A COMPREHENSIVE ASSESSMENT OF THE TAX ISSUES RELATED TO INDIGENOUS SETTLEMENT TRUSTS

A Thesis Submitted to the College of
Graduate and Postdoctoral Studies
In Partial Fulfillment of the Requirements
For the Degree of Master of Laws
In the College of Law
University of Saskatchewan,
Saskatoon, Saskatchewan

By

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ABSTRACT

In this thesis I examine the taxation issues related to Indigenous Settlement Trusts (“Settlement Trusts”). I argue that Settlement Trusts should be taxed differently than other personal trusts under the Income Tax Act (“Tax Act”). Currently, a Settlement Trust is taxed just as any other trust, as an individual pursuant to s.104(2) of the Tax Act, which means that revenues are taxed at the top personal marginal tax rate. Therefore, Bands rely upon the application of an attribution provision, s.75(2) of the Tax Act, to attribute revenues to the Band. The Band is then tax exempt, pursuant to s.149(1)(c) of the Tax Act, because they are interpreted by the Canada Revenue Agency as public bodies performing a function of government in Canada. However, unnecessary administrative processes and costs for the Band result from having Settlement Trusts taxed in this manner. Additionally, because s.75(2) of the Tax Act is applied here contrary to its legislative intention (to prevent tax avoidance), the application of s.75(2) could trigger the General Anti-Avoidance Rule (“GAAR”). This creates legal uncertainty for Bands. I review existing legal principles that could apply to Settlement Trust taxation. I argue that making a tax expenditure available to exempt this revenue could be justified for sound policy reasons such as the long historical Indigenous-Crown relationship and the objective of preserving Indigenous property. I also argue that s.87 of the Indian Act could apply to exempt Settlement Trust revenues from taxation but do not extend far enough as the law is still evolving in this area. Finally, I argue that Settlement Trusts are sui generis in nature, thus the principles of fiduciary law and the honour of the Crown could be applicable here; that is, the Crown may have an obligation to reconsider Settlement Trust tax treatment. However, it is also unclear whether these doctrines could extend far enough to apply to Settlement Trust income taxation. I conclude nonetheless that, all factors considered, the Federal government should amend the Tax Act to exempt Settlement Trust revenues from being taxed under the general trust tax provisions to eliminate or minimize administrative costs and legal uncertainty for Bands. Bands could then claim Settlement Trust revenues directly through s.149(1)(c) (absent s.75(2)) in the same manner that Bands claim all other Band revenues.
ACKNOWLEDGMENTS

Thank you to the College of Law for enabling this research by providing financial support. I am incredibly grateful to my supervisor, Tamara Larre, for her professional feedback, guidance and unwavering support throughout this process. You have helped me become a better writer, researcher and passionate advocate for a cause that I believe in. Thank you to my committee members, Felix Hoehn and Larry Chartrand, for also contributing to this thesis. I appreciate your efforts.

I am also appreciative of the countless lawyers and other experts for giving your time and insight on the many practical aspects of Indigenous Settlement Trusts, Tax Law and Aboriginal Law. There are too many to mention here but you know who you are. You have all contributed to this important research in some way.

Thank you to my amazing and supportive husband, Jason Young, for being my greatest advocate and supporter. Where would I be without you? Where would we be if I did not keep taking you on all of these “adventures”? 😊 Without your unending support this research would not have been possible, and I love you for always encouraging me to pursue my dreams. I am blessed to be able to do life with you.

I dedicate this thesis to the Indigenous peoples of Canada. Through my research I hope to add value to the discussion related to the legal issues that impact Indigenous peoples in this country. As it relates to Indigenous Settlement Trusts, this is the beginning of the discussion, but it cannot be the end. These trusts are important fiscal management vehicles for Bands. Therefore, I firmly believe that they must be carefully considered as unique and viable mechanisms to increase Indigenous wealth in Indigenous communities. Wela’lin.
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CHAPTER 1: INTRODUCTION AND BACKGROUND

1.1. Background

The Federal government should amend the *Income Tax Act* (“*Tax Act*”)\(^1\) to exempt Indigenous Settlement Trust (“Settlement Trust”) revenues from being taxed under the general trust tax provisions. Currently, Settlement Trusts are taxed just as any other personal trust, as an individual taxpayer, pursuant to s.104(2) of the *Tax Act*.\(^2\) Therefore, Bands are required to depend upon the application of an attribution provision, s.75(2) of the *Tax Act*,\(^3\) which attributes the Settlement Trust revenues to the Band to qualify for tax exemption, pursuant to s.149(1)(c) of the *Tax Act*.\(^4\)

\(^1\) RSC, 1970, c I-6 (now RSC, 1985, c I-5) [*Tax Act*].
\(^2\) *Ibid*, s 104(2).
\(^3\) *Ibid*, s 75(2).
\(^4\) *Ibid*, s 149(1)(c).
I argue in this thesis that this method of taxing Settlement Trusts creates the necessity for Bands to take certain additional (and unnecessary) steps in order to qualify for tax exemption. First, the Band must take legal, tax and accounting steps to ensure that Settlement Trust income is attributable to the Band through the application of s.75(2) of the Tax Act. Next, because a trust is considered a separate individual taxpayer, the Band must file a Settlement Trust tax return for each trust that the Band has created.

On the contrary, the Band does not file tax returns for any of its other income because it is considered tax exempt, pursuant to s.149(1)(c) of the Tax Act. Notably, for Settlement Trust revenues, in the end, the Band gets to the same result. That is, the application of s.149(1)(c) of the Tax Act exempts the Settlement Trust income from taxation because such income is attributed to the tax-exempt Band through the application of s.75(2) of the Tax Act. I argue that these administrative steps would largely be reduced or eliminated by making an amendment to the Tax Act.

In addition, I argue that a risk exists that Bands could be held to account through the application of the General Anti-Avoidance Rule (“GAAR”) for the manner in which a Band arranges its Settlement Trust terms so that it can claim tax exemption through the application of s.75(2). An amendment would eliminate the risk of legal uncertainty in this regard.

I first review existing legal principles that either apply or could apply to Indigenous people’s property and interests under certain circumstances. For example, tax law allows for certain deviations from the normative benchmark tax provisions; that is, where the government seeks to further certain policy objectives, tax expenditures may be justified to provide tax exemptions. As such, due to strong Indigenous policy reasons, a tax expenditure could be a means of directly exempting Settlement Trust revenues from taxation.

However, as was noted earlier, the Band, as a public body performing a function of government in Canada, already benefits from a tax expenditure. The Band qualifies for tax exemption on Settlement Trust revenues by using the application of an attribution provision, s.75(2) of the Tax Act, to attribute revenues to the tax-exempt Band. Therefore, one solution could be to broaden the scope of the s.149(1)(c) tax expenditure so that Settlement Trust
revenues would be taxed directly under this provision without the requirement of an attribution rule to attribute revenues to the Band.

Further, I also discuss certain Indigenous tax exemptions under s.87 of the Indian Act. I apply the connecting factors set out in Williams v Canada\(^5\) to argue that a case could be made that this tax exemption applies to Settlement Trust revenues. However, it is likely that this tax exemption does not extend far enough to Settlement Trust revenues because some connecting factors may not be met here.

Finally, I address the fact that because of the unique nature of Settlement Trust property, the principles of fiduciary law and the honour of the Crown could be applicable here. However, it is unclear whether the circumstances of Settlement Trust taxation could meet the strict fiduciary duty tests set out in the case law. Nonetheless, the honour of the Crown is an overarching principle that must be upheld when dealing with certain Indigenous property interests. For that reason, a possibility exists that these interests could include Settlement Trusts.

While no one particular aforementioned legal principle on its own extends far enough to fully resolve the issue of Settlement Trust income taxation, overall these legal principles could be persuasive. Regardless, I argue that the best way to solve the taxation issues is to make a tax amendment to the general trust provisions (exempting Settlement Trusts from falling under these provisions) so that Settlement Trust revenues would be taxed directly just as any other Band revenues under s.149(1)(c) of the Tax Act.

But first, to lay a foundation for subsequent arguments, I review the background of the relationship between Indigenous peoples and the Crown that formed the basis for Indigenous tax exemption as it applies to Indigenous property.

It has long been recognized that the Crown has a unique historical relationship with Indigenous peoples.\(^6\) This special relationship resulted from the Crown inserting itself into the affairs of Indigenous peoples who had always occupied and been guardians over lands\(^7\) that

\(^7\) Borrows, supra note 6 at 194. See also Guerin v The Queen, [1985] 2 SCR 335 at 336, 13 DLR (4th) 321 [Guerin].
would later be encroached upon by settlers. A system of settler property law was subsequently propagated over such lands. Prior to this proliferation of settler property law, Indigenous peoples had their own systems of dealing with property; when the Europeans arrived in North America they required the assistance of Indigenous peoples to become acquainted with these systems.⁸

In 1763 after Great Britain had conquered the French colonies in North America, British settlers were then eager to enter into private land dealings with Indigenous leaders, in fact, they sought control and ownership over these lands.⁹ Two issues were significant here: first, the dichotomy between the Anglo-American system of land ownership and the Indigenous system of land ownership created a situation where conflict and misunderstandings could arise in relation to Indigenous land transactions;¹⁰ and second, unscrupulous and contentious actions were taken against Indigenous peoples because the primary motivation was to acquire as much new territory (Indigenous territories) as possible.¹¹ The British Crown sought to enter into agreements with Indigenous peoples, largely because these peoples had been allies and trading partners with the French.¹² Where agreements were not entered into voluntarily, Crown conquest was justified as a matter of national security.¹³

The Royal Proclamation of 1763¹⁴ was a doctrine enacted at that time to govern the dealings between the Crown and Indigenous peoples. The Proclamation contained terms about how the Crown and Indigenous communities were supposed to proceed going forward to avoid conflict around the taking up of Indigenous lands. One provision within the Proclamation was foundational to setting in motion a centuries long enjoining of Crown and Indigenous interests that was not without its own contentions. It reads as follows:

We do, with the Advice of our Privy Council strictly enjoin and require, that no private Person do presume to make any purchase from the said Indians of any Lands reserved to the said Indians, within those parts of our Colonies where, We have thought proper to allow Settlement: but that, if at any Time any of the Said Indians should be inclined to dispose of the said Lands, the same shall be Purchased

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⁸ Borrows, supra note 6 at 1, 193. They had their own powers of governance closely connected to land and family; emphasis was on spiritual, familial, economic and political spheres.

⁹ Luk, supra note 6 at 5; Borrows, supra note 6 at 193.

¹⁰ Luk, supra note 6 at 5.

¹¹ Ibid; See also Borrows, supra note 6 at 194

¹² Luk, supra note 6 at 5.

¹³ Borrows, supra note 6 at 198.

¹⁴ Ibid, citing the Royal Proclamation, RSC 1985, App II, No 1 [Royal Proclamation].
only for Us, in our Name, at some public Meeting or Assembly of the said Indians, to be held for that Purpose by the Governor or Commander in Chief of our Colony respectively within which they shall lie.\textsuperscript{15}

Through the terms of the Proclamation the reserve creation process was instituted in that traditional lands, not yet surrendered to or seized upon by the Crown, would remain with the Indigenous nation. The following provision describes this:

And whereas it is just and reasonable, and essential to our Interest, and the Security of our Colonies, that the several Nations or Tribes of Indians with whom We are connected, and who live under our Protection, should not be molested or disturbed in the Possession of such Parts of Our Dominions and Territories as, not having been ceded to or purchased by Us, are reserved to them, or any of them, as their Hunting Grounds.\textsuperscript{16}

Present day reserve lands are a result of this method of land surrenders and sale.\textsuperscript{17} Most notably, despite this method of land surrenders and “in the face of colonial intrusions”, Indigenous peoples believed that they retained sovereignty over their people and territories, thus should not be susceptible to taxation.\textsuperscript{18} In fact, Canadian Indigenous tax exemption is traced as far back as the 1850s when a law was implemented by the Province of Canada (as it was then) to codify the fact that tax would not be levied against an Indian person or anyone married to an Indian person.\textsuperscript{19}

Consequently, before Canadian confederation in 1867, the Crown agreed that it would not tax Indigenous lands and personal property situated on reserves.\textsuperscript{20} The purpose of this tax exemption is two-fold. First, it preserves Indigenous people’s entitlement to reserve lands while ensuring that such property is not eroded.\textsuperscript{21} Second, pursuant to property received via the Crown’s special obligations to Indigenous peoples, it prevents a situation where a taxing government could erode any benefits given to them by that same government.\textsuperscript{22}

\textsuperscript{15} Ibid at 6 [emphasis in original].
\textsuperscript{16} Ibid at 5 [emphasis in original].
\textsuperscript{17} The Indian Act defines a reserve as a tract of land that is set apart for the use and benefit of a Band, but which legal title is vested in the Crown. See Indian Act, RSC 1970, c I-6 at Interpretations [Indian Act].
\textsuperscript{18} Borrows, supra note 6 at 901.
\textsuperscript{19} Ibid.
\textsuperscript{21} Williams, supra note 5 at 886.
\textsuperscript{22} Ibid.
Given this background, it is indisputable that a unique relationship exists between Indigenous peoples and the Crown (unlike any other relationship in Canadian history), from which Crown legal obligations flow.\textsuperscript{23} In fact, because Indigenous land interests can only be alienated to the Crown, the Crown possesses firm legal obligations.\textsuperscript{24} In Guerin v The Queen,\textsuperscript{25} the Supreme Court of Canada held that the Indigenous-Crown relationship is fiduciary in nature.\textsuperscript{26} The significance and effect of the recognition of this fiduciary relationship will be described further in chapter 5, section 5.2.

Prior to this ruling, Aboriginal rights\textsuperscript{27} were also afforded constitutional protection and recognition, pursuant to s.35(1) of the Constitution Act, 1982.\textsuperscript{28} This constitutional protection confers certain legal obligations upon the Crown toward Indigenous peoples,\textsuperscript{29} and, in fact, the potential to erode Aboriginal rights is possible if the Crown is not bound by a legal duty to honour or recognize such rights.\textsuperscript{30} Justice Binnie, in R v Marshall,\textsuperscript{31} indicated that the enactment of s.35(1) in the Constitution conferred a “sterner” protection of Aboriginal rights and the Crown would have to justify any interference of such rights.\textsuperscript{32} Thus, government obligations flow from the limitations placed upon Crown sovereignty, pursuant to s.35 rights.\textsuperscript{33}

\begin{itemize}
\item \textsuperscript{23}Borrows, supra note 6 at 435.
\item \textsuperscript{24}Ibid at 437 [emphasis mine]. Also see Canadian Pacific Ltd. v Paul, [1988] 2 SCR 654 at 678, 53 DLR (4th) 487 [Canadian Pacific].
\item \textsuperscript{25}Guerin, supra note 7.
\item \textsuperscript{26}Ibid at 336.
\item \textsuperscript{27}I use the term “Aboriginal” here in relation to the common law use of the term in describing “Aboriginal rights”.
\item \textsuperscript{28}The Constitution Act, 1982, Schedule B to the Canada Act 1982 (UK), 1982, c 11, s 35 [Constitution].
\item 35 (1) The existing aboriginal and treaty rights of the aboriginal peoples of Canada are hereby recognized and affirmed.
\item (2) In this Act, “aboriginal peoples of Canada” includes the Indian, Inuit and Métis peoples of Canada.
\item (3) For greater certainty, in subsection (1) “treaty rights” includes rights that now exist by way of land claims agreements or may be so acquired.
\item (4) Notwithstanding any other provision of this Act, the aboriginal and treaty rights referred to in subsection (1) are guaranteed equally to male and female persons.
\item \textsuperscript{29}Borrows, supra note 6 at 435.
\item \textsuperscript{30}Ibid at 437.
\item \textsuperscript{31}[1999] 3 SCR 456, 177 DLR (4th) 513 [Marshall]
\item \textsuperscript{32}Ibid at para 48. Also see R v Sparrow, [1990] 1 SCR 1075, 70 DLR (4th) 385 [Sparrow].
\item \textsuperscript{33}Borrows, supra note 6 at 437.
\end{itemize}
In *R v Sparrow*, La Forest, J., writing for the majority, also indicated that the *sui generis* nature of Indian Title and the responsibilities assumed by the Crown establishes the source of the Indigenous-Crown relationship. Subsequently, in *R v Van der Peet*, the Supreme Court of Canada recognized that the source of these rights is the reconciliation of pre-existing Indigenous occupation of traditional territories with the assertion of Crown control over such lands.

As such, the history of the Indigenous-Crown relationship is relevant in so far as it illustrates the entrenched Indigenous-Crown dealings that began hundreds of years ago and continue to present day. It is against this backdrop that Crown obligations are invoked. These Crown obligations will be discussed in detail in chapter 5 to show how the Courts in Canada have defined, to a degree, the nature of certain duties and the obligations that flow therein.

Given the fact that Indigenous peoples held independent land interests pre-contact, it should not be surprising that Indigenous peoples have a long history of participation in the commercial economy as far back as pre-contact. Such participation has yielded property for the benefit of Indigenous societies, be it commercial assets and property, such as saleable goods, or the monetary assets yielded from the sale of goods.

Notably, in terms of the taxation of Indigenous property as it relates to present day participation in the commercial economy, certain legal consequences ensue. Legal protections apply to Indigenous property on reserve in order to respect the policy of preserving Indigenous property. The Supreme Court of Canada has held that policy reasons support Indigenous people’s right to have property held on reserve, pursuant to treaty or agreement, preserved. However, although the *Indian Act* provides protections related to the seizure of or taxation of

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34 *Sparrow, supra* note 32.
35 *Indian Act* supra note 32.
36 *Delgamuukw v British Columbia*, [1997] 3 SCR 1010, 153 DLR (4th) 193 [Delgamuukw].
37 *Sparrow, supra* note 32 at 1108.
38 [1996] 2 SCR 507, 137 DLR (4th) 289 [Van der Peet].
39 *Ibid* at 508.
40 *See for example* *R v Gladstone*, [1996] 2 SCR 723, 137 DLR (4th) 648 [*Gladstone*].
41 *Ibid* at para 26. The Heiltsuk of British Columbia are an example of an Indigenous group who engaged in commercial activity though trading herring spawn on kelp for either money or goods.
42 *Indian Act, supra* note 17 at s 87 and s 89. These protections include freedom from either seizure or taxation of Indigenous property.
43 *Bastien, supra* note 20 at para 53.
44 *Indian Act, supra* note 17.
Indigenous property,\textsuperscript{44} it is clear that these protections are only applicable on reserved lands. Otherwise, if Indigenous nations choose to participate in the commercial mainstream economy they shall generally forego such protections.\textsuperscript{45}

Notwithstanding the general lack of \textit{Indian Act} protection when Bands participate in business dealings in the commercial mainstream, one must be careful not to construe Indigenous people’s desire to participate in the commercial mainstream economy as a desire to abandon their traditional economy.\textsuperscript{46} There is a misconception that the Indigenous traditional economy and the commercial mainstream economy are not compatible, thus mutually exclusive.\textsuperscript{47} The Supreme Court of Canada warned as much in \textit{Bastien Estate v Canada}\textsuperscript{48} when it indicated that distinguishing the two may risk setting up “a false opposition between commercial mainstream activities and activities on a reserve” and thus “the use of the term commercial mainstream might imply, incorrectly, that trade and commerce is somehow foreign to the First Nations”.\textsuperscript{49} Yet, to a large degree:

The limited understanding of how Indigenous peoples’ participation in historical commercial industries affected their pre-contact economies has led to a general acceptance of the idea of a dual economy in contemporary Indigenous communities that has in turn influenced economic development models proposed for these communities.\textsuperscript{50}

This misunderstanding likely results from a lack of knowledge around Indigenous people’s historical participation in economic activities; this is not a new concept and is not a result of settler activity, although the commercialization of some Indigenous economic activities resulted from settler involvement.\textsuperscript{51} Even before reserve creation, the Indigenous economy was vibrant;

\textsuperscript{44} Ibid at s 87 and s 89.
\textsuperscript{45} Williams, supra note 5 at 886.
\textsuperscript{47} Ibid.
\textsuperscript{48} Bastien, supra note 20.
\textsuperscript{49} Ibid at para 56 citing Folster v Canada, [1997] 3 FC 269, 148 DLR (4th) 314 (FCA).
\textsuperscript{50} Parker, supra note 46 at 1.
\textsuperscript{51} Ibid.
later settler arrival, as early as the seventeenth century,\textsuperscript{52} was the catalyst for the commercialization of aspects of the pre-contact economies of Indigenous peoples.\textsuperscript{53}

Nonetheless, a discussion of self-determination and self-government is necessary to show that Indigenous people’s commercial and economic activities existed long before European contact. In fact, prior to settler arrival,\textsuperscript{54} Indigenous peoples exercised powers of governance for many ages.\textsuperscript{55} While historically Indigenous peoples maintained a connection to ancestral lands in order to maintain Indigenous ways of life,\textsuperscript{56} unlike settlers, Indigenous governments did not separate the spiritual and political aspects of governance. That is, the two are inexplicably intertwined in the same way that the physical and spirit world cannot be separated.\textsuperscript{57} As such, this unique connection between the land and the spiritual, economic and political spheres were prevalent in Indigenous traditional governance.\textsuperscript{58}

The unique manner in which Indigenous peoples handled their economy should not be misconstrued as having been a lack of participation in commercial activity simply because it appeared to be different than how the mainstream economy operates today. In fact, pre-contact, economic activities were a way for Indigenous nations to sustain themselves, just as in the case of any other self-sustaining government. For example, in \textit{Gladstone}, Lamer, J. writing for the majority, found that clear evidence showed that the Heiltsuk, two members of which were the claimants, engaged in the trade of herring spawn on kelp prior to European contact.\textsuperscript{59}

In that decision, members of the Heiltsuk people of British Columbia were charged with a summary offence for allegedly offering and attempting to sell herring spawn on kelp.\textsuperscript{60} The trial judge and the Supreme Court of British Columbia acknowledged that the Heiltsuk continuously

\textsuperscript{52} For example, the Canadian fur trade.

\textsuperscript{53} \textit{Parker}, supra note 46 at 1.

\textsuperscript{54} Settlers include Europeans and others who arrived and settled in North America. See \textit{Borrows}, supra note 6 at 1.

\textsuperscript{55} \textit{Ibid}.

\textsuperscript{56} \textit{Ibid} at 333.

\textsuperscript{57} \textit{Ibid} at 303.

\textsuperscript{58} \textit{Ibid} at 1.

\textsuperscript{59} \textit{Gladstone}, supra note 39 at para 26.

\textsuperscript{60} \textit{Ibid} at para 1.
traded herring spawn on kelp from pre-contact to present day\textsuperscript{61} and the Court of Appeal agreed that this pre-contact right to trade herring spawn on kelp existed and had not been extinguished.\textsuperscript{62}

On appeal, the Supreme Court of Canada looked at whether the trade of herring spawn on kelp was integral to the distinct Aboriginal Heiltsuk community and whether it was a pre-contact practice,\textsuperscript{63} a test set out \textit{Van der Peet}. Thus, the Supreme Court of Canada had to determine whether the “exchange of herring spawn on kelp for money or other goods, and/or the sale or trade of herring spawn on kelp in the commercial marketplace, were, prior to contact, defining features of the distinctive culture of the Heiltsuk”.\textsuperscript{64} In fact, McLachlin, C.J.C. (as she was at that time), writing for the majority, found that trade was not merely incidental to the Heiltsuk’s social and ceremonial activities, but rather was central to the unique culture of the Heiltsuk.\textsuperscript{65} The Supreme Court of Canada held that:

It cannot be disputed that hundreds of years ago, the Heiltsuk Indians regularly harvested herring spawn on kelp as a food source. The historical/anthropological records readily bear this out. I am also satisfied that this Band engaged in inter-tribal trading and barter of herring spawn on kelp. The exhibited Journal of Alexander McKenzie [sic] dated 1793 refers to this trade and the defence lead [sic] evidence of several other references to such trade.\textsuperscript{66}

This is but one example of how Indigenous people’s participation in commercial activities are guided by traditional practices that are unique to their culture.

Although the purpose of this discourse is not to argue for Indigenous self-governance as a right or that Indigenous nations are sovereign nations,\textsuperscript{67} these concepts should be mentioned to emphasize that Indigenous participation in the commercial economy is not new. Such participation is necessary for a self-sustaining society. According to Indigenous peoples, the most

\textsuperscript{61} \textit{R v Gladstone}, (1991) 13 WCB (2d) 60 [\textit{Gladstone BCSC}]. See also \textit{Gladstone}, \textit{supra} note 39 at para 7,11.
\textsuperscript{62} \textit{R v Gladstone}, (1993) 180 BCLR (2d) 133, 29 BCAC 253 [\textit{Gladstone BCCA}]. See also \textit{Gladstone}, \textit{supra} note 39 at para 11.
\textsuperscript{63} \textit{Gladstone, supra} note 39 at para 25.
\textsuperscript{64} \textit{Ibid}.
\textsuperscript{65} \textit{Ibid} at para 26.
\textsuperscript{66} \textit{Ibid} quoting Lemiski Prov Ct J [emphasis added by McLachlin, CJC].
\textsuperscript{67} However, I contend that Indigenous people’s right to self-governance and right to be characterized as sovereign nations is grounded in historical practices. For example, the fact that the “French and British Crowns concluded alliances and treaties with First Nations demonstrates that these nations were sovereign peoples capable of conducting international relations”. \textit{Borrows, supra} note 8 at 5.
basic definition of sovereignty is the right to know who you are, that is, the “right of all human beings to define, sustain and perpetuate their identities as individuals, communities and nations.”\textsuperscript{68}

As such, intertwined with this Indigenous right to self-determination is the authoritative right to self-govern; this right is inherent to the peoples claiming the right, it does not come from outside sources.\textsuperscript{69} In \textit{R v Sioui},\textsuperscript{70} the Supreme Court of Canada legally recognized the inherent nature of the autonomy and independence of Indigenous peoples in Canada.\textsuperscript{71} Further, the characterization of the self-government of Indigenous nations was described much earlier in \textit{Worcester v State of Georgia},\textsuperscript{72} a United States decision that explains British policy toward Indigenous peoples.\textsuperscript{73} The United States Supreme Court held that:

Such was the policy of Great Britain towards the Indian nations inhabiting the territory from which she excluded all other Europeans; such her claims, and such her practical exposition of the charters she had granted: \textit{she considered them as nations capable of maintaining the relations of peace and war; of governing themselves, under her protection; and she made treaties with them, the obligation of which she acknowledged.}\textsuperscript{74}

That Indigenous peoples were historically self-governing nations and engaged in economic activities before settlers arrived is sufficiently recognized in Canadian jurisprudence. In fact, inferences can be drawn from decisions that do not directly address self-governance. In \textit{Delgamuukw}, the Supreme Court of Canada recognized the fact that Aboriginal title is distinguished from other property interests because it is communally held.\textsuperscript{75} As such, a collective right to land held by all members of an Aboriginal nation requires that the nation make decisions

\textsuperscript{68} \textit{Ibid} at 3. It should be noted that some Indigenous peoples believe that the use of the term sovereignty is a European political construct and does not necessarily align with Indigenous thought. Rather than subscribe to one sovereign power or system, Indigenous people’s method of government is related to a more consultative process upon which everyone in the community is involved. See \textit{Borrows, supra} note 8 at 5.

