

FIRST NATION TAXATION and NEW FISCAL RELATIONSHIPS

Presented to:

**The Indian Taxation Advisory Board
and
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Policy and Strategic Direction Branch
of
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by

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**This paper reflects the views of the authors only and not necessarily that of the
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Executive Summary

The paper examines the state of First Nation government tax powers and their potential for generating increased revenues. It concludes that taxes are presently a very small percentage of First Nation government revenues. There are three explanations.

1. First Nation governments have federally recognized authority over only a small part of their potential tax base - property tax, the tobacco components of the GST and, some provincial tobacco taxes. These accounted for roughly 14 per cent of the tax receipts of other governments in 1995 (Canadian Tax Foundation, 1996).
2. Relatively few First Nation governments are exercising these powers. Fifty First Nation governments are taxing property and only two have legislation enabling them to tax tobacco.¹ The questionnaire portion of this study suggests that there is considerable tax potential which is not yet being exploited.
3. Low levels of economic activity on First Nation lands reduce the revenue potential of taxes.

First Nation governments will soon need more tax revenue because: (1) rapidly growing populations will drive up the expenditures needed to maintain current levels of service. (2) they will have to compete for additional federal funds against political pressure for tax cuts, increased spending on social programs and the cost increases associated with an aging society. (3) Self government and economic aspirations require funds over and above those needed to maintain existing service levels.

To some extent, self government can be financially accommodated by redirecting funds from service provision agreements to cash transfers. However, these funds will be insufficient to meet the expectations for self government - new administrative and physical infrastructure, improved services and the economic development aspirations of First Nation communities. Furthermore, no government is truly autonomous unless it is financed primarily by its own revenues.

The paper identifies three general barriers to First Nation government taxation:

1. An insufficient land base
2. Low states of economic development
3. Political barriers facing both First Nation and non-First Nation governments.

The paper discusses mostly political and economic barriers. Addressing the adequacy of the land base is a separate and larger issue.

The general findings are that Indian reserves are characterized by low incomes, investment and

¹

A complete listing of First Nations with tax authorities or receiving grants-in-lieu is available at the ITAB web site "<http://itab.cactuscom.com>."



business activity, and this makes taxation less viable. Political barriers outside First Nation communities stem from public mistrust, reluctance by other governments to vacate tax room, the need to maintain the integrity of the national tax system, disagreements regarding the appropriate scope of self government and federal-provincial disputes concerning obligations for registered Indians and off-loading in general. Political resistance within First Nation communities stems from a philosophical opposition to taxation, a fear that developing tax authorities will lead to declines in federal transfers and the end of the statutory exemption for registered Indians, and the difficulty of selling taxation to people already suffering poverty. These views were supported in the questionnaire which was developed as part of this study.

The paper's principle thesis is that taxation can lead First Nations out of poverty, allow the federal government to accommodate self-government, without creating substantial costs, and even reduce costs for provincial governments. However, the federal government must work with First Nations to address the following challenges:

1. Further develop First Nation tax authority;
2. Create incentives for tax effort by First Nations; and,
3. Address the barriers to doing business on First Nations' land.

The paper sets forth recommendations and suggests research to support these challenges. The recommendations aim at overcoming both political and economic barriers, with the principle recommendation addressing developing a new fiscal relationship between First Nation governments and the federal government. The paper concludes that such a relationship could increase First Nation governments' tax authority, tax effort and even fiscal capacity. To achieve this relationship, the following criteria need to be met.

It must:

- ▶ spell out the relationship between new tax revenues and transfer entitlements; and,
- ▶ create incentives for taxation;

It should:

- ▶ improve the business climate on reserves by improving financial reporting, addressing issues of accountability and by providing a clear understanding of the form new tax regimes will take;
- ▶ promote standardized accounting and reporting practices;
- ▶ allow First Nation governments to assume tax powers at their own pace;
- ▶ create true political and economic autonomy;
- ▶ create incentives for clarifying the fiscal relations between provincial governments and First Nations; and,
- ▶ fit within the federal fiscal plan.

It should not:

- ▶ compromise the federal-provincial transfer system; or,
- ▶ penalize First Nation governments which do not assume tax powers;

It is strongly recommended that this framework be developed in close consultation with First Nations. This is necessary first because of the complexity of the issue and the sheer volume of information which must flow both ways to ensure success, the direct relevance of the issue to so many First Nations, and the diversity of interests within First Nations. Second, it is likely necessary given the long legacy of mistrust by First Nations towards the federal government. First Nations taxation organizations are particularly well positioned to represent First Nation interests, as well as identify and address political impediments and technical issues. These organizations are the Indian Taxation Advisory Board, the Federation of Saskatchewan Indian Nations Tax Commission, the Assembly of First Nations and the First Nations Tax Administrators' Institute.

The paper presents three options for future work.

1. **The Status Quo.** First Nation tax authorities would continue to be developed tax-by-tax and band-by-band. Supporting research would focus on improving statistics, and promoting better accounting and reporting practices.
2. **Develop New Fiscal Relationship.** This includes the work of Option One, and also research aimed at developing the new fiscal relationship.
3. **Develop New Fiscal Relationship and Tax Base.** This includes Option Two and also initiatives to improve investment on First Nations land and access to capital by First Nation businesses.

Introduction

“The Government’s position is that financing self-government is a shared responsibility among federal, provincial and territorial governments, and Aboriginal governments and institutions. Specific financing arrangements will be negotiated among governments and the Aboriginal groups concerned.”

- Federal Policy Guide, Aboriginal Self-Government, 1995

The First Nation Revenue Generation Project is an initiative of the Research Directorate of the Department of Indian Affairs and Northern Development (DIAND). The Revenue Generation Project has been divided into four phases:

1. A Case Study Project on Non-tax Revenue Sources;
2. A National Project on Non-tax Revenue Sources;
3. A Case Study Project on Tax Revenue Sources; and,
4. A National Project on Tax Revenue Sources.

This paper represents the fourth phase of this research initiative as it investigates First Nation taxation systems from a national perspective. Specifically, it identifies the extent to which they have been implemented, their fiscal potential, their policy environment, political and economic barriers to their implementation, and makes recommendations for overcoming barriers as well as a research agenda to support these recommendations.

The research has been co-steered by the Research and Analysis Directorate of the Department of Indian Affairs and Northern Development (DIAND) and the Indian Taxation Advisory Board (ITAB). The research has been contracted to Fiscal Realities located in Kamloops, B.C..

The research is being undertaken so as to investigate how First Nations can use taxation to generate revenues and meet some of the costs of self government and provide the necessary infrastructure for economic development. This is in keeping with federal policy and the interests of First Nations.

All contracting parties recognize the importance of First Nation taxation. Tax and other own source revenues can increase the monies available for providing improved services and infrastructure on First Nation lands. As such, they are an essential tool for implementing self-government, promoting economic development and employment opportunities on First Nation land, and ultimately improving the quality of life for First Nation citizens.

The federal government is interested in promoting the self-sufficiency of First Nations through own source revenue generation. Taxation revenue is an important component of any new First Nation fiscal relationship with Canada, taxation is an essential tool for economic development, and First Nations have to be enabled, but not forced, to implement tax regimes.

This document is intended for First Nation communities and those with an interest in First Nation tax policy.

The project began in February, 1997. It entailed answering the following research questions:

Q: What is the current policy environment concerning First Nations taxation?

A: This was addressed by a policy review of stakeholders, a literature review, a phone survey of the provinces and a review of powers currently available.

Q: How do a cross-section of First Nations leaders feel towards the issue of First Nations taxation and what are their concerns?

A: A questionnaire and database was developed for a pre-selected sample of respondents.

Q: What is a methodology for estimating the potential magnitude of taxation revenues?

A: Tools used by various agencies such as Departments of Finance were assessed. The best method was found to be developing the tools for First Nation self-estimation.

Q: What are the barriers to exercising tax jurisdiction and what mechanisms can be used to overcome these?

A: General barriers, such as inadequate land base and poor tax base were identified as well as legislative, policy and attitudinal barriers specific to taxation. These were based on the survey results and literature review.

Q: What future research should be conducted?

A: A number of research questions were specified, aimed for the most part at addressing barriers to tax jurisdiction. Some address specific aspects of taxation while others suggest improving the environment by developing an appropriate fiscal relationship between the federal government and First Nations.

1. First Nations Tax Legislation

Two kinds of First Nations taxation power are currently recognized in federal legislation: real property (Bill C-115) and sales tax (Bill C-93). Three years elapsed between the Kamloops Indian Band beginning to petition for C-115 and the passage of the legislation. Another four years elapsed before 15 communities actually passed property tax by-laws. It will clearly be a long time before there will be significant tax revenues for First Nations.

1.1 Real Property Tax

Bill C-115 (1988) amended the Indian Act to make it clearer that leased lands were still part of an Indian reserve, and to enable a band council to enact property tax by-laws in respect of leased reserve lands. The conditional land surrender process was abandoned and replaced by a land use “designation” process to accommodate leasing arrangements. Thus the former “*surrendered*” lands which by definition were excluded from reserve status have become “*designated*” lands.² These legislative changes enable First Nation governments to tax third party interests on designated lands through the enactment of taxation by-laws. The by-laws are submitted for review to the Indian Taxation Advisory Board (ITAB) which may then recommend them for the Minister of Indian Affairs’ approval. Each First Nation council submits an initial property tax and assessment by-law and annual expenditure and rates by-laws. In the eight years since its inception, the ITAB has made over 400 recommendations to 5 different Ministers for signature, with every ITAB recommendation being adopted.

At the time of writing, 58 First Nation communities have enacted property tax by-laws. The ITAB estimates that these communities collect over \$20 million in property tax revenue annually.

1.2 Federal Sales Tax - Westbank and Cowichan

The federal government passed Bill C-93, The Budget Implementation Act in April, 1997 whereby Westbank and Cowichan were granted authority to tax the sale of tobacco and tobacco products to Natives and non-Natives alike on the Westbank and Cowichan reserves. If these bands levy a tax identical to the GST, the federal government will coordinate with them by vacating this tax room. If the tax is implemented, it will be collected by Revenue Canada for Westbank under a Tax Collection Agreement.

The Bill also contains provisions to enable the Cowichan Tribes of Indians to impose a tax similar to that imposed under the British Columbia Tobacco Tax Act, on sales of tobacco products to Indians on the Cowichan reserves. This will fill tax room that had previously been left vacant by s.87 of the Indian Act. Non-Indians will continue to pay the provincial tax to the Province. This legislation will facilitate the conclusion of a tax collection agreement with the Province of British Columbia whereby the Province will collect this tax on behalf of Cowichan.

If bands assume power in respect of sales tax, the federal government will absorb the costs of

² Terms in bolded italics are defined in the glossary after the bibliography.

administration, much as it does for the provinces, under Tax Collection agreements. Administration costs include the cost of collection, enforcement actions and appeals. Input tax credits, collection, and enforcement provisions will be virtually identical to those for the GST. The aim is to make it administratively simple for Revenue Canada and to minimize paperwork requirements for retailers.

The Tax Collection Agreements to facilitate this legislation were still being worked out as of July, 1997.

1.3 Conclusion

Property tax and tobacco sales tax represent a small and inadequate piece of the total tax pie if the aim is to help finance First Nation self-government. The present process will take a very long time to provide First Nation governments access to significant tax revenues.

The left side of Figure 1 illustrates the share that fuel, tobacco and property taxes comprise of total tax receipts. The right side shows the percentage of First Nation communities that are exercising authority over *some elements* of these taxes.

Figure 1 - Relative Size of First Nation Tax Authority - 1997

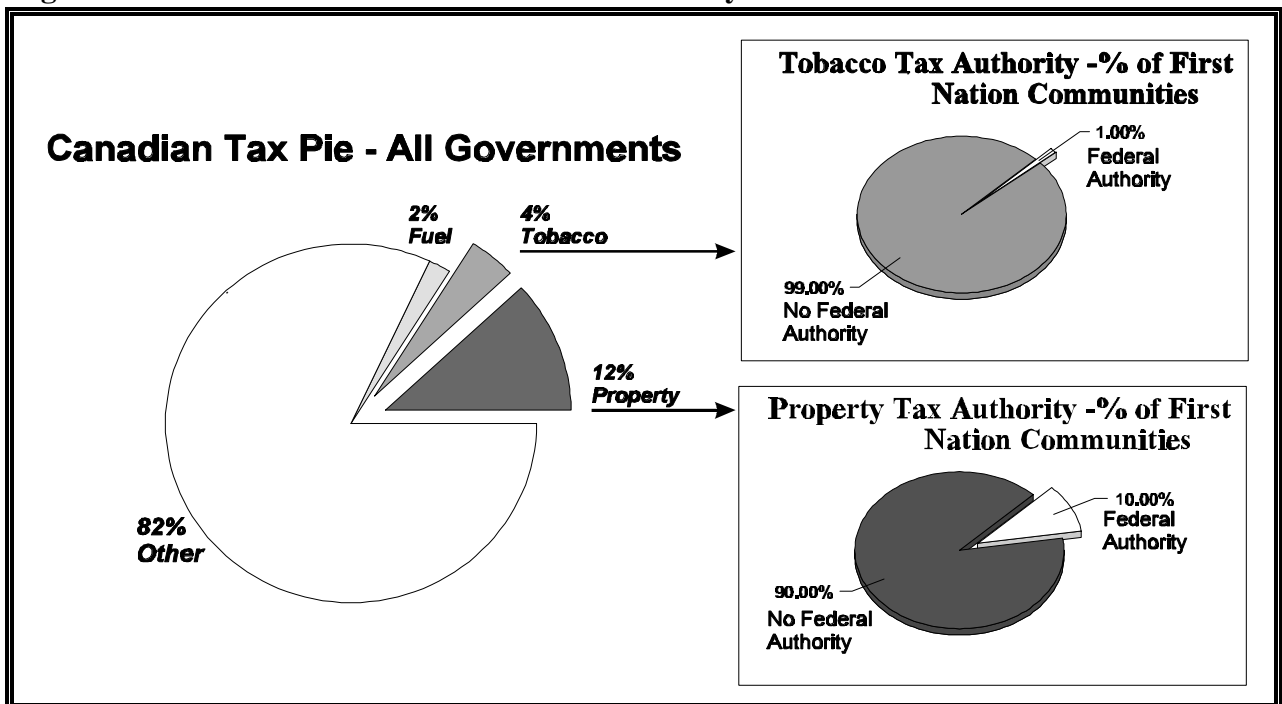
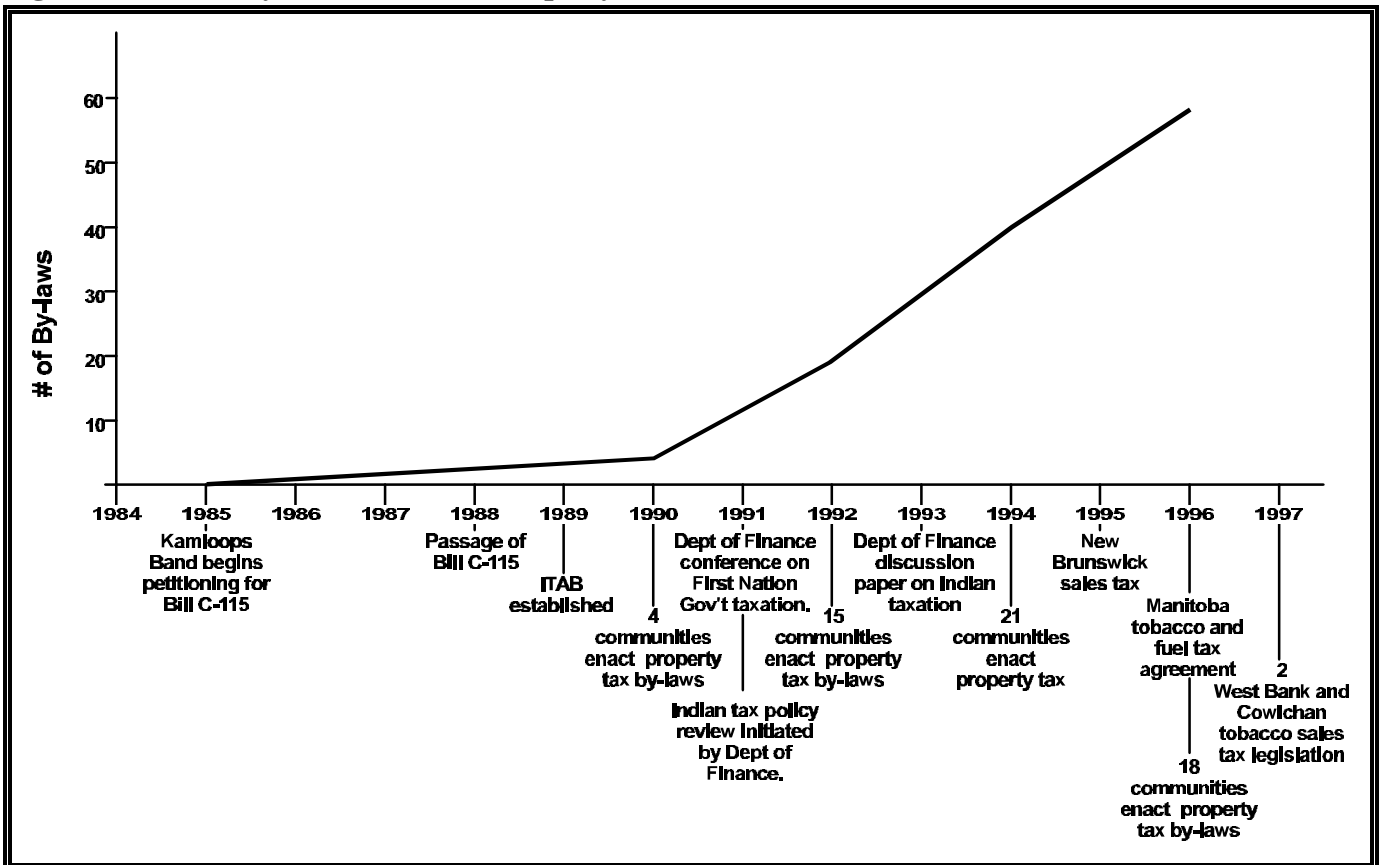


