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# Income Tax, Investment Income, and the Indian Act: Getting Back on Track

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## PRÉCIS

La jurisprudence récente sur l'application de l'exemption d'impôt à l'article 87 de la Loi sur les Indiens au revenu de placement d'un Indien a adopté une position qui tranche avec l'objet et la portée de l'exemption, tels que ceux-ci sont formulés dans les arrêts clés de la Cour suprême du Canada. Ce qui est plus frappant encore, c'est que dans les arrêts portant sur la question à savoir si un compte de dépôt appartenant à un Indien est situé sur une réserve en application de l'article 87, on arrive à la conclusion qui est à l'opposé de celle exprimée dans les arrêts examinant la question pour l'application de la disposition complémentaire, l'insaisissabilité à l'article 89 de la Loi sur les Indiens, et ce, même si la Cour suprême du Canada a affirmé que les articles 87 et 89 doivent être interprétés et appliqués de la même manière. Cet article comporte l'examen de la jurisprudence dans laquelle des approches divergentes ont été présentées et la suggestion d'une nouvelle façon de déterminer si le revenu de placement ou un autre bien incorporel d'un Indien est situé sur une réserve et est, de ce fait, exempt d'impôt.

## ABSTRACT

Recent case law on the application of the tax exemption in section 87 of the Indian Act to Indian investment income has taken a very different approach to the purpose and scope of the exemption from that expressed in the leading decisions from the Supreme Court of Canada. Most strikingly, the cases that have addressed the question of when a deposit account belonging to an Indian is situated on a reserve for purposes of section 87 reach the opposite conclusion to those considering the issue for purposes of its companion provision, the exemption from seizure in section 89 of the Indian Act, even though the Supreme Court of Canada has said that sections 87 and 89 are to be interpreted and applied in the same way. This article examines the jurisprudence in which the divergent approaches have developed and suggests a new approach for deciding when investment income and other intangible property of Indians is situated on a reserve, and thus exempt from taxation.

**KEYWORDS:** NATIVE PEOPLES—CANADA ■ INVESTMENT INCOME ■ TAX EXEMPTIONS ■ SUPREME COURT DECISIONS ■ INTANGIBLE PROPERTY

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## INTRODUCTION

This article examines the issue of how the exemption from taxation in section 87 of the Indian Act,<sup>1</sup> which applies to personal property of an Indian<sup>2</sup> or a band situated on a reserve, should be applied to intangible property such as debts and other rights or choses in action. The issue has taken on more significance in light of three recent cases decided by the Tax Court of Canada in the spring of 2001, *Lewin v. The Queen*<sup>3</sup> and the joined cases of *Sero* and *Frazer*<sup>4</sup> regarding the location of deposit accounts. These decisions have severely limited the availability of the tax exemption in a manner that, it is argued, goes against the principles laid down in the leading decisions of the Supreme Court of Canada in *Mitchell v. Peguis Indian Band*,<sup>5</sup> *Williams v. The Queen*,<sup>6</sup> and *Union of NB Indians v. NB (Minister of Finance)*.<sup>7</sup>

The question of how the Indian Act tax exemption should be applied to intangible property is also increasing in importance as the movement toward aboriginal self-governance gains momentum. Federal government policy is firmly in favour of promoting economic development on reserves<sup>8</sup> and according greater governance and taxing powers to bands.<sup>9</sup> Section 83 of the Indian Act has long provided for real property taxation of reserve lands and interests in reserve lands by bands. Land claims settlements with the Nisga'a Nation in British Columbia and with various First Nations in Yukon Territory provide not only real property tax jurisdiction for First Nations governments, but also general direct taxation, including income tax, jurisdiction.<sup>10</sup> The settlement agreements contemplate future First Nation taxation of non-First Nations citizens who own property or carry on economic activity on First Nations lands. As self-governance and taxing powers of First Nations expand, clear principles must be articulated for determining which government—federal, provincial, or First Nations (or all three)—has tax jurisdiction over intangible property such as investment income.

Until the mid-1990s, the Canadian courts demonstrated willingness to apply section 87 in a broad and liberal manner, adapting its interpretation to changes in the taxes imposed by governments and their incidence on the various forms of personal property owned by an Indian or a band. When first enacted, the tax exemption was undoubtedly understood to apply primarily to real property taxes imposed by provincial or municipal authorities.<sup>11</sup> But as provincial and federal governments imposed new taxes, the courts applied the exemption to a much broader range of taxes and property, including income tax on salary and wages,<sup>12</sup> sales tax on electricity provided to an Indian on a reserve,<sup>13</sup> and sales tax on lease payments made by a band for use of a ferry.<sup>14</sup> More recently, however, 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.

The availability of the exemption for income from employment now seems to depend most heavily on the employment duties being performed on a reserve.<sup>15</sup> A similar test, the place where the business activity or professional services were performed,<sup>16</sup> determines the application of the exemption to business or professional income. Where income of an Indian is not derived from employment or business

activities, but arises as a passive entitlement to investment income, the case law now appears to exclude the application of section 87 in all but the rarest of cases.

This article reviews the reasons of the Supreme Court of Canada in *Mitchell*, *Williams*, and *Union of NB Indians*, identifying the essential elements of the decisions and the guidance given by the court as to the principles for application of the section 87 exemption. It then summarizes the post-*Williams* case law in the lower courts, noting the various ways in which the “connecting factors” test prescribed by *Williams* has been applied and, frequently, misapplied and distorted.

*Sero*, *Frazer*, and *Lewin* are then analyzed critically, and the judicial approach to the exemption from taxation taken in these cases is contrasted with the treatment of the exemption from seizure of deposit accounts situated on a reserve under section 89 of the Indian Act.<sup>17</sup>

Finally, the issues that have not as yet been given thorough consideration by the courts and the new issues raised by increasing self-governance and economic development on reserves are discussed.

## **THE SUPREME COURT’S POSITION: MITCHELL, WILLIAMS, AND UNION OF NB INDIANS**

The facts in *Mitchell* were quite simple. The Manitoba government had imposed and collected sales tax on electricity purchased by Indians or bands and consumed on reserves. This practice was determined to be illegal<sup>18</sup> under section 87. The bands demanded refunds of the tax and engaged an agent to negotiate with the government in exchange for a fee calculated as a share of any refund. The province agreed to refund the tax, the bands refused to pay the agent’s fee, and the agent garnisheed the funds held by the government in a special account located in Winnipeg.

Following the leading cases at the time, the situs of a debt for purposes of the Indian Act was considered to be the place where the debtor was situated,<sup>19</sup> so that the funds subject to the garnishing order were situated off reserve. The primary issue was whether section 90(1)(b) of the Indian Act<sup>20</sup> applied to deem the funds always to be situated on a reserve. Six of the seven judges held that section 90 did not deem the funds to be situated on reserve on the basis that the reference in that provision to “Her Majesty” was a reference to the federal Crown only and did not include the provincial Crown. However, three of these six judges, in reasons written by Wilson J, held that on a proper interpretation of the Manitoba Garnishment Act, the funds were not subject to garnishment. The three other judges, in reasons written by La Forest J, held that allowing the funds to be garnisheed would effectively expose to creditors property that was otherwise exempt from tax or seizure and that had been illegally removed from the reserve in contravention of section 87; accordingly, they ruled that the garnishing order must be set aside.

The enduring impact of *Mitchell* has been the historical and purposive analysis of sections 87, 89, and 90 of the Indian Act provided by La Forest J, discussed below. This analysis was adopted by the full court in *Williams*, which is still the leading case on intangible property and section 87, and demands more detailed review.

In *Williams*, the court considered whether unemployment insurance benefits received by an Indian were exempt from tax under section 87. It instituted the “connecting factors” test directing judges, when determining the situs of intangible property for purposes of the Indian Act, to apply a two-step process of identifying the various “connecting factors” that are potentially relevant to determining location of the personal property, and then assigning weight to those factors on the basis of (1) the purpose of the exemption, (2) the character of the property in question, and (3) the incidence of taxation upon that property.<sup>21</sup> The underlying consideration in assigning weight to the various connecting factors is whether taxing the particular form of property in the particular manner would amount to an erosion of the entitlement of the Indian qua Indian on a reserve.

The facts in *Williams* were as follows. Mr. Williams was a member of the Penticton Indian Band and resided on Penticton Indian Band Reserve No. 1. He had worked on the reserve for a logging company situated on the reserve.<sup>22</sup> He had also been employed by the band in a special job-creation project carried out on the reserve, funded by the Canada Employment and Immigration Commission (herein referred to as “the commission”), and administered by the band, which was designated the employer under an agreement with the commission. The job-creation project was part of a general federal government program available to Indians and non-Indians alike.

Mr. Williams received regular unemployment insurance benefits, for which he had qualified when working for the logging company, and “enhanced” unemployment insurance benefits in respect of the job-creation project. Payment of both types of benefits was by federal government cheque issued from the commission’s regional computer centre in Vancouver.

In a unanimous judgment written by Gonthier J, the court held that the unemployment benefits were situated on a reserve. The most significant connecting factor was that the qualifying employment, on which the entitlement to benefits depended, had been situated on a reserve. The residence of the recipient might have been relevant if it had pointed to a location other than that of the qualifying employment. The location of the debtor, the federal Crown, was considered of very little relevance given that the Crown is present and may be sued throughout Canada.

