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Tax Decisions Bring Challenges And Opportunities To Tribes

By **Rob Roy Smith** (June 29, 2018, 4:03 PM EDT)

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Federal tax law, both generally and as it applies to Indian tribes, continues to quickly evolve. Two cases decided in June 2018 — United States v. Jim[1] and South Dakota v. Wayfair Inc.[2] — have important implications for Indian tribes nationwide.

United States v. Jim and the Tribal General Welfare Exclusion Act

The General Welfare Exclusion is an IRS doctrine which recognizes that payments made under legislatively provided social benefit programs for promotion of the general welfare are excludable from gross income. The doctrine is an exception to the general rule that payments made to or on behalf of individuals or other persons under governmental programs are included within the definition of gross income, unless an exclusion applies.[3]

As the doctrine applies generally, there is a three-part analysis which requires that the payment be: made pursuant to a governmental program; for the promotion of the general welfare (i.e., based on need); and not represent compensation for services.[4] In September 2014, Congress enacted the Tribal General Welfare Exclusion Act of 2014, which codifies the general welfare doctrine for Indian tribal government programs. The act amended the Internal Revenue Code to add new Section 139E, which provides that gross income does not include the value of any “Indian general welfare benefit.” Section 139E adopted a broad and flexible approach reaffirming the tribal government’s ability to establish and design programs to meet the specific needs of tribal citizens.

At issue at the Eleventh Circuit were payments made to Sally Jim in 2001 by the Miccosukee Tribe derived from a tax on gaming revenues. Jim did not file a tax return in 2001.[5] After the federal government filed suit in July 2014 seeking to force Jim to pay taxes on her payments from the tribe, a belated tax return was prepared in January 2015 in which she said she received $272,000 in benefits from the tribe for herself, her husband and their two children.[6] The benefits were listed as “other income” excluded from gross income as Indian general welfare benefits.[7]

The Miccosukee Tribe, which intervened in the case, argued that the 1984 gross receipts tax that funded the payments to Jim was not designed to let members avoid paying taxes on casino revenues.[8] The tribe argued that the payments to Jim and her family were nontaxable general welfare benefits provided from the tribe's gross receipts tax under the act, 26 U.S.C. § 139E.

The Eleventh Circuit disagreed. The panel held that, "in enacting [the Act], Congress expressed no intent to release the per capita payments of gaming revenue from federal taxation."[9] Employing common principles of statutory analysis, the Eleventh Circuit panel reasoned that "Congress spoke clearly when it imposed federal income taxation on per capita payments derived from gaming revenue," the panel said. "If Congress intended [the Act] to undo this arrangement, it knew the words to do so. It chose not to use them."[10] The panel found that "the distribution payments cannot qualify as Indian general welfare benefits under [the Act] because Congress specifically subjected such distributions to federal taxation in IGRA."[11]

South Dakota v. Wayfair and Online Retailer Sales Tax

For 51 years prior to June 21, 2018, commerce clause law only allowed states to impose sales or use tax obligations on businesses physically present within their borders. No longer. By a 5-4 split, the United States Supreme Court held that "physical presence" is no longer required for a state to impose a sales tax on retailers, opening the door to broad state taxation of on-line retailers.[12]

The Supreme Court cautioned that sufficient protections must exist with the state statute to pass muster under federal law. The 2016 South Dakota legislation at issue requires remote vendors to collect and remit sales tax if their annual sales in a state exceed $100,000 or 199 transactions.[11] The state exempts sellers that have limited transactions from tax collection obligations, does not apply its law retroactively, is one of more than 20 states that have pledged to reduce administrative and compliance costs, and pays for sales tax administration software that it provides sellers. Many state governments may now adopt something similar to South Dakota's remote seller statute.

However, such state laws must fit within the framework established for taxation within Indian Country. First, each federally recognized Indian tribe has the inherent power to tax sales on its reservation.[12] Thus, since South Dakota is permitted to tax items that a distant internet or mail-order retailer delivers to the state, a tribe can also tax the same items when the same retailer delivers them to tribal members, or others living on Indian land, on the tribe's reservation. Second, states' taxing authority in Indian country is significantly constrained by federal law. States cannot impose taxes directly on a tribe or a member of the tribe on the tribe's reservation.[13] Further, federal law prohibits state sales taxes imposed on any retailer, on or off the reservation, who delivers goods to a tribe or a tribal member on its reservation.[14] The Wayfair decision does not change these long standing rules.

