



U.S. Tax Exemption for Indigenous Communities

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TODAY'S AGENDA

1. Why is this important
2. The U.S. tax exposure of indigenous groups
3. Strategies to eliminate tax exposure
4. Refund claims
5. Benefits
6. Successes so far

Why does this matter?

- How would you feel if your Council or Trustees took \$5,000, or \$10,000 or \$50,000 and gave it to someone who was not a member and got nothing in return?
- Paying U.S. withholding taxes is giving money to the U.S. Internal Revenue Service and getting nothing in return



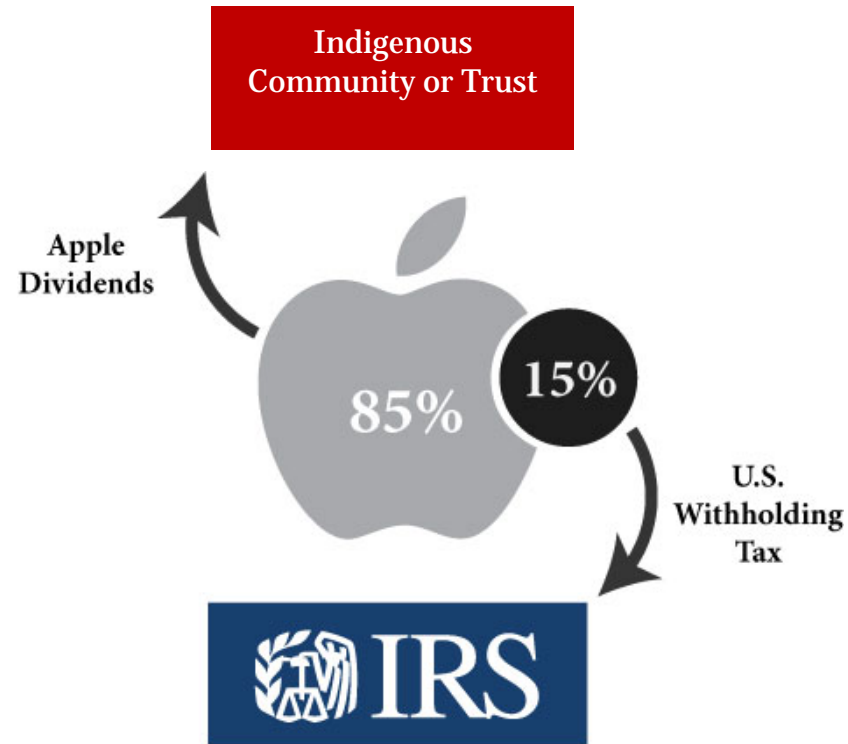


Part 1 – Current U.S. Tax Exposure

U.S. Tax on Dividends

- Tax on dividends from U.S. stocks withheld at source
- 15% of dividends from U.S. stocks
- Since you don't pay tax here you can't offset Canadian taxes with the taxes withheld

Illustration of U.S. taxes





Part 2 – How to Eliminate U.S. Taxes

Overview

- Foreign sovereign governments are not exempt from U.S. withholding taxes
 - Indigenous governments are considered as political subdivisions of a foreign sovereign government
- To eliminate U.S. tax:
 1. Get an opinion – all scenarios are different
 2. Convert U.S. equity portfolio to segregated basis
 3. File forms with the custodian telling them to stop withholding. Only needs to be done once.

Section 892

- Exempts foreign governments from U.S. taxes
- Section 892: the rules that apply to a foreign government also apply to a political subdivision of a foreign country
- Section 892 asks: is it a government under local law?
- IRS rulings that municipality can benefit from tax exemption
- Look at this from a Canadian, New Zealand, and Australian perspective

Canadian context

- Under Canadian law:
 - Section 35 of Charter -> constitutionally entrenched powers;
 - Section 81 of *Indian Act* gives legislative powers to First Nation;
 - Section 149(1)(c) of *Income Tax Act* treats First Nation same as municipality (a government);
 - Other examples.
- First Nation/Métis settlements -> a foreign government
- FN powers exceed that of municipality
- Conclusion - > strong position that Canadian aboriginal communities are foreign governments under s. 892 of the U.S. tax code

Australian context

- Following 1967 referendum, Australian Parliament had power to make laws regarding Indigenous peoples
- This authority has been used to enact a wide variety of legislation
- Land Councils exercise powers over regional land
- Created by Australian federal statute
- May be a political subdivision for US tax purposes
- May qualify for US tax exemption as a sub-national entity
- Further research required

New Zealand

- Not experts in New Zealand constitutional/indigenous law
- New Zealand is a unitary state with Parliamentary sovereignty
- The Treaty of Waitangi establishes the relationship between New Zealand government
- Treaty of Waitangi may not be part of NZ law
- Iwi (Maori groups) have some authority
- This authority may be delegated to them by the NZ Parliament
- Iwi may be political subdivisions of NZ – qualify for US tax exemption
- Would need to explore in much greater detail

What about trusts?