\textsuperscript{69} \textit{Ibid} at 5 citing Alex Christmas, Eskasoni, Nove Scotia, 6 May 1992.

\textsuperscript{70} [1990] SCJ No 48, [1990] 1 SCR 1025 [\textit{Sioui}].

\textsuperscript{71} \textit{Ibid} at 1026. In this decision, the Supreme Court of Canada recognized that Indigenous peoples have an inherent right of self-governance because they had the authority to enter into nation to nation agreements, such as with France or Great Britain. Also see \textit{Borrows, supra} note 8 at 9.

\textsuperscript{72} 31 US (6 Pet.) 515 (1832) [\textit{Worcester}].

\textsuperscript{73} \textit{Borrows, supra} note 6 at 10.

\textsuperscript{74} \textit{Ibid} at 11 quoting \textit{Worcester, supra} note 72 at 548-9 [Emphasis added].

\textsuperscript{75} \textit{Delgamuukw, supra} note 35 at para 115.
about that land interest. Therefore, the nature of communal property rights implies that some form of self-government exists such that the nation has the ability to regulate control over and use of the land.

Further, in Van der Peet, the Supreme Court of Canada held that the purpose of s. 35(1) is the “reconciliation of the pre-existence of distinctive Aboriginal societies with the assertion of Crown sovereignty”. The fact that the Supreme Court of Canada recognizes that Indigenous peoples formed pre-existing distinct nations prior to contact also assumes the existence of some form of self-government. Arguably, this organized pre-existence is the source of Indigenous self-determination and carries with it Indigenous people’s right to retain their communal identity.

Evidence exists to show that historically Indigenous nations were self-governed; this self-governance also demonstrates that Indigenous participation in commercial ventures was necessarily a means to sustain a self-governed nation. Today self-government agreements are generally negotiated with the Crown on a nation to nation basis. Nonetheless, Indigenous nations participate in commercial ventures with or without legally recognized self-government agreements in place in Canada.

Notably, the Canada Revenue Agency has interpreted the Tax Act to recognize Bands, for tax purposes, as self-governed bodies. Because this designation, relating specifically to the taxation of Band revenues, considers Indian Act Bands to be public bodies performing functions of government, Bands are construed as tax-exempt bodies, pursuant to s.149(1)(c) of the Tax Act.

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76 Ibid.
80 Borrows, supra note 6 at 65.
81 Tax Act, supra note 1, s 149(1)(c) See wording of provision in Footnote 4.
82 See Canada Revenue Agency, Interpretation Bulletin IT- 0645031I7, “149(1)(c)-Indian Act Bands” (27 July 2016) [CRA]. The text of the Bulletin reads as follows:
This is to advise that we have reviewed our policy with respect to the interpretation of paragraph 149(1)(c) of the Income Tax Act ("Act") as it relates to Indian Bands that are created under the Indian Act....The federal government, through the Indian Act, specifically creates an Indian Band.
This tax exemption applies to Band revenues whether earned on or off reserved lands. Therefore, tax exemption under this provision is not contingent upon revenues being solely earned on reserve. Rather, tax exemption is related to the status and nature of a Band as a public body performing a function of government in Canada. More about this provision will be discussed in chapters 2 and 4.

It is against the preceding background that I analyze Indigenous participation in the commercial financial economy through the use of a trust. Notwithstanding that the use of trusts have some unique challenges, they are one means to manage Indigenous treasury and increase Indigenous wealth. I elaborate on this in the next chapter. For now, I set out the objective, the research methodology, the limitations of this research and the outline of the chapters contained herein for this thesis.

1.2. Objective

Courts have grappled with how to analyze legislative provisions and common law rules that apply to Indigenous peoples. Of particular importance to this thesis is how tax laws impact the management of Indigenous treasury through the use of a trust. In this thesis, I seek to provide a contribution to the discussion around Settlement Trust taxation issues. The core objective is to stimulate discussion on how an amendment to the Tax Act to exempt Settlement Trusts from being taxed under the general trust provisions could resolve some of the administrative challenges and legal uncertainty related to Settlement Trust taxation.

Under the Indian Act, these Bands or First Nations may be able to levy property taxes and create by-laws that affect its members. Consequently, the very nature of an Indian Band and its council under the Indian Act is that of a local government, similar in nature to a municipality...Rulings has gathered even more extensive experience with determining whether a Band qualifies as a municipal or public body performing a function of government in Canada. As a result, it is our view that all Bands created under the Indian Act meet the criteria to be considered municipal or public bodies performing a function of government in Canada for the purpose of paragraph 149(1)(c) of the Act and are therefore exempt from income tax.

I note that although this is not binding law, it is the position that the Canada Revenue Agency has taken for the assessment of Band income.

1.3. Research Methodology

This thesis research was conducted by analyzing academic literature and text book sources related to Tax Law, Trust Law and Aboriginal Law. Additionally, leading Supreme Court of Canada cases related to Indigenous peoples and the relevant sections in the Tax Act were analyzed. Legal databases were accessed that contain written judgments from across Canada. Legal cases related to the thesis topic were extensively canvassed through searches conducted in Quicklaw, Westlaw, CanLII, Taxnet Pro, and the Canadian Tax Foundation databases. The material was evaluated and used in accordance with relevance to this topic. Discussions also occurred with practitioners in the fields of Tax, Trust and Aboriginal Law to provide practical context for this thesis.

1.4. Limits of Thesis Research

This thesis research is restricted to Indian Act-recognized Bands and the Settlement Trusts that they create. First, while I recognize that circumstances vary for Indigenous nations across Canada, my arguments revolve around tax exemption that applies to public bodies performing a function of government in Canada. Recall that Indian Act-recognized Bands may be considered tax-exempt bodies pursuant to s.149(1)(c) of the Tax Act if they meet the criteria set out by the Canada Revenue Agency.84

Next, I also recognize that every Settlement Trust is unique and trust terms vary based upon the creativity of the parties who draft them. I acknowledge that no two trusts are exactly the same.85 In fact, some Settlement Trusts may not experience the kinds of issues that I set out in this thesis. For example, a Settlement Trust that has an administration office on reserve would not be the subject of this thesis because the revenues from the Settlement Trust are easily connected to the Band or reserve.

Therefore, this research only applies to those instances where Settlement Trusts are administered off reserve and it is necessary to find a way to connect the revenues to the Band or reserve. It is in those instances that I argue that tax issues could arise, and administrative

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84 That is, the Band has enacted a by-law and performs a function of government by providing public services to its membership. See CRA, supra note 82.
85 And the examples of trust clauses contained herein are only certain examples of how trust clauses may be drafted. They are not exhaustive as Settlement Trust circumstances vary.
challenges and legal uncertainty exists related to these taxation issues. It is not my intent to make sweeping generalizations, rather, to identify those situations where tax issues could and do arise. In those instances, I argue for possible solutions.

1.5. Outline of Chapters

In Chapter 2, I describe the concept of trusts and how Bands use Settlement Trusts to manage Indigenous treasury. Also discussed is the current taxation of Settlement Trust revenues under the general trust provisions of the Tax Act and the related necessity for the application of an attribution rule so that income qualifies for tax exemption. The resulting administrative processes and costs as well as possible legal issues that could arise from having Settlement Trusts taxed in this manner are also covered in this chapter.

In Chapter 3, I firstly discuss the technical benchmark tax system and how it is evaluated. I then apply a normative analysis to argue that deviations from taxation under the technical tax provisions are sometimes necessary to further certain non-tax governmental policy objectives. I argue that a tax expenditure, in the form of a tax exemption applied to Settlement Trust revenues, could be justified to further the policy objective of preserving Indigenous property.

In Chapter 4, I discuss Indigenous tax exemptions that exist outside of the Tax Act, such as s.87 of the Indian Act. The Williams connecting factors are outlined in this chapter to show that while a good case may be made for tax exemption, s.87 does not actually extend far enough. I argue that, rather than relying upon s.87, a more likely solution is to amend the Tax Act to exempt Settlement Trusts from the general trust provisions so that s.149(1)(c) of the Tax Act applies directly to Settlement Trust revenues (as it does to any other Band revenue).

In Chapter 5, I consider whether the Crown owes a fiduciary duty or must uphold the honour of the Crown to reconsider the tax treatment of Settlement Trusts. I argue that strict fiduciary duty tests set out by the Supreme Court of Canada in key decisions may not apply here because it is difficult to meet the narrow criteria set out in the tests. The honour of the Crown, being a more comprehensive framework, could apply here but this principle is not a cause of action in and of itself. The law is still evolving in this area.

Chapter 6 provides a final conclusion and recommendations. I conclude that a great deal of uncertainty exists as it relates to the arguments advanced in the preceding Chapters.
Therefore, I recommend that an amendment to the *Tax Act* be made so that Settlement Trust revenues are precluded from being taxed under the general trust provisions. Bands could then claim trust income under s.149(1)(c) of the *Tax Act* (without the necessity of the application of an attribution provision) and income would be tax exempt.
CHAPTER 2: TAX PROBLEMS RELATED TO INDIGENOUS SETTLEMENT TRUSTS

2.1. Introduction

As discussed in Chapter 1, historically, Indigenous people’s participation in economic and commercial activities was intertwined with traditional Indigenous governance practices. Thus, participation in economic activities is not a new concept for Indigenous peoples. In fact, activities that yielded economic benefits flowed from Indigenous self-determination and self-governance. It is on this premise, that, through participation in commercial activities, Indigenous peoples are able to acquire property in various forms in the same manner that non-Indigenous people do.

In this Chapter, I discuss how Bands acquire assets by participating in the financial mainstream economy, namely through investment structures related to trusts. Section 2.2 provides the background on a Band’s use of an Indigenous Settlement Trust ("Settlement Trust") to manage settlement funds. Section 2.3 then discusses the taxation of Settlement Trusts under the general trust provisions of the *Income Tax Act* ("Tax Act").¹ Then in Section 2.4, the problems that Bands experience due to the application of general trust provisions to Settlement Trust structures is discussed.

I conclude that current legislation related to the taxation of Settlement Trusts is problematic because the Band is required to take advantage of an attribution rule in the *Tax Act* to attribute revenues to the Band to qualify for tax exemption. This carries with it some administrative costs and creates legal uncertainty for the Band. In fact, it burdens both the Band and the Canada Revenue Agency with unnecessary administrative processes that could easily be minimized or eliminated completely.

2.2. The Nature of Indigenous Settlement Trusts

Express trusts are intentional trusts created for the benefit of persons.² The practice of holding trusts dates back over six hundred years and its original purpose was for it to be a legal

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¹ RSC, 1970, c I-6 (now RSC, 1985, c I-5) [*Tax Act*].
“use”. Legally, a party could hold property in trust for the use and benefit of another party, the beneficiary. As such, trusts are a valuable conduit for control and ownership of property. The trust concept may be defined in the following manner:

A trust is an equitable obligation, binding a person (called a trustee) to deal with property (called trust property) owned by him as a separate fund, distinct from his own private property, for the benefit of persons (called beneficiaries, or, in old cases, cestuis que trust), of whom he may himself be one, and any one of whom may enforce the obligation.

Notably, a trust is not an entity, rather is a “relationship involving obligations owed by the person who holds the trust property”; as such, the trust does not hold property, instead the trustee holds property in trust for the benefit of another party. It is against this backdrop that the nature of Settlement Trusts is considered in this chapter.

A Settlement Trust is an express private trust that is intentionally created by a Band so that Settlement Agreement funds are held in trust for the benefit of the membership of the Band. Holding settlement funds in trust is also a means through which Bands participate in the commercial financial economy because the settlement funds are managed and invested in the securities market to yield income from these investments. Therefore, such structures may be considered financial management vehicles through which trust assets are invested in the financial economy to yield returns. These returns are then used for the overall maintenance and development of the Indigenous community (the Band) subject to the trust terms.

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3 Oosterhoff et al, supra note 2 at 8; Waters, supra note 2 at 6; and Dennis Pavlich, Trusts in Common-Law Canada, 2nd ed (Toronto: LexisNexis, 2016) at 32.
4 Oosterhoff et al supra, note 2 at 8.
5 Ibid at 10.
6 Ibid at 18.
7 Ibid [emphasis in original].
8 A Settlement Trust is considered an inter-vivos trust, that is, it is established by a living person, a settlor. It is a legal agreement that forms the basis for a fiduciary relationship in which a party, the settlor, transfers property to a second party, the trustee, for the benefit of a third party, the beneficiary. The beneficiary and the settlor may sometimes be the same party, as in the case of Settlement Trusts. See Jinyan Li, Joanne Magee and J. Scott Wilkie, Principles of Canadian Income Tax Law, 9th ed (Carswell: Toronto, 2017) at 433-4 [Li et al]. The property is held in trust by the trustee for the beneficiary and shall only be distributed under such terms as the trust indenture allows for. It is incumbent upon the trustee, acting in a fiduciary capacity, to contemplate the terms of the trust and relevant trust law when receiving instruction in relation to the investment or transfer of trust property, including income distribution. See Trustee Act 2009, SS 2009, c T-23.01, s 7 [Trustee Act].
9 Other sources of Band revenues, such as business revenues, may also be deposited from time to time.
The use of a trust allows for important financial planning as well as to ensure that funds are directed to the beneficiary of the trust. It is a flexible means that provides for dispositions of property,\(^\text{10}\) in this case to the Band for the functioning of the community.

Settlement Trusts are established with settlement monies awarded to Indigenous peoples because of the adverse impacts, caused by government or industry, upon Indigenous land rights. The form of these settlement monies is dependent upon the terms of the agreements entered between a Band and either Canada, the province or an industry proponent. Agreements vary based upon the type of claim advanced and the party toward which the claim is directed.

The agreement leading to the creation of a Settlement Trust may be the result of a Treaty claim or some other type of claim. Treaty claims - including Treaty Land Entitlement claims, Treaty Annuity claims, Railway claims, or Agricultural Benefit Claims, to name a few – are asserted when the Crown is alleged to have not honoured certain terms of a Treaty with the relevant Band. A federal-specific claims process has been established for Treaty claims under $150,000,000, in order that they be resolved in as expeditious and judicious a manner as possible.\(^\text{11}\) In the case of non-Treaty claims, agreements may be the result of negotiations with the province or industry partners who compensate Bands for taking up business on reserved lands.

Funds resulting from resolved claims, are settled into a Settlement Trust account upon which certain terms dictate fund allocation. The use of settlement funds empowers Bands in areas of economic support, community development and the long-term sustainability of the community for generations to come. Because Settlement Trust terms are specific to each community’s precise needs and individual circumstances, the trust terms are drafted with the long-term future of that community in mind. The Band, with its political disruptions every two to four years, and often with a lack of infrastructure within the community, may not have the

\(^{10}\) Oosterhoff et al, supra note 2 at 10.

\(^{11}\) The Specific Claims Tribunal was established on October 16, 2008 to further the resolution of specific claims. Such claims are monetary damage claims made against the Crown regarding the breach of Treaty obligations and administration of land and other First Nation assets. As a joint initiative with the Assembly of First Nations, it is part of the federal Justice at Last policy. The goal is to provide justice for First Nation claimants and more certainty for government, industry and the rest of Canada. An independent adjudicative body, comprised of up to 6 full time Federal judges appointed from Provincial Superior Courts across the country, has been created so that First Nations may file a claim with the Tribunal. See the Tribunal, online: Specific Claims Tribunal Canada, www.sct-trp.ca [Tribunal].
systems in place to manage settlement funds for long-term use.\textsuperscript{12} Thus, Settlement Trusts are a suitable and common financial management vehicle for the management of such capital.

\textbf{2.3. The Taxation of Indigenous Settlement Trusts}

Although Settlement Trusts are a feasible way for Bands to manage Indigenous treasury, there are some unique challenges related to the taxation of Settlement Trust revenues as compared to the taxation of other Band revenues. This section will provide an overview of the current tax treatment and some of the issues that are involved.

\textbf{2.3.A General Trust Tax Treatment}

Income earned by a trust is taxable; trusts are taxed as individuals under s.104(2) of the \textit{Tax Act}.\textsuperscript{13} Pursuant to s.248(1), an individual is deemed to be anyone other than a corporation.\textsuperscript{14} Although a trust is treated as an individual taxpayer, the trust is taxed at the \textit{top personal marginal tax rate}, pursuant to s.122(1) of the \textit{Tax Act},\textsuperscript{15} rather than at progressive rates like other individuals.\textsuperscript{16} Trusts are taxed this way to avoid the possibility of income splitting.\textsuperscript{17} Trust revenues remaining in the trust are taxed to the trust, and those payable out of the trust in that

\textsuperscript{12} William H. Cooper, “The Essentials of First Nation Settlement Trusts” (Presentation delivered at the Aboriginal Financial Officers Association Annual General Meeting, Halifax, February 2014), [unpublished] [Cooper].

\textsuperscript{13} \textit{Tax Act}, supra note 1, s 104(2).

\textsuperscript{14} Ibid, s 248(1).

\textsuperscript{15} Ibid, s 122(1) [emphasis mine].

\textsuperscript{16} Under the progressive rate structure, the Canada Revenue Agency calculates the percentage of tax within each tax bracket up to the total of the last dollar earned and then takes the average or effective amount for the overall tax amount owed. See \textit{Li et al}, supra note 8 at 378.

\textsuperscript{17} Income splitting- when a party assigns a portion of his or her total income to another party to lower his or her overall tax bracket- is discussed in the next section. \textit{Li et al}, supra note 8 at 396.
particular fiscal year are to be included in the beneficiary’s income, pursuant to s.104(13) of the Tax Act.¹⁸

For example, when the income is paid out, or entitled to be paid out,¹⁹ to the beneficiary in a given taxation year, that income is added to the beneficiary’s total income for the fiscal year and tax owing is then calculated based upon that total taxable income, pursuant to s.9(1) of the Tax Act.²⁰ The trust can then deduct the amounts paid to the beneficiary in calculating its taxable income, pursuant to s.104(6) of the Tax Act.²¹ As such, the amount that the trust deducts has to be included in the income of the particular beneficiary who receives a payment or who is entitled to receive a payment from the trust.

2.3.B Applying the Tax Rules to Settlement Trusts

Regardless of the fact that settled assets in a Settlement Trust result from settlements between the Crown and the Band, in most cases, or from other agreements between the Band and third parties, in other cases, revenues from these trusts are taxed just as any other trust under the aforementioned general trust tax provisions. In order for tax exemption to apply, Settlement Trust revenue must be connected to the Band in such a way so that Indian Act or Tax Act exemptions apply. The most obvious way this can be done is through the attribution rule in s.75(2) of the Tax Act, which deems income to be attributed to the settlor of a trust for tax purposes. I discuss the conditions upon which an attribution provision might apply in the next section.

¹⁸ Tax Act, supra note 1, s 104(13). Also see Li et al, supra note 8 at 436.
¹⁹ A promissory note may also be issued for the income owing; it is defined under the Bills of Exchange Act, RSC, 1985, c B-4, s 176(1) [Exchange Act]:

176(1) A promissory note is an unconditional promise in writing made by one person to another person, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer.

The amount of the promissory note is subject to taxation as it is considered accrued taxable income, that is, revenue is recognized as income at the time that it is earned even if it has not been received. See Tax Act, supra note 1, s 12(1)(b). Also see Li et al, supra note 8 at 200.
²⁰ Tax Act, supra note 1, s 9(1).

9(1) Subject to this Part, a taxpayer’s income for a taxation year from a business or property is the taxpayer’s profit from that business or property for the year.
²¹ Ibid, s 104(6).
2.3.B.a Tax Attribution Rules

The general rule of income taxation is that a person who identifies income as his or her own for tax purposes is the person who is legally entitled to that income.\(^{22}\) However, in actuality where one taxpayer transfers income to another taxpayer who is taxed at a lower rate to avoid tax, called income splitting,\(^{23}\) the income may not be considered that of the transferee for income tax purposes. In fact, the application of attribution rules to prevent income splitting requires that income that is claimed by one person, the transferee, is deemed to be the income of another person, the transferor.\(^{24}\)

Preventing a higher income taxpayer from diverting taxable income to a lower income taxpayer is the primary purpose of an attribution rule.\(^{25}\) If a taxpayer were to try to reduce the total tax owed by transferring income to another party, the application of an attribution rule would prevent this from happening by attributing the income back to the transferor.\(^{26}\)

The attribution provision of the Tax Act that applies specifically to trusts is s.75(2), which states:

75(2) If a trust, that is resident in Canada and that was created in any manner whatever since 1934, holds property on condition:

(a) that it or property substituted therefore may

(i) revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as “the person”), or

(ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or

(b) that, during the existence of the person, the property shall not be disposed of except with the person’s consent or in accordance with the person’s direction, any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a

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\(^{22}\) Li et al, supra note 8 at 398.
\(^{23}\) Ibid at 396.
\(^{24}\) Ibid.
\(^{25}\) Ibid at 399.
\(^{26}\) Ibid.
loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person.\textsuperscript{27}

From this wording, this provision applies when certain conditions exist, including: 1) the trust is created and resident in Canada; and either 2(a) trust property (or substituted property) may revert back to the person from whom it was received or to a person determined by the settlor of the trust property at some point after trust creation, or 2(b) the person, in so long as is in existence, must consent or direct any disposition of the property. The result is that any income or loss resulting from the trust property will be deemed to be that of the settlor.

If a trust receives property under these conditions, s.75(2) is triggered. Through the application of s.75(2), any income, losses or capital gains earned from the property are attributed to the person who directly or indirectly settled the property into the trust.\textsuperscript{28} In essence, this provision implies that where a person contributes property to a trust and retains certain types of control over such property, the property cannot be considered transferred to any other party for income tax purposes. Rather, the person who settled the property into the trust is considered to still own the property and is liable for taxes levied upon income earned on that property.\textsuperscript{29}

In \textit{Sommerer v The Queen},\textsuperscript{30} the Federal Court of Appeal interpreted this provision to determine the kinds of circumstances in which s.75(2) applies. In analyzing those circumstances in which s.75(2) applies, a purposive interpretation must be undertaken to give effect to its application.\textsuperscript{31}

In the facts of \textit{Sommerer}, a father registered a private foundation\textsuperscript{32} in Austria where he was located, settled assets and designated his son and family, located in Canada, as the beneficiaries.\textsuperscript{33} While the assets were settled into and administered by the foundation in Austria, the beneficiary son resided in Canada at all times.\textsuperscript{34}

\textsuperscript{27} \textit{Tax Act}, supra note 1, s 75(2).
\textsuperscript{28} \textit{Ibid}. Also see \textit{Li et al}, supra note 8 at 441.
\textsuperscript{29} \textit{Li et al}, supra note 8 at 441.
\textsuperscript{30} 2012 FCA 207, [2012] DTC 5126 [\textit{Sommerer}].
\textsuperscript{31} \textit{Ibid} at para 48.
\textsuperscript{32} Part of the analysis was whether the foundation could be considered a trust and the Supreme Court of Canada held that it was.
\textsuperscript{33} \textit{Sommerer}, supra note 31 at para 20-22.
\textsuperscript{34} \textit{Ibid} at para 19.
The son, Mr. Sommerer, eventually sold certain shares to the foundation and when the foundation sold the shares it realized capital gains on the sale.\textsuperscript{35} When Mr. Sommerer’s (the beneficiary son) income was assessed in Canada, the Minister took the position that the capital gains realized by the foundation on the sale of the shares were attributable to him. He was considered to be the contributor of the funds, via the shares, pursuant to s.75(2) of the \textit{Tax Act}. Mr. Sommerer successfully appealed the Minister’s tax reassessment to the Tax Court of Canada and the Minister appealed to the Federal Court of Appeal.

The Federal Court of Appeal upheld the Tax Court’s decision on the basis that if fair market value dispositions\textsuperscript{36} were caught by s.75(2) absurd consequences would ensue. This could lead to two parties being taxed on a disposition by the trust; that is, the original settlor and the beneficiary who contributed property by way of fair market value dispositions into the trust would both be taxed.\textsuperscript{37}

The reason this double taxation does not make sense is because the text of s.75(2) indicates that the person who contributes property to the trust either directly or indirectly is the person that capital gains, income or loss earned from the property should be attributed to.\textsuperscript{38} A trust is only legally valid after a settlor contributes property for the benefit of the beneficiary. Therefore, it makes sense that the time of the \textit{creation of the trust} is the time that determines the settlor because that is the time frame that the original property is situated into the trust.

As such, the Federal Court of Appeal found that if a trust is created when property is received from the settlor, then only the settlor could be "the person" who subsequently determines who the property passes to, pursuant to s.75(2)(a)(i).\textsuperscript{39} Therefore, the Minister erred by assuming that s.75(2) applied, thus assessing taxes on the beneficiary son’s contribution in the trust.

\textsuperscript{35} \textit{Ibid} at para 30.
\textsuperscript{36} A fair market value disposition simply means that Mr. Sommerer sold the shares to the foundation for fair market value. Thus, this forces the foundation to recognize, for tax purposes, all realized capital gains. See \textit{Li et al, supra} note 8 at 302.
\textsuperscript{37} \textit{Sommerer, supra} note 31 at para 49.
\textsuperscript{38} \textit{Ibid} at para 51.
\textsuperscript{39} \textit{Ibid} at para 57.
The Federal Court of Appeal also considered the plain and ordinary meaning of “reversion”. It found that reversion simply means that the settlor has a right of disposition of the trust property.\footnote{Ibid at para 48.} Property that is contributed by a settlor but may return to the settlor at some future date, shall be a "reversion" as it relates to s.75(2).\footnote{Ibid.}

Finally, the Federal Court of Appeal considered the overall purpose of s.75(2):

subsubsection 75(2) generally is intended to ensure that a taxpayer cannot avoid the income tax consequences of the use or disposition of property by transferring it to another person in trust while retaining a right of reversion or a right of disposition with respect to the property or property for which it may be substituted. A common example of the application of subsection 75(2) is the settlement of a trust where \textit{the settlor is also a beneficiary} with an immediate or contingent right to a distribution of the trust property. In that situation, and in many other situations contemplated by paragraphs 75(2)(a) and (b), subsection 75(2) achieves its intended purpose.\footnote{Ibid.}

This described purpose is relevant in so far as it informs those situations where a taxpayer might create a trust for improper purposes, such as to avoid taxes. This provision is designed to prevent tax avoidance. Next, I discuss how this provision applies in relation to Settlement Trusts.

\textit{2.3.B.b. Application of Attribution Rules to Settlement Trusts}

A Settlement Trust is created when the Band, the settlor, deposits settlement assets into the trust for the benefit of the Band, the beneficiary. The Band, as settlor, is the “person” who determines to whom the property passes under the terms of the Settlement Trust. The Band is also the beneficiary of the Settlement Trust assets because the very purpose of creating a Settlement Trust is for the long-term benefit of Band members. Therefore, the Settlement Trust property will revert to the Band at a future date.

