Native American Tribes and Taxation

By Robert W. Wood

At times there can be a palpable tension between Native American tribes and the federal government. After all, American Indian tribes are sovereign nations even though they may be located within the boundaries of the U.S. Moreover, individual Native Americans are members of their own tribes, but they are also U.S. citizens. A whole host of legal and regulatory issues springs from this duality. And then there is the taint and sensitivity of our sometimes unsavory history of American Indian affairs.

When it comes to taxes, there is undeniable tension between tribes, their members and the IRS. Taxes are the fuel that keeps government running yet the sovereign status of tribes is fundamental. The U.S. government doesn’t tax England or France, and it can’t tax Native American tribes either. But there are nevertheless interactions between Native Americans and the IRS.

As you might expect, some of it today stems from gaming, which is undeniably profitable. But the interaction may not come in the way you might expect. In California v. Cabazon Band of Mission Indians, 480 U.S. 202 (1987), the U.S. Supreme Court ruled that tribes can conduct gaming on Native American lands unhindered by state regulation in states that allow gaming.

Some payments to Native Americans, however, are tax-exempt. In particular, some “general welfare” payments to individuals under social benefit programs qualify. In general, to be tax-free, payments must be made under a governmental program; be for the promotion of general welfare (i.e., based generally on individual, family or other needs); and not be compensation for services. This General Welfare Exception from income has become increasingly controversial as applied to tribal members, and the IRS is being asked to interpret the law.

State income taxes as applied to tribal members are tricky, and often draw the line between income earned on versus off the reservation. Absent an express authorization from Congress, states do not have the power to tax Native Americans living on a reservation whose income is derived from reservation sources. However, a state may tax Native Americans on income (including wages from tribal employment) if they reside in the state but outside the reservation. Line-drawing and disputes inevitably occur.

In a recent court battle, the IRS sought to subpoena banks as it was examining a Florida Native American tribe’s financial records. The IRS was conducting an investigation into gambling profits.

Predictably, the Miccosukee Tribe claimed protection under sovereign immunity. Nevertheless, the 11th U.S. Circuit Court of Appeals ruled for the IRS, holding that the agency can subpoena bank records. See Miccosukee Tribe of Indians of Florida v. United States, No. 11-14825 (11th Cir. Oct. 15, 2012). The IRS is investigating whether federal tax withholding and reporting requirements were met for gambling profits distributed to 600 members of the tribe from 2006 to 2009.

Again, the tribe itself is tax exempt. Yet the tribe must deduct and withhold income taxes from gambling revenues paid to tribal members. According to the case, the tribe failed to comply with its tax obligations from 2000 to 2005. That triggered an IRS investigation into the tribe’s finances from 2006 to 2009.

The tribe refused to hand over the records, so the IRS subpoenaed the documents from four banks. The tribe argued that it was shielded by sovereign immunity, and that the records would reveal confidential financial information and would force them to change their banking practices. The court rejected this argument too, noting that the Miccosukee Tribe gave the information to the banks, making the records the property of the banks, not the tribe.

Individual Native Americans may have interactions with the IRS as well. For example, the Miccosukee Tribe has acknowledged that at least 100 Miccosukee members owe the IRS more than $25 million in back taxes, penalties and interest. There are other troubles too, including the tribe’s suit against its former chairman, Billy Cypress, over an alleged $26 million in gambling profits allegedly used for his lavish lifestyle. That lawsuit even claims two former U.S. attorneys conspired with Cypress to hide the theft.

As with many other tax rules, these rules are becoming more controversial, and some legislators have even proposed no longer exempting tribes on gaming income. Expect renewed discussion of these rules and their limits in the future.

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