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## Structuring First Nations Economic Development

### INTRODUCTION

The trend around the world has been for governments to get out of the business of doing business. The last twenty years has seen this trend continue and grow, from the privatization of airlines, railways and other transportation ventures, to include what have historically been considered common government services, such as the delivery of mail and other communication services. Moving opposite this worldwide trend are aboriginal governments.

In addition to providing increasing levels of government services to their members, more and more aboriginal governments are investing, and are directly involved, in for profit business ventures. This increasing involvement has many reasons, such as a desire to provide employment opportunities for members, alternate sources of cash flow as government equalization transfers decline, a desire to share in the wealth of the natural resources taken daily from their traditional territories or the desire to access the capital wealth of their reserve or treaty lands.

Whatever the reason, when First Nation governments participate in the world of mainstream economic development, they should keep in mind the following three primary considerations:

1. reducing liability exposure;
2. maximizing profits (by minimizing taxes and avoiding own source revenue claw backs by Canada); and
3. separating political considerations from business decisions.

Our economic development structuring addresses the above three primary considerations through the following two components:

1. a corporate structure (creating the legal entities and relationships owned by the First Nation to carry out its economic development); and
2. a governance structure (establishing the processes, roles and responsibilities of the key stakeholders in the First Nation's economic development).

Each of these components will be discussed in detail below.



## **RATCLIFF & COMPANY LLP'S EXPERIENCE**

Ratcliff & Company LLP is one of Canada's leading law firms representing First Nations on issues of concern to them. Our First Nations practice has been a cornerstone of our firm for almost 50 years. We have assisted First Nations with successfully asserting and establishing their aboriginal rights and land claims, negotiating and implementing treaties and other landmark agreements, regaining lost lands, and developing profitable and successful business and land development opportunities. Through all of these areas we seek to help First Nations increase the wealth and prosperity of their communities and protect and promote their distinct and vibrant cultures.

A significant part of our work consists of assisting First Nations across British Columbia in structuring their economic development opportunities, both on and off their reserve lands or treaty lands. Based on what we have learned from that experience and from our review of the Harvard Project<sup>1</sup> reports, we have developed a model for structuring economic development for First Nations that we believe is un-paralleled. We have assisted well over a dozen First Nations with implementing these corporate structures and governance structures over the past number of years.

## **CORPORATE STRUCTURE**

Our corporate structuring addresses the first and second primary considerations for First Nations when they engage in economic development: reducing liability exposure and maximizing profits (by minimizing taxes and avoiding own source revenue claw backs by Canada).

### *Liability protection*

The most common way to reduce liability exposure is to use a separate incorporated legal entity to pursue the economic development opportunity, such as a corporation. The advantage of this is, as the shareholder of a corporation, the liability for the business operations remains with that separate legal entity and should not flow back to the First Nation. The disadvantage is that a corporation is taxable. This conflicts with the second primary consideration of maximizing profits by minimizing taxes.

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<sup>1</sup> Founded by Professors Stephen Cornell and Joseph P. Kalt at Harvard University in 1987, the Harvard Project on American Indian Economic Development (Harvard Project) is housed within the Malcolm Wiener Center for Social Policy at the John F. Kennedy School of Government, Harvard University. Through applied research and service, the Harvard Project aims to understand and foster the conditions under which sustained, self-determined social and economic development is achieved among American Indian nations. For over two decades, the Harvard Project has undertaken hundreds of research studies and advisory projects. Results of Harvard Project research are published widely. Summary treatments are provided in "Reloading the Dice: Improving the Chances of Economic Development on American Indian Reservations" (Cornell and Kalt) and "Sovereignty and Nation-Building: The Development Challenge in Indian Country Today" (Cornell and Kalt). [Extract from <http://hpaied.org/about-hpaied/overview/>.]

## Avoiding tax

A Indian band, in most cases, should be tax exempt as a “public body performing the function of government” under section 149(1)(c) of the *Income Tax Act*. A modern Treaty First Nation, either under the terms of its Treaty or a side agreement to the Treaty, is typically tax exempt as a “public body performing the function of government” under section 149(1)(c) of the *Income Tax Act*.

There is a principle in Canadian Constitutional law that one government does not tax another government. This underlies the public policy behind section 149(1) of the *Income Tax Act*. What the Canada Revenue Agency (“CRA”) looks for in determining whether or not an entity is a “public body performing the function of government” involves a two-part test.<sup>2</sup> Firstly, is the entity a “public body” and secondly, is it “performing a function of government”?

The factors the CRA considers in determining whether or not an entity is a “public body” include the following:

- Does the entity’s existence and authority arise from statute?
- Does the entity have a governance purpose and is it accountable to those governed (election procedures are one form of that accountability)?
- Does the entity have functions and carry out transactions for the benefit of the community over which it has authority?

The factors the CRA considers in determining whether or not an entity is a “performing a function of government” include the following:

- Does the entity carry out activities undertaken to meet a governance role within a geographic area?
- Has the entity enacted laws and imposed taxes?
- Has the entity been involved in negotiating and implementing a treaty with Canada, a province or territorial government?
- Has the entity been providing government services (such as services relating to education, health care, protection of the environment, management of natural resources, land use designations, water, sewage, waste, infrastructure, public transit, police and fire protection, ambulance, services, social services, etc.)?

For a First Nation that meets these criteria, it is a “public body performing the function of government” and is tax exempt under section 149(1)(c) of the *Income Tax Act*. To have a degree of clarity on this point, however, requires a First Nation to obtain a ruling from the CRA

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<sup>2</sup> See CRA statement “Qualified Donee – Municipal or Public Body Performing a Function of Government in Canada” dated March 7, 2013 at <http://www.cra-arc.gc.ca/chrts-gvng/qlfd-dns/mncplpblcbds-ltr-eng.html>.

on the question. Such a ruling is not required for most Treaty First Nations since their designation as a “public body performing the function of government” is certain, either under the terms of its Treaty or a side agreement to that Treaty. However, advance rulings from the CRA are always qualified by the CRA saying they are not bound by the advance ruling and are free to take a contrary position in the future.

For business opportunities on the First Nation’s own reserves or treaty lands, this tax exempt status will be extended by section 149(1)(d.5) of the *Income Tax Act* to a corporation that is at least 90% owned by the First Nation, provided that 90% of the corporation’s income is earned on the reserve or treaty lands of that First Nation.<sup>3</sup> In addition, the tax exempt status under section 149(1)(d.5) would extend to a corporation of which the First Nation and one or more additional tax-exempt First Nations or Canadian municipalities collectively own at least 90% of the capital, provided that 90% of the corporation’s income is earned within the boundaries of the reserve or treaty lands of the First Nation owners and, if applicable, within the boundaries of the municipal owners. However, 100% of the income of a corporation is fully taxable if the corporation is more than 10% owned by entities that are not tax exempt First Nations or Canadian municipalities or if more than 10% of the corporation’s income is earned outside the boundaries of its First Nation and municipal owners.

For a First Nation that is tax exempt under section 149(1)(c) of the *Income Tax Act*, utilizing a corporation for business activities on that First Nation’s reserves or treaty lands provides limited liability protection to the First Nation (as shareholder) and should minimize any taxes that must be paid, thereby meeting the first two primary considerations set out above. However, utilizing a corporation to pursue economic development opportunities that involve other owners which are not tax exempt First Nations or Canadian municipalities, or that are conducted off of that First Nation’s reserves or treaty lands, does not provide any tax advantage because, in either case, the corporation would not qualify to be tax exempt under section 149(1)(d.5) of the *Income Tax Act* due to the 90% ownership or income requirements. In those circumstances, in order to provide limited liability protection and maintain the First Nation’s tax advantage, a different structure must be utilized.

