

The Evolving Interpretation and Significance of

Section 87 of the *Indian Act*

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I. INTRODUCTION

The *Indian Act* is a long statute: 122 exciting sections and 15 fascinating regulations. One section, however, grabs an overwhelming amount of attention – section 87, the foundation of the *Indian Act* tax exemption. Some of the attention is a result of the classic and endless tug-of-war between the taxman and the taxpayer. Some flows from a misplaced jealousy of a particular economic advantage flowing to aboriginal people (conveniently ignoring, of course, the formidable array of economic disadvantages faced by aboriginal peoples and their communities). First Nations (and their professional advisors) see this provision as a potentially powerful tool in the process of building aboriginal economic independence and, on occasion, as a means to help resolve disputes between aboriginal peoples and third party developers.

This paper will begin by setting out the content and history of the tax exemption. It will then examine the judicial interpretation of section 87 over time, and analyze the development of the “connecting factors” test and the concept of the “commercial mainstream”. This paper will examine ways in which the section 87 tax exemption, coupled with First Nation taxation authority, may help to bridge the gap in accommodation negotiations. Finally, it will discuss the near-obsessive desire on the

¹ I gratefully acknowledge the assistance of my articulated student Mariana Storoni in the background research of this paper.

part of Canada and British Columbia to eliminate section 87 protection for British Columbia First Nations proposing to enter into modern treaties.

II. SECTION 87 OF THE *INDIAN ACT*

The main statutory tax exemption for First Nations is embodied in section 87 of the *Indian Act*:

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.

The exemption of Indians and bands from taxation was first enacted by the Province of Canada in 1850.² Section 4 of the 1850 *Act for the protection of the Indians in Upper Canada from imposition, and the property occupied or enjoyed by them from trespass and injury*³ provided:

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.

² Richard H. Bartlett, *Indians and Taxation in Canada*, 3d ed. (Saskatoon: Native Law Centre) at 1 [Bartlett, *Indians*]

³ *Act for the protection of the Indians in Upper Canada from imposition, and the property occupied or enjoyed by them from trespass and injury*, S.C. 1850, c. 74

The tax exemption remained unchanged until 1876, when the *Indian Act*⁴ exempted the real or personal property of an Indian situated on a reserve, but no longer expressly extended to the person:

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.

65. All land 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.

In 1951, the tax exemption was rewritten⁵ in its present form.

Only an “Indian” or a “band” can claim the section 87 tax exemption. Under s. 2(1) of the Indian Act, an “Indian” is defined as “a person who pursuant to this Act is registered as an Indian or is entitled to be registered as an Indian”. A “band” is defined under s. 2(1) as “a body of Indians (a) for whose use and benefit in common, lands, the legal title to which is vested in Her Majesty, have been set apart before, on or after September 4, 1951, (b) for whose use and benefit in common, moneys are held by Her Majesty, or (c) declared by the Governor in Council to be a band for the purposes of this Act”.

The section 87 tax exemption is not, therefore, available to non-status Indians, Métis and Inuit. Similarly, corporations are not eligible for the exemption, as they are neither Indians nor bands.

Under section 87, both real and personal property situated on reserve are eligible for the tax exemption. Much of the section 87 jurisprudence has turned on the question of the location of the property in question. While it is generally easy to determine whether tangible personal property is located on reserve, the location of intangible personal property can be more difficult to determine. We will now examine the application of the

⁴ *Indian Act*, S.C. 1876, c. 18, ss. 64-65

⁵ *Indian Act*, S.C. 1951, c. 29, s. 86; *Indian Act*, R.S.C. 1970, c. I-6, s. 87

exemption to intangible personal property. In particular the application of the exemption to a very popular type of intangible personal property: income.

III. EARLY SECTION 87 JURISPRUDENCE

Until the Supreme Court of Canada's decision in *Williams v. The Queen*,⁶ the leading section 87 case was *Nowegijick*.⁷ Mr. Nowegijick was a status Indian living on reserve. He worked off reserve as a logger for a corporation that had its head and administrative offices on reserve. Mr. Nowegijick was paid at the corporation's head office on reserve. He claimed that his wages were exempted from taxation by virtue of s. 87 of the *Indian Act*. The Tax Court judge agreed but the Federal Court of Appeal reversed the judgment.

The Supreme Court of Canada held that salary or wages are the personal property of an Indian for the purposes of section 87. The Court then examined whether the property was situated on reserve. The Court viewed employment income as a debt and held, based on a conflict of laws principles, that employment income is normally situated where the debtor (in this case, the employer) is. Given that Mr. Nowegijick's employer was resident on reserve, the income was situated on reserve and thus exempt from income tax.

The next significant case on the section 87 tax exemption was *Mitchell*.⁸ In that case, a law firm had represented the Peguis Indian Band to recover sales tax improperly paid to the province of Manitoba. The Band did not pay its legal bill and the firm commenced legal action against the Band. When the firm attempted to garnish funds held for the Band by the government of Manitoba, the Band argued that section 90 of the *Indian Act* deemed the *situs* of the funds on reserve. The funds were, therefore, exempt from garnishment by virtue of section 89.

