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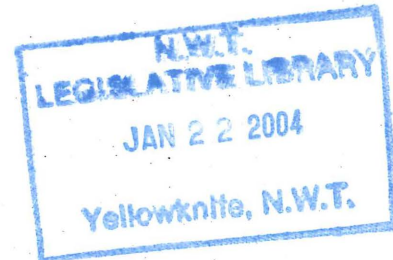
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TAX EXEMPTION:

A TOOL FOR ECONOMIC DEVELOPMENT
FOR FIRST NATIONS

SORTING OUT THE ISSUES

EXECUTIVE SUMMARY



Prepared for
The O. I. Group of Companies

Dr. Fred Lazar
Joseph Fiorini

July 2002

Greetings:

Our Aboriginal and Treaty Rights are being redefined by others. Courts should not be placed in the position of being asked to define who we are as First Nations people.

We are members of sovereign nations. If we truly believe that we are sovereign, then we must start defining our own governance structures. We should not expect others to do that for us.

Governance embodies our political, bureaucratic and judicial institutions. If we are truly sovereign, these jurisdictions are ours to define, develop or reshape. One can not govern if one does not have independent sources of revenue. Our independent and non-negotiable sources of revenue arise from transfer payments from the government of Canada and reflect it's fiduciary and other obligations to our people. These obligations emerged from the treaties signed and other agreements made with the settlers because, we, as a people, have never been defeated in Canada. Taxation is within the jurisdiction of sovereign First Nations governance to shape, define and implement as is gaining control over our own resources.

The O.I. Group of Companies commissioned this study from a respected and prominent economist, Dr. Fred Lazar, to help us organize our aspirations as sovereign Nations and illustrate how they can be implemented in harmony and without infringing on the priorities Canada may have.

This Executive Summary of the discussion paper with the same title is being widely distributed amongst First Nations and others in Canada and internationally to begin a dialogue on how we as First Nations will shape our sovereignty and develop a governance framework which reflects our aspirations, our cultural values, our vision of self-determination, our similarities and differences and embodies our creative solutions which do not necessarily mirror the mainstream.

We want you, the reader, to become part of the dialogue. OI has facilitated the structuring of a Working Committee representing all the National First Nation bodies and other key visionaries who are providing valuable input and helping to move this forward. Please provide us with your thoughts and comments.

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If you want a copy of the entire document, not just the Executive Summary, please contact us. For more information about our companies, you may join us on our newly reconstructed web site at www.oigroup.ca.

All My Relations,



Roger Obonsawin

CROSSROADS

Robert Nault, the present Minister for Indian and Northern Affairs Canada, stated at a recent conference in Ottawa (April 18, 2002: *Beyond the Indian Act*):

"Make no mistake. We stand at an historic turning point in our relationship with First Nations. Change is in the air – change which puts the tools of economic self-sufficiency into the hands of First Nations. Change which knows that the old cycle of social assistance does not work and must not continue. Change that sees economic development – not economic dependency – as the road ahead."

Nault is right, the First Nations and Canada are at a crossroads; however, they have been at this juncture for decades, with little progress to show. Despite tens of billion of dollars in spending by INAC and other federal government departments over the past 50 years, there have been limited economic payoffs for Aboriginal peoples.

Although Canada is among the top countries in which to live according to the United Nations' Human Development Index, Inuit and on-reserve Indians are ranked below many developing nations. Many First Nations and Inuit communities face housing shortages, as well as rates of unemployment, dependence on social assistance and youth suicide that are higher than the national average. Indeed, the United Nations Committee on Economic, Social and Cultural Rights has observed that **there has been little or no progress in the alleviation of social and economic deprivation among the Aboriginal peoples.**

Economic development for the First Nations is imperative. Stephen Cornell and Joseph Kalt have stressed that **sovereignty, nation-building, and economic development go hand in hand.** Without sovereignty and nation-building, economic development is likely to remain a frustratingly elusive dream.

There is general agreement that the First Nations must be in control of their destiny, regain the rights to resources, expand their land bases and continue to

receive reparations from the federal government to support economic development initiatives, including education, health care, infrastructure and social programs.