### *Own source revenue*

All modern Treaty First Nations are faced with issues concerning own source revenue (“OSR”). Under the terms of its Fiscal Financing Agreement and Own Source Revenue Agreement, a Treaty First Nation’s funding contributions from Canada are subject to reduction in an amount

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<sup>3</sup> There are two conflicting bodies of case law relating to First Nations being “municipalities” for purposes of section 149(1)(d.5) of the *Income Tax Act*: *Otineka Development Corporation Limited and 72902 Manitoba Limited v. Her Majesty the Queen*, [1994] T.C.J No. 23 (T.C.C.) (which found an Indian Band was a “municipality” for purposes of that section) and *Tawich Development Corporation v. Deputy Minister of Revenue of Quebec*, [2000] J.Q. no 1552 (QCCA) (which found an Indian Band was not a “municipality” for purposes of a similar section under Quebec tax law).

equal to a percentage of its OSR. This OSR reduction is typically phased in over a 20 year period after the Treaty effective date, with an exemption of 100% for the first five years, followed by a 3.3% increase each year thereafter up to a maximum of 50%. This OSR rate is applied to defined revenues to determine the annual reduction. Dividends from corporations and distributions from a partnership are two of these defined sources of revenue. However, dividends and distributions are not subject to OSR reduction until actually paid to the Treaty First Nation. If they are never paid, the Treaty First Nation will never be subject to that OSR reduction. To avoid the OSR claw back, then, requires the Treaty First Nation to not receive profits from its business operations. This may create difficulties if the First Nation requires profits from one of its business opportunities to invest in a new business opportunity.

Issues around OSR are also becoming a growing concern for Indian bands. Until recently, OSR was only a concern for First Nations entering into modern treaties with Canada. However, OSR issues are also coming up for First Nations not in the treaty process. We have recently seen these issues arise in education funding negotiations between Canada and a number of First Nations seeking to control their own education systems on their reserves. Utilizing our corporate structure may assist in avoiding these OSR concerns for Indian bands, as well as Treaty First Nations, in the future.

### *Recommended corporate structure*

#### *Corporations and limited partnerships*

The structure that we have found the most successful for limiting liability exposure and maximizing profits (by minimizing taxes and OSR) is a limited partnership registered under the *Partnership Act*. A partnership is a relationship (usually contractual) between partners doing business together. This relationship is governed by the *Partnership Act* and the contract (partnership agreement) that establishes the partnership. A limited partnership under the *Partnership Act* is required to be registered and have a general partner and at least one limited partner. The general partner is typically a corporation that holds the assets of the business and is subject to all the liabilities of the business. The limited partner, on the other hand, is only liable for the amount that it invests in, or loans to, the partnership. If the business fails or other liabilities arise, these liabilities cannot be traced back to the limited partner and they remain with the general partner. This limited liability protection for the limited partner continues as long as the limited partner does not engage in the management of the business (this is discussed further below). If more than one First Nation is involved in the business opportunity, each First Nation can be a separate limited partner. The limited liability protection that limited partnerships provide assists with addressing the first primary consideration of reducing liability exposure.

Because of the legal uncertainty under the *Partnership Act* as to whether or not an *Indian Act* Indian band has the legal capacity to hold units in a partnership, we utilize a corporate bare trustee to hold those partnership units on a bare trust on behalf of the Indian band as a limited partner. A bare trust is ignored for liability and tax purposes. Although the Indian band is a limited partner through its bare trustee, liability is not a concern since it is protected from liability as the limited partner. However, the profits from the business under the terms of the

partnership agreement can be allocated for tax purposes directly through the bare trust to the Indian band if it is tax exempt under section 149(1)(c) of the *Income Tax Act*. If more than one Indian band is involved in the business opportunity, each Indian band could be a limited partner represented either by its own bare trustee corporation or one bare trustee corporation could represent all the Indian bands involved.

#### *Allocation of income for tax purposes in limited partnerships*

In addition to the liability protection a limited partnership provides to the limited partner, because of the way section 96(1)(f) of the *Income Tax Act* treats partnership income for tax purposes, the partnership agreement can be structured in such a way that virtually all of the profit from the business is allocated to the limited partner, if such an allocation is justified. One justification might be if the limited partner provided all the investment capital for the business start-up. Profits are allocated for tax purposes to each partner's capital account in accordance with the terms of the partnership agreement. If a limited partner has an advantageous tax position (such as a First Nation under section 149(1)(c) of the *Income Tax Act* as discussed above), then the profit may be earned on a tax free or tax reduced basis.

#### *Own source revenue and limited partnerships*

The partnership agreement can also be structured in such a way that a portion of the profit, although allocated to the limited partner for tax purposes, can be retained by the partnership to sustain or expand the current business or pursue new business opportunities. Any decision concerning distributions from the capital accounts to the partners is left to the general partner, which must consider the needs of the partnership, both as to current and future operations and the growth of the business. Therefore, having a partnership agreement that allows for profit to be retained in the limited partner's capital account, available for future economic development opportunities, avoids having that profit distributed to the First Nation as own source revenue which would reduce Canada's funding contributions to the First Nation. The avoidance of tax and OSR addresses the second primary consideration stated above (maximizing profits by minimizing taxes and OSR).

#### *Two-tiered limited partnerships*

As noted above, we also recommend that the corporate structure for First Nations' economic development include one "holdings" limited partnership and multiple "operating" limited partnerships, with the ability to add new operating limited partnerships as new business opportunities are pursued. There are three reasons for this recommendation:

1. The creation of separate "operating" limited partnerships to pursue each business opportunity ensures that, if one business opportunity fails, it will not have a negative impact on all the other successful businesses. Since each corporate general partner for each operating limited partnership is a separate legal entity, the liabilities and risks in pursuing each separate business opportunity are compartmentalized, isolating them from the others. This is discussed in greater detail below as part of our recommended governance structure.

2. Establishing a holdings limited partnership between the First Nation and the operating limited partnerships allows profits from one operating limited partnership to be moved through the holdings limited partnership to another or new operating limited partnership, which should allow the First Nation to avoid OSR claw backs because of that revenue.
3. Having a holdings limited partnership further separates business decisions from political considerations (discussed in greater detail below). The board of directors of the general partner in the holdings limited partnership (the “holdings board”) can be mandated to oversee the implementation of the First Nation’s economic development strategy. The First Nation can appoint to the holdings board individuals who have particular expertise in making business and investment decisions, including individuals representing the First Nation (such as a member of Council, an elder or a youth) and others from the community with the required expertise. The separation of politics and business is discussed in greater detail below as part of our recommended governance structure.

#### *Holdings limited partnership*

In our recommended corporate structure the First Nation would be the limited partner in the holdings limited partnership. If the First Nation is an Indian band, it would be a limited partner in the holdings limited partnership through a numbered corporation acting as bare trustee (to address the concern that a First Nation is not a “person” under the *Partnership Act*). For both Indian bands and Treaty First Nations, this limited partnership would serve as the “holdings” limited partnership, discussed above. A Treaty First Nation, as the shareholder of the general partner of the holdings limited partnership, would appoint the board of directors for the general partner. Likewise, an Indian band, as shareholder of the bare trustee corporation which, in turn, is the shareholder of the general partner of the holdings limited partnership, would appoint the board of directors for these two companies. The role and size of this board is discussed in greater detail below as part of our recommended governance structure.

#### *Operating limited partnerships*

The holdings limited partnership, through its general partner, would, in turn, be the limited partner in each operating limited partnership. The general partner of the holdings limited partnership would be the shareholder of each of the general partners of the operating limited partnerships and the holdings board would appoint the board of directors of each of these operating general partners (the “operating boards”). These operating boards should be individuals who have particular expertise relating to the particular business opportunity being pursued by that operating limited partnership. Alternatively, if there are insufficient individuals with the expertise to fill positions on all the operating boards, the same individuals can be appointed to all the operating boards (this is discussed in greater detail below as part of our recommended governance structure).

These operating limited partnerships would carry out the existing economic development opportunities of the First Nation. Other operating limited partnerships can easily be added to this

structure for each new business opportunity as it arises. This ensures that if one business opportunity fails, it will not have a negative impact on any of the others.

#### *Implementing our recommended corporate structure*

Transitioning a First Nation's current business operations into our recommended corporate structure may have tax implications, depending on the legal ownership of those business operations and where they are legally located. A transfer of a business and its assets to a limited partnership may trigger certain taxes, including income taxes and transfer taxes, even if the corporation currently holding those assets becomes the general partner of the limited partnership. Tax advice should be obtained by a First Nation implementing our recommended corporate structure, especially if current business operations are to be transitioned into the new corporate structure, to ensure that, to the greatest extent possible, those taxes, including transfer taxes, are minimized.

#### *Provincial sales tax*

It is worth noting that, although the limited partnership structure we utilize allocates profits to the limited partner for the purposes of income tax, it may not allow the limited partnership to avoid payment of provincial sales tax without taking additional steps. Courts have recently found that a general partner must pay the full amount of provincial sales tax that applies to any of its purchases made on behalf of a limited partnership, even where the limited partner would not have to pay such taxes.<sup>4</sup> Avoiding the payment of provincial sales tax associated with First Nations' economic development has now become more challenging. We are currently working on a structural solution to address this concern so it can be rectified.

