State and Federal Personal Income Taxes Applicable to Indian Allotted Owners (Allottees)

2013

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Federal and State Personal Income Tax Rates

- Federal personal income tax rates – 10%-35%.
- State personal income tax rates vary between states and are assessed over different income brackets.

Unless Exempted, Federal Personal Income Tax Applicable to American Indians

- First, we are going to discuss the applicability of the federal personal income tax to American Indians in general.

Unless Exempted, Federal Personal Income Tax Applicable to American Indians

- Generally, **individual American Indians** are subject to federal income taxation, even if their income is earned in Indian country, **unless exempted by treaty, statute, or Act of Congress**.

Unless Exempted, Federal Personal Income Tax Applicable to American Indians

- Tribal membership does not exempt an Indian from federal taxation. *Choteau v. Burnet*, 283 U.S. 691 (1931); *United States v. Brown*, 824 F. Supp. 124 (S.D. Ohio 1993); Rev. Rul. 54-456; 154-2 C.B. 49.

Unless Exempted, Federal Personal Income Tax Applicable to American Indians

- "The Internal Revenue Code of 1939 contains no provision exempting an individual from the payment of Federal income taxes solely on the ground that he is an Indian."

Unless Exempted, Federal Personal Income Tax Applicable to American Indians

- "Based on the decisions of the Supreme Court … it is the position of the Internal Revenue Service that exemption from the payment of Federal income tax may not be implied, and that if exemption of Indians from the payment of such tax exists, it must derive plainly from the Federal tax statutes, or from treaties or agreements with the Indian Tribes concerned or some Act of Congress dealing with their affairs."

Unless Exempted, Federal Personal Income Tax Applicable to American Indians

- Even the salary of a tribal official is subject to federal personal income tax. *Commissioner v. Walker*, 326 F.2d 261 (9th Cir. 1964).
- Per diem payments made to tribal council member are also subject to federal personal income tax. *Hoptowit v. Commissioner*, 709 F.2d 564 (9th Cir. 1983).

Allotments

- **Terminology**
- An ‘allotment’ is a term of art in Indian law, describing either a parcel of land owned by the United States in trust for an Indian (''trust'' allotment) or owned by an Indian subject to a restriction on alienation in the United States or its officials (''restricted'' allotment).

Allottee

- Holder of a restricted or trust allotment is referred to as an ‘allottee.’

Allotments

- Trust and restricted allotments are subject to federal restraints on encumbrance and alienation, and are exempt from federal and state taxation during the restricted period.

Allotments

- An ‘encumbrance’ is a legal term of art for anything that affects or limits the title of a property, such as mortgages, leases, easements, liens or restrictions.

Allotments

- The restrictions on encumbrance and alienation apply by operation of law, whether they appear in the patent or other title document.
- Also, the restrictions on encumbrance and alienation are not personal to the allottee, but generally run with the land to the allottee's Indian heirs or devisees.

Exemption by Statute

- One federal statute found to exempt income derived directly from Indian trust or restricted allotted lands from federal and state taxation is the General Allotment Act.

General Allotment Act

- Under the General Allotment Act of 1887, 24 Stat. 388, the President had the authority to allot land to tribal members, and the land would be held in trust by the United States for a period of twenty-five years or longer, when a fee patent would be granted.

Burke Act

- The Burke Act of 1906, 34 Stat. 182, clarified that state civil and criminal jurisdiction over allotted lands would only lie at the expiration of the trust period when the land had been conveyed by fee patent. A proviso to the Burke Act authorized the President to issue a fee patent prior to expiration of the specified trust period, and provided that upon such premature patenting all restrictions as to sale, encumbrance, or taxation of the land would be removed.

General Allotment Act

- Under the General Allotment Act, individual Indians could freely sell their land which resulted in a loss of 90 million acres of land of the previously designated 150 million acres of land.

Indian Reorganization Act of 1934

- Due to the large loss of land as a result of the General Allotment Act and various tribal allotment acts, the General Allotment Act was repudiated by the Indian Reorganization Act of 1934, 25 U.S.C. § 465 ("IRA").

Indian Reorganization Act of 1934

- "[H]ereafter, no land of any Indian reservation, created or set apart by treaty or agreement with the Indians, Act of Congress, Executive order, purchase, or otherwise, shall be allotted in severalty to any Indian."

Indian Reorganization Act of 1934

- "Section 2. The existing periods of trust placed upon any Indian lands and any restriction on alienation thereof are hereby extended and continued until otherwise directed by Congress."

Allotments after 1934

- After 1934, lands may be taken into trust as allotments only under the IRA or other statutes enacted thereafter. For example, section 5 of the IRA authorizes the Secretary of the Interior to place into trust any interest in land acquired by or for an Indian ''through purchase, relinquishment, gift, exchange, or assignment.”

Allotments after 1934

- Other, more specific statutes authorize land to be placed in trust for an Indian in the Secretary's discretion. The federal government has not initiated any further reservation allotment programs under its own authority.

Federal Regulations Applicable to Allotments

- The federal regulations applicable to the sale, gift, exchange, inheritance, devise, partition, mortgage and condemnation of allotments are set forth at 25 C.F.R. Part 152. Any such transaction is not valid unless it complies with the enabling statute and implementing regulations.

