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# THE SECTION 87 TAX EXEMPTION AS A TAX EXPENDITURE

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## I INTRODUCTION

The myth that “Indians<sup>1</sup> don’t pay taxes” is relatively pervasive among the non-Indigenous population of Canada.<sup>2</sup> While stemming from ignorance and a lack of education on the matter, this myth has potentially disastrous effects for Indigenous communities and their peoples.<sup>3</sup> It perpetuates negative stereotypes that can lead to discrimination, both in policy-making that affect Indigenous nations and in the daily lives of Indigenous peoples. This paper hopes to become part of the academic literature that denounces this myth by shedding light on the realities of the limited application of the tax exemption contained in section 87 of the *Indian Act*<sup>4</sup> (the “section 87 exemption”).<sup>5</sup>

This paper will explore this issue by putting the section 87 exemption through the tax expenditure analysis<sup>6</sup> to determine to what extent the expenditure is functioning to benefit First Nations and Indigenous peoples.<sup>7</sup> As will be discussed at the outset, there is no clear, government-stated objective for the expenditure. This alone makes the section 87 exemption difficult to apply, track, and determine its effectiveness. As the tax expenditure analysis will reveal, without a Parliamentary objective or appropriate tax expenditure reporting and data gathering, and in light of the millions of dollars spent bringing the issue of the application of the section 87 exemption to court, there is no way to be sure that the exemption is a worthwhile expenditure. This is particularly true to the extent that it fosters negative stereotypes about Indigenous peoples in Canada.

This paper will begin by discussing the difficulty of viewing the section 87 exemption as a tax expenditure, as well as arguments in support of this view. It will then delve into the tax expenditure analysis, outline the common law objective, and discuss how this objective has stunted economic development on reserve land. It will then discuss the academically argued view that the section 87 exemption amounts to a nation-to-nation tax treaty and the implications this has for Aboriginal rights. The paper will then move on to the distributional fairness of the expenditure, its distorting effects, the administrative and compliance costs associated with it, and its implementation. Finally, it will look at another vehicle for delivering the subsidy.

## II THE SECTION 87 EXEMPTION AS A TAX EXPENDITURE

Section 87 of the *Indian Act* reads as follows:

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<sup>1</sup> In keeping with Myra J Tait’s article, cited below, it is important to note that the term “Indian” is used in a legal sense here only, as defined in the *Indian Act*, s 2(1) and s 6, and meant to convey a group separate from Inuit, Métis, and persons of Indigenous descent who are not registered with the federal government as Indians and thus are not governed by the *Indian Act*. Further clarification on the issue of terminology can be found at Indigenous Foundations, “The Indian Act” (2009), online: <[indigenousfoundations.web.arts.ubc.ca/the\\_indian\\_act/](http://indigenousfoundations.web.arts.ubc.ca/the_indian_act/)>. When the word “Indian” is not required, First Nation, Aboriginal, or Indigenous will be used in its place, with awareness on the part of the author regarding the different meanings of these terms. Please note that the appropriate term is “Indigenous”. “Aboriginal” is used when Canadian law is being applied to Indigenous peoples. “First Nation” is used when speaking of a collective Indigenous nation.

- 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 Management Act*,<sup>8</sup> 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.
- (3) No succession duty, inheritance tax or estate duty is payable on the death of any Indian in respect of any property mentioned in paragraphs 1(a) or (b) or the succession thereto if the property passes to an Indian, nor shall any such property be taken into account in determining the duty payable under the *Dominion Succession Duty Act*,<sup>9</sup> chapter 89 of the Revised Statutes of Canada, 1952, or the tax payable under the *Estate Tax Act*, chapter E-9 of the Revised Statutes of Canada, 1970, on or in respect of other property passing to an Indian.

It is unclear on its face whether section 87 of the *Indian Act* can be characterized as a tax expenditure because it is not derived from the *Income Tax Act* (ITA)<sup>10</sup> nor from a federal budget. Neil Brooks argues that there are two methods for classifying a tax provision as a tax expenditure: (1) Either all deviations from the ITA are considered tax expenditures, or (2) they are labelled as such because they are justified according to a government-spending objective (i.e., alternatives to direct spending government programs).<sup>11</sup>

For the section 87 exemption to be considered a tax expenditure, then, the first method must be applied. However, looking at the language used by Brooks, there is still the underlying assumption that the exemption derives from a provision in the ITA, which is not the case here. Additionally, case law and academic articles that discuss the section 87 exemption do not explicitly refer to it as a “tax expenditure.”<sup>12</sup> The section 87 exemption does, however, appear in the government of Canada’s (GOC) *Report on Federal Tax Expenditures*<sup>13</sup> and will thus be treated as such for the purposes of this paper.

This paper takes the position that section 87 of the *Indian Act* is a tax expenditure. It is designed to provide tax relief to a segment of the Canadian population, which Parliament has exempted from paying personal and business income tax to achieve a social objective. Brooks argues that the objective of a tax expenditure is generally to correct a market failure

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<sup>8.</sup> *First Nations Fiscal Management Act*, SC 2005, c 9.