#### *Advantages of corporate structure*

1. The advantage of this structure is the holdings limited partnership and the operating limited partnerships provided two tiers of liability protection for a First Nation, protecting it from any liabilities that may arise from the business activities of the operating limited partnerships.
2. Further, with this corporate structure, one operating business is protected from the other operating businesses because it is conducted through a separate operating limited partnership. If one business fails, it should not impact the others, provided the limited liability protection this corporate structure provides is not lost for some reason (which we will discuss next).
3. All the while, because of how partnerships are treated for tax purposes under section 96(1)(f) of the *Income Tax Act*, an operating limited partnership can be structured in such a way that 99.99% of the active business profits from the operating limited partnership may be allocated to the holdings limited partnership for tax purposes, provided such an allocation can be

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<sup>4</sup> *Edenvale Restoration Specialists Ltd. v. British Columbia (Finance)*, 2013 BCCA 85; *R. v. Tron Power Inc.*, 2013 SKQB 179.



justified. Likewise, 99.99% of the profits allocated to the holdings limited partnership may be allocated back to the First Nation for tax purposes, which should be tax exempt under section 149(1)(c) of the *Income Tax Act*. This means 99.98% of operating profits may be earned on a tax free or tax reduced basis.

4. Finally, the partnership agreements can be structured in such a way as to ensure profits may be invested to expand current business operations or invest in new business opportunities without having those profits flow through the First Nation as OSR.

The above achieves the first two primary considerations discussed at the beginning by providing liability protection while maximizing profits by minimizing taxes and OSR.

### *Loss of liability protection*

One of the risks First Nations must be aware of in using corporations and limited partnerships to pursue economic development is what is known as the “piercing of the corporate veil” and its associated loss of limited liability protection. The limited liability protection offered by corporations and limited partnerships may be lost in three circumstances.

#### *Inaccurately using corporate names*

The first is when people dealing with the business are not aware they are dealing with a limited liability entity. Corporations often have names that contain three elements: 1) a distinctive element (something that sets the name apart from all other names), 2) a descriptive element (something that describes the nature of the business) and 3) a corporate designation (“Ltd.”, “Inc.”, “Corp.” or “Company” or similar words). A limited partnership must have the words “limited partnership” at the end of its name.

In its business dealings, a corporation or limited partnership is required, in order to maintain the limited liability protection, to use its full and proper name in the business, including the corporate designation or limited partnership designation. If it does not and a person suffers loss, the courts will look to the shareholders or limited partner to cover that loss (thereby “piercing the corporate veil”). It is therefore critically important that each corporation or limited partnership created to carry out the economic development opportunities of a First Nation always use its full and proper legal name as it conducts its business. The naming of a First Nation’s businesses is discussed further below as part of our recommended governance structure.

#### *Lacking clarity in who is conducting the business*

Secondly, the limited liability protection can be lost when it becomes unclear who is carrying out what business. This can happen when a First Nation has multiple companies, some with similar businesses, and it is not always kept perfectly clear which company is operating which business. If the separation is not perfectly clear at all times and there is confusion regarding who a person is actually doing business with, the limited liability protection may be lost by a court saying all the companies are liable. Strategies for the “compartmentalization” of a First Nation’s

businesses to avoid this risk are discussed further below as part of our recommended governance structure.

### *Managing by the limited partner*

The third circumstance under which limited liability protection may be lost is if a limited partner engages in the day-to-day operations of the business. Under section 64 of the *Partnership Act*, a limited partner is not liable for the debts of the partnership "...unless he or she takes part in the management of the business." It would be important if our corporate structure is implemented for a First Nation, in order to maintain the limited liability protection corporations and limited partnerships provide, that the First Nation's government (both the political leadership and senior administration) not be seen to be engaged in the management of the business of the holdings limited partnership. This "management and control" issue is also discussed in greater detail below as part of our governance structure.

### *Reversionary trusts*

We have been asked in the past to comment on other structures that have been utilized for First Nations economic development, in particular, reversionary trusts which rely on section 75(2) of the *Income Tax Act* (the "attribution rules") to access the tax exemption for "Bands" and "Indians" relative to reserves and property on reserves found under section 87 of the *Indian Act* without relying on section 149(1)(c) of the *Income Tax Act*.

Like a corporation, a trust (whether it is reversionary or discretionary) is not an "Indian" under the *Indian Act* and therefore, in and of itself, is not tax exempt. In fact, trusts (other than estate trusts) are usually taxed at the highest tax rates. The idea behind utilizing a reversionary trust is to trigger the attribution rules found in section 75(2) the *Income Tax Act* so first generation income of a reversionary trust is deemed to be income of an Indian band. If a reversionary trust is created properly (with a right of reversion to the settlor), the attribution rules will most likely be triggered, deeming the first generation income of the reversionary trust to be income of the Indian band and not taxable under section 87 of the *Indian Act*. However, this deeming does not extend to second generation income (income earned on income). There also remains the question of whether or not the first generation income is actually earned on reserve, which is required in order for the Indian band to claim the tax exemption for that income under section 87 of the *Indian Act*. This may not be as easy to accomplish as it once was thought, since the courts have consistently strived to narrow the application of that section.

Without attempting to provide an exhaustive overview of the very technical and complicated law relating to section 87 of the *Indian Act*, we can say that for a reversionary trust and section 87 of the *Indian Act* to be successfully used in economic development to allow income of the reversionary trust to be tax exempt without relying on section 149(1)(c) of the *Income Tax Act*, the following criteria must be met:

1. the reversionary trust must be "resident" on reserve (where the trustees reside, where the decision making takes place, where management and control of the trust is exercised, where

the assets of the trust are located and where the beneficiaries of the trust reside are all factors considered by the CRA),

2. the income must be earned on-reserve (where the activities are located giving rise to the income earned will be considered by the CRA), and
3. all second generation income (income earned on income, as opposed to capital) must be distributed (paid or made payable) to the Indian band each and every year.

It is, in our view based on the case-law, becoming increasingly difficult to structure off-reserve economic development in such a way so that, as a matter of law, the income is deemed to be earned on-reserve. To the extent that the income of a reversionary trust is earned off-reserve in the “commercial mainstream” (to use a phrase from case-law on the topic), it will, in our view, most likely be taxable, thereby cutting into profits. Further, the requirement that all second generation income (income not attributed to the Indian band under section 75(2) of the *Income Tax Act*) be distributed each year in order to avoid it being taxed at the highest marginal tax rate, restricts the ability of the First Nation’s business operations to retain the financial resources necessary to sustain or expand the business, thereby limiting growth and success. Others have dealt with this concern by using promissory notes each year to make that income payable on demand from the trust to the Indian band and not actually distribute the income to the Indian band. This practice, although likely avoiding the tax payable on that income, results in ever increasing amounts “payable to” and “payable from” being recorded on the financial statements of the trust and the Indian band which likely never will (or even could) be paid, and is therefore a fictitious asset for the Indian band and a growing liability for the trust which distorts the true reality of the First Nation’s business operations. In addition to these difficulties, the law around trusts is also complex and restrictive and the duties and fiduciary obligations placed on trustees may result in personal liability for those trustees which they otherwise wouldn’t have to face. This may make it difficult to even find individuals, properly advised, to serve as trustees of a reversionary trust.

Reversionary trusts add additional levels of complexity to a First Nation’s economic development which, in our view, are completely unnecessary and likely do not accomplish what they are intended to do. In the end, we have greater confidence relying on corporations, limited partnerships and section 149(1)(c) of the *Income Tax Act* in order to have economic development income earned off-reserve be tax exempt and available to a First Nation’s business operations to sustain and expand the businesses than we do relying on reversionary trusts and section 87 of the *Indian Act*. That is why corporations, limited partnerships and section 149(1)(c) of the *Income Tax Act* are our preferred corporate structure for First Nations economic development, the focus of which must often be, of necessity, off-reserve.

### GOVERNANCE STRUCTURE

Below we review the rationale behind the governance structure model we recommend to our First Nation clients for structuring their economic development. When implemented, our recommended governance structure would establish the processes, roles and responsibilities of

the key stakeholders in a First Nation's economic development. Our governance structure helps to address the first and third primary considerations when a First Nation participates in the world of mainstream economic development: reducing liability exposure and separating politics from business decisions.