Under these facts, the Band is caught by the application of s.75(2) because the Band is both the settlor as well as the beneficiary and has the right to a distribution of the Settlement
Trust property. In filing the Settlement Trust income tax return, the income is attributed to the Band, pursuant to s.75(2) of the Tax Act.

Arguably, the application of s.75(2) to Settlement Trusts is contrary to the legislative purpose of this provision, which is to prevent the settlor from avoiding tax on income through the use of a trust. In *Brent Kern Family Trust v The Queen*, the Tax Court addressed the purpose of this section as follows:

> Once applicable, subsection 75(2) effectively prohibits a person from transferring property to a trust and having the income, loss, capital gain or capital loss (“benefit”) flow to a different entity, where the transferor may have a future opportunity to again receive the benefit. Instead, the rule under subsection 75(2) confers the benefit back to the transferor immediately and thereby precludes the diversion of the benefit through the use of a trust.

Here we see that the application of s.75(2) to Settlement Trust revenues has a different effect than was intended by legislators. In the next section, I expand upon the application of this provision as a part of a review of some of the drawbacks for Bands related to the current tax treatment of Settlement Trusts.

### 2.4. Settlement Trust Tax Problems from the Band’s Perspective

Whether the application of s.75(2) is appropriate, from a policy perspective, in dealing with the taxation of Settlement Trust revenues is a matter of debate. The application of s.75(2) in the case of Bands employs the use of a workaround that is a round-about way of usurping
s.104(2) of the *Tax Act*, Arguably, s.104(2) of the *Tax Act* is overly broad in that it automatically includes Settlement Trusts. I argue that sufficient consideration has not been given to whether Settlement Trusts should be taxed differently than other trust structures. The current tax treatment puts Bands in a position to have to draw upon the application of s.75(2) to gain tax exempt status. However, Bands incur administrative costs and legal risks because of its application (as compared to a more direct tax exemption in the *Tax Act*). These costs and risks will be covered in the following sections.

2.4.A. Administrative Costs

Rather than simply drafting the terms of a Settlement Trust with the *key objective of prioritizing community interests* in mind, Bands must consider the legal, administrative, and tax accounting mechanisms necessary to assist in managing tax considerations. Mostly, lawyers, consultants, accountants, trustees and tax experts benefit financially from this, and, conversely, Bands incur financial costs. Yet, these costs are necessary to ensure the application of s.75(2) so that income is attributed back to the non-taxable Band so that returns on settlement monies are not eroded by income tax.

Managing and administering Settlement Trusts, drafted specifically to catch the application of s.75(2) in order to yield tax benefits, can also be administratively burdensome. Section 75(2) only applies to first generation income and because second generation income is not considered income earned on property contributed by the settlor, the Band, it will be taxable to the extent that it is not paid to the beneficiaries.

Therefore, it is necessary to either track the lines of investment income in order to avoid the payment of taxes on second generation income, issue a promissory note for the revenues owing or ensure that all taxable income is paid out of the Settlement Trust each year. Further, it is necessary to ensure that all of the Settlement Trust’s tax-deductible expenses are taken into consideration first in order to reduce the total taxable income in the trust. As such, this would also require a tracking of relevant deductible expenses.

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48 Refer back to Footnote 2 for wording of s 104(2).
49 Second generation income is income derived from the investment of annual income retained within the Settlement Trust in any fiscal year.
It is pertinent here to note that this line of action is not required when dealing with any other type of Band income; the Band simply does not file a tax return for other sources of income that is considered tax exempt, pursuant to s.149(1)(c) of the Tax Act.50

In the next section, I address concerns related to the General Anti Avoidance Rule ("GAAR") that might be used by the Minister to deny a tax benefit to Bands who use the application of s.75(2) to qualify for tax exemption on Settlement Trust revenues.

2.4.B. General Anti-Avoidance Concerns

No guarantee exists that Bands will not be held to account for the application of s.75(2) to avoid tax liability. Under the Canadian tax system, the purpose of including attribution provisions in the Tax Act is to prevent a taxpayer from avoiding taxes through the reduction of total taxable income. Yet, in the case of Settlement Trust revenues, the application of s.75(2) accomplishes the very thing that the Tax Act frowns upon: the avoidance of income taxation. The fact that the Tax Act contains provisions that prohibit avoiding tax liability underlies the significance of the application of s.75(2) in this situation.

Tax avoidance that is allowable does not necessarily involve fraud or concealment.51 Rather, because taxpayers are able to choose to order their affairs for personal and business considerations, ancillary tax advantages may be the result of such ordering.52 In fact, careful business planning that minimizes tax implications may not even be considered avoidance at all.53

However, when specific steps are taken to primarily reduce or avoid tax all together, the Canada Revenue Agency may argue that this is impermissible tax avoidance.54 The line is drawn between “good” tax avoidance intended by Parliament and “bad” tax avoidance that employs mechanisms intended to circumvent the intention of Parliament.55 Taking advantage of credits or deductions that are permissible under the Tax Act56 is encouraged by law because relevant

50 See MNP, supra note 44.
51 Li et al, supra note 8 at 530.
52 Ibid.
53 Ibid.
54 Ibid at 530.
55 Ibid at 528.
56 Ibid at 531.
provisions were enacted for that purpose. However, when a “transaction violates the legislative intention and scheme of the Act” the purposes of the provision(s) in question may be frustrated.\(^{57}\)

Specific anti-avoidance rules exist in the *Tax Act* that are designed to counter tax avoidance in certain circumstances. The context of such rules was aptly described by *Weisbach* in “Costs of Departures from Formalism: Formalism in the Tax Law”:

The government has the first move, in which it must determine the content of the law. The taxpayer then determines her transactions. The government has the pen; the taxpayer has the plan. Given this game, the taxpayer has a distinct advantage over the government, because the taxpayer acts with complete knowledge of the government’s decisions while the government can only guess at the taxpayer’s decisions. One way [anti-avoidance] rules level the playing field by reducing the taxpayer’s ability to take advantage of the situation.\(^{58}\)

Nonetheless, these specific rules are highly technical in nature, are interpreted strictly by the Courts and are not always applicable to a more general range of transactions.\(^{59}\) Therefore, a tax rule that covers a broad range of tax avoidance activities was enacted. It was during the Tax Reform of 1988 that the enactment of the GAAR in the *Tax Act* occurred.\(^{60}\) This general rule, found in s.245 of the *Tax Act*, reads as follows:

S.245(1) In this section, “tax benefit” means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax Treaty or an increase in a refund of tax or other amount under this Act as a result of a tax Treaty;

“tax consequences” to a person means the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by or refundable to the person under this Act, or any other amount that is relevant for the purposes of computing that amount;

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\(^{57}\) *Canada Trustco Mortgage Company v Canada*, 2005 SCC 54 at para 45, [2005] 2 SCR 601 [*Trustco*]. Also see *Li et al*, *supra* note 8 at 544. Consideration must be given to the object, spirit or purpose of a provision by researching Parliament’s comments when the provision or statute was discussed. Also, the intent of the department of finance when it drafted the legislation must be considered. See Joe Dalton, (2012) “Copthorne’s Legacy: The Future of Canada’s GAAR” 23 Int’l Tax Rev 18 at 18 [*Dalton*].


\(^{59}\) *Ibid* at 541.

\(^{60}\) *Ibid* at 542.


“transaction” includes an arrangement or event.

(2) Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

(3) An avoidance transaction means any transaction

(a) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit; or

(b) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.

(4) Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

(a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
(i) this Act,
(ii) the Income Tax Regulations,
(iii) the Income Tax Application Rules,
(iv) a tax Treaty, or
(v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or

(b) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.61

The purpose of invoking the GAAR is to deny a tax benefit that results from employing tax avoidance mechanisms.62 Pursuant to s.245(1) of the Tax Act, a tax benefit is a reduction, avoidance or deferral of tax or other amount payable under the Act.63 That is not to say that if a

61 Tax Act, supra note 1, s 245 (1), (2), (3), (4).
62 Li et al, supra note 8 at 544.
63 Tax Act, supra note 1, s 245(1).
transaction provides a benefit but is undertaken for bona fide purposes or is not considered abusive that it cannot be saved from the GAAR. To date, the Supreme Court of Canada has dealt with limited cases relating to the application of the GAAR.

One of the key decisions that considered anti-avoidance transactions is Canada Trustco Mortgage Co. v Canada. In the facts of that case, Trustco was a mortgage lender and as part of its business operations it obtained large revenues from leased assets. Trustco purchased trailers and then circuitously leased the same trailers back to the vendor, with arrangements made such that Trustco was effectively assured the lease payments would be made. The purpose of the circular transactions was to offset the leased trailer revenue by claiming a capital cost allowance ("CCA"). A transaction entered into whereby a purchase is made from a particular party and then the item purchased is leased back to that party, without risk of non-payment, could raise some questions with the Canada Revenue Agency.

By engaging in this arrangement, taxes on the amount of profits reduced by the CCA deductions were deferred, so that taxes would not be payable until a later time. Subsequently when the trailers were sold, the CCA would factor into the income earned (as recapture) and taxes would then be payable. The Minister did not allow the CCA claim on the grounds that title had not been acquired by Trustco or, alternatively, that the GAAR applied to deny a tax benefit. The Tax Court of Canada set aside the Minister’s decision, finding that the transaction fell within the spirit and purpose of the CCA provisions under the Tax Act. As such, the GAAR was said to not apply. The Federal Court of Appeal and the Supreme Court of Canada both affirmed the Tax Court’s decision.

The Supreme Court of Canada applied a three-step analysis to determine whether the GAAR was invoked to deny the tax benefit claimed by Canada Trustco Mortgage Company. The

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64 For example, Trustco, supra note 58 and Li et al, supra note 8 at 550.
65 Trustco, supra note 58.
66 Ibid at para 2.
67 Ibid. Capital Cost Allowance is a tax deduction upon which a business may claim the depreciation expense of equipment owned by the business. It is applied in calculating the overall taxable income. In this case, the amount of $31,196,700 was claimed as tax deductible against lease revenues of $51,787,114 for the 1997 taxation year. See Trustco, supra note 58 at para 2.
68 Ibid.
69 Ibid at para 5.
70 Ibid.
Supreme Court of Canada found that before the GAAR can be applied to deny a tax benefit, all three of the following requirements must be fulfilled:

1) A tax benefit arises from a transaction under s.245(1) and (2);
2) The transaction was not arranged for bona fide purposes other than to obtain a tax benefit such that it is an avoidance transaction under s.245(3); and
3) The avoidance transaction is abusive under s.245(4).\(^{71}\)

The taxpayer must refute parts one and two while the Canada Revenue Agency must establish part three.\(^{72}\) In this decision, the Supreme Court of Canada found that 1) a tax benefit was incurred by claiming the CCA on the leased trailers; 2) an avoidance transaction did occur by leasing the trailers to the vendors and claiming the CCA toward them; and 3) a misuse of the Tax Act provision allowing the CCA deductions did not occur. Therefore, the Supreme Court of Canada ultimately reached the conclusion that the questioned transactions fell within the spirit and purpose of the CCA provisions.\(^{73}\)

In applying the three requirements, one must analyze the relevant transaction or series of transactions to determine whether abusive tax avoidance has occurred.\(^{74}\) Even if only one transaction in the series could constitute abusive tax avoidance, the GAAR may be found to apply.\(^{75}\) As in the Trustco decision, even if it is found that a tax benefit exists and a transaction was not arranged for a bona fide purpose, abusive tax avoidance may still not be proven. This is likely because the Canada Revenue Agency has a strict burden to prove that abuse of a provision has occurred.

In the situation at hand, the following are the transactions in the series that a Band engages in to benefit from the application of s.75(2) of the Tax Act:

a) Settlement Agreement funds are to be paid to the Band;
b) Settlement Trusts are drafted in such a way that the trust will be caught by s.75(2) and the Band subsequently deposits the settlement funds into the Settlement Trust;
c) The Band enters into investment agreements with investment companies;
d) The Settlement Trust assets earn first generation income on the investment of the assets;

\(^{71}\) *Ibid* at para 17.
\(^{72}\) *Ibid* at para 66.
\(^{73}\) *Ibid* at para 78.
\(^{74}\) *Ibid* at para 22.
\(^{75}\) *Ibid* at para 34.
(At this point, the application of s.75(2) is used to attribute income back to the settlor of the trust assets, the Band)

e) Annual income may be paid out to the beneficiary, the Band, to avoid the accumulation of second generation income and the trust deducts the expense, pursuant to s.104(6) of the *Tax Act*;

f) If first generation income remains in the trust, which in some cases it may, second generation income is earned; and

g) Second generation income is dealt with by either tracking the lines of investment income as it continues to earn revenue (third generation income), paying it out completely or issuing a promissory note to the Band for the value of any second-generation income earned.\(^\text{76}\)

(As a result, the Band is tax exempt on income attributed to it, pursuant to s.149(1)(c) of the *Tax Act*.)

The requirements that determine whether the GAAR applies will each be discussed below in relation to the above noted series of transactions.

1) *Whether a Tax Benefit Exists*

The Canada Revenue Agency may assume the existence of a tax benefit, in which case the onus is on the taxpayer to refute this assumption because the taxpayer has comprehensive knowledge of the transaction or series of transactions.\(^\text{77}\) A tax benefit is defined in the *Tax Act* as a “reduction, avoidance or deferral of tax or other amount”.\(^\text{78}\) While this can result from either a transaction or a series of transactions, a factual determination will generally inform whether a tax benefit exists.\(^\text{79}\)

If a reduction in tax is clear from the application of a tax provision then a tax benefit exists.\(^\text{80}\) For example, if a tax exemption exists, the existence of a tax benefit is clear, because there is an obvious reduction in tax. Alternatively, if an obvious benefit cannot be found, the Supreme Court of Canada has held that it is necessary to determine whether a benchmark transaction exists that the taxpayer Band could reasonably have carried out whether or not a tax

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\(^\text{76}\) In some cases, a promissory note is issued (see *Exchange Act*, *supra* note 20) and otherwise the second-generation income is tracked because this income does not constitute contributions by the settlor such that it would be attributable to the settlor.

\(^\text{77}\) *Trustco, supra* note 58 at para 63. Also see *Copthorne Holdings Ltd. v Canada*, 2011 SCC 63, [2011] 3 SCR 72 [*Copthorne*].

\(^\text{78}\) *Tax Act*, *supra* note 1 at s 245(1).

\(^\text{79}\) *Trustco, supra* note 58 at para 19.

\(^\text{80}\) *Ibid* at para 20.
benefit might exist.\textsuperscript{81} Bear in mind that “[b]y considering what a [taxpayer] would have done if it did not stand to gain from the tax benefit, this test attempts to isolate the effect of the tax benefit from the non-tax purpose of the taxpayer”.\textsuperscript{82}

In the case of Settlement Trusts, it is clear that the application of s.75(2) yields a tax benefit because Settlement Trust revenues are tax exempt when income is diverted back to the tax-exempt Band. However, if this was not obvious, one might compare the manner in which a “general” personal trust is drafted (a benchmark transaction) and the way a Settlement Trust might be drafted, to determine whether a tax benefit exists.

Under a general personal trust,\textsuperscript{83} income from the trust is still taxed either to the trust or to the beneficiary. The key here is that the settlor, who is usually a different person than the beneficiary, will want the income to be paid out to the beneficiary to be taxed in the beneficiary’s hands, otherwise it will be taxed to the trust. Additionally, a general personal trust will last for the lifetime of the capital beneficiary because the trust terms are presumed to exist for the benefit of the beneficiaries;\textsuperscript{84} thus, trust assets are distributed out to the capital beneficiaries during their lifetime and at the time that the trust winds up or is considered terminated.

Alternatively, a trust that is drafted to be caught by s.75(2) is drafted in such a way so as to ensure that it is clear that the Band is both the settlor and the beneficiary. Additionally, pursuant to s.75(2)(a)(i), provisions must be drafted to ensure that the trust property either can or will revert back to the settlor of the trust assets. Further, pursuant to s.75(2)(b), provisions must be drafted to effectively deal with the annual income of the trust, that is, income is to be attributed to the settlor of the trust.\textsuperscript{85} Although it is certainly possible, and perhaps even probable, that a Settlement Trust may be set up in this way regardless of the tax implications, it

\textsuperscript{81} Ibid.
\textsuperscript{82} Copthorne, supra note 77 at para 35.
\textsuperscript{83} Although there are different kinds of trusts, here I simply referring to an express trust for persons and not purposes, that is, a trust set up for the benefit of either individuals or corporate persons. I am simply distinguishing between a non-Indigenous trust and a Settlement Trust that is drafted to catch s.75(2). For an express trust to be valid four requirements must be met: a) parties must have capacity to enter into a trust relationship; b) certainty of intention, subject-matter and objects of the trust must be clear; c) trust property must be transferred to the trustee; and d) requisite formalities must be met. See Oosterhoff, supra note 2 at 24, 183.
\textsuperscript{84} Ibid at 40.
\textsuperscript{85} Examples of such provisions will be outlined in the next section.
is possible that a court may accept an argument that this would not be the case, and therefore a benefit exists.

As such, if a tax benefit exists, and I argue that one exists here, the courts will then measure this benefit “by reference to the higher tax cost of the alternative that the taxpayer avoided”; nonetheless, the extent of the tax benefit is not relevant at this step of the analysis. The purpose of entering into the transactions must first be considered. I discuss this step next.

2) **Whether the Transaction(s) is for a Bona Fide Purpose**

Next, the transaction(s) in question must be considered to be an avoidance transaction(s) within the meaning of s.245(3) of the *Tax Act*. This part of the analysis serves to:

remove from the ambit of the GAAR transactions or series of transactions that may reasonably be considered to have been undertaken or arranged primarily for a non-tax purpose. The majority of tax benefits claimed by taxpayers on their annual returns will be immune from the GAAR as a result of s. 245(3). The GAAR was enacted as a provision of last resort in order to address abusive tax avoidance, it was not intended to introduce uncertainty in tax planning.

In *Trustco*, the Supreme Court of Canada found that multiple transactions could be considered to determine the primary motivation of the application of the tax provision in question. The Supreme Court of Canada has adopted the test for a “series of transactions” as “pre-ordained in order to produce a given result”. Recall that if at least one transaction within the series of transactions can be found to be an avoidance transaction then the tax benefit may be denied under the GAAR.

In applying this analysis to Settlement Trusts specifically caught by s.75(2), recall the relevant transactions noted above. Some of these transactions in and of themselves might not be considered avoidance transactions. A trust is a viable financial management vehicle and the need to deal with the settlement funds obviously exists. Therefore, settling such funds into a trust may have a non-tax purpose. Further, entering into investment agreements is a common

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80 *Trustco*, *supra* note 58 at para 19-20. Also see *Li et al*, *supra* note 8 at 552.
82 *Ibid*.  
83 *Ibid*.  
84 *Ibid* at para 22.  
86 *Ibid* at para 34.
investment management transaction for the settlor of trust assets. Earning income and having it paid to the beneficiary are also transactions that would occur under any personal trust. However, two transactions can be identified that may not have primary non-tax purposes: drafting a trust so that s.75(2) applies and issuing a promissory note to exempt tax on secondary income.

i) Drafting a Trust so that s.75(2) Applies

When a Band specifically drafts a Settlement Trust to ensure that it will be caught by s.75(2), this could be construed as entering into an avoidance transaction. Certain trust provisions may be included in a Settlement Trust to accomplish this. First, the Band must be the settlor of the trust assets, especially in cases where various sources of settlement funds are received from either the Crown or third-party industry proponents. The Band must also be both the settlor and the beneficiary. Settlement Trust provisions, drafted in the following manner, accomplish this:

The Trustee acknowledges that the Compensation shall be deposited by or on behalf of the First Nation to the Trust Account. Any monies deposited or transferred to the Trust Account and accepted by the Trustee are *deemed to be contributed by the First Nation* and shall be added to the Trust Property and governed by the terms of this Agreement.

- and -

The First Nation and the Trustee acknowledge that the *First Nation*, acting through its duly elected Chief and Council, *is the Beneficiary* of the Trust, with all of the rights and powers normally vested in a beneficiary to compel enforcement of the Trustee’s duties under this Agreement.93

Note here that monies paid out by third parties (such as industry proponents) are *deemed* to be contributed to the Settlement Trust by the Band. This is because to qualify for tax exemption the trust property must be attributed to the settlor, the Band. In addition, to qualify for tax exemption pursuant to s.149(1)(c) the beneficiaries must the *collective* Band and not individual Band members.

Next, a Settlement Trust should be clear that the property either can or will revert back to the settlor at some time either during the lifetime of the Band or upon termination of the trust,

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93 Redacted source of Settlement Trust clauses filed with author [emphasis mine].
pursuant to s.75(2)(a)(i) of the *Tax Act*. The trust property cannot revert to individual Band members. The following Settlement Trust provision accomplishes this:

If this Trust is terminated by order of a court for any reason after the Compensation Date, the Trustee shall pay any outstanding amounts owing for Authorized Expenses forthwith and *shall transfer the remaining balance of the Trust Property to the First Nation*, or such other person or trustee as may be designated by Council.

On the contrary, in the case of a personal trust, the winding up of a trust would cause the distribution of assets to go to individual beneficiaries, not the settlor.

Provisions must also be drafted to ensure that annual income is paid (or owed) to the Band. Subsection 75(2) only applies to first generation income, the income earned from the investment of the initial assets of the Settlement Trust. However, second generation income is not deemed to be contributed by the settlor of a trust. Therefore, in the first year, income can be attributed to the Band. Subsequently, if the income stays in the Settlement Trust the revenues earned on first generation income (second generation income) cannot be attributed to the Band.

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94 *Tax Act*, *supra* note 1, s 75(2)(a)(i).
95 Ibid.
96 Beneficiaries are then responsible for tax consequences.
99 For clarity sake, sample transactions follow: 1) Year One: Investment income is earned and if it remains in the trust it is attributed to the Band and is tax-exempt. Alternatively, if paid out to the Band, it is deducted from the trust’s income and taxed to the Band (who is exempt under s.149(1)(c)); 2) Year Two: If first generation income was retained in the Settlement Trust this income will yield second generation income that cannot be attributed to the Band. Therefore, it must be tracked and paid out or a promissory note issued for its value. It will be deducted from the trust’s income and taxed to the Band that is exempt under s.149(1)(c); and 3) Year Three and onward: Income continues to accumulate in the trust if it was not previously paid out or a promissory note issued. This income is not tax exempt and therefore must be tracked and paid out or a promissory note issued to achieve tax exemption.
As such, Settlement Trust provisions must be clear on the income that is getting distributed from the trust, so that favourable tax treatment can be ensured. The following provisions relate to the payment of annual income from a Settlement Trust:

“Annual Income” means all income for Canadian federal income tax purposes arising from the Trust Property in any Fiscal Year as determined in accordance with the Income Tax Act but without reference to subsection 104(6) of the Income Tax Act, including, but not limited to, interest, dividends and the taxable portion of the aggregate of the capital gains less the aggregate of the capital losses realized by the Trust during such Fiscal Year, and less all expenses and deductions eligible for Canadian federal income tax purposes.

-and-

Notwithstanding anything to the contrary in this Agreement, the Annual Income shall be deemed to be due and payable in its entirety to the Beneficiary as at December 31 of each Fiscal Year and attributed as income to the Settlor pursuant to the application of subsection 75(2) of the Income Tax Act.  

Setting up Settlement Trust terms specifically to trigger the application of s.75(2), could be considered taking steps to avoid tax. Fiscal management (a non-tax purpose) could easily be achieved without the necessity of the aforementioned provisions. Next, I will address issuing promissory notes.

ii) Issuing a Promissory Note

A second possible avoidance transaction is considered here. A promissory note is defined under the Exchange Act as an “unconditional promise in writing made by one person to another person, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer”.  

Because a promissory note is recognized at law, it is enforceable as a legal demand. Settlement Trusts may contain provisions related to issuing promissory notes:

In order to avoid any adverse tax consequences, the Trustee shall, in each Fiscal Year, distribute the Annual Payment, Special Loan Payments, Authorized Loan Payments, Legal Costs, and Authorized Expenses firstly from any Secondary Income, secondly, by deducting any balance owing under a Promissory Note, thirdly, from Annual Income, and lastly, from capital.

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100 Redacted source of Settlement Trust clauses filed with author.
101 Exchange Act, supra note 20, s 176(1).
As soon as practicable following transfer of the Annual Payment to the Revenue Account, the Trustee shall issue a Promissory Note to the Beneficiary for the amount of any Secondary Income that has not been distributed in that Fiscal Year. Where a balance remains owing under a Promissory Note from any previous Fiscal Year, the Trustee shall issue a Promissory Note to replace the earlier Promissory Note for the total outstanding amount owing, if any, as of that date. Each Promissory Note will be payable on demand and will bear no interest and shall be issued as evidence of absolute payment by the Trustee of any Secondary Income for a Fiscal Year of the Trust to the Beneficiary.102

Income received via a promissory note is recognized as income at the time that the note is issued even if the payee has not received payment.103 Therefore, a Band may avoid taxation on second generation income when a trustee issues a promissory note for the value of any secondary income.

The use of a promissory note to deal with tax consequences may be questionable if it is unclear whether payment will ever actually be demanded. The dubious use of promissory notes was addressed in Gleig v The Queen.104 Justice Lyons found that if promissory notes are issued by parties who never actually intend to demand payment of the notes, such notes may be construed as sham transactions.105 In this case, where promissory notes are issued for no other reason but to avoid tax consequences, it is possible that issuing such notes could be considered avoidance transactions.

In sum, an avoidance transaction may be found either through issuing promissory notes to avoid tax or through drafting a Settlement Trust to specifically attract s.75(2). However, this

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102 Redacted source of Settlement Trust clauses filed with author [emphasis mine].
103 Tax Act, supra note 1 at s 12(1)(b). Also see Li et al, supra note 8 at 200.
104 2015 TCC 191 [Gleig]. In this decision, work was performed by a party and the appellants issued a Note with a promise to pay on demand for the respective amount plus interest of 6% per year. Each appellant claimed their respective entire amount as CREs (comprised of Canadian Development Expenses (“CDEs”) and Canadian Exploration Expenses (“CEEs”)) pursuant to section 66.3 of the Tax Act in the 2002 taxation year. The Tax Court found that promissory notes that are issued as consideration are considered a prescribed benefit and not deductible if the recipient never intends to demand payment of the Note. See para 13, 17, 42. There was also an issue here in that the party promoting the scheme (who received the promissory note) did not apply for a tax shelter identification number around the interest being marketed.
105 Ibid at para 27, 46 [emphasis mine].
is not the end of the analysis. At the next stage, whether a provision was misused or abused must be considered. I discuss the last requirement in the next section.

