TAM 8337004, 1983 WL 202972 (IRS TAM)

Internal Revenue Service (I.R.S.)

Technical Advice Memorandum

April 13, 1983

Section 61 -- Gross Income v. Not Gross Income
61.00-00 Gross Income v. Not Gross Income
61.32-00 Indians

Legend

Taxpayers = * * *
Tribe = * * *
Reservation * * *
District Director: * * *
Taxpayers' Names: * * *
Taxpayers' Address: * * *
Taxpayers' Identification No.: * * *
Years Involved: * * *
Date of Conference: * * *

ISSUE:

Whether, under the circumstances described below, Indian related income can appropriately be allocated between income that is directly derived from the land, and income that is derived from improvements to the land, and, if so, what is the proper allocation method?

FACTS:

(Taxpayers are husband and wife. The facts of this memorandum relate only to the husband's business interests. Therefore, husband will be referred to as Taxpayer in this memorandum).
Taxpayer is a member of Tribe and is a resident of Reservation. In * * * Taxpayer acquired a possessory holding of land which is held in trust for Tribe by the United States Government. During the years * * * through * * *. Taxpayer derived income from various retail shops located on his possessory holding, and from the rental of land and improvements.
Taxpayer's retail shops include an ice cream parlor and two craft and gift shops that derive income from the purchase and resale of merchandise. Depreciable assets used by Taxpayer's retail businesses had a cost of * * * FOR * * * FOR * * * AND $ * * * FOR * * * improvements and other depreciable assets rented to third parties had a cost of $ * * * for * * * and * * * for * * * and included an ice cream parlor and craft shop.
Taxpayer's taxable income amounted to $ * * * for * * * $ * * * for * * *, $ * * * for * * *, and $ * * * for * * *.
Taxpayer's business interests are primarily tourist oriented and rely on visitors to the nearby national park and surrounding area for income.

APPLICABLE LAW AND RATIONALE:

It is well settled that, unless some provision of a statute or treaty expressly confers an exemption, Indians are subject to federal income tax to the same extent as any other

U.S. citizen. Squire v. Capoeman, 351 U.S. 1 (1956), 1956-1 C.B. 605. The Supreme Court of the United States has interpreted the General Allotment Act of 1887 to exempt from federal income tax income that was "derived directly" from the land. Capoeman, 351 U.S. at 9.

The Capoeman decision established a strict rule regarding the exemption of Indian-related income that is directly derived from the land. In Capoeman the Supreme Court considered whether the sale, on behalf of a noncompetent Indian, by the U.S. Government of standing timber on allotted Indian lands was subject to capital gains tax. In distinguishing the Capoeman situation from one in which Indian-related income was derived from investment of surplus income from the land, the Supreme Court emphasized that the harvesting of the timber lessened the value of the respondent-Indian's allotment. The term "directly derived" was thus narrowly drawn. On this basis, the Supreme Court held that the proceeds from the sale were not subject to federal income tax.

In Rev. Rul. 67-284, 1967-2 C.B. 55, modified by Rev. Rul. 74-13, 1974- 1 C.B. 14, the Internal Revenue Service set forth its position concerning the federal income tax treatment of Indian-related income. The Rev. Rul. states that income derived directly by a noncompetent Indian from allotted and restricted land held under acts or treaties containing an exemption provision similar to the General Allotment Act is not subject to federal income tax. Included within the list of exempt income items are rentals (including crop rentals), royalties, proceeds from the sale of natural resources of the land, income from the sale of crops upon the land and from the use of land for grazing purposes, and income from the sale or exchange of cattle or other livestock raised on the land.

In Critzer v. United States, 597 F.2d 708 (Ct.Cl.1979), cert. denied, 444 U.S. 920 (1979), the court considered whether Indian-related income received from the operation of businesses and building leases on a possessory holding was exempt from federal income tax. In Critzer the taxpayer operated a motel, restaurant, and gift shop, and also received income from building rentals. The court concluded that income received by the taxpayer from the operation of the businesses described above is not income directly derived from the land and is not immune from federal income tax simply because the business and buildings are physically located on tax exempt reservation land.

The court recognized, however, that the land underlying the buildings was necessary to the operation of those businesses. Although the court never reached the allocation issue, it was suggested that an allocation may be appropriate in certain circumstances. Critzer, 597 F.2d at 714.

The Service has previously recognized the composite nature of certain Indian-related income items and has considered the possibility of allocation between income attributable to land factors and income attributable to improvements on the land. An allocation approach was adopted in Rev. Rul. 60-377, 1960-2 C.B. 13, revoked by Rev. Rul. 62-16, 1962-1 C.B. 7, which involved the taxability of proceeds from the sale of livestock by an Indian. The Rev. Rul. concluded that the proceeds were exempt from taxation in an amount equal to the grazing fees that could have been obtained had the land been leased for grazing purposes. However, Rev. Rul. 62-16 revoked Rev. Rul. 60-377 and allowed a complete exemption. Rev. Rul. 62-16 reasoned that the formula set forth in Rev. Rul. 60-377 proved too difficult to implement. Therefore, the position of the Service has been to allow a total exemption where Indian-related income is primarily attributable to land factors. It is consistent then to allow no exemption of Indian-related income when such income is primarily attributable to factors other than the land.

Arguably, a case could arise that would prove appropriate for application of an allocation formula. However, there exists no basis for application of an allocation formula in cases in which income is derived primarily from improvements that enhance the value of the land.

CONCLUSION:

Taxpayers' Indian-related income may not be allocated between land and non-land sources.

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

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