<sup>9.</sup> *Dominion Succession Duty Act*, RSC 1952, c 89.

<sup>10.</sup> *Income Tax Act*, RSC 1985, c 1 (5th Supp) [ITA].

<sup>11.</sup> Brooks, *supra* note 6 at 72.

<sup>12.</sup> This insight was made on review of the leading case law and scholarly articles, all of which will be discussed below.

<sup>13.</sup> Department of Finance Canada, “Non-Taxation of Personal Property of Status Indians and Indian Bands Situated on Reserve” in *Report on Federal Tax Expenditures* (2018) at 200, online (pdf): *Government of Canada* <[www.fin.gc.ca/taxexp-depfisc/2018/taxexp18-eng.asp](http://www.fin.gc.ca/taxexp-depfisc/2018/taxexp18-eng.asp)> [*Report on Federal Tax Expenditures*].

with a tax exemption (or credit, deduction, etc.), but that the objective can be for the furtherance of social justice in some instances.<sup>14</sup> The section 87 exemption can arguably be seen as furthering social justice by allowing First Nation members to retain more of their income for their own personal use and benefit and in so doing prevent the erosion of their property via taxation. This is in fact the common law objective of the exemption, which is discussed further below. Given their disadvantaged position in society,<sup>15</sup> this is certainly a small but potentially beneficial means by which to accomplish this objective.

### III OBJECTIVES OF THE SECTION 87 EXEMPTION

As iterated above, Parliament has not provided a definitive objective of the section 87 exemption. It has thus been left to the courts to decide its purpose. Scholars also theorize about potential objectives and the exemption's benefit in relation to various aspects of economic development<sup>16</sup> and self-determination<sup>17</sup> for First Nations peoples. For the purposes of this paper, the common law objective will be used in the tax expenditure analysis.

#### A. The Courts and Section 87

One of the first cases to deal with the section 87 exemption was *Nowegijick v R.*<sup>18</sup> This case found that salaries and wages were personal property of an Indian, and that the *situs*<sup>19</sup> of the wages or salaries were the location of where the debtor was to be found, as that is the place where the debt can be enforced. However, it was not until the *Mitchell*<sup>20</sup> case that the common law objective underlying section 87 was discussed in detail.

In *Mitchell*, LaForest J stated that the purpose of the section 87 exemption is to protect Indian property on reserve land from erosion and dispossession by shielding it from taxation by the Crown and capture by creditors.<sup>21</sup> The GOC reiterated this interpretation from *Mitchell*

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<sup>14</sup> Brooks, *supra* note 6 at 73.

<sup>15</sup> Human Rights Committee, *Concluding Observations on the Sixth Periodic Report of Canada*, United Nations International Covenant on Civil and Political Rights, 114, UN Doc CCPR/C/CAN/CO/6 (2015).

<sup>16</sup> See Joseph A Gill, Judith Charbonneau Kaplan & Nicole Watson, "First Nations Tax Issues with a Business Focus" (paper delivered at the 2018 Prairie Provinces Tax Conference, Saskatoon, 28 May 2018) [Gill, Kaplan & Watson] for the section 87 exemption use in economic development.

<sup>17</sup> See Tait, *supra* note 2, where she argues that the section 87 exemption can in fact be used as an aid to treaty implementation.

<sup>18</sup> *Nowegijick v R.*, [1983] DTC 5041 (SCC) [*Nowegijick*].

<sup>19</sup> Bryan A. Garner, *Black's Law Dictionary*, 10th ed (St. Paul, MN: Westlaw, 2014) sub verbo "situs."

<sup>20</sup> *Mitchell v Peguis Indian Band*, [1990] 2 SCR 85 [*Mitchell*].

<sup>21</sup> Bill Maclagan, "An Update on Tax Exemptions for First Nations and Related Matters" in *2016 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2016), 3:1-69 at 3 [Maclagan].

in online materials.<sup>22</sup> This judicially stated objective has also been used approvingly in later court decisions.

The court in *Mitchell* stated that since the signing of the *Royal Proclamation of 1763*,<sup>23</sup> “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.”<sup>24</sup> Bill Maclagan notes that the consequence of this judicial statement has generally meant that the courts interpret the exemption narrowly.<sup>25</sup>

This objective was reiterated in *Williams v The Queen*,<sup>26</sup> in which Gonthier J created the Connecting Factors Test (CFT). This case amended the principles laid out in *Nowegijicki* as they relate to the situs of the income.<sup>27</sup> The court in this case, instead, looked to determine if the income of a Status Indian was sufficiently connected to section 87’s purpose and therefore exempt from taxation.<sup>28</sup> To do so, one must first determine the purpose of the section 87 exemption, which required one to keep in mind the nature of the benefits in question as well as the manner in which the taxation applied to these benefits.<sup>29</sup>

The CFT, as set out by Gonthier J and which remains good law, is as follows:

[layout as quote, with 1, 2, a,b,c bullets]

1. Identify the various connecting factors which are potentially relevant, and
2. Analyze these factors to determine what weight they should be given in identifying the location of the property, in light of three considerations:
  - a) The purpose of the exemption under the *Indian Act*;
  - b) The type of property in question; and
  - c) The nature of the taxation of that property.