- Many First Nations invest through Trusts
- Trusts are likely “grantor trusts” (as defined by U.S. tax law)
- Grantor trust = same result as s. 75(2) Income Tax Act
- Indigenous government is considered to be the “owner” of trust property by the IRS
- So if s. 892 will benefit Indigenous community, then trust can benefit as well
- IRS ruling to this effect

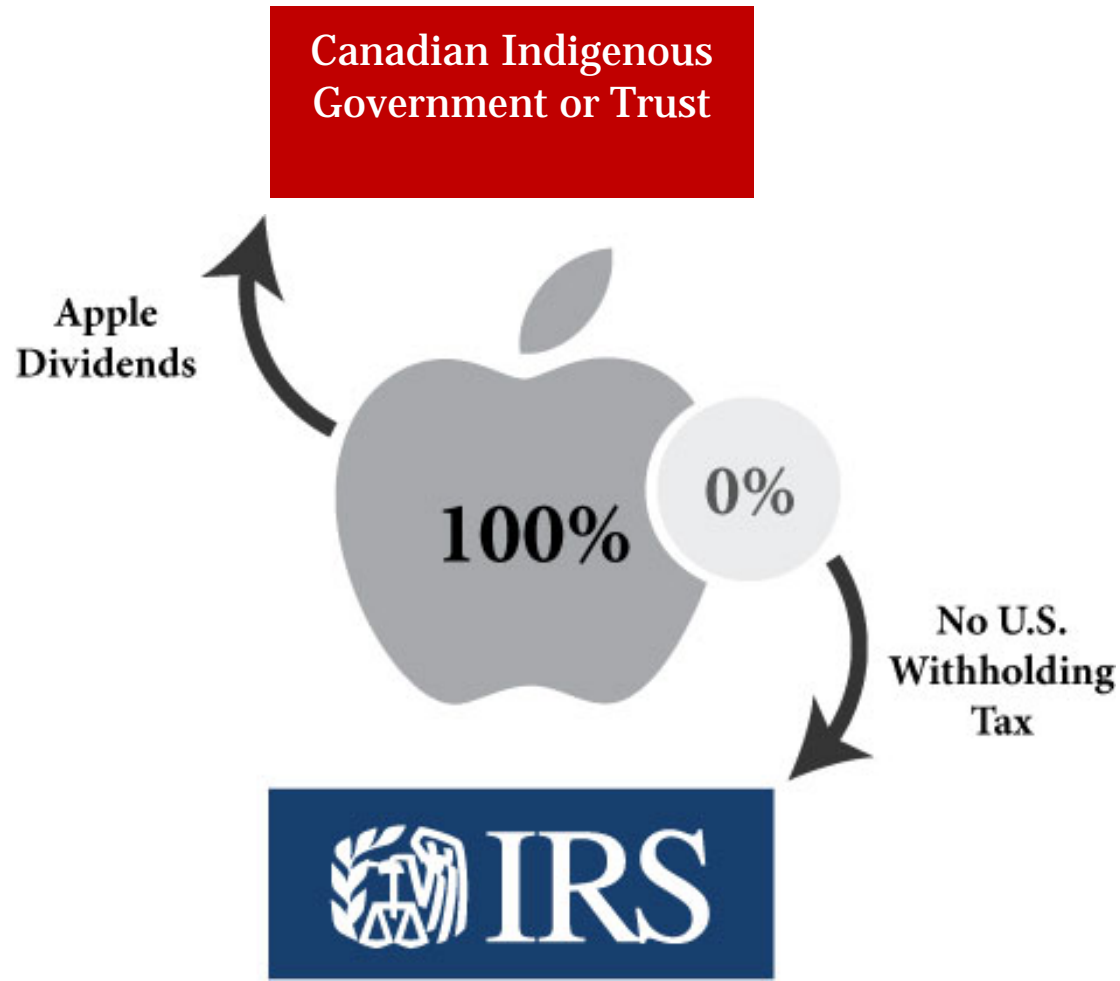
Segregate U.S. Equity Portfolio

- Holding securities on a segregated basis means that you own the individual securities and they are registered in your name
- All forms dealing with withholding taxes apply only to your securities
- Pooled funds where you own units of the fund which owns the actual securities generally withhold taxes for everyone invested through the fund.
- The U.S. securities must be held on a segregated basis. Your Investment Consultant or Portfolio Manager can advise on whether it makes sense to segregate all North American Equities.