⁶ *Williams v. The Queen*, [1992] 1 S.C.R. 877 [Williams]

⁷ *R. v. Nowegijick*, [1983] 1 S.C.R. 29 [Nowegijick]

⁸ *Mitchell v. Peguis Indian Band*, [1990] 2 S.C.R. 85 [Mitchell]

While *Mitchell* was a section 89 case, the Supreme Court of Canada made some general comments on the section 87 tax exemption. La Forest J. held that sections 87 and 89 of the *Indian Act*:

... constitute part of a “legislative package” which bears the impress of an obligation to native peoples which the Crown has recognized at least since the signing of the *Royal Proclamation of 1763*. From that time on, the Crown has always acknowledged that it is honour-bound to shield Indians from any efforts by non-natives to dispossess Indians of the property which they hold qua Indians, i.e., their land base and the chattels on that land base.⁹

The purpose of section 87, La Forest J. noted:

... 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).¹⁰

La Forest J. further stated, in a comment that is critical to the proper interpretation of the “commercial mainstream” concept that:

It would follow that if an Indian band concluded a purely commercial business agreement with a private concern, the protections of ss. 87 and 89 would have no application in respect of the assets acquired pursuant to that agreement, except, of course, if the property was situated on a reserve. It must be remembered that the protections of ss. 87 and 89 will always apply to property situated on a reserve (emphasis added).¹¹

Certain cases since *Mitchell* have latched on to the phrase “commercial mainstream” as if it stood for the proposition that the section 87 tax exemption does not apply to the income of status Indians or bands acquired in the conventional commercial activity. That, however, is not what the Supreme Court said. *Mitchell* explicitly states that section 87 exempts from taxation all personal property that is situated on reserve. The critical question, then, is not whether income flowed from an enterprise in the

⁹ *Ibid.* at para. 87

¹⁰ *Ibid.* at para. 88

¹¹ *Ibid.* at para. 108

commercial mainstream. The critical question is still: where is the property situated? The concept of the commercial mainstream is simply part of the overall factual context within which the relevant connecting factors are weighed and assessed.

Prior to *Williams*, *Nowegeijick* would answer the question of the location of income by looking at the location of the employer. The advantage of this test was that it provided certainty in tax planning. The disadvantage was that it allowed income to be characterized as being located on reserve even when the connections to reserve were tenuous or even artificial. This situation would soon change. With the *Williams* decision the law became less arbitrary (although arguably less predictable).

IV. WILLIAMS: THE “CONNECTING FACTORS” TEST

In *Williams*, still the leading case on intangible property and section 87, the Supreme Court of Canada considered whether the unemployment insurance benefits received by an Indian were tax-exempt under section 87. Mr. Williams was a status Indian who resided on a reserve and had worked on the reserve for a logging company also situated there. He had also been employed by the band on a job-creation project that was funded by the federal government and was carried out on the reserve. Mr. Williams received unemployment insurance benefits for which he had qualified when working for the logging company and for the band in the job-creation project. His benefits were issued from a computer centre in Vancouver.

Gonthier J., for a unanimous Court, held that the employment benefits were situated on reserve and thus tax-exempt pursuant to section 87. To ascertain the *situs* of the employment benefits in that case, the Court articulated the “connecting factors” test. This test directs judges to apply a two-step process of identifying the factors that connect the property to the reserve, and assigning weight to those factors taking into account: (i) the purpose of the tax exemption, (ii) the type of property, and (iii) the nature of the taxation of that property. Gonthier J. further held that “[t]he 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 amount to the erosion of the entitlement of the Indian qua Indian on a reserve”.¹²

The Court in *Williams* adopted the conclusion from *Mitchell* that the purpose of section 87 was “to preserve the entitlements of Indians to their reserve lands and to ensure that the use of their property on their reserve lands was not eroded by the ability of governments to tax”.¹³ The purpose of section 87, the Court continued, “was not to confer a general economic benefit upon the Indians”.¹⁴

The Court in *Williams* identified the following connecting factors: the residence of the debtor, Mr. Williams’ residence, the place the benefits were paid, and the location of the qualifying employment. The most significant connecting factor was found to be the location of the qualifying employment, which had been carried out on reserve. The location of the debtor was given little weight on the basis that the federal Crown is present throughout Canada and may be sued anywhere in Canada. Finally, the Court held that Mr. Williams’ residence might have been potentially significant if it had pointed to a location different from that of the qualifying employment.

The Court adopted La Forest J.’s pronouncement in *Mitchell* concerning the purpose of section 87:

The 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).¹⁵

¹² *Ibid.* at para. 37

¹³ *Williams*, *supra* note 6 at para. 16

¹⁴ *Ibid.*

¹⁵ *Mitchell*, *supra* note 8 at para. 88, cited in *Williams*, *supra* note 6 at para. 16

The Court also noted that status Indians and bands have a choice: whether they “...remain within the protected reserve system or integrate more fully into the larger commercial world is a choice left to the Indian”.¹⁶

The Supreme Court’s references to “commercial mainstream” therefore, are embedded in the very case that sets out the connecting factors test. *Williams* cannot properly be read to say that if an Indian earns income from a company in the commercial mainstream, that income is, therefore, taxable. The real question is whether that income is located on or off reserve. It is entirely possible for income earned in the commercial mainstream to be located on reserve or, conversely, for income earned outside the commercial mainstream to be located off reserve. The key is to look to the test set out in *Williams* rather than focussing on the phrase “commercial mainstream” disembodied from the *Williams* decision itself.

V. POST-WILLIAMS CASE LAW AND THE NOTION OF THE “COMMERCIAL MAINSTREAM”

1. The Development of the “Commercial Mainstream” Concept

The application of the “connecting factors” test to the section 87 tax exemption has been the subject of dozens of cases. Some of these decisions, while logical in outcome, contain unfortunate *dicta* contrasting the “commercial mainstream” with the “traditional aboriginal way of life”. This was not, of course, the distinction that the Supreme Court of Canada was making in *Williams*.