3) **Whether Misuse or Abuse of a Tax Provision Occurred**

The Supreme Court of Canada determined that it is necessary to apply a two-part inquiry to determine whether a provision has been misused:

a) determine the object, spirit or purpose of the provisions of the *Tax Act* relied upon to construe a tax benefit, having regard to the scheme of the *Tax Act*, the relevant provisions and permissible extrinsic aids; and

b) next, examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provision at issue.\(^\text{106}\)

Two potential avoidance transactions were identified in the previous stage of analysis: (1) drafting a trust so that s.75(2) applies, and (2) issuing a promissory note so that secondary income is not taxed. In both cases, the direct or indirect consequence is that the first or second-generation income is tax exempt. The various provisions of the *Tax Act* that work together in the series of transactions in question must be contextually considered as a whole.\(^\text{107}\)

In this case, the provisions of the *Tax Act* that may have been abused are s.75(2) (which attributes the trust income to the settlor) in the first case, s.104(6) (which allows the trust to deduct an amount paid or payable to a beneficiary) in the second case, and s.149(1)(c) (which is considered by the Canada Revenue Agency to exempt Bands) in either case. Each of the three tax provisions is discussed, in turn, below.

a) **Abuse of s.75(2)**

(i) **The Object, Spirit and Purpose of s.75(2)**

A specific attribution provision related to trusts exists to address the possibility that taxpayers could avoid tax by creating numerous trusts to split their income. Under some circumstances, income splitting is valid, such as splitting pension income between spouses, a practice permissible under the *Tax Act*.\(^\text{108}\)

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\(^{106}\) *Trustco, supra* note 58 at para 55.

\(^{107}\) *Ibid* at para 39.

However, s.75(2) prohibits a person from transferring property to a trust to avoid tax because the settlor will be liable for any tax through the application of this provision. The object, spirit and purpose is to deter parties from avoiding tax on income earned in the trust that should be taxed in the hands of the taxpayer. Next, one must consider whether the object, spirit and purpose of this provision is frustrated.

ii) Frustration of the Object, Spirit and Purpose of s.75(2)

This part of the analysis turns on whether the impugned transactions (here, drafting a trust to which s.75(2) applies or issuing a promissory note for secondary income earned) allows Bands to gain a tax advantage that frustrates the valid purpose of s.75(2). The intent of the legislator must be considered here.109 Subsection 75(2) is intended to prevent tax avoidance.

The Supreme Court of Canada has held that “when a taxpayer relies on specific provisions of the Tax Act in order to achieve an outcome that those provisions seek to prevent”,110 this constitutes abusive tax avoidance. In fact, if a provision is used in a manner that defeats the underlying rationale of the provision, this is a misuse of the provision in question.111 Here we have a case where Bands specifically draft s.75(2) trusts to gain tax exempt status. Arguably, this is a misuse of s.75(2).

Next, the use of s.104(6) of the Tax Act will be considered to determine whether it may be considered an abusive transaction.

b) Abuse of s.104(6)

(i) The Object, Spirit and Purpose of s.104(6)

Subsection 104(6) of the Tax Act allows the trust to deduct the expense of income that is paid to the beneficiary in a fiscal year. Tax should only be assessed based upon the amount of income that accumulates in the hands of the trustee and not on income that is paid out to the beneficiary in that year.112 Therefore, beneficiary payments are tax deductible.

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109 Trustco, supra note 58 at para 40.
110 Ibid at para 45.
111 Ibid.
The object, spirit and purpose of this provision is to allow the trust to offset revenues earned in the trust against incurred expenses, such as income paid the beneficiary. Next, one must consider whether the object, spirit and purpose of this provision is frustrated.

(ii) **Frustration of the Object, Spirit and Purpose of s.104(6)**

Under this provision in certain circumstances trustees are given discretion about whether to deduct the full designated amount paid or payable to the beneficiary, pursuant to s.104(6)(b). Further, s.104(13.1) allows those amounts not deducted (and therefore taxed in the trust) to be excluded from the beneficiary’s income. Thus, there is a fair degree of flexibility inherent in s.104(6), which could include income splitting opportunities between the beneficiary and the trust. This provision is key to the flow through nature of trusts. For this reason, it is unlikely that the Band’s use of this provision frustrates its purpose because reduction of tax could be a reality for any taxpayer who takes advantage of this provision.

Lastly, the use of s.149(1)(c) of the Tax Act is considered to determine whether it may be considered an abusive transaction.

**c) Abuse of s.149(1)(c)**

(i) **The Object, Spirit and Purpose of s.149(1)(c)**

For policy reasons the Tax Act exempts from tax certain specified persons under s.149. Because governments are required to enact laws and oversee the constituents in its jurisdiction, the object, spirit and purpose of s.149(1)(c) is likely to allow for the provision of

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113 *Tax Act, supra* note 1, s 104(6)(b).

104(6) Subject to subsections (7) to (7.1), for the purposes of this Part, there may be deducted in computing the income of a trust for a taxation year (b) in any other case, the amount that the trust claims not exceeding the amount, if any, determined by the formula.


104(13.1) Where a trust, in its return of income under this Part for a taxation year throughout which it was resident in Canada and not exempt from tax under Part I by reason of subsection 149(1), designates an amount in respect of a beneficiary under the trust, not exceeding the amount determined by the formula... the amount so designated shall be deemed, for the purposes of subsections 104(13) and 105(2), not to have been paid or to have become payable in the year to or for the benefit of the beneficiary or out of income of the trust.

115 *Hogg et al, supra* note 112 at 518.

116 *Edgar et al, supra* note 108 at 183.

117 Canada Revenue Agency, Interpretation Bulletin IT-0645031I7, “149(1)(c)-Indian Act Bands” (27 July 2016) [CRA Ruling II].
public services unencumbered by tax obligations. Public bodies appear to play an important role in providing important governmental services for the good of the community. The purpose of this provision is likely so that governments can preserve funds used for these services.

Next, I will consider whether the object, spirit and purpose of this provision is frustrated.

(ii) **Frustration of the Object, Spirit and Purpose of s.149(1)(c)**

The question at hand is whether either of the two identified transactions that may potentially be considered an avoidance transaction - the creation of a trust that triggers the application of s.75(2) and the issuance of a promissory note for secondary income - frustrates the object, spirit, or purpose of s.149(1)(c).

Generally, for income connected to the Band, the Band benefits from the Canada Revenue Agency’s interpretation that a Band is a public body performing a function of government in Canada and is tax exempt. Notwithstanding that trust income would not ordinarily be considered Band income, once it is attributed to the Band via s.75(2), it is taxed in the hands of the Band. Under this interpretation, it is perfectly reasonable that Band income be treated as tax exempt.

It is unlikely that drafting a Settlement Trust so that s.75(2) applies could be interpreted as frustrating the purpose of s.149(1)(c) (preserving government funds). As was indicated earlier as long as an entity is considered a public body performing a function of government in Canada (and the Canada Revenue Agency has interpreted Bands as such) it should be tax exempt. That is, it should be able to meet the objective of preserving government funds.

The last consideration is whether issuing a promissory note could be interpreted as frustrating the purpose of s.149(1)(c). As noted earlier, if the Band is the beneficiary of the Settlement Trust property, the assets the Band receives, even if through a promissory note, should be protected. In fact, it appears that the objective of s.149(1)(c) is more aptly met through these transactions because such transactions allow Bands the kind of protection that s.149(1)(c) seeks to achieve.
Conclusion on the GAAR Analysis

All three requirements of the GAAR analysis must be met for the Minister to deny a tax benefit: 1) whether a tax benefit exists; 2) whether the transaction(s) are for a bona fide purpose; and 3) whether a tax provision(s) is abused.

Under requirement one, it is clear that the application of s.75(2) yields a tax benefit because Settlement Trust revenues are tax exempt when income is diverted back to the tax-exempt Band.

Next, under requirement two, several transactions were relevant, drafting a Settlement Trust so that it is caught by s.75(2) and issuing a promissory note to the Band for any income not directly paid out in a fiscal year. Setting up a trust to be caught by s.75(2) entails drafting specific provisions so that the Band benefits from s.75(2). Therefore, it is unlikely that setting up Settlement Trusts in this manner could be for a bona fide purpose other than to avoid tax.

Next, if promissory notes are issued for no other reason but to avoid tax consequences, it is possible that issuing a promissory note is not for a bona fide purpose. Therefore, under requirement two, no bona fide purpose likely exists for either issuing a promissory note or for drafting a Settlement Trust specifically to attract s.75(2).

Lastly, under consideration three, the application of three tax provisions, s.104(6), s.149(1)(c) and s.75(2) were considered. It is likely that the Band has not misused the application of s.104(6) because a fair degree of flexibility is inherent in this provision. A reduction of tax is possible for any taxpayer who takes advantage of the application of s.104(6).

Similarly, it is likely that the Band has not misused the application of s.149(1)(c) because as beneficiary of the Settlement Trust property, if the Band (considered a public body performing a function of government) receives income from the trust via s.75(2) or a promissory note, it should be tax exempt. Therefore, it is unlikely that drafting a trust that triggers the application of s.75(2) or issuing a promissory note could be seen as frustrating the purpose of s.149(1)(c). Arguably, the objective of s.149(1)(c) is more aptly met here.

Finally, it is likely that the Band has misused the application of s.75(2). Here Bands use this provision in a manner that the legislature had not intended. The purpose of s.75(2) is to prevent tax avoidance. It is somewhat inconceivable that legislators would draft trust provisions and
specific anti-avoidance provisions related to trusts to prevent tax avoidance, to then have a taxpayer take advantage of the application of the provision to qualify for tax exemption.

Therefore, it is possible that the GAAR could be applied to deny a tax benefit to Bands. Drafting Settlement Trusts with the application of s.75(2) in mind so that tax is avoided, is a use of the provision contrary to its legislative purpose.\textsuperscript{118}

2.5. Conclusion

By taxing Settlement Trusts under the general trust provisions, a burden is placed upon Bands in that they rely upon s.75(2) to qualify for tax exemption. The Band is faced with the uncertainty that the Canada Revenue Agency could question the application of s.75(2) in this manner. The application of s.75(2) also causes Bands to have to engage in certain administrative processes (arguably unnecessary) to manage tax and accounting considerations for compliance reasons.

The current method of taxing Settlement Trust revenues under general trust provisions is in place because the Canada Revenue Agency has likely not considered the \textit{sui generis} interests involved and the implications of taxing Settlement Trust revenues in this manner, or that, unless challenged, the status quo prevails.

The problem of the administrative burden incurred, and the possible issues related to the GAAR could be resolved if the general trust provisions were amended to exclude Settlement Trust revenues from being taxed under these provisions. I argue that it is appropriate to remove the uncertainty and have settled law in this regard. Other solutions exist that could apply to the taxation of Settlement Trust revenues. Such solutions will be addressed in the next chapters and will provide more clarity to Bands around the taxation of its Settlement Trust income.

\textsuperscript{118} It is conceivable that the GAAR should not apply because of overriding policy reasons. That is, it would be politically charged for the Canada Revenue Agency to deny a tax benefit to Bands given the current political climate in Canada between the Crown and Indigenous peoples. Yet, in \textit{Trustco}, the Supreme Court of Canada indicated that Parliament does have a responsibility to maintain legitimacy in its drafting and interpretation of provisions. See \textit{Trustco, supra} note 58 at para 41.
CHAPTER 3: UNDERLYING PRINCIPLES THAT INFORM THE TAXATION OF SETTLEMENT TRUSTS

3.1. Introduction

In Canada, income taxes are enforceable under legislation, the Income Tax Act ("Tax Act");¹ the rules that apply to the taxation of income are set out therein. Taxation under this Act has been the subject of ongoing political and social debate² because income taxation is an important element of Canadian society. In fact, even proponents of income taxation diverge in opinions around its full and proper function.³ On the one hand, a need exists to lower taxes to stimulate economic growth, while on the other hand, reasonable income tax is necessary to manage vital government programs.⁴ Nonetheless, income tax is a central component of fiscal management that enables the government to function and society to prosper.⁵

A general definition of income tax is that it is a “compulsory transfer of money from private individuals or organizations to the government not paid in exchange for some specific good or benefit.”⁶ Analyzing the tax policies related to income taxation may involve different forms of reasoning, namely analytical, empirical or normative reasoning.⁷ All of these forms of reasoning assist in one way or another to clarify issues related to income taxation.

For example, analytical reasoning may apply to determine whether tax policies “ensure consistency, equal treatment and continuity”; this kind of reasoning focuses on the methods in which values and facts are determined, not necessarily on the values and facts themselves.⁸ Rather, empirical reasoning may be applied to provide scientific explanations as to causal relationships, that is, how one variable can explain another variable.⁹ Lastly, normative reasoning can be applied to make determinations of “what ought to be” and not necessarily “what is”. Therefore, normative reasoning may involve making moral or ethical judgements.¹⁰

¹ (RSC, 1985, c 1 (5th Supp) [Tax Act].
³ Ibid.
⁴ Ibid.
⁵ Ibid.
⁷ Ibid at 24.
⁸ Ibid at 25 [emphasis mine].
⁹ Ibid at 29.
¹⁰ Ibid at 26.
Normative reasoning is most often applied in tax policy analysis because it deals with important questions, such as whether the tax system should provide concessions. For that reason, a normative analysis is most relevant to this thesis because we are dealing with policy issues related to Bands and how their Settlement Trusts should be taxed.

Analyzing the taxation of Settlement Trusts should necessarily begin with a determination of how the *Tax Act* views the “concept of income”. The most widely accepted theory of income is the Haig-Simons concept of income\textsuperscript{12} - income should be calculated as the monetary value of the taxpayer’s accumulation in economic power minus the taxpayer’s consumption of goods\textsuperscript{13} - discussed in section 3.3. This definition was elaborated upon and restated in the Carter Report,\textsuperscript{14} which stated that income should be the market value of assets held by the taxpayer in a fiscal year *plus any annual change* in the market value of those assets.\textsuperscript{15} While opinions may vary on the concept of income, to meet the objective of a fair tax system persons in similar circumstances should be treated similarly under the law, and those in different situations should be treated differently; social justice also demands this.\textsuperscript{16}

Therefore, I apply a normative analysis to determine whether Settlement Trust revenues can be justified as tax exempt. First, in section 3.2, I discuss how income taxes serve a practical public purpose by raising revenues for government spending. Next, I also review the more commonly accepted definitions of income. Then in section 3.3, I review the tax system objectives of equity, neutrality and simplicity which are applied to evaluate whether the tax system is actually accomplishing what it sets out to accomplish. I also discuss here how the application of these objectives might apply to Settlement Trust revenues to determine whether they should be taxed under the benchmark provisions. Lastly, in section 3.4, tax expenditures are discussed.

\textsuperscript{11} *Ibid* at 27.
\textsuperscript{14} *Report on the Royal Commission on Taxation* (Carter Report) (1966), 6 volumes [Carter Report]. The federal government established a Royal Commission on income taxation in 1966 led by an accountant by the name of Kenneth Carter out of Toronto, ON. The Carter Report produced a thorough and comprehensive study of the Canadian income tax system and made key recommendations for change to the method of tax calculations at that time. Some of these recommendations were adopted and some were rejected.
\textsuperscript{15} Li et al, supra note 13 at 105 [emphasis mine].
\textsuperscript{16} Larre, supra note 12.
Here I also discuss whether a Settlement Trust tax expenditure could be justified due to convincing policy reasons.

I conclude that not taxing Settlement Trust revenues is justifiable due to the historical Indigenous-Crown relationship that has, in fact, been legally recognized as a fiduciary relationship (discussed in chapter 5). Additionally, the Courts have also ruled that preserving Indigenous property is a policy goal related to the historical surrender of Indigenous lands (discussed in chapter 1). But first, I provide a basic overview of income taxation and the concept of income.

### 3.2. Income Taxation and the Concept of Income

Income taxes – a portion of a taxpayer’s income that is paid to the government at predetermined intervals - are compulsory because income tax revenues finance government programs. While government objectives can be met through raising various sources of tax revenues, income taxes are a vital source of revenues that assist in achieving these objectives.

Income tax laws are crucial to stabilizing the economy. Because income restrains economic growth and retrenchments by moving taxpayers into higher and lower income tax brackets as income increases or decreases, taxation may have a stabilizing effect upon the economy. Tax laws allow for the redistribution of revenues to deal with society’s unequal wealth; they also regulate private activities in order to promote social and economic policies.

Interpreting the provisions of the Tax Act is an ongoing effort. Even so, analyzing the concept of income is a good starting point to understanding (at least as much as is reasonably possible) how income taxes should be determined under the Tax Act. This concept will be discussed here along with several theories that inform the evaluation of income tax.

Defining the concept of income is necessary in determining a benchmark that tax could be calculated upon a taxpayer’s total income. Therefore, I will review several concepts of

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17 Edgar et al, supra note 6 at 12.
18 Li et al, supra note 13 at 2.
19 Ibid.
income - the Haig-Simons Theory and the restatement of this theory in the Carter Commission Report – which are touchstones for how income should be calculated.

3.2.2. A. The Haag-Simons Theory of Income

In 1921, Robert Murray Haig proposed the accretion concept of income. Under this theory, Haig argued that income should be calculated as “the money value of the net accretion to one's economic power between two points of time”.\(^\text{23}\) Any accumulation of various sources of income over the tax year should count as income.\(^\text{24}\)

Subsequently, in 1938, Henry C. Simons argued that “consumption” should also be considered in determining income. In fact, Simon defined his theory as: “the algebraic sum of 1) the market value of right exercised in consumption and 2) the change in the value of the store of property rights between the beginning and the end of the period in question”.\(^\text{25}\) It was through this “consumption” concept that Simons expanded upon Haig’s accretion of income theory by accounting for the total of goods consumed in the tax year.\(^\text{26}\)

Subsequently, the Haig-Simons concept of income became widely accepted and is considered to be the ideal definition of income because in theory it is not complex.\(^\text{27}\) It is used by analysts to test the fairness of income taxation upon taxpayers’ income.\(^\text{28}\)

However, difficulty arises from the ambiguity related to the terms “consumption” and “wealth” because no criteria exists to clarify these terms.\(^\text{29}\) For example, this theory indicates that all gains - salary income, wages, property income, capital gains, business income, gifts or inheritances, direct sales or profits from one’s own labour or property - should be included in measuring a taxpayer’s income.\(^\text{30}\) Thus, accretion in wealth should be able to be objectively quantified.\(^\text{31}\) Yet, some challenges exist, for example:

In the case of unrealized gains and non-monetary benefits this presents a huge valuation task, not to mention the problem of detection. It would be more

\(^{23}\) Hogg et al, supra note 20 at 77.
\(^{24}\) Ibid.
\(^{25}\) Ibid at 77-8 citing Simons, Personal Income Taxation (1938), 50.
\(^{27}\) Ibid at 436.
\(^{28}\) Hogg et al, supra note 20 at 78.
\(^{29}\) Thuronyi, supra note 22 at 48.
\(^{30}\) Hogg et al, supra note 20 at 78.
\(^{31}\) Ibid.
convenient to tax gains on realization than on accrual. In addition, there is the liquidity issue. Taxpayers might have to sell the assets producing their income in order to pay their taxes, notwithstanding their increase in wealth. Finally, there may be overriding social and political reasons for not taxing certain economic gains, such as gifts, damages for pain and suffering, or the value of unpaid housework, even if they constitute gains.  

Further, a definition of income should be practical enough so that taxation can be easily administered by the government. However, because the Haig-Simons concept of income was borrowed from economics, it does not have the same practical application in law as it does in economic theory. This theory of income was restated in the Carter Report and will be discussed in the next section.

3.2. B. The Carter Commission’s Definition of Income

The Haig-Simons theory was restated in the Carter Report to argue that income is actually “the sum of the market value of goods and services consumed or given away in the taxation year by the tax unit [the taxpayer], plus the annual change in the market value of the assets held by the unit”. This concept of income, known as the new comprehensive tax base, argues that income should measure the taxpayer’s annual increase in his or her assets in a fiscal year. As such, all gains in wealth should be counted as income to calculate income tax. Because this concept of income argues that all income should be taxed, the phrase “a buck is a buck is a buck” was coined.

The Carter Commission resulted in several key policy changes, two of which were: 1) the tax base broadened to include numerous sources of income; and 2) tax rates only increased as income increased. Therefore, it was found that the ability of a taxpayer to pay should be a key objective of the income tax system. In fact, the ability to pay is considered more fair and

32 Ibid.
33 Ibid.
34 Thuronyi, supra note 22 at 46.
35 Li et al, supra note 13 at 40 quoting the Carter Report, supra note 14.
36 Ibid at 40.
37 Ibid.
38 Ibid.
39 Ibid at 41.
40 Ibid at 49.
equitable because income taxes should only increase if a taxpayer’s income increases. The ability to pay objective will be addressed in the next section.

3.3. The Objectives and Evaluation of The Technical Tax Provisions

The tax law objectives of raising revenue, redistributing income, and regulating private activities, noted earlier, should be evaluated by certain criteria to determine whether these objectives are in fact met. The evaluative criteria of equity, neutrality and simplicity are applicable in determining whether income tax revenues are secured in an equitable, efficient and sustained manner.

The most fair, neutral, and simplest tax system would likely be no system at all because these objectives are not perfectly achievable. However, they should still provide some basis in which to measure the tax system. Notwithstanding that shortcomings exist, I will review each of these principles - equity, neutrality, and simplicity- in the following section.

3.3.A Equity

The objective of equity requires that no one taxpayer should carry the burden to make his or her payment of taxes any more or less than any other taxpayer. Evenhandedness should be a key objective of the tax system and so similarly situated taxpayers should be treated the same. In fact, fairness should be the touchstone of any tax system. One way to determine whether a tax system is equitable is to look at the concept of the taxpayer’s ability to pay tax.

Two concepts of equity are relevant to the objective of the ability to pay: 1) horizontal equity in that taxpayers in similar circumstances should bear the same burden of taxes; and 2) vertical equity in that taxpayers in different circumstances should bear an appropriately different burden of taxes. The “circumstances” under consideration should be the circumstances of the taxpayer’s total income. According to the Carter Commission, income determines the

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41 Ibid.
42 Edgar et al, supra note 6 at 65.
43 Ibid.
44 Li et al, supra note 13 at 49.
45 Ibid.
46 Ibid.
47 Ibid [emphasis mine].
48 Larre, supra note 12 at 591.
taxpayer’s ability to pay tax. This simply means that if a taxpayer has a higher income his or her ability to pay tax increases. Likewise, a lower income taxpayer has a lesser ability to pay tax.

However, measuring the ability to pay is not as simple as it may appear. Some scholars, such as John Stuart Mill, link ability to pay with “equality of sacrifice”.\(^{49}\) However, no agreement exists with respect to how, exactly, differing taxpayer’s social and economic life influences the sacrifice a taxpayer should make.\(^{50}\)

Nevertheless, because equity (fairness) is certainly the ideal,\(^{51}\) a tax system should work to achieve it as a significant priority. Other criteria, such as the objective of neutrality, should also be balanced against equity. Neutrality will be addressed in the following section.

3.3.B Neutrality

A tax system in which paying taxes does not interfere with the free market economy is considered neutral.\(^{52}\) That is, in theory, a neutral tax system should not interfere with an individual’s free choice to weigh the costs and benefits of working.\(^{53}\) Decisions about how much to work should be the same in a world that requires income taxes to be paid as in a world that does not require income taxes to be paid.\(^{54}\) That is to say that an income tax system, if neutral, should bring about minimum change in the taxpayer allocation of resources within the private sector.\(^{55}\)

On the other hand, if taxpayers are influenced by the income tax system such that it significantly changes the allocation of society’s resources, the tax system is not considered to be neutral.\(^{56}\) Thus, for a system to be neutral, income tax preferences should be eliminated. That is:

the allocation of resources in response to free market forces will in general give in the short run the best utilization of resources, and in the long run the most satisfactory rate of increase in the output of the economy.\(^{57}\)

\(^{49}\) Li et al, supra note 13 at 49.

\(^{50}\) Ibid.

\(^{51}\) Ibid.

\(^{52}\) Ibid at 51. See also Carter Report, supra note 14, vol 2 at 8.

\(^{53}\) Ibid.

\(^{54}\) Ibid.

\(^{55}\) Ibid.

\(^{56}\) Ibid.

\(^{57}\) Ibid.
However, the market system is not always perfectly efficient and so governments make available to taxpayers certain incentives to correct market failures.\textsuperscript{58} Where governments implement tax credits, deductions, or other tax preferences the neutrality principle could be violated because all taxpayers are not necessarily treated the same.\textsuperscript{59} Therefore, tax incentives available through the current system of income taxation, violates a neutral tax system\textsuperscript{60} because they provide tax incentives to some taxpayers and not to others.

Notably, if a market were perfectly efficient, a neutral income tax system would have each taxpayer taxed the same regardless of the level of income.\textsuperscript{61} Therefore, if all taxpayers pay the same regardless of ability to pay, the rule of equity is violated because the ability to pay is disregarded.

I will review the objective of simplicity lastly in the next section to inform another way that tax system objectives might also be met.

3.3.C Simplicity

Improving administrative efficiency through simplicity is also an objective of the tax system.\textsuperscript{62} When tax laws are too complex, the legitimacy of income tax law is threatened.\textsuperscript{63} Income tax laws should be in plain enough terms such that a taxpayer is able to understand and apply the rules.\textsuperscript{64} While it is not necessary for all taxpayers to understand every provision, the general principles should be “intuitive” and consistently applied.\textsuperscript{65}

Nonetheless, when compliance and administrative costs are much higher than they should be, the income tax system may be considered too complex (and compliance and tax planning industries capitalize on this).\textsuperscript{66} If taxes are too difficult to administer “the tax will fail to serve its intended function as a reliable source of revenue.”\textsuperscript{67}

\begin{thebibliography}{99}
\bibitem{58} Ibid.
\bibitem{59} Ibid at 52.
\bibitem{60} Ibid.
\bibitem{61} Ibid.
\bibitem{62} Ibid.
\bibitem{63} Edgar et al, supra note 6 at 71.
\bibitem{64} Ibid at 72.
\bibitem{65} Ibid.
\bibitem{66} Ibid at 71.
\bibitem{67} Li et al, supra note 13 at 52.
\end{thebibliography}
Notably, while keeping the tax system as simple as possible may serve the objective of administrative efficiency, it may also compromise the objectives of equity and neutrality by influencing the structure of the Tax Act. For example, the principle of simplicity has influenced the timing of the recognition of a capital gain or loss which was simplified to make it more easily administered. No matter how perfect a tax may appear, if it is difficult to administer it has not met the objective of simplicity.

Arguably, these three objectives are not always easy to attain. Nonetheless, income tax rules should be predictable and reasonably certain. Taxpayers should also be able to comply with the income tax rules without unnecessary costs and invested time. Finally, the income tax system should be relatively simple to enforce because those tax systems that are difficult to enforce unfairly shift the tax burden from dishonest taxpayers to honest taxpayers. Although these criteria have drawbacks, evaluating the income tax system using these normative criteria assists in determining those objectives in which the income tax system should achieve.

3.3.D Evaluating the Tax Act as Applied to Indigenous Settlement Trusts

Based upon the principles discussed in the previous sections, applying a normative analysis to the taxation of Settlement Trust revenues will assist in determining how these revenues should be taxed. The concept of ability to pay (persons in similar circumstances be treated the same under the law) should be weighed against the “pragmatic concerns such as administrative and compliance costs, comprehensibility, certainty of application, and likelihood of avoidance or evasion.” Therefore, evaluating Settlement Trust taxation through the objectives of equity, neutrality, and simplicity is a good starting point.