Figure 2 demonstrates just how long it is taking to develop a comprehensive First Nation tax system using current enabling legislation. At the present rate, it would take 90 years for all First Nation governments just to institute property tax systems.

Figure 2 - A History of First Nation Property Taxation



2. First Nations Tax Policy

This chapter briefly summarizes the salient policy papers on Indian taxation, and tries to draw out their implications. However, the subject area is very large, and each paper focuses on different dimensions of it. It is difficult to make direct comparisons or fully characterize positions. Nonetheless, some conclusions can be drawn.

2.1 A Working Paper on Indian Government Taxation

The Department of Finance's 1993 draft discussion paper A Working Paper on Indian Government Taxation was intended as a starting point for discussion about tax powers under self-government³. It was also a discussion paper and not a policy paper. Nonetheless, it provides important insights into federal thinking about First Nations taxation.

The paper accepts that tax revenues are an important, and ultimately necessary component of self-government. Self-government will require expanded tax powers to help finance services, infrastructure and administration.

Finance wishes to facilitate the assumption of tax powers by those First Nations who wish to do so. However, their chief responsibility remains, "maintaining the integrity of the Canadian tax system". Finance sets many parameters on First Nations tax systems because of this interest. For example, First Nations tax systems must not create economic distortions or substantial transition or administration costs. Other federal interests are limiting the federal financial obligation, creating the financial ability to exercise self-government and creating incentives for First Nations' governments to create tax systems.

The paper's specific conditions are itemized below.

2.1.1 *Maintaining the integrity of the Canadian tax system:*

- ! The First Nation government's tax power is to be geographically based⁴;
- ! The federal government will consider administering harmonized taxes within the federal system, provided administrative costs are not too high;
- ! Indirect taxation is to remain strictly a federal power;
- ! Tax relationships must be consistent with increased autonomy and self-sufficiency for First Nations;
- ! The First Nation government must coordinate any taxation authority over previously non-exempt

³ For example on its first page the document states, "This paper sets out for discussion the issues surrounding the development of a new relationship on taxation between the federal government and Indian governments".

⁴ Page 13 states "Indian government taxation powers will operate concurrently with federal and provincial taxation authority *within reserve lands*". Emphasis added.

sources with federal and provincial powers so as to maintain similar tax rates, and prevent tax avoidance and unintended over-taxation and finally to minimize compliance and administrative costs;

- ! The issues of taxing third parties without representation and ensuring that taxes paid are in line with services actually provided must be addressed within a negotiated framework. Non-First Nations persons on First Nation lands are to be subject to the same rates of taxation as First Nation members. There are to be no punitive taxes aimed at established interests on First Nation land. Taxpayers must have access to courts;
- ! There is to be no point of sale GST exemption for individual Indians;

2.1.2 Powers and Rights of Indian Governments:

- ! The property of Indians which is situated on reserves should remain exempt from *non-Indian* government taxation;
- ! Indian governments and their institutions will be exempt from taxation by other governments;
- ! Own source revenues are not to be used as a rationale for replacing existing funding arrangements unless the institutional infrastructure and level of service provision of a given First Nation government is reasonably equivalent to that of surrounding communities;⁵
- ! The federal government will consider giving First Nations authority to levy all direct taxes;
- ! The federal government is willing to consider entering into arrangements to redirect a portion of federal tax revenues raised from Indian individuals on reserve to the First Nations government. However, in the case of the GST, this will likely affect the eligibility of low-income Indian citizens for the GST rebate;
- ! The extent to which non-First Nation members living on First Nation land will pay taxes to the Indian government is to be negotiated.

2.1.3 Commentary

- ! The development of First Nations tax authorities must be subordinate to maintaining the integrity of the Canadian taxation system.
- ! It will be difficult to implement self-government for First Nations or for them to gain political and

⁵ The paper is somewhat ambiguous on this point. Page 14 states “[Indian government tax revenues] cannot be viewed as a mechanism for replacing existing funding arrangements for First Nations communities”. However, this seemingly firm statement is softened somewhat as the paper then spells out conditions under which own source revenues would replace federal transfer funding, “These revenues [Indian government taxation] should influence the negotiated requirements for funding only when an Indian community has in place an institutional infrastructure reasonably equivalent to that in place in surrounding communities”.

economic autonomy without considerable cooperation from provincial governments under either proposal. Provincial governments will continue to occupy much of the tax room from First Nations territories⁶.

- ! A situation may develop on First Nation lands where the provinces levy taxes on non-First Nation citizens while First Nation governments levy that same tax on First Nation citizens. This will increase the complexity of government and compromise the territorial model of taxation.
- ! If coordination with the provinces is not addressed, First Nation individuals will pay tax to provincial governments for services provided by First Nation governments. This reduces tax revenues for First Nation governments, affects both their viability and their autonomy and is inconsistent with notions of promoting greater accountability. This situation would also cause differences in service quality between First Nations and provincial jurisdictions. Where provincial governments are willing to create tax room, First Nations from different provinces could face very different conditions. For example, one province may want concessions over natural resources, and another may want agreements on gaming. The immediate result would be very different rules and stipulations for different First Nations. The end result would be compromised autonomy and investor confusion regarding First Nations.
- ! The Finance paper makes no recommendations on the *fiscal framework* within which First Nations taxation would be set. This provides no certainty within which First Nations can consider the costs and benefits of developing tax systems.
- ! The paper notes that the development of First Nations tax systems must deal with the issue of taxation without representation i.e. the taxing of non-Citizens interests, where non-Citizens are not entitled to vote. It does not mention the issue of taxation without services implied by the provincial occupation of First Nations tax room. First Nations citizens will continue to pay taxes to provincial governments for services that government does not deliver to them. The issue could be partly dealt with through arrangements by which the federal government would redirect provincial transfer entitlements to First Nations, should they wish to assume service responsibility.
- ! The paper implies that businesses operating on reserves currently have an unfair advantage because they can make exempt sales to Status Indians⁷. However, it is not clear that this “distortion” is the most significant one affecting business on-reserve. Despite this advantage, there are relatively fewer businesses located on reserves than off. Put another way, there are clearly other distortions at work besides exempt sales, and these distortions are inhibiting on-reserve business activity. In light of this, it is not understood why the “advantage” that retailers on reserve receive from making exempt sales is singled out as a major factor for improving economic efficiency. In fact, removing it may

⁶ It would appear that First Nations would have the right to levy new taxes on top of existing provincial or federal tax, but this would be nearly impossible because of their likely effect on investment.

⁷ Page 18 of the paper contains the following, “Since the exemption in general only applies to transactions taking place within a specific geographic area, competitive inequities exist between retailers operating within and outside the reserve. Generally, retailers on the reserve are able to sell to Indian individuals on an exempt basis. Those outside the reserve are not. This competitive inequity causes economic distortion.”

make the effects of other distortions even more pronounced. A more useful approach might be to conduct research into the nature of the distortions which limit business activity on reserve.

- ! The issue of taxation without representation will likely not be serious because First Nations will be forced by administrative issues or the need to be competitive to develop tax systems that are harmonized with surrounding jurisdictions. For example, taxes created from GST room will be identical with the GST. Property tax rates will have to be kept in line with neighbouring jurisdictions in order to attract tenants.

First Nations face a taxation without services question roughly analogous to taxation without representation. For example, First Nations citizens on reserve who work off reserve continue to pay taxes to provincial governments. These taxes pay for services, such as provincial health care, which are actually provided by the federal government on-reserve. Also, many provinces receive equalization payments based in part on the effect that the depressed incomes of First Nations people have on their average tax receipts. Again, these payments finance provincial services.

2.2 *Assembly of First Nations (AFN) Position on Taxation*

The Assembly of First Nations Round Table Meeting with Ministers on Taxation in May, 1995 produced a resolution on taxation which is summarized as follows:

- ! New tax arrangements must be worked out with the Government of Canada on a government to government basis.
- ! First Nations have full tax jurisdiction over all their territory. Until agreements are reached, First Nations own all taxes collected from non-Indians on reserve lands.
- ! First Nations citizens will never pay taxes to the Crown no matter where they reside.
- ! New mechanisms are required to deal with issues of First Nations taxation.
- ! Consultations for new tax regimes must be conducted internally by First Nations. While this is underway, a six month moratorium must be placed on all of Revenue Canada's assessments, audits, collections and legal actions pertaining to the implementation and enforcement of the current Revenue Canada Guidelines, and amendments to tax legislation affecting Citizens of First Nations directly or indirectly.
- ! A joint working group consisting of senior Government of Canada officials and First Nations representatives will explore taxation issues as they pertain to First Nations and produce a framework process aimed at resolution of the issues.
- ! A new dispute resolution mechanism is requested as an alternative to Canadian Courts.

2.2.1 *Commentary*



- ! The AFN's views have been virtually ignored by government.
- ! First Nations currently receive very little of the taxes paid by non-Indians residing on reserve.
- ! Most First Nations individuals currently do pay taxes to the Crown.
- ! No moratorium has been put in place. No new dispute resolution system has been established.
- ! The AFN also passed a resolution calling for a new *fiscal relationship* between First Nations and the federal government.
- ! Many of the AFN positions were reiterated in the survey portion of this study. For example one respondent declared, "No taxation for any Native person period. Taxation will be the downfall of our people, once land claims are settled". Another declared, "First Nations should be able to control all of their affairs within their defined jurisdiction."

2.3 *Royal Commission on Aboriginal Peoples (RCAP)*

RCAP supports the development of an Indian tax system. Its position is that this system should be developed within the context of a new fiscal framework for Aboriginal governments. It made recommendations about the structure of such a framework. RCAP envisions a comprehensive transfer formula plus a legislative enabling framework for assuming taxation powers. This would take the place of the current transfer system, which is arbitrary, conditional, and negotiated between individual Indian bands and the federal government.

A new fiscal framework for Aboriginal governments is seen as necessary because:

- ! the current transfer system is too arbitrary. It is conducted largely on a year over year, band by band basis. This creates the possibility of inequities among bands, and between First Nations and other governments. It also increases the possibility of inconsistencies in the future treatment of own source revenues. The risks will grow more pronounced as the tax system grows and develops further points of contact with this transfer system.
- ! transfers are currently too short-term and uncertain to allow for long term planning and rational investment by First Nations; and,
- ! the current transfer system is too conditional to allow for true autonomy. This is stifling entrepreneurship and economic growth.

RCAP envisions offering First Nations the option of developing a tax system and using a transfer system modelled after the Equalization program. This would specify the relationship between tax revenues and transfer entitlements for all First Nations.

Under Equalization, the federal government tops up the revenues of poorer provinces to whatever receipts their tax effort would generate if their tax base corresponded to a hypothetical five province average. This

system creates incentives to tax, even for jurisdictions with limited revenue capacity because tax effort determines their equalization entitlement. For example, due to low incomes, Personal Income Tax (PIT) receipts for many First Nations communities would be negligible if they had an income tax. However, if there was an equalization program in place, they would still have incentives to tax because they would receive equalization revenues based on this tax effort.

Important adjustments would have to be made to an equalization formula before it could be applied to First Nations. First Nations will likely not have access to the same tax base or provide the same services as provinces. First Nations are often very remote and poor which raises service costs. This effect is not accounted for by the equalization system. RCAP proposes introducing the element “need” into the transfer formula. The precedent is that this is done with the territorial financing system.

RCAP also recommends that First Nations be granted an expanded land base and access to its resources.

The tax system proposed by RCAP would be structured as follows:

- ! The First Nation will have control over the full range of direct taxes and other revenue sources. This includes: personal income tax; corporate income tax; sales taxes; property taxes and lease fees; gaming revenues; resource royalties; licenses and fees; and, user fees;
- ! Taxes would be residency based. First Nations would receive some of the taxes from non-Aboriginal people on First Nations land. They would not receive taxes from purchases made by First Nations persons outside their own jurisdictions, or income earned by First Nations persons residing outside their jurisdiction;
- ! Federal personal income tax receipts on First Nations land would be directed to the Aboriginal government. Transfer arrangements should account for any inequities this might create with surrounding jurisdictions;
- ! First Nations will set tax policy on their lands, subject to Canada’s international treaty obligations and a provision that they not establish tax havens on their territory;
- ! Non-Aboriginal residents on First Nations land will be represented on advisory councils;
- ! Aboriginal governments will receive the same tax treatment as the federal and provincial governments. They will be exempt from taxation by other governments and will be eligible for *grants-in-lieu* from other government institutions on their lands.

2.4 An Assessment of the Policy Positions

The RCAP and Finance papers discussed a more complete range of the issues related to tax powers for First Nation governments than did the AFN. The two papers also addressed the issues from different perspectives. RCAP’s chief interest was promoting self-government and the well being of Aboriginal peoples, whereas Finance’s interest in promoting First Nation tax powers is constrained by their need to maintain the integrity of the Canadian tax system, control costs and deal with the practicalities of

implementation.

There is substantial agreement between the two papers. Both accept that First Nations must have taxation in order to meet their aspirations. Both agree that other tax systems will be operating concurrently on First Nation lands. Both agree that new tax systems must be harmonized with other jurisdictions.

A key difference regards the process for developing a new tax system. The RCAP position is that a First Nations tax system should be developed within the context of a new fiscal relationship, and this fiscal relationship must specify the relationship between new tax revenues and transfer entitlements. RCAP seems to view this as a necessary precondition for the large scale exercise of *tax authority* by First Nations governments and as a necessary ingredient of self-government. Their inference is that, without such a framework, uncertainties will create political resistance towards developing tax systems within First Nations.

The Finance paper is not clear on process. It seems to imply that First Nation tax systems will continue to be built tax-by-tax and band-by-band. The paper suggests that eventually own source revenues will be taken into account when determining federal transfer entitlements. They recognize the need to maintain incentives for taxation by First Nations. The implication is that an offset formula would be negotiated only after new tax revenues are developed.