A good example to this false dichotomy is *Folster v. The Queen*.¹⁷ Here the Federal Court of Appeal held that the employment income of an aboriginal woman who worked as a hospital administrator was tax-exempt. The Court rejected the Tax Court’s decision to focus only on the location of the employer and the location of the hospital, which were both off-reserve. Instead, the Court assigned more weight to the nature of the employment and the circumstances surrounding it. The employee lived on reserve

¹⁶ *Williams*, *supra* note 6 at para. 18

¹⁷ *Folster v. The Queen* (1997), 148 D.L.R. (4th) 314 (F.C.A.) [*Folster*]

and worked at a hospital near the reserve which was dedicated to meeting the health needs of the reserve community. Taking these and other factors into consideration, the Court held that Ms. Folster's income was tax-exempt because it was intimately connected to the reserve.

Left at that, the decision represents a non-controversial application of the *Williams* connection factors test. The Court of Appeal, however, framed the purpose of section 87 as “the preservation of property held by Indians qua Indians on reserves so that their traditional way of life would not be jeopardized” (emphasis added).¹⁸ Further, the Court held that where “an Aboriginal person chooses to enter Canada’s so-called ‘commercial mainstream’, there is no legislative basis for exempting that person from income tax on his or her employment income”.¹⁹ In this context, the Court admitted that it had used the term “commercial mainstream” reluctantly, as it incorrectly suggests that commercial activity is foreign to First Nations.²⁰

In fact, the Supreme Court decisions in *Mitchell* and *Williams* in no way suggest that commercial mainstream activity could not attract section 87 protection. Indeed these decisions explicitly stated that income derived from such activity would be tax exempt provided that activity was located on reserve. Thus, a pulp mill selling into the “mainstream” economy generated section 87 protected income.²¹ The question wasn’t whether working at pulp mills was a traditional aboriginal activity. The question, correctly, was whether the income was located on reserve – applying the connecting factors test. The Federal Court of Appeal held it was.

*Recalma v. Canada*²² is another Federal Court of Appeal decision where the conclusion is not surprising but certain language in the judgment strays onto the wrong track. *Recalma* summarized the general approach to section 87 stating:

¹⁸ *Ibid.* at para. 16

¹⁹ *Ibid.* at para. 14

²⁰ *Ibid.* at para. 14

²¹ *Amos v. Canada*, [2000] 3 C.N.L.R. 1 (F.C.A.)

²² *Recalma v. Canada*, [1998] 3 C.N.L.R. 279, leave to appeal to S.C.C. refused, [1998] S.C.C.A. No. 250 [Recalma]

In evaluating the various factors the Court must decide where it "makes the most sense" to locate the personal property in issue in order to avoid the "erosion of property held by Indians qua Indians" so as to protect the traditional Native way of life. It is also important in assessing the different factors to consider whether the activity generating the income was "intimately connected to" the Reserve, that is, an "integral part" of Reserve life, or whether it was more appropriate to consider it a part of "commercial mainstream" activity.²³

While these comments are largely consistent with *Williams* they inject the issue of protection for the "traditional Native way of life" that is not necessarily relevant to the section 87 analysis. Further, the general language could be read to suggest that income is either located on reserve or flows from the commercial mainstream. In fact both of these propositions can be simultaneously correct.

The Court in *Recalma* correctly noted that the "commercial mainstream" concept was not a separate test for determining whether property is situated on reserve. Rather, the Court stated, it was intended to be an "aid" in assessing the weight of the various connecting factors to be considered.²⁴

In *Recalma*, the Court had to determine whether the investment income of the appellants was situated on reserve. The appellants were status Indians residing on reserve. Each of them purchased banker's acceptances and investment trusts at a branch of the Bank of Montreal located on reserve. The appellants argued that the investment income was situated on reserve, while Canada argued that it had been earned in the commercial mainstream.

The Federal Court of Appeal held that investment income:

... must be viewed in relation to its connection to the Reserve, its benefit to the traditional Native way of life, the potential danger to the erosion of Native property and the extent to which it may be considered as being derived from economic mainstream activity... Investment income, being passive income, is not generated by the individual work of the taxpayer. In a way, the work is done by the money which is invested across the land.²⁵

²³ *Ibid.* at para. 9

²⁴ *Ibid.* at para. 9

²⁵ *Ibid.* at para. 11

The Court held that the income was earned in the commercial mainstream through investments off reserve. The Court concluded, in effect, that while the investments were purchased on reserve, the branch of the bank only acted as an agent in off-reserve transactions.

After concluding that the income earned in this case was not tax-exempt under section 87, the Court held that:

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. The result may, of course, be otherwise in factual circumstances where funds invested directly or through banks on reserves are used exclusively or mainly for loans to Natives on reserves. 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.²⁶

On the facts of the case the conclusion is not surprising. The risk, again, is that the language will be read acontextually. The juxtaposition of tax exemption and the “general mainstream of the economy” points away from the real test: the on or off reserve location of the income.

2. Application of the “Connecting Factors” Test Post-*Recalma*

a. Economic Development

Three months after *Recalma* the Supreme Court of Canada rendered its decision in *Union of New Brunswick Indians v. New Brunswick (Minister of Finance)*.²⁷ In *Union of NB Indians*, the Court had to consider whether the respondent Indians were exempt from paying provincial sales tax on goods purchased off reserve for on-reserve use. McLachlin J., as she then was, held that since the tax in question was a sales tax, the

²⁶ *Ibid.* at para. 14

²⁷ *Union of New Brunswick Indians v. New Brunswick (Minister of Finance)*, [1998] 1 S.C.R. 1161 [*Union of NB Indians*]

issue was the location of the property at the point of sale. Since that was off reserve, the Court denied the Indians' claim.