But what is the road ahead? What needs to be done?

TAX EXEMPTION: A Tool For Economic Development

It is also time for Canada to show the world that it is indeed an honourable country that will stand by all of its commitments and promises. If Canada chooses to continue to mistreat the First Nations, then what do we stand for as a people and as a country, and why should we continue to exist as an independent nation?

Dr. Fred Lazar

THE PATH AHEAD

We know the following:

1. **Sovereignty is critical if the First Nations are to ever move beyond the state of dependency and revitalize their economies so as to narrow and eliminate the economic and social gaps their peoples have long endured. But sovereignty and the fiscal capacity to govern must go together.**

The Canadian federation has long recognized the need for each province to have the fiscal capacity to provide its residents with public services that are reasonably comparable to those in other provinces. The equalization program is the federal government's most important program for reducing fiscal disparities among provinces. In fiscal year 2001-02, this program ensured that all provinces would have revenues of \$5,869 per resident to fund public services. Seven of the eight eligible provinces received almost \$10.5 billion in 2001-02.

These payments accounted for 26% or more of the

total revenues of four of the provinces and 19% for Manitoba. Equalization payments averaged in excess of \$1,165 per capita in five provinces.

The magnitude of these annual payments and their importance for providing the fiscal capacity for most provinces in Canada to provide the needed public services must always be kept in mind by the First Nations as they negotiate with the federal government to fund the provision of basic services such as health, education, housing and public infrastructure in all First Nations communities.

The First Nations are not the beneficiaries of "generous" handouts by Ottawa and the taxpayers of Canada. They are fully entitled to the payments they currently receive.

But these payments cover only part of what is owed to the First Nations.

2. Substantial economic gaps exist. John McCallum has summarized the socio-economic plight of Aboriginal peoples very succinctly and very well: "The statistics leave no doubt as to the very sad state of aboriginal economic and social development today."

- On-reserve Indians fare poorest in the labour market – their unemployment rates much higher than the non-Aboriginal labour force – almost three times higher in 1996; off-reserve Indians have the second highest levels of unemployment.
- The participation rates of on-reserve Indians are much lower than the non-Aboriginal labour force. A relatively lower participation rate goes hand-in-hand with higher unemployment rates. High unemployment rates tend to discourage active labour force participation and so this leads to lower labour force participation rates. The unemployment rates for registered Indians, both on and off reserve, do not measure the so-called hidden unemployed – those individuals who have dropped out of the labour force altogether because they could not find any jobs. If one includes the hidden unemployed, the unemployment rate for registered Indians would have stood at 40% in 1996.
- The unemployment rates for the Aboriginal labour force is consistently over twice the levels for non-Aboriginals in Canada in 1996, regardless of geographic location.
- In all the major urban centers across Canada, the Aboriginal population fares much worse than their non-Aboriginal counterparts in the labour market – higher unemployment rates, lower participation rates (reflecting poorer job prospects) and lower employment rate (reflecting higher unemployment and lower participation rates).
- Poor labour force status translates into equally poor income status. According to the 1996 census, the average earnings of all Aboriginal earners were only 66% of the average earnings of all earners in Canada. The relatively poorer earning status of Aboriginals is partly the outcome of their being less likely to find full-time, full-year jobs. Part-time and/or part-year jobs pay less.
- Registered Indians are over-represented among those with less than a high school education – 22% of all registered Indians and 30% of on-reserve Indians had less than a grade nine education in 1995 compared to only 12% of non-Aboriginals – and under-represented among those with a university education or with some other post-secondary degree or certificate. In 1995, only 6% of on-reserve Indians, 15 years or older were high school graduates and only another 2% had a university degree. 15% of non-Aboriginals had a high school degree and another 13% had a university degree.
- Educational attainment is positively correlated to labour force experience – the more educated experience lower rates of unemployment and are more likely to participate in the labour force because of the better job prospects and thus are likely to have higher participation rates. Educational attainment also is positively

correlated with earnings and income. For example, in 1995, the average earnings of all Canadians with less than a grade nine education, who worked during the year, were 85% of the average earnings of all Canadians with a high school certificate, but only 46% of the average earnings of those with a university degree. Among Aboriginals who worked during the year, the average incomes of those with less than a grade nine education were 80% of the average earnings of Aboriginals with a high school certificate and 44% of those with a university degree. Education does pay off.