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- In *Squire v. Capoeman*, 351 U.S. 1 (1956), the U.S. Supreme Court held that the personal income of an Indian owner derived directly from his/her restricted Indian allotment was exempt from federal personal income tax in order to fulfill the purposes of the General Allotment Act ("GAA").

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- In 1943, the Bureau of Indian Affairs sold the standing timber on a restricted Indian allotment of a Quinault Indian. The Internal Revenue Service ("IRS") demanded the payment of capital gains taxes by the allottee on the sales proceeds. The allottee paid the amount demanded and sought a refund which led to this case.

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- In finding that the proceeds were exempt from federal taxation, the Court relied first on the terms of section 5 of the GAA, which provided that at the end of the trust period the allotment must be conveyed to the allottee or the allottee's heirs in fee ''free of all charge or incumbrance whatsoever.'' Interpreted in the light most favorable to the Indians, the ''charge and incumbrance'' language “might well be sufficient to include taxation.” *Id*. at 7.

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- The Court also relied on the 1906 amendment to section 6 of the GAA, which expressly refers to the removal of "all restrictions as to sale, incumbrance, or taxation" on an allotment after the allottee receives a fee patent. *Id*. at 7. The Court found that the provision implied a congressional intent not to tax during the trust period.

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- Although the exemption language in the GAA referred only to encumbrance or taxation of the allotment itself, the Court held that this exemption applied as well to income from the sale of timber on the land or income derived directly from the restricted allotment by the allottee.

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- The government, in enacting the GAA, intended to preserve the full value of allotments for allottees so as to ''protect the Indians' interest and 'to prepare the Indians to take their place as independent, qualified members of the modern body politic.' '' To implement this intent, the Court held that it was necessary not only to exempt the trust lands from taxation, but also the ''income derived directly therefrom.''

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- A tax on the income derived directly from the restricted allotment would be "at the least, a sorry breach of faith with these Indians." *Capoeman* at 9.

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- The Court held this exemption applies to federal, as well as state, taxation, relying in part on an Attorney General opinion to this effect. 35 Op. Att'y Gen 1 (1925); 34 Op. Att'y Gen 439 (1925); 34 Op. Att'y Gen 275 (1924).

Attorney General Opinion, March 15, 1924

- The Attorney General cited several cases to support his position that states could not tax restricted Indian allotments.
- In *United States v. Rickert,* 188 U.S. 432 (1903), involving the imposition of taxes affecting the Sisseton and Sioux Indians in South Dakota, the Supreme Court said:

Attorney General Opinion, March 15, 1924

- “To tax these lands is to tax an instrumentality employed by the United States for the benefit and control of this dependent race, and to accomplish beneficient objects with reference to a race of which this court has said that 'from their very weakness and helplessness, so largely due to the course of dealing of the Federal Government with them and the treaties in which it has been promised, there arises the duty of protection, and with it the power. …

Attorney General Opinion, March 15, 1924

- "To say that these lands may be assessed and taxed by the county of Roberts under the authority of the State, is to say that they may be sold for the taxes, and thus become so burdened that the United States could not discharge its obligations to the Indians without itself paying the taxes imposed from year to year, and thereby keeping the lands free from incumbrances." *Id*. at 14-15.

IRS Revenue Bulletin

- The *Capoeman* decision led to the issuance of IRS Revenue Bulletin 1956-1 C.B. 605 and IRS Rev. Rul. 56-342:
- "Income held in trust for or received by the patent holder which is derived directly from allotted and restricted Indian lands while such lands are held by the United States, as trustee, in accordance with section 5 of the General Allotment Act of 1887, 24 Stat. 388, as amended, 25 U.S.C. 348, is exempt from Federal income tax."

IRS Revenue Bulletin

- "Such exempt income includes rentals (including crop rentals), royalties, proceeds of sales of the natural resources of such land, and income from the sale of crops grown upon the land and from the use of the land for grazing purposes. Such income is not includible in computing net earnings from self-employment …" *See also* Rev. Rul. 67-284, 1967-2 C.B. 55.

IRS Revenue Ruling 57-523, 1957

- In 1957, the IRS specifically addressed income received by a member of the Three Affiliated Tribes:

Three Affiliated Tribes Member - Allotment Owner

- The IRS found the following types of income exempt: "that from land allotted and used for farming, and income from grazing fees and oil lease bonus, where the land and mineral rights were both held in trust; but it does not include income from a trust allotment rented from another Indian."

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- Similarly, courts have granted exemptions for royalties from mineral deposits (*Big Eagle v. United* States, 300 F.2d 765 (Ct. Cl. 1962)) and bonus income from signing an oil and gas lease (*United States v. Daney*, 370 F.2d 791 (10th Cir. 1966)).

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- The federal and state taxation exemptions under *Capoeman* extend to trust allotments located outside Indian reservations. The GAA expressly provides in section 4 that allotments beyond reservation boundaries are to be held under the same terms as reservation allotments.