The Court endorsed a plain meaning interpretation of section 87. McLachlin J. also emphasized that the point-of-sale test would provide an incentive for aboriginal peoples to establish businesses on reserve, hence resulting in increased economic activity and employment on reserve.²⁸ Implicit in the Court's decision is, therefore, the proposition that "commercial mainstream" activities carried out on reserve are exempt from tax pursuant to section 87. Thus, involvement in the commercial mainstream does not rule out the applicability of section 87; indeed section 87 is meant to promote the location of certain aspects of the commercial mainstream on reserve.

The Supreme Court's recognition of the importance of the role of section 87 of the *Indian Act* in fostering economic development on reserve was echoed by the Federal Court of Appeal in *Monias v. Canada*.²⁹ In that case, the Court held that the "purpose of section 87 is to protect reserve lands, and Indians' personal property on a reserve, from erosion, so that the Bands are able to sustain themselves on the reserves as economic and social units" (emphasis added).³⁰

It is submitted that this framing of the philosophy underlying section 87 better captures the entire jurisprudence than does the false dichotomy between the "commercial mainstream" and the "traditional native way of life".

b. Employment income case law

In *Bell v. Canada*,³¹ the appellants were status Indians who were employed by a fishing company. The company was owned by James Walkus, a status Indian, and its office was on reserve. The Court had to consider whether the appellants' employment income derived from their work with the fishing company was situated on reserve and thus tax-exempt under section 87.

²⁸ *Ibid.* at para. 44

²⁹ *Monias v. Canada*, [2001] 4 C.N.L.R. 194 (F.C.A.), leave to appeal to S.C.C. refused, [2001] S.C.C.A. No. 482

³⁰ *Ibid.* at para. 23

³¹ *Bell v. Canada*, [2000] 3 C.N.L.R. 32 (F.C.A.), leave to appeal to S.C.C. refused, [2000] S.C.C.A. No. 372 [*Bell*]

The Court applied the “connecting factors” test articulated in *Williams*. Even though James Walkus’ company had an office on reserve, the Court concluded that the income of its employees was taxable. The Court agreed with the Tax Court that the residence of the appellants (on reserve for some and off reserve for others) was not a connecting factor that should be assigned much weight. Similarly, the Court found that the fact that the company had an office on reserve should be ascribed little weight, as few activities were carried out there. Also, the Court found that the fact that the fishing itself was performed off reserve was not determinative, as that was where the fish were.

The most important connecting factor, in the Court’s opinion, was the nature of the employment and the way it was carried out. The Court agreed with the Tax Court’s rulings that there was no evidence that the company’s fishing activity had a close connection to the reserve or that the company carried on its business in a manner different than a non-Indian company would. The Court concluded that the company’s fishing activity “was simply a commercial activity: its catch entered directly into the mainstream of commerce”.³²

Based on the above conclusions, the Court held that the appellants were not engaged in a business that was integral to the life of the reserve and were, therefore, not entitled to the section 87 tax exemption.

A significant body of evidence that could have linked the income to the life of the reserve was not adduced at trial in *Bell*. This was the well documented historical fact that coastal Indian reserves were generally set apart on small and unproductive parcels of land on the basis that these reserves would provide a base for the Indian’s principal livelihood: commercial fishing. Thus, a profound connecting factor was simply not before the Court in that case.

The Federal Court of Appeal commented further on the location of income in *Akiwenzie v. Canada*.³³ Mr. Akiwenzie was a status Indian employed with the Department of

³² *Ibid.* at para. 13

³³ *Akiwenzie v. Canada*, [2004] 2 C.N.L.R. 1 (F.C.A.), leave to appeal to S.C.C. refused, [2004] S.C.C.A. No. 49 [*Akiwenzie*]

Indian Affairs and Northern Development. He spent about a fifth of his time on various reserves and the rest of his office in Hull, Quebec. The Crown conceded that 20 percent of his income was tax-exempt pursuant to section 87, but contended that the remaining 80 percent was taxable.

The Tax Court judge found that Mr. Akiwenzie was entitled to a tax exemption on all of his employment income. He found that his employment was “integral to the future of reserves” and that “everything he did, he did as an Indian *qua* Indian”:

His employment was anything but caught up in a commercial mainstream: his duties were integral to the future of reserves. Everything he did he did as an Indian *qua* Indian, be it fighting for Indian rights, raising a family on the reserve, restoring pride in Indians on reserves or working through the only agency in Canada for which he might truly be in a position to integrally affect the lives of Indians on reserves. His office could have just as readily been on a reserve as in Hull: there was a 'commercial mainstream' as such that required duties to be performed from an office in Hull.³⁴

The Tax Court held that while Mr. Akiwenzie’s employment was not sufficiently connected to the reserve on which he resided, it was connected to “each and every reserve in Canada” and that he had “no less of a connection with a reserve simply because he had contact with 480 reserves”.³⁵

The Federal Court of Appeal disagreed with the Tax Court’s conclusions. Noël J.A. held that the fact that Mr. Akiwenzie was a “genuine Indian” and his duties were “integral to the future of reserves” was not sufficient to situate his income on these reserves.

