations exercised some form of government prior to First Contact is not in dispute. Whether they are qualified to possess the sovereign status afforded international actors is, however, another matter. Even if Canada's constitutional arrangement provided for self-government on the basis of independent statehood, an analysis under the rules of

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[7] *Ibid.*
[8] *Ante*, Chapter One, note 3.
[9] Federation of Saskatchewan Indians, "Indian Government" (Prince Albert, Saskatchewan: 1977), cited in Richard Bartlett, *Indians and Taxation in Canada*, 3rd ed. (Saskatoon: Native Law Centre, 1992) at 19.

international law suggests that First Nations, as such, do not qualify as states in an international sense.

The starting point in any discussion on the characteristics of statehood is the *Montevideo Convention on the Rights and Duties of States*.[10] It provides the most widely accepted criteria for sovereignty at an international level.[11] Article 1 provides:

> The State as a person of international law should possess the following qualifications:
> (a) a permanent population:
> (b) a defined territory:
> (c) a government; and,
> (d) capacity to enter into relations with other states.

The factual prerequisites of statehood are fundamental to the 'declaratory' school of thought.[12] There is, however, a competing tenet, the 'constitutive' theory, "which maintains that it is the act of recognition by other states that creates a new state and endows it with a legal personality."[13] According to the constitutive theory, the desire of peoples to self-determine is legitimised *vis-à-vis* the political act of recognition by international actors, *i.e.*, states.

The declaratory and constitutive theories have been amalgamated under the so-called 'Lauterpacht doctrine', which is "an ingenious bid to reconcile the legal elements in a coherent theory."[14] Lauterpacht's theory is both declaratory, in that it is based upon certain definite facts, and constitutive in that it accepts that recognition by the international community is inherent to statehood. Hence, according to Lauterpacht, a state is defined as a

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[10] *Montevideo Convention on the Rights and Duties of States*, 1933, 135 League of Nations Treaty Series (1936) 19.
[11] Martin Dixon, *Textbook on International Law* 3rd ed. (London: Blackstone Press, 1996), at 100.
[12] Malcolm Shaw, *International Law* 4th ed. (Cambridge: Cambridge University Press, 1997), at 296.
[13] *Ibid.*
[14] *Ibid.*, at 300

'territory' with a 'permanent population' and a 'government' that has been recognised by the international community.

It does not appear that First Nations qualify for sovereign status because international law does not recognise the right of various non-contiguous bodies – in the present case, Indian bands – to comprise a nation-state. Self-determination requires, above all else, a defined territory because the 'self' in self-determination does not refer to ethnic, cultural, or religious groups, but a large-scale, self-sufficient territorial entity.

> Self-determination refers to the right of the majority within a generally accepted political unit to the exercise of power. In other words, it is necessary to start with stable international boundaries and to permit political change within them.[15]

Indeed, minorities enjoy the right under international law to have their identity as a separate ethnic group recognised by the mother-state, but they possess no inherent right to secede.[16] Simply stated, the international community would almost certainly not recognise First Nations as having international legal personality, *i.e.*, an existence independent of Canada, which would thus disqualify them from entering the international arena as independent states.

Finally, even if First Nations did possess the requisite criteria of statehood and were recognised by the international community, sovereignty requires the entity in question to exert a degree of fiscal independence that First Nations are clearly not in a position to embrace. This is not meant to disparage First Nations' capacity to self-govern; it merely recognises that, with perhaps two or three exceptions, it is unlikely that any region in Canada could lead a completely autonomous existence without sacrificing a great deal in terms of living standards. Our success as a confederated nation depends upon the interrelationship between the provincial and federal governments.

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[15] Heather Wilson, *International Law and the Use of Force by National Liberation Movements*, (Oxford: Clarendon Press, 1988), at 80.

