

# First Nations: When is interest income tax-exempt?

November 2011

A recent Supreme Court of Canada (SCC) decision, *Dubé v The Queen*,<sup>1</sup> has resulted in a significant change in the legal landscape with regard to the tax exempt status of interest income for members of the First Nations community.

In the previous landmark case of *Williams v The Queen*, a list of “connecting factors” was developed to establish whether income was related to the reserve. Typically, amounts that can be shown to be related or connected to a reserve are more likely to be exempt from income tax. Due to a lack of “connecting factors,” interest income earned on deposits at an on-reserve financial institution has generally been considered to be taxable as the funds would have been invested in the “commercial mainstream” and, therefore, not sufficiently connected to the reserve.

The recent SCC decision in *Dubé v The Queen* has changed this result. In this case, Mr. Dubé had a term deposit with a Caisse Populaire that was situated on a First Nations reserve. The location of the Caisse on the reserve appeared to be the only connecting factor. Additionally, there were several factors that would typically count against the taxpayer:

- the funds that were used to make the investment were not tax exempt,
- the taxpayer was not a full-time resident of his or her reserve, and
- the interest income was not necessarily spent on a reserve.

As a result, the Canada Revenue Agency (CRA) assessed the interest income as being taxable. Mr. Dubé did not agree with the CRA’s position and appealed it to the courts.



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<sup>1</sup> 2011 SCC 39—heard together with the *Estate of Rolland Bastien vs. The Queen* (2011 SCC 38).

Ultimately, the case was heard by the SCC which ruled in favour of the taxpayer.<sup>2</sup> Although the Caisse may have produced its revenue in the “commercial mainstream” off the reserve, the SCC found that this was irrelevant given the nature of the investment itself. When an individual invests in a certificate of deposit, he or she is not investing in the “commercial mainstream.” The individual is simply earning interest. How the Caisse chose to invest the funds to allow it to pay its obligation to Mr. Dubé should not impact the tax consequences to Mr. Dubé. As a result, the SCC found that the interest income earned was connected to the reserve and, therefore, tax exempt.

The results of this case could provide for some significant opportunities for tax savings if you:

- 1 Are an Indian as legally defined in section 2 of the Indian Act (i.e., you have a status card); and
- 2 Invest your funds with a financial institution located on a reserve (dependent on the type of the investment).

Please contact your Grant Thornton LLP adviser if you would like more information or to discuss how this decision may impact you.

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<sup>2</sup> The decision was not unanimous, with five judges in favour of the taxpayer and two dissenting.