The court in *Williams* adopted and succinctly restated the reasons of La Forest J in *Mitchell*, observing that the purposes of sections 87, 89, and 90 of the Indian Act are “to preserve the entitlements of Indians to their reserve lands and to ensure that the use of their property on their reserve lands is not eroded by the ability of governments to tax, or creditors to seize.”<sup>23</sup> However, the purpose of the exemptions from taxation and seizure is not to confer a general economic benefit upon Indians.

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

The court also considered the provisions of the Income Tax Act<sup>25</sup> applicable to unemployment insurance premiums and benefits. Generally, in computing income for tax purposes, an employee was allowed a deduction for premiums paid and had to include in income any benefits received.<sup>26</sup> The combination of deduction and inclusion was designed to minimize the effect of the unemployment insurance program on general tax revenue. In the case of an Indian whose qualifying employment is exempt from tax, the premiums are paid, but no effective deduction can be claimed in the computation of taxable income. The court found that taxation of the unemployment insurance benefits in these circumstances would not merely offset the tax saved by deduction of the premiums, but would erode the entitlement created by the Indian's employment on the reserve. That is to say, it would constitute an erosion of the Indian's entitlements, qua Indian, to exemption from tax for his property on the reserve.<sup>27</sup>

The court was able to find that the qualifying employment was located on reserve because the employment was performed by the Indian at premises of the employer located on the reserve. The issues of where the employer's head office and customers were located, where the employer raised its capital, and who its shareholders and directors were, were not even mentioned in the agreed statement of facts at trial, on appeal, or in the Supreme Court of Canada's reasons. The unemployment benefits were situated on reserve even though the unemployment insurance program was and is mandatory for Canadian employees, Indian and non-Indian, whether their employment is on or off reserve, and notwithstanding that the vast majority of contributions to the program would have come from non-Indian employees and taxpayers.

The decision in *Williams* is praiseworthy for its recognition that the question of where intangible personal property is situated must be determined with regard to the purposes of the Indian Act, rather than by mechanically applying rigid conflict-of-laws principles, which, the court noted, might be open to manipulation or abuse. The court allowed the exemption where conflict-of-laws principles would have denied it, evidencing a willingness to consider Indian entitlements in a broad and evolving light. Unfortunately, there are ambiguities in the court's reasons. At one point, the court seems to state that the situs of the debtor should be discarded as a factor in determining the situs of debts owed to Indians; but at another point, it states that the situs of the debtor could be the determining factor in other circumstances.<sup>28</sup> This lack of clarity has led other courts to dismiss the situs of the debtor as irrelevant or of very little weight in cases (discussed below) that bear no factual resemblance to *Williams*, and with respect to debtors other than the federal Crown.

It is important to take note of what *Williams* does not say. It provides no indication of how much weight should be ascribed, and in what circumstances, to the place of residence of the owner of the income. Most significantly, *Williams* does not require any relationship between the intangible property and traditional First Nations culture, and it does not require that the income, either in the way it is earned or in the way it is spent by the owner, be integral to or provide a benefit to the reserve community.

In *Union of NB Indians*, the issue was whether New Brunswick could validly impose a sales tax on sales made at off-reserve locations to Indians who were resident on reserve and would use or consume the goods purchased primarily on the reserve. The five-judge majority of the court, in reasons written by McLachlin J, held that the tax was a sales tax, not a consumption tax, and the issue was the location of the property at the point of sale, since that was when the tax became payable. The “paramount location” test,<sup>29</sup> which would allow the exemption if the property was primarily located, used, or consumed on reserve, was rejected for sales tax purposes. If the sale is made on reserve, or the goods are delivered to the Indian purchaser on the reserve before the property in them passes, the transaction is exempt from tax under section 87.

Although the case dealt with sales tax on tangible personal property, it is relevant here because it contains a number of statements of principle relating to the Indian Act tax exemption.

First, the court’s decision reaffirms that where there is ambiguity, the interpretation of section 87 that most favours the Indians is to be preferred, provided that it is consonant with the purposes of the Indian Act.<sup>30</sup> The majority judgment summarizes *Williams* as holding that, in the case of intangible personal property, the issue is whether the property is “*effectively on the reserve at the time of taxation* [emphasis added].”<sup>31</sup>

The adoption of the point-of-sale test in preference to the paramount location test can be viewed as an application of the direction in *Williams* to consider the incidence of taxation on the property as part of the process of determining the situs of the property at the relevant time for purposes of the Indian Act. The point-of-sale test has the attraction of providing certainty as to whether the exemption applies at the time the tax is payable. In contrast, the paramount location test requires an assessment of the primary location at which the property will be used or consumed. In many, if not all, cases, the seller charged with the collection of the tax would be in the impossible position of having to evaluate the purchaser’s circumstances and intentions in relation to the property at the time the sale occurs.

Second, McLachlin J emphasized that the point-of-sale test would allow Indians living off reserve to benefit from the exemption when they purchased goods and services on reserve, and it would provide an incentive for Indians to establish their own businesses on reserve, leading to increased economic activity and employment. It would also create an on-reserve tax base, allowing aboriginal governments the opportunity to impose taxes for the benefit of band members. These are clear indications that there is no general requirement that an Indian reside on reserve in order to be entitled to the benefit of section 87, and that the income of an Indian derived from economic activity on reserve is exempt from tax. *Union of NB Indians* is particularly notable in that both the majority and the dissenting reasons emphasize the choice that Indians are given to locate their property on reserve in order to avoid taxation. Both judgments recognize that the exemption can apply to economic activity on reserve between Indians and non-Indians that is analogous to the activity carried on by non-Indians off reserve.

## THE POST-WILLIAMS CASE LAW

The application of the *Mitchell* and *Williams* decisions to the taxation of employment, business, and investment income of Indians has been the subject of dozens of cases and of extensive insightful criticism by commentators.<sup>32</sup> Although the Tax Court of Canada and the Federal Court of Appeal have continued to list connecting factors and assign them weight, an additional factor, not found in *Williams*, is often given overriding weight: whether the source of the income was integral to the life of the reserve, or tended to preserve the traditional native way of life. A second tendency has been to conflate the connecting factors test into a determination of whether the income was earned in “the commercial mainstream,” an inadequately defined concept that seems to refer to activities or sources connected or analogous to activities or sources in the off-reserve economy. If the income is earned in the commercial mainstream, it is ipso facto not situated on the reserve.

There appear to be two misconceptions that have led to these somewhat related distortions of the connecting factors test. The first seems to be a confusion of the test for what must be proved to establish the existence of an aboriginal right protected by section 35(1) of the Charter of Rights and Freedoms<sup>33</sup> with the test for eligibility for the section 87 exemption.<sup>34</sup> Briefly, to establish an aboriginal right protected by section 35, it must be shown that the activity that constitutes the aboriginal right must be (inter alia) an element of a practice, custom, or tradition integral to the aboriginal community that claims the right.<sup>35</sup> The idea that the purpose of section 87 is to exempt income derived from activities that are integral to the life of the reserve, or to preserve the traditional Indian way of life, first arose in *Folster v. The Queen*,<sup>36</sup> a decision on situs of employment income, and is now thoroughly entrenched in the jurisprudence.

The second distortion appears to stem from a misreading of the reasons in *Mitchell* on the proper scope of section 90(1)(b) of the Indian Act. In *Mitchell*, La Forest J used the phrase “commercial mainstream” to refer to property that was situated off reserve under section 87 or 89 and was not deemed to be situated on reserve under section 90 because it was not given to an Indian or to a band under a treaty or agreement between a band and Her Majesty. La Forest J’s point was that property that is given to Indians by treaty with the federal Crown, and that is protected from taxation and seizure wherever it is situated, is different in principle from property that is held off reserve and is used in ordinary commercial dealings, including those with the provincial Crown, off reserve.<sup>37</sup> Thus, the concept “in the commercial mainstream” as used in *Mitchell* refers to property that is off reserve and is not deemed to be on reserve by section 90; it is not a factor in determining whether property is actually situated on reserve under section 87 or 89.

Even in the decision in *Folster*, the Federal Court of Appeal had to admit that the term “commercial mainstream,” when used to distinguish non-exempt income from income integral to the life of the reserve, suggests incorrectly that commercial activity is not traditional to First Nations.<sup>38</sup> It has also been recognized by the court as “counter-intuitive” to regard employment as being in “the commercial

mainstream” when the work was for a non-profit social agency “delivering programmes to assist Native people, in large part through reconnecting them with their culture and traditions.”<sup>39</sup> However, since the Federal Court of Appeal holds firmly to the ruling that “‘commercial mainstream’ is to be contrasted with ‘integral to the life of the reserve,’”<sup>40</sup> the implication is that any income that is not integral to the life of the reserve is ineligible for the section 87 exemption.

The effect of these adaptations of the connecting factors test has been to restrict the availability of the tax exemption for income from employment and business, and more severely for income from investment. As noted earlier, no support can be found for these developments in the three most recent decisions of the Supreme Court of Canada.