If, however, First Nations were accorded full sovereignty, it would solve the problems identified in the previous chapter. First Nations would be forced to develop an independent tax system. Under this approach, Indians residing in 'Canada' would be taxed on their world-wide income – including income earned on-reserve – and moreover, Indians residing on-reserve would be taxed on the portion of the income earned in 'Canada'. Conversely, First Nations could tax all people residing on their lands on the totality of their world-wide income and moreover, could tax non-residents on the income earned on-reserve. The structure of the First Nations' tax system would, of course, be a matter for their own government.

5-2 PROVINCIAL MODEL

Under a quasi-provincial model of self-government, First Nations would integrate into the federal structure at par with the provinces. The result would be a 'First Nations Province' comprised of the 2,250 reserves throughout Canada. This would allot the First Nations Province a land mass approximately twice the size of Prince Edward Island and a population base of nearly 800,000.[17] As such, the First Nations Province could organise itself around a legislative assembly, which would be allotted the powers available to a province, as *per* Section 92 of the *Constitution Act, 1867.*

Under such an arrangement, First Nations would be entitled to equalisation payments based on a similar formula as currently exists for transferring resources between the federal

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[16] As acknowledged by the EC Arbitration Commission on Yugoslavia: also known as the 'Badinter Commission': Dixon, *supra* note 11, at 103.
[17] Strother and Brown, *supra* note 2 at 21-2.

and provincial governments.[18] This would address the problems identified in the preceding chapter because the First Nations Province could levy direct taxes, including income tax, on reserve residents in much the same manner as is currently undertaken under the federal-provincial arrangement.[19]

Cassidy and Bish outline the following steps that would be required to successfully develop equalisation-based fiscal transfers for Indian governments:

> (a) an estimation of the current tax base for property taxes, sales and excise taxes, individual and business income taxes, and royalties;
> (b) an estimation of the amount of revenue the First Nation would receive if tax rates used by Canadian provincial and local governments were applied to the First Nation tax base;
> (c) a comparison of the amount of revenues that would be received from the use of average tax rates within the First Nation with the revenue that would be received if the First Nation's wealth and income were equal to the Canadian average. The difference would provide the first estimate of the size of the equalizing grant the First Nation should receive in order to provide services at about the same level as other citizens of Canada receive; and,
> (d) following the estimate, additional adjustments would have to be made to account for the division of functions decided upon between the First Nation, provincial, federal and local governments.[20]

Using the 'First Nations Province' model, financing previously directed to affluent bands, rich in natural resources or other revenue generating accoutrements, could be devoted to reserves with a lesser revenue generating capability. This would help to ensure that less

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[18] Such an idea was raised in the Penner Report (Penner Keith, *Indian self-government in Canada. Report of the Special Committee.* Ottawa: Supply and Services.) under the ambit of 'equalization', much as it appears in section 36 of the *Constitution Act*, 1982, with respect to federal/provincial transfer payments.

> The basic idea behind federal equalization payments to provinces is that each province in Canada should be able to provide its citizens with the same level of public services for the same tax rates as in any other province. If tax bases are below average, and average tax rates bring in below average revenue, the federal government provides a grant to make up the difference between the revenues collected and required.
>
> The application of the equalization approach was a fundamental part of the Penner Committee's approach to Indian government. Essentially, Penner put forward the proposal that federal financing of Indian governments be premised on equalization as determined through negotiation.

Cassidy and Bish, *supra* note 4, at 117.

privileged reserves were allotted the funding they require to provide band members with a more uniform level of reserve services across the country.

5-3 MUNICIPAL MODEL:

A municipal model of self-government recognises that Indian government is, first and foremost, band government.[21] The similarities between reserve based self-government models and municipal governments are too obvious to ignore. Under a municipal government it would be the individual band councils' responsibility to assess the needs of constituents and negotiate with the federal government for access to funding to meet those needs. Such arrangements are already in place under the auspices of the *Sechelt Indian Band Self-Government Act*[22] and the *Cree-Naskapi (of Quebec) Act*,[23] for example. Section 4 of the Sechelt legislation authorises the band[24] to "exercise and maintain self-government on