The RCAP proposal appears to favour pre-specifying the First Nation tax authorities, which would be recognized, and the conditions which would be attached to First Nations assuming these. However, RCAP is vague as to which specific authorities should be recognized.

The Finance paper states it is willing to consider the transfer of authority for *all* direct taxes. It does not however, specify the logic it would apply to this consideration, other than that implied by maintaining the integrity of the Canadian tax system. The approach *appears to be* considering these transfers one by one, presumably in response to lobbying from First Nation governments. If so, then the process would next call for the federal government to consider each request and, if it assents, negotiate the conditions under which it would coordinate with the new authority.

The Finance position allows the interests of third parties to be better protected. Explicit provision for third parties would likely be negotiated each time it vacated tax room. Furthermore, First Nation governments would likely be aware that their treatment of third parties would be a consideration regarding their assumption of future tax authorities. Under RCAP, such protection would only be negotiated once, at the time the new fiscal relationship was specified. RCAP does suggest providing non-First Nations citizens with forums to hear their concerns, however these would not carry the political weight of a vote.

The Finance approach is clearly more pragmatic. It focuses on what is immediately achievable and does not complicate it with other issues. It is less likely to get entangled in broader issues such as land claims or self-government. It is also well suited to Finance's chief interest, maintaining the integrity of the Canadian tax system. Moving so slowly and carefully will reduce political opposition towards recognizing First Nations tax authority. Moreover, it is the approach which has been proven to work already, and it is the approach by which the process of developing First Nation taxation was initiated.

However, as was noted in Chapter One, this approach is slow to meet the future demand for own source revenues. It is unlikely to develop significant revenues in time to promote economic development for First Nations and meet the financial demands of self-government, and deal with the growth of the First Nations' population.

This approach also does not address the political problems facing First Nations' leaders who may wish to champion taxation, because it does not pre-specify an offset formula. Without this formula, First Nations leaders will be unable to spell out the likely consequences of tax initiatives to their constituents. In effect, leaders who choose to champion taxation will have their political fates determined after the fact by decisions from outside authorities.

The tax-by-tax approach increases the likelihood of an inconsistent patchwork of First Nations tax arrangements developing. Individual First Nations may find themselves negotiating the conditions for the recognition of tax authorities with different governments and, as a result, different First Nations could negotiate very different conditions for assuming the same tax authority. The result would be a patchwork of arrangements which would create investor uncertainty about First Nations and higher administrative and compliance costs. Such a state of affairs would also cause resistance from the business community towards First Nations tax systems, create distrust between the federal government and First Nations, and increase the potential for conflict between First Nations and surrounding jurisdictions.

A tax by tax approach will increase the total cost of developing a First Nation tax system. This approach means the recognition of every specific tax authority must be negotiated, possibly on a band by band basis, and each negotiation will be conducted without a clear framework. Each band which exercises this tax authority, will then have to negotiate a separate tax collection agreement. Affected parties, such as those subject to the new tax or wishing to make investments in affected jurisdictions, will have to learn the new rules, every time this occurs. As a result, new investment uncertainty will be created. The total costs of negotiating a comprehensive First Nation tax system will be substantially increased.

Tax Room Conflict

Problems negotiating service agreements while there is a dispute over tax room are illustrated by early experiences with property tax. Both BC and Quebec had cases where the First Nation property tax authority required the withdrawal of the then existing municipal property tax systems. For some municipalities this represented a substantial fall in revenue. Not surprisingly, when First Nations attempted to negotiate service agreements with these same municipal governments some acrimony was present. In one case between Adams Lake and Salmon Arm, the dispute went to court, and in two others, Tsawout and Central Saanich, and the Ushat Mak Mani Utenam and Sept Iles the matter went to arbitration involving the Department of Indian Affairs. These conflicts were settled and/or are still being settled at great cost to all parties.

By contrast, the RCAP plan calls for a new fiscal relationship which would likely pre-specify transfer entitlements, service responsibilities, tax powers and the conditions under which the federal government would vacate tax room on First Nations land. Because it pre-specifies many of the generic conditions, negotiation costs are reduced. Because it provides for uniform rules, affected parties need learn the new “rules” only once.

3. Existing Models of First Nations' Taxation

This section discusses those First Nations tax authorities which have been recognized in recent treaties.

3.1 Nisga'a Agreement-in-Principle

Note: This is an agreement-in-principle only and not a formal treaty. These arrangements will not be protected by the Constitution or considered as Treaty Rights. This section is an interpretation of that agreement.

The Nisga'a Agreement-in-Principle (AIP), while not legislative or binding, provided a blueprint for a comprehensive tri-partite agreement on principles of taxation. Many of its pertinent conditions will not be fully specified until a Final Agreement is reached. At that time, the tax provisions will be more fully spelled out. However, these will likely be specified in accompanying legislation and not the Final Agreement. The AIP is highlighted below:

- ! The Nisga'a government may make laws for direct taxation applicable to Nisga'a citizens on Nisga'a land for the purpose of the Nisga'a government. However, this will not limit the ability of Canada or British Columbia to impose taxes or make laws in respect of taxation. Nisga'a powers will operate concurrently with federal and provincial powers.
- ! Provision was made so that Canada and British Columbia may eventually provide the Nisga'a government with direct taxation authority over non-Nisga'a persons on Nisga'a land.
- ! Nisga'a taxes will be coordinated with the federal and provincial systems.
- ! Possible reductions in transfers from other governments will be negotiated as the Nisga'a collect own source revenues. Whatever is negotiated will be less than a one for one reduction in transfers versus new own source revenues.
- ! The Indian Act exemption will be removed with respect to Nisga'a *reserves* as of the effective date of the Final Agreement. A remission order will then be put in place by both Canada and British Columbia effectively providing Nisga'a citizens with eight years exemption from sales taxes and twelve years from other taxes, such as income tax. This will not apply outside areas currently comprising the Nisga'a reserve.
- ! When the remission orders expire, Nisga'a citizens will not be eligible for exemptions on other Indian reserves.
- ! An exemption from real property taxation will apply indefinitely to Nisga'a government and non-profit activities. There will be no capital taxes on unimproved Nisga'a government capital. Improvements on Nisga'a citizen residences, public works and forest resources will also be exempted from capital taxes.
- ! The parties will negotiate what improvements are taxable. This will not include Nisga'a government

institutions which are exempt because of their government status. Provincial taxes such as the social service tax other than alcohol and provincial motor fuel tax are recoverable whenever they were paid in the conduct of government business.

- ! The transfer of the property tax authority to the Nisga'a government from British Columbia will be negotiated.
- ! Nisga'a government and its institutions will not be exempt from the GST but will be eligible for a 100% rebate of that portion of the GST paid in the course of carrying out government functions. Rebates of provincial sales taxes are being contemplated.

3.2 Council of Yukon Indians (CYI) Umbrella Agreement

The CYI was a tripartite agreement among the Government of Canada, the Government of the Yukon and fourteen Yukon First Nations. Four First Nations have signed self-government agreements under this umbrella agreement which specify tax powers, tax status and a new fiscal relationship. The tax provisions from one such agreement, the First Nation of Nacho Nyak Dun, are discussed below:

3.2.1 Tax Powers

- ! The First Nations will share jurisdiction over property tax on all interests in their Settlement Land.
- ! The First Nations will share jurisdiction over the direct taxation of their Citizens on their Settlement Lands. Provision was made for future agreement regarding the direct taxation of other people and entities. However, other Governments retain the authority to tax these lands.
- ! The Yukon government is committed to sharing property tax room with the First Nations so long as the property tax is being enacted to provide local services. The Yukon government is committed to ensuring that Yukon municipalities do not suffer any financial losses as a result of First Nation property taxes.
- ! The statutory exemption under s.87 will expire three years after the date of signing.

3.2.2 New Fiscal Arrangements

- ! The Yukon government and the First Nations will commit themselves to negotiating as necessary to provide for the efficient delivery of local services and programs.
- ! The Government of Canada will negotiate a self-government financial transfer agreement with the First Nations. This agreement is intended to ensure that the First Nations provide services reasonably equivalent to those prevailing in the Yukon, provided the First Nations are imposing reasonably comparable levels of taxation.
- ! This agreement will spell out funding to be provided towards the costs of services, for the maintenance of government institutions and other matters.

- ! The service agreement will consider the First Nations' own source revenue potential, differences in service costs owing to the scale and location of the First Nations, incentives for efficiency and the fiscal situation in Canada.
- ! The transfer formula *may* include a base year with adjustment factors and may be based on the Formula Financing Agreement between Canada and the Yukon.
- ! Transfer agreements will run for five years.
- ! First Nation programs will be roughly equivalent to existing Government programs.
- ! First Nation programs will be coordinated with other Government programs with the intent of achieving administrative efficiency.
- ! Yukon contributions will be calculated according to a formula which accounts for expenditure savings, loss of administrative efficiencies, and revenue losses from transferred taxes which continue to be considered as Yukon revenues in the determination of their transfer entitlements.
- ! First Nation revenues from a given tax base will be considered in determining transfer entitlements two years after the First Nation gains access to that tax base. The formula will be negotiated, however this formula will reduce transfer entitlements by an amount lower than the new revenues which have been generated

3.3 *Provincial Policies*

Provincial policies with respect to First Nations taxation are not uniform. There are substantial differences in their treatment of the tax status of Indian individuals and institutions and in the level of provincially recognized First Nation tax authority. In many instances, there is a policy vacuum.

The Province of New Brunswick had passed legislation which offered fuel, tobacco and provincial sales tax receipts to any First Nation agreeing to collect tax from non-exempt sales on reserve. Under the agreement, the Province would hand over 95 per cent of these receipts to the Band government. New Brunswick would also exempt from tax, a quantity of those products sufficient for consumption by Status Indians on reserve. Six bands had agreed to collect at least some of the taxes and four or five more had expressed an interest.

This arrangement has since been complicated by the introduction of the Harmonized Sales Tax (HST), which blended provincial sales taxes with the federal GST. Under the HST, Revenue Canada is responsible for collecting all sales taxes in New Brunswick. The province no longer records these receipts and is therefore no longer able to easily track that portion of sales taxes which are paid on reserve. New Brunswick is presently exploring options for addressing this problem. These include working with Revenue Canada or working directly with First Nations to devise an alternative reporting scheme.

There had been multiple aims to the legislation. First, it was intended to ensure that retailers on reserve operated on an equal tax footing with retailers off reserve. There had been some problem with on-reserve

retailers selling products without charging tax or not remitting the tax to the provincial government. Second, it helped ensure that New Brunswick's Status Indians had access to exempt sales of these products. Finally, it was intended as an economic development tool for First Nations.

The issue has been further complicated by a recent ruling of a New Brunswick court that Status Indians are entitled to a point of sale exemption from sales taxes. This decision is currently being appealed to the Supreme Court of Canada.

By contrast, the Cowichan agreement with the Province of British Columbia explicitly assigns ownership of the provincial tobacco tax from sales on reserve to the Province. Most other provinces continue to occupy this tax room. In fact, until 1996 Manitoba occupied all the sales tax room including sales to Status Indians on reserve.

There are reports that some provinces are striking unofficial agreements with different Indian bands. These allow jurisdictions to experiment with collection methods without being trapped in legislative gridlock. However, they also further the perception by business that First Nations are characterized by inconsistent and changing business environments. This reinforces the general perception that it is expensive to do business with First Nations and that First Nations taxation arrangements will unnecessarily add to the cost and complexity of government.

4 Estimating First Nations' Tax Potential

The previous chapters illustrated that although federal legislation, provincial policies, recent land claim settlements and treaties have enabled some First Nations to enact tax systems, relatively few First Nations have exercised their tax authority. One possible reason for this is that First Nations are unaware of their tax revenue potential.

The First Nation Taxation Questionnaire⁸, completed by 20 of 31 possible respondents, indicates that property and tobacco tax potential exists in many First Nation communities, yet only one in five Taxation Questionnaire respondents had a property tax system and no respondents had a tobacco sales tax system⁹. This section will develop a methodology for estimating the tax and own source revenue raising capacity of First Nations.

Own source revenues consist of taxes and other revenues. Tax revenues currently supported by either legislation or government policy, potentially available to First Nations, include property taxes, school taxes in some jurisdictions, and tobacco sales taxes. Also included among taxes, though not technically a tax, are grants-in-lieu of property tax, paid by Crown Corporations and other governments operating on First Nation lands. Other own source revenues include lease revenues, gaming revenues, interest from investments and user fees.

Including the GST, these own source revenues made up approximately 25% of all 1995 government revenues in Canada (Canadian Tax Foundation, 1996). The simplest method of estimating First Nations tax potential would be to use reserve populations and assume a First Nations tax authority would obtain "Canadian average" tax receipts. However, this would be a large over-estimate. The GST and property taxes would likely not be as valuable to First Nations as they are to other governments because of the low levels of economic activity on First Nation land (RCAP, 1996).

A more prudent method is to review the literature which has attempted to estimate the own source revenue potential of First Nation governments and either utilize these estimates, or extract the tax estimation lessons from these studies, for the purpose of evolving a more accurate estimation methodology.

Four separate research projects which include both national taxation revenue potential estimates, and tax revenue estimates from 12 First Nation communities are briefly reviewed below:

1. A First Nations Province - Thomas Courchene, 1992
2. An Economic Study of Five Indian Communities - Indian Taxation Policy Group, Department of Finance, 1993
3. Some Economic Impacts of Treaty Settlement in B.C., - Andre Le Dressay, 1996

⁸ The summary results of this questionnaire, along with an overview of the questionnaire methodology, response rate, biases, and a copy of the questionnaire instrument and letters are attached in Appendix B.

⁹ 80% of respondents indicated that their communities had property taxable interests, and 100% of respondents indicated that tobacco was being sold in their communities. At this time, no First Nation community in Canada has yet implemented a federally legislated tobacco tax system.

4. Tax Potential Estimates for Opaskwiak, Listigouche, White Bear and Okanagan First Nations, ITAB, 1992 - 1996.

4.1 A First Nations Province

This paper proposed that a province comprised of First Nations is a feasible model of self-government within the Canadian fiscal framework.

Courchene estimated that if current Indian reserves comprised a province, they would have raised \$102 million in income tax in 1991. This relatively low figure is explained by his assumptions that no lands other than current reserves are included in the First Nations province, and it includes only Indians currently on reserve, where incomes are on average very low. Courchene assumed that the new province used prevailing provincial tax rates. Data was collected from DIAND as well as the Census.

Courchene noted that some of his results were suspect owing to data deficiencies and he could not make a sales tax estimate. This methodology of projecting patterns from aggregate data, rather than building data sets from the smallest unit up, provides poor estimates. In this regard he was unable to supply a sales tax estimate, noting only that currently many on-reserve Indians purchase the majority of their goods off reserve.

Interestingly, while Courchene used the existing land base of reserves in estimating potential resource revenues, he also assumed that much currently undeveloped land will be developed. Using DIAND data, Courchene estimates that there are three quarter million hectares of land of a quality suitable for agriculture on reserve land. There are 1.3 million hectares of land available for forestry, although this is of lower quality than Canada as a whole. In the late 1980s, the annual harvest of forest products from Indian lands was 623,000 cubic metres. There are one million hectares suitable for supporting wildlife. Approximately 650 of 2267 reserves have potential for mineral production. Roughly \$4 million per year is currently being paid in mineral royalties to Indian bands. Revenues are also earned in the Indian Band funds which are collected by DIAND. \$71 million was earned in the capital account primarily through oil and gas and \$104 million in the revenue account, primarily interest income (Courchene, 1992).

4.2 An Economic Study of Five Indian Communities

In 1991, as part of its Indian Tax Policy Review the Department of Finance conducted tax potential studies of five Indian Communities. To protect data confidentiality, none of these communities are named in the final public report.