### INCOME FROM INVESTMENT AND SECTION 87

The only investment income case to be decided at the appellate level is *Recalma et al. v. The Queen*.<sup>41</sup> It has been discussed in detail by others<sup>42</sup> and will be reviewed only briefly here. In *Recalma*, the section 87 exemption was denied to income, in the form of distributions from mutual fund trusts and proceeds from investments in bankers’ acceptances, received by Indians resident on a reserve. The taxpayers argued that they had deposited the investment funds in a bank account at a branch situated on a reserve and had made the investments through that branch,<sup>43</sup> so that the income from the investments was exempt from tax. The Tax Court and the Federal Court of Appeal both held that the income was derived in the commercial mainstream through investment in off-reserve mutual fund units and bankers’ acceptances.

The issuers of the bankers’ acceptances were corporate borrowers not connected to a reserve in any way. The mutual fund trusts had their head offices in Toronto, and the capital contributed by unitholders (including the *Recalmas*) was invested by the trustees in short-term debt of Canadian governments and corporations and in mortgages on real property, none of which was shown to be situated on or connected to a reserve.

The result in *Recalma* was that the income was not situated on a reserve. The fact that the capital had been deposited in a bank account on a reserve before being invested in the mutual funds and bankers’ acceptances was irrelevant to the location of the income from the latter sources. The Federal Court of Appeal specifically stated that the investments in bankers’ acceptances and mutual funds were very different from ordinary bank deposits in a bank branch on a reserve.

With respect, the reasons given by the court are too subjective and vague to be useful as precedent. In purporting to apply the connecting factors test, Linden JA stated that a court must decide “where it makes the most sense” to locate the personal property in issue in order to avoid the erosion of property held by Indians qua Indians and to protect the traditional native way of life. Following his approach in *Folster*, Linden JA framed the issue as whether the income-generating activities of the corporations that issued the bankers’ acceptances and of the mutual fund

trusts, from which were derived the amounts used by the corporations and mutual fund trusts to pay the investment income to the Indian taxpayer, were intimately connected to the reserve, and whether the activities were an integral part of reserve life.

The court in *Recalma* seems to have regarded it as necessary that there be some “activity” from which the income was derived, rather than merely a passive entitlement to receipt of income. This presumption led the court to an examination of where the mutual fund trusts and the issuers of the bankers’ acceptances carried on their businesses, rather than where the source of the Indians’ investment income was situated. The income for which the exemption is claimed—that is, the investment return received by the Indians, and not the investment income of the payer—is the income that must be situated on the reserve. In *Recalma*, both the Indians’ entitlement to the income and the business activities of the payers were off reserve, so that the result was not affected by the court’s concern with where the business activities of the issuers of the bankers’ acceptances and the mutual fund trusts were located. Unfortunately, however, this reasoning has been applied in later cases, discussed below, where it has been critical to the result.

The point to be emphasized is that there should be no requirement that the funds used by a debtor to pay an entitlement to an Indian investor be traceable to a source on a reserve. This is clear from *Williams*, where the unemployment benefits were paid out of funds collected from all Canadian employers and employees, supplemented by general federal revenues under a program available to all Canadian employees, whether Indian or non-Indian, and both on and off reserve. It would have been sufficient and appropriate in *Recalma* to deny the tax exemption on the basis that the Indian taxpayers’ income in respect of the bankers’ acceptances was derived from debts owed by corporations with no presence on or connection of any kind to a reserve and that the income received from the mutual fund trusts was the return on the Indians’ beneficial interests in property not situated on a reserve.

The Federal Court of Appeal also erred in *Recalma* in opposing income earned in “the commercial mainstream” to income “situated on the reserve.” The court’s approach implies that commercial activities that are otherwise situated on the reserve but are analogous to commercial activities pursued off reserve will not be eligible for the tax exemption. This reasoning became the basis of the decision in *Lewin*, discussed below.

## **THE DEPOSIT ACCOUNT CASES: SERO, FRAZER, AND LEWIN**

*Sero*, *Frazer*, and *Lewin* were all concerned with the issue of whether interest paid in respect of an Indian’s account at a branch of a financial institution on reserve is exempt from tax. In all three cases, the tax exemption was denied in large part on the basis that the financial institution that operated the on-reserve branch (or, as in *Lewin*, had its head office and branch on reserve) derived income, from which it paid the interest to the Indian taxpayer, from off-reserve operations or investments. A further important factor in *Lewin* was that the financial institution’s business had

no distinctively aboriginal characteristics, but was essentially the same as that of any financial institution based off reserve.

The appeal of Cyril Frazer was heard together with the appeal of Audrey Sero,<sup>44</sup> although the facts in the two cases differed in some respects that are arguably significant. The common facts were that both Ms. Sero and Mr. Frazer were Indians registered to bands located on the Six Nations of the Grand River Reserve No. 40 (“the reserve”). Both deposited funds in term deposit accounts with the Royal Bank of Canada at its Ohsweken branch located on the reserve. Both claimed the section 87 exemption in respect of interest earned on the accounts.

Ms. Sero had never lived on a reserve, and all of the funds deposited at the Ohsweken branch were savings accumulated from employment performed off reserve. By contrast, Mr. Frazer was born on the reserve and grew up there. He lived and worked off reserve until 1985. He then returned to live on the reserve. He owned a laundry business on the reserve, the income from which, the Crown agreed, was exempt from tax. The funds deposited by Mr. Frazer at the Ohsweken branch were savings accumulated from the laundry business.

The Tax Court had no difficulty in finding that the interest income was personal property of the taxpayers, or that the term deposits were “deposit accounts” for purposes of the Bank Act.<sup>45</sup> The principal argument made by the appellants was that section 461 of the Bank Act deemed the accounts, and therefore the source of the income, to be on reserve, and that the connecting factors test was not applicable because it was to be only used to resolve uncertainty regarding situs of property under section 87 of the Indian Act.

Section 461 of the Bank Act defines the “branch of account” with respect to a deposit account for the purposes of the Bank Act, which in both *Sero* and *Frazer* was the Ohsweken branch. Section 461 provides that the debt owing by the bank to the depositor is payable only at the branch of account, and the person entitled to the funds may not demand payment or be paid at any other branch of the bank. Most significantly, section 461(4) of the Bank Act provides that “[t]he indebtedness of a bank by reason of a deposit in a deposit account in the bank shall be deemed *for all purposes* to be situated at the place where the branch of account is situated [emphasis added].”

The Crown’s position was that section 461 applied for purposes of the Bank Act only, and since it represented the conflict-of-laws approach, rejected in *Williams*, it should be ignored. Alternatively, if section 461 was applicable, it was not determinative, but only affected the weight to be given to one of the connecting factors, the location of the branch. Relying on *Recalma*, the Crown argued that investment income, whether earned from investing in mutual funds or bankers’ acceptances or as interest on a deposit account, was passive income not earned by the efforts of the investor. The interest income was not connected to the land base or any chattels on the reserve<sup>46</sup> and thus should not be exempt from tax simply because it was paid in respect of a deposit account on reserve land.

Hamlyn TCCJ rejected the appellants’ argument that section 461 of the Bank Act was determinative and applied the connecting factors test, adopting the list of

potentially relevant factors from his trial judgment in *Recalma*. He was of the view that the Federal Court of Appeal in *Recalma* had determined that in all cases involving investment income, it is the place where the income stream of the payer—that is, the bank—is generated that governs.

There was no recognition in Hamlyn TCCJ's analysis that the interest received on the deposit account at the on-reserve branch was distinguishable from other types of investment income, even though the Federal Court of Appeal in *Recalma* considered a deposit in an on-reserve bank account distinguishable from the bankers' acceptances and mutual funds in that case.

In the *Frazer* case, the court found that all of the relevant connecting factors, except the "residence" of the bank (meaning its head office) and the location of the bank's income-generating activity and property, supported the location of the income on the reserve. However, the court found that the income of the bank, from which the interest was paid to Mr. Frazer, was generated off reserve, and consequently, Mr. Frazer's interest income was situated off reserve.

The result in *Frazer* is clearly wrong. It is not the bank's source of income that is relevant; the bank is subject to tax on all of its income, whether generated on or off reserve. Rather, the relevant factor is whether the individual Indian's entitlement to the interest income is on or off reserve.

The Indian who chooses to deposit savings in an on-reserve deposit account has chosen to situate his or her property within the protected reserve system. The interest income of an Indian from an on-reserve deposit account is connected legally and factually to the branch that occupies premises leased from Her Majesty or from a band member on reserve lands, that may pay property tax and licence fees to the band, and that provides financial services on the reserve. The bank accepting deposits and paying interest at its branch established on reserve cannot be distinguished in any substantial sense from the provincial electric utility supplying electricity to an Indian's residence on reserve, as in *Brown*,<sup>47</sup> the forest products company leasing premises and employing reserve residents for its operations on the reserve, or the Crown agency accepting premiums and paying unemployment insurance benefits in respect of on-reserve employment in *Williams*.

In holding that the interest income was taxable because the bank's head office and most of its assets and operations were off reserve, the court gave paramount importance to the location of the indirect source of the debtor's income, rather than to the legal situs of the direct source of the Indian's income. Mr. Frazer had made the choice he was entitled to make: to earn a tax-free living and accumulate savings on reserve, and to deposit the savings with a branch that was established on reserve, rather than investing it off reserve. The anomaly of the ruling in *Frazer* is apparent when one realizes that an Indian employee of the branch would be exempt from tax on her employment income, as would the income of an Indian business person who, for example, provided janitorial services to the branch as an independent contractor.