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68 Ibid.
69 Ibid. For example, when a taxpayer exchanges one property for another, gives property (other than cash) as a gift, converts shares or other securities, settles or cancels a debt owed, transfers certain property to a trust; lastly, when a taxpayer’s property is expropriated, a taxpayer’s property is stolen, a property is destroyed or an option to buy or sell property expires. See Canada Revenue Agency, Capital Gains 2017, T4037(E) Rev 17.
70 Ibid.
71 Edgar et al, supra note 6 at 72.
72 Ibid.
73 Ibid.
74 Larre, supra note 12 at 591.
A Settlement Trust earns investment revenues when assets are invested, and returns are yielded. If equity is a concern, one must consider whether there is an increase in ability to pay. Clearly the ability to pay is increased when returns are yielded from Settlement Trust assets.

Next, it must be determined whose ability to pay has increased. One could argue that trusts are a legal fiction with no ability to pay because they are not natural persons\(^7^5\) and cannot bear the tax burden. Therefore, the Band as beneficiary could be considered to bear the burden to pay taxes. However, because the Band is also not considered a natural person, rather a public body, arguably, the Band cannot bear the burden to pay tax. Therefore, the increase in the ability to pay likely falls upon the Band members, the beneficiaries.

That is, if the wealth of the Settlement Trust increases, it is actually the beneficiary’s wealth that increases because the value of the property in which the beneficiary holds, the beneficial legal interest, has increased. Under this scenario, the increase in wealth must be taxed, whether in the trust or in the hands of the beneficial owner, the beneficiary, because an increase in ability to pay has occurred.

The fact that deductions from the taxable income are applied to calculate a base from which tax applies also relates to the concept of the ability to pay. That is, the accumulation of Settlement Trust investment income minus any tax-deductible expenses or payment out to beneficiaries determines the tax base for Settlement Trust taxation. This appears to be a reasonable measurement of the Settlement Trust’s ability to pay. Further, there are practical reasons to tax the trust, for instance where multiple discretionary beneficiaries exist, or liquidity is a problem because the beneficiary has to come up with payment for the tax.

Regardless, according to the concept of the ability to pay, if an increase in wealth or ability to pay occurs this should be captured in the tax system. As such, the objective of simplicity is also likely better met through taxing the Settlement Trust.

\(^{75}\) A.H. Oosterhoff, Robert Chambers, Mitchell McInnes and Lionel Smith, *Oosterhoff on Trusts: Text, Commentary, and Materials, 7th Edition*, (Toronto: Carswell, 2009) at 18 [Oosterhoff et al]. A trust is not an entity, rather is a “relationship involving obligations owed by the person who holds the trust property”; as such, the trust does not hold property, instead the trustee holds property in trust for the benefit of another party.
Note that because neutrality would have all taxpayers pay the same tax regardless of the taxpayer’s ability to pay, this could violate the objective of equity. However, it is supported in tax policy literature that these objectives are difficult to achieve in balance, one with the others.\footnote{Hogg et al, supra note 20 at 27-30.}

Therefore, all factors considered, the fact that Settlement Trust revenues are taxed based upon the ability to pay by calculating total revenues earned minus tax-deductible expenses, makes it likely that Settlement Trusts should be taxed under the normative tax system. Next, I will consider tax expenditures and how they may be justified to exempt Settlement Trusts from taxation.

3.4. Tax Expenditure Theory and Evaluation

Governments may use direct spending programs, government loans or grants or tax expenditures to grant taxpayers financial assistance.\footnote{Stanley S. Surrey and Paul R. McDaniel, “Tax Expenditures” (Cambridge, Mass.: Harvard University Press, 1985) at 3 [Surrey].} While some debate exists around the use of these mechanisms, they may assist in accomplishing government objectives.\footnote{Ibid.} I will consider here how tax expenditures may be justified to achieve certain government objectives.

Tax expenditures are “provisions in the Income Tax Act that represent deliberate departures from a comprehensive and fair income tax base”.\footnote{Neil Brooks, (1979) “The Tax Expenditure Concept” 1 Can Tax’n 31 [Brooks TE].} A tax expenditure may include a tax credit, an exemption, a reduced tax rate, a deduction, or a granted deferral of taxes.\footnote{Neil Brooks, (2016) “Policy Forum: The Case Against Boutique Tax Credits and Similar Tax Expenditures” 64 Canadian Tax Journal 65 at 70 [Brooks].} Tax expenditures are a means for governments to achieve policy objectives by distributing resources more efficiently and more justly.\footnote{ Ibid at 70.}

The availability of a tax expenditure encourages taxpayers to make certain personal choices about where they will allocate their resources.\footnote{Ken Boessenkool, (2015) “Policy Forum: Kids are Not Boats” 63 Canadian Tax Journal 1001 at 1002 [Boessenkool].} The idea is that they should be entitled to some form of tax relief due to personal circumstances.\footnote{Brooks, supra note 80 at 70.}
For example, if a taxpayer takes advantage of buying a home for the first time, the taxpayer may receive a first-time homebuyers credit. Likewise, if a taxpayer attends a post-secondary institution he or she may receive a tax credit for relevant tuition.

Tax expenditures are not evaluated in the same manner as the technical tax provisions of the *Tax Act.* Consequently, the next section will discuss the distinct evaluation of tax expenditures.

3.4.A. The Evaluation of Tax Expenditures

Tax expenditures are not tax measures; rather, spending programs designed to meet various non-tax policy goals. Therefore, evaluating tax expenditures through the lens of neutrality, equity and simplicity is not appropriate. Rather, the evaluative budgetary criteria used for direct spending programs should be applied to tax expenditures because they represent a cost to the government and a benefit to certain taxpayers.

In evaluating tax expenditures, the following should be considered:

1) whether tax expenditures serve legitimate and important government policy objectives;
2) whether they effectively and equitably achieve such objectives; and
4) whether alternatives exist to achieve governmental objectives more effectively and equitably.

In some cases, legitimate governmental purposes justify tax expenditures, such as the purpose of encouraging certain taxpayer behaviors. However, certain government objectives may not be met fairly through the use of tax expenditures because benefits are unequally distributed amongst taxpayers; in fact, such benefits are not available to non-taxpaying parties.

Tax expenditures could be justified through convincing economic, social or policy reasons, such as to further social justice. While costs are only one consideration, the expenditure must

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84 *Brooks,* *supra* note 80 at 70.
85 *Ibid* at 89.
86 *Edgar et al,* *supra* note 6 at 74.
87 *Li et al,* *supra* note 13 at 64.
88 *Edgar et al,* *supra* note 6 at 74-5.
89 *Ibid* at 75.
90 *Ibid* at 74.
also be a notable benefit to the taxpayer that it targets, thus be effective in meeting its claimed objective.\textsuperscript{91}

However, if other tax mechanisms exist that could achieve the same objective, those other possibilities should be considered.\textsuperscript{92} As such, tax expenditures should only be available to taxpayers where a benefit is provided that could not be more effectively provided through other means,\textsuperscript{93} such as through a direct expenditure program.

In the next section, I will discuss whether a tax expenditure, in the form of Settlement Trust income tax exemption, is justified.

3.4.B. Whether the Tax Exemption of Settlement Trusts is Likely Justified

To determine whether exempting Settlement Trust revenues from tax is justified, first a benchmark tax structure should be assumed. That is, it is assumed that revenues are taxed under the technical benchmark provisions of the \textit{Tax Act}; next, it should be considered whether a deviation from the technical provisions is justified based upon the tax expenditure’s merits.\textsuperscript{94} Generally if compelling policy reasons exist, a tax expenditure is justified.

As already discussed in section 3.3 of this chapter, it is likely that based upon the ability to pay, Settlement Trust revenues should be considered taxable income under the \textit{Tax Act} normative benchmark provisions. Thus, it must be determined whether Settlement Trust tax exemption is justified as a separate assistance program.\textsuperscript{95} In order to be justified, Settlement Trust income tax exemption must be supported by sound policy reasons.

A review of the principles discussed in chapter 1 will demonstrate that good policy reasons do, in fact, exist. First, I will discuss these important policy objectives. Next, I will discuss whether a tax expenditure would effectively and equitably achieve these objectives or whether alternatives exist that could achieve governmental objectives more effectively and equitably.

a) Important Policy Objectives

Recall that Indian Bands create and are the beneficiaries of Settlement Trusts. Therefore, reviewing the government’s relationship with these Bands could inform this situation. The Crown

\textsuperscript{91} Ibid at 75.
\textsuperscript{92} Ibid.
\textsuperscript{93} Ibid.
\textsuperscript{94} Li et al, supra note 13 at 65.
\textsuperscript{95} Ibid.
has a special historical relationship with Indigenous peoples that began hundreds of years ago when the Crown extended protection over Indigenous lands. At that time, third parties sought to enter into land deals with the Indigenous leaders of the day,\textsuperscript{96} and the Royal Proclamation of 1763\textsuperscript{97} was created to dictate how land surrenders would occur. The Proclamation contained a provision that found that land could only be alienated to the Crown.\textsuperscript{98} Further details on the history of this relationship are contained in chapter 1, section 1.1.

Notably, because Indigenous land interests are only alienable to the Crown, the Crown possesses firm legal obligations toward Indigenous peoples.\textsuperscript{99} In fact, the Supreme Court of Canada held in \textit{Guerin v The Queen},\textsuperscript{100} that the Indigenous-Crown relationship is fiduciary in nature and that the Crown must act honourably when dealing with Indigenous lands and interests. The significance and effect of the recognition of this fiduciary relationship and the honour of the Crown is described in further detail in chapter 5, section 5.2.

Ultimately, through the land surrenders and sale of Indigenous lands, reserve lands were created. Before Canadian confederation in 1867, the Crown agreed that it would not tax Indigenous lands and personal property situated on reserves.\textsuperscript{101} Therefore, Indigenous tax exemption is traced as far back as the 1850s when a law was implemented by the Province of Canada (as it was then) to codify the fact that tax would not be levied against an Indian person or anyone married to an Indian person.\textsuperscript{102}

The purpose of this tax exemption is two-fold. First, it preserves Indigenous people’s entitlement to reserve lands while ensuring that such property is not eroded.\textsuperscript{103} Second, pursuant to property received via the Crown’s special obligations to Indigenous peoples, it prevents a

\begin{itemize}
  \item \textsuperscript{96} Senwung Luk, (2013) “Not So Many Hats: The Crown’s Fiduciary Obligations to Aboriginal Communities Since Guerin” 76 Sask L Rev 1 at 5 [Luk]. See also \textit{Calder et al v Attorney-General of British Columbia}, [1973] SCR 313, 34 DLR (3d) 145 [Calder].
  \item \textsuperscript{97} \textit{Royal Proclamation}, RSC 1985, App II, No 1 [Proclamation].
  \item \textsuperscript{98} Luk, supra note 96 at 6.
  \item \textsuperscript{99} \textit{Canadian Pacific Ltd. v Paul}, [1988] 2 SCR 654 at 678, 53 DLR (4th) 487 [Canadian Pacific].
  \item \textsuperscript{100} \textit{Guerin v The Queen}, [1985] 2 SCR 335, 13 DLR (4th) 321 [Guerin].
  \item \textsuperscript{102} \textit{Ibid}.
  \item \textsuperscript{103} \textit{Williams v Canada}, [1992] 1 SCR 877 at 886, 90 DLR (4th) 129 [Williams].
\end{itemize}
situation where a taxing government could erode any benefits given to them by that same government.\textsuperscript{104}

Most notably, the legally-recognized fiduciary relationship between the Crown and Indigenous peoples,\textsuperscript{105} and the policy of encouraging the preservation of Indigenous property,\textsuperscript{106} create certain legal obligations for the Crown to consider the unique nature of Indigenous property (discussed more fully in chapter 5). Arguably, these obligations are not just persuasive reasons but could (and do) justify exempting taxes on Settlement Trust revenues.

On another note, one purpose of certain tax expenditures is to encourage certain kinds of taxpayer behavior.\textsuperscript{107} Encouraging Bands to settle assets into a trust, tax free, encourages the investment of assets that would in the long run increase the net worth of Indigenous peoples. Promoting the increase of a Band’s net worth makes sense from a policy perspective. Additionally, recall that, in many cases, the assets that form the basis for a Settlement Trust result from claims made against the Crown or a third party due to the adverse impacts upon Indigenous lands and interests. Arguably, for policy reasons revenues from these assets should be preserved.

All of these policy reasons are strong grounds to justify exempting Settlement trust revenues from tax. Such an exemption would demonstrate the government’s respect for not only the historical Indigenous-Crown relationship but the values of protecting and preserving Indigenous property. That is, making a tax expenditure available would show respect for the important policy objective of protecting and preserving Indigenous property in as effective and cost-effective manner as possible (with minimal administrative processes and costs).

b) Whether a Tax Expenditure Will Effectively and Equitably Achieve These Objectives

A tax expenditure could effectively and equitably achieve these policy objectives in this situation because it can be implemented through increasing the scope of an existing expenditure. Recall that Bands already have benefit of a tax expenditure for Band income, pursuant to

\textsuperscript{104} \textit{Ibid.}
\textsuperscript{105} See \textit{Calder et al v Attorney-General of British Columbia}, [1973] SCR 313, 34 DLR (3d) 145 [\textit{Calder}]. \textit{Also, see Guerin, supra} note 100.
\textsuperscript{106} \textit{Mitchell v Peguis Indian Band}, [1990] 2 SCR 85, 71 DLR (4th) 193 at 130 [\textit{Peguis} and affirmed in \textit{Williams, supra} note 103.
\textsuperscript{107} \textit{Boessenkool, supra} note 82.
s.149(1)(c) of the *Tax Act*. This tax expenditure applies to public bodies performing a function of government in Canada and the Canada Revenue Agency has interpreted Bands as such; thus, Bands are tax exempt on any income connected to it. The issue here is that Bands are required to depend upon an attribution rule to connect its Settlement Trust revenues to the Band to qualify for s.149(1)(c).

By increasing the scope of the Band’s exemption under s.149(1)(c), this tax expenditure could cover Settlement Trust revenues directly without the requirement of an attribution provision. The most effective manner in which to increase this scope would be via an amendment to the *Tax Act* exempting Settlement Trusts from the general trust provisions. The proposed amendment (discussed further in chapter 5) could also note that Settlement Trust income is considered Band income.

Through an amendment the above noted objectives could be achieved effectively and equitably because it would require minimal administrative costs to effect such a change. It also adds no greater cost to the government in foregone revenues because Bands already take advantage of s.149(1)(c) of the *Tax Act* as it relates to income connected to it. On the contrary, developing a new mechanism to create a tax exemption to apply specifically to Settlement Trust revenues, based upon the policy reasons argued here, would require considerably more time and effort.

While there are many good reasons for exempting Settlement Trust income from tax, one must consider whether better ways exist to achieve tax exemption on these revenues. Whether this kind of tax exemption is better achieved through existing policies and legislative provisions - such as the application of an attribution rule discussed in chapter 2, section 2.3.C.a or the application of s.87 of the *Indian Act* discussed in chapter 4, section 4.2.A - should also be a part of the analysis.

I argue here that other tax mechanisms likely will not assist more aptly because, as was discussed in chapter 2, the existing tax treatment is problematic because it adds unnecessary administrative processes and costs and legal uncertainty (refer to chapter 2, section 2.4 for a

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recall of the details). In addition, in chapter 4, I argue that the provisions outside of the Tax Act that exempt certain types of Indigenous income do not extend far enough to include Settlement Trust revenues.

Therefore, I contend that a tax expenditure is justified and the best option overall. The aforementioned strong policy grounds support this. Increasing the scope of s.149(1)(c) to include Settlement Trust revenues (without the requirement of s.75(2)) by excluding Settlement Trusts from taxation under s.104(2) of the Tax Act would engage minimal administrative costs.

3.5. Conclusion

Income tax, one of the central components of fiscal management, enables the government to function and society to prosper. Reasonable taxation upon taxpayer income assists in the management of vital government programs to achieve broad social and economic objectives. On the other hand, tax expenditures may also be justified to achieve certain public policy objectives.

According to the ability to pay concept of income and the principles of equity, neutrality, and simplicity, Settlement Trusts in all likelihood should be considered taxed under the normative benchmark provisions. However, a tax expenditure is justified to exempt Settlement Trust earnings from tax. In fact, a number of policy reasons support this, such as the existence of the historical Indigenous-Crown relationship, the social policy of preserving Indigenous property and the nature of settlement trust payments as compensation for the adverse impacts upon Indigenous interests or lands.

Additionally, recall that governments often make tax expenditures available to encourage certain kinds of taxpayer behavior. It was argued in this chapter that, it is good public policy to encourage Bands to investment assets into a trust, tax free, to increase the Bands net worth in the long term. I argue that the best option for implementing this tax expenditure is to extend s.149(1)(c), which already applies to Band income, to apply directly to Settlement Trusts (without requiring the application of s.75(2)).

110 Boessenkool, supra note 82.
In the next chapter, I discuss how s.87 of the *Indian Act*, a provision that provides for tax exemption of Indigenous income under certain conditions, could apply to Settlement Trust revenues. I also argue that this provision may not extend far enough. This further supports my position that a more direct application of s.149(1)(c) of the *Tax Act* could simplify or eliminate the administrative costs and legal uncertainty related to Settlement Trusts for Bands.
CHAPTER 4: TAXATION PRINCIPLES THAT APPLY TO INDIGENOUS PEOPLES

4.1. Introduction

Section 81(1)(a) of the Income Tax Act ("Tax Act")\(^1\) provides that income declared to be exempt by any other legislation will not be included in the taxpayer's income for income tax calculation purposes.\(^2\) The Indian Act ("Indian Act")\(^3\) is one piece of legislation that declares income attributed to Indigenous peoples on reserve, to fall outside of the Tax Act. Subsection 87(1) of the Indian Act,\(^4\) if applicable, grants tax exemptions on property related to the interest of an Indian or a Band in reserve lands or the personal property of an Indian or a Band situated on a reserve. In the leading cases of Williams v Canada,\(^5\) Bastien Estate v Canada\(^6\) and Dubé v Canada,\(^7\) the Supreme Court of Canada has interpreted the application of s.87 related to certain types of Indigenous income to determine the provision’s parameters of operation.

Despite the parameters set out in these decisions, some uncertainty still exists as it relates to certain types of income. Typically, s.87(1) does not apply to trusts (or corporations), even if they are owned or controlled by an Indian, because trusts are taxed as separate individual taxpayers.\(^8\) Therefore, a trust cannot be considered an Indian trust for the purposes of tax exemption. However, if income is paid out of the trust to an Indian beneficiary located on reserve this income may be tax exempt, pursuant to s.87(1) of the Indian Act.

Recall that, but for the income attribution rules discussed in chapter 2, section 2.3.B.a, income earned from Indigenous Settlement Trust ("Settlement Trust") assets would be taxed to

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1 RSC, 1970, c I-6 (now RSC, 1985, c I-5), s 81 [Tax Act].
3 RSC 1970, c. I-6 [Indian Act].
4 Ibid, s 87.
87 (1) Notwithstanding any other Act of Parliament or any Act of the legislature of a province, but subject to section 83 and section 5 of the First Nations Fiscal Management Act, the following property is exempt from taxation: (a) the interest of an Indian or a Band in reserve lands or surrendered lands; and (b) the personal property of an Indian or a Band situated on a reserve.
7 2011 SCC 39, 2 SCR 764 [Dubé].
8 Tax Act, supra note 1, s 104(2). For a discussion related to this provision see Jinyan Li, Joanne E. Magee and J. Scott Wilkie, Principles of Canadian Income Tax Law, 9th Edition (Thomson Carswell: Toronto, 2017) at 437 [Li et al].
the trust as an individual\(^9\) and at the top personal marginal tax rate.\(^{10}\) Therefore, to qualify for tax exemption these revenues must be connected to the Band or the reserve.

If a trust administration office exists on reserve such that the management and control of the Settlement Trust assets occurs on reserve, then the connection may be clear, and the revenues will typically fall within the gambit of s.87 protection.\(^{11}\) However, if the Band does not have its own trust administration office on reserve, the Band is required to demonstrate that certain connecting factors exist that connect the revenues to the reserve to qualify for tax exemption. I review the connecting factors in this chapter to determine whether Settlement Trust revenues could qualify for tax exemption, pursuant to s.87(1) of the \textit{Indian Act}.

Another means also exists by which Bands may achieve tax exempt status. Provided that the Band is considered a public body performing a function of government, its sources of revenues are tax exempt pursuant to s.149(1)(c) of the \textit{Tax Act}.\(^{12}\) Notably, while the s.87 tax exemption does not apply to income earned off reserve, s.149(1)(c) applies to all Band income whether earned on or off the reserve.\(^{13}\) I will discuss this in further detail in this chapter.

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\(^{9}\) \textit{Tax Act}, supra note 1, s 104(2).

\(^{10}\) A trust shall, for the purposes of this Act, and without affecting the liability of the trustee or legal representative for that person’s own income tax, be deemed to be in respect of the trust property an individual.

\(^{11}\) Some Bands have the means, training and expertise to administer their Settlement Trust on reserve. For those Bands, these taxation issues may not be as relevant because the application of s.87 to property on reserve and the connecting factors enunciated in \textit{Williams v Canada} may be more easily applicable. Courts might look to certain connecting factors that connect the trust income to the reserve including: a) trust is situate on reserve; b) income is earned on reserve; c) records and meetings of the trustees are on reserve; d) bank accounts for the trust are kept at a bank on reserve; e) Band members are appointed as trustees; and f) the trustees pay the net income of the trust each year to the First Nation so that the trust has no residual income on which income tax would be payable. See Jeanie Lanine, “\textit{First Nations Tax Exemptions}” (Paper delivered at the On Common Ground Forum, Duncan, 23 June 2006) at 4 [unpublished] [Lanine].

\(^{12}\) No tax is payable under this Part on the taxable income of a person for a period when that person was c) a municipality in Canada, or a municipal or public body performing a function of government in Canada.

\(^{13}\) Lanine, supra note 11 at 8.
But first, in section 4.2, I discuss Indigenous tax exemption principles and the Supreme Court of Canada’s interpretation of the application of the s.87 *Indian Act* protection. Next, in section 4.3, I discuss the importance of s.149(1)(c) of the *Tax Act* to Bands for the purposes of achieving tax exempt status on various sources of income. I conclude that it makes better administrative sense to exempt Settlement Trusts from tax under the general trust tax provisions so that this income can be taxed as direct sources of Band revenues, absent the requirement of s.75(2) of the *Tax Act*. For this to occur, a revision of the *Tax Act* is required such that Settlement Trusts would be excluded from being taxed under the general trust provisions.

### 4.2. The Basis for Indigenous Tax Exemption under the *Indian Act*

Legislative provisions, interpreted in common law decisions, allow for income tax exemption on certain kinds of Indigenous property under certain conditions. This is not a comprehensive exemption that applies in all situations. Rather, the parameters of Indigenous tax exemption have been set out in certain key decisions. Here I consider the Supreme Court of Canada’s analysis related to the kinds of circumstances in which income may be considered connected to the reserve to qualify for tax exemption under the *Indian Act*.

#### 4.2. A Indian Personal Property or Interests Situate on Reserve

Subsection 87(1) of the *Indian Act* grants tax exemption on certain property related to an Indian or Band interest in surrendered or reserve lands and personal property of an Indian or Band on reserve.\(^\text{14}\) This provision is reproduced below:

\[
87 \ (1) \text{Notwithstanding any other Act of Parliament or any Act of the legislature of a province, but subject to section 83 and section 5 of the First Nations Fiscal Management Act, the following property is exempt from taxation: (a) the interest of an Indian or a Band in reserve lands or surrendered lands; and (b) the personal property of an Indian or a Band situated on a reserve.}\]

In interpreting provisions that apply to Indigenous peoples, the Supreme Court of Canada has found that a liberal interpretation must be employed and any doubt or ambiguity in

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\(^{14}\) *Indian Act*, *supra* note 3.

\(^{15}\) *Ibid*, s 87.
interpretation should be resolved in favour of Indigenous peoples. Justice Dickson, writing for the majority, said as much in *Nowegijick v The Queen* when he stated:

It is legal lore that, to be valid, exemptions to tax laws should be clearly expressed. It seems to me, however, that treaties and statutes relating to Indians should be liberally construed and doubtful expressions resolved in favour of the Indians. If the statute contains language which can reasonably be construed to confer tax exemption that construction, in my view, is to be favoured over a more technical construction which might be available to deny exemption.

Yielding to a liberal interpretation demonstrates the broad intention in extending such protections in the first place. That is, Indigenous peoples should be able to preserve property that flows from relevant historical land rights. In the next section, I review the Supreme Court of Canada’s interpretation of the *Indian Act* tax exemption.

4.2.B The Application of Section 87 of the Indian Act

*Nowegijick* was one of the earliest decisions to consider the application of s.87 of the *Indian Act*. The facts of this decision involved a registered Indian who lived on reserve and claimed certain income to be tax exempt. He was employed by an Indian corporation having its offices on reserve and was paid through that corporate head office; however, the work from which he received payment was performed off reserve. The Supreme Court of Canada sought to answer the question of whether the employment income was exempt from tax under s.87(1) of the *Indian Act* because the tax was upon “personal property” on reserve.

There were conflicting views in the lower Federal Court and Federal Court of Appeal decisions. Justice Mahoney, for the Trial Division, considered that taxation was actually upon income as “personal property” and not upon a person per se and was therefore not taxable. On the other hand, Heald, J. for the Court of Appeal, found that the tax was actually imposed on Mr. Nowegijick and was therefore taxable as it was not taxation in respect of personal property within the meaning of s.87(1) of the *Indian Act*. Therefore, on appeal to the Supreme Court of

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16 *Nowegijick v The Queen* (1983), [1983] 1 SCR 29 at 36, 144 DLR (3d) 193 (SCC) [*Nowegijick*] [emphasis mine].
17 Ibid.
18 Ibid.
19 Ibid at 29.
20 *Nowegijick v The Queen*, [1979] 2 FC 228, [1979] CTC 195 [*Nowegijick TC*].
Canada, the analysis turned on whether Mr. Nowegijick was exempt from tax on the employment income because it was considered personal property situated on reserve.\textsuperscript{22}

The Supreme Court of Canada considered certain provisions of the Tax Act to determine whether the tax was in respect of personal property situated on reserve; the relevant sections are reproduced here:

S.2. (1) An income tax shall be paid as hereinafter required upon the taxable income for each taxation year of every person resident in Canada at any time in the year. (2) The taxable income of a taxpayer for a taxation year is his income for the year minus the deductions permitted by Division C.\textsuperscript{23}

-and-

S.5. (1) Subject to this Part, a taxpayer’s income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by him in the year.\textsuperscript{24}

Section 2(1) indicates that the tax is payable upon the \textit{taxable income} of every person resident in Canada, and s.2(2) states that taxable income is the taxpayer’s income for the year, as adjusted. Subsection 5(1) requires that the taxpayer’s income include salary, wages and other remuneration.