These factors, the Court held:

... have nothing to do with the preservation of the respondent's personal property *qua* Indian on these reserves. Specifically, it cannot be said that the taxation of the respondent's income would result in the erosion of his entitlement *qua* Indian on any or all of these reserves as there is no connection whatsoever between this income as such and these reserves as economic bases or physical locations.³⁶

³⁴ *Akiwenzie v. Canada*, [2003] 2 C.N.L.R. 1 (T.C.C.) at para. 57

³⁵ *Ibid.* at paras. 58-59

³⁶ *Akiwenzie, supra* note 33 at para. 13

The Court concluded that Mr. Akiwenzie's income was situated at the Department of Indian Affairs and Northern Development office and was, therefore, subject to taxation.

The Court of Appeal's decision is consistent with the function of section 87 rejecting, as it does, the Trial Court's incorrect emphasis on whether the income was earned in the "commercial mainstream". Here the income was not earning in the commercial mainstream, but neither was it exempt from taxation. Why not? Because it was not situated on reserve.

The Federal Court of Appeal had previously dealt with similar facts in *Stacey-Diabo v. Canada*.³⁷ Like Mr. Akiwenzie, all of the appellants but one worked for the Department of Indian Affairs and Northern Development. While they resided in the National Capital Region, their work was for the benefit of aboriginal peoples across Canada.

The Tax Court judge held in *Stacey-Diabo* that "[w]hile the appellants' work helped maintain and enhance the quality of life on reserves for the members of the bands living there, it did not connect the acquisition or use of their employment income to the reserves as physical locations".³⁸ Given the appellant's admission that broader opportunities existed for them off reserve, the Tax Court judge concluded that they had "accepted fuller integration into the larger commercial world and thereby accepted dealing on the same basis as all other Canadians".³⁹ Since the Tax Court did not find a benefit to the appellants' own reserves, their income was found to be taxable. The Federal Court of Appeal found no error in the Tax Court judge's reasons.

Stacey-Diabo, it is submitted, was correctly decided but for the wrong reasons. It wasn't the fact that the employees were fully integrated into the larger commercial world that was critical. The critical fact was that their employment was not connected to the "reserve" as an economic and social unit. Had the individuals lived on reserve and been employed by a major commercial or industrial enterprise located on reserve there

³⁷ *Stacey-Diabo v. Canada*, 2003 D.T.C. 5723 (F.C.A.), aff'g 2003 D.T.C. 200 (T.C.C.) [*Stacey-Diabo*]

³⁸ *Ibid.* (T.C.C.) at para. 69

³⁹ *Ibid.* (T.C.C.) at para. 72

can be little doubt that their income would be tax exempt – even if the factory or facility were fully integrated into a national or global market.

Various cases have considered the issue of whether section 87 requires the property to be situated on the taxpayer's own reserve. In *Desnomie v. Canada*,⁴⁰ the Federal Court of Appeal doubted whether the section 87 exemption applies to personal property located on a reserve other than the taxpayer's own reserve.⁴¹ The Court held that when:

... in the context of a connecting factors analysis, the location of the employer, employee, employment and place where the payment is made are all far from any reserve and in particular the appellant's own reserve, it is not inappropriate to have regard to remoteness in relation to a reserve in determining whether property is held by an Indian qua Indian on a reserve.⁴²

This view received some support in *Shilling v. Canada (M.N.R.)*,⁴³ although the Court in that case declined to decide whether the words "a reserve" should be interpreted to restrict the tax exemption to the taxpayer's own reserve.

As a result, while there is some uncertainty in the jurisprudence, there are indications that the section 87 tax exemption could be interpreted to apply only to an Indian's own reserve. It may be argued, however, in the appropriate case, that this is just the sort of hard and fast rule-driven approach that the Supreme Court of Canada was trying to avoid when it established the purposive and fact-driven connecting factors test.

c. Business income case law

There have been two significant section 87 cases dealing with business income. The first is *Southwind v. Canada*.⁴⁴ In that case, the property at issue was the income of a status Indian who resided on reserve and owned a logging business. His business

⁴⁰ *Desnomie v. Canada* (2000), 186 D.L.R. (4th) 718 (F.C.A.), leave to appeal to S.C.C. refused, [2000] S.C.C.A. No. 297

⁴¹ *Ibid.* at para. 21

⁴² *Ibid.* at para. 26

⁴³ *Shilling v. Canada (M.N.R.)*, [2001] 3 C.N.L.R. 332 (F.C.A.), leave to appeal to S.C.C. refused, [2005] S.C.C.A. No. 262

⁴⁴ *Southwind v. Canada*, [1998] 2 C.N.L.R. 233 (F.C.A.), aff'g [1995] T.C.J. No. 788 (T.C.C.) (QL) [*Southwind*]

provided logging services exclusively to a non-Indian business off reserve. Mr. Southwind spent most of his work time logging off reserve, but returned to his home on reserve to perform the administrative work connected with his business. He was paid by cheque drawn on the off-reserve company's bank account.

Canada argued that the following connecting factors ought to be considered in determining the *situs* of Mr. Southwind's business income: (i) the location of the business activities; (ii) the location of the customers; (iii) the location where the business decisions were made; (iv) the nature of the work and the business; (v) the place where payment was made; (vi) the degree to which the business was in the "commercial mainstream"; (vii) the location of a fixed place of business; and (viii) Mr. Southwind's residence.

The Tax Court judge considered all those factors and concluded that Mr. Southwind's income was not situated on reserve for the purposes of section 87. The Federal Court of Appeal agreed and noted, in particular, that while it was significant that Mr. Southwind resided, stored the business records and performed administrative work on reserve, he had not engaged in a business "integral to the life of the Reserve", but in a business that is in the "commercial mainstream".⁴⁵

The *Southwind* decision was applied by the Tax Court of Canada in *Cleary v. Canada*.⁴⁶ The appellants in that case were two status Indians who earned income through a partnership. Neither of them lived on reserve. The partnership performed part of its commercial activities on reserve, but its only client was CCI, a corporation owned by the appellants that carried on business in the Montréal region. The partnership's suppliers were also off reserve.