The question with regard to each connection 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.<sup>30</sup>

Gonthier J then set out a “conceptual framework” with relevant factors in determining the *situs* of the section 87 exemption: “the place of residence of the employer; the place of residence of the employee; the location of the employment income which gave rise to the

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<sup>22</sup> Government of Canada, “Information on the Tax Exemption under Section 87 of the Indian Act” (10 May 2019), online: *Government of Canada* <[www.canada.ca/en/revenue-agency/services/aboriginal-peoples/information-indians.html#hdng2](http://www.canada.ca/en/revenue-agency/services/aboriginal-peoples/information-indians.html#hdng2)> [GOC Information on s 87].

<sup>23</sup> George R, Proclamation, 7 October 1763 (3 Geo III), reprinted in RSC 1985, App II, No 1.

<sup>24</sup> *Supra* note 20 at para 87.

<sup>25</sup> *Supra* note 21 at 3.

<sup>26</sup> *Williams v Canada*, [1992] 1 SCR 877, 92 DTC 6320.

<sup>27</sup> *Ibid* at 888.

<sup>28</sup> *Supra* note 21 at 10.

<sup>29</sup> *Ibid* at 11.

<sup>30</sup> *Supra* note 26 at 878.

benefits; and the place where the income is to be paid to the employee.”<sup>31</sup> It was noted that this is not an exhaustive list of factors.

The CFT provides the Canada Revenue Agency (CRA) and judiciary broad discretion in determining the weight to be given to each of the factors at issue and in determining whether or not it would lead to the erosion of Indian property on reserve. As Tait notes, the CFT “reinforced the already disadvantaged social and economic positions of Indians, by putting their culture and experience of colonization at the centre of the courts’ assessment.”<sup>32</sup> Indeed, Leslie Pinder has pointed out that the test gives the CRA the mandate to assess the factors “according to [their] fancy”<sup>33</sup> and that it allows prejudice to favour denying the application of the exemption.<sup>34</sup>

Martha O’Brien has observed that “the courts have shown a marked tendency to apply the exemption restrictively and to require that the source of income have a demonstrably ‘Indian character,’”<sup>35</sup> namely focusing on the ways in which judges view “Native life” prior to contact and how these can be applied using the CFT. Ultimately, the CFT has been criticized as being too vague and subjective to be much use as a precedent for subsequent cases,<sup>36</sup> though courts have indeed attempted to do this. Tait also argues that in determining which factors are the most critical and where the weight should be accorded, judges simply determine this based on what “makes the most sense” to them.<sup>37</sup> The potential for bias and discrimination based on negative stereotypes here is high.

While the CFT has been upheld in subsequent court decisions, premised on the objective of the section 87 exemption being avoiding erosion of Indian property on Indian reserves by taxation via the government, it has not necessarily resolved the uncertainty surrounding the objective specifically as it informs and is the basis of this test. In *Robertson*,<sup>38</sup> Evans J stated: “It is easier to say what the purpose of section 87 is not, than to state positively what it is.”<sup>39</sup> In a concurring opinion, Pelletier J agreed, noting that the section 87 exemption is far from clear.<sup>40</sup>

This lack of guidance by the federal government as to the objective of the section 87 exemption is compounded by the highly political nature of the *Indian Act* as well as the current and historical treatment of First Nations and their members by the different levels of the Crown and its agencies.<sup>41</sup> In light of this, it is imperative that the highly technical discourse

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<sup>31</sup> *Williams*, *supra* note 26; Maclagan, *supra* note 21 at 11.

<sup>32</sup> Tait, *supra* note 2 at 38.

<sup>33</sup> Leslie J Pinder, “The Indian Act Taxation Exemption—Beguiling Simplicity: *Shilling v The Queen*” (2000) 48:5 Can Tax J 1496 at 1497 [Pinder].

<sup>34</sup> *Ibid* at 1497.

<sup>35</sup> Martha O’Brien, “Income Tax, Investment Income, and the Indian Act: Getting Back on Track” (2002) 50:5 Can Tax J at 1571 [O’Brien].

<sup>36</sup> *Ibid*.

<sup>37</sup> *Recalma v Canada*, [1998] 3 CNLR 279 (FCA) [*Recalma*].

<sup>38</sup> *Canada v Robertson*, 2012 FCA 94 at paras 45 and 51 [*Robertson*].

<sup>39</sup> *Ibid* at para 45.

<sup>40</sup> *Ibid* at paras 91 and 92.