In the case of a deposit account governed by section 461 of the Bank Act,<sup>48</sup> a clear, legally binding rule capable of determining with certainty the situs of the

interest income on the account has been provided in a federal law of general application. Since, according to the *Williams* test, it is the location of the Indian's contractual or other entitlement to receive the income that must be on reserve, it seems legally undeniable that the source of the Indian's interest income in *Sero* and in *Frazer* was on reserve. The issue of whether section 461 is conclusive with respect to on-reserve bank accounts, or is simply a connecting factor, is one that deserves more careful analysis by a higher court.

Hamlyn TCCJ's denial of the section 87 exemption in *Sero* may be distinguished from the decision in *Frazer* and defended on the basis that two of the relevant connecting factors, the residence of the taxpayer and the source of the accumulated savings on deposit, pointed to the income being situated off reserve.

There are, however, strong arguments that the residence of the Indian taxpayer off reserve should be accorded little weight. First, the requirement that the Indian reside on reserve in order to be entitled to the exemption was removed from the precursor to section 87 when a new Indian Act was enacted in 1876.<sup>49</sup> *Union of NB Indians* determined that, at least in the case of sales tax, Indians living off reserve have the same entitlement to the tax exemption for purchases made on reserve as that available to Indians who reside on reserve. The residence of the Indian taxpayer on or off reserve has been accorded little weight in the leading cases on employment income and business income.<sup>50</sup>

The circumstances that have caused the majority of Indians to live off reserve were recently acknowledged by the Supreme Court of Canada in *Corbière v. Canada*.<sup>51</sup> The court ruled in *Corbière* that the denial of voting rights to band members who were not ordinarily resident on reserve in section 77 of the Indian Act was an infringement of the right not to be discriminated against in section 15 of the Charter. The judgments of both majority and minority described the reasons why many Indians live off reserve: the lack of housing and of economic and educational opportunities on reserve, and the operation of past Indian status and band membership rules imposed by Parliament, which had unconstitutionally stripped many Indians of their status. Laws that restored Indian status had affected mainly Indians living off reserve. The court recognized that the entitlement of Indians who ordinarily reside off reserve to participate in the election of the band council was based on their equal entitlement with band members who live on reserve to the band's reserve lands and other assets, and to representation in negotiations with governments and within aboriginal organizations.

It may be argued that these findings in *Corbière* should diminish the weight to be accorded to residence on reserve as a connecting factor in taxation of intangible property and should support the proposition that Indians who live off reserve should be entitled, at least in principle, to the same opportunity as Indians who live on reserve of choosing where to situate their property for tax purposes. While the actual circumstances of Indians living off reserve may make it inconvenient or impossible for them to situate their property on reserve, the fact that an Indian lives off reserve should not be an important determinant of where his or her property is situated, as a matter of law.<sup>52</sup> In the case of investments, provided that the Indian's

source of the investment income is effectively on reserve and the reserve investment is not used as a mere conduit to an off-reserve source, the residence of the Indian should be immaterial. Reinstating residence on reserve as a requirement, or a significant factor, to qualify for the tax exemption smacks of the old laws that required Indians to give up their status (and, consequently, the protections for their property wherever situated) if they left the reserve or became citizens of Canada.

Admittedly, *Corbière* was a Charter case and dealt with a denial of voting rights, so that the applicability of the court's analysis regarding residence on reserve in the present context is open to debate. Many would argue that the Charter right not to be discriminated against, particularly in respect of a fundamental democratic right, the right to vote, is more deserving of protection than is the section 87 right to exemption from taxation.<sup>53</sup> But there is substance to the argument that the nature of the protections from taxation and seizure in the Indian Act are, like Charter principles, deserving of special regard, since they originate in the promises made by the Crown to Indians in exchange for their acknowledgment of the Crown's sovereignty, and bind the honour of the Crown.<sup>54</sup> The right to the exemptions from taxation and seizure belongs to every Indian in respect of his or her property on a reserve; an additional requirement that the Indian person reside on reserve should not be read into the statute to exclude property that is otherwise situated on a reserve.

Finally, undue reliance on residence as a connecting factor for investment income may have the undesirable consequence of precluding any certainty as to where the income is situated. The Income Tax Act requires interest to be included in a taxpayer's income in the year in which it is received or receivable,<sup>55</sup> or to the extent that it has accrued to an anniversary date of the investment contract that occurs during the year.<sup>56</sup> If an Indian transfers his or her residence on or off reserve during the term of the term deposit, should the interest income be apportioned for tax purposes between that which accrued while the Indian resided on reserve and that which accrued while the Indian resided off reserve? What if the Indian usually resides on reserve for part of the year and off reserve for the rest? What if the Indian has a residence on reserve and another residence off reserve? If it is determined by a higher court that the location of the residence of the Indian taxpayer is a connecting factor of significant weight, these questions will have to be resolved.

The source of the funds deposited in the bank account on reserve is another connecting factor that was considered relevant in *Sero* and should be more closely examined. Obviously, if the funds in the account have their source in on-reserve business, employment, or investment of an Indian, this factor should connect the interest received from depositing the funds in an on-reserve bank account to the reserve. Again, it may be argued that Indians should have the choice of where to locate their after-tax savings, regardless of the source of the income from which the savings were accumulated. It is only where a person attempts to avoid tax legitimately payable on the income derived off reserve by utilizing the on-reserve account as a conduit that the section 87 exemption should be denied.<sup>57</sup>

Only a few weeks before the *Sero* and *Frazer* cases were decided, the Tax Court of Canada rendered judgment in *Lewin*. Mr. Lewin resided off reserve, but was a member of the Huron Wendat Nation and had put his name on a waiting list to live on the reserve. He deposited funds in an account with the Caisse Populaire Desjardins du Village Huron (“the credit union”), which had its head office and main business location on the Huron Wendat reserve. Mr. Lewin was assessed for income tax in respect of interest paid on the deposit account at the credit union.

The credit union was established as an initiative of the Huron Wendat Nation for the primary purpose of providing housing loans and other debt financing for Indians living on reserve. The credit union was run by the Indians, and its activities were originally confined to the reserve. A main function of the credit union was to provide loans for housing construction on the reserve by providing a matching loan to grants made by the band council, and to this end the band council and management of the credit union cooperated. Most of the employees of the credit union were Indians, and the majority of its member-owners and customers were Indians living on the Huron Wendat reserve. Otherwise, it offered the same services and operated in the same way as all other credit unions in the network. The credit union accumulated substantial surpluses, which it invested in the normal capital markets off reserve.

Although Tardif TCCJ readily accepted that the loan agreement between the appellant and the credit union that generated the interest income was located on reserve,<sup>58</sup> the interest income was held to be subject to tax. If the court had based its judgment on the source of the appellant’s capital, and the fact that the taxpayer lived off reserve and the interest income would therefore be enjoyed off reserve, the result might be defended as a reasoned application of the connecting factors test, on the same basis, discussed above, as *Sero* might be upheld. However, the approach taken in *Lewin* is a complete departure from precedent and principle.

Among the reasons given for denying the tax exemption, the court held that, although the “vast majority” of members of the credit union were Indians, any non-Indian could be a member and, in theory, it would be possible for non-Indians to control and run the credit union, even though its situs did not lend itself to such an outcome. Thus, a theoretical fact situation, admitted even by Tardif TCCJ to be remote, was considered more important than the actual state of affairs. Also, it has not been considered significant, at least expressly, in the section 87 cases that the payer of the income held to be on reserve was neither an Indian nor completely owned and controlled by Indians.<sup>59</sup>

The court also noted, as a basis for denying the tax exemption, that the credit union’s operations and activities were not exclusively directed at the development of the Huron Nation, and that the services provided by the credit union to the Indian community on the reserve could have been provided by any financial institution and had nothing to do with the Indians’ culture and traditional way of life. This is the most extreme statement so far of the position that the tax exemption is restricted to income generated through activity traditional to First Nations and for

the benefit of a reserve community, and it goes well beyond any statement of the Federal Court of Appeal.

The court also considered it very significant that the credit union invested its surpluses off reserve in the capital markets. Again, the source of a portion of the credit union's income is hardly relevant to the application of section 87 to Mr. Lewin's income. The credit union is not an Indian or a band, and it is subject to tax no matter where its property is situated or its income is earned.

The emphasis on the off-reserve sources of the credit union's income raises concerns as to whether there is any situation in which Indians may conduct business, directly or indirectly, with non-Indians without losing the benefit of section 87.<sup>60</sup> For example, if an Indian carrying on a business venture on a reserve borrows from an off-reserve source, should the business on the reserve be subject to tax, since it obtained its financing off reserve? Does the fact that an Indian's on-reserve business has some customers who are not Indians make the business profits subject to tax? Should an Indian's share of profits from a partnership of Indians and non-Indians that has its assets and operations on reserve be subject to tax? Should liability for tax depend on whether the Indian partners are actively engaged in the business or are mere silent partners? *Frazer* and *Lewin* propound an approach that denies the tax exemption except where every aspect of a business or investment activity originates within the reserve system and is for the benefit of the reserve community as a whole and traditional to First Nations culture. Although the cases had different factual underpinnings, it is significant that in *Frazer* and *Sero*, Hamlyn TCCJ expressly relied on *Lewin* and considered that it supported his ruling.