The Tax Court judge found that the connecting factors set out in *Southwind* were applicable to the case at bar, and analyzed each in turn. When he came to consider the degree to which the business was in the "commercial mainstream", the Tax Court judge

⁴⁵ *Ibid.* at para. 13

⁴⁶ *Cleary v. Canada*, 2005 D.T.C. 12 (T.C.C.), aff'd [2006] A.C.F. No. 353 (F.C.A.) [*Cleary*]

found that the partnership constituted “an artificial extraction of profit made by CCI in the operation of its business in the Montréal region”.⁴⁷

He also noted that the evidence pointed to tax planning. This comment is striking, especially when contrasted with the prior recognition by the British Columbia Court of Appeal in *Danes v. The Queen*⁴⁸ of aboriginal peoples’ right to engage in tax planning like every other Canadian:

I do not think the exemption is defeated merely because it may appear the purchase was arranged in such a way as to attract the exemption. Taxpayers are entitled to organize their affairs to obtain the advantages provided by law. If a legal right is abused then the remedy lies with the legislators, not with the courts, whose function it is to interpret the legislation, not to amend or repeal it.⁴⁹

The Court’s conclusion in *Cleary* was that the appellants’ business income was not sufficiently connected to the reserve and was, therefore, subject to taxation. The Federal Court of Appeal upheld that decision.

These two cases underline a potential confusion as to the role of the concept of “commercial mainstream” in applying the *Williams* connecting factors test. As the Supreme Court of Canada has pointed out, income is always tax exempt if located on reserve. Mainstream commercial activities can be and are located on reserve. Indeed, as the Supreme Court of Canada has noted, section 87 is meant to generate economic activity on reserve – whether “mainstream” or otherwise. The correct approach to section 87 analysis, then, is to apply the *Williams* connecting factors test. If the income generating income in question is within the “commercial mainstream” the Courts must carefully assess whether this fact is indicative of income located on reserve, or income located off.

⁴⁷ *Cleary*, *supra* note 46 at para. 43

⁴⁸ *Danes v. The Queen* (1985), 61 B.C.L.R. 257 (C.A.)

⁴⁹ *Ibid.* at para. 28

d. Investment income case law

*Sero & Frazer*⁵⁰ and *Lewin*⁵¹ addressed the issue of whether the interest earned in respect of an Indian's account at a financial institution's on-reserve branch was exempt from tax under section 87. The tax exemption was denied in these cases mainly because the financial institution derived income from off-reserve investments.

The appeals of Ms. Sero and Mr. Frazer were heard together by the Tax Court. Both were status Indians who had deposited funds in term deposit accounts with an on-reserve branch of the Royal Bank. Ms. Sero never resided on a reserve and the deposits were derived from her employment off reserve. In contrast, Mr. Frazer lived and owned a business on reserve, and the funds deposited were savings derived from his on-reserve business.

The appellants' main argument was that the accounts, and therefore the income they generated, were deemed to be on reserve by virtue of section 461 of the *Bank Act*⁵² which provides that the debt represented by a deposit with a bank is enforceable only at the branch where the deposit was made. The Crown argued that the approach advocated by the appellants was the very conflict-of-laws approach rejected in *Williams*.

The Tax Court judge agreed with the Crown that section 461 was not determinative and applied the "connecting factors" test. Citing *Recalma*, he held that the main factor was the location of the income-generating activity underlying the income. He found this to be off reserve, even in Mr. Frazer's case. The fact that Mr. Frazer had generated the capital for his investment through a business on reserve was overridden by the *situs* of the bank's income-generating activities. The Federal Court of Appeal upheld the Tax Court's decision.

Shortly before the *Sero & Frazer* case was decided, the Tax Court rendered its decision in *Lewin*. Mr. Lewin did not live on reserve but had placed his name on a waiting list to

⁵⁰ *Sero v. Canada; Frazer v. Canada*, [2001] 4 C.N.L.R. 307 (T.C.C.), aff'd, [2004] 2 C.N.L.R. 333 (F.C.A.), leave to appeal to S.C.C. refused, [2004] S.C.C.A. No. 88 and [2004] S.C.C.A. No. 89 [*Sero & Frazer*]

⁵¹ *Lewin v. Canada*, 2001 D.T.C. 479 (T.C.C.), aff'd 2003 D.T.C. 5476 (F.C.A.), leave to appeal to S.C.C. refused, [2003] C.S.C.R. no 19 [*Lewin*]

⁵² *Bank Act*, S.C. 1991, c. 46, s. 461

do so. He deposited money in an account with a credit union that had its head office and chief place of business on reserve. The credit union was solely run by Indians on reserve, but made investments off reserve. The issue was whether Mr. Lewin, a status Indian, was entitled to a section 87 exemption from taxation on the income generated by his credit union account.

The Tax Court judge denied the tax exemption and his decision was upheld by the Federal Court of Appeal. One of the reasons given by the Tax Court was that while the credit union was run by Indians, “any non-Indian could have been a member and, in theory, it would have been possible for non-Indians to control and run it, although its situs did not lend itself to this”.⁵³ This theoretical possibility, acknowledged by the judge to be remote, was considered more significant than the actual way in which the credit union was run.