### *Politics and business*

One of the three primary considerations stated at the beginning for First Nations when structuring their economic development is the importance of separating politics from business. The Harvard Project reports suggest that one of the keys to successful aboriginal economic development is competent business management free from political interference. In other words, the separation of politics from business. We agree, based on our experience, that this separation of politics from day-to-day business decision making is essential for successful First Nation economic development.

A common problem often seen with First Nations economic development is the lack of clear separation between the First Nation's government, both leadership and administration, and their business administration. It is often First Nation employees that provide management, administrative, financial, record keeping, accounting and advisory services to the First Nation's businesses. Often the businesses do not even have their own bank accounts, with business income deposited in the First Nation's bank accounts and business expenses paid from those accounts. The only separation is in the general ledgers of the First Nation's accounting systems where the businesses are treated as separate departments of the First Nation government. As well, it is often the case the First Nation's senior administrator is also acting as the businesses' chief executive officer or most senior manager. It is difficult for business decisions to be made without political considerations when politicians are the ones making (or directing) the business decision. Political considerations seldom result in sound business decisions. Business often requires tough decisions to be made which, at times, may be unpopular, particularly for politicians who, of necessity, are interested in maintaining popularity with the voters. Having the First Nation's government representatives in charge of economic development creates challenges that are difficult, if not impossible, to overcome. These problems have been well documented in the Harvard Project reports and invariably cause the failure of many aboriginal businesses.

Separation of politics and business ensures that day-to-day business decisions are made by people with business expertise to achieve sound business objectives and not by politicians influenced by political considerations for political purposes. In our recommended governance structure, the operating limited partnerships are left to pursue the business opportunities they have been mandated with in the manner the operating board thinks best. Although ultimate ownership and control would remain with the First Nation as the ultimate shareholder, its rights as shareholder under the common law and the *Business Corporations Act* are limited to, among other things, appointing and removing the holdings board, not actually telling the holdings board or the operating boards what to do on a day-to-day basis. Oversight of the First Nation's economic development would be left to the holdings board, separate from the politics of the First Nation's government (the elected members or senior administration). Similarly, although the

holdings board would appoint the operating boards, decisions of the operating boards concerning the day-to-day operations of the operating limited partnerships would be separated from the holdings board and twice separated from the First Nation's government.

A lack of separation between the First Nation's government and its business administration would not only decrease the chances of having successful businesses, as found by the Harvard Project research, but it would also blur the separation (or "compartmentalization") between the First Nation and its businesses which may lead to the "piercing of the corporate veil" (discussed above as well as being discussed further below), with its associated loss of limited liability protection. Separating the First Nation government from business administration by having separate management, separate employees, separate bank accounts, separate accounting and financial records, separate signage, invoices, letterhead, business cards and promotional material (including its internet presence), etc. is important for the success of the business and for maintaining the compartmentalization and limited liability protection for the First Nation and its businesses.

### *Roles and responsibilities*

The Harvard Project reports also conclude that for aboriginal economic development to be successful, the roles and responsibilities of the key participants (the First Nation's government, boards of directors and senior business management) must be clearly written out and adhered to. Tensions and mistrust develop when people perceive others intruding on their areas of responsibility, stepping outside their roles or lacking in transparency or accountability. Where such behaviours take place, senior business management spends more time dealing with government administration and politics than running successful businesses. When this happens, the business will most likely fail.

The Harvard Project reports suggest that the proper role of the aboriginal government in its economic development is to determine the vision, mission and values of, and set the strategic direction for, its economic development. The proper role for the boards of directors would be to implement the First Nation's vision and mission for its economic development in accordance with the approved values, oversee senior business management, make major operational decisions, approve policy and procedure for the businesses and report on the business operations to the First Nation government. It would be the proper role of senior business management to direct the day-to-day operations of the businesses, including human resource decisions, implement the policies and procedures approved by the board of directors and report to the board of directors on business operations.

It has also been confirmed by our experience and the Harvard Project reports, however, that written roles and responsibilities (whether they are in policy, agreements or even legislation) can only go so far to ensure successful economic development. What also is required is leadership (political leadership, government administration and business leadership) who are not only capable of fulfilling their assigned role and responsibilities, but who are also committed to not intruding into the roles and responsibilities of others. All leadership in First Nation's economic

development, while guarding their own roles and responsibilities, must respect each other's roles and responsibilities and allow each to do their job as they see fit.

The key leadership stakeholders on the business side of First Nation's economic development would be the boards of directors. If our recommended corporate structure and governance structure are to be implemented by a First Nation, careful thought must be given to which individuals are to fulfill the roles and responsibilities of the various boards of directors and what skill sets they will need to bring to the table. Boards comprised of skilled and experienced directors with the strength to withstand political interference are essential for successful economic development.

### *Board of directors*

We have been asked at times to comment on the optimum size of a board and who should be appointed to the board. To answer these questions requires an analysis of the role of the particular board in question within the overall governance structure of the First Nation's economic development. An understanding of the traditional decision making processes for the First Nation is also helpful.

### *Director qualifications and selection criteria*

The board of directors of a corporation is elected by the shareholders to oversee and guide the activities of the corporation and to give "direction" to the corporation (hence the name "directors"). As such, they are stewards of the corporation and its assets. Legally, to be appointed as a director, an individual must be at least 19 years of age, be capable of managing his or her own affairs, not be an un-discharged bankrupt and not have been convicted of an offence in connection with the promotion, formation or management of a corporation or involving fraud. A director must also be ethical, act honestly and in good faith in the best interests of the corporation and avoid or declare conflicts of interest in his or her decision-making (sometimes referred to as fiduciary duties).

In addition to the above legal requirements, an individual appointed to a board of directors must have the availability and be able to commit the time to be actively involved. Attendance at board meetings is imperative in order to effectively carry out a director's responsibilities and meet their legal obligations (and avoid personal liability). Time is also required in advance of board meetings for reviewing information and becoming informed on the decisions to be made. Taking the time for preparation is essential for efficiency in board processes, ensuring board meetings are not overly long and decisions can be made in a timely manner. Having an aptitude for business is also essential (such as start-up business experience, managerial experience, financial or accounting expertise, legal expertise, an understanding of human resource issues, etc.). Many of the issues directors are asked to make decisions on will involve complex considerations covering a broad range of expertise, including legal and financial considerations. Having individuals on the board that bring specialized expertise with them is invaluable.

A director must also be prepared to participate fully and frankly in board discussions, be willing to listen and demonstrate openness to other's views and opinions and be a positive and constructive contributor to board deliberations. Having a certain degree of independent (but respectful) thinking is also an asset. A director must have the confidence and will to make tough business decisions, including, at times, to challenge the majority view. Appropriate and respectful interactions with others in a supportive and non-confrontational manner, while respectfully standing firm on matters of conviction, are essential to being a productive member of a board of directors.

Below is a summary of what we believe would be key skills and experience necessary to have represented on a board of directors for a corporation created to carry out economic development for a First Nation:

- previous experience as a director;
- ability to comprehend financial and non-financial performance reports;
- ability to comprehend strategic plans, concept studies, business plans and risk management strategies;
- knowledge of board processes;
- knowledge of government processes;
- ability to recruit and select a chief executive officer and hold him or her to defined accountabilities;
- knowledge of, and experience in, one or more of the following areas: business generally, investment, legal, financial, management, human resources, marketing or the specific business field within which the business operates;
- fiduciary experience or understanding;
- strong communication and interpersonal skills; and
- experience with or a good understanding of the First Nation and the specific needs of the First Nation's community.

The following personal qualities are also an asset for any individual assuming the position of a director on a First Nation's corporate board:

- interest in and care for the First Nation's economic development and the good of the First Nation's membership as a whole;
- respected image and profile in the First Nation's community;
- respected image and profile in the local business community;
- acts with honesty and integrity;
- demonstrated trustworthiness;
- high level of diligence and care when executing his or her duties;
- demonstrated good judgment;
- demonstrated respect for others and their views;
- ability to maintain confidentiality and impartiality;
- a desire and willingness to enhance skills and develop new skills; and

- an ability and willingness to commit the required level of experience and time to fulfill their responsibilities.