## SEIZURE OF DEPOSIT ACCOUNTS OF INDIANS

The exemption from tax and the exemption from seizure<sup>61</sup> have been applied quite differently by the courts in determining when a deposit account is situated on a reserve. In the cases subsequent to the *Mitchell* and *Williams* decisions, the location of a deposit account at a bank or trust company, and thus the question whether the account is subject to garnishment by a creditor, has been determined according to whether the branch of account was located on reserve. The common law rule, established in *Rex v. Lovitt*,<sup>62</sup> is that a bank account is situated for legal purposes where it is payable, and it is payable where, in the ordinary course of business, it would be paid and the holder would seek payment, and that is at the bank branch where the holder deals. As early as 1913, the Ontario Court of Appeal applied this principle to hold that funds held in an off-reserve bank account by an unenfranchised Indian, living on reserve, could be garnished by a non-Indian.<sup>63</sup>

As noted in the discussion of the tax exemption cases above, the common law rule has been statutorily enacted and expanded in section 461 of the Bank Act and section 447 of the Trust and Loan Companies Act. In addition, section 462 of the Bank Act and TLCA section 448 make it clear that a garnishing order or other legal process of seizure of the funds in the account must be served at the branch of account, or at the branch that has possession of the property, and the bank or trust

company cannot be compelled to pay an amount held on deposit except at the branch of account.

Two cases have held that a deposit account of a band at an off-reserve branch of the Peace Hills Trust Company (PHTC), which has its head office on the Samson Indian Reserve in Hobbema, Alberta, is not exempt from seizure pursuant to section 89 of the Indian Act. In *Webtech Controls Inc. v. Cross Lake Band of Indians*,<sup>64</sup> the funds were held in an account belonging to the band at the Winnipeg branch of PHTC. Master Lee considered the situs of the funds to be off reserve, rather than at the on-reserve head office of PHTC. Section 447 of the TLCA was not in force at the time of the decision, and no mention was made of the common law rule. In the result, the funds were exempt from seizure since they had been paid to the band to compensate its members for impairment of their rights under a treaty or ancillary agreement, and were therefore deemed by section 90(1)(b) to be always situated on a reserve.

In *Alberta (Workers' Compensation Board) v. Enoch Band*,<sup>65</sup> the Alberta Court of Appeal allowed the seizure of band funds in a deposit account at the Edmonton branch of PHTC. Although PHTC had been continued under the TLCA at the time of the court's decision, it is not clear whether the TLCA applied to PHTC at the time the funds were seized.<sup>66</sup> The majority of the court applied the common law rule in *Lovitt* since the deposit account and related services provided by the trust company were analogous to those provided by a bank, and accordingly the situs of the account was not on reserve. The majority found that an agreement between PHTC and the band, by which the monies in the account were deemed to be held at the head office of PHTC on the Samson Indian Reserve, was not effective as against third-party creditors, given that the band's actual practice was to deal with the account solely at the Edmonton branch of PHTC. The majority was of the view that applying the connecting factors test in *Williams* did not change the result.<sup>67</sup>

Under section 461 of the Bank Act and TLCA section 447, the financial institution and the customer may designate the branch of account by agreement, and the financial institution may permit the customer to deal with the funds through another branch. Thus, it appears that a properly drafted agreement between the band and the trust company designating the branch of account as the head office on the reserve would now be effective, even if the funds were usually dealt with by the band at another branch.

In *Houston v. Standingready*,<sup>68</sup> a case predating *Williams*, the owners of the accounts were Indians who resided on reserve and who had been held personally liable to pay a wrongful dismissal judgment to a non-Indian. The accounts were maintained at off-reserve branches of two banks and a credit union. The Saskatchewan Court of Appeal applied the test based on the purpose of section 89 prescribed in *Mitchell* but found no "discernible nexus" between the bank accounts and the reserve. The accounts were therefore situated off reserve.

In British Columbia, it appears to be undisputed that a deposit account is situated on reserve if the branch of account is on reserve. In *CIBC v. E & S Liquidators Ltd.*,<sup>69</sup> Warren J held that it was the intention of section 89 to exempt

from garnishment personal property of Indians located on “designated lands.”<sup>70</sup> Since the branch of account was situated on designated lands, he found that the funds were situated on reserve and not subject to seizure. It does not appear that *Mitchell* or *Williams* was relied on by either party in that case.

In the recent case of *Gifford v. Lax Kw' Alaams Indian Band*,<sup>71</sup> the garnisheed funds belonged to the defendant band and were held in an account at the Duncan branch of the Toronto-Dominion Bank. The Duncan branch is situated on a reserve, and all parties conceded that the account was situated on reserve. The court held that the funds were exempt from seizure since they were situated on reserve, and that a status Indian assignee of the creditor's claim against the band could not rely on the exception to section 89 that permits an Indian creditor to seize property of an Indian situated on reserve.

In summary, the cases regarding seizure of funds in deposit accounts all apply the test of where the depositor may demand payment of the funds, or the situs-of-the-debt test, to determine whether the funds are situated on reserve. While there is little or no discussion of the principles of *Mitchell*, the connecting factors test in *Williams*, or the Bank Act or TLCA provisions, the courts seem to accept that the Indian or band can choose to deposit funds at an on-reserve or off-reserve branch, and that that choice is determinative for purposes of section 89. In short, the courts apply the test of where the branch of account is situated.<sup>72</sup>

The difference in treatment of deposit accounts under sections 87 and 89 is curious, given that the two exemptions arise from the same historical sources and have the same purpose: to protect Indian property from the power of governments to tax and creditors to seize.<sup>73</sup> It could also have anomalous, not to say nonsensical, results. For example, on the basis of *Frazer* and *Lewin*, an Indian, whether residing on or off reserve, would be subject to tax in respect of her interest income from a deposit account held at a bank or trust company branch on the reserve. However, on the basis of the case law applying section 89 of the Indian Act, the funds in the deposit account would not be subject to seizure to satisfy the tax liability.

It may be that the section 89 cases on deposit accounts are the true anomaly, or that there is an unarticulated explanation for the readiness of the courts to accept the situs of the account on reserve for section 89 purposes, but not for section 87 purposes. The section 89 cases do not appear to have been argued in *Sero* and *Frazer* or *Lewin*.

## AREAS OF UNCERTAINTY IN THE SECTION 87 CASE LAW

As discussed already in this article, two areas of uncertainty in the connecting factors test are the weight to be ascribed to the residence of the Indian and the weight to be accorded to the source of the funds invested by the Indian. A third and related issue is whether the intangible property must be situated on the Indian's “own” reserve or must simply be situated on “a” reserve.

As noted in *Corbière*, the majority of Indians do not live on reserve. In many cases, they lost their status under the former law, because they left their reserve,

obtained Canadian citizenship, or otherwise became entitled to vote,<sup>74</sup> or in the case of Indian women, married non-Indian men. The Charter restored the right to be registered sometimes many years after it had been lost and after the First Nations person had ceased to live on a reserve to which he or she was connected by band membership. Individuals may live on the reserve to which their spouse's First Nation is connected, or where a job suiting their skills is available, rather than the reserve to which they are most closely connected through the band affiliation of one or both of their parents.

The reference in sections 87 and 89 is to property that is situated on "a" reserve. Various statements have been made by the courts in respect of this issue, but no court has addressed it directly. In *Desnomie v. Canada*,<sup>75</sup> an employment income case, it was suggested that only personal property located on the taxpayer's own reserve was eligible for the exemption. The Federal Court of Appeal in *Shilling* further suggested (but declined to decide) that the wording of section 87 did not compel the conclusion that location on any reserve was sufficient, intimating that the property must be situated on the Indian's own reserve.

In *Alberta v. Enoch Band*, the court thought it made no difference that the branch of account might be situated on a reserve connected to another band. In *Union of NB Indians*, the court found no difficulty in the fact that Indians who lived off reserve, or who lived on another reserve, travelled to make purchases on a reserve in order to benefit from the exemption. Thus, it seems that there is support at the appellate level for both interpretations.

There remains considerable confusion over the extent to which the situs of the debtor survived the *Williams* decision and can affect the taxation of income from a debt obligation. In *Metlakatla Ferry Service*,<sup>76</sup> McLachlin JA had no difficulty in concluding that the obligation to make lease payments under a lease of the ferry to the Metlakatla Band was situated on reserve, since the debtor, the band, was on the reserve. In *Mitchell*, La Forest J generally approved a liberal approach to the situs of debt obligations, citing *Metlakatla*. The court in *Williams* then clearly indicated that the situs of the federal Crown was of little or no relevance in determining the situs of unemployment benefits, but was clearly of the view that the location of the employer on reserve was significant in determining where the qualifying employment income was situated. In the investment income cases, the immediate contractual connection with a branch of the debtor on reserve has been ignored where the head office, primary business operations, or assets of the debtor are off reserve.