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[19] The relevant legislation for determining federal-provincial income tax arrangements is the *Federal-Provincial Fiscal Arrangements and Established Programs Financing Act*, S.C., 1976-77, c. 10.
[20] *Ibid.*, p. 129.
[21] Cassidy and Bish, *supra* note 4, at 73.
[22] *Sechelt Indian Band Self-Government Act*, S.C. 1986, c. 27.
[23] *Cree-Naskapi (of Quebec) Act* S.C. 1983-84, c. 18.
[24] Sections 6 and 8 outline the following powers of the band council, and provide that the council is the governing body of the band:

> 6. The Band is a legal entity and has, subject to this Act, the capacity, rights, powers and privileges of a natural person and, without restricting the generality of the foregoing, may
> (a) enter into contracts or agreements;
> (b) acquire and hold property or any interest therein, and sell or otherwise dispose of that property or interest;
> (c) expend or invest moneys;
> (d) borrow money;
> (e) sue or be sued; and,
> (f) do such other things as are conducive to the exercise of its rights, powers and privileges.
>
> 8. The Sechelt Indian Band Council shall be the governing body of the Band, and its members shall be elected in accordance with the constitution of the Band.

Sechelt lands and to obtain control over and the administration of the resources and services available to its members."

The municipal model of self-government is premised along the lines of 'super-municipality', being a municipality responsible directly to the federal, as opposed to provincial, government.[25] The municipal model is not, however, without its detractors. For example, the Union of British Columbia Indian Chiefs declared:

> Municipal self-government is a form of self-government which has no Indian government roots at all.... Perpetual vulnerability is the quicksand upon which Indian people will be standing if they choose the municipal model of Indian self-government. A municipal government is not a distinct order of government. It does not have exclusive jurisdiction.... It is a creature of the senior level of government that created it and it can be limited or destroyed by its creator with impunity.[26]

The Union of British Columbia Chiefs fears that the municipality model leads to First Nations as "domestic dependent nations", a concept arising in the early American jurisprudential interpretation of the role of Indian self-governance.[27]

5-4 CONCLUSION

Recommending the appropriate model for First Nations' self-government is not germane to the topic of this thesis, and in any event, is a matter of politics and negotiation between First Nations and the federal government. The concern here is to reform the Canadian tax system – for the benefit of Indians and non-Indians alike – by filling in the proverbial cracks caused by the 'connecting factors' approach. Such reforms will ultimately

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[25] Strother and Brown, *supra* note 2 at 21-2.
[26] Union of British Columbia Indian Chiefs, *Our Land is Our Future* (North Vancouver, British Columbia: 1987).
[27] *Johnson v. MacIntosh*, 8 Wheat. 543, 574 (1823). – cited in Bruce Clark, *Native Liberty Crown Sovereignty* (Montreal: McGill-Queen's University Press, 1990), at 16.

require all people, regardless of racial designation, to contribute to the tax system in accord with their ability-to-pay.

The policy of exempting First Nations from tax originated as late as 1850, on the premise that Indians were incapable of managing their own affairs and dealing with property on par with all other Canadians. At the Federal Court, Trial Division, in rendering the *Guerin* decision, Justice Collier observed that

> ...according to the evidence, a great number of Indian affairs personnel, *vis-à-vis* Indian bands, and Indians, took a paternalistic, albeit well meaning attitude: the Indians were children or wards, father knew best.[28]

The originating policy is both offensive and outdated. Moreover, even if one finds no fault with exempting First Nations from the Canadian tax system, it does not follow that First Nations should be deprived of the opportunity to levy taxes on their residents, as the *Indian Act* so restricts them from doing.

The time for reform is upon is. At stake is the integrity of the Canadian tax system and the right of First Nations to chart their destiny by exerting true self-government *vis-à-vis* meaningful control over their resources and revenue bases.

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[28] *Guerin v. The Queen*, [1982] 2 C.N.L.R. 83 at 103 (F.C.T.D.).

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