# 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.

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A year later, Congress enacted the Indian Gaming Regulatory Act of 1988 (IGRA). This law created a regulatory framework for gaming on American Indian lands. The National Indian Gaming Commission within the Department of the Interior was given oversight. And since then, the revenues have piled up. Gaming on Native American lands earned $26.5 billion in 2011.

In all, 236 Native American tribes operate 422 facilities across 28 states. In California, 59 tribes operate 60 casinos. Yet Native American tribes and their wholly owned tribal corporations are not subject to federal income taxes on their earnings. This tax exemption applies regardless of the source of the income. Tribes are exempt from federal income taxes even when conducting commercial activities. They can form corporations to conduct business and their income remains exempt.

Individual Native Americans, on the other hand, can be taxed by the IRS and by California. Native Americans are U.S. citizens and are subject to federal income taxes. Even exempt tribal income can be taxed when distributed to individual members of the tribe. One of the more complicated provisions of IGRA permits Native American tribes to make per capita distributions of revenue from gaming activities to tribe members. These per capita distributions are taxed.

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.

**Robert W. Wood** *is a tax lawyer with a nationwide practice (www.WoodLLP.com). The author of more than 30 books including "Taxation of Damage Awards & Settlement Payments" (4th Ed. 2009 With 2012 Supplement www.taxinstitute.com), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*