Indian Tax Exemptions

- Why and on what basis do First Nations not have to pay tax?
- Do Indians have to pay income tax on wages earned from an employer located on or off-reserve?
- Do Indians and Indian businesses have to pay tax on business or investment income?
- Do Indians or bands have to pay provincial tax on purchases off-reserve if the goods are intended for use or consumption on-reserve?
- Have First Nations maximized their GST exemptions and taken full advantage of any input tax credits?

First Nations and First Nation peoples individually who have structured their business affairs to minimize their tax exposure based on past Revenue Canada rulings and directions are advised to review their tax planning strategy in light of recent court decisions. Significant uncertainty in federal policy as a result of the Williams and other court decisions justifies a closer examination at how First Nations should develop their tax planning strategies for the future. Several questions have been raised which this bulletin attempts to answer.

Basis For Tax Exemption

Q: Why and on what basis do First Nations not have to pay tax?

In determining the tax liability of First Nation peoples and businesses, the courts have focused primarily on the statutory provisions under either the Indian Act, the federal Income Tax Act or provincial sales tax legislation. The courts have not fully explored possible exemptions from having to pay tax under the numbered treaties, nor have they yet considered the tax provisions under various comprehensive claims settlements i.e. contemporary treaties.

The Income Tax Act, under section 81(1)(a), states that any amount which is declared to be exempt from income tax by other federal legislation is exempt from taxation. Falling under this provision, section 87 of the Indian Act exempts from taxation:

(a) the interest of an Indian or a band in reserve land or surrendered lands; and

(b) the personal property of an Indian or band situated on a reserve.

In terms of what constitutes "property situated on a reserve", section 90 of the Indian Act states that personal property either purchased with Indian money or monies appropriated by Parliament for Indians or bands or monies given to them under treaty or an agreement between the band and Her Majesty, are deemed always to be situated on the reserve.

For First Nations who have entered into comprehensive claim settlements, the terms of the settlement agreement usually set out the taxation rules. For example, under the Yukon Umbrella Final Agreement no tax will be charged on the settlement dollars transferred into Settlement Corporations on income earned on this amount through qualified investments while in the hands of the Corporations. Also Settlement Lands are deemed to not be reserves under provisions of the Indian Act, which means that the tax exemption in section 87 will not apply on Settlement Lands.

Tax on Income

Q: Do Indians have to pay income tax on wages earned from an employer located on or off-reserve?

Two Supreme Court of Canada decisions have influenced Revenue Canada's policy on the tax exempt status of income earned by Indians on-reserve. In Nowegijick the Supreme Court established two things in 1983: first, that income and wages are personal property which could be exempt under section 87 of the Indian Act; and second, that since income is a simple debt, the location of the corporation's head office on-reserve is a key factor in determining whether the employment income of an Indian employee is tax exempt. If the employer (corporation) is located on-reserve, the income of an Indian employee of that company is tax exempt regardless of where he or she performs the work.

This position was modified by the Williams decision of the Supreme Court in 1992. Now the location of the employer is just one "factor" to take into account in determining the tax exempt status of the income. The Court suggested that there may now be a wide range of "connecting factors" to take into consideration in concluding whether the debt is owed on-reserve. In this particular case, although the UIC benefits were paid by Canada off-reserve, the Court looked at the fact that the employer who made the UIC payments was on-reserve; the Court considered that the Indian employee worked and lived on-reserve; and the Court noted that his UIC contributions were based on work performed on-reserve. The court concluded that all these "connecting factors" pointed towards an on-reserve location and therefore his UIC benefits, as income, were tax exempt.

Since Williams, other court decisions have established the following relevant connecting factors: residence of the employer (where the central control and management is, and whether it is closely connected to the reserve); residence of the Indians; location of where the work is performed; whether the work was for and to benefit Indians on reserve; whether the income was out of monies appropriated by Parliament to benefit Indians or bands; and whether employment was "within the general commercial mainstream" or closely connected with the reserve.

In response to Williams, Revenue Canada issued revised guidelines identifying those situations where employment income will be tax exempt:

1. Where at least 90% of the employment services are performed on-reserve.

2. If less than 90% of employment services are performed on-reserve, then only that portion of work performed on-reserve will be tax exempt (proration rule). Accurate records need to be maintained to Revenue Canada's satisfaction. This is consistent with the approach taken by the various Indian Remission Orders from 1987 to 1991.