<sup>41</sup> For a brief history on these issues, please see The Royal Canadian Geographical Society/Canadian Geographic, *Indigenous Peoples Atlas of Canada* (Ottawa: Canadian Geographic, 2018).

surrounding tax expenditures not overshadow the serious implications that section 87 has, both in practice and at a scholarly level. Section 87 may well be a window of sorts into how the government and its agencies view and treat Indigenous peoples and the nature of Crown-Indigenous relations. It may also have consequences in other areas, such as self-government agreements, treaty negotiations, the implementation of own-source revenue on reserves (including property taxation), among numerous other issues.<sup>42</sup> Clarifying the objective and creating certainty in section 87's interpretation and application would also help dispel the idea that "Indians don't pay taxes" and that the exemption is akin to a government handout.

## 1. Implications for On-reserve Economic Development

LaForest J in *Mitchell* made it clear that while the objective of section 87 was to protect Indian property on reserve, it was "not [meant] 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."<sup>43</sup> This was cited with approval in *Williams* and subsequent cases that used the CFT in an attempt to ensure that the business engaged in was integral to life on the reserve and outside of the commercial mainstream.<sup>44</sup>

One of these cases was *Recalma*, which reiterated the four connecting factors set out in *Williams* and applied them to investment income. Restated somewhat, the CFT as applied to investment income is to test (1) the investment income's connection to the reserve, (2) the benefit of the investment to the "traditional Native way of life", (3) the potential danger of the erosion of Aboriginal property, and (4) the extent to which the investment income may be considered as being derived from mainstream economic activity.<sup>45</sup> The commercial mainstream test became the determining factor in assessing the *situs* of intangible property.<sup>46</sup>

For thirteen years it was held that intangible property was not tax exempt because it did not directly relate to the "traditional Native way of life" and that income generated would only be tax exempt if it related to an "integral part" of reserve life.<sup>47</sup> While this test was largely rejected in *Bastien*,<sup>48</sup> which saw that factor as only one, non-determinative factor to consider as it relates to intangible property, *Recalma* narrowed the utility of the section 87 exemption to such an extent that it stunted economic development on reserve by making the pursuit of economic gains less attractive. When one looks at the incentives for mining companies, for example, via the Mineral Exploration Tax Credit for flow-through share investors (which is meant to attract investment), it is evident that such tax subsidies are, in fact, useful and beneficial to economic development.<sup>49</sup> It appears to be the case that First Nations communities

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<sup>42</sup> Morry and Ranson, *supra* note 3.

<sup>43</sup> *Mitchell*, *supra* note 20 at 131.

<sup>44</sup> *Southwind v The Queen*, [1998] DTC 6084 (FCA).

<sup>45</sup> *Recalma*, *supra* note 37 at para 9.

<sup>46</sup> Tait, *supra* note 2 at 63.

<sup>47</sup> *Recalma*, *supra* note 39 at para 9.

<sup>48</sup> *Bastien v The Queen*, 2011 SCC 38 [*Bastien*].

<sup>49</sup> *Report on Federal Tax Expenditures*, *supra* note 13 at 172. See also KMPG, "Guide to Oil and Gas Taxation in Canada" (2018), online (pdf): <assets.kpmg.com/content/dam/kpmg/ca/pdf/2018/05/oil-gas-guide.pdf>.



are being excluded from something akin to a tax subsidy that, in another form, is being used to the great benefit of other segments of the population.

The underlying premise of this interpretation is arguably the discriminatory and stereotypical view the courts have taken in relation to “Native ways of life”. As Tait argues, this interpretation in *Recalma* “perpetuated the normalization of the ‘poor Indian stereotype’”<sup>50</sup> and, in particular, fostered the view that Indigenous ways of life are frozen, never meant (or allowed) to change or evolve over time.

## B. Academic Views of the Objectives of Section 87

There is an argument on the part of some scholars that the acknowledgement of Indian property on Indian land being exempt from Canadian taxation was in fact an indication of a tax treaty between two independent nations—the Indigenous Nation and the Dominion of Canada.<sup>51</sup> This was a point of issue in *Benoit v Canada*.<sup>52</sup> The Federal Court of Appeal found that there was no general exemption from tax found in Treaty 8 by virtue of section 87 being considered a tax treaty, based on the evidence presented. Modern treaties have made this exemption explicit, to remedy this evidentiary gap in the future,<sup>53</sup> but the question remains whether the exemption rises to the level of a tax treaty between two nations.

If treaties were intended to be a protection of sorts of First Nation sovereignty over their lands, then an argument also exists that tax exemption on reserve or treaty lands is part of an inherent Aboriginal right to self-government.<sup>54</sup> This may mean that the exemption is constitutionally protected under section 35 of the *Constitution Act, 1982*.<sup>55</sup> This argument has been academically debated at length, but it presents an interesting argument that courts will perhaps have the opportunity to consider in the future.

# IV EVALUATING THE SECTION 87 EXEMPTION

## A. Fairness of Distribution

Only Indians registered with the Canadian government (i.e., Status Indians) are eligible for the section 87 tax exemption, pursuant to the definition of “Indian” in the *Indian Act*.<sup>56</sup> The CRA has stated that despite the 2016 Supreme Court of Canada (SCC) decision in

<sup>50</sup> Tait, *supra* note 2 at 64.