Further, the Tax Court judge noted that not only were the credit union’s activities not aimed exclusively at the development of the First Nation, but also the services provided by the credit union could have been provided by any financial institution off reserve. Finally, the Court also considered it relevant that the credit union made investments off reserve.

The source of the financial institution’s income was a highly significant consideration in this case as it had been in *Sero & Frazer*. Taken together these cases underline that it will be difficult to draw investment income under the protective umbrella of section 87. The cases do leave open, however, the potential for the design of an investment product that could offer the advantage of section 87 applicability.

e. Recent Developments

The section 87 tax exemption was found to apply in *Phillips v. Canada*.⁵⁴ In that case, the Tax Court applied the “connecting factors” test and made no mention of the concept of the “commercial mainstream”.

⁵³ *Lewin*, *supra* note 51 at para. 61

⁵⁴ *Phillips v. Canada*, [2006] T.C.J. No. 35 (T.C.C.) (QL) [*Phillips*]

At issue in *Phillips* was the application of section 87 to the levying of Goods and Services Tax (“GST”). The Canada Revenue Agency’s (“CRA”) policy provides that “[s]ervices acquired on or off a reserve by an Indian band or band-empowered entity (incorporated or unincorporated) for band management activities or for real property on a reserve are not subject to the GST/HST”.⁵⁵ Mr. Phillips, relying on policy, did not collect GST on fees from First Nations for various educational conferences he provided at reserve locations. Despite CRA’s policy, the CRA reassessed Mr. Phillips on the basis that Mr. Phillips should have applied GST to the conference fees.

The Court had to consider two issues:

- (i) whether the conference fees were property; and
- (ii) if the conference fees were property, whether that property was situated on reserve.

The conference fees were paid in advance and the right to attend was transferable. The Court found, therefore, that the property purchased was the right to attend the conferences at a future date and that it was intangible personal property.

In determining the *situs* of this property, the Tax Court judge applied the “connecting factors” test. After analyzing the relevant connecting factors, he held that there was a strong nexus between the property and the reserves. In particular, the Court found it significant that the property was acquired by Indian bands and band entities in the course of operating education and health facilities to ameliorate the quality of life of Indians on reserve and the administration of the reserve lands. The Court found that the acquisition of the property was physically linked with the reserve by the presence on the reserve of the bands when they acquired the rights, and by the purpose for which the rights were acquired. This, in the Court’s view, was “indicative of a strong nexus

⁵⁵ Canada Revenue Agency, GST/HST administrative policy - Application of the GST/HST to Indians, B-039R2, October 2005

between the property and the occupation of the reserve lands by the Indian bands and band entities”.⁵⁶

Based on the above factors, the Tax Court judge ruled that the right to attend the conferences were on reserve at the time they were acquired. Since he held that GST attaches at the moment that the property is acquired, he concluded that the section 87 tax exemption applied to the conference fees.

f. Summary

The connecting factors test, as set out in the Supreme Court of Canada in *Williams*, didn't turn on whether an activity was, or was not, part of the “commercial mainstream”. The Supreme Court of Canada did use this phrase but only as a way of underlining that activities which were largely unrelated to Indian reserves would not benefit from this section 87 tax exemption. Indeed, the Supreme Court of Canada has made it clear that income derived from mainstream commercial activities will fall within the ambit of section 87 protection as long as this income is situated on reserve. Further, the Supreme Court of Canada has explained that section 87 is meant to promote commercial development on reserve. Accordingly, it is submitted that the dichotomy implied by some cases between the “commercial mainstream” and the “traditional native way of life” is a jurisprudential blind alley.

VI. ACCOMMODATION AND ABORIGINAL TAX ISSUES

The existence of section 87 of the *Indian Act*, especially when considered together with the ability of First Nations to tax third party land interests on reserve, may provide a bridge in certain circumstances to resolving difficult issues concerning accommodation.

As discussed elsewhere in the conference materials, when a third party seeks permission from the Crown to conduct industrial or commercial activities on Crown land within the traditional territory of a First Nation, the Crown's honourable and constitutional obligation to consult and accommodate the First Nation will likely be

⁵⁶ *Phillips*, *supra* note 54 at para. 43

triggered. This is true whether the land is subject to claims of aboriginal rights and title⁵⁷ or Treaty rights.⁵⁸ The jurisprudence clearly establishes that the obligation to consult and accommodate has both procedural and substantive aspects.⁵⁹

If a third party is able to propose the siting of some or all of its operations on reserve land, the company may be able to address many of the economic interests of the First Nation without necessarily incurring an additional expense. If the industrial or commercial facility is located exclusively on reserve then it is almost certain that the section 87 tax exemption will be triggered for First Nation employees at the facility. Further, the First Nation will have the jurisdiction, through its bylaw making powers, to levy property taxes on the facility and thereby raise revenues that can be applied to the pressing social and economic needs of the community.

Even if it is impossible to locate the entire facility on reserve it may be possible to confer tax benefits on the First Nation by locating a portion of the facility on reserve. In *Amos* the Federal Court of Appeal examined the situation where the First Nation had contracted with a company to allow a portion of the company's facilities to be situated on reserve. The integrated nature of the facility enabled the Federal Court of Appeal to conclude that the income earned by Indian employees of the company was subject to section 87 protection even though these employees worked at a portion of the facility that was off reserve.⁶⁰

Thus, while the obligation to consult and accommodate lies with the Crown and flows from constitutionally protected aboriginal or Treaty rights, in certain circumstances, at least a partial resolution may be facilitated through the creative use by the First Nation and the third party proponent of Indian reserve lands and of the statutory taxation exemption and the taxation authority set out in the *Indian Act*.