3. Where the employer and Indian is resident on-reserve.

4. Where at least 50% of the income is earned on-reserve and either the Indian or employer is resident on-reserve.

5. Where the Band, Tribal Council or other organization dedicated to the social, cultural, education or economic development of Indians on-reserve, is the employer resident on-reserve and the employment income, whether performed on or off-reserve, is related to the employers non-commercial activities undertaken for the benefit of Indians resident on-reserve.

For those Indians caught by the uncertain state of the law concerning the tax exempt status of employment income prior to Nowegijick, the Indian Statute Barred Income Assessment Order was passed in 1989 to forgive any outstanding balances prior to 1983.

Tax On Other Forms of Income

Q: Do Indians and Indian businesses have to pay tax on business or investment income?

In terms of other income, it is not clear what effect the Williams decision will have on these but at this time Revenue Canada and the courts appear to treat them as follows:

1. Indian owned and controlled corporations cannot claim the exemption under section 87 of the Indian Act (Kinookimaw). However, they may qualify from exemption from income tax under terms of the Income Tax Act either as a "non-profit organization" under section 149(1)(l) of the Act (Gull Bay); as a municipality under section 149(1)(c) and (d) of the Act (Otineka); as a charitable trust under section 149(1)(f) of the Act; or as a Settlement Corporation (Yukon Umbrella Final Agreement).

2. Business income of Indians is generally exempt if the permanent establishment of the business is on-reserve, although this is uncertain due to a number of technical factors that would have to be considered in light of Revenue Canada's rulings. A recent Nova Scotia Court of Appeal decision, Shubenacadie Band vs. Francis has also raised some question as to whether the "business property" of an Indian is exempt from tax under section 87 of the Indian Act.

3. Investment income of Indians, again depending on the connecting factors, will be treated according to the location of the debt. In Recalma the tax court found that the investments and income on these investments were taxable since they arose off-reserve even though the branch of the Bank was on-reserve.

4. RRSP and RRIF income, C.P.P. and U.I.C. benefits are non-taxable if they are paid to an Indian by a employer whose principal place of business was located on-reserve, the employment income was on-reserve, the recipient of the benefit resides on-reserve and the payments are sent to him on-reserve.

5. The training allowance received by an Indian is tax exempt if the Indian qualified for the training allowance through employment which is tax exempt, or where the training allowance is paid by the government and the Indian either lives on a reserve or takes the training on a reserve or lives on-reserve, then takes training off-reserve but returns on-reserve.

6. Trust income should be non-taxable if the trust is structured to ensure that the income is located on-reserve and distributed or allocated annually to the beneficiaries. If the beneficiaries are Indians or a band, whether that employment income is taxable in their hands depends on whether the income property is on-reserve and on the nature of that property (Recalma - investment income).

7. There is no law yet on the treatment of capital gains and losses on the disposition of property, but presumably a "paramount location" or "the connecting factors" test would apply.

8. Sick leave and vacation pay will be exempt provided they meet the Williams connecting factors test. Administratively, Revenue Canada calculates the exemption based on time spent providing employment services on-reserve (proration rule).

Exemption From Provincial Sales Tax

Q: Do Indians or bands have to pay provincial tax on purchases off-reserve if the goods are intended for use or consumption on-reserve?

Provincial sales tax was introduced in the provinces during the depression and these have generally been levied by legislation or administrative practice so as to exempt from tax Indian "purchases for consumption or use on a reserve". Because provincial tax is a "tax", an Indian or a band will be exempt from such tax in respect of personal property situated on a reserve or designated land. A fair degree of litigation has arisen around what constitutes property situated on a reserve or designated land.

In British Columbia certain rules have been established to ensure that Indians and Indian bands are exempt from provincial tax on purchases that take place on-reserve, including designated land. Exempt purchases of hotel accommodation, motor fuel or tobacco products are dealt with under different provincial rules.

To be eligible for provincial tax exemption:

1. the purchaser must be either an Indian or an Indian band with proof of Indian status;

2. the item purchased must be located on a reserve at the time the sale takes place; and

3. the item purchased or leased must be for the personal use of the individual or for the use of the band.

Unless purchased on behalf of an Indian individually or a band, corporations or cooperatives with Indian shareholders, tribal councils and band owned entities don't qualify as Indians under the Indian Act so purchases by them are subject to provincial tax even if the organization and goods are located on-reserve at the time of the sale.