<sup>51</sup> Tait, *supra* note 2.

<sup>52</sup> *Benoit v Canada*, 2003 FCA 236, leave to appeal denied 2004 CarswellNat 1209 (SCC).

<sup>53</sup> Morry and Ranson, *supra* note 3 at 8.

<sup>54</sup> Morry and Ranson, *supra* note 3 at 7. See also *Campbell v British Columbia*, (2000) 189 DLR (4th) 333.

<sup>55</sup> *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982 (UK)*, 1982, c 11 [*Constitution Act, 1982*].

<sup>56</sup> *Indian Act*, *supra* note 4, s 2(1) “Indian.”



*Daniels*,<sup>57</sup> which declared that Métis and non-Status Indians<sup>58</sup> are “Indians” for the purposes of Parliamentary law-making under subsection 91(24) of the *Constitution Act, 1867*,<sup>59</sup> the ruling had no bearing on the *Indian Act* definition. First Nations bands can also access the section 87 tax exemption.<sup>60</sup>

When discussing issues of fairness as it relates to personal property, two concepts must be defined: vertical and horizontal equity. *Vertical equity* in the tax system refers to “ethical treatment that unequals be treated appropriately differently.”<sup>61</sup> *Horizontal equity*, on the other hand, refers to the view that “people who are ‘similarly situated’ should pay the same amount of tax.”<sup>62</sup> On the horizontal level, where two individuals are considered Status Indians, only those living or working on reserve and who are being paid by their employer on reserve, among other connecting factors, are able to apply the section 87 exemption to their income.<sup>63</sup> This does comply with the common law objective of the tax expenditure, as it protects Indian property on Indian land from erosion via taxation. However, the reality is that reserve land does not often provide economic or other opportunities for Status Indians living on them, which forces them to move off reserve to find employment and financial stability.<sup>64</sup> As the latest census data indicate, Indigenous peoples are moving away from reserves to urban centres at increasing rates, thus shrinking the pool of those potentially eligible for the tax exemption.<sup>65</sup>

On the vertical level, Inuit, Métis, or are non-Status First Nations members are excluded from receiving the exemption because they are not considered Status Indians.<sup>66</sup> Of the 1,673,785 Aboriginals in Canada (including First Nations, Métis, and Inuit), only 744,855 are Status Indians and thus eligible for the expenditure.<sup>67</sup> This excludes an enormous number of Indigenous peoples in Canada from accessing the exemption at first instance, all based on definitions and criteria set out by the federal government.

Another issue with respect to fairness of distribution is the *situs* of the Indian property. The exemption can only be accessed when the Indian property is on reserve land (or earned on reserve).<sup>68</sup> This is certainly in keeping with the judicially stated purpose of the section 87 exemption—to prevent economically induced dispossession of Indian property on Indian

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<sup>57.</sup> *Daniels v Canada*, 2016 SCC 12.

<sup>58.</sup> *Reference Re Eskimos* [1939] SCR 104 determined that “Inuit” are considered “Indian” for the purposes of s 91(24) of the *Constitution Act, 1867*.

<sup>59.</sup> *Constitution Act, 1867* (UK), 30 & 31 Vict, c 3, reprinted in RSC 1985, App II, No 5 [*Constitution Act, 1867*].

<sup>60.</sup> *Indian Act*, *supra* note 4, s 2(1) “band.”

<sup>61.</sup> Brooks, *supra* note 6 at 66.

<sup>62.</sup> *Ibid* at 65.

<sup>63.</sup> GOC Information on s 87 Tax Exemption, *supra* note 22.

<sup>64.</sup> James Hopkins, “Bridging the Gap: Taxation and First Nations Governance” (2008), research paper for the National Centre of First Nations Governance.

<sup>65.</sup> Statistics Canada, “Aboriginal Peoples in Canada: Key Results from the 2016 Census” (25 October 2017), online: *The Daily* <www150.statcan.gc.ca/n1/daily-quotidien/171025/dq171025a-eng.htm> [Stats Can].

<sup>66.</sup> Gill, Kaplan & Watson, *supra* note 16 at 3.

<sup>67.</sup> Stats Can, *supra* note 65.

<sup>68.</sup> Gill, Kaplan & Watson, *supra* note 16 at 4.

lands.<sup>69</sup> However, not only does the exemption only apply to a subset of Indigenous peoples,<sup>70</sup> it also requires that the Status Indian live or work on reserve to qualify for the exemption (in addition to the other numerous criteria that must be met).

Whether looking at the horizontal or vertical equity levels, there is a problem with the distribution of the section 87 exemption in the broader scope of fairness. Indeed, Tait argues that the stated purpose of section 87 in *Mitchell* was built on two premises: protecting Indians and their property while also limiting the application of the section 87 exemption, apparently to ensure fairness to non-Indians.<sup>71</sup> However, it is the case that the section 87 exemption's common law objective is being upheld in this regard. By limiting its scope and application, the exemption is ensuring that it is protecting Indian property, which can only be owned by Status Indians in a legal capacity on Indian reserve land.

