

Section 87 of the *Indian Act*: More Tax, Less Exemption

By Christopher Devlin¹

1. INTRODUCTION

Section 87 of the *Indian Act*² states:

87. (1) Notwithstanding any other Act of Parliament or any Act of the legislature of a province, but subject to section 83 and section 5 of the *First Nations Fiscal and Statistical Management Act*, the following property is exempt from taxation:

- (a) the interest of an Indian or a band in reserve lands or surrendered lands; and
- (b) the personal property of an Indian or a band situated on a reserve.

(2) No Indian or band is subject to taxation in respect of the ownership, occupation, possession or use of any property mentioned in paragraph (1)(a) or (b) or is otherwise subject to taxation in respect of any such property.

While the meaning of “personal property of an Indian or a band situated on a reserve” would appear to be obvious, the provision has been the subject of prolonged legal wrangling.

In the particular, the courts have struggled with the treatment of intangible property such as wages, investment returns and business income. The Supreme Court of Canada (“SCC”) decision *Williams v. The Queen* (“*Williams*”)³ marks a major shift in the Section 87 jurisprudence. As discussed below, *Williams* offers a more nuanced, but also a less concrete mechanism for applying Section 87. As a result, the courts have continued to grapple with the scope of Section 87.

Underlying these struggles is a fundamental disconnect with respect to the purpose of section 87. While applicants have linked the section to economic development aimed at remedying the historical injustices faced by aboriginal peoples, the courts have consistently limited the purpose of the section to protecting on reserve aboriginal assets.

2. WHO DOES SECTION 87 APPLY TO?

Section 87 applies to “Indians” and “Bands.” Under 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”, while a Band is

¹ Much thanks to Tim Watson, articled student at Devlin Gailus, for his tremendous assistance in the preparation of this paper.

² *Indian Act*, R.S.C. 1985, C.-1.

³ *Williams v. Canada*, [1992] 1 S.C.R. 877

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defined 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.

As a result, the section 87 tax exemption is *not* available to non-status Indians, Inuit or Métis peoples. Nor is the exemption available to corporations because a company cannot, by definition, be an Indian.

3. EARLY CASE LAW

Nowegijick

Nowegijick v. The Queen (“*Nowegijick*”)⁴ was the first major case in which the Supreme Court of Canada (“SCC”) considered the application of section 87. Mr. Nowegijick, a status Indian who resided on reserve, worked as a logger for a corporation based on reserve. While he carried out his work off reserve, he claimed that his wages were the property of an Indian situated on reserve and therefore should be tax exempt under section 87.

The SCC determined that the location of employment income is where the debtor is situated (the employer), because this is where the debt can be enforced. As a result, because Mr. Nowegijick’s employer resided on reserve, his income was situated on reserve and thus tax exempt under section 87.

Mitchell

Seven years later, the SCC commented again on section 87 in *Mitchell v. Peguis Indian Band* (“*Mitchell*”).⁵ While the facts in *Mitchell* did not deal with section 87, the SCC’s comments on the section have been picked up in later cases.

In *Mitchell*, a law firm attempted to garnish funds from the Peguis Indian Band (the “Peguis”), in order to discharge an outstanding legal bill. The Peguis argued that the funds could not be garnished due to section 89 of the *Indian Act*.

During its examination of section 89, the SCC also discussed the intent and purpose of sections 87:

The historical record makes it clear that ss. 87 and 89 of the Indian Act, the sections to which the deeming provision of s. 90 applies, constitute part of a legislative "package" which bears the impress of an obligation to native peoples which the Crown has recognized at least since the signing of the Royal Proclamation of 1763. From that time on, the Crown has always acknowledged that it is honour-bound to shield Indians from any efforts by non-natives to dispossess Indians of the property which they hold qua Indians, i.e., their land base and the chattels on that land base.

...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

⁴ *Nowegijic v. The Queen*, 83 D.T.C. 5041 (S.C.C.)

⁵ *Mitchell v. Peguis Indian Band*, [1990] 2 S.C.R. 85.

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.⁶

....

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.⁷

The Court's characterization of the purpose of section 87 as reference to "the commercial mainstream" is key, as the theme of the "commercial mainstream" is repeated in later section 87 cases as discussed below.