- **But education pays off less for the Aboriginal peoples. Within each education group, the average earnings of Aboriginal earners ranged from 72% to 76% of the average earnings of all Canadians. The average earnings of all Aboriginal earners were only 66% of the average for all Canadians. Thus, not only do Aboriginal workers earn less, regardless of their level of education, but also Aboriginal workers have less education than do non-Aboriginal peoples. Tax exemption does not close the current earnings gaps.**
- Registered Indians fare worse on several indicators of health status – life expectancy, infant mortality rates and age standardized TB incidence. These findings are not surprising since health status and labour force and income status are positively correlated. Individuals active in the labour market who earn above average income levels tend to be healthier and/or have better access to health care. So the inferior health status of registered Indians is the mirror image on their relatively poorer labour force, income and education status. Economic development for the First Nations should improve the economic status of registered Indians and this should lead to improvements in their health. **The status quo does have considerable hidden costs and the payoffs from economic development could be substantial not only for the Aboriginal peoples but also for all other people in Canada.**

- Housing on reserves has improved between 1996 and 2000. However, overall on-reserve housing is among the worst in Canada. In some First Nations communities, poor housing conditions threaten the health and safety of residents. The lack of adequate, affordable housing contributes to health and social problems.

Eliminating the gaps could produce sizable benefits for both the First Nations peoples and all peoples living in Canada. RCAP calculated an annual net benefit of \$7.5 billion.

Closing only the income gap between registered Indians and non-Aboriginals could lead to a net economic benefit of between \$5.8 and \$7.8 billion.

These estimates do not include the additional savings that would result from lower health care costs, lower social assistance payments and lower costs for justice and correctional services. With conservative estimates for these additional savings, the net economic benefits could well exceed \$9.0 billion annually.

In total the net economic benefits could well exceed \$9.0 billion annually.

3. **The land and resources of this country have never been shared as originally contemplated by the First Nations. Section 9 of the *British North America Act* transferred ownership of natural resources to Quebec, Ontario, New Brunswick and Nova Scotia in 1867. The *Natural Resources Transfer Act, 1930* did the same for the Western provinces. Resource revenues for the First Nations were not entrenched in either piece of legislation and so the First Nations have never had control over resource revenues rightfully owing to them.**

It is useful to put the area of the land set aside for reserves for the 600+ Indian bands into some context in order to gain a better understanding of the issues surrounding land claims. Canada has a land mass of 6.5 million square kilometers. Over 130,000 square kilometers have been set aside for National Parks (2% of the total land mass).

There are currently only 26,300 square kilometers of reserve lands (0.4% of the total land mass). In comparison, registered Indians comprised 1.9% of the total population in Canada in 1996.

Canada has prospered from the lands and resources. For example, in 2001, resource-based exports (agriculture and fishing products, energy products and forestry products) totaled \$125 billion or 29% of total exports from Canada. Trade in resource products generated a trade surplus for Canada of \$84 billion. Trade in all other products produced a deficit of \$20 billion.

The resource sectors directly generated almost \$50 billion in gross domestic product (GDP) in 1999 (5.5% of total GDP). Resource-based manufacturing industries accounted for an additional \$40 billion in GDP (4.7%). So at least 10% of Canada's economy is driven by resources.

In fiscal 2001-02, the provincial governments of Alberta, British Columbia and Saskatchewan raised almost \$11 billion in revenues from the resource sectors. This total does not include corporate income taxes paid by companies in these sectors. Resource sector revenues accounted for 32%, 13% and 20% respectively of the total revenues of the Alberta, B.C. and Saskatchewan Governments.