## B. Distortion

Distortion speaks to the need for an individual or business to change their behaviour to take advantage of the tax expenditure.<sup>72</sup> The section 87 exemption certainly requires such behaviour to happen. As has been discussed, the criteria that must be met to access the exemption are broad, complex, and highly discretionary and subjective as it relates to the entity that is determining the application of the exemption. This section will discuss the section 87 exemption of both employment income and business income.

### 1. Employment Income

Because of the uncertainty in the application of the CFT, for tax planning purposes it is incumbent on someone to ensure that their employment or business is set up to have as many of the factors as possible connect their income to a reserve. Such factors to consider include the residence of the debtor, the residence of the person receiving the income (creditor), the place where the income is paid, the location of the employment/business giving rise to income, the nature of the services rendered, the special circumstances of performance, and anything else the CRA may view as a strong connecting factor between the individual or band and the reserve.<sup>73</sup>

The issue of whether one is tax planning or attempting tax avoidance is highlighted in the *OI Group* and *Native Leasing Services (NLS)* cases.<sup>74</sup> Premised on a pre-*Williams* interpretation of the application of the section 87 exemption, *NLS*, which was located on reserve land, hired Status Indians as employees, who would then go off reserve to work and perform their employment duties.<sup>75</sup> Post-*Williams*, Revenue Canada (now the CRA) demanded the payment of back taxes on income that had been claimed as exempt under section 87

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<sup>69.</sup> Morry and Ranson, *supra* note 3 at 6.

<sup>70.</sup> That is, it only applies to those who meet the government of Canada's criteria for being deemed an "Indian" pursuant to the flawed *Indian Act*, which, as *Daniels* notes, has severely disadvantaged Indigenous women by virtue of its sexist provisions.

<sup>71.</sup> Tait, *supra* note 2 at 38.

<sup>72.</sup> Brooks, *supra* note 6.

<sup>73.</sup> *Williams*, *supra* note 26.

<sup>74.</sup> For a history and review of these cases, please see Tait, *supra* note 2 at 47.

<sup>75.</sup> Tait, *supra* note 2 at 48.

because they found there were few, if any, connecting factors between the employment income and the reserve, per the CFT, particularly in that their employment duties were performed off reserve.<sup>76</sup> *Shilling*<sup>77</sup> was one of the test cases for the debacle. This case, along with numerous others that have occurred post-*Bastien*,<sup>78</sup> which rejected the commercial mainstream test, stated that there were insufficient connections between the income earned and where that income was earned.

These cases highlight the lack of clarity with respect to how one can ensure that the section 87 exemption will apply to their earned income. The fact that the majority of the individuals that the CRA targeted for payment of arrears were low-income individuals, and their employment, though off reserve, was namely in the service and interests of Indigenous peoples, has not been lost on academics in this field.<sup>79</sup>

## 2. Business Income

*Dickie*<sup>80</sup> set out a list of non-exhaustive factors for the application of the section 87 exemption in the context of business income, and it highlights the discretionary nature of the CFT. The factors the CRA considers for allowing business income exemptions include the type of business and the location of the business activities, the location of the customers (debtors) of the business and where payment was made, the residence of the business owners, where decisions affecting the business are made, the location where the books are kept, the nature of the work and the commercial mainstream, among other factors.<sup>81</sup> *Dickie* namely dealt with the issue of business income earned from a proprietorship operated on reserve but where the customers and the physical labour of the business were off reserve.<sup>82</sup>

Case law since *Williams* has clarified, to an extent, the weight to be given to these various factors by the CRA and the courts as it relates to the applicability of the section 87 exemption. Gill, Kaplan, and Watson note that there are at least three broad “practical principles” that the case law has laid out to help somewhat with tax planning and tax advice relating to this exemption by making business activities more attractive for the application of section 87.<sup>83</sup> First, the majority of business-making decisions must be conducted on reserve, as the factors in *Dickie* set out. Second, the business activities in question should be economically significant to a particular reserve.<sup>84</sup> For a Status Indian business owner, this will include the number of employees of the business who are also members of the First Nation who live on the reserve and whether that number is a material percentage of the total number of reserve members. Additionally, the percentage of total business activity revenues on reserve that the business generates will also be a factor. Third, the business activities should be linked to the traditional

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<sup>76.</sup> Tait, *supra* note 2 at 50.

<sup>77.</sup> *Shilling v MNR*, [2001] 4 FCR 178, leave to appeal refused 2002 CarswellNat 502 SCC.

<sup>78.</sup> See *Zoccole v The Queen*, 2015 FCA 258; *Baldwin v The Queen*, 2014 TCC 284.

<sup>79.</sup> See Tait, *supra* note 2; Pinder, *supra* note 33; O’Brien, *supra* note 35.

<sup>80.</sup> *Dickie v The Queen*, 2012 TCC 242, aff’d 2014 FCA 40 [*Dickie*].