Running through the cases on situs of intangible property, there seems to be a concern on the part of the courts that the connection of the property to a reserve be substantial. While the right of an Indian to choose the situs of income through effective planning is frequently reiterated, connections that are viewed as artificial or abusive are not allowed to determine the location of intangible property. This is a salutary approach, and completely in keeping with the connecting factors test. It would be more helpful, however, if the courts would identify this concern expressly, rather than resorting to the coded determination of whether the property was in the commercial mainstream as opposed to integral to the life of the reserve.<sup>77</sup> The

purpose of the Indian Act, to protect the property of Indians that is effectively and substantively located on a reserve, would be better served if courts were willing to identify what connections they consider to be artificial and why.

Taking as an example the results in the deposit account cases, it seems that the test of situs of the debtor, the common law rule as to situs of bank accounts as expressed in *Lovitt*, and the statutory rules in the Bank Act and the TLCA that situate a deposit account at the branch of account “for all purposes” have effectively been dismissed as technical or artificial and thus discounted as connecting factors. In the three cases considering this issue discussed above, the courts have treated the location of the branch of account as not significant and instead have looked to where the financial institution earned some or all of its income, indicating that they consider the general legal rule as to the situs of the income to be at best a technical determinant of location of the income.<sup>78</sup>

Another concern is the unarticulated but apparent prejudice in the cases against independent business and investment activity sources of income to Indians that are entitled to the tax exemption (if they are factually and legally situated on reserve). This prejudice is revealed in the investment income cases in the courts’ emphasis on the location of the head office, assets, and activities of the payer, rather than on the legal and effective location of the agreement entitling the Indian to the income. The connections of the payer to the general Canadian economy are not generally an issue in employment cases, nor were they in *Williams*, where the income was paid under a universally available social program. Where Indian investment and business are concerned, the courts demand that they benefit the reserve community rather than the individual Indian, and that they preserve traditional Indian culture. These concerns are far less evident in the employment cases, where the emphasis is clearly on the place where the duties of employment are performed. These aspects of the cases are disturbing, since they seem to limit the entitlements of individual Indians to the tax exemption, without having provided a sound basis for the different approach. As noted by T.E. McDonnell,<sup>79</sup> there is a patronizing and discriminatory aspect to these decisions, and it is objectionable.

## **GETTING BACK ON TRACK: A NEW APPROACH TO TAXING INTANGIBLE PROPERTY OF INDIANS**

The effect of the decisions in *Lewin* and *Frazer*, drawn to their logical conclusion, would be to reduce the “protected reserve system” with respect to Indian investment income to a separate, ring-fenced, exclusively traditional economy that has no direct or indirect connections or commercial analogues in the off-reserve world. This narrow application conflicts with current federal government policy with respect to First Nations, which aims to promote the development of modern economies with opportunities for employment and investment on reserves, to provide a framework for more extensive self-government, and to assist and encourage implementation of direct taxation on reserves for the benefit of the reserve community. These policy objectives were recognized and accepted by the Supreme

Court of Canada as being consistent with the purposes of the Indian Act, in *Union of NB Indians* in 1998.

The argument made here is not that Indians should enjoy exemptions from tax and seizure for property that is not effectively situated on a reserve. Rather, it is argued that fair, consistent, and certain principles for determining when property is situated on a reserve must be more clearly articulated. It is time for the Supreme Court of Canada to hear a case on the proper application of section 87 to income and to adopt or reject the line of cases since *Williams* that emphasizes consideration of whether the income is integral to the life of the reserve, or preserves the traditional native way of life, in determining eligibility for the exemption.

On the assumption that such reasoning will be found to be in error, the opportunity should be taken to restate the connecting factors test. First, enactments and general legal principles that bear on the situs of intangible property should be expressly recognized as relevant and broadly determinative of where such property is situated for purposes of sections 87 and 89 of the Indian Act. The Canadian legal order is not ousted just because the Indian Act is in issue. The exemptions from taxation and seizure in sections 87 and 89 were enacted within a legal framework that included rules for determining the location of property. The assumption must have been that such rules would apply, since no special rules for determining the situs of Indian property were provided. Indians are normally subject to the general law of Canada and are expressly subject to provincial laws of general application unless those laws are inconsistent with the Indian Act.<sup>80</sup> The approach taken in *Union of NB Indians* illustrates this point. The court's choice of the legal point-of-sale test over the more fact-based paramount location test implicitly approved the application to section 87 of general sales law principles governing the passage of property in goods. Since the result did not, in the court's view, erode the legitimate scope of the tax exemption, no variation of the normal rule was needed.

It is submitted that conflict-of-laws principles can be very helpful, and are not inherently inappropriate, to the determination of where intangible property is situated for purposes of the Indian Act. They are, after all, the result of judicial consideration over time of the practical realities of various transactions and activities in the commercial sphere (and other private law areas). Where an Indian participates in commercial transactions, there is no reason why normal conflict-of-law or other applicable general legal rules should not apply. As discussed earlier in this article, the cases on seizure of deposit accounts uniformly apply general legal rules for determining the location of deposit accounts and other debts owed to Indians.

In *Williams*, the conflict-of-laws principle pertaining to situs of debts was rejected in favour of the broader connecting factors test. While no criticism is made here of the court's purposive approach in *Williams* to the determination of the situs of intangible property under the Indian Act, it may also be observed that the private law rule as to the situs of a debt is not obviously relevant to the location of the statutory obligation of a federal agency to pay social benefits, whether to an Indian or to a non-Indian. It now seems somewhat surprising that the situs-of-the-debtor test was rejected on the basis of the broad historical and policy arguments in

favour of protecting Indian entitlements, and not (also) on the basis of a consideration of whether the situs-of-the-debtor rule should extend at all to public law statutory rights to social benefits.

In addition to general statutory and common law rules for determining situs of intangible property, it is submitted that courts could seek guidance in generally applicable rules in domestic tax law and even standard provisions in Canada's bilateral tax conventions as indicators of where to situate various types of income. It may be recalled that Gonthier J in *Williams* identified the incidence of taxation on various types of income as a relevant consideration in determining situs, and this analysis was applied in *Union of NB Indians*. The existing domestic and international rules determine the location of a source of income for the purpose of allocating taxing jurisdiction among two or more competing taxing authorities. While not uniform throughout the world, international tax agreements represent what two sovereign taxing jurisdictions agree are the most significant factors effectively connecting income to a location within their territory, so that the jurisdiction to tax the income can be allocated to avoid double taxation. Obviously, the issue with respect to section 87 of the Indian Act is not double taxation but whether the income is exempt or taxable. But as First Nations begin to exercise jurisdiction to tax on reserves, such rules will undoubtedly have to be applied, no doubt with appropriate variations, in allocating tax jurisdiction between First Nations and provincial and federal governments in order to avoid double taxation and the disincentive to investment and economic activity that results from it.

For example, employment income is usually considered to arise where the employment duties are performed. Canada taxes non-residents in respect of employment performed in Canada.<sup>81</sup> It generally allows the other country to tax the employment income of a Canadian resident derived from employment duties performed in the other country.<sup>82</sup> Whether consciously or not, the Canadian courts have adopted the test of where employment duties are performed for purposes of applying the Indian Act tax exemption.<sup>83</sup> Where an Indian performs the duties of employment on reserve, the employment income is exempt, and where duties are performed off reserve, they are taxable. This reasoning was in fact applied in *Williams* to determine where the qualifying employment income was situated, in that the court found that the employment was located on reserve.

Similarly, business income is usually allocated to one or more branch locations or permanent establishments of a taxpayer through which the income is generated.<sup>84</sup> Interest and royalty income is subject to taxation by the country where the branch of the payer to which the interest or royalties are effectively connected is located, even though that income may also be taxed in the country of residence of the recipient. Thus, the source of intangible property for tax purposes is determined according to factors that, as agreed by both countries, indicate effective connection to a particular jurisdiction.

By analogy, an Indian would be entitled to the exemption for business income attributable to a permanent establishment situated on reserve, and subject to tax in respect of income attributable to permanent establishments off reserve. How income

would be determined to be “attributable” to one branch or another would have to be examined in each factual context.

The permanent establishment test also applies to passive income in the form of interest and royalties, so that the source of the interest or royalty income is considered to be the permanent establishment of the paying entity to which the interest is “effectively connected” or in connection with which the obligation to pay the royalties is incurred.<sup>85</sup> Thus, an Indian who licensed intellectual property to businesses located on reserve could claim the exemption for the royalties received from those businesses, but would have to pay tax on royalties received from licensees off reserve.

It is not advocated here that principles identical to those generally applied under Canada’s federal tax system or internationally should be rigidly applied in the context of section 87 of the Indian Act. The courts will still have to undertake a careful assessment of whether the purposes behind the existing domestic and international allocation principles are in keeping with the Indian Act and with the realities of economic activity and income sources both on and off reserve. However, it may be observed that the objectives of the connecting factors test are parallel to those of the allocation principles in international taxation law—namely, to determine the legal and effective location of a source of income on the basis of key factual criteria. The allocation rules have been broadly accepted as reasonable and fair by Canada’s 70 tax treaty partners and by other countries that adopt the standard provisions of the OECD model tax convention.<sup>86</sup>

In conclusion, the recommended approach would be based on general legal and tax principles regarding the location of a source of income, and on real and substantial factual connections to a reserve, and would reject any considerations of the traditional Indian character of the income or its benefit to the reserve community. Such an approach would be more defensible in law, and more respectful of the economic and self-governance aspirations of First Nations, than are the recent decisions discussed above. It would also be in keeping with the Supreme Court of Canada’s decisions in *Mitchell, Williams*, and *Union of NB Indians*.