In the Supreme Court of Canada’s view, since tax is payable on “taxable income”, the issue was whether the taxable income was “personal property”,\textsuperscript{25} thus could be exempt under s.87(1).

The Supreme Court of Canada also considered that:

[t]he \textit{Indian Act} contemplates taxation in respect of specific personal property \textit{qua} property and not taxation in respect of taxable income as defined by the \textit{Income Tax Act}, which, while it may reflect items that are personal property, \textit{is not itself personal property} but an amount to be determined as a matter of calculation by application of the provisions of the Act.\textsuperscript{26}

\begin{flushleft}
\textsuperscript{22} Nowegijick, supra note 16 at 33.  \\
\textsuperscript{23} Tax Act, supra note 1, Liability for Tax, Part I, Division A, s 2.  \\
\textsuperscript{24} Ibid, s 5(1).  \\
\textsuperscript{25} Nowegijick, supra note 16 at 38.  \\
\textsuperscript{26} Ibid at 35-6 [emphasis mine].
\end{flushleft}
The Supreme Court of Canada also considered *Bachrach v Nelson*, a United States decision, to determine whether income could be considered personal property. This decision found that:

The overwhelming weight of judicial authority holds that it is. The cases... define what is personal property and in substance hold that money or any other thing of value acquired as gain or profit from capital or labor is property, and that, in the aggregate, these acquisitions constitute income, and, in accordance with the axiom that the whole includes all of its parts, income includes property and nothing but property, and therefore is itself property.

The Supreme Court of Canada also relied upon a 1972 Interpretation Bulletin that demonstrated the Department's established interpretation and policies. While not determinative, these policies can be important factors in making determinations of law. Bulletins set out by the Canada Revenue Agency are not legally binding, but they may be persuasive to the trier of fact in a court of law. The Bulletin indicated in para 5 that while the exemption in the *Indian Act* refers to "property" and the tax imposed under the *Tax Act* is calculated on the income of a “person”, the intention of the *Indian Act* is not to tax Indians on income earned on reserve. This was a pivotal decision because income is now considered personal property of an Indian for tax exemption purposes.

It was later in the *Williams* decision that the Supreme Court of Canada further developed this jurisprudence, this time focusing on whether income could be connected to the reserve for tax exemption purposes. The *Williams* decision involved the payment of unemployment insurance benefits as the source of Indigenous income in question. Various situses were analyzed via the connecting factors framework to determine the location of the employment income for tax purposes.

According to the Supreme Court of Canada, the relevant connecting factors included: the residence of the payor; the residence of the payee; the place of payment; and where the activity

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27 182 NE 909 (1932) [*Bachrach*].
28 *Ibid* at 914.
29 *Nowegijick, supra* note 16 at 37.
30 *Ibid*.
31 *Ibid*.
giving rise to the qualification for benefit was performed. The Court found that the relevant connecting factors should also be weighed against: the purpose of the exemption; the type of property in question; and the incidence of taxation upon that property.

This contextual analysis must be applied on a case by case basis because applying a strict test would not adequately consider the many different contexts in which Indigenous peoples earn income including employment, unemployment, and investment income. For instance, a complicating factor in the Williams decision was the existence of different situses - situs of the debtor, situs of the creditor, situs where the payment is made, situs of the employment which created the qualification for the receipt of income, situs where the payment will be used, and no doubt others relevant to determining the location of unemployment income. It makes sense then that applying a contextual analysis by considering the numerous factors that could potentially connect taxable income to the reserve would be more determinative.

In the Bastien decision, the Supreme Court of Canada went on to apply the reasoning of Williams to analyze the application of s.87 of the Indian Act to an Indian’s investment income. Prior to his death, a moccasin business owner, Mr. Bastien, resided on reserve and ran his business on reserve. He held interest earning term deposits in a financial institution, the Caisse Populaire, also situated on reserve. Because the moccasin business was located on reserve, the activities giving rise to the interest earning term deposits were also performed on reserve. After his death, Mr. Bastien’s estate claimed that the interest income earned on the term deposits was tax exempt, pursuant to s.87 of the Indian Act. Rather, the Minister had assessed the income as taxable.

Notably, both the Tax Court and the Federal Court of Appeal were of the view that four factors applied to determine the location of the income: its connection to the reserve; whether it benefited the traditional Indigenous way of life; the risk that taxation would erode Indigenous

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32 Williams, supra note 5 at 891-3.
33 Ibid at 892.
34 Williams, supra note 5 at 891.
35 Ibid.
36 Bastien, supra note 6 at para 1.
37 Ibid.
38 Ibid.
39 Ibid.
property; and the extent to which the investment income was derived from economic mainstream activity. 40

Both levels of court found, and the Crown concurred in its arguments before the Supreme Court of Canada, that a significant factor was that the income was a result of investments derived from commercial mainstream investment activity, thus could not be tax exempt. 41 Additionally, the fact that the contract was entered into on reserve was given no weight by the lower courts, while the belief that the income should be connected to maintaining a native lifestyle was also significant. 42

This analysis - mode of life as one criterion 43 for assessing whether an Indian’s property is sufficiently connected to the reserve - is fraught with ambiguity because mode of life is not easily interpreted. In fact, the following assessment addresses this ambiguity:

In Sappier, Justice Bastarache acknowledged the uneven quality of judicial engagements regarding what is integral or distinctive to an Aboriginal people’s culture. He wrote: “Culture, let alone 'distinctive culture,' has proven to be a difficult concept to grasp for Canadian courts.” Justice Bastarache posited that part of the difficulty is that “[u]ltimately, the concept of culture is itself inherently cultural,” and he accepted scholarly criticism that the section 35(1) jurisprudence risked reducing Aboriginal cultures to “racialized stereotypes” and “anthropological curiosities.” 44

Arguably, Indigenous culture throughout Canada (and certainly other jurisdictions) has been influenced by the impact of colonial systems over such culture. Tying tax exemption to maintaining a native lifestyle in this regard seems counter intuitive.

Irrespective, in the Bastien decision, the Supreme Court of Canada overturned this finding, that is, that income be connected to maintaining ones’ native lifestyle is no longer valid law. 45 Rather, the residence of the payor; the residence of the payee; the place of payment; and where the activity giving rise to the qualification for benefit was performed was considered in

40 Bastien, supra note 6 at para 7. These factors were also set out in Recalma v Canada, (1998) 158 DLR (4th) 59.
41 Ibid at para 7-8.
42 Ibid.
44 Ibid at 402.
45 Bastien, supra note 6 at para 26-29.
this case.\textsuperscript{46} The Supreme Court of Canada gave considerable weight to the residence of the payor in that the Caisse Populaire’s office was on reserve and the contractual agreement that resulted in the interest payments was made on reserve.\textsuperscript{47}

The Supreme Court of Canada also considered the second and third \textit{Williams} factors, that the residence of the payee was also on reserve and the interest income was paid to an account on reserve.\textsuperscript{48} Next, the type of activity that gave rise to the income in question, the moccasin business located on reserve, was also relevant to its analysis.\textsuperscript{49} Further, the Supreme Court of Canada was not so much concerned with the generation of income by the Caisse Populaire in the commercial mainstream, rather, how the original capital was generated, and the subsequent fixed income investments, which were also purchased on reserve.\textsuperscript{50}

In fact, the Supreme Court of Canada emphasized that the focus should be on the income earning activities of the tax-exempt Indian, rather than on the Caisse Populaire’s income generating activities in the commercial mainstream economy.\textsuperscript{51} Acquiring a fixed income investment on reserve generates the right to earn a fixed return.\textsuperscript{52} Thus, the Supreme Court of Canada considered that because the Indian entered into a contractual debt obligation on reserve, where the debtor institution earned its profits to pay its debts should not be a concern.\textsuperscript{53}

The Supreme Court of Canada then balanced these factors with three considerations – the type of property, the purpose of the tax exemption, and the nature of the taxation of the property.\textsuperscript{54} As such, that the source of capital used to purchase the term deposits was a result of business activity engaged in on the reserve where Mr. Bastien resided was important. Further, that the interest earned was to be reserved for Mr. Bastien’s use, and that the nature of the taxation flowed from income earned from Mr. Bastien’s property on reserve were also relevant. As a result, a finding that s.87 applied to this investment income was made.

\textsuperscript{46} Ibid at para 38,43.
\textsuperscript{47} Ibid at para 44.
\textsuperscript{48} Ibid at para 45.
\textsuperscript{49} Ibid.
\textsuperscript{50} Ibid at para 48.
\textsuperscript{51} Ibid at para 60.
\textsuperscript{52} Ibid at para 48.
\textsuperscript{53} Ibid at para 60.
\textsuperscript{54} Ibid at para 45.
Notably, Deschamps, J., writing for the dissent, argued that entering into a contract on reserve should be given no weight because this could open up the possibility that the s.87 exemption could be abused; her comments follow:

In my view, it would be unsatisfactory from the standpoint of legal certainty to give significant weight to the place where the investment contract providing for the right to be paid interest was signed, since this is a factor that would be open to manipulation. For example, the parties to a contract could choose to sign it in a given place for the sole purpose of benefiting from an exemption. Such a choice could be an artificial one. On its own, therefore, the place where the contract was signed does not appear to constitute a sufficiently objective legal basis for determining the location of a right to be paid interest provided for in an investment contract.\(^\text{55}\)

It appears that her rationale is that factors which can be assessed objectively should be given the most consideration, otherwise the risk of easy manipulation ensues.\(^\text{56}\) This may be a valid concern; however, the purpose of considering context in the first place is that the Court has the discretion to determine how much weight to give each factor. Arguably, how much weight is given to each factor will vary in each situation because of the varied circumstances in which tax exemption is claimed.

In the subsequent *Dube* decision, upon which similar and distinguished facts arose, Mr. Dube invested capital in a financial institution on a *different* reserve from the location of his home reserve; he did not reside on the reserve where he invested his capital, in fact, the Court was not persuaded that his principle residence was on any reserve.\(^\text{57}\) A considerable portion of the invested capital was not earned on reserve, nor was interest spent on reserve.\(^\text{58}\) Yet, the Supreme Court of Canada found that the connection to the reserve was not weakened because the capital invested was not derived from the tax-exempt activities on a reserve.\(^\text{59}\) A finding was made in favor of Mr. Dube.

Notably, the lower court in *Dube* applied the connecting factors and found that because the Caisse Populaire’s investment activities occurred in the commercial mainstream, the resulting

\(^{55}\) *Bastien, supra* note 6 at para 90.

\(^{56}\) *Ibid.*

\(^{57}\) *Dube, supra* note 7 at para 7.

\(^{58}\) *Ibid.*

\(^{59}\) *Ibid* at para 30.
income did not qualify for s.87 protection. On the contrary, the Supreme Court of Canada did not view this as a convincing factor; it found that the focus should be on the place of entering into the contract, the place of payment and the location of the Caisse Populaire.\textsuperscript{60}

The fact that Mr. Dube did not reside on his own reserve was also not of consequence to the analysis. Subsection 87 indicates that protection is on “a” reserve and not an Indian’s “own” reserve. Cromwell, J., writing for the majority, stated that, in looking to the legislative history, no requirement exists that the residence where property should be protected need be the Indian’s own reserve.\textsuperscript{61} The Supreme Court of Canada found that an Indian was not required to earn the money on his own reserve nor was required to reside on the reserve from where he received the income,\textsuperscript{62} thus could not be required to enter into the investment contract on his home reserve.

In sum, the most relevant factors that the Supreme Court of Canada considered were that the location of the Caisse Populaire was on reserve, the place where Mr. Dube received payment was on reserve, and the contract was entered on reserve.\textsuperscript{63}

However, Deschamps, J., again writing for the dissent, argued that using the basis of entering into contracts on reserve to grant tax exemption was not consistent with the purpose of the exemption because “the parties would have been free to choose a place without regard to any objective requirement that it be connected with a reserve”.\textsuperscript{64} In response to Deschamps, J’s concerns, while the contracts entered into on reserve are given considerable weight, other connecting factors are also considered to strengthen the connection between the income earned and the reserve.

Nonetheless, the majority prevailed in its view. These Supreme Court of Canada rulings are important developments in that significant weight is placed on the fact that contracts were entered on reserve. In fact, this analysis is consistent with the spirit of the s.87 tax exemption because the focus should be on the activities of the Indigenous party and not the activity of third parties.\textsuperscript{65}

\begin{footnotes}
\item[60] \textit{Ibid} at para 21,28.
\item[61] \textit{Ibid} at para 15.
\item[62] \textit{Ibid} at para 16.
\item[63] \textit{Ibid} at para 12.
\item[64] \textit{Ibid} at para 36.
\item[65] \textit{Bastien, supra} note 6 at para 60.
\end{footnotes}
Had the lower Court’s rulings and Deschamps, J.’s dissent prevailed, both decisions might have been critical to how the Courts deal with Indigenous investment activities with connections to the commercial mainstream. Given the global nature of modern financial institutions, it is unlikely that investment activities will take place within the reserve. Justice Pelletier addressed the global nature of investment markets in the *Bastien*, Federal Court of Appeal decision:

> While the sources of the capital put on the market are local and the projects in which that capital is invested are local, the fact remains that the market itself is global. Investors can access that market from their own communities, but the point of entry does not, in itself, limit the market in which investors make profits and incur losses. I therefore conclude that in the case of the investment of capital through a financial institution, including a Caisse Populaire, the weightiest factor in determining the situs of the investment income is the nature of the capital market itself, which is not limited to a reserve, a province or even a country.⁶⁶

The fact that the Courts recognize the global nature of investment activity could bode well in developing the law further in this area. However, to date, the Supreme Court of Canada has only recognized certain kinds of investment activity in the commercial mainstream - debt obligations with a fixed return - that could qualify for tax exemption.

Notwithstanding these limitations, I will apply the connecting factors to Settlement Trust revenues to determine if the s.87 exemption could apply to this income. It is clear that Settlement Trust income must be connected to the reserve. In applying the connecting factors test- the residence of the payor, the residence of the payee, the place the payment is made, and the activity giving rise to the payment of the benefit – to Settlement Trust income, several factors work in the Band’s favour. First, the residence of the payee is on reserve in that the Band resides on the relevant reserve. Next, the place of payment is on reserve in cases where a Band Revenue Account is set up on reserve to receive Settlement Trust revenues.

However, it is unlikely that the residence of the payor- that is, the investment companies that pay the revenues resulting from the invested assets- could be found to be located on reserve. Such companies rarely have officers on reserve; this does not work in the Band’s favour. Additionally, as noted above, to date only fixed return income yielded from fixed investments has been recognized as the kind of income that may be found to be connected to the reserve for

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tax exemption purposes. As previously noted, where an Indian investor could expect a fixed income return, the focus should be on the investment activity of the Indian investor and not on that of the debtor financial institution.

However, Settlement Trusts typically hold diversified portfolios that include securities such as stocks, bonds, and possibly short-term investments. It is unlikely that the Courts would view this kind of investment activity as those of the Indian investor; rather the focus would likely be on the investment company’s commercial mainstream investment activity.

On the other hand, the location of the investment activity is only one factor. If the Band, through the trust, enters into the investment contract on reserve it will be a strong contributing factor to connect the revenues to the reserve. In fact, the Band has benefit of entering into both the Settlement Trust agreement and the investment contract on reserve. The location of entering into the contract was a factor very favourable to the taxpayer in both Bastien and Dube. This could hold true even if the investments are not for fixed income.

Several other considerations might also strengthen the connection such as whether the records and meetings of the trustees are kept on reserve, whether Band members are appointed as trustees, and whether the trustees pay the net income of the Settlement Trust each year to the Band so that residual income is not retained in the trust upon which tax could be payable. It is not clear whether these aspects would be considered connecting factors by a Court.

An additional factor that could weigh in the Band’s favour is the activity giving rise to the qualification of the benefit. As it relates to Settlement Trust assets, such assets are the result of Settlement Agreements between the Crown or third parties and Bands because of adverse impacts upon Indigenous land interests. Pursuant to s.90 of the Indian Act, monies arising from

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67 Bastien, supra note 6 at para 48.  
68 Ibid at para 60.  
69 For example, investment income earned through the sale of stocks triggers a tax payable on 50% of the amount of the capital gain from the sale. See Edgar et al, supra note 2 at 512.  
70 See Lanine, supra note 11.  
71 See Williams, supra note 5, Bastien, supra note 6, and Dube, supra note 7.  
72 Indian Act, supra note 3, s 90. Monies awarded from third parties, such as industry proponents, and through non-treaty agreements may not fall under this provision.
Settlement Agreements between the Crown and the Band as a result of Treaty obligations are deemed situate on reserve. To tax revenues resulting from these settlement assets seems counter to the policy reasons around and the spirit of such settlements.

The Supreme Court of Canada’s finding in *Mitchell v Peguis Indian Band*[^73] was that the purpose of these protections is to preserve Indigenous property.[^74] As such, earning tax-free income from these settlement funds, unencumbered by having to jump through certain administrative hoops, is certainly one way to preserve Indigenous property.

To recap, the *Williams* connecting factors that weigh in the Band’s favour include: the residence of the payee is on reserve, the payment is made into the Band Revenue Account on reserve, the contract(s) is entered on reserve, and the activity giving rise to the qualification of the benefit is a result of Settlement Agreements.

Notwithstanding that the preceding factors may be favourable, the fact that settlement funds and resulting income are held in trust should be addressed. Subsection 87 of the *Indian Act* indicates that to qualify for tax exemption the property must be that of the Indian or Band.[^75] Legally the trustee has title to the trust assets while the beneficiary is the beneficial owner.[^76] As such, it should be considered whether the assets and investment earnings can be the *property of the Band* for the purposes of s.87 of the *Indian Act* if the trustee has legal title to the trust property.

First, the trust is not a distinct entity and does not actually hold the trust property, rather property (which is to be distributed to the beneficiary) is *held in trust by the trustee*.[^77] The ownership of the trust property is uniquely shared:

One party, the trustee, “legally” owns and exercises control over the property (i.e., is said to have a “legal interest”) but must use it in a way that secures benefits (income, let’s say) for the other “owner” (of the “equitable interest” in the trust asset), the beneficiary.[^78]

[^73]: [1990] 2 SCR 85, 71 DLR (4th) 193 [Peguis].
[^74]: Ibid at 130.
[^75]: *Indian Act*, supra note 3, s 87.
Therefore, a trust is really a creature of equity, a concept that originated to deal with deficiencies in the common law that could not resolve certain legal interests.\textsuperscript{79} Equity recognizes that a distinction exists between the legal and beneficial ownership of trust assets.\textsuperscript{80} In fact, “the beneficial owner of the property has been described as the real owner of property even though it is in someone else’s name.”\textsuperscript{81}

Therefore, the Band is entitled to the “property”, that is, the beneficial interest of the Settlement Trust property (access to income from the Settlement Trust and capital if trust terms permit), and the trustee is subject to obligations to distribute the trust property to the beneficiaries according to the terms of the trust.\textsuperscript{82} As such, the earnings of a Settlement Trust are considered that of the Band even if they remain inside the Settlement Trust and the trustee has legal title.

Nonetheless, this analysis, arguably, may be both irrelevant and unnecessary because the Band already has a mechanism, s.149(1)(c) in the \textit{Tax Act}, to qualify for tax exemption whether Band income is earned on or off the reserve.\textsuperscript{83} As long as the Canada Revenue Agency interprets Bands to be public bodies performing a function of government in Canada, pursuant to s.149(1)(c) of the \textit{Tax Act}, and to date they have, a Band may claim tax exemption.\textsuperscript{84} This will be discussed in more detail in the next section.

\subsection*{4.3. Public Bodies Performing a Function of Government in Canada}

Rather than rely upon s.87(1) of the \textit{Indian Act}, a mechanism already exists within the \textit{Tax Act} that Bands rely upon for income tax exemption for various sources of Band income. Currently, this mechanism does not directly apply to Settlement Trust income, aside from the application of the attribution rules. However, broadening the purview of s.149(1)(c) to directly include Settlement Trust income could be a sound policy choice for the reasons set out in the remainder of this chapter and the following chapter.

\begin{flushright}
\textsuperscript{79} Oosterhoff et al, supra note 77 at 4-5. \\
\textsuperscript{80} Pecore \textit{v} Pecore, 2007 SCC 17 at para 4, [2007] 1 SCR 795 [Pecore]. \\
\textsuperscript{81} Ibid citing Csak \textit{v} Aumon, (1990) 69 DLR (4\textsuperscript{th}) 567 (Ont HCJ) at p 570. \\
\textsuperscript{82} Oosterhoff, supra note 77 at 18. See also \textit{The Trustee Act}, 2009, SS 2009, c T-23.01, s 7(3). \\
\textsuperscript{83} See Lanine, supra note 11. \\
\textsuperscript{84} \textit{Tax Act}, supra note 1, s 149(1)(c). Also see CRA Views, Interpretation—internal, 2016-06450317 [CRA].
\end{flushright}
A Band is defined in the *Indian Act* as a group or body of Indians who have a common interest in the use and benefit of lands set apart by the Crown; the relevant section the *Indian Act*, is reproduced below:

2 (1) In this Act,
Band means a body of Indians
(a) for whose use and benefit in common, lands, the legal title to which is vested in Her Majesty, have been set apart before, on or after September 4, 1951,
(b) for whose use and benefit in common, moneys are held by Her Majesty, or
(c) declared by the Governor in Council to be a Band for the purposes of this Act.\(^{85}\)

While a Band’s autonomy and right to self-governance is not fully recognized under the *Indian Act*,\(^{86}\) the *Tax Act*, at least in so far as it is interpreted by the Canada Revenue Agency, construes a Band to be a public body performing a function of government, and is thus tax exempt, pursuant to s.149(1)(c).\(^{87}\) This provision is reproduced below:

s.149(1)(c). No tax is payable under this Part on the taxable income of a person for a period when that person was c) a municipality in Canada, or a municipal or public body performing a function of government in Canada.\(^{88}\)

In 1948, the *Tax Act* was amended to include a tax exemption for “a municipality or a municipal or public body performing a function of government”; yet, the *Tax Act* does not contain a definition of a municipality or public body performing a function of government.\(^{89}\) It is likely that municipalities were added to the list of tax exempt entities to make it explicit that they are not subject to income tax because they are a part of the provincial Crown.\(^{90}\)

The Canada Revenue Agency’s interpretation for tax purposes is that a Band appears to be an entity, similar in nature to a municipality,\(^{91}\) which governs its members. Bands may levy property taxes, pursuant s.83 of the *Indian Act*, as well as create by-laws that affect its members,

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85 *Indian Act*, *supra* note 3, s 2.
87 CRA, *supra* note 84.
88 *Tax Act*, *supra* note 1, s 149(1)(c). Also see *Lanine*, *supra* note 11.
89 CRA, *supra* note 84.
90 Ibid.
91 Ibid.
pursuant to s.81 of the *Indian Act*. Consequently, the very nature of a Band and its Council is that of a local government performing a public function for the benefit of its constituency, likened to municipal, provincial or federal governments.

Notwithstanding the significance of this interpretation, a tax interpretation is not binding law; as such, no guarantee exists that the interpretation would be upheld by the courts. However, it may certainly be persuasive information for a court to consider. While the Canada Revenue Agency could change its administrative position on this point, I know of no situation to-date where the Canada Revenue Agency does not consider a Band to be a public body performing a function of government in Canada.

One way in which the Settlement Trust’s income can be considered income of the Band, and thus tax exempt, is to utilize the flow through nature of the trust. The flow-through character of income in a trust is such that by simply making payments to the beneficiary in the year that the income is earned, the income would then be taxed in the beneficiary’s hands, pursuant to s.12(1)(m) of the *Tax Act*. Of course, because in this situation income would be considered Band income, the revenues would be tax exempt, pursuant to s.149(1)(c) of the *Tax Act*. However, these payouts could limit the usefulness of Settlement Trusts as long-term investment tools to meet the fiscal management needs of the community.

Another way in which the Settlement Trust’s revenue can be attached to the Band, thus making the s.149(1)(c) exemption available, is through the use of s.75(2) of the *Tax Act*, as

92 *Indian Act*, supra note 3, s 81, s 84.
93 *CRA*, supra note 90.
94 One example where the Supreme Court of Canada used a Canada Revenue Agency Interpretation Bulletin to inform its analysis was in *Nowegijick v The Queen* where income was interpreted as personal property for tax purposes. In light of the Canada Revenue Agency’s Bulletin, the Supreme Court of Canada adopted the same interpretation. See *Nowegijick*, supra note 16.
95 *Li et al*, supra note 8 at 439.
96 *Tax Act*, supra note 1, s 12(1)(m).

12 (1) There shall be included in computing the income of a taxpayer for a taxation year as income from a business or property such of the following amounts as are applicable (m) any amount required by subdivision k or subsection 132.1(1) to be included in computing the taxpayer’s income for the year, except
(i) any amount deemed by that subdivision to be a taxable capital gain of the taxpayer, and
(ii) any amount paid or payable to the taxpayer out of or under an RCA trust (within the meaning assigned by subsection 207.5(1)).
discussed in chapter 2, section 2.3.B.a. Recall, from chapter 2 that s.75(2) operates to attribute the Settlement Trust’s income to the Band as the settlor of the trust. I argue that having to yield to a reversionary measure to draw upon s.149(1)(c) to grant Bands tax exempt status as it relates to Settlement Trust revenues has the effect of adding further steps in the process of dealing with these revenues. In the end, these revenues will be attributed to the Band regardless. If Settlement Trust income was treated the same as any other Band income, the Band would qualify for tax exemption through having Settlement trust revenues taxed directly under s.149(1)(c).

Notably, connecting Settlement Trust revenues to the Band through the application of s.75(2) in the Tax Act has the same effect, in principle, as Bands being taxed directly as public bodies performing a function of government in Canada. Yet, the former, the application of s.75(2) of the Tax Act to Settlement trust revenues, requires Bands to have to jump through administrative, tax, legal and accounting hoops, as was discussed in detail in chapter 2, section 2.4.A. In addition, as was discussed in chapter 2, section 2.4.B, legal uncertainty exists for Bands as it relates to the application of s.75(2).

If an amendment to the s.104(2) general trust provision of the Tax Act occurred, exempting Settlement Trusts from being included in this tax provision, the administration process related to the care and management of Settlement Trust transactions would be largely simplified.

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97 Tax Act, supra note 1, s 75(2).  
75(2) If a trust, that is resident in Canada and that was created in any manner whatever since 1934, holds property on condition:  
(a) that it or property substituted therefore may  
(i) revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as “the person”), or  
(ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or  
(b) that, during the existence of the person, the property shall not be disposed of except with the person’s consent or in accordance with the person’s direction, any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, shall, during the existence of the person while the person is resident in Canada, be deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person

98 Ibid, s 104(2).  
104(2) A trust shall, for the purposes of this Act, and without affecting the liability of the trustee or legal representative for that person’s own income tax, be deemed to be in respect of the trust property an individual, but where there is more than one trust and  
(a) substantially all of the property of the various trusts has been received from one person, and
A further case will be made in chapter 5 for extending the exemption under s.149(1)(c) of the Tax Act for policy reasons. Relevant considerations that could be contemplated to implement this policy change will also be discussed.

