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INCOME TAX EXEMPTION FOR STATUS INDIANS: REVENUE CANADA'S NEW POLICY

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INCOME TAX EXEMPTION FOR STATUS INDIANS: REVENUE CANADA'S NEW POLICY

Media attention has recently focused on a sit-in staged by status Indians in Toronto to protest against Revenue Canada's new policy regarding employment income earned off-reserve. Following the 1992 decision of the Supreme Court of Canada *Williams v. Canada* [(1992), 90 D.L.R. (4th) 129], Revenue Canada amended its *Indian Remission Order* so that an Indian working off-reserve would no longer be exempt from paying income tax merely because his or her employer was situated on a reserve. For several years, Revenue Canada deferred the implementation of its new policy, but no further extension was provided for this fiscal year. Effective 1 January 1995, status Indians working off-reserve for an employer situated on reserve will not automatically be tax exempt. This paper will review the general tax exemption granted to Indians under section 87 of the *Indian Act*, summarize the *Williams* decision, and highlight the most recent changes to Revenue Canada's policy, including the *Indian Income Tax Remission*

Order, P.C. 1994-799, 12 May 1994, *Canada Gazette Part II*, 1 June 1994.

SECTION 87 OF THE INDIAN ACT AND THE WILLIAMS DECISION

Subsection 87(1) of the *Indian Act* grants a general tax exemption to status Indians for personal property situated on a reserve. The provision reads in part as follows:

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

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

Further, subsection 87(2) provides that no Indian or band is subject to taxation in respect of the ownership, occupation, possession or use of any property mentioned above. The key issues to resolve are whether the tax is levied against the "personal property" of an Indian, and whether that property is "situated on a reserve." One must look at the leading cases to understand the meaning of those expressions.

In 1983, the Supreme Court of Canada decided the case of *Nowegijick v. The Queen* [(1983), 144 D.L.R. (3d) 193], in which it determined that an Indian employed by a logging company located on reserve did not have to pay tax on income for work actually performed off reserve. In its initial discussion, the Court queried whether the fact that the services were performed off reserve was relevant to the *situs*: in other words, were the wages received by Mr. Nowegijick actually situated on the reserve? In argument, the Crown conceded that Mr. Nowegijick's salary was indeed sited on the reserve; that was where his employer resided and, hence, where the wages were payable. The Supreme Court acknowledged that the proper test to be applied in determining the *situs* of income is the residence of the debtor, that is to say the place of business of the employer. The Court went on to find that income was "personal property" and, as a result, taxes payable on the income were also "personal property." Since the Court had decreed that section 87 of the *Indian Act* created a tax exemption for both persons and property, it was irrelevant whether the taxation of employment income was characterized as a tax on persons or on property. In either event, Mr. Nowegijick was not liable to pay taxes in respect of his wages.

The issue in dispute in *Williams*, the decision rendered by the Supreme Court of Canada in 1992, was not the taxation of employment income but rather unemployment insurance benefits collected by a status Indian living on reserve. The Supreme Court was asked to determine whether the benefits received were "situated" on the reserve, within the meaning of section 87 of the *Indian Act*. The Court reviewed the reasoning in *Nowegijick*, which had determined that the *situs* of employment income was the residence of the debtor. In *Nowegijick*, the court had merely emulated the general rule applied in conflict of laws cases; that is, to say a debt is normally enforced where the debtor resides. The Supreme Court explained in *Williams* that it was not appropriate simply to adopt general conflicts principles in this particular context; rather, the Court was to look at the scheme and purposes of the *Indian Act* and the *Income Tax Act* in order to determine whether taxing the receipt of unemployment insurance benefits would amount to eroding the entitlement of an Indian *qua* Indian on a reserve. The

Court stressed, however, that in some circumstances the residence of the debtor would be an important factor, or even the exclusive factor in assessing the *situs* of benefits received.