This study of five Indian communities was based on their demographic characteristics and income and expenditure patterns. The data were used to illustrate the revenue generating capacity of certain forms of taxation at the First Nation community level. The federal tax system was used as the taxation model with the assumption that all economic activities are subject to tax, all federal credits would be available and no other tax system was in operation.

Information on residents on reserves, excluding those on leased lands, was obtained by survey in each community. Information on residents on leased lands in two communities was obtained through existing



sources. Information on corporations was obtained through community sources.

Tax estimates:

Personal income tax (PIT) receipts for residents on reserves (excluding leased lands) were estimated using a tax calculation model developed by the Department of Finance. The survey instrument mirrored closely the existing income tax form. This model was applied to the data collected in the survey using the age structure of the residents as of December 31, 1991 and their 1991 annual income information. PIT receipts of residents of leased lands was calculated by adjusting 1990 personal income tax data adjusted to reflect the 1991 federal tax system and account for inflation. The average PIT payable for communities was about \$700 per capita;

Sales tax receipts were estimated for residents on reserves, excluding leased lands, using the Provincial GST Base Model developed by the Sales Tax Division of the Department of Finance. Sales were estimated by commodity group. The model determined what share of each expenditure category was taxable and the household surveys determined how much spending occurred in each category for each community. This generated taxable expenditures and possible sales tax receipts for each community. Estimates of sales taxes payable averaged about \$120 per capita for the five communities. More precise estimates of the federal sales taxes collected by on reserve businesses were not made in this study.

The study concluded that there were high leakages from the on-reserve economy and that high rates of unemployment were causing relatively low own source revenue raising potential.

4.3 *Some Economic Impacts of Treaty Settlement in B.C.*

This study was the first attempt to measure comprehensive tax revenues within a First Nation. It was based on a survey of expenditures of 454 Shuswap households, 11 Shuswap governments and 45 Shuswap owned and non-Shuswap owned businesses, all located on-reserve.

This study provided estimates of taxes paid on First Nations land which were not in the Courchene or Department of Finance studies. For example, by extrapolating from business survey results, it was found that \$16.3 million was paid in income and sales tax by the businesses of the Mt. Paul Industrial Park in Kamloops.

In addition to providing improved estimates of tax potential, this research demonstrated the improved revenue projection accuracy associated with community case studies and the reduced response, non-response and interviewer bias associated with community initiated research.

4.4 *Tax Potential of Listigouche, Opaskwiak, Okanagan and White Bear First Nations*

In 1992 the ITAB conducted tax potential estimates in Opaskwiak, Manitoba and Listigouche, Quebec at the request of the Chief and Council of each community. Although the results from these studies can not be reported here, it is interesting to note that the studies focused on all taxes (sales, income, corporate and property) collected in these communities and took about 3 weeks of research. The result was that neither

community submitted a property tax by-law to the ITAB¹⁰.

In 1995 the ITAB developed a property tax revenue potential software product which allowed First Nations to conduct self-evaluations of their property tax potential using market value assessments and average utility assessments per kilometre. It required an average of three hours to enter the data. A report was then printed as soon as data entry was complete outlining revenue potential for the benefit of Chief and Council. The software was used by the Okanagan First Nation in February, 1996 and the Whitebear First Nation in May, 1996. After studying the property tax projections and preliminary estimates of associated service costs, both communities submitted a by-law to the ITAB.

4.5 *Summarizing the Lessons from the Literature*

This brief literature review, and the research of ITAB in particular, points to four First Nation tax revenue estimation lessons.

- 1) Potential sales tax revenues for First Nations are difficult to estimate given the lack and poor quality of data (Courchene, 1992, and Department of Finance, 1993). This observation, and the potential impact of poor data quality on the block transfer component of a First Nation's fiscal relationship with Canada, is made more forcefully in the anecdote below.
- 2) Community initiated and focussed research is more accurate than aggregated approaches (Le Dressay, 1996, Department of Finance, 1993 and ITAB, 1992-1996).
- 3) First Nations must be provided with the tools to conduct revenue projections at their convenience (ITAB, 1992-1996) and,
- 4) Projection tools should focus on revenue sources which are immediately available to the First Nation (ITAB, 1992-1996).

¹⁰

The Opaskwiak Cree submitted a property tax by-law to the ITAB in 1996.

Data Quality

The extent of the data quality problem for First Nation populations is shown in the following table. Statistics Canada and Department of Indian Affairs and Northern Development both made population estimates in 1991 for four communities and substantial differences showed up. Although some deviation is to be expected given the mobility of the populations, the average populations of these four communities for each federal agency are statistically different from each other at a relatively high 93% confidence level (Le Dressay, 1994)

1991 Population Counts for 4 Shuswap Communities

	Bonaparte	North Thompson	Skeetchestn	Canoe Creek
Stats Can	197	246	154	201
DIAND	130	222	128	108

Statistics Canada - Statistics Canada data compiled from series 95-384 of the 1991 census.

DIAND - Department of Indian and Northern Affairs of Canada 1991 on-reserve band membership data

Given this level of discrepancy, establishing a new fiscal relationship for self-government would be difficult. For example, suppose that a block transfer of \$13,500 per capita (Courchene, 1992) was paid to each First Nation government to pay for their government services and public infrastructure. Would the Canoe Creek government receive \$2.7 million or \$1.45 million?

4.6 Software for Estimating First Nations' Own Source Revenues

On the basis of these lessons, Fiscal Realities believes that First Nations, the ITAB, and DIAND would be better served with a community focussed, own source revenue estimation tool which could provide more accurate revenue projections than current methods. Therefore, Fiscal Realities has significantly revised the existing ITAB property tax projection software.

The revised ITAB revenue potential software can now estimate all own source revenues which First Nations have or could have federally recognized authority over, i.e. own source revenues were chosen on the basis of tax powers currently supported by federal legislation or policy. Formulas were based on those used by professionals in the field of revenue projection. The revised ITAB revenue potential software not only allows a preliminary own source revenue potential estimate but also allows First Nations to perform a sensitivity analysis on their potential tax base.

Other features of the software include the use of market value assessments, variable rates, assessment of agricultural, residential, commercial and utility properties, inclusion of own source revenues and inclusion of seven per cent sales taxes.

A stand alone copy of the software is available for the cost of the diskettes and the labels from the Indian Taxation Advisory Board. A more complete description of the software and an alpha tester user's guide are

attached in Appendix C.

To test this software, Fiscal Realities has supplied a preliminary version to the United Anishnaabeg Councils (UAC) in Ontario to use in their assessment of their taxation potential. A copy is also being supplied to the Department of Finance for evaluation.

4.7 A Methodology for Estimating First Nations' Own Source Revenue

This software is the ideal tool for generating a more accurate First Nation own source revenue potential estimate. The approach taken would be as follows:

- 1) Stratify First Nations on the basis of key economic and demographic variables. The stratification will be based on existing literature;
- 2) Select samples from each strata and estimate their revenue potential using the revenue potential software, or have the First Nations estimate their own revenue potential using the software;
- 3) Extrapolate from the samples based on the assumption of representativeness;
- 4) Test the robustness of the representativeness assumption by assessing other First Nations.

A better estimate of First Nation own source revenue potential will have two important benefits in the current policy and legislative environment.

1. It will help First Nation communities assess the costs and benefits of exercising their tax authorities. This could facilitate more First Nation tax systems.
2. Own source revenues will be a component of any new fiscal relationship for First Nations. A process through which more accurate own source revenue estimates can be obtained means better policy.

5 Barriers to Taxation

First Nations need a tax system to meet the cost pressures created by population growth, to help finance self-government and to help supply the additional services required to meet their economic aspirations.¹¹ First Nation tax systems are also in the federal government's interests. Recent population growth suggests that it will require substantial increases in expenditures to simply maintain existing levels of service on reserve, let alone provide for incremental ones. First Nations' tax revenues will not only ease this fiscal pressure, but will make federal financing more politically acceptable.

There are many barriers standing in the way of a viable First Nations tax system. Addressing them will mean changing perceptions and, in some cases, changing current economic realities.

First Nations citizens must be convinced that a tax system is part of the means by which they will share in Canadian prosperity.¹² This will be very difficult. The costs of a tax system are immediately obvious from an individual's perspective - taxes come out of a person's pocket book and this person is immediately aware of what the money could have bought. The benefits of a tax system are public services. They are less immediate, less tangible and often of general, rather than personal benefit. To First Nations citizens who are often near the poverty line, taxation, other than that of third parties, will simply not make sense.

Despite this, many First Nation communities recognize that they need taxation. They need the revenues and autonomy it will provide, if they are to improve the business climate on their lands. They realize that without this they will always lack the autonomy, flexibility, infrastructure and services needed to attract business, and that without business they will remain mired in poverty. The first objective for them is gaining control over more of the taxes that are collected from their lands.

There are many other barriers. Some are specific to taxation - for example, cases where the necessary enabling legislation or collection procedures do not exist. Other barriers stem from larger problems, such as unsettled treaties and/or land claims, disputes over jurisdiction, creating political will outside First Nations or poverty so severe that taxation is not viable. These are presented in Figure 3 as progressive hurdles, categorized as land, political and economic.

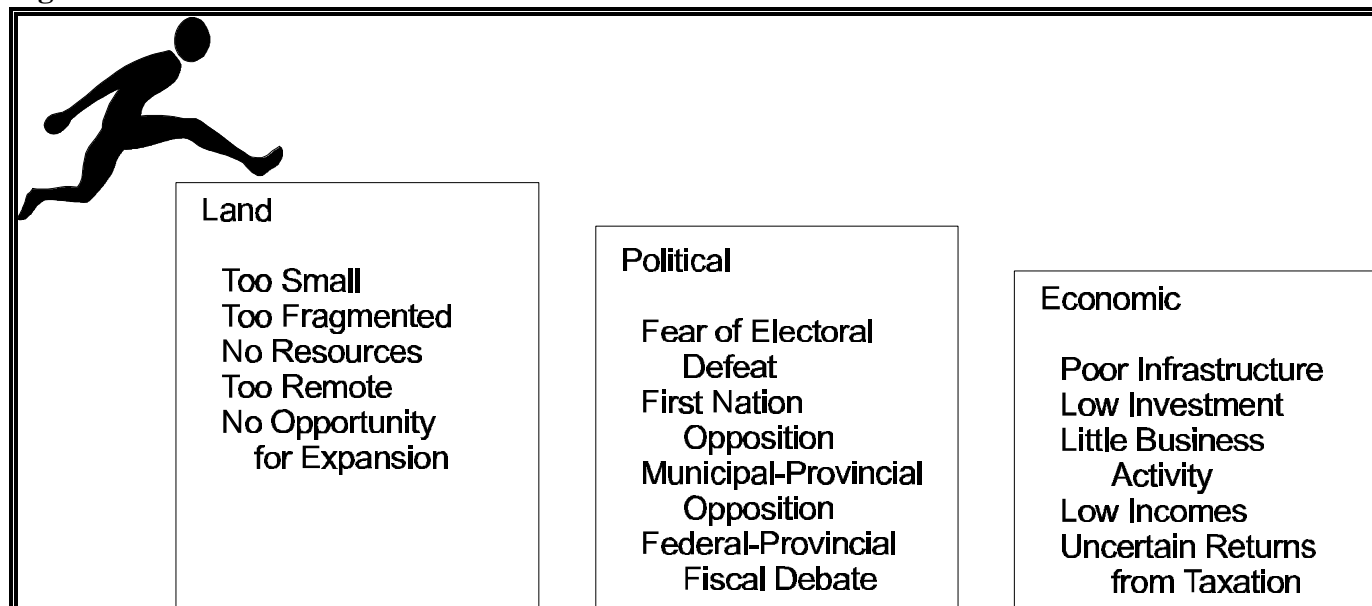
The diagram suggests these barriers are discrete and unrelated. This is not the case. Most barriers are related to one another. For example, while a poor land base is a barrier to taxation in its own right, it is also a cause of low incomes, low investment and reduced business activity on reserve. These barriers are presented as entities in order to focus the analysis and aid in presentation.

The chapter below summarizes each barrier and suggests solutions.

¹¹ According to RCAP, "from 1981 to 1991, overall Canadian population increased by 10.9 per cent, while the on-reserve, registered Indian population grew by 34.0 per cent and the total registered Indian population increased by 58.1 per cent."

¹² While a majority of the survey respondents agreed with the statement, "First Nation tax jurisdiction will help community and economic development", there was evidence of a strong cynicism. For example one respondent declared, "no taxation for any native person, period. Taxation will be the downfall of our people"

Figure 3 - Barriers to First Nation Taxation



5.1 Land Barrier - Access to resources, land base and remoteness.

Many First Nations do not have access to a sufficient tax base. In fact, in many cases, tax receipts would actually be exceeded by collection and compliance costs¹³. The most commonly noted reason for this is a poor land base (First Nations Tax Questionnaire, 1997).

The land base is inadequate because:

- ! it is relatively small. It comprises roughly one half per cent of the Canadian land mass south of the sixtieth parallel. RCAP notes that, by contrast, American Indian reservations comprise three per cent of the lower 48 states despite American Indians representing a much smaller percentage of the population and the generally higher quality of the land in the lower 48 states¹⁴;
- ! only a small percentage of Canadian reserve lands are usable for commercial, residential or recreational uses. Throughout Canadian history, Indian reserves were generally located or often relocated away from the best lands as the settler population expanded (RCAP, 1996). It was a deliberate policy to use land with low agricultural or mineral potential because of the rationale that

¹³ It is likely, of course, that these costs would be absorbed by a federal or provincial tax collection agency.

¹⁴ However, much of the American Indian land base is accounted for by the large reserves for tribes such as the Navajo in the American West. Nonetheless, per capita land allocations and the quality of land are both higher in the United States.

Indian lands would never be properly developed. As a consequence, many reserve lands have little natural resources and are located well away from major population centres. According to RCAP, almost 80 per cent of Indian bands are located more than 50 kilometres from the nearest access centre;

- ! the patchwork nature of reserve lands makes it more difficult to establish infrastructure, do major development projects or establish viable businesses. According to RCAP, 80 per cent of Indian reserves are below 500 hectares in size; and
- ! Reserves are less able than municipalities to expand their land base. This is to some degree correctable, through purchase of *fee simple* lands. However, in order to add this to their tax base, the land would also have to be reconstituted. Furthermore, First Nations' buying power is limited by low incomes and their purchases may be resisted by municipalities concerned about the alienation of their own potential property tax base.

5.1.1 Solution

A major part of the solution is the fair and prompt settlement of outstanding land claims.

5.2 Political Barrier - Fear of Electoral Defeat by First Nations Leaders

First Nation leaders who champion tax systems face an *unnecessarily high* risk of electoral defeat because the policy and legislative context for implementing a tax system is not sufficiently specified. As a result, leaders cannot fully explain the consequences of implementation to their constituency. They cannot assure them that developing own source revenues will not result in substantial reductions in cash transfers or lead to the end of their s.87 exemption.

5.2.1 Solution

One solution would be to clarify a transfer offset formula for First Nations developing new taxes. The federal government could do this through a comprehensive legislated framework or simply establish it as policy. They could also declare some term of moratorium on offsets for any First Nation which introduces a new tax.

5.3 Political Barrier - Taxation Without Representation

There are substantial non-First Nation populations and interests on First Nation territories. These interests will likely grow as modern treaties are implemented. Under any territorial model of taxation, coupled with a First Nations' citizenship model of government, this raises the issue of taxation without representation.

This issue has already arisen with respect to property taxes. Non-First Nation citizens who are resident in

housing projects or commercial establishments located on Indian land cannot vote in the elections of the First Nation government that levies their taxes. This acts as a barrier to investment and a problem which prevents First Nations from more fully exercising jurisdiction over their lands.

Third party interests may also not understand First Nation governments and create political resistance to their tax authority. If they do not understand to whom, and for what, First Nation governments are held accountable, this will increase their apprehension. Such political opposition means First Nations will have more trouble negotiating for tax room from other governments and they will have more trouble attracting investment, especially residential. This will limit their tax base. Many potential residents and businesses may choose not to locate on Indian lands even when there are compelling economic reasons for them to do so.