4.4. Conclusion

Two means exist by which Indigenous income can qualify for tax exemption: s.87(1) of the Indian Act and s.149(1)(c) of the Tax Act. However, in the current state of the law, both of these are limited in their application in exempting Settlement Trust investment earnings from tax.

In the case of s.87(1), the property of an Indian or Band situated on a reserve is tax exempt. Two challenges could be present here. The first challenge is whether the Settlement Trust’s investments earnings can be considered “situated on reserve”. The Supreme Court of Canada has been clear that the connecting factors test must be applied. While an argument could certainly be made that Settlement Trust revenue’s connection to the reserve is sufficient, there is uncertainty, particularly for non-fixed investment returns.

The second challenge evolves around whether the investment earnings are considered the “property” of the Band for the purposes of s.87 of the Indian Act because the trustee holds the legal title to the trust property. However, because the trust is a creature of equity a distinction is made between the legal and beneficial ownership; the beneficial owner is considered the real owner at law. The trustee is bound by its obligations to distribute the trust property (the income from the Settlement Trust and capital if trust terms permit) to the beneficiary, according to the trust terms. As such, the earnings of a Settlement Trust are considered that of the Band even if they remain inside the Settlement Trust and the trustee has legal title.

In the case of s.149(1)(c) of the Tax Act, it is clear that the administrative position of the Canada Revenue Agency is that the provision applies to exempt Bands from tax as they are “a municipal or public body performing a function of government”. As was explained in chapter 2,

(b) the various trusts are conditioned so that the income thereof accrues or will ultimately accrue to the same beneficiary, or group or class of beneficiaries, such of the trustees as the Minister may designate shall, for the purposes of this Act, be deemed to be in respect of all the trusts an individual whose property is the property of all the trusts and whose income is the income of all the trusts.

99 Pecore, supra note 80.
100 Oosterhoff et al, supra note 77 and Trustee Act, supra note 82.

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the Settlement Trust’s investment income can be attributed to the Band via s.75(2), which will then be exempt under s.149(1)(c) of the *Tax Act*. This does offer a solution for the taxation of Settlement Trust revenues. However, arguably, the bureaucratic process of filing a trust tax return and attributing Settlement Trust revenues to the Band requires unnecessary administrative processes and costs.

A simple amendment stating that Settlement Trust income is not considered taxable to the trust would resolve this issue. Instead Settlement Trust revenues could be taxable directly to the beneficiary Band and would put Bands in a position to rely directly upon s.149(1)(c) of the *Tax Act* as it relates to these revenues. I further build upon this argument in the next chapter.
CHAPTER 5: JUSTIFICATIONS FOR SETTLEMENT TRUST EXCLUSION FROM THE GENERAL TRUST PROVISIONS IN THE INCOME TAX ACT

5.1. Introduction

As previously discussed, because Indigenous Settlement Trust ("Settlement Trust") revenues are taxed to the trust or to the beneficiary, as an individual\(^1\) and at the top personal marginal tax rate,\(^2\) they are a source of income taxed under the \textit{Income Tax Act} ("\textit{Tax Act}").\(^3\) The \textit{Tax Act} taxes trust revenues as individual taxpayers regardless of whether certain parties have distinct circumstances, such as Bands under the \textit{Indian Act}.\(^4\)

Absent the application of s.75(2) of the \textit{Tax Act}, treating Settlement Trust revenues in the same manner as other trust revenues under the \textit{Tax Act} is not consistent with the policy of preserving Indigenous property. The idea of preserving Indigenous property flows from historical land dealings that underpin the legally recognized Indigenous-Crown relationship. In \textit{Guerin v The Queen},\(^5\) the Supreme Court of Canada ruled that this relationship is fiduciary in nature.

The recognition of the "Crown as fiduciary" forged a new path for Indigenous peoples as it relates to their protected legal rights. However, arguably, this legal construct places Indigenous peoples at the mercy of the Crown. Additionally, in some cases, the scope of claims that Indigenous peoples can bring against the Crown is limited because of the narrow legal tests that determine when a Crown fiduciary duty is invoked.

Applying the legally-recognized overarching principle that governs this special relationship, the honour of the Crown, from which certain Crown obligations flow, may more aptly assist in delineating Crown obligations. At the very least, more options may be available as a basis for Indigenous claims. That is to say that Crown fiduciary obligations may not be easily

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\(^1\) \textit{Income Tax Act}, RSC, 1970, c I-6 (now RSC, 1985, c I-5), s 104(2) [\textit{Tax Act}].

\(^2\) \textit{Ibid}, s 122(1).

\(^3\) \textit{Tax Act}, \textit{supra} note 1.

\(^4\) RSC 1970, c I-6 [\textit{Indian Act}].

\(^5\) [1985] 2 SCR 335, 13 DLR (4th) 321 [\textit{Guerin}].
recognized in some cases because the strict legal tests may be difficult to apply to certain Indigenous interests.

This chapter will review the Crown obligations that flow from the overarching principle of the honour of the Crown to justify an amendment to the *Tax Act* that would exempt Settlement Trusts from taxation under the general trust provisions. In section 5.2, I consider how the Supreme Court of Canada applied the conventional fiduciary doctrine in a non-conventional context. In addition, I explain why this application of the law may not easily apply to certain Indigenous interests.

In section 5.3, I consider how the overarching honour of the Crown principle may inform Crown obligations as it relates to the legal uncertainty of the tax treatment of Settlement Trust revenues. In section 5.4, I also consider the concept that Indigenous interests are unique in nature to argue that Settlement Trusts may be considered *sui generis*. In section 5.5, I argue that amending the *Tax Act* to exempt Settlement Trusts from being taxed under the general trust provisions is justified. As discussed in the previous chapter, if the *Tax Act* were amended to exclude Settlement Trust revenues from being tax under the general trust provisions, this income could be taxed just as any other Band income and qualify for tax exemption, pursuant to s.149(1)(c) of the *Tax Act*.6

I conclude that regardless of the legal uncertainty that exists related to these doctrines, the Crown must act honourably in its interactions with Indigenous peoples and their property interests.

**5.2. Crown Fiduciary Obligations**

A fiduciary is one who holds something in trust for the benefit of another party, the beneficiary; the beneficiary is dependent upon the fiduciary’s “honesty, integrity, and fidelity” and relies upon the trust placed in the fiduciary.7 Therefore, “the hallmark of a fiduciary relation is that the relative legal positions are such that one party is at the mercy of the other's

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6 *Tax Act*, *supra* note 1, s 149(1)(c). Recall that this is the provision of the *Tax Act* that considers public bodies performing a function of government in Canada to be tax exempt. The Canada Revenue Agency has provided a tax interpretation that Bands meet the criteria of a public body performing a function of government because they enforce by-laws and govern their members. See CRA Views, Interpretation—internal, 2016-0645031I7 [CRA].

discretion”.

The primary purpose of fiduciary law is to protect a beneficiary’s interests from possible unscrupulous actions taken by a fiduciary.

The first legal recognition of a fiduciary duty as it related to Crown conduct that impacted Indigenous interests was found in Guerin. Prior to this case, it was unclear whether fiduciary rules applied to Crown conduct toward Indigenous peoples.

In Guerin, the relevant facts involved a Band that surrendered valuable reserve lands to the Crown; the Crown then leased the land to a golf club. The Band approved certain terms at the surrender meeting; yet, the Crown obtained much less favourable terms than those approved by the Band. The less favourable terms were never referred to in the surrender document nor were they ever received by the Band. In fact, the Crown withheld relevant information from the appraiser of the proposed lease terms as well as the Band.

The trial judge held that the Crown was in breach of trust for entering the lease on reduced terms; loss of income damages was awarded based upon how much the Band could have received under the more favourable terms. Subsequently, the Federal Court of Appeal set aside the trial judgment and the Band sought leave to appeal to the Supreme Court of Canada.

The Supreme Court of Canada held that because the Crown had assumed a position of wide discretion to act in the best interests of the Band when negotiating the terms of the lease, it had a fiduciary relationship with the Band. Of note is this quote by Dickson, J.:

The purpose of this surrender requirement is clearly to interpose the Crown between the Indians and prospective purchasers or lessees of their land, so as to prevent the Indians from being exploited. This is made clear in the Royal Proclamation itself, which prefaced the provision making the Crown an intermediary with a declaration that "great Frauds and Abuses have been committed in purchasing Lands of the Indians, to the great Prejudice of our Interests, and to the great Dissatisfaction of the said Indians ...." Through the

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8 Guerin, supra note 5 at 384.
9 Borrows, supra note 7 at 447.
10 Ibid.
11 Ibid at 335.
12 Ibid.
13 Ibid.
14 Ibid.
15 Ibid.
16 Ibid at 389.
confirmation in the *Indian Act* of the historic responsibility which the Crown has undertaken, to act on behalf of the Indians so as to protect their interests in transactions with third parties, Parliament has conferred upon the Crown a *discretion* to decide for itself where the Indians' best interests really lie. This is the effect of s. 18(1) of the Act.\(^\text{17}\)

Yet, Dickson, J. also indicated that:

> It should be noted that fiduciary duties generally arise only with regard to obligations originating in a private law context. Public law duties, the performance of which requires the exercise of discretion, do not typically give rise to a fiduciary relationship. As the "political trust" cases indicate, the Crown is not normally viewed as a fiduciary in the exercise of its legislative or administrative function.\(^\text{18}\)

While typically fiduciary principles only applied in a private law context, Dickson, J., conceded that neither private law duties nor public law duties fit perfectly within the scope of Indigenous-Crown dealings due to the nature of the independent Indigenous legal interest in land.\(^\text{19}\) However, Dickson, J. also conceded that the nature of the *sui generis* Indigenous-Crown relationship makes the duty more like a “private law-like” duty.\(^\text{20}\)

While Indian lands are subject to Crown discretion, pursuant to s.18(1) of the *Indian Act*,\(^\text{21}\) due to the independent Indigenous legal interest, Crown duties cannot be characterized as public law duties. However, the inimitability of Indigenous legal interests demonstrates the difficulty in characterizing the resulting Crown legal obligations. In fact, the Supreme Court of Canada, acknowledged the unique nature of the Indigenous land interests and the difficulty with characterizing Crown obligations one way or another.\(^\text{22}\)

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\(^\text{17}\) *Ibid* at 383-4 [emphasis mine].

\(^\text{18}\) *Ibid* at 385.

\(^\text{19}\) *Ibid*.

\(^\text{20}\) *Ibid*.

\(^\text{21}\) *Indian Act*, *supra* note 4, s 18(1).

\(^\text{22}\) Guerin, *supra* note 5 at 383-7.
Subsequently, in *Wewaykum Indian Band v Canada*, the Supreme Court of Canada found that a Crown fiduciary duty does not exist at large, rather, it only applies to specific Indigenous interests. Thus, a fiduciary duty is not really a “source of plenary Crown liability” that covers all aspects of the Indigenous-Crown relationship. In fact, after *Wewaykum*, the Crown was understood as one that owes a broad range of duties to both Indigenous and non-Indigenous parties alike.

However, thinning Crown fiduciary obligations owed Indigenous peoples may further diminish the scope of these obligations. Arguably, a constant core of invoked obligations exist because Indigenous peoples hold a unique position in Canadian history; such obligations are more onerous because of the s.35 constitutional recognition of Aboriginal rights and the limitations placed upon Crown sovereignty. For this reason, Indigenous interests cannot be viewed in the same light as the Crown’s public interest obligations. As such, the need to balance Crown obligations to Indigenous peoples with its duties to other parties warrants a contextual analysis.

Notably, two contexts in which Crown fiduciary obligations may arise were clarified after the *Guerin* decision: a) where the Crown seeks to justify an infringement of an Aboriginal right; and b) where a specific cognizable Aboriginal interest exists, and the Crown assumes discretionary control over such an interest. The two frameworks require that an Aboriginal “right” or “interest” be proven in order to then determine whether Crown obligations are

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24 *Ibid* at para 81.
25 *Ibid*.
26 Senwung Luk, (2013) “Not So Many Hats: The Crown’s Fiduciary Obligations to Aboriginal Communities Since Guerin” 76 Sask L Rev 1 at 2 [Luk].
27 *Ibid*.
28 Borrows, *supra* note 7 at 437.
29 Luk, *supra* note 26 at 4.
31 See *R v Sparrow*, [1990] 1 SCR 1075, 70 DLR (4th) 385 [*Sparrow*]. This leads to the Duty to Consult obligation where the Crown is acting in a fiduciary capacity.
32 *Wewaykum, supra* note 23 and *Manitoba Metis Federation Inc. v Canada*, [2013] SCC 14, 1 SCR 623 [*MMF*].
invoked. That is, a recognized principle of law is that legal rights have corresponding legal obligations.\(^{33}\)

Therefore, to successfully argue that a Crown fiduciary obligation is owed, an Aboriginal right or interest must be proven. Next, whether the Crown assumed discretionary control over or infringed upon a particular Aboriginal right or interest should be considered. In the next section, I discuss the scope of the Supreme Court of Canada’s analysis related to Crown fiduciary obligations. In addition, whether the fiduciary tests set out in key decisions could apply to resolve the taxation issues around Settlement Trusts will also be discussed.

5.2.A. Applying the Fiduciary Doctrine to Indigenous Settlement Trusts

This section examines the body of jurisprudence most relevant to the issue of the Crown’s fiduciary obligations to Bands. While these cases do not concern Settlement Trusts, they do involve commercial mainstream dealings, and thus share this common element with Settlement Trusts.

Recall that, for the purposes of the analysis at hand, Settlement Trusts are taxed pursuant to s.104(2) of the Tax Act, a broad provision, that taxes all trust revenues as individual taxpayers regardless of whether certain parties have distinct circumstances, as Indian Bands do. As such, for Bands whose Settlement Trusts are administered in the commercial mainstream economy, the application of attribution rules is necessary to qualify for tax exemption. The consequence is that an attribution rule is applied contrary to its legislative purpose, which is to prevent tax avoidance.

Whether the Crown could have a fiduciary duty to reconsider the taxation of Settlement Trusts to protect the interests of Bands will therefore be analyzed. An application of the principles, set out in Sparrow and Wewaykum, assist here to inform this analysis.

First, the Crown owes a fiduciary duty in instances where an Aboriginal right is being infringed and the Crown seeks to justify this infringement (this test was set out in the Sparrow decision). On the facts of this situation, an argument could be made that an Aboriginal right is being infringed based upon the fact that s.104(2) is a broad provision that catches Settlement

\(^{33}\) Jamie Dickson, The Honour and Dishonour of the Crown: Making Sense of Aboriginal Law in Canada (Purich Publishing Limited: Saskatoon, 2015) at 12 [Dickson].
Trust revenues instead of treating such revenues as separate Band revenues. However, the potential “right” to be claimed in the context of Settlement Trusts in the commercial mainstream is not clear.

The Supreme Court of Canada held in *R v Van der Peet*[^34] that a right must be a practice, custom, or tradition that has continued from a practice, custom or tradition that was in existence prior to European contact[^35]. Thus, to meet the test, a right shall be specific to the Indigenous group and clearly connected to pre-contact activities. Arguably, Indigenous peoples engaged in various kinds of commercial dealings pre-contact[^36]. However, the commercial activity needs to be a specific activity engaged in pre-contact.

Investing trust assets in the commercial mainstream economy may not be considered a pre-contact activity as trust structures are a more recent financial investment vehicle for Bands. Although Bands would have certainly engaged in some sort of public resource allocation, it is not clear how the evolution to the present-day use of trust structures in the commercial mainstream would be interpreted by the courts. Not having benefit of a claimed right would make it difficult to claim a corresponding Crown fiduciary obligation. Therefore, the fiduciary framework set out by the Supreme Court of Canada may not be easily applicable.

Relevant case law reveals instances of these kinds of challenges. In *Batchewana Indian Band (Non-Resident Members) v Batchewana Indian Band*,[^37] the Federal Court of Appeal applied the *Van der Peet* test to consider whether excluding non-residents from voting was a practice integral to the distinct culture of the Band prior to contact. They found that because voting did not exist until 1902, excluding non-residents from voting could not be defined as an Aboriginal right[^38].

[^34]: [1996] 2 SCR 507, 137 DLR (4th) 289 [*Van der Peet*].
[^35]: *Ibid* at para 44. The Supreme Court of Canada found that existing Aboriginal rights ought to be interpreted flexibly to permit their evolution over time. As such, rights not yet defined under s 35 shall be considered through the lens of the ‘flexible interpretation of rights’. See also *Sparrow*, supra note 31 at 1076.
[^38]: *Ibid* at para 1.
This analysis raises serious concerns because a democratic system would have to precede determining voting eligibility; this means that the Federal Court of Appeal did not consider democracy an activity prior to contact.\(^3^9\) Therefore, determining voting eligibility could not be a right protected by s.35 of the Constitution. Freezing Indigenous political organization to pre-contact times prevents Indigenous communities from evolving their political structures to adapt to current times; in that case, it also precluded the possibility that the asserted right was a claimed right to self-determination.\(^4^0\)

In applying the Supreme Court of Canada’s analysis in \textit{Batchewana} to this situation, it appears that fiscal management had to have been a necessary component of a Band’s pre-contact practices. Whether the Courts would find that Settlement Trusts are simply a modern financial management vehicle that has evolved from Band public resource allocation practices from pre-contact to suit current times, is debatable. However, based upon the \textit{Batchewana} decision, the Courts may be unlikely to view it this way.

In \textit{R v Pamajewon},\(^4^1\) the Supreme Court of Canada also heard a claim to the right of self-government which involved regulating gambling activities. Regulating gambling activities must have been fundamental to the culture of the First Nations in question pre-contact. Yet, no evidence existed to show that gambling was the subject of Indigenous regulation at that time.\(^4^2\) Therefore, the Supreme Court of Canada found that gambling was not a practice that could be connected to the self-identity of the Bands pre-contact.\(^4^3\) These cases highlight some of the challenges in advancing Aboriginal rights claims, that, if proven, warrant corresponding Crown obligations.

Next to consider is whether a fiduciary duty, flowing from the Crown’s assumption of discretionary control over a specific cognizable Aboriginal interest, exists. A cognizable interest must be distinctly Aboriginal; that is, communal in nature and integral to the distinct community and its relationship to the land.\(^4^4\) In view of these criteria, a specific and cognizable Aboriginal

\(^{3^9}\) Chartrand, supra note 37 at 255.
\(^{4^0}\) Ibid.
\(^{4^1}\) \[1996\] 2 SCR 821, 4 CNLR 164 [Pamajewon].
\(^{4^2}\) \textit{Ibid} at para 30.
\(^{4^3}\) \textit{Ibid}.
interest related to Settlement Trust indentures must be proven. Arguably, these financial instruments are central to the Aboriginal economy in that funds are specifically disbursed for the maintenance and development of the Band members.

Bands are also communal in nature and are distinctly Aboriginal in that they are Indian Act-recognized Bands. Bands and Settlement Trust funds are both integral to the functioning of the community. In addition, Settlement Agreements are related to settlements resulting from Crown impacts upon Aboriginal lands and interests. Settlement Trust indentures may therefore be proven to meet the test of a “specific cognizable interest”.

The question of whether the Crown assumes discretionary control over such structures is not as easily answered. Whether discretion flows from the act of legislating tax provisions that catch Settlement Trusts used by Bands (who manage this interest in a way that is most beneficial to its members) is unclear. Because the Tax Act is of general application, this situation would likely be distinguished from the facts of *Manitoba Metis Federation Inc. v Canada.* In that decision, it was found that the Crown’s exercise of discretion was related to the administration of land grants under *specific legislation* that applied to the Metis children, that is, ss. 31 and 32 of the *Manitoba Act.*

The difficulty in applying current jurisprudence to contexts that do not fit squarely within the fiduciary duty legal frameworks is illustrated here. Whether Crown duties apply in the commercial mainstream is also complicated by competing interests: the constitutionally-protected Aboriginal interests versus the interests of those who do not benefit from this protection, as well as the interests of the Crown. The law relating to balancing these competing interests is vague.

Arguably, in the originating *Guerin* case, the Supreme Court of Canada pushed the limits to apply the fiduciary doctrine to this unique Indigenous-Crown relationship. Because a breach of trust argument was not accepted in that case, the Supreme Court of Canada stretched its

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45 MMF, supra note 32.
46 *Ibid* at para 52 [*emphasis mine*].
47 Luk, supra note 26 at 3.
48 *Guerin*, supra note 5 at 386.
analysis to find a way to provide an equitable remedy through the application of fiduciary principles.

Attaching fiduciary principles to this special relationship has negative implications for Indigenous peoples.\(^{49}\) This non-conventional application of fiduciary principles to the Indigenous-Crown relationship is problematic\(^{50}\) because it has the effect of negating Indigenous sovereignty. When Indigenous peoples surrendered lands, it was never understood by them that they would lose their sovereignty; sovereignty is a gift from Creator that cannot be negotiated nor given or taken away.\(^{51}\)

Fiduciary law also has the effect of reinforcing a paternalistic power structure.\(^{52}\) The history of Indigenous-Crown land dealings and the effect of land surrenders makes this even more problematic. Nonetheless, Brian Slattery, in *Understanding Aboriginal Rights*, argues that:

> [T]he sources of the general fiduciary duty do not lie, then, in a paternalistic concern to protect a “weaker” or “primitive” people, as has sometimes been suggested, but rather in the necessity of persuading native peoples, at a time when they still had considerable military capacities, that their rights would be better protected by reliance on the Crown than by self-help.\(^{53}\)

However, we see that the Crown’s involvement in Indigenous land dealings ensured that purchasers would *have to buy* under the Crown and not through the Band. Purchasing lands only through the Crown ensured the “underlying title fiction”. Indians are only considered vulnerable under the colonial definition of Aboriginal title where the legal title belongs to the Crown. From the perspective of this imposed doctrine, a paternalistic structure is reinforced.

Additionally, the Supreme Court of Canada in *Galambos v Perez*\(^{54}\) indicated that the purpose of conventional fiduciary law- the protection of one party from possible abuse of power by another party- is that “not all relationships are characterized by a dynamic of mutual autonomy”.\(^{55}\) In fact, if Indigenous peoples had “considerable military capacities”\(^{56}\) and were not

\(^{49}\) Dickson, *supra* note 33 at 9.

\(^{50}\) Ibid.

\(^{51}\) Borrows, *supra* note 7 at 4.

\(^{52}\) Dickson, *supra* note 33 at 9.


\(^{56}\) Slattery, *supra* note 53 at 753.
viewed as having a weaker position than the Crown, as Slattery indicates, then the essence of fiduciary law should not apply here. Arguably, characterizing the Indigenous-Crown relationship as fiduciary in nature implies that a power-dependency relationship exists.

Additionally, in *Galambos*, the Supreme Court of Canada also held that:

*The fiduciary must relinquish self-interest; that is an act which the fiduciary does, not an act which is done to the fiduciary. This was put slightly differently by Austin Scott, who said that “a fiduciary is a person who undertakes to act in the interest of another person.”* [Emphasis in original.]57

It is debatable whether the Crown can be construed as having relinquished its self-interest, most notably because, ostensibly, the Crown has benefited, often at the expense of Indigenous peoples, through both the lawful and unlawful surrender of Indigenous lands. As such, the Crown has a vast interest in the manner in which Indigenous lands are dealt with.

After the *Guerin* decision, the manner in which the Supreme Court of Canada applied fiduciary law to the Aboriginal context was not questioned. In fact, in subsequent decisions, the circumstances that trigger a Crown fiduciary duty, the scope and content of such a duty and subsequent Crown obligations to Indigenous peoples was further analyzed. Questions were not raised about whether the application of fiduciary law to the Indigenous-Crown relationship was even appropriate. Yet, Dickson, J., in providing an analysis in *Guerin*, referred two lower court decisions related to the doctrine, without using other precedent to substantially support this interpretation.58 Justice Dickson referred to *Laskin v Bache & Co. Inc.* and *Goldex Mines Ltd. v Revill*, both Court of Appeal decisions, to argue that it is the nature of a relationship that gives rise to a fiduciary duty, not the specific category of relationship.59

Stretching the doctrine of fiduciary law to apply to the Indigenous-Crown context, has, in my view, narrowed the scope of the kinds of claims Indigenous peoples can advance around Crown conduct. Additionally, in the commercial economy the fiduciary relationship is also at odds with the self-interested bargaining that typifies commercial mainstream dealings.60 As such, to

57 *Galambos*, supra note 54 at para 68.
58 See Dickson, supra note 33 at 54 citing *Guerin*, supra note 9 at 384-385.
60 *Wilson et al*, supra note 30 at 236.
say that the Crown has a duty to act with integrity and in good faith\textsuperscript{61} contradicts the nature of the Crown’s self-interest in certain Indigenous commercial dealings.

Notwithstanding that the law is in a “state of flux”, Supreme Court of Canada rulings have hinted at its “emerging analytical approach”,\textsuperscript{62} as it relates to Indigenous commercial mainstream dealings. Its position is that Indigenous peoples should be treated the same as their non-Indigenous counterparts in commercial mainstream dealings. In \textit{Mitchell v Peguis Indian Band},\textsuperscript{63} the Supreme Court of Canada held that the purpose behind this position is that Indigenous parties should not be given a better economic advantage than their non-Indigenous counterparts. This position is rich with irony and I digress from the fiduciary doctrine for just a moment to address this position.

\textit{5.2.B. Distinguishing Indigenous Peoples in Certain Mainstream Dealings}

Indigenous peoples lag in every meaningful area of economic development such that the highest incidence of poverty and other social disadvantage exists in Indigenous societies. In \textit{R v Kapp},\textsuperscript{64} McLachlin, CJC (as she was then) and Abella, J., writing for the majority, indicated that “Aboriginal peoples experience high rates of unemployment and poverty, and face serious disadvantages in the areas of education, health and housing ...This disadvantage, rooted in history, continues to this day”.\textsuperscript{65}

As it relates to Settlement Trusts, arguably, treating all trust indentures the same seems to support the Supreme Court of Canada’s stipulation that Indigenous peoples should be treated the same as non-Indigenous peoples in commercial mainstream dealings. Yet, in \textit{Kapp}, it was found that Indigenous parties may be treated differently for ameliorative purposes.\textsuperscript{66} In this decision, Indigenous fishing rights were considered.

In the facts of that case, Band members were given a 24-hour window in which they could fish commercially while non-Indigenous parties could not fish during that particular time.\textsuperscript{67} The

\textsuperscript{61} Ibid at 233.
\textsuperscript{62} Ibid.
\textsuperscript{64} [2008] SCC 41, 2 SCR 483 [Kapp].
\textsuperscript{65} Ibid at para 59.
\textsuperscript{66} Ibid at para 61.
\textsuperscript{67} Ibid at para 9.
purpose of the commercial fishing window was to provide important economic opportunities to Indigenous peoples in the commercial fishery. When a claim of discrimination was brought by non-Indigenous fishermen, the Supreme Court of Canada held that the ameliorative program was developed to benefit and improve the conditions of disadvantaged Indigenous peoples in greater society. It was found that the principle of equality does not always require all parties be treated the same for the result to be equitable. In fact, the Andrews v Law Society of British Columbia decision also held that similar treatment for the similarly situated does not inevitably result in equality, nor does differential treatment automatically result in inequality.