The provincial governments of Manitoba, Nova Scotia, New Brunswick and Newfoundland raised an additional \$1 billion in revenues from the resource sectors in 2001-02, while the federal government received \$4.7 billion from excise taxes on energy. The federal government's revenues exceed the net transfers from INAC to the First Nations, and the resource sector revenues of the three Western

provinces far exceed the total expenditures by all levels of government on the First Nations.

Contrast the position of the First Nations with one of the fundamental principles of the constitution; namely, that to finance and exercise power of self-government, an adequate resource base is essential. If the First Nations were to receive annually only 25% of all the revenues generated by the federal government and the provincial governments from the resource sectors, they could receive in excess of \$ 6 billion. At 50%, they would receive well in excess of \$12 billion annually.

The sharing of resource revenues would have gone a long way towards allowing the First Nations to govern themselves, pay for basic services and support an array of economic development initiatives, without any need to impose an income tax on their citizens and their enterprises.

4. The lack of development and economic opportunities on reserves has pushed many of the more highly educated and possibly more of the risk takers off the reserves in search of better prospects elsewhere; and has created a culture of dependency on reserves. A welfare economy is both seductive and destructive. And the loss of many of the "brightest and the best" erodes the human capital and dynamism of the First Nations communities, encouraging others to leave as well. This produces a vicious cycle that threatens the long-term viability of these communities.

5. The federal government is not interested in spending any more money in total in dealing with the First Nations.

In 2001-02, most of the money spent by the federal government for the First Nations (primarily through Indian and Northern Affairs Canada and Health Canada) was spent on education, health, housing and social programs. While all are important in creating the foundation for strong communities, they all involve services, which are provided to all people in

Canada. Moreover, these levels of expenditures only have kept the economic opportunities gap from widening. Either not enough is being spent or it is not being spent wisely or there is insufficient flexibility in designing the programs and spending the money.

The expenditures for health, education and social programs averaged approximately \$2,500, 2,200 and \$2,000 per registered Indian respectively in 2001-02. Per capita health expenditures in 1997-98 averaged \$1,800 across Canada. Per capita expenditures by the provinces on education averaged \$1,300 in 1997-98. Per capita expenditures on vocational and postsecondary education averaged an additional \$800. In 1998-99, the provinces spent collectively \$30 billion on social services or approximately \$1,050 per capita. *If the economic status of the First Nations began to approach that of non-Aboriginals, spending on health care for the First Nations would decline (health and incomes are positively correlated) – if spending declined to \$1,800 per capita, the aggregate annual savings could be approximately \$350 million; and spending on social programs also would decline sharply – if spending declined to \$1,050 per capita, the aggregate annual savings could exceed \$500 million.*

It is important to consider the following:

- More is spent annually to prop up the incomes of farmers than is spent on education for First Nations' children. The farm income assistance program spending swamps the spending on direct economic development initiatives for all First Nations.
- Canadian Heritage spends on subsidies for the cultural industries about 50% of what health Canada spends annually on health care for Aboriginal peoples. The Canadian Film Development Corporation receives almost as much as is spent on direct economic development programs for the First Nations.
- Total expenditures on international agencies run about \$100 million below the annual expenditures by INAC on capital facilities maintenance on reserves and in the North.
- CIDA's annual budget almost exceeds total

INAC spending on education and social programs for Aboriginal peoples.

- The financial assistance provided by Human Resources Development through subsidies for post-secondary education is equal to the total spending on education by INAC for all First Nations peoples.
- The non-taxation of business-paid health and dental benefits costs governments \$1.6 billion annually exceeding Health Canada's expenditures of \$1.4 billion for health care for Aboriginal peoples.
- The charitable donations credit produces an additional cost of \$1.3 billion. Compare this to INAC's expenditure of \$1.0 billion for social programs for Registered Indians and Inuit.
- The foregone tax revenues for personal expenditures for education (tuition fee credit, education credit, transferred credits, carry-forward of credits, student loan interest credit, RESPs, partial exemption of scholarship, fellowship and bursary income) are \$1.4 billion – an amount well in excess of INAC's annual expenditures for education.