<sup>81.</sup> *Ibid.*

<sup>82.</sup> Maclagan, *supra* note 21 at 34, in discussing the *Dickie* case.

<sup>83.</sup> Gill, Kaplan & Watson, *supra* note 16 at 6.

<sup>84.</sup> *Ibid* at 6.

or historical way of life of that particular reserve, namely fishing and hunting activity.<sup>85</sup> All of these will require that the business owner structure their business and its activities meticulously in the hopes of having sufficient connection to the reserve to be eligible for the section 87 exemption. This necessarily leads to distortion in how they may normally wish to conduct their business.

It must be remembered that the CRA, in determining applicability of the section 87 exemption, still assesses deductions pursuant to section 67 of the ITA, which sets out the general reasonableness standard. Gill, Kaplan, and Watson note that it is important for Indians and bands to create and retain records that support the reasonableness of a particular expenditure.<sup>86</sup> It is apparent on these factors that an Indian or band attempting to access section 87 must structure their income-earning activity to appear attractive enough to the CRA to qualify for the exemption. Individuals will have to make decisions that affect where they live, where they work, and how they conduct their business in an attempt to qualify for the section 87 exemption.

The courts in both *Bastien* and *Robertson* make reference to the potential for abuse of the CFT, arguably in reference to the *OI Group* and *NLS* cases.<sup>87</sup> Both cases make the argument that where Indian taxpayers manipulate the system to avoid paying taxes, they may well be found to be liable.<sup>88</sup> While this potential exists for both Indigenous and non-Indigenous peoples, because of the uncertainty surrounding the section 87 exemption, what may be an attempt to qualify for the exemption could be seen as potential tax avoidance. This is incredibly troublesome and requires the GOC and its agencies to set firm guidelines and rules for them and the judiciary to follow when applying the section 87 exemption.

### C. Administration and Compliance Costs

There is no indication in the *Report on Federal Tax Expenditures* as to how much administering and complying with section 87 is costing the government.<sup>89</sup> The section 87 exemption, in light of the CFT, is difficult to understand and apply to one's income, assuming First Nations are even aware of its existence, which is not clear given the lack of data. While administering the exemption does not seem to be too cumbersome, as it appears incumbent upon the individual or band to seek the exemption when they file their taxes,<sup>90</sup> the compliance costs since *Williams* have likely been extraordinary. Since the creation of the CFT, the CRA and taxpayers have had to clarify the connecting factors in court numerous times, appearing before the SCC on this issue on several occasions. Additionally, the number of audits the CRA has likely undertaken (though exact figures are unavailable) is another indication that it has cost the Canadian taxpayers a tremendous amount of money to ensure that First

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<sup>85</sup> Gill, Kaplan & Watson, *supra* note 16 at 6.

<sup>86</sup> *Ibid* at 7.

<sup>87</sup> Tait, *supra* note 2 at 55.

<sup>88</sup> *Bastien*, *supra* note 48 at para 62; *Robertson*, *supra* note 38 at para 41–42.

<sup>89</sup> *Report on Federal Tax Expenditures*, *supra* note 13.

<sup>90</sup> The form one must fill out to request the exemption is TD1-IN, "Determination of Exemption of an Indian's Employment Income." It is also one of the numbered boxes one fills out when filing taxes. Please see <[www.canada.ca/en/revenue-agency/services/forms-publications/forms/td1-in.html](http://www.canada.ca/en/revenue-agency/services/forms-publications/forms/td1-in.html)> for further information.

Nations are exempted from tax only within the narrow confines created by the Canadian judiciary and the CRA.

Even if the GOC had adequately reported the loss in tax revenue from the application of the section 87 exemption, it is not clear that this information would spur change in the law. It could conceivably lead to further dissatisfaction on the part of non-Indigenous Canadians who do not believe First Nations and Indigenous peoples should receive any tax breaks, especially if they want to be participating members of Canadian society and thus should receive the same benefits as the rest of the tax base. However, beyond this potential, it would appear that the only way in which these figures would help spur change would be by making it glaringly obvious how much it is costing taxpayers to ensure that the section 87 exemption is applied appropriately, which is a herculean task in light of the CFT and case law post-*Williams*.

## D. Government Accountability

There is no accountability on the part of the government concerning the section 87 exemption because there are no data reported that are made available to the public. One can only guess at the reason behind this lack of reporting, but the reality is that without these figures the only indication of the use and application of the section 87 exemption comes from the position taken by the CRA.<sup>91</sup> Despite this, however, there are no data for the number of people granted or denied the exemption or the reasons behind the decisions when made. Additionally, litigation is not always an option for individuals, where those who may qualify cannot prove this to the CRA in court. The *OI Group* and *NLS* cases, discussed above, highlight the fact that the CRA appears willing to use taxpayer dollars to demand the payment of back taxes from individuals who are living near the poverty line to ensure appropriate, though ill-defined, application of the section 87 tax exemption.<sup>92</sup>

It could be argued that because the section 87 exemption is not often seen by the courts or the CRA as an expenditure in the traditional sense, and because it does not appear in the ITA, the need to report on its usage rates and tax revenue losses is not as glaring as with other such expenditures. However, because the exemption appears in the *Report on Federal Tax Expenditures*, it would logically appear necessary to report such data. The lack of reporting leads to a lack of GOC accountability with respect to the lost tax revenue from the section 87 exemption, as well as proof as to whether this exemption is fulfilling its elusive objective.