4. **WILLIAMS ("connecting factors test")**

The SCC revisited section 87 in *Williams*, reigning in the "inclusive" test set out in *Nowegijick*. The decision in *Williams* introduced the 'connecting factors test' which has become the method for evaluating the application of section 87. In essence, *Williams* overruled the *Nowegijick* proposition that the employer's location is the only factor in examining the application of section 87.

In *Williams*, the SCC examined the case of a status Indian who worked for an Indian Band. All of Mr. Williams' duties were carried out on reserve; he was paid on reserve and resided on reserve.

When Mr. Williams' job ended, he applied for unemployment insurance. He did not pay tax on his unemployment insurance income. The Canada Revenue Agency ("CRA") applied the *Nowegijick* test and found that despite the fact that the employment income which corresponded to the unemployment insurance was tax exempt under section 87, the unemployment benefit income should be taxed because the cheques were issued from an office located in Vancouver, not on reserve. As a result, the SCC found that under the *Nowegijick* test the "employer" would be located off reserve.

However, the SCC found the location of the Crown to be an elusive concept and responded to the awkward facts in *Williams* by rejecting the *Nowegijick* "location of the debtor" analysis and replacing it with the "connecting factors" test. While location is still a consideration, the "connecting factors" test takes into account a spectrum of factors which are intended to reflect the purpose of section 87, as set out in *Mitchell*:

The question of the purpose of ss. 87, 89 and 90 has been thoroughly addressed by La Forest J. in the case of *Mitchell v. Peguis Indian Band*, [1990] 2 S.C.R. 85. La Forest J. expressed the view that the purpose of these sections 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, or creditors to seize. The corollary of this conclusion was that the purpose of the sections was not to confer a general economic benefit upon the Indians.⁸

⁶ *Mitchell*, para 88.

⁷ *Mitchell* para 108.

⁸ *Williams*, p. 12.

Under the “connecting factors” test, the location of intangible property is determined by evaluating the various connecting factors that tie a property to one location or another. The test has two steps: (1) identify the factors that connect the property to the reserve; and (2) assign weight to those factors taking into account:⁹

1. the purpose of the exemption;
2. the type of property in question; and
3. the incidence of taxation upon that property.¹⁰

According to *Williams*, “the ultimate question is to what extent each connecting factor is relevant in determining whether taxing the particular kind of property in a particular manner would erode the entitlement of an Indian *qua* Indian to personal property on the reserve.”¹¹

In *Williams*, the court identified the following connecting factors:

1. Place of residence of the employer;
2. Residence of the recipient of the payment; and
3. The location of the employment which gave rise to the benefits¹²

The SCC determined that the location of the employment which gave rise to the benefits was the most important factor and concluded that Mr. William’s unemployment insurance benefits were tax exempt.

5. APPLICATION OF THE CONNECTING FACTORS TEST: OVERVIEW

While the courts have considered numerous section 87 cases since *Williams*, the application of the “connecting factors” test has at times been inconsistent. Furthermore, the fact-specific nature of the test makes it difficult to identify overriding principles for the application of the exemption.

For ease of analysis, our discussion of the cases is broken down under the categories of employment income; economic development income; investment income, business income and point of sale taxation. The courts’ treatment of the *Mitchell* commercial mainstream criteria is also considered.

a. Employment Income

The body of case law applying the “connecting factors” test to employment income is large and at times inconsistent. Given the fact specific nature of the analysis and that the SCC has not commented substantially on section 87 since *Williams*, it is hard to enunciate general principles.

Following the *Williams* decision, the Canada Revenue Agency (“CRA”) produced a set of guidelines to help individuals assess whether their income falls under the section 87 exemption. The guidelines, which are outlined below, reflect perhaps a generous interpretation the courts’ application of the “connecting factors” test. More importantly, they suggest how the CRA will assess a given fact pattern:

⁹ *Williams*, p. 20.

¹⁰ *Williams*, p. 20.

¹¹ *Williams*, p. 20.

¹² *Williams*, p. 22.

1. Working mostly on reserve

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

Proration Rule

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

CRA Examples:

Examples where exempt

Mr. A works as a mechanic for an automobile repair shop, performing his duties in a garage located on a reserve. The wages he receives are exempt because the duties are performed on a reserve.

Mr. B lives off reserve and works as a driver for a heating-oil supplier, performing almost all of his duties making deliveries to houses on a reserve. The wages he receives are exempt because more than 90% of the duties are performed on a reserve.