The Supreme Court then went on to consider which connecting factors would be relevant in deciding the *situs* of U.I.C. benefits. In the Court's view, connecting factors must be assessed in reference to the type of property taxed and the nature of the taxation levied. On behalf of the Court, Gonthier J. noted that connecting factors may have different relevance to unemployment insurance benefits than to employment income or pension benefits. In the context of U.I.C., the Court did not consider the residence of the debtor and the place where the benefits were paid to be relevant factors. Rather, the Supreme Court found that the strongest connecting factor was the location of the qualifying employment on which the benefits were based. The Court decreed that U.I.C. benefits were better characterized as a benefit paid through the employment of employed persons rather than a benefit granted by the government out of its general revenues. The residence of the person receiving the benefits could be potentially significant if it pointed to a different location from one where the person had performed the qualifying duties. In this particular case, Mr. Williams had qualified for unemployment insurance benefits for previous employment performed on the reserve, and had received his U.I.C. benefits while residing on the reserve. The Court decreed therefore that the U.I.C. benefits received by Mr. Williams were clearly situated on the reserve.

Mr. Justice Gonthier cautioned that the facts in *Williams* did not lend themselves well to formulating a test for determining the site of employment income. At page 143, he made the following remarks:

However, this would not be an appropriate case in which to develop a test for the *situs* of the receipt of employment income. All the potential connecting factors with respect to the qualifying employment of the appellant point to the reserve. The employer was located on the reserve, the work was performed on the reserve, the appellant resided on the reserve, and he was paid on the reserve. A test for the *situs* of employment income could therefore only be developed in an abstract vacuum in this case, since there is no real controversy of relevant factors pulling in opposite directions. The same would be true of any consideration of weight, if any, to be given to the residence of the appellant upon receipt of the benefits as this was also on the reserve.

Furthermore, as can be seen from our discussion of the test for the *situs* of unemployment insurance benefits, the creation of a test for the location of intangible property under the *Indian Act* is a complex endeavour. In the context of unemployment insurance we were able to focus on certain features of the scheme and its taxation implications in order to establish one factor as having particular importance. It is not clear whether this would be possible in the context of employment income, or what features of employment income and its taxation should be examined to that end. (emphasis added)

Even though the Supreme Court indicated that the connecting factors applied in the

Williams case would not necessarily be retained in the context of employment income, Revenue Canada relied on the *Williams* decision to justify the recent changes to its policy and the *Indian Income Tax Remission Order*.

REVENUE CANADA'S NEW POLICY AND THE INDIAN INCOME TAX REMISSION ORDER

In December 1992, Revenue Canada announced that it would be changing the way it applied the *Indian Act* tax exemption in light of the ruling of the Supreme Court of Canada in *Williams*. A letter of the Assistant Deputy Minister of the Legislative and Intergovernmental Affairs Branch dated 29 December 1992 was reproduced in *Canada Tax Service* [Stikeman, De Boo, *Canada Tax Service*, at pages 81-111 & 81-112]. Employment income would henceforth be assessed for taxation purposes in the following manner:

The *Williams* decision confirms that income earned on a reserve is tax exempt. However, as a result of the decision, the salary of an Indian will no longer be exempt merely because it is paid by an employer situated on a reserve. The principal factor connecting income to a reserve will now be where the duties are carried out. The location of the employer will continue to be a factor, but other factors connecting the income to the reserve will also have to be present for the income to be tax exempt. This will lead to an application of the *Indian Act* tax exemption that more accurately reflects its purpose to exempt from taxation the personal property of Indians which is situated on a reserve.

Revenue Canada has restricted the scope of the application of the tax exemption provided under section 87 of the *Indian Act*. Revenue Canada has not stated that all employment income for work performed off-reserve will inevitably be taxed; rather, its new approach is no longer to consider the *situs* of the employer as the sole critical factor.

Under the *Indian Remission Order*, employment income attributable to duties of office or employment performed on a reserve was exempt from tax for the 1983 to 1991 taxation years. After Revenue Canada modified its policy following the *Williams* decision, it introduced a further remission order to provide a reasonable period of transition for Indian individuals and organizations who had arranged their affairs on the basis of previous court decisions. Section 3 of the *Indian Income Tax Remission Order*, which remits income tax on certain employment income received by Indians from employers residing on a reserve or Indian settlement, was initially extended to the 1992 and 1993 taxation years; then it was extended to the 1994 taxation year in cases where an office or employment had been held continuously since before 1994.

After 1 January 1995, status Indians who earn employment income for duties performed off-reserve will be taxed. Media reports vary, but it is estimated that approximately 3,000 status Indians could be affected by these new rules. Aboriginal leaders have stated that they consider Revenue Canada's new policy to be an infringement of their treaty rights and that they will mount a legal challenge to prevent its implementation.