What Should Tribes Do Now?

In the wake of these two cases, Indian tribes should consider taking the following actions to protect their rights under the general welfare exclusion and assert their sovereignty to impose new sales taxes.

Develop or Review Tribal General Welfare Plans

The Jim decision serves as an important reminder of the importance of having developed written guidelines for implementation of tribal general welfare plans that track the safe harbors in the Tribal General Welfare Exclusion Act of 2014. The problem for Jim and the Miccosukee Tribe is that they could present no evidence to show that the payments made in 2001 were anything but taxable per capita payments. Significantly, there was no evidence that Miccosukee Tribe had a general welfare plan — either at the time of the payment at issue in 2001 or at any time thereafter. There was also evidence adduced of other payments made by the tribe for housing, education, medical care and elder care in addition to the distribution at issue, further reducing the likelihood that the 2001 payment could also qualify as need-based.

Conduct General Welfare Audits

Tribes with existing general welfare plans we should use the Jim case as an opportunity to conduct “spot check” audits of both the general welfare program and tribal member recipients’ use of the money to ensure compliance. Making sure that payments are being used in accordance with the limitations of the general welfare plan is critical to ensure that general welfare payments are not deemed to be disguised per capita payments that would be subject to federal income tax.

Consider Enacting On-Line Sales Tax Ordinances

The Wayfair decision provides a golden opportunity for tribes to consider expanding their own sales tax codes to capture online sales delivered to the reservation. The Supreme Court suggested that any state internet sales tax must provide sufficient safeguards to prevent discrimination and avoid undue burden on retailers, similar to the South Dakota legislation. Since tribes, like states, have the inherent sovereign power to impose taxes on certain transactions, to the extent a tribal online sales tax may do the same, it should withstand judicial scrutiny. An online sales tax, if properly drafted to avoid “double taxation” and meaningfully enforced, could result in significant new governmental tax revenue for tribes and further tribal sovereignty over reservation lands.

Actively Work to Secure Exemptions and Guard Against State Overreach

Nothing in the U.S. Supreme Court’s decision enables states to tax items delivered to tribal governments or tribal members on a tribe’s reservation, where Native Americans are immune from state sales taxes. Tribes will need to be vigilant to ensure that states do not tax and retailers do not begin passing on state sales taxes on internet sales delivered to tribal governments or tribal members on reservation land. Tribes should consider immediately reaching out to state tax agency liaisons to ensure that improper collection from exempt purchasers is minimized. In the alternative, tribes should work with states to develop refund mechanism for tribes and tribal members who may be charged the sales tax or to develop blanket exemption certificates for such sales.

Although these recent tax decisions can be overwhelming, they present real opportunities for tribes to protect and further fundamental principles of Indian law, and foster greater self-determination.

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[1] No. 16-17109 (11th Cir., June 4, 2018)

[2] No. 17-494, (U.S. Supreme Court, June 21, 2018)

[3] 26 U.S.C. § 61.

[4] IRS Rev. Rul. 2005-46.

[5] United States v. Jim, No. 16-17109, Slip Op. at 2-3.

[6] Id. at 7 & n.7.

[7] Id.

[8] Id. at 14-15.

[9] Id. at 16.

[10] Id.

[11] Id. at 17.

[12] South Dakota v. Wayfair, Inc., 585 U. S. ____ (2018), Slip Op at 17.

[13] Id., Slip Op. 22-23.

[14] See Kerr-McGee Corp. v. Navajo Tribe of Indians, 471 U.S. 195 (1985).

[15] See Okla. Tax Comm'n v. Chickasaw Nation, 515 U.S. 450, 458 (1995).

[16] See Warren Trading Post Co. v. Arizona State Tax Commission, 380 U.S. 685 (1965); Central Machinery Co. v. Arizona State Tax Commission, 448 U.S. 160 (1980).