6. The federal government wants new treaties to limit its financial exposure and risks. Canada's continued refusal to respect the spirit and intent of the historic treaties, while they implement "modern day treaties", which are extinguishment agreements rather than treaties, are part of this strategy.

Modern day treaties are extinguishment agreements rather than treaties.

- 7. Paternalism has been and continues to be the basis for the relationship between the federal government (and provincial governments as well) and the First Nations. The *Indian Act* smacks of the worst excesses of colonial paternalism. The First Nations Governance Initiative is no better.
- 8. The Chretien government's ultimate goal still

appears to be assimilation as originally spelled out in the 1969 "White Paper". The 2001-02 "White Paper" model is just more sophisticated and is being sold to the public more effectively than the original. It also builds upon the failure of 30 years of policies with the failures presented to give credence to the paternalistic view of Canada towards Aboriginal peoples.

Chretien's governments' ultimate goal is assimilation and is being sold to the public more effectively.

Consequently, the goals of the First Nations must include:

- Getting rid of the *Indian Act*;
- Negotiating constitutionally entrenched and protected sovereignty, including appropriate compensation;
- Creating a First Nation government and economic development strategy.

What is the strategy to achieve these goals?

It must consist of several components.

One involves public education, especially of the history of the relationships between the First Nations and the white settlers. **The Report of the Royal Commission on Aboriginal Peoples should become required readings in all Canadian History courses at all levels of education.** It is also critically important that the public is made aware of the conclusive findings of the Harvard Research project on the need for sovereignty.

A second component involves attacking the federal government with its own words. There are numerous examples one could use.

The third component involves the international community. A road trip by the AFN leadership to meet with the major energy and forestry companies abroad with interests in Canada, major fund management companies and the three major credit rating agencies in the U.S. to spell out clearly the current situation regarding control/ownership of

lands and resources in Canada and the potential liabilities of resource companies and governments in Canada should be a priority.

Moreover, it is of utmost importance for the First Nations to recognize that they are entitled to multiple income streams from the federal government and they should not compromise on this in their negotiations.

First Nations must recognize that they are entitled to multiple income streams from the federal government.

First Nations and their peoples receive some or all of the following sources of money from the federal government:

- Grants/transfers for education, health, social services, housing, cultural activities, infrastructure, "economic development";
- Cash payments (one-time or spread out over period of years) for land settlement claims or extinguishment of treaty rights;
- Resource revenues (royalties, etc.); and
- Tax exemption.

The First Nations are entitled to all four sources. There should not be any trade-offs made in negotiations. That is, First Nations should not be willing to take a little bit more of one type of payment in return for reducing the amount of another type. This type of trade-off will never work to the advantage of the First Nations.

Grants/transfers are required to fund the basic foundation required for sustained economic development. The First Nations should conduct an inventory of minimal acceptable requirements for education, health care, housing, government services, communications / transportation/ environmental infrastructure, and determine the current financial gaps to meet these minimal standards. The federal government should then commit to top up the existing transfers so as to finance the minimal standards. The transfers should be maintained indefinitely in real per capita terms. The transfers also should be unconditional –

how they are spent should be determined entirely by the First Nations' governments.

The federal government could increase the transfers in part by greatly reducing the current administration expenses of INAC that are in the range of \$600 to \$650 million.

This source of money should be viewed as partial reparations to compensate for the wealth taken from the First Nations. These transfers, even if provided indefinitely, would represent but a fraction of the income and wealth generated from the resources and the lands that should have been shared between the First Nations peoples and the immigrants to this country.

The one-time cash payments generally attached to a land claims or treaty settlement represents an arbitrary value. It does not represent compensation for past damages. The grants/transfers should be viewed in this way.

These one-time payments, even if spread out over a number of years, provide a trust fund that could be used either to provide pension benefits to First Nations peoples or to finance economic development initiatives. The transfer payments should be used for either of these purposes.