#### *Size of the board of directors*

The size of a board must balance the need for a variety of perspectives and expertise on the board (the more directors appointed to the board the broader the perspectives and expertise represented on the board) with the need for efficiency and cost savings (the fewer directors appointed to the board the more efficient board meetings will be and the less cost for honourariums and director expenses). In short, the board needs to be large enough to include diverse perspectives but not so large as to be cumbersome and expensive. An uneven number of directors is helpful in order to minimize tie votes. Three directors provide a focused board that is more likely to be efficient, but may be lacking in broader perspective. A board of directors of three individuals is best suited as an operating board focused on one operating limited partnership's discreet business activity (such as forestry). In circumstances where the board of directors oversees a wider variety of business activities (such as the holdings board or multiple operating boards with the same individuals appointed to each board and who oversee diverse business activities), a board of five or seven individuals may be more appropriate to provide that broader perspective.

When considering our recommended corporate structure and governance structure, we are of the view that the holdings board should be five or seven, but never more than nine, individuals. The general partner of the holdings limited partnership would make recommendations to the First Nation concerning investment in future business opportunities and would oversee, at a very high level, all the current active business operations of the First Nation. We feel a holdings board of five or seven individuals would be appropriate in these circumstances. This would allow one individual of the First Nation's government (elected or from administration) to be represented as well as having two or three business persons, a First Nation member, a youth or an elder also represented to provide those broader perspectives. Many First Nations appoint their economic development committee to serve on this holdings board. Similarly, the operating board should be three or five, but never more than seven, individuals, depending on the number of operating boards those same individuals are appointed to.

In our Indian band corporate structure, since the bare trustee corporation does not serve any purpose other than to hold the limited partnership units on behalf of the First Nation on a bare trust, only a small board of one individual is required (typically the Chief of the First Nation)

#### *Changing traditional ways of decision making*

We have witnessed many First Nation governments experience difficulty in "letting go" of economic development decision making and relinquishing that decision making to business leaders. This should not be unexpected in First Nation cultures which have, since time immemorial, looked to their leadership (their chiefs and elders) to make, or at least give advice on, the important decisions of the First Nation. The necessity for altering these traditional ways when it comes to economic development decision making is not always intuitive and is, at times, resisted. As well, particularly in small First Nations, there may only be a small number of





capable leaders in the community and they often already sit on Council, and may have done so for years, perhaps decades. These few individuals, the only ones who have made the important political and business decisions for the First Nation for so many years, may not see the value of allowing business leaders to make business decisions free from the politics of Council. It should not be surprising, then, if traditional decision making processes in a First Nation are difficult to change when it comes to that First Nation's economic development. More than once we have seen our corporate structuring rendered ineffective because of Council's inability to let go of business decision making. However, as suggested by the Harvard Project reports, successful aboriginal economic development often requires new ways of thinking and new ways of making decisions.

While we agree a First Nation's economic development governance structure must be in harmony with the governance needs and practices of the First Nation, it must also keep in mind the importance of separating political considerations from business decisions as found by the Harvard Project to be a key for economic development success. As well, issues concerning the "management" and "control" of the business of the limited partnership by a limited partner (the First Nation) and the risk of losing limited liability protection must also be kept in mind. In our governance structure, we see value in having one First Nation government representative (or perhaps two, depending on the size of the board) appointed to the holdings board and, perhaps, even the operating boards, to serve as a liaison and communication conduit between the businesses and the First Nation government. However, it is our considered opinion that, for the reasons discussed in this paper, if the First Nation implements our corporate structure, its government representatives must never form a majority of any board.

#### *Capacity concern*

One of the concerns expressed at times regarding our recommended corporate structure and governance structure is the number of individuals required to serve on the holdings board and the various operating boards. This is particularly so because of the concern discussed below regarding section 64 of the *Partnership Act* and a limited partner being prohibited from engaging in the management of the business of the partnership. It is for this reason that the members of the First Nation's government (either the political leadership or senior administration) must not form the majority of the holdings board and that members of the holdings board must not form the majority of an operating board. With multiple operating limited partnerships required to separate each active business opportunity from the others, how can a First Nation, particularly a small First Nation, have the capacity to fill all those positions?

The answer to this question lies in the fact that one does not necessarily require different individuals on each operating board. It is possible for individuals to sit on more than one operating board at a time. In these circumstances, however, it is important for individuals with multiple roles and responsibilities to be very clear at all times in their communication and documentation which role and which responsibility they are fulfilling at any given point in time. Having the roles and responsibilities for each position written out and strictly followed assists greatly in the separation of their various responsibilities.

### *Complimentary Role of First Nation Political Leadership*

The separation of politics from business does not eliminate other important aspects of a First Nation's role in economic development on its lands or within its traditional territory. As a government, its processes for, or involvement in, development on its lands (through land use and zoning laws) or within its traditional territory (through consultation and accommodation) must be adhered to by all, including its business enterprises. First Nations are recognized as having law making authority over their reserves or treaty lands and having a right to be consulted with and accommodated when activities take place within their traditional territories. This may also include being involved in strategic level resource management with other governments within the traditional territory. These rights and authorities continue regardless of whether or not it is a First Nation's business enterprise engaging in a particular business activity.

Political decision making under these rights and authorities should be seen as complimentary to its economic development and not as a barrier. A First Nation can use its rights and authority as strategic leverage and competitive advantage for its business activities. The ability to exercise such leverage, however, requires efficient internal communication and coordination between the First Nation and its business enterprises. In our governance model, it would be the First Nation's role, through the economic development committee, to ensure this internal communication and coordination takes place. Without this internal communication and coordination, decision-making on both sides will be less effective and more likely to create conflict with an increased risk that the First Nation and its business enterprises are working at cross purposes. An example of this cross purpose might be where a First Nation government has determined that environmental stewardship of natural resources is its most important objective within its traditional territory. The First Nation's business enterprises, however, feel that large scale commercial fishing or forestry operations present the most significant economic opportunities to be pursued. Understanding and adhering to clear roles and responsibilities while maintaining strong internal communication and coordination of planning will ensure the First Nation and its business enterprises are not working at cross purposes in a situation such as this.

### *Planning for Success*

Too often a First Nation is asked to implement what is thought by some to be an assured successful business opportunity. Unfortunately, many times little or no thought has been given, or planning carried out, to ensure the business opportunity will indeed be successful. In our governance model, planning processes are set out which are aimed at ensuring each new business opportunity has been thought through carefully and a plan is in place to give that business opportunity the best chance of success.

These planning processes are carried out in two phases. The first is a concept study which is a high level overview of a new business opportunity. This less expensive overview is intended to provide a general description of the key elements of the business opportunity sufficient to allow the First Nation to determine if it fits within the overall strategic direction of its economic development. A concept study would address the following topics:



- a brief description of the purpose of the new business opportunity, the goods or services to be offered and the potential location of the new business;
- a brief overview of the market for the goods or services to be offered, including target consumers and competitors;
- an estimate of the capital required to establish and maintain the new business opportunity and the possible sources of that capital, including, where known, potential business partners;
- an overview of the possible risks facing the new business opportunity and possible action that could be taken to mitigate those risks; and
- an overview of the potential employment and training opportunities for First Nation members.

After a concept study has been prepared and if it has been approved, the new business opportunity would be added to the economic development plan for the First Nation. The economic development plan would form the cornerstone of the First Nation's economic development and is intended to articulate the strategic direction of its economic development for the following five years.

The second phase of planning for success is the preparation of a business plan for a new business opportunity. If a new business opportunity has been included in the economic development plan, then, at the appropriate time, a business plan may be developed which will, if approved, guide the implementation of the new business opportunity. A business plan is intended to be a detailed and comprehensive analysis of the business opportunity which addresses the following topics:

- a detailed description of the purpose of the new business opportunity, the specific goods and services to be offered and the location of the new business opportunity;
- an assessment of the new business opportunity as compared to other new business opportunities identified in the economic development plan in terms of likely return on investment, risks and sustainability;
- a comprehensive analysis of the market for the goods and services to be offered, including target consumers, competitors and estimated market share;
- the capital required to establish and maintain the new business opportunity and the planned source of that capital, including, where applicable, the business partners that have expressed interest in participating in the new business opportunity and the capital they will contribute;
- a description of the corporate structure for the new business opportunity;
- an estimate of the profit or loss of the new business opportunity for the first five years, including projected financial statements and estimates of return on investment;
- an assessment of the possible risks facing the new business opportunity and actions that could be taken to mitigate those risks;
- an overview of the financial performance, employment and training objectives for the new business opportunity for the first five years; and
- a description of any other requirements to implement the new business opportunity such as the purchasing, leasing, surveying, registration or rezoning of land or other approvals required from any applicable government or governing body.