## E. Program Implementation

There is information available to First Nations members, both for personal and business income, regarding the section 87 exemption. The GOC website now provides guides, forms, and basic information related to the exemption, which may be helpful for Status Indians who wish to access the program.<sup>93</sup> However, with respect to planning one's affairs to gain access

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<sup>91</sup> See GOC Information on s 87, *supra* note 22.

<sup>92</sup> Tait, *supra* note 2 at 52.

<sup>93</sup> Government of Canada, "Individuals—Aboriginal Peoples" (2011), online: *Canada Revenue Agency* <[www.canada.ca/en/revenue-agency/services/forms-publications/forms-publications-listed-client-group/other-aboriginals.html](http://www.canada.ca/en/revenue-agency/services/forms-publications/forms-publications-listed-client-group/other-aboriginals.html)>.

to the exemption, there is still significant uncertainty as to whether the First Nation or their people will qualify.

With the amount of resources that go into auditing individuals who claim the section 87 exemption (though, again, this information is not available), program implementation is failing on at least two counts. First, the individual or band is not able to access the exemption in the first place. Second, the subsidy is not justified because it costs enormous amounts of tax dollars to implement the program, given the potential number of audits undertaken to ensure the exemption is applied appropriately.

If the common law objective of the section 87 exemption is to protect Indian property on Indian reserve from erosion via taxation, without adequate reporting there is no certainty as to whether or not the implementation of this objective is being borne out. As argued above, the narrow applicability of the exemption to any individual or band may well ensure that the objective is in fact being met, but there is no evidence to argue this issue one way or the other. There must be reporting and data available to the public, at the very least to ensure that the section 87 exemption is fulfilling its common law objective.

## F. Another Vehicle to Deliver the Subsidy

One possible alternative delivery method of the section 87 exemption may be simply giving every First Nations member a credit on their income tax return. It may be fashioned as reparations, for example. However, there is a risk with this approach, as it may only serve to foster the view by non-Indigenous Canadians that Indigenous peoples are incapable of supporting themselves and could conceivably lend credence to the view that Indigenous peoples are not able to order their affairs appropriately for long-term financial stability.

## V CONCLUSION

The section 87 exemption can be considered a tax expenditure because it provides tax relief to a segment of the population in Canada that has been historically and is currently disadvantaged. While there is no Parliamentary-stated objective, the common law objective has been accepted as being the prevention of economically induced erosion of Indian property on Indian lands via government taxation. This is supported by CRA and GOC online materials, and thus is likely the objective according to which the federal Crown operates.

It could be argued that the narrow application of this expenditure allows this objective to be borne out by the GOC by ensuring that it goes exclusively to the protection of Indian property on Indian reserve land. However, the approach taken by the courts has done incalculable harm to the potential for economic development of First Nations,<sup>94</sup> not to mention the daily lives of First Nations and Indigenous peoples, namely because of the uncertainty in its interpretation and its subjective application.

The reality is that the tax provisions of the *Indian Act* have been used to limit the scope and power of Indigenous economic development on the parcels of land provided to them by the Crown. It ensures that First Nations peoples, their rights and their cultures, are kept frozen and stuck in the past, never allowed to progress and move forward because their

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<sup>94</sup> Tait, *supra* note 2 at 62.

“traditional Native way of life” is the connection they require to access the Western, colonial laws imposed upon them. While *Bastien* and *Dickie* certainly helped alleviate this particular issue by making such a connection to a traditional way of life a non-determinative, though still potentially relevant, factor in the application of section 87, this provision has still gone a long way in stunting economic development on reserve lands, ultimately negatively impacting Indigenous peoples.

This is reflected in the laissez-faire approach the Crown has taken to even reporting on the section 87 exemption. With so little information regarding its access, use, and the amount of lost tax revenue to ensure its “appropriate” application, there is no accountability on the part of the government. This leaves the door open for others to draw discriminatory and stereotypical views of First Nations via the exemption, as reflected in both CRA and judicial decisions.

When there is a lack of information and education on such a serious topic, in particular where there already exists biased and discriminatory undertones to the issue, it is imperative that Parliament step up to clarify the section 87 exemption, both with respect to its objective and its application. What is ultimately required is greater certainty for Indigenous peoples in Canada as they embark on economic development for themselves, whether as communities or individually.<sup>95</sup>

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<sup>95</sup> H Michael Dolson, “Daniels: Tax Changes for Non-Status Aboriginals?” in Vivien Morgan, ed, *Canadian Tax Highlights* (Toronto: Canadian Tax Foundation, 2016) 24:5.