My intent is not to advance an equality argument, rather, to show that legal uncertainty exists, as well as contradictions in legal rulings related to Indigenous peoples. This legal uncertainty is detrimental to the continuing Indigenous-Crown relationship. Indigenous peoples are entitled to clarity in relation to owed Crown legal obligations because “Crown obligations toward Indigenous peoples are a part of Canada’s hidden constitution”.

As such, the legal analysis should be refocused and clarified related to Crown legal obligations. Arguably, the mutual relationship between Indigenous rights or interests and the resulting Crown obligations is largely “under-theorized”, thus rights are left unrecognized. Highlighting the inadequate legal analysis to date that defines the parameters of Crown legal obligations toward Indigenous peoples demonstrates that clarity is required.

Having said that, the Supreme Court of Canada has made it clear that the general duty to act with integrity and in good faith ought to be balanced with the duty to act loyally and to faithfully consider the best interests of Indigenous peoples, while avoiding conflicts of interests. Arguably, a conflict of interest does exist, in that much at stake for the Crown in terms of

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68 Ibid at para 6.
69 Ibid at para 61.
71 Ibid at 144.
72 Dickson, supra note 33 at 11.
73 Ibid.
74 Borrows, supra note 7 at 436.
75 Ibid.
76 Ibid.
77 Wilson et al, supra note 30 at 233.
Indigenous lands. Therefore, the application of conventional fiduciary law to a non-conventional Indigenous-Crown context is even more suspect.

Having said that, the overarching guiding principle, the honour of the Crown, may be useful because its application may produce results that cannot be achieved through the application of the strict fiduciary tests. In MMF, the Supreme Court of Canada indicated that the honour of the Crown is a guiding principle that applies to situations involving the reconciliation of Aboriginal rights with Crown sovereignty, thus is applicable to many different facets of Indigenous-Crown dealings.

Nonetheless, the challenge with this overarching principle is that no specific framework has been articulated by the Supreme Court of Canada that guides the application of the honour of the Crown. Rather, it is a plenary principle that invokes a certain duty. Each duty then has its own analysis to determine whether a breach has occurred. In the next section, a review of the general principles of the honour of the Crown provide some guidance as to whether the Crown could have an obligation to reconsider Settlement Trust income taxation.

5.3. The Honour of the Crown: Principles at Law

As discussed, the Supreme Court of Canada has long established that a special relationship exists between Indigenous peoples and the Crown from which a Crown fiduciary duty may flow. The overarching principle from which all Crown duties flow, the honour of the Crown, has also been recognized. It is an independent constitutional principle of which the ultimate purpose is to reconcile the pre-existence of Indigenous communities with the Crown’s assertion of sovereignty.

The honour of the Crown is engaged by the constitutional obligations owed to Indigenous peoples; thus, “in all its dealings with Aboriginal peoples, from the assertion of sovereignty to the resolution of claims and the implementation of treaties, the Crown must act honourably.”

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78 MMF, supra note 32 at para 68.
79 Ibid at para 73.
80 Haida v B.C. (Minister of Forests), 2004 SCC 73, [2004] 3 SCR 511 [Haida]. Also see MMF, supra note 32.
81 MMF, supra note 32 at para 66.
82 Ibid at para 91.
83 Haida, supra note 80 at para 17.
In *Haida v B.C. (Minister of Forests)*, the Supreme Court of Canada found that this principle arises “from the Crown’s assertion of sovereignty over an Aboriginal people and de facto control of land and resources that were formerly in the control of that people”.  

The honour of the Crown provides that the Crown must strive to balance competing ideas and rights. This balancing could be especially relevant to the reconciliation of Indigenous and non-Indigenous peoples.  

In *MMF*, the Supreme Court of Canada indicated that the honour of the Crown is not a cause of action in and of itself. Rather, it informs the obligations that flow from it. Therefore, in determining whether the Crown has acted honourably, the Court will consider the obligations that flow from this principle.

Because the honour of the Crown is not a cause of action in and of itself, a sound legal conclusion can really only be made if this principle is applied directly to a specific legal issue. Specific legal issues, recognized by the Supreme Court of Canada in *MMF*, include:

a) when the Crown wishes to justify the infringement of an Aboriginal right, giving rise to a fiduciary duty to consult and accommodate where necessary;  
b) when the Crown has assumed discretionary control over specific Aboriginal interests, thus a fiduciary duty arises;  
c) where the Crown has constitutional obligations, thus has a duty to implement purposively and act diligently to fulfill these obligations;  
d) where Aboriginal rights are yet to be defined, pursuant to s.35, thus the duty to negotiate dictates that the Crown must act to define those rights; and  
e) where treaty promises were made the Crown has a duty to implement such in good faith.

Additional Crown obligations may be recognized as the s.35 rights continue to be defined and legal developments ensue. Legal developments are crucial to expanding

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84 *Haida*, supra note 80.  
85 *Ibid* at para 32.  
86 *R v Lefthand*, 2007 ABCA 206 at para 75, [2007] 10 WWR 1 [*Lefthand*].  
87 *MMF*, supra note 32 at para 73. Some proponents argue that Indigenous societies are better served through applying the principle of the honour of the Crown rather than strict fiduciary principles. It appears that the Supreme Court of Canada is going in this direction after the *MMF* decision, but no clear framework has been elucidated. See *Dickson*, supra note 33.  
88 *Ibid*.  
89 *Lefthand*, supra note 86 at para 75.  
90 *MMF*, supra note 32 at para 73.  
91 See *Haida*, supra note 80 at para 25.
obligations recognized under the honour of the Crown. Uncertainty still exists in some areas because the doctrine is still evolving and has had limited application.

In this case, whether the honour of the Crown could be applied to Settlement Trust taxation under the Tax Act is particularly relevant. Bands could argue that the duty to negotiate applies in this situation. Interestingly, this duty was explicitly stated in s.37 of the Constitution,\(^92\) which has since been repealed. However, it is unclear as to how a duty to negotiate argument could be advanced here because the only advanced claims to date have applied to the negotiation of treaties.

Notwithstanding that much is still to be resolved as it relates to the honour of the Crown, a review of the competing approaches - the “fiduciary-based” approach first articulated in Guerin and the “honour-based” approach subsequently articulated in Haida and MMF\(^93\) - demonstrate that the honour of the Crown could be a more comprehensive guiding principle.

On the one hand, the fiduciary-based approach provides some guidance as to Crown obligations owed but is mainly a rule-based approach. One of its limitations is that it continues to put Indigenous peoples at the mercy of the Crown’s fiduciary power.

On the other hand, the honour-based approach is a principle-based approach that gives rise to specific duties. This approach does not relegate Indigenous peoples to any sort of vulnerable position; rather, dictates that they must be treated honourably in dealing with their interests. In fact, in MMF, the Supreme Court of Canada found that the obligations arising from the honour of the Crown flow from a place of respect for the strength of Indigenous peoples and

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\(^92\) Constitution Act, 1867 (UK), 30 & 31 Victoria, c 3, s 37 (repealed) [Constitution].

37. (1) A constitutional conference composed of the Prime Minister of Canada and the 1st ministers of the provinces shall be convened by the Prime Minister of Canada within one year after this Part comes into force.

(2) The conference convened under subsection (1) shall have included in its agenda an item respecting constitutional matters that directly affect the aboriginal peoples of Canada, including the identification and definition of the rights of those peoples to be included in the Constitution of Canada, and the Prime Minister of Canada shall invite representatives of those peoples to participate in the discussions on that item.

\(^93\) Dickson, supra note 33 at 75. Here I refer to the approach depicted in Guerin upon which a singular rule against self-interested conduct is applied in certain contexts. Post Guerin, a slight shift to the principled-based approach occurred in Haida but subsequent decisions such as MMF reverted to the rule-based approach. A deep analysis of the two is beyond the scope of this thesis; the intention here is only to provide a broad overview.
not any such desire for paternalistic protections of Indigenous peoples. The Supreme Court of Canada recognized that:

The honour of the Crown thus recognizes the impact of the “superimposition of European laws and customs” on pre-existing Aboriginal societies...Aboriginal peoples were here first, and they were never conquered; yet, they became subject to a legal system that they did not share.95

A key precept of the honour of the Crown is that it is assumed from the onset that the Crown intends to fulfil its promises, and as such the claimant need only show that the Crown breached its duty to act honourably. This is a very different approach from the fiduciary rule-based approach under which a claimant must first prove that a right exists, that a corresponding duty is found and then prove that it was breached.

Because the honour of the Crown assumes from the onset that the Crown will act honourably in its relations with Indigenous peoples, it ought to be given independent legal strength. It is relatively untested in this regard. Currently, the Supreme Court of Canada has not interpreted the honour of the Crown as an independent restriction upon Crown conduct as it relates to Indigenous interests. However, the honour of the Crown was validated as a constitutional principle when the Supreme Court of Canada held that the “Crown's honour cannot be interpreted narrowly or technically but must be given full effect in order to promote the process of reconciliation mandated by s.35(1)”98

Returning to the Supreme Court of Canada’s summation in MMF, whether the Crown has acted honourably depends upon whether certain duties are fulfilled. Advancing a claim under the honour of the Crown framework such that several duties may be found and subsequently argued could provide more options in advancing claims. However, if the narrow fiduciary duty tests are not able to be applied, the scope of recourse available could be still limited.

Nonetheless, the principle of honour does more closely align with reconciliation. Respecting and valuing special obligations in a relationship should be the touchstone of

94 MMF, supra note 32 at para 66.
95 Ibid at para 67 citing R v Van der Peet, supra note 34 at para 248 and Haida, supra note 80 at para 25.
97 MMF, supra note 32 at para 73.
98 Taku River Tlingit First Nation v British Columbia (Project Assessment Director), (2004), 2004 SCC 74 at para 24 [Taku River].
reconciliation. Consequently, resulting actions would flow from a place of reconciliation, not a burden of duty. On the contrary, the fiduciary doctrine has, in some cases, become more “prescriptive than analytical”.99 This inflexibility arguably creates more uncertainty and frustrated the resolution of outstanding issues related to Crown duties owed Indigenous peoples.

In fact, fiduciary legal rules as applied in Guerin, have become somewhat unquestionable about whether they should be applied to the Indigenous-Crown context. Rather, the rules “exist as self-evident truths without ever having been put through a thorough examination of their applicability or appropriateness to the Indigenous-Crown relationship”.100 This application of the fiduciary doctrine has not been fully fleshed out by the Supreme Court of Canada.101

As numerous obligations are found to flow from the honour of the Crown, it may be some time before the Supreme Court of Canada is able to analyze this doctrine more fully. The manner in which the Supreme Court of Canada proceeds in applying the honour of the Crown doctrine to advance the determination of Aboriginal rights and corresponding legal duties remains to be seen. However, the effect of s.35 is that the Crown must act honourably in defining those rights recognized therein.102 Because Indigenous-Crown reconciliation is an ongoing constitutional process, rather than a final remedy,103 a more comprehensive recognition of Aboriginal rights and resulting obligations is always required.

The Supreme Court of Canada held in MMF that in all dealings between the Crown and Indigenous peoples “servants of the Crown must conduct themselves with honour when acting on behalf of the sovereign”.104 That is, the unique Indigenous-Crown relationship is characterized by the honour of the Crown.105 Whether the application of the general trust provisions of the Tax Act to Settlement Trusts is consistent with the honour of the Crown when legal uncertainty exists is debatable.

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99 Borrows, supra note 7 at 442.
100 Ibid at 443.
101 Ibid.
102 Haida, supra note 80 at para 20.
103 Ibid at para 32.
104 MMF, supra note 32 at para 65.
In considering Settlement Trust assets, the Crown should act honourably by bringing clarity to tax jurisprudence that affects Bands. Such jurisprudence: a) puts Indigenous peoples in an untenable situation; and b) is ambiguous in its application. Nonetheless, as the law is still underdeveloped in this area, the issue still remains that no cause of action is available to clearly assist Bands in resolving this matter. The law must evolve in this regard.

The law should evolve to develop a more comprehensive honour of the Crown framework that applies to varied Indigenous interests. In fact, it is good public policy that Indigenous peoples have clarity regarding legislation that applies to their property interests. The honour of the Crown is a guiding principle for Crown conduct. Therefore, the inadvertent application of general tax legislation to Indigenous property interests, should burden the Crown to consider whether the current method of taxing Settlement Trust assets is justifiable.

In the next section, I consider the sui generis nature of Settlement Trusts to show that this is one more reason why the Crown should act honourably. The Crown should at least consider whether Settlement Trusts should be distinguished at law from other trust structures.

5.4. The Sui Generis Nature of Indigenous Settlement Trusts

Certain Indigenous interests have been found to be sui generis in nature by the Supreme Court of Canada. For example, in Delgamuukw v British Columbia, it was determined that the doctrine of Aboriginal title does not have the same general nature as any other proprietary interest; rather, it is sui generis in nature. The Supreme Court of Canada set out several characteristics of Aboriginal title that makes it unique. First, it cannot be transferred, sold or surrendered to anyone but the Crown, thus is inalienable to third parties. The unique nature of Aboriginal title also stems from the pre-occupation of Aboriginal peoples prior to British sovereignty. Lastly, Aboriginal title is held communally.

Likewise, these features are applicable to other kinds of Indigenous interests as well. For instance, as noted earlier, in MMF, the Supreme Court of Canada held that a specific cognizable Aboriginal interest must be distinctly Aboriginal, that is, communal in nature and integral to the

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107 Ibid at 1014.
108 Ibid.
109 Ibid.
110 Ibid.
distinct community and its relationship to the land. Setting apart Indigenous interests from non-Indigenous interests by distinguishing how unique legal rules apply to such Indigenous interests is the hallmark of Aboriginal Law in Canada.

Arguably, Settlement Trusts are also *sui generis* in nature. These financial instruments are central to the Indigenous economy subject to the trust. Additionally, funds are specifically disbursed for the maintenance and development of the community to benefit the Band members. Bands are also distinctly Aboriginal in that they are *Indian Act*-recognized Bands which are also communal in nature. Finally, the Settlement Trust initial assets also comprise compensation that results from Settlement Agreements with the Crown or third parties. These Settlement Agreements result from the deleterious effects of Crown and third-party actions upon Indigenous lands and interests.

It is difficult to reconcile, given the aforementioned unique features of Settlement Trust structures, that they would be treated as “individual taxpayers” for tax calculation purposes. The very essence of a Band is that it is communal in nature. It defies logic that trust assets that flow from a unique communal entity, a Band, in which income subsequently flows back to that same communal entity, would be taxed as a separate individual.

Bands are clearly not individuals and hold a unique position in Canadian society due to the nature of historical dealings between the Crown and Indigenous peoples. In the next section, I discuss why it makes sense to have Settlement Trusts distinguished from other personal trusts under the general trust provisions of the *Tax Act*.

5.5. Exempting Settlement Trusts from Inclusion under the General Trust Provisions in the *Tax Act*

The fact that Settlement Trust structures are *sui generis* in nature supports the argument that Settlement Trusts should not be taxed under the general trust provisions of the *Tax Act*. If Settlement Trusts were exempted from being taxed under the general trust provisions, Bands would simply claim trust income directly through s.149(1)(c) of the *Tax Act* just as any other income. Therefore, no tax return would even be filed for these revenues, as is the case with all other Band revenues.

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111 *MMF, supra* note 32 at para 53.
I contend that it is also justifiable for the legislature to clarify that Bands fall under s.149(1)(c) of the *Tax Act* so that a Band is not merely relying upon an administrative interpretation from the Canada Revenue Agency to be considered a public body performing a function of government in Canada for taxation purposes.

It seems that a solution exists that would eliminate the bureaucracy around the taxation of Settlement Trusts. It would simplify the administration for all parties involved including the Canada Revenue Agency. Bands would not have to go through the administrative exercise of filing Settlement Trust tax returns when the end result is that income will be attributed to the tax-exempt Band anyway. Further, the Canada Revenue Agency would not have to concern itself with the administration of numerous Settlement Trust tax returns that, through the application of s.75(2), are tax exempt anyway.

Arguably, the current method of Settlement Trust taxation perpetuates a redundant administrative process. An amendment to the *Tax Act* to exclude Settlement Trust revenues from the general trust provisions would achieve the same result as the application of s.75(2) currently does. This could also result in greater clarity in the law. To enact such an amendment several considerations would need to be contemplated.

First, the definition of what constitutes a Settlement Trust is critical. The obvious response is that they are trusts enacted through the deposit of settlement funds (and other Band assets) by a Band. Additionally, to qualify for tax exemption under s.149(1)(c) of the *Tax Act*, a Band is currently required to be an *Indian Act* recognized Band to begin with. As such, it is likely that Settlement Trusts, exempted under s.104(2) of the *Tax Act*, would need to be settled by Bands that qualify as a public body performing a function of government in Canada.

At the heart of the justifications for exempting Settlement Trusts from the general trust provisions of the *Tax Act* is that *Indian Act* protections and *Tax Act* provisions both already address the tax treatment of revenues attributed to Indigenous peoples under certain conditions. I contend that amending the *Tax Act* to exempt Settlement Trusts from being included in the general trust provisions allows Bands to rely upon the *Tax Act* provisions that would treat Settlement Trust revenues as any other Band revenues, pursuant to s.149(1)(c) of the *Tax Act*. 
This is a more justifiable manner to treat such revenues. A Tax Act amendment would bring immediate and greater certainty to the issue of Settlement Trust taxation.

5.6. Conclusion

Notwithstanding the unique position of Indigenous peoples, all citizens are entitled to be clear on the law that applies to such citizens. A quote by Lon L. Fuller, a legal philosopher, clarifies the relationship between government and citizens as it relates to clarity of law:

Government says to the citizen in effect, “These are the rules that we expect you to follow. If you follow them they are the rules that will be applied to your conduct.”

In chapter 2, I argued that it is not necessarily clear that if a Band follows the rules of tax law that allow it to apply s.75(2) of the Tax Act to its Settlement Trust revenues, that it will not be adversely used against them. The reason for this is because no guarantee exists that the General Anti Avoidance Rule will not be triggered. Thus, resolving this ambiguity in how Settlement Trusts are taxed is critical.

Further, the honour of the Crown principle requires more than mere reflection- it requires important Crown action, that is, Crown action that will have meaningful impacts upon Indigenous property interests. While reflection upon the historical Indigenous-Crown relationship is critical to understanding the basis for Crown obligations owed to Indigenous peoples, it may also be that progress requires the reframing of legal principles that the Supreme Court of Canada has characterized to date.

As Indigenous societies continue to participate in the commercial mainstream it will be more critical for Crown obligations to be clarified. Applying strict fiduciary principles alone will not solve the issue of undefined Crown obligations because this places too much of a burden upon Indigenous peoples to prove that such a duty exists when certain circumstances of Indigenous peoples may not be served through the application of fiduciary duty tests. Likewise,

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112 Lon Fuller, *The Morality of Law* (Yale University Press: New Haven and London, 1964) at 22 [Fuller]. Also see *R v Wonderland Gifts Ltd*, 135 DLR (4th) 632 (NLCA) [Wonderland Gifts]. The Newfoundland and Labrador Court of Appeal stressed the need for clarity of intent in statutes, subordinate legislation and by-laws to avoid situations where the law might be unable to be applied by reason of uncertainty.
in the case of Settlement Trusts, it is not clear whether the Crown has a fiduciary duty to reconsider Settlement Trust tax treatment.

Yet, one cannot deny that Settlement Trust structures are unique in nature and the Supreme Court of Canada has already ruled that the honour of the Crown obligates the Crown to consider the *sui generis* nature of the distinct interests of Indigenous peoples when dealing with their relevant property interests. That fact alone obligates the Crown to reconsider the tax characterization of these structures and the fact that Settlement Trusts are taxed under general trust provisions as individuals when Bands are clearly not individuals.

I contend that amending the *Tax Act* to exempt Settlement Trusts from being included in the general trust provisions is justifiable. With such an amendment, Bands would not be required to rely upon the application of an attribution provision, s.75(2) of the *Tax Act*, to garner tax benefits for Settlement Trust revenues. Bands would instead be able to claim Settlement Trust revenues as any other Band income, pursuant to s.149(1)(c) of the *Tax Act*, applicable to Band income in general. Such an amendment could only result if the Crown committed to engaging honourably to resolve this matter.
CHAPTER 6: CONCLUSION AND RECOMMENDATIONS

6.1. Conclusion

Through engaging in meaningful legal discourse in this thesis, I aimed to provide persuasive arguments for making an amendment to the Income Tax Act ("Tax Act")\textsuperscript{113} to exempt Indigenous Settlement Trusts ("Settlement Trusts"), created by Indian Bands, from being taxed under the general trust provisions. Arguably, an amendment would minimize or eliminate the administrative processes and costs in which the Band is responsible, and the legal uncertainty related to the possible triggering of the General Anti Avoidance Rule ("GAAR").

As previously noted, the Courts have grappled with interpreting legislative provisions and common law rules related to Indigenous people’s property or interests. Yet much remains unresolved in this regard. Therefore, of particular importance to this thesis was how tax laws that impact the management of Indigenous treasury through the use of a trust could be clarified.

A trust is one means that Bands use to engage in the financial economy by settling and investing Settlement Agreement assets (and other Band assets) in securities and other investments, to yield returns off of these assets. However, the use of a trust is not without challenges for the Band. Because Settlement Trusts are taxed as individual taxpayers, pursuant to s.104(2) of the Tax Act,\textsuperscript{114} Settlement Trusts that are administered off reserved lands may not qualify for tax exemption because the revenues must be connected to the reserve or Band in order to gain such exemption.

Therefore, Bands rely upon the application of s.75(2) of the Tax Act,\textsuperscript{115} an attribution provision, to attribute Settlement Trust revenues to the Band to qualify for tax exemption, pursuant to s.149(1)(c) of the Tax Act.\textsuperscript{116} However, this is problematic because it causes the Band to incur numerous administrative processes and costs. Additionally, in this context, the application of an attribution rule is contrary to the legislative purpose of s.75(2), which is to prevent tax avoidance. Rather, here the Band is using it to avoid tax. As such, the application of

\textsuperscript{113} Income Tax Act, RSC, 1970, c I-6 (now RSC, 1985, c I-5) [Tax Act].
\textsuperscript{114} Ibid, s 104(2).
\textsuperscript{115} Ibid, s 75(2).
\textsuperscript{116} Ibid, s 149(1)(c).
this attribution provision could trigger the GAAR. This could create some legal uncertainty for the Band.

Other possibilities were considered in relation to how best to deal with the taxation of Settlement Trust revenues. The technical benchmark tax system and how it is assessed was considered to show that while the benchmark tax system is crucial to fairly collect revenues in order to aid in the provision of government programs, sometimes deviations from it are necessary to further certain governmental policy objectives. Policy reasons - the long history of the unique Indigenous-Crown relations and the concept of preserving Indigenous property - were advanced to justify a tax expenditure in the form of a tax exemption as applied to Settlement Trust revenues. In other words, a tax expenditure could be a means to exempt tax from Settlement Trust revenues based upon the fact that it would further the objective of preserving Indigenous property as it relates to Settlement Trust income.

In fact, a tax expenditure already exists in the Tax Act that provides tax exemption to Band income via s.149(1)(c). However, as this provision does not apply directly to Settlement Trust income (absent the application of s.75(2)), I argue that an amendment to the Tax Act to exempt Settlement Trust revenues from being taxed under the general trust provisions, would be the most appropriate means to have this tax expenditure extended to directly include Settlement Trust income.

Other Indigenous tax exemptions that exist outside of the Tax Act were also discussed. Subsection 87 of the Indian Act exempts Indian personal property, either located on reserve or connected to the reserve, from taxation. The connecting factors set out in Williams v Canada\textsuperscript{117} - the residence of the payor; the residence of the payee; the place of payment; where the activity giving rise to the qualification for benefit was performed; and where the contract was entered - were analyzed to argue that a case could be made to connect Settlement Trust revenues to the reserve for tax exemption purposes.

However, certain factors did not err in the Band’s favour. For example, in Bastien Estate v Canada\textsuperscript{118} and Dubé v Canada,\textsuperscript{119} the form of investment income that the Supreme Court of

\textsuperscript{117} [1992] 1 SCR 877, 90 DLR (4th) 129 [Williams].
\textsuperscript{119} 2011 SCC 39, 2 SCR 764 [Dube].
Canada ruled could be connected to the reserve resulted from term deposits because a guaranteed return should be expected. Conversely, Settlement Trust assets are invested largely in the securities market and other non-fixed income investments. Therefore, some uncertainty exists about whether Settlement Trust income could be connected to the reserve through the connecting factors set out in Williams. The law is still underdeveloped in this area.

An argument was also advanced that Settlement Trusts are *sui generis* in nature and so their taxation should be specifically considered by the Crown. In terms of Crown obligations, I considered whether the Crown has a fiduciary duty to reconsider the tax treatment of these Settlement Trusts. I argued that it would be difficult to find that a Crown fiduciary duty is owed in this context because it is unlikely that a Band would be able to meet the criteria articulated in the strict fiduciary duty tests set out by the Supreme Court of Canada in key decisions, such as *Manitoba Metis Federation v Manitoba*.120

Rather, I argued that the honour of the Crown might be a more comprehensive framework. Nonetheless, challenges still exist with this framework because the honour of the Crown is not a cause of action in and of itself. However, the idea of bringing clarity to the law is consistent with the overarching principle of the honour of the Crown.

A common theme throughout the arguments advanced in this thesis is that, while the law is somewhat evolving in the several areas of law discussed and analyzed relating to Indigenous people’s property and interests, a great deal of uncertainty still exists. This uncertainty should compel government to act on the recommendations set out below.

In conclusion, I argue that it is unlikely that any one of the individually identified legal principles on their own could extend far enough to fully resolve the issues related to Settlement Trust taxation, though overall these legal principles could be persuasive. Amending the *Tax Act* to exempt Settlement Trusts from being taxed under the general trust provisions is, in my view, the best solution here. As such, I set out several recommendations in the following section.

### 6.2. RECOMMENDATIONS:

In summary, I make the following recommendations:

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120 [2013] SCC 14, 1 SCR 623 [MMF].
1. The Federal government should amend the *Tax Act* by indicating under the general trust provisions (most notably, s.104(2)) that Settlement Trusts are excluded from being taxed under these provisions. This amendment should also clarify that Settlement Trust income is considered Band income. By accepting this recommendation, the Federal government would eliminate or largely minimize the redundant administrative steps and legal uncertainty for Bands whose Settlement Trusts are taxed under the general trust provisions of the *Tax Act*.

2. Settlement Trust income should be taxed directly just as any other Band income, pursuant to s.149(1)(c) of the *Tax Act*. For taxation purposes, the legislature should also clarify that Indigenous government bodies, including Bands, fall under s.149(1)(c) of the *Tax Act* so that such bodies are not merely relying upon an administrative interpretation by the Canada Revenue Agency to be considered a public body performing a function of government in Canada.
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COMMENTARY


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