After a business plan has been prepared and if it has been approved, the new business opportunity would be passed on to the holdings limited partnership to implement. Once a new operating limited partnership has been created to realize the new business opportunity, it must do so in accordance with its approved business plan.

### *Transparency and Accountability*

One of the pitfalls we have seen in the separation of politics and business in First Nations' economic development is the mistaken belief that this separation removes any accountability on the part of the businesses to its owner, the First Nation. We have seen situations where the First Nation's government representatives hesitate to even talk to the business leadership and feel they cannot ask any questions about the businesses for fear of being accused of "mixing politics and business". We have also seen businesses refuse to provide any sort of financial accounting to the First Nation's government because "it's none of their business, we are separate."

The separation of politics from business does not remove the common law shareholder rights to financial accountability and profits from the business. Neither does the separation of politics and business eliminate the right of the shareholder to remove a board of directors if they are not acting in the best interests of the company. As indicated in the Harvard Project reports, transparency and accountability are key to successful First Nations' economic development.

Our governance structure includes regular reporting requirements and annual planning processes that would ensure the First Nation remains informed on the activities, successes and failures of its businesses and that the boards of directors, who oversee those businesses, remain accountable to the ultimate owner, the First Nation. To ensure transparency around annual planning and profit sharing, processes are spelled out which not only guide budgeting and profit distribution decisions (which ensure the businesses have the resources to sustain and grow their business), but also ensure the First Nation receives a return on its investment in those businesses.

### *Governance and Fiscal Agreement*

One of the tools we have found helpful for our First Nation clients to separate politics from business is to have the First Nation enter into a written agreement with each of its business enterprises (which we call a Governance and Fiscal Agreement). The purpose of this agreement is to have the roles and responsibilities of the key stakeholders in the First Nation's economic development and key decision making processes clearly spelled out. The roles and responsibilities of the First Nation's government, the holdings board, the various operating boards, the First Nation's economic development officer and senior business management, are all very different. Having their various roles and responsibilities spelled out in a written agreement ensures everyone is aware of their own and everyone else's respective roles and responsibilities. As well, the process of developing the Governance and Fiscal Agreement with a First Nation is a very productive, informative and instructional tool for discussions with all these participants regarding who is, or should be, responsible for the various decisions and activities involved in economic development, what the processes should be for making those decisions and what each of their respective roles and responsibilities should be as part of that process.

Our Governance and Fiscal Agreement would address the roles and responsibilities of the corporations, boards of directors and limited partnerships created to carry out the First Nation's economic development. This agreement would also set out reporting and profit sharing expectations that would differ from normal corporate reporting requirements, which would be necessary given the unique role that a First Nation's corporations would play in its economic development. This will help to ensure the transparency and accountability that is necessary for the success of the First Nation's economic development. Our Governance and Fiscal Agreement template addresses the following general topics:

- limited role of government in business operations (exercising common law shareholder rights as owner and approving major decisions such as structural changes, operational anomalies and annual plans);
- appointments to, and removal from, the operating boards with a right of appeal;
- role of the boards of directors (holdings board and operating boards) and senior management;
- annual planning and budgeting requirements;
- profit sharing and distribution processes;
- reporting frequency and content requirements;
- how major operational decisions are made and operational anomalies approved;
- how management services are provided; and
- requirements for certain corporate policies and procedures to be implemented.

We have developed templates for corporate policies and procedures that set out in greater detail the expectations on how the board of directors and senior business management of each business should conduct their affairs.

It has been suggested to us that the roles and responsibilities of all key stakeholders in First Nation economic development need only be set out in policies and procedures of the First Nation. While this may be true in some circumstances, the fact remains that policies and procedures can easily be changed by a First Nation without any consultation with the corporations that carry out its economic development or any due process. The contractual nature of the Governance and Fiscal Agreement ensures that those roles and responsibilities, as well as the systems and procedures that separate politics and business, will not be unilaterally changed. Further changes to a First Nation's economic development governance structure would require consultation with business leadership through a system of recognized processes. This will assist in ensuring that, once business decisions have been freed from political consideration, that separation cannot easily or unilaterally be undone. This is necessary in order to maintain the transparency and accountability, and therefore the predictability, of a First Nation's economic development, thereby creating the best possible governance environment for its success.

For our Treaty First Nation clients, we have also developed an *Economic Development Act* and related *Governance and Fiscal Agreement Regulation* which governs the Treaty First Nation's role in economic development as well as establishing certain reporting requirements and restrictions for the operating limited partnerships. This is not possible with *Indian Act* bands that do not have the authority to enact such laws. For our Treaty First Nation clients we are able to

relocate the most relevant and important provisions from the Governance and Fiscal Agreement into the *Economic Development Act*. The advantage of an *Economic Development Act* is that the provisions of the Act have the force of law which may be helpful in ensuring the separation of politics from business while maintaining the transparency and accountability of the Treaty First Nation's business enterprises.

### OTHER GOVERNANCE STRUCTURE CONSIDERATIONS

Besides separating politics from business, there are a number of additional governance matters that should be considered when developing a First Nation's economic development governance structure. These are each discussed below.

#### *Compartmentalization*

A reoccurring problem we have seen in First Nations' economic development is the failure to "compartmentalize" separate business activities into separate legal entities and to clearly and methodically carry on those business activities separately from the others. Failure to compartmentalize business activities may take a number of different forms, such as the following:

- one legal entity carries on, and owns the assets required in, multiple and unrelated business activities (e.g. a First Nation's campground, hotel, construction business and forestry business are all operated by the same legal entity);
- multiple legal entities carry out exactly the same or indistinguishable business activities and there is no clear separation between which legal entity is actually carrying out a particular activity at any given point in time (e.g. multiple legal entities owned by the First Nation operate campgrounds and related services);
- one legal entity owns assets that are required by another legal entity for its business activities (resulting in inter-company loans or accounts payable and receivable recorded in their respective financial statements as fees for the use of the assets); and
- there is no discernible separation between the First Nation and its business entities (as discussed above).

The circumstances above create situations where there is no "compartmentalization" of discrete business activities and the assets necessary to carry out those activities into separate legal entities. In those circumstances, public perception can easily be blurred regarding which entity is carrying out which business activity. Any blurring of the corporate separation (the "corporate veil") is more likely to result in the "piercing of the corporate veil", when the courts look to the shareholders or limited partner to cover the losses of the business (thereby eliminating the limited liability protection that corporations and limited partnerships are intended to provide).

Compartmentalization is not only necessary as between the various businesses owned by the First Nation, but as between the First Nation and the legal entities that carry out its economic development. To ensure that the First Nation's and each business's limited liability protection remains intact, they must each be clearly seen as separate from the others. This requires



separating the First Nation's government and administration from business administration by having separate management and separate employees, as well as separate bank accounts, separate accounting and financial records, separate signage, invoices, letterhead, business cards and promotional material (including their internet presence), etc. This separation is important for maintaining the compartmentalization and limited liability protection for the First Nation and each of its individual business enterprises.

### *Advantages of Compartmentalization*

The compartmentalization of different business activities, and the assets necessary to carry out those activities, into separate legal entities offers a number of advantages. Primarily, compartmentalization is more likely to ensure limited liability protection in the event one business activity fails or causes harm. If there has been no blurring of the corporate veil, a court is not likely to pierce that corporate veil and will limit the liability from the failure or harm to the legal entity that failed or caused the harm. A failing business activity will not affect the other successful business activities if it is carried out by a separate legal entity.

Compartmentalization also leads to more accurate and transparent financial reporting for each business activity. Having assets (other than valuable capital assets, which are discussed below) owned by one legal entity that are necessary for another legal entity to carry out its business activity may lead to a growing number of inter-company accounts payable and receivable or inter-company loans on the financial statements of the various First Nation businesses. This can, over time, become confusing and misleading to a reader and distort the true value of the First Nation business and the true cost of carrying out a particular business activity. Inter-company loans, accounts receivable and accounts payable are less likely to be required if each discrete business activity is carried out by one legal entity and it holds the assets necessary to carry out that business activity. Clarity concerning financial reporting (an integral part of transparency and accountability) is essential to establishing trust and confidence between a First Nation and its economic development arm.