5.3.1 Solution

There are many partial solutions. Forums for non-First Nations citizens to have their views heard is one often suggested possibility. This is one role currently being provided by the ITAB. The establishment of binding dispute resolution mechanisms may be another.

Of course, these institutions would lack the political power to actually influence the government in question, so to some extent the problem would remain. Another solution is tying First Nations' tax rates to those of the surrounding communities or otherwise limiting First Nation's abilities to arbitrarily change tax rates. This is the solution contained in the ITAB property tax rates policy. Another potential solution is for the provincial and federal governments to operate their tax system for non-First Nations citizens, concurrently with the First Nation by not vacating the tax room. However, this raises the possibility of people receiving services without paying taxes.

5.4 Political Barrier - Philosophical Opposition to Taxation

The First Nation Tax Questionnaire results indicated a substantial philosophical opposition or apprehension towards taxation by First Nation peoples. This is especially pronounced when the tax under consideration is on previously exempt First Nation citizens or enterprises. Many respondents indicated they fear that such taxes will cause an erosion of the federal government's fiduciary responsibility towards Indians. Others feel that taxation is contrary to the traditional way of life.

Apprehension is most pronounced in remote communities. Many of these have a limited economic base and little opportunity to participate in urban centred growth. They will never be able to develop tax systems capable of financing even a small portion of their service costs and so their fear of transfer cuts is very real. Many First Nation citizens also fear that if other First Nations choose to tax their own citizens this will affect the portability of their exemption and will undermine First Nation solidarity around the taxation issue. The survey indicates a general acceptance of taxing non-Aboriginal businesses or non-First Nations persons on First Nations lands.

There is controversy regarding the proper ends of a tax system. Some First Nation citizens do not support using own source revenues to provide services because they believe this will lead to an erosion of federal fiduciary responsibilities. There is greater support for a taxation system if it is explicitly aimed at redistributing wealth within the First Nation.

5.4.1 *Solution*

Philosophical opposition to taxation will only dissipate through the accumulation of success stories, and the dissemination of consistent, accurate and enlightened information on its ability to promote some sharing of wealth. Over time, tax systems will come to be viewed as essential to ensuring the economic development of First Nations.

5.5 *Political Barrier - Political Gridlock*

Gridlock over federal-provincial relations will make it more difficult to gain the cooperation of the federal and provincial governments for creating First Nation tax authorities. Cooperation is necessary because these tax systems will have to be coordinated with both levels of government and in many cases, these governments will be asked to vacate tax room in favour of First Nation governments.

At the root of this problem are the declining federal financial contributions to provincially administered programs, such as social services and health care. There is also a dispute over fiduciary responsibility for status Indians off-reserve.

The provincial position is that the federal government has too much control over the national tax base relative to the programs it actually administers. As a result, they will be very reluctant to give up provincial tax room to First Nations without substantial compensation from the federal government and/or new service agreements regarding responsibilities for First Nation citizens.

The problem has also caused difficulties between municipalities and First Nations. Provincial governments have cut transfers to municipalities and other third parties, partly in response to reduced federal contributions. As a result, municipalities have become much more dependent on their own source revenues, principally property tax. In many situations, this has put them in direct conflict with First Nation communities, which are asserting jurisdiction over property tax on

Provincial Offloading

The federal-provincial dispute over the fiduciary responsibility for *registered* Indians living off-reserve and general reductions in federal transfers has led to provincial “*offloading*” onto First Nations and accompanying administrative problems for the Kamloops Indian Band. The provincial government has begun to refer non-First Nation citizens living on the reserve back to the band when they apply for welfare. The Band must then apply to the federal government for compensation.

This underlines the uncertainty within which the implementation of tax systems and self-government proceeds and the importance of clarifying service responsibilities and tax authorities under any new fiscal arrangement.

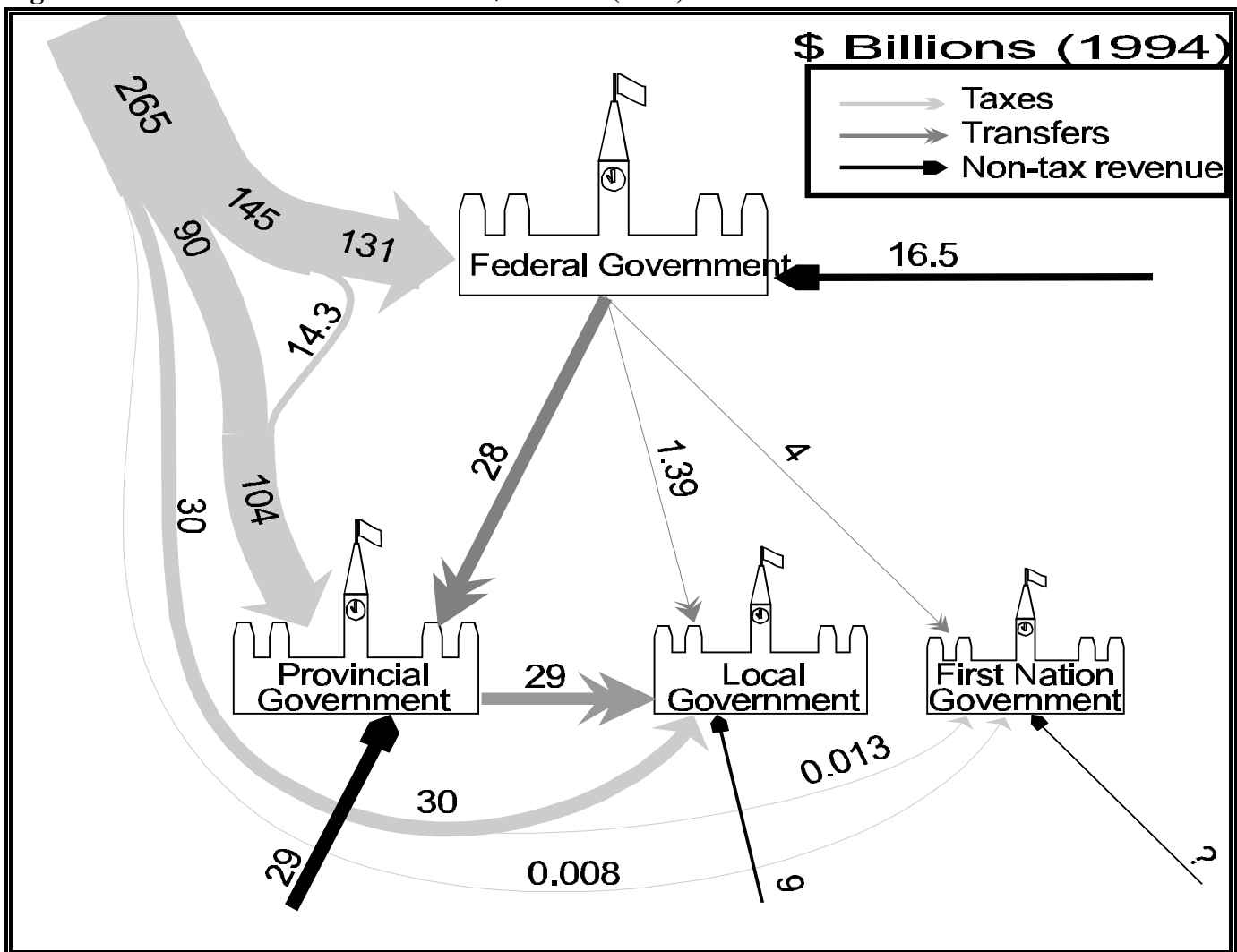
It also points towards a “taxation without service” problem for First Nations. If they are being asked to assume financial responsibility for non-First Nation people, they should also receive the taxes they pay.

their lands. It is clear that both the municipal and First Nation levels of government suffer from a common affliction - not controlling their own revenues and transfer dependency.

5.5.1 Solution

The salient point is that First Nations and municipalities are competing over a very tiny part of total tax receipts. They are in this situation because they are both very dependent on transfers. This is illustrated in Figure 4. The accompanying table also indicates the relative size of the taxes over which some First

Figure 4 - National Fiscal Framework - \$ Billions (1994)



Nations have gained some elements of authority relative to total tax receipts.

1995 Government Receipts - Financial Management System Basis						
Source: Canadian Tax Foundation						
	Consolidated -all Gov't		Federal		Provincial-Local	
	\$ Billions	Per cent	\$ Billions	Per Cent	\$ Billions	Per Cent
Income	122	40	75	55	47	24
Property	33	11	0	0	33	17
General Sales	42	14	21	15	21	11
Fuel	10	3	4	3	6	3
Alcohol & Tobacco	5	2	3	2	2	1
Other	91	30	34	25	57	29
Transfers	N/A		N/A	0	31	16
Total	303	100	137	100	197	100

A longer term solution will await the resolution of federal-provincial disputes over national service standards and the fiscal framework for supporting these. An intermediate step is to make the case with the federal and provincial governments that disputes over responsibility for registered Indians and over tax room are frustrating First Nation ambitions and worsening the problem. Ultimately developing First Nation self-government will improve the fiscal positions of all orders of government.

5.6 Political Barrier - Compliance and Administrative Costs

There is some resistance outside of First Nations to establishing taxation systems for First Nations because these are seen as adding another order of government. People fear that another order of government implies higher taxes, additional coordination problems, new compliance and administration costs and ultimately more bureaucracy.

5.6.1 Solution

The solution lies in First Nations marketing themselves and the advantages of doing business on First Nations land. They must address the perception of higher compliance costs because this is largely a problem of perceptions. First Nation tax systems have been designed with an aim to minimizing compliance costs because it is in everyone's interests to do so.

First Nations have incentives to minimize compliance costs. Higher compliance costs reduce their potential revenues. Higher administrative costs make tax systems less cost effective and make it more likely that a collection agreement can't be worked out.

One means of ensuring this is by developing a negotiated framework within which new taxes can be introduced. This will spell out conditions and reporting requirements and ensure they are harmonized both among First Nations and between First Nations and surrounding communities.

The introduction of First Nations taxes may actually reduce compliance and administrative costs. The tobacco tax agreement under negotiation with the Cowichan and Westbank Indians is instructive. Their new system under negotiation would create the appearance of a single tax with single reporting requirements for retailers, even where they collect two different taxes. Retailers on these reserves would no longer have to separate sales to Status Indians from other sales.

5.7 Political Barrier - Policy Clarity

Provincial policies across Canada surrounding the issues of Indian taxation require more specification, **harmonization** and clarity. At present, they are often non-existent or inconsistent across the country. The net result is confusion for business, which worsens the investment climate. In many cases, First Nation governments are also losing potential revenues.

An example of inconsistencies is the difference in the policies regarding payment of grants-in-lieu. At present, one Ontario Crown Corporation pays grants-in-lieu to Indian governments. Quebec has also agreed that it should pay grants-in-lieu but requires First Nations to first register. British Columbia crown corporations do not pay grants-in-lieu. In the recent Court Decision, Westbank versus the British Columbia Hydro and Power Authority, it was declared “inequitable” that British Columbia Crown Corporations pay grants-in-lieu to municipalities and not First Nations, but not redressable by the court. B.C. Hydro continues not to pay grants-in-lieu to First Nations.

The situation with respect to sales taxes is also confused. New Brunswick had formally offered to collect sales tax on behalf of First Nations. Provincial treatment of the sales tax exemption differs across the country. Status Indians from outside Alberta are effectively denied their exemption on reserves by the requirement that they show an Alberta issued card indicating eligibility. Until recently, Status Indians in Manitoba were denied their exemption and while this policy has been changed, there is a dispute over compensation for the years in which this Constitutional right was denied.

5.7.1 Solution

Provincial governments are reluctant to clarify their positions on Indian taxation. They may wish to first resolve their complaint that the federal government is offloading the costs of providing service to registered Indians. They may fear that an Indian tax authority will seek to occupy tax room presently held by themselves. Finally, they have little to gain politically from delivering Indian taxation, because self-government is seen as more of a federal issue. They may fear political criticism that self-government constitutes a “special deal” for First Nations or will be very costly to taxpayers.

The first step towards a solution is to make clear to all orders of government and taxpayers that providing First Nations with meaningful tax powers will ultimately cost less than not doing so. First Nations need the tax powers to finance true self-government and they need self-government to create economic opportunities for themselves. If provinces resist providing First Nations with the necessary tax room, they will gain very

little in tax receipts. The tax base will generate more revenues if it is collected by a First Nation government than by the provincial government. Furthermore, under this scenario, the provinces will continue to face mounting cost pressures on their services as Indians migrate from reserves.

5.8 Economic Barrier - Low incomes

Average income on First Nations lands is well below the national average. 64.2 per cent of Indian people on reserve had incomes below \$10,000 in 1991, compared to a Canadian average of 34 per cent (RCAP, 1996). This reduces the potential of First Nation sales and income taxes.

Relatively low personal incomes imply even lower potential personal income tax (PIT) receipts, because of the progressive nature of the Canadian tax system. Projected PIT receipts will decline as average incomes decline, but at a faster rate because of the progressive nature of the tax system. Many First Nations have average household incomes so low that little or no PIT would be payable¹⁵. The Department of Finance (1994) found many communities where the average tax payable under an income tax scheme would be negative.

Low incomes would also reduce the potential receipts from sales taxes. Lower incomes obviously reduce purchases and also tend to skew household purchases more towards goods which are exempt from tax, such as food and rent. This should be weighed against the possibility that should First Nations take over federal GST room to establish their own sales tax, much of their population would no longer be eligible for GST rebates, thus reducing their incomes further.

5.8.1 Solution

Until the incomes of First Nation citizens are moved closer to Canadian averages, taxation will be resisted by many First Nation leaders and citizens as simply “taxing poverty”. Until incomes are raised, the potential receipts from a tax system will be low. This points to the necessity of developing First Nation economies both as an end in its own right and as a means of meeting the common interests of the federal government and First Nations. The dilemma is that tax revenues could be part of the solution to low incomes since First Nations require the supplementary services and infrastructure that own source revenues can provide.

However, there are other causes of low incomes which should also be addressed. Low incomes are partly the result of the inadequacies of the Aboriginal land base, the effect of the Indian Act on the costs of doing business, low levels of education, inadequate infrastructure, discrimination against Aboriginal people, a lack of autonomy by Aboriginal communities, barriers to investment (discussed below) and the relative youth of the Aboriginal population.

Other parts of the solution are: (1) improving the land base through modern treaties; (2) prudently investing monies received as part of comprehensive settlements; (3) more autonomy for First Nations so as to improve their responsiveness to business opportunities; and, (4) the development of other revenues such as gaming.

¹⁵ Federal income taxes payable in the under \$10,000 income class, which comprise the majority of Indian households average 3 per cent of assessed income (Courchene, 1992).

Nonetheless, low incomes will remain a problem for the foreseeable future. Improvements in the business climate and responsiveness of public services are long term projects, as is the institution of modern treaties.

Real solutions must come from focusing on the subject of the next two parts to this chapter: the lack of business activity and low levels of investment.

5.9 *Economic Barrier- Lack of Business Activity*

Reserves are characterized by low levels of business activity. This is both a cause and a result of low incomes. However, low incomes do not fully explain reduced business activity. They do not explain the reluctance of non-retail businesses to locate on reserve, since buying power is not an issue. The lack of buying power also does not explain why 80 per cent of expenditures by resident Indians are made off reserve (Le Dressay, 1997).

Low levels of business activity reduce tax receipts of First Nations. Sales and property tax receipts both depend upon this. They reduce the expected revenues of other tax sources such as corporate and personal income taxes as well.

Some explanations have already been discussed - many reserves are located too far from business service centres. Many reserves are also too small to support a retail sector.

However, this problem is too pervasive to accept remoteness or insufficient size as the only explanation. Even reserves located adjacent to municipalities tend to have an under developed business presence. This holds true despite the opportunities locating on reserve offers for making exempt sales.