## NOTES

1 RSC 1985, c. I-5, as amended. Section 87 provides:

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

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

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

2 I use the term “Indian” rather than the preferred “First Nations person” or “native” when the context refers to the statutory definition in the Indian Act. “Indian” is defined in section 2 of the Act and is restricted to persons who are registered as Indians pursuant to the Act or who are entitled to be registered as Indians.

3 2001 DTC 479 (TCC).

- 4 *Sero et al. v. The Queen*, 2001 DTC 575 (TCC).
- 5 (1990), 71 DLR (4th) 193 (SCC).
- 6 92 DTC 6320 (SCC).
- 7 (1998), 161 DLR (4th) 193 (SCC).
- 8 This is evident in the response of the federal government to the *Report of the Royal Commission on Aboriginal Peoples* (Ottawa: the commission, 1996) as expressed in Canada, Department of Indian Affairs and Northern Development, *Gathering Strength: Canada's Aboriginal Action Plan* (Ottawa: Department of Indian Affairs and Northern Development, 1997) (available on the Web at [http://www.ainc-inac.gc.ca/gs/chg\\_e.html](http://www.ainc-inac.gc.ca/gs/chg_e.html)), and in the department's annual reports and policy updates.
- 9 For example, in the Budget Implementation Act, SC 1997, c. 26, the federal government provided the statutory basis for the imposition of tobacco taxes on Indians on the Cowichan and Westbank reserves by the band councils. The provisions of the Budget Implementation Act contemplate imposition of "direct taxes" of all kinds, notwithstanding section 87(1) of the Indian Act. In its budget statements from 1997 to 2000, the federal government indicated its willingness to put into effect direct taxation arrangements with interested First Nations. For a more complete discussion of current taxation on reserves by Indian band councils, see Dominic C. Belley, "Indian Taxation Powers: Sharing Canadian Prosperity" (Automne 2000) vol. 60 *Revue du Barreau* 185-245.
- 10 See, for example, the Selkirk First Nation Self-Government Agreement, chapter 14 (available on the Web at <http://www.cyfn.ca>), and the Nisga'a Final Agreement Act, SBC 1999, c. 2, schedule (Nisga'a Final Agreement) chapter 16.
- 11 See *Nowegijick v. The Queen* (1983), 144 DLR (3d) 193, at 196 (SCC).
- 12 *Nowegijick*, *ibid.*, was the first case to hold that section 87 income from employment was personal property, and that section 87(2) could exempt an Indian person from taxation under the Income Tax Act "in respect of" such personal property. An earlier case, *The Queen v. National Indian Brotherhood* (1978), 92 DLR (3d) 333 (FCTD), had accepted in principle that income from employment was personal property that could be exempt from income tax under section 87.
- 13 *Brown v. The Queen in Right of British Columbia* (1979), 107 DLR (3d) 705 (BCCA).
- 14 *Metlakatla Ferry Service v. The Queen* (1987), 37 DLR (4th) 322 (BCCA).
- 15 A review of the results of the employment cases demonstrates (with only two exceptions) that the Indian must perform the major part of his or her employment duties on reserve to claim the exemption. See the recent cases of *The Queen v. Monias* (2001), 205 DLR (4th) 106 (FCA) and *The Queen v. Shilling* (2001), 201 DLR (4th) 523 (FCA), leave to appeal to the Supreme Court of Canada denied in both cases, March 14, 2002. A review of the case law on employment income is beyond the scope of this article. For a recent and thorough discussion of that case law, see John Hurley, "Aboriginal Tax Case Law in 2001," in *Report of Proceedings of the Fifty-Third Tax Conference*, 2001 Conference Report (Toronto: Canadian Tax Foundation, 2002), 31:1-43.
- 16 See *Southwind v. The Queen*, 98 DTC 6084 (FCA). Mr. Southwind was a sole proprietor living on reserve, with his logging services business based at his home, where he carried out the administration and stored business records and logging equipment. All the logging services provided by the business were performed off reserve, and the business income was held to be taxable. In addition, *Dykstra v. Monture*, [2000] 3 CNLR 59 (Ont. SCJ) essentially holds that the location where professional services are performed determines the location of the professional income, albeit in a different context.
- 17 Section 89 of the Indian Act provides protection for Indian real and personal property from charge or seizure by non-Indians: "89(1) Subject to this Act, the real and personal property of an Indian or a band situated on a reserve is not subject to charge, pledge, mortgage, attachment, levy, seizure, distress or execution in favour or at the instance of any person other than an Indian or a band."

- 18 See *Brown*, supra note 13.
- 19 *Nowegijick*, supra note 11, and *Metlakatla Ferry Service*, supra note 14. Since *Williams*, it may be argued that the debtor, the provincial Crown, is present through the province.
- 20 The relevant portions of section 90(1) are as follows:  
 For the purposes of section 87 and 89, personal property that was . . .  
 (b) given to Indians or to a band under a treaty or agreement between a band and Her Majesty,  
 shall be deemed always to be situated on a reserve.
- 21 Supra note 6, at 6329.
- 22 Greenwood Forest Products (1983) Ltd. carried on a remanufacturing operation at premises located on reserve land, leased from a band member and the Crown. The company's shareholders and directors were non-Indians and its head office, and presumably most of its customers, were off reserve. (Telephone conversation with Peter Beulah, president of Greenwood Forest Products (1983), Ltd., Penticton, August 2001.)
- 23 *Williams*, supra note 6, at 6323.
- 24 *Ibid.*, at 6324.
- 25 RSC 1985, c. 1 (5th Supp.), as amended (sometimes referred to in this article as "ITA").
- 26 Since the taxation year under consideration in *Williams* (1984), the deduction from income for employment insurance premiums has been replaced by a tax credit: ITA section 118.7, added by SC 1988, c. 55, section 93.
- 27 Supra note 6, at 6328.
- 28 Gonthier J states, *ibid.*, at 6325, "It is simply not apparent how the place where a debt may normally be enforced has any relevance to the question whether to tax the receipt of the payment of that debt would amount to the erosion of the entitlements of an Indian *qua* Indian on a reserve." However, he concludes that paragraph by saying, "It may be that the residence of the debtor remains an important factor, or even the exclusive one." Later in the judgment (at 6326-27), he concludes that "the residence of the debtor is a connecting factor of limited weight in the context of unemployment insurance benefits," having found that "the purposes of fixing the *situs* of an ordinary person do not apply to the Crown."
- 29 In *Danes v. R, etc.* (1985), 61 BCLR 257 (CA) and *Leighton v. British Columbia* (1989), 57 DLR (4th) 657 (BCCA), it was held that personal property of an Indian that has its paramount location on reserve may not be seized or subject to taxation. Paramount location is determined by the pattern of use and safekeeping of the property.
- 30 *Nowegijick*, supra note 11. La Forest J in *Mitchell*, supra note 5, at 236, explained that the *Nowegijick* rule that statutory ambiguities must be resolved in favour of the Indians did not imply automatic acceptance of a given construction simply because the Indians would favour it over any other competing interpretation. He supported a broad and liberal interpretation aimed at maintaining Indian rights, and a narrow interpretation of any provision aimed at limiting or abrogating Indian rights, but emphasized that it was also necessary to reconcile any given interpretation with the policies the Indian Act seeks to promote. He approved (*ibid.*, at 228) the result in *Metlakatla Ferry Service*, supra note 14, saying that a broad and liberal approach to paramount location and situs of the debtor was appropriate.
- 31 Supra note 7, at 200.
- 32 See, in particular, Murray Marshall, "Business and Investment Income Under Section 87 of the Indian Act: *Recalma v. Canada*" (1998) vol. 77, nos. 3-4 *The Canadian Bar Review* 528-48; Donald K. Biberdorf, "Aboriginal Income and the 'Economic Mainstream,'" in *Report of Proceedings of the Forty-Ninth Tax Conference*, 1997 Conference Report (Toronto: Canadian Tax Foundation, 1998), 25:1-23; Bill Maclagan, "Section 87 of the Indian Act: Recent Developments in the Taxation of Investment Income" (2000) vol. 48, no. 5 *Canadian Tax*