Ms. C works in an office on a reserve. Her duties include a daily drive into a nearby town where she does the banking for the business and picks up the mail and supplies for the business. The wages she receives are exempt, although she incidentally leaves the reserve in the course of carrying out her duties.

Example where NOT exempt

Mr. D works for a logging company that is not resident on a reserve, cutting trees under license on provincial Crown land. The wages he receives are taxable because the land does not form part of a reserve. (Note: Mr. D lives on a reserve, but this factor alone is not sufficient to connect the income to a location on a reserve.)

2. Employee and employer live on reserve

- When the employer is resident on a reserve; and
- the Indian is resident on a reserve:

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

CRA Examples:

Examples where exempt

Mrs. H works for a logging company that is resident on a reserve. Mrs. H lives on a reserve, but performs her duties at lumber camps located off the reserve. Her employment income is exempt from income tax because the place where she lives and the residence of her employer are factors connecting her income to a reserve.

Mr. I is a construction worker employed by a construction company that is resident on a reserve, to work on building sites that are not located on a reserve. Mr. I lives on a reserve, except for short periods each year when he lives near the construction sites. When away from the reserve, he retains his residence on the reserve where his family lives. Mr. I is exempt from income tax on his employment income because the place where he lives and the residence of his employer are factors connecting his employment

income to a reserve.

Examples where NOT exempt

Ms. J lives on a reserve and works as an accountant at the head office of a bank located off reserve in a nearby city. The bank maintains a branch on Ms. J's reserve and arranges for her to be paid at that branch. Ms. J's employment income is taxable because the only substantive factor linking her employment income to a reserve is her residence which, without other substantial connecting factors, does not result in exemption. Payment on the reserve is viewed as a connecting factor of relatively little weight.

Mr. K is a construction worker employed by a corporation situated on a reserve. The corporation is an employment agency that makes employees available to work for clients that are not situated on a reserve, on building sites not located on a reserve. Mr. K lives on a reserve. The employment agency had an office on the reserve, but carried out very few of its business activities on the reserve. The guidelines would not apply in this case, and one must therefore do an analysis of the connecting factors. Mr. K's employment income is taxable because the residence of the employer in this case has little weight as a connecting factor. The only other substantive factor connecting Mr. K's employment income to a reserve is his residence, which is not sufficient to bring the employment income within the exemption.

3. If a person works partly on a reserve, but either the person or the employer live on a reserve
 - 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 of the income of an Indian from an employment will usually be exempt from income tax.

CRA Examples:

Examples where exempt

Ms. L lives on a reserve and works as a policewoman for an off-reserve employer. She performs more than one-half of her duties on reserve, and she has an additional connecting factor in that she lives on the reserve. Therefore, she is exempt on the whole of the employment income.

Examples where NOT exempt

Ms. M lives off reserve in a town where she works in a restaurant owned by a corporation resident on a reserve. Once a week, she drives to the reserve to pick up the pay cheques for the restaurant staff. She is taxable on the whole of her employment income because the only factor connecting the income to a reserve is the residence of the employer and, without other connecting factors, this is not sufficient to confer the exemption.

4. If a person does non-commercial work for certain Indian organizations
 - 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 the employment are in connection with the employer's non-commercial activities carried on exclusively for the benefit of Indians who for the most part live on reserves;

All of the income of an Indian from an employment will usually be exempt from income tax.¹³

CRA Examples:

Examples where exempt

Mr. N works for the education department of a tribal council at an off-reserve location central to several reserves. Mr. N lives off reserve and the tribal council is resident on one of the reserves. Mr. N is exempt from income tax on his employment income because the duties he performs for the tribal council are connected to the reserves served by the council, and the employer is resident on a reserve.

Ms. O is a librarian working for a technical training institute operated by five Indian bands for Indians who live on reserve. The administrative office of the institute is on a reserve.

Ms. O lives off reserve and works at an off-reserve location central to several reserves.

Ms. O is exempt from income tax on her employment income because the duties she performs for the Indian organization that employs her are connected to the reserves served by the Indian organization, and the employer is resident on a reserve.

Mr. P 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. P 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. P is exempt from income tax on his employment income because the duties he performs for the Indian organization that employs him are connected to the reserves served by the Indian organization, and the employer is resident on a reserve.

Ms. Q works for a company that is resident on a reserve and owned by a tribal council. The company exists to provide adequate low-cost housing on reserves and the company's property is for the most part on reserves. Ms. Q performs her duties at an off-reserve location central to several reserves. Ms. Q is exempt from income tax on her employment income because the duties she performs for the Indian organization that employs her are connected to the reserves served by the Indian organization, and the employer is resident on a reserve.