The real explanation is that uncertainties and increased costs of doing business caused by uncertainty are skewing business location decisions. In fact, these negative distortions are larger than the positive distortions created by exempt sales.

Costs of Doing Business

Both First Nations and developers have to spend significantly more money for commercial projects on First Nation lands than similar projects elsewhere. Whereas the guidelines for developments in municipalities are provided in provincial legislation, no such provisions are contained in the Indian Act. As a result, First Nations have to develop what amounts to separate legislation in order to provide liability protection for the developer. Furthermore, environmental legislation in municipalities is provincial whereas on reserve, it is federal. Developers face higher compliance costs because they are less familiar with the federal legislation. First Nation administrative staff are generally unfamiliar with developing such agreements because of their focus on the Indian Act. The result, according to one estimate (The Sun Rivers Development of the Kamloops Indian Reserve), is that First Nations can spend up to five or six times more on legal, engineering and professional fees than would a municipality for similar developments. Similarly, a developer will spend five or six times more on reserve than off reserve in legal and other professional fees. That such developments are going forward indicates the high rate of return and the potential for much higher investment by reducing these costs.

Identifying and analyzing all the factors at play here would be a research program unto itself. It should be noted, that there is often uncertainty over land title, uncertainty regarding the future of self-government



causing political instability, uncertainty created by s.89 of the Indian Act respecting seizures. Uncertainty has been created regarding access to the business. It is more difficult to obtain regulatory approval or even identify the necessary authority, and there is a greater potential to get involved in jurisdictional disputes among different orders of government,

5.9.1 Solution

Federal-provincial regulatory harmonization may provide some part of the solution. A more focussed approach to attracting businesses and fostering entrepreneurship would also help. However, this would likely require more autonomy for First Nations. If funds were available they could consider establishing “one-stop shopping” business service centres.

Unfortunately, implementing many of the existing tax system models (such as Cowichan and Westbank) could actually hurt the many existing First Nation businesses which depend on exempt sales. This is not the case with the New Brunswick model of sales tax collection.

5.10 Economic Barrier - Under-Investment

Low levels of investment underlie pervasive economic problems such as low incomes, high unemployment and the lack of business activity. Business investment creates jobs, jobs create incomes and incomes generate tax revenues.

From the investor’s point of view, there are many additional difficulties with doing business on First Nation lands. It is difficult to get collateral. Investors base their decisions on available information and as this paper has already noted, statistical information is often of poor quality. Investors may be unfamiliar with First Nation entrepreneurs and leaders. Jurisdictional differences mean new information is required about regulations and procedures. Infrastructure which supports business investment is often beneath the standards of surrounding communities. Finally, there is a pervasive uncertainty regarding the political and business environment which extends all the way down to security over land title.

Poor physical and social infrastructure contributes to low business investment. Sound public infrastructure often increases the return on private investments. For example, a sound transportation and communications infrastructure will reduce the costs of shipping and inventory. This, in turn, makes businesses where these factors are important more profitable. Hence, the infrastructure attracts investment. Social infrastructure can improve the quality of life in an area, which acts as an inducement to finding qualified workers. This will also attract investment. Unfortunately, the present state of infrastructure on Indian lands is far below Canadian standards.

Land title uncertainty characterizes much First Nation land, however the problem is most acute in British Columbia because of the absence of treaties. This has created uncertainty regarding the demarcation between Aboriginal title to the land and Crown title. The Government of British Columbia estimates that this uncertainty has stalled \$1 billion in investments in its forestry and mining sectors alone (Government of British Columbia, 1996).

Legislative restrictions limit investment. The inability to conduct seizures on Indian lands or against Indian

property makes it more difficult to use the lending market. However, financial institutions and bands have come up with creative arrangements to address this problem. For example, under s.58(3) of the Indian Act, the Minister may lease certificate of possession land on behalf of individuals without the land being designated. The terms and covenants of such a lease may then be used for security.

Uncertainty is created by the differences in the legal context and business practices. As has already been noted, legal costs of establishing a business are generally higher on First Nation lands. Many business people find it more difficult to do business on First Nation lands - cultural differences make it more costly to establish trust and identify contacts. This “intangible” cost is likely the most significant of all, because it results in lost opportunities. Its net effect on business defies quantification but an estimate of its effects on the costs of information collection is available (Le Dressay, 1994).

Political uncertainty limits investment. Simply put, investors are afraid of political unrest or factionalism within the Indian community. It raises the possibility they could be denied access to their businesses or become subject to very different business conditions. Political uncertainty can be specific to a First Nation community, yet there is also a general uncertainty regarding the ultimate authority of First Nation governments within the Confederation. Investors are uncertain about what powers or form self-government will take. They may be afraid that self-government will result in First Nation lands being characterized by poor services and punitive taxation. They may suspect that reductions in federal transfers will lead to sub-standard services. They do not know what compliance costs may be created by new tax systems or whether self-government will precipitate disputes with surrounding jurisdictions.

Residential investment may be stalled because potential buyers may have a general perception that First Nation governments are not sufficiently accountable or will not provide adequate services to non-citizens.

5.10.1 Solution

Reducing uncertainty on reserves will reduce the costs of doing business on reserve. This will increase the value of the tax base and make taxation more viable.

Uncertainty created by excessive political factionism within a First Nation community will always be a problem, as it is for any jurisdiction. It will be reduced over time, as political factions come to recognize its impact on, and the importance of, their investment climate. Political uncertainty can also be reduced through the involvement of First Nation organizations in the policy which affects their economy¹⁶. Uncertainty about land title and the implications of land claims and new treaties can only be resolved by their prompt settlement.

Uncertainty is created because while it is generally accepted that self-government will happen, no blue print or time line has been laid out. For example, it is not clear what tax powers First Nations will eventually have recognized, what the scope of their borrowing authority will be, how their reporting requirements will be constructed, what the scope of self-government will be, or how third party interests will be represented. This uncertainty can be reduced by sketching out the fiscal framework for self-government with these questions in mind.

¹⁶For example, they must be involved in determining the fiscal underpinnings of self-government.

Improvements in First Nation social and physical infrastructure will improve their investment climate. However, this will be difficult unless there is either a significant injection of new transfer funds or First Nations gain access to new funds such as tax revenues or settlement monies. Another option would be a tax credit for First Nation improvement bonds, similar to municipal bonds in the United States. However, this would require significant legislative change including changes in the restriction on band borrowing.

Reducing pervasive uncertainty ultimately requires a strong legacy of successful business dealings between First Nation communities and investors. This is the only way that the necessary familiarity will be developed. At present, many investors are reluctant to even consider First Nations. First Nations can help by marketing themselves, much as municipalities and regions currently do. Such a marketing effort would be greatly enhanced by aiming it explicitly at commonly held fallacies concerning doing business on First Nation lands.

An investment tax credit scheme would act as an additional inducement for investors to consider First Nations as investment sites and thus help generate familiarity. Such a tax credit should not be justified on the basis of low incomes on First Nation lands, but rather out of recognition that they are characterized by pervasive *market failure* - namely higher risk, higher information costs and little opportunity to develop trust. The lack of familiarity and trust is actually preventing what would otherwise be profitable investments. The aim of a tax credit scheme would be to provide some compensation for taking on risk and thereby encourage investors to give First Nations a hard second look.

Legislation providing some conformity in the administration of First Nations tax systems and spelling out the powers they could assume and the conditions which would be attached to those powers would provide investors with some certainty within which to plan.

The establishment of tribunals for hearing third party issues with respect to First Nation tax issues would also provide investors with some reassurance.

Federal-provincial regulatory harmonization will help by reducing jurisdictional differences between First Nations and surrounding territories.

Lastly, measures providing First Nations with more *fiscal autonomy* would make them better able to respond to the specific needs of potential investors. Again, the importance of this measure is growing as technology increases the importance of specialization in the economy.

5.11 Economic Barrier - Distortions from Sales Tax

Many First Nation businesses do a significant amount of business in exempt sales. The introduction of a sales tax system will hurt the viability of these businesses.

There are also political implications when status Indians from other reserves make purchases on a reserve which has imposed a First Nations tax. In essence, these persons will have lost some of the portability of their exemption because s.87 will no longer apply on that tax. While this may be legal, from a First Nation citizen's perspective, it means they have lost some of the portability of their exemption without their consent. This could cause widespread political opposition to First Nation taxation within the Indian

community.

5.11.1 Solution

The loss of business from exempt sales could further depress business, where businesses are already sparsely located. The relative under representation of businesses on First Nation lands also suggests that the size of the economic distortion caused by exempt sales is significantly smaller than those which work against the establishment of businesses on reserve. In any event, the establishment of First Nation tax regimes will effectively remove the distortion if they take over sales tax room created by the exemption. The revenues, this creates will also create greater fiscal means for First Nations to support business development. However, the larger distortion will remain and its effects will grow more pronounced. Investment tax credits and venture capital funds could help attract new businesses to First Nation lands.

5.12 Conclusions

First Nations taxation is in the interests of First Nations because it provides them with the financial means for self-government. It is in the fiscal interests of both the federal and provincial governments. It will alleviate the social costs on reserve by providing economic opportunity, it will help alleviate the migration from reserve onto provincial services.

This section has identified many barriers to taxation. They have been categorized as land, political and economic barriers. There are many dimensions to all of these. For example, political barriers exist both within and outside First Nations. Economic barriers are characterized by under development, which is the result of many inter-related factors. Under development is simultaneously a barrier to instituting taxation and a result of the lack of tax systems.

Because of their inter-relationships, it will be difficult to make much headway on these barriers if they are approached individually. Yet, seen as a whole, they can appear insurmountable. The key to a successful strategy is to identify the common underpinnings which underlie them. This report has found one such underpinning to be the pervasive uncertainty surrounding First Nation governments and lands. This uncertainty is slowing economic development and contributing to political instability. It stands to reason that any strategy for creating a successful tax system for First Nations must reduce this uncertainty.

The next chapter proposes such a strategy and packages the solutions suggested here into a series of policy and research options.

6. Policy Options and Associated Research

The present system of supporting First Nation governments is under stress. It is placing increasing demands on the Canadian taxpayer and it is not meeting the aspirations of First Nation citizens. Demographic pressures are driving up the expenditures necessary to merely maintain present service levels. Declining federal deficits may provide some funds to address these declines, however First Nations will have to compete for this financing against other powerful constituencies. In light of this, it is unlikely that federal contributions will be able to maintain present service levels. Federal funding will certainly not be sufficient to support the demands for self-government or provide for substantive improvements in quality of life.

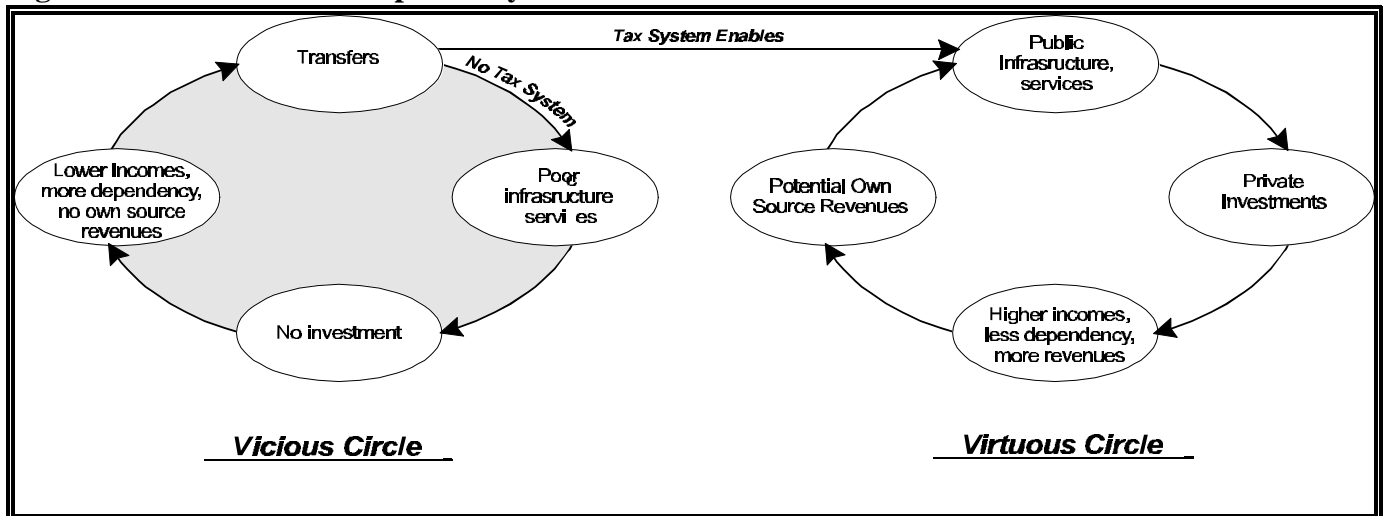
It is in the interests of all Canadians to fix this system. First Nations aspire to the standard of living that other Canadians enjoy. Other Canadians are facing increased contributions to First Nation governments and greater pressure on their service costs as populations move from reserve.

The solution is developing greater self-sufficiency on reserves through economic growth and taxation. This will slow the out-migration from reserves, improve the standard of living on reserves, thereby reducing the social costs of poverty and provide greater fiscal autonomy for First Nation governments.

This paper has argued that taxation, and the economic autonomy it creates, will help First Nations achieve economic growth. Previous studies have agreed with this conclusion (Connell and Klatt, 1992). However, this is not sufficient. Neither a viable tax system nor economic growth are possible without a strategy for reducing the pervasive uncertainty which is stifling investment on First Nation lands. The role of taxation in creating economic growth is illustrated in Figure 5.

The condition of most First Nations is characterized by the circle on the left. Their governments have little own source revenues and, as a consequence, little autonomy. This condition means they do not have the

Figure 5 - The Path from Dependency to Wealth Creation



flexibility needed to respond to potential investors, and are unable to provide the public investments which

attract private investment. Their communities are characterized by low rates of business activity, low investment, high unemployment, low incomes, little entrepreneurship, and low own source revenues. This is labelled the vicious circle of transfer dependency.

The circle at the right illustrates a healthy, wealth creating economy. It is characterized by strong own source revenues and a high degree of autonomy. It is able to provide public investments and respond to private investors. As a result, private investment is strong and the business sector is well developed. The strong business sector delivers high incomes, low unemployment and ultimately strong tax receipts. The tax receipts allow it to perpetuate the circle by maintaining autonomy and making further public investments. This is the virtuous circle of wealth creation.

The key to moving from the vicious circle to the virtuous circle is creating tax revenues. Tax revenues create autonomy and investments which start the wealth creation process. This paper has identified many barriers to developing such a tax system. It has also discussed possible solutions to each. However, there are many barriers and many possible solutions. Many barriers are clearly inter-related. And there is also a dilemma in that low states of economic development are themselves a barrier to establishing a tax system.

A strategy is needed which addresses this dilemma, and which organizes solutions in order of priority. This is provided by the observation that one condition underlies both political and economic barriers - pervasive uncertainty. This same condition is simultaneously a barrier to developing a tax system and a cause of under development in its own right. Properly specifying a new fiscal relationship between First Nations and the federal government is the single most effective means of addressing this uncertainty.