Compartmentalization is more likely to provide greater organizational efficiencies by eliminating potentially costly duplication because the business activity is not spread out over multiple legal entities, each with their own administrative and servicing costs. This also provides greater transparency and accountability because the reporting on a particular business activity will more accurately reflect the true cost of carrying out that business activity (rather than being spread out and "hidden" over multiple First Nation businesses).

### *Consequences of Failing to Compartmentalize*

The consequences of not having each discrete business activity and its assets compartmentalized into separate legal entities may include the following:

- increased risk of the loss of business assets owned by a business carrying out multiple business activities because of the failure of one activity unrelated to the asset (e.g. the hotel is lost because the forestry business failed);



- potential loss of operational efficiencies with multiple businesses carrying out the same business activity (e.g., campgrounds run by multiple corporations, each of which must file separate annual reports, prepare separate financial statements and have separate licensing costs);
- organizational confusion concerning which business is carrying out which activity, making it more difficult to communicate with members concerning economic development and potentially increasing a perception of a lack of transparency and accountability in economic development; and
- the above confusion may also result in an increased risk of a court “piercing the corporate veil” when it is unclear which business is carrying out the business activity that caused a loss or damage, so all are held liable for the loss or damage, potentially even the First Nation.

### *Business mandates*

A First Nation does not engage in economic development simply to be “in business”. As mentioned earlier, there are typically four goals for a First Nation in pursuing economic development: 1) jobs for members; 2) alternate sources of revenue; 3) access to the wealth taken daily from its traditional territories; and 4) access to the capital wealth of its reserve or treaty lands. The type of economic development opportunities pursued can reflect back on the First Nation, both as to its perceived character and its place within the broader community (with regard to both the nature of its business enterprises (forestry versus casinos) and its success (being profitable or going bankrupt)).

Because its economic development will reflect back on a First Nation, it should have (and our governance model would provide) with a say in the nature and planning for success of each business opportunity to make sure it meets the goals for economic development as prioritized by the First Nation. This isn’t only because the First Nation’s resources will likely be required to start a new business opportunity. If this were the only reason for a First Nation to have a say in its economic development, it would suggest that if those resources were not required, the First Nation would not have a say). We disagree with that proposition, a First Nation will always have a concern (and therefore, in our view, must have a say) in what businesses its economic development arm engage in because of how the businesses reflect back on the First Nation, the opportunities created for it and its members, and its position within the broader community. In addition to the economic development plan approved by the First Nation which would set the strategic direction for its economic development, this “say” by the First Nation would also be established in our governance model through the concept of the “business mandate”. In this model, businesses are required to operate within their approved business mandate.

One may ask why a First Nation should be given this control, especially if the businesses are self-sufficient and not reliant on the resources of the First Nation, and wouldn’t such control “pierce the corporate veil”? When we say the First Nation’s proper role is in strategic planning, we refer to the direction it chooses for its economic development. In our view, there is no logical principle that would suggest the businesses should have the right to change that strategic direction (by engaging in whatever business they choose) simply because the First Nation’s



resources may no longer be required for a new business opportunity. At all times, but especially in times of success, the First Nation's businesses must always remember the reason for their very existence: to meet the strategic goals for economic development as prioritized by the First Nation. Further, regardless of whether or not the current resources of the First Nation are required for new business opportunities, at the end of the day, all the resources owned by the businesses belong indirectly to the First Nation, as ultimate owner of the business enterprises. Even if a new cash injection is not required directly from the First Nation to get a new business opportunity up and running, it still will require the resources of one or more of the business enterprises to be injected into that new business opportunity. As such, those start-up resources will not be available for distribution as available cash back through the holdings limited partnership to the First Nation and, in our view, the First Nation has the right to have the final say in where those resources are utilized. This is the essence of strategic planning: determining where one chooses to invest resources.

The concept of the "business mandate" also assists with compartmentalization. As discussed above, the limited liability protection offered by our corporate structure may be lost when it becomes unclear which business entity is carrying out which business activity. This can happen when a First Nation has multiple companies, some with similar or common businesses, and it is not always kept perfectly clear which company is operating which business. If the separation is not perfectly clear at all times and there is confusion regarding which legal entity is actually carrying out which business activity, the limited liability protection may be lost by a court saying all the companies are liable. However, compartmentalization will ensure that the separation is maintained between the business enterprises and when that separation is perfectly clear, if one business enterprise fails, it should not affect the other successful business enterprises. Business mandates, therefore, actually assist in decreasing the risk of a court "piercing the corporate veil" with its associated loss of limited liability protection.

To ensure compartmentalization, our recommended governance structure for First Nations' economic development would establish a business mandate for each operating limited partnership to carry out discrete, or closely related, business activities as a single business separate from any of the other operating limited partnerships' businesses. These business mandates must be broad enough to include all the business activities that are necessary or desirable for each operating limited partnership to function effectively and efficiently, but should also be narrow enough to ensure the transparency and accountability of its business operations. If a First Nation wishes to pursue economic development opportunities that do not fall logically into the business mandate of an existing operating limited partnership, then a new operating limited partnership would be created and assigned the business mandate to carry out that new economic development opportunity.

Determining business mandates for each First Nation business enterprise and requiring them to only operate within their business mandates will compartmentalize discrete business activities into each business enterprise and ensure the strategic direction for a First Nation's economic development.

### *Business names and branding*

A tool we use in our governance structure to maintain limited liability protection is the “business naming protocol”. As discussed above, the limited liability protection offered by corporations and limited partnerships may be lost when those dealing with the business are not aware they are dealing with a limited liability entity.

The *Business Corporations Act* requires corporations in British Columbia to have names that contain three elements: 1) a distinctive element (something that sets the name apart from all other names, such as “XFN”), 2) a descriptive element (something that describes the nature of the business activities, such as “Forestry” or “Fisheries”) and 3) a corporate designation (“Ltd.”, “Inc.”, “Corp.” or “Corporation” or similar words) that indicates it is a limited liability entity. A limited partnership must have the words “limited partnership” in its name.

In order to maintain the limited liability protection that companies and limited partnerships provide, in its business dealings a limited liability entity must use the full and proper name of the business, including the corporate designation or limited partnership designation. All signage, invoices, letterhead, business cards, promotional material (including its internet presence) etc. associated with the business activity must clearly indicate the full legal name of the entity carrying out the particular business activity. If it does not and a person suffers loss, the courts will look to the shareholders or limited partner to cover that loss (thereby “piercing the corporate veil” with the loss of liability protection).

It is common in business when someone owns a group of companies that they create a “look and feel” for those companies to communicate that, although they are all separate legal entities, they are all part of the same group of businesses. This can be done through similar logos and through a business naming protocol. This is often referred to as “common branding”. It must be kept in mind, however, that at all times it must be clear which entity is carrying out each separate business activity in order to ensure the “corporate veil” is not pierced. This can be done through variations in logos (such as using designs with readily noticeable differences, such as colour) and related but different names. Sometimes the connection is simply stating something like “a member of the XFN group of businesses”.

A First Nation’s businesses are assets of the First Nation and are likely viewed as its representatives in the larger business community. As such, there is value in making the association between the First Nation and its various business enterprises readily apparent through common branding. One of the tools for common branding is a business naming protocol for the related business enterprises. A business naming protocol for a First Nation’s business enterprises may consist of the name of the First Nation, its acronym or a traditional word as the distinctive element, such as “XFN”; a descriptive element of one or two words, such as “Power” or “Forestry Ventures”, which describes the business activities that correspond to the business enterprise’s activities (as required by the *Business Corporations Act*); and the corporate designation “Inc.” for the general partners and “Limited Partnership” for the limited partnerships. This is important for ensuring the limited liability protection provided by our recommended corporate structure is maintained. As well, this business naming protocol lends itself to the use

of distinctive acronyms for each First Nation business enterprise for ease of communications and reporting on business activities in general, such as “XHI” for XFN Holdings Inc. and “XHLP” for XFN Holdings Limited Partnership.

### *Management and control*

One of the circumstances under which limited liability protection may be lost is if a limited partner engages in the management of the business of the limited partnership. Under section 64 of the *Partnership Act*, a limited partner is not liable for the debts of the partnership “...unless he or she takes part in the management of the business”. A limited partner is a “silent investor” and must remain separate from the active business operations of the limited partnership. Failing to maintain that separation runs the risk of the limited partner losing its limited liability protection. Because in our corporate structure the First Nation would be the limited partner in the holdings limited partnership, it would be important, in order to maintain its limited liability protection, that the First Nation (both the political leadership and senior administration) not be seen to be engaged in the management or control of the business of the holdings limited partnership. Likewise, because the holdings limited partnership is the limited partner in each of the operating limited partnerships, it is important, in order to maintain its limited liability protection, that the holdings board not be seen to be engaged in the management or control of the business of an operating limited partnership.