Resource revenues are compensation for development by non-Aboriginal companies of resource wealth located on reserves. These revenues could be used to augment the services provided by First Nations' governments. As well, they could be put into trust to pay future pension benefits.

Tax exemption is an Aboriginal or treaty right or both and is critical for economic development and integral for the sovereignty of First Nations.

Tax Exemption

Tax policy should be viewed from the point of view of incentives rather than as a source of

revenues for First Nations governments. This latter perspective plays into the hands of the federal government and runs counter to the view that the federal government should maintain, if not expand, its financial support of First Nations communities.

There are at least three lines of argument to support tax exemption for all First Nations peoples and their companies, whether they are collectively or individually owned.

One line of argument follows from the fact that the right to set tax rates and formulate tax policy belongs to a government and is an important instrument for a sovereign nation to control governments.

If First Nations are to have self-government and eventually be treated as equals, they alone must determine how their people should be governed, and this includes how they should be taxed.

The second line of argument follows from the fact that tax policies have long been considered and used for a wide range of economic and social objectives, and as such, they can play a key part of a First Nations economic development strategy. The current and former Ministers of Finance in the Chretien government have made tax cuts a major component in their economic growth strategies.

Further, the federal government continues to have in place a large number of tax incentives to stimulate economic growth and these measure cost the government billions of dollars annually in foregone revenues.

Thus, at a minimum, First Nations peoples should not be subject to an income tax since economic development is critical to reduce and eventually eliminate the income gaps that exist between the First Nations peoples and non-Aboriginal peoples in Canada.

Incentives do matter, regardless of cultural and historic differences.

Higher after-tax incomes create the incentive to invest in education and training.

A more highly educated and skilled work force is essential for the First Nations to have the talent to govern themselves and to have the talent that will be necessary to drive their economies. Tax exemption produces higher after-tax incomes, as long as employers do not try to capture some or all of the tax benefits.

Small businesses generally rely on personal savings and those of family and friends, as well as on internally generated cash flows, to finance the early years of their start up and growth. Higher after-tax personal incomes provide the cushion for savings, which could be invested in small businesses. Higher after-tax business incomes translate into larger cash flows, which can be re-invested in the business. Tax exemption, especially when extended to companies and their profits, could play a major role in addressing the capital barriers faced by small business and especially those started by and owned by the First Nations peoples.

So, if tax cuts and tax incentives are considered important by the federal government and the Department of Finance, they are even more important for First Nations trying to develop their economies. **It makes no sense from an economic perspective, nor should it from a political perspective, to try to raise tax rates for First Nations peoples, many of whom fall below low-income cutoff levels, when the thrust of fiscal policy is to cut tax rates and when tax incentives continue to be integral to the federal government's policies to make the country more competitive and wealthier.**

Once the tax powers are fully transferred to the First Nations, a tax model based on "citizenship" should be chosen; that is, all registered Indians should be eligible, regardless of residence and this would include all companies owned and/or controlled by registered Indians, collectively or individually.

Finally, the third stems from the proper definition of property and income generated by property. In economics, property is viewed as the wealth of an individual or family, and as such, consists of all the assets possessed by an individual or family less any liabilities owing. Assets include human capital, financial assets, equity in one's business, real estate, art, etc. The link between property/wealth and income can be seen more clearly in the definition of personal income. In the National Accounts, personal income consists of the following:

- Wages, salaries and supplementary labour income;
- Accrued net income of farm operators from farm production;
- Net income of non-farm unincorporated business;
- Interest, dividends and miscellaneous investment income; and
- Current transfers from government, corporations and non-residents.

If the Courts had defined property correctly and if they had been cognizant of what comprises one's personal income, then the connecting factors test would have been unnecessary and most, if not all, cases under section 87 would have ruled in favour of tax exemption.

Bottom Line

There are two global options available for the First Nations: constitutionally-entrenched First Nations' governments with specific responsibilities similar to those enunciated in the *BNA* setting out provincial and federal responsibilities; or local/municipal type governments under the control of the provinces without any further protection of treaty and Aboriginal rights.

The path the First Nations take at the crossroads is theirs to choose.