Fiscal Realities has identified three options for proceeding with the development of a First Nation tax system: (1) Status Quo; (2) New Fiscal Relationship; (3) Broad Based Policy initiatives. These options and associated research are summarized in the following table:

Summary of Policy Options

6.1 Option 1 - Status Quo

	Associated Research	Costs and Benefits
Option 1 Status Quo	<ul style="list-style-type: none"> ▸ Tax Data Pilot Projects ▸ Taxation without Representation ▸ Accountability and Reporting Requirements 	<ul style="list-style-type: none"> ▸ Maintains integrity of national tax system ▸ Slow Process ▸ Maximum control over costs
Option 2 New Fiscal Relation	<ul style="list-style-type: none"> ▸ All of Option 1 Plus ▸ Criteria for New Fiscal Relations ▸ Impact on National Fiscal Framework ▸ Resistance to First Nations' Tax Authority ▸ Indigenous People's Tax Systems ▸ Taxation without Service 	<ul style="list-style-type: none"> ▸ Reduces uncertainty ▸ Ensures consistency ▸ Reduces implementation costs ▸ Faster Process ▸ Higher Tax Receipts ▸ Risk Political Criticism
Option 3 Broadbased Initiatives	<ul style="list-style-type: none"> ▸ All of Option 2 Plus ▸ Investment Tax Credits ▸ Use of Property Tax Policy ▸ Barriers to Doing Business on First Nations' Land ▸ Infrastructure Assessment ▸ Best Policy Practices 	<ul style="list-style-type: none"> ▸ Fastest Process ▸ Most Expensive Process ▸ Highest Tax Receipts ▸ Highest Risk of Criticism

Work towards a First Nation tax system should follow the same process as it has to date. First Nations will lobby for each tax authority they wish to assume to either the federal or provincial governments. These governments would consider this, and if they accept, would then set the conditions for assuming this authority.

6.1.1 Supporting Research

The existing process by which First Nations assume a tax authority could be made more efficient with the following research projects.

6.1.1.1 Tax Data Pilot Projects

Statistical information regarding First Nations is not good. Good policy depends on good statistics. Unfortunately, this study has shown that even basic statistics such as population have been found to be suspect.

At present, First Nation governments do not have good mechanisms for estimating the revenue potential of the different taxes potentially available to them. Other governments often do not have the means of estimating the effects of a transfer of authority or calculating the total taxes paid by First Nation citizens. In some jurisdictions, there are problems calculating the amount of sales tax paid by registered Indians on reserve for certain products.

This pilot project would build on the techniques described in Chapter 4 to develop better tax statistics and reduce the costs of collecting data by working directly with First Nations. This pilot project should be established with a First Nation community which will be collecting sales taxes in BC or New Brunswick. The aim of the pilot project should be to develop a harmonized and efficient tax data collection system.

6.1.1.2 *Taxation without Representation*

This study would assess the issue of taxation without representation under First Nation tax authorities. It would identify where this could be an issue, under which tax authorities it would be a problem, its impact on investment, and possible solutions. Solutions investigated would include putting limitations on the power, comfort clauses such as linking assessments to surrounding jurisdictions, or the formation of “representative” councils.

6.1.1.3 *Accountability and Reporting Requirements*

This study will investigate practices from other jurisdictions, assess their applicability within the First Nation context and make recommendations. It should also investigate best practices used by other governments in debt and asset management.

6.1.2 *Costs and Benefits of Option 1*

Option 1 maintains the greatest fiscal flexibility for the federal government. It also allows it to closely scrutinize the transfer of every tax authority to every First Nation government and ensure each such tax is properly coordinated with other jurisdictions. This approach minimizes the risk of a new tax creating economic distortions or mis-use of the new funds.

The problem is that this approach is slow. It will not allow First Nations to develop tax revenues in time to respond to demographically driven cost pressures, nor to provide the additional services required for self-government. As already noted, the currently recognized tax authorities are insufficient. This approach also does not provide greater financial certainty for First Nations. It does not address the pervasive uncertainty limiting investment on Indian lands. It sheds no light on the effects of tax revenues on transfer entitlements, nor what the fiscal framework between the federal government and First Nations will look like.

The political uncertainties created by Option 1 could be reduced if the Minister of Finance declared a moratorium on offsets against First Nation tax revenues. Such a moratorium would likely have very little effect on the federal government’s fiscal position over the short term.

6.1.3 *Sample Outputs of Option 1*

- ! new forums for hearing 3rd party concerns with respect to First Nation taxation.
- ! development of software which integrates accounting and data compilation. This would reduce administration costs and provide better reporting of tax receipts at both the band and commodity levels.

6.2 Option 2 - Develop a new Fiscal Relationship

A new fiscal relationship must have objectives beyond meeting expenditure targets set by the federal government. If it is to have the fullest positive impact, it must also: pre-specify tax powers potentially available to First Nations and the conditions which would apply to assuming these; specify transfer and offset formulas for First Nations choosing to tax; specify other aspects of the fiscal relationship; provide incentives for taxation; and, improve the business climate.

If done correctly, a new fiscal relationship would: reduce political uncertainty for First Nation leaders; reduce the costs of negotiating the transfer of tax authority; and reduce the uncertainty associated with doing business on reserve.

6.2.1 New Fiscal Relationships - Criteria for Enabling Legislation

There are many advantages of a new fiscal relationship: (1) it could help First Nation leaders address the political barriers to taxation created by uncertainty regarding transfer offsets; (2) it could reduce the costs of doing business on reserve; (3) it could ensure that substantial inconsistencies or inequities don't develop among First Nations or between First Nations and other governments; and, (4) it could create more revenue certainty and thereby promote long term thinking and planning by First Nations.

A fiscal relationship must have an implementation strategy to realize these advantages. This could be facilitated, in part, through the development of enabling legislation. Such legislation would make available new tax powers, new transfer arrangements and accompanying conditions to First Nations wishing to develop tax regimes.

The advantages of this approach are as follows. The legislation would assure First Nations that the decision to tax, and the pace with which to introduce taxes is their decision. It would allow them to make that decision with a more complete understanding of the political and economic consequences. For the federal government, such legislation would create greater political acceptance by First Nations. They would not be seen as simply imposing taxation by threatening transfer reductions.

Enabling legislation should meet the following criteria. It must:

- ! clearly address First Nations concerns that developing own source revenues will lead to the erosion of the federal fiduciary responsibility for Indians.
- ! specify offsets and ensure incentives to generate own source revenues.
- ! not penalize Indian bands who will be unable to raise significant revenues;

- ! provide increased political and economic autonomy for First Nation governments that create new taxation regimes. Fewer conditions should be attached to transfers and accountability provisions should be no more onerous than for other governments; and,
- ! provide certainty of funding over the long term;

It should:

- ! minimize the negotiation costs of assuming a tax authority, provide adequate tax powers, and pre-specify conditions of harmonization;
- ! specify support to First Nation governments in setting up tax administrations; and,
- ! provide investors, third parties and other governments with a clear understanding of the eventual limits of First Nation tax authorities. It should assure them that First Nation taxation implies no increase in their tax burden or compliance costs.

6.2.2 *Supporting Research*

Research in support of new fiscal relationships would include all the research identified in support of Option 1. However, the topic is sufficiently complex that it would clearly benefit from a more detailed examination and analysis. This analysis would explore the interests of both First Nations and the federal government. The best approach would be to publicly commit to develop new fiscal relations in conjunction with First Nation taxation organizations and other tax authorities. This would ensure that all parties' interests are fully explored and would ultimately make new legislation more politically saleable. Indian tax organizations include the Indian Taxation Advisory Board, the Federation of Saskatchewan Indian Nations Tax Commission, the Assembly of First Nations, and the First Nations Tax Administrators Institute.

This research would explore the potential of different legislative options to provide greater political certainty for First Nation leaders, provide them with incentives to develop tax revenues, promote the economic union and enhance the investment climate on Indian reserves, and provide First Nations with the tools to support economic development. The implicit constraints placed on these options would be minimizing the costs to other levels of government, maintaining the integrity of the national fiscal framework, maintaining equity of treatment among First Nations and with other jurisdictions, and ensuring efficient service delivery.

Specific research projects should include the following:

6.2.2.1 *Impact on the National Fiscal Framework*

This would assess the impact of different transfer formula/tax power scenarios for a new fiscal relationship. It would estimate impacts on First Nation revenues and on both the federal and provincial fiscal positions by assessing their impact on tax receipts, transfer entitlements and service costs.

6.2.2.2 *Resistance to First Nations Tax Authorities*

The study would identify issues raised by third parties against the development of Aboriginal taxation. It would characterize public perceptions, identify specific concerns and evaluate them. Possible avenues of investigation include: the perception that Aboriginal taxes mean new and additional taxation of non-Aboriginal people; the impact on third party interests; the potential for increased compliance costs; the perception that such a tax system will convey an unfair advantage to First Nation businesses; and, the perception that First Nation taxation will increase the cost and complexity of government.

The aim of the study is to better understand these concerns in order to address them. This study could serve as a tool for First Nation leaders and other champions of First Nation taxation as they seek to build a broader constituency in support of this objective. The federal government could use this to develop a communications strategy for new fiscal relationships and to ensure that any legislation addresses the interests of all parties.

6.2.2.3 *Indigenous People's Tax Systems*

This study would focus on international precedents for indigenous people's taxation systems and fiscal relations, such as the Maori in New Zealand. It would assess the commonalities between situations in other countries and Canada, describe the historical evolution of institutions for their indigenous people, assess their fiscal and political impact, their impact on economic and social outcomes, lessons learned and the applicability of these models in the Canadian context.

6.2.2.4 *Taxation Without Service*

First Nations citizens living on, but working off reserve pay income and other taxes to provincial governments. However, provincial governments are not responsible for providing these citizens services such as health care and education¹⁷. As a result, these people are essentially paying for services rendered to others and which are not provided for them.

This study will estimate the incidence and magnitude of taxation without service and make recommendations, such as transferring tax authority, which might correct this situation. The ultimate aim is to enhance the integrity of the national tax system by promoting *fiscal equivalence* ie. a correspondence between taxes paid and services received.

6.2.2.5 *Criteria of a New Fiscal Relationship*

This project would involve consulting First Nations and summarizing their criteria and principles for a new fiscal relationship. Research could be conducted through a forum, individual interviews, a poll or a questionnaire sent to a representative sample.

¹⁷ In fact, in British Columbia, non-Aboriginal people living on reserve and paying all provincial taxes have recently been denied provincial social assistance.

6.2.3 *Costs and Benefits of Option 2*

Option 2 could contribute to a substantial reduction in uncertainty, if it is conducted in close consultation with First Nation organizations. If it is not implemented with the necessary consultation and analysis, a great opportunity to enhance the investment climate of reserves will be lost. It could even generate political opposition and create more unrest.

This approach calls for more resources and time up front, than Option One. If it is done correctly, these resources will behave like a sound investment that yields downstream benefits. The business climate on First Nation lands will have been improved, taxation will be both more viable and more politically saleable and the costs of negotiating the recognition and coordination of tax authorities will be much reduced. Secondary benefits are that it would speed the implementation of First Nation tax systems and the time required to generate significant revenues. It would be seen as delivering on an important component of self-government. It would reduce the costs of negotiating and implementing First Nation taxation and could serve as a means of unravelling disputes among federal, provincial and First Nation governments concerning services rendered versus taxes collected. Lastly, by offering a uniform framework, this approach would ensure that First Nations are treated equally, the economic union is best maintained and investors are better able to understand the rules on First Nation lands.

6.2.4 *Sample Outputs of Option 2*

- ! a “cost of doing business on First Nation lands” study. This would provide a blue print for determining how to organize administrative responsibilities, accountability provisions and construct tax authorities and transfer authorities so as to create economic opportunity on reserves. The aim would be to construct a fiscal relationship which provides long term certainty, promotes harmony with other jurisdictions, creates the means and ability to do long term capital projects and greatly improves the ability of First Nation governments to respond to the needs of investors.
- ! The development of a successful new transfer formula for those First Nations which choose to implement taxation. If properly researched, this formula would account for tax effort, own-source revenues, differences in circumstances and cost structures, and the needs of the investment community. Accounting for these factors will help ensure the formula’s acceptance.
- ! successful enabling legislation which would specify those First Nation tax authorities that the federal government would recognize. Such legislation could also specify accompanying conditions and administrative responsibilities, streamline the procedures for assuming such authority and contain comfort clauses for 3rd parties and the investment community.
- ! creation of a framework for concluding service agreements.

6.3 *Option 3: A Broad based Approach: New Fiscal Relationship with Economic Development Initiatives*

This option incorporates all of Option 2 but would add some additional elements. These are summarized below.

6.3.1 Investment Tax Credits

Investment tax credits (ITCs) could help address investor uncertainties which are currently inhibiting otherwise profitable investments. ITCs encourage investment by compensating investors for taking on higher perceived risk. The ITC corrects a market failure. With an ITC in place, more investors would invest on First Nation lands or even be willing to consider First Nation sites for investment. It is likely that, over time, investors would grow more familiar with and trusting towards First Nations as a result. At the same time, First Nations would become more familiar with the needs and interests of investors and would develop sophistication in their business dealings with them.

The net result is that many business deals which currently do not proceed, because of a lack of information or trust regarding the other party's interests, would proceed. And this would, in turn, help develop the economy of the First Nation community and its potential tax base.

6.3.2 First Nation Sponsored Venture Capital Funds

The aim is to address the difficulties First Nation businesses and entrepreneurs have in accessing venture capital. All Canadians would be eligible to invest and receive an income tax deduction. These would be structured similarly to labour sponsored venture capital pools. The funds would have to make capital available to First Nation businesses.

6.3.3 Supporting Research

6.3.3.1 Investment Tax Credits - A Study of the U.S. Experience and its Application to Canadian Circumstance

The 1997 Department of Finance Budget Plan contained references to possible investment tax incentives for First Nations. This research would focus on the experience in the U.S. where such incentives have been in place since 1994. It could also review the possible impacts of Canadian First Nation investment tax credit proposals made to date. Specifically, it will investigate whether these could be structured so as to speed the development of investor familiarity with and confidence in First Nation institutions.

6.3.3.2 How First Nations Use Property Tax Policies to Encourage Investment

Among the 58 First Nation property tax systems, some have used their tax authority to promote investment. This research would develop a case study analysis of these policies and would discuss their impact on economic development within the First Nation and on the surrounding non-First Nation jurisdictions.

6.3.3.3 Barriers to Doing Business on First Nation Lands

This study would identify and analyze factors preventing investment and business location on First Nation lands. It would assess investor perceptions, and the legal and other costs entailed in establishing businesses, based on case studies. It would identify both real cost barriers and fallacious beliefs.

The aim of the research is to identify a strategy by which the federal government and First Nation

governments can address market failures specific to First Nation lands and thereby attract more businesses and develop their tax base.

6.3.3.4 *Infrastructure Assessment*

This study will assess the current physical, social and administrative infrastructure within First Nation communities and compare it against benchmarks as to what is needed. This would serve both as a guide for First Nation governments in making investments and for the federal government for promoting economic development on First Nation lands.

6.3.3.5 *Best Practices - Policy Tools*

This project would identify “success stories” of First Nations, indigenous peoples and small communities, and identify the policies that made the difference. It would then map these results into a First Nation context and assess their applicability. It would identify those policy tools that the First Nation community must hold in order to ensure success.

6.3.3.6 *Cost and Benefits of Option 3*

Option 3 is more expensive than Option 2, and runs the risk of creating political opposition because First Nations are being given “special treatment”. The additional initiatives would help develop the First Nation tax base more quickly and provide greater incentives to tax for First Nations caught in poverty. It will be seen as “delivering” on RCAP.

6.3.4 *Sample Outputs of Option 3*

- ! an infrastructure program for First Nations.
- ! Investment Tax Credit for investments on First Nation lands.
- ! executive management programs aimed at First Nation administrators.

6.4 *Conclusion*

The approach taken to new initiatives is nearly as important as the research itself. Given the long legacy of mistrust by First Nations and the volume of information which must be communicated to ensure the success of a new relationship, a partnership model is strongly advised.