Court cases on this issue are relatively sparse, not only in British Columbia but across Canada, and there has been little judicial discussion of the topic in recent years. It is generally clear, however, that a limited partner who controls aspects of the day-to-day operations of the limited partnership’s business will be found to be taking part in the management of the business. A review of Canadian case law on the subject suggests the following to be forms of “management” or “control” that may cause a limited partner to lose its limited liability protection:

- a limited partner identifying themselves as an officer of the partnership;<sup>5</sup>
- a limited partner signing cheques or conducting bank transactions on behalf of the partnership;<sup>6</sup>
- a limited partner making managerial decisions;<sup>7</sup>
- a limited partner acting as a general contractor for the partnership;<sup>8</sup>
- a limited partner negotiating agreements on behalf of the partnership;<sup>9</sup>
- a limited partner providing daily maintenance to the assets of the partnership;<sup>10</sup>

<sup>5</sup> *Haughton Graphic Ltd. v. Zivot*, [1986] O.J. No. 288 (Ont HC). Affirmed [1988] OJ No 2957, 38 BLR xxxiii (Ont CA), leave to SCC refused [1988] SCCA No 212, 38 BLR xxxiii (SCC). Reasoning adopted in *Nordile Holdings Ltd. v. Breckenridge* (1992), 66 BCLR (2d) 183 (BC CA).

<sup>6</sup> *Ibid.*; *Laplante v. Canada*, [1994] TCJ No 1211, [1995] 1 CTC 2647.

<sup>7</sup> *Nordile Holdings Ltd. v. Breckenridge* (1992), 66 BCLR (2d) 183 (BC CA).

<sup>8</sup> *Laplante v. Canada*, [1994] TCJ No 1211, [1995] 1 CTC 2647.

<sup>9</sup> *Ibid.*

- a limited partner providing a guarantee on a partnership loan;<sup>11</sup>
- a limited partner paying for the expenses of the partnership;<sup>12</sup>
- a limited partner employing the manager of the partnership;<sup>13</sup>
- a limited partner being paid for management services by the partnership;<sup>14</sup> and
- a limited partner registering property in its name that belongs to the partnership.<sup>15</sup>

It should be noted that the *Partnership Act* uses somewhat different language to address this subject from many other provinces' legislation so the examples identified above may or may not apply in British Columbia in all circumstances. The *Partnership Act* states that a limited partner is liable as a general partner where "he or she takes part in the management of the business." In contrast, other provincial legislation uses the word "control" of the business. Some observers have stated that this may set a somewhat different standard in British Columbia,<sup>16</sup> however, it is difficult to say given the relatively limited commentary by the courts on the topic. Creating a management limited partnership (discussed below) to provide management services to the First Nation's business enterprises would assist in avoiding that problem.

### *Management limited partnership*

Another tool we utilize in our governance structure to accomplish compartmentalization is that of the "management services limited partnership". It is unlikely all of a First Nation business enterprises would have the resources to support their own management, administrative, financial, record keeping, accounting and advisory services in-house. Having a management services limited partnership provide those services to all the First Nation business enterprises would eliminate the need for them to provide those services in-house or to have them provided by the First Nation. In the interest of separating the First Nation government administration from business administration, it is prudent (from a liability perspective) and efficient (from a cost savings perspective) to have a management services limited partnership provide these services to the other First Nation business enterprises. This also eliminates concerns regarding section 64 of the *Partnership Act* since a management services limited partnership is not a limited partner in any other limited partnership.

A management services agreement forms an integral part of our recommendations for implementation of our governance structure model. A management services agreement would be entered into between the management services limited partnership and the general partners of all

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<sup>10</sup> *Ibid.*

<sup>11</sup> *Ibid.*

<sup>12</sup> *155569 Canada Ltd. v. 248524 Alberta Ltd.* (1996), 43 Alta. L.R. (3d) 189 (Alta QB).

<sup>13</sup> *Michel v. Lafrentz*, 1999 ABCA 38.

<sup>14</sup> *Michel v. Lafrentz*, 2000 ABQB 714.

<sup>15</sup> *Re Forest & Marine Financial Corp.*, 2009 BCCA 319.

<sup>16</sup> Maurice Coombs, *Halsbury's Laws of Canada – Partnerships*, accessed via Quicklaw on May 22, 2012, HPJ-72.

of the First Nation's business enterprises requiring those business enterprises to utilize the management services limited partnership to provide management, administrative, financial, record keeping, accounting and advisory services to them. The purpose of the management services agreement is to document how those services are provided and to clearly set out the terms and conditions of those services, such as how time, fees and other expenses are allocated between the business enterprises. Having the cost of providing those services charged to each general partner for each business enterprise for actual time spent on its behalf would more accurately reflect the true cost of carrying out those business activities by that business enterprise. This would provide more accurate financial reporting, leading to greater transparency and accountability for that business enterprise as it fulfills its business mandate. This may also assist in addressing concerns regarding section 103(1) of the *Income Tax Act* where CRA can reallocate profit between a general partner and a limited partner in circumstances where CRA determines the general partner is not properly compensated for what it has contributed to the partnership.

### *Capital assets limited partnership*

A common practice in business is the compartmentalization of valuable capital assets into a separate legal entity, isolating them from the potential liabilities which may arise from active business operations. We typically recommend doing so by holding those valuable capital assets in a capital assets limited partnership which does not carry on any other active business operations, except to lease or rent those valuable capital assets to other operating limited partnerships. Such valuable capital assets may include land, heavy equipment and machinery, water licences, forestry licences, fishing licences or other passive investments. The leases or rental agreements should be structured in such a way that if the operating limited partnership fails or is otherwise forced into bankruptcy or liquidation proceedings, the leases or rental agreements would immediately terminate and the possession and control of the valuable capital asset immediately revert to the capital assets limited partnership so it does not form part of the bankruptcy or liquidation proceedings. Utilizing a capital assets limited partnership protects those valuable capital assets from failed business operations and preserves the valuable capital assets for use elsewhere by the First Nation's business enterprises.

Some have suggested that the holdings limited partnership in our corporate structure should serve in the role we have contemplated for the capital assets limited partnership since it is already playing a "holdings" role by holding the limited partnership units in the operating limited partnerships. As already noted, case law suggests that if a limited partner holds assets that are required for the business operations of a limited partnership it could lose its limited liability protection.<sup>17</sup> As well, if all the valuable capital assets are held by the holdings limited partnership it will likely be called upon to provide a guarantee for the credit facilities of an operating limited partnership. Case law suggests the granting of such a guarantee may also cause

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<sup>17</sup> See footnote 15.

a limited partner to lose its limited liability.<sup>18</sup> This would not be of concern for a capital assets limited partnership structured as we recommend since it would not hold limited partnership units in any of the operating limited partnerships. It is therefore prudent to have a capital assets limited partnership hold the valuable capital assets of the First Nation utilized in its economic development.

### CONCLUSION

With our recommended corporate structure and governance structure, the three primary considerations of limiting liability, maximizing profits (by minimizing taxes and avoiding OSR) and separating politics from business decisions would be achieved. The utilization of corporations and two tiers of limited partnerships would create a double barrier intended to prevent liability from flowing back through to the First Nation while allowing 99.98% of the profits to be allocated back to the First Nation on a tax exempt or tax reduced basis and assist in avoiding OSR claw backs. As well, utilizing the governance structure model we recommend in the Governance and Fiscal Agreement (and *Economic Development Act* for Treaty First Nations) would serve to further separate political considerations from the important business decisions that must be made in order to pursue successful economic development opportunities for First Nations, while ensuring those businesses remain transparent in their operations and are held accountable for their actions. In doing so, the First Nation business enterprises would be better able to conduct themselves in a businesslike manner with a better chance of achieving success, free from political interference, which would likely make them more suitable and desirable as business partners.

We would be happy to discuss these matters with you further if you wish to proceed in setting up your First Nation's economic development with our recommended corporate structure and governance structure.

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<sup>18</sup> See footnote 11.



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