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The following types of sales to Indians or Indian bands have been recognized as being exempt from provincial tax.

1. Private sales between Indians of goods situated on-reserve at the time of sale.

2. Sales to Indians or Indian bands from stores located on-reserve land.

3. Sales to Indians or Indian bands where sellers have brought goods onto reserve land to sell to Indians or the Indian band for immediate delivery at the time of the sale.

4. Sales made for delivery to reserve land, provided that the goods are delivered by the seller, or by a common carrier, to reserve land, at the vendor's expense, as a condition of the sale. Title to these goods cannot pass to the purchaser until they are located on the reserve.

5. Sales of items which are exempt under the Social Services Tax Act.

The application of tax to leased goods, legal services, with respect to taxable services, electricity and natural gas, pay television and telecommunication services and equipment depends on the nature and location of the service.

The question of whether the goods need to be purchased on-reserve to be tax exempt has been challenged in the courts. Davis & Co. represented the First Nations of New Brunswick in the May 1996 New Brunswick Court of Appeal decision involving the Union of New Brunswick Indians. That decision ruled that the location where the sale takes place is not the key factor. What must be determined instead is whether the item purchased will ultimately be used and consumed on the reserve. For the personal property of an Indian to be situated on-reserve it must be used or consumed there. In other words, as long as an Indian purchaser of goods uses or consumes them on-reserve, it doesn't matter where the purchase takes place.

Despite the New Brunswick decision, other court decisions have found that sales to Indians or bands at stores off-reserve are subject to tax because title to the goods passes to the purchaser at an off-reserve location at the time of the purchase, even though these goods may be used or consumed on-reserve later. Application by the Province of New Brunswick to the Supreme Court of Canada to argue this issue has just been made and Davis & Company will be representing UNBI.

Exemption From GST

Q: Have First Nations maximized their GST exemptions and taken full advantage of any input tax credits?

Revenue Canada has issued certain guidelines with respect to the application of GST as follows:

1. GST does not apply to 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, unless the members are in a remote location where certain exceptions apply.

2. GST does not apply to services purchased on-reserve by Indians where the benefit is realized totally on the reserve (i.e. haircut or taxi service on-reserve).

3. Unlike provincial tax, unincorporated band-empowered entities (boards, councils, associations or other businesses or organizations owned or controlled by a band, group of bands or tribal council) may purchase goods and services on the same GST-exempt basis as an Indian or band. In situations where they may have to pay GST, input tax credits may be claimed for purchases off-reserve, similar to other businesses.

4. Incorporated Indian businesses are treated in the same way as other corporations who have to pay GST for goods and services. However, incorporated band-empowered entities are not required to pay GST on property or services acquired for band management activities or real property on-reserve.

5. GST does not apply to services such as legal or accounting services when purchased by the Indian or band or unincorporated band-empowered entity if it is for band management purposes or in connection with real property located on-reserve.

6. Band and band-empowered entities pay GST on off-reserve purchases of transportation, short term accommodation, meals and entertainment, unless these services are purchased for management activities or for real property located on-reserve.

7. To qualify for the 50% GST rebate for non-profit organizations, band funding of Indian non-profit organizations is treated as equivalent to government funding.

Proof of Indian status must be provided by the Indian to the vendor in order to claim an exemption. Likewise, a certificate must be provided by the Indian bands or band-empowered entities advising the vendor or the person providing the services that they are acquiring property on the reserve or acquiring services for band management activities in order to be exempt from GST.

Conclusion

Pursuant to provisions under the Indian Act, the extent to which Indians, bands or band-empowered entities are exempt from federal or provincial tax will depend largely on whether the income, work, goods or services are provided or situated on an Indian reserve. This exemption is not based on any aboriginal or treaty arguments. For those Indians or bands who do not happen to have a reserve land base, they are subject to tax similar to the general public, unless there is some tax exemption built into a land claim settlement. Given recent court pronouncements and tax rulings First Nations are advised to review their tax planning strategies carefully.

First Nations may also be able to benefit from the many tax-planning strategies that are available to all organizations under federal and provincial Income Tax Acts. Davis & Co. can work with First Nations and individuals to develop tax planning strategies available under the Indian Act, treaties, and Income Tax Acts which are tailored to their specific situations.

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