- Journal* 1503-24; and Thomas E. McDonnell, "Taxation of an Indian's Investment Income," Current Cases feature (2001) vol. 49, no. 4 *Canadian Tax Journal* 954-60.
- 33 Part I of the Constitution Act, 1982, being schedule B of the Canada Act 1982 (UK), 1982, c. 11 (herein referred to as "the Charter"). Section 35(1) of the Charter provides, "The existing aboriginal and treaty rights of the aboriginal peoples of Canada are hereby recognized and affirmed."
- 34 Marshall, *supra* note 32, makes this point at 537-38.
- 35 This is the conclusion of the "trilogy" of *R v. Sparrow*, [1990] 1 SCR 1075; *R v. Van der Peet*, [1996] 2 SCR 507; and *Gladstone v. The Queen*, [1996] 2 SCR 723, all cases dealing with interference with protected aboriginal fishing rights.
- 36 97 DTC 5315 (FCA), rev'g. 94 DTC 6658 (FCTD), rev'g. 92 DTC 2267 (TCC). See the Federal Court of Appeal decision at 5319-20.
- 37 This point is drawn from the analysis of Maclagan, *supra* note 32, at 1507.
- 38 *Folster*, *supra* note 36, at 5319, note 27 (FCA).
- 39 *Shilling*, *supra* note 15, at paragraph 64.
- 40 *Ibid.*, at paragraph 65.
- 41 98 DTC 6238 (FCA), leave to appeal to the Supreme Court of Canada refused, December 10, 1998. As an associate lawyer in the Vancouver office of Blake Cassels & Graydon at the time, I had a minor role in the *Recalma* appeal to the Federal Court of Appeal.
- 42 See, in particular, Maclagan, *supra* note 32, and Marshall, *ibid.*
- 43 In *Recalma*, the branch was located at Park Royal Shopping Centre South, which is on lands that have been surrendered to the Crown, otherwise than absolutely, for lease for the benefit of the band, or "designated lands." The Indian Act tax exemption applies to property situated on designated lands, which are included in the definition of "reserve" for purposes of sections 87, 89, and 90 (*inter alia*).
- 44 See the extensive and thoughtful comment on these cases by McDonnell, *supra* note 32.
- 45 SC 1991, c. 46, as amended.
- 46 Since numerous cases, including *Williams*, have accepted that intangible property is eligible for the exemption from tax if situated on a reserve, the suggestion that there is a requirement that the intangible property be connected to land or chattels on reserve has no validity.
- 47 *Supra* note 13.
- 48 Or the equivalent provision, section 447, in the Trust and Loan Companies Act, SC 1991, c. 45, as amended (sometimes referred to in this article as "TLCA"). Section 447 is identical to section 461 of the Bank Act except that it applies to a "company" instead of to a "bank."
- 49 See Richard H. Bartlett, *Indians and Taxation in Canada*, 3d ed. (Saskatoon: University of Saskatchewan, Native Law Centre, 1992), 1-4, for an outline of the historical amendments to the tax exemption. The second edition of Mr. Bartlett's monograph was extensively cited by La Forest J in his historical analysis of the protections from taxation and seizure in *Mitchell*.
- 50 *Southwind*, *supra* note 16; and *Shilling*, *supra* note 15.
- 51 [1999] 2 SCR 203.
- 52 In the case of tangible personal property, the "paramount location" test provides a supportable exception, holding that the residence of the taxpayer on reserve is relevant to the pattern of use and safekeeping of the property, and thus to its paramount location.
- 53 There has not so far been a judicial opinion on whether *Corbière* excludes, as offensive to Charter section 15, residence on reserve from the connecting factors analysis. In *Shilling*, *supra* note 15, the Federal Court of Appeal acknowledged the respondent's argument based on section 15 of the Charter and *Corbière*, but in the absence of either evidence or significant

- argument on the point, was unwilling to apply a section 15 analysis to the connecting factors test under section 87. It is not argued here that *Corbière* is directly relevant, since the application of the Charter is beyond the scope of this article. But *Corbière* contains a recognition of a factual basis for limiting the weight to be given to residence on reserve in the context of section 87 of the Act.
- 54 See *Mitchell*, supra note 5, at 226: “In summary, the historical record makes it clear that ss. 87 and 89 of the *Indian Act* . . . constitute part of a legislative ‘package’ which bears the impress of an obligation to native peoples which the Crown has recognized at least since the signing of the Royal Proclamation of 1763. From that time on, the Crown has always acknowledged that it is honour-bound to shield Indians from any efforts by non-natives to dispossess Indians of the property which they hold *qua* Indians, *i.e.*, their land base and the chattels on that land base.”
- 55 ITA paragraph 12(1)(c).
- 56 ITA subsection 12(4).
- 57 The case of *Bennett v. The Queen*, 99 DTC 938 (TCC) is an example of a situation in which the court ought to have relied on the exception provided in *Williams* where allowance of the exemption would have resulted in an abuse. An Indian person who had never lived on reserve and was employed off reserve made contributions to a deposit account governed by a registered retirement savings plan (RRSP). The contributions were deductible in computing her income for tax purposes. The appellant subsequently converted the RRSP into a registered retirement income fund (RRIF). The issue was whether amounts withdrawn from the account were subject to tax in accordance with ITA section 146, which requires a taxpayer to include in income for tax purposes withdrawals from an RRSP or RRIF. The appellant argued that the funds were received from a deposit account on a reserve and were tax-exempt under section 87 of the *Indian Act*. This argument was rejected, in part on the basis that an RRSP/RRIF was “not merely” a bank account. A carefully reasoned analysis of the nature of the taxation, upholding the symmetry of the deduction-inclusion scheme governing RRSPs and RRIFs, and the fact that the use of the bank account on reserve as a mere conduit was not within the purposes of the *Indian Act* exemption, would have been more useful and is clearly mandated by *Williams*.
- 58 The account was, of course, not governed by section 461 of the *Bank Act* or *TLCA* section 447. Nor would the common law rule as to the situs of a bank account, discussed below, apply, since the case arose in Quebec.
- 59 The employers in *Williams*, *Folster*, and *Amos et al. v. The Queen*, 99 DTC 5333 (FCA) were all non-Indians. In addition, in the *Amos* case, the employer was a multinational forest products company with its head office in Montreal, and only a tiny fraction of its assets and operations were on reserve.
- 60 See the discussion of this issue in McDonnell, supra note 32.
- 61 In section 89 of the *Indian Act*. See supra note 17.
- 62 [1912] AC 212 (PC).
- 63 *Avery v. Cayuga* (1913), 13 DLR 275 (Ont. SC).
- 64 [1991] 3 CNLR 182 (Man. QB).
- 65 [1994] 2 CNLR 3 (Alta. CA).
- 66 *TLCA* sections 447 and 448 came into force on June 1, 1992. It is not clear from the case reports when the funds were seized.
- 67 In dissent, Bracca JA gave effect to the agreement, deeming the funds to be held at the head office. In doing so, he relied on an exception to the common law rule whereby the bank and the customer may, by special agreement, abrogate the implied term in their agreement that the deposited funds will be repayable on demand only at the branch of account. The difference between majority and dissent was thus largely a matter of interpretation of the agreement between the bank and PHTC, and it was accepted by both that funds in an on-reserve account could not be seized.

- 68 [1991] 2 CNLR 65 (Sask. CA).
- 69 [1994] BCJ no. 2710 (SC).
- 70 In section 2 of the Indian Act, “designated lands” are defined as lands conditionally surrendered by the band to Her Majesty, usually for lease for the benefit of the band. As noted earlier, “reserve” is defined to include designated lands for the purposes of, inter alia, sections 87, 89, and 90.
- 71 (2000), 72 BCLR (3d) 363 (SC).
- 72 Although a full discussion of seizure of intangible property is beyond the scope of this article, the cases on seizure of debts other than deposit accounts tend to apply the *Mitchell and Williams* reasoning, and frequently turn on whether section 90 applies. See, for example, *Nathanson, Schachter and Thompson v. Sarcee Band of Indians*, [1994] 4 CNLR 58 (BCCA); *Maracle v. Ontario (Minister of Revenue)*, [1993] OJ no. 1173 (Gen. Div.); and *Brant v. Minister of National Revenue* (1998), 146 FTR 318.
- 73 *Williams*, supra note 6, at 6323.
- 74 See Bartlett, supra note 49, at 9-14.
- 75 (2000), 186 DLR (4th) 718, at paragraph 21 (FCA).
- 76 Supra note 14.
- 77 For example, in *Shilling*, supra note 15, the Federal Court of Appeal could have stated more clearly that the location of the head office of Ms. Shilling’s employer on a reserve was not, in its view, a substantial connection to a reserve, and that since the organization for which Ms. Shilling actually performed employment services, which directed and supervised her performance of her duties of employment, and provided the funds for her remuneration, had no connection to a reserve, and since the employment was not performed on reserve, the effective location of the employment income was not on reserve.
- 78 This position was also taken by the Tax Court of Canada in a case decided under the informal procedure: *Hill v. The Queen*, 99 DTC 3504; [1999] 3 CTC 2073. The reasons in *Bennett v. The Queen*, supra note 57, also rely in a minor way on the location of the bank’s head office.
- 79 Supra note 32, at 958.
- 80 Section 88 of the Indian Act.
- 81 ITA subsection 2(2).
- 82 Article XV of the Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997 (herein referred to as “the Canada-US tax convention”).
- 83 See supra note 15, and the cases and paper cited therein.
- 84 Part XXVI of the Income Tax Regulations contains detailed rules for allocating an individual’s earned income to the various provinces where activities are carried on. Similar rules for allocating income between two countries can be found in Canada’s tax conventions, in articles 5 and 7.
- 85 See, as examples, articles XI and XII of the Canada-US tax convention, supra note 82.
- 86 Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD) (looseleaf).