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- Also*, Capoeman* applies to allotments issued pursuant to tribe-specific allotment statutes, regardless of whether the GAA applies to those allotments or not.

- *See Stevens v. Comm'r*, 452 F.2d 741, 744-746 (9th Cir. 1971) (construing Ft. Belknap Allotment Act of March 3, 1921, 41 Stat. 1355); Rev. Rul. 74-13, 1974-1 C.B. 14 (exemption described as applying to restricted lands generally rather than specifically to GAA lands).

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- The taxation exemption for restricted allotted lands applies when individual trust property is transferred to a subsequent **allottee,**
- whether by gift,
- devise [under will],
- inheritance (*Asenap v. U.S.*, 283 F. Supp. 566 (W. D. Ok. 1968),

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- where the federal government purchases lands for individual Indians which is held in trust solely for their benefit, or
- when restricted allotted land is voluntarily exchanged for restricted allotted land of like value when such exchange is authorized by the Secretary of Interior.
- *See* Rev. Rul. 57-523, 1957-2 C.B. 51; Rev. Rul. 67-284, 1967-2 C.B. 55; Rev. Rul. 74-13, 1974-1 C.B. 14.

No Federal/State Personal Income Tax on Income Derived Directly by Indian Allotment Owner(s) (Not Third Party) from His/Her/Their Allotted Lands

- There is no federal or state tax exemption for income **derived by a third party, other than the allottee(s),** from a lease of a restricted or trust Indian allotment. *Wynecoop v. Comm'r*, 76 T.C. 101 (1981) (mineral lease).

Fee Patent Allotted Land Subject to State Taxation

- Under the GAA, however, when a fee patent has been issued to the Indian allotment owner, the allotted land becomes subject to federal and state taxation.

Fee Patent Allotted Land Subject to State Taxation

25 U.S.C. § 349, Patents in fee to allottees

> That at the expiration of the trust period and when the lands have been conveyed to the Indians by patent in fee, as provided in section five of this Act [25 U.S.C. § 348], then each and every allottee shall have the benefit of and be subject to the laws, both civil and criminal, of the State or Territory in which they may reside;

Application for Fee Patent

- Today, a number of statutes authorize the issuance of fee patents, the alienation of allotments, or both.
- Current regulations at 25 C.F.R. Part 152 require a finding of competency in most cases, and generally require adult allottees to apply for a fee patent or certificate of competency, or to consent to the sale.

Application for Fee Patent

- The Secretary has ruled that there is no mandatory duty to approve an application for a fee patent or sale even if an allottee is found to be competent. 86 Interior Dec. 425 (1979); 61 Interior Dec. 298, 301-302 (1954.)

Application for Fee Patent

- The Secretary may also withhold approval if the removal of restrictions would adversely affect the best interests of the tribe or other Indians, until the affected parties have had a reasonable opportunity to acquire the applicant's interest. 25 C.F.R. § 152.2.

Forced Fee Patent

- A fee patent forced upon the allottee may not be set aside if claim is made beyond statute of limitations period. *United States v. Mottaz*, 476 U.S. 834 (1986).

American Indian Probate Reform Act of 2004

American Indian Probate Reform Act of 2004, H.R. Rep. No. 108-656 (2004) established uniform probate system. Since state law had applied to intestacy prior to this Act, which generally provides for an heir to receive an equal share of the undivided interest in a parcel of land, some Indian land had become highly fractionated.

Unallotted Tribal Lands

- Income derived directly from unallotted Indian tribal lands by an allottee pursuant to a lease or permit, however, is taxable. Rev. Rul. 58-320; 1958-1 C.B. 24.

Unallotted Tribal Lands

- Income of tribal member from cattle grazing on tribal trust land held taxable. *Holt v. Commissioner*, 364 F.2d 38 (8th Cir. 1966), *cert. denied*, 386 U.S. 931 (1967).

  Income from tribal members on rents from tribal trust lands held taxable. *Anderson v. United States*, 845 F.2d 206 (9th Cir.), *cert. denied*, 488 U.S. 966 (1988).

Unallotted Tribal Lands

- Income of Indian logging subcontractor from logging on reservation lands held taxable. *Fry v. United States,* 557 F.2d 646 (9th Cir. 1977), *cert. denied,* 434 U.S. 1011 (1978).

IRS Tax Exemption Test

- Rev. Rul. 67-284; 1967-2 C.B. 55

- The Service will therefore recognize the exempt status of income received by an enrolled member of an Indian tribe where each of the following tests are met:
- (1) The land in question is held in trust by the United States Government; (2) such land is restricted and allotted and is held for an individual noncompetent Indian, and not for a tribe;

IRS Tax Exemption Test

- (3) the income is "derived directly" from the land; (4) the statute, treaty or other authority involved evinces congressional intent that the allotment be used as a means of protecting the Indian until such time as he becomes competent;

IRS Tax Exemption Test

- and (5) the authority in question contains language indicating clear congressional intent that the land, until conveyed in fee simple to the allottee, is not to be subject to taxation. If one or more of these five tests is not met, and if the income is not otherwise exempt by law, it is subject to Federal income taxation.

Thank You For Coming!!

- Please fill out evaluation form.

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