⁵⁷ *Haida Nation v. British Columbia (Minister of Forests)*, [2004] 3 S.C.R. 511 and *Taku River Tlingit First Nation v. British Columbia (Project Assessment Director)*, [2004] 3 S.C.R. 550

⁵⁸ *Mikisew Cree First Nation v. Canada (Minister of Canadian Heritage)*, [2005] S.C.C. 69

⁵⁹ "Meaningful Consultation: Reconciliation through an Honourable Process" by Jennifer Griffith presented at the Insight Information 2nd Annual Western Canada Aboriginal Law Forum, May 8, 2006

⁶⁰ *Amos*, *supra* note 21, para. 3

VII. TREATY NEGOTIATIONS AND THE FUTURE OF SECTION 87

No treaties have yet been signed under the British Columbia Treaty Process but a good number of First Nations are advancing through the process. The emerging model being advanced by Canada and British Columbia within the British Columbia Treaty Process would see the elimination of reserve lands as a requirement for a modern-day Treaty.

There are advantages and disadvantages to reserve land. The disadvantages are well known and are often emphasized by Federal and Provincial negotiators during the Treaty negotiation process. Management and development of reserve lands can become difficult and cumbersome. The Department of Indian Affairs is often perceived as standing in the way of, or at least slowing, the implementation of rational land use decisions.

Reserve land status, on the other hand, carries with it significant potential benefits. As noted above, Indian reserve status is the foundation of the *Indian Act* tax exemption for personal property (including income) situated on reserve. The ability of First Nations to tax non-First Nation users of their reserve lands can be a major source of economic development for First Nations. The *Indian Act* protections from seizure are also linked to the reserve status of land. Accordingly, the loss of reserve status may, depending on the First Nation involved, be a significant price to pay for reaching a Treaty.

The emerging British Columbia Treaty Process model would see tax exemptions being phased out over 8 or 12 years from the date of Treaty depending on the nature of the tax involved. British Columbia First Nations who are not part of the British Columbia Treaty Process are not required to abandon the tax exemption. Neither are British Columbia First Nations who entered into Treaty 8 over a century ago. Elsewhere in Canada, of course, First Nations living under numbered treaties have never been asked to abandon these significant tax advantages.

In British Columbia, both levels of government are taking a very strong position that these tax exemptions must be abandoned if a First Nation wishes a Treaty within the British Columbia Treaty Process. This position has often been justified by a reference

to “equality”. This justification rings hollow. First it fails to take into account the century-and-a-half of injustice at the aboriginal peoples in British Columbia. Suddenly treating everyone the same way will not make up for this sorry history of unequal treatment. The current approach draws to mind Tommy Douglas’ commonly attributed description of free enterprise: “every man for himself, as the elephant said, dancing amongst the chickens”.

The current approach would create a patchwork quilt of First Nations who entered into numbered treaties long ago, and therefore retain their tax exemption, First Nations who have rejected the British Columbia Treaty Process and therefore retain their tax exemption, and those who have decided to reconcile their modern day claims with Canada and British Columbia and have therefore lost their tax exemption.

The current approach would put into place arbitrary distinctions between First Nations within and outside of British Columbia. It would create arbitrary distinctions between First Nations within British Columbia itself. The McLeod Lake First Nation, for example, received a considerably greater financial benefit and land base than is presently being proposed for any First Nation involved in the British Columbia Treaty Process.⁶¹ Because the McLeod Lake First Nation resolved its claims through a modern day adherence to an old numbered Treaty (Treaty 8), McLeod Lake will retain their Indian reserve-based tax exemption.⁶²

Lawyer Graham Allen has noted the significance of Crown intransigence on the tax exemption issue to the collapse of the Sechelt Treaty negotiations. In his interesting article⁶³ Mr. Allen sets out a detailed alternative to the Crown’s favoured model; ultimately rejected by British Columbia and Canada. There can be little doubt that the Crown’s ideology-driven position interferes with the Crown’s ability to achieve proper reconciliation through modern day treaties.

⁶¹ McLeod Lake Indian Band Final Agreement dated March 27, 2000

⁶² *Ibid.*

⁶³ “Taxation Aspects of the Sechelt Agreement-in-Principle” by W. Graham Allen, *Canadian Tax Journal*, (2000), Vol. 48, No. 6 1817

In practical terms, unless and until the Crown changes its position on this issue, it makes sense for a First Nation to determine whether, from a financial perspective, it is giving up more by entering into a Treaty than it stands to gain. An assessment should be made of what would be given up if the tax exemptions from income tax and transaction taxes were brought to an end. This calculation should be part of the First Nation's research within the Treaty process. It is hard to see how a First Nation could reasonably vote on a proposed Treaty without a clear understanding of the financial cost of the Treaty as well as the financial benefits. Without this information a Treaty would, in essence, be a shot in the dark.

VIII. CONCLUSION

Section 87 of the *Indian Act* is, as it was always meant to be, an important protection to the integrity of Indian reserve communities. A healthy community requires a healthy economy and, the Supreme Court of Canada has advised, this is what the section 87 tax exemption is meant to foster. A proper understanding of section 87 will help to eliminate a misuse of the concept of "commercial mainstream" when interpreting section 87. It may help to bridge potential divides between third parties and aboriginal communities by offering opportunities for economy accommodation. This understanding may allow governments to back away from their dogmatic insistence on the abolition of tax exemption through modern-day treaty negotiations. If not, at least it will allow First Nations to understand the scope and nature of the benefits that they enjoy – knowledge critical to the Treaty negotiation process itself.