Mr. R works for an Indian organization that manages funds provided by the government to assist in planning for future education needs on reserves. His employer is resident on a reserve, but he works at a location off reserve. Mr. R is exempt from income tax on his employment income because the duties he performs for the Indian organization that employs him are connected to the reserves served by the Indian organization, and the employer is resident on a reserve.

Examples where NOT exempt

Mr. S works for a commercial building supplies company that is owned by a tribal council and is resident on a reserve. He performs his duties off reserve and lives off reserve. Mr. S is taxable on his employment income because, although there is one factor, the residence of the employer, connecting the income to a reserve, this factor by itself is not sufficient to confer the exemption when the employer and the employee are active in the

¹³ <http://www.cra-arc.gc.ca/brgnls/gdlns-eng.html>

commercial mainstream of society.

Ms. T works for an Indian organization dedicated to organizing social programs for off reserve Indians. The organization is located off reserve. Ms. T is taxable on her employment income because there are no factors connecting that income to a location on a reserve.

5. Employment-related income

- The receipt of unemployment insurance benefits, retiring allowances, Canada pension plan payments, Quebec pension plan payments, registered pension plan benefits or wage loss replacement plan benefits will usually be exempt from income tax when received as a result of employment income that was exempt from tax. If a portion of the employment income was exempt, then a similar portion of these amounts will be exempt.

CRA Examples:

Mr. U has always lived on a reserve and, until recently, he worked as a labourer for an employer located on the reserve. Mr. U is currently unemployed and receives Unemployment Insurance benefits. Since the income from employment that entitled him to these benefits was not subject to income tax, the Unemployment Insurance benefits will not be subject to income tax.

Mrs. V worked for a public health office located in a city off reserve. Throughout her career, one-fifth of her annual employment income was exempt from income tax because she spent one day a week performing her duties at a clinic on a nearby reserve. Upon retiring, Mrs. V received a retiring allowance from her employer and started receiving Canada Pension Plan payments. One-fifth of her retiring allowance and one-fifth of her Canada Pension Plan payments will not be subject to income tax.

b. Investment Income

The courts have consistently found that interest from investment activities that took place off reserve does not attract the section 87 exemption.¹⁴ A survey of jurisprudence suggests that the key connecting factor is whether the income-earning activities of the investment took place on reserve.

If the investment income was derived from dividends from a corporation located on reserve and the principal income-generating activities of the corporation are located on reserve; section 87 likely applies. Rental income from on reserve property also attracts the section 87 exemption.

However, the CRA takes the position that income from investments such as Canada Savings Bond interest is not exempt under section 87, even if the bond was purchased from an “on reserve” branch of a bank, using exempt-on reserve employment income. This position is currently being considered by the SCC in *Bastien v. Canada* (“*Bastien*”) and *Dubé v. Canada* (“*Dube*”).¹⁵

¹⁴ See *Recalma v. Canada* 98 D.T.C. 6238 (FCA); *Sero v. The Queen* and *Frazer v. Canada* 2004 FCA 6.

¹⁵ *Bastien v. Canada*, 2009 CAF 108; *Dubé v. Canada*, 2009 CAF 109

The key issue in *Bastien* and *Dube* is whether the investment income of a status Indian, generated by an on reserve financial institution, is subject to section 87. In both cases, the Federal Court of Appeal found that the financial institution's participation in global and Canadian capital markets had the effect of situating the investment income off reserve. This factor was found to trump the other connecting factors which linked the income to the reserve.

Hopefully, the SCC's decisions in *Bastien* and *Dube* will significantly clarify the law in relation to the application of section 87 to investment income. The SCC heard the appeal on May 20, 2010 and judgment is still reserved.

c. Business Income

The courts have also interpreted the application of section 87 exemption narrowly in relation to business income.

In *Southwind v. Canada* ("*Southwind*"), the Federal Court of Appeal considered the case of a status Indian who resided on reserve and operated a logging business.¹⁶

Southwind provided logging services exclusively to a non-Indian business situated off reserve. Administrative work was performed on reserve; however, the actual logging was carried out elsewhere. The business's banking was also conducted off reserve.