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Glossary

designated lands - a tract of land or any other interest therein the legal title to which remains invested in Her Majesty and in which the band for whose use and benefit it was set apart as a reserve has, otherwise than absolutely, released or surrendered its rights or interests, whether before or after the coming into force of this definition.

exemption - the legislated exclusion from a tax of a household, firm or legislatively defined group of households or firms

fee-simple - a fee simple title is an estate of virtually infinite duration conveyed or granted absolutely to a person and his heirs indefinitely. Strictly speaking the holder of the estate is known as the tenant in fee simple . . . (technically a tenant of the Crown)

fiscal autonomy - the ability of a government to spend its funds without conditions imposed by other governments

fiscal framework - the sum of fiscal relationships among governments

fiscal relationship - the combination of: transfers (including equalization); own source revenues; coordination of taxes; and service responsibilities that characterize the relationship between two orders of government

grants-in-lieu - grants paid by one order of government to another in lieu of the property tax for which they would be liable, if they were not exempted.

harmonization - the process through which two or more governments achieve consistency in their rules and regulations. In this document, harmonization primarily refers to rules and regulations surrounding taxation.

market failure - situations where market forces do not allocate resources towards their highest valued use

offloading - the utilization of the fiscal framework to shift financial responsibilities for services from one order of government to another

portability - the ability to transfer the Section 87 tax exemption from one reserve to another throughout Canada

registered - registered as an Indian in the Indian Register

reserve - a tract of land, the legal title to which is vested in Her Majesty, that has been set apart by Her Majesty for the use and benefit of a band.

surrendered lands - means a reserve or part of a reserve or any interest therein, the legal title to which remains vested in Her Majesty, that has been released or surrendered by the band for whose use and benefit it was set apart.

tax authority - refers to authority to collect a given tax, authority can be delegated to a government by the government having jurisdiction

tax jurisdiction - refers to the level of government which has the legislative jurisdiction over a given tax

**APPENDIX A - PROVINCIAL GOVERNMENT and FIRST NATION ORGANIZATION
TAX POLICY CONTACTS**

Note: These tend to be sales and property tax contacts because these are the powers currently federally recognized.

Provincial Governments - Indian Tax Policy Contacts

British Columbia	Taxpayer Services (604) 660-4515
Alberta	Tax Information Services (403) 427-3044
Saskatchewan	Taxpayer Services (306) 787-6645
Manitoba	Taxation Division (204) 945-6444 (fuel and tobacco) & 945-5603 (sales)
Ontario	Taxpayer Services Branch (905) 432-3332 Sales & (905) 433-6316 (fuel)
Quebec	Revenue Quebec (418) 659-6500
New Brunswick	Consumer Tax Division (506) 453-2404 (sales) & Fuel, Tobacco and Amusement Division (506) 453-2255
Nova Scotia	Tax Information Section (902) 424-6708 (sales) & Department of Finance (902) 424-6714 (fuel and tobacco)
Prince Edward Island	Revenue Division (902) 368-4070
Newfoundland	Tax Administration Branch (709) 729-3831

First Nation Organizations - Tax Policy Contacts

Organization	Contact	Phone Number
Indian Taxation Advisory Board	Ken Scopick Brent Moreau	(250) 828-9857 (613) 954-9769
FSIN Tax Commission	Blaine Favel	(306) 665-1215
Assembly of First Nations		(613) 241-6789
First Nation Tax Administrator's Institute	Larry Fast	(604) 263-3261

APPENDIX B –THE FIRST NATION TAXATION QUESTIONNAIRE

This appendix contains:

- B1. A statistical summary of the FN Tax Questionnaire results
- B2. A summary of the Survey methodology and possible biases
- B3. The French and English versions of the letter sent to respondents and the French and English versions of the First Nation Taxation Questionnaire and
- B4. A summary of the data for all respondents and by region

B1 First Nation Taxation Questionnaire Statistical Summary

First Nation own source revenues

1. Significant property tax by-law development potential may exist in Eastern, Central and Atlantic Canada. Five of the 20 respondents reported that they currently collect property tax (25%). Three of the five property tax collecting First Nations reported their location as West. Fourteen of the fifteen non-property tax collecting respondents suggested that their communities would be interested in collecting property taxes. Ten of these were from Central, Eastern or Atlantic Canada.
2. All respondents (100%) reported tobacco tax retail sales in their communities. Given the recent passage of Bill C-93, it is possible that more First Nations could establish tobacco sales tax systems. Furthermore, 85% of the respondents reported on reserve retail fuel sales, and 45% reported on reserve retail alcohol sales. First Nations may have the revenue potential to justify more First Nation sales tax authority.

The Philosophy of Taxation

3. There is substantial agreement among respondents that taxation is a fundamental power of government. This question had the highest level of agreement among the respondents.
4. A barrier to more First Nations asserting taxation jurisdiction is the fear of unfair transfer offset provisions. There was a higher average disagreement with taxation as a mechanism to pay for government services than as a method to redistribute wealth at the 5% level of significance among the survey respondents.
5. There was stronger support for territorial based taxation jurisdiction than for citizenship based taxation jurisdiction. There was higher average agreement with territorial jurisdiction than citizenship jurisdiction at the 5% level of significance among the survey respondents.
6. There was substantial agreement with the statement “Each First Nation community should decide if it would like to raise revenue form its citizens”. This statement had the second highest average level of agreement among respondents.
7. There was relative disagreement with the statement “First Nation citizens should be immune from



taxation by other governments”. This statement had the second highest average level of disagreement among respondents.

B2 Survey Methodology

Survey Overview

English Surveys	French Surveys	Date Sent	Date last one received
30	3	Feb. 15-27	April 15

Respondent Summary

Surveys sent	Not applicable surveys	Net potential respondents	Actual respondents	Response Rate
33	3	30	20	67%

Regional Summary

	B.C.	Alta	Sask	Man.	Ont.	Que.	Atlantic	North
Surveys sent	6	5	3	4	4	6	3	2

For confidentiality reasons the number of respondents by region will not be reported.

Respondent Selection Criteria (in order of importance)

1. Regional representation
2. Representative of leaders of First Nation communities or organizations
3. Attendance at ITAB workshops in past
4. Expressed interest (positive or negative) in work of ITAB in past
5. Four voting members of ITAB

The purpose of these selection criteria was to minimize response and interviewer bias. The representativeness of the resultant sample is discussed below.

Information Collection Biases

There are three principle types of biases in information collection, response, non-response, and processing.

Response bias occurs when the respondent misinterprets a survey question or the survey instrument

misleads the respondent. This survey attempted to minimize these errors by following up the survey with phone calls to ensure respondents understood questions. Moreover, a number of respondents filled in the comment section in the philosophy of taxation area thereby stating their interpretation of questions. Although all these comments were included, no adjustments were made to quantitative values as a result of any respondent bias.

Non-response bias occurs when responses are not obtained from a portion of the sample. It was speculated that the \$75 honorarium for completing the questionnaire and the high level of confidentiality would minimize respondent bias. Of the 10 non-respondents, 3 sent their cheques back so 7 kept the honorarium without completing the survey. The direction of this bias given the confidentiality of the survey is unknown.

Processing errors occur when data is incorrectly entered into the data storage device. A sample of 2 completed questionnaires was compared to the results that were input and no difference was evident. It is assumed, therefore, that there were no processing errors.

Sampling Biases

There are two types of sampling bias: normality of population, representativeness of population.

In order to conduct t-tests on quantifiable survey results, it should be assumed (ignoring for the moment, the central limit theorem) that the population from which the sample is drawn follows a normal distribution. Although there are tests of this assumption, none were conducted for this research. Alternatively, two rules of thumb were used to validate this assumption:

1. The covariance of variation (standard deviation/mean) was quite low and
2. Approximately 67% of all quantifiable responses in the philosophy of taxation section were within one standard deviation of the mean.

Perhaps the most serious bias in this survey is the speculation that this sample is not representative of the population. This is particularly important given that 4 respondents (20%) were ITAB members and 5 respondents were property tax collecting First Nations (2 of these 5 were ITAB members) who may be more accepting of the philosophical issues surrounding First Nation taxation than are the rest of the First Nation population. This assumption has not been tested since even the ITAB member's responses were kept confidential. Should this bias exist, than the philosophical barriers to taxation identified in the study are even more prevalent in the First Nation population than is reported in this survey.

B3

**Selected Summary Results from the First Nation
Taxation Questionnaire**

Note to the translator: This section will be emailed / faxed to you at a later date. Please contact Daryl Nearing at (819) 997-8153 for this section.



B4

**The French and English Version of
the First Nation Taxation Questionnaire Letters and
The First Nation Taxation Questionnaires**

Note to the translator: This section will be emailed / faxed to you at a later date. Please contact Daryl Nearing at (819) 997-8153 for this section.



APPENDIX C -FIRST NATION OWN SOURCE REVENUE POTENTIAL SOFTWARE AN OVERVIEW

The purpose of this software application is to provide a preliminary own source revenue potential estimate for First Nations and allow First Nations to perform some sensitivity analysis on their tax base. Categories of own source revenue were chosen on the basis of First Nation tax powers supported by existing federal legislation or policy. Formulas used in estimation were developed to reflect the current estimation techniques used by revenue projection professionals.

The prototype application was developed in MS Access version 2.0 so it will be compatible with Windows 3.1 or Windows 95. The three diskettes included in this package are the alpha versions of the revenue potential software for B.C.. You do not require a copy of MS Access to run this software since a run time version is included in these diskettes. Simply place diskette 1 in drive a: while in Windows 3.1 or Windows 95 and enter:

"a:setup" in the program manager run command line

The holders of these copies are asked to record all errors and possible bugs and report them to the developers for refinement.

Fiscal Realities
618 Pleasant St.
Kamloops, B.C., V2C 3B2
(250) 851-0780

Estimating First Nation Own Source Revenue Potential

An alpha user's guide

Software application Features

- ! Button driven user interface
 - ! User interface to be customized for each province to account for different grant in lieu and variable property tax rate calculation methods
 - ! Custom entry capability for property tax, sales tax and non-tax own source revenue components
 - ! Four detailed reports for property, sales, grant in lieu, utility and non-tax own source revenue potentials, and one summary report of the First Nation's own source revenue potential
-

Requirements

- M Math co-processor as contained in 486DX CPUs or higher
 - M Windows 3.1 or higher
 - M 8 Mb of RAM
 - M 5 Mb of Hard Drive space
-

Software Description

This description is the user guide of the alpha version of a software. It is absent of many details given the usual comprehensive understanding of the subject matter associated with alpha testers.

Opening screen

Enter a name of a First Nation. If you are running a test, then enter Test. Hitting return will take you to the General information screen.

General Information Screen

Populations are entered for potential summary statistics such as own source revenue per capita in subsequent versions of the software. Click the main menu button to continue. To move from data field to data field either use your cursor or the tab key.

Own Source Revenue Potential Menu

There are four own source revenue potentials which can be estimated with this software:

Property Taxes
Utility and Grants in lieu
First Nation sales taxes
Other Non-Tax revenues

The data for each of these can be entered by clicking the appropriate button. A description of the necessary data for each own source revenue is provided below.

Also at the bottom of this screen is the option to print summary reports or quit the application. It is recommended, although not necessary, that the user enter data before printing summary reports.

Property Taxes

Property tax estimation have been divided into three possible property types: residential, commercial/industrial and farm and others. The formula for estimating property taxes is quite simple:

Assessed taxable value of property x Tax rate for that property

It is generally accepted, although not practised in all parts of Canada, that assessed taxable value should reflect the best estimate of the market value of a property. In each property type the user has the option of entering in the approximate market value of a property type and the number of similar properties of similar assessed value.

In the industrial/commercial and farm property types, the user can enter custom property types. For example, some First Nations have a saw mill on reserve which they may consider levying property taxes against. The saw mill could be named in the property description field, an estimate of its market value could be made and the quantity of similar property types would be entered. Usually for custom properties, they are one of a kind so 1 would be entered in the number of properties field.

Upon completing the property tax area, the user should enter the tax rates. In B.C., variable tax rates are charged for residential, farm, utility and industrial/commercial properties. Limits on these rates have been hard coded into the application. A useful starting place, and the policy of the ITAB, is to use the tax rates of the nearest taxing jurisdiction.

Utility Taxes

Although utility taxes, at least those on private utilities, are just another form of property taxes, they have been separated out from this application because it is difficult to estimate the market value of 5 km of pipeline. This problem has been solved in this application by asking the user to input the km or the number of the specific utility and applying the following formula to this data:

(Assessed value per km of utility)(# of km)(utility tax rate)

The assessed value per km of utilities have been extracted from the British Columbia Assessment Authority property and utility tax assessment guide. For example a class 1 rail road is assessed at \$135,961 per km. Similarly, rights of way for linear utilities are assessed per acre by the BCAA at rates, for example of \$2,003 per acre for electrical power corporations. All these rates and suitable averages

have been hard coded into the application for relatively easy utility property tax assessments. A pop up screen specifying general tax rates for utilities (the school tax rate is fixed) is used to obtain the utility tax rate total (utility tax rate = school + general).

A number of utilities, however, are crown corporations and are subsequently immune from property taxation by other governments, according to the latest ruling in the Westbank First Nation - B.C. Hydro case. In these events grants in lieu of taxation can be provided to the First Nation. In B.C. these are calculated at 1% of gross revenue in that jurisdiction + the school tax portion of the property tax. In Ontario, these are calculated for Bell Canada and Ontario Hydro as 5% of the gross revenue collected by the utility in that jurisdiction. The grants in lieu formula for B.C. has been hard coded into the application.

Non-Tax Revenues

This is the simplest of all revenues to calculate but perhaps the most difficult to estimate. The formula used in the application is:

(user fees)(user)

For most non-tax revenue sources, business licenses, building permits this is a relatively straightforward if error prone estimate. Non-tax revenue sources such as interest on investments and lease revenue poses a problem since these are generally already aggregated. It is assumed therefore that these are like user fees except there is only one user. A pop-up screen asking for total lease revenues and interest on investments provides the opportunity for the user to enter this data in aggregate form. It will appear as a user fee on the screen with the number "1" in the # of user fields, should editing be required.

First Nation Sales Taxes

The introduction of Bill 93 has made the possibility of First Nations collecting GST type sales tax from all on reserve purchases (status and non-status) a legislative reality. Although there are a number of local issues a First Nation would have to consider before collecting this form of tax, this estimation option has been included to provide First Nations with the information they need to assess their sales tax potential.

First Nation sales taxes have been divided up into 4 categories; fuel, tobacco, alcohol and other commodities. Clicking on each category provides the data input screen for the user. It is assumed, based on the tobacco GST provisions contained in Bill 93, that the First Nation will be able to charge a GST style tax on all final sales of the particular good or service. Subsequent versions of the application will provide for custom tax rates.

There are five parameters necessary to estimate on reserve GST style sales tax potential by commodity:

- 1) units sold
- 2) % of sales made to status customers
- 3) current price of good or service for status customers
- 4) current price of good or service for non-status customers and
- 5) % of total sales of good or service made to consumers.

The user is expected to conduct some research into the estimation of these parameters. For alcohol and tobacco it is assumed in this version of the application that 100% of the sales are to consumers.

The formulas used in this estimation are:

FNST non-status: $(\text{units sold})(1 - \% \text{ status})(\% \text{ sold to consumers})(\text{non-status price} - (\text{non status price}/1.07))$
when FNST is included in final sales price or

$(\text{units sold})(1 - \% \text{ status})(\% \text{ sold to consumers})(\text{non-status price})(.07)$ when FNST is not included in the final sales price

FNST status: $(\text{units sold})(\% \text{ status})(\% \text{ sold to consumers})(\text{non-status price})(.07)$

It is assumed for the purpose of this estimation that for fuel and alcohol that the FNST will be included in the final price for non-status sales, and for tobacco and other products it will not be included.

Upon completing the data input the user can return to the main menu and click the print reports button. This will provide a detailed estimate of each revenue source and a summary report of all revenue sources. Although these appear in print preview form, the user can easily push file, print, to obtain a hard copy version of the estimates (assuming the user has printing capabilities).

Please Note

It is incumbent upon the developer to caution the user of this application that the majority of the revenue potentials estimated in this application are not discretionary in nature. This is especially true for property taxes which are generally used for the provision of local services. A First Nation community may also wish to estimate the costs associated with assuming these tax and non-tax authorities. In this regard, the Indian Taxation Advisory Board has another application for estimating the cost of local service provision which is available free upon request.