File Forms with Custodian

- Third step – provide forms to custodian
- First Nation -> Form W-8EXP
- Trust - > W-8IMY
- Forms are complicated
- **Don't file without opinion first as all clients are different and a minority may not be eligible**

No U.S. Taxes Payable



Other Benefits

- Opens up tax free investments in more complex U.S. investments
- Can invest in certain U.S. REITs on tax free basis
- Can invest in certain U.S. Private equity funds on tax free basis
- Each complex investment is different and requires specific tax advice



Part 3 – Refund Claims

Overview

- Can claim refunds for past taxes paid in prior three or four years
- Segregated portfolio - > simple
- Pooled funds -> more complex
- Can net a lot of new revenue

Segregated Funds

- Refund of tax withheld
- Get Form 1042-S from the custodian
- File Form 1120-F for each of the last 3 years
 - On the basis that the funds were not subject to U.S. withholding pursuant to Code section 892

Pooled Funds

- More difficult to get refunds when funds invested in pooled funds
- Withholding is done at pooled fund level
- Pooled fund organized as trust in Canada
- Pooled fund usually takes the position it is a corporation for U.S. tax purposes
- Alternate view -> it is actually a partnership
- Withholding done on behalf of partners
- First Nation is a partner - > can claim refund



Part 4 – Benefits

Benefits

- Investment Consultant or Portfolio Manager can provide precise amounts of tax withheld
- Here are some estimates based on portfolio size
- These estimates are net of any potential increase in custody fees
- Savings can dramatically increase annual income that can benefit the community

Potential Savings - \$12 Million portfolio

Actual Trust that applied for exemption

- CAD \$12 million portfolio
- Estimate ~ CAD \$9,000/year in future savings
- \$90,000 estimate over 10 years.
- Refund claim (for previous 3 years) -CAD \$15 – 27,000

Potential Savings - \$40 Million portfolio

- CAD \$40 million portfolio
- Estimate ~ CAD \$25,000/year in future savings
- \$250,000 over 10 years.
- Refund claim (for previous 3 years) -CAD \$45 – 75,000

Potential Savings - \$70 + Million portfolio

Actual Indigenous Government body

- CAD \$80 million portfolio
- Estimate ~ CAD \$70,000/year in future savings
- \$700,000 over 10 years.
- Refund claim (for previous 3 years) -CAD \$150-210,000



Part 6 – Past Successes

Past Successes

- Successfully implemented this for ten communities
- Got refunds for two different communities
- IRS granted refund of CAD 90K to one client for funds invested in pooled funds
- No unsuccessful refund claims

Conclusion

- There is never enough money to do everything you want whether it is economic development or youth programming or housing
- Why leave money on the table for the U.S. government
- As a fiduciary you want to and have a **duty** to act in the best interest of the beneficiary
- From an investment perspective why wouldn't you want to keep the extra return

Conclusion, cont'd

- Current tax paid is material on most portfolios
- Strategy can yield significant benefits over time on portfolio investments and open up alternative asset classes
- Professional fees pay for themselves in one year
- Very low tax risk

QUESTIONS?

ABOUT KELLY RODGERS, CFA



Kelly Rodgers has over 30 years experience in investment management and investment consulting and was awarded the Chartered Financial Analyst designation in 1989. In 1993, she formed Rodgers Investment Consulting and has been widely published and quoted on portfolio management issues. Her firm provides portfolio analysis, asset management consulting, manager search services and expert witness reports for individuals, not-for-profit organizations and aboriginal communities.

She has worked with Aboriginal communities since 1996, providing Chief and Councils and Trustees with assistance in the development of Investment Policies, investment manager selection and the development of trust agreements. Rodgers Investment Consulting was a founding member of NATOA and led the curriculum development for the investment content of the Trustee Training program.

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Kelly is currently the Vice Chair of the Finance and Investment Committee of Anishnawbe Health Foundation

ABOUT MAX REED



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Max is a cross-border tax lawyer. He assists clients with tax problems that span the U.S./Canada border with a particular emphasis on U.S. taxation for Canadian corporations, trusts, and individuals and investment funds.

Max has written widely on the topic of cross-border taxation. He wrote co-wrote a book on the taxation of U.S. citizens in Canada, numerous technical tax articles (one of which one an award from the Canadian Tax Foundation), a series of columns for the National Post. He is regularly invited to speak on cross-border tax issues including at conferences organized by the Canadian Tax Foundation, the New York Society of CPAs, Democrats Abroad Canada, and he was invited to testify before the Canadian House of Commons Finance Committee on the impact of U.S. tax law on Canadians.

Prior to joining SKL, Max worked at an White & Case LLP, an international law firm in New York City where he provided U.S. tax advice to individuals, corporations, and foreign states. He holds a BA and two law degrees from McGill University and is admitted to the bars of BC and New York.

THANK YOU!