The Federal Court of Appeal agreed with the Tax Court finding that section 87 did not apply. Significantly, the Federal Court of Appeal noted that Southwind had not engaged in a venture "integral to the life of the reserve", but rather a business "in the commercial mainstream."¹⁷

Both courts suggested that the most significant connecting factor with regard to business income is whether the income earning activity takes place on reserve.¹⁸ This interpretation is also advanced by the CRA.¹⁹

Other connecting factors in examining business income that are suggested by the CRA include:

- Whether or not you live on a reserve;
- Whether or not you maintain an office on a reserve or take business orders from a location on a reserve;
- Whether your books and records are kept on a reserve;
- Whether your administrative, clerical or accounting activities take place on a reserve.²⁰

As discussed under employment income, if some revenue-generating activity takes place on reserve, the section 87 tax exemption may be pro-rated.

¹⁶ *Southwind v. Canada* 98 D.T.C. 6084 (F.C.A.).

¹⁷ *Southwind*, para 13.

¹⁸ *Southwind*.

¹⁹ <http://www.cra-arc.gc.ca/brgnls/stts-eng.html#heading5>

²⁰ <http://www.cra-arc.gc.ca/brgnls/stts-eng.html#heading5>

CRA Examples:

Example 1

John is a self-employed Indian logger who lives on a reserve. He cuts timber on land off the reserve and sells it off the reserve. John's income from this business is considered to be taxable, because his income-earning activities and customers are off the reserve.

Example 2

Delia is an Indian who owns a retail store on a reserve. The store sells goods to both Indian and non-Indian customers. Since Delia's business activities take place on a reserve, her income from this business is tax-exempt.

6. POINT OF SALE TAXATION

In *Union of New Brunswick Indians v. New Brunswick (Minister of Finance)* (“*New Brunswick*”), the SCC considered whether the section 87 exemption applied to goods purchased off reserve, but intended for use on reserve.²¹ The SCC found that the key issue was the location of the property at the point of sale. As the sale was conducted off reserve, the provincial sales tax applied.

The CRA takes the position that, in British Columbia, HST applies to taxed goods bought off reserve by Indians, Indian bands and unincorporated band-empowered entities unless the goods are delivered to a reserve by a vendor or vendor's agent, or the goods are purchased at a qualified remote store.²²

7. COMMERCIAL MAINSTREAM

In *Mitchell*, the SCC discussed the application of section 87 to activities that fall within the “commercial mainstream”:

...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.²³

....

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.²⁴

Allan Donovan's paper “The Evolving Interpretation and Significance of Section 87 of the *Indian Act*” argues that the key question is whether or not the income-earning activity takes place on or off reserve, not whether the

²¹ *Union of New Brunswick Indians v. New Brunswick (Minister of Finance)*, [1998] 1 S.C.R. 1161.

²² <http://www.cra-arc.gc.ca/brgnls/stts-eng.html#heading16> Note: Ontario has a point of sale exemption that allows Indians to avoid sales tax on goods intended to be used on reserve, regardless of whether they are purchased on reserve.

²³ *Mitchell*, para 88.

²⁴ *Mitchell*, para 108.

activity takes place within the commercial mainstream.²⁵ Section 87 can apply to activities within the commercial mainstream, if the income-earning activity and other connecting factors are sufficiently linked to the reserve.

Despite Donovan's astute analysis, the courts have from time-to-time rejected section 87 exemptions on the basis of the income-earning activity being in the commercial mainstream. The jurisprudence in this area is inconsistent and, in the author's opinion, at times incorrect.²⁶

8. LOOKING FORWARD

The courts have consistently narrowed the scope of section 87 since the *Williams* decision in 1992. As a result, section 87 provides a tax exemption for a limited number of Aboriginal people in specific circumstances.²⁷

While *Bastien* and *Dube* have yet to be decided, if the SCC continues along the current trend found in the lower courts, the scope of section 87 may be diluted even further.

²⁵ Allan Donovan, *The evolving Interpretation and Significance of Section 87 of the Indian Act*, www.aboriginal-law.com.

²⁶ Donovan provides a good overview of the judicial treatment of commercial mainstream in Donovan, "The Evolving Interpretation and Significance of Section 87 of the *Indian Act*."

²⁷ In 2003, Merle Alexander suggested that only 5.6% of status Indians would be eligible for the section 87 exemption. See Merle Alexander, *Income Tax Rules for Aboriginal People*, (